Using Integrated Profitability Management to answer your key business questions

The marketplace is more challenging than ever, with a number of trends impacting customer, product and channel profitability.

To succeed in this environment, companies must have clarity on where they create and destroy profit.

Existing methodologies such as Activity Based Costing (ABC) failed to deliver the expected clarity, and often resulted in cottage industries producing complicated analyses.

Integrated Profitability Management (IPM) is a fresh attack on the issue. IPM follows driver-based modelling techniques like ABC, but adopts a more pragmatic approach to answering specific business questions related to how and where the organisation is profitable. This insight is then integrated with the core Business Performance Management processes to ensure a continuous focus on enhancing profitability.

Shifting cost and revenue profiles dictate a fresh look at your profitability

One of the principal impacts of changing business models and the recent downturn is that the profile of customer, product and channel profitability has shifted significantly. There is no guarantee that the products and customers that generated profit in the past will continue to be your cash cows.

There are a number of trends impacting the marketplace today:

- Stagnating domestic growth resulting in a growing focus on emerging markets
- Product proliferation and personalisation, adding complexity to the supply chain
- The emergence of new channels to market, which combine and generate new revenue profiles
- Falling disposable incomes in domestic markets with consumers adopting a mature "value" mindset, causing a downward pressure on revenues.

Companies' responses to these trends impact the bottom line, but an objective analysis is required to show precisely how.

Integrated Profitability Management pragmatically provides the objective analysis for better business decisions

Put simply, Integrated Profitability Management is about making sure that resources are focused on profit-making activities. This is achieved through focused analysis, which is then acted upon within the business.

IPM focuses on revenue streams, not just costs, reflecting the organisation's multi-channel operating model. It also supports scenario modelling to show the impact of cost and revenue drivers.

Similar to ABC, this necessitates the construction of one or more driver-based models, but IPM takes a different approach to building these. The approach benefits from the positive and negative experience of previous ABC projects (see panel, above).

As a consequence of the IPM approach, the models tend to have a greatly reduced maintenance effort, can be developed more quickly and the outputs are easier to understand.

IPM sits at the heart of the Business Performance Management Framework

IPM should be used as a weapon to shift the focus from "chasing revenue" (at any cost) to "chasing profit".

This cannot be achieved without integrating the outputs and analyses from IPM into a number of other components of the Business Performance Management Framework (see diagram, overleaf). This includes:

- **Effective Business Planning** – the analyses and outputs of IPM should play directly into the planning cycle, with the model being used to support scenario modelling and forecasting. The profitability analysis should provide the common language used to decide the trade-offs between Finance, Supply Chain, Sales and Marketing
- **Cascaded Objectives** –unless an organisation, at all management levels, is focused on improving profitability rather than growing the top line, with personal objectives and rewards aligned to the organisation's goal, it is unlikely that any progress will be made.
- **Business Partner Skills** – their role is to influence and coach the business in the financial impact of operational decisions. This intervention should support the shift of focus to "chasing profit".
- **Management Process** –it is imperative that the outputs of IPM are not seen as just an interesting piece of analysis, but are embedded into the plan-do-review management cycles. As such action can be taken to improve the overall profitability of the organisation's product, customer and channel portfolios.

IPM provides the base analysis to understand profitability across your product, customer and channel portfolios

There are a number of commercially legitimate reasons why an individual product is loss-making. Therefore a portfolio view (see figure, on last page) is key to taking the right action.

Responses may include portfolio rationalisation, but also price re-negotiation, targeted cost reduction, or a drive for higher volumes. The IPM analysis is the start of the journey.

Learning the lessons from ABC

In its heyday it seemed like most organisations were experimenting with ABC, but these days you rarely hear the term. So why is this? One of the reasons behind this fall from grace is that ABC had a number of failings, which IPM addresses:

- IPM focuses on specific business issues rather than trying to answer all possible questions that could be answered by the model.
- IPM only allocates costs that are relevant to the business issue, and is also focused on revenue streams; whereas ABC tended to allocate "all costs" and then simply assign revenues to cost objects.
- IPM follows a flexible allocation methodology, not tied to the traditional 3 allocation stages found in ABC implementations. The result of this being a more bespoke model, with more relevant results.
- IPM takes a pragmatic view, only adding complexity where it will materially improve the quality of the business decision support. For example, ABC models often contained complex allocations including iterative reallocations.

Our approach can deliver change in as little as 8 weeks

We follow a structured process of:

- Start up and objective setting – to engage the business, and to identify and agree key decision support questions and underlying hypotheses.
- Agreeing the model design – by confirming the scope and allocation methodology.

