

## Process, Productivity, and Profit: The SMB Executive's Framework for ERP Investment

*by David Caruso*

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# Process, Productivity, and Profit: The SMB Executive's Framework for ERP Investment

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SMB companies that are not aggressively developing an effective ERP strategy will be at some disadvantage to their peers by 2006. Forward-thinking executives will consider strategic business capabilities as the drivers for ERP investment justification.

The  
Bottom  
Line

Over the past several years, competitive pressures have triggered massive shifts in the style and speed of global business. For Small and Midsize Businesses (SMBs), managing customer satisfaction and supporting high growth rates demand entirely new ways of doing business. Competing profitably will require information systems that can speed innovation, improve customer response, and provide global visibility for effective decision making. In addition to those operational concerns, the current stringent regulatory compliance reporting requirements demand that executives assess how their information systems support their future plans.

Many organizations, particularly smaller firms, have realized that they do not have the IT architecture needed to compete in the new demand-driven world. For many companies, this means going back to the basics: an Enterprise Resource Planning (ERP) system that will standardize business processes, extend the company's reach with its suppliers and customers, and reduce overhead.

## Four drivers frame the business case for ERP investment

In a 2005 study that AMR Research conducted with over 550 companies regarding their ERP investment plans, we found that only 27% of small companies (fewer than 500 employees) are currently using ERP. This is in sharp contrast to the 57% of large companies (500 to 2,499 employees) and 70% of enterprise-sized companies (2,500-plus employees) that have operational ERP systems.

Given this data, it is not surprising that almost 50% of the respondents interviewed will be making substantial changes to their existing ERP systems over the next 12 to 18 months. The challenge for executives charged with the decision is establishing a powerful context for making the ERP investment.

When considering the ERP investment decision from the perspective of the executive suite, there are four overarching drivers that frame what executives need to consider:

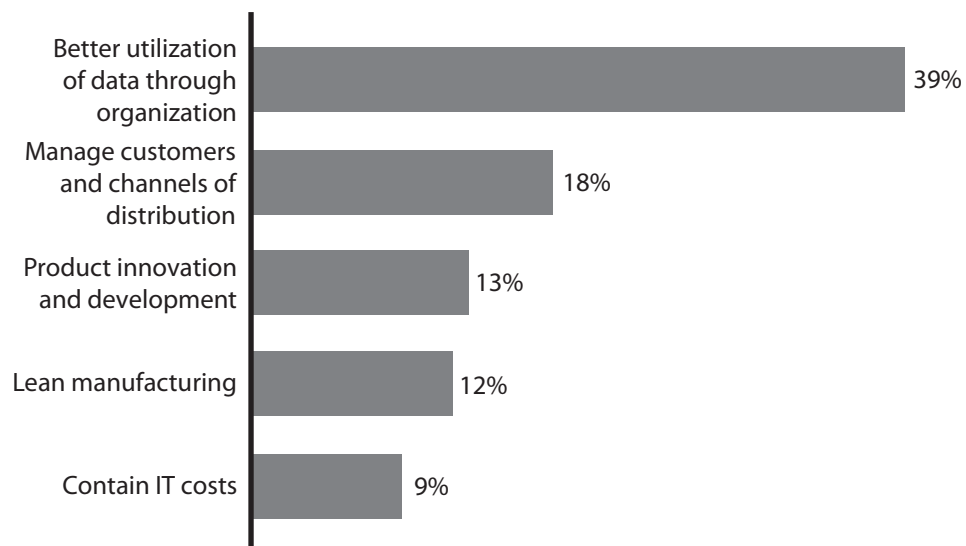
- **Productivity**—Getting the most from your valuable employee assets
- **Connectivity**—Working collaboratively with your key customers and suppliers
- **Business insight**—Improving the speed and quality of decision making
- **Total cost of ownership**—Reducing the cost of owning and operating IT systems

## Employee productivity: Essential for competition

Executives instinctively know that their employees are their most valuable asset. Indeed, in many industries—such as Financial Services and Real Estate—the employee population is the most critical asset and manageable cost. The nagging issue is how they can create a more efficient work environment and unlock the value of these employees. Unfortunately, many existing IT products and environments hamper progress toward that goal.

