



Overview of Dawson's Cost To Serve (CtS) Methodology

DAWSON CONSULTING

a Dawson Group company

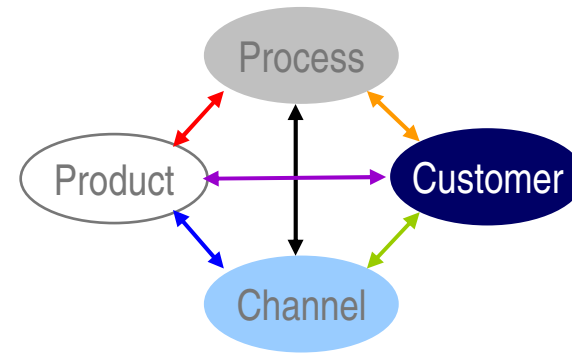
Traditional costing and cost allocation methods rarely provide visibility and insight into the true cost of doing business

Traditional Approach to Costing



- Look to singular process – product relationships and averaging mechanisms, without providing adequate context for the segment / outcome to which the costs relate
- Various approaches, functional isolation and rigid cost segmentation allows for misrepresentation of real costs
- Traditional methods of cost measurement have focused on dollar outcomes, rather than providing a wider perspective on operational efficiency
 - fixed, variable, semi-variable, direct, in-direct, differential, incremental, controllable, sunk, opportunity
- Make it difficult to set prices that accurately reflect full cost inputs
- Do not provide adequate transparency to allow management to add / drop product lines and customers or increase / decrease production components etc.

Dawsons Cost to Serve (CtS) Approach



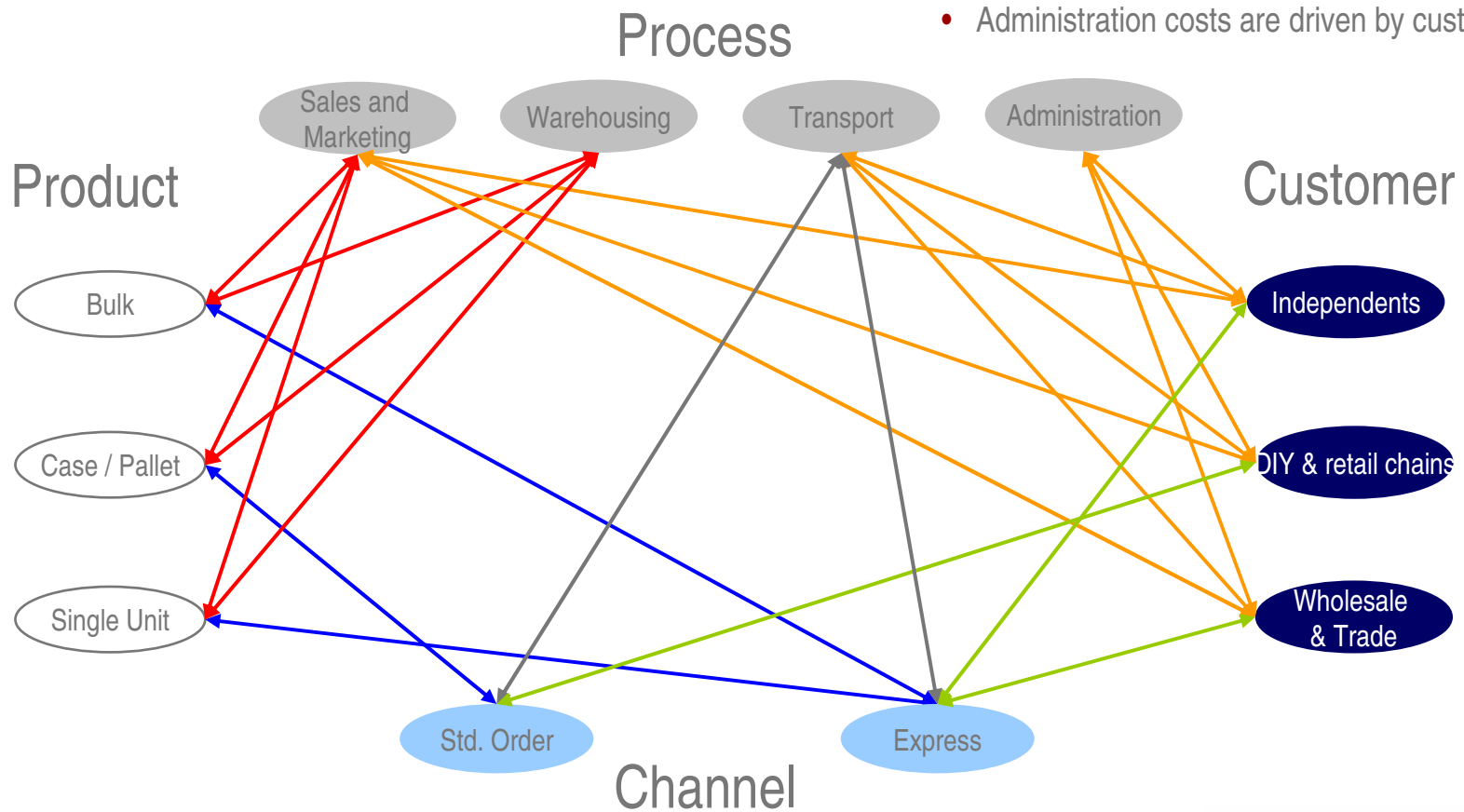
- Seeks to establish the relevant cost relationship between the following key supply chain elements: Process, Product, Channel, Customer
- Provides visibility of the true cost of doing business
- Facilitates sound strategic decision making such as the exiting of permanent loss customers to competitors and the capture of high profit customers from competitors
- Allows protection of highly profitable customers
- Encourages re-pricing of existing products and services
- Allows for discounting to gain new business with low cost to serve customers
- Encourages the negotiation of win-win relationships with customers who are prepared adopt a collaborative approach

