

Rob O'Byrne - MD Logistics Bureau

Cost To Serve – an Introduction

How its application can improve EBIT performance by up to 20%

**To read more about Cost To Serve Services by Logistics Bureau, see
http://www.logisticsbureau.com/cost_to_serve.htm**

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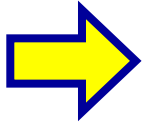
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Introduction

To provide background and context to commentary and case studies

Cost To Serve

What is Cost To Serve ?

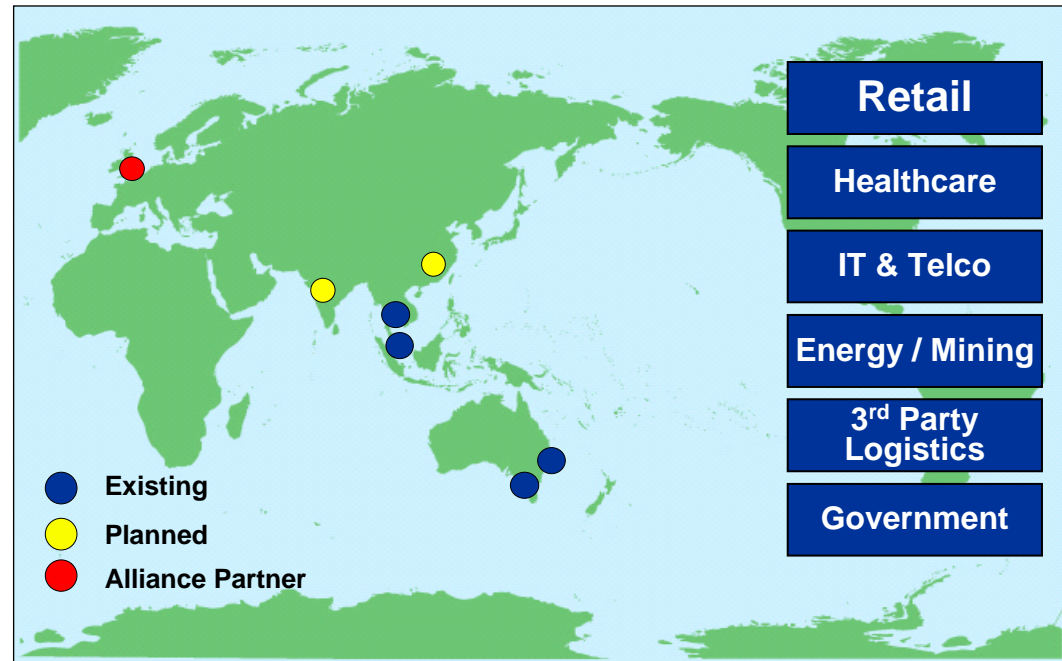
What benefit does it deliver?

How is it implemented?

Questions/Discussion

Introduction - Logistics Bureau

- Largest specialist Supply Chain consulting company in the Region
- Breadth and depth of experience, with over 700 Supply Chain projects completed
- We are independent, objective and guarantee results
- We are specialists in cost to serve



Focus – Core Industry Sectors

Cost to Serve Case studies from the 3 sectors at the top

Healthcare

Animal health
Hospitals
Government health
Optical and dental
Pharmaceutical distribution
Pharmaceutical wholesale
Pharmaceutical retail
Pharmaceutical manufacturing
Pathology & Imaging

FMCG & CPG

Agriculture
Appliances
Baked goods
Beverages
Cold stores
Consumer goods
Cosmetics
Dairy
Dry goods
Meat
Milling
Packaging
Retail Discount & Variety
Retail Fashion
Retail Fast Food
Retail Grocery

Energy Mining & Construction

Building products
Cable companies
Construction companies
Distributors
Electrical distributors
Energy, oil, gas, electricity
Explosives
Fabrication
Mining Equipment and parts
Power distributors

IT & Telco

Carriers
Distributors
Parts & service
PC manufacturer
Printer manufacturers
Software distributors
Telecommunication manufacturers
Wholesalers

Government & Economic Development

Development groups
Federal government
International government
Local government
Specialised services
State government

3PL

Freight forwarding
Ocean freight
Parcel carriers
Warehouse & distribution

Some of Our Customers

- AAP Communications
- Abbott Laboratories
- ACF
- ACG
- ADI
- AEI
- ALDI
- ALM
- A.P.I.
- Air New Zealand
- Alcon Laboratories
- AMCOR Australasia
- Auditor General Victoria
- Australian Aerospace
- Australian Trade Coast
- Australian Wheat Board
- Bangkok Gen Hosp Group
- Barbeques Galore
- Bayer
- Bega Cheese
- Beringer Blass Wine Estates
- Berli Jucker
- BHP Billiton
- Bluegum Technology
- Bluescope Steel
- Boots Healthcare
- Boral
- Brightpoint
- Brisbane Airport Corp
- Bunnings
- Buy.com
- Carlton & United Beverages
- Castrol
- Cement Australia
- Ceva
- Chanel
- Chomtana
- Christian Dior
- Colorado
- Corporate Express
- Cosmax Cosmetics
- Costa Group
- Coty Lancaster
- CP Foods
- CSR
- Crompton Lighting
- Daimler Chrysler
- Diageo
- Delta Electricity
- Dept of Defence
- Dept Transport & Regional Svcs
- Dexion
- DHL
- Diethelm Thailand
- Diethelm Vietnam
- Don Smallgoods
- Double A
- Dulux
- EFFEM
- Elgas
- Elizabeth Arden
- Energy Australia
- Epson Australia
- ETSA Utilities
- Exel Logistics
- FiK International
- Fosters
- Freedom Group
- Frutex
- Fujitsu
- GAC
- Gardner Smith Group
- General Pants
- George Weston Foods Group Office
- GlaxoSmithKline
- Goodman Fielder
- Grays online
- GUD Holdings
- Harper Collins
- Ingram Micro
- James Hardie
- Jeans West
- Jalco Group
- John Danks & Sons
- Johnson Controls
- Johnson & Johnson Pacific
- Juvena
- Komatsu
- Laminex
- Lend Lease
- Li and Fung
- Lion Nathan
- Maersk Logistics
- Mariner
- Mars Corporation
- Melosi
- Masterfoods
- Minor Foods
- Mitr Phol Sugar
- Mitsubishi Trucks
- National Blood Authority
- National Foods
- Nokia
- Novartis
- NSW Health
- NSW Police
- NYK Logistics
- Nylex
- Olympus
- Orica Explosives
- Philmac
- Pinkertons
- Pfizer
- Pelerman Group
- Petroleum Inst of Thailand
- Post Logistics
- Provimi
- Siam City Cement
- Selleys
- Shell
- Siemens Dematic
- Signum
- Southcorp
- Southern Health
- SPC Ardmona
- Speedibake
- St Vincent de Paul
- Star Track Express
- Stramit
- Sunbeam Foods
- Supa A Mart
- Sylvania Lighting
- Tattersalls
- Tech Pacific
- Tenix
- The Warehouse Group
- Tip Top
- TNT Express
- TNT Logistics
- Toll
- Transend
- Trimex
- Unilever
- Unimin
- UPS
- Vinidex
- Weight Watchers
- Wesfarmers
- Weston Bio Products
- Weston Biscuits
- Weston Milling
- Whirlpool
- Woolworths
- World Bank
- Yates
- Zuellig Pharma

→ Markets

- Geographic expansion, acquisition, product range expansion

→ Retail Stores

- Better stock allocation systems, new point of sale unit loads

→ Distribution

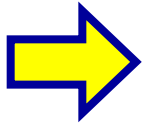
- Rationalisation of DC networks, more supplier centralisation

→ Factory Gate Pricing

- Changes to order profiles

*These...and more, will impact supplier's processes,
use of resources and cost to serve*

Introduction



Cost To Serve

What is Cost To Serve ?

