

The Rise of Two-Tier ERP

What it is and what it means

By Ron Gill, CMA, CFM

A new trend is evolving in enterprise resource planning (ERP). It's the concept of two-tier ERP, and it has become a growing area of discussion in corporate finance and information technology (IT) departments. Done well, it promises to finally attain the global visibility, standardization, and efficiency we all imagined large-scale ERP would bring back before those systems proved too complex, costly, and slow to deploy. What is two-tier ERP, and when is it right?

The State of ERP Today

You may recall that in the late 1990s and through to the middle of the last decade the mantra was “single-instance” ERP. This was a global corporate system standard that was centrally planned and managed and implemented across the entire organization. It seemed like the right idea. With vendors such as SAP and Oracle touting the strategy and with analysts and the industry press joining them, many large enterprises adopted a “single-vendor” or “one global standard” strategy for ERP and began projects to try to make the vision real.

As a theory, it makes complete sense. When every subsidiary, division, and geographic region from corporate headquarters to Timbuktu is running on the same ERP system, good things happen—from more efficient financial processes to clearer, quicker business visibility and better business alignment.

Some large companies have achieved the single-instance ERP vision. But for every single-instance company success story there are many more failures, not only

implementations that failed outright, but companies that have been implementing for years without ever achieving that global standardization. They watched the perpetual implementation project, coupled with maintenance and upgrades, devour their available resources of time and money. I’ve often thought of these massive global system rollout projects as being like painting the Golden Gate Bridge: Once you get started, you’re in a constant state of implementing, maintaining, or upgrading, and some part

of the system always shows a little rust and needs extra attention. Of course the difference is that the entire Golden Gate Bridge eventually does get painted, but many of these companies end up with large sections of their enterprise (overseas subsidiaries, acquired business units, new divisions) that have never deployed the “standard” system and continue to run on something else (with each “something else” driving its own need for attention to maintenance and upgrade).

Even companies that achieved true global standardization at one point in time have often watched their infrastructure devolve into a nest of multiple systems as the pace of deployment and maintenance of a heavy, on-premise system couldn’t keep up with the pace of expansion, acquisition, or innovation in the enterprise. So, for many enterprises, the current state of ERP falls far short of the vision.

The Failings of Single-Instance ERP

Why have so many ERP deployments fallen short of the promise of single-instance? What is keeping us from bringing it completely to fruition? The reasons are manifold, but they typically fall into the categories of too much cost, too much time, too much risk, and an inability to keep up with the rest of the organization.

Cost. For a large company, the cost of deploying Oracle or SAP enterprise-wide will run in the millions or tens of millions of dollars. An estimate published in *CIO* magazine in 2009 placed the cost of the *average* SAP deployment at \$17 million and that for Oracle Applications at close to \$13 million. It’s possible that that type of outlay makes sense for a major global enterprise in order to get improved processes and visibility across the vast bulk of the company. The problem comes when the headquarters installation is finished and the first few major subsidiaries have been brought online. With the core complete, the economics become decreasingly justifiable as you move toward the edges of the organization. At each location there will be hardware and software to be purchased and deployed, an IT team to be dispatched, and a new span on that Golden Gate Bridge needs its own permanent paint crew. Another million dollars just to bring the Singapore subsidiary online? Somehow that cost/benefit doesn’t seem as compelling as it did in the earlier stages of the project. Factor the cost of a major system deployment into the business case for my potential acquisition? That will kill the economics, and I’ll never get approval for the deal!

Time. Single-instance ERP deployments take an enor-

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mous amount of time. Global rollouts taking years and years and straddling the tenure of multiple finance and IT personnel are the rule rather than the exception. Again, momentum can fall off significantly the further you get from headquarters or the largest subsidiaries. And each new subsidiary, division, or process added means that the core IT team will be spending a larger and larger portion of its time caring for and feeding the systems already installed and have less and less capacity to apply to rolling out to new subsidiaries, divisions, or processes. Then the general manager of one of those far-flung subsidiaries says, “Yes, they’re going to roll it out here as well but I’ve seen the rollout calendar, and I’m scheduled to get it in 2019. I need something now.”

