ABC Costing Analysis for Dream Beauty Case Study

Traditional costing and ABC costing results:

In Traditional costing method is when all manufacturing costs are classified as material, labour, or overhead and assigned to products regardless of whether they drive or are driven by production. All manufacturing costs are considered to be part of the product cost, whereas nonmanufacturing costs are not considered to be production costs and are not assigned to products, regardless of whether the costs are based on the products. For example, the machines used to receive and process customer orders are necessary because product orders must be taken, but their costs are not allocated to particular products.

In the Dream beauty case, the traditional costing method gives a misrepresented scenario of the whole net profit % contribution from Retail stores, mass merchant and convenience stores. It says that net profit is 22% for all the customers of Dream Beauty. It also tells that the order processing and packaging costs is cheaper for convenience stores as compared to retail stores and so convenience stores are beneficial for the company.

When looking at the ABC costing, it provides a more accurate picture of the actual costs allocated for each cost driver activity for the 3 types of customers. There are multiple overhead cost pools, and each has its own unique measure of activity. This provides more accurate rates for applying overhead, but it takes more time to implement and results in a higher cost. The allocation bases (i.e., measures of activity) often differ from those used in traditional allocation. Multiple cost pools allow management to group costs being influenced by similar drivers and to consider cost drivers beyond the typical labour or machine hour. This results in a more accurate overhead application rate.

To summarise, the results of the ABC costing are:

1. There is actually a net loss incurred from the convenience store sales of 23.51%.
2. The order processing cost, packaging cost and delivery cost of servicing the convenient stores is the highest among the three types of customers.
3. Labelling cost is only incurred by mass merchants because they are the only customers who are being services the labelled products. The retail stores and convenience stores take care of labelling on their side.
4. The actual inventory cost incurred due to all the 3 customers is much less than projected by the traditional costing method.
5. The highest net profit % contribution of 45.83% is through the mass merchants and the overall net profit is 20.36%.

The graph of COGS and Gross profit tells that:

1. All the 3 customers generate more gross profit than the Cost of Goods Sold (COGS). COGS is the cost of acquiring or manufacturing the products that a company sells during a period, so the only costs included in the measure are those that are directly tied to the production of the products, including the cost of labour, materials, and manufacturing overhead.

Since, there is a loss because of the convenience stores, I have analysed the 10 convenience stores who are dream beauty's customers to check for areas of improvement for turning the loss into a profit.

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Analysing the 10 convenience stores which dream beauty supplies their products, it can be said that:

1. Looking at the sales and net profit comparison of all the 10 stores, all of them are generating sales but only 4 stores out of them are generating a net profit. Rest all are incurring a loss for the company even though they are generating sales.
2. The store Beauty Bliss is generating the highest sales 1,00,00,000$ but is giving the lowest net profit only 3,99,600$. Similarly, the store Looking Good is generating sales but they are incurring only 26.600$ net profit. This means that the store is barely breaking even.
3. Further analysis could reveal the reasons for these losses. One reason could be that the location of the stores and the dream beauty products kept in that store are not aligning with the customer demand in that location. Another reason could be that the transportation cost of supplying the products to those stores is very high as compared to the sales that are generated. Hence, operational costs increase even though there are not enough sales to cover those costs.
4. If we look at the sales net profit generated by the 4 profitable convenience stores, Cosmo Naturelle gives the highest profit and Looking Good is barely breaking even.

Hence, some recommendations to generate a net profit from the Convenience stores could be:

1. Only supply products to the 4 profitable convenience stores because these 4 stores will generate a net profit of 12% as opposed to a net loss of 21% as shown earlier.
2. It could also be possible to stop supplying to convenience stores altogether and focus on only retail stores and mass merchants. This will divert the high operating costs for convenience stores to the other two channels and this will enable greater customer satisfaction because more evolved marketing strategies could be used with the extra budget to retain those customers.
3. Instead of having a 3-day fulfilment cycle, it would also be possible to have same day delivery to retail stores and mass merchants if only those channels are maintained and convenience stores are out of the picture.

