



CIMA BiteSize Briefing
Pruning for Profit

16 July 2010

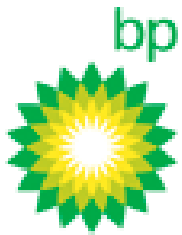
Clients



Scandinavian Airlines



Shell



Retirement has more potential with

PRUDENTIAL



Agenda



- **Introduction – Steve Crook**
- **“Pruning for Profit” – Steve Benham**
- **Survey Results – David Werrett**
- **Wrap-up – Steve Crook**



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Making an impact on shareholder value

3) Drive future growth and expansion

Shareholder value

**ENTERPRISE PERFORMANCE MANAGEMENT
(balanced scorecard)**

**Optimise
Process
Cost**

**Manage
LEAD
indicators**

**Predict
Profit**

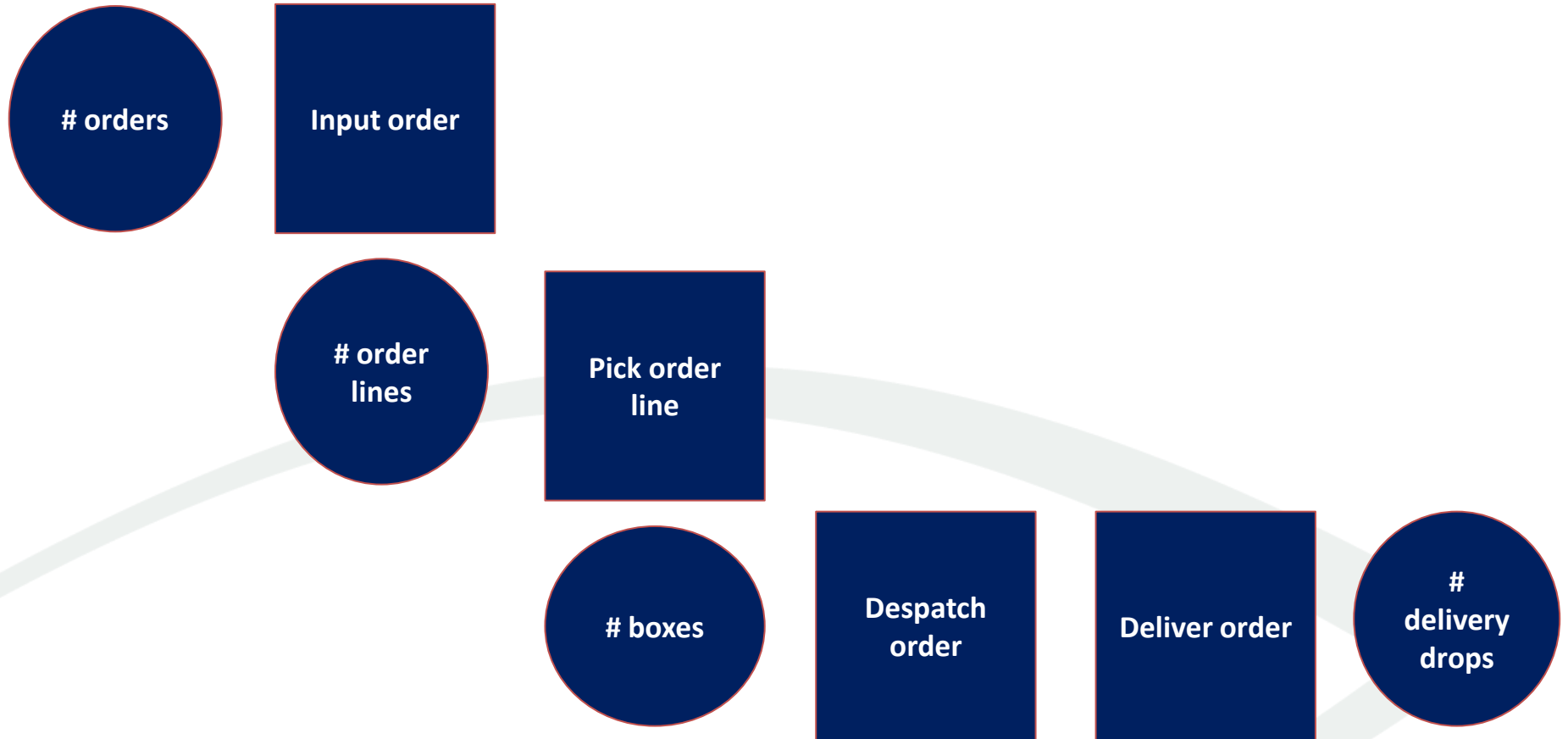
**Optimise
Customer
Product
Channel
Profit**

2) Enable Core Business Processes

Cause & effect model(s)

