Lecture 7: the Feasibility Study

▪ What is a feasibility study?
  ▪ What to study and conclude?
▪ Types of feasibility
  ▪ Technical
  ▪ Economic
  ▪ Schedule
  ▪ Operational
▪ Quantifying benefits and costs
  ▪ Payback analysis
  ▪ Net Present Value Analysis
  ▪ Return on Investment Analysis
▪ Comparing alternatives

Why a feasibility study?

▪ Objectives of a feasibility study:
  ▪ To find out if an system development project can be done:
    ▪ ...is it possible?
    ▪ ...is it justified?
  ▪ To suggest possible alternative solutions.
  ▪ To provide management with enough information to know:
    ▪ Whether the project can be done
    ▪ Whether the final product will benefit its intended users
    ▪ What the alternatives are (so that a selection can be made in subsequent phases)
    ▪ Whether there is a preferred alternative
▪ A feasibility study is a management-oriented activity
  ▪ After a feasibility study, management makes a “go/no-go” decision.
  ▪ Need to examine the problem in the context of broader business strategy
Content of a feasibility study

Things to be studied in the feasibility study:

- The present organizational system
  - Stakeholders, users, policies, functions, objectives, ...
- Problems with the present system
  - Inconsistencies, inadequacies in functionality, performance, ...
- Goals and other requirements for the new system
  - Which problem(s) need to be solved?
  - What would the stakeholders like to achieve?
- Constraints
  - Including nonfunctional requirements on the system (preliminary pass)
- Possible alternatives
  - "Sticking with the current system" is always an alternative
  - Different business processes for solving the problems
  - Different levels/types of computerization for the solutions
- Advantages and disadvantages of the alternatives

Things to conclude:

- Feasibility of the project
- The preferred alternative.

Exploring Feasibility

The "PIECES" framework

- Useful for identifying operational problems to be solved, and their urgency
  Performance
    - Is current throughput and response time adequate?
  Information
    - Do end users and managers get timely, pertinent, accurate and usefully formatted information?
  Economy
    - Are services provided by the current system cost-effective?
    - Could there be a reduction in costs and/or an increase in benefits?
  Control
    - Are there effective controls to protect against fraud and to guarantee information accuracy and security?
  Efficiency
    - Does current system make good use of resources: people, time, flow of forms, ...
  Services
    - Are current services reliable? Are they flexible and expandable?

See the course website for a more specific list of PIECES questions
Four Types of feasibility

- **Technical feasibility**
  - Is the project possible with current technology?
  - How much technical risk is there?
  - Does the technology exist at all?
    - Is it available locally?
    - Can it be obtained?
    - Will it be compatible with other systems?
  - © Easterbrook 2004

- **Economic feasibility**
  - Is the project possible, given resource constraints?
  - What benefits will result from the system?
    - Both tangible and intangible benefits
    - Quantify them
  - What are the development and operational costs?
  - Are the benefits worth the costs?

- **Schedule feasibility**
  - Is it possible to build a solution in time to be useful:
    - Any constraints on the schedule?
    - Can these constraints be met?

- **Operational feasibility**
  - Urgency of the problem and the acceptability of any solution:
    - If the system is developed, will it be used?
  - Human and social issues...
    - internal issues:
      - Available of human resources?
      - Potential labour objections?
      - Manager resistance?
      - Organizational conflicts and policies?
    - external issues:
      - Social acceptability?
      - legal aspects and government regulations?

Technical Feasibility

- Is the proposed technology or solution practical?
  - Do we currently possess the necessary technology?
  - Do we possess the necessary technical expertise, and is the schedule reasonable?
  - Is relevant technology mature enough to be easily applied to our problem?

- What kinds of technology will we need?
  - Some organizations like to use state-of-the-art technology
  - ...but most prefer to use mature and proven technology.
  - A mature technology has a larger customer base for obtaining advice concerning problems and improvements.

