Indus Consumer Products Limited

New ERP Proposal

Indian school of Business

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NEED FOR A NEW ERP

INDUS' revenue has been growing at an average rate of 26% over the last few years. While R&D and product marketing is decentralized into four product segments – toilet soaps, hair colour, liquid detergents and toiletries, production, purchasing, finance, customer support, HR, IT and sales organizations remained centralized. Yet, the absence of an integrated enterprise system across these business functions has led to a fragmented organization that has limited cost optimisation and forging of effective partnerships across the supply chain.

INDUS was one of the first companies to install MFG/PRO, an earlier generation ERP, in the 1990s. At that time, since the product was new in India, there were very few consultants to help with successful installation and customisation. Production modules were first installed in one of the factories with the objective of meeting delivery targets, increasing plant productivity, and reducing plant maintenance costs. Subsequently, as the company grew, the software was installed in the new factories in new geographies. However, MFG/ PRO's decentralised architecture resulted in discrete and location-specific customised systems. The lack of standardisation and centralised control resulted in multiple, and often widely varied, configurations of the application. Each configuration currently requires idiosyncratic training and support, thus increasing personnel costs. There is also a resultant multiplicity of servers and other hardware, with attendant support problems.

Further, the production module in the current ERP is not integrated with the purchasing or finance systems. The result is silos of product information that cannot easily be used across business functions across product segments across geographies.

On account of the rapid and haphazard growth of the company, procurement of raw material could not be systematically monitored. This was because the purchasing automation software, which was designed to monitor inventory and procurement activities, was not implemented across all factories for different product segments. What further complicated the matter was that some of these factories were acquired from other companies and had their own purchasing automation software. As a result, vendor databases are individually maintained by each factory. Since vendor and item codes are not synchronized across the company, it is not unusual for the same vendor to supply the same product to different factories at different prices. Thus, not only does the company lose out on large-quantity discounts, it faces major vendor management issues on account of competing delivery priorities within the company.

Further, as the company grew, so did the need for process and system transparency. This was considered crucial for streamlining financial reporting and month-end closing. However, the company's existing finance system is not extended to MFG/PRO. This has led to the use of multiple general ledgers across factories. Further, since only some modules got installed, data

of one function is not usable in the other. This results in discrepancies in the outstandings statement. Thus, it is not uncommon for marketing to offer a discount to a customer, which is recorded in the sales software but not immediately picked up in the accounts receivable software.

It is clear that compared with other offerings available in the market, MFG/PRO has not kept pace with modern developments and is considerably behind in technological features. Moreover, as the company has undergone significant business expansion, not only does it require an application with sound technical features, it also needs periodic engagement with the service provider. It is, thus, important for INDUS to replace its existing ERP platform with a more up-to-date and dynamic system.

REPLACING THE MFG/PRO SYSTEM

The Operations group at INDUS has examined various alternatives available to replace the MFG/PRO system, and zeroed in on SAP's ERP offering. The product is robust and widely adopted by other FMCG companies. It has a centralized architecture that will integrate manufacturing with purchasing and finance functions, thereby, providing a unified view of the organization across business functions, product segments and geographies. INDUS views this as an internal efficiency improvement platform that will replace the extant ERP, purchasing and financial systems. The proposed ERP will not have any supply chain modules that connect the firm to its business partners.

FINANCIAL BENEFITS

With the installation of SAP, INDUS hopes to capture benefits that yield an IRR of 81%. The benefits are estimated over the 5-year period following the implementation of the ERP system[1]:

REDUCTION IN IT COSTS

Implementation of an integrated ERP will optimize systems use across different locations and functions of the enterprise. This will lead to greater control, efficiency and elimination of redundancies. As a result, the cost of IT ownership will reduce by INR 0.73 million in the first year following implementation[2] and then by INR 1.45 million in each subsequent year.

REDUCTION IN OPERATIONAL COSTS

The ERP will facilitate integration and standardization of product and vendor information across the enterprise. This will help in addressing competing delivery priorities across different

[1] *All the benefits will start accruing in the first year following the year of implementation*

[2] *The current year, 2013-14, is the decision year as well as the implementation year*

factories and allow the company to avail of vendor discounts. Further, an integrated view of data will help with better inventory management and reduce coordination costs. Overall, operational expenses of the firm will reduce by INR 17.3 million in the first year following implementation and then, by INR 34.6 million in each of the subsequent years.