1) Build the Base

LEAD Indicators



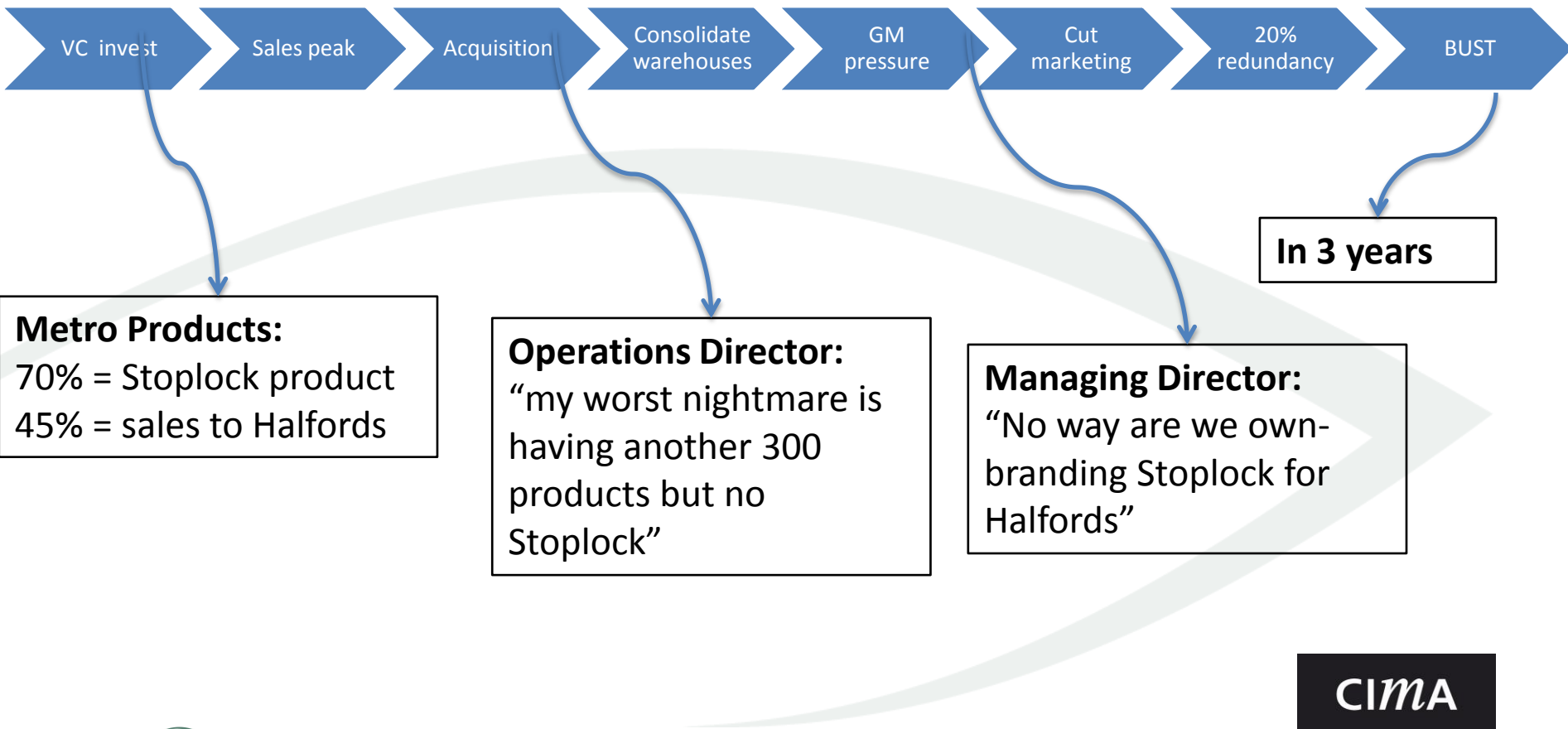
Why Pruning for Profit?

**“If we cut the roots off
– of course the rose
will die”**

How does your company prune?

- % reduction across all cost centres?
- Cut discretionary spend?
- Redundancy programme?

Metro Products



Why doesn't it work?

**NO UNDERSTANDING
of
CAUSE AND EFFECT**

Why doesn't it work?

NO IDEA WHERE TO “SNIP”

Traditional costing

COST CENTRES	£
• Customer Services	100
• Sales management	50
• Goods In	20
• Warehouse	60
• Repair workshop	25
• Credit Control	15
TOTAL	£270

Traditional costing– Allocate using volume

CUSTOMERS	Vol	Cost	Prof
• Customer A	100	50	(5)
• Customer B	40	20	2
• Customer C	120	60	(30)
• Customer D	50	25	5
• Customer E	30	15	10
• Customer F	200	100	25
TOTAL	540	270	7

What rational decisions can we make?

CAUSE

- What are the causes of the losses?
- We don't know

EFFECT – of cutting these customers

- Loss of profitable customers
- Downward spiral
- Continued WASTE

How to optimise profit – eliminate WASTE

UNDERSTAND – What you DO?

Supply Chain



UNDERSTAND – What the CAUSE is?

