An Application-Centric Approach to IT Portfolio Cost Reduction

A Rich Consulting Whitepaper

Presented by:

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Contents

A Perspective on Utility IT Spending

- According to recent Meta Group research, utility and energy companies will absorb the largest industry sector cuts in IT spending

- From 2001 to 2002, utilities are experiencing
  - 20% decrease in absolute dollars, and
  - 28% decrease in spending as a % of revenue

- 60% of utility IT spending in 2002 is for O&M activities

- Lower O&M costs have become the most important index in evaluating IT portfolios for utilities. Minimizing the number of applications and associated costs through application-centric portfolio analysis is the key to managing total IT cost

- Effective cost management is especially important in this constrained spending environment, since it provides a source of funds for essential infrastructure renewal and high impact process improvement

More than ever, it is critical that a process be established to continually assess the business value of each application and to optimize total portfolio costs.

The Management Challenge

Systematic short-term and long-term actions are required to *optimize the total cost of owning and operating* the current application portfolio, and thereby provide a source of funding *for essential infrastructure renewal and business process improvement*.

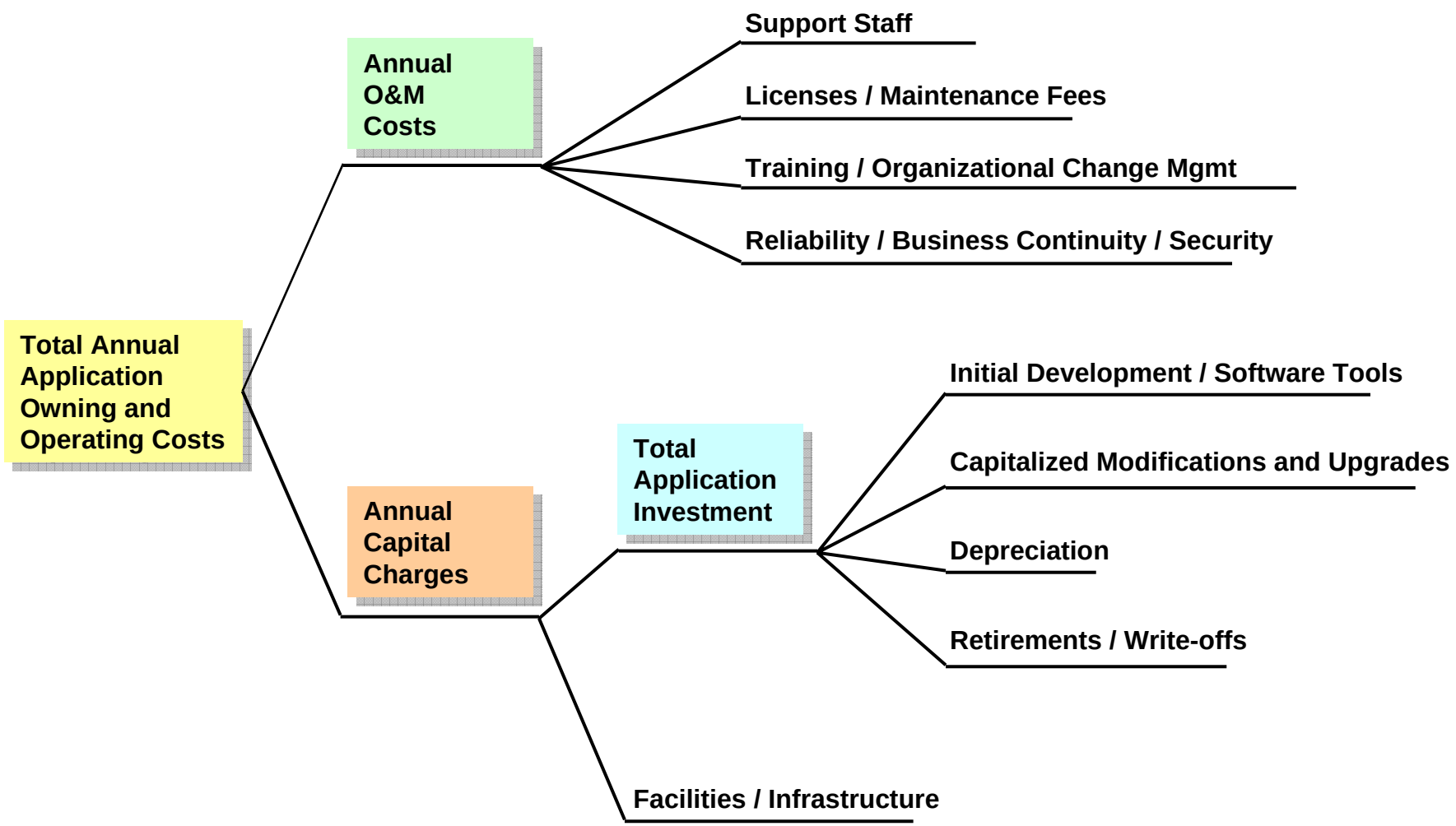
Potential Actions

- In the short-term, decisions can be made to consolidate applications and their environments, terminate maintenance/license agreements, and defer capital investment
- In the long-term, the spending on each significant application must be optimized through an application-centric life-cycle cost evaluation, which properly balances five factors:
  - Business value of the application
  - Anticipated development/acquisition costs
  - Long-term maintenance costs
  - Organization support costs
  - Availability and quality of alternatives (outsourcing, ASP agreements, etc.)

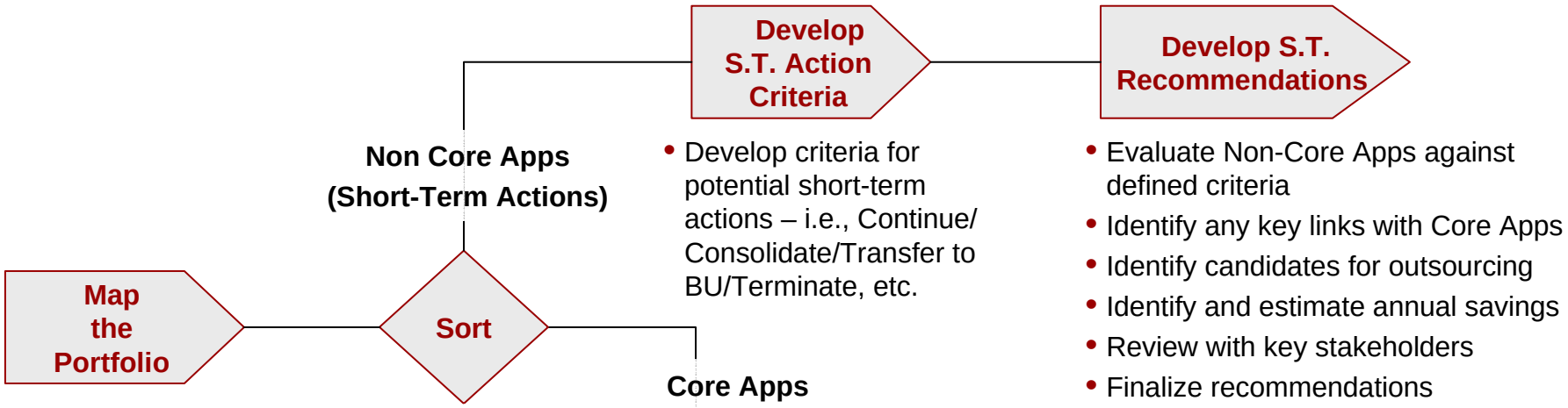
Approach to Developing an Optimization Process

- The approach described in the following pages incorporates both short-term and long-term actions and leads to the development of an ongoing process for optimizing IT costs

Application-Centric Dimensions of IT Cost



Application-Centric Portfolio Analysis



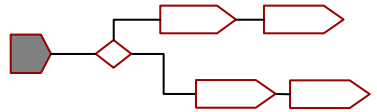
- Review prior inventory of applications; update as necessary
- Identify ongoing and planned software and hardware initiatives
- Allocate Capital and O&M costs to each application
- Establish current owning and operating cost baseline

- Establish sorting criteria
  - Required for reliability or reg. compliance
  - Supports key operating principles
  - Supports essential business functions
  - Spans multiple business units
  - Etc.

