What's driving profitability?

How profitability insights can improve the performance of your business.

KPMG New Zealand

kpmg.com/nz

The need for greater profitability insights

New Zealand businesses require an improved understanding of what drives their profitability if they are to position themselves more competitively for tomorrow.

Businesses face growing margin pressure as they battle to adapt, contain costs and grow. The pace of internal change is also increasing driven by technology innovation, shifting consumer preferences and increased competition.

To meet these challenges, organisations are placing trust in readily available information and long standing processes within their businesses.

This information, however, often falls short of being able to support actionable change and managers instead turn back to their intuition or make assumptions based on incomplete information.

This can often result in ineffective decisions and misdirected change.

Five examples of common assumptions made include:

1 Customers with higher revenue or sales volumes are assumed to contribute more to the bottom-line and therefore attract more marketing investment, sales investment and greater rebates or discounts;

2 Digital channels are assumed to be less expensive than traditional face-to-face or phone channels attracting project investment;

3 Product portfolios are commonly expanded based on a desire to provide a greater range to customers, without understanding the impact on profitability;

4 Process improvements are targeted based on management opinion rather than cost improvement potential; and

5 Pricing is set in response to the market without understanding product costs.

To make decisions with greater certainty requires a look beyond a traditional general ledger and towards a view that clearly shows how company resources are aligned towards future profit potential. Without this, businesses will continue to struggle to prioritise and set a clear direction.

CASE STUDY

Example of why businesses need these insights

A large construction and building supplies company faced increased margin pressures from competition entering the New Zealand market.

A customer profitability study was undertaken as part of a salesforce effectiveness programme to ensure that account customers were receiving an appropriate level of salesforce investment and that pricing was competitive and applied consistently across different regions.

The study took income statements from the largest stores and allocated revenue and operating expenses to each managed customer. Collectively this provided a single view of customer profitability across the business. The salesforce then provided their view on the future revenue potential in each account which was incorporated into the analysis to provide a forward-looking view.

The findings showed that a number of the largest customers by revenue, were some of the less profitable, mainly due to significant and inconsistent discounting applied by the salesforce. The analysis also showed that growth and retention investment was not aligned to future customer value. This provided an opportunity to apply these insights to grow the business.

Consequently, the profitability insights led to a 5% EBIT improvement across stores over a one year period.

The insights assisted in pricing renegotiations and standardisation across retail stores. Standard sales planning meetings were also introduced in a selection of stores, to draw on customer profitability insights and shift salesforce activities to customers with the greatest potential.

KPMG's three profitability lenses

KPMG's three profitability lenses clearly show how value is created, by a business's ability to respond to customer demand for products and services, across different channels.

Three lenses are required to understand how value is created by customers' demand for products and services across different channels.

PRODUCT PROFITABILITY

Product profitability provides a fully costed view of profitability across a product lifecycle. These insights are typically used to rationalise product portfolios or to identify areas of cost improvement.

01

CUSTOMER PROFITABILITY

Customer profitability provides a view of profitability by customer or customer segment. This allows a business to identify and prioritise customers that contribute the most to profits.

