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Bridge the Gap Between Strategy and Tactics: Part 2

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Discover how managers use the Magic Matrix to analyze their companies, plan their actions, and achieve tight internal alignment that unites them with key jurisdictions.

Part 2

The November column's core message was that the Magic Matrix provides a powerful way for managers to translate great strategies into sound plans, and sound plans into effective tactical actions.

The Magic Matrix is a spreadsheet chart with key products or service lines on one dimension, and key market segments or accounts on the other, both arranged in descending order by total revenues. Managers can populate the product-account cells with valuable information ranging from revenues to profitability to sales potential to differentiation. The Magic Matrix is a very powerful, intuitive, easy-to-use model of a company as it interacts with its markets. Managers who use the Magic Matrix develop the shared viewpoints and cooperative culture that allows the company to reach its full profit potential.

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Magic Matrix-based planning
November's column explained that there is a typical way to approach Magic Matrix-based integrated planning: first, by analyzing revenue and profitability patterns, then proceeding on to more sophisticated applications. The former is core integrated planning, which is the subject of this column. The latter is advanced integrated planning, which January's column will explain. Both can be approached in either a qualitative or quantitative manner.

Core integrated planning
Core integrated planning is a five-step process. Here are the key Magic Matrices, and some important planning issues they enable managers to address.

Revenue Matrices. The product-account Revenue Magic Matrix is a deceptively simple yet powerful way to manage product mix and account selection. The individual cells tell how much of each product each account bought. Conclusions literally jump out of the matrix. Is there too high a percentage of sales in too few products or accounts? Is the spread too wide? Does the company have too much revenue in declining products or unattractive accounts? How is the account concentration by industry, location, and account size? What is the product sales concentration by account and market segment? Who buys the most profitable products? Which products do the best or worst accounts buy?

The matrix often reveals strange patterns. Some large customers might buy only one or two products. Does this reflect their needs or are the salespeople not cross-selling? Other large customers may buy only a small bit of each of many products. Are they using the company for "fill-ins," or "cherry-picking" each product line? In one meeting, the manufacturing vice president noticed that an unprofitable customer was buying only products that were on allocation; no one had noticed this before.

The Revenue Magic Matrix can be displayed by percentage of total revenue accounted for by each cell, the Percentage Revenue Magic Matrix. Is a dangerously large percentage of total sales coming from the purchases of a single product line by a single customer?

Unit and Price Matrices. Operations managers think in units, not revenues. The Unit Magic Matrix, which shows unit sales, is particularly useful for identifying capacity issues. Can the company supply the units of output that are inherent in the revenue forecast?

The Price Magic Matrix shows average prices in each cell, can be turned into an index chart by dividing each price by the grand average, or the product or account average. Do some large accounts pay on average much less than what other large accounts pay?

In most companies, the most powerful way to use the Price Magic Matrix is to look horizontally through the columns at prices paid by different customers for the same product. If one customer is paying less than the other customers for all products, it is a danger signal. Unexplained variation also indicates a problem. Perhaps there is no coherent pricing policy, or, pricing authority in the sales force is not being managed well, and sales people are succumbing randomly to customer price pressure.

A particularly useful variation on the Price Magic Matrix is the Relative Price Magic Matrix. This is a matrix of price divided by a product characteristic, such as price per horsepower. It shows the relationship of pricing policy to product policy, and provides useful product-to-product comparisons that can help explain profitability patterns.

Potential, Penetration, and Capacity Matrices. The Sales Potential Magic Matrix shows customer purchasing capacity, which is necessary for account planning, account management, and measuring success in terms of account penetration.

The view of a company's sales relative to its accounts' purchasing capacity is the Sales Penetration Magic Matrix. Where are the relative strengths and weaknesses? Is there a pattern? Is the company weak across all products at some accounts? Or is it weak across all accounts for some products? The account-oriented weakness raises issues about account selection and sales quality. The product weakness may be related to pricing, product technology, quality, delivery, or marketing-communications support. What is the penetration by sales unit or product team? Are all accounts in the Eastern Region weak across all products or only some?

Still more can be learned from the Opportunity Magic Matrix, where a company's current sales are subtracted from potential, or where current sales are subtracted from product manufacturing capacity.

A manager can sum the potential for each product for all accounts and compare it to manufacturing capacity using the Capacity Magic Matrix. Is the company's capacity profile congruent with its accounts' potential? If not, should it be? Should the company change its accounts so that it can sell what it produces, or can it change its mix of capacity so it can produce what it might sell? The same analysis applies to service industries, including both professional service firms and consumer service companies.

Growth Matrices. The Magic Matrix is extremely valuable in aligning a company's managers on the company's most productive growth path. Almost invariably, there are major disconnects between the headquarters-based product managers and the field-based account managers. The Future Revenue Magic Matrix provides the basis for this alignment.

