

Profitability Management From Both Sides of the Coin

How Cost Accounting can drive excellence in Pricing and Profitability

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The Association of
Accountants and
Financial Professionals
in Business

Featured Presenter

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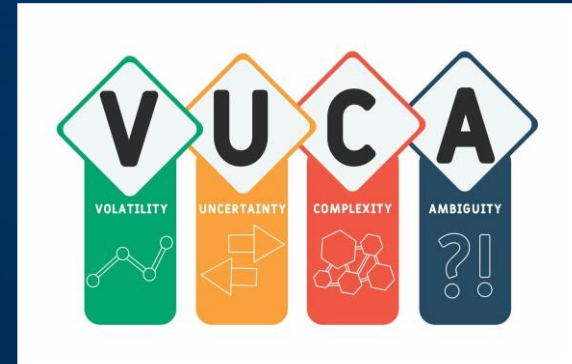
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Agenda

1. Introduction
2. Challenges in a VUCA World
3. Tackling the Issues
4. What Champions Do
5. Summary & Take-aways



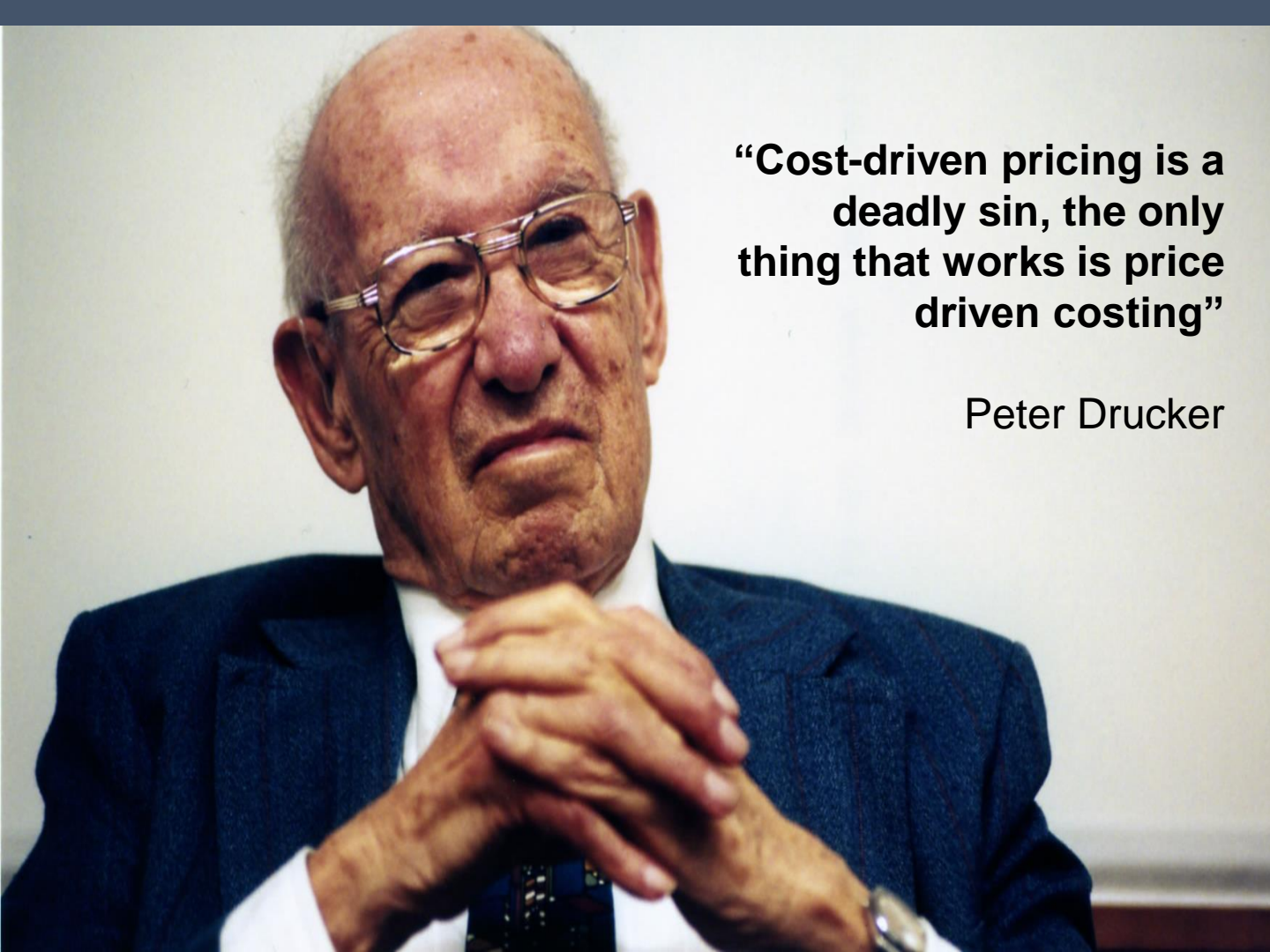
Challenges in a VUCA world

Poll Question 1:

The following challenges exist in today's world:

- A. Increased Volatility
- B. Lack of Transparency
- C. Continuous Pressure for Efficiency
- D. All of the above

Poll Question 2 Results: (Placeholder)



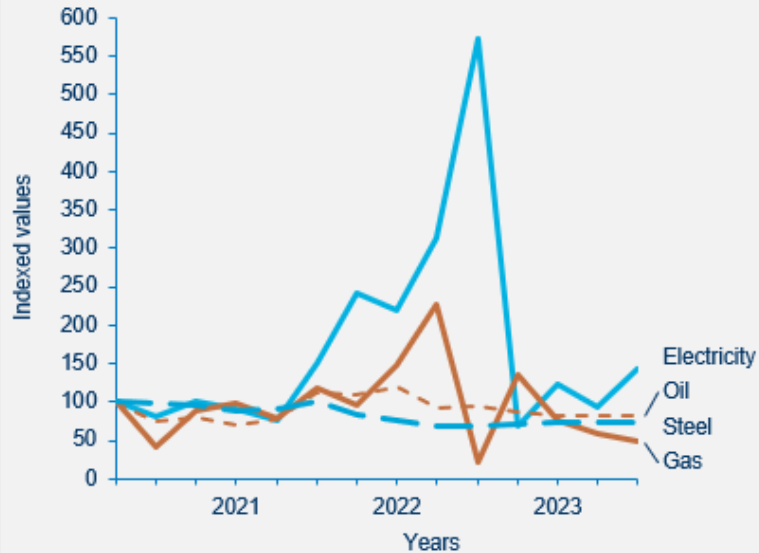
**“Cost-driven pricing is a
deadly sin, the only
thing that works is price
driven costing”**

Peter Drucker

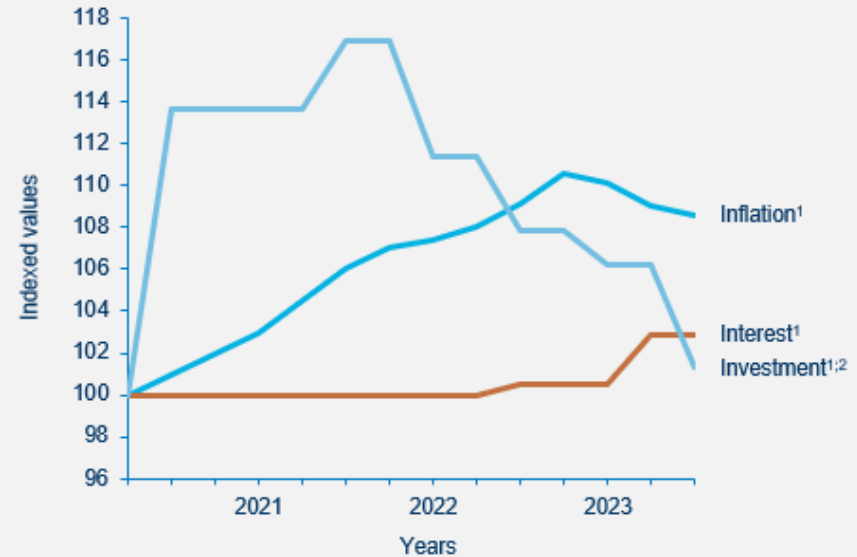
**But what do we do
when costs have
become extremely
volatile?**

