

ABC for customer and product profitability

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About ALG Australia

- ▶ Part of “The Bestrane Group” Founded in 2004
- ▶ Former partner of the Armstrong Laing Group (UK organisation purchased by Business Objects in 2006)
- ▶ Now a Solution Provider of Business Objects/SAP and entirely focused on Business Objects/SAP “Profit” suite of applications
- ▶ “Sell, Implement, Operate and Support” business model
- ▶ Offices in Melbourne and Sydney
- ▶ 15 Employees with in excess of 100 years combined ABC and profitability analysis experience
- ▶ Over 15 active Profit implementations in the ANZ region across several industries
 - ▶ Finance
 - ▶ Logistics
 - ▶ Industrial
 - ▶ Government



BOBJ's Profit suite has a long history of Constant Innovation



- ▶ 1991 ABC power
 - ▶ 1st multi-dimensional ABC Engine
- ▶ 1994 Hyper ABC
 - ▶ 1st 'What if?' analysis
- ▶ 1998 Metify ABM
 - ▶ 1st client server application
- ▶ 1999 ABM Enterprise solution
 - ▶ 1st 3-tier enterprise application
- ▶ 2004 Metify ABM 3.0

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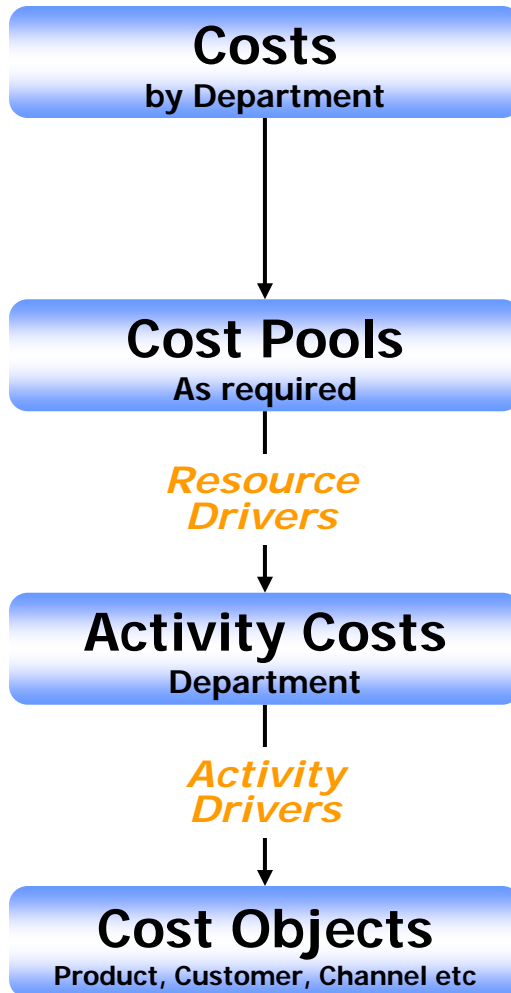
- ▶ 2002 Predictive Planning
 - ▶ 1st driver-based planning and budgeting application with on demand calculation, integrated ABC and Shared Services costing and cross charging
- ▶ 2003 Activity Analysis
 - ▶ 1st Web-based application offering all ABC methodologies including time-driven and transactional
- ▶ 2007 Integration with BOBJ reporting tools
- ▶ 2008 Purchase of Business Objects by SAP



Insight

What is Activity Based Costing ?

ABC 101..... Not a new idea !



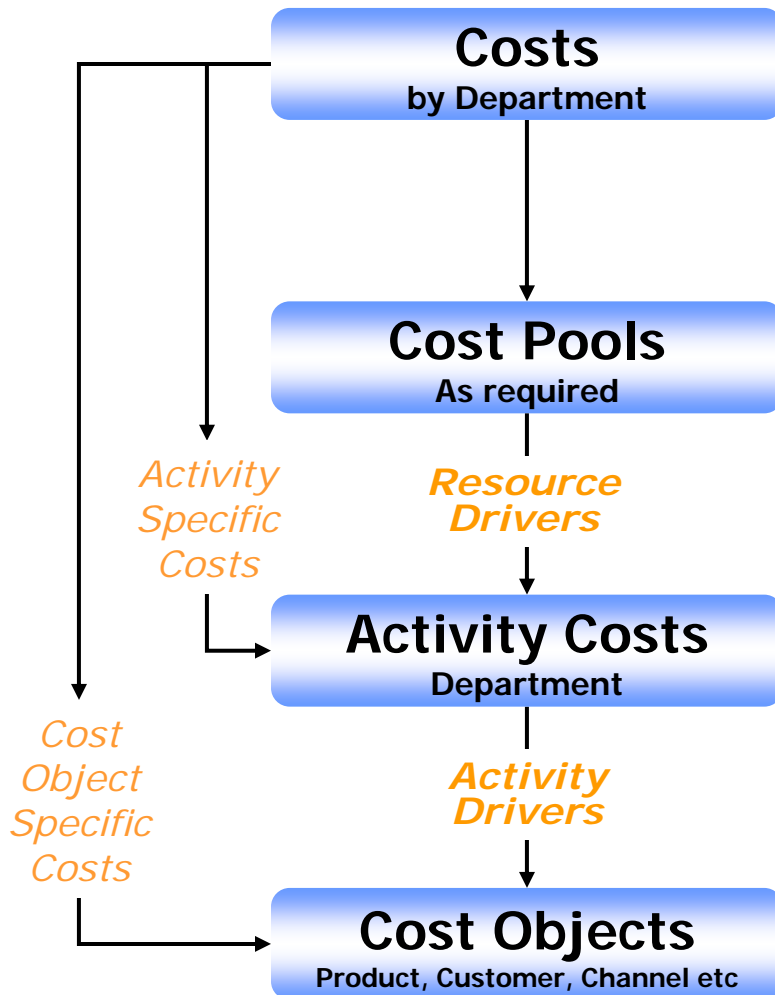
Costs collected by the GL

...are assembled into cost pools

...which are allocated to business activities ...

..and then driven to cost objects

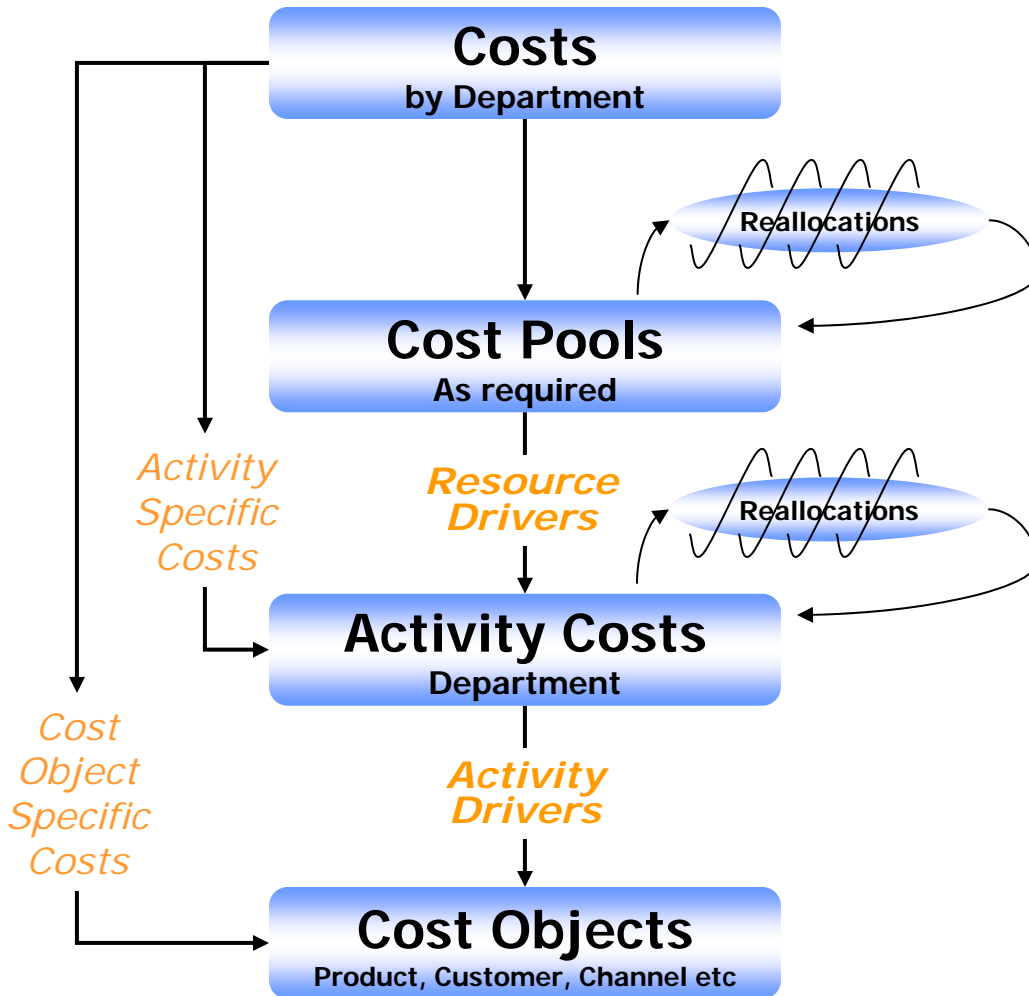
ABC 101... Not everything is modeled



Some costs do not need to follow the theory

..e.g "sponsorship of a specific product" can go from GL straight to product

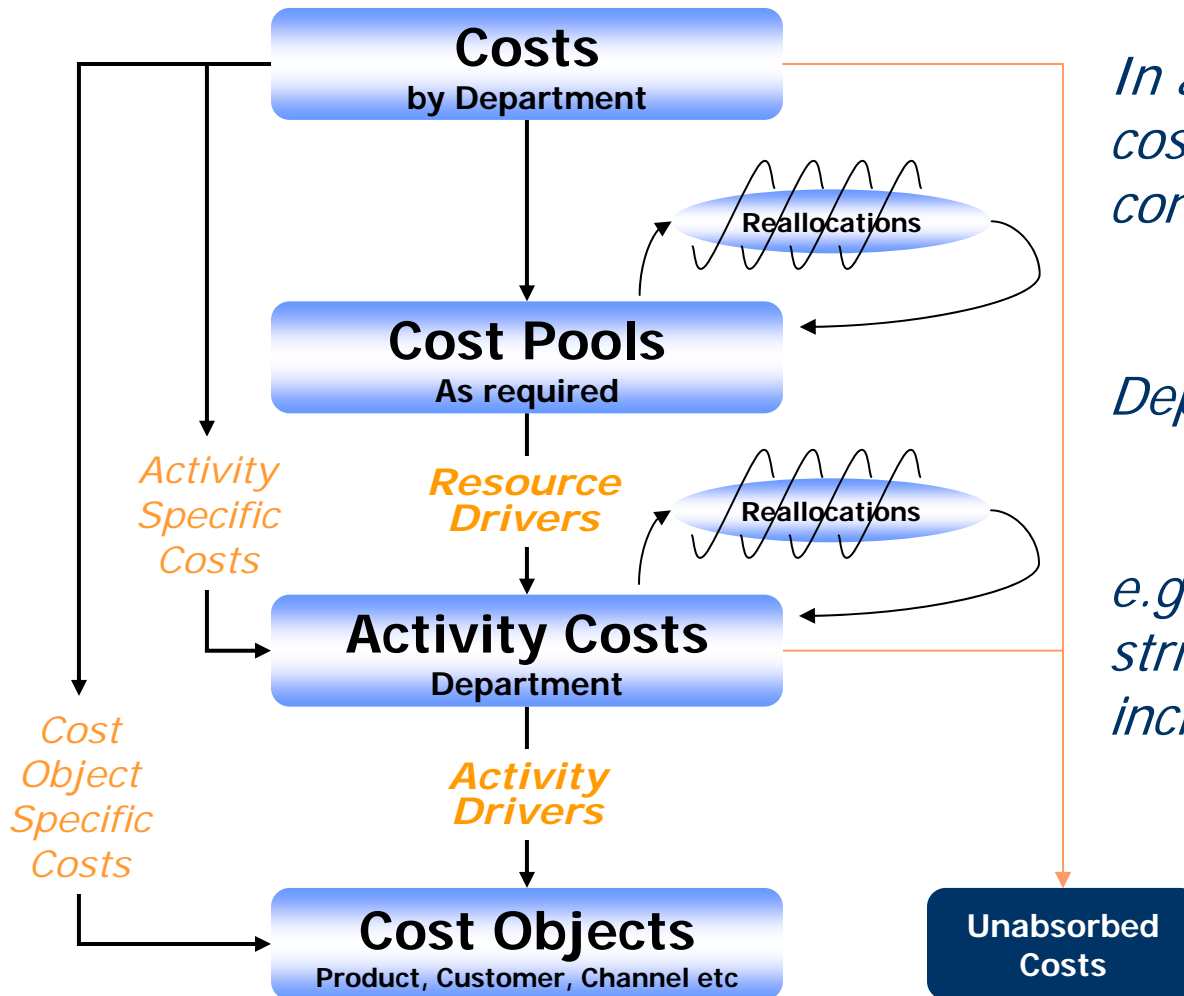
ABC 101.. This can get complicated



Real life is more complicated when some activities are designed to support others

