Presented by Dr. Albert D. Bates

PROFIT IS EVERYBODY'S BUSINESS

A Member Service from the Convenience Distribution Association (CDA)

Session One:

How Are We Doing?

Exhibit 1
Key Financial Results:
The Typical Firm in the Industry

	Dollars	Percent of Sales
Net Sales	$20,000,000	100.0 %
Cost of Goods Sold	18,700,000	93.5
Gross Margin	1,300,000	6.5
Expenses		
Payroll and Fringe Benefits	750,000	3.8
All Other Expenses	450,000	2.3
Total Expenses	1,200,000	6.0
Profit Before Taxes	$100,000	0.5 %
Accounts Receivable	$650,000	
Inventory	$950,000	

Exhibit 2
The Three Profit Pressure Points

1. Sales Growth	Ability to grow faster than the overall market
2. Gross Margin Percentage **a. Buying Prices** **b. Selling Prices**	Ability to buy effectively and get paid for services provided
3. Expense Percentage	Ability to operate in a productive manner while still compensating employees in line with their efforts

Exhibit 3
Economics of Improving Profit

Result	Generate somewhere around three times the profit of the typical firm in every industry
How They Do It	Doing just a little better on the three factors identified in Exhibit 2—Sales Growth, Gross Margin Percentage and Expense Percentage
Important Note	High profit doesn't mean bigger, just slightly better

Exhibit 4
A Mantra to Remember

Little Things Mean a Lot

- Crank the sales a little bitty bit
- Just a smidgen more gross margin
- Watch those expenses

Session Two:

What are the CPVs?

Exhibit 5
A Reminder About the Typical Company

	Dollars	Percent of Sales
Net Sales	$20,000,000	100.0 %
Cost of Goods Sold	18,700,000	93.5
Gross Margin	1,300,000	6.5
Expenses		
Payroll and Fringe Benefits	750,000	3.8
All Other Expenses	450,000	2.3
Total Expenses	1,200,000	6.0
Profit Before Taxes	$100,000	0.5 %
Accounts Receivable	$650,000	
Inventory	$950,000	

Exhibit 6
A New Expense Concept

Fixed Expenses	Tend to stay the same until somebody takes action	$800,000
Variable Expenses	Tend to change automatically when sales change	2.0% of Sales or $400,000

Exhibit 7
The Impact of Doing 1% Better on the Critical Profit Variables

The Three CPVs—Four Action Points	The Impact on Dollar Profits of of a 1.0% Improvement
1. Gross Margin—Two Actions	
a. Selling Prices	196.0 %
b. Buying Prices	187.0
2. Net Sales	9.0
3. Total Expenses	12.0

Exhibit 8
The Impact of the Gross Margin Actions

		Making Changes From Current Performance	
	Current	Lowering Cost of Goods With Better Buying	Raising Sales With Higher Prices
Net Sales	$20,000,000	$20,000,000	$20,200,000
Cost of Goods Sold	18,700,000	18,513,000	18,700,000
Gross Margin	1,300,000	1,487,000	1,500,000
Expenses			
Fixed Expenses	800,000	800,000	800,000
Variable Expenses (2% of Sales)	400,000	400,000	404,000
Total Expenses	1,200,000	1,200,000	1,204,000
Profit Before Taxes	$100,000	$287,000	296,000
Increase in Profit—$		$187,000	$196,000
Increase in Profit—%		187.0%	196.0%

Exhibit 9
The Impact of the Sales and Expense Actions

	Current	Sell More Merchandise	Lower Expenses
Net Sales	$20,000,000	$20,200,000	$20,000,000
Cost of Goods Sold	18,700,000	18,887,000	18,700,000
Gross Margin	1,300,000	1,313,000	1,300,000
Expenses			
Fixed Expenses	800,000	800,000	792,000
Variable Expenses	400,000	404,000	396,000
Total Expenses	1,200,000	1,204,000	1,188,000
Profit Before Taxes	$100,000	$109,000	$112,000
Increase in Profit—$		$9,000	$12,000
Increase in Profit—%		9.0%	12.0%

