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# IN THE BATTLE FOR VOLUMES AND MARGINS

A case study of customer profitability at a Sporting Goods Company

## ABSTRACT

This is a case study of a company in the sporting goods industry. The aim of this thesis is to examine how customer profitability differs between large volume customers. An Activity Based Costing (ABC) approach is used to allocate resources and to measure each customer's profitability defined as net margin minus the cost to serve. Our findings show that despite similar large-volume characteristics, two out of the three customers incur much higher relationship costs leading to lower customer profitability. The "middle-sized" customer turns out to be least profitable due to a combination of high discounts as well as a high cost to serve. Behind the varying discounts and cost to serve lie differences in business models and degree of centralization affecting both sales procedures and types of services available. To conclude none of the customers were unprofitable.

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# **1. INTRODUCTION**

In today's highly competitive environment serving customers has become a key element in the battle for both volume and margins. Suppliers have often responded by either increasing discounts or increasing level of service available to their customers, hoping that the additional volume generated will protect their profits. Even though increased customization and services creates customer value and customer satisfaction (Veen-Dirks and Molenaar, 2009), additional discounts and service creates extra activity and costs, which in turn affect the margins (Bellis-Jones, 1989). Knowing the costs related a customer can make a difference on how to price products and services (Stapleton, et al, 2004)

The relation between size and customers profitability is a frequently discussed topic within the customer profitability literature. Most firms are well aware of the 80/20 rule, i.e., 20% of the customers account for 80% of revenues and most of a firm's profit. (DeWayne, 2004). Another well-known example is the study of the firm Kanthal, which revealed that 20 percent of the customers accounted for 225 percent of the profits while the remaining customers contributed with no profits or even losses. However, the same study also uncovered that two of the largest customers in terms of sales volume turned out to be the most unprofitable ones (Kaplan and Cooper, 1998). Evidently, high sales volume does not necessarily mean high income (Shapiro, 1987), although many companies think their highest-volume customers are the most profitable. Further, the cost for service can differ a lot between customers and have far reaching impact on profitability. In increasingly competitive markets, it is therefore critical to know customer profitability as well as product profitability (Howell and Sourcy, 1990).

## **1.1 Purpose and Research Question**

In the light of the above findings, the purpose of this study is to examine differences in profitability between large-volume customers.

The company chosen for this study operates within the sporting goods industry, and is one of the dominating players, internationally as well as in Sweden. The industry is characterized by dense competition, where sales and marketing activities represent essential functions. Furthermore, the fact that the case company operates within a business-to-business setting, which involves a balance between large volumes and customized services, makes it an interesting case with

regards to customer profitability. Currently, the company only measures net margin<sup>1</sup> earned by its customers, and does not allocate any indirect costs. The company is thus unaware of the total costs associated with serving the customers, and consequently, their profitability is unknown.

Few studies have been conducted on customer profitability within the retail sector, why we hope that our study of customer profitability within the sporting goods industry, can serve as a contribution. The reasoning above leads us to the following research question:

*How does profitability differ between large-volume customers?*

## **1.2 Delimitations**

Customer profitability contains two main components; net margin and Cost-to-Serve (CTS). Our intention is to explain and analyze both components. However, emphasis will be on CTS since the case company is a sales organization and we have had limited insight in production costs.

The chosen case company operates in a cyclical business i.e., workload and sales fluctuate during season, why we have decided to use an entire financial year as the basis for our analysis. Financial data and organizational structure from FY09<sup>2</sup> have been used, since that is the latest completed financial year. Further, a number of restructurings have been incorporated during the last couple of years, why older data would not reflect the current situation with regards to resource usage and costs.

After discussions with the CEO (referred to as Area Manager Nordics internally) we decided to limit our study to the Swedish organization and their three largest customers' due to a number of reasons. Firstly, the company has streamlined its customer base by transferring a large number of small customers to an agent. As a result, the company works mostly with large volume customers and specialty stores today. Secondly, their three largest customers represent essentially the whole sporting goods market in Sweden and is internally treated as large-volume customers. Thirdly, these customers represent more than 80% of the company's total revenue and their different business models have more or less shaped the set-up of the Swedish sales force. Additionally, there is a significant heterogeneity between how these three customers are

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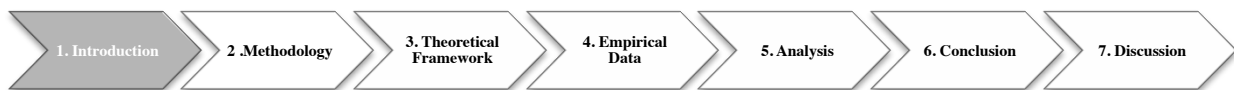
<sup>1</sup> Net Sales (including discounts) – Cost of Goods Sold (COGS)

<sup>2</sup> May 31<sup>st</sup> 2008 – May 31<sup>st</sup> 2009

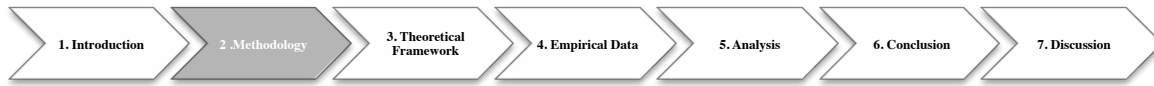
treated. To conclude, we believe the delimitations mentioned above will enable us to conduct a thorough analysis that can provide useful information for the company.

### 1.3 Disposition

After this introduction, our methodological approach is described in section 2, followed by a presentation of the theoretical framework in section 3. The empirical data, presented in section 4, provides an introduction to the case company and a description of the customer related functions. Section 5 contains a profitability analysis using the net margin and CTS for each customer, connecting our research findings to the theoretical framework. The conclusions are presented in section 6. Finally, a discussion of strengths and weaknesses of our thesis as well as suggestions for future research areas are presented in section 7. The disposition of our thesis is shown in the figure below.



## 2. METHODOLOGY



*This section presents the research methodology used to answer our research question. First, we will describe our choice of method and case company, and thereafter explain our method for data collection. Finally, we will discuss the quality of the study.*

### 2.1 Methodological Approach

The purpose of this study is to examine differences in customer profitability. Previous research has been used to gain deeper knowledge about the subject, and will serve as a base for our analysis.

The choice of conducting a case study can be traced back to our research question. According to Yin (2009), “how” and “why” questions are explanatory and therefore suitable for case studies. A case study also allows for an in-depth study of a distinct problem over a limited time period (Bell 2000), allowing for a detailed analysis with broad explanations (Alvesson and Sköldeberg, 1994). Further, several kinds of empirical data, such as interviews, observations, and internal documents can be used, which is another advantage with conducting a case study. The disadvantages with case studies concern its basis for scientific generalizations and the risk of subjective and biased interpretations by the researchers, (Yin, 2009), which will be further discussed under the section reliability.

A crucial distinction in designing case studies involves the choice between single- and multiple-case study designs (Yin, 2009). We have chosen to make a single case study, which will allow a comprehensive study of customer profitability. Although a multiple case study would have enabled generalization of conclusions, the limited scope and time frame of this study would not have allow us to make a though analysis of several companies.

One can relate method and theory through three different approaches; inductive, deductive, and abductive. The first approach involves multiple case studies, and consequently allows for

conclusions to be generalized. The deductive approach originates from theories, which are later applied to a real case. The abductive approach uses empirical findings with a theoretical framework as a basis, and is a combination of the above approaches (Alvesson and Sköldeberg, 1994). The abductive approach is the most suitable for this case study, since the empirical findings will be compared to the presented theoretical framework.

## **2.2 Choice of Case Company**

As mentioned in section 1, the company chosen for this study is a market leader within the sporting goods industry, both internationally as well in Sweden. Moreover, there have not been any previous studies made on customer profitability at the case company, although they have a conscious strategy to focus on large-volume customers. Further, management found this type of research to be both interesting and valuable. Due to sensitive company information, the case company has requested to be anonymous, and is referred to as Athletic Sports. Accordingly, the customers will also be anonymous, and from now on referred to as Alpha, Beta and Gamma.

