

## Sustainable Profitability

In yesterday's commentary, I talked about our economic dilemma, summed up in this quote from Sunday's NYT:

[http://www.nytimes.com/2010/07/26/business/economy/26earnings.html?\\_r=1&scp=1&sq=industries%20find%20surging%20profits&st=cse](http://www.nytimes.com/2010/07/26/business/economy/26earnings.html?_r=1&scp=1&sq=industries%20find%20surging%20profits&st=cse)

“This seeming contradiction – falling sales and rising profits – is one reason the mood on Wall Street is so much more buoyant than in households, where pessimism runs deep and joblessness shows few signs of easing.”

Yesterday's WSJ ran an article, “Investors Say No to ‘Let's Expand’ Companies”

<http://online.wsj.com/article/SB10001424052748704719104575389172070900184.html?KEYWORDS=investors+say+no+to+lets+expand+companies>

that expanded this view.

What's wrong with this picture?

What's missing is the concept of sustainable profitability. Managers and analysts today make the huge hidden assumption that in a stagnant economy, growth diminishes profitability, unless through some mysterious mechanism the whole economy strengthens and all ships rise on the incoming tide. Picture the airlines where all carriers chase business and add capacity until they run out of money.

This assumption is completely false.

In my research and consulting in over a dozen industries, I've found that even in the best-known leading companies, 30-40% of the business is unprofitable by any measure, and 20-30% provides all the reported profits and subsidizes the losses. In years of my writing about this, no one has disagreed.

What this means is that every company has a core portion of its business that generates high, sustainable profitability, and that even leading companies look like islands of profit in a sea of red ink. The islands can be identified, secured, and grown rapidly, yielding high sustainable profitability even in a weak economy. Moreover, a lot of the marginal business can be turned around in a surprisingly easy way, and can become sustainably profitable.

What keeps managers from doing this? Three key factors stand out:

(1) our historical accounting systems were developed in a prior business era, and they fail to show managers where their core sustainable profitability resides;

(2) sales compensation is not aligned with the need to grow business that has high sustainable profitability – in most companies, all sales or gross margin dollars are equally desirable;

(3) most companies have a blind spot when it comes to creating compelling new value for the customers that are capable of giving them high sustained profitability – instead they spread their efforts across their whole customer base, or focus mostly on large accounts, without regard to which do, and which do not, yield sustainable profitability.

Sustainable profitability is within the reach of every manager. It does not require capital, but it does require insightful management and leadership.

Picture Southwest Airlines, the exception to the airline industry portrayed above. Southwest has prospered and grown in good times and bad because it clearly understands what business fits and yields high sustainable profitability, and, more importantly, it understands and avoids the business that does not.

Sustainable profitability is the key to lasting success. With it, companies can both prosper and grow, and in the process, play a vital role in reversing our economic malaise.