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**Delivering a Return
on IT Investment**

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Introduction

As technology has become more sophisticated and is increasingly widely used across the whole of a business it has become more and more important for businesses to achieve a return on IT investment.

In the early days of computerisation when accounting and administration were being computerised you didn't need to do a calculation to see that using computers would save you a significant amount of time.

Today, with IT impacting on almost every aspect of business there are numerous IT choices available and many of the "easy wins" of computerisation have already been obtained. The choices now are about much less "clear cut" investments where the business issues and the interaction of people and IT is far more sophisticated.

You could be forgiven for thinking that now is perhaps not the time to be investing in IT. However IT is impacting not just on administration but also critically on key areas such as customer service, marketing, and the Internet.

It can be difficult for a business to distinguish between the relative merits of various IT spending options since many of the benefits are intangible, but now may actually be the right time to invest to gain competitive advantage.

For many businesses IT expenditure is significant and there are a number of research studies which suggest that we don't always get the return on investment that we should.

In addition, when IT cost benchmarking studies are undertaken across companies of a similar size in the same industry it is sometimes found that the highest IT spenders can be spending 2 and even 3 times more than the lowest IT spenders. Furthermore, the highest spenders in these studies are often the least profitable! Hence it is important to:

- calculate the return on investment
- then plan to achieve the return
- and finally monitor progress to ensure you actually achieve the return.

Whilst businesses really should calculate the return on investment it is often just too difficult to do especially for small and medium sized businesses. The "calculation" that many businesses carry out is a "gut feeling" or an assessment of savings against current costs. For many SME's and for relatively small investments in IT this "methodology" is often the only practical option.

Where businesses fail is in the next step of "planning to achieve the return". For example, if the justification for buying some new software is that we can redeploy an administrative person to a sales role because the software makes the administration more efficient then the only way that a return on investment is going to be achieved is if that person is **actually** redeployed. If they aren't redeployed, then it doesn't matter what the return on investment calculation was, the return will not be achieved.

To help you to achieve a return on IT investment there are useful tips on how to handle IT procurement, IT support & staffing and IT training later in this guide.



So how do you calculate ROI?

Calculating the return on investment for IT projects is the same as for other investments. ROI is the net increase in gains/benefits divided by the cost of investment and expressed as a percentage. Hence the calculation is:

$$\text{ROI} = \frac{\text{Net gains / benefits}}{\text{Cost of investment}} \times 100$$

Cost of investment

The net gains/benefits are the savings and improvements relating to the investment as a result of carrying out the project. Because ROI in IT will be obtained over a number of years then ROI cannot be measured over just one year. ROI is therefore often measured over say three or five years depending upon the project.

There are a number of variants of the formula above but they effectively amount to the same calculation.

You should include all costs which are directly attributable to the project and a relevant proportion of those partially attributable to the project.



Costs to include

You need to include the following costs:

- **Hardware – include all hardware costs directly attributable to the project including the cost of maintenance.**
- **Software – include all directly attributable software costs including support costs.**
- **Staff costs – include the relevant cost of internal IT personnel.**
- **Training – include all your training costs and associated expenses.**

Other costs – include other costs which arise because of the investment such as consultants fees for example.

Net gains/benefits to include

Certain benefits are easy to measure because they are tangible. For example, staff cost savings through more efficient order entry or through eliminating duplicated work in re-keying data into spreadsheets. Of course where the re-keying is with one person then it is easy to make the saving but when you calculate that one man day per day is spent re-keying data across the business it is not so easy to actually make the saving since it is spread across many people. Other items which are relatively easy to measure include the gains from reduced internal and external IT costs - for example as a result of replacing legacy systems.

There are also the intangible benefits such as increased customer satisfaction, reduced delivery times or indirect benefits such as the increase in spend per customer as a result of having a feature in the software which reminds sales people that as a customer buys a product they can also offer a complementary product. However it is difficult to be sure how much is attributable to the project since how do you know the customer wasn't going to buy the complementary product anyway?

The way to resolve this is to make estimates of the cost savings and to be as prudent and practical as possible. Remember that because the calculation includes estimates then it can only ever be a guide to help you make your decision. Different people in an organisation will place different values on the estimate of benefits and often this is done with the required bias to prove or disprove the theory that the IT investment in question is good or bad dependent upon each individual's "gut feeling".

Using an ROI calculation is not without flaws since as we have seen there are too many estimates required. In addition, ROI takes no account of the risk of the investment and depending upon how many years you calculate it over you will get a different answer. Other measures which are used include payback period – the time taken for the investment to "pay for itself", discounted cash flow (DCF), net present value (NPV) and total cost of ownership (TCO). Each has its advantages and disadvantages but the key thing to remember is that when we look at return on IT investments we are in effect trying to predict the future which means that we have to use estimates and judgement. Hence, once we have done our calculations, used our judgement and made the investment the key thing to do is to plan to obtain the returns you set out to achieve.

