INTRODUCTORY COMMENTS TO THIS CHAPTER 2 DRAFT OF REINVENTING DISTRIBUTOR PROFITABILITY

This document is a draft of the second chapter of my forthcoming book. We encourage you to:

- Tell as many people about it and where to find it (www.merrifield.com) as possible
- Although it is copyrighted, we grant you permission to copy and circulate it
- Give us feedback. Be editors and critics. We have already made significant improvements to both chapters due to readers' contributions. Send comments to bruce@merrifield.com

We expect the book to be available in paperback in the late fall. Before then, more of the book will be made available via the net and excerpts will appear in our weekly "Distribution Channel Commentary" (DCC) series. For past DCCs, look in the upper right hand corner of our home page. For those of you who would like an automatic mailing of new DCCs, which normally go out on Wednesdays in an attached word document format, please send your e-mail address to karen@merrifield.com.

Here's hoping that Chapter 2 will help you to specifically identify operating, financial assumptions and practices that actually limit you from improving and growing your "profit power". If we can't identify the causes around us that are blinding us to upside opportunities and binding us to past, wheel spinning activities, then we can't reinvent our companies to be an ever better economic ride for ever improving and more motivated stakeholders.

Sincerely,

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SUMMARY OF CHAPTER 2:

In Chapter 1, we reviewed strategic "maps" for ideas on how to better run our companies. If these maps did offer some fresh insights to you, the odds are that you will only increase your current "knowing-doing gap". Most companies already know how to be better than they are, but can't change because they are frozen by accumulated, dated and mostly unspoken operating: assumptions, practices, reporting systems, incentives and more.

Chapter 2 and 3 are dedicated to systematically identifying and naming what these status-quo enforcers are. Chapter 2 focuses on financial management themes that blind us, bind us and cause us to do, in some cases, even conscious, Dilbert-Zone, dumb stuff.

This chapter applies strategy map thinking from Chapter 1 to nine conventional financial management themes or practices within distribution: buy low, sell high, collect early, pay late, hire cheap, work hard, sell more, win with infotech and don't share the general numbers with everyone. In each case, the "dark side" of these practices is identified, then suggestions are made for how these themes can be modified to improve profit power instead of harming or harvesting it.

Both Chapters 2 and 3 are designed for readers to skim through and focus on the specific themes that may be the biggest anti-change factors for their own business. If we can't first identify, name and cure what has been holding us back in the past, then all of the how-to prescriptions covered in the rest of the book can not be successfully applied within a conventionally run distribution business.

CHAPTER TWO

New Maps vs. Financial Management = Blind Spots?

In Chapter 1 we skimmed through six strategy maps to stimulate some new thinking about how to reinvent distributor profitability. The in-depth stories of the maps are told in later chapters.

To keep open minds about the forthcoming, in-depth coverage, we should first articulate the old thinking and cultural habits that have been holding us back. If we can pinpoint the differences between our traditional behavior and what the strategy maps advocate, then we might be able to:

- Minimize our emotional resistance to the new ideas throughout the book;
- Agree on why and how we need to modify and perhaps blend both the old and the new;
- Have better transitional dialogues with employees who have the most to loose by adopting new things. (Remember, according to Machiavelli: "Change has no constituency.")

To surface traditional thinking assumptions and their differences with the map theories, Chapters 2 & 3 are dedicated to an imaginary grid exercise of map ideas vs. traditional (distributor) guidelines.

AN IMAGINARY GRID OF NEW vs. OLD IDEAS

Imagine a grid with horizontal bars labeled on the left with some shorthand phrase for the six strategy maps from Chapter 1. They were in order:

- PBIT/customer
- butterfly economic$
- resynch with life-cycle curve realities
- service retention theory
- service value improvement process
- strategy first (to reweave the kinetic chain and) to reshape "good ideas"

Then, across the top, I have chosen the following 10, traditional-thinking, column headers broken into two sub-categories:

Chapter 2: Financial Management Themes (with blind spots that destroy profits)[1]

- General comments on financial management for profit power
- Buy low
- Sell high
- Collect early/pay late
- Hire them cheap/work them hard
- Sell more volume to share fixed costs
- Cut costs with information technology
- Share numbers on a needs to know basis (not open-book)
  (add others if you would like)

[1] In 1974, right out of business school, I took my first job as the assistant branch manager of the Peoria Paper (distribution) Company in Peoria, IL. I reported to a 55-year-old, ex-Navy Chief, numbers chap who told me: "Junior, the key to making money in this business is to buy low, sell high, hire them cheap, work them hard, collect early, pay late and sell more volume to share out fixed costs." It took me several years to learn what bad advice this was.

Chapter 3: Controlling the Product Promotion Channel Culture

- Schedule/execute strategic product promotions (to grow product sales)
- Outside sales people are the growth generators

If we were to actually review each cell on this hypothetical 6 x 11+ grid, which we won't, we could enter a number of conclusions into our imaginary grid spaces. Some examples are: "does not apply; "blend both" with a range of weighting possibilities from 10/90, 50/50 to 90/10; etc. This exercise, in other words, should be an open-minded, non-defensive, flexible thinking exercise. This is not meant to be a confrontation between my theories and your traditional thinking or practices in which one is 100% right and the other 100% wrong.

All management theory and advice is, at best, only one blade of one pair of scissors. The other blade represents your company's unique context made of many inter-dependent variables, personalities and legacy baggage all for better or worse. Management must choose when, where and how to use which pair of scissors. Often the most creative solutions that really work are when a company figures out how to take what appears to be two conflicting ideas and finds the synergistic, third way, compromise solution.

In the spirit of finding best new blends of the old and the new, let's play the grid game.

FINANCIAL MANAGEMENT FOR PROFIT IMPROVEMENT; GENERAL THOUGHTS

Before critiquing the dark side of financial management, I want all hard-nosed, hyper-trophied, left-brain, bean-counting, tough guys to know that I agree with them on this point: minding the numbers is an important part of running a high performance business. Setting financial improvement goals with calendar deadlines (a false sense of urgency) and performance incentives attached can occasionally spark creative, non-destructive thrift ideas and win-win solutions that improve the numbers by bonus time. At the very least, it helps everyone to not be wasteful or lackadaisical with expenses and cash flow.

We should also be aware, right up front, that numbers that appear on financial statements are only symptoms of the underlying root causes for creating profit power. You can not manage symptoms to improve the root cause factors. All you can do with good financial management in the absence of good profit power development, especially in a mature industry, is die more slowly than if you were financially lax.

As a quick test of the thesis that financial management can not improve profit power, realize that no amount of financial number analysis can provide the insight from and the answers to the questions raised by the strategy maps in Chapter 1. To find those strategic answers and to then measure, manage and reward the creation of new profit power, we will need to develop a second, internal scorekeeping system that we will address throughout the book. The two systems, financial management and strategic profit power management (SPPM), will overlap and complement each other.

Why has our financial management reporting system evolved the way it has? There have been at least three big shaping forces:

- Securing asset-backed lending (double-entry balance sheets for lenders started in the Italian City States during the Renaissance)
- Paying the right amount of taxes on a timely basis;
- Managing for positive cash flow by "collecting early/paying late and keeping internal costs that we can count, know and manage (originally by hand) to total less than the margin dollars coming in to insure a profit.

