Making Enterprise Business Systems Pay Dividends

May 2013

ERP IN THE CLOUD FOR WHOLESALE DISTRIBUTION: IT'S ALL ABOUT COST

COST SAVINGS COUPLED WITH LOWER TOTAL COST OF OWNERSHIP

As a wholesale distributor in today's challenging global economy, you face increasingly global competition, growing complexity of supply chains and trade regulations, and continued volatility of oil prices impacting transportation cost. And to top it off, you operate on razor thin margins. World Class Enterprise Resource Planning (ERP) implementations have been shown to address these challenges and produce amazing results. Yet many are still "making do" with a solution that you know can't help you achieve a competitive edge. Think there's nothing better? Think again. Don't have the capital? Think you can't afford it? Don't have the internal resources to make it happen? Think (just maybe) you're sticking your head in the sand? Maybe it belongs in the cloud instead.

Data Source

In late 2012 and early 2013 Mint Jutras collected more than 475 qualified responses to an electronic survey for its ERP Solution Study. These were qualified by the participant's knowledge of and involvement in ERP implementations and responses were used to investigate ERP goals, challenges and status and also to benchmark performance of ERP implementations.

Survey respondents represented companies from many different industries. However for purposes of this report we included only wholesale distributors This resulted in a sample size of 108 responses.

Additional data is referenced from a survey conducted in August and September 2012 for the purpose of determining levels of understanding, perceptions and preferences for enterprise applications deployed as Software as a Service (SaaS).

"MAKING DO"

About 70% of wholesale distributors have something they call ERP[1]. Mint Jutras feels this percentage is optimistic at best. While we believe all 70% are using some type of business applications, these solutions might not be what **we** would call ERP. This is partly because the acronym is used rather loosely and many find it difficult to define it. Mint Jutras defines ERP as an integrated suite of modules that provides the operational and transactional system of record for your business. Bear in mind though, most ERP solutions today do much more.

This definition allows for a lot of variability in the scope of solutions. Some of that variability results from different types of companies having different needs. But a key word in our definition is "integrated." If you are running a collection of disparate commercial or home-grown applications that are tied together with the software equivalent of duct tape, bailing wire and a prayer, your solution may not be ERP at all. Of course, even if you do have a "real" ERP solution, it may not be comprehensive enough to meet the special needs of a wholesale distributor. You might be filling gaps with other applications that may (or may not be) interfaced to ERP. Or you might have stopped short of a full implementation.

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If you find yourself in any of the situations described above, chances are you are leaving money on the table instead of taking full advantage of the applications and technology available today. Perhaps you **think** what you have is "good enough." But if it doesn't help you achieve a competitive advantage, maybe it isn't. Even worse… you also run the risk of putting yourself at a severe competitive disadvantage.

ERP IS LIKE THE REAL ESTATE MARKET… SORT OF

In some ways, ERP is a lot like your home. In a sluggish economy, the future becomes uncertain. Maybe you're in a modest home today without all the modern conveniences. Maybe it's not energy efficient and therefore your heat (or air-conditioning) is costing you way too much while still leaving you cold (or hot). Maybe it is too small. Maybe your life circumstances have changed since you moved in. You'd like to upgrade but with the market being what it is, you "make do" with what you have.

If you own your own home, theoretically you have been building equity. This is good because chances are you can't turn an older home built on a small, crumbling foundation into a large, energy efficient dream house. Home improvements can only take you so far. So your best option is to invest in a new one (at least new for you). It's time to make that equity work for you.

But you may only be building equity in theory. Building equity assumes market values are on the rise. Unfortunately, all too many properties today remain "under water" (worth less than your outstanding mortgage.) Let's face it, not all property values recover at the same rate. So the price of your dream home may be escalating while the market value of your own home is stagnant or declining. In other words… you feel locked in.

You may also feel locked into your current ERP. Business applications have come a very long way in the last few years in terms of functionality, largely because of supporting infrastructure and enabling technology. But seriously outdated technology could be the software equivalent of that small, crumbling foundation. You may be able to update to a newer release (the software equivalent of home improvement), but if you are looking for your ERP to give you a competitive edge, you just can't get there from here.

To make matters worse, there is really no "resale value" in your current ERP. The equity you have been building is in sweat equity and experience and understanding the challenges and the limitations. But if you really can't get there from here, you need to buy a new one and you can't do that without an outlay of cash – cash you might not have, further contributing to that "locked in" feeling. But what if you could significantly reduce that cash outlay?

