

Five Principles For Creating Believable ROIs

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Contents

- **How Not To Do an ROI**
- **The Five Principles**
 1. **You Only Get What You Put In**
 2. **Benefits Are More Than Just Finding Cost Reductions**
 3. **Good Data is Important, But Don't Shortchange the Analysis**
 4. **Tell the Story**
 5. **Verify the Results**
- **Conclusion**

How Not to Do an ROI

Typical “White Paper” ROI

XYZ Company Fabulous Application Justification

COST COMPONENTS	CALCULATIONS	NOTES
a. Deployment Costs	\$500,000	Estimated, provided by vendor
b. Year 1 service and usage expenses	\$1,200,000	Estimated, provided by vendor
c. Year 1 costs	\$1,700,000	a + b
d. Year 2 service and usage expenses	\$1,250,000	Estimated, provided by vendor
e. Average hourly cost/worker	\$65	Provided by company
f. Number of workers	150	Provided by company
g. Number of hours worked per year	1920	Provided by company
h. Total hourly cost/workers per year	\$18,720,000	e x f x g
PAYBACK ANALYSIS	CALCULATIONS	NOTES
Year 1		
i. % Productivity gain per worker needed to achieve a cost payback for Year 1	9.1%	c / h
j. Minutes per hour per employee	5	i x 60
k. Minutes per day per employee	40	j x 8
Year 2		
l. % Productivity gain per worker needed to achieve a cost payback for Year 2	6.7%	d / h
m. Minutes per hour per employee	4	l x 60
n. Minutes per day per employee	32	m x 8

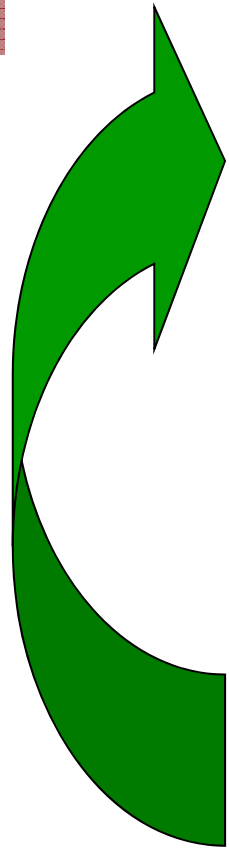
How Not to Do an ROI

- **Issue 1:** Obvious bias – it is designed to sell products not find meaningful benefits
- **Issue 2:** Focus on breakeven rather than likely benefits
- **Issue 3:** Credibility of the numbers
 - How were the estimates performed?
 - Are the costs real and complete?
 - Do I trust the assumptions?
 - Can I explain (and stand behind) the calculations to my boss?
 - Do I really believe we'll get the productivity?
- **Issue 4:** (not shown) Reliance on industry “studies”
 - How do I know if the study was valid?
 - Will it apply to my situation?

Principle 1: You Get Out Only What You Put In

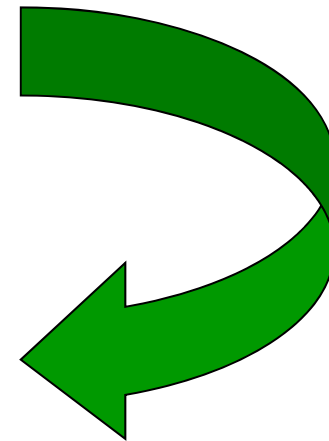
- **It's your career! Invest the time to do it right!**
 - Cutting corners means losing credibility when challenged
 - Mistakes come back to haunt you
- **Start with the right level of detail**
 - Audience
 - Size of investment
 - Complexity of the solution
- **Capture the best possible data**
 - Real numbers vs estimates
 - Historical data vs industry statistics
 - Assumptions are only as good as their source
 - Ask internal experts to supply reasonable numbers
 - Get assumptions from the people responsible for execution
 - Pilot when feasible

