

# KNOW YOUR CUSTOMER



By

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## 3D BUSINESS TOOLS

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There are many financial and non-financial measures in every business. Management must determine which measures are most critical to the success of their Company. There are three measures important to every Company. 3DBT calls them the “**Three Bottom Lines**”. They are Profits, Cash and Assets. The purpose of this paper is to focus attention on how a Company’s Customers affect the Company’s performance on the *Three Bottom Lines*.

### **Customers Are A Company’s Most Valuable Asset**

Knowing your Customer well includes knowing:

- 1) How they affect the Company’s 3 Bottom Lines, Profits, Cash and Assets.
- 2) Which Customers are Valuable Customers and which are not?
- 3) How do Customers affect operational efficiency?

While the value of Customers does not appear on Financial Statements, it is fair to say that Customers are a Company’s most valuable asset. Without Customers, there is no business. For purposes of simplicity, in this paper, the term Customer refers to a person, company, government organization or other entity that purchases goods or services from the Company. To make the following process more manageable, Customers may be grouped into categories of Customers with similar characteristics (Customer Groups).

It is important for management to understand the value of each Customer and how to enhance that value. To do that, management must answer two sets of questions.

1. The first set of questions must be answered from the Company’s point of view; it will help you determine the value of each Customer.
2. The second set of questions must be answered from the Customer’s point of view. Those questions will help management understand what their Company can do to assure retention and growth of “Valuable Customers” the conversion of “Burdensome Customers” to Valuable Customers and the acquisition of new Valuable Customers.



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### **I. Which Customer Are “Valuable Customers”?**

To determine the value of each customer, management must answer the following questions:

1. ***How much would it cost the Company to replace each Customer?*** (To answer this question, you must calculate the following replacement costs :)
  - a. Marketing, sales and sales support costs to acquire a replacement Customer
  - b. Cost of training Company personnel as a result of new Customer acquisition
  - c. Learning curve costs
  - d. Lost business between from the time of loss to the time of replacement
  - e. Lost opportunity as a result of focusing resources on replacement instead of growth
2. ***Which Customers improve Company’s performance (Valuable Customers) and which do not (Burdensome Customers)?*** (To answer this question management must be able to calculate rank, review and compare each Customer’ performance and trends by the following important criteria :)
  - a. Gross Margin (GM)
  - b. Return on Allocated Assets (ROAA)
  - c. Cash on Allocated Assets (COAA)
  - d. Contribution to Overhead, Profit (COP)
  - e. Payment Performance (PP)(See a sample report attached as Annex A.)
3. ***Which Customers help the Company improve operational efficiencies and which hinder them?***



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### **II. How Does Management Improve Company Performance?**

Once management has answered the first set of questions it will know which of the Company's Customers are Valuable Customers and which are Burdensome Customers. Management must apply a similar process to evaluate its Company's Suppliers to determine which are Valuable Suppliers and which are Burdensome Suppliers.

**Supply Chain Management is a key to being both competitive and profitable. Management of your Company's Customers must also determine which of *their* Suppliers are Valuable Suppliers and which are Burdensome Suppliers. Therefore, you must be prepared for your Company to be subjected to the same sort of tests by its customers.**

With that in mind, the next steps require the development of plans and strategies to: (i) Assure retention and growth of the Company's Valuable Customers, (ii) Convert Burdensome Customers to Valuable Customers and (iii) Remove and replace Burdensome Customer with Valuable Customers. To do that, you will need to answer the following questions for each Customer or group of Customers:

- 1. What are your Customers' goals and objectives?***
- 2. What does it take for your Customers' to achieve success?***
- 3. How do your Company's products or services help your Customers' succeed?***
- 4. Does your Company have the processes and resources in place to properly support your Customers'?***
- 5. Which potential Customers fit the profile(s) of your best Customers (Target Customer)?***
- 6. Are your marketing and sales efforts effective in reaching Target Customers?***

Gathering, analyzing and evaluating the information needed to answer both sets of questions are massive and important undertakings. Planning, implementing, reviewing and communicating the appropriate responses are yet other major



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tasks that must be accomplished. The larger and more complex the enterprise the more difficult it is to achieve success efficiently.

