AN ORDER IS NOT AN ORDER IS NOT AN ORDER

By Dr. Albert D. Bates

One of the major profitability challenges facing distributors over the course of the last decade has been the inability to lower payroll costs as a percent of sales. This challenge has continued despite the application of new technology focused specifically on the payroll issue, such as automated order picking, online ordering, and enhanced fleet scheduling.

There are a number of issues behind the inability to lower payroll costs. They range from escalating health care costs to a shift in the employee mix toward higher-compensated employees, especially in the IT area.

One overlooked factor in the payroll cost challenge is the inability to get control of operating economics. That is, many distributors continue to process too many orders and a large portion of those orders are of too little value. It is a challenge that distributors need to face directly.

This report will examine the nature of order economics. It will do so from two distinct perspectives:

- **The Nature of Order Economics**—An analysis of how even small improvements in the average order size can yield large profit gains.
- **Order Size Strategies and Tactics**—A discussion of the opportunities to improve the economics of a typical order.

The Nature of Order Economics

Exhibit 1 examines the nature of operating economics for the typical DHI member based upon the latest PROFIT Report. As indicated in that report, the typical firm generates $20 million in revenue. Of key importance to this discussion, the firm processes 9,524 orders per year. While the orders vary in size, the average order value is $2,100. This is with an average of 7.0 lines per order. Each line has an individual value of $300.

The results indicate that the typical firm is extremely productive, in its warehouse trucking and office operations. The fact that this large workload can be handled profitably is a credit to DHI members.

However, firms have the potential become more profitable if they could maintain their high level of productivity while generating additional sales volume. The key to this involves focusing on both the number of lines per order and the average order value. The result should be higher sales without additional activity or cost.

The reality is that when most firms think about enhancing sales, they inevitably look to increasing the customer base. While this is certainly a desirable activity over time, it does nothing to change the economic structure of a typical order.

All things being equal, with additional customers the firm will increase the number of orders averaging the same number of lines per order and the same order line value. Sales and payroll costs will tend to move upward together.

In sharp contrast, if firms changed the nature of the orders received from existing customers, it could enhance sales with only a modest increase in payroll costs. The assumption is that the same set of customer would be placing the same number of orders, but with some minor tweaks to the order size.

This is shown in the Potential Results column in Exhibit 1. At the top, the number of orders remains the same. The first change is that the number of lines per order increases from 7.0 to 7.2, a very modest change. The net result, though, is that the number of order lines processed increases by 1,905. This does represent slightly more work. However, since the number of orders being processed is the same, the increase is modest.

From a strategic perspective, the 1,905 more lines processed means that competitors collectively are processing 1,905 fewer lines. It is not only an

EXHIBIT 1: **The Impact of Improved Order Economics for a Typical DHI Member**

Factor	Current Results	Potential Results
1. Number of Orders	9,524	9,524
2. Lines per Order	7.0	7.2
3. Order Lines Processed [1 x 2]	66,667	68,571
4. Average Line Value	$300.00	$303.00
5. Net Sales [3 x 4]	$20,000,000	$20,777,143
6. Sales Increase %		3.9%

operational change, but a competitive one as well.

Finally, the average line value is increased by one percent, which takes the figure from $300 to $303. Once again, it is a small, but probably challenging, change to the firm's operations.

The net result is that sales increase from $20,000,000 to $20,777,143, an increase of 3.9 percent. It is not an earth-shattering number, but it is important. It represents organic sales growth that is not dependent upon the market. It also is achieved with only a modest increase in payroll costs.

Order Size Strategies and Tactics

They two keys to changing order economics in a significant way require developing both a sophisticated information reporting system and a more action-oriented mindset. In short, the proper information must be available and it must actually be used in decision making.

Information Reporting System: If the firm does not know its average lines per order or its average line value, then it has no chance of improving them. It is not just enough to have the information at the total firm level. The information must be accumulated and available for reviewing individual customers and individual salespeople—both inside and outside sales. This is yet another example of where "big data" comes into play in management. With existing technology, having such information readily available is no longer a major challenge.

Action-Oriented Mindset: Collecting the information is an essential first step. Relatively speaking, it is not particularly difficult. Developing improvement programs based on that information is a much more challenging and time-intensive effort. It necessitates specific approaches to improve the two order economics pressure points identified in Exhibit 1.

- **Lines per Order**—Superficially, this would seem to be nothing more than a "would you like fries with that" effort. This is important and where information on performance by salesperson comes into play. Overtime sales people get tired, develop bad habits and fall into low-performance ruts. Continual follow-up and reinforcement is required.

However, there is also a strategic component at the total firm level. It is essential to fully understand the range of products that customers would like to purchase. Items not in the product line can't add to the lines per order. It is also necessary to have the items in stock on a systematic basis. Ultimately, being out of stock causes the lines per order to fall to zero.

- **Average Line Value**—This is by far the more challenging of the two improvements shown in Exhibit 1. It is also more profitable by far.

Customers have the unpleasant habit of ordering only the quantity they need right now. Getting them to buy more is an uphill battle. However, by working with customers to understand that placing a lot of small orders costs them more money, it is possible to help them plan ahead and buy less often, but more each time. The impact is small, but important.

A much more impactful course of action is to raise prices where there is the opportunity to do so. This cannot be an across-the-board activity. However, in every business there is the potential for modest price increases on slower-selling items. Eventually these small changes add up.

Moving Forward

Technology is important in helping control payroll costs. However, technology by itself will never produce meaningful changes. The key to controlling costs is to review order economics on an on-going basis. ■

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