As part of the 2004 National Manufacturing Week Technology Trends Survey compiled by AMR Research, executives made the link between information and performance. Clearly, executives recognize that the critical data needed to succeed is already within their firm; the challenge now is to leverage its use throughout the organization for better decision making.

**Figure 1:** What is the single most important driver of 2004 IT investment?



Source: AMR Research, 2005

Simply put, companies are looking for ways to use information to shorten the time to respond to business events such as new sales leads, customer order fulfillment, and service requests. Today, inefficient workflow processes and inaccessible islands of information are the root causes of bloated overhead costs and poor response times. Oftentimes employees waste valuable time rekeying redundant information into many different systems because these systems are not integrated. In addition, manual processes that support new regulatory compliance must be automated to free valuable resources for more productive use.

The good news is that for SMBs, the current generation of ERP systems provides a powerful value proposition. These systems effectively integrate activities, employees, and trading partners through manageable business processes, enabling companies to automate and orchestrate interactions in a highly flexible and efficient manner. For many executives, this represents an opportunity to reduce cost and establish a platform for continued profitable growth.

In terms of business processes and employees, ERP system covers a footprint of employees and business processes unprecedented compared to earlier applications. Today's typical ERP system includes a host of capabilities unheard of in previous generations of products. It should, in most firms, reach well into the 90% range of required functionality. Current generation ERP systems can include applications to manage the following key business functions:

- New product development
- Financial management and reporting
- Purchasing, procurement, and supply chain
- Manufacturing and production operations
- Projects and services
- Quality, health, and safety
- Bill of materials and specifications
- Human resources and payroll
- Customer order management
- Customer relationships, sales, and service
- Business Intelligence (BI) and analytics

## Connectivity: Reaching out to your customer and supplier partners

The most important initiatives of many SMBs are often driven by their customers. Indeed, most Fortune 1000-class firms are exploring more ways to work with their suppliers to reduce cost and speed time to market wherever possible. In many cases, these suppliers are SMBs. Effectively outsourcing design and production will demand closer collaboration and better data sharing between firms. Manual or disconnected systems impair successful partnering and connectivity.

In addition, disconnected systems cost companies in terms of responsiveness, market and customer visibility, and higher inventories. This is driving more companies to address expensive and complicated issues of several areas of importance: customer and channel management, supplier integration, and supply chain collaboration. Several examples of collaboration are shown in Table 1.

**Table 1:** Types of collaboration and their impact

Types of collaboration	Impact
Multigroup design collaboration	Time to market/product cost
New product introduction	Time to market/ market share
Engineering change management	Time to volume/ customer satisfaction/ quality
Procurement/supplier collaboration	Product cost/ working capital
Contract manufacturing	Product cost/capital utilization
Demand management and forecasting	Manufacturing costs/ working capital/ logistics costs
Team selling	SG&A/order closure times
Customer service	Reduced overhead/ customer satisfaction
Project management	Faster problem resolution/ reduced travel cost/ on-time delivery

Source: AMR Research, 2005

From the perspective of the Fortune 1000-class customer, it's costly and inefficient to do business with partners that have manual processes (for example, sending or receiving orders by fax requires manual handling and is time consuming). On the other hand, for the SMB firm that lives and dies by servicing its key clients, not being able to collaborate effectively can have serious cost impacts—not to mention customer satisfaction issues. It can be costly to connect with business partners that have automated processes. For example, it can be difficult and costly to provide access to your system; this often requires a certain level of IT skills as well as time-consuming manual intervention for setup.

In today's wired world, ERP is the very infrastructure of how your business operates. And this infrastructure must extend beyond the four walls of your company. Indeed, for many firms, a core value proposition is their agility in working with their key customers' needs. In addition to improved customer satisfaction from these collaborative activities, partner connectivity has the simple but powerful impact of reducing transactions costs.

