

A New Approach to Costing Freight and Other Expense Groups

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SAPtips

How Do We Assess Customer Profitability? A New Approach to Costing Freight and Other Expense Groups

by Russ Hardy, Data2Info Inc.

Editor's Note: To get a real handle on customer profitability, you need to account for the hidden costs in the order fulfillment process. As FI/CO Editor Russ Hardy notes, SAP® customers have a great opportunity to truly identify their most profitable customers—just by using functionality that comes with the CO module in virtually all versions of R/3. In this issue's cover story, Russ walks us through how to take a customer-profitability approach to the costing of freight, returns, and other expense groups. In future editions of SAPtips, Russ will expand on the theme of customer profitability as it applies to the identification of other significant "hidden costs"—all by using the underutilized but standard R/3 functionality.

When I read Harry Joiner's "Five Secrets of a Winning CRM Strategy" in the April 2003 edition of SAPtips, I realized that customer profitability is one of the key areas in SAP that companies have under-utilized. The perspectives Harry provided reinforced, in my mind, the benefits of different approaches to measuring and reporting profitability within SAP.

One of Harry's references was to the outdated production and advertising approach of "mass markets." Harry notes that it's getting more difficult to achieve profitability in a saturated "me too" marketplace, where customers have 24/7 access to products and expect customized solu-

tions at rock bottom prices. To be profitable, firms need to use information to discover opportunities within their individual customer value streams. A shift to customer-centricity, however, requires an awareness of when and where to spend money to achieve high ROI on marketing expenditures. Customers are not all the same, and the costs of providing efficient interactivity with customers should be part of a customer profitability analysis.

Since the core R/3 transaction processing system has crucial data that is relevant to customer-profitability analysis, it makes sense to use CO-PA for some of this analysis. In this article, we'll give readers several tips for using CO-PA to analyze customer profitability. We'll start with an in-depth look at a better way of allocating freight expenses, and then we'll

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touch on how these same techniques can be used in other expense areas, such as returns and special handling. These tips can be utilized in all versions of SAP from 3.1 onward.

Costing Freight, Part One: A Typical Scenario

A common scenario for the order-to-cash process is the recording of freight charges. Often a firm has a freight-rating system that calculates a suitable freight rate for a given shipment to a customer ship-to address. This is usually recorded in the form of an SD Pricing Condition Type ZF00, for example (note that the SAP delivered condition types of HD00 or KF00 could also be used). Once recorded, the same freight rate can be shown on the sales billing document-pricing procedure.

Another part of this common approach is to have a cost center that collects the actual freight costs as they come in from the purchasing/AP system. Often these expenses are aggregated and bear no attributes to differentiate by customer/product detail. Even if they did, the A/P and cost center accounting systems do not have a mechanism to post detail to customer segments. The freight expenses are also often posted in a different fiscal period than the sales billing documents. This accounting treatment does not lend itself to any on-line integrated customer-profitability analysis.

If the FOB¹ terms result in the freight charges being billed to the

¹ Freight On Board – the contractual terms of shipment detailing who pays for what and when ownership changes.

customer, then the SD design is usually to record these dollars as a "cost recovery to a cost center." This is accomplished by having the Condition Type ZFCC mapped to account key ERF that has an account assignment to an expense cost element type 1 and a cost object assignment of a cost center (usually the same cost center that has captured the expenses). The configuration has to address the SAP treatment of cost objects, where a profitability segment is the primary cost object and a cost center would have a statistical posting. There is a substitution rule that sets the profitability segment to "null," allowing the cost center to be the real cost object in Controlling.

If the shipping contracts are being managed appropriately and the freight-rating system is maintained consistently with the contracts, then the freight cost center would probably have only a small residual net balance. This is assuming that any time differences between recognition of expenses and the capture of recoveries are ignored for this analysis and everyone is happy (from an internal expense management perspective).

But we haven't addressed customer profitability! We don't know which customers are costing us the most in freight charges, and

we have no way of determining which accounts are the most profitable (and deserve the most attention and service).

Costing Freight, Part Two: How to Allocate Freight Costs to Individual Customer Accounts

If we want to tie freight costs to individual customers, the question comes down to whether the customer is billed for these freight charges or not. Many companies have customers with both "FOB shipping plant" or "FOB customer dock." This obviously impacts customer profitability and the comparability of one customer with another. We need to find a way to meet the cost center accounting view described above, while also creating a customer profitability view in costing based CO-PA. One can accomplish this

by defining the SD Pricing Procedure to deal with freight, using three lines (shown as 300, 400, & 500 in the example in Figure 1).

The intent is to record freight charges in CO-PA as a customer-related cost, except for those billings where the customer pays. The freight recoveries would be posted to a cost center. See Figure 2.

For us to realize a "profitable" approach to freight costing, the following points must be addressed:

1. The freight-rating system (or an SAP condition record) should populate SD condition ZF00 with a freight charge appropriate for this product/customer ship-to scenario. This condition type

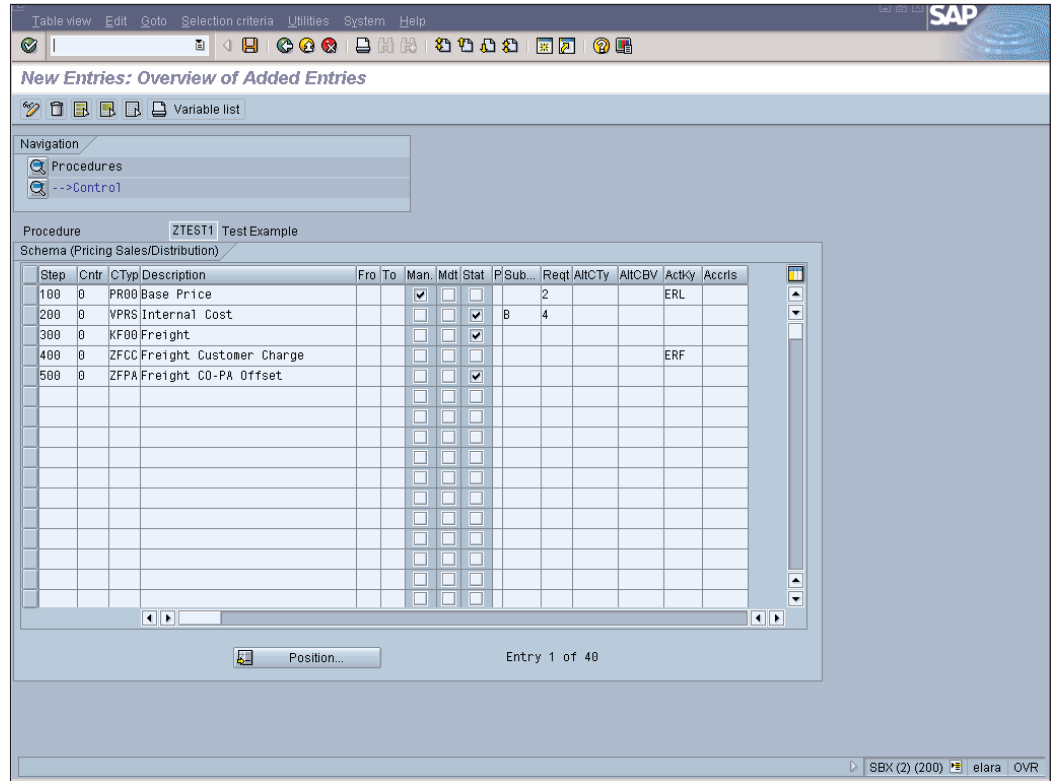


Figure 1: SD Pricing for Freight