- Develop strategies including:
  - Reduce maintenance costs
  - Rationalize licenses
  - Evaluate interfaces
  - Consolidate infrastructure requirements

- Develop application lifecycle cost/value model
- Review for consistency with operating principles and architectural configuration
- Analyze alternatives
- Evaluate outsourcing candidates
- Develop recommendations

Analysis Process Details



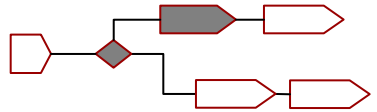
Map the Portfolio

- Review applications list and update as necessary to create a current application inventory
- Identify all current and planned software and hardware acquisitions, upgrades, etc.
- Identify business models and cases for planned investments
- Review budget information and allocate all capital and O&M costs to applications
- Identify all other capital and O&M costs (e.g., allocations from other BUs) to generate comprehensive view of all costs
- Create an accurate owning and operating cost baseline for metrics and measurement

Obtain demographic information for each significant application environment

- Required information includes:
  - Business unit/user/purpose
  - Total number of users
  - Total support costs (FTEs, license fees, maintenance costs, etc.)
  - Key development initiatives (ongoing and planned)
  - Key linkages/interfaces with other application environments
  - Total infrastructure and facilities costs
  - Associated regulatory requirement (s)
  - Availability of alternatives
  - Associated technical risk
  - Associated operational/business risk

Analysis Process Details (cont.)



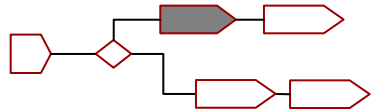
Sort Core vs. Non-Core

- Establish sorting criteria. Suggested criteria include:
  - Necessary for reliability or regulatory compliance
  - Supports key operating principles or core processes
  - Provides essential services such as billing, payroll, cost accounting, security, etc.
  - Spans multiple business units
  - Limited availability or high risks associated with alternatives

Develop Short-Term Action Criteria for Non-Core Applications

- Develop non-core sorting criteria and process to determine disposition – i.e., each non-core application should fall into one of four categories:
  - Continue to support the application centrally
  - Consolidate with similar applications
  - Transfer application responsibility to the primary department or business unit user (with clearly defined central support service level requirements)
  - Terminate the maintenance or use of the application

Analysis Process Details (cont.)

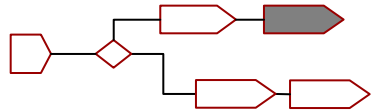


Develop Short-Term Action Criteria for Non-Core Applications (cont.)

- Sample criteria for the C/C/T/T sort include:

	Continue	Consolidate	Transfer	Terminate
Business Value/ Functionality	▪ Required by all/most business areas ▪ Required for reliability ▪ Clear business case/value	▪ Overlaps with other existing applications ▪ No clear business case for separate apps	▪ Functionality required by only the primary business user ▪ Limited business case	▪ Bulk of functionality no longer critical or exists in other applications ▪ Lack of business case
Technology	▪ Well understood technology, or ▪ Technology specific to application, or ▪ Technology offers flexibility	▪ Modular components ▪ Technology or compatibility advantage to one of the apps	▪ Technology only used by application ▪ Technology not common to other business units	▪ Obsolete and no longer supported by vendor ▪ Lack of flexible architecture
System Complexity	▪ Extensive links to other systems ▪ No simpler alternative	▪ Modular system ▪ Average complexity	▪ Stand-alone systems or minimal/simple interface requirements	▪ Unreliable or overly complex interfaces
Staffing / Resources	▪ Flexible staffing options	▪ Cheaper staffing options available through consolidation	▪ Limited centralized staffing requirements ▪ Support resources available in business units	▪ Increasing ongoing staffing requirements

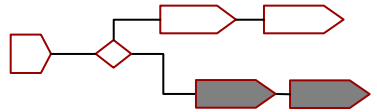
Analysis Process Details (cont.)



