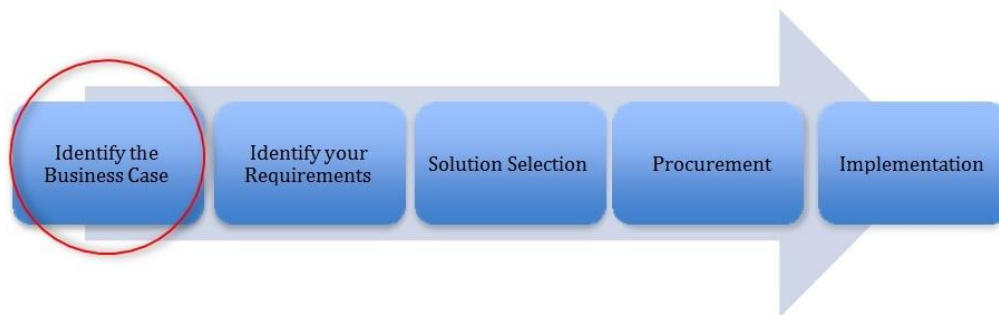




Quick guide: Developing a Business Case for IT investment

This Quick Guide is one of a series targeted at small to medium sized businesses contemplating the purchase of an Information Technology (IT) solution. This could include a new financial management system, an Enterprise Resource Planning (ERP) solution, a Customer Relationship Management (CRM) system, or a new cloud based IT service. The focus of this Guide is on developing a Business Case to support your investment.

While these systems help businesses to grow, improve efficiency and production and reduce costs, they are a significant investment. There is a lot at stake for a business if the wrong decision is made. It is therefore critical that these decisions are well-considered and planned and the company is clear about how their investment will benefit their business.



Role of a Business Case

Understanding the cost of a new business system is relatively easy. However, understanding why it is needed, the benefits that will be delivered and how these will impact and improve the performance of the business is far more difficult.

Simply put, the role of a business case is to explain why the investment should be made and how the business will see a return on that investment (ROI) at some point in the future. A well-considered business case provides decision makers with the information they need to decide if the investment should proceed. It is also a mechanism to ensure the rest of the organisation 'buys in' to the investment proposal and provides a framework to help keep the project on track when work is initiated.

What goes into a Business Case?

A business case can be a lengthy, detailed formal document - but it doesn't need to be. A short, concise document detailing what's proposed, why, the level of investment, the benefits that will be returned and the risks that need to be managed is sufficient.

- What are you doing?
- Why are you doing it?
- What will it cost?
- What are the benefits?
- What are the risks that need to be managed?



Building a Business Case

What are you doing?

The business needs to be clear about what it is planning to do. This involves a simple statement describing what is proposed, e.g. to purchase an Enterprise Resource Planning (ERP) system. Additional information about the scope, i.e. what is included and what is out of scope for the initiative can also be included. For example, you want a system that supports business operations but you do not want to replace your current payroll system.

Why are you doing it?

To help identify if the benefits the investment will deliver are relevant to your business, you need to understand why you are proposing to make the investment. These can be articulated as the objectives driving the initiative or described in terms of the 'problem' that needs to be solved. The list is endless but could include:

- Current systems have reached end of life
- Improve speed to market
- Operating errors need to be reduced
- Productivity improvements to retain competitiveness

What will it cost?

- Reduce paperwork and manual processes
- Support for compliance obligations
- Faster and more accurate reporting
- Customer service improvements
- Operating costs need to be reduced

Cost considerations should reflect both the up-front capital costs of purchasing and implementing a new solution as well as anticipated on-going costs. Costs may include:

Initial:

- Hardware (e.g. Servers, end user PCs/interfaces)
- Software Licenses
- Implementation (e.g. Project management, Software configuration, Data cleansing and conversion, Customisation)
- Training

Ongoing:

- Annual (or periodic) license renewal fees
- Maintenance and support
- Communications and data storage costs



In evaluating how much a new system will cost, it is important to take into account things like up-front costs, ongoing support costs and the impact on cash flow, before and after tax. For example, small to medium businesses can qualify for accelerated write-off of computer hardware and software, improving the speed with which capital outlays can be recovered.

What are the Benefits?

A core component of a business case is identifying the benefits the business can expect as a result of their investment. These should address the objectives that were initially identified.

Benefits fall into two categories (i) tangible and (ii) intangible benefits. Tangible benefits can be quantified. These are benefits you can put a value against. Intangible benefits are those that you expect will occur but which are difficult to quantify.

Examples of Tangible Benefits

Savings:

- Carry cost of inventory reduced through improved inventory management
- Waste reduction through better procurement and material management
- Reduced labour costs due to improved scheduling and reduction in overtime
- Resource savings through reduced duplication of processes and rework
- Resource savings due to automation of tasks

Income:

- Increased sales through improved production throughput
- Increased throughput from better scheduling of labour, equipment and sub-contracting operations
- Accuracy of inventory counts results in increased sales

Examples of Intangible Benefits

- More accurate planning and forecasting
- Improved financial controls
- Increased employee / customer satisfaction
- Improved management of assets
- Standardised processes and procedures
- Improved legal and regulatory compliance

Quantifying Benefits

Both tangible and intangible benefits are important. But only tangible benefits can be used to calculate the financial return of an investment. Below are some simple examples of benefits calculations.

- Inventory level reductions: Assume 10% reduction in inventory carry costs
 - $\text{Current inventory carry value} \times 10\% = \text{Annual benefit}$
- Improved Process Efficiency: Assume annual labour cost reduction of 10% and overhead reduction of 15%



- $Labour\ cost \times 10\% + Overhead\ cost \times 15\% = Annual\ process\ cost\ savings$
- Waste Reduction:
 - $Value\ of\ wastage \times Estimated\ reduction\ rate = Annual\ waste\ reduction\ savings$

Calculating Return on Investment (ROI)

Return on Investment (ROI) refers to the ratio of money gained (or lost) relative to the amount of money invested (the total cost). While various calculations can be applied the most straight forward formula is shown below.

- $ROI = (Return - Investment) \div Investment \times 100$

	Start	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Estimated Benefits	\$0	\$50,000	\$90,000	\$90,000	\$90,000	\$90,000	\$320,000
Estimated Costs	\$40,000	\$30,000	\$20,000	\$20,000	\$20,000	\$20,000	\$150,000
ROI	113						

In this example, ROI is calculated by taking the estimated total benefits (\$320,000) subtracting the total estimated costs (\$150,000), dividing by the total estimated costs then multiplying by 100 to arrive at the ROI (113%). This calculation is over a 5 year period but can be applied on an annual basis.

Managing Risk

Understanding the risks that could impact the success of the investment means you can (i) put in place actions to avoid the risk eventuating and (ii) if it does eventuate, know how you will respond to minimise its impact. In the context of an IT investment project risks could include:

- Insufficient budget
- Cost blow out
- The solution purchased is inadequate
- Staff resistance to change
- Prolonged disruption to business operations

Understanding which risks are the most critical and potentially most damaging to the investment initiative is also important. This allows you to prioritise efforts to ensure those that are most important are the focus of your mitigation efforts. A very simply way to identify and manage risk can be represented along the following lines.

Risk	Importance	Mitigation Actions	Ownership
Cost blow out	High	Formalise project management reporting arrangements with weekly monitoring spend	Project Manager
Staff resistance to change	Medium	Involve staff in developing business requirements for new system	HR Manager

Further information

Visit the business website at business.gov.au.