Think Big, act small: Fail Forward With Brilliant* Mistakes

***9F's: Fail Forward, Factually, Fearlessly, Frugally, Faithfully, Flexibly, with Fun, Fast (Now!)**

"Think Big" is the "vision thing" but 95% of established companies can start by defining their historic, profit-strategy much better than they have, and then doing some critical, big and deeper thinking in that area. To do this we must do the four steps of "core management optimization" which are:

Specifically **define** a specific number of most profitable customers buying a specific number of most profitable products/services.

Refine/Renew our understanding of and of our "service value equation" for this core intersection of customers and products to a higher level.

Expand our profits from this core by another 20 to 100% due to a more focused, systematic selling of a better value proposition.

Extend/Leverage our business into new niches or markets using our enhanced core competencies and free resource flow which exceeds the financing needs of a dominated, slower-growing original core.

Don't pursue new customers or offerings until we are a dominant #1 at what we have historically done best in a heretofore unfocused manner.

Act small is putting a toe in the water instead of diving in headfirst. Taking rapid baby steps v. big jumps

Brilliant mistakes assumes that when we try new-to-us stuff, we won't be initially perfect. But, thanks to excellent upfront experiment design, the worst-case, downside cost of whatever we do try will be greatly exceeded by the value of the learning we get from the small experiment. We insure this brilliant cost/benefit return on every action by adhering to the design guidelines of the 9 F's in the sub-title.

AGENDA

1. Vocabulary in the title (breeze through)

2. How and Where to "Think Big":
   a. "The Core"
   b. Profit extremes (20/80 => 20/200)

3. Closing Questions

If we are going to increase our corporate capacity for effective innovation, then every employee will have to share a new vocabulary which adds up to the philosophy behind the title slide.

20/80 is Pareto's "power law" about typical wealth distribution amongst populations of country's regardless of the political/economic system in place. Other power laws with different numbers apply in other contexts. For example, 1% of the movies will get over 80% of ticket sales. About 10-20 of distribution customers will generate about 120-150% of the total internal profits. The excess over 100% then finances all of the losing customers in the portfolio.

My 20/200 law is that the 20% of the most profitable (or potentially so) customers within a distributors #1 core niche may generate about 120-150% of the current internal profits, but have an upside potential of 200% if a distributor will do: core management; a formal transformation effort on super-losing accounts into profitable ones; and do "the DURRR" –Downsize, Upgrade, Re-focus, Re-educate and Re-compensate- the salesforce. (article 4.11)

Sec. 1: “Think Big, Act Small”

A popular business book title

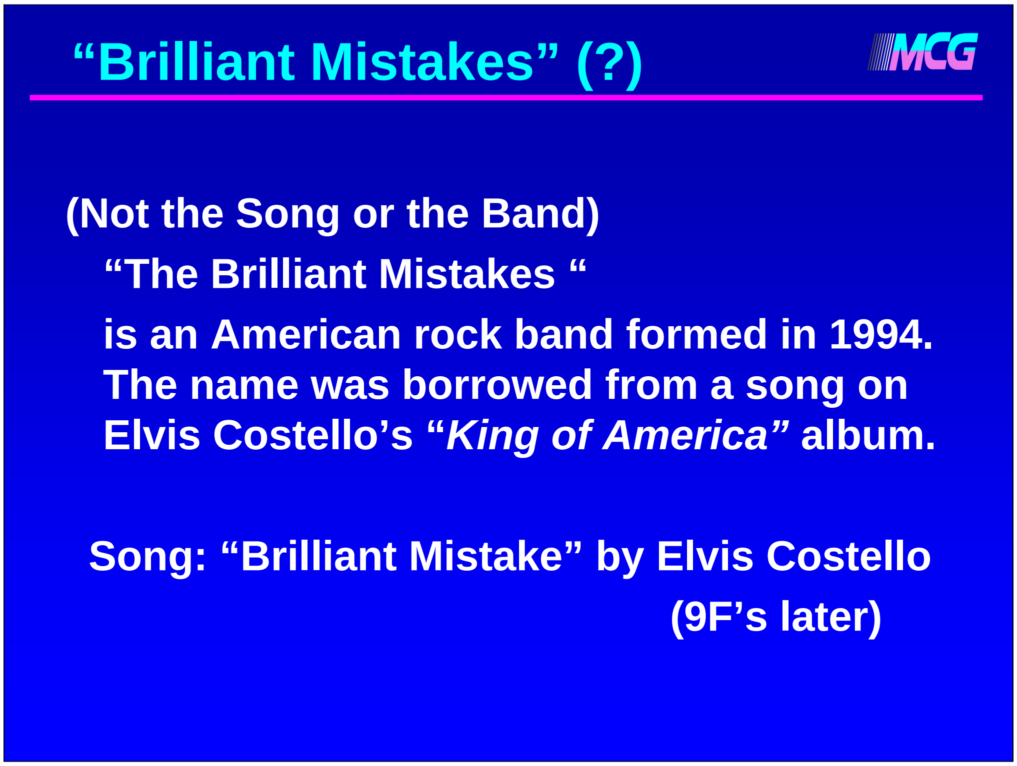
By Jason Jennings

Published in 2005

Many 5 star reviews (it’s OK)

Buy it used for $.01

Jason Jenning’s book is entitled: “Think Big, Act Small”. It’s an OK read; I bought it used at Amazon for $.01 + 4.00 shipping.



I googled "Brialliant Mistakes" and found out that there is a band that goes by that name. And, they got it from a song entitled "Brilliant Mistake" by Elvis Costello. I had not heard of either the band or the song before.

I just wanted to elevate making "good mistakes" to brilliant by adhering to more design guidelines (the 9 F's).

Today's Problems

- "Frugality is in" for 92% of the population
- L, job-loss Recovery = "New Normal"
- Retail (many industries) capacity over shoot to rationalize
- Cutting costs: necessary, but not "value"
- "Innovation" is the solution; but more risky than ever, because…
- Times are volatile and fast (4G's) shifting

Regardless of your economic weather forecast beliefs…Innovation is the only way to escape "margin gravity" defined below. (I personally belief that we are in for an L-shaped, stagflation "recovery".)

Margin gravity occurs when competitors all fine-tune their pasts and pursue industry best practices so that two or more head-to-head competitors compete in the same way leaving "price" as the only differentiator in the customers' minds. Competitors than compete on price to make no profit and hope to be the last competitor standing. But, suppliers and customers will always conspire to keep at least one other, me-too competitor going.

Companies that perpetually innovate to find new ways to lower total cost and/or increase customer value can grow and make good money while the fine-tuners of the past die.

Clearly we are in volatile economic and financial times (early 2010), and chip power is causing bandwidth and remote data processing and storage to become free. The software-as-a-service revolution will change informational insight economics for businesses that want to understand the how and whys.

Solution Pieces

Pick an Innovation Mind-Set Quadrant

Search first for “think big” ideas in:
- **“diamond core” and**
- **“black-hole loss” parts of your business**

Go from 20-80 to 20-200 Mgt. to:
- **Renew Core, Maximize, then Vector from**

Test ideas with brilliant (little) mistakes

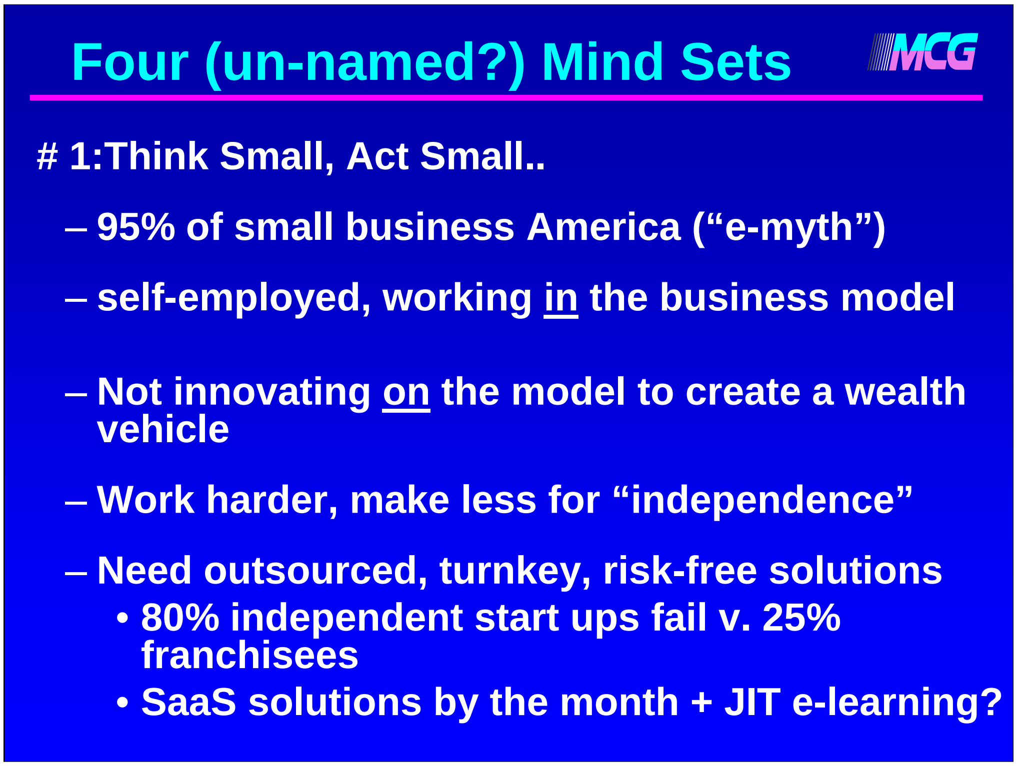
Think Big (or) Small (x) Act Big (or) Small creates four mind-set possibilities. Whatever our current (unconscious) mindset might be, we need to name it, own it and then re-assess it. I happen to think that the “Think Big, Act Small” (TBAS) is the best for innovating our way to premium success and wealth for all of our stakeholders.

With the use of both customer and item/supplier net-profitability ranking reports, distributors can zero in on the small intersections of:

Most profitable customers buying most profitable items with most efficient replenishment practices (**the diamond core**)

And, at the other extreme, the most unprofitable customers buying the most unprofitable items with most inefficient (on a total-cost, system basis for both parties) replenishment practices (the **black-hole** profit eater)

20-80 to 20/200 is covered in a previous slide.