In a multi product, multi channel, multi customer environment the need for 'Cost to Serve' visibility is critical

Illustrative

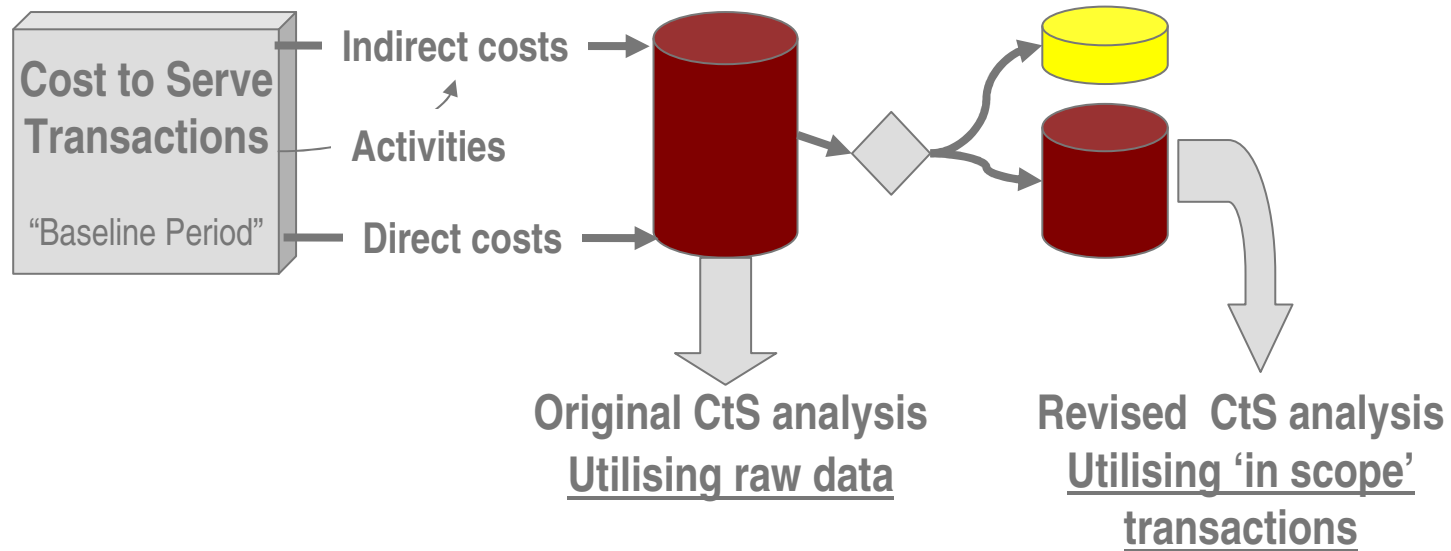
In this example:

- Sales and Marketing costs are driven by product
- Warehousing costs are driven by product
- Transport costs are driven by channel and customer
- Administration costs are driven by customer

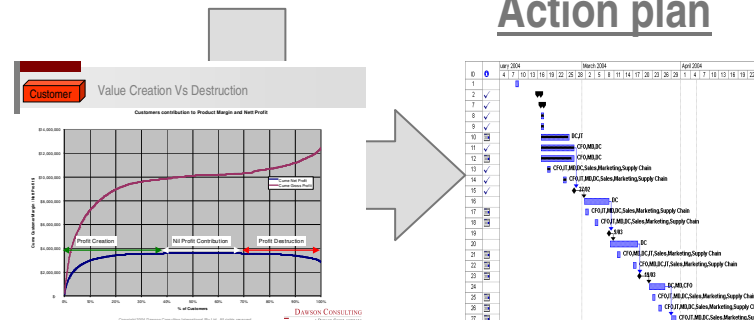


The analysis is typically performed in two stages

Quarantine non representative and/or transactions already actioned



Action plan



The key output is a fully costed transaction base that can identify the net profitability of each line item



e.g.

