

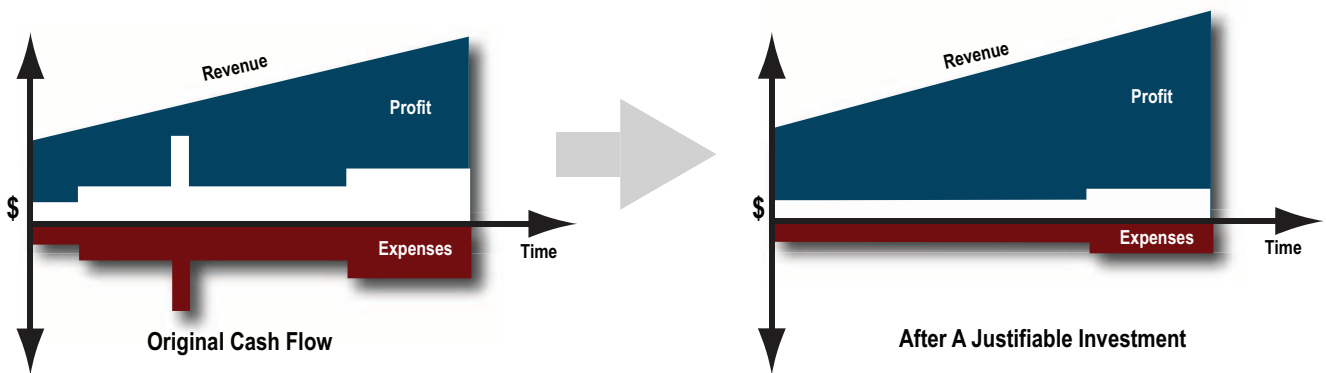
A Case For:

Developing a Return on Investment Analysis for Supply Chain Projects

Best practices in the Supply Chain can be elusive, dynamic and expensive. Those that involve the procurement of tangibles such as equipment, automation and software need to earn their keep and pay back to the owner by delivering shareholder value and/or improved customer service.

ACCOUNTING 101

There are those projects that are justified based on non-financial forces such as image, regulations or sheer desire. For all others, there must be a financial payback.



In terms of basic accounting, the name of the game is to maximize profit. This requires that you increase revenue and/or reduce ongoing periodic or sporadic expenses. Thus there are two ways we measure the ROI of an investment; does it reduce costs or increase revenue over a given period of cash flow?

THE ROI ROADMAP

The prospect of considering a project or investment can come from market pressure, cost concerns, safety regulations, customer demands or plain instinct. Regardless of its origin, correctly evaluating your options requires a sequence of steps to render an accurate assessment. The following is a roadmap to help develop a reliable outcome and serve as the outline for the HK ROI tool located at: www.hksystems.com/ROI.

STEP 1 – DEFINE THE REAL TASK AT HAND

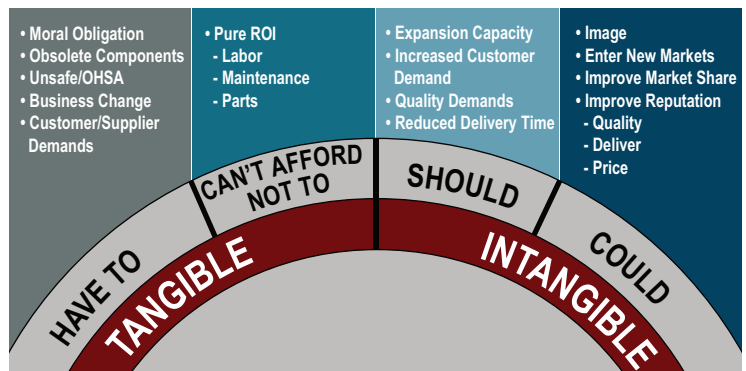
As the leader of the ROI process, your job is not to justify the project, your job is to make the best use of the company's resources. Maintaining an objective perspective is paramount in a solid evaluation.

STEP 2 – DEFINE YOUR PLANNING HORIZON

It is critical to consider the lifespan of the asset you are considering, your company's "range" of thinking, the economic forecast and the volatility of your environment before defining a period of evaluation. When in doubt, a 10 year look forward is a good default.

STEP 3 – COMMIT TO YOUR OBJECTIVES

Clearly state the driving reasons for considering this investment and never lose sight of them. Along the road, you may discover added rewards, but keep your eye on the origin of the potential justification. Understand that there is a continuum of objectives that may cause your ROI to be more or less tangible.



