SOCIETY OF ACTUARIES

Article from:

Independent Consutltant

November 2008 – Issue 22

Newsletter of the Entrepreneurial Actuaries Section Issue No. 22, November 2008 | Published in Schaumburg, IL. by the Society of Actuaries

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Why IT ROI Needs to Be Rethought

by Stephen E. Lipka

In the world of information technology (IT), return on investment (ROI) is king. But should it be? How many approved IT projects have you seen with projected returns that—in spite of the vetted calculations—you just didn't believe? And how many projects, rejected because ROI couldn't be calculated or proven, would have turned your company into a well-oiled machine? ROI can be a great tool, but it's not the only mechanism for judging value. You may be using the wrong tool—like using a chisel instead of a screwdriver. Let's look at some situations that arise when managing IT and see how well ROI works in each instance.

The Broad View of IT Value

"Information technology"—both the technology itself and the department or team organized to apply it—is a means to achieve business objectives. Its value is derived from how well it achieves this objective. So, how is value achieved? As we'll see, ROI is not a direct predictor of value.

- The company sets its business objectives (e.g., expand business to two new continents).
- IT sets its own objectives consistent with its mission and with the business objectives (e.g., increase international usability of applications).
- IT designs its projects and services with the intent of achieving its objectives (e.g., three proposed projects for language extension, geographic address localization and mapping).
- The outcome is changed operations and the concomitant benefits.
- The changed operations drive achievement of the business objectives and the IT objectives.

Achieving business objectives is a long-term matter if they've been set appropriately, and continuous progress towards the objectives often takes the cumulative effect of many projects.

Where is ROI in this picture? If it exists at all, it's in a project. (It may not exist for some projects, such as foundation infrastructure or technology platform work, for example.)

So what's the value of IT? It's in the achievement of its own financial and customer benefit objectives (increased usability and use in foreign countries, in this example), and it's in the indirect achievement of the business objectives

- Assembling a "virtual firm,"
- Structuring your deal with partners,
- Managing intellectual property,
- Independent contractors vs. employees, and
- Taking a minority interest in a business.

Find more information here on the SOA Website.

Ruth Ann Woodley, Editor
ph: 860.651.6236
ruthann@ruarkonline.com

SOA Staff:
Meg Weber, Staff Partner
ph: 847.706.9585
mweber@soa.org

(increased international revenue). It's not in the ROI calculation of any one project (e.g., extend applications to Spanish).

ROI may be illustrative, but it's not a measure of IT value.

Making Project Choices
There are always more projects than there is budget flexibility, so how does an organization choose? The snap answer is "pick the projects with the highest ROI for the money" … but not so fast! Would you choose to build and support what you thought was a killer iPhone application, potentially a lucrative business, if your company only offered outsourced support services? Probably not. You first must have real alignment with your strategic objectives. Would you choose a project, all other things being equal, if another project delivered results *faster*? Would you choose a project, all other things being equal, if another project could drive achievement of two strategic objectives, not just one? Again, probably not.

On the other hand, would you settle on a project that had no ROI but allowed you to pass your Sarbanes-Oxley audit? Would you pick a project that yielded no new revenue, but prevented loss of revenue to a competitor? Would you pick a business-continuity project if no such plans were in place, even though you may never get any benefit from it? Probably yes for all, because the business impact is potentially significant.

Good governance suggests that there be a sensible, understood and predictable scheme for choosing projects. This requires a scoring scheme agreed to by all who have a say in the work of IT. The scheme can have any number of factors —ROI/impact, number of objectives served, time to impact, etc. Pick your factors and the weighting of each. Certainly ROI fits into the scoring scheme, but it's not the only factor.

Judging Project ROI
One way to balance your portfolio of projects and services is to classify them by whether they're about *running the business, transforming the business or growing the business*. The ROI calculations are different, and each has a differing level of credibility.

Running the business includes all IT activities that support day-to-day operations of the business and all IT improvements that fit neither of the other two categories.

Projects in this group are often motivated by cost savings or compliance. For the latter, there is no ROI calculation or it's the potential cost of not doing the project. Cost savings calculations are usually straightforward—you can compare the projected cost reduction with the amortized investment. Examples include hosting or server consolidation, outsourcing support or replacing printed invoices with e-mailed invoices. The "optimism" of each assumption, in the author's experience, is easily judged, largely because the facts are available (assuming vendor proposals are credible). But, as car manufacturers caution about EPA estimates, "Your mileage may vary."

Growing the business includes work focused on increasing revenue, fueling organic growth, increasing demand or supporting a new line of business.