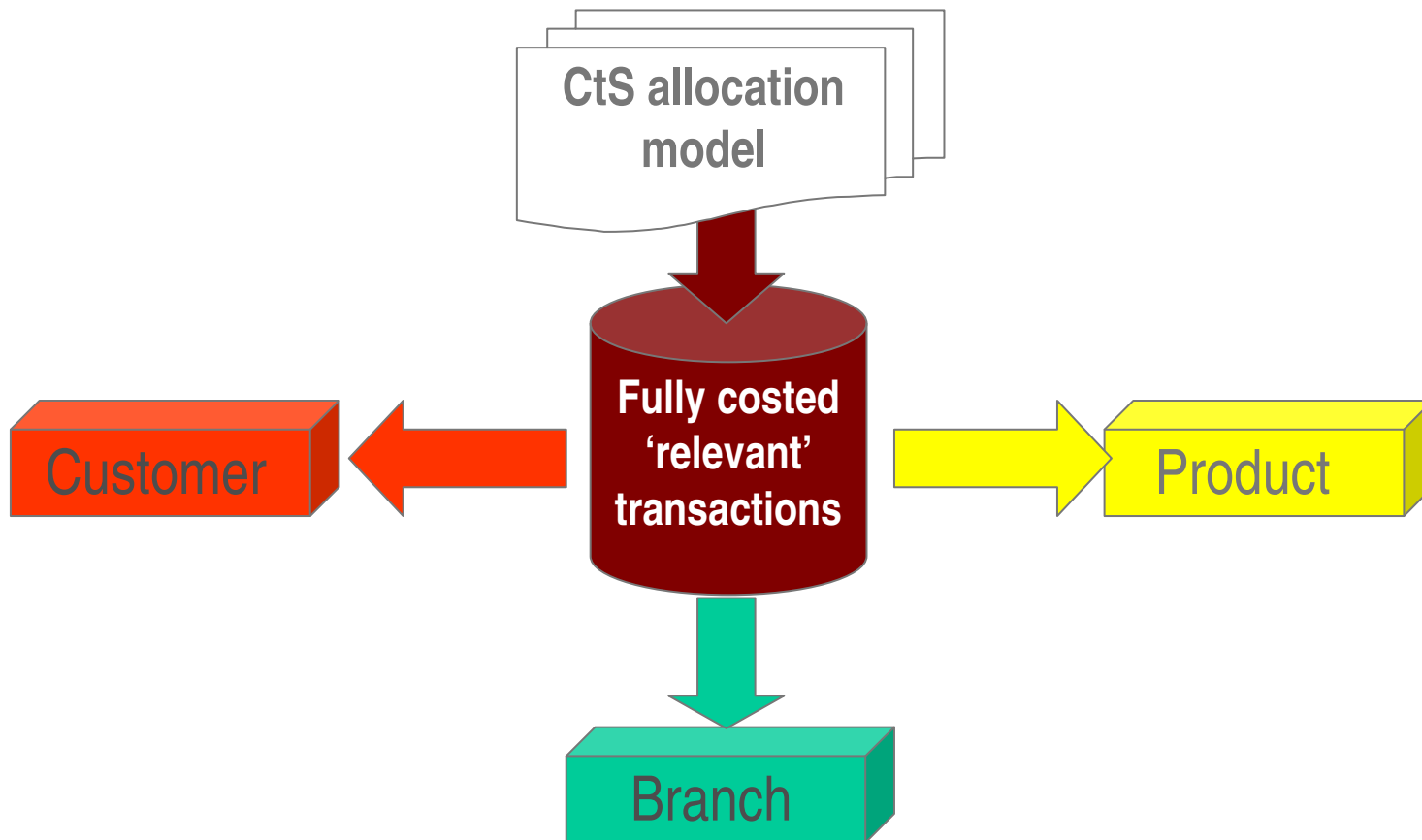
Transactional data								Gross Margin	Allocated Costs						Product Margin	
BillDoc	Material	Sales office	Customer	Units	COG	Sales	Max Sales		Customer Freight	Cust Rebate	Interbrch Freight	Freight Recovery	Allocated Whse Cost	Allocated HO Cost		ETC
45000000	ABCDEF	S511	ABC	5	\$200	\$300	\$360	\$100	\$15.00	\$0.20	\$1.40		\$10.30	\$7.70	\$4.00	\$61
45000000	HJKLM	S511	ABC	3	\$2	\$5	\$6	\$3	\$10.00				\$3.20	\$7.40	\$3.00	-\$21
45000001	ABCDEF	S514	EDS	1	\$20	\$25	\$30	\$5	\$5.00		\$3.20		\$7.40	\$8.30		-\$19
