

**A ROADMAP  
FOR SUCCESS:  
ACTIVITY  
BASED  
MANAGEMENT  
FOR  
FOODSERVICE  
PROFESSIONALS**





# A ROADMAP FOR SUCCESS: ACTIVITY BASED MANAGEMENT FOR FOODSERVICE DISTRIBUTORS

*Efficient Foodservice Response*

*Written by: Karen J. Ribler  
KJR Consulting*

February 2001

---

Copyright © 2001 by Food Distributors International (NAWGA/IFDA), IFMA, UCC, ASMC Foodservice, GMA, NRA, and CCGD. All rights reserved. This publication may not be produced, stored in any information retrieval system or transmitted in whole or in part by any means—electronic, mechanical, photocopying, recording or otherwise—without the express written permission of Food Distributors International (NAWGA/IFDA), IFMA, UCC, ASMC Foodservice, GMA, NRA, and CCGD. Contact Mark Allen, Executive Director, EFR (703/532-9400) for permission to reprint material in this report.

---

---

# Table of Contents

About Efficient Foodservice Response . . . . . VII

Executive Summary . . . . . XIII

Introduction . . . . . 1

The Basics . . . . . 5

The Recipe for Success: Have a Champion at the Top! . . . . . 11

The First ABC/M Initiative . . . . . 15

The “Team” . . . . . 21

ABM Dictionary . . . . . 25

A Discussion on Software . . . . . 31

Gathering the Data . . . . . 35

Completing the Initiative. . . . . 49

Summary. . . . . 53

Appendix A: Distributor Activity Chart. . . . . 57

Appendix B: Distributor Activity Dictionary. . . . . 59

Appendix C: Pilot Activity Dictionary. . . . . 69

Appendix D: ABC Team’s Steps . . . . . 71

Appendix E: ABC/M Resources. . . . . 73

Appendix F: Glossary of Terms . . . . . 75

The following organizations are sponsors of the Efficient Foodservice Response Initiative:

**International Foodservice Distributors Association (IFDA)**

Food Distributors International  
(NAWGA/IFDA)  
201 Park Washington Court  
Falls Church, VA 22046  
703/532-9400  
703/538-4673 (fax)  
www.fdi.org

**International Foodservice Manufacturers Association (IFMA)**

Two Prudential Plaza  
180 N. Stetson Avenue, Suite 4400  
Chicago, IL 60601  
312/ 540-4400  
312/540-4401 (fax)  
www.ifmaworld.com

**Uniform Code Council, Inc. (UCC)**

7887 Washington Village Drive  
Suite 300  
Dayton, OH 45459  
937/435-3870  
937/435-7317 (fax)  
www.uc-council.org

**Association of Sales and Marketing Companies – Foodservice**

2100 Reston Parkway, Suite 400  
Reston, VA 20191  
703/758-7790  
703/758-7787 (fax)  
www.asmc.org

**Grocery Manufacturers of America, Inc. (GMA)**

1010 Wisconsin Avenue, NW  
Suite 900  
Washington, DC 20007  
202/337-9400  
202/337-4508 (fax)  
www.gmabrands.com

**National Restaurant Association (NRA)**

1200 17th Street, NW  
Washington, DC 20036  
202/331-5900  
202/331-2429 (fax)  
www.restaurant.org

**Canadian Council of Grocery Distributors (CCGD)**

300 Léo-Pariseau, Suite 1100  
P.O. Box 1082, Place du Parc  
Montreal, Quebec H2W 2P4  
Canada  
514/982-0267  
514/849-3021 (fax)  
www.ccgd.ca

## **EFR Initiative** **Sponsors**

## About Efficient Foodservice Response

In late 1994, the International Foodservice Manufacturers Association (IFMA) and the International Foodservice Distributors Association (IFDA) provided the catalyst for the formation of an ad hoc group comprised of representatives from foodservice manufacturers, brokers, distributors, operators and key industry trade associations. The group was formed to examine Efficient Consumer Response (ECR), a grocery industry initiative, and its relevance to the foodservice supply chain. Group members also explored ways to work with ECR pioneers.

After weathering a severe snowstorm during its first meeting, which was hosted by Rich Products Corporation in Buffalo, NY in January 1995, the team became known as the Buffalo Blizzard Group.

Several members had been involved with ECR, and all — directly or indirectly — had observed its implementation in the grocery supply chain. All had seen ECR's impact since its introduction in 1993. To date, its results include increased supply chain efficiency and improved competitive dynamics — both facilitated by more cooperative channel-trading relationships.

While grocery represents the “food-prepared-at-home” half of the food supply chain, foodservice represents the other half, or “food-prepared-away-from-home.” Since one complements the other, the “Buffalo Blizzard Group” questioned whether an ECR-like initiative in the foodservice supply chain would make sense. Although many ECR principles are relevant to the foodservice supply chain, the difference between foodservice and the grocery industry is significant enough that total ECR adoption is not appropriate.

The group also recognized that motives for change in the foodservice supply chain differ from those in the grocery industry's and that the foodservice industry would require its own economic case for action. The motives for launching beginning ECR as well as the Quick Response movement in the general merchandise channel before it — included heightened competition from alternate trade channels. Dramatic increases in imports from countries with drastically lower labor costs rates in the mid-1980s had given rise to Quick Response; the . The growth of grocery sales in the alternative format store sector was the catalyst for ECR.

In contrast, the foodservice supply chain of the mid-1990s faces no such outside threats. Conditions are ripe, however, for development of such threats. The foodservice supply chain features many of the characteristics other supply chains displayed possessed before they lost market share to alternative competition. They include:

- Mistrust and lack of cooperation between supply chain trading partners.
- Pervasive lack of focus on providing value to the consumer.

- Archaic business practices that complicate trade between buyers and sellers.
- Poor penetration of modern supply chain practices and information technologies that which could enable quantum leaps in effectiveness and efficiency.

After adopting “EFR” as the name of the initiative and developing a logo, the group commissioned a study to accomplish three objectives:

- Quantify the cost of inefficiencies to the foodservice industry.
- Define the strategies that comprise EFR and remove non-value-adding costs.
- Educate the industry about EFR.

In August 1995, the group selected Computer Sciences Corporation (CSC) to fulfill these objectives because it possesses a core competency in supply chain management consulting and had helped develop ECR. CSC proposed a collaborative effort with the Stanford Supply Chain Forum at Stanford University, which features a core competency in supply chain management consulting and helped develop ECR. Stanford University has a record of bringing brought academic credibility, objectivity, and relevant research into supply chain economics and modeling.

The EFR study shows that there are \$14.3 billion in non-value-adding costs accruing throughout the foodservice supply chain. This figure represents the potential benefit of EFR to the total supply chain, and applies almost equally to operators, distributors and manufacturers/brokers. It should be noted that this figure is extremely conservative and based on today’s technology. Nothing needs to be invented to capture these benefits — they represent an attainable goal, not a theoretical maximum in an ideal world. In reality, \$14.3 billion is the tip of the iceberg. Actual cost savings opportunities are much higher.

EFR is intended to align efforts throughout the foodservice supply chain to build a solid platform for profitable growth. The \$14.3 billion figure simply represents the benefit of this platform. Foodservice supply chain professionals, after establishing a foundation, should be able to focus on a slice of the \$800 billion in incremental industry growth potential. EFR is not a destination; it is a pathway to a new era of renewed prosperity for the foodservice industry.

The EFR mission statement is presented below. While it contains many words, it may be summed up as a philosophy that can be shared by all supply chain participants. If all supply chain segments meet the primary objective — and geared to eliminating costs that do not add value to the consumer — EFR. Further, meeting this objective, which is common to all supply chain segments, it will create a stronger, more competitive, and more profitable business environment and will provide lasting value for the consumer.

### **EFR Mission**

*Efficient Foodservice Response (EFR) is the voluntary undertaking of planned and directed activities among all the partners in the value chain to achieve a low-cost, high-performing value chain. The purpose is to eliminate inefficiencies and wasteful practices, thereby enhancing the ability of each party to compete fairly and vigorously. Each functional component in the chain works in unison with the others to increase value, while minimizing the cost burden on any other value chain component. Thus, the value chain is closely synchronized, highly flexible, reliable, and responsive to customer demands, with short cycle times and lower total value chain costs from raw material ingredient supplier to consumption.*

This mission is accomplished via the study of five strategies that comprise a number of interrelated initiatives. The initiatives within each strategy progress from basic to advanced capabilities allowing diverse organizations to develop unique implementation paths within a common EFR framework. As an overview, the five EFR strategies are:

*Equitable Alliances* – These are the building blocks that support EFR implementation and the attainment of benefits. Initiatives included address the complex funds flows within the supply chain and how value is measured. A fundamental initiative is activity based costing, which builds the foundation for initiative bundling and value-based incentives. There is no economic benefit attributed to this strategy as it is a “cost-neutral” mechanism that enables shifts in the way costs and revenues accrue in the supply chain.

*Supply Chain Demand Forecasting* – This strategy encompasses initiatives that create a supply chain characterized by a common view among trading partners of end-consumer demand coupled with an integrated set of planning processes. The industry benefit reaped from implementation of initiatives within this strategy is estimated to be \$2.9 billion.

Initiatives within supply chain demand forecasting integrate demand creation and demand fulfillment processes across all segments. These initiatives include standard product identification and bar coding, common product information databases, demand and planning information sharing, and market-level reporting and forecasting.

*Electronic Commerce* – This Electronic Commerce is the biggest EFR initiative in terms of quantifiable benefits. The initiatives that comprise this strategy represent a \$6.6 billion savings opportunity across all industry segments. Most of these benefits come from reduced administrative cost resulting from streamlining the revenue cycle processes between supply chain buyers and sellers. The five integrated initiatives include business process simplification, product maintenance EDI (electronic data interchange), revenue cycle EDI, electronic funds transfer, and invoiceless payment. An initiative originally identified as part of supply chain demand forecasting — common product information databases — is also being addressed by electronic commerce.

