

Return on Investment for e-Business Initiatives

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Why we're here

- Learn to calculate the real impact of technology's benefits on the bottom line of your organization is a must for any department deploying a technology solution.

This workshop will improve your understanding of the baseline costs, business processes and how they build an accurate return on investment.

What you'll learn

- 1. To convert soft costs and indirect benefits into quantitative hard dollars for cost analysis.**
- 2. Identify additional sources of cost savings to help improve the direct benefits in an ROI calculation.**
- 3. Methods of measuring ROI including, payback period, total cost of ownership and net present value**

What is ROI?

- **ROI = return on investment**
- **The financial benefit, (usually profit, revenue or cost savings) that results from money spent on a specific alternative**
- **A measure of how well a company is managed.**

ROI Reduces Risk

- **Selecting the best e-business suite or best of breed technologies for your company is a critical business decision.**
- **Negotiating better terms for technology that may have a cost structure different from your current business position.**
- **Ranking e-Business Goals and Objectives**

ROI is not always about dollars

- **Could also measure immediate corporate and strategic objectives**

- getting market
- revenue share
- building infrastructure
- positioning itself for sale
- other initiatives

ROI as a Business Tool

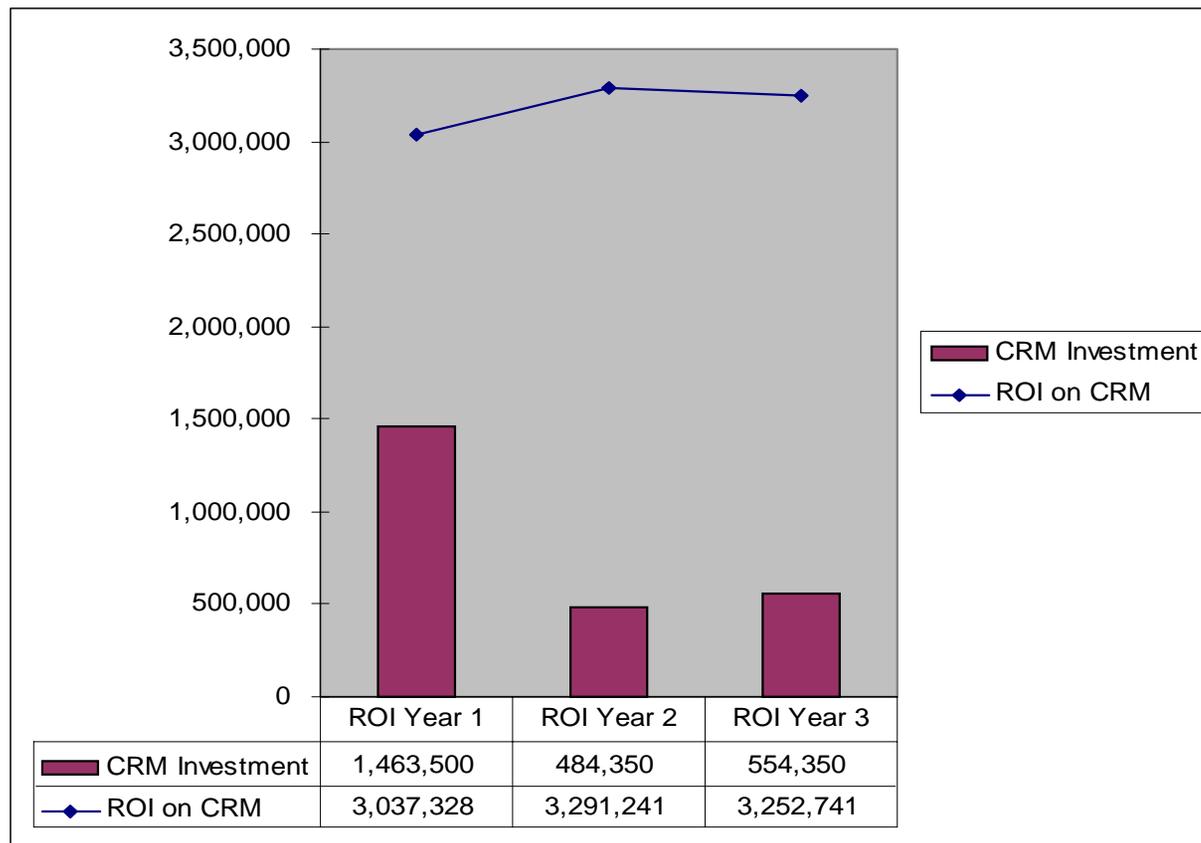
- **Supports planning and decisions**
 - Corporate Priorities
 - New Business Initiatives
- **Determines consequences**
 - Cash flow
 - Rationalizes and quantifies costs and benefits
 - Assesses risks
- **Decision Support**