With computers, spreadsheet software and ever-expanding, tax-code grabs at all three levels of government, we can begin to understand why:

- Financial management has gotten increasingly more complicated
- The accounting industry has continued to grow with the tax codes and the cost for audits
- Why we avoid personal financial moves that make doing our own taxes even more difficult
- (Side benefit) More companies are now able to use new software to calculate customer profitability as a first step to reinventing corporate profitability.

We tend to assume financial management is important to profit power development, because we have grown up in a world of financial numbers accompanied with no shortage of expert opinion on how to "squeeze more profitability" out of what companies already are doing or out of consolidation activity. With computers providing increasing data, we can get distracted and misled playing "what if" games. One type of financial what-if analysis does at least point towards a valid profit power development path that I call "sensitivity analysis." A brief review of how it works follows.

"WHAT IF" GAMES + SENSITIVITY ANALYSIS = PROFIT POWER INSIGHTS

Let's assume you are a shareholder in a privately held distribution company, and you want to get rich sooner as opposed to never. The best measure for increasing your wealth in a business is to improve the "return on (shareholder) investment or ROI.[2] For ROI to improve, we just need to find the best ways to grow the PBIT line.

Together we look at the company's financial statements and make a few assumptions:

- If we super-focus on one number in the financials, we could find some way to improve that one factor by 1% to the good. By example, 1% more margin would be good, whereas l% less for any expense item would also be good.
- Some portion of the incremental improvement would "flow-through" to the PBIT line.
- Because 1% of a big number is a more interesting result than 1% of a small one, we would ideally focus on the biggest number of all – "sales" – instead of a smaller number like the utility bill. We do want, of course, everyone playing the "let's pay us, not them" thrift game with every expense detail. (But, why would they? What's in it for them? Do they get the numbers, the responsibility and some of the achieved benefits?)

Considering "sales", we quickly realize that there are two ways we could try to increase sales by 1%. We could get more volume, or we could raise prices. But, the 1% improvements would have significantly different flow-through impact on the PBIT line. *The sensitivity impact of "selling high" is much higher.*

To illustrate the difference in flow-through rates, let's assume that we are a distributor with $100 in sales at an average margin percent of 20%. If we increase sales by 1% or $1.00 at the same mark-up, then only 20 cents of the dollar flows-through to the gross margin line because the variable cost of the goods was 80 cents. Then, the 20 cents in margin gets further consumed by 1% more variable cost increases in order fulfillment activity, commissions and financing charges for the incremental increase in inventory and receivable investment.

If the company has a current, tough-economy, 2% PBIT line, how much of the 20 cents in new margin will get to the PBIT line? The correct answer is: "it depends on a number of variables". Two extreme

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[2] Synonyms for ROI are return on equity (ROE), return on net worth (RONW); they are all calculated by dividing Profit After Tax (PAT) by the year-end (or the average equity figure) for the past fiscal year. As an approximation for PAT, we can use for operational "what if" games, the operating income or profit before interest and taxes (PBIT).

examples for incremental sales gains would be: more small, losing orders from new accounts that are not in our best niche(s) for losses; and, following ABC Distribution's strategy in Chapter One of selling more best items to best customers tacked on to an already profitable order size flow. ABC's incremental sales growth could achieve 5 to 10 cents of PBIT flow-through from the incremental 20 cents of gross margin line for every dollar of sales.

SELL HIGH; FLOW-THROUGH SUMMARY RESULTS; SO WHAT?

But, **the best flow-through of all happens if we just raise prices and don't lose any volume.** Then, the extra $1.00 of sales flows 100% to the margin dollar line which would be 5 times the 20 cents that we would get if we just sold more. Then, there are no variable transactional costs except incentive compensation of perhaps 5 cents. So, 95 cents goes to the PBIT line, which is:

- **45 x** the average PBIT of 2%
- **19 x** the flow-through increment of selling more to profitable accounts only; and,
- **9.5 x** the flow-through of selling more best items to best customers on a systematically generated, larger average order size basis.

Don't these sensitivity multiples suggest that we should re-think our marketing objectives and resource allocations? Are too many sales promotion efforts aimed at selling some product to any and all customers that are statistically unprofitable? Don't we also sell a lot of products with some sort of (price) deal attached? Isn't promoting load-up, price deals in conflict with the marketing message of co-creating a replenishment system that provides the lowest, everyday TPC?

How much of our marketing resources are focused on:

- How to sell higher prices, terms, special charges to customers for which our distinctive, focused, service value would still be delivering the lowest TPC in comparison to some other, "bargain price, bargain service" competitors? (Especially to modest, PBIT-losing customers that we are truly under-charging and/or over-servicing.)
- Systematically selling more, best items to best customers on a system basis?
- Selling only profitable accounts with a promising future on a total team, laser beam basis?

What is the positive trade-off, break-even point for selling high and a little less? Would we have any problem doubling our PBIT on 5% less sales? What would we do with the order fulfillment personnel slack if we had 20 to 30% less, transactional activity? Couldn't we then afford to do some: personnel education; some extra team focusing on and value experimentation with the 3 to 5% of our accounts that will generate 80% of the new PBIT growth over the next 5 years?

The answers depend upon how distinctive our service is and how well we orchestrate our losing customer segment plays. In Chapter 4, we will see how distributors who have not formally addressed the money-losing order and customer problems can easily double their profits within six months while also freeing personnel time to reinvest into jumpstarting profitable, sales growth with the right accounts.

Sensitivity analysis can spotlight "sell high", etc., but then our own bottom-up, empirical investigations have to find out the real starting points for each location to improve their service value and profit power in very customer niche focused ways. In the rest of the chapter, let's see how we might convert financial sub-themes and their blind spots into more creative, productive guidelines for our businesses.

A CASE STUDY: A SENSITIVITY PICTURE THAT SPOKE LOUDER THAN WORDS

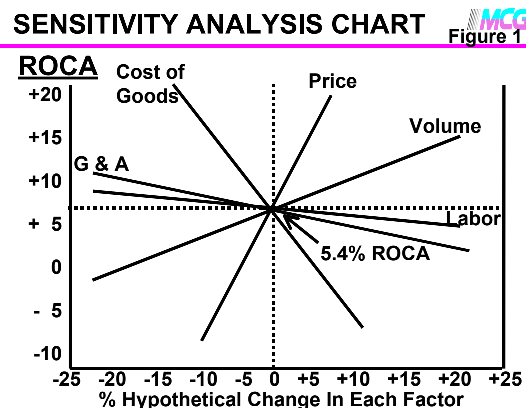
In the late '70's, when I was helping to run a distribution chain in the mid-west, I was struggling with getting the "sell high/better" story across to the top 20% of the payroll that included the outside sales force. At management meetings, I would sneak in some training, but when I would ask the question: "how much of an incremental dollar of new sales gets to the PBIT line?" I would get conventional wisdom answers. A financial person might say, for example: "More than our average, because we have lots of fixed costs". Note the precision of "more" and "lots" when in fact our general overhead expenses had been growing as fast or faster than sales over the preceding 5 years.

An aggressive sales marketing person would say something for which the sub-text was: do more promotions on more new products to more new accounts with more feet on the street, and cut the price "a little" to get orders, because we will make it up on volume. Were these managers going back to their branches to:

- develop actual case studies involving their branch's buyers and sales rep in which there had been either better or worse buying or selling economics?
- then, host monthly case study discussions at the branch with both purchasing and sales reps?
- persist in this type of training for 6 to 12 months to: improve margins from 23 to 27%; boost average order size 25%; successfully bill a significant amount of extra service charges; etc?
- and generally obsess first and foremost about how to create, sell and get paid for service value?[3]

What to do? Show them a picture! I had access to a very large corporation that had a software package that allowed me to create the graph below. The program allowed the user to graph how the change in different financial factors impacted (in my case) the pre-tax return on total "controllable"assets (ROCA).[4] The steeper the slope for a given variable, the bigger the impact on or flow-through to the PBIT line which was the numerator for ROCA.

