SERVICE EXCELLENCE JOURNEY IN SMALL-STEP VIDEO CLIPS:

VERSION 1.0

VISION: For past clients that have used one or both of my video-based training products[1], this will be the next iteration. I envision well over 100 YouTube video clips with an index of content and links here at www.merrifield.com. For fans of 24/7 e-video learning, there are two sites that particularly inspire me: www.ted.com and www.khanacademy.org.

Ted.com offers the best and brightest in their research niche to do an 18 minute or less, best infomercial possible. Ted can then offer these often fantastically compelling presentations to the world, and the resource hopes that fans will Google them and subscribe to their: book, video, course, corporate services.

Khan Academy is a great tutorial support for any high school kid taking just about any course. Go there and watch some of the publicity videos and one or two of the teaching modules that appeals to you the most.

This collection of video clips will be open to other contributors. There are plenty of wise distributors and consultants who can augment – with depth, breadth and specific channel cases – as well as counter-point my views. All are welcome to contribute. Contact me, and I will help you interpose your contributions in the video clip format.

These video clips will allow any distribution executive who wants to turn their business into a high-performance wealth creating machine for all stakeholder to learn whatever they want, whenever and wherever. And, to use it as an instant training tool for 1 or more associates, customers or suppliers. Hope you like the idea and the clips which will be posted by October 1st.

The outlines that follow are living documents. I will continue to revise and expand them with the intention of eventually doing video clips on all points and questions therein.

MAIN SECTIONS TO BE COVERED IN THIS PROJECT:

SECTION ONE: WHAT ARE THE BIG QUESTIONS?

SECTION TWO:WHAT ARE MY TEACHING ASSUMPTIONS IN THIS ENDEAVOR?

[1] The first video was a VHS format created in ’86 entitled “The Dynamics of Distribution” which had 9 modules totaling 3 hours and 20 minutes of content. The sequel, “High Performance Distribution Ideas for All”, was created in ’01. It has 53, roughly 10 minute modules totaling 11 hours and 40 minutes of training. It is still available on our homepage, although any prospect that sits through a Waypoint Analytics demo or attends a Waypoint sponsored, “Advanced Profit Management Conference” can get a free copy.

SECTION THREE: WHY DO THE BIGGEST BUSINESS GAINS COME FROM CHANGING MINDSETS?

I. GENERAL QUESTIONS ABOUT SERVICE VALUE
II. HOW TO ACHIEVE & THEN SELL DISTINCTIVE SERVICE VALUE
III. NECESSARY ANALYTICS FOR:
   a. DEFINING NICHES & SERVICE MODEL CUT-OFF BOUNDARIES
   b. TUNING FILL-RATE ECONOMICS
   c. FOCUSING EVERYONE (ESP. REPS) ON WIN-WIN SUPPLY CHAIN ECONOMICS & NET PROFIT IMPROVEMENT
IV. HOW TO MIGRATE A PRODUCT/SALES CENTRIC SALES FORCE TO SUPPLY-CHAIN VALUE CONSULTANTS
V. HOW DOES SERVICE EXCELLENCE EXPRESS ITSELF IN THE ULTIMATE BY-PRODUCT, DERIVATIVE-SYMPTOM AREA: FINANCIAL NUMBERS FOR ALL STAKEHOLDERS

SECTION ONE: WHAT ARE THE BIG QUESTIONS?

For each stage of a channel's industry life-cycle (most are in the last "consolidating stage") what is the appropriate type of outside sales force and their: sales objectives; selling skills; and compensation incentives?

Why in most product channels has the power switched from the manufacturers of unique, expanding product lines with exclusive distribution channels to big end-users dictating most efficient, demand-replenishment, service systems for the repeat buying of commodities that are distributed widely?

What exactly is "service value" for each niche of customers that a distributor might choose to target?

How should a distributor proceed then to – define, measure, improve to distinctive levels, sell, get paid for and partner with – basic, service-excellence?

How does a distributor's service model; cost-to-serve; and the net-profit growth for each customer inter-relate?

