Cases from Management Accounting Practice

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edited by

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The American Accounting Association (Management Accounting Section)
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Preface

The cases in this volume were presented at the Management Accounting Section of the American Accounting Association’s 2000 annual meeting in Mesa, Arizona. The cases describe the implementation and application of management accounting innovations to systems designed to support the maintenance and creation of value in the modern enterprise. Each of the cases presents an application of management accounting techniques to support change management.

Starting with an excellent review of the strategic management of new product lines by Mercedes-Benz, Tom Albright contributes an interesting and insightful picture of how target costs need to consider both current and strategic value issues. Mercedes’ use of a target cost index to integrate cost and strategic value is particularly interesting. The next three cases focus on the implementation and use of the balanced scorecard and performance measures to influence change. Larry Carr’s Lucent Technologies and Hugh Grove, Tom Cook, and Ken Richter’s Coors Brewing Company cases provide really excellent examples of the implementation and use of balanced scorecard performance measures. Both cases present detailed and enthralling stories about the cultural imperatives needed to implement effective change. In addition, contrasting these cases can introduce a lively debate about conditions that will lead to the relative success or failure of balanced scorecard implementations. The Coors case highlights supplier chain management.

Leif Sjöblom’s BG Bank is a fascinating case that links strategic reevaluation to performance measures designed to bring the company into line with a new strategy for creating value. Supporting video clips, free of charge, are available from Leif at sjobbom@md.ch. This case paints a dynamic and interesting classroom experience that highlights strategic planning, implementation, and performance measurement design.

The remaining two cases are powerful examples of the issues related to real-world applications of activity-based management (ABM). Gary Siegel, Nancy Mangold, and Gail Kaciuba provide an excellent insight into the design of an activity-based costing system in a Medical Practice. This insightful and detailed case gives students the opportunity to understand the accuracy limitations inherent in an ABC system while examining the economies and operating realities of current medical practices. If desired the case can be used with ABC software. Finally, Jon Guy and Jane Saly have contributed an excellent and straightforward application of ABM to an analysis of distribution costs related to alternative distribution channels, in Colombo Frozen Yogurt.

Combined, these cases provide a vivid illustration of the use of management accounting for the implementation and management of target costing, strategic value analysis, change management, performance measures, balanced scorecard, value chain, activity-based costing, and activity-based management.

All of these cases have been applied in the classroom many times. The support materials are detailed and provide excellent guidance for the successful classroom application of these cases. The
cases and teaching notes may be duplicated for classroom use. However, they may not be included in articles, books, or other publications without the prior consent of the Institute of Management Accountants. Users of these cases should remember they were intended as a basis for class discussion rather than to illustrate either effective or ineffective management.

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Abstract: Marketing costs are coming under increased scrutiny, and activity-based costing (ABC) is often the tool used to analyze such costs. ABC is useful because it requires the identification of cost drivers and provides information that is directly applicable to decisions about marketing costs and benefits. This case illustrates the application of activity-based costing to marketing costs in a food manufacturer. It illustrates how marketing support costs may differ across two channels of distribution. This information is very useful for understanding profitability in the two channels and for decisions about how to service the two channels.

In 1994, General Mills Incorporated, a $6 billion consumer goods company, acquired Colombo Frozen Yogurt. General Mills Inc. (GMI) believed they could add Colombo frozen yogurt to their existing product lineup to increase net sales with little addition in marketing cost. Frozen yogurt is sold through two distinct market segments—indpendent shops and impulse locations such as cafeterias, colleges, and buffets. The shop business revolves around frozen yogurt and specialty items made from yogurt. In the impulse segment, yogurt is an add-on to the main business. GMI's large sales force already served the impulse market with brand items such as Cheerios, Gold Medal Flour, Betty Crocker, Chex Snacks, and so on. The financial results in the first couple of years were mixed. Profits increased along with sales volume. However, when sales hit a plateau, earnings dropped. The sales people were dissatisfied with yogurt sales and said their customers weren't happy either. The GMI sales force focused on the impulse segments and saw increases in volume there. However, volume in the shop segment declined at alarming rates. While GMI knew sales by segment, they didn't track costs by segment. Instead costs were allocated based on sales dollars. Therefore, they needed a new method to track costs—activity-based costing.

Frozen Yogurt Market Structure

Colombo Yogurt Company, an early innovator in the frozen yogurt market, did well during the early craze when customers flocked to frozen yogurt as a healthy alternative to ice cream. As the market continued to develop, Colombo chose to market mainly to independent shop owners. As a result, Colombo lost customers when franchise operations such as TCBY encouraged independent shops to become a franchise and purchase the product from the franchiser. In the early 90s, the market changed again as food service operators such as cafeterias, colleges, and buffets started to add soft-
serve yogurt to their business. By the late 90s, these impulse locations accounted for two-thirds of the soft-serve market.

The economics of shops is similar to that of restaurants. The shops focus on maximizing profit per square foot. While they are aware of food cost, shop owners are rooted in a culture dominated by guest counts (new and repeat) and check averages. These variables are more linked to the kind of customer referrals where word of mouth brings in new customers and the total experience brings them back again. The key variable is the quality of the product and experience (service and feeling). To compete with other shops, they must innovate by adding distinctive new products such as smoothies, boosters, and granitas. Otherwise they may go out of business as thousands have done in the last decade.

The economics of impulse locations is very different. They make their living from other items, and the soft-serve trade is only performance topspin. These firms are unwilling to take any risk (new equipment or extra labor) to serve highly differentiated products such as smoothies or granitas. They generally are interested in providing a quality service for a reasonable price. They typically measure performance with cost per serving, and they have a difficult time understanding profit contribution as opposed to food cost. Impulse locations are typically small.

