The Full Monty:
Managing IT for the Short and Long Term

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The Problem

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slide 2

The Tyranny of the Short Term

"How often would your company be prepared to take the following actions in order to safeguard short-term earnings?"

	Often (%)	Sometimes (%)	Never (%)
Change the timing of asset sale / disposal	13	72	15
Cut spending on R&D, marketing, IT services	27	54	19
Delay a project even if it would be profitable	10	41	49

Source: Management survey by Marakon Associates and the Economist Intelligence Unit

IT organisations tend to be slaves to perceived short-term pressures

A Market Bias Toward the Short Term?

- In the survey, nearly two-thirds of managers said that there is a bias both in management and in the markets toward **short-term earnings**
- Conventional wisdom:
  - The market cares disproportionately about the next set of earnings
  - Every earnings announcement must surpass the last one or you will be punished by the market (and your management)
  - If this is true, then we are forced to choose between short-term earnings and long-term health
- **But is this conventional wisdom true?**

The Markets and the Short Term

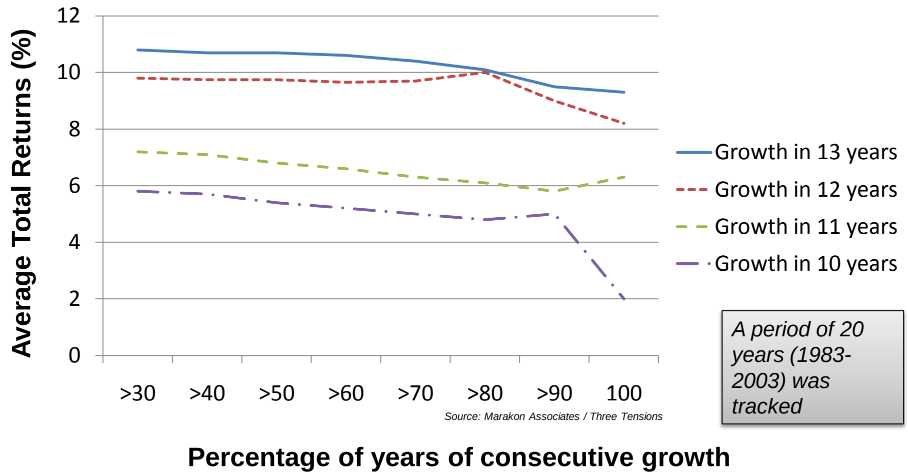
- Is it true that the markets only care about short-term earnings?
  - Only around 20-30% of a company's share price can be explained by the next three years of earnings
  - For many high tech companies, most of the share price is determined by its long-term prospects
- Current example: **Apple and Microsoft**
  - In May 2010, Apple overtook Microsoft as the technology company with the highest market capitalization
  - But its earnings are far below those of Microsoft, who announced record earnings in September 2010
  - Future prospects! (iPads, shift to mobile, netbooks, etc.)
- Those reactions to quarterly earnings reports don't reflect the dominance of the short term
  - Those reactions (sometimes excessive) reflect the market's continuous adjustment of its estimates of the company's prospects for the future

Consecutive Earnings Growth?

- What about **consecutive earnings growth?**
  - Companies strive for the ability to keep increasing earnings quarter after quarter, year after year
    - ✓ Companies who miss their earnings targets are severely punished by the markets
  - The high tech / IT industry places particular emphasis on constantly raising and hitting growth targets
    - ✓ Carly Fiorina was forced out of H-P after it didn't hit its ever-increasing earnings growth targets
    - ✓ In 3 days the company lost $23B in market value after finally missing its (very ambitious) target
  - But is continuous, consecutive earnings growth really that valuable? Is it really that necessary?

The Tyranny of Consecutive Growth

Is consecutive earnings growth really superior?



