

Profitability and Performance Management

How efficiently can you track the profitability and cost management of your services and operations?

As experts in delivering solutions for Analytics, Planning, Consolidation and Reporting we can assess and help you defining flexible profitability models.

A powerful solution that address the objectives of an optimal profitability model is SAP Profitability and Performance Management (PAPM). This tool is built on SAP HANA and empowers teams and decision-makers with clear insights on:

- how their business runs and is being feed
- understand, control and manage cost drivers
- how value is generated and can be optimised

SAP PAPM's models can be quickly built, personalised, tested and simulated by end users. Data from multiple sources can be used to calculate results swiftly without data replication. It is also capable of performing complex calculations in just second and it is fully transparent, traceable and auditable.

1. Case Study

One of the most common uses of PAPM is the cost allocation. This paper covers an example of a cost monitoring program scenario using PAPM.

Global company MS¹ is a global entity present in 4 geographical areas, with 43 offices worldwide. Part of its Opex (15% as of Jun2019, circa CHF100m) is cost run by the HQ.

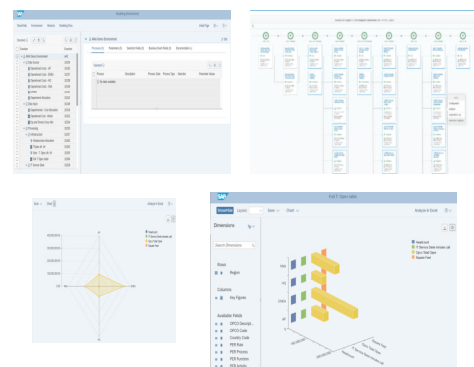
The geographic distribution and the breakdown of Opex is presented below:

About the author

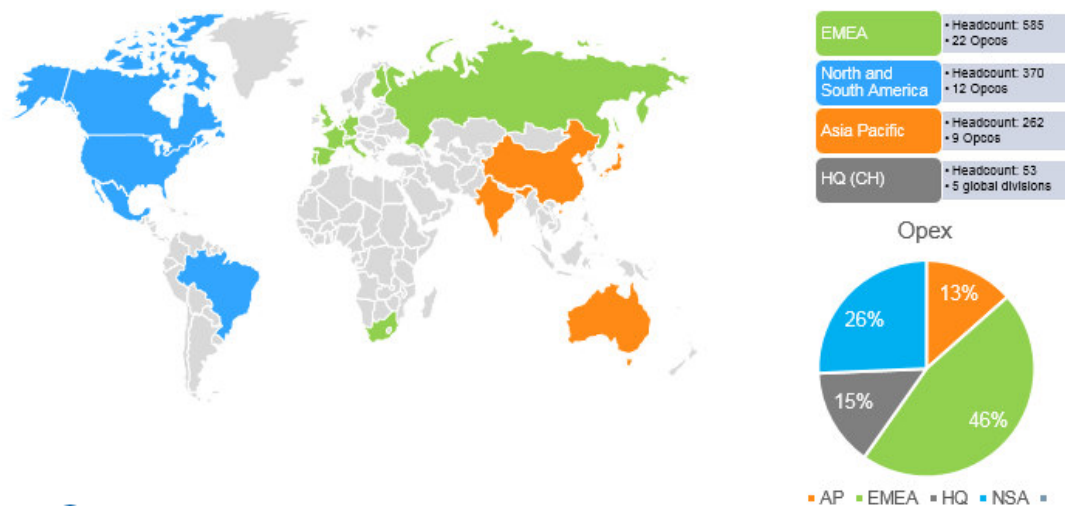


André Almeida

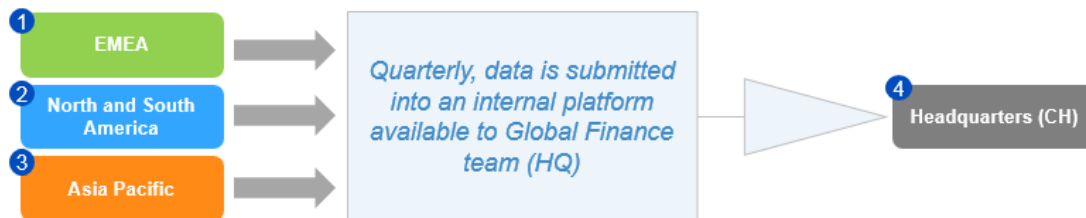
André is a Manager at Stampa Partners and Chartered Fellow of the Chartered Institute for Securities & Investment MCSI. He has over 10 years of international experience advising and auditing clients in Africa, Europe and Middle East. As a consultant, André developed expertise in finance transformation, process optimization and regulatory and internal reporting.



