

TIPS *from* LauberCFOs

Managing the Risk of a Single Large Customer

A Sales VP proudly announces “we just closed an account that will double our volume. Is this good news, bad news or some of both? Many businesses rely on one large customer for a majority of their revenue. That situation has its benefits, but it also has risks that should be carefully managed.

The major benefit of a large customer is the revenue that your company probably would not realize from a collection of smaller, individual customers. Additional benefits are economies resulting from ability to preplan longer production runs, economical material sourcing, improved labor utilization and credibility in the marketplace.

As long as the large customer is doing well and you are properly servicing the business, you, as a vendor, should do well. Conversely, when a large customer is amid difficult business circumstances or decides to “go offshore”, vendors are affected, sometimes significantly.

Aside from working to expand and diversify a customer list, businesses that rely on a single large customer should have a very clear picture of the financial relationship with those main clients. Managers often assume there is a cost benefit (i.e. lower admin costs) associated with dealing with a large customer. While this may be true, often it is terribly wrong.

While a vendor may be well aware of the revenue the large customer is providing, many times the costs associated with serving a large customer are not well understood.

Those unique costs can be associated with:

- Communication requirements
- Interfacing with customer’s systems
- Inventory carrying costs
- Invoicing requirements
- Longer invoice payment periods

- Material obsolescence
- Need to stock low volume parts
- Overtime
- Quality documentation
- Quantity discounts or rebates
- Rush orders
- Seasonal fluctuations
- Special packaging

In addition to sometimes hidden costs, there can be other risks associated with large customers:

- Physiological barriers to raising prices.
- Difficulty turning down individual unprofitable requests.
- Required investments in production capacity without protection of long term contracts.

It’s essential to have a good handle on those costs that, in some cases, are higher than the costs of serving other customers.

- The knowledge will let you know how your costs to serve that customer compare with costs to serve other clientele, and whether you are actually making money off the large customer.
- Good information could help your efforts to expand your business. If you are pricing work based off the higher costs of doing business with a large customer, potential new customers may see your costs as excessive. After you recognize the true costs of doing business with a large customer, you can set prices for other customers based on a more appropriate cost allocation.
- You will be in a better position to negotiate pricing with a large customer if you can show clear and complete information on the costs of serving that customer. Your negotiation powers also will increase if you are positioned as an integral part

of the large customer's operations. Constantly strive to tie your business to the success of the large customer, making your contributions more valuable and making it hard for the company to cast aside your business.

- A joint planning process can help identify additional areas where you can add value to your key customer.
- Preplanned update sessions should help to eliminate surprises in the relationship.

Of course, being closely tied to a large customer does not guarantee continued profitable business, or continued business at all. Wisconsin and the Midwest have seen plenty of large manufacturers move operations to other regions or offshore in the face of economic pressures. Those moves have significantly impacted smaller, local suppliers. Some have adjusted by redeploying in a more

profitable way. Others have gone out of business or reduced operations.

Our economy will continue to evolve. If a major portion of your business is with one large customer, or if you are seeking to do business with a large company that could provide the bulk of your business, it's extremely important to evaluate the risks. How would your company deal with the loss of that business?

If you'd like to confidentially discuss the true financial impact of a large customer on your business, call us at 414-273-8060 or, outside of Milwaukee, at 800-358-8060. You can also e-mail us at John.Lauber@LauberCFOs.com. One of our LauberCFOs would be happy to confidentially work with you.

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