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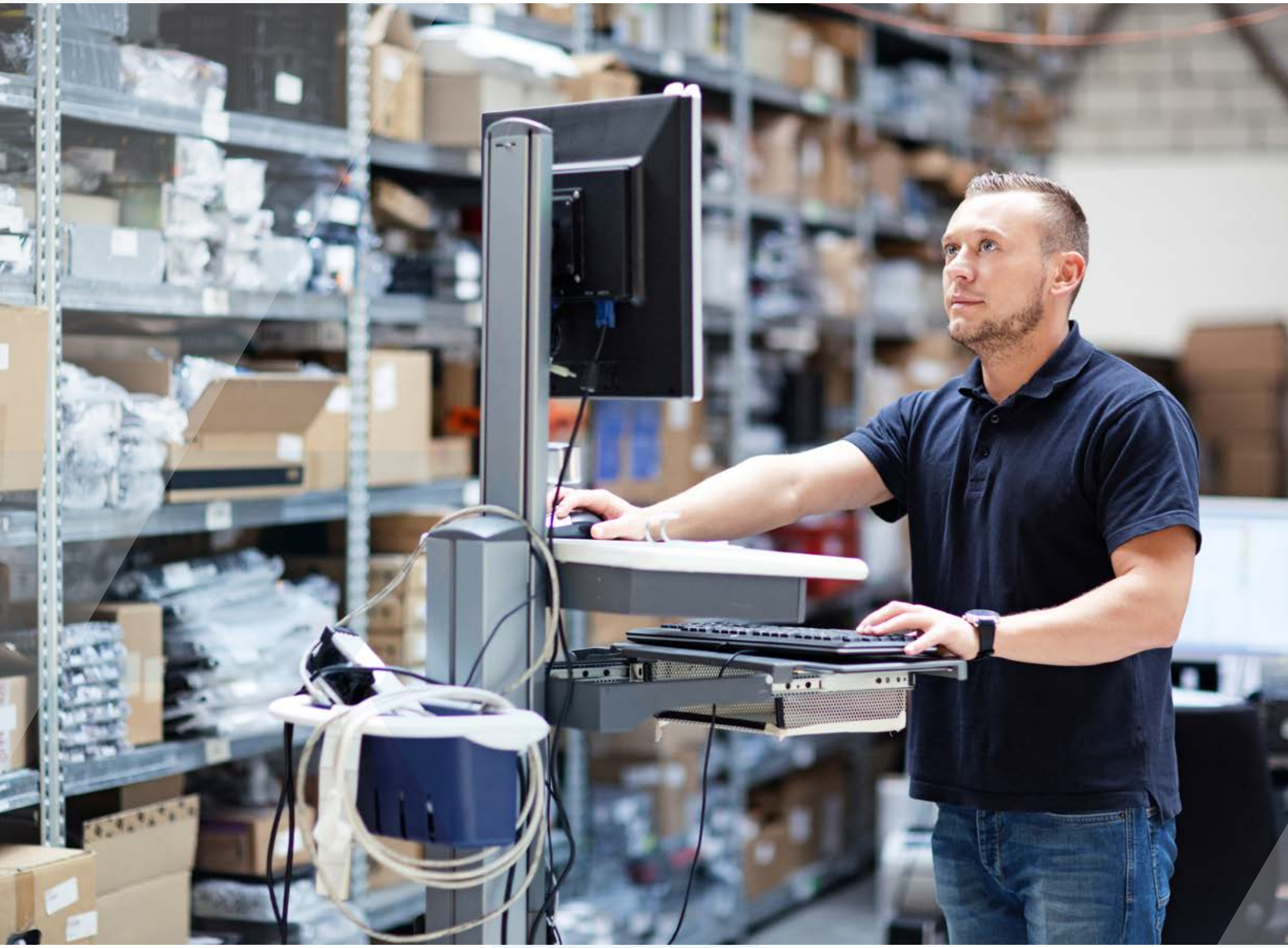


BUYING AN ERP SYSTEM
How to avoid common pitfalls and maximize your ROI

Canada

THE GROWING POPULARITY OF ERP SYSTEMS

Market competition has transformed the modern business environment. Companies today must reduce costs, maximize return on investment and be more responsive to customer needs. One of the best ways a company can improve its performance is by implementing a fully integrated software solution, commonly known as an enterprise resource planning (ERP) system.