¹ MS is a fictional company only used for the presentation of this case study.



Each main regional office submits on a quarterly basis information on their operations into an internal platform. This information is processed by the Global Finance team.



More recently, MS started a cost monitoring program. One of the objectives of this program is to gradually narrow salary gaps between top paid and lower paid employees. Recent media coverage has put greater scrutiny on how companies distribute income to workers.

MS uses the regional office data to allocate overheads to its local operations using a waterfall structure.

The allocation process supports the pursuit of those goals:

- **Infrastructure** → country's headcount as proxy
- **IT Service Desk** → charges (number of minutes) per call to IT Service Desk
- **HR Costs** → Salary x Salary GAP x Headcount as a proxy
- **Admin expenses** → Operating expenses

In order to speed the process and reduce effort and risk of the manual solution in place, MS decided to adopt SAP PAPM (PAPM). How will this tool use its features to address MS objective efficiently?

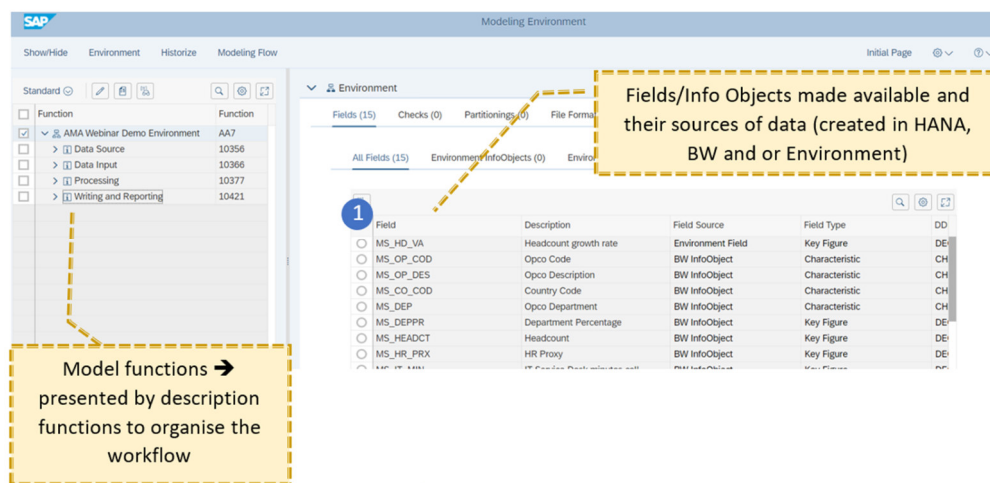
Process and Build Up

→ Phase 1 - Adding and aggregating units

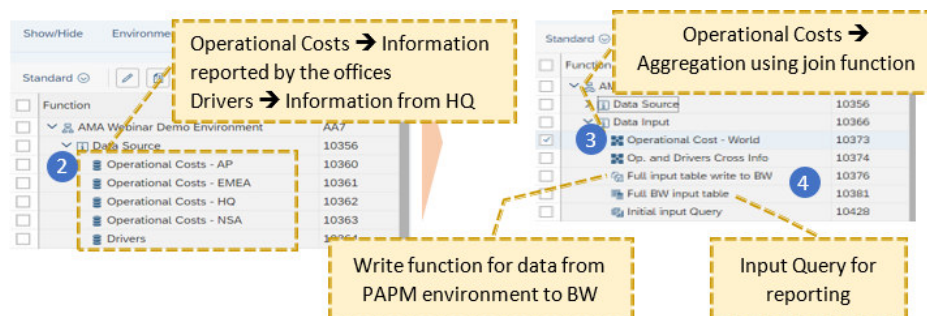
SAP PAMP contains a broad set of functions that can be used for different purposes. This allows the user to build a scenario from scratch, define the allocation drivers and analyse the results at the end of each round.

