

## ARTICLE REPRINT

### Fire Your Best Customers?

What would you do if the sales consultant you hired to help increase your company's profitability told you to fire some of your best customers? You would listen, if your sales consultant was our customer profitability expert, Jim Lambert.

Jim reminded me about recent studies that indicate that at least 15% of a company's customers actually cause out-of-pocket losses to the seller. It is no small wonder that more executives don't focus on the profitability of their customers, especially in this tough economic environment.

For some companies, like distribution enterprises where margins can be razor-thin, regularly assessing customer profitability is a metric that usually spells the difference between sustained profits and a trip to bankruptcy court.

Unfortunately, traditional approaches to assessing customer profitability often do more to confuse and generate arguments among stakeholders than to provide a meaningful picture of a customer's profitability.

A traditional accounting approach like activity-based-costing (ABC), for example, assigns a percentage of all overhead costs to every transaction. For the sales organization, this creates at least three problems: 1) the sales organization is charged with costs they have no control over; 2) unnecessary complexity actually hinders the attempt to understand a customer's profitability; 3) disagreements over the appropriate allocation of costs diverts management's attention from meaningful analysis.

In many cases, the profitability of high revenue customers is overstated and the profitability of lower revenue customers is understated. This leads senior managers, sales managers and salespeople to erroneously conclude that their higher revenue customers are their "best" customers.

Accurately determining customer profitability requires a more sound methodology and a disciplined approach. Adopting a methodology Jim Lambert calls Responsibility Accounting (RA) can paint a clearer picture of customer profitability. The RA approach holds salespeople and their managers accountable only for the costs associated with specific account revenue streams that are within their control.

With the R.A. methodology, direct costs such as salaries, order processing, packaging, invoicing, returns and allowances, costs of sales calls, servicing costs and order-to-cash-cycle are assigned to individual customer revenue. Because some customers may have

excessive costs in some of these categories, it is often surprising for managers to learn that their companies are losing money by selling to some of their “best” customers.

We are convinced that Responsibility Accounting is a more accurate methodology for determining true customer profitability than the more standard, traditional accounting approaches like activity-based-costing. Managers may find that R.A. helps to identify those among their “best” customers who are the least profitable, and helps them avoid focusing on expanding business with the wrong customers.

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About the author: Steve Chriest is the founder of Selling Up™ ([www.selling-up.com](http://www.selling-up.com)), a sales consulting firm specializing in sales revenue improvement for organizations of all types and sizes in a variety of industries. He is also the author of *Selling The E-Suite*, *The Proven System For Reaching and Selling Senior Executives* and *Profits and Cash – The Game of Business*. You can reach Steve at [schriest@selling-up.com](mailto:schriest@selling-up.com).