How to calculate Return on Investment

One of the most common reasons to calculate return on investment is to validate a proposal’s potential cost savings. However, it’s also a useful tool to measure the impact of projects that support company strategies to improve productivity, IT infrastructure, competitive positioning, or reduce environmental impact.

To calculate a proposal’s return on investment (ROI), add up the value of its benefits and subtract its costs. In most cases, you’ll also need to account for the time required for the improvement to pay for itself. A payback of three years or less is generally considered worthwhile.

The more complex the proposal, the more difficult it is to calculate ROI accurately. The tips offered here are intended for small or moderately-sized proposals. For larger scale proposals, enlist the aid of a financial analyst or other accounting expert to accurately calculate your project’s ROI.

ROI Formulas

ROI can be expressed in a simple formula:

\[
\frac{\text{Benefits} - \text{Costs}}{\text{Costs}} = \text{ROI}
\]

Calculating Benefits

How will the proposal benefit your company or department? Common project benefits include one or more of the following:

- Cost reduction
- Productivity increases
- Process improvements
- Waste reduction

To calculate the benefits of a proposal use this simple formula:

\[
\text{Current Cost} - \text{Cost after Change} = \text{Benefits}
\]

If quantifying your current costs is too difficult you may be able to use industry averages. If your proposal involves a supplier, consider enlisting their help in calculating your ROI. If they’ll provide a reference you may even be able to discuss the actual ROI with one of their customers.
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