Using Labor Wisely

At our firm, we provide a highly-detailed cost and profit analysis system distributors use to understand and improve their profit drivers. In my role, I spend a lot of time with our clients, discussing emerging challenges (and the strategies employed to meet them) so they can deliver higher growth and profits.

Recently, we've been looking carefully at the impact of labor scarcity, and collaborating on how to use the shortage for a competitive advantage. Ultimately, our clients are targeting areas where efficiency gains let them apply labor costs more favorably, and customer programs that generate new cash-flow to fund market-leading wages.

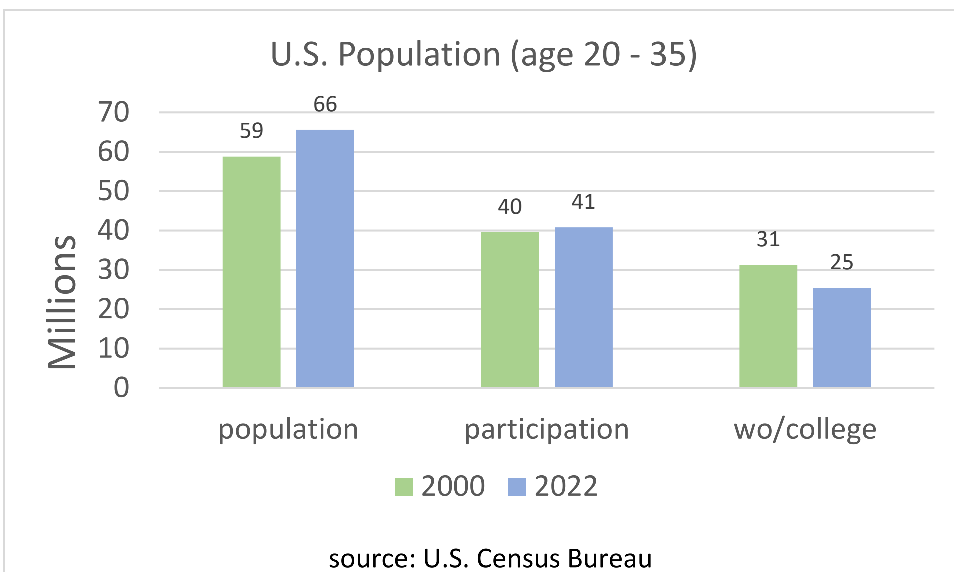
In this three-part series, I'm sharing what we're seeing and the insights and actions being employed in high-profit distributors. In this second part, I'm focused on the labor side of the equation.

Demographic Shifts Have Changed the Game

The 2020s have presented historic challenges for the wholesale/distribution industry. The retrenchment we saw with COVID-19, the rapid and passing sales acceleration in its aftermath, and record inflation have whipsawed executives trying to be responsive to the market. The shift to "work-at-home", and more customers insisting sales calls move to virtual, is changing the landscape even more.

Now, we're feeling shifts in the labor market reaching near-crisis levels. This is being driven by demographics, and the numbers are sobering.

According to the U.S. Census Bureau and the Department of Labor Statistics, the pool of non-college people in the 20–35 age bracket has shrunk from 31 million in 2020 to just 25 million in 2022, a drop of 19.4%.