Many corporations are turning to sophisticated planning and analysis tools to help organize and compile information to improve decision making. The problem with many of these products is that they are typically 3<sup>rd</sup> party systems that must either be integrated into complex Enterprise Resource Planning (ERP) systems or other “back end” systems or they require manual input of data. Both approaches have pitfalls; integration is time consuming and expensive and may not yield sought after results. Manual input is resource intensive and subject to human error or manipulation.

Ideally, a comprehensive management system would (i) Model the Company, including all its relationships with employees, customers and suppliers (ii) Capture all the financial transactions of the Company, (iii) Capture all the important non-financial measures of the Company, (iv) Provide easy access to financial and non-financial data and relationships, (v) Generate required reports for “insiders looking in” and for “outsiders looking in” and (vi) Incorporate powerful Planning & Analysis Tools that turn raw data into meaningful, performance information. 3DBT’s Enterprise Management System (EMS) provides that solution. Let’s take a look at how EMS helps Companies know their customer better.

### **1. How Do Customers Affect Company Performance?**

The first group of questions (above) addresses the fundamental issues regarding which of your Company’s Customers are Valuable Customers and which are not. EMS’s “Whole Business Thinking” approach will help management answer these questions instantly and accurately.

EMS powerful analytical tools are fully integrated into the system. They include hundreds of business ratios and formulae to help management analyze the Company’s performance. Let’s look at how some of these performance measures are used to answer the questions related to the value of Company’s Customers.



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## 1. Which Customers improve Company performance and which don't?

EMS powerful Attribute Center System (ACS) automatically acquires the data needed to evaluate Customer performance

EMS can link Strategies such as Return on Allocated Assets (ROAA) and Cash on Allocated Assets (COAA) to a specific Customer or group of Customers. By assigning specific EMS Attributes to the transaction fields, data is tagged and then assembled into flexible "Attribute Centers". Attribute Centers can gather virtually any combination of data recorded in the system, including both financial and non-financial information.

For example: If a Company sells paper clips to Boeing, and management wants to know if Boeing is a Valuable Customer or a Burdensome Customer, management can easily and instantly make that determination by directing EMS to automatically affix, in real-time, a Boeing Attribute Group to all transactions that involve revenues, expenses and other costs of doing business with Boeing, including:

- Sales and other income
- Cash inflows and outflows
- The costs of:
  - Marketing, Sales and General and Administrative (MSGA)
  - Manufacturing, warehousing and shipping
  - Warrantee and service
  - Special training
  - Other direct and indirect costs
- the allocation of all or a portion of the cost of facilities or other assets

Boeing Attributes can also include Boeing's payment performance, how many boxes of paper clips they purchase, the seasonality of their purchases and any other financial or non-financial measures management specifies.

Transactions could also be tagged with additional Attributes such as aerospace; US based business, etc so that management can compare Boeing's performance with other similar or dissimilar Customers or industry standards.



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Boeing Attributes are collected into Boeing Attribute Centers on demand for easy, instant access. Management can create a Profit & Loss Statement for Boeing and analyze Boeing's financial and non-financial performance as a Customer.

Because Boeing's purchases are large enough to have a significant impact on your Company, management should run an analysis that would project how the Company would do without Boeing as a Customer. Removing Boeing as a Customer would result in changes to the financial and operational infrastructure that could then be included in the analysis.

Sales reports tell what, when and how much a Customer buys but do not reveal WHY a Customer buys. EMS also helps Companies answer the WHY questions.

Management can set up "Customer Attribute Centers" and then run comparisons among Customers and industry standards. Imagine having concrete financial information that tells you how each Customer affects the Company's bottom line. Management can run an unlimited number of "What If" scenarios comparing companies and industries.

Profitably is not the only measure used to evaluate whether a Customer is a Valuable Customer or a Burdensome Customer. How Customers affect operational efficiency, their potential for growth, their cash performance, and market share strategies should also be included in the analysis.

Because EMS captures real-time transaction data as well as static and non-financial data, accurate seasonal variation and trend analysis can be done based on a single Customer, a Customer Group or all Customers. External factors such as interest rate forecasts, new tax laws, industry provided growth estimates, or effects caused by new legislation, etc should be incorporated into the analysis so that the assumptions are as accurate as possible and "What-If" scenarios can be explored. EMS provides projected performance reports based on the facts of the past and assumptions about the future.

