

Making Fast Strategic Decisions with High Confidence in the Outcome

Squeezing more insight from less data

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In this white paper we describe a thought process that enables CEOs to act decisively on limited information about a strategic problem and yet have the confidence in the expected results that can never come from merely “shooting from the hip.” This process, which we call Facts for Action™, quickly identifies the facts needed to drive a portfolio of competitive actions. We arrive at the facts themselves using small sample research and corroborate them from multiple sources.

We have all had this experience: The Sales VP walks in to the CEO's staff meeting and announces that there is a crisis: “Our sales reps are getting killed in the market place because Competitor X is radically cutting prices and adding hot new features to its flagship product.” The Marketing VP then says that the sales reps are just whining – they should simply sell harder. However, if the CEO wants the facts for a definitive answer, Marketing would be glad to run a large-scale strategy project with a global consulting house including market research on thousands of customers for the next six months and a total price of \$3 million. VP Service and Support then pipes up that to meet the proposed new price point without giving up on margin, he will need tens of millions of dollars to redesign key products and processes for lower cost. And he has to begin the program now if the company wants to see any results this fiscal year. Finally VP Product Development says that he too needs tens of millions of dollars to design the desired new features into the product...and it will take two years before they are market-ready.

The only problem with all this is that maybe VP Sales is only reporting an anecdote or two that have become folklore in the sales organization...or maybe he is on to something real in the marketplace. And VP Marketing is notorious for being afraid to change anything without the be-all and end-all study to back him up...but he is certainly right to ask whether there are any facts to help guide the decision. And, the VPs for Customer Service and Product Development always want the gold-plated version. Maybe the current products and production processes only need a face-lift rather than a top to bottom redesign.

The key question is: What is the minimum information that the CEO needs in order to decide on a course of action? If he waits six months until VP Marketing does his study, the company may lose a lot of market share, especially since it will then take Customer Service and Product Development many more months to implement. On the other hand, if he buys Sales' story, he may be shooting from the hip on poor information. That could kill the company's near term margins by cutting prices and/or buying into the expensive and potentially unnecessary projects proposed by Customer Service and Product Development. Imagine what it will do to the value of his stock options! What would you do if you were in his place?

Several of our clients have come to us with similar dilemmas in the past year. We were pressed to come up with solid defensible answers in a matter of 10–12 weeks. In response we developed an approach we call Facts for Action™ that combines quick and dirty market research, financial analysis, operations analysis and/or competitive benchmarking to tell a powerful story. Under this approach we gather the minimum amount of market and/or operating data that would supply enough confidence to enable major competitive decisions, and then work with our clients to determine the right course of action. We have successfully employed this approach to solve questions of pricing, competitive positioning, product bundling, brand value, sales processes and tactics, and internal processes and cost structures.

Our approach works because major decisions address large issues. These issues are so large that they can be measured relatively easily. By contrast, it takes a great deal

more data to measure small things, such as subtle shifts in market share or operating margin that may come to only a couple of percentage points. Our approach works because:

1. It produces a portfolio of strategic actions based on solid facts about the market, competitors, and internal operations; this portfolio produces results much more reliably than any single action,
2. It takes surprisingly little data to determine a fact to a confidence level of 80%+ and
3. If you get similar results to this confidence level through two independent approaches, you can have more than 95% confidence in the answer.

In the next few pages, we explain the underlying theory and then show how we applied it in two recent cases.

The Facts for Action™ approach:

How it works

In cases such as these, we are trying to discern whether there are major gaps among:

- Customers' expectations from our clients and their competitors
- How competitors choose to compete with our clients
- How our client sells, delivers and operates relative to the competition
- What our client's cost position is compared to its competitors

Because small differences of up to about 5% can be covered with combination of short-term steps each of which contributes a couple of percentage points to closing the gap, we define a major gap as being one that causes operating metrics to miss targets by more than this threshold. The types of short-term steps we have in mind here are the usual actions that skilled line managers use to manage quarter-to-quarter P&L variations: running sales contests, having short-term price promotions, delaying hires or other costs, eliminating a nice-to-have special project of questionable long-term value, and the like.

