Douglas T. Hicks, CPA

Douglas T. Hicks, CPA is President of D. T. Hicks & Co., a consulting organization concentrating on the decision costing needs of small and mid-sized organizations. Before establishing his firm in 1985, he accumulated over fifteen years of financial and management accounting experience, twelve of those years in industry. A graduate of the University of Michigan - Dearborn’s School of Management, he is a member of the Michigan Association of CPAs, the Institute of Management Accountants, and the Institute of Management Consultants. He is also a member and serves on the Executive Committee of the Society of Cost Management. In 1997, he was presented with the University of Michigan – Dearborn Alumni Association’s Professional Growth and Scholarship Award in recognition of his work in the development of advanced cost measurement and management.

Since 1985, Doug has worked with over two hundred businesses to develop cost-effective ways to improve the cost and other management information they rely on in making both strategic and day-to-day decisions. These client organizations have ranged from $2 million to over $500 million in annual sales and have included firms in health care, distribution, printing, packaging, marketing services, and other service sectors as well as automotive, aerospace, office equipment, furniture, and other manufacturers.

This work has resulted in the "abc" solution™, an “activity-based” decision support process, originally designed for small and mid-sized organizations, but one that has proven to be effective for larger organizations as well. Using the “abc” solution™, businesses are able to develop the accurate and relevant cost information they need to make effective product pricing, product line management, investment, cost reduction, and other critical decisions.

As Doug’s down-to-earth approach to cost and performance measurement and management issues has become more widely known and accepted, he has become a popular speaker on the subjects. Many trade, accounting and other professional associations have used him as a resource for their members including the Institute of Management Accountants (IMA) and Michigan Association of CPAs (MACPA) for whom he has been a regular speaker and educator for two decades. He has spoken at over 100 MACPA conferences and seminars and, in addition to speaking at scores of local IMA Chapter and regional meetings, he was a featured speaker at the IMA’s 1993, 1994, 1996, 1998, 2005 and 2007 annual conferences. In 1998, he was chosen by conference and seminar participants as the IMA’s “Instructor of the Year.”

Doug has authored scores of articles that have been published in a wide variety of professional and trade magazines including Journal of Accountancy, ActionLine, Manufacturing Engineering, Journal of Cost Management, Modern Casting, Plastic Technology, Michigan CPA, Internal Auditor, Precision, and Management Accounting. His first two books, Activity-Based Costing for Small and Mid-Sized Businesses: An Implementation Guide and Activity-Based Costing: Making it Work for Small and Mid-Sized Companies (both published by John Wiley & Sons) have sold over 15,000 copies worldwide and have been translated into four languages. His most recent book, I May Be Wrong, But I Doubt It: How Accounting Information Undermines Profitability is available at www.lulu.com and www.amazon.com.

© 2012 D. T. Hicks & Co.
A BLINDFOLD RACE

Three blindfolded runners are about to run a 220-yard race:

- Runner #1 does not know there are hurdles
- Runner #2 knows there are 36” hurdles – but only knows to within ±12” where they are
- Runner #3 knows there are 36” hurdles – and knows exactly where they are

Which runner is in “big trouble?”
“An error in measuring the magnitude of an effect usually is far less serious than mistakes due to wholly overlooked consequences.”

- Dr. Alfred R. Oxenfeldt
QUESTIONS FOR A DISTRIBUTOR

• Is the “price” of a product purchased for distribution the same as its “cost?”

• At the time of its sale, does a small $10 item that has been in inventory for one month “cost” the same as a large $10 item that has been in inventory for six months?
• If two customers purchase the same quantity of the same item for the same price, is the profit the same for:
  – 1) the customer who placed one order and entire quantity was sent in a single shipment as it is for
  – 2) the customer that placed six small orders that were sent in six shipments?
THE IMPORTANCE OF MODELS

• Most phenomena are too complex to be completely understood.

• People must function in a world where those phenomena exist and have an effect on their decisions and actions.

• To function effectively they create “models” of those phenomena.
THE IMPORTANCE OF MODELS

• Models represent an individual’s “internal version” of the outside world that makes that world more understandable and easier to deal with.
THE IMPORTANCE OF MODELS

“It is our models of phenomena that determine our behavior, not the phenomena themselves.”

Alfred Oxenfeldt
THE IMPORTANCE OF MODELS

• “The validity of our decisions depends on our perception and understanding of reality.

