



Your guide to
exploiting Profit Pools
and *delivering*
superior shareholder value.

Do you know where the real Profit Pools are?

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Ever had that feeling you've got a great business, but that it's not delivering the results it really deserves? More likely than not, you do have a great business – it is simply that its strengths are not being directed towards the right opportunities, or that those opportunities are not being well exploited.

This discussion outlines a new approach to market strategy – an orientation around 'cash-based' Profit Pools. In it, we outline what the right opportunities are, how to find them, and how to exploit them. In summary, we see that:

1. *Most businesses have a poor understanding of the nature of existing and prospect Profit Pools*

- a. GAAP distorts the profit picture: With large non-cash and tax adjustments, working capital changes, allocations etc.
- b. The right information is simply not available: No profit views by customer, channel, offering, or geography; grossly insufficient granularity, poorly allocated expenses and very limited competitor and partner information
- c. The right skills are not at right place: Separated skills in Finance and Marketing; Profit Pool strategies need a blend
- d. Management is not explicitly focusing on Profit Pools

2. *A Profit Pool driven market strategy has a dramatic impact to a business' intrinsic value*

No other aspect of business strategy has a greater impact on business value than market strategy, and no other approach to market strategy boosts Economic Profit over time (business value) than one oriented around Profit Pools

3. *The path forward starts first with getting a Profit Pool view of the existing business, and then to getting that view for new markets and crafting an attack centered on market cash profit potential*

1. What are Profit Pools?

A Profit Pool is a part of a market that offers some sort of economic return to participant players. A good Profit Pool offers a large amount of cash-based profit (we'll discuss the focus on cash later) over a certain amount of time into the future. A less attractive Profit Pool simply offers a smaller profit opportunity, while an unattractive Profit Pool offers net losses to its participants.

Simple enough in concept, though quite elusive to properly characterize and exploit.

The non-production printer market provides a simple illustration of a Profit Pool view. The offering comprises three parts; the printer machine (two types; ink and laser), supplies, and some level of service. In addition, customers are relatively distinguishable; in terms of size (Fortune 500, mid-size and SOHO), and in terms of industry.

Well, the most attractive market Profit Pool is the SOHO customer, in certain professional and retailing sectors, that buys ink printers. Interestingly, it is not that SOHO customers have the greatest demand for ink printers, because they don't.

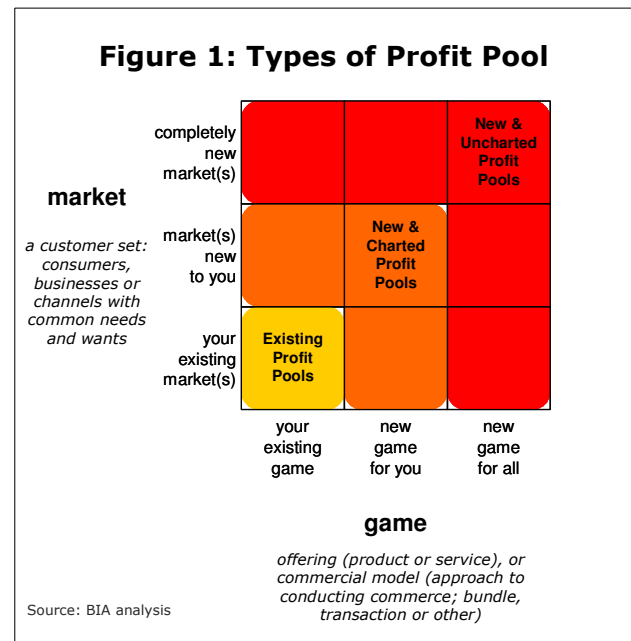
They are the most attractive Profit Pool because their lifetime profit contribution is the greatest of all other market Profit Pools. It turns out that SOHO customers do not have the purchasing departments that can efficiently analyze the per-page costs of ink, and use competitive bidding to achieve a more reasonable price. In addition to paying a far higher price, many types of SOHO customer (professional and retailers in particular) have a very high per-machine page throughput. Over time, the profit from a SOHO ink customer in these areas far outstrips others.

Conversely, a relatively unattractive Profit Pool is well illustrated by Fortune 500 laser printer customers. The laser printer's price point may be higher (largely driven by its production cost), and the volume of printers sold may be higher also, but the supplies prices have been negotiated down significantly by sophisticated buyers, and the per-machine throughputs are relatively low.

If you were investing in this market, where would you focus your incremental funds? Why is it that the existing players in the market do not seem to see which sectors deserve the highest priority for growth investments?

Types of Profit Pool

There are three types of Profit Pool when considering a move in the market. As in Figure 1, the first and most readily accessible Profit Pool is that already addressed by the business (marked as "Existing"). Here, Profit Pools are segments of the market already served by the business.



The second type (marked as "New & Charted") is an increment to the existing business. Here, the business is looking at taking the existing game ("offering" or "business model") into a new market/segment ("customer set"); or alternatively, expanding its servicing of an existing market/segment with a new offering/business model. Notably, in this type of Profit Pool the move to new markets/segments or offerings/business models has already been charted by others; competitors already exist there.

Finally, the third type of Profit Pool (marked as "New & Uncharted") refers to a move into uncharted areas. Little is known or established before entering these new areas; either there is low familiarity with customer needs, or the offering/business model has not been tried before, or both.

Existing Profit Pools

While it might be reasonably expected that a business is already extracting all the profit that it can from the market, it turns out that this is not the case at all. Existing Profit

Pools are actually a surprisingly rich source of improved performance and profitability.

In fact, we have found that most businesses have a very limited knowledge of their own performance in extracting cash-profits from markets. There appear to be four factors driving this (see detail in panel over):

- GAAP distorts the real profit picture
- The right information is simply not available
 - not enough granularity, and very limited view by customer, channel, offering, or geography
 - poor/inaccurate expense allocations
 - limited competitor and partner information
- The right skills are not at the right place
- Management is not explicitly focusing on Profit Pools

These four forces come together with devastating effect. Were it enough that the lack of visibility caused businesses to not focus on the good Profit Pools – that would be one thing – but the reality is that they also causes the business to serve areas where the Profit Pools are actually negative!

In our work, we observe this unfortunate situation with boring regularity. The value-creating effort being expended at one end of the business is actually being destroyed with cash-based losses – at *the same end of the business*, simply by serving the wrong part of the market.

One last note on Existing Profit Pools. The indications of internal cash-profitability discussed above are a proxy for, though not a substitute for an understanding of market profitability. A solid understanding of competitor, partner and customer economics, now and into the future, is essential to properly see where all the opportunities and trade-offs are, and to predict the behaviors of other market players and customers. This is explored in Section 3.

New Profit Pools

Naturally, one of the most powerful ways to increase shareholder value, indeed the entire business' value to all stakeholders, is to grow future cash-based profitability.

