CUSTOMER AND PRODUCT PROFITABILITY ANALYSIS – A MUST!!

by Louis J. Biscotti

All too often, food and beverage companies do not analyze customer and product profitability. It is one of the most important items we address with our clients.

The first step in analyzing customer profitability is to sort your annual sales by customer in descending order. You will notice that the top 20% of customers generate 80% of your sales. Therefore, 80% of your customers only account for 20% of your sales. This means that there are 4 times as many customers in this lower-value group that consume much of your time and resources. By applying a cost factor to the sales of each customer, you can derive gross profit by customer. For an even more sophisticated analysis, you can apply only your variable costs to the sales. Variable costs include not only direct product costs, but distribution and direct sales expenses and exclude all fixed costs, such as rent. By using only variable costs, you arrive at a contribution margin rather than a gross profit, which is more granular and revealing. You also need to allocate all of your promotional expenses, discounts, allowances, rebates and returns to the sales. Once you’ve done this analysis, you should have a good idea which customers are generating the most profit for your company and why.

The best of the best should receive your best service, best pricing and most nurturing. You should be spending your time developing more sales with these customers and enhance your relationship. If there are any customers with a negative margin, immediate steps must be taken to eliminate the negative amount because you are losing money on each and every sale. You could decrease deliveries or have minimum order quantities, increase pricing or send the customer to your competitor. Your sales force should be given the information on the low margin customers and either develop a plan for how to increase the margin or be directed to not sell to them anymore.

This process should be performed each year in conjunction with a customer rating. You should rate customers not only on profitability, but on your ability to utilize that customer in marketing campaigns (prestige), referrals obtained from that customer, how quickly they pay their bills, and how easy they are to deal with.

Reducing the number of low or negative margin customers and nurturing your best customers will provide enormous results in the form of better margins, less work for you and more quality.

Product profitability also needs to be considered. Companies are enamored with rolling out new products and satisfying customer demand, however not all products contribute equally. To analyze product profitability, start by sorting your annual sales by product in descending order. Again, you will notice that the top 20% of your products generate 80% of your sales – in a company with 1,000 sku’s, 800 sku’s only generate 20% of sales. Now correlate the costs of ordering,
warehousing, developing, and promoting these products and the impact can again be enormous. Apply the same cost factors discussed above to arrive at margins by product and better refine your analysis. Look at your top products and determine if the gross profit is sufficient for each. Develop a plan to increase margins for each of these top products. Use criteria and analysis as discussed above and sell the best products to the best customers.

For the lower 80% of products, consider the margins, why they exist and, unless they are enhancing relationships with your major customers or are emerging brands, seriously think about eliminating or, at the very least, decrease the quantities of or increase the pricing on these products.

By performing these analyses and taking appropriate actions to rectify and improve margins, profitability will be increased dramatically. It’s a relatively simple process that will produce extraordinary results.

Louis is a Partner in our Long Island Practice. He can be reached at 516.282.7201 or at Louis.Biscotti@WeiserMazars.com.

"Reducing the number of low or negative margin customers and nurturing your best customers will provide enormous results in the form of better margins, less work for you and more quality.\"