

Report by Simon Vail
 Illustration: PhotoDisc

Many happy returns

As ROI now figures highly in the requirements of most companies when looking at IT implementation, more advanced ways of studying the numbers when designing a business case can be invaluable

Sales people close deals by luck, a nose for a deal, and a buoyant market. But as IT sales executives have found, all three have run out in recent months. The deals are far fewer, the market is static, or at least growing only slowly, and CIOs are a lot tougher. To persuade IT buyers to part with a firm's cash, IT sales executives now need to argue a financial case and prove a return on investment (ROI).

Outsource providers have, of course, made most of their money by proving to IT directors that there is a strong financial case for running all or part of an IT operation outside the company. But the same financial arguments are now starting to filter down to any IT purchase.

Bertelsman, for instance, a European book publisher, moved its IBM 9672 mainframe-based book club software, a COBOL program capable of running the account enquires of 3.5 million customers, to a Windows-based platform because

it wanted to reduce its mainframe running costs and show a positive ROI within 18 months.

"With that customer we were able to show an increase in performance and a reduction in costs," says Richard Simpson, MicroFocus vice-president of worldwide sales. "The business case is now absolutely vital. It is much easier to win the attention of senior executives in support of your pitch for the pool of money inside a company if you can connect the business drivers of the project with the key drivers of the company itself." MicroFocus, like several other software vendors, has an ROI calculator on its Web site.

THE RIGHT ADVICE

But designing a business case is easier said than done. According to Mike Evans, senior partner with Cambashi, a Cambridge-based firm of management consultants which advises on the selling and buying of IT, not only does

every company have a different idea of what a business case should be, but financial directors have long memories.

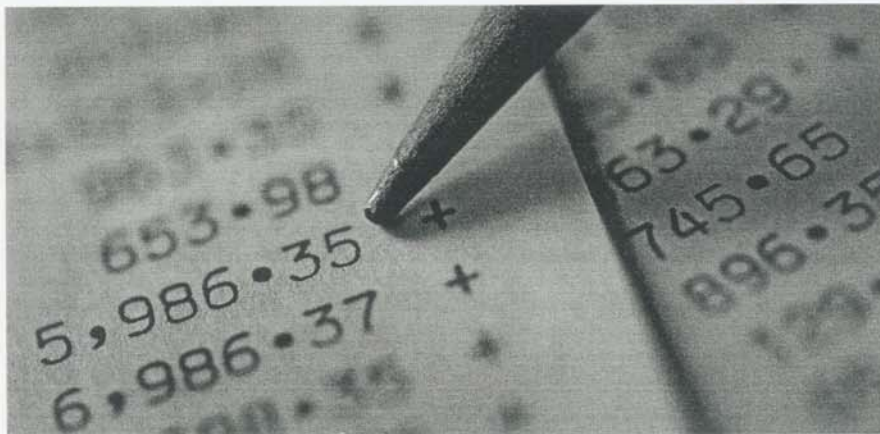
"One big problem IT people have is that they have not delivered on claims they made in the past. If an IT company says it will make a 40 per cent saving, a finance director thinks it will be quarter of that," he points out.

Finance directors will be judging IT alongside other investments that a company could make. Evans recently advised a food industry client which makes vitamins. The food company had a choice: it could invest in a CRM system that would make sales people more efficient, or it could put more controls into its factory floor and use less energy. "Oil cost \$30 a barrel when the company started thinking about this choice. As it did the business case, oil dropped to \$20 a barrel. Even so, the company decided that it would opt for energy efficiency — and is very glad it did because oil now costs \$53 a barrel."

Sales executives acknowledge that they now have to help IT buyers show the value of IT against other projects. Koen Vanpraet, European sales director of telco provider Easynet, says that vendors have used ROI justifications successfully for a long time.

He used to sell Rank Xerox copying machines for between £250,000 and £300,000; Rank Xerox had produced a standard ROI model comparing legacy offset printers against new machines. On monthly print sales, taking into account the number of users, the Xerox machines always won.

Now he sells end-to-end managed IP networks to companies around Europe, trying to negotiate deals ranging in size from €300,000 (£206,504) to €2m. Customers that are under cost pressure, such as manufacturers which are competing



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Return on investment

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Richard Simpson, MicroFocus: “The business case is now absolutely vital”



with China, want to find more efficient processes. An ROI discussion is an important part of a sale, says Vanpraet, and depends heavily on an understanding of the customer’s own internal ROI model.

“Professional telecoms sales executives should understand the customer application and the business. But they also need to know their expected growth rate, and the customer’s own internal rate of return [IRR]. Are they looking for an IRR over a short or long period? What does the customer typically do?” asks Vanpraet.

POWERS OF PERSUASION

Qualified accountant Martin Southern, an IT veteran who has held board-level positions in IT and telecoms companies, believes an understanding of ROI is a vital part of an IT sale. He is so convinced, in fact, that he has set up a company called Shark Finesse to sell his own ROI software tool — at £1,500 a licence — aimed at IT and telco sales executives.

He has already persuaded sales teams at Sage and Siemens, as well as Microsoft Business Solutions resellers, that they should take Shark Finesse with them on sales visits and persuade nervous IT directors to talk about ROI and how they are going to justify any purchase to financial directors and ultimately the boardroom.

Southern says the toughest objection IT sales executives have to overcome in the current climate is the ‘do nothing’ syndrome. Prospective IT directors appear to be excited at an IT sale — they listen to an extensive pitch on the features and benefits of a product, but in the end fail to create the purchase order because they cannot win a share of the company’s discretionary budget. Often, IT directors are arguing against

other company directors who have a better understanding of finance and know how to talk to the board.