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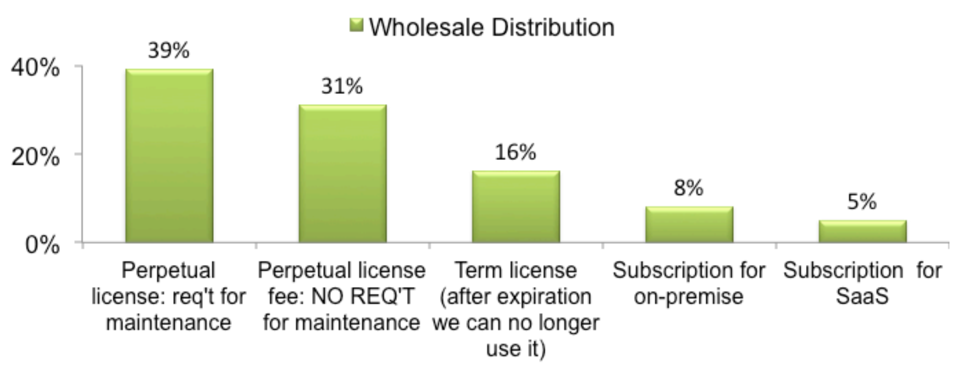
The alternative to home ownership is renting. Maybe you didn't have the up front cash or you weren't ready to commit to the responsibilities of home ownership or the potential for "lock in." Some might view SaaS ERP as the equivalent of renting versus buying. When this happens it often has a negative connotation, largely because of the whole concept of building equity. Why continue to pay each month knowing you will never "own" it? But we already saw that the whole concept of building equity, even in a home, could be a fallacy. Furthermore, while there might be some similarities to renting versus buying a home, there are a few critical differences that are important to understand. First of all, unlike a home, which you purchase, you don't buy ERP. You license it.

In days gone by, it was quite common for ERP vendors to offer perpetual licenses with no strings attached. You paid for it up front and it was yours to use forever. Most customers also paid an ongoing maintenance fee, much like you pay taxes and maintenance on your home. But if you stopped paying maintenance, you still had the software and could continue using it.

Those who have not "shopped" for ERP recently might assume this scenario is still common, but that is definitely no longer the case. Figure 1 shows how our survey respondents paid for their ERP solutions. Seventy percent (70%) do still have a perpetual license, but less than half of those (31%) are able to continue to use the software if they discontinue paying maintenance. The remaining 39% have a clause in their contracts that require them to continue to pay maintenance in order to continue using the software.

Figure 1: How did you pay for your ERP?



Source: Mint Jutras 2013 ERP Solution Study

In fact the second column above (31%) is the only type of license option that does not require an ongoing payment for continued use, and these are largely found in older implementations. So if you are assuming purchasing a new license for ERP is inherently cheaper because you will "own" the software installed on-premise, you are almost assuredly mistaken and are underestimating the ongoing cost of an on-premise license.

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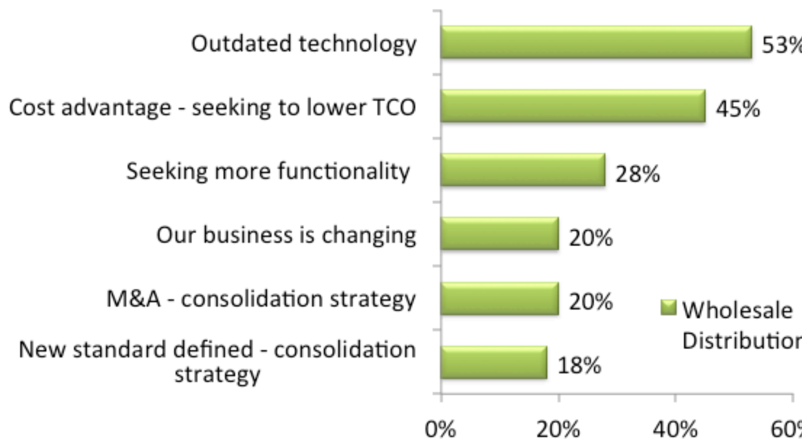
Yes, there will be on-going costs, whether or not you select a cloud option. But there is no doubt that the startup cost of a SaaS solution will be lower. There is no outlay of cash for hardware or a large upfront software license. So if you are strapped for cash, it could very well be a very viable alternative.

COST FACTORS WEIGH HEAVILY

If you are considering a change, before you can determine your next move, it is important to understand what is motivating it. The majority of wholesale distributors that are seeking to replace whatever they have today do so for one of two reasons: They either need to replace sorely outdated technology or they seek a cost advantage through lower total cost of ownership (TCO). Often you need to spend money in order to save even more in the long run. Of course there are other contributing factors (Figure 2) but one of these two motivations (or both) fuel the vast majority of decisions to replace existing solutions.

