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Customer accounting and customer profitability analysis for the order handling industry—A managerial accounting approach

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Abstract

Market-oriented businesses are concerned with customer satisfaction and business profitability, both in the longer term. Thus the marketing managers need updated decision-relevant information (marketing metrics) with respect to the set of processes that are leading to customer values and economic customer values. The attention of this study is focused on the profitability aspects of marketing. The context is the business-to-business order-handling industry, i.e. four exporting companies and 176 of their customers in 36 various markets. A market-oriented accounting framework that can be included as a natural part of a managerial accounting system is introduced and discussed, and financial reports as well as graphic representations and key figures for various levels of a market hierarchy are presented. The findings with respect to the profitability of orders, customers and markets are presented and the managerial implications are discussed.

Keywords: Customer profitability; Order profitability; Market profitability; Market-oriented accounting framework; Practice of marketing; Managing customer relationships at a profit

1. Introduction

Market-orientation implies that great importance is attached both to customer satisfaction and business satisfaction. Customers are satisfied when the offered products and services meet their needs, desires and requests, i.e. are creating customer values. Businesses are satisfied when exchanges and relationships result in long-term profitability, i.e. are creating economic customer values. This duality has been called attention to in many publications since the marketing concept came into use at the end of the 1940s (e.g., Ames, 1970; Anderson & Mittal, 2000; Bagozzi, 1975; Felton, 1959; Grønroos, 1990; Kohli & Jaworski, 1990, 1993; Narver & Slater, 1990). Nevertheless, the focus has mainly been on the customers' needs. Customer- and market-oriented accounting and profitability analysis have not got the same attention (e.g., Foster & Gupta, 1994; Howell & Soucy, 1990; Oliver, 1997; Zeithaml, 2000).

This duality with respect to customers and businesses also appears in various definitions of marketing, e.g. the two most widely used:

"Marketing is the management process which identifies, anticipates, and supplies customer requirements efficiently and profitably" (UK Chartered Institute of Marketing).

"Marketing is an organizational function and a set of processes for creating, communicating and delivering value to customers and for managing customer relationships in ways that benefit the organization and its stakeholders" (American Marketing Association).

The definition of marketing of the American Marketing Association (AMA) is new. It was officially unveiled at the AMA Summer Educators' Conference in Boston in August 2004. The last time the definition was revised was in 1985. At that time it had been unchanged for 50 years. Thus, the cited definition of marketing is the third AMA-version. This new definition differs from the former one[1] in various ways, e.g. by focusing on "a set of processes for … delivering value to

[1] The formulation of the former definition was as follows: "Marketing is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchange and satisfy individual and organizational objectives".

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customers and for managing customer relationships in ways that benefit the organization and its stakeholders". The management of the processes with respect to creating value to customers and economic value to the business unit may be based on available decision-relevant information included in the database of the organization.

Any organisation will hold information on its customers, e.g. the customers' buying behaviour and the performance of the organisation. This information may be part of an organisation's customer base or it may be hidden within invoicing, accounting and sales reporting systems. However, in order to make decisions in accordance with the principal objectives of marketing, the marketers need information with respect to the various value creating processes. Both the literature discussing the marketing concept and the definitions of marketing cited above implicitly highlights the importance of marketing metrics both from the point of view of the customers and from the point of view of the managers and the marketers of a business unit, i.e. "customer-based" and "business-unit-based" marketing metrics. Customer-based marketing metrics may include measures of concepts such as customer satisfaction, customer loyalty and corporate reputation, as well as measures of the antecedents or drivers of those variables. Such metrics should give information with regard to the processes for creating, communicating and delivering value to customers. Business-unit-based marketing metrics may include measures such as customer revenues, customer costs and customer profitability figures (economic profit of a customer), as well as measures of revenues, costs and profitability related to other market levels (orders, market segments, markets, etc.). Of course, both the customer-based and the business-unit-based performance measures are important marketing metrics for marketers and managers. Thus, customer profitability figures probably are mandatory marketing performance metrics for decision makers that are going to manage customer relationships at a profit.

The main research question addressed in this paper is as follows: How can business-unit-based marketing performance metrics be elaborated and presented so that the managers and the marketers of an order handling business unit have available the necessary information for managing customer relationships at a profit? Customer profitability analysis (CPA) as well as other market-oriented financial analysis can be prepared in various ways, cf. the brief discussion in the next part of this article. The first objective of this article is to offer a comprehensive managerial accounting approach for the order handling industry with respect to customer account profitability (CAP) and customer profitability analysis (CPA). The chosen approach is based on customer accounts. According to this way of thinking, customer accounts represent a natural part of managerial accounting. Thus, customer performance metrics should be available for the marketing managers in the same way as analogous performance metrics are available for the managers of other business areas, e.g. the managers of production. In addition to the profitability of customers, the marketing managers also need insight into the profitability of orders, market segments, markets, etc. Thus, the second objective is to introduce consistent performance metrics for different levels of a market hierarchy. Both orders and markets/market segments are included. However, more levels can be included, cf. the discussion at the end of the paper. For each level of the market hierarchy (orders, customers and markets) market-oriented reports are offered, as well as graphic representations and key figures. The context is four Norwegian exporters of fish products and their customers. This industry was chosen because it has a very high level of attributable costs (about 98%). Thus, the lack of arbitrary allocations implies that there are low uncertainties in the measures of the profitability of customers. However, since the marketing and distribution costs are spread out on a high number of different accounts, it is very difficult for the managers to identify the profitability of single customers. This industry is suitable as context, cf. the discussion below.

The paper is organized as follows. In the next part a brief literature review is presented. This is followed by a brief discussion of the context and the methods used. Next the findings are offered, i.e. market-oriented reports as well as graphic representations and key figures for the following levels of the chosen market hierarchy: orders, customers and markets. Then findings and managerial implications are discussed. Finally, limitations and implications for further research as well as a conclusion are presented.

2. A brief literature review

During the last two decades there has been a growing interest in market-oriented managerial accounting (Hergert & Morris, 1989; Ratnatunga, Pike, & Hooley, 1988; Shields, 1997; Ward, 1992). Most attention has been directed to customer profitability analysis (Foster & Gupta, 1994; Guilding & McManus, 2002; Ryals, 2002). However, research has been very limited, and more printed publications have been requested (Foster, Gupta, & Sjoblom, 1996; Oliver, 1997; Zeithaml, 2000).

Some of the existing contributions are mainly focusing on problems that have to be solved in order to establish reliable figures of customer accounts (Anandarajan & Christopher, 1987; Connolly and Ashworth, 1994; Foster et al., 1996). Others have chosen a cost accounting approach, thus mainly treating various cost problems (Lewis, 1991; Goebel, Marshall, & Locander, 1998; Schiff, Schiff, & Schiff, 1991; Stevenson, Barnes, & Stevenson, 1993). Other researchers are preoccupied with "theoretical" aspects such as the lifetime economic value of a customer or the balancing of acquisition and retention resources in order to maximize customer profitability (Berger & Nasr, 1998; Blattberg & Deighton, 1996; Jacobs, Johnston, & Kotchetova, 2001; Pfeifer, 2005; Reinartz, Thomas, & Kumar, 2005). Still others have been studying relationships between customer profitability and various antecedents of customer profitability, particularly customer retention, customer loyalty and customer satisfaction (Anderson, Fornell, & Rust, 1994; Anderson & Mittal, 2000; Bowman & Narayandas, 2004; Yeung & Ennew, 2000). Some researchers have been studying customer segments and are offering methods for analyzing segments and for preparing segment-oriented key figures