And finally, you must also consider what other factors might impact upon the success of the project and hence the return on investment. For example, if you are using a third party supplier you need to ensure you choose the right supplier and undertake a thorough due diligence check, not just on the products but also on the supplier. Ask yourself whether you have the necessary skills and time within your organisation to carry out the IT project. If you haven't, then get some help from an external consultant. You should also consider the culture of your organisation since it is important not to make too big a change in IT in one go since your staff may find it difficult.



What to do once you have done the ROI calculation

Whereas in the early days of computerisation there was almost no need to do an ROI calculation, today the tendency for too many companies is to carry out the calculation, get it approved at board level, start the project and then proceed to completely ignore the ROI justification! Of course if you ignore the ROI calculation then it is very unlikely that you will get the return you thought you were going to achieve.



“Plan to achieve”

Once you are satisfied that you are ready to go ahead with the investment, the key to delivering your return is to go through the ROI justification and break the project down into targets/ achievements and then set milestone dates for each one. So if you plan to make labour savings then make sure you put them into the timetable, describing exactly what they are and then make sure that they actually happen. You need to regularly monitor progress towards achieving the targets and therefore your planned ROI. Monitoring the progress to your targets needs to be done at a senior management level and must also be reported to the board of directors on a regular basis.

There is a lot of truth in the view that once you have decided you will go ahead with the investment and negotiated the price to a satisfactory level then “it’s not what you paid for your IT which is important it’s what you do with it once you have got it”.

To show how a lack of “planning to achieve” can affect ROI, there are cases where a business buys software which includes functionality the business never gets round to implementing. Five years later and after a number of staff changes everyone has forgotten about the functionality so it never gets implemented. In some cases the scenario gets even worse because the company then buys some more software because they think the existing software doesn’t have the required functionality even though it does!

Some practical tips to help you achieve a return on investment

If you are going to get a return on investment you need to ensure you have a good approach to IT in the areas of:

- IT procurement
- IT support and staffing
- IT training

With IT procurement you should:

- Ensure your IT decisions are based upon the targets in your business plan.
- Consider having a zero IT budget and only buy what you need when you need it and with management approval
- Accept that you need to look at processes and procedures before investing in new software - you may be able to do things differently and better. Your current software may have led to inefficient working practices, so don't be tempted to require the new software to work in the same way as you do now.
- Ensure you have an appropriate level of integration between your systems. If you have disparate software packages are they costing a lot of money each year to integrate?
- Choose an appropriate replacement cycle for hardware.
- Be prepared to accept that sometimes you have made the wrong decisions with IT. Sometimes it can be more costly to continue to follow past decisions and choices than to replace the systems with what you really need.
- Employ IT staff who also really understand business and in particular your business. This will ensure that you have a business needs focus to IT. IT staff with a pure IT background have less understanding of business and focus too much on IT without being able to relate it to your business.
- Make sure you maximise your buying power with your IT suppliers. You need to know your IT costs and review them regularly and get competitive quotes.



With IT support and staffing you should:

- Ensure you don't pay for support more than once. Some companies pay for support twice and even three times over. Firstly they pay a third party, then they are paying an IT manager who tries to solve the problem and finally their users spend too long trying to resolve problems themselves before contacting the supplier.
- Consider outsourcing as much IT support as possible as sometimes there are significant savings to be made.
- Create a culture of "balanced user self help" so that users don't ask the IT department to resolve simple IT problems such as "my computer froze". This will mean that your IT staff can get on with the work they really should be doing.



Utilise on site, "on the job training" wherever possible so that your staff are trained on what they need to know in the context in which they need to know it.

With IT training you should:

- Carry out a training needs analysis and ensure you have an appropriate training plan for each member of staff.
- Control the training program so that your staff are really taught what they need to know in the depth they need to know it. It is all too easy for trainers to spend too long on the "easy stuff" and not enough time on the more "difficult stuff" or to spend time on functionality staff members won't use.
- Utilise on site, "on the job training" wherever possible so that your staff are trained on what they need to know in the context in which they need to know it.
- Ensure training is carried out just before staff are going to use the functionality. If the gap is too long between training and use then people forget what they have been taught.
- Ensure new starters are trained adequately and remember that as staff leave a lot of knowledge about how to use the software goes with them and is not passed on to their replacements.

Summary

To help you get the most out of your investment in IT and to deliver a return on investment you need to:

- Carry out an ROI calculation but be practical about it
- Ensure you set achievement targets and also set a timetable. Remember you need to “plan to achieve” ROI.
- Ensure you monitor progress towards the targets and ensure you achieve what you set out to achieve.
- Manage your IT procurement, and once you have invested your money ensure that you manage your IT staffing and support and your IT training.



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Virtual Business Source

PO Box 501
The Nexus Building
Broadway
Letchworth Garden City
Herts SG6 9BL

T: 0800 018 0590
F: 01462 687336

Contact smordecai@virtualseource.co.uk

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