STRATEGIC BENCHMARKING

CAUSE = input = # Sales Orders

EFFECT = output = # deliveries

Cost/Sales Order = 1000

Cost per order	
Quartile 1	750
Quartile 2	900
Quartile 3	950
Quartile 4	1000

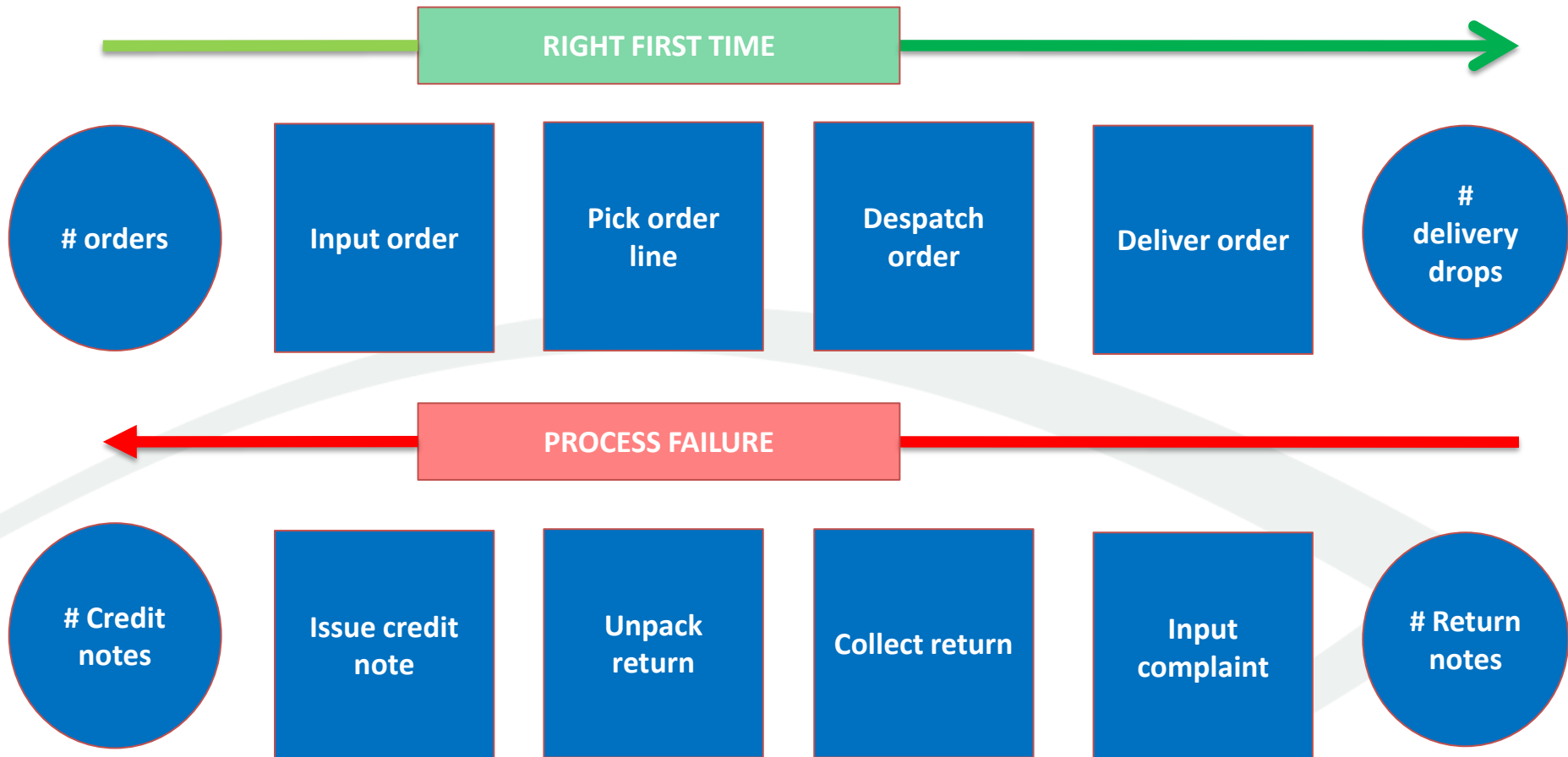
Pricing Strategies

- Mail order computer accessories and components
- Fulfil Customer Demand process = £98/order
- 70% orders < £98
- Set minimum order value at £100 so each order makes a contribution
- AND check WASTE in the process because the competitors may have a lower cost/order

THE SEVEN WASTES – operational level

- **Overproduction**
- **Delays (waiting time)**
- **Transportation**
- **Process**
- **Inventories**
- **Motions**
- **Defective products**

WASTE – “what goes wrong?”



WASTE – What is the COST of what goes wrong

COST CENTRES	GL	Proc A	Proc B
• Customer Services	100	95	5
• Sales management	50	49	1
• Goods In	20	15	5
• Warehouse	60	55	5
• Workshop	25		25
• Credit Control	15	5	10
TOTAL	£270	£219	£51

