By Craig Hughes

Looking for ROI in LOS

Inevitably, the funding appropriation process for any large capital expenditure begins with some form of cost-benefit analysis (CBA). During that process, the claim is made that the proposed initiative will pay for itself within an acceptable time frame through the resulting return on investment (ROI). Too often, this ROI is purely hypothetical and not something the project—or anyone associated with it—is held accountable for after the fact. Projects are typically measured solely by being on time and on budget—not by achieving the intended results.

When that project is a loan origination system (LOS) replacement effort, even time and budget too often go out the window and success is measured simply by getting the system up and running—at which point attempting to actually measure ROI is the last thing on anyone's mind.

In the vast majority of LOS replacement projects, obtaining a quantifiable ROI by traditional measures just isn't possible. They simply take too long and cost too much—not to mention experience unacceptably high failure rates—to pay for themselves over the short term. It is important, therefore, to think about LOS replacement differently from the outset and set expectations accordingly.

The basis for most CBA efforts is something called the "increasing revenue, avoiding cost and improving service" (IRACIS) model. Many shorten this list down to simply growing revenues and lowering costs, as service quality is cynically viewed as just a tactic for attracting additional revenue with no intrinsic value of its own.

ROI calculations predict that the combination of increased revenue and lowered costs will surpass the required cash outlay within a reasonable period of time—typically one to three years. The ideal project from an ROI perspective, therefore, is relatively inexpensive to execute and delivers significant near-term value. LOS replacement efforts typically are too big and ultimately require too many compromises along the way to completion to yield a positive return by these traditional standards of increased revenue or lowered cost to produce.

Does this mean LOS replacement is a bad course of action? No, not necessarily, but in too many cases it means that the replacement is being done for the wrong reasons or with the wrong expectations—which can be setting the project up for failure. Further, when a major initiative is being driven by the wrong purpose, such as unrealistic, ill-conceived ROI expectations, the likelihood of misrepresenting the most meaningful system requirements is high.

Not that long ago, CC Pace was working with a client that said its No. 1 initiative was replacing its LOS so that it could significantly lower its cost of production. Skeptical of its expectations, we ran the lender's recent production history through some analytical models and quickly found that its pull-through rates were remarkably—and unacceptably—low.

In the client's situation, too much time was spent processing too many loans that were not going to close, and no matter how efficient you became on the back end, it was simply impossible to make a meaningful dent in the resultant production costs. The answer to the client's most pressing problem was not improving efficiency on the back end, but fixing the quality of its front-end sales process, which would not be solved by replacing its LOS.

In working with our client further, however, it became apparent that there was a compelling need to reorganize its existing branch structure, centralizing a number of activities to better align with a corporate mandate that would be difficult to achieve under the existing origination system due to certain architectural limitations. LOS replacement therefore was critical to achieving a critical corporate strategy, even though it had little chance for meeting its original ROI expectations. Notably, the requirements being defined would likely be very different depending on which rationale was driving the effort.

So what are some other compelling reasons to change your LOS, even though those reasons don't support a traditional ROI?

> **In these trying times, stability isn't a concern limited only to lenders; vendor viability is a real issue as well.**

You can't get there from here

There are times when you find you have simply dead-ended with your current system, and a change is the only way out. In today's market, for instance, if you find yourself running on a platform that simply doesn't work for government loans, making a change may be the only way of staying in business. In this case, the rationale has less to do with increasing revenue than with survival, and while the costs may be high, the stakes are even higher. The previous example of meeting a strategic imperative also falls into this category.

Nice knowing you

In these trying times, stability isn't a concern limited only to lenders; vendor viability is a real issue as well. If you find yourself in the regrettable situation of losing your vendor to insolvency, take little solace in the source code you had placed in escrow—the likelihood of attaining self-sufficiency on supporting a vendor's code base in an acceptable time frame, even assuming you had the necessary developers on staff, is near zero. This is as close to a "gun to the head" situation as you'll find, and system replacement is the only rational solution.

Leapfrog

The practical reality for many lenders is one of holding off on implementing new releases of their current system until they simply can't put it off any longer—because the vendor no longer provides support for the older version or some long-awaited enhancement has finally been included in a new release. The unfortunate predicament is that too often jumping ahead multiple releases of an existing system is just as difficult—and costly—as moving to an entirely new system. In situations like this, evaluating the potential benefits that could be realized through a change is often warranted.