Session Three:

Cost of Good *Not* Sold

Exhibit 10
A Reminder About the Sample Company

	Dollars	Percent of Sales	
Net Sales	$20,000,000	100.0	%
Cost of Goods Sold	18,700,000	93.5	
Gross Margin	1,300,000	6.5	
Expenses			
Fixed Expenses	800,000	4.0	
Variable Expenses (2% of Sales)	400,000	2.0	
Total Expenses	1,200,000	6.0	
Profit Before Taxes	$100,000	0.5	%

Exhibit 11
The Impact of Missing Some Potential Sales

	Current	5.0% Sales Not Made
Net Sales	$20,000,000	$19,000,000
Cost of Goods Sold	18,700,000	17,765,000
Gross Margin	1,300,000	1,235,000
Expenses		
Fixed Expenses	800,000	800,000
Variable Expenses (2% of Sales)	400,000	380,000
Total Expenses	1,200,000	1,180,000
Profit Before Taxes	$100,000	$55,000
Decrease in Profit—$		$45,000
Decrease in Sales—%		5.0%
Decrease in Profit—%		45.0%

Volume Sensitivity: Sales Change Versus the Profit Change

Exhibit 12
The Driver of Sales Maximization

	Current	Potential
1. Customer Orders	6,667	6,667
2. Lines per Order	**63.16**	**64.26**
3. Lines Ordered [1 x 2]	421,053	428,400
4. Fill Rate (Service Level)	**95.0%**	**96.0%**
5. Lines Filled [3 x 4]	400,000	411,264
6. Average Line Value	**$50.00**	**$50.50**
7. Sales Generated [5 x 6]	$20,000,000	$20,768,832
Increase in Sales		3.8%

Exhibit 13
The Areas of Emphasis in Growing Sales

<u>Sales Driver</u>	
Lines per Order	• Add-on selling • Breadth of assortment—one-stop shopping • Customer Awareness of the Assortment
Fill Rate	• In-stock on key items at all times
Average Line Value	• Good/Better/Best selling • Selectively raise prices
Adding New Customers	• Continual effort

Session Four:

The Sales to Payroll Wedge

Exhibit 14
The Sample Company One More Time

	Dollars	Percent of Sales	
Net Sales	$20,000,000	100.0	%
Cost of Goods Sold	18,700,000	93.5	
Gross Margin	1,300,000	6.5	
Expenses			
Payroll and Fringe Benefits	750,000	3.8	
All Other Expenses	450,000	2.3	
Total Expenses	1,200,000	6.0	
Profit Before Taxes	$100,000	0.5	%

Exhibit 15
The Sales to Payroll Wedge

The Key Concept

- Control payroll costs so they increase two percent less than the increase in sales

Supporting Concepts

- Sales growth is key to increasing profits
- Expense control is also key
- Employees are the way the company provides its services, and effective employees deserve increases in pay

Some Changes That Will All Drive Higher Profits

Sales Increase (Sales Growth)	Payroll Increase (Payroll Growth)	Sales to Payroll Wedge
15.0%	13.0%	2.0%
10.0%	8.0%	2.0%
5.0%	3.0%	2.0%

Exhibit 16
Two Sales Increase Scenarios

		5.0% Increase in Sales	
		Payroll	Payroll
	Current	Up 3.0%	Up 7.0%
Net Sales	$20,000,000	$21,000,000	$21,000,000
Cost of Goods Sold	18,700,000	19,635,000	19,635,000
Gross Margin	1,300,000	1,365,000	1,365,000
Expenses			
Payroll and Fringe Benefits	750,000	772,500	802,500
All Other Expenses	450,000	472,500	472,500
Total Expenses	1,200,000	1,245,000	1,275,000
Profit Before Taxes	$100,000	$120,000	$90,000

Exhibit 17
A Reminder About Order Economics

**** Raise the Average Line Value**

- The only increase in payroll costs would be comissions
- It is the exact same amount of work being done