The GMI-Colombo Marketing Plan

It was the impulse business in the Foodservice operations that made Colombo an attractive acquisition for General Mills. The GMI Foodservice Division was already marketing brands such as Cheerios, Yoplait, Betty Crocker, Gold Medal Flour, Hamburger Helper, Pop-Secret, and Chex Snack to food management firms, hospitals, and schools. Colombo yogurt was added to this product lineup, and the Foodservice sales force covered both shop and impulse locations.

Sales Force

Colombo’s sales force was merged into the Foodservice sales force. Customers were reassigned to sales people who already serviced that geographical area. The sales people varied in their reaction to the product. Some found shops easy to sell to, while others avoided the shops despite the possible lost commission. Many spent a lot of time helping their impulse customers understand how to use the machinery.

Merchandising Promotions

Colombo traditionally charged the shops for merchandising that was large scale and eye popping (neon signs). The shops used these signs to draw customers inside. Since GMI traditionally provided merchandising at no cost, they stopped charging for it. Sales people used the merchandising as a reason to visit the customers, and the same merchandising was provided to both shops and impulse locations. While shops expressed interest in the kits, some sales people noticed that the impulse locations didn’t even hang them up.

Pricing Promotions

Pricing promotions are a mainstay of GMI’s impulse location approach. GMI’s sales force generally used these promotion events as an opportunity to visit their accounts and take advantage of the occasion to meet service needs and sell other products that might not be featured.

GMI made price promotions available to both segments of the market. While the deals were typically around $5 per case, they averaged $3 per case against all the volume shipped during the year. GMI marketing knew price was not a major decision factor for shops, and they did not target pricing promotions to them. However, shops were aware of the promotions and took advantage of them.
The Business Status Pre-ABC

**Profit and Loss by Segment Pre-ABC**

<table>
<thead>
<tr>
<th>Category</th>
<th>Impulse Segment</th>
<th>Yogurt Shops</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales in cases</td>
<td>1,200,000</td>
<td>300,000</td>
<td>1,500,000</td>
</tr>
<tr>
<td>Sales revenue</td>
<td>$23,880,000</td>
<td>$5,970,000</td>
<td>$29,850,000</td>
</tr>
<tr>
<td>Less: price promotions</td>
<td>- $ 3,600,000</td>
<td>- $ 900,000</td>
<td>- $ 4,500,000</td>
</tr>
<tr>
<td>Net sales</td>
<td>$20,280,000</td>
<td>$5,070,000</td>
<td>$25,350,000</td>
</tr>
<tr>
<td>Less: cost of goods sold</td>
<td>- $13,800,000</td>
<td>- $3,450,000</td>
<td>- $17,250,000</td>
</tr>
<tr>
<td>Gross margin</td>
<td>$ 6,480,000</td>
<td>$1,620,000</td>
<td>$ 8,100,000</td>
</tr>
<tr>
<td>Less: merchandising</td>
<td>- $ 1,380,000</td>
<td>- $ 345,000</td>
<td>- $ 1,725,000</td>
</tr>
<tr>
<td>Less: SG&amp;A</td>
<td>- $ 948,000</td>
<td>- $ 237,000</td>
<td>- $ 1,185,000</td>
</tr>
<tr>
<td>Net income</td>
<td>$ 4,152,000</td>
<td>$1,038,000</td>
<td>$ 5,190,000</td>
</tr>
</tbody>
</table>

**ABC Analysis of Cost of Goods Sold**

Cost of goods sold is made up of $14,250,000 for ingredients, packaging, and storage and $3,000,000 for pick/pack and shipping. Since the product is the same across segments, the cost to produce should be the same. However, pick/pack and shipping costs vary according to whether or not the order is for a full pallet. Full pallets cost $75 to pick and ship whereas individual orders cost $2.25 per case. There are 75 cases in a pallet and the segments differ in their utilization of full pallets, as shown below.

<table>
<thead>
<tr>
<th></th>
<th>Impulse Segment</th>
<th>Yogurt Shops</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cases in full pallets</td>
<td>60,000</td>
<td>240,000</td>
<td>300,000</td>
</tr>
<tr>
<td>Individual cases</td>
<td>1,140,000</td>
<td>60,000</td>
<td>1,200,000</td>
</tr>
<tr>
<td>Total cases</td>
<td>1,200,000</td>
<td>300,000</td>
<td>1,500,000</td>
</tr>
</tbody>
</table>

**ABC Analysis of Merchandising**

Merchandising costs consist mainly of kits costing $500 each. A review of where the kits were sent indicated that a total of 3,450 kits were delivered, 90 of them to shops.

**ABC Analysis of Selling, General, and Administrative (SG&A)**

Since sales representatives service several products, their costs were allocated to the various products based on gross sales dollars. GMI gave diaries to 10% of the sales force in randomly selected markets of the country and asked them to track their time in activity classifications for 60 days. The diaries indicated that sales representatives spent much more time per dollar of sale on yogurt than other products. When SG&A costs were allocated based on time, the total allocation to yogurt jumped from $1,185,000 to $3,900,000. Of their time spent on yogurt, only 1% of the time was spent on the shops.
Questions for Discussion

1. Briefly summarize Colombo’s competitive environment and General Mills’s strategy in response to that environment.
2. Using the ABC analysis, determine new segment profitability statements.
3. Based on your analysis in questions 1 and 2, what changes would you suggest to General Mills?