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The Age of Precision Markets

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The changes we are experiencing in business are as profound as when markets first developed. Welcome to the "Age of Precision Markets," says Jonathan Byrnes.

by Jonathan Byrnes

We are entering a new era in business.

The changes we are beginning to experience are as profound and disruptive as those that occurred when roads were first paved, local markets began to join together, and mass markets first developed. I call this new era the Age of Precision Markets.

In his landmark book, *New and Improved: The Story of Mass Marketing in America*, HBS professor Richard Tedlow traces the transition about a century ago from localized, inchoate markets to mass markets. He describes how companies like Sears aggregated demand, standardized supply, and drove down the costs of production and distribution.

Toward the middle of the twentieth century, mass markets had developed to the point where their submarkets, or segments, were large enough to support efficient-scale production and market development. These segments were defined by demographics and psychographics (e.g., children's aspirin, jogging shoes). In response, mass marketing companies adapted or differentiated their products to fit these markets in a sort of "theme and variations" strategy. For ease of exposition, I'll refer to both the earlier mass markets and these large segmented markets as "mass markets."

The rise of mass markets created huge benefits for society, and also formed the dominant paradigm of how companies are managed today.

All that is changing.

Today, the locus of value creation is shifting from product innovation to account management/supply chain process innovation. Exhibit 1 depicts this.

This shift is gradual but accelerating quickly. Most companies today live partly in both worlds, and their managers are struggling with this transition. This is equally true for product companies and service companies.

General Foods in its heyday characterizes the mass market paradigm. The company turned product innovation into a science, and distributed its goods to broad, homogeneous markets, and market segments, in a largely standard way. Dell represents the emerging new era of precision markets. This company carefully selects its customers, and individualizes every transaction to "sell what it has," often changing its product features and pricing literally minute by minute. (For a more complete description, see my column, "Dell Manages Profitability, Not Inventory.")

The watershed event in this market shift was the new relationship that P&G and Wal-Mart developed about ten years ago. Before this, P&G was a classic mass marketer like General Foods. With Wal-Mart, however, P&G changed its strategy. Instead of serving Wal-Mart in a standard, arm's-length way, P&G focused on creating intercompany supply chain processes like vendor-managed inventory that radically increased Wal-Mart's profitability on P&G products. This increased profitability drove P&G's sales to Wal-Mart and its own profitability through the ceiling. As one key P&G Vice President put it, "Wal-Mart's CFO became our prime customer."

At the same time, P&G withdrew from distributing directly to many smaller accounts, choosing instead to set up master distributors. No longer did "one size fit all." (See "Supply Chain Management in a Wal-Mart World.")

Offensive terminal point
The "offensive terminal point" is a key concept in military strategy. It reflects the principle that the narrower your front, the deeper you can penetrate the battlefield.

By analogy, in its days as a mass marketer, P&G's customer engagement "front" was very broad, and therefore its offensive terminal point (intercompany supply chain) was very shallow. As a precision marketer in this new era, however, P&G carefully manages its customer relationships to develop a very deep offensive terminal point with a few customers like Wal-Mart, while choosing a much more standard, arm's-length relationship with others, and sometimes withdrawing completely from a direct relationship with still other customers.

It is this process of choosing and managing the development of different relationships with different customers that characterizes the Age of Precision Markets.

Fundamental market shift
Five key factors are driving this fundamental market shift:

- Mature, sophisticated customers like Wal-Mart, seeking to increase their profitability, are exerting pressure on suppliers.
- Increased competition is filling the ecological niches in industry after industry.
- Sophisticated IT capabilities are being deployed inside and between channel partners.
- Sophisticated supply chain management capabilities are being developed in many channels.
- Strong offshore competitors are forcing domestic incumbents to find new ways to compete through service innovation.

The shift from mass markets to precision markets is manifested along several dimensions. It is a shift (1) from product-driven competition to account-driven competition; (2) from product innovation to supply chain innovation (including related services); (3) from broad-market targeting to precision account targeting; (4) from standardized, broad market engagement to focused, aligned, flexible market engagement; and (5) from functional department separateness with periodic budgetary and planning alignment to functional integration with overlapping responsibilities and ongoing alignment.

The locus of value creation is shifting from product innovation to account management/supply chain process innovation.

Like all paradigm shifts, the old will not simply go away; rather, it will be subsumed, enriched, and extended by the new. The essential difference between the old and the new is what each leads to operationally. Mass markets accommodate "silo" management, and the management focus is primarily on marketing and product positioning. Precision markets offer a new way of thinking about a business, where marketing is just one of the main components. Even though a precision market will be defined around a "segment," which may be just an account, developing these markets requires an organic, whole-business response that goes far beyond classical marketing.

Old management paradigm
The problematic consequences of managing for the mass markets in this emerging Age of Precision Markets are evident in almost every company today. In over two decades of research and consulting across numerous companies and industries, I have found a consistent pattern within each company: a few islands of high profitability in a sea of marginal business. I wrote about this in my first *HBS Working Knowledge* column ("Who's Managing Profitability?"), and how to change it has been a theme in many columns since.

The classic management paradigm of the mass marketer is the source of this problem. Products are relatively standardized within a market or segment, and all customers are treated more or less the same. Managers in various functional departments like Sales, Marketing, and Supply Chain Management are largely separate, and linked primarily through the company's planning and budgeting cycles. Performance information is collected along departmental lines, such as account and product revenue, category contribution, and distribution cost. All sales dollars look equally attractive.

