



Profitability Driven Performance

CONSIDERATIONS FOR SOFTWARE SOLUTIONS

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In today's volatile business environment, organizations in every industry must look beyond traditional cost-cutting measures to increase profits. One way that organizations can drive sustainable growth in profitability is through robust and consistent profitability-focused planning and performance management. By providing credible profitability information enterprise-wide, organizations can support decision making across departments that drives revenue and manage costs. However, in most organizations profitability reporting is limited and based upon the general ledger. The key to providing meaningful profitability results lies in the details – granular cost assignments and allocations, and techniques such as activity based costing/management (ABC/M). It is difficult to accomplish this on a sustainable basis without the use of profitability management software. Cost & Profitability Management solutions are part of Performance Management software suites that include business intelligence reporting/analytics as well as planning and budgeting capabilities.

Although most companies have some type of profitability reporting, many are investing a lot of effort to produce relevant cost and profit information. There are limitations to the information that companies compile which may have a significant impact on decision making. Manual processes, disparate data sources, a lack of sophisticated costing capabilities, and an inability to drill down to the details all hinder the ability of business managers to make well-informed decisions that can drive profits.

Investing in software to support profitability reporting can make a significant difference in both the quality of information as well as expanded access to decision makers. Over the last several years there has been significant growth in the use of software to manage profitability, and in the face of economic and competitive pressure these solutions can play a pivotal role.

The paper will further explore how organizations can utilize profitability management systems to improve both operational and financial decisions that ultimately drive revenue and deliver profits.



THE CHALLENGES OF PROFITABILITY MANAGEMENT

There is a misalignment between the importance of profitability information to the enterprise and the methods and supporting systems used to produce that information. In particular, spreadsheets typically serve as the "system of record" for organizations, providing high-level results but falling short of requirements for deeper analysis to support real decision making. Spreadsheets limit the ability to increase the frequency of reporting and to respond to management requests for information, and they pose a significant risk of error – factors that inhibit a sustainable profitability reporting process.

Additionally, planning to support profitability targets is many times an exercise in cost center budgeting that is then rolled up into high level profitability reports. While there is value to that process, the more detailed insight into real profitability drivers is missing.

Many organizations are realizing this 'information gap' and are investing in profitability management solutions to improve that information. The market for profitability software has shifted to vendor purpose-built solutions for profitability. These profitability management applications combine software logic to support detailed allocations with a business intelligence (BI) framework that enables reporting and more sophisticated analytics. From a business user perspective, these solutions offer capabilities that lessen the reliance on IT, and provide connectivity to spreadsheets that make them easy to use yet are a structured part of enterprise reporting.

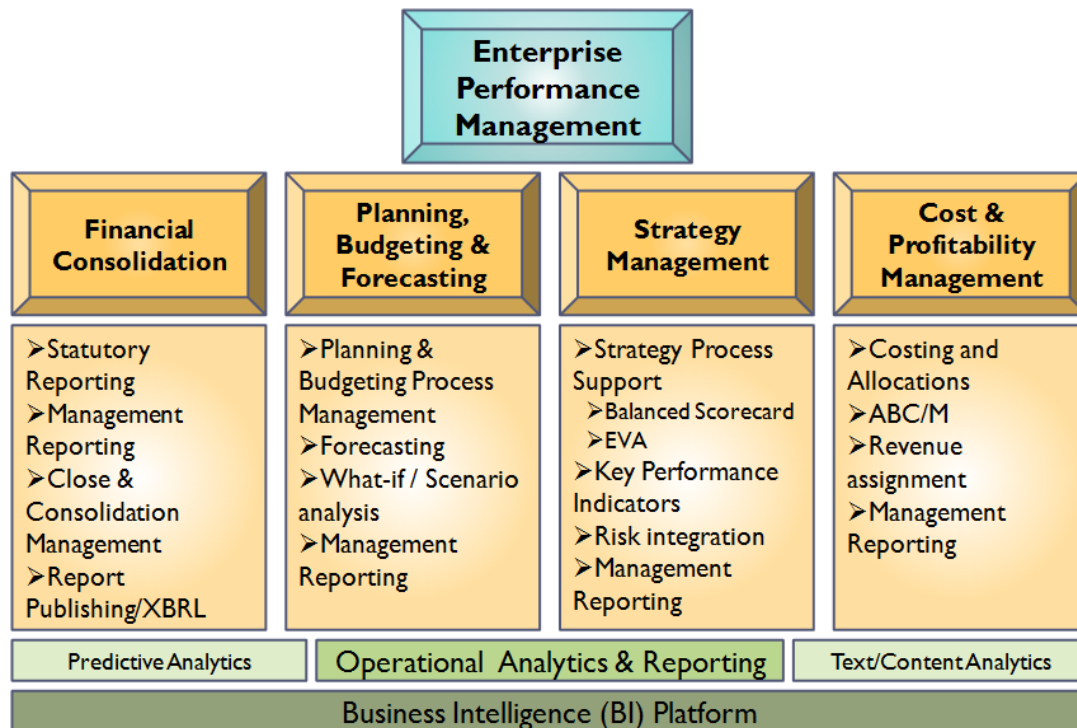
While profitability reporting is an integral part of information delivered to management teams and field personnel, many companies cite limitations in their current profitability reporting processes. These limitations include 1) the high level of manual effort; 2) an inability to respond to detailed management requests for information and 3) a lack of detailed, sophisticated costing processes with visibility into the details.

In the areas of statutory and management reporting as well as planning and budgeting processes, organizations are being asked to report and analyze more frequently and with more details than ever. The result is that finance is feeling the burden of processes that are based upon excessive manual effort and are supported by complex spreadsheets that pose the risk of error. . As management makes more demands for detailed information, business users cobble together information from disparate systems. When it comes to profitability, the alignment of costs with revenues is many times only as good as general ledger accounting and cost center budgeting results, with no real sophistication that can help organizations see where profits are being earned and opportunities lie. For example, many organizations report difficulty identifying the 10% of customers who contribute 90% of profits.