With this in mind, business must also search for growth in high cash-margin revenues, in addition to improving existing business performance. They need to be very careful, however, to ensure that they only grow in positive Profit Pools – the more positive, the better. Growth in Profit Pools where cash profitability is negative, results in a destruction of business value; negating all the efforts made in that Profit Pool, but also stealing the results of

efforts in positive Profit Pools. Such 'bad' growth is very common (and actually the base motivation for this paper).

Now, obtaining an understanding of New Profit Pools is mostly an exercise of looking externally, at competitors and others.

New Charted Profit Pools

By definition, charted Profit Pools have already been penetrated by participating players, and as such there is both information out there on their attractiveness (including current and future economics), and the market has an existing structure with working commercial models.

The first attribute, that there is existing information, makes it easier to identify and understand the nature of specific Profit Pools. It also allows a high level of risk mitigation – since new market entrants (should) know more on what they are getting to.

New market entrants need to get information and estimate the economics of existing players and that of un-penetrated parts of the market, now and into the future. Information needs include; economics of competitor and channel business models, market unit demand, customer value proposition and other factors – existing, and future. Only with this can the nature of those Profit Pools be understood and effectively leveraged in market strategy formulation.

It is worth adding that this external information is surprising available. Our experience shows that GAAP statements, pricing information, customer and channel sources, and public sources (including *legal* surveillance) are good enough to build a picture to manage by. Obviously, the information is not perfect and, of course, not as good as internal information.

We take the view that it is incumbent on management to get this information, and process it, as it underpins all thoughtful decisions at the strategic level. To the extent that information is not perfect, it does allow decisions to be informed – rather than uninformed – and it allows risk to be mitigated. Knowing specific risk areas, their magnitude, and the development of contingencies is a primary responsibility of managers - as agents of shareholders.

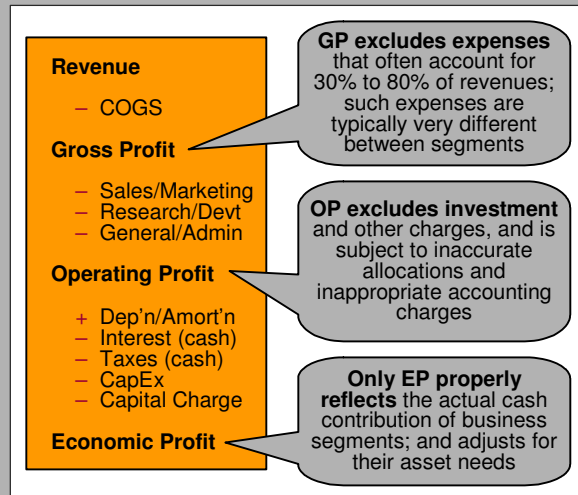
Further, in our work we continuously encounter situations where the absence of readily available information, or its proper processing, resulted in the destruction of vast amounts of shareholder value. This includes poorly invested cash, ongoing losses, etc.; far in excess of what it would have taken to develop insights before the investment

What's stopping me from seeing real profitability?

1. GAAP distorts the real picture:

A business's value to its shareholders is directly related to its ability to deliver a flow of cash to them – now and into the future. Oddly enough, this generation of cash is a notion this is very different from the reporting that the accounting industry has built, and the regulators have set in stone.

Regardless, most businesses rely on GAAP-based information systems to report performance to managers. The result is that profit reporting includes many artificial adjustments that accountants put in to smooth profit results. One example is depreciation – a 'non-cash' item that artificially stretches out the effect of cash investments; making them span several years. GAAP systems also distort tax payments, working capital changes, expense allocations and other items, as set out in Figure 2. Note that the newest distortion, in the press, uses convoluted calculations to expense employee options.



2. The right information is simply not available:

Not Enough Granularity: Only when armed with information on where the business is making cash profits, will the business be in a position to decide where to play, where to invest and grow, where to avoid, and what the inter-relationships need to be managed. An accurate view of profitability in each of four 'dimensions', and at the intersect between them, enables such insights:

- by customer set and customer
- by channel and channel partner
- by offering family, and specific offer (product / service)
- by geographic region or area

Poor Allocations: Most information systems do a very poor job allocating expenses. While standard costs tend to be well determined (primarily used in COGS), allocations below Gross Profit are typically very inaccurate - Marketing, Sales, R&D, and Administration - misleading decision-making as a result.

Limited Competitor Partner Information: With an understanding of the economics of channel and other value chain partners, managers may predict and alter partner behavior. Such information is very useful, though rarely pursued; leading to a mismanagement of channels and market positioning.

3. The right skills are not at the right place:

To get the sort of information would not be too difficult, except that most businesses (the larger they are, the worse it becomes) are organized with a Finance group, and a separate Marketing group. This structure is driven by the skills needs of each in *day-to-day* operations; the net result is that there tends to be few cross-skills in each silo - Finance recruits accountants, Marketing recruits product managers (for the most part). Insightful dissections of markets for cash profitability requires a blend of both skills; cutting through GAAP is itself a challenge, to say nothing of properly segmenting a market in an actionable and measurable way. Layered on top are the other usual inhibitors; differing motives (GAAP reporting in Finance, revenue in Marketing), incentives, turf-stakes and others.

4. Management is not explicitly focusing on Profit Pools:

Management generally focuses on near-term issues; which are difficult enough to get done in the day, without additional longer-term strategic demands. Naturally though, without continuously orienting decisions around Profit Pools, the business drifts into using other approaches.

and there is opportunity cost; the capital investment could have been made into Profit Pools that would have delivered solid returns.

The second attribute of Charted Profit Pools, that there is an existing commercial model in the market, results in less scope for new entrants to define market structure to their terms and strengths. In addition, the presence of an existing competitor set will undoubtedly make the market difficult to break into – and first-mover rewards have already gone.

New *Uncharted* Profit Pools

Uncharted Profit Pools have only rudimentary market information available (high-level ethnography and addressable market -type information), and there is no commercial model in use. This situation is a mirror reflection of Charted Profit Pools; risk due to the lack of information is high, while the limited opportunity to define the market, its offering and structure dramatically increases potential returns; as does the opportunity to be first mover.

With that said, it is still critical that managers considering a move into Uncharted Profit Pools gather the same type of information as in Charted Profit Pools to estimate their nature (including unit demand, potential customer value proposition, economics of potential business models, and etc.). Obviously, there is greater uncertainty over this information, making it much more important to understand the probabilities of outcomes and develop well considered contingencies and their associated triggers.