Modern ERP systems allow companies to automate and efficiently manage multiple aspects of their business—finances, customer relationships, human resources, supply chain and much more. With an ERP system, your business no longer struggles to integrate various software tools across different departments. The system integrates it all, saving time and money, while providing your company with information and business intelligence.

In Canada, as demand for ERP systems has increased, many new platforms have appeared, each offering unique capabilities and industry specializations. If you're looking to invest in an ERP system, the task of selecting the right one has never been more complex.

Unfortunately, entrepreneurs make critical investment decisions without sufficient information or a well-planned buying approach. This has contributed to low implementation success rates for ERP systems in recent years.

An investment in an ERP system represents a considerable, long-term financial commitment for your business. As a result, it's important to make sure you're giving yourself the best odds of success when buying and implementing a system.

Many factors are known to contribute to the low implementation success rates of ERP system implementations. These include:

- Unclear or unreasonable expectations for an ERP system.
- Lack of unbiased information about available systems.
- Poor fit between selected system and business needs.
- Over-customization of system during implementation.
- Software licence and implementation agreements that favour vendors.
- Incomplete budgeting for the total cost of ownership.
- System implementation challenges resulting from poor project management.
- Insufficient user training and/or internal expertise.

Why is it so difficult to choose an ERP system?

Businesses looking to purchase and implement an ERP system almost always find the process complex, time consuming and expensive. Here are some of the factors that make the ERP choice so difficult.

- **Numerous products**—Thousands of ERP systems exist on the market today. They range from leading ERP packages that cater to a wide array of industries and are supported by large, well-known organizations to niche solutions developed by smaller vendors. Choosing the right product requires you to evaluate the capabilities, scalability, ongoing support, cost and configurability of various competing systems.
- **A lack of standardization**—One product's financial accounting or customer relationship management module can be vastly different from the next product's. This means you have to dive into the details and confirm which capabilities are included in each package.
- **Frequent updates and consolidations**—Vendors often update their products to add or remove capabilities. In some cases, software products may also be withdrawn from the market, consolidated or repurposed. Choosing a product that has the longest shelf life will help ensure you get the most out of your investment.
- **Customization and plug-ins**—Many systems can be configured to address specific needs. Systems can also be customized, or recoded, to add capabilities not present in the original system. In addition, many third-party plug-ins for common packaged systems exist to address particular industry needs. Understanding configuration, customization and third-party add-ons is critical when comparing options.
- **Different sales channels**—Some systems are licensed and implemented by the software developer. Other systems rely on a network of resellers or integrators that may be responsible for specific geographic regions or industries. In some cases, resellers will adapt and rebrand pre-packaged solutions to offer a unique product to the market.
- **Platform choices**—In recent years, many ERP vendors have started offering systems on a variety of platforms. They range from software as a service (SaaS), to on premise (On Prem) and everything in between, including hybrid platforms, such as infrastructure as a service (IaaS) and platform as a service (PaaS). Each platform offers its own distinct benefits and disadvantages.

- **Vendor contracts**—Due to the large number of ERP implementation failures, vendors have developed complex and often highly vendor-oriented contracts. Businesses looking to buy an ERP system often find themselves needing to sign software licence and implementation contracts that do not offer them much protection or recourse in the event of a problem.
- **Total cost of ownership**—Comparing prices offered by different ERP vendors can be a complex task because of the various costs involved. The cost of a typical ERP system can include the software licence, hardware, data migration, maintenance, training, and implementation fees, all of which can be calculated based on the number of users or company revenues.

Selecting the right ERP system is one of the most important decisions a business can make. The right decision can propel your business forward, while the wrong decision can be a costly handicap. For all these reasons, using the skills of a knowledgeable advisor, who has expertise in ERP system selection and implementation, can yield great benefits.

ONE ENTREPRENEUR'S ERP JOURNEY

Back in the early 2000s, Roger Lee realized rapid growth at his vehicle parts company was putting a strain on his computer systems and something needed to be done.

North American Powertrain Components of Edmonton remanufactures a wide variety of powertrain parts, including custom and rebuilt transmissions and engines. It has more than 6,000 customers, who often have unique service requirements and billing arrangements.

In 2005, Lee decided the answer to his IT problems was an ERP system that would integrate financial management, purchasing, inventory and sales processes. But selecting and implementing an ERP system has been "beyond frustrating," Lee says.

The first system "handcuffed" the company for five years because of its poor inventory management functionality. But when Lee switched to another system in 2010, the problems grew even worse, sending North American Powertrain into a five-month tailspin. "Our customers couldn't understand our invoices and I was unable to send my financials to my bank. It was a disaster."

