BUSINESS ANALYTICS

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TOOLS FOR MODEL BUILDING

- LOGIC AND BUSINESS PRINCIPLES
- COMMON MATHEMATICAL FUNCTIONS
- DATA FITTING
- SPREADSHEET ENGINEERING

LOGIC AND BUSINESS PRINCIPLES

- DEFINE THE DECISION TO BE MADE
- DETERMINE WHAT OUTPUTS WOULD HELP MAKE THAT DECISION
- DESIGN THE ANALYSIS THAT CREATES THOSE OUTPUTS
- GET THE DATA NEEDED FOR THE ANALYSIS
- EXECUTE THE ANALYSIS

LOGIC AND BUSINESS PRINCIPLES

- A CONCEPTUAL BUSINESS MODEL IS A DIAGRAM THAT ILLUSTRATES HOW AN INDUSTRY OR BUSINESS FUNCTIONS.
- IMPORTANT TO UNDERSTAND THE QUESTIONS THAT NEED ASKING AND WHAT THE RESULTS WILL MEAN IN THE REAL WORLD.
- IT IS ALSO IMPORTANT TO INVESTIGATE FULLY THE SOURCES (DOWNSTREAM) OF WHERE THE DATA COMES FROM AND THE USE OF THE RESULTS (UPSTREAM)

COMMON MATHEMATICAL FUNCTIONS

- UNDERSTANDING DIFFERENT FUNCTIONAL RELATIONSHIPS IS INSTRUMENTAL IN MODEL BUILDING. THE AIRLINE PRICING EXAMPLE USED A LINEAR FUNCTION THAT RELATED PRICE TO DEMAND.
  - LINEAR Y=MX+B
  - LOGARITHMIC Y=LN(X)
  - POLYNOMIAL Y=Ax^2+BX+C
  - POWER Y=a^b
  - EXPONTENTIAL Y = ab^x

DATA FITTING

- FOR MAY APPLICATIONS, FUNCTIONAL RELATIONSHIPS USED IN DECISION MODELS ARE DERIVED FROM THE ANALYSIS OF THE DATA.
- THE TRENDLINE TOOL PROVIDES A METHOD OF DETERMINING THE BEST FITTING FUNCTIONAL RELATIONSHIP. USING THE TRENDLINE TOOL YOU CAN TRY FITTING EACH FUNCTION TO THE DATA.
- DATA FITTING IS COMBINED WITH LOGICAL APPROACHES IN MODEL BUILDING.

SPREADSHEET ENGINEERING

- VERIFICATION
- IMPROVE THE DESIGN AND FORMAT OF THE SPREADSHEET ITSELF.
- IMPROVE THE PROCESS USED TO DEVELOP A SPREADSHEET.
- INSPECT YOUR RESULTS CAREFULLY AND USE APPROPRIATE TOOLS AVAILABLE IN EXCEL.
  - USE THE DATA VALIDATION TOOL
  - INSPECT AND AUDIT FORMULAS

NEW PRODUCT DEVELOPMENT MODEL

	A	B	C	D	E	F
1	**Moore Pharmaceuticals**					
2						
3	**Data**					
4						
5	Market size	2,000,000				
6	Unit (monthly Rx) revenue	$ 130.00				
7	Unit (monthly Rx) cost	$ 40.00				
8	Discount rate	9%				
9						
10	Project Costs					
11	R&D	$ 700,000,000				
12	Clinical Trials	$ 150,000,000				
13	Total Project Costs	$ 850,000,000				
14						
15	**Model**					
16						
17	Year	1	2	3	4	5
18	Market growth factor		3.00%	3.00%	3.00%	3.00%
19	Market size	2,000,000	2,060,000	2,121,800	2,185,454	2,251,018
20	Market share growth rate		20.00%	20.00%	20.00%	20.00%
21	Market share	8.00%	9.60%	11.52%	13.82%	16.59%
22	Sales	160,000	197,760	244,431	302,117	373,417
23						
24	Annual Revenue	$ 249,600,000	$ 308,505,600	$ 381,312,922	$ 471,302,771	$ 582,530,225
25	Annual Costs	$ 76,800,000	$ 94,924,800	$ 117,327,053	$ 145,016,237	$ 179,240,069
26	Profit	$ 172,800,000	$ 213,580,800	$ 263,985,869	$ 326,286,534	$ 403,290,156
27	Cumulative Net Profit	$(677,200,000)	$(463,619,200)	$(199,633,331)	$ 126,653,203	$ 529,943,358
28						
29	Net Present Value	$ 185,404,860				