How do you calculate ROI?

Basic Formula

The incremental gain from an action
by the cost of that action

ROI Chart



Business Case for New Technology

- **Efficiencies of new software**
 - Capital Cost of required hardware
- **Why existing systems can not be used**
- **ROI on new technology acquisitions**
 - Work your Vendor!

ROI Components

● Hard Factors

- **Revenue**
- **Cost of Sales**
- **Gross Margin**
- **Marketing Expense**
- **Overhead**
- **Handling Costs**
- **Inventory Costs**
- **Net Product Profitability**
- **Customer Retention**

● Soft Factors

- **Improved effectiveness**
- **Increase speed and response time**
- **Staffing costs**
- **Customer Satisfaction**
- **Reducing Turnover**
- **Improved Process Management**
- **Increased Operating Efficiencies**

Quantifiable ROI

Elements

- Decreasing the Average Sales Cycle Time
- Increasing Win Rates
- Reducing Sales, General, and Administration Expenses
- Increasing Average Monthly Number of Qualified Leads
- Average Size of Sales Opportunity
- Increasing Gross Margin
- Decreasing COGS

Benefits of the e-Business

- **Reduced MRO Expenses**
- **Increased Sales Effectiveness**
- **Marketing Expenses Justified**
- **Procurement Efficiencies**
- **Qualified Business Knowledge**
- **Stimulated Customer Loyalty**

ROI Benefits for e-Business

● **Direct Benefits**

- Revenue
- Cost of Sales
- Gross Margin
- Marketing Expense
- Overhead
- Handling Costs
- Inventory Costs
- Net Product Profitability
- Customer Retention

● **Indirect Benefits**

- Improved effectiveness
- Increase speed and response time
- Staffing costs
- Customer Satisfaction
- Reducing Turnover
- Improved Process Management
- Increased Operating Efficiencies

e-Business Cost Factors

- **Basic Financial Information**
 - Assumptions
- **e-Business Software Cost Information**
- **Software Expensed**
- **Software Depreciated**
- **Hardware Expensed**
- **Hardware Depreciated**
- **Consulting**
- **Personnel**
- **Training**
- **Other**

ROI Research

- **Measure pre-e-Business Cost of Sales**
- **Target inefficient processes**
- **Maximize Direct Benefits**
- **Get detailed capital and H.R. costs**
- **Quantify Indirect Benefits**
- **Why existing systems can not be used**
- **ROI on new technology acquisitions**
 - Ask your sales rep.

Vital ROI Research

- **Measure Current Business Processes from start-to-finish**
 - Marketing Contact to Legal Contract
 - Customer Interactions & Frequency
- **Quantify Soft Costs**
- **Capital Cost of required hardware**
- **Determine Telecom Costs**
- **Identify Wasteful Processes**
- **Efficiencies of new software**

Translating ROI

- Sells business benefits
 - **not features**
- Translating what ROI means
 - 1. Your decision will realize a 15% ROI**
 - 2. Your investment will pay off in 18 months and can increase your profits by 6% annually**

Discovery

- **General Information**
- **General e-Business and System**
- **Sales Process and Sales Effectiveness**
- **General Marketing Requirements**
- **General Service/Support/Operations Requirements**
- **Supply Chain Requirements**

