**Theme 2 : Profit Pools – a fresh look at Strategy**

**U-haul example:**

* Battle in u.s. consumer truck rental business.
* U-haul appeared to be at disadvantage, older fleet of trucks, higher maintenance costs than rivals **but**  charged lower prices
* Looked like likely to fall behind but actually most profitable company in the industry -10% oppertaing margin above industry average of 3%, the number two competitor abandoned the consumer rental business selling off its fleet
* U-haul looked beyond core rental business and found large untapped source of profit. – accessories to business, boxes, insurance and storage space.
* Margins low because consumers shop around aggressively for best rate, accessories was different story. Once signing contrat becomes captivated by company and compelled to buy the accessories.
* Recognizing true profit structure of its business u hauls scooped up cheapest storage space in key locations before competitors could react gaining cost advantage.
* Kept prices low to ensure high volumne of customers selling accessories to them.
* U hauls strategy redefined the rental business giving the company control of large share of industry profits.
* There are many different sources of profit in any business, business that sees it first will be best prepared to capture a disproportionate share of industry profits.

**Gucci- problem with growth**

* For most managers growth is the holy grail.
* When changing strategys usually focus ways to expand revenuses believing higher sales will bring higher profits.- scale of efficiencies
* However profit doesn’t necessarily follow revenues.
* Gucci luxury leather goods- launched aggressive strategy of revenue growth- added set of lower price goods and pushed goods into department stores.
* Sales soared but it carried a high price- tarnished its sterling brand image
* Sales of high end goods dropped leading to erosion in profitability.

**The profit pool lens:**

* Profit pool can be defined as the total profits earned in an industry at all point along the industrys value chain.- structure is usually complex
* Shape of a profit pool reflects the competitive dynamics of a business- profit concentrations form from actions and enteractions of companies and customers they form in area where barriers to competition exist or areas that have been overlooked.
* Many mangers pursue startegies that run counter to them by focusing on revenue growth and market share assuming that profits will follow
* To create strategies that result in profitable growth help to begin by creating a systematic picture of and industy profit pool.
* Profit pool map answers most basic questions about an industry. Where and how is money being made?
* Us car market- from revenue 60% is sales. But profit pool lens reveals that auto leasing is by far the most profitable activity in value chain and other financial products sucah as insurance and loans are above average. The core activies are characterised by weatk profitability.
* Care manufactures moved towards auto financing- ford generating half its profit from financing over the past 10 years but only accounts for 20%companys revenue
* Today auto dealerships are only marginally profitable most profit comes from service and repair because of over production. Used car sales tripled in 1996- dealers investing here
* Some profit sources exert influence over others and shape competition- leasing cars will become used cars therefore saturating the used car market lowering prices.

**Turbulent industries:**

* profit pools useful in industries undergoing rapid structural change- results in a shift in the distribution of profits along the value chain- can open or close sources of profit.
* Pharmaceuticals – merck triggered wave of restructuring in industry when it acquired medco the larges pharmacy benefit manager. Others followed suit.
* Companies critised for overpaying for these acquisitions but accoreding to profit pool perspective comapnines received more than their moneys worth.
* Traditionally profits generated by developing new drugs and convincing doctors to prescribe them. Patent protection for new drugs eliminated price competitionand because drugs were mainly paid by insurers customers wernt price sensitive
* Distribution of drugs was separate layer in chain but low margin business.distributors earned oprerting margins of 5% far lower than 25% of manufactures.
* Pharmacy drug managers began to move into business seeking to control cost for their cooperate clients. This posed a direct threat to established profit structure of industry.
* If they were succesfu lthey would be able to siphon off profits from drugmakers.
* Us federal government stepped in to put restraints of pbm’s influence over prescriptions.
* Oveall did not over pay for the acquisition mercks market value rose by 80billion and lilly market value tripled.

**Choke points in the profit pool:**

* When economy was based on seaborne trade country that held strati of gibralter had enormous power.-had control of flow or revenue and profits to nations.
* The strait was an economic choke point that helped determine the shape of world commerce.
* Can arise because of- granting of patent for a core component of a product, establishment of industrywide operating standard that all companies must obey, consolidation of contol over the customer interface.
* Choke points take many different forms-intels dominance of microprocessors. However do not always represent major sources of profit bu hold enormous strategic importance. Can influence the distribution of profits among its direct competitors and among other value chains.
* Micro soft built on control of choke points.

**When growth isn’t good:**

* Pc industry-profit much more highly concentrated in microprocessor and software segments than in hardware manufacturing yet few can challenge Microsoft or intel as they have resources to defend themselves.
* Company can look within its own profit pool for pockets of profit.
* Dell- competes in the least attractive segment of industry but has unique perspective on industry.
* Operates on direct sales-departed from industry norm- eliminating the middle man allowing it to keep a portion of the dealers profit poll for itself and shares it with customers by way of lower prices.
* 1990’s dell suspected unable to sustain companys growth trajectory by relying on direct distribution along.
* Dell entered retail channel- strategy worked dell grew more than 505 per year from 1989-1993 but losses in 1993.
* Retail chanel simply not profitable.serving customers one to one allowed them to monitor changes, by going through indirect channels it lost vital conduit to its customer base.
* Pulled out of retail channel in 1994 gearing its business to serve only the most profitable segments such as big companies, regularly tracks profit pool and is able to respond quicker than its competitors, also declines to participate in less profitable parts of industry.
* Dells sales tripled between 1994-1997 pretax profit of 9% three times industry average, controls approx 10% entire profit pool for pc’s.

**Creating and managing a profit pool:**

* In rapidly growing industry profit pool perspective helps dell to focus and refocus its resources on its best opportunities.
* U.s. beer industry- anheuser bush had insigh about making and marketing of beer, disparity between profitability of premium and discount beers- both cost same to produce and distribute but premium sold at higher price,
* Would need to improve image by advertising to increase market share in premum sector and carefully manage difference between discount and premium beers.
* Needed to be assured of market share if making investment that profits would not be eaten away by by competitors. Needed to make premium sector less profitable for its competitors needed to build cost advantage over competitors to do this.
* Packaging- changed from bottles to cans would produce big savings, could fit more on delivery truck and save money- was able to extend distribution radius with increased volume
* Integrated vertically and offered special offers to outlets to ensure sales.
* Grew its profit pool by expanding premium sector but also cutting manufacturing and dist costs and raised competitive barriers.
* Competitors were unable to match advertising and economics of scale of amheuser

**A new set of imperatives:**

* Profit pools can take many shapes depending on economic and competitive forces at work in industry.
* Use pool to identify new sources of profit in low margin industries,- u haul, to chart acquisitions and expansion strategy – merck, to decide which customers to persue – dell or guid product pricing and operatind decisions- amheuser busch beer.
* Understanding of pool helps gude decisions about every facet of a companys operation and strateg
* Offers a very different perspective on an industry
* may require over turning of old assumption or rethinking of old decisions to formulate strategy.
* How a company puts its profit pool insigh to work will depend on companys competitive situation, capabilities economics and aspirations.