Risk. Cost and time add up to risk. These massive deployments often overshoot on time and cost and subsequently crumple under their own weight. Part of the company may end up live, but that may be where the deployment fizzles and proceeds no further. Because these deployments have been so disruptive, so risky, and simply so much harder than imagined at the outset, companies hesitate to deploy more broadly.

Agility. Worst of all for the single-tier strategy is that, during the years-long global deployment project, neither the world nor the business has stood still. New companies have been acquired or divested, new products and processes have been introduced, and new regulatory and accounting requirements have been enacted. Because these systems take so long and cost so much to deploy, they’ve been completely unable to keep pace with the changing environment. The unmanaged change results in patching systems and processes with a variety of point solutions, stand-alone ERP systems, manual processes, and, in gener-

al, exactly the kind of chaos everyone was trying to avoid with this single-tier strategy in the first place.

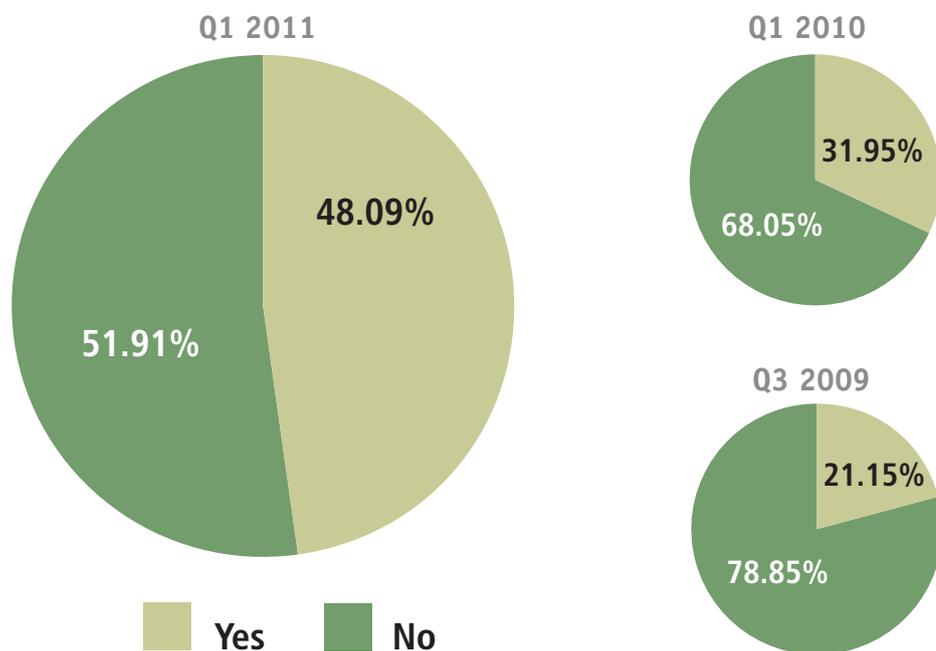
What does all that mean to the organization? Fundamentally, it’s a failure to achieve those gains that were the original vision of the strategy, namely global visibility, process efficiency, and standardization.

Disparate, unconnected systems running in subsidiaries that make up a measurable portion of the business mean that the only way the corporate CFO can know how business is going in those subsidiaries is to pick up the phone (and pick it up several times each month). Even with the subsidiary CFO on the phone, without standardized systems and processes, there’s no guarantee that everyone is speaking the same language.

The handoffs between those disparate systems also are challenging. Processing orders across subsidiaries, reconciling intercompany charges, and consolidating the books at month-end are complicated when there’s no standardization. Clumsy manual handoffs of information across systems are not only inefficient, but they create opportunities for the introduction of errors and erode confidence in the integrity of the process.

Finally, executing change in this environment can be an enormous challenge. For example, if you add a new department or general ledger (GL) account to track something globally, you’ll need to make separate changes in dozens (or maybe hundreds) of different places. More complex changes, such as rolling out a new process because of a change in Generally Accepted Accounting Principles (GAAP), can consume huge amounts of time and resources that are far out of proportion to the real magnitude of the change.

