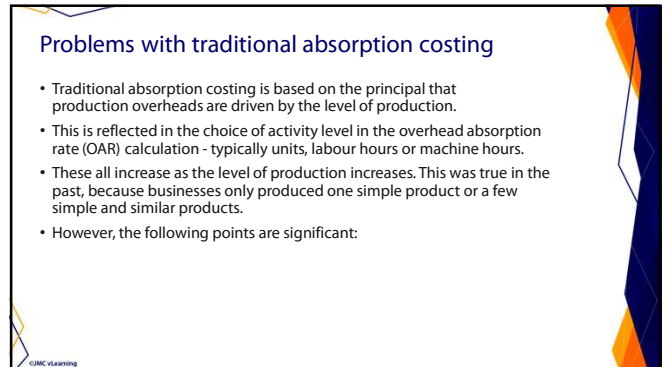
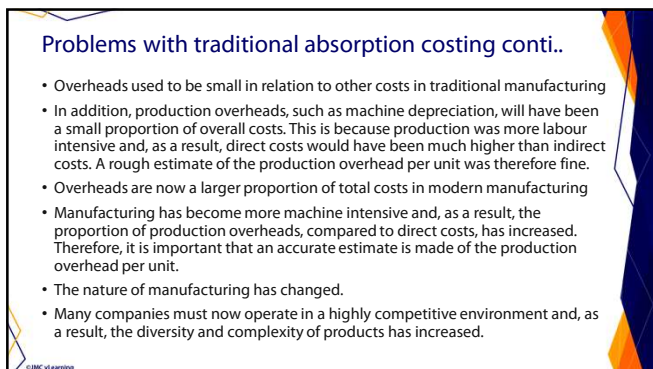


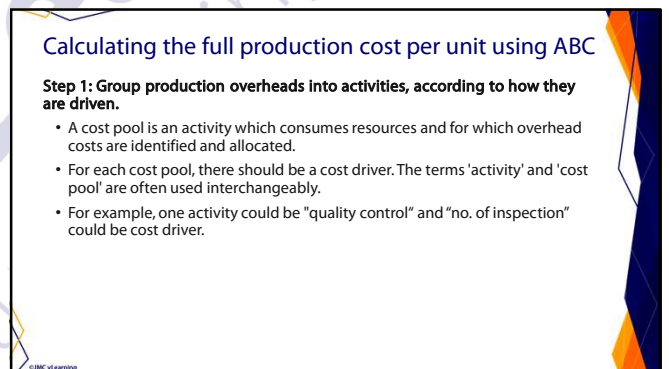
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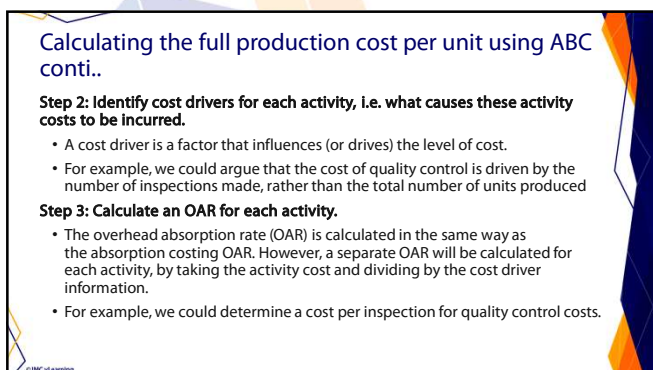
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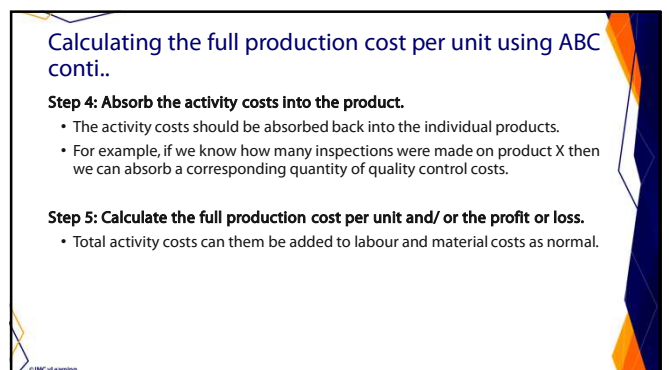
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### Cost pools and drivers

Cost pool / Activity	Possible cost driver
Ordering cost	No. of orders
Material handling cost	No. of production runs
Machine set up cost	No. of machine set-ups
Machine operating cost	No. of machine hours
Production scheduling cost	No. of production runs
Despatching cost	No. of despatchers

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### Advantages of ABC

- ABC provides a more accurate cost per unit. As a result, pricing, sales strategy, performance management and decision making should be improved.
- It provides much better insight into what drives overhead costs.
- ABC recognises that overhead costs are not all related to production and sales volume.
- In many businesses, overhead costs are a significant proportion of total costs, and management needs to understand the drivers of overhead costs in order to manage the business properly. Overhead costs can be controlled by managing cost drivers.
- It can be applied to derive realistic costs in a complex business environment.
- ABC can be applied to all overhead costs, not just production overheads.
- ABC can be used just as easily in service costing as in product costing.

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### Disadvantages of ABC

- ABC will be of limited benefit if the overhead costs are primarily volume related or if the overhead is a small proportion of the overall cost.
- It is impossible to allocate all overhead costs to specific activities.
- The choice of both activities and cost drivers might be inappropriate.
- ABC can be more complex to explain to the stakeholders of the costing exercise.
- The benefits obtained from ABC might not justify the costs.
- Other systems may need to be changed - for example, how variances are calculated.