## **2.3 Collection of Data**

One of the major strengths of conducting a case study is the opportunity to use many different sources of evidence. Documentation, interviews, observations, archival records, and physical artifacts are the most commonly used sources (Yin, 2009).

### **2.3.1 Interviews**

Interviews constitute one of the most essential sources of information in case studies (Yin, 2009). The empirical findings in this study have primarily been collected through interviews and information from Athletic Sports' internal data system. The interviews followed a semi-structured approach and were based upon open questions complemented by follow up questions. Information gained during the previous interviews have influenced and shaped the questions asked throughout the rest of the interview process. The interviews were conducted between 2009-10-02 and 2009-11-05 and involved employees at different levels in the organization, ranging from management to sales representatives (see Appendix 1).

### **2.3.2 Selection of Interviewees**

As mentioned above, a majority of the empirical findings have been collected through interviews, and consequently, the interviewees represent the main source of information for this case study.



The screening and selection of interviewees is an important process to ensure that appropriate and relevant information is collected (Langemar, 2005).

To get a brief understanding of the company background, the business, and the customer profitability at Athletic Sports, our initial interview was held with the Area Manager Nordics. The two following interviews were conducted with the Country Sales Manager and the Financial Manager, who are also a part of management team, to attain information about each customer and their business models, as well as the financial data. In total, eleven employees have been interviewed at the company. In addition to this, we have had several informal meetings and follow-up interviews for confirmation and clarifying purposes. Our ambition has been to map out customer related activities and costs, why we have met with the majority of the employees involved with the customers.

### **2.3.3 Observation**

Observing behaviors and environmental conditions through direct observations is another source of evidence in a case study (Yin, 2009). The main part of the study has been conducted and written at the case company, where we got access to a conference room throughout the process. By working closely to our study object we have been able to cross check previously gathered data. The combination of observations and informal conversations has provided us with vital information and enabled us to create our own opinion about the company. The observations also served as comparisons between employee behavior and information gained from interviews. Further, one of the researchers has worked at the company for five months, which helped us when selecting interviewees.

### **2.3.4 Secondary Data**

The initial phase of the study included an extensive collection of literature and theories about customer profitability, using both printed- and electronic sources. Early on, it became evident that Activity-Based Costing (ABC) was an established method for conducting a customer profitability analysis, why this constitutes for a substantial part of our literature. We have also consulted a professor at SSE regarding the ABC analysis. Using the literature as a starting-point, we formulated interview questions and established an approach for how to conduct the case study.

Furthermore, we have used written documentation as a source of data, such as financial data, information from the internal ordering system, company presentations and other internal documents related to marketing events and customers. Previous research studies within the field have also served as inspiration.

## **2.4 Processing of Empirical Material**

To obtain a general understanding of Athletic Sports business in Sweden, our initial steps included interviews with management, observation, and a review of the financial records. Through the initial data collection, we identified a number of main activities related to the customers. The following step included interviews with team managers and other employees, to get an understanding of which activities that were associated with certain cost items. Thereafter, these costs were linked to the identified activities. The information gathered during the data collection has served as a base for how costs later have been allocated to the respective customer. This approach allowed us to distinguish relevant data that should be included in the empirical section. It also helped us to discover where additional information was needed and served as a base for further information gathering. Throughout the process we have had several follow-up conversations and informal meetings with employees and team managers, to ensure that our data and calculations were accurate.

## **2.5 Quality of the study**

When conducting a qualitative study, the quality of the study can be assessed by its reliability and validity. Validity relates to how well a study measures what it intends to measure, while reliability ensures that another researcher, following the same procedures, would arrive at the same findings and conclusions (Yin, 2009).

### **2.4.1 Validity**

To ensure validity, we have used a triangulation approach throughout the research process. This included comparisons of information collected from interviews with observations and financial data, which have allowed us to cross check information. The semi-structured interviews were conducted at different levels in the company, and based on a number of questions that were asked in each interview. Our model is based on estimates made by the employees, regarding how much time they spend on each customer and activity. There is a risk that these estimates are not

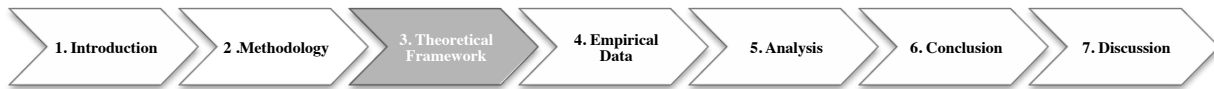
precise, which affect the validity of this study. To mitigate this risk, each employee was asked to fill out a form a few days after the interview, where we asked similar question regarding time spent on each customer and activity. In a few cases there has been somewhat contradicting answers, which have been clarified during follow-up conversations.

Validity is also concerned with how well the findings are generalizable beyond the particular case study (Yin, 2009). The choice to conduct a single case study, and thus focus on an in-depth study at the expense generalization, consequently results in a lower validity compared to a multiple case study.

#### **2.4.2 Reliability**

As mentioned above, we have reduced the risk of biased information through the usage of several sources and follow-up questions. Further, all interviews have been transcribed and both researchers have been present during all interviews, except for one. Since some of Athletic Sports' costs cannot be directly related to a customer, they are consequently left out of the analysis. As a result, there are discrepancies between the figures in our analysis compared to those in the internal system. However, the costs related to activities have been compared to the total allocated cost, to ensure reliability of the raw data used in the model.

### 3. THEORETICAL FRAMEWORK



*This section intends to provide a general understanding of customer profitability, and how this can be assessed using an Activity-Based Costing (ABC) approach. The theories presented below are relevant for understanding and analyzing our research findings.*

#### 3.1 Customer Profitability

The advantage of pursuing a customer profitability analysis is a profound understanding of the resource deployment in a company. An awareness of customers' resource usage can enable a company to make better and more motivated decisions about, for example, pricing and supply of products (Pearce, 1997). Furthermore, an analysis can serve a decision basis for whether a company has an appropriate discount system, and reveal information on how a firm could capitalize on the profitable customers and change the unprofitable ones (Bellis-Jones 1989).

Customer tends to have different behaviors towards its suppliers, depending on if they are profitable or unprofitable. Kaplan and Atkinson (1998) have identified a number of characteristics that typically define a customer as expensive or inexpensive in regards to what service they require. In addition, Smith and Dikolli (1995) have expanded Kaplan and Atkinson's model to include two more characteristics; discounts and costs associated with the return of products. The characteristics identified by the authors mentioned above are summarized in the table below.

High Cost-to-Serve Customers	Low Cost-to-Serve Customers
<ul style="list-style-type: none"><li>• Order custom products</li><li>• Small order quantities</li><li>• Unpredictable order arrivals</li><li>• Customized delivery</li><li>• Change delivery requirements</li><li>• Manual processing</li><li>• Large amounts of pre-sales support</li><li>• Large amount of post-sales support</li><li>• Require company to hold inventory</li><li>• Pay slowly</li><li>• Large discounts</li><li>• Initiates separate sales credits for each item of product returned</li></ul>	<ul style="list-style-type: none"><li>• Order standard products</li><li>• High order quantities</li><li>• Predictable order arrivals</li><li>• Standard delivery</li><li>• Low changes in delivery requirements</li><li>• Electronic processing</li><li>• Little amounts of pre-sales support</li><li>• No post-sales support</li><li>• Replenish as produced</li><li>• Pay on time</li><li>• Nil to low discounts</li><li>• Collated any sales credits and claims monthly</li></ul>

Table 1. Customers' behavior influencing Cost-to-Serve (Kaplan & Atkinson, 1998)

One question that has been frequently mentioned in the customer profitability literature is the size effect – how does customer size influence customer profitability? The literature points to a pattern: customer profitability increases with customer size (Triest, 2005). A well-known example is the study of the firm Kanthal, mentioned in section 1, which concluded that a small fraction of the customers accounted for a large share of the profits (Kaplan and Cooper, 1998). Larger customers often contribute to the total profitability to a larger extent due to larger sales volumes, more efficient ordering processes, lower distribution costs, etc. Even though larger customers often benefit from high discounts, their low costs to serve manage to compensate for their lower product margins (Triest, 2005).