Indexed price developments and economic indicators show the amount of volatility we all face

Indexed price increases (\$) and volatility of key input factors



Indexed key economic indicators



We see multiple challenges in today's environment



Lack of transparency



Continuous pressure for efficiency



Increase of uncertainty and ambiguity



Ways-of-Working and Workforce Challenges



Increased volatility



New technological developments – AI, RPA, ML



Permanent competitive pressure and new competitors



Paradigm shift centralized vs. decentralized

Poll Question 2:

According to Peter Drucker, cost driven pricing is:

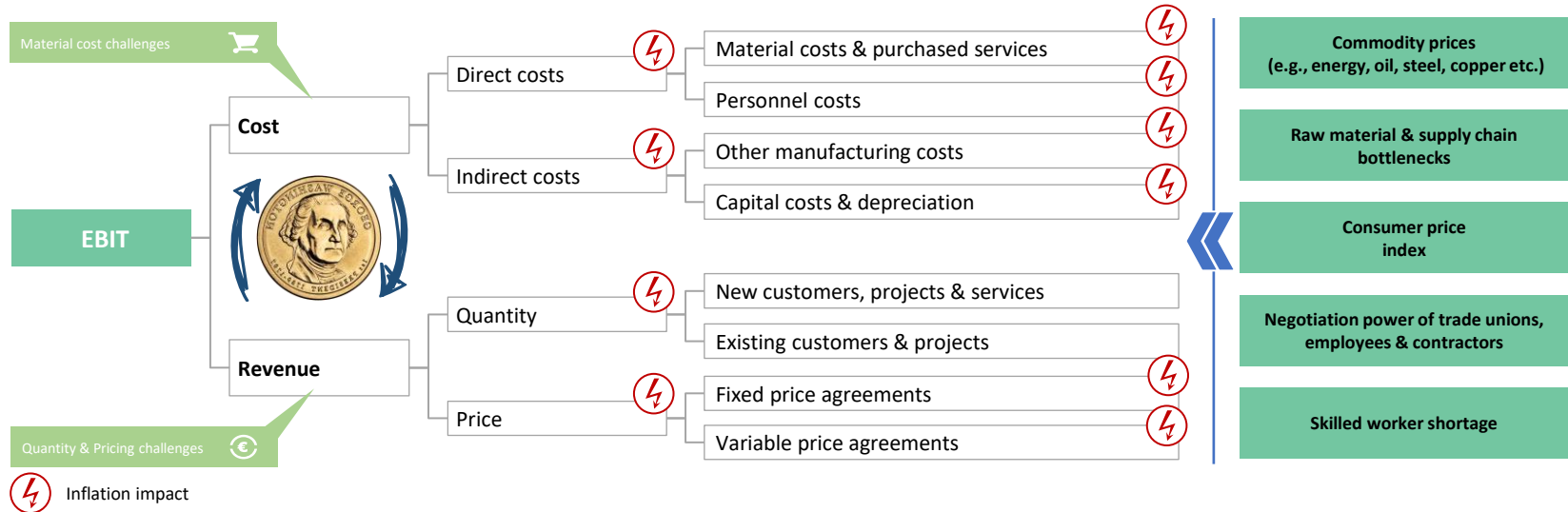
- A. A requirement in today's world
- B. A challenge to execute
- C. A deadly sin
- D. Not something we should worry about

Poll Question 2 Results: (Placeholder)

