The Challenge of Active Profitability Management

Overcoming Data and Software Barriers

VENTANA RESEARCH

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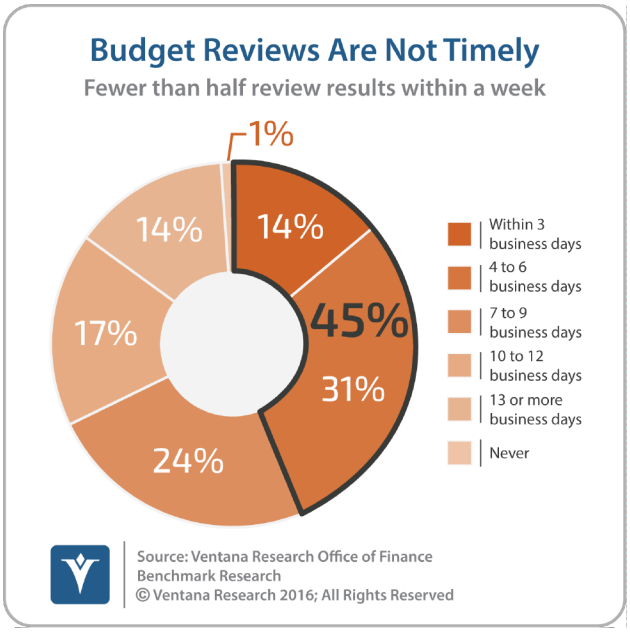
The Profitability Challenge

Managing profitability effectively is important in today's constrained pricing environment. However, our benchmark research on the Office of Finance finds that relatively few companies actively manage profitability through the use of analytics. Just 29 percent of participants said they apply analytics to manage product profitability, and only 26 percent said the same about customer profitability. Determining the cost to serve specific customers is essential to managing profitability, but our research shows that only 6 percent of companies perform this type of analysis.

There are three reasons why companies do not actively manage profitability. One is that they lack data that is accurate, appropriate, timely and reliable enough to enable them to properly measure the costs associated with specific sources of revenue. Consequently, they cannot sustain a profitability management effort – by, for example, tracking compliance to budget in a timely way. In our research, more than half of organizations said they take more than a week to review their budgets.



The second reason is that they don't have software that is up to the task – that is, they lack a dedicated application that enables business users to conduct profitability analyses without the involvement of IT. The third reason applies to companies that have issues with data quality or produce profitability analyses that aren't credible: They face resistance to profitability management initiatives from line-of-business people.

In our view, addressing the first two problems will effectively deal with the last.

The Importance of Active Management

Active profitability management is a rigorous approach to increasing the profitability of any aspect of a business – profitability viewed, for instance, by customer, product, channel or region. Having such an analysis makes it feasible to adopt more sophisticated ways of managing costs. Active profitability management identifies cost drivers so that managers can develop strategies to avoid unnecessary spending. It also provides actionable metrics such as the cost to serve a customer, and does so sufficiently accurately and in enough detail to

enable the company to develop pricing frameworks and policies aligned to its customer and channel strategies to optimize profitability.

Ultimately, having a complete yet detailed understanding of where it makes its money enables an organization to better allocate its capital and other resources to achieve its strategic objectives. However, despite the substantial benefits that can accrue from actively managing profitability, many companies find it difficult to do so because of data and software issues.

Addressing Data Issues

One of Peter Drucker's best-known maxims – that you can manage only what you can measure – applies to profitability. The data used for managing profitability must be accurate, consistent and timely. Businesses collect large amounts of transactional and operational data, but merely collecting it does not guarantee that it will be readily available. Some data, for example, may be collected in systems that are not easy to access or in formats dictated by the applications being used. Moreover, data often is held in multiple systems, making it difficult to assemble integrated and thus easily usable sets of data. For example, the detailed operational data necessary to accurately allocate costs may have to be pulled from maintenance, repair and overhaul, facilities management and professional services automation systems.

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As a result of these real-world situations, business users can find it difficult to connect costs and expenses with specific customers, products and services, channels and regions. In our research nearly half (47%) of companies identified data availability and quality as an issue that must be addressed to improve performance.