Although the relationship between customer size and customer profitability seems well grounded in the literature, the drivers of customer profitability can act in different directions. The common denominator for large-volume customers is that the relationship is more than a series of one-off transactions, implying that other activities, such as service, advising and training aimed at improving the relationship are essential. If a customer is more valuable to a company it is likely that additional resources will be invested to foster the relationship. Consequently, the costs to serve the customer will increase and thus affect profitability (Triest 2005). Returning to the case of Kanthal it is evident that costs to serve a customer can have far reaching impact on profitability, since two out of three large-volume customers were unprofitable (Kaplan and Cooper, 1998). This occurrence has also been supported by several studies later on (Foster et al, 1996, Guerreiro et al, 2008). Large customers tend to be either the most profitable or the least profitable of the entire customer base (Kaplan and Cooper, 1998).

### **3.2 Customer Profitability Analysis and Activity-Based Costing (ABC)**

The basic idea with a customer profitability analysis is to identify the costs related to a specific customer and then compare these costs against the revenues generated by that same customer (Smith and Dikolli, 1995, Sharman, 1996). As mentioned above, a solid customer profitability analysis constitutes a base for making well-grounded decisions with regards to resource allocation in a company. However, this is a rather unexplored research area within financial control. Nonetheless, several researchers have advocated and used ABC to measure individual customer's profitability (Howell and Soucy, 1990).

ABC has proven to be a valuable tool for measuring long-term product profitability (Bergstrand, 2003), but also useful for measuring and improving customer profitability (Howell and Sourcy, 1990). Several researchers have used the term Cost-to-Serve (CTS) to describe the costs for serving customers (Kaplan and Atkinson, 1998). By comparing net margin to CTS, illustrated in the matrix below, one can show different ways of how a company can benefit from profitable customers. Thus, customer profitability is dependent on the net margin earned and CTS. The contribution margin is calculated by subtracting the production costs (estimated by ABC) including discounts, from the price paid by the customer. CTS reflect the resources required to serve to the customers (Shapiro et al, 1987). Customers that are above the cost-plus diagonal are considered more profitable (Kaplan and Atkinson, 1998)

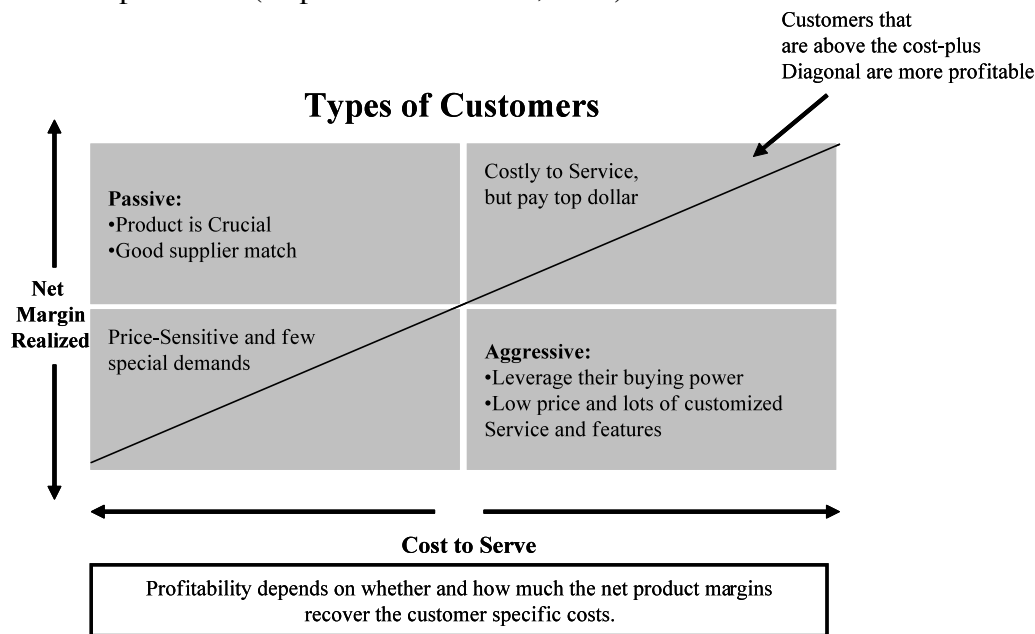


Table 2. Options for Managing Customers (Shapiro et al (1987) in Kaplan & Atkinson (1998)

### 3.3 The Design of ABC

Traditional cost systems can accurately measure the resources that are consumed in proportion to the number of units produced. However, many resources exist for activities and transactions that are not directly related to the volume of units produced. Accordingly, traditional cost systems do a poor job of attributing the expenses of these support resources (Cooper and Kaplan, 1991).

ABC was developed to provide more accurate ways of assigning the costs of indirect resources and support functions to cost objects, i.e., processes, products, services, and customers. In contrast to traditional cost system, the purpose of ABC is not to allocate all costs but only the ones that can be traced to a specific cost object. The direct costs are assigned to the produced products, while the indirect costs are divided into activities. As a result, some costs will not be allocated, which is something that the reader has to bear in mind (Kaplan and Atkinson, 1998). Since no one is using some activities, it should not be allocated to any cost object (Bergstrand, 2003).

ABC rests upon the assumption that activities generate costs. In developing an ABC system, the company needs to identify activities that can be linked to indirect resources and support functions. One can then assign the related expenses to the activities performed. Once resource costs have been traced to activities, managers can gain insights by identifying critical attributes for each activity. In the second stage, activity costs are assigned to cost objects based on the consumption of the activity (Cooper and Kaplan, 1991). By identifying a cost driver for each activity, one can link costs to individual cost objects (Kaplan and Atkinson, 1998). The picture below illustrates of how resources are allocated to cost objects, using activities.



### 3.3.1 Analysis of Activities

Activities performed in a company have different aims, and can be classified accordingly. *Products sustaining* activities are performed to enable products and services to be produced and sold. *Customer sustaining* activities enable the company to sell to an individual customer, and can include customer service, analysis of buyer's behavior, phone calls and travels etc. These costs should be assigned to the customer and also be included in the price. Product- and customer sustaining activities can easily be traced to individual cost objects. Some resources cannot be linked to individual products or customers, but are nevertheless required for all companies,

independent of production and sales. Such activities include product development and advertising, and are classified as *business sustaining* (Kaplan and Cooper, 1998).

### **3.3.2 Analysis of Cost Drivers**

The link between activities and cost objects is accomplished by using activity cost drivers. An activity cost driver can be seen as a measure of output for an activity, for example, number of orders, or number of invoices. There are different types of activity cost drivers to choose from; transaction, duration, and intensity (direct charging). *Transaction drivers* refer to how often an activity is performed, while *duration drivers* represent the amount of time required to perform an activity. *Intensity drivers* should be used in cases when the resources associated with an activity are both expensive and variable each time it is carried out. In these cases, activity costs have to be directly charged to the output (Kaplan and Cooper, 1998).

The selection of activity cost drivers reflects a subjective trade-off between accuracy and the cost of measurement. One does not need extensive time-and-motion studies to link resource spending to activities. Rather, the goal is to be approximately right rather than precisely wrong. The important aspect is that each cost assignment is traceable to the resources consumed by the cost object (Ibid).



## 4. EMIRICAL DATA - The Athletic Sports Company and its Customers



*This section includes an introduction to Athletic Sports and a detailed description of the business areas that have a connection to the customers. Finally, a description of each customer's characteristics is provided.*

### 4.1 The Organization - Global

Athletic Sports Group is a multinational company, operating in more than 160 countries worldwide with over 30 000 employees. The company was founded in the US during the 1970s. Today it is a world leader within the sporting goods industry, both as a designer, marketer and retailer of athletic apparel, footwear and equipment. The Group's revenue for FY 09 amounted to \$ 19.2 billions, equivalent to a 3% increase over last year's earnings.

