

# Use Adaptive Sourcing to Drive Double-Digit Cost Optimization of IT and Business Processes

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Sourcing and vendor management leaders are directly involved in, and can proactively define, cost optimization initiatives on IT and business processes while supporting digital innovation. A proactive stance in delivering business value is needed to increase SVM leaders' business influence.

## Analysis

Economic uncertainty and increased pressure to improve financial health and increase investments in digital transformation<sup>1</sup> are creating continuous pressure on cost optimization. Sourcing and vendor management (SVM) leaders must support cost optimization efforts that cut across IT and business processes to increase business performance while investing in and preparing for the digital future (see Figure 1).<sup>2</sup>

Figure 1. Potential Impact of Cost Optimization Initiatives



Source: Gartner (February 2017)

The Gartner 2017 IT Key Metrics Data<sup>3</sup> confirms that IT costs just represent an average of 4.6% of operating expenses (varying between 1.3% and 9.4% of vertical segments).<sup>4</sup> Thus, IT cost

optimization efforts can only deliver limited value, by addressing less than 10% of the operating cost (see the left portion of Figure 1). Business process cost optimization (see the center portion of Figure 1), in contrast, can potentially affect up to 90% of the operating cost. Digital business initiatives have an even bigger potential when replacing outdated processes with digital processes spanning business, customers and products (see the right portion of Figure 1).<sup>5</sup> This research identifies a number of approaches that sourcing and vendor management leaders can leverage to identify, seize, propose and collaboratively deliver cost optimization efforts across the business.

## Sourcing, Procurement and Vendor Management Play a Significant Role in Cost Optimization and Digital Business Initiatives

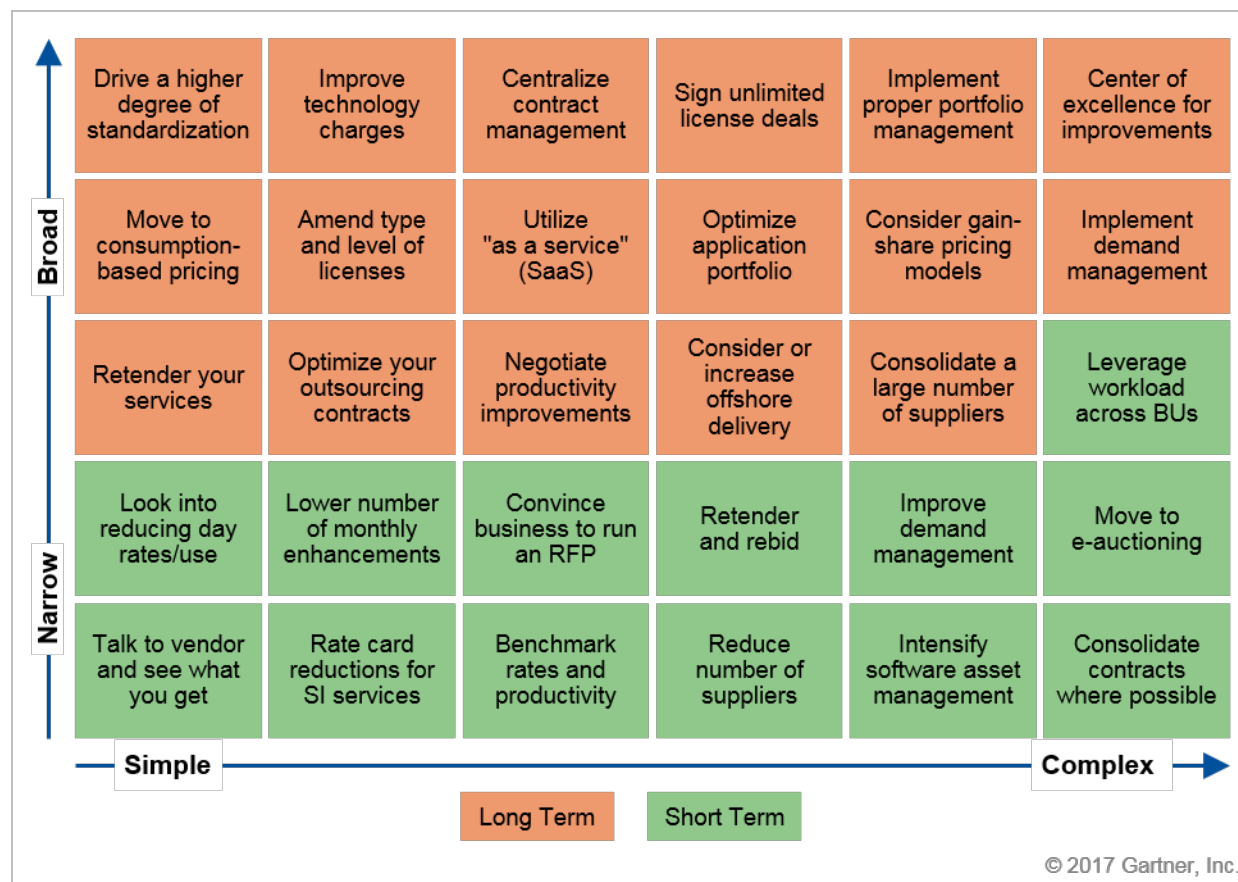
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Cost optimization and the need to move funding into the development of digital business models are forcing multiple parallel-running business-critical initiatives (like implementation of an IoT platform, a blockchain proof of concept, data center modernization, offshore increase, agile sourcing, cloud and SaaS migration). These initiatives challenge SVM leaders' capabilities to deliver value. Technology sourcing, procurement and vendor managers are the critical links between organizations' internal capabilities and the external digital business ecosystem. SVM is also the key discipline that oversees all external spending, making it, therefore, a core component of cost optimization efforts.

