



# CUSTOMER PROFITABILITY ASSESSMENT

---

PROFILED COMPANY



**FY2004 Annual Revenue:** US\$1 Billion–US\$5 Billion

**Industry:** Health Care Products

**Headquarters:** North America

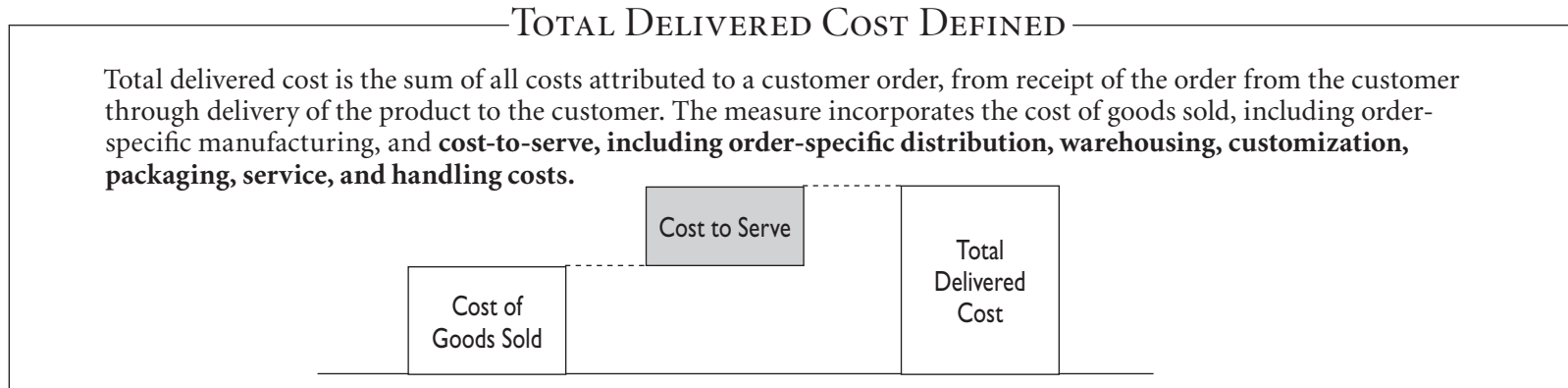
## ECONOMICS LOST

After supplier negotiations, internal business partners managing supplier relationships can easily lose sight of contract agreements as they react to undeniably unpredictable day-to-day needs. Many times these “one-off” requests can aggregate into operating norms that permanently alter contract economics. In the past, suppliers, knowing something was amiss, were reluctant to bring such challenges to their customers because claims of rising costs were difficult to substantiate. However, thanks to development of increasingly capable information systems, such as ERP and business analytics, suppliers now have greater visibility into the actual costs associated with executing against customer requirements. A critical and previously overlooked component of total delivered cost (the sum of all costs attributed to a customer order) is cost-to-serve, including elements such as order-specific distribution, customization, and nonstandard packaging costs.

Suppliers who understand cost-to-serve can furnish sales teams with this data, leading to economically principled decisions based on true customer profitability, rather than reliance on volume and revenue considerations alone that may mask profit-eroding customer behavior. As a result, sales reps can avoid unprofitable concessions and refuse to close money-losing deals. While the immediate implication for customers is a loss of relationship leverage, Procurement organizations easily use this information to its advantage by proactively identifying internal business partner behaviors that undermine the negotiated contracts. By taking this preventative step, Procurement nullifies supplier excuses for denying scarce resources to internal business partners due to poor relationship behavior.