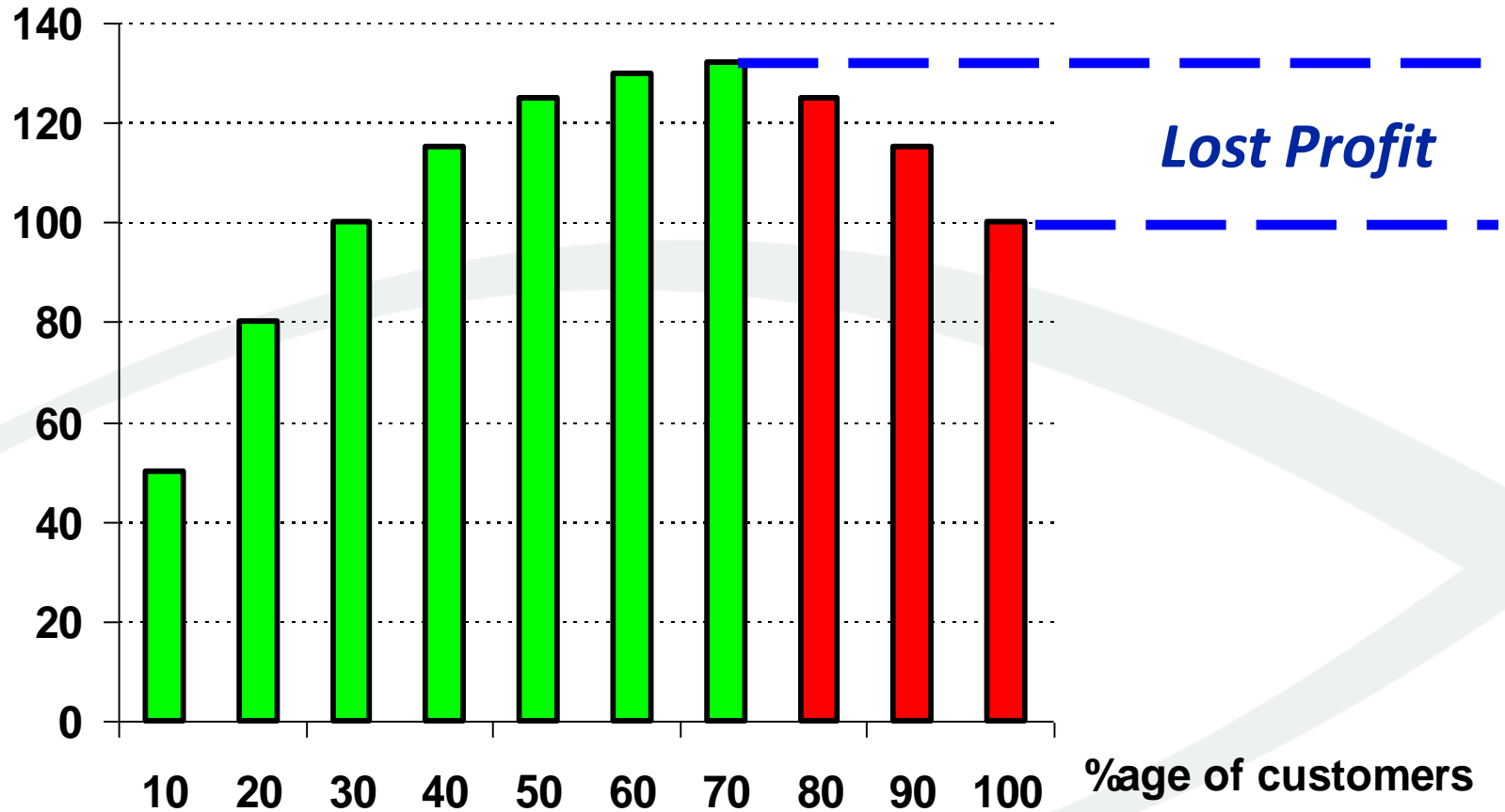
A = Fulfil Customer demand B=handle customer return

