Customer profitability analysis

Business

A customer profitability analysis is an evaluation process that focuses on assigning costs and revenues to segments of the customer base, instead of assigning revenues and costs to the actual products, or the units or departments that compose the corporate structure of the producer. Approaching profitability from this angle can sometimes provide valuable insights into how each step of the process of designing, manufacturing, and ultimately selling a good or service incurs cost and generates revenue. Many businesses use a customer profitability analysis as a means of streamlining processes so they provide the highest degree of efficiency and return, while generating the lowest degree of cost. In actual practice, a customer profitability analysis looks at each segment of the process of creating and selling products to customers. The idea is to look closely at the costs that are associated with each of those segments, and compare those costs with the gains that result from the processes and procedures connected with the operation of that segment.

Breaking down the task into segments makes it much easier to identify what is actually working to increase profitability with a major client or a group of clients within the customer base, as well as what elements may be inhibiting the potential for earning more revenue from those same clients. Along with aiding in making sure that every aspect of the business operation is functioning in a way that allows for the generation of maximum profits, a customer profitability analysis can also help identify factors that could have a negative impact on the future of the company. For example, most customer profitability analysis templates allow for determining what percentage a given customer or group of customers actually make up of the overall client base, usually in terms of revenue generated. If the analysis makes it clear that the company is depending on two or three large customers to generate half or more of the its business volume, then steps are usually taken to diversify and expand the client base, often by attracting more small to mid-sized customers. As a result, the business is less likely to be crippled in the event that one of those major clients decides to withdraw, since the increased bank of smaller customers who are less likely to wander now accounts for a larger share of the monthly revenue.

A proper customer profitability analysis will also look closely at how much of the company's resources are dedicated to producing goods and services for specific clients. The idea is to determine if the maximum benefit is being earned from the current use of those resources, or if there is some way to allocate a portion of those resources to other functions while still satisfying the customer. Reallocating resources also makes it possible to engage in responsible cost allocation, which in turn strengthens the business over the long term.