*** More Lines on Every Order**

- Increases payroll costs slightly as more items have to be picked, inspected and ultimately, re-ordered from suppliers
- However, sales should increase more than payroll costs

Exhibit 18
Some Other Ways to Control Payroll Costs

Identify and Work With Problem Customers

- Some customers are extremely expensive to service properly
- Rethink their cost impact
  - –Do they buy too often in very small quantities?
  - –Do they have lots of returns?
  - –Are they excessive on emergency orders?
- If costs can't be controlled, adjust prices

Review the Service Profile

- Some services provided are essential
- Some services may not have any real value

Session Five:

Trying to Make it up With Volume

Exhibit 19
You Guessed It—The Sample Company Again

	Dollars	Percent of Sales	
Net Sales	$20,000,000	100.0	%
Cost of Goods Sold	18,700,000	93.5	
Gross Margin	1,300,000	6.5	
Expenses			
Fixed Expenses	800,000	4.0	
Variable Expenses (2% of Sales)	400,000	2.0	
Total Expenses	1,200,000	6.0	
Profit Before Taxes	$100,000	0.5	%

Exhibit 20
Let's Cut Our Prices

	Current Price	New Price	Percent Change
Average Transaction (Order)	$3,000.00	$2,982.00	-0.6 %
Supplier Cost per Transaction (Order)	$2,805.00	$2,805.00	0.0
Gross Margin Per Transaction (Order)	$195.00	$177.00	9.2
Gross Margin Percentage	6.5%	5.9%	

Exhibit 21
What Happens If We Do Cut Price?

	Current	0.6% Price Cut	Percent Change	
Average Transaction (Order)	$3,000.00	$2,982.00	-0.6	%
Cost of Goods per Transaction (Order)	$2,805.00	$2,805.00	0.0	
Number of Customer Transactions	6,667	6,667	0.0	
Net Sales	$20,000,000	$19,880,000	-0.6	%
Cost of Goods Sold	18,700,000	18,700,000	0.0	
Gross Margin	1,300,000	1,180,000	-9.2	
Expenses				
Fixed Expenses	800,000	800,000	0.0	
Variable Expenses (2% of Sales)	400,000	397,600	-0.6	
Total Expenses	1,200,000	1,197,600	-0.2	
Profit Before Taxes	$100,000	-$17,600	-117.6	

Exhibit 22
The Sales Increase Required to Offset
The Price Cut

	Current	0.6% Price Cut	Percent Change	
Average Transaction (Order)	$3,000.00	$2,982.00	-0.6	%
Cost of Goods per Transaction (Order)	$2,805.00	$2,805.00	0.0	
Number of Customer Transactions	6,667	7,669	15.0	
Net Sales	$20,000,000	$22,868,098	14.3	
Cost of Goods Sold	18,700,000	21,510,736	15.0	
Gross Margin	1,300,000	1,357,362	4.4	
Expenses				
Fixed Expenses	800,000	800,000	0.0	
Variable Expenses (2% of Sales)	400,000	457,362	14.3	
Total Expenses	1,200,000	1,257,362	4.8	
Profit Before Taxes	$100,000	$100,000	0.0	

Exhibit 23
Things Really Can Get Even Worse

Original Sales Level	Price Cut	Sales Required To Offset The Price Cut	Percentage Increase In Sales
$20,000,000	0.0 %	$20,000,000	0.0 %
$20,000,000	0.6	22,868,098	14.3
$20,000,000	1.1	26,011,105	30.1
$20,000,000	1.6	30,204,638	51.0
$20,000,000	2.1	36,081,081	80.4
$20,000,000	2.6	44,907,787	124.5

Session Six:

Increasing Gross Margin

Exhibit 24
We Are All Getting Tired of the Sample Company

	Dollars	Percent of Sales
Net Sales	$20,000,000	100.0 %
Cost of Goods Sold	18,700,000	93.5
Gross Margin	1,300,000	6.5
Expenses		
Fixed Expenses	800,000	4.0
Variable Expenses (2% of Sales)	400,000	2.0
Total Expenses	1,200,000	6.0
Profit Before Taxes	$100,000	0.5 %

