



Profitability and Cost Analysis

An Eye on Value

A KPMG and ACCA Thought Leadership Report



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ABOUT THE RESEARCH

This global report is the third of three pieces of research that have been jointly commissioned by ACCA and KPMG to evaluate how the Enterprise Performance Management (EPM)* capability within Finance functions is providing the business with insightful Profitability and Cost Analysis through appropriate people, processes and technology.

The data used in the report is from a survey which was conducted between 13th January 2016 and 26th January 2016, and represents the view of over 1,100 Finance professionals from more than 90 countries. Whilst employees from organisations of all sizes participated in the survey, 60 percent were from organisations with over 1,000 employees with annual turnover of at least \$100m.

In addition, 31 percent of the respondents identified themselves as a Senior Finance Manager/Manager, 18 percent as newly qualified/experienced Accountants, 13 percent as Financial Controllers, 8 percent as Directors/Partners, 8 percent as CFOs and the remaining 22 percent spread between a range of roles that included CEO, Internal Audit and Consultants.

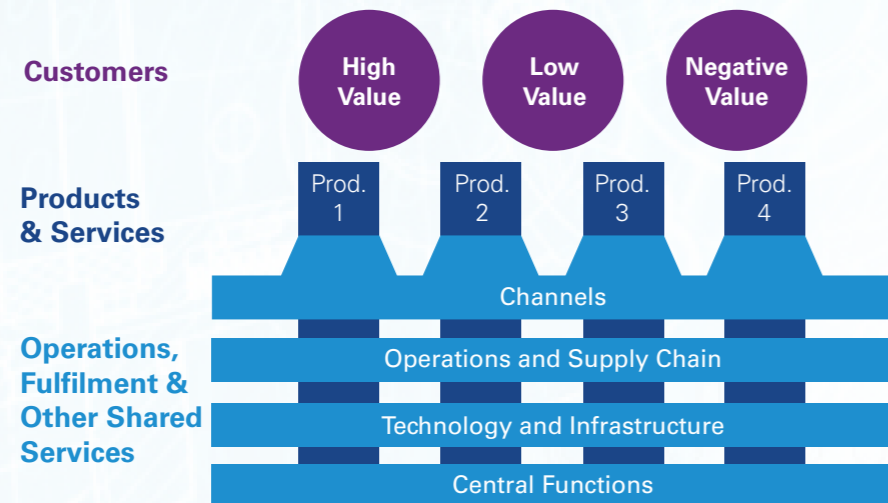
THIS REPORT REPRESENTS THE VIEW OF
OVER 1,100 FINANCE PROFESSIONALS
FROM MORE THAN 90 COUNTRIES



*EPM consists of Planning, Budgeting & Forecasting, Performance Reporting and Profitability and Cost Analysis.

INTRODUCTION

Our view is that Profitability and Cost Analysis should be developed within a performance management framework consisting of three core components (the other two being Planning, Budgeting & Forecasting and Performance Reporting) where organisations can efficiently and effectively analyse business costs, income and profitability at multiple levels to make informed business decisions.



Most major organisations sell and service a broad range of products and services to a diverse mix of customers via multiple channels managed and facilitated by many internal departments. Understanding the real cost and profitability over these multiple dimensions is essential to make informed decisions and effectively steer the performance of the organisation.

Without Profitability and Cost Analysis management is in the dark. A client we worked with recently completed such analysis which showed 20% of its branches were delivering 60% of its profit and 20% of customers did not even generate a profit.

The majority of organisations have understood this business challenge and have implemented an enhanced level of Profitability and Cost Analysis aligned to the key business dimensions, moving beyond traditional cost and profit centre reporting. This is used to support these organisations in both strategic investment/rationalisation decisions as well as ongoing cost and income optimisation. However, many organisations are too simplistic in the level of their approach and analysis, impacting the decision support that Finance is able to provide to the business.

Finance is currently bearing the weight of responsibility to deliver more business-focused insight to drive decision-making. Perhaps now is the appropriate checkpoint to ensure organisations have the foundations in place to support this.

EXECUTIVE SUMMARY

Effective Profitability and Cost Analysis is at the heart of great business decision making, whereby organisations use cost allocation to analyse performance (cost, income and profit) across different business attributes, also referred to as dimensions. This analysis provides insight into the true value drivers of the business and provides management with the right information at the right time to make informed business decisions such as whether to discontinue an existing product, invest in a new asset, operate in a new channel or market. As a consequence of this insight, organisations can improve forecast accuracy, with increased data available to validate the expected profitability impact resulting from a change in its operations such as loss of a key customer or change in sales channel mix.

Finance has understood the power of this insight, and risen to this business challenge, however this study suggests that there are various opportunities to improve, ranging from the maturity, dynamicity and depth of the Profitability and Cost Analysis performed, to ensuring this can be delivered efficiently and sustainably over time including technology enablement and delivery model effectiveness. Without these next steps, value is being left on the table, decisions may be flawed if the insight is not robust, or business opportunities may be missed.

This study suggests there are three critical areas to focus on to improve current Profitability and Cost Analysis.

1

STRENGTHEN THE QUALITY AND DEPTH OF INSIGHTS

- Key business decisions around cost and profitability are essentially focused on WHAT products and services are offered, WHO they are provided to and HOW and WHERE these are sold and serviced efficiently.
- Transparency and action on customer and channel profitability presents a real opportunity for strengthening financial performance.
- The most effective methods and models for Profitability and Cost Analysis are focused, clear, and end-to-end.
- It is important not to overlook the stakeholder engagement, cross-functional collaboration and governance that will play a major role in achieving the desired outcomes.

2

DESIGN AND BUILD A MODEL FOR EFFICIENCY

- The data model needs to align to both business and Finance needs and both parties have a role to play in defining and delivering an effective data model.
- To remain relevant to business needs, review of the model should be part of the annual strategic planning cycle or triggered by a particular event, such as regulatory change.
- Sustainable and efficient analysis across dimensions will usually be aided by implementing a specialist software tool, provided that data is structured appropriately.
- Over-frequent refresh of data is often not a good investment of effort – focus on turning outputs to insight to answer key business questions and drive decisions.

3

OPTIMISE THE ORGANISATION MODEL

- A Centre of Excellence (CoE) for Profitability and Cost Analysis can provide the organisational capability for a step increase in output quality and operating efficiency, helping to overcome people, process and tooling barriers.
- An effective delivery structure can only be successful when the CoE, retained Finance and the business work together.
- An effective approach is business owned and Finance governed - business areas own the data, dimensions and insight, Finance ensure integrity and consistency across the organisation.