Figure 1



*ROCA - Return On Controllable Assets

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[3] A number of them did these things at three branches which improve their PBIT levels by over 400% within one year. The case study with how to's is covered in module 4.12 in the Merrifield video, "High Performance Distribution Ideas for All."

[4] All of our mangers were paid a bonus on ROCA, which we defined as the PBIT at a branch divided by the branch's average investments in both receivables and inventory. For most distributors those two assets are 80 to 95% of the total assets. So, ROCA is a close cousin to pre-tax return on total assets (ROTA).

I will spare you the details, but what was important was that the graph got everyone's attention. Everyone could quickly and visually see that "Price" had the steepest slope and that cutting the price to get more "volume" would almost always be a negative trade-off. The graph could not tell us much more, but once minds were open to exploring how to "sell and buy better" we could overcome conventional reflexes and start "pushing the wheel of learning" in the right areas.

THE DARK SIDE OF FINANCIAL MANAGEMENT: THE DILBERT ZONE

When we put too much pressure and incentives on employees to make certain financial numbers by a calendar period deadline, we are apt to get some longer-term, net-negative decisions. Here are a few categories of such behavior to think preventatively about.

WIN/LOSE NEGOTIATIONS

In the spirit of getting an extra 1% to the good, why not focus on cajoling a concession out of two other big numbers: cost of goods sold (suppliers) and the payroll (employees)? **The problems are: it isn't creating long-term sustainable profit power, and it violates the golden rule**. Would we like someone to force us to give up 1%?

We could persist with our 1% reduction goal. Perhaps we could add a few empty promises to make it up to them in future years with no specific plans or ideas for how to do it. What could be the future negative trade-off costs? Our abused "business partners" could first go into a passive aggressive funk before the good employees leave, while the weak do even more damage by staying. What is the cost of:

- The slacking off of effort;
- Turnover costs of our best people, especially when they go to our competition;
- Loss of can-do spirit and energy if we were to try to make something new work;
- Loss of trust in management to do smart, right, new things?

These costs usually total a sum much greater than "negotiating" an extra 1% reduction for just this year.

GAME THE SYSTEM TO LINE OUR POCKETS

We all know the stories of executives at big, public companies who got paid big bonuses for gaming the financial numbers to actually erode their companies longer-term profit power? But, aren't we guilty in our own, small-time ways of the same patterns? Don't we game our internal financial systems to make our personal, departmental or branch numbers look better, either at the expense of someone else in the company or of creating a deferred cost hole in the next period? Don't financial games take energy away from creating service value to support true profit power? Why do we all laugh at Dilbert cartoons? Could it be because we sense that our companies are guilty of the same dumb, often financial management driven behavior?

BARGAIN PRICE, BARGAIN SERVICE TRAPS

We have all fallen for "bargain price, bargain service" traps that come in many disguises. Most distributors have experienced losing business when a new buying authority at an established account decides to shop the business to a fast, real "price savings." Because no one on the customer's payroll is in charge of tracking the "hidden costs" of the new, bad service that ensues, it takes a while for the account to realize that they have made a negative trade-off. Some customers may actually come back to us at our old terms! In the heat to make the numbers, are we sometimes guilty of buying or hiring cheap and then paying a bigger, long-term, hidden cost in lousy service from a supplier or poor quality aptitude and attitude with an employee?

CUT BACK THE OATS, OR REINVENT OUR FARMING STRATEGY?

A farmer's story gets across the idea of how "financial management for profit power" eventually milks a cash cow company dry. Here's the tale:

"I had a friend who was in the midst of tough times, so he cut back the oats on his plow horse. Well, the horse kept on doing his job, but the animal did start losing some weight. My friend thought that this money saving idea worked so well that he cut back the oats some more. This time the horse's productivity fell off a bit, but oat's savings were greater than the lost plowing productivity. And you know, just when he had almost trained the horse to go on no oats at all, the horse died."

Here are some questions the story might suggest:

- If times and profits are so bad that we can't afford to feed our horse (payroll) AND try new reinvention ideas, then how can we shape up or out the losing elements of our business to free up resources to invest more in the very best parts? We could, for example, re-negotiate today with our biggest losing accounts to have them become profitable or have them get leave. When some do leave, we can either lay off and/or re-deploy the slack to sell more, best items to best customers like ABC did. Weed to feed! Prune to grow!
- If we aren't trying new-for-us stuff and failing forward with cheap experiments, won't we keep getting the same and perhaps even a dead horse?
- How much time, talent and treasure is in our current budget for trying some experiments that will move us toward a better tomorrow?
- What are our new "North Star" metrics for guiding our experiments and getting to higher sustainable returns? (e.g. GM$/employee; PBIT/customer per niche and strata[5])

We have reviewed four general categories of dysfunctional, financial-management behavior; there may be more. Let's now look at the drawbacks of some popular financial management sub-themes that are often preached and practiced within distribution companies.

"BUY LOW" vs. THE SIX STRATEGY MAPS

Negotiating with suppliers for many different types of concessions takes up an enormous amount of a distributor's energy. On the surface, no other activity can make as big and as easy an impact on profits as getting extra discounts or subsidies that no one else in the channel is getting (although they usually are.)

Since most channels have a huge variety of supplier deals, most distributors have to play the game to insure that <u>at the least, they are not getting over-charged in comparison to the competition.</u> Wal-Mart has been the one great exception. They have the clout, the insight and the capability to demand that all expenses for channel games be put into one lowest price on the planet. Because channel deals are essentially bribes to get all channel players to buy and sell everyday items in waves and troughs, they are inefficient in comparison to everyday low prices and constant, continuous replenishment systems.

We already know from the butterfly economic$ map (map 2) that <u>we don't want to confuse the lowest price with the lowest total procurement cost</u>. The ABC Distribution case study in Chapter 1 hinted at a <u>next level beyond TPC that was centered on maximizing fill-rates for strategic one-stop-shop baskets of items.</u>

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[5] For more on new guiding metrics read "E=MC2 Measurements for Distributors"; article #2.16 at www.merrifield.com

We might also observe from the ABC Distribution case that "buying lower" wasn't even an initial, primary, strategic lever for their renewed profit power. Their top priorities were all service value enhancement driven. They wanted to:

- Determine who the most profitable customers were and "retain" them (maps 1 and 4)
- Improve fill-rates for their number one, best niche + other service enhancements (map 5)
- Maximize butterfly economic$ with better fill-rates (and systems tuning) to boost average order size (map 2)
- Then, apply the service value improvement process for one niche and specifically the 5 most profitable and 5 most promising profit growth target accounts within the niche to tune other non-inventory services and discover a new "extra service."

Considering all of the positive economics that ABC discovered from their fill-rate improvement strategy for the 20+ customers that bought a common basket of items, how might they re-think the "buy low" theme of their past? Between two theoretical supply options wouldn't a distributor pay a higher price and still get a better total, long-term value from a supplier that:

- Had a broader, better fitting line for a target customer niche? If a distributor can buy more SKUs with one purchase order on one in-bound shipment on a more frequent basis instead of splitting volume between two suppliers, then increased frequency of buying from one source can improve a buyer's ability to fine-tune fill-rates at a higher level.

