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The Problem With Planning

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All too often, planning focuses on creating improvements over the status quo, without gauging what more could be done. Jonathan Byrnes provides a tool for planning profit potential.

by Jonathan Byrnes

Part VIII
How do you know if your company is as successful as it can be?

This is a critical question, especially in this difficult economic environment, and it is essential to an effective planning process.

Yet all too often, planning focuses on creating improvements over the status quo, without gauging what more could be done. Are the company's plans propelling it to reach its full potential profitability, or only a portion? The problem with planning is that most plans do not provide a good answer to this seemingly simple question.

Here's what most top managers reviewing their companies' plans will learn: they will learn whether they are projected to make money; they will learn whether they will do better than last year; they will learn what important initiatives will take place in different areas of the business; and they will learn whether they will likely do as well as their competitors.

The problem is with what the plans generally *don't* tell them: they won't know whether they are achieving their full profit potential, and they won't know how much potential gain they are leaving on the table.

Most companies do not have a measure of their *latent profitability,* or unrealized profit potential. In fact, not only will many executives not be able to answer the question of whether their companies are as successful as they can be, but also most have not even thought to ask it.

And what is unmeasured is unseen and unachieved.

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Besides this lack of visibility into unrealized profit potential, in many companies functional plans fail to maximize overall profitability. This can occur in each business area: sales often brings in unprofitable revenues; operations focuses on improving the efficiency of operating systems that are fundamentally mismatched with clusters of customers; marketing initiatives often are aimed at broad segments of customers and have varying impact on different specific customer groups.

Here's what a former VP of operations of a Fortune 500 consumer products company said. "In my experience, not only are the functional department plans unidirectional and uncoordinated, but they also often conflict and partially cancel each other out." This is an important underlying reason why many companies fail to achieve consistently high levels of profitability.

Each functional plan "makes sense" in that it will generate a significant improvement over the status quo. Yet there is no measure of how much more could be gained if the plans were tightly coordinated and prioritized against the latent profit opportunities.

The next level
In last month's column, "Profit-focused Selling," I described how the general manager of a distribution company had increased his net profits by 50 percent in three years. He wanted to take his business to the next level. The key to doing this is *integrated profitability planning.*

The essence of integrated profitability planning is (1) to cluster accounts and products into prioritized action categories, described below, (2) to estimate the profit upside potential in each category based on best-practice standards and likelihood of success, and (3) to apply integrated packages of sales, operations, and marketing activities to achieve the objectives in each category.

First and foremost, a company must act forcefully to secure its most lucrative accounts, which I call Category I accounts. Secondly, the company must identify the high-potential, under-penetrated, or turnaround accounts, which I call Category II accounts, and aggressively focus its resources on converting them into Category I accounts. After that, or sometimes concurrently, the company should turn to its inherently low-potential, or Category III, accounts. Executives should utilize appropriate profit levers, ranging from multi-tiered selling to service differentiation, to turn as many of the remaining marginally profitable bad accounts as possible into well-performing good accounts.

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To illustrate this, consider the case of a company that sells devices that require on-site installation. The sales rep in one of the company's direct sales territories had about 100 accounts in the territory. These accounts ranged from large to small, and had differing potential profitability based on the inherent economics of on-site installation. (For clarity of explanation, I'll hold the product mix constant in this example.)

The accounts were classified by sales volume, and the rep was expected to call on the high-volume accounts more frequently than the low-volume accounts. The installers were expected to service the accounts as the products were sold. The sales rep had a quota that sought to increase the overall territory sales volume, and the installers devised careful measures to control their costs.

Of the hundred accounts, about five to ten were high-volume "A" accounts, an additional ten to fifteen were medium-volume "B" accounts, and the rest were low-volume "C" accounts.