Gartner advises SVM leaders to create a dedicated cost optimization team to work collaboratively across functions to help restructure operational spending and deliver cost reduction in IT and business processes. On top of that, SVM leaders must ensure that their support and participation in the delivery of digital business innovation initiatives deliver what is expected by the business in terms of Mode 2 innovation, with the required degree of efficiency and effectiveness.

When analyzing cost optimization ideas, the SVM teams — acting as a single collaborative discipline — should analyze the potential cost optimization impact in relation to the scale and complexity of the required effort. SVM leaders should consider starting with short-term ideas that can provide sizable value first (see Figure 2). Although it seems logical to start with short-term initiatives, decisions must start from the business strategy and objectives, which might require focus on some major initiatives first. Priorities are defined by business objectives, not IT objectives.

Figure 2. Cost Optimization Potential Initiatives: Examples From Clients' Workshops



Source: Gartner (February 2017)

## Research Highlights

For more details on how to leverage cost optimization opportunities, create a core team to investigate cost optimization opportunities and restructure operational spending to channel funds into initiatives that drive business value, see the research highlighted in Table 1.

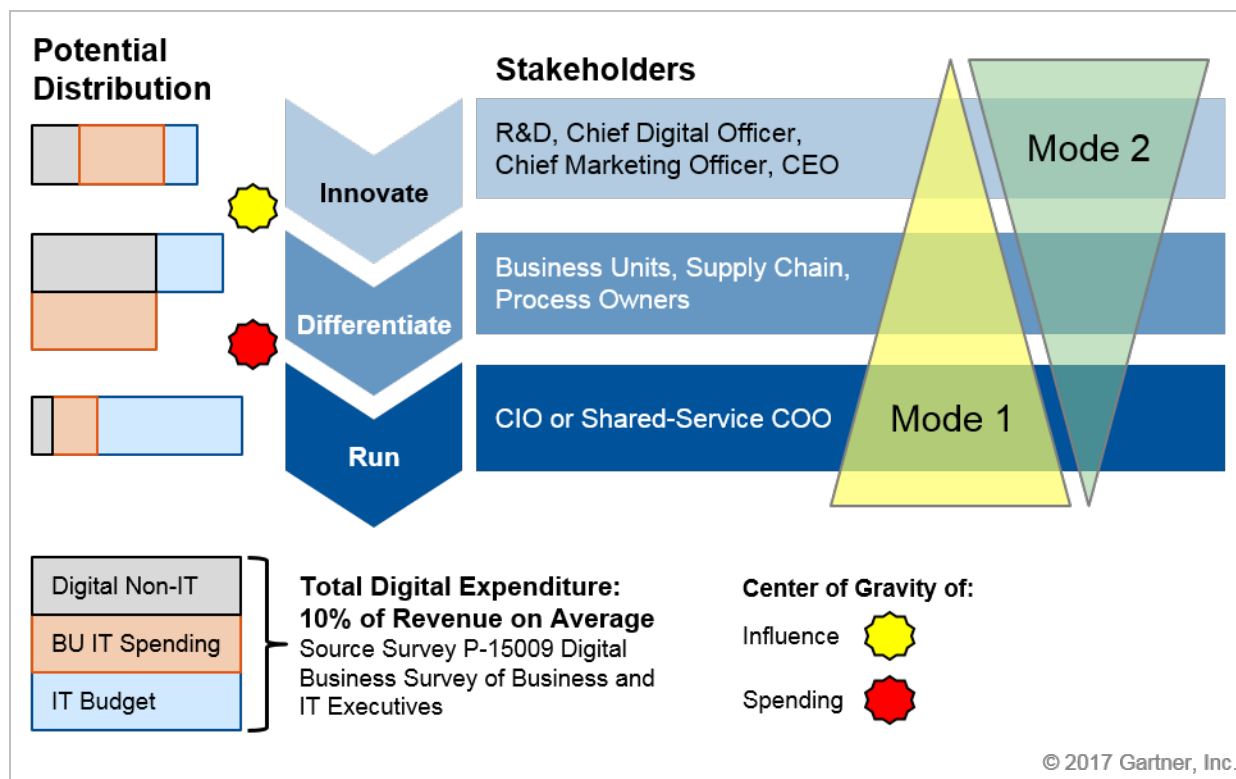
Table 1. SVM Role in Cost Reduction Initiatives

Title	Summary	Authors
"Cost Optimization Secrets: Strategic Sourcing and Vendor Management Realign Costs and Protect Revenues"	IT sourcing executives must embrace innovation and partner with key stakeholders in driving innovation through sourcing initiatives. Digital disruption requires organizations to innovate. Adaptive sourcing is a model to drive business innovation using new technologies and external sources.	Stewart Buchanan
"The Gartner Top 10 Recommended IT Cost Optimization Ideas, 2016"	Gartner has advised hundreds of organizations on IT cost optimization during the past several years. Here, we highlight 10 ideas we most frequently recommend to CIOs and IT leaders.	Jim McGittigan, Sanil Solanki