- Had shorter, more consistent lead times for delivery that would allow a reduction in safety stocks and an increase in fill-rates?

- Had a tighter, better focus on the same end-user niche? If a supplier has been a number one brand leader and innovator for a distributor's target niche historically, will they continue to be the leader in the future at a premium price?

- Was a master wholesaler for slower-moving, smaller-volume items that rounded out or filled in an expanded definition of what our one-stop-shop assortment was for our number one niche? Although we could buy the goods directly from manufacturers at lower prices, the greater minimums would reduce turns more than "the earn" went up AND reduce the frequency of ordering to undermine average fill-rate effectiveness. (Lots of distributors are guilty of this buy direct for a lower price, negative trade-off!)

In conclusion, two points on "buy low":

- Once a distributor targets a customer niche for 50 to 80% domination through service value revival, "buy low" changes to "buy the lowest total procurement cost, highest fill-rate service from the best sub-network of suppliers for the best one-stop-shop assortment."

- Any best practice guideline like "buy low" is the right thing to do, IF all other factors between two suppliers are strategically equal, which they rarely are. Remember that both maps 6 and 6.1 in Chapter 1 illustrated how good ideas, or in this case, a general "best practice" theme, "buy low" all need to be re-shaped by the kinetic chain. Don't apply any "best practices" or "one good idea" in a strategic vacuum.

SELL HIGH

Like “buy low” with suppliers, “sell high” is a constant battle with aggressive, buy-low customers, and it is the most powerful profit-impacting activity from a financial management sensitivity analysis, as we saw early in this chapter. What do the strategy maps suggest to us about selling high?

The profitability ranking reports (map 1) will reveal that the most profitable customers generally pay lower than average prices and margin percents because of their big volume. Superior butterfly economic$ (map 2), however, account for why they have the highest PBIT margin percentages. The better, butterfly economic factors include:

- Buying faster-moving, commonly purchased items (slow or non-moving special stock items drag down an account’s profitability)
- Buying in larger average order sizes due to their own: focused strategy, bigger volume needs, and/or a disciplined replenishment system that avoids emergency small orders and generates larger average orders without creating excess stock on any items.

Customers that pay higher prices on much smaller orders that still receive full wholesale services including delivery and trade credit are, on the other hand, always losers, because our transactional activity cost exceed the margin dollars in the orders.[6]

The life-cycle curve (map 3) tells us that customer pressure for getting lower prices will continue to grow, so like Judo experts, let’s not fight them, let’s throw them in the direction that they want to go. Can we reflexively counter with:

“Why settle for just a lower price, is there some way that we can work together to co-create a buy-sell relationship/system that lowers ALL 11 elements of your TPC? If we can simultaneously lower our total costs to sell and service you by getting larger average orders that are a happy by-product of a good replenishment system, then we can afford to give you a lower price on a sustainable basis and still make a profit. As a way of starting to explore this opportunity, etc.

“Back to your, initial, simple request for getting a lower price, it’s a nice offer, but we will have to pass. According to our profitability analysis of your account, we are: already losing; only breaking even; not making a sufficient return. To lower the price even more would certainly help you right away, but we would suffer and eventually do one of two, poor, longer-term changes:

- We could go broke or quit the account, causing you supplier switching costs; or,
- In the spirit of mutual opportunism, we could cut back on our service quality promises to reduce our costs enough to make a profit. But, that would evolve into a bargain price, bargain service net, negative trade-off for you.

“So, all things considered, would you like to explore how we might re-think our relationship and systems to create a better win-win solution?”

To make this confrontational scenario possible, we will probably have to get better at:

- Targeting customers who already want to buy TPC and can do their share of the work that is required to co-create and then maintain the systems that make lowest TPC/TSSC happen for both of us. (Or, customer who will pay us a fee to outsource their internal replenishment activities.)

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[6] In some channels and some companies, the small accounts can become profitable if treated in a quasi-retail fashion with help-yourself, retail formats and prices.

- Selling, installing, measuring, improving, and documenting TPC value which will in turn allow us to get paid on a profitable, sustainable basis. The test of our TPC documentation and education efforts will be when key purchasing authorities turnover and the new person thinks that they can get the same total service value solution at a lower price by putting everything out to bid. (More on this in Chapter___)
- Walking away from customers who aren't going to let us make a profit, so that we can spend our scarce resources on the few, best, growing customers that will.

The Wal-Mart supplier model is relevant. Wal-Mart's has been voted the number one customer to do business with by more suppliers than any other mass merchant. The general consensus is that although Wal-Mart may demand and get the lowest price, they do the best job of working with suppliers to get even greater costs out of the total replenishment process. <u>Suppliers, therefore, are making both their best PBIT as a percent of sales and getting their greatest annual growth rate with Wal-Mart. We should all find these rare "gazelle" customers to partner.</u>

Finally, the service value improvement process map (#5) asks us to become "price-makers" who at least can get last look plus something more than the price from a mediocre service provider. If we can't explain in a concrete, confident and convincing way how our superior service offering provides the lowest TPC at a higher price, then we will have to become price-takers too.

SELL HIGH CONCLUSIONS:

- Nothing affects PBIT more than convincing customers to pay more and not leave.
- For customers that are currently costing us money, we will review in Chapter 4 a number of ways to raise prices and terms; increase order sizes and volume; and/or reduce our costs to service to make every customer eventually profitable or they will leave.
- For the most profitable and most important customers, we should expect prices and margins to drop as an intended by-product of our TSSC (total sales service cost) dropping enough to hold or increase the PBIT margin as Wal-Mart suppliers have discovered.
- Win-win replenishment systems built on maximizing butterfly economic$ and process collaboration are barriers to competition and marries us to the customers' future growth prospects. <u>Try to marry only the winners with good lifetime profitable growth forecasts. Less than 5% of a distributor's active accounts will generate 80% of the profitable growth for some supplier over the next five years. Who are they? Do all employees stand ready to make heroic extra efforts happen for them?</u>
- If we have indisputable, measurably distinctive service value for a niche, then we can ask for last-look+ a premium because our TPC proposition is still the lowest, albeit at a higher comparative price.
- <u>If our sales force can not get last look and a bit more just for their own past efforts to grow the customer's bottom line, then they also will not be able to sell the company's best-TPC service for a premium. Reps must either change from or be re-assigned away from the key accounts with which we have important new agenda opportunities.</u>

COLLECT EARLY, PAY LATE

Let's first look at this issue through the lens of the life-cycle curve (#3). When industries are first starting up and growing fast, using big channel partners to finance working growth capital on both the buy and sell side is common. It is easier for lots of little companies to try to borrow from a cash rich partner with a credit line than for each of the little guys to try to get asset-backed lending from financial service companies that see fledglings in new industries as too incomprehensible and risky.

In mature, consolidating industries, the financing growth problem goes away for viable firms. Channel players are either throwing off more cash than they can re-invest in a slow or shrinking growth, OR, they are looking for someone to finance the postponement of their eventual demise. We don't want to finance the living dead that are already in violation of their bank lending agreements. Think of K-Mart, for example, leaning on suppliers before declaring bankruptcy and taking the grocery wholesaler, Fleming, down with them.