e.g. IT activities that support HR and vica versa

ABC 101.. Not all costs are equal

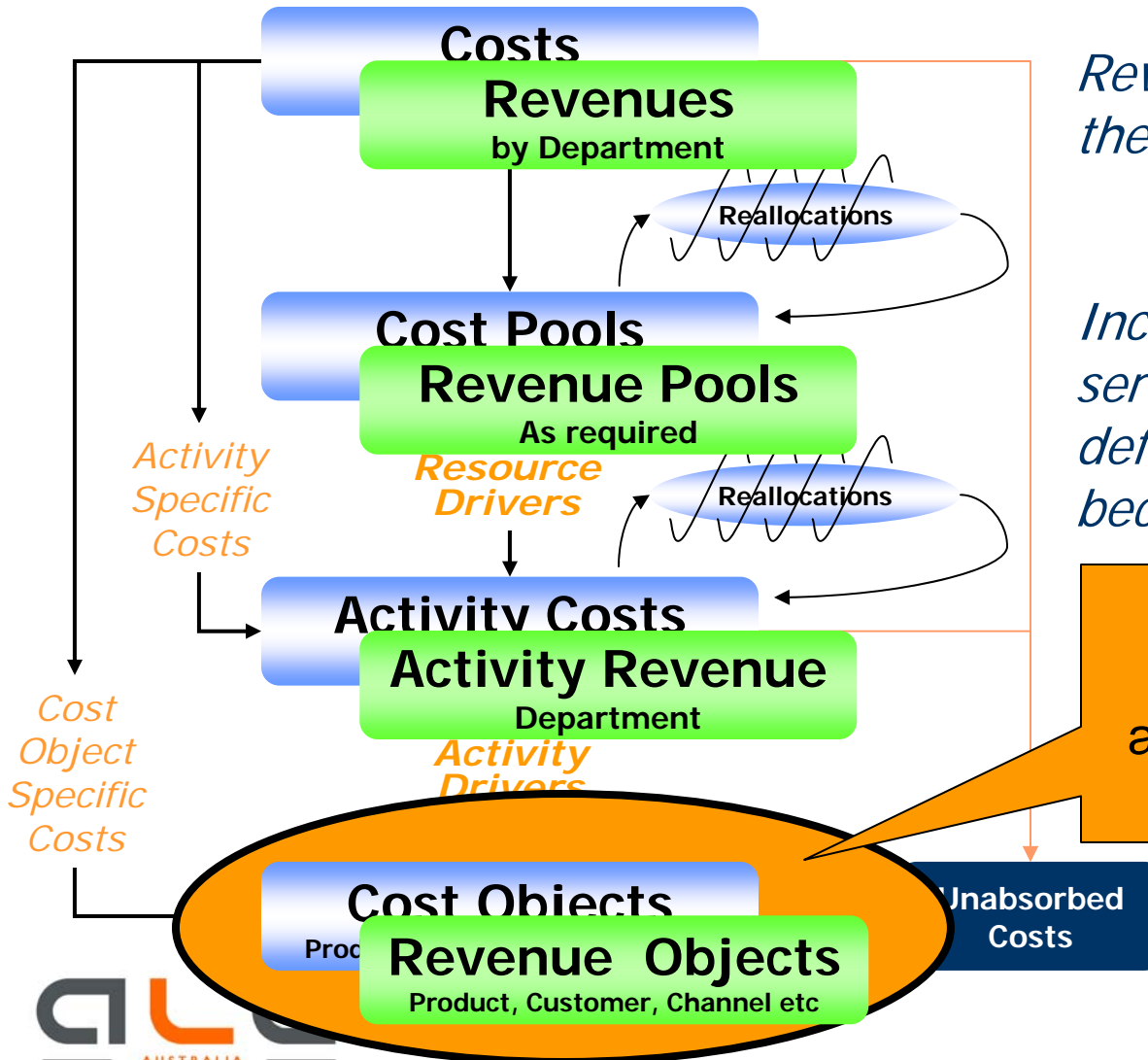


In addition there are some costs that should not be considered at all

Depending on the purpose

e.g. ACCC compliance is very strict as to what costs can be included

ABC 101... its also about Profitability



Revenue can be modeled in the same way as costs

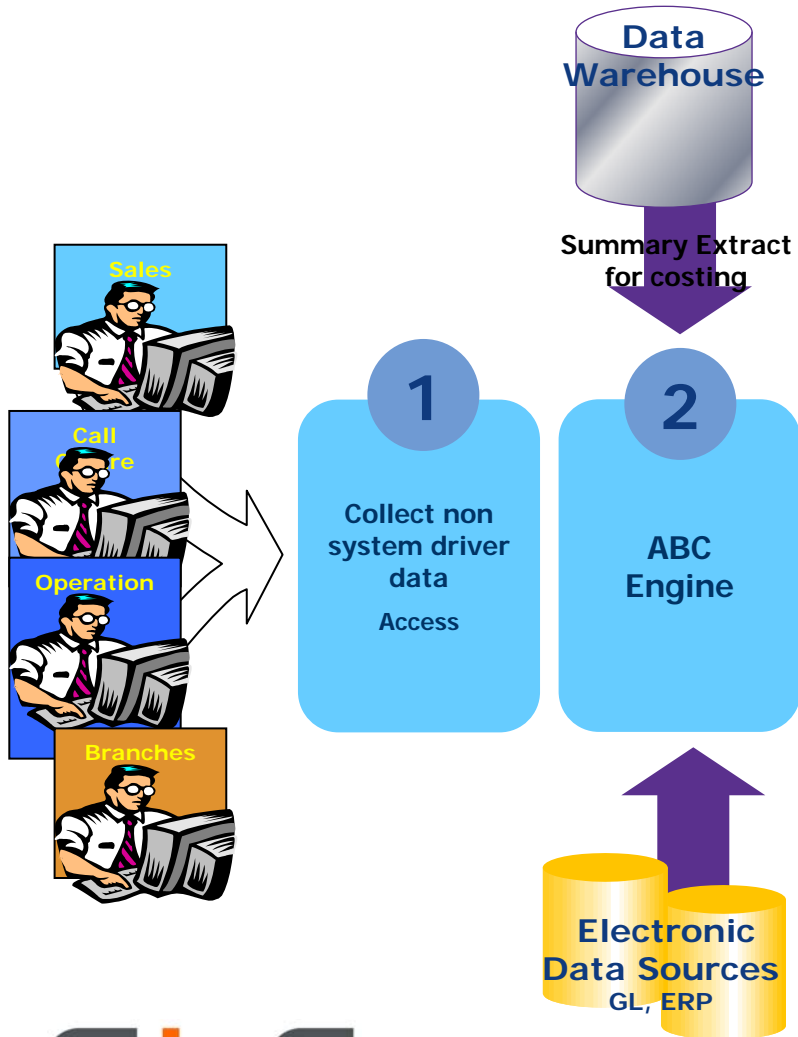
Increasingly relevant to service industries where the definition of the product is becoming blurred

“Profitability Analysis” requires both revenues and costs to be modeled in multiple dimensions

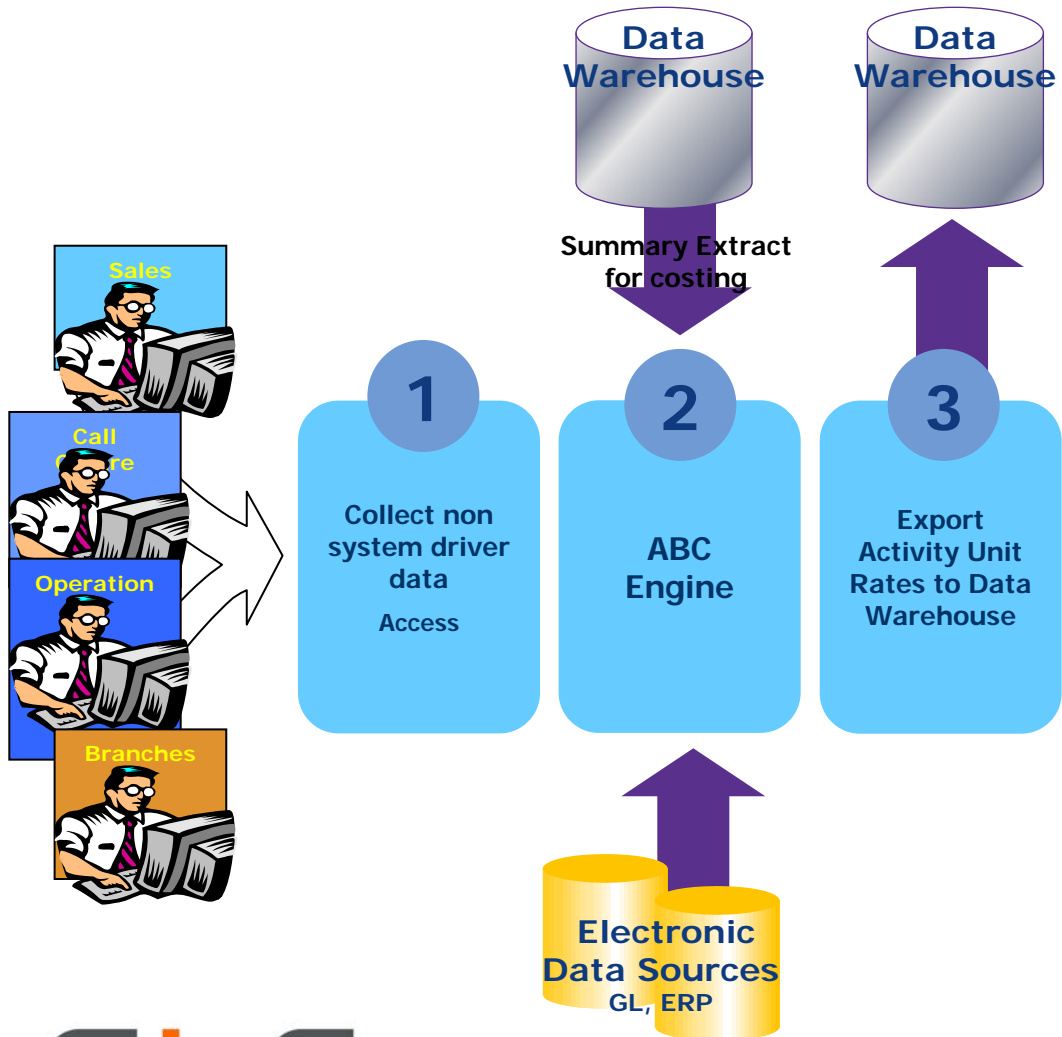
Insight

How did it work?