- Is the required technology available "in house"?
  - If the technology is available:
    - ...does it have the capacity to handle the solution?
  - If the technology is not available:
    - ...can it be acquired?
Economic Feasibility

Can the bottom line be quantified yet?
- Very early in the project...
  - a judgement of whether solving the problem is worthwhile.
- Once specific requirements and solutions have been identified...
  - the costs and benefits of each alternative can be calculated

Cost-benefit analysis
- Purpose - answer questions such as:
  - Is the project justified (i.e. will benefits outweigh costs)?
  - Can the project be done, within given cost constraints?
  - What is the minimal cost to attain a certain system?
  - Which alternative offers the best return on investment?
- Examples of things to consider:
  - Hardware/software selection
  - How to convince management to develop the new system
  - Selection among alternative financing arrangements (rent/lease/purchase)
- Difficulties
  - benefits and costs can both be intangible, hidden and/or hard to estimate
  - ranking multi-criteria alternatives

Benefits and Costs

Tangible Benefits
- Readily quantified as $ values
- Examples:
  - increased sales
  - cost/error reductions
  - increased throughput/efficiency
  - increased margin on sales
  - more effective use of staff time

Intangible benefits
- Difficult to quantify
  - But maybe more important!
- Examples:
  - increased flexibility of operation
  - higher quality products/services
  - better customer relations
  - improved staff morale

How will the benefits accrue?
- When - over what timescale?
- Where in the organization?

Development costs (OTO)
- Development and purchasing costs:
  - Cost of development team
  - Consultant fees
  - software used (buy or build)?
  - hardware (what to buy, buy/lease)?
  - facilities (site, communications, power,...)
- Installation and conversion costs:
  - installing the system,
  - training personnel,
  - file conversion,

Operational costs (on-going)
- System Maintenance:
  - hardware (repairs, lease, supplies,...),
  - software (licenses and contracts),
  - facilities
- Personnel:
  - For operation (data entry, backups,...)
  - For support (user support, hardware and software maintenance, supplies,...)
  - On-going training costs
Example: costs for small Client-Server project

Personnel:
1. System Analysts (400 hours/ea $35.00/hr) $28,000
2. Programmers/Analysts (200 hours/ea $35.00/hr) $25,000
3. GUI Designer (200 hours/ea $35.00/hr) $7,000
4. Telecommunications Specialist (60 hours/ea $45.00/hr) $2,700
5. System Architect (100 hours/ea $45.00/hr) $4,500
6. Database Specialist (15 hours/ea $80.00/hr) $1,200
7. System Librarian (50 hours/ea $10.00/hr) $500

Expenses:
8. Smalltalk training registration ($3500.00/student) $14,000

New Hardware & Software:
9. Development Server (Pentium Pro-class) $18,700
10. Server Software (operating system, misc.) $1,500
11. DBMS server software $7,500
12. DBMS client software ($950.00 per client) $6,650

Total Development Costs: $118,200

PROJECTED ANNUAL OPERATING COSTS

Personnel:
13. Programmers/Analysts (125 hours/ea $25.00/hr) $6,250
14. System Librarian (20 hours/ea $10.00/hr) $200

Expenses:
15. Maintenance Agreement for Pentium Pro Server $995
16. Maintenance Agreement for Server DBMS software $525
17. Preprinted forms (15,000/year @ .22/form) $3,300

Total Projected Annual Costs: $11,270

Analyzing Costs vs. Benefits

- Identify costs and benefits
  - Tangible and intangible, one-time and recurring
  - Assign values to costs and benefits

- Determine Cash Flow
  - Project costs and benefits over time, e.g. 3-5 years
  - Calculate Net Present Value for all future costs/benefits
    - determines future costs/benefits of the project in terms of today’s dollar values
    - A dollar earned today is worth more than a potential dollar earned next year

- Do cost/benefit analysis
  - Calculate Return on Investment:
    - Allows comparison of lifetime profitability of alternative solutions.
    - \[ \text{ROI} = \frac{\text{Lifetime benefits} - \text{Lifetime costs}}{\text{Lifetime costs}} \]
  - Calculate Break-Even point:
    - how long will it take (in years) to pay back the accrued costs:
      \[ \text{Accrued Cost (initial + incremental)} < \text{Accrued Benefit} \]
Calculating Present Value

A dollar today is worth more than a dollar tomorrow...