Principle 2: Benefits Are More Than Just Finding Cost Reductions



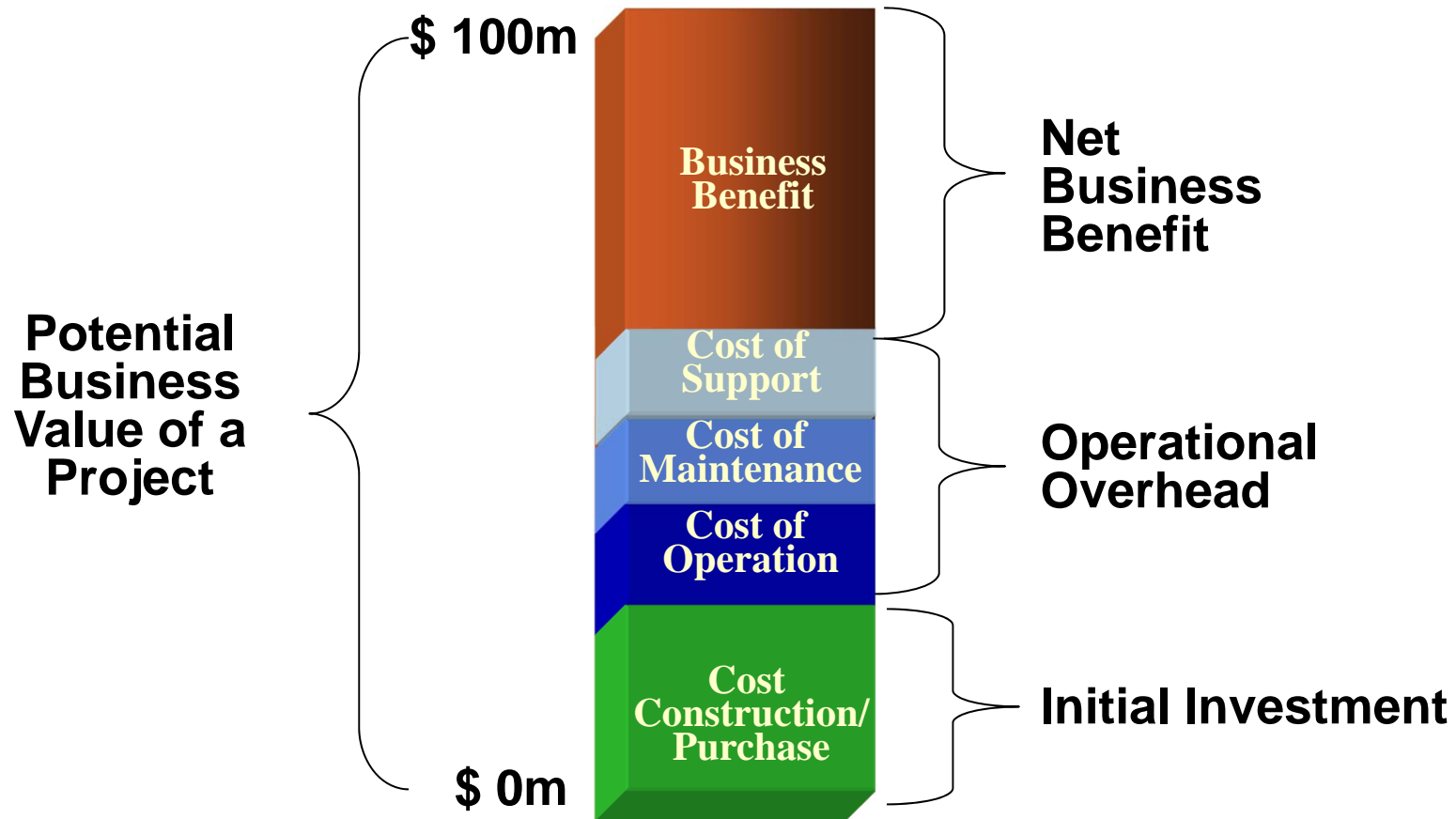
Invest in high value opportunities

- **Increase business benefit (greatest value)**
 - Optimize project to provide greater value
- **Decrease costs (usual target)**
 - Reduce support needs
 - Cut maintenance/lease costs
 - Lower operating costs
 - Reduce the initial investment
- **Find better investments**

