

# Customer Profitability Analysis

**In a recent survey, it has been shown that on average 25% of Australian businesses have customers which are unprofitable to that business – that is, one in four customers make a negative contribution and that the supplier would be better off without that customer.**

Until recently, businesses strove to satisfy their customers at all cost – the customer was king and much effort was made to retain that customer, despite the fact that many of them were unprofitable. All that has changed however, under the new business focus, – Customer Profitability Analysis, or ‘CPA’, which encourages businesses to continue to deal only with those customers who are profitable to that business. CPA supports the view that the only good customer is a profitable customer, and that businesses should know their unprofitable customers and take active steps to remove them from their portfolio of clients!

Professor Michael Porter of Harvard Business School, who regularly writes for Harvard Business review, has discussed CPA as part of his ‘competitive advantage model’ for which he is well known worldwide. Under the caption ‘*Profits in Not Doing Too Much for Customers*’, Professor Porter commented that “strategic planning starts with deciding what companies won’t do for their customers. A common strategic mistake is for companies to try to do everything for their customers, rather than try to identify target markets.”

CPA is being employed by some of Australia’s major banks, insurance companies, airlines and retailers, who are asking themselves which are the unprofitable and profitable customers on whom they should

be refocusing their attention, marketing, logistics management and capital investments? Under CPA, a typical unprofitable customer tends to:

- buy small order quantities
- order special/non standard products
- order the low margin products
- demand heavy discounting and haggle over price
- have unpredictable demands which adversely impact production scheduling
- change delivery arrangements
- demand high technical & sales support
- pay very slowly, if at all.

By contrast, a typical profitable customer tends to:

- buy large order quantities
- order standard products
- order the high margin products
- be price inelastic – no haggling over price
- provide predictable demand to manufacturer
- retain existing delivery arrangements
- demand low technical and sales support
- pay on time

In addition, the demands of an unprofitable customer, are those of:

- extra discounts or commissions, especially for volumes
- additional marketing, promotions and sales support
- extra display stands or floor space or fees for such
- special packaging or documentation, generic brands
- special inventory and delivery arrangements
- electronic trading, efficient customer response (ECR) less, more often,
- special credit and payment terms, eg 90 days credit
- additional technical support and customer field service

And generally, these customers are not prepared to pay for these services and want a one way relationship – all their way!

Businesses employing the CPA approach are asking the following questions:

- which of our customers are unprofitable and which are profitable?
- which are the **most** profitable customers and do we focus on them exclusively?
- do we concentrate on only profitable customers and eliminate or manage out unprofitable customers?
- do particular market segments meet our profitability criteria? Have they ever? Can they ever? If so, how and when?
- on which type of customers should we focus new business effort?
- do large customers really make money for us?
- do small customers really make money for us?

The CPA approach provides that after trying to turn a customer around, it becomes obvious that that customer will always be unprofitable, then a business is better off without that customer. In this regard, CPA could equally stand for Creating Profitable Associations with profitable customers for every business. By adopting this new business approach, Australian businesses may better understand their most valuable and least valuable customers, and learn to manage their relationships with them.

*by John Petty, Pitcher Partners*