

Run, Grow and Transform the Business IT Spending: Approaches to Categorization and Interpretation

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Business transformations of all kinds will drive CIOs and other strategic stakeholders to better categorize the value of investments. Use "run, grow and transform the business" views of IT spending as a catalyst for effective communication, decisions and forecasting.

Key Challenges

- IT organizations with goals for "doing more with less" find it difficult to quantify, estimate and communicate the level of nondiscretionary IT spending needed to sustain business transformation.
- CIOs and IT leaders continue to struggle with directly relating IT's contribution to the enterprise's strategy or business outcomes; the lack of feedback and success definition is delaying plans related to digital business.
- Lack of clear definitions and understanding with the application of the run, grow and transform model has led to classification gaming and reinterpretation of the results of IT-enabled investments, and to suboptimized benefits realization.

Recommendations

- Use run, grow and transform the business IT spending categorizations to help communicate the funding needed for business transformation and the cost to maintain legacy business models.
- Divide the run the business IT spending by business outcome metrics to show per-unit-cost productivity improvement, with the related volumes, to better show its value to the enterprise.
- Use other IT spending portfolios in addition to the run, grow and transform the business IT spending model, to help strategic stakeholders to make optimized business investment decisions, and to drive innovative thinking.

- Show the interdependency of run, grow and transform the business IT spending, IT spending as a percentage of revenue, and reduction in run IT spending as a litmus test for five-year strategic planning.

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Introduction

Positive and negative business disruptions require an investment strategy that can clearly communicate to strategic stakeholders the benefits of IT. CIOs and IT leaders must create a quantitative story around IT investments, or any business investments. However, not all IT investments are the same or deliver the same benefits for the risks that are accepted. Over the past few decades, IT organizations have adopted the strategic IT spending categories of run, grow and transform (RGT) the business IT spending to better categorize expenses and investments. Because of the collective fluency of CIOs with RGT, these metrics can be benchmarked annually by general vertical industries using the Gartner IT Key Metrics Data (see "IT Key Metrics Data 2016: Executive Summary").

This level of CIO fluency with RGT has also created industry-accepted standards for the meaning of the split between "run" IT spending and "change" IT spending (which combines grow and transform IT spending). CIOs can estimate and forecast the changes in run versus change IT spending over the span of a five-year strategic plan. They can then calibrate IT spending or budget goals, as well as future maintenance expense increases in the run, to test constraints in investment planning.

As a general fact of life, new systems require maintenance in future years. "Change" investments result in future maintenance liabilities that increase the size of the "run" in subsequent years. Also, run investments often require future investment to replace or update those systems, assets or services.

Many CIOs get creative with the use of RGT, estimating these levels for each business unit or product or service line to see if investment strategies match traditional tendencies with the split between RGT or run versus change IT spending. Higher maturity organizations use RGT categories to segment business capabilities, business units, geographic business units and staff. This ability to use RGT definitions for many segmentation exercises makes it nearly the universal "portfolio" taxonomy, where the percentages can be adjusted by most strategic stakeholders to drive goals, instead of just communicating value or performance.

This research is designed for CIOs and IT leaders to revisit their current application of RGT. Alternately, those new to using RGT can use this research to communicate IT spending differently to strategic stakeholders — or to make different decisions around IT spending or investment levels. Now more than ever, because of digital business and other transformations, the use of RGT is mandatory to show numerically whether RGT percentages or IT spending levels are optimized to the goals or strategy of the enterprise.

Use of RGT categorizations for communication and prioritization will aid in driving more value from business projects. Yet, business value realization also requires a focus on the people and processes driving change, not just on classifying technology investments into RGT. Seldom, if ever, does just one framework, aspect or action drive a positive outcome by itself.

Analysis

Use Industry-Standard Definitions for RGT

IT organizations should start with industry-standard definitions, and then expand into finer qualification of the definition. This eventually leads to utilization of more creative or customized portfolio classifications, as explored later in this research. Initial attempts to classify IT operating and capital expenses to the RGT taxonomy can create frustration; however, once completed, repeating the process becomes less problematic. IT organizations should balance simplicity with accuracy when using RGT taxonomies. Too much refinement of individual purchases or resource estimates reach a point where the effort produces immaterial results. The ultimate goal in using industry-standard definitions is to classify IT spending into categories that show impact on business outcomes or success, can aid alignment and quantify underinvestment in IT.

Gartner uses the following portfolio spending categories and definitions:

- **Run the business:** This is an indicator of how much of the IT resource is consumed and focused on the continuing operation of the business. It includes all nondiscretionary expenses as part of the run-the-business cost. Some businesses call this "business as usual," "keep the lights on" IT spending, or sustain investments. Run expenses do not directly increase revenue, or achieve by themselves new or enhanced goals of the enterprise.
- **Grow the business:** This is an indicator of how much of the IT resource is consumed and focused on developing and enhancing IT systems in support of business growth (typically organic growth). These investments also drive bottom line improvements or operational efficiencies that reduce business operating costs. Discretionary investments are more likely to be included in the grow-the-business or transform-the-business cost.
- **Transform the business:** This is an indicator of how much of the IT resource is consumed and focused on implementing technology systems that enable the enterprise to enact new business models. This is a "venture" category represented by activities, such as an insurer introducing usage-based insurance products, or a supermarket combining real-time analytic monitoring with in-store task management to provide automated alerts to store staff to perform pre-emptive tasks.

- **Change the business:** This combines the grow and transform the business IT spending categories for the sake of simplicity. If change the business IT spending is used as a category, this often means that grow and transform categories are not used (thus, run versus change the business IT spending). Use of this categorization is often favored where there is ambiguity as to the classification of expenses or investments, but where there is still a clear distinction between run and change the business investments.

Categorize IT Assets, Resources, Projects and Outcomes as Either Run, Grow or Transform

There are several approaches or litmus tests that can be applied to categorizing IT assets, resources or staff expenses to the RGT categories. Categorization of outcomes (that include an aggregation of assets, resources and staff) like projects, programs or services are also categorized using RGT. Thus, there are "ingredients" that are categorized as RGT and "outcomes" that are also categorized. In the larger value chain of IT economics, there might be a mixture of outcomes and ingredients that are categorized. At the highest level, all outcomes are an ingredients to a higher-level taxonomy.

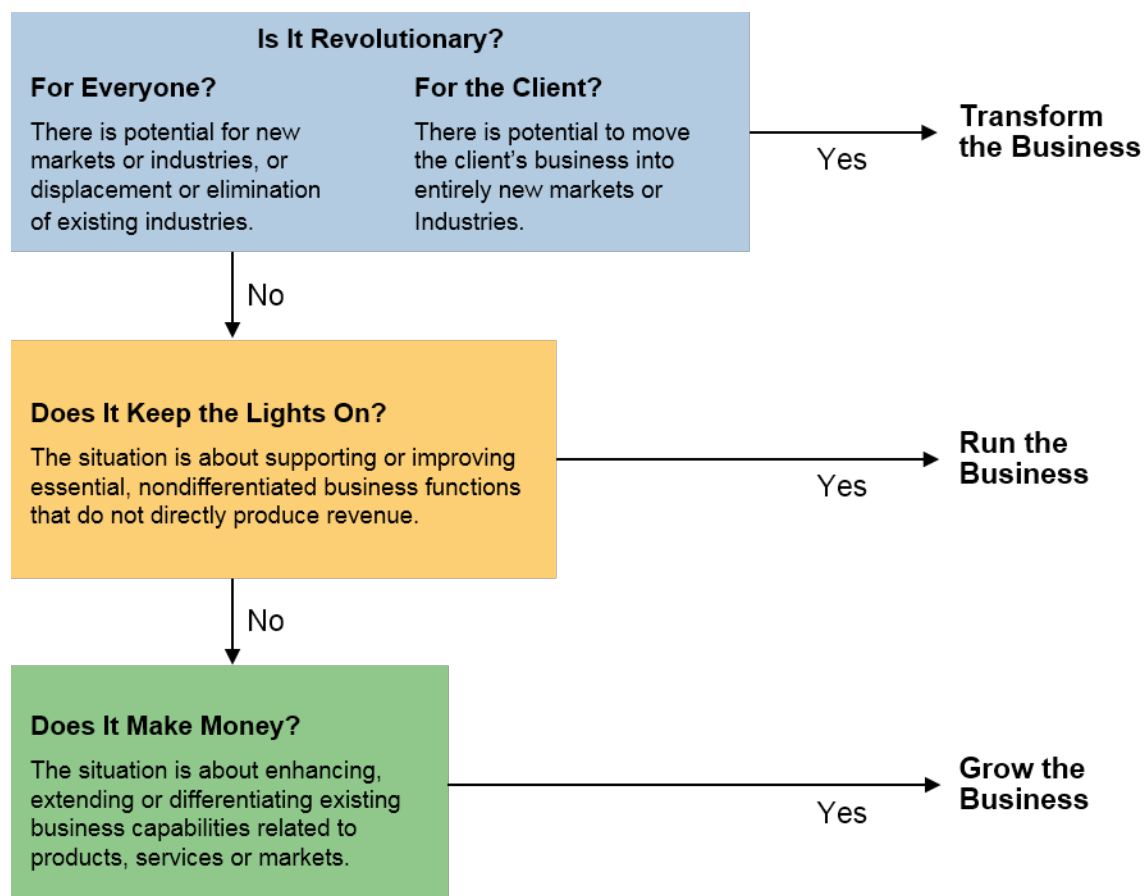
There is a tendency, although not absolute, for grow and transform expenses (either opex or capex) to include line items that are predominantly project or program outcomes (basically, calculations that contain a collection of IT assets, resources and staff), and for run expenses to include line items of purchases or staff hired for maintenance (see "New Metrics Are Required to Justify Communications Service Provider Investment in IT").

