Setting Priorities in B2B Customer Portfolio Management – Aspects of Customer Ranking Lists

GSSI Hiroshima 2015

1) Abstract

Allocating different amounts of attention to different customers has shown good success in B2C marketing. Concentrating attention and service to profitable customer groups concentrates efforts to the promising leads. In B2B marketing and specially in sales engineering customer priorization is mostly based upon simple ABC lists describing the current size of the turnover. The target of this paper is to develop an easy to use method of setting up different ABC lists according to the different tasks of the sales management taking into account current and future turnover and current and future contribution, supporting the control of the activities of acquiring new business.

2) Introduction

Companies are in constant search on how best to allocate their rare sales resources in order to maximise the benefit. One important way is to allocate more resources to the customer group, which is expected to contribute more to the financial wellbeing and to reduce the allocation of ressources for less contributing customers or customer groups (e.g. Zeithaml, Rust and Lemon 2001). This means that the company has to classify their customers into different classes which get different attention and treatment (e.g. Bowman and Das Narayandas (2004). By reducing attention to less important customers, capacity is generated to give a high degree of service and attention to the important customers (Wiegers, 1999, Starr, 2005, Homburg, Droll, Totzek 2008).

It has been shown that this customer prioritization has given beneficial results, although the ranking of customers in practical life is more problematic than anticipated. A couple of investigations and proposals have been made on how to do this prioritization. The most obvious method is to use the current turnover or current contribution as a ranking criterion (Niraj, Gupta and Narasimhan 2001). In B2C business quite complex methods have been developed for the customer segmentation and customer ranking, like in banks or insurance companies. One of them is the RFMR method or Recency Frequent Monetary Ratio method, which evaluates the last recent purchases of each customer and draws conclusion on the probability of the next purchase.

Little investigations of customer rankings have been done in the B2B business, especially in the field of sales engineering, where engineering products are sold to industrial customers. In sales engineering the products are often co-created between supplier and customer in order to satisfy specific customer needs. The above cited RFMR method for example cannot be applied as there is a dependency between supplier and customer and customers are not really free to change the supplier from one day to next for technical reasons. A short indicative survey of B2B sales engineering companies done by the author has shown that customer rankings exist, but they are merely based upon turnover or contribution as indicator for the customer importance. Companies selling technical products often have limited marketing resources; they concentrate upon the technical side of the business and the selling side. It is the target of this paper to set up a simple method for customer classification based upon easily available information which is applicable in practical industrial life.

Table 1 shows the typical ABC- turnover list of customers as used in sales engineering. Customers are listed according to the turnover. They are classified in groups ABC, where the borders for A, B and C are set by the sales management, sometimes following Pareto values (80/20%), but most of the time following what is perceived as a "meaningful" segmentation. Of course the turnover is not the most important ranking criteria, when it comes to judging the customers value to the company. The contribution, defined as sales volume minus variable cost, is a much better indicator as it describes the financial importance of each customer. Table 2 shows the ranking of the same customers as in table 1, but ranked according to their absolute contribution to the company. It shows, that the customer C is financially more important than A, although being smaller in turn over.

Customer	Turn Over	Acc. Turn Over	Turn Over %	T.O. Class
Cust A	$ 2.200.000	$ 2.200.000	30%	A
Cust B	$ 1.800.000	$ 4.000.000	54%	A
Cust C	$ 1.400.000	$ 5.400.000	73%	A
Cust D	$ 800.000	$ 6.200.000	84%	B
Cust E	$ 600.000	$ 6.800.000	92%	B
Cust F	$ 250.000	$ 7.050.000	95%	B
...	...	...	...	...
Cust O	$ 18.000	$ 7.393.000	100%	C

Table 1: Customer ranking according to turnover

Customer	Turn Over	% Contribution	Contribution	Class
Cust C	$ 1.400.000	35%	490.000 €	A
Cust A	$ 2.200.000	21%	462.000 €	A
Cust B	$ 1.800.000	20%	360.000 €	A
Cust E	$ 600.000	41%	246.000 €	B
Cust D	$ 800.000	14%	112.000 €	B
Cust F	$ 250.000	32%	80.000 €	B
...	...	...		...
Cust O	$ 18.000	27%	4.860 €	C

Table 2: Customer ranking according to contribution

3) What can be learned from Tunover and Contribution lists?

The ABC *turnover list*, table 1, shows which customers keep the company busy. It gives valuable information for financial aspects as they generate the biggest amount of cash flow. ABC *contribution list*, table 2, shows which customer is the most valuable for the company and should have the greatest attention. The second list gives an indication of risk aspects, too: if the number of A-customers is very low (three or less), the dependency from these few big customers is very high and any break in relationship of whatever nature will endanger the company heavily. If the number of C-customers is too high, the efficiency of the company is probably very low, as it has high operations cost and a reduced profitability. Although smaller jobs from smaller customers may tend to have slightly higher relative margins, absolute margins are usually low and often not worthwhile (see customer O).

