Databender

FREE GUIDE

Know Who Actually Makes You Money

Customer Profitability for Distributors

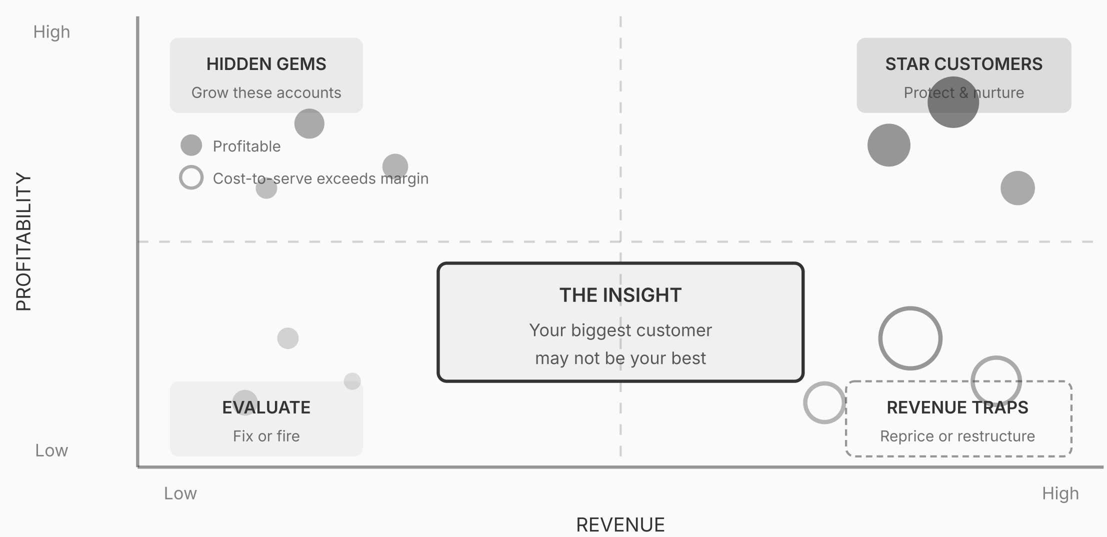
databender.co | Data & AI Consulting for Growing Businesses

20%

Hidden Loss Makers

20% of customers may actually be unprofitable when true costs are calculated.

Customer Profitability Matrix



Your biggest customer isn't necessarily your best customer.

Revenue ranks are easy. Sort by sales, and the top 10 customers are obvious. But revenue ignores the work required to serve them. The expedited shipments. The special packaging. The price exceptions. The extended payment terms. The service calls that eat your team's time.

Profit ranks tell a different story. Some high-revenue customers barely cover their cost-to-serve. Some mid-sized customers throw off exceptional margin. Without visibility into true profitability, sales teams chase volume while finance wonders why growth doesn't translate to profit.

The Cost-to-Serve Blind Spot

Gross margin is visible. Everyone knows the spread between buy price and sell price. What's invisible is everything else.

Order processing costs. A customer placing 200 small orders costs more to serve than a customer placing 20 large ones. Same annual volume. Different processing load. If you handle orders manually, the labor difference is substantial.

Delivery costs. One delivery to a customer's central warehouse costs less than five deliveries to five job sites. Free delivery above a threshold sounds generous until you calculate what it actually costs per drop.

Special handling. Custom labels. Split shipments. Same-day expedites. Blanket order management. Every special request consumes resources that don't appear on the invoice.

Returns processing. Some customers return 2% of purchases. Some return 15%. Processing returns costs money. Restocking costs money. Products returned damaged cost even more.

Payment collection. A customer who pays in 30 days is cheaper than one who pays in 90. Financing receivables costs 6-12% annually. A slow payer with 25% gross margin and 90-day terms might yield 20% actual margin after capital costs.

Service time. Technical support calls. Account management meetings. Problem resolution. Some customers require constant attention. Others are self-sufficient. The labor isn't free.

When you add cost-to-serve to gross margin, the rankings change. Often dramatically.

An Example That Hurts

A regional HVAC distributor analyzed their top 10 customers by revenue. Three of them turned out to be bottom-10 by profit contribution.

