What are the Best ROI Measures to Share with Hospital CFOs?

Introduction

One of the more important objectives for The FiscalHealth Group is helping sales organizations more effectively engage their economic buyers, including CFOs and CEOs. This objective includes helping sales professionals better understand how investment opportunities are evaluated.

In our line of work, it is not surprising that we have been witness to countless approaches to and styles of ROI (Return on Investment) models that vendors use to "sell" the financial value of their solutions. However, if not constructed and presented properly, these different ROI models may do more damage to your sales effort than good. In terms of successfully engaging a CFO, one of the most important model components is the actual financial measure used to reflect the ROI.

Hospital CFOs and other finance professionals use a variety of ROI measures to assist in making purchasing decisions when evaluating different investment opportunities. Our goals are to help you understand these different ROI measures, as well as how to successfully use and position them in your sales process.

Our Example

For each of the ROI measures discussed below, let's use the same simple scenario:

	Today	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Benefits	$0	$50,000	$200,000	$225,000	$250,000	$275,000	$1,000,000
Costs	$0	($200,000)	($125,000)	($135,000)	($140,000)	($150,000)	($750,000)
Net Cash Flow	**$0**	**($150,000)**	**$75,000**	**$90,000**	**$110,000**	**$125,000**	**$250,000**

Net Cash Flow

While the Net Cash Flow is the most basic ROI measure, it is very important. It is simply benefits less investment costs and is typically evaluated on both an annual basis and in total. The Total Net Cash Flow in our simple example above is $250,000.

If the Net Cash Flow is positive, the investment is viewed as favorable. If the Net Cash Flow is negative, the investment will likely be viewed as unfavorable. Net cash flow is particularly valuable when evaluating subscription-based pricing scenarios (i.e., an operating expense) because the CFO typically expects the Net Cash Flow to be positive each year.

NPV (Net Present Value)

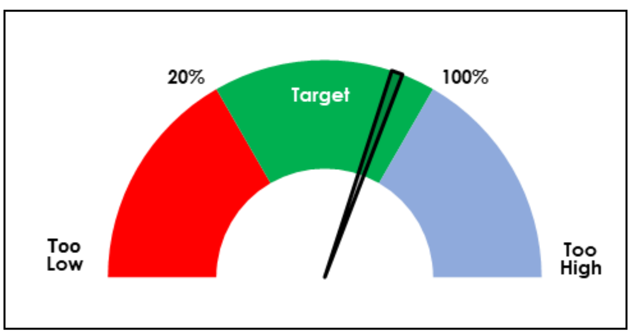
NPV is an important measure because it reflects the concept that money is worth more today than it is in the future. The NPV is the Net Cash Flow (see above), reflected in today's dollars. Future year benefits and investment costs are discounted based on the organization's Cost of Capital. The Cost of Capital is essentially the interest rate an organization pays on money borrowed — typically around 5%.

If the NPV is positive, the investment is viewed as favorable. If the NPV is negative, the investment will likely be viewed as unfavorable. Fortunately, you do not need to calculate the NPV manually; let Microsoft Excel do that for you. In our simple example from above, the NPV is $191,000.

IRR (Internal Rate of Return)

CFOs typically use the IRR (Internal Rate of Return) calculation as an ROI measure for evaluating capital purchases. The IRR represents a percent (%) ROI and is used to judge an investment against a minimum acceptable return for any investment and against other investment opportunities. As with the NPV, Microsoft Excel can easily calculate the IRR for you.

From our simple example above, the IRR is 49%. At a minimum, the IRR needs to be greater than the organization's Cost of Capital (typically about 5%) and probably greater than their minimum expectation for any investment (20% typically), but not so high that it is perceived as unrealistic (typically greater than 100%), which would destroy the financial credibility of your investment proposal.



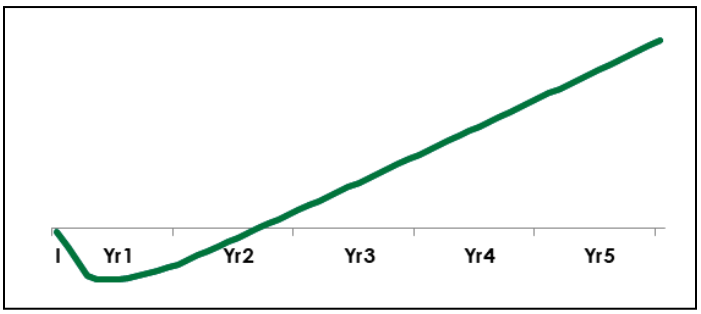
Ratio of Benefits to Investment Costs

This ratio is another simple calculation; Total Benefits divided by Total Investment costs. If the ratio is greater than 1.0, then the benefits are greater than the investment costs. However, if the ratio is less than 1.0, the investment costs are greater than the benefits, indicating an unfavorable investment option. In our example from above, the ratio of Benefits ($1,000,000) to Investment Costs ($250,000) is 4.0: $4 in benefits for every $1 in investment costs.

Months to Break-even or Break-even Point

The Months to Break-even represents the number of months from when the first investment is made by the organization until the cumulative benefits equal or exceed the cumulative investment costs. This calculation begins when the first dollar is spent — not from the go-live date.

In capital investment proposals there are usually large initial investment costs for software and/or hardware (i.e., purchase), plus implementation. In these situations, CFOs understand break-even may not occur for two or more years. Because there are typically very little, if any, initial investment costs in subscription-based pricing scenarios, CFOs typically expect break-even in the first 12 months. While important, CFOs do not typically consider this measure as influential as the other ROI measures discussed.



Summary

When presenting an ROI analysis for your investment proposal, it is critical to develop your financial analysis in a manner that is credible for CFOs and other economic buyers.

By understanding these different financial measures, you can clearly demonstrate your financial expertise and influence those economic buyers requiring an ROI with your proposal. CFOs and other finance professionals are looking for reasons to dismiss your proposal, so by clearly understanding these financial measures and providing the supporting analysis used to calculate the ROI of your proposal, you have a greater chance of successful selling. Good luck!

About The FiscalHealth Group (FHG)

The FiscalHealth Group is the leader in identifying the Financial Value and Return on Investment of Healthcare solutions. We are dedicated to assisting Healthcare vendors quantify the Financial Value and ROI of their products by creating customized sales tools to communicate this value to economic buyers, including CFOs, CEOs, and other finance professionals. Visit www.thefiscalhealthgroup.com for more information.