THE PROFIT REPORT:

Expanding an Invaluable Service

By Dr. Albert D. Bates

The PROFIT Report is continually ranked as one of the most valuable services that DHI provides. At the same time, a number of DHI members do not take advantage of this important (and free) service. Part of the problem appears to be a difficulty in making use of the information provided.

Starting in 2016, two important additional outputs will be provided as part of the PROFIT Report service. The additional outputs are designed to indicate what each member must do to improve profitability. The enhancements, collectively, are what the Profit Planning Group, the firm that prepares the PROFIT Report, calls *Prescriptive Benchmarking*.

Prescriptive benchmarking represents the ultimate level of data presentation. It not only provides comparisons, it structures information in a way that allows management to know what should be done and by how much. It combines the "how are we doing" component of traditional benchmarking with a "what if" component and then adds a dose of consultative support.

The two enhancements contained in prescriptive benchmarking are a three-way performance analysis chart (yes, that is a mouthful of words) and a dynamic performance dashboard. The first enhancement provides a precise indication of what the firm needs to do. The second provides a basis to use the PROFIT Report results in planning.

The three-way performance chart, as the name implies, brings three important measures of performance together. It does so for the five key Critical Profit Variables (CPVs)—sales growth, gross margin percentage, operating expense percentage, inventory turnover and the DSO (days sales outstanding). A sample chart is shown in **Exhibit 1**.

On the horizontal axis, the exhibit presents the individual firm's percentage ranking on each factor. This can rank from one to 100 percent. That is, the firm can outperform somewhere