Customer A: $2.4 million in revenue. Looked great. But 52 deliveries per month to scattered job sites. Eight emergency expedites in a quarter. Returns rate of 18%. Net-90 payment terms consistently stretched to 120. When all costs were allocated, Customer A contributed $32,000 in annual profit. That's 1.3% of revenue.

Customer B: $800,000 in revenue. One delivery per week to their warehouse. Zero expedites. Returns under 3%. Net-30 terms paid on day 28. Annual profit contribution of $96,000. That's 12% of revenue.

Customer B was worth three times Customer A in actual profit on one-third the revenue. Before the analysis, the sales team treated Customer A like royalty. Customer B got standard service.

That's backwards. And every distributor has versions of this lurking in their customer base.

Calculating True Profitability

Building customer profitability requires three steps.

Step 1: Collect cost data. Start with costs you can assign directly. Delivery logs show drops per customer. Order systems show order count and lines. Returns reports show return volume. AR aging shows payment patterns. Pull what you have.

Step 2: Allocate indirect costs. Some costs don't attach to specific customers but vary with customer behavior. Warehouse labor scales with order complexity. Customer service time scales with call volume. Allocate based on drivers that make sense: orders processed, calls logged, special requests tracked.

Step 3: Calculate contribution. Revenue minus product cost minus allocated cost-to-serve equals customer contribution. Express it in dollars and as a percentage. Rank customers by both.

The precision matters less than the insight. Even rough allocations reveal which customers contribute and which consume. Don't let the perfect be the enemy of the useful.

Some distributors build this in spreadsheets. It works until the customer count exceeds manual capacity. Purpose-built analytics or BI tools scale the calculation across thousands of customers.

What the Analysis Reveals

Customer profitability analysis usually surfaces four patterns.

Profit stars. High volume, high margin, low cost-to-serve. These customers fund the business. Protect them. Don't take them for granted. Understand what keeps them loyal and make sure it continues.

Hidden gems. Mid-size customers with excellent profitability ratios. They don't appear on the revenue radar but deserve more attention. Growth here is highly accretive. They're candidates for deeper relationship investment.

Profit drains. High volume, thin margins, excessive cost-to-serve. They generate activity that looks like success but contributes little. They need restructuring: price increases, service reductions, or honest conversations about fit.

> **Question marks.** Customers whose profitability is acceptable but not stellar. They require judgment. Some are worth developing. Some are worth maintaining. Some aren't worth the effort.

The goal isn't to fire unprofitable customers, though sometimes that's the right answer. The goal is to manage each customer appropriately for what they actually contribute.

Aligning Sales Comp to Margin

Sales compensation drives behavior. If reps earn commission on revenue, they'll chase revenue. Even revenue that doesn't make money.

The classic problem: A rep closes a large deal at thin margin with extended terms. Commission gets paid. Finance winces. The rep moves on to the next deal. The company lives with the consequences.

Margin-based compensation changes the math. When commission ties to gross margin dollars instead of revenue, reps think differently about price negotiations. When additional weight goes to customers with strong profitability, reps invest time where it matters.

The transition is sensitive. Reps used to revenue-based comp will resist. The change needs to be gradual and explained clearly. Show the logic. Share the profitability data. Align incentives with what actually helps the business.

One electrical distributor shifted from revenue commission to margin commission over 18 months. Average deal margin increased 3.2 points. Total margin dollars grew even as some low-margin volume walked. The sales team complained initially, then noticed their checks were larger on smaller deals.

The Conversations That Change Behavior

Some unprofitable customers don't know they're expensive to serve. They assume their volume earns them favorable treatment. Showing them the cost changes the conversation.

"Your 40 monthly deliveries cost us $X. Your competitors receive once-weekly delivery. We'd like to discuss consolidation."

"Your return rate is three times our average. The processing cost affects the pricing we can offer. Let's identify the root cause."

"Payment terms of Net-90 require us to finance the receivable. That cost is embedded in your pricing. Net-30 would let us sharpen the numbers."