*Logistics Optimization* – This strategy aims to Logistics optimization is a set of initiatives with a goal of optimizing the end-to-end total supply chain costs across all segments. Initiatives dealing with physical flows from point-of-supply to point-of-consumption are represented within this strategy. These include direct shipment, consolidation, shared distribution, coordinated transportation and cross-docking. The industry benefit attributed to implementation of logistics optimization is \$2.7 billion.

*Foodservice Category Management* – This strategy includes initiatives to profitably manage the inherent complexity of a supply chain that produces millions of end products in a variety of service configurations. Its industry benefit is estimated to be \$2.1 billion. Initiatives within foodservice category management address the way the supply network is loaded with products against the marketplace's raw demand. They include balanced variety, product deletions, new products, and centralized conversion.

The five EFR strategies are designed to create a more effective end-to-end supply chain. Only a holistic view of the supply chain as a whole machine will create a truly effective supply chain that optimizes the value creation process from end to end. Consequently, the EFR studies can assist trading partners as they consider changing the way they conduct business. Achievement of EFR's mission rests with the senior executives from companies that make up the foodservice supply chain. Success requires these executives' vision and support.

By striving to improve business processes presents, companies within the foodservice industry have a unique opportunity to become stronger. strengthen as well. The Efficient Foodservice Response project provides important analytical tools to help our industry prepare for a tougher business environment in the next millennium.

The EFR Executive Committee encourages you to begin understanding the EFR strategies. The committee is making every effort to support the industry by providing these educational documents and creating an arena for industry-wide continuous improvement.

## Background

At no time in history has the foodservice distributor been faced with so much potential.

EFR, if implemented industry-wide, could achieve industry growth of \$800 billion and savings of \$14.3 billion.

Of this \$14.3 billion, 35 percent would go to distributors in the following areas:

- 53% administration
- 26% handling
- 10% inventory
- 9% transportation

This study singles out activity based cost/management (ABC/M) as a fundamental EFR enabler that will allow the foodservice community to realize this savings and growth.

Activity based costing (ABC) provides management with:

- A process perspective of how the organization's business is being conducted
- A numeric picture of how costs accrue
- Data that can be used to measure performance
- A means of "seeing" where the inefficiencies reside and where opportunity may exist
- A means of measuring "true cost" and "true profit"

## The Primer

Recognizing the foodservice distributor's opportunity, the Efficient Foodservice Response initiative commissioned the development of this primer to help the industry better understand the basics of activity based costing and its use as a business tool.

The primer is designed to walk an organization through its initial ABC initiative. The text assists in helping the reader understand how ABC is

## Executive Summary

different from a traditional financial perspective; how ABC data can be used to verify or modify the strategic direction of an organization; and how ABC data can be used to improve an organization's bottom line.

In order to develop a reality-based primer, an ABC pilot task force was assembled. The primer uses the experiences of pilot participants to illustrate the basics, convey insights and point out potential pitfalls.

It is the intent of this primer to encourage ABC data use on an ongoing basis for strategic as well as tactical decisions. ABC data when used in an organization's decision-making process, becomes activity based management (ABM).

The use of ABM throughout the foodservice distribution community will assist distributors in:

- Quantifying the value that they provide to the supply chain
- Understanding the dollar impact of inefficient or unnecessary internal and industry practices
- Implementing change to reduce (if not eliminate) activities that add cost, but not value
- Identifying potential new services
- Identifying the activities that support growth in foodservice and other channels
- Benchmarking and implementing continuous improvement.

Each chapter is a steppingstone to the next phase of the ABC/M initiative.

Chapter 1 Introduction

Chapter 2 Basic concepts of ABC and ABM, including how ABC differs from traditional costing

Chapter 3 Importance of senior level direction and support

Chapter 4 Selecting the focus for an organization's first foray into activity based costing.

Chapter 5 ABC management team; composition and role

Chapter 6 Development and role of an activity dictionary

Chapter 7 Insights into software selection

Chapter 8 Steps in building an ABC model, including gathering the data and managing the results of each phase

Chapter 9 Importance of putting cost findings into perspective and communicating the initiative's results to the organization

Chapter 10 Summary

Activity based management at its best is a powerful management tool. Foodservice distributors who understand their costs and manage their activities through this understanding will be well positioned for a prosperous future.

# *Introduction*

In 1997 the foodservice community was presented with a study, *Enabling Profitable Growth in the Food-Prepared-Away-From-Home Industries*, conducted by Computer Sciences Corporation (CSC) for the Efficient Foodservice Response (EFR) initiative. The study quantified \$14.5 billion in non-value-added costs in the supply chain. Of the \$14.3 billion, 35 percent was to accrue to the foodservice distributor.

The report noted that these savings could be realized by eliminating redundant, inefficient and “low value” supply chain practices. Further, it reported that the industry, with the right practices in play, faced potential growth of \$800 billion.

CSC identified activity based costing (ABC) as a key enabler to assist industry members in realizing this potential. ABC was deemed as instrumental in:

- Identifying the activities that support business growth in the food-service channel
- Quantifying the cost of doing these activities in support of the business
- Understanding the dollar impact of inefficient or unnecessary industry practices
- Implementing change to reduce (if not eliminate) activities that added cost, but not value
- Making good decisions that would result in realizing lower supply chain costs and ultimately better serve the consumer.

EFR commissioned the development of this primer to help foodservice distributors better understand the basics of ABC with an eye toward improving business practices and realizing the potential savings.

Because of the complexity of change, EFR felt that an ABC publication that focused on foodservice distributor activities would facilitate the initial use of ABC as a strategic management tool.

This primer is augmented by the experiences of foodservice distributors who participated in an ABC pilot specifically for the development of this text. Their experiences are used as illustrations throughout the publication.

The primer is designed to provide:

- A basic discussion of ABC/M
- A guide for foodservice distributors to “get started”
- An activity dictionary
- Real examples to illustrate ABC/M steps and possible pitfalls
- References for further reading and discussion.

The fruits of ABC/M can be very rewarding. The use of ABC as a strategic and tactical tool is an ongoing process. It is not a project, but rather a continuous journey that provides the organization with cost data and the ability to develop performance measures to optimize returns. It is the intent of this publication to provide the ingredients to launch any interested organization into its first initiative.

The billions of dollars identified by EFR is an attainable goal when behavioral change can be articulated, measured and reinforced. The text that follows is designed to underscore the potential value of using ABC data to effect and manage change.

# *The Basics*

Activity based costing (ABC) is a methodology that recasts an organization's general ledger to focus on the activity cost of doing business.

Looking at a business from an ABC perspective allows management to:

- obtain a clear view of which activities are performed most often and which activities might benefit from a reengineering effort;
- obtain a “true” measurement of customer and/or product profitability;
- define which services are value added and which are not, based on activity costs;
- obtain insights into activity contribution and cost with an eye toward improving the profitability of the organization.

The purpose of ABC is to obtain a better understanding of business costs from a “process” perspective. The process view acknowledges the cross-functionality of how work gets done. ABC can improve an organization's product or services costing and promotes a better understanding of how the organization's resources are consumed.

ABC differs from the traditional financial approach, which assigns cost to a function such as sales or marketing. This method of assigning organizational cost was designed to meet government reporting requirements.

Using this method, the true cost of specific activities is not captured. Given the definition of what traditionally constitutes a department's costs, the cross-functionality of activities is not taken into consideration in traditional financial reporting. Thus, for example, all of the activities outside of the sales department that contributed to any given sale are “lost” when trying to measure the cost of the sale.

Traditionally, indirect costs are spread across the organization with each department realizing its allocated share. For the most part, this allocation is not tied to what is causing the expense from a consumption basis.

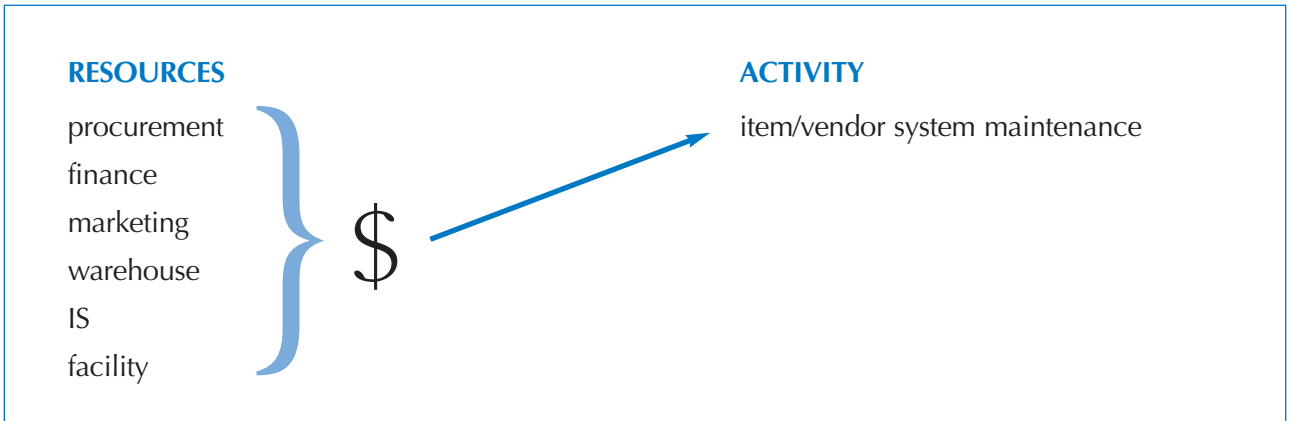
The traditional financial statement is not designed to measure cost from a process perspective, i.e., how the work is done. Therefore, many organizational accounting systems do not assist management by taking true costs into account when decisions are made.

