

Measure for Measure: The Difficult Art of Quantifying Return on Digital Investments



Most companies are struggling to quantify the impact of digital transformation

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Unlike Traditional Investments, Measuring Digital ROI Is Proving To Be an Insurmountable Problem for Many

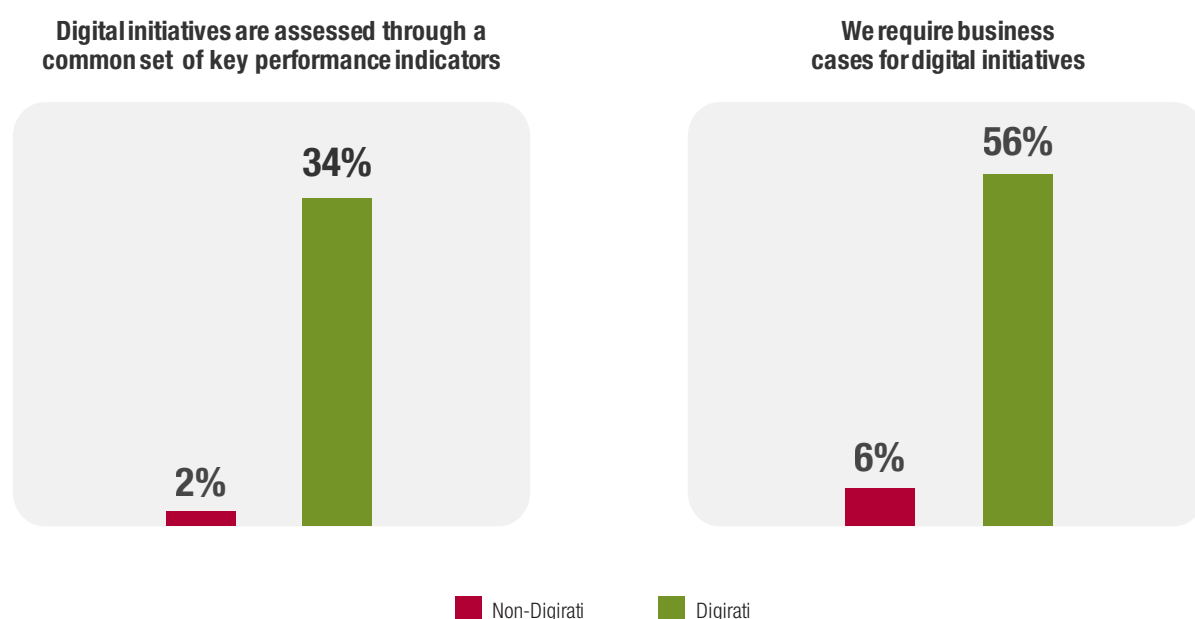
What do you do when you are convinced of the merits of an investment based on your gut feeling, but you cannot create a compelling ROI-driven business case? That is the situation many digital pioneers face. While they are convinced of the merits of digital transformation – our research with the MIT Sloan Management Review indicated that over 78% of executives consider it to be a critical issue – many cite the lack of a clear business case as a significant barrier. One executive characterized the problem thus: “It is still difficult to compute ROI on many social media activities (at least to the satisfaction of the executive board).”

Even among digital leaders, what we call the ‘Digirati’, only 56% of organizations create a business case. Moreover, only 34% of the Digirati assess digital initiatives through a common set of key performance indicators (see Figure 1). The figures are startlingly lower across non-Digirati, at 6% and 2% respectively.

These measurement difficulties are having a direct impact on funding. CFOs are hardwired to divert organizational funding to projects that can be clearly measured.

Give this context, what should organizations do to encourage digital innovation while maintaining sound budgetary practice? In this paper we look in more detail at exactly why digital initiatives are difficult to measure; how organizations can make a best effort; and finally we offer some specific steps and approaches for getting started.

Figure 1: Usage of KPI and Business Case for Digital Initiatives



Source: The Digital Advantage: How digital leaders outperform their peers in every industry, Capgemini Consulting and the MIT Center for Digital Business, 2012.

