

Schwab Directs Profitability Analysis Toward the Small Picture



By 2003, Charles Schwab's 11-year old home-grown profitability program was bogging down. The company's mix of business had grown more complex, volumes had risen sharply, and the software could not keep pace with either the rising complexity or the increasingly sophisticated requirements of internal users. Poor integration meant the profitability team was spending too much on data processing at the expense of analysis, and by the time reports were produced they were nearly six weeks old.

The company used its old profitability engine on an ad hoc basis for some strategic decisions, such as its pioneering mutual fund supermarket, Web pricing based on channel expense data combined with client information, and investment advisory offers.

It was also used for the recent corporate restructurings after the market downturn, when Schwab laid off thousands of staff.

"We had been using profitability information for strategic decisions for 15 or so years," said Rhett Bratt, vice president of profitability analysis at Charles Schwab. "But there's a big difference between occasional use of a system and bringing profitability measures into the mainstream of the company's business."

Schwab's management wanted a profitability tool that could be applied to smaller decisions, such as how much to spend on a marketing campaign, or whether to add another branch. To be an effective business instrument, a profitability application needs to provide credible data, timely

reporting, clear accountability, profitability targets, and a link to compensation, according to Bratt.

"This re-look at profitability analysis coincided with a period of change at Schwab," he said. After 25 years of phenomenal growth, the stock market bubble bursting in 2000 presented the company with severe shocks, and it found out it wasn't structured well to deal with the new lean and challenging times. Senior executives wanted to know more detail about cost structures and revenue streams.

To apply profitability analysis to the routine processes of decision-making at Schwab would require a new approach, the firm realized. The old in-house system delivered results on average 32 days after the close of a month – reasonable enough for the occasional bit of strategic analysis, but pretty useless for operational decision-making.

"Spreadsheets are ok if you are doing this analysis on an ad hoc basis, but if you are doing it monthly across all business units you need an application," said Bratt.

After looking at several products, Schwab chose a profitability application from Acorn Systems, a software vendor whose applications provide profit analytics. Acorn solutions provide actionable cost and profitability information for every dimension of a business, including profitability by customer, product and transaction; facility benchmarking; cost-to-serve process costs; and internal services cost allocations. The Microsoft Gold Certified partner, which has experience in retailing and heavy industry, is expanding into financial services where its clients include Citigroup, Union Bank of California, ATB Financial, AIG and Aon.

Acorn, which runs on an entirely Microsoft platform, uses the latest in Microsoft technology, including the analytical and reporting features in SQL Server 2005.

"The data visualization in SQL Server 2005 is excellent," said Jerome Patterson, vice president of business development at Acorn. The relational database generates analytical cubes automatically. Any changes in underlying data or business rules are immediately translated into new cubes without the need to call in maintenance staff to revise code.

"The logic will flow to the cube automatically," Patterson said. "You can extend this to thousands of seats and offer role-based reporting, so the firm can use it for forward planning and budgeting."

The true benefits of automatic cube generation are tremendous, noted Acorn's chief operating officer, J. Alex Fernandez. "A lot of work goes into the model and to push it out without having to hire a cube specialist is a huge advantage. Then users can hit it with Excel or tools from any of the business intelligence vendors. The time-to-value is very rapid." At Schwab, which continues to use Hyperion Essbase cubes, the Acorn solution produces account-level profitability analysis within five business days after the accounting close.

In its analytics, the Acorn system also picks up capacity measures, previously a blind spot at Schwab which never knew for sure how much capacity was left, or whether a marketing campaign might overwhelm existing systems.

"You have to have this information and it has to be timely or it won't be perceived as useful," said Bratt.

Where do the measurements start? At Schwab, senior executives decided that it all starts with the customer, so anyone running a customer-facing business would have ownership of the P&L. It's their responsibility to manage service level agreements from support areas of the company.

Measuring profitability is not as simple as installing a piece of software. It requires many decisions by senior management, and it takes a change in the company's culture.

Schwab decided to make the client organizations the focus and then it structured the data to deliver information to them in a way they could understand easily.

Naturally, it wasn't that simple. The cost piece was a challenge, Bratt said. "We have to spend a lot of time working very closely with our businesses to understand what they are doing so we can organize our costs and assign them appropriately. IT was a real challenge for us," he said.

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Assigning costs can be an issue in many organizations, added Fernandez.

“We help organizations understand the cost of products to their internal customers. That way you can run a centralized IT organization more like a business,” he said.

With Acorn, Schwab found excess capacity, especially in IT. This insight allowed for renegotiation of key contracts with outside vendors, as well as redeployment of human resources and technology assets in a more efficient manner. Overall the insight and resulting action supported strategic initiatives to reduce its overall cost structure by \$600 million on an annual basis

Schwab doesn't use standard rates, such as the average cost per transaction – it looks for actual costs and actual volumes every month. The company reports that performance is measured through a cost allocation system that develops fully-loaded profit margins so business leaders have a clear picture of their costs, including such indirect costs as technology, finance, and human resources. All this makes sense only if it can be tied back to compensation for the productive employees. At Schwab, profitability is one of a handful of measures the company uses to set bonuses. One example of an issue that implementation of Acorn exposed: How do you compensate the sales person who brings in a \$50,000 client who then likes the company so much he transfers over \$1 million, and moves from the emerging affluent group to the affluent group? Acorn has shown that the sales staff is doing better than the company expected, even though it isn't holding onto all new customers in the emerging affluent category because they are graduating up the asset chain within the firm.

That was just one benefit of using Acorn to better understand customers.

“I don't think most clients have a good top-down view of their best and worst customers,” said Jeffrey Duncan, a regional vice president at Acorn. “With our software, they can aggregate the costs and look across the enterprise in a way they hadn't been able to do before.”

When Schwab did that, said Fernandez, they were surprised to find that their customer segmentation wasn't as accurate as they had thought.

“A lot of customers were in the wrong bucket,” he said.

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