

# Improving Company Profits through Customer Profitability Analysis



# Industry Background/Backdrop

- Increasingly Competitive Selling and Pricing Environment
- Competition Coming from New Directions and Trade Channels (Warehouse Clubs, Internet, Wagon Jobbers, DSD)
- Diminishing Trade and Performance Programs from Manufacturers (especially cigarettes)
- Dramatically Increasing Operational Costs (Fuel, Insurance, Wages, etc.)

# Industry Background/Backdrop

- Bracket and Minimum Order Squeeze from Manufacturers Increasing Inventory Levels and Slowing Turns
- Line & SKU Extensions Increasing Inventory Carrying Costs as Manufacturers Try to Extend & Leverage Brand Equity
- Excise Tax Increases Chewing Away at Working Capital
- Gross Margin Driven Methods of Compensation (Commission, Bonus) With No Consideration for Customer Cost to Serve
- Increased Working Capital Costs as Manufacturers Have Tightened Trade Credit

# Result

- Decreasing Gross Margins on Business to Your Customers
- Increasing Costs to Serve Your Customers
- Lower Net Margins for Your Business
- “Where is the Light at the End of this Tunnel?”
- Increasingly Unacceptable Return on Assets
- Difficult Environment in Which to Implement an Acceptable Exit Strategy
- Industry Profit-.....Last

# What is the Strategy and How do You Fix the Problem?

Do These Fixes Sound Familiar?

- Easy Answer-"Just Raise Prices to Your Customers"
  - Risky if used with a sledgehammer approach
  - Could cause loss of better customers
- Another Easy Answer-"Just Do More with Less"
  - Flies against the philosophy of creating value in the supply chain (ie The Distributor Value Equation)
  - Creates organizational strain

# Better Answer

- Define the Strategy & Set Goals
- Involve the Entire Business with Every Department Having a Role in the Strategy
- Implement & Communicate Timetables for Specific Components of the Strategy Across All Departments
- Measure Progress to Goals on a Regular Basis
- Do not Negotiate With Yourself!

# Administrative Answers

- Fuel Surcharges
- Customer Product Return Fees-Code Specific
- Promotional Strategy Review
- Special Order Fees
- Finance & Late Pay Charge Compliance

# Purchasing Answers

- Inside Margin Strategies
- Vendor Penalties on Lost or Delayed Orders
- Manufacturer Price Change Policy
- Allowance Window Purchasing Guidelines
- Case Break Fees

# Marketing Answers

- Publication Fees
- P.O.S. Fees-Vendors and Customers
- Field Equipment Assets and Product Consumption
- Event Fees
  - Trade Shows
  - Vendor Fairs
  - Customer Events
  - Sales Meetings

# Sales Department Answers

- Minimum Order Policy
- Compensation Tied to Gross Margin Improvement
- Intelligence on Competitive Pricing
- Customer Profitability Analysis

# Customer Profitability Goals

- Objective Analysis to Determine Which Customers Are Most Detrimental and Which Customers Are Most Beneficial to Your Bottom Line
- Easy for Sales Department to Understand
- Could Be Accomplished Multiple Times Over the Course of the Business Year
- Was “Actionable” and Specific

# A 3-Step Approach to Improving Customer Profitability

- Step One-Customer Profitability
  - Determine Gross Profit by Customer
  - Net Profit After Activity Based Costs Applied-Sales Cost, Fill Cost (Pick & Pack), & Delivery Cost
  - Rank Customers by Region from Highest to Lowest

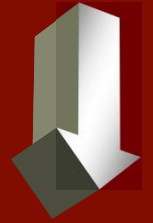
# Step One-Customer Profitability After Activity Based Cost to Serve Applied

- Establish Customer Gross Profit Dollars After All Adjustments (by Company, Region, or Territory)
- Determine Cost of Average Sales Call (i.e. - \$47.21)
- Determine Average Unit Fill Cost (Pick and Pack)(i.e.-.18 per unit)
- Determine Transportation & Delivery Cost Per Delivery (i.e.-\$94.69)

