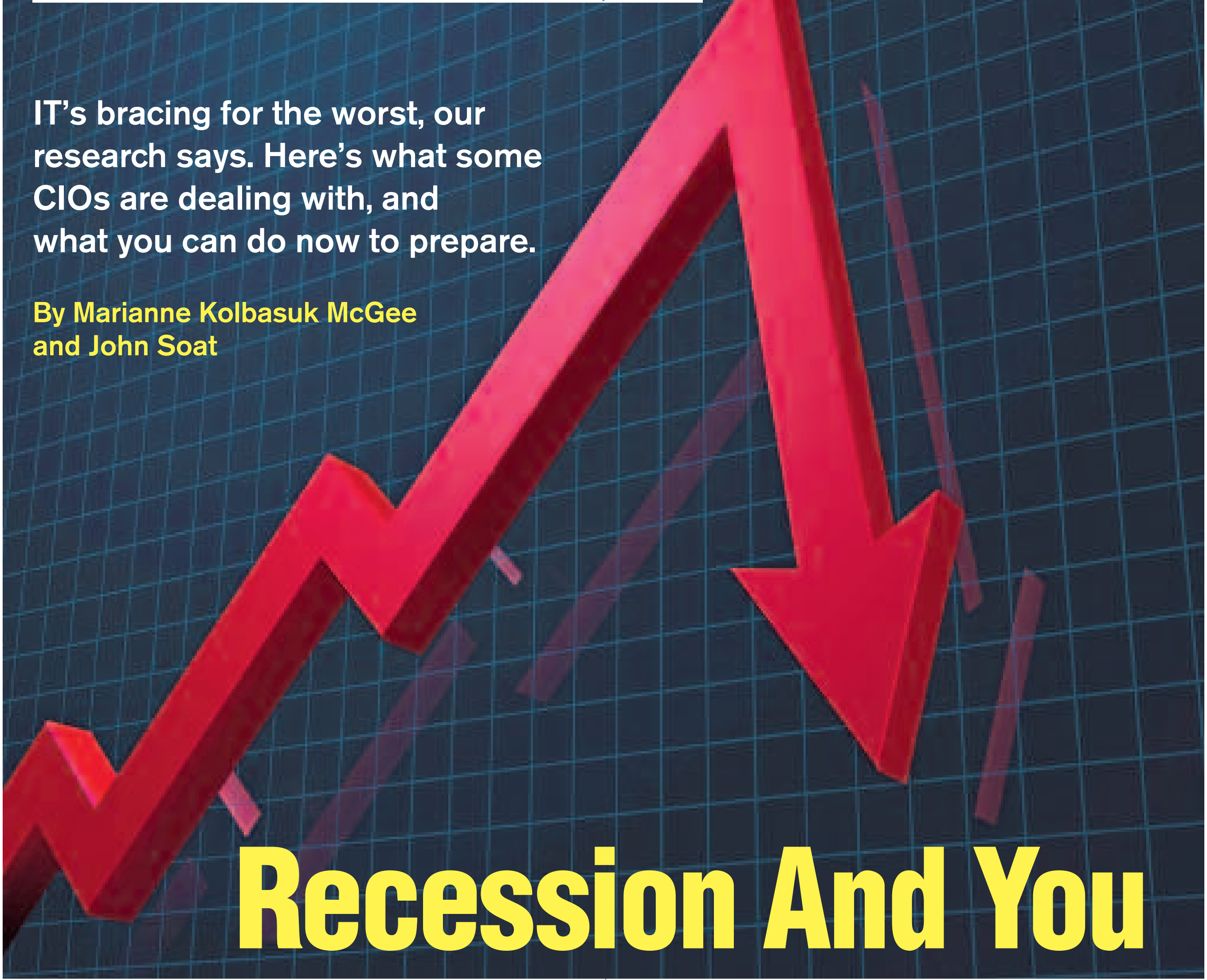
InformationWeek
Research & Reports



Recession And You

IT's bracing for the worst, our research says. Here's what some CIOs are dealing with, and what you can do now to prepare.

By Marianne Kolbasuk McGee and John Soat

TO PARAPHRASE AN OFT-USED FInancial aphorism, when business sneezes, IT organizations catch a cold. Amid grave worries about the U.S. economy's health, tech leaders are preparing to cut projects and spending as needed, and in most cases already are, our survey of 374 business technology pros shows. Hiring's by far the first thing that will be put on hold, with infrastructure upgrades and new application projects next in line.