Our approach is based on three facts about decision making under uncertainty:

Fact 1: Closing a large financial gap is something that requires a portfolio of actions, perhaps four or five. It is rare indeed that a single magic bullet will do the trick. If we are 80-90% confident that each of these four or five actions will deliver its share of the results to within

$\pm 10\%$, we can be highly certain of reaching our overall goal. It would be extremely unlikely that all of the actions would fall short – basic probability theory suggests that at this level of confidence the likelihood would be less than 1% that four items out of a five item program would simultaneously fall short by more than 10%. Instead chances are that shortfalls in some areas would be offset by over-achievement in others in the portfolio.

The principle here is the same as the one underlying the need for a diversified stock portfolio. While the future price of any one stock is difficult to predict, a portfolio enables the shareholder to realize good overall result with the disappointments in a few stocks more than offset by the superior performance of other members of the portfolio. Likewise, we devise corporate strategies, not as one high stakes, winner-take-all initiative but as a coordinated portfolio of initiatives where a shortfall in one dimension will be more than offset by upside surprises in others.

Fact 2: If we have two independent pieces of evidence pointing towards a conclusion, and we are 80% confident in each piece of evidence, then we can be more than 95% confident in the overall conclusion. For example, if

- Customer interviews suggest that a competitor offers a price that is 10% lower than our client's list price to one-third of his prospects, and
- We can confirm this estimate with interviews of recent former members of the competitor's organization, we can be confident that this pricing model is a true fact. See Figure 1.

Figure 1

If two sources point to a single conclusion, one has higher confidence in the conclusion than in the individual sources.

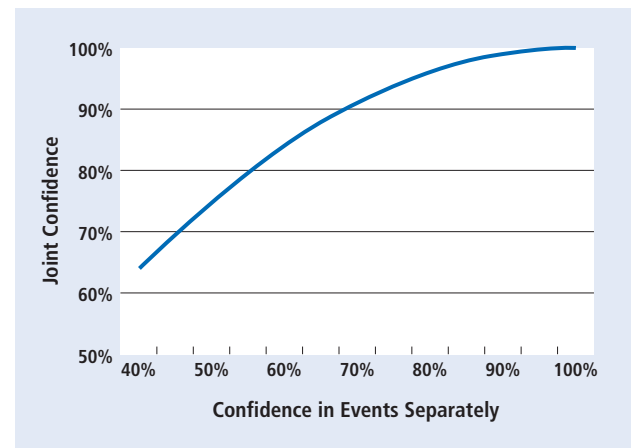
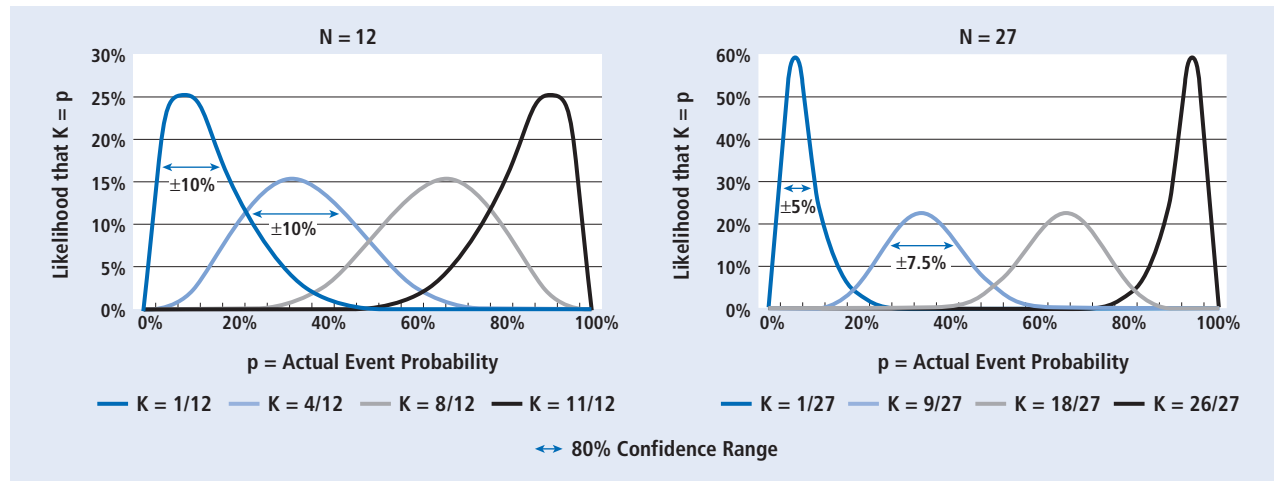


Figure 2
Small samples can give sufficient confidence to draw strong conclusions.