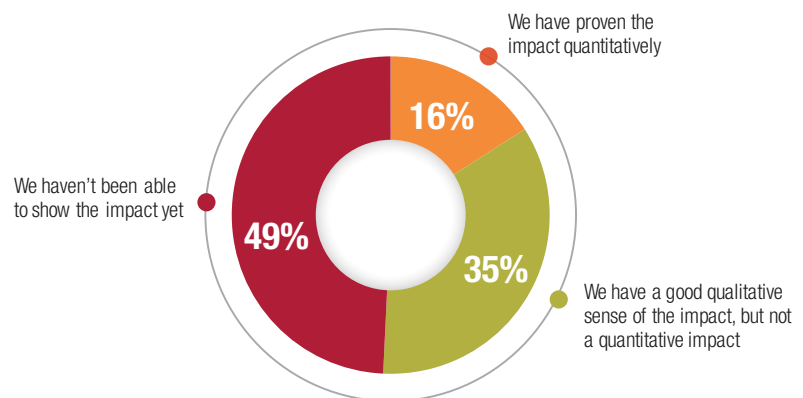
Why is it Difficult to Evaluate Returns from Digital Technologies?

Traditional Metrics Such as ROI Do Not Capture the Wider Impact of Digital Investments

Many companies are struggling to compute ROI for digital investments, not least because these investments have wide-ranging impacts that ROIs cannot capture. For instance, proving the value of social media initiatives is notoriously difficult, as organizations try their hardest to find a link between metrics such as customer sentiment and revenue growth. A recent survey of marketers provides stark evidence of this (see Figure 2). Only 16% of marketers said they have been able to prove the quantitative impact of social media on their business. Similarly, in the highly proliferated mobile app space, where the business case is still evolving for most firms, a Gartner study predicts that through 2016, 75% of mobile apps will be developed without a positive business case or with no business case².

“It is still difficult to compute ROI on many social media activities (at least to the satisfaction of the executive board).”

Figure 2: Which best describes how you show the impact of social media on your business?, CMO Survey, February 2014



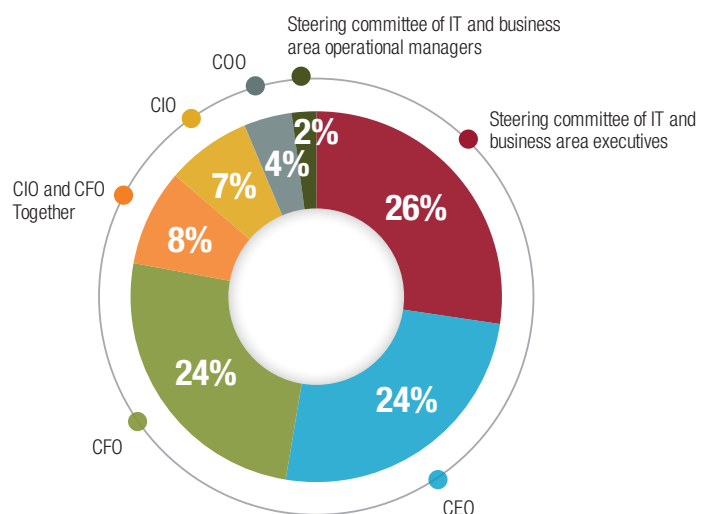
Source: The CMO Survey, “Highlights and Insights”, February 2014

CFOs Mostly Rely on Traditional Metrics

In many organizations today, the CFO is the top technology decision-maker³. A recent survey indicates that CFOs have a significant influence over technology investments, with a greater influence than

any other executive (see Figure 3). The same survey also indicates that this role is growing – by as much as 44% compared to 2010-2011⁴. This creates a problem as many CFOs will use standard financial metrics such as ROI – a measurement that fails to capture the full value of digital investments.

