

Passing the ROI Test: A Three-Tiered Model for Obtaining Project Funding

Airtight calculations of ROI vastly improve a technology investment's chances of receiving senior management's approval.

by Lawrence Serven



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WHY SHOULD WE BUY this?" That might be the most frequently asked question in business today, given the current economic climate and competitive landscape. Provide the right answer to this question, and you'll win the support — and, more important, the purchase order — you need to move forward with a BPM implementation. Fail to answer this question in compelling terms, and you will have to live with your current circumstances.

How you go about building the case to support a desired technology purchase affects whether the decision is "yes" or "no." To convince others that an investment in technology is worthwhile, you need skills beyond those you learned in accounting class. Finance people tend to be good at discounted cash flow analyses and finding the internal rate of return, but many forget that in the corporate world eyes glaze over quickly when, for example, accountants delve into the nuances of how they selected the discount rate used in their model. These details are not what senior management wants to hear. Decision-makers want to know why a software purchase makes good business sense — how it will improve results. No matter how sound the underlying analysis is, straight talk, defensible data, and compelling arguments are key to winning approval.

Unfortunately, there is no one-size-fits-all-occasions model for making a convincing tech-investment presentation. For example, it doesn't make sense to spend a month building a rigorous business case for purchasing a \$200 external Zip drive. The value of the hours you would devote to that exercise would far exceed the proposed expense; a simple "I could sure use a quick way to back up my files" argument should suffice. On the



other hand, if you want your company to invest a million dollars in a budgeting and planning tool, your case had better be buttoned down when you present it to senior management.

The time and effort you should put into developing an ROI argument depends upon your unique circumstances. That's why The Buttonwood Group has devised a three-tiered system for convincing decision-makers of the benefits of a particular software purchase. You can choose the level of analysis that represents the best fit for your situation, then tailor it as appropriate.

Before getting into these ROI models, though, I should note that in some circumstances a gut feeling can suffice — as in purchasing a \$200 Zip drive. Over time, people build up a valuable set of experiences and can make effective decisions on that basis alone. A justification based on a combination of knowledge and intuition may be appropriate when there is a widespread and passionate sense among decision-makers that something needs to be done. However, be careful not to underestimate the need for data in decision-making. Especially important in purchase decisions is cost-savings data, the subject of our first analysis.

Level 1: Cost-Justified ROI

The most common approach people take when trying to project the ROI of a proposed solution is to focus on potential cost savings. This isn't surprising, since potential cost savings often provide the most vivid and tangible rationale for making a business investment. Nevertheless, many software purchase proposals fail to persuade because their underlying assumptions are not grounded in defensible data. Costs are estimated on the back of an envelope, and projected savings appear to be wishful thinking. Net result? Senior management does not buy in, and the project doesn't receive approval. There is a way, though, to build a solid case for cost savings. Our cost-justified ROI model is predicated on the notion that the only truly defensible justification for investing in new technology is to cut costs.

What types of cost savings can we assume, and on what basis do we make those assumptions? These two questions get at the heart of cost-justified ROI and represent the two most common areas of probing during senior management review of proposed investments. The most important and valuable tool for making the cost-justified case is solid benchmarking data. After all, it's one thing to know that your organization's cost for some process is \$1 million, but it's another to know how that compares with what other companies are spending — especially other companies in your industry. Exhibit 1 shows a template for calculating the cost of a process; you can modify the template to estimate expenditures on virtually any process. This template's results can be very revealing on their own, but they offer a whole new level of information if they are compared with benchmark data from other companies.

A common pitfall of using benchmark data is that if you're not making an "apples to apples" comparison, discrepancies may quickly become apparent to others as they review your work. For example, if you estimated what the planning/budgeting process costs your company, then compared that estimate with benchmark data, how could you be sure that you estimated your costs the same way the benchmarked companies did? For that matter, how do you know all companies that participated in the benchmarking study calculated their costs the same way? One company might base its cost estimate only on the number of finance professionals dedicated to the process, while another might include the time that nonfinancial managers spend developing departmental budgets or the time senior management spends reviewing plans. To address these concerns, you need to make sure every company being compared, including yours, is on the same footing. This doesn't have to be difficult. When The Buttonwood Group surveyed 225 businesses on the cost of planning, participants used an online tool, which asked them a series of questions, to estimate their costs. Because all participants answered the same questions, their cost estimates in the survey were highly consistent. Now when a company wants to compare itself with the benchmark averages, it uses the same tool to calculate its costs, so its comparison is accurate.

