



Yorkshire & Humber Regional Development Agency

■ Case Study

- Strategic Cost Management Programme

Synopsis

A pilot study into Strategic Cost Management was undertaken, working with 10 companies in the Advanced Engineering and Metals (AEM) sector in Yorkshire and Humber. The pilot established a procedure for introducing Activity Based Costing (ABC) quickly and effectively to the SME environment. A new process - Rapid Build ABC - has been developed. It greatly reduces the time and effort required to improve strategic cost management within the SME community.

Background

Yorkshire Forward sponsored a pilot programme for Strategic Cost Management within the Advanced Engineering and Metals (AEM) cluster in Yorkshire and Humber. The pilot involved working with 10 firms in the cluster to develop a more effective method of strategic cost management, called Rapid Build ABC. The 10 companies have a combined turnover of £43m and employ over 600 people.

Rapid Build ABC

The process applies the techniques of Value Management and prototyping to capture fundamental cost information and business issues. It examines the key activities within the business from receiving orders, through the manufacturing processes, to delivering to customers.

Rapid Build ABC allocates costs to products, customers, and services based on resources actually used. This is a distinct improvement over the arbitrary allocation of indirect costs sometimes used in traditional accounting systems.

The approach needs the involvement of a management team and key members of staff. The team's experience and judgement are used to map out the Key Activities, their linkage, pull and utilisation of corporate resources. This consultation process helps to build confidence and consensus at each stage of the Rapid Build ABC process, where decisions on relevant weighting and resources are needed.

Summary of Findings

The 10 firms involved engaged very freely with the advisory team. This collaborative working produced a significant body of information, several major findings within each firm and the beginnings of a data bank to benchmark key activities for future participants in the Strategic Costing Programme. Some key highlights are:

- The sample shows a wide range of indirect costs - from a low level of 15% up to 60% for companies making many different product lines and selling these into many markets;
- Only 39% of indirect costs related to production therefore 61% of all indirect costs supported this key activity;
- There were at least three cases where product lines were being reviewed based on their true profitability;
- Several large potential and current customers received heavily subsidised products, especially in the early stages of the relationship;



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- One of the areas of major interest for the pilot SMEs was the cost to serve customers. The impact of high cost to serve small and medium sized accounts became apparent when customers were classified using the activity matrix;
- Most of the companies who undertook the customer analysis were reluctant to drop customers - however small and costly to serve. The important thing was to concentrate on reducing the cost to serve and sometimes to increase prices to more realistic levels;
- Participants' feedback has been enthusiastic, especially in the examination of critical business areas such as loss making product groups and high cost to serve customers; and
- The approach has proven to be flexible and usable (several SME participants have been refining their cost models after their base models had been developed).

Sample feedback from the pilot

Management buy-in and the availability of the right project team are essential for a successful outcome. Typical feedback from the pilot:

"It is good to stand back from the day to day management tasks and assess from first principles the cost structure of the firm, especially the use of the key resources normally considered as indirect costs."

- James Terry, Managing Director PCT Automotive Ltd.

"Activity Based Costing has attractions. A company can tend to over estimate the income and underestimate the costs associated with both developing new business and product lines. It is important that these new costs are accurately estimated, otherwise there is a degree of cross subsidy between the profitable existing lines and new product and market development"

- Mark Jenkins, Divisional Director and General Manager, Edward Pryor & Son Ltd.

"We are keen to develop the model further in order to have an estimating model which will use ABC to price products taking account of the cost of serving customers"

- Ian Pack, Managing Director Metalformers Ltd.

"The process was useful, even if the results might make people uncomfortable. The information provided by activity based costing is akin to 'seeing the light'. It is a different way of looking at the business. This new perspective is a powerful management tool."

- Andrew Coulthard, Managing Director, Watsons Anodising Ltd.

Outcome

The 10 participating firms found the process easy to understand and believe it has provided them with valuable insights into company performance. Typical benefits derived were the identification and examination of loss making product groups and high 'cost to serve' customers. The majority of these firms have initiated action plans based on the outcome of Rapid Build ABC.

References

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