NAW
2017 Billion Dollar CEO Roundtable

Global Pricing Briefing for Billion Dollar Distributors:

Pricing for Maximum Profit

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October 12, 2017

PROFIT ISLE

Today's Menu

- From One-Dimensional Pricing to Price-Based Profit Levers
- Three Cases
- The Pricing Dilemma
- The Pricing Star of Value
- Profit Stacks and Profit Levers
- Managing Pricing for Maximum Profit
- Huge New Opportunities

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From One-Dimensional Pricing to Price-Based Profit Levers

- Broadening Focus
  - From simple revenue enhancement

    … to MPG – Managing Profitable Growth

- Broadening Focus
  - From contradicting function price setting

    … to integrated profit management

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Three Cases

Case Example 1: Craft Beers

- Anchor brands
  - 60% of the distributor's revenues
  - 75% of these revenues were profitable
  - 25% of these revenues were unprofitable
  - The unprofitable revenues' losses eroded about 20% of the profits earned by the profitable business
- Craft brands
  - 40% of the distributor's revenues
  - 30% of these revenues were profitable
  - 70% of these revenues were unprofitable
  - The unprofitable revenues generated losses amounting to three times the profits generated by the profitable business
- What should they do?

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Three Cases

Case Example 2: EDI Replenishment

- EDI replenishment orders were generating strong growth and gross margins
- The all-in net profit analysis showed surprisingly large net profit losses
- What should they do?

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Three Cases

Case Example 3: Process Control Devices

- Two primary customer segments: semiconductor fabs and universities
- Traditional accounting showed that the fabs produced weak gross margins, while the universities produced very strong gross margins
- The MPG analysis showed that the universities produced surprisingly large net profit losses, while the fabs produced high profits
- What should they do?

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The Pricing Dilemma

Sales Rep Comparison Example

	Revenues ($000)	**Gross Margin ($000)**	**Net Profit ($000)**
Rep 1	1,349	346	216
Rep 2	664	131	(25)
Rep 3	2,773	328	64
Rep 4	3,920	556	217

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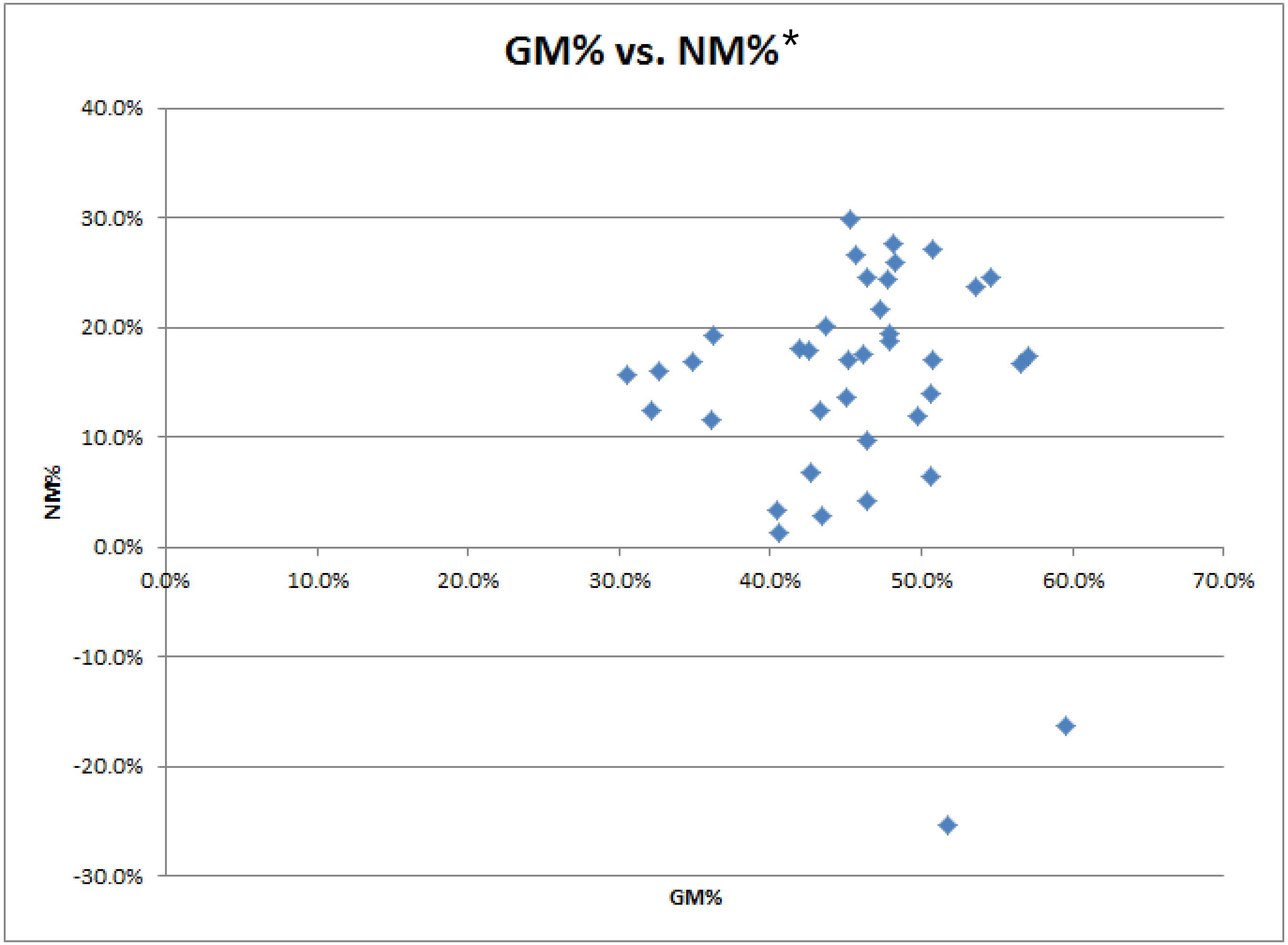
Gross Margin is Not Correlated with Net Margin



* Disguised actual data representing product categories of a very successful company

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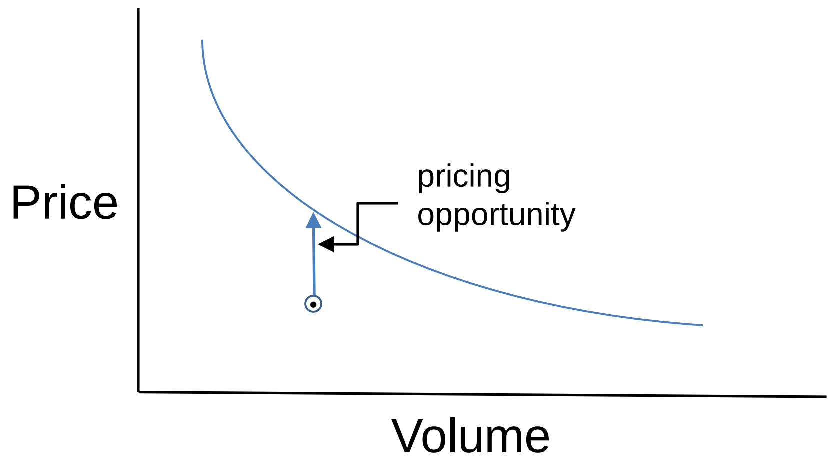
What's Wrong With This Picture?



