

## **The Art of Profitability**

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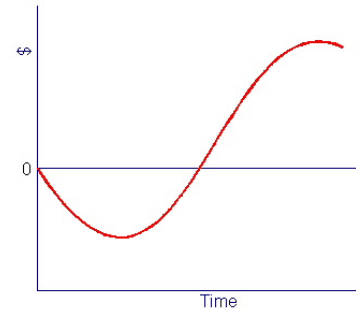
Questions to ask whilst thinking about these profit models:

- Which of these models are at work in my company?
- How does profit happen in competitors businesses?
- What can I do in the next 90 days to intensify my organisations focus on profitability?
- What profit model would enable us to maximise profits this year?

### ***23 Profit Models***

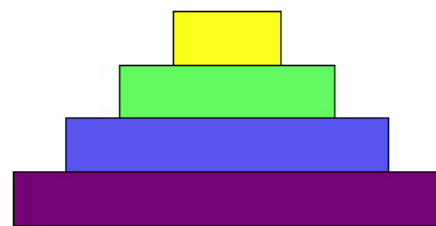
#### **1 – Customer Solution Profit**

- ≡ How could a company of 36 people generate \$24M in revenue, compared to 400 people generating \$40M in revenue?
- ≡ They identified the customer they needed, sent 2 people to work there for 2-3 months, and learned everything about the customers business. Then they sold their product to the customer, fully integrating it into their business.
- ≡ This principle is basically universally applicable.



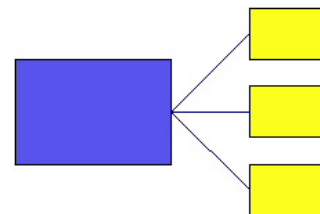
#### **2 – Pyramid Profit**

- ≡ Multi-tier product strategy that encompassed a core product, a standardised (but high quality and efficiently produced) product as a low-end “competitive firewall” to block new entrants from the market, through to a “rolls-royce” product.
- ≡ Each should appeal to a specific niche and requires a specific understanding of all customer, both current and potential.
- ≡ Examples include Nokia phones, AMEX’s credit cards and GM cars.
- ≡ An example of poor execution would be petroleum and the flat pyramid relationships caused by a focus on price competition, as opposed to functionality.



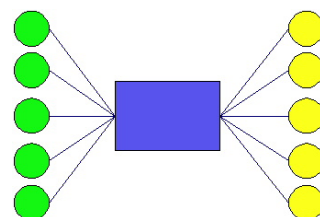
#### **3 – Multi-Component Model**

- ≡ This model applies where a single product is applied at a different price to different channels.
- ≡ The best example is Coke Cola. You buy the same product at different prices (according to price sensitivity at each) at a vending machine, a supermarket or a restaurant.
- ≡ Customers usually are consistent to all channels rather than just one. The situation (ie where they are and what they are doing) is what specifies the channel.



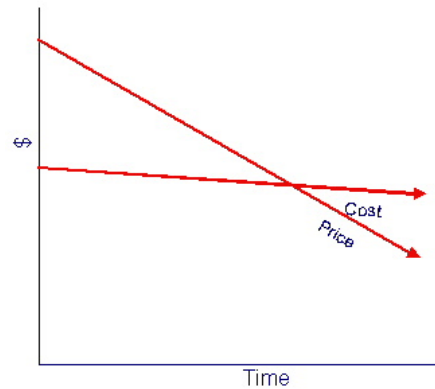
#### **4 – Switchboard Profit**

- ≡ The bringing together of sellers, with buyers to create a monopoly on high-value sales.



### **5 – Time Profit**

- ≡ Upfront innovation yielding large profits that are eroded over time by competitors entering the market created.
- ≡ The key to building large profits is to master the art of innovation so efficiently, that you maximise the profits upfront.

