Measuring Up

By Preston Cameron

A growing number of companies have recently begun searching for new ways to measure the return on investment (ROI) of their IT and E-commerce business projects. For less strategic projects, such as those that increase the efficiency of the supply chain, traditional ROI evaluations are still being used. But the new bottom line is that E-commerce business is seen increasingly as something that must be pursued at all costs.

Every CFO and accounting professional can do it in their sleep. Calculating a project's Return on Investment (ROI) is just part of "Business 101." When you ask accounting professionals if they require it for new Information Technology (IT) projects, the answer is yes – well, sort of. Evaluating the potential return on the investment in an IT project can be straightforward – at least in theory. When a CIO shows that a new system will cut costs and pay for itself after a couple of years, or that it will significantly improve efficiency at a reasonable price, top executives usually sign up and give them the green light. This is especially true of the more tactical IT projects, such as new applications that cut order-processing costs, or reduce production costs. But in other cases, some IT initiatives have become so important that companies are either not evaluating them with an ROI, or they're looking for new ways to measure ROI to take into account a project's strategic value.

Wait a minute! You mean there is somebody out there in our organization spending money (and sometimes a lot of it) on IT projects and there is no payback analysis? How can this be? It's quite simple. IT projects can be justified for a number of reasons without ever having considered the calculation of a ROI. For example:

- If your organization's systems were not Y2K compliant, or your legacy systems are antiquated.
- If your business has grown and all those acquisitions have

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created a cumbersome snake pit of integrated systems and databases.

- If your company's business model has changed in the most fundamental and basic way, and your competition can do things with systems that are killing yours.

In cases like these – and there are a lot of them – insisting on a strict ROI calculation justification could seem somewhat beside the point. Does that mean that all IT projects can fit into one of these scenarios? Not necessarily. Does it mean that these projects are not justifiable? Pick one of those scenarios from above and ask yourself, "What's the cost to our organization of not doing this?" And then ask yourself, "How can I measure my company's ROI on these IT projects?"

You can begin by dividing these IT projects into some basic arenas. Almost every IT project fits within one of these arenas or has one of these components:

- E-commerce
- ERP (that all encompassing Enterprise Resource Planning system)
- Intranets
- Data Warehousing

E-commerce

Many organizations feel a tremendous sense of urgency to push ahead with those "Web-asizing" projects without considering ROI. CEOs and CIOs often stutter when asked to value a competitive advantage, new marketing channel, or improved customer satisfaction by using the Web. But this doesn't mean that an ROI analysis might not be required.

ERP

A host of companies by-passed the scrutiny of the accounting professional by justifying that the project was needed to replace outdated or non-compliant applications. The publicity of some large notable projects that have gone sour has many executives afraid to go back and review their expenditures, arguing that the costs are "sunk," with a sinking feeling that their own project's ROI is probably negative. But this doesn't mean that an ROI analysis might not be required.

As organizations launch these e-commerce or electronic-business projects, many are tossing out their conventional thinking about the need for a return on investment. Instead, they are focusing on how these initiatives can advance their overall business strategy.

Intranets

Many applications are so inexpensive to create and deploy throughout the organization, that many executives assume that the ROI is a "no-brainer." But this doesn't mean that an ROI analysis might not be required.

Data Warehousing

The process of mining through an organization's data to find the information that leads to reduced costs or increased sales can be tough to value – usually because there are adjoining processes that must also be improved in order to get to the

Justifying IT Costs

In a recent survey of IT and business executives, only 17% of IT managers and 12% of responding business executives said their companies formally required them to demonstrate the potential payback of their E-commerce applications. And 28% of IT managers and 39% of business executives said their companies required no ROI analysis or justification whatsoever.

The Softer Side of ROI Analysis

In assessing your investments in these IT projects, some traditional ROI metrics could be applicable. If not, then an attempt to value the project's relationship in concert with your organization's strategic objectives might help identify some new ROI metrics for your organization to use. For example, ask yourself the following questions:

* Does this IT project target a valuable customer segment?
* Does it improve the quality of your customer service?
* Does it reuse existing IT infrastructure and technology?
* Does it give you a commanding market-share lead from being first to market?
* Does it help your organization learn more about your customers?
* Is it a strategic fit with your other existing ventures?

