

How aligned is your organization on the needs and methods for creating value?

Determining the real costs and benefits of strategic accounts at Electrolux Major Appliances - Europe

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Driving business profitability through customer value creation is a major undertaking, especially for global companies with highly complex customers spread around the world. Five years ago the European division of AB Electrolux, an international household appliance company, began installing the principles and tools of measurable financial value creation at the core of the division's strategic account management system.

Electrolux Major Appliances – Europe has created a system that enables strategic account managers to use financial data to manage relationships with strategic accounts, including the negotiation of annual agreements with these strategic customers. This unique system has not only resulted in significant profit enhancement but has also generated numerous projects for enhancing processes that have measurable benefits to both retailer and supplier.

Changing dynamics in the household appliance business

Although headquartered in Stockholm, AB Electrolux runs its European appliances division and international strategic accounts from its Brussels office. As an industry leader, AB Electrolux recognized several years ago that the concentration and global growth of a handful of retailing groups including Carrefour SA,

Karstadt Quelle AG, Kingfisher plc, DSG International, METRO AG and, of course, Wal-Mart Stores Inc., was resulting in more and more value being shifted from the manufacturer to the retailer and ultimately to the end consumer.

Consumers were being offered increasingly more sophisticated and more valuable products, yet at lower prices. The end result seemed inevitable. Retailers and manufacturers that could not find new ways of creating measurable value for their companies would disappear, leaving the market to price cutters with manufacturing operations in the low-cost countries of Eastern Europe and Asia.

Senior management at AB Electrolux determined that new systems for driving business with strategic accounts would need to be based on a deeper understanding of how the company made money with different customers.

Measuring the financial value created or destroyed by customers

The first major challenge we faced at Electrolux Major Appliances – Europe (hereinafter "Electrolux Europe") was calculating the amount of financial value each customer either created or destroyed for the company.

We started to understand that for shareholders to invest in our business, we had the responsibility to demonstrate where we invested, why we invested and what return could be expected. Hence, we needed to take

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the calculation beyond gross margins and even beyond the Earnings Before Interest & Tax (EBIT) level to begin to determine the asset investment requirement by customer.

What do we measure today, and is it sufficient?

One of the first challenges is to take the measurements beyond market shares, net sales and gross margins. Although this gives us good indications on profitability, they are only indications, which sometimes can be misleading. Why do we say that? Well, the explanation is quite simple. Each customer usually will operate a different business model, which will impose different costs on its suppliers. (See Figure 1.)

It is obvious that if Customer 4 and Customer 5 had the same gross margins, then Customer 5 would be the most profitable and potentially where we would invest. I say "potentially" because we had one other consideration to consider first.

We needed the cost of capital required for each customer, which was dependent upon the asset resources consumed. When you have accounts receivables that can vary between 3 percent and 40 percent of net sales and inventories between 0 percent and 14 percent of net sales, you could have 6 percent EBIT-positive customers that actually destroy value.

Understanding which customers created value and which were value destroyers was a major step forward. However, unless we could explain how this calculation was made and what the business drivers were to the operational organization, the exercise would not have had the desired benefits.

How do we get the sales organization to understand value creation?

