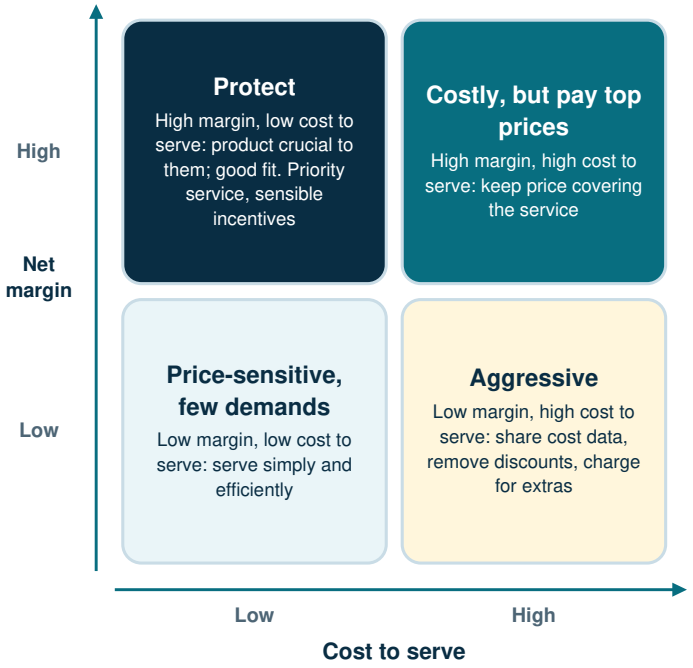
Customers 2: profit strategies

MODULE 6 | PART F.1.2 | STUDENT COMPANION

Net margin and cost to serve



Menu-based pricing

Price depends on both the product and the level of service chosen - standard delivery and support cost less; urgent, customised or high-touch service costs more.

Judge big customers on long-term costs and benefits

What makes a customer costly to serve

Cost area	High cost to serve	Low cost to serve
Pre-sales	Heavy marketing and technical support	Standard prices and specifications
Product	Customised	Standard
Stock	Supplier holds stock	Customer holds stock
Ordering	Unpredictable, small, manual	Predictable, large, online
Delivery	Urgent, customised, frequent changes	Standard, on an agreed schedule
After-sales	Installation, training, help lines, field service	Little or none
Payment	Slow	On time

Case notes: in 2004 the Wall Street Journal reported that Best Buy sorted customers into 'angels', who bought high-margin products without waiting for markdowns, and 'devils', who among other tactics bought products, claimed rebates, returned them and bought them back at a discount; Best Buy set out to attract angels and discourage devils. In mid-2007 Sprint ended service for around 1,000 customers over very frequent customer-care calls, waiving termination fees; critics said the calls reflected Sprint's own service problems. Find the root cause before blaming the customer.

When to keep an unprofitable customer

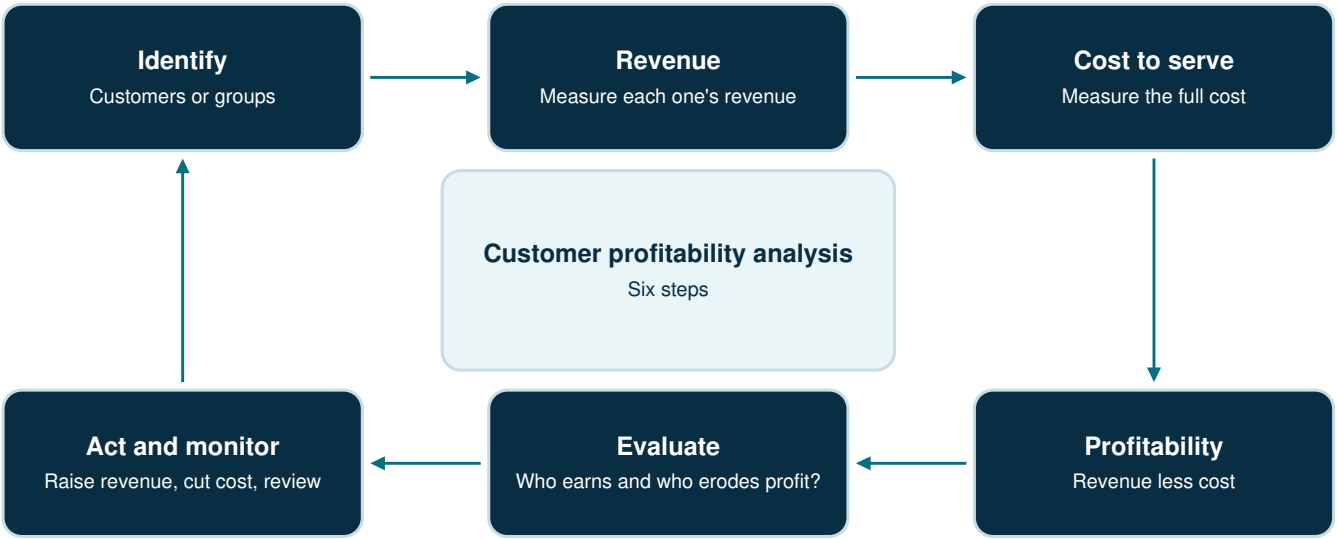
New and growing
May become profitable, or open lucrative markets

Qualitative benefits
Leading-edge technology or marketing know-how

Reputation
Credible names that help win profitable business

Kaplan's three reasons to keep some unprofitable customers

Customer profitability analysis in six steps



Benefits and limitations

Benefits	Limitations
Identifies unprofitable customers, not just products	Common costs such as advertising are split arbitrarily
Shows when poor service activities cause losses	Unallocated committed costs (a sales manager's salary) still need recovering
Directs attention to improvement options	Needs good activity data and judgement
Strengthens customer relationship management	Short-term losses may hide long-term value

Sources: Wall Street Journal (8 November 2004) as summarised by Columbia Business School and others; NPR and ABC News (July 2007).

Formulas and rules

Item	Rule
Ideal customer	High net margin, low cost to serve - protect, but watch incentive costs
Aggressive customer	Low margin, high cost - share cost data, remove discounts, charge for special services
Menu-based pricing	Price varies with product and service level
Retention	Converting an existing unprofitable customer can be cheaper than finding new profitable ones

Question 1 - Place and plan

For a wholesale florist (imagined), place each customer on the net margin and cost to serve map and recommend one action: (a) a hotel group paying list prices with standing weekly orders; (b) a wedding planner paying premium prices but demanding custom arrangements and urgent deliveries; (c) a supermarket that buys standard bunches at keen prices; (d) a large events company that negotiates deep discounts and changes orders at the last minute.

Worked answers

MODULE 6 | PART F.1.2 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Worked answer

Customer	Answer
(a) Hotel group	High margin, low cost to serve - protect with priority service and a loyalty incentive
(b) Wedding planner	High margin, high cost - keep prices covering custom work; charge for urgent delivery
(c) Supermarket	Low margin, low cost - serve efficiently with standard products and schedules
(d) Events company	Low margin, high cost - share cost data, remove discounts or add change fees, offer a service menu; consider long-term value before exiting