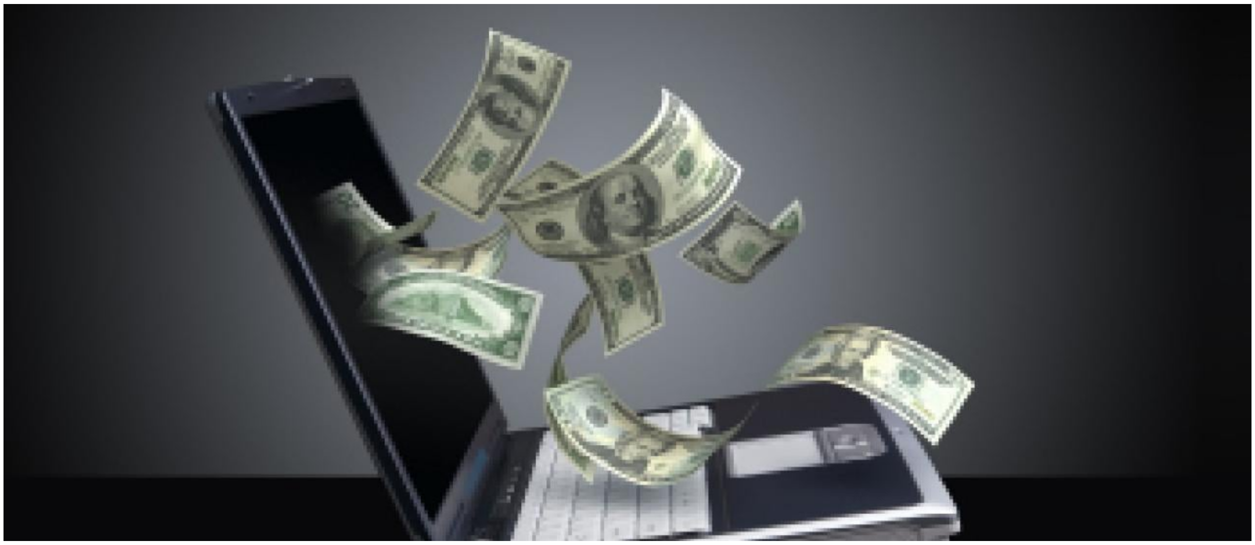
Winning with value



Too many companies focus on just the cost of software systems, rather than look at the business value they generate. That may not be surprising given the complexities of trying to assess the value of software assets, but according to a new study by INSEAD professor Soumitra Dutta, companies who do this are taking the easy way out.

In the study called '*Recognising the True Value of Software Assets*', Dutta argues that this key existing asset represents 'enormous hidden value for the firm.'

But for organisations to switch their attention to value rather than focus on cost will require a shift in mindset, he says.

"What is important to realise is that as an organisation you not only need to keep costs under control but you also need to focus on value. And value is generated not only by more top line, but also by managing the risks in the system in a much more effective fashion," says Dutta, the Roland Berger Chaired Professor in Business and Technology at INSEAD.

