

## Three Cornerstones of Profitable Growth

What essential elements does a company's top management team need to put in place to create years of strong, profitable growth?

Here's my old family recipe: information, process, and value footprint.

These cornerstones formed the basis for a two-month series of workshops that I recently conducted with my colleague, Lisa Dolin, for the top 150 managers of an extremely effective global company.

All three elements are important and essential; without any of the three, the company will not reach its potential.

### Information

A company's core profitability information is contained in a profit map. I describe profit mapping in my award-winning book, *Islands of Profit in a Sea of Red Ink*. In essence, a profit map is built by developing a full P&L (including overheads) for every invoice line. Once this is accomplished, the profit map answers the critical question: What is the actual profitability of every product in every account?

It also answers a multitude of other critical questions about product and supplier profitability, as well as highly focused questions like: Are my low-volume unprofitable products largely consumed by my low-volume unprofitable customers (guess the answer...)?

Here are some important tips in developing and using profit maps:

*Invoice-line information.* Developing fully-costed information on every invoice line is absolutely essential. All too often, managers starting on the road to understanding and managing profitability focus on customers, with a rough *invoice-level* (as opposed to an *invoice-line* level) costing usually based on sales volume. These efforts give an inaccurate and incomplete picture. Even in your biggest, most obviously profitable customers, over 20-30% of the products are unprofitable by any measure – and without *invoice line* costing, this is completely hidden. Also, critically-important opportunities to work with suppliers are undiscovered.

*Strategy first.* One of the biggest surprises in profit mapping is how obvious the strategic opportunities and problems are. Many managers start the process with the assumption that they will focus on tactical issues like pricing and whether to take certain business. As soon as they see a profit map, they are struck by the fact that big portions of similar business are either very profitable, or very unprofitable. Immediately, they see what the company needs to do for really big improvements that put really big new profits on the table. Only later do they turn to the more tactical opportunities that need systematic grassroots mining.

*Big opportunities early.* Here's what almost always happens when you give a profit map to a sales rep without guidance or training: He or she goes after small changes in small accounts

(e.g. getting the customer to order three rather than five times per week), declares victory, and goes back to business as usual.

Instead, it is most productive to focus first on the big profitable customers, where you have the best relationships, the highest volume, and most often where you have a 20-30% fast profit upside.

*To repeat: focus first on your big, profitable customers – your islands of profit – both because they offer the largest, fastest profit gains, and because securing these critical accounts is the absolute most important way to protect your business from fatal profit erosion.*

After that, look at the large, low profit customers. These are more difficult to change because they often are unprofitable due to unfavorable pricing or contractual obligations. These take time to change. The lesson: if you really understand your profit map, your true net profit landscape, you can ensure that your customer relationships are profitable from the start.

*Don't forget your products and suppliers.* Most companies have as much, or more, upside opportunities on the product and supplier sides of their business, yet most instinctively focus on their customers. With profit mapping, you can see which customers are buying which products, and it is not at all unusual for over 50% of a company's products to be unprofitable (and often purchased by unprofitable small accounts).

*Keep it simple.* Ultimately, your profit information will be used by lower level sales reps, supplier managers, and others. These individuals almost always do best with relatively simple formats and standard ways of analyzing and acting on the information. The lesson: don't design the information for a highly quantitative analyst who loves to explore data. Instead, design the right tool for the job.

## **Process**

The second cornerstone is process. Without effective processes, even the best profit mapping information will not be converted to action. Here are some process tips.

*Regularity and discipline.* It is imperative that a company create a set of processes that are regular and disciplined, with clear accountability for results. These processes span strategy, market planning, account planning, product management, and supplier management. In my experience, the best combination is monthly planning and results tracking at the local level (e.g. account planning), and quarterly planning and results tracking at high levels (e.g. strategy, supplier management).

If possible, tie these processes into the company's natural cadence of planning and control (e.g. profit mapping becomes the core of the planning and budgeting cycle).

*Wade in.* All too often, companies spend inordinate amounts of time developing information, very little time developing core processes to convert the information into results, and almost no time on training and organizational development. This is a big mistake.