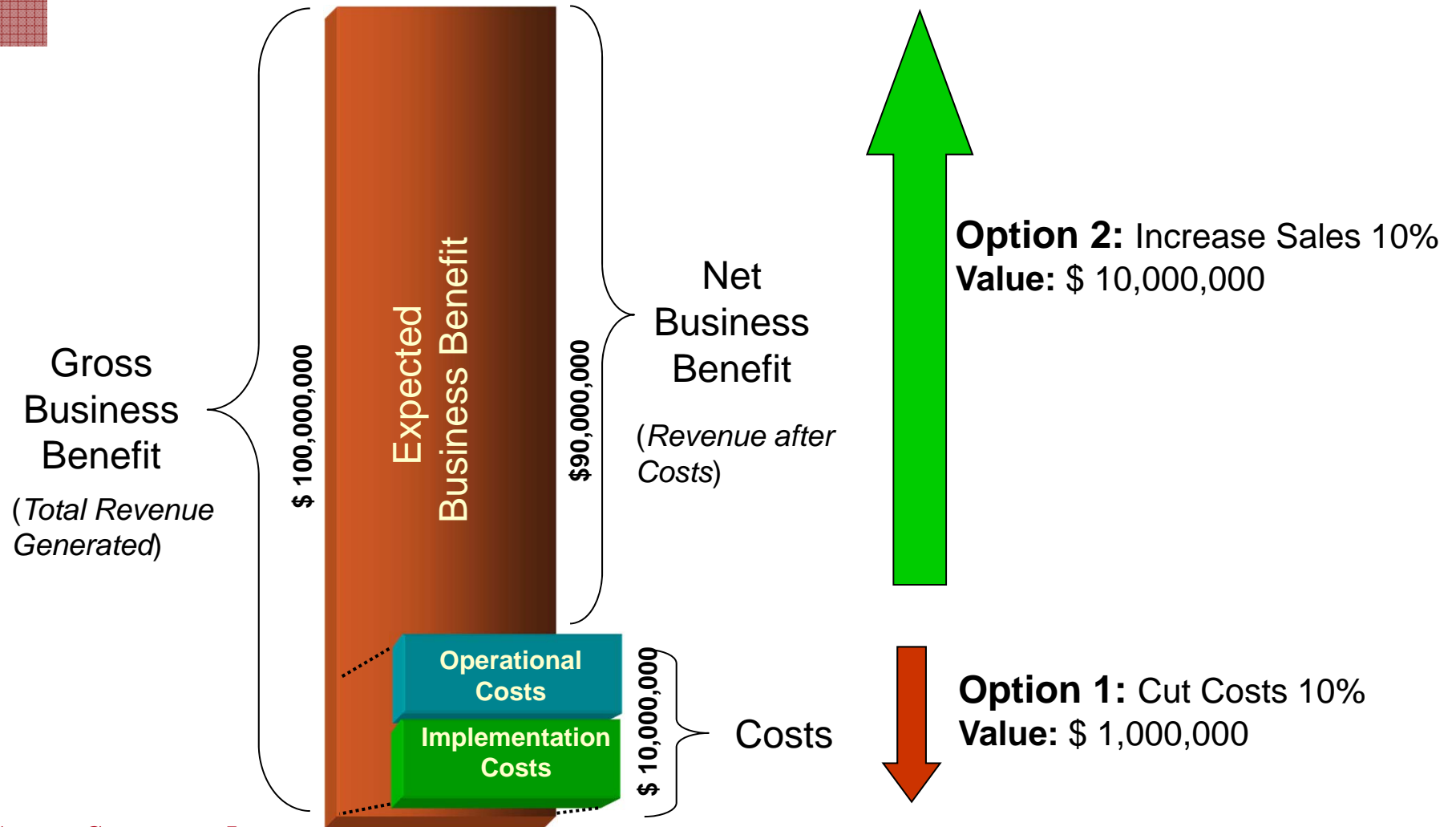


Free funds for strategic investments

Principle 2: Benefits Are More Than Just Finding Cost Reductions



Principle 2: Benefits Are More Than Just Finding Cost Reductions



Principle 2: Benefits Are More Than Just Finding Cost Reductions

Evaluating Potential Benefits

- **Substance** – Can I see and touch the results?
 - Tangible and quantifiable (ex: brings in 25 new customers)
 - Semi-tangible (ex: more attractive web site)
 - Intangible (ex: improved morale)
- **Potential** – How large is the benefit if it is fully realized?
- **Certainty** – What are the odds of actually receiving the benefit?
- **Beneficiary** – Who gets the benefits?
 - Primary benefits to the sponsors
 - “Pay off” benefits for project constituents

Principle 2: Benefits Are More Than Just Finding Cost Reductions

Example 1: Simple revenue enhancement for a software company (Assumptions)

XYZ Software		
Number of sales people	50	Source Sales VP
Quota	\$1,000,000	Sales VP
Annual Revenue	\$50,000,000	Calculated
Number of work weeks	40	Sales VP
Average sale	\$10,000	Finance
Average # of sales per rep	100	Calculated
Number of sales per rep per week	2.5	Calculated
Close ratio	10%	Sales VP
Number of calls to close annual sales	1000	Calculated
Number of calls per rep per week	25	Calculated
Number of calls per rep per day	5	Calculated

