

## **IT Re-Alignment and Profit Margin Improvements**

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Since 1991 CogniTech has had the opportunity to work with almost 200 companies and to do longitudinal work with dozens of clients. Of these, many have re-measured within a sufficiently short period (within 18 months), for CogniTech to compare profits before and after their work with CogniTech. Of the companies re-measured within 18 months, 62% increased their IS Contribution score. One company had an increase in IS Contribution after the first year but suffered a decline in the second year. The remainder declined between the 1<sup>st</sup> and 2<sup>nd</sup> measure. The reasons for increases and declines are varied and the are described in the case studies below.

Across all the companies that increased their IS Contribution score within an 18-month re-measurement period, additional profits totaled \$1.5 Billion or an average of 5.9% additional profit.. These are profits over and above those that would have been generated had each of the companies' profits increased or decreased by the same percentage as their industry average.

The following outlines in brief, the story for some of these companies:

### **A. Those that improved IS Contribution:**

**Company 1** was measured twice with a thirteen month interval. It is a very large heavy manufacturing company and is a primary government contractor. Its revenues are in the \$5 Billion range.

Its IS Contribution score at the time of its first measurement was 40.7 (where 50 is average and IT impact on profitability begins at an IS Contribution score of 48). Clearly, this was a company in which the IT organization made little contribution to the managers' ability to meet their goals and therefore their strategic targets. Meetings held with the CIO and business leaders during which the CogniTech findings were shared, resulted in the identification of a business need that had been heretofore undiscovered and not included on any business manager's "IT Request" form. Only through direct Business Planning Interaction discussion between the business managers and the CIO and his direct reports did it come to light that the biggest deterrent to obtaining government contracts was the manual proposal process. The process required a team to be brought together from all over the world into one location where each member was responsible for gathering the required information to complete the proposal. The result of this process was proposals that missed deadline targets and/or were incomplete.

Based on these meetings, the business managers across several business units funded the development of an IT'based proposal system that took only six months to complete. As a result of this proposal system, this company was able to complete a complex government proposal in only six weeks (estimated time for completion without the new system was six months) landed a \$2 Billion government contract they would have been unable to compete prior to the new system.

IS Contribution scores increased to 53.3 from 40.7 in the second measurement -- clearly reflecting the increased IT support for the business managers' goals. At the same time, profits beyond the increase in the industry average totaled \$58.1 Million.

**Company 2** was measured twice within 15 months. This is a very large retail organization with revenues of approximately \$45 Billion.

This company used the CogniTech data which indicated that timely restocking was a critical issue. Using the CogniTech data, the CIO was able to justify putting computers in the delivery trucks. This enabled a restocking truck to be re-routed on demand to a store out of stock on a high demand item.

IS Contribution score increased from 54.6 to 55.9. Even with this very modest increase in IS Contribution, profits in the first year after putting computers into the restocking trucks was \$121 Million more than they would have made had their profits increased by the industry average.

**Company 3** was measured with an 18-month interval. They are a large retail organization with revenues of approximately \$17 Billion.

The CogniTech data indicated that this company had a big culture issue within their entire organization. People were rewarded based upon the opinions of a small group of business managers. Salary increases, bonuses, promotions were awarded with little or no regard to performance. The CIO changed the reward structure within the IT organization in the next six months. (He was unable to affect the business organization). However, by linking the IT bonuses to business performance, he motivated the IT managers to implement Planning Interaction e.g. facilitated the willingness of IT managers to meet with and "listen" to the business managers. This resulted in a significant re-prioritization of IT projects, the initiation of some new projects, and the abandonment of some old projects no longer needed.

At the time of re-measurement, this company's IT Contribution score and the year over year profits increased by \$107 Million above what they would have made based on the increase in the industry average profit margin.

**Company 4** worked with CogniTech over several years with an average re-measurement interval being 14 months. They are a \$1.5 Billion subsidiary of a large retail organization.

In its first measurement this company scored 53.6, which is well above average. However, it felt there was room for big improvements. The first action taken as a result of CogniTech's recommendation was the inclusion of the senior IT manager into the business planning process. Secondly, Planning Interaction was implemented throughout the organization. It came clearly to light during the Planning Interaction meeting with multiple business groups that the primary business problem was the manner in which they restocked their stores. They had a standard restocking plan in which every store got the same shipment of stock shipped at the same time. Discussions between IT and business managers during Planning Interaction meetings consistently brought to light the fallacy of this plan. Stores in some locations (Florida for example) sold different merchandise than other stores (like Alaska). All stores had problems keeping their best selling items in stock while they were inundated with stock that did not move.