Exhibit 25
Adding a Half Point to Gross Margin by Either buying Low or Selling High

Dollars	**Current**	**Buying Low**	**Selling High**
Net Sales	$20,000,000	$20,000,000	$20,107,527
Cost of Goods Sold	18,700,000	18,600,000	18,700,000
Gross Margin	1,300,000	1,400,000	1,407,527
Expenses			
Fixed Expenses	800,000	800,000	800,000
Variable Expenses (2% of Sales)	400,000	400,000	402,151
Total Expenses	1,200,000	1,200,000	1,202,151
Profit Before Taxes	$100,000	$200,000	$205,376
Percent of Sales			
Net Sales	100.0 %	100.0 %	100.0 %
Cost of Goods Sold	93.5	93.0	93.0
Gross Margin	6.5	7.0	7.0
Expenses			
Fixed Expenses	4.0	4.0	4.0
Variable Expenses (2% of Sales)	2.0	2.0	2.0
Total Expenses	6.0	6.0	6.0
Profit Before Taxes	0.5 %	1.0 %	1.0

Exhibit 26
The Profit challenges Associated With Buying Low and Then Selling Low

	Current	Buying Low	Buying Low and Then Selling Low
Net Sales	$20,000,000	$20,000,000	$19,893,048
Cost of Goods Sold	18,700,000	18,600,000	18,600,000
Gross Margin	1,300,000	1,400,000	1,293,048
Expenses			
Fixed Expenses	800,000	800,000	800,000
Variable Expenses (2% of Sales)	400,000	400,000	397,861
Total Expenses	1,200,000	1,200,000	1,197,861
Profit Before Taxes	$100,000	$200,000	$95,187
Reduction in COGS from Buying Low		0.535%	0.535%
Reduction in Sales from Selling Low		0.000%	0.535%

Exhibit 27
The Impact of a 5.0% Supplier Price Increase: Passing it Along or Absorbing Some of the Increase

	Current	Dollar for Dollar	Percent for Percent
Net Sales	$20,000,000	$20,935,000	$21,000,000
Cost of Goods Sold	18,700,000	19,635,000	19,635,000
Gross Margin	1,300,000	1,300,000	1,365,000
Expenses			
Fixed Expenses	800,000	800,000	800,000
Variable Expenses (2% of Sales)	400,000	418,700	420,000
Total Expenses	1,200,000	1,218,700	1,220,000
Profit Before Taxes	$100,000	$81,300	$145,000

Exhibit 28
Three Important Conclusions About Gross Margin

Pricing Versus Buying	• Raising prices is more powerful than buying better, even at the same gross margin percentage
Buying Better	• Do not decide that buying better is an opportunity to lower prices
Supplier Price Increases	• Pass them along percent for percent

Session Seven:

Pricing For Profit

Exhibit 29
You Already Knew Where We Would Start—The Sample Company

	Dollars	Percent of Sales	
Net Sales	$20,000,000	100.0	%
Cost of Goods Sold	18,700,000	93.5	
Gross Margin	1,300,000	6.5	
Expenses			
Payroll and Fringe Benefits	750,000	3.8	
All Other Expenses	450,000	2.3	
Total Expenses	1,200,000	6.0	
Profit Before Taxes	$100,000	0.5	%

Exhibit 30
The Different Types of Items in the Assortment

Item Category (Velocity Code)	Percent of Sales	Pricing Reality
A: Commodities	60.0 %	If you are high on these, you are saying you are high on everything
B: Basics	20.0	Probably about the same gross margin percent as the total firm
C: Slow Sellers	15.0	Bought infrequently so a possible opportunity to get more margin
D: Really Slow Sellers	5.0	Bought only when absolutely needed—the big opportunity
Total	100.0 %	

