

# Getting to the Light At the End of the Tunnel

Prepared For

**NAED**

Prepared By

Distribution Performance Project  
3985 Wonderland Hill Ave., Suite 201  
Boulder, CO 80304  
720-668-8840  
bigal6212@gmail.com  
distperf.com

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## Objectives Of The Session

- Review a Financial Appraisal of Where the Firm Stands
- Identify the Key Mistakes From the Past to be Avoided
- Suggest an Action Plan to Improve Long-term Financial Performance
- Identify Some ***Free*** Software that Might be of Assistance in Planning

Exhibit 1

Distribution Performance Project

## Income Statement Results For A Typical Firm

	<u>Dollars</u>	<u>Percent</u>
Net Sales	400,000,000	100.0
Cost of Goods Sold	<u>310,000,000</u>	<u>77.5</u>
Gross Margin	90,000,000	22.5
Payroll and Fringes	50,000,000	12.5
All Other Expenses	<u>26,000,000</u>	<u>6.5</u>
Total Expenses	<u>76,000,000</u>	<u>19.0</u>
Profit Before Taxes	14,000,000	
Fixed Expenses	60,000,000	
Variable Expenses	16,000,000	4.0

Exhibit 2

Distribution Performance Project

### Selected Balance Sheet Items For the Typical Firm

Cash	\$10,800,000
Accounts Receivable	\$50,000,000
Inventory	\$40,000,000
Accounts Payable	\$25,000,000

Exhibit 3

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### The Two Key Survival Ratios

- **Break-even Point:** How much of a sales decline can the firm manage without resorting to desperation measures
- **Collection Sensitivity Ratio:** How much can collections lag before the firm faces a severe cash crisis

Exhibit 4

Distribution Performance Project

The Results When The Band Stops Playing:  
The Break-Even Point

Gross Margin %	=	22.5
\$ Fixed Expenses	=	60,000,000
Variable Expense %	=	4.0
Sales Required to Break Even	=	$\frac{\$ \text{ Fixed Expenses}}{\text{Gross Margin \%} - \text{ Variable Expense \%}}$
	=	$\frac{60,000,000}{18.5}$
	=	324,324,324

Exhibit 5

Distribution Performance Project

What Happened There?

Summary <u>Income Statement</u>	<u>Current</u>	<u>Break Even</u>	<u>Percent Change</u>
Net Sales	400,000,000	324,324,324	-18.9
Cost of Goods Sold	<u>310,000,000</u>	<u>251,351,351</u>	-18.9
Gross Margin	90,000,000	72,972,973	-18.9
Fixed Expenses	60,000,000	60,000,000	0.0
Variable Expenses	<u>16,000,000</u>	<u>12,972,973</u>	-18.9
Total Expenses	<u>76,000,000</u>	<u>72,972,973</u>	-4.0
Profit Before Taxes	14,000,000	0	-100.0

Exhibit 6

Distribution Performance Project

### Measuring Accounts Receivable Performance

Collections Per Day	Amount Received Each Day From Past Credit Sales		
		$\frac{\text{Annual Credit Sales}}{365}$	
		$\frac{400,000,000}{365}$	= 1,095,890
Collection Period (The DSO)	Number of Days the Typical Credit Customer Takes to Pay		
		$\frac{\text{Accounts Receivable}}{\text{Collections Per Day}}$	
		$\frac{50,000,000}{1,095,890}$	= 45.63

Exhibit 7      Distribution Performance Project

### The Collection Sensitivity Ratio

$$\frac{\text{Cash on Hand}}{\text{Collections per Day}} = \text{CSR}$$
$$\frac{\$10,800,000}{\$1,095,890} =$$