Establishing these two lists gives valuable information upon the customer portfolio, but they lack of one important aspect: no information can be drawn from them about the future sales and contribution as they are just a snapshot of the current business. But exactly this is what sales management has to care for: preparing the future in order to continue to grow and prosper.

4) Including Customers Potential in the Ranking

The sales potential of the customers is not easy to determine. Although the customers are aware of their purchasing volume per product category and usually communicate this information openly, a couple of different factors play quite an important role. First of all not all the purchasing volume may be accessible to the supplier due to technical reasons (manufacturers machine park does not allow to produce all products etc.). Secondly, the customer may have a double sourcing strategy, distributing the procurement over two or three sources for safety reasons. Please note that the expressions “sales potential” and “purchasing potential” are synonyms in this context, they are used to express who defines the value (supplier or customer).

	Sales Potential (1)	Accessible Sales Potential (2)	Sales Potential after Sourcing Strategy (3)	Biggest Customer Criterion (4)	Current Turnover	Growth Potential
Cust. O	60.000.000 €	17.000.000 €	12.000.000 €	2.000.000 €	18.000 €	1.982.000 €
Cust. F	8.000.000 €	6.000.000 €	5.000.000 €	2.000.000 €	250.000 €	1.750.000 €
Cust. D	50.000.000 €	10.000.000 €	10.000.000 €	2.000.000 €	800.000 €	1.200.000 €
Cust. C	120.000.000 €	5.000.000 €	5.000.000 €	2.000.000 €	1.400.000 €	600.000 €
Cust. B	10.000.000 €	4.000.000 €	2.000.000 €	2.000.000 €	1.800.000 €	200.000 €
Cust. E	900.000 €	900.000 €	900.000 €	2.000.000 €	600.000 €	300.000 €
…	…	…	…	…	…	…
Cust. A	25.000.000 €	8.000.000 €	4.000.000 €	2.000.000 €	2.200.000 €	- 200.000 €

Table 3: Different criteria limit the sales potential of a customer

Table 3 shows, how the total purchasing volume of a customer has to be stripped down step by step to find his the real sales potential to the supplier. Starting from the total sales potential (1), the supplier has to reduce it to the accessible sales potential (2). If the customer has a double sourcing strategy, the sales potential has to be reduced to the sales potential according to the sourcing strategy (3). If from the side of the supplier there is a policy installed not to have too big customers in order to avoid strong dependencies, the potential (4) has with the sales potential (3) and whatever value is smaller, needs to be used for comparison. The sales potential, which can be called growth potential in this table, is the difference between current sales and the smaller value of (3) and (4).

Looking at the ranking, it becomes obvious that customer O has the biggest sales potential, although the company is currently doing little turnover with him. Customer A has grown so much in the past that the internally set limits of the supplier (no customer bigger than 2.000.000 EUR) have been passed. Although further growth is possible, supplier may not want to take these chances, which means that this customer is ranked last when it comes to acquiring new business. The growth potential gives clear indications to the sales management: companies with high growth potential need to be followed aggressively and the best acquisition people need to take care of these customers.

5) Including Customers Profitability into the Ranking

Sales Potential and growth potential is relatively easy to determine. As contribution is the better indicator of the value of customers, this needs to be taken into account when it comes to customer target acquisition lists. Of course it is not possible to foresee future contribution rates, but as a working hypothesis the current contribution rate can be extrapolated to the near future. In doing so, the ranking list for the acquisition priorities changes again, putting customer F in the first place as can be seen in table 4.

	Growth Potential	% Contribution	Potential Contribution Growth
Cust. F	1.750.000 €	32%	560.000 €
Cust. O	1.982.000 €	27%	535.140 €
Cust. C	600.000 €	35%	210.000 €
Cust. B	200.000 €	20%	40.000 €
Cust. D	200.000 €	14%	28.000 €
Cust. E	- 100.000 €	41%	- 41.000 €
...	...		...
Cust. A	- 200.000 €	21%	- 42.000 €

Table 4: Customer ranking according to potential contribution growth

6) Taking into Account the Future Business Development of the Customers

Up to now we have considered the current sales potential and contribution potential of the customers. Nothing has been said up to now about their future development. This means that table 4 is valid for the next few years. But due to the fact that business acquisition cannot be done overnight but has a horizon of sometimes five to 10 years, long term information should be included into the target acquisition list. In order to do so, the current and, if possible, the future growth rate of the customers have to be taken into account. This information may be available at the customers and can possibly be learned in a qualified sales meeting. If no information is available, it seems not unreasonable to extrapolate the accessible sales growth figures of the past 5 years into the future.