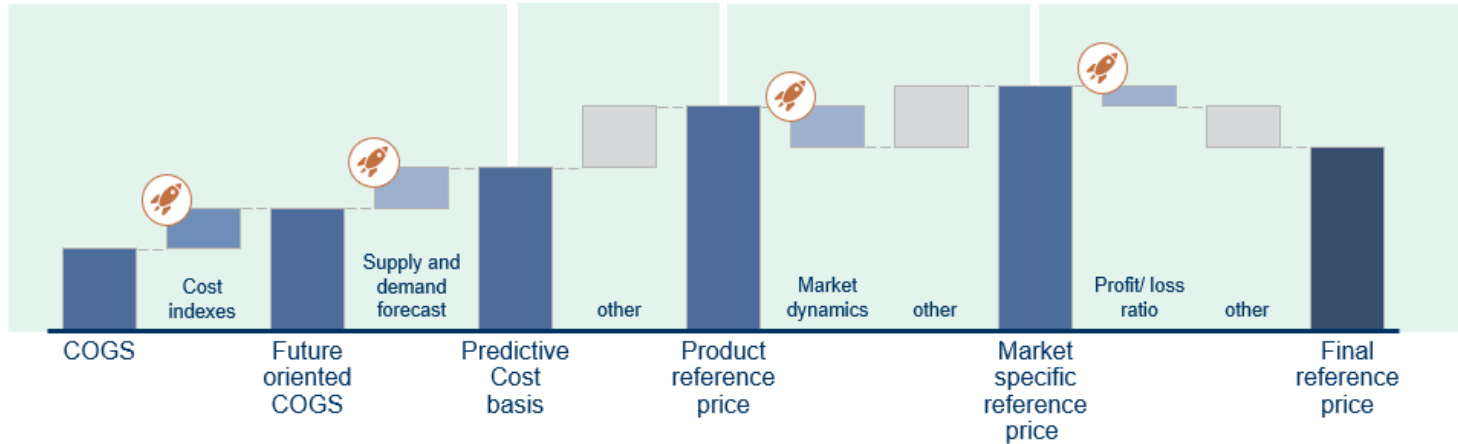
Tackling the Issues

Pricing, quantity and cost challenges impact EBIT along the driver tree and must be managed in an integrated way – Both “sides of the coin” are critical

Driver Tree: EBIT Levers



In the future “predictive costing” – the link to dynamic pricing - will become more relevant than ever



Dynamic pricing and respective costing components with strong influence on current business models require dedicated attention and management- Future costs become inputs to current prices

Poll Question 3:

The goal of linking costing to pricing is:

- A. Smooth our risk exposures
- B. Maximize profitability
- C. Provide better performance insight
- D. All of the above

Poll Question 3 Results: (Placeholder)

Example Approach

3 Components to Succeed

Foundation

Foundation: Horvaths' performance management framework



Transparency

Transparency: 5 hypotheses on digitalization at the interface between finance and commercial