Exhibit 8      Distribution Performance Project

### The Increase In Unit Sales Required To Exactly Offset A Price Reduction

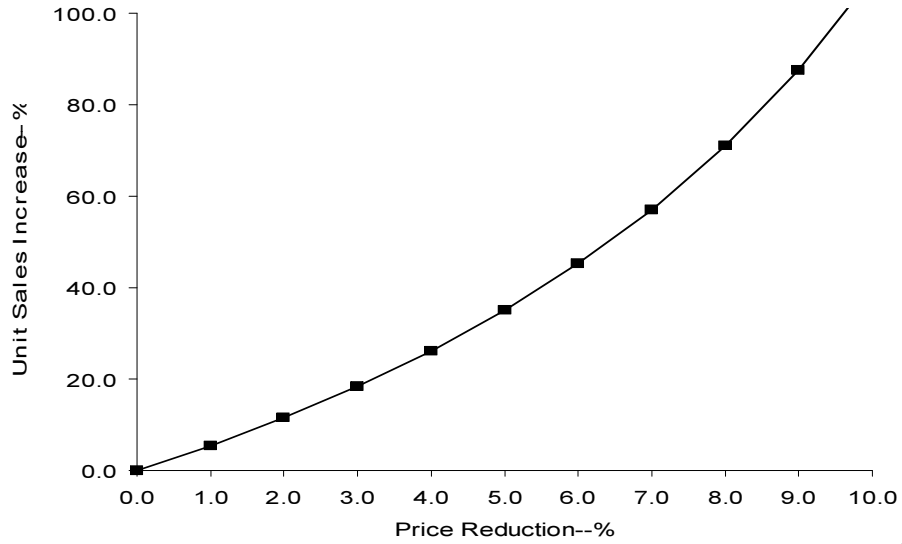


Exhibit 9 Distribution Performance Project

### The Economics of Price Adjustments by Velocity Code

<u>Velocity Code</u>	<u>Price Change</u>
A (60% of Sales)	-5.0
B (20%)	5.0
C (15%)	6.7
D (5%)	20.0

Exhibit 10 Distribution Performance Project

### What Does It Mean Financially To Collect Faster?

1	Collections Per Day	1,095,890
2	Collection Period Goal	45.6
3	Accounts Receivable Goal [ 1 X 2 ]	50,000,000
4	New Collection Period Goal	40.6
5	New Accounts Receivable Goal [ 1 X 4 ]	44,493,151
6	Reduction in Accounts Receivable [ 5 - 3 ]	5,506,849
7	Carrying Cost	8.0%
8	Profit Impact [ 6 X 7 ]	440,548

Exhibit 11      Distribution Performance Project

### Measuring The Break-Even Point For A Sales Decline Associated With Faster Collections

New Sales Equals:

<u>Fixed Expenses + Current Profit - Gain from Collections</u>				
Gross Margin % - Variable Expense %				
60,000,000	+	14,000,000	-	440,548
22.5%		-		4.0%
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<u>73,559,452</u>	=	397,618,660	=	
18.5%				

Exhibit 12      Distribution Performance Project

## Pareto's Law And Inventory Planning

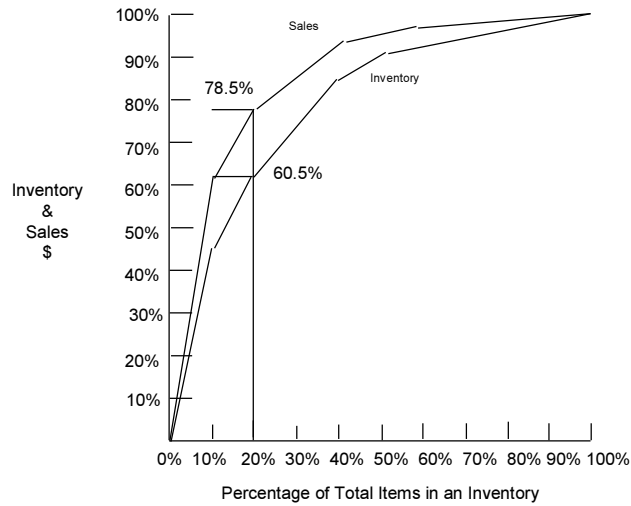


Exhibit 13

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## What Do Most Customers Really Want?

- Fill Rate
- Depth of Assortment
- Speed of Delivery
- Order Accuracy
- Pricing

Exhibit 14

Distribution Performance Project



### What's Wrong With This Picture?

Sales Per Employee:

2013: \$574,500

2018: \$652,500

Payroll Percent of Sales:

2013: 12.6%

2018: 13.0%

Exhibit 15

Distribution Performance Project

### Where Do The Payroll Dollars Go?

<u>Payroll Category</u>	<u>Percent of Sales</u>	<u>Percent of Payroll</u>
Officers/Owners	1.4	10.8
Sales Force	6.3	
Operations	2.0	15.4
All Other	<u>3.3</u>	<u>25.4</u>
Total	13.0	100.0