The assumptions:

- Identical product
- Identical cost to serve
- Single market segment
- Perfect information

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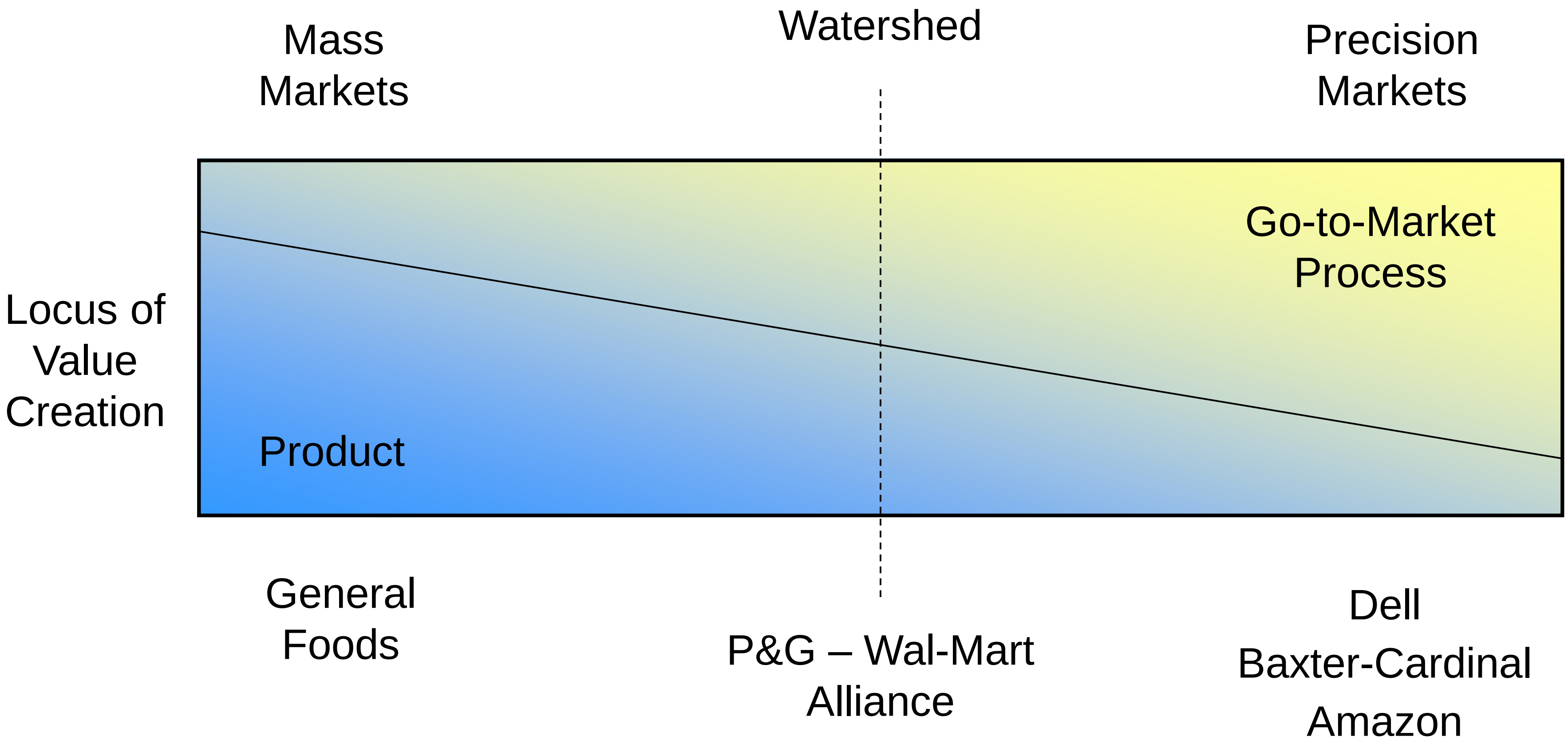
New Locus of Value Creation



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New Era, New Imperatives

Mass Markets

- Stable, homogeneous markets
- Broad-market targeting
- Separate revenue and cost initiatives
- Traditional disjointed pricing process

Precision Markets

- Dynamic, heterogeneous markets
- Precision account targeting
- Aligned price-based profit levers
- Integrated profit management

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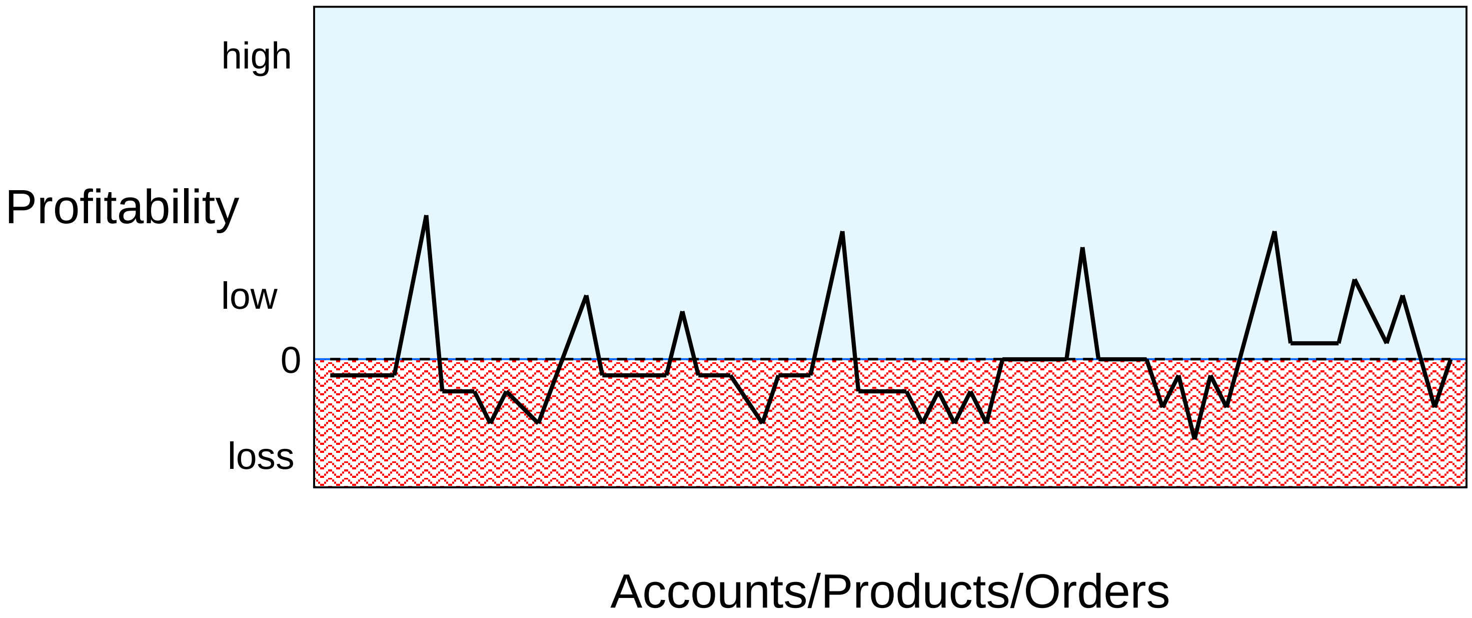
Problematic Consequences – Huge Opportunities

