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Costing and Customer Profitability Analysis

8.1 Introduction and objectives

Traditional 'cost accounting' was product driven and internally focused. Modern strategic managerial accounting focuses more strongly outwardly and recognises the important role the market and customers have in making an organisation successful and profitable. This chapter explores a number of management accounting tools that aid this modern view of organisations. The notion that: 'It is customers, not products and services, that generate profits for organisations' is key to this market emphasis.

After studying this chapter you should be able to:

- Understand the relationship between the marketing and management accounting functions
- Understand and use activity-based costing (ABC) and activity-based management (ABM) to support management decisions; and
- Critically evaluate the use of; market segment profitability analysis, customer profitability analysis, and profit sensitivity analysis as tools to aid managers' in hospitality, tourism and events environments.

8.2 Market decisions

An external focus of an organisation leads to decisions as to:

- Which specific market are we in?
- Who is our customer?
- What do these customers want?
- Can we deliver what they want?
- Will this make us a profit?
- Could other markets offer a better profit potential?

If an organisation is to maximise its returns to its shareholders such strategic questions have to be addressed. To do this both marketing and accounting functions need to work together to generate the management information needed to answer these questions.

8.2.1 Market and customer examples

General industry sectors are easy to identify, but within those there are a lot of variations, subsectors and different customer needs to consider.

Table 8.1: Markets, customers and their needs

What market are we in?	Who are our customers?	What do they want?
Events – weddings	Those who want a bespoke service	Something designed specifically for them, a 'one-off' event, but prepared to pay for this 'uniqueness' desired from the event.
Events – weddings	Those on a budget, but wanting a special day	They want a memorable day, cost is a concern so they want to select from pre-set all-inclusive packages that they can budget for.
Events – music festival	18–25 year olds with a passion for contemporary music	Top artists, mixing with like-minded individuals, basic camping facilities, bar facilities and a simple food provision.
Events – music festival	Families	A safe friendly environment, with good music for the adults, but also entertainment for the children, with workshops and family-focused camping facilities, quality food and drink provision.
Hospitality 5* hotel (international airport)	Airline crew and air passengers	A one-night stay with easy access to the airport, possibly parking whilst away, 24 hour services so they can arrive, eat and leave at a time convenient to flight needs.
Hospitality 5* hotel (city centre)	Overseas travellers at the 'high end', and corporate executive travellers	Traditional hospitality, opulent surroundings, attention to service details, traditional hotel styling and atmosphere, like-minded customers
Hospitality 5* hotel (city centre)	Entertainment and creative industry executives, younger celebrities, 'young money'	Want 5* facilities, but with a lively, vibrant modern atmosphere in a hotel with a contemporary style and modern service and up-to-the-minute gadgets and technology.

The list of examples in Table 8.1 could go on and on, but just these simple examples illustrate the point of how different customers influence the product/service offered, even in what is perceived to be a single market.

8.2.1.1 London 5* hotel market example

Consider two well-known London 5* hotels: the Dorchester and the Metropolitan. Both are the same star rating, on the same street, in the same city. If you look at their respective websites you will quickly identify very different imagery, styling,

facilities and descriptions. This is not to say their customer groups never overlap, but they are 'targeted' in very different ways. The Dorchester offers the traditional grandeur and opulent styling, whilst the Metropolitan focuses on its minimalist contemporary styling and has its own exclusive nightclub, 'The Met Bar'.

Whilst both serve a 5* hotel market in the same location their 'offering' (products and services) are quite distinctive from each other. Both these hotels have survived over the years, but clearly have made distinct market positioning decisions. It could be argued, this 'works' as they each take the customers the other 'doesn't want', fill specific niches in the marketplace. To do this accounting and marketing functions have to work closely together, not only to identify markets, but to consider which markets will maximise profitable returns (see Boston Consulting Group BCG discussion in Chapter 16 on strategic management accounting, which can be linked to this point).

8.3 The accounting/marketing interface

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There are a number of research papers in this area, including that of Phillips and Halliday (2008) that looks specifically at the interface during planning. A number of authors draw a similar conclusion that these two functional areas have to work together to maximise organisational performance and shareholder wealth. However, authors also agree that there is often insufficient combined working between marketing and accounting, leading to potential organisation performance issues. There are calls for a holistic view of performance which needs a combined approach.

8.3.1 Problem examples of lack of marketing/accounting interface

The examples in Table 8.2 highlight how basic operational decisions can cause conflict between these two functions, where a holistic 'joined up' approach would better serve the organisational needs.

The illustrations in Table 8.2 identify that working together and thinking through the decision from both perspectives gives a better decision than one on its own. There are a number of costing techniques and market based analysis approaches that provide valuable information to assist in such decision making in organisations.