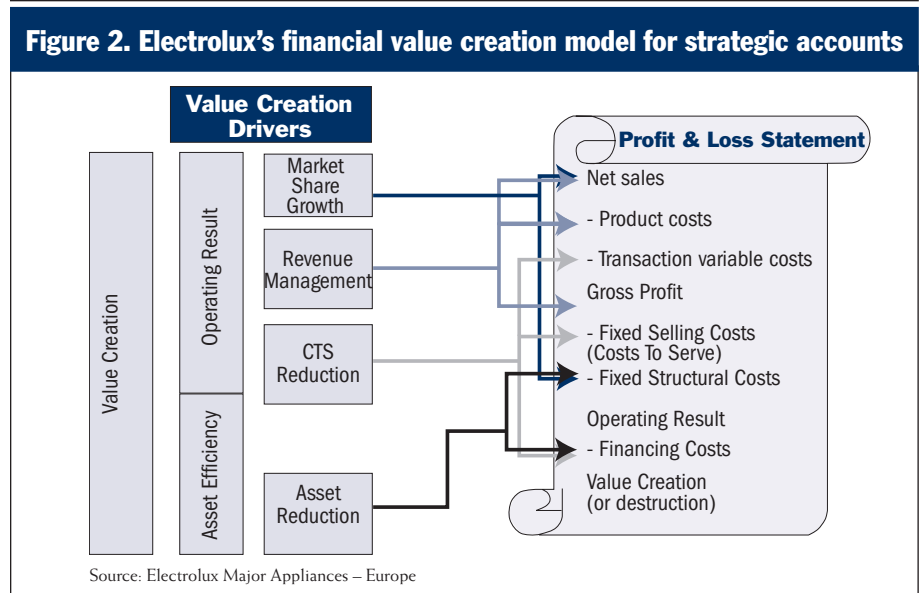
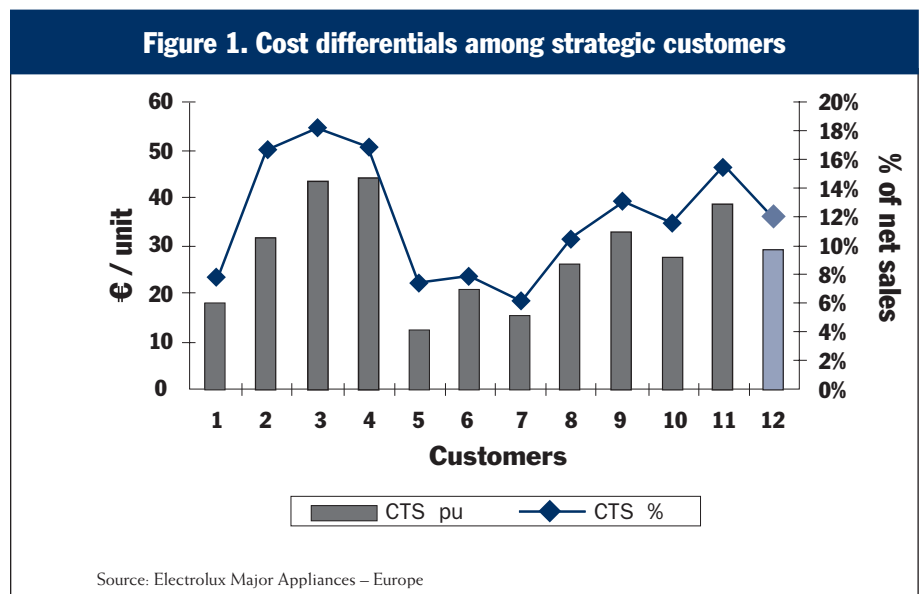
Electrolux Europe started with two standard measures of value creation – operating profit and asset utilization – and identified more detailed measures for each driver within the Strategic Account

Value Creation Profit and Loss Statement, which included the following:

- volume and sales revenue;
- variable manufacturing costs;
- variable transactional costs;
- supporting costs to serve for the account; and
- customer net assets tied up by the account (principally accounts receivables and inventory), multiplied by a weighted average cost of capital to reflect the carrying costs incurred by Electrolux Europe for carrying these assets on its books

There were a number of important features for these financial metrics:

1. The financial measures were directly reflected in Electrolux Europe's financial statements
2. Trust was quickly built into the figures, and a self-belief resulted that they really could improve the overall business, even in circumstances where price increases were difficult to achieve.
3. The financial measures used could also be influenced by both the retail customer and Electrolux Europe's own strategic account manager and supporting team. This meant there was more analysis than before, which led to more action-oriented direct improvements and joint improvement projects with retailers.