“Sales guys still have to have the best differentiated technical solution. Sales discussions are still feature and benefit-driven. But on top of this is this ghoul: the beast that is ‘I don’t have to do anything’. You have to win the traditional sales arguments, and then the budget decision as well.”

The Shark Finesse program will present rational financial arguments for an IT sale and, claims Southern, will do it far more quickly and efficiently than the traditional alternative — the Excel spreadsheet.

PREPARE FOR BATTLE

Three of the most common financial questions asked as part of the battle to win a share of a customer’s internal budget are: what is the payback, the internal rate of return and the net present value of this IT product?

Sales executives instinctively run away from these questions, preferring to build a relationship with the buyer, using sales techniques they have learnt from the several sales courses on offer, such as Target Account Selling, Spin Selling or Bosworth Solution Selling. These techniques make little or no mention of the need for ROI, or how to create one.

“An IT sales executive should absolutely engage the buyer on these questions,” says Southern. “The buyer needs help on the justification of the business case against the enemy of ‘do nothing’. If you don’t help the buyer, the ‘do nothing’ becomes a relatively strong position, and the sale is lost.”

With payback, for instance, IT sales teams will often overlook the installation period of any potential sale. An infrastructure project might not

deliver any payback at all during the time it takes to install a network — say nine months — but a finance director will ask what is happening to the firm’s money during those nine months.

An IT director might claim that payback for a project is within 12 months. Payback is, in fact, in 21 months if the initial nine-month installation period is taken into account. A payback justification that did not make this clear would not impress a finance director.

Equally unimpressive would be an internal rate of return argument for a new IT project that failed to recognise the company’s own internal rate of return required for any investment project. These internal rates of return are often published in annual accounts.

The last of the three common ROI justifications — net present value (NPV) — projects the value of a project against future cash flows. By comparing the NPVs of several competing projects, a finance director can assess the best overall return. For instance, is an investment that brings £3m of savings in five years’ time a better bet than an investment bringing in £1m in one year? NPV allows a company to value both investments in today’s cash equivalents.

BUILDING TRUST

John Cruickshank, now a sales consultant and previously sales director of telco Equant, says Shark Finesse helped Equant win deals where procurement departments and chief financial officers were asking for evidence of clear financial returns.

“CIOs were worried about how they were going to articulate value to their chief financial officer or chief executive officer. The really clever thing we were able

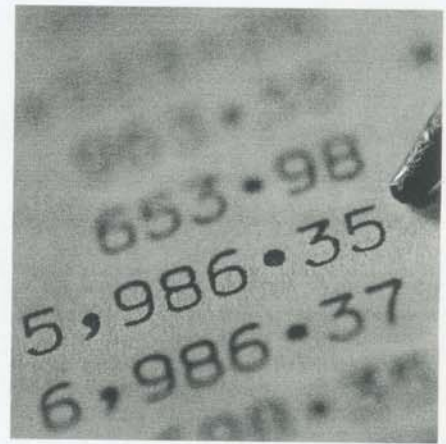
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Return on investment

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to do was build a number of modules within Shark Finesse allied to our service mix. As we talked to customers, the program would throw up a number of prompts asking the customer to quantify what he thought he would get out of the sale."

The program helped Cruickshank become something that every sales executive is trying to become in front of a customer — the trusted advisor. As well as explaining the rationale behind financial terms, Shark Finesse will also generate an automatic report in Word, suitable for presentation to a board.

By providing the IT director with a coherent, financially based report that could be submitted to the board as part of an internal pitch, Cruickshank was able to counter arguments from procurement departments that would separate out project management, service management and service level agreement charges in an attempt to buy these elements of a package more cheaply from competitors.

STICKING WITH BASICS

Other executives say ROI is becoming more and more important as part of the customer sell, but they are, for the time being, happy to use Excel. Andrew Marshall, sales director of LSI Business Solutions, says he used a heavyweight ROI tool from Deloitte & Touche when he worked at BT, which was useful but inflexible. When he discusses ROI now, he lists the costs and benefits in Excel.

Marshall says that ROI discussions depend heavily on the amount of information a customer is prepared to disclose. Customers often feel that if they reveal their true operating costs, they will weaken their negotiating

position, he says. Sometimes they simply do not know their operating costs at all. If they don't know their costs, it is very hard to say how they will save money through IT efficiency savings.

Shark Finesse's Southern acknowledges that discussing economics with customers can be difficult, but points out that if the discussion

goes well, the ROI case can be compelling. "How many sales people could quickly tell a customer turning over £50m that if they improved their cash collection by just two days they would free up £273,000 of cash? Automating that discussion means sales executives have their wits about them and can start for other items that will win the business case."

Financial definitions

What is behind a return on investment calculation? Common measures are:

Payback

When do I get my money back, either through increased revenues or cash savings? If I spend £100,000 on an IT project, at what point will I get my money back? Many IT projects ignore the time it takes to set up a project.

Internal rate of return (IRR)

A measure of proportion — how much will a company get back as a percentage of what it invests? Most companies set a minimum IRR that projects have to achieve before they will be considered. The minimum IRR is also known as the 'hurdle rate'. Projects with high IRRs will have more chance of success. A typical IRR might be 16 per cent per annum over a three-year period.

Net present value

A mini profit and loss account for a project, including both costs and benefits for a project. It calculates what the future costs and benefits are worth now by subtracting the costs of inflation and interest using standard accounting measures. The longer a £100,000 project takes to implement, the more expensive it is. It includes a cost of money at perhaps ten per cent, and measures a project over a defined time period.

Hurdle rate

What companies expect from any investment they make. An IT project has to meet or beat that figure to stand a chance of success. It will take into account how much it costs to fund the capital required for the project.