Building the model, using a fit-for-purpose technology, and collating the business data required.
Reviewing outputs and embedding the solution, to ensure that the analysis is understood and acted upon.

Key principles and critical success factors

There are a number of key principles that we bring to our engagements to ensure that they deliver the benefit and value expected:

Know your objectives – successful implementations are crystal clear on their scope and objectives and never lose sight of this practical vision.

Keep it simple – Don't aim for 100% accuracy and don't undertake additional analyses unless they materially improve the ability to answer the specific business question.

Be pragmatic – Perfection in all areas can be expensive; but over-simplification is not acceptable. There is a spectrum of sophistication along which a model can evolve. For example in the area of distribution costs, the spectrum spans from simplistic allocations of costs based on customer revenue, through to detailed allocation based on volume and distance, down to an SKU level. A pragmatic first step down this journey could be the clustering of costs by distribution channel with allocation based on volume rather than revenue.

Engage the business – IPM projects will not succeed without business buy-in. Therefore we focus on securing this through the implementation process :

- Ensuring that the business sponsors, articulates the objectives of, and evangelises around the programme.
- Securing management support for a move from "revenue focus" to "bottom-line focus".
- Embedding the IPM with key decision-making cycles at the right time in the performance management cycle.
- Not being secretive – sharing the results throughout the process.

Technology options

Simple, non-recurring analyses based on easily available data can be achieved through basic spreadsheet tools. However, a variety of technology options exist across mainstream and niche vendors.

The technology decision is dependent upon a number of key criteria:

The complexity of the allocation model, including the number of dimensions across which the analysis is required.

The volume and availability of data, including the number of sources of data and the potential to "plug and play" with existing data sources.

The frequency of refresh – clearly the more frequent the analysis the greater the business case for automating capture of data into a fit-for-purpose application.

Capgemini's Business Performance Management Framework

Client success story

Capgemini was engaged by a large global manufacturing organisation to develop an understanding of the cost to serve and the relative profitability of its distribution channels. The aim was to embed this analysis into the business decision making to identify and tackle process inefficiencies and, in particular, inform decisions around the use of e-commerce as a customer order channel.

By effectively engaging the business from the outset we were able to provide clarity around the costs of the order to cash process across a number of functions and geographies. This was supported by the development of a spreadsheet-based model which provided analysis and insight into the differences between order types for the company's various channels.

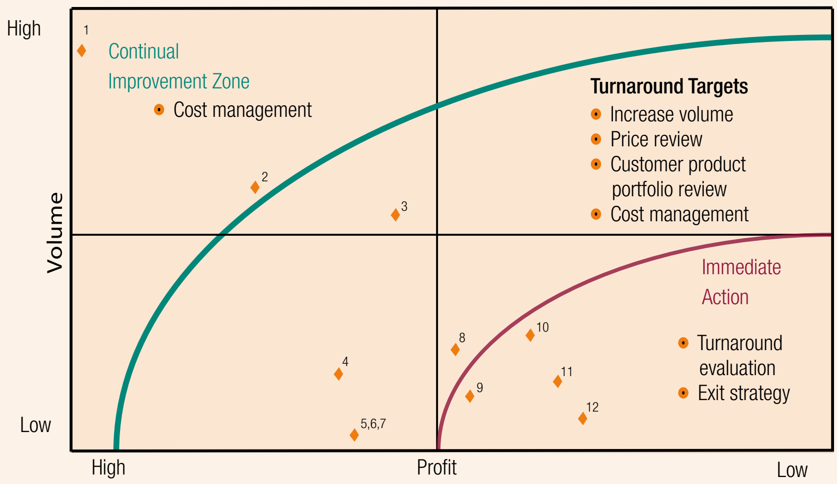
The analysis highlighted several areas where the cost to serve was significantly higher than expected. For e-commerce, we identified that regular system problems meant that order processing was actually costing more than orders received by phone or in writing. This insight provided the evidence required to inform pricing decisions and initiate changes to the existing processes, thereby improving profitability. This ensured that the analysis was acted upon and not just seen as an interesting study.

Why Capgemini?

Capgemini has a unique approach to IPM, supported by:

- A proven methodology.
- Experienced practitioners who have completed many IPM engagements at global companies.
- Understanding of the key success factors, drawing-on the best elements of several techniques.
- A collaborative approach to every engagement, which helps you develop and retain capability long after the end of the project.

Profitability / volume matrix by customer / product, with strategic and tactical options



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