• Good decisions require good models,

• …and the caliber of our decisions reflects the quality and validity of our models.”
PHILOSOPHICAL MISTAKE #1

Cost Accounting ≠ Management Accounting

The primary purpose of cost accounting may be to support the traditional financial accounting system, but that is not the primary purpose of management accounting.

The primary purpose of management accounting is to provide management with the accurate and relevant economic information it needs to make economically sound decisions and take economically effective actions.
THE TAXONOMY OF ACCOUNTING

Based on Gary Cokins' “Accounting Taxonomy” Diagram

© 2012 D. T. Hicks & Co.
The impact of inaccurate and incomplete cost information on the quality of decisions and the organization’s financial performance is shown in a phenomenon known as…

*Hicks’ First Law of Pricing*
HICKS’ FIRST LAW OF PRICING

A company will get a lot of business when it gives away the work it does, but it will not get much business when it charges its customers for work that it does not do for them.
HICKS’ FIRST LAW OF PRICING

- Jobs Won
- Jobs Lost
- Loss Jobs
- Profit Jobs
- Quoted Price
- Estimated Cost
- Market Price
- Potential Profit
- Loss
- Profit
- Cost Most Underestimated
- Cost Most Overestimated

© 2012 D. T. Hicks & Co.
$30 \text{ sales} - 28 \text{ expenses} = 2 \text{ profit}

Net Revenues Minus ABM costs = Profit

THE “FISHING POLE” DIAGRAM

© 2012 D. T. Hicks & Co.
COST OF PRODUCTS SOLD
Total Cost of Ownership

**Acquisition Costs**
- Mat Control Purchasing
- Engineering
- Quality

**Inbound Freight**
- Fees
- Duties
- Taxes

**Incoming Quality**
- Mat Handling
- Put-Away
- Obsolescence
- Spoilage

**Receiving**
- Sort
- Repack
- Relabel
- Storage

**Receiving/Put-Away/Storage Costs**

**Money Costs**
- Cost of Capital

**Item TCO at Time of Sale**

*If offshore also include:*
- Paperwork snake and travel
- Time difference difficulties
- Impacts of unreliable delivery
- Advance payments (C of C)
- Stateside repacking
- Impact of anti-lean, anti-mass customization, anti-JIT

© 2012 D. T. Hicks & Co.
COST OF CAPITAL

Because the owners’ investment in a business is not “free money”
Cost of Capital

Remember Oxenfeldt’s rule…

“An error in measuring the magnitude of an effect usually is far less serious than mistakes due to wholly overlooked consequences.”
# Cost of Capital

## Value of Company Assets

<table>
<thead>
<tr>
<th>Source of Capital</th>
<th>Amount of Investment</th>
<th>Net Cost of Investment</th>
<th>Cost of Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Debt</td>
<td>$3,500,000</td>
<td>4.8%</td>
<td>$168,000</td>
</tr>
<tr>
<td>Trade Credit</td>
<td>$1,000,000</td>
<td>0.0%</td>
<td>$0</td>
</tr>
<tr>
<td>Owners' Equity (Value)</td>
<td>$5,500,000</td>
<td>15.0%</td>
<td>$825,000</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>$10,000,000</strong></td>
<td><strong>9.9%</strong></td>
<td><strong>$993,000</strong></td>
</tr>
</tbody>
</table>

*Value per Books*

*Value to Owner(s)*

*Value of Company Assets*

*Return on Assets Required to Meet ROI Target*

*“The Cost of Capital”*

© 2012 D. T. Hicks & Co.
# Cost of Capital

<table>
<thead>
<tr>
<th>Source of Capital</th>
<th>Amount of Investment</th>
<th>Net Cost of Investment</th>
<th>Cost of Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Debt</td>
<td>$3,500,000</td>
<td>4.8%</td>
<td>$168,000</td>
</tr>
<tr>
<td>Trade Credit</td>
<td>$1,000,000</td>
<td>0.0%</td>
<td>$0</td>
</tr>
<tr>
<td>Owners' Equity (Value)</td>
<td>$5,500,000</td>
<td>16.4%</td>
<td>$900,000</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>$10,000,000</strong></td>
<td><strong>10.7%</strong></td>
<td><strong>$1,068,000</strong></td>
</tr>
</tbody>
</table>

*Return on Assets Required to Meet ROI Target “The Cost of Capital”*
## Cost of Capital

