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Calculate ROI or Your Program is a Roll of the Dice

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Agenda

- **What is ROI**
- **Why is ROI important to organizations today**
- **Calculating ROI**
- **The Business Case**
- **Tracking the Results**
- **Other ROI calculations**
- **Questions**

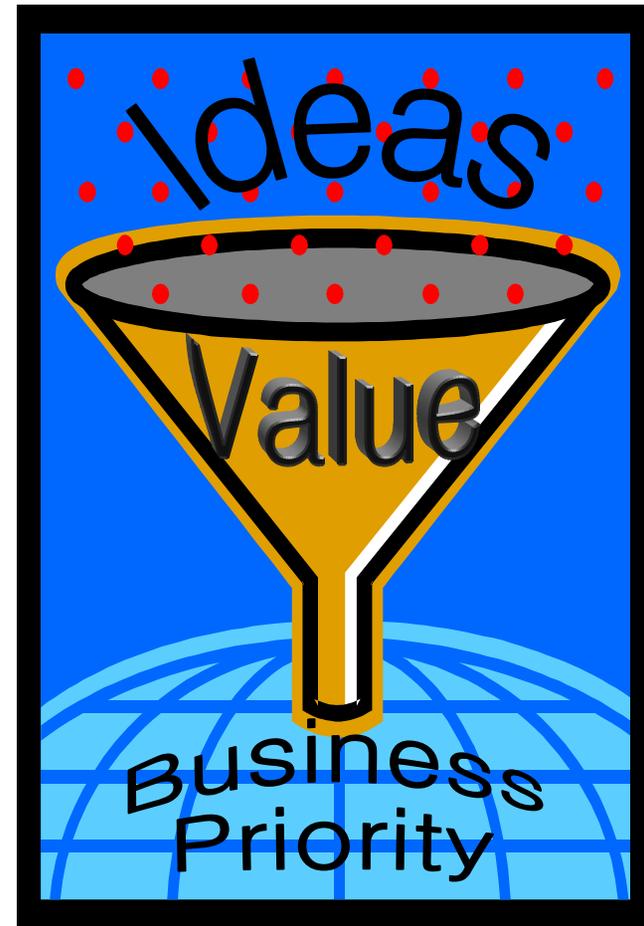
What is ROI?

- Return On Investment is a process for calculating an expected return
- There are many ways to calculate ROI including:
 - Cost Benefit Ratio
 - Break Even Point or Payback Period
 - IRR – Internal Rate of Return
 - NPV – Net Present Value
- ROI is one dimension used in the decision making process of whether to move forward with a given investment
- ROI provides a direct financial look at the potential for return.



Why is ROI important to organizations today?

- Today's currency is about bringing value to the organization.
- In order to consistently achieve double-digit returns organizations must be selective about where they spend their resources (people, time and money)
- Programs or projects, including internal improvement projects, must quantify the benefits in terms the leadership in the organization can understand, ROI is the most common method.



Calculating ROI: Important Steps for Success

- **Seek input** from practitioners and managers;
 - What is not working well today?
 - What if we were able to improve it?
 - Would that improve our speed or quality?
 - How much?
- When calculating ROI you must **forecast and quantify**; wager a prediction on the most likely outcome based on your criteria and data available.
- **Test** your assumptions and enroll an analyst from the finance department to **validate** your numbers.



Calculating ROI: Important Steps for Success

- **Gain support** from senior leadership on these assumptions
 - “Improving the testing environment will improve our defect detection rate by 20%.....Do you agree with these assumptions? Will you sponsor the program, helping to ensure this remains a priority for us?”



The single most important element for calculating ROI is using the method approved by the organization.

Calculating ROI Sample Case: Funding A Measurement Program

- Step 1: Define the case for performing the work.

Question

Why are we doing x? OR What is the risk if we do not do x?

In order to improve business decision making we need to capture and utilize our internal performance data. We risk ___% of our 8MM development budget or \$30MM marketing budget to poor decisions.

Calculating ROI Sample Case: Funding A Measurement Program

- **Step 2: Quantify Opportunity.** (See Important Steps for Success)
 - **Opportunity:** Our history of failed projects and input from peers shows we miss key opportunities representing a conservative 5% of our development and marketing budgets.
 - **Investment:** 1 FTE (Full-Time Equivalent), data repository, reporting tool, 16 hours monthly from key personnel to capture data and review reports.
 - **Assumptions:** Program personnel will capture data and attend a monthly meeting to review the results. Senior leadership will use the reports as input to key decisions. Measurement FTE will be expected and permitted to be dedicated to data capture, review and analysis. The program will be funded by October 2007 and fully functional by January 2008.

The Business Case

Description: In order to improve business decision making we need to capture and utilize our internal performance data. We risk ___% of our \$8MM development budget or \$30MM marketing budget to poor decisions.

Assumptions: Program personnel will capture data and attend a monthly meeting to review the results.
Senior leadership will use the reports as input to key decisions.
The program will be funded by October 2007 and fully functional by
Results begin in June 2008.

	Year 0	Year 1	Year 2	Total
Costs	\$ 51,250	\$ 152,200	\$ 152,200	\$ 355,650
Benefits		\$ 200,000	\$ 400,000	\$ 600,000
Return	\$ (51,250)	\$ 47,800	\$ 247,800	\$ 244,350

The cost benefit ratio is 1:1.7 or a return of 70% by the end of year 2.

Tracking the Results

- Program results must be tracked to cement the **integrity** of the **process**, NOT the accuracy of the people!
- Results should be **periodically tracked** at pre-defined intervals, e.g end-of-period or every 3 to 6 months.
- It **is** important to track the **accuracy** of the forecast. It is **not** important to compare the results from program to program.
- Review the results to **improve** the process for calculating ROI; the assumptions and calculations should be available for future program managers.



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Other ROI Calculations

NPV = Net Present Value

The present value of a future investment using a discount rate, payments or investment and income.

In our example, the present value of our investment at 10% annually is \$286,000

IRR = Internal Rate of Return (a percentage)

In our example, the IRR is 177%

Break Even Period

The amount of time required to recover the initial investment. (months or years)

In our example our BEP is 11 months.

References

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QUESTIONS?