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‘The Scarcity Playbook’

Tim Romberger –
December 3rd, 2021

The cover of a recent edition of *The Economist* read ‘The shortage economy’. Whether you are running a business or simply looking to do some early holiday shopping, it is hard to miss what *The Economist* was trying to capture: today we live in a world where in many markets demand is outstripping the ability of companies to supply it.

You can debate the underlying causes:

- Container ships unable to unload cargo in ports around the world
- A suddenly disappearing labor base that reflects some sort of macroeconomics version of the 1978 cult classic ‘Invasion of the Body Snatchers’
- A Covid-induced shift in consumer spending from services to products, or…
- Government policies that are now putting up barriers to the free flow of goods across borders

Regardless of the underlying drivers, the implication is clear: companies that create value for their shareholders by converting resources – labor, materials, or capital – into profits must adapt to a current reality in which there are less of at least two of those to go around.

In the brief commentary that follows we draw on recent experiences and best practices to offer up four ideas on what companies can do to drive value under these conditions – or what we refer to as the ‘**scarcity playbook**’.

Pick Your Spots

Be willing to make significant – rather than incremental – changes in how you allocate your capital, capacity and commercial resources to grab share in priority segments

A good strategy is more important than ever. If you have fewer resources, you need to use more discretion in where you deploy them. What are the most attractive markets from a top-line growth and bottom-line return perspective? In which markets do we have a right-to-win based on the relevant sources of competitive advantage? Lean hard into those segments that pass both screens and then stress test those segments against your pipeline, your channels to market and where the sales team spends its time. As part of a recent strategic planning process a manufacturing client determined that roughly two thirds of its commercial sales time, and a greater share of its existing pipeline, was outside of the most attractive markets where they had the best chance of winning. In the current environment companies need to be willing to make significant – rather than incremental – changes in the allocation of capital, capacity and commercial resource to grab share in priority segments. The concept of not being everything to everyone is arguably critical whether living in the shortage economy or not, but that much more important when you are not flush with the resources you need.

Strengthen the Pricing Muscle of the Organization

If you have less stuff to sell (and it costs more to produce) you better get the best possible price for it. In some respects that is stating the obvious. But the reality is that over the past three decades most industrial and B2B businesses have created value via two primary levers: operating efficiency (cost reduction) and portfolio management (asset allocation). What has been less in focus is 'commercial excellence', for which pricing excellence is perhaps the most notable – and high impact – discipline.

Fundamentally most industrial companies are 'cost+' in the way that they price, given either:

- Highly commoditized markets where supply vs. demand and the industry cost curve dictate achievable margin relative to cost or
- Highly tailored/bespoke goods & services that don't lend themselves to a market benchmark price

Under these conditions those organizations with underdeveloped pricing capabilities often leave money on the table in three ways:

1. Not getting 'cost' right (e.g., differentiating between short and long runs, full vs. LTL loads, etc.) or contracting/transacting in a way that 'leaks' margin to the customer (e.g., unearned rebates, MOQs)
2. Operating with weak pricing governance which results in high levels of unwarranted price variance across similar products to similar customers, and often a long tail of low margin customers
3. Not tailoring margin targets (i.e., the '+') to be reflective of differences in leverage across products, services and customers – what we refer to as the 'courage meter'

Strengthening the pricing muscle of the organization via better processes, tools and resourcing is worth a lot in 'normal' times, but worth that much more in a world where its critical to realize every $ possible on each transaction. The CEO of one of our recent clients reinforced this point in noting 'the investment we made in building our pricing capabilities in 2020 really positioned us to handle the current environment much better that we would have otherwise'.

'Hard Code' Allocation and Order Management

When resources are scarce and capacity is tight, which customers get their orders filled first? This process of allocation in many companies is often ill-suited to the current market conditions and prone to influence from customers who know who to call or email when they want to get their needs fulfilled. The result is often an outcome in which allocation skews to larger, less profitable customers and away from those customers that offer better near-in profit realization and/or better longer-term growth.

A better approach to allocation will get scarce product in the hands of the most critical customers while delivering material margin improvement

A better approach is to formalize an allocation framework that splits customers into <u>cohorts</u> based on:

A. Whether they are single sourced or not (so we don't shut them down)
B. Differences in pricing/profit realization and
C. A segmentation framework that takes into account the nature of the existing relationship and the longer-term potential associated with that customer

Companies can then set guidelines for the proportion of demand (or % relative to contract) allocated to each customer based on the cohort they are in. This logic can then be hard coded into existing systems and order management tools such that orders that go above that allocation are kicked out for review prior to getting 'auto-filled'.

A better approach to allocation will get scarce product in the hands of the most critical customers while reducing the internal strain on resources responsible for managing that process and communicating in a timely manner with customers. But it is also worth real $ - recent experience suggests that small changes in allocation can unlock upwards of 100bp in margin improvement vs. typical approaches.

Make Customer Service a Source of Competitive Advantage

Regardless of the robustness of your allocation process, one thing is for certain when operating in the shortage economy: you are going to disappoint customers. Someone will get less than they want and/or later than expected. Or not get shipped at all. The first line of defense in this situation is a robust customer service organization. But in far too many companies the mindset associated with customer service is that of a 'cost center', secondary to sales, rather than a critical investment in customer relationships and demand generation.

But this is where opportunity presents itself for companies that want to think and act differently. The ability to respond to and communicate with customers in a timely and accurate manner not only serves to protect existing business, but also can be a platform for gaining share when your competition falls short. Recent 'voice of customer' surveys highlight a rebalancing in customer decision drivers, bringing 'OTIF', 'responsiveness' and 'service' more on par with 'product quality' and 'price'.

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The path to competitive differentiation in customer service is multi-dimensional. Increasing the investment in talent is one step, but just as important is ensuring internal processes and systems deliver the right information to the customer service team when they need it. Elevating customer service into more of an account management role alongside sales, while leveraging segmentation to skew resources and responsiveness to those customers that most need it are other possible steps. Ultimately building a better platform for customer engagement is the glue that reinforces the other elements of the scarcity playbook and puts an organization in a position to play offense instead of defense.

Concluding Thoughts

Whether a temporary phenomenon or not, the shortage economy is real and consequential in terms of its impact on any given company's ability to perform and drive value creation. But the current situation also creates opportunity for those companies that want to move more aggressively to strengthen their business models, commercial processes and underlying organizational capabilities. Labor will eventually return as government subsidies dry up, the container ship backlog will ease as the supply chain adjusts, and demand for goods will re-balance as people go back to spending more on services. Those companies that move boldly today against the scarcity playbook will not only most effectively weather the storm in the meantime, but also position themselves to win longer term.

About the author:
Tim Romberger is a 27-year veteran of the management consulting industry and currently runs the boutique advisory firm, TRC Advisory (www.trcadvisory.com). Prior to TRC Tim spent 20 years with Marakon, a global consultancy. In 2012 Tim took a short detour from consulting to co-found Cyteir Therapeutics (CYT), a now public early-stage biotech company focused on developing small molecule therapies for oncology patients. Tim sits on the Cyteir Board of Directors and also serves in a Board capacity for Sur-Seal LLC, a Heartwood Partners portfolio company. Tim received his BS in Economics from the Wharton School of Business at the University of Pennsylvania in 1994. tim@trcadvisory.com