How did we get the sales organization to understand how to drive value creation?

Quite often we hear businesses requesting greater sales revenue or lower cost demands to drive profitability. But are those aspects the drivers or just the outputs? We put more emphasis on what we considered the drivers upon which the sales organization needed to understand and concentrate its efforts. (Figure 2 on Page 16 depicts how the Strategic Account Profit and Loss Statement connected to customer value drivers, which could ultimately be connected to improvement actions.)

The two measures that were the most challenging to establish and yet perhaps the most interesting were cost to serve and customer net assets.

Cost-to-serve calculations were based on direct costing of such elements as shipping costs, warehousing, service, etc., plus activity-based assignment of costs, such as order processing, customer service, etc., to customer accounts. This was a major challenge as the controllers in the organization had cost centers and allocation bases that were not applicable in doing proper cost-to-serve calculations

on customers. We had to take a leading role in a challenge that still today can be difficult in parts of our organization.

Calculating the value of customer net assets was not straightforward and had been previously considered too complicated. We had the difficulty of figuring out how to allocate warehouses, factories, payables, etc., to a customer as it was even difficult to arrive at a country net assets amount. Hence, our design of a simple approach based on our company's balance sheet structure. We could take the customer's accounts receivables balance, and where we had a supply chain model for a customer that was more efficient than the country average, we made a financial adjustment – in reality a credit – to the accounts receivables net asset number. In this way we were able to apply a net asset figure to each customer that from any detailed scrutiny gave us a very reasonable and fair net asset number per customer.

The beauty of this model was that all our sales organizations could easily understand their customers' net assets and cost of capital, but even more importantly they understood how to lower their cost of capital, thereby improving the value generated by their customers.

Some key components in changing to value creation

In going from gross profit to value creation, we opened many management areas that previously did not get the attention their potential warranted. We have already mentioned the subject of understanding the customer's cost to serve and asset requirement. The potential from our management of these two areas alone was enormous. We would like to touch on some other areas that when we gave greater focus brought insights that yielded more visibility and, hence, better investment decisions.

Market share or profitability?

Many sales organizations debate whether their organization seeks market share or profitability. In reality it is difficult to realize profitability goals unless the organization has sufficient market share, meaning a No. 1 or No. 2 spot in the marketplace. This is particularly true in the high-fixed-cost appliance industry. Hence, market share becomes a driver in creating value.

But not all market share can be beneficial. This is when we brought the financial and sales organizations together and mapped where our market share stood and where we were gaining or losing against the contribution obtained. (In Figure 3 you can see an example of how this is mapped by sales channel, country, customer and business area.)

It is important to distinguish between the retailer's share in the market and our share within the retailer. If a retailer is opening stores, then we need to reflect that fact in our target setting and discount bonus setting. Together with the actual data on the retailers and this visualization of problems and opportunities, we start to gain clear insight into where we should invest our scarce resources. The objective here

Figure 3. A tool for mapping market share

Total Market	Channels	Customers	Retailer's Share						Electrolux Share					
			PL1	PL2	PL3	PL4	PL5	PL6	PL1	PL2	PL3	PL4	PL5	PL6
	Mail Order	A	Blue	Gray	Blue	Blue	Blue	Blue	37*	Gray	Blue	Blue	Gray	Blue
		E	Blue	Gray	Blue	Blue	Blue	Blue	55	Gray	Blue	Blue	Gray	Blue
		F	Blue	Blue	Blue	Blue	Blue	Blue	54	Blue	Blue	Blue	Blue	Blue
		G	Blue	Blue	Blue	Blue	Blue	Blue	48	Blue	Blue	Blue	Blue	Blue
		I	Blue	Blue	Blue	Blue	Blue	Blue	58	Blue	Blue	Blue	Blue	Blue
	Multiples	J	Blue	Blue	Blue	Blue	Blue	Blue	54	Blue	Blue	Blue	Blue	Blue
		L	Blue	Blue	Blue	Blue	Blue	Blue	45	Blue	Blue	Blue	Blue	Blue
		K	Blue	Blue	Blue	Blue	Blue	Blue	58	Blue	Blue	Blue	Blue	Blue
		N	Blue	Blue	Blue	Blue	Blue	Blue	55	Blue	Blue	Blue	Blue	Blue
		O	Blue	Blue	Blue	Blue	Blue	Blue	45	Blue	Blue	Blue	Blue	Blue

