Value Analytics Series:
Return on Investment and Savings on Investment (ROI vs. SOI)

In the current climate of a down-turned economy, cost savings is king. Management gravitate towards cost containment because of the benefit of immediate cash. Though a necessary process for maximizing profits and downsizing the organization to match the economic pressures, there is a tendency to sustain a "Cost Orientation" throughout the enterprise as the status quo. Oftentimes the line item cuts from management are a percentage across the board—regardless of the prohibitive impact such as random cut will have on risk avoidance and quality. Moreover, once departments show they can absorb the hit to the budget, they tend to educate management that it can be done again and again, until some managers find themselves coming in at 4:00 am to fill in the gaps they have created in headcount! These across-the-board line item cuts can be averted for greater benefit to the organization when managers and teams within targeted departments begin to evaluate and demonstrate their value by more accurately defining their return on investment (ROI). By creating a "value orientation" of their contribution to the bottom line, cost centers can strike a more logical balance between cost savings and business impact.

Savings on Investment

One great misconception about ROI is that cost savings on the budget are considered a return on investment when in actually a Savings on Investment (SOI) is being realized. If I give you a dollar and you deliver services for $.80, the $.20 saved by investment terms is not an ROI which reflects the way we define "value". The typical SOI approach defines value to the organization in two basic ways: Cuts to the budget and improvement of organizational processes—known as the "cost savings orientation". The highest form of SOI activities include reliance on the discovery of mass economies of scale, hyper-efficiencies, and business processes that reduce waste and time, such as Six Sigma initiatives.

Though a necessary step for maximizing resources available, this "cost savings orientation" is a process of diminishing returns that seeks to solve short-term goals, may misinterpret business drivers of clients, and potentially fail to inspire break-through value for the organization. If the leader and team considers budget dollars to be a line item to fulfill or beat and the goal is make the client happy, the emphasis is steered away from greater value being

generated if the same budget dollars are considered an investment and the client's success is the goal. The additional perspective to the SOI mentality or "cost savings orientation" is an ROI perspective or the "value orientation" that assumes all spending is an investment that requires a cost savings plan, business case, measurable outcomes, and alignment with the company strategies.

Return on Investment

The ROI of a project or groups of projects assumes a measurable financial return that is connected to the bottom line of the organization. Through the "value orientation", leaders and teams seek a longer-term, strategic benefit for which interviews, surveys, and focus groups will not reveal. Measuring business impact requires statistical analysis to isolate the benefit from other possible inputs to the benefit. In contrast the "cost orientation", the "value orientation" relies on greater connectivity and communication between interacting departments—a systems view demonstrating alignment with the strategic goals of the organization. In addition, departments could realize stabilized or increasing returns as they educate management to their new value propositions, they may experience increased creative breakthroughs as they consider strategic outcomes, and they may gain a better understanding of the business drivers for internal clients. Measurement of ROI is usually considered a historical look on the benefits of a current project. Using an analytics approach, through careful identification of intervention and control groups, departments can tease out additional information to optimize their strategies and deploy the projects across the enterprise for even greater return. Long considered too expensive, complicated, or impossible, measuring business benefit is not only possible, but it is fast becoming a business imperative.

Case Study 1: IT Department at Bank

(For a more detailed account of this case study, see our **Business Case Study: The Financial Value of IT Projects.**)

Oftentimes, departments with organizations bring enormous value to the company but they fail to communicate it effectively to management and to internal clients. The result often leads to a low perception of value to that department, diminished budgets, lowered head count, and possibly the removal of the department to outsourcing.

For example, the IT Department of a national bank focused on metrics that, upon analysis, gave them the ability to report "savings on investment" to their senior management: trouble tickets and system down time. These metrics enabled them to demonstrate that they were saving time (by increasing the number of trouble tickets they could complete in a given time) and perhaps saving customer frustration (by limiting system down time), but these metrics actually had little meaning to their customers and thus failed to demonstrate

the business value they actually were providing. Value was created when the department leaders and team members become more aware strategically of their impact on the organization, and changed their key reporting metric to an indicator of ROI: "financial value delivered to the bank for each minute the system is maintained and running." This metric focused the attention on their contribution to the goals of the bank as a whole, and put their requests for project funds in a clearer context: "if we invest x amount in maintenance and improvement projects for the system, it will result in y amount of revenue generation."

In general, teams need to expand their understanding of value to include metrics outside of their "world" and take the extra steps to demonstrate the impact of their contributions on the financial (and strategic) accomplishments of the organization as a whole.

Case Study 2: Seed Company Sales
(For a more complete account of this example, see our **Business Case Study: Measuring the True ROI of Training .**)

Training companies have been notorious for use of "SOI" reporting, especially in this past decade of movement towards web-based training. Many companies have sold their training on the basis of lowering the cost of training per participant (a classic SOI measure) as opposed to increasing the value of the learning delivered per dollar spent (ROI).

An agricultural products company accomplished this by moving beyond typical training evaluations to statistically correlate changes in actual sales to a sales training they piloted with some of their sales associates. By using the pilot approach, and only putting part of their sales force through the training, they were able to conduct a controlled study that ended up indicating that the trained group achieved $23 million in sales MORE than they would have without the training. They were thus able to document a return on investment of almost 200% (profit generated from the $1 million expenditure on the training). non-trained group.

Conclusion

For years, achieving ROI metrics seemed to be an unachievable "holy grail." Indeed, in some situations, the variables are too many or too interconnected to meaningfully isolate the impact of a particular activity on financial output. In these cases, "savings on investment" is sometimes the best a team can do. But never say "never"… Utilizing new statistical approaches and a business analytics measurement approach to isolate the business impact of projects has made actual ROI metrics more achievable.