



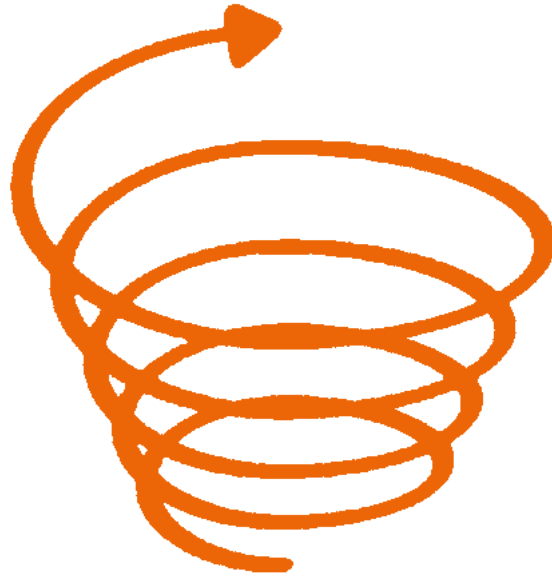
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**180° segmentation
in action**
– Star Laundry Inc.

CHAPTER 3

BUSINESS PROCESS RE-ENGINEERING AND THE VIRTUOUS CYCLE

BY: ROBERT EDEN



CHAPTER 3

Business process re-engineering and the Virtuous Cycle

In the previous chapters I introduced 180°-segmentation as a necessary tool for understanding the Star Laundry case. The central theme was in segmenting the New York hotel laundry market using a completely new set of dimensions, and thereby finding a customer segment that was more attractive to the company than any other. Brainstorming for new

critical segmentation criteria (or dimensions) is a type of innovation and discovering them is what opens the door to strategic advantage. But to enter through the door the company must next turn its attention to its internal processes, as they need to be re-engineered to align with the new strategy.

The objective is to create a virtuous cycle.

Episode 4 is arranged into 4 chapters:

- **Chapter 1:** 180° segmentation – uncovering the sweet spots in your market
- **Chapter 2:** Star Laundry and 180° segmentation in action
- **Chapter 3:** Business process re-engineering and the Virtuous Cycle
- **Chapter 4:** Creating a Virtuous Cycle in the New York hotel laundry business.



Increased profit margin

When a company discovers a sweet spot segment in a market and decides to target it, it has a chance to improve its profit margin through two mechanisms: lower costs and/or higher prices.

1. **Lower costs:** targeting those segments that can be served with lower costs enables the company to increase its profit margin. Finding the levers that can yield this outcome is the main benefit of the 90° angle/ industry segmentation view, but the cost benefits won't produce themselves. Processes need to be reengineered to produce them.
2. **Higher price:** some segments will have "jobs" that aren't currently being taken care of to the quality level they require and would be willing to pay extra to have the job done as they like it. Using the Jobs Theory/180° view enables identifying those segments and targeting them will result in a higher profit margin. But again, processes must be re-engineered to deliver the new value proposition to the required quality level, but in a way that produces fewer additional costs than the extra price gained.

So, the next natural step is business process re-engineering (BPR) to actualize the cost advantages and/or higher prices. But, the question arises, where do you derive specific guidelines for the new process designs? As powerful as BPR is as a technique, its Achilles' heel is its non-specificity.

Here the 180°-segmentation exercise gives us its' one final gift. The criteria we used to segment the market and find the sweet spots also give us the KPI's, parameters, and guidelines for the new process designs.

Process re-engineering

Re-engineering for cost benefits

When re-engineering processes for cost benefits we must turn to the 90° view. Start with listing out the operational factors you found in the segmentation exercise. Then, take each factor and list out 1-3 specific aspects of each factor that have a direct impact on costs. Finally, derive 1-2 process design targets from the aspects you identified.

Let's look at this idea through a hypothetical example: A wholesale company has discovered that it can segment customers based on order size and frequency, and that customers fall into one of two categories: (1) those who place small orders frequently, and (2) those who make large orders infrequently.

Let's also assume that the company has done its operational analysis and identified type 1 customers as it's sweet spot segment. It came to that conclusion by realizing there is more scope for cost efficiencies in frequent small orders than in infrequent big orders. The company has decided it wants to target type 1 customers and is now looking to re-engineer its processes accordingly.