EXHIBIT 1: A THREE-WAY PROFIT INTERACTION CHART

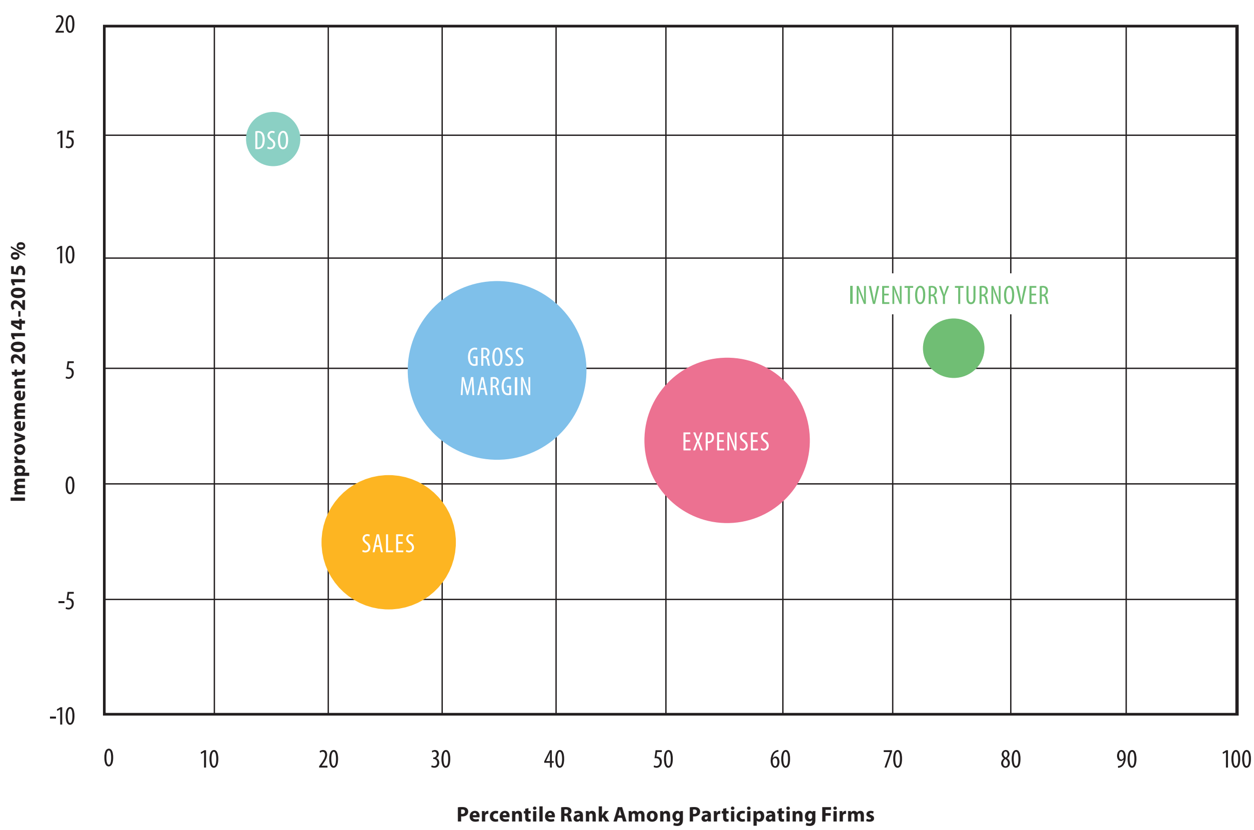

EXHIBIT 2: A SAMPLE DYNAMIC PERFORMANCE DASHBOARD

	Goal Performance Rank	Goal Value	Service
Return on Assets	59	10.9	Check
Profit Margin	68	4.2	Check
Gross Margin	46	21.2	Check
Operating Expense %	68	16.8	Check
Asset Turnover	34	2.6	Check
Sales Change %	51	7.6	Check

Use Throttle & Control set goals which improve performance ranks. Use Check buttons to investigate contributing factors.

Throttle & Control	Current	Change By	Change %	Goal	Current Rank	Goal Rank
Total Annual Invoice Lines	40,000	2,400	6.0	42,400		
Avg. Selling Price Per Invoice Line	250.00	3.75	1.5	253.75		
Avg. Purchase Price Per Invoice Line	200.00	0.00	0.0	200.00		
Payroll & Fringe Benefits	1,250,000	37,500	3.0	1,287,500	56	64
All Other Operating Expenses	500,000	25,000	5.0	525,000	71	73
Other Income/Expenses (non-operating)	0.0	0.0		0		
Warehouse Sales (% of sales)	72.0	0.0	0.0	72.0		
Inventory Turnover (turns)	3.5	0.0	0.0	3.5	27	27
Credit Sales (% of sales)	94.0	0.0	0.0	94.0		
DSO (days)	48.5	0.0	0.0	48.5	78	78
Fixed & Noncurrent Assets	1,000,000	0.0	0.0	1,000,000		
Income Tax Rate (%)	30.0	0.0	0.0	30.0		
Interest Rate (%)	7.0	0.0	0.0	7.0		
Cash Change Used to Reduce Debt (%)	0.0	0.0	0.0	0.0		

between one and 100 percent of its peers within DHI. For example, the sample firm in Exhibit 1 (every firm has a different chart) outperforms about 75 percent of its peers on inventory turnover.

The firm's percentage improvement on each of the CPVs is shown on the vertical axis. Since the change can be negative, this factor must be scaled to reflect the actual change, either positive or negative. For DSO, the firm improved by about 15 percent during the course of the last year.

These two axes position each variable in terms of importance and improvement. The final factor in the exhibit is that the size of the circles reflects the relative impact that each of the critical profit variables has on profitability. In this particular instance, the gross margin circle is the largest and the DSO (days' sales outstanding) is the smallest. Again, all of this information is company specific.

The exhibit provides an instantaneous feedback mechanism for management. It indicates how well the firm is doing compared to its peers, how performance is changing and how important each factor is. It is a roadmap for improving results.

The dynamic performance dashboard shown in **Exhibit 2** provides a mechanism to help participants move from understanding financial issues to taking action on those issues. It converts the static historical dashboards into a planning dashboard.

The top of **Exhibit 2** provides information on the six most important metrics in distribution. Three are overall performance measures—return on assets, profit margin and asset turnover. The other three are the three most important of the CPVs—gross margin percentage, operating expense percentage and sales growth.

What makes the dashboard unique is that each participant has the potential to make changes in fourteen different areas, each of which is identified in yellow at the bottom. The cumulative changes have resulted in shifts in the performance metrics at the top. For example, the top factor (Return on Assets) has risen to 10.9 percent from what it was previously.

With an interactive dashboard, the association is now providing a package that moves benchmarking from a method of presenting historical data to one of helping firms improve performance. It makes benchmarking dramatically more important to the membership.

The enhancements are provided at the same price the PROFIT Report has always had—it is free. It is a great way for firms to really get serious about improving their performance.

DR. ALBERT D. BATES is founder and president of Profit Planning Group. His recent book, *Breaking Down the Profit Barriers in Distribution*, is the basis for this report. The book is available in trade-paper format from Amazon and Barnes & Noble.