Module 6 quick reference: tools for creating and managing value

SMA EXAM REFERENCE PACK | MODULE 6 | PRINT AND KEEP WITH YOUR NOTES

Exam technique: name the tool the question needs (costing, pricing, cost management, supplier, quality or customer analysis), state the formula, set out workings in a table, then interpret - what the number means for strategy - and finish with the qualitative factors and limitations.

Value and the value chain

Topic	Remember
Value	Revenue less costs; two levers - strategic revenue management and strategic cost management (they interact)
Stakeholder value	Each group defines value differently (money and quality of life); customer revenue funds most of it
Porter's value chain	Primary: inbound logistics, operations, outbound logistics, marketing and sales, service. Support: firm infrastructure, HR, technology development, procurement
Margin	Value added less the cost of creating it
Value system	Supplier - organisation - channel - customer value chains; upstream links drive cost management, downstream links drive revenue management
ABC vs ABM	ABC costs products and other cost objects through activities; ABM manages activities to cut cost and add customer value

Activity-based costing (ABC)

Topic	Formula or rule
Why	Volume-based rates (labour or machine hours) distort costs when overheads are driven by complexity and diversity - cross-subsidies
Cost hierarchy	Unit level; batch level; product-sustaining; facility-sustaining (no cause-and-effect link - avoid arbitrary allocation)
Seven steps	1 activity analysis; 2 cost pools; 3 cost drivers; 4 driver transactions; 5 rate; 6 allocate; 7 cost per unit
Pool rate	Cost pool / total cost driver transactions
Allocation	Product's driver transactions x pool rate; then allocated overhead / units produced
Value engineering	Keep only functions customers value; minimise their cost
Fits best	High overheads, diverse and complex products, customers or channels; implementation can take over a year

Time-driven ABC (TDABC)

Item	Formula or rule
Inputs	Cost per time unit of capacity; unit time of each activity (Kaplan and Anderson)
Theoretical capacity	All paid time, e.g. staff x days x hours x 60 minutes
Practical capacity	Theoretical less breaks, meetings, training (often estimated at 80-85%)
Capacity cost rate	Cost of capacity supplied / practical capacity
Activity cost	Unit time x capacity cost rate
Unused capacity	(Practical capacity - time used) x rate - shown separately, not buried in product costs
Time equation	Complex activity time = standard time + each variation time that applies (variations are added)

Strategic revenue management

Topic	Remember
Hard functions	Technical and economic use: performance, life, running costs, ease of use - easier to price
Soft functions	Image: appearance, aesthetics, prestige - support premium positioning
Features and pricing	Generic - cost plus (reduce cost); specified - competitive parity (estimate rivals' prices); augmented - value to customer (estimate value)
Surplus value	Value to the customer - price; maximum profit = upper limit of willingness to pay - cost
Pricing map	Rapid skimming (high price, high promotion); slow skimming (high, low); rapid penetration (low, high - price-sensitive, rivals, scale); slow penetration (low, low - long life cycle)
Legal	Price fixing, market sharing and bid rigging are cartel conduct under the Competition and Consumer Act - informal understandings count

Strategic cost management

Topic	Remember
Lasting savings	Across-the-board cuts erode; focus on how to cut, not how much
Five questions	Non-value-adding? Cheaper resource? Less time and effort? Under-utilised? Can it be shared?
Spare capacity dilemma	Efficiency gains create unused capacity - savings are real only when capacity is used or removed
Cost drivers	Structural (scale, scope, technology, complexity, structure) vs executional (workforce, quality, utilisation, layout, linkages)
Life cycle costing	Product as an investment over its whole life; cash curve dips then rises; most costs committed at design, incurred later

Topic	Remember
Reverse flows	Returns, warranty, recalls, take-back; re-use, remanufacture, recycle, dispose - design for end of life
Target costing	Target cost = target price - target profit; gap = estimated life cycle cost - target cost
If cost > target	Accept lower margin; reduce cost (redesign, process, inputs); add valued functionality; or don't proceed
Kaizen costing	Small continuous reductions during production: resource use, waste, productivity, outsourcing (e.g. x% a year)
ABM steps	Activity analysis and map (inputs, drivers, outputs); focus on outputs; improve activities and the map
ABM factors	Scale, scope, experience, technology, complexity, channels, quality of operational management
BPM	Radical redesign from the customer's viewpoint with the best technology; may restructure around processes
Value-adding test	External customer value? Required by rules? Sound practice? Internal customer value? Waste? - else eliminate
Continuous improvement	Teams and empowerment; gainsharing; productivity ratio = output / input (higher is better)

Upstream: suppliers, quality and outsourcing

Topic	Formula or rule
Supplier-related costs	Purchasing; holding inventory; poor quality; delivery failure - usually hidden in overheads
Supplier cost performance ratio	Supplier-related costs / invoice cost
Total procurement cost	Invoice cost + supplier-related costs
Supply chain risk	Macro (disasters, war, downturns, regulation) and micro (demand, manufacturing, supply, infrastructure, financial)
Global sourcing	Cheaper labour, taxes, commodities, skills vs freight, lead times, exchange rates, customs, political, cultural risk
Codes of conduct	Hiring, hours, pay, WHS, environment - monitor with audits; Modern Slavery Act 2018 (Cth) reports from $100m revenue
JIT and VMI	Less inventory and working capital; needs reliable suppliers; disruptions raise safety stock needs
Supplier choice	Single (trust, innovation) vs multiple (competition, back-up); track on-time, in-full, to-spec; behavioural to attitudinal compliance
Quality costs	Prevention and appraisal (controlling) vs internal and external failure (failing to control); classify by nature
Rework	Non-value-adding but can be economic (resale value - rework cost vs scrap cost)

Topic	Formula or rule
Outsourcing	Compare avoidable costs only; include redundancy, contract management, dependence, security, knowledge, labour issues
Outsourcing pyramid	Never: strategic direction; tight control: audit, HR, legal; SLAs: logistics, call centres, data centres; low risk: payroll, security, catering

Downstream: customer profitability

Topic	Formula or rule
Gross margin	Sales - cost of goods sold
Net margin	Net price (after discounts and allowances) - cost of goods - customer-related costs (cost to serve)
Cost to serve	Customer's driver transactions x ABC rates (orders, deliveries, service hours, returns)
Whale curve	Top 20% of customers often earn 150-300% of profit (Kaplan and Narayanan)
Customer map	High margin, low cost: protect; high margin, high cost: price for service; low margin, low cost: serve efficiently; low margin, high cost: change behaviour or charge
Menu-based pricing	Price varies with product and service level chosen
Keep unprofitable?	New and growing; qualitative benefits; reputation (Kaplan)
Six steps	Identify; measure revenue; measure cost to serve; determine profit; evaluate; act and monitor
Limitations	Arbitrary common costs (advertising); committed costs still need recovering