ABC, on the other hand, does address the above issues. It measures cost

## **ABC vs. Traditional Costing**

by recasting functional accounting into a process driven system. It measures the “who” and the “what” costs of doing business based on their contribution to performing or sustaining an individual task.

More simply stated, the costing of products and services from an ABC perspective is based on tracking the organization’s resources (people, facilities and machines) to its activities. For example, the activity “item/vendor system maintenance” when using ABC includes procurement, finance, marketing, warehouse, information systems (IS) and facility dollars. All six departments contribute their time and resources to ensuring the system is maintained. Therefore, when measuring this organizational cost, all six elements are included on a contribution basis.



### Getting the Terms Straight

The terms activity based costing (ABC), activity based management (ABM) and activity based cost/management (ABC/M) are all used to describe this costing technique. For the purposes of this text, ABC is the process of gathering the data and translating it into usable information. ABM is what you do with the information to manage your business. ABC/M takes into account the data gathering, crunching and use of the information.

ABC/M is not intended to replace traditional accounting. The organization’s monthly financial statements and general ledger provide an organization with one slice of information. ABC/M is above all a strategic planning tool meant to augment the information provided by more traditional accounting.

ABC/M is primarily a strategic management and decision-making tool. The use of ABC/M provides an organization with a language to think about how business is being conducted with an eye toward improving efficiency, increasing profitability and achieving the organization's stated mission.

## Why Activity Based Cost Management?

The ABC/M process promotes better resource management. There are activities that organizations "do" that may not support the business objective. These activities are carried out without reflection because "that's how it's always been done" and because they are not measured. Therefore, the cost associated with these activities may never be questioned.

An ABC/M initiative prompts the organization to:

- Look at the activities performed
- Look at who is carrying out these activities
- Become more aware of how time is being spent
- Assess the cost of these activities by taking into account all resources that contribute to the process
- Understand what elements drive or influence cost
- Assess the value of these activities, products and services
- Measure the profitability of a product or customer with a more complete understanding of the true costs

ABC/M facilitates conversation throughout the organization by answering:

- Whether the activities performed reflect the organization's overall strategy
- Who is doing the work
- Whether time/resources are spent "sensibly"
- Whether costs are "in line"
- Whether behavior can be modified to reduce costs or increase efficiency

- Whether there are activities, products or services that are low in value that could be reduced or eliminated
- Whether profitability assumptions are correct

ABC/M information provides organizational benchmarks for:

- Continuous improvement
- Incentive programs
- Supply chain initiatives

ABC/M will not tell you what to do, but it will provide useful information to better understand and manage your business.

*The Recipe  
for Success:  
Have a Champion  
at the Top!*

The key in any successful initiative is the organization's commitment to see it through. An ABC/M undertaking is no exception. Your ABM initiative will require commitment at the top. When the project is a visible priority of the president, partner or COO, it gets done.

On the other hand, when the commitment is not apparent, the project is bound for mediocrity at best. Clear vision, time, resources and commitment are all required in making any project a success. ABC/M projects initially are very time consuming, involve many people, require data collection and are fueled with information that may make personnel uncomfortable. Clear support from the executive office is the first step in ABC success.

The next step is the establishment of a cross-functional project team that will be responsible for ABC/M execution (see Chapter 5). The team will require direction, resources and encouragement to get the job done.

Organizations whose top executives understand the resource commitment and think through their vision — clearly answering the questions “why do it?” and “who should be involved?” — will position their organization to receive the full benefit of their ABC effort.

As basic as it may seem, the executive vision must be articulated. Clarity of vision and the ABC project's priority to the organization, coupled with the expectation for clear deliverables, will ensure success. The best ABC/M endeavors leave nothing to chance. They are clearly mapped out with an agreement between the ABC/M management team and the executive champion defining the business objective, the resource expectations and the time requirements.

“How do you spend your time?” is a very basic ABC question. This question, with the right management support, can be a morale builder. Or it can cause anxiety and yield poor data. To pave the way for a successful ABC/M initiative, top management should acknowledge that employees who do the work know the most about the tasks they perform; thus, their participation is essential. Management should:

- Decide who will serve on the project team

## Commitment

## Expectation

## Communication

- Introduce the initiative to employees in a memo, newsletter, speech or other means
- Underscore the priority of the undertaking as well as management's intention to improve the organization, solicit employee input, and share the results
- Clarify time frames and how the project team will operate
- Set a positive tone for the entire project

Unless management takes the time to introduce the project as a priority and communicate its value, it may appear to be a head-cutting exercise or just one more thing that management wants employees to do. Appropriate communication will facilitate the ABC/M project team's work and provide information for better management decisions.

*The First  
ABC/M Initiative*

In today's business environment, trying to put 10 pounds in a five-pound bag is not unusual. However, the bag can break. More ABC/M projects are shelved than carried to completion due to an overly ambitious first effort.

If hindsight has 20/20 vision, most experienced ABM teams would advise organizations new to ABC/M to start with a small, focused project that has the following characteristics:

- Be framed around a clear business question.  
(Example: What does it cost me to serve my top five customers?)
- Be crafted in such a way that it initiates the organization's journey (i.e., it would acknowledge ABC/M as an ongoing decision support tool).
- Have a set beginning and a defined end.
- Include specified touch points to provide top management with feedback.

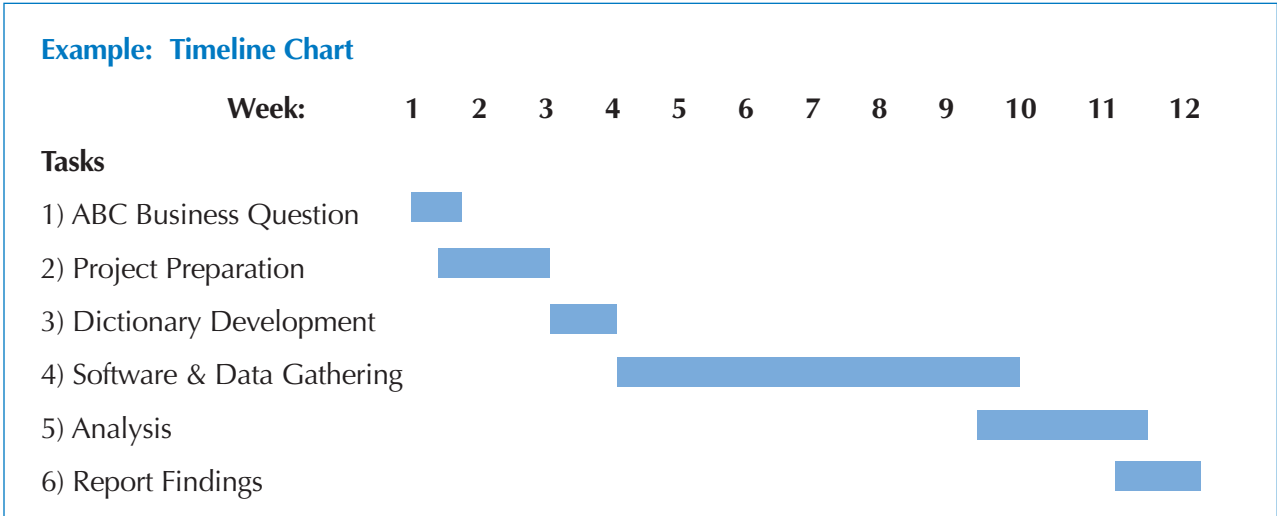
ABC initiatives that are shelved usually have unrealistic expectations, lots of initial enthusiasm, and limitless project scope. These projects are exhausting and become non-priorities due to the sense that there is no end in sight.

Eating the elephant one bite at a time is the image that should guide the ABM team's efforts when defining their project's scope. Initiate the organization's first endeavor with the thought that ABC/M will be a journey. As information and insights are obtained, they will beget additional questions. These additional questions will lead to refining the ABC/M process. The insights may lead to implementing change, thereby leading to another ABC analysis to measure the impact of these changes. You will learn from these first few efforts and will want to improve your ABC models, activity definitions or how you collect and report data.

As we've noted, top management should articulate a business question and a vision of what ABM can do for the organization. Taking time to discuss how ABC/M is to be used over the long haul will assist the ABM management team in designing an initiative that will work in the short term.

A realistic timeline is important. There is no formula for your team's time requirements. Many projects begin by focusing on one quarter's activity. Elements in the timeline include: project kickoff; discussion of the activities that will be included in the study; activity definitions; identification of data sources and how to "get at" the data; data collection;

populating an ABC model (a spreadsheet or ABC software); analyzing the results and communicating the findings. It is not unusual to spend 25 percent or more of the initiative’s time in the data collection process.



Due to the intense learning curve, most first endeavors take more time than originally thought. Provide time in your timeline to learn! It takes time for the ABM team to learn how to implement and execute an ABC/M effort and it takes time for the organization’s personnel who are not on the team to understand what ABC is, why they are involved, and what’s in it for them. Investing in educational efforts at the onset of an ABC rollout is an investment in ABM success. (See Appendix E for a list of resources.)

The first project will serve to:

- Provide cost information on the question at hand, (i.e., what are the activities being performed, what or who are the contributing resources to these activities, what or who are driving the costs of these activities and what are the costs).
- Provide insights about what it takes to execute an ABC/M initiative.
- Confirm or cause discussion regarding the organization’s use of ABC/M.

The above discussion will hold true whether the ABC/M management team is being guided by a consultant or is solely using internal resources to move ahead. If a consultant is facilitating the process, it is still the ABC/M management team’s responsibility to: provide the knowledge of their organization, actively participate in defining the scope, conduct the study, think through the meaning of the data, conduct post-analysis and determine how the information is to be used.

