

IMPROVEMENT SKILLS CONSULTING LTD.

“Simply, improvement...”



Activity Costing and Best Value

Activity Costing and Best Value

“Finance people know the cost of everything and the value of nothing. Sales people know the price of everything and the cost of nothing.”

Lessons from Best Value

Having worked with numerous public sector organisations to help them carry out Activity Costing exercises and Best Value Reviews we thought it worth sharing some of the lessons learned. Best Value (or Value for Money) is likely to remain high on the public sector’s agenda so it’s worth understanding how to make use of Activity Costing in that context.

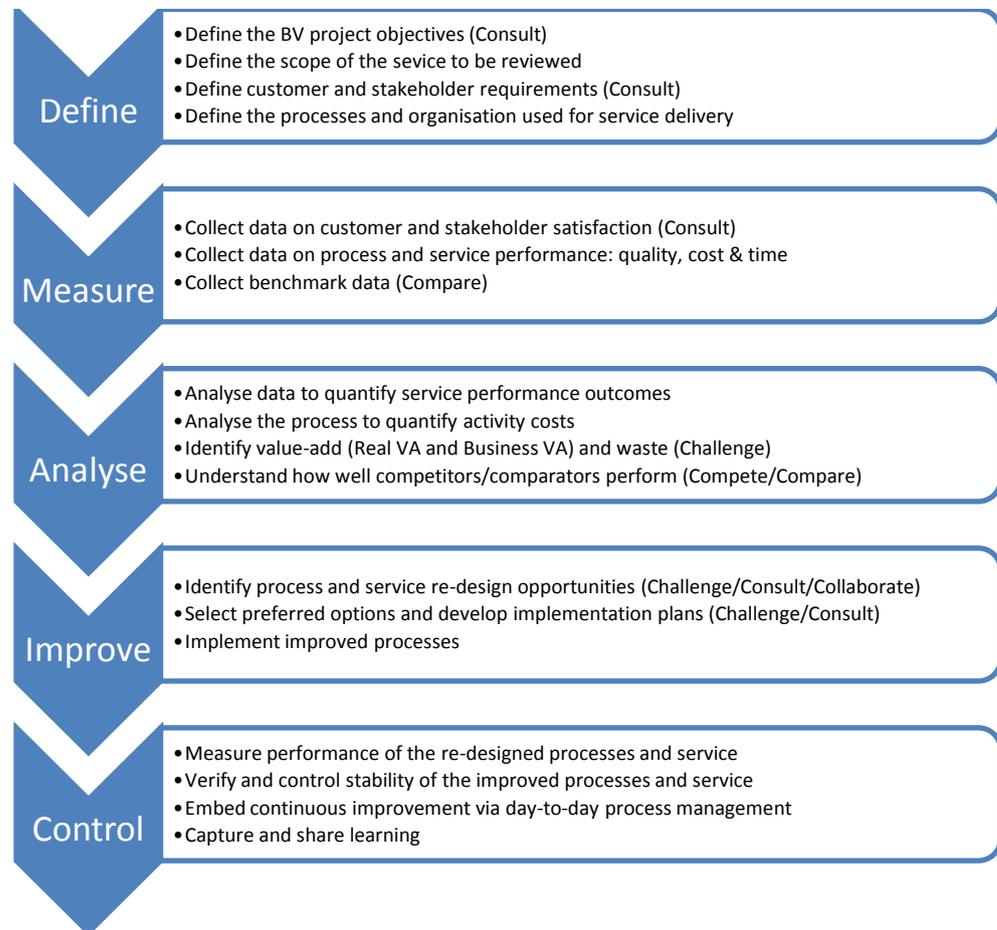
Best Value was launched with four underpinning principles; the 4 Cs:

-  Consult – with customers and stakeholders on their requirements
-  Challenge – how you meet your objectives
-  Compare – against other service providers
-  Compete – with alternative service providers

With the drive by central government for Better Quality Services, a fifth C was added:

-  Collaborate – with others to deliver best value

It is important to remember the 5 Cs are principles, not a process for conducting a BV Review. Typically a Best Value Review will need to go through the stages shown in the diagram below, which some readers will recognise from many process improvement projects:



Where Activity Costing Fits

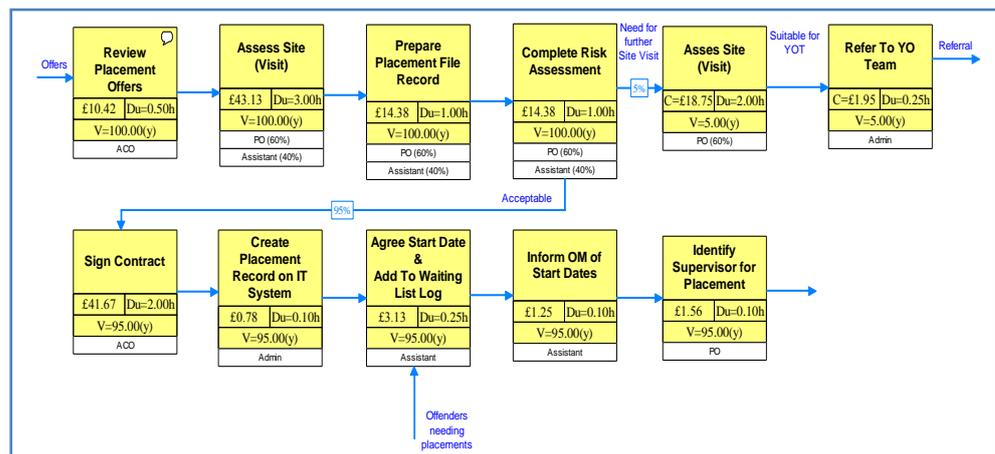
It is clear from the above BV Review steps that Activity Costing will be done in the Measure and Analyse steps. But its scope is actually established in the Define step, where the processes to be costed are identified. To be meaningful, i.e. in order to be able to get to an understanding of Value Add and Waste, Activity Costing has to be done at the individual process level. In practice, that means breaking down a service into its constituent parts:

Service	Key Processes	Activity Level Processes
Single service name	6-10 Key processes	Process maps for each key process

Costing is done at the Activity Level Processes, for which you need to start with a Process Map and quantify:

- The volume of transactions going through each process
- The durations of each activity in the process
- The resources carrying out each activity and their cost (per unit of time)

Armed with these three sets of data for each Activity you can calculate the direct cost of operating each process and cumulatively, of operating the service. A process mapping tool with costing functionality (see diagram below) is very helpful, but equally, it can be done on a spreadsheet.



A key learning point is that you need to map the process in order to get the list of activities and to understand the flow of transactions (especially where there are multiple routes through the process).

A further learning point is that the process maps need to be created in a disciplined and consistent way with clear activity definitions (Verb + Noun format, as in the example above). Otherwise it can be hard to collect the right volume, cost and time data and it becomes very difficult to make comparisons with others' processes, or to identify where the value really is added. Done properly, you can put a financial value to each of the Real, Business and Non-value-add activities in your service processes.

It's important also to remember that at this level of analysis you have only quantified the direct costs of operating the processes. To get a true picture of the full cost, you need help from your Finance Department to come up with meaningful apportionment of overhead costs. If your BV Review is being done in

partnership with other organisations, this stage is critical; otherwise you can't compare "apples with apples".

Overhead costs to apportion include:

- Premises/Office Costs
- Central Functions (HR/IT/Finance/Legal) and Management Costs
- Governance and Business Development Costs
- Any other overheads

There is no one right way to do this, and the drivers for cost allocation may be based on headcount, time, expenditure or volume (or something else).

If you want the Activity Costing data to be credible, you have to involve your Finance Director.

It's about Value, not Cost

There are two main traps organisations can fall into:

- Not being rigorous enough gathering relevant outcome data
- Forgetting value and only analysing cost

Outcome data will sometimes be difficult to get hold of, but is essential because it quantifies the extent to which your services are meeting their stated objectives. Some public sector organisations depend on Central Government research to provide such data, but it's always worth trying to get local data as well. The use of local customer and stakeholder perception surveys can add a real insight to what your services are really achieving.

It's easy to get caught up in analysing costs, particularly when making comparisons between your organisation's processes and those of others. Some very "attractive" theoretical big cost savings can be identified. It's not unusual to see cost per transaction differences of 50-100% between similar public sector service providers. Showing this data on its own, to senior managers, can be very dangerous. Activity Costing data on its own only tells you about the costs of delivering Outputs.

Cost data has to be looked at in conjunction with outcome data.

Key Learning Points

- Make sure Senior Management agree the scope of the BV Review and are clear about the degree of challenge they want from it
- Map the service delivery processes to a level of detail where you can quantify volumes, durations and resource costs
- Get the best Outcome data possible, otherwise you'll end up only focussing on the cost of delivering Outputs
- Get a senior Finance person to help with the methodology and to validate the numbers
- Home in on Best Value by looking at outcomes, processes and organisation

And finally...

There are no services or processes that can't be improved.

It's only Best Value if you implement some improvements.

Our track record

Our consultants have been helping organisations in the private and public sectors to manage and improve their services and processes for nearly two decades. We have supported European and UK Quality Award winners in their approach to process management and continuous improvement.

We are not wedded to a particular methodology. We help clients identify their improvement goals and then develop an approach to achieve these; invariably ensuring their people develop the skills to make further improvements themselves.

Please contact us for more information about how we can help you to manage and improve your processes.

SIMPLY, IMPROVEMENT...

Activity Costing and Best Value

© 2008 Improvement Skills Consulting Ltd.
204 Blind Lane, Flackwell Heath, High Wycombe HP10 9LE
Phone 07850 728506 • Fax 0871 221 5638
E info@improvement-skills.co.uk • W www.improvement-skills.co.uk