

# The bottom line: Analyzing your customers and products to drive profitability



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**P**roduct and customer profitability analysis is frequently cited as a tool that can help a company enhance its profits by identifying and correcting specific areas for improvement. Interestingly, in many companies, profitability analysis is viewed exclusively as a customer relationship management tool discussed within the sales function. However, companies that employ a more holistic approach to their product and customer profitability analysis by seeking the input of various departments, such as accounting, often produce the most effective bottom line results.

By involving the accounting department in your process to analyze product and customer profitability, your organization can recognize several key benefits:

## **Better use of your financial reporting system's data**

Product and customer profitability analysis requires dis-aggregation of key financial information. In most instances, the financial reporting system provides an opportunity to identify revenues and the cost of materials by stock-keeping unit (SKU) or customer identification number. The dis-aggregation and analysis of the raw data will provide an initial assessment of the gross profit by product line or customer without allocating certain direct and indirect

costs. The continuation of the analysis on a specific identification method is often difficult as a result of numerous costs that add to the investment in the specific product. The application of a standard overhead allocation rate to a specific product is often cost beneficial.

## **A more thoughtful growth strategy**

Creating a growth strategy is an essential element of the business process. The level of risk that a company is willing to bear should be a key component in determining its strategy because the challenges can vary widely depending on the targeted sources of growth, such as market penetration or new product development. The least risky growth strategy for any business is to simply sell more of its current product to existing customers. By contrast, product development for existing and new customers is often deemed risky because success is almost

entirely dependent upon the product actually being produced and marketable. Plus, the investment in product development is often significant. However, new product development can provide the ability to tap new markets or increase share of wallet among existing customers. There may also be opportunities for research and development tax credits, which can be significant. Conducting a profitability analysis helps an organization size up the pros and cons of each option to determine which strategy makes the most sense for the business.

## **Enhanced internal synergies**

As companies cut operating costs and reduced overhead over the last several years, many integrated departments and operating philosophies. As a result, they experienced enhanced relationships among cross-functional disciplines, mitigating the risks associated with various departments

working toward, at times, opposing goals. Taking a more holistic approach to profitability analysis builds on these synergies. For example, it was not unusual in the past for the sales department to try to keep customers satisfied by committing that the company's products would always be in stock. However, this approach could be at odds with the accounting department's discipline to keep inventory as lean as possible to maximize cash-flow requirements. By working together, departments can better understand how to meet their individual objectives (satisfied customers, better cash flow) while continuing to work toward the company's overall profitability goals.

Companies that utilize a more holistic approach in performing a product and customer profitability analysis are better equipped to answer those critical "why" questions that can help drive toward a better bottom line. Why has our gross profit changed in a period? Why are we selling more but making less? Why are we in a specific product line? Why can we not afford to offer discounts to a specific customer? If you aren't currently able to answer these types of questions, now is the time to utilize a more holistic approach and involve your accounting department in analyzing the data that is available in your financial reporting package. **LE**

