

# The Real Profit Drivers

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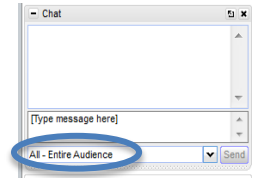
Flexible | Convenient | Affordable

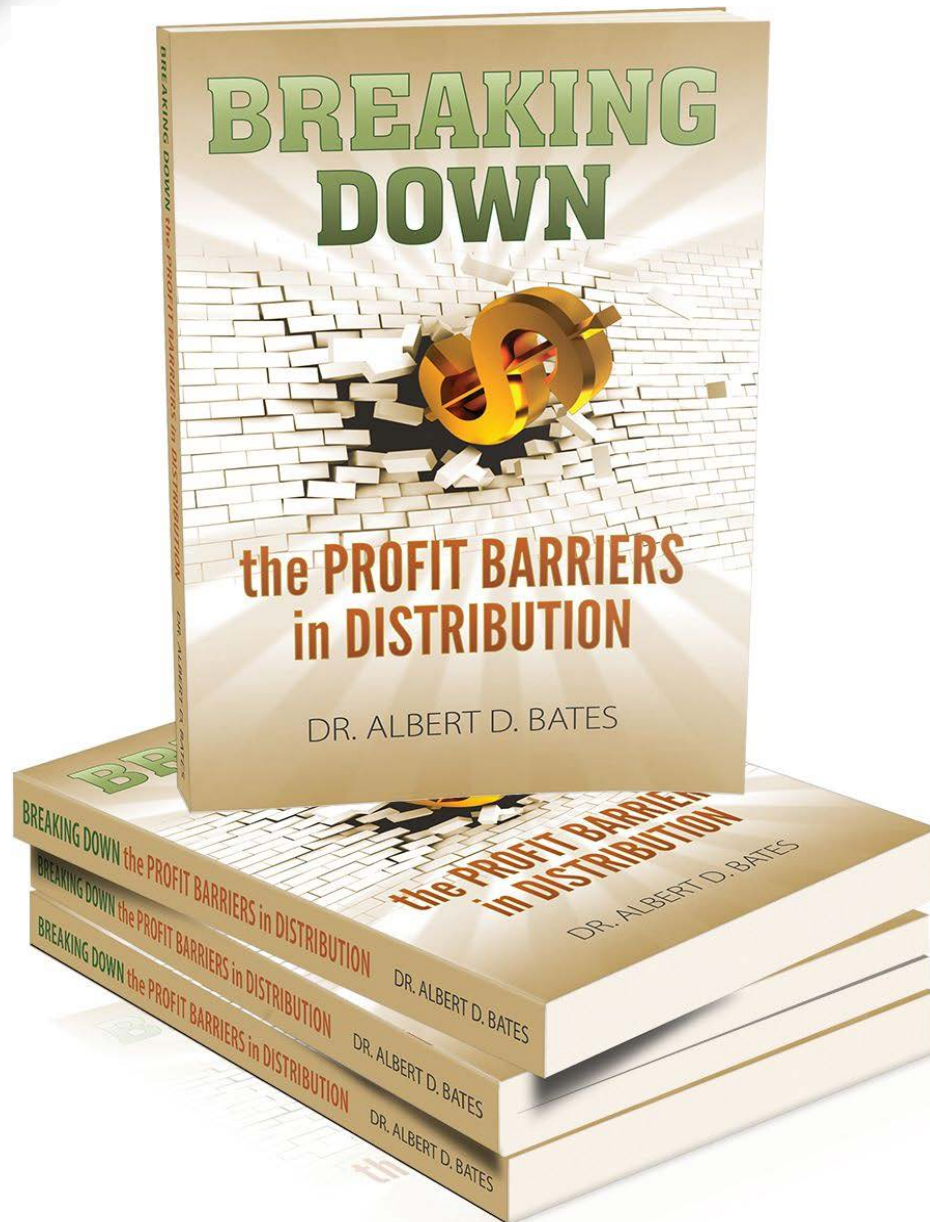
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# Welcome!

*Notes about today's webinar...*

- All attendees muted 
  - Submit questions via Chat/Question box
  - Or send a question to directly to Dr. Bates
- **1** DHI CEP pt. is available
- A recording of today's webinar will be available on DHInteractiv for members
  - Handout available now
  - Notified via email when recording is available
  - Go to **DHInteractiv**
  - Click on **Membership** on top left
  - Click on **Members Only**





# Objectives Of The Session

- Review the Results of the Largest Study of Distributor Profitability Ever Conducted
- Identify the Key Pressure Points in Improving Profitability
- Develop an Action Plan to Improve Financial Performance

# Scope of the Project

- Sample Size: 885 Distributors, 17 Lines of Trade
- “Normal” Sales Growth Year
- Wide Diversity of Operations
- Focus: The CPVs That Increase ROA and PBT
- Two Tests: High/Low Test and Continuous Improvement Test (Quintiles)

# Scope of the Project

- Sample Size: 885 Distributors, 17 Lines of Trade
- “Normal” Sales Growth Year
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- Focus: The CPVs That Increase ROA and PBT
- Two Tests: High/Low Test and Continuous Improvement Test (Quintiles)

