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All Customers Are Not Created Equal: How To Find The Most Profitable Customers

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Many marketing efforts seem devoted to the goal of increasing the number of customers for the enterprise. Primary marketing communication channels such as traditional advertising are so cluttered with persuasive messages that attracting more customers may—at least in the short run—be a losing proposition. The costs to attract a new customer will quite likely exceed the margin that the new customer generates for some period of time. Indiscriminate spending on marketing efforts designed to get more business may actually make the situation worse rather than better.

On the other hand, businesses that fail to provide a flow of new customers to replace those who defect to the competition, move out of the area, or otherwise leave the market face serious long-term problems.

What, then is the answer? The secret is using customer analysis to identify the truly profitable types of customers and then focusing marketing efforts on them. Most business managers and owners know that some customers are better than others. However, few take the time and effort to analyze customer segments. This relatively easy business tool can provide a mountain of insight into the type of customers that your organization wants to attract and retain.

The majority of people in business are familiar with the “80-20” principle. Simply put, the

principle is that 80 percent of revenue typically comes from 20 percent of the customers. The key to this principle is not in understanding it, but rather, in using it to focus your marketing efforts.

Customer margin analysis breaks out the appropriate typology of customers and then uses your financial records to determine the amount of margin that those customers contribute, both individually and as a group.

Briefly, the margin generated by a customer is estimated by the average yearly revenue sold to that customer less the costs of sales to that customer. Usually, there are a few very profitable customers, some that are marginal, and others whose business actually costs money. In fact, our group has seen some cases where the top 20 percent of the customers represented over 100 percent of the company’s revenue. The firms in question were actually losing money on the remaining 80% of their customer base. Knowing this and finding ways to improve the situation—including firing some wildly unprofitable customers—can produce dramatic increases in profitability, without an increase in marketing expenditures.

After performing a margin analysis, you can segment your current customers into three groups: All-stars, potential all-stars, and customers who will most likely never be very profitable for your company.

It is at this point in the analysis when decisions become difficult. By examining your best customers, you can identify who your next group of all-stars might be. Often, with the right approach, there are other customers in your database who you could potentially move into the profitable realm occupied by your top customers. In fact, we often find that the most profitable marketing efforts focus on a tightly defined and relatively small target—customers that are

potential all stars. Often the best marketing advice you can give a company is to determine how they attracted their top customers and repeat the process.

As for those customers who are costing you money, there are two potential remedies. Find a way to make them profitable, or find a way to fire them as customers. Often, there are other suppliers of what you sell who are better set up to serve these customers. Sometimes they'll even refer customers that match your all-star type to your company in exchange. If you're worried about the impact of ignoring or driving away customers on your business, consider this: not only are these customers costing you money, they are tying up resources that could be used to attract and service current and future all-star customers.

The rewards for effectively performing customer margin analysis are high. Knowing which customers are profitable, and—maybe more importantly—which ones are not, creates a more efficient and profitable marketing focus.



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