

Why Upper Management Doesn't Trust Project TCO and ROI Analyses, and How to Fix the Problem.

- Empowering Management to Estimate, Forecast and Track the Business Impact of Projects and Changes in Business Processes
- Bridging the Different Viewpoints of Project Managers and Upper Management

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A Discussion with the Senior VP

In late 2002, I was meeting with a Senior VP of a Fortune 100 corporation about a proposed project. During the first part of the meeting, he paused and said,

"It's nice to discuss this proposal, but we have stopped funding all new projects. I know this proposed work will reach pay off in three months, and lead to major future cost savings, but that still won't fly with the funding committee."

Needless to say, I was surprised, and asked why? He responded,

"In general, Upper Management Does Not Believe the Forecasts of Projects' Business Impact for Project Justifications. They also do not feel that they receive the promised benefits. They do not receive reports tracking the business benefits of projects to see if they actually met their business goals."

"When there were high profits and revenue was growing, the funding committee would look at the benefits of proposed projects, including their TCO (Total Cost of Ownership) and ROI (Return on Investment) and approve them if they felt they made sense. But with revenues down and no profits, the funding committee has changed its approach."

"The problem is that we, first, don't believe the numbers that we get and, second, we don't think we ever get the return that has been promised to us. For all these projects we have funded over the last years, no one has actually measured the business impact to tell us whether we got our investment back as promised."

"Since we don't have the ability to accurately forecast and measure the business impact of projects, we have decided to not fund anything until there are sufficient funds such that we don't have to depend on the projects providing their promised return."

There is a Fundamental Flaw in the Way Most Companies Create Their Business Impact, TCO and ROI Analyses for Proposed Projects

Fortunately, with the economy improving, this particular company has recently started several new projects, but the basic problem has not been addressed. Upper Management still does not believe that their project managers can forecast the business impact of their project with confidence. And when a project goes into production, they still do not feel they get the promised benefit or that the project's business impact can be measured.

Having been involved in many companies, it appears that the root cause of this concern is due to the different views of upper management and project management caused by their different roles in an organization. The flaw is that almost all organizations create project-centric analyses and in doing so, have not linked these projections to their organization's overall budgets and headcounts.

Upper management focuses on overall budgets, resource requirements and performance. Project managers focus on their specific project, and its benefits. In order to solve this problem, an organization needs to provide the project managers with the information needed to bridge these two different viewpoints. In this way, they will be able to express their projects goals and benefits in terms that are useful and credible to upper management.

New activity-based budgeting and planning tools are addressing these concerns of upper management. They enable Program, or Project, Management Offices (PMOs) to create much better business impact estimates and to track the benefits of projects. They do this by enabling the PMO to create a business-unit centric model that captures the demand on their businesses, links this to the work activities that need to be done to support the demand, and automatically create forecasts of budgets and resource requirements.

These systems are optimized for doing Scenarios. They enable the user to change a wide range of personnel, technology, business demand, customer life cycle and other factors. As such, they provide the foundation for empowering PMOs to analyze, forecast and track the business impact of multiple, simultaneous, projects being implemented in an organization.

Lastly, there is an approach, Practice Knowledge, to gathering data and measuring the work that is being done by an organization. This approach makes it possible to quickly and accurately support the goal of understanding and measuring the business impact of the multiple projects that affect an organization.

What are the Two Approaches to Determining Business Impact, TCO and ROI Analyses Typically Created?

Upper management and project managers have two different views of their organization. Upper management focuses on overall budgets, resource requirements and performance. Project managers focus on the benefits and costs of their specific areas of responsibility. The Business Unit-Centric Approach to managing an organization's projects is designed to bridge these two different viewpoints.

If we focus on the project productivity portion of a business impact analysis, almost all project funding requests are based upon what I will call *Project-Centric Analysis*. Project-centric analysis takes the viewpoint of the project, and asks, "What will change if this project is approved?"

To address the credibility and tracking problem, it is necessary to use a *Business Unit-Centric Approach*. This approach takes the viewpoint of the business unit, whether it is a department, division, or the entire business unit. A business has a budget, personnel and other resources, such as facilities, technology or manufacturing capacity. This approach asks, "How will this project change the way my business does work, therefore resulting in an alternative overall budget, headcount and other resource forecasts?"

An Example of the Project-Centric Approach

The two tables in this section provide an example of the approach that is typically used for creating the TCO and ROI portion of project justifications in businesses. As can be seen, the viewpoint of this analysis is from the standpoint of the project. It stands 'in the center of the world' and asks, "What will change because of this project?" As such:

1. The project's business impact determines changes in the organization's full time equivalent employees due to changes in productivity. It does not use the framework of total employees and show the project's impact on the total employee base.
2. It calculates changes in management and operations personnel, but does not place this in context with the overall population of these skills.
3. It calculates changes in budgets and investment, again, not placing these in context of the total business unit budget and investment category.