45000002	HJKLM	S512	FDS	3	\$50	\$150	\$180	\$100	\$0.00	\$0.50			\$1.10	\$2.50		\$96
45000003	HJKLM	S511	EDRF	3	\$21	\$23	\$28	\$2	\$10.00	-\$0.50				\$4.40	\$4.00	-\$16
45000004	ABCDEF	S512	ABC	1	\$100	\$120	\$144	\$20	\$5.00	\$0.00			\$3.20	\$12.30	\$4.00	-\$5
45000005	HJKLM	S513	ABC	3	\$50	\$75	\$90	\$25	\$0.00	\$0.50	\$1.30		\$1.70	\$12.00	\$2.00	\$8

ERP systems typically show line items at the gross profit level

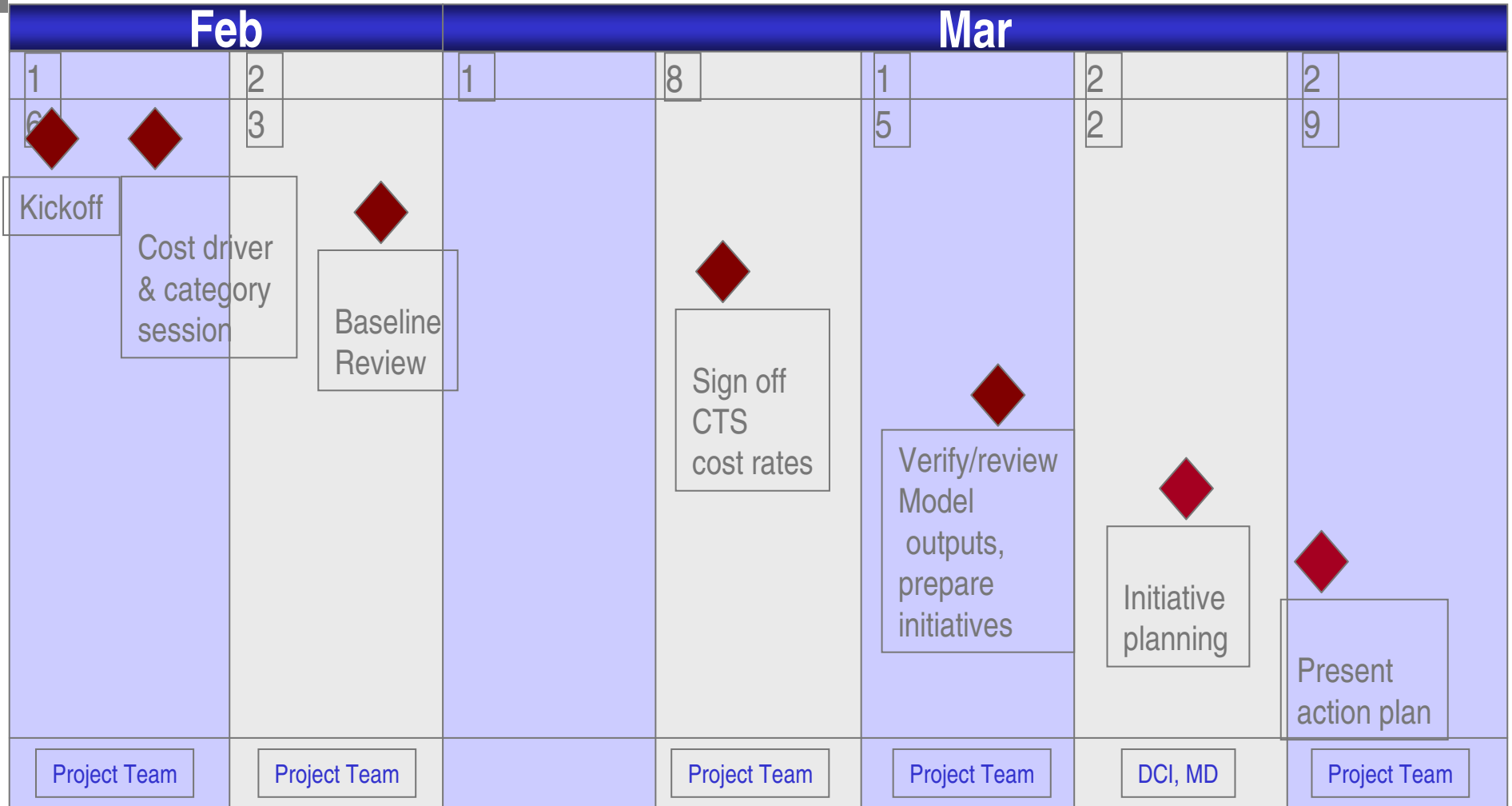
Cost to Serve analysis determines the appropriate indirect costs to apply to each transaction