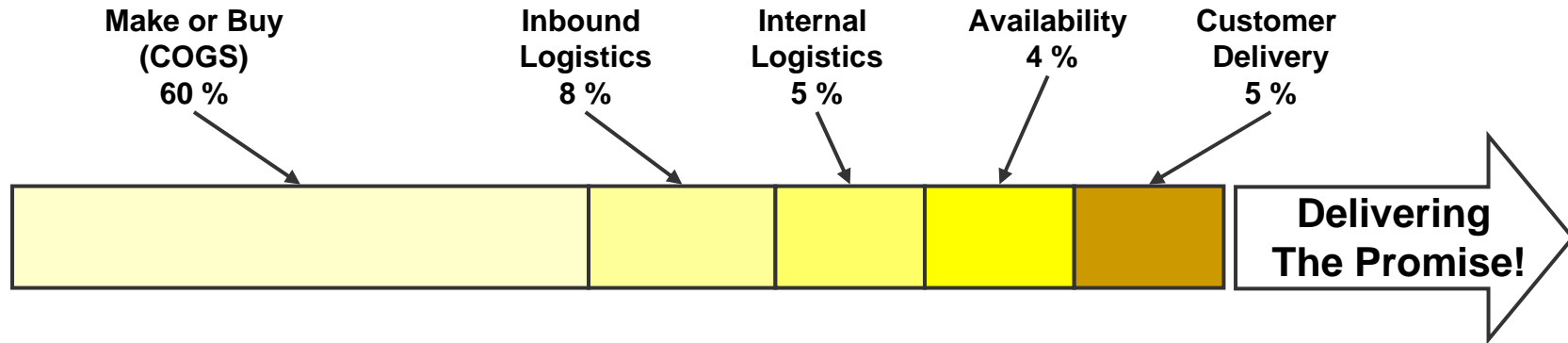
What benefit does it deliver?

How is it implemented?

Questions/Discussion

Supply Chain Dimensions

It's about..... Asset Performance (AP), Supply Chain Network (SCN) and Planning (P)



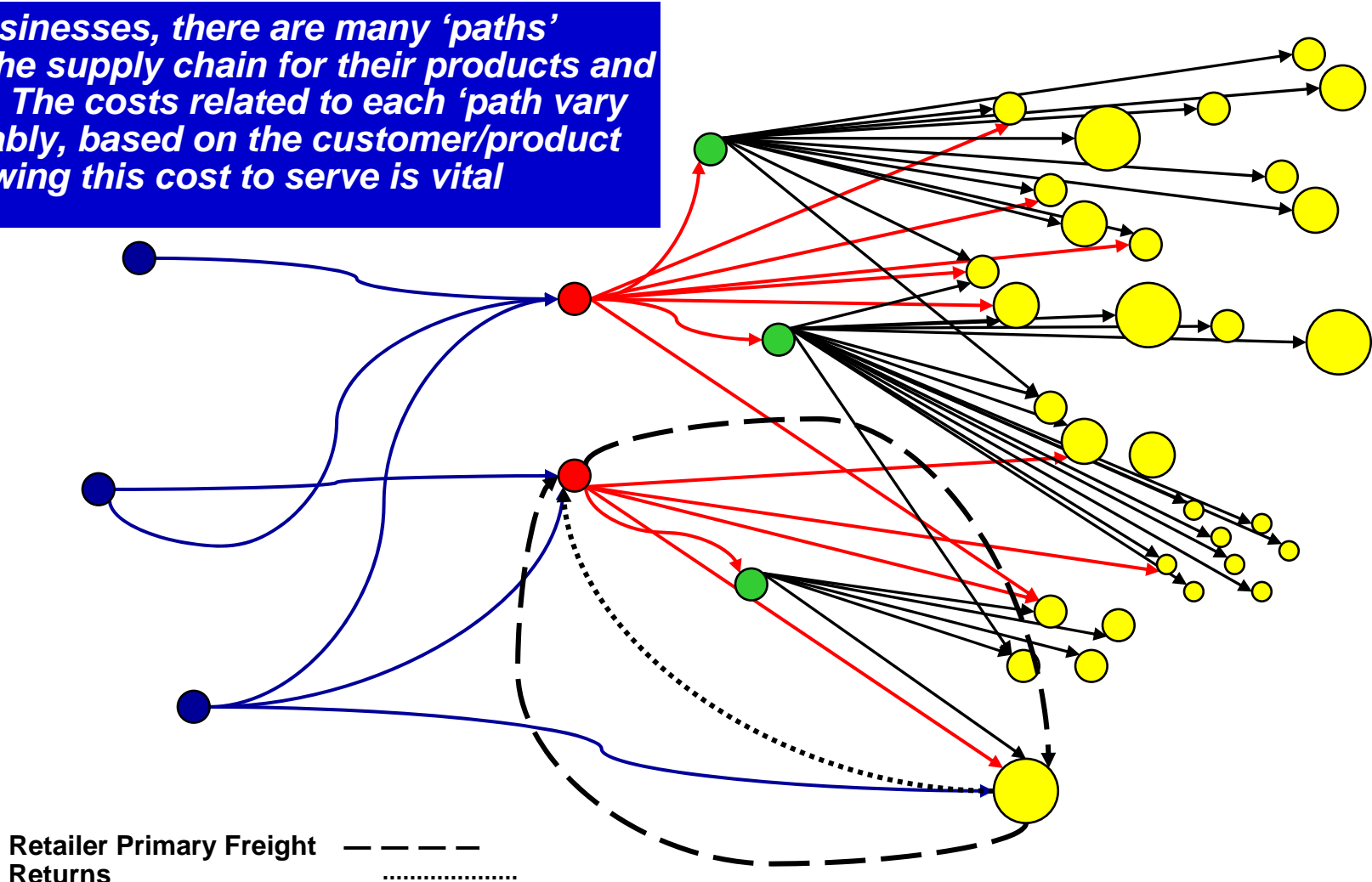
- (AP) ← **Organisation:** Structure, responsibilities, accountabilities, culture, skills →
- (AP) ← **Performance:** SOPs, KPIs →
- (SCN) ← **Physical Assets:** Facilities, storage equipment, vehicles, MHE →
- (SCN) ← **Transport:** Speed, Utilisation of time & capacity, consolidation, backloads →
- (P) ← **Time:** Lead Time, order size, order frequency, flexibility, responsiveness →
- (P) ← **Stock:** How much and where, Regional, National, Local, Suppliers →
- (P) ← **Processes and Systems:** ERP, add ons →
- (P) ← **Optimisation:** Trade offs: costs, f assets, w capital, availability, sales, customer retention →