So far, less than half, 43%, of respondents to an *InformationWeek* survey, conducted the first week of March, haven't been asked to change their IT spending because of the worsening economy. Of the rest, 28% say they've been asked not to increase IT spending as much as they had planned; 23% have been asked to cut the budget by a specific percentage; and 20% have been asked to cut specific projects. Some companies are taking more than one of these cost-cutting steps.

Joe Buser, VP of information services at Delta Faucet, isn't going to get the increase in IT spending he was looking forward to this year, as the slowdown in the housing market hits company profits. He's already cut a couple of nice-to-have projects, such as a network access control security application and an integration project that would have fed Dun & Bradstreet credit-worthiness data into Delta Faucet's ERP system. What isn't going to get cut: customer-facing projects. "We're doing the right things," Buser says.

Business leaders increasingly are asking how long and how bad a recession could be, not whether we'll face one. JPMorgan Chase's recent buyout offer for investment bank Bear Stearns—at the fire sale price of $2 a share, engineered with the help of

Federal Reserve officials—only adds to the worries.

Even a week before the Bear Stearns meltdown, 58% of business technology pros were saying the economy is in a recession or headed for one. While they're split on how they're dealing with that economic uncertainty now, they're clearly prepared to put the brakes on IT spending quickly.

"Nothing's been taken off the calendar yet," says John Rough, CIO of DBL Distributing, an electronics wholesaler. However, Rough was asked to delay some IT spending from the first to the second quarter because the company's growth slowed in the first quarter. That makes him a little antsy about what's ahead. "Because we're in consumer electronics, we're a nonnecessity," he says, adding, "now that the Super Bowl is over."

Ever the optimists, CIOs also can paint a glass-half-

Financial Firms Face IT Squeeze

LOOK OUT BELOW. IN the wake of the stunning fall of Bear Stearns, financial services IT organizations are bracing for big cutbacks—while being called on to implement systems to help prevent future debacles of the scale of the credit crisis now rippling throughout the industry.

Most analysts expect overall IT spending in the financial industry to flatten or fall this year, after growing strongly through the first half of 2007. "For some larger banks, IT budgets could be down by as much as 15%," depending on their degree of exposure to the subprime mortgage mess, says David Easthope, at research company Celent.

The slowdown started last year, says Larry Tabb, CEO of the Tabb Group. His analysts have lowered their estimates of 2007 tech spending growth by financial institutions to 8.1% from 10.6%. This year will almost certainly see a decline, he says, due in part to the collapse at Bear Stearns, which had to negotiate a buyout offer at a huge discount from JPMorgan Chase last week. "Bear Stearns alone was probably in the $800 million to $1 billion range in terms of IT spend," Tabb says, or 4% to 5% of total industry spending.

"I've heard bad things on the Wall Street side," says a technology fund manager, who declined to be identified, "10%, even 20% headcount reductions in IT, budgets being cut this year. Everybody's tightening their belts."

However, certain technology areas, such as risk management software and high-speed, low-latency network infrastructure for obtaining market data and making instantaneous trades, will continue to get IT dollars because banks and trading firms have no choice. That means IT directors at financial institutions face a delicate balancing act over the next 18 to 24 months. Paul Sutton, CEO of Kabira, a provider of real-time transactional systems to financial services companies, says he heard about a large bank canceling a major IT deployment because of the secondary effect of the subprime mortgage defaults, adding, "and this is a bank not even directly exposed to it."

Outside the United States, things are less dire. In Europe, banks and brokers must upgrade systems to comply with the new regulatory regime called the Markets in Financial Instruments Directive (MiFID), which went into effect last November. All of which means that if U.S. financial services companies sharply curtail their IT spending, they could be looking at a technology gap with European firms two years down the road.

James Goodnight, CEO of analytics software vendor SAS, says SAS has typically fared well during recessions "because it's a time that companies begin looking inward and try to improve some of their processes." If financial services companies don't make those long-term improvements this time around due to budget pressures, they may regret it later, he says. The prices for systems like his "are relative to how much money banks have lost," Goodnight adds. "We don't cost much in comparison to that."