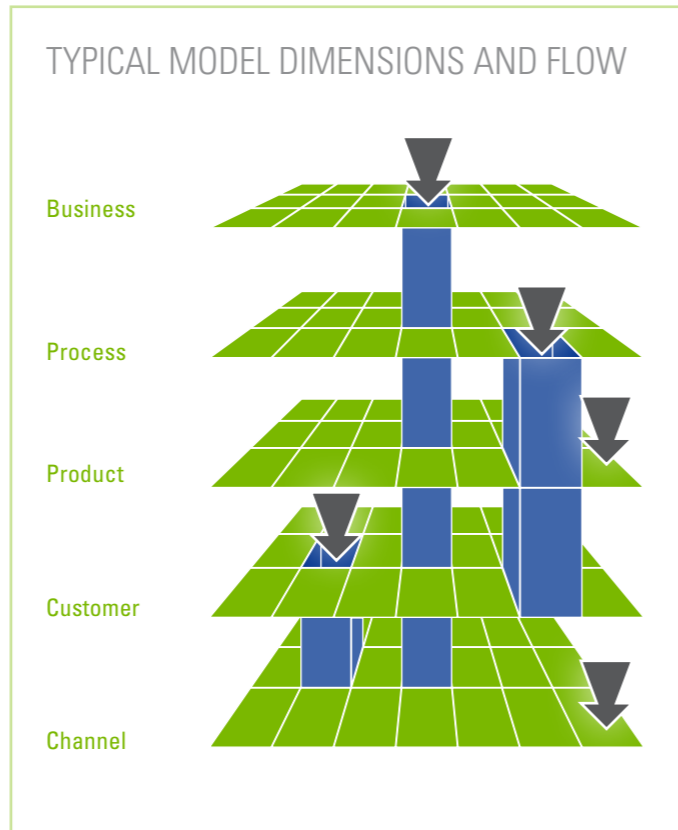
1 STRENGTHEN THE QUALITY AND DEPTH OF INSIGHTS



The aim of Profitability and Cost Analysis is to inform business decision making with a view to systematically optimising profitability and ultimately shareholder value. Key business decisions around cost and profitability are essentially focused on WHAT products and services are offered, WHO they are provided to and HOW and WHERE these are sold and serviced efficiently. Understanding and making the right decisions against each of these questions is key. Business operating models are becoming increasingly complex and fragmented and there are many components to the WHAT, WHO, HOW and WHERE. We call these dimensions and we align Profitability and Cost Analysis to these dimensions in order to support decision making against the organisation's key financial goals.

Many dimensions are common across organisations however prioritisation and focus is unique to an organisation depending on their key business objectives. Choosing the right dimensions to support key business decisions without creating too much complexity supports an optimised approach.

85% OF RESPONDENTS INDICATED THAT THEIR ORGANISATIONS CARRY OUT ANALYSIS ON COST AND PROFITABILITY.



Dimensions are interconnected so the link between them must also be considered – products and services are fulfilled and managed through processes, delivered through channels and consumed by customers in different locations. Getting the right dimensions in the right order, to flow cost through the dimensions, allows a multidimensional view of costs and drill down ability on the outputs (such as channel cost by customer type or product).

This survey indicates that most organisations have invested in Profitability and Cost Analysis and many have a relatively

mature view of profitability. Almost 85% of respondents indicated that their organisations carry out analysis on cost and profitability, and that this is considered across multiple dimensions (product / service 72%, company 66%, geography 52%). Furthermore, this survey indicates that a significant proportion of the cost and income base, direct costs as well as an allocation of many shared service costs, is included in the analysis. There is, however, evidence that approaches could be improved to better support commercial decision making.

SOLVING THE CUSTOMER VALUE EQUATION; THE DATA CHALLENGE

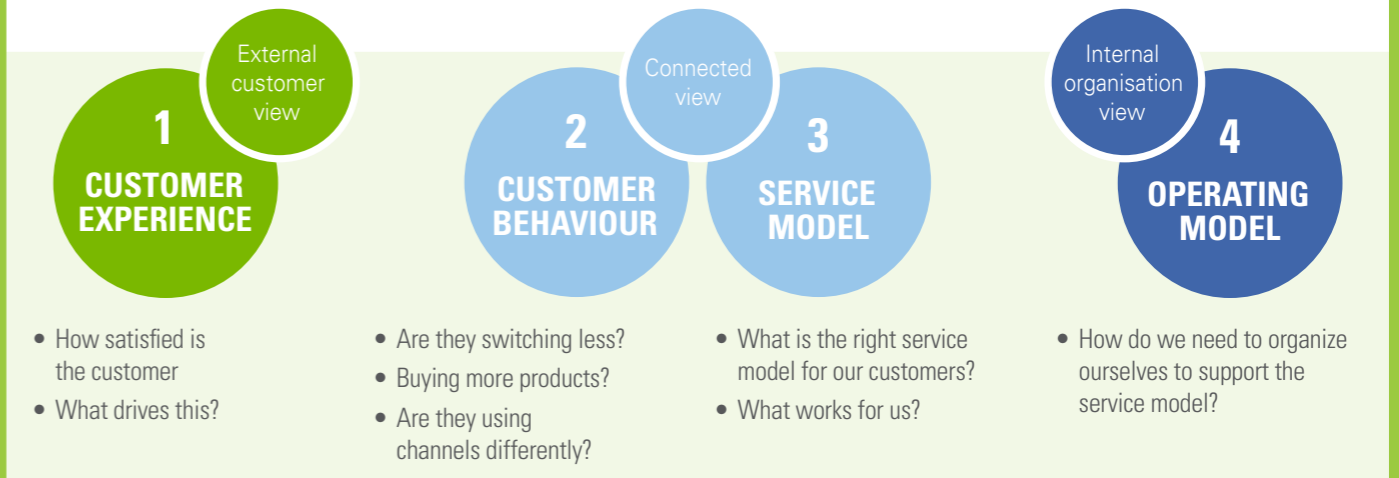
Maurice Lips | Director, KPMG Financial Management

We are living in the age of the customer and the currency of our age is customer experience (CX). At no prior time has the customer had such an influence on how the company does business. Customers' desire consistent and high-value experiences, transparent pricing, customized offerings and may go elsewhere if they don't receive it.

So, will future success belong to those companies who can provide the best customer experience?

We believe success belongs to those companies who master the economics of customer experience which allows them to find the optimal balance between customer satisfaction and organisational performance.

Shifts in customer behaviour (switching, buying patterns and channel preferences) will be a significant driver of disruption in the industry, desired service models and related operating models (see below).

