



Bulletin

- Water
- Energy
- Retailing
- Transport
- Financial services
- Healthcare
- Telecoms
- Media
- Post
- Competition policy
- Policy analysis and design
- Regulation
- Strategy
- Contract design and evaluation
- Dispute support services
- Market design and auctions

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Pull the other one

USING ROOT-CAUSE ANALYSIS IN EVERYDAY BUSINESS DECISIONS

All businesses claim to spend a lot of time collecting data and analysing it. But in Frontier's experience, managers that take a more structured approach to using evidence are able to take some of the guesswork out of decision-making and tend to be more effective as a result.

Thanks to developments in technology, businesses can assemble and manipulate more information about their operations than seemed possible just a few years ago. But for many day-to-day decisions, managers still feel obliged to rely on gut feel and guesswork. The problem is not so much a lack of information, as difficulty in collating and refining it. Different types of information reside within different parts of the organisation and no-one may be responsible for putting two and two together. And, all too often, the process works the wrong way round. Rather than being assembled, and analysed, before decisions are taken, evidence is collected to support decisions that have already been made.



To get a grip on the information tangle, Frontier helps clients carry out “root-cause analysis”. This starts by identifying levers and outcomes, in order to arrive at an understanding of the links between them.

- **Levers** are the things that a business can control directly. They include prices, product range, quality, delivery, advertising, location, terms and conditions.
- **Outcomes** are the results of these levers being pulled, by the business or its competitors: market size and shares, sales and profits.

Most businesses obsessively compare their outcomes with those of their competitors. But to understand what is driving the difference, they need to work back to the differences in use of the various levers. And understanding the impact of these levers, in turn, requires analysis of customer behaviour.

It is essential that a business understands which levers have most effect on its customers, since this varies greatly between markets. For some products, demand is highly price-elastic; while for others, it is heavily influenced by perceptions of quality, service or advertising. There are well-developed economic techniques that allow managers to test their assumptions about the drivers of demand. What is needed is a framework within which to decide what to test.

KEY QUESTIONS

To understand the relationship between levers and outcomes, managers need to work systematically through the following sort of questions:

- Which levers have been pulled by the business in the past year? Which levers have competitors pulled?
- What differences would customers see? How have their perceptions changed?
- What has happened to market shares?

The template below shows one way of bringing the answers together.

Changes in past year	Your business	Competitor 1	Competitor 2	Importance to customers
Price	Same	Same	Better	1 st
Quality	Same	Same	Same	2 nd
Range	Same	Same	Same	3 rd
Advertising	Same	Higher	Higher	4 th
Service	Same	Better	Better	5 th
Sales	-£1m	Same	+£9m	
Mkt share	-2%	-1%	+8%	

Sample template of relative changes in levers and outcomes

Source: Frontier client

Completing a template like this commonly involves drawing together data and opinions from different parts of the business. Tracing information back to source and getting to the bottom of apparent inconsistencies may be time-

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CHEAP OR CHEERFUL?

A straightforward insurance product, providing extended service cover, was sold in ten separate price bands. In the belief that customers would find a simpler pricing structure more attractive, the provider ran an experiment with a pricing structure using only three bands. Sales increased, suggesting customers had indeed been put off by complexity. However, root-cause analysis was used to test this against an alternative hypothesis: that the restructuring of prices had led to changes in the actual level of prices offered to different customers, and that the changes in sales could be attributed to the price elasticity of demand.

To test whether there had been a “simplicity effect” or a “price effect”, the sales data was analysed in more detail. Customers in the lowest price band were paying, on average, 5% more than under the previous system. Sales to this group were similar to those in the previous year. Customers in the middle price band were paying prices similar to those under the old system, and sales to this group were also largely unchanged. By contrast, customers in the top price band were paying, on average, 10% less, and sales to this group were about 15% higher.

The company could therefore see that the increase in sales was largely attributable to the price cuts at the higher end of the price spectrum, offset by small price increases at the lower end. Further evidence against the “simplicity effect” came from the fact that customers in the middle band, who were unaffected by price changes, had not increased their purchases. So the company reverted to the original number of price bands, but fine-tuned prices to charge more in the lower bands, less in the upper ones, and achieved still greater increases in sales.

consuming, but is likely to pay dividends. And, once assembled and involved, a core group of people with a deep understanding of the information can provide a valuable sounding board. With the right information in front of the right people, management can arrive at a set of plausible hypotheses – and then test them. The list of possible explanations can usually be shortened quite quickly.

Let’s suppose that sales have fallen. Then either the business has lost market share, or the market as a whole has contracted (or, of course, both have happened simultaneously). Suppose, once again, that market share has fallen. Then the next set of questions should be focused on the levers competitors have pulled, to attract customers away. Did other companies improve their price competitiveness? Have they launched a new range? Have they improved the service they offer, or did their new advertising campaign have a big impact?

It usually makes sense to start with the factors that have changed over a given period, and then order these in terms of their demonstrable impact on customers. So in the sample template shown opposite, we see that Competitor 2 has not only pulled more levers than others over the past year, but has used the lever – price – that the evidence suggests has most impact in this particular market.

REPEAT AS NECESSARY

Understanding the root causes of commercial performance is a continuous learning process for every business. Hypotheses and tests need to be recorded, and the lessons collected as performance evolves. This is particularly important

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STYLE OVER SUBSTANCE

When a department store chain suffered four months of declining sales of soft furnishings, management's view was that the problem lay with an outdated product range. Closer examination of the pattern of sales, however, revealed that the drop in sales was much more pronounced in some stores than others. So if it was a style problem, why did customers react more in some areas than others?

Root-cause analysis quickly weeded out some possible explanations. Location, demographics and income could be ruled out, as there were poor-performing stores in all parts of the UK and across the socio-economic range. So could the proximity of competitor stores, as there was no systematic pattern of effects.

This analysis led management to explore much more basic causes. Discussions with the managers at the stores suffering the biggest decline in sales revealed problems with the availability of stock, held in quantities below the normal level of customer demand. In blaming under-performance on style, management had missed the substance of the immediate problem. Fixing stock availability in the problem stores generated higher sales and allowed more time to plan how best to refresh the range.

where, as so often, the answer is far from clear. The remaining hypotheses should be ranked in order of likelihood, and different tests and experiments identified that will clarify the connections over time. But a systematic approach need not be cumbersome. Given good management information, ordered in the right way, such an approach may require little more than putting the right three or four people together in a room for a few hours once a quarter to work through performance metrics and come to a common view.

However, a cultural shift may be needed, if such an approach is to yield useful results rather than another pile of underused data. Rather than asking, "What happened, and what are you going to do?" management needs to ask what caused it to happen, and how the chosen response will cause things to change.

It's a dull boardroom that allows no airtime to market gossip or local anecdote. But a disciplined framework for analysis, understood and agreed around the table, is the best foundation for strategic initiative or competitive response. And it's a far better use of business data than for the retrospective justification of decisions taken on hunch.

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