

Tying IT Expenditures to Business Value Delivered

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Is there an effective approach for measuring the business value delivered from various IT investments?

- Finding a means to tie IT expenditures to business value delivered frees IT from relentless pressure to focus on cost cutting
- Purely cost-focused management approaches motivate ineffective behaviors and miss valuable business opportunities
- Assessing business value delivered requires a before and after analysis of the business processes affected by an IT project
- There are no simple formulas that work across the board for all business value calculations, but almost any situation can be handled on a custom basis
- The combination of accurate cost and benefit information enables ROI-based IT investment decisions

Finding a way to tie IT expenditures to the business value they provide has long been a “holy grail” for senior executives. It is an issue pursued from two distinctly different viewpoints. Especially in tight economies, CEOs and CFOs suspect that they are spending too much on IT for the value they receive and seek ways to bring spending into alignment with that perceived value. Not surprisingly, CIOs and other IT executives often believe that IT is under-funded for the value it delivers. As always, reality lies somewhere between these opposing viewpoints, but finding it has proven to be very difficult. A major stumbling block is the inability to meaningfully measure IT’s contribution to the prosperity of the business it supports. Conversely, costs are easy to capture, providing a convenient fallback for measuring IT performance, but bearing no relationship to the results driven by IT expenditures.

The Cost Measurement Trap

Focusing on cost without offsetting benefit measures motivates a single behavior – driving those costs down. Common high-level IT measures such as IT expenditures as a percentage of company revenue and IT cost per unit of product produced seem superficially valuable, but fall within this trap. For example, company may spend 2% of its \$ 200 million of revenue on IT. Driving IT costs down to 1.5% of revenue improves that metric and generates savings of \$ 1 million in IT costs per year. But adding another \$2 million to the IT budget may allow the development and continuing support of an entirely new online sales channel that generates an additional \$ 20 million/year in revenue. In this case, IT expenditures have risen to 2.7% of total revenues (\$6 million/\$220 million) and perhaps even exceed the averages for the company’s industry, but the results are clearly beneficial.

The Challenge of Assessing Benefits

While costs are easy to track, measuring tangible benefits takes considerable effort. Unlike costs, there are no standard formulas for capturing benefits. Each process has its own unique benefits and each benefit identified is likely to require its own custom method of measurement. Unfortunately, the best and largest benefits are often the ones that are the hardest to measure. As a back office operation in most companies, IT tends to be several layers removed from the business outcomes enabled by its services. For example, IT may implement a new customer relationship management (CRM) application to enable the company's marketing and sales organizations to better serve their customer base. Presumably, the end result is happier customers who buy more products from the company, however, there are likely to be many steps and variables between the CRM system and this end result. Moreover, when revenues increase, was the major driver the CRM system, a marketing program enabled by that system or the newly hired vice president of sales and marketing?

Measuring the Value Chain

If the company's sales and marketing processes are carefully documented, measured and managed by their respective organizations, the questions posed above can probably be answered and a fair share of the benefit can be apportioned to the new CRM system. Although business process management is rapidly gaining favor, it is likely that most corporate processes remain undocumented and unmeasured. While documenting internal business processes is ultimately the responsibility of the business areas owning and using those processes, IT has a vested interest in supporting and even assisting in the documentation effort. Ideally, a business process would be fully documented and measured before making any large IT investments in that process. Creating an "as is" map to document the process's current state before implementing a new IT system, enables the business area and IT to better predict benefits and establish a baseline from which to measure those benefits. In the case of the example CRM system, the analysis may determine a per customer value based on current purchasing trends. The goal of the CRM system and the activities it enables may be to increase that per customer value by a given percentage. The change in this value can be measured after the system is in operation, and can also be translated into a direct revenue value for the company.

Improving ROI

Capturing tangible benefits along with costs enables IT organizations to evaluate their expenditures through return on investment (RIO) analyses. These analyses are not only important for justifying new projects, but should be regularly updated on existing efforts to see if those efforts merit continued investment. In the ideal case, an IT organization could roll-up the ROI produced from all of its efforts into an organizational ROI. Making IT funding decisions would be much easier if a company's CEO and CFO knew for instance, that each dollar invested in IT produced an average return of 17%. Similar to managing any other investment portfolio, overall IT ROI could be improved by shifting funds from lower performing assets and activities to higher performing ones. This theory

is the basis for increasing interest in both application portfolio management and project portfolio management efforts. These approaches seek to direct budgets to (or from) business applications and IT projects, respectively, based on their business value contribution.

Action Items

- Understand that accurately assessing business value from IT investments may take considerable effort, particularly in the early stages of implementation.
- Avoid the temptation to accept the easiest to measure business benefits. These benefits are likely to be cost-focused and not truly tied to the greatest value generated by the investment.
- Start by documenting a key business process that is under consideration for an IT project. Note the steps in the process, types of deliverables being created and passed, and the methods used to assess the success of each step and the process overall. Document a baseline level of performance for this process and its current level of business value delivered.
- For each documented process, determine which process deliverables are affected by the IT system or activity, the level of that effect and the value of the effect per deliverable.
- Combine cost and benefit data to create formal ROI analyses to better target IT investments.

About Clarity Consulting, Inc.

Clarity Consulting is a management consulting firm specializing in Information Technology strategies and emerging trends in areas such as outsourcing, process redesign, efficiency enhancement, productivity and service level metrics, service offering development, and IT product and service positioning..

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