For example, an enterprise initiative for replatforming mainframe services would be classified as a "grow" initiative, because there is a decrease in its per-unit cost and increased capacity. Any hardware, software and services purchased or used in this initiative would be classified as grow.

At the same time, a CRM and sales replatforming initiative would have a more elaborate business case that includes hardware, software and services purchased or used. All of those would be classified as grow as well, due to extension of existing revenue-based business outcomes from an existing capability. Both deliver financial and accounting-based benefits. Although the financial outcomes are different, they both can be classified as a grow investment.

For certain aspects of the IT budget, categorization is more art than science. Paramount in the classification decision is how the expense relates to business outcomes. A common misconception is IT investments for the sake of IT could be considered "transformational" for the IT organization, but still be considered a "run" investment because the business outcomes do not change. Also, some of the largest investments can be considered to deliver "grow" benefits and "transform" benefits simultaneously (where a 50%/50% split would be applied to large investments where there are multiple value propositions). See Figure 1 for a useful decision tree for categorizing individual budget items or investments.

Figure 1. Business Value Category Decision Tree for Run, Grow and Transform the Business IT Spending



Source: Gartner (June 2016)

All too often IT organizations and their business counterparts may become overoptimistic regarding individual projects and misclassify them. In general, if an investment is approved knowing that it will produce a negative ROI or it is difficult to classify its benefits, then the default classification is "run." Ironically, some "transform" spending is often small, high risk, high reward in nature that has a failure rate of 66%, in general, and may be misclassified as "run" because of this characteristic. In this case, it would still be classified as "transform" because of its promise or potential to create new revenue or new business models.

For quick classification of IT spending in RGT categories, the operating expenses typically are all classified as run, except for the estimate of effort or labor in the application development area, where staff work on grow and transform projects. Another exception to this operating expense rule is in the office of the CIO (OCIO), where estimates of time or effort could be created for the enterprise architect, head of the advanced technology group and other functions here. As much of the discretionary spending is either grow or transform in nature, projects are classified accordingly along with level of effort or quantification of time and billable rate.

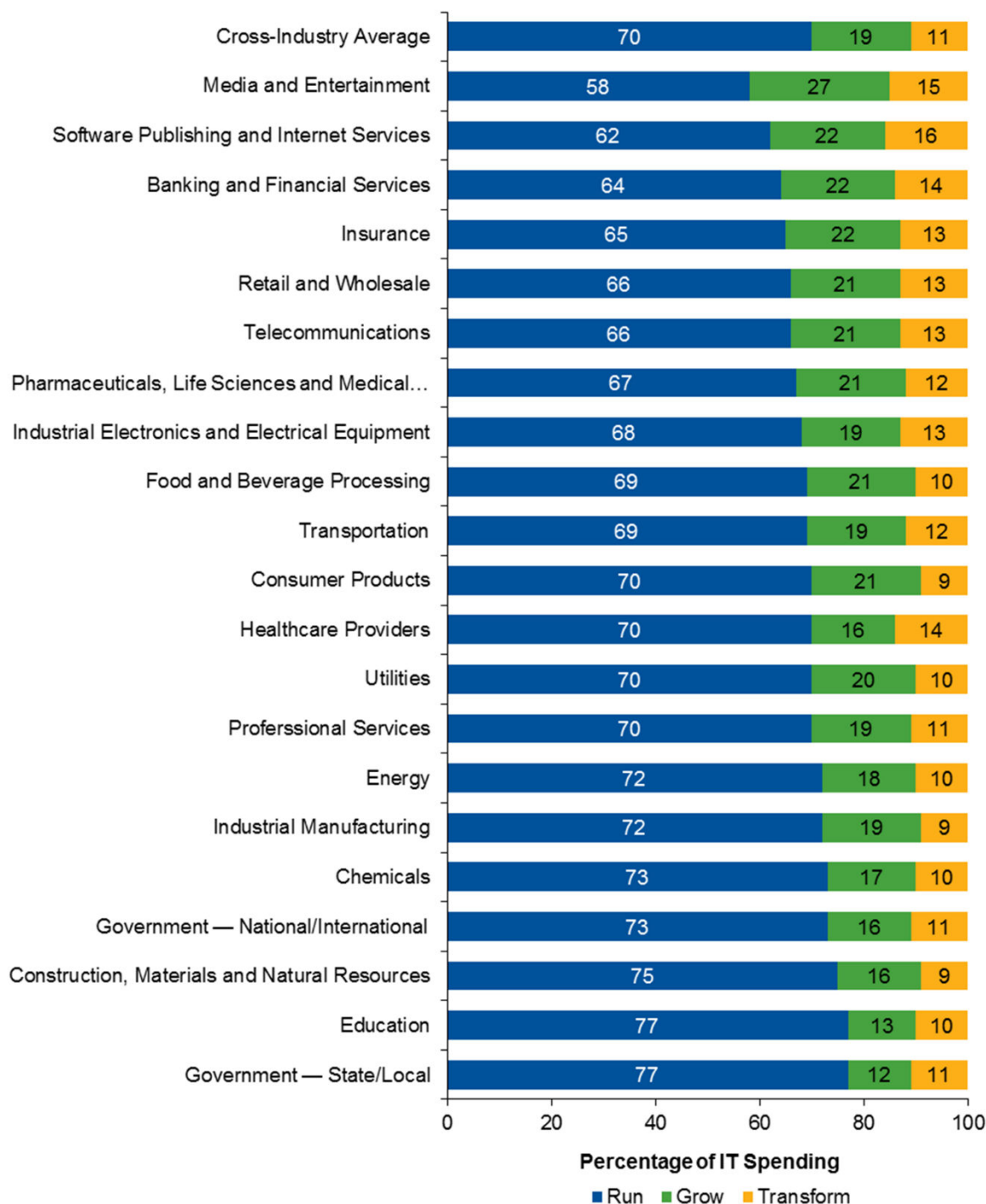
Billable time for application maintenance and support related to customization of systems is often a categorization conundrum. If there are bug fixes or enhancements made to existing systems that originate in the change management process, but do not have a formal business case (like in a business case that requires cost and benefit calculations, ROI and so on), this work is typically classified as "run." However, if benefits can be quantified on a repeatable basis, this would be classified as a "grow" investment.

As stated earlier, the materiality of the benefit must be well-defined, repeatable and significant to be considered grow or transform.

Benchmark RGT by Industry Using Gartner IT Key Metrics Data

Once standard definitions are used for the RGT categories, industry-specific benchmarks can be used to help CIOs and IT leaders with forecasting, planning and communicating the value of IT. Each year Gartner published updates to the averages as part of the industry-specific IT Key Metrics Data research, as shown in Figure 2 (also see "IT Key Metrics Data 2016: Executive Summary"). There is a tendency for "information smart" industries to have a lower percentage of their IT spending (opex and capex, excluding depreciation) devoted to the run, leading to a higher combined percentage devoted to grow and transform ("change IT spending"). National infrastructure and traditional industries occupy rankings where run-the-business IT spending is quite high as a percentage, compared to information-intensive industries (such as media and entertainment, software publishing and internet services, and banking and financial services).

Figure 2. IT Spending to Run, Grow and Transform the Business, by Industry, 2015



Source: Gartner (June 2016)

Often, organizations will use this benchmarking information and target another industry's average RGT percentages for long-range planning, but use their industry's averages for steady state

periods. If the use of RGT becomes a staple of the strategic planning process or governance planning, these benchmarks for RGT can be considered critical assumptions in justifying investment, funding, budget and staffing levels. However, CIOs and IT leaders are cautioned that their plans require a purposeful deviation from the industry benchmarks to match their strategic objectives and budget size. While RGT (or any area) benchmarks are useful as an input indicator, they should be cautious not to mimic benchmarks exactly to the exception of organizational strategy and goals.

Often, CIOs and IT leaders find that benchmarking RGT against industry averages, like in Figure 2, can be misleading, as it does not take into account just enterprises with similar goals to the benchmarking organization. In general, benchmarking averages are just that: averages that take into account over- and underperforming enterprises. IT organizations must take into account many assumptions when using benchmarking organization, including how RGT percentages would be different based on the goals, circumstances or aspirations of the enterprise.

