

HOW EFFECTIVE IS YOUR IT GOVERNANCE?¹

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IT governance specifies accountabilities for IT-related business outcomes and helps companies align their IT investments with their business priorities. But IT governance is a mystery to key decision makers at most companies. Our research indicates that, on average, only 38% of senior managers in a company know how IT is governed and ignorance is not bliss. Senior management awareness of IT governance processes proved to be the single best indicator of IT governance effectiveness with top performing firms having 60, 70 or 80% of senior executives aware of how IT is governed. It is worth the trouble to implement, communicate and evaluate IT governance processes—it pays off.

In our study of 300 enterprises around the world, we did not identify a single best formula for governing IT.² However, one thing is clear: effective IT governance doesn't happen by accident. Top performing enterprises carefully design governance, and managers throughout the enterprise make daily decisions putting that design into practice.

IT governance is *the decision rights and accountability framework for encouraging desirable behaviors in the use of IT*. IT governance reflects broader corporate governance principles while focusing on the management and use of IT to achieve corporate performance goals.

¹ This MIT CISR briefing is the fifth in a series on IT governance. See also "A Matrixed Approach to Designing IT Governance," *MIT Sloan Management Review*, Vol. 46 No. 2, Winter 2005, pp 26–34.

² The study is based a survey of CIOs at 256 enterprises and 50 case studies on how enterprises govern IT. We would like to acknowledge Marianne Broadbent and her Gartner colleagues for their many contributions to this research.

A Quick Assessment of Your IT Governance

We assess an enterprise's or business unit's governance performance by evaluating the effectiveness of IT governance in delivering four objectives weighted by their importance to the enterprise. Using a weighted average formula, a score out of 100 is calculated. Figure 1 contains the questions and formula to calculate governance performance so that any enterprise or business unit can benchmark itself with our research results. We suggest you complete Figure 1 now to compare your enterprise with the results that follow. For a more reliable evaluation, ask a group of your senior colleagues to also complete the assessment and discuss the results.

Governance performance varies significantly across enterprises and is approximately bell shaped. The average governance performance score among our sample was 69. The minimum score was 20 and the top third performing firms had scores over 74. Only 17% of enterprises scored 80 or above and only seven percent scored 90 or over. Achieving high governance performance meant that the enterprise's IT governance was very successful in influencing desired measures of success. How does your enterprise compare? How urgent is the case for action?

Firms with above average IT governance following a specific strategy (e.g., customer intimacy) had 20% higher ROAs of firms with poorer governance following the same strategy. The governance performance measure also statistically significantly correlates with several three-year average measures of financial performance (e.g., ROE and market capitalization growth).

Centralized, Decentralized or Hybrid Governance

Given different strategies and organizational forms, different enterprises will strive to encourage different behaviors. Accordingly, the governance arrangements of top performing firms varied from more centralized to more decentralized approaches sometimes using a hybrid of both depending on their objectives. As shown in Figure 2, centralized IT governance supports profitability by focusing on business process costs. In contrast, decentralized governance supports

innovation and growth, while hybrid governance models correlate with asset utilization.

Centralized Approaches to IT Governance

Top performing firms on profit tended to be centralized in their approach to IT governance. These firms' strategies emphasize efficient operations often focusing on measures of business process cost and profitability. It follows that desirable IT behavior embodies a high degree of standardization in the pursuit of low business costs.

As a not for profit, UNICEF (the United Nations Children's Fund) doesn't worry about profitability. But UNICEF is very concerned about low cost and rapid organizational learning, so it has instituted a centralized approach to IT governance. For years, IT at UNICEF supported administrative tasks at headquarters but was nearly nonexistent in the field offices where the needs of children were directly addressed. UNICEF operates in remote and sometimes dangerous locations including sites affected by armed conflict, natural disasters and other tragedies.

In the mid-1990s senior management recognized that the lack of IT in field offices was handcuffing operations. Led by CIO Andre Spatz, UNICEF equipped remote locations with online access to critical data involving important tradeoffs among features like cost, reliability, speed and accessibility. The CIO worked with the other C-level managers to take ongoing governance responsibility for IT principles, architecture, infrastructure and investment decisions. Through the leadership of these CXOs, IT has fundamentally transformed the way UNICEF operates and has improved global knowledge, information flow, transparency and communication. Field offices can serve their constituents based on transaction-level and value-added information they could not access only a few years ago.

Decentralized Approaches to IT Governance

Top performers on growth were more focused on innovation and time to market. These firms insist on local accountability. Top performers on growth minimize constraints on creativity and business unit autonomy by implementing little enterprise-wide process or IT standardization.

