



Private Equity Insights: The Painful Truth about your High IT Costs

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Let me confirm your suspicion; your IT department is needlessly wasting a ridiculous amount of money on all the wrong things while under delivering what the business requires to succeed. The supporting benchmark studies for the mid-market paints a dismal picture; although IT is supposed to enable the business to succeed, IT is increasingly a board level topic to approve unbudgeted money or worse yet is the reason the business can't execute a strategic initiative critical to value creation. It's no secret that competition for deals are driving multiples up to near historic levels while portfolio companies continue to be held hostage by IT.

The good news is you're not alone and it's not because you don't have the right team (well maybe a little). In other words, everyone is having the same problem and when you part ways with your CIO (again), you should know he is going down the street to replace the guy you just hired. The reality is, the IT landscape has changed significantly in IT over the last 5 years and although most PE's have adopted a new Cloud based/outsourcing model most are finding costs are increasing not decreasing and IT is now stuck in a semi-permanent state of transition.

There are subtle yet important strategic (non-technical) reasons behind these surprising trends that we will outline below. Have confidence that not only is it possible to deliver high-performance IT, but you can do it well below industry benchmarks at the same time. What surprises most is that one actually goes with the other.

Thinking the mid-market CIO will figure out how to optimize/cost cut

Don't get me wrong; there is a group of progressive rising stars in the mid-market CIO ranks that have the skills and mindsets to capitalize on these new trends. However, most mid-market CIOs will end up increasing costs because they are being asked to do something very difficult with little practical experience in today's changing world of outsourced IT.

Regardless of what they say, the new outsourcing model goes against everything IT leaders have been taught by their mentors and predecessors. They have been trained to fight management for money powered by a self-entitled view that, in general, they have been taught IT cannot be done correctly on normal budgets because non-IT leadership doesn't understand how hard it is. We do agree it's a difficult business, but when you think the problem lies externally, it's human nature to stop focusing on internal improvement. Let's break down why these beliefs exist and what to do about them.

CIOs want to do it themselves

Almost all CIOs spent the majority of their careers in the technical ranks in a do-it-yourself IT shop. The majority of their experience only applies to insourcing, and they tend to make decisions based on preserving or increasing internal staffing. The reality is that the vast majority are anti-outsourcing, and for good reason. To begin with, outsourcing didn't work that well in the past and most have had a bad experience. In addition, outsourcing took jobs away from IT and in the process became the enemy. On the other side of the coin, IT leaders today have very mature skill sets around insourcing and typically VERY little experience outsourcing; naturally they are going to do what they know.

Asking them to cut staff and outsource is against their nature and their "upbringing." We have seen many CIOs who are so religiously against outsourcing they subconsciously find ways to prove it's failing just so they can staff



up. The challenge is there is overwhelming data supporting the theory that mid-market just doesn't have the economies of scale to support all the skill sets necessary to pull off a DIY strategy in today's technology market. Market data supports the fact that technology is way too complicated for the mid-market in today's world and is why studies show that 20-30% of IT budgets get wasted on failed initiatives – Money spent to improve the business end up having no value.

IT Leaders Commonly Make Huge Mistakes Outsourcing

Outsourcing for big companies has been around for a long time, but mid-market "cloud" options are relatively new. Market demand for "the cloud" has grown exponentially and as a result, there are a lot of weak providers with great marketing who won't make it in the long run but once you sign up for a 3-year contract in many cases you're stuck. The current generation of IT leaders are just learning now about this emerging trend as it unfolds, and for the most part, the first outsourcing deal they sign your company to, is likely the first one they have ever done. Ernest Hemingway said it best, "the first draft of anything" You get the picture. Bottom line is IT leaders are in a learning curve in a changing environment and making huge mistakes in choosing partners.

Once a bad contract is signed, it lasts for years leaving the successors of the mistakes with legacy problems/contracts they cannot escape. The pressure of M&A often leads to "rushed" outsourcing choices in order to accomplish short term goals such as TSA exit when a more thoughtful approach would solve years of cost overruns. The outsourcing mistakes typically fall into two categories:

Too many cooks in the kitchen

As we have covered before in previous articles, one common mistake IT leadership makes is bidding out every piece of IT and ending up having to manage a big pile of disconnected partners. Multiple contracts and sales people are just the beginning of the problem, but the real costs come in when vendors point at each other for problems. In an outsourced model IT no longer has budget for the talent to figure out which vendor is actually at fault. You may have to pay a little more for one quality vendor to take multiple roles, but your overall cost will go down dramatically by eliminating the need to hire people to manage gaps between vendors. This will free up your IT leaders to work on strategic value creation initiatives such as asset rationalization and optimization.

Staffing up anyway because you picked the wrong Cloud vendor

The second most common issue is picking Cloud vendors that don't manage their own assets forcing you to "staff up" and take on the hardest part of IT, which is HR and IT operations. There is a reason why most of the big players don't manage their own assets – they know how difficult it is. Think about it; there is a lot more margin in services yet big cloud companies who have unlimited resources want nothing to do with what they are providing to the market. Why would you think a mid-market IT shop could do this when the people that built these clouds are too afraid of their own invention?

Suggestions to prevent run-away costs

Make sure your new IT leader has experience with outsourcing and brings a successful set of relationships to the table that can be verified. If you hire a legacy IT leader whose experience is buy and build, just make sure he or she has the savvy to adopt the new strategy. Understand what your potential IT leaders approach is to staffing and vendor management and watch out for those that find reasons to staff up.

Do yourself a favor and think carefully before going to a big cloud player – And be prepared to manage your own systems. Realize you will have no leverage on them if something goes wrong, forcing you to move again if they don't perform to expectations. You will be better off finding a mid-size player that keeps your CIO out of the IT operations business, and who values you as a client versus "just another" number.