

INTRODUCTION

ISLANDS OF PROFIT in a sea of red ink. The fundamental premise of this book is an astonishing proposition: nearly 40 percent of every company is unprofitable by any measure, and 20 to 30 percent is so profitable that it is providing all the reported earnings and cross-subsidizing the losses. The rest of the company is only marginal.

I first discovered this about twenty years ago in work that I did with one of the premier companies in the laboratory supply industry. Since that time, I found the same pattern in my research and consulting with leading companies in industries as diverse as hospital supplies, telecommunications, and steel. And these were not laggards; they were among the highest-performing firms in business.

In these projects, I created a systematic process for analyzing a company's profitability, and I developed a number of "profit levers" for turning unprofitable business into good business, and good business into great business.

Two puzzling questions

This work raised a couple of very puzzling questions: Why is this occurring now in so many companies across all industries? Why is it difficult for managers to get their arms around this huge opportunity, and to act on it?

When I explored these two issues with a number of insightful managers, it became clear that the answer is rooted in a major, historical

transition that business is going through today: a change from the prior Age of Mass Markets to a new era in business, the Age of Precision Markets (more on this later). The underlying problem is that most of the management processes and control information in business were developed in the prior era, and are no longer appropriate.

This is the cause of the high level of embedded unprofitability in industry after industry. It means that effective managers today not only have to understand how to profit from this huge new opportunity, they also have to recognize the sources of resistance, and be adept at managing constructive, paradigmatic change.

HBS *Working Knowledge*

A few years ago, Sean Silverthorne, the editor of Harvard Business School's *Working Knowledge* e-newsletter, suggested that I write a monthly column on this subject. Over the course of four years, I wrote a series of columns that covered these topics.

I remember when I wrote my first column, "Who's Managing Profitability," which forms the basis for the first chapter of this book. *Working Knowledge* has a readership of tens of thousands of managers all over the world, and the premise of the column was that in most companies, *no one* is managing profitability effectively. I held my breath when the column went out over the Internet on a Monday morning, wondering what the reaction would be.

The reaction was immediate and decisive. My in-box was flooded with dozens of e-mails from managers agreeing with my conclusions.

I wrote nearly fifty columns on profitability management. In each one I explained how to systematically improve a core business process in a practical, hands-on way. I wrote the columns to be high-impact guidelines for action, designed to be read quickly on the Internet—lots of meat without much fat, most with a very precise to-do list at the end.

Most of my columns were widely reprinted in other publications. Many are used in university courses and training programs. Each of these columns was read by and vetted against the experience of thousands of managers. To this day, no one has disagreed with my conclusions and recommendations.



Overview of this book

A number of managers have asked me to develop my *Working Knowledge* columns and some of my other writings into a book. The book that you have in hand is the result of these requests.

I've kept the action-oriented format, and I've organized the chapters into four topics:

- ▶ Thinking for Profit
- ▶ Selling for Profit
- ▶ Operating for Profit
- ▶ Leading for Profit

This book is about how to make more money from an existing business without costly new initiatives. Its chapters tell you how to systematically improve your business, land the best customers, build your managers' capabilities, and secure your future through thoughtful, effective management. These improvements will not cost you money; in fact, almost all of them will generate profits and cash from the start.

This is a handbook for all the managers in your company, whether you're a global conglomerate or a local shop with five employees. Regardless of the size of your business, it will guide you in moving your business up to its full potential.

At the end of each chapter, I've included a section called "Things to Think About," which highlights the chapter's critical points and suggests how to put them into action. In my courses at MIT, I conclude each class session this way to help my students consolidate their understanding and relate it to their careers. Many have said that this is one of the most valuable parts of my teaching. Several have told me that they keep a typed version of these comments close at hand for reference.

This book follows a logical sequence that enables you to understand the new opportunities, identify the most productive courses of action, and lead the creation of a high-performing management team. I designed the format to help you thumb through to, or return to, the topics that interest you, and easily share these ideas with your colleagues and associates. You should follow your interests, but reading the whole book in order will give you the complete picture you need to manage effectively in today's new era of business.

New era in business

Why are these huge opportunities present in so many companies today? The answer lies in the sea change that's taking place in business, which I explain in chapter 3, "The Age of Precision Markets."

Today, business is going through a transition from one era to another, from an era of mass markets to an era I call the Age of Precision Markets. In the old era, companies distributed their products as widely as possible using arm's-length customer relationships. Their goal was mass production and mass distribution. In the mass-market era, broad management measures like aggregate revenues and costs were adequate for maximizing profitability. Almost all the management systems and processes in companies today are implicitly geared to meet this legacy objective.

In the new era, however, companies increasingly form different relationships with different sets of customers. These relationships range from arm's length to highly integrated, and include almost everything in between. Today, leading companies are reducing the ranks of their suppliers by 40 to 60 percent or more, creating enormous new opportunities for their most capable suppliers to dramatically increase profits and market share.