Make Assumptions

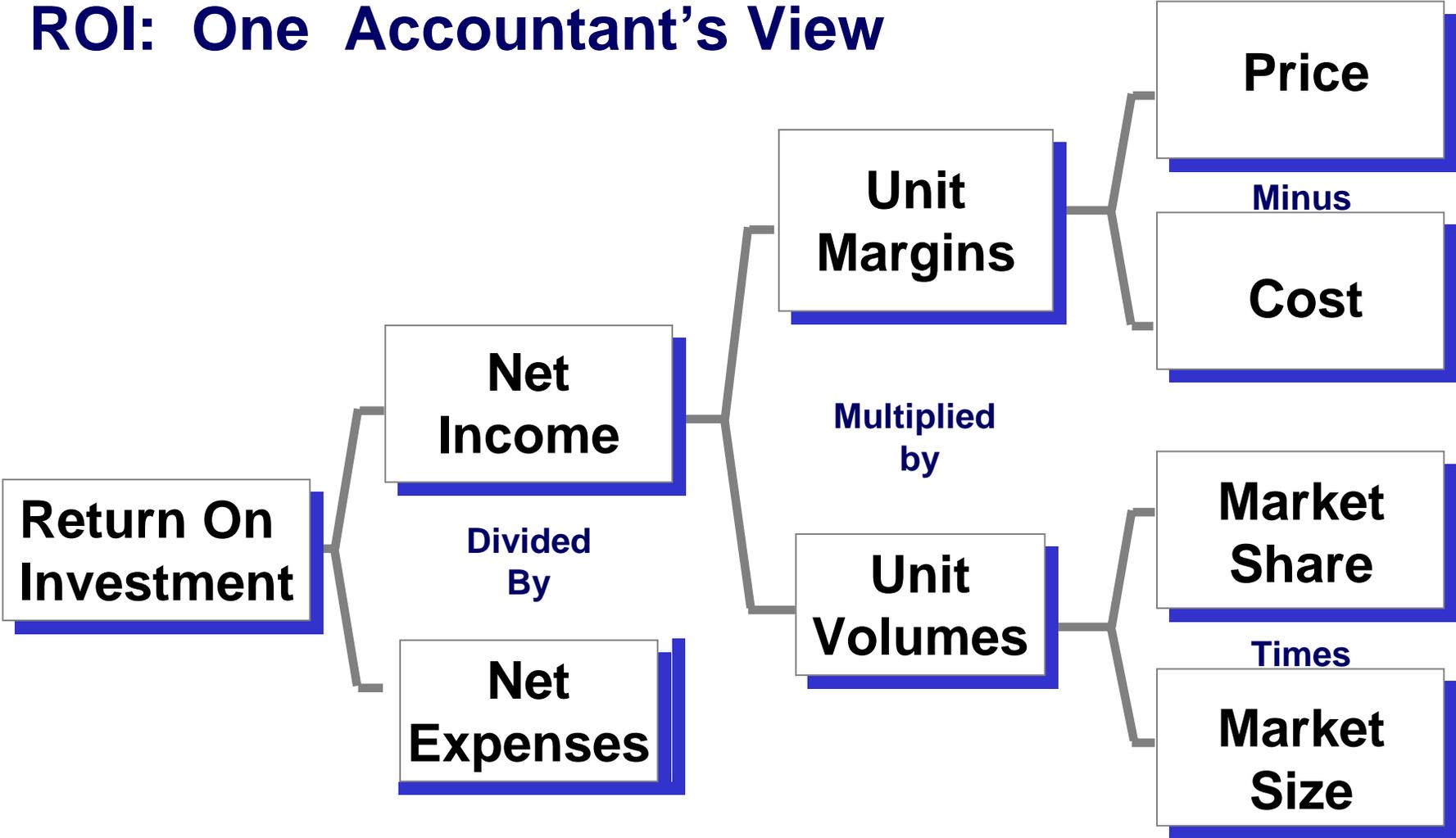
● **The Following assumptions can be made for CRM**