What are the differences between a traditional distributor that runs their sales/marketing efforts to achieve growth in (product) sales and gross margin dollars v. a distributor that seeks to:

> Maximize net-profit per customer and customer niche by maximizing the spread between best-supply-chain-service-value to the customers and the cost-to-serve those customers and then customizing replenishment systems as needed by each large customer?

Penetrate and retain best (growing) customers in best target niches at a greater rate (lower defections to competitors) than product (and sales rep) centric competitors.

If product-centric distributors discover that roughly:

20% of their customers generate 150% of the peak, internal net profit

20% of the suppliers generate 170% of the peak, internal net-profit; and,

20% of the active SKUs generate 500%+ of the peak, internal net-profit

And, in all three views – customers, suppliers, and items – the bottom 1-5% are large, active, profit eaters.

Then:

How can a distributor have different peak, net-profit numbers?

How much more net-profit is possible from managing the top 20% elements better than the average or diluted attention that they had been receiving?

By diagnosing the underlying reasons for the big losers, how can they be transformed into highly profitable contributors with different service models and precision supply chain solutions (often already existing and proven in consumer channels)?

For a distributor to migrate from selling products for more volume and presumably margin dollars and profit to the paradigm of “service value less cost-to-serve” customer-niche centric selling, what is the best educational delivery approach?

<u>SECTION TWO</u>: WHAT ARE MY TEACHING ASSUMPTIONS?

E-video training is the way to go.

In an ADD world, video clips longer than 5 minutes will be “too long”.

Most people need to listen to a new idea multiple times before they really get in a way that they will both remember and use it. The e-videos will never get tired of replaying.

When teaching whole new ways of looking at a business, most people are not going to readily see the new forest or paradigm and be able to creatively fill in all of the new details. Most would rather master one indivisible concept/idea at a time (trees) that eventually add up to a dynamic forest that has both living and dying edges to it.

Speaking of “new paradigms”, the 100-year-old push products and more volume through channel paradigm is over. A one-best-book that explains why it is now time for “precision supply chain solutions” is entitled: Islands of Profit In a Sea of Red Ink.

How can all 5 competitors in the same market do the same strategic rethinking of their business and all do better? It is because of niche math and the distinctive best in each niche dominates the “profit pool” for the niche.

#1 gets the lion’s share. In consolidated, mature industries the #1 best players will capture about 80% of the profits made in the industry, #2 gets the rest, and the others are breaking even at best.

Don’t be a decathlete, dominate 2 out of every 10 niches you are currently selling. Assume 5 competitive distributors in one market are all going after 10 different customer niches with the same general, industry model for competing, then:

> They are providing un-adaptable, mediocre service value to all customers
>
> None have sufficiently differentiated, compelling better service for any one niche. They all think that they have better service than their competitors perhaps based on generic service metric measurements in-house. But, they all still must meet the competitors’ lower price in their established accounts to keep the business. 90% of distributors have, therefore, devolved into selling commodities for a price. Cutting costs and compensation is the short-term cure for survival before death.
>
> All ecosystem companies and employees are losing.

But, if each of the 5 re-focused on being distinctive within two niches that they dominated, then:

> They might all have the same volume in sales, but
>
> They would be delivering much higher service value for their target niche customers at a much-lower, tuned-to-the-niche, cost-to-serve with 2 to 4 times the profits and return.
>
> Every ecosystem stakeholder group would be better off due to strategic focus effectiveness.

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MINDSET QUESTIONS:

1. What is a new paradigm? (earth is round not flat; bacteria exist, wash hands; sell supply chain effectiveness to retain/penetrate best customers/niches instead of product for price to all possible customers)
2. Some complicated paradigms must be understood a meme, building-block at a time.
    a. Analogy: 1 tree at a time adds up to a forest which turns out to have both living and dying edges, and movement in a particular direction.
    b. A meme is the smallest indivisible concept that can go from one brain to another (Wikipedia it, entire pseudo-science called "memetics")
        i. Advertising lines: "where's the beef?"
        ii. Songs/tunes: "somewhere over the rainbow"
        iii. Aphorisms: golden rule
    c. Some memes can expand into or are part of a bigger meme-plex: an inter-related cluster of memes. Memeplexes that will be part of this e-video project:
        i. The right service value equation for a best, customer niche with the right-tuned service model lowers both the total procurement cost (for the customer) and the cost-to-serve (for the supplier) while increasing up-time economics (for the customer) and increasing economies of scale within and barriers of entry to the targeted niche for the successful distributor branch.