This sub-section reviews the four main mindsets for running a business starting with Think Small, Act Small (TSAS) which is what growing-no-where, self-employed small business America overwhelmingly uses. (Well over 80% + of all small businesses according to “The E-Myth” and other research studies).

Although every small business owner will state that they are ambitious and want to make more money. If an owner is too busy working in their business instead of working on innovating their business model, then they will only go where the industry tide is taking their respective business ecosystem.

If a truly hard-working TSAS owner can be sold on buying into a turnkey solution which has built in strategic intelligence and/or operational effectiveness, then they can grow profitably. This is why franchisees of most successful business models will do so much better than independent startups.

There are, however, about 4% of business CEOs in every industry that are statistically the “visionary, early-adopting, perpetual innovators” who will buy new solutions and make them work. Find those customers and partner them to grow your own business by selling to and through them.

SaaS= software-as-a-service. This technology cluster will allow a lot of new, commercial information services to be delivered to small businesses.

Think Big, Act Small (TBAS) types are the most vocal complainers and critics at any forum of business owners. They often seem to be “smart” in a bookish, have lots of facts way. They may be oppositional, nit-picking critics who will find the exceptions to every rule. I sometimes think that they have big, look-at-and-listen-to-me ego needs, but perhaps it is just a combination of:

1. being afraid to change within their own business;
2. needing to desperately protect the past (as they imagined it); and
3. feeling entitled to a democratically fair, social-justice deal.

The town hall meetings over the “new Wal-Mart store” that is trying to be opened is populated with these types. My view on WMT, BTW, isn’t that the company is good or bad, its just competes ruthlessly within the rules of free-market capitalism. The real problem is the 85% of the driving-able shoppers in the US who have visited a WMT store one or more times in the past year. Shouldn’t we lock them up for freely choosing to drive buy other (small business) competitors who offer smaller, one-stop-shop assortments at lower fill-rates and much higher prices? ☺

WMT is a perpetual innovating company that has TBAS roots and failed forward to pioneer continuous replenishment. If your business is being threatened by a perpetual innovator, then either meet and beat their innovation prowess or find some (niche) grass between the feet of where this elephant walks.

#3: Think Big, Act Big

Old-school, hard-work/lucky/ruthless success who can't adapt to next model

Dreamers, Promoters (Con), gamblers, new-deal politicians (all with "OPM") that go bust when tide shifts

VC/IPO$'s x new industry platform:

– E.g. Staples 5/86…not in today's climate

One guy out of how many wins the power-ball lottery, and the media trumpets it. The media does not report, however, the daily totals for how many people bet and lost money that they couldn't afford to lose. Gambling with hope as a strategy and betting big is not the best mindset for sustainable success.

And, business winners will revise history. I don't hear Bill Gates confessing in an auto-biography about the string of lucky breaks (each one of which he did, to his credit, take advantage of) that he got to have a near monopoly on PC operating software.

Best to TBAS to MAKE your own luck by minimizing downside risks while maximizing upside gain potentials.

#4: Think Big, Act Small

- Solid, ambitious vision
- Respect for unpredictable, accelerating-change environment
- Ever easier to design great experiments
- Easier to outsource all but key value step

The change in the business and economic environment is picking up as everyone in the world is connected to all of the information and outsourced resources they need through what quickly will become a free mobile information device.

It’s faster and easier to do research on any theory thanks to google. It’s faster and easier to do thought experiments and computerized simulations with potential co-creator partners thanks to business intelligence informational insights, go-to-meetings, etc.

Revise “Think Big” Quotes:

“Think big, believe big, act big, and the results will be big.”

“What the mind can conceive and believe it can achieve.”

If at first you don’t succeed, try, try again (presumably smarter in a right direction).

(Or) "Stupid people make stupid mistakes. Brilliant people make brilliant mistakes."

Rohan Kar

First quote: add: “if you are pursuing an idea for which you are uniquely competent at and credible and then win the lottery”

Second quote: again is the idea strategically sound, well-suited to our capabilities and context and sharply focused?

Third quote: totally devoid of any strategic direction in which case any path will take you somewhere which will be statistically not rewarding

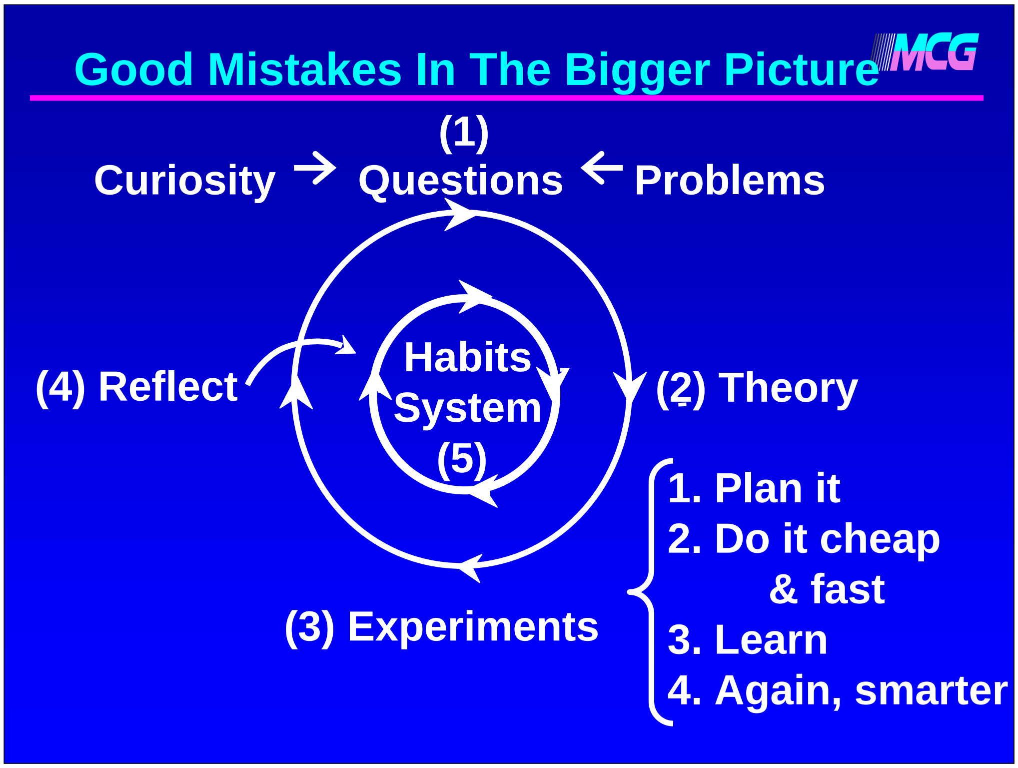
Fourth quote: so what are the guidelines for designing and executing “brilliant mistakes”?

How to Act Small/Smart?

1. **Introduce a new experimental philosophy/grammar to your corporate culture**
2. **Apply Scorecard Criteria (9F's) retrospectively to some past initiatives to create case studies (weak to strong)**
3. **Then apply scorecard x all new experiments**
4. **Your first, fail forward assignment is to experiment with:**

   "Good-Mistake, Design Capability"

The 4 mind-sets and the 9F's are vocabulary/grammar concepts that you can adopt and adapt to your firm to increase your collective ability to innovate better.



"Pushing the wheel of learning" and the four-step sub-set for experiments is describe in detail in exhibit #24 at www.merrifield.com;

http://www.merrifield.com/exhibits/Make_Lots_of_Good_Cheap_Mistakes.pdf

Each step – questions, theories, experiments, reflection – take special skills that are rarely found in one individual. In any organization, there will be, conversely, some people who have great challenges with executing or coping with one or more of the steps. Don't let them kill the process.

These are the nine design guidelines. They don’t have to happen in the exact, chronological, linear way that I have listed them above. Nor, do they all have to be included.

I did purposely put the biggest hurdle “FEAR” in the #6 spot with the assumption that the more design steps we do and discuss before acting, the more the general fear levels, which can vary widely, amongst any group of employees will drop.

“Fail” Our Way To Mastery

- **No one does anything worthwhile perfectly the first time**
- **Best-takes-all mastery takes time & insight**
- **Failure is an event, not a person**
- **Design in affordable limits to downside**

“Worst case cost is “X” and least possible benefits are 2X+, and we will all still love you so: why not try it?”

The first F stands for “FAIL”. The presumption is that if we try anything new for the first time –that is worthwhile- then we will FAIL to some degree. No one does anything worthwhile perfectly the first time. If we are innovating, then no one in our competitive sphere –that we know of- has ever before done what we are considering.

In kinesthetic disciplines (sports, instrument playing) experts will practice 4 hours a day, six days a year for 10 years to become outstanding. <u>They will fail their way all the way to excellence</u>, because playing people (or musical pieces) that are a little better than your ability is the way to stretch your understanding, ability and motivation.

We need to teach the learning how to learn concepts that go into **“Mastery”.** (Great small book gem by that title by George Leonard.) Every employee should at least be aspiring to be a black belt X degree performer at their current job which then makes them promote-able, because they have proven to both management and themselves that they have “learned how to learn” and presumably can do it again in a next-level position.

Good entrepreneurs aren’t “risk-takers”, because they are so good at minimizing the downside and maximizing the upside of whatever innovative step they take.

"Forward"

- Connotes some strategic path/direction
- Start with a vision space hunch; specific goals can come later
- Think Lewis & Clark: "head west"
- Columbus: sail west to get to the east
- Have to blaze a trail & make the map to get premium profits v. me-too, slow death

Failing "forward" suggests that we do have some "north star" for a strategic direction. Most of us are scared about blazing a new trail towards that vision, because:

We don't have a how-to, cook-book recipe or detailed map for moving forward that has been endorsed by industry experts and is consistent with out general group-think/feelings.

We don't have the expert skills at doing whatever the new experimental step is demanding (no one else does either).

As an expert manager we don't have any specific, "I know what we are doing answers" for any followers. The idea of "we will make it up as we blaze our own trail to the distant mountain peak that we want to get to" isn't comforting to most, vocal followers or critics.

Perhaps about 10% of the human gene pool has brain wiring/chemistry that just won't let them change from past orthodoxies which they will therefore defend tenaciously and loudly. This in turn affects a big percent of the followers who don't know what to think or feel.

The upside realities, though, are that:

If we copy what every one else is doing, then we have a commodity-for-a-price proposition. Only innovators can grow faster and more profitably than the herd's financial outcome numbers.

If we are very strategically focused and design our experiments very well and small, then our upside learning if not economic results will far exceed our small risk/cost/tuition outlays.