If we make N observations and K of these give a specific result, then one can be 80% confident that p , the real probability of that result, is close to K/N .

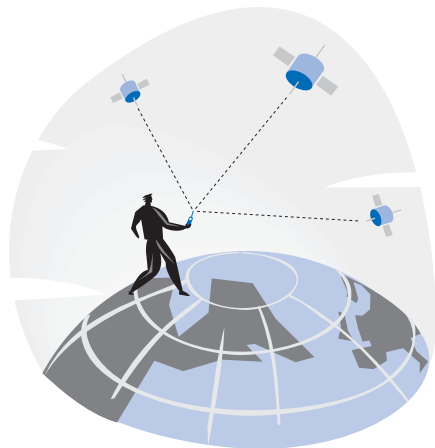


If we are only 70% confident in each of the two pieces of evidence, then we can be 91% confident in the overall conclusion. And even if we are only 55% confident in each piece of evidence, we can be 80% confident in the overall conclusion

Fact 3: It takes a surprisingly small numbers of observations to reach these levels of confidence about a fact. If we talk to a dozen randomly selected customers and only one tells us that the competitor's price is 10% or more lower than our client's list price, we can conclude with 80% confidence that the competitor has offered such a low-ball price to less than 20% of his customers. If four (i.e. one-third) of the dozen customers report such a price, we can conclude with 80% confidence that the competitor has offer such a price to $33\% \pm 10\%$ of his customers. If we interview 27 customers, the spread narrows to $\pm 7.5\%$. We illustrate this phenomenon in Figure 2 above.

Figure 3
Squeezing more insight from less data

Just as a GPS system uses signals from multiple satellites to determine an exact location even though the signal from any one would be insufficient on its own, the Facts for Action™ approach determines the full situation by integrating information from multiple sources each of which has only a limited view of the facts.



Case Example # 1

Competitive pricing and positioning for an enterprise systems company

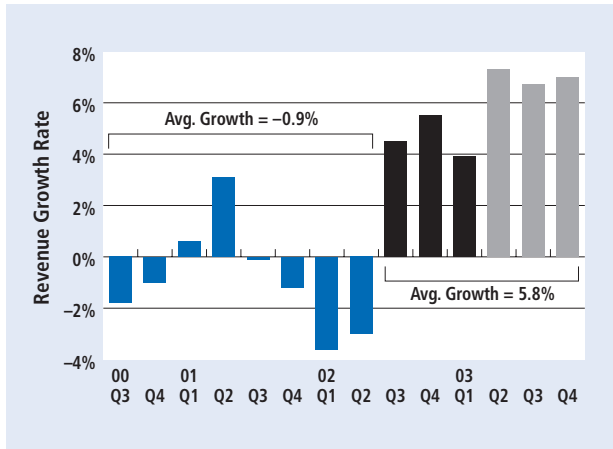
In the first case, our client's sales reps reported that their much smaller competitor, the Company X in the opening story, had suddenly started attacking our client very vigorously. These reports came in after many years in which X had muddled along as a distant number two in its market. The rumors were that X had hot new products with greatly improved technology and that it was selling these products very cheaply. And, with each retelling of the story, the rumors grew more ominous.

A quick review of Company X's financials showed that that the company had indeed changed its performance quite sharply. Revenues were growing again after a long period of gradual decline. In addition, X's margins had also begun to recover after a period of abysmal profitability. See Figures 4–5 on the next page.