You Are Not Exempt

# The Do Three Things Well Model: The Impact on PBT

	Sales Size	Sales Growth	GM	Oper. Exp.	DSO	Inv. Turn	Impact on PBT	Resulting PBT	Number of Firms
1			✓	✓	✓		147.5	4.9	42
2	✓		✓	✓			122.2	4.4	53
3		✓	✓	✓			120.5	4.4	42
4			✓	✓		✓	118.8	4.4	37
5		✓		✓	✓		65.6	3.3	121
6	✓			✓	✓		60.9	3.2	113
7	✓	✓			✓		58.7	3.2	104
8	✓		✓			✓	57.9	3.2	71
9	✓		✓		✓		57.9	3.2	79
10	✓	✓	✓				56.1	3.1	96
11				✓	✓	✓	50.0	3.0	124
12	✓	✓		✓			46.3	2.9	158
13		✓	✓		✓		43.5	2.9	97
14		✓	✓			✓	40.6	2.8	73
15	✓				✓	✓	36.8	2.7	96
16	✓	✓				✓	31.3	2.6	119
17		✓		✓		✓	31.0	2.6	145
18	✓			✓		✓	28.9	2.6	154
19		✓			✓	✓	28.8	2.6	114
20			✓		✓	✓	3.4	2.1	86
	✓	✓	✓	✓	✓	✓	128.6	4.6	9

Exhibit 3



# The Do Three Things Well Model: The Impact on PBT

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Hi/Lo Tests



Notice the Top Four and Top Six

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Exhibit 3

# What's Wrong With This Picture?

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Exhibit 3



# How Do You Know If You Are High or Low?

Bonus Exhibit



# How Do You Know If You Are High or Low?

## Take Part in the Profit Survey

# Financial Results For Mountain View, Inc.

	<u>Dollars</u>	<u>Percent</u>
Net Sales	10,000,000	100.0
Cost of Goods Sold	<u>7,000,000</u>	<u>70.0</u>
Gross Margin	3,000,000	30.0

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Payroll and Fringes	2,000,000	20.0
All Other Expenses	<u>800,000</u>	<u>8.0</u>
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Profit Before Taxes	200,000	2.0



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Profit Before Taxes	200,000	2.0
Fixed Expenses	2,300,000	
Variable Expenses	500,000	5.0

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Fixed Expenses Only Change When Action is Taken

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Variable Expenses	500,000	5.0
Fixed Expenses Only Change When Action is Taken		
Variable Expenses Change Automatically		