The overall goal is to carry out innovative thinking that can help athletes to reach their full potential, which drives and creates business opportunities for the company. The company has a strong brand portfolio that makes them present in areas such as sports, retail, lifestyle, media and entertainment. (Athletic Sports Homepage)

### 4.2 The Organization - Sweden

Athletic Sports Sweden (Athletic Sports), which is primarily a sales and marketing organization was established in 1982 and had 47 employees during FY09. As a part of a global company, Athletic Sports is categorized under the NECE-region. (Northern Europe Central Europe.) The revenue for FY09 increased with 6 % compared to previous year, which placed Sweden as the most successful country within the Nordic region. (Nordic Customer profitability report FY09)

The organization can be divided into the following areas; Sales, Marketing, Retail, Customer Service, Finance, HR, IT and Operations. The company has a matrix structure, which implies that some people report to two managers, one in Sweden and one at the European Headquarters. (Area Manager Nordics). Our study is limited to personnel registered in the Swedish organization, which is included in the picture below.

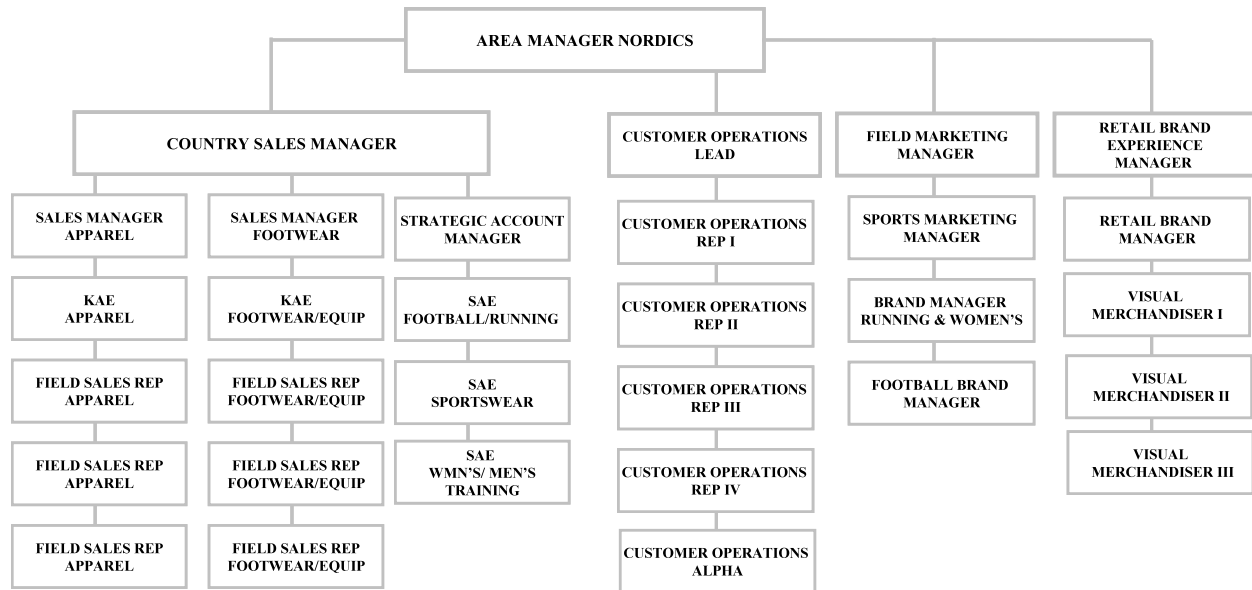


Table 3. Organizational Structure FY09, (only including departments that will be included in this study)

### 4.3 Sales Process and Discounts

As for many other retailers the sales process is divided into four different seasons; Spring, summer, fall and holiday. The sales procedure includes two main components, *Futures* and *At-once* orders. Future orders are placed six months in advance and makes up approximately 85% of the turnover. In addition to future orders customers can replenish during season as well, placing so called At-Once orders. However the procedure for At-once business is somewhat different in comparison to future orders and can be more or less time consuming depending on availability of products at the Central Storage in Europe. In some cases products are reserved beforehand to assure availability during season without any commitment from the customer to buy later on. This can partly be explained by the different order deadlines between Athletic Sports and some of their customers. The company has to reserve a lot of products to assure the customers availability of products since they place orders after Athletic Sports deadline has passed. (Country Sales Manager)

The Swedish branch is a sales organization, why they do not distribute or store any of the products themselves. Instead, products are shipped directly to the customer from the European

storage in Belgium. The product price, i.e., the price that Athletic Sports pay, only consists of the product cost. Other costs involved with purchasing, such as storage and distribution costs, are allocated to the European headquarters (Financial Manager). When pricing the products, the company uses a fixed mark-up for all its products, which is the same regardless of the customer. The factor influencing the wholesale price is the discount. To influence buying behavior among customers an extensive discount system has been implemented. Customers are given different discount agreements depending on their revenue and business set-up. Naturally, large volume customers are encouraged with a higher discount as well as customer placing future orders rather than at-once orders. Logistics and marketing strategies are other parameters that are taken into account when negotiating discounts. Contractual agreements regarding discounts are reviewed and negotiated on a yearly basis. (Country Sales Manager)

## **4.4 Customer Related Functions**

### **4.4.1 Sales Force**

The sales force has been the core function for Athletic Sports for many years, and is also the largest division, employing 20 people. The Country Sales Manager (CSM) has the overall responsibility for sales in Sweden and ensures that targets set by the Global Office are reached. The sales force can be divided into three business units; Apparel, Footwear and Equipment. However footwear and equipment has been grouped into one unit that is managed by a Sales Manager (SM). The SM is responsible for pricing, goal setting and long-term strategies. Additionally, the SM is accountable for managing a team of Key Account Executives (KAE) and Field Representatives (FR) within their business units. The apparel unit is organized the same way. The set-up of the sales force is to a great extent adapted to fit their customers' buying processes, which will be further explained in section 4.5 (Sales Manager F&E).

The KAEs work on a centralized level, creating product assortments and negotiating large volume deals. Moreover, they are accountable for the whole buying process for future orders as well as building sound customer relationships. The largest customers and central purchasers are invited to the office each season to get a preview of the up-coming product assortment. Although their work tasks vary throughout the season they are in daily contact with their customers (Sales Manager F&E).

FRs have a regional responsibility and spends the majority of their time out on the field, visiting small to medium sized stores, to capitalize on replenishment opportunities and to assure that sales are followed through. It is also their task to perform clinics out in the stores i.e., to educate sales personnel regarding more technical products. The FRs are in close contact with the respective KAE and SM providing feedback from customers and sell-through information. (Field Representative)

Aside from the roles mentioned above, Athletic Sports has a few sales representatives working only with specialty stores. However they will not be included in this study.

#### **4.4.2 Marketing and Retail**

Marketing and retail are divided into two separate teams but they co-operate on many levels. Together they are responsible for all brand related communication on the Swedish market. (Field Marketing Manager). The marketing team focuses on the overall strategy for each product category while the Retail team is responsible for merchandizing of products and In-store communication e.g., installations. The scope of the installation varies depending on the size and location of the store. Taking into account that Athletic Sports has no own stores in Sweden they have to negotiate retail space with their re-sellers. It is the Retail Brand Manager's (RBM) responsibility to assure that in-store communication is implemented within the given budget frame and according to agreements with the customer. Three full-time Visual Merchandisers (VM) support the RBM out on the field, making sure that new campaigns are implemented according to global guidelines (Retail Brand Manager).

Aside from the internal retail budget, Athletic Sports has agreed to invest in a mutual marketing fund, a so-called co-operation fund, together with its three largest customers. The idea is that both parties contribute with the same amount, and that the money should be spent on joint marketing initiatives such as events, product promotions in customer magazines and in-store campaigns. However, in many cases, funds have been misused by the customers, who spent the money on internal marketing campaigns without a clear connection to Athletic Sports. Both the retail and marketing team have a constant dialogue with the customers and are sometimes involved when the sales force performs an important sales pitch (Field Marketing Manager).