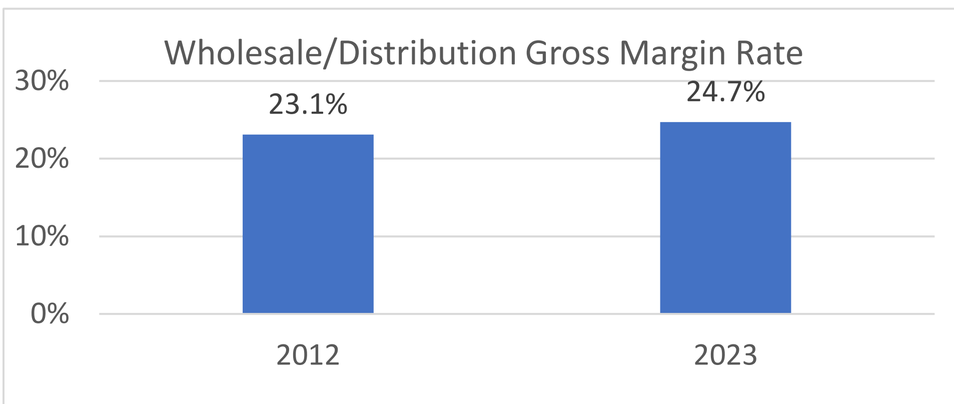


The non-college-educated population has dropped from 31M to 25M, down 19.4%.
This pool is shared with construction, driving, hospitality and all other industries.

This cohort is the source of labor for distribution, construction, hospitality, clerical workers, and the military. In wholesale/distribution, competition for workers has driven wages from $20.04 in 2006 to $33.82 in 2023, up a whopping 68.8%. If companies can't pay wages above the average, turnover is severe.

Wages in wholesale/distribution are up 68.8% since 2006.

This has made labor availability and labor costs the determining factor for company success, and the first priority for senior executives. For distributors, this has had a double impact – not only are our own labor costs skyrocketing, wage inflation in manufacturing has driven up purchase price of products.



Industry margins have barely moved since recovering from the financial crises.

Since margins have been static, rising labor has put an unprecedented squeeze on profits. Companies are now applying labor more wisely, and developing additional cash flow to fund higher wage rates. It's become too expensive to waste labor on orders and activities with insufficient value to cover labor costs, and good analytics are essential to knowing where, exactly, this is happening.

Managing Labor Costs

Simply put, with labor getting scare and expensive, it's now a requirement to utilize it only where there's sufficient profit available to justify it. It used to be that labor was such a commodity, you just hired enough people to do the work. Now you need to decide which work is valuable enough to assign labor to it. For the rest, you reduce the needed labor component, eliminate that business, or subsidize it where it's strategically necessary.

For most, this is a completely new way of thinking. But continuing as before is a road to failure. The challenge is: How do you decide?

For this, you must have analytics.

Data Analytics for Labor

Let's start with a couple of base concepts.

First, Gross Profit (what we a WayPoint refer to as OpCash, or operating cash) represents profit opportunity in a sale or a customer account. If a sale has $100 of OpCash, you cannot make any more than $100 of profit so your expenses need to be less than $100 and, practically, a lot less.

Second, the cost structure for each particular sale can vary widely. Profitability depends on a myriad of factors: how many items are on the order; how much product is sharing the cost of the delivery; what rebates apply; are commissions paid? Depending on these and many other elements, costs may exceed OpCash (sometimes far exceed OpCash), producing losses.

You'll need to have a reasonably sophisticated cost and profit analysis system so you can target your efforts. Many companies use our system, where each cost is distributed to its related products and related customer accounts, and very precise profit numbers are known for every customer, product, territory, etc. If you'd like to know about our system for this, you can contact me (info in the bio below).

Using rule-of-thumb estimates (based on averages) won't cut it. Like all such metrics, you miss the outliers at the top and bottom of the range – and these are the ones that matter. You need to identify customers and sales with superior profit rates because those will fund higher wages. Those with losses indicate target areas for manpower reduction and efficiency gains.

To assign labor wisely, knowing with certainty which accounts, products, and situations to prioritize is as vital as knowing which to avoid. Detailed profit analysis (whether internally developed or from a professional system) provides the roadmap for action.

Improving Labor Productivity & Efficiency

Targeting labor where it can drive the best return is important, but there's no practical way you can make individual decisions on thousands of orders. That's why order classification is so useful.

Classify orders into groups most likely to produce high profit rates (and those that almost guarantee losses) to guide your labor assignment. Identify areas where automation or new processes can turn money-losers into money-makers.

Innovating to move more product value for less manpower has a magnifying effect by making more of your order portfolio profitable. In turn, this makes all your accounts more profitable and shifts some from unprofitable to profitable. Just as important, it expands the addressable market of potentially profitable accounts, making sales efforts more productive.