Principle 2: Benefits Are More Than Just Finding Cost Reductions

Example 1: Simple revenue enhancement for a software company (Benefit Calculation)

Benefit Calculation	Current	Opportunity
Number of calls per day	5	5.2
Close ratio	10%	10%
Value per sale	\$10,000	\$10,000
Revenue per rep	\$1,000,000	\$1,040,000
Annual revenues	\$50,000,000	\$52,000,000
Increased revenue		\$2,000,000

Potential Benefit:
Better Close Ratio

Potential Benefit:
Larger Sale

Benefit 1 : More calls

Principle 2: Benefits Are More Than Just Finding Cost Reductions

Example 2: Cost Impact of IT Portfolio Management on a 500 Server IT Organization

	Year 1	Year 2	Year 3	Year 4	Year 5	Total	Net Benefit
Current Utilization							
Number of Servers	500	575	661.25	760	875		
New Purchases	\$0	\$300,000	\$345,000	\$396,750	\$456,263	\$1,498,013	
Annual Support Cost	\$1,000,000	\$1,150,000	\$1,322,500	\$1,520,875	\$1,749,006	\$6,742,381	
						\$8,240,394	\$0
Cost Avoidance							
Number of Servers	500	500	500	500	500		
New Purchases	\$0	\$0	\$0	\$0	\$0	\$0	
Annual Support Cost	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000	\$5,000,000	
						\$5,000,000	\$3,240,394
Cost Reduction							
Number of Servers	250	288	331	380	437		
New Purchases	\$0	\$0	\$0	\$0	\$0	\$0	
Annual Support Cost	\$500,000	\$576,000	\$662,000	\$760,000	\$874,000	\$3,372,000	
						\$3,372,000	\$4,868,394

Assumptions

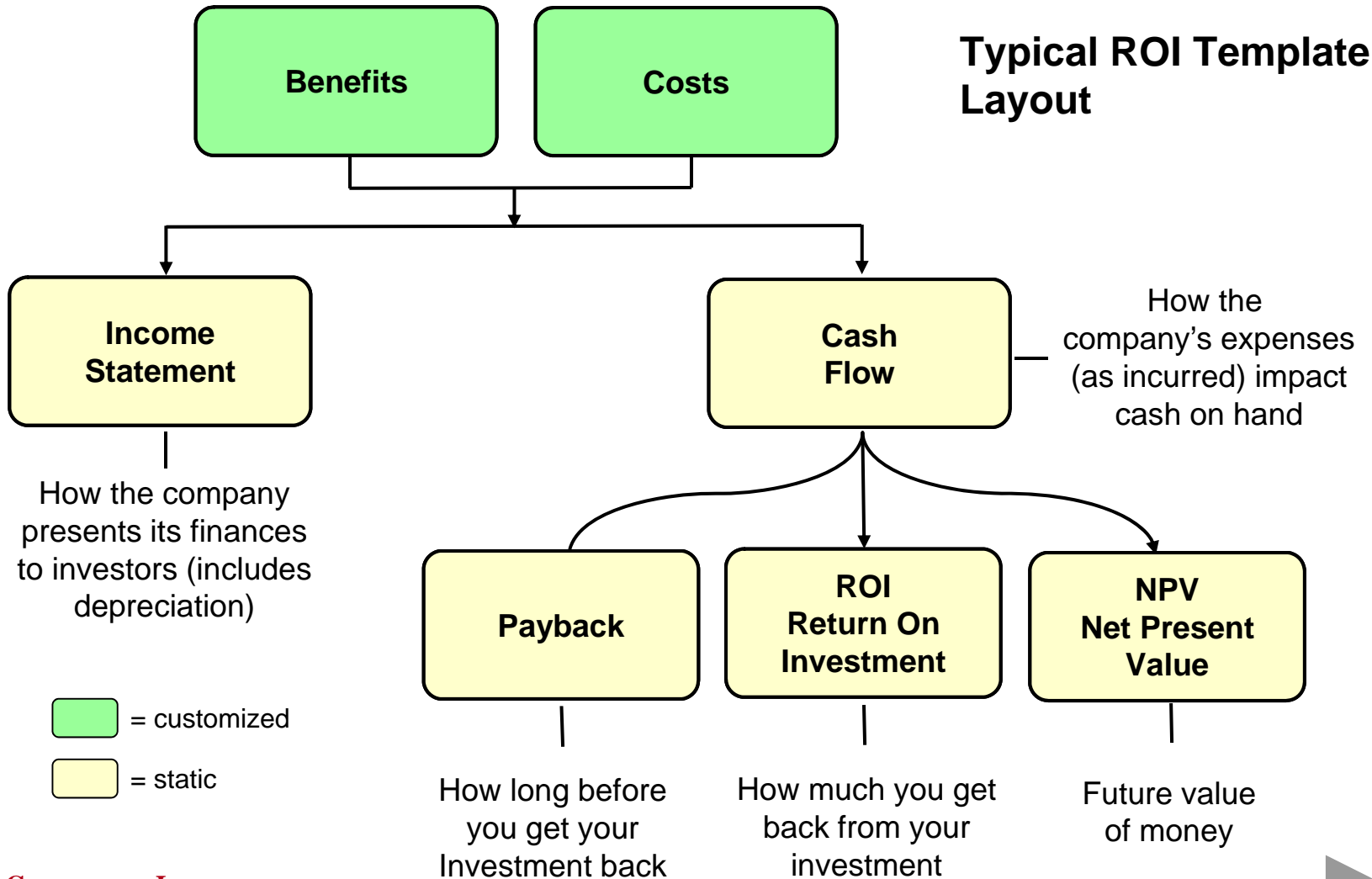
Annual Growth Rate	15%
Server Purchase Cost	\$4,000
Annual Support	\$2,000
Current Utilization	20%
Projected Utilization	40%