WASTE – Use CAUSE to allocate cost

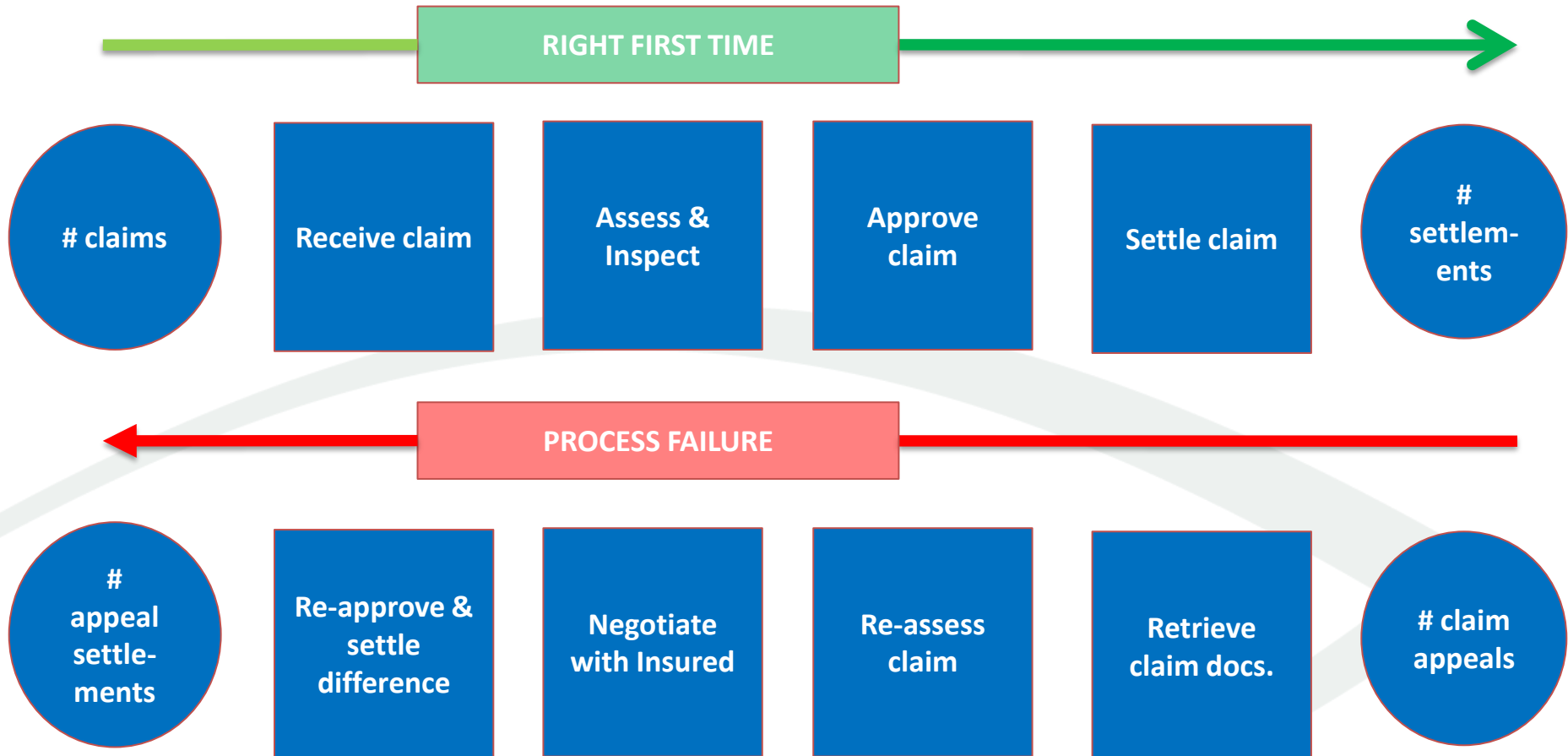
CUSTOMERS	Vol A	Vol B	Cont	NP
• Customer A	20	1	13	(5)
• Customer B	20	5	(14)	2
• Customer C	25	20	(28)	(30)
• Customer D	10		14	5
• Customer E	20		(6)	10
• Customer F	45	29	28	25
TOTAL	140	55	7	7

A = # order lines B = # return lines

Customer Product Channel Profitability



General Insurance – what goes wrong?



OTHER SECTOR EXAMPLES

Sector	Fulfil demand	Failure
Retail	Serve merchandise customers	Handle customer return
Telecoms	Supply telecoms network capacity	Handle unplanned network outage
Defence	Supply equipment to correct readiness state	Source incorrect equipment
Central Heating maintenance	Correct fault on first visit	Re-book multiple visits

The key is the ACTIVITY DICTIONARY

DO?	CAUSE?	INTERNAL FAILURE	CAUSE?	EXTERNAL FAILURE
Sell flights				
Check in passengers & despatch				
Fly plane				

The key is the ACTIVITY DICTIONARY

DO?	CAUSE?	INTERNAL FAILURE	CAUSE?	EXTERNAL FAILURE
Sell flights	#web booking enquiries	Change flight schedule	# schedule changes	cancel/change booking
Check in passengers & despatch				
Fly from A to B				