Your analysis should be normalized to "current year" dollar values.

The discount rate

measures opportunity cost:
- Money invested in this project means money not available for other things
- Benefits expected in future years are more prone to risk

This number is company- and industry-specific.
- "what is the average annual return for investments in this industry?"

Present Value:

The "current year" dollar value for costs/benefits n years into the future
- for a given discount rate i

\[
\text{Present\_Value}(n) = \frac{1}{(1 + i)^n}
\]

E.g. if the discount rate is 12%, then
- \(\text{Present\_Value}(1) = \frac{1}{(1 + 0.12)^1} = 0.893\)
- \(\text{Present\_Value}(2) = \frac{1}{(1 + 0.12)^2} = 0.797\)

Net Present Value

Measures the total value of the investment

...with all figures adjusted to present dollar values

\[
\text{NPV} = \text{Cumulative PV of all benefits} - \text{Cumulative PV of all costs}
\]

<table>
<thead>
<tr>
<th>Cash Flow</th>
<th>Year 0</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dev. Costs ($100,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oper. Costs ($4,000)</td>
<td>($4,000)</td>
<td>($4,500)</td>
<td>($5,000)</td>
<td>($5,500)</td>
<td></td>
</tr>
<tr>
<td>Present Value</td>
<td>0</td>
<td>0.893</td>
<td>0.797</td>
<td>0.712</td>
<td>0.636</td>
</tr>
<tr>
<td>Time-adj Costs ($100,000)</td>
<td>($3,572)</td>
<td>($3,587)</td>
<td>($3,560)</td>
<td>($3,816)</td>
<td></td>
</tr>
<tr>
<td>Cumulative Costs ($100,000)</td>
<td>($103,572)</td>
<td>($107,159)</td>
<td>($110,719)</td>
<td>($114,135)</td>
<td></td>
</tr>
<tr>
<td>Benefits</td>
<td>0</td>
<td>$25,000</td>
<td>$30,000</td>
<td>$35,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>T-adj Benefits</td>
<td>0</td>
<td>$22,325</td>
<td>$23,310</td>
<td>$24,920</td>
<td>$31,800</td>
</tr>
<tr>
<td>Cumulative Benefits</td>
<td>0</td>
<td>$22,325</td>
<td>$45,635</td>
<td>$70,550</td>
<td>$102,355</td>
</tr>
<tr>
<td>Net Costs/Net Benefits</td>
<td>$100,000</td>
<td>($81,243)</td>
<td>($60,924)</td>
<td>($39,564)</td>
<td>($11,580)</td>
</tr>
</tbody>
</table>

Assuming subsequent years are like year 4...
- the net present value of this investment in the project will be:
- after 5 years, $13,652
- after 6 years, $36,168
### Payback Analysis for Client-Server System Alternative