The Revenue Magic Matrix can be converted into a Growth Magic Matrix for the past or the future by dividing one year's revenue by the previous year's. This will show which parts of the business are growing quickly and which parts are growing slowly. Color coding helps highlight patterns.

Revenue and Growth Magic Matrices can be used as a short-term budget tool or a long-term planning tool. For some leading companies, they have become the core way both to plan and budget.

Profitability Matrices. The Magic Matrices that we have looked at so far deal directly with two of the key strategic issues that all top managers face: (1) What do we sell? and (2) To whom do we sell? The profitability matrices enable us to answer two key questions about profits: (1) Where do we make money? and (2) How do we make money?

In a complex contemporary company, even a fairly small one, it is difficult to figure out where the company makes money, why the company is as profitable as it is, and why it is not more profitable. The Magic Matrix enables managers to answer these questions because it allows them to think simultaneously about products, accounts, cost structure, and capacity.

We like to use a whole set of Profit Magic Matrices to create a richly textured, comprehensive view of profitability. The first is the Total Profit Magic Matrix, which shows the distribution of total dollar profits, followed closely by the Percentage Profit Magic Matrix, which depicts the percentage of total company dollar profit accounted for by each cell. These matrices enable the team to think about both profit patterns and risk.

Does the company have too high a percentage of profits in too few cells?

A complementary set of Magic Matrices enables executives to manage profitability at a very disaggregated, granular level. The Percentage Profitability Magic Matrix, which shows the percent profit-to-revenue margins of the cells, reveals the details. Two versions can be developed: one based on contribution, the other on fully-allocated costs.

The Percentage Profitability Magic Matrix allows managers to identify major opportunities and problems. Are profits lowest in the largest accounts? Are profits best in the newest products? Such analyses can provide great insight for product planning, pricing, and account management. The cell-level product-account profitability data provide more answers to the "why" questions. If an account is low in profitability, is that due to one particular product or all or most products? Do the low profitability accounts buy a "lean" product mix, or do they provide lower profitability across all products? Are the "best" customers also the most profitable?

A more advanced approach is to turn the profit numbers into returns on investment, using the Return on Investment Magic Matrix; or profit per unit of scarce resource, using the Resource Productivity Magic Matrix. These require investment allocation across cells. Even at a "70 percent accuracy" level, the results will be extremely informative.

The Resource Productivity Magic Matrix is a particularly effective planning tool in capital-intensive businesses such as metals, transportation, chemicals, petroleum, telecommunications, power, and professional service firms with unusually gifted individual performers. It follows the logic of the theory of constraints by allowing managers to maximize the profitability of a scarce resource. In some industries, profit per unit is the most useful measure. This is the Unit Profit Magic Matrix, which also helps the management team make resource allocation decisions such as where sales effort should be concentrated.

Managers can combine different Magic Matrices to get deep insights into the business. A matrix with penetration and profitability in each cell separated by a slash can reveal interesting patterns. Is penetration strongest where profitability is highest? Color coding cells can be very useful. If the most profitable 20 percent of the cells are colored green, and the least profitable 20 percent red, the sales, capacity, or penetration numbers can be viewed in a new light.

The most important part of this framework, however, is the interjursidictional process and substance that underlies it. Each jurisdiction can see its impact on the others, and on corporate or division profitability. Everyone can focus on the critical interaction among product mix management, account selection, cost control, and capacity management. Even using the Magic Matrix purely qualitatively will yield many valuable benefits.

Managing profitability

The Magic Matrix provides managers with a powerful, systematic way to analyze their companies, to plan their actions, and to achieve tight internal alignment melding together their key jurisdictions and managers. Core integrated planning, the topic of this column, provides a solid foundation for bridging the traditional gap between strategy and tactics.

Advanced integrated planning offers managers sophisticated ways to overcome many of their most dangerous and pressing strategic issues. This will be the topic of January's column, which will conclude this three-part series on integrated planning using the Magic Matrix.

See you next month.

A more complete version of this series is available from Harvard Business School Publishing (#9-999-008), and can be ordered by calling 800-988-0886 or online at http://www.hbsp.harvard.edu/.

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Exhibit 1

The Magic Matrix

<u>Vertical Dimension:</u>

Account Management
Target Market Selection
Account Selection
Channel Segments
Go-to-Market Approaches
Supply Chain Management

<u>Horiz. Dimension</u>:

Product Line Mgmt.
Operations Mgmt.
Capacity Mgmt.

	Account 1	Account 2	Account 3	Account 4	All Other	**Total**
Product/ Service A						
Product/ Service B						
Product/ Service C						
Product/ Service D						
All Other						
Total						

<u>Cells</u>:

Order Cycle Mgmt.
Pricing
Customer Service