FINANCIAL FOUNDATIONS

An Educational Ebook Series for Small Business Owners

BOOK 13

Client Profitability

Find which clients truly strengthen your bottom line.

TLC Business Solutions · Expert Bookkeeping & Accounting Services

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How to Tell If a Client Is Costing More to Service Than Income Derived From the Client

A practical guide to measuring true client profitability, spotting the quiet drain on your margins, and making confident decisions about pricing, renegotiation, and when to walk away.

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Not all revenue is created equal. The client who looks like your biggest win on the top line may quietly be your smallest contributor to profit — or even a net loss. This chapter shows you how to measure what each client truly costs to serve, spot the ones draining your business, and make confident decisions about pricing, renegotiation, and when to walk away.

01 Understanding Client Profitability Beyond the Gross Revenue Number

It is easy to fall in love with a big top-line number. When a client brings in $120,000 a year, that figure feels like success — and on a revenue report, it is. But revenue is only half of a two-part equation. Until you subtract every cost required to earn that revenue, you do not actually know whether the client is profitable.

Client profitability is the difference between the revenue a client generates and the total cost of serving that client. A client who pays $120,000 but consumes $115,000 of labor, materials, and overhead contributes just $5,000 to your business. Meanwhile, a smaller client paying $40,000 against $12,000 in costs contributes $28,000 — more than five times the profit, from a third of the revenue. Gross revenue tells you who is busy; profitability tells you who is actually building wealth.

For small businesses, this distinction matters more than it does for large ones. Your capacity — your hours, your team's hours, your equipment, your attention — is finite. Every hour spent on a low- or negative-margin client is an hour unavailable for a better one. When you measure profitability per client, you stop managing by gut feel and start managing by contribution.

This chapter walks through the full process: calculating the true cost to serve, tracking the data you need, identifying the "quiet drain" of high-maintenance clients, using gross margin as a decision metric, and knowing when to renegotiate or part ways.

02 Calculating the "Total Cost of Service"

Total Cost of Service =

(Labor Hours × Loaded Labor Rate)

+ Materials & Direct Costs + Allocated Overhead

+ Specialized Resources

Four cost layers make up the total cost of serving a client. Miss any one and your profitability number is wrong.

Labor. This is usually the largest component. Multiply the hours your team spends on the client — including meetings, email, revisions, and travel — by a loaded hourly rate. "Loaded"

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means the rate includes not just wages but payroll taxes, benefits, and paid time off. A $25/hour employee often costs $32–$38 per hour fully loaded. Use the loaded figure, or you will systematically understate cost.

Materials and direct costs. Anything purchased specifically for that client: raw materials, subcontracted work, software licenses dedicated to the engagement, travel and lodging, and shipping. If you would not have bought it without this client, it belongs here.

Allocated overhead. Rent, utilities, insurance, administrative salaries, accounting, and general software do not vanish because a client is "easy." Allocate a share to each client based on a sensible driver — labor hours, revenue, or headcount. A simple method: total annual overhead divided by total labor hours gives an overhead rate per hour; multiply that rate by the hours spent on the client. This ensures every client carries its fair share of the cost of keeping the doors open.

Specialized resources. Some clients demand niche capabilities: a particular certification, specialized equipment, or a software platform you bought just for them. If a resource serves essentially one client, assign its cost to that client.

When all four layers are summed, you have the Total Cost of Service — the real price of earning that client's revenue.

03 Tracking Time and Direct Expenses per Client

You cannot calculate client profitability without data, and the data begins with time. Every hour worked must be attributable to a client or to a defined internal category. Time tracking is not surveillance; it is the only way to know which clients actually consume your capacity.

- **Track time daily, by client and by task.** Memory degrades fast; end-of-week reconstruction misses 10–20% of hours — usually the small administrative ones that hurt the most.
- **Capture the "invisible" work.** Email, phone calls, internal coordination about the client, revisions, and rework. These are the hours that quietly erode margin.
- **Tag direct expenses to the client** in your accounting software at the moment of purchase. Reconstructing expenses at month-end is slow and incomplete.
- **Review time and expense data monthly per client.** A monthly cadence catches problems early enough to act on them.

Most modern accounting and project-management tools support client-level time and expense tracking. The barrier is rarely the software — it is the discipline of consistent entry. Build it into the daily workflow, not the monthly cleanup.

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COMMON PITFALL

A frequent mistake is tracking only billable time. Non-billable time — the extra revision, the fifteenth status email, the meeting that ran long — is real labor you are paying for. If you measure only billable hours, your cost numbers will look healthy while your bank account tells a different story.

04 The "Quiet Drain": Admin Time and Scope Creep

Some clients are loud about being expensive: they demand discounts, pay late, and renegotiate constantly. But the most damaging clients are often quiet. They are pleasant and agreeable — and they consume hours of work you never billed for and never tracked. This is the "quiet drain," and it takes three common forms.