Profit Pool Attractiveness and the Business Model

A business model is the formula a business creates and uses to create value in product (or service) markets, and translate that value into cash flow to the capital markets (share and debt holders). It comprises the following (among others):

- The configuration of internal operations – including manufacturing structure, the organization, etc.
- The ‘commercial model’ – that is the structure of the transaction(s) with the customer and others, including pricing structure, bundling, etc.

Naturally, one business model is different from another – such that one player’s profitability is also different from another’s. This affects the total profit available in a Profit Pool, which may alter if shares were different or change.

This issue must be recognized by strategists, and the probabilities and impacts of differing business models need to be incorporated in future plans and contingencies (and investment-return assessments). In most situations the impact is relatively small in comparison with the order of magnitude differences between Profit Pools.

However, there are instances where business model variances do have a non-trivial impact – such as Dell’s introduction of a new operations configuration into the PC market; one that effectively gives them several points in profit margin above all competitors. Right now, the PC’s overall Profit Pool is much more attractive than it would be if one or more other players copied Dell’s model; in that scenario, profits would dip and PCs would not be as attractive an opportunity. Dell investors appear to be betting this will not happen.

A second interesting perspective on business models and understanding Profit Pools lies in a value chain view. Here, strategists need to look at Profit Pools across the flow by the offering to the end customer. This is important as they have an opportunity to alter the commercial model or other factors to cause a re-distribution of the overall Profit Pool across the value chain.

These and other issues and perspectives add a layer of complexity into the market strategy equation that allows the savvy manager to gain advantage. Strength in increasing shareholder value tends to circle back to add to competitive strength in product markets.

2. Why care about Profit Pools?

In short, no other aspect of business strategy has a greater impact on business value than market strategy, and no other approach to market strategy boosts Economic Profit, and thus business value, than one that is oriented around Profit Pools. It works like this:

We must start with the premise that the *intrinsic* value of a business (not its *market* value; which is subject to volatility arising from macro-economic and other near-term factors) is the present value of all future cash flow it is expected to generate (as first set out by Alfred Rappaport in 1981). This notion is almost universally accepted today; the cash generated by a business in each year going into the future is discounted to its value today, and simply summed.

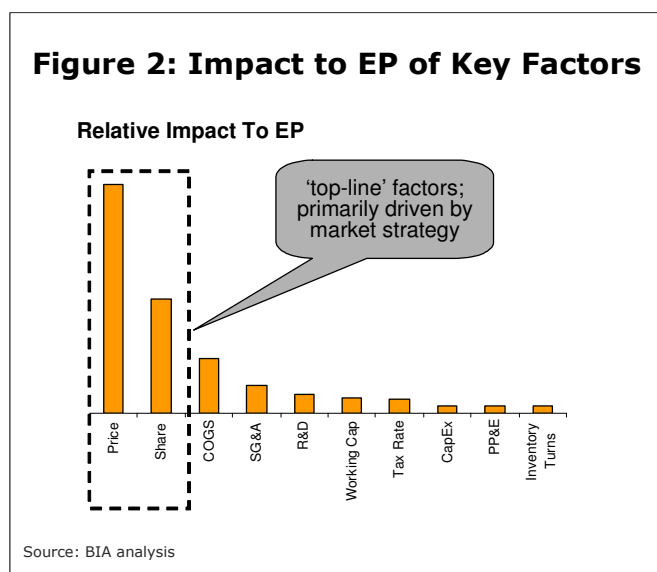
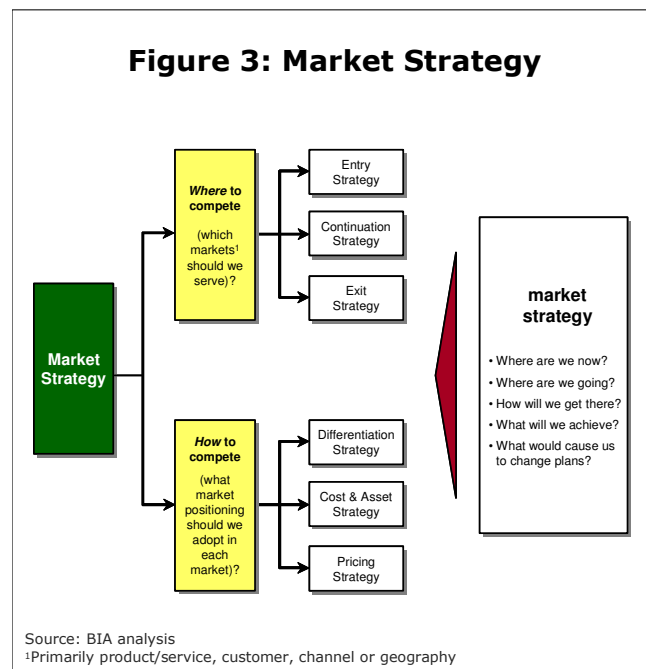


Figure 2 – compiled based on a composite of the economics of many businesses – illustrates the relative impact of key business economic factors on cash flow (in this case, Economic Profit; which includes a charge for the assets in use). As can be clearly seen from the chart, the most powerful drivers of cash flow are what we call ‘top-line’ factors – unit sales and price.

Market strategy governs the performance of these top-line factors more than any other aspect of business strategy. As shown in Figure 3, market strategy is a plan (needs to be continuously updated) that states with great specificity and appropriate detail; what parts of the market will the

business participate in, and, how will it compete in those market areas?



Such decisions have a direct bearing on the business’ ability to both grow profitably, and to compete. Success at competing has a direct impact to share, thus unit sales, and price, thus also profitability. In addition, success with profitable growth will only come if the targeted markets offer both increased penetration and/or expansion, and the opportunity for profitable commerce.

Now, a market strategy deliberately focused on deep, positive Profit Pools provides the maximum potential for a great *positive* impact to cash flow over time. Conversely, a lack of focus results in participation a non-trivial amount of ‘shallow’ – some even net loss-making – Profit Pools, resulting in less than optimal overall cash-flow.

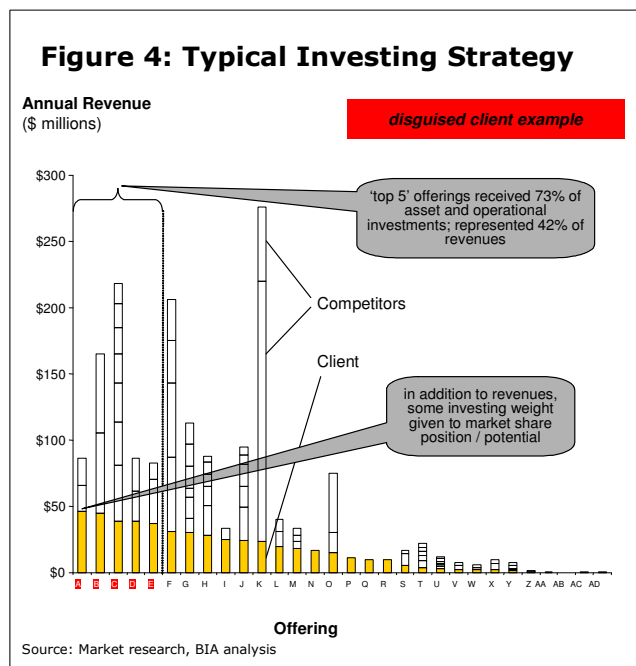
It is worth reiterating cautionary comments at this point. Markets with the largest revenue opportunity do not necessarily offer the best long-term profit opportunity. In fact, we frequently find the reverse is true; with many players in the large revenue markets, profitability has declined, and smaller markets become more attractive.