"Cost Optimization in the Age of Digital Business"	Many organizations are already behind the curve in terms of funding digital business. An economic slowdown further threatens organizations' ability to make these investments. CIOs should be proactive about IT and business cost optimization to fund digital business.	Barbara Gomolski, Rich McAvey
"Top Challenges and Must Do's for Technology Sourcing, Procurement and Vendor Management Leaders in 2017"	Organizations are struggling with proliferating parallel initiatives regarding digital business, operational efficiency, rapid innovation and cost optimization. Sourcing and vendor management leaders involved in technology and services procurement can learn here how to lead, communicate and succeed.	Claudio Da Rold

Source: Gartner (February 2017)

While evaluating cost optimization efforts across IT, business processes and digital business innovation, SVM leaders can use the adaptive sourcing layered approach (see Figure 3). Gartner IT Key Metrics 2017 data confirms that 70% of IT cost is focused on the run layer.<sup>6</sup>

Figure 3. Follow the Money: Digital Spending Versus Adaptive Sourcing Layers



Source: Gartner (February 2017)

## IT Cost Optimization: The Run Layer

Gartner IT Key Metrics Data revealed the relative size of different aspects of IT cost, identifying infrastructure (and specifically the data center) and applications (both development and management) as key areas where 60% or more of IT cost is covered:<sup>7</sup>

- Data Center, 23%
- Application Management, 20%
- Application Development, 17%

Also due to rapid market changes such as commoditization, cloud first, increase of productivity and reuse in application services, we expect that cost optimization efforts that align with key infrastructure and application services are likely to be the most efficient to realize cost optimization and modernization efforts. Software licenses are also a relevant focus area because they are currently evolving into SaaS or subscription-based contracts, and they often represent sizable cost areas and large contracts.