When starting PAMP, MS can access the modelling environment as well as to the defined processes, activities and reports. In this case study only the first is presented. Main steps were followed:

1. MS defined the info objects in HANA (in alternative MS could have done it directly in the Environment):



2. Data sources were received from the 4 Main Offices (reported by the 43 local offices) and financial data on cost to be allocated from the Headquarters;
3. MS aggregated all the sources (info from Offices) and drivers (info from HQ) using a **join function** (i.e. Op. and Drivers Cross Info);
4. MS transform the resulting table into a Model BW using a **writer function** and use the result as an input query for reporting purposes (i.e. Initial Input Query):



→ Phase 2 – Processing inputs

With the aggregation concluded, MS will now process this information:

1. MS creates a processing functions structure for each phase of the allocation, starting with the infrastructure costs;
2. MS defines the input to be used in the allocation (i.e. sender);
3. MS defines the rule of allocation. For infrastructure Costs, the defined driver is country's / office Headcount:

Allocation function to distribute Infrastructure Costs to local offices

Selection of sender info to be allocated

Headcount as the distribution base

Function List:

Function	Function ID
Webinar Demo Environment	AA7
Data Source	10356
Data Input	10366
Processing	10377
Infrastructure	10378
Infrastructure Allocation	10379
T. Opex aft. Infrs	10387
T. Opex aft. Infrs	10388
Full T. Opex table af. Infrs	10390

Configuration Details:

- Allocation Type: Default (Allocation)
- Include original In...: Default (No)
- Result Handling: Default (include enriched data)
- Suppress initial R...: Yes
- Periodic: Default (No)
- Value Adjustment: No Adjustment
- Result Model Table:

Input Function: Full BW input table

Rule Details:

Rule	Description	State	Rule Type	Distribution Base	Sender Value Fields
R1	Rule 1	Default (Active)	Indirect	Headcount	

Sender Rule: Posted Amounts

Sender Share: 100.00

Mapping Method: Default (Empty as value)

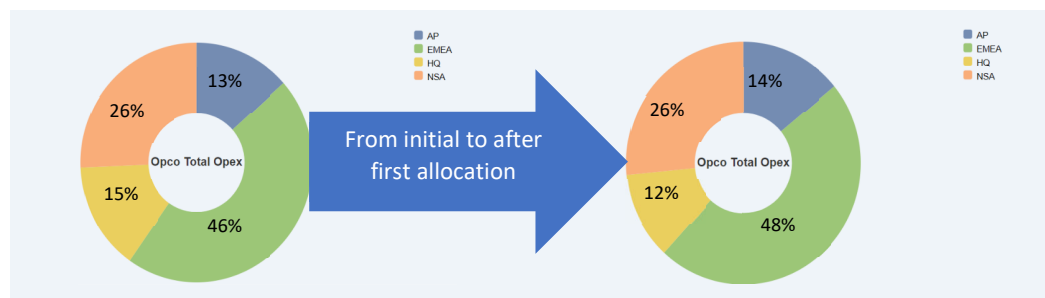
Finally, MS will concatenate this result (i.e. value of infrastructure cost per office) with the resulting table of phase 1, i.e. Full BW input table using a join function. This step will generate a table containing all the relevant information and includes the Infrastructure cost allocated. This last table will then be used as an input for the remaining allocations (IT Service Desk, HR Costs and Admin Expenses).

As these allocations follow the same principle they are not presented in this paper. However, you can see them in our Webinar available online.

Results

The first allocation round presented the distribution of HQ's Infrastructure costs which amount to circa CHF 20m. The allocation of Infrastructure cost will use the proportion of the chosen driver, i.e. Local office's headcount. The allocation result is the following:

Initial Situation				Allocation of HQ costs to local Opco's according to Headcount		
MS_OP_COD	MS_OP_DES	MS_HEADCT	MS_OP_TOPEX	INF Allocation %	INF Allocation	Total Opex (After 1 st Allo.)
OP_0001	Head – Exec	5	29,872,115	0.40%	82,433	29,954,548
OP_0002	Head – Finance	10	21,995,918	0.80%	164,867	22,160,785
OP_0003	Head – HR	7	13,428,240	0.56%	115,407	13,543,647
OP_0004	Head – IT	12	13,868,950	0.96%	197,840	14,066,790
OP_0005	Head – Infrastructure	19	20,624,847	0.00%	-	-
OP_0101	Australia – Perth	18	13,505,289	1.44%	296,760	13,802,049
OP_0102	Australia – Sydney	19	14,107,857	1.52%	313,247	14,421,104
OP_0201	Belgium – Brussels	32	21,390,907	2.56%	527,574	21,918,481
OP_0301	Brazil – Rio de Janeiro	27	7,659,733	2.16%	445,141	8,104,874
OP_0302	Brazil – Salvador	15	3,826,206	1.20%	247,300	4,073,506
OP_0303	Brazil – São Paulo	48	13,453,543	3.84%	791,361	14,244,904
(...)	(...)	(...)	(...)	(...)	(...)	(...)
TOTAL	-	1.270	684,265,796	100%	20,624,847	684,265,796

