IT Innovation Spurs Renewed Growth

High-growth companies are frequently ahead of the curve when it comes to IT innovation. Those that actively spur innovation in IT operations and business technology will stay one step ahead of competitors and industry trends.
For more than a decade, A.T. Kearney has studied clients and organizations worldwide to determine what drives innovation in IT and how to realize the benefits. Our studies of technological innovation began during the go-go days of the Internet boom and continue to this day. We have seen IT innovation as a standalone industry killer and as an integrated tool that helps orchestrate and enable strategic shifts. One thing that has not changed is the belief among executives that more aggressive technology adoption and investment is a clear path toward growth and profits: A.T. Kearney’s 2012 study finds that high-growth companies are frequently ahead of the curve when it comes to IT innovation.

A.T. Kearney defines IT innovation as game-shifting, technology-enabled strategies—the kind that creates sustainable competitive advantage or leads to significant cost reductions. A common goal of IT innovation is the delivery of new solutions to customers, products, or supply chains—for example, analytics that predict customers’ needs or offer new ways for customers to find and order products or services. Innovation in products includes how automakers design vehicles to improve lifestyles by integrating cars with drivers’ mobile devices, homes, and offices. Other examples include supply chains that are continually being transformed by IT as forecasting and tracking improves both the delivery of goods and the monitoring of assets.

High-growth companies look to their IT organizations to drive revenue, not just to reduce costs or streamline operations.

Our 2012 study yields several noteworthy findings (see sidebar: About the Study on page 3). For one, executives at major global companies continue to recognize the value of IT innovation and believe they should allocate a larger portion of their IT budgets to innovation. Yet most do not, especially when compared with high-growth companies that invest more in technology innovation and do so earlier in the technology life cycle. These companies rely less on large service providers for innovation than their medium- and low-growth counterparts, and instead build internal IT processes and operating structures to develop their own IT innovation capabilities. Indeed, they look to their IT organizations to drive revenue, not just to reduce costs or streamline operations.

What do these findings mean for the average company? That growth and innovation can be generated in the IT organization, but only if the IT organization gets the necessary funding and resources and steps up to the challenge.

Strategic Differentiation: Important but Still Difficult

The majority of study participants rank IT as either important or very important as a competitive differentiator. Among C-suite executives, 42 percent consider IT innovation as an extremely important strategic differentiator, while just 25 percent of senior managers share this belief.

Almost 90 percent of companies contend IT innovation has become more important over the past five years, yet investments in IT innovation have declined noticeably. Executives believe

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1 High-growth companies are those with 10 percent or more annual growth, medium-growth companies grow between 5 and 10 percent annually, and low-growth companies fall into the 0 to 5 percent growth category.
that a larger amount of their IT budget should be devoted to innovation, but only 12 percent of the IT budget is actually allocated to innovation. Our studies performed over the past decade reveal that funding for IT innovation has decreased through the years (see figure 1).\footnote{A.T. Kearney’s published IT innovation studies include: The Road to Business Value (2003), Where Have All the Early Adopters Gone? (InformationWeek, 2003), Bridging the CEO-CIO Disconnect (InformationWeek, 2004), Why Today’s IT Organization Won’t Work Tomorrow (2005), IT Innovation at a Crossroads (2009), Delivering Technology Innovation (2009), Where the Money Isn’t (Sloan Management Review, 2010), and Technology: The Insurance Industry’s Pivot Point (2011).} We find that much of the problem lies in the areas of communication and delivery. IT and business leaders are often unable to articulate clearly the benefit of investing in IT innovation to stakeholders, so the bulk of IT investment tends to go to business enablement and operations. Similarly, IT departments often become barriers to effective implementation of innovation, thus suppressing more aggressive investments in technology.

Figure 1

Companies continue to underinvest in IT innovation

<table>
<thead>
<tr>
<th>Year</th>
<th>Innovation (%)</th>
<th>Business enablement (%)</th>
<th>IT operational excellence (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>30</td>
<td>33</td>
<td>37</td>
</tr>
<tr>
<td>2002</td>
<td>35</td>
<td>37</td>
<td>28</td>
</tr>
<tr>
<td>2005</td>
<td>20</td>
<td>47</td>
<td>33</td>
</tr>
<tr>
<td>2009</td>
<td>14</td>
<td>41</td>
<td>45</td>
</tr>
<tr>
<td>2012</td>
<td>12</td>
<td>50</td>
<td>38</td>
</tr>
</tbody>
</table>

Source: 2012 A.T. Kearney IT Innovation and Effectiveness Study
The desire to invest earlier in the technology life cycle still exists. In 2012, nearly 60 percent of respondents say they should invest in IT innovation at the leading-edge and early-adopter stages, yet only 27 percent indicate they actually do. In fact, the gap between where executives believe they should invest and where they actually do invest in the technology life cycle has increased since 2005 (see figure 2).