“Intel servers running at 10 to 15% utilization are common” - Gartner

Principle 3: Good Data is Important, But Don't Shortchange the Analysis

- **Good data is an essential foundation**
 - If the data is weak, nothing will save the ROI
 - But analysis translates data into executive information
- **Excel Templates and ROI tools can help**
 - Avoid simplistic vendor-provided templates
 - Use internal ROI templates if available (check with finance)
 - But templates can't do everything...
- **Some math and statistics knowledge is required**
 - Don't avoid important analysis due to math phobia
 - Calculators and worksheet functions eliminate the need to know formula details
 - Focus on the whys – the purpose of each technique

Principle 3: Good Data is Important, But Don't Shortchange the Analysis



Benefits

Benefits Input

	2004	2005	2006	2007	2008
Increased revenues	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000
Benefit 2	\$ -	\$ -	\$ -	\$ -	\$ -
Benefit 3	\$ -	\$ -	\$ -	\$ -	\$ -
Total	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000

Other Tags

Year 1	2004	(replace x with actual year, ex. 2003)
Year 2	2005	
Year 3	2006	
Year 4	2007	
Year 5	2008	

Costs (1)

General Cost Parameters

Sizing Parameters	
Number of Users	50
Extra Units	5

Activation Fees	
One Time Activation Fee	\$0
Total Activation Fees	\$0

Airtime	
Monthly Airtime per Unit	\$85.00
Annual Airtime Costs	\$56,100

Tax Rate	23%
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Vendor Cost Parameters

Hardware Costs	
Cost per Unit	\$399
Total Hardware Costs	\$21,945

Software Costs	
One-Time Charges	\$50,000
Annual Maintenance %	15%
Annual Maintenance Fee	\$7,500
Monthly License per Unit	\$25.00
Discount	\$0.00
Annual License Fees	\$16,500
Annual Software Cost	\$24,000

Consulting	
Application Customization	\$150,000
Application Integration	\$0
?	
?	
?	
?	
Deployment Support	\$0
Training Support	\$0
Total Consulting	\$150,000

Costs (2)

Internal Cost Parameters

One Time Costs	
Project Management	\$40,000
Development and Integration	
Process Analysis & Design	\$0
Application Integration	\$0
Documentation	\$0
Deployment Costs	
Communications	\$0
Consulting Support	\$0
Training - Trainers & Development	\$0
Training - Users	\$20,000
Travel	\$0
Total Deployment Costs	\$60,000

Recurring Costs	
User Support	\$20,000
Training/Communication	\$0
Recurring User Support Costs	\$20,000
IT Application Support	\$0

Miscellaneous Costs	
?	\$0
?	\$0
Total Miscellaneous Costs	\$0

Document Assumptions!