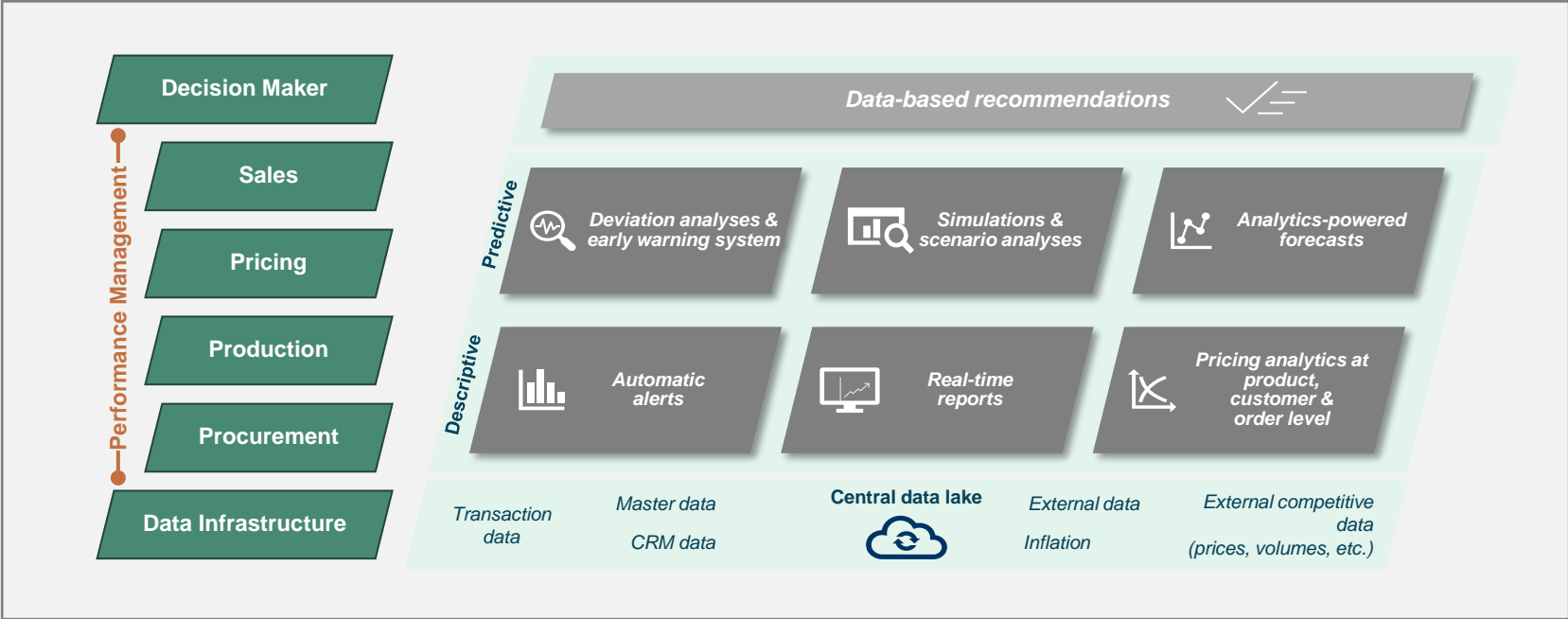
- 1 Digitalization helps to connect the silos - e.g. helps to connect procurement with sales
- 2 Digitalization increases transparency - in near real time
- 3 Finance and Accounting need to shape, manage and steer the data and KPI's
- 4 Analytics powered dashboards simplify reporting - always up to date with less manual effort
- 5 AI powered forecasting brings increased certainty into the VUCA world (when done right)

Index based Forecasting

Index based risk management: using financial instruments linked to market indexes to mitigate risk and protect inventory from adverse market movements



Foundation: Horvaths' performance management framework



Transparency: 5 hypotheses on digitalization at the interface between finance and commercial