Islands of Profit in a Sea of Red Ink



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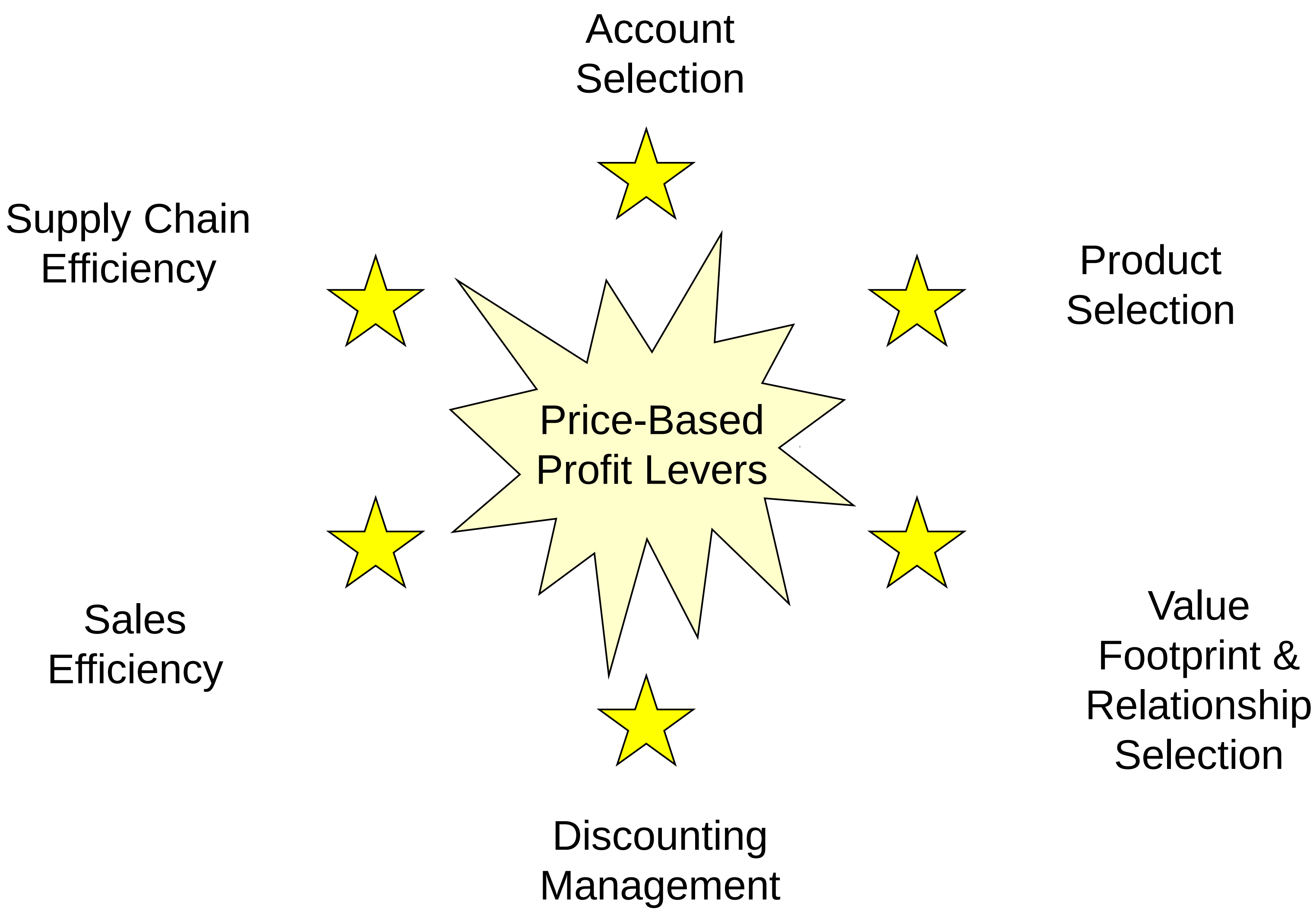
The Pricing Star of Value



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Profit Stacks and Profit Levers

The Domain of Pricing

Profit Stack	Traditional Pricing	Price-Based Profit Levers
Revenue	✓	✓
- COGS		✓
GM		✓
- Sales cost		✓
- SC cost		✓
- G&A cost		✓
Net Profit		✓

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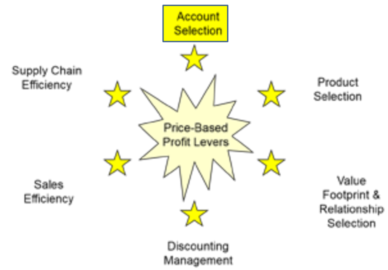
Account Selection: Customer Profit Map*

Focus resources on 17% of the customers to build more profits with customers who are already the best customers – sell to your strengths



Profits	Low revenues	High revenues
high	**Palm Trees** 1% of customers 1% of revenues 3% of profits	**Islands of Profit** 17% of customers 47% of revenues 136% of profits
low	**Minnows** 54% of customers 20% of revenues 8% of profits	**Coral Reefs** 28% of customers 32% of revenues (47%) of profits

How would you price these? (→ Palm Trees)

Which are potential IOP customers? (→ Minnows)

Vendor Loyal (→ Islands of Profit)

Brand Loyal (→ Coral Reefs)

Revenues: low – high

* Disguised ACTUAL data

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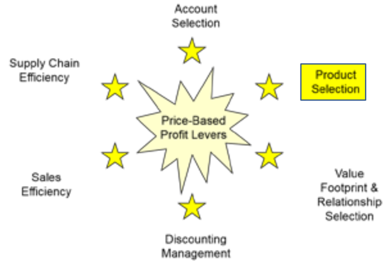
Product Selection: Product Profit Map*

Focus resources on the 5% of products that are producing 158% of the profits – highest leverage



Profits \ Revenues	low	high
high	**Palm Trees** 1% of products 1% of revenues 7% of profits	**Islands of Profit** 5% of products 53% of revenues 158% of profits
low	**Minnows** 87% of products 19% of revenues (25%) of profits	**Coral Reefs** 7% of products 27% of revenues (40%) of profits

How do you insulate these from competitors? (Palm Trees)

Who is managing the product mix and substitutes? (Islands of Profit)

How many of these are bought only by Minnow customers? (Minnows)

These are profitable when sold to IOP customers (Coral Reefs)

Over half of the sales and supply chain costs are supporting unprofitable business (Minnows, Coral Reefs)

* Disguised ACTUAL data

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Value Footprint and Relationship Selection

- How to win a price war
- Relationship hierarchy
- Match cost to serve with profit potential
- Market mapping
- Relationship migration paths
- Build barriers to entry

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Discounting Management

- Speeding tickets
- Best practice: Islands of Profit
  - Customers
  - Sales reps
- Build your value footprint
- Conditional pricing
- Manage loss leaders
- Don’t discount to fill capacity
- Profit toolkits with real-time net profit metrics