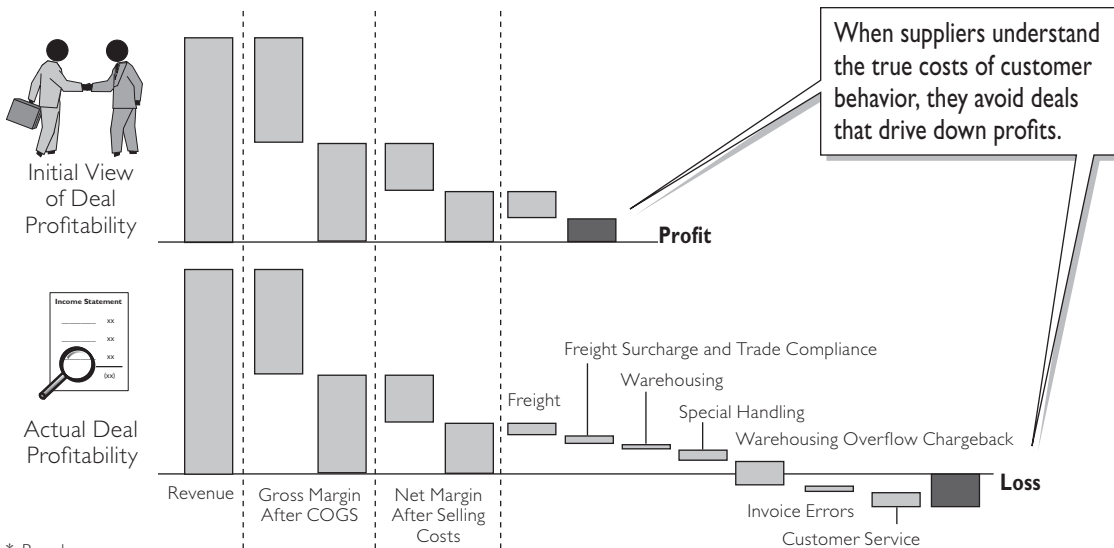
# HIDDEN COSTS

**Total Delivered Cost is defined as the true out-of-pocket expense required to fulfill the customer order...**



**...which can devastate deal economics**

Order Profitability  
Adapted from Wight International\*



**DO SWEAT THE SMALL STUFF**

“Tiny, seemingly innocent changes to a contract can have devastating economic consequences. If we fail to adjust our data-tracking systems and negotiation parameters we run the risk of eroding deal profitability from within.”

Vice President, Sales Operations  
Consumer Goods Company

\* Pseudonym.

Source: Sales Executive Council research; Supply Chain Executive Board research; Procurement Strategy Council research.

# CUSTOMER PROFITABILITY ASSESSMENT TOOL

The customer profitability assessment tool is the foundation for Beta's\* cost-to-serve conversations with prospective key accounts. The tool enables the sales and supply chain functions to be on the same page when going into a meeting with a new customer, identifying the main cost drivers of the relationship, and recommending the necessary actions to improve account profitability.

The graphic on the facing page is a representation of Beta's customer profitability assessment tool. The company's supply chain group identified 17 critical drivers of cost-to-serve and listed these down the first column on the left-hand side of the tool. As described in the first callout box at the top left of the page, this list of 17 critical cost drivers enables Sales to better educate customers about the full picture of the behaviors that impact cost-to-serve. Additionally, the list provides a valuable education for sales representatives, as they previously did not have a strong grasp of the total costs involved in serving customers.

At the bottom of the page, the last three rows of the tool track overall information about Beta's service relationship with its customers. As highlighted in callout box number two, Sales uses this information to track its contributions to the bottom line.

Finally, as shown in the third call out box on the right-hand side of the facing page, the sales representative and supply chain manager use the tool to run various scenarios to illustrate potential order and service combinations and their resulting savings impact for Beta.

## Practical Application of Cost-to-Serve Analysis for Procurement

Procurement organizations can use the scorecard shown below to pinpoint internal business partner behavior that adversely affects the economics of supplier relationships.

By working with individual functions to assess the costs and opportunities for improvement, Procurement can encourage internal business partners to consider the supplier-facing consequences of their actions. Tabulating and reporting back business partner results periodically ensures that key supplier interests will remain top of mind for offenders.

Communicating improvements back to suppliers increases relationship goodwill and the likelihood of securing customer of choice benefits from the supplier.

\* Pseudonym.

# HELPING US HELP YOU

## Assessment Tool Illustrates Necessary Cost and Customer Service Trade-Offs to Drive Profitability

### Customer Profitability Assessment Tool<sup>2</sup>

**1** Sales uses information from the assessment to educate customers about standard cost drivers, such as order size and rush-delivery requirements, and less-visible cost drivers, including price protection.

**2** Sales uses the bottom section to track its contributions to profitable company growth and the bottom line.

**3** Supply Chain calculates potential savings from different combinations of customer order and service alternatives. This permits economically rational prioritization and trade-offs of order-pattern improvements.

