How to Secure and Grow Your Islands of Profit

MIT – Systems Design and Management

Jonathan L.S. Byrnes
jlbyrnes@mit.edu
http://mit.edu/jlbyrnes
www.profitisle.com

Copyright © 2013 Jonathan L.S. Byrnes
Today’s Menu

• Astonishing But True
• Accelerating Supply Chain Profitability
• Islands of Profit in a Sea of Red Ink
• Barriers to Profitability
• Managing the Profit Acceleration Process
• Step on the Gas: Turbocharged Supply Chain Profitability
• Transformational Leadership
Astonishing But True

In almost every company – even leading ones:

• 30-40% of the business is unprofitable by any measure
• 20-30% is so profitable it provides all the reported earnings and subsidizes the losses
• No one is responsible for managing profitability
• Even if everyone makes budget, the company will still have huge embedded unprofitability

This is the biggest issue/opportunity for quantum increases in supply chain profitability.

Virtually all top managers agree – but they don’t know how to fix it
Profitability acceleration

- Not particularly difficult
- Very different from day-to-day management and improvement
- Generate cash from the start
- Results come surprisingly quickly
- Systematic pathway to success
- Market segmentation and supply chain alignment are critical
Accelerating Supply Chain Profitability

The President’s dilemma

A leading distribution company

- Accounts – 33% unprofitable
- Order lines – 35% unprofitable
- Products – 40% unprofitable
- Suppliers – 40% unprofitable
- Sales channels and supply chain – not aligned with profit potential
- But – everyone made budget

Upside: 30%+ profit increase within a year with no investment
Islands of Profit in a Sea of Red Ink

Profitability

Accounts - Products - Orders
Islands of Profit in a Sea of Red Ink

Same picture in leading companies in over a dozen industries, including:

- Laboratory supplies
- Steel
- Transportation
- Food and beverage
- High tech
- Financial services
- Healthcare
- Telecom
- Retail
# Sales Rep Comparison Example

<table>
<thead>
<tr>
<th>Rep</th>
<th>Revenues ($000)</th>
<th>Gross Margin ($000)</th>
<th>Net Profit ($000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rep 1</td>
<td>1,349</td>
<td>346</td>
<td>216</td>
</tr>
<tr>
<td>Rep 2</td>
<td>664</td>
<td>131</td>
<td>(25)</td>
</tr>
<tr>
<td>Rep 3</td>
<td>2,773</td>
<td>328</td>
<td>64</td>
</tr>
<tr>
<td>Rep 4</td>
<td>3,920</td>
<td>556</td>
<td>217</td>
</tr>
</tbody>
</table>
Barriers to Profitability

Three big barriers

• Accounting systems
• Sales compensation
• Lack of focus on the profitable core

The legacy of the Age of Mass Markets
Three Eras of Markets

Local Markets

Mass Markets

Precision Markets

1900

2000
Expanding the Value Footprint

- Stuck in the mud
- What business are we in?
- Major cost reductions – foreseen and unforeseen
- Surprise revenue increases
- Pile on!
What’s Going On?

- Huge new revenue increases
- Decisive strategic differentiation – enduring financial gains
- It’s not about the products!
- 30-60% supplier base reductions across industries
- Who wins big? Who gets pushed out?
Managing the Profit Acceleration Process

Four key elements

• The right information
• The right priorities
• The right processes
• The right compensation
The Right Information

What’s wrong with accounting

Profit mapping
Profit Mapping

Five-step process

Select a Set of Invoice Lines → Income Statement for Each Line → Database Analysis → Hunt for Profits → Targeted Actions

Tips and pitfalls
Profit Maps

High Profits

High Revenues: Islands of Profit

Low Revenues: Minnows

Low Profits

Palm Trees

Coral Reefs
Profit Maps – Example: All Accounts

<table>
<thead>
<tr>
<th>Revenues</th>
<th>Profits</th>
</tr>
</thead>
<tbody>
<tr>
<td>low</td>
<td>low</td>
</tr>
<tr>
<td>92%</td>
<td>1%</td>
</tr>
<tr>
<td>19%</td>
<td>1%</td>
</tr>
<tr>
<td>(20%)</td>
<td>(20%)</td>
</tr>
</tbody>
</table>

- **Palm Trees**
  - 1% of customers (43)
  - 1% of revenues
  - 6% of profits

- **Minnows**
  - 92% of customers (6,390)
  - 19% of revenues
  - (20%) of profits

- **Islands of Profit**
  - 6% of customers (422)
  - 68% of revenues
  - 122% of profits

- **Coral Reefs**
  - 1% of customers (43)
  - 12% of revenues
  - (8%) of profits
### Profit Maps – Example: All Products

<table>
<thead>
<tr>
<th></th>
<th>High Profits</th>
<th>Low Profits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Palm Trees</strong></td>
<td>1% of products (245)</td>
<td>83% of products (28,470)</td>
</tr>
<tr>
<td></td>
<td>1% of revenues</td>
<td>19% of revenues</td>
</tr>
<tr>
<td></td>
<td>8% of profits</td>
<td>(10%) of profits</td>
</tr>
<tr>
<td><strong>Islands of Profit</strong></td>
<td>5% of products (1,733)</td>
<td>11% of products (3,468)</td>
</tr>
<tr>
<td></td>
<td>27% of revenues</td>
<td>53% of revenues</td>
</tr>
<tr>
<td></td>
<td>173% of profits</td>
<td>(71%) of profits</td>
</tr>
<tr>
<td><strong>Minnows</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Coral Reefs</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
# Profit Maps – Example: Single Customer’s Products