"Factually"

- Make data-driven management decisions
- Otherwise, loudest, highest paid, most experienced, golden-gut opinion wins
- Is the (scientific) experiment so designed that:
  - we can learn from it and/or
  - the cost/time to do it is trivial?
  - It's aimed at a strategic, profitable target?

An amazing amount of corporate resources our bet on "experienced" hunches. Then when things don't work – at a greater cost and elapsed time than necessary - no one is sure why or what can be learned from the failed experiment.

We can't make smaller, smarter resource bets with bigger upside potential without upfront informational insights that other competitors don't have. Then, we can't track how well the experiment is working without good tracking reports. So, designing our own best business intelligence analysis and tracking tools is a key pre-requisite for making brilliant mistakes.

Fortunately for distributors, there is a business intelligence service from Waypoint Analytics which is a breakthrough cost/benefit value that will allow whole new levels of innovation to happen. More about that service from Waypoint Analytics at www.quantumprofitmanagement.com.

Frugally (1)

- **Frugality starts in the idea pipeline:**

  -- Get one great, high-ROIR* idea by starting with a lot of good ones

  -- Brainstorm on ideas in best, think-big opportunity ponds. . .then develop down the pipeline

*** ROIR= return on invested resources**

If we are cleverly inexpensive about how we rapidly experiment with an idea for creating new value and/or more cost efficiency, then we don't have to be so scared of the downside costs of our necessary, partial failures on the path to success.

One problem many companies have is not first generating enough "good" ideas that must compete with each other. The next three slides are inserts that illustrate an "innovation management" sub-set skill called "ideation". The main concept is that in order to have one fantastic idea we should first start out with a lot of good ideas to analyze, discuss, simulate and prototype to get down to one highly evolved, excellent for us experiment to bet on.

“Ideation”: Terms & Mgt.

1. ***Opportunity*** **= Gap between today & envisioned future**
2. ***Idea*** **- Embryo of new product or service**
   Raw **- unwritten (even unspoken & unstirred)**
   first thinking is old thinking
   Submitted **= Written - 1 line**
   Researched **= Written - 1 page**
3. ***Concept*** **= Well-defined; written; & visual form**
4. ***Portfolio funnel odds*****?**

If we could get in the habit of writing simple one page briefs on any ideas quickly to answer or at least raise the basic questions:

What’s being proposed?

Why?

Who would benefit; how and how much?

What would it cost in time, talent , treasure and any other resources?

What’s the upside potential: worst, likely and best case scenario/odds

What’s the downside risk: most, likely, least?

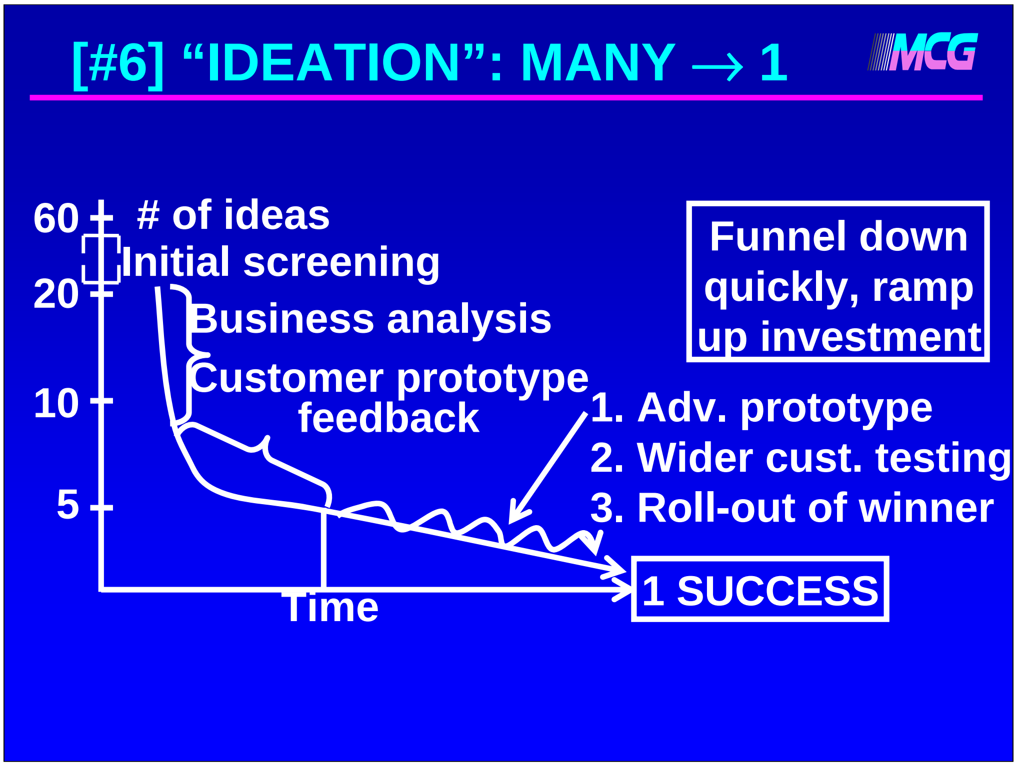
Why is this a good strategic fit for who we are, what we can do and where we want to grow to?

What are our underlying (unspoken?) assumptions about why this is a good idea?

What are some big unanswered questions or more information we would like to have?

For questions we don’t have immediate, somewhat solid answers for, we can jot down one or two additional research steps that we can take quickly to get a better fix on the questions.

At this stage it is better to focus on finding the right, best, most compelling questions, than answers or even trying to rate the relative attractiveness of each idea. Then a champion for each idea can do some research, report back and very quickly some ideas will evolve to have greater or lesser appeal.

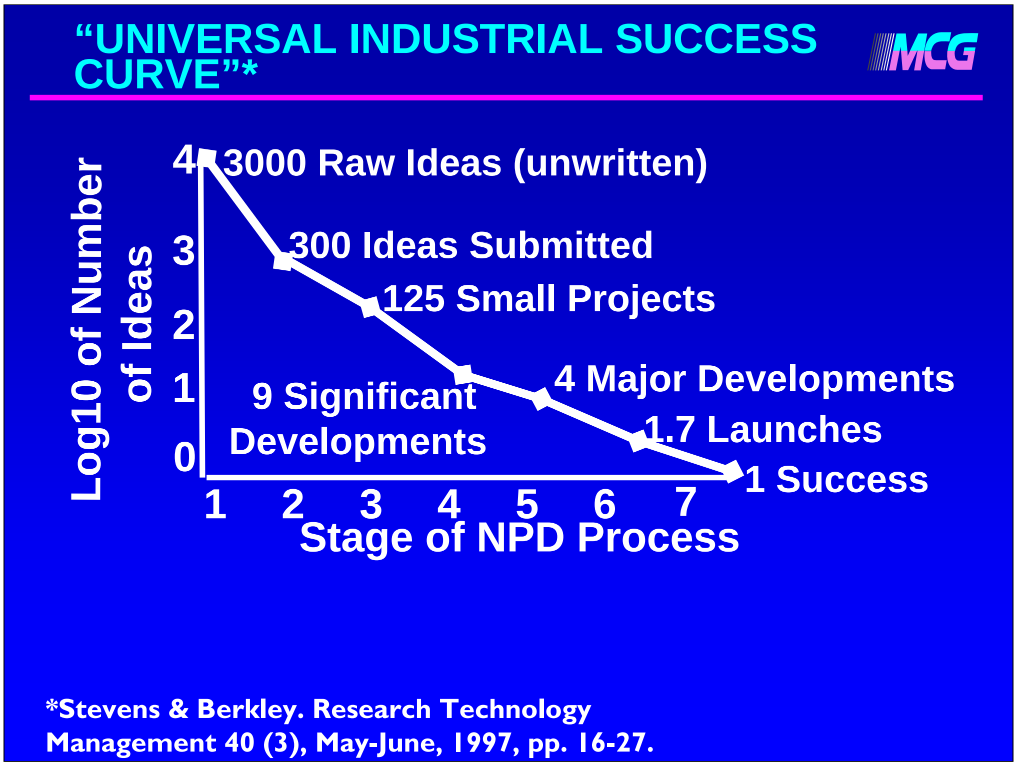


Note how many ideas get sidelined from simple "business analysis". The idea is to winnow the ideas down as quickly as possible to allow increasingly more resources to be put into fewer, ever-better-evolving ones.

Part of identifying and then analyzing a lot of small, calculated-bet ideas are *having access to good profitability ranking analytics for all of the elements* – customers, items/suppliers, and sales territories- within a distribution businesses sales activity mass. **Why** is the single biggest losing customer or supplier that way? What sub-profit-ranking reports do you have to break the bigger problem – losing money- into smaller contributing pieces to then analyze and rethink the vital few, big elemental contributors?

An "idea" could be one extremely profitable or unprofitable customer or supplier or even an item of one supplier at a time.

Again, Waypoint Analytics' "quantum profit management service" will serve as an idea generator, idea analyzer and an let's-go-with-it idea progress tracker and even compensator, because incentives can be based on "net profit" after the "cost to serve" has been subtracted out of sales activity.



This is an actual case study illustrating the winnowing steps of the ideation pipeline. Note that only 10% of the raw ideas even got a short written document submitted (3000 raw ideas to 300). Another big reduction occurred from "small projects" (125) to "major developments" (4).

What (quick-and-dirty experiment) would your company's pipeline look like for the past 1-2 years?

Frugally (2)

- Frugality continues in design of experiments:
  - -- Brainstorming to get the right, best questions in the right best order is cheap
  - -- "What if" conversations with best, right 2-3 people is cheap.
  - -- $20 for 20" survey with best, few people is trivial.
  - -- Living with, into - best questions/thought experiments- reduces actual test execution costs.
- Then, acting Small and Fast => lower costs

How can we do what we are thinking about more frugally, simpler and faster? These are guideline questions that we need to ask ourselves at every step of the idea pipeline process. They are, of course, inter-related: "simple" usually reduces the cost and time. If we do it fast, we can't make it complex and expensive.

The overall general math assumption is that: if we can fail earlier and often to learn the most for the least cost, then we can ultimately innovate successfully sooner, better and cheaper than if we tried to go big and right the first time.

