

ERP project justification: Return on investment (ROI)



Most companies will complete a capital expense justification (return on investment or ROI analysis) before committing to an ERP system. ROI analysis is the process of identifying the expected direct and indirect costs of the project compared to the benefits, both over some reasonable lifetime – typically 5 to 10 years for an ERP system. If the return is sufficient to meet board and lender requirements, the project can be given the green light.

Every company's situation, needs and solutions are different and therefore each company's costs and benefits will be different. While there is no "generic" ROI analysis, your solution provider or consultant can help you with cost estimates and suggest benefits and returns as experienced by other customers. It is important to complete the ROI calculation for a reasonable lifecycle for the system – at least 5 to 7 years – and include all identifiable ongoing costs as well as one-time purchase and implementation costs.

The following list should provide a good starting point for your own ROI calculations:

Purchase and implementation costs

- Computer hardware, operating system, database, networking and tools, including installation, start-up and testing
- Application software (ERP) license, installation, tailoring, data conversion/loading
- Procedure development, testing and documentation
- User training
- Vendor and consultation assistance with implementation

Note: Cloud/SaaS systems are priced differently with little or no up-front (capital) cost but higher on-going (operating) costs. Nevertheless, ROI analysis is still valid as long as the timeframe (expected lifecycle) is appropriate.

Ongoing costs – many will be replacements and changes (up or down) from existing costs

- IT departmental costs for utilities, personnel, consultants and support
- Software annual licensing/maintenance fees
- Continued training for skills enhancement and new employees
- Budget for system expansion and enhancement

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Benefits

Direct benefits fall into two general categories: 1) Cost savings and cost avoidance and 2) Increased revenue and profit. However, all benefits from ERP flow from:

- having greater visibility to demand and schedules
- closer management of materials, equipment and personnel
- the ability to better manage work flow and production schedules
- greater coordination of resources to efficiently deliver the right products in the right quantities at the right time

1) Cost savings and cost avoidance

- Inventory reduction, including materials, parts, finished goods and work-in-process
- Increased productivity and throughput in the plant
- Reduced scrap, rework, expediting, and wasted materials
- Less overtime, expediting, premium freight, and additional set-ups due to last-minute schedule changes

2) Increased revenue opportunities

- Increased sales due to better customer service, improved quality, better on-time delivery and shorter lead time
- Sales and margin improvements due to faster time-to-market for new products and product variants, cost reductions

Indirect benefits

These are a little harder to identify and measure, but can be at least as valuable as direct savings and return.

- Improved retention and higher productivity from employees who are less frustrated and more effective in their jobs
- Less panic, disruption, and chaos in the plant and in the office due to fewer last-minute changes and surprises. More stable schedules, less expediting.
- Smarter moves in the market – pricing decisions, specials, product releases or changes, inventory deployment, to name a few – due to better information and insight into market conditions, customer needs and competitive activity.

Getting started

There are many more factors to consider when developing a complete ROI statement. Just be sure to go through the process and document the results, first of all to justify funding the project. Furthermore, this will also provide visibility and motivation to all project participants that this project is worthwhile, is important to the survival and success of the company in the coming years, and that there is benefit for each and every employee, department and functional area throughout the company.

Ask your solution provider for information about companies similar to yours, and what benefits they were able to experience from implementation and use of their systems.