## Infrastructure and Application Service Cost

Service industrialization is reducing the unit price of outsourced and cloud data center infrastructure services by more than 10% per year, year over year. Data centers (compute capabilities) represent 24% of CIOs' budgets. Businesses require falling total cost of ownership for infrastructure, rapid increase of units or both. Today, customers' infrastructure costs are mostly based on capital expenditure (capex) and fixed costs, which is also reflected in most outsourcing deals that embed flat prices or rates.

IT organizations can't match market price erosion internally and must use public cloud price points, plus remote infrastructure management fees per unit, as a benchmark for hybrid infrastructure cost per unit performance. They must also migrate to low-cost platforms by implementing a "cloud first" infrastructure modernization strategy. Managed service contracts must be negotiated or renegotiated to embed workload migration to low-cost platforms, align to real market pricing trends, and pay for used or reserved capacity.

Thirty-five percent of IT budgets are devoted to application development and support, and this percentage is increasing as bimodal, DevOps and new skills are required.<sup>8</sup> CIOs can use application-sizing best practices and external service market trends to optimize application costs and save 3% to 5% per year. To achieve that, SVM and IT leaders must conduct an application portfolio analysis (APA) to benchmark application development and maintenance (ADM) productivity metrics and prioritize cost optimization opportunities.

Gartner recommends that all full-time equivalent (FTE)-based contracts must be renegotiated to include benchmarked productivity measures. Savings will enable investments in demand management competency focused on application services, and a program to control ADM productivity metrics. These actions will enable a progressive alignment with market benchmarks, plus a further 4% yearly cost improvement to justify investment and payback. For more practical details, see Table 2.

Table 2. Infrastructure and Application Service Cost Reduction Initiatives

Title	Summary	Authors
"How to Leverage Industrialized 'Low-Cost' Market Prices to Optimize Your Data Center Infrastructure Service Cost"	Service industrialization is reducing the unit price of outsourced and cloud data center infrastructure services by more than 10% per year. CIOs can optimize their infrastructure costs by aligning 24% of their IT budgets to real market price trends.	Claudio Da Rold, Gianluca Tramacere, David Edward Ackerman, Lydia Leong, David Groombridge
"CIOs Can Save by Using Sourcing and Market Trends to Optimize Application Costs"	Thirty-five percent of IT budget is devoted to application development and support, with costs increasing. CIOs can use application-sizing best practices and external service market trends to optimize application costs and save 3% to 5% per year.	Claudio Da Rold, Kris Doering, Arup Roy, Davide Levi
"Effective Strategies to Deliver Sustainable Cost Optimization in Application Services"	The relentless pressure for cost optimization of application services is compounded by the added demands of digital, IoT, analytics and smart machine initiatives. Sourcing executives can move to outcome-based contracts, automate and include productivity terms to deliver sustainable results.	Kris Doering, Stewart Buchanan
"Toolkit: Applications Portfolio Analysis for IT Services Sourcing Strategy Formulation"	Sourcing managers are responsible for business and IT services strategies that address their business strategy and market trends. Use this Toolkit to execute an APA, which is the critical prerequisite for creating your application service sourcing strategy.	Frances Karamouzis, Gilbert van der Heiden
"Save Time and Money With 50 Contracting and Pricing Applications Outsourcing Guidelines"	Sourcing managers acquiring application services should apply 50 guidelines to improve their application outsourcing contract, particularly for changes in rates, pricing indexes, currency fluctuation, incentives, discounts and improvement over time.	Gilbert van der Heiden, Grant Bayne, Frank Hersbach

Source: Gartner (February 2017)

## Software and SaaS Cost

An area of significant one-off IT savings is also associated with the negotiation or renegotiation of software contracts (often in the range of \$1 million each). Sourcing and vendor management leaders who focus on procurement often struggle to reduce onerous software maintenance and support costs, but can find ways to reduce expensive premium-priced support services, reduce impact of shelfware or leverage self-support approaches.

One top five action to perform before renegotiating the cost of a Microsoft Enterprise Agreement is to specifically focus on changes in license models, terms and cloud subscriptions to help identify areas of leverage to increase bargaining power during contract renewals.