—RICHARD MARTIN (rmartin@techweb.com)

full scenario for their business technology organizations, and it goes like this: Use this time of uncertainty to evaluate everything, including infrastructure, services, and personnel; negotiate hard with vendors—they're more worried than you are; seek alternatives like on-demand software services, which promise lower up-front costs and maintenance; look to squeeze productivity gains out of tools already in place, from virtualization to automation; and think like an investor—what IT spending can provide measurable returns that push the company forward in this challenging time?

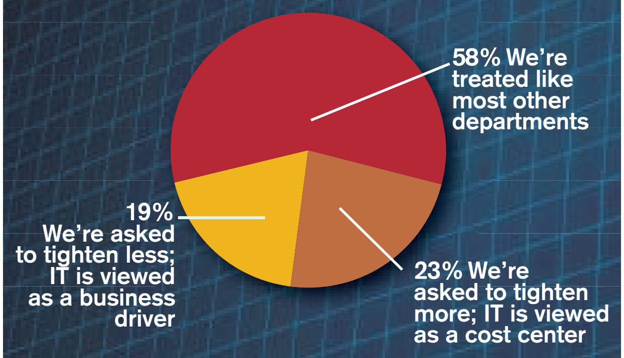
Despite the economic uncertainty, 53% of survey respondents say the mood in their business technology organizations is "cautiously optimistic." Almost one-quarter, though, describe the mood as "fear and loathing," and anecdotally it seems to vary based on people's location, industry, and whether they've weathered downturns before, including the recession of the early 2000s. Given the subprime mortgage meltdown, parts of the banking industry seem sure to take hits (see story, p. 32).

NOT MUCH FAT LEFT

What's happening in Jeff Anspach's IT department in El Dorado County, Calif., reflects how sour the economy tastes in much of California, which has been hit especially hard by the housing market downturn and rising gas prices. Anspach, a director of IT, says his department received orders for budget cuts earlier this year, as did all the county's departments. For Anspach, whose organization supports about 70 users, that means chopping his budget in half. An IT equipment budget of $30,000 is now only $15,000, which doesn't leave much wiggle room. The heaviest users will get new PCs, while their hand-me-downs will go to employees with the oldest PCs. For the PC purchases that are made, Anspach plans to talk with more vendors and work the best deals. "If you save $10 here and $10 there, it adds up," he says.

In most business technology organizations, if budget push comes to cutback shove, "there's not a lot of fat," says Rebecca Wettemann, an analyst at Nucleus Research. U.S. IT jobs were cut substantially in the last downturn, with IT unemployment shooting above 5%, high for a professional job segment. While IT employment has clawed back to above pre-slump levels, it's hardly been a hiring binge at most companies.

When times get tough, how is IT spending viewed at your company against other business investments?



Data: *InformationWeek* Research survey of 374 business technology professionals

That's certainly the case at auto parts manufacturer Dana. The company recently emerged from Chapter 11 bankruptcy, so tight budgets have been a fact of life for the company's IT organization. "Last couple of years, we've been asked to cut wherever possible, and then asked to cut some more," says Allan Marillier, Dana's IT lead for enterprise computing and storage. "We're down to the bone already."

With the weakening economy adding more financial pressure, Dana's IT managers are evaluating projects already in the pipeline. But rather than look for "one gigantic project" to eliminate, Dana's controller has instructed managers to trim smaller projects. In terms of IT, those reductions already have come from "lower-hanging fruit," Marillier says, such as server virtualization and consolidation, and moving tape backups to less-expensive disk libraries.

Virtualization helped E.&J. Gallo cut its server population in half over the last 18 months, says CIO Kent Kushar. That's an example of using technology itself to help with budget savings, Kushar points out. Virtualization reduces "licenses, software, maintenance, physical space, power—it has a lasting effect," he says.

Kushar says he strives to run a lean IT organization under any circumstances, and as a percentage of revenue, Gallo's 2008 IT budget is flat compared with 2007's. Still, the California company is always prepared to adjust IT spending, whether it's because of the economy or shifts in the wine business. If the economy goes south, the company's prepared to "tighten budgets across the board," Kushar says, and he'll shelve nice-to-have projects. What makes the must-have cut? Projects that touch customers (both consumers and internal customers) as well as those that help grow revenue.