Consecutive Growth is not the Key

- In the chart we can see that, unsurprisingly, the companies with the most years of earnings growth over the 20-year period delivered overall higher returns
- But those with the highest consecutive runs of earnings growth in fact delivered *lower* returns than their peers in the same category
- Unmistakable conclusion: the market doesn't care about whether earnings growth is consecutive year-to-year

What the Market Really Cares About

- It may feel good to blame the market for forcing you to worry only about short-term results, but it doesn't fit the facts
  - The market does not have a short-term obsession with the next set of earnings
  - The market does not have a short-term obsession with increasing earnings from one consecutive period to the next
- So what does the market really care about? What does it really reward?
  - The market really cares about **both the short and long term – The Full Monty**

The Market Values Both Short & Long Term

Today's Performance
Earnings Growth This Year

	Biased toward negative	Biased toward positive
Biased toward positive	**Growing earnings today, but on a path to losing money tomorrow** **Average TSR = 6%**	**Growing earnings today and on a path to making money tomorrow** **Average TSR = 21%**
Biased toward negative	**Not growing earnings today, and on a path to losing money tomorrow** **Average TSR = 1%**	**Not growing earnings today, but on a path to making money tomorrow** **Average TSR = 12%**

Source: The Three Tensions

Tomorrow's Performance
Cumulative Economic Profits over subsequent five years

Total Shareholder Returns (**TSR**) over a 15-year period for 1000 companies

The Cycle of Renewal

Don't look to the capital markets for the problem – **look to the product markets**

The perceived tension between today and tomorrow comes from the need to renew assets and capabilities as the industry evolves

The Common Bond

Past

Earnings can be borrowed from the past by continuing to exploit obsolete technologies and capabilities

Present

Sustainable Earnings

Sustainable earnings are the common bond between the short and long term

Future

Earnings can be borrowed from the future by deferring investment that will have to be made

Sustainable earnings are those earnings that are not influenced by borrowing between timeframes

Borrowing from the Future

- There are many ways to increase single-year earnings without actually increase performance
  - Postpone projects requiring upfront investment
  - Cut R&D, marketing, and any other discretionary spending whose benefits are felt after the current year
  - Sell assets – facilities, equipment, whatever you can put down as a capital gain this year
  - In general, postpone costs into the next year or pull earnings into the current year
- But this isn't sustainable
  - This isn't renewing the assets necessary to keep earning
  - It's moving earnings between timeframes without any economic reason

Borrowing from the Past

- Earnings increases from squeezing more performance out of a business model whose time as passed are also unsustainable
  - This happens when technologies or capabilities that have produced earnings in the past must be *replaced* rather than *renewed*
  - Telecom networks, moving to the web, electronic publishing
  - Assets have become unable to compete with newer competing assets that deliver more value

The Boiled Frog Syndrome

- Sometimes the transition is extremely gradual and it's not clear when the move must be made
  - "Should we move to the Cloud?"
  - "Should we go mobile?"
  - The frog who doesn't realize he is slowly being boiled – until it's too late

Borrowing from the Present

- We have seen how we penalize the long-term by borrowing from the past or future
  - Now let us see how we penalize the short-term by **borrowing from the present**
- We borrow from the present through **excess investment**
  - Excess investment is investment (money, time, people, effort) **beyond what is necessary to achieve the future profits for which it is designed**

Excess investment hurts the short-term

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Penalizing the Short-Term

- All things being equal, the less money you need to build tomorrow's business, the less often you will have to choose between today and tomorrow
  - Cutting back excess investment is in itself a way to increase sustainable earnings, because it doesn't harm the future
- In IT, excess investment is everywhere
  - Over-specification of systems
  - Bad cost control
  - Bad process management

Gold-plated keyboard

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How to Avoid Borrowing From the Past

- Look for the symptoms
  - Simply raising prices on ongoing projects and personnel in order to squeeze more revenue
  - The “cash cow” syndrome: becoming complacent about a successful business model – a classic trap for IT service companies who just place personnel and then sit back
- What you can do:
  - Take every technological development in your area of business dead seriously
  - Allocate management time for re-evaluation of business models and future sustainability
  - Establish an “observatory” of technological evolution relevant to your business
    - ✓ Look broad and deep – “substitution” is a key factor in IT obsolescence

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How to Avoid Borrowing From the Future

- Look for the symptoms
  - Start-stop investing
  - Technical debt – deferred implementation, maintenance, even professional development
  - Consecutive-earnings-growth syndrome

- What you can do
  - “Dollar cost average” investment – don’t fall in the trap of investing only in the good times
  - Make a realistic analysis of the potential for growth in your sector – you’ll still be the best

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How to Avoid Borrowing from the Present

- Look for the symptoms
  - Bad project management skills – wasting time, money
  - “Gaming” the funding process
  - Buying new equipment when current equipment would do the job

- What you can do
  - Lean processes can help
  - Strive for correct funding levels
  - Master time management

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Borrowing Between Timeframes