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Delivery Charge Discounting — by Order Size and Profitability

Delivery charges are a $21M revenue item with discounting
Based on the list price base delivery charge of $99.99, discounting costs the company $4.3M per year
Nearly $3M in delivery discounts are given to unprofitable orders

Delivery Charges by Order Size						Delivery Charge Range			
Order Size	# Orders[1]	Revenue	Profit	Total Dely Chgs	Avg DelChg	$0-$50	$50-$99	$100-$150	>$150
< $500	43,136	$ 14,111,654	$ (4,573,881)	$ 2,657,172	$ 61.60	$ 262,010	$ 2,310,428	$ 159,183	$ 579
$500-$1,000	66,744	$ 49,344,073	$ (2,236,181)	$ 5,529,856	$ 82.85	$ 296,641	$ 4,852,952	$ 443,530	$ 960
$1,000-$2,500	104,894	$ 169,173,436	$ 15,401,097	$ 9,420,932	$ 89.81	$ 287,742	$ 8,373,162	$ 805,823	$ 3,250
$2,500-$5,000	30,702	$ 100,454,387	$ 17,541,313	$ 2,737,879	$ 89.18	$ 82,388	$ 2,431,079	$ 231,822	$ 1,900
> $5,000	3,972	$ 26,451,273	$ 5,891,308	$ 330,866	$ 83.30	$ 13,144	$ 291,797	$ 25,784	$ 1,441
	249,448	**$ 359,534,824**	**$ 32,023,656**	**$ 20,676,705**	**$ 82.89**	**$ 941,925**	**$ 18,259,418**	**$ 1,666,143**	**$ 8,130**

[1] Includes all orders with delivery charge > 0 and order revenue > 0

Delivery Charges by Order Size						Delivery Charge Discount			
Order Size	# Orders[1]	Revenue	Profit	Total Dely Chgs	Avg DelChg	Avg Discount[2]	Avg Disc %[2]	Total Disc $	% of Profit
< $500	43,136	$ 14,111,654	$ (4,573,881)	$ 2,657,172	$ 61.60	$ 38.39	38%	$ 1,655,997	36%
$500-$1,000	66,744	$ 49,344,073	$ (2,236,181)	$ 5,529,856	$ 82.85	$ 17.14	17%	$ 1,143,877	51%
$1,000-$2,500	104,894	$ 169,173,436	$ 15,401,097	$ 9,420,932	$ 89.81	$ 10.18	10%	$ 1,067,419	7%
$2,500-$5,000	30,702	$ 100,454,387	$ 17,541,313	$ 2,737,879	$ 89.18	$ 10.81	11%	$ 332,014	2%
> $5,000	3,972	$ 26,451,273	$ 5,891,308	$ 330,866	$ 83.30	$ 16.69	17%	$ 66,294	1%
	249,448	**$ 359,534,824**	**$ 32,023,656**	**$ 20,676,705**	**$ 82.89**	**$ 17.10**	**17%**	**$ 4,265,601**	**13%**

[1] Includes all orders with delivery charge > 0 and order revenue > 0
[2] From $99.99 base delivery charge per order

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Sales Efficiency

- Omnichannel management
- EDI tips and pitfalls
- The paradox of product variety
- Substitute management
- Customer service management
- Order management and forecasting

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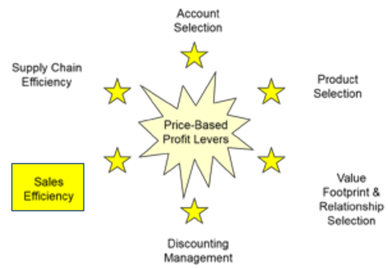
Sales Associates: Profit Map



17% of the sales associates (264) provide 100% of the profits
The other associates (1,323) generate about $450M in revenues and no profits

PALM TREES™	FY 15	$ / Line	% of Rev	% of Total
No. of SalesReps	26			1.6%
Revenues	$9.1	$320.85	100.0%	1.3%
Gross Profit	$4.2	$150.57	46.9%	1.4%
Operating Expense	$2.1	$73.27	22.8%	0.8%
Net Profit	$2.2	$77.30	24.1%	5.6%
Invoice Lines	28,222			1.0%

ISLANDS OF PROFIT™	FY 15	$ / Line	% of Rev	% of Total
No. of SalesReps	238			15.0%
Revenues	$209.6	$288.29	100.0%	31.1%
Gross Profit	$96.5	$132.74	46.0%	32.2%
Operating Expense	$60.1	$82.65	28.7%	23.1%
Net Profit	$36.4	$50.09	17.4%	93.4%
Invoice Lines	727,024			26.4%

HIGH PROFIT
Revenues
$218.7
32.5%
Profit
$38.6
99.0%
% of SalesReps
16.6%

MINNOWS™	FY 15	$ / Line	% of Rev	% of Total
No. of SalesReps	810			51.0%
Revenues	$114.8	$221.06	100.0%	17.1%
Gross Profit	$50.0	$96.24	43.5%	16.7%
Operating Expense	$52.2	$100.55	45.5%	20.0%
Net Profit	($2.2)	($4.31)	(1.9%)	(5.7%)
Invoice Lines	519,103			18.9%

CORAL REEFS™	FY 15	$ / Line	% of Rev	% of Total
No. of SalesReps	513			32.3%
Revenues	$339.5	$229.64	100.0%	50.5%
Gross Profit	$148.7	$100.61	43.8%	49.7%
Operating Expense	$146.1	$98.82	43.0%	56.1%
Net Profit	$2.6	$1.78	0.8%	6.8%
Invoice Lines	1,478,317			53.7%

LOW PROFIT
Revenues
$454.2
67.5%
Profit
$0.4
1.0%
% of SalesReps
83.4%

Totals	No. SalesReps	Rev	GP	Op Exp
	1,587	$672.9	$299.4	$260.4

Totals	NP	Inv Lines	GM %	NM %
	$39.0	2,752,666	44.5%	5.8%

Dollar figures (Except / Line) and Invoice Lines are in Millions

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Supply Chain Efficiency

- Demand Management: Product mix and channel characteristics
- Demand Management: Order variance
- Service Differentiation: Order cycle

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Demand Management: Product Mix

The Case of Dell – Just in Time with No Inventory

- Spectacular results – four year period:
  - 50% CAGR
  - Revenues rose $2B to $16B
  - Stock rose 62% per year
  - Eight year stock increase: 17,000%
  - ROIC: 217%

- Key success factors
  - Account selection – corporate accounts
  - Demand management – sell what you have
  - Supplier management – 30% on cost, 70% on quality, service, flexibility

