Financial Analytics – Profitability Analysis

*Surviving turbulent economic times and thriving beyond*

Overview

Turbulent economic times and an increased focus on profitability are driving companies to look inward as they ask themselves three rudimentary questions on performance:

- How are we doing?
- Why are we on or off track?
- What should we do to perform better?

This corporate soul searching has stepped up the pressure on finance organizations to take a variety of actions to help their companies navigate the current economic turbulence. Not only do businesses need short-term lifelines to respond to a weak global economy and limited access to capital, but they also need to drive cash flow, contain and reduce costs, manage risks and improve profits. In addition, they are being asked to transform critical business processes, so that when the economy recovers they are in a position of sustainable competitive advantage.

As finance organizations navigate through these challenges and prepare for a new economic reality, there has been a simultaneous explosion of information in their companies. Information is now a strategic asset that businesses use to compete. Finance organizations must capitalize on this information, using it to build intelligence and acquire the insight to respond more effectively to changing business conditions.

One of the most critical challenges that CFOs face is improving profits while using to their strategic advantage the information gleaned from their intelligence discovery processes. IBM offers solutions to help CFOs and finance organizations meet this challenge.
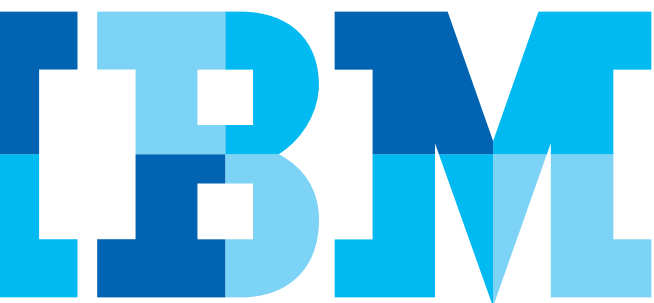
Profitability: The new imperative and approach

Profitability analysis (also sometimes referred to as financial analytics) is a relatively new cross-enterprise discipline that unlocks profit potential to drive performance. Once a management and accounting-driven reporting exercise, it is now being used to help all parts of a company gain the insight necessary to deploy limited resources in pursuit of the most profitable opportunities. Company departments and divisions, such as sales, marketing, operations and engineering, can use profitability analysis to answer simple profit-focused questions in the context of their day-to-day strategic and tactical business decisions. Examples of these questions include:

- Who are my profitable customers?
- What are my profitable products or service lines?
- Which are my profitable sales channels?
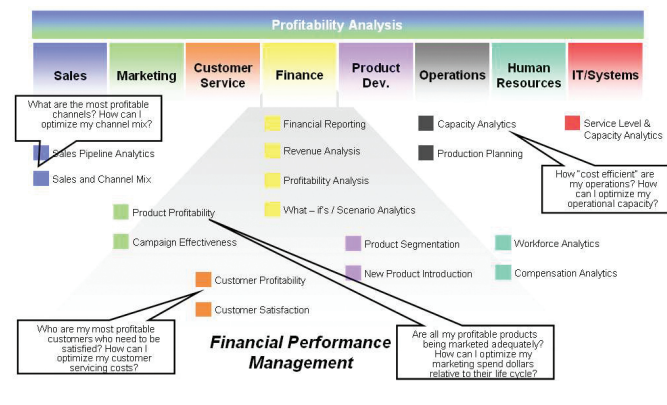
Profitability analysis now extends beyond management and accounting to help all divisions, departments and functions answer critical questions.

With this evolution of profitability analysis, profitability itself has moved to the front lines of a business where employees are making "micro-optimization" business decisions. This transformational shift is compelling finance organizations to move beyond the complexity of costing to focus on an approach that helps their entire business. The requirement that finance become a better business partner underscores the importance of looking at profitability modeling and optimization through the eyes of the company (as opposed to looking at it through accounting and financial lenses only). Finance starts with a business decision that needs to be made and moves back through a number of activities and disciplines to get the source information needed to make the decisions.