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## CUSTOMER PROFITABILITY ANALYSIS

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### Customer profitability analysis

- Customer profitability analysis uses an activity based approach to relate revenues and costs to groups of customers in order to assess their relative profitability.
- Customer profitability analysis (CPA) is 'the analysis of the revenue streams and service costs associated with specific customers or customer groups'.
- Marketing departments should be aiming to attract and retain profitable customers but in order to do this they need to know which customers are profitable and how much can be spent on retaining them. The costing system should provide the necessary answers.
- Customer profitability analysis (CPA) provides important information which allows an organization to determine both which classes of customers it should concentrate on and the prices it should charge for customer services. Its use ensures that those customers contributing sizeably to the profitability of the organization receive a comparable amount of attention from the organization.

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### Customer revenue and cost

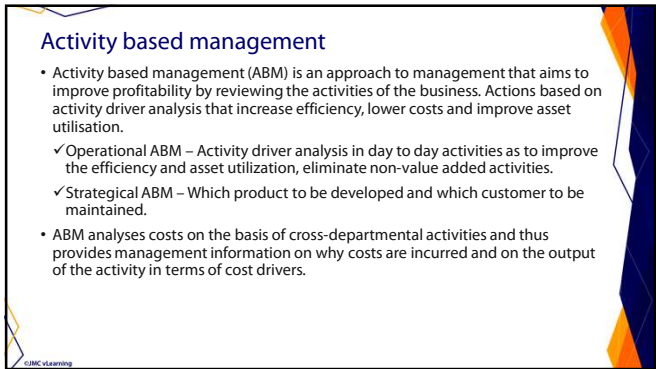
- Customer revenues are cash flows from customers. They are influenced by different factors, mainly allowances and discounts.
- Different customers use different amounts of activities, it is possible to build up costs for individual customers or groups of customers on an activity basis so that their relative profitability can be assessed. Therefore ABC system can be used to calculate the cost of the customer.

Activity	Driver
Order taking	No. of order taken
Sales visit	No. of sales visit
Emergency orders	No. of rushed orders
Delivery	KMs travelled

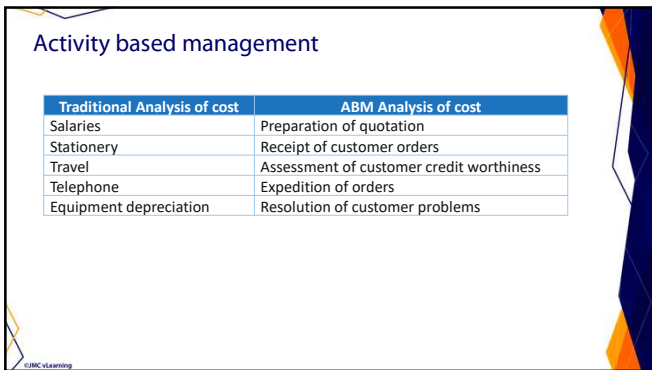
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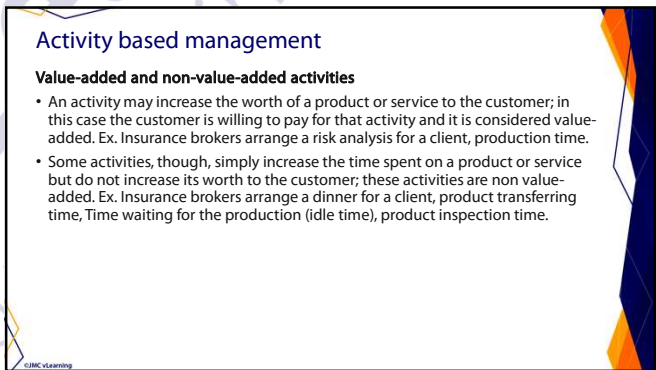
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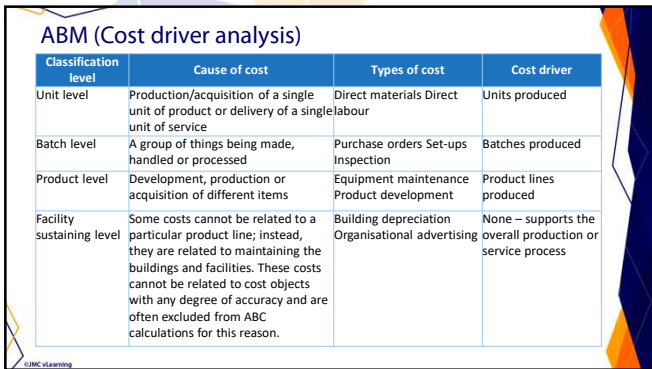
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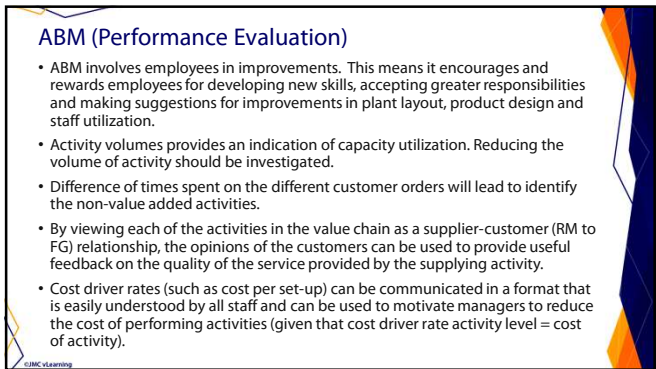
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