1. Digitalization helps to connect the silos –e.g. helps to connect procurement with sales

2. Digitalization increases transparency – in near real time

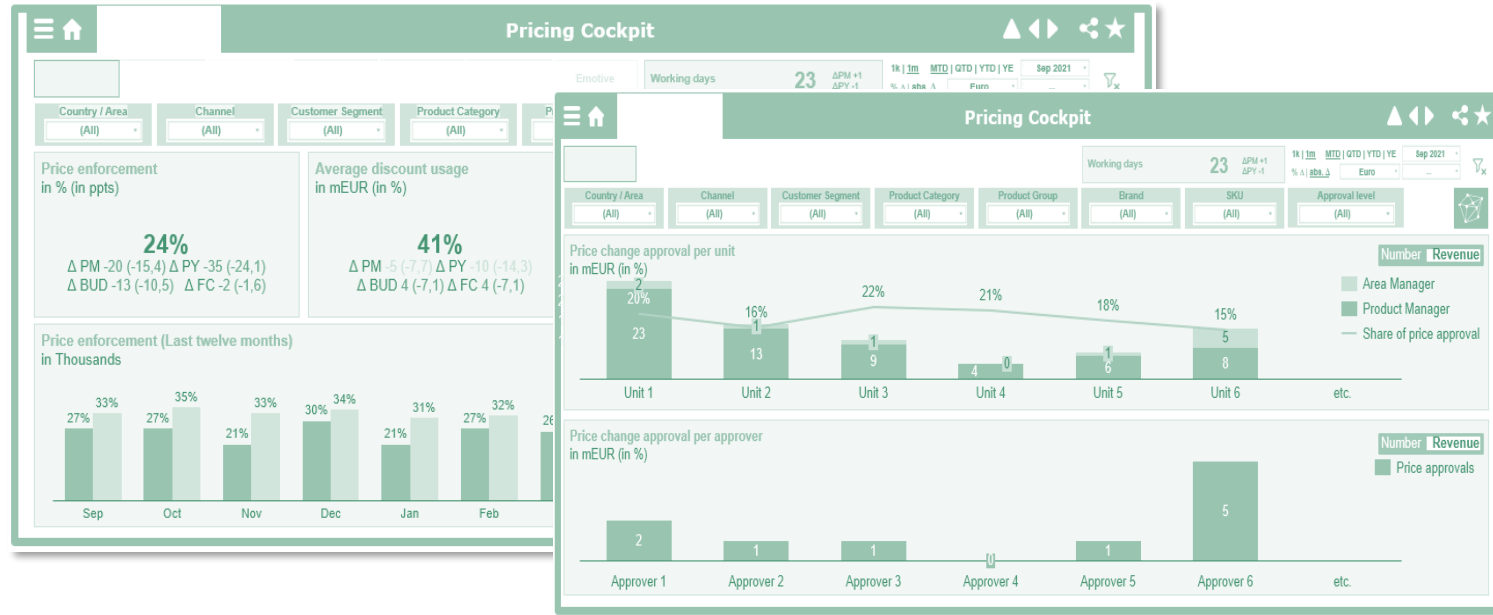
3. Finance and Accounting need to shape, manage and steer the data and KPIs

4. Analytics powered dashboards simplify reporting - always up to date with less manual effort

5. AI-powered forecasting brings increased certainty into the VUCA world (when done right)

Transparency: Real-time cross-functional pricing dashboards are key for full transparency and to get ahead of the wave

ILLUSTRATIVE



Forecasting: An automotive supplier was facing the risk of negative margins due to rising raw material prices

Project Case: Comparison of raw material prices from procurement and sales



Automotive

2 bn

10k



Al Cu Zn Ni

THE CHALLENGE

- Lack of transparency regarding procurement and sales prices for strategic raw materials
- Supplier price escalator agreements bound to market indices on the procurement side are not reflected on sales side
- Client was faced with the risk of negative margins in case of rising raw material prices

Initial Situation and Challenges



Risk of negative margins due to rising raw material prices



Raw material price development not used as a basis for pricing decisions



Supplier price escalation agreements bound to market indices on the procurement side are not reflected on sales side