Figure 3: Role That Authorizes Technology Investment, Gartner Survey, May 2013



Source: Gartner, “Survey Analysis: CFOs’ Top Imperatives from the 2013 Gartner FEI CFO Technology Study”, May 2013

Making the wrong bets

Digital investments often deal with emerging technologies that evolve rapidly and have an uncertain future. For instance, take the case of smartphones. In a little over six years, Android has emerged and then rocketed to seize a massive 79% of the smartphone operating system market⁵. Organizations that had invested in alternate platforms today face challenges in recovering their investments. Similarly, take the case of the 3D printing market or the wearables technology market. In both cases, developments have been extremely rapid in recent months with the technology leapfrogging many generations of features. In such a scenario, it becomes challenging to make long-term decisions.

Measuring digital impact is hindered by a siloed approach and legacy power structures

The impact of digital technologies cuts across traditional silos, affecting multiple parts of the business such as marketing, IT, customer experience and operations. Digital has the power to change customer interactions, internal business processes and even business models. This requires organizations to have a firm-wide view to be able to assess these investments. However, most companies are simply not equipped to do this. Our research with the MIT Sloan Management Review found that only 19% of companies have cross-functional steering committees that manage and foster digital investments⁶ at a corporate level.

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Only 36% of finance executives agree that the metrics they use to assess technology investments are commonly understood across the company.
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The language of digital is typically alien to C-Suite leadership

Technology – and the language of technology – has often met with a level of bewilderment in the boardroom. CxOs understand the language of costs, revenues and resources. Most digital technologies come with their own vocabulary, which is in itself quite different from traditional technology. Take the case of a social media investment plan. In order to analyze outcomes, the CxO must embrace the language of “click-throughs”, “sentiment analysis” and “likes” and convert them to financial parameters. This can, to put it mildly, be a challenge.

And we must not forget that this miscomprehension can be mutual. A survey by CFO Research Services found that only 36% of finance executives agree that the metrics they use to assess technology investments are commonly

understood across the company⁷. This leads to a situation where the objective is lost-in-translation, with both parties looking at the same project but through a different lens.

In the following section, we look at how organizations can deal with this uncertainty and find a meaningful way to build a digital transformation business case.

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How Can Organizations Measure Digital Initiatives?

CFOs and digital leaders are realizing the need for alternative approaches of measuring returns on digital investments. Based on our research, we see three broad types of digital investments: maintenance or business as usual (BAU)^a, transformative^b, and emerging digital technology^c. Here, we take a look at how to measure returns on these three types (see Figure 4).

Maintenance/ BAU Investments Are Measured Using Traditional Metrics

BAU investments are characterized by the necessity to keep the business running and/or minimizing risk. They are a pre-requisite for business. For instance, on-going maintenance of web sites and security/compliance-related projects fall under this category. The goals of such investments are clear upfront and such

projects should be tracked against typical project metrics of conformance to budget, schedule, productivity and quality. Such projects make up the bulk of technology investments in most companies. A survey of respondents from 3,700 companies showed that they spend an average of 72% of their budgets on replacing/expanding capacity and supporting ongoing operations and maintenance⁸.

