

A Strategic Approach to Establishing Two-Tier ERP

A Single System May Not Be the Right
Choice for Your Company

White Paper
Sponsored by
Microsoft[®]



Aligning Business and IT To Improve Performance

Ventana Research

6150 Stoneridge Mall Road, Suite 350

Pleasanton, CA 94588

info@ventanaresearch.com

(925) 474-0060

www.ventanaresearch.com

Table of Contents

| | |
|---|---|
| The Complexity Conundrum..... | 3 |
| Putting Standardization in Perspective..... | 3 |
| The Value of More Than One ERP Vendor..... | 4 |
| Assessing Costs and Benefits | 5 |
| Choosing the Right Tier 2 ERP Vendor | 5 |
| The Right Choice..... | 6 |
| About Ventana Research | 8 |

The Complexity Conundrum

Many large corporations of 1,000 or more employees and even some midsize ones (those with between 100 and 1,000 employees) conduct their business using ERP systems from more than one software company. In many cases that's because the company has made the strategic decision to use a large system from a vendor such as Oracle or SAP for its headquarters and larger divisions or business units while deploying for smaller business units or operational divisions an ERP system designed expressly for their needs.

On its face, supporting two different types of ERP systems goes against the general advice that whenever possible systems should be consolidated to minimize IT system complexity. However, identifying unnecessary complexity is not always straightforward, especially when both business and IT requirements must be considered. Too often, Ventana Research finds that companies assume end-to-end standardization is always the right approach, especially if that assessment is heavily influenced by the IT department. We believe that it is important for every company to do its own thorough analysis of its situation. Choosing to use a two-tier approach for ERP systems for a corporation's larger and smaller business units potentially will better satisfy the smaller operating units' business needs and at the same time be less costly for the organization to buy (because of lower initial license and implementation fees), operate (because fewer IT resources – people and equipment – are needed) and maintain (because of lower maintenance fees and easier software updates and add-ons).

Choosing to use a two-tier approach for ERP systems potentially will satisfy the smaller operating units' business needs and be less costly to buy and maintain.

Putting Standardization in Perspective

Our research consistently finds that information technology complexity is a challenge for most IT departments in larger companies, from both a data management and a business perspective. This has led some to conclude that when it comes to the ERP system, a best practice is to have a single instance (that is, a universal data structure and a single chart of accounts) configured on a single vendor's ERP system. While this will work for some companies, Ventana Research believes that this ideal is frequently impractical, and may even be counterproductive.

A single ERP standard often does not work well for companies with diverse lines of business that require different processes or accounting methods, or that have a mix of large and small autonomous divisions or operations in geographically remote locations. To maintain a single ERP standard, companies that regularly acquire new divisions or businesses will have to carry out an extensive back office technology and process integration program to incorporate them into its management structure as quickly as possible. Regardless of the particulars, doing the work of creating a single

ERP standard is impractical if the all-in cost of the switch is not justified by the savings to be gleaned over a five-year period.

Indeed, a single ERP standard may well be counterproductive for some corporations with a mix of larger and smaller business units. In such cases, there is a solid business case to be made for why the Tier 1 vendor (such as Oracle or SAP) that the company uses for its large business units is not a good fit for the smaller units. Instead, their different needs are best served by selecting a Tier 2 system that meets their needs.

The Value of More Than One ERP Vendor

Our research finds that one-third of companies with more than 1,000 employees use an ERP application supplied by a single vendor while two-thirds use software from two or more vendors; one-third have software from four or more vendors. There are largely two reasons why companies have heterogeneous ERP environments. One is purely historical: Automating back office functions began decades ago, and companies initially did not roll out or upgrade the systems across the entire enterprise. Moreover, some parts of the organization may have been built through acquisitions. If the acquired entity was relatively large, it often made sense to leave the existing systems in place.

When it comes to ERP, one size simply does not always fit all.

A second reason is that, when it comes to ERP, one size simply does not always fit all; lines of business can be different enough that a single vendor's offering is not well suited to the needs of all. A two-tier approach recognizes that a big ERP system generally, and the headquarters ERP system specifically, often is a bad fit for the needs of a small offsite division or a remote manufacturing unit in, say, Recife, Brazil that is

part of a mostly services-oriented corporation. Using the headquarters ERP vendor's manufacturing application capabilities may well be overkill for this single-site operation.

On the other hand, using an ERP system designed specifically for a business of this size, scope and with its specific characteristics is likely to yield considerable total cost of ownership (TCO) savings. Moreover, the time to implement, modify and upgrade likely will be shorter. Deploying such a system thus will deliver a shorter time-to-benefit and the ability to modify the system as needed more quickly and easily than would be the case with the one used by headquarters.

The Recife example illustrates another argument for the two-tier solution: because of its location, the company will find it too costly and difficult to support the headquarters system. Generally, dissimilar business units and geographically distributed operations are likely to benefit from using a locally installed ERP system and one that has been designed specifically to meet the needs and fit with the operating characteristics of midsize organizations.

Assessing Costs and Benefits

Today's Tier 1 ERP systems are impressive both in the breadth and depth of their features and functionality and in their flexibility. Yet it is precisely these characteristics that are an important reason why they may not be well suited for its divisions.