Metrics for Managing Labor

Getting good metrics in place has been an important step for the companies that are knocking it out of the park. These are where we focus first:

OCR (OpCash Ratio) – OCR indicates the scale of the opportunity to make profits. [OpCash (or Gross Profit) ÷ Expenses]: OCR indicates how much product value is handled per dollar spent, and higher numbers represent the best profit opportunities. Focus on growing areas with high OCR, and increase OCR by reducing the need for manpower in those areas. (More on this below.)

OpCash Ratios					
	HQ	Fairview	Centerville	Riverside	All Branches
Net Revenue	530.61	536.50	361.10	244.55	420.21
Net CoGS	2.81	(1.99)	1.60	5.01	2.21
Op Cash	527.80	538.49	359.50	239.54	418.00
Selling Exp	14.35	17.26	14.46	8.71	13.48
Order Entry Exp	3.46	3.57	3.24	1.93	3.04
Whse Exp	31.90	7.36	6.22	6.21	15.00
Delivery Exp	11.46	11.93	12.66	7.84	10.90
G & A + Other	39.63	41.15	36.08	20.22	34.16
Operating Exp	100.79	81.27	72.67	44.91	76.57

With HQ moving significantly more product value per expended dollar,
direct customer deliveries from HQ may be a very good way to increase profitability.

ROX (Return on Expenditures) – ROX indicates the amount of profit returned per expense dollar. [Net Profit ÷ Expenses]: This is the end-result of operational activities, and accounts for how much cost is actually incurred. Implement this at the branch, warehouse, and product category level to identify high and low points and prioritize those with the highest rates. Target low (below $1.00 returned per dollar spent) for labor cost reductions.

ROX Metrics							
	Jun 2022	Jul 2022	Aug 2022	Sep 2022	Oct 2022	Nov 2022	Total
Net Revenue	440.39	417.65	403.91	389.18	390.23	431.39	411.06
Net CoGS	2.04	2.42	1.31	2.37	1.95	2.31	2.07
Op Cash	438.35	415.22	402.60	386.81	388.28	429.08	408.99
Selling Exp	14.10	13.89	12.95	12.21	12.00	12.48	12.88
Order Entry Exp	3.11	3.07	2.92	2.90	2.80	2.80	2.92
Whse Exp	14.93	14.69	14.48	15.34	16.13	17.59	15.58
Delivery Exp	11.01	11.18	10.57	10.97	10.46	10.32	10.73
G & A + Other	36.07	34.34	33.04	32.27	30.68	31.04	32.75
Operating Exp	79.22	77.17	73.96	73.69	72.07	74.23	74.87

Warehouse productivity increases are improving ROX.
Now it's time to address efficiency in Selling and Delivery, the next opportunity areas.

Productivity Measures – These indicate the amount of potential value derived from any particular resource unit. [e.g., OpCash ÷ labor payroll]: These are the fundamental manageable metrics that drive operational efficiency. The base units can be headcount, manhours, payroll dollars, warehouse square foot, or any of a myriad of others you may invent. You can make comparisons between operating units to find the leaders and laggards, or across time to see improvement or deterioration.

Using These Metrics

The most capable systems calculate and display all of these measures across: locations; product lines; delivery methods; and much more. Managers can target time and attention where the stats lag, and also exploit high productivity areas to increase cash-flow.

You absolutely <u>must have detailed cost analytics</u> so the expenses associated with each order, customer, or product are known. Expense allocations are the determinative factor for profitability at every level of analysis. Whether you invest time and manpower to roll-your-own, or rent a high-end system, you need accuracy so your initiatives won't be misdirected.

Driving Improvements

There are many actions that the market leaders have adopted, and which are recurring topics of our strategy sessions with clients. Here are a few you might consider:

Warehouse Reorganization

Analyzing where and why "walk time" occurs, and then organizing to reduce it can seriously impact labor requirements. When Items frequently sold together are proximate, more orders are picked with lower headcount. If your warehouse is organized by vendor or product category, you're likely wasting manpower.