A point of clarification is that Figure 2 shows all IT spending (opex and capex) devoted to RGT categories. Most organizations have a similar percentage split for just their current project portfolio to leverage RGT. The power of RGT is seen when organizations show a top-down allocation rather than a bottom-up rollup of just input ingredients like hardware, software, personnel and external services. Here, IT organizations and their enterprises need to leverage the industry benchmarks and use their strategic planning processes for an initial evaluation of what allocation to set, then determine which projects fit into the portfolio (and which remain out). Otherwise, the results would end up just repeating historical allocations.

Use Industry-Standard Run Percentages for Long-Term Planning and High-Level Estimating

CIOs and IT organizations can be deceived by the dynamic nature of the split of RGT, or run versus change. RGT is at its heart a portfolio. Increases or decreases in any RGT element or the level of total IT spending will cause percentages to change, and could indicate something very different from the intention of the IT organization or larger enterprise. In general, the percentage level of run IT spending often indicates the long term status or current bias of the enterprise from a change (or non-change) perspective.

Gartner research shows that the level of run-IT spending (or conversely, the level of change-the-business IT spending) can often indicate quite a bit about the general health or sustainability of an enterprise. As shown in Table 1, the level of run-IT spending can be set, is based on or is incidental to the general status or "health or sustainability" of the enterprise.

Based on Gartner interactions with clients for decades, enterprises with run-IT spending levels at 85% indicate that the enterprise is in optimization mode. Enterprises with 50% of IT spending devoted to running often means enterprise transformation is ensuing, and requires 50% of IT spending devoted to changing the business or enterprise.

Table 1. Run the Business IT Spending Levels and General Enterprise Status

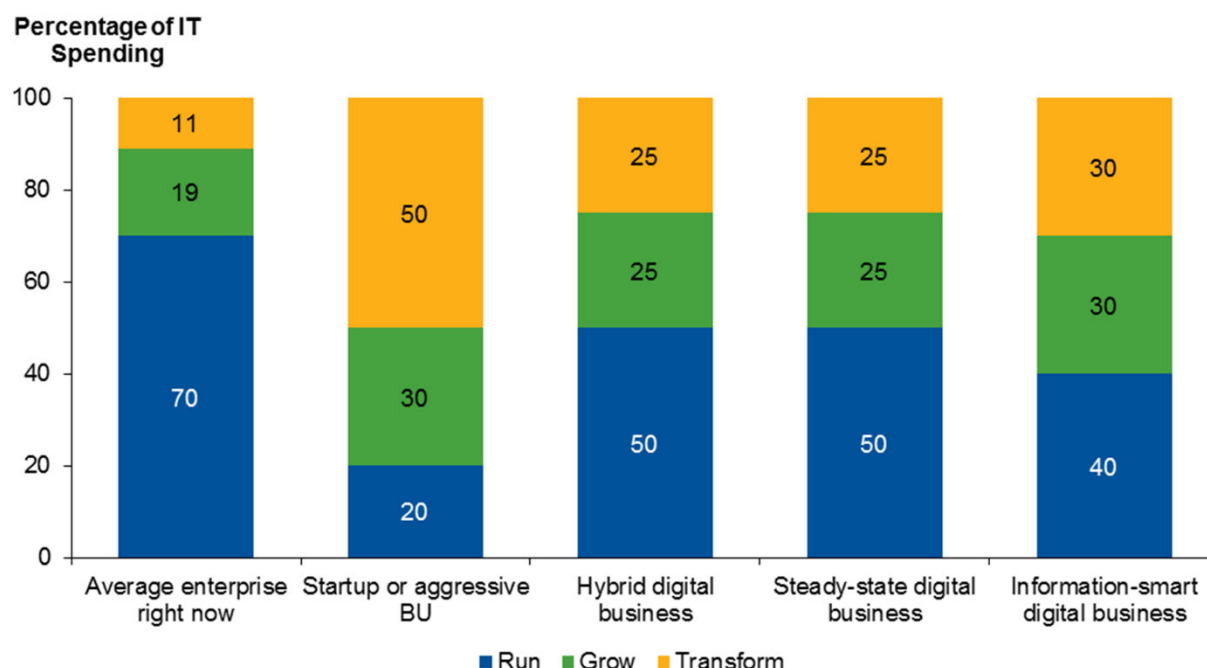
Run as a Percentage of IT Spending	General Status
100%	Retrenchment
85%	Optimization
75%	Mature steady state
70%	Typical for average performers
50%	Transformation
20%	Fast-growth startup
0%	Not in business yet

Source: Gartner (June 2016)

The figures listed in Table 1 may be misleading for some enterprises, as they represent a snapshot in time, and can change significantly based on the long-term planning of the enterprise. As organizations deliver grow and transform outcomes in Year 1 of a five-year plan, those investments turn into maintenance and other expense requirements of future years of that plan (that increase the run IT spending). Additionally, the size of the organization, as well as maturity of the industry and enterprises, have an influence on the level of technical debt that factors into the allocations listed in Table 1. (See Figure 10 for more context on the behavior of RGT over a five-year planning cycle.)

Based on the dynamic nature of business and industry in general, it is nearly impossible to maintain a constant level (percentage) devoted to run and change year over year. Additionally, if an industry is "information smart," like banking and financial services, a 45% run rate is not unusual during periods of transformation. Traditional industries often have difficulty increasing the change percentage and reducing the run percentage to reach 50%/50% run versus change IT spending. Because of the prevalence of digital business transformations, typical RGT portfolio percentage splits shown in Figure 3 are additional representations (and additive to Table 1) of IT spending assumptions used by the indicated type of transformation.

Figure 3. Typical RGT Changes to Ensure the Right Portfolio Balance for Sustaining Digital Business Transformation



Source: Gartner (June 2016)

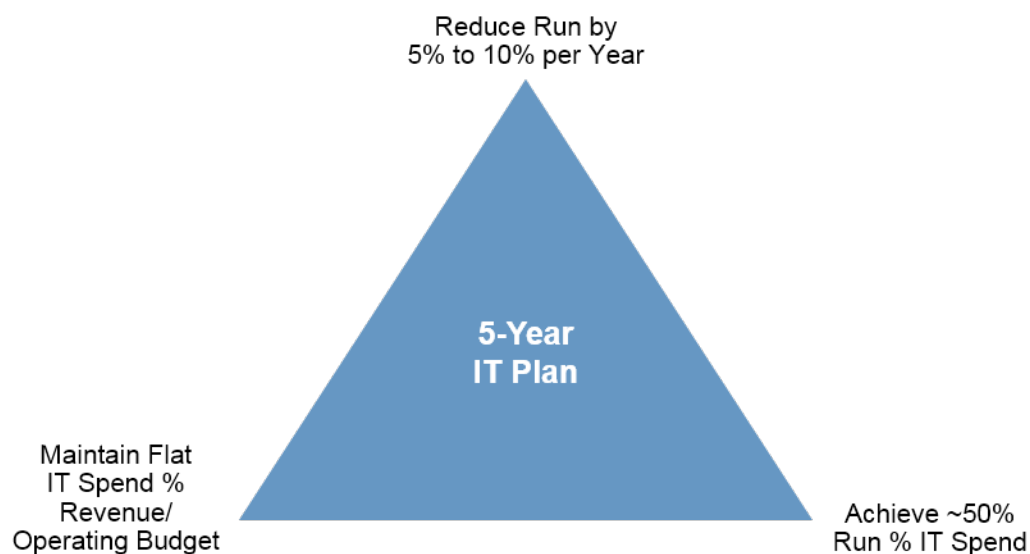
In any given year, a large percentage of IT spending devoted to the "change" IT spending category (which includes grow and transform IT spending) naturally leads to a higher percentage of the "run" IT spending category in subsequent years. This increase in the run IT spending often includes or is driven by unplanned maintenance cost, unfunded liabilities or "technical debt." Normally, significant revenue growth is required to minimize the technical debt. CIOs and IT leaders must inform and challenge strategic stakeholders on their future cost assumptions during transformational planning. This will often include IT estimates for how RGT changes, or for simplification purposes, how run and change IT spending moves over the three- or five-year planning cycle.

Triangulate RGT, the Level of IT Spending as a Percentage of Revenue, and Reduction of the Run for Goals of Doing More With Less

In discussions with market-leading enterprises in all vertical industries, a constant theme keeps appearing about setting a strategy for simultaneously cutting IT expenses and transforming the business through IT. This doctrine or theme of "doing more with less" is typical in most enterprises. For enterprises that are growing quickly, most continue organic transformation by increasing IT budgets or spending and cannot be bothered with cutting IT costs (the run) significantly as it is a distraction. For mature enterprises, there are many constraints to this approach to transformation, and market-leading enterprises are tying three key metrics together as a reasonableness test for their spending and strategy, and to in effect, "cutting and transforming" simultaneously. Figure 4

shows the basic framework for three IT goals or metrics working together to achieve better and balanced business outcomes.