## Pilot Business Question

The pilot work group spent several meetings discussing what might be most appropriate for their first foray into activity based costing. Their discussion centered on obtaining usable data to address a precise business question, and on learning the methodology of ABC.

The participants were somewhat limited in the nature of their first initiative (in that they were a part of a trade association study, a public undertaking). The group represented three organizations of varied size, scope and geographic location.

To select this first initiative, discussion revolved around the following questions:

- What were some of the more pressing business questions facing their organizations that lent themselves to a trade association share group setting?
- Once possible studies were identified, the group asked, what are we trying to learn?
- What is to be measured?
- How is the information to be used?
- What value would the information have (would this information be worth the effort to obtain)?

Projects that were considered included:

- Understanding the cost of serving selected customers.
- Understanding the cost of doing business by region, replicating discovered efficiencies where possible.
- Understanding the cost of carrying a category of product in the warehouse to facilitate efficient assortment decisions.

All three projects were doable. The group decided to pursue an ABC perspective on assortment. Their business question was: “Are we carrying an efficient assortment of brands in the salad dressing category?”

This question was selected because:

- It supported EFR. (Category management had been identified as an EFR enabler). And, understanding the contributing costs to a category is an important element in a category management undertaking.

- Salad dressing is an “unemotional” category that might benefit from an ABC/M study.
- It was a focused question that was small enough to “go to school on” but large enough to obtain usable information for the benefit of the organization.
- All organizations carry salad dressing.
- It would allow measurable results.
- It was a pilot that could have the potential for ABC to be used as a management tool and could be built into a reward system.

The participants were careful not to be overly ambitious and decided to analyze costs at the brand level. They agreed to a timeline and initiated their project.

# *The “Team”*

Team size, composition and meeting schedules vary by organization (see the example that follows this section). There is no magic prescription. One of the highest indicators of whether the ABC/M initiative will succeed is the creation of an ABM management team that is composed of multiple perspectives and is based on trust.

Why would an ABM team make a difference? Activity based management is the study of an organization's work from a process perspective. Its strength as a management tool is the fact that it measures cost by taking into account the many departments that contribute their time/resources in getting the job done.

The finance department is called to action whenever "costing" decisions are being made. This is true of an ABC initiative as well. In most organizations the finance department's participation on the ABM management team is critical. Confidential financial data is required and the insights of finance personnel who regularly work across all departments are very helpful. But finance personnel cannot carry the initiative alone.

The people who "do" the work know the activities of an organization and what activities they "touch." Operations personnel carry with them a "hands on" perspective. They offer front line access, the language needed to define the activities and the trust required to obtain buy-in for the project. They know what causes the work and what influences the workload. Their input on "cost drivers" can save the project many hours because their perspective comes from doing the job. Therefore, senior operations representation is an important contribution to the management of the ABM team.

Obtaining information and knowing what data an organization has is instrumental to the success of an ABC initiative. The IS department's systems expertise is called upon at all junctures of an ABC/M study. Having IS representation on the project team will reduce re-do work and increase the speed at which needed information is forthcoming. This group knows where the data is and how to manipulate disparate databases to get information needed, and in a format that is acceptable.

In a best case scenario, the "team" reports to the president or COO of the organization. It is an understatement, but worth noting again — if the CEO or COO champions the ABM project it will get done! As noted above, the team includes senior representation from finance, operations and IS. Other individuals are called upon on an "as needed" basis for additional insight, opinions, and direction.

Lastly, the successful ABM management team creates a project timeline that is communicated to the organization. Regular communiques about the project’s progress are included on the timeline and adhered to. The communication aspect of the team’s work provides all individuals in the organization ownership and a perspective regarding the team’s work.

As with most undertakings, there is more than one way to structure the organization to address the needs of a cross-functional ABM management team.

### **An Example: A Virtual Team**

One project participant found that a “virtual” team worked best for his organization. The team consisted of all senior managers. The ABM team leader was the vice president of finance.

The ABM leader’s role included keeping the team informed of the project’s progress during their bi-weekly management meetings. Regular ABC/M pilot project input was sought and encouraged at these meetings.

This arrangement was informal. No specific ABM project meetings were held, but this group guided and participated in the pilot as would a more formal team.

The senior managers served as a sounding board. The group directed and supported the actions of the ABM team leader within the organization’s functional groups. Support for the ABM initiative and communication about the pilot was provided to all personnel through these individuals.

As a virtual team, senior management guided, supported and owned the ABC effort. This approach proved to be a good example of how to operationalize ABM as ABC/M discussion found its way into management’s planning and decision-making processes.

# *ABM Dictionary*

One of the first steps in an ABM initiative is the creation of an activity chart and an activity dictionary. The activity chart serves as a visual listing of the activities performed in your organization from a process perspective. The dictionary spells out your organization's understanding of what each activity means.

The process of developing your organization's chart and dictionary for your ABC/M initiative(s) provides the team with another opportunity to think through your business. Obtaining definitional agreement for each activity will pay off when the data collection step is addressed.

Ordinarily the ABM management team will begin with a blank canvas and carry out active discussion regarding the organization's activities and their definitions. However, the foodservice community's work is considerably lightened by drawing on prior EFR work such as; the EFR *ABM Value Chain Activity Chart* and *the EFR ABM Dictionary*.

These tools were developed by the EFR Equitable Alliances Committee as the first step in their ABM initiative. The committee's work provides a supply chain perspective and defines activities carried out by the foodservice community (manufacturer, agent, distributor and operator) as well as definitions for these activities. It is a supply chain dictionary designed for use in a supply chain study.

Rather than starting from scratch, the ABM Project participants used the EFR Activity Dictionary as a catalyst to create an ABM activity chart and dictionary specifically for the foodservice distributor community. The Foodservice ABM Activity Chart and Dictionary used in this study is cast slightly differently to reflect more accurately the flow of the foodservice distributor's business. Just like the EFR ABM dictionary, the definitions take into account the process at hand, as opposed to a more functional or silo point of view. (See Appendix B.)

### **Example: Dictionary Development Insights**

The distributor dictionary places “Respond to Product Returns” under the mega process-Order Fulfillment (see Distributor Activities Chart, Appendix B). Its placement reflects the position or workflow of this activity within the process as articulated by our pilot participants. It does not suggest who is doing the work, as the group noted during its discussion that the following departments contributed to the cost of this activity: accounting, sales, warehouse and transportation. A more traditional viewpoint would place these costs in the warehouse department, thus losing sight of the true cost of product returns.

Just as the EFR ABM Dictionary provided the pilot participants with a starting point, the distributor ABM Dictionary is intended to provide organizations with a place to begin. Having organizational agreement regarding the definition of the activities performed is one of the key ingredients to a successful ABM project.

The development of a dictionary may be made easier by evaluating the distributor dictionary vis-a-vis your organization. If the project’s definition does not reflect your organization’s language or tasks, change it; if activities are missing, add them; if activities are included that you do not do, leave them out. Keep in mind that it is your business you are modeling. A good dictionary reflects the activities being performed in the organization, taking into account workflow and the language of the work culture.

Activity dictionaries are rarely static. Once the activity chart and dictionary are developed, they should not be carved in stone. The management team will want to encourage feedback and tweak the definitions as needed. It is appropriate to review these tools on an ongoing basis to be certain that there is continuing agreement about what is being measured. Plus, you may decide to add new activities.

### **ABM Dictionary: the Group's Experience**

The first effort of project participants was to create an activity chart and dictionary for the foodservice community. These tools would take into account all the activities performed by foodservice distributors from a high-level perspective.

The activity chart and dictionary continues to be a work in progress. As noted, the group had an advantage compared with most ABM projects. The EFR Activity Chart and Dictionary were the starting points for the project. The group spent three meetings refining the chart format and activity definitions. This does not take into the account the discussions participants had with their operations and IS counterparts.

The group found that corporate culture affected the understanding of what the activity entailed. Creating a meaningful definition that all three organizations could recognize as the activity was a challenge. Talking about the activities, thinking about the activities, and enlisting others outside our group to refine the definitions all were important steps.

The industry activity chart and dictionary served as the starting point when the group moved ahead with its pilot.

*A Discussion  
on Software*

## Software Selection

In many undertakings, software can be useful to help simplify a task at hand. Most “plug and play” software packages are relatively easy to use, so most organizations expect to purchase an easy-to-implement ABC software tool and proceed to create actionable information — right now.

This section features a discussion of software because the experiences of many companies indicate that selecting the right software for your organization is worth investing some time and perhaps resources.

ABC software choices continue to grow. Most come with a basic package with add-on solutions that can be purchased as your analytical needs grow. One might approach this like purchasing a car. What is the sophistication of the user? What features are required? (For example, is it necessary to be able to directly link the ABC package with the organization’s general ledger program or database?) What features would be nice? (For example, the ability to directly create charts and graphs while using the ABC package rather than export the data to a spreadsheet package to accomplish this task?) Who will be using the software? What are the more advanced features? Who will be responsible for its maintenance? How will the package be used?

Active discussion among the ABM project team participants is required to ensure a good fit. This should not be a finance department decision or an IS decision. Team input is needed. Most ABC software is “good,” but not all packages may suit your organizational needs. Take the time to think through what you believe are your initial requirements.

Next, contact the software vendors. Listen to their pitches. Bring your wish list, take notes and ask for a list of clients who are using their software. You may also ask for a demo disk.

Speaking with other practitioners can be one of the best investments you make in advancing your ABC/M initiative. How did they decide on their software package? How do they use it? What was the learning curve like? Did they use outside resources to set up their ABC model? If so, do they continue to use outside resources? Did they take classes? If so, who went? Do they find the software user-friendly? Who has access to the software? Are they happy with the reporting functions? Who is responsible for the software? Are they happy with the technical support? Is there a users group or some other type of support group for this product? What would they have done differently? What improvements would they like to see?