## **Business insight: Real-time visibility improves decision making**

As shown in the previous table, the most frequently cited business issue driving IT investment is better utilization of data throughout the organization. However, achieving this can be a major problem when information in the system is not up to date or hard to access and share. The result: employees are notified too late of problems or opportunities to make a difference. Savvy execs want to provide more active planning and decision-making applications that are guided by business goals and assist employees with real-time monitoring and response capabilities. From information on procurement costs and financial performance to the increasingly robust set of data collected on customer demographics and order preferences, the ability to collect, analyze, and share information that supports decision-making processes is an absolute priority.

BI tool adoption is on the rise across a growing midsize market in 2005. In fact, more than 82% are in some stage of adoption of BI tools for reporting and analysis. And talk about getting leverage from information across the organization, in the AMR Research *Alert* article "Midsize Companies Are Serious About Business Intelligence," December 21, 2004, we found that 71% are delivering BI to more than 50 users, and 20% will have more than 500 users in 2005. Beyond the corporation, 24% of SMBs are using BI tools to deliver information to customers, partners, and suppliers.

Fortunately, today's ERP systems coupled with powerful and simple-to-use analytic tools finally give powerful context to the way you wish to manage your business. Among many others, here are some key examples:

- Supplier metrics can be stated in terms of on-time performance and the measure of product, service, and order quality.
- Customer metrics can be analyzed by stats of loyalty or price sensitivity.
- Sales metrics are measured against unit counts, customer mix ratios, and profitability.
- Employee metrics can be created to monitor attrition rates or performance ratings.
- Manufacturing performance can be measured for quality, cycle times, and schedule attainment.
- Distribution can be measured for on-time fulfillment and perfect order performance.

Regardless of the measurement, the enterprise demands that operation plans be stated financially to fully assess the monetary impact on the enterprise. Finally, functional and executive leadership has access to information from other operating units, enabling users to make decisions that optimize performance globally, not just locally.

## **Total cost of ownership: Making the most of your IT dollar**

Bailing wire and duct tape: that is how many managers describe their IT environment. While certainly not the fault of the hard-working IT crew, it has come to that through the myriad different systems added over the years. The result: needed data is not reliable because moving data from one source to another and reformatting it for analysis is error prone and has built-in time lags.

Firms with these dated systems are likely paying another price: inflated IT costs as small staffs struggle with this complex environment. Many small and midsize companies have disparate systems and applications from many different vendors. While certainly added for good reason, these systems none the less often still require different technical skillsets, integration programs, and handcrafted add-on reports. As a result, it's costly for IT staffs to implement, learn, use, maintain, and upgrade these systems—not to mention the time and money it takes for an expert consultant to get the systems to work together.

To put this in perspective, IT budgets for SMBs average 6.3% of revenue in the Americas, as compared to larger enterprises whose budgets are typically at 2% for manufacturers and 5% for services companies. Clearly some of this investment could be put to better use.

## Conclusion

Midsized companies that are not aggressively developing an effective ERP strategy will be at some disadvantage to their peers by 2006. Companies cannot let inertia be their primary strategy. Some action items that executives should put on their near-term to-do list include the following:

- **Review employee productivity.** Is this performance impaired by the overhead of rekeying, paperwork, time-lagged batch interfaces, and manual processes?
- **Understand your external partner requirements for information.** Are they demanding more information and better response? Are they requesting that you participate in initiatives for electronic collaboration or financial transaction integration?
- **Consider your decision-making needs.** Do you have the visibility to drive the business? Is information timely and in context? Do your line-of-business managers have the up-to-the-minute insight to make the right decisions?
- **Analyze your IT expenditures.** How much of your IT budget is spent maintaining ageing systems? Does the current system environment prevent you from getting accurate information? Does the complexity of all the interfaced systems slow down new business process improvement programs?

While investing in a new ERP system may seem a little daunting, it could provide a renewed efficiency to your IT managers and put your firm on the fast track to becoming a profitable global competitor.

# Notes

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# Acronyms and Abbreviations

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BI	Business Intelligence
ERP	Enterprise Research Planning
SMB	Small and Midsize Business

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