<table>
<thead>
<tr>
<th>Source of Capital</th>
<th>Amount of Investment</th>
<th>Net Cost of Investment</th>
<th>Cost of Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Debt</td>
<td>$2,000,000</td>
<td>5.0%</td>
<td>$100,000</td>
</tr>
<tr>
<td>Trade Credit</td>
<td>$500,000</td>
<td>0.0%</td>
<td>$0</td>
</tr>
<tr>
<td>Owners' Equity (Value)</td>
<td>$1,500,000</td>
<td>20.0%</td>
<td>$300,000</td>
</tr>
<tr>
<td>Totals</td>
<td>$4,000,000</td>
<td>10.0%</td>
<td>$400,000</td>
</tr>
</tbody>
</table>

© 2012 D. T. Hicks & Co.
# Cost of Capital

<table>
<thead>
<tr>
<th>Selected Activity Centers</th>
<th>Asset Value</th>
<th>Cost of Capital @ 10.0%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>$500,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>$1,400,000</td>
<td>$140,000</td>
</tr>
<tr>
<td>Building &amp; Grounds</td>
<td>$1,100,000</td>
<td>$110,000</td>
</tr>
<tr>
<td>Management &amp; Administration</td>
<td>$150,000</td>
<td>$15,000</td>
</tr>
<tr>
<td>Information Technology</td>
<td>$100,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Material Handling</td>
<td>$200,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Shipping &amp; Receiving</td>
<td>$50,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>Repack</td>
<td>$100,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Packaging</td>
<td>$250,000</td>
<td>$25,000</td>
</tr>
<tr>
<td>Delivery</td>
<td>$150,000</td>
<td>$15,000</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>$4,000,000</strong></td>
<td><strong>$400,000</strong></td>
</tr>
</tbody>
</table>
PRODUCT LINE, MARKET, CHANNEL & CUSTOMER COSTS

Product Line Cost

Product Line A
Product Line B
Product Line C

Customer, Market or Channel Cost

Customer/Market 1
Customer/Market 2
Customer/Market 3
ACTIVITY-BASED CONCEPTS ARE...

the “lens” through which management can view the company to develop a valid economic model of the organization
THE THREE KEY TYPES OF COST INFORMATION

• **Fully-absorbed costs** – calculable at various volumes and mixes of business

• **Incremental/total costs** – calculable under various business assumptions

• **Process costs** – the cost of performing the organization’s primary business activities
Activity-Based Concepts (ABC) are a “lens” for taking the complex operations of a business enterprise and developing a cost model that accurately reflects the relationships between the company’s costs, activities, and products.

The purpose of Activity-Based Concepts is insight, not calculations.
ABC’s BASIC PREMISE

• Products and services cause activities and those activities cause costs.

• Associate costs with the activities that make them necessary and then associate accumulated activity costs with the products or services that make them necessary.
BASIC “ABC” COST / ACTIVITY FLOW
“bottom up”

Activities

Cost of Activities Performed

Costs

Non-Labor “Direct” Costs

Products & Services

Activities Performed
BASIC “ABC” COST /ACTIVITY FLOW
“top down”
How do products and services drive activities?

How do activities drive costs?

How do costs relate to activities?

How do activity costs relate to products and services?
BASIC “ABC” COST /ACTIVITY FLOW

Activities

Costs

Support Activity Costs

Activity Costs

Products & Services

Incremental and/or Total Costs "What if? Analyses"

Process/Activity Costs

Fully-Absorbed Costs & Rates
“An error in measuring the magnitude of an effect usually is far less serious than mistakes due to wholly overlooked consequences.”

- Dr. Alfred R. Oxenfeldt
The effectiveness of an activity-based costing model or system is more dependent on its design than on its method of implementation or the data used to populate the model or system.

“It is better to estimate the right things than to precisely measure the wrong things.”