Marketing uses other tools to enhance demand creation in addition to the activities mentioned above, such as digital, print and other media channels. However those activities rarely have a clear connection to a specific customer. In total marketing and retail employs nine people.

#### **4.4.3 Customer Service**

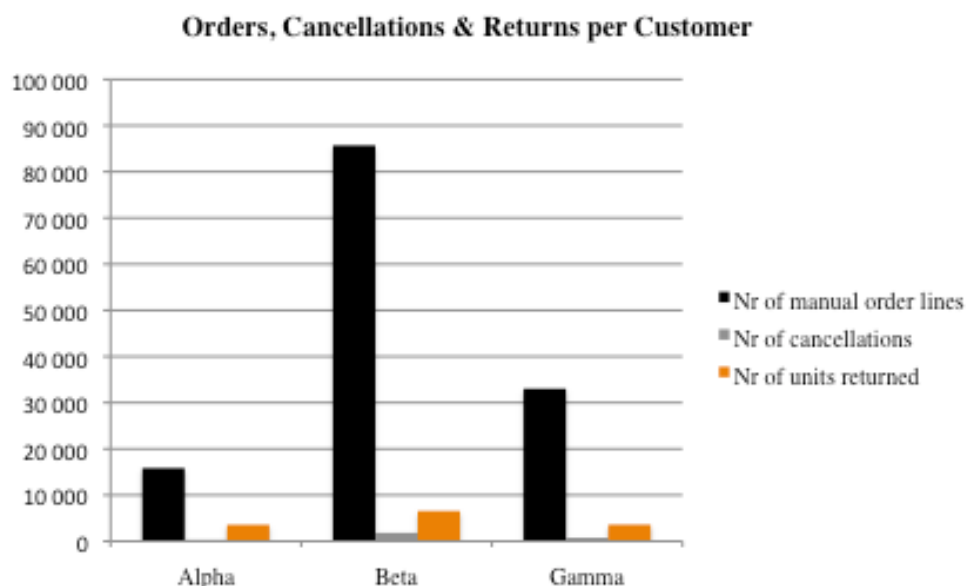
Customer Service functions as link between the sales force and their customers, helping both parties. The team includes six full-time employees with varying areas of responsibility. The Team Manager also referred to as Operations Lead, is in charge of customer operations on a strategic level, and thus has no direct contact with customers. A substantial part of their day is spent on order management and handling returns (Operations Lead).

The time spent on order management is highly dependent on two things; the number of manual order lines and the availability of products. One order can contain one or several order lines, which in turn can contain one or several units. Order placements are mainly done manually with an exception for one customer, who processes some of their orders automatically through EDI (Electronic Data Interchange). When needed, contract workers are brought in to assist the customer service team with order placements. At-once orders are placed through phone or via email while future orders go through the sales team before they are forwarded to the customer service team. In these cases, customer service co-operates with KAE for the respective customer or buying group to make sure that orders are placed in the system and that products can be delivered on time. Order management also includes handling of cancellations of orders, which are processed manually (Operations Lead).

The company offers additional service to their customers through an AthleticSports.net account, where each customer can place orders and file returns themselves. This is also an attempt, trying to minimize the number of customers calling in. However, today there are not many customers who take advantage of this service when it comes to order entry (Country Sales Manager).

In addition to order placement, returns are the second most time consuming activity (Employee questionnaire). They occur when the customer, for some reason do not want the product(s). One return can include one or several units. The procedure for returns starts by a customer filing a return on AthleticSports.net. Thereafter it is a manual process handled by the customer service team. All products are sent back to the warehouse in Belgium, and each returns has to be

approved by the sales team prior to any action from the customer service team (Operations Lead). The figures related to order management and returns are summarized in the chart below.



**Table 4. Orders, Cancellations & Returns per Customer (Internal Database)**

#### **4.4.4 Other Administrative Functions**

One person is responsible for handling invoices and payment reminders. An invoice is triggered and automatically created, as soon as the products leave the storage in Belgium. (Financial Manager) The invoice is then printed and sent out to the respective customer by the cash collector.

When an invoice is due and no payment has been received, reminders to pay are also processed and created automatically. Consequently, both invoices and reminders do not create a lot of extra work for the employee. To send out invoices and reminders are equally time-consuming, regardless of the customer. Normally, the most time consuming activity related to reminders regards phone calls to customers in order to get them to pay. However, due to other commitments during the previous year, the responsible employee did not have time to pursue these follow-up calls (Cash Collector).

#### **4.4.5 Logistics**

One person, the supply chain manager, is responsible for improvements related to supply chain activities at Athletic Sports. The main task is to make sure that the company is as cost efficient as possible throughout the whole supply chain.

As mentioned in section 4.3, the majority of products sold in Sweden are shipped from a central storage in Belgium, since there is no product inventory in Sweden. Athletic Sports has decided that the customers should not have to suffer due to their choice of inventory location. Shipping is therefore free of charge for the customer, as long as they reach a minimum order value of € 500 (Supply Chain Manager). The cost for distribution is allocated directly to the European Headquarters, which leaves the Swedish profit and loss statement unaffected (Financial Manager). However the shipment routine differs a lot between customers depending on how they place orders in regards to frequency and quantities, and the number of end-destinations. Further, the costs for distribution vary from \$ 0,30 to \$ 2,11 per unit, depending on total weight per shipment. The costs involved with returns are much higher compared to the cost for distributing the products to the customer (Supply Chain Manager).

#### **4.5 Customers**

As mentioned above, customer set-up and purchase procedures differ between the three largest customers that are chosen for the analysis. The section below will give a description of each customer and its key characteristics.

##### **4.5.1 Customer Alpha**

Athletic Sports has had Alfa as customer for a long time. The relationship has developed throughout the years and today Alpha is classified as a strategic account. Hence, it is treated as a highly prioritized customer internally. In Sweden, Alpha is one of the largest retail-houses on the sporting goods market, with 99 stores. During FY09, their turnover amounted to 4,1 BSEK (Sportfack Homepage) and represented more than 40% of Athletic Sports' total revenue (Financial Manager).

A dedicated sales team has been set-up to solely serve Alpha. The team is lead by a Strategic Account Manager (SAM), who is responsible for the overall strategies and to ensure that internal resources such as marketing and sales are allocated in the best possible way. Three Strategic

Account Executives (SAE), each accountable for one category, are responsible for that sales targets are reached in the respective category. Overall, there are two main categories, Sportswear and Sports Performance, including a number of subcategories.

The buying procedure and order placement takes place at the office during one-on-one meetings. Alpha has a centralized buying process, which means that Athletic Sports only needs to communicate with a small group of people each season that is mandated to decide assortment for the whole chain. The majority of products are sold as future orders six months in advance. However the SAEs have daily contact with the customer to discuss sell-through numbers and evaluate different alternatives to increase sales (Strategic Account Manager).

As a strategic account, Alpha benefits from both pre- and post-sales support. The Visual Merchandisers are frequently out in the stores to upgrade in-store material. Moreover, the marketing team is sometimes involved when planning larger campaigns and the co-operation fund is only partly covering these activities why Athletic Sports uses additional resources to execute some of these initiatives. (Field Marketing Manager)

A full-time customer service representative, handling *At-Once* order placement as well as returns, supports the Alpha team. Some orders are processed electronically since both firms use a data system that enables EDI. However, a majority of the orders is placed manually (Operations Lead).

#### **4.5.2 Customer Beta**

Beta is a voluntary specialized store chain, which means that the majority of stores are owned and driven by separate owners, who all collaborate under a common name. Throughout this paper, the whole chain will be treated as one customer.