From business decision to information—finance needs to look at profitability modeling and optimization through the eyes of the entire company.

Forward-thinking organizations are applying new business practices, tools and automation to profitability analysis so that they can effectively:

- Assess the right profitability measures that optimize business performance.
- Move from merely a costing-oriented profitability reporting exercise to a forward-looking profitability modeling paradigm.
- Undertake profitability analysis for different dimensions of profitability (for example, customer, channel, product and so on).
- Use statistical and advanced analytical techniques to predict profitability outcomes better and thereby work towards optimizing resource inputs.
- Tie profitability analysis to all other enterprise performance management processes such as planning, consolidation and control, strategy management, scorecarding and more.

Profitability analysis solutions

Profitability analysis solutions powered by IBM Cognos® software provide the necessary solution frameworks to address the spectrum of enterprise profitability problems. These solutions primarily rely on the power of IBM Cognos® TM1 software, a component of the IBM Cognos Performance Management platform, along with IBM Cognos Performance Blueprints and other IBM Information on Demand software capabilities.

Financial and business teams can primarily use the power of Cognos TM1 software for intensive profitability analysis and rapidly extend these capabilities to other organizations in their companies in a matter of weeks or even days using the broader capabilities of the Cognos Performance Management platform. In addition, given the information intensive nature of profitability analysis, having the right information is critical. IBM's industry leading Information on Demand offerings can help address the most complex information needs. IBM's business and technical consulting services combined with a powerful ecosystem of partnerships with companies specializing in profitability analysis can simplify deployment and enable quick time to value.

These solutions help a broad range of users navigate the different stages of profitability analysis. They start with finance but move seamlessly into other domains in an enterprise, such as sales and marketing, customer service, engineering, manufacturing, human resources and more.

In addition, these solutions address the profitability problems specific to industries. For example, in the banking industry, a customer service department might use customer profitability to up-sell or cross-sell products. In the semiconductor industry, a manufacturing department could apply profitability analysis to manage inventory threshold levels.

Technical specifications

IBM profitability analysis solutions feature advanced technology combined with capabilities that you can apply to the profitability analysis process:

- Modeling diverse and unique profitability problems for an entire enterprise
- Absorbing direct and indirect costs data by integrating with a variety of costing applications, including activity based costing (ABC) engines
- Driving complex analysis of the profitability problem using both spreadsheet calculations created manually or statistical or advanced analytics created by algorithms
- Providing highly customized information in forms that can be displayed and absorbed simultaneously on mobile devices, dashboards, reports, Web based forms
- Contributing to the inclusion of the decisions derived from these analytical insights in enterprise plans, so that the future course of a business can be modified

The sections that follow provide more technical detail about these capabilities.

Model

Cognos TM1 software easily adapts to profitability analysis processes and rapidly incorporates best practices such as driver-based profitability modeling for complex business domains combined with accounting and operational information. The advantage of this type of modeling is that companies can tie profitability data and metadata with their associated business rules. Further, users, processes and applications can share this profitability model consistently, enabling collaboration between finance and business teams for optimal decision making.

Integrate

Cognos TM1 can connect every component of a profitability model. Whether is is costing information from an ABC engine, operational driver data from an enterprise resource planning (ERP) system or revenue information from a custom system developed in house, Cognos TM1 can extract, transform and load the necessary information seamlessly into your profitability model. These data integration tools streamline the loading of disparate data and help provide a consistent and single version of the truth (a common problem with multiple spreadsheets). Users can even create their own processes to automate data importation, metadata management and other tasks.

Analyze

Profitability analysis primarily involves developing profitability models that depict business problems. Such a paradigm requires calculating various analysis scenarios that are based on who is ultimately using the analytical insights. While lines of business executives and business managers might perform trending, slicing and dicing, predictive and other forms of analysis, financial analysts use scenario modeling (or "what-if" analysis) extensively.