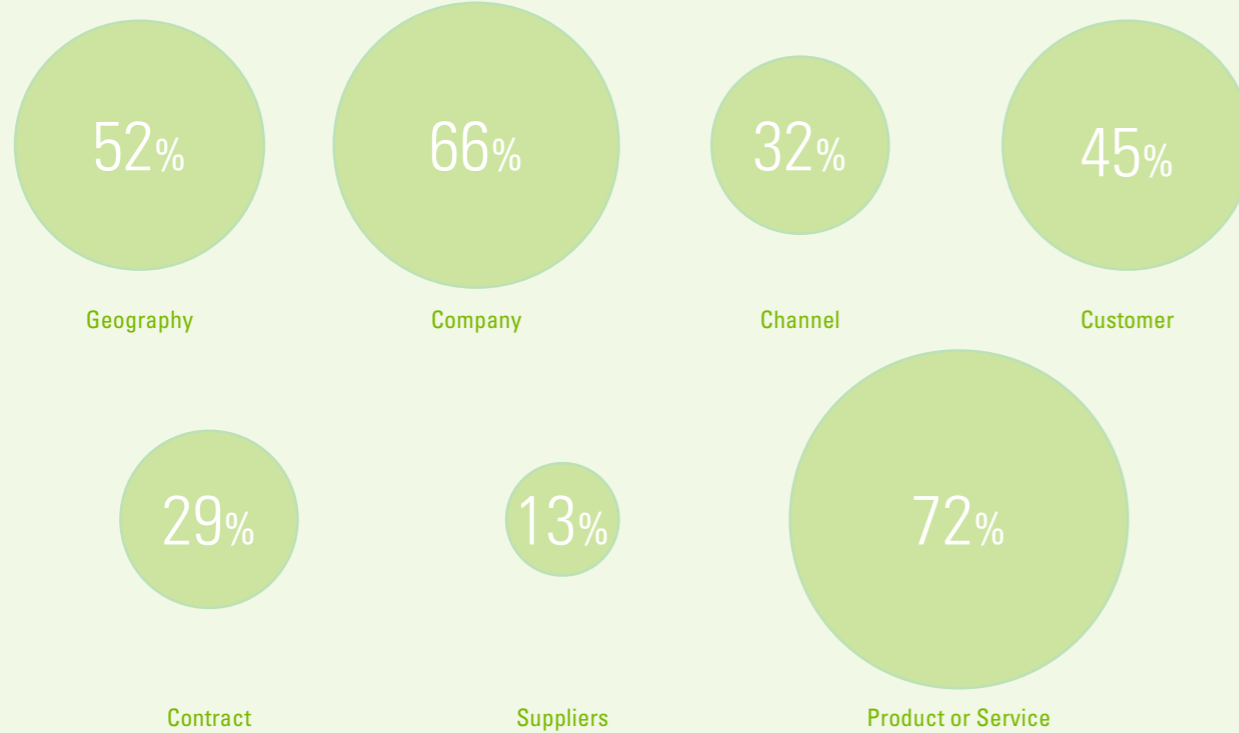


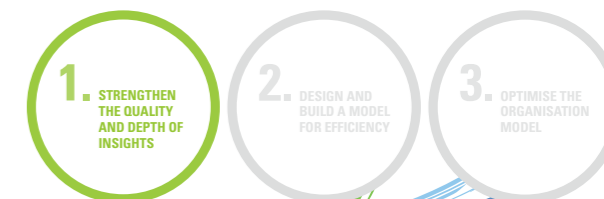
Understanding the impact these 4 steps have on one another is therefore crucial in solving the customer value equation; how does the 'ripple effect' of positive CX influence the metrics that impact the bottom line? With CX truly moving beyond the traditional organisational boundaries, it challenges the traditional ways of working in terms of data requirements and ownership; who owns E2E customer value and what data is required to truly understand what drives this. Our work with clients suggests that current insights are based on incorrect estimations of the benefit potential and do not include comprehensive cost data, making the picture incomplete and inaccurate.

To solve the equation, organizations will have to move away from snapshot financials and move towards trending and prediction on a more frequent or event driven basis. Putting data and metrics in context and correlation with one another will put them in a position to find the winning formula that works for them and their customers.

In summary, driving insight through customer reporting and understanding the correlation between CX and changing customer behaviours which influence the cost to serve and share of wallet is the Holy Grail that will deliver real competitive advantage.

Q1. In your organisation, profitability analysis is available for which of the following dimension(s) to support decision making:





TRANSPARENCY AND ACTION ON CUSTOMER AND CHANNEL PROFITABILITY PRESENTS A REAL OPPORTUNITY FOR STRENGTHENING FINANCIAL PERFORMANCE.

Only 32% of respondents indicated that Profitability and Cost Analysis is available for distribution channels. This is concerning given the ever increasing focus on channel optimisation. Organisations need insight to make decisions around whether or not to invest in digital platforms, virtual operating models and how to optimise supply chains and multi-channel strategy. The channel that a product or service is delivered through can have a significant impact on profitability – quantifying and managing this can influence channel usage, support digital investment decisions and enable informed channel based pricing.

Similarly, identifying and analysing profitable vs non-profitable customers delivers insights on the key customer levers, such as pricing, customer experience and product and channel preferences. This is key to attracting, retaining and driving more value from customers. This contrasts with the survey results, where only 46% of respondents indicated that Profitability and Cost Analysis is available for customers.

Transparency and action on customer and channel profitability presents a real opportunity for strengthening financial performance.

The survey suggests that traditional P&L reporting aligned to the organisation structure is the primary basis (83%) of Profitability and Cost Analysis. However the majority of organisation structures separate product management, shared services such as operations, supply chain and technology and central functions such as Finance and HR. As such, in almost all cases, organisational structures will not provide an effective basis for Profitability and Cost Analysis, as granularity over the key decision making dimensions does not exist.

Although most respondents indicated that financial reporting is based on an allocation of some or all of the organisation's shared service costs, the prevalence for an organisational view and the basis for allocation used to derive this may explain the limited transparency of such shared costs, as suggested by the survey. Most respondents (66%) indicated that apportionment was used as the basis for allocation of shared costs instead of a driver based approach. A driver based approach would provide a more accurate and informed picture, linking activity performed with cost consumed and income generated as a result of undertaking such activities. This in turn helps to rapidly provide insight around cost efficiency, revenue optimisation and focus on non-value adding activities.

KNOW YOUR CUSTOMERS, UNDERSTAND THEIR VALUE TO YOUR BUSINESS AND HOW THEY INTERACT WITH YOU

Oliver Haywood | Senior Manager, KPMG Customer & Growth

In the era of customer, I find it concerning that product-centricity remains the dominant and evidently hard-to-shift mind set in many organisations. Analysing performance through the lens of your product portfolio is vital. However if you can't correlate that insight with your customer base are you adequately informed to make decisions about product rationalisation or investment for growth? Having the ability to interrogate financial performance through the lens of your customers is critical – and yet our survey reveals that a mere 38% actually do (for cost) and 45% (for profit). Compare that to the 71% of respondents who stated they are able to analyse by product and

we start to see how financial analysis may be misaligned to the needs of a customer-centric business.

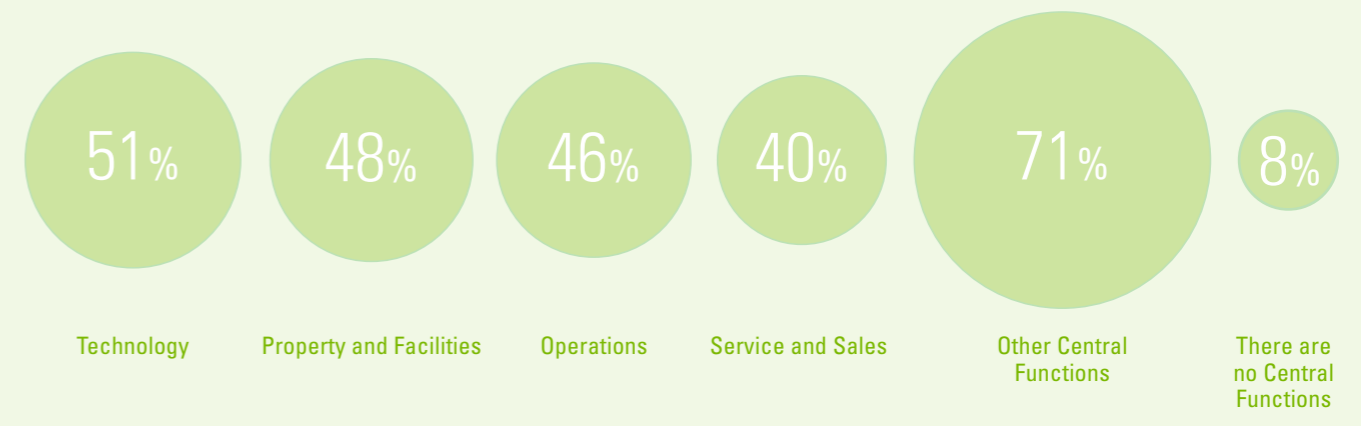
Furthermore with the rapid adoption of digital technologies in most markets, understanding performance also requires an ability to analyse how customers interact and transact with you. Millennials continue to adopt and use ecommerce and social media as default channels by which to research, compare, select and buy. For other segments the intimacy of in-store or phone interaction retains an important role in their brand experience and loyalty. Deploying and maintaining a responsive Omni-channel strategy is mandatory for any business that

wants to win in its market. Profitability and Cost Analysis by interaction channel can significantly help a business to more effectively engage and interact with specific customer segments. Yet only a staggering 31% (cost) and 32% (profit) of organisations could report on performance by channel. Fundamentally insight on cost to sell and serve by channel needs to be adapted as a core element in overall financial reporting.