“It is better to be approximately correct than to be precisely wrong.”
CATEGORIES OF COSTS/ACTIVITIES

- Throughput or Direct Costs
- Service and Operations Support Activities
- Throughput or Direct Cost Support Activities
- Direct or Value-Adding Activities
- Event or Transaction Activities
- Market or Customer Support Activities
- Product or Product Line Support Activities
- General and Administrative Activities

Incoming Repack
Incoming Relabel
--- o ---
Outgoing Repack
Outgoing Relabel

Order Processing
Line Items Picked
Pick Units
Ship Prep - Physical
Ship Prep - Admin
Delivery
Returns

© 2012 D. T. Hicks & Co.
Softgood Distribution’s Costs

General Management
- MIS
- Accounting
- Receiving
- Packing/Shipping

Product
- Receive
- Put-Away
- Store

Orders
- Waves
- Transition Picking
- Relabel
- Transition
- Packing-General
- Packing-Dedicated
- Shipping

Independents
- Large Chains
- “Big Box” Stores

Base Softgoods
- Seasonal Items
- Ancillary Products

Gen & Admin

Softgood Distribution’s Cost Objectives

© 2012 D. T. Hicks & Co.
## DIRECT / THROUGHPUT SUPPORT ACTIVITIES

<table>
<thead>
<tr>
<th>Activity Center</th>
<th>Activity Cost</th>
<th>Driver Identify</th>
<th>Measure</th>
<th>Cost per Driver Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receiving</td>
<td>$300,000</td>
<td>Cartons</td>
<td>500,000</td>
<td>$0.60</td>
</tr>
<tr>
<td>Put-Away</td>
<td>$100,000</td>
<td>Pallets</td>
<td>25,000</td>
<td>$4.00</td>
</tr>
<tr>
<td>Storage</td>
<td>$250,000</td>
<td>Pallet Years</td>
<td>5,000</td>
<td>$50.00</td>
</tr>
</tbody>
</table>

© 2012 D. T. Hicks & Co.

**EXAMPLE**
# DIRECT / THROUGHPUT SUPPORT ACTIVITIES

<table>
<thead>
<tr>
<th>Activity Center</th>
<th>Activity Cost</th>
<th>Identify</th>
<th>Measure</th>
<th>Cost per Driver Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receiving</td>
<td>$300,000</td>
<td></td>
<td>500,000</td>
<td>$0.60</td>
</tr>
<tr>
<td>Put-Away</td>
<td>$100,000</td>
<td></td>
<td>25,000</td>
<td>$4.00</td>
</tr>
<tr>
<td>Storage</td>
<td>$250,000</td>
<td></td>
<td>5,000</td>
<td>$50.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Driver Units</th>
<th>Cost/Carton</th>
<th>Cost/Pallet</th>
<th>Cost/Piece</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Product A</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pieces/Carton</td>
<td>36</td>
<td>$0.60</td>
<td>$14.40</td>
<td>$0.017</td>
</tr>
<tr>
<td>Carton/Pallet</td>
<td>24</td>
<td>$0.17</td>
<td>$4.00</td>
<td>$0.005</td>
</tr>
<tr>
<td>Annual Turns</td>
<td>6</td>
<td>$0.35</td>
<td>$8.33</td>
<td>$0.010</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>$1.114</td>
<td>$26.733</td>
<td>$0.031</td>
</tr>
<tr>
<td><strong>Product B</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pieces/Carton</td>
<td>24</td>
<td>$0.60</td>
<td>$9.60</td>
<td>$0.025</td>
</tr>
<tr>
<td>Carton/Pallet</td>
<td>16</td>
<td>$0.25</td>
<td>$4.00</td>
<td>$0.010</td>
</tr>
<tr>
<td>Annual Turns</td>
<td>3</td>
<td>$1.04</td>
<td>$16.67</td>
<td>$0.043</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>$1.892</td>
<td>$30.267</td>
<td>$0.079</td>
</tr>
<tr>
<td><strong>Product C</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pieces/Carton</td>
<td>24</td>
<td>$0.60</td>
<td>$28.80</td>
<td>$0.025</td>
</tr>
<tr>
<td>Carton/Pallet</td>
<td>48</td>
<td>$0.08</td>
<td>$4.00</td>
<td>$0.003</td>
</tr>
<tr>
<td>Annual Turns</td>
<td>12</td>
<td>$0.09</td>
<td>$4.17</td>
<td>$0.004</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>$0.770</td>
<td>$36.967</td>
<td>$0.032</td>
</tr>
</tbody>
</table>

© 2012 D. T. Hicks & Co.
# Summary

## Example 1 - How It All Works

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$700,000</td>
</tr>
<tr>
<td>Product Cost</td>
<td>$525,000</td>
</tr>
<tr>
<td>Product Support Costs</td>
<td>$25,000</td>
</tr>
<tr>
<td>Total Product Costs</td>
<td>$550,000</td>
</tr>
<tr>
<td>Customer Margin</td>
<td>$150,000</td>
</tr>
</tbody>
</table>