Figure 4. Triangulation of Run-IT Spending Cuts, IT Spending as a Percentage of Revenue and RGT Distribution



Source: Gartner (June 2016)

The triangulation in Figure 4 ensures that goals set for individual metrics are reasonable, balanced and considered, given their interdependency. If the primary goal often is to achieve a 50%/50% split between run and change-the-business IT spending, then this may not be achievable if IT spending as a percentage of revenue is set to decline. If IT spending as a percentage of revenue is set to remain flat (a typical aspiration), but the run category is set to be cut by only 2% a year, the 50%/50% run versus change split may not be achievable. This is especially true for enterprises that have already been through three years of cutting IT expenses. Many organizations track and set goals for these three metrics, but are seldom cognizant that they are interdependent.

Organizations will use the RGT differently or become creative with it. Some will use it as a strategic alignment tool — think litmus test or sanity check. Others will use it to drive goals based on historical tendencies (see Table 1). Most will use RGT as both a sanity check and to drive goals that are reconciled in their dynamic strategy and governance processes. Constant feedback from the strategy and strategic planning process (and the early results of the investment strategy) will guide:

- Adjustments to revenue projections
- IT spending as a percentage of revenue
- Reduction in the run category (or slowing the growth of the run)
- The split between the RGT categories

In most instances, all these elements will ideally align and be logical. Otherwise, organizations will have unrealistic or confused priorities.

By combining RGT with other perspectives on IT spending, the synergies create a better perception and connectedness to IT business value than what is expected by them individually. By setting more balanced and considered IT spending goals, the organization significantly increases its chances of improving the perception and actual value of money delivered to the business (thus, improving the strategic relevance of IT).

One metric by itself delivers a questionable or indirect view of business value; combined, it can show a powerful and strategic representation of IT business value.

Figure 4 is the strategic framework for simultaneous cutting and innovating. However, few large enterprises are able to sustain a 50%/50% split indefinitely. New maintenance expenses that will be incurred due to high change-the-business IT spending levels will often push back up the run/change split to normal levels (for example, 70%/30% run versus change).

The assumptions for maintenance must be considered and estimated — often, new run expenses that are created for maintaining new systems or investments are estimated at 15% to 30% of implementation costs (see "Don't Let Operational Spending Erode Investment Funding"). This triangulation is a perfect example of cutting from the past (run expenses) and redistribution to the future (change-the-business expenses). To add more color to this, the cuts in the run-IT spending can be called "business reinvestments." See the case study below for a larger illustration of triangulation of metrics that includes RGT changes and estimates.

Modify the Definitions of RGT to Differentiate Your Investment Planning

As IT organizations grow in their maturity with categorizing, communicating and actioning RGT methods, many find that the use of marketplace, best practice or standard definitions are too constraining for their dynamic environments. Often the cultural issues or corporate financial management requirements force an organic change in definitions of RGT. Sometimes the changes are driven by stakeholders "gaming" their governance processes by finding loopholes in definitions that favor selection of their project. Other times, the collective understanding of what is keep the lights on, productivity improvement or new sources of revenue morphs and causes changes to the definition.

The further astray the definition departs from the industry standard, the less simple it is to benchmark RGT. However, at this stage of maturity, the guidelines in Table 1 and Figure 3 become more useful for setting goals and expectations than industry-specific benchmarks of "average" RGT percentages in Figure 2.

Shown below are modifications that we have collected in our research. Although anecdotal, these examples will help "give permission" to IT leaders to allow changes to their internal RGT definitions, as this often is inevitable to drive differentiated business outcomes.

Example 1

New maintenance and support expenses caused by last year's grow and transform investments are excluded from the calculation of the run for one year of the forecast period. The issue here is often that projects that start out as grow or transform are optimized to the project finish date. When they are made operational (run), there is still work to be done to refine the new system that was abandoned to meet deadlines. This delayed work or spending would normally be classified as a run expense, but in reality it is a continuation of the project from last year that was then classified as grow or transform.

Example 2

Regulatory, compliance or audit IT spending that should be categorized in the run category are often recategorized as grow investments because of their size. For large regulatory and compliance projects, because they fail the litmus test of contributing positive benefits to the enterprise (grow or transform), they are categorized as run investment by default.

However, in some enterprises, because their investment size exceeds documented capitalization thresholds, the corporate finance function follows guidelines that if the investment exceeds this threshold, it must be categorized as at least a grow investment and the related assets depreciated. Some corporate financial rules often tie opex/capex categorization to RGT categorizations.

Example 3

For emerging large enterprises where initial ERP investments (typically run investments) basically create from scratch these capabilities, the positive disruptive nature of its implementation drives recategorization to a grow or transform investment.

Back-office ERP systems are typically incrementally advanced over the life of an enterprise, but do not drive direct "new" benefits to business outcomes, and are classified as run investments. However, if the initial implementation drives material changes to the operational effectiveness of the enterprise, some enterprise have reclassified this from run to grow (or transform). Where ERP investments drive lower cost transactions, or where ERP consolidation drives the removal of redundancies (and hence a positive ROI), then a grow classification is warranted.

Example 4

Security — loosely classified as a compliance expense and thus categorized as a run investment — is often driven as a competitive advantage capability to win new customers or clients with new digital business services. If security investment is increased above and beyond what is necessary traditionally within the IT organization to secure new business, some enterprises reclassify these expenses as growth or transformational.

Drive Competitive Differentiation by Adopting Other Portfolio Categorizations to Supplement RGT

There are literally unlimited portfolio categories, classifications and taxonomies. Typically, the business or IT leader who has the "last say" in an organization often has design or definitional rights, but then, the challenge becomes the ability to benchmark their portfolio percentages. As a general principle, those enterprises with different or differentiated portfolio categories drive better and differentiated business results with customized categorizations, but they give up the ability to benchmark. The addition of a new category to the RGT model, or renaming categories can give goal legitimacy to strategy and governance. The creation of a new category (like "digital business," as a general example) draws attention and funding to that category and drives activity.

CIOs and IT leaders, in pursuit of competitive differentiation and to align to differentiating enterprises goals, often use RGT in conjunction with other portfolio categorizations. As the beliefs of stakeholders will be different by enterprises, the adoption of other portfolio categorizations is likely and guaranteed.

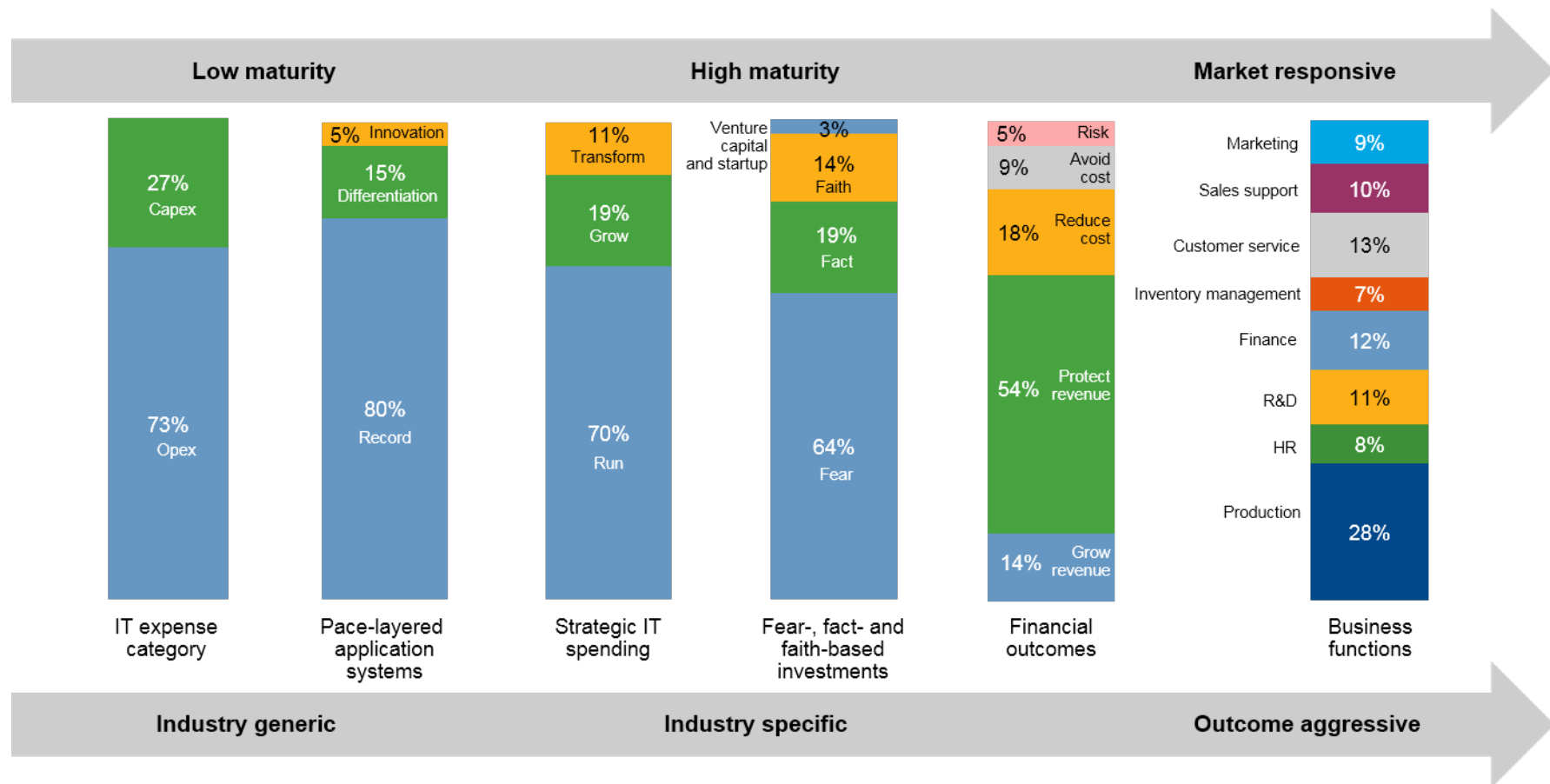
One could state that use of higher-maturity portfolio categorizations should be attempted first and RGT should be abandoned. However, movement to higher maturity frameworks often starts with RGT because of its adoption in the marketplace and the availability of its general definitions. The institutional knowledge gained by starting with RGT will lead to an appetite for more refined and aligned categories.