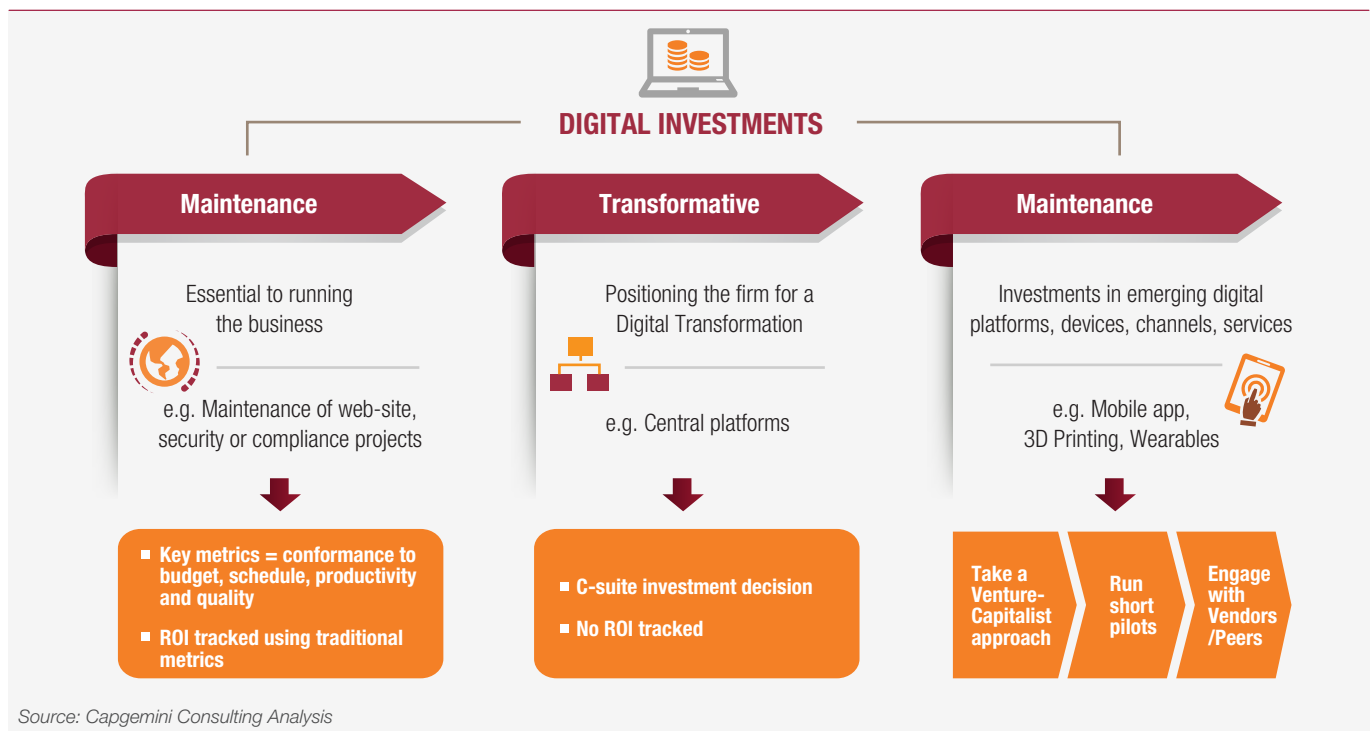
Transformative Investments Are Driven Through a CEO Mandate - Measuring Them can be a Waste of Time

Transformative investments have the explicit mandate of supporting an organization-wide digital transformation. In most cases, they are usually cost-intensive and their benefits are highly distributed. In such cases, drawing up a

business case is not necessary. In fact, it even might be waste of time. This is why decisions for such investments should be taken at the top, usually by the CEO, and should be funded centrally. Investing in core systems, platforms or services that enable advances in digital customer experience or operations are examples of transformative investments.

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For emerging technologies, the key is to evaluate ROI at the right time – too early-on can kill a good idea and too late can mean a sunk investment.”

Figure 4: Measurement Techniques for Digital Investments



a Maintenance investments are those that are essential to the running of the business or in response to regulatory compliance requirements; for instance, website maintenance, security updates, regulatory compliance projects

b Transformative investments are made with the explicit mandate of positioning the organization for the digital age

c Emerging digital technologies refer to digital devices, platforms, channels across customer experience, operational processes and business model

Emerging Digital Investments Require Iterative Assessment

Emerging digital investments deal with nascent, un-established technology. We believe that returns on such investments need to be evaluated differently since calculating ROI for such investments is not a straightforward task.

Manage these investments in a venture capitalist style

These investments are typically in areas where the technology is rapidly evolving. In most cases, the returns from such investments are highly speculative. Moreover, the lack of historical benchmarks or industry examples complicates the creation of a business case. In such cases, organizations should adopt an approach that is closer to that of a venture capitalist. The idea would be to make small investments in a variety of ideas, allow them to rapidly iterate, identify those with potential and shut down others.

Ideas with potential should be implemented in pilots

Ideas with potential should then be evaluated in a proof of concept or pilot version. Once some hard data is gathered, it should be fed into a business case to test the feasibility and should then be accordingly continued or stopped. Incubators, digital labs, innovation centers are examples of such investments. For instance, L'Oreal established an incubator called "The NEXT lab" to invest in latest digital technologies such as mobile e-commerce, location and retail⁹.