NEW PRODUCT DEVELOPMENT MODEL FORMULAS

	A	B	C	D	E	F
1	**Moore Pharmaceuticals**					
2						
3	**Data**					
4						
5	Market size	2000000				
6	Unit (monthly Rx) revenue	130				
7	Unit (monthly Rx) cost	40				
8	Discount rate	0.09				
9						
10	Project Costs					
11	R&D	700000000				
12	Clinical Trials	150000000				
13	Total Project Costs	=B11+B12				
14						
15	**Model**					
16						
17	Year	1	2	3	4	5
18	Market growth factor		0.03	0.03	0.03	0.03
19	Market size	=B5	=B19*(1+C18)	=C19*(1+D18)	=D19*(1+E18)	=E19*(1+F18)
20	Market share growth rate		0.2	0.2	0.2	0.2
21	Market share	0.08	=B21*(1+C20)	=C21*(1+D20)	=D21*(1+E20)	=E21*(1+F20)
22	Sales	=B19*B21	=C19*C21	=D19*D21	=E19*E21	=F19*F21
23						
24	Annual Revenue	=B22*$B$6*12	=C22*$B$6*12	=D22*$B$6*12	=E22*$B$6*12	=F22*$B$6*12
25	Annual Costs	=B22*$B$7*12	=C22*$B$7*12	=D22*$B$7*12	=E22*$B$7*12	=F22*$B$7*12
26	Profit	=B24-B25	=C24-C25	=D24-D25	=E24-E25	=F24-F25
27	Cumulative Net Profit	=B26-B13	=B27+C26	=C27+D26	=D27+E26	=E27+F26
28						
29	Net Present Value	=NPV(B8,B26:F26)-B13				

SINGLE PERIOD PURCHASE DECISIONS (NEWSVENDOR MODEL)

- C = PURCHASE COST
- R = SALE PRICE
- S = SALVAGE VALUE
- D = DEMAND DURING A SINGLE PERIOD
- Q = QUANTITY PURCHASED
- NET PROFIT = R * QUANTITY SOLD + S * SURPLUS QUANTITY - C * Q

NEWSVENDOR MODEL SPREADSHEET

	A	B
1	**Newsvendor Model**	
2		
3	**Data**	
4		
5	Selling price	18
6	Cost	12
7	Discount price	9
8		
9	**Model**	
10		
11	Demand	41
12	Purchase Quantity	44
13		
14	Quantity Sold	=MIN(B11,B12)
15	Surplus Quantity	=MAX(0,B12-B11)
16		
17	Profit	=B14*B5+B15*B7-B12*B6

	A	B	C	D	E	F	G	H	I	J	K	L	M	N
1	**Newsvendor Model**			***Demand***					**Purchase Quantity**					
2				***$ 237.00***	40	41	42	43	44	45	46	47	48	49
3	**Data**			40	$ 240.00	$ 237.00	$ 234.00	$ 231.00	$ 228.00	$ 225.00	$ 222.00	$ 219.00	$ 216.00	$ 213.00
4				41	$ 240.00	$ 246.00	$ 243.00	$ 240.00	$ 237.00	$ 234.00	$ 231.00	$ 228.00	$ 225.00	$ 222.00
5	Selling price	$ 18.00		42	$ 240.00	$ 246.00	$ 252.00	$ 249.00	$ 246.00	$ 243.00	$ 240.00	$ 237.00	$ 234.00	$ 231.00
6	Cost	$ 12.00		43	$ 240.00	$ 246.00	$ 252.00	$ 258.00	$ 255.00	$ 252.00	$ 249.00	$ 246.00	$ 243.00	$ 240.00
7	Discount price	$ 9.00		44	$ 240.00	$ 246.00	$ 252.00	$ 258.00	$ 264.00	$ 261.00	$ 258.00	$ 255.00	$ 252.00	$ 249.00
8				45	$ 240.00	$ 246.00	$ 252.00	$ 258.00	$ 264.00	$ 270.00	$ 267.00	$ 264.00	$ 261.00	$ 258.00
9	**Model**			46	$ 240.00	$ 246.00	$ 252.00	$ 258.00	$ 264.00	$ 270.00	$ 276.00	$ 273.00	$ 270.00	$ 267.00
10				47	$ 240.00	$ 246.00	$ 252.00	$ 258.00	$ 264.00	$ 270.00	$ 276.00	$ 282.00	$ 279.00	$ 276.00
11	Demand	41		48	$ 240.00	$ 246.00	$ 252.00	$ 258.00	$ 264.00	$ 270.00	$ 276.00	$ 282.00	$ 288.00	$ 285.00
12	Purchase Quantity	44		49	$ 240.00	$ 246.00	$ 252.00	$ 258.00	$ 264.00	$ 270.00	$ 276.00	$ 282.00	$ 288.00	$ 294.00
13														
14	Quantity Sold	41												
15	Surplus Quantity	3												
16														
17	Profit	$ 237.00												

