

JUNE 2010

Growth Strategies

INSIDE:

Is all revenue good revenue?
Understanding customer and product profitability

AlixPartners
When it really matters.





Customers—both business and consumer—are spending less, and being much more selective about where they put their money. This is certainly not news, but it should motivate companies to do all they can to make the most from the products and services they do sell.

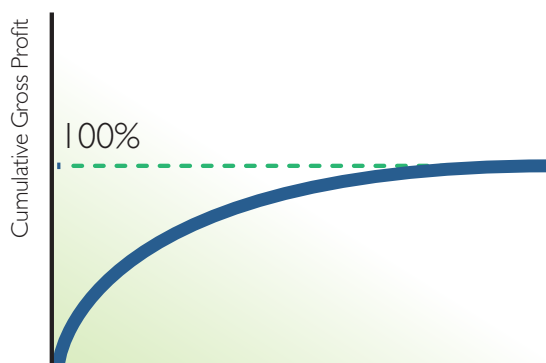
When under pressure, many companies chase volume at the expense of profit margin and, as a result, take on too much low- to no-margin business, adding valueless complexity and cost. This compounds the

effect of previously lost business that was working to cover base overhead. Loss of existing business, combined with marginally priced new business, can quickly create a profitability death spiral.

A far more effective—and profitable—approach to growth involves developing a detailed understanding of the profitability of customers, channels and products that enables management to make better-informed decisions about how products are priced, serviced, and sold.

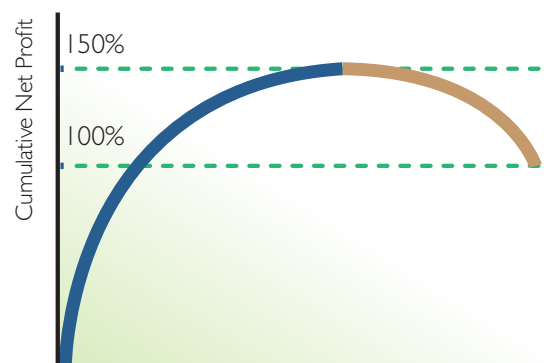
Our experience indicates that many companies are stranding 25% to 35% in additional profit that is readily recoverable through rapid re-pricing and rationalization.

TRADITIONAL PROFIT ESTIMATES OFTEN ERRANTLY INDICATE THAT MOST REVENUE IS GOOD REVENUE



Products/ Customers in Order of Gross Profitability

IN REALITY, A MINORITY OF THE PRODUCTS AND CUSTOMERS DELIVER 100%+ OF THE PROFIT



Products/ Customers in Order of Gross Profitability

Customer & Product Profitability | Growth



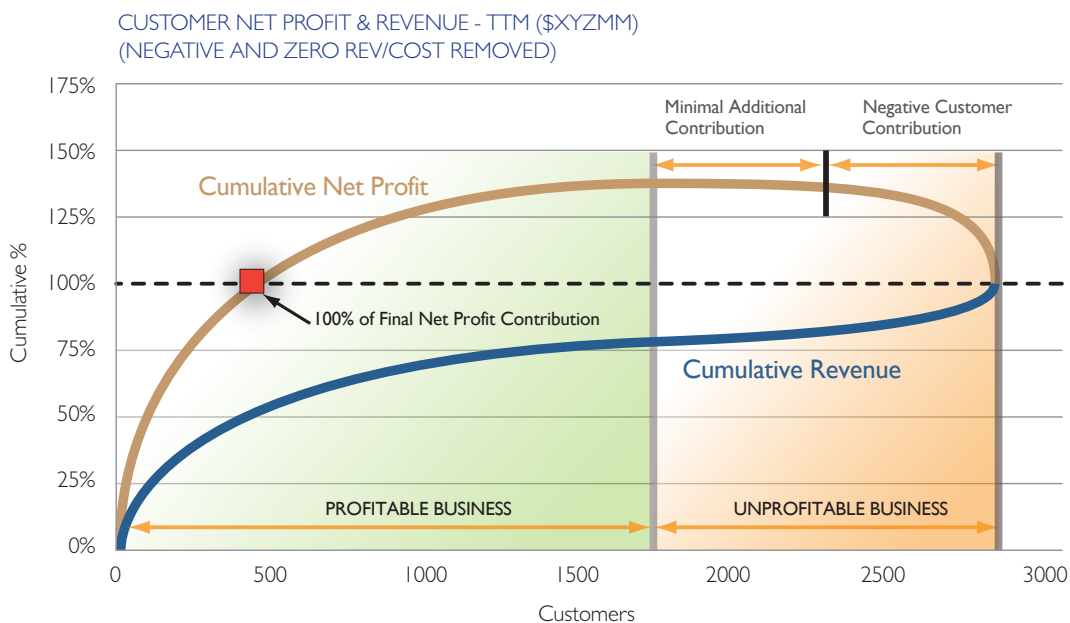
IS ALL REVENUE GOOD REVENUE?

Executives who fall into the marginal revenue trap—thinking all gross profit is good—tell themselves that there is no new cost associated with this incremental revenue. But this simply isn't true. At some point, new costs are incurred, and those costs must be recovered in pricing. But how? Should costs be attributed equally to all customers, regardless of the levels of capacity, service infrastructure, and other overhead required to complete each transaction?

Direct costs are often well understood and assigned through costing systems. But indirect costs, including all selling, general, and administrative expenses (SG&A), are usually “peanut butter spread” across all revenue rather than directly assigned to customers or products. If the resources required to serve all

customers were equal, then it might be possible to use this rough allocation to predict net profit. But, that is rarely the case. To calculate profit accurately, critical costs must be assigned using specific drivers (or indirect indicators of how a cost is incurred).

When all costs are attributed or assigned to the associated customer or product, one can build a very telling profile of a company's profit performance. Customer-product combinations can be ranked in contribution order and summed to present a comparison of profit and revenue contribution, by customer, for the company's entire portfolio. The amount of loss-making business, valueless complexity, and lost profit potential becomes clear (Figure 1).



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Customer & Product Profitability | Growth



DO YOU REALLY UNDERSTAND YOUR PROFITABILITY?

Tracking costs and profit on the activity level can be a Herculean task. It's complex, burdensome and often companies that attempt to build activity-based costing systems see those systems collapse under their own weight. Instead, an equally detailed but far less onerous analysis can be performed in a single moment of time across the organization to provide a crisp snapshot of current profitability. This enables management to properly assign costs and identify critical cost drivers such as customer segment, competitive intensity, product type, and sales channel.

Evaluating the profitability of customers, product lines, and market segments in this way provides valuable insights on cost to serve, the effect of pricing pressure, and the return on future investment in new products. Using this information, leaders can focus resources on high-value activities, including

redirecting research and development, better aligning the sales team, or enabling more intelligent pricing. If, for example, a particular group of customers is found to yield consistently lower profitability than others, changes can be made to how these customers are priced and served. This repricing and rationalization can often be executed rapidly to provide a quick and predictable change in revenue and net profit—which is certainly easier than growing market share.

Companies that make an investment in truly understanding the profitability of their customers and products will make better and more targeted decisions, resulting in significantly improved profit performance—independent of revenue—and allowing them to better focus on real growth.

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AlixPartners conducts a broad range of surveys and research in industries around the globe. To learn more about our publications, or to contact the AlixPartners professional nearest you, please visit www.alixpartners.com

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