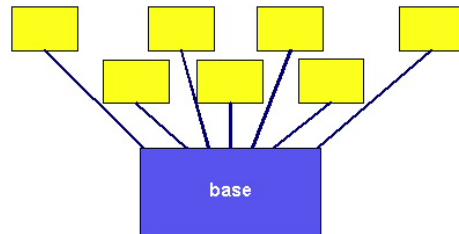


### **6 – Blockbuster Profit**

- ≡ Applicable to managing a product pipeline.
- ≡ Differentiation of high-profit R&D vs anti-profit RD i.e. a market where customers won't pay for what you develop.

### **7 – Profit Multiplier Model**

- ≡ The use of a multiplier effect to more than merely double profits.
- ≡ A good example is Honda's manufacturing car engines, outboard motors, industrial engines and more. Basically using a base skill of motor engineering to create products across different markets.
- ≡ Forms of realisation include skills, assets and Intellectual Property.
- ≡ Different products that realise a Blockbuster Business Operating Model to increase the odds of success.

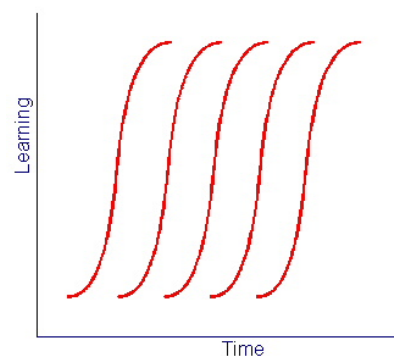


### **8 – Entrepreneurial Profit**

- ≡ Fundamental tenants: copy your competitors, celebrate star performers, save money, experiment, cut loses quickly, focus on wins and have fun.

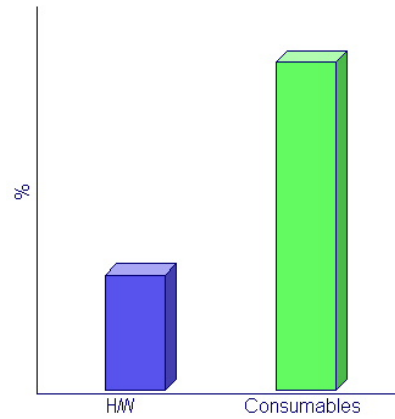
### **9 – Specialist Profit**

- ≡ Really learning vs just learning a topic.
- ≡ EDS did not learn everything at once. It chose a segment and learned it exquisitely well. They learned all the processes of an industry so well, not just in general, but specifically for each player.
- ≡ This can lead to a reputation for experience, leading to higher utilisation of resources, and high sales volumes and margins per sale.
- ≡ Additionally, this model can attract better talent to a business, shorter sales cycles, higher quality outputs and a better ability to up-sell to customers.
- ≡ Most of the cost is in developing the solution.



**10 – Install Base Profit**

- ≡ Demand volatility: high vs low
- ≡ Price sensitivity: high vs low
- ≡ Per unit cost: high vs low
- ≡ Consumer control: high vs low
- ≡ Sellers can screw this up buy having too high a price on consumables, or marking it too hard for the customer to buy.

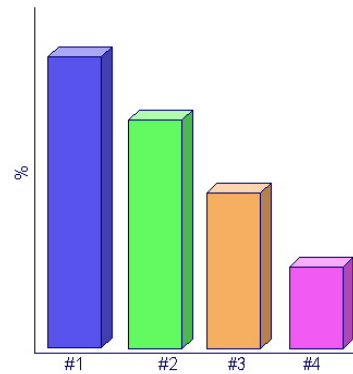


**11 – De Facto Standard**

- ≡ Surprises cost money, therefore De Facto Standard allows for plan-ability for customers.
- ≡ IBM Mainframes, Microsoft Windows, Oracle DB...