Some companies have managed to close this gap by investing in skills or research to anticipate technology trends and then communicate to senior management the advantages of early adoption. For example, high-growth companies tend to adopt technologies earlier than medium- and low-growth companies. In fact, 38 percent of high-growth companies are either leading-edge or early adopters, compared with 28 percent of medium-growth and 21 percent of low-growth companies. The timing of investments can be essential to capitalizing on an innovation opportunity, with leading-edge and early adoption being key time periods for developing innovations that differentiate a company from its competitors.

There continues to be a strong correlation between getting the basics right in IT service delivery and innovation. More than 30 percent of companies that invest significantly in IT innovation rate the delivery of their IT services as very positive compared with companies that invest lesser amounts. Those that rate their basic IT services as satisfactory say they are in a better position to deliver more innovative business technologies.

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**Figure 2**

**Companies are looking to invest earlier in the technology life cycle**

<table>
<thead>
<tr>
<th>In which stage should you invest in IT to achieve your strategic goals?</th>
<th>In which stage do you currently invest in IT?</th>
</tr>
</thead>
<tbody>
<tr>
<td>33%</td>
<td>35%</td>
</tr>
<tr>
<td>35%</td>
<td>38%</td>
</tr>
<tr>
<td>5%</td>
<td>10%</td>
</tr>
<tr>
<td>Leading-edge</td>
<td>Early-adopter</td>
</tr>
</tbody>
</table>

Source: 2012 A.T. Kearney IT Innovation and Effectiveness Study

1 Leading-edge adopters are companies that implement technology solutions early in the life cycle and well ahead of competitors.
2 The 2009 study did not specifically research technology adoption timing.
IT Innovators: Success Is Not an Accident

The characteristics of IT innovators are clear. They understand the importance of IT innovation, determine the right levels of investment, and design an organizational structure that encourages and manages new ideas. IT managers are attuned to the needs of the business and understand how best to use their IT assets to drive growth. Almost half of respondents with significant investments in IT innovation report that their IT organizations play a major role in generating revenues (see figure 3). In 2012, more than 20 percent of respondents cite IT innovation as a revenue driver, up 7 percent from 2009 and 2005. This supports a shift in the perception of IT from business enablement and cost optimization to growth engine.

IT innovation does not happen by accident, but rather by design and focused execution.

Not surprisingly, leading-edge and early adopters allocate a greater portion of their IT budgets to innovation. Fifty percent of leading-edge and 25 percent of early adopters are considered IT innovators, compared with only 16 percent of early-maturity and 6 percent of late adopters.

Figure 3
Companies that invest significantly in IT innovation put more focus on generating revenues

What is the significance of your IT organization in generating revenues? (by investment in IT innovation)

Source: 2012 A.T. Kearney IT Innovation and Effectiveness Study

* Study participants who invest 25 percent or more of their IT budgets on IT innovation are classified as IT innovators.
IT innovators rely less on third parties and deliver needed innovation in-house. Only 13 percent of IT innovators cite the role of third-party partners as being extremely important in driving their innovation agendas, compared with 31 percent of medium investors in innovation and 39 percent of those who barely invest in IT innovation (see figure 4). Leading IT innovators view innovation as a core competency and gain advantage by keeping innovation activities in-house—especially those capabilities that are or can become competitive differentiators—rather than outsourcing this role to third-party suppliers.

Outsourcing contracts that are too rigid often preclude third parties from offering new ideas—whether that means more innovative ways to improve products, services, or processes. The best contracts are those that include harnessing innovation from partners. For example, IT innovators include clauses in their contracts that provide incentives to vendors for help in spurring innovation.

Additionally, outsourcing contracts are being broken down into smaller, more manageable parts rather than the “big deals” that give third-party providers room to breathe and provide more innovation. This makes way for more competition and transparency in offerings and conditions, particularly in the infrastructure market. Competition from emerging low-cost providers, such as Google for messaging services and Amazon and Microsoft for cloud-based infrastructure, is adding to the pressure. Moreover, with pay-per-use programs, clients are more independent from providers. Although the IT outsourcing-services industry is still relatively fragmented, consolidation is taking place because global presence and scale are more important factors for maintaining cost leadership and satisfying clients’ innovation needs.6

6 For more information, see Finding What Every ICT Services Provider Craves: Healthy Profits, A.T. Kearney (June 2012).
IT innovation does not happen by accident, but rather by design and focused execution. The decisions IT innovators arrive at regarding the organization and operations are made to foster IT innovations, such as appointing a leader or group to accelerate the innovation process. Approximately 45 percent of medium- and high-growth companies report creating management processes and operating structures to drive innovation. They also consider the perception of the IT department in the role of innovation and structure innovation as a partnership with the business. In fact, IT organizations are increasingly serving as innovation incubators. They rank behind only sales and marketing functions in generating ideas that create a competitive advantage for the company, continuing a trend that began in 2009.

IT Effectiveness and Operations: Walk Before You Run

Overcoming common roadblocks is crucial to realizing IT innovation. System complexity, data inconsistencies, and operational issues can divert time and energy that could otherwise be spent on game-changing activities.

