"Revenues are Good, Costs are Bad" and Other Business Myths

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The key to a company achieving its full potential is precise thinking and business discipline on the part of every manager, says Jonathan Byrnes. Start by clearing out all that bad business mythology.

by Jonathan Byrnes

Precise thinking and business discipline are essential for business success. Yet, for too many managers in too many companies, "self-evident truths," that really are vague generalities, get in the way. I call these "business myths." I'll draw on material from previous columns I've written here to expose ten of the worst offenders.

1. Revenues are good, costs are bad
This is the biggest myth of all. The truth is that some revenues are very profitable, and some are very unprofitable. If you look carefully at the net profitability of virtually any company, using a technique I call profit mapping, only 20-30 percent of the company by any measure (customers, products, orders) is profitable, while 30-40 percent is unprofitable, and the remainder is marginal.

By focusing on average, or aggregate, profitability, you lose this essential fact, along with the opportunity to radically increase profitability at very little cost using sharply targeted measures. Because most sales compensation systems are based simply on revenues, most companies are doomed to carry significant embedded unprofitability.

What about costs? If all revenues are viewed as equally desirable, it follows that all costs are uniformly bad. Thus, most cost reduction programs are broad and across the board. In fact, the very profitable portion of your business can support the extra expenditures needed to lock in and grow that portion of your business. But this is usually precluded because the unprofitable business absorbs unwarranted resources. The danger is that competitors can identify and pick off your best business by focusing their resources very selectively.

2. We should give our customers what they want
This myth goes to the heart of how you define your business. You should give your customers what they *need,* which often is different from what they *want.* What your customers want is usually defined by their current way of doing business; what they need usually moves them forward and enables them to change and improve their business.

Your ability to move a customer to a new and better way of doing business will make you an essential strategic partner, and not just a substitutable vendor. This is how you leapfrog your competitors and lock in lasting advantage. You can discover real customer needs, and new ways to create value, by spending time with the customer and employing powerful tools like channel mapping.

Often, a customer will not immediately see its real needs, and both lower-level purchasing people and your own sales reps can resist change. There are, however, effective measures that you can employ to sell and manage the change within the customer.

3. Sales reps should sell, operations should fulfill orders
In transactional account relationships, where you are responding to one-off customer needs, this distinction holds true. But in relationship selling, operations has a critical role, both in the initial sale and on an ongoing basis. Important companies in industry after industry are reducing their supplier bases by 40-60 percent. The suppliers that remain see huge market share increases, while others see big losses. The key factor that allows a supplier to remain is the ability to increase the customer's profitability on the supplier's products by employing vendor-managed inventory, co-design, and other intercompany operating innovations. Here, the operations team is critical to successful account retention and revenue growth.

4. All customers should get the same great service
In most companies, if you try to give all customers the same great service, you wind up in a syndrome in which service declines and costs spin out of control. When this happens, management has trouble rebalancing the supply chain: The objectives swing back and forth between cost and service like a pendulum. One quarter, management focuses on reducing inventories because costs are too high; the next quarter, they push for increased inventories because "the customers are screaming."

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The answer is service differentiation, a process in which you set different order cycle times for different customers and products. Typically, customers are divided into core and non-core categories, according to sales volume, profitability, and loyalty. Products are similarly divided into core and non-core categories according to sales volume, profitability, criticality, and substitutability.

When you break your customers into these four groups, it turns out that each group can best be served with a different supply chain, each with finely tuned service and cost characteristics. The key is to make different but appropriate order cycle promises to different customers for different products, but always to keep the promises you make.

5. Supply chain integration is a great goal
I recall seeing a presentation depicting the stages of supply chain evolution. The stages progressed from primitive arm's-length relationships to sophisticated, fully integrated channels. The clear implication was that the latter was the ideal to which all supply chains should aspire. This is ridiculous.

The proper degree of supply chain integration should reflect a variety of factors, including channel economics, customer willingness and ability to innovate, loyalty, and customer-supplier strategic alignment. For example, if you created a simple 2x2 matrix with customer importance on one axis, and customer willingness and ability to innovate on the other, you would find that the correct degree of supply chain integration depends on the quadrant the customer is in. Because companies have finite resources, and supply chain integration is a very intense relationship, it is necessary to be very selective and tailor the degree of supply chain integration to the account relationship.

6. If everyone does his or her job well, the company will prosper
In a stable situation, in which customer needs are known and unchanging, and markets are relatively homogeneous, a company can set policies for each functional area that managers can carry out for a period of time without much change. This was the situation that most companies faced in the Age of Mass Markets, decades ago.

But the world has changed enormously for most companies. Today, companies face increasingly heterogeneous markets, and they form very different relationships with different customers. In this situation, which I call the Age of Precision Markets, what one manager does has a huge impact on other managers, and managers need to have overlapping responsibility.

