

## ACTIVITY BASED COSTING

### – COST TO SERVE

#### CLIENT BACKGROUND

With a radical proposal to change distribution arrangements in the offing, an improved understanding of the impact on net profitability was essential for a national distributor.

Our client delivered 4,500 items to 22,000 accounts across the UK, from multiple RDCs, by a mixture of own transport, 3rd party and customer collections.

#### APPROACH AND METHODOLOGY

It was vital to start with a consensus around the key objectives. In this case they were two-fold:

- to gain a clear understanding of the net profitability of customers and products.
- to enable actions to be taken to improve net profitability.

Working with functional representatives from each area of the business, Harold Whitehead & Partners (HWP) closely examined the client's Management Accounts, ensuring any apportionment of costs was closely tied with the accepted layout. For each cost specified in the accounts, HWP identified the associated processes, activities and drivers.

By adopting a time-based approach and using detailed transaction data, costs could then be allocated at customer and item level.

All revenue and costs for customers and SKUs were aggregated at orderline level, providing full visibility of net profitability from the most detailed level, accounts and items, right up to

the highest level of customer sector and product category.

This approach enabled our client to have full drill-down visibility to investigate the drivers and processes behind customer and item profitability. In addition, reports could be configured from a traditional accounting perspective, highlighting departmental costs, or from a process perspective, such as customer delivery.

#### RESULTS

The Cost to Serve analysis proved to be a useful tool in a number of areas. It provided some startling insights into customer and product profitability, highlighting the fact that less than half of all customers and products generated a net profit.

More importantly, based on a sound understanding of relative product and customer profitability, it enabled the distributor to re-evaluate their commercial strategy; to focus on more profitable customers and product categories, by reviewing their customer service and sourcing strategies.

Tactically they were able to renegotiate prices with suppliers and redirect sales force activities by modifying the sales incentive scheme drivers.

#### FURTHER DEVELOPMENTS

The model can be further enhanced to provide the framework for a live analysis, sales and purchasing tool, creating true cross-functional understanding of corporate profitability.

Cost to Serve provides a toolset for all employees to make informed decisions increasing net profitability.

Each Cost to Serve model is unique to the client. This ensures each cost element accurately and proportionately reflects the true business processes, activities and drivers.

*“...serviced 4,500 items to 22,000 accounts across the UK.”*

*“...an improved understanding of the impact on net profitability was essential.”*

*“...toolset for all employees to make informed decisions.”*

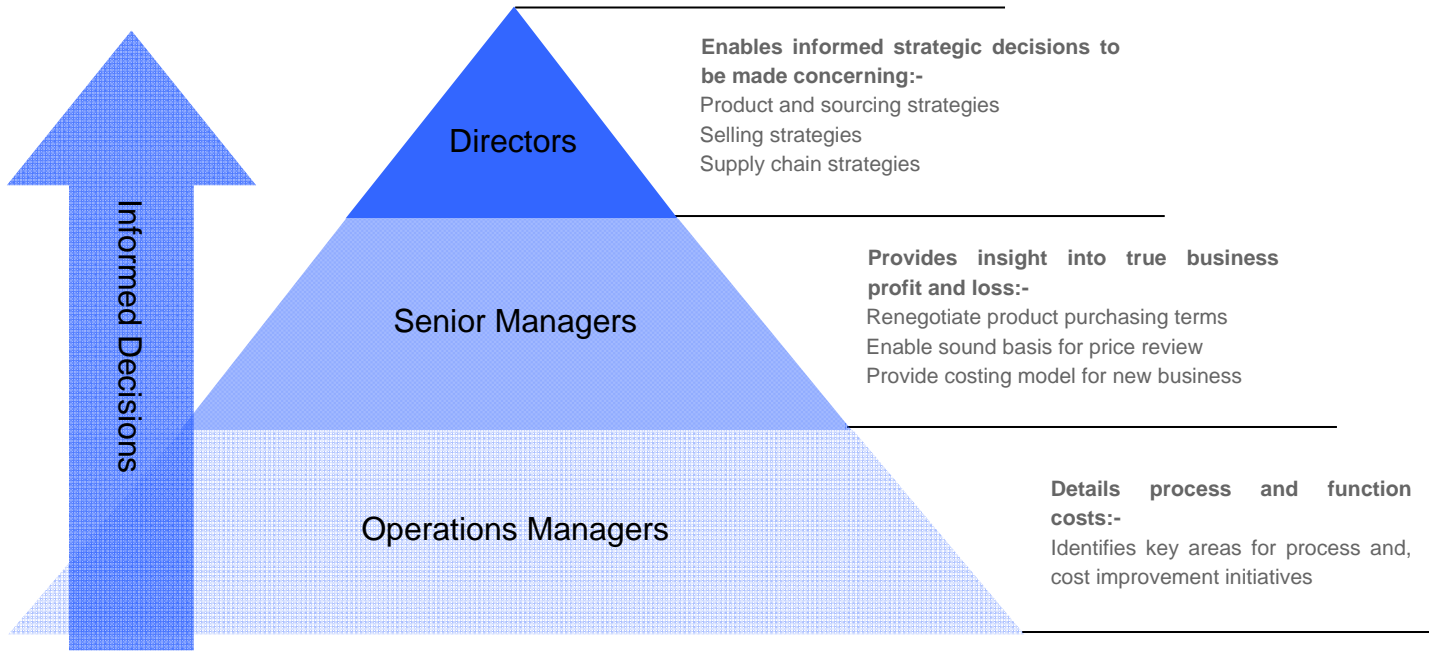
#### Deliverables:

- Understand net profitability
- Improve net profitability
- Stimulate change

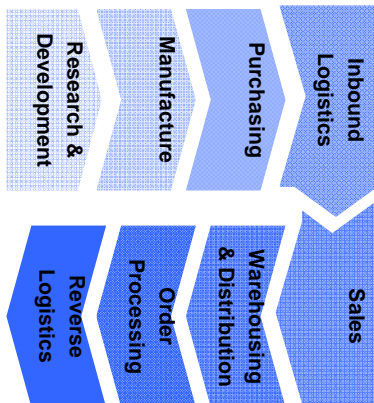
#### Results:

- Item and product profitability
- Basis for commercial strategy
- Basis for tactical negotiation

# Framework for Informed Decisions



Cost to Serve has relevant applications to a series of processes and activities within any business function. The flexibility of Cost to Serve allows detailed cost apportionment from a single process element up to the modelling of the complete business.



## BUSINESS SNAPSHOT

HWP will initially develop the Cost to Serve model to provide a single snapshot of business performance; usually the previous financial period.

This key milestone enables functional heads and key users to “buy-in” to both the methodology and the results. Also the process enables methodologies to be applied to exceptional costs.

For many companies this snapshot is the key deliverable, enabling a sound

basis for informed strategic, tactical and operational business improvements; the pyramid above reflects the hierarchical improvement drivers a Cost to Serve model can provide.

## CONTINUOUS IMPROVEMENT

The benefits of Cost to Serve are not limited to a single snapshot picture of company performance. The processes and activities assigned during the review can also be assigned to ledger codes, allowing the Cost to Serve to be reported on a regular basis.

This approach provides accurate time-based management reporting, enabling KPIs to be set and continuously measured.

## TOOLSET

HWP can customise a proven management tool to cover any activities within the business. Strategic, tactical and process improvement initiatives can all be derived from knowing the true Cost to Serve of customers and items. In addition, KPIs can be set and measured against a proven robust tool which truly reflects the business and operational processes.

## Harold Whitehead & Partners

Harold Whitehead & Partners enable our clients to achieve their strategic objectives and improve their operational effectiveness and profitability, by successfully implementing their change initiatives.

Founded in 1929, we are the longest established, independent, professional management consulting firm in the UK. The profile of clients and consulting activities has changed over time but our commitment to harnessing expertise, delivering client-focused results and applying acknowledged standards has remained constant. As Harold Whitehead himself put it in 1923, focused professionalism and the positive qualities of “service and constructive suggestion” still hold true for us today.

Another of his principles that has stood us in good stead is to never pre-judge or assume. Every organisation is unique and the decisions they face are specific to their particular situation. This precept is central to our approach and, based on it, we have delivered benefits worth many millions to our clients and provided savings many times in excess of project costs.

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