    ii. Everyone wants to partner with <u>a "gazelle" firm</u>; gazelles chose only the best – employees, suppliers, customers and investors – for partners.
        1. Gazelles are the 4% within a mature industry that are perpetual innovators. This allows them to expand more rapidly and profitably than their industry and provide all stakeholder groups premium present and future economics.
        2. Since everyone wants to ride these fast trains, the gazelle can then choose the best partners to work with and get their best efforts. A virtuous cycle back to #1 is created.
        3. What are all of the high-performance service values, strategies, principals and tactics that we can borrow from gazelles to become one too?
    iii. <u>The "service profit chain</u>": a) Best people work together to. . b) make best service value happen daily which… c) achieves maximum profits to… d) reinvest in the next round of growth for all.
        1. There are many internal reinforcing cycles within this "strategy map".
        2. This map does not tell a branch, though, what its best, most profitable historic niche of customers is and how to do that niche two times better through refined service and net-profit focus.

3. What are the origins of our existing belief-systems that have many data-unproven, half-truths? How do they hold us back?
    a. Financial management assumptions, guidelines that are flawed:
        i. <u>***Buy low***</u>? Or, buy
            1. the lowest total procurement cost with
            2. the best turn-earn and best fill-rate economics
            3. the shortest consistent lead times
            4. from the supplier with the best next 5 year improvement trends
            5. with the best operational "kinetic chain score"
            6. and the best track record at supply-chain partnering
        ii. ***Sell high***?
            1. for what distinctive extra service value that makes a higher price a total-cost bargain?
            2. if we have best service, why not propose partnering with key customers to get all of the volume on a more integrated, automated basis so that together we can: Lower their TPC, increase their uptime economics, lower our cost-to-serve

more than the price, and make a better net-profit on much more volume.

iii. **<u>Collect early</u>** (not an ROI sensitivity, just don't get write offs)

iv. **<u>Pay late.</u>** not realistic with consolidated, suppliers and their discount offers

v. **<u>Hire them cheap</u>**.

1. then service value can't happen
2. don't measure "PPR" (people costs divided by total margin dollars), but the inverse VAPE (value-added per employee = total margin dollars (our value added) by employees. The higher it is the more we can pay everyone.

vi. **<u>Work them hard</u>**. (working smart and service value focused with good, retained, cross-trained people is the way to go)

vii. **<u>Sell more</u>** to see more incremental margin dollars flow past the fixed costs of running the business (distributors have high operational leverage like manufacturers use to?) Distributors are one of the most variable cost business models and service capacity can be readily redirected in many ways.

4. Sales volume assumptions that are more flawed as an industry life cycle ages; why; and what better alternative guidelines:
   a. get more sales by getting more lines and items to sell to more customers by more sales reps (feet on the street)
   b. all items that move at a "decent margin percent" are good
   c. all customers that generate any margin dollars are good
   d. little customers grow into big customers like acorns into mighty oaks
   e. items and customers that average the highest margin percentages are very good
   f. all sales reps are profitable if they are on commission and covering their draw
   g. a commissioned sales rep can -- 100% by themselves -- meet all of the on-site customer needs (don't mess with their territories).
   h. for sales reps to be protective of any other employees generating their own loyalty links to the highest net-profit, net-present-value customers is OK
   i. if sales reps have below-average share of a gazelle customer account, that is OK.
   j. if senior reps want to harvest their territories that is OK
   k. if sales reps want to continue to call and sell the way that they have always been doing, even though the times are changing along with

personnel at key accounts and what their buying strategies might be, that's OK.

l. for g-k, we have no measurable standards, limits, boundaries for sales rep behavior which is OK.
m. if we aren't nice to the sales reps, then they will switch to a competitor and take their business (all of their most net-profitable customers?) to the competitor?
n. what are the criteria for the few reps that do control what-criteria-type customers? Is this a fading fear that can be managed in a very focused way as opposed to thinking about sales rep policy in global generalities?
o. why don't we have customer-centric sales rep/service team and compensation policies, especially for the 5-10 highest NPV customers?

