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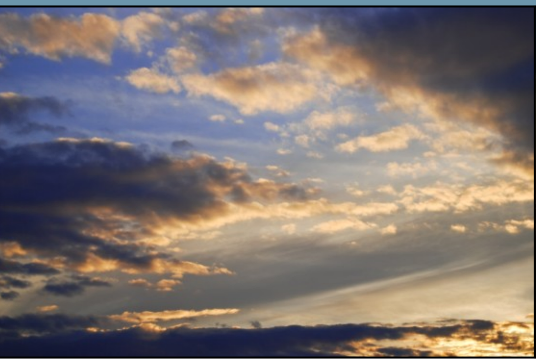
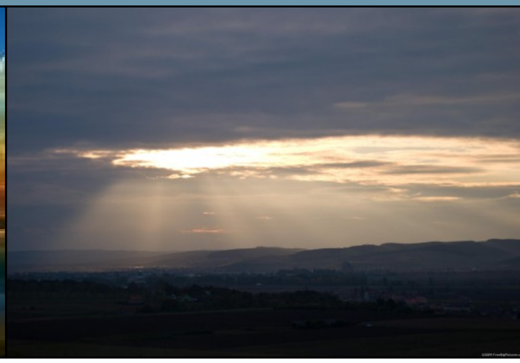
Better Outcomes





# Achieving Economic Escape Velocity

## Growing Revenue – "The core business is the foundation for the future"

### Introduction

Developing a successful revenue strategy is the cornerstone of achieving escape velocity. Growing profitable revenue streams, however, may necessitate reducing revenue in the first instance in order to focus resources on the core profitable market segments and product groupings of the business. Having established a stable and strengthened core, the business can look to grow revenue either from a deeper penetration of its core markets and products and/or from successfully developing adjacent market segments to the core.

### Thinking through the options

Before making the strategic choices required to develop a growth strategy the management team needs to have a good understanding of the current market segments in which the business competes. Insight can be gained by viewing the current market segments through three separate lenses;

**MARKET SEGMENT**

Attractiveness

- Size
- Growth
- Life cycle
- Profitability

…….and ability to Compete

- Market Share
- Penetration
- Value proposition

- **LENS 1 - Segment Attractiveness and Competitive Strength**

Each market segment needs to be assessed for its attractiveness, that is, the ability to earn profits in the segment. There are a number of tools that can assist in making this assessment, for example, Michael Porter's five force model. In addition other factors can also be taken into account, for example, overall market size and its growth rate, the stage of the products/services life cycle within the segment, overall profitability of the segment.

Having established and ranked the attractiveness of the segments it is necessary to make an assessment of the company's competitive strength in each of the segments. Factors which can be taken into account to assess competitive strengths are numerous and include, relative market share, profitability compared with competitors, the degree of product/service penetration across the key market segment categories and how well the business's customer value proposition matches the customer needs in the market segments.

Having segmented revenue and assessed both the attractiveness and competitive strength in each of the segments management can gain significant insight into the current core strengths of the business and those adjacent market segments that offer attractive returns and into which the business may seek to expand.

**SEGMENT PROFITABILITY**

Profitability details by segment grouping:

- Product/ Service
- Customer
- Gross Margin
- EBIT
- Indirect cost allocation impact

- **LENS 2 Segment and Product Profitability**

Having segmented the revenue streams it is now necessary to understand the profitability of each of the segments and product grouping (for product grouping read products and services) but not just at the gross margin level but at the EBIT level to take into account the cost to serve the customer segment not just the cost of the product.

The allocation of indirect costs to customer and product groups is to a degree subjective but there are tools to assist in this process for example activity based costing. Using this approach management can gain insight into which customer groups and products have low profitability or indeed may even incur a loss. A food processing business was of the opinion that its products and customers all more or less produced a similar percentage return as it based this analysis of the gross margin . However it failed to appreciate the cost of delivery; the cost of driving a van around London to deliver 2 boxes of product compared to 200 is very different and has a very considerable impact on customer profitability.