The chain has 145 stores and the turnover amounted to 3,6 BSEK in FY09 (Sportfack Homepage). Their sales process is somewhat complicated since it is managed both on centralized level as well as on a store level. Depending on turnover and classification by Athletic Sports, the stores are treated differently. The most prioritized customers are invited to the office for one-on-one presentations before the purchase process starts every season. Thereafter, medium sized stores are invited for group presentations. Besides those visits, Beta as a chain organizes a fair four times a year when Athletic Sports can meet with all individual storeowners. Further, order



placement for the coming season is also handled during these fairs. The KAEs for each business unit; Footwear/Equipment and Apparel, as well as FRs attend the fairs. For less prioritized customers, the fair is the only time during the buying process that these customers can meet with an Athletic Sports representative. The FRs makes local visits to the smaller customers during season to capitalize on replenishment opportunities and to preserve customer relationships. (Field Representative) Further, Beta receives a marketing contribution according to contractual agreements. However, neither retail nor marketing spend much time on projects related to Beta. Except for a small number of installations executed by the retail team in carefully selected stores. (Retail Brand Manager)

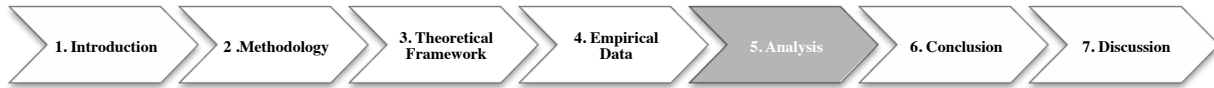
Order placement is done manually for each store due to incompatible ordering systems and different deadlines. This demands a lot of extra work and additional workers are hired to register orders in the system each season. Beta is assigned a CSR that helps out with manual order placements as well as to keep track of campaigns and to make sure products are shipped on time. A majority of Beta's orders are placed through a Sales Representative or by calling Customer Service. Beta has no central storage, instead Athletic Sports has to send shipments to each store. All in all, ten people at the office are somehow directly involved in the process of serving Beta. (Operations Lead and Sales Manager F&E)

#### **4.5.3 Customer Gamma**

Gamma has a similar structure to Beta with a number of individual storeowners collaborating under a common name. The owner-structure was modified in 1994 and today the company is partly own by the storeowners (47,5%) and partly by a Sports foundation (52,5 %) that act in favor for a sustainable development of Gamma (Gamma Homepage). The chain as group had a turnover of 2,2 BSEK in FY09 including 112 stores (Sportfack Homepage). Gamma is one of the largest players on the sporting goods market in Sweden. Similar to Beta, the whole chain will be treated as one customer throughout this paper.

The whole set-up and the services provided for Gamma is similar to Beta but with a few exceptions with regards to marketing and retail. Gamma receives a marketing contribution but no in-store support or other marketing resources. As in the case with Beta, Gamma has no central storage and orders are shipped to each store. Internally, ten people are involved in the process of serving Gamma (Operations Lead and Sale Manger F&E).

## 5. ANALYSIS



*This section provides an analysis of our empirical data with the intention to answer our research question. The empirical findings are discussed and linked to our theoretical framework. Costs related to sales, marketing, customer service and logistics are treated as CTS, while net margins are analyzed in separate section. Finally, each customer's profitability is presented and discussed.*

### 5.1 Activities and Cost Drivers

A number of activities and cost-drivers have been identified for the customer related functions while interviewing the employees at Athletic Sports. Additional information from the profit and loss statement has enabled us to recognize some costs that cannot be traced to an activity, but are directly associated with a certain customer. Thus, direct allocation has been used as a cost driver when possible.

When linking activities to costs, it is important to allocate them to the right cost object. The activities performed in a company have different aims, as mentioned in section 3. To make an accurate customer profitability analysis, we have therefore only included costs associated with customer sustaining activities in our analysis.

As mentioned in section 1, net margin is defined as revenues (including discounts) minus production costs. To make an accurate customer profitability analysis, the costs related to production should be calculated using ABC. Since Athletic Sports is a sales organization, we have had no insight concerning production costs and do not know how or which costs that has been allocated to each product. The activities related to the purchasing process, such as storage and distribution, are considered to be product sustaining and should therefore not be allocated to the customers. However, since all costs related to these activities are taken centrally and thus are not included in the product price that Athletic Sports pay, we believe it is appropriate to use Cost of Goods Sold (COGS) derived from the net margin in their actual profit and loss statement.

As mentioned earlier, **sales** is one of the core functions at the Swedish branch and has been identified as an activity. All sales representatives have been asked to estimate how much time they spent on a number of activities that was identified during interviews. It would have been preferable to use activities such as number of sales meetings, e-mails, visits, and phone conversations related to each customer but we had no access to such information. In addition to time spent, the cost for fairs has been directly allocated to the respective customer. Yet, it is questionable whether these costs should burden the customer, as it can be seen as a business sustaining activity. However since the customer organizes the fairs and a majority of future orders are placed during these fairs, they have been categorized under sales expenses. Finally, car usage is a parameter that has been included in the result in order to reflect the different needs for transportation when conducting business. Number of days using a car for customer related activities has been identified as the most appropriate cost driver since no mileage information was found. Customers visited by Field Representatives will thereby carry a larger cost for auto expenses.

A number of activities have been identified in relation to **Marketing and Retail**, starting with installations. They have been recognized as one of the activities directly correlated to In-store communication expenses, which compose a significant part of the retail budget. The cost driver for an installation is based on material expenses and manpower needed for the implementation. An average material cost has been calculated for each customer based on actual invoices for in-store material. As mentioned above the scope between installations differs between customers, which is reflected in the varying average costs of material. The cost driver for manpower is based on the number of involved employees and total time spent on installations. Thus, both number of installations and time spent is used as a cost driver for this activity.

Moving on to marketing contributions, it is worth questioning whether this cost should be treated as customer sustaining, considering that the fund should be used for activities and initiatives benefiting both parties. However, even if Athletic Sports can somewhat decide how this money should be spent the company is actually funding some of their customer's own campaigns. Due to the misuse of these funds, money is allocated directly to the customers based on the invoiced amounts.

Estimated time spent on other initiatives related to a specific customer is also included in the total marketing cost. Time spent has been recognized as the most accurate cost-driver to use since work-tasks and processes differs between each project and initiative. The estimated costs related to installations and time spent on each customer, plus the direct allocation of marketing contributions, are shown as an aggregated result called marketing and retail.

For **customer service activities**, including support, order management and returns, the most appropriate cost driver would be the exact time spent on emails and phone calls. However, since there is no information about minutes spent on each activity and customer, we have identified different cost drivers related to time. Regarding order management, the number of manual order lines is clearly linked to the amount of work, why the number of order lines is an appropriate cost driver. For returns however, it is the same internal procedure to file one return, regardless of the number of order lines involved. Instead, the cost is dependant on the number of units included why it is more accurate to use number of units as a cost driver. For regular customer support, estimated time spent on emails and phone calls is used as a cost driver.

For **administrative activities**, the numbers of invoices and reminders sent to each customer can be seen as an appropriate cost driver. However, the cost for letter rates was minor, why we have decided not to include this in our results.

Regarding **logistics**, number of units and number of shipments has been identified as the most appropriate cost-drivers given the set-up for our case company. Since we have had limited insight in the actual number of units involved in a delivery, we have made estimations on how many units that are included in each delivery<sup>3</sup>, resulting in an average number of units involved in one delivery. The actual shipment cost per unit has then been calculated according to the distributor's price-list.

### 5.3 Results

The net margin and the CTS are presented as a percentage of each customer's net revenue, in order to protect sensitive data and for competitive reasons. Net margin reflects revenue adjusted

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<sup>3</sup> Total number of units bought/Total numbers of deliveries

for discounts in relation to COGS, while CTS shows how expensive the customer is to serve. The calculations are based on the activities and cost drivers identified above while formulas can be found in Appendix 2.

### 5.3.1 Net Margin Realized

Due to sensitive company information, we will not be able to reveal each customer's discounts. However it will be included in the results and discussed below. As mentioned in section 4, the discounts are mainly based on revenue, and to some extent on how each customer's business set-up fit Athletic Sports marketing and sales strategies. However, the results below contradict the discount strategies mentioned above since customer Beta is receiving a larger discount although Customer Alpha generates a substantially higher turnover.