And the best place to start to make a change? The business – across marketing, sales and service operations - needs to articulate the right questions for Finance to help answer.

Q2

Individual businesses in your organisation have visibility of the organisation's shared costs incurred on their behalf for:



THE MOST EFFECTIVE METHODS AND MODELS FOR PROFITABILITY AND COST ANALYSIS ARE FOCUSED, CLEAR, AND END-TO-END

Half of the respondents indicated that individual businesses do not have transparency around technology costs and less than half have transparency around the cost of their operations, channels and facilities which support their operating models. Such resources constitute a large opaque element of the cost base in many sectors. Organisations that possess the ability to understand and influence these costs have a significant competitive advantage. Again, the survey reinforces this point with 39% of respondents indicating that recipients of allocated costs did not understand how to influence them.

While the scope of dimensions and costs and the accuracy of cost allocation drivers within a model are important factors, developing complex models with many dimensions and detailed cost and driver information is not the answer. The most effective methods and models for Profitability and Cost Analysis are **focused, clear, and end-to-end**.

FOCUSING the design of the model on the key decisions required from Profitability and Cost Analysis will significantly improve the likelihood of successful outcomes. This starts with being clear on the purpose of the insights and the objective of the profitability and cost model. Having clear articulation of the purpose, stakeholders and frequency of usage are key foundation components to ensure the right focus. Being critical when defining dimensions, allocation drivers and granularity will support a more usable model which in turn will be easier to implement, operate and understand.

This focus can be achieved through analysis of the key value drivers for the organisation, involving the primary constituent parts that underpin strategic objectives. The value drivers will identify the key areas for decision making and performance management. It is also crucial that the business (the primary end user) is involved from the start and committed to contributing their requirements during the design and providing data, assumptions and sign off during the build phase.

CLEAR cost and profitability outputs can be driven through a focus on the key outcomes, a logical model structure and selection of the most appropriate allocation drivers. Many organisations fail in this area, either with models that are very detailed which users do not understand or by using generic allocation drivers that do not represent real cost and income drivers. Focus on the few allocation drivers that relate to 80% of the cost or income rather than the many that are required to "accurately" reflect 100%. This will result in a pragmatic and relevant allocation model. Having a clear model is still of little use if the business does not buy into it. Shared ownership between Finance and business areas around the approach, data and outputs is therefore key to ensuring that the model is sustainable and insights are used for decision making by the business.

END-TO-END Profitability and Cost Analysis insight, linked to the organisational value chain provides one of the key advantages over a traditional cost and profit centre view based on the organisational structure. End-to-end means

39% OF RESPONDENTS INDICATED THAT RECIPIENTS OF ALLOCATED COSTS DID NOT UNDERSTAND HOW TO INFLUENCE THEM.

that all aspects of the value chain are included so that decisions are fully informed. For example, the end to end cost to sell a tin of beans would include raw materials for the product and packaging, operations/supply chain, distribution and channel, supporting technology as well as promotion and management overheads. Product design/set-up costs could also be included so that the full product lifecycle cost is considered. Assessing the sale price against this end-to-end cost will show if this product is truly contributing financial value to the organisation. Looking at the end-to-end revenue and costs for the key dimensions shows how value is created and destroyed across the organisation and exposes

opportunities for optimisation not previously visible. An end-to-end view also provides the insight to support collaboration on cost reduction and income growth between departments, which may not be apparent when transparency and influence is limited within functional silos.

Ultimately, an effective approach for Profitability and Cost Analysis is one which influences the right behaviours. Clear and insightful outputs are essential but it is important not to overlook the stakeholder engagement, cross-functional collaboration and governance that will play a major role in achieving the desired outputs: optimised costs and increased profitability.

THE ACCOUNTABILITY GAP

Nathan Doran | Senior Manager, KPMG Financial Management

Driving cost and profitability performance is as much (or more) about behaviours as it is about insight. We need insight to illuminate the right path but unless we are incentivised to make the journey then we might never reach the right destination. Financial accountabilities provide the incentive but often these have not kept up with the way organisations now operate and the cost and profitability decision support that is now available.

Organisations are now orientated much more around customers, products and services with an end-to-end view but financial accountabilities are often still firmly planted against cost centres or profit centres, departments or sales lines. Activities and costs are driven down the value chain and across departments based on demand, decisions and design rather than being fully contained within organisational silos. Collaboration between

departments to drive financial performance is key. Financial accountabilities should reflect decision makers' ability to influence across the organisation and support collaboration – but there is a gap.

The accountability gap is evidenced by the survey responses: 44% of respondents indicated that employees are not accountable for areas of the P&L that they cannot influence and 39% of respondents indicated that employees have accountability for areas of the P&L that they cannot influence. This shows that accountabilities can be better aligned.

Although not yet obsolete, cost centres and profit centres are now less relevant for performance management and there are a range of options to better align accountabilities. Following the lead of operational management and implementing end-to-end financial accountabilities

for products, services, processes and customers – with the authority to drive this – can eliminate organisational boundaries and focus financial performance. Internal recharging and cost allocation also has an important role in aligning financial accountability with influence, and driving an accurate view of net margin. Also, moving beyond total cost targets and considering KPI and unit cost targets can address the trade off between demand creators and internal service providers.

Changes to accountabilities can be emotive and it is important these are well considered and measures are established, understood and trusted, to avoid unintended or counter-productive behaviours. The key aim is to instil commercial decision making and cross-business collaboration at all levels. The rewards in getting this right, and bridging the accountability gap, can be significant.

IT IS IMPORTANT NOT TO OVERLOOK THE STAKEHOLDER ENGAGEMENT, CROSS-FUNCTIONAL COLLABORATION AND GOVERNANCE THAT WILL PLAY A MAJOR ROLE IN ACHIEVING THE DESIRED OUTCOMES.