Not to belabor this traditional guideline any longer, a few quick thoughts:

- For payables, borrow from the bank to take all supplier discounts financially worth taking. Otherwise, borrow at today's low interest rates to pay on time to keep product flowing to maximize fill-rates for the customer niches you are pursuing. Both the service value and retention maps demand this. Better fill-rates trump going long on suppliers for financing.
- If you are max'ed out on your bank line, then don't go long on suppliers. You will get put on credit hold, your fill-rates will plummet and your best, most profitable customers will defect. Do a radical downsizing using customer profitability analysis to shape up or out losers fast, while laying off least productive employees in proportion to the drop in empty transaction volume per day. Sell slow moving inventory at whatever price you can. The only metrics that matter are fill-rates to support profitable customers and net, positive cash flow.
- Receivables management is a universal science that applies to all businesses, so pay the most to get the best, experienced credit collection people you can; they are especially worth it.[7] The few distributors with distinctive service value can be the most forceful with slow pay accounts, because the valued service can't be gotten anywhere else. If a distributor has the worst service, then all they have to sell is price and/or terms. If that is your case, cut the price before you give relaxed credit to living dead customers.
- Profitability ranking reports are a big help to credit departments. They will allocate their time and creativity with customers far differently when they know who the few are that are actually profitable.

HIRE THEM CHEAP, WORK THEM HARD

The converse for this traditional theme – pay more to get more to achieve the best, most productive service – will be covered quite thoroughly in Chapter ___. For now, both the maps for service retention theory (#4) and (continuous) service value improvement (#5) suggest that this old-fashion, exploitive guideline is a non-starter.

The life-cycle curve (#3) might also remind us that hiring cheap did work in the '50's. Back then, there was a generation of new employees who had survived the depression and World War 2. Their goals were to get and hold on to a reliable job, "their meal ticket", and "be loyal" to their employer. They made the song "16 Tons", the #1 hit in the nation in 1955. Perhaps even more importantly, distributors had, in those days, exclusive supplier franchises that sold at book price into an economy that periodically boomed faster than supply, thus creating shortages. "Good service" was having the good franchises and extra allotments.

Fast forward to 1978, Johnny Paycheck's single "Take This Job and Shove It" made it to #1. Employee expectations, for right or wrong, had skyrocketed and the loyalty between company and employee was fading fast. Products were starting to become commodities and domestic supply had become chronically

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[7] Merrifield Consulting Group, Inc. offers a very affordable video training product on "Receivables Management" entitled Trade Credit Tactics for Today's Economy. More information is in the products section of www.merrifield.com. While there check out article 4.4 "Turn Salespeople into Trade Credit Assistants."

in excess of domestic demand. By 1985 cheaper, better, clone products started to pour in from Japan, Taiwan, Korea, etc. China and India took most of the '90's to get their capitalistic infrastructure ready to now bury the world with ever-greater excess supply for the foreseeable future.

Most distribution execs might agree with some of my generalized sweep of distribution channel history, but how about the following, contemporary, assumption series:

- "Service" is our only means of differentiation, because 90%+ of our sales are on products that are equally excellent, if not the same brand as our competitors.
- Distinctive service comes from great employees, so employees are our most important asset. The equity that we have built in them is not measured, managed or rewarded by our financially oriented scoring system.
- Better aptitude and attitude employees do cost more than average ones to initially hire and keep long enough for their skills to be improved to be part of the service excellence capability. Then, we can get a return on our up front investment in them.
- Service retention theory does make sense. If there is lower than average employee turnover, then all of the virtuous, reinforcing cycles within the model have a chance of taking off. If turnover is average or worse than the industry, then all of the virtuous cycles could become vicious ones causing greater sales defections to the best service value providers. None of these economic patterns are visible in our current financial management reports. Maybe they should be.
- Our industry does have too much capacity and too many price-takers. Trying to be one of the survivors in the price-taker group doesn't look like a promising path to be on.
- Turnover is presently not the problem it was from the '90s up until 2002. Because the job market is weak for those who might want to leave, we can freeze wages and people will stay.
- Achieving and leveraging distinctive, focused service per niche are big challenges. Asking our employees to work harder, differently and more responsibly would evoke the silent question: "Yeah, why bother, what's in it for me?" Educating them on the why's and how's of this change would be a tough challenge.
- We haven't historically been real successful with any big change programs. No matter what we try to do differently, things seem to eventually drift back to a former equilibrium. We can't afford any big change implementation failures right now.

Most Execs would agree with or "know" a lot of the logic above, but how many "do" it? To close our knowing-doing gap, we will need the right strategic maps and information, better change management skills and an overhauled cultural mindset. Can we articulate our financial management biases for "hiring cheap" in order to overhaul them for accommodating today's realities?

What are our past educational experiences? Below are some common quotes that I have heard from distributors, then followed by some comments:

- "Business is tough, we can't afford raises let alone educational expenses."
- "In our best years, we have tried general training, but with no measurable results. Education is only stimulating to a few and then they leave for more upscale jobs before we can get a return on our investment."
- "We don't budget education. We react to and choose from what suppliers offer. We occasionally accommodate requests from go-getter employees who press us to pay for some educational needs that they might have."
- "The only distributors that do formal educational training in my channel are the big chains, and they lose their best people to the rest of the industry all of the time."

If "we can't afford it", then how are we going to educate everyone to be part of the solution for any big service improvement initiatives; aren't the front-line folks going to make the better, flexible, heroic service happen? If we keep cutting back the oats on the horse, won't we just have weaker numbers and bigger funding problems next year? To avoid the downward spiral scenario, is there some way we can quickly improve profits and free up some time to simultaneously re-invest in some quick return service economics like ABC Distribution did?

For "training…with no measurable results": The kinetic chain (map #6.1) reminds us to proactively shape any educational ideas and investment with the first four steps that precede "education" which is step 5. If we don't have the right (1) leadership, (2) strategy (guidance), (3) (educational) systems AND (4) the right (aptitude and attitude) employees, then an off-the-shelf (5) educational activity will not have a good ROI.

The wheel of learning (map #5.1) suggests that most learning doesn't even happen in a classroom, from a book or for all people at the same time in the same way. This book and the customer profitability ranking reports may provide some fresh insights and also raise big questions (step 1 of the wheel). Then, we need to find out which individuals will work to push the wheel of learning through steps 2-4 with our most important, progressive customers within a target niche. This will involve testing cheaply, failing forward with some real economic upside for everyone at stake.

You can budget technical, job training like going to Hamburger U or Caterpillar mechanic certification classes. But, the wheel of learning activity must go on continuously as we work; it is part of work. For this to happen, however, people do have to have some slack time to both do their jobs and rethink their jobs as well as have permission to make good affordable mistakes. If we are all working over-time without extra pay just to get orders out the door mostly to breakeven or losing customers, then who has the time or energy to push the wheel with best customers in best niches?

Reacting to suppliers' educational agendas seems like a good freebie, but make sure the intent isn't to stock and push more products to any and all customers which will increase losing products, customers and orders at a 4 to 1 ratio over profitable ones. As a general rule, if there are potential, big, end-users for slow moving products that we aren't selling, it is because they are not in our best niches. To sell them successfully with a superior total value offering will require a lot more breadth and depth of inventory investment into their one-stop-shop basket of items plus service tuning. Pushing a few new products to them won't generate any profitable butterfly economic$. The only reasons why they might buy from us would be to cherry pick special offer prices and then go slow on payments.

