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**THOMAS & JOAN READ CENTER FOR
DISTRIBUTION RESEARCH & EDUCATION**
TEXAS A&M ENGINEERING EXPERIMENT STATION

Customer Stratification



TALENT INCUBATOR
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**GLOBAL SUPPLY CHAIN
LABORATORY**
TEXAS A&M ENGINEERING EXPERIMENT STATION



Overview and Need

Customer Stratification has the power to enable us to transform our company from being product-driven to customer-driven. It has helped us understand our customers in greater detail, enabling us to optimize our selling resources, which will result in an improved ROI.

-Don Schalk, President and COO, C.H. Briggs Company

Wholesaler-Distributors operate in a complex environment. Customers view distributors as “middlemen” providing logistics services, local inventory and credit terms. Distributors have been facing gross margin pressure from both suppliers and customers for a long time, yet they are still expected to provide increasing quantities of value-added services. In light of these difficulties, many distributors have turned to scientific methods to determine which customer segments to prioritize and upon which to focus their improvement efforts. Customer stratification is a valuable strategic tool for distributors to understand how to build sustainable customer relationships that drive growth, improve efficiency, and increase return on investment (ROI).

The customer stratification process begins with an analysis of how individual customers impact the distributor’s success and develops criteria for understanding how to improve customer relationships. This analysis enables the distributor to develop strategies that can increase sales, improve margins, drive customer loyalty, and lower the cost to serve. The analysis can be used to direct the sales force on how to pursue potential core customers, drive low profit/high service cost customers to the core, and optimize the core customer relationship.

Texas A&M’s Thomas and Joan Read Center for Distribution Research and Education has pioneered Customer Stratification through its research consortia, and has since conducted multiple Customer Stratification projects for a variety of distributors. They have honed the process into a refined analytical method that leverages customer knowledge to deliver real results.

Our research team will collaborate with your process experts and high-potential candidates to teach them to develop a Customer Stratification process for your firm. We will then conduct an education session that enables all decision makers to leverage the process to redefine and elevate the firm’s competitive position.

Methodology

An Education Driven Optimizing Process:

The firm’s internal experts and high-potential leadership candidates will work with our research team to develop a customer stratification process and an educational program that is relevant and specific to their customer data. The process steps are as follows:

1. Mapping the supply chain and current stratification process:

Understand the firm’s current supply chain in terms of material and information flows from source to destination, along with any current customer stratification practices.

2. Customer Stratification - Design and analysis :

a. Cost to Serve (CTS):

One of the critical components of the customer stratification model is ‘cost to serve’. This analysis is difficult to measure quantitatively, due to the complexity involved with the required data. Proxy measures, however, can be defined to design and develop a company-specific cost to serve model. These proxy measures provide a high degree of accuracy while allowing for more tractable calculations and ease of understanding by key decision makers such as the firm’s management and the sales force.

b. Customer Stratification – Design & Analysis:

A classification of customers into groups based on profitability, cost to serve, loyalty and buying power is an essential step in developing a customer-centric operations strategy. The Texas A&M customer stratification model will be customized for this session to fit the company’s environment. The customer stratification model will be applied to stratify customers into four different groups such as Core, Opportunistic, Marginal, and Service-drain.

3. Custom Education Session:

The Executive Session focuses on the Applications of Customer Stratification including Pricing, New Product and Service Introductions, and Marketing Strategies, as well as Salesforce Deployment, Enablement, and Compensation. This session will identify strategies to both acquire new relationships and to realign those of existing customers. The presentation of stratification results in a workshop setting will provide attendees with the knowledge and skills necessary to develop objectives and a strategic growth plan, along with the initiative to pursue their strategies and achieve the relevant objectives.

Project Description:

The project will be conducted as illustrated in Figure 1:



Figure 1: Customer Stratification Project Steps

Customer Stratification Analysis

Determining the cost to serve for each customer is critical to making any effective pricing or service support decision. CTS includes allocation of total costs to each customer beyond basic materials costs. Most firms find CTS difficult to estimate given that it contains numerous, highly complex variables. CTS, however, is typically most heavily influenced by a small set of easily measured factors.

