Spotlight

Improving return on sales by better managing small customers

Ingo Aghte and Georg Winkler

Many chemical companies wrestle with a large and complex portfolio of small customers that generates disappointing margins. Poor performance is often driven by two factors: service levels mismatched to the profitability of the customer and failure to leverage the full potential of distributors. But both of these factors can be directly attacked—and doing so drives substantial profitability improvement. Companies that have addressed these two areas have improved their overall return-on-sales performance by 5 to 15 percent within just 12 months.

Differentiated service levels:
Matching service to account profitability

Many chemical companies provide a large number of small, low-margin accounts with the same customized order management, technical support, logistics, and special product grades that they offer to larger, more profitable customers. This often creates a situation where 70 to 80 percent of the customer base generates only 10 percent of the gross margin, while damaging return-on-sales performance by swallowing 30 to 40 percent of total sales, general, and administrative (SG&A) costs (Exhibit 1).

One way to fix this problem is to segment customers based on their profitability after accounting for cost to serve and then modify the service levels provided for each segment. The highest-value customers should be given a broad line-up of options for delivery flexibility and packaging, field technical service, laboratory support, customized grades, and field sales staff; low-value customers receive these service elements only if they pay separately for them. Often, this exercise leads to moving the lowest-value customers to

Exhibit 1

Having many small customers can create complexity and often dilutes profits.

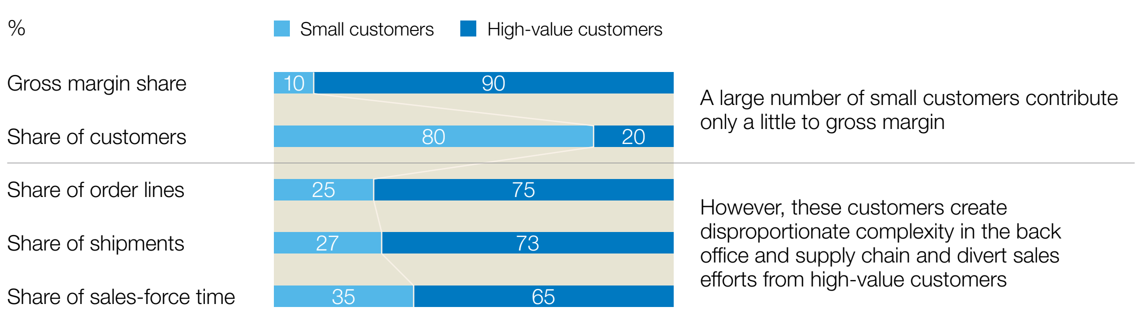


Exhibit 2

Differentiated service levels and a new approach to distributor management can raise profitability significantly.

Impact on return on sales, percentage points

Lever	Complexity-reduction model: Differentiate service levels for small accounts	Complexity-reduction model: Manage distributor as key account	Comments
Margin improvement	1.8	1.0	• Give lower discounts to distributors and impose higher prices in phone-sales channel
Sales (frontline and back-office)	0.5	0.2	• Reduce costs by scaling back frontline and back-office sales functions
Technical application	0.6	0.2	• Reduce technical services for lower-tier segments
Outbound freight	0	0.2	• Bundle shipments to distributors • Increase single-location and full-truckload deliveries
Warehousing	0	0.1	• Distributors cover most warehousing cost • Reduce order lines
Other	0	0.1	• Realize other benefits of distributor consolidation, eg, reduce payment terms
Total[1]	**2.8**	**1.7**	• Typical impact from complexity reduction

[1] Figures do not sum due to the effects of rounding.

distributors, which are better equipped to handle these customers' needs—providing smaller quantities, shorter lead times, and complementary products. One company that undertook a segmentation found that 45 percent of its customers—which contributed less than 10 percent of sales but nearly 20 percent of SG&A—would be better served by distributors.

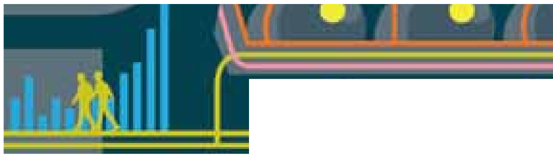
While customer segmentation is conceptually easy, it sticks only with considerable effort. The new service levels and segmentation should be incorporated into contract terms, and sales bonuses should be tied to account profitability after all costs to serve have been covered, thus removing the temptation to give away additional services as in the past. Some companies have gone further, making organizational changes (for example, moving to inside phone sales instead of using travelling sales representatives) and hardwiring service-level rules into their ordering systems.

Segmentation can drive significant profitability improvements. One North American specialty-chemicals business that used this approach increased its total return on sales by 15 percent within 12 months. It did this by reclassifying all but the most profitable accounts to the appropriate service tiers and imposing strict rules on service levels. Furthermore, by shifting to phone sales for small customers, margins for this segment grew by about 15 percent and volume rose by as much as 30 percent. Overall customer satisfaction also improved, as more frequent phone contact drove a better understanding of smaller customers' needs.

From stockist to key account: Leveraging the full potential of distributors

Too many chemical companies still see distributors as inventory-stocking, margin-absorbing delivery services. However, the most successful go-to-market models recognize that distributors can act as service providers and an extended sales force—the two critical roles needed to serve small accounts.

Redefining the distributor relationship requires more than a simple mind-set shift; it requires better selection and management of distributors. Companies must approach the selection of distributors with the same rigor used in the selection of a top vendor, including proper requests for quotations, distributor selection days with one-on-one meetings, and detailed screening. The company's objectives should determine the kind of distributor that is selected. For growth and small-customer service, for example, midsize distributors may be the best match since they offer sufficient reach and are hungry to expand customer portfolios and regions.



Once relationships with the right distributors are established, they must be nourished. The central feature of the highest-performing relationships is that the chemical company treats the distributor as a key account with significant volume and growth potential. Hallmarks of best-practice approaches include designating a dedicated distributor manager in the commercial organization; relieving restrictions to allow distributors to attack a broader range of customers; installing a tiered pricing structure driven by growth and service performance, not just volume; and investing to develop the skills and product knowledge of the distribution sales forces.

Improved distributor management works (Exhibit 2). One European surfactants maker saw gross margins rise by six to nine percentage points within six months of reselecting and consolidating its distributor base. Many products became more profitable than they had been when they were sold directly to small customers. The company is currently on track to increase the profitability of its small-customer business by 15 to 20 percent over the next two years.

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