Don't try to appease or reward go-getters with some educational stimulation; it's like giving them a bite of the apple in Eden. Educational enlightenment is apt to teach them sooner rather than later that the company is frozen in the past with an unfocused strategy. They will then become more frustrated and leave sooner. Involve them, instead, with kinetic chain reweaving challenges starting with new strategy map insights. Sign them up to be your "intrapreneurs" who will make new service transformation and marketing plays happen.[8]

Chains are about half-right in thinking that they can have economies of scale for educational training. They can get economies for training on technical subjects that are the same for many to all locations, but management training doesn't generally work unless:

- It focuses on strategic process that can be situationally applied to each location's own accidental best niches and opportunities for creative, organic, profitable growth.

[8] In-house, continuous innovation and improvements are dependent on both intrapreneurs and having an intrapreneurial climate. For the whole story go to www.intrapreneur.com.

- It has holistic, kinetic chain implementation that also accommodates the unique strategic opportunities at each location.

In Chapter 3 we will see a case study that illustrates how monolithic, product promotional programs with related educational efforts don't work, as a rule, because of local customer niche differences.

ONE LAST, BIGGEST PROBLEM: CAN A DONKEY WIN THE DERBY?

What if we don't have people with the right aptitude and attitude to be at least top 10%-ile performers at their position within our channel? In spite of what people say about not wanting to "check their brain at the door", many really can't cope with the pressure of being measurably accountable at the individual and peer group level for continuous improvement responsibility.

"But Bruce, we pay 'fair wages' and have 'good' people." No doubt many of them will rise to the challenge and be proud to handle both the additional responsibilities and privileges of a high performance environment. We just have to be prepared for some percent turning out to be passive dependent types who really just want to show up, be given the benefit of the doubt and be taken care.

Trying to migrate from a work environment with average wages, average outputs and low individual responsibility for productivity and profits to all "highs" is the single biggest challenge for a distributor who is trying to move to all around high performance. The best migratory solution that I have evolved is to use five different sub-programs in parallel. They are tersely summarized below, the details will follow in later chapters.

- A small order/unprofitable customer program creates slack, higher profits and productivity
- A #1 niche service reinvention and target account selling program generates fast, high flow-through profits, sales growth and productivity
- A new set of numbers get posted focusing the entire team on: service process metrics improvement; GM$/employee; and PBIT/customer per niche and per strata.
- A learn-n-earn, cross-training program that allows hourly employees to earn incremental wages towards a premium level as GM$/employee also grows to afford it.
- A new six-step personnel management process is used to start recruiting to replace the ones who won't make the transition and to have reserve candidates on file to help prevent backsliding in performance.

Don't be overwhelmed by the list above. The first three are only emotionally tough for some to implement, but they provide quick, positive results. Then, with the new metrics posted everywhere and the profitable customer centricity, the last two programs become natural, self-evident necessities. They are still best implemented, though, on an anticipator, comprehensive basis instead of on a reactive, piece-meal basis.

SELL MORE VOLUME TO SHARE FIXED COSTS

We touched on this traditional theme earlier in the chapter when discussing "sensitivity analysis." We will hit on it again in Chapter 3 when we look deeply into the how's and why's of measuring customer profitability using different degrees of activity based costing.

For now, the two big problems with this guideline are:

- Most fixed costs can become quickly variable. Every company should do a trend analysis over a number of years to see how general overhead costs actually vary quickly and variably

with both sales volume and headcount. Many firms have realized during the past two years how quickly "fixed" overhead can be downsized in tough times.
- Not all, additional "volume" is equal in its ability to "share" costs. PBIT losing customers don't share costs, they add to them.

One aspect of getting new volume that we haven't touched on is getting new volume by stocking and promoting new items? As an historical, reality check we should first analyze the bottom 50% of our items that may account for about 1% of the total sales and 10 to 20% of our inventory dollars. Do the analysis and ask (the team) these questions:

- Weren't all of these items "new" at one time?
- How much do you suspect that we spent unsuccessfully in trying to get them to sell?
- In the future, how can we do a better screening of potential new items to pick far fewer items that we then might sell in a more persistent, customer niche focused way to increase our success rate?
- Before we consider any more new items, shouldn't we first systematically exhaust the selling of more old items to old customers as the ABC Distribution case illustrated?
- Then after the old-to-old marathon, wouldn't it be easier to find new items by reviewing miscellaneous supplier folders with our top 10 accounts in a niche. We could look together for new items and lines that we could add, because two or more of the customers wanted to lower their TPC by consolidating out miscellaneous suppliers and transactions? Even if we only sold 20% of the customers in the niche small quantities of these new items, they would be performing a lot better than our current bottom 50% items. Right?

All of the questions above are assuming that a distributor is in a mature channel. If a start-up firm is at the beginning of a potential new channel life-cycle, then all sales must be on new products to new customers. There may even be a race with other start-ups to get to all of the logical, best customers before others do.

(I expect this life-cycle pattern to play out amongst new importers of knock off goods from China that typically cost 10% of the domestic manufacturers' price. The first mover will offer mature distributors low-prices and good margins for both the distributor and the importer. The fast followers will quickly undercut the first mover's prices for goods from the same Chinese factories perhaps without even a different label. The eventual winner of the race will be the one who, from the outset, plans to have the broadest one-stop-shop, high-fill rate basket of items for one segment of distributors at a time. The importer that sells the biggest commodity knock off items to 16 different channels may initially grow faster, but will have no structural butterfly economic$ to fall back on when margins collapse. The length of the life-cycles for Chinese knock-offs that will go through most, durable goods channels will be fast – perhaps 3 to 5 years?)

Even as a distributor systematically extends and exhausts the selling of old, best items to old, best customers within a niche, there will be "new product" opportunities pushed by manufacturers. Will we try some of them? This will be a situational g decision for each company to make in light of their new strategy map opportunities and the supplier relationships and pressures that they may have.

Sell More Conclusions

- Volume is vanity, profit is sanity is a generally true statement. But, our strategy maps lead us to methods for achieving both. Retaining profitable, right-niche customers and targeting the few that are both strategic and promising will generate faster volume growth as a by-product, than doing product promotions to too many customers on a deal basis.

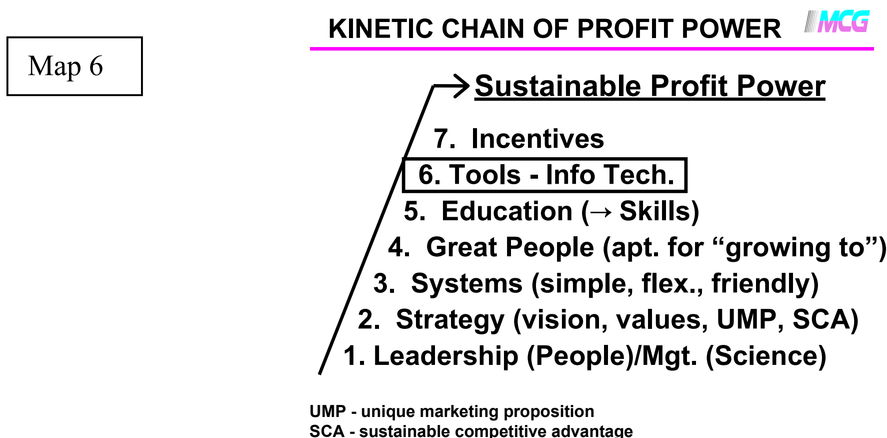
- Don't be seduced by suppliers offering great product launch packages loaded with temporary concessions unless an appropriate number of your core niche(s) customers agree that it upgrades your one-stop-shop offering to them and that they will buy it.
- When suppliers protest about your not working with their product managers and their promotions, they will warn you that you will lose out on "rebates." Remember this, if we focus on what makes strategic sense we will grow faster and more profitably than the industry. We will sell more total volume for our suppliers, although spread over fewer items, and both higher profits and growth rebates will be there at the end of the year. If suppliers see that in spite of your cherry-picking their total line and promotions, they are growing faster with you and getting paid on time, they will all be happy except for product managers with products that your niche(s) doesn't buy.
- Do a trend analysis on "fixed costs" as a percent of sales for a few years to find out how fixed they are.