A European beverage company wanting to launch an enterprise-wide social network offers a good example of how

organizations should go ahead with digital investments in areas with uncertain visibility of returns. The company decided to focus its attention on a pilot in the first year. Adoption rates and other user behavior from the pilot were monitored and were subsequently used to build the business case and associated KPIs. An executive summed up their thinking behind investing in an emerging technology, "This investment was primarily based on what I would call an 'art business case', rather than the 'science business case,' and this was the right thing to do. We did the investment big enough to be successful, but small enough to not be stupid."¹⁰

The risk that firms run in managing such initiatives is identifying the right time to evaluate ROI – too early-on can kill a good idea and too late can mean a sunk investment. The BBC offers a good case of an investment that was let to drag on for too long. The BBC launched a digital media initiative in 2008 as a means of transforming the way staff developed, used and shared audio/video material. However, even by 2013, the project had generated 'little or no assets'. In the end, by the time the initiative was scrapped in 2013, it had already cost the BBC £98 million¹¹.

Support the investments with learnings from vendors and peers

Most of the investments in new technologies have few industry benchmarks available for reference. While building a business case may not be totally clear, firms should look at other companies that have made similar investments to understand the benefits and hidden costs. Companies need to follow a piecemeal, iterative approach to investment to ensure alignment with business goals.

Firms should also look for data from third-party research firms, publications or technology vendors to provide inputs into the business case. For instance, a VP of digital marketing used data from a third-party analyst for building a business case for more social marketing headcount and the proposal was approved. Why? Because according to the VP, "the CMO could not argue with research from a credible source."¹²

When there is a complete lack of clarity of ROI, let the investment pay for itself

There will still be instances where executives are faced with no clear business case/ROI for a digital investment. However, that should not be a cause for worry. Organizations should strive to get the incremental revenues to fund the digital initiative. The growth targets for the digital initiative should be set, and achieved, in a manner that covers not only its initial CapEx, but also its running OpEx.

"This investment was primarily based on what I would call an 'art business case', rather than the 'science business case'.

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Transformative Investments at Amazon

Amazon is well known for its long-term view on digital investments with a focus on building market share while taking years to generate profits.

Over the past few years, the company has invested heavily in its Prime delivery services platform, Kindle tablet and digital media, operating on slim margins and negatively impacting profits. The company's CEO Jeff Bezos explains that the investments are focused on its customers and believes its strategy is best for the long-term. This long-term view is reflected while measuring the Kindle tablet's success- the CEO maintains that "usage" of the device rather than device sales is the preferred success metric.

Source: CNET, "Amazon's Bezos defends heavy investments in Prime, Kindle", April 2013

Maximizing your chances of funding

So you have built a business case - but that is not all. To maximize your chances of funding, you need to ensure that you have taken a holistic, organization-wide view and paid attention to softer points for converting the naysayer to an advocate.

Look at cross-organizational areas of impact

Any digital initiative is bound to impact on various parts of the organization. For instance, it can reduce the importance of a certain business function and may cause political friction. On the other hand, it can benefit multiple business units. Such softer factors should also be factored in when building the business case in terms of risks, costs and benefits.

Identify champions within the organization

As with any new initiative, you need to recruit champions to support and further your cause, without which the business case will collapse. Identify stakeholders that would be affected by your initiative and determine and address their concerns. For instance, in order to launch a mobile sales app, the marketing team could identify champions from the product, IT, finance and communications teams.

Tailor the business case for the audience

The decision maker for the funding may be the CFO, CEO, CMO, etc. Ensure that the business case addresses concerns and provides data for the audience at hand. For instance, the CFO may be more interested in detailed ROI calculations whereas the CMO may be more concerned about the impact of the initiative on other marketing programs.

How Should Organizations Make the Investment Decision?

Once a business case is presented, taking the actual decision to invest is a combination of having the right governance in place while ensuring that there is a reasonable amount of portfolio balancing at an organizational level.