In practice, the cost to the organization of implementing the capabilities the business unit or division needs may prove to be higher than would be the case if the same capabilities were being delivered using Tier 2 software. The difference in required outlay can be significant, especially if the Tier 2 option is software specifically designed for a particular type of business (rather than generically supporting, for example, "manufacturing") or if the package includes the services of an implementation partner with the capabilities and experience to deploy the software quickly and fit it to the needs of people in the operations and finance organizations.

A thorough business case analysis – one that considers initial licensing fees, implementation costs (including consulting and hardware), ongoing maintenance fees, the cost of upgrades, modifications and keeping up with the vendor's release schedules (especially if these will require the business unit to hire outside consultants to handle these changes) – may well conclude that deployment of a Tier 2 ERP system to serve a smaller unit will have a considerably lower TCO than use of the headquarters system.

A thorough analysis may well conclude that deployment of a Tier 2 ERP system will have a lower TCO than use of the headquarters system.

Beyond the cost issues, an ERP system designed expressly for subsidiaries can make managers in smaller business operations more effective: It potentially is better suited to the business unit's specific needs, enables easier and faster changes to adapt to shifting business requirements, and makes it possible to generate management reports sooner. And establishing the option of deploying a right-sized, well-designed ERP system locally avoids the danger that the insistence on a single Tier 1 system winds up short-changing the smaller business units.

Choosing the Right Tier 2 ERP Vendor

Finding a system that meets a business unit's requirements means looking at how well the design of functions and features matches the business's needs and how easy it will be to implement, configure and update. In this regard, specification sheets are of only limited use; it is essential that those assessing the suitability of the software to business needs carefully check references from similar businesses. The goal here should be to confirm that the software will fit their needs, that implementation and/or localization will not be burdensome, and that the company and its partners have a good track record. Buyers also need to consider the quality of the software

company's technical support infrastructure, especially if the Tier 2 deployments will be in geographically dispersed locations.

The selection process must consider not only fit with operating needs but also the system's IT characteristics. The software should fit well with the business unit's IT infrastructure and be manageable with existing in-house or third party skills. It's also important that the Tier 2 ERP system fit well with the existing headquarters ERP system and into the company's overall IT infrastructure.

As with any software selection, careful attention must be paid to the vendor. This is especially important for ERP systems, regardless of the size of the purchase, because these applications are both long-lived and mission-critical. Since one important goal in the deployment of any core system is to establish a durable standard, vendor viability is important. Equally important, though, is its long-term technology roadmap and the resources it has at its disposal to extend its existing products and adapt or take advantage of evolving information technology capabilities. For companies that operate or plan to expand globally, geographic presence by either the vendor or capable partner organizations should be a key requirement.

As with any software selection, careful attention must be paid to the vendor, especially for ERP systems because these applications are both long-lived and mission-critical.

Although Ventana Research believes the reality of operating a business means justifying a single ERP standard may be difficult or inappropriate, we do not advocate a free-for-all in selecting software packages. We recommend that when companies select a Tier 2 ERP vendor they use that same system wherever possible in situations that call for a Tier 2 system in order to minimize complexity.

Consideration of ERP deployments often raises the issue of data complexity. Although the subject of managing data complexity is worthy of its own white paper, we note that some (but certainly not all) data complexity issues arising from supporting two tiers of ERP systems can be mitigated by having appropriate data governance processes and data management software in place, as well as ensuring that the Tier 2 vendor's systems are well matched to the corporation's existing infrastructure.

The Right Choice

In making choices for its IT systems, a company must balance what often proves to be a wide array of business and IT requirements. While there is value in IT standardization, we find that for many companies deciding to support two tiers of ERP systems is the right choice for their business.

The Right Choice

Tier 1 ERP systems are feature- and function-rich. Over the years, vendors have developed and built into them many out-of-the-box industry-specific capabilities. Nonetheless, for smaller, geographically dispersed business units

or operating units that have a significantly different business model than the rest of the company, a separate Tier 2 ERP system often will be a better choice.

A Tier 2 system may well address the business needs of the operating unit better. And because it has been designed from the start to meet the needs of business divisions or midsize companies, it is more likely to deliver a lower total cost of ownership and to be able to adapt more quickly and easily to the business unit's evolving requirements. A Tier 2 system will offer a higher return on investment if it has a lower TCO, a faster time- to-benefit and is better tailored to the needs of a company than the organization's headquarters system.

About Ventana Research

Ventana Research is the leading benchmark research and advisory services firm. We provide expert guidance to help organizations manage and optimize performance – to become not only more efficient but more effective. Our unparalleled insights and best practices guidance are based on our rigorous, research-based benchmarking of people, processes, information and technology across business and IT functions worldwide. The combination we offer of benchmark research, thorough market coverage and in-depth knowledge of hundreds of technology providers means we can deliver business and technology education and expertise to our clients where and when you need them. Ventana Research provides the most comprehensive analyst coverage in the industry; more than 2.5 million business and IT professionals around the world benefit from Ventana Research's insights. To learn how our benchmark research and assessment and advisory services can improve your organization's performance, visit www.ventanaresearch.com.