5. INDUSTRY LIFE-CYCLE REVIEW TO RE-SYNCH WITH WHAT WILL BE.
   a. Managers tend to manage by drawing upon the experiences and guidelines that they gathered while growing up in the industry. But, if the industry is changing, then how dated or lagging might their belief-systems be?
   b. Industry and companies in industries can go through four general stages:
      i. Entrepreneurial start-up beginnings
      ii. Systematic, hierarchical expansion
      iii. Maturity, Consolidation
      iv. (Eventually) Decline
      v. 99% of all businesses that ever existed in the US don't today
      vi. How do we avoid being the star of "Good to Great" in 2000 to terminal by 2002 like Circuit City?
   c. Lifecycles for product distribution channels stayed in the first/second stage take-new-products to market from as early as 1880 to roughly 1985. Long enough to think they should never change.
      i. Then the rate of change in all mature industries started to rapidly increase with the data/automation/quality/roll-up/globalization trends from the mid-'80's on.
   d. To get good at the success rules for the next stage of a lifecycle reduces, however, the value of veteran managers and sales reps experience.
      i. Who wants to be a beginner again (and perhaps get paid like a beginner in a new job and industry thanks to huge consolidation and automation)?
      ii. How do you measure what could happen in the future? Why not just measure the past which we can do and fine-tune it?
      iii. Any change involves measurable expenditures and people dissatisfaction/resistance NOW. We have 20/20 nitpicking

downside risk vision, but who can see the un-measurable dynamic upside of future. Isn't a bird in the hand NOW, better than four that might not be in the bush?

e. What are the life-cycle stages and appropriate strategies for each one? ("Dealing with Darwin" for distributors):
    i. Stage one: making market demand. Remember exclusive supplier franchises worth having and growing up with America (through '82)?
        1. Sales agency commission, product volume promotion stage; feet on the street; all new accounts are good accounts (and most were growing with post WW2 boom; now shrinking with "new normal").
    ii. Stage two: Formal sales management and marketing campaigns. Capturing customer share from the competitors with more products, more services and better reps.
    iii. Stage three: Consolidation. Product push => supply chain demand replenishment buying
        1. How/when did 90% of our sales involve equally-excellent commodities (in the customers' minds)?
        2. '82-90: TQM + Lean Manufacturing + Chip-powered robotics => 6 sigma clones
        3. Law of diminishing, then negative returns on (micro) niche products for the steady activity cost models within physical distribution channels.
            a. New opportunity for web-sellers of freight-friendly, long-tail, parts and pieces that can't turn well locally with high picking costs per line.
        4. When did customers start wanting perfect service from fewer-to-one integrated-supplier to achieve lower cost supply chain replenishment systems?
        5. Drivers: Experienced repeat buyers know all they think they need to know about repeat-buy products and how to use them; product quality is guaranteed; customers under industry consolidation, take-cost out pressure; have WMT's "quick response" envy; have SAP-type total supply-chain process software capability (e.g. centralized spend management on MRO needs and maverick purchases); b2b ecommerce technologies for global 2000+ corporations.

6. Key dates in shift from factories push product volume through distributors – to – big end users pull, demand-replenishment supply chain systems through distributors:
    a. ’88 WMT “no more reps” and going into groceries
    b. SAP + re-engineering in ‘90’s
    c. In ‘90’s HMO’s trigger consolidation of healthcare providers & distributors and ISS contracts from customer back through distributors to manufacturers
    d. GE trumpets ISS success for MRO buying ‘96
    e. WWG enters ISS in ’97
    f. 2001 NAPM changes name to ISM
    g. NAPM survey on what do you value most
    h. ’70 outside rep #1; ’90 7^{th} place (and last)
    i. Why did Circuit City fire 100% commissioned sales force on February, 2002?
    j. Why is Best Buy struggling now?