<table>
<thead>
<tr>
<th>Year</th>
<th>Operation &amp; maintenance cost</th>
<th>Development cost</th>
<th>Discount factors for 12%</th>
<th>Time-adjusted costs discounted to present</th>
<th>Cumulative time-adjusted costs over</th>
<th>Benefits derived from operation of new</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1.00%</td>
<td>$9,000</td>
<td>$1,000</td>
<td>$9,000</td>
<td>$9,000</td>
<td>$99,000</td>
</tr>
<tr>
<td>2</td>
<td>1.00%</td>
<td>$18,000</td>
<td>$2,000</td>
<td>$20,000</td>
<td>$20,000</td>
<td>$299,000</td>
</tr>
<tr>
<td>3</td>
<td>1.00%</td>
<td>$27,000</td>
<td>$3,000</td>
<td>$30,000</td>
<td>$30,000</td>
<td>$699,000</td>
</tr>
<tr>
<td>4</td>
<td>1.00%</td>
<td>$36,000</td>
<td>$4,000</td>
<td>$40,000</td>
<td>$40,000</td>
<td>$1,299,000</td>
</tr>
<tr>
<td>5</td>
<td>1.00%</td>
<td>$45,000</td>
<td>$5,000</td>
<td>$50,000</td>
<td>$50,000</td>
<td>$2,199,000</td>
</tr>
<tr>
<td>6</td>
<td>1.00%</td>
<td>$54,000</td>
<td>$6,000</td>
<td>$60,000</td>
<td>$60,000</td>
<td>$3,199,000</td>
</tr>
</tbody>
</table>

Cumulative lifetime time-adjusted costs over = ($1,000,000 / $5,000,000) = 0.2

\[
\text{Payback Period} = \frac{51,611}{70,501 + 51,611} = 0.42
\]

Therefore, the payback period is 3.42 years.
Return on Investment (ROI) analysis

- For comparing overall profitability
  - Which alternative is the best investment?
  - ROI measures the ratio of the value of an investment to its cost.

- ROI is calculated as follows:
  \[ \text{ROI} = \frac{\text{Estimated lifetime benefits} - \text{Estimated lifetime costs}}{\text{Estimated lifetime costs}} \]
  or:
  \[ \text{ROI} = \frac{\text{Net Present value}}{\text{Estimated lifetime costs}} \]

  - For our example
    \[
    \text{ROI} = \frac{795,440 - 488,692}{488,692} = 62.76\%,
    \]
    \[
    \text{or} \quad \text{ROI} = \frac{306,748}{488,692} = 62.76\%\]

- Solution with the highest ROI is the best alternative
  - But need to know payback period too to get the full picture
  - E.g. A lower ROI with earlier payback may be preferable in some circumstances

Schedule Feasibility

- How long will it take to get the technical expertise?
  - We may have the technology, but that doesn’t mean we have the skills required to properly apply that technology.
    - May need to hire new people
    - Or re-train existing systems staff
    - Whether hiring or training, it will impact the schedule.

- Assess the schedule risk:
  - Given our technical expertise, are the project deadlines reasonable?
  - If there are specific deadlines, are they mandatory or desirable?
    - If the deadlines are not mandatory, the analyst can propose several alternative schedules.

- What are the real constraints on project deadlines?
  - If the project overruns, what are the consequences?
    - Deliver a properly functioning information system two months late...
    - ...or deliver an error-prone, useless information system on time?
  - Missed schedules are bad, but inadequate systems are worse!
Operational Feasibility

- How do end-users and managers feel about...
  - the problem you identified?
  - the alternative solutions you are exploring?

- You must evaluate:
  - Not just whether a system can work...
  - but also whether a system will work.

- Any solution might meet with resistance:
  - Does management support the project?
  - How do the end users feel about their role in the new system?
  - Which users or managers may resist (or not use) the system?
    - People tend to resist change.
    - Can this problem be overcome? If so, how?
  - How will the working environment of the end users change?
  - Can or will end users and management adapt to the change?

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Feasibility Study Contents

1. Purpose & scope of the study
   - Objectives (of the study)
   - who commissioned it & who did it,
   - sources of information,
   - process used for the study,
   - how long did it take,...

2. Description of present situation
   - organizational setting, current system(s).
   - Related factors and constraints.

3. Problems and requirements
   - What’s wrong with the present situation?
   - What changes are needed?

4. Objectives of the new system.
   - Goals and relationships between them

5. Possible alternatives
   - including 'do nothing'.

6. Criteria for comparison
   - definition of the criteria

7. Analysis of alternatives
   - description of each alternative
   - evaluation with respect to criteria
   - cost/benefit analysis and special implications.