# The Relationship Between An Investment Reduction And Profit Margin

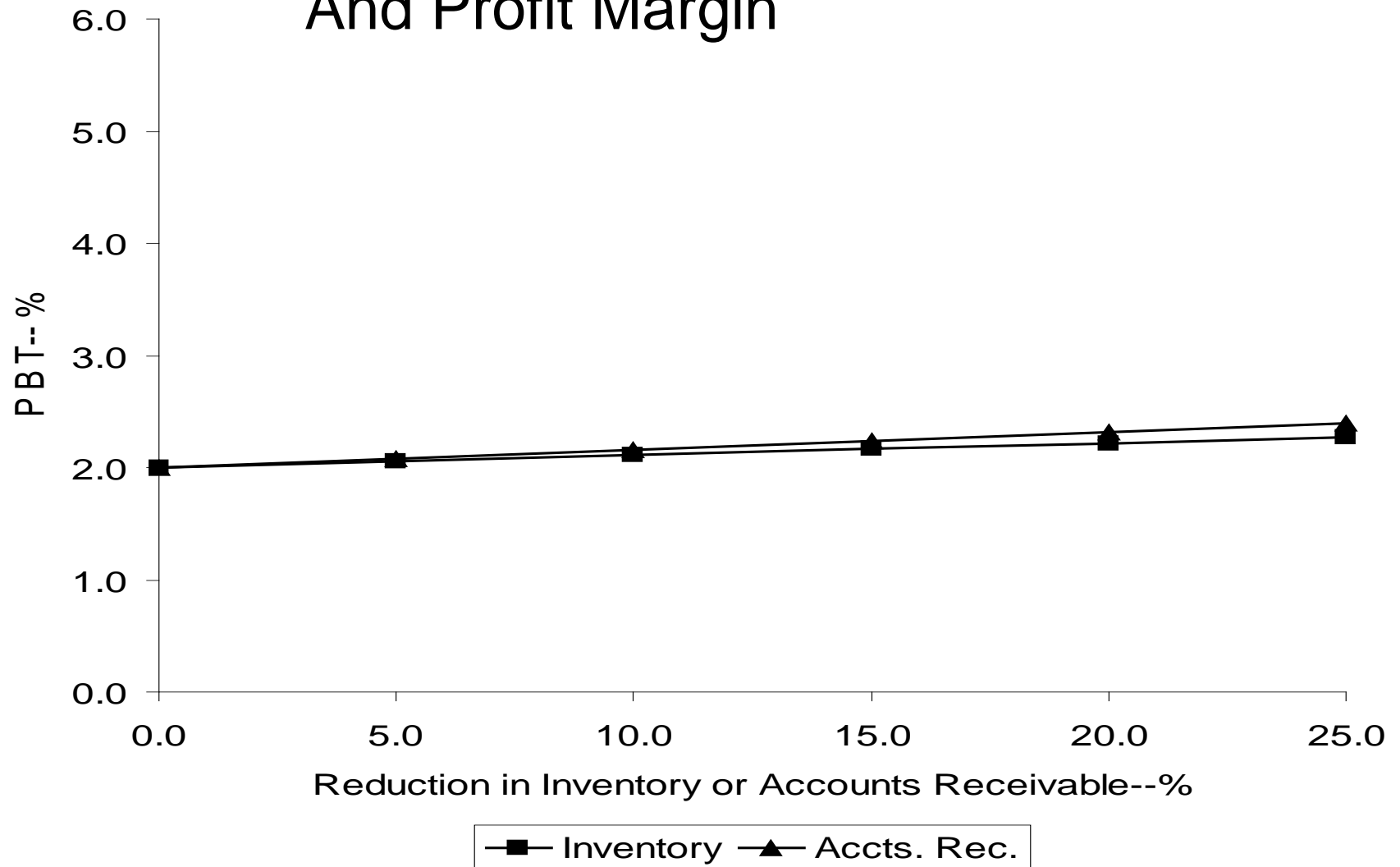


Exhibit 5

# The Relationship Between A Sales Increase And Profit Margin

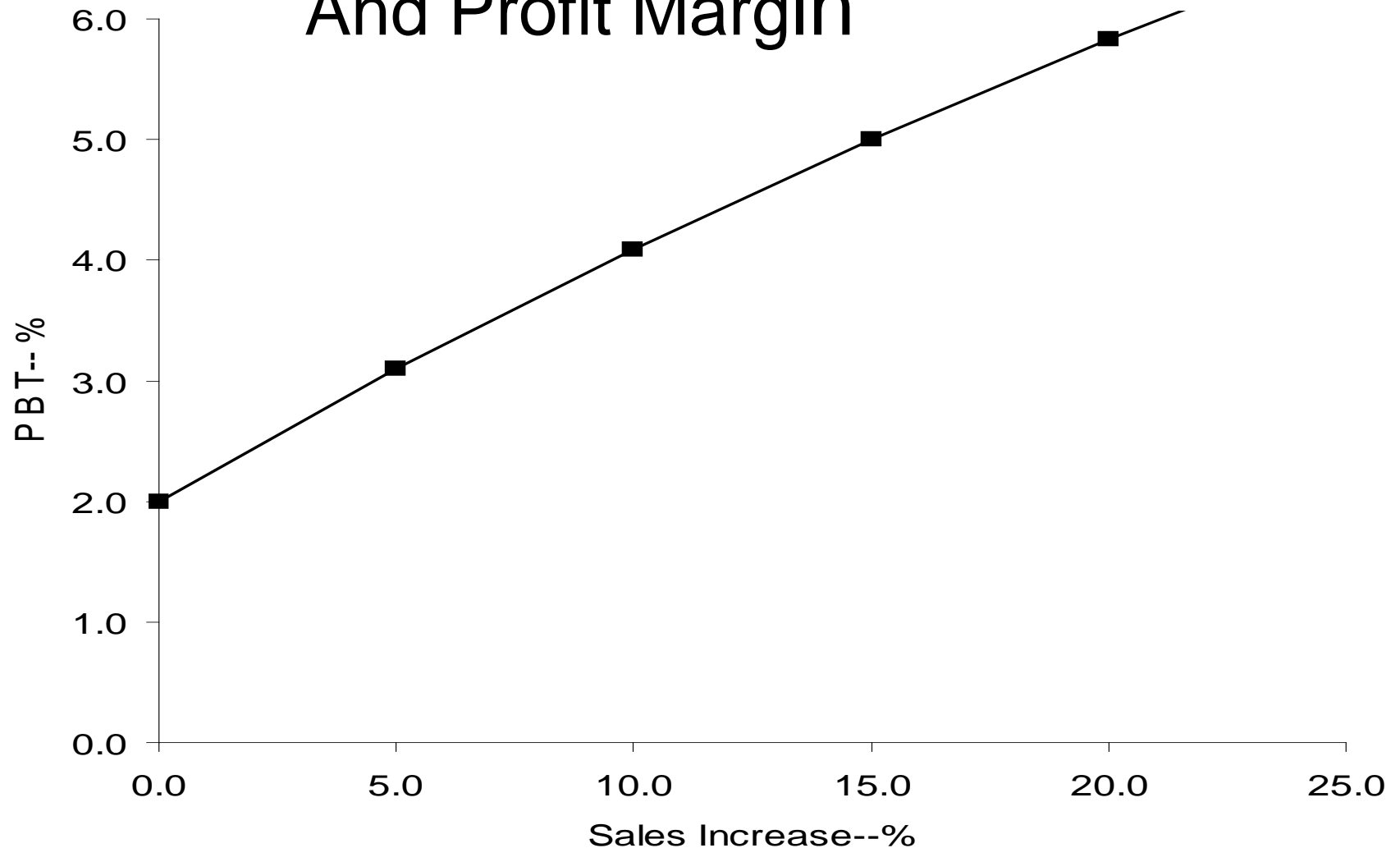


Exhibit 6

# The Relationship Between An Expense Decrease And Profit Margin

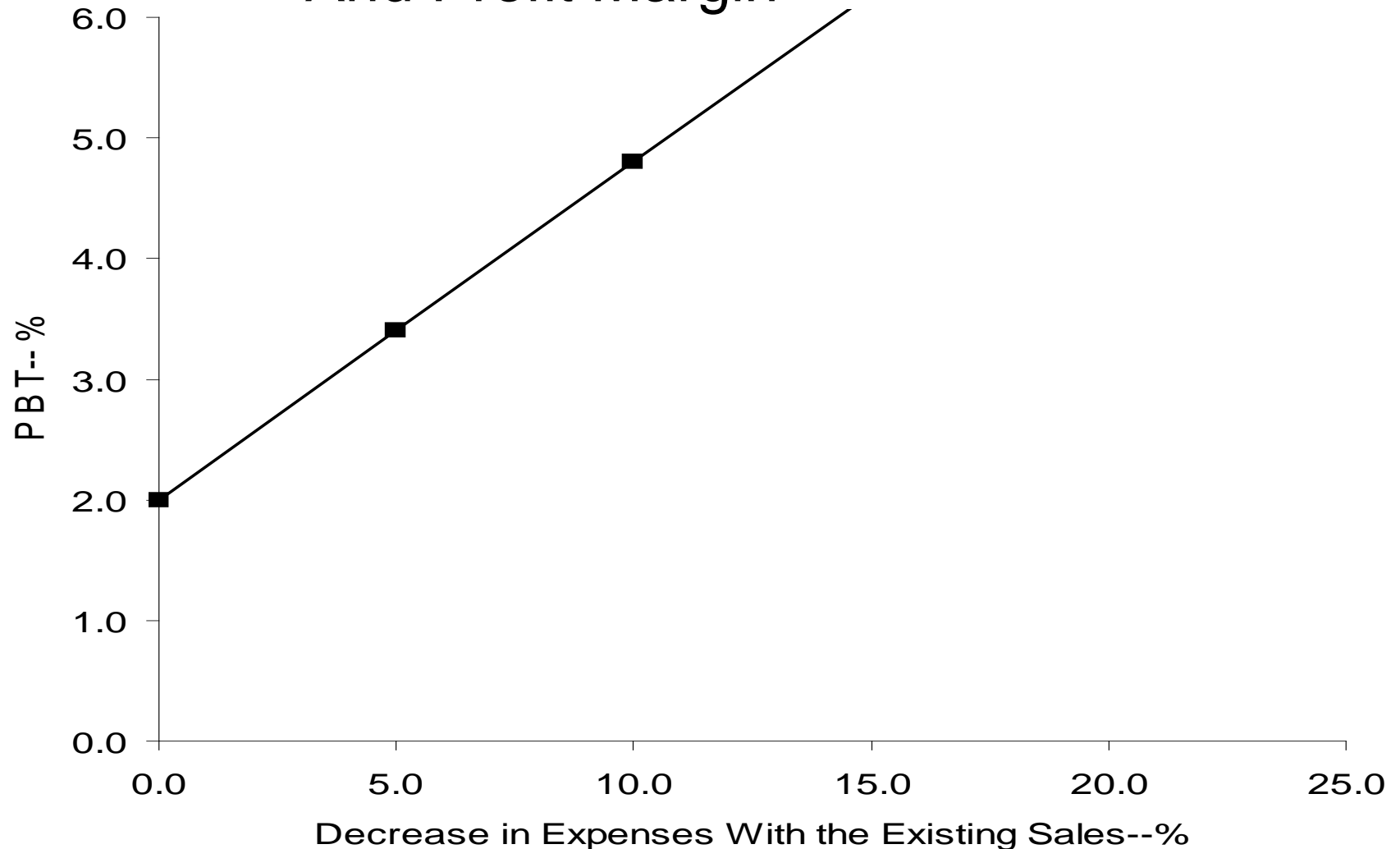


Exhibit 7

# The Relationship Between A Gross Margin Increase And Profit Margin

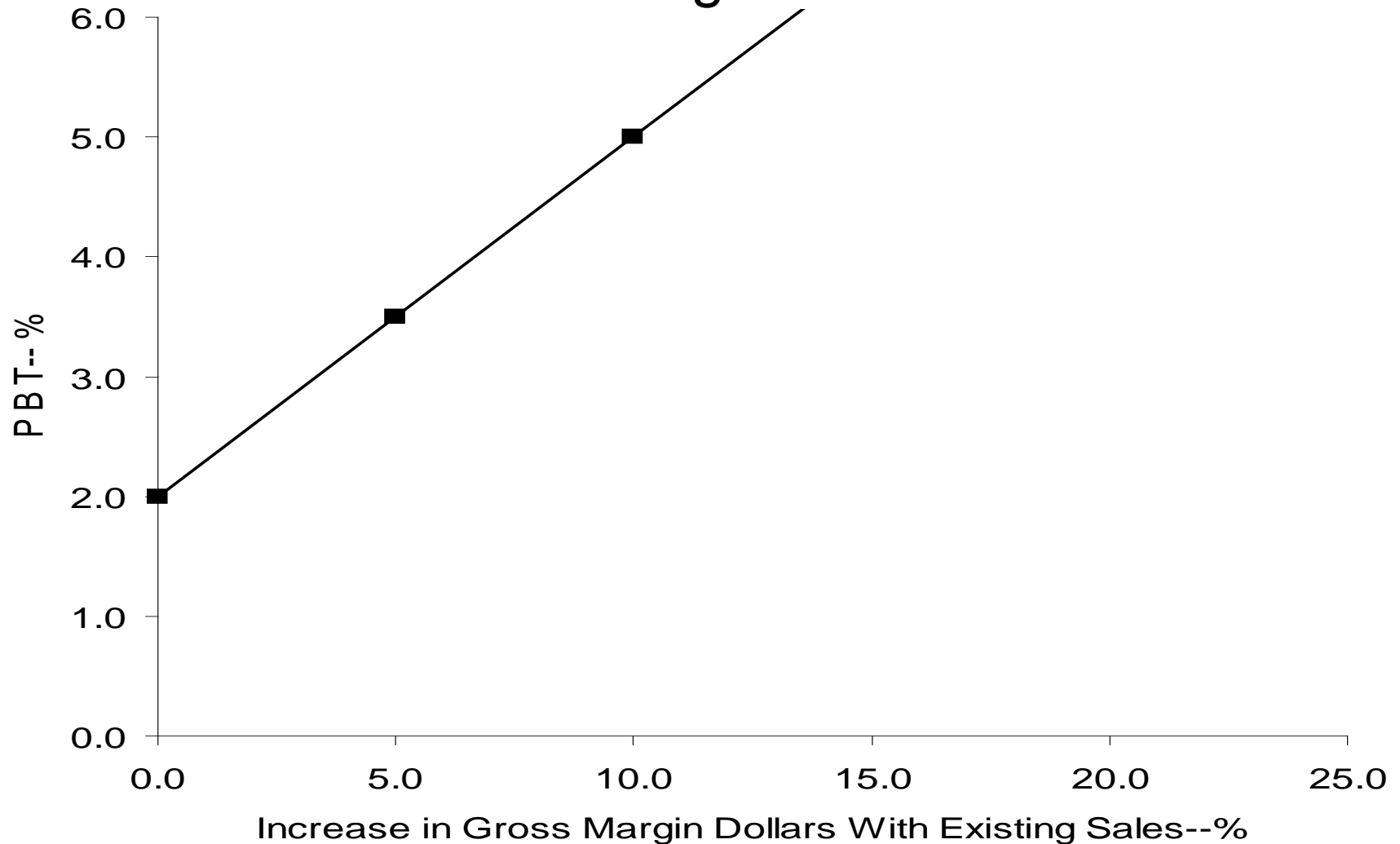


Exhibit 8



# Summary And Conclusions

- A realistic profit goal is an 6.0% PBT  
(maybe even 8.0%) with proper action

# The Improvement Model: A Rack-Suit Plan

- Increase sales by at least the inflation rate plus a safety factor of
- Force payroll to grow slower than sales to create a sales to payroll wedge of
- Increase the gross margin percentage by
- Decrease the other expense percentage by

# The Improvement Model: A Rack-Suit Plan

- Increase sales by at least the inflation rate plus a safety factor of 3.0%.

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- Increase sales by at least the inflation rate plus a safety factor of 3.0%.
- Force payroll to grow slower than sales to create a sales to payroll wedge of 2.0%.
- Increase the gross margin percentage by .2%.

# The Improvement Model: A Rack-Suit Plan

- Increase sales by at least the inflation rate plus a safety factor of 3.0%.