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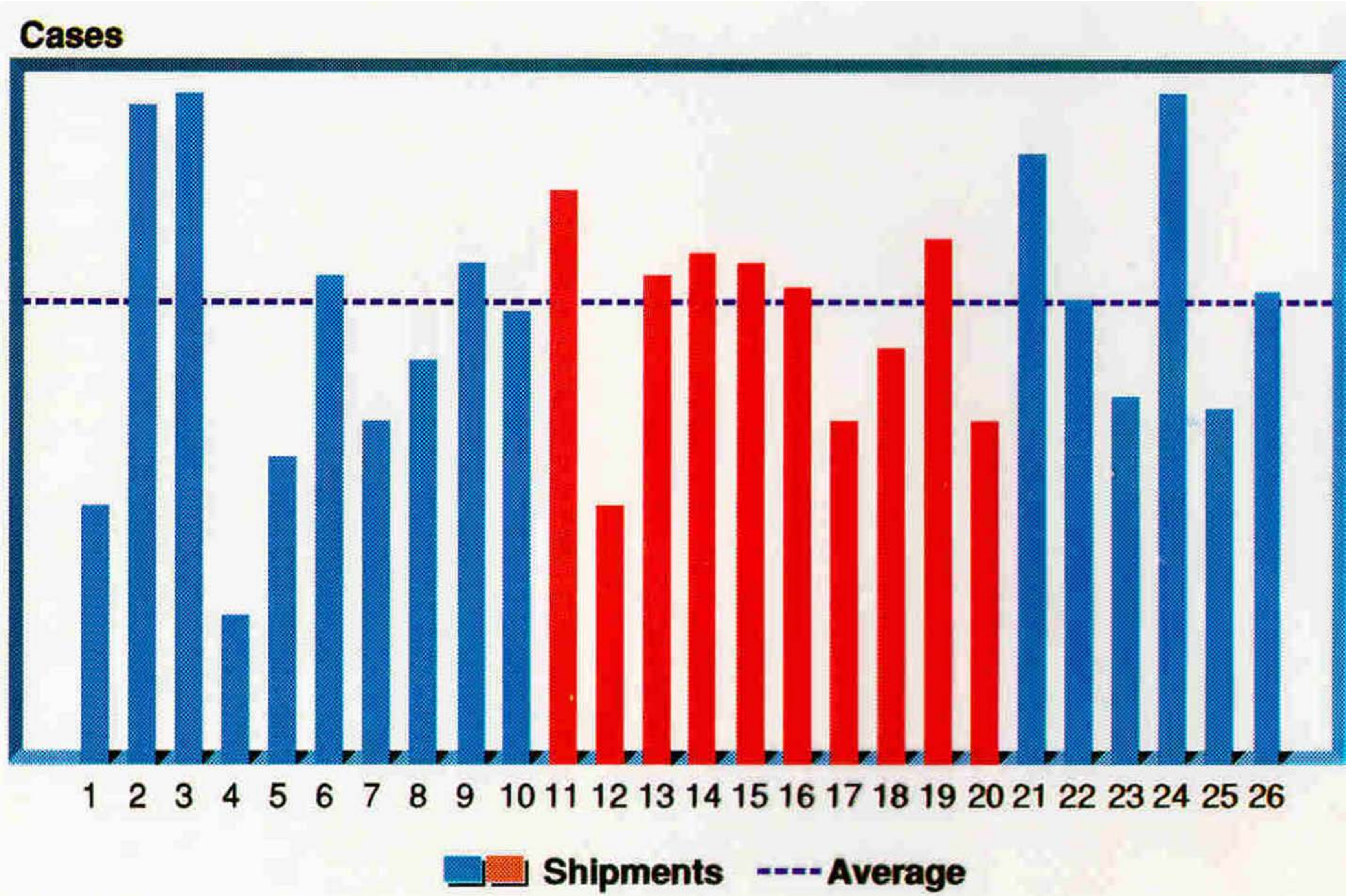
Demand Management: Order Variance
Manufactured Product – Customer Shipments

Product A – Region 1



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Product A – Region 1

Customer Shipment Data

Major Hospitals	Week Data										Total	Rel. Dev. from Mean
Hospital 1	100		102	100		98	104		110	98	712	0.600
Hospital 2	48	173	84	98	200	48	193	48	183	48	1123	0.534
Hospital 3	100		50	50	50	50	50	100	50	50	550	0.327
Hospital 4	165	102	70	82	110	110	70	85	40	65	899	0.283
Hospital 5	128		192	128	128	192		64	128	128	1088	0.482
Hospital 6			50	65		60		40	75		290	1.000
Hospital 7	120			120			85		120		445	1.200
Hospital 8		1	80	3					2	2	8	1.200
Hospital 9	80		63	80		100	100	20	100		560	0.729
Hospital 10					51			59			173	1.400
Hospital 11	24			10	38			24			96	1.200
Hospital 12	78	75	30		82			82	40	73	390	1.000
Hospital 13		40	20		40		25			16	191	0.832
Hospital 14	90			30	60	50	40	60	12	15	365	0.644
Hospital 15	10			20	15	10	5	5		15	92	0.583
Hospital 16	10		18	5		8		10	23	7	40	1.000
Hospital 17			3	24		24	1	23			113	0.982
Hospital 18	4	5		2	1		4	4			23	0.739
Hospital 19	6	6			20			12			44	1.200
Hospital 20	25		6	20				25			70	1.400
Hospital 21		3		6		8				5	17	1.400
Hospital 22						4			10		15	1.400
Hospital 23	10		10	15		15					50	1.200
Hospital 24				8	13	4	11	4		8	58	0.724
Subtotal	*998*	*405*	*778*	*866*	*808*	*781*	*688*	*665*	*893*	*530*	*7412*	*0.919*
Small Hospitals	*115*	*140*	*158*	*119*	*166*	*128*	*82*	*156*	*132*	*167*	*1363*	
Total	*1113*	*545*	*936*	*985*	*954*	*909*	*770*	*821*	*1025*	*697*	*8775*	