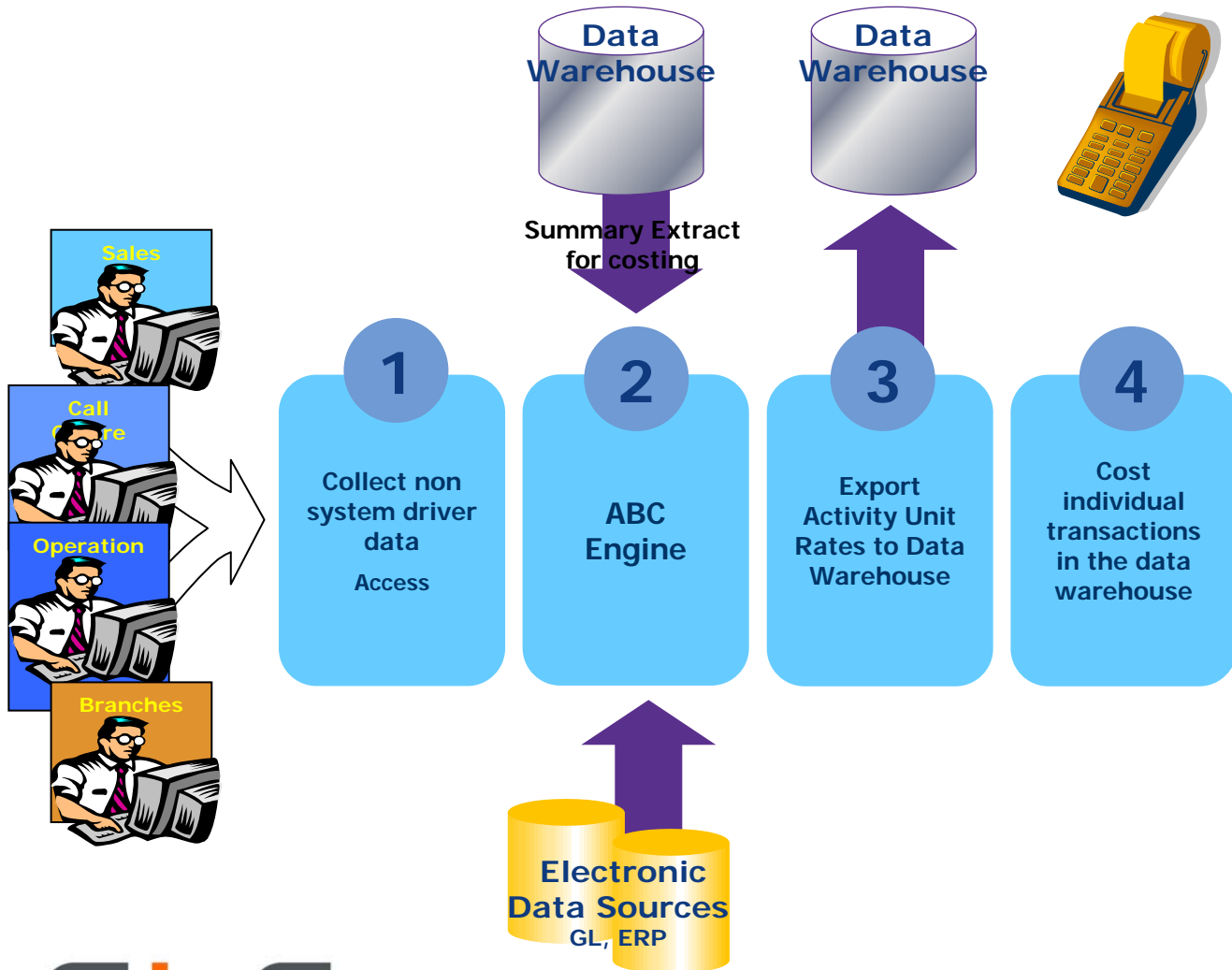
Transactional ABC As It Was



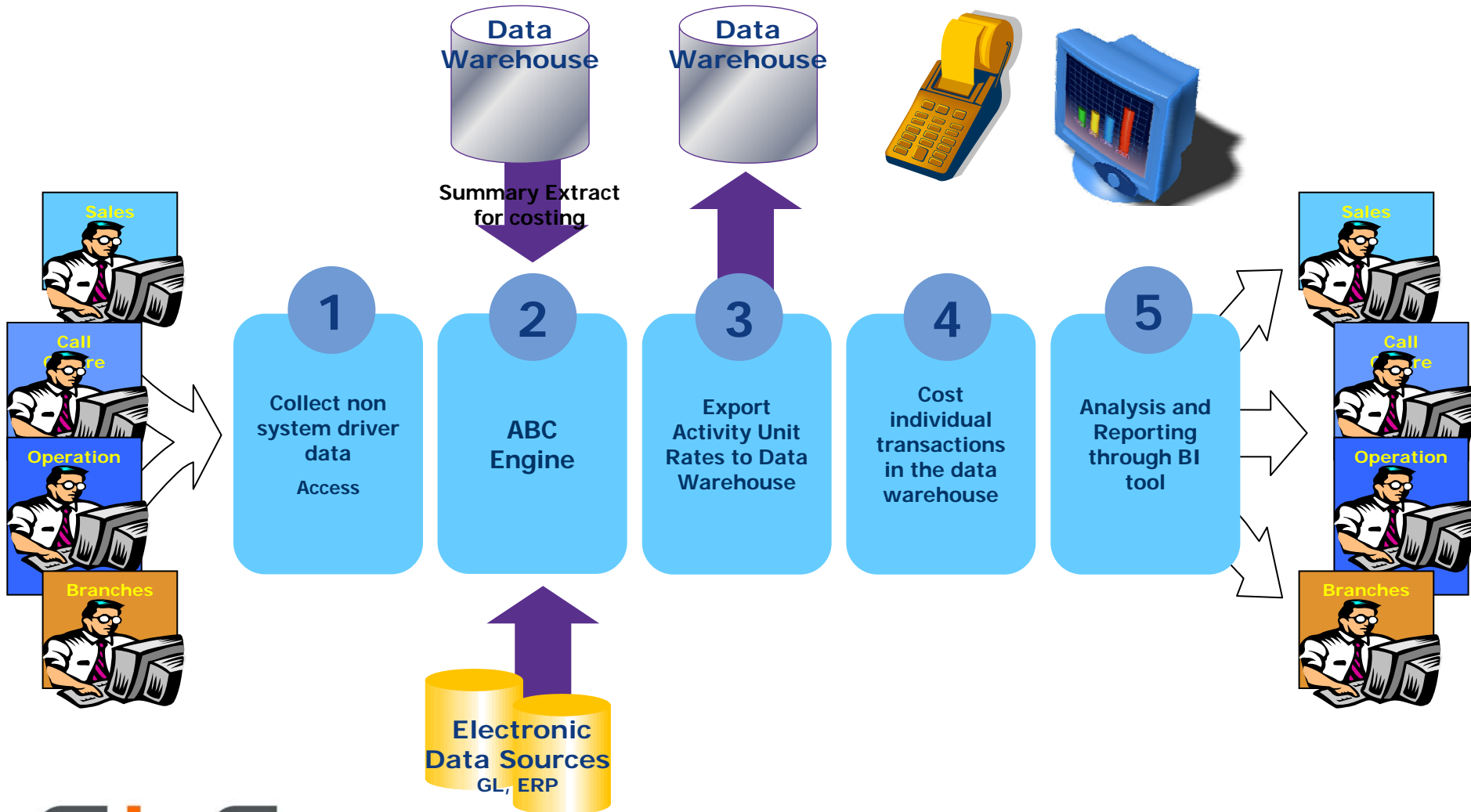
Transactional ABC As It Was



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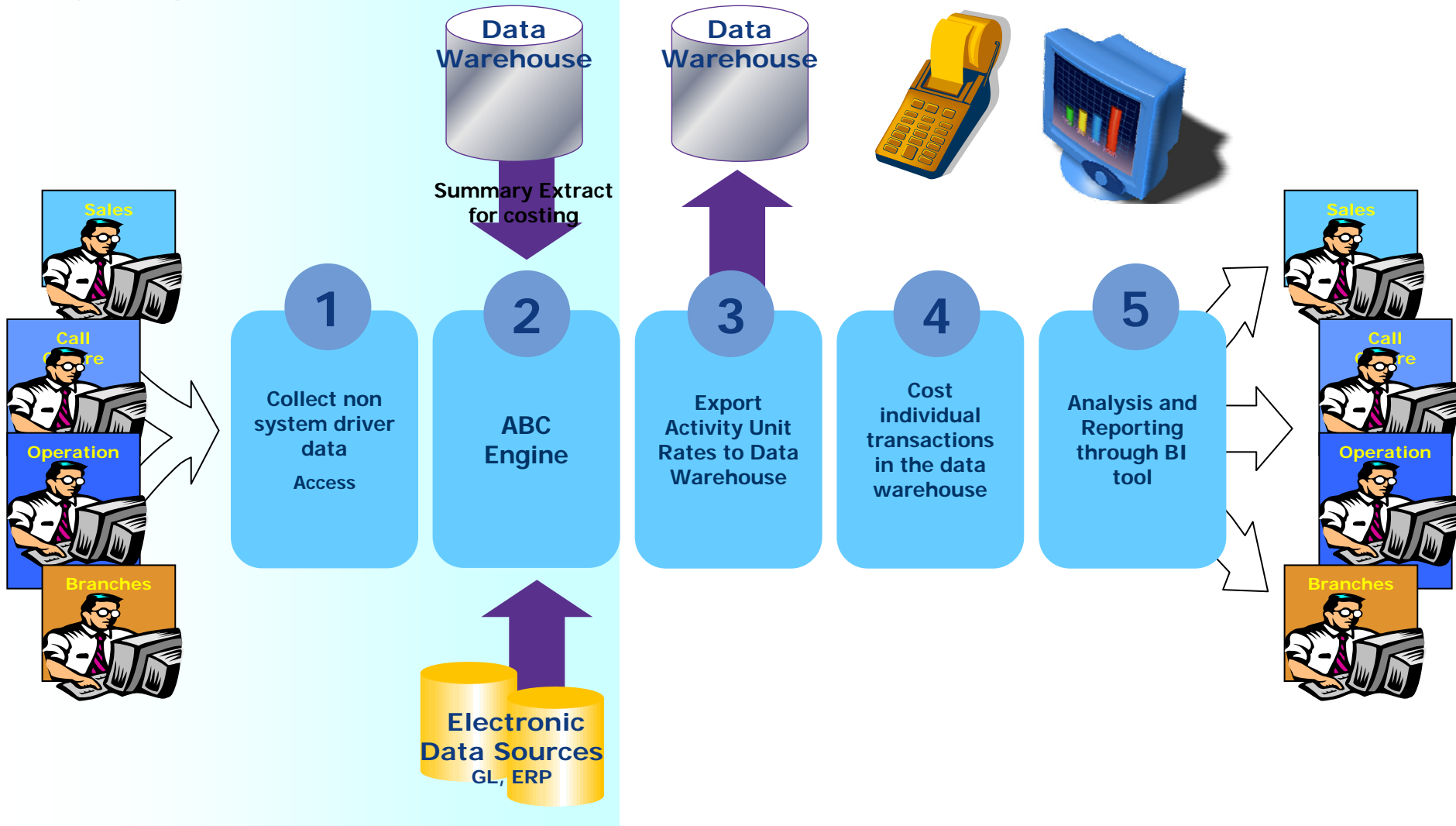