- Force payroll to grow slower than sales to create a sales to payroll wedge of 2.0%.
- Increase the gross margin percentage by .2%
- Decrease the other expense percentage by .2%.

# Summary And Conclusions

- A realistic profit goal is an 6.0% PBT (maybe even 8.0%) with proper action
- Driving higher profit requires focusing on the right things



# Distributors Have Gotten Much More Sophisticated In Recent Years

- Bar Coding
- Fleet Scheduling
- Activity Based Costing
- Internet Sales
- Supply Chain Management
- RFID Technology
- Lots More

# Controlling Payroll Without Sacrificing Employee Enthusiasm (Well Maybe A Little)

Build a Two Percent Sales Growth to Payroll Growth Gap

Sales Growth

Payroll Growth

5

3

10

8

15

13

# The Profit Impact of a Sales to Payroll Wedge

Income Statement (\$)	Current Results	2.0% Sales to Payroll Wedge	
		5.0% Sales Growth	15.0% Sales Growth
Net Sales	10,000,000	10,500,000	11,500,000
Cost of Goods Sold	<u>7,000,000</u>	<u>7,350,000</u>	<u>8,050,000</u>
Gross Margin	3,000,000	3,150,000	3,450,000
Expenses			
Payroll and Fringe Benefits	2,000,000	2,060,000	2,260,000
All Other Expenses	<u>800,000</u>	<u>840,000</u>	<u>920,000</u>
Total Expenses	<u>2,800,000</u>	<u>2,900,000</u>	<u>3,180,000</u>
Profit Before Taxes	200,000		