**Solution: A Data Warehouse.** An enterprise wide problem was surfaced. An enterprise-wide solution was designed by the IT organization and approved and financially underwritten by senior business management. The IT organization was able to get the stocking section of the Data Warehouse implemented in 3 months (12 months for the entire project).

The results of the Data Warehouse information where stock sold by store and restock shipped by individual store requirements was impressive. Stockouts were reduced and these were fewer drastic markdown sales. IS Contribution scores rose from 53.6 to 60.1 and profits improved by \$26 Million US (\$12 Million over industry average profit margin increases). In addition, the senior IT manager was promoted from Director to Vice President.

**Company 5 (AlignCo\*)** was measured over the course of several years. This is a large utility with revenues in the \$5 Billion range. This company measured in the year prior to deregulation of its industry trying to find a means of making the transition into its new competitive world.

During its first measurement this company scored right at the 48 level (at 48.1) where IT starts to have an impact on profit margin. During the period in which AlignCo worked with CogniTech, its IS Contribution score improved from 48.1 to 54.6. In that period, the industry average profit margin declined from 19.6% to 8.7%. In the same period, AlignCo's profit margin increased from 7.8% to 11.8%. In dollars, the impact on AlignCo's profit compared to what it would have earned had it followed the industry average is on average \$192 Million per year.

\*The entire AlignCo case study is available upon request. See our website at: [www.cognitechcorp.com](http://www.cognitechcorp.com)

**Company 6** is a \$3 Billion Petroleum company that was first measured in 1997 and re-measured several times over the course of the ensuing years. While the company struggled with a few issues, CogniTech identified one reoccurring theme that was a critical path to their success. The business managers clearly focused their top priority on revenue generation while the IT organization consistently focused their resources on improving the efficiency of the existing operations – clearly a misalignment of resources. Over the course of a couple of measures, the IT organization finally got the message.

IT organized and ran meetings to identify the business projects planned for the coming year that were targeted to improve revenue. IT then worked with the business managers responsible to identify ways IT could aid in the success of those projects and made those IT projects their top priority, Planning Interaction. As a result, over the course of the next year their IS Contribution score increased and the company's profit margin exceeded the industry average by almost 13% which resulted in an additional \$432 Million profit (over and above that which would have accrued at the industry average profit margin).

## **B. IS Contribution is first up and then down:**

**Company 7** was measured over three years. This is a UK-based worldwide service/manufacturing company located in 20 countries with average revenue of \$1 Billion.

After its first measurement in the US subsidiary of this company, Planning Interaction was widely implemented throughout the US branch. Realignment between IT projects and business goals was widely effected and the IS Contribution score increased from 47.7 (below the IT impact level of 48) to 52.4. Profits over and above those that would have accrued from industry average increases were \$37 Million after the first year.

The success of the US firm came to the attention at the UK Headquarters the result being that the CogniTech methodology was rolled out worldwide. The US company was their top performer.

In the ensuing year, the UK CIO determined that SAP would be implemented worldwide and that the US company would be the first to implement. By edict, all IT projects were put on hold. Planning Interaction was abandoned (if nothing was to be done but SAP there was no need to meet with business managers to realign IT projects with business goals). In the third measurement, the IS Contribution score dropped from 52.4 to 48.6. More important is what happened to profit. The industry profit margins continued to increase with the average growing by .6%. However, the US company's profit margin declined by 4% resulting in a reduction in profit margin of \$47 Million.

This is a clear indication of the impact tracked by IS Contribution. Not only do profits increase in conjunction with increasing IS Contribution scores, but they decrease with the decline of IS Contribution scores. When IT projects are kept aligned with business projects (prioritized based on business goals through frequent reassessments), the company is more profitable. Furthermore, the IS Contribution measure accurately reflects the degree of alignment between IT and business goals and its movement over time.

## **C. IS Contribution in decline:**

**Company 9** is a \$1 Billion minerals extraction company which is part of a worldwide conglomerate. At its first measure it scored one of the highest baseline IS Contribution scores recorded. The parent company was impressed by the results and the processes already in place that enabled fairly good alignment of IT projects and business goals. These processes included regular meetings in which IT managers met with business managers to continuously re-visit the IT project priority list and making sure that IT was working on projects that were consistent with the business managers top priority projects (Planning Interaction). After each meeting, IT adjusted its resource allocations to those IT projects that supported the top business project priorities (based on business goals).