Exhibit 31
Stretching the Price Matrix

Current Performance	Sales	Gross Margin Dollars	Gross Margin Percentage
A: Commodities (60% of Sales)	$12,000,000	$240,000	2.0 %
B: Basics (20%)	4,000,000	260,000	6.5
C: Slow Sellers (15%)	3,000,000	495,000	16.5
D: Really Slow Sellers (5%)	1,000,000	305,000	30.5
Total	$20,000,000	$1,300,000	6.5 %

A 10% Price Increase on D Items	Sales	Gross Margin Dollars	Gross Margin Percentage
A: Commodities (60% of Sales)	$12,000,000	$240,000	2.0 %
B: Basics (20%)	4,000,000	260,000	6.5
C: Slow Sellers (15%)	3,000,000	495,000	16.5
D: Really Slow Sellers (5%)	1,100,000	405,000	36.8
Total	$20,100,000	$1,400,000	7.0 %

Exhibit 32
Common Characteristics of Blind Items

Low Sales Level	Items tend to be bought infrequently
Not Heavily Promoted	An absence of on-going price information
Bought Only When Needed	Availability outweighs price
Low Price	On a $2.00 item, price is inconsequential
Repair Parts	Paying $20 to repair a $10,000 piece of equipment
Unusual	Only a few firms actually carry the item
Non-Seasonal	No peak demand to spur price sensitivity
Unbranded	Limited ability to price shop

Session Eight:

The Dual Challenge with Inventory

Exhibit 33
The Sample Company, But a New Emphasis

	Dollars	Percent of Sales	
Net Sales	$20,000,000	100.0	%
Cost of Goods Sold	18,700,000	93.5	
Gross Margin	1,300,000	6.5	
Expenses			
Payroll and Fringe Benefits	750,000	3.8	
All Other Expenses	450,000	2.3	
Total Expenses	1,200,000	6.0	
Profit Before Taxes	$100,000	0.5	%
Inventory	$950,000		
Cash	$100,000		

Exhibit 34
The Two Challenges in Improving Inventory Performance

	Meeting Customer Needs for Merchandise <u>at all Times</u>	Financing Growth to Avoid Running <u>out of Cash</u>
Measurement Tool	Service Level	How Much Inventory
Ease of Measurement	Difficult	Easy
Cost of Not Performing	Lost Customers	Run out of Cash
Implication for the Firm	More Inventory	Less Inventory

Exhibit 35
The Profit and Cash Implications of Less Inventory

	Calculation	Amount
1. Current Inventory		$950,000
2. Reduction in Inventory—%		10.0%
3. Reduction in Inventory—$	[1 x 2]	$95,000
4. Original Cash		$100,000
5. New Cash	[3 + 4]	$195,000
6. Inventory Carrying Cost (ICC)*		9.0%
7. Increase in Profit	[3 x 6]	$8,550

A Comparison: Profit decrease from a 5.0% sales decrease $45,000
(See Exhibit 11)

*The Inventory Carrying Cost includes interest, obsolescence, shrinkage and all other costs associated with having inventory.

Exhibit 36
Trying to Have Your Cake and Eat It Too

Item Category (Velocity Code)	Percent of Items	Percent of Sales	Percent of Inventory Investment
A: Commodities	10.0 %	60.0 %	40.0 %
B: Basics	20.0	20.0	20.0
C: Slow Sellers	20.0	15.0	20.0
D: Really Slow Sellers	50.0	5.0	20.0
Total	100.0 %	100.0 %	100.0 %

Session Nine:

The Hated Accounts Receivable

Exhibit 37
Almost Done With the Sample Company

	Dollars	Percent of Sales	
Net Sales	$20,000,000	100.0	%
Cost of Goods Sold	18,700,000	93.5	
Gross Margin	1,300,000	6.5	
Expenses			
Payroll and Fringe Benefits	750,000	3.8	
All Other Expenses	450,000	2.3	
Total Expenses	1,200,000	6.0	
Profit Before Taxes	$100,000	0.5	%
Accounts Receivable	$650,000		
Cash	$100,000		

Exhibit 38
Why Accounts Receivable is Highly Emotional

The Underlying Issue	• They have our money
It Can Only Get Worse	• The jerks stiffed us

However, they buy from us <u>because</u> we extend them credit.