KEY ACTIONS

PRIORITISE DIMENSIONS WHICH SUPPORT KEY BUSINESS DECISIONS AND VALUE DRIVERS



STRENGTHEN ANALYSIS BY INCORPORATING THE CHANNEL AND CUSTOMER DIMENSIONS



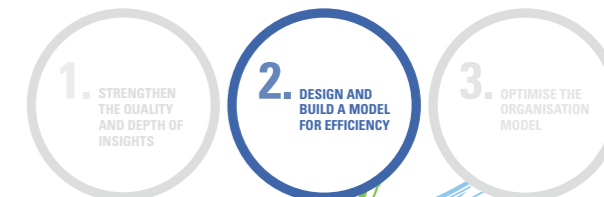
IMPLEMENT DRIVER BASED ALLOCATION MODELS



ELIMINATE COMPLEXITY AND ENSURE THE MODELS ARE CLEAR, FOCUSED AND END-TO-END



2 DESIGN AND BUILD A MODEL FOR EFFICIENCY



The data model is the foundation of Profitability and Cost Analysis. It is critical to get this right and yet it is an area where most organisations struggle. The challenge presents itself on multiple fronts including:

- Identifying, sourcing and combining the relevant data in a data model, combining financial and non-financial data.
- Investing in technology solutions to drive sustainable and efficient Profitability and Cost Analysis and reducing the dependency on manual interventions.
- Governance and oversight of the integrity of the data model and sources.
- Maintaining relevance of the data model and allocation models in a dynamic business environment.

Without these foundations in place an organisation can be faced with an ineffective data model which does not deliver the business insight required and/or an expensive data model which is not sustainable on a long-term basis.

Defining the data model requirements is a joint initiative between the business and Finance. The business' objectives and goals should be used as the basis for driving the required level of detail and complexity. A consistent approach to allocating revenue and costs to dimensions based on the appropriate value drivers should be agreed. For the approach to be accepted, business stakeholders must agree the cost pools, resources, activities, products/ services, customers, dimensions and drivers on which allocations are based.

Once agreed, to maintain value, integrity and relevance, we recommend a periodic review of the allocation model as part of the annual strategic planning cycle. But in order to stay relevant, organisations should also adopt an "event-based" review following, for example, a regulatory change or organisational restructure.

ENTERPRISE PERFORMANCE MANAGEMENT

John O'Mahony | Head of Enterprise Performance Management, KPMG UK

The immediate question I pose with most clients is what better decisions will you make as a result of an allocation of cost or revenue? Many organisations develop arithmetically correct models involving primary and secondary allocations only to find that instead of providing transparency, they have in fact created opacity. Secondly, allocations are made under the false assumption that it somehow provides for a basis of greater accountability. Don't get me wrong, I'm not saying don't bother with allocations, but do so in the knowledge that it aligns consumption of resources or aligns revenue against a function or area that can not influence or control indirectly such costs / revenue.

Allocation of cost or revenue should focus around how it will help the organisation drive value, focus accountability or indeed fulfil a mandatory requirement (i.e. statutory or regulatory reporting). Whilst accepting this as a key principle, attention then focuses on how do we determine the

most appropriate driver to provide the basis of allocation – i.e. it needs to be equitable, appropriate, pragmatic and logical in a way where stakeholders across the organisation accept the allocation basis and in turn it incentivises them to drive behaviours which focus on adding value. We have all seen examples of where the wrong decisions have been made around the cost of provisioning products, services etc., where the expected impact on bottom line performance as a result of a decision based on parameters involving allocations differs what results in practice.

It is also important that areas receiving an allocation believe that the associated cost or revenue basis has been managed well at source and that where it relates to costs that it represents value for money or where revenue is involved that it's optimised.

Hence our belief is that there are a number of key principles which we feel most organisations need to explore when

allocating costs / revenue in order to drive value for the organisation:

- What better decisions will the allocation drive?
- Will it drive the rights behaviours?
- Is there a mandatory need to perform the allocation (e.g. statutory or regulatory)?
- Has the baseline cost been managed effectively at source / can I rely on the accuracy of the revenue number at the point of record?
- Is the basis of allocation linked in some way to the basis of consumption of cost or earning of revenue?
- Have I got a solid basis of recording to volumetric used to derive the allocation?
- Is the basis of allocation pragmatic or is it overly complex?



The quality and granularity of financial and non-financial data is key to the level of insight presented by Profitability and Cost Analysis. In most cases, an organisation's financial ledgers and reporting infrastructure support the financial element of the data model, however the level of granularity in the financial ledgers largely determines the level of detail that can be incorporated into a Profitability and Cost Analysis tool. Non-financial data such as operational data typically presents a bigger challenge for organisations due to the fragmentation across multiple systems and owners. Non-financial data can range from business volumes held in product systems, operational tools or ERP modules to customer data sourced from customer integration platforms.

The ability of the Finance function to efficiently deliver Profitability and Cost Analysis insights is undermined by the existence of manual processes such as manual / ad-hoc allocation journals (31% of respondents) and manual Excel spreadsheets to integrate and analyse data. Nearly half (45%) of respondents stated that their organisation had not invested in a software application suggesting that spreadsheets are still widely used. Technology

is the key enabler for eliminating the need for manual intervention. During the initial set-up it is critical to establish the foundations such as master data and general ledger granularity, and then to utilise systems to their full extent to allow integration of multiple data sources.

Robust governance is critical to maintaining integrity while integrating disparate financial and non-financial data in one data model. In most organisations Finance is best placed to determine the criteria for data quality, determine where best to manage master data and implement a standard process for changes to the data model. The survey suggests that this central role of Finance already holds true, with over 70% of respondents identifying Finance as the primary preparer of Profitability and Cost Analysis.

There is no one-size fits all solution, but sophisticated and efficient analysis across dimensions is often aided by a specialist software package. The survey is emphatic in respect of organisations who have invested in a software application experiencing some benefits.

However, as discussed earlier, benefits can only be realised if the right data is available at the right time, structured in the right way, with sufficient granularity needed for transparent dimensional analysis.

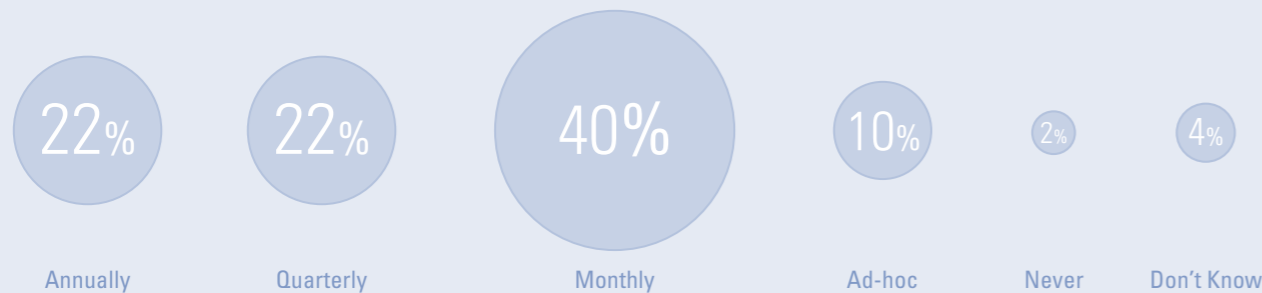
Once the appropriate set-up and tooling have been defined, a key question is how often to run the analysis. Profitability and Cost Analysis is primarily carried out to provide strategic insight, informing key decisions such as pricing thresholds, which products to promote or retire, how to strengthen and segment customer relationships and where to invest to reduce process/channel costs and improve the customer experience. These key decisions require insight, consideration, time to implement and they should be supported with a clear baseline against which to measure performance improvements.

Running full analysis on an annual/quarterly basis, in line with the planning cycle, and on a major event-driven basis

is often sufficient. However, as evidenced by the survey results, almost 40% of organisations run detailed analysis on a monthly basis. Over-refresh of the model can destroy value as resources are diverted from analysing insight and supporting decisions to churning data and analysis is focused more on month-to-month variances than key strategic headlines. While cost allocation tools can reduce the burden of performing analysis, the motive for frequent refresh should be understood and challenged.