The table captures an example of this approach.

TCO Element	Description	Savings per Year	Additional Costs 1st Year
Changes in User Productivity	Saves 20 User FTE at \$55,000 / Yr Fully Weighted Cost	\$ 1,100,000	
Changes in Training	Requires 2 hours of Training for 400 people plus costs of \$25,000 to develop materials		\$ 52,000
Changes in Unit Costs	Saves \$0.80 per Unit, 1 Million Units per Year	\$ 800,000	
Changes in Operations Personnel	Saves 6 Operations FTE, but adds 4 FTE for net reduction of 2 FTE, at \$70,000 per Year	\$ 420,000	\$ 280,000
Changes in Investment	New System Capitalized Investment is \$1.5 million		\$ 1,500,000
Maintenance & Upgrade Expenses	New System will have \$350,000 per Year of Maintenance, retiring old process with \$100,000 per Year	\$ 100,000	\$ 350,000

The data in the above table leads to a cash flow analysis, as shown in the next table, which provides the TCO and ROI of this project.

	Year 1	Year 2	Year 3
Impact on Cash Flow			
Annual Savings	\$2,420,000	\$2,420,000	\$2,420,000
Annual Total Cost of Ownership	\$2,182,500	\$ 682,500	\$ 682,500
Net Change in Cash Flow	\$ 237,500	\$1,737,500	\$1,737,500
Cumulative Net Change in Cash Flow	\$ 237,500	\$1,975,000	\$3,712,500
New System Total Cost of Ownership			
Cumulative TCO	\$2,182,500	\$2,865,000	\$3,547,500
Return on Investment (based on TCO)	11%	69%	105%

So why doesn't this approach provide upper management with the confidence they need to justify funding? Let us answer this by referring to the response provided by the Senior VP of the large company.

1. Why doesn't Upper Management trust business impact analyses produced by Project-Centric Methods?

- a. It doesn't place the business impact of the project into the budgets and forecasts of the organization, so upper management can't make a common sense judgment as to whether the promised benefits make sense, in the context of other projects and changes that are anticipated to affect the organization.
- b. The cross-elasticity across separate projects is not obvious – management may receive funding requests for six seemingly independent projects, which when summed together show a 120% reduction in costs – obviously this won't happen!
- c. There is no discipline in the numbers across different projects – each Project-Centric Analysis makes its assumptions based on different sets of numbers. There is not a single framework and set of data that all proposed projects use in order to ensure that there is a common foundation for comparing the projects.

2. Why Doesn't Upper Management believe that they get the financial benefits they are promised?

- a. First, it is not common that a project makes a serious effort at measuring its business impact, so upper management doesn't typically receive structured feedback on this question.

- b. The benefits of each project, when there are multiple initiatives simultaneously changing the environment, are difficult to track since there is no business unit-wide framework supporting the ability to track project performance, separating out the impact of one project versus another.

The Baseline – the Foundation of Business Unit-Centric Approach

To obtain credibility with Upper Management, project proposals need to be presented in terms that are relevant to this group and make it easy for them to understand and evaluate the benefits of each proposed project. The term Business Unit Baseline will be used to describe this model of the business unit. It is designed for determining the impact of proposed projects on a business and supporting the ability to track their performance as they go in production.

The Baseline captures the volume of work that is done and how it is done. This data is required because projects affect these factors – they change how much work needs to be done and they change how work is done. In particular, the Baseline captures:

1. The current and forecasted demand on the organization. In other words, what causes the business unit to do work? Is it supporting the customer base? Perhaps it is the need to make sales goals, or the provisioning of new services? Is it manufacturing a certain numbers of goods?
2. What Work Activities and Tasks does the organization do to meet the demand that it supports? For instance:
 - a. To support a sales effort, one needs to find prospects, make sales presentations, take orders, etc.
 - b. To support a new customer (depending on the type of product), one needs to ship product, handle installations, provide training, and the flurry of new customer questions.
3. Each of these work activities is accomplished by a specific type and amount of a resource (a combination of labor, technology, and other elements). What is the resource that supports the work activity and its cost?

With this data, the Baseline can be created. It holds all of the information needed to forecast the business unit's budgets and total resource requirements.

It is a portrait of the entire business unit – which is exactly what upper management focuses on in making its decisions. In addition, the data it holds (demand, work and resources) is the data that projects change when implemented, so it holds the information to evaluate a project proposal, and if approved, determine its success by measuring how demand and work activities change due to the project.