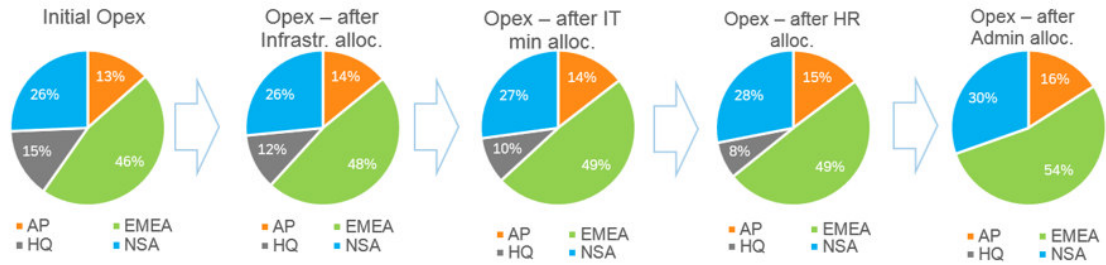


The first allocation round used 3% of MS's total cost and impacted more on Asia Pacific with higher proportional headcount.

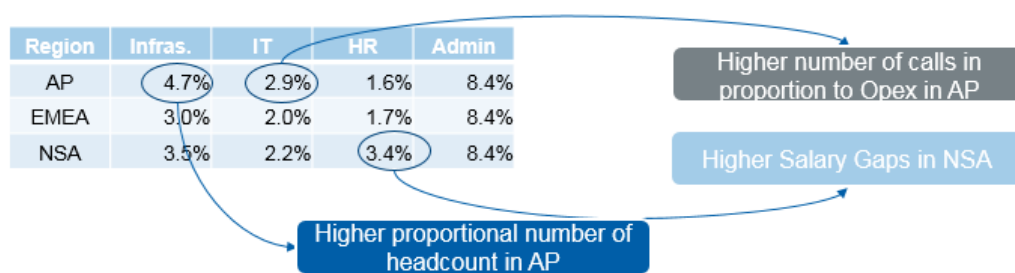
Following a waterfall structure in SAP PAPM, MS will allocate the remaining HQ's costs and drivers:

- IT Service Desk → charges (number of minutes) per call to IT Service Desk
- HR Costs → Salary x Salary GAP x Headcount as a proxy
- Admin expenses → Operating expenses

The Opex allocation results at end of each round were the following:



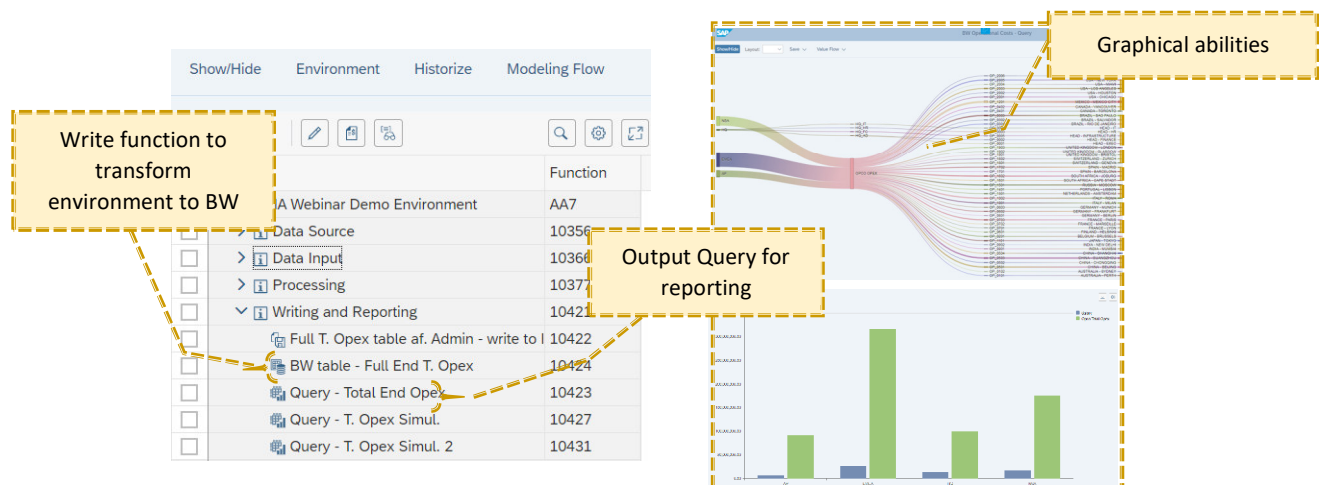
The weight of HQ costs in the structure of MS decreased gradually from 15% until 0% at the end of the four rounds of cost allocation. This process impacted more heavily in Asia Pacific (+18.7%), followed by North & South America (+18.5%) and EMEA (+15.8%). Partial impacts were the following:



The impact of each round impacted differently each region:

1. Infrastructure costs impacted more Asia Pacific as it has the higher proportional headcount;
2. IT Service Desk costs impacted more Asia Pacific as the region with higher number of Service Desk calls;
3. HR costs impacted more the North and South America region as it presented higher salary gaps than the other three;
4. Admin expenses impacted equally.

Using SAP PAMP, MS can analyse the distribution of flows of its several graphical representations including Volume Flows at the end of each round:



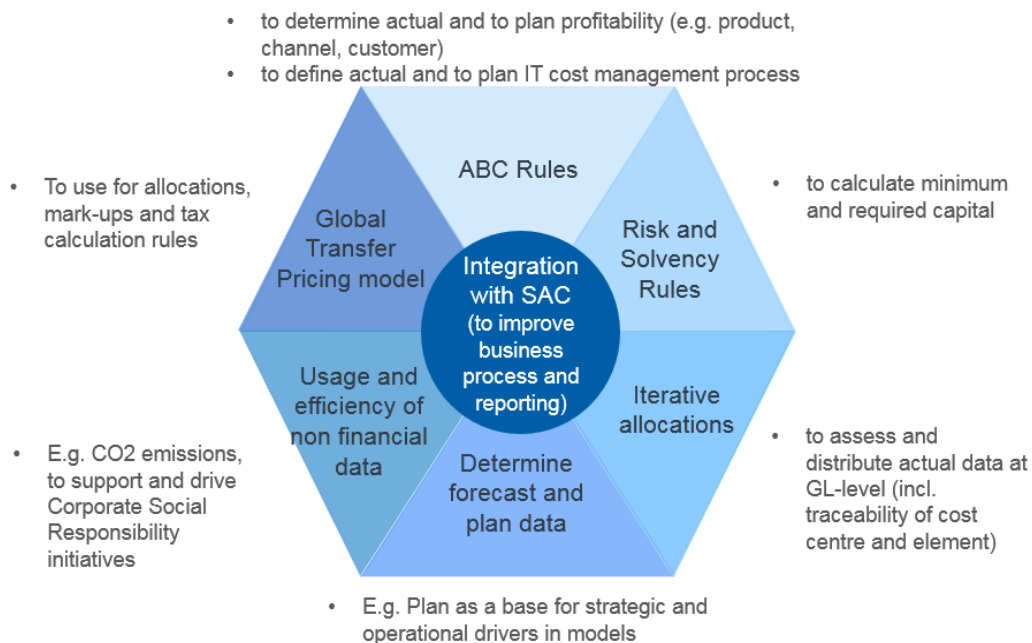
Integrated queries and reports allow for analysis of current data and generated results