Performance to drive strategic improvement must be driven and measured frequently. Rather than a full refresh of Profitability and Cost Analysis, a more appropriate approach is often to identify the key drivers/metrics that underpin the desired performance improvement (identified, for example, through value driver analysis) and to track performance against these KPIs on a monthly basis. This provides a more efficient approach to driving cost and profitability performance.

Q5. In your organisation, how frequently are internal cost allocations reviewed and discussed?



WHAT'S A CUSTOMER? WHAT'S A PRODUCT? NOT SUCH STUPID QUESTIONS!

Gerard Harris | Director, KPMG Financial Management

It's amazing the power of good quality data. It's even more amazing the detrimental effect of lost opportunity, poor negotiating ability and bad decisions made on poor quality data. From not understanding the true value of a 'customer' who has both business and personal accounts at a bank or utility, through to not understanding and being able to quantify the true buying power as a retailer, being clear and consistent with master data is more important than ever. Take customer – if as a business you can't understand that Mr Harris, Mr G Harris, and Mr Gerald Harris (!), who all live at the same address are the same person, but have multiple accounts, then you are unlikely to see me as a highly valuable customer and put me in an 'I don't care if he stays or goes' segment. On the inverse – I may be seen as a highly profitable customer should I get incorrectly tagged as also being Mr Steven Gerrard! Getting a single view of your customer is

hugely important these days especially where we have Omni-channel and we look to cross-sell against our current client base, working out who it's profitable for us to sell to, and also looking after our most valuable assets!

Product comes in two different packets – what we sell to our customers (now we know who they are), and also what products do we buy (to use or sell on). Take retail for example – if I understood that globally certain soft drinks are called different things in different markets, and that I buy them from different distributors in different countries then when I added them all up I may well work out that I buy a lot more from said brand than I first thought, thus enabling me to negotiate a reduction in price point and increase profitability. In terms of what we sell again we need to understand what our products are and what are the constituent parts of it

in terms of well...parts, at least in terms of manufacturing, but also understanding the overheads associated with selling and marketing the product. That's likely to be more difficult if there's no consistency over what products (and parts) are called.

So what's the solution – surely this can't be that difficult can it? Can't I just get some software to sort it out for me? Well you can buy MDM (Master Data Management) tools which will help to maintain the lists or hierarchies, but a lot of the work is around the governance you need to wrap around the tool and how it interacts with the myriad of systems we have in place. A tool can help but it's not the solution alone – process and governance is key.

So it's not such a stupid question after all – as it's awfully difficult to understand customer or product profitability without first understanding what a customer and a product is...

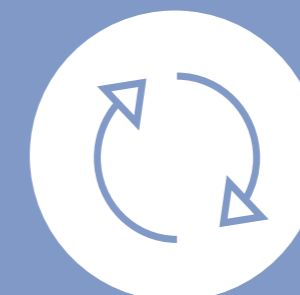
KEY ACTIONS

AGREE DEPTH OF INFORMATION REQUIRED FOR EACH DIMENSION AND VALUE DRIVER



ENSURE DATA IS CONSISTENT AND ACCURATE

EMPLOY APPROPRIATE SYSTEMS AND TOOLS TO DRIVE AUTOMATION



ALIGN REFRESH OF THE MODEL WITH THE PLANNING CYCLE. AVOID OVER REFRESH OF THE MODEL.

3 OPTIMISE THE ORGANISATION MODEL



Establishing the right organisational model for Profitability and Cost Analysis insight is crucial to ensuring that the right information can be efficiently produced to inform decision making. An effective delivery model combines strong business ownership with efficient operations and focused finance decision support.

Traditionally organisations, with much success, have focussed their efforts on the creation of economies of scale through the development of shared services centres for transactional activities, however significant value has been “left on the table” around economies of skill for high value repeatable tasks in areas such as reporting.



BUSINESS AREAS OWN THE DATA AND THE INSIGHT AND FINANCE ENSURE INTEGRITY AND CONSISTENCY.

The Finance function tends to be seen as the custodians of performance reporting and the provider of Profitability and Cost Analysis insight, however when we assess the basis of many of the activities they complete e.g. cost allocations; a significant proportion of these are repetitive. In many cases highly trained Finance professionals are spending their time organising data rather than producing meaningful actionable information.

This, in conjunction with other indicators such as the presence of shadow reporting in other parts of the organisation (16.3% of respondents) suggests value in the development of a different type of competency centre, an analytical and reporting Centre of Excellence (CoE) that would provide an arena for standardising, simplifying and automating Profitability and Cost Analysis.

However the study suggests that less than a quarter of organisations actually employ such a model with almost half fulfilling activities within the retained organisations.

Moving the core operational activities of Profitability and Cost Analysis to a Centre of Excellence provides three key opportunities:

1. Process optimisation
2. Increased business ownership
3. More effective Finance Business Partnering

With a CoE, common **processes can be optimised**, controls strengthened and expertise and technology investment can be leveraged across the organisation.

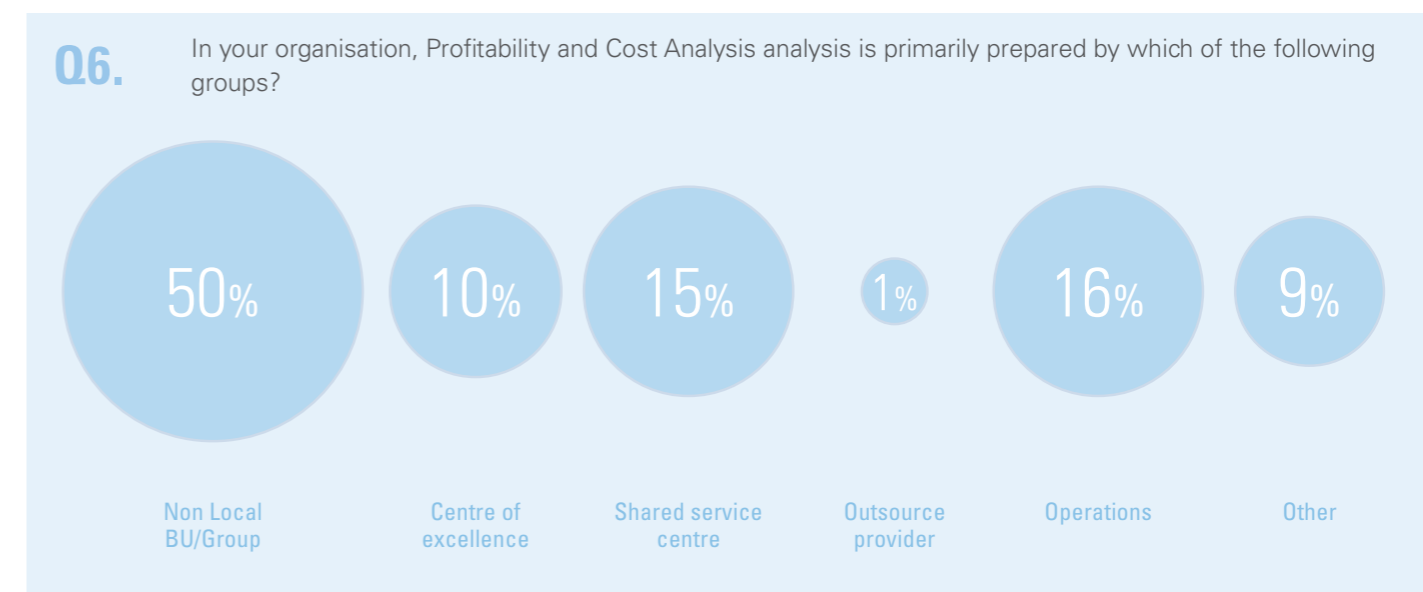
Over 50% of survey respondents highlighted process as a barrier to

effective cost allocations so clearly something is not working - this was second only to people and culture. Addressing the process challenge with a dedicated capability, which standardises and strengthens the approach across the organisation, can improve the chances of success.