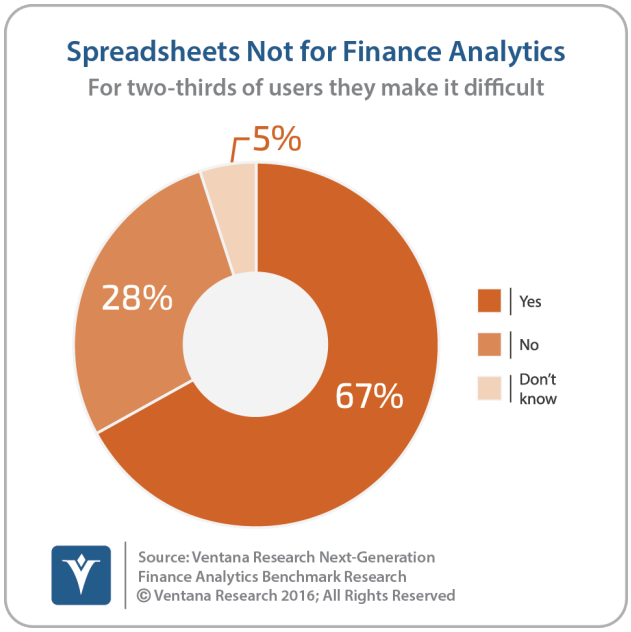
Although two-thirds (65%) of companies said that the data they use in financial analysis is accurate, just 6 percent said all the information is up-to-date. As a result, executives and managers are left to make decisions about pricing, product development and capital investment based on profitability measures that are likely to be dated, inconsistent or inaccurate. And if they lack complete and accurate information on what drives these costs, they won't understand how best to enhance margins on products and services or gain increased value from customers.

ERP systems almost always are the primary source of the data needed to measure profitability. However, only 38 percent of companies with more than 1,000 employees have a single ERP vendor, and 29 percent have systems from three or more vendors. Multiple systems of record that span products, customers and

channels make it necessary to synchronize data to ensure that what is being counted is similar from one system to the next. Unless this data normalization is handled consistently, analysts will wind up with different results, producing variances and unreliable conclusions. Moreover, general ledgers are not designed to measure profitability, and modifying them to support this analysis runs the risk of overburdening the system.

Overcoming Software Barriers

Software and modeling issues arise when companies rely on desktop spreadsheets, which almost half (45%) of research participants use exclusively for finance analytics. Reflecting one of the most common themes in our research findings, two-thirds (67%) of companies said reliance on spreadsheets makes it difficult to produce accurate and timely analytics.



We caution against using these personal productivity tools for enterprise tasks such as profitability management; spreadsheets invariably create issues when used in collaborative company-wide analyses and reports because of their inherent technology limitations. For example, spreadsheets are two-dimensional grids, but businesses are multidimensional. Companies need to be able to assess and report on profitability in several dimensions at once, such as by product, customer, geography or channel. Limited dimensionality makes it difficult and time-consuming to model and report on profitability using spreadsheets. Moreover, errors in data and formulas are common, undermining the credibility of the analysis.

Enabling Profitability Management

Companies can overcome data and software barriers by adopting software that automates the collection and storage of all the financial and operational data needed to actively manage profitability. Such software can create and maintain data that is always accurate, up-to-date, comprehensive and consistent – the trustworthy data that is essential for profitability measures to be credible.

Advanced software can enable business users to create models that are flexible enough to adapt to changes in the business and to quickly assess the impacts of multiple scenarios. It can make cost allocations to revenue streams fully transparent, support action-oriented analytics and automate routine tasks such as

reporting. It can fully automate calculations of costs and profitability by customer, product, channel or region. It also can perform what-if analysis that enables an interactive examination of the impact of a range of options.

Information and technology issues that prevent companies from actively managing profitability usually are invisible to senior executives and line-of-business managers, and many of those who are aware of these issues may not know that there are alternatives. These pernicious data and software issues can stymie attempts to develop more effective profitability management. Having the right technology enables companies to manage profitability more effectively because it provides them with the tools to measure costs and thus true profitability more easily.

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