Customer Intimacy vs. Operations Excellence:

Why Not Have Both?

Several years ago, popular business books trumpeted the importance of focusing your company by choosing a distinct business model. One best-selling book offered these alternatives: (1) customer intimacy – delivering what specific customers want; (2) operations excellence – delivering quality, price, and ease of purchase and use; and (3) product leadership – creating the best products and services.

While strategic focus is an appealing idea, my long experience working with companies on profitability management suggests that there are other dimensions that are much more subtle and powerful. And much more profitable.

Take the example of the choice between customer intimacy and operations excellence.

It seems obvious that a company cannot both provide individual service to customers and drive operating costs down. After all, individual service is custom-tailored and expensive, while operations cost-minimization requires extreme standardization. How can you have both?

Islands of profit

The answer lies in the central message of my book, *Islands of Profit in a Sea of Red Ink*. Every company I have seen is 30-40% unprofitable by any measure, while 20-30% provides all the reported earnings and subsidizes the losses.

The core reason why this occurs in so many companies is that managers so often serve all their customers in an “all the same” way. They standardize on a business model, and simply assume that it will fit all their customers (otherwise, they wouldn’t fit as customers).

Leading companies today, however, have shattered this approach to business strategy. And they are reaping enormous, lasting benefits – leaving their competitors in the dust.

Several months ago, I participated, along with the heads of operations of P&G, Chiquita, and Pepsi, on a panel on Supply Chain Transformation. These three leading companies have been creating enormous new profits and market share gains, even in the depth of the recent recession, by doing exactly what the old popular business books disparaged – *combining customer intimacy with operations excellence*.

All three companies are pursuing a similar strategy. They have analyzed their profit maps, and they clearly understand which customers are providing them with high sustained profitability – their islands of profit. They have the insight and discipline to invest considerable resources in securing and growing these customer relationships.

It turns out that the best way to secure and grow a key customer relationship is to integrate your operations with those of your customer – in a highly individualized and effective way. When you do this well, you lower your key customer's cost and increase the customer's profitability. This pulls through surprisingly large *sales* increases, often 35% or more, even in highly-penetrated accounts.

As a P&G vice president once observed in an MIT workshop, "We sell to Wal-Mart's CFO." That's why P&G's account team in Bentonville Arkansas includes a very strong component of financial managers. Their job is to calculate Wal-Mart's increase in profitability created by P&G's supply chain and marketing integration, and use this information to pull through even more product sales.

What's happening here? Customer intimacy combined with true operations excellence driving customer profits, and creating big revenue increases.

Virtuous cycle

But that's not all. At the same time that these three companies are creating huge customer gains through custom-tailored operations integration, they are radically lowering their own operations costs. How? By smoothing order patterns, tuning customer inventories, deploying substitutes in carefully-selected situations, and other measures.

These initiatives shift the focus of supply chain efficiency initiatives from optimization solely within the vendor's "four walls," to optimization of the joint vendor-customer supply chain. This shift creates enormous new efficiencies – *for both companies*.

Fortunately – well, insightfully really – all three companies invest a major portion of their operations efficiency gains into deepening their key account relationships, especially operations integration. This smart move renews the cycle, enabling them to create even more customer profitability, to further grow their market share, to gain new operational efficiencies for themselves, and to gather even more resources to invest in making their key customers ever-more profitable – renewing again this endless virtuous cycle.

The key to success: customer intimacy merged with operations excellence.

Sea of red ink

But that's not the whole story. There are two keys to success. The first, described above, is the ability to use custom-tailored operations excellence to lock in and grow your most profitable business – your "sweet spot" in the market, your islands of profit.

The other key to success is to create differentiated serving models for your other segments. For customers who are important, but not willing or able to partner well, you can develop other, more appropriate relationships backed by clear, distinct service models. For yet other customers who did not warrant integrated relationships, you can offer more standard, menu-driven approaches. (I cover this thoroughly in the Operating for Profit section of *Islands of Profit in a Sea of Red Ink*.)

One major company even told its smallest customers that unless they could order a truckload of product a week, they would only serve them through master distributors (who specialized in serving small order customers very efficiently). This enabled the company to draw back a major portion of its resources, and channel them into more rapidly growing its "sweet spot" customers.

Multiple parallel service models

What does this mean for the profit-maximizing manager?

You have to move beyond the old “one size fits all” approach to business strategy, and understand that within your book of business, you have a number of very different types of customers – and that each type of customer, or market segment, requires a different, appropriate, cost-effective service model (and degree of operations integration).

For your most important “islands of profit” customers, you may need to customize individual, highly-integrated supply chains. For other customers, you probably need a relatively small number of standardized serving models tailored to each of your market segments. How many? Old Byrnes family recipe: perhaps 5-10.

This more subtle understanding of your business will enable you to secure and grow your islands of profit, and convert your sea of red ink into a very lucrative expanse of business.

Customer intimacy or operations excellence? False choice. The right answer is: the right blend in the right places.*

* Thanks to Brent Grover of Evergreen Consulting for pointing out this terminology when we participated, along with Klein Steel’s Laurie Leo, in a panel at the recent Waypoint Analytics Advanced Profit Management Conference.