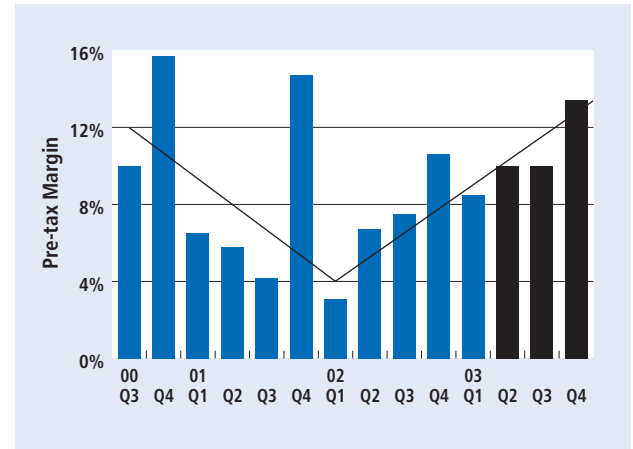
Furthermore, there seemed to be more opinions about what to do among our client's staff than there were people on the staff. Sales reps thought the right answer was to cut prices immediately. Various product managers wanted to start crash programs to add features to differentiate the existing products from X's. Product Development wanted to use this as the excuse to rebuild the product suite from the top down. Everyone was on Service and Support's case saying that implementation and operations costs were too high. Service and Support in turn pointed the finger at Product Development, Product Management and Sales, saying the products were too complex, poorly

Figure 4

After 2 years of falling sales, X began to grow at 6%.

**Figure 5**

X's shrinking margins also began to grow again.



designed, and over-sold, causing lots of downstream costs. And each of these departments ran to the CFO asking for the money to implement their pet solutions.

The CFO and EVP Marketing jointly retained us to help them solve the following two problems, and they needed answers fast:

- Determine Company X's market strategy and how best to respond to it.
- Understand Company X's operating cost structure and margin objectives to learn how they can offer the new products at the reported low prices.

We applied our Facts for Action™ approach. From this approach we identified a portfolio of strategic responses to Company X that included (i) meeting them on pricing, (ii) running a fast track product upgrade over six months to match them on technology and operating cost, (iii) implementing several tactical steps to improve cross-selling, (iv) highlighting our client's stellar reputation for honest dealing and high quality service and support, and (v) protecting the installed base.

The combined effect of this portfolio of five strategic actions will enable our client to resume his normally superior market position relative to company X. Moreover, our client can proceed with the confidence that the combined portfolio is much more likely to succeed than would an approach of a single responsive action.

The case for this set of approaches rested on evidence from 30 in-depth interviews with customers who had made purchase decisions between our client and Company X within the past six months. It was corroborated by

X's public statements about its business and interviews with about two dozen current and recent former members of X's staff and their technology vendors. We approached the current members of X's staff at various public venues such as conferences and trade shows or on reference from X's customers.

Because there was no consensus among our client's staff on the issues to examine, we decided to let the market tell us. We asked the customers we interviewed to tell us what they saw as the important differentiating factors between the two companies' offerings, and then interviewed them in depth on those factors.

Company X's market strategy

What emerged from this work was a clear picture of X's new strategy:

- The "hot new product" was a cut down version of the same old software repackaged with a spiffy Web-based front end and sold on an ASP (Application Service Provider) basis. This repackaging was accomplished over a few months at a cost of less than \$5 million.

Fact Sources: Interviews with X's Sales and IT staff; published articles by X's IT vendor

- The sales force was single-mindedly focused on selling this version with great success. In fact, X was gaining share much faster than our client suspected; where our client used to out-sell Company X by four to one, X was moving rapidly towards a 2:1 ratio.

Fact Sources: Interviews with X's customers and sales reps; analysis of client's lost sales

- To gain their added market share, X's sales reps were focusing on our client's installed base of customers with older, more costly systems. Our client was going to have to take action to protect its installed base.

Fact Sources: Interviews with X's customers and sales reps; analysis of client's lost sales

- X had given its sales force authority to compete aggressively on price, and was on average undercutting our client by 8–15%, depending on the deal. Also, X was willing to accept much lower pre-tax margins than our client. Moreover, customers had become very price sensitive – in only one case out of 30 did the higher-priced vendor win.

Fact Sources: Interviews with X's customers and sales reps; analysis of client's lost sales

- X was using the more standardized ASP product offering to reduce the cost of both implementation and customer support. Because there are many fewer versions of the software in use, and it was less customized, it was much cheaper to install, and problems could be resolved much faster. The net effect was an installation cost advantage of the order of 10% and an operating cost advantage of nearly 30%.

