

Cost-to-Serve:

Cost & Profitability Analysis

“Standard costing systems aren’t accurate.
They allow you to lie to yourself.”

— **Tim Jahnke**

CEO, Elkay Manufacturing

Improving Profitability through Cost-To-Serve Analysis

Only the most profitable survive in today’s business climate. While companies strive to boost sales, cut costs, and increase market share – no business model can withstand a lack of profit. Calculating net profitability can be a challenge. Many companies are drowning in data, unable to determine true cost. Organizations know they have unprofitable customers, SKUs, product lines, and channels, but they can’t easily identify which ones are sabotaging their bottom line. Increasingly, companies are looking for solutions that deliver the level of detail needed to pinpoint the problems and provide answers to how to improve net profits, and ultimately earnings per share.

Cost-to-serve is a well-established approach for learning which customers and products matter most and how to manage them with the proper cost/service balance. Cost-to-serve analysis provides an activity driven view of how specific dimensions, such as products, customers, and channels, consume resources and incur costs. With this complete insight, those responsible for bottom-line performance can make critical and well informed strategic decisions while quickly identifying the underlying causes of poor profitability.

Acorn Systems’ profitability and cost management solution enables companies to understand their costs at multiple levels. Our solution allows business users to perform comprehensive costing calculations and modeling to gain a deeper understanding of profitability while eliminating inefficient and error prone manual costing activities in data collection, calculation, and analysis. Our unique approach to validation provides undeniably accurate data to influence organizational buy-in and accelerate operations use of the analysis.

Understanding and Managing Cost-to-Serve

Profitability at the Transaction Level



While most companies do some type of profitability and cost management, the pressure to better manage costs and ensure that all revenue growth is profitable has led many organizations to reconsider the effectiveness of their solution. Results from Excel, Access, financial components of ERP applications, or custom solutions pose numerous problems, including significant manual effort, undesired trade-offs, and disconnected models. More importantly, the output lacks the breadth, depth and business context required, often leaving more questions than answers.

Every customer, product and supplier delivers different value to the bottom line. To effectively improve profitability, it's critical to identify the most valuable ones, and test the impact that changes in pricing and process improvements will have on costs and profitability.

The Impact of Cost-to-Serve

Not all customers are equally profitable; in fact, 20-40% of them are losing you money. Much of this discrepancy is due to what they buy

and how they buy it. Calculating costs at the individual transaction level provides the most accurate representation of profitability.

Cost-to-serve analysis allows you to drill down from summary results to the transaction level and calculate the profitability of each customer account, based on the actual business activities and overhead costs incurred to service that customer. Traditional costing methods spread these indirect cost-to-

serve expenses across customers and products taking no account of the unique needs and cost drivers of certain customer and product types. Measuring on aggregated data like this prevents you from identifying the driving force behind their cost and profitability.

For example, in the Customer Profit and Loss Report below (figure 1) both Customer A and Customer B are practically identical based on total revenue. They are also both profitable based on gross profit; however, once cost-to-serve is factored into the comparison (figure 2), it becomes apparent that Customer B is very unprofitable. Drilling down to actual indirect costs reveals that Customer B has high sales, distribution and warehousing costs as well as substantial returns.

Customer P&L Traditional Approach		
	CUSTOMER A	CUSTOMER B
Revenue	10,000	11,000
Cost of Sales	(7,000)	(7,000)
Gross Margin	3,000	4,000
Overhead (30% COS)	(2,100)	(2,100)
Profit/Loss	900	1,900

Figure 1: Before cost-to-serve analysis.

Customer P&L Acorn's Approach		
	CUSTOMER A	CUSTOMER B
Revenue	10,000	11,000
Cost of Sales	(7,000)	(7,000)
Gross Margin	3,000	4,000
Cost-to-Serve	(2,020)	(5,660)
Administration	(100)	(200)
Brand activity	(300)	(200)
Sales	(600)	(1,500)
Order processing	(120)	(360)
Warehousing	(200)	(750)
Distribution	(350)	(1,100)
Customer service	(200)	(500)
Trade marketing	(50)	(250)
Returns	(100)	(800)
Profit/Loss	980	(1,660)

Figure 2: A more detailed and accurate picture

Complete Visibility Into Your True Costs and Profitability

Acorn Systems' Profitability and Cost Management Solution

Performance Analyzer,TM Acorn's profitability and cost management solution, enables you to get an accurate understanding of the costs associated with your products, customers, and services. Our solution provides undeniably accurate data, allowing you to perform comprehensive costing calculations and modeling to gain a deeper understanding of profitability while eliminating inefficient and error prone manual costing activities in data collection, calculation, and analysis.