...to determine the nett profitability of each line item

These fully costed transactions can be viewed from a variety of perspectives



Project Management: - Overall timeline is about 8 weeks





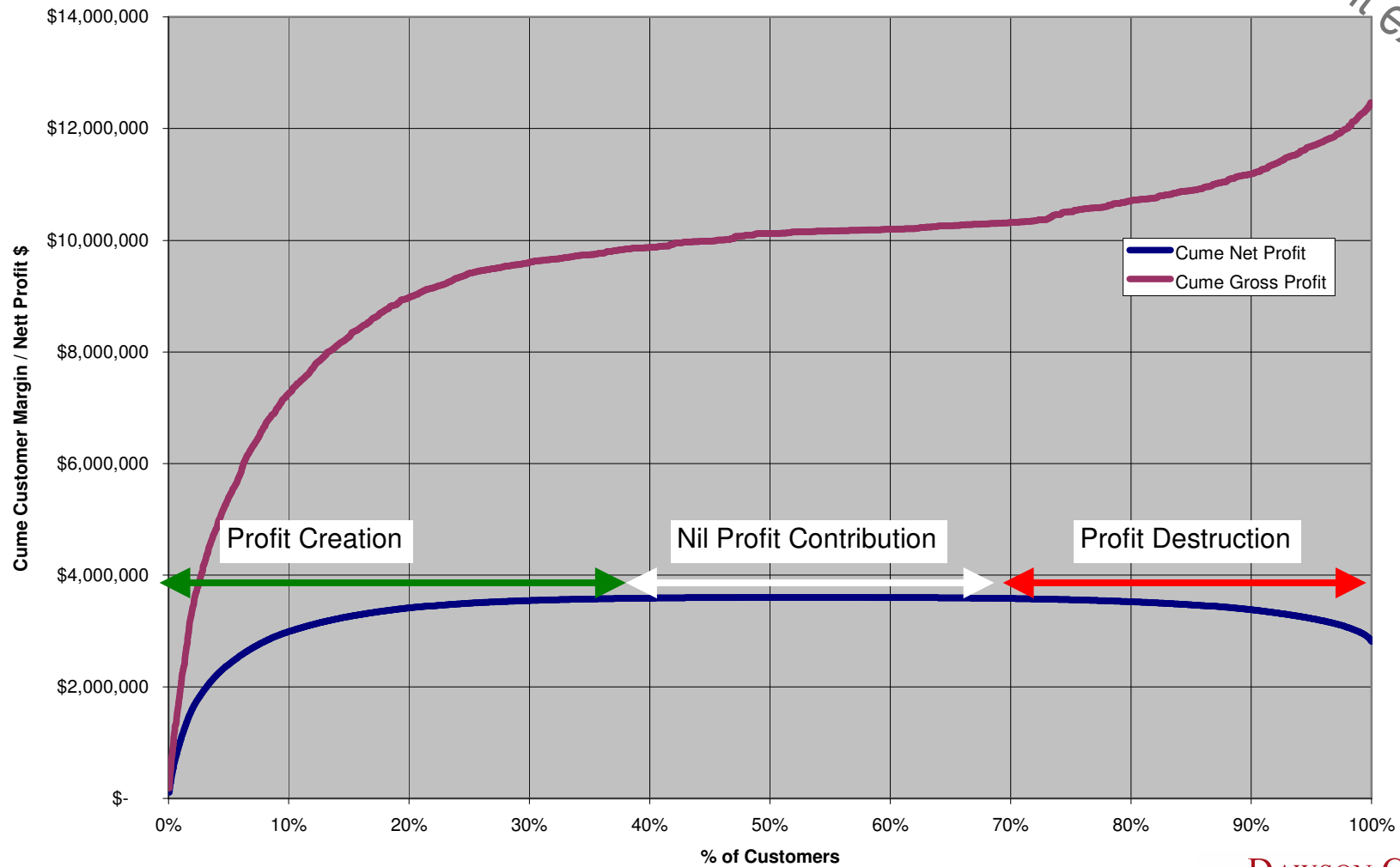
Model Output; Client Example

Customer

Model Output - Value Creation vs Destruction

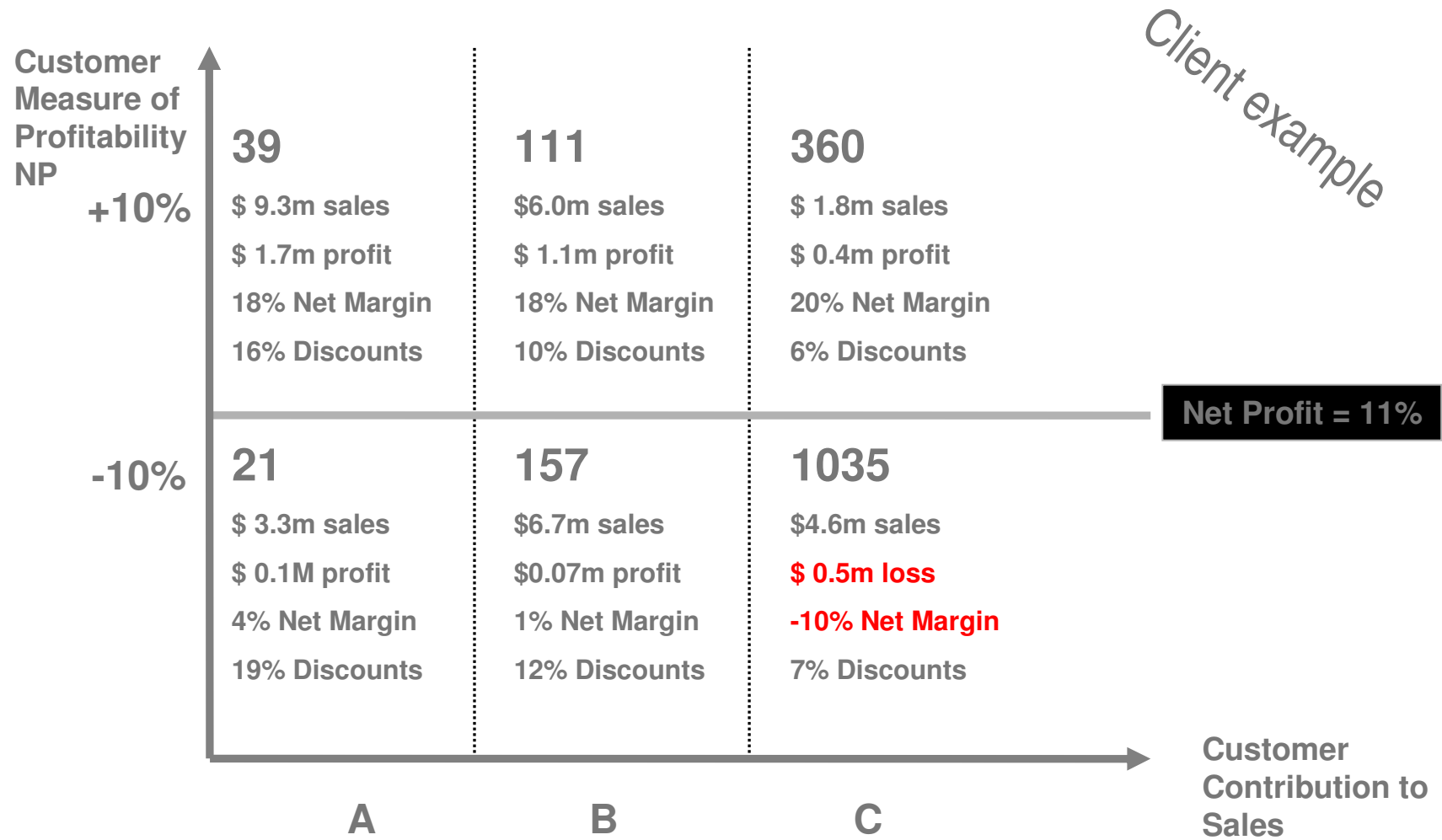
Customers contribution to Product Margin and Nett Profit