Take the example of the lubricant market; the profit opportunity in high-volume combustion engine segments is outstripped by that targeted – but well branded – WD-40 driven segment.

This phenomenon is not unique. Most industries are replete with examples of defensible segments being peeled off and exploited. This does not mean that large markets tend to be unattractive – as many are clearly attractive; it simply makes it incumbent on managers to seriously consider specialist and similar markets, and how they play in them.

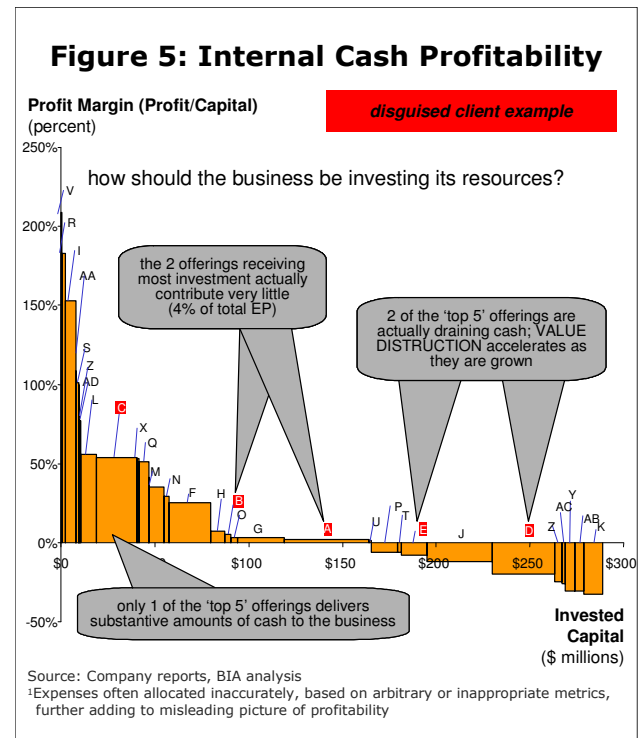
Caring about ‘Existing’ Profit Pools

We find most businesses orient investments (capital, market spend and human resources) around today’s revenue performance. Considerable emphasis is placed on historic revenue performance, though some weight is given to positioning issues, such as share, top ‘x’ positioning and the like. One such example is in Figure 4 (this client example has been disguised; suffice to say that it represented a range of product and service offerings to business customers):



The orientation towards investing in large revenue markets (the yellow bar represents the client’s revenues) is clear and obvious. This is a relatively common approach; almost applying the 80:20 rule; where 20% of offerings generate 80% of today’s revenue – and so (mistakenly) deserve 80% of investments.

However, the alternative view of the business is to look at Existing Profit Pools from an internal viewpoint. What we found is shown in Figure 5.



The insight revealed in this cash view of invested capital was that 40% of assets were actually driving losses. In fact, of the five offerings favored for investment resources, only one represented an attractive Profit Pool opportunity.

The view in Figure 5 is limited; though it is a first step to fine tuning the business and delivering superior returns. In particular, the view is single year (rather than future-oriented), internal-only (i.e. not looking at the market’s Profit Pool opportunity), and is limited since it looks at the business only by offering; and not addressing the same information by customer, channel and geography.

With this information, and information on inter-dependencies between the various offers and markets, management is in a far better position to make informed decisions on where to invest to grow profitably, and where to ‘manage’ businesses to, at a minimum, limit loss.

Caring about New Profit Pools

As mentioned above, one of the most powerful ways to increase shareholder value, indeed the entire business' value to all stakeholders, is to grow revenues that have attractive future cash-based margins. Again, care is needed to avoid the reverse.

As we have seen, GAAP-based profit measures (e.g. Gross and Operating Profit) are not only inaccurate – they are misleading. They mask offerings, or customers, or channels that are actually negative in cash-based profitability, since not all charges are incorporated. They also improperly allocate M&S, R&D and G&A – distorting the picture of relative attractiveness between opportunities – and they include many of the accountant's adjustments, such as non-cash depreciation and other charges.

Managers that are truly focused on maximizing shareholder value, *must* look at market opportunities through a *clean* cash-profit lens, and expend the needed effort to understand the true nature of market Profit Pools; this will dramatically mitigate the risk of investments by being better informed, and by understanding the situation and having contingencies and triggers for corrective action.

A quick ROI on the effort needed to get a good picture of the nature of market Profit Pools will almost always show that the effort is easily paid back, when considering the magnitude of all that is riding on a market entry.

Finally, in the case of considering new markets/segments that are as yet uncharted, managers are facing the risk of opportunity cost, in addition to that of as potential failure. Such an entry is really the creation of market/segment. If that process is not done right, such as in building the offer or business model, much of the potential value of that market could be lost.

3. What to do? How do we exploit Profit Pools?

Profit Pools offer an opportunity to get your cash-generation machine (your business) humming at an optimal rate. To make it work, however, the business' leaders must first embrace the focus on intrinsic shareholder value through cash-flow growth, and commit to the Profit Pool approach to market strategy.

In terms of practical steps, that means prioritizing parts of the market with the most attractive Profit Pools (even if they aren't great revenue sources), and competing with a business model that can extract high and sustained levels of profit, while capturing share (see Figure 3).

