Balancing cost and service

Logistics can be a low margin sector. Even before a sniff of Covid & Brexit, the combined might of the top 100 logistics companies were reporting only 2.22% pre-tax profit, rising to 2.74% if you looked at the top 10. I wonder if, in Dragon's Den, Touker Suleyman would consider it worth getting out of bed.

Depending on what part of the industry you're in, your cost and service considerations will be different: dedicated facilities with open book and a set margin, perhaps with gain-share agreements; shared facilities with a number of specific clients and the risk that if one contract is lost, some element of marginal costing puts profit at risk; network facilities which depend on getting the volume throughput to cover the costs of the capital investment.

Or if, as a retail or manufacturing company, you're operating your own warehouse or fulfilment centre, you will still have to make calls on what is acceptable when it comes to demands placed on you by customers and other parts of the business.

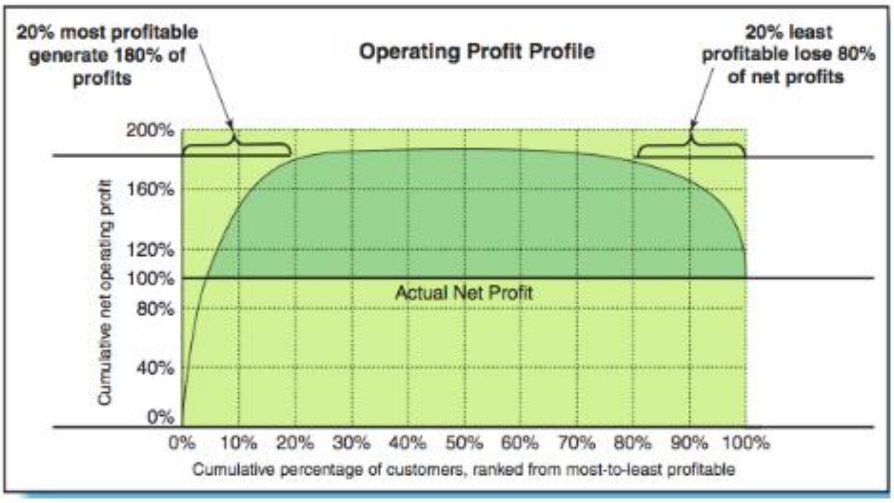
In all these situations it can be easy to get a mismatch in the cost and service balance - in trying to offer great customer service, it can be easy to start including extras, or stretching agreements, that then add to cost, and erode profit or break the budget: extended order cut-offs, no real minimum order quantities…

It's helpful to look at your business order by order and allocate costs. What does it cost you to receive, check, store, replenish, pick, pack and despatch that order, and then deal with returns? The answers to some of the detailed calculations will be different depending on whether what you despatch is B2C, B2B, retail, bulk… To what extent does the size of an order affect the costs?

There can be all sorts of reasons why you might accept a particular unprofitable order: it's an individual customer which is part of a big profitable group, it's the boss's mother-in-law, it's an influencer, it's someone you owe a favour to, it's someone you let down last time, it's a new sector you're targeting… When I was at TNT, I questioned one of our clients and he responded that they wouldn't get the profitable business if they didn't do the little deliveries - effectively part of the marketing budget.

If you're a third party logistics provider, what do you charge for each order, what is the profit or loss? If you're a retailer or manufacturer, what percent of your budget is it using – perhaps compare the cost with a target percentage of sales. If you can calculate some of this and plot it on some graphs – the turnover that is being generated by some of the different business streams, and what is it costing you to service them – you will be able to appreciate what some of these extras and rule-breakers are costing you.

Cont overleaf



Sometimes it doesn't even have to be your own data! Just the picture of the idea can make you think differently about your operation - I used the Whale graph as illustrated here by Tim Pei https://bit.ly/TimPeiWhaleChart in a client meeting to show how if you put all your deliveries in a row with most profitable to the left through to largest loss-makers on the right, and cumulative profit on the Y Axis, you end up with the same profit as if you only did a proportion of the work.

It won't be that easy to eliminate all the unprofitable business, but at least you'll know why you're doing it!

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Here is the article on the web archive:
https://web.archive.org/web/20221002230326/https://www.shdlogistics.com/data-analysis/balancing-cost-and-service