

Management briefing

8 tips on calculating the ROI of an SCP&O solution

Avoid common ROI pitfalls and arrive at a more accurate estimate.

SUPPLY CHAIN PLANNING & OPTIMIZATION

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Real-world tips and examples to keep you on top of the buying process

You've decided your business needs a supply chain planning and optimization (SCP&O) solution. But how do you calculate the returns on this investment?

According to Forrester Research, many organizations do a poor job of measuring the business value of their IT investments. This is understandable. It can be difficult to determine the exact ROI of an SCP&O implementation. In fact, it isn't always easy to determine an indication of potential returns.

Here's how you can avoid common ROI pitfalls, and arrive at a more accurate estimate.

Tips for calculating ROI

A useful tip for calculating the ROI for an SCP&O solution is:

$$\text{ROI} = \frac{(\text{savings} + \text{additional income} - \text{investment})}{\text{investment}}$$

It's important to remember that:

- Savings are realized in virtually all SCP&O implementations.
- Additional income is generated by improvements in areas such as delivery performance, transparency, and supply chain integration.
- Investment consists of the external and internal costs needed to implement and maintain an SCP&O application.

However, the difficulty lies in determining what to include in each category. Here's what you should bear in mind.

Tip 1: Make sure you calculate the ROI – don't leave it to the solution provider

This is crucial. By calculating the ROI yourself, you will:

- Capitalize on your knowledge, and the knowledge of key colleagues: Your combined familiarity with internal processes will help to produce a more accurate ROI.
- Avoid conflicts of interest: A solution provider may be tempted to generate a less realistic ROI.
- Preserve credibility at board level: Externally generated calculations are less likely to be accurate – this will be detected by board executives.

Tip 2: Consider the total cost of ownership

Consider each cost component over the entire life cycle of the SCP&O solution.

For example, while an out-of-the-box solution may seem to cost less, the cost of configuring it could be substantial. Similarly, value-based pricing may seem like a good option until you take the total cost of ownership into account.

Tip 3: Consider your return horizon

Where will most of your savings occur? From improvements in:

- Short-term scheduling?
- Mid-term capacity planning?
- Long-term strategic planning?

The more dynamic your operations, the more you will benefit from a scheduling solution that delivers results in the short term. The less dynamic they are, the more you stand to gain from a tactical or strategic solution.

Compare, for example, a postal company and a groupage logistics company. The postal company's relatively stable operations will benefit from a tactical re-planning of routes – rather than from daily optimization. The groupage company – with its constantly changing orders and customer addresses – will gain more from daily optimization.

Tip 4: Require proof of quantifiable benefits

A demo or proof of concept that proves the effectiveness of the technology is far more convincing than an ROI report that's full of assumptions.

Don't expect an accurate ROI estimate from a proof of concept alone. It isn't possible to determine actual savings (e.g. by re-planning historical data) unless all your company-specific business logic has been included.

Tip 5: Be aware of interactions

Savings often affect each other.

- Savings in one part of a process may limit other savings. For example, reducing the number of empty kilometers may limit the loading efficiency of trailers.
- Savings in one area may increase other costs in another part of the process. For example, reducing set-up times may lead to higher storage costs.

Tip 6: Factor in 'moving efficiency' effects

There are cases where huge savings appear to be made – only to be called into question later. The culprit often turns out to be 'moving efficiency'.

Take, for example, a transport company that outsources its transportation but plans the trips itself. In an attempt to reduce costs, the company implements an intelligent planning tool that appears to increase efficiency. However, further analysis reveals that these gains were achieved at the expense of opportunities to combine shipments.

The increased costs borne by the subcontractors will, almost certainly, be passed back to the company in the form of higher quotes.

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Tip 7: Look out for ERP-related savings

An SCP&O solution can lower the cost of an ERP implementation. Certain functions that require tremendous effort to implement in an ERP system can easily be added to an SCP&O solution.

Tip 8: Quantify what can be quantified but don't ignore other benefits

How do you quantify the savings from centralized production planning? Or the benefits of being able to simulate the financial consequences of outsourcing versus increasing present capacity? These should all be taken into account.

While it is impossible to determine the exact returns on an SCP&O investment, these tips will help you arrive at a solid estimate.

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