

The ROI on Consulting Services

Many companies are having a hard time coming up with metrics that demonstrate whether the consulting services are worth the extra cost

The Credit Union of Texas, based in Dallas, is typical. It has used consultants to implement large-scale business-intelligence and imaging systems over the past several years. But consulting costs haven't been part of the budget analysis because they're too difficult to quantify, says CIO Jerry Thompson. "We wouldn't even attempt to calculate ROI on consulting engagements because we've never been able to figure out how to," he says.

20 top-level IT executives were asked to describe how they measure ROI from consulting services, and only two would discuss it.

Researchers at Kennedy Information Inc. in Peterborough, N.H., say that large companies typically spend up to 1% of their annual revenues on IT consulting, which is quite a bit, considering that most of the Fortune 500 earned more than \$3 billion last year.

The cost of consultants is often double or triple that of the hardware and software they help implement. That adds up when a CIO requests funding for a \$100 million ERP system.

"ROI from consulting has to be looked at through the larger prism of the product purchase," says Anna Danilenko, an IDC analyst. "Users are spending \$3 to \$4 on consulting services for every \$1 they spend on hardware and software."

Wettemann puts it another way: "ROI is really a measure of delta. Measuring ROI from consulting services is a question of what I would have to do to get to the same point without them."

Elements of an ROI calculation

Tangible Benefits

The tangible benefits of a solution measure the costs of implementation, against possible savings and gains, to calculate the quantifiable financial benefits of the solution.

The costs portion of the tangible benefits equation measures all of the up-front and on-going costs for implementing the project. These include:

- Capital Expenses - the investment in systems, software, networks, peripherals, supplies and equipment to deploy and maintain the project
- Implementation Labor - the staff and contract labor to research, purchase, plan, test and deploy the proposed solution
- On-going Management and Support - the staff and contract labor to manage and support the solution after it is deployed
- Operations and Contracts - the recurring fees, leases, facilities and power costs, and the on-going maintenance and support contracts

The savings portion of the tangible benefits are typically grouped into four categories:

- Labor Savings - the savings due to expected headcount reduction from implementing the planned project.
- Capital Expense Reductions - the savings in expenses such as office supplies, printing costs, power or facilities expenses from implementing the planned project.
- Productivity Benefits - the gains in user productivity from implementing a solution, including reductions in system downtime or efficiency gains in performing specific user tasks. Often, productivity benefits are discounted, to account for the fact that not all of the productivity gains will yield a gain in productive work time
- Business Benefit - the gains in profit resulting from revenue gains such as those from increased sales, customer acquisition and conversion percentages, and increased customer retention.

The measure of the tangible benefits ultimately pits the project's costs against the total benefits, culminating in the derivation of four key tangible measures of project viability:

- ROI - the ratio of the net gain from a proposed project, divided by its total costs
- Risk-adjusted ROI - the ratio of the Net Present Value gain from a proposed project, divided by the Net Present Value of total costs
- TCO - the lifecycle ownership costs comparison and benefits.
- NPV - a measure of the net benefit of a project, in today's dollar terms.
- IRR - the discount rate necessary to drive the NPV to zero; in more practical terms, the value another investment would need to generate in order to be equivalent to the cash flows of the investment being considered.
- Payback Period (Breakeven) - time frame it takes for the project to yield a positive cumulative cash flow

Intangible Benefits

Many projects have more benefits to an organization, but some of these benefits may be difficult to quantify. For this, we use Intangible Benefits.

All of the benefits of a solution are quantifiable. Intangible benefits represent benefits that are difficult, or impossible, to accurately predict and measure in financial terms. Often, however, these intangible benefits can be quantified into Key Performance Indicators such as % market share, or industry ranking.

Some intangible benefits that are considered when evaluating and measuring the performance of a project include:

- Brand Advantage -reinforcing, advancing or changing a company's brand
- Strategic Advantage - working towards or meeting overall corporate objectives
- Competitive Advantage - releasing solutions faster, developing solutions less expensively, better addressing customer needs, meeting changing market demand, scaling easily and more cost effectively, and gaining market share
- Intellectual Capital - increase in relevant knowledge gained by the staff, and the perceived market value from those gains
- Organizational Advantage - enabling an organization to function more effectively, or reinforcing or recreating a corporate culture
- Risk Avoidance - the risk of NOT implementing a solution

Risk

Risk is a predicted issue that may affect a project, and hurt the achievement of the expected tangible and intangible gains. Risk can be measured based on the probability of occurrence, and the likely impact on the costs and benefits, in some instances discounting the value of the project significantly.

The risk measurement may include items such as:

- Labor Resources - the risk that required resources may not be available, not have the proper skill set or training, or rely on a small group of experts that cannot be retained easily
- User Acceptance - users may not accept the solution and rebel, or more likely, they will not adopt all or some of the key features, which reduces the benefits substantially.
Compatibility - the solution may not be compatible with current or future operating systems, platforms or other applications.
- Vendor - the vendor may not be able to deliver the solution in the promised time frame or to the required specifications. The vendor may be a start-up, or not financially sound, so they may not be around in several years to support the solution and deliver required updates and upgrades.
- Management Commitment and Funding - the senior management and the stakeholders may not be fully committed to the project with management support, and especially funding.
- Market or Strategic - the market may shift, competitors may change their strategy, or the company may change strategic direction, changing the project requirements, or changing the business benefits equation.
Schedule - the project requirements may drive a schedule that is unrealistic. The overruns in schedule may cause cost overruns, delays to benefits, and impacts to other dependent projects.
- Legal and Governance - there may be legal and governance risks and exposures in the project, such as not being able to implement the project in time to meet legal regulations, or a failure that may risk legal exposure. The project or issues with the project may also effect compliance with governance issues such as financial reporting requirements.
- Organization - there may be risks to the organization as a whole, such as a risk involving employee morale or organizational dynamics should issues occur.
- Dependencies - there may be risks that can effect a family of dependent projects, such as delays, resources or budgets