Building
Tomorrow's Enterprise

View Point

Cost and Profitability Management:

Gaps in traditional costing systems and how they can be overcome

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Abstract

Management is always under pressure to select the best alternative to maximize the profit and thus shareholder value. This requires a thorough understanding of all the factors that drives a company's profit as well as cost. This demands for a system that not only provides actionable insights into the cost and profitability but also provides simulations to test the strategy.

This viewpoint discusses how an analytical cost and profit management system like SAP PCM can fill the gaps in traditional costing systems. It also delves into the features and limitations of SAP PCM and how it compares with some of the other leading products in this space.

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“Operations claim that the plant efficiency has improved by 40 per cent in the last three years; but on the contrary our profit margin has dipped from 20 percent to 10 per cent. I wonder where all that ‘efficiency’ vanished!” [1] This is a typical problem faced by CFOs of many companies. While the companies improve or thinks they improve operational efficiency, the bottom line continues to be in pressure. Accurate cost and profit management is needed to fill this missing link between finance and operation.

Today profitability is one of the most important KPIs for the office of the CFO. Despite this, many of them think that their costing numbers are not accurate, or not sufficient, or not actionable, and hide more information than they reveal. If we go by research reports conducted by leading analysts, a considerable number of companies agree that their current profitability management and reporting landscape has some or the other limitations. Most of these limitations revolve around the degree of automation, responsiveness and flexibility, ease-to-use and level of detail.

We discuss below how a cost and profitability management tool like SAP BusinessObjects Profitability and Cost Management (PCM) can help organizations take care of these issues. We also provide our views on the maturity of the product, its strengths and limitations as well as the path ahead.

What are SAP customers doing for Cost and Profit Management?

The Controlling (CO) module of SAP ECC 6.0 is one of the most comprehensive offerings for cost and profit management. The tight integration of CO with all the other modules of ECC namely FI, SD, MM, PP, PS makes sure that all the financial, sales and expense entries get collected in the CO module. The integration aspect as well as the rich features of the tool has made it a tool of choice for most of the cost and profit management aspects. These are standard costing, inventory valuation, budgetary controls and profitability analysis to name a few.

However, there is a need to look beyond SAP CO in many cases where:

- Data is to be collected from heterogeneous sources
- A more accurate overhead cost analysis is required taking an activity based costing approach
- Cost analysis for cross-charging of shared services has to be performed
- Business processes don’t match with SAP CO processes and need a significant level of customization
- Decision making and what-if simulations are key requirements
- Flexibility of cost modeling is required
- Business wants to own the system

Here, a specialized tool like SAP BusinessObjects Profitability and Cost Management (SAP PCM) can be looked at to fill the gaps in the SAP CO offerings.

[1] *Hypothetical numbers*

SAP BusinessObjects Profitability and Cost Management (SAP PCM) Offerings

Evolution of SAP PCM

SAP PCM brings with it a rich history of innovation. It was the flagship product of Armstong Laing Group (ALG), a company founded in 1991 where it evolved into a robust tool for all activity based costing and driver based planning requirements over the next 15 years. In 2006, Business Objects acquired ALG and positioned it with its own Enterprise Performance Management (EPM) stack. With SAP’s acquisition of Business Objects, ALG came into SAP’s Business Objects EPM portfolio. SAP renamed this as SAP BusinessObjects Profitability and Cost Management and invested in its integration with SAP BW, ECC, other SAP EPM products and non-SAP systems. The current version PCM 7.5 is currently in ramp-up and should be available on the shelf soon.

PCM advantage

As PCM has evolved outside SAP, it is different from SAP’s typical products in many aspects. It has got better and intuitive user interface; offers the flexibility; and can be owned by business without much IT support. It is however, still similar to other SAP products in the way that it provides best-in-class functionality for its offering area.

Some of the key PCM features are listed below:

Inbuilt ABC engine: Many companies have found the cost and complexity of implementing Activity Based Costing (ABC) prohibitive. SAP PCM comes with an inbuilt ABC engine. This lets companies implement ABC and still remain insulated from its complexities. Just by configuring the PCM Model Builder, they are ready to use ABC. This in-turn saves cost, effort and time that would have gone in developing these ABC logics in-house.

Transactional costing: Some companies want to perform cost and profit analysis down to a very granular level, say sales order line item level. Transactional costing is a unique offering from PCM that enables analysis to a very high level of detail.