A medical products company ostensibly had a very profitable industrial first aid business. However, as the customers in this market segment made numerous daily small orders the company had an extremely large customer service department which mainly dealt with the order intake from the industrial first aid segment. Once the cost of this department's activity had been allocated appropriately, the industrial segment business no longer made a profit. This insight enabled the management to reconfigure how the industrial segment was serviced. Or the wine warehouse that charged customers on a per case basis but then allowed customers to request individual bottles of wine to be picked to make up cases introducing considerable complexity and cost into the business resulting in a number of major customers becoming exceedingly unprofitable.

**DYNAMIC MARKETS**

Forces for change:

- Pace of Change
- New Technology
- Regulation
- New entrants

- **LENS 3 - Forces for Change-**

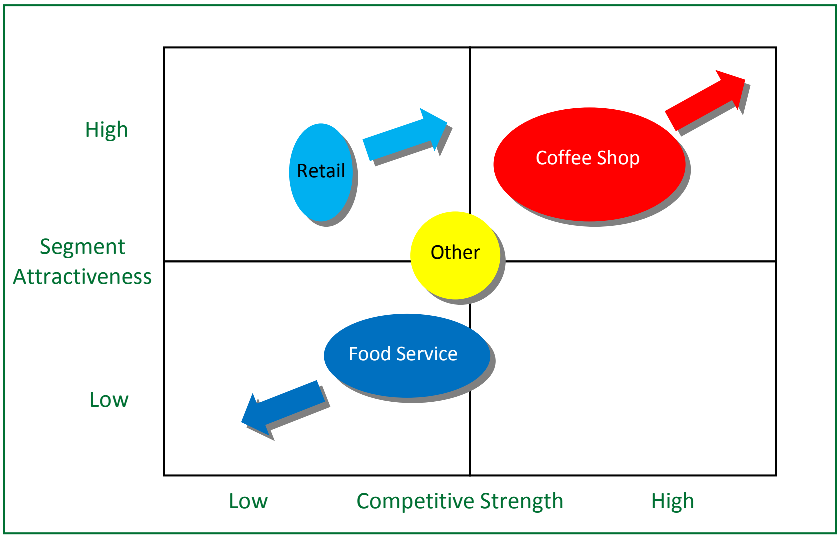
The advantage and disadvantage of markets is that they are dynamic. Simply because the business has a strong competitive position in a market segment at the present time does not mean it will last forever unless the business is able to undertake the necessary action to maintain its strength. Indeed the pace of change in numerous industries has quickened considerably over the last 20 years eroding the status quo.

Therefore, having assessed market segment attractiveness, competitive strengths and understood the profitability of such segments and product groupings, it is then necessary for the management team to give consideration to the major forces for change which will impact the market segments in the foreseeable future.

Such forces could be new competitors with a lower cost base, new products, new technologies, regulatory changes. What will such changes mean for the attractiveness of market segments and competitive strength of the business and most importantly how should the business respond in developing a growth strategy.

## Putting theory into practice

In an actual case the insight that was gained applying the above approach lead to a re-positioning of the business.




The case involved a food processing business. The figure on the right summarises its market position. The business had three main market segments, coffee shops, foodservice (e.g. Canteens in commercial, industrial and educational establishments) and to a lesser extent multiple retailers. Foodservice was the original core of the business. The size of the ovals in the above figure is an approximation of the absolute earnings contributed from the various segments. The arrows represent the direction of travel of the perceived opportunity for the business given the forces for change within the segment. Subsequent analysis of segment profitability by customer and product group delivered the result that there were 300 small food service customers that were currently loss-making and required action.

## How the growth strategy developed

The growth strategy for earnings and revenue contained the following themes;

- taking action in respect of the 300 small food service customers in order to enhance earnings within the segment.
- working with coffee shops to develop the food category both in terms of breadth and depth, for example the development of different sandwich offerings at improve margins , the development of breakfast offerings.
- improving the level of penetration in multiple retailers by a detailed analysis of the category offering and developing products to address the perceived category gaps, for example expanding the lunchtime desert offering in Boots.

The insight gained by using the three lenses outlined above was a key ingredient in the shift of this food processing business's strategy to achieve growth in both earnings and revenue.

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