Add’l Cost Benefit Thoughts

- **Minimize the downside risks and expense**
- **Maximize the upside, 35\60-degree learning**
- **Least-learning to max. expense ratio**
  = Tuitional bargain
- **Co-create it with a team (including best customers) quickly to discover:**
  -- “Best ideas that I never initially had”
  -- Targeted serendipity

“Maximize 360 degree learning”: we can do this if we make sure that we get everyone who might have a perspective on the experiment or be influenced by whatever we are proposing to weigh in before and after the experiment. Too often a (project) champion is viewing the whole process through their functional and personal view of the world.

“Co-create it with a team including the target beneficiaries” ..I’ve read of day long contests in which teams that each have whole-brained company members blended with most progressive customers competing to present the best new value/cost-reduction ideas. And, the best ideas emerge spontaneously out the clash of views: ones that no one initially even had.

Serendipity is accidental discoveries for the good. But, if we are fishing where the biggest, hungriest fish are that best like our company bait, then the odds of getting lucky go up. Let’s both wake up and make our own luck.

“Faithfully”(1)

MCG

We believe that:

Failing is necessary to get better

“We do that already” isn’t black belt 10th

Businesses must change the rules to succeed (at triune brain discomfort)

Strategic focus/direction is good

In a comparable-measurement vacuum, most people think that they are “pretty good” at what they are doing if not a “black belt” performer.

In sports, how we perform is much more instantly - visible; measurable; and comparable- than in business roles. In any service process activity, we can - with not much work - start to put performances into more measurable piles and then measurably start to explain why , - for example, a “10” sales rep is better than and different than a “1” in the customers’ minds.

“Triune Brain discomfort”? The human brain has three parts: at the base, the reptilian (fight, flight, freeze; if ti works don’t change it); then the mammalian (which makes a herd animals in search of conformity, harmony and nurturance); and then the cerebral cortex for rational thinking. The reptilian brain does not like change, if things seem to be fine in the moment. The mammalian part does not like to do anything that the herd is not doing (groupthink and industry best practices is good).

“Loved regardless” touches on the assumption that “failure” is a small, temporary, learning step-stone as opposed to a personal-character flaw. We should, in fact, publicly praise all who do fail forward brilliantly. (See article 6.3 on praising statements.) I encourage all CEOs to make case studies out of both their brilliant and not-so-brilliant mistakes. The latter being examples of how we would have redesigned the experiments better if we could do all over again, which well you might.

“It’s all good” is a popular phrasing of the Buddhist belief that only death is final. Otherwise, every set back has its own lessons. If we have ego-driven addictions and aversions that keep us from failing/learning forward, than we need to convert those to mild preferences so that we don’t hold ourselves and all other stakeholders back.

“Serendipitous” benefits, allies, chain-reaction events will happen. If we have good: strategic thinking; co-creative partner selection; and good experiment design, then we will be addressing real needs that need good new answers and the dynamic market economy will be attracted to supporting our initiative. So, stay 360-degree vigilant and mentally flexible. Even big negative reactions from partners is the tip of some hidden big need (and new learning for us) that we can in judo fashion handle. Throw them where they want to go.

“Faithfully”(3)

We believe that when pitching new stuff:

The offerings co-created with leading edge customers will sell better to rest.

Initial “no’s” from customers aren’t final; they have fears of buying that require repetitive, comfort-zoning, ed. marketing.
(the adoption curve does apply)

If we can create new, “extra” services that allow us to sell to and through our best customers on both a lower total cost-to-serve basis (for us) as well as a lower total-procurement-cost (for the customer) basis, then those solutions should also sell well to other similar (homogeneous) customers. And, the first users of our new, inter-business process re-engineering ideas can often serve as credible testimonials to our next wave of customers.

“Initial No’s” are to be expected, and the bigger and more repetitive they will be as the complexity and true newness of our solutions increases. Most people take 5 to 7 repetitions of being educated about a new (system) solution before they really start to understand it. Then, we will have to hold their hand and co-install it “failing forward”, because they have never seen it or done it before themselves.

The adoption curve which ranges from “visionary first users” to “late adopters” is a reality for the human gene pool. Big innovations – like quantum physics or giving women the right to vote in the US – require a next generation to grow up with the idea before the “late majority” will embrace it. And, in those cases, the late majority does not consciously switch from the old way to the new way. They just grow up from birth in the “new way” environment.

Next: The Biggest F, “Fear”

If we apply the 5 why’s analytical technique to “why are you/we afraid to change from the old way to new proposed way?” We may get several levels of stall answers, but getting to the bottom, root of the fear which is: “if failure can be attributed to me, then I won’t be loved and then I will die”. This is totally irrational to both the listener and the speakers cerebral cortexes, but it is the emotional gist of what comes out of the first two levels of most triune brains that grew up with a lot of “obey the rules” from authority figures we were dependent upon.

The amygdala in the lowest, reptilian-part of our triune brain freaks out if we change from something that seems to be working. As creatures of nature, we exist in a natural world that may take generations to change, so if any path to the water hole initially and randomly works safely, than never deviate from that path.

The rational part of our brain can comprehend, however, that:

In the business world, the innovators are always changing the rules to get an advantage.

The accumulated change from all of the innovators in free markets is creating ever-faster environmental change.

If we don’t change (adapt) as fast as the collective change around us, we will commercially die for sure (not physically before our time arrives).

If we change faster and strategically more proactively than the environment than we can thrive not just survive.

“Fearlessly” (1)

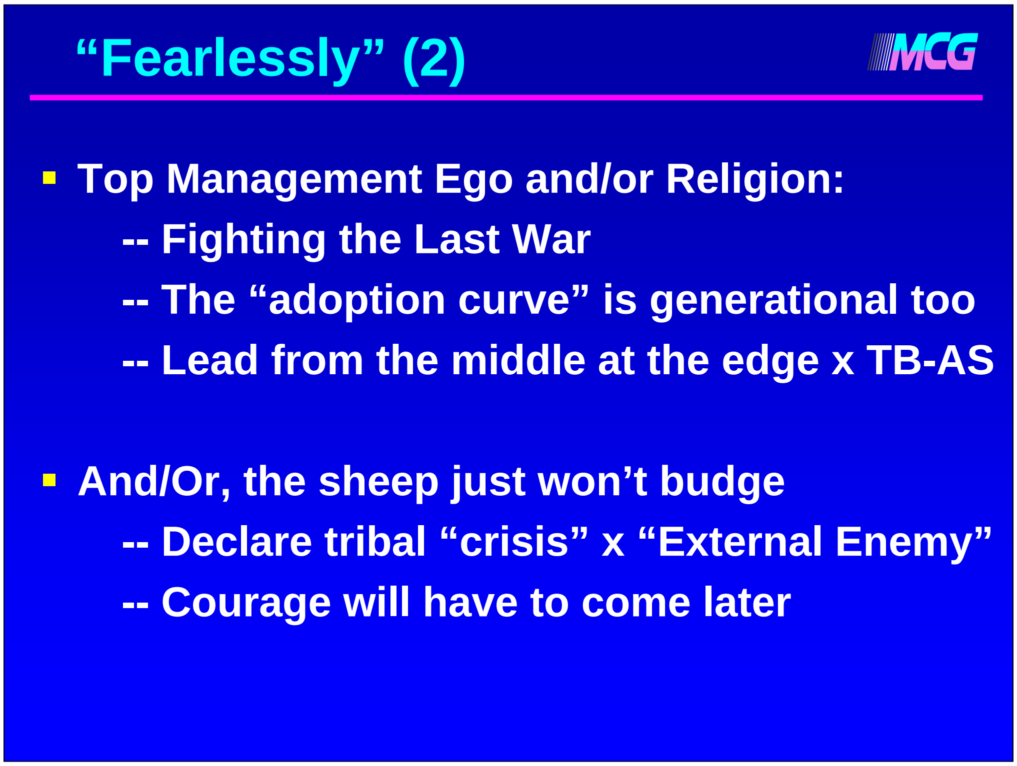
- #1 Reason people don’t want to change
  worked for 3.5MM years
  problematic for biz. Innovation needs
- Fear drops - some - if first 5 F’s are done
- Then, modulate the size of the steps by individual, if possible:
  -- Kaizen philosophy (trivial baby steps)
  -- Wellness program:
  healthy hydration; pedometers x steps per team/day
  Ex: March in place during TV commercial

I put “fearlessly” late in the order, so that if we have done all of the preceding design steps and can explain them to all involved, then the amount of free-floating-anxiety-based fear should drop a lot.

A second big measure for fear reduction is to reduce the size of the experiment to a level that is so “measurably, factually” small that the risk portion is trivial.

Once action, progress and learning begins, then the frequency and size of the steps can often be quickly increased. Turn-around experts who know in their bones that certain things will work and have a financial gun pointed at the company will have to do major moves. If there is financial leeway, then it may be better to patiently start small with most everyone on board and then ramp up the pace of change as decreasing fear levels allow.

On “wellness programs”: companies can’t continuously improve on the macro level if every employee isn’t improving at the micro level. Two goals that speak to all employees are “better health” and “more workplace safety”. But, many people on their own can not, for example, lose weight. So, a “kaizen philosophy” (long journey begins with a simple, non-threatening step, then another, etc.) would allow everyone to choose their own pace and program starting with: how many steps do they happen to take with a pedometer in a 5 minute walk with a “workout buddy or few”; or “healthy hydration” (for more on this see exhibits 35-39.)



What if you are a branch manager who attends my University of Industrial Distribution all-day seminar (3/9/10; info at http://www.univid.org), and you want to do some of my radical profit improvement plays? But, your company doesn't have and doesn't seem to want to know what profitability ranking reports will reveal about customers, items/suppliers and sales territories? (www.quantumprofitmanagement.com)

Can you lead your organization from the middle, by doing your own TBAS failing forward experiments? If you think you can or your can't, your right.

If you are given a turn-around branch or company to run, what happens if the sheep don't easily or fearlessly understand your profit improvement vision and related plays?

You'd like to think that you could explain and sell all on how better service value tuned to one best customer niche at a time would benefit all four stakeholders. But, that is too abstract.

Humans are wired, however, to be part of clans and easily roused to protect themselves from enemy tribes encroaching on our territory. So, declare war on the biggest head-to-head competitors and the desire to better retain our best customers and steal their best ones to get a more sustained, energized effect.

“Fearlessly” (3)

Guidelines for: “Predictably Irrational”

1. **Take more calculated risks like VCs & wildcatters:**

Public arenas are more problematic:

-- Runyon x Belichick’s 4th down gambles

-- Deflate incipient housing bubble in 2005?