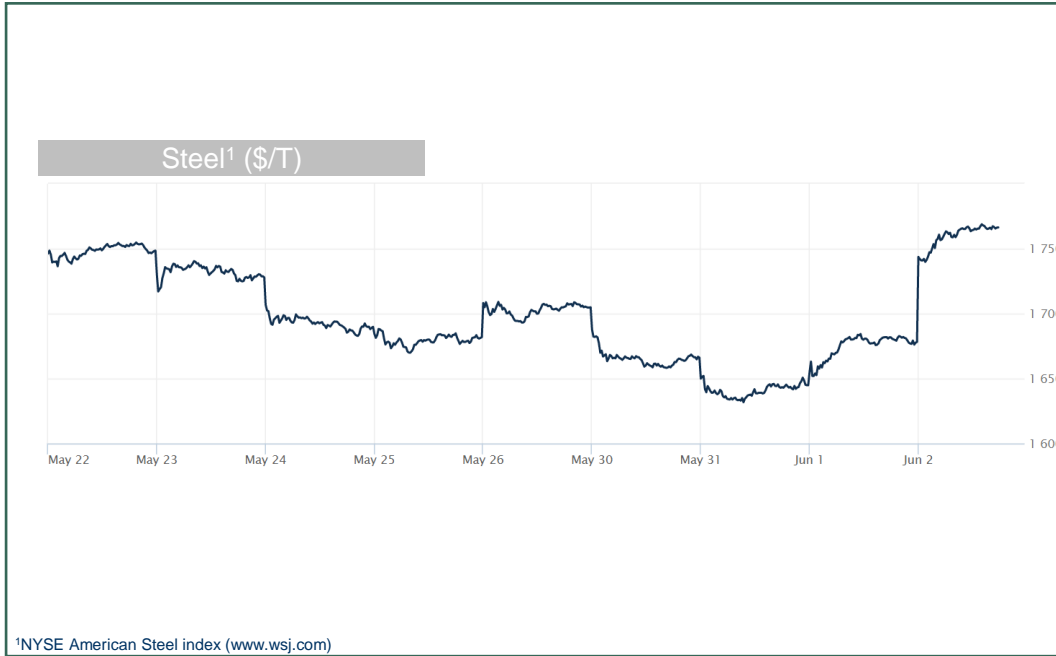


Performance measurement of sales and procurement is not adjusted for raw material effects



Missing transparency on raw material prices on the procurement and the sales side

Forecasting: Raw materials with volatile market valuation illustrate the impact of cost increase and pricing concepts

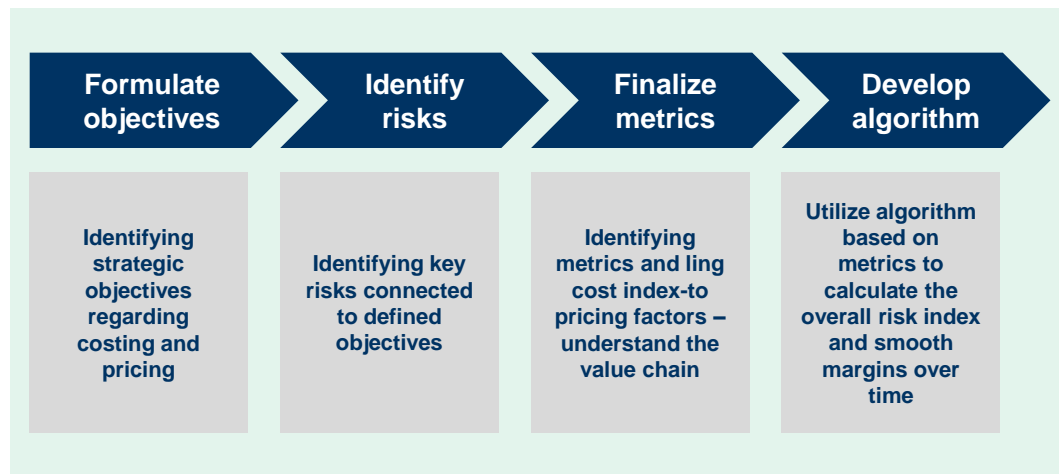


Results

- Following LIFO valuation, substantial and abrupt (accounted) cost increases squeeze margins or push prices
- Significant impact especially for cost plus based price companies (or vice versa → windfall profits)
- Results in volatile costs structures

Index based risk management: Using financial instruments linked to market indexes to mitigate risk and protect inventory from adverse market movements