Cost To Serve is a critical 'enabler' in identifying & driving improvement

Supply Chain - Physical Complexity

● Source ● Primary DC ● Satellite DC or Flow Through ● Customer

For all businesses, there are many 'paths' through the supply chain for their products and services. The costs related to each 'path' vary considerably, based on the customer/product mix. Knowing this cost to serve is vital



Retailer Primary Freight Returns

→ **Cost To Serve is:**

Understanding the total cost of servicing our customers

....at a customer and product level

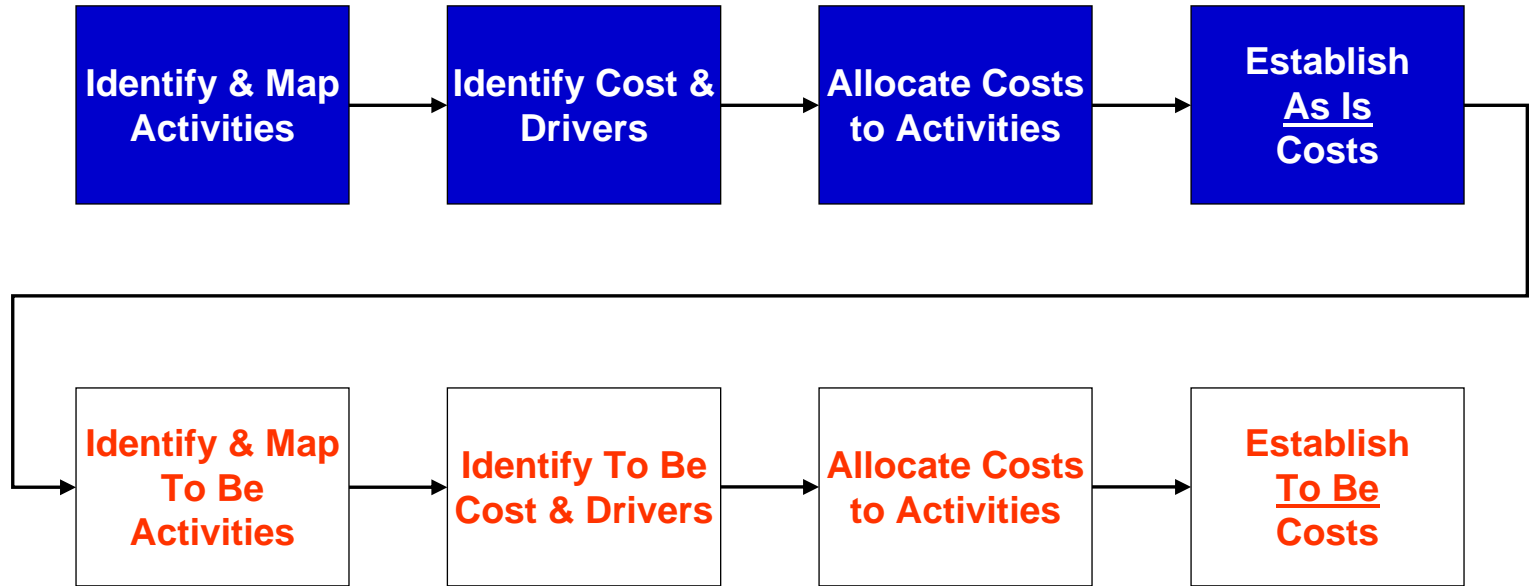
....so that the business can provide appropriate levels of service to its customers

....to achieve business goals

→ **Cost To Serve is NOT:**

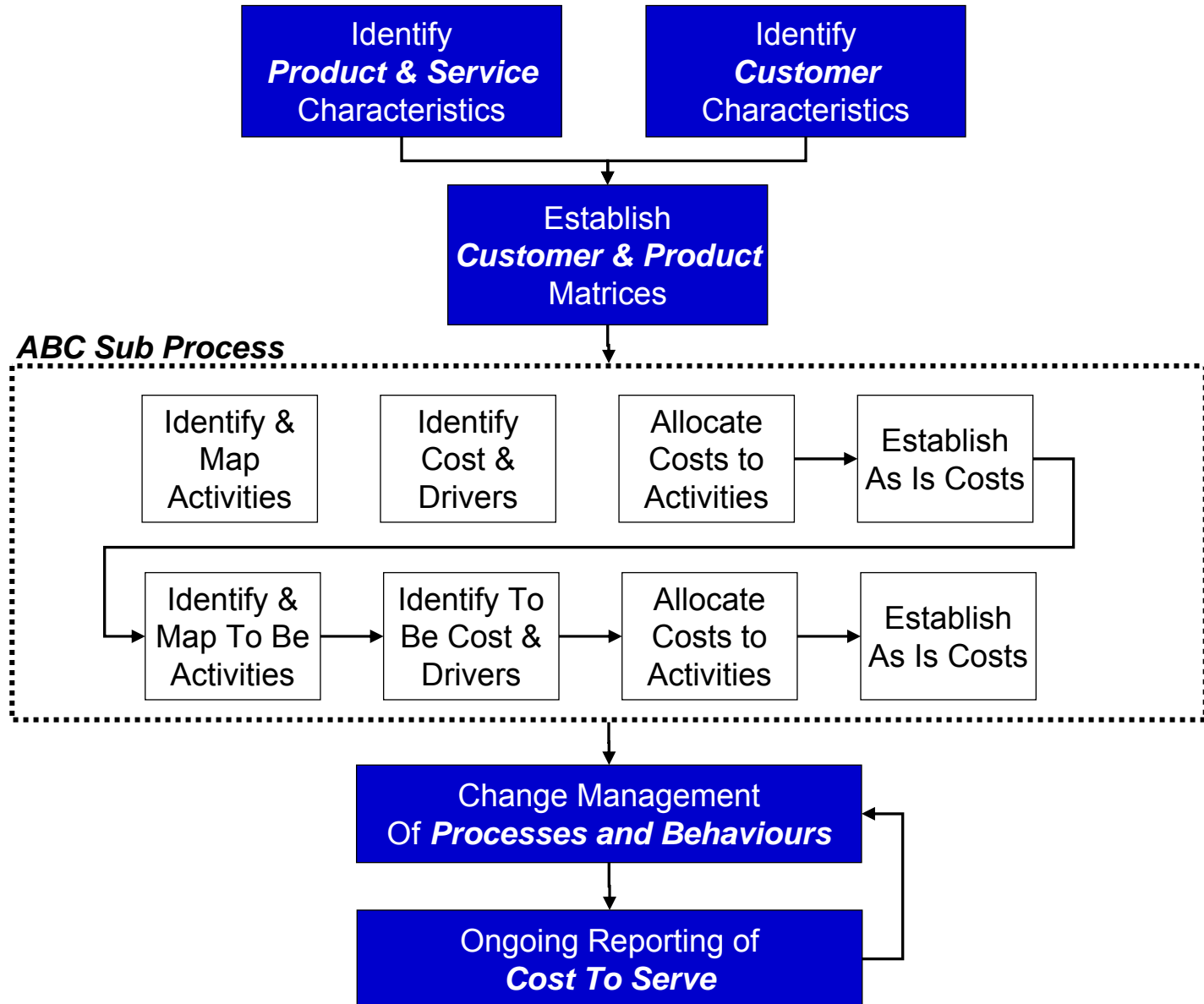
—Activity Based Costing

Traditional ABC Approach



This approach takes no account of the customer and product characteristics that can drive additional costs into the Supply Chain.