About three-quarters of companies looking to cut their IT spending say they'll scale back new hires; 55% say they'll hold off on infrastructure upgrades, including PCs, servers, and other hardware; and 45% cite new application development and other software projects as probable casualties. Reflecting Kushar's sentiments about keeping customers satisfied, only 30% say end-user technologies, including Web 2.0 projects, will likely get the ax. And only 28% cite new outsourcing engagements as expendable.

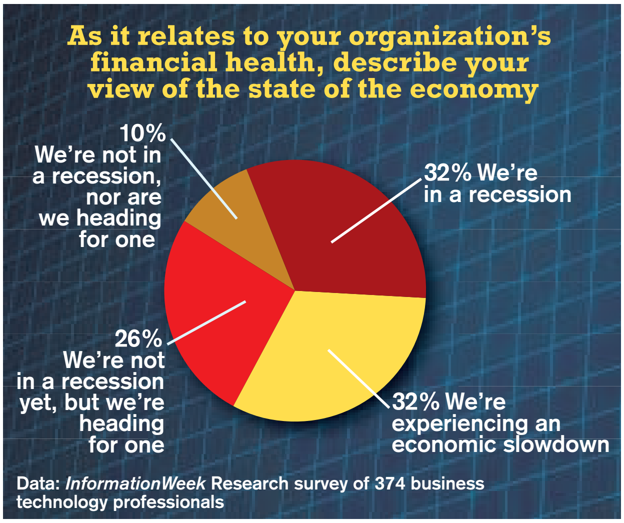
An IT hiring slowdown is probably already here. David Van De Voort, a principal of human resources consulting firm Mercer, says that while he hasn't seen big reductions in IT staffs yet, demand for new hires seems to be dropping off. "In late 2006, early 2007, hiring was picking up, and we were even seeing some sign-on bonuses returning," he says. But now it looks frozen again. There's still demand for certain skill sets, Van De Voort says, but a "hunkering down" is starting to set in.

At auto parts maker Dana, all new positions, including those in IT, have to be approved by the CEO. The IT staff is small and has been shrinking through attrition ever since the company filed for Chapter 11. And while Marillier isn't planning to hire in the near future, he hates to contemplate the opposite. "We can't cut any more," he says.

Now's the time to pressure vendors for better deals, even if your contracts aren't up.

–Ken Harris, CIO, Shaklee

Even as a majority in IT hold on to a cautious optimism about the economy, that edge of desperation is starting to creep in. "We've already reached a point where, if you cut more, you'll have issues," says Alok Kumar, information security officer at computer system vendor NCR. Kumar says NCR has been on a cost-cutting tear the last several years, driven by former CEO Mark Hurd, who's now doing the same thing at his current employer, Hewlett-Packard. Since Hurd left a couple of years ago, though, NCR's IT spending has leveled off. "Last year we didn't cut anything, and this year we're still moving ahead as planned so far," Kumar says. Still, the cutbacks haven't left much room for accommodating a dramatic downturn, though if that happens Kumar's sure that IT, like other business units that don't generate revenue, is vulnerable to even more cuts.



CIOs NEED A GAME PLAN

So what should business technology executives do in this challenging economy?

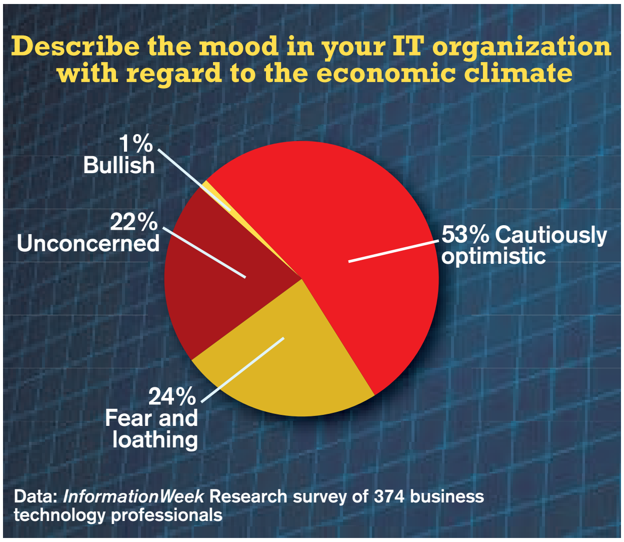
For one, start putting the pressure on vendors to get better deals, even if contracts aren't up for renewal, says Ken Harris, CIO at Shaklee, a maker of health and cleaning products. Harris' main approach to identifying savings from vendor contracts—and everywhere else in the IT budget—is zero-base budgeting reviews, whether he's trying to cut costs or just ensure that costs are as low as they can go.