*Contribution per unit

Blue = Increased market share

Gray = Decreased market share

Source: Electrolux Major Appliances – Europe

is to invest in gaining profitable market share.

Revenue management

The ability to manage your revenue is probably the most important fundamental skill in creating value in an organization. In strategic account management this is even more vital as we trade in a market where retailers are consolidating and generating even more buying power, where production capacity exceeds market demands and consumers have greater price visibility across markets.

Working with our sales organization, we concentrated more on tactical pricing rather than the strategic pricing aspect. The importance of pricing is emphasized when we compare a 1 percent volume increase to a 1 percent price increase where the profitability increases are 4 percent and 10 percent, respectively. One of the successes we had at Electrolux Europe was the development of some simple tools to review and help plan our activities in the revenue management area.

Through our strategic account management we have greater analysis and control on the numbers, which yield better results than otherwise would be the case. In one example last year we reduced our volume by nearly 20 percent, but due to our revenue management the absolute gross margin increased. The benefit from setting prices correctly on innovative products is powerful. We believe that absolute euro value is more important than margin percentage. Percentages do not pay the bills!

Supply chain management

Before strategic account management was introduced at Electrolux Europe, there was no proactive approach taken to changing the supply flow models used by many accounts. After the sales organization understood the double benefits in changing the supply flow model, by eliminating double warehousing

Figure 4. SAM financial training curriculum

Example of a level 1 SAM training session at Electrolux Major Appliances - Europe, 2003

- Strategic accounts business management
Value creation, profitability
- Revenue fanatics 1
Pricing, contribution
- Revenue fanatics 2
Cost to serve, customer's value creation
- Winning the business
Brand strategy, consumer segments, negotiating
- Preparing for a profitable future
Strategic projects, partnerships
- Creating the path to success
Budgets 2004, customer plans 2004-2006

Source: Electrolux Major Appliances - Europe

and handling – and thereby also having less inventory in our warehouse – we gained both in EBIT performance and asset efficiency.

Challenges to implement value creation

We faced a number of challenges in introducing the concept of measuring our sales organization according to the value created rather than merely according to

gross margins or market shares. One of the first tasks was to provide the sales organization with the skills and knowledge regarding how to use the newfound information. Sales teams, senior management and the financial director spent significant time learning and incorporating these concepts into day-to-day activities.

In addition to the instruction in Figure 4, training was conducted in supply chain management, category management and negotiation skills. One of the key differences of this program compared to normal training courses was that you were graded only on whether you satisfactorily completed a strategic plan for your customer and how you presented it to the company's CEO.

We took care not to invent or impose complex IT solutions on the sales organization. Rather, we utilized tools developed with the sales force that could be used immediately.

There is a natural tendency for the financial people to complicate the value creation calculation, particularly in relation to the net assets. One major country I remember kept using three full



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pages of calculations compared to our couple of lines even though both results were fairly similar. It took some time for everyone to trust the simple calculations, which were the only ones anybody could understand and, therefore, act upon.

Within Electrolux Europe we had not done any activity-based costing exercises, so these processes met resistance in some countries, although they were a necessary evil in assigning costs to each customer. Customer profitability reporting was not an official requirement, so at first we needed to explain the rationale behind requiring customer Profit and Loss reporting.