CUT COSTS AND WIN WITH INFOTECH

All types of businesses have bought the hardware/software industries two themes of: cut costs through automation and improve performance using information as a strategic weapon. Since the late '80's, when more powerful desktops started to become affordable, American businesses have loaded up with computing capability. The problem with this huge investment wave is that on average, according to every cross industry study, **there is no correlation between how much a company has invested in infotech "solutions" and the company's ROI**.

INFOTECH = A KINETIC CHAIN STEP 6 "TOOL"

The main reason for poor returns is that infotech solutions are tools. Map 6, the kinetic chain, (below) suggests that infotech is step 6. What good are such tools without (step 2) effective, right strategies being implemented through (3) right processes by (4) good aptitudinal people with the (5) right skills and (7) motivation to appreciate better tools. Companies, in fact, have been so caught up in achieving financial measurement overkill that they are now suffering from infoglut and info distraction with a dearth of strategic profit power measurements.



If an IT solution provider starts to sell us on how their solution will make individuals (step 4) more productive (laptops for sales reps) or an entire department (warehouse automation), what does the kinetic chain model suggest to us?

- The infotech solution isn't going to help improve a vague, misdirected strategy (step 2).

- It won’t re-engineer the processes (step 3) that snake through the departments, so there will be structural, infotech disconnects at the departmental boundaries.
- The solution won’t be measuring the final output metrics for the service processes that make distinctive service happen for target niches. Steps 1 and 2 determine those.
- The solution may well improve the efficiency of an individual(s) or a department, but at what total (hidden or in denial) IT cost? And, if all other competitors buy the same automation to achieve the same simple superficial efficiencies, where are the competitive advantages and sustainable profit power? Efficiencies that everyone can buy are necessities, but the savings gets competed away.

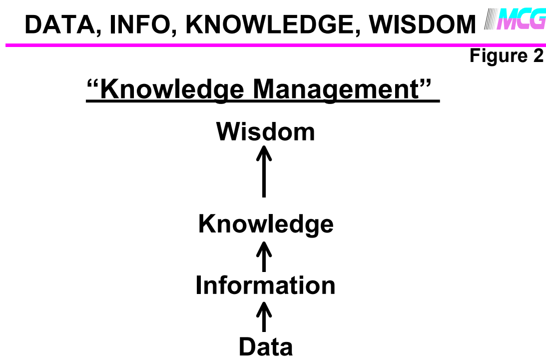
We have all read and heard about the implementation stories for big software solutions that didn’t work so well for too many “users”. By using the kinetic chain as a shopping tool for infotech, as well as an implementation tool in collaboration with “solution providers”, we might avoid a lot of pain and frustration and gain a lot more real “solutions”.

“INFORMATION” MAY NOT PRODUCE THE RIGHT “KNOWLEDGE OR WISDOM”

What about “information” and “knowledge management” providing a competitive edge? There are no shortages of databases and business intelligence packages in the distribution world containing enormous amounts of “data and information”. These terms aren’t an effective strategy, however, and the data gathering and information-generation aren’t typically strategically guided.

To illustrate the difference between knowledge hype and strategically generated wisdom, let’s apply two models towards thinking about “fill-rates”.

Figure 2



Here are definitions and explanations for the four terms in the diagram above:

- “Data” is copious, stored nearly for free and not very useful. Example of a data point: “92%”
- “Information” results from taking data and packaging into a meaningful number that might describe an average trend. Example: “Our company inventory generates an average fill-rate of 92%.”
- “Knowledge” is being able to explain why the information has come to be and why it fits in the rules of the game. Example: “We feel that 92% is a competitive service level, and it is an optimal inventory investment point. To achieve higher fill-rates requires increasing inventory investment much faster for each point of increase in fill-rates. This would be (from a financial

management viewpoint) a negative trade-off because the carrying costs would exceed the incremental benefits of higher fill-rates."

- "Wisdom" is being strategic. It involves getting outside of the "conventional industry rules or knowledge" to see how the environment and the success rules are changing. Or, it involves seeing how a company can redefine the marketplace to find a niche opportunity that they can focus on and exploit, because the other's don't see the need differences for a particular group of homogeneous customers. Next are two examples of wisdom trying to change the rules:

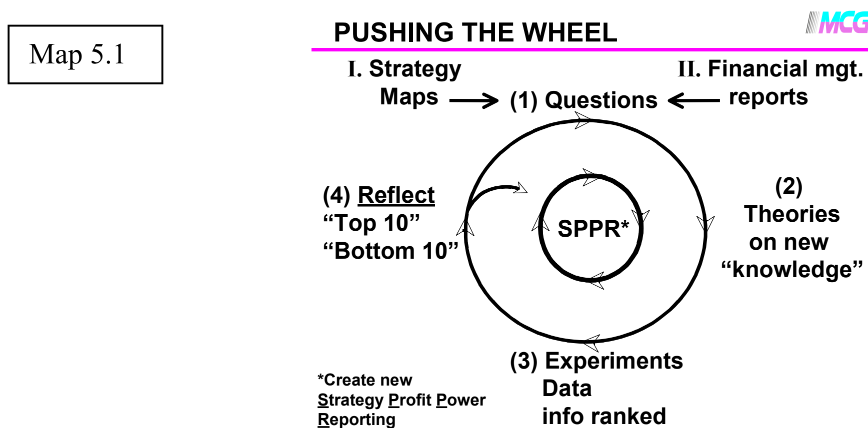
Old think (good financial management perspective): "We have invested in some fancy new inventory management software that allows us to do demand forecasting nine different ways at the SKU level. We think this will help us to boost fill-rates a bit and reduce inventory, both of which will boost our ROI. "

Strategy Map think: "We (at ABC Distribution in Chapter 1) discovered that 3 of our top 10 most profitable customers (PBIT/Customer Map) were all quite similar. They, along with about 20 of our other profitable customers, could be re-classified into one niche that buys a common basket of items. We determined what this niche's most popular 500 items were out of the 10,000+ we stock. We increased the fill-rates on the 500 to 99%. The extra carrying costs where nothing compared to the positive economics we got from retention and order size economics.

The strategic, fill-rate improvement is only a first step down an entirely new, service value-creation path for this niche. We plan to lock up the most profitable 50 to 85% of the niche with distinctive services built on top of our unmatchable, best inventory fill-rates. Others may eventually try to beef up their inventory too, but it will be too late, we will have the customer niche volume to generate the turns and they won't. We will also have the rest of the totally tuned service formula. They won't, because they are too product, volume oriented to see the customer niche differences that we did."