Income Statement (%)			
Net Sales	100.0	100.0	100.0
Cost of Goods Sold	<u>70.0</u>	<u>70.0</u>	<u>70.0</u>
Gross Margin	30.0	30.0	30.0
Expenses			
Payroll and Fringe Benefits	20.0	19.6	19.7
All Other Expenses	<u>8.0</u>	<u>8.0</u>	<u>8.0</u>
Total Expenses	<u>28.0</u>	<u>27.6</u>	<u>27.7</u>
Profit Before Taxes	2.0	2.4	2.3

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Gross Margin	3,000,000	3,150,000	3,450,000
Expenses			
Payroll and Fringe Benefits	2,000,000	2,060,000	2,260,000
All Other Expenses	<u>800,000</u>	<u>840,000</u>	<u>920,000</u>
Total Expenses	<u>2,800,000</u>	<u>2,900,000</u>	<u>3,180,000</u>
Profit Before Taxes	200,000	250,000	
Income Statement (%)			
Net Sales	100.0	100.0	100.0
Cost of Goods Sold	<u>70.0</u>	<u>70.0</u>	<u>70.0</u>
Gross Margin	30.0	30.0	30.0
Expenses			
Payroll and Fringe Benefits	20.0	19.6	19.7
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Total Expenses	<u>2,800,000</u>	<u>2,900,000</u>	<u>3,180,000</u>
Profit Before Taxes	200,000	250,000	270,000
Income Statement (%)			
Net Sales	100.0	100.0	100.0
Cost of Goods Sold	<u>70.0</u>	<u>70.0</u>	<u>70.0</u>
Gross Margin	30.0	30.0	30.0
Expenses			
Payroll and Fringe Benefits	20.0	19.6	19.7
All Other Expenses	<u>8.0</u>	<u>8.0</u>	<u>8.0</u>
Total Expenses	<u>28.0</u>	<u>27.6</u>	<u>27.7</u>
Profit Before Taxes	2.0	2.4	2.3