Manheim Auctions, the US market leader in business to business car auctions, recognized during the early years of e-commerce that the Internet would offer opportunities to grow its business. To launch its fast growth online business and reinforce its industry dominant position, Manheim created an independent business unit Manheim Online. Hal Logan, the CEO of Manheim Online, worked with

the Manheim senior management team to define strategic business requirements. Like most high growth start-ups, the firm did not tightly govern architecture or infrastructure, focusing instead on managing projects for rapid development.

Manheim's decentralized approach to IT governance allowed the firm to successfully innovate and grow its business base. Eventually development teams' focus on speed of system delivery became unsustainable in the context of the larger firm. At that point, Manheim identified a need for greater attention to a more centralized architecture and reusable infrastructure services. Today the online business is integrated into the overall Manheim Auctions business model, relying on a set of shared IT services.

Hybrid Approaches to IT Governance

Firms pursuing asset utilization attempt to balance the contrasts between governance for profitability and governance for revenue growth and innovation. These firms often use shared services to achieve a combination of business unit driven customer responsiveness and economies of scale and standardization. They introduce governance mechanisms to address the tensions between enterprise-wide and local control. Asset utilization demands a hybrid approach to governance, mixing elements of centralized and decentralized governance.

Carlson Companies won the 2004 IPQC award for the "best mature shared services organization." Carlson is a \$20 billion privately owned conglomerate in the marketing, hospitality and travel business including brands such as Radisson, Regent International and T.G.I. Friday's. Although Carlson's business units are large and mostly autonomous, the CEO believed the firm could benefit from sharing both IT and financial services. The company's use of shared services is well served by a hybrid IT governance model.

IT governance responsibilities at Carlson are vested in five decision groups: the Carlson Technology Architecture Committees residing in each operating group, the Enterprise Architecture Organization, the IT Council, the Carlson Shared Services Board, and the Investment Committee. These groups allow for strong representation from Carlson's business units but drive a healthy enterprise ROA.

Conclusion

While no simple formula offers specifications for implementing IT governance, we have found that thoughtful governance design can help firms deliver on their strategic objectives.

Figure 1: Assess Your IT Governance Performance

1. Question:
How important are the following outcomes of your IT governance on a scale from 1 (not important) to 5 (very important)?

2. Question:
What is the influence of the IT governance in your business on the following measures of success on a scale from 1 (not successful) to 5 (very successful)?

a. Cost effective use of IT	<input type="checkbox"/> X <input type="checkbox"/>	= <input type="checkbox"/>
b. Effective use of IT for growth	<input type="checkbox"/> X <input type="checkbox"/>	= <input type="checkbox"/>
c. Effective use of IT for asset utilization	<input type="checkbox"/> X <input type="checkbox"/>	= <input type="checkbox"/>
d. Effective use of IT for business flexibility	<input type="checkbox"/> X <input type="checkbox"/>	= <input type="checkbox"/>
Importance Total = <input type="checkbox"/>	Total = <input type="checkbox"/>	

3. Calculate governance performance: $(\text{Total} \times 100) \div (5 \times \text{Importance Total}) = \text{[]}$

Figure 2: Governance Lessons from Performance Leaders³

	Performance		
	Profit	Asset Utilization	Growth
Strategic Driver	Profitability via enterprise-wide coordination and focus on core competencies	Efficient operation by maximizing IT sharing and reuse	Encourage BU innovation with few mandated processes
Key Metrics	ROI/ROE and business process costs	ROA and unit IT cost	Revenue growth
Key IT Governance Mechanisms	<ul style="list-style-type: none"> ▪ Enterprise-wide management mechanisms (e.g., executive committee) ▪ Architecture process ▪ Capital approval ▪ Tracking of business value of IT 	<ul style="list-style-type: none"> ▪ Joint decision making by central IT and each BU ▪ Business/IT relationship managers ▪ Process teams with IT members ▪ SLA & chargeback ▪ IT leadership decision making body 	<ul style="list-style-type: none"> ▪ Budget approval and risk management ▪ Local accountability ▪ Portals or other information/services sources
IT Infrastructure	Modular capabilities centrally coordinated and architected	Layers of shared IT services	Local customized capability with few required shared services
Key IT Principles	Require process standardization and IT modularity	Low unit IT costs and use of shared services	Local innovation with communities of practice and integrate later
Governance	More centralized	Blended	More decentralized

³ Based on analysis of firms with statistically significantly higher three year industry adjusted performance: Profit (ROI/ROE), Asset Utilization (ROA), Growth (Revenue Growth).

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- Enterprise Architecture
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