-- TSA precautions 6 months before 9/11?

Ounce of prevention doesn’t work easily in politics

“Behavioral economics” has been a hot area for economics research and popular business books in the past 20 years. There are a number of irrational economic things that humans will do. Because of our reptilian brains and hyper-active, flight-fight-fear amygdalas, we do not take the calculated risks we should, especially in a data-free vacuum. Rental car companies and appliance retailers will all try to sell us insurance that we:

1. Don’t need, because we are already covered under our general insurance policies; or,
2. If we did the statistical analysis for the true risk, cost, benefits, we would find that if we are an above-average driver or careful user, we are better to “self-insure” by a big margin.

In business, we fear ideas/changes that we shouldn’t if we actually had the true profitability data for – customers and items/suppliers. And, agreed to experiment with the lowest risk, highest reward one baby-step at a time.

Using TBAS management with good profitability ranking tools, we will take lots more, very-smart, calculated bets/experiments than we have in the past.

“Fearlessly” (4)

2. **Don’t panic, cut losses and move on.**
3. **Don’t make decisions in heat of moment**
4. **No chest thumping on wins; respect luck**
5. **Role model “good mistakes” & “lucky” wins**
6. **Act confidently, share info, build trust**

Other guidelines that will both minimize potential losses and related fears:

1. If we monitor an experiment which starts to fail in an unforeseen and bigger way or isn’t yielding the upside we thought we had, then stop, cut losses and go back to the drawing board. There’s no rule that says we have to continue doing something harmful when new information tell us it is so.
2. If and when things take turns for the worse, don’t make hasty decisions. Pause if you can, do some deep, slow breathing and centering. Let the mud settle and see what then makes sense.
3. With TBAS x 9F’s we will “get a lot more lucky” and be surprised about serendipitous support that may emerge from other business partners who hear about our strategic, bite-sized experiments. Like a good coach, give all of the credit for wins to the players and take all responsibility for the losses.

But, how big can the losses be versus the upside learning if our experiments are well-designed. And, this is the way that we build both a culture for and corporate capacity for change.

“Flexibility”

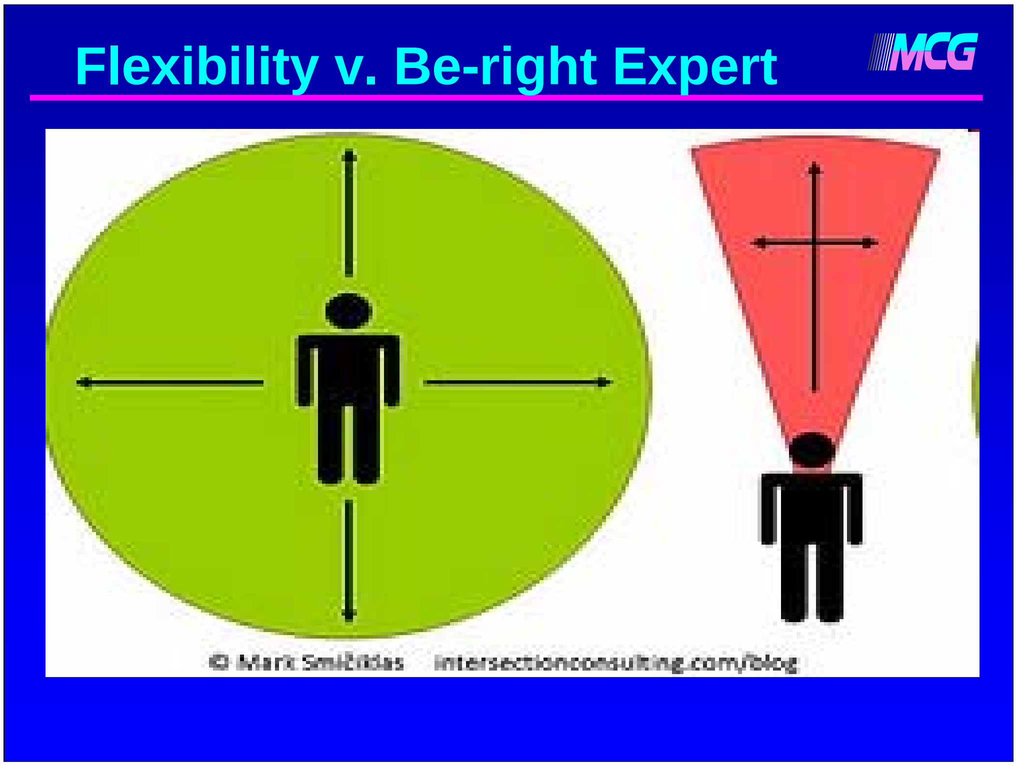
- We are in a complex, chaotic soup…
- Can’t forecast future, but make/shape it
- There will be both -/+ surprises
- All are good catalysts for 360 learning
- Doesn’t kill us, makes us stronger
- Merge learning into future vision we are imagining and co-creating with allies

A “chaos system” with “emergent objects” which are shaped by “hidden attractors” is a system that:

1. Has too many inter-dependent variables to even know let alone try to model.
2. Is quite un-forecast-able if and when the variables are very volatile (meteorologists can’t forecast hurricane paths 15 minutes out).
3. Still does have outer boundaries (e.g. record highs and lows for a given calendar day in a given city)
4. But, in a rainstorm emergent streams of water will move towards the ocean, because the hidden attractor affecting the “cats and dogs” downpour is gravity.

Our brains are chaotic systems for which emergent objects are ideas and anxieties that pop into our heads and dreams. Business ecosystems are complex systems. If we change, then everything around us will react, pro-act (and reinforce the smart stuff that starts to work) to what we might do.

Although we may have our working theories that help to design and conduct our experiments, we must be open-minded to any and all unforeseen positive and negative reactions. Then, learn from them and adjust. Many people succeed for all of the wrong reasons, but they did ACT in the right place at the right time and SEIZED the unforeseen opportunities.



This slide shows "the expert" on the right who has ego needs to:

1. Think they are smarter than everyone else
2. Needs to control every experiment.
3. And then sees only what they want to see to support their theory and experiment.
4. When the target "dog doesn't want to eat the dog food", they aren't apt to ask: "Really, why not? What other priorities and problems are on your mind?" Which might reveal an entire new opportunity.
5. This is all very limiting.

The guy on the right has an ego that informs him that:

1. No one is as smart as all of us.
2. The customer is always right even when they may be intellectually, factually wrong to some degree.
3. Every frictional push-back to any proactive, innovative experimenting is the tip of a learning insight. The bigger the pushback the more valuable the underlying reasons and lessons whatever they might be.
4. We don't have to be marginally right in one pre-meditated way, we can be very successful eventually for a number of unforeseen ways.
5. When we put our foot into a new space (path) unforeseen players will come along and trip over our foot. Turn them into allies and co-creators of new wealth.
6. A prepared, ego-free mind sees MANY MORE opportunities than the unprepared and/or rigidly-fixed mind.

(with) “Fun”

(Triune Brain Reassurances)

- **Failure is an event, not a person**
- **No matter the outcomes, its all good.**
- **Accept sting, then: “fascinating gift”**
- **Focus on all upside aspects of the process**
- **Enjoy the wins; we’re making our luck**

-- “Never up, never in”…..Bill Walton

-- “I miss 100% of the shots I don’t take”…#99

I think all of these phrases have been covered already; or, they may be self-evident.

For non-basketball fans, Bill Walton was once a star center in both college and professional basketball. His quote is referring to when you get an offensive rebound near the basket. Then, “when in doubt go for it”; muscle any type of shot towards the basket to get the ball headed toward the hoop. When it is close to the rim it can often go in or another team-mate can tip it in. And/or, you can often draw a foul for two free throw shots and foul-out concerns for the opponent. Be bold near the basket and good stuff can happen.

#99 is Wayne Gretzky’s retired professional-hockey jersey number. What he is alluding to is that if he does have - even a low percentage- shot, goals can then happen: directly; on deflections by team mate’s sticks as the puck is heading towards the net; or off of rebounds from the goalies pads. A similar – look at all of the odds – story to Walton’s adage.

Skip two slides ahead and read Goethe’s quote for more on why “never up, never in” works better than most people think who worry only about “what if I miss” and don’t think through the total odds for being bold.

“Fast”

- Law of the Harvest:
  -- We reap what we sow
  -- Plant seeds daily
- Avoid analysis, paralysis
- Crawl, walk, run, fly
- Goethe’s advice: “Boldness =>magic..”

If we “act” and do so “fast”, we can’t spend a lot of time and money, we will be “frugal”.

We should always preface our early “prototype” experiments with: “let’s try a quick, cheap experiment which won’t be close to the final best answer. But, if we can fail forward in the right space based on the right factual insights, then we will get a flood of new insights, ideas about how to get where we eventually want to go a lot smarter and quicker”.

Analysis paralysis is what people do who think that:

They must be right/perfect the first time or they will lose face or won’t be considered smart and competent.

They really can perfectly model and forecast a dynamically changing, complex system including the minds of many irrational team mates and customers.

But, the more we model, the more complex the environment and the model become, so it often crushes under its own weight or raises even more questions for which we don’t have answers. Keep it simple, jump in with failing forward, learning expectations by all parties.

Crawl, walk, run, fly alludes to “rapid prototyping” to accelerate learning for the least cost. We will get further, better, faster, for less if we practice rapid prototyping.

A Favorite “Act Now” Quote:

Until one is committed, there is hesitancy, the chance to draw back, always ineffectiveness. Concerning all acts of initiative and creation, there is one elementary truth the ignorance of which kills countless ideas and splendid plans: that *the moment one definitely commits oneself, then providence moves too. All sorts of things occur to help one that would never otherwise have occurred.* A whole stream of events issues from the decision, raising in one's favor all manner of unforeseen incidents, meetings and material assistance which no man could have dreamed would have come his way. Whatever you can do or dream you can, begin it. Boldness has genius, power and magic in it. Begin it now.

Johann Wolfgang van Goethe

Read this quote at the beginning of every day.

Create a simple grid on a page in a notebook with a few columns for “cheap personal investment experiments” with 11 horizontal lines for writing in: Think Big (and strategically); Act Small; and then the 9F’s.

Write in some of the speculative investments you have personally made in the past few weeks to check for what TBAS criteria you are doing well and not.

What experimental seeds will you plant today to fail forward towards what creative vision objective?

Sec 2: How/Where To Think Big?