Scope creep. The engagement starts with a defined deliverable, and over time the client asks for "just one more thing" — repeatedly. Each addition seems small, but together they turn a profitable project into an unpaid one. Scope creep is especially insidious because each request is reasonable in isolation.

Administrative drag. Some clients require far more coordination than others: endless status emails, meetings that should have been messages, approvals routed through five people, and re-explaining the same context to new contacts on their side. None of it is billable; all of it is labor.

Rework and revision loops. A client who cannot finalize requirements, or who changes direction after work is complete, forces your team to redo finished work. The original hours still cost you money; the redo is pure loss.

WHERE TO LOOK

The quiet drain shows up in your time data, not your invoice data. Pull a report of non-billable hours by client. If one client's non-billable time is two or three times the average, you have found the drain. The client is not behaving badly on purpose — but they are costing you more than the invoice reflects, and that gap is coming straight out of your profit.

05 Using Gross Margin per Client as a Decision-Making Metric

Once you have revenue and Total Cost of Service for each client, two metrics turn that data into decisions.

Gross Margin per Client = Client Revenue − Total Cost of Service

Gross Margin % = Gross Margin per Client ÷ Client Revenue

Gross Margin per Client is the absolute dollars the client contributes to covering your profit.

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Gross Margin % shows efficiency — how much of each revenue dollar survives after serving the client. Rank every client by Gross Margin per Client, not by revenue. The ranking is almost always surprising: your highest-revenue client may sit in the middle of the pack on margin, while a modest, easy-to-serve client quietly tops the list. This reordering is the whole point — it shows you where profit actually comes from.

Tier	Gross Margin	Profile	Action
A	High	Profitable and efficient to serve	Protect and grow
B	Moderate	Acceptable, with room to improve	Pursue efficiency gains
C	Low / Negative	Drains capacity and margin	Renegotiate or release

A useful exercise: sum the Gross Margin of your top 20% of clients and your bottom 20%. In most small businesses, the top 20% generates the majority of profit, and the bottom 20% generates little or none — sometimes a net loss. That bottom group is where capacity is being trapped that could serve better clients.

Gross Margin per Client is not a one-time calculation. Revisit it quarterly. Clients drift between tiers as scope, pricing, and your own costs change. A Tier A client can slide to Tier C without anyone noticing — unless you are watching the numbers.

06 Knowing When to Renegotiate or "Fire" a Client

Not every unprofitable client relationship should end. Many can be repaired with a conversation and a pricing change. The decision framework is simple: act when a client is persistently unprofitable and the causes are fixable, and part ways when they are not.

Signals that it is time to act:

- Gross Margin per Client has been negative or near-zero for two consecutive quarters.
- Scope creep is chronic despite documented engagement terms.
- Non-billable administrative time is a multiple of your client average.
- The client pays slowly or disputes invoices regularly.
- Servicing the client ties up specialized resources that could serve more profitable work.

Renegotiate first. Most clients do not realize they are costing more than they contribute. A clear, data-grounded conversation often resolves it: raise the rate to reflect actual scope, restructure the engagement to cap revisions, add fees for out-of-scope work, or move to a retainer that covers administrative time. Frame it as sustainability — you want to keep serving them, and to do that well, the economics need to work for both sides.

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When to part ways. If renegotiation fails, or if the relationship is a net drain on your team's energy and your business's capacity, it is time to release the client. "Firing" a client sounds harsh, but done professionally it is a normal business decision. Give notice consistent with your agreement, finish committed work, hand off records cleanly, and — if appropriate — refer them to a better-fit provider. Then redirect the freed capacity to Tier A and B clients, or to acquiring new ones.

The relief is usually immediate. Owners who have released a chronically unprofitable client consistently report higher profit, better team morale, and recovered time for the clients who actually sustain the business. The cost of keeping a bad client is rarely just money — it is the opportunity you could not pursue while serving them.

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Key Takeaways

- Revenue is not profit. A client's true value is measured by Gross Margin, not top-line revenue.
- Total Cost of Service has four layers: labor at a loaded rate, materials and direct costs, allocated overhead, and specialized resources. Missing any layer understates cost.
- Track time and expenses by client, daily — including non-billable and administrative hours. That is where margin quietly disappears.
- The "quiet drain" of scope creep, admin drag, and rework shows up in your time data, not your invoices. Look there first.
- Rank clients by Gross Margin per Client. The top 20% usually drive most of your profit; the bottom 20% may drive none.
- Renegotiate before you release. Many unprofitable clients become profitable with a single pricing or scope conversation.
- When a client cannot be made profitable, part ways professionally. The capacity you free is worth more than the revenue you give up.

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