Examples of the use of other portfolio categories are countless:

- One enterprise renamed the RGT nomenclatures "catch up, keep up and get ahead" to reinvigorate their prioritization process, but the underlying definitions remained aligned to the traditional RGT definitions.
- Another enterprise wanted to highlight the burden of regulatory, compliance and audit expenses, and added this to the RGT model (run, regulatory, grow and transform).
- Still others did a total "reset" on RGT model. They kept the terms, but redefined the definitions to relate the outcomes of the IT spending based on how it interacts with external clients. Where clients do not interact with run systems for the company, grow systems are transactional client-facing systems, and transform systems were defined as new relationship-based client-facing systems.

Enterprise leaders can use the maturity glide path shown in Figure 5 for ideation of new portfolio categories to supplement the RGT model. It puts into context where RGT fits with other portfolio or segmentation models.

Figure 5. Maturity Glide Path and Multiple Portfolio Views of IT Spending



Source: Gartner (June 2016)

Moving from industry-generic to industry-specific categorizations is a sign of higher maturity with governance and prioritization. Even higher in maturity is the ability to segment IT spending into categories that are refined into business functional or business capability categories to allow for better prioritization of the overall portfolio of IT spending. These higher maturity and "market responsive" categories tend to be more outside focused, whereas many consider the RGT model to be inwardly focused.

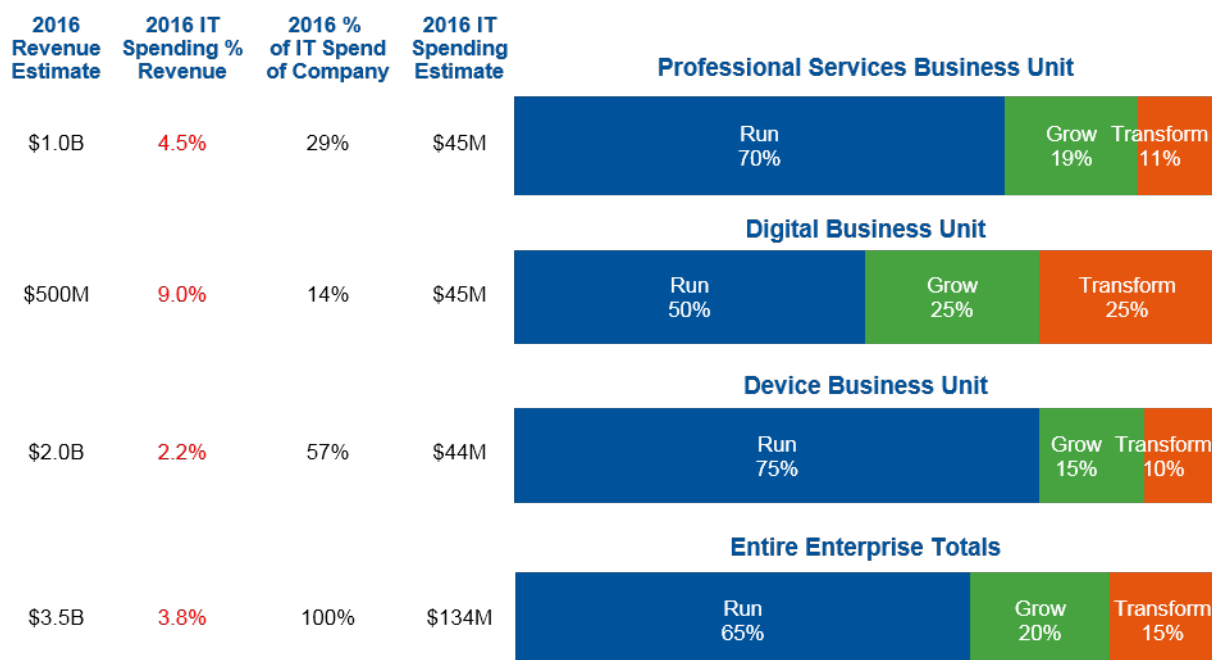
As is the case with having different metrics to compete or provide insights with general IT budgeting (an asset/resource category view versus a service view), strategic stakeholders make more optimized decisions with different views of the same level of IT spending. Basically, all portfolios add up to 100% of IT spending. For additional portfolio highlights, see "Digital Business Means Big IT Changes That Start With a Basic Business Portfolio Decision."

Communicate Different RGT Figures for Different Business Unit or Business Capability Segments

For simple enterprises, the use of one industry's RGT average might be enough to aid with future business planning as a strategic alignment tool. However, most large enterprises are really a combination of multiple small, midsize and large businesses with different goals, business models and aspirations. In this situation, a weighted planning model might be appropriate in the use of RGT to avoid unnecessary subsidization, the starvation of emerging business models that require more grow and transform IT spending, or misguided overspending for mature business models.

Figure 6 is an illustration of the modeling of RGT levels based on different business units. Here, RGT levels are set for the reality or goals of the individual business units, along with IT spending levels based on either existing average benchmarks, or a strategically negotiated IT spending level. The data from Figures 2 and 3 and Table 1 was used to create this classic illustration.

Figure 6. Business Unit Modeling of RGT That Allows Balanced Outcomes and Reflect Aspirations



Source: Gartner (June 2016)

When IT spending levels and RGT are viewed this way during planning or governance sessions, fundamental decisions can be made about project selection, investment allocations and overall business priorities. Depending on the general investment allocation doctrine of the enterprise — either (1) allocate IT spending or capital on a percentage basis to business units first, then prioritize project candidates, or (2) prioritize project candidates regardless of business unit — an optimized agreement can be reached that doesn't unnecessarily maximize or minimize the needs of individual business.

Assumptions and conclusions based on Figure 6 are many and far reaching for this illustration:

- The device business unit is in a mature steady-state situation where overinvestment would take away from profitability without future benefit. Thus, the IT spending as a percentage of revenue level was set at the industry average of 2.2% (average for industrial electronics and electrical equipment companies).

Because of its competitive situation, the RGT split of 75%/15%/10% was imposed to prevent undue subsidization from other business units. Although the average for similar enterprises was 68%/19%/13%, recent investments were seen as unsuccessful.

Decisions were made to shift the percentages to "mature steady state" as indicated in Table 1 (see "IT Key Metrics Data 2016: Key Industry Measures: Industrial Electronics and Electrical Equipment Analysis: Current Year" for typical IT spending and RGT figures).

- The professional services business unit has historically performed on average with competitors, and is treated as a "cash cow" aspect. Because its success is tied more to the synchronization of products and services of the other business units in the larger enterprise (and not to independent expansion goals), a decision was made to treat all investment decisions as "average." This entailed using average IT spending as a percentage of revenue (4.5%) and average RGT (70%/19%/11%) for professional services companies (see "IT Key Metrics Data 2016: Key Industry Measures: Professional Services Analysis: Current Year").
- The digital business unit has grown significantly for this enterprise over the past several years, and the growth outlook is good over the five-year planning horizon. Also, new competitors are emerging that are attempting to duplicate their success, but these competitors do not benefit from the business unit synergies of this example enterprise.

However, they are not willing to take the risk of disintermediation, and decide to continue a RGT investment pattern typical of big change or transformational enterprises (50%/25%/25%). The enterprises leaders here did not have a solid benchmark for IT spending levels, as this is a wildly different business model that defies standard industry categorization. They decided to align many of their high-level IT spending benchmarks to software publishing and internet services — not using average spending figures, but third quartile (9.0% of revenue for IT spending).

See "Pick Your Future Industry to Estimate Digital Business IT Spending Levels" and "IT Key Metrics Data 2016: Key Industry Measures: Software Publishing and Internet Services Analysis: Current Year."

- For these three business units, they are treated differently in respect to overall IT spending levels and the allocation goals for RGT. After a weighted roll up of the capital and operating expenses for all three business units, the RGT split becomes 65%/20%/15%, which indicates an enterprise change posture between average performance and transformational. This weighted total may lead to additional rounds of prioritization and calibration, where the possible goal may be to leave the run level at 70% to reduce portfolio risk or increase overall business profitability. This would result in a reduction of the grow and transform percentages (projects and budget).

