Enhancing financial stability by creating a balanced customer portfolio

About five years ago a new industrial manufacturing client of mine was proudly showing me its newly constructed segmentation model. It primarily sold into six different industries, but automotive accounted for roughly 40% of its revenue. When I asked what the company liked so much about selling into automotive, the answer I received was “Nothing”. In fact it had the worst price realization and consumed the most resources per revenue dollar of any industry served. But when I asked what the company was doing to de-emphasize its focus on automotive, I received blank stares. They had never considered the idea of shaping who their customers were. When the economy eventually slowed in ‘08/’09, company revenues dropped by 45% year over year. Had its exposure to automotive been less significant, the drop would have been less severe. The bottom line is that it isn’t enough to simply understand the segmentation of your customer base, you have to actively manage and shape your customer base in a way that mitigates your risk and fosters financial stability.

Creating a balanced customer portfolio requires a company address three critical questions:

1. *What do we know about each segment’s prospects?* Assessing a segment’s prospects requires both a macro and a micro-economic perspective. From a macro perspective it is important to understand what the major opportunities and risks are for the segment as a whole. For example, the birth of on-line shopping created an increased need for transportation and shipping services. These industries grew significantly in those years and many companies that served them benefited. Another example is the alternative energy industry which is highly dependent upon legislation for tax credits that affect its spending. A quick change in legislation can change fortunes quickly. From a micro-economic perspective the company must understand how well-positioned it is to serve the segment profitably in the future relative to the competition.
2. *What does our ideal segment allocation look like?* Once the company understands each segment’s prospects, it should determine the targeted amount of business it wants from each segment. Designing a customer portfolio is not all that different from designing a financial portfolio. No one knows what the future holds, but experience has shown that investors that strike the right balance of exposure to different instruments (e.g., stocks versus bonds), geographies (e.g., Europe versus Asia) and industries (e.g., energy versus transportation) tend to achieve better returns. The same holds true for a customer portfolio. The company should consider its goals and tolerance for risk in setting its desired segment mix.
3. *How should we guide our investments to achieve the ideal allocation?* Achieving the desired mix is typically a function of how the company uses its resources. If the company would like to increase the portion of its business coming from a particular segment it should direct activities like product development, marketing and sales targeted towards that segment. Segments that are less in-focus should receive relatively less investment.

Like any strategic objective, managing a balanced customer portfolio requires discipline and focus. Increasing emphasis on one segment often means not committing resources to a potentially promising opportunity in another segment that is targeted to be de-emphasized. The portfolio needs to managed and adjusted constantly, but the long-term benefits of stability and risk mitigation are well worth the effort.

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