After a few phone conversations (or, better yet, personal visits) your team will be in a better position to refine your organization's ABC software wish list and "take in" the features conveyed by each vendor's sales pitch. The team will also have a better idea of what it takes to move ahead with the software of your choice. Time commitment, ease of use, price, integration, security, support, flexibility and tool features will all have weight in your decision.

Purchasing the software after having talked through the options and after hearing the input of the vendors' clients will serve to move your project ahead. This active pre-purchase discussion will clarify expectations and reduce the likelihood of the software stalling your ABC/M initiative. Adequate time and attention to the software tool and its potential use will most certainly pay off.

*Gathering  
the Data*

Once the business question has been defined, it helps to work “backward.” Ask yourself, what is the end goal? What are the sub-elements within this business question that would make a difference to the organization? What are the activities? What resources support the activities? For whom (or what) are these resources being used? What data will be required and how is it obtained?

There is a tendency to feel a bit overwhelmed when first defining the data that is needed and a plan to obtain it. Rest assured, much of the data is readily available. It resides in your general ledger, your information systems and your people’s understanding of the activities they perform. Further, by taking the end-goal approach, this step is made easier since there is clear agreement about what is to be studied.

In the jargon of activity based costing, the team will link “resource costs” to “activities” to “cost objects.” ABC is the assignment of costs from resources to activities and then from activities to cost objects.



This means:

- Taking dollars that an organization spends over a defined period of time, including both direct and indirect costs (i.e., resources)
- Connecting these dollars to the things you do (i.e., the activities)
- Connecting the dollars to whom or what you are doing these activities for (cost objects).

The dollars will be assigned to the things you do and who you are doing them for through the use of cost drivers. Drivers send costs through your ABC model. These drivers tend to be the number of times something is done, or the number of hours it takes to do something, or the number of items handled, percent of use and so forth.

Again working backward, the cost object is easy to identify. In the case of the pilot, the cost object was the brands in the dressing category. Another example may be the top five customers when trying to determine cost to serve your best customers.

What are the activities? ABM techniques encourage organizations to allow themselves a true understanding of how work gets accomplished. The activities to be studied include all the actions that an organization performs to address the desired outcome. In the case of the pilot, the activities included the actions required to support the carrying of a category in a foodservice distributor organization. In the cost-to-serve example, the activities would be those associated with serving the customer.

The identification of an organization's resources and how they are consumed by activities is the last step in the team's brainstorming session and the first step in their analysis.

### The Resource Data



The general ledger captures the "resource cost" information of an organization. Salary, benefits, automobiles, building upkeep, phones, equipment and so forth are all available for analysis with little manipulation. Whether ABC software, a spreadsheet or paper and a pencil is used, the general ledger is the starting point.

### Assigning Cost

Thinking about how the money flows is helpful in this first step. Which resources support other resources (thereby contributing cost to those resources)? And, which resources are consumed by what activities?

ABC is very much a "touch point" tool. The questions to ask are: What resources are supporting the activity indirectly, and who is doing the activity? In most cases, activities are carried out by a combination of individuals from a cross section of departments. For example, the cost of carrying a product is more than a warehouse expense or purchasing expense or sales expense; it is the sum of costs from all of these resources plus a portion of indirect resource supporting costs.

**Example**

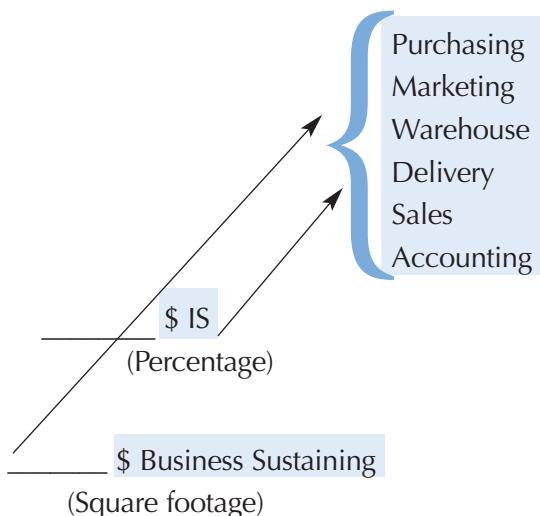
The general ledger below has eight departments:

- Purchasing
- Marketing
- Warehouse
- Delivery
- Sales
- Accounting
- Information Systems
- Business Sustaining (building, executive office)

The business question is “Are we carrying an efficient assortment of brands in the salad dressing category?” Thus, what is the relationship of these departments to our business question?

- Which resources contribute to the process?
- Which resources support our contributing resources?

Looking at the general ledger in this example, the costs associated with IS and Business Sustaining are indirect costs that support our other six resource centers. These costs, because of their supporting role, need to be assigned in some way to these six resource centers. This assignment is made by using resource drivers that best capture the relationship between the resources. Examples of drivers that can be used include percentage of use, square footage and percentage of time.



The assignment of these dollars to these resources is based on use as opposed to spreading the cost over the organization. Purchasing receives a greater percentage of IS cost than sales, and sales receives a higher percentage of IS cost than does delivery.

Once this step is completed, the resource centers or “cost buckets” represent “fully loaded” resources. The next two questions are: What resource touched what activity? To what extent are these resources consumed by the activities and cost objects identified in our study?

The relationship between resource and activity, and then between activity and cost object, is for the most part mapped out. The challenge is to assign cost in the proportion that reflects consumption. This is done through the use of cost drivers.

This example is very simplistic. It is meant to underscore two points. One, the business question identifies the resources that directly contribute dollars to the activities we wish to cost. Two, all costs in an ABC initiative are accounted for based on “use” as opposed to the traditional method of spreading indirect costs evenly across all departments (the peanut butter approach).

**The Activity Data**



The activity cost data of an organization resides in its IT systems and its people who perform the various activities. Through the use of reports, interviews and observation the ABM team can verify who contributes to the activities (which resources) and identify a means of quantification through the use of an appropriate cost driver.

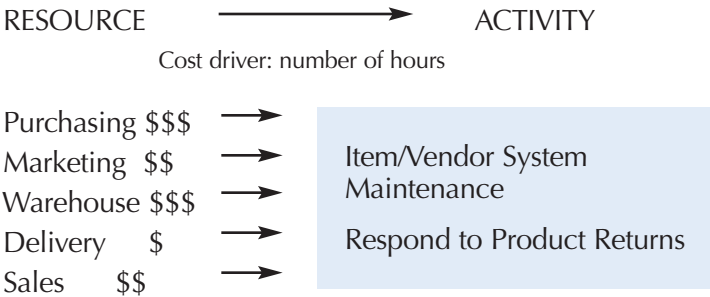
Selecting the appropriate cost driver accomplishes two things:

- It links resource to activity for activity costing.
- It allows the organization a means of performance measurement.

Drivers are selected based on how best to quantify the relationship. Number of hours, number of full time equivalents (FTE's), and percentage of use are all examples of drivers that are used to link resource cost to activities.

**Example**

In our pilot we wanted to know how much we spent over a quarter on item/vendor system maintenance. We wanted to be able to cost out this activity in total, and by purchasing, marketing, warehouse, delivery and sales. The pilot team agreed that the driver that could best capture what was “driving” the cost, was the number hours spent on this activity. The amount of time spent on this activity was determined through interviews.



Determining the degree of granularity that is needed helps the team select the method used to obtain driver information. Asking personnel to estimate how much time they spend on each activity is sufficient to obtain a directionally correct picture regarding activity costs. Some organizations prefer a greater degree of precision and ask personnel to keep daily logs of how time is spent. Other organizations use observation and stop watches to obtain a sense of how time is spent. All of these methods work; however, it is suggested that for the organization's first ABC initiative, the ABM team keep their methodology as simple as possible.

After completing this phase, the team now has meaningful data: the cost of the study's activities. At this point the team may wish to continue with the study and determine how these activities are being consumed by the selected cost objects (products or customers) or they may wish to reflect on the information at hand before moving to the next phase.

The activity cost information will highlight how resources are being used. It will highlight the organization's focus (for the question at hand). Looking at the activity costs from a high to low listing is helpful. Do the costs reflect the organization's strategy? Are the costs what you expected? Are there some costs that are out of line?

### **Example**

The pilot participants found some activity costs within their organizations to be different than anticipated. These results provided an opportunity to reflect on how the work was being done, by whom and whether there was a way to do things more efficiently.

The following shows the similarities and differences in activity costs for the pilot organizations (depicted in percentages to note the range of the group). Note: Pilot participants defined and studied the actions that they believed best reflected what was required to support the carrying of a category in a foodservice distributor organization.

<b>PROJECT ACTIVITIES</b>	<b>RANGE OF COST</b>
Procurement Strategy	1% to 2%
Promotion Execution	1% to 5%
Purchase Order Management	1% to 2%
Supplier Support Program	1% to 2%
Confirm P.O. with Supplier	0.4% to 1%
Item /Vendor System Maintenance	0.4% to 1%
Chargeback Admin./Resolution	0.4% to 1%
Confirm P.O. Quantities Received	2% to 5%
Inventory Management	6% to 8%
Picking and Cubing	8% to 16%
Respond to Product Returns	4% to 5%
Damaged Goods & Overstocks	1% to 3%
Food Shows	2% to 6%
Accounts Payable	1% to 6%
All Other Activities	47% to 67%

**Cost Objects — For Whom or What Do We Carry Out the Activity?**



The last phase in the analysis is to assign activity costs to the cost objects. If you are studying the cost of serving your customers, your customers will be your cost objects. In an effort to measure the cost of serving each customer, your task will be to determine which customers are absorbing (requiring) which activities and to what degree. In the pilot, the participants’ task was to: 1) determine which brand required which activities, and 2) what each brand cost the organization to be included in the category.