If there are corporate imperatives for profitability that dampen desired IT spending levels, goals might be highlighted to reduce run expenses in one business unit. This will result in an organic numerical expansion in the percentage of spending for grow and transform in another business unit. Grow and transform spending might be reduced, or the grow and transform spending in one business unit might be sacrificed to focus on other business units. The decisions and recalibration can be endless without solid strategy and governance to back up RGT thinking.

Beware of Miscategorization or Gaming of IT Spending or Investments Using RGT

Explained early as a best practice for mature users of RGT methods was the modification in RGT definitions as a differentiation agent. Also, simplification of RGT to run versus. change can help with definitional ambiguity between grow and transform categories (and to eliminate some gaming or overenthusiasm).

An extreme level of this modification would be considered gaming, where projects or spending is purposely or subconsciously misclassified to promote preferential selection or to gain favorability in future prioritization exercises. This miscategorization happens at the highest levels in the enterprise, all the way down to the operational supervisor level, and often can never be fully remediated.

CIOs and IT leaders need to be aware of these practices, recognize this when it is happening, and be prepared for higher future technical debt or cost cuts to compensate for these miscategorizations.

Over the years, Gartner has seen patterns with RGT miscategorization. Examples include classifying ERP upgrade investment as a growth investment, when new functionality, cost reduction or added transaction capacity was absent. Several large enterprises created a new back-office platform that would be used for all world regions and classified the investment as transformational. However, enterprise stakeholders came looking for ROI and quantifiable benefits a few years later that were never part of the original business case (which is a leading indicator of miscategorization). As a general rule, if a project or investment is absent of ROI, it should automatically be classified as a run investment, unless a program-level distinction or business capability distinction is identified as part of the governance process.

The conclusion drawn by many CIOs and IT leaders when seeing the challenge of "gaming" is to stop it through a better definitions, governance or whistle-blowing during any stage of the business case process. Human nature is difficult to correct in any survey, benchmark or statistic. Also, the issues of gaming would lead many to believe that benchmarking would be of minimal value as it is widespread based on client discussions. As with most benchmarks available in any area, the assumption must be that some enterprises overstate some categories, while others understate the same categories, which leads to an optimized benchmark where the averaging process cleanses out the imperfections. Perfect benchmarks are always an ideal and a work in progress.

While enterprises are healthy and growing, miscategorization may go unnoticed, or few may even care about it. However, when enterprises enter uncertain growth periods or face sudden disruptive events, all eyes return to previous investments in an attempt to squeeze more benefits out of these past investments.

Those enterprise and IT leaders that tacitly take part in the silent conspiracy of miscategorization or gaming often face an uncomfortable period of "reverse justification." This is where all the conspirators know about the misclassification, but the CFO asks for a proof of value or benefits explanation that leaves many scrambling to show value. This seems a mild form of betrayal as the funding was provided with scant financial justification in the beginning (see "IT Economic Gravity to Support Big Change and Digital Business Transformation").

Related to gaming and miscategorization of RGT elements is the treatment of decentralized IT, business unit IT or shadow IT in the roll-up of RGT figures. Often, RGT figures automatically assume that all enterprise IT spending is included or known, but in large enterprises this can be ambiguous. CIOs and IT leaders might count only the RGT elements that are within their budgetary control or provide rough planning estimates for additional views of RGT similar to Figure 6. For additional insights into business unit IT metrics and benchmarks that can be used for pro-forma estimates, see "Metrics and Planning Assumptions Required to Drive Business Unit IT Strategies."

Show the Business Value of Run IT Spending by Benchmarking or Dividing It By Universal Business Outcomes

For decades, the debate has ensued around the business value of IT, and this is more pronounced when related to run the business IT, often referred to as nondiscretionary IT spending. By its nature, many IT and enterprise leaders feel there is business value in maintaining and operating supporting business capabilities that drive existing and predictable business outcomes. The nature of business performance expectations is that the "change" the business IT spending (grow and transform) delivers the IT outcomes (projects) that drive goals for growth, profitability and cash flow. There is business value from run IT spending, but it must be calculated in a different way than from an ROI perspective, as shown in Figure 7. Some call this price for performance of the run.

Figure 7. Traditional Value Propositions for RGT

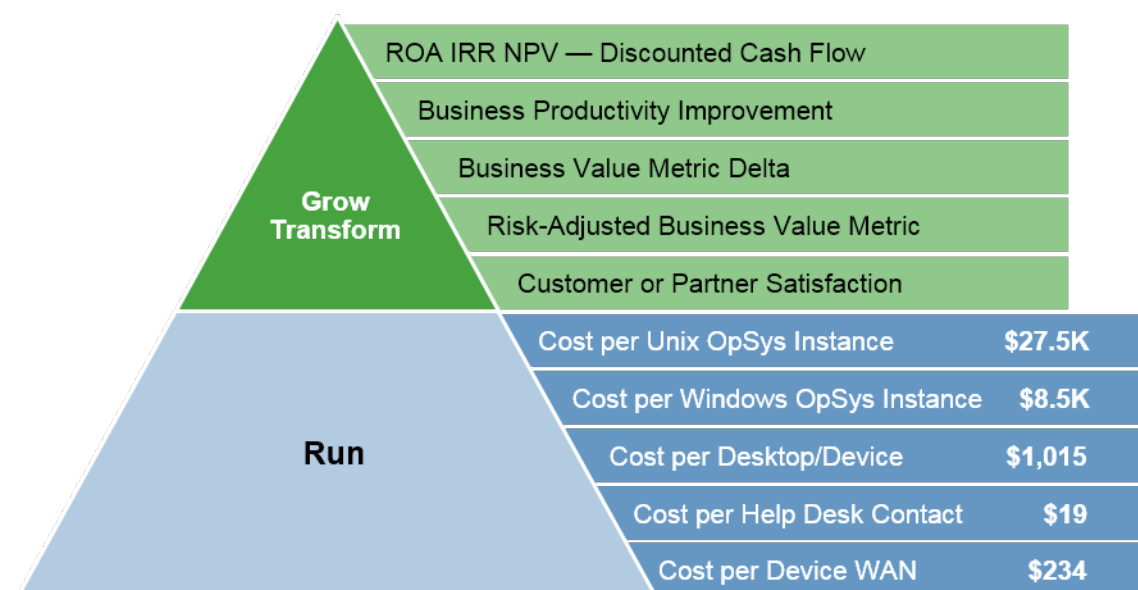


Figure meant to be illustrative and not a formal benchmark.

Source: Gartner (June 2016)

As shown in Figure 7, use of cost-per-unit benchmarking by individual domains within the run are often useful to compare against external sources. If the internal IT organization average is less than a published or consultant-provided per-unit cost, the IT organization is doing its job efficiently and effectively. Along with this per-unit cost, the volume of those units must be considered. If the external per-unit cost benchmark is lower than that internally, this leads to activity or investment to reduce the per-unit cost to validate its value. As is the nature of many IT investments or services, having the capability is a requirement, but its value must be derived from comparison as value is relative.

Also, use of "only" per-unit cost may breed a bias of value, as other metrics should be considered to make an optimized assessment of value. For example, service-level and per-unit cost are difficult

to accurately calibrate, even with the best prescriptive consulting services. The investment history or plans for reducing run costs, episodic run investments or the staggering of run investments (to sustain the business) will have an impact on the interpretation of these benchmarks. The forecast of per unit costs is often necessary to create a holistic picture of the success of run or cost management.

To more accurately assess what level of expense or spending should be devoted to the run, and in individual domains, consider:

- The percentage of IT cost devoted to that domain
- The year-over-year budget level for that domain
- That domain's per-unit cost
- The number of units or transactions
- Satisfaction with the services within that IT domain

Often, a lower per-unit cost does not consider that maybe the enterprise has too many units and as such is not proof of value somewhere else in the portfolio or economic ecosystem. However, for a simple assessment of the business value of the run, typically a per-unit cost by domain assessment is enough to satisfy stakeholders that are seldom satisfied for very long.

Increasingly, enterprise or strategic stakeholders do not want to get into the weeds within areas of IT that they do not understand; they may understand run IT spending from a conceptual perspective but not the capabilities underneath it. For this reason, many CIOs and IT leaders have taken to dividing the run (either in its entirety or into carefully segmented pieces) by business outcomes, as shown in Figure 8.