The key is the ACTIVITY DICTIONARY

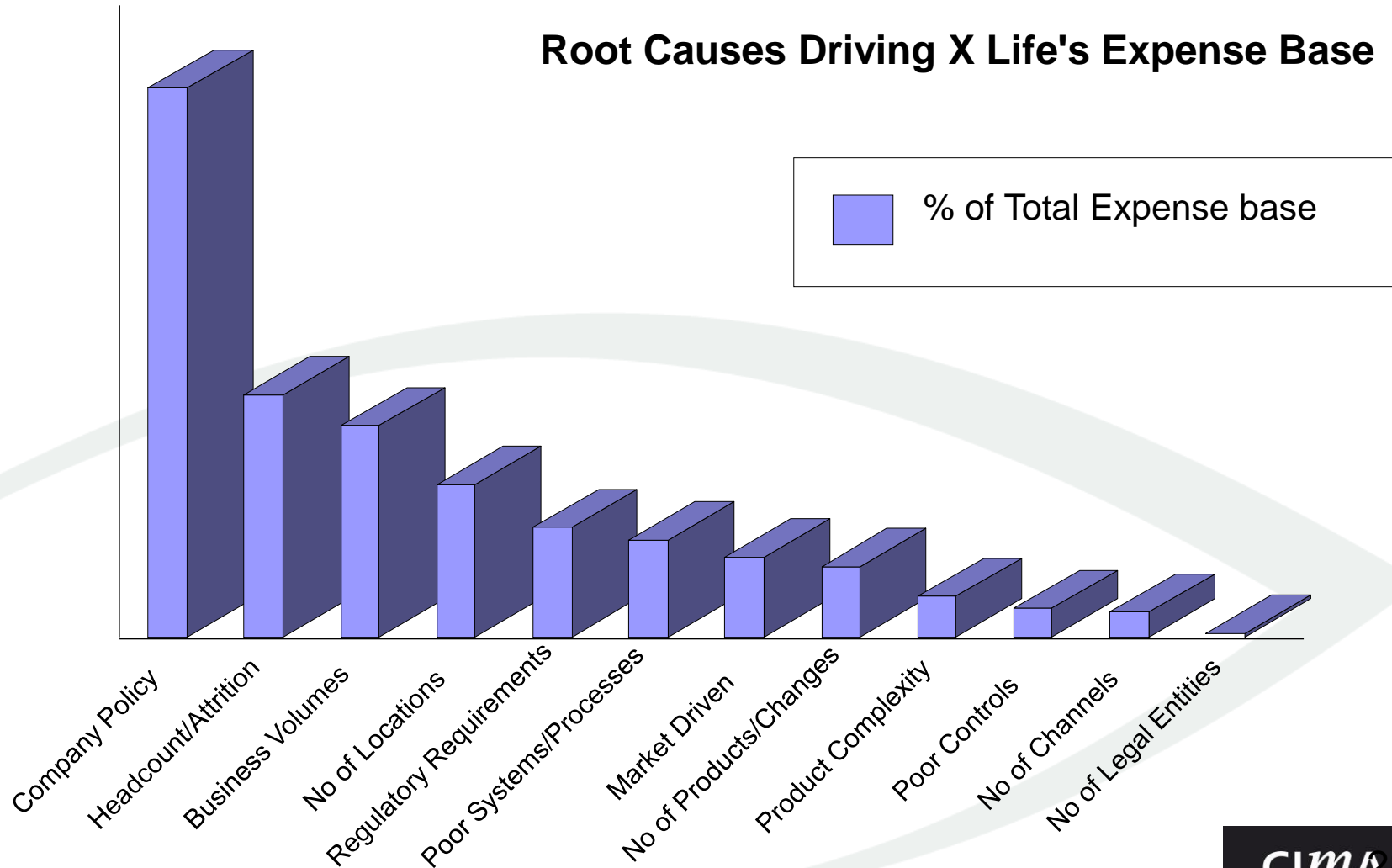
DO?	CAUSE?	INTERNAL FAILURE	CAUSE?	EXTERNAL FAILURE
Sell flights	#web booking enquiries	Change flight schedule	# schedule changes	cancel/change booking
Check in passengers & despatch	#pax	Recover check in system failure	# check in failures	Chase “no shows” at gate
Fly from A to B				

The key is the ACTIVITY DICTIONARY

DO?	CAUSE?	INTERNAL FAILURE	CAUSE?	EXTERNAL FAILURE
Sell flights	#web booking enquiries	Change flight schedule	# schedule changes	cancel/change booking
Check in passengers & despatch	#pax	Recover check in system failure	# check in failures	Chase “no shows” at gate
Fly from A to B	#take-offs # km flown	Delay departure	#equipment failures	Change flight plan

Cause of cost in a Life Company

Root Causes Driving X Life's Expense Base



Optimise Process cost – reduce process waste

- **CAUSE** - Reduce the process failure volume
- **EFFECT**
 - reduces work and creates spare capacity
 - Then reassign staff to Value Adding work
- **NOT THE CAUSE** - Reduce staff
 - Only works if there is spare capacity
 - Assumes 2 people doing one job
 - Seeboard example

Build the foundation stone

- Define what you **DO** – including main process failures
- Collect the **CAUSES** (cost drivers)
- Gives you the **EFFECT** on cost of what you **DO**