To handle the diverse needs of those involved in the profitability analysis process and the intense nature of the calculations involved, Cognos TM1 provides a high performance in-memory on line analytical processing (OLAP) engine. With this engine, users can analyze all kinds of frequently changing profitability data for millions of items, such as stock keeping units (SKUs) in the retail industry or customer transactions in the retail banking industry. The Cognos TM1 OLAP engine also provides a fact-based approach for deep analysis capabilities that can validate assumptions about what drives profitability.

To simplify the business calculation processes of profitability analysis, Cognos TM1 supports changes in input values and dynamically recalculates on-the-fly. This technically intense process (not possible with spreadsheets) is where the strong performance capabilities of Cognos TM1 stand users in good stead. Further, Cognos TM1 makes it possible for users throughout your organization to create personal scenarios from larger data sets that they can use for a variety of what-if analyses.

Because Cognos TM1 can integrate with a variety of advanced statistical engines, it is possible to add predictive analytics to the profitability analysis process. For example, analysts can use econometric regression for predicting future profitability or linear programming models for optimizing resource input in maximizing profitability.

Use and absorb

Any analytical process ultimately results in the use of analytical insights—and profitability analysis is no different. The Cognos Performance Management platform supports the spectrum of insight visualization from high touch dashboards to applications on mobile devices. It integrates with applications such as Microsoft® Excel and can publish spreadsheets to the Web, from which users can configure their own applications, maintain data and generate reports quickly and easily.

With Cognos TM1, users can create personal hierarchies for visualizing the profitability problem in the context of their specific functions. For example, a customer service manager might wish to see the profitability at the time of rendering service to a customer and in the process view the effect of offering some discounts (with an eye on retention) to the customer instantaneously.

Commit

Insights derived from profitability analysis must ultimately be committed to and then linked to all other enterprise performance initiatives so that any future course of action can be managed. The Cognos Performance Management platform makes it easy to add new plans, decisions and information based on profitability analysis to enterprise performance management processes such as strategy management, scorecarding, planning, consolidation and financial management control capabilities. Such process integration in a single platform creates superior organizational extensibility.

Product Profitability Analytics Performance Blueprint

Over the last several years, finance organizations have invested substantially in sophisticated costing and management accounting processes. The net effect of these investments has been, at best, a backward look at product level profitability. Business users from many departments in an organization such as sales and marketing, product development and even procurement are struggling to use product profitability financial intelligence to gauge their performance and to undertake specific actions to enhance profits.

To help organizations with the challenge of analyzing product level profitability, experts and thought leaders from the IBM Cognos Innovation Center for Performance Management worked with leading-edge innovators and business partners to develop the IBM Cognos® Product Profitability Analytics Performance Blueprint.

The IBM Cognos Innovation Center for Performance Management is a community that assists organizations seeking innovative concepts, functions and business practices that they can use to achieve higher levels of performance. The Cognos Innovation Center transforms proven best practices in industry into practical, easily implemented solutions called IBM Cognos Performance Blueprints. These Blueprints are pre-defined data, process and policy models that address a number of essential functional process areas as well as the unique needs of specific industries.

The Product Profitability Analytics Blueprint uncovers product level profitability in the context of operational business decisions, moving profitability management from the CFO's office to the front lines where decisions affecting profitability are really made. The CFO's office now becomes the facilitator of such decisions rather than being the gatekeeper.

Conclusion

Profitability analysis is important to all companies but in times of economic uncertainty, it becomes critical because organizations need a comprehensive and forward-looking view of profitability to ensure that they remain financially viable. For companies to be successful, they need automated systems that manage data effectively, analyze profitability and provide detailed granular metrics for assessing profitability and measuring performance. IBM offers solutions that can meet those needs.

About IBM Business Analytics

IBM Business Analytics software delivers complete, consistent and accurate information that decision-makers trust to improve business performance. A comprehensive portfolio of business intelligence, advanced analytics, financial performance and strategy management and analytic applications gives you clear, immediate and actionable insights into current performance and the ability to predict future outcomes. Combined with rich industry solutions, proven practices and professional services, organizations of every size can drive the highest IT productivity and deliver better results.

For more information

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