Develop Short-Term Recommendations for Non-Core Applications

- Evaluate non-core applications against defined evaluation criteria to determine disposition
- Develop short-term recommendations for actions. Any applications that are continued or consolidated will be flagged for future outsourcing evaluation, as appropriate.
- Estimate annual savings expected to be generated by recommended actions (measured against pre-established owning and operating cost baseline)
- Review recommended disposition with key stakeholders; refine and revise as necessary
- Implement “quick win” opportunities upon receipt of stakeholder agreement
- Schedule transition periods
- Develop program plans to implement more complex changes

Analysis Process Details (cont.)



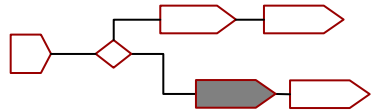
Develop Short-Term Cost Reduction Strategies for Core Applications

- Apply cost reduction levers as shown on the following page:
  - Maintenance agreements
  - Licenses
  - Interfaces and data flows
  - Infrastructure (e.g., hardware, telecommunications, …)
- Develop recommendations for short-term savings in each category
- Estimate annual savings generated by recommendations as viewed against owning and operating cost baseline
- Review recommendations with key stakeholders
- Harvest quick-win opportunities and develop schedules for more complex actions

Develop Long-Term Recommendations for Core Applications

- Develop lifespan application cost/value model:
  - Lifespan expectation of the application and business vision
  - Lifetime complexity costs vs. flexibility value
  - Technical and operational risk
  - Lifetime management and organizational costs
- Analyze more cost effective alternatives (e.g., functionality, architecture, interface design, etc.)
- Evaluate candidates for outsourcing
- Develop long-term action recommendations

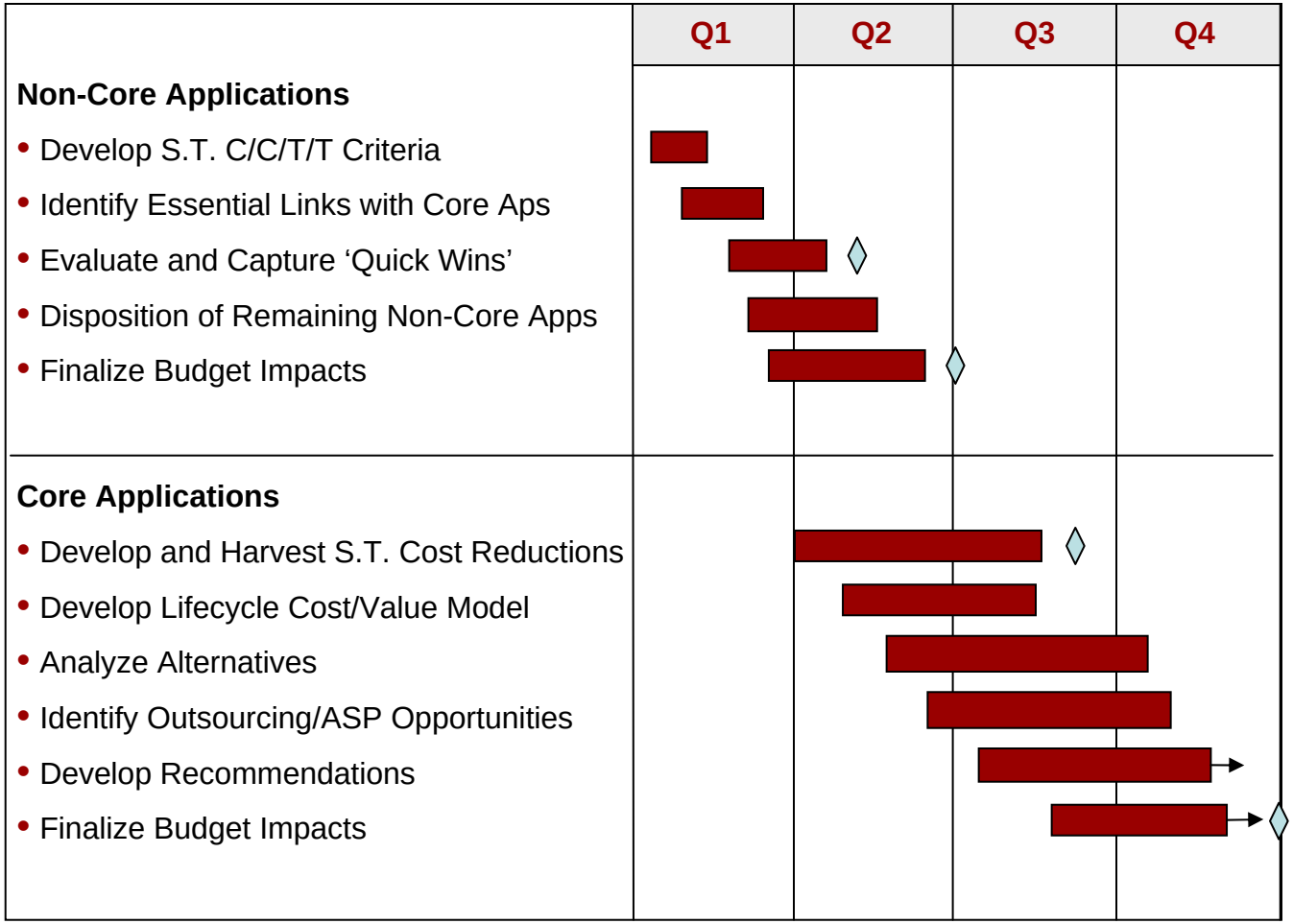
Analysis Process Details (cont.)