Data integration with heterogeneous sources: PCM 7.5 can source data from any SAP or non-SAP system. The data integration is possible using SAP PCM Data Bridge or SAP BusinessObjects Financial Information Management (FIM) 7.5. Data Bridge is suitable for integration with SAP BW, RDBMS and flat file, while, SAP FIM is a web service based ETL that can be used with almost any source systems

Data input, validation and correction: It is possible to create web reports for manual data input, validation and correction. With this feature business can input manual data or correct erroneous data. The audit trail feature maintains details of all the manual changes for auditing and compliance.

What-if simulations: This feature enables the decision maker to model various scenarios and perform what-if simulations. For e.g. A sales manager can simulate multiple what-if conditions and choose the best strategy to make a loss-making customer profitable; An operations manager can use these features to simulate the expected benefit of an improvement initiative etc.

Native reporting tool: PCM comes with its own reporting tools - Book Manager and Book Viewer. Book Manager can be used to create reports for ad-hoc analysis. Book Viewer can be used to share it with other stakeholders either over web or by downloading it into a pdf. This reporting tool is excellent for ad-hoc reporting. For enterprise analytics, it is advised to load the PCM result data into the enterprise datawarehouse (EDWH) and perform reporting from there.

Driver Analysis: This ensures that management focuses on planning drivers that really matter to the business by allowing users to test the impact of resource and activity drivers on the input and output costs. This functionality uses the existing ABC allocation by reversing them and can also be used for driver based planning and budgeting.

Note: Driver-based planning is a methodology to identify and manage the true drivers of organizational financial success. Its purpose is to deliver to the management a more accurate picture of future business performance, using key operational activities that drive corporate performance. For e.g. consider a manufacturing company where management proposes that investing in supervisors training will reduce cost of inspection and cost of servicing warranty. In the driver based planning scenario, management plans to increase number of training offerings by 50% and thus expect 20% reduction in number of inspections and 10% reduction in number of warranties invoked. The planners enter the driver values – planned number of trainings, forecasted number of inspections and warranties invoked into PCM. PCM, then, proposes the budget for Training, Quality and Post-Sales Service departments taking these drivers into account.

Benefits to Business

SAP PCM provides significant business benefits, the most important ones are as follows:

Insights for better management of cost and profitability: PCM analyzes overhead cost taking an activity based costing approach. This leads to more reliable and actionable information. PCM enables companies to track cost and profitability at a very detailed level.

Flexibility: PCM offers flexibility to model a costing system, build custom reports and input manual data. This helps organizations become responsive to the changing external and internal business scenarios.

Supports decision making: PCM provides actionable insights which support decision making. These decisions can range from operational to tactical to strategic. It can be operational - if the profitability analysis has to support a day to day decisions like - is the sales order profitable or can a discount be offered on customer's request and still maintain margin? We call it tactical if it is to segment customers based on profitability or to identify the best product. It is strategic if it helps us identify the right investment opportunity. Business users can use simulation to choose the best options among the alternatives.

Aids in planning process: PCM Driver Analysis can support the planning process by suggesting the input cost based on the planned drivers.

Business owned system: PCM can be owned by business with minimal support from IT. This gives the power of information in the hands of the team that is going to use it.

Reduced TCO: Faster implementation coupled with reduced training and IT maintenance costs significantly reduce the TCO.

Integration of SAP PCM with other EPM tools

PCM is positioned as a part of SAP BusinessObjects Enterprise Performance Management (SAP EPM). It plays a very crucial role in EPM and interfaces (as depicted in Fig 1) with all the other EPM tools, to illustrate a few examples:

SAP SSM: PCM can interface with SAP BusinessObjects Strategy Management (SSM) by providing information about KPIs linked to operations (like operational efficiency), finance (like profit margin) and sales (like customer profitability).

SAP BPC: PCM can interface with SAP BusinessObjects Planning and Consolidation (SAP BPC) and support the planning process and monitoring of the plan. BPC based plans can be tested and improved using the PCM driver analysis. Driver based planning enabled by PCM can augment the BPC based planning to use the best features of both the tools.

SAP SCPM: PCM can also interface with SAP Supply Chain Performance Management (SAP SCPM) by providing inputs about profitability of supply chain channels and partners.

