CUSTOMER PROFITABILITY AT STOKE PLC

Introduction

Managers at Stoke plc have been using various teams to collect activity-based data since 2000. Each team has consisted of one or more management accountants working closely with department managers. The teams typically work for 3-6 months on data collection and developing spreadsheets. To date the teams have mainly focused on product costing. Recently two teams have been set up to collect data to improve the company's understanding of customer-related costs and profitability. One team has looked at distribution costs and the second at order related costs.

Only 3 customers were included in the analysis. Theses 3 customers represent 10`% of total sales. The company has approximately 250 customers in total. Finally the teams only considered labour related costs and direct costs for the cost pools.

The first objective for each team was to estimate the total annual overhead cost and annual volume for each cost driver. As the company only focused on three customers the data was quickly estimated. The second objective was to estimate the percentage of each cost driver per customer.

Collecting Data

The management accept that a 'cost sampling' or snapshot' approach is the best way to identify key activities and their costs. This technique helps the department to develop estimates of how much time is devoted to different activities. Then by using an average hourly rate for all staff managers will be able to estimate the total annual cost of an activity. The decision to use an average hourly rate for all staff will save time.

Managers decided that between 4 to 8 activities should to be identified by each team. The possibility of identifying 20-30 activities was considered but this was rejected because there was very little time to do the work. For the whole exercise it was felt that the information must not take too long to collect and interpret.

Most of the managers involved with the new teams have little experience of collecting data regarding activities and cost drivers. With some activities several cost drivers were discussed. This confused some managers who felt unclear why a cost driver was rejected or accepted. The management accountants believed these problems would not affect the accuracy of the data.

ABC data:

Team 1 - Order related overheads
(Data based on 3 customers)

Activity cost pool	Cost driver	Annual overhead cost for the 3 customers	Annual volume for the 3 customers
Changes to orders	Number of order amendments	£50,000	3,000
Pre-sales support	Number of hours of pre-sales support	£100,000	3,800
Post-sales support	Number of hours of post-sales support	£100,000	2,200
Delayed payments	Number of delayed payments over 3 months	£70,000	1,250

Order processing	Number of orders	£60,000	20,000
Invoicing	Number of invoices	£25,000	22,500

Team 2 - Distribution costs
(Data based on 3 customers)

Distribution related overhead costs	Cost driver	Annual overhead cost for the 3 customers	Annual volume for the 3 customers
Storage expenses	Average cartons in stock	£12,000	5,000
Requisition handling	Number of requisitions	£8,500	10,000
Standard deliveries	Number of standard deliveries	£5,000	3,000
Special deliveries	Number of special deliveries	£12,800	500

Customer sales and activity analysis

Customer	North	South	East
Annual Sales	£175,000	£178,000	£173,000

The following table summarises the percentage of each cost driver per customer.

Customer	North	South	East	Total
	%	%	%	%
Number of order amendments	20	2	20	100
Number of hours of pre-sales support	16	10	30	100
Number of hours of post-sales support	10	15	20	100
Number of delayed payments	10	12	10	100
Number of orders	10	30	30	100
Number of invoices	20	30	50	100
Average cartons in stock	40	30	30	100
Number of requisitions	30	30	40	100
Number of standard deliveries	10	40	50	100
Number of special deliveries	20	60	20	100

Requirements:
Question 1
Calculate the profit for each customer based on the ABC data and discuss what steps the company should consider to improve the profitability of individual customers.

Question 2
Assume that the company has a complete analysis of all customer-related revenues and costs. Discuss why such data is needed and how it can be used to help a company compete profitably.

Reference:
McGraw-Hill Higher Education
http://highered.mcgraw-hill.com/sites/0077098595/student_view0/case_studies.html