The excel sheets are as follows:

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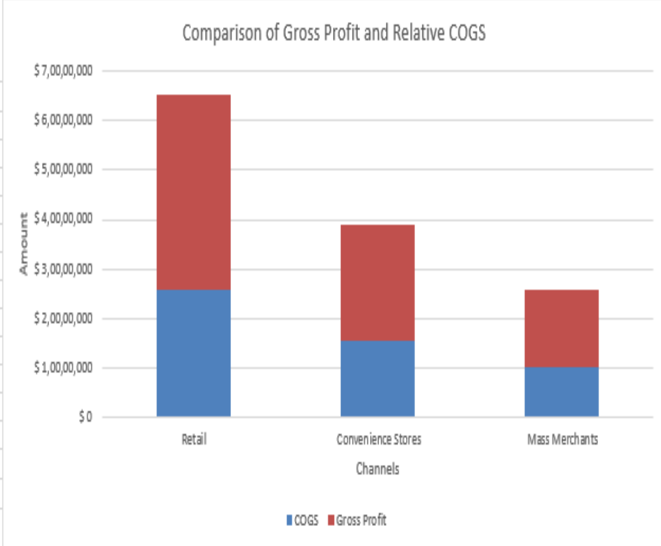
Dream Beauty Cost Summary by % of Sales using Traditional Costing Method

Details	Retail Stores	Convenience Stores	Mass Merchants	Total
Dream Beauty Sales	$6,50,00,000	$3,90,00,000	$2,60,00,000	$13,00,00,000
COGS	$2,60,00,000	$1,56,00,000	$1,04,00,000	$5,20,00,000
Gross Profit	$3,90,00,000	$2,34,00,000	$1,56,00,000	$7,80,00,000
		Traditional Costing		
Order Processing Cost	$50,00,000	$30,00,000	$20,00,000	$1,00,00,000
Packaging Cost	$40,00,000	$24,00,000	$16,00,000	$80,00,000
Labeling Cost	$10,00,000	$6,00,000	$4,00,000	$20,00,000
Delivery Cost	$1,50,00,000	$90,00,000	$60,00,000	$3,00,00,000
Total Supply Chain Cost	$2,50,00,000	$1,50,00,000	$1,00,00,000	$5,00,00,000
Net Profit	$1,40,00,000	$84,00,000	$56,00,000	$2,80,00,000
Net Profit %	21.54%	21.54%	21.54%	21.54%

Formulas
1. ROA(Return on Assets) = Net Profit/Dream Beauty Sales
2. COGS= Cost of Goods Sold *40% of sales
3. Net Profit= Gross Profit - Total Supply Chain Cost
4. Gross Profit= Dream Beauty Sales- COGS
5. Activity Cost is divided among three channels as follows:
Retail stores= 50%
Convenience Stores = 30%
Mass Merchants = 20%



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COGS	$ 2,60,00,000	$ 1,56,00,000	$ 1,04,00,000	$ 5,20,00,000
Gross Profit	$ 3,90,00,000	$ 2,34,00,000	$ 1,56,00,000	$ 7,80,00,000
		ABC COSTING		
Order Processing Cost	$ 27,77,778	$ 69,44,444	$ 2,77,778	$ 1,00,00,000
Packaging Cost	$ 32,00,000	$ 44,00,000	$ 4,00,000	$ 80,00,000
Labeling Cost	$ 0	$ 0	$ 20,00,000	$ 20,00,000
Delivery Cost	$ 83,33,333	$ 2,08,33,333	$ 8,33,333	$ 3,00,00,000
Inventory Cost	$ 9,75,000	$ 3,90,000	$ 1,73,333	$ 15,38,333
Total Supply Chain Cost	$ 1,52,86,111	$ 3,25,67,778	$ 36,84,444	$ 5,00,00,000
Net Profit	$ 2,37,13,889	$ -91,67,778	$ 1,19,15,556	$ 2,64,61,667
Net Profit %	36.48%	-23.51%	45.83%	20.36%

Total Sales of Dream Beauty is given annually:
1. Days of Inventory holding by retail= 90 days
Therefore, retail stores hold inventory 4 times in a year(annually)
2. Days of Inventory holding by convenience stores= 60 days
Therefore, they hold inventory 6 times in a year