Similarly, items to be negotiated in SAP deals include leveraging your negotiation power in the first (or most significant) SAP cloud deal to avoid discovering too late that far higher prices must be paid for subsequent incremental units or services.

Negotiating Cloud contracts with Oracle also requires specific best practices, addressing contractual documentation, removal of URLs, locking-in the current net pricing for additional quantities, renewal price caps and the renewal service period.

While moving into a SaaS subscription, the long-term cost implications are often elusive, requiring SVM leaders to perform specific approaches and activities. Overlooking nonobvious costs during SaaS selection and negotiation can potentially lead to an extra 50% of the annual subscription fees. Gartner's highlighted research provides practical advice on how to control cost for support, testing environments, sandboxing and other often-neglected aspects like storage, backup, languages, encryption and bandwidth. Advice on key T&C that must be negotiated for SaaS contracts is provided, with specific focus on volume requirements, switching costs, repurchase costs and bundling, audit, and geographical limitations. For more practical details, see the research in Table 3.



Table 3. Software Contracts and SaaS — Cost Reduction Initiatives

Title	Summary	Authors
"Reduce Your Software Maintenance and Support Costs by Up to 50% by Deploying These Often-Overlooked but Effective Best Practices"	Sourcing and vendor management leaders who focus on software procurement often struggle to reduce onerous software license maintenance and support costs. Here, we offer best-practice techniques to help significantly reduce those annual recurring costs for on-premises software licenses.	Rob Wilkes, Roberto Sacco
"Five Ways to Optimize Cost Before Signing a Microsoft Enterprise Agreement"	Technology procurement leaders struggle to identify negotiating levers and are often not aware of all the contractual options that can increase flexibility in Enterprise Agreements. Here, we cover the top five actions to take before signing a three-year EA, to minimize upfront and ongoing costs.	Dolores Ianni, Ben Jepson, Marie Sienkowski, Stephen White
"Key Terms to Negotiate in SAP Cloud Service Agreements to Reduce Direct Costs and Risks"	SAP has recently made significant changes to its cloud contracting structure and terms, resulting in some improved entitlements and a more synthesized support offering. However, a number of concessions can be negotiated to reduce cost and risk.	Dawn Hubbard, Alexa Bona, Lori Samolsky
"Key Terms to Negotiate in Oracle's Cloud Service Agreements to Reduce Costs and Minimize Risks"	Sourcing and vendor management leaders focused on negotiating Oracle Cloud service agreements are often unaware of the full extent of their complexity and risks. Failure to identify and effectively negotiate the key terms of these agreements will have long-term negative effects and costs.	Dawn Hubbard, Melanie Alexander, Jo Liversidge
"Mitigate the Unforeseen Costs of SaaS Contracts by Negotiating Support, Sandboxes and Other Key Variables"	Significant unbudgeted fees can result from failure to research and document all subscription-related costs before signing SaaS contracts. Sourcing and vendor management leaders need to uncover upfront and best negotiate the more common unforeseen costs.	Jo Liversidge, Dawn Hubbard
"Four Essential Contract Clauses That Are Often Overlooked When Negotiating a Software or SaaS Contract"	Technology procurement leaders engaged in contract negotiations who focus overly on price will fail to address critical terms that preserve flexibility after the deal is signed. Avoid unnecessary risk and unbudgeted costs by adding these four essential clauses to your contract checklist.	Rob Wilkes, Bill Ryan
"Consumption-Based Pricing Is Emerging From Leading SaaS Providers, but Beware!"	Consumption-based pricing is often assumed to be synonymous with cloud offerings, but has been absent from major SaaS vendors' offerings. Sourcing and vendor management leaders can take advantage of consumption pricing from leading providers to reduce costs in SaaS purchases.	Jo Liversidge, Alexa Bona
"What to Consider Before Canceling Your ERP Vendor's Maintenance Agreement and Switching to Third-Party Support"	Gartner clients are asking about canceling their maintenance agreements with enterprise resource planning vendors as ERP leaders explore alternative support options. ERP leaders must understand the impact of any cancellation and plan for ongoing ERP maintenance and support services.	Pat Phelan

Source: Gartner (February 2017)

## Business Process Cost Optimization: The Differentiate Layer

As part of business process cost optimization initiatives that are driven by innovation and supply chain transformation, SVM leaders can proactively address new areas enabled by new services and technologies in the area of digitization, advanced automation, and replacement of labor with automation and intelligent services (smart-machine-based services).