Visualization of phase approach

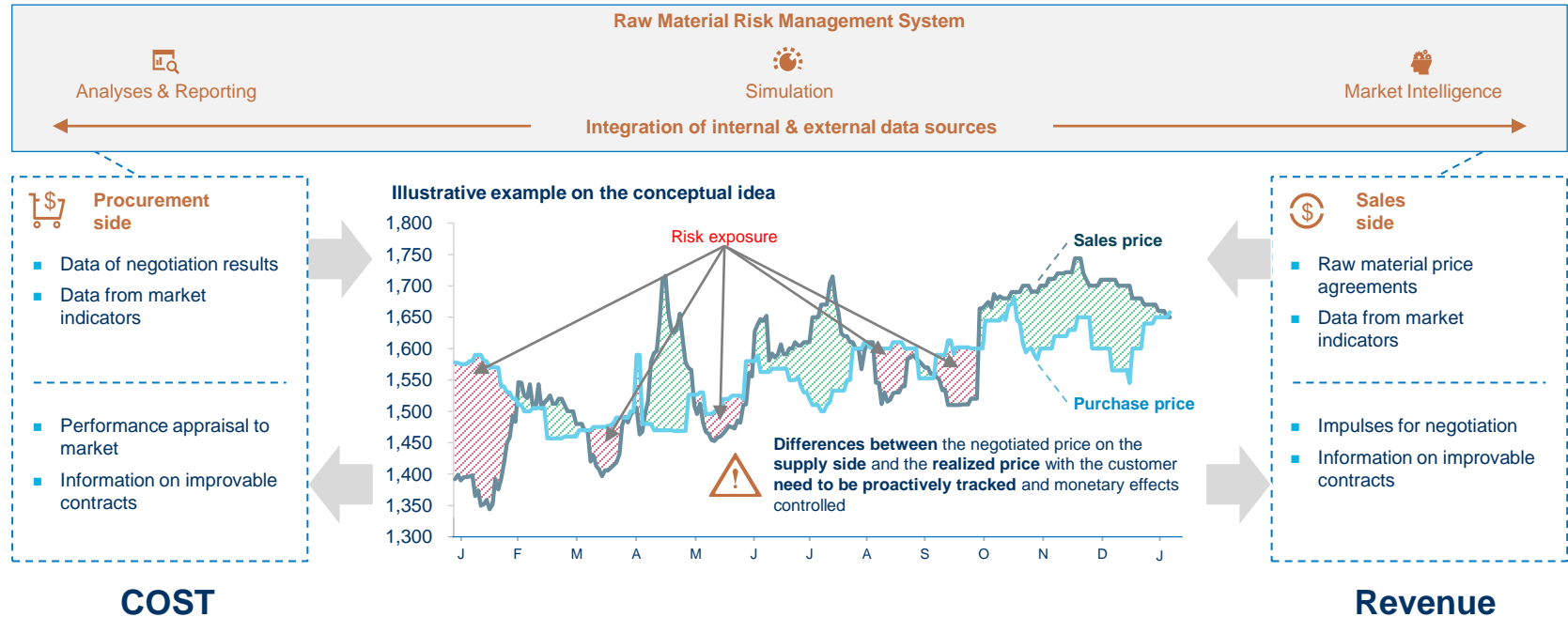


Description

- Analyze and mitigate potential pricing fluctuations and uncertainties
- Reduce the impact of market volatility on a company's financial performance
- Enablement of more informed pricing decisions and risk management strategies
- Provides insights into cost fluctuations and enables proactive strategies to mitigate those risks, thereby improving cost management and enhancing overall profitability.
- Generative AI and more traditional predictive techniques are all options for developing cost forecasts

Solution Example: We designed a raw material reporting process to better manage risk exposure and reflect it in pricing – over time, the goal is to smooth out risk exposure by better aligning costs with revenue

Project Case: Comparison of raw material prices from procurement and sales



Poll Question 3:

According to this presentation by Horvath, the three components to succeed at linking costing to pricing are:

- A. Foundation, Transparency and Index Based Forecasting
- B. Volume, Price and Variance Analysis
- C. Hard work, dedication and focus
- D. There are more than three requirements

Poll Question 3 Results: (Placeholder)

Summary & Take-aways

Key Take Aways – Call to Action

1. Company-wide **internalization** to integrate both sides – **costing and pricing**
2. **Anticipation of cost increases** based on efficient forecasting algorithms leading to more **strategic pricing decisions** in order to **stay ahead of margin pressure**
3. Usage of **advanced analytics and predictors** along with **high quality data**
4. **Crash silos** – avoid narrow-minded thinking of individual departments. Enable employees to collaborate and share knowledge – **accountants can drive this behavior**
5. **Enable mindset switch:** lead accounting practice from a reactive role of documentation and reporting to an **active role as business partners** within the company

Questions and Answers

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Thank you!



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