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PATHWAYS TO PROFIT

Steps to improving profitability: No 'bad' customers

Costs less to keep customers than to gain new ones

BY LEAH THISS

In last month's column, I shared how important it is to ask the "why?" questions when measuring profitability. Understanding what factors contribute to or reduce profits and why they do is the key to knowing what actions are needed to improve profitability.

Many companies find that a close review of "who" they are selling to and individual customer behavior is worth the time and effort for the insight it can provide.

The goal of this exercise is not to identify bad customers, because there is no such thing. All customers are valuable assets. Research has found that it costs companies between six to 10 times more to acquire a new customer than to keep an existing one.

In my opinion, there really are only two types of customers: those who are profitable and those who have the potential to be.

Your first instinct may be to look at the revenue generated from each customer and subtract the cost of goods sold to calculate your customer's profitability. However, in order to measure true profitability, you need to understand the total cost of the relationship.

This means understanding the touch points — mail, telephone, Internet, direct sales, retail store, etc. — that a customer uses to interact with your company, how often contact is made and the cost of those interactions. This will require assigning a cost to these interactions and developing a system to capture them as they occur.

Interactions can include answering questions and providing pricing before a sale, the actual sales transaction, after-sale support, etc. You will find that the highest-revenue customers are not always the most profitable. Customers who require a great deal of help, make a habit of questioning their invoices and are slow to pay are what we like to call "high maintenance" and can be a drain on profitability.

Once you have calculated the profitability on each of your customers, you can segment them into meaningful groups. Each segment will require a different strategy to retain, grow or change the existing customer relationship.

There are four possible segments between revenue and the cost of doing business with the customer:

➤ High revenue, high margin — These are your ideal customers. Develop strategies to retain these customers and make it a priority.

➤ Low revenue, high margin — These customers have the most potential. Develop strategies to keep and grow their business. How can you compel them to buy more?

➤ High revenue, low margin — Look at what factors are affecting the margins. Is it the cost of interactions — can you change their behavior? Is it the cost of goods sold — can you find ways to reduce costs?

➤ Low revenue, low margin — Start by revising your pricing structure to this segment. This may not always mean raising prices. It might require bundling products and services, which can result in higher revenues (increase transaction value) and margins (same resources required to sell and support one product versus a suite of products).

Your accounting professional can ensure that accurate and detailed financial statements and reports provide the information you need to track profitability now and over time, customer by customer, segment by segment, product by product, etc. to answer the why questions.

One final point, when asking who and why, be sure to look inward as well. There are two sides to the relationship — you and the customer.

How your company interacts with customers is as important as how they interact with you. How effective your customer service people and processes are will significantly factor into how well and how profitably you manage those relationships.

Make a strong commitment to customer service. Consistently delivering a good customer experience is what will enable you to retain your customers. Efficiently handling customer issues will reduce the cost of interactions and positively impact profitability.

These positive customer experiences will be shared and lead to acquiring more customers. That all adds up to more profits.

MORE CUSTOMERS = MORE PROFITS

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Leah Thiss is the CEO and president of BBBS Inc., an outsourced accounting and bookkeeping services company with offices in Yuma and San Diego. She can be reached at leaht@bbbsinc.com or 329-8000 or by visiting www.bbbsinc.com.