Client example



Customer

Model Output - Customer segmentation

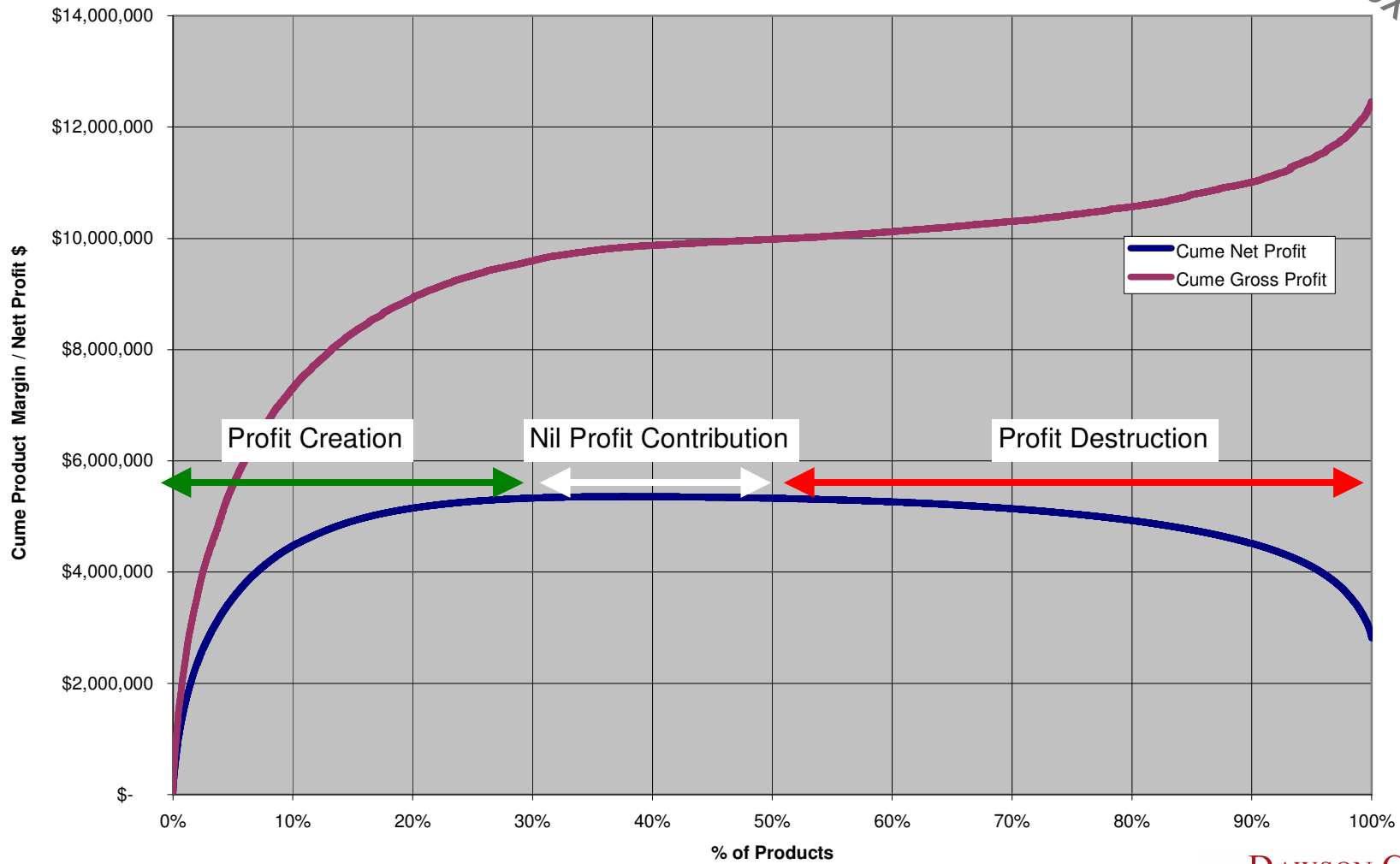




Model Output - Product Value Creation vs Destruction

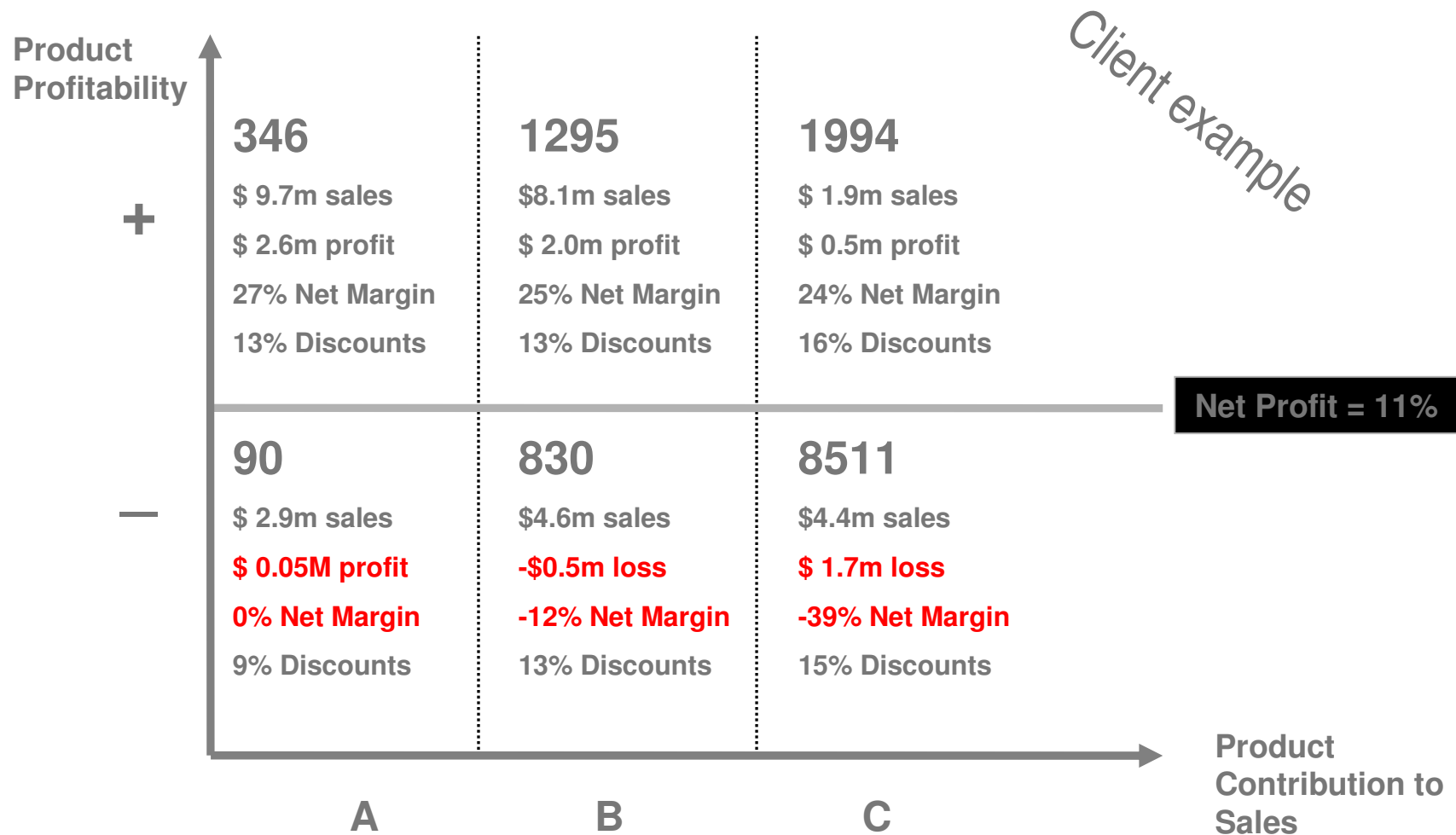
Product contribution to Product Margin and Nett Profit