Cost To Serve Approach



Different Cost Perspectives

GL View	
Wages	\$100,000
Rent	\$30,000
Depreciation	\$20,000
Other	\$20,000
Total	\$170,000

ABC View	
Order Management	\$30,000
Receipt & Putaway	\$30,000
Storage	\$60,000
Picking & Despatch	\$50,000
Total	\$170,000

CTS View 1	
Continuity fulfilment	\$65,000
Seasonal fulfilment	\$35,000
Promotional fulfilment	\$70,000
Total	\$170,000

CTS View 2	
Mass retailers	\$55,000
Independent retailers	\$65,000
Route trade	\$50,000
Total	\$170,000

The Cost To Serve (CTS) view allocated costs based on the characteristics of customers and products.

→ Typical Cost to Serve outcomes include:

- Identification of *low margin customers*
- Identification of *low margin products*
- Identification of *high cost processes*
- Ultimately.....*making all customers profitable*, or more profitable!

The aim is not to delete low margin products or customers, but to make them all profitable. Knowing your cost to serve makes this possible.

→ **With Cost to Serve reporting, a company has the ability to:**

- Negotiate terms with major customers
- Test alternative distribution modes/service
- Improve customer profitability
- Improve pricing methodology
- Improve processes

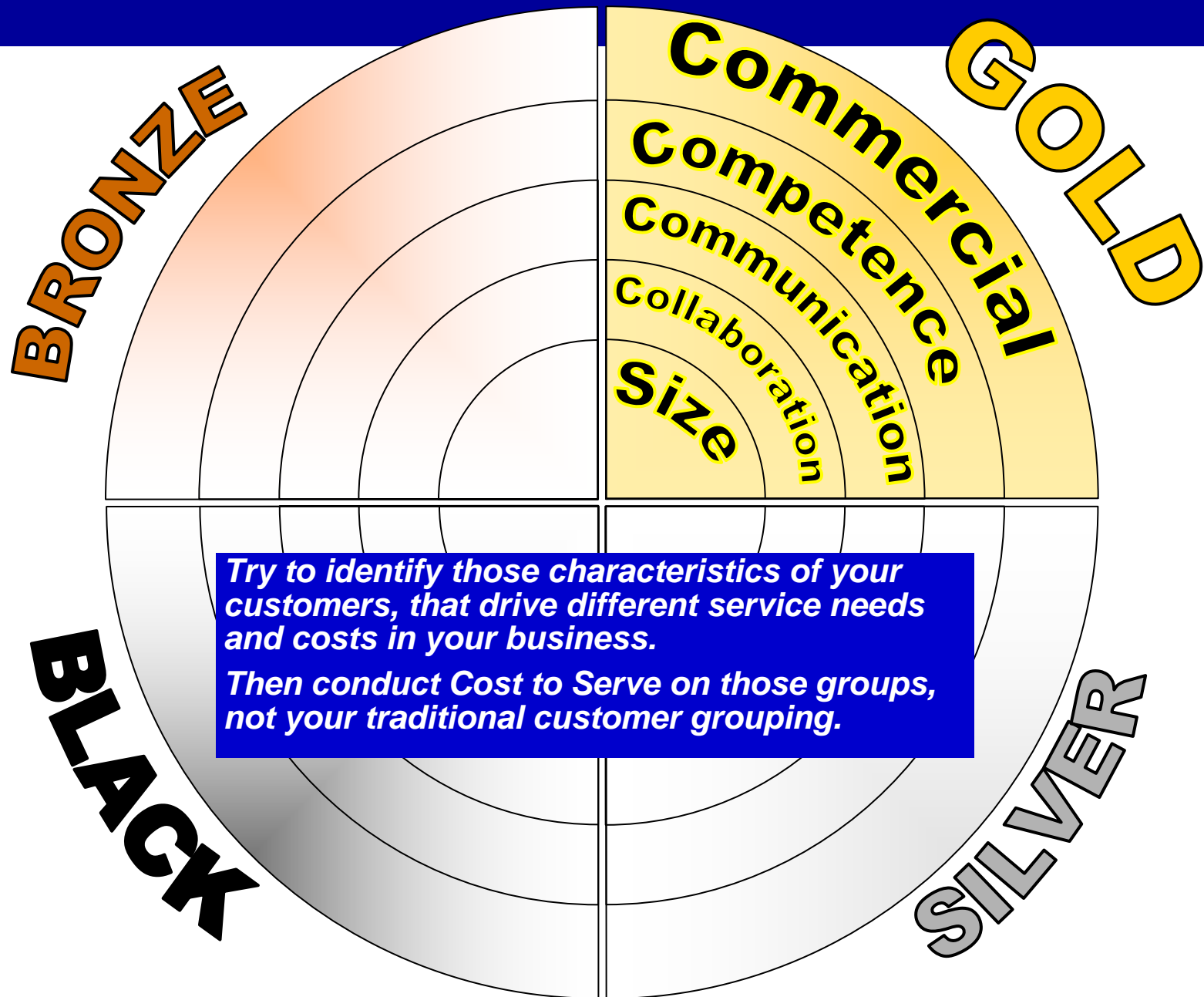
A review of Cost To Serve is often the first step to major Supply Chain improvement.

→ Why Cost to Serve often fails:

- Data is not comprehensive
- Data extraction too difficult
- Lack of business 'buy-in'
- Process is too complicated
- Not fed into Business Strategy
- Cost to Serve not done well first time
- No early wins to be seen

Starting with a specific area of the Supply Chain, such as warehousing or delivery, and focussing on costs by customer and product group only, is often a less resource intensive way to start undertaking cost to serve analysis.

Understanding Customer Characteristics



Cost To Serve view – Customer Segmentation

A great example of customer segmentation, where service expectation, and cost to serve vary considerably.



Fare Types
First Class (F,P)
Business (J,C)
Economy (Y)
Sub Classes (B,H,L,M,V)

Service considerations?
Cost to serve implications?

Business

*I know what I want!
I want it now!
I'm willing to pay a premium.
And hey ! This wine is too warm !*

Economy

*The Ticket was a good price!
I wonder if we'll get a decent meal on this flight ?*

Discount Economy

Hey HoneyI can see the harbour Bridge !