Accurate, Actionable Insight

Performance Analyzer provides unparalleled process modeling and calculation functionality that allows you to precisely calculate cost-to-serve. This powerful product collects data from a variety of disparate sources and turns it into accurate, enterprise-wide performance measurement content for every dimension of a company's costs and resource capacity utilization. Once costs are identified and performance opportunities understood, a strategic plan is developed to decrease costs and increase revenue across the business.

Performance Analyzer is the only enterprise modeling and simulation application that allows you to analyze the total supply chain cost, trade-deal funding, and net profit of any product through any flow path. This enables cost-effective and proactive supply

chain decisions, reducing supply chain costs by 3-5% on average. Performance Analyzer uses actual cost drivers and process rates from your company's transactional systems to simulate the entire supply chain. It can be easily configured to accurately reflect the most profitable flow path.

What-if Analysis and Scenario Modeling

Performance Analyzer allows decision makers to create proactive plans and answer "what if" questions about operational changes as they conduct driver-based planning and forecasting by instantaneously simulating hypotheticals and drawing upon real-time data to deliver results. What-if scenarios can be evaluated side by side to decide proactively which logistical and operational decision is the most profitable. The insight created by Performance Analyzer enables you to confidently negotiate because all the numbers you need are at your disposal.

“Until we began using Acorn's profitability solutions, we couldn't put our finger on the cost of doing business. What would it cost to add a new product line, some new trucks, a new customer? Should we get rid of certain products? Enforce minimum order sizes? We never had a definite answer.”

— Kurt Anderson

Director of Operations, J&B Wholesale

KEY FEATURES:

- Flexible business modeling application
 - Unlimited business dimensions and transaction volumes
 - Single, unified model – not multiple applications or models
 - Integration into heterogeneous data sources
 - Excel and web-based access for ease of use
 - Only solution that truly supports Time-Driven Activity-Based Costing
 - Rapid time to deployment based on methodology
 - Enterprise class security, traceback and audit
 - Pre-built and ad-hoc reporting and analytics
 - Multi-currency, multi-language
 - Multiple model versions, scenarios and time periods
-

“Acorn Systems’ solution gives us even greater visibility into the profitability of our individual stores and products we sell. Acorn’s ability to bring expertise in retail and activity-based costing was critical to a successful implementation.”

— Steve Stone

Senior Vice President & Chief Information Officer, Lowes

Model Development

Acorn creates a model of all SKUs, sales, units, gross to net adjustments, operating and support expenses for all categories across the enterprise (figure 3). This model matches the complexity of your business including your internal and external supply chain. Using time-driven activity-based costing techniques, we then differentiate

among processes operating at norm, those that are substantially better than norm, and those that drive extra costs and exhaust capacity. Using this detailed, granular costing insight, we then simulate the product flow path of thousands of products and SKUs through the supply chain to optimize your flow path and network.

BUSINESS BENEFITS:

- Transform the complexity of your business and gain actionable insight into the true drivers of profitability across your enterprise.
- Accurately determine the net profitability of individual SKU's, customers and suppliers, through accurate allocation of indirect costs and value-added services.
- Create proactive plans and test changes that will impact your bottom line using driver-based scenario modeling and simulation.
- Remove inefficiency and non-value added costs.
- Calculate the profitability of new contracts before you sign them.
- Negotiate better terms with your suppliers and transportation firms.
- Make better business decisions, with information at your fingertips.

