



# CostPerform – delivering bottom line benefits

## Improving product and customer profitability

This dairy had sales of £14 million but was making a loss of 12% of sales.

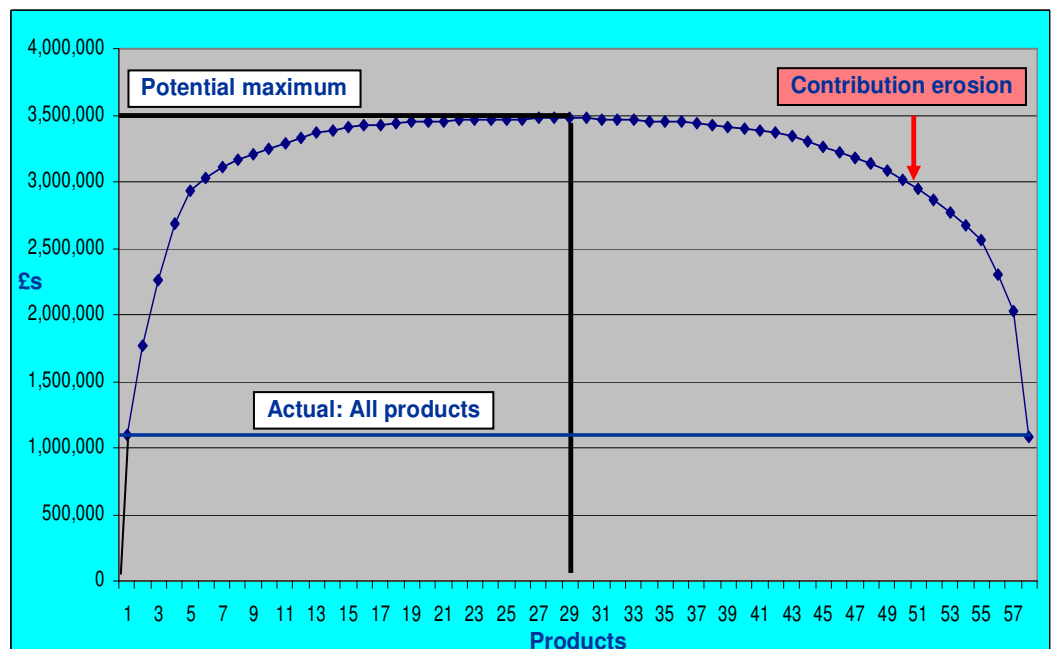
The cost of milk was 72% of sales, operating costs at 40%. Breakeven could be reached by reducing the cost of milk by 30% or operating costs by 17% or by increasing prices by 12%. Each option on its own was not realistic and even a mixture was going to be unpalatable.

There was an urgent need for a proper understanding of the true costs of the 60 products and the true costs of the dairy's relationships with its 700 customers.

### Product profitability

By building an Activity Based Costing model, costs were assigned to each of the products and the costs compared to revenue.

The resulting curve of cumulative product profitability from highest profit product to lowest is shown **right**.



### There was some good news

Around 50% of the products were profitable. Just these products alone would have made a product contribution of 30% of sales, 350% higher than the actual 8% of sales. Among them, half fat milk with 20% of sales, 13% of costs and a healthy 80% return on costs, was the most popular product and showed that there was at least a sound business base.

Double cream, almost a by-product of making half fat milk enjoyed a 500% return on costs.

## However, a longer list of product profitability issues existed

<b>Organic milk</b>	Farmers were paid 50% more than for ordinary milk and collection and silo costs were over 400% higher than normal processing due to high installed capacity for very low demand.
<b>Yogurts and Crème Fraiche</b>	High diversity in the range but low relative volumes.
<b>Ice cream &amp; Spreadable butter</b>	High equipment costs, low utilisation.
<b>Skimmed Milk Powder</b>	Used the excess raw milk. Selling price lower than the costs of production.
<b>UHT mini pots</b>	Unfortunately the result of a high volume, high discount contract where the sales didn't cover the cost of production. Not an unusual occurrence in many companies where the real costs are hidden from key decision makers.

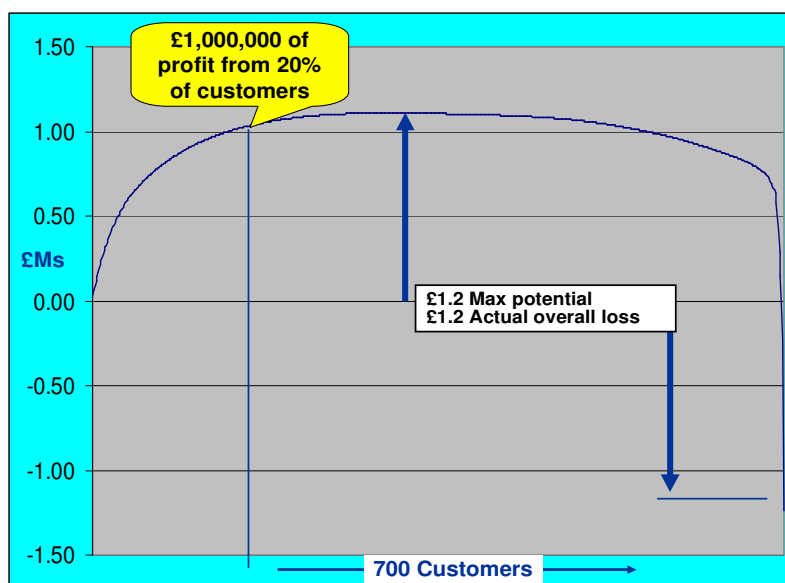
## Customer profitability - There was some good news

Around 40% of customers were profitable. Just these customers alone would have made a profit of 18% on their sales, rather than the 12% loss for the business as a whole.

## However, a complex situation existed in terms of customer profitability

Above an order value of £20, order value and sales value were not related to profitability. Big orders and big volumes kept people busy, often working for zero or negative return. Each customer relationship cost and product mix ordered had to be examined in detail to uncover the cause of the problem.

An order value of less than £20 was always unprofitable. These customers abused the level of service provided by ordering small quantities, on sale or return, often as emergency deliveries. Changing the service levels to something more rational brought the company back to at least breakeven at a stroke!



## Benefits demonstrated by the analysis

The ABC analyses were able to show the business where it could take immediate action to reverse its fortunes. Some of the actions taken are listed below:

- Where prices were patently wrong they were adjusted where the market could absorb the increases
- Products were deleted where there was no hope of them ever making a contribution
- Better promotion of high margin products was started along with the development of new products that were likely to have the same price characteristics
- No product introductions were to be made without a business case proven using ABC costings
- No customer contracts to be entered into without proven profitability based on ABC costings
- Change service level contracts with all commercial customers to eliminate abuses
- Examine every customer relationship cost and product mix ordered in detail to uncover further opportunities to reduce margin erosion