Robotic process automation tools are a way to cut costs, eliminate keying errors, speed up processes and link applications together, and these tools may have visible effects in terms of replacement of labor with automation in business processes. Gartner research highlighted in Table 4 helps identify potential areas of application in your business and provides a guide to the market for available tools and related services.

Cases of savings in the range of 30% to 50% of labor involved in specific business processes, achieved within a relatively short term across retailers, financial services, automotive, technology manufacturing, mining, freight services, are reported when joining automation tools and artificial intelligence into intelligent automation services (also known as smart-machine-enabled services). Highlighted research provides an introduction on real use cases and approaches.

**Table 4. Business Process Cost Optimization (the Differentiate Layer): Ideas, Tools and Services**

Title	Summary	Authors
"Ten Ideas for Business Cost Optimization in the Age of Digital Business"	We highlight 10 major opportunities for CIOs to exploit information technology to maximize business outcomes through increased digitalization of business processes, information delivery and innovative business models.	John P. Roberts
"Market Guide for Robotic Process Automation Software"	Robotic process automation tools are a way to cut costs, eliminate keying errors, speed up processes and link applications together. Enterprise architects must understand the capabilities of these tools and evaluate the need for them within their operations.	Cathy Tornbohm
"Use Cases for Robotic Process Automation: Providing a Team of 'Virtual Workers'"	We discuss use cases for robotic process automation and how IT and business process owners can start to choose when they would use RPA or an iBPMS, a dedicated software solution, or a cognitive tool.	Cathy Tornbohm
"Smart-Machine-Enabled Services Optimize IT and Business Processes"	Smart machines are evolving at an unprecedented pace and can be harnessed by enterprises to accelerate the digital business journey. Sourcing executives must identify IT and business processes where smart machines can be applied, using a decision framework to optimize cost, quality and scalability.	Ruby Jivan, Frances Karamouzis, David Edward Ackerman

Source: Gartner (February 2017)

## Digital Business Initiatives: The Innovate Layer

Although digital innovation is not focused on cost reduction as a first objective, digital processes delivered by digital disrupters (like Amazon, Uber and Airbnb) show a lower structural cost due to innovative real-time approaches, customer involvement and high technology intensity. These

structural and digital lower costs are therefore crucial to allow innovation to flourish and to avoid pitfalls (such as not showing enough value-add for customers and the business) that would then prevent POCs and pilots from becoming real project and services. SVM leaders must implement a bimodal approach to enable their organizations to support digital innovation and leverage innovation to unleash the highest potential of cost optimization. To evolve in that direction, SVM professionals must show leadership, influence and business reach to drive sourcing, procurement and vendor management to the core of digital business, as the key link between internal capabilities and the external ecosystem.

SVM leaders struggling with proliferating parallel initiatives regarding digital business, operational efficiency, rapid innovation and cost optimization can learn how to lead, collaborate with CIOs and business unit leaders, communicate, and succeed by leveraging some of the highlighted research in Table 5. By applying open innovation, current IT services trends, and external ecosystem and provider's capabilities, SVM leaders can finally play a more strategic role as the critical link between internal capabilities and external digital ecosystems.

Table 5. SVM Leaders and Digital Business Initiatives (the Innovate Layer)