## Customer Costs:

<table>
<thead>
<tr>
<th>Description</th>
<th>Quantity</th>
<th>Unit Cost</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orders</td>
<td>200</td>
<td>$5.00</td>
<td>$1,000</td>
</tr>
<tr>
<td>Waves</td>
<td>100</td>
<td>$5.00</td>
<td>$500</td>
</tr>
<tr>
<td>Pick Line Items</td>
<td>2,000</td>
<td>$3.00</td>
<td>$6,000</td>
</tr>
<tr>
<td>Labels</td>
<td>600</td>
<td>$5.00</td>
<td>$3,000</td>
</tr>
<tr>
<td>Transition A</td>
<td>8,000</td>
<td>$1.00</td>
<td>$8,000</td>
</tr>
<tr>
<td>Transition B</td>
<td>4,000</td>
<td>$3.00</td>
<td>$12,000</td>
</tr>
<tr>
<td>Transition C</td>
<td>8,000</td>
<td>$5.00</td>
<td>$40,000</td>
</tr>
<tr>
<td>Packing-Carton</td>
<td>600</td>
<td>$1.00</td>
<td>$600</td>
</tr>
<tr>
<td>Packing-SKU/Ctn</td>
<td>4,000</td>
<td>$0.50</td>
<td>$2,000</td>
</tr>
<tr>
<td>Shipping-Admin</td>
<td>100</td>
<td>$2.00</td>
<td>$200</td>
</tr>
<tr>
<td>Shipping-Container</td>
<td>600</td>
<td>$1.00</td>
<td>$600</td>
</tr>
<tr>
<td>Gen &amp; Admin</td>
<td>10%</td>
<td></td>
<td>$73,900</td>
</tr>
</tbody>
</table>

**Total Customer & Admin Costs**

$83,790

Net Customer Margin

$66,210
### Example II - How It All Works

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$700,000</td>
</tr>
<tr>
<td>Product Cost</td>
<td>$525,000</td>
</tr>
<tr>
<td>Product Support Costs</td>
<td>$35,000</td>
</tr>
<tr>
<td><strong>Total Product Costs</strong></td>
<td><strong>$560,000</strong></td>
</tr>
<tr>
<td>Customer Margin</td>
<td>$140,000</td>
</tr>
</tbody>
</table>

**Customer Costs:**

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orders</td>
<td>250 @  $5.00</td>
</tr>
<tr>
<td>Waves</td>
<td>80 @    $5.00</td>
</tr>
<tr>
<td>Pick Line Items</td>
<td>3,000 @ $3.00</td>
</tr>
<tr>
<td>Labels</td>
<td>500 @   $5.00</td>
</tr>
<tr>
<td>Transition A</td>
<td>9,000 @ $1.00</td>
</tr>
<tr>
<td>Transition B</td>
<td>6,000 @ $3.00</td>
</tr>
<tr>
<td>Transition C</td>
<td>12,000 @ $5.00</td>
</tr>
<tr>
<td>Packing-Carton</td>
<td>1,200 @ $1.00</td>
</tr>
<tr>
<td>Packing-SKU/Ctn</td>
<td>6,000 @ $0.50</td>
</tr>
<tr>
<td>Shipping-Admin</td>
<td>120 @   $2.00</td>
</tr>
<tr>
<td>Shipping-Container</td>
<td>500 @   $1.00</td>
</tr>
<tr>
<td>Gen &amp; Admin</td>
<td>@ 10%</td>
</tr>
</tbody>
</table>

**Total Customer & Admin Costs** $119,099

**Net Customer Margin** $20,901
### Example I - How It All Works

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales</strong></td>
<td>$700,000</td>
</tr>
<tr>
<td><strong>Product Cost</strong></td>
<td>$525,000</td>
</tr>
<tr>
<td><strong>Product Support Costs</strong></td>
<td>$25,000</td>
</tr>
<tr>
<td><strong>Total Product Costs</strong></td>
<td>$550,000</td>
</tr>
<tr>
<td><strong>Customer Margin</strong></td>
<td>$150,000</td>
</tr>
</tbody>
</table>

