

So What Is Return On Investment?

By Leslie Furlow

Return on investment has become big business in selling consulting services during the last five to ten years. Consultants will tell a client, that if their changes are implemented the cost of services provided will be recovered. But what does this really mean to the bottom line?

To better understand this question, this consultant went in search of definitions. In looking through several financial publications, it seemed that Return on Investment could be summed up as a percent of money earned or saved in relation to money spent on a particular program, item, or development. It is almost always time sensitive in that one would say; "The ROI is 50% over the first year of implementation."

Let's look a little closer at how this definition is applied when used by some consultants. Frequently, a cost reduction strategy consultant, such as inventory, or supply cost reduction, or personnel cost reduction, will state that the actual savings will offset the cost of services, i.e. their fee. For example, say a consultant's fees for an inventory reduction project is \$500,000. Let's assume that the inventory on hand at the beginning of the project is \$5000,000, and that the way ordering is presently done keeps the inventory at this level. First the consultant recommends that any out of date stock be returned to the manufacturer. Savings equaling \$15,000. Next inventory reorder points are re-established to decrease the amount of inventory in stock. Savings totaling to \$450,000. Finally, two stock handlers in the warehouse are discharged. Savings equaling \$35,000 (combined salary and benefits). Whella! The savings offset the cost. Additionally, if you continue to maintain this system, your cost will not increase, and you will realize another \$500,000 savings next year as well. Thus your ROI is 200% over the next two years!! Sounds great! But what did it really do to your bottom line? And since you didn't change the behavior

of your staff, or spend the time to get the buy-in of your customers, how long will it be before the system is circumvented?

Now let's look at a re-engineering project. The cost of one of these projects can range anywhere from \$250,000 (for a small company) to \$5,000,000 plus (for a large one) However, the consultant's guarantee is that if you go with them, you will have a 100% return on investment over the next 2 or 3 years. How might they compute this claim? Assume an organization currently has 25 department managers who each oversee 8 to 15 people. These managers are paid about \$75,000 a year in salary and benefits. The consultant re-organizes the departments to 10 managers, leaving each of them with the responsibility of managing 26 to 32 people.

Savings \$125,000, Looks great. Got your ROI! But without changing the way or the type of work the managers and staff are required to do will lead to burn out, inefficiencies, and turnover. And it is always the best that leave first. What is the cost of turn over? With that span of control, how can the employees be trained and motivated? If they are not provided training to make them more self-directed, the worst habits will prevail and the employees who are the best will move on. Were these issues considered prior to implementation and calculated as a function of a true ROI? Probably not.

Let's look at another example. Let's say we reduce the amount of time it takes to process an order from 24 hours to 10 hours. That's a savings of 14 hours per order, Now let's assume we process 300 orders per day And we pay our processing personnel \$800 per hour The math is 14 hours per order, times 300 orders per day, times \$800 per hour which equals \$33,600 Big savings! But did you layoff anyone, or if fact did the savings really only amount to a few minutes here and a few minutes there, but we still have just as many people? Hopefully our customers

are happier, provided of course that our shipping department and other support functions can keep up. But the bottom line may not show an immediate impact. And again, if we do not deal with the behaviors of the individuals implementing the changes, the old habits will return. How long will the savings really last?

It might appear that this consultant is not interested in ROI. That is not true. This consultant is interested in long term profitability, not short-term savings. Long-term profitability comes from changing the culture and behaviors of the organization. The cost and ROI needs to be viewed over a five year period that will provide continuous improvement and rational savings.

In his book, "Coaching For Improved Work Performance," Ferdinand Fournies asks the question, "Can you picture yourself going into your boss' office and stating that a piece of equipment you purchased twelve months ago for \$30,000 was not what you really needed; that you had made a wrong purchase?" The purchase decision was certainly made with an eye toward ROI. We will look at ROI on equipment, consulting fees, and other resources, but not on human resources. This is a mistake that has long term implications. Try calculating the cost of replacing a human resource the way you calculate non-human resources. If companies would, maintain their staff as well as they do their equipment and inventory, the need for cost containment consultants would decrease tremendously.

So what is the bottom line? Before hiring a consultant based upon their guarantee of a return on investment, ask a few hard questions. What exactly do you mean by return-on-investment? How will it be calculated? What is the overall bottom line impact of implemented recommendations? Will the changes help us achieve our strategic intent? And whom did you help five years ago, who still see the value in the

process? Look for a consultant who understands and can help to keep a focus on the inter-relationships between strategy, people and systems and bases their approach upon achieving long term returns that also produce competitive advantages. Even better look for a consultant who will partner with you to provide learning to your organization, rather than one who comes in, makes changes without using those who best know the processes (your employees), leaves to go, and the organization is responsible for cleaning up the mess that they created. Even though the consultant may have written a book, they do not know your processes and customers better than does your own organization. Clever calculations of ROI will not competitively improve an organization or its bottom line, developing your people to continuously improve your processes to better serve the customer will.



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