

Part 3: The Return on Investment on an ERP System

The traditional return on investment (ROI) calculation of a software project is often based on the idea that an organisation will see tangible benefits from its new software as soon as it's installed.

This concept is not as easily applied to an ERP solution because the ROI is typically delivered through the improvement of a business's processes. In most cases, this can take time to become apparent or be measured.

That's not to say, however, that it isn't possible to undertake a ROI calculation before purchasing an ERP solution. In fact, it is a critical part of the decision process. So how do you do it? Referring back to the first article in our series, we are reminded that an ERP system takes key data from a variety of sources within a business and transforms that raw data into actionable information.

With an ERP solution in place you will be able to see - at a glance - daily sales, stock levels, accounts receivable, work in progress and a host of other key performance indicators. You will be able to make more informed decisions, access detailed information faster, prepare key reports automatically and track transactions as they occur. Calculating a return on investment, then, is about putting a value to what this new found capacity and efficiency will bring to your business.

ROI for all

While it's true that every business is different, there are many common processes that every business has to tackle. For example, every business will send and receive invoices, undertake banking, receive and process orders, pay staff and comply with tax regulations. In the process of preparing for an ERP purchase, you will have started by mapping out how these internal business processes occur at your company. You will know how an order gets processed through your system - and you will have identified bottlenecks and inefficiencies.

Calculating ROI means applying a dollar figure to the value of correcting the inefficiencies you have documented. Take the recent case of a manufacturer with a paper-based accounts department. The company was dealing with around 1800 transactions a day and employed 20 staff to manage the process. With much of this work automated by an ERP solution, the company estimated it would be able to process the same number of transactions with three staff - thus decreasing its operating expenses and overhead costs by \$1.3M annually.

CALCULATING A RETURN ON INVESTMENT OF AN ERP SYSTEM IS ABOUT PUTTING A VALUE TO THE NEW FOUND CAPACITY AND EFFICIENCY THAT IT WILL BRING TO YOUR BUSINESS

ROI across different sectors

Of course, while all businesses do have some common processes, the similarities between companies typically evaporate once you leave the accounts department - and specialisation is the name of the game. For this article we will be highlighting ROI in five core industry types - Wholesaling, Manufacturing, Professional Services, Not For Profit and Trades. Within each of these sectors there are a number of common areas where ROI can traditionally be calculated.

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Wholesaling

For companies in the wholesaling sector, inventory turnover is the key to profitability. Too much stock leads to full warehouses and aging inventory - while too little stock can mean unfulfilled orders and lost customers. Having accurate inventory information at your fingertips enables management to optimise stock levels and buying cycles. What would a 20% reduction in average stock levels coupled with a 20% improvement in order fulfilment over a year mean to your business's bottom line?

The owner of a leading furniture manufacturer says prior to installing an ERP, his company was "drowning in inefficiencies" with even the most routine of queries too difficult to answer. "People were asking simple questions like whether we had something in stock, and we couldn't tell them." Today the visibility provided by the company's ERP system easily answers that question. "We now do random stock checks any time of the day and know exactly what's what. Customers have really noticed the difference."

But that's only scratching the surface "We can go into the manager's reports area and get a snapshot of our performance based on KPI, branch, dollar value for sales period or estimated sales periods. It's brilliant. An ERP has not only allowed us to properly run, operate and manage our business, it's given us a vehicle to forecast and plan going forward."

Manufacturing

The transparency provided by an ERP system greatly aids manufacturers in process improvement, inventory control, purchasing, cost of goods estimation and production scheduling. This enables more efficient use of fixed assets and an overall lowering of variable production costs.

The Managing Director of an Australian sheet metal fabricators says the real time information provided by an ERP's dashboard reporting has given his team actionable performance information and sped up the company's time to market.

"We can look at where a job is at," he says, "and if it's falling behind we now have the opportunity to fix the problem, rather than waiting until the end of the job and trying to figure out what went wrong. You can make decisions much more quickly because the information you're seeing is live. It really speeds everything up."

Professional services

For architects, accountants, solicitors and others, the ability to accurately track billable hours is critical to maintaining and enhancing a firm's profitability. The return on investment calculation for these organisations is directly related to being able to easily track billable time spent on phone conversations, emails and so forth, and then being able to allocate that time quickly and accurately to a client, job or project.

Typically this task isn't done as thoroughly as it could be and significant ROI can be gained from an ERP solution. In one recent example, an IT firm found that after analysing their billable hours, that it was only invoicing 40% of its time. With an ERP solution in place this has since risen to 85% - and delivered a 114% increase in annual revenue.

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Not for profits

The lack of a profit motive does not mean a non-profit organisation can afford to be less focused on its finances. In fact, with resources being scarce, their efficient allocation becomes even more important. And while the types of work undertaken by non-profits is varied – charities, health insurance, automobile associations to name a few - how they allocate their funds and subsequently report on them is very similar.

Operating expenses, salaries and short and long term project funding all require complex reporting. The manual workload to produce these reports is frequently very high - absorbing significant time and resources. The return on investment of ERP for non-profits centres around delivering accurate and easily generated reports. This frees up administrative time that can then be allocated more productively elsewhere.

The manager of a large New Zealand based not for profit, specialising in providing skills and training to those in need, says the recent deployment of an ERP has given them extra transparency, the ability to implement straightforward systems, improve its report writing and easily extract information into one-off reports. Instead of struggling with formatting Excel spread sheets she says the new solution “allows management more time to spend actually analysing and implementing new systems - rather than getting bogged down in day-to-day financial matters.”

Trades

For electricians, plumbers, carpenters and technicians that have grown beyond a sole trader size, the return on investment from an ERP solution comes via improved job and project costing, accurate allocation of labour and materials to projects and more efficient resource planning and scheduling.

One case study for an electrical company whose accounts manager says her growing company needed better stock control and more accurate job costing, found its solution in an ERP. “A job costing module and time sheet facilities were the key factor in choosing an ERP solution,” she says, “kKnowing our margins at all times on jobs is very important.”

Six months after deploying an ERP, she says the new system has delivered on its promise. “We are flowing much better, the stock is accounted for and every month I get accurate accounting reports that give a clear picture of how the business is performing.”

ROI summary

The decision to deploy an ERP solution must be driven by relevant process improvement objectives. As we have discussed in this paper, some improvements are common across all businesses – while others are unique to a specific organisation or industry sector.

The key to conducting a worthwhile return on investment analysis is to assess your likely ROI against the specific process improvements you have identified in your own internal audit. Once you have defined the metrics for measuring improvements in your organisation, the value of those improvements can easily be estimated.



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