

Effective ROI – A Guide for Decision Makers



A White Paper
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Abstract

The following paper defines why ROI is important, what are the key characteristics of an effective ROI tool and how should IT decision makers judge a good ROI statement.

This Fujitsu series of white papers is designed to educate retail information technology (IT) decision makers about key criteria on making IT purchase decisions. No specific Fujitsu products and services are covered and all discussion is related to providing information to retail executives.

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Introduction

The market environment today is markedly different from the one a few years ago. No key IT driver, such as Y2K, is fueling the IT purchase decision. The market has swung from a seller's market to a buyer's market as growth rates decline and companies shift from a strategy of managing growth to one of protecting market share.

IT buyers are under considerable budget pressures due to a transition from historical over buying to a more disciplined approach to spending. IT purchase decision making is evolving from an exclusive purview of the CIO to a shared decision making model with blended business and technology considerations.

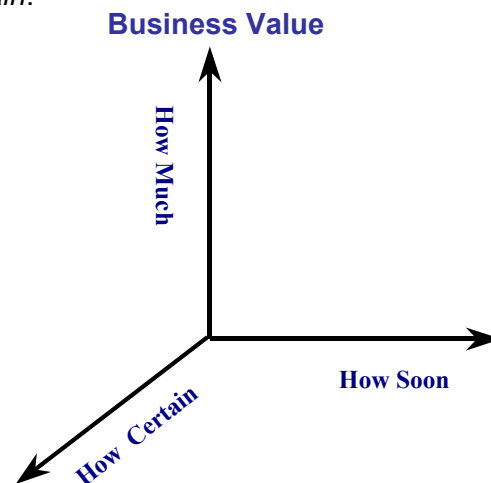
Technology is now seen as an enabler to achieve real business value and IT purchases must demonstrate that value and show financial impact.

Return on Investment (ROI) is used more or less as a generic term to mean defining the business value of an IT investment. To be effective in today's market environment, ROI must transcend the base levels of cross-industry technology and business benefits to show vertical industry and business process specific benefits from the investment under consideration.

ROI statements should provide an accurate representation of business value, appeal to the shared decision making model, be believable, and capture the total investment.

A comprehensive ROI statement needs to define business value along the three key dimensions of *how much*, *how soon*, and *how certain*.

The rest of this document will examine the key criteria for ROI tools as well as major drivers for determining the validity of ROI statements.



What you should look for in an ROI tool

For an ROI tool to be effective it must have the following key characteristics:

- ☐ Industry and Business Process specific benefit modeling
- ☐ Account for all costs related to the investment
- ☐ Easy to understand and communicate
- ☐ Easy to change assumptions driving the model
- ☐ Provide key project viability measures
- ☐ Ability to model Hard and Soft benefits
- ☐ Allow for Risk Adjustments and Uncertainty Modeling
- ☐ Perform Sensitivity Analysis
- ☐ Allow for customization of model by modification/extension of base model
- ☐ Audit all model assumption and parameter changes
- ☐ Provide for Target versus Actual ROI comparison



Some of the above capabilities are more important than others for different projects. An effective ROI tool will have most, if not all, of the above characteristics.

This section will elaborate on the key characteristics defined above of effective ROI tools.

An effective ROI tool must go beyond modeling base infrastructure benefits related to horizontal technology investments. It should take into account benefits derived from Efficiency gains, Productivity improvements, Risk reduction, cost/loss reduction, revenue generation, etc. from a cross industry and a vertical specific, and more importantly, business process specific perspective.

The ROI tool and model must account for all costs related to the investment in question. Initial costs such as Capital, Licenses, Resources, Procurement, Training, Installation etc. must be accounted for. Life cycle costs such as Maintenance, Operate Services, etc. must also be accounted for.

The benefit and cost modeling in the ROI tool must be easy to understand and communicate. Large, complicated spreadsheets make for a poor vehicle to communicate complex ROI models related to an enterprise wide IT investment. Shared decision making in today's business environment dictates that people other than finance professionals participate in and understand the business value of IT investments. This necessitates a methodology in building ROI statements that makes them easy to understand and take ownership of.

In addition to making a complex ROI easy to understand, the ROI tool must also allow for quick, easy and interactive modification of model parameters or assumptions. This allows for easy what-if modeling and leads to better understanding of the model by the decision makers.

The ROI tool must provide all the key measures of project viability to allow decision makers greatest latitude in choosing the relevant criteria. Project measures such as *Net Present Value* (NPV), *Internal Rate of Return* (IRR), *Payback Period*, and *Return on Investment* (ROI) must be provided so that the decision makers can evaluate the project along whichever criteria they deem relevant.