The initial cost of the second system was $80,000, but by the time all upgrades had been completed, the bill had hit $250,000. And the company had to add 15 employees, including four in the accounting department, to cope with the fallout from introducing the new system.

"At that point, I phoned my external accountant, my business coach and my banker and I said: 'This company is in a free fall, I need help.'"

He turned to BDC's system selection experts, who helped the company find a new system that suits its needs.

"Buying an ERP system is one of the most critical decisions in a business's life, so you need to bring in experts," Lee says. "If we weren't in a strong financial position, the previous ERP system implementation would have crippled our business."

SELECTING YOUR ERP SYSTEM

There are many ERP system selection approaches. However, two main methodologies have dominated the information technology industry over the last two decades.

1. **Requirements definition**—In this approach, buyers define their system requirements (also called functional requirements), and vendors respond by saying whether their solution supports each requirement. This approach is typically used when businesses are looking to purchase a packaged solution. They don't need a highly customized system and are willing to adapt some business processes to avoid the additional costs and risks of a highly customized solution. Small and medium-sized companies tend to use this approach when selecting a technology package.
2. **Business process mapping**—In this approach, buyers map their current business processes and provide them to vendors. The vendors respond by saying whether they can support each business process or not. This approach is typically used when businesses are looking for a customized system that can be closely adapted to their business needs. Larger companies tend to use this approach when selecting technology platforms.

REQUIREMENT DEFINITION
PROS
Allows less room for change request from vendors, leading to additional fees during implementation.
Can be used to identify the level of customization needed in a proposed solution.
Allows for quantitative and multi-faceted comparison of vendor responses.
CONS
Requires more effort from buyers to prepare a request for proposal (RFP) and from vendors to submit a proposal.
Some vendors might not be willing to respond, given the extra effort required.

BUSINESS PROCESS MAPPING
PROS
Easier for vendors to respond.
Provides vendors with processes to which the solution needs to adhere.
CONS
Less protection from change request from vendors, leading to additional fees during implementation.
Buyer doesn't know how much customization will be required in proposed vendor solution.
Does not provide much information to compare vendor offerings.
Will typically result in a more expensive solution that has been tailored to existing business processes.

For most small and medium-sized businesses looking to purchase an ERP system, it's typically best to use the requirements definition approach. In general, this approach offers more protection from costly change requests during an ERP implementation project and discourages over-customization of the system by the vendor.

To customize or not to customize

There is wide consensus among IT practitioners that minimizing the level of customization within any given technology system is an effective way to reduce risks and costs for buyers. Unfortunately, many businesses continue to look for software solutions that perfectly fit their business processes, rather than using established, packaged technology systems.

While a highly customized technology system can provide significant business benefits, it also introduces business continuity, implementation and long-term ownership risks. It's important that business leaders understand these risks before making an investment decision.

- **Business continuity risk**—In most cases, a highly customized system creates a dependency on the system developer. In these cases, business continuity becomes dependent, in part, on the quality of the relationship between the business and the technology system vendor. Conversely, mainstream packaged systems are typically supported by a number of vendors and little effort is required to switch from one to another.
- **Implementation risk**—To deliver a highly customized solution, software vendors must strike a difficult balance between project scope (system functionality), quality (absence of system bugs) and cost (development effort). For vendors working on a fixed project budget, cost will often trump quality and scope of the final deliverable. Conversely, packaged systems already have defined and pretested functionalities that can often be implemented by any number of resellers with few or no surprises.
- **Long-term ownership risk**—To function properly, ERP systems are dependent on other technology components, including hardware, operating systems and software applications. As these other components evolve or vendors stop supporting them, a highly customized solution will require frequent updates to continue to operate properly. Even when vendors start with a packaged solution, they often need to redo customizations each time an upgrade is released. Therefore, the less customization is done on a mainstream packaged system, the easier it will be to maintain over time.