Comparing the Results of Project-centric and Business Unit-centric Analyses

A simple example shows the different results of the two approaches. Our example business unit has five separate projects, in different parts of its operation, being presented to upper management. Five different project managers, all of who are experts in their fields, independently created their business impact analyses. The table below shows a summary of the five proposals, as well as the 3-year TCO and anticipated ROI, when each manager makes their independent project-centric analysis of their opportunity.

<u>Projects Requesting Funding</u>	Business Impact Under Project-Centric Approach to Calculating TCO and ROI		
	<u>3-Year Value of Benefits</u>	<u>3-Year Total Cost of Ownership</u>	<u>3-Year Return on Investment</u>
New CRM User Interface	\$22	\$9	144%
Upgrade Self-Service Resources	\$24	\$6	300%
Change Employee Hiring Profiles	\$5	\$2	150%
Re-Engineering Customer Fulfillment Business Processes	\$8	\$4	100%
Update Inventory Management System	\$12	\$5	140%
TOTAL IMPACT on Organization	\$71	\$26	173%

(Dollar values represent millions)

At first appearance, these are relatively independent projects which all show a solid business case justifying project funding.

However, when one takes the Business-Unit Centric approach, the story changes. The reason is that, even though these appear to be independent solutions, there is a high degree of cross-elasticity between the projects. In particular:

1. The Self-Service project will reduce the workload on personnel using the New CRM User Interface, therefore there will be fewer employees using this resource and the cost savings will be lower as the Self-Service Project deploys and meets its goals.
2. By changing the Employee Hiring Profile, the organization will be focusing on somewhat more skilled, computer and business process oriented new hires. As the proportion of new hires grows in the overall workforce, their higher level of skills will help compensate for inefficiencies in:
 - a. The current CRM User Interface,
 - b. The current Inventory System, and
 - c. The current Customer Fulfillment Business Processes.

Therefore, part of the justification for investing in the higher skilled employees was based on that fact that the productivity using the current systems would be higher. This lowers the productivity gains from the New CRM User Interface, the Re-Engineered Customer Fulfillment Business Processes and the Updates to the Inventory Management System. Vice-versa, perhaps the investment in these systems will make it unnecessary to change the Employee Hiring Profile.

3. Lastly, since all of the projects will lead to higher productivity, there will be fewer total employees getting the benefits of each project. This also lowers the cost savings available from each project.

The net of these cross-elastic factors is that the productivity opportunities from all of the projects are significantly lower than if management simply picked one and implemented it. The following table shows the results when the Business Unit-centric view is used to determine the financial justification for the project proposals.

Projects Requesting Funding	Business Impact Under Business Unit-Centric Approach to Calculating TCO and ROI		
	3-Year Value of Benefits	3-Year Total Cost of Ownership	3-Year Return on Investment
New CRM User Interface	\$12	\$9	33%
Upgrade Self-Service Resources	\$24	\$6	300%
Change Employee Hiring Profiles	\$3	\$2	50%
Re-Engineering Customer Fulfillment Business Processes	\$3	\$4	-25%
Update Inventory Management System	\$9	\$5	80%
TOTAL	\$51	\$26	96%

(Dollar values represent millions)

This table would lead to a very different set of decisions by upper management. In fact, they would pick two, or perhaps three, of the projects and not fund the others.

With Practice Knowledge and Tools, Creating Accurate Baselines is Fast, and Will take Between Several Weeks to a Few Months Depending on the Complexity of the Business

With the proper activity-based, integrated planning and budgeting tools, it takes surprisingly little effort to create a Business Unit Baseline that is highly accurate and enables upper management to understand the business opportunities from multiple, simultaneous project opportunities. It also enables each project to track its success, so that both of the concerns of upper management are addressed.

In terms of time, for a typical mid-size organization, creating the Baseline will take between 1 and 3 person months. Initially, a simple Baselines may be created, which may only take several days. This starts the process and can support a single project analysis, showing its impact on the overall business unit.

The reason that Baselines can be created quickly is that, with the proper software tools supporting the process, the effort is a *top-down data gathering process*. This means that one starts by capturing high level data, for instance a high level view of demand and work activities, then ensuring that it provides results that reproduce current budgets and resources within 1% - 3% of actuals. This process ensures that the Baseline is providing accurate results and projections.

For projects that are being considered, one dives into more detail about the specific work activities and demand being done by the business unit that are relevant only to the specific project. Therefore, detail is not captured unless it is needed for considering a particular business question. In this manner, over time, the Baseline becomes more and more granular, based on the most important questions that are being addressed by Project Management and Upper Management. Time is not spent on detailing activities that are not being considered for change.

By using this process, creating an initial Baseline to consider a single project may take only a few weeks of effort, therefore enabling the business to obtain benefits quickly from introducing the Business Unit-centric approach to modeling business impact.