# The Sales To Payroll Gap: The Potential to Have a Negative Gap

Summary <u>Income Statement</u>	<u>Current</u>	<u>Potential</u>	<u>Percent Change</u>
Net Sales	10,000,000	10,500,000	5.0
Cost of Goods Sold	<u>7,000,000</u>	<u>7,350,000</u>	5.0
Gross Margin	3,000,000	3,150,000	5.0
Payroll & Fringes	2,000,000	2,140,000	7.0
All Other Expenses	<u>800,000</u>	<u>840,000</u>	5.0
Total Expenses	<u>2,800,000</u>	<u>2,980,000</u>	6.4
Net Profit	200,000	170,000	-15.0

# The Attack Points in Driving a Sales to Payroll Wedge

- Controlling (Maybe Eliminating) the Problem Portion of the Sales Force
- Fundamentally Altering Order Economics
- Working with the Customer Set to Change Behavior



# Changing The Expenses Just A Smidgen

Fixed Expenses	2,300,000
----------------	-----------

Variable Expenses	500,000
	5.0%

Commissions	300,000
	10.0%
	of Gross Margin

All Other Variable	200,000
	2.00%
	of Sales

# The Profit Impact Of Low Sales Performance

## Summary

### Income Statement

### Total Firm

Net Sales	10,000,000
Cost of Goods Sold	<u>7,000,000</u>
Gross Margin	3,000,000
Commissions	300,000
Other Variable Expenses	200,000
Fixed Expenses	<u>2,300,000</u>
Total Expenses	<u>2,800,000</u>
Net Profit	200,000

# The Profit Impact Of Low Sales Performance

<u>Summary Income Statement</u>	<u>Total Firm</u>	<u>Per Sales Person</u>
Net Sales	10,000,000	2,000,000
Cost of Goods Sold	<u>7,000,000</u>	<u>1,400,000</u>
Gross Margin	3,000,000	600,000
Commissions	300,000	60,000
Other Variable Expenses	200,000	40,000
Fixed Expenses	<u>2,300,000</u>	<u>460,000</u>
Total Expenses	<u>2,800,000</u>	<u>560,000</u>
Net Profit	200,000	40,000

# The Profit Impact Of Low Sales Performance

<u>Summary Income Statement</u>	<u>Total Firm</u>	<u>Per Sales Person</u>	<u>80% Volume Producer</u>
Net Sales	10,000,000	2,000,000	1,600,000
Cost of Goods Sold	<u>7,000,000</u>	<u>1,400,000</u>	<u>1,120,000</u>
Gross Margin	3,000,000	600,000	480,000

# The Profit Impact Of Low Sales Performance

Summary <u>Income Statement</u>	<u>Total Firm</u>	Per Sales <u>Person</u>	80% Volume <u>Producer</u>
Net Sales	10,000,000	2,000,000	1,600,000
Cost of Goods Sold	<u>7,000,000</u>	<u>1,400,000</u>	<u>1,120,000</u>
Gross Margin	3,000,000	600,000	480,000
Commissions	300,000	60,000	48,000
Other Variable Expenses	200,000	40,000	32,000
Fixed Expenses	<u>2,300,000</u>	<u>460,000</u>	<u>460,000</u>
Total Expenses	<u>2,800,000</u>	<u>560,000</u>	<u>540,000</u>

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Fixed Expenses	<u>2,300,000</u>	<u>460,000</u>	<u>460,000</u>
Total Expenses	<u>2,800,000</u>	<u>560,000</u>	<u>540,000</u>
Net Profit	200,000	40,000	-60,000

# The Profit Impact Of Low Sales Performance

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Net Profit	200,000	40,000	-60,000

Cost of Goods Not Sold

# Summary And Conclusions

- A realistic profit goal is an 6.0% PBT (maybe even 8.0%) with proper action
- Driving higher profit requires focusing on the right things
- We have to plan payroll in relationship to sales



# The Attack Points in Driving a Higher Gross Margin Percentage

- Establishing a Meaningful Market Position
- Ensuring that Opportunistic Buys Actually Increase Profit
- Raising Prices in a Systematic Manner
- Controlling the Sales Force Yet Again
- Capitalizing on Supplier Price Increases

# Improving The Gross Margin Percentage By Either Buying Or Pricing

Summary <u>Income Statement</u>	<u>Current</u>	<u>Buying Potential</u>	<u>Pricing Potential</u>
Gross Margin--%	30.0	30.5	30.5
Net Sales	10,000,000	10,000,000	
Cost of Goods Sold	<u>7,000,000</u>	<u>6,950,000</u>	<u>7,000,000</u>
Gross Margin	3,000,000	3,050,000	3,071,942
Variable Expenses	500,000	500,000	503,597
Fixed Expenses	<u>2,300,000</u>	<u>2,300,000</u>	<u>2,300,000</u>
Total Expense	<u>2,800,000</u>	<u>2,800,000</u>	<u>2,803,597</u>
Profit Before Taxes	200,000	250,000	

# Improving The Gross Margin Percentage By Either Buying Or Pricing

Summary <u>Income Statement</u>	<u>Current</u>	<u>Buying Potential</u>	<u>Pricing Potential</u>
Gross Margin--%	30.0	30.5	30.5
Net Sales	10,000,000	10,000,000	10,071,942
Cost of Goods Sold	<u>7,000,000</u>	<u>6,950,000</u>	<u>7,000,000</u>
Gross Margin	3,000,000	3,050,000	3,071,942
Variable Expenses	500,000	500,000	503,597
Fixed Expenses	<u>2,300,000</u>	<u>2,300,000</u>	<u>2,300,000</u>
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Gross Margin	3,000,000	3,050,000	3,071,942
Variable Expenses	500,000	500,000	503,597
Fixed Expenses	<u>2,300,000</u>	<u>2,300,000</u>	<u>2,300,000</u>
Total Expense	<u>2,800,000</u>	<u>2,800,000</u>	<u>2,803,597</u>
Profit Before Taxes	200,000	250,000	268,345