- Reduction in Sales Cycle
- Reduction in Non-Selling Time
- Increased percentage of Sales Reps now Hit Quota Increase in win rate.
- % of Customer who leave due to neglect that could be Retained

Return on Investment for e- Business Initiatives

**To convert soft costs and indirect
benefits into quantitative hard
dollars for cost analysis.**

ROI: One Accountant's View



Long Term Customer Value

● Profitability

- **Wallet-share**
- **Sales Forecasting**
- **Cross-selling**
- **Testimonials**
- **Quality Feedback**
- **Referrals**

● Reduced Costs

- **Marketing**
- **Administration**
- **Accounting**
- **Market Research**
- **Product Testing**

Converting Indirect Benefits

• **Customer Satisfaction**

- Pre and Post e-Business Satisfaction Levels
- Profitability of Satisfied Customers
- Satisfied Customer Retention Percentage

• **Improved Productivity**

- Weighted employee cost per hour
- Pre and Post e-Business time requirements
- Inefficiency Factor

Converting Indirect Benefits

- **To convert soft costs and indirect benefits into quantitative hard dollars for cost analysis.**
- **Usually requires three steps or more**
- **Know your calculations!**

Research Required

- Average Weighted Cost of Employees
- Vendors Assumptions for Productivity
- Industry Productivity Benchmarks
- Activity Based Costing
 - **Specific to functions enhanced by e-business**
- Employees Impacted

Accountants don't like Indirect Benefits

Financial professionals and other management reason that a performance improvement resulting in a 10% savings in time is not often a direct benefit to the company.

Converting Indirect Benefits

• **Customer Satisfaction**

- Pre and Post e-Business Satisfaction Levels
- Profitability of Satisfied Customers
- Satisfied Customer Retention Percentage

• **Improved Productivity**

- Weighted employee cost per hour
- Pre and Post e-Business time requirements
- Inefficiency Factor

Converting Productivity

- Promised 20% Productivity Enhancement
 - **1,000 employees impacted**
 - **Weighted average employee cost of \$60,000**
 - **Inefficiency factor of 35% for year one**

Converting Loyalty

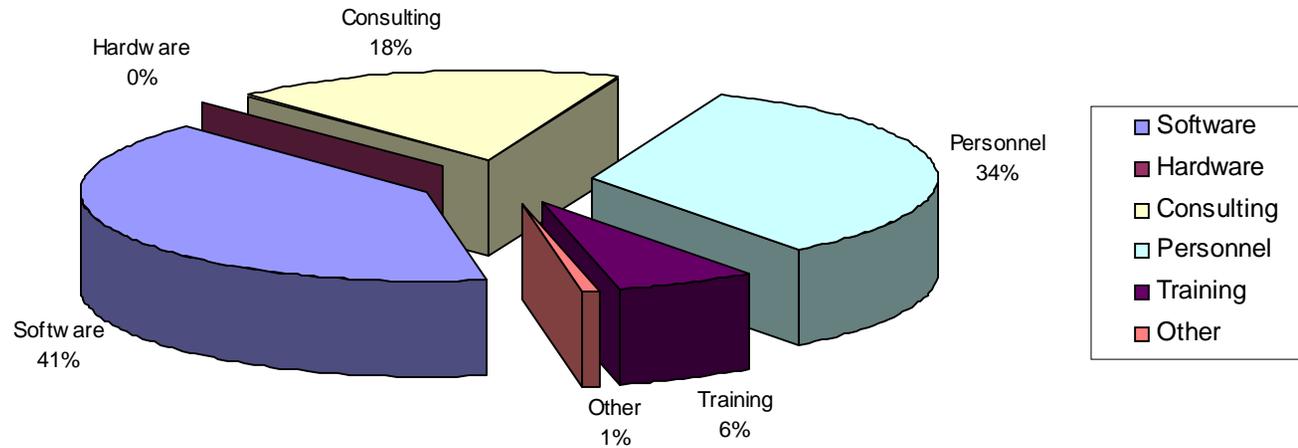
- Assumed 10% increase in Loyal Customers
 - **10,000 active customers**
 - **2000 are considered loyal**
 - **Loyal Customers spend \$250,000 / year**
 - **2 % of loyal customers lost due to mergers, bankruptcy and other factors**
- What is the value of customer loyalty?