In Conclusion, Using a Business Unit Centric Approach to Estimating Project Business Impact will Significantly Increase the Credibility of TCO and ROI Analyses, and will Help Bridge the Gap Between Upper Management and Project Management

Using a Business Unit Centric approach to creating project business impact analyses will increase the credibility of TCO and ROI analyses, make obvious multi-project cross-elasticities, and help bridge the gap between Upper and Project Management. An activity-based, integrated planning and budgeting solution mixed with practice knowledge

will enable a business to quickly capture the relevant information for its Baseline and such an environment automatically creates the budgets and total resource requirements needed to meet the demand on the business.

In particular, such a solution provides several major benefits:

1. Enables one to easily capture the goals and consequent demand on an organization.
2. Lets one easily capture the work processes, activities and costs of the business processes that are used to meet the demand on the organization.
3. Identifies the human, IT, facilities and other resources and costs incurred to meet an organization's goals.
4. Automatically projects budgets and resource forecasts, and also links the organization's financial information directly to the customer base and operational work activities, and
5. Enables Scenarios, such that by changing any of the goals, resource or cost factors, or customer relationships, the forward-looking changes to the group's financial and resource performance becomes available. Then detailed Scenario Comparisons may be viewed, letting the management group examine the business impact of various strategies.

Use of a solution also requires Practice Knowledge. There is a way of approaching the collection of Baseline data and structuring the Baseline Model so that it supports the project and strategic questions being asked by the management group.

With the combination of such tools and the practice knowledge, the bridge between Upper Management and Project Managers will be created, leading to a better process for evaluating and tracking projects.

Appendix 1: The Primary Matters Guide™ Activity-based Budgeting and Business Impact Analysis Solution

The Primary Matters Guide™ is a powerful activity-based integration planning and budgeting tool available to organizations. When employed to create budgets and resource requirements, or used as a diagnostic probe, a change management counselor, or a forward-looking planning tool, The Guide plays an important role in the management of organizations. The Guide is also Primary Matters' publishing platform. It holds information about typical systems, personnel and service costs, enabling the user to simply 'click and choose' what is most important for their environment, and to investigate potential changes to that environment.

The Guide is a sophisticated budgeting and planning tool. Yet it addresses the biggest problems with tools of this nature--that of complexity, long time to benefit, high expense, and lengthy training requirements. It has been designed so that the user focuses only on the factors that will make a material difference to The Guides' results and its ability to support critical business decisions. Many organizations receive formal training and, literally, within three to five days, are obtaining significant business benefits from the environment.

What does The Guide Do?

The Guide provides a managerial tool and decision support system that enables executives and managers to *create budgets & resource requirement forecasts*, *evaluate* the current performance of their business operations, *manage* their business operations, *plan* for future growth, and *test new scenarios*. Just answer a few basic questions — projected activity volume, tasks that must be accomplished, technologies, and anticipated growth — the Guide builds a complete business model and produces a wealth of management information in hours rather than weeks or months. The Guide:

- Provides an accurate, three -year, line item budget covering fully-loaded labor costs, external labor costs, technology operation and maintenance costs, telecommunication and other service costs, facilities, marketing, travel, and miscellaneous costs.
- Unearths the fully allocated and variable costs of the Activities and Tasks a company must do to meet its goals, whether they be for sales, customer service, installation, or other functions.
- Specifies resource requirements to achieve target growth objectives — staffing, skills, systems, equipment, facilities, etc.
- Examines 'what-if' scenarios, showing the impact of alternative work processes, personnel programs, contact methods, and technology on resources and budget.

Historically, budgeting and forecasting have been the Achilles heel of managers, consuming hours of valuable time. The Guide delivers a quantum improvement in information richness, detail, and accuracy. Established companies, with large mature operations, as well as startup operations have embraced The Guide.

What Makes The Guide Unique?

The manner in which people, systems, and activities are defined and linked to enable forward looking projections of resource requirements and costs is patent pending.

- The structured, easy to follow user interface creates Baseline Budgets and Resource Requirements in hours not weeks.
- Activity-based costs are a part of the Baseline Reports, and enable targeted cost cutting at the task level.
- Every single data element is a potential change scenario, with comparisons to the baseline produced in seconds.
- System Categories and Templates are pre-populated with production data, producing ROI reports in seconds.
- Activities can be reengineered and the results evaluated in minutes--prior to spending money and talent.
- Business Drivers--your installed base, your new customers, your sales goals, etc., are linked to activities, and become important sources of 'what if' analyses. Instantly understand the impact of an improved sales process on your contact volume.

The Guide gives you revolutionary planning and decision support ability. We guarantee you will be up and running and receiving value from The Guide in days.