REAL WORLD CASE 1

The Rowe Cos. and Merrill Lynch: The ROI Process in Business/IT Planning

At the Rowe Cos. (www.therowecompanies.com) in McLean, Virginia, sales were falling and budget planners were slashing. The $400 million furniture maker and retailer cut its $8 million IT budget to slightly less than $6 million in 2002, says CIO Suzanne Krupa. So any project at Rowe that can't promise a 17-month payback will be scrapped or postponed, says Krupa. Interoffice telephone lines are being clipped because Internet telephony is cheaper. Two point-of-sale systems will be combined, saving the company $250,000 a year in licensing and support costs. Krupa also plans to postpone upgrades for software such as Microsoft Windows and Office by two years. "We did a pay-now vs. pay-later analysis on Microsoft, and guess what? We are going to pay later," she says. That will net Rowe $300,000 a year in smaller license fees and support costs.

Krupa says she uses simple ROI calculations to help prioritize IT projects for planning purposes—but it isn't enough. She also uses Economic Value Added (EVA) analysis, which is broader in scope and is geared to maximizing shareholder value. EVA takes into consideration the cost of capital for a project, risk factors associated with the project, and a targeted value return percentage. For example, Krupa says she used EVA analysis to evaluate a proposed enterprise resource planning system for a manufacturing subsidiary. It enabled her to estimate the cost of delaying the project, and when she found that it would be less than the computed cost of the business disruption associated with the system, she decided to postpone the project indefinitely.

Krupa has recently begun using a newer measurement called return on opportunity (ROO). ROO combines more than a dozen factors to assess the rate of change in the business environment, the rate of change in business processes and IT infrastructure, the competitive environment, and the value of intangible assets. It focuses on the potential gains in new business from, say, attracting new customers or boosting revenue from existing customers.

Krupa is also spearheading reengineering planning at Rowe. "Instead of looking at new technologies, we are taking an introspective look at each of our businesses," she says. Those efforts, each assisted by IT people, are intended to find ways to reengineer processes for cost savings or quality improvements. Says Krupa, "As IT executives, we have to first and foremost look at the business units and say, 'Here are the things that can help you improve your performance and your budget.'"

Merrill Lynch. New York–based Merrill Lynch (www.ml.com) has ROI evaluations at the core of its IT project planning processes. "This process has clearly lowered our technology spending on what I'd call nonstrategic investments and redirected spending to more strategic areas," says Marvin Balliet, chief financial officer for the technology group at Merrill Lynch. The financial services company now requires that the businesspeople who will use the technology are involved in budgeting and planning for IT.

For the past three years, Merrill Lynch has required a risk-and-payback analysis for every technology initiative that costs more than $2.5 million. The process is similar to how Merrill Lynch would measure a capital investment in real estate, for example. This year, there will be 50 to 100 IT projects evaluated, quite a bit fewer than the 230 the brokerage reviewed in 2000, given the restraints of the recessionary economy.

Merrill Lynch launched its ROI methodology three years ago. Before then, every technology purchasing decision was made by technologists. Now, other than technology infrastructure investments, all IT decisions are "made by businesspeople, with technology people sitting next to them," Balliet says. Standing review committees in each of Merrill Lynch's business units are made up of managers from the business, finance, and technology departments who meet monthly and assign low, medium, or high probabilities to the expected benefits of a project.

When Balliet started the process in late 1998, there were seven review standards, or templates, that management at Merrill Lynch used to evaluate projects, each one favoring its own business area. Now a single standard six-page template is used that poses yes-or-no questions to evaluate project success factors. The document is coupled with a detailed five-page financial report. Questions asked include, "Is the success of this project dependent on another business or technology unit?" and "Have the business functions and the data requirements been identified and agreed to with the business units?"

"The businessperson and the technology person sit down together, and it's an agreement between the two sides before we start to spend," says Balliet. "The only rule to this is that the process has to be assigned to the businesspeople; it cannot be assigned to the technology people." Before Merrill Lynch launched its ROI program, about half of its projects ran above cost and never delivered all the promised benefits, Balliet says. Now the number of individual projects that exceed costs is down to 10 percent.

Case Study Questions

1. What are the benefits and limitations of the Rowe Companies' ROI methods for IT project planning?

2. What is the business value of the ROI methodology required for project planning by Merrill Lynch?

3. Do you agree with the IT investment decisions being made by the Rowe Companies in response to changing economic conditions? Why or why not?

Source: Adapted from Gary Anthes, "The Budget Squeeze," *Computerworld*, December 10, 2001, pp. 40–41; and Matt Hamblen, "In Search of ROI Measurements," *Computerworld*, March 25, 2002, pp. 32–33. Reprinted with permission from *Computerworld*.