Zero-base budgeting assumes there's no budget for the next year and forces people to justify every dollar they spend; it makes them look at each item individually and ask if it's really needed. Harris encourages everyone on the IT management team to get involved in the process and asks that the CFO or a CFO designee be involved as well. By involving a senior financial person, there's an "independent voice" that can confirm that everything's been evaluated. "This solves the communication problem," he says.

Among things to look for are whether software licenses are for duplicate copies, older software that's rarely used, more seats than are actually needed, or maintenance for off-the-shelf software. "Are you paying maintenance for software you don't use?" he says. "Without zero-base budgeting, you tend to overlook this sort of thing."

On the hardware side, companies often have more capacity than they realize and tend to pay maintenance on more machines than they need. "Maybe we have 47 machines but can get by with only 43," Harris says. "That's the sort of question that zero-base forces you to examine."

Mark Ricca, a senior analyst at research and consulting firm Intellicom Analytics, agrees that an economic slowdown is a good time to take inventory and assess needs. But business technology leaders must be mindful of staff morale and the tone they're setting. "We're not pushing the panic button," he says. In renegotiating with vendors, he recommends looking for service contracts and software licenses expiring or coming up for renewal—in the data center in particular. "Security, storage, network, software, hardware—look at everything in the data center," he says. "There are deals for everything you need." That's because during economic slowdowns, many providers of IT products and services become more flexible with their pricing and discounting policies. "There

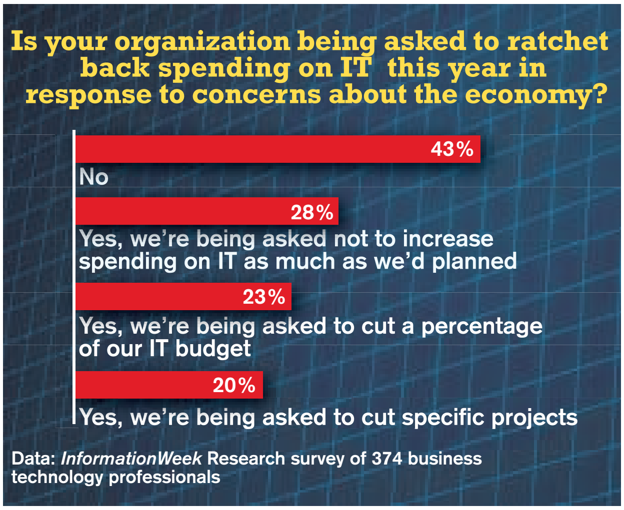


Describe the mood in your IT organization with regard to the economic climate

Data: *InformationWeek* Research survey of 374 business technology professionals

are bargains offered during these periods that aren't available during booming, high-demand periods," Ricca says.

Intellicom Analytics itself recently struck a network services deal that's "20% less than what we were paying for the same service, with the same provider, for the previous two years," says Ricca. In working with clients to acquire network services, new IP telephone systems, and communication applications, Ricca says he's noticed more willingness from vendors in the last two years to negotiate discounts, which he attributes to



Is your organization being asked to ratchet back spending on IT this year in response to concerns about the economy?

Data: *InformationWeek* Research survey of 374 business technology professionals

"the economic slowdown and their need to keep business coming in."

Cautiously optimistic or not, business technology managers need to meet the coming economic challenges head on, and not wait to get the call from the CFO. "There's a rocky road ahead," predicts Nucleus Research's Wettemann, so making smart investments in IT are key. For example, on-demand services can save money up front on software and hardware purchases and require less employee support, freeing up those people to focus on other critical work, she says.