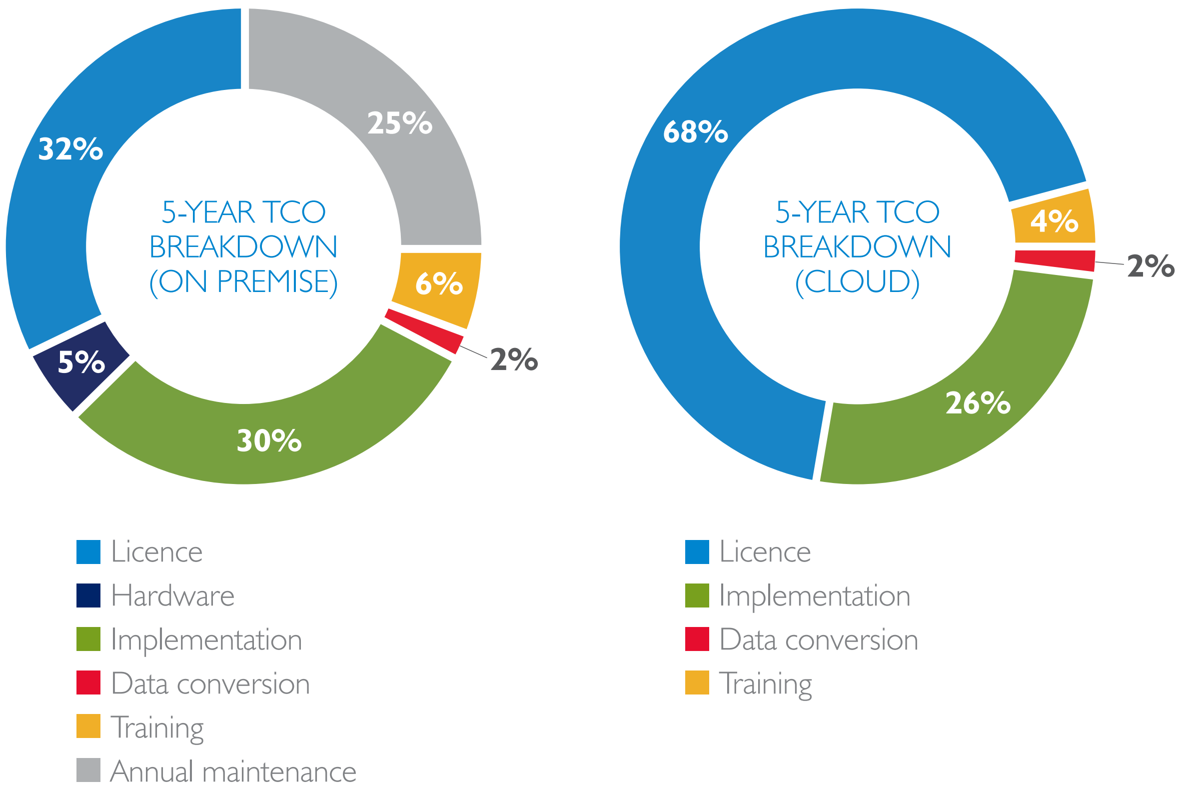
Understanding total cost of ownership

Comparing and understanding ERP pricing can be a complex task for business leaders. As a result, many experts use an IT concept known as total cost of ownership (TCO). This an all-encompassing calculation of costs for licensing, hardware, maintenance, data migration, training and implementation to determine the total cost of owning an ERP solution over a defined time period, typically five years.

TCO also provides a means to compare various vendor offerings by understanding how their proposed solutions are priced. For example, a vendor proposal that shows low licence fees but high implementation fees might suggest a highly customized solution. Alternatively, a proposal including small or no fees for items such as training and data migration might suggest certain services are not included in the vendor quote.

Since TCO does not factor in the functionalities that the ERP system will deliver, it should not be the only metric you use to rank or select an ERP solution.

TYPICAL BREAKDOWN OF THE 5-YEAR TCO OF ERP SYSTEMS, FOR BOTH ON-PREMISE AND CLOUD-BASED SYSTEMS



Understanding vendor contracts

With the growing number of ERP implementation failures, software licence and implementation contracts have become critically important to both buyers and vendors. Contractual norms exist and generally relate to one of four following areas: product, price, performance and protections.

Product—Product clauses cover contractual elements relating to software, implementation and deliverables. These elements should include a detailed description of what functionalities are to be delivered by the software product; the licence agreement between all parties; implementation timeline and scope; user acceptance terms; and many other such elements.

Price—Contractual elements relating to the solution price can provide buyers with many opportunities to mitigate risks by defining payment schedules, price increase protections, change request approval mechanisms, risk-sharing agreements and so on.

Performance—Performance relates to the availability and stability of the purchased solution. Contractual clauses relating to performance guarantees, software warranties, service response times, defects escalation and many other matters can offer buyers an opportunity for recourse if an ERP solution does not deliver the promised performance.