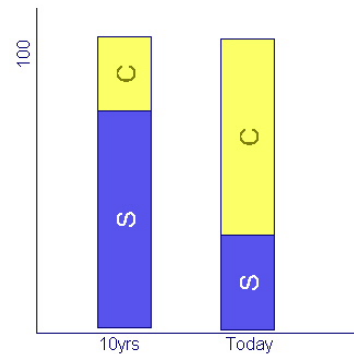
**12 – Brand Profit**

- ≡ A cumulative effect of ad spending.
- ≡ We spend what we can afford rather than spending to drive market share.
- ≡ This shouldn't preclude finding more leveraged methods i.e. differentiation, better channels or Share Determining Segments (SDS).
- ≡ SDS is where high share today translates to high share of the whole market tomorrow. An example is architects.



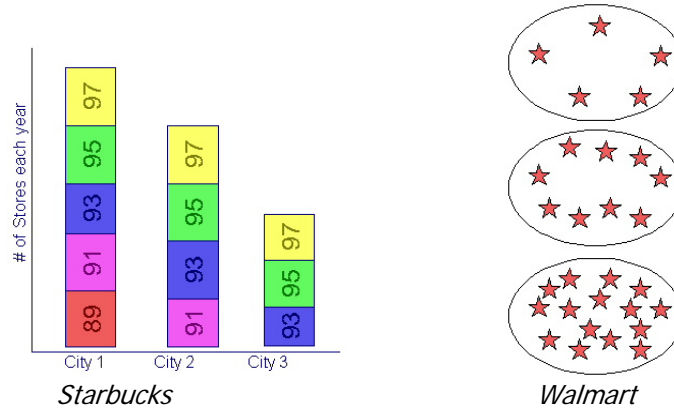
**13 – Specialty Product Profit**

- ≡ Specialist products earn higher gross margins.
- ≡ This shift for specialist to commodity is something every business needs to do at some point.



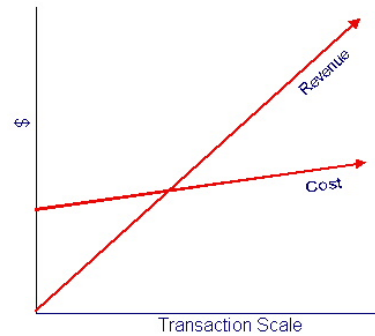
### 14 – Local Leadership Profit

- ≡ Generates higher buying power, better traffic, lower recruiting costs, high impact – low cost marketing whilst allowing for premium pricing.
- ≡ The effect is regional business fuelling growth to neighbouring regions.
- ≡ This approach requires a consistent and persistent approach.



### 15 – Transaction Scale Profit

- ≡ Big transactions mean bigger profits.
- ≡ Big transactions = relationships.

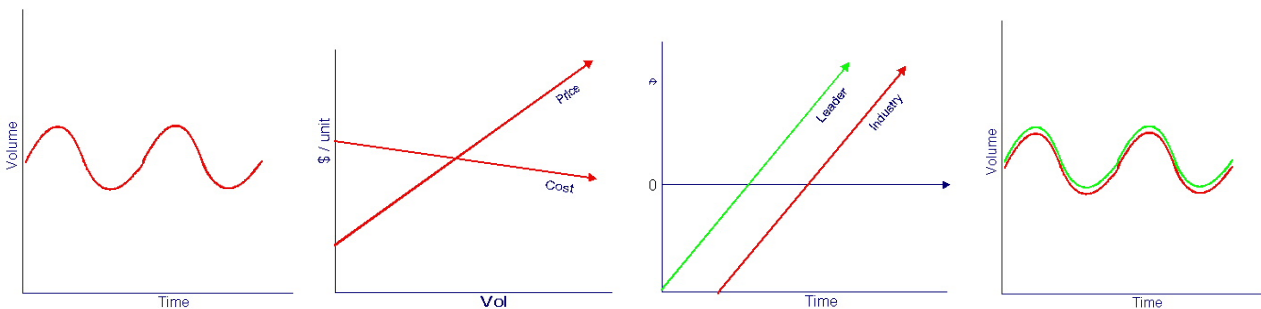


### 16 – Value Chain Profit

- ≡ Some locations in the value chain are more important than others (e.g. Microsoft and Intel)
- ≡ The key is identifying the control point and owning it.
- ≡ Points change and emerge across industries.

