



# The IT Payoff: Measuring the Business Value of Information Technology Investments

By Sarv Devaraj, Rajiv Kohli

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Does technology really add value? If so, when? What's the best way to quantify and maximize technology ROI? *The IT Payoff* gives you powerful new tools for answering critical technology investment questions. Discover where technology can add the greatest value; when to adopt new technologies; how to coordinate process and technology change, and more. Includes new metrics, hands-on templates, and a complete action plan for making smarter funding decisions!

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## **Editorial Review**

### From the Back Cover

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### About the Author

SARV DEVARAJ is a faculty of the Management Department at the Mendoza College of Business, Notre Dame, specializing in technology management, quality and productivity management, and manufacturing strategy. He consults widely in the areas of technology management, performance evaluation, just-in-time manufacturing, work teams, and optimizing manufacturing. He is also a Fellow of India-based software companies. Devaraj speaks frequently at conferences, including the Annual Conference for the Decision Sciences Institute. His work has won several international awards.

RAJIV KOHLI is a faculty in the College of Business and Economics at Lehigh University, specializing in strategic information systems, enhanced decision support systems, process innovation, and the role of information technologies in enabling competitive advantage. Recently, he was an internal Consultant in the Decision Support Services at the corporate office of Trinity Health in South Bend, Indiana. He has worked and consulted with organizations in manufacturing, telecommunications, and healthcare.

Devaraj and Kohli's recent joint publications include "Information Technology Payoff in the Health-Care Industry: A Longitudinal Study," published in the *Journal of Management Information Systems* and (with Ming Fan) "E-Loyalty: Elusive Ideal or Competitive Edge," published in *Communications of the ACM*. They are currently jointly researching new methods for analyzing e-commerce customer satisfaction and loyalty.

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## **Foreword**

*The IT Payoff* is all about being a professional. It's a *management* book that addresses the single most important issue for the future of the information services (IS) field and one that will become more and more central to general managers and functional managers: the need for a compelling, convincing, disciplined and well-communicated financial model for IT investments. The IS field has largely lacked all four of the adjectives that precede "financial model" in my previous sentence. Indeed, many executives would argue that it's lacked any sense of financial realism and hasn't had any model.

Historically, to be an IT "professional" meant having training and experience in systems development and project management. Development was the core of any information services organization and technology skills the necessary base for its success. There was very little attention paid to what should have been a

priority: *the financial responsibility of true professionals* to ensure effective use of the firm's capital investment in IT. This just wasn't on the agenda. In the close to thirty years that I've taught at major business schools, I can't recall a single course devoted to the topics *The IT Payoff* so lucidly and comprehensively addresses. In the 1980s, the focus of IT education did shift from development to IT-and-competitive-advantage (an almost breathless single word), but the focus was on market share, growth and new product, and service development. Here again, the financial responsibility was ignored. The implicit assumption was that growth would generate return and that competitive advantage ends up on the bottom line.

I recall my own book *Competing in Time*, published in 1986; it did not contain a single page on managing the costs and benefits of the investment. In 1988, I sponsored and published a book, *Getting Business Value from IT*; it sank with little trace. The flood of books about *Net Something* were largely naive or even irresponsible about the financial side of the dotcom era. Of course, there has for a long time been plenty of discussion of the issues of IT payoff. Much of this has basically been ideological in nature and highly repetitive, centered around the Productivity Paradox, a term coined by an economist skeptic about IT that set the agenda for much of the academic research on IT payoff. (Most economists have been skeptics in this regard.) Little of this work has had any real management relevance. It ignores what I believe is the strength of *The IT Payoff*: attention to the *process* of financial analysis, justification, and communication.

The data the academic work has used has also largely been very dubious; it uses macro level figures that are incomplete and do not reflect the multiplicity of cost elements. IT costs are scattered across many budgets and in my own experience only 20% of them are visible; the rest is what I call the cost iceberg. In addition, the fundamental problem in assessing IT payoff has always been how to attribute value to infrastructures that enable specific applications. At the level of the individual project it's possible to measure return on investment (ROI) in many instances, though even here, it's very difficult to quantify all the "soft" benefits such as "better" service, "improved" communication, and the like. All this is well-known but until the problem of the search for payoff is handled in managerial rather than conceptual terms we will see no more progress in the next ten years than we have in the past ten.

Business executives have long been frustrated by the IT payoff problem. The last 3-5 years have seen several shifts in their view of IT that in my own opinion demand that IS make the financial side of IT its professional core. The earliest shift came from the accelerated move of technology from the periphery of business to its mainstream, first through the massive investments in ERP necessary to end the mass of disintegrated applications and infrastructures that had accumulated over a twenty year period, and second, the emergence of e-commerce as a force that has transformed many industries and is now part of everyday life, regardless of whether or not companies make money from it. Executives now realize that technology is an executive responsibility. In around half the firms I work with, the Chief Marketing Officer or Chief Operations Officer is effectively the CIO. More and more IT investments are led by the business.

The second shift was Y2K. This was a massive and largely unplanned expenditure that in many companies took money away from other priorities. CEOs and CFOs felt they were being forced to write a blank check. Perhaps the business community as a whole might have felt the investment more worthwhile if Y2K had been a disaster instead of a non-event! In any case, when the third shift came, Y2K looked inexpensive. This was the dotcom frenzy. Here, CFOs who had long been concerned about controlling IT costs and ensuring detailed ROI analyses, lost all control. The new blank checks had extra zeros on the end of the figures, with minimal business justification. "Never again!" That's the view from the executive boardroom, a boardroom that knows much more about IT than it did a few years ago.

We are in a fourth major shift: from customized systems development as the norm and packages the exception, to the reverse. The art form of development is now "tweaking" and "chunking"—my own term for how companies now integrate ERP, CRM, legacy systems, and data resources through such tools as

C++/Java and XML.

All these shifts subtly, sometimes slowly, inevitably redefine the role of the IS professional. Of course technology skills still matter, but many of these will be obtained from outside, by using integrators and software houses, many will be built in business units, such as data warehousing and CRM expertise. What has changed is the matter of financial responsibility. *Who is responsible for ensuring IT payoff?* If not IS, then who? If, though, IS has the responsibility and leadership, then it had better have the professionalism. The topics of this book are the core of that professionalism. If the business is responsible, it too needs a new management competence. Again, this book provides the grounding for that competence.

The strengths of *The IT Payoff* are its management focus and its inclusion of all the elements of cost, benefit, technology, and business justification. It's marked by its realism and lack of the fogginess of so much of the ideologically-driven work pro or con the Productivity Paradox. It does full justice to the wide research and methodologies that have emerged over the past decades but places them in their business and organizational context. It is simple in the best sense of the term: well-articulated, well-paced, well-reasoned, and not simplistic. It is a very valuable contribution to helping IS people become business professionals and also to aiding non-IT managers in understanding and taking charge of business change, which almost invariably now requires substantial investment in IT as platform, enabler, or support for innovation.

The era of IT as technical development is coming to its close. The era of IT as financial responsibility is long overdue.

—Peter G. W. Keen

Chairman, Keen Innovations,  
and Senior Fellow, Differentis  
Fairfax Station, Virginia  
December, 2001

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