8. Recommendations
   - what is recommended and implications
   - what to do next;
     - E.g. may recommend an interim solution and a permanent solution

9. Appendices
   - to include any supporting material.
Comparing Alternatives

How do we compare alternatives?
- When there are multiple selection criteria?
- When none of the alternatives is superior across the board?

Use a Feasibility Analysis Matrix!
- The columns correspond to the candidate solutions;
- The rows correspond to the feasibility criteria;
- The cells contain the feasibility assessment notes for each candidate;
- Each row can be assigned a rank or score for each criterion
  - e.g., for operational feasibility, candidates can be ranked 1, 2, 3, etc.
  - A final ranking or score is recorded in the last row.

Other evaluation criteria to include in the matrix
- quality of output
- ease of use
- vendor support
- cost of maintenance
- load on system

Example matrix

<table>
<thead>
<tr>
<th>Description</th>
<th>Candidate 1 Name</th>
<th>Candidate 2 Name</th>
<th>Candidate 3 Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operational Feasibility</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technical Feasibility</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Schedule Feasibility</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Economic Feasibility</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ranking</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Feasibility Criteria</td>
<td>Wt.</td>
<td>Candidate 1</td>
<td>Candidate 2</td>
</tr>
<tr>
<td>------------------------------</td>
<td>-----</td>
<td>--------------------------------------</td>
<td>--------------------------------------</td>
</tr>
<tr>
<td><strong>Operational Feasibility</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Functionality: Describes to what degree the alternative would benefit the organization and how well the system would work.</td>
<td>30%</td>
<td>Only supports Member Services requirements and current business processes would have to be modified to take advantage of software functionality</td>
<td>Fully supports user required functionality</td>
</tr>
<tr>
<td><strong>Political</strong> : A description of how well received this solution would be from both user management, user, and organization perspective.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Technical Feasibility</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technology: An assessment of the maturity, availability (or ability to acquire), and desirability of the computer technology needed to support this candidate.</td>
<td>30%</td>
<td>Current production release of Platinum Plus package in version 1.0 and has only been on the market for 6 weeks. Maturity of product is a risk and company charges an additional monthly fee for technical support.</td>
<td>Although current technical staff has only Powerbuilder experience, the senior analyst who saw the MS Visual Basic demonstration and presentation has agreed the transition will be simple and finding experienced VB programmers will be easier than finding Powerbuilder programmers and at a much cheaper cost.</td>
</tr>
<tr>
<td>Expertise: An assessment of the technical expertise needed to develop, operate, and maintain the candidate system.</td>
<td></td>
<td>Required to hire or train C++ expertise to perform modifications for integration requirements.</td>
<td></td>
</tr>
<tr>
<td><strong>Economic Feasibility</strong></td>
<td>30%</td>
<td>Score: 60</td>
<td>Score: 100</td>
</tr>
<tr>
<td>Cost to develop:</td>
<td></td>
<td>Approximately $350,000.</td>
<td>Approximately $418,040.</td>
</tr>
<tr>
<td>Payback period (discounted):</td>
<td></td>
<td>Approximately 4.5 years.</td>
<td>Approximately 3.5 years.</td>
</tr>
<tr>
<td>Net present value:</td>
<td></td>
<td>Approximately $210,000.</td>
<td>Approximately $306,748.</td>
</tr>
<tr>
<td>Detailed calculations:</td>
<td></td>
<td>See Attachment A.</td>
<td>See Attachment A.</td>
</tr>
<tr>
<td><strong>Schedule Feasibility</strong></td>
<td>10%</td>
<td>Less than 3 months.</td>
<td>9-12 months</td>
</tr>
<tr>
<td>An assessment of how long the solution will take to design and implement.</td>
<td></td>
<td>Score: 60</td>
<td>Score: 85</td>
</tr>
<tr>
<td><strong>Ranking</strong></td>
<td>100%</td>
<td>60.5</td>
<td>92</td>
</tr>
</tbody>
</table>