These conversations require data. Saying "you're expensive to serve" is an accusation. Showing the specific costs is a business discussion. Customers respond differently when the numbers are clear.

Some customers will consolidate deliveries. Some will improve their returns process. Some will accelerate payment for better pricing. Some will refuse to change. Knowing which is which helps you allocate resources appropriately.

A plumbing distributor had one customer requesting daily deliveries to multiple sites. Delivery cost exceeded gross margin. The account manager presented the data. The customer consolidated to three weekly deliveries and actually improved their own efficiency. The relationship strengthened because both parties benefited.

Pricing by Customer Segment

Once you understand profitability, pricing can reflect reality.

High-cost customers should pay prices that cover their cost-to-serve. If delivery is expensive, delivery charges should reflect it. If returns are high, restocking fees make sense. If payment is slow, terms should carry appropriate premiums.

Low-cost customers deserve recognition for their efficiency. Consolidated orders? Better pricing. Strong payment history? Extended terms at the same price. Low returns? No restocking concerns.

The pricing doesn't need to be explicit about cost allocation. But the structure can reflect it. Volume discounts for customers who consolidate. Early payment discounts for customers with capital. Surcharges for expedited service. The mechanics vary by market and relationship.

The point is alignment. Prices that reward profitable behavior and discourage unprofitable behavior. Customers select the behaviors that suit them. The distributor earns appropriately either way.

Building the System

Customer profitability analysis requires data infrastructure that most distributors don't have out of the box.

> **Transaction data** comes from the ERP. Revenue, product cost, and margin by customer by invoice. This is usually accessible.

> **Cost-to-serve data** is harder. Delivery logs. Order processing metrics. Service call records. Return volumes. Payment history. This data often exists in separate systems or not at all. Building the data collection is often the biggest lift.

> **Allocation logic** requires decisions. How do you allocate warehouse labor? Delivery costs? Service time? There's no single right answer. The method needs to make sense for your business and be explainable to the people affected by it.

> **Reporting and analysis** turns data into insight. Application views that show profitability by customer. Trend analysis that shows changes over time. Alerts when profitability drops below threshold. The analysis needs to be regular and actionable.

Some distributors build this in Excel. It works for analyzing the top 50 customers manually. It doesn't scale to thousands. For larger customer bases, proper BI tools or custom analytics applications are necessary.

Getting Started

You don't need perfect data to start improving profitability visibility.

Pick your top 25 customers by revenue. This is probably 60-80% of your volume. It's manageable to analyze manually.

Estimate cost-to-serve for each. Use available data. Delivery frequency from logs. Order complexity from the system. Returns from the returns log. Payment patterns from AR aging. Be approximate. Precision isn't the goal.

Calculate estimated profitability. Revenue minus product cost minus estimated cost-to-serve. Rank by contribution dollars and percentage.

Identify the surprises. Which customers look worse than expected? Which look better? The gaps between revenue rank and profitability rank are where action lives.

Have one conversation. Pick a customer whose cost-to-serve seems fixable. Discuss the data. Propose a change. See what happens.

This manual process takes maybe a week. The insights last much longer. And you'll know whether building a more systematic approach is worth the investment.

What Changes

Organizations with customer profitability visibility behave differently.

Sales focuses on profitable growth, not just growth. Time and energy go where returns are highest.

Pricing becomes strategic. Instead of across-the-board adjustments, price changes target customers and situations where margin improvement is most needed.

Service investments make sense. High-value customers get high-touch service because the math works. Low-margin customers get efficient service because the math demands it.

Hard conversations become easier. When data shows a relationship isn't working, both parties can see it. The discussion shifts from "we think you're difficult" to "here's what the numbers show."

One industrial distributor improved overall margin by 2.1 points in 18 months. They didn't raise prices across the board. They restructured specific customer relationships where cost-to-serve exceeded contribution. Some customers changed behavior. Some accepted higher prices. Some left for competitors who could serve them more efficiently. Every outcome improved the distributor's position.

> *Ready to see which customers actually make you money? Talk with our team about building customer profitability visibility for your operation, or explore our full wholesale distribution solutions.*