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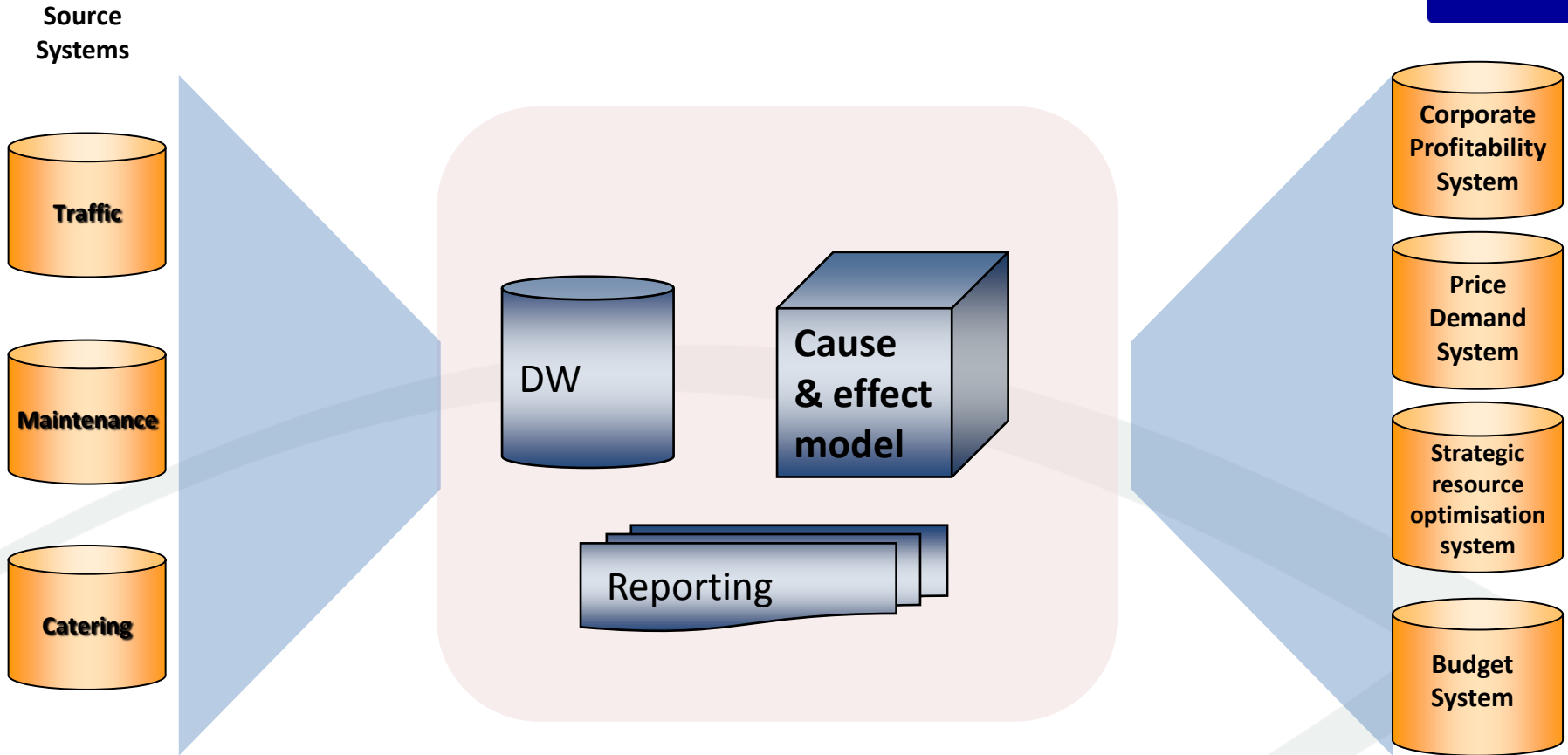
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Cause & effect model(s)

1) Build the Base

Rolling forecasts - Scandinavian Airlines



Rolling Forecasts

Cost element	Driver	Vol	Tariff	Forecast
Landing fees	# take-offs	12	2500	30,000
Check in and despatch	# pax	1500	10	15,000
Club lounge	# club pax	100	25	2,500
Engine maintenance	# km flown	24000	1.2	28,800
Total				76,300

Zurich International Solutions



- Provides financial services to individuals and organisations across the world
- Dubai, Hong Kong, Geneva, UK
- Part of Zurich Financial Services Group, one of the world's largest financial services companies with more than 35 million customers in over 60 countries
- Cause & effect model as basis of all central performance management processes
 - operational planning
 - budgeting
 - process costing
 - profitability analytics (product, channel, customer, etc)
 - strategic scenario planning

IT shared services

“Run IT Like a Business - Follow the Money”

**Barbara Gomolski,
Research Vice President
Gartner**

What Business Unit managers want

- **Simplicity**

“Make what I’m paying for clear and simple to understand.”

- **Fairness**

“I’ll pay my share, and I’m not paying for anyone else.”

