

CASE STUDY

—
RETAIL

PROFIT ISLE

DRIVING RETAIL PROFITABILITY

A durable goods retailer
dramatically increased
profitability in the face
of intense competition

EXECUTIVE SUMMARY

[Disguised Actual Data]

THE CHALLENGE:

Rapidly increase profitability through distinctive positioning and sales/product/operations focus despite fierce competition from national and local firms.

THE PROFIT ISLE SOLUTION:

Executed a three-month configuration of the Profit Isle Solution. Identified a three-pronged profit improvement solution that resulted in profits of over \$100 per square foot, compared to an industry average of less than \$5 per square foot.

Opportunity 1—Customers: Identified Islands of Profit customers, and rapidly increased business with this segment using a range of social media and in-store measures.

Opportunity 2—Products: Determined that the Islands of Profit customers were store-loyal, while the Coral Reef customers were brand shoppers, leading to a major shift to private branding and selective price increases.

Opportunity 3—Operations: Developed a powerful new understanding of the cost to serve specific market segments and specific products, with critically important consequences for product management, customer targeting, and core operational processes.

IMPACT ON CLIENT BUSINESS:

Rapid profit increase to industry leadership benchmark of \$100 per square foot, over 10X industry average, with industry leading market share in the most lucrative customer segments and a pathway for sustained profitable growth within and beyond the current footprint.

THE CHALLENGE

Client was a successful retailer with a solid reputation and good profitability, but faced extremely fierce competition from both national players and strong local firms. Profits were starting to erode.

The challenge was to identify and implement a competitive positioning, market focus, and set of implementation policies that would enable the client to “own” the most lucrative high-growth customers while boosting its sustained profitability to industry-leading levels.

Current financial reporting structures and key performance indicators (KPIs) are not suited for rapidly changing environments and industries. Overly broad P&Ls lack visibility into the core value of the business – Net Profitability – on a granular enough basis to focus action.

As markets and supply chains become increasingly complex, and as competitors become more focused, it is more important than ever to measure the all-in profitability of every transaction (invoice line), which yields a complete understanding of a company's internal and prospective profit landscape.

Traditional approaches to business cost structure leave managers focused on Gross Margin, assuming that some proportion will hit the bottom line. The reality, proven in our analysis of tens of billions of client revenue dollars, is that Gross Margin is statistically unrelated to Net Profits.

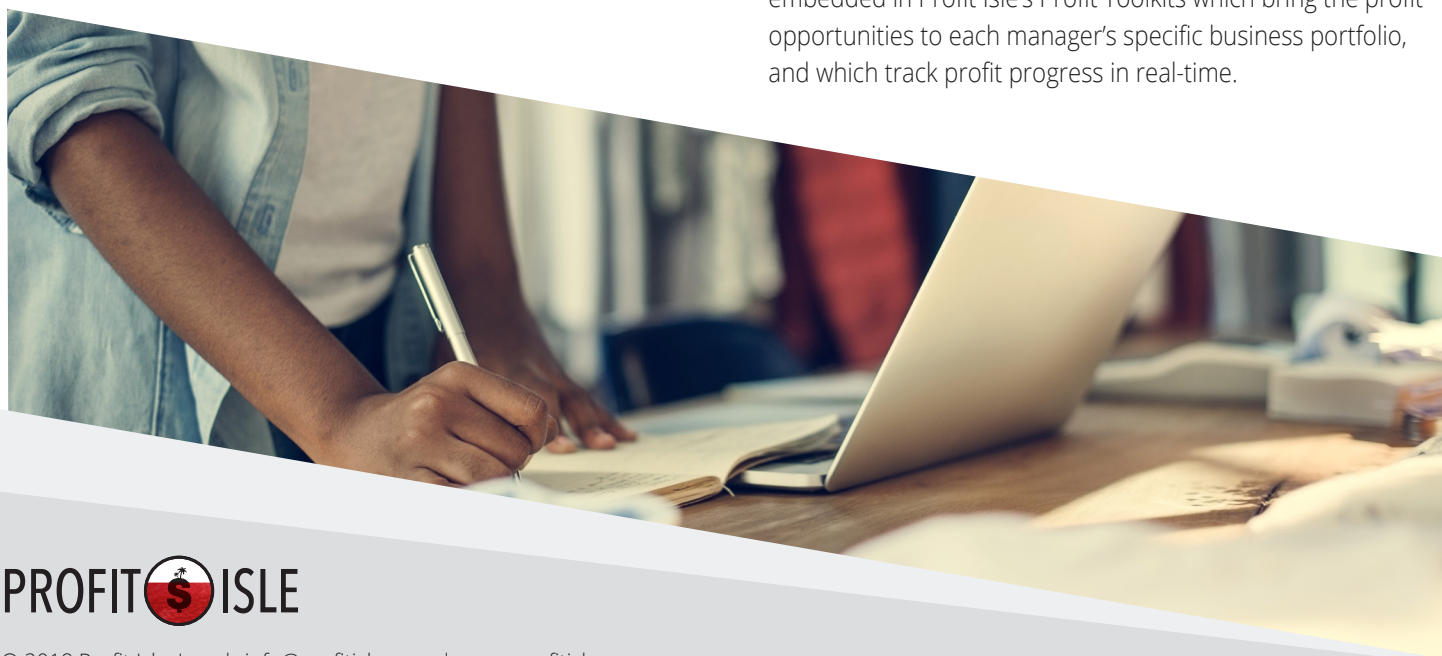
For this durable goods retailer, this could not have been more true.

