

## Securing the benefits from *Cost-to-Serve*

***With the continued focus on driving profitability and cash generation, Paul Derbyshire & Julian Mosquera explore the best approach to Cost-to-Serve to avoid many of the common pitfalls and deliver the maximum benefit.***

### Understanding true profitability

The power of *Cost-to-Serve* is in creating an understanding of the profitability of products that differentiates between customer segments and routes to market. This is critical in shaping businesses decisions on service mix and operational change.

Our observation is that a major shortcoming of many such studies is their failure to address the real complexity of product mix, the range of products purchased by individual customers and natural customer groupings, and the extended supply chain through which products are sourced and moved to customer.

The supply chain often has a disproportionate influence on product profitability, since sourcing options and handling characteristics can erode Gross Margin, yielding a far lower Net Margin that reflects the true *Cost-to-Serve*, resulting in lower profitability than planned.

A successful implementation of *Cost-to-Serve* will deal with supply chain complexity, identifying the real cost drivers and causes of margin erosion, enabling a focus on management for profit. It will deliver a clear, replicable and agreed cost position for any business, an essential requirement for benchmarking performance and operational improvement. It will drive supply chain savings for a business and its customers and improve collaboration on key initiatives.

Many companies have encountered barriers to implementing *Cost-to-Serve*, which often frustrate wider understanding of the output and prevent the true value of *Cost-to-Serve* being unlocked.

### What barriers are encountered?

Some of the typical barriers encountered during a *Cost-to-Serve* implementation are:

- Lack of clarity as to which parts of the business to include
- Overly complicated implementation processes
- Excessive analysis clouding the decision process
- Insufficient information on which to base decisions
- Lack of acceptance of output

These problems can be mitigated by following a robust implementation process that combats these issues from the outset.

### The LCP approach to *Cost-to-Serve*

At LCP we follow a tried and tested approach, applying our proprietary *Cost-to-Serve* technology, but crucially considering the business principals that apply and selecting the right implementation method and scope.

Beyond the obvious technical analytical approach and methodology that needs to be addressed (see [Our Approach](#)), some of the key factors and activities we consider in our approach are given below:

1. **DEFINITION** – Some simple questions need to be answered:
  - What is the nature of the issue being explored and what does the business want to achieve?
  - Which parts of the business are to be focused upon, what is the extent of the study? Whilst we talk about an end-to-end study, from source to point of consumption, often the scope is more limited
  - Is a comprehensive implementation of *Cost-to-Serve* the most applicable approach? Again we sometimes find that the issue being evaluated doesn't justify such a significant investment, instead a higher level *Flow Costing Model* may be applicable and point to areas of significant benefit more rapidly
2. **PEOPLE** - Involving the right people is key ... and it involves many functions beyond finance. There are key stakeholders at each point of the supply chain who are best able to interpret and validate the results of such a study and they will learn much from the exercise. Careful consideration should be given to the project organisation and management to ensure early and constant engagement of all stakeholders

# a thought leadership Insight

3. **DESIGN** – Run a series of collaborative workshops to agree the scope of business processes, their cost allocations and cost drivers. Getting this right is critical, reducing the time required to configure the *Cost-to-Serve* tool and improving understanding and acceptance of the output
4. **DATA COLLECTION & VALIDATION** – The 'raw material' for *Cost-to-Serve*, we work closely with many functions to identify, obtain and validate all data prior to undertaking any modelling. We often find that a complete data set can only be created by interrogating multiple software systems
5. **MODEL BUILDING** – A well structured model is critical if it is to be replicated, adjusted or embedded alongside business ERP systems, for use on a regular basis. LCP's *Cost-to-Serve* tool was developed to be configurable, structured and robust to 'crunch' the numbers
6. **REPORTING OUTPUT** – It is essential that any model developed is capable of producing output that can rapidly report at different levels of detail, from the P&L down to analysis of individual order line at any point in the supply chain. We have invested heavily into this capability ... after all, the insights only become real when they are communicated well, understood and capable of being actioned
7. **ESTABLISHING THE NEXT STEPS** – The findings from such a study can provide compelling evidence for the need to change. Resulting decisions should be carefully planned, with a clearly defined roadmap to guide the process and the organisational implications documented fully. Our experience is that success will only be achieved when clear recommendations are endorsed and supported by the Board.

## Typical results

The benefits of our approach are demonstrated by the impact it has for our clients:

- 15% reduction in distribution costs and significant improvements in profitability of new customers for a major petroleum client
- Savings of £millions for a media distributor through changes to supplier terms
- Significant improvements in profitability for many clients through improved customer management
- Profit improvements of £millions through improved management of promotional activity for a food manufacturer
- Major opportunities to reduce supply chain cost through improved fleet utilisation.

For more insight on our methodology and the benefits (see [Our Methodology](#)).

## Summary

Before embarking on a *Cost-to-Serve* study, it is important for companies to give proper consideration to what they want to achieve and how best to implement the study.

Gaining clarity and understanding of the issues from the outset and the extent of the supply chain to be considered, will save a considerable amount of time later on, as well as deliver a focused output that shows the true margin impact and crucially meets with stakeholder consensus.

LCP's *Cost-to-Serve* methodology and experience in implementation adheres to these principles, enabling companies to understand cost accumulation and to truly drive profitability.

**Cost-to-Serve is a Registered Trade Mark of LCP Consulting**

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## About LCP Consulting

LCP Consulting is a leading specialist in customer-driven supply chain management. With over 20 years' experience in the field, we identify where supply chains make major contributions to how businesses operate profitably and compete effectively. We support businesses review, re-design and implement changes to their end-to-end operations. Our fact-based diagnostics pin point exactly where & how to cut costs, enhance operational efficiency and invest for the future.

LCP Consulting is a member of the Green Logistics Consultants Group, which is an international collaborative network of supply chain consultants who focus on improving the environmental performance of supply chains.

Head Office:  
LCP Consulting  
The Stables  
Ashlyns Hall  
Chesham Road  
Berkhamsted  
Hertfordshire  
HP4 2ST  
UK  
Telephone: +44 (0) 1442 872298  
For more information please visit [www.lcpconsulting.com](http://www.lcpconsulting.com)