The successful business today creates huge competitive advantage and high sustained profitability by developing innovative customer relationships and new types of customer value, and by aligning its internal processes. However, this is a two-edged sword: if customers are matched with the right relationships, and the new value is compelling, sales and profits can increase . . . but if these matches are not done well, profitability plunges.

In this new world, the broad metrics and management approaches of the past no longer enable managers to maximize their companies' profitability. This is the underlying reason for the problematic profitability patterns I've seen so often. It creates an enormous new set of opportunities for the manager who wants to take up the challenge to manage in a new way.

The chapters in this book chronicle this transition and tell you how to create the successful business of the future—what to do, how to do it, what difficulties you'll probably encounter, and how to overcome them. My objective, the reason I wrote this book, is to give you the road map, perspective, and tools that you need to be a highly effective manager in this new era of business.

Your own best practices

Think about this. Imagine that someone took a comprehensive video of everything that went on in your company over the course of a year, and then edited it carefully to pull out your own best practices. When you view the edited film, I'm certain you'd see the best company in the world.

The problem, however, lies on the cutting-room floor: all the rest of your company's activities that don't live up to your own best practice. When you look at your company's actual performance—net profits, market share, customer relations, operations efficiency—you're looking at a blend of your own best practices and everything else that doesn't meet this standard.

How important is this? It creates the profitability pattern that is the core of this book: islands of profit in a sea of red ink.

When my first *Working Knowledge* column appeared on the Internet, several thoughtful managers sent me notes sharing their experiences.

One CEO wrote to say that he saw this pattern in his company. His biggest concern was how vulnerable he would be if a competitor focused on picking off his most profitable customers.

A senior vice president of sales wrote, "I guess I have two ways to get a 30 percent profit increase: boost my sales by 40 percent, adding a lot of new low-margin business, or focus on managing the day-to-day details of the business. It's a pretty easy choice."

These executives' reactions sum up what this book is about. There is an enormous amount of money to be made by improving the business you already have in hand. For some managers, it's easier to spend money on glossy new initiatives than to systematically improve the business. But when your business is tuned up to its full potential, you can drive it like a Ferrari. It's hugely fun and immensely satisfying to manage. It's also very rewarding.

Who should read this book

This book is designed to be a handbook of profitability management, one that a top manager in either a large or small company can give to every manager in his or her organization. However, in my experience corresponding with readers, particular sets of managers are especially interested in certain material. Here's a quick guide.

TOP MANAGERS (CEOs, vice presidents, and general managers). These managers need to read the book from cover to cover in order to develop

effective profitability management programs and guide their subordinate managers. Most top managers have been particularly interested in the material in sections 1 and 4. In particular, chapters 1, 2, 3, 4, 9, 10, 16, 17, 19, 25, 26, 31, 32, 33, and 36 have generated a lot of top management e-mails. Chapters 31 and 32 are especially critical for this group.

CFOs. This whole book is extremely relevant for a CFO. If a CFO wants to read selectively, I suggest starting with chapter 9, then continuing with chapters 1, 2, 3, 6, 7, 8, 10, 12, 14, 19, 20, 21, 24, 25, 27, 32, and 34.

Department heads (director-level managers). These managers are the heart of all successful profitability management programs. They need to understand the overall concepts, and must coordinate with their counterpart department heads. For all these individuals, sections 1 and 4 are critical. In addition, they should do a “deep dive” in their respective areas of responsibility, and also develop a general understanding of their counterparts’ respective areas of management. Above all, department heads must develop a very clear understanding and practical appreciation for chapters 28, 31, and 32, which explain change management and organizational effectiveness.

Front-line managers. A front-line manager should focus on developing and managing the profit levers in his or her area of responsibility. Sections 2 and 3 provide deep knowledge in this area. Beyond this, the overall understanding of profitability management that section 1 provides, and the broad overview of leadership that section 4 provides (especially chapter 36), will give a front-line manager an important leg up on career advancement.

Small business owners/managers and entrepreneurs. The name of the game for these managers is to go as far as possible with as few resources as possible. These individuals should focus strongly on section 1, especially chapters 2, 5, 6, 9, and 10. In addition, the chapters in sections 2 and 3 offer a number of concrete ways to maximize asset productivity and cash flow. Chapters 11, 12, 13, 15, 16, 18, 19, 21, 22, and 23 are especially relevant. In section 4, chapters 27, 29, 30, and 35 are very important to this group.

Major profitability and market share increases

All the chapters in this book are based on work that I’ve done directly with great companies and creative managers over a period of more than twenty years. In most of these consulting projects, I have worked directly

with the top-level executives of leading companies to create new strategic initiatives and new ways of doing business that have transformed their companies and industries. I have been very fortunate that I've been given the scope to "challenge everything" and look for innovative ways to make things better. This book is the direct result of these experiences.

In addition to my corporate work, I'm a teacher. I have taught graduate students and executives at MIT for nearly twenty years. Thousands of my former students are putting these ideas into practice every day, and letting me know about their successes.

I hope that this material helps you transform your company, and I look forward to hearing about your experiences.