INCREASE IN GROSS MARGIN

The ERP system will provide access to real-time data and better visibility into supply and demand, thereby, improving overall profitability; the system will increase gross margins by INR 24.2 million each year following the implementation of the system.

COSTS

Though most of the costs of the ERP systems are one-time costs, the enormity of the investment will be the chief concern. The main costs involved are:

Upfront Costs: These are one-time costs that will be incurred in the current financial year, the year of implementation.

- Licence: Software licence cost of INR 25 million will be incurred in the year of implementation of the system.
- Hardware: Cost of INR 15 million will be incurred in the year of implementation of the system.
- Training: Internal training cost of INR 5 million will be incurred in the year of the implementation.
- Implementation: Costs will be incurred for conversion and migration of data from legacy systems to the new ERP. This will result in an implementation cost of INR 2.5 million in the year of the implementation.
- Consulting: Cost of INR 8 million to be incurred in the year of implementation.

Recurring Costs: The implementation will incur recurring operational costs of INR 3 million per annum and administration costs of INR 1.28 million per annum. The company will incur these costs beginning 2014, the year following the implementation of the system.

The decision to adopt the new ERP system cannot be based simply on the above financial analyses. An internal impact analysis[3] suggests that various quadrants of the organization will be differently influenced by the ERP implementation:

[3] *Impact Analysis scores: High/Significant Impact- 3, Moderate/Medium impact- 2, Low/Marginal impact- 1*

- *Financial metrics:* Elimination of redundancies across business processes and functions will significantly improve free cash flow. However, the system will have a moderate impact on return on IT spend and low impact on revenue growth and asset utilization.
- *Customer metrics:* Customer satisfaction will only moderately improve. The application will have a low impact on the defect rate. The company will not benefit at all in terms of lead time over competition and number of products first to market.

- *Process metrics:* The application will facilitate a beginning-to-end process overhaul. The cycle time-order to delivery will significantly get impacted with the substantial reduction in the lead time to procure inventory. Resulting in a substantial improvement in capacity utilization, the application will significantly reduce inventory obsolescence on one hand and increase inventory turnover on the other. The close vigil on inventory procurement will have a high impact in terms of preventing stock-outs. Order-backlogs, as a result, will reduce sizably, leading to a moderate improvement in on-time deliveries

- *Learning & Innovation:* Business processes will be significantly improved and their streamlining will help the company take better-informed operational decisions. The new ERP system will play a moderate role in facilitating the creation of new business capabilities. In order to steer its growth in the right direction, the company will need to acquire new customer insights and create new business models. However, the new ERP system will not be very useful for this purpose as it will only have a low impact on these two metrics.

Finally, a unified view of the firm allows for more intelligent decision making. This will help the firm better utilize its business intelligence systems to create superior value propositions.

CHALLENGES

The following challenges make it difficult to justify the costs against the identifiable benefits:

- Most of the benefits are not immediate and will be derived only in the future. Therefore, the delayed realization of benefits may act as a deterrent in terms of going ahead with the investment.

- With all the business processes being reengineered, serious change management issues including internal resistance are on the cards.

- Customization of the application to the company's requirements is crucial. A one-fit-all solution will not work, given the inherent variance across INDUS' factories.

- Past attempts of this magnitude by other companies ended with 40% of them failing to either implement or realize the projected benefits of the new ERP. The experience of other companies in the FMCG sector only emphasise these challenges[4].

Owing to the maturity of the product, there are enough industry consultants and product experts available to assist the company with customization and implementation, training of users, and process changes. Further, over the years, INDUS has developed the technological capabilities to effectively implement a dynamic and complex ERP system. Both these factors significantly contribute to mitigating the above risks of implementing the new ERP, and support the company's decision of a big bang, one shot roll-out of the ERP system- a process similar to the one adopted by CISCO Systems.

[4] *Refer to: Worthen, Ben. "Nestle's ERP Odyssey", http://www.cio.com/article/31066/Nestl_eacute_s_Enterprise_Resource_Planning_ERP_Odyssey*