Transactional ABC As It Was



Transactional ABC As It Was

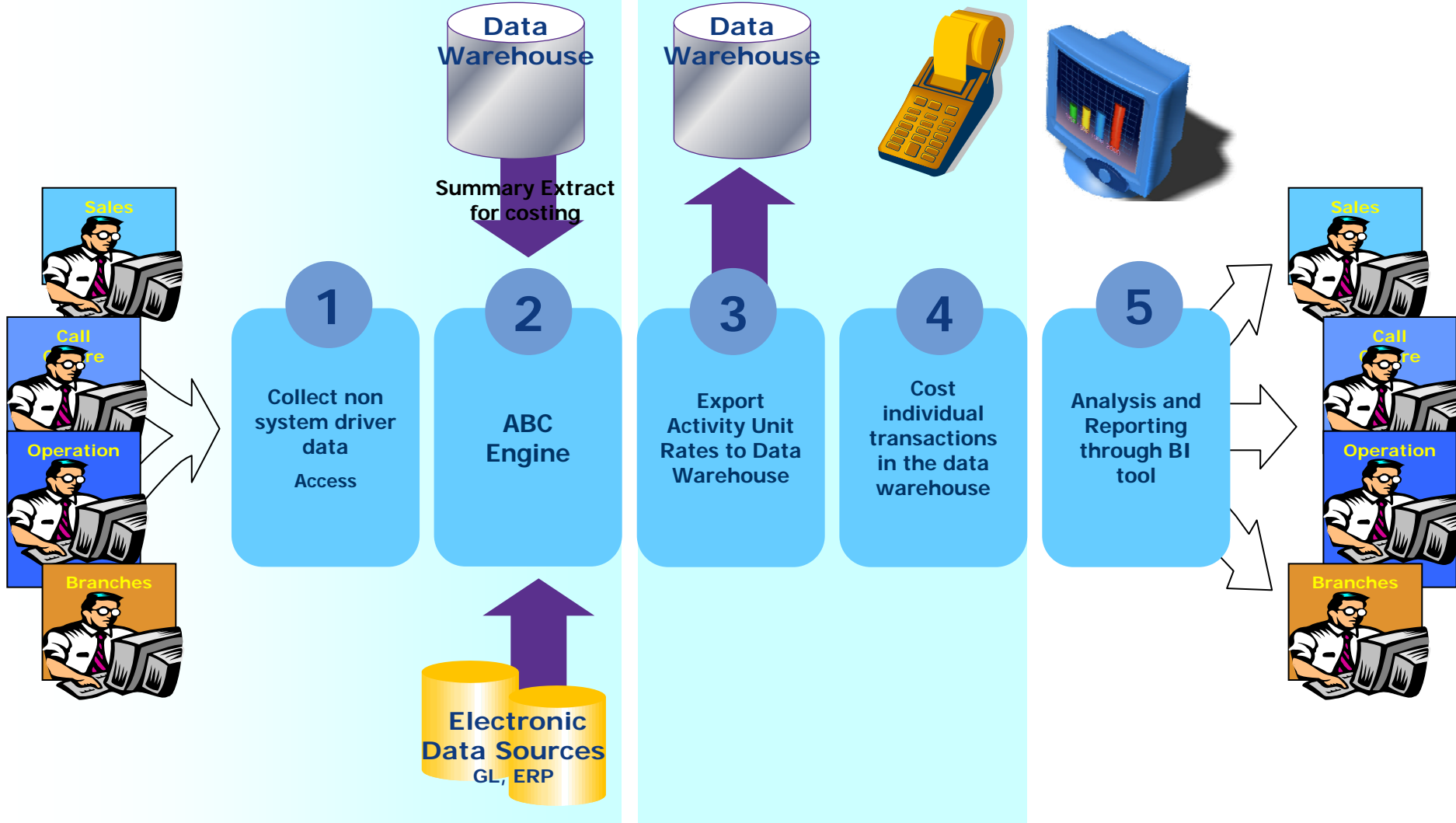
ABC ENGINE



Transactional ABC As It Was

ABC ENGINE

DATA WAREHOUSE

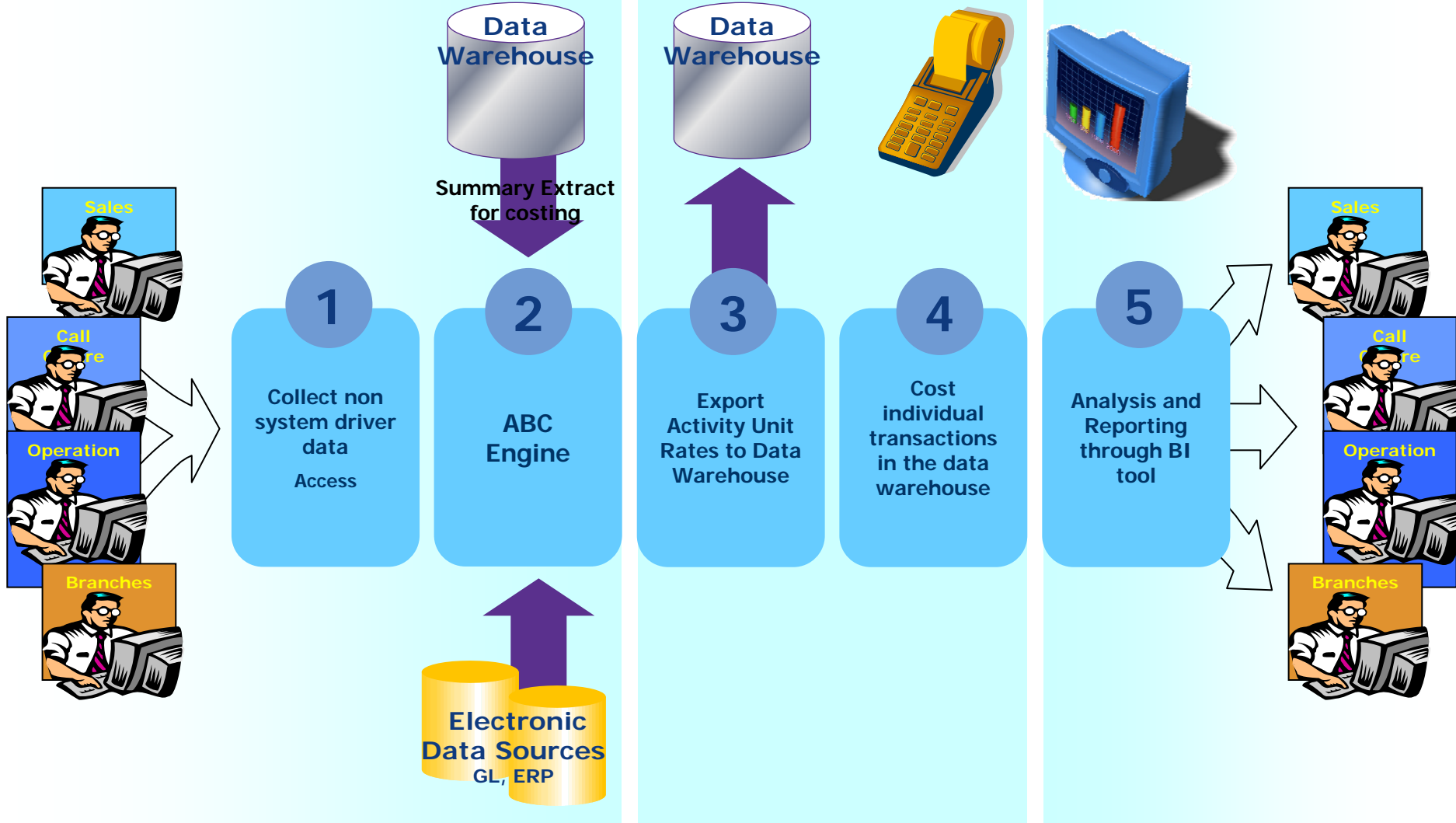


Transactional ABC As It Was

ABC ENGINE

DATA WAREHOUSE

BI TOOL

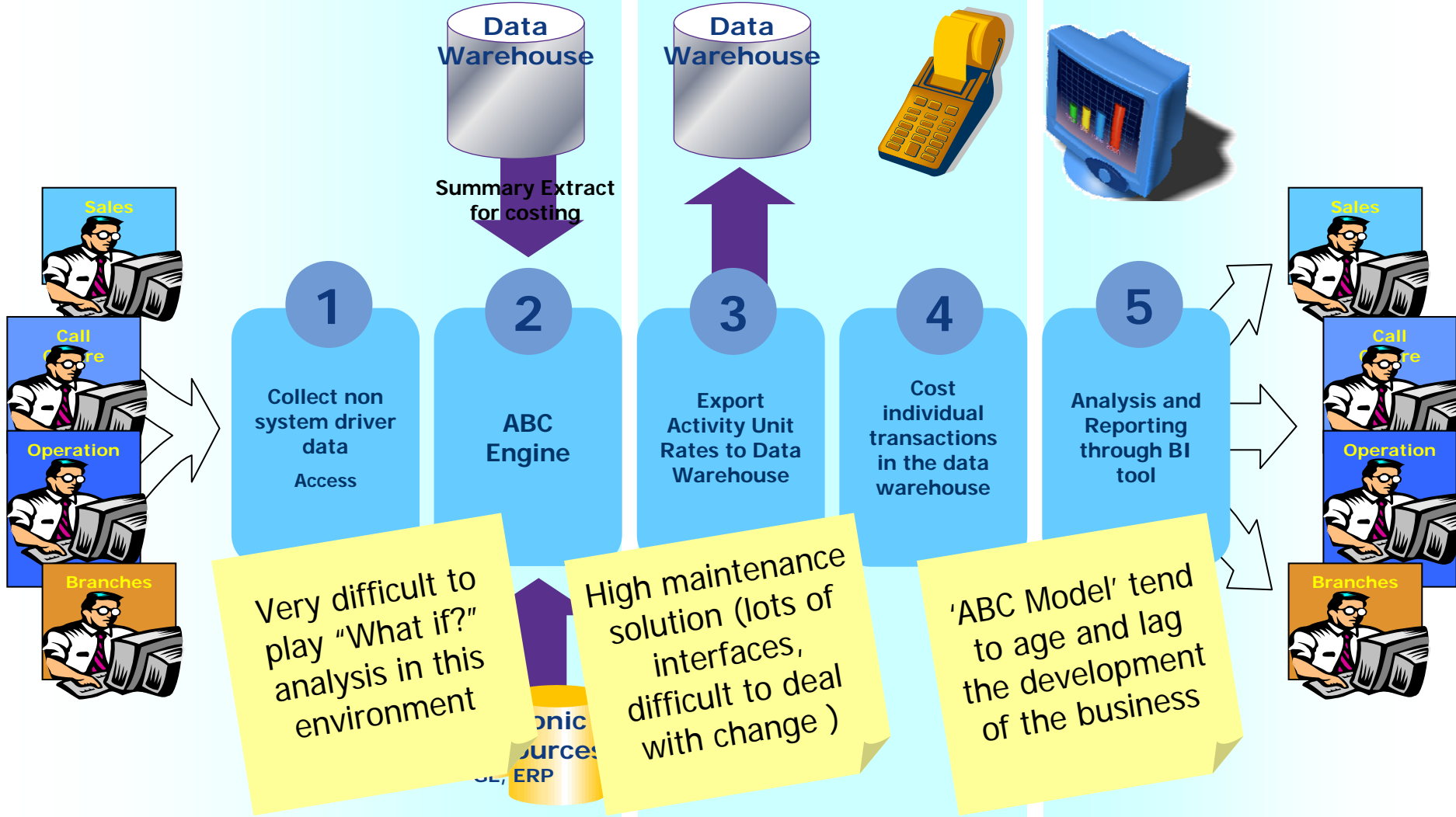


Transactional ABC As It Was

ABC ENGINE

DATA WAREHOUSE

BI TOOL



Insight

Why (the thing previously known as) **ABC** **is back on the agenda**

Four key pressures driving the current interest in Profitability Analysis

Compliance

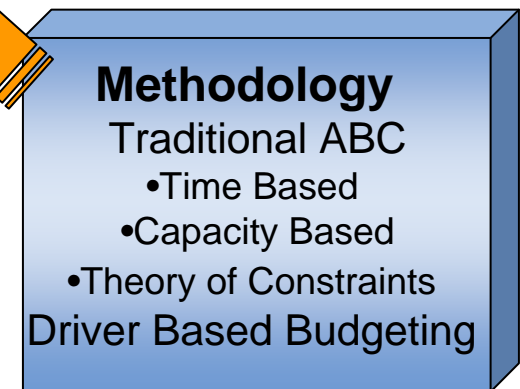
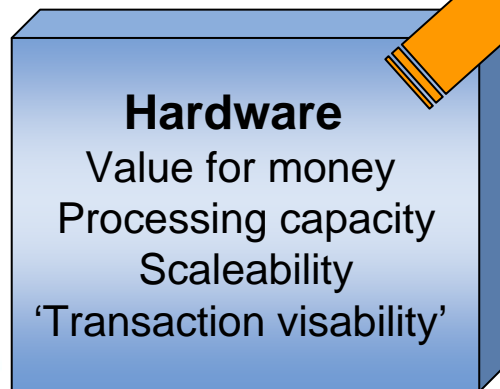
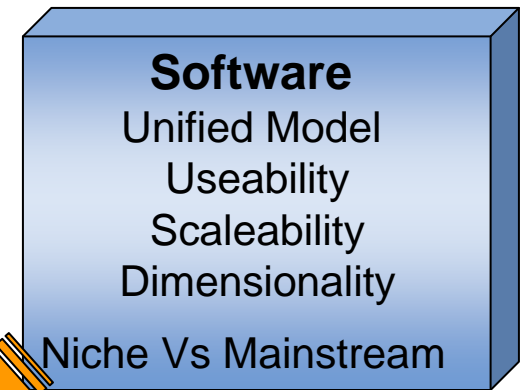
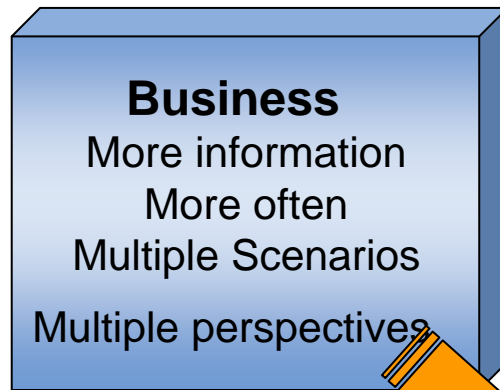
M & A

Management reporting

Shared Service Chargeback

Make Vs Buy

Cost to Serve



Changing focus

The Past

Current and Future

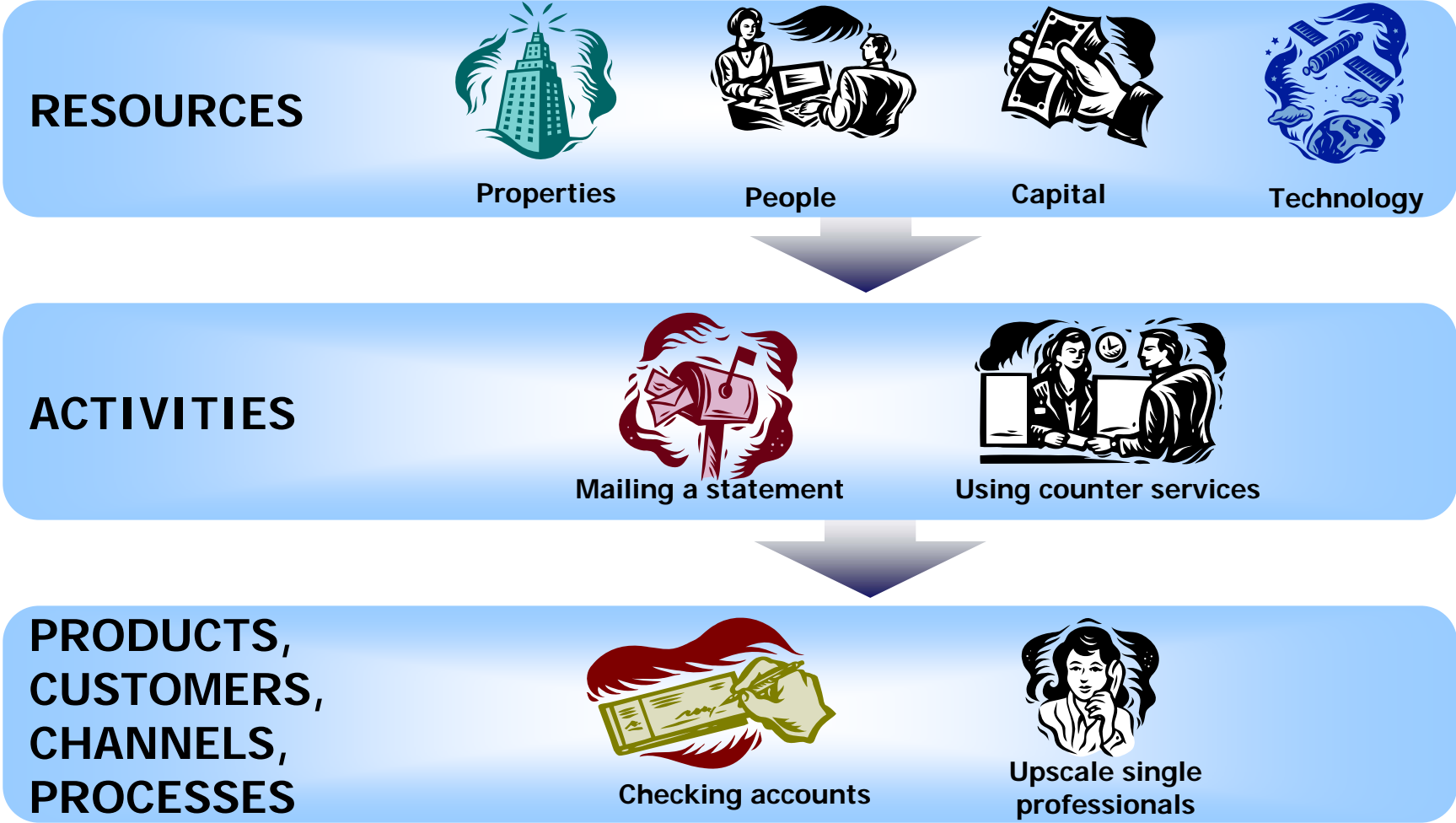


“What Happened ?”



“What might happen ?”

Profitability Analysis links business resources and activities to financial outcomes



... which has enabled it to redefine Corporate Performance Management

Initial definitions of CPM/ BPM

Planning,
Budgeting &
Re-forecasting

Score Carding
and Metrics
Management

Financial
Consolidation

Today's definition of CPM/ BPM

Planning,
Budgeting &
Re-forecasting

Cost and
Profitability
Analytics
(ABC)

Score Carding
and Metrics
Management

Financial
Consolidation

Profitability Analysis provides the missing link between traditional recording systems (e.g. GL) and business activities that are the focus of much of today's dashboards

Questions now being asked

- ▶ Which products, customers or channels are truly profitable – and which incurring losses?
- ▶ How can we reduce our cost without damaging our customer service?
- ▶ How can we guide our sales force in pricing and negotiating their key accounts?
- ▶ How much do each of our key business processes cost – and should we focus efforts to improve them?
- ▶ How do we make our cross charging more accurate and transparent?