Again, in my experience, the training and implementation process works best in four steps.

First, create custom workshops for the top managers. The objective is to expose them to the information and to help them create the processes to convert the information into results. Here,

we have found that the best results come from a combination of teaching cases, custom cases that we write on the company's own business units, and planning sessions. The custom cases are crucial, as they give teams of the company's top managers actual hands-on experience in working with profit maps and planning processes.

Second, develop pilot processes. Here, try a few alternative ways to work with the profit maps in formal processes. I suggest using a few great managers and effective sales reps to try things in separate efforts; the same holds with other functional areas like supplier management. It is important to have a few independent initiatives going, so you can see what works, and ultimately develop a combination of the best practices.

Third, create a way to scale the process. Even the best process needs to be changed in order to operate at scale, especially when less capable individuals are involved. Do this over several months in a purposeful way.

Fourth, work the processes into the company's DNA and muscle memory. It takes time to perfect the implementation and to make the processes a way of life. Without this, the company will fall back on comfortable old practices, even if much less effective.

My old family recipe for wading in is: 6/6/1 – six months for steps one and two, six months for step three, and one year for step 4.

*Compensation.* If you continue to compensate your sales reps on revenues and gross margin, and they “work their pay plan”, it is obvious that you won't maximize your profitable growth. Your sales reps need to be carefully trained, and the compensation has to be modified as they develop the new understanding and skills. Compensation is a very sensitive and complex topic, but I suggest that a bonus overlay works well in the first year.

In parallel, we focus strongly on training the trainers (especially the sales managers and their counterparts). Here the relevant metaphor is to school excellence: if the principal of a school is great, the school will be great; but if the principal is mediocre, the school will underperform almost regardless of how talented the teachers are.

## **Value Footprint**

Your value footprint, or value proposition, is critical. The value that you create for your customers and suppliers determines the value that you can harvest. Several chapters in *Islands of Profit in a Sea of Red Ink* explain how to create a powerful value footprint – for example, check out Chapter 17, “Profit from Customer Operating Partnerships.” Several of my blog posts also focus on how to be effective in creating a value footprint – and importantly, how to match a set of value footprints to sets of customers (necessary for creating big value without having your costs blow up).

Here are a few important aspects of creating a strong value footprint.

*Islands of Profit.* The absolute most important priority is to secure and grow your islands of profit – your high-volume, high-profit customers – both to gain large, fast profit growth and to protect your core profit source. This is where pushing the envelope on your value footprint is most important and productive. And, in the process you will lower your operating costs by 20% or more, and increase your share of wallet by over 35%, even in your most highly penetrated accounts.

*Not just customers.* You certainly have an opportunity to develop a decisive value footprint for your customers – indeed, this is where everyone focuses. But, you have an equally strong opportunity to create value for your suppliers. The latter is almost always overlooked.

*Showcases.* I have written at length in my book and in my blog posts about the importance of showcase projects. A showcase is a small exploratory project, often with a relatively small well-run customer or supplier, in which you can jointly embark on a journey of discovery to find inventive new ways to do business together.

Vendor-managed inventory, cross-docking, category management, and many other widespread innovations grew out of showcase projects.

Here, the key is to keep a completely open mind and to learn by doing.

Resist the strong temptation to work with a major customer or supplier, and instead work with a smaller partner who is well-run and innovative. Work where the conditions for success are highest, and the risks of failure are lowest. Great companies have a constant portfolio of showcase projects. That's how they stay in the lead.

And, as with any process, creating and improving a value footprint must be a regular, disciplined process with responsibility, regular cadence, results tracking and clear accountability – not just an occasional one-off project.

### **Huge gains**

All companies have an opportunity for huge, fast gains and sustained profitable growth. I have been personally involved in projects involving nine-figure profit gains.

The secret of success is to cement in place the three cornerstones of profitable growth – information, process, and value footprint. With these in place, the company will naturally accelerate its profitability, growth, and competitive advantage.