Figure 8. Divide the Run by Business Outcomes to Show Productivity Improvement or Refined Business Value

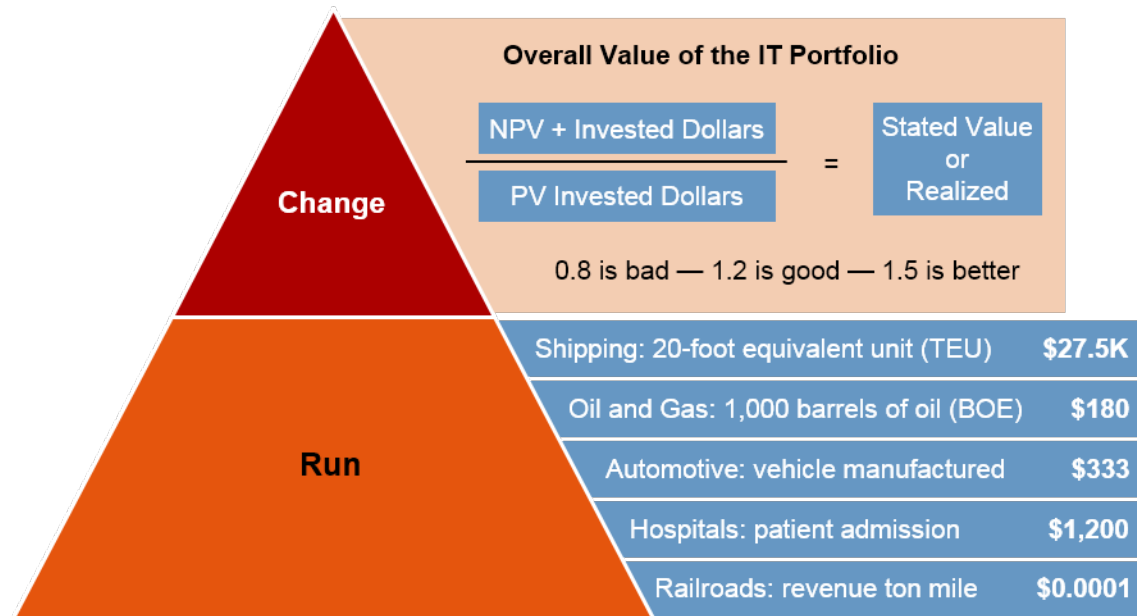


Figure meant to be illustrative and not a formal benchmark.

Source: Gartner (June 2016)

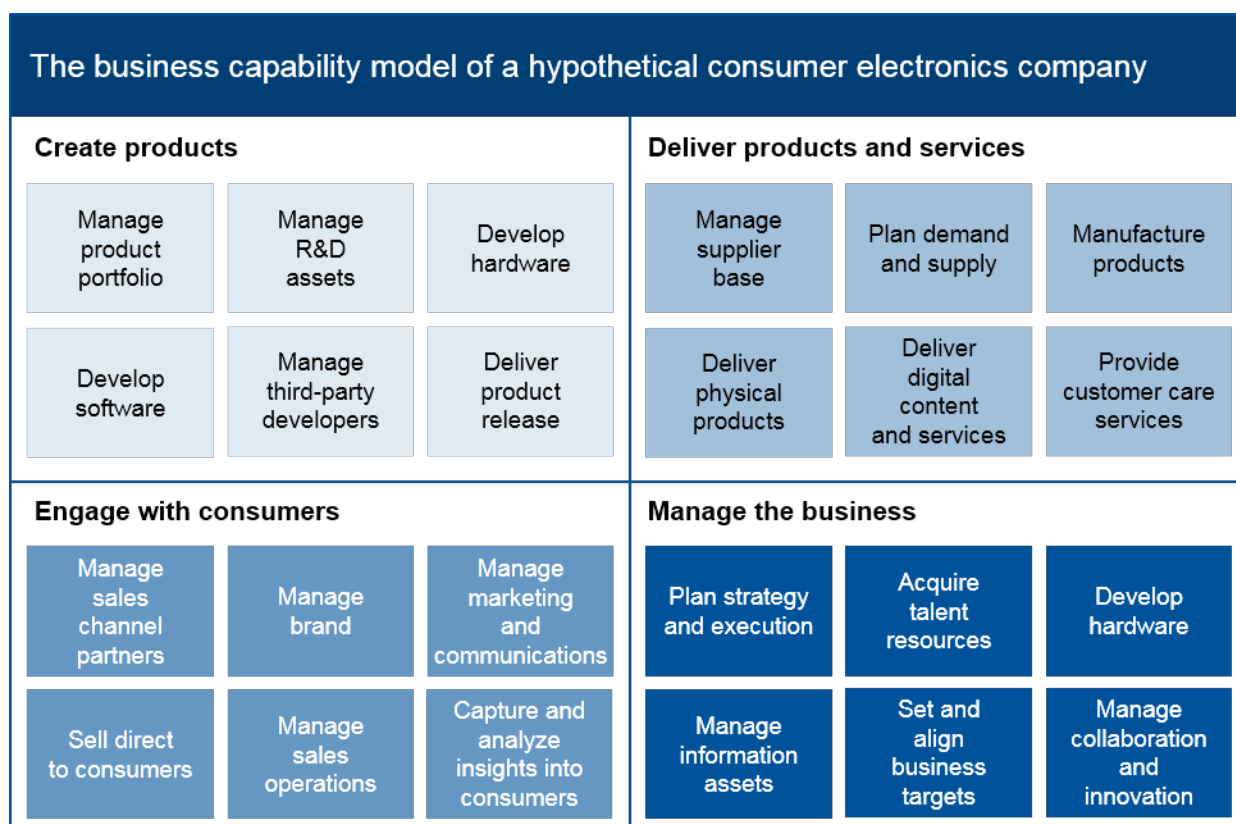
From Figure 8, we see that if the business model and its outcomes are well-defined, common or well-understood, they act as an excellent and useful denominator for all run expenses. Run IT spending per automobile, 1,000 barrel of oil equivalent (BOE), hospital bed, etc. can be used as an internal benchmark where plans or results can be compared, and where lower than the previous average is considered successful management of the run. One local government recently calculated the run expense per citizen, discovered it was just 25 cents, and used to as justification leverage in budget discussions with stakeholders. Also, showing average or less than average run IT per business outcome can help with "reverse justification" (mentioned earlier in this research) of previous investments that may have been misclassified, but eventually show up in the run IT category.

Noteworthy in Figure 8 is the message that CIOs and IT leaders must become more creative with calculating and communicating metrics of all shorts to strategic stakeholders. Figure 7 accurately assesses that the values of the grow and transform segments often have a fundamental ROI element to them to prove success (or more transactions, if a not-for-profit enterprise). Yet, some enterprises that want to move beyond best-practice maturity roll up the ROI from all change the business IT spending or investment, and create a ratio to help communicate the health of the overall portfolio (as shown in Figure 8). Aiding this would be two years or more of collecting and collating of benefits and metrics from the use of consistent business-case templates.

Use RGT Categories to Prioritize Business Capabilities During the Strategic Planning Process

A best practice for IT organizations with high maturity strategic planning and governance disciplines is to base IT decisions on business capability taxonomies. Although some IT organizations may create this artifact themselves due to distracted business partners, most problems or conflicts related to governance arise from the lack of this basic artifact. While dividing IT spending, investments or costs into well-defined business capability categories is a portfolio unto itself, and should be viewed along with the RGT portfolio. Some organizations combine RGT with the business capability portfolio to see continuing investments in a different light. This also helps with the systemic problem of a financial-bias with RGT. This financial bias is that, an IT-enabled business project is considered grow or transform for the year it is a project, but once it is operational, it is automatically considered a run expense. With dynamic businesses, a business capability can be classified as "transformational" for three or five years, and that would not be reflected actually when prioritizing new investments or IT spending. A sample business capability taxonomy is shown in Figure 9.

Figure 9. Business Capability Modeling Example



Source: Gartner (June 2016)

For example, in Figure 9, the entire business capability category for "create products" might be considered transformational IT spending. Underneath this, from a financial perspective, any

maintenance and support provided to this capability would be considered "transform" in the RGT model. Within "engage with customers," management of the brand ("manage the brand") may be considered a grow the business IT spending category, while others in the larger category may be considered "run" in the RGT model. Regardless of the type of IT spending (run, grow or transform), the business capability categorization of RGT would be set for (usually) the length of the strategic planning cycle (three or five years). This philosophy of capability categorization helps with funding commitments for multiyear programs, preprioritization of business cases, and is a litmus test to strategic stakeholder commitments.

The use of a business capability map helps RGT categorization of transformational programs that include significant run components (like renovation of the core investments) that are necessary to be in place before transformation projects, programs or benefits can be realized.

With normal use of RGT, run investments related to transformational investments would be categorized as run investments. With initial categorization of business capabilities, all related investments to the business capability would be categorized as transformational if the business capability category is defined as such for a three- or five-year period. Organizations must have clear definitions to avoid undue complexity in this approach to investment planning.

Case Study

Throughout this research, anecdotes and miniature case study references give contextualization to the benefits of RGT categorization and analytics. This fuller case study is typical for many large enterprises. It shows how RGT is used to prioritize the larger IT spending portfolio, narrow in on IT budget levels, and consider cuts to (or slowing the growth of) the run IT spending area.

Enterprises often calibrate the three IT goals to drive funding or optimization actions that result in "doing more with less." Showing a different percentage or goal over each year of a five-year plan can help to bake-in maintenance and innovation funding assumptions, and ensure there are fewer surprises in the latter years of the plan.