Client example



Product

Model Output - Product segmentation



Model Output - Nett profitability of individual transactions can be viewed by product and by customer

Client example

Customer product profitability matrix

Each transaction can be 'tagged' depending upon the rate of net profitability e.g. "+" transactions have nett profitability > x%

Customers	Products		Total
	+	-	
+	\$3,481,079	-\$411,928	\$3,069,151
-	\$1,584,006	-\$1,842,606	-\$258,600
	\$5,065,085	-\$2,254,534	\$2,810,552

There is a bigger issue with "-" products than "-" customers

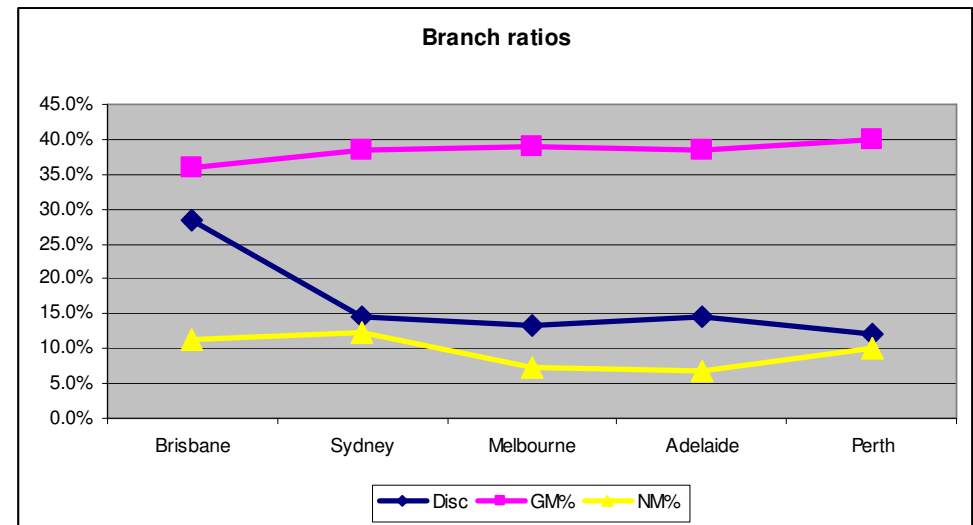
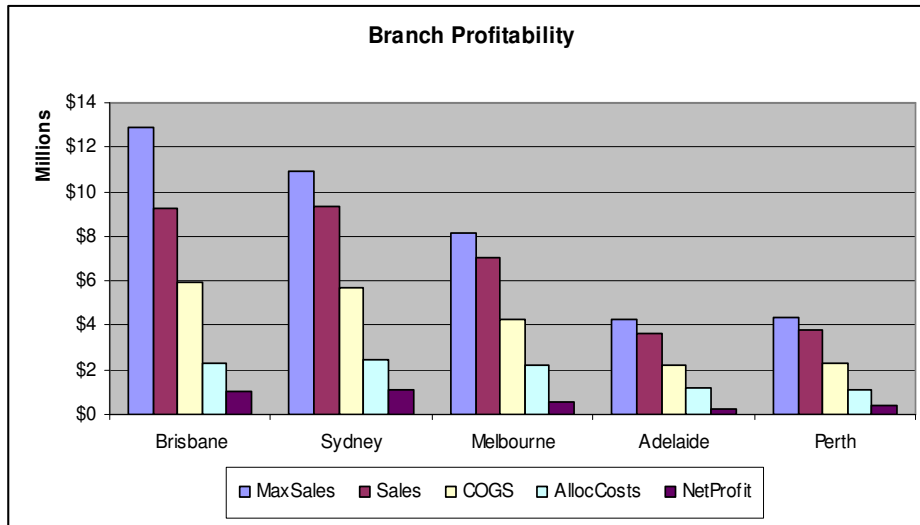
Branch

Model Output - The branch network has some key differences

Branch View

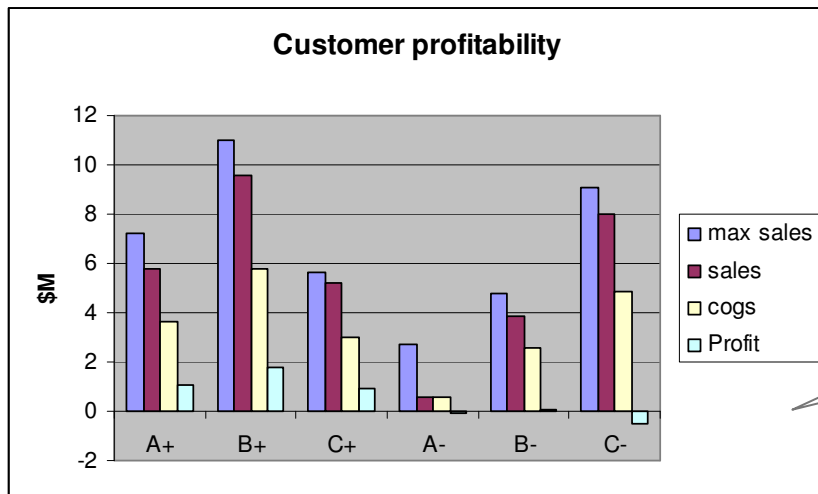
SOff		MaxSales	Sales	AveDiscount	Disc	COGS	GM%	AllocCosts	Total cost	NetProfit	NM%
S511	Brisbane	\$12,920,311	\$9,237,098	\$3,683,213	28.5%	\$5,908,591	36%	\$2,288,840	\$8,197,431	\$1,039,666	11.3%
S512	Sydney	\$10,894,180	\$9,301,902	\$1,592,278	14.6%	\$5,729,771	38%	\$2,437,440	\$8,167,211	\$1,134,691	13.2%
S513	Melbourne	\$8,117,797	\$7,033,852	\$1,083,945	13.4%	\$4,288,749	39%	\$2,224,653	\$6,513,402	\$520,450	7.4%
S514	Adelaide	\$4,262,640	\$3,644,513	\$618,127	14.5%	\$2,245,932	38%	\$1,147,778	\$3,393,710	\$250,803	6.9%
S515	Perth	\$4,321,523	\$3,802,570	\$518,953	12.0%	\$2,282,628	40%	\$1,140,898	\$3,423,527	\$379,043	10.0%
Total		\$40,516,452	\$33,019,935	\$7,496,517	18.5%	\$20,455,671	38%	\$9,239,609	\$29,695,281	\$3,324,654	10.1%