SAP									BW Operational Costs - Query	
Show/Hide		Layout:		Save		Data Grid				
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Region	Opco Cost T...	Opco Code	Opco Description	Cou...	Headcount	Salary	IT Service Desk min...	Opco Total Opex		
AP	OPCO OPEX	OP_0101	AUSTRALIA - PERTH	AU	18,000	1,114,900,000	2,555,000	13,505,289,000		
		OP_0102	AUSTRALIA - SYDNEY	AU	19,000	1,154,400,000	2,924,000	14,107,857,000		
		OP_0501	CHINA - BEIJING	CN	48,000	623,480,000	7,692,000	9,892,544,000		
		OP_0502	CHINA - CHONGQING	CN	70,000	738,570,000	4,088,000	4,185,714,000		
		OP_0503	CHINA - GUANGZHOU	CN	55,000	710,090,000	10,337,000	11,832,036,000		
		OP_0504	CHINA - SHANGHAI	CN	40,000	500,500,000	5,707,000	8,152,853,000		
		OP_0901	INDIA - MUMBAI	IN	19,000	185,740,000	2,757,000	3,214,858,000		
		OP_0902	INDIA - NEW DELHI	IN	13,000	130,000,000	1,768,000	2,226,187,000		
		OP_1101	JAPAN - TOKYO	JP	30,000	2,250,462,000	3,900,000	24,976,681,000		
		Result			262,000	6,909,142,000	41,728,000	92,094,019,000		
Result			262,000	6,909,142,000	41,728,000	92,094,019,000				
	OP_0201	BELGIUM - BRUSSELS	BE	32,000	1,600,000,000	4,160,000	21,390,907,000			
	OP_0601	FINLAND - HELSINKI	FI	20,000	1,436,800,000	2,600,000	16,263,479,000			

2. Profitability and cost management as a tool

SAP P4PM is a powerful and flexible solution that can empower users to build up models that support business decisions. You can use this tool for several uses which can increase significantly the ROI of this implementation.

Examples:



Cross Industry Profitability

PAPM enables users to optimize profitability by providing deep insights into granular revenue and cost information at any customised level (e.g. product, service, channel, customer).

You can use in all types of industries:

1. **Oil & Gas:** Profitability of upstream that focuses on extraction of crude oil and natural gas, on refining, trading and distribution in Downstream of business units
2. **Banking and Insurance:** Profitability of each back office or front office activities, according to the business division and region
3. **Healthcare:** Profitability of hospitalization, medical screening, laboratory analysis, surgery and pharmacy
4. **Lifesciences:** Profitability of pricings, and the impact on profitability of considering legal aspects and by applying quality control resources
5. **Manufacturing:** profitability of production process (e.g. of industrial machinery, heavy equipment, industrial components, laboratory instruments, semiconductors, among others).

ABC Costing

PAPM allows to cross-charge direct and indirect costs using allocation processes and by applying activity-based costing (ABC). As an example, you can perform an ABC model, incorporating a set of activities to actual, planning and forecasting data for a product and / or service profitability. With this model setup you can then run a what-if simulation.

You can also do the same for your shared services in IT and HR. As an example, within healthcare sector, you can allocate costs of your services to procedures, physicians, facilities, diagnoses and patient, thus enabling drill down to the most detailed level. The complete calculation of the cost model is available including input/output values of each process step. On top of that, you can run allocation processes not only for actual data, but also for planning and forecast data.

3. Controlling and Metrics

Controlling

PAPM can be used for project-based planning and controlling for different types of activities and businesses. For example, for constructing companies, it can be a relevant tool for project management and supervision of residential, commercial, industrial or civil construction and engineering.

Metrics

PAPM is a tool that can handle specific metrics and reports for any type of industry. Well designed, it can provide a complete multidimensional P&L at granular level.

- Calculation of activity data
- Assignment of GL accounts to resources
- Allocation of resources to activities, activities to services and service groups, products and services to customers and subscriptions and of marketing costs to processes, campaigns, customer groups and products and services
- Value flow report (as presented in our case study), which gives the user end to end traceability from resources through all applied drivers to the result.

PAPM is also a flexible and strong tool to handle any relevant metrics / ratios, such as:

- Net profit margin per dimension
- Net working capital
- Inventory turnover
- Cost of services, supplies and other areas of operations on a per case basis

This is relevant for any business user that pretends to use the tool to support business decisions and comply with reporting. The user can use it as a planning tool, but also to measure defined ratios, identify and reassess target ranges for ratios to maximize how resources are been used, to realize overhead optimization, optimize the supply chain and fulfil with broad regulatory reporting requirements for compliance with regulatory bodies.

We also organized a Webinar on this case study. If you are interested please check our website where you can find the link or contact us.

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We at Stampa & Partners have an extensive track record working with CFOs and supporting organisations in Europe successfully digitalise finance functions, leverage analytics and ensure compliance with new accounting standards. Therefore, we can advise your business with the best solutions to fulfil your goals.

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