Activity Based Costing techniques consider a much larger set of cost drivers, but they can quickly become too complex due to the lack of reliable data and the inability of decision makers to collate and understand the output. Surrogate measures are simple to understand, few in number, allow for action-based decision-making, can be easily calculated, and are thus used in calculating the customer stratification results.

Some critical factors that can be used to quantify CTS are illustrated in Figure 2 on the next page.



Figure 2: Cost to Serve (CTS) Model

Classification of customers into groups based on profitability and volume is an essential step in developing a customer-centric operations strategy. Best practices include the stratification of customers into different groups such as Core, Opportunistic, Marginal and Service Drain. Core customers are profitable customers who transact in high volume on a regular basis. To increase profitability, the most effective decision that a firm can make is to maximize the share of sales made to Core Customers. Identifying, analyzing, and building strategies to optimize relationships with all customer groups are critical to achieving a superior ROI.

Figure 3 shows the major activities that will occur in this program in sequence:

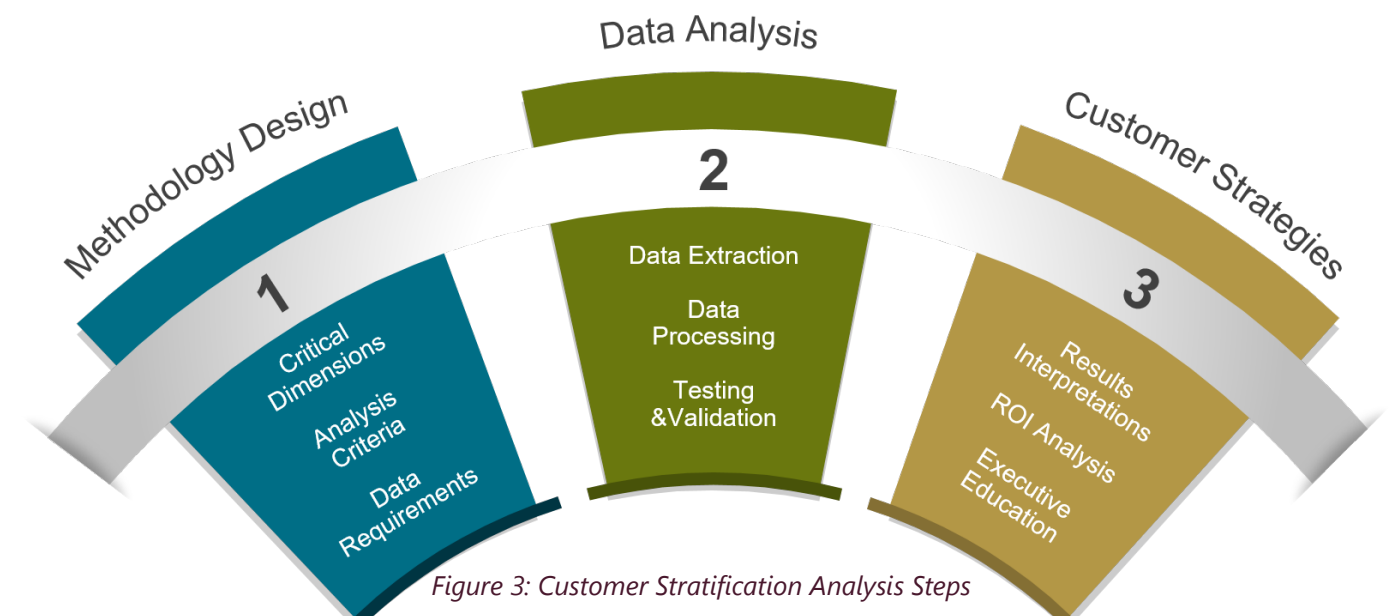
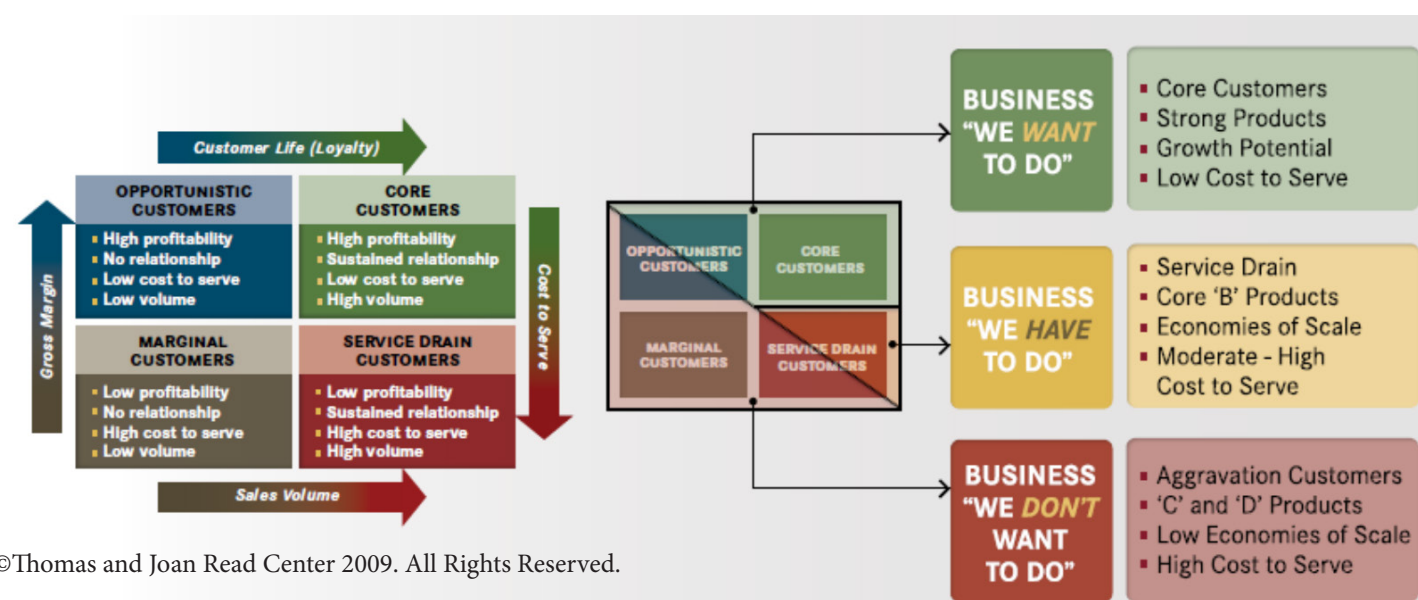