Cost drivers are used to move dollars to the cost object causing or responsible for the activity. The data for the most part resides in the information technology database of an organization. Typical drivers are the number of times something is done, the number of lines on an invoice, and the number of boxes shipped. Using interviews or observation to determine an understanding of the demands, time and complexity of the activity is important.

For example, some orders are more difficult to process than others. Having an individual record the time it takes to process each order may be unrealistic. In this case, the most easily obtainable driver is the number of orders. However, if the number of orders is used as the driver, then the customer order requiring more attention would not receive its representative share of the cost. In this case, the ABM management team may wish to use this driver, but account for the complexity by using a “weight.”

ACTIVITY	→	COST OBJECT
Process Order	\$\$\$	Customer 1
	\$	Customer 2
	\$\$	Customer 3

The driver remains the number of orders with a weighting system of 1, 2 and 3. Weights are assigned based on complexity of the order requirements noted by observation; interview; or the number of steps involved (with 1 being least complex and 3 being most complex). Criteria should be spelled out so that the weighting is consistent and the team may easily recall why the driver was used in this manner.

**Example**

To assign the appropriate cost of responding to product returns for each brand in the salad dressing category, pilot participants elected to use number of line items on the credit return as the driver. This driver was selected because it was easily obtainable and would accurately capture the flow of cost. It was felt that “number of returned products” would entail a lot of counting and possible duplication of effort. The idea of timing how long it took to respond to a product return was deemed unrealistic.



The following are the cost drivers used in the study:

<b>PROJECT ACTIVITIES</b>	<b>COST DRIVER</b>
Procurement Strategy	Percentage*
Promotion Execution	# of Vendor Invoices
Purchase Order Management	# of Line Items
Supplier Support Program	# of Supplier Support Programs (weighted)
Confirm P.O. with Supplier	# of Purchase Orders
Item /Vendor System Maintenance	# of Changes Per Item /or Percentage
Chargeback Admin./Resolution	# of Chargeback
Confirm P.O. Quantities Received	# of Cases Received
Inventory Management	# of Cases Received
Picking and Cubing	# of Units Sold
Respond to Product Returns	# of Line Items on the Credit Return
Damaged Goods & Overstocks	# of Cases
Food Shows	# of Food Show Cases Shipped
Accounts Payable	# of Line Items Received (weighted)
All Other	

\* Given the pilot category, salad dressings, the participants felt that “percent” would best capture the cost of this activity to the brands. For most of the pilot organizations, 100 percent of this activity cost was assigned to “all other” brand/vendors. Those organizations that brought on a new brand of salad dressing were able to depict this cost by determining the appropriate percentage.

## Pilot Cost Object Analysis — The Results

This phase of the pilot resulted in each organization obtaining an understanding of the cost to carry each brand in the salad dressing category as well as an understanding of what went into the total cost.

<b>BRANDS</b>	<b>Represents</b> (% of total category costs)
Brand 1	3.12%
Brand 2	2.95%
Brand 3	2.96%
Brand 4	3.14%
Brand 5	2.84%
Brand 6	2.88%
Brand 7	2.81%
HOUSE	3.19%

The study provided participants a much better sense of how this category used organizational resources. With so little variation, the big “aha!” was the question of whether the organization required so many brands to provide a reasonable assortment of dressings. Would it be reasonable to eliminate a couple of brands, thereby reducing the redundancy of activities performed to have such a large assortment (administrative and warehouse savings) and to free up space in the warehouse for greater potential income?

The participants felt that the next study should take the cost object down to the SKU level. By understanding the brand performance at the SKU level, each organization could make an informed decision about which brands were key performers and which brands could be “covered” by other brands that offered similar dressings and contributed to the overall category strategy.

This further analysis would also allow the distributor to understand the cost of carrying a particular dressing for a customer and weigh the value of continuing this practice.

*Completing  
the Initiative*

The final steps in the ABC process include the “whiff test,” turning data into information, and communication.

The whiff test takes a critical look at the results of your effort and asks the team if the data makes sense. Is there anything that stands out? Is there anything that might reflect incorrect reporting or driver data? Is there anything that warrants further data gathering? If there are questions regarding the validity of the results, address the concerns. Re-interviewing, talking it over with those involved or thinking through the use of a driver vs. another driver are suggested methods to shake out misinformation. The data may indeed accurately reflect activity cost, but it is important to actively question the initiative’s results.

Once it is agreed that the ABC study reflects the best data at hand, the next step is to turn the data into meaningful information for the organization’s use.

The activity cost data, as noted throughout this text, highlight how the organization’s resources are being consumed. But is this consumption supporting the organization’s strategy and vision? The ABM management team’s discussion at this point focuses on activity value, cost and process improvement.

The team’s discussion analyzes the ABC data from two perspectives, internal (the organization) and external (the customer). Questions include:

- How valuable is the activity?
- Does the degree of cost (effort) reflect our strategy/business vision?
- Could the activity go away? Would it be missed internally or externally if it was performed less often, by other resources, or not at all?
- Is there a more efficient means of performing the process?

This discussion takes the ABC data and creates information to develop a usable ABM plan. Having information on activity costs does not translate into action. Far too often the discussion about the meaning of the data, how it is to be used and its potential impact on the organization and its customers is missing.

Creating meaningful management reports and a suggested action plan is imperative to the success of the organization’s ABC/M efforts. Further, as

## Process Improvement Opportunities

### Profile Number 3

this plan is crafted, it is important to keep in mind that ABC data is meant to support better management decisions, not dictate them.

The guiding principle that “the customer is always right” may seem to be at odds with some of your ABC results. The purpose of costing your activities is to determine the cost of doing business and how to better manage your business.

ABC data provides insight into the use of your organization’s resources and who or what is driving the consumption of those resources. But, the data is only one piece of the puzzle. If the activity cost data were the only factor used in decision-making, our pilot participants would de-list all brands but one or two. Customer specifications, demographics, demand and market strategy all come into play when determining the right assortment. Understanding the contribution of each brand in a category is important to making informed decisions.

In our example, ABC analysis allows the distributor to understand the cost of carrying a particular brand of dressing for a customer and to decide whether or not to continue this practice. Determining the cost of carrying a particular brand of dressing might seem absurd, but when assessing this cost and including factors such as customer profitability and support of marketing strategy, the decision could prove impactful.

The ABM action plan might, therefore, include a recommendation to price the most costly product at a premium or bundle certain combinations of products to create increased turns or recommend a product be eliminated if it can be replaced with a less expensive brand. With the understanding of cost based on the activities to sustain the product selection, management has better information to discuss its options. Regardless of the option(s) selected, ABC data provides activity insight and cost information, and when combined with strategy, promotes a proactive business approach to making solid business decisions.

Communicating the action that will be taken as a result of the ABC initiative is key to ensuring results as well as providing an opportunity for continuous improvement.

Key to the management team’s responsibility is a report with action steps. It is also important to integrate possible reward systems to support the activity based decision(s). Without an actionable vision, ABC becomes just another exercise at best and a cost center at worst. Further, it is human nature to do what is comfortable; change is slow, especially if it is not clearly articulated and then rewarded.

# *Summary*

Having reflected on the contents of this primer, you are now armed with the knowledge required to begin your organization's ABC/M journey.

Follow the chapters as your preliminary roadmap; the first ABC initiative is the most difficult. Your success will rely on key factors:

- The commitment of top management to see the initiative through with clear expectations and required intermittent management reports;
- A business question that is clearly defined and manageable;
- A reasonable timeline taking into account that the first project will more than likely take more time due to a learning curve;
- A cross-functional ABM management team that includes representation from finance, operations and information systems;
- The development of an activity dictionary that articulates the activities of your organization so that there is agreement with what you are measuring and an understanding of how the work is being done;
- An understanding of the resources, activities and cost objects coupled with an understanding of cost drivers; and,
- A communication and action plan so that the information from the activity costing exercise becomes activity based management.

There is no better time to begin your activity based understanding of your business than today. ABC/M is a powerful strategic tool that will provide fact-based information for good business decisions and greater efficiency.

## Appendix A: Distributor Activity Chart

This chart depicts activities that can occur at the distributor.

