How to Become a Super-Performing Wholesale Distributor

by Randy MacLean, WayPoint Analytics

Countless distributors have labored under tremendous misconceptions in regards to how their companies really make money. However, because everybody was at a similar disadvantage, there was a near-level playing field.

All of this changed with the advent of high-end analytical software which suddenly allowed distributors