Understanding Customer Characteristics

and how they vary across industries

Customer Profile Characteristics - Mining

Customer Name: ABC Mines

Customer Category:	Major	Special Service needs:	Shot Crews
Region:	Qld	Special Account needs:	Detailed invoices
Industry:	Coal	Planning Focus:	Disciplined
Market Segment:	OCCO	Flexibility:	Low
Ordering Frequency:	Daily	Mine Road Condition:	Good
Av Order Size (t)	350	Demand predictable:	Yes
Delivery Service Need (days)	1	Part Loads Req'd	No
Type of Contract:	3 year rolling	Contract complexity:	Low

Customer Profile Characteristics - FMCG

Customer Name: Col Mart

Customer Category:	Major	Special Service needs:	30 min delivery window
Region:	National	Special Service needs:	1 SKU per pallet
Industry:	Retail	Special Account needs:	7 day terms
Market Segment:	RG	Forecasting ability:	Poor
Ordering Frequency:	Daily	Contract relationship:	Needs extra effort
Av Order Size (plts)	50	Payment History:	Medium
Delivery Service Need (days)	Next day	Returns History:	High
Type of Contract:	Annual	Contract complexity:	Low

What customer characteristics drive cost in your business?

What customer characteristics drive up cost to serve?

Cost to Serve Reporting by Customer

For this customer, freight charges are much higher than average. This should be investigated.

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Main Menu

CTS Customer Report

	\$m	% of Sales	Co Av
Sales	\$34.00		
Primary Freight	\$0.17	0.5%	0.4%
Factory	\$1.36	4.0%	4.0%
Secondary Freight	\$0.31	0.9%	1.6%
Secondary Storage	\$0.14	0.4%	0.3%
Plant	\$1.36	4.0%	4.0%
Delivery Fleet	\$2.18	6.4%	6.4%
Head Office	\$1.02	3.0%	3.0%
Freight to Customer	\$1.02	3.0%	0.7%
Sales & Tech Support	\$0.52	1.5%	1.5%
Total costs	\$8.08	23.8%	22.0%

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Report - By Customer

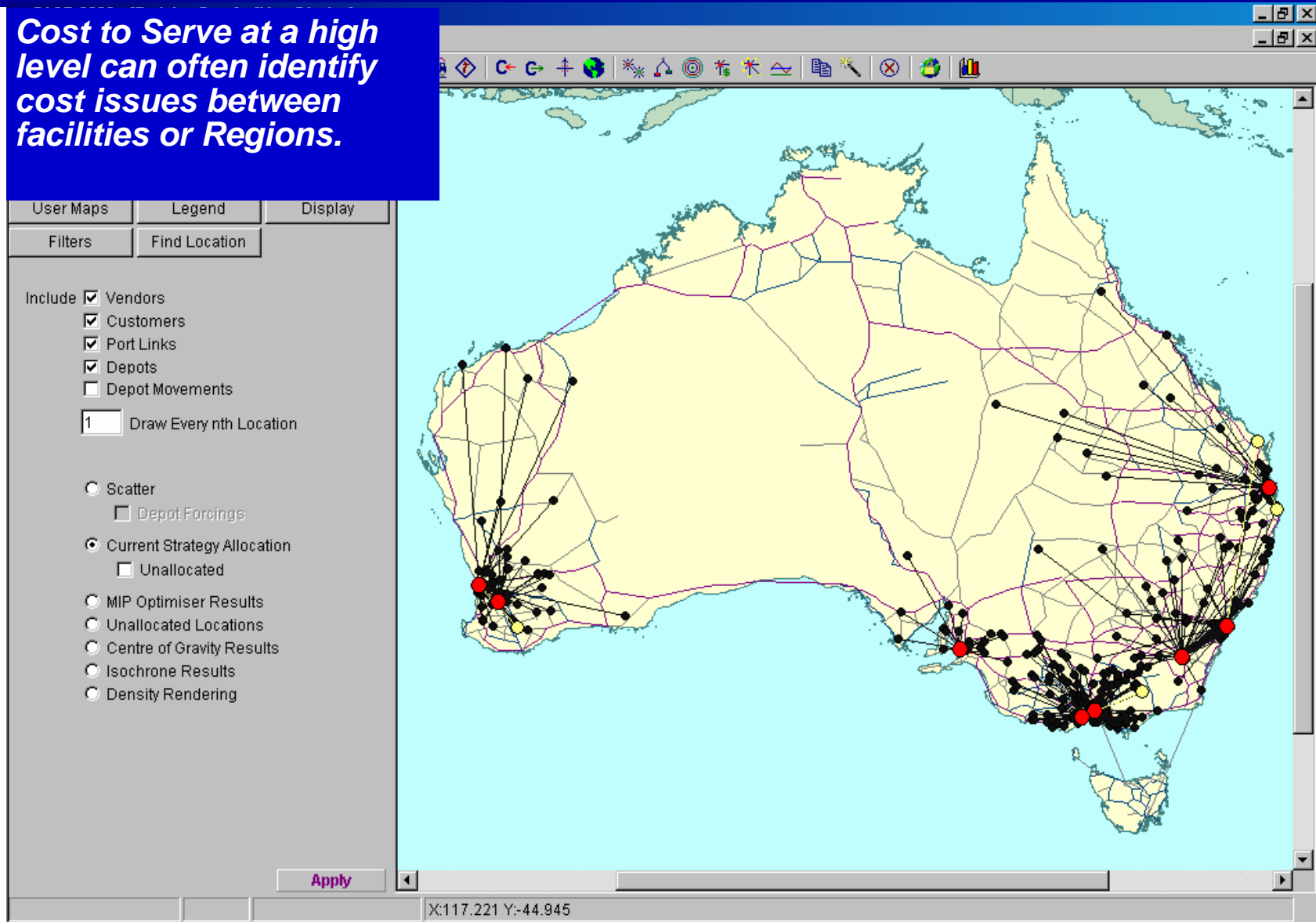
Report - By Product

Report - By State

	\$m	% of Sales	Co Av
Sales	\$34.00		
Primary Freight	\$0.00	0.5%	0.4%
Factory	\$0.00	4.0%	4.0%
Secondary Freight	\$0.00	0.9%	1.6%
Secondary Storage	\$0.00	0.4%	0.3%
Plant	\$0.00	4.0%	4.0%
Delivery Fleet	\$0.00	6.4%	6.4%
Head Office	\$0.00	3.0%	3.0%
Freight to Customer	\$0.00	3.0%	0.7%
Sales & Tech Support	\$0.00	1.5%	1.5%
Total costs	\$0.00	23.8%	22.0%

Network Modelling & Cost to Serve

Cost to Serve at a high level can often identify cost issues between facilities or Regions.