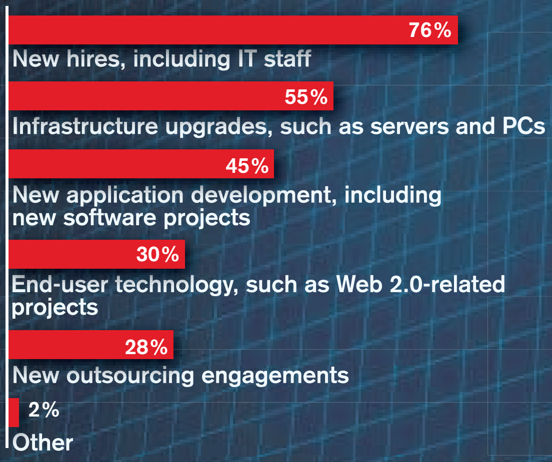
Some improvements can be done in small increments that aren't disruptive and wring more value out of existing IT investments, Wettemann says. Projects as simple as training workers on how to manage e-mail in folders can boost productivity. "Things that touch the user have a direct impact on productivity," she says.

Streamlining the supply chain by making it easier to share information is another area where incremental tweaking can make a big impact, Wettemann says. Not so for infrastructure upgrades: "If it's not broken, don't fix it," she says. For that reason, infrastructure hardware and software companies are likely to have a difficult time weathering the slowdown, so watch for bargains.

Other opportunities for savings, says Shaklee's Harris, include consumer-oriented online services such as Google Desktop, which is "cheap compared with Microsoft's alternative." This might not be good for all parts of the company, he says, but could be good for some. Ditto for Amazon's online storage offering. "Amazon offers tremendously cheap off-site storage," Harris says. "You may not be able to use that for real-time processes, but it's good for backup."

NCR has been squeezing costs out of IT over the last few years by replacing expensive licensed software with open source alternatives whenever possible, says

Which types of projects or investments are you most likely to scale back on?



Data: *InformationWeek* Research survey of 374 business technology professionals; 208 respondents experiencing IT spending cutbacks

Kumar, such as switching from Microsoft SQL Server to the MySQL database. Also, instead of sending users to off-site training classes, training at NCR is done online, a move that has saved considerable travel costs. And, as others are advising, NCR's IT managers have been instructed to look for savings anytime vendor contracts expire. "We'll start evaluating what contracts expire next year" and look to negotiate better deals with those vendors, he says.

'THIS HAS ROI'

Swinerton, a commercial construction company in the San Francisco area, hasn't been directly affected by the mortgage mess in the residential home sector, says VP and director of IT Larry Mathews, at least not yet. Its construction deals for this year are set, he says. but company executives are less certain about the economy's impact on commercial construction in 2009.

Still, Mathews thinks his practical IT strategy—based on tying spending to business goals—makes it less likely IT will be cut, or cut as severely, if there is a downturn. Swinerton's 2008 IT budget of $8 million represents an increase of about 28% over 2007 but is still less than 1% of the company's total revenue. And that's after many years of very small increases primarily related to small IT purchases and pay raises, Mathews says.

This year the company caught up in terms of IT staffing and technology investments it had been putting off. "We delayed things too long in the past," says Mathews. The three people added to Swinerton's 21-person IT organization, for instance, bring needed skills in technical support of end users, application programming, and network operations.

Mathews' IT investment strategy is to demonstrate value to the business, and by doing that make it much harder to rationalize cutting IT. "People don't buy quarter-inch drill bits; they buy quarter-inch holes," he says. For example, the company recently spent about $500,000 on new storage. "We didn't sell the company on new storage. We sold the company on virtual design and construction—new capabilities that require enormous storage," he says.

The new storage also provides "litigation support" for the company's need to be able to save and retrieve e-mails. "These were opportunities to show value to the business, and are things that can't be cut," he says.

Looking ahead, Swinerton is considering investing in Web faxing, which is less expensive than conventional faxes and saves paper. "We want to be more green and cost effective," he says. Also, Swinerton is investing in wireless networking that can be implemented at major construction sites in a day, providing all the bandwidth workers need. Right now, it takes too long to set up major construction sites, he says, and one of the reasons is the time it takes to get networking in place. "You don't need to wait for a T1 line to get installed," he says. "This has ROI."

Like Mathews, business technology leaders need to get ahead of the downturn. Earlier this month, 71% of the 55 economists in a *Wall Street Journal* poll said the United States is in a recession, and, on average, they gave it a 48% chance of being worse than the downturns in 2001 and 1990. Most IT and business pros in our survey also see a recession upon us or looming. When the usually upbeat tech managers join economists in seeing tough times ahead, it's time to prepare for the worst, even if you hold out hope for the best.

Write to Marianne Kolbasuk McGee at mmcgee@techweb.com.