Armed with carefully compiled cost estimates and benchmarking results, a project leader can take the next important step: setting cost-reduction targets. Is a 10 percent reduction too high, or is a 40 percent reduction too conservative a goal? With solid benchmarking data, you can much more easily set targets. If your organization's costs are above the national average for your industry on a rate basis, getting down to the average cost is a reasonable goal. If your company is doing better than average, your goal might be to get in the top quartile or even the top 10 percent. Of course, setting goals requires a degree of professional judgment and experience, and you should solicit the input of senior management, as well.

Decision-makers want to know why a software purchase makes good business sense. Straight talk, defensible data, and compelling arguments are key to winning approval.

Exhibit 1

Estimating Process Costs

The right tool can improve the accuracy of estimates of a process's costs — and a project's potential cost savings. The following worksheets calculate the amount a company spends developing its annual plan, but they can be modified to fit virtually any process. Results of such an analysis can be compared with benchmarks to help shape the goals of process improvement initiatives.

COST OF DEVELOPING THE ANNUAL PLAN

PART 1: PRIMARY INPUTS

# 1	Number of employees	10,000	Input
# 2	Percentage of employees participating in the planning process	25%	Input
# 3	Number of planning participants	2,500	Calculation (#1 x #2)
Percentage of participants who are:			
# 4	Almost uninvolved (dedicated 1 day or less)	10%	Input
# 5	Barely involved (dedicated 2 to 3 days)	10%	Input
# 6	Somewhat involved (dedicated 4 to 5 days)	60%	Input
# 7	Moderately involved (dedicated 6 to 10 days)	20%	Input
# 8	Heavily involved (dedicated 11 to 20 days)	0%	Input
# 9	Most involved (dedicated over 20 days)	0%	Input
# 10	Total check (sum to 100%)	100%	Calculation (sum #4 through #9)
# 11	Input days over 20 for employees in #9	N/A	Input

PART 2: PERSON-DAYS COST CALCULATION

# 12	Number of planning participants (from #3)			2,500	
		Percentage	Factor	Number of Person-Days	
	Almost uninvolved (taken from #4)	10%	1.0	250	Calculation (percentage x factor x #12)
	Barely involved (taken from #5)	10%	2.0	500	Calculation (percentage x factor x #12)
	Somewhat involved (taken from #6)	60%	4.0	6,000	Calculation (percentage x factor x #12)
	Moderately involved (taken from #7)	20%	6.0	3,000	Calculation (percentage x factor x #12)
	Heavily involved (taken from #8)	0%	11.0	0	Calculation (percentage x factor x #12)
	Most involved (taken from #9)	0%	(from #11)	0	Calculation (percentage x factor x #12)
# 13	Total person-days required by the planning process			9,750	Calculation (sum)
# 14	Cost of a person-day			\$500	Input (standard rate is \$500/day)
# 15	Total cost			\$4,875,000	Calculation (#13 x #14)

PART 3: COST PER PLANNING COMPONENT

# 16	Cost of producing the annual plan (from #15)			\$4,875,000	
		Percentage of All Time Spent Developing The Annual Plan	Cost		
# 17	Strategic direction	10%	\$487,500	Calculation (percentage x #16)	
# 18	Departmental budgets	20%	\$975,000	Calculation (percentage x #16)	
# 19	Sales & revenue projections	10%	\$487,500	Calculation (percentage x #16)	
# 20	Marketing & promotional spending	15%	\$731,250	Calculation (percentage x #16)	
# 21	Raw materials usage & costs	20%	\$975,000	Calculation (percentage x #16)	
# 22	Capital spending	20%	\$975,000	Calculation (percentage x #16)	
# 23	Other expense projections (i.e., R&D, cost of funds)	5%	\$243,750	Calculation (percentage x #16)	
# 24	All other/miscellaneous	0%	\$0	Calculation (percentage x #16)	
	Total check (sum to 100%)	100%	\$4,875,000	Calculation (sum #17 through #24)	

SOURCE: BUTTONWOODLLP.COM

Most management teams want to hear about savings before anything else. It's easy to mistake that focus for a lack of interest in other potential benefits of a proposal.