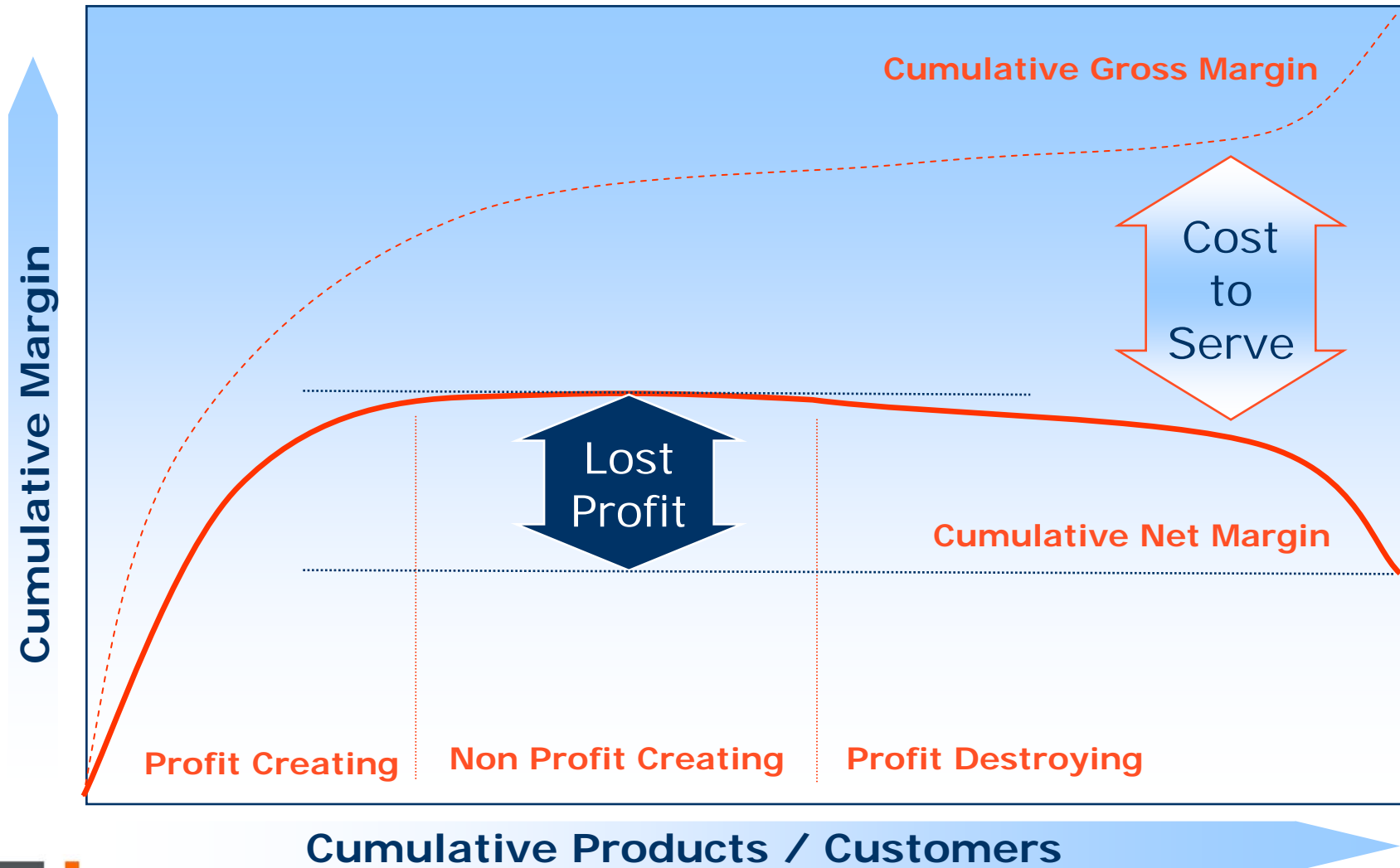
Insight

Real insight to enable real decisions

Client Examples

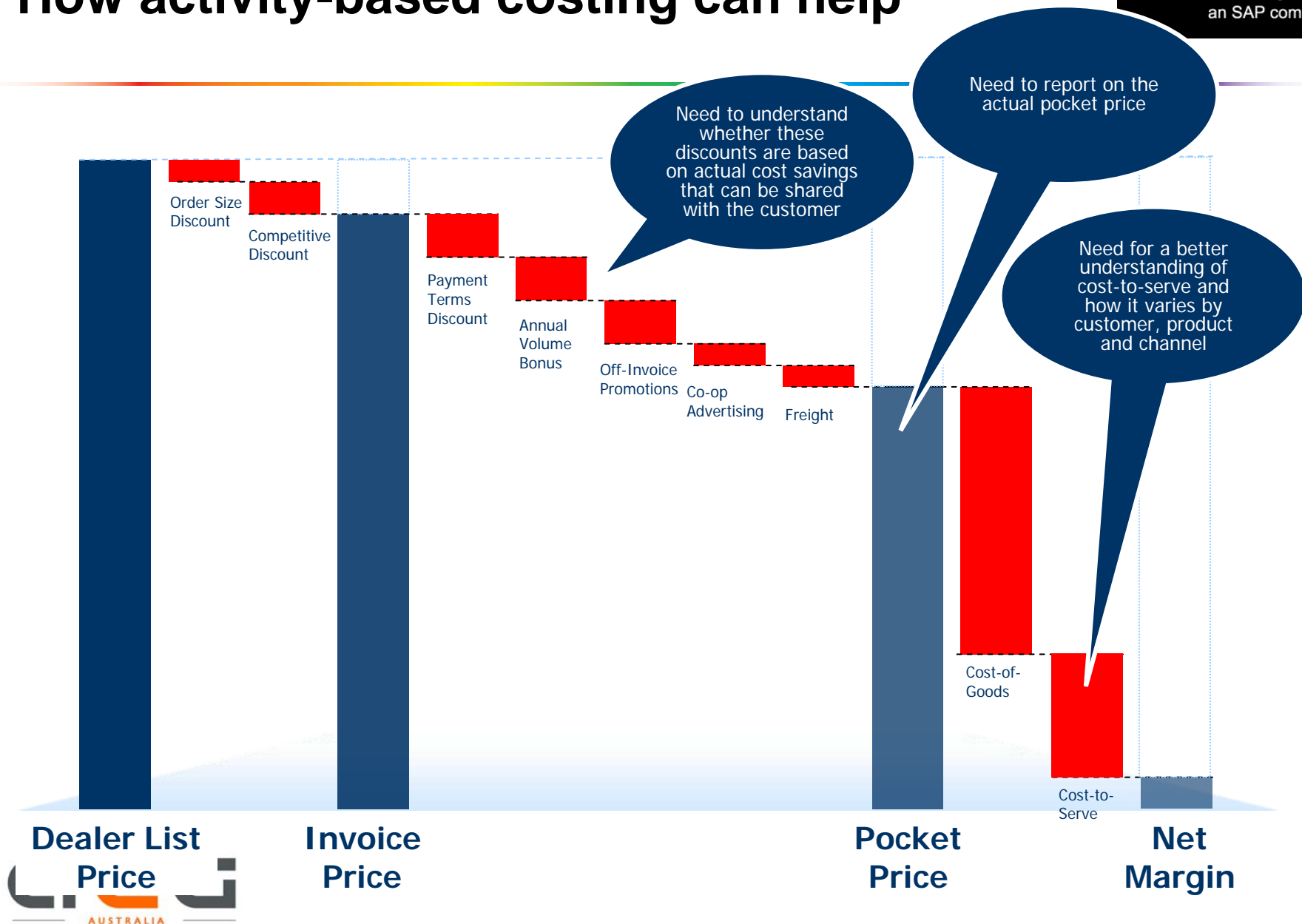


Identifying the true 'cost-to-serve'





How activity-based costing can help





Segmenting products and customers

- ▶ **Products and customers can be segmented using the following two dimensions:**
 - ▶ Profitability ('+'=Net margin above target, '-'=Net margin below target)
 - ▶ Relative Size (Total revenue A=top 20%, B=40%, C=last 40%)

