BLOCKING AND TACKLING: OBSOLETE CONCEPTS?

By Dr. Albert D. Bates

Over the course of the last few years, the emphasis in distribution has moved away from improving operations to completely re-thinking the nature of the business. New ideas have included dramatically reducing the number of customers served, using "big data" to gain a marketing advantage, structuring separate Web-based entities and using mobile technology to preempt competitors. Countless other strategic initiatives could also be listed.

Somewhat lost in the discussion is the idea of managing the existing business for greater profit. It is not that distributors have no desire to improve profitability. It is just that the idea of improved performance from blocking and tackling better seems so twentieth century.

This report will examine the economic realities of improved operations. It will do so from two distinct perspectives:

EXHIBIT 1: THE IMPACT OF ONE PERCENT IMPROVEMENTS FOR A TYPICAL DHI MEMBER

Income Statement ($)	Current Results	Potential Results	Percent Change
Net Sales	15,000,000	15,150,000	1.0
Cost of Goods Sold	10,450,000	10,508,545	0.6
Gross Margin	4,550,000	4,641,455	2.0
Payroll Expenses	3,360,000	3,326,400	-1.0
All Other Expenses	765,000	757,350	-1.0
Total Expenses	4,125,000	4,083,750	-1.0
Profit Before Taxes	425,000	557,705	31.2
Income Statement (%)			
Net Sales	100.0	100.0	
Cost of Goods Sold	69.7	69.4	
Gross Margin	30.3	30.6	
Payroll Expenses	22.4	22.0	
All Other Expenses	5.1	5.0	
Total Expenses	27.5	27.0	
Profit Before Taxes	2.8	3.7	

- The economic impact of small improvements—An analysis of how even modest operational changes can lead to much higher profit levels.
- Guidelines for operational improvements—A discussion of the opportunities for blocking and tackling better.

The Economic Impact of Small Improvements

Exhibit 1 examines income statement performance of a typical DHI member based upon the latest PROFIT Report. As indicated in the "Current Results" column of the exhibit, the typical firm generates $15 million in revenue. It operates on a gross margin of 30.3 percent of sales with expenses of 27.5 percent of sales. As a result, it generates a pre-tax profit of $425,000, or 2.8 percent.

The "Potential Results" column reflects the impact of three very modest, seemingly inconsequential, improvements. The specific improvements are: (1) a 1 percent increase in sales, (2) a 1 percent improvement in the gross margin percentage from 30.3 to 30.6 percent [30.3 percent times 1.01], and (3) a 1 percent reduction in total expenses. It is blocking and tackling better personified.

While each of the improvements in operations are all a modest 1 percent, the impact on profitability is far from modest. The firm's pre-tax profit increases from 2.8 percent of revenue to 3.7 percent. Of greater consequence, the dollar profit increases by $132,705, a 31.2 percent improvement. This increase in profit provides a basis for financing the foray into more strategic actions.

For years the author has repeated the mantra of "little things mean a lot." Admittedly, many distributors have tired of hearing the refrain. As a result the idea of systematic improvements has lost favor. The profit impact of such improvements suggests it might be time for an operational renaissance.

Guidelines for Operational Improvements

It is one thing to talk about operating the existing business more effectively. It is something else to actually do it. In essence, how does the firm block and tackle better? In making the improvements, there are two important issues to consider: (1) focusing on what matters and (2) developing a consensus in the business as to what those item really are.

Operational Focus

There were three areas of change driving the financial improvements shown in Exhibit 1: net sales, gross margin and expenses. Each needs to be addressed. In doing so, firms need to avoid over-complicating the improvement actions required. Focusing on a few key issues should be emphasized.

Net Sales—Research in distribution routinely indicates that many distributors are missing anywhere from 3 to 5 percent of their sales potential for one very basic reason—namely, they have cut back on their inventory investment.

The move in distribution to cut back on inventory began almost a decade ago as firms began to take a more "financial view" of their businesses. The move to reduce inventory continues even as research project after research project shows that the two main complaints that customers have regarding their distributors is an inadequate service level and an assortment that is too narrow.

Gross Margin—For most firms, there is a significant and largely untapped opportunity to improve the gross margin percentage. It involves identifying items where prices can be increased without impacting the firm's competitive position.

Such items, almost all of which are slow selling SKUs, represent a small proportion of sales volume. At the same time they have the potential to contribute to a significant improvement in the firm's overall gross margin percentage. Every pricing study that has been conducted has found a potential gross margin improvement that is at least three times as large as the improvement in Exhibit 1.

Expenses—The overwhelming majority of distribution managers are tired of hearing about expense control. The economic disaster of the so-called Great Recession followed by eight years of tepid growth has left most managers feeling that there is nothing left to cut. They may well be right.

The real key to expense control is not to cut expenses or even become more productive. What is needed is an emphasis on internal order economics, a topic covered in previous articles. In simplest terms, the battle is to get the maximum number of items on every order. If that can be done, expenses will systematically fall as a percent of sales, even as they continue to increase in dollars.

Operational Consensus

As distribution businesses have increased in size and scope, they have become more bureaucratic in nature. In far too many instances they have moved beyond bureaucratic to the point of being Balkanized.

Recent research conducted by the Distribution Performance Project in a number of lines of trade has found an amazing lack of consensus among key managers as to what is really important in improving performance. It is not uncommon for half of the firm's key managers to feel that prices should be reduced to gain sales volume, while another half feels that prices should be increased.

Interestingly, it is not just the "sales guys" that argue for lowering prices. The uncertainty about what to do afflicts every aspect of the operation. With such disparity of understanding there is little chance of making meaningful improvements.

The key to achieving goal congruence is management education. There is often a feeling that "they all know that" regarding issues such as the impact of inventory reductions. The reality, in fact, is that half of them don't know that.

Education must be geared towards providing a basic understanding of what really drives profit in the firm. There should be no intent to make everybody an accountant. However, it should be relatively easy to ensure that all managers understand the economics of price cutting, for example.

Moving Forward

There is no denying that distribution is in an era of significant change. Every firm must be looking for ways to take advantage of new strategic initiatives, new technology and new ways of servicing customers.

However, if firms ignore the profit opportunities in the existing business, they are severely limiting their ability to take part in the new distribution future. The existing business is a massive profit improvement opportunity that must be optimized. It is time to once again emphasize blocking and tackling better. ■

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