In an effort to replicate the results across other units of the organization the CIO moved these top IT managers into other areas of the company. Unfortunately, the positions vacated were either not filled or were filled with other managers lacking the vision of those removed and who failed to see the importance of maintaining these "alignment" meetings. There were no efforts to transfer knowledge, teach the new managers, or emphasize the importance of maintaining the alignment between business project priority and IT project priority. Consequently, the minerals extraction company's IS Contribution score declined as did its profit margin resulting in \$69 Million less in profit than they would have made if they equaled industry profit margin.

While moving these managers around the organization resulted in a temporary net gain for the worldwide organization as more units implemented “alignment” meetings, it was made at the expense of the minerals extraction company. Furthermore, since no effort to spread the knowledge held by these managers nor to emphasize the importance of taking action based on the results of alignment meetings, the improvements stagnated and/or reversed. Rolling out the successful processes across all the conglomerates companies and training more managers in conducting Planning Interaction or “alignment” meetings could have resulted in gains across all fronts. Instead, the conglomerate embarked on a roller coaster ride of ups and downs among the units over the next few years depending upon where it reassigned its managers. In the end, despite warnings from CogniTech, the good managers including the CIO burned out and resigned, companies were spun off or closed, and IT was variously outsourced, in-sourced, distributed, centralized, decentralized..... All this left the organization without the baseline of knowledge of what worked or why their IT just did not contribute to their business success as it had previously. Less: These processes need to be made a part of the regular fabric of the organization or they can disappear.

**Company 10** is a state-of-the-art metal mining company with approximately \$800 Million in annual revenue. When first measured, the company scored well with an IS Contribution score of 61.1. However, in the interim between measures, the parent company decided to outsource its IT, the CIO resigned, and implementation of SAP began.

All IT employees except for a few staff were transferred to the outsourcer and all work on non-SAP related projects were stopped. The CIO was replaced with an IT manager. In only 14 short months the IS Contribution score declined 11 points and profit declined \$37 Million (after adjustment for industry changes). Not only did IS Contribution decline but so did Customer Satisfaction with IT performance

This company discovered the hard way that regardless of what decisions are made at the corporate level, it is imperative for IT to keep its focus on the ever evolving set of business goals. Despite the implementation of SAP, despite outsourcing, despite losing key IT people, the work of IT is to support the projects that are critical to the successful achievement of the business strategy.

While long-term solutions such as ERP must move forward, they cannot do so at the expense of the short-term projects that enable each business manager to achieve his top priority goals. To do so invariably means lower profits.

**Conclusion:** Over \$1.5 Billion in additional profit accrued to companies that: 1) implemented CogniTech's alignment recommendations and 2) re-measured within an 18-month period. These additional profits include only those over and above what would have accrued had the companies enjoyed the same percentage growth as that enjoyed by the industry as a whole. On average, these companies enjoyed an IS Contribution increase of 5.3 points and 5.9% additional profit between measures. **This is over a 1% increase in profit margin for every one point increase in IS Contribution.** This far exceeds our overall claim of .4% increase in profit margin per one point increase in IS Contribution over our entire database of companies scoring over 48.

By comparison, those companies in which IS Contribution decline had profits decline by an average 6.1% with an IS Contribution average decline of 4.9 points (a decline in profit or 1.2% per one point decline in IS Contribution).

Without exception in our longitudinal cases, IS Contribution increases and decreases are linked to corresponding changes in profit. For those companies that improved, both business and IT senior managers are consistent in pointing to the improved alignment between IT and business goals resulting from the knowledge gained from the IS Contribution measure as the major factor in their business profit improvement beyond industry average. For those companies that declined, the CIO's were able to identify the reasons for the poorer alignment between IT and business goals as the major factor in poorer than industry standard profit margins.

The IS Contribution measure accurately tracks the impact of IT project alignment with business goals. Not only does profits increase in conjunction with increasing IS Contribution scores, but they decrease with the decline of IS Contribution scores. When IT projects are kept aligned with business projects prioritized based on business goals through frequent reassessments, the company is more profitable. Furthermore, the IS Contribution measure accurately reflects the degree of alignment between IT and business goals and its movement over time

***Based on 16 years of experience, we now have longitudinal data that establishes that better alignment between IT projects and prioritized business goals results in improved profit.***