Exhibit 39
The Profit and Cash Implications of Less Accounts Receivable

	Calculation	Amount
1. Current Accounts Receivable		$650,000
2. Reduction in Accounts Receivable—%		10.0%
3. Reduction in A/R—$	[1 x 2]	$65,000
4. Original Cash		$100,000
5. New Cash	[3 + 4]	$165,000
6. A/R Carrying Cost (ARCC)*		5.0%
7. Increase in Profit	[3 x 6]	$3,250

A Comparison: Profit decrease from a 5.0% sales decrease $45,000
(See Exhibit 11)

*The Accounts Receivable Carrying Cost includes interest, bad debts and the cost of hounding customers who are past due.

Exhibit 40
A Summary of the Key Points from Sessions One Through Nine

- For most distributors profit is adequate but not what it could be
- The key to improvement is to focus on the CPVs—sales, gross margin and payroll
- Sales needs to grow faster than payroll
- Generating the sales to payroll wedge requires working on order economics—the number of lines per order, the fill rate and the average line value
- It is almost impossible to make it up with volume
- Buying and pricing need to be two distinct operations
- Price increases should be passed along percent for percent
- There are numerous opportunities to increase prices on D items
- Changes in both inventory and accounts receivable have a large impact on cash, but a much smaller one on profit
- Concerted effort will lead to higher profits as well as better salaries and bonuses

Session Ten:

Little Things Mean A Lot

Exhibit 41
It's Kind of Sad—Our Last Look at the Sample Company

	Dollars	Percent of Sales	
Net Sales	$20,000,000	100.0	%
Cost of Goods Sold	18,700,000	93.5	
Gross Margin	1,300,000	6.5	
Expenses			
Payroll and Fringe Benefits	750,000	3.8	
All Other Expenses	450,000	2.3	
Total Expenses	1,200,000	6.0	
Profit Before Taxes	$100,000	0.5	%

Exhibit 42
A Potential Profit Plan: One of Many

Sales Increase	5.0 %
Gross Margin Increase	7.0
Payroll Increase	3.0
Other Expense Increase	2.0

Exhibit 43
Little Things Mean a Lot

Dollars	Current	Potential	Percent Change
Net Sales	$20,000,000	$21,000,000	5.0 %
Cost of Goods Sold	18,700,000	19,609,000	4.9
Gross Margin	1,300,000	1,391,000	7.0
Expenses			
Payroll and Fringe Benefits	750,000	772,500	3.0
All Other Expenses	450,000	459,000	2.0
Total Expenses	1,200,000	1,231,500	2.6
Profit Before Taxes	$100,000	$159,500	59.5

Percent of Sales	Current	Potential
Net Sales	100.0 %	100.0 %
Cost of Goods Sold	93.5	93.4
Gross Margin	6.5	6.6
Expenses		
Payroll and Fringe Benefits	3.8	3.7
All Other Expenses	2.3	2.2
Total Expenses	6.0	5.9
Profit Before Taxes	0.5 %	0.8 %

Who Is This Guy?

Dr. Albert Bates is founder and President of the Profit Planning Group. His company prepares financial benchmarking surveys for most of the major lines of trade in distribution.

Prior to starting the Profit Planning Group, Al was a member of the faculty of the University of Colorado. He also served as a Vice-President of Management Horizons, a leading distribution consulting firm—until he left.

Al received his doctorate from Indiana University. While there he was one of the first recipients of the Ford Foundation Fellowships in Business Education.

He is married and has three grown daughters who have all fled to Europe to get as far away from him as they can. All four of the ladies in his life have black belts in Tae Kwon Do. Criticize this video program at your own risk.

What If You Really Want to Know More About Profit?

Al is the author of ***Breaking Down the Profit Barriers in Distribution***. It is a book that every manager in distribution should read. It is available from both Amazon and Barnes & Noble. Sorry, but because of the technical nature of the material it is not available in ebook format.