Logistics and Distribution Company

Case Study

65%
UNPROFITABLE CUSTOMERS

-$155k
LOST PROFITS

-$777k
LOST VALUE

-66%
LOST VALUE PERCENTAGE

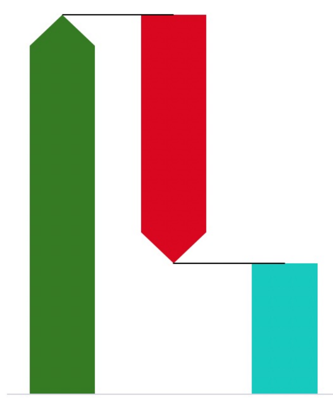
Company

- 34 customers
- 22 employees
- $3m revenue

Situation

Facing declining sales and commoditization of the offering upon which the company had been founded, the Company added two distinctively different services in an attempt to grow sales. Motivated by top-line sales target incentives, revenues grew. However, even though all three offerings were priced to yield the same gross margin, profit plummeted.

Analysis



▼ **66%**
OF PEAK VALUE LOST

	Earnings Multiple	
▲ **$237K** Peak Profit	x 5.00 =	▲ **$1.2M** Peak Value
▼ **-$155K** Lost Profit	x 5.00 =	▼ **-$777K** Lost Value
■ **$82K** Net Profit	x 5.00 =	■ **$408K** Net Value

Note: values may not add up due to rounding.

	% of Customers	Profit
Profitable Customers	**35%**	**$237k**
Unprofitable Customers	**65%**	**-$155k**
Total	**100%**	**$82k**

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Beware the “Gross Margin Illusion”!

Because incremental costs associated with new offerings were buried in operational expenses rather than allocated directly to the accounts generating them, margins associated with new offerings were assumed to be identical to incumbent offering average margins—a mistake that resulted in the illusion that the new accounts were much more profitable than reality.

Sales incentives targeting top-line growth instead of profitability compounded the problem.

After *Profit Inc* properly allocated both direct and indirect costs, 65% of customers were revealed to be unprofitable.

66% of the company’s value was being destroyed.

Manage by <u>net</u> profit margin, not gross profit margin

Insights Revealed by Profit Inc’s Analysis

- Rather than implementing a proactive, financially-informed plan, ’s “ad-hoc” expansion into distinctively different service offerings substantially increased service-levels and their associated costs
- Costs generated by expanded offerings were buried in operating costs rather than directly allocated to appropriate accounts, thereby making profit margins appear much higher than reality
- Revenue-based sales incentives motivated unprofitable action by sales reps: they found it easiest to generate more sales with the least profitable customers
- Management failed to adequately train personnel in new offerings, resulting in costly mistakes
- The Company paid less compensation than the industry average, thereby attracting lower talent quality and resulting in high personnel turnover costs

Advisory Team Recommendations

- Implement a disciplined pricing process using a detailed pricing configurator that accounted for all direct costs for a prospective customer
- Raise prices on all unprofitable offerings
- Create a growth strategy built around the most profitable offerings
- Recruit, train and retain better employees by developing performance standards, paying higher base wages and incentivizing all employees with a profit-sharing plan

Results

After enthusiastically implementing the advisory team’s recommendations, the Company’s profitability and value doubled within 6 months.