If benchmarking data is not available, an alternative way to choose an improvement target is to determine the cost of the proposed system on a per user basis, then calculate the minimum improvement that would be necessary to cover that cost. Proper research, including reference checks, can help you assess how realistic the targeted improvement is. Once the goal has been set, you can easily calculate the potential savings. For instance, according to the The Buttonwood Group survey, producing an annual plan costs the average company \$1,000 per employee. If your company pays \$1,200 per employee, then it's reasonable to target a \$200-per-employee savings.

The important elements of a cost-justified ROI argument for a BPM software purchase are an understanding of current costs, a benchmark with which to compare those costs, and a cost savings target based on achieving some level of improvement compared with the benchmark.

Some management teams refuse to even look at a proposal unless the cost savings it generates outweigh the out-of-pocket expense to implement. While that restriction surely kills some projects that generate positive shareholder value (e.g., implementing customer profitability analysis tools), it is nonetheless a reality that many finance teams have to live with. If you work for such a company, you have little choice but to build the strongest case you can using the cost-justified ROI model. Even at more open-minded companies, sometimes a purchase's only expected benefit is a cost reduction. The cost-justified ROI approach is appropriate in this scenario, as well.

Often, arguments for investments are strongest if they move beyond simple savings. Most management teams want to hear about cost savings before they hear about anything else. That's understandable. But it's easy to mistake that focus for a lack of interest in other potential benefits of a proposal. For example, I once witnessed a complete reversal in a CEO's mood when she learned that a proposed technology tool would allow her to see the contribution margin by market on a weekly basis and drill down to a store level of detail. The lesson is simple: It may be worthwhile to invest some time fleshing out the list of an investment's benefits beyond cost savings.

Level 2: Cost-and-Benefit-Justified ROI

The cost-and-benefit ROI picks up where the pure cost ROI leaves off. Rather than focus exclusively on costs, this approach opens the gate to understanding all of the benefits the organization will realize. The cost-and-benefit ROI leaves no stone unturned in building the case for "yes." While less familiar for many finance professionals than a financial cost analysis, the investigation into potential benefits of a technology purchase may reveal the most compelling arguments yet.

Quantifying the benefits of an investment in technology isn't always easy, but some tools can provide assistance. One of the most beneficial is a "gap analysis." Simply put, this method enables an organization to assess, based on internal surveys, where it is today and compare results with where it wants to be. This gap provides an opportunity for improvement, and with some work that opportunity can be quantified.

Constructing a gap analysis starts with the identification of performance criteria that are appropriate for the process or area you are assessing. The next step is figuring out who in the company should be surveyed. The Buttonwood Group usually recommends a cross-section of employees to provide a broad perspective. Administering the survey can be as easy as sending out an Excel file and then collating results, but to ensure anonymity — important for receiving candid responses — you might want to hire a third party to coordinate the survey and compile the results. Exhibit 2 illustrates one company's gap analysis of the value it realizes through its current planning process, versus the value it could enjoy if the process were "highly effective."

When a project manager can add benchmark data to the gap analysis — perhaps even data on other companies in the same industry — the performance gap becomes much more compelling. Consulting firms that have done extensive benchmarking in the areas of planning, budgeting, and performance management can supply this information. Most notable in this area are The Buttonwood Group, AnswerThink, and the Parson Group.

Two approaches can estimate the benefits of closing the performance gap. The first is to attempt to quantify individually the benefit of closing each gap that surfaces in the survey results. For instance, the leader of the project in Exhibit 2 might separately calculate the results of increasing transparency to a value of 4.7, driving shareholder value to 4.6, etc. Although this is a sound and rigorous approach, it may be perceived by some senior management teams as presenting an unrealistic level of precision. Executives may see improving the planning process, helping management make better decisions, improving goal alignment, and increasing transparency as worthwhile objectives but consider quantifying them one by one to be impractical.

