

## ARTICLE REPRINT

### The Unprofitable Crisis

If you knew that between fifteen and forty percent of your customers took cash out of your pocket, would you continue selling to them? It's no small wonder that more senior executives don't pay closer attention to targeting profitable customers and eliminating the unprofitable ones.

Several studies conducted by the Harvard Business School and top-flight consulting firms prove that nearly all companies have customers that cost them cash out-of-pocket. In fact, it is clear that oftentimes 15% to 20% of a company's customers subsidize its unprofitable customers and contribute most of the company's net profit. So, why is this allowed to happen?

As senior managers respond to pressures to increase profitability and market share, they often view increased sales as the most efficient way to improve the bottom line and expand their share of markets. Unfortunately, this strategy often backfires, resulting in declining profits.

Why does profitability often decline as sales revenue increases? Blame it on the tactics employed to increase sales volume. To increase sales, many senior executives authorize special buying programs, prizes, rebates or quantity purchase discounts designed to expand appeal to a wide variety of customers. The problem occurs when the wrong customers, the unprofitable ones, take advantage of the special offers.

The wrong customers are generally unprofitable because they only buy when prices have been reduced, and they usually demand high-cost, extraordinary services that drain company resources. Worse, these customers are often higher credit risks.

Another side effect of the tactics employed to increase sales volume is the propensity of competitors to match price cuts, prizes, rebates and purchase discounts. This usually leaves competitors selling the same overall number of products and services to the market, but at lower prices and reduced profitability.

As margins decrease because of lower prices and increasing costs, companies are forced to sell aggressively to increase sales volume just to earn the same profit they earned before prices were reduced. This vicious cycle, once set into motion, disappoints investors, stockholders, company employees and the senior executives who sponsored the sales growth strategy.

Until recently, a lack of technology and the absence of proper analytical methodology made it extremely difficult to measure and understand the profitability of individual customers. Financial information designed for external users like banks and investors was little or no help in analyzing the true profitability of customers.

Today, fortunately, computing power and accounting procedures make it possible for senior managers to determine the relative profitability of products, product groups, and individual customers. Further, it is possible to measure customer profitability on a real-time basis.

As astute managers become aware of the processes and tools available to measure customer profitability, and the potential impact these can have on the bottom line, they will use these processes and tools to their competitive advantage and will stop selling to customers that continue to take cash out of their pockets. There will be little or no excuse for selling to unprofitable customers.

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About the authors: Steve Chriest is the founder of Selling Up™ ([www.selling-up.com](http://www.selling-up.com)), a sales consulting firm specializing in sales 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).