PUSHING THE WHEEL

How can we blend both our financial management capability with a new evolving "strategic profit power reporting" (SPPR) capability? Below is a modified "push the wheel of learning" slide that we used in Chapter 1.



What if we re-shaped our infotech tools by using the wheel and starting with "strategic" questions instead of just financial management ones. Here is a thought exercise scenario:

(1) (Proactively asked) QUESTIONS:

- (Financial) “How can we do what we are doing more efficiently?”
- What type of infotech “knowledge” tool would help us answer the question: where do we make our money? Wouldn’t that be our hidden, historic strategy?
- (Strategic) “Who are our most profitable customers and why?”

(2) THEORIES: “What about some sort of customer profitability ranking report? Clearly customers that give us nothing but big, juicy margin orders are more profitable than customers that give us nothing but small orders.”

(3) EXPERIMENT: “How do we create such a tool without getting lost in “activity based costing” models? What is something that we can do quickly, cheaply, but insightfully? Couldn’t we give Bruce’s first approximation equation a try?”[9] (Then, if that helps, we could fine-tune our way towards some final, sufficiently good “strategic profit power solutions”- SPPR).

(4) REFLECTION: “The simple customer profitability ranking report works shockingly well for the very best and worst accounts; this is actionable information. This raises new questions (step 1): what should we specifically do with our 10 best and worst accounts? For the inner circle, the step 1, some questions are: how should we refine this initial report to run separate rankings by: location, sales territory, different niches of customers, etc?”

CONCLUSIONS ON INFOTECH

- Invest in infotech after thinking through the first six steps of the kinetic chain. If we can use infotech to measure, manage and reward for creating strategic profit power (SPPR), then we will have a huge advantage over the crowd that tries to have ever better, top-down, incremental, financial management control of departmental costs and sales/margin volume pushed into all territories and accounts.
- SPPR numbers posted everywhere will be crucial to getting everyone moving together in a new, re-aligned way to create more profits.
- Business intelligence packages that slice, dice and graph financial (symptom) numbers many ways will only tell us real time that things aren’t as good as we would like and to try harder. But, if they are tweaked to capture and report SPPR, then these application packages are actionable and valuable.
- Using infotech to pursue traditional financial management activities and themes, or to do what we are doing more efficiently or faster at the personal or departmental level, will be like having a high maintenance cost racecar without having a roadmap to high ROTA-ville.

IT’S TIME TO GO OPEN-BOOK

Here are some warm up, logic questions related to open-book management:

- If our company is going to define target niches around core, target accounts and use them to re-tune service metrics, how will things measurably improve if all the employees are given access to real time service performance data?
- Why should the employees want to suffer change? What’s in it for them?
- If we have to share so much more information, shouldn’t we just go ahead and share all of the general financial numbers, so they can be measurably responsible for improving them too?

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[9] This method is in Chapter 4 and also at www.merrifield.com articles #ed 2.3, 2.15, 2.19.

- Don't all of the great companies we keep reading about share numbers and have different forms of profit gain-sharing? If we want to be great, should we consider these practices?

What do distributors think about "open-book management"? For over 20 years I have sporadically asked rooms full of distributor principals a few, raise-your-hand questions:

- Who shares all of the general financial numbers with all of the employees?
- If you don't, what do you think the hourly employees think your profit after tax is as a percent of sales and how much of that is taken home by the owners?
- What percent of your employees understand that if shareholders make a good ROI, then they are more motivated to reinvest the profits back into the business to finance the growth of everyone's future?
- If 100% of all of the super-star companies in America that are featured in all of those business books share the numbers and usually the profits in one or more ways with all of their employees, why don't we do the same?

The answers:

- For 20 years somewhere between zero to eight percent of the audiences – perhaps an average of 4% – have shared the numbers. The number has stayed constant through up and down economies.
- Employees' guesses at profitability: if they are sure about a sales figure, then the rumors about profits (after tax!) range from 10 to 40%. If the sales figures aren't regularly and explicitly shared, then the rumor has been, in some cases, that the sales figure is what the management took out of the business the previous year. 100% of sales dividended out! Microsoft and drug dealers don't even come close to that.
- Only a few of the managers might understand the idea that "reinvested profits are not just a cost of capital, but the cost of the employees having a growing future."
- Why not share? Three waves of responses: superficial reasons; cultural religion (we just have never done it or really thought about it); and emotional difficulty reasons.

In a few thousand words, I could list all of the objections that have surfaced in the three waves just mentioned above along with some thoughtful answers. But, I have already done that on my web site, so I will refer you to three articles to read in a certain order in this footnote. [10]

Emotional concerns aside, there are two big practical problems with sharing the numbers. One is how to meet the educational challenge. Management may intuitively understand the numbers, but to teach them to everyone in an effective, patient, believable, trustworthy way is daunting.[11]

The second big problem has been raised by some of the firms that have shared the numbers. They pointed out that at first the employees were: confused; some a bit scared; but, all curious and flattered ("I'm on the team and he trusts me"). But, after awhile boredom set in, because the next question was: "Well what should we do to make the numbers better; we are already doing the best we can?"

If we don't have a plan for how to reinvent our profit power, then why educate the troops about how chronically weak the profits are? On the other hand, if we have a bunch of profit power plays to run as a

[10] Go to www.merrifield.com, click on "articles" and read #s 5.14, the support notes for 5.14 and then article #5.3.

[11] One solution is The Merrifield Consulting Group video product entitled "High Performance Distribution Ideas for All" that dedicates 53, ten-minute video modules to this key educational challenge.

result of our profitability ranking of customers, and we can't do it without everyone being on board, then we have to share the numbers, especially the new SPPR ones.

This raises another educational challenge. How can we affordably educate everyone about:

- How we are going to totally re-think our customer portfolio?
- Why and how the new profitability does work?
- Why it is fair that customers be segmented and treated differently?
- How we must re-define, achieve and sell different service (metric) packages to different customers? And,
- Why we all have to be responsible for growing strategic productivity per employee and PBIT/employee?

Again, all of these issues and more are covered in 53, ten-minute video modules in this book's companion video in footnote #9.

CONCLUSIONS ON OPEN BOOK

- If our profitability is chronically weak, and we have no big change plans to address the problem, then we shouldn't bother going open-book.
- If this book provides us with the vision, the map and the how-to implementation plays to reinvent our profit power, then we have to figure out how to go open-book to put all employees into the game, let them keep score and be responsible and rewarded accordingly.
- Read the footnoted articles about going open-book for more reinforcement in this big step.

FINAL THOUGHTS ON FINANCIAL MANAGEMENT

Here are a few key points and action steps to consider:

- Most of us are guilty of unknowingly over relying on financial management to try to improve our profit power. Top down, incremental, cost-cutting financial management can't create new, organic profit power growth.
- Make a list of "blind spot" practices or themes that may net negative effects on your company and discuss them openly. Sometimes just surfacing them will help to balance their use and curb their abuses.
- Start making a wish list of "strategic profit power reports" and of some analytic capabilities that you would like to have. How can we track what the strategy maps suggest we do? How can we measure, manage and reward everyone on doing things to improve our service value proposition for the right customers in the right niche(s), so we can dominate one niche at a time to grow sustainable, structural profit power? Add to this list throughout the book.
- Consider how financial management themes have pervaded our assumptions about promoting products through our field sales force. We won't be able to pursue a true, customer-centric, customer profitability strategy until we can re-think product promotions and field selling. These two issues are the subjects of the next chapter.