In this context, information on real account profitability, product profitability, order profitability, and supply chain productivity (return on invested capital, "ROIC") is neither collected nor analyzed. Consequently, in virtually every company, 20–40 percent of the accounts, products, and transactions are unprofitable by any measure. Often, a small fraction of the business provides well over 100 percent of the profits, and an amazingly large portion of these are consumed, making up for the losses incurred in the unprofitable parts of the business. This is a massive issue in business, and in years of writing and consulting in this area, no one has disputed my finding.

The "Fifth P"
At the core of marketing in the Age of Mass Markets is a four-factor classification of marketing decision variables that everyone learns in first-year marketing courses, the "four P's." These P's are product, place, promotion, and price.

What's missing? Profitability, which I call the "fifth P."

The four-P mentality is responsible for the crazy-quilt pattern of profitability in every business today. It is simply assumed that if the four P's are set correctly, maximum profitability will be the byproduct. This assumption is completely wrong.

In the Age of Precision Markets, both sales and returns will be driven to a large extent by direct profitability maximization, both within companies and between suppliers and customers, using techniques I've explained in this series of columns.

The fifth P represents management imperatives like selecting accounts that fit your operating capabilities, differentiating your company through your ability to increase your customers' return on invested capital, and developing services like vendor-managed inventory that both reduce costs and increase sales for you and your customers.

What's at stake? Quantum gains in profitability and market share.

Today, companies can improve their profitability by 30–40 percent or more, without investment, through better internal profitability knowledge, selectivity, and coordination. At the same time, most accounts are reducing their supplier bases by 50 percent or more, and a company's ability to improve customer internal profitability determines whether it will get this quantum market share increase or whether its competitors will.

No longer can Marketing stand alone. No longer can Supply Chain Management simply be a service function. The fifth P requires the merged capabilities of Marketing, Sales, and Supply Chain Management, as well as IT and Finance.

Managing change
Here's the really critical question: If everyone agrees that their companies have this problematic profitability pattern, why do so few companies do something about it?

The answer is that at a tacit level, the mass market management paradigm is the dominant management paradigm today. As long as this paradigm is in place, managers will be blocked from creating meaningful, company-wide change.

A few months ago, I wrote a column, "The Challenges of Paradigmatic Change." Within hours of publication, I received a flood of e-mails from readers. Clearly, it struck a nerve.

In the column, I argued that many worthy change initiatives hit the wall of "the way we do business." This means that even great initiatives flounder if they conflict with the underlying management paradigm, and that the most effective way to get constructive change is to make the paradigm explicit and to show that a better one can replace it.

New management paradigm
The new management paradigm for the Age of Precision Markets requires that managers be highly skilled at three things: account management, supply chain management, and change management.

They must be able to survey their customers and markets, and develop a road map for the ideal depth of offensive terminal point and nature of relationship in different accounts and market segments. Armed with this road map, managers in different functional areas must be adept at working together to select and develop appropriate relationships with appropriate accounts.

Managers across a company must achieve a high degree of aligned focus, and have superb change-management skills, both internally and within customers. Interdepartmental coordination must be ongoing, fluid, and characterized by overlapping capabilities and responsibilities.

Precision markets offer a new way of thinking about a business, where marketing is just one of the main components.

For example, in last month's column ("Achieving Supply Chain Productivity"), I described how supply chain managers have to shift from reactive cost control to proactive supply chain productivity, which entails teaming with colleagues to maximize the earning power of their assets (ROIC).

The same broadening of responsibility is needed in every functional area. For example, account managers must be knowledgeable and proactive in using supply chain innovations to develop account relationships and increased penetration. Marketing managers must understand how to develop product and relationship migration paths to deepen their business and increase their profitability in target accounts, and they must recast their market segmentation criteria to incorporate factors such as account potential, operating fit, and readiness to change.

It all comes together in the account planning and account management processes, which must become a key focal point for company-wide coordination. (See "Account Management: Art or Science?")

This change is profound. It requires open-minded, creative managers, and new coordinative processes. All this without dropping the ball on internal efficiency.

Can it be done? Managers in leading companies are doing it today. In upcoming columns, I'll describe the critical elements of this new management paradigm.

Which is the business?
As companies develop more deep, interlocked relationships with their focus accounts, and deploy well-honed profit levers more selectively, the question always arises: Is this something we are doing in addition to the business, or is this the business?

When this happens, and it will, you will be standing face-to-face with a paradigm shift.

Some managers will find reasons to resist the change: too much complexity to see a pathway, too many moving parts to manage, too much risk of failure, too hard to get people to change, too much going on elsewhere to get to it. These managers will fail.

But other managers will step up to the new management paradigm and become adept at teaming with their counterparts to innovate and excel, both internally and across their extended supply chain. If you choose to be one of these managers, you can move into the Age of Precision Markets with confidence and success.

See you next month. wK

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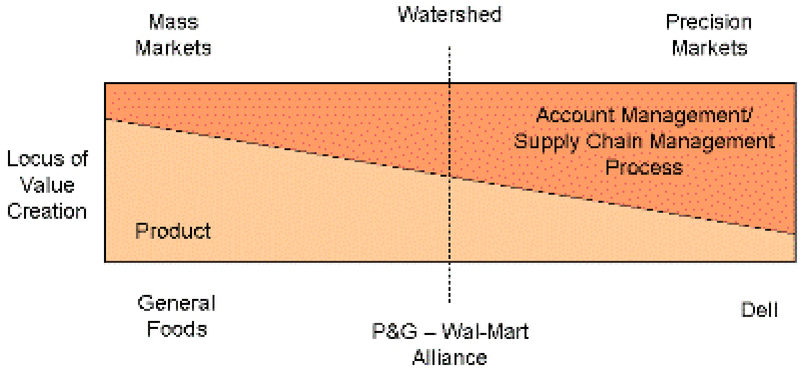
EXHIBIT 1: Shifting Locus of Value Creation



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