Case Study

Cost-to-Serve in Performance Nutrition

'*Cost-to-serve*': analyzing the profitability of your business – by supply chain, fulfilment method, etc. – to make better select customers for sales.

About the Company

This company is a leader in the sale and distribution of performance nutrition products, like the meals and supplements used by muscle-builders and dieters. They use both a highly successful online platform that engages consumers, and they have a fitness challenge for customers that has grown the sales in their sports club, health store, and online sales channels.

With their deep expertise in importing and distributing in Canada, the company is a natural one-stop shop for American brands. They import, label, distribute, sell, and market substances and formulas in over-the-counter products. Since they are a big company, they have the resources to follow all rules and regulations. They offer a foundation of strong quality and ethical business practices they believe will be a strong base to continue to grow their business.

The Challenge

The company has established a robust operating model representing three brands in three channels. To drive further growth, they want to know four main things:

1. Is the set-up of their operation well-adapted to today's business to support growth?
2. Will the most profitable and lowest-risk growth come from new channels or new brands, such as new products like bars and beverages?
3. Is each line on their *profit & loss statement* a significant expense?
4. Is each expense significantly different from one brand or channel to another?

The Process

To answer these questions, we went through a detailed process with many steps. First, we identified about 25 different *cost buckets* (elements of cost) for just over $10 million in sales. The *cost of goods sold* information came directly out of their accounting software, so we adjusted *gross contribution* as a solid starting point. We then allocated the *cost buckets* using activity volumes and management assessments of where effort was being consumed. Brands were loaded with inbound physical distribution, customs, drug inspection and testing, compliance, graphics adaptation (American to Canadian) and supplier costs.

To continue our analysis, we then sorted the costs into sales, shows, promotion, outbound distribution (field warehouses, freight), and collections into each channel. Since the tie-in to the brand was so strong, we sorted the entire cost of the fitness challenge program to that specific brand (call centre and website), but allocated order fulfillment costs to the direct-to-consumer (B2C) channel. We then sorted the management and admin costs according to the suggestions by management themselves, based on their opinion of their efforts were being spent.

We ended up with inbound costs-to-serve ratios of 7% to 18% of COGS (costs of goods sold), and outbound cost-to-serve of 4% to 25%. Clearly, the profitability was seriously impacted depending on the brand and channel. Looking closely at the baseline cost-to-serve analysis showed that the wholesale channel is profitable, while the smaller orders is less profitable. We also believe that the web-sales were strategically important; even if not profitable today, having that platform would support growing sales on a fixed cost in the future.

We then reviewed the findings and ran several simulations to inform management as they set their strategic directions:

- How would it affect the business if we sold a new brand to existing customers?
- What if we started selling to new channels?
- Do we have the right set of distribution centres to cover Canada?
- Should we do more direct shipments instead of bringing everything through our central distribution centre?

For each of these simulations, we went back to the *cost-to-serve* analysis to identify the closest model to the type of business we were considering, so we could capture the cost dynamics, make reasonable adjustments, and be able to generate a tentative *profit & loss statement* for each options.

The Conclusion

After completing all the analysis, we concluded that the most attractive new business opportunity was to take on a new brand of complementary products, and to sell them through existing relationships. These new products would need little effort for sales, slightly increased fulfillment costs, and the inbound logistics would fit into what is already in place. New channels were a far riskier proposition, with limited profit, although the volumes were possibly very significant.

Through the process, several operational adjustments were identified, including increasing the capacity at local distribution centres and arranging for direct shipment to these centres. Overall, we identified an opportunity to fine-tune inventory strategies to trade-off central efficiencies with local responsiveness and simplicity.