Monday Morning

March 3, 2008

ONE EIGHTY

Upcoming 2008 Events

- CAM-I First Quarter Meeting
Charlotte NC
March 9-12

- APQC 13th Annual Knowledge Management Conference
Chicago
April 28-May 2

- CAM-I Second Quarter Meeting
Baltimore
June 9-12

People in the News

- Srikant Sastry, Grant Thornton and Ashok Vadgama, CAM-I and the rest of the CAM-I team for their success in India for the CII Performance Conference

- Thank you to Tim Clarke, Hewlett Packard, for his contribution to this One Eighty segment

Fixed Costs

Driven by automation, technology, and economic trends (manufacturing to service), fixed cost as a percentage of total cost has been increasing.

In some companies, fixed costs are 75%+ of the total, a complete flip flop from the 75% variable cost businesses of yesteryear.

Common today are network fixed costs. An example is an airline. Once the flight and route schedule is in place, the cash costs of flight crews, maintenance, and fuel (with a variable component for fuel prices) are fixed into the foreseeable future.

The same is true for a network of hotels, bank branches, gas pipelines, and even the networked IT structure for a company like E-Bay, where most of the cost is fixed.

In the fixed cost world the incremental cost of adding another customer may be zero. Breakeven points are higher but once attained each dollar of new customer revenue drops to the bottom line.

That doesn't happen when 75% of costs are variable.

Scalability, capacity, and utilization are the basis for management decision and action when most of the cost structure is fixed.

Drivers of profitability are pricing practices, breakeven points, capacity utilization, and scalability (more products and services with the same network). When costs are fixed, the opportunities for cost reduction are limited.

Management decision and action are more strategic. Pricing decisions are made on getting the most value from the network. This is especially true for those businesses with the so called "Network Effect" where, like a telephone, the service becomes more valuable as the network grows and more people participate.

Product/service offering, capital investment, and partnering to share capacity are also critical to improving the ROI of the business.

Conventional pricing, costing, and performance measurement practices are either wrong for most management uses or have severely limiting conditions.

When accountants include fixed cost in the calculation of the organization's products and services, what happens? Unit costs go up or down each month even though fixed costs don't change. How helpful is that?

Those same unit fixed cost calculations, when included in pricing decisions, could be misleading when the marginal cost to serve one more customer or add a new service is minimal.

Performance measurement should focus on capacity utilization, available capacity, breakeven points, incremental costs, product/service offering, pricing, customer acquisition and retention, and new product/service introduction.

Measure the right things in your fixed cost business…

John A. Miller

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