Govern the Investment Decision Through A Central Digital Committee

Digital has an impact for firms that is felt across traditional silos and requires more coordination when making investment decisions. To coordinate properly, firms should create a centralized digital steering committee that aligns around the company vision and evaluates and funds digital initiatives centrally. Such committees also make investment decisions that might not be feasible for a single business unit to undertake. For instance, an investment in an initiative that touches several parts of the company and comes at significant cost.

Most firms have a long way to go in this regard. Our research with the MIT Sloan Management Review shows that only a narrow set of companies have specific cross-functional committees (37%) with enterprise-level authority on digital

investments¹³. Steering committees should be allotted the task of prioritizing and funding digital initiatives, made up of senior executives from marketing, technology and product and reporting to the CEO.

Balance the Overall Company Investment Portfolio

Looking at an investment proposal on a standalone basis is not sufficient; decision-makers must look across the overall investment portfolio in business as usual (BAU), transformative and emerging technology projects. This is essential to balance out risks and short- and long-term payoff. This ensures that funding is given to the right type of investments.

There is no ideal portfolio. It depends on a firm's industry as well as its strategic direction and risk appetite.

Use Guidelines for Making the Investment Decision

How ready are you for digital investments? Having clear guidelines will help you answer this question.

The table next page provides such a guideline for determining where your organization stands with respect to readiness for assessment of digital initiatives. While no means exhaustive, this toolkit provides the decision maker with a quick starting point from where the discussion can be further refined.

As more organizations embark on their digital transformation, it will increasingly become an imperative to define and measure digital initiatives. Nevertheless, the lack of a well-defined measurement methodology should by no means be a stumbling block to funding digital initiatives. As technology matures, leaders can start expecting to see more refined ways of measuring digital investments. However, until then, we might need to rely on that strong gut instinct and take a leap of faith.

Table 1: Are you ready for digital investments?

Give an honest assessment for each central questions based on the initiative being proposed with a rating from 1 to 7 (1=strongly disagree, 3=neutral, 7=strongly agree). For each of the steps, total your scores across the individual questions and arrive at the recommended action to be taken for the particular initiative.

	Your Score	Action/ Next Step
How well do you understand digital investments?		
We understand traditional investments such as ERP systems	1	You need to urgently upskill your knowledge of new digital technologies
We understand online investments such as portals, websites	3	You have the basics right, however, digital technologies are more than just channels. They exist across several corporate functions
We have an understanding of digital technologies including social media, mobile apps, analytics solutions, cloud-based services	7	You now need to understand how companies across sectors are investing in such digital initiatives. Also, bear in mind that these technologies are constantly evolving
Where do you see digital investments contributing in your overall investment mix?		
We see digital investments having impact primarily in enhancing customer experience	1	While customer experience is a good starting point for digital initiatives, it is by no means, the only area
Digital investments can also help in driving the efficiency of operations, beyond enhancing customer experience	3	You have rightly realized that digital investments can play a key role in unlocking latent efficiency in operations
Digital investments can help us in creating new business models, or radically transform existing models	7	You have rightly identified the role that digital investments can play in your organizational transformation.
What is your approach to investing in digital initiatives?		
We invest only in initiatives that have clear ROI associated with them	1	You need to recognize that digital investments are as much, if not more, important for your organization's survival in the digital age
We are OK with investing small amounts in digital initiatives that have proof of success from other companies	3	You have made the right start, but you need to constantly keep yourself abreast of latest technologies and encouraging investments
We have a 'labs' setup where we encourage investments in emerging technologies, with no clear ROI	7	You have the right approach to investing in digital initiatives
Do you have the right governance structure for administering digital initiatives?		
We deal with digital investments as and when they are brought up	1	This approach will prove a significant hindrance in today's hyper-competitive times
We try and aggregate digital investment needs based on geography/BU	3	You are on the right path, however, you need to think beyond geography/BU for unlocking full potential
We have a central governance structure for identifying, evaluating and implementing digital initiatives	7	You have the right structure for running digital initiatives. You need to start investing now

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