

PROFITABILITY

Focus on top clients

Increase your profitability by understanding that not all customers are created equal. By Steven Delpont



Do you treat all customers the same or do you treat them differently? Do you know which clients generate substantial sales and more importantly, which customers generate substantial profits and cash flow?

In order to determine the relative importance of your customers, rank each customer in terms of the following criteria:

- 1) Sales
- 2) Profitability
- 3) Payment history.

1 Sales
How much and how regularly does the customer spend money with you? Is sales revenue stable, increasing or declining? What is the sales revenue per month over 12 months or more? To calculate sales revenue, first identify the products sold and then the number of units of a product sold x selling price per unit. Then deduct any discounts granted.

2 Profitability
Look at profitability by product purchased and then adjust or reduce for discounts, delivery and returns. When we talk about client profitability we are referring to gross profit. Gross profit is equal to sales less the cost of buying or manufacturing stock.

The calculation of the cost of sales for a wholesale or retail business is very different to that of a manufacturing business.

Wholesale or retail business

In the case of a wholesale or retail business, the actual cost of a product is the purchase price less any discounts received plus all costs incurred in getting the product to your warehouse or store (transport, insurance, import duty, equipment hired or purchased to unload, the cost of labour used to unload stock etc).

Manufacturing business

In the case of a manufacturing business, the calculation of the cost of sales is much more

complex as one has to take into account direct material, direct labour and other manufacturing overheads.

- » Direct material forms part of the final manufactured product, eg. wood used in a table, and the quantity used varies with production volumes (you use twice as much wood for two tables as you would for one).
- » Direct labour is the labour physically applied to manufacturing the product.
- » Manufacturing overheads include all manufacturing costs except direct material and labour.
 - Indirect material does not form part of the final manufactured product eg cleaning materials or materials whose cost is so small that it's not worth calculating eg cotton for sewing a suit
 - Indirect labour cannot be directly linked to the final product eg the factory supervisor or people who maintain and service the machinery
 - Factory rental
 - Rates and taxes
 - Water
 - Electricity
 - Insurance of the factory and stock
 - Leasing of machinery and equipment
 - Depreciation of machinery and equipment.

3 Payment history
How do the credit payment terms compare to other customers? Look at the frequency and ease with which you are paid for your products and services. If you are paid late and have to follow up frequently, this adds to your costs and should be used to adjust the customer profitability. The key question here is: Are the credit terms reasonable for that customer and are you paid on time in terms of the agreed credit terms? You have already identified your

key customers who generate the majority of your sales and profits. How many of these are your late or bad payers?

From your categorisation you now have customers that roughly fall into the following categories:

- » Premium
- » Intermediate
- » Marginal.

Is there over-reliance on any of your premium customers? Would the livelihood of your business be threatened if one of these customers closed down or moved their business elsewhere? If the answer is "Yes," then you firstly need to ensure that these customers are exceptionally well looked after and secondly that you actively identify and target potential new premium customers so that your reliance on your current key customers is reduced.

Now assess those customers in the intermediate and marginal categories with a view to determining their potential future revenue and profit potential for your business. Do they buy exclusively from you or occasionally from you? Are their businesses well managed?

How many of the intermediate and especially marginal customers have substantial future revenue potential?

You should now have the following clients:

1. **Premium** - in terms of existing revenue spend
2. **Intermediate** - with good

opportunity for future revenue and profit growth

3. **Intermediate** - with little opportunity of future sales and profit growth
4. **Marginal** - with good opportunity for future growth
5. **Marginal** - with little opportunity for future growth.

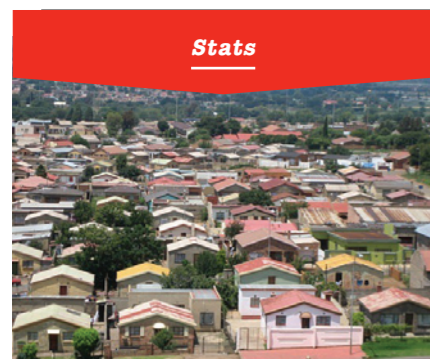
In categories 1, 2 and 4 you need to ensure that the relationship and service levels are maintained or improved still further. You should develop the relationship at multiple levels with the customer.

In category 3 the relationship and service levels should be maintained or possibly reduced.

In category 5 you need to exit or improve profitability. Since sales volumes cannot be increased, then the way to increase profitability is to:

1. Increase prices and/or reduce discounts
2. Reassess the credit terms
3. Strictly enforce payment terms
4. Do not accept returns
5. Establish a minimum value for goods to be delivered or charge for delivery
6. Reduce the number of client calls made or limit customer contact to phone calls. □

 **STEVEN DELPONT** is a business improvement specialist focusing on boosting profitability and cash flow through a collaborative approach, integrating strategy, operations and finance. Visit www.integerconsultingsolutions.com



Stats

A study conducted in 2008 showed that the spending power of Soweto township stood at

R12 billion

and only **24%** of this was circulating in the township.

Source: Township Enterprise Hubs

WE SAY While this figure may have improved since 2008, townships are an excellent business opportunity for entrepreneurs able to spot the gaps in the market, and offer consumers what they want.



Valued employees

"I don't pay good wages because I have a lot of money; I have a lot of money because I pay good wages."

ROBERT BOSCH



FEDH/24507/ENT The Cheese Has Moved

Let's be REAL

If we give your staff cheaper movie tickets, you won't find them any more productive.

What we'd rather give them is medical aid with real benefits – like treatment at a casualty ward that's paid for by us, and not just subtracted from their Savings. So if you want to pay for their entertainment, give them a bonus. If you want them healthier and more productive, give them the benefits of belonging to a **Real Medical Aid** - with a consistently high Global Credit Rating of AA- and reserves well over the required 25%, we're as stable as we are serious about health. Choose Fedhealth. Because nothing replaces real.



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