The starting point for the re-design job is to identify 1-3 key levers (aspects) that drive costs associated with order size and frequency. Here I've identified 3 possible aspects:

1. **The Pick & Pack process:** once an order is taken by the sales department, it is passed on to the warehouse for picking and packing. How many steps that process involves, how many minutes/hours an order spends going through the process and how many resources need to be utilized to complete it have a direct impact on costs. The company can therefore derive specific process design parameters by setting exact design targets linked to these considerations. For example, it can re-design its Pick & Pack process around the targets of reducing process time by 10% and cutting process steps from 30 to 20.
2. **Product availability:** an aspect that causes delays and extra costs in order handling is not having the right stock at the right time in the warehouse. Extra costs are incurred because the customer must now be informed of the delay, the company might have to fulfill the order through multiple late shipments, penalties might have to be paid etc. The list of additional costs goes on and on. The company might therefore decide to approach the product availability issue by setting a 0-tolerance policy on stockouts and by setting its DIFOT target rate (Delivered in Full, On time) at 95%.
3. **Delivery process:** once an order is picked & packed, its ready for shipping out to the customer. Here the company has multiple different options for getting the job done. Courier companies, the postal service, running its own fleet of delivery vehicles etc. are all

possible options. To decide on which option to go with the company might set cost efficiency and punctuality as the most important things to work towards. It can then for example decide to design

the delivery process to hit the specific targets of having a maximum cost of 5 Eur per delivery and reducing the delivery slot (the time window for arrival promised to the customer) from 6 hours to 2.

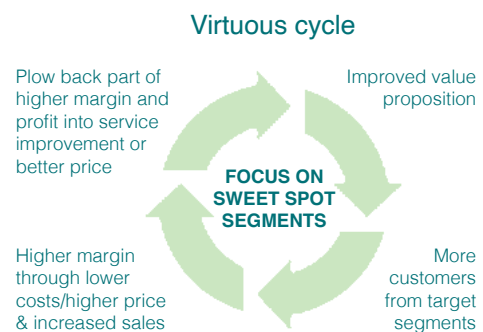
Operational factor Order size & frequency	Aspect 1 Pick & Pack process	Possible KPI's Order fulfilment process time Number of process steps	Possible design targets Reduce by 10% Reduce from 30 to 20
	Aspect 2 Product availability	Possible KPI's Number of backorders DIFOT rate	Possible design targets 0 tolerance 95%
	Aspect 3 Delivery process	Possible KPI's Cost efficiency Accuracy/punctuality	Possible design targets 5 Eur per delivery Reduce delivery time frame from 6h to 2h

The table above illustrates the idea of breaking down each operational segmentation factor down to aspects with cost implications and further down to specific process re-design targets.

Re-engineering for higher prices

The customer decides if you have the right to charge higher prices or not, and what influences their willingness to pay a premium is tied to better quality, improved performance, additional design features, better customization, convenience, durability etc. The list of possible factors is long, but you can discover what the key levers are through the Jobs Theory/the 180° view. Moreover, by re-engineering your processes to deliver on a key aspect you decide to target is what gives you the opportunity to charge higher prices.

The processes of transforming the critical segmentation criteria into specific process redesign parameters is the same as when re-engineering for cost benefits, but the focus is just different. This time the focus is on customer expectations and the possible list of KPI's to design processes around might include metrics such as SERVQUAL, Customer retention rate and First Contact Resolution (FCR). (For a great library of KPI's, please visit: <https://bernardmarr.com/kpi-library/>)



The virtuous cycle

In the beginning of this chapter, I wrote that the objective for the process re-engineering exercise is to actualize the price & cost benefits to ultimately create a virtuous cycle. Re-engineering processes to improve margins is the first step, but creating a virtuous cycle involves one more key ingredient; a feedback loop mechanism.

An increased profit margin creates an opportunity to plow some of that margin back into the product or service offering, making it even more attractive to the target segment. For example, it can use some of the additional margin to make special pricing offers, boost service quality, use better materials in the product or service process etc. The additional margin acts as a lever for improving the product or service just that much that an increasing number of customers in the target segment become interested.

What finally creates the cycle and gets it spinning is the increase in profit (not profit margin per se) you get through the continuously increasing volume of customers you are able to recruit through the continuously improving value proposition. Every bit of the increased profit that is fed back into the cycle creates yet another dose of competitive advantage that spins the cycle faster and faster. What we therefore get is a self-reinforcing feedback loop and a winning formula:



VIRTUOUS CYCLE = Higher Margin + Increasing Volume + Continuously improving offering through profit feedback

In the final chapter

In the fourth and final chapter of this episode we look at what operational changes Hijazi implemented to be able to target the sweet spot segments, boost profitability, and create a virtuous cycle in the New York hotel laundry industry.



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