**Customer Costs:**
- **Orders**: 200 @ $5.00 = $1,000
- **Waves**: 100 @ $6.00 = $600
- **Pick Line Items**: 2,000 @ $3.00 = $6,000
- **Labels**: 800 @ $6.00 = $4,800
- **Transition A**: 8,000 @ $1.00 = $8,000
- **Transition B**: 4,000 @ $3.00 = $12,000
- **Transition C**: 8,000 @ $6.00 = $48,000
- **Packing-Carton**: 600 @ $1.00 = $600
- **Packing-SKU/Ctn**: 4,000 @ $0.50 = $2,000
- **Shipping-Admin**: 100 @ $2.00 = $200
- **Shipping-Container**: 600 @ $1.00 = $600
- **Gen & Admin**: @ 10% = $980

**Total Customer & Admin Costs**: $83,750

**Net Customer Margin**: $65,210

### Example II - How It All Works

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales</strong></td>
<td>$700,000</td>
</tr>
<tr>
<td><strong>Product Cost</strong></td>
<td>$525,000</td>
</tr>
<tr>
<td><strong>Product Support Costs</strong></td>
<td>$25,000</td>
</tr>
<tr>
<td><strong>Total Product Costs</strong></td>
<td>$550,000</td>
</tr>
<tr>
<td><strong>Customer Margin</strong></td>
<td>$140,000</td>
</tr>
</tbody>
</table>

**Customer Costs:**
- **Orders**: 250 @ $5.00 = $1,250
- **Waves**: 50 @ $5.00 = $250
- **Pick Line Items**: 3,000 @ $3.00 = $9,000
- **Labels**: 500 @ $5.00 = $2,500
- **Transition A**: 9,000 @ $1.00 = $9,000
- **Transition B**: 6,000 @ $3.00 = $18,000
- **Transition C**: 12,000 @ $5.00 = $60,000
- **Packing-Carton**: 1,200 @ $1.00 = $1,200
- **Packing-SKU/Ctn**: 6,000 @ $0.50 = $3,000
- **Shipping-Admin**: 120 @ $2.00 = $240
- **Shipping-Container**: 500 @ $1.00 = $500
- **Gen & Admin**: @ 10% = $14,009

**Total Customer & Admin Costs**: $119,089

**Net Customer Margin**: $20,901
NOW I’VE GOT GOOD COST INFORMATION, SO WHAT?

• More informed pricing decisions:
  – Catalog
  – Contracts
  – Special Quotations

• More informed sourcing decisions:
  – Total cost of ownership
NOW I’VE GOT GOOD COST INFORMATION, SO WHAT?

• Expanded process improvement possibilities:
  – Visibility of processes and their cost

• More informed product line decisions

• Support for Customer Resource Management (CRM)
A SHIFT TO LONG-TERM CUSTOMER INVESTING

“Most sales people manage for short-term revenues (regardless of profits). … Going forward, we believe that companies will have to think beyond short-term revenue and profitability of today. They will have to take the long-term view and manage their strategic customer relationships as assets. They will attempt to maximize the net present value (NPV) of future profit streams from these customers, thus shifting to the enhancement of long-term Customer Relationship Capital.”

Peter F. Mathias and Noel Capon
Managing Strategic Customer Relationships as Assets, p. 2
Colombia Business School
IMAGINE YOU ARE PHARMACEUTICAL SUPPLIER.

Which Customer is more Important?

Dentist A
Sales = $750,000
profits = $100,000
Age 61

Dentist B
Sales = $375,000
profits = $40,000
Age 25

Which is more profitable?
Which is more valuable?
BLENDING COST MODEL & COST SYSTEM

Conceptually Valid Cost Model

Computational Cost Model
Predictive

ERP System
Data Base
Historical Data*

Other Input Distributions, Forecasts, etc.

Costing Rates

Data

Rates at alternative volume and mix scenarios
Projected incremental cost impact of decisions
Projected total cost after change or decision
Comprehensive and accurate product and customer profitability information
Economic vs. Accounting cost comparisons
Situation specific fixed vs. variable analyses
Simpler, yet more accurate, forecasting, planning and budgeting

* Including orders, line items, customer returns, etc.
THANK YOU!

QUESTIONS?

Douglas T. Hicks, CPA
D. T. Hicks & Co.
6905 Telegraph Road – Suite 325
Bloomfield Hills, MI  48301
248.761.3706
dohicks@aol.com
www.dthicksco.com

© 2012 D. T. Hicks & Co.