Jacque Kirkwood, Staff Editor
ph: 847.706.3572
jkirkwood@soa.org

Sue Martz, Section Specialist
ph: 847.706.3558
smartz@soa.org

Here, you can compare the projected revenue growth with the amortized investment. Examples include building an e-commerce channel to supplement the sales force, building a new e-commerce site in another language to capture another market or offering a new low-cost self-service plan. But how do you project revenue growth? In the author's experience, some of these projections are wildly optimistic. To be credible, these ROI projections must be vetted by an experienced and knowledgeable group and may require some market research or research into past industry experience with similar work. There may be fewer facts on which to base the proposed benefits.

Transforming the business includes work that transforms the way the company does business through faster or less work-intensive business processes or work that supports new business models.

Projects in this group are motivated by the belief that IT can be an innovative and disruptive force, driving business to change for the better. Often, these projects drive business process changes. Frankly, who knows the outcome with certainty? Customer relationship management (CRM) is a perfect example. How can you calculate the benefits of knowing your customers better or of the personalized touch you can now offer them? How can you calculate the benefits of management's increased ability to understand in near real time whether that new value proposition is failing and succeeding?

Because transformations almost always have unintended consequences—good and bad—it's impossible to predict all the outcomes. Additional examples illustrate this:

- A change in process and its supporting system seeks to reduce processing cost and "red tape." It may happen to increase customer satisfaction enough to increase revenue.
- A contracts workflow system can be motivated by the desire to reduce physical paperwork and eliminate mailroom delays. What happens when parties in the workflow realize that their decisions and rationale can be more easily scrutinized than before, when it was all buried in paper? Will they take more time?
- An integrated CRM-finance system is motivated by the desire to speed the order process and put in place the infrastructure needed for significant growth. What happens when management visibility ends excessive discounts the sales reps have been giving to make the quarterly numbers? Will revenues drop due to loss in unit volume, or will revenues increase over time due to less discounting, with a side benefit of leveling peaks and valleys?

In summary, ROI projections can be highly credible for *run the business* IT projects. They will be less so for *grow the business* projects. ROI calculations can be illustrative examples for various scenarios in transformation projects, but they're not definitive.

It's That Vision Thing
Vision is the ability to see possibilities—possibilities far in the future, or possibilities arising from proper alignment of strategy, resources and external forces. Vision requires a holistic view, taking into consideration all the "moving

parts," all the effects the parts and forces have on each other and all the delayed and indirect effects involved. Vision requires intuition, and visionaries often go on faith—faith that even though they can't necessarily quantify the enabling mechanics and the outcomes, the result will be great.

Calculating the expected ROI requires a different kind of thinking. It requires choosing and quantifying a manageable number of variables and assumptions. It requires quantifying the relationships and validating the computations based on experience and research.

ROI analyses can only be developed when there are a limited number of assumptions, variables and relationships, lest they become unwieldy or they grow beyond comprehension. And bullet-proof analyses become exponentially difficult and expensive as the assumptions, variables and relationships grow in number, by virtue of the research and experience needed to validate them.

Broad visions have too many unprovable calculations to be judged by ROI analysis. So take bold steps based on broad visions. Building a bulletproof case may kill your vision or your market leadership.

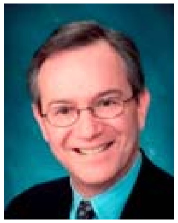
Perception of You as a Technology Leader
The arguments for or against a project can be qualitative, quantitative, subjective or objective. But because ROI is a hard-number calculation (veracity aside) it carries more weight in the minds of many who may comment on your successes and failures. So, what can happen if you take a contrarian position? The table below suggests perceptions.

	Project Outcome	
	Beneficial Results	No Benefits
Favorable ROI Projections	Confirmed expectations	You may not be thinking critically or executing well
Unfavorable ROI Projections or No Calculation	You're a visionary!	What were you thinking?

Failure of a project to deliver value is never good, but if you believed the failed project would succeed in spite of an unfavorable ROI projection, your peers and your boss will wonder what you were thinking. But if it brings benefits in spite of expectations, you're a visionary!

If there's a steering committee on which you only have one vote, it's more complicated.

There are cases where ROI can be a valid and valuable tool for assessing the value of a project. But it's not the only measure by which to score the value of a project, and it's not a measure of IT's value to the organization. Beware of the use of ROI as the primary criterion for IT work.

*Stephen Lipka, PhD, CMC, is a principal of Avatar Strategic Partners, where he guides clients to higher profits through better use of information technology. His career spans 33 years in management, consulting and product development. Steve received his PhD in Computer Science at SUNY Stony Brook. He is a certified management consultant (CMC), a designation held by only 1 percent of U.S. management consultants. He can be reached at* slipka@AvatarSP.com.

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475 North Martingale Road, Suite 600 • Schaumburg, Illinois 60173
Phone: 847-706-3500 • Fax: 847-706-3599 • www.soa.org