Client Example

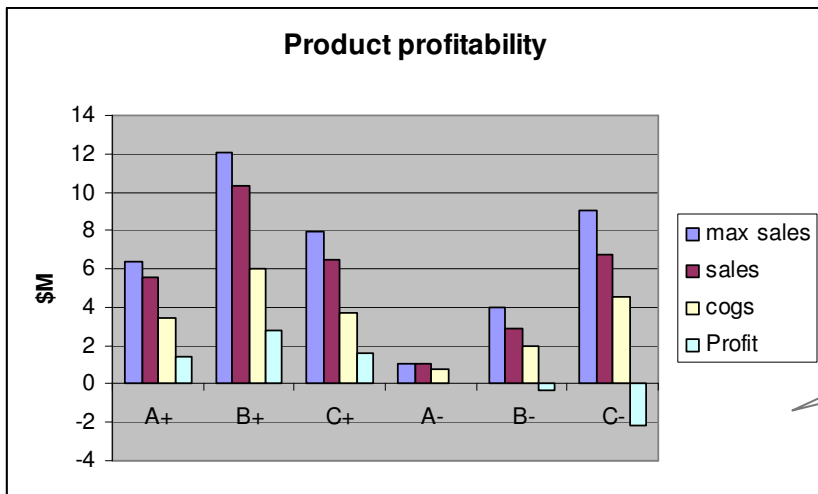


Model Output - Where are the issues?

Client example



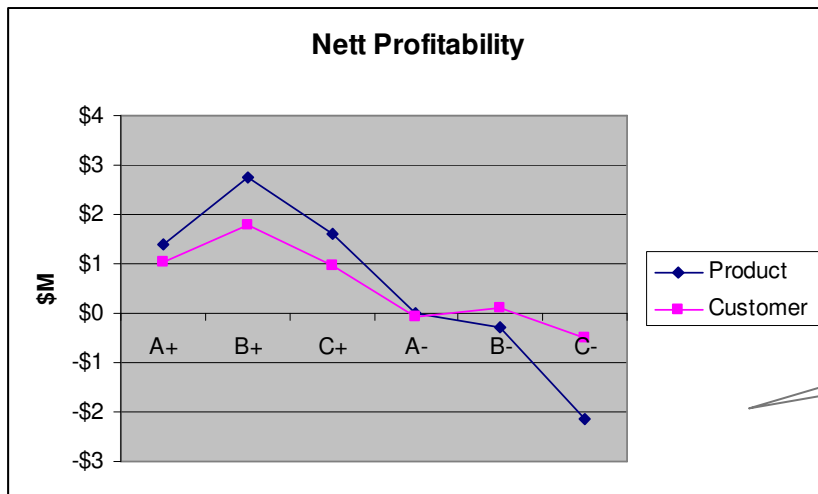
Profit is generated mainly through “+” Customers



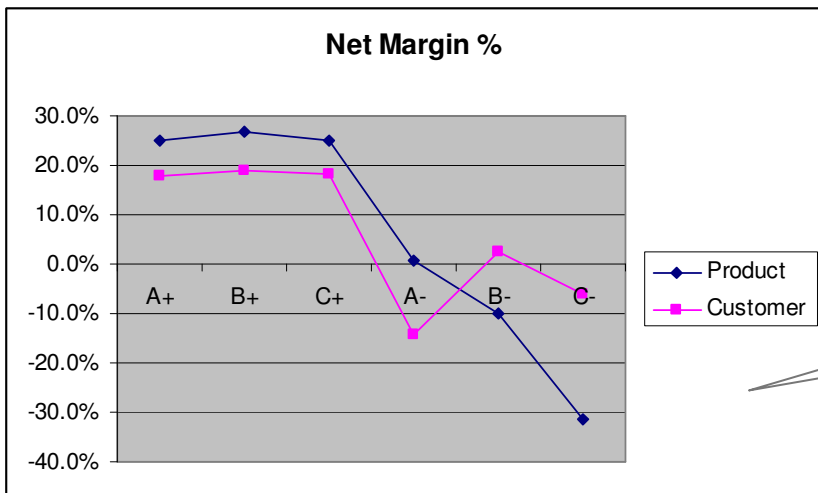
...and especially through “+” Products

There appear to be key trends in product and customer profitability

Client example



Profitability strongly correlated to both customer and product categorisation



..a similar picture emerges when nett profitability in % terms

This analysis also identifies and quantifies other supply chain issues

- Customer returns Significant activity (over 10% of sales)
- Pricing
 - Level of discounting Relevance of “Max sales” (average discount 18%)
 - Errors in Execution Numerous credit and debit memos and adjustments
- Inter office product movements
 - Interbranch transfers \$ 300k
 - Interstate supply \$ 228k (of 760k total customer freight)
 - Freight recovery Now recovering only 70% of budget amounts (about 70% of actual amounts)
- Role of branch facilities Significant costs in the distribution facilities (\$3.7m unallocated)
- Allocation sensitivity Most costs allocated using “Salary and Wages” allocation methods (\$6m)

Client example