

ROI IS NOT A FORMULA, IT IS A RESPONSIBILITY

Setting IT priorities based on return on investment is a fool's game.

Jacob Varghese

TRADE PUBLICATIONS, MARKETING BROCHURES, AND ANALYST reports devote excessive amount of ink to helping business leaders calculate IT's return on investment. Methods recommended include simple cost-benefit analysis, internal rate of return, discounted cash flows, total cost of ownership, earned value added, and real options. Among all this mumbo-jumbo of numbers and formulas, one loses track of the most important factor that will ensure "returns" on your investments, that is, accountability.

Basing IT priorities on ROI rankings is a fool's game, a game in which the biggest liar wins. By relying solely on ROI figures to approve a project or decide between projects, managers are shirking their responsibility for understanding how technology will affect their businesses. ROI numbers do not ensure that technology initiatives will be in line with business strategy. The success of any technology initiative depends on whether the person responsible for implementation has the required incentives, authority, and credibility across the span of the organization that would be affected by that initiative. ROI figures should merely be used as a means to ensure that the planning is as comprehensive as possible and the totality of impact has been considered. And managers should avoid approving the entire funding up front. Rather, funding should be an ongoing contingent upon the project team meeting key milestones and realization of planned benefits.

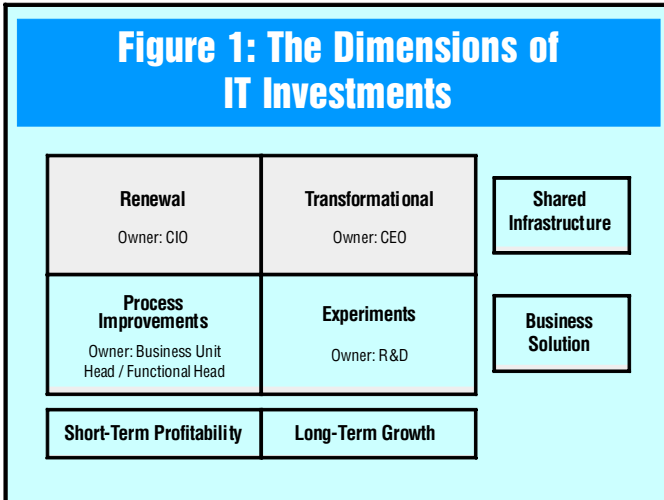
Managers involved in deciding on IT investments will have to look beyond ROI numbers to ensure that their organizations get a "return" on their investments. To do so, enterprises will have to

- bridge the business-IT divide
- establish responsibility for "return" on investment
- implement risk management processes into project management

Bridging the Business-IT Divide

The constantly changing competitive landscape makes strategy a moving target that is increasing the divide between business executives and technologists. While the business side focused on coping with change, it has left the critical responsibility of aligning business strategy and IT solely to MIS departments. In today's world, where business leadership is increasingly technology-driven, this relationship has to change.

Figure 1: The Dimensions of IT Investments



Business users of IT must play a key role translating business strategy into technology requirements and also make the effort to understand how emerging technologies will affect their businesses. The first step toward this transition is for business users to take responsibility for IT investments that will touch their operations, instead of delegating them to their MIS departments. CIOs and IT managers are critical but they can only be partners with those responsible for planning and executing strategy.

Establishing Responsibility

In "New Approaches to IT Investment," Jeanne W. Ross and Cynthia M. Beath break all IT investments along two dimensions: (1) strategic objectives (short-term profitability vs. long-term growth) and (2) technological scope (shared infrastructure vs. business solutions). (The dimensions are illustrated in Figure 1.) Based on those two dimensions, all IT investments can be broken into one of the following four categories:

Transformational: IT investments that aim to remove the infrastructural barriers to long-term growth across the organization (for example, integrated CRM, enterprise information portals, or end-to-end processing). Given the organization-wide impact and the imperative that such investments must be in line with organizational strategy, the CEO must own these investment decisions. The success of these projects should be his responsibility.

Renewal: The aim of renewal IT investments (such as legacy modernization and platform conversion) is to improve the service levels of the existing shared infrastructure or reduce the cost of support and maintenance. The ownership of such projects should lie with the CIO, since the boundaries of these projects are well defined and benefits accrued can be quantified up front. Moreover, it is the CIO's responsibility to ensure the service levels from the shared IT infrastructure are constantly improved.

Process Improvements: The end objective of IT investments that focus on short-term profitability or incremental process improvements might be to speed time to market, lower the cost of operations, or to differentiate services/product offerings. The ownership of such investments should lie with the business unit head, functional head, or the process owner, depending on how the organization is structured.

Experiments: New technological trends that present significant opportunities for long-term growth should be the focus of IT experiments that use pilot programs to validate the technology's promise and impact. There is no fixed home for these projects. In one the industry, they might reside within the R&D organizations, in another, the enterprise architecture teams of MIS departments might take responsibility.

The responsibility chart in Figure 2 establishes who in the organization should own IT investments in each category, from conception to implementation. Splitting IT investments into these categories ensures funding for deserving but relatively low priority projects that otherwise might not have been approved. In contrast, with a single-size-fits-all-ROI-formula-driven approach, transformational projects would always get sidelined because no single business unit or IT department could justify the investment cost.