### MARKETING

**010 Sales & Marketing Strategy**  
011 Marketing Plan Development  
012 Customer Prospect Identification  
013 New Customer Development

**020 Sales Call**  
021 Sales Call Preparation  
022 Sample Request  
023 Executing a Sales Call  
024 Customer Relations

### 030 Food Shows

**040 Promotions**  
041 Promotion/Product Strategy  
042 Promotion Execution

### PRODUCT PROCUREMENT

**050 Procurement Strategy**  
051 Procurement Planning  
052 Vendor Selection

**060 Supplier Support Programs**  
061 Develop/Negotiate Marketing Programs  
062 Trade Shows  
063 Program Administration  
064 Chargeback Administration  
065 Chargeback Resolution

**070 Item/Vendor System Maintenance**  
071 Set up New Items/Vendors  
072 Product Data File Admin

**080 Purchase Order Management**  
081 Order Product  
082 Demand Evaluation  
083 Create Purchase Order  
084 Confirm PO w/ Supplier  
085 Confirm Purchased Quantities Received

### 090 Inbound Freight Logistics

091 Backhauls  
092 Contract Carriers

### 100 Inventory Management

101 Unloading In-bound Freight  
102 Put Away  
103 Storage & Handling  
104 Inventory Reconciliation  
105 Damaged Goods/Overstocks

### ORDER FULFILLMENT

#### 110 Order Administration

111 Receipt/Review/Enter Order  
112 Prepare/Send Order Confirmation  
113 Change Orders  
114 Order Follow-up

#### 120 Special Requests

121 Respond to Complaint  
122 Quote Pricing

#### 130 Respond to Special Orders

#### 140 Respond to Product Returns

#### 150 Invoice Administration

151 Create Invoice  
152 Send Invoice  
153 Collection of Funds

#### 160 Order System Maintenance

161 Set up Customers  
162 Maintain Order Processing System

#### 170 Picking & Cubing

171 Pick Order Preparation  
172 Picking/Cubing  
173 Catch Weight Processing

#### 180 Inspection & Staging

#### 190 Loading

### 1000 Delivery

1001 Load Delivery Administration  
1002 Delivery  
1003 Unloading  
1004 Customer Wait Time

### INTERNAL SUPPORT SYSTEMS

#### 1010 Business Development

1011 Strategic Planning  
1012 Mergers & Acquisitions

#### 1020 Human Resources

1021 Recruiting  
1022 Employee Evaluations  
1023 Benefit Administration  
1024 Employee Training/Development  
1025 Employee Issues Resolution

#### 1030 Compliance

1031 Compliance Activities

#### 1040 Accounting

1041 Budgeting/Financial Planning  
1042 General Accounting  
1043 Accounts Payable  
1044 Accounts Receivable

#### 1050 Facility Administration

1051 Office Services  
1052 Building Maintenance  
1053 Warehouse Equipment Maintenance

#### 1060 Information Systems

1061 Administration  
1062 Development  
1063 Operations

#### 1070 Fleet Management

1071 Administration  
1072 Maintenance

The following dictionary describes each activity that is found on the Distributor Activity Chart (Appendix A).

## **Appendix B: Distributor Activity Dictionary**

### **MARKETING**

#### **Sales and Marketing Strategy (010)**

All activities associated with determining the organization's sales and marketing strategy and development of a marketing plan. This includes market analysis, customer targeting and market research.

**Marketing Plan Development (011):** All activities associated with the development of the organization's sales and marketing plan.

**Customer Prospect Identification (012):** All activities associated with identifying prospects, targeting, qualifying and researching both the competitive situation and the customer. These activities include overall customer pricing, review of overall geography and routing, and contracts.

**New Customer Development (013):** All activities required to activate a client relationship with a new customer.

#### **Sales Call (020)**

All activities associated with communicating with potential or existing customers with the end goal of selling. Types of sales calls include face to face and telemarketing.

**Sales Call Preparation (021):** All activities associated with preparing for the sales call, including developing presentations, planning strategies and obtaining supporting marketing materials.

**Sample Request (022):** All activities associated with a sample request from the request to sales follow-up. Includes the handling of the product and creation of the paper work.

**Executing a Sales Call (023):** All activities associated with the actual sales call presentation to the customer either face to face or via a telemarketing call. This includes travel time.

**Customer Relations (024):** All activities designed to improve the customer relationship, including follow-up phone calls, pricing reviews/updates, contract maintenance, sales reporting and analysis.

### **Food Shows (030)**

All activities associated with the preparation, on-site execution and follow-up from the selling activity, food show. This includes pre-show planning, preparation, travel time, attending/conducting, and post-show activities.

### **Promotions (040)**

All activities associated with analysis, planning, merchandising (placement and display), concept development, advertising and execution.

**Promotion/Product Strategy (041):** All activities associated with preparing and developing company promotional strategies, including advertising.

**Promotion Execution (042):** All activities associated with executing a promotion.

## **PRODUCT PROCUREMENT**

### **Procurement Strategy (050)**

All activities associated with determining the organization's procurement strategy. This includes vendor selection and evaluation of product lines.

**Procurement Planning (051):** All activities associated with analyzing customer demand, creating procurement plans, developing supplier long-term forecasts, assessing new product lines and setting vendor selection criteria.

**Vendor Selection (052):** All activities associated with determining from whom to procure products, including vendor profitability, credit checks, quality checks, service level checks, price, automation capabilities, internal culture, etc.

### **Supplier Support Programs (060)**

Activities typically associated with the development and administration of broker, manufacturer and buying groups promotional programs.

**Develop/Negotiate Marketing Programs (061):** All activities associated with the development and negotiation of marketing programs. This includes buy side and sell side programs.

**Trade Shows (062):** All activities associated with the preparation, on-site execution and follow-up from the buying activity, trade show. This includes pre-show planning, preparation, travel time, attending/conducting, and post-show activities.

**Program Administration (063):** All activities associated with the maintaining, tracking and reporting of programs.

**Chargeback Administration (064):** All activities associated with the administration of chargebacks.

**Chargeback Resolution (065):** All activities associated with resolving chargebacks (including deduction resolution).

### **Item/ Vendor System Maintenance (070)**

All activities associated with the maintenance of item/vendor information in the company systems.

**Set-up New Items or Vendors (071):** All activities associated with setting up a new vendor or item file.

**Product Data File Administration (072):** All activities associated with the maintenance of items and vendor files once a file is set up. This includes all item-costing activities.

### **Purchase Order Management (080)**

All activities associated with monitoring / managing the PO process. This includes managing deviations from the process.

**Order Product (081):** All activities associated with the ordering of distribution center inventory.

**Demand Evaluation (082):** All activities, including review of sales history and analysis of buying opportunities.

**Create Purchase Order (083):** All activities associated with the development of a Purchase Order document including the transmission of a PO to a supplier.

**Confirm Purchase Order with Supplier (084):** All activities associated with Purchase Order Confirmation.

**Confirm Purchased Quantities Received (085):** This includes matching paperwork, counting product and recording variances.

### **Inbound Freight Logistics (090)**

All activities associated with receiving freight.

**Backhauls (091):** All activities associated with scheduling and monitoring in-bound freight on the company's private fleet as well as drive time.

**Contract Carriers (092):** All activities associated with scheduling and monitoring in-bound freight on contracted carriers.

### **Inventory Management (100)**

All activities associated with Tracking and control of inventory.

**Unloading In-bound Freight (101):** All physical activities involved in preparing inventory for put-away, including the inspection of product at the time of receipt.

**Put Away (102):** All activities associated with transferring of received product to its first storage location (slot).

**Storage and Handling (103):** All activities including product inspection, rotation, product shuttles and pick slot replenishment.

**Inventory Reconciliation (104):** All activities associated with verifying and reconciling inventory.

**Damaged Goods/Overstocks (105):** All activities associated with the handling and return of damage goods, spoils, vendor overstocks as well as any vendor returns. Includes all paper work.

## **ORDER FULFILLMENT**

### **Order Administration (110)**

All activities involved in receiving orders from customers (paper based, verbal, electronic/EDI, fax, vendor-managed inventory, etc.) Included are all activities from the receipt and acceptance of an order from a customer/consumer.

**Receipt/Review/Enter Order (111):** All activities associated with receiving, reviewing/verifying and entry of customer orders and the credit check for that order.

**Prepare/Send Order Confirmation (112):** All activities associated with preparation and distribution of customer order confirmations.

**Change Orders (113):** All activities associated with changing orders prior to shipment.

**Order follow-up (114):** All activities associated with following-up on an order to ensure the order is delivered in a timely fashion and resolving any delivery problems.

### **Special Requests (120)**

Includes activities, typically of short duration, performed to resolve a question, problem or complaint within the customer order process.

**Respond to Complaint (121):** All activities associated with resolving a problem.

**Quote Pricing (122):** All activities associated with special quotes for inventoried items.

### **Respond to Special Orders (130)**

All activities associated with special orders from order request to delivery of non-inventoried items.

### **Respond to Product Returns (140)**

All activities associated with responding to a customer returned product (from pickup to issuance of credit approval).

### **Invoice Administration (150)**

All activities associated with billing customers, including associated data entry.

**Create Invoice (151):** All activities associated with generating an invoice; may include data entry.

**Send Invoice (152):** All internal activities associated with sending the invoice, whether electronic or paper based.

**Collection of Funds (153):** All activities that take place to physically obtain the funds either in person or over the phone.

### **Order System Maintenance (160)**

All activities associated with updating customer master files.

**Set Up Customers (161):** All activities associated with inputting, changing and removing customers within the order processing system, (may include initial routing, credit terms and pricing).

**Maintain order processing system (162):** All activities associated with maintaining customer information within the order processing system. This includes customer file, pricing and contract maintenance.

**Picking & Cubing (170)**

All activities associated with picking an order and cubing a pallet including the processing of catch weight products.

**Pick Order Preparation (171):** All activities associated with receiving an order, including all the paperwork, generation of pick slips, receipt of electronic (RF) instructions.

**Picking/Cubing (172):** All activities associated with picking an order and cubing a pallet.

**Catch Weight Processing (173):** All activities associated with processing catch weight products.

**Inspection & Staging (180)**

All activities associated with inspecting the cubed pallet and making the necessary corrections for delivery. This includes: inspecting trailer/van requirements; identification of load pattern, inspect pallets for proper cubing, change staging if necessary, review paper work and make necessary corrections.

**Loading (190)**

All activities associated with the loading of customer orders, including add-on's.

**Delivery (1000)**

All activities associated with the delivery of product according to the order received from a customer.

**Load Delivery Administration (1001):** All activities associated with routing, scheduling and dispatch.

**Delivery (1002):** All activities associated with the transportation of product to and from the customer. Includes drive time (except back-haul)

**Unloading (1003):** All activities associated with unloading and storing the merchandise for the customer at the customer's site. Includes completion of customer paper work.

**Customer Wait Time (1004):** All activities associated with the waiting time required to deliver product to the customer (sitting, chatting, etc.).