Housing the key tools and data repositories, such as an enterprise information model, and consolidating data and processing in a CoE can support one version of the truth across the business and thus better insight to enable informed decision making.

A dedicated CoE can provide an effective bridge between Finance and the business, supporting **business ownership** in a way that is difficult to achieve when activities are performed in a Finance Shared Service Centre.

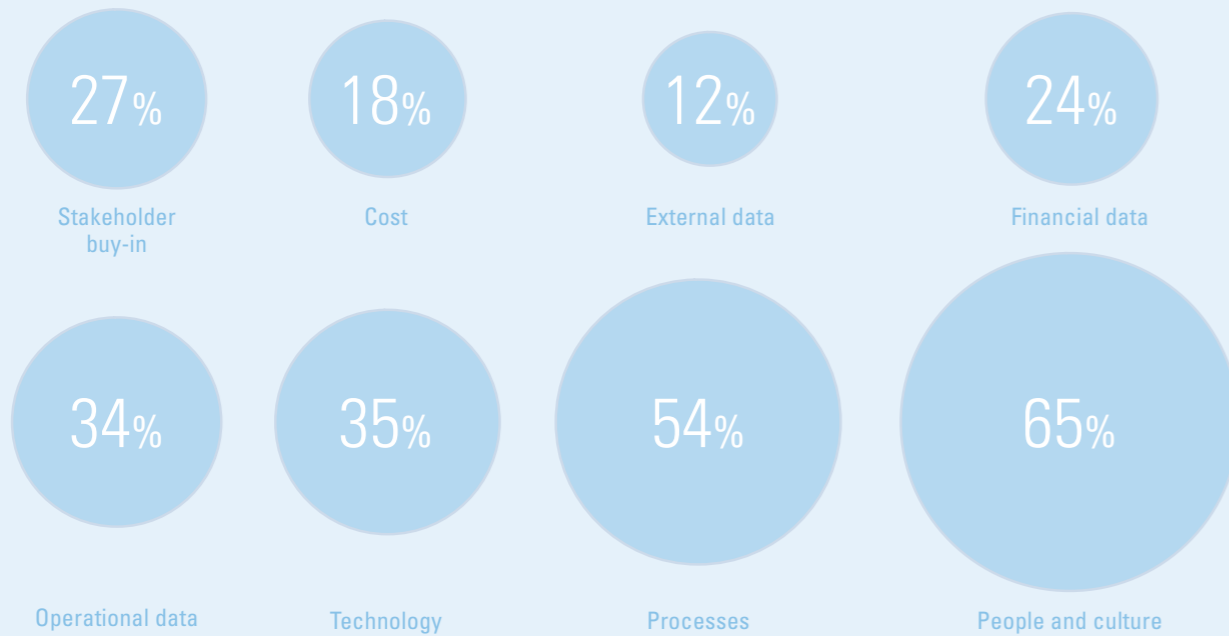
AN EFFECTIVE DELIVERY MODEL COMBINES STRONG BUSINESS OWNERSHIP WITH EFFICIENT OPERATIONS AND FOCUSED FINANCE DECISION SUPPORT



For Profitability and Cost Analysis to be trusted, clear and acted upon, the business areas that are expected to use this analysis to make decisions must play a key role. The dimensions and drivers must be owned by them and therefore meaningful. In this joint venture between the business and Finance - business areas own the data and insight but Finance, in particular the members of the CoE, are there to

ensure integrity and consistency of it. The transfer of the role of data governance to the CoE will provide the opportunity for retained Finance to now act as true business partners and work with the business to support strategic and operational decision making. This bridge is crucial to ensuring that insight drives effective action and competitive advantage is truly obtained.

Q7. In your organisation, which of the following do you feel are the main barriers to an effective cost allocation approach?



ORGANISATIONAL VALUE IS DRIVEN END TO END, THROUGH PROCESSES AND PRODUCTS SO WHY ARE FINANCE RESPONSIBILITIES NOT ASSIGNED ACCORDINGLY?

In our experience, where Finance has tried to do everything the desired outcome is often not achieved – the business users of the data do not understand or trust the insights, they may not feel bought-in to the approach or responsible for the benefits it can bring. Finance should not be seen as acting from the outside in but instead a key partner in supporting effective analysis and insight.

The interaction between Finance and the business on the delivery of Profitability and Cost Analysis insight can be thought of as a push and pull mechanism, Finance often “pushes” information to the business when a business “pull” approach is often more effective. Our experience suggests that in many cases Finance is willing to provide the insight the business requires but there is a misalignment in the way these requirements are articulated

and understood. This highlights a key challenge to be overcome in the business partnering approach.

There are also broad considerations for **Finance Business Partnering**. The development of a CoE can release time previously used on the production of management information to now focus on providing insight and driving business decision making. Effective definition of the Finance Business Partner role is important in order to allow Finance Business Partners to successfully offer business leadership and financial challenge.

A factor to consider when understanding the role of Finance Business Partners is the traditional cost centre structure that forms the basis of how they partner with the business. Responsibilities are all too often assigned based on traditional budgetary views rather than going

across end-to-end business processes or products. Operationally this represents how value is driven so why shouldn't Finance Business Partners align this way? Some Finance functions have overcome this by creating matrix business partnering structures which encompass both traditional and dimension based partnering models.

Each organisation is different and the most effective delivery model for Profitability and Cost Analysis insight will be dependent on a number of factors. Giving broad consideration to the needs and accountabilities of the business, the role of Finance Business Partners and how these are best enabled by the broader Finance organisation will support effective and efficient Profitability and Cost Analysis.

KEY ACTIONS

ESTABLISH BUSINESS OWNERSHIP AND CLEAR BUSINESS AND FINANCE RESPONSIBILITIES



CENTRALISE KEY TOOLS AND DATA REPOSITORIES IN A CENTRE OF EXCELLENCE



REFOCUS FINANCE BUSINESS PARTNERS ON PROVIDING INSIGHT AND DRIVING BUSINESS DECISIONS



CREATE A MATRIX BUSINESS PARTNER STRUCTURE WITH KNOWLEDGE ACROSS END-TO-END BUSINESS PROCESSES OR PRODUCTS





INVEST IN CREATING CAPACITY AND INCREASING CAPABILITY TO DELIVER REAL BUSINESS PARTNERING

Hayley Rocks | Senior Manager, KPMG Financial Management

The survey had some interesting findings for Finance Business Partnering; nearly 50% of Profitability and Cost Analysis is produced by BU Finance Teams or Group; considered alongside the fact that only 17% of respondents are getting the benefit they expected from a specific tool. This supports my view that Finance are still drowning in data and analysis and do not have the capacity to deliver real Business Partnering.