Title	Summary	Authors
"Sourcing and Vendor Management Leadership Vision for 2017"	IT sourcing is the critical link between organizations' internal capabilities and the external digital business ecosystem. Technology sourcing, procurement and vendor management leaders can use this slide deck in planning for 2017 and in presentations to leadership, peers and teams.	Claudio Da Rold, David Edward Ackerman, Christopher Ambrose, Stewart Buchanan, Rob Schafer
"A Practical Guide to Bimodal Adaptive Sourcing Research"	Sourcing organizations have a responsibility toward their stakeholders to embark on bimodal and adaptive sourcing strategies now to support digital transformation. Sourcing executives can use this collection of research to initiate their journey and ensure enterprise success in their digital future.	Claudio Da Rold, Ruby Jivan
"Market Insight: Vertical Industry Opportunities for Digital Business Process Optimization Services"	Business process optimization is more than just implementing technology: It's about improving business process and operational efficiencies, as well as meeting dynamic customer requirements. Digital business practice managers can use this research to perfect their vertical industry strategies.	Susanne Matson, Patrick J. Sullivan, Twiggy Lo, Julie Short
"Exploit Infrastructure Service Trends in Your Sourcing Strategy to Improve Innovation and Optimize Delivery"	The growth of digital business is triggering IT organizations to implement new styles of infrastructure services. Sourcing executives must devise new strategies to take advantage of the latest trends in the infrastructure service market.	David Edward Ackerman, William Maurer, Daniel Barros
"Exploit Application Service Trends in Your Sourcing Strategy to Improve Innovation and Optimize Delivery"	Digital business growth is triggering higher demand for agility, innovation and improved user experience from business, resulting in opportunities to exploit new sourcing models. Sourcing executives must take advantage of the latest trends in application services to meet business expectations.	Neil Barton, Frances Karamouzis, Jim Longwood, Gilbert van der Heiden, Daniel Barros
"Bridge Your Innovation Delivery Gap Through Joint Ownership With Your Service Provider"	Digital agility and cost optimization are driving the need to hold service providers to their innovation promises. To deliver innovation, sourcing and vendor management leaders must define direction, use incentives for innovation delivery in contracts and drive change working with service providers.	Alan H Stanley, David Groombridge
"Use Open Innovation to Bring Talent and Capabilities Into the Business Ecosystem"	The smartest people may not be in the room, but out in the business ecosystem. Organizations with a track record of successful innovation use "open innovation" to leverage the talent and competencies of the business ecosystem.	Marcus Bloesch, Betsy Burton

Source: Gartner (February 2017)

## Gartner Recommended Reading

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

"A Practical Guide to Bimodal Adaptive Sourcing Research"

"Sourcing and Vendor Management Leadership Vision for 2017"

"Cost Optimization in the Age of Digital Business"

### Evidence

<sup>1</sup> Many enterprises are increasing spending on technology at a rapid and increasing rate, and much of that spending does not go through traditional (IT organizational) channels and the oversight employed in those channels (see "Get Ready to Maximize Focus and Outcomes for Investments in Digital Business").

<sup>2</sup> In 4Q16, Gartner conducted a Sourcing and Vendor Management Trends Survey that highlighted the importance of cost optimization as an objective for procurement teams. In the survey, 41% of respondents listed this as their top priority. In government organizations, the importance is highest (68%), and in communications organizations, it's the lowest (26%).

<sup>3</sup> The Gartner IT Key Metrics Data (ITKMD) research series contains more than 2,000 IT investment, cost, staff, and performance metrics covering five topic areas and 92 documents.

<sup>4</sup> Average IT spending as a percent of revenue continues to slowly increase, rising to 3.5% in 2016, and it is projected to rise further to 3.6% in 2017. Average IT spending as a percentage of operating expenses, at 4.6%, also continues to increase, rising by 0.3 percentage points compared to 2015 (see "IT Key Metrics Data 2017: Executive Summary").

<sup>5</sup> These are examples from adjacent and related industries that leaders can use to inspire broader creativity and spark digital business strategy conversations in their organizations (see "Fifty Examples of Digital Business: A CIO and CEO Resource").

<sup>6</sup> See Figure 11, Cross Industry: IT Spending to Run, Grow and Transform the Business in "IT Key Metrics Data 2017: Key Industry Measures: Cross Industry Analysis: Current Year."

<sup>7</sup> See Figure 16, Cross Industry: Distribution of IT Cost and Staffing by IT Functional Area in "IT Key Metrics Data 2017: Key Industry Measures: Cross Industry Analysis: Current Year."

<sup>8</sup> In the 2016 Gartner CIO Survey, 45% of the responding CIOs listed increasing technical depth as a key driver for additional cost when going bimodal. In the survey, 41% of respondents saw additional head count for running their Mode 2 program and 31% saw the culture of "haves" and "have nots" as the key driver.

### More on This Topic

This is part of an in-depth collection of research. See the collection:

- Scaling Bimodal — Fusing IT With the Business: A Gartner Trend Insight Report

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