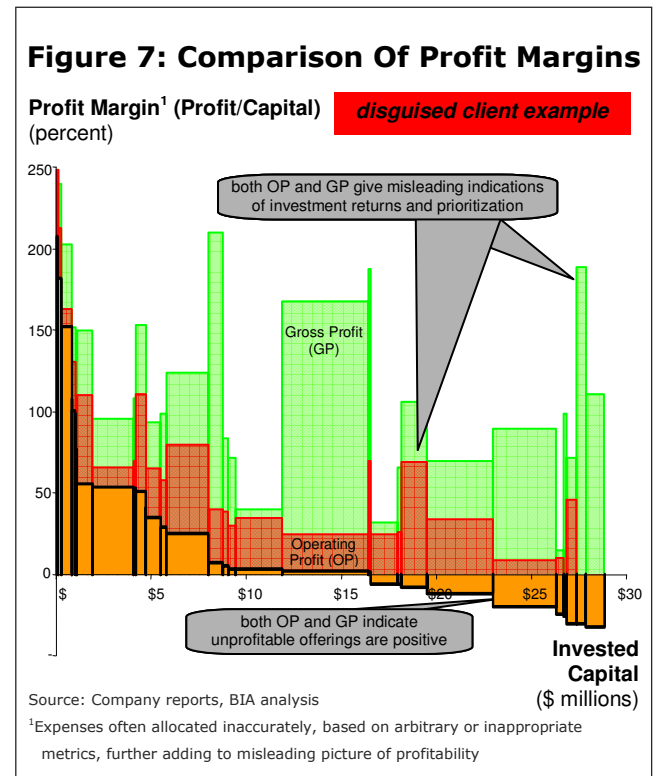
We encourage business leaders to address three sets of issue, as set out in Figure 6, in their efforts to adopt a Profit Pool driven market strategy:



Understand your own ACTUAL PERFORMANCE

The first step is to get visibility of your own business' profitability. This means an accurate and granular view of cash-based profits - by offering, customers, channels and geographies - using existing segmentation schemes.

As discussed above, this means that managers need to cut through GAAP. This is an important step, besides getting visibility, it re-orient's management's psyche around value-creating measures. To illustrate the importance of these, Figure 7 shows the impact of using cash-based measures, versus typical GAAP measures (note that GAAP measures have been corrected here to eliminate expense allocation inaccuracies, and adjusted to increase granularity).



Note how the use of Gross or Operating Profit would mislead management in two critical ways. First, the parts of the business on the right (in this case we are looking at offerings) are actually unprofitable as a result of tax, financing and other charges - where as GAAP measures paint them as positive contributors. The second issue is the prioritization the GAAP measures would have you work to; many of the offerings on the right have attractive Gross or Operating Profit profiles, and may actually be grown by managers - unaware that their growth actually destroys cash generation and value.

With this profitability picture in hand, the next step is to identify cross-relationships and inter-dependencies between each area of business. There is a temptation in business to be simplistic and simply 'lop-off' those offerings, customers, channels or geographies under the

line on the right side of the chart. This is a very dangerous point in the exercise as management has only half the picture; both the customer and the business itself (through bundling, etc.) are typically greatly inter-twined.

So, management needs to understand these inter-relationships well. The objective of this exercise is not to cut out parts of the market, but to improve performance. We can do this by identifying loss-making businesses and finding ways to get them to profitability (or letting them shrink). We can also do this by directing growth investments to Profit Pools that are known to deliver positive results.

With that said, actions should not be taken in either area without first obtaining a strategic view of the various markets.

Get a STRATEGIC VIEW of Markets

A strategic view is one that provides insights to the two issues addressed in Figure 3; where should the business compete – and, how should it compete in target areas?

To deliver this, an assessment of the attractiveness of markets areas (in this case, Profit Pools) is needed, as is an outline of the various competitive ‘plays’ or positionings that have been adopted (and un-adopted but viable).

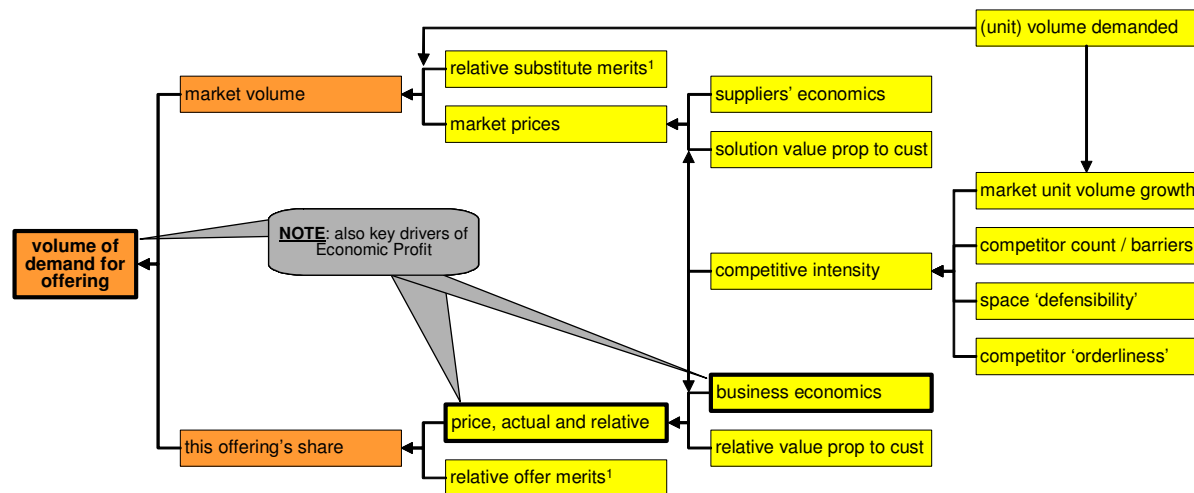
For existing and charted markets, much of this type of information is the same, and obtainable in similar ways and from similar sources. In the case of uncharted markets, additional techniques are needed as, in many ways, the market is as yet undefined.

For existing and charted markets

An understanding of existing and new markets has to start with segmentation. Segmentation is a crucial activity, as it is the basis upon which all targeting and competitive activities will be based. Segmentation is a very high-value activity. Unfortunately, it is not easy to come up with a powerful segmentation scheme from the start, and it is an iterative process.

We find that market analysis should begin with existing or known segmentation schemes along the four ‘dimensions’

Figure 8: Key Drivers Of Market Demand & Economics



Source: BIA analysis
¹Non-price; features / functionality

(offering, customers, channels and geographies), subsequently finding new and more useful schemes at a later date. Such other schemes must be crafted with two criteria in mind for segmentation; to be both measurable and actionable.

For example, we might start an analysis of the beverage market, in the customer ‘dimension,’ looking at all the usual suspects – age, ethnicity, income – and then come to notice that there is another scheme that reflects highly useful behavioral attributes; such as heavy users tend to be highly brand loyal. This is a critical insight, and loyalty drives premium prices and reduces certain competitive-related expenses. We can then find ways to measure and target heavy users; perhaps fine-tuning traditional measures (age, ethnicity, income), or identifying new ones (retail outlet type, etc.).