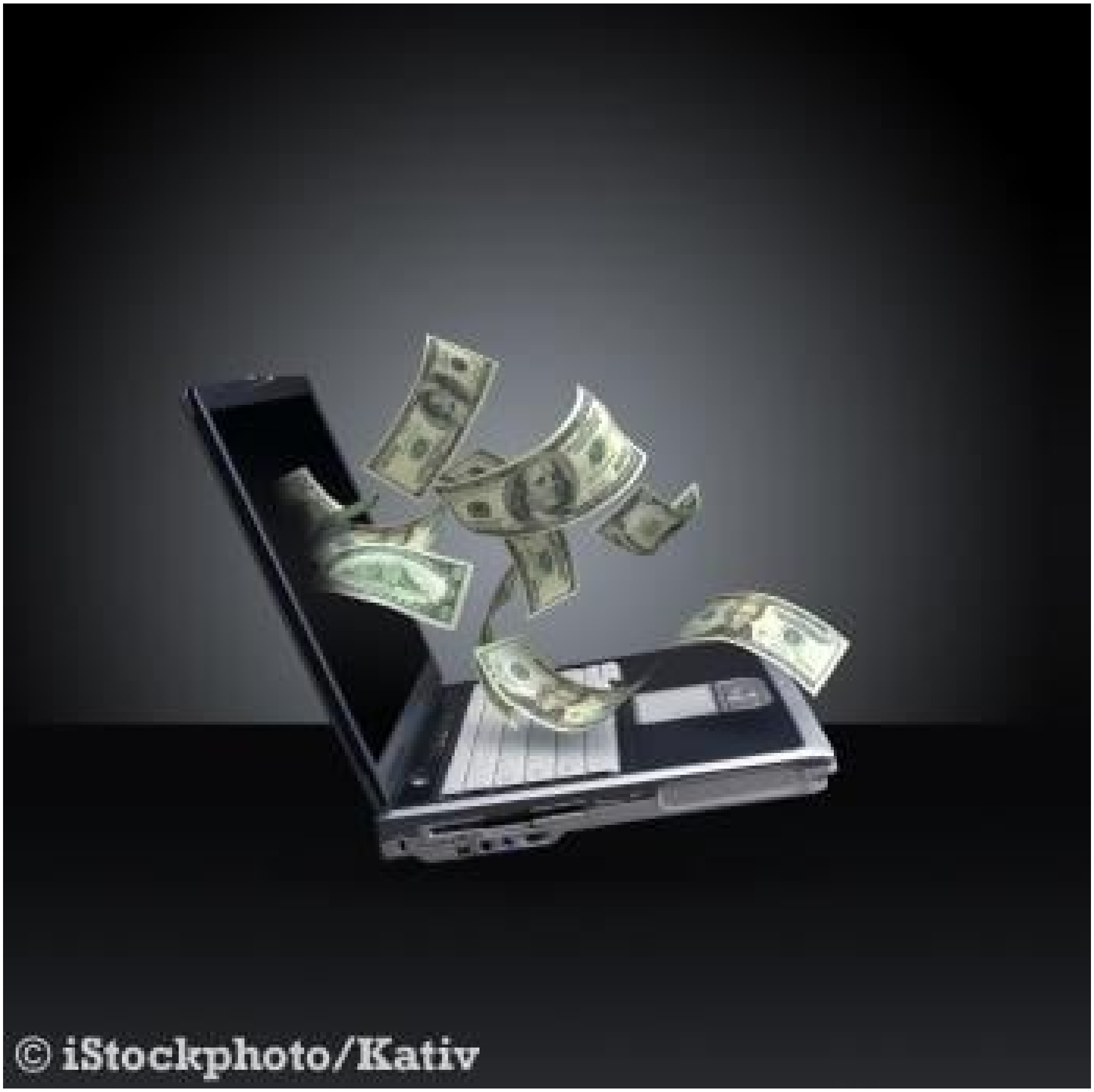
"So you need to understand which of your software systems are critical for your business value generation, either generating new revenues or in protecting your current revenues, and then to be able to decide and make the right choices of limited resources in the right systems. So it’s really a question of being aware, and once you’re aware of the implications, then hopefully management will make the right decisions.”

The study, based on a survey of some 250 CIOs and CFOs at companies with revenues of $100 million to more than $1 billion, found that 77 per cent of these C-level executives thought their core software assets were critical or very critical to their business strategy. Yet, that said, some 60 per cent said they did not know the size of these assets. Also, around one in three of these C-level executives (29 per cent) said they didn’t even know how much they spend on these assets each year.

“I sensed a great deal of frustration in the basic question: ‘are we as an organisation getting the right return back from this investment in software?’” Dutta told INSEAD Knowledge.

“What we find is that, as a result of these complexities of the nature of software and the lack of appropriate tools and methodologies, many organisations have taken a very simplistic cost-dominated view to managing software.”

“There’s very little discussion and proper management of not the cost side – which is important – but much more important is the value side, to ask the question: ‘how much value did we generate from this investment in software and how can we increase the value from software investments?”



Indeed, only one in ten of the CIOs and CFOs surveyed rated as ‘excellent’ their team’s efforts to communicate the business value of core software assets to their boards.

New software projects tend to get the most attention, the report says, as they are easier to understand. By contrast older software systems are often treated as ‘sunk costs’, even though they probably support ‘the back-bone of the operations of most companies.’

The problem lies in the fact that software systems are difficult to assess in terms of business value. They are rarely traded on the open market, especially if they ‘reflect the DNA of the organisation and are deeply entwined within its core operational processes.' Instead of taking a market-based approach, the study suggests companies should treat these core assets like other intangibles, such as intellectual property and the company's brand. It proposes that companies use conjoint analysis, a marketing tool used for deciding between different sets of product attributes.

"How do you measure the value of agility? How do you measure being more innovative?," Dutta says. "Those are not always easy and that I think points to some of the core issues and challenges you see in trying to understand the business value of software."

Conjoint analysis, he says, has been widely used for marketing problems, but was never applied to the software world. "So we came to the realisation that this can provide a very good avenue for understanding and addressing the issue of the business value of software."

While there's still a long way to go before companies shift their mindsets regarding assessing the value of their software systems, some are moving more quickly than others. Notably those in the financial sector are becoming "more sophisticated," Dutta says, due to the regulatory requirements laid down by the Basel II agreement, which makes banks measure their operational risks and put up capital.

"Operational risks in a banking system or financial institution are very intimately tied to software systems, so in some sense the entire sector is now being required to understand and assess the operational risks, which are very closely linked to software risks and then allocate capital to cover for those risks," Dutta explains. "So you'll see some sectors moving ahead at a faster pace than others."

The next phase of the research will aim to develop a tool that can be used by CIOs and other executives in assessing the business value of core software assets 'in real business settings.' The study was conducted in collaboration with Micro Focus.

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