Calculating the Return on Better Planning

A Framework for Investment Decisions

White Paper
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Assessing Return

Realizing an appropriate return on capital spending is critical. Poor allocation of strategic funds can impair the competitiveness and profitability of a corporation, which is why well-run organizations have a disciplined methodology for making these decisions. Using the right framework and measuring the potential return is the first step in ensuring that a company considers all relevant factors and weights them appropriately in evaluating investment opportunities.

Companies use an array of different approaches to assess potential capital investments, but in all cases it's important to accurately define the costs and benefits and estimate the value attached to each. For many projects, the numbers are cut-and-dried and measuring the payback is straightforward. However, when it comes to buying software to address planning and budgeting (as well as performance management capabilities such as scorecards, dashboards and performance analytics), the sources of return on investment are not always obvious. That's because software investments can have complex impacts on both efficiency and effectiveness.

Consider Both Efficiency and Effectiveness

Efficiency is about doing things the right way. Effectiveness is about doing the right things. Both are important, and both must be considered in making business decisions. After all, reducing the cost of manufacturing a defective product is not a winning strategy, but neither is a quality-at-any-cost approach.

Dedicated software for budgeting and planning can play a transformative role in helping companies balance efficiency and effectiveness.

Dedicated software for budgeting and planning (and for performance management generally) can play a transformative role in helping companies balance efficiency and effectiveness in strategy and execution. For that reason, Ventana Research advises companies to understand the implications for both in making software investment decisions.

Improved effectiveness is particularly important as a source of return for companies that are considering replacing a desktop-spreadsheet-driven process with one that uses a dedicated application. Using desktop spreadsheets in any sort of collaborative, repetitive enterprise process is so time-consuming that companies don't have enough time do many of the things they can and should be doing in their budgeting, forecasting and review processes – things that would enable executives and managers to make better decisions faster and with greater reliability. Thus, it's important to recognize and assess the full range of benefits that companies can achieve, including the ability to provide executives with deeper insight about the consequences of one course of action or another, to make their monthly reviews more forward-looking and action-oriented, and to dramatically shorten the time it takes to prepare and revise corporate budgets and plans.

Calculating the impact of increased efficiency is usually straightforward: more output for any given unit of input. Efficiency is typically measured on a "cash-on-cash" basis: direct savings attributable to the investment made. While the payoff from increased efficiency thus may be readily determinable, increased efficiency by itself is not always the right evaluation criterion. Pursuing the wrong objectives with great efficiency is a recipe for disaster, while embracing inefficiency for the sake of performance can be the right call if it ultimately makes a company more successful.

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A Framework for Measuring Software ROI

A framework is a conceptual structure that allows for a consistent and rigorous analysis of an issue. A useful framework speeds problem-solving and makes the process more reliable because it guides the user through a methodical examination of all of the relevant elements.

Sources of Efficiency

For a repetitive and iterative set of processes like budgeting, forecasting and review, the single biggest efficiency gain delivered by a dedicated application will be the time saved in not having to work with desktop spreadsheets. The desktop spreadsheet was designed as an individual productivity tool for ad-hoc analysis and reporting. Spreadsheets have inherent technological defects that make them poorly suited to doing any collaborative, repetitive company-wide task.

We have studied extensively the enterprise use of spreadsheets. Our benchmark research finds that spreadsheets fall short because users at all skill levels have trouble rolling up spreadsheets into a consolidated view. Nearly all, regardless of their level of experience, find the process time-consuming. Moreover, although the two-dimensional structure of a spreadsheet makes it easy to create and use simple business models or calculations, spreadsheets are not well-suited to handling the multiple dimensions (such as divisions, products, customers and time) that are characteristic of the business models used for budgeting, forecasting, reporting and reviews.

To calculate the value of the improved efficiency resulting from using a dedicated application compared to spreadsheets, companies typically use these key inputs:

- the fully-burdened cost (including salary and all benefits) of the people involved in the process.
- the time currently spent by these individuals on the full cycle of budgeting, forecasting and reporting over the course of a year.

- the time saved (in absolute terms or as a percentage reduction) by adopting a dedicated application.