### 17 – Cycle Profit

- ≡ This focuses on volume and not the relationship between cycles and profit.
- ≡ The goal is to reduce the costs of production so you are ahead of the industry in break even and profits.

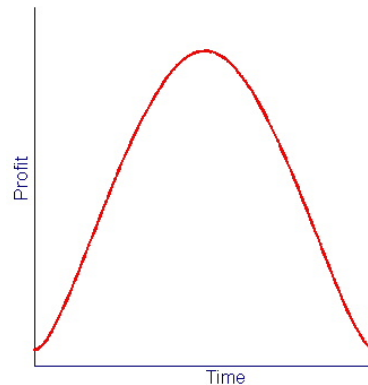
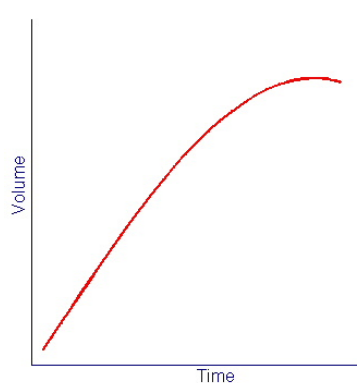


### **18 – After Sale Profit**

- ≡ Price sensitivity is highest when ticket price is high, variability is high and there are lots of options. The converse is also true.
- ≡ This can create an environment for follow up opportunities.
- ≡ Different to install base – in this case, the manufacturer doesn't benefit from the "follow up" market.
- ≡ It takes a different sort of organisation to focus on sales after the big ticket sale.

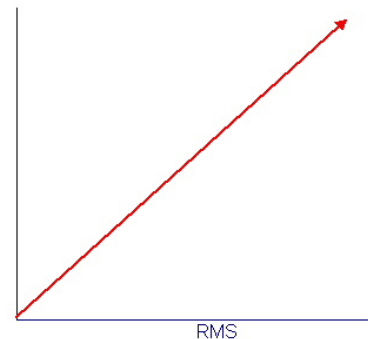
### **19 – New Product Profit**

- ≡ Not to be confused with Time or Specialty Product profit models.
- ≡ Over invest on the upside and cut back investment on the downside.
- ≡ Measure everything that will give you an indication that you are approaching the peak i.e. growth rates, price changes, etc.



### **20 – Relative Market Share Profit**

- ≡ Characterised by Jack Welch
- ≡ It works via scale in manufacturing combined with the lowest purchasing prices.
- ≡ This results in the lowest cost per unit, with the lowest R&D cost per unit.
- ≡ In addition, this brings other benefits in that RMS becomes a magnet for talent and also combines multipliers such as Value Chain Profit and De Facto Standard profit models.



### **21 – Experience Curve Profit**

- ≡ Was 60% of a 1960's Business School curriculum – now about 1%.
- ≡ Similar to RMS but focuses purely on taking costs out of the system.
- ≡ Experience curve is also about learning rates i.e. knowing when to cut costs, what to focus on.
- ≡ The danger here is completely managing details and losing vision for where the product lifecycle is going i.e. new paradigm (cans to bottles) or a new system (DELL, Southwest).

### **22 – Low-Cost Business Design Profit**

- ≡ Focusing on inflicting value chaos to experience curve or RMS models by undercutting on price (by taking 20-30% of the costs out of the system) or the next system (i.e. cans to pet bottles).

### **23 – Digital Profit**

- ≡ Shifting from conventional to digital can have a huge impact on profitability
- ≡ A great example is DELL. Others include: CEMEX, Oracle. All delivering more than 10x more profitable models.
- ≡ Delivers higher customer control to select (Choice Boards)
- ≡ *But it can't redeem a crummy business model !!!*