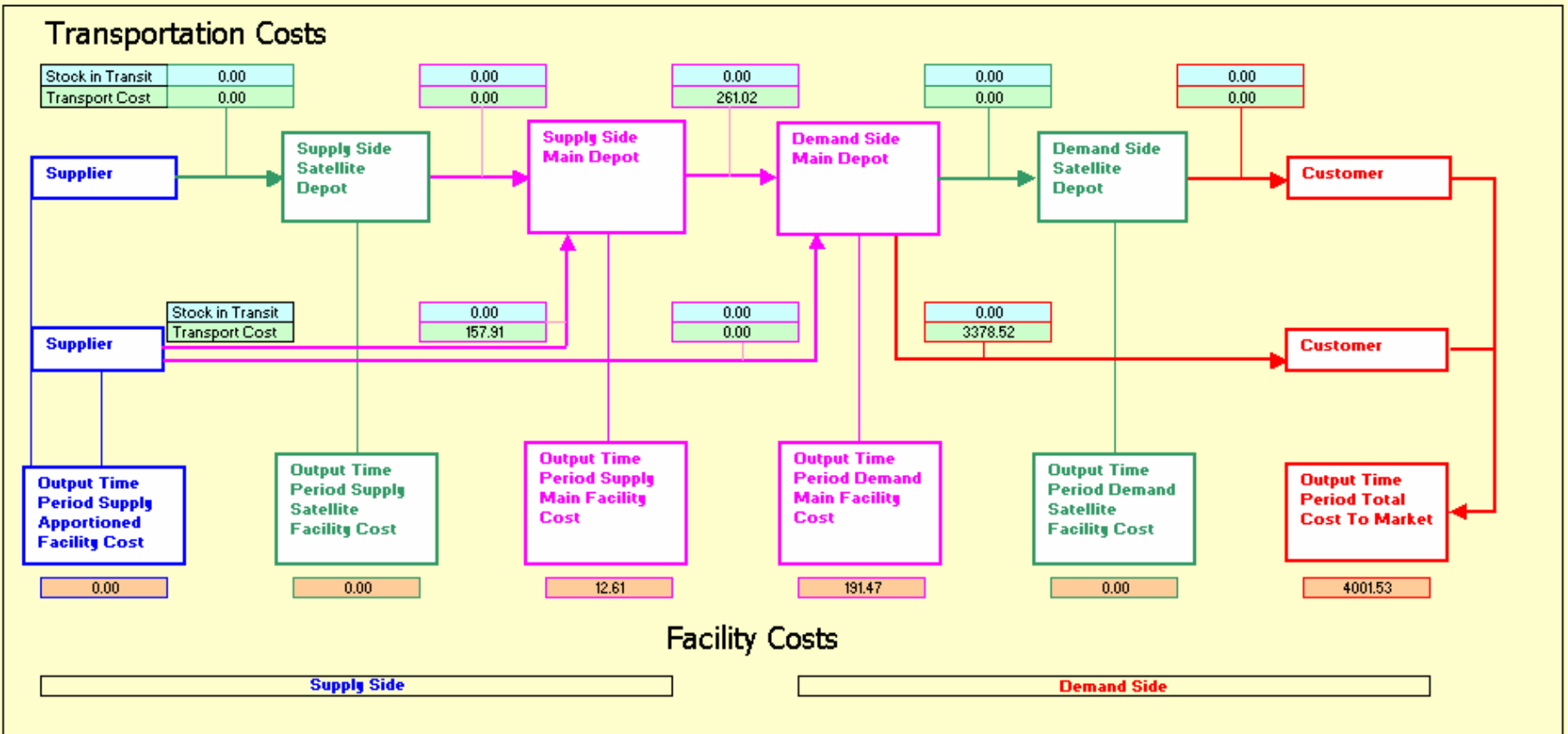


Network Cost to Serve Outputs

Cost to Serve reporting can be at a customer and SKU level if required.

Select Customer Record: 56 - 6758 - FAST

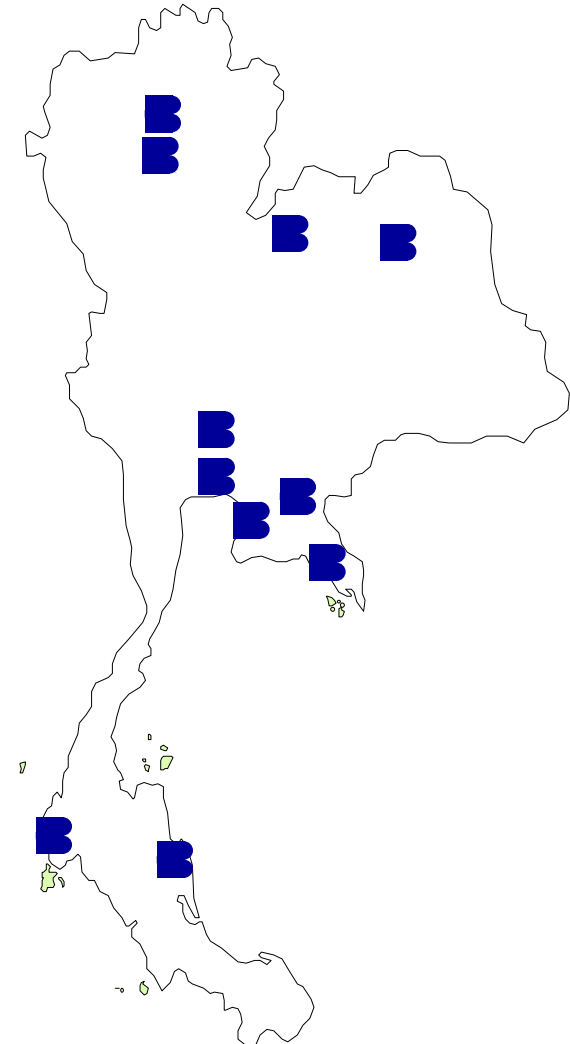
Customer Delivery Quantity	25.47	Unit Cost	
Number of Deliveries	6.00		
Total Cost To Market	4001.53	157.11	

