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How do you know when you need to 'fire' one of your customers?

Every small business needs to understand where it adds value, and knowing when a customer is unprofitable is the first step

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Entrepreneurs are generally optimists who believe even the most complicated customer who demands so much and quibbles over every penny of additional cost will eventually come good.

The trouble is, they very rarely do, according to Stephen Archer, a business analyst and director at Spring Partnerships. In his experience of advising SMEs, company heads need to be constantly asking their team how much each client brings in and how much it costs to service them. Unprofitable customers should then be considered for "firing".

"Entrepreneurs are normally happy for business, particularly in the early days," Archer says. "It can be easy to forget you actually need profitable business. So every business needs to review its customers every quarter and see if there's anyone they need to fire.

"It may sound counterintuitive but you just can't afford to lose money on people. You may get resistance from the team who brought the business in but if it's not profitable business, it's just not worth having."

So, after staff have laboured hard to win a customer and a client might be publicly unhappy about being let go, how does one go about "firing" a customer?

"The simplest way of getting rid of a customer is to raise your cost," advises Archer. "It's the best approach because a lot of companies will just pay it and then you've turned them into a profitable customer. If they don't, then at least you've not fired them outright and they can take their loss-leading business to bleed one of your rivals dry with."

Adding value

The process may be difficult but it can actually help a SME define how it adds value and avoids pursuing low-value, cost-cutting projects, which ultimately impact profitability. That is the encouraging advice from serial entrepreneur and lecturer at the Henley Business School, Stuart Morris.

"Companies need to take a long look at what they do and where they add value," he says. "If there are clients who need more servicing than others, and so are unprofitable, they need to be made aware that they're costing you money.

"You can't be afraid of charging for the value you bring or else you'll just find the customers who you thought would make you bigger are just holding back profitability. So, if people are quibbling over cost then you have to be prepared to let them go or mutually decide on an aspect of the products or service they take from you that can cut back."

Although any director should be able to find out who are the company's least profitable customers by asking the right people for the figures, there is another telltale sign to listen out for.

"If there's a customer costing you money you often find out about them because their name just keeps cropping up," he says.

"In a business I'm involved in, for example, one client kept cropping up as putting in lots of support calls. It wasn't until we called them that we realised they had replaced most of their in-house support team and so were placing a lot of calls with us. So we split the cost of a training session to bring their new guys up to speed. If we hadn't worked together to solve the issue, we'd have probably ending up needing to have a very different conversation. You just can't allow someone to take up your resources and expertise without paying for it."

Avoiding mistakes

Quite often SMEs need to realise that there is not a problem with either their company or the customer, the issue may be that a business is not set up to work efficiently with particular types of clients.

That has certainly been the experience of Carl Benfield, managing director at renewable energy company, Prescient Power.

"You have to be realistic about who you want to work with and who it's profitable for you to work with," he says.

"We've found out the hard way that many public sector bodies simply aren't worth us bothering with. You spend months and months pitching for a project and can end up on a shortlist of a dozen or even 20 rival providers. You have to factor in your time not just in servicing a customer but in winning them and when you're spending all this time, it's likely not to be worth it, particularly if you've put in all that work and there's still not a decision."

Future focus

A positive aspect of parting company with clients or breaking off negotiations with prospects who are not a good fit is that they can help focus a business on its next stage of development.

That is certainly true of Sam Parton's online sports booking startup, OpenPlay. He tried to work with some big customers early on but was not at a stage where he could fully support them. They now top his to do list for client meetings in the year ahead.

"We were finding some clients were just too complicated for what we could offer," he says. "Some leisure centres and gyms want to make their facilities bookable online through us but only to certain types of members at certain times and at different rates. These, and other complications, meant it would've been too expensive for us to develop the required technology.

He adds: "However, we're working on what they need and so have used the exercise to find out what features our next batch of customers will need to fuel our next stage of growth."

So, parting ways with customers can be a positive step. On the one hand they may react positively to a frank talk about fees going up in line with their demands. On the other, you can define the way your company adds value at the same time as identifying tomorrow's conquest opportunities.