Maintain Flat IT Spending as a Percentage of Revenue or Operating Budget

Most enterprises will require higher and permanent increases in IT spending as a percentage of revenue due to digital business. For the sake of this illustration, however, the level of IT spending does not wander too far from what is typical for the enterprise. In fact, as a starting position, IT spending as a percentage of revenue is considered to be the same in most of the outlying years of a five-year plan. Based on the goals for the enterprise, IT spending as a percentage of revenue may be increased if reductions to the run are not feasible or prudent for the enterprise.

Reduce Run IT Spending by 5% to 10% per Year

If an increase in IT spending as a percentage of revenue is not a planning assumption, then cuts to the run will be necessary to fulfill against the goals for run vs. change splits in IT spending. Usually, most enterprises devise a mix of cutting the run percentage (by 5% or 10%, for example) and

increasing IT spending as a percentage of revenue. Sometimes the run percentage is reduced "organically" by increasing IT spending less for the run and significantly more for the change part of the equation (adjustments to both the numerator and denominator). In this goal, estimates for new run expenses or new maintenance are thoughtful.

A higher percentage of RGT devoted to "change" will result in higher maintenance and run in future years, which are often secondary considerations to meeting change project goals ("worry about it later").

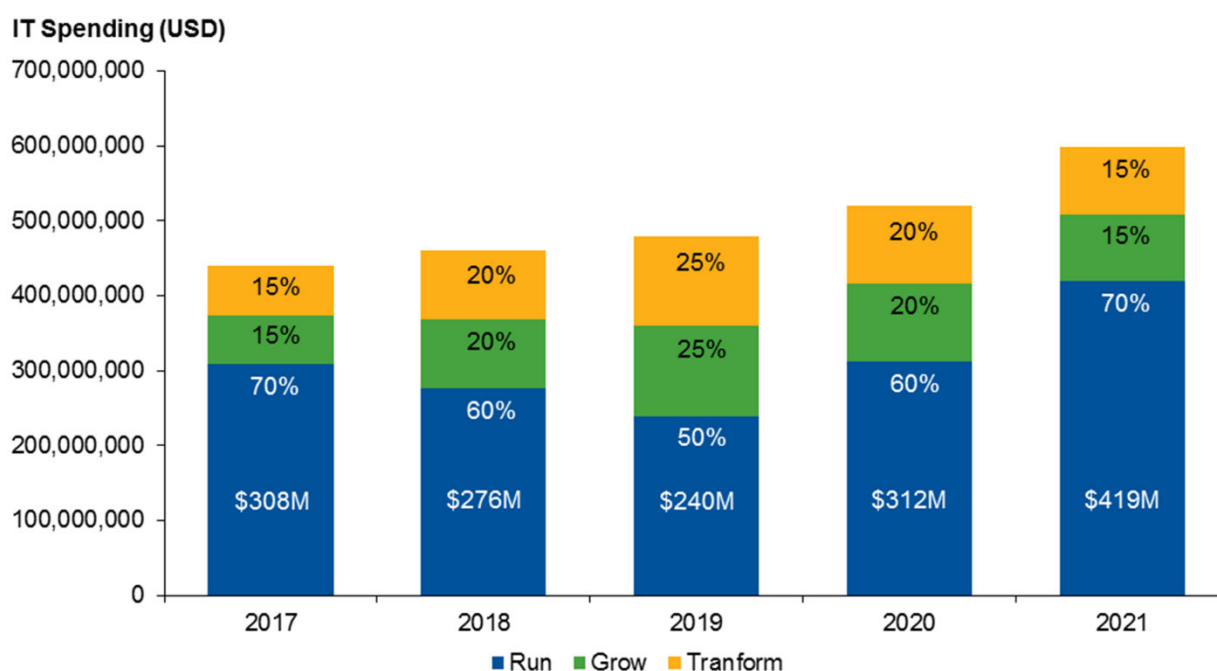
Achieve Approximately 50% Run the Business IT Spending Level

Although a different run percentage might be desirable for any year of a five-year plan, for the sake of this illustration, a 50% run (and thus, a 50% change percentage) is typical for many organizations and a symbol of "enterprise transformation."

Shown in Figure 10 is the percentage of IT spending that is devoted to run IT, starting with 70% in 2017, moving to 50% in 2019, and then regressing back to the normal 70% in 2021. Unless revenue growth is significant (20% to 30% or more annually), most enterprises will have to "do more with less," curtail grow and transform investments, or cut the run continually to stay within the goal of a flat IT spending as a percentage of revenue figure.

Even if IT spending as a percentage of revenue is flat, increases in revenue will mean net increases to the IT budget as shown in Figure 10. As a higher percentage of IT spending for change (grow and transform) often means bigger commitments in outlying years to maintenance, few can maintain a 50%/50% split between run and change.

Figure 10. Case Study of Five-Year Plan for IT Spending and RGT



Source: Gartner (June 2016)

CIOs and IT leaders must customize communication artifacts similar to Figure 10; additional assumptions are shown in Figure 11. This will help:

- Communicate the nature of RGT IT spending.
- Highlight the need for increases in budget to deal with new maintenance or expenses ("technical debt") that come from change projects.
- Codify future assumptions for IT spending in outlying years to pay for new IT-enabled products and services.
- Catalyze the practice of good governance to drive goals related to RGT percentages.
- Collaborate with strategic stakeholders on long-term revenue assumptions.

Figure 11. Case Study Assumptions for a Five-Year Plan for IT Spending and RGT

Assumptions	2017	2018	2019	2020	2021
Revenue Size	11,000,000,000	12,100,000,000	13,310,000,000	15,306,500,000	17,602,475,000
Revenue Growth	10%	10%	10%	15%	15%
IT Spending % of Revenue	4.0%	3.8%	3.6%	3.4%	3.4%
IT Spending Size	440,000,000	459,800,000	479,160,000	520,421,000	598,484,150
Run Percentage	70%	60%	50%	60%	70%
Change (Grow/Transform) Percentage	30%	40%	50%	40%	30%
Run Size	308,000,000	275,880,000	239,580,000	312,252,600	418,938,905
Change Size	132,000,000	183,920,000	239,580,000	208,168,400	179,545,245

Source: Gartner (June 2016)

Many case study enterprises related to this thinking discovered they were not receiving the benefits (revenue increase) from the IT investments in Years 1 and 2 (shown here as 2017 and 2018), and that this will lead to a continuation in cutting the run (from \$276 million to \$240 million). Half of the funding for grow and transform in 2019 was deferred, meaning that instead of a 50%/25%/25% RGT percentage profile, that a 66%/17%/17% profile was assumed (or from 50%/50% to 66%/34% from a run versus change perspective).

For most enterprises undergoing traditional transformations (that are not "bet the business" in nature), the run versus change boomerang pattern of 70%/30%, 50%/50%, 70%/30% is very predictable, although the figures might understandably be slightly different by a few percentage points.

Several technology-based enterprises have reported that large and transformation programs often resulted in a higher IT spending level (as a percentage of revenue), but that business execution

using the IT investments were lackluster. Thus, the business was given the IT-enabled tools for business transformation, but were not successful in meeting higher business goals for market share or revenue, which inflated IT spending as a percentage of revenue figures. IT spending as a percentage of revenue would have been lower with higher revenue (which is a constant optimization exercise between numerator and denominator of the calculation of IT spending as a percentage of revenue).

One healthcare enterprise using this modeling abandoned their financial plan in Year 2 (similar to 2019 in Figure 10) because new urgency was created to just "complete" the project versus driving an unrealistic goal for an optimized outcome. After project completion, significant reduction in the run expenses occurred, which were, in reality, the elimination of legacy systems and staff that were replaced by the transformational project.

In some enterprises using this modeling in Figure 10 (predominantly financial services companies), the desire was often to attempt a 50%/50% run versus change profile indefinitely. However, external disrupters like global financial crisis, recession or market changes often leave these enterprises with several years of optimization to recalibrate IT spending levels with revenue, to contribute to profitability and cash flow goals. Often discussed was that during the postproject reviews and benefits realization exercises, half of the IT-enabled projects in the change categories were found to have failed — which 50% had failed was still a mystery, as the doctrine of these enterprises was to generate a lot of projects, discover what was working, and abandon modification of those capabilities, systems or services that were not effective or efficient. Because their companies were disrupted by external forces, they were never afforded the benefit of evaluating what may or may not have been viable for more investment or attention.

Gartner Recommended Reading

Some documents may not be available as part of your current Gartner subscription.

"Digital Business Means Big IT Changes That Start With a Basic Business Portfolio Decision"

"Consider Fear-, Fact- and Faith-Based Investment Portfolios for Stakeholder Design of Digital Business"

"Flipping IT Financial Thinking to Prepare for Digital Business"

"IT Economic Gravity to Support Big Change and Digital Business Transformation"

"Use Run-the-Business IT Spending per Business Outcome to Show IT Business Value"

"IT Metrics: New Economic Rules of IT Spending and Staffing Metrics"

"Business Key Metrics Data: Accelerate the IT Value Journey"

"IT Metrics: Align IT Investment Levels With Strategy Using Run, Grow, Transform and Beyond"

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