In order to raise net profit, while fighting intense new competition, the client used the Profit Isle Solution to gain deeper visibility into its profitability, which revealed highly focused high-impact insights.

THE PROFIT ISLE SOLUTION

Profit Isle used its proprietary big data analytics engine and easily configured cloud platform to rapidly provide visibility to the transaction level profitability of the company – the client could literally see the full components of profitability of every product sold to every customer every time, summed into any configuration (customers, products, operations). The profit improvement process has five steps:

1. Calculate the all-in profitability of customers, products, and operations across the entire organization by utilizing the client's invoice records, generating a profit and loss statement for every transaction.
2. Create a set of “Profit Maps”, which reveal the areas of concentrated profit in the company by segmenting total profitability into four quadrants – Islands of Profit for high revenue, high profit business; Coral Reefs for high revenue, but low profit business; Minnows for low revenue, low profit business, and Palm Trees for low revenue, but high profit business – across all variants of customers, products, and operations (e.g. for a money-losing product, why are some transactions highly profitable while most are very unprofitable?)
3. Analyze and compare each segment of the company with the most profitable (best practice) portion for that segment (e.g. like products in like customers).
4. Prioritize an opportunity set which will produce the greatest profit improvements, consistent with the company's internal initiatives and constraints.
5. Train the client's managers throughout the organization to manage profitable growth using (a) Profit Isle's profit solution, which produces an updated profit landscape every month and (b) Profit Isle's world-class change management techniques, embedded in Profit Isle's Profit Toolkits which bring the profit opportunities to each manager's specific business portfolio, and which track profit progress in real-time.



THE EMERGING PROFIT PATTERNS AND PROFIT LEVERS

CUSTOMERS

The client's profit maps showed a sharp disparity between the Islands of Profit customers and the Coral Reef customers. About 15% of the customers were Islands of Profit, while about twice that amount were Coral Reefs, yet the Islands of Profit customers provided nearly 150% of the client's revenues, while the Coral Reefs actually eroded a third of the Islands' profits. Why?

A quick survey of the Islands of Profit customers showed that they were very store-loyal (a trait that we have seen in many other companies across industries), while a separate but parallel survey of the Coral Reef customers showed that they were brand-oriented bargain hunters. This was the clue we needed.

Working with the client's profit team, we developed a set of social media and in-store programs to enhance the Islands of Profit customers' buying experience and revenues/profits. For example, the client offered concierge services to these key customers, including after-hour appointments, and wine and cheese receptions for their family and friends (the survey had identified this as a prime recruitment incentive for potential Islands of Profit customers).

We placed icons on the Sales reps' iPads that identified Islands of Profit customers, and outlined their buying preferences, while the client's smart social media probed the Minnow customers to find those who had the potential to be Islands of Profit if we paid attention to them. This latter initiative alone offered the possibility of a 30% or higher potential profit increase in a short period of time.