This is the common reality finance faces today. Given the current situation, it makes sense to develop a new strategic approach that will move organizations toward the global standardization and transparency originally envisioned and promised by ERP much more quickly and effectively than the one-system strategy has done. That’s where two-tier ERP comes in.

Figure 1: Are You Considering Two-Tier ERP Strategies?

Source: Q1 2011 Software Insider Next Gen IT Leader Survey (n=113/235), Q1 2010 (n=77/241), Q3 2009 (n=55/260)
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The Emergence of Two-Tier ERP

Two-tier ERP is about designing an infrastructure that can be deployed quickly and cost effectively outside headquarters. The infrastructure will provide the visibility and standardization hoped for in single-instance ERP but will also be agile and cost effective enough to be deployed even in the farthest reaches of the organization.

The idea is to achieve most of the major benefits of the single-instance ERP—standard processes, consistent definitions, streamlined financial consolidation, and better business visibility across the organization—but without the outsize cost and risk and while still ensuring the business can adapt to change going forward. It's about closing the gap between what finance needs and what IT can deliver effectively with the resources they have at their disposal.

In short, two-tier ERP means running one ERP system for corporate, such as SAP or Oracle, and adopting another ERP solution for everywhere else that's lighter weight and easier to deploy and customize. The two-tier strategy should provide a standard, templatable deployment for subsidiaries while reducing the overall number and variety of distinct systems throughout the organization. By using a two-tier approach, an enterprise ideally should be able to whittle down its distinct ERP solutions

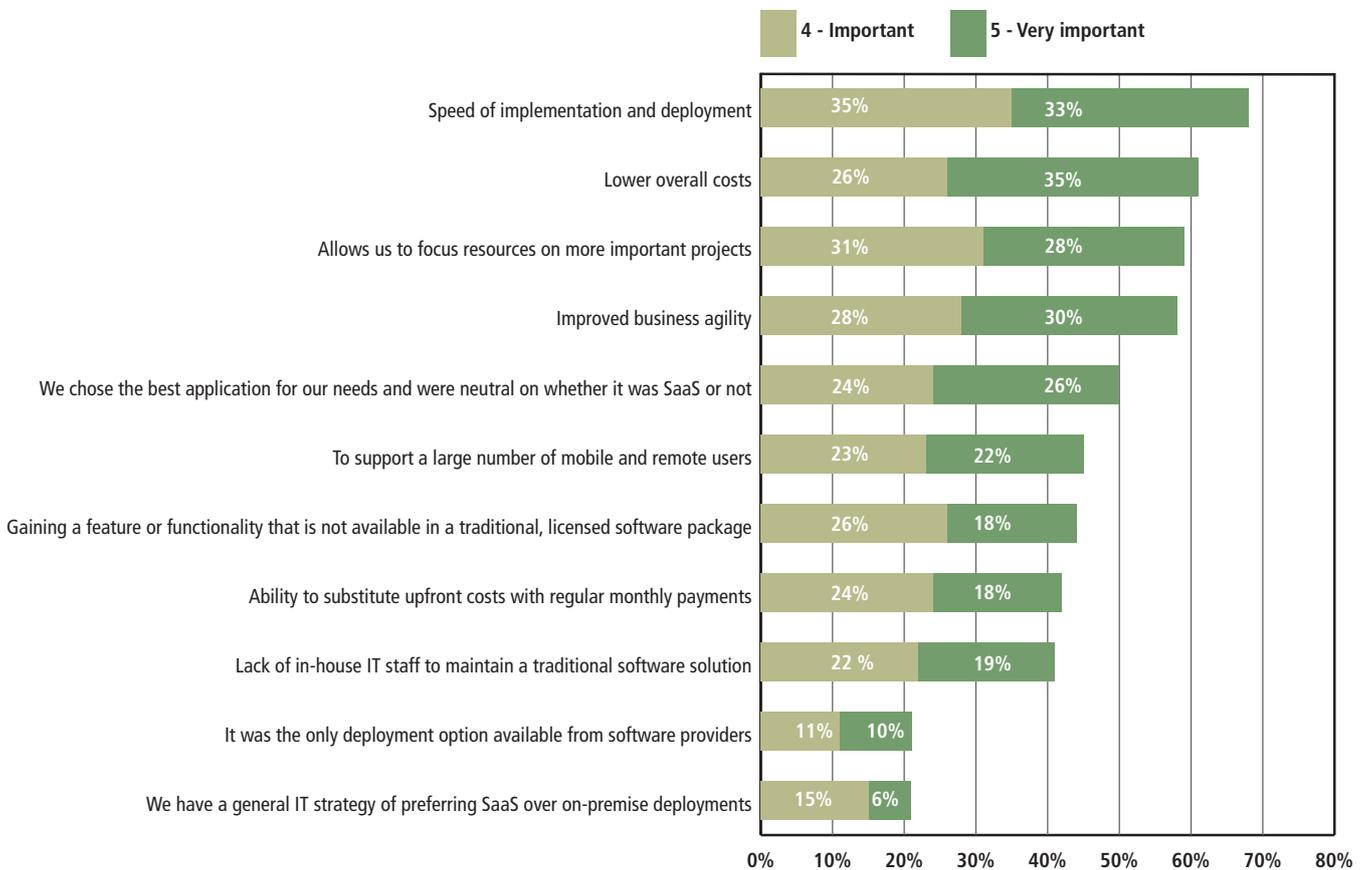
to two or three vendors. For CFOs and controllers, this means a dramatically simpler financial consolidation process: fewer individual feeds, fewer systems to track, and more effective financial and management reporting overall.