Product / Customer Profitability

A+

B+

C+

Profitability Target

A-

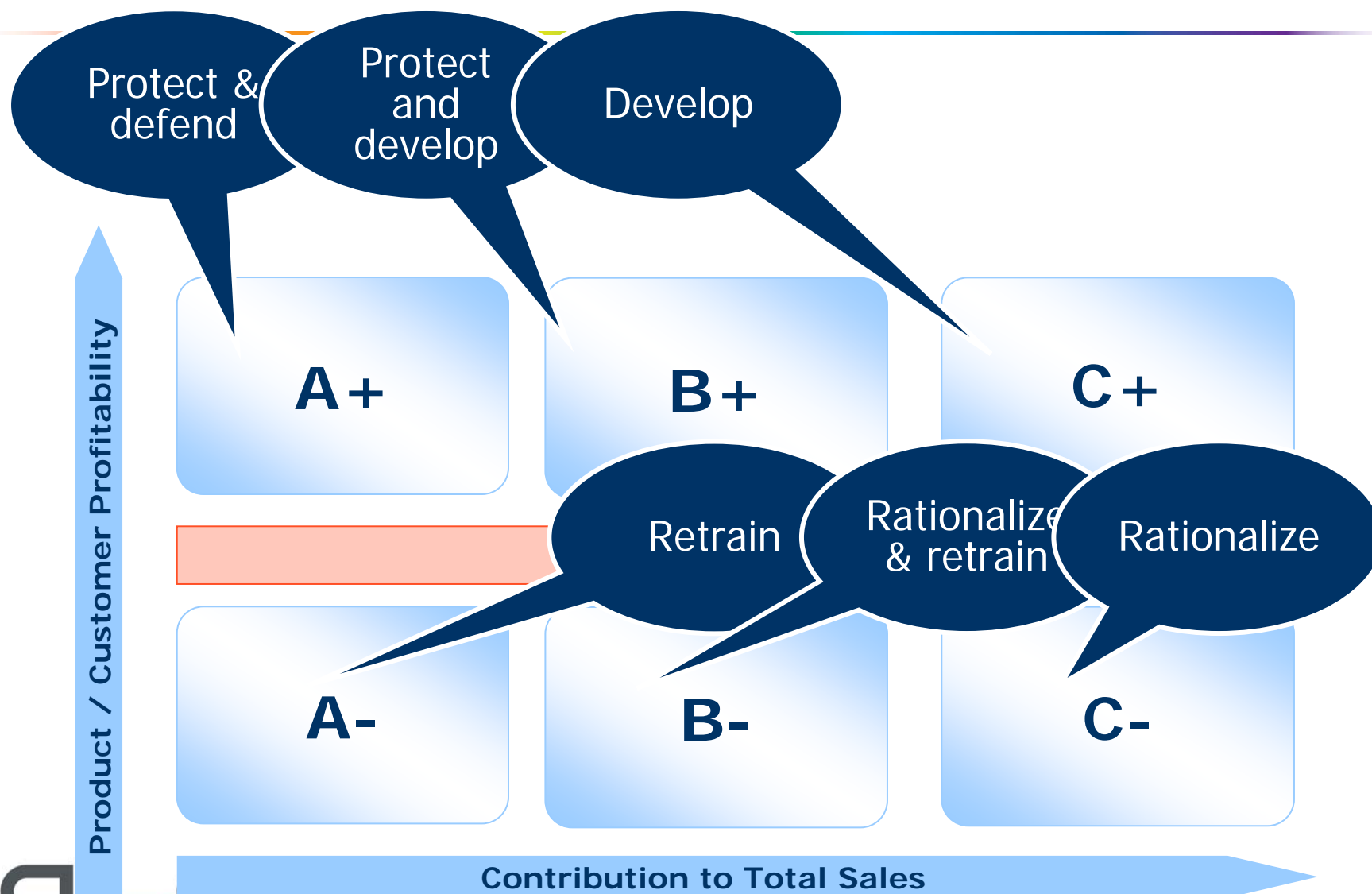
B-

C-

Contribution to Total Sales

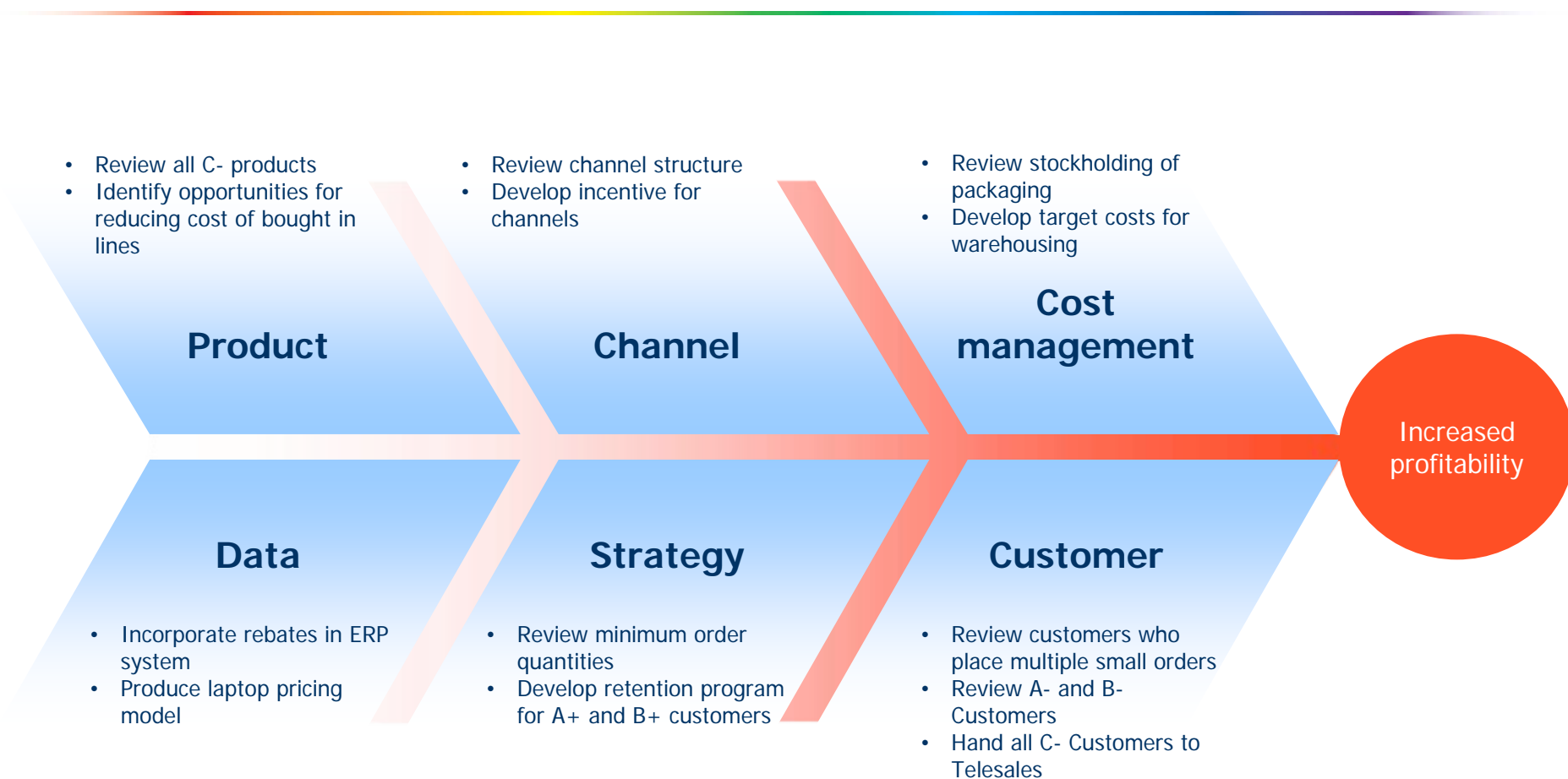


Segmenting products and customers





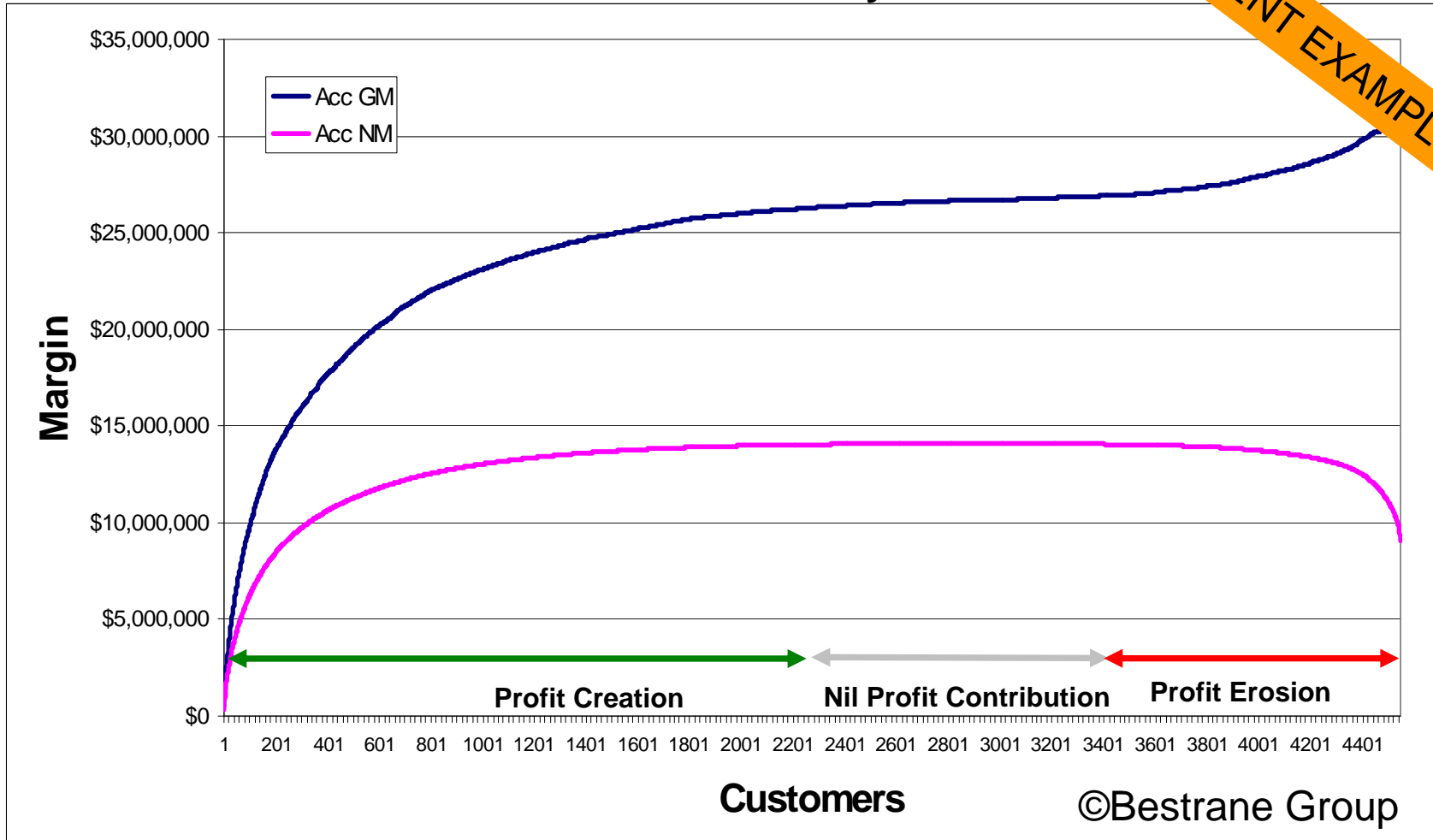
Routes to increased profitability



There is a large group of profitable customers ..and a small group of very unprofitable customers

Customer Pareto Analysis

CLIENT EXAMPLE





Customer Matrix by Sales team

19 A+ customers delivering 20% of revenue and 100% of net profit

CLIENT EXAMPLE

Select a Sales Team

	Date	A	B	C	Grand
PLUS	Number of Customers	19	57	191	267
	Net Revenue	\$3,174,482	\$2,690,117	\$1,321,449	\$7,186,049
	Gross Margin	\$1,405,455	\$1,275,764	\$713,959	\$3,395,178
	Gross Margin %	44.3%	47.4%	54.0%	47.2%
	Net Margin	\$560,749	\$645,944	\$352,720	\$1,559,412
	Net Margin %	17.7%	24.0%	26.7%	21.7%
	Total Activity Costs	\$844,707	\$629,820	\$361,239	\$1,835,766
MINUS	Number of Customers	11	90	368	469
	Net Revenue	\$1,957,302	\$4,798,907	\$1,958,522	\$8,714,730
	Gross Margin	\$343,373	\$998,370	\$603,321	\$1,945,064
	Gross Margin %	17.5%	20.8%	30.8%	22.3%
	Net Margin	-\$195,318	-\$487,633	-\$292,669	-\$975,621
	Net Margin %	-10.0%	-10.2%	-14.9%	-11.2%
	Total Activity Costs	\$538,691	\$1,486,003	\$895,991	\$2,920,685

600 "C" customers delivering the same revenue and almost no net profit

...with drill down on demand

Select a Sales Team:

	Data	N	C	Grand Total
PLUS	Number of Customers	19	57	194
	Net Revenue	\$3,174,482	\$2,690,117	\$1,321,449
	Gross Margin	\$1,405,455	\$1,275,764	\$713,959
	Gross Margin %	44.3%	47.4%	54.0%
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	Net Revenue	\$1,927,382	\$4,798,907	\$1,958,522
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	Net Margin %	-10.0%	-10.2%	
	Total Activity Costs	\$538,691	\$1,486,003	

Cust	Cust Desc	cust Rating	Cust Grp	Sales Off							
3657007	XYZ PTY LTD	A Plus	Retail	VIC							
Item	Item Desc	Item rating	Product Group	Total Revenue	Discount	Discount %	Gross Margin	GM %	PPG Net Margin	NM %	
12500	Product List	A Plus	C01	\$54,603	\$6,649	11%	\$20,001	37%	\$10,097	18%	
22095		B Minus	D01	\$29,209	\$1,538	5%	\$7,041	24%	\$2,457	8%	
41020		B Minus	E01	\$8,165	\$0	0%	\$2,878	35%	\$1,113	14%	
31625		A Plus	A01	\$6,964	\$0	0%	\$3,511	50%	\$2,176	31%	
31138		B Plus	A01	\$5,793	\$0	0%	\$2,942	51%	\$1,704	29%	
91306		C Minus	B01	\$1,794	\$0	0%	\$415	23%	\$48	3%	
21550		C Plus	E01	\$932	\$0	0%	\$284	30%	\$27	3%	
32508		B Plus	A01	\$775	\$0	0%	\$357	46%	\$171	22%	
11361		A Minus	C01	\$746	\$104	12%	\$202	27%	\$50	7%	
51268		C Minus	E01	\$513	\$117	19%	\$107	21%	-\$12	-2%	
52688		C Minus	E01	\$392	\$89	19%	\$73	19%	-\$28	-7%	
22251		B Minus	D01	\$375	\$20	5%	\$32	8%	-\$40	-11%	
811066		C Minus	E01	\$341	\$33	9%	\$126	37%	-\$2	-1%	
91769		C Minus	B01	\$334	\$0	0%	\$126	38%	\$86	26%	
33365		B Minus	A01	\$138	\$0	0%	\$67	49%	\$11	8%	
811638		C Minus	E01	\$116	\$11	9%	\$42	36%	-\$49	-42%	
811034		C Minus	E01	\$90	\$7	7%	\$26	29%	-\$47	-52%	
811462		C Minus	E01	\$61	\$7	10%	\$28	45%	\$9	15%	
811660		C Minus	E01	\$59	\$6	9%	\$26	44%	\$8	13%	
811836		C Minus	E01	\$44	\$4	8%	\$17	38%	-\$20	-45%	
811430	C Minus	E01	\$44	\$4	8%	\$17	38%	-\$20	-45%		
812180	C Minus	E01	\$28	\$3	9%	\$10	37%	-\$8	-29%		
Pallets			Pallets	99	\$372	\$0	0%	\$890	239%	\$577	155%

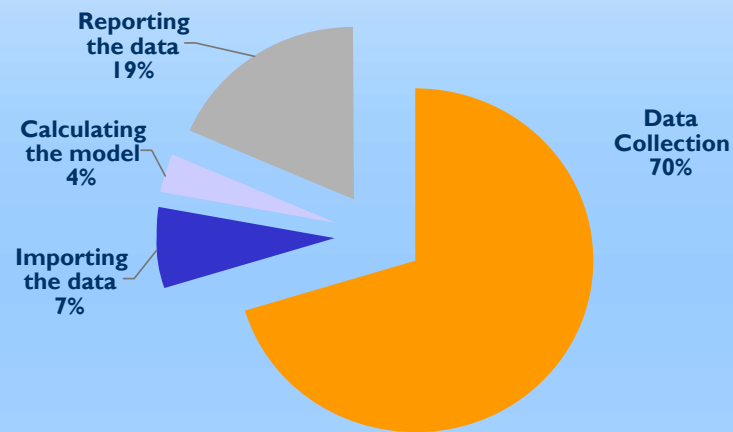
Insight

Today's Best Practice Profitability Analysis

Today's best practice Profitability Analysis

- ▶ The Web has transformed the ability to source and report data
- ▶ Web enabled data collection and report distribution

Collecting non-system data and reporting used to be the bug-bears



Findings from a survey of ABC Program Managers
See **ABC Survey White Paper**

Can ... Integrate with existing data sources

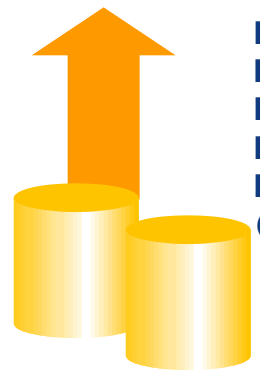
Web-based data entry



ResourceOwner	Headcount	Square Met	Days trained	Flights	Flights used	Consult
Advertising	21.00	2050.00	1.00	2050.00	21.00	
ResourceOwnerS	595.71	0.41	0.00	0.00		
Advertising	3.00	490.00	0.00	0.00	0.00	
ResourceOwnerS	1123.71	1300.00	0.00	0.00	0.00	1.00
Advertising	695.71	0.00	0.00	0.00	12.70	
ResourceOwnerS	3.00	490.00	0.00	250.00	7.00	
Catalogue	12000.00	0.00	0.00	0.00	0.00	0.00
ResourceOwnerS	1171.43	0.41	0.00	0.00	0.00	0.00
Launch Motives	490.00	0.00	0.00	0.00	0.00	0.00
ResourceOwnerS	2400.00	0.00	0.00	0.00	0.00	0.00
Advertising	410.00	0.20	0.00	0.00	0.00	0.00
ResourceOwnerS	2.00	245.00	0.00	1000.00	3.00	
Special Promotions	0.00	0.00	0.00	0.00	0.00	0.00
ResourceOwnerS	0.00	0.00	0.00	0.00	0.00	0.00
Advertising	0.00	0.00	0.00	0.00	0.00	0.00
ResourceOwnerS	0.00	0.00	0.00	0.00	0.00	0.00
Advertising	0.00	0.00	0.00	0.00	0.00	0.00
ResourceOwnerS	0.00	0.00	0.00	0.00	0.00	0.00
Export out of area	0.00	0.00	0.00	0.00	0.00	0.00
ResourceOwnerS	0.00	0.00	0.00	0.00	0.00	0.00
Advertising	0.00	0.00	0.00	0.00	0.00	0.00
ResourceOwnerS	0.00	0.00	0.00	0.00	0.00	0.00
All Activities	0.00	0.00	0.00	0.00	0.00	0.00
ResourceOwnerS	0.00	0.00	0.00	0.00	0.00	0.00
Advertising	0.00	0.00	0.00	0.00	0.00	0.00
ResourceOwnerS	0.00	0.00	0.00	0.00	0.00	0.00
Spare Resource	0.00	0.00	0.00	0.00	0.00	0.00
ResourceOwnerS	0.00	0.00	0.00	0.00	0.00	0.00
Advertising	0.00	0.00	0.00	0.00	0.00	0.00
ResourceOwnerS	0.00	0.00	0.00	0.00	0.00	0.00