Figure 2: Reasons for Replacing Current Solutions



Source: Mint Jutras 2013 ERP Solution Study

We already saw that if seriously outdated technology is holding you back, you may be left with no choice other than whole scale replacement of what you have. But if outdated technology is driving you to the ERP equivalent of that bigger, better, more modern house, where is the cost advantage? A new system will require an initial investment of time, effort and money, as well as on-going cost. Can cloud options have a significant impact here? The participants in our Understanding SaaS survey think so.

Survey respondents were given a list of five categories of potential benefits of cloud deployment and asked to rank them in order of importance from 1 (least important) to 5 (most important). Figure 3 shows the results. The actual

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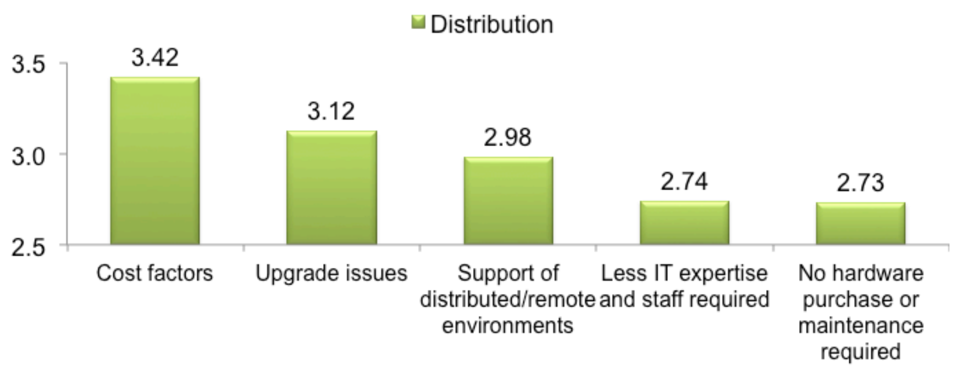
ranking is less important than the order of importance. Cost factors are clearly recognized as having the most potential.

Figure 3: Relative Importance of Cloud Benefits



Source: Mint Jutras Understanding SaaS

The cost factors that can significantly contribute to lowering the total cost of ERP ownership include:

- Lower startup costs: those upfront license fees are eliminated. Those choosing a SaaS deployment might also choose (or be required) to commit to a year or more of service, but will likely have flexible payment options.
- The elimination of hardware costs: This may represent additional startup costs, or an upgrade of existing hardware. But don't forget that if hardware is eliminated, so is the maintenance cost associated with that hardware.
- Lower cost and effort of upgrades: Anyone running on-premise applications today understands the costs associated with upgrades in terms of time, effort and potential disruption to your business. Subscribing to software as a service relieves you of most of that burden. Of course you will want to understand new features as they become available and this may translate to training and the implementation of new processes, so there is some "cost" but you only pay the price for real value added.
- Lower cost or added value from IT staff: If you have limited or no IT staff today, there is no need to add headcount to support a SaaS deployment. If you have IT staff, you can potentially relieve them of the burden of the day-to-day maintenance, allowing them to operate more strategically, thereby adding more value to your business.
- The cost of money: Paying for software as a service, instead of upfront license fees (and possibly hardware) allows you to pay on a subscription basis, freeing up cash for other investment strategies. It

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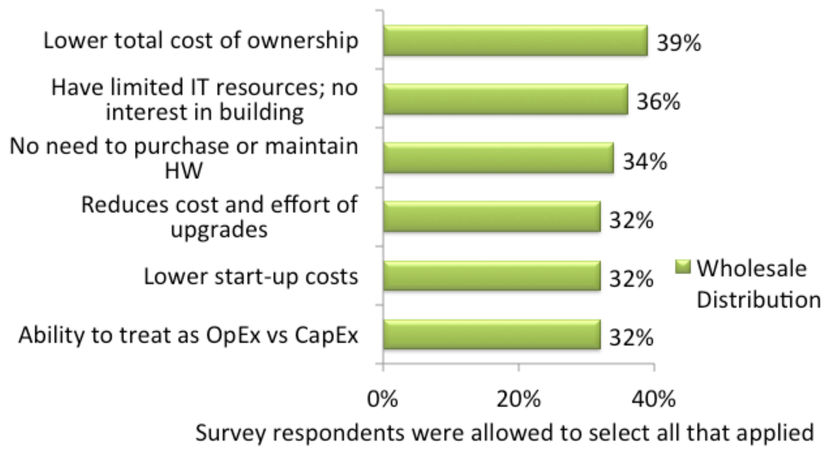
also allows you to account for the cost as an operating expense (OpEx) versus a capital expense (CapEx).