Return on Investment for e- Business Initiatives

**Identify additional sources of
cost savings to help improve the
direct benefits in an ROI
calculation.**

Cost Chart

Total 3 Year Costs



Identify Hard Costs

- Basic Financial Information
 - **Assumptions**
- Software Cost Information
- Software Expenses
- Software Depreciated
- Hardware Expensed
- Hardware Depreciated
- Consulting
- Personnel
- Training
- Other
- Telecom

Return on Investment for e- Business Initiatives

**Methods of measuring ROI
including, payback period, total
cost of ownership and net
present value**

Measurement Methods

- 1. Payback period**
- 2. Total Cost of Ownership (TCO)**
- 3. Net Present Value**
- 4. Net Cash Flow**
- 5. Accounting Rate of Return**
- 6. Impact on Earnings per Share**

Payback Period

- A time measurement
 - **Months, quarters or years**
- A powerful indicator of risk and one of the best measurements to use before deciding to approve a project.
 - **The shorter the payback period the better your chances of covering your costs before new technology makes your current solution obsolete.**

Total Cost of Ownership

- Total Cost of Ownership
 - **The total costs, benefits and value associated with your IT investment over its lifetime**
- Average Cost of Ownership
 - **Divide the Total Cost of Ownership by the length of time used to calculate the ROI.**

Net Present Value

- The value of money over time.
- The present value in "today's dollars" of the future net cash flow of a project.
- Compare the NPV against the amount of money needed to implement your project.
 - **If the NPV is greater than the cost, the project will be profitable**

Net Cash Flow

- Before Taxes
- After Taxes

Accounting Rate of Return

- $\text{Net Value} / \text{Initial Cost}$

Impact on Earnings per Share

- Step 1

Benefits / Costs
= Net Yearly Value Derived

- Step 2

Net Yearly Value Derived
/ Number of shares outstanding:
= Impact on Earnings Per Share

Market Valuation Impact

- Important for Publicly Traded Companies
- E-Business investments will reduce earnings and cash reserves in the short term
- Calculating Stock Market Evaluation
 - *Stock value less tangible assets pre-project*
 - *Minus*
 - *Stock value less tangible and e-business assets*

How to use ROI

Evaluating the effectiveness of the initiative or the overarching strategy

Calculating ROI

- **Consolidated ROI Calculations**
- **Summary Results**
- **Annual benefits**
- **Depreciation Schedule**
- **Expensed Costs**
- **Financial Analysis**

Can ROI fail your project?

- **Cold shoulder from management**
 - No alignment to corporate goals
- **When implemented, real costs and benefits differ significantly from projected estimates.**

Creating the Conditions of Success

How to be in the 33% of
Successful Enterprise
Application Implementations

Bigger may not be better...

- Successful project:
average size
\$10 million
 - Failed project:
average size
\$90 million
- Boston Consulting Group, 2000

Diminishing ROI...

- A Case Study:
 - **80% of the cumulative annual benefit derived from an application initiative could have been achieved in the 1st 33% of capital outlay**
 - Boston Consulting Group, 2000

Up-Front Analysis is Key!

- Business Capabilities Analysis
 - **Your Existing Best Practices**
 - **Industry Benchmarks**
 - **Your Competitors Best Practices**
 - Successful Projects
 - 56% were based on analysis
 - Failed Projects:
 - 8% were based on analysis