"The Core" :

-- Zook's 3 Books on: Renew; Lead from; Innovate from – the core & competencies

-- "Shrink to Grow" v. more "sniff & scurry"

Take 20-80 rule to 20-200

-- 20/140 "true profits" intersection of most profitable customers and products

-- Bottom 1% customers that eat 20% of profits

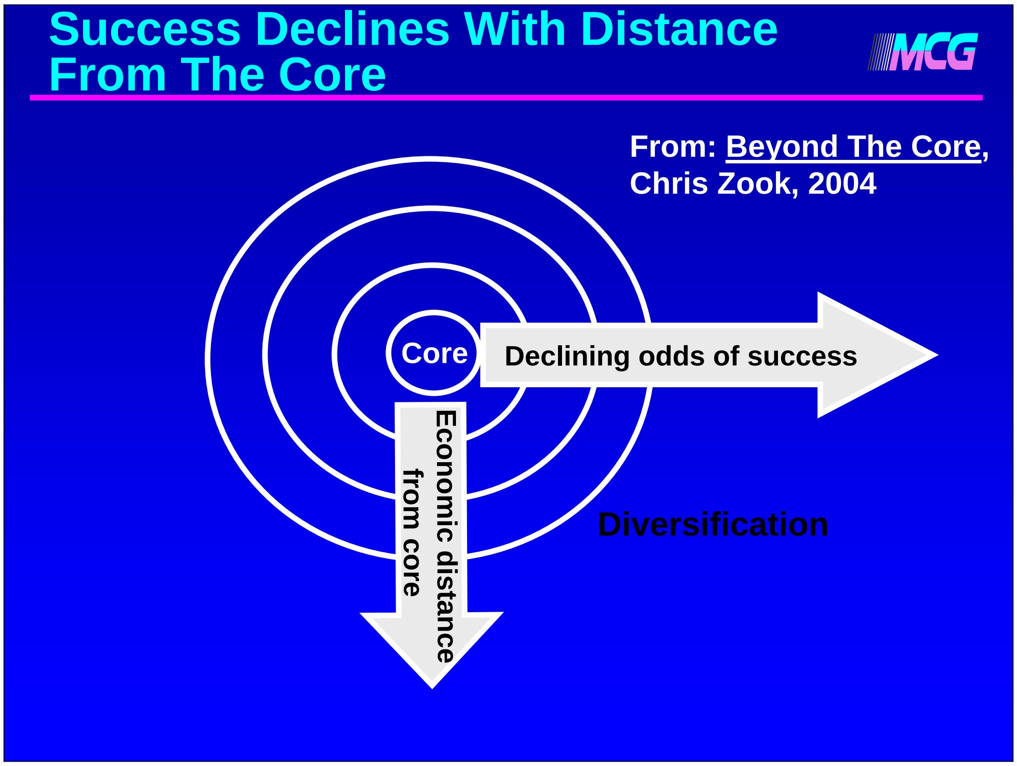
Chris Zook is an in-house research and writing specialist at Bain Consulting. Bain did research on many proactive initiatives that (big) companies tried to see which ones worked best. The most successful strategy, by far, was to refocus on and reinvent the core usually accompanied by weeding losing divisions (activities) that were not core. The further an initiative or acquisition was from the core, the less successful it was. The next two slides summarize some of these findings.

The steps for "core management" are:

DEFINE THE CORE MEASURABLY (which is typically about 20% of a distributors customers that generate 150% of the true, peak, internal profits. The extra 50% than finance all of the active losing customers. And, the anti-core (the bottom 1% of the biggest losing customers are leaking out 20% of the peak profits).

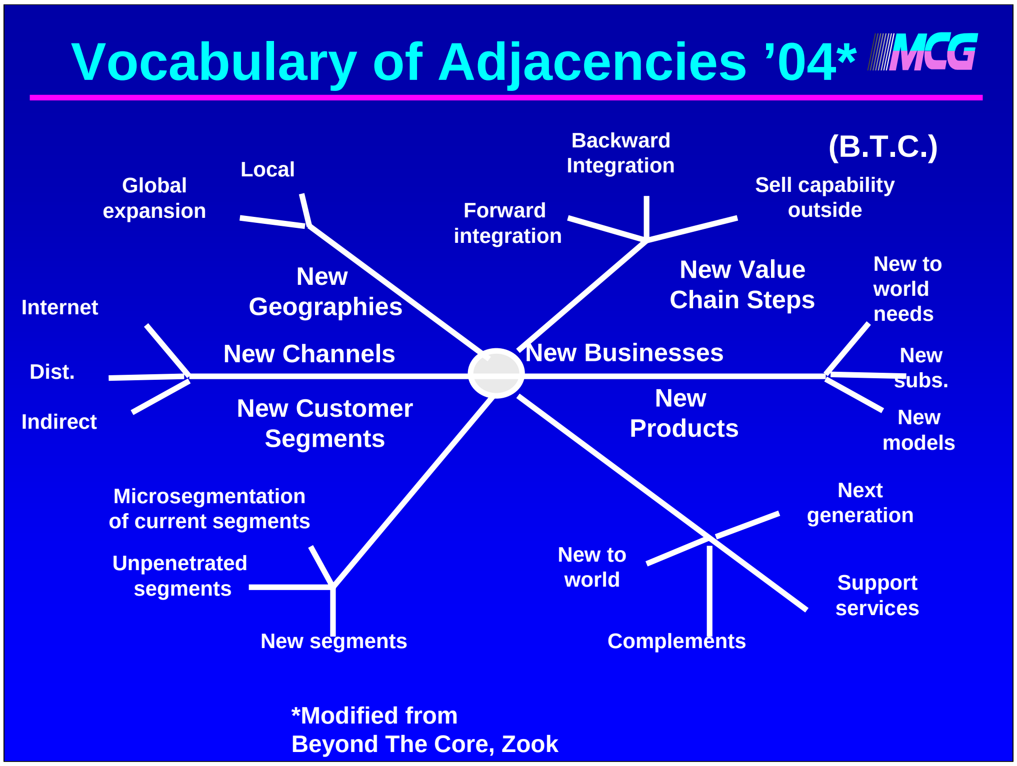
Then RENEW & TRANSFORM the losers into winners or weed them to have slack resources to reinvest back into taking the core customers value proposition to at least a next level. The top 20% have the untapped, upside potential of doing as much as 200% of the reported profits. And, transforming the bottom 1% into winners will add another 20 to 25 points of profits. Call this the(20 + 1=) 21% => 225 more-from-the-core power law.

EXTEND what we learn from innovating at the extremes of the ranking report into new target accounts; new markets; etc. Build on our powerful core capabilities which are unique, don't buy other people's problems and try to run them with financial numbers.



The further we stray from reinventing our core knitting, the bigger the chance we have to fail. Think Time-Warner merging with AOL. 85% of the big mergers engineered by investment bankers turn out to be net losers with no net "synergies" realized.

The great majority of roll-ups within distribution channels done by financial engineers looking for economies of scale through consolidation cost-cutting have done poorly when they ran out of deals to do and money to borrow. They need to do better "core management" on an every branch basis.



As we look at the vocabulary for "adjacencies" think about how bored managers get with their existing business, because trying harder coupled with managing by financial numbers doesn't work. If only they could have better economies of scale.

Instead, they need to do better core management. I've worked with high-performance distribution firms that have gotten so good at core management that suppliers, customers, best prospective employees (from competitors) and banks/investors are bugging the distributor to do more with them. When you are the Secretariat of your channel, the fastest train to get on board, everyone is pitching you first with their ideas. Nice spot to be in. Who needs to do adjacencies?

Another way of phrasing this is: if we are mediocre at what we know and have been doing for a long time, why would we presume to think that we could be excellent in some other competitive arena where we know a lot less? If we could become a top 5%-ile performer in our core game, then maybe we might presume that we could get brilliant at yet another business. But, then we would overwhelmed with offers in our existing game, because we would be Secretariat.

“Quantum Profit” Analysis (QPA)*

“Quantum level”: smallest indivisible unit of both matter and profit/loss increments

Mgt. by margin dollars for customers and products averages out different activity cost scenarios

What does good, QPA reveal?
Like Galileo’s telescope at 30X…..

*Investigate “Cloud Analytics” venture for distributors at www.quantumprofitmanagement.com

In the ’60’s reps got paid 5% of sales, because companies didn’t have accurate, timely margin dollar totals. In the ’80’s mini-computers were used to sell distributor-specific ERP solutions, so we could pay reps 25% of the margin dollars which ran at say 20%. Same net compensation dollars. But, reps had 5 times the incentive to sell-high and not cut the price.

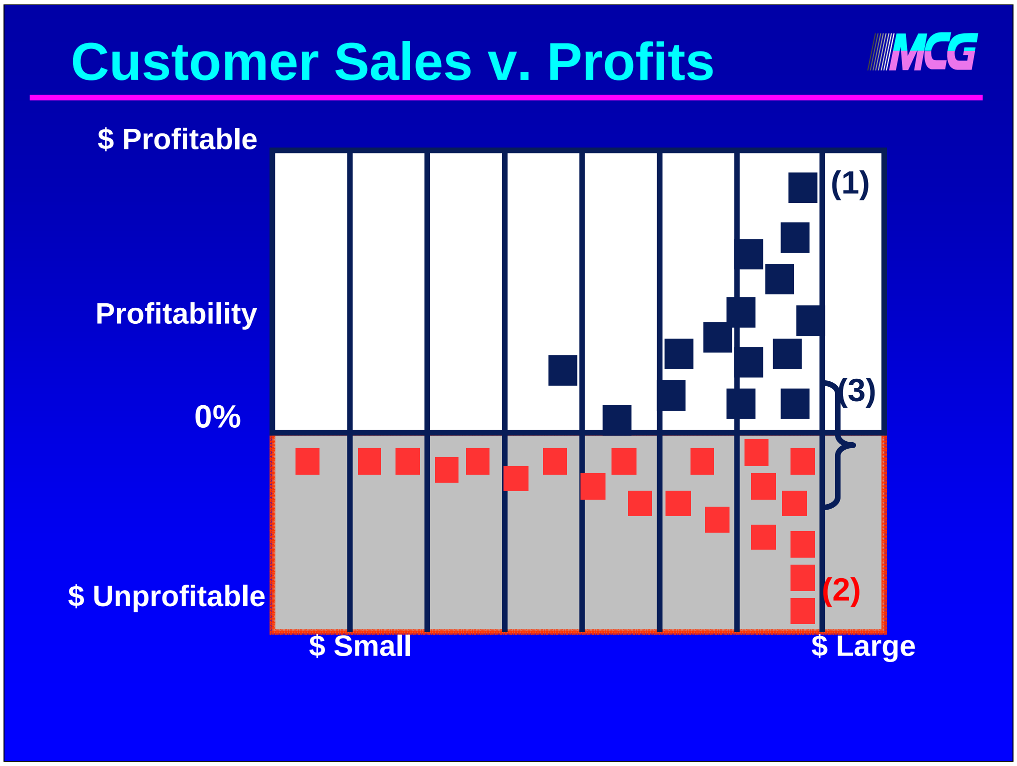
When, however, we run our business on margin dollars and margin percentages we don’t know what the cost-to-serve is for different order-cost scenarios (direct; indirect; warehouse; counter; web x order-size ranges + freight, etc). What if we could measure the net profit or loss on each line/item on each invoice scenario. Then these units of profit or loss could be totaled up in different ways to yield profitability ranking reports by customer, item/supplier and sales territory.