OVERBOOKING DECISIONS

	A	B
1	**Hotel Overbooking Model**	
2		
3	**Data**	
4		
5	Rooms available	300
6	Price	$120
7	Overbooking cost	$100
8		
9	**Model**	
10		
11	Reservation limit	300
12	Customer demand	290
13	Reservations made	290
14	Cancellations	15
15	Customer arrivals	275
16	Overbooked customers	0
17		
18	Net revenue	$33,000

	A	B
1	**Hotel Overbooking Model**	
2		
3	**Data**	
4		
5	Rooms available	300
6	Price	120
7	Overbooking cost	100
8		
9	**Model**	
10		
11	Reservation limit	300
12	Customer demand	290
13	Reservations made	=MIN(B11,B12)
14	Cancellations	15
15	Customer arrivals	=B13-B14
16	Overbooked customers	=MAX(0,B15-B5)
17		
18	Net revenue	=MIN(B15,B5)*B6-B16*B7

MODEL ASSUMPTIONS, COMPLEXITY, AND REALISM

- VALIDITY
- ALL MODELS REFLECT ASSUMPTIONS USED BY THE MODELER.
- ASSUMPTIONS SIMPLIFY MODELS AND MAKE THEM EASIER TO MANIPULATE AND SOLVE
- ASSUMPTIONS SHOULD BE AS REALISTIC AS NECESSARY TO MAKE MODELS USEFUL BUT NOT OVERLY COMPLEX
- ASSUMPTIONS SHOULD BE CLEARLY STATED AND DOCUMENTED
- TO ADD MORE REALISM TO A MODEL GENERALLY REQUIRES MORE COMPLEXITY

EXAMPLE: RETIREMENT PLANNING

	A	B	C	D	E
1	**Retirement Plan Model**				
2					
3	**Data**				
4	Retirement contribution (% of salary)	8%			
5	Employer match	35%			
6	Annual salary increase	4%			
7	Annual return on investment	8%			
8					
9	**Model**		Employee	Employer	
10	Age	Salary	Contribution	Contribution	Balance
11	25	$50,000	$4,000	$1,400	$5,400
12	26	$ 52,000	$4,160	$1,456	$11,448
13	27	$ 54,080	$4,326	$1,514	$18,204
14	28	$ 56,243	$4,499	$1,575	$25,735
15	29	$ 58,493	$4,679	$1,638	$34,111
16	30	$ 60,833	$4,867	$1,703	$43,410
17	31	$ 63,266	$5,061	$1,771	$53,715
18	32	$ 65,797	$5,264	$1,842	$65,119
19	33	$ 68,428	$5,474	$1,916	$77,719
20	34	$ 71,166	$5,693	$1,993	$91,622
21	35	$ 74,012	$5,921	$2,072	$106,945
22	36	$ 76,973	$6,158	$2,155	$123,814
23	37	$ 80,052	$6,404	$2,241	$142,364
24	38	$ 83,254	$6,660	$2,331	$162,745
25	39	$ 86,584	$6,927	$2,424	$185,115
26	40	$ 90,047	$7,204	$2,521	$209,650
27	41	$ 93,649	$7,492	$2,622	$236,536
28	42	$ 97,395	$7,792	$2,727	$265,977
29	43	$ 101,291	$8,103	$2,836	$298,195
30	44	$ 105,342	$8,427	$2,950	$333,428
31	45	$ 109,556	$8,764	$3,068	$371,934
32	46	$ 113,938	$9,115	$3,190	$413,994
33	47	$ 118,496	$9,480	$3,318	$459,911
34	48	$ 123,236	$9,859	$3,451	$510,013
35	49	$ 128,165	$10,253	$3,589	$564,656
36	50	$ 133,292	$10,663	$3,732	$624,224

	A	B	C	D	E
1	**Retirement Plan Model**				
2					
3	**Data**				
4	Retirement contribution (% of salary)	0.08			
5	Employer match	0.35			
6	Annual salary increase	0.04			
7	Annual return on investment	0.08			
8					
9	**Model**		Employee	Employer	
10	Age	Salary	Contribution	Contribution	Balance
11	25	50000	=B11*$B$4	=$B$5*C11	=C11+D11
12	26	= B11*(1+$B$6)	=B12*$B$4	=$B$5*C12	=E11*(1+$B$7) + C12+D12
13	27	= B12*(1+$B$6)	=B13*$B$4	=$B$5*C13	=E12*(1+$B$7) + C13+D13
14	28	= B13*(1+$B$6)	=B14*$B$4	=$B$5*C14	=E13*(1+$B$7) + C14+D14