PROFITABILITY SOFTWARE

The range of software solutions that users employ to support profitability reporting include the most simplistic reporting as part of the general ledger, attempts at more refined results using BI reporting tools or budgeting solutions, or more complex modeling in spreadsheets. To implement a dynamic decision support initiative that impacts the bottom line requires complexity and sustainability for which more purpose-built technology adds real value. This has driven significant growth in the category of performance management software (FIGURE 1) on the market known as cost and profitability management solutions. The key to success in profitability management is to leverage technology. A framework of cost assignment and revenue tracking that is scalable and flexible, and supports a repeatable model for profitability planning and reporting is ideal to facilitate decision making. Companies that have made this investment cite a more strategic use of profitability information that extends outside of finance.

FIGURE 1



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Performance management solutions consist of applications whose main purpose is to measure, analyze, and optimize financial and business performance and analysis. While finance departments may initially design and implement these solutions, the goal is to drive the visibility of performance information enterprise-wide and optimize performance management processes such as planning and budgeting. As organizations look to improved reporting and gain greater accuracy and visibility, evaluating software is the norm. Software enables more complete and sophisticated cost allocations such as activity based costing for products, resources and services, or shared services allocations. This enables a more accurate matching of resources and other costs to product or services revenue that expands insight beyond traditional accounting.

THE BENEFITS OF PROFITABILITY MANAGEMENT

As organizations become aware of the limitations of the current manual effort to produce profitability information and the resulting lack of timeliness and accuracy, it is clear that profitability reporting processes are ripe for improvement. One area that increases the credibility of profitability information is the move toward more sophisticated cost assignment practices. While some adhere to strict activity-based costing or full absorption costing methodologies, the majority of companies use a combination of several methods, and more robust allocations that are defensible are a key part of the equation. Many organizations start by modeling costing in spreadsheets to get a sense of what information is needed, but this process is not sustainable. As organizations endeavor to better understand and assign costs, general ledger systems and BI reporting alone do not deliver the granularity organizations require to determine true profitability. As a result, finance still spends too much time combining information to provide key insight across the organization.

Typically, finance is the gatekeeper of financial information and is in the best position to calculate profitability information. Consequently, finance almost always owns reporting. However, from a decision-centric point of view, profitability information must be delivered to key stakeholders across the organization for it to be meaningful. Marketing and sales organizations are key users of this information once it is made accessible. Profitability by product, customer and channel give these operating teams key insight that influences day to day decisions.

Meeting the myriad of user and information requirements with a single reporting and analysis platform for profitability management can result in several quick time-to-value improvements such as the following:

- A reduction in the manual workload



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- The ability to produce more accurate information
 - The ability to produce reports more frequently
 - New insights not visible in general ledger results

Such improvements in the nuts and bolts of how profitability management is conducted establish the foundation for deriving significant decision-making benefits. External go-to-market decisions that organizations make based upon profitability data include identifying customers that are most profitable or represent the best chance for up-sell opportunities, implementing dynamic pricing frameworks based upon the most current information, or where to focus marketing campaigns. In a broader business context, a single and integrated platform for profitability management can help organizations achieve the following capabilities:

- Increased transparency into cost & profitability details
- Visibility into business results at the operational level
- Accurate information to guide investment/disinvestment decisions
- Enhanced planning and budgeting results
- Better resource allocation
- Improved understanding of shared costs, which can be used for benchmarking against outside services
- Shortened reporting times
- Repeatable, consistent reporting processes

A single platform for profitability management can help an organization to more easily identify both under-performing areas of the business as well as opportunities for growth. In addition, enterprises are better equipped to model cause and effect in areas such as pricing or customer retention decisions during enterprise planning processes. This information enables end users in various departments, such as sales and marketing as well as finance, to understand in greater depth why targets are not being met, and to make decisions using the most accurate and timely information.

CONSIDERATIONS

There are several obstacles to organizational plans to improve profitability reporting. Historically, cost and profitability reporting was prepared manually by finance on an infrequent basis. Organizations find it hard to make the leap from an initiative conducted by just a few employees to making a software investment. This mindset is changing, and



organizations are embarking on broader performance management reporting strategies that are based upon a single platform of technology and information delivery.

Solutions on the market have evolved over the past several years, and this software segment is rapidly evolving into the category of enterprise software. End users are becoming more aware of the purpose-built profitability solutions available on the market today. They realize the need for a more robust platform to support profitability by enabling organizations to leverage the information in their existing systems, apply more accurate costing practices, and produce more accurate and timely profitability reporting at the customer, product, and business segment levels.

CONCLUSION

In today's economic climate, many organizations are struggling to find areas of growth. One way to identify potential growth areas while also putting a spotlight on under-performing areas is through profitability management. Organizations are moving away from high-level, point-in-time profitability reporting characterized by the use of spreadsheets, and are making investments to automate profitability management and reporting processes. Those companies that already have made investments readily report ROI related to improved decisions and manual workload reductions that exceed the cost of investing in software. The benefits of having information that expands the organizations' understanding of where profits lie – whether in terms of customers, product lines or specific markets – far outweigh the costs, and an investment in a platform to support these efforts is an investment in accuracy, a sustainable, repeatable process, and the ability to deliver information to support true day-to-day decision making. As organizations strive to respond to market dynamics with strategies such as refined pricing techniques and focused marketing campaigns, a fact-based foundation on which to make these decisions is required. Hence, companies should strongly consider the capabilities for profitability management that are on the market today.