In physics, Aristotle speculated about “atoms” being the smallest indivisible unit of matter. Science progressed to the “nuclear” level and then finally to the “quantum level”. What if you could analyze your business at the quantum profit, line/item level?

When all of the customers on a customer profitability ranking report are graphed, the whale curve is a typical pattern. This distributor has over 800 active accounts along the horizontal axis. But, the top 20% or 250 accounts generate $1.2MM in profit before the "tail of the whale" customers eat up $950,000 of that profit. The company then reports $250,000 in financial profit.

Financial accounting averages out the profit subsidies going on within the customer portfolio. Many of the 500 customers between #250 and 750 are chronically small, growing-no-where, self-employed customers. Even if this distributor has 100% of their business, the service costs per transaction equal or exceed the margin dollars in each transaction.

These small customers need a different 'service bundle, price and/or terms" to allow them to either become profitable or to leave to be a losing drain for another full-service-for-all competitor.



From the “whale curve” in the previous slide, we can infer that the very largest winner and loser accounts are also “large” in sales volume activity and potential. What we can’t determine – for sure – is the size (potential) for the many breakeven and milder-losing accounts.

When we plot the size of accounts versus their profitability we find that small customers are all breakeven at best and generally losers IF we tend to have a one-size fits all service model.

This would be similar to a casino giving all patrons free drinks and meals whether they are playing the nickel slots and losing $10 every three hours, or the customer is a drug lord losing $10MM in one night. The casino would lose money on all of the slot players and 99%+ of them will never: “grow up into good accounts (let alone whales losing $10MM per night) and stay loyal to the supplier who (over) serviced them (at a chronic loss) when they were small.”

Meanwhile the big gamblers will be lured away by the casinos who know the “net profit” realities and chose to invest some of the 10mm in “profits” into: flying the Whales entourage to the casino for free; giving them free super-deluxe rooms; etc.

Any distributor who does not have specific, margin-dollars-per-month boundary lines for segmenting different-sized customers within an industry group for different service value/cost offerings will:

1.Chronically lose money on small, growing-nowhere customers;

2. Employ too many sales reps who are making too many money-losing calls on small accounts. Keep only “A” reps who call on only “A” accounts (article 4.11)

3. Be vulnerable to losing their few super-profitable whales to competitors who don’t have to cross-subsidize losses from: super-losers, many small losers and too many sales reps.

Then What?

MCG

"Next Level" for Super-Winners/Gazelles
- **-- Why are they so profitable?**
- **-- Do anthropological 360 process audits**
- **-- Reinvent value equation offering**

Super-Losers:
- **-- Transform, lose-lose inter-biz process to win/win**
- **-- Spin-out to lower cost service model**
- **-- Re-price-&-Term to profitability or exit**
- **-- Redeploy cost-to-serve slack options**

Once we know who our super-profitable accounts are, we can drill down to find out that they are: large; buy lots of most profitable items; and do so in a most win-win effective replenishment, healthy order-size basis.

If one of our managers with a title - who has some sense of how to improve "inter-business buy/sell processes and touchpoint experiences (ex. 4 at merrifield.com)- does an "audit" of each of our top 10+ customers, what will they discover. If they just "staple" themselves to the flow of both paperwork and product to and through the customer starting with when a customer first has a "I have a problem I need to talk to a supplier about", what will they observe about: fumbles, delays, frustrations, incomplete understandings, other items we could sell them more effectively than small vendors, etc.

Write up the recommendations for how we can redesign how the two businesses work together and help them measure: reduction in paperwork costs, shopping time, delay, erros; and increases in uptime, on-time and done right the first time for the next party in the value-forward chain. Then do it.

The benefits:

pick up 10 to 100%+ more sales volume;

delight more of their people more thoroughly;

reduce total costs to serve and to buy;

measure the increases in the customers heretofore hidden economic benefits;

create "new services" that you can practice with other best customers and then

Tactical Ranking Plays:

- More to the Core
- Lead to Gold
- Team Hyper-Focus x 10 Core + Gazelles
- Create Tracking, Focus Reports
  - -- 5-5-5-5-5
  - -- Profitable, gazelles, losers, m-o-m up & down
- Start Failing Forward in what size steps?

For more detailed description on all of these “profit improvement plays” that are applied to the extremes of the net profitability ranking reports (by customers, item/supplier and sales territory from Waypoint), see exhibits #ed: 56-58 at merrifield.com.

QPA Goes Better Than 20/80 (1)

- **Vilfredo's initial "power law" observation**
- **Input causes v. Output consequences**
- **Natural unbalances vary from 20/80**
- **30/70: customers/margin dollars**
- ***20/120-200: customers/profit dollars***
- **Similar for: items, suppliers, reps**
- **Different views on same extreme intersections**

QPA= quantum profit analysis which makes QPMS (quantum profit management service) possible.

Pareto's 20/80 applied to citizens and wealth within a country. We find that in a natural, complex systems that there are different "power laws" that reflect that for a small percent of input into a system, big disproportionate outputs may be possible.

For distributors about 20% of the most net-profitable customers generated about 120%+ of the total peak profits before unprofitable accounts reduce the bottom line to 100% of what it is reported to be.

If we re-focus on these core customers, do our audits and systematically sell more old items to them in more win-win effective process ways we can typically grow the profits from the top 20% to 200% of what our bottom line is. Hence the 20/120+ becomes the 20/200 law.

The same hyper-leverage results can come from focusing on innovating to the next level of effectiveness with most profitable or unprofitable: items/suppliers and sales territories.

20/80 (2)

Human popularity/brand amplification effects:

- **1% movies/80% of ticket sales**
- **1% of language words/80% of usage (“OMG”)**
- **#1, #2 and I haven’t a clue about #3**
- **First in new space effect:**
  - **Mona Lisa, Bannister, Lindberg**

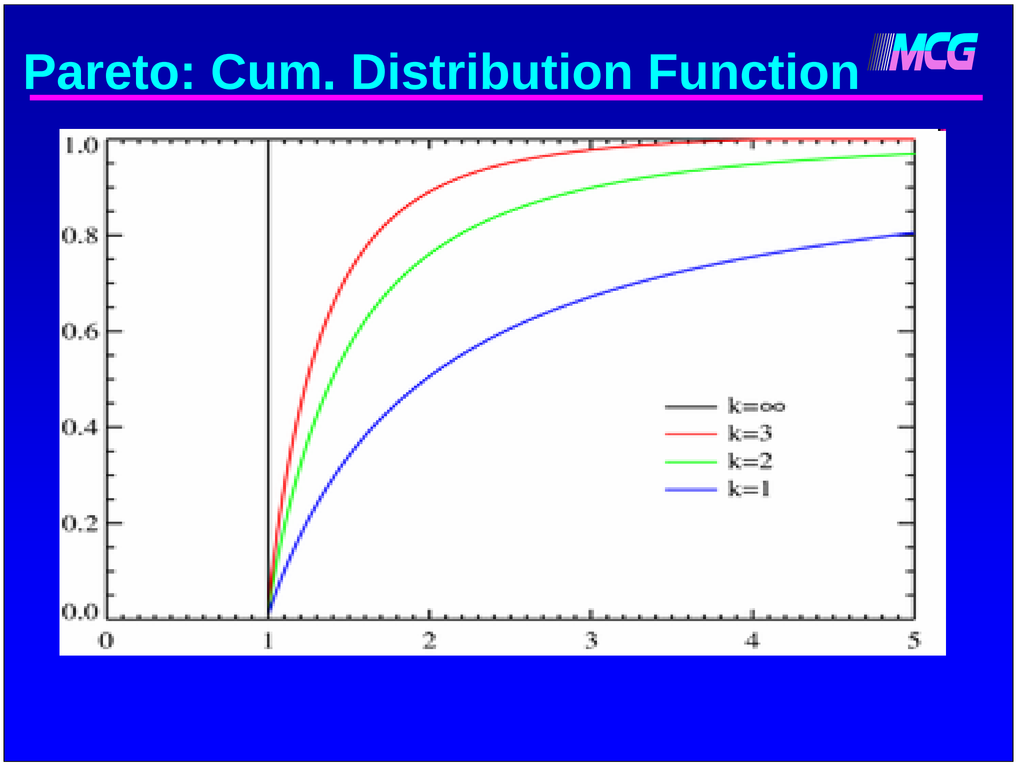
Brand items more true net profit than margin % suggests?

“Direct Product Profitability” (DPP) within drug channel?

50% of retail grocery private labels are losers!*

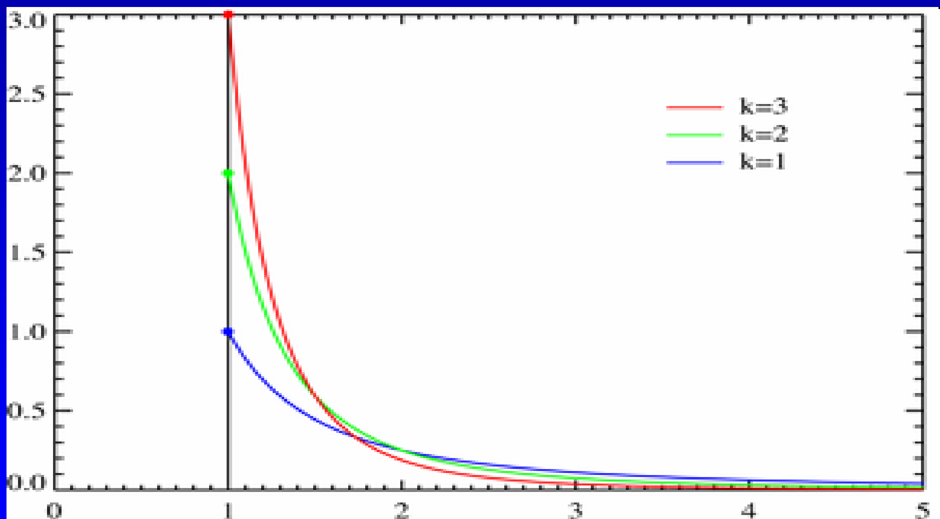
“Private Label Strategy” by Kumar; Steenkamp

Hopefully self-evident.