With our segmentation scheme settled, we have an object on which to develop a strategic view. We need to understand the various sizes of these segments, their future sizes, and future profitability. In this respect, the model outlined in Figure 8 is very useful:

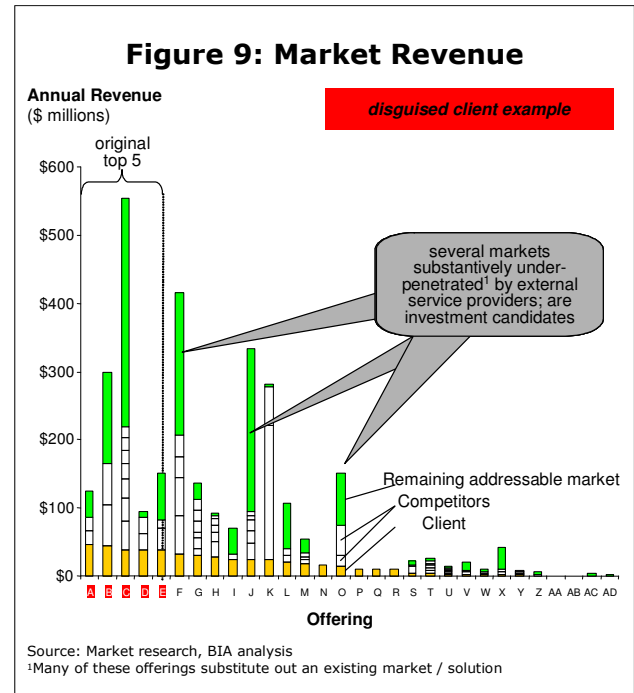
As can be seen, there are a number of elements of understanding (in yellow) that are needed. We will touch on three key ones here; though it is notable that many factors are inter-related, and drive each other (Figure 8 is somewhat simplistic, though it covers the bases):

Expected future demand: In the absence of any substitute solutions for the customer (a big assumption that needs to be investigated), an understanding of future demand is critical for estimating market unit sales, and highly influential for assessing competitive intensity (which tends to get worse in low-growth markets).

Competitive intensity: In competitively intense markets, pricing tends to be low, driving down returns and the attractiveness of Profit Pools. We can forecast competitive intensity through an understanding of factors such as the barriers to enter and exit a market, the ability to build a position that can be well defended (such as a strong brand, which customers appreciate in offerings that need trust – such as banks), or the liquidity of the market itself (liquid markets are relatively intensively competitive).

Price and offer merits (Customer Value Proposition): Price is often a function of business economics (for what returns is the business willing to deliver the offer) and Customer Value Proposition (which, in turn, entails a solid understanding of customer economics – particularly important to business customers). Though, competitive intensity plays a role, also.

Out of this analysis comes an assessment of the market’s current and potential revenue, shown in Figure 9:



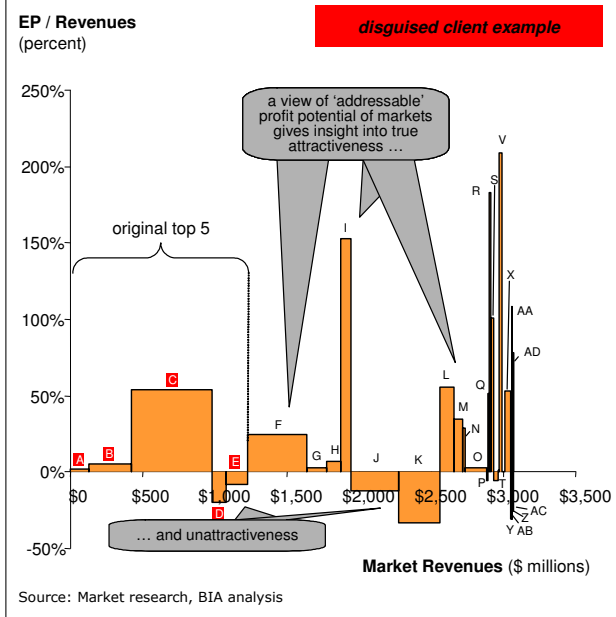
In this example, there is clearly an opportunity in certain areas to increase penetration and drive growth. However, we need to map in the insights we gained on future cash based profitability for the entire market – including competitors – based on existing offerings and business models. This we can see for the current year in Figure 10.

In this view we can see what the profit potential is for the year in the entire market. It is a very insightful picture for managers to have, as they can see what turf is worth fighting for.

To create this, we have developed an understanding of competitor economics at a relatively granular level. This is achieved by starting with GAAP statements, and gathering competitor information from a variety of sources:

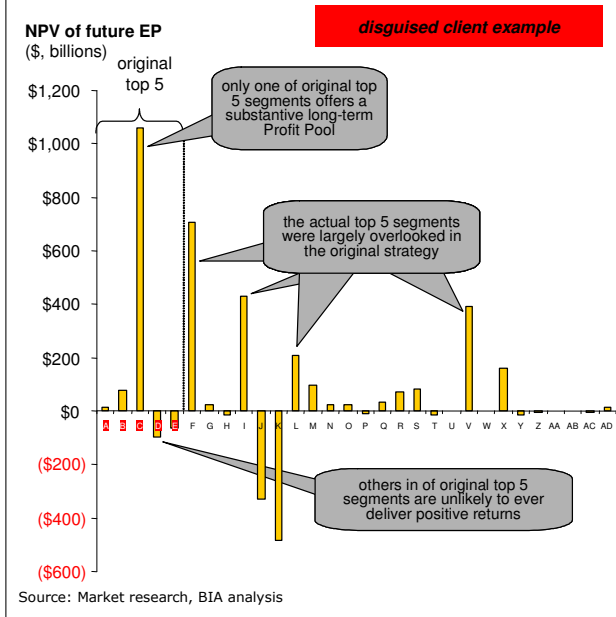
- Customers and channel partners
- Financial reports
- Company statements and press release
- Direct observation (factories, etc)
- Analyst reports (capital and product markets)

Figure 10: Market Profit Pools



Now, even this is not enough. Markets come and go, and it is critical to overlay a forecast of profitability. Continuing with this example we have the present value the total potential profit in each part of the market (Figure 11):

Figure 11: Market Profit Pools In Time



This perspective captures the growth and disappearance of markets over time. It accounts for low penetration in certain areas, and uses reasonable judgment to assess a reasonable amount of growth. It also captures the relative magnitude of the potential in each market.