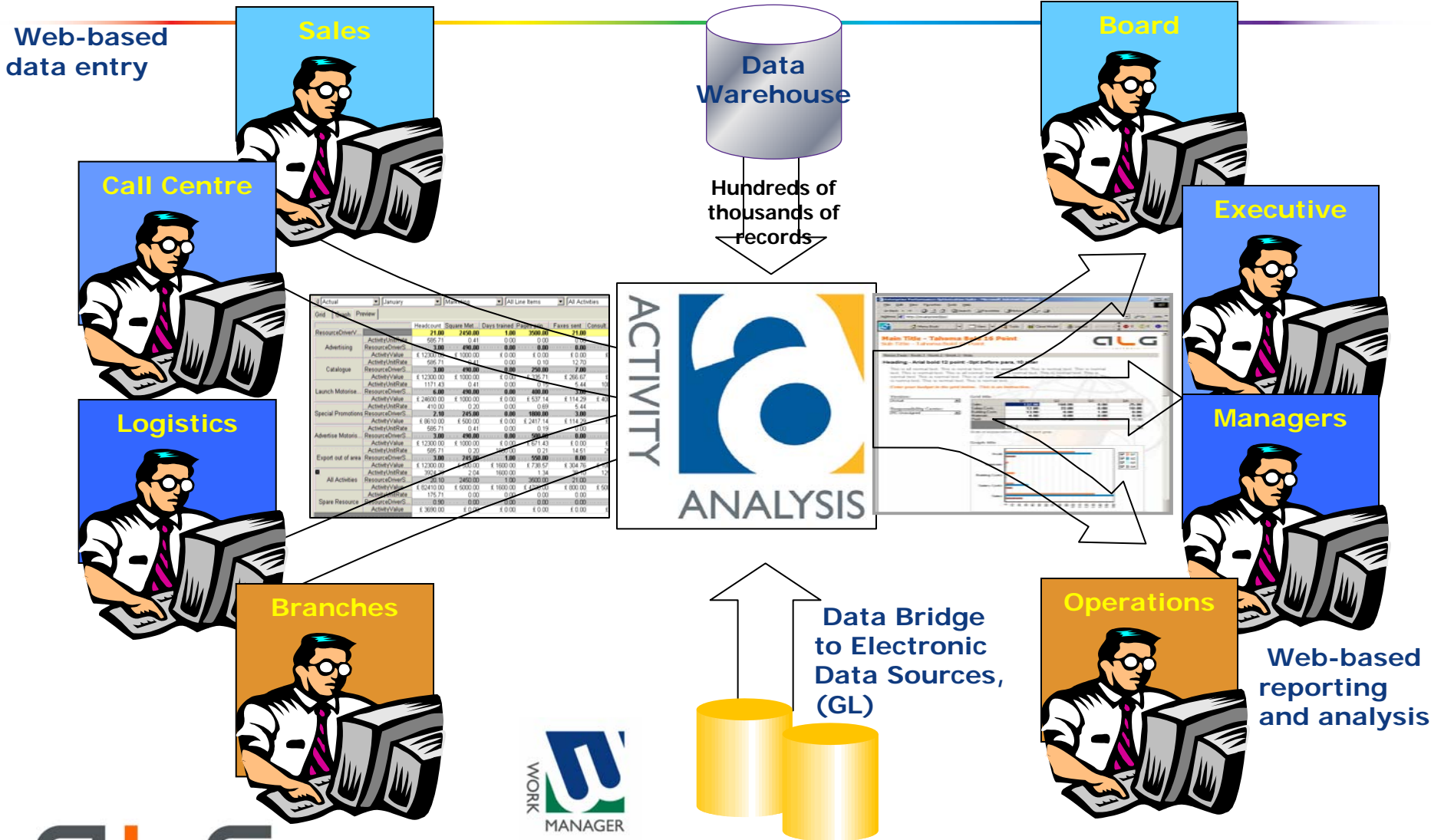


ETL, Data Quality
Hundreds of thousands of records



ETL and Data Bridge
From other Electronic Data Sources, (GL)

Can ... Provide tools to keep the model current



Workflow tool to enable model maintenance

Insight

The new rationality in ABC

Decisions ABC can support



Decisions ABC can support






Decisions ABC can support



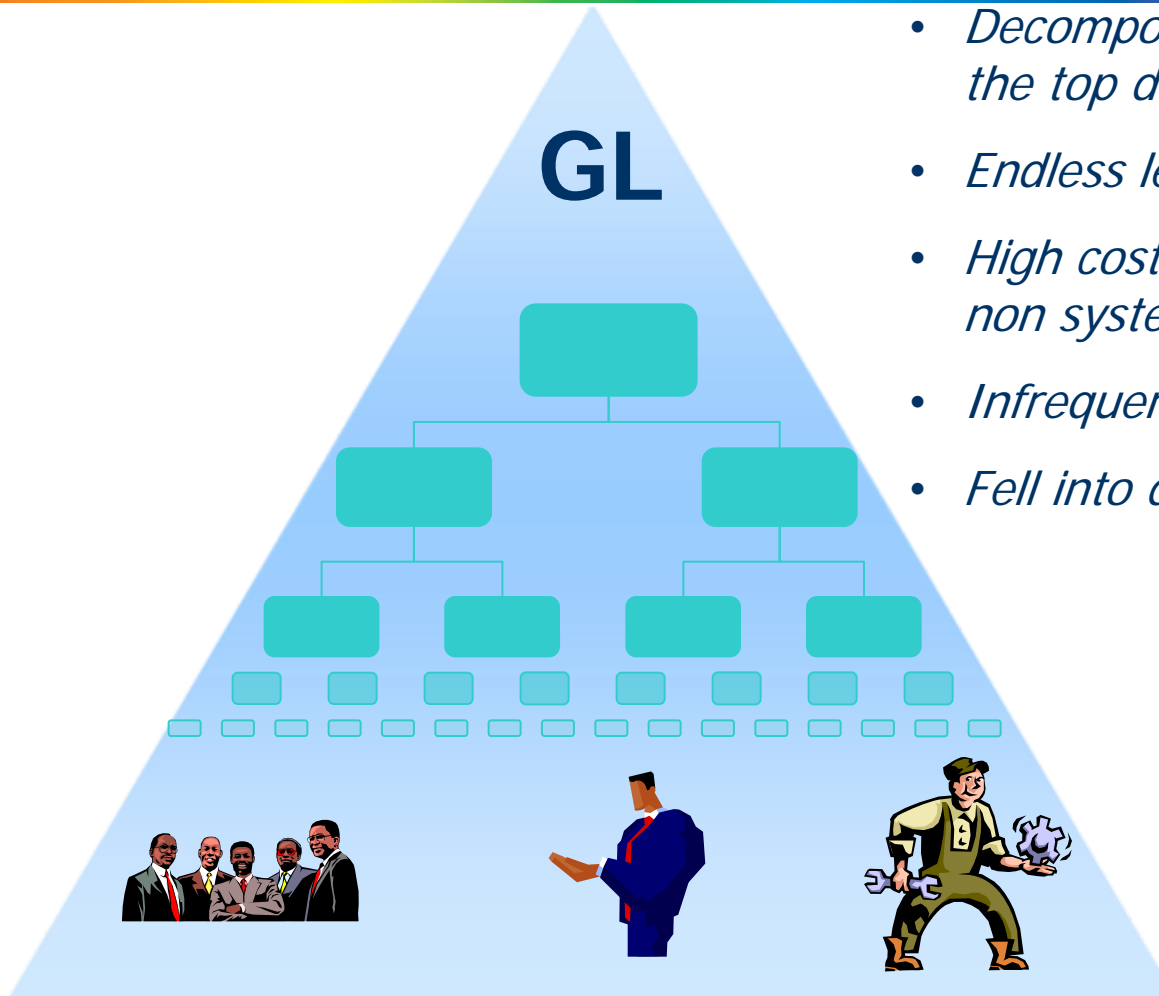
Decisions ABC can support



Different models for different purposes

		Frequency of Calculation	# Activities (I.e. Level of Detail)
Strategic		Low 1/year	Low
Managerial		Medium 1/Qtr	Medium
Operational		High 1/Mth	High

The old way of doing ABC



- *Decompose the GL from the top down*
- *Endless level of detail*
- *High cost of collecting non system driver data*
- *Infrequent reporting*
- *Fell into disuse*

The Cost of Accuracy

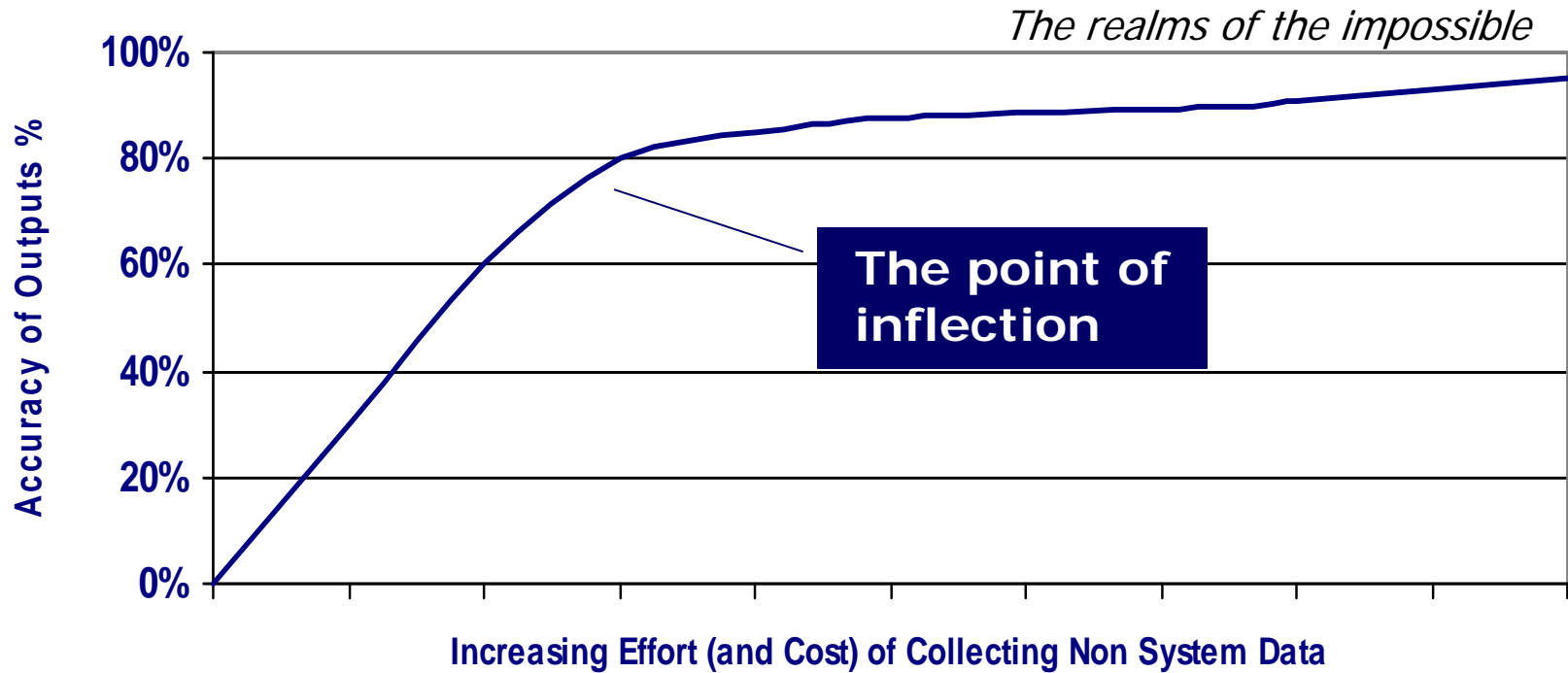
- ▶ There will always be a better basis for allocation
 - ▶ Finer definition of activities should provide better cost definition
 - ▶ More frequent and more detailed surveys can determine better quality allocation drivers

- ▶ But.....

- ▶ Accuracy has a cost associated with it and in many instances it is better to trade off accuracy against the amount of effort and cost involved in collecting “non-system” data

- ▶ Good model design limits the level of detail to the point where additional effort and cost delivers diminishing accuracy

Pareto was right!



- ▶ The goal of the model designers is to achieve an acceptable level of accuracy at an acceptable cost for the purpose at hand



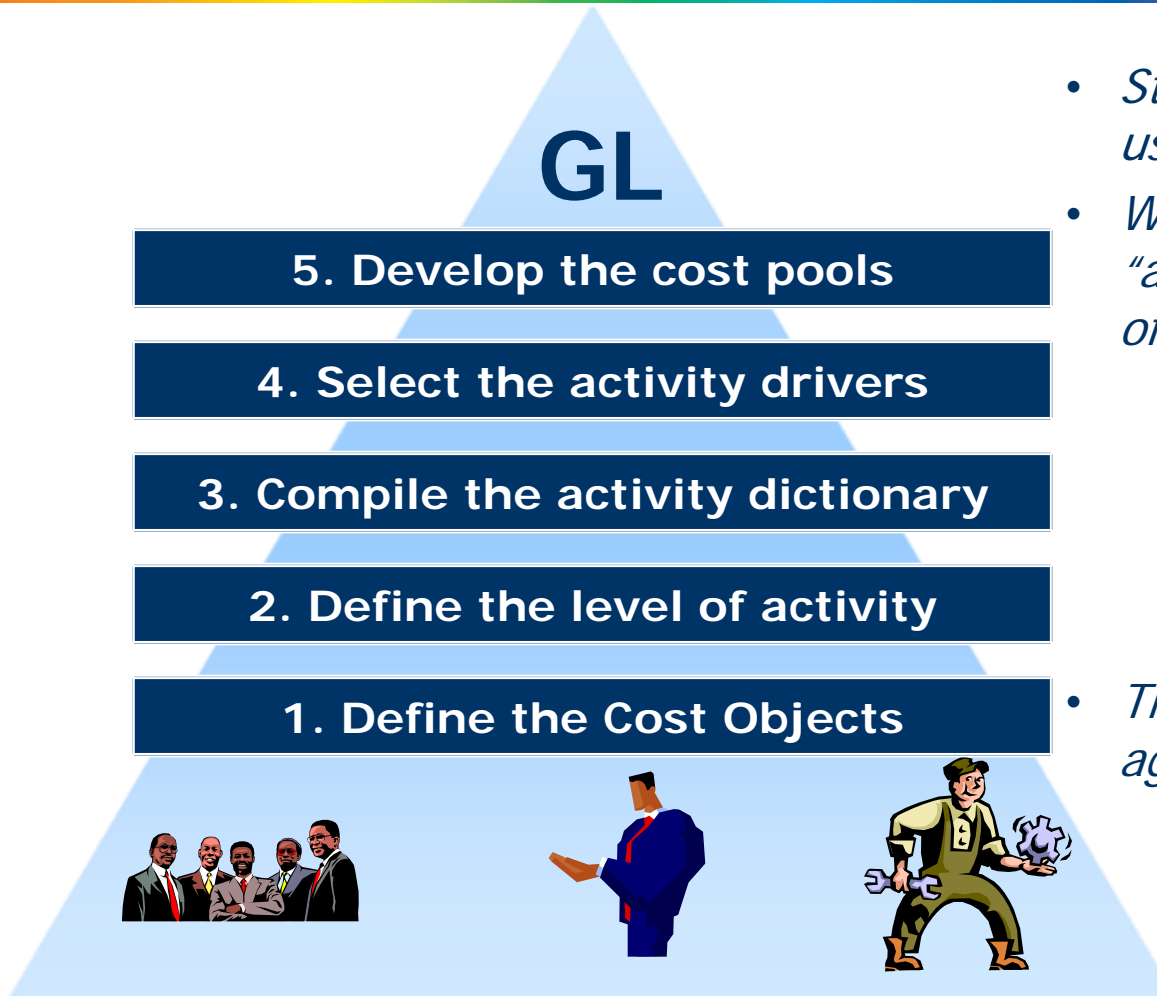
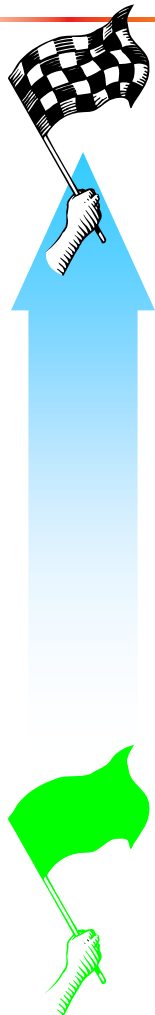
Defining the appropriate activity definition for the organisation AND the purpose