The calculations can be detailed (working with specific individuals and their pay levels) or more general. The value gain typically is calculated over the period the company expects to use the application or for a minimum of five years. If the company is using a net present value (NPV) approach, the present value of these savings is calculated using the company's cost of capital. If a company wants to consider only efficiency in deciding whether to shift from spreadsheets to a dedicated application, time saved is where the analysis of benefits would stop.

Some finance executives argue that unless a company actually lays people off, the savings from efficiency should not be counted. However, we think this does not apply to the budgeting, forecasting and review process because most companies can reapply the time these individuals are spending to overcome spreadsheet shortcomings to activities that add real value. Thus, a highly paid business analyst can spend his or her time analyzing the business, not wrangling spreadsheets.

Viewed from another perspective, the hours not saved by switching to a dedicated application represent the "cost" of using spreadsheets. Were company executives to assess whether this additional cost provides a worth-while return, in most cases the answer would be no.

Our research shows that companies that replace spreadsheet-based budgeting systems with dedicated applications are able to achieve significant improvements in effectiveness.

There is a separate efficiency issue that companies also need to address. Is it better to buy and install the software on the company's premises or to acquire these capabilities from a software-as-a-service (SaaS) vendor? To answer this question, a company will need to determine the total cost of licensing and implementing planning and budgeting software, buying the hardware and maintaining the package on premises over the same time period as the benefits it calculates. The net present value of the outlays for this total cost of ownership should be calculated and compared to the NPV of the monthly payments made to a SaaS software provider. Time to value may be another consideration in comparing SaaS with on-premises. This will be the case if there will be a lag of more than one or two months between buying the on-premises software and when it is ready to be used.

Sources of Effectiveness

While it is an important metric, assessing only efficiency is short-sighted. Shortcomings in the effectiveness of a company's budgeting, forecasting and review process also can be costly in preventing it from achieving its potential. Ventana Research has benchmarked planning and budgeting in hundreds of companies over the past decade. Our research shows that companies that replace spreadsheet-based budgeting systems with dedicated applications are able to achieve the following improvements in effectiveness:

- a faster budgeting process, including the ability to do a detailed rebudget more quickly.
- more in-depth contingency planning throughout the year.
- increased participation in the budgeting process.
- a more effective review process, including the ability to drill down to detail during reviews.
- better decision-making.

A Faster Budget Cycle

In addition to the time spent on-task, how long it takes from start to finish to complete it matters as well. A majority of midsize and large companies (those with more than 100 employees) have an annual budget cycle that takes two to four months to complete. This is because the process of rolling up and consolidating the budget submissions using desktop spreadsheets is so complex, difficult and error-prone that it requires long cycle times to process each iteration of the budget. This duration means that many of the assumptions and decisions about the upcoming year are made as much as 16 months ahead of time.

The heightened volatility of the past few years has left many budgets dead on arrival.

Unfortunately, business doesn't move at that same slow pace, so often companies find they must work around, rather than work with, a document they've labored many hours to produce. Indeed, the heightened volatility of the past few years has left many budgets dead on arrival from the starting day of the fiscal year. But most are too pressed for time to do anything more than a high-level revision and ongoing work-arounds. Business volatility is a fact of life, so a shorter planning cycle can produce more accurate and more consistently relevant budgets from the start. And when a budget or plan must be changed, they can do this more easily and quickly.

More Effective Contingency Planning

During the annual planning process, one of the most important questions that a manager can pose to a direct report after listening to his or her presentation about the upcoming year is this: "What can go wrong, and what do you propose to do about it if it happens?" Most companies do some sort of contingency planning as part of preparing their annual budget, but too often it's a simplistic base-upside-downside case with general parameters (assuming, say, revenues increase five percent, increase ten percent and decline five percent, respectively). They may focus on a couple of key variables in working out the model (such as the price of a raw material or currency exchange rates, for example). Unfortunately, most cannot explore potential scenarios in any real detail. For instance, if a competitor cuts its price, would it be better for the company to match it or accept a lower volume of sales? What changes in the company's cost structure represent the optimum choice with either one of these decisions? Exploring contingencies and their implications in depth enables companies to reach the best decision faster and react sooner with greater coordination.