### **Increase Business With Valuable Customers**

Answers to the second set of questions are critical to success with Customers.



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To answer the question, “What are the Customer’s goals and objectives?” management must have a clear understanding of the Customer’s business, how they make money and what is important to them. Management must understand the value proposition *from the Customer’s point of view...* what value the Company’s products and services provide to its Customer. If the Company doesn’t provide value to its Customers, the relationship with them will probably be short-lived. This applies to every single product – from paper clips to the most sophisticated computer systems.

Understanding and eliminating process problems is critical.

Automating bad processes only ensures that they will be done more quickly and efficiently.

EMS provides in depth financial and non-financial analyses for a single Customer, a group of Customers or all Customers. While sales figures tell management what, when and how much Customers are buying, they tell nothing about WHY Customers are buying or are not buying. To answer that question, management must have a deep understanding of the Customer’s value proposition to *their* Customers. Non-financial indicators such as Customer’s market trends, market share, effect of economic changes, what the Company’s competitors are providing to the Customer’s competitors, information about Customer’s new products and services, etc. Some of the information will be available on the Internet, some must be acquired by research and some must be sourced from Customers.

EMS provides analytical tools to help management access information, organize it, use it in EMS provided formulae and graphs and formulae and graphs provided by management. Management can identify and quantify the affect of these elements on Customers and how that will affect the Company’s performance.

Finally, to ensure proper support of a Valuable Customer, the following questions must be answered: (i) Does the Company have the right resources and processes in place to be a Valuable Supplier to its Customer(s)? (ii) What does management have to change to increase the Company’s value to its Customer(s)?



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Operating efficiency ratios such as return on assets and other asset management ratios can provide quantifiable results regarding how efficiently the Company is supporting its Customers. For example, by analyzing Accounts Receivable Turnover for a specific Customer, management can identify whether or not the Customer's cash performance falls within predefined Accounts Receivable objectives. If not, policies that apply to slow pay accounts can be implemented.

Every decision may have unintended consequences. In the case of a credit policy change, the unintended consequence may be a loss of sales. Management must understand and optimize the tradeoff between tougher credit policies and fewer sales. EMS provides the tools to help management achieve that objective.

Other ratios such as Return on Average Assets ( $ROA=N/A$ ), Gross Margin (Net on Sales =  $N/S$ ) and Asset Turnover ( $S/A$ ) can be attributed to a specific Customer, Customer Group or all Customers. These ratios give management a good indication of how efficiently and how effectively the Company is performing to meet the demands of its Customers. They answer the questions, "Is the Company doing things worth doing?" and "Is the Company doing them well?"

### **Conclusion**

Customer Relationship Management (CRM) requires that management understands how each Customer impacts the Company's Three Bottom Lines, Profit, Cash and Assets and how Company's products and services, help its Customer meet their goals and objectives.

3D Business Tools' Enterprise Management System combines the tasks of accounting, analysis and planning into a powerful computer model that accurately captures and organizes all the Company's financial and non-financial transactions as well as its relationships with Employees, Customers and Suppliers. EMS provides users with the power to track and analyze how each Customer or Supplier impacts Company performance, to explore an unlimited variety of scenarios and to optimize plans and strategies.



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## ANNEX A

### CUSTOMER ANALYSIS REPORT

Quintile #	Customer Name	Dollar Volume (\$)						Gross Margin (GM)						Payment Performance			Overall Rank
		Importance Value =			Importance Value =			Importance Value =			Importance Value =						
		\$ Sales	Rank	Trend	% Sales	Rank	Trend	GM\$	Rank	Trend	GM %	Rank	Trend	Rec T O Days	Rank	Trend	
1																	
2																	
3																	
4																	
5																	
	TOTAL																
Quintile #	Customer Name	Return on Allocated Assets (ROAA)						Contribution to Overhead & Profit (COP)						Cash on Allocated Assets (COAA)			Overall Rank
		Importance Value =			Importance Value =			Importance Value =			Importance Value =						
		ROAA	Rank	Trend	COAA	Rank	Trend	\$	Rank	Trend	%	Rank	Trend	Rec T O Days	Rank	Trend	
1																	
2																	
3																	
4																	
5																	
	TOTAL																