The alternative approach is to estimate the combined benefit of working to close all the gaps. For example, according to benchmarking data collected by The Buttonwood Group, the combination of the benefits of improving the planning process should help drive a revenue increase of at least 1 percent through the combination of better decision-making, improved goal alignment, and increased transparency.

Calculating ROI using the cost-and-benefit-justified method means adding up all the identified cost savings and other quantifiable benefits, then dividing these by the cost to implement. There are normally a few additional nuances and subtleties to consider, but this represents the basic methodology.

How do you know whether a level-two ROI analysis is appropriate? When cost savings are simply not enough to justify expenditures for your proposed solution, expanding the analysis to

Level 3: The Business Case ROI

The business case approach to evaluating the ROI of a project is by far the most complete and compelling, but it also requires the greatest investment of time. For that reason and others, you must decide up front whether to develop a business case for your project. Waiting until the last minute to put together a business case is like waiting until a house is built before hiring an architect to design the blueprint.

The process of building a business case can help you and your team clarify why you think change is necessary and what value that change will bring to the organization. There is no stronger or more convincing ROI argument than one that is founded on a sensible business case. The larger the project, the more important having a strong business case becomes.

A business case is a written document in presentation format (e.g., PowerPoint) that contains a few standard components: descriptions of the process's current state, the project's scope, the desired business results, and the approach for achieving those results, plus an economic analysis of ROI. What differentiates this approach from the cost-benefit ROI method is that it is more comprehensive and takes into consideration the needs of departments beyond the finance function.

For purposes of illustration, let's follow a finance manager building a business case to upgrade his company's planning process. He starts with the current state section, describing what planning is currently like, prior to making any improvement. Some people shortchange this activity and simply write up their own opinion. That's a mistake. Use this as an opportunity to interview senior management and end users. Talking with other people is key to building organizational buy-in and commitment, and it will pay enormous dividends when you come back to ask for money for your project. One way to solicit feedback from a lot of people is through a short survey. For comparative purposes, you're better off using a standard survey that matches established benchmarking data so that you can see how your company stacks up against other organizations.

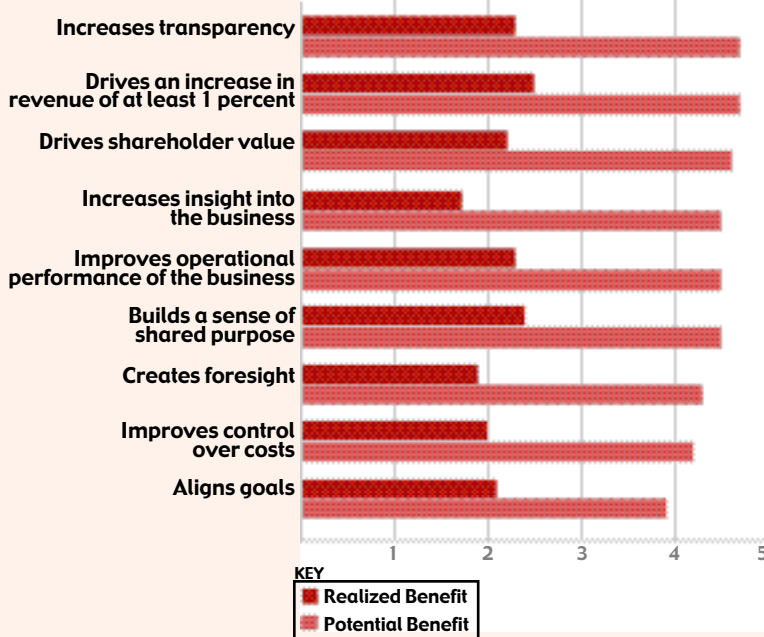
So, what do employees and executives like — and what don't they like — about the current process? In our example, the project leader finds

general agreement that the planning process takes too long, decision-making is very slow, and the planning process doesn't often lead to good decisions. Finance personnel spend most of their time crunching data while they should be (and want to be) providing decision support. Developing the annual plan and monthly forecasts takes way too long, so the company can't quickly react when an important variable, like pricing, changes. Finally, the current planning process fails to align the goals of the organization, creating competing goals instead. Our finance manager summarizes these findings and more like them in the first section of his business case.