Net Margin	Alpha	Beta	Gamma
Net Margin (including discounts)	51,20%	50,81%	54,69%

A more thorough analysis leads us back to previous empirical findings regarding reserved products. The fact that these products are treated as sold products when doing forecasts, means that the sales force has to get the products sold regardless if the customer wants to replenish during season or not. Apparently, a higher discount is given than initially planned which leads to a distortion of the original discount system. When looking into the different discounts, this mainly concerns customer Beta, and to some extent also Gamma. It is interesting to note that Beta has the lowest margin and thus receives the highest discounts, even though Alpha receives extra discounts based on its centralized business set-up.

### 5.3.2 Cost-to-Serve

Our results related to sales, marketing, customer service and logistics are shown in the section below as well as an analysis of the underlying reasons.

#### 5.3.2.1 Sales

As mentioned in section 4.5 the same number of people is involved in the process of serving Beta as Gamma. However our calculations show that much more time is spent on serving Beta compared to Gamma. Actually, Beta appears to be the most time-consuming customer out of all three. The total time spent on customers is divided as follows: Alpha 37%, Beta 42% and

Gamma 21%. It is interesting to note that Gamma stands out as the customer consuming most sales resources in relation to its revenue even though Alpha has its own dedicated sales team.

CTS of Net Revenue	Alpha	Beta	Gamma
Sales	1,49%	2,94%	4,84%

By studying the individual components of the result above more information is found related to how the different business models influence resource allocation. As for auto expenses, both Beta and Gamma generates much higher costs since sales representatives has to visit individual stores when conducting business instead of visiting only one counter-party, as in the case of Alpha. Moreover, the fairs organized by Beta and Gamma is not only time-consuming, costs for travelling and fees also have to be included. It is evident that both Gamma and Beta requires a lot of pre-sale support. Not only is Alpha the cheapest customer to serve with regards to time spent, no additional resources are needed for neither fairs nor costly travelling.

#### 5.3.2.2 Marketing and Retail

The results show that Alpha benefits from most post-sales support in terms of both marketing and retail in comparison to Beta and Gamma. As expected, Gamma shows a lower result than the other two since they receive little in-store support or attention from the marketing division.

CTS of Net Revenue	Alpha	Beta	Gamma
Marketing & Retail	3,68%	3,32%	2,14%

A substantial part of the marketing costs, 68% originates from the marketing contributions. Our results show that all three large volume-customers receive a marketing contribution in line with contractual agreements. Moreover the estimated cost for campaigns, based on time spent, makes up only 5% of the total cost to serve for marketing. The quite low number could be explained by the fact that the majority of campaigns implemented rarely have a unique connection to one chain and is therefore not included in the calculation. Instead they can be seen as brand building, and thus business sustaining. Installations and In-store communication represents the remaining 27% of marketing and retail costs. However the level of support differs a lot between the customers and 93% of the estimated retail costs can be directly related to Alpha. They receive

the largest number of installations and have the highest average cost of material, which indicates that the scope of the average installation for Alpha is relatively large.

#### 5.3.2.3 Customer Service

A majority of costs generated by Customer Service can be traced back to returns, amounting to 62%. Order management and support represent 27% and 11% respectively. The manual order placement is foremost an activity that is needed for customer Beta and Gamma, since Alpha place a substantially lower amount of orders in total. Both customer Beta and Gamma have a higher return rate than customer Alpha, which further explains the result. In actual numbers, customer Alpha is the cheapest one to serve, while customer Beta is the most expensive one. However, turning to percentage of revenues, the smallest customer Gamma is most expensive to serve, as shown in the table below.

CTS of Net Revenue	Alpha	Beta	Gamma
Customer Service	0,35%	0,93%	2,00%

One can also look at the average order value per order line, to explain the differences in time spent and costs. In doing so, it becomes evident that the customers have different buying behaviors. Customer Alpha has an average order value of SEK 15 000 per order line, while customer Beta's and Gamma's average order value amounts to SEK 1800 and SEK 1500 respectively. Alpha has the largest order value in total, but the lowest amount of order lines. Thus, Alpha buys a large number of units per order line, resulting in a high average order value. Beta and Gamma have a different organizational structure compared to Alpha, leading to the placement of smaller and more frequent orders.

#### 5.3.2.4 Logistics

The results presented below are based on the assumption that each customer receives 1,5 shipment every week throughout the year and that units are distributed evenly between stores when shipments are sent to separate doors. Not only does Alpha order more units in total, their average weight per shipment is much higher compared to both Gamma and Beta. Consequently they receive a much lower price per unit, since price is based on average weight per shipment.

<b>CTS of Net Revenue</b>	<b>Alpha</b>	<b>Beta</b>	<b>Gamma</b>
Logistics	1,50%	5,26%	6,26%

All in all we believe our simplified calculation with regards to logistics brings out an important difference between the three customers.

## 5.4 Comparison of Results

Our Analysis has been based on two parameters, Net Margin and CTS. The final result has been obtained by subtracting the estimated CTS for each customer from their respective Net Margin. The table below illustrates the results of each customer's profitability.

<b>Customer Profitability</b>	<b>Alpha</b>	<b>Beta</b>	<b>Gamma</b>
Net Margin	51,20%	50,81%	54,69%
<b>CTS of Net Revenue</b>	<b>Alpha</b>	<b>Beta</b>	<b>Gamma</b>
Sales	1,49%	2,94%	4,84%
Marketing & Retail	3,68%	3,32%	2,14%
Customer Service	0,35%	0,93%	2,00%
Logistics	1,50%	5,26%	6,26%
<b>TOTAL</b>	<b>44,18%</b>	<b>38,36%</b>	<b>39,45%</b>

As seen in the table, none of the three customers are unprofitable. Alpha stands out as the most profitable customer in relation to revenue and is also cheapest to serve. Moreover it is interesting to point out that Beta appears to be least profitable out of the three, receiving the largest discounts at the same time as their CTS is 1.7 times higher in comparison to Alpha. Gamma on the other hand receives much lower discounts that better balance their substantially higher CTS and ends up as more profitable in relation to Beta.

It is evident that logistics represents a substantial part of the total cost to serve. This is also where the CTS differs the most between the customers. These costs do not appear in Athletic Sports Financial Statement and is instead based on our estimations. However, in this case we refer to the argument that it is better to be approximately right, than precisely wrong, which is in line with an



ABC approach. Alpha carries a lower cost due to their centralized distribution center, while delivering to Beta's and Gamma's individual stores is more expensive.

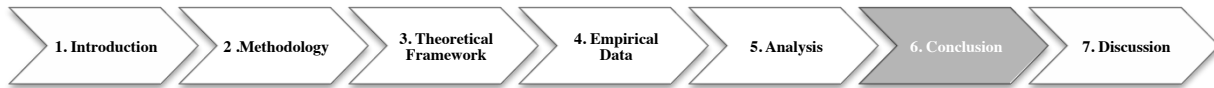
Marketing and Retail also represents an essential part of the CTS. Besides the marketing contribution which all customer's receive, Alpha benefits from a large amount of post-sales support, which makes Alpha the most expensive customer to serve. It is also arguable whether the marketing contribution should be treated as an extra discount instead of CTS. However, such redefinition would only affect net margin but our final results would remain unchanged.

When comparing our findings to the theoretical framework it is evident that all three customers possess some of the characteristics of both a high and a low CTS customer. However, more high CTS characteristics can be observed for Beta and Gamma. Key behaviors related to the customers and that have influenced our results have been summarized in the table below.