Constellation Research, a firm that tracks ERP strategy, has documented the rise of this approach within the enterprise. According to its research, enterprise CIO interest in two-tier ERP has jumped from 20% to nearly 50% in just 18 months (see Figure 1).

That rapidly growing interest flows from the operating realities businesses face. Competitive pressures, globalization, a changing regulatory environment, and market volatility mean that organizations need both to be more agile and to step up the level of transparency and visibility across and into the business. Of course, the laser focus on spending also means that companies need to achieve these goals while dedicating a flat or declining portion of their resources to infrastructure.

The impact of adopting a two-tier strategy can be substantial. Jollibee Foods Corporation, an international restaurant chain with more than \$50 billion in revenue and with thousands of restaurants and hundreds of subsidiaries worldwide, embarked on a two-tier ERP strategy after years of struggling with a

Figure 2: Reasons Businesses Choose the Cloud



Source: Forrsights Software Survey, Q4 2010, Forrester Research, Inc., November 2010. Base: 534 North American and European enterprise and SMB software decision makers.

one-platform approach. Faced with continuing to try to roll out Oracle Financials into China, Vietnam, Thailand, and North America from its corporate headquarters in the Philippines, Jollibee's CFO realized that the approach simply wasn't practical. Given the substantial, ongoing IT overhead investment that would be required in each location where the system was to be deployed and the years-long time horizon to complete the global rollout, he decided to switch to a two-tier structure. Two years later, the company has successfully incorporated two ERP solutions, one for corporate and one for its operating subsidiaries, at a fraction of the time and cost it would have taken to implement the single-instance approach. Jollibee chose to use cloud computing as its vehicle for two-tier ERP because it enabled the company to roll standardized ERP to each subsidiary quickly and without overtaxing the IT organization. It also meant that Jollibee corporate could easily access divisional and subsidiary reports through the Web—making the organization more transparent and timely. By using a cloud two-tier

ERP approach, Jollibee saved millions in infrastructure and software costs compared to using an on-premise deployment, and it achieved in months what would otherwise have taken years to complete.

I've talked with many CFOs and CIOs who have gone the two-tier road, and there are some key traits to consider when designing the two-tier ERP strategy to help make the approach succeed.