# Impacting Gross Margin With Blind-Item Pricing

Velocity Code	<u>Current Performance</u>			<u>Potential Performance</u>		
	<u>Gross Margin</u>			<u>Gross Margin</u>		
	<u>Sales</u>	<u>%</u>	<u>Dollars</u>	<u>Sales</u>	<u>%</u>	<u>Dollars</u>
A	6,000,000	25.0	1,500,000	6,000,000	25.0	1,500,000
B	2,000,000	30.0	600,000	2,000,000	30.0	600,000
C	1,500,000	40.0	600,000	1,500,000	40.0	600,000
D	<u>500,000</u>	<u>60.0</u>	<u>300,000</u>	<u>550,000</u>	<u>63.6</u>	<u>350,000</u>
Total	10,000,000	30.0	3,000,000	10,050,000		

# Impacting Gross Margin With Blind-Item Pricing

Velocity Code	<u>Current Performance</u>			<u>Potential Performance</u>		
	<u>Gross Margin</u>			<u>Gross Margin</u>		
	<u>Sales</u>	<u>%</u>	<u>Dollars</u>	<u>Sales</u>	<u>%</u>	<u>Dollars</u>
A	6,000,000	25.0	1,500,000	6,000,000	25.0	1,500,000
B	2,000,000	30.0	600,000	2,000,000	30.0	600,000
C	1,500,000	40.0	600,000	1,500,000	40.0	600,000
D	<u>500,000</u>	<u>60.0</u>	<u>300,000</u>	<u>550,000</u>	<u>63.6</u>	<u>350,000</u>
Total	10,000,000	30.0	3,000,000	10,050,000		3,050,000

# Impacting Gross Margin With Blind-Item Pricing

Velocity Code	<u>Current Performance</u>			<u>Potential Performance</u>		
	<u>Gross Margin</u>			<u>Gross Margin</u>		
	<u>Sales</u>	<u>%</u>	<u>Dollars</u>	<u>Sales</u>	<u>%</u>	<u>Dollars</u>
A	6,000,000	25.0	1,500,000	6,000,000	25.0	1,500,000
B	2,000,000	30.0	600,000	2,000,000	30.0	600,000
C	1,500,000	40.0	600,000	1,500,000	40.0	600,000
D	<u>500,000</u>	<u>60.0</u>	<u>300,000</u>	<u>550,000</u>	<u>63.6</u>	<u>350,000</u>
Total	10,000,000	30.0	3,000,000	10,050,000	30.3	3,050,000

# Common Characteristics Of Blind Items

Characteristic	Implication
● Low Sales Level	Bought rarely, unlikely to remember the last price paid
● Not Heavily Promoted	Information about price not readily available
● Bought Only When Needed	Availability more important than price
● Low Price	On a small item, no real concern about price
● Repair Parts	Buy something small, avoid buying something large
● Unusual	Hard to find, availability is key
● Non-Seasonal	No need to discount "in season"
● Unbranded	Difficult to obtain specific price information



# Summary And Conclusions

- A realistic profit goal is an 6.0% PBT (maybe even 8.0%) with proper action
- Driving higher profit requires focusing on the right things
- We have to plan payroll in relationship to sales
- We must get control of gross margin, largely through pricing

# The Mandate for Change During Each of the Next Five Years

Net Sales

5.0

*An Arbitrary Number*

# The Mandate for Change During Each of the Next Five Years

Net Sales	5.0
Gross Margin %	0.2
Sales to Payroll Gap	2.0
Other Expense %	-0.2
Inventory Turnover	0.0
Collection Period	0.0

# The Impact of Making The Mandated Changes

	<u>2014</u>	<u>2015</u>	<u>2019</u>
Net Sales	10,000,000	10,500,000	12,762,816
Sales Growth	5.0% Per Year		

# The Impact of Making The Mandated Changes

	<u>2014</u>	<u>2015</u>	<u>2019</u>
Net Sales	10,000,000	10,500,000	12,762,816
Cost of Goods Sold	7,000,000	7,329,000	8,806,343
Gross Margin	3,000,000	3,171,000	3,956,473
Gross Margin %	30.0%	30.2%	31.0%

# The Impact of Making The Mandated Changes

	<u>2014</u>	<u>2015</u>	<u>2019</u>
Net Sales	10,000,000	10,500,000	12,762,816
Cost of Goods Sold	7,000,000	7,329,000	8,806,343
Gross Margin	3,000,000	3,171,000	3,956,473
Payroll and Fringes	2,000,000	2,060,000	2,318,548
All Other Expenses	800,000	819,000	893,397
Payroll	3.0%	Per Year	
All Other	8.0%	7.8%	7.0%

# The Impact of Making The Mandated Changes

	<u>2014</u>	<u>2015</u>	<u>2019</u>
Net Sales	10,000,000	10,500,000	12,762,816
Cost of Goods Sold	<u>7,000,000</u>	<u>7,329,000</u>	<u>8,806,343</u>
Gross Margin	3,000,000	3,171,000	3,956,473
Payroll and Fringes	2,000,000	2,060,000	2,318,548
All Other Expenses	<u>800,000</u>	<u>819,000</u>	<u>893,397</u>
Total Expenses	<u>2,800,000</u>	<u>2,879,000</u>	<u>3,211,945</u>
Profit Before Taxes	200,000	292,000	744,528