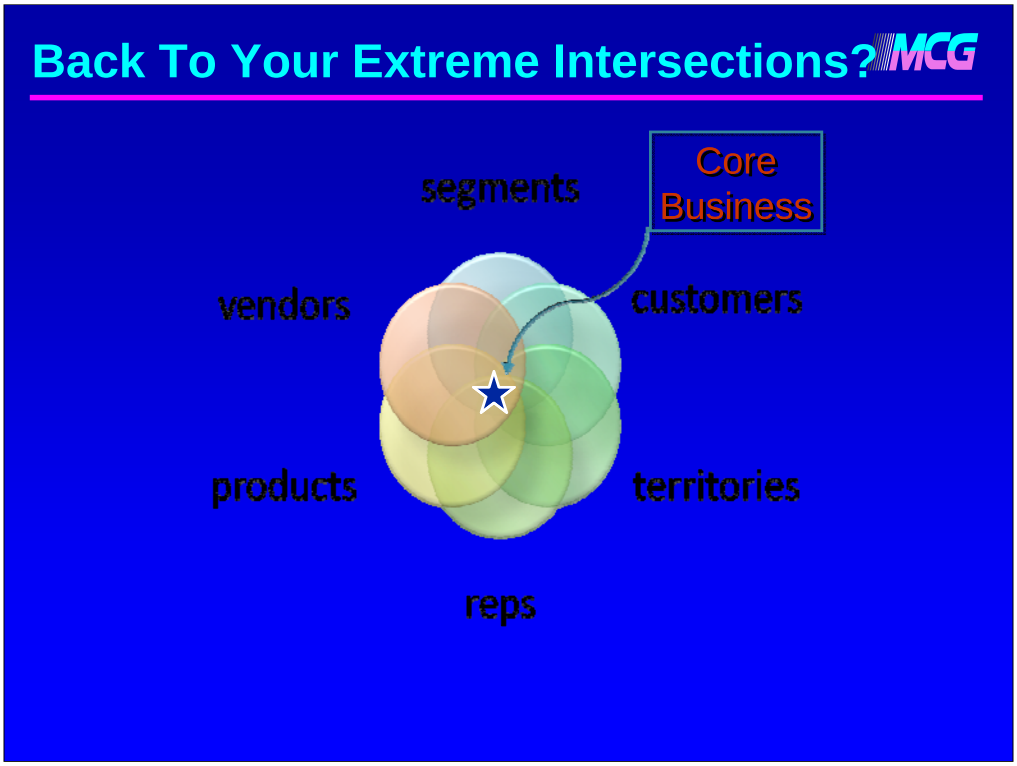


These are different graphical representations of power laws that illustrate how a small # of factors along the horizontal axis account for a big percent of the action measured up the vertical axis.

Pareto: Probability Density

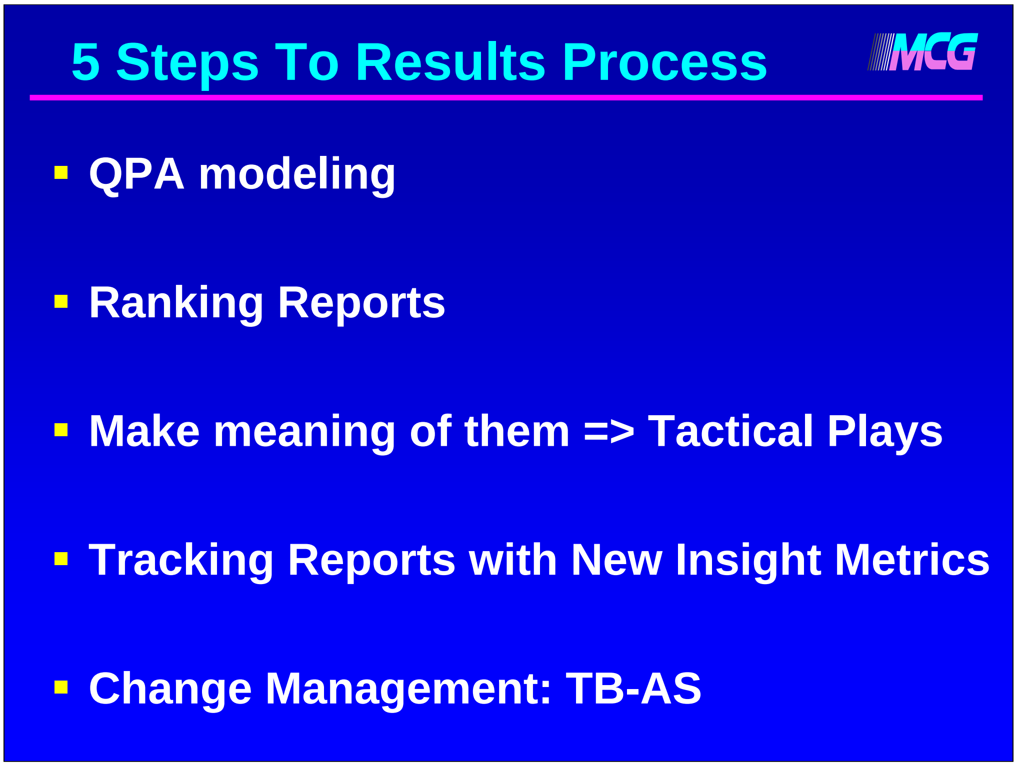


These curves invert the action up the vertical axis. We start with 100% of the action and subtract the contribution of the biggest players on the horizontal axis. This creates “the long tail” going out to the right. Before Amazon made visible all 4MM books in print in the English language and cut deals with publishers to stock all of those books in their warehouses for 3PL fees (publishers pay fees to Amz for: receiving, storing, picking, shipping and selling the book with consigned inventory), the long tail books couldn’t get into a super-store with 120K titles. 50% of AMZ’s book sales are on books that rank below 130,000 in popularity. They sell ALL of the publishers back-listed books. It’s a win-win-win for the publishers, AMZ and the end-users. What new channel models could manufacturers with long-tails to their product lines develop with their independent distributors to achieve the same 3-win for manufacturers, distributors and end-users? Call me if you can’t answer the question.



When a distributor looks at their net profitability ranking reports by different elements (products, vendors, reps, customers, etc), they will get different “power laws”. For example one distributor got the following peak profit totals: 20% customers => 152% profit; 24% suppliers => 171% profit; 30% rep territories => 132% profits, etc. But, there is only one 100% of financial profits reported, what’s going on? The different net profit perspectives overlap and our inter-dependent. Super-winning customers are buying substantially super-winning items from super-winning suppliers and are in super-winning sales territories. The same in reverse is true for super-losing customers buying super-losing items, etc. This allows us to zero in on the intersections of both all things good and all things bad to co-create a few simple changes with our customers and suppliers to get huge improvements in profit. But, you have to have the right analytics to find these intersections and then be able to get management involved in doing some simple innovative changes. Don’t expect traditional reps trained in traditional ways to pursue margin dollars (not net profit improvements) to be part of the initial solution.

This slide just rephrases was the previous slide pictorially tells us. We want to work with all of the best elements at their intersection points to get huge results. So, “think big” in the most strategically intense places, the intersection points of all good profit elements (the diamond core) and all of the bad profit elements (the black hole of profit destruction).



In Waypoint's QPMS, there are five steps to the entire service:

1. QPA involves the activity-based cost modeling expertise that allows for…
2. The generation of profit ranking reports by all elements
3. My 35+ years of experience in high-performance distribution management turnarounds has allowed me to make sense of what's going on at the extreme poles of these reports and what "profit improvement plays" can be pursued to get high-leverage profit improvement results.
4. As we do the plays, how do we know if and when they are being successful to then lay-off and/or re-deploy operational slack and reward employees based on improvements in profit swings? We need special tracking and compensation reports which Waypoint QPMS provides.
5. Doing the first 4 steps is all "too new" for many traditional distribution channel denizens. So, how to implement and manage the human side of this change is tough and needs the virtual support via go-to-meetings as well as educational materials (like this slide show, my DVD on "High Performance…" etc.)

Closing Questions (1)

1. Innovate or die? (T/F)
2. TB-AS is a best, mindset quadrant? (T/F)
3. TB about the “core” for “good ideas” to put into the pipeline is a starting point? (T/F)
4. Can you factually define “your core” on a true profit basis? (Y/N)

These questions are rhetorical. We know we need to do all of this stuff, the question is how which is what this slide show has hopefully made a good start of addressing.

Closing Questions (2)

5. If you can, can you renew and expand on core?
   -- Don’t forget “weed to feed;
   -- Subtract before pro-acting organic growth reality

6. Find innovation vectors from renewed/unencumbered core?

7. Will 9F’s help overcome: inertia to action and fear of failure?

Closing Questions (3)

8. **Can you throttle "devil's advocates" with new idea requirement? Is the status quo an option?**

9. **Environment &/or competitor innovation change rates greater than ours equals what? (hint: death)**

THE END

Your Questions?

RE: Devil's Advocates.. These guys are great at criticizing, nit-picking any new idea. What they are really doing is saying: this isn't perfect, we don't have all of the exact answers for how we will proceed, there is some implementation risk involved, so lets just keep doing what we are doing. They aren't offering any alternative, how to innovate and move forward ideas, just shooting down stuff in order to keep doing what they are doing. But, the status quo is long-term death for the company and all of its stakeholder groups usually after the Devi's Advocate has harvested their job, the company and retired. The solution is to set down this rule: "Anyone can nitpick any ideas, but only if they have an additional new, moving-forward idea to then offer. We won't allow anyone to nitpick and therefore defend the status quo which we know is loaded with imperfections and heading towards commoditization, no profits and eventual death."