

## Uncovering unprofitable products & customers

A brewery had annual sales of approximately £50 million and was suffering long term decline. The company had around 1000 people in the brewery, warehouse and managed estate. They also had tenanted pubs. Their wholesale wines and spirits division, which accounted for around £10 million of sales, operated in a highly competitive market.

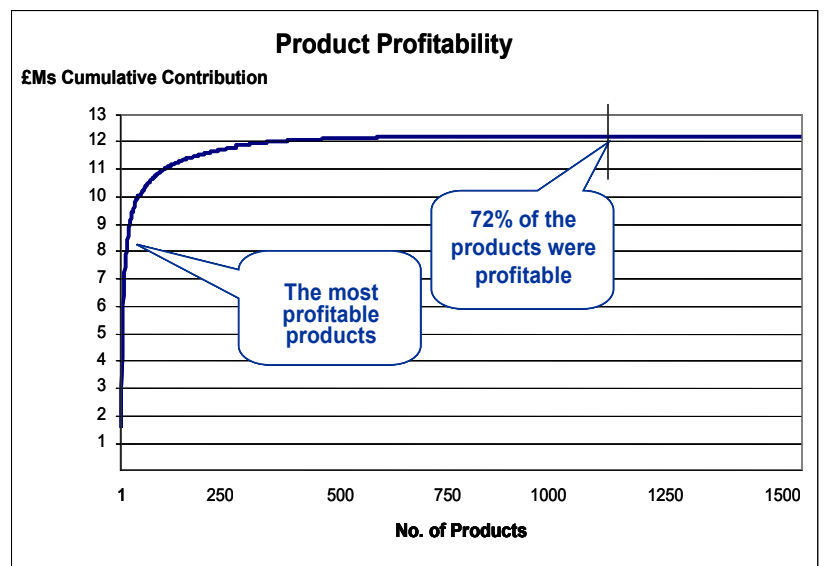
Although margins overall were shrinking, management suspected that some parts of the business were performing worse than others. But the gross margins of the different product groups and customer segments, as reported in the management accounts, and used as their key performance measure, all looked fine. Managers suspected that gross margins had become an inadequate measure of profitability, masking hidden costs. The company needed to understand its *net margins* - for all its products, for all its customers.

### The Activity Based Management project

The objectives of the project were to create an ABM model of net product and customer profitability, train the company's staff in the principles and techniques of ABM and in model-building, and to draw conclusions from the results.

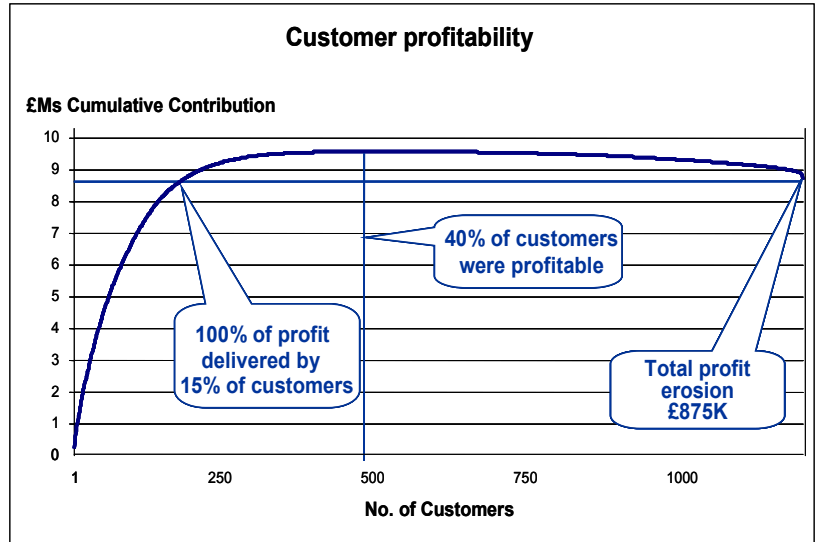
### Results

For each product, the contribution to profits was calculated by subtracting from its revenue all costs that supported it or that were driven by it. The results were presented graphically (as shown right) by sequencing the products by size of contribution, biggest on the left, and plotting the cumulative contribution of them all. Although a number of products were highly profitable, about 40% of them provided close to zero contribution - the flat part of the graph. The last 28% were marginally losing money.



A similar exercise was carried out for each customer. The result was a shock: Only around 40% of their customers were profitable. The rest were losing the company £875K.

100% of profit delivered by 15% of customers



Further analyses showed up other interesting results, some of which were a real surprise. For example:

1. 20% of the customers of the wholesale business were profitable, contributing £300k. Unfortunately the others pulled profitability down to an overall loss of £100k. The only viable option was to withdraw from certain geographic regions because little could be done to bring costs down to the levels needed to turn this part of the business round.
2. 50% of the free trade made a healthy profit, mainly because the product mix was predominately 'draught'. Where the mix was mainly 'bottled' this segment lost money.
3. All tenanted and managed houses were profitable, which was reassuring.
4. Only 50% of the Take home/National business was profitable. This segment needed working on to build up gross margins.

The analyses in the model showed management where specific actions would lead to healthy gains in profitability in the short to medium term. Further refinement of the model then delivered many pointers to subtle changes in the business that helped it continue to build a growing and robust bottom line.

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### Why did the project make such a difference to business performance?

In the words of the Managing Director - "The Develin & Partners approach made all the difference. It uncovered where profits were being made or lost. It showed the underlying reasons for losing money and what we needed to do to turn unprofitable business around. And it gave management the confidence to drop whole segments of unprofitable business when there was no hope of turning it to profit"