## INTERNAL SUPPORT SYSTEMS

### **Business Development (1010)**

All activities associated with planning for the long-term growth of the business.

**Strategic Planning (1011):** All activities associated with planning/ visioning for long-term business development and growth. Activities include development and preparation of the strategic plan, business plan, and/or vision plan.

**Mergers and Acquisitions (1012):** All activities associated with mergers and acquisition, including planning, execution and integration activities.

### **Human Resources (1020)**

All activities associated with recruiting, supervising, training, evaluating and retaining employees.

**Recruiting (1021):** All activities associated with identifying, screening, and interviewing potential employees.

**Employee Evaluations (1022):** All activities involved in appraising employee performance, including the evaluation process and the administration of the appraisal system.

**Benefit Administration (1023):** All activities involved in the administration of the benefit program, including explaining benefits to new hires and existing staff as well as maintaining, managing and evaluating the program.

**Employee Training/Development (1024):** All activities associated with the training and development of personnel, (including safety training and professional development training programs), as well as the development and administration of training sessions. Includes internal as well as external programs.

**Employee Issues Resolution (1025):** All activities associated with employee “issues.” Examples of issues include resolving conflicts, counseling, dealing with health issues, activities associated with union activity, etc. Activities include all paper work, administration, research and face-to-face time.

**Compliance (1030)**

All activities associated with administering, maintaining, researching and maintaining compliance programs.

**Compliance Activities (1031):** Keeping drivers’ time/logs up to date; all activities associated with complying with government regulations and staying apprised of such issues.

**Accounting (1040)**

All activities associated with the internal administration of the business (finance).

**Budgeting/Financial Planning (1041):** Activities associated with financial planning, preparing departmental budgets, forecasting of financial plans and data entry in support of the financial planning process.

**General Accounting (1042):** All activities associated with internal payroll processing, month-end journal close, fixed asset management, tax reporting, bank reconciliation, commission reconciliation, cash management, time keeping and account data entry.

**Accounts Payable (1043):** Activities associated with accounts payable functions through cash disbursement.

**Accounts Receivable (1044):** All activities associated with accounts receivable functions, including the administration and data entry functions, plus the development of statements and payment applications.

**Facility Administration (1050)**

All activities associated with internal office and facilities administration.

**Office Services (1051):** All activities associated with providing administrative assistance, including telephone monitoring/reception, mail room activities, maintenance of the copy equipment, faxes, etc.

**Building Maintenance (1052):** All activities associated with the upkeep of the facilities. This includes snow removal, lawn up-keep, sweeping, janitorial functions, security, housekeeping, etc.

**Warehouse Equipment Maintenance (1053):** All activities associated with maintaining warehouse equipment, including freezers, dock levelers, pallet jacks, forklifts, doors, etc.

### **Information Systems (1060)**

All activities associated with the general maintenance and administration of information systems including: mainframes, laptops, networks, Internets, intranets, telecommunications and implementation of new technology.

**Administration (1061):** All activities associated with supporting the organization's information systems, including paper work, keeping abreast of new technology, ordering equipment, sourcing software, vendor negotiation, equipment maintenance, etc.

**Development (1062):** All activities associated with the development and maintenance of new and existing software applications.

**Operations (1063):** All activities associated with the day-to-day operation of the organization's information systems.

### **Fleet Management (1070)**

All activities associated with fleet management and administration including configuration of fleet owned, leased or for contract.

**Administration (1071):** All activities resulting from the ownership or leasing of the fleet.

**Maintenance (1072):** All activities associated with maintaining the fleet in good operating condition. (Includes keeping equipment repaired, charged, inventoried, etc.)

The following activities represent the major tasks involved in carrying salad dressings.

## **Appendix C: Pilot Activity Dictionary**

### **Marketing**

#### **030 Food Shows**

#### **040 Promotions**

042 Promotion Execution

### **Product Procurement**

#### **050 Procurement Strategy**

051 Procurement Planning

052 Vendor Selection

#### **060 Supplier Support Programs**

061 Development and Negotiation of Marketing Programs

062 Trade Shows

063 Program Administration

064 Chargeback Administration

065 Chargeback Resolution

#### **070 Item/Vendor System Maintenance**

071 Set-up New Items or Vendors

072 Product Data File Administration

#### **080 Purchase Order Management**

081 Order Product

082 Demand Evaluation

083 Create Purchase Order

084 Confirm Purchase Order with Supplier

085 Confirm Purchase Quantities Received

#### **100 Inventory Management**

101 Unloading In-bound freight

102 Put Away

103 Storage and Handling

104 Inventory Reconciliation

105 Damaged Goods/Overstocks

### **Order Fulfillment**

#### **140 Respond to Product Returns**

#### **170 Picking & Cubing**

171 Pick Order Preparation

172 Picking/Cubing

173 Catch Weight Processing

### **Internal Support Systems**

#### **1040 Accounting**

1043 Accounts Payable

### **All Other Activities**

All other activities performed that are not listed above. Including sales, fleet management, delivery, invoice administration and human resources. Although these activities are important, they were excluded from the pilot to keep it manageable.

ABC Team's Steps:

- 1) Confirm the business question
- 2) Note the supporting sub-questions
- 3) Identify the cost objects
- 4) Identify the activities
- 5) Identify the resources
- 6) Identify the drivers of cost (resource/activity)
- 7) Note where the data resides (general ledger, people, IS)
- 8) Gather data
- 9) "Crunch" data
- 10) Analyze results with the whiff test (does it make sense?)
- 11) Compile a management report including:
  - Observations
  - Trends
  - Pertinent "external" information
  - Recommendations

## ***Appendix D:*** ***ABC Team's Steps***

***Activity Based Management, A Primer for Foodservice Brokers***

Association of Sales & Marketing Companies

Reston, VA 703-758-7790

Authors: Debra Dixon, Ernst & Young

Karen J. Ribler, ASMC Foundation

**Appendix E:  
ABC/M Resources**

***Activity Based Management for Foodservice: Getting Started***

Joint Industry Project on Efficient Foodservice Response

703-532-9400

Authors: EFR Equitable Alliances Committee

KPMG LLP

***Common Cents, The ABC Performance Breakthrough***

Cost Technology, Portland, OR 1-800-368-COST

Author: Peter B.B. Turney

***Cornerstones of Decision Making: Profiles of Enterprise ABM***

Oakhill Press

Greensboro, NC

Authors: Steve Player, Arthur Andersen

Carol Cobble, Armstrong Laing

***The Balanced Scorecard: Translating Strategy into Action***

Harvard Business School Press

Boston, MA

Authors: Robert S. Kaplan

David P. Norton

***Activity Based Management: Arthur Andersen's Lessons from the ABM Battlefield***

MasterMedia

New York

Authors: Steve Player

David E. Keys

***Activity Based Management: Arthur Andersen's Global Lessons from the ABM Battlefield***

John Wiley & Sons

New York

Authors: Steve Player

Roberto Lacerda



## Appendix F: Glossary of Terms

**activity based costing (ABC)** – a costing method that enables a business to understand fully how and where it makes a profit. In ABC, all major activities in a cost center are identified and the costs of performing each activity are calculated, including costs that cross functional or departmental boundaries. The resulting costs are then assigned to the products, product lines, customer, suppliers, or channels that caused the activity to be performed. ABC provides a more complete picture than traditional accounting methods of the profits and costs of doing business, fine-tuned to a particular category, vendor or item. It also includes costs that add or delete value for the customer.

**activity based management (ABM)** – a strategic tool focusing on the management of activities as the route to improving the value received by customers and the profit achieved by providing this value. This process includes cost driver analysis, activity analysis and performance analysis. ABM draws on ABC as a major source of information.

**activity cost driver** – the factor used to assign cost from an activity to a cost object. A measure of the frequency and intensity of use of an activity by a cost object.

**activity dictionary** – a listing of the work performed in an organization, along with detailed definitions of each activity. Within the context of ABM, the activity dictionary can be customized for the organization using it and should be structured to provide an appropriate level of activity cost to answer the business issues being addressed with ABM.

**activity rate** – the cost per individual unit of activity; derived by dividing the activity cost by the activity cost driver quantity. Activity rates can be used as performance measures or to track the progress on specific operational improvement initiatives.

**bill of activities** – a listing of the activities and activity costs that make up the total ABC cost for a particular cost object or group of cost objects, such as customers, suppliers, and products.

**cost driver quantity** – the number of units of output of a cost driver, this typically consists of transactional data such as number of orders, number of invoices, number of complaints, and number of new product set-ups. Cost driver quantities are used to assign activity costs to cost objects, so they should be collected by individual cost object — for example, by supplier, by customer, or by product.

**cost object** – the reason for performing an activity; that which causes the activity to be performed. Cost objects include products, services, customers, suppliers, projects, and contracts. Cost objects consume activity costs based on activity cost drivers.

**electronic data interchange (EDI)** – the computer-to-computer transmission of business information between trading partners in an industry-wide standard format.

**performance management** – the use of ABM to improve profitability. It includes identifying cost reduction or process improvement opportunities, guiding efforts to improve quality and service, and measuring performance.

**performance measure** – an indicator of the work performed and the results achieved in an activity. A measure of how well an activity meets the needs of its customers. Performance measure may be financial or non-financial.

**process** – a series of activities that are linked to perform a specific objective.

**resources** – people and non-people expenses used to perform an activity. Typically, the general ledger, cost center account balances, and subsidiary ledger reporting from payroll and fixed asset systems are the source for resource data. Resources may include salaries and wages, employee benefits, building lease/space costs, equipment depreciation, supplies, utilities, and other expenses that appear on a cost center report. Resources are consumed by activities based on resource drivers.

**resource driver** – used to assign resources to activities. For people-related expenses, the resource driver may be an employee survey designed to identify what activities people perform, and how often.