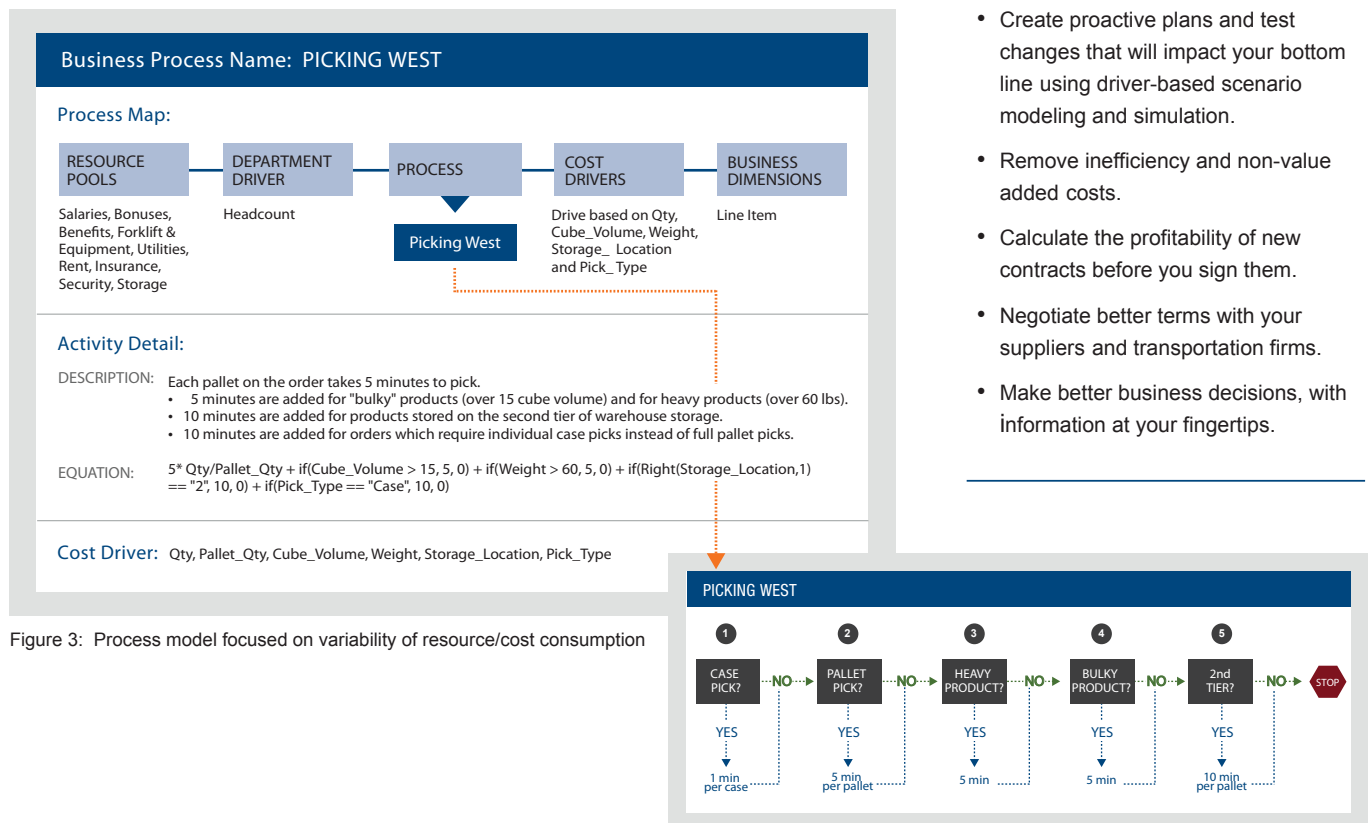


Figure 3: Process model focused on variability of resource/cost consumption

“Beyond the significant value we achieved, the real value is that people no longer argue about where we make our money and why. It’s now about what we do to improve.”

— **John Hrudicka**
Chief Financial Officer, Elkar Manufacturing

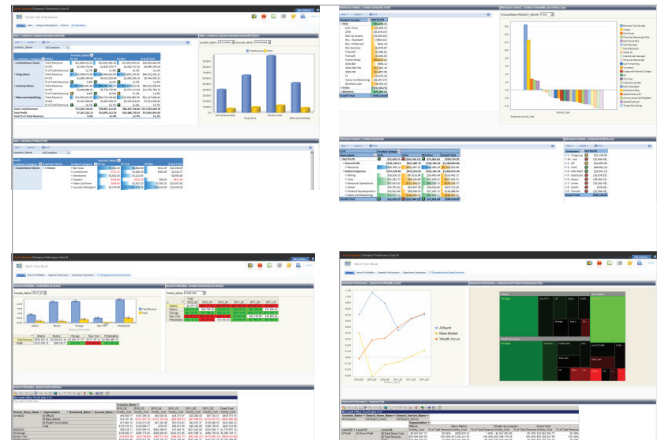
Sophisticated Reporting and Analysis

Transform the complexity for your business into actionable information and make better business decisions using information at your fingertips. Our clear, actionable reports will quickly show you which products, customers and suppliers are making and losing money, and why.

Management Reports

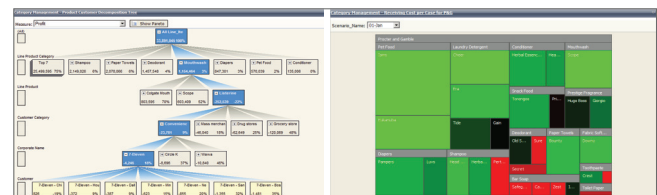
Category	Amount	Percent	Change
Customer Service	\$1,208.23	1.9%	1.9%
Order Entry	\$2,702.00	4.2%	4.2%
Order Loading	\$3,375.00	5.2%	5.2%
Order Ship	\$1,889.00	2.9%	2.9%
Shipping	\$4,524.00	7.0%	7.0%
Accounting	\$6,875.00	10.6%	10.6%
Revenue	\$63,831.00	98.3%	98.3%
Revenue Profit	\$51,451.75	80.6%	80.6%