The ROI tool should allow for modeling both Hard and Soft benefits. More effective tools will make a distinction between benefits that:

- ☐ Remove exiting costs
- ☐ Avoid future costs
- ☐ Improve Performance

It will also allow the decision maker to easily choose between including and excluding some or all of a particular class of benefits. In turn, the decision maker will only include those benefits in the ROI statement that they are comfortable with counting.

An effective ROI tool must allow for the decision maker to apply Risk Adjustments to realization of benefits as defined in the model. Decision makers bring a unique and necessary perspective to assessing the achievable versus potential realization of any benefit statement. An effective ROI tool will allow the decision to apply Risk Adjustments by benefit statement to produce both a best-case ROI statement and a more achievable and Risk Adjusted ROI statement.

Not all parameters and assumptions driving an ROI model can be determined with exactness. An ROI tool that allows for modeling uncertainty for assumptions and parameters adds a key dimension to the believability of the ROI model by modeling reality more accurately. With some or all of the assumptions driving the model being uncertain, the project viability measures become *forecasts* based on the cumulative uncertainty behavior of the driving assumptions. Such sophisticated modeling and analysis capabilities differentiate a world class ROI tool from the ordinary.



A comprehensive ROI model for an enterprise wide IT investment may very well have hundreds of assumptions and parameters driving the model. Decision makers need to be able to determine key assumptions so that appropriate time and resources can be allocated to determining their value. An effective ROI will provide Sensitivity Analysis to determine the key assumptions underlying the ROI model for the investment in question so that appropriate time and energy is spent in determining their value.

The juxtaposition of new process and technology in an existing legacy situation (both legacy technology and process) often results in new (and perhaps unique) benefits to a given decision maker. An effective ROI tool allows for modification of existing benefit models as well as addition of new benefits and assumptions to the ROI model in an easy-to-perform manner. Having the ROI tool programming staff change the model rather than the changes be interactively made in the presence of the decision makers diminishes the effectiveness of the tool.

Parameters and assumptions driving the ROI model are gathered after much research and deliberation. It is not uncommon for values of assumptions to change as research uncovers better answers. An effective ROI tool allows for version control and audit of all parameter changes. This allows the decision makers to have a full record of how the values of the various assumptions evolved to their current set. It also allows the decision makers to revert back to an earlier data set if changes in the current set are deemed unsatisfactory.

Establishing a target project ROI is often not sufficient. Decision makers are being asked to validate the decision by conducting post implementation audits. An effective ROI tool allows the decision makers to do an *actual* versus *target* ROI comparison for the investment in question.

What Makes an ROI Statement Great

The prior section detailed some of the key capabilities of effective ROI tools. This section will define some of the key attributes of an effective ROI statement.

Quantifying added business value along its three dimensions of *how much*, *how soon*, and *how certain* is key to an effective ROI statement. Project viability measures such as NPV and Payback period backed by comprehensive cash flow statements from all components of the ROI model are key to answering the first two questions of *how much* and *how soon*.

To answer the third question requires that the ROI statement provide a Risk Adjusted view to partially answer the *how certain* question. A more complete answer to that question requires that the ROI statement define the response to the first two questions of *how much* and *how soon* with an answer like *'We are 95% confident that we will be able to achieve a Net Present Value of \$3.5 Million with a Payback period of 9 months'*.

Individual Benefit statements detailing improvements in specific business processes are key to an effective ROI statement.



An effective ROI statement should provide a good executive summary as well as complete detail on all benefit statements and underlying assumptions, parameters and costs. In addition, details on the ROI methodology are key for those who are reading the ROI report but did not participate in the process.

Graphs and charts often do a better job of communicating than tables of numbers. An effective ROI statement must provide charts and graphs illustrating benefit and cost cash flows as well as others detailing the cash flow contributions from various benefit sources.

The ROI statement is a financial document and like any good financial document the ROI statement must be protected from tampering. An effective ROI statement will be protected from changes to bolster its believability.

In Closing

The business climate has fundamentally changed and is now characterized by low to moderate growth and a buyer's market. IT suppliers must position against and demonstrate business value to be successful. This is a major shift in the sales and marketing approach for the IT suppliers.



Comprehensive ROI statements from IT suppliers, which are vertical industry and business process specific, demonstrate key understanding of the market place in which the supplier is trying to sell and help to crystallize value of the IT investments that a decision maker is grappling with.

This white paper has defined both the key capabilities of effective ROI tools as well as key attributes of ROI statements. Fujitsu is a world-class supplier to retailers with its Life Cycle solutions and is able to demonstrate the business value added by their deployment.