Using answers to questions like these can help you identify some of the softer sides of the ROI analysis, or even help create new organizational ROI metrics you can use. But they are also the more difficult attributes to quantify.

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The IT ROI Model

Today, the ROI evaluation for any IT project can be a slippery mess. What is traditionally referred to as a calculation to show the value of something has become the buzzword for any new venture justification. Mistakes can often occur when that justification is based solely on tangible benefits. Generating a positive ROI has become a multi-pronged task. The IT ROI calculation requires detail analysis to help manage your organization's expectations, digging deep to reveal hidden costs and new profits, holding tight to a project's parameters, and putting a price tag on intangible benefits.

Tangible benefits are the ones that are easy to identify and quantify. They include the typical advantages like lowering head count, reducing inventory, or reduced processing costs.

In the emerging arena of E-business, any new ROI metric you develop must be flexible enough to adapt as your company's E-business strategy evolves. And although the Internet has accelerated the pace of business to near light speed, E-business ROI metrics need to reflect the traditional long-term vision of ROI.

However, quantifying an intangible benefit like customer satisfaction or closing the books faster can be tough. And then there are the "strategic" benefits like increased market share that can be downright confusing. It takes more than the traditional set of flashcards to assemble the ROI for today's IT projects. It requires a new business view that the IT project is really its own business venture and that it requires its own set of books. That means building a careful plan with specific definitions, and then managing your project to that plan. If the project calls for intangible or strategic benefits, the plan should identify specifically what will be required to achieve that benefit. By valuing those activities, you are now on your way to gathering the data to perform the ROI analysis.

Everybody knows that the Internet has changed the way companies communicate, how they gather and share information with their business partners, and how they buy and sell; and it's also changing the way they view their IT investments. As organizations launch these e-commerce or electronic-business projects, many are tossing out their conventional thinking about the need for a return on investment. Instead, they are focusing on how these initiatives can advance their overall business strategy – whether it's to improve customer satisfaction, increase company and brand awareness, or simply to open up new sales channels.

It's easy to measure the ROI of an IT application that reduces your back-office processing costs, more so than one that improves your customer's satisfaction. But as you struggle to come up with new ROI metrics that measure the ROI of IT projects, you will also need to take into account another key aspect of nearly all new IT E-business initiatives – cross-functional projects. The investments that you will need to make will come from different organizational buckets. Don't get tangled up in looking at the project as "just another IT project." In the emerging arena of E-business, any new ROI metric you develop must be flexible enough to adapt as your company's E-business strategy evolves. And although the Internet has accelerated the pace of business to near light speed, E-business ROI metrics need to reflect the traditional long-term vision of ROI.

What if your IT project looks like it's become that never-ending pit of expenditure that has consumed your entire organization? Can you get it back on the road to success? Yes, but it might require a new approach to the traditional management diet. Try to build, or rebuild the business case for the project with clearly-defined goals and terms. In short, prepare a business and operational plan for the project. What are the critical factors required for success of the project and how will they be achieved? What does the next phase mean in terms of dollars and cents, in both costs and benefits? What are the risks, detours, and short- and long-term benefits? And most importantly, does everybody up and down the organization understand his role in the project?

Regardless of the type of an organization's IT project, it is increasingly clear that the more central technology is to a company's ability to exist, accounting professionals are being forced to re-evaluate the traditional components of the ROI valuation. The result: it has less to do with calculating monetary returns and more to do with pure business management. And it has more to do with the effort it takes to find the tangible, intangible, and strategic benefits that are meaningful to your organization.

Preston D. Cameron is the President & Managing Director of Oculus Consulting Group. He can be reached at 314-422-6365 or via e-mail at oculus_consulting@att.net. Visit http://oculus_consulting.home.att.net.