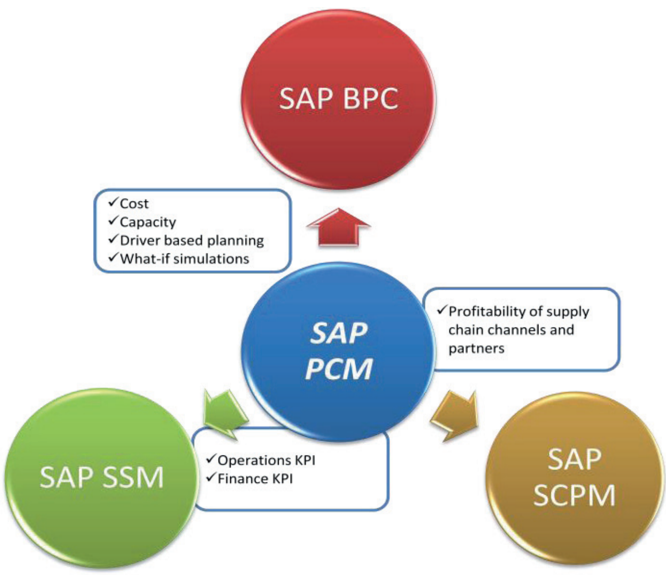

Figure 1: SAP PCM interfaces with EPM tools

Limitations and way forward for PCM

PCM has traditionally been among the market leaders in the area of analytical cost and profitability products. The tool has been enhanced with additional features since it has come in SAP's fold. For e.g. The current version PCM 7.5 now provides rich ETL capabilities by modifying Data Bridge to load data from multiple sources, this version also works on a Windows 64-bit server which significantly improves performance.

SAP PCM has a few limitations and it will be interesting to see how SAP improves the features of PCM to consolidate its leadership position. Some of these limitations are listed below:

Integration with other EPM tools: PCM can be loosely integrated with other EPM tools either through SAP BW or FIM. The purpose of closed loop performance management will be better served if SAP provides a single platform for PCM and other EPM tools.

Limitation on number of cost objects: Up to five cost objects can be defined in PCM. That means the cost and profitability analysis can be done for up to five cost objects. Though this could be sufficient for most of the business requirements, this restriction should go sooner than later.

Industry solutions and business content: Customers always value a solution more than they value a tool. There is potential to build pre-configured content for different industry verticals and SAP should consider this on priority.

Need for still better user interface: The user interface of PCM is easy and intuitive compared to the traditional SAP products. However it is still somewhat complex for non-savvy business users as compared to the other best-in-class EPM tools.

Other leading products in this space

For customers who are open to looking beyond SAP, there are competitive offerings from other vendors as well. Two prominent competitors are ACORN systems and SAS Activity Based Management (SAS ABM).

ACORN systems doest have any limitation on the number of cost objects. It provides excel based user interface which is more acceptable to the business users and comes loaded with industry solutions and other accelerators that shorten the implementation cycle. Its unique feature is its on-demand offering, which is very attractive for organizations that want to convert their capex into opex or that want to run it on pilot for few months. Moreover, this also provides good integration with non-SAP and SAP systems. ACORN systems had a reseller agreement with SAP till 2007 and even is a SAP Software Solution Partner as well as SAP xApps certified solution. In our view, this provides a credible alternate to SAP PCM.

SAS ABM also has a strong offering in this area. Its strengths include excellent integration with SAS Strategic Performance Management and other SAS EPM tools. This also provides good ETL capabilities, activity based budgeting capabilities and standard reporting templates. Many research reports have evaluated this among the best tools for cost and profitability analysis.

There are other good tools from Oracle, Tagetik and niche vendors which may address some unique requirement as well. None of these tools, however, provide for integration with all SAP EPM products and hence a complete closed loop performance management in a SAP centric landscape.

Summary

Cost and profitability analysis is one of the most important KPIs for the CFO's office and most CFOs feel that they need to have a better understanding of their cost and profitability numbers. While SAP CO provides a comprehensive offering by being part of the transactional system (SAP ECC), SAP PCM fills the gaps by being an analytical tool specializing in activity based costing and profitability analysis. SAP PCM can help organizations reduce manual effort in performing cost and profitability analysis, enable cost accountants to respond to management requests, provide sophisticated ABC processes and offer as much detail as desired.

PCM is positioned as an EPM tool and interfaces with BPC, SSM and SCPM for closed-loop performance management. While PCM has its limitations, like other tools in this space, we expect further integration and improvements in the versions to come. Customers with a SAP centric landscape are recommended to consider this product to improve their profitability and cost management.

About the Author

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