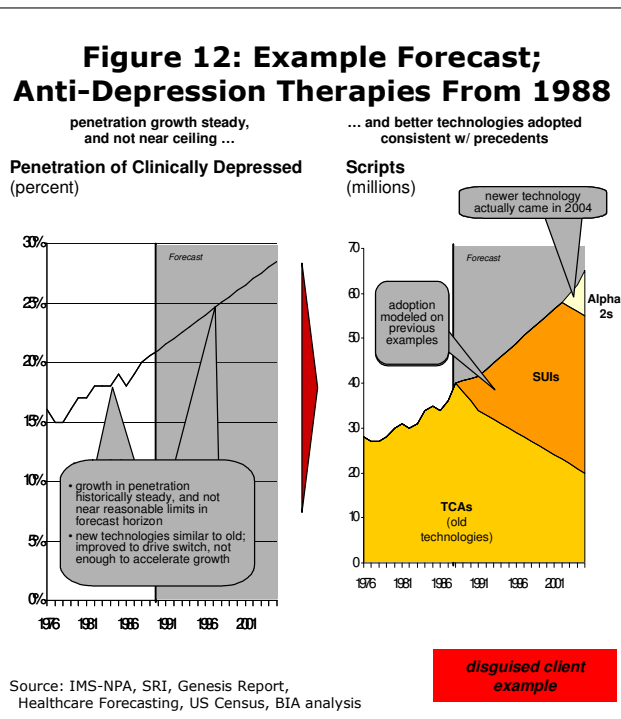
A short study of this chart and it becomes clear where management needs to be investing, and where it needs to be 'managing' poor performance.

Naturally, forecasts are never highly accurate. However, there is an order-of-magnitude certainty that is usually very high indeed, for purposes of comparing market opportunities.

There are four principals for forecasting in the formulation of market strategy:

- Developing market forecasts allows much better management decisions than uninformed decision (oddly enough, many managers today rarely think through issues of future profitability and total potential)
- Awareness of uncertainty, and its degree, facilitates improved contingencies and remedial action (the greater the uncertainty, the more alternative paths need to be thought through)
- Order of magnitude is often enough (other factors come to play in selecting markets to target, such as organizational strengths, etc., and we have found that order of magnitude assessments are good enough for input to such decisions)
- When viewed in hindsight, most market forecasts are highly accurate, for purposes of strategy and investments (we have found that organizations have a surprising amount of the core information needed to conduct market forecasts, and that when completed, the rationale and key 'way-point' used in the forecast have been enough to stand the test of time)

Figure 12 is an example of a forecast done for an anti-depressant over 15 years ago. In it, basic information was used to create an order of magnitude forecast of unit sales; such as continued patient penetration, availability of new technologies, etc..



This and many other forecasts have stood the test of time – certainly enough for management to weigh alternative investment strategies.

For uncharted markets

Without doubt, uncharted markets are more difficult to address than charted ones. Similar to the artist's white canvas issue; uncharted markets demand vision.

With that said, vision is not enough. Business acumen is needed to avoid getting into a 'Pool' that will never deliver a return to investors, and to avoid taking a good opportunity and creating a market business model that will also never deliver a return to investors. The three stepped approach in Figure 13 is very effective in understanding uncharted opportunities.

The first step is to develop a picture for each of the likely market outcomes. This starts with collecting baseline ideas from leaders, market specialists and observers, engineers and others. This is readily synthesized in a war-gaming exercise, where the market scenarios are worked out together with potential business models.

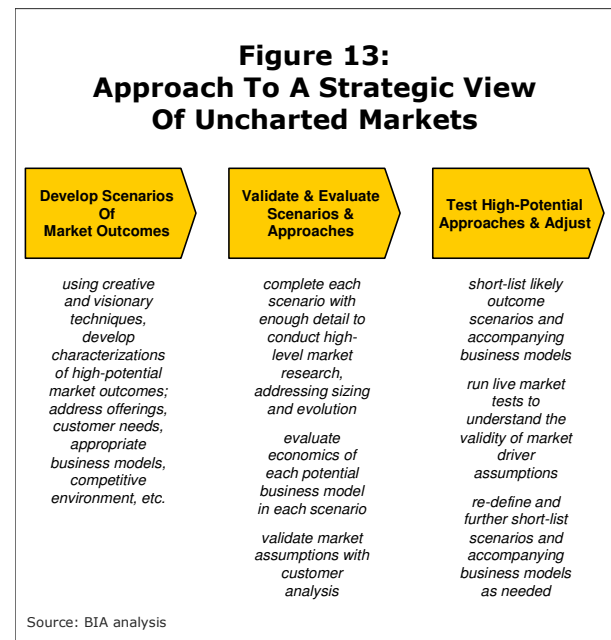
Such an exercise is very high-value; war-gaming pits the various interests against each other together within the limits of realistic frameworks to map how markets will

evolve. Such efforts need to be then be quantified in the second step to understand the economics of each scenario and business model.

In this step, the use of ranges and order of magnitude information is very useful. The target is, as in the efforts in 'existing' and 'charted' markets, to get down to an outline of what the time-adjusted market 'Profit Pool' looks like from an order of magnitude perspective.

Interestingly, this technique also uncovers a great deal of other useful management information, such as what the options are at any one point in market evolution, what decisions can be postponed, etc..

The last step is essential; without it, the path forward is very high-risk. The approach forward has been built on a certain number of assumptions – usually of the sort where customer behavior is assumed based on one 'driver' or other. In the third step, such drivers need to be tested.



Such testing can range from putting various proto-types into the market under differing business models, to isolating specific customer drivers and finding creative ways to address their validity.

One thing is for sure, in undefined markets, asking the customer what they want is useful as input, though they rarely have the vision to directly tell you what the offering

should look like in the end-game – and less likely to define a business model formula that is optimal for your business.

Define a path that EXPLOITS OPPORTUNITIES

In formulating the path forward, it is useful to consider the alternative generic market strategies and their typical risk/reward profiles and associated likelihood for success.

