

The Trouble with ROI

By Marek Jakubik

Being a sound and widely accepted financial yardstick, ROI (return on investment) also is a strongly intuitive measure that tells us where to invest. Since the corporation's capital can be invested in a variety of ways—people, training, new products, new territories, technology, etc.—organizations rightly feel compelled to know which of the choices would give them the best return. ROI can do exactly that. Furthermore, as a financial and comparative measure, the ROI formula is simple: benefits divided by investment. No wonder, especially following an era when technology investments often were driven by buzz marketing and me-too attitudes, the solid, tangible nature of ROI attracts so many followers.

Yet many businesses find the key promises of ROI an elusive target. While the concept is widely accepted, organizations experience difficulties implementing it—especially for the larger, more complex IT projects. Moreover, many of the issues and difficulties tend to be more pronounced within small and midsize enterprises due to their limited budgets and narrow access to specialized talent.

First, let's take a look at the nature of those difficulties and the key reasons for their existence; then we can offer practical tips for working through and around those problems. We will focus on two areas where most of the hurdles exist: making ROI calculations credible and enforcing the benefits. For ROI to be an effective law, companies need a means to make it a fair, practical, and enforceable law.

1. *Credibility Threshold*

An initial step in establishing credibility is to make the initial ROI calculations objective and believable. It is here where the first cracks appear, as organizations fail to invest enough time and resources to reach the credibility threshold. Their efforts fall short for reasons that are objective (getting the right input data for large IT projects is inherently complex) and cultural (organizations lack the proper structure to produce an objective analysis).

2. *Making Things Simple Takes A Lot of Work*

Measuring ROI is no exception. ROI as a single measure is beautifully simple; however, developing it is not. The techniques applied to calculations are well understood and can be used competently by almost any accountant. However, it matters not whether a company uses the accounting rate of return (ARR), cash flow analysis, or much simpler payback period method as a measuring stick. The problem lies elsewhere. The critical and most difficult part has to do with the uncertainty of future assumptions. Inevitably, they depend on a wide array of events and trends such as global and domestic affairs, the economic environment, strategic plans of the company, and in the case of technology investment, on highly unpredictable technology change patterns. Since no single person in the company is ever knowledgeable in all these areas, the only solution is to assign a team of experts—an expensive, time-consuming obligation. Failure to make such a dedicated commitment is the first blow to the credibility of ROI analysis.

A colleague at my firm, managing director Vladimir Orovic, offers this caution: "This cannot be done on the 'back of an envelope,' as many organizations attempt. The complexity arises from the interdependency of business drivers and IT capabilities and needs that ultimately determine the ROI, and this combination is highly unique for every organization. An expert team typically might execute a two- to four-week engagement to look at the state of the business, changes driven by technology implementations, and ways to track those changes. Shortcutting this process and using rules of thumb almost always yields wrong results."

3. *Lies, Lies, and ROIs*

Concurrent with committing a skilled team to the analysis, companies must protect against inevitable competing agendas and biases. Two parties play principal roles: the Business Unit (BU), which is a

primary recipient of the investment, and the IT unit responsible for delivering and managing the solution. Such division of roles clearly delineates responsibilities for both elements of the ROI ratio: BU responsible for delivering the numerator side (benefits) and IT responsible for delivering the denominator (investment). Making such a separation of responsibilities clear is the first necessary step. The second has to do with managing the intangibles of the analysis. To avoid the highly probable skewing of the assumptions toward whatever end consciously or subconsciously fits the parties' goals, the process needs an independent arbiter. That function, in most organizations, should belong to the CFO. As a result, the three parties—CFO (arbiter), business VP (beneficiary), and CIO (supplier)—create a basic structure within which they collaborate to deliver the best possible analysis.

Now that we have resources assigned, rules defined, and accountabilities clarified, let's look at the other area of corporate governance that causes the ROI process to fail—enforcement.

4. *Swinging the ROI Stick*

Some aspects of enforcement are easy, and most CIOs know that all too well. Within three to nine months, most projects will start giving off either a fragrance of success or a stench of failure. Slipping project schedules and bulging budgets are tough to hide, especially when everyone's focus and attention still is on the project. However, since IT is responsible for the ROI denominator (in this case, cost), it is all fair game. To those CIOs who may want to debate this point, I only can offer the old adage: "Do not promise what you cannot deliver." This aspect of a corporate culture and behavior is well understood, and I see no need to elaborate. Instead, let's turn our attention to a hidden and often bigger problem that still lies in the future.

5. *The Forgotten Numerator*

This is where, over time, a large number of ROI-based decisions lose (what's left of) their credibility. The upfront commitments made by the business that defined the benefits of automation often are neither monitored, nor verified, nor enforced. The reasons are partially

objective. First, the benefits of automation have a long accrual time—little to do with technology itself, a lot to do with people's abilities to absorb the change. We tend to compound that problem by making overly optimistic ROI assumptions with respect to how quickly an organization can derive the value from an investment.

Second, passing time does make human attention wander away. Decisions made two years ago rarely retain a lot of focus. Moreover, what is there to do when one or more of the original decision-makers has left, retired, or moved on? Who is to be held accountable for the subpar results?

For a variety of reasons, one of them being lack of political clout and astuteness, it often means the CIO. Such a broken and inherently unfair process produces cynicism and negative attitudes and gives IT ROIs a bad rap. But there are ways the scenarios described here can be avoided or, at least, circumvented. Most of them are under the CIO's control.

6. *How to Protect the CIO's Neck*

1. Rely on methods and metrics that fit your company's style and capabilities. Predicting the outcomes and then translating project costs and benefits into cash outflows and inflows can be tenuous at best, and many costs and benefits are difficult to quantify. Develop a clear consensus with your executive team as to what works and what doesn't. Your CFO should be the best guide in that process. Engage him/her as much as you can.

2. Keep it simple, or alternatively, find experts to help you. The experts may live inside your company (hint: talk to Finance). If you can't find them internally, get them from the outside.

3. Insist and build consensus on basic points of process discipline. Engage the Executive and make him/ her agree maximizing returns on technology investments is a collaborative process where everyone shares risks and rewards. Insist all responsibilities be clearly defined.

4. Complement ROI with measures that demonstrate a continuity of improvements. Here are some examples.

- Employ ROA (return on assets) to

measure the company's ability to generate profits from the IT asset base. Use ROA to show you can deliver more with less.

- Measure key business transaction unit costs; an excellent metric to compare with your peers.

- At the macro level, monitor the overall productivity ratio, e.g., the revenue per employee divided by an average salary per employee—again, a very good apples-to-apples measure for comparing with your peer companies.

7. *True Value of ROI*

An IT ROI analysis never should be viewed as a numbers exercise that produces a line item on a corporate projections sheet. Its true value lies in enforcing discipline and collaboration within and between the business and IT stakeholders. Treated in such spirit and together with other "soft" metrics, it genuinely and positively can influence business' confidence in IT.

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