3. Days of Inventory holding by mass merchants = 40 days

Therefore, they hold inventory 9 times in a year

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Total Ordering Costs for C-	$ 69,44,444	COGS of C-Stores	40% of Sales		Order cost per order	$ 2,778		$ 24,37,080
Total Packaging Costs for (	$ 44,00,000	Total Orders	$ 2,500		Packaging Cost per o	$ 4,000		$ 2,00,00,000
Total Delivery Costs for C-S	$ 2,08,33,333	Total Packages	$ 1,100		Delivery Cost per orde	$ 8,334		$ 12
		Total Deliveries	$ 2,500	1 order= 1 Delivery (GIVEN)				

C-Store Name	Sales	COGS	Gross Profit	Orders	Packages	Delivery	Order cost	Packaging Cost	Delivery Cost	Total Supply Chain Cost	Net Profit	Net Profit %
Cosmo Naturelle	$ 35,00,000	$ 14,00,000	$ 21,00,000	60	30	60	$ 1,66,680	$ 1,20,000	$ 5,00,040	$ 7,86,720	$ 13,13,280	38%
La Balle Femme	$ 50,00,000	$ 20,00,000	$ 30,00,000	200	20	200	$ 5,55,600	$ 80,000	$ 16,66,800	$ 23,02,400	$ 6,97,600	14%
Beautyss Bliss	$ 1,00,00,000	$ 40,00,000	$ 60,00,000	450	150	450	12,50,100	$ 6,00,000	$ 37,50,300	$ 56,00,400	$ 3,99,600	4%
Looking Good	$ 15,00,000	$ 6,00,000	$ 9,00,000	75	10	75	$ 2,08,350	$ 40,000	$ 6,25,050	$ 8,73,400	$ 26,600	2%
Love Your Style	$ 50,00,000	$ 20,00,000	$ 30,00,000	300	50	300	$ 8,33,400	$ 2,00,000	$ 25,00,200	$ 35,33,600	$ -5,33,600	-11%
Nuttin' Homely	$ 10,00,000	$ 4,00,000	$ 6,00,000	100	35	100	$ 2,77,800	$ 1,40,000	$ 8,33,400	$ 12,51,200	$ -6,51,200	-65%
Make-up Galore	$ 20,00,000	$ 8,00,000	$ 12,00,000	175	10	175	$ 4,86,150	$ 40,000	$ 14,58,450	$ 19,84,600	$ -7,84,600	-39%
Wild by Nature	$ 30,00,000	$ 12,00,000	$ 18,00,000	200	100	200	$ 5,55,600	$ 4,00,000	$ 16,66,800	$ 26,22,400	$ -8,22,400	-27%
Beautee Fatale	$ 10,00,000	$ 4,00,000	$ 6,00,000	100	100	100	$ 2,77,800	$ 4,00,000	$ 8,33,400	$ 15,11,200	$ -9,11,200	-91%
Fruity Beauty	$ 15,00,000	$ 6,00,000	$ 9,00,000	120	120	120	$ 3,33,360	$ 4,80,000	$ 10,00,080	$ 18,13,440	$ -9,13,440	-61%
L'Air Du Jour	$ 10,00,000	$ 4,00,000	$ 6,00,000	150	75	150	$ 4,16,700	$ 3,00,000	$ 12,50,100	$ 19,66,800	$ -13,66,800	-137%
Tuti Fruity	$ 20,00,000	$ 8,00,000	$ 12,00,000	250	200	250	$ 6,94,500	$ 8,00,000	$ 20,83,500	$ 35,78,000	$ -23,78,000	-119%
Le Beau Monsieur	$ 25,00,000	$ 10,00,000	$ 15,00,000	320	200	320	$ 8,88,960	$ 8,00,000	$ 26,66,880	$ 43,55,840	$ -28,55,840	-114%
Total	$ 3,90,00,000	$ 1,56,00,000	$ 2,34,00,000	2,500	1,100	2,500	########	$ 44,00,000	#########	$ 3,21,80,000	$ -87,80,000	-23%

Total Net Profit for first 4 Stores:	$	24,37,080
Total Sales for first 4 Stores:	$	2,00,00,000
Proft % generated by first 4 stores:		12%

Note: - Some values are rounded up in this excel sheet

Formulas
1. Gross Profit= Sales-COGS
2. COGS= 40% of sales
3. Order Cost=Number of Orders* Cost per order
4. Packaging Cost= Number of Packages *cost per packages
5. Delivery Cost= number of Delivery * Cost per delivery
6. Net Profit= Gross Profit - Total Supply Chain Cost