	Sales Potential (1)	Average growth rate per year	Sales Potential in 10 Years (1*)	In 10 Years Accessible Sales Potential (2*)	Sales Potential in 10 Years after Sourcing Strategy (3*)	Sales Potential in 10 Years after Biggest *Customer* Criterion (4*)	in 10 Years Extrapol. Turnover	Turnover Growth Potential
Cust. O	60.000.000 €	2%	72.000.000 €	25.000.000 €	25.000.000 €	4.000.000 €	21.600 €	3.978.400 €
Cust. F	8.000.000 €	1%	8.800.000 €	6.600.000 €	5.500.000 €	4.000.000 €	275.000 €	3.725.000 €
Cust. E	900.000 €	9%	1.710.000 €	1.500.000 €	900.000 €	4.000.000 €	1.140.000 €	2.860.000 €
Cust. D	50.000.000 €	5%	75.000.000 €	15.000.000 €	15.000.000 €	4.000.000 €	1.200.000 €	2.800.000 €
Cust. B	10.000.000 €	7%	17.000.000 €	10.000.000 €	8.000.000 €	4.000.000 €	3.060.000 €	940.000 €
Cust. C	120.000.000 €	15%	300.000.000 €	100.000.000 €	50.000.000 €	4.000.000 €	3.500.000 €	500.000 €
Cust. A	25.000.000 €	6%	40.000.000 €	30.000.000 €	15.000.000 €	4.000.000 €	3.520.000 €	480.000 €

Table 5: Growth potential in 10 years

Table 5 shows the expected growth potential for the abovementioned customers. The expected average annual growth rate is shown and the current sales potential (1) extrapolated to the future sales potential (1*). Of course the accessible sales potential (2*) has to be revised, as the capabilities and capacities of the own company will develop in the next 10 years. The future sourcing strategies of the customers need to be found out and inputted into column (3*). Finally the own growth will influence the biggest customer criterion (4*) and will go up with increasing turnover. This leads to a different order of the customer ranking due to future developments, for example customer E has gone up from rank 6 to rank 3.

As shown before, extrapolating contribution rates into future will lead to future contribution rates. Table 6 shows the future contribution under the assumption that current contribution rates will be held more or less.

	Turnover Growth Potential	Current Contribution Rate	Contribution Growth Potential
Cust. F	3.725.000 €	32%	1.192.000 €
Cust. E	2.860.000 €	41%	1.172.600 €
Cust. O	3.978.400 €	27%	1.074.168 €
Cust. D	2.800.000 €	14%	392.000 €
Cust. B	940.000 €	20%	188.000 €
Cust. C	500.000 €	35%	175.000 €
Cust. A	480.000 €	21%	100.800 €

Table 6: Customer ranking according to contribution growth potential

The interpretation of this chart shows, that Customer F, E and O shall be developed primarily, as they have good contributions. Customer D needs to be judged, if there are opportunities to increase the contribution rate: 14% is quite low and if this cannot be raised by some actions, the customer should be phased out.

It has been shown, that customer rankings can be established based on few accessible information, giving support and information for different sales management decisions:

- Turnover lists give information about the amount of day to day work and financial aspects such as cash flow
- Contribution lists give information about the profitability and basic risk aspects of all customers
- Turnover growth and contribution growth lists give information about which customers should be targeted for acquisition possibilities in the short and medium term
- Future turnover and future contribution lists give indication of the possible development of customer needs and possible future contributions. They are a bit more difficult to establish and include more incertainty, but give the most valuable information for steering a company's acquisition activities.

All possible lists are important and serve different functions in sales and financial management. They have to be handled carefully, as some of the information is based upon assumptions.

References

Bowman, Douglas and Das Narayandas (2004), "Linking Customer Management Effort to Customer Profitability in Business Markets," *Journal of Marketing Research*, 41 (November), 433–47.

Görne

Homburg, Matthias Droll and Dirk Totzek (2008), „Customer Prioritization: Does It Pay
Off, and How Should It Be Implemented? Journal of Marketing, Vol 72 (Sept. 2008), 110 – 130

Niraj, Rakesh, Mahendra Gupta, and Chakravarthi Narasimhan (2001), "Customer Profitability in a Supply Chain," Journal of Marketing, 65 (July), 1–16

Starr, Amy Christine (2005), „The implication of Customer Priorization on Lead Time“ Bachelor Thesis Ohio State University

Wiegers, Karl E. „First Things First: Prioritizing Requirements“,*Software Development*, September 1999

Zeithaml, Valarie A., Roland T. Rust, and Katherine N. Lemon (2001), “The Customer Pyramid: Creating and Serving Profitable Customers,” *California Management Review*, 43 (4), 118–42.