**Sledd Co.**

**ABC Store Customer Analysis - West Region**

**5 Months Ending May 31, 2007**



Customer Name	Sales	Cost	Gross Profit	GP After Adj	# Del	Units Shipped	Selling Effort	Ware-House Effort	Deliver Effort	ABC Adjusted Profit
Customer A	\$160,491.18	145,955.2	\$14,535.56	\$12,191.96	8	7940	377.68	1,429.20	757.52	\$9,627.56
Customer B	\$331,621.04	308,012.24	\$23,608.80	\$13,307.80	14	15212	660.94	2,738.16	1,325.66	\$8,583.04
Customer C	\$309,381.97	292,263.50	\$17,118.47	\$12,771.75	11	16177	519.31	2,911.86	1,041.59	\$8,298.99

- Rank Customers Highest to Lowest in ABC Adjusted Profits for Time Period Measured
- Assign Top Third Performing Customers as Level Green
- Assign Middle Third Performing Customers as Level Yellow
- Assign Bottom Third Performing Customers as Level Red

# Step Two-Assign Customer Cost to Serve Score

- Measure and Score Customer Compared to a Perfect C-Store Customer (See Customer Evaluation Worksheet)
  - 100 Point Grading Scale
  - Use Data Currently Available or Determinable
  - Use Applicable Department to Score Customers on Various Criteria

# Step Two-Customer Cost to Serve Criteria on Which a Perfect C-Store Customer is Measured



- Payment Terms-C.O.D.
- Cigarette Mix-Favorable to Trade Programs
- Order Entry-Telxon
- Delivery Frequency-Once Per Week
- Ease of Delivery-Single Drop in Store
- Abides by Order Deadline-Never Misses Deadlines
- Low Returns & Credits
- Standard Retail Price Plan Maintenance
- Allows for Efficient Cigarette or Pricing Adjustments
- Demonstrate Targeted Business Tangibles as a Customer
- Reset Integrity Maintained
- Full Planogram Compliance

# Perfect C-Store Customer



## Customer Test

Grading Attribute	Grading Scale
Payment Terms	<ul style="list-style-type: none"><li>■ Grade = 10 when customer chooses to pay upon delivery</li><li>■ Grade = 8 for in-term customers with 7 day terms</li><li>■ Grade = 6 for in-term customers with 14 day terms</li><li>■ Grade = 4 for in-term customers with 21 day terms</li><li>■ Grade = 2 for in-term customers with terms GT 21 days</li><li>■ Grade = 0 for any customer 3 days or more past due</li><li>■ Add 1 for EFT</li><li>■ Add 1 for personal guarantee from the owner</li></ul>
Cigarette Mix	<ul style="list-style-type: none"><li>■ Grade = 5 for Phillip Morris GT 45%, 3 for GT 40%, 2 for GT 35%, 1 for GT 30% and 0 for LT 30%</li><li>■ Add 5 for R J Reynolds GT 30%, 3 for GT 25%, 2 for GT 20%, 1 for GT 15% and 0 for LT 15%</li></ul>

## Order Entry

- Grade = 10 for customer prepares & sends order via Telxon
- Grade = 5 for customer prepares order, but salesperson sends it via Telxon
- Grade = 0 for salesperson prepares & sends order via Telxon
- Grade = 5 if customer faxes order, and we key it into the system
- Grade = 0 if customer calls in the order (and we key it while on the telephone with customer)
- Subtract 10 for weekly salesperson visit

## Delivery Frequency

- Grade = 15 for one delivery per week
- Grade = 10 for two deliveries per week
- Grade = 5 for three deliveries per week
- Subtract 2 for occasional unexpected deliveries by truck or salesperson
- Subtract 5 for frequent unexpected deliveries by truck or salesperson

## Ease of Delivery

- Grade = 10 for single drop within store
- Grade = 8 for several drops within store (i.e., three spots or less)
- Grade = 5 for aisle delivery within store
- Subtract 15 from grade if check-in required
- Subtract 3 from grade for "time of day" receiving demands

## Abides by Order Deadlines

- Grade = 5 for never misses deadlines
- Grade = 3 for sometimes misses deadlines
- Grade = 1 for often misses deadlines

## Returns and/or Credits

- Grade = 5 for infrequent returns and/or credits
- Grade = 3 for some returns and/or credits
- Grade = 1 for many returns and/or credits
- Add 5 for accepts / does not refuse cigarette manufacturers' force outs

## Retail Price Maintenance

- Grade = 3 for standard retails
- Grade = 2 for exceptions made at category level
- Grade = 0 for exceptions made at the item level

## Cigarette Rebate Processing

- Grade = 3 for rebates given via invoices
- Grade = 2 for rebates given via credit memos
- Grade = 0 for rebates given via check