Fact Sources: Interviews with X's implementation and support staff; published articles by X's IT vendor

Our client's portfolio of competitive counterattacks

However, our findings were not all bad news for our client. X had left itself wide open to counter-attack in many dimensions. First, our client could knock off X's ASP product with one of its own in just a few months, and then use its scale economies to both undercut X on price and sustain its own superior margins. Second, X's "one size fits all" focus on selling the ASP version of its products meant that X's new solution was a poor fit for many customers. Our client is now training its sales force to identify customers for whom this solution is a poor fit, and then helping those customers choose the right product, from our client's broad range of offerings.

Most important, however, was that X's sudden shift in strategy had created turmoil in its own ranks: More than half of the X-customers whom we interviewed expressed serious post-sales disappointments. About one-third of X's sales reps were seriously over-promising, 30–40% of implementations became mired in technical difficulties resulting in major delays and customer frustration, and X's customer support left 35–45% of new customers

somewhere between sullen and furious. These problems are so severe that several buyers we interviewed had thrown Company X out after less than a year.

Fact Sources: Interviews with client's and X's customers

The Company X issues we uncovered are ones that our client can drive a truck through with its disciplined sales force and superior service. As a byproduct of our work, clients and competitor personnel also pointed out a few small areas in which our client could improve its own sales and support approaches. Our client is now launching a focused counter-attack against Company X.

Lessons from the case example

With fewer than three dozen customer interviews and two dozen interviews with Company X staff, we could paint a crisp picture of X's market strategy and cost position. Further we could identify its major vulnerabilities permitting our client to counterattack vigorously with a portfolio of actions. And because each element in the portfolio was corroborated from two or more sources, our client could act on this information with great confidence. Our client can proceed with the assurance that if he carries through on this portfolio of five strategic actions, his company will resume its historical leadership relative to Company X.

Case Example # 2

Service pricing, profitability, bundling and sales tactics for an international information technology vendor

In our second case our client was a company that sells both large-scale computer systems and associated engineering and support services to a global base of corporate customers. The questions on the table revolved around service pricing and account profitability. Sales reps were complaining that the best customers were pushing back very hard, demanding significant volume discounts. Sales further argued that competitors were charging much less for the same services. At the same time, Service Operations was complaining that Sales was discounting too heavily leaving many accounts with thin margins.

Using our Facts for Action™ approach we developed a portfolio of remedies including (i) new discounting policies and control mechanisms to meet market demands and preserve account profitability, (ii) revised service bundles with value-based pricing, (iii) new service

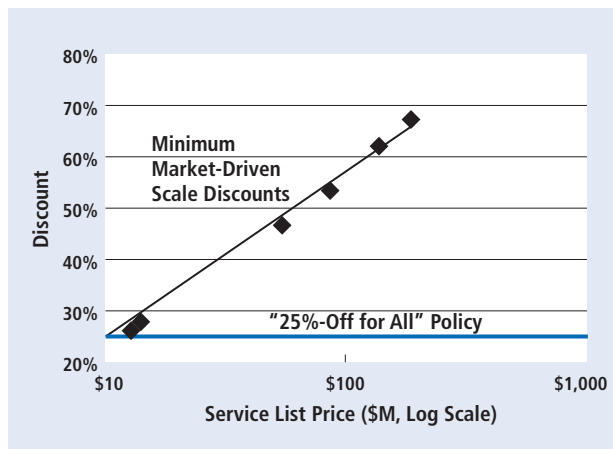
delivery models that added more value than cost, and (iv) improved account management approaches to increase account penetration and value communications.

The facts to support these actions came from an in-depth analysis of about three dozen large accounts. More specifically, we examined past behavioral data on what they bought, at what price and level of discount, and how much profit each account generated. We then obtained qualitative and quantitative market data from these same accounts through a program of in-depth interviews with three to ten economic buyers at each account and also had each interviewee complete an adaptive conjoint questionnaire on the Web. The qualitative data corroborated the behavioral and quantitative marketing data by explaining why the customers behaved as they did or would likely behave in the future as the quantitative data suggested.