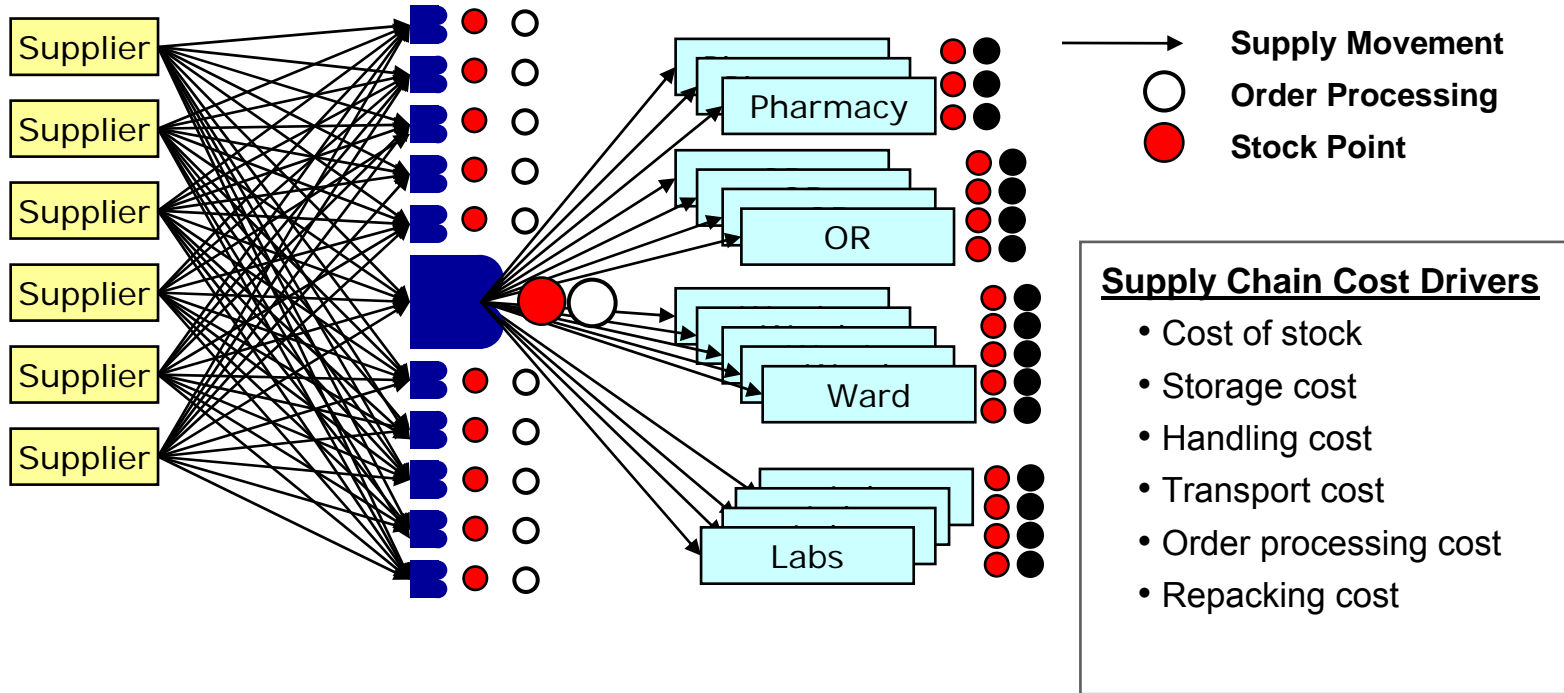


Created Using CAST 2003

→ Overview

- Currently 20+ Hospitals in the group.
- Some supplies are purchased locally by each Hospital, with others (about 20%) handled through the central purchasing department.
- 4,000 to 7,000 different supply items are purchased.
- Suppliers are pushing e-commerce.





- Minimise Multiple Handling
- Minimise Stock Levels
- Minimise Order Processing
- Improve Supplier Management