STEP 4 – IDENTIFY THE ALTERNATIVES

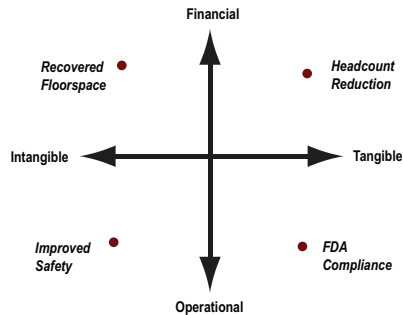
Sounds simple, but the traditional choices of “spend or don’t spend” are incorrect. Here you need to brainstorm the array of alternatives available where both the costs and rewards may change at varying rates until a clear winner surfaces.

For example, evaluating the prospect of a new automated warehouse (or not) may better expand into...

- Retrofit our current warehouse
- Build an automated warehouse
- Build a semi-automated warehouse
- Partner with a 3PL to maintain our inventory

STEP 5 – ESTIMATE THE COMPLETE CASH FLOW FOR EACH ALTERNATIVE

This is the heavy lifting part. For each scenario, project in great detail, the cash in and out of your company that will occur over the proposed period. Conduct this exercise from both an operational and financial perspective, being sure to involve a team of future benefactors from various relevant corners of your company. This will yield comprehensive data as well as assure “buy in” for your evaluation.



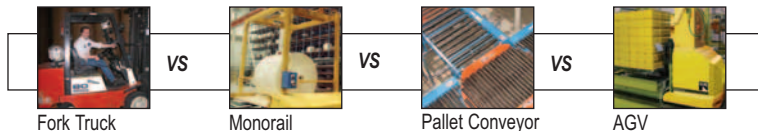
STEP 6 – SPECIFY THE INFLATION RATE AND COST OF CAPITAL

These assumed percentages will impact the Internal Rate of Return calculations as well as the effect of expected changes in the economy on your payback. Be sure to tie these to some commonly accepted indices.

STEP 7 – COMPARE THE ALTERNATIVES

Once the cash flow data is entered, compare the results in terms of measurements such as payback period, internal rate of return, ROI%, etc. When more than 2 alternatives are under consideration, compare each to one “control” scenario that has the highest level of accuracy.

Sample Comparison Of Pallet Transport Technologies



STEP 8 – PERFORM SENSITIVITY ANALYSIS

Here, you make adjustments to the input data that are you are least sure of and experiment to see if the outcome is particularly sensitive to one or more assumptions.

STEP 9 – SELECT THE BEST ALTERNATIVE

Go back to your guiding objectives for the project and be sure that those are met by your modeled project. Is this a “have to do” project, in which case the financial ROI is not as relevant? Are there other better places for the company money that would override even a favorable ROI? Now apply the power of the team you have built and make a decision.

STEP 10 – CHECK YOUR RESULTS

Once justified, implemented and operational, take the time to go back and compare the actual results with what you modeled. Did you cut the expenses you hoped for and/or increase revenue? Where did the actual cash flow not match your estimates and why? This often ignored step will help you refine your process and make you more wise for the next opportunity.

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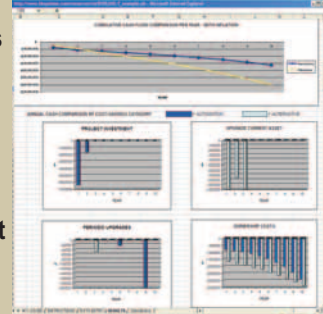
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A SINGLE SOURCE SOLUTION FOR A RETURN ON INVESTMENT TOOL

HK Systems has built a business on applying technology in the Supply Chain when it makes sense and provides a justified return for the owner. To assist end users with



project justification, we have developed a simple, proven and cost-free ROI tool to organize your cash flow data and generate meaningful results for you to analyze. It is our hope that this tool will assist you in your quest to evaluate improvements for your company.

The HK ROI tool compares the results, over ten years, of two business scenarios, technologies or investments. The exercise drives the user to fully compare the effects of conducting a project with some alternative that may be as simple as “do nothing”. A ten year period was chosen as a reasonable timeframe to identify trends.

Visit www.hksystems.com/ROI to preview or download the HK ROI tool. Follow the general steps involved to apply this tool to your scenario(s) and click on the RESULTS tab to interpret the findings. Feel free to call 1-800-HKSYSTEMS with questions or for assistance with the exercise.



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