In fact these were the top six reasons participants in our 2013 ERP Solution Study found SaaS ERP appealing (Figure 4).

Figure 4: Appeal of SaaS ERP



Source: Mint Jutras 2013 ERP Solution Study

Progress measured against possible goals:

Survey respondents were asked to rate progress (on a scale from No Progress to Fully Achieved) for each of the following possible goals:

- √ Better visibility from quote to cash
- √ Sustained growth without additional headcount
- √ Reduction or redeployment of headcount
- √ Reduction in operating cost
- √ Reduction in administrative cost
- √ Reduction in inventory cost
- √ Reduction in obsolete inventory
- √ Better utilization of resources
- √ Reduce time-to-decision (better decision-making)
- √ Positively impacted bottom line profits
- √ Reduction of waste
- √ Increased value delivered to customers

THE COST OF DOING NOTHING

Of course there is another side to the coin here. If you are ready to make a move with a new ERP solution, then reducing the total cost of ownership is certainly important. But if you are still thinking you can "make do" with a solution that doesn't give you a competitive advantage, perhaps the better perspective is to consider what that decision (or lack of a decision) is costing you.

In order to quantify the lost opportunity cost of doing nothing, we look to the cost savings realized by ERP implementations in wholesale distribution. The results we captured in benchmarking ERP were quite similar when we compare cloud deployments with on-premise installations. We do not separate out SaaS from on-premise in wholesale distribution in the figures below because the sample size of cloud deployments in wholesale distribution was smaller than the standard Mint Jutras sets as a minimum for comparison.

We do however compare "World Class" implementations to all others. When we refer to "World Class," we refer to the ERP implementation. We capture cost savings and other improvements measured since the current ERP solution was installed and combine those results with progress measured against a set of possible goals. Of course not all distributors have the same specific goals for ERP, but the more goals that are set and the more progress that is achieved

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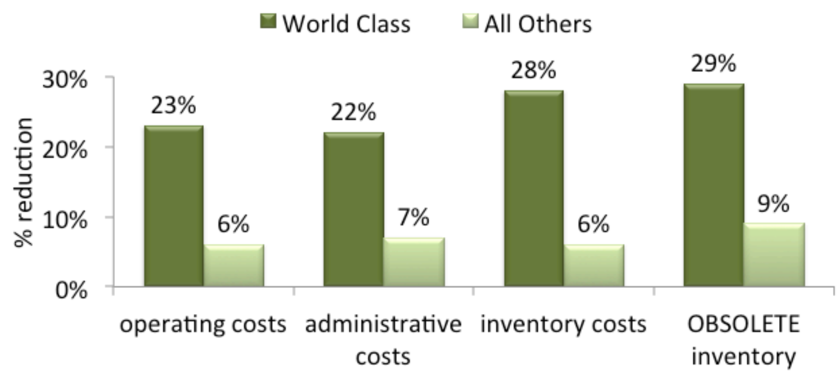
against those objectives, the higher the probability the implementation will achieve "World Class" status. Possible goals relevant to wholesale distribution are listed in the sidebar to the left. Finally, we temper those results with some universal measures of current performance. Each company receives an aggregate "score" based on all three, and the top 25% are categorized as "World Class."

Figure 5: Cost and Inventory Reduction Since Implementing ERP



Source: Mint Jutras 2013 ERP Solution Study

We start by comparing cost and inventory savings measured since implementing ERP. While the categories of operating and administrative costs are quite broad and leave some room for interpretation, a precise definition is less important when we measure the savings as a percentage of total costs.

To put this in perspective, let's use a mid-size distributor that is carrying $10,000,000 worth of inventory on its books. By reducing that inventory by 6% it realizes a savings of $600,000 of cold, hard cash. This doesn't even take into account any operating or administrative cost savings. If that same distributor achieves World Class status with its ERP implementation, it sees an **additional** savings of $2.2 million.

Think about your own operating costs, administrative costs and inventory costs. Think about inventory on your books that is obsolete and simply will not move. Take 6%, 7% or 9% and do the math. You might have your return on investment right there. These are the average savings produced by implementations that are not World Class. Then take those savings and multiply by three or four, and you have savings realized by World Class implementations. If 6% is significant, 23% or 28% is extraordinary.