f. If all creatures in our product-channel ecosystem – suppliers, rep agencies, distributors, customer groups, trade associations, ERP vendors – are consolidating, then what two groups of creatures do we partner?
    i. What are gazelles?
    ii. How do you find them; evaluate them
    iii. NPV of net-profit stream from gazelles
    iv. And, partner, value-added, operating consolidators. Be careful of financial only roll-ups.

g. Why would they want to partner us? Basic service excellence guaranteed + “yes, can do” to supply chain co-creation solutions.

h. What type of rep force, selling what with what comp plan do we need for each stage of the lifecycle?
    i. Take new products to market: agency model
    ii. Maturing markets with some brand preference – add/sell BSE, TPC, Uptime
    iii. Consolidating markets: marketing team x consultative ISS goals, practices
    iv. Direct sales to contractor-principal buyers last bastion of “relationship-loyal” selling.
        1. Do you think factory reps are worth 5% of sales to your bottom line?
        2. Would your reps like to sell their cost to customers on an unbundled basis?

            3. Who will skim your biggest, most profitable accounts with a new sales value/cost model?
            4. Why not break “sales force” questions into sub-sets?
            5. Have customer-centric incentive pay based on “net-profit improvement” to be aligned with management incentives?
        v. Why is pushing products for prices (with reps incentives tied to gross margin) the path to: bankruptcy, liquidating or selling out unfavorably?
            1. Too many players and capacity still doing it for not enough old school demand; profits and future re-investment are negligible.
            2. Old school buyers are dying.
            3. Incremental profits can’t finance working growth and a good stakeholder talent.

6. We lock in, reinforce and amplify belief system half-truths with:
    a. GAAP accounting rules to pay taxes and borrow from banks
    b. ERP Software to support GAAP needs leaves us with financial metrics
    c. Incentives that are geared to volume and ignore cost-to-serve and net-profit of customers and items
    d. Co-created channel partner systems and expectations
    e. Seniority entitlements base on the assumption that the growth stage will go on forever v. leveling out
7. The alternative of doing the Long Service Excellence Journey on uncertain trail is paralyzing and can’t afford it right now.
8. How to lower the cost of each step while increasing the immediate free-cash-flow payback at the start of this journey?
    a. Big cash burn for big (possible?) return doesn’t work for most distributor executives.
    b. No outlay (except free OT sweat equity) for fast smaller return is possible.
    c. Lots of singles before maybe a double.
    d. Downsize, upgrade turn-around approach generates free cash-flow, more profits immediately…but practically requires an outside, top-down, value-added turnaround ace to execute it.
9. Oldest, highest paid don’t have the energy to change nor the long-term need to…grandfathered in and good luck to the next generation of owners, managers, stakeholders.
10. “We already know what to do, and we are doing it” (at a hacker level). In a service process industry, are:
        i. All of our people black belt Nth degree (BBNth) performers or is there a wide range of excellence with the average being quite average?
        ii. How fast can we grow new people to be BBNth performers?
            1. Recruiting systems for attitude and aptitude?

        2. Culture training + functional cross-training to sustain high-performance, high-service quality economics?
    iii. Otherwise, firms rise and fall with the quality and intensity of the leadership at the branch level.

11. How do we nibble at the edges of our belief system to start migrating towards selling supply chain – tweakings, tunings or new custom service solutions?
    a. Name and educate all about the old-order "half-truths" next to the new order assumptions coupled with hard, factual 'COST-TO-SERVE & NET-PROFIT PER CUSTOMER AND ITEM evidence enough times to: understand, accept, comfort-zone and eventually embrace a step at a time.
    b. Rules of 5-7 for getting, accepting and remembering it.
    c. Rules of 1-10 for being able to teach, tell/sell new ideas with inculcating conviction.
    d. Use evidence based analytics to prove and focus on new-think, net-profit improvement opportunities.
12. How do we make brilliant -small steps; experiments; mistakes – to learn for free?
    a. Wheel of learning.
    b. Designing a good experiment x 9f's.
    c. Take one high-leverage area bite at a time, build confidence, skills and MO.

D. Bruce Merrifield, Jr.

Merrifield Consulting Group, LLC