Figure 3: Customer Stratification Analysis Steps



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Figure 4: Texas A&M Customer Stratification Framework

Figure 4 illustrates the Texas A&M customer stratification model. The following critical factors and other parameters will be addressed in detail during the design and analysis stages.

Buying Power: Customer buying power is the level of spending and collaboration that customers exhibit. Most distributors use a one-dimensional approach based on revenue to rank customers, but the Read Center's approach is to measure buying power using a combination of factors such as customer spending (revenue), number of items accessed, and product line penetration.

Profitability: High sales volume, in and of itself, does not automatically make a customer profitable. Apart from the direct effect on profitability, Gross Margin \$ and Gross Margin % indicates whether a customer is a tough negotiator on pricing.

Cost to serve (CTS): CTS eats into the distributor's gross margins. Some customers demand higher levels of services, which keeps net profits (NP) down. If these customers have high sales volume, and are tough negotiators with low gross margins, they could become service drain customers. Conversely, if they have low sales volume, they will more likely be marginal customers.

Customer Alignment / Loyalty: A customer could be very profitable with a high sales volume, but could switch suppliers abruptly based on solely on price. It is extremely difficult to come up with a good measure for Alignment but the number of orders or hits can serve as a good estimate of customer lifetime loyalty.

Custom Education Session:

The Executive Session will focus on the applications of Customer Stratification, including Pricing based on Customer type, New Product and Service Introductions, and Marketing Strategies, along with Salesforce Deployment, Enablement, and Compensation. Stratification results will be presented to attendees so that they can learn the knowledge and skills necessary to develop objectives and a strategic growth plan, along with the initiatives to implement customer strategies and achieve their goals.