For example, if a supply chain manager works hard to bring inventory costs down by 10-20 percent on a product, and the product is unprofitable, should the supply manager feel successful? The answer is that his or her "job" has to extend beyond traditional cost control to encompass asset productivity, which encompasses both costs and revenues. Both the supply chain manager and the sales and marketing managers should feel joint responsibility for the profitability of each piece of the company. Unless they act together, the interactions between their functions will almost inevitably lead to high levels of embedded unprofitability.

You have to define the "job" properly in each situation in order to have any chance that someone might do it well, and this definition is a rapidly moving target. The best execution will fail if the managers are not executing what needs to be done.

7. If you are promoted, you should keep doing what brought you success
This is the natural inclination of many managers. However, this is exactly the wrong thing to do when you are promoted. In many companies, managers at all levels manage "a level too low." They focus on micromanaging their subordinates, who often have their old jobs. Rather than teaching the subordinates and focusing on helping the subordinates improve their work processes, they force the subordinates to spend an inordinate amount of time preparing for a "grilling" on their operating performance.

This causes two problems. First, the subordinates lose the opportunity to learn and grow. Second, the

manager fails to accomplish the key components of his or her new job.

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Simply put, first-line managers should operate the company. Directors should coach the managers and spend an equal amount of time working with their counterpart directors in other functional areas to ensure that each piece of the business is productive and profitable. Vice presidents should coach the directors and spend the majority of their time defining and developing the company as it will need to be in three to five years. When everyone focuses only on the day-to-day, the opportunity cost from embedded unprofitability and failure to position the company for the future is enormous.

8. Business cases can drive significant change

The business case process is a key component of the resource allocation process in most companies. If a manager wants to create a new initiative, he or she assembles a request for resources, which includes projected benefits and projected costs. If the likely return is high enough, the initiative will be funded.

Business cases work well in well-understood situations where both costs and benefits can be predicted. The problem is that many of the most important strategic initiatives move a company into uncharted territory. These investments require a very different decision process, one that involves funding market experimentation without a clearly defined stream of returns.

I recall working with a number of leading companies in the early days of PCs, cell phones, and the Internet. All of these now-huge markets were relatively small and undefined at the time. Investments to probe these markets and learn how to accelerate their development had great difficulty passing muster in the rigorous, traditional business case processes. Instead, in many cases, new competitors captured enormous market share from incumbents.

9. Big changes can't be done without crisis

Large-scale change in advance of crisis is one of the most challenging problems a top manager can face. Resetting the fundamental way a company does business requires a completely different management process. An effective process for managing large-scale change can be derived from successful companies' experiences and from observing change management in fields as diverse as the development of scientific theory.

Successful change management before crisis has four cornerstones. First, the top manager must present clear evidence that without change, crisis will occur. Second, he or she must develop a clear picture of what success looks like, because a company will only move toward a concrete, detailed, believable new way of doing business that solves the old problems and creates new advantage. Here, strategic market investments like limited-scale showcases to discover and demonstrate new ways of doing business can be extremely effective. Third, the top manager must be relentless and unwavering in advocating the need for change and the effectiveness of the new way of doing business. Fourth, as in the process of climbing a large mountain, the organization needs a set of base camps in the change process. These make change digestible, allow managers to acclimate to new ways of doing things, and enable different parts of the organization to catch up with each other.

Even in this context, large-scale change is not at all linear. The organization probably will resist change for a time, then suddenly it will lurch forward as a critical mass of managers change their attitudes and influence each other, then it will remain stationary for a time, then lurch forward again. This is why well-thought-out base camps are so important for managing large-scale change. Contrast this process with the business case process discussed earlier.

10. Don't change a good thing

"If it ain't broke, don't fix it" is management at its worst. Leading companies are great because, no matter how good they are, they are desperate to get better. Lagging companies are most often complacent and self-satisfied, and that's why they stay behind. When great managers have a lead, they step on the gas.

Successful management is reinforcing. Leading companies are not just looking for change, but also their managers get acclimated to constant change and become expert at managing progressive change. This environment attracts creative, disciplined managers, and together it creates a virtuous cycle. The more they change, the more they can change, and the more they do change.

Can a lagging company become a leader? Certainly, but this requires considerable leadership from the top management team, and a well-defined, disciplined program for large-scale change in advance of crisis. Note that this is not continuous improvement, but rather disruptive, discontinuous change.

Beyond mythology
Every company has enormous potential waiting to be unleashed: a potential for enhanced profitability, for accelerated growth, for renewing change. The key to achieving this potential is precise thinking and business discipline on the part of every manager, particularly those at the top.

The ten business myths I discussed in this column are not really wrong, they are imprecise enough to be misleading. And this is what creates so much unrealized potential in company after company.

By moving beyond business mythology, you can develop a systematic program of relentless business improvement and renewing change.

See you next month . . . here and at my Web site!

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