High Cost-to-Serve Customers	Low Cost-to-Serve Customers
<ul style="list-style-type: none"> <li>• Small order quantities</li> <li>• Unpredictable order arrivals</li> <li>• Customized delivery</li> <li>• Manual processing</li> <li>• Large amounts of pre-sales support</li> <li>• Large amount of post-sales support</li> <li>• Large discounts</li> </ul>	<ul style="list-style-type: none"> <li>• High order quantities</li> <li>• Predictable order arrivals</li> <li>• Standard delivery</li> <li>• Electronic processing</li> <li>• Little amounts of pre-sales support</li> <li>• No post-sales support</li> <li>• Nil to low discounts</li> </ul>

**Table 5. Identified customer characteristics influencing Cost-to-Serve**

## 6. CONCLUSION



In the presented theoretical framework, we concluded that there was contradicting research in the area of customer profitability and size. As shown in our result, none of the largest customers were unprofitable. However, as suggested by several authors (Shapiro, 1987, Howell and Soucy, 1990), customer profitability is not only driven by sales volume. In conformity with Guerrerio et al (2008), our study shows that there are differences in costs related to serving these customers. The largest customer Alpha is the cheapest one to serve, and is most profitable since their lower margin by far compensates for their relatively low CTS. Beta, however, receives the largest discount but also generates high CTS mostly related to large pre-sale support and logistics cost, why they end up as the least profitable customer. In actual numbers, Beta is in fact more expensive to serve than Alpha, even though Alpha's revenue is more than 60% higher than Beta's. Gamma stands out as the most expensive customer to serve and consumes over twice as much resource as Alpha. Gamma is, however, the smallest customer in terms of revenue, thus receives the lowest discount, why their higher margin makes them more profitable than Beta.

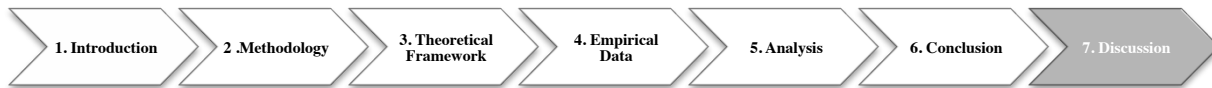
Gamma and Beta have many of the characteristics that typically define a high CTS customer, such as small order quantities, specialized deliveries and a large amount of pre-sales support. Aside from these characteristics, we have identified two other parameters related to business set-up that has had a major impact on our results; degree of centralization and order deadlines. There is no question that team Alpha has to spend less time on pre-sales support in comparison to both Gamma and Beta. Moreover they can provide better post-sales support in terms of sales strategies as well as retail support. While representatives for Gamma and Beta are attending fairs, trying to convince each separate store owner on what to buy, team Alpha can concentrate on replenishment and to capitalize on opportunities that occur during season.

Another important component related to business set-up is miss matched order deadlines that have long gone effects on discounts, as reserved volumes are treated as sold products heavy price reductions are given away in order to reach sales target. This is obviously a general explanation

of two quite complex phenomena, however we believe they are the most appropriate components to take out when trying to explain the underlying reasons behind our results.

To conclude, it can be questioned whether the current discount system and sales process encourage a desired behavior among the customers. Customer's can obviously gain from not placing future orders, even though these initially are associated with a higher discount. Consequently, this leaves the customers with little incentives to change their buying behavior. In the end, the current miss-match between order deadlines makes it difficult for the company to influence this process. Further, this could also be seen as a result of the bargaining power that these large customers possess, as they more or less dominate the whole sporting goods market in Sweden.

## 7. DISCUSSION



### 7.1 Strengths and Weaknesses

To begin with a case study is by definition limited to its context and the results must be viewed accordingly, which the reader has to keep in mind when possible generalizations have been made. As we have mentioned already it is questionable whether marketing contributions should be treated as customer sustaining or business sustaining.

Due to limited internal documentation much of our empirical data has been based on information during interviews. There is a risk that answers have been affected by personal opinions and that time estimations might deviate from the actual results. Moreover, it would have been interesting to include a customer perspective to validate and compare data collected from the case company.

Actual numbers has been hidden in this study due to confidentiality reasons. In some cases it would have been valuable to use actual numbers to better describe some of our findings. However, we have compensated by giving thorough explanations for how and which components that has been included in each result.

By limiting our study to only three customers we have managed to conduct an in-depth analysis in line with our theoretical framework and to measure profit margins in relation to CTS for all three customers.

### 7.2 Suggestions for Future Research

A number of issues beyond our research question have surfaced during the process of this study. Below we present some suggestions for future studies that could provide additional information as well as further develop our reasoning.

- Conducting a similar customer profitability analysis at another company within the Sporting Goods industry would enable more general findings applicable for the industry as a whole.

- A follow-up case study on how customer profitability could be increased and how resources should be allocated based on our findings.
- As the company will implement a new organizational structure during FY10 based on category alignment rather than business units. It would be interesting to compare our findings with a similar study on customer profitability, given the new organization.

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## **APPENDIX 1**

### **Interviews**

Area Manager Nordics, 2009-10-02

Financial Manager, 2009-10-08

Country Sales Manager, 2009-10-08

Sales Manager Footwear & Equipment, 2009-10-06

Strategic Account Manager, 2009-10-06

Customer Operations Lead, 2009-10-16

Supply Chain Manager, 2009-10-09

Field Marketing Manager, 2009-10-16

Cash Collector, 2009-11-03

Retail Brand Manager, 2009-11-05

Field Representative Footwear & Equipment, 2009-11-05

### **Interview Questions**

What is your position in the company?

What are your main responsibilities?

How many employees are included in the team and what are their main responsibilities?

How much time and workload is normally devoted to each task (percentages)?

How much time do you spend on each customer in regards to the mentioned tasks (percentages)?

Does the workload related to your tasks differ depending on the customer involved, and why?

What are the main differences between the customers?

Can the workload related a task differ depending on circumstances? If so, what circumstances?



## APPENDIX 2

### Formulas

The percentage for each customer has been calculated according to the below formulas:

#### Sales

$$\frac{\text{Percentage of estimated time spent on sales related activities} \times \text{Average Wage Cost} \\ (\text{including employment tax, bonuses, other benefits, and rent cost}) + \\ \text{Fair Expenses} + \text{Auto Expenses}}{\text{Net Revenue Customer}}$$

Wage related costs include wage expenses, bonus, benefits, and employment taxes and is based on information from internal financial data. For each function we have used the total wage related cost to derive an average wage related cost for each worker. This is based on an assumption that all employees within the same function have the same wage.

The cost for rent is based on the assumptions that each employee works 250 days per year, 8 hours a day, which corresponds to 83,33 days per year ( $250 * (8/24)$ ). The total rent cost is divided by the number of workdays per year, and then divided by the total number of employees at the office. The field representatives, who spent most of their time out on the field, have been excluded.

Car usage has been derived using an average daily costs, based on an monthly leasing charge for a car, and is dependant on how many days an employee use a car for customer visits.

#### Marketing

$$\frac{\text{Number of Installations} \times \text{Cost per Installation (including material and labor expanse)} + \\ \text{Time spent on Marketing and Retail Activities} \times \text{Average Wage Cost} + \\ \text{Co-operation Funds}}{\text{Net Revenue Customer}}$$

The co-operation funds have been directly allocated to the respective customer based on the invoiced amounts.

Number of installations has been derived from the retail calendar for FY09, showing all installations made for each customer, including the material expenses. Labor expenses are based on the total time spent on installations and the number of people involved.

#### **Customer service**

$$\begin{aligned} &\text{Number of Order Lines} \times \text{Order Cost} + \\ &\text{Number of Cancellations} \times \text{Cancellation cost} + \\ &\text{Number of Units Returned} \times \text{Return Cost} + \\ &\text{Times spent on customer support} \times \text{Average Wage Cost} \end{aligned}$$

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Net Revenue Customer

The cost per order is estimated by the total time spent on orders, dividend by numbers of orders. The same estimation is made for cancellations. The return costs per unit is based on the figures from the internal database, including the cost for handling returns and the charge for distribution of products.

#### **Logistics**

$$\underline{\text{Number of Deliveries} \times \text{Average Delivery Cost}}$$

Net Revenue Customer

Number of deliveries is based on the assumptions that the customer receives from 1.5 deliveries per week, i.e., 72 deliveries annually. The average delivery cost is based on the number of units included in each delivery, which in term determinates the weight. The unit cost is based on the average weight.