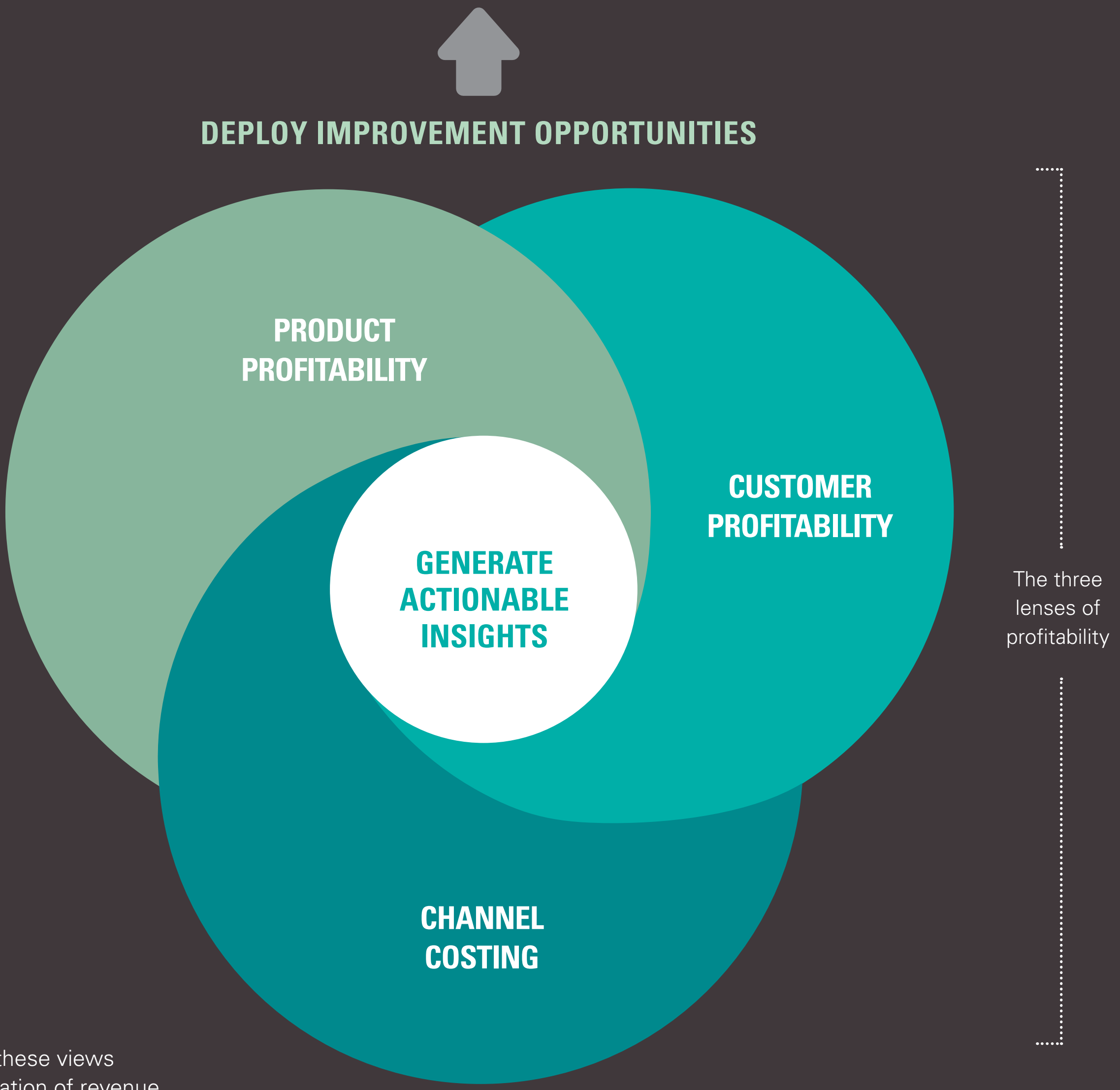
02

CHANNEL COSTING

Channel costing shows the cost of providing different services and activities over different channels. This is used to inform channel strategy and investment.

03

The three-lens process/theory



Development of these views requires the allocation of revenue and costs to customers, products and channels. Whilst revenue and direct costs are often straight forward to allocate, indirect costs are more difficult to allocate.

Allocation of costs to activities provides a missing link between the activities a business performs and the subsequent impact on customer, product and channel profitability. The result is actionable and targeted insight, which can direct business improvement to specific activities and measure the financial impact of changes to these activities.

Broad benefits realised

DRIVE PERFORMANCE IMPROVEMENT FROM ACTIONABLE INSIGHTS

These insights can lead to improvements delivering a benefit range of 6-13% EBITDA.

COLLECTIVE UNDERSTANDING OF PROFITABILITY

This analysis facilitates agreement between different business units on product and customer profitability.

IMPROVE FINANCE INSIGHTS

Finance departments have deeper insights to determine how operational performance and change affect profitability.