Increased Participation

Having more people representing different functions involved in the budgeting and planning process can result in a more accurate budget if it means that more "front-line intelligence" is brought to the process. Increasing participation improves communication across a company and broadens everyone's understanding of what issues contribute to achieving its objectives. Better communication can help managers outside the finance function to better understand the financial implications of their decisions, while for managers with finance responsibilities improved communication can yield a better understanding of the operational side of the business. Increased participation also can translate to more buy-in to the process by making it not just "the finance department's budget" but rather "our budget." Spreadsheet-based budgeting interferes with this.

Better Decisions

Having the right software does not automatically guarantee your company will improve its management effectiveness. However, the right software does enable good managers to make better decisions more quickly and consistently. Armed with timely, accurate data, they can take advantage of better-performing markets sooner, respond to competitive moves with greater agility, and cut costs by reducing investments in or exiting poorly performing markets earlier. Integrating a broader set of contingency plans, increasing participation and accelerating planning cycles will enhance the executive team's ability to assess the full implications of their options, both risk and return, before they have to make a decision.

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Use the Right Tool for the Job

A dedicated budgeting/performance management application enables companies accelerate their planning cycles, do more contingency planning, and replan at the same level of detail faster compared to spreadsheets. The amount of time a company devotes to creating a budget represents a substantial investment; it's important that it gets a better return on that investment. Ask yourself: What are the most obvious ways in which your company can improve its budgeting, forecasting and review process?

- Wouldn't it be better if executives could do in-depth contingency planning – rather than relying on general scenarios, being able to quickly probe different sets of assumptions for specific parts of the business and immediately seeing the impact on margins, cash flow and the balance sheet?
- Wouldn't your plan be more accurate and relevant if instead of starting three or four months before your fiscal year begins, you could produce the same plan in half the interval (beginning in October or November rather than August, for example)?

- Wouldn't executives benefit from your company being able to do a more thorough revision to the company's budget rather than an abbreviated work-around whenever conditions changed enough to make it necessary?
- Wouldn't your actuals-to-plan review process be more productive if your organization was able to focus on just the key metrics and important exceptions rather than inconsequential month-to-month aberrations? If during the review meeting you were able to drill down as needed to find out exactly why something was better or worse than expected? Or be able to see that underneath a seemingly benign key metric a worrisome trend is developing?

A "yes" answer to one or more of these questions indicates that a failing with your existing process, likely that's because your company does not have a dedicated budgeting/performance management application. One important reason to invest in this type of software is because for all practical purposes you cannot address any of these issues using desktop spreadsheets.

Spreadsheet budgeting or planning may appear to be inexpensive, but in reality it is far too costly.

Calculate the Return From Greater Efficiency and Effectiveness

Not too long ago, dedicated budgeting and planning applications were practical only for very large corporations. Today, however, alternatives to spreadsheet budgeting exist that are designed for organizations from mega-corporations to all but the smallest companies. Some are deployed only on a company's premises while others are offered in a SaaS mode to cut the cost and difficulty of ownership and reduce implementation time and risk.

Spreadsheet budgeting or planning may appear to be inexpensive, but in reality, for most midsize and larger companies, it is far too costly. The time a company can save by using a dedicated application to support budgeting, forecasting and review process likely translates into an attractive return on investment. The time savings can be applied either to reducing headcount or to enabling your skilled employees to do more useful and productive work. By freeing up time, your finance department and your company can operate more efficiently and effectively.

The time saved by eliminating the unproductive work to circumvent the limitations of spreadsheets can be devoted to finding ways of saving the company money. Better preparation for dealing with future contingencies will reduce the time needed to react to change and enable a company to consistently make better decisions faster and more consistently. Although it may be hard to quantify the income statement impact of these improvements, the value is very real.

About Ventana Research

Ventana Research is the leading benchmark research and advisory services firm. We provide expert guidance to help organizations manage and optimize performance – to become not only more efficient but more effective. Our unparalleled insights and best practices guidance are based on our rigorous, research-based benchmarking of people, processes, information and technology across business and IT functions worldwide. The combination we offer of benchmark research, thorough market coverage and in-depth knowledge of hundreds of technology providers means we can deliver business and technology education and expertise to our clients where and when you need them. Ventana Research provides the most comprehensive analyst coverage in the industry; more than 2.5 million business and IT professionals around the world benefit from Ventana Research's insights. To learn how our benchmark research and assessment and advisory services can improve your organization's performance, visit www.ventanaresearch.com.