<table>
<thead>
<tr>
<th>Profits</th>
<th>Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>high</td>
<td>Palm Trees</td>
</tr>
<tr>
<td></td>
<td>1% of products (27)</td>
</tr>
<tr>
<td></td>
<td>1% of revenues</td>
</tr>
<tr>
<td></td>
<td>6% of profits</td>
</tr>
<tr>
<td>low</td>
<td>Minnows</td>
</tr>
<tr>
<td></td>
<td>53% of products (2,059)</td>
</tr>
<tr>
<td></td>
<td>30% of revenues</td>
</tr>
<tr>
<td></td>
<td>0% of profits</td>
</tr>
</tbody>
</table>
## Sales Rep Comparison

<table>
<thead>
<tr>
<th></th>
<th>Sales Rep 1</th>
<th>Sales Rep 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues (000)</td>
<td>$ 1,600</td>
<td>$ 1,600</td>
</tr>
<tr>
<td>Gross Profit (000)</td>
<td>293</td>
<td>248</td>
</tr>
<tr>
<td>Net Profit (000)</td>
<td>117</td>
<td>(81)</td>
</tr>
</tbody>
</table>
The Right Priorities

The intuitive response

The four priorities:

• Secure your high profit business
• Get more business that fits
• Turn around your marginal business
• Reprice what’s left

Don’t forget to build bridges to your suppliers
Secure and Grow Your Islands of Profit

Islands of Profit Customers

Your Sweet Spot for Turbocharged Profitable Growth

Islands of Profit Products

Islands of Profit Sales Reps
Get More Business That Fits

- Reach the right prospects
- At the right time
- With the right products and promotions
- As efficiently as possible
Reach the Right Prospects

- Profile your Islands of Profit customers
- Profile those customers who should be Islands of Profit
- Define your market segments and buying profiles
- Identify prime prospects
At the Right Time

• Buying triggers
• Seasonality and trends
• Purchase sequencing
• Purchase timing
• Integrate into forecasting and replenishment
With the Right Products and Promotions

• Islands of Profit products

• Products that should be Islands of Profit

• Build your value footprint in a coordinated manner
As Efficiently as Possible

- Identify the most efficient vehicles to reach prime prospects
- Create outreach mix to maximize each
- Showcase projects
- Metrics and measures
The Right Processes

Get Sales, Marketing, Supply Chain, & Purchasing on the same page

- Standardize your relationships
- Map the market
- Institute an action profit generation process
The Right Compensation

Front wheel drive

Are all revenues equal?

Align sales with profitability
Step on the Gas: Turbocharged Supply Chain Productivity

- Comprehensive Profit Maps
- Compelling Value Footprint
- Focused Organization
- Relentless Profit Improvement Processes

Sustained Profitable Growth
Comprehensive Profit Maps

- Objectives
  - Improve all aspects of profitable growth
  - Identify best practice performance, drive all aspects of the business to best practice standards, and relentlessly improve the best practice standards

- Comprehensive profit maps – fully interactive and granular
Compelling Value Footprint

• Priorities
  − Secure the Islands of Profit
  − Grow the Islands of Profit
  − Turn around the Coral Reefs and Minnows

• Value footprint: Islands of Profit
  − Unique and compelling value proposition tailored to each segment
  − Build customer value and competitive differentiation through supply chain management

• Value footprint: Coral Reefs and Minnows
  − Appropriate value proposition – balance investment with returns
  − Focus on improving the three key profit levers: (1) pricing; (2) product mix; and (3) service package

• Establish constant innovation of the value footprint as a core organizational process with planning and accountability
Relentless Profit Improvement Processes

- Macro Strategy
- Value Footprint
- Account Selection
- Sales & Supply Chain Productivity
- Account Management – Product & Service Mix
- Supplier Selection & Management
- Product Portfolio Management & Rationalization

Profit Improvement Processes
Example: Focused Organization

- Matrixed full company engagement

- Focused profitable growth processes with systematic planning and accountability
Example: Progress Overview

- **Q1 & Q2 of Year 1**
  - Develop organization & processes
  - Pilot the profit improvement processes in a systematic, carefully-managed manner
  - Prime focus on securing and growing the Islands of Profit

- **Q3 & Q4 of Year 1**
  - Grow and spread the profit improvement processes throughout the business
  - Lock in and grow the Islands of Profit
  - Focused initiatives to identify and grow potential Islands of Profit
  - Develop initiatives to turn around the marginal business

- **Year 2**
  - Continue to refine the profit improvement processes
  - Complete the process of making sustained profitable growth an essential part of the business’s DNA
Transformational Leadership

Transforming the business

The fallacy of large-scale change

Transforming the culture
Secure and Grow Your Islands of Profit

High sustainable profitability

Grow into your sweet spot

Enduring strategic advantage