EMPOWERS FRONTLINE TO MANAGE CUSTOMER PROFITABILITY

This information can empower the salesforces to manage the profitability of customers at an individual level.

Self-check: Does your business have a good understanding of profitability?

Can you list your businesses' top three and bottom three products by profitability?

☐

Do you understand how many customers are unprofitable and the benefit of moving these customer to a more profitable relationship?

☐

Can you describe the key characteristics of your customer base that provide you with the greatest profit?

☐

Is sales and marketing investment focused on customer segments that have the highest potential to generate future profits?

☐

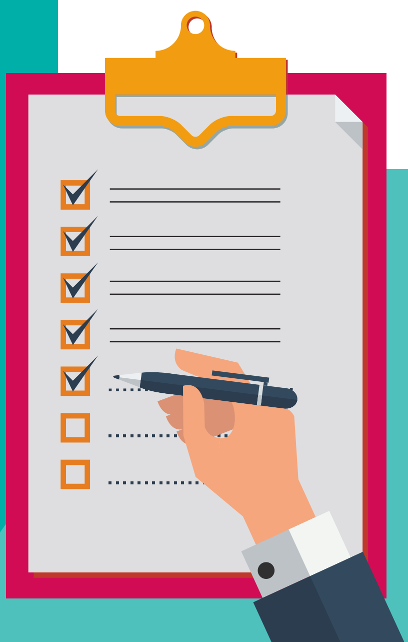
Of the channels your business adopts which is the most profitable and why?

☐

Does your channel strategy account for a complete view of channel costs (i.e. on-going direct and indirect costs)?

☐

Is pricing and discounting being used to drive customer profitability by the salesforce?



Does your business understand the cost of performing different business activities and how these impact the profitability of customers and products?

☐

Is your product portfolio rationalised based on an accurate view of product profitability?

☐

Insights reveal significant value

KPMG's profitability projects typically uncover improvements of between 6-13% EBITDA.

Significant and measurable improvements can be realised by investing in a profitability analysis. The list below provides a number of typical benefits that can be unlocked by these insights.

	BENEFIT	VALUE	RETURN
01 Improved pricing, discounting and rewards.	A view of current customer profitability will provide a price baseline and show inconsistencies between discount and reward policies.	» Manage pricing for less profitable customers; » Develop pricing strategies for different markets; and » Improve consistency of pricing and discounting.	1-3% **EBITDA**
02 Customer prioritisation and alignment.	A forward looking view of customer profitability will highlight the misalignment of salesforce and servicing investment to customers.	» Align sales activities to customer potential; » Ensure an appropriate level of customer care; and » Strategies to manage unprofitable customers.	1-2% **EBITDA**
03 Product rationalisation and decommissioning.	A view of product profitability can assist to rationalise product portfolios.	» Determine which products are unprofitable; and » Simplify product portfolios and remove associated business complexity.	2-3% **EBITDA**
04 Channel investment.	A view of service or activity cost across different channels provides the clarity required to guide channel investment.	» Clearer business cases to guide channel investment; and » Support of channel strategies.	**Determined on a case-by-case basis**
05 Product performance improvement.	A marginal product view of profitability can direct the business to areas of waste and improvement.	» Reduce non-value add waste across the product lifecycle.	2-5% **EBITDA**