Exhibit 2

Results of a Gap Analysis

How one company's survey respondents rated, on a scale of 1 to 5, the capability of their current planning process to deliver value, versus the potential value of a highly effective process.



include potential benefits can prove effective. Plus, if you work for a larger company, your senior management is probably accustomed to seeing a cost-benefit-based ROI, and you'll appear unprepared if you haven't done the legwork. Finally, if the benefits expected are large and material, including them in your presentation can only bolster your case. Still, even an accurate cost-benefit analysis may not be compelling enough to sway decision-makers. Senior executives may see the analysis as dry and unconvincing simply because it doesn't speak to their concerns or goals. Sometimes to ensure that your proposal gets the attention it deserves, you must make an even greater level of commitment.

Next he looks at the scope of the improvement effort. The scope needs to include all important areas identified by management during the interview process and any areas in which benchmarking identifies material performance gaps. In our example, the scope extends a bit beyond the strict boundaries of planning and budgeting into management reporting. (After all, why bother to plan something if you can't track its progress?)

The business case's next question is perhaps the most important: What business results are we hoping to achieve through this project? To answer this question, our finance manager needs only to revisit the findings from his interviews and company survey. He decides change efforts should reduce the length of the decision-making process, improve decision quality, increase finance's role in decision support, shorten the time needed to produce plans and forecasts, develop the capability to revise forecasts quickly, and align goals throughout the organization.

What's all this improvement worth? While faster, better-quality decision-making and the ability to turn around a driver-based forecast on a dime are admirable aims, their value to the organization is not easy to quantify, at least not with any precision. The project team in our example decides to bundle these benefits, estimating that the company should realize a revenue increase of at least 1 percent from the combination of all of their project's decision support improvements. If their company's sales averages \$100 million a year, they can expect to bring in an additional \$1 million annually. Coming up with the revenue improvement estimate requires a fair amount of professional experience and judgment. Our team bases the number in large part on projected benefits of closing performance gaps between their company and national benchmarks and on the expectations of the senior management team.

Referring back to the benchmarking analysis they completed, the team also establishes a goal of reducing the cost of generating the annual plan from \$1,500 per employee to \$1,000 per employee. Because the company has 800 employees, the planning process upgrade will save \$2 million in expenses over five years.

Achieving these results will require a combination of process change and investment in new technology. The company will have to call in outside expertise to design and implement the process changes, but its major expenditure will be on software. To calculate ROI, our team combines the benefits they expect their project to achieve, subtracts out the costs, then divides the result by the costs. In this simple example, the bottom line of the business case is impressive: With total expected benefits worth \$7 million over five years and the total cost of ownership — including ongoing maintenance of the system — projected to be \$4 million over that same period, the project leader predicts that the company will see an ROI of 75 percent. (\$7 million minus \$4 million is \$3 million, divided by \$4 million equals 75 percent.)

In most circumstances, a business case should be developed for any project that will ultimately require senior management's approval. The Buttonwood Group also recommends this approach for projects that may face skeptics or be subject to much debate. In fact, because the business case approach to ROI is designed to build commitment from senior management and organization-wide support, it is worth considering for every project that needs widespread buy-in.

However, building a business case takes time, at least if it's done well. Thus, a project leader needs to decide early on whether this is the route he or she wants to take. We've seen many situations in which a project manager has concluded that the team can get away with a simple cost-savings approach, only to realize too late that senior management just isn't convinced. Trying to identify desired business results and get executives on board after a cost-savings argument has failed is an uphill climb that usually doesn't work.

What's the lesson in all of this? Plan ahead, and choose carefully which ROI approach best fits your circumstances. While a full-blown business case is an obvious first choice in many situations, don't assume that it's any more of a one-size-fits-all solution than any other option; remember the \$200 Zip drive. Know what wins over senior management in your company. That should serve as your ultimate guide to building a compelling ROI.

Exhibit 3