Example:

(assumes a project manager
6 months @ \$ 80k)

(assumes a user support specialist
1/4 time @ \$ 80k)

Income Statement

Project Income Statement

	2004	2005	2006	2007	2008	Total
Benefits						
Increased revenues	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	10,000,000
Benefit 2	0	0	0	0	0	0
Benefit 3	0	0	0	0	0	0
Total Benefits	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	10,000,000
Expenses						
System Depreciation	56,389	56,389	56,389	56,389	56,389	281,945
Maintenance Contracts/Fees	24,000	24,000	24,000	24,000	24,000	120,000
Service Charges - Airtime	56,100	56,100	56,100	56,100	56,100	280,500
User Support	20,000	20,000	20,000	20,000	20,000	100,000
Application Support	0	0	0	0	0	0
Miscellaneous	0	0	0	0	0	0
Total Expenses	156,489	156,489	156,489	156,489	156,489	782,445
Income						
Pre-Tax	1,843,511	1,843,511	1,843,511	1,843,511	1,843,511	9,217,555
Income Tax (23%)	424,008	424,008	424,008	424,008	424,008	2,120,038
Net Income	1,419,503	1,419,503	1,419,503	1,419,503	1,419,503	7,097,517

Cash Flow

Project Cash Flow

	Initial Investment	2004	2005	2006	2007	2008	Total
Benefits							
Increased revenues		2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	10,000,000
Benefit 2		0	0	0	0	0	0
Benefit 3		0	0	0	0	0	0
Total Benefits		2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	10,000,000
Expenses							
External Costs							
Hardware Purchase	(21,945)						(21,945)
Software Purchase	(50,000)						(50,000)
Development Consulting	(150,000)						(150,000)
Deployment	(60,000)						(60,000)
Maintenance Contracts/fees		(24,000)	(24,000)	(24,000)	(24,000)	(24,000)	(120,000)
Service Charges	0	(56,100)	(56,100)	(56,100)	(56,100)	(56,100)	(280,500)
User Support		(20,000)	(20,000)	(20,000)	(20,000)	(20,000)	(100,000)
Application Support		0	0	0	0	0	0
Miscellaneous		0	0	0	0	0	0
Income Tax (23%)		(424,008)	(424,008)	(424,008)	(424,008)	(424,008)	(2,120,038)
Total Expenses	(281,945)	(524,108)	(524,108)	(524,108)	(524,108)	(524,108)	(2,902,483)
Net Cash Flow	(281,945)	1,475,892	1,475,892	1,475,892	1,475,892	1,475,892	7,097,517

Payback

Project Payback Period

	Initial Investment	2004	2005	2006	2007	2008
Initial Cash Outflow	281,945	0	0	0	0	0
Net Cash Savings		1,475,892	1,475,892	1,475,892	1,475,892	1,475,892
Payback Period	0.191 Years					



Net Present Value (NPV)

Net Present Value

	Initial Investment	2004	2005	2006	2007	2008	Total
Net Cash Flow	(281,945)	1,475,892	1,475,892	1,475,892	1,475,892	1,475,892	7,097,517
Net Present Value of Cash Flow	(281,945)	1,261,447	1,078,159	921,504	787,610	673,171	4,439,946

Discount Rate 17.0%



Return on Investment (ROI)

Project Return on Investment

Annual Cash Benefit (5 year Average)	\$ 1,475,892
Capital Investment	\$ 281,945
Average Return on Investment	523%



Principle 4: Tell The Story

- **Projects are not chosen by spreadsheets alone**
 - ROI spreadsheets tell only the financial side of the story
 - Sell sizzle backed by credible numbers
 - Watch out for peripheral players!
- **Build a story around the investment and its benefits**
 - Create a vision of the solution in operation
 - Be sure to emphasize tangible and intangible benefits by constituent – show how the constituent gets the benefit!
- **Use a live spreadsheet when presenting the ROI**
 - Review the assumptions with the individuals who provided them
 - Review the calculations, get buy-in step-by-step
 - Be willing to make adjustments
- **Practice handling objections**

Principle 5: Verify Results

- **ROIs are rarely revisited after the fact**
 - Fear that results weren't actually achieved
 - Laziness
- **Verification provides valuable benefits**
 - A chance to identify and correct project issues
 - Important source of data for future analyses
 - Verifies if assumptions were correct in practice
 - Builds credibility for future projects
 - An opportunity for continuous improvement
- **Ease verification**
 - By incorporating data collection mechanisms in project implementation
 - Tracking ROIs and results through a PMO

In Conclusion

- **ROIs don't have to inspire fear and loathing**
 - Avoid math phobia with knowledge and templates
 - Careful preparation avoids objections
 - A well-prepared ROI is a valuable project tool rather than an exercise in drudgery
- **Do:**
 - Adjust the analysis to fit the project and audience
 - Look for non-cost benefits
 - Use finance-approved templates where feasible
 - Tell a compelling story in reports and presentations
 - Verify results so everyone will see how you got it right!



Thank You!

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