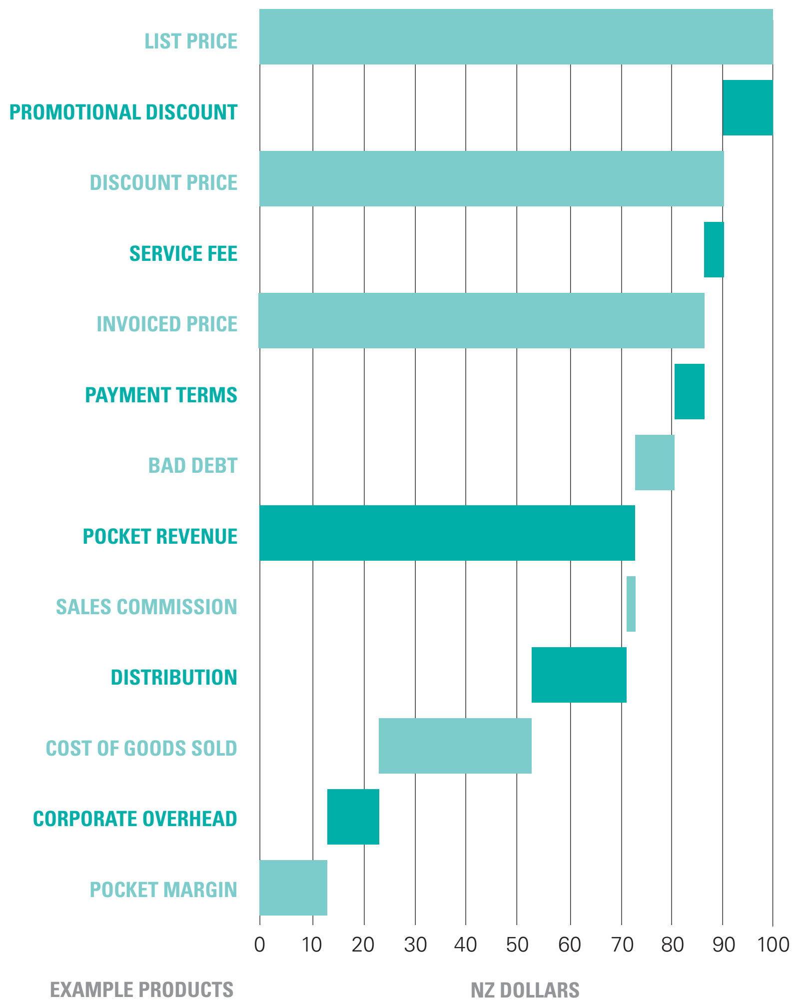
*Benefit range estimates are based on global KPMG experience

Example of types of insights

(Product performance improvement)

A marginal comparison of profitability by product provides valuable insights into how pricing, discounting and operational costs contribute to profits.

A waterfall chart is one way to visualise this type of analysis. It can be used to compare product costs with other products (internally or across similar businesses) to focus the business on pricing or cost improvement opportunities.



CASE STUDY

Financial services cost optimisation programme

A financial services client in New Zealand was looking to streamline its business by improving the cost performance of different products and channels.

The project worked across the business to understand how activities consumed costs. The team then used KPMG's profitability tool to allocate activity costs to customers, products and channels. This allowed the team to create a multidimensional view of profitability.

The final analysis was presented to the Executive team to inform business strategy and to focus improvement opportunities.