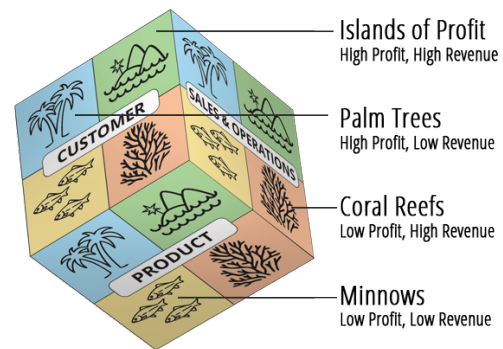
Importantly, had we simply surveyed all high-revenue customers, as traditional marketing approaches dictate, we would have targeted a profile that produced Coral Reef customers and neglected the Islands of Profit customers – the likely result: net profits actually drop like a stone.

And, this led to a policy of not matching discounts with the competitors on branded products, even at the loss of a sale.

PRODUCTS

The insight that the client's high-profit customers were store loyal had very important merchandising implications. The client quickly accelerated its store branding program, as store brands had much higher mark-ups than national brands – and the best customers actually preferred store brands. At the same time, once the client decided not to match the price wars raging on national brands, it developed a program to raise prices – carefully and selectively – checking each week to see if volume dropped.

The store brand program was so successful that the client featured it in a major advertising campaign, which brought in both new Islands of Profit customers, and prior customers who were attracted to the offering.



OPERATIONS

The Profit Isle granular net profit information had a big positive impact on Operations as well. When the operations staff reflected on their actual cost structure product-by-product, they quickly saw that several categories of products needed a lot of handling and assembly, and that these activities were driving these high-gross margin products into major net profit losses.

The operations managers met with the product managers, and substituted non-assembly products that were more expensive to customers, but much lower cost to handle. Because the client was focusing its customer development efforts on its price-insensitive Islands of Profit customers, the result was an increase in sales and a big hike on profits at the same time.

A second, critical understanding was clear from the Profit Isle profit landscape: the Islands of Profit customers were costlier to serve – but that this was the best investment that the company could make. Previously, these customers were viewed as simply high-cost, and all operations efforts were focused on reducing this cost differential. With the Profit Isle perspective, these costs were seen as completely justified by the additional profits they generated.

INSIGHTS TO ACTION: THE CLIENT RESULTS

Organizations can only handle limited change—you need to make it count!

1. The genius in your business.

Most Profit Isle clients have been under-resourced in their most profitable segments, where there is huge, untapped profit. The Profit Isle Solution clearly identifies their Islands of Profit, and encourages clients to rapidly accelerate their profits by:

- Growing their Islands of Profits;
- Shifting resources from underperforming areas to the high-profit areas – when, in most companies, the problem areas actually consume the most resources.

2. Pounds per square inch.

All of Profit Isle's clients have engaged in major initiatives – raising revenues, reducing costs – with limited visibility to their actual net profit impact. And, as seen in this case study, the effect very often is counterintuitive and opposite.

Profit Isle initiatives can join and support existing client initiatives with more focus and clear all-in net profit expectations. The Profit Isle Solution clearly identifies the largest profit opportunities, and the set of specific tasks that will:

- Drive successful change, starting with two or three major initiatives to maximize immediate profitable growth;
- Where possible, showcase each initiative to demonstrate success and speed company-wide acceptance and deployment;
- Accelerate and sustain profitable growth, through the installation of all-in net profit metrics at the top management level and throughout the organization;
- Drive permanent, company-wide profit maximization, even as the company grows and evolves, through Profit Isle's Profit Toolkits that optimize the profitability of each manager throughout the company.

3. The whole is greater than the sum of the parts.

Most Profit Isle clients have functional organizations, with each department having its own KPIs. The Profit Isle Solution identifies the surprisingly large opportunities in the gaps in coordinating between the functional areas, not reflected in the functional KPIs, and this opens a huge new set of profit opportunities that are latent within the company by:

- Modifying selected functional department KPIs;
- Initiating focused cross-functional teams to eliminate these profitability barriers.

This is a critically important area: in our experience improving the profitability of tens of billions of dollars of client revenues, many of the most important profit levers are unseen, unmeasured, unmanaged, and nearly painless to implement for both the client and for its customers.



NEW VISION OF PROFITABILITY.

EFFECTIVE, PROVEN CHANGE
MANAGEMENT.

HIGH-IMPACT RESULTS.

PROFIT ISLE.