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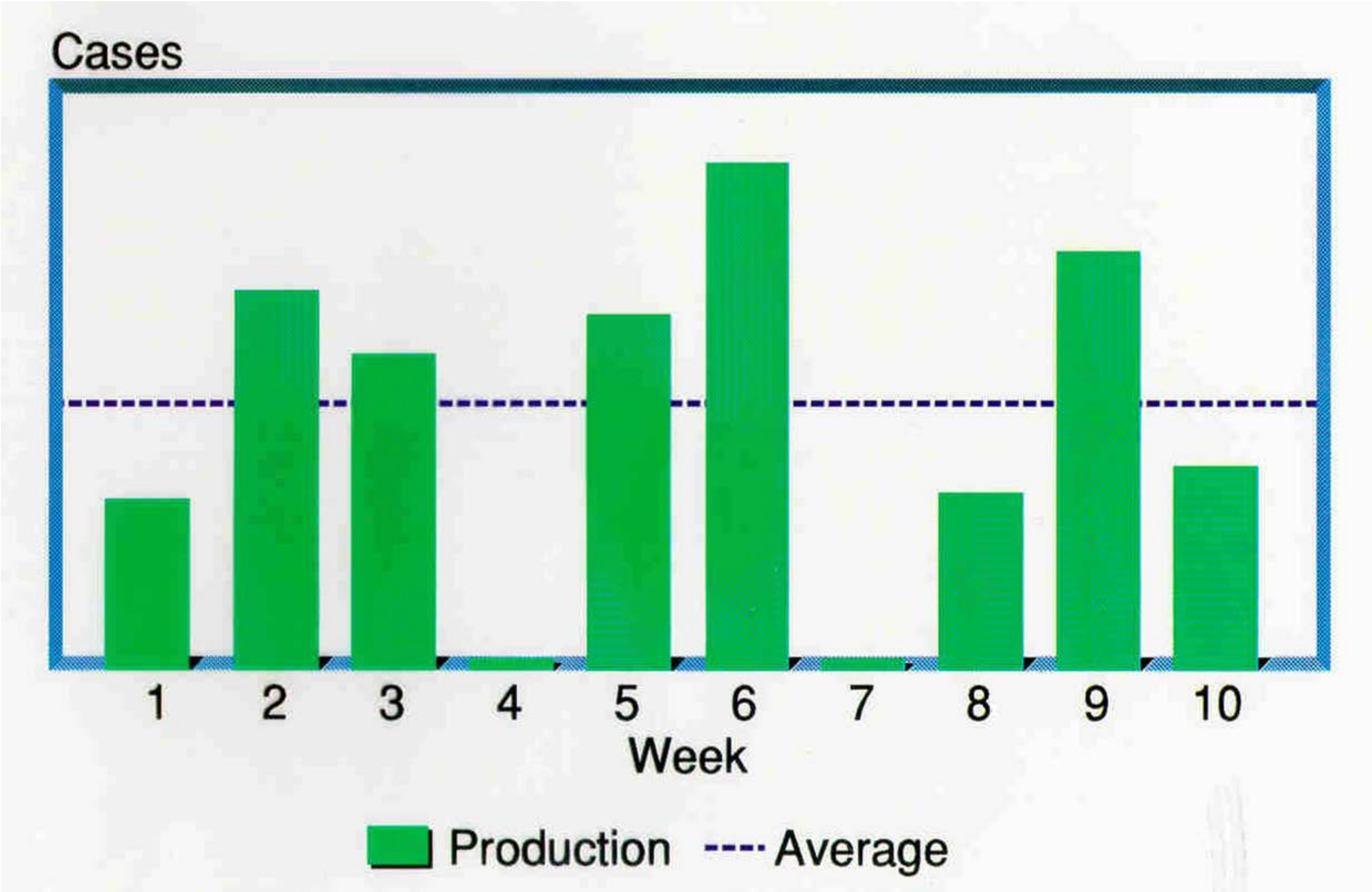
Product A – Production Output



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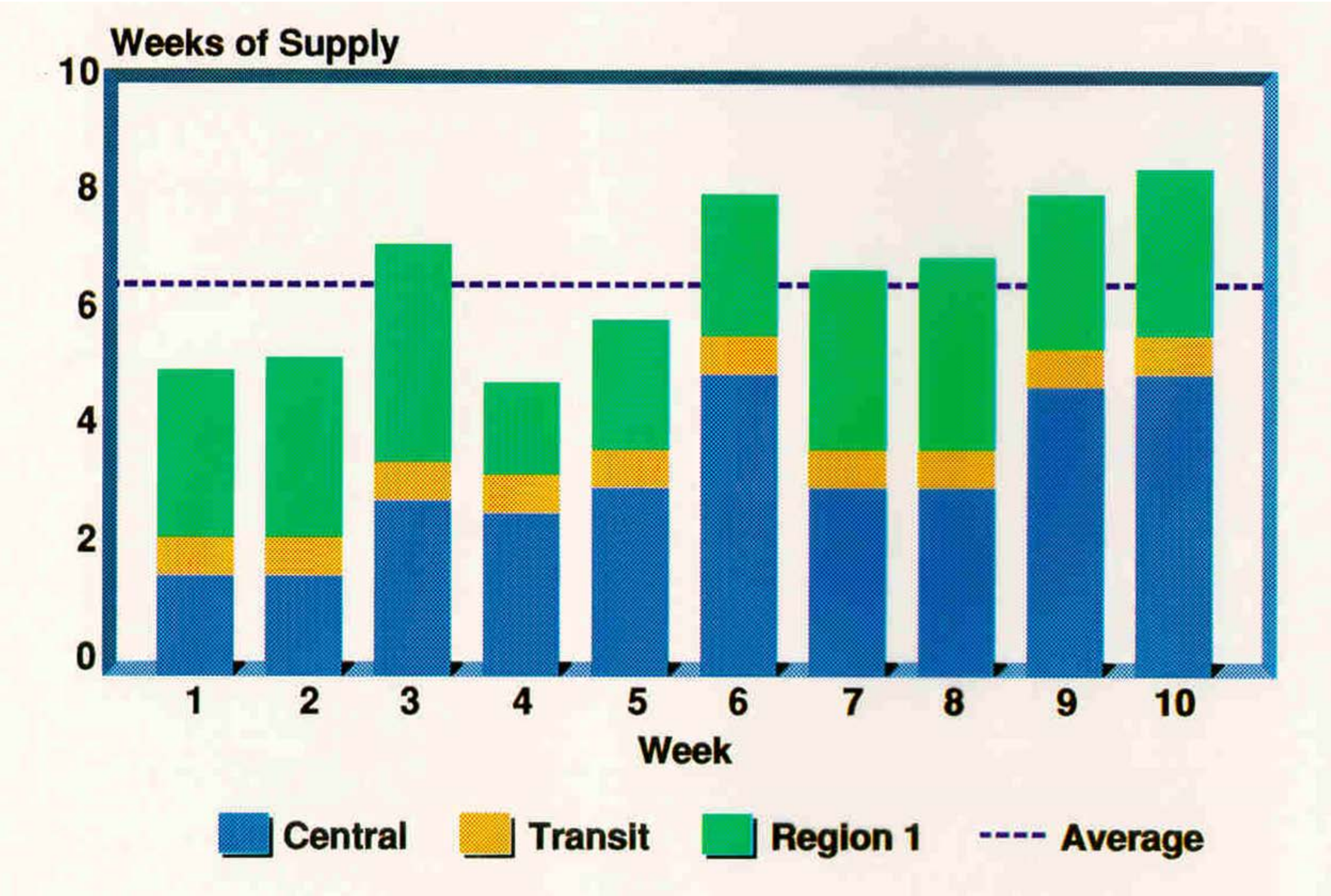
Product A – Region 1 (Total System)



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The Solution…

- A standing order system – weekly orders
- Major hospitals – major products
  - Total hospitals 120
  - Major hospitals 23
  - Focus hospitals 12
  - Key focus hospitals 4
- Contingency backups
- Custom pack

What is the value of doing this?