Exhibit 16

Distribution Performance Project

### The Relative Impact of Improvements in the CPVs On Profit Before Taxes

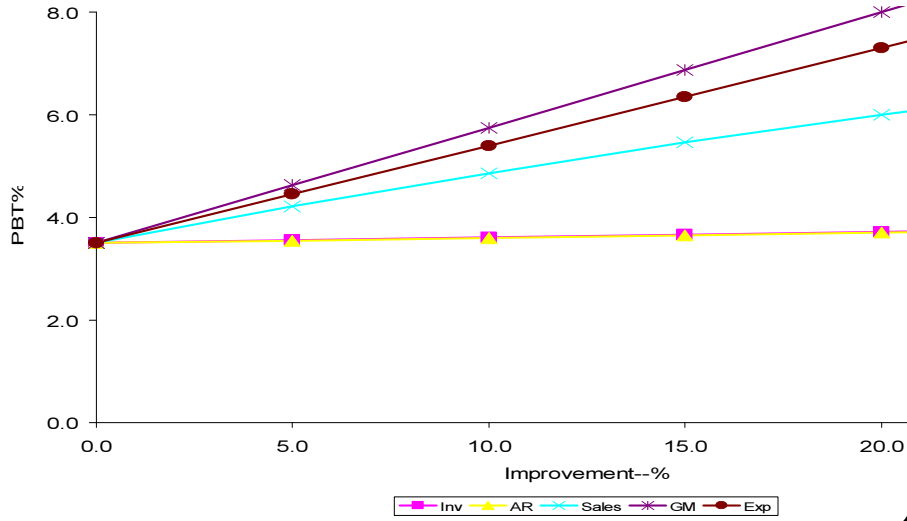


Exhibit 17

Distribution Performance Project

### The Volume Sensitivity of Three Profit Groups

Member Category	Current Profit Margin	Margin With a 5% Sales Decline	Sales Decline Leading to Break Even
Low Profit	1.5%	0.6%	7.6%
Typical	3.5%	2.8%	18.9%
High Profit	6.5%	5.9%	34.6%

Exhibit 18

Distribution Performance Project

### The Sales Impact of Enhanced Order Economics

	<b>Item</b>		<b>Current</b>	<b>Potential</b>
1	Number of Orders		701,754	701,754
2	Lines per Order		3.0	3.1
3	Lines Ordered	[ 1 x 2 ]	2,105,263	2,175,439
4	Fill Rate		95.0%	95.2%
5	Lines Filled	[ 3 x 4 ]	2,000,000	2,071,018
6	Average Order Line		\$200.00	\$202.00
7	Net Sales	[ 5 x 6 ]	\$400,000,000	\$418,345,544
	Increase in Sales			

Exhibit 19      Distribution Performance Project

### The Reality Of Customer Profitability

<u>Customer Category</u>	<u>Percent of Customers</u>	<u>Percent of Profit</u>
High Profit	15	100
Good Profit	15	35
Some Profit	35	10
Unprofitable	<u>35</u>	<u>-45</u>
Total	100	100

Exhibit 20      Distribution Performance Project

## The Conceptual Planning Process

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- Forecast Sales
- Nudging Gross Margin
- Calculating Expenses
- Target Investment Levels

Exhibit 21

Distribution Performance Project

## Free Planning Help: distperf.com Programs/Hands-on Tools

### **Profit-First Planning**

A template to help firms generate a plan that actually increases profit.

[To download a free Excel template for profit-first planning, please click here.](#)

There is a User's Manual that accompanies the Excel template. It reviews the concept of Profit-First Planning and provides guidelines for success in addition to explaining the template.

[To download the User's Manual \(pdf\), please click here. It is best to print the manual front and back.](#)

Exhibit 22

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## Using the Profit-First Template

### Goal 1: Planning Profit First

The first step in the planning process **MUST** be to determine how much profit the firm should make. You may enter any number you think is realistic.

In **Profit-First Planning** it was suggested that a reasonable one-year improvement in the ROA% was 2.0 to 3.0 percentage points. That logic still applies. Care should be used to avoid too large of a change too quickly.

Simply enter the planned profit number in the yellow box. The computer will provide you with a "sanity check" on the target.

Current Profit Before Taxes	500,000
Current ROA%	5.0%
Target Profit Before Taxes	<b>600,000</b>
Percentage Change	20.0%
Resulting ROA% if Assets Don't Increase	6.0%

Profit Guru Comment  
This is a small change in the ROA%.  
A typical one-year change is between 2.0 and 3.0% points.

Exhibit 23

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## Who Is This Guy?

Dr. Albert Bates is founder and Principal of the Distribution Performance Project, a research and education entity focusing exclusively on distribution. He makes approximately 100 presentations each year on topics such as Improving the Bottom Line, Doing More With Less and Pricing for Profit. He also heads the firm's investigation into profitability research for over fifty different trade associations.

Al received his doctorate from Indiana University. He is married and has three daughters. All four of the ladies in his life have black belts in Tae Kwon Do, so don't criticize his presentation too much.

Buy the book: **Breaking Down the Profit Barriers in Distribution** from Amazon or Barnes & Noble. Trade paper only.



Exhibit 24

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