Dashboards



Traceback and Validation

Decomposition Trees and Heat Maps



Excel Enabled and Ad Hoc Reporting

Customer Category	Product Rank	Scenario Name	Average Order Size	Order Breakdown	Orders Less Than Breakdown	Customer Deliveries	Cost Per Delivery	Delivery Cost Per Mile	Sales Cost Per Minute
7 Elkar - Boston	5.00	65,556.11	57,418.11	2.00	4.00	3,754.84	4.39	8.20	
10 Elkar - Chicago	7.00	53,688.08	45,675.14	2.00	3.00	2,472.40	24.72	8.70	
11 Elkar - Dallas	5.00	90,514.75	76,559.40	1.00	3.00	2,636.16	5.66	8.12	
12 Elkar - Houston	3.00	87,803.10	84,621.41	2.00	1.00	3,340.80	11.93	6.77	
13 Elkar - Los Angeles	6.00	83,524.41	83,524.41	4.00	3.00	5,552.14	6.24	8.30	
14 Elkar - Minneapolis	3.00	39,545.03	35,586.49	0.00	1.00	14,058.17	7.79	10.61	
15 Elkar - New York City	5.00	85,873.77	85,873.77	2.00	5.00	5,407.10	9.34	7.17	
16 Elkar - San Francisco	11.00	43,145.77	39,056.44	4.00	4.00	2,428.44	6.82	13.29	
17 A & P - Boston	7.00	58,147.48	58,178.42	4.00	5.00	8,193.67	5.37	11.72	
18 A & P - Chicago	7.00	56,539.12	53,071.18	2.00	4.00	3,246.04	11.41	8.20	
19 A & P - Dallas	2.00	32,606.19	30,606.14	0.00	2.00	4,606.16	24.90	8.70	
20 A & P - Houston	8.00	45,464.27	57,975.19	3.00	4.00	2,813.83	8.78	10.61	
21 A & P - Los Angeles	6.00	39,526.46	39,526.46	2.00	3.00	5,552.14	7.05	10.61	
22 A & P - Minneapolis	2.00	39,526.46	39,526.46	1.00	2.00	3,481.99	12.80	10.61	
23 A & P - New York City	3.00	39,526.46	39,526.46	1.00	1.00	1,974.95	13.91	8.20	
24 A & P - San Francisco	5.00	81,847.82	81,835.41	3.00	3.00	2,705.14	6.85	8.20	
25 Albertson's - Boston	9.00	44,387.10	41,738.42	4.00	7.00	2,305.84	4.33	9.02	

Cost-to-Serve In Action:

North American, Multi-Tier Wholesale Distribution Company



Overview

Focused on service, this North American, multi-tier wholesale distribution company runs 14 warehouses and has recently been party to three mergers and acquisitions.

The company was an early adopter of cost-to-serve methodology, building its own system for analysis. However, the limitations of the system caused the team to look for packaged applications. The company's homegrown system took too much time to run, and the technology did not allow discovery of better options through drill-down analytics and what-if analysis.

Business Challenge

This distributor experienced revenue growth associated with a rapid decline in profitability. Several years earlier they had expanded from high end products into the retail channel with lower end products. This created an explosion in services, trade deal funding and SKUs. P&Ls were high level and greater transparency into the net

profitability for customers, channels, SKUs, and brands was needed to effectively grow revenue.

Solution

Implementation of Acorn's Performance Analyzer gave management visibility into the net profitability for accounts, channels, segments, products and shared services. With the new enterprise-wide performance measurement system solution in place, managers can access detailed financial information, including analysis on the cost of different activities and the profitability of individual customer accounts. This supports management decision making and has enabled a wide range of proactive cost reduction and profitability improvement initiatives.

High Performance Results

- Greater granularity into cost information for a range of cost drivers
- Improved timeliness and accuracy of reporting
- Reduced SKUs by 7%
- Achieved \$7M savings with one customer
- Top line revenue growth on every negotiated deal
- Prevention of two plant closures
- ROI of 20X within 1 year
- Overall business impact > \$25M

About Acorn Systems

Acorn solutions combine technology and proven methodology to reveal profit improvement opportunities across the enterprise - customers, channels, segments, products, vendors, and processes. Acorn has delivered over \$5 billion in profit improvements and billions in new shareholder value for Global 2000 companies in Financial Services, Retail, Consumer Products, Manufacturing, Distribution, Logistics and Services.

Contact

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visit: www.acornsys.com

email: sales@acornsys.com

call: 800.982.2676