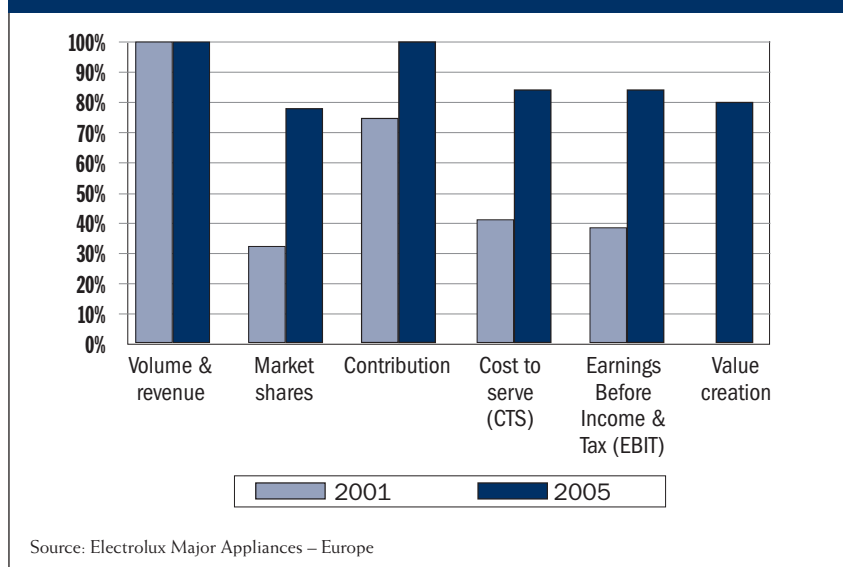
One of the keys to ensuring the success of a company's strategic account management program is making certain that the organization is aligned on the same goals. Having value creation produces such a common goal, but aiming for both local account managers and corporate account managers to have these same objectives in their performance incentive packages is critical. It sounds obvious, but this cannot be taken for granted in any large global organization.

The progress has not been overnight. We have to put constant pressure on the organization to keep improving the processes and continue the training for existing and new employees. However, significant progress has been made; the development of our value creation measurements is illustrated in Figure 5.

How has Electrolux Major Appliances – Europe benefited from measuring value creation?

There have been a number of direct and indirect benefits since the introduction of value creation on a customer level.

Figure 5. Customer value creation development



Probably the most beneficial aspect (but also the hardest to measure) is the enormous strides the sales organization is making using its new knowledge and skills, thereby helping us meet the challenges in our business. A company's sales force and management are two of the most expensive areas. Through our strategic account management program we have been able to make them far more effective and cost efficient.

The whole organization is now far more aware of the impact from credit terms or business models operated by customers. This has given the company new insights into how to take out costs. We have been successful in extracting them by giving attention to the cost drivers within given customers. By making strategic account managers responsible for the bottom line, you unleash another resource in removing costs. Examples in Electrolux Europe have been the introduction of electronic methods for doing business, the reduction in order and delivery frequency, the lowering of returns and the elimination of non-essential sales promotional activities.

In developing our strategic account management, we found we required some basic tools to analyze customers' business, not just from a market share or financial viewpoint but also in how to measure the strategic importance of our major

customers and their potential to create value. These tools were always kept simple and non-IT project-driven. Of course our biggest challenge was to get customer financials from many countries around Europe into one database. Here we invested in a database and processes to make that happen. Many of the applications developed within the strategic account competence center became standard throughout the organization.

In financial terms some customers have completely outperformed against our country averages, while other customers have shown profitability improvement that otherwise would not just have happened.

Conclusion

The work on customer accounts has led to the preparation of customer strategic plans that are now required before any major investment is made in any account. Our customers' strategic plans are integrated into each business area plan. Overall, we are seeing a dramatic improvement in all aspects of business planning.

Finally, our strategic account managers understand that the drivers of value creation for our retailers are very similar to our own and that unless we work toward "win-win" solutions with our retailers, the long-term profitability and creation of value for their accounts cannot be achieved. 🤝

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