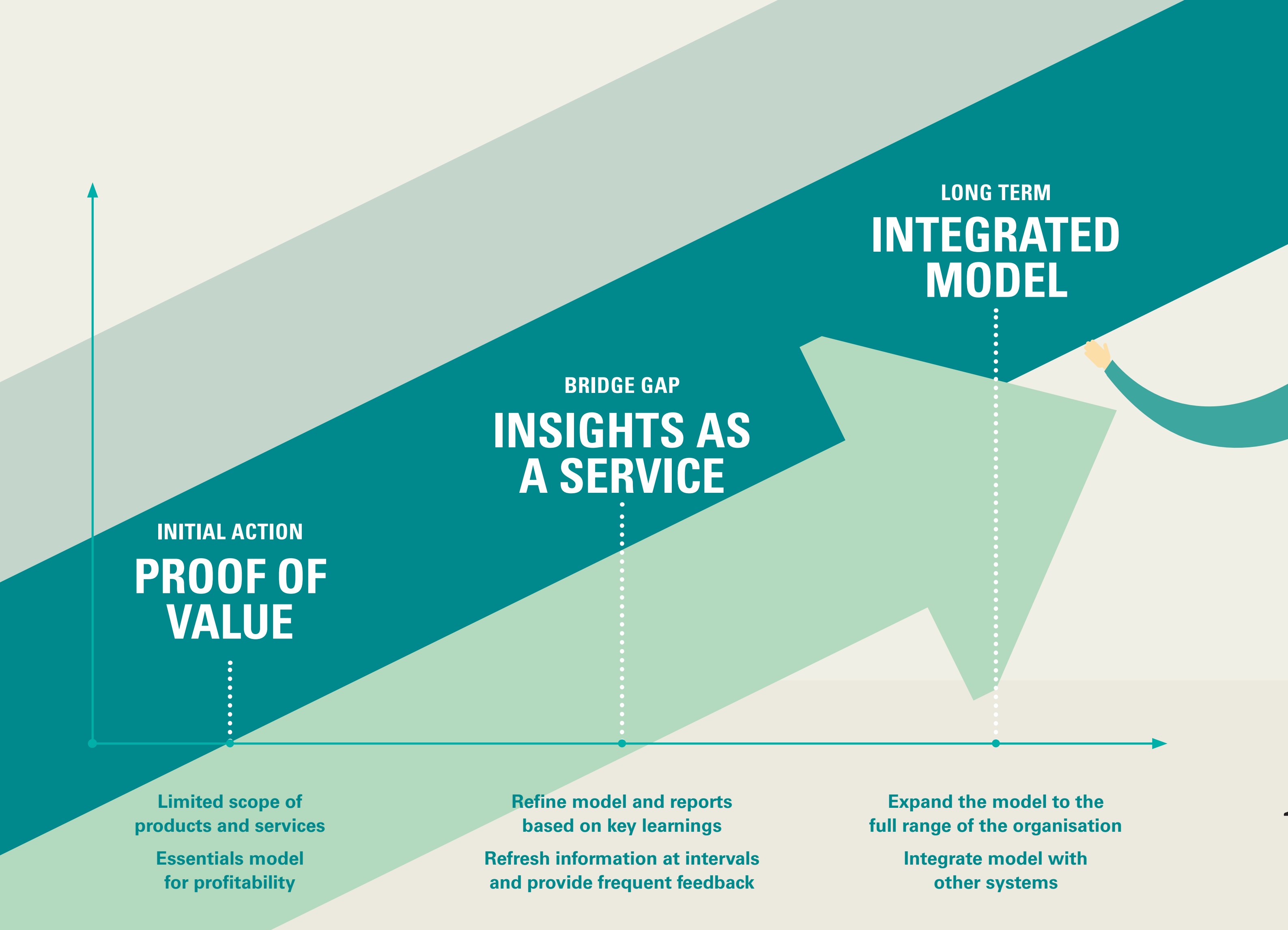
These insights supported the development of a broader channel strategy and led to various process improvements and product rationalisation initiatives.

How KPMG can help

KPMG enables you to rapidly develop profitability insights, and provides you with a roadmap to sustaining a long-term solution.

An initial proof-of-value will enable your business to generate and action insights quickly, before embarking on a longer term solution. It will allow your business to tailor the insights generated to ensure that they meet the needs of the business and demonstrate the usefulness of the insights.

The proof-of-value can be deployed within five to fifteen weeks, depending on the scope of the insights needed, the scale of the business and the quality of information available. The model can then be updated at regular intervals by your staff or by KPMG, as an ongoing service.



What KPMG's expertise can offer?

Experience: Profitability studies require strong finance, modelling and strategic skillsets to develop the model and draw out the right insights. You will require a team with a broad understanding of business activities. We offer a team with broad business knowledge and experience of successfully completing these types of projects.

Plug 'n Play analytics: KPMG will bring a profitability tool and reporting that you can plug your data into, to quickly to gain insights. We provide an on-going service to refresh the data and provide ongoing insights and measurement.

Cross business collaboration: KPMG's approach ensures that the method and conclusions are well understood by the business. This approach has successfully brought business units together to form a single view of customer, product and channel profitability across the business.

A sustainable solution: We work with your team on the proof-of-value project to ensure that they become experts in allocating revenue and costs to business activities. They can then continue to provide this expertise to the business.

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