I truly believe organisations who invest in creating both capacity and capability to deliver real Business Partnering will outperform their competitors. Many Finance Organisations are too focused on short term efficiencies and cost reductions targets. CFOs have left the Financial Crisis no longer confident to make investment decisions that will not deliver short term tangible benefits. The fundamental issue is how do you quantify the benefit of a better decision in the future without a leap of faith?

Aside from the failure to provide a robust Business Case to develop appropriate Profitability and Cost Analysis, a key issue

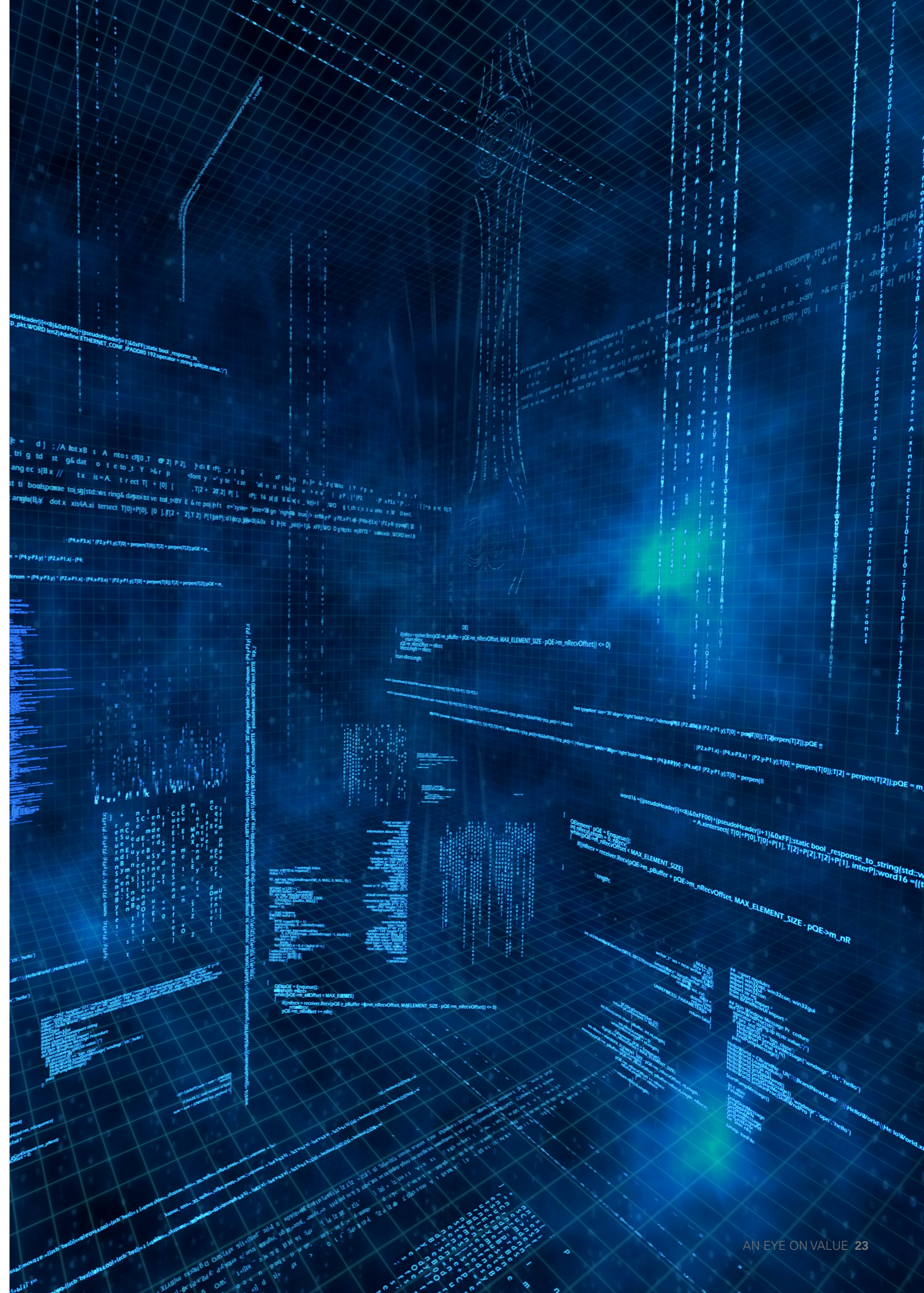
is capability: having the right people to effectively use this in the business.

To excel in this area organisations must focus on the capability of their teams. A team with capability and confidence to interpret this data and challenge Business Leaders is more critical in this area than any other. For most organisations this probably means making some tough decisions about existing Finance teams: who has the capability? Who can be developed? And who just isn't going to make the journey?

I believe Finance functions are failing to attract and retain talent with true capability to Business Partner. My own decision to join Finance was influenced by an attraction to this type of work. Yet I often found myself in front of a complex Excel spreadsheet for many of my working days with little time to interpret the information and discuss what it meant for the business. For me it's the interesting and exciting part of the job, being involved in decisions at the heart of the business: what should be we selling? Who should we be selling

to? What should we change? What will the impact be? Exposure to this type of information and the decision making process at a relatively early stage in their career is why I think some of the strongest performing CEO's come from Finance backgrounds. The progression opportunity Finance can offer to the most senior roles in the organisation is a key driver for attracting top talent.

Our survey respondents know the business needs this and would benefit from improvements but we still don't see the required levels of investment in this area. Without this, the goal to embed a culture where Finance is at the heart of decision making and is focused on strategic analysis will not be realised by many. Those who do achieve this will outperform their peers and attract the top talent to deliver real Business Partnering.



ABOUT THE AUTHORS



JOHN O'MAHONY

John leads the Enterprise Performance Management service offering in KPMG's UK member firm, which supports large, complex, multi-national organisations in transforming their Planning, Budgeting & Forecasting, Performance Reporting and Profitability and Cost Analysis processes.

Prior to joining KPMG, John spent nine years within industry, where he held several senior roles including Finance Manager and Divisional Finance Director positions with global blue chip firms.



JAMIE LYON

Jamie is the global knowledge lead for ACCA's activities and research on the CFO function, Jamie has contributed to numerous management and finance media including the Financial Times, Accountancy Age, Finance Director Europe, Finance Director Outsource Magazine and ITN as well as media around the world.

Before joining ACCA he qualified as an accountant and spent his formative career in industry working in the UK and internationally for leading FTSE 100 businesses.

ACKNOWLEDGEMENTS

We would like to thank the many people from KPMG and the ACCA who contributed to the report, including Lauren Newman and Vishal Mehta from KPMG's Financial Management team in the UK, Omid Tissier from ACCA and of course our Subject Matter Experts who provided valuable insight to complement the survey results and main body of the report (Nathan Doran, Gerard Harris, Oliver Haywood, Maurice Lips and Hayley Rocks).



Contact us

John O'Mahony

Head of Enterprise Performance Management, KPMG in the UK

T: +44 (0)7768 542 078

E: john.o'mahony@kpmg.co.uk

www.kpmg.com

Jamie Lyon

Head of Corporate Sector, ACCA

T: +44 (0)7736 630 682

E: jamie.lyon@accaglobal.com

www.accaglobal.com

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