On further examination

On careful examination, it turned out that some of the "A" accounts were well-penetrated Category I accounts, achieving very high sales volumes relative to total purchase potential, but others had significant untapped potential relative to the best-practice standard of the well-penetrated accounts. Some of the "B" accounts were well penetrated, while some actually were quite under-penetrated large Category II accounts with the potential to be strong "A" accounts. The "C" accounts were a mixture of "natural" Category III "C" accounts, or small customers, along with a surprisingly large number of very low-performing Category II "turnaround" accounts that really had the potential to be high-volume "A" accounts.

Moreover, some of the "natural" "C" accounts had attractive profitability because they were located in clusters of large accounts which made installation and sales costs very low; and some of the "B" accounts were quite unprofitable because they were located at some distance from installation depots.

If profitability lagged, top management could precisely identify the problem areas and create a set of highly effective solutions.

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Despite the sales standards of more frequent visits to the small number of "A" accounts, over half of the sales time was devoted to "C" accounts that generated only 10 percent to 20 percent of the territory's sales volume and far less of its profitability. In practice, the sales rep typically avoided the low-performing, high-potential turnaround "C" accounts because it would be necessary to invest significant time in turning each account around, and this would hurt his ability to make quota during the development period.

In order to reprioritize the territory, the rep estimated the upside potential of the low-performing, high-potential Category II accounts, the time (number of visits) required to turn around each, and the likelihood of success. This process showed the investment cost set against the expected gain in the turnaround accounts.

It turned out that by focusing first on securing the well-penetrated "A" accounts, second on the under-penetrated "A" and "B" accounts, and third on turning around the "C" accounts that really should be "A" accounts, the rep could double the territory's production in a relatively short period of time. To complement this new focus on high-performing and high-potential accounts, the rep suggested that a number of natural "C" accounts be handled by inside sales.

Importantly, because the rep had thought through a simple set of best-practice penetration standards and likelihood of success, he could see his progress against the territory's unrealized potential as well as the current baseline.

What's the priority?

In the next step, the company created a set of relatively straightforward profitability models, and applied these against the clusters of current and potential business. These formed the basis for integrated profitability planning. Based on account profitability and profit potential, the rep reprioritized some accounts. For example, some marginal "B" accounts were relegated to inside sales.

Armed with an understanding of account profit potential, the rep could argue for dedicated installers and special marketing support for Category II turnaround accounts that warranted the investment. This was especially important because relatively more resources were needed to stem the inertia of a turnaround account than were needed to grow a somewhat under-penetrated account.

Conversely, with a view of the varying customer profitability terrain within the territory, operations and marketing could get aligned with sales, and with each other, to jointly focus their resources on the highest-payoff situations. (Note that this requires a change in the goals and rewards of the functional departments or business units.)

In this context, account plans became committed business cases jointly developed on an integrated multi-functional basis. The territory plans rolled up to regional and corporate plans, which contained current baselines, upside expectations, required investment, and a clear statement of latent profitability as yet unrealized.

New planning process

What changed here? In the past, each functional department planned improvements over its current baseline largely in isolation from each other, and none felt the tacit pressure of highly visible untapped profit potential. If profitability declined, top management did not have a clear understanding of cause and effect.

With integrated profitability planning, the functional departments could jointly identify the highest-payoff situations, and align and focus their resources to maximize the company's profitability. With a relatively straightforward set of standards, they could see clearly not only how they were doing, but also what they had not yet achieved. If profitability lagged, top management could precisely identify the problem areas and create a set of highly effective solutions.

In this way, integrated profitability planning provides managers with a powerful process to focus, prioritize, and align their functional departments, or business lines.

This process enables managers to determine the set of actions that will lead most rapidly and directly to high profitability increases. Note that these profitability increases stem directly from good management measures: clarity in identifying highest-payoff opportunities, setting appropriate goals, aligning interfunctional initiatives to achieve these tightly defined goals, and great management of the day-to-day details of the business. Major capital investment is not required.

By the way, do you have a problem with planning? The answer should be "No! We're as successful as we can be!"

See you next month.

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