Cost savings, while very important in terms of cost justification and profitability, are both very internally focused results from ERP. In order to stay competitive and achieve a competitive advantage, you also need to produce

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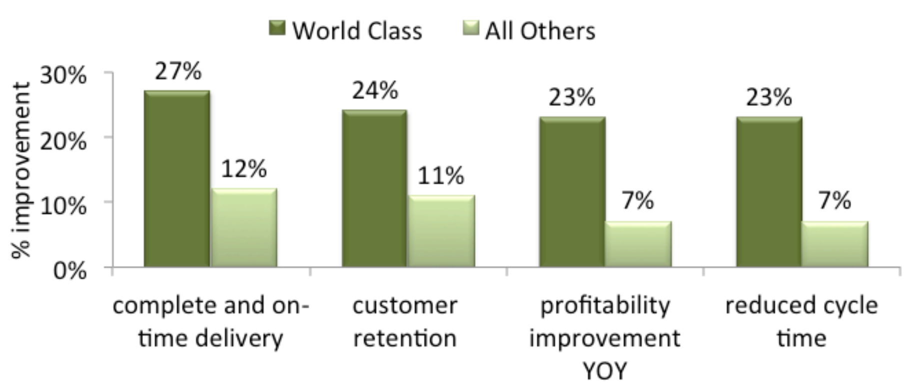
results that are more focused on your customer. In order to measure this type of success, we use a variety of metrics, which are shown in Figure 6.

As in measuring cost savings, with the exception of profitability, we measure the improvements since implementing ERP. Profitability is the exception primarily because of the wide range of maturity of ERP implementations. Yet profitability is extremely important in wholesale distribution as operating margins are razor thin as compared to other industries, leaving little or no room for error. While 49% of distributors responding implemented their current ERP solution within the past four years, 18% are operating with ERP implementations that are more than eight years old. While profitability is certainly a valid means of measuring performance, it can also be adversely affected by external factors such as economic and market conditions. For those who implemented ERP right before the most recent recession, profitability may have taken a hit, from which they needed to recover. New implementations might have been undertaken when profitability was already on the upswing. And yet improving profitability should be a sustainable goal. So we use the improvement in profitability over the two most recent fiscal years as a way of normalizing it.

Metrics Defined

- ✓ *Complete and on-time delivery are delivered 100% complete, on or before the promised delivery date*
- ✓ *Customer retention is the percentage of customers retained from the previous year*
- ✓ *Profitability is measured via operating margin*
- ✓ *Cycle time for **distributors**: receipt of order to fulfillment*

Figure 6: Other Improvements Measured Since Implementing ERP



Source: Mint Jutras 2013 ERP Solution Study

The remaining metrics are intimately dependent on one another. Complete and on-time delivery is a critical metric and can directly impact customer retention. Cycle times can directly impact your ability to deliver, not only as promised, but also as customer requested. One symptom that indicates you need (a new) ERP is not being able to meet customer demand, even as your inventory levels rise.

RECOMMENDATIONS

If you are like most wholesale distributors today, you are operating on a tight budget. You face increasingly global competition, tighter global trade regulations and unpredictable transportation costs. This puts added pressure on operating margins that were already thin and doesn't leave a lot of cash on the table to spend on new and improved back-office systems. "Making do" with solutions that don't help you achieve a competitive advantage can mean you are actually leaving money on the table: cost savings (and other improvements) that can be achieved through a successful ERP implementation.

You may feel like you're between the proverbial rock and a hard place. A well-run ERP solution can provide the type of controls and visibility to achieve both operational excellence and that competitive edge, while also producing cost savings. But ERP costs money and if you aren't performing at this level yet, it is likely that you are cash-strapped. You need a way out that doesn't involve a lot of cash up front, one that allows you to fund it through operating expense rather than capital expense, one that focuses squarely on return on investment.

A cloud deployment of a modern, ERP solution designed to cut operating, administrative and inventory costs of wholesale distributors could very well be the answer.

[1] Note this adoption rate does not come from our ERP survey, but from our Understanding SaaS study, which captured adoption rates of all deployment models of 22 different enterprise applications, including ERP.

About the author: Cindy Jutras is a widely recognized expert in analyzing the impact of enterprise applications on business performance. Utilizing over 35 years of corporate experience and specific expertise in manufacturing, supply chain, customer service and business performance management, Cindy has spent the past 7 years benchmarking the performance of software solutions in the context of the business benefits of technology. In 2011 Cindy founded Mint Jutras LLC (www.mintjutras.com), specializing in analyzing and communicating the business value enterprise applications bring to the enterprise.

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