Profitability Management: 
Value Creation in the Supply Chain 

Jonathan L.S. Byrnes
jlbyrnes@mit.edu
May 28, 2003
Today’s Menu

- The Opportunity
- The Solution
- Three Key Elements
- Business Model Fit
- Profit Mapping
- Internalizing the Process
The Case of Dell

The Dell Dilemma...
Dell – A Company that Got It Right

Demand Management

Sell What You Have

Weekly Meetings of Sales, Marketing, Manufacturing, Purchasing

Screens and Incentives

Dell
Profitability Management
The Opportunity

Make More Money

From your Existing Business

Without Costly New Initiatives
A Case Study

A National Lab Supply Distributor

- Solid Performer
- Just as Good as the Competitors
Lab Supply Company Profitability

- 33% Accounts Unprofitable
  - 29% to 42% by region

- 35% Order Lines Unprofitable
  - 23% to 50% by region

- 40% Product Lines by Vendor Unprofitable
  - 38% more were marginal!

- Telesales GM (41%) > Field Sales GM (36%) > Large Accounts GM (30%)
  ...but telesales penetration was 3% to 32% by region

- Fast-movers GM (36%) > Slower Movers GM (34%) > Special Orders GM (29%)
The Opportunity

- Profit Improvement Opportunity of 30%+
- Management Adjustments to Current Business Mix
- No Capital Expenditures
- Rapid Implementation
Who Manages Profitability?

- Everyone Pays Attention to Profitability, But Few Systematically Manage It
- Every Executive Team Has a Profit Plan
- All VPs Own Plan Components
- But, No One is Responsible for Managing the Day-to-day Interaction of the Components
Who Manages Profitability?

...”I’m the only one who didn’t make his numbers”

Company CEO
What Happened?

- VP Sales – New Customers...
- VP Operations – Local Out-of-stocks...
- Yet Both Made Their Numbers
The Solution

Profitability Management

- The Missing Element in Horizontal Process Management
- Unseen and Unmanaged
Three Key Elements

Profit Map, Profit Levers, Profit Management Process
Try This Today

- Five Customers...
- Five Products...
- Five Services...
The Question of Fit

What Fits?
- Customers
- Products
- Orders

Fits What?
- Company Business Model
The Case of a National Trucking Company

- Yield Management Team (YMT) Defined Cost Drivers as the Whole Route
- Developed Cost Models – Fixed Costs, Variable Costs, Special Costs
- Created a Six -Month Transaction Database
- Applied Cost Models to the Database
- Found:
  - A Few Islands of Profitability (20-30% margins)
  - Fully 40% of the Business was Unprofitable
The Case of a National Trucking Company

- General Cost Reduction was Not Enough
- Aggressively Secured the Highly-Profitable Customers
- Pricing:
  - Rates with Fixed and Variable Components
  - Forecast Accuracy
- Shared Risks and Rewards with Customers
  - Trucking Company Could Presell Capacity
  - Customers Got First Priority and Shared Savings
- Monthly Cost Reduction Meetings
- More Integration with Key Customers
- “We stopped saying ‘Yes’ to everyone”
The Case of a National Trucking Company

- YMT Held Periodic Reviews of Account and Service Profitability
- Day-to-day Profit Management at the Account Level
- Grassroots Training of Associates
The Case of a National Trucking Company

Profitability More Than Doubled!
Profit Mapping – Five Key Steps

- **Process Accuracy**
  - Good Old 70% Accuracy

- **Profitability Database**
  - Allocate All Costs
  - Tie to Financials
  - Pro forma Changes

- **Model a Customer**
  - Profit Levers
  - Intuitively Clear Cases

- **Project to the Whole Business**
  - Big Pools of Profit and Loss
  - High Payoff Actions
  - Secure the High-Profit Segments
  - Fix the Broken Segments
  - Shift Resources from the Segments that Don’t Fit

- **Institutionalize Profit Mapping**
  - Repeat Every Six Months
  - Build Into Account Qualification
Internalizing the Process

“Financial systems often do not have the information that you need. If they did, the problems would have been solved long ago. To be truly effective, you need to create a cross-functional team that understands how the business operates. This will allow the conversion of financial information into management information which, through analysis, will lead to action.”

Service Company CEO
“I guess I have two ways to get a 30% profit increase: boost my sales by 40%, 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.”

SVP Sales
Conclusion

Profitability Management -

Identify and Manage

The Profits That Lie Latent

In Your Existing Business