- Borrowing between timeframes can be difficult to see
  - **Borrowing from the past** by clinging to obsolete business models can creep up slowly
  - **Borrowing from the present** by excess investment can be hard to recognize, especially if it is your own “pet” project or investment
  - **Borrowing from the future** by deferring needed investment may be hard to distinguish from unneeded excess investment

- But it is essential for an IT manager to learn to recognize the difference
  - They are all enemies of sustainable earnings and force a choice between short and long term performance
  - Earnings should only be moved between timeframes when it makes economic sense

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The Nature of Sustainable Earnings

- Sustainable earnings are underpinned by assets and capabilities with a sustainable future life
  - They don't borrow between timeframes
- In their purest form, sustainable earnings come from assets and capabilities that only *you* have
  - Outstanding, robust development processes
  - Strong brand name that stands for excellence
  - Outstanding technical capabilities
  - Proprietary technology, IP
- They cannot be copied by the competition easily, cheaply, or at all

Managing for the Short and Long Term

- You manage for the short and long term by **managing for sustainable earnings**
- Manage the long term by managing **how the short term is produced**
- Don't just hold post-project technical retrospectives – hold **post-earnings retrospectives**
  - Where did those earnings come from?
  - Did they steal from the past or future?
  - Did they contribute to building sustainable earnings?

Retrospectives are not just for agile developers, but also for managers

Which Resources are Scarce?

- **Talent is not scarce**
  - Talent is not scarce but cheap
  - Talent is available but expensive
- **Capital is not scarce**
  - Capital is not scarce but cheap
  - Capital is available, even plentiful, but expensive

- The best value-based managers today know that investment opportunities with sustainable earnings will always find plentiful sources of capital

> "[In November 2010], Google gave every employee a raise of 10 percent or more. The motivation was, in part, the 'war for talent,' [CEO Eric] Schmidt said. People who have other job offers have been persuaded to stay with seven-figure bonuses."
> *- New York Times, 29 November 2010*

The Scarcest Management Resource

- **The only real scarce management resource is time**
  - A one-year survey of 187 companies to understand how top management time is invested (or squandered)
  - Focus on the corporate decision-making process
- Some conclusions from the study:
  - Management teams often spend little time together: average of only two days per month
  - Only 5% had any kind of disciplined process for setting agendas
    - ✓ Ironically, they all had a rigorous and disciplined process for allocating **capital** and for assigning and developing **talent**
    - ✓ Yet no process for managing the only scarce resource: **time**

80% of the Time Spent on 20% of the Value

Total Top Management Time	250 hours / year
Subtract from that:	
Operating performance reviews	62
Crises of the moment	27
Administrative issues and policy	22
Workforce issues	22
Corporate governance	18
Financial policy	14
Investor communications and guidance	12
Team building	11
Succession planning	10
Litigation	6
Community service / social responsibility	6
Other	3
Time left for strategy development	**37 hours / year**

(Marakon Commentary Winter 2005)

Manage for sustainable earnings, not "fire fighting"

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1: Measure the Value of Every Agenda Item

- **Measure the real, sustainable value of every item on the agenda**
- Is it really possible to do that?
  - Consider this: "we have five things we need to discuss, and one of them is worth 20 times the other four combined." Where would you start?
- Estimating the sustainable value of every agenda item in a strategy meeting is one of the most powerful tools to help management set priorities
  - Do the exercise *before* the meeting in order to set focus

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2: Put Real Choices on the Table

- **The best managers continuously formulate and evaluate alternative strategies for the business**
  - Much different mindset from the “one, perfect PowerPoint presentation”
- CEO, Lloyd’s Bank: equate strategy development with the search for alternatives
  - “You have to bring me three alternatives, they have to be viable, and we’ll make the selection based on value.”

- Viable strategies: Henry Kissinger’s three alternatives
  1. Invariably led to thermonuclear war
  2. Unconditional surrender to the Soviet Union
  3. The one the staff really wanted to pursue
- Viable strategies not just for the destination, but also for the road: the path of sustainable earnings

Eyes to the Hills

- Remember: IT is myopic
  - It does not see the hills
  - It only sees the grindstone
- The principles of agile processes are a great help in managing for the short and long term
  - **But by themselves they will not do the job**
- The processes must be applied at the level of the business

“[The manager] must … keep his nose to the grindstone while ***lifting his eyes to the hills*** *– which is quite an acrobatic feat”*
– Peter Drucker

Further Reading

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