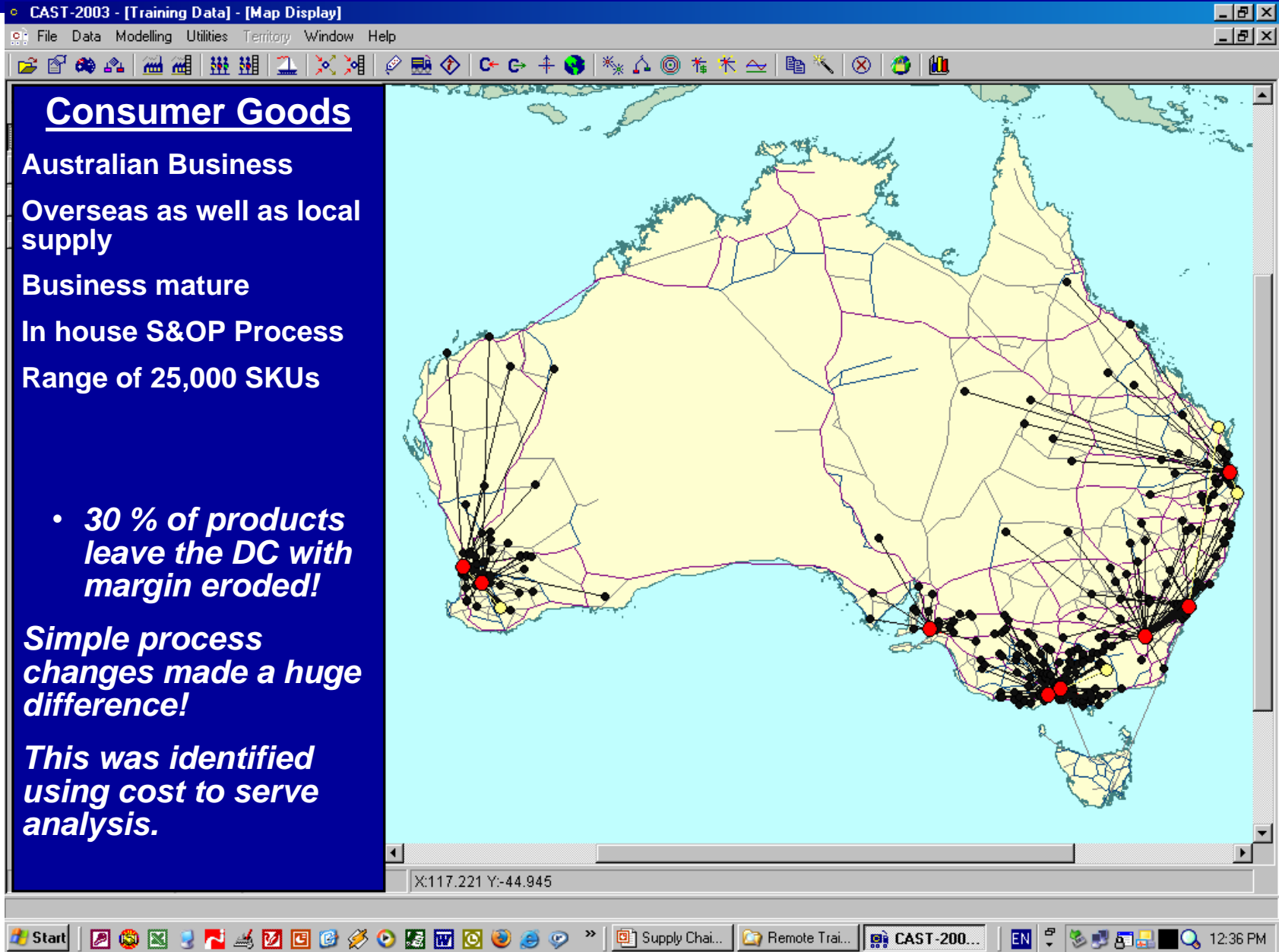


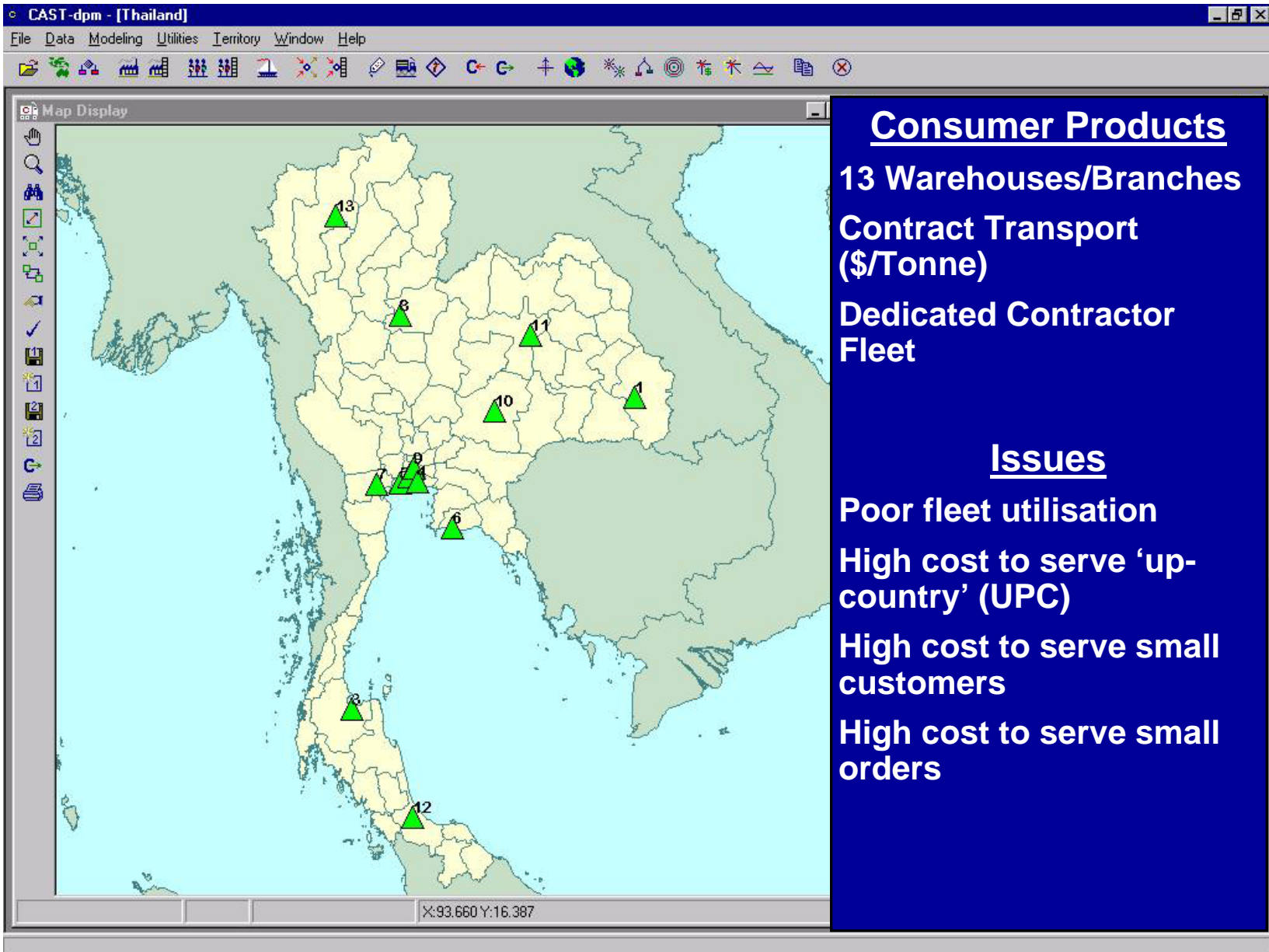
BUT.....

Not at the expense of patient care

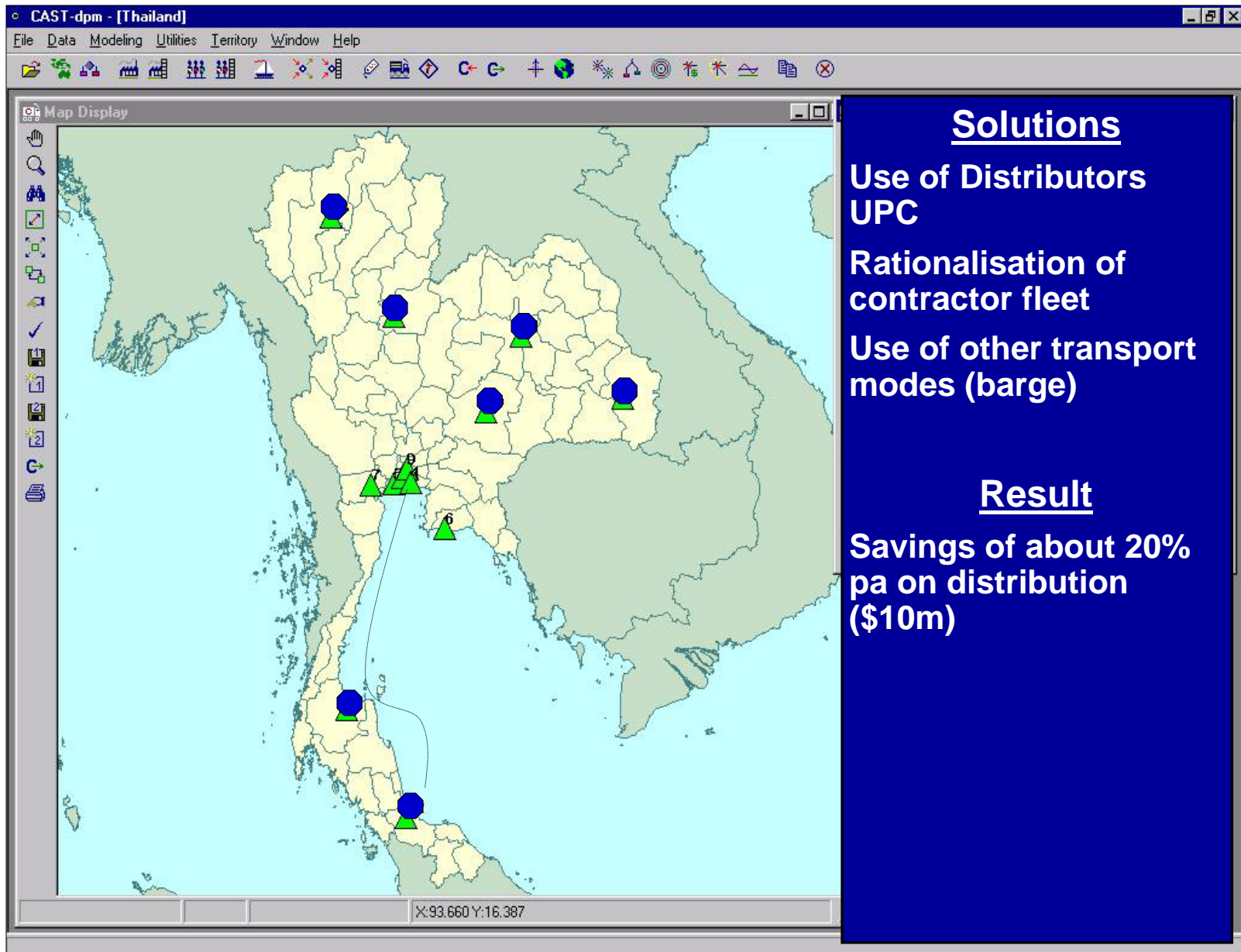
A complex Supply Chain, but Cost to Serve highlighted easy wins for reducing costs, that were 'invisible' through normal cost reporting.

Cost to Serve Case Study - Order Size





Cost to Serve Case Study – Channel Strategy



→ Granularity

- Level of detail? Customer, customer group?

→ Units of Measure

- Tonnes, pallets, Cases, \$

→ Resourcing

- Finance and IT support is essential

→ Timelines

- Simple study = 3-4 weeks

→ Data availability

- Extraction and validation can take time

→ One Off

- Network Audit for Strategic Alignment of Supply Chain

→ Periodic

- Quarterly/Annually to audit performance

→ Dynamic

- Automated real time update of reports

- Supply Chains are constantly changing
- Supply Chains continue to be a 'differentiator'
- Visibility of Cost To Serve is essential

*Start on just one area of your Supply Chain,
and see what you can find!
You will be surprised....*

Cost To Serve

How its application can improve EBIT performance by up to 20%



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