Customer 14

Parameter	Today	Beta Desired	Savings to Target (\$)	Savings to Target (% Gross Sales)	Comments
Order Management		Weekly			
Percentage of Orders with EDI		95%			
Percentage of Orders Fewer Than \$3,000		0%			
Percentage of Orders Fewer Than 500 Pounds		0%			
Percentage of Deliveries by Parcel		0%			
Forecast Accuracy Percentage		80%			
Inventory Management		VMI			
Pallet Configuration		Standard			
Marketing and Labeling		Standard			
Delivery (carrier/notification/terms, etc.)		Standard			
Number of Shipping Locations (stock items)		3			
Lead-Time Excursions (number of rush orders)		0			
Percentage of Rush Order Freight Paid by Customer		100%			
Fines Paid U.S. Dollars		0			
Price Protection Claims U.S. Dollars		0			
Stock Balance Percentage to Sales		0%			
Returns Percentage to Sales (not including quality defects)		0%			
<b>Total Potential Savings</b>					
Freight/Warehouse Cost as Percentage of Sales		3%			
Gross Margin Improvement		20%			
Percentage of Orders on Time, in Full (Perfect Order)		90%			

#### Collaborative-Customer Activities

- Conducting data-driven service trade-off assessment
- Identifying ongoing opportunities for profitability improvement

<sup>1</sup> Pseudonym.

<sup>2</sup> Data are for illustrative purposes only and do not reflect actual operations at Beta Company.

Source: Beta Company; Sales Executive Council research; Supply Chain Executive Board research; Procurement Strategy Council research.

## CUSTOMER FOCUS

Beta's\* customer profitability assessment process has enabled both the sales and supply chain functions to be more effective in serving customers.

As highlighted on the left-hand side of the facing page, Beta was able to reduce its days inventory on hand in Operating Unit A from 71 to 53, just more than 25%, between 2003 and 2004. The company credits a significant portion of these results to the introduction of the customer assessment tool, through which Beta was able to involve its key customers, and achieve efficiencies that it would never have generated through internal efforts alone.

By proactively heading off some unprofitable customer behaviors and working collaboratively with key accounts to improve the way they do business together, Beta is able to migrate its entire customer portfolio to a more attractive mix, as shown on the right-hand side of the facing page.

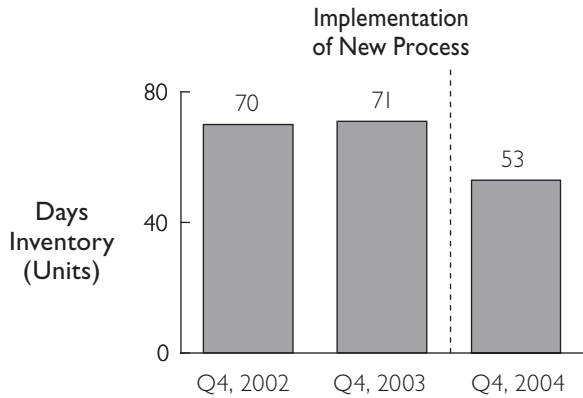
The customer profitability assessment process has achieved gains inside the company as well. The quote on the bottom of the facing page comes from the head of supply chain regarding the process's benefits in improving relationships with Sales and better enabling the function to meet its goals.

\* Pseudonym.

# PROFITABLE OUTCOMES

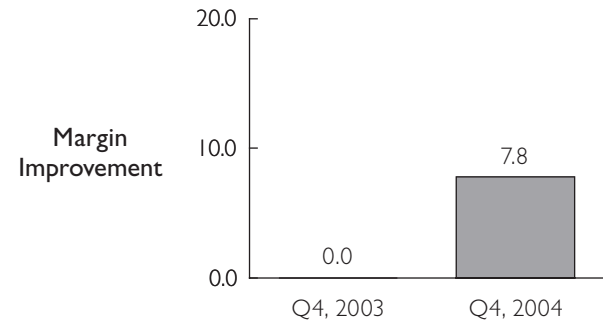
**Supplier reduces inventory...**

Days Inventory on Hand  
Beta Company Operating Unit A, 2002–2004



**...and increases account profitability...**

Account Margin Improvement  
Beta Company Operating Unit A, 2003–2004; Index = 2003



**...while helping achieve corporate goals**

— A FRIEND INDEED —

“With greater corporate emphasis placed on improving margins, Sales has been mandated to focus on customer profitability. They really welcome the simplicity of this tool, as it enhances navigation of supply chain factors that can complicate achievement of margin improvement objectives.”

Supply Chain Operations Director  
Beta Company

\* Pseudonym.

Source: Beta Company; Sales Executive Council research; Supply Chain Executive Board research; Procurement Strategy Council research.