# The Impact of Making The Mandated Changes

	<u>2014</u>	<u>2015</u>	<u>2019</u>
Net Sales	10,000,000	10,500,000	12,762,816
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All Other Expenses	<u>800,000</u>	<u>819,000</u>	<u>893,397</u>
Total Expenses	<u>2,800,000</u>	<u>2,879,000</u>	<u>3,211,945</u>
Profit Before Taxes	200,000	292,000	744,528
Net Sales	100.0	100.0	100.0
Cost of Goods Sold	<u>70.0</u>	<u>69.8</u>	<u>69.0</u>
Gross Margin	30.0	30.2	31.0
Payroll and Fringes	20.0	19.6	18.2
All Other Expenses	<u>8.0</u>	<u>7.8</u>	<u>7.0</u>
Total Expenses	<u>28.0</u>	<u>27.4</u>	<u>25.2</u>

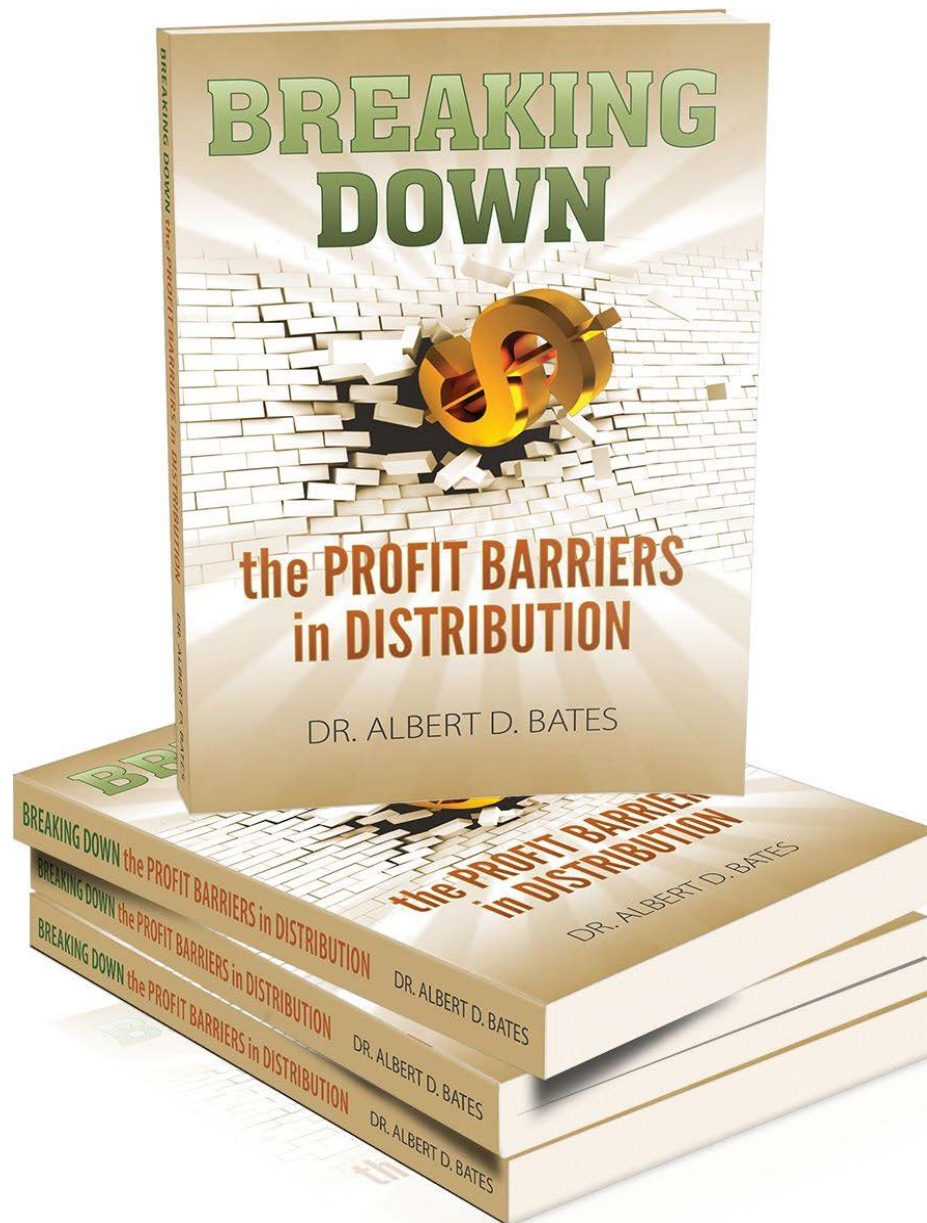


# The Impact of Making The Mandated Changes

	<u>2014</u>	<u>2015</u>	<u>2019</u>
Net Sales	10,000,000	10,500,000	12,762,816
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Total Expenses	<u>2,800,000</u>	<u>2,879,000</u>	<u>3,211,945</u>
Profit Before Taxes	200,000	292,000	744,528
Net Sales	100.0	100.0	100.0
Cost of Goods Sold	<u>70.0</u>	<u>69.8</u>	<u>69.0</u>
Gross Margin	30.0	30.2	31.0
Payroll and Fringes	20.0	19.6	18.2
All Other Expenses	<u>8.0</u>	<u>7.8</u>	<u>7.0</u>
Total Expenses	<u>28.0</u>	<u>27.4</u>	<u>25.2</u>
Profit Before Taxes	2.0	2.8	5.8

# Summary and Conclusions

- A realistic profit goal is an 6.0% PBT (maybe even 8.0%) with proper action
- Driving higher profit requires focusing on the right things
- We have to plan payroll in relationship to sales
- We must get control of gross margin, largely through pricing
- We probably should have a plan



# THANKS FOR ATTENDING!

- Recording will be available by the end of the week at DHInteractiv
- Handouts are available now at DHInteractiv



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