Making the most of it

Even if you buy into the argument that achieving a true measurable ROI from an LOS implementation is highly unlikely, it doesn't mean you shouldn't do everything you can to try to beat the odds. There are several key steps you can take to ensure you close the cost-reward gap as much as possible.

First, it is important to realize that technology is one piece of a three-legged stool, with organization and process being the other two pieces. We refer to this as the organizational component model.

In virtually every situation, the best results are achieved when all three components are taken into account. It is relatively easy to understand that if you want to make an organizational change, you need to make changes to your processes and your technology to support it. Perhaps less obviously, the same is equally true of any technology change: To get the most out of it, you need to examine your people and processes as well.

Working with a smaller organization, a new LOS provided the ability for our client to define closing-document packages within the system. The client's existing system required a highly skilled closer to select each document on a case-by-case basis, often creating a bottleneck in closing due to the limited supply of knowledgeable closers.

With the new technology in place, we were able to assist our client to create two levels of workers in its closing department—junior and senior closers. Then we changed its process to route simpler loans to the newly created junior closers, when minimal review was required, while routing more complex closings to more seasoned workers.

This combination of technology, organization and process change allowed the client to lower costs by leveraging a reduced cost structure for new closers, while increasing revenue capacity by removing the constraint on growth imposed by the reliance on highly skilled resources. Optimal results were possible only by changing all three components of the operation.

Use the system you bought

All too often, LOS initiatives are complicated by overzealous attempts to shape the system to your way of doing things, with little or no willingness to adapt your existing processes to the system. Consider that there may actually be some validity for why the system does things the way it was designed, as backed up by the collective experience the vendor gained by working with its other customers.

Being willing to change some of your processes to conform to the best practices engendered by your new LOS can often simplify the implementation and contain the cost of implementation, and quite possibly yield better system performance to boot.

Keep it simple, and don't bite off more than you can accomplish in a reasonable time frame. If you picked your new system for the right reasons, be more accepting of the system and give it a chance to work for you before going overboard with customizations. Frequently we hear lenders say that if they don't customize right upfront, they fear they'll never get a second chance. The fallacies with that perspective are twofold. First, it is unreasonable to expect that you know a new system well enough to fully understand what you really need—as opposed to *want*—to change. Second, and potentially more important, if you fear not being able to make critical changes further into the life of the system, chances are you'll find yourself replacing that new system altogether too soon. Failure to make needed enhancements regularly to current systems is arguably the leading contributor to system obsolescence.

Working with another client recently, we were called upon to lead the implementation of an interim system for a new business channel while a large-scale, highly customized implementation effort was ongoing in its mainstay retail operation.

The quick success of our straightforward implementation quickly caught the attention of the lender's chief executive, who recognized that there were functionality trade-offs made in exchange for the modest cost of the interim system, but who questioned whether that was preferable to the cost overruns being experienced in the lender's quest for richer functionality on its other project. Clearly, one of the easiest ways to achieve ROI is by limiting the cost and time to deployment of the implementation.

Down to business

Finally, the surest way of falling victim to the statistics is to call the effort a technology project—so don't. Sure, it's a technology system, but it also happens to be the foundational support for the very core of your business. Failure to give the effort anything less than the full commitment of your management team, and as much attention as possible from the best and brightest of your team, is tantamount to the kiss of death.

For the business side of the house to hand a project of this importance off to your information technology (IT) team is unwise, unfair and unwarranted—no matter how talented the IT group may be—and an unconscionable abdication of responsibility. For all the right reasons, the most successful projects are business projects first and technology projects second—so make sure business remains actively involved throughout.

In short, the best things you can do to achieve something approaching an ROI on LOS replacement are to make sure you're doing things for the right reasons, take those reasons into account during the implementation, and ensure that the business side of the house reflects on its process and organization as well as the technology. It may still be a costly proposition, but the results will be so much more rewarding. MBt

Craig Hughes is managing director of financial services consulting at CC Pace, a nationally known management and technology consulting company based in Fairfax, Virginia. He can be reached at craig.hughes@ccpace.com. Bill Lehman and Debbie Shatz, directors in the mortgage practice, contributed to this column.