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Before and After Views

Product A – Region 1

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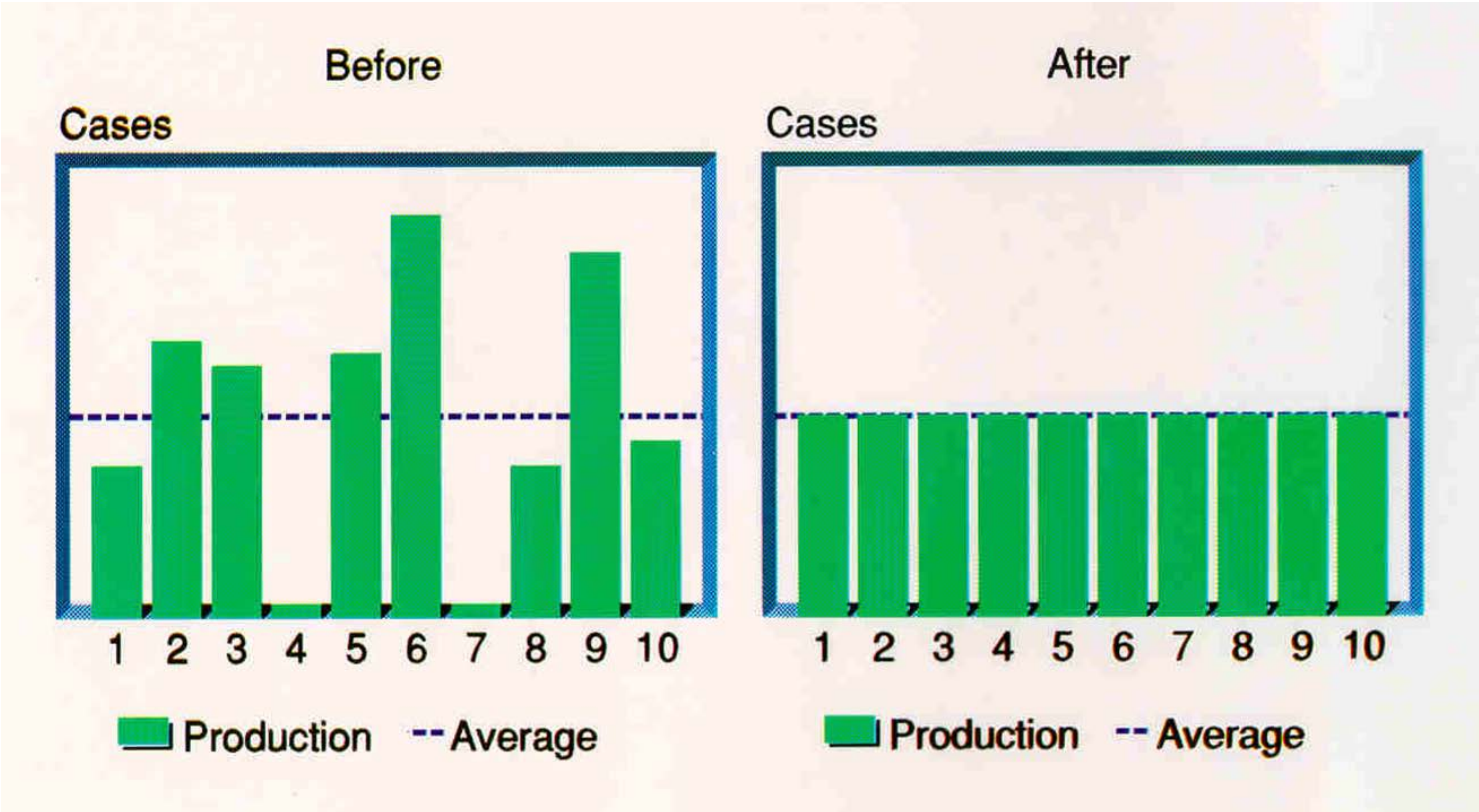
Before and After Views

Product A – Production Output



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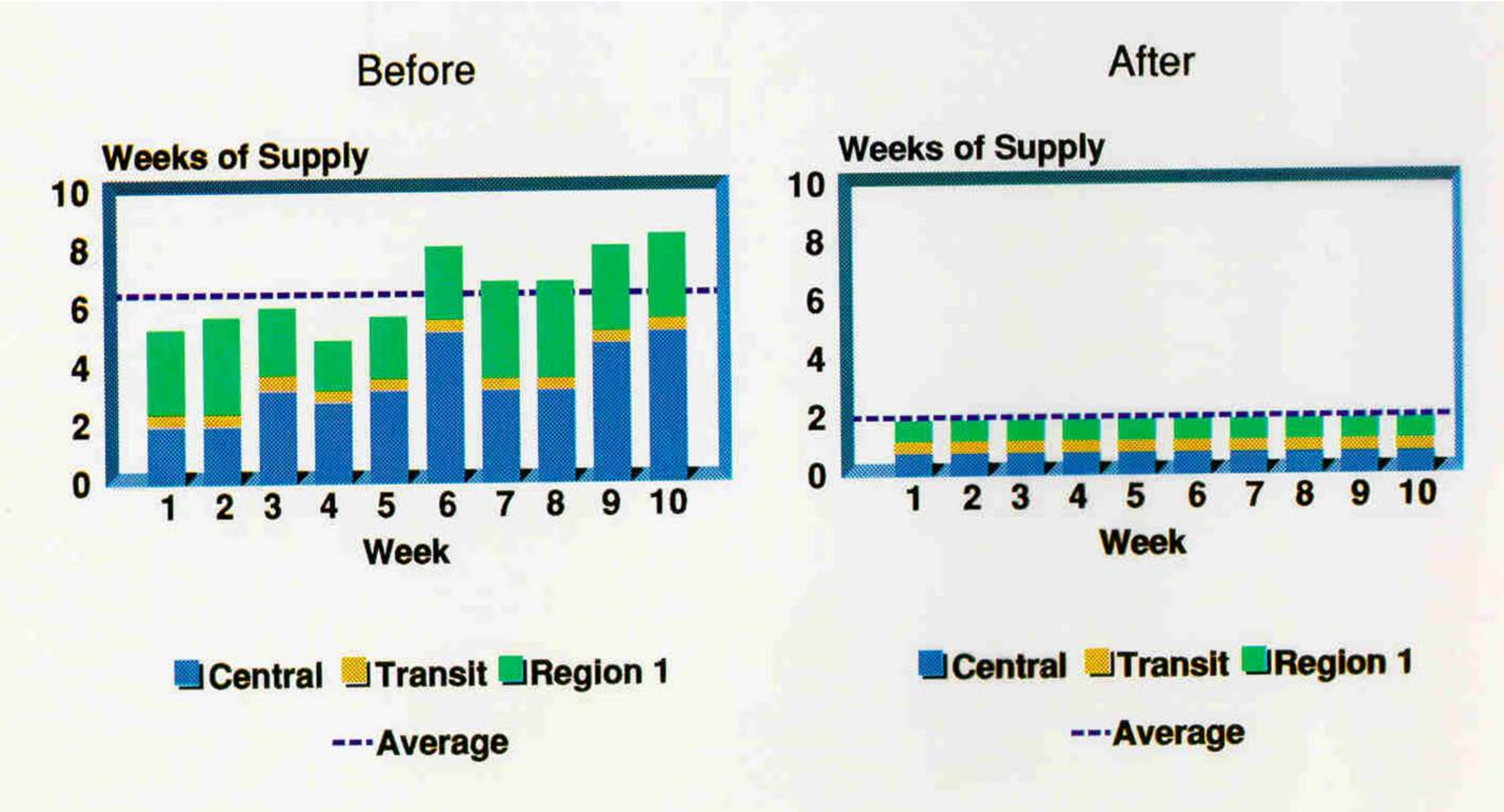
Before and After Views

Product A – Region 1



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Product A

Channel Microeconomics

Central facility	75% cost reduction
Interwarehouse freight	No change
Customer facing warehousing	25% cost reduction
Freight to customer	No change

Summary	50% Vendor Cost Reduction

Plus significant hospital cost reductions (ordering, handling, inventory), with increased service levels:

Confirmed 50+% hospital cost reductions

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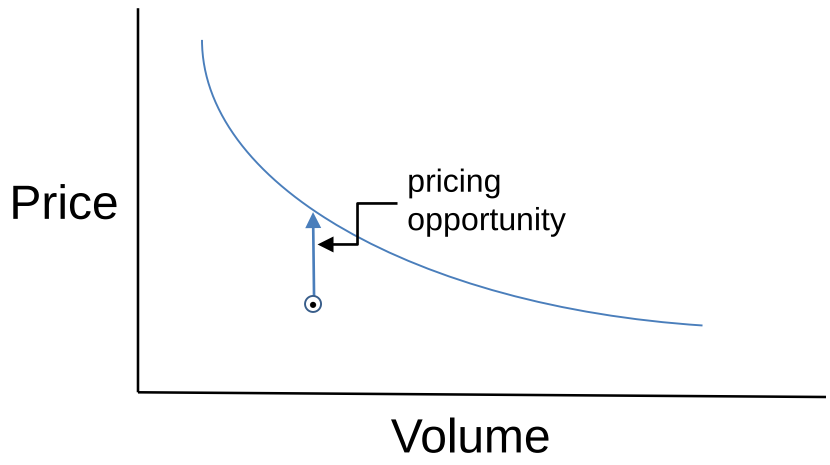
What's Wrong With This Picture?



The assumptions:

- Identical product
- Identical cost to serve
- Single market segment
- Perfect information

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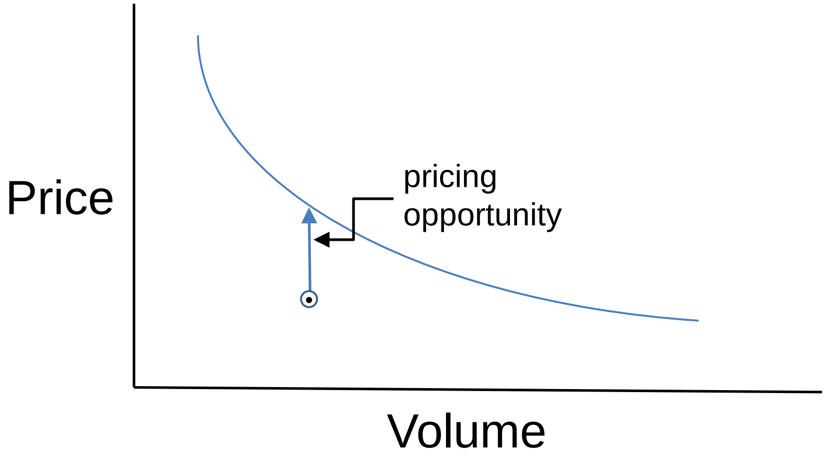
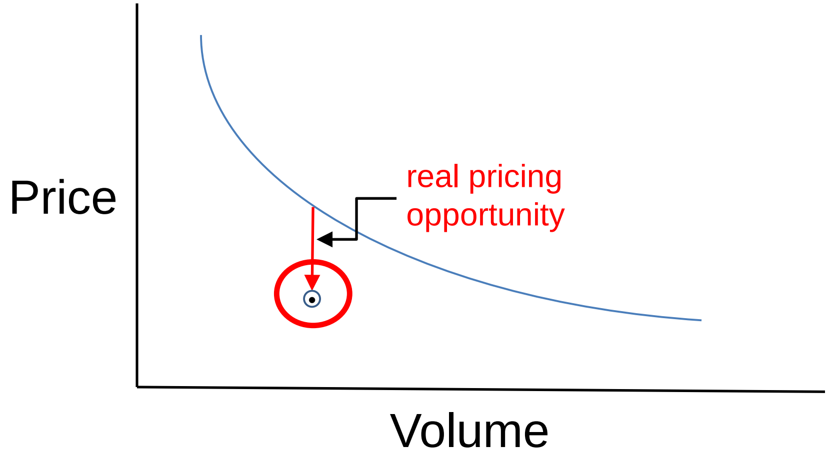
Real Pricing Opportunity





The assumptions:

- Identical product
- Identical cost to serve
- Single market segment
- Perfect information

What is the impact on gross margin?

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Service Differentiation

Order Cycle

Product \ Customer	non-core	core
core	3 days	1 day
non-core	5 days	3 days

Customer

What is Customer Service?

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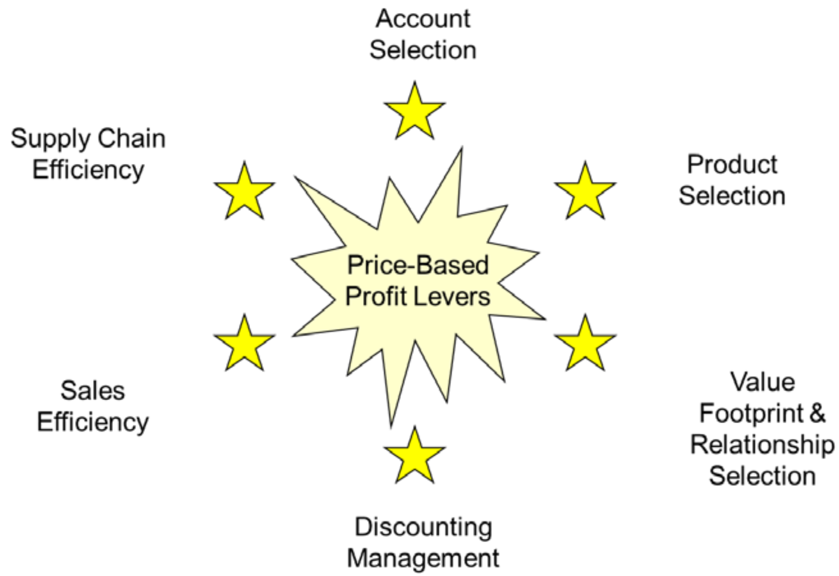
Managing Pricing for Maximum Profit



<u>Foundation Capabilities</u>

- Profit Mapping & All-in Profit Stacks
- Strategy Alignment – Account Selection, Relationship Hierarchy, & Market Mapping
- Profit Toolkits & Real-time Metrics – Sales, Marketing, & Supply Chain

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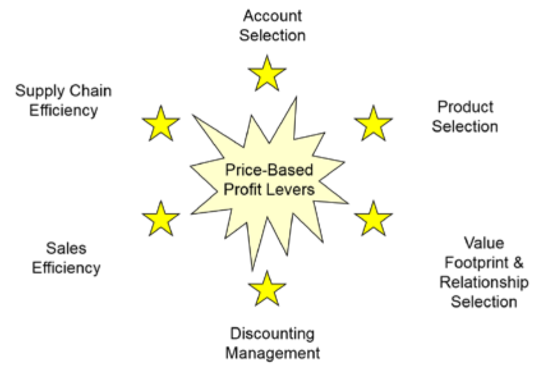
Huge New Opportunities



- Price-Based Profit Levers

… Driving Huge New Profitable Growth Increases

- Coordinated Decentralized Pricing Management

… Driving Huge New Efficiency Gains

- Financial Performance

… Going Through the Roof

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