Many IT departments are buckling under the pressure—not because they lack the know-how or capabilities, but because of complexities woven into the organization and architecture over time. IT complexity continues to be a major barrier to improving process support and integration (see figure 5). Excessive complexity also creates a host of new problems. A simple change in IT can take too long and run over budget, or a new application may fail to bring the promised savings while creating additional complexity. It can take years and hundreds of millions of dollars

Figure 5
IT complexity continues to be a major barrier

Which IT barriers are most relevant to your business?
(5 = most important, 1 = least important)

Source: 2012 A.T. Kearney IT Innovation and Effectiveness Study
to dig out of legacy applications and take the business to the next level, only to see it fail due to the sheer complexity of the IT environment.

While all complexity is not necessarily bad, too much complexity in technology—or the wrong kind—can hinder growth. Technology must remain flexible enough to meet the changing needs of the business by providing cost-effective applications, data, and processes, while being sophisticated enough to help companies overcome barriers to growth.

A conversation with one chief information officer (CIO) will help illustrate this. He explained how his firm had launched a project to re-examine its application portfolio and develop a five-year IT-application strategy. For more than six months, a team worked on segmenting and cataloging the application portfolio before delivering the results to the CIO. But he could not move ahead with the project. The final report did not have a comprehensive total-cost-of-ownership (TCO) analysis or a clear plan for transformation. “I was handed a study instead of an implementable blueprint that I could take and immediately use to transform our IT assets,” he explains. “We still had to do a lot of work before we could take action.”

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IT complexity reduction is becoming a more common focus for architectures, systems, and IT delivery, including segmenting the software portfolio, standardizing data structures, and eliminating redundancies. In addition, IT departments are trying hard to make the shift from putting out daily fires and allocating more resources to high-value initiatives designed to cut costs and spur growth.

Rationalizing applications continues to top the list of ways to reduce IT costs and complexity, followed closely by improved governance. The number and type of software applications has grown significantly over the past decade as business-led solutions, web technologies, and mobile apps spread into all areas and functions. The result is a fragmented inventory with a long trail of applications that are difficult to manage and operate at an appropriate cost. In our last two studies, executives identified IT complexity as the most significant barrier to business growth and cited minimizing the number of software applications as the largest cost-reduction opportunity within IT. In fact, streamlining applications has consistently scored higher than offshoring and outsourcing.

Adopting, nurturing, and supporting commercial platforms are other innovation strongholds. For example, the explosion in smart phones and mobile commerce (m-commerce) makes a presence in mobile applications a major competitive advantage. Mobile applications and Big Data are cited as technologies that have transformed industries the most over the past five years, and should continue to do so.
As the pace of business and IT innovation intensifies, so will the dependency on applications to drive next-generation capabilities. A clear application blueprint can not only help cut costs and improve capabilities but also lead to much-needed flexibility and improved governance. IT organizations that keep pace with changing demands will not fall behind their more agile rivals.

Six Distinct Steps to Success

A.T. Kearney's studies over the past decade and in 2012 reveal that leaders demonstrate not only vision and out-of-the-box thinking, but also an ability to recognize the roadblocks to making the vision a reality. Study of these best-practice companies again clearly shows that effective IT innovation is not an accident. Rather, leading companies and IT innovators take the following six distinct steps:

1. Develop world-class IT delivery capabilities

The best IT departments get the basics right. They focus on delivering IT services—reducing complexity in the application portfolio, developing business skills within IT, and forecasting business needs better. This frees up resources for more innovation.

2. Invest and measure IT innovation

Placing IT initiatives and investment targets under a single umbrella can help ensure that IT innovation gets the investment it needs. IT can be viewed as an all-inclusive portfolio rather than a series of independent projects.

3. Balance IT leadership with business partnerships

More companies and industries are outlining specific positions and establishing IT councils and other forums to drive IT innovation. Companies that do this are more likely to have a positive view of IT and its contributions to the company.

4. Integrate products and services with traditional back-office IT

Because the IT perspective cuts across all functions, it can improve integration and innovation with the business. By integrating data and information, IT can improve products and services, including delivery and the customer experience, which can increase customer loyalty and position IT as a revenue generator.

5. Ensure IT innovation is a “core” activity

IT innovation must be managed across all stakeholders: IT, business, technology suppliers, and customers. However, successful IT innovators make sure the capability is owned and driven internally.

6. Make sound business decisions on emerging technologies

Evaluating which nascent technologies will support your corporate strategies—and which should be ignored—is critical to establishing a competitive position. A culture that encourages IT innovation will allow for experimentation and time to gauge the true impact of an idea.
Placing the Bets

The economy is beginning to rebound, albeit slowly, and more companies are reshaping and retooling their IT capabilities to capitalize on market opportunities. Developing critical skills to drive innovation internally, and knowing when and where to place bets on new technologies and capabilities, is vital to allocating pieces of an ever-shrinking pie and maintaining stakeholder confidence. Failure to make the transition will widen the gap between low-growth and high-growth organizations. Those that understand the strategic value of IT innovation, get the basics right, and build the needed business-technology capabilities to be successful will be the winners in an economy that’s pivoting toward renewed growth.

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