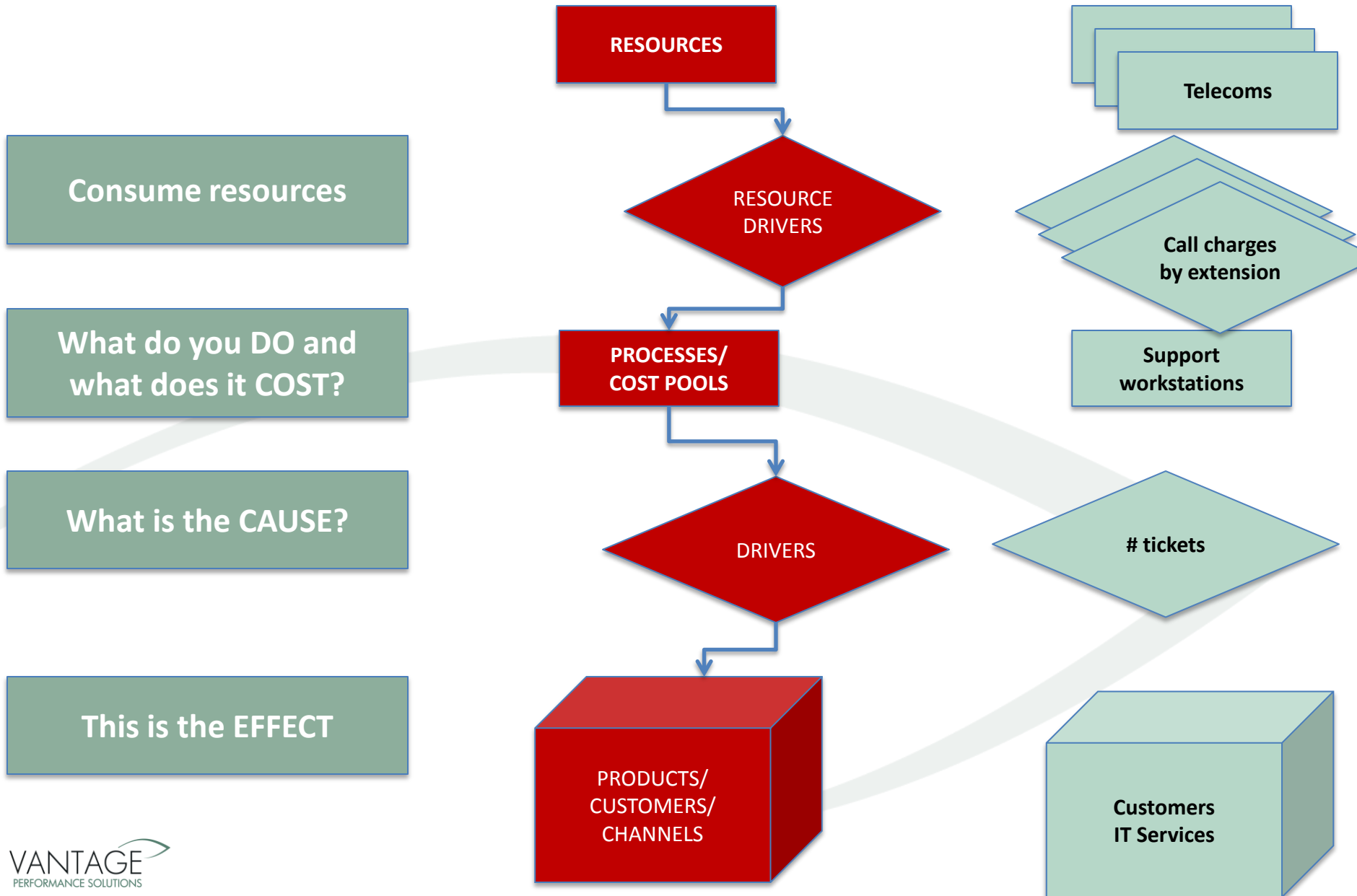
- **Predictability**

“I’ll pay what I need to, but you can’t increase the charge.”

- **Controllability**

“I need to cut my budget, and I need to get some of the cut from IT.”

How to build the FOUNDATIONS



IT Shared services tariff card

What do you do?	Cost	Cause?	Volume	Tariff
Deploy & support PC	120,000	#Cases	800	150
Run applications (specific)	600,000	#end users	100	6,000
Provide server capability	2,400,000	#servers	100	24,000
Projects	1,500,000	Booked time	3,000	500
Operate Network	1,800,000	#GigaByte hours	900,000	2
Manage IT department	180,000	#customers	10	18,000

Simple + Fair + Predictable + Controllable

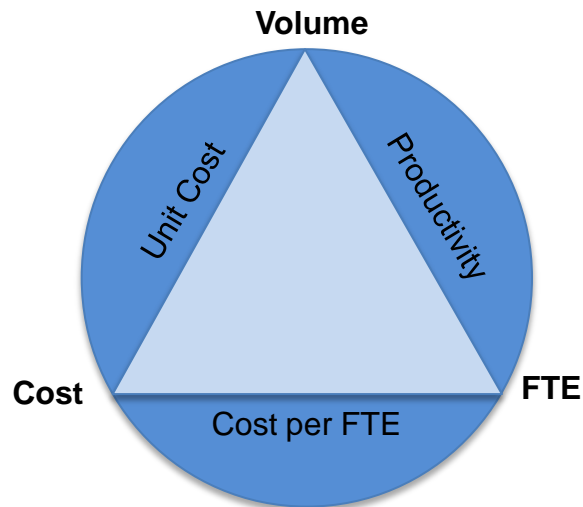
US Retailer – capacity management

- 8,000 servers and a total monthly spend on servers of \$8M.
- identified that average utilization is 25%.
- identified potential monthly savings of \$1.1M from consolidation, \$700K from virtualization, and \$150K by moving UNIX to Linux,
- \$200K by reducing service levels
- all of which add up to over \$10M of savings on an annual basis.

Department for Work and Pensions

How are the results from used?

- The diagram below depicts the key metrics produced by the model. All metrics can be analysed by Geographical Location, Activity, Output and Product.



Integrated resource planning is achieved by linking Cost, Headcount and Volumes with performance and efficiency metrics resulting in **balanced forecasts**.

By understanding the operational activities undertaken by the most efficient regions, **best practice** and **process improvement** is deployed to under performing regions.

Cost metrics are analysed by different types of activities: Direct, Operational Support and Central Overhead. Non value add activities are targeted in **cost reduction programmes**.

- Informs resource allocation decisions from understanding Activities required to deliver an Output
- Job Centre Plus have used the model to forecast the FTE and Productivity levels required to meet the increase in unemployment volumes.

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RETURN ON INVESTMENT



Scandinavian Airlines

Has seen a dramatic improvement in its profits since being able to forecast flight/day profitability by round trip, aircraft, cabin class, and sales region



Improved profit by rewarding sales representatives on contribution after distribution costs



ZURICH

Improved profit by understanding business processes and identifying waste then used this “cause and effect” model to build an integrated planning and forecasting system

THANK YOU! QUESTIONS WELCOME



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