The distribution of IT budget across these four categories is driven by strategic imperatives, and business life cycle stage. Figure 3 illustrates how the budget distribution across the four categories could vary across the typical S-shaped business life cycle. Most of the investments in transformational projects would be made in the initial phase, as the business ramps up to the first strategic inflection point. As the transformational projects

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near implementation, the process improvement projects would kick in to meet the increasing competition. Thereafter, each business unit would invest in renewal projects, if their managers believe extra profits can be squeezed from the systems. Meanwhile, the organization is investing a constant number of experimental projects to ensure that the business is keeping pace with changing technology.

Implementing Effective Risk Management Processes

After firms have crossed the first two most difficult hurdles (bridging the business-IT divide and thereby establishing the responsibility, and ensuring that the IT investments are in line with business realities), the chosen projects must be executed flawlessly. This takes effective project management processes. A key component of effective project management processes is risk management. To manage risks:

- Establish a cross-functional team comprised of representatives of all stakeholders. Empower these teams and foster a sense of urgency.
- Provide a mechanism for making a business decision (go, no-go, change direction) on each project milestone. This mechanism should be under close supervision of the responsible person identified above. These milestones are standard, measurable checkpoints. They establish mandates that define next-phase targets as well as boundaries for conducting interim reviews. These reviews should ensure forward-looking focus on business viability
- Allocate resources to approved projects that are consistent with business priorities and maintain demand-supply balance between key resources across the pipeline of projects.

Figure 2: Responsibility Chart

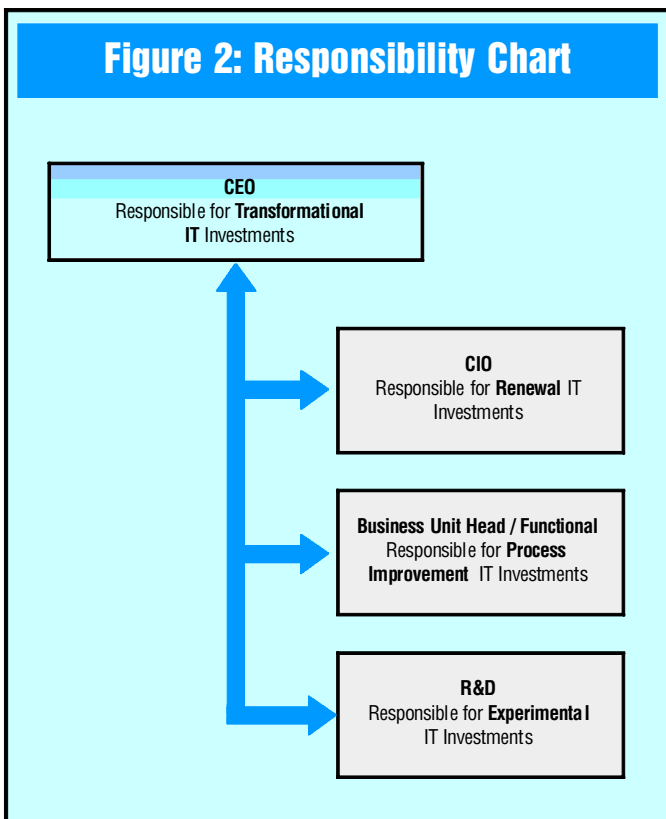
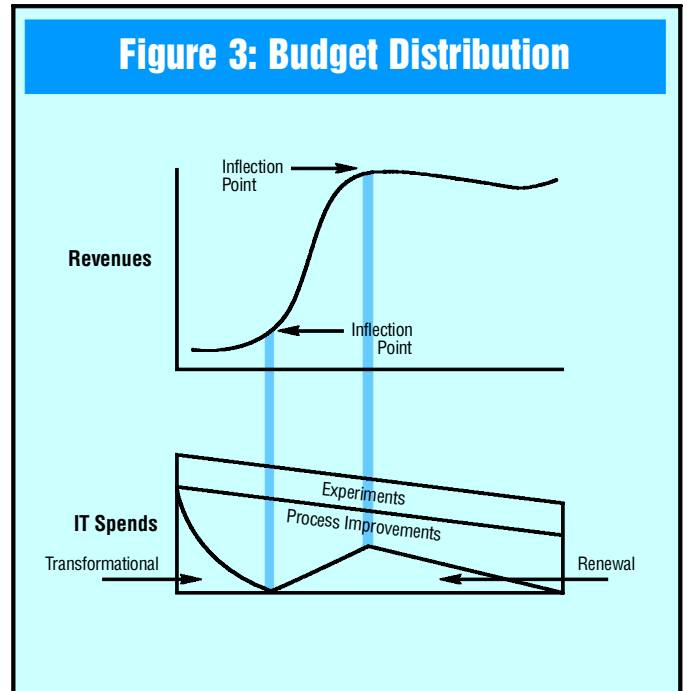


Figure 3: Budget Distribution



ROI is increasingly becoming a fact of business life, where CEOs, CFOs, and everybody in between insist on

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hard ROI numbers. However, any of the various methods for computing ROI can at best be rough approximations; they should never be used to set priorities for technology investments, except for the obvious extremes. Those priorities must directly link to business strategy. Therefore, responsibility for IT investments must not be the sole province of the MIS department.

The need for IT people to understand business strategy has been beaten to death; today's imperative is for business people to understand the implications of technology for their business. ♦

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