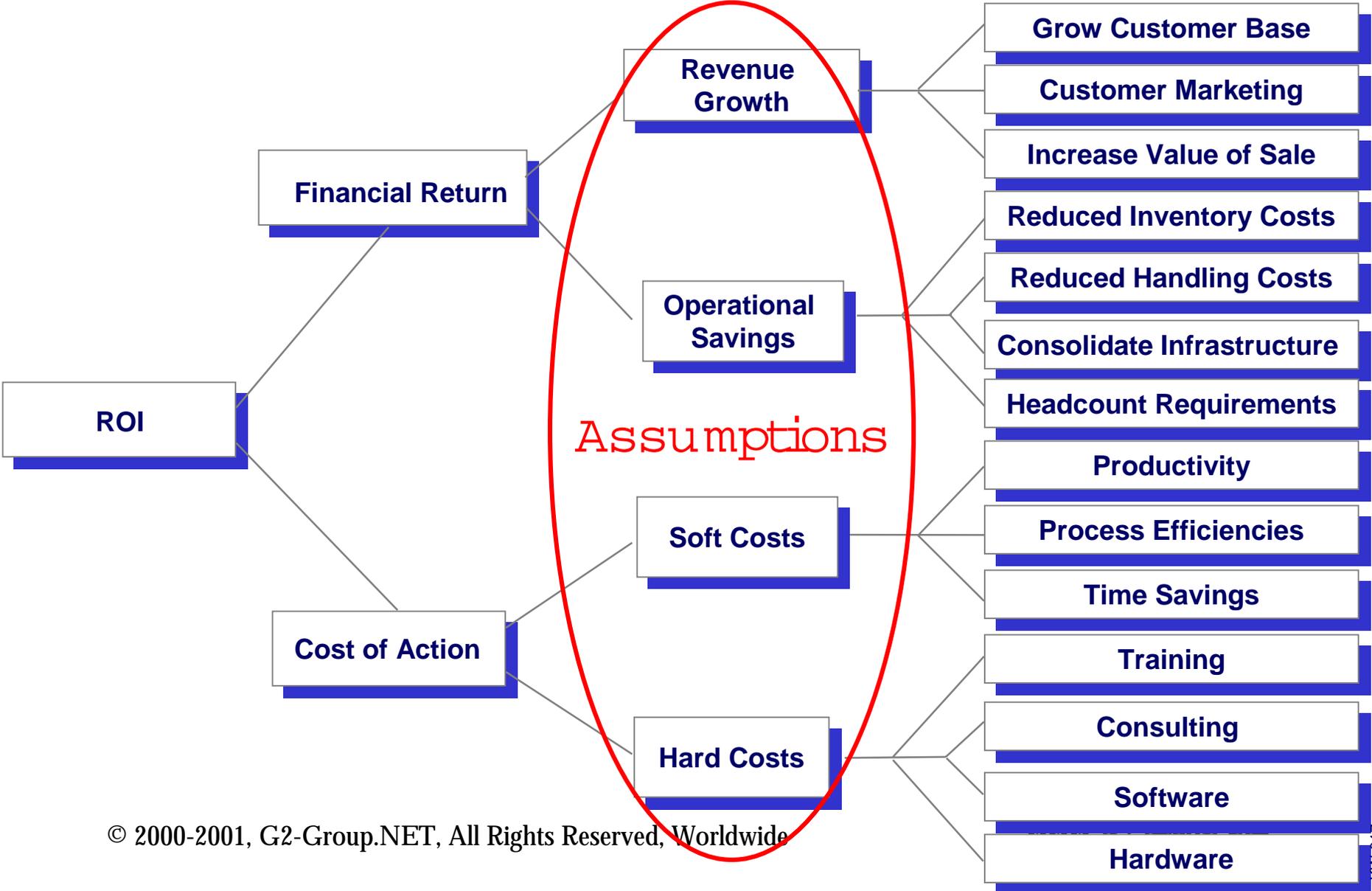
– Boston Consulting Group, 2000

Identify Options & Alternatives

- I.E.: software upgrades, process redesign, interim solutions, outsourcing...
 - **Successful Projects**
 - 43% included this evaluation
 - **Unsuccessful Projects**
 - 9% included this evaluation

» Boston Consulting Group, 2000

ROI: The Strategists View



e-Business ROI RESOURCES

- Online at <http://www.g2-group.net/istrategy>

Thank-you!

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ROI Resources at HP World

- Software Innovation / Booth 877
- Same Aisle as EMC Booth

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