Develop Short-Term Cost Reduction Strategies for Core Applications (cont.)

Cost Drivers	Hypothesis	Strategies
Maintenance	▪ Maintenance contracts often become outdated as systems change over time (e.g., maintenance may still be in place when a system is no longer in production) ▪ Maintenance contracts are often evergreen (i.e., renew automatically)	▪ Identify and analyze all maintenance contracts ▪ Renegotiate / Terminate
Licenses	▪ Like maintenance, the need for licenses often changes as systems change ▪ Licenses and maintenance contracts are closely linked, but may not be in sync	▪ Identify all current licenses and review against license needs (e.g., no. of seats needed vs. covered by license) ▪ Renegotiate / Eliminate
Interfaces	▪ Interfaces between applications can be a major driver of O&M cost. The full extent of this cost is often hidden ▪ Many applications have both standard and "ad hoc" interfaces. Lack of transparency leads to redundant effort and cost	▪ Map interfaces and data flows ▪ Identify redundancies and candidates for elimination ▪ Integrate EAI solutions into all application development efforts (LT)
Infrastructure (Hardware and Telecommunications)	▪ Cheaper alternatives are emerging that offer similar service levels to traditional channels ▪ Application often result in infrastructure "silos" which leads to excess capacity	▪ Ensure consistent platform configurations ▪ Optimize infrastructure on a shared network basis and consolidate excess capacity ▪ Eliminate costly telecommunications options (e.g., VANs) where service level is not needed

A Sample Schedule



Conclusions and Recommendations

Focus First on Short-Term Opportunities

- Complex analyses are required to develop least-cost strategies for large, core applications
- Significant short-term benefits can be achieved, however, through a systematic, application-centric review of non-core systems, the total costs associated with each, and the development of actionable C/C/T/T recommendations
- We would recommend the following action plan:

Capture Quick Wins in Non-Core Applications

- Map current application landscape, establish baseline cost models and identify cost components with most variability
- Sort ‘core vs. non-core’ applications
- Determine the subset of non-core applications that can be evaluated immediately
- Develop recommended actions, review with stakeholders, and implement

Continue Non-Core Evaluations

- Evaluate the balance of non-core applications in subsequent quarters
- Develop recommendations, including outsourcing where appropriate, review with stakeholders and implement in the following quarters

Conclusions and Recommendations (cont.)

Evaluate Core Applications for Short-Term Cost Reduction Strategies

- Develop recommendations to apply short-term cost reduction levers in the first half of 2003
- Harvest “quick-win” opportunities for core applications and implement action schedules for more complex recommendations

Develop Long-Term Recommendations for Core Applications

- Initiate the development of long-term analysis tools and techniques (modifying functionality, simplifying architecture, incorporating eAI interfacing capabilities, etc.)
- Develop life-cycle cost model during the second half of 2003
- Begin sequential evaluations of core applications
- Identify and evaluate candidates for outsourcing
- Begin implementation of recommendations by the end of 2003

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