## Business Tangibles

- Add 2 for creating "point of destination" via food service offerings
- Add 1 for WAM earnings GT \$200 Annually
- Add 1 for attending Sledd Co. annual trade show

## Store Maintenance

- Grade = 10 for they maintain store after initial reset
- Grade = 5 for we maintain store after initial reset
- Subtract 10 if customer allows store set to deteriorate rapidly after any reset
- Subtract 2 for each reset within last 12 months

# \$helf \$ense Implementation

- Grade = 10 for full implementation across all product categories
- Grade = 5 for implementation of 5 target categories only
- Grade = 0 for no implementation

Grand  
Total >>>>>>>>>>

Customer Score



Customer	Total Score	Pay-ment Terms	Cig Mix	Order Entry	Del Freq	Ease Del	Order Dead lines	Returns and / or Credits	Ret Maint	Cig Reb Proc	Bus Tang	Store Maint	\$helf \$ense Imple ment
Customer A	69	0	7	10	10	8	5	10	3	2	4	10	0
Customer B	80	6	8	10	15	8	5	10	2	2	4	10	0
Customer C	64	8	8	0	10	8	5	8	3	0	4	10	0

# Customer Cost to Serve

- Rank Customers Highest to Lowest in Cost to Serve Score for Time Period Measured
- Assign Top Third Performing Customers as Level Green (Green = Good)
- Assign Middle Third Performing Customers as Level Yellow (Yellow = Caution)
- Assign Bottom Third Performing Customers as Level Red (Red = Danger)

# Coded Cost to Serve Analysis

Customer	Total Score	Payment Terms	Cig Mix	Order Entry	Del Freq	Ease Del	Ord Dead lines	Returns and / or Credits	Ret Maint	Cig Reb Proc	Bus Tang	Store Maint	\$elf \$ense Imple Ment
Customer A	69	0	7	10	10	8	5	10	3	2	4	10	0
Customer B	80	6	8	10	15	8	5	10	2	2	4	10	0
Customer C	64	8	8	0	10	8	5	8	3	0	4	10	0

# Where Are We Now?



- At This Point, Each Customer Should Have Two Measurements Established (Gross Profit and Cost to Serve) and a Code Assigned to Each Measurement
- Red = Danger
- Yellow = Caution
- Green = Good

# Your Best Customers

Customer Profitability

High



Cost to Serve

Low



- Recognize These As Your Most Valuable Customers
- Insure You and Your Organization are Treating Them as Valuable Assets to Your Business
- Understand That This Group of Customers is Subsidizing Non Profitable Customers in Your Business Mix

# Your Worst Customers

Customer Profitability

Low






Cost to Serve

High



- Recognize These as Your Least Profitable or Unprofitable Customers
- Target These Customers for Immediate Action
- Utilize Your Sales Force to:
  - Remedy the High Cost to Serve the Specific Customer or
  - Increase Pricing to the Customer or
  - Terminate the Customer Relationship

# Step 3-Action Step

Customer	Targeted Completion Date	Anticipated Score After Improvement	Specific Action Plan for Improvement
Customer A			
Customer B			
Customer C			

- Target Red/Red Customers As Immediate Priority
- Target Red/Yellow & Yellow/Red Customers Over the Subsequent Cycle
- Consider Building Improvement Accomplishment into Sales Force Compensation

# How to Use This Analysis

- Ongoing and on Regular Cycles to Constantly Identify the Worst of Your Worst Customers
- Build and Instill Awareness of Customer Cost to Serve in Your Sales Department
- Insure That Your Best Customers Can be Objectively Measured for Identification Throughout Your Organization

- Reinforce Customer Cost to Serve or Margin Rehabilitation with Tie-in to Compensation
- Ensure That More “Demanding (ie High Cost to Serve) Customers Are Being Charged Appropriately
- Let Your Competition Spend Time Serving Fired Customers While You Create Additional Time to Seek Out Profitable Customers
- Qualify Customers Up Front Before They Become or are Identified as Problematic

# In the End-

- What Do You Have to Lose?
- This Will Create an Effect on Both Existing Customers and New Potential Customers
- Know Who Your Best Customers Are and Complement with Proactive TLC
- You Will be More Profitable

Thank You For Your Time

Questions?

Improving Company Profits Through  
Customer Profitability Analysis

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