Zone Picking

Where feasible, warehouse organization can match destination organization. If destinations have distinct product patterns (like grocery store aisles or manufacturing plant campuses), having all the product used by each sub-destination together in the warehouse facilitates individual cartons for each sub-destination.

Pre-Packing

Where feasible, items sold on their own and in significant volumes can be ordered "shipping-ready" from suppliers, needing only a shipping label applied, eliminating packaging cost and labor.

Value-Add Areas

Kitting, converting, or preparing inventory to make it more suitable for customer needs is a prevalent strategy. Organizing so these operations are proximate to the needed inventory reduces labor consumed moving input components.

Third-Party Logistics

Off-loading warehousing and shipping to third-party logistics companies, particularly when reaching into smaller markets can be very productive. 3PLs have greater efficiency and provide cost variability, avoiding unwelcome cost escalation from seasonality or other dynamics.

Amazon has become an avenue to remote markets, as well as a mechanism to liquidate slow-moving inventory. This channel also provides predictable costs and eliminates manpower needed to support a largely small-order portfolio.

Self-Service Picking

Expanding the "will-call" area so customers can pick their own product, and making this strictly "cash-and-carry" (check or credit card only, with no shipping) is a very good manpower reduction strategy.

Automation

It's getting prohibitive to use people to move product within the warehouse. Elimination of "walk time" ranges from using simple conveyors up to robotic picking. Even small distributors are looking more like Amazon than the traditional rack rows and pushcarts of the past.

Eliminating "Touches"

Every time someone touches the product, it costs money (and consumes manpower). Branch replenishment from a distribution center is a model that is becoming increasingly difficult to keep profitable or competitive. Direct DC-to-customer deliveries eliminate touches and conserves manpower.

Funding Manpower

The necessary first step is eliminating unnecessary activities, and monitoring using the productivity and efficiency metrics suggested above to drive and lock in gains. (You'll need good cost and profitability analytics for this.)

The next step will come from the sales side, where customer selection is also driven by detailed profit analysis. A combination of working with customers whose business model naturally supports your efficiency initiatives, and using certain advanced techniques to exploit those that already provide profit rates two to five times the average will close the loop on addressing the labor crisis.

Work on the sales side will directly fund high wage rates out of sales gains instead of out of the company's bottom line. I'll cover the sales side in detail in part three of the series.

Get Guidance with the DPA Tool

To get you started with a baseline for your initiatives, we've created a confidential assessment system for the use of qualified wholesale distributors. The Distributor Performance Assessment (DPA) combines your numbers with the performance ranges in over $100B of industry data and delivers a personalized consultants' report, benchmarking your company against both industry standards and (so you can see what's realistically possible) that of the market leaders.

There's no charge or obligation, and our automated system sends your confidential report to your mailbox in just a couple of minutes. The DPA report provides actionable suggestions to get you going. Click to learn more: confidential DPA report.

Conclusion

The critical situation in labor will not end, and is expected to become even more severe. It's already having a significant impact on distributor profits, and will sink those that are too slow to react and adapt.

Getting started on the ideas I've included here will change your trajectory, and will deliver better cash-flow and profits right away. In Part 3, I'll lay out how new sales tactics will provide critical new funding so you can pay so well that labor challenges will melt away.

I hope you and your team will get started with these ideas right away. Productivity and efficiency measures can secure your success.

The Labor Demographics Series:

Be sure to check out the rest of this series:

Part 1: How Changing Demographics Killed Profits
Part 2: Using Labor Wisely
Part 3: Covering Labor Costs with Sales

About the Author

Randy MacLean is President of WayPoint Analytics, the leading provider of cost and profit analysis software to the distribution industry. Since 2008, his firm has been focused on the dynamics that drive (or destroy) profitability, and he's created many of the advanced metrics companies use to monitor and manage their performance.

Coming from a career in sales, management, and software engineering, he works with distribution leadership teams on their cost management and profitability initiatives. WayPoint clients produce profits at more than three times the industry standard.

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