Generic Strategies

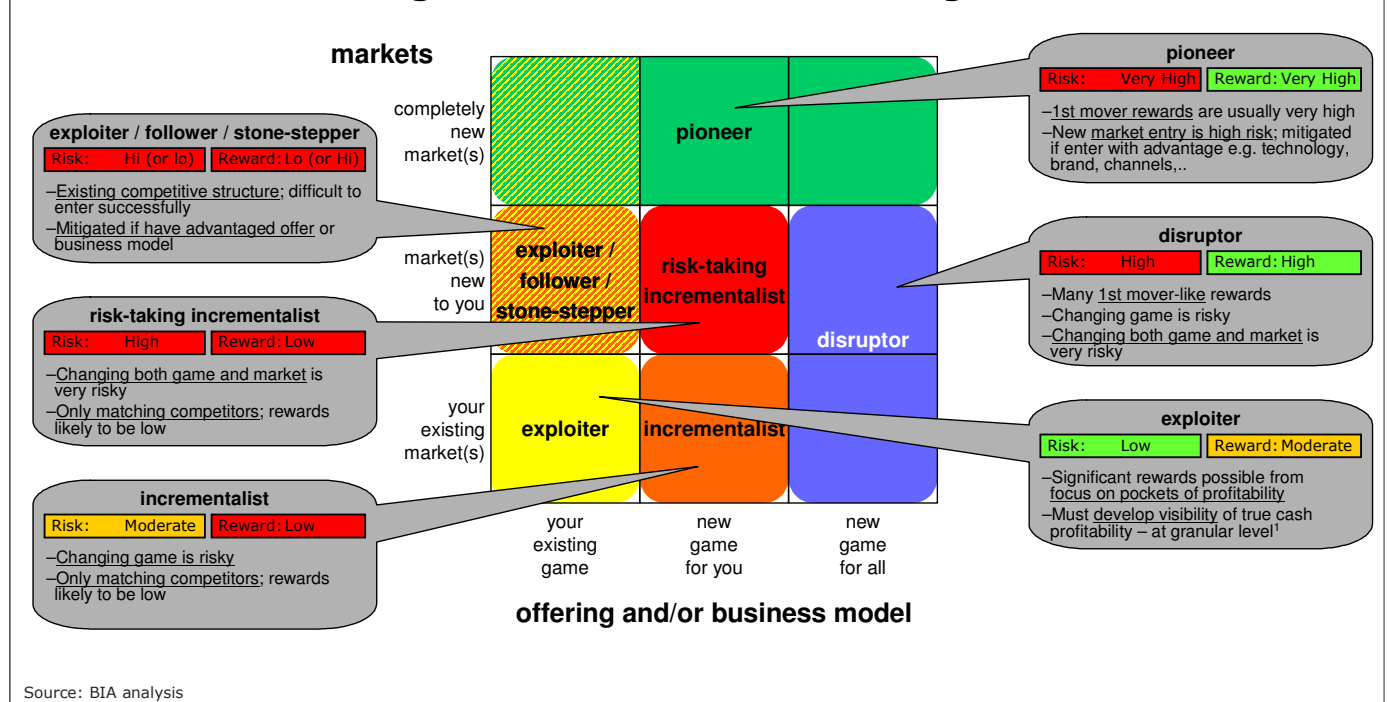
The two areas that market strategy addresses, where to compete, and how to play in those targeted areas, are reflected at a high-level in Figure 14. An existing business has the opportunity to move in one or both directions, and in doing so it can simply follow others, or it can do something new.

the business into competition with existing players. As such it does not offer as great an opportunity to capture the benefits of a first mover (which include a high probability of a dominating share position, and a superior pricing level based on a stronger brand or other position). See Figure 15 for an illustration of the typical share achievements of new market entrants – based on a composite of performances within several very different markets.

As a result, the Incrementalists are unlikely to get very good returns, while risking the chance of investing a great deal to enter the market.

The Risk-Taking Incrementalist has the additional burden of making headway in markets where there is no existing presence to build off; having to develop customer relationships from scratch. Having to develop both new customer sets and new offerings where there is already an

Figure 14: Generic Market Strategies



At a general level, there are a limited number of strategy types that are available. Each is discussed separately:

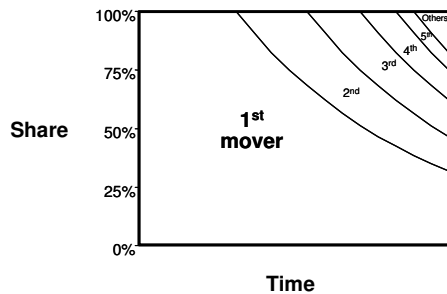
The Incrementalists: This strategy involves extending the offering to the business' existing customer set, or altering the business model (changing the terms of the transaction). By definition, the Incrementalist is a strategy that moves

existing base of competitors is very unlikely to result in success – or economic rewards.

The Exploiter / Follower / Stone Stepper: Expanding an existing offering / business model into new market areas (the 'Exploiter') does offer the opportunity for high-returns and low risk IF that offer / business model is truly

powerful. However, expanding an 'also-ran' offering / business model into new market area (the 'Follower') will only deliver the relatively low sort of returns that can be expected in the Incrementalist strategy.

Figure 15: First Mover Performance



The ('Stone Stepper') enters a new market area with the business' existing offering / business model. The purpose is to use such a move as a bridgehead into another market as a Pioneer (described below); the risk / return profile is very unpredictable.

The Disruptor: Taking a new offering / business model into an existing market has demonstrated itself to be a very effective market strategy. Here, the game is redefined, and a formula that improves both the customer value proposition and margins will deliver very attractive economic returns. First mover rewards are available to Disruptors.

Notably, since the customer market already exists, there is considerable existing knowledge available. This information and familiarity needs to be fully exploited to mitigate risk, and craft a business model that will actually deliver superior returns. The Disruptor strategy offers a very good risk/return profile – provided the strategy is formulated with an eye to Profit Pools and related techniques.

The Pioneer: Opening up a new market is one of the most high risk moves that can be made, particularly with a new offering or business model, and often reserved for venture capital. However, the first mover rewards are the highest of all when the right formula is found.

The risk level in the Disruptor and Pioneer strategies is high; making them particularly in need for the risk-mitigation information efforts discussed. Furthermore,

those same efforts will also reap rich rewards as they are also directed at defining high-return business models.

Strategy Formulation

In short, with the information base gathered, formulating strategy is a very situation specific exercise. The most useful approach is hypothesis based; that is, designing a set of viable strategic options, and evaluating them for business / shareholder value creation. The higher the risk, the greater the need to more fully understand potential evolution paths, and the greater the need to have solid contingency plans.

Such hypothesized strategic options set out which markets to target, and how to play. They also detail the offer, the business model, and the path forward.

In each of these considerations, the business' value can only have a chance of achieving its potential if it is focused on the most attractive Profit Pools.

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Leveraging market strategy to maximize cash flow and business value is a passion for Mr. Jones. Since the 1980s he has helped large and small technology clients find and exploit market Profit Pools; creating billions in cash flow.

Previous to Business Intelligence Associates, Mr. Jones was a Partner and practice leader in the Business Strategy practice of PricewaterhouseCoopers (PwC); engagements included assessing decisions on market entry and strategy, competitive tactics, investment and turnarounds. He led several Business Strategy practice areas, including Shareholder Value, eMarkets and the Technology sector. Before joining PwC, Mr. Jones was a project manager with Marakon Associates, where he served consumer, health and pharmaceuticals clients; prior to that he was New Product Manager with Thomson Consumer Electronics.

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Business Intelligence Associates is a global market strategy consultancy. We help clients maximize long-term cash profitability and shareholder value by finding and focusing on Profit Pools, and leveraging competitive strategies that drive returns.

Business Intelligence Associates was launched in 2002 by three Partners from the Business Strategy Consulting practice at PricewaterhouseCoopers. We have assembled a considerable body of proprietary intellectual capital at the intersection of shareholder value and market strategy; including market segmentation, Profit Pool targeting, competitive strategy formulation, and customer understanding through ethnography and other techniques.

We primarily work with C-suite managers at Fortune 500 companies, their business units, and other mid-market firms. Clients include Hewlett Packard, IBM, Liberty Media, Samsung and others.

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