

# Profit Maximization through Contribution Management

## Practice Area Profile

In any industry, understanding the nature and behavior of cost is fundamental to profitability management.

But, to maximize profitability, you have to go beyond cost. Maximizing profitability involves determining how employees can maximize contribution<sup>1</sup> from every decision they make. Rather than relying on a traditional 'financial-accounting' view of your company, you, as a strategic decision maker, need to understand how, for example, the sale of a product in a specific market affects the bottom line, not only today but into the future.

Maximizing contribution depends on understanding how product and service revenues consume plant, generate costs, and then lead to organic revenue growth. The key to contribution management is to drive decisions toward improving (increasing positive or decreasing negative) contribution period over period. To do this, costs do not need to be allocated down; rather, managers are assigned the revenue and costs that they control.

The CostQuest contribution management approach captures the economic principles of cost causation and management. It provides tools to help you understand the relationships among customer revenue, cost, contribution, and profitability in a complex business

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<sup>1</sup> Contribution is defined as the value that results from your decisions. This value can be positive or negative. For example, contribution can be the economic profit that product managers deliver for a year from their product sales. It can also be the cost for a support group in the company.

environment. These tools help you make decisions that maximize your company's profit over the long term.

The CostQuest contribution management approach identifies:

- ✓ Whether you are really making a profit on each sale—or incurring a loss
- ✓ Where assets can be leveraged
- ✓ Who manages the costs
- ✓ Whether costs assigned to specific managers can be controlled
- ✓ How to raise year by year contribution
- ✓ Effects of new pricing strategies
- ✓ Information pertinent for operational management
- ✓ Whether more units should be priced below financial costs

The CostQuest contribution management system helps you understand how, for example, expanding into a new market will affect firm profitability. If more items are sold, will the cost basis for those items be the same as other units of production? Or, will the growth in sales require a new, extremely expensive unit of plant to meet the demand? In other words, is historic marginal cost as good a predictor of true economic cost as you need?

The CostQuest contribution management approach provides managers with insight into the various dimensions of revenue generation—geographic markets, product lines, or product families—just to name a few. This multi-dimensional view of revenue is necessary for accurate, profitable decisions about expanding product lines.

Finally, the CostQuest contribution management approach is scalable and flexible to support multiple users analyzing multiple business scenarios.

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### CostQuest Contribution Management Tools

#### include:

- ✓ Compass (COntribution MAnagement and Profitability and Analysis System), a customizable tool designed to meet your needs
- ✓ Custom Solutions designed to meet the specific objectives of your business

### Some Examples of Problems Solved by CostQuest Contribution Management Solutions

- ✓ Profitability of flexible service bundles deployed throughout multiple regions and markets was determined for a national cable and telecom carrier.
- ✓ Flexible, multi-dimensional product contribution analysis systems that forecast and decompose revenues and costs prospectively across products, markets, and geographic dimensions are now in use in the U. S., Colombia, and Hong Kong.
- ✓ Geographic and market segment profitability analyses were developed for a mid-sized, U. S. telecommunications firm.
- ✓ Corporate value acquisition analysis to support negotiations with potential equity investors was developed for a major Colombian carrier.
- ✓ Build/buy scenarios were developed to help a large U.S. financial institution evaluate alternative solutions for telecom service.

For more information, please contact us or visit us at [www.costquest.com](http://www.costquest.com).