Protections—Various clauses can be included to provide buyers with added protection when purchasing an ERP system. These can range from maintenance and support terms to source code ownership in the event of vendor bankruptcy.

Competitive necessity or competitive advantage?

Even when an implementation goes well, many businesses receive only limited business benefits from their new ERP system. That's because they have purchased a system that provides only basic business functionalities.

Over the last 20 years, ERP systems have evolved to perform increasingly sophisticated functions. This evolution has meant that they can now be a source of competitive advantage for your business, greatly increasing return on investment. For this reason, it's important to seek the most information possible before choosing an ERP system.

For many companies, ERP implementation projects have become opportunities to transform their businesses. However, this requires a clear vision, and a close alignment between the company's strategy and its technology capabilities.

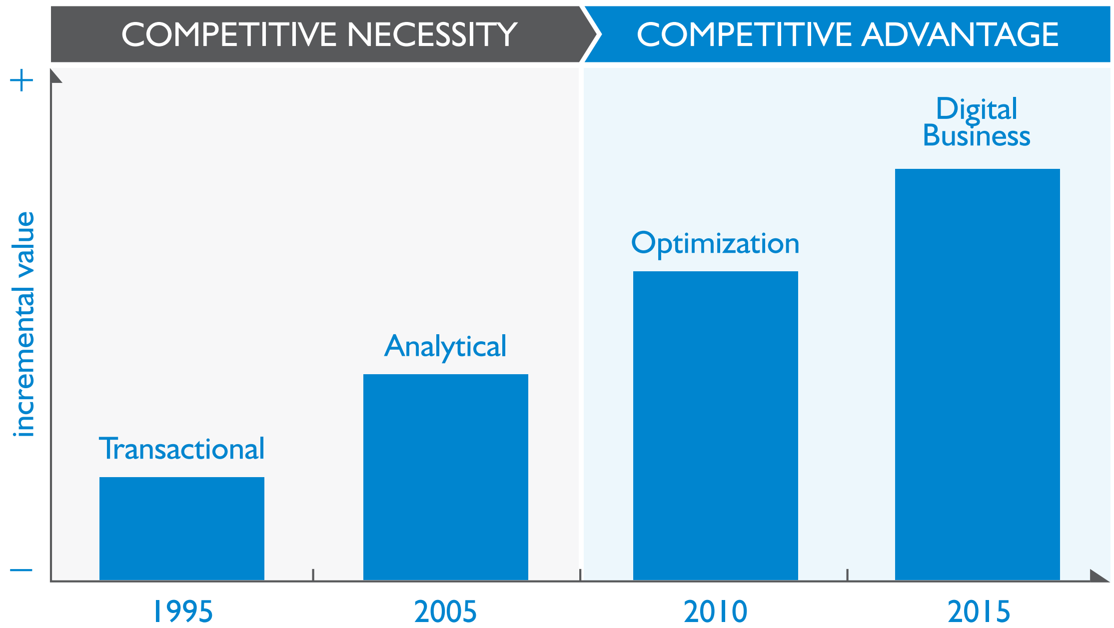
ERP system capabilities have evolved from simple transactional processing to transformative business tools.

1995 to 2005—Transactional capabilities help direct business activities and boost productivity.

2005 to 2010—Analytical capabilities emerge, providing business intelligence aligned with company key performance indicators.

2010 to 2015—Optimization capabilities become mainstream, helping to eliminate waste and improve resource utilization in an automated fashion.

Today—Digital business capabilities allow for efficient and automated interaction between your business, customers and suppliers.



CONCLUSION

An ERP system can help your business compete and win in a tough marketplace by making it more efficient, productive and innovative. However, deploying an ERP system can be an expensive and risky proposition.

Many ERP failures can be traced to systems that don't fit the needs of the business. For this reason, a rigorous approach to choosing your ERP system is essential to avoid common pitfalls and maximize the return on investment from the outset.

However, most entrepreneurs and management teams don't have the expertise, time or resources to manage a major system selection initiative. So, it makes sense to get the help of an experienced, independent consultant who can provide you with the knowledge and expertise you need to manage your ERP project.

Make an informed decision.

From defining your needs to negotiating a favourable contract, our system selection experts can help.

> Identify the solution and vendor best suited to your business.

> Get higher quality vendor proposals in a shorter timeframe.

> Benefit from our extensive market intelligence and powerful selection tools to invest with confidence.

Flexible financing available

You can apply for a BDC technology loan* to finance the cost of consulting fees and/or to purchase hardware and software.

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