To Cloud or Not to Cloud

Are all ERP solutions equal when it comes to a two-tier strategy? One critical difference is whether the ERP offering is cloud or on-premise. Although it's possible to standardize on another on-premise package for two-tier deployment, in the numerous locations where it will be used, most of the cost, time, risk, and agility problems will remain. Worse still, the systems will age, not track with change, and potentially pose the same challenges to corporate finance as the applications they replaced.

If you aren't familiar with cloud computing, I encourage you to read my *Strategic Finance* article from January

2011 titled, “What the Cloud Means to Finance.” Forrester Research, however, has summed up some of the key reasons businesses choose the cloud—or software as a service (SaaS)—over a traditional on-premise route (see Figure 2).

It’s important to evaluate any cloud vendor in terms of the feature and function set it can provide, its viability, and its approaches to security. But data management and flexibility, the main drivers cited in the Forrester survey for switching to SaaS, align remarkably well with the cost, time, agility, and risk problems we identified with the large ERP strategy.

In terms of speed, cloud ERP enables businesses to get a standard systems infrastructure in place across multiple subsidiaries in multiple countries in a matter of weeks, not months or years. A company such as Groupon can’t begin to imagine a global rollout project for a big ERP system that could keep up with its aggressive international acquisition strategy. That company decided to implement in spring 2011 and quickly began rolling out cloud-based ERP into its foreign subsidiaries. As of this writing, Groupon has 26 subsidiaries live and plans to have completed rollout in 46 countries within a year. That’s 46 overseas subsidiaries going from separate, individual, on-premise systems to a globally standardized, centrally managed and deployed system in less than a year. That’s a massive step up in global standardization, visibility, and economy at a pace that’s simply inconceivable with traditional on-premise systems.

The ease and speed of deployment, along with the elimination of the need to purchase hardware and periphery software (operating systems, databases, etc.) for each deployment site, have a material impact on costs, with cloud solutions costing less than half of their on-premise counterparts. Combined, the speed of deployment and lower cost mean significantly less risk in deployment.

Some Unique Benefits

In addition to solving some of the big ERP deployment problems, cloud ERP can deliver some additional unique benefits:

- ◆ Browser-based access makes it much easier for a corporate headquarters to get instant visibility into subsidiary performance than when the desired data is locked away on servers in a remote office. With a cloud ERP system, rather than phoning the local CFO, the corporate finance team can simply log in if it wants to see current performance metrics or check on the status of the close.

- ◆ The centralized architecture SaaS ERP provides also means you’ll likely be able to achieve a level of data redundancy and security that would have been prohibitive for the local IT team.

- ◆ A centrally managed SaaS-based system not only allows for quicker and more standardized initial rollout, but it does a much better job of facilitating enterprise-wide changes related to new processes or metrics.

- ◆ With SaaS vendors regularly upgrading the remote system to the newest version, a cloud-based second tier could mean the end of version lock for the subsidiaries.

SaaS or not, however, it’s critical to ensure that the second-tier ERP system can be customized to the needs of the business unit and easily connected back to the corporate ERP system. IT must be a close partner when a company is formulating any two-tier strategy and trying to understand the level of customization that’s possible and the connectors and integration tool sets that are available.

The Road to Better-Aligned ERP

There is clearly a gap between the strategy as envisioned and the current state of ERP on the ground today. For most enterprises, the current trajectory is unsustainable.

Corporate and division finance can’t deliver uniform consistency and transparency while working in a systems environment that’s increasingly diverse, inconsistent, and opaque. At the same time, our IT counterparts can’t continue to have a larger and larger portion of their resources and efforts consumed by patching and tweaking a complex mess of existing systems while needs for innovation and expansion go unmet. Something clearly has to give, and the smart organizations are getting out in front and building an efficient, pragmatic strategy for their ERP systems.

The maturation of cloud computing solutions finally provides for a practical, effective two-tier strategy, which means that the original vision for ERP of transparency and standardization across the enterprise can at last be realized. The initial implementation will finally be possible over a manageable cost and time horizon, and the deployed solution will be agile, automated, and scalable enough to stay current and stay in sync with the business as it grows and changes. **SF**

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