We adopted a two-phased approach to assembling the relevant facts. The first phase examined the past behavior and produced the pricing and discounting policies and their associated control mechanisms of item (i) above. The new policies resulted from a detailed review of what prices Sales was negotiating and how those differed from the company's official "25%-off for all" pricing policy. The second phase of our work produced initiatives (ii)–(iv) based on qualitative and quantitative customer research. By executing this portfolio of four strategic actions, our client can be much more confident that he will add 12 or more points of revenue and profit growth from the service division than he would be were he to pursue a single step.

Figure 6

The market imposed a scale-driven discount policy.



The first phase: pricing, controlling discounts and customer profitability

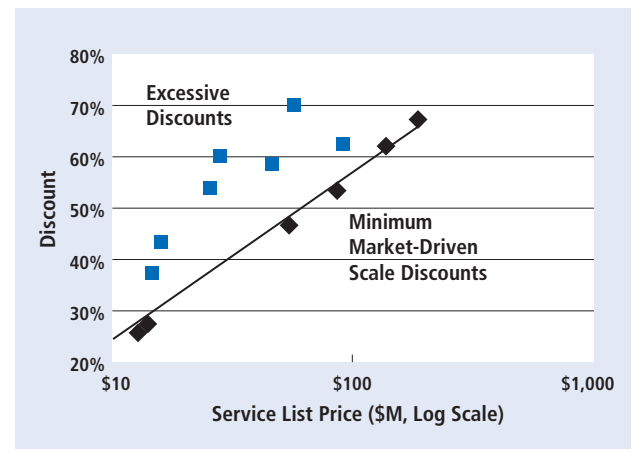
First we examined account-level discounting and profitability for a sample of three dozen large accounts buying between \$2M to \$200M annually in services. This task was complicated because these accounts typically had dozens of service contracts for different types of services. Further, there was no central database of contracts; one either had to pore through rooms of paper files or track down the sales reps who had written them to learn what services were covered under what terms. Finally, the service delivery teams could not accurately track their efforts back to individual contracts, so one could not answer the question of whether or not a contract had been over-discounted relative the amount of effort required to fulfill it.

We solved this part of the problem by aggregating revenues and costs by account. Our first analysis covered discounting. By dividing the accounts into clusters of similar-sized relationships and then picking out the one or two accounts in each cluster with lowest average discount from list price, we determined this company's de facto market-driven volume discount policy. In particular, we proved that the company's official pricing scheme "25%-off for all" was not working at all in the market. See Figure 6 below.

We then mapped the remaining accounts onto the same chart, and discovered that Service Operations was right: Sales' discounting processes were totally out of control, and many accounts were getting discounts substantially in excess of this de facto policy. See Figure 7 below.

Figure 7

Many accounts received excessive discounts.



Next, we estimated account-level profitability, and found that margins varied all over the map. Some accounts were getting stronger discounts than the de facto policy suggested, but were nonetheless highly profitable, because they were inexpensive to serve. In these cases, either by design or good luck, Sales had chosen to share some of this extra margin with the account, thereby cementing a good relationship. In other cases, however, accounts that were relatively high cost to serve also received huge discounts, resulting in poor account margins.

Fact Sources: Review of pricing, discounts and profitability by account; subsequently reinforced by customer interviews and conjoint analysis

This first phase of the project resulted in two immediate changes to our client's pricing policies. First, he replaced the official pricing model with the volume discount policy we had derived. Second, we created a simple process for estimating account-level profitability and embedded that set of calculations into the process for approving extra discounts beyond what the volume discount model called for. For high margin accounts, sales managers could approve extra discounts. For poor-margin accounts, they were instructed to hold the line on prices, no matter how much the sales reps complained.

The second phase: value pricing and communications, service bundling and improved account management for portfolio items (ii)–(iv)

Our second phase was to determine what should service prices be relative to the competition. For this phase of the work, we conducted in-depth interviews with three to ten different economic buyers in each of the same three-dozen accounts. We also invited the same individuals to participate in an adaptive conjoint survey administered over the Web.

From the interviews we learned several things. First, customers found our client's services to be significantly more useful than corresponding services from competitors; our client staffed its service functions with more skilled engineers and imbued them with a superior service ethic than did the major competitors.