Figure 5: Customer Stratification Applications

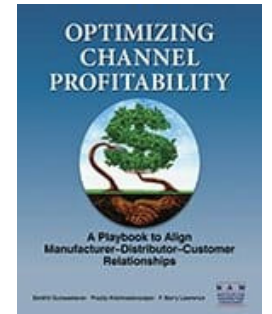
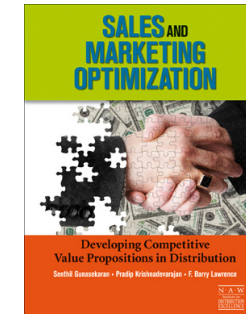
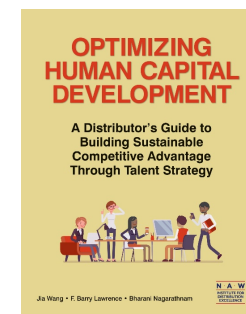
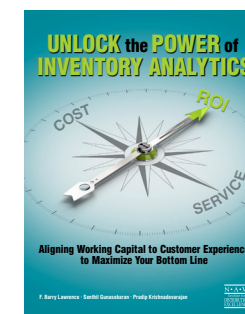
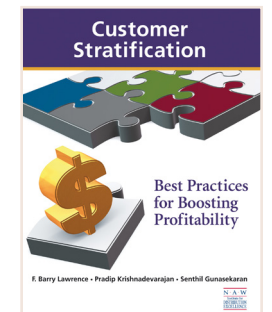
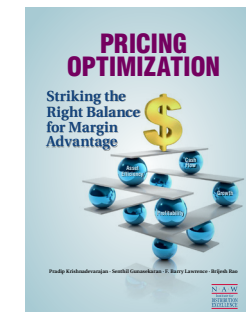
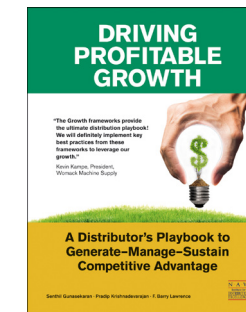
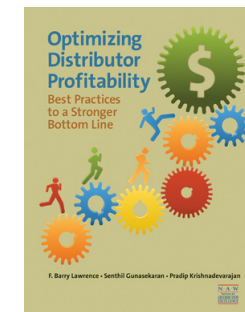
Who Should Attend?	Benefits
<ul style="list-style-type: none"> Sales and Branch Managers Customer Service Personnel Executives and Strategic Managers Business Analysts and IT Managers 	<ul style="list-style-type: none"> A structured analytical approach to help companies achieve and sustain success during rapid business growth. A neutral, third-party perspective by Texas A&M with a supply chain focus leading to global (overall company) instead of local optimization.

Current Publications



All publications are published through Texas A&M University's partnership with the NAW Institute for Distribution Excellence. The following publications can be purchased here:

<https://www.naw.org/naw-institute-for-distribution-excellence/#CRDBP>



Deliverables

- Cost to Serve (CTS) Methodology - Company specific CTS model will be developed.
- Cost to Serve Results – The CTS results for locations at the customer level in spreadsheets will be a key deliverable.
- Customer Stratification Methodology – The stratification criteria list the ranking rules for different customer categories. This will include Texas A&M's analytical method to derive the final stratification rank combining 4 ranks based on key dimensions such as Sales, GM (\$ and %), Alignment, and CTS.
- Customer Stratification Results – The stratification results for locations at the customer level will be recorded in spreadsheets to be used for validation of results and for more effective future decision-making.
- Executive Session – Attendees will receive comprehensive education on the theory and practice of Customer Stratification, and how to leverage it for future business success.

WHY WORK WITH US?



Number 1

Industrial Distribution program in the world.



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60 years

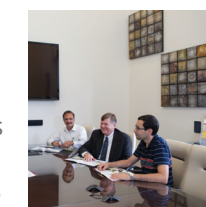
Program duration is

1-5 Days



10+

unique topics that will boost your firm's bottom line.



Learn secrets to implement key best practices in

3-6 Months



Help more than **265** companies each year to create competitive advantage

Over 1,000

business professionals attend our workshops every year

24 Instructors

Average teaching experience of at least 16 years



For more information, please contact Patrick Dolan at readcenterinfo@tamu.edu.



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