CLIENT EXAMPLE



The new way of doing ABC



- *Start with the users*
- *Work at an "appropriate" level of detail*
 - *E.g. Which level should you be working at:*
 - *Process*
 - *Activity*
 - *or task*
- *Trade off accuracy against utility*

Benefits of the new approach to ABC

- ▶ Web-enabled data collection and report distribution
- ▶ Work Manager tool to speed data collection
- ▶ Automated imports and updates

- Today models are “business focused” rather than “finance focused”
 - i.e. Bottom up rather than Top down
 - 80:20 approach
- Quick and easy to collect non system driver data such as time splits and cycle times
- Reduces time and cost of data collection giving a lower cost of ownership
- Models can be refreshed more frequently
- Data can be distribute to a wider community of users using a variety of methods

Insight

Summary & Conclusion

Some basic premises

- ▶ Endeavour to work at the level that is appropriate to the decision making the Profitability project is designed to support
 - ▶ i.e. If decisions are taken at the higher level, provide analysis that is relevant at the higher level....that can be believed

- ▶ Consider the level of diversity in the customer base
 - ▶ If they all pay the same amount for the same product or service and they exhibit similar behaviour, work at the higher level

- ▶ Consider the level of diversity between individual transactions
 - ▶ If the cost of the activities consumed do not vary by customer or transaction, work at the higher level

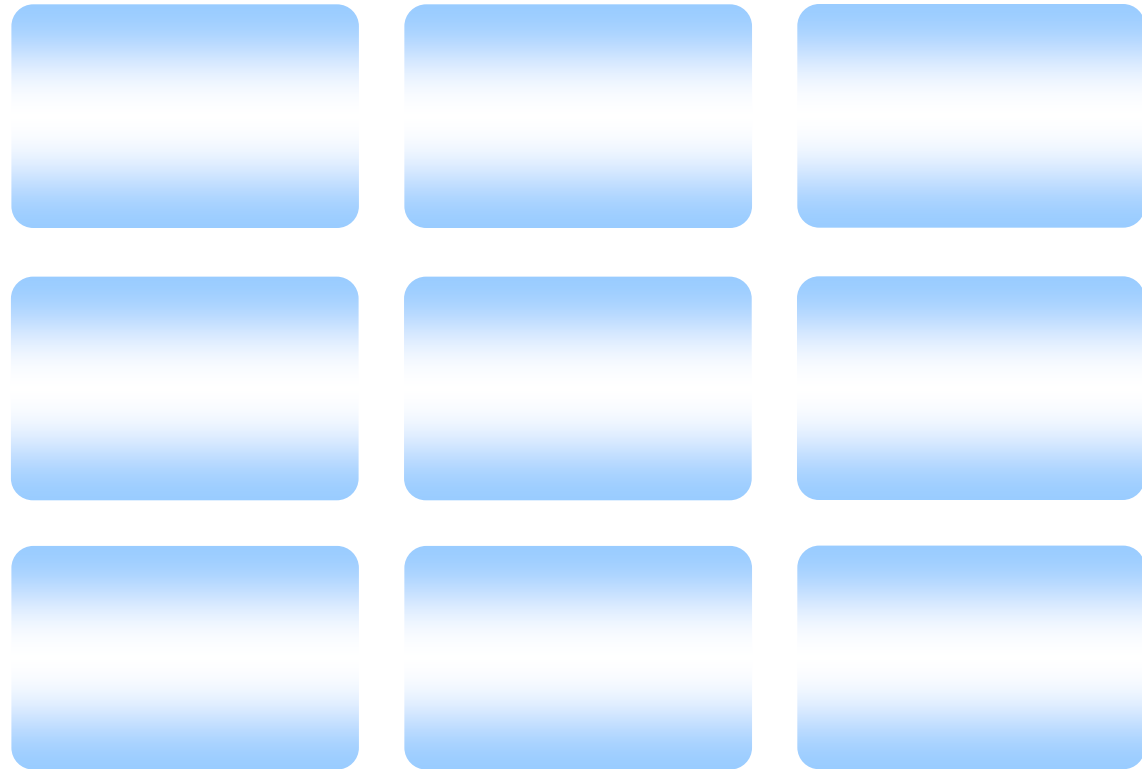
So when to use it?

Increasing diversity between customers →

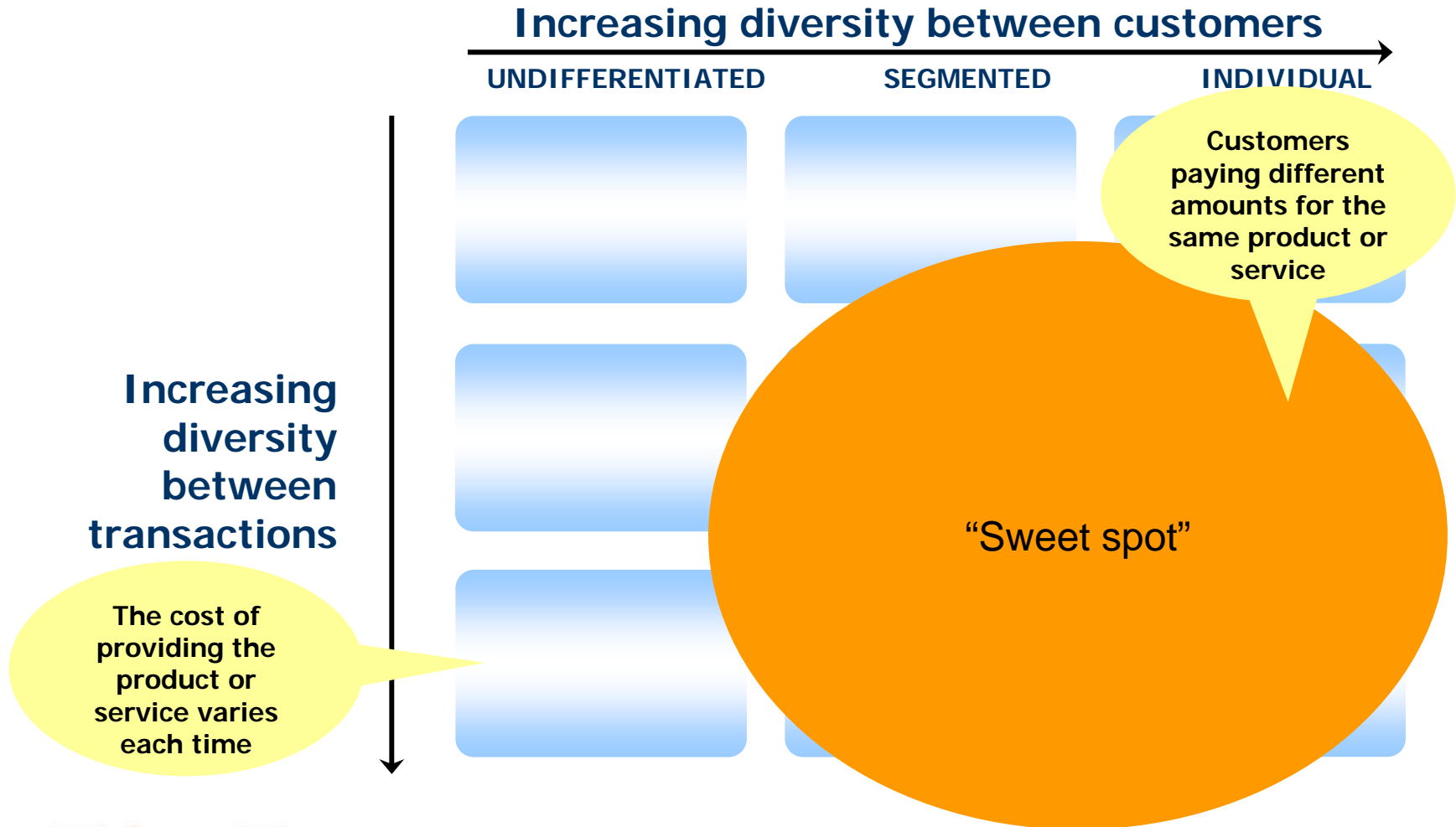
UNDIFFERENTIATED

SEGMENTED

INDIVIDUAL



So when to use it?



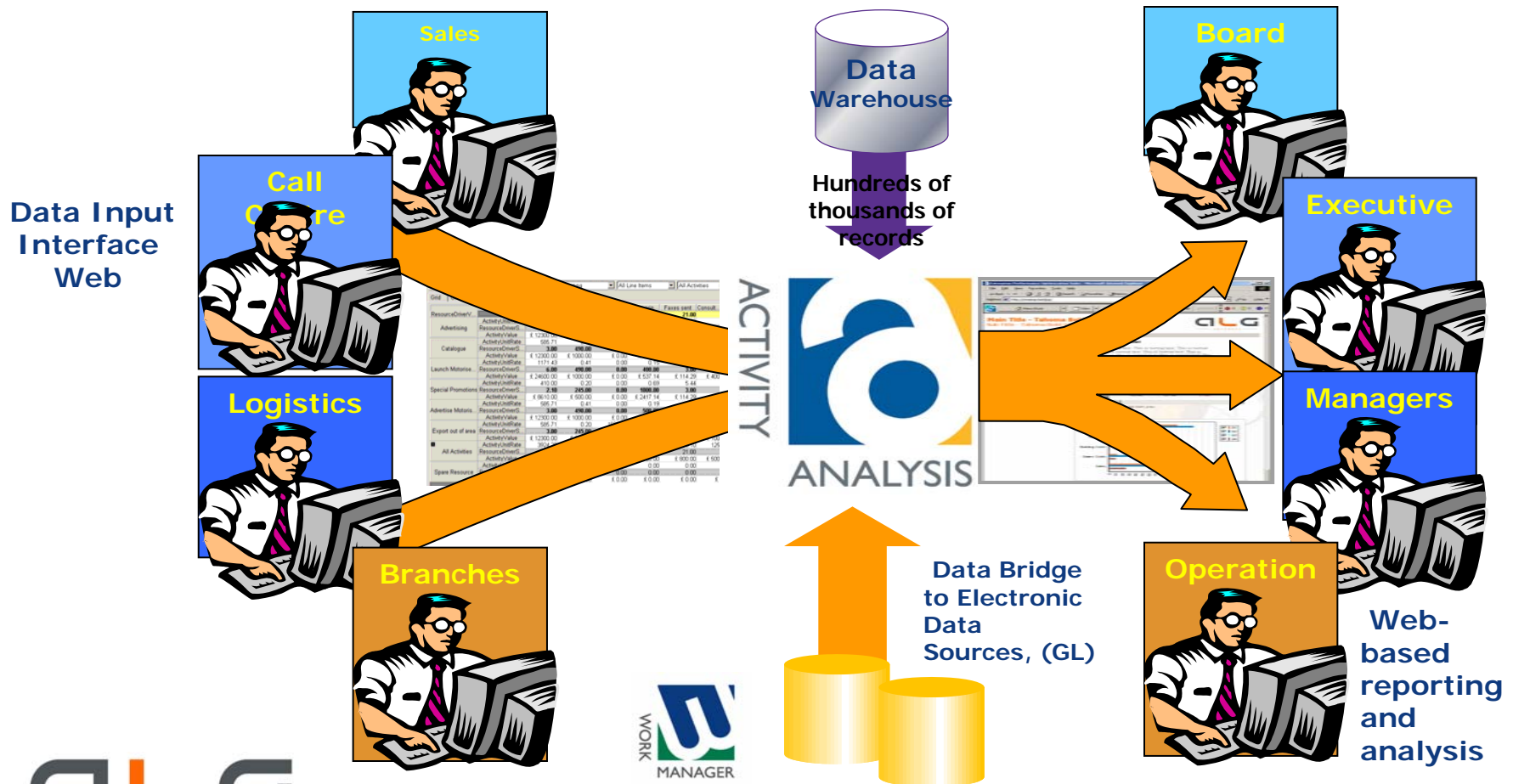
Ask Yourself These Questions

- ▶ Before starting any form of profitability analysis, it is essential to define its scope and purpose
 - ▶ What are the key business issues that the organisation needs to address?
 - ▶ Who will use the information?
 - ▶ Is the information meaningful?
 - ▶ What performance is required of the system?
 - ▶ Is it manageable?
 - ▶ How will we provide the right information at the right time?

- ▶ Determining what information is needed to answer these types of questions will outline the level of detail required for the model.

What is next ???

Profitability models have traditionally been “backward looking”. i.e They have used history (e.g. GL and details of activities) to determine “what happened”



Thank You