Fact Sources: Customer interviews and discussions with client's sales reps showed a gap between delivered and communicated value

Second, we learned that the economic buyers were typically unaware of what they were actually paying for the services they were buying. Final price negotiations were left to purchasing agents who would simply report back that our client was "expensive." A quick check showed the unsurprising result that the purchasing agents made the

same report on every vendor – it is their job to beat vendors down on price. As a result of this lack of clear awareness of pricing, the economic buyers could not evaluate whether or not they were over-paying for the extra value in our client's services. The default conclusion that they drew, no doubt colored by the purchasing managers' comments on prices, was that they were overpaying. The clear conclusion from this observation is that our client's sales reps needed to do a much better job of communicating value to the economic buyers, and not default that communication to the biased purchasing managers.

Fact Sources: Customer interviews and discussions with client's sales reps showed a gap between delivered and communicated value

Third, we learned that our client bundled his services into packages that touched multiple economic buyers in the customers' organizations. As a result, either purchase decisions became very complex, long-cycle sales to get everyone affected by a given purchase to agree on what to buy, or else buyers had to buy more services than they wanted to get the services they needed, effectively increasing the price side of their price-value calculation. When we reported this observation back to Sales, we learned that the sharpest sales reps were in fact unbundling these complex packages to simplify the sales process. We recommended that our client re-package its services to align them with the buying authority of single departments within customers' organizations.

Fact Sources: Customer interviews and conjoint analysis pointed to the needs for service re-bundling and improved account management

Fourth we learned that customers' appetite for our client's services was substantially higher than actual sales. In short, most accounts were substantially under penetrated. Many sales reps were not finding their way to all the potential buy-points in a given account, and thereby leaving significant amounts of potential revenue on the table. This observation was immediately incorporated into Sales' account planning process.

Fact Sources: Customer interviews and conjoint analysis pointed to the needs for service re-bundling and improved account management

We then analyzed the results from the adaptive conjoint study to calibrate pricing for the different services. We learned our client's superior service delivery model commanded price premiums from 10 to 20% relative to comparable services from our client's competitors. Further, the conjoint analysis enabled us to measure the relative value of the different service elements, so that our client could price the re-bundled packages to value.

Finally we found that certain modest changes to how services were delivered could increase buyers' perception of value far in excess of the marginal cost to make the changes. Our client then made the corresponding service reformulations.

Fact Sources: Customer interviews and conjoint analysis pointed to the "correct" prices for service bundles relative to competitors and each other

Project value and lessons

At the conclusion of this work we estimated the revenue and profit impact of all of these changes to be at least 12% incremental revenue every year in a multi-billion dollar business unit, and possibly as much as twice that. These incremental revenues would come from a combination of better discounting control, reformulated offers, pricing to value and greater account penetration. Given the leverage in our client's business model, the profit impact would be even greater.

The two key lessons from this example are:

1. How much one can learn by asking the right questions across a surprising small sample of accounts, in this case an in-depth analysis of approximately thirty accounts. Our client could proceed with confidence because each recommended action was supported by two or more facts from:
 - The analysis of discounting and customer profitability
 - The in-depth interviews, and
 - The conjoint analysis
2. How much more powerful a portfolio of strategic actions can be than any single element in the portfolio. Our client could proceed with a high degree of confidence that the expected incremental revenues and profits would arrive as expected because any shortfall from one action would be offset by upside surprises in the others.

In conclusion

This Facts for Action™ approach produces very compelling and actionable analyses of competitive threats or operational issues that enable our clients to respond quickly and confidently. It pulls together small amounts of information from a number of areas: customers and distributors, sales forces, marketing staff, finance, and operations.

This approach then ties all these inputs together to paint a coherent picture of the whole situation. It helps to distinguish what is truly important from all the background noise and identifies the portfolio of fundamental actions necessary to resolve important issues with a high degree of confidence in the outcome. And it does all this quickly without launching massive data gathering and analysis exercises that are often more confusing than enlightening.

About the author

George Sacerdote, the President of Sacerdote & Co., Inc. has counseled telecommunications and information technology companies on issues of corporate strategy and operating efficiency for 25 years. Recent consulting projects he has led have included:

- Developing and implementing market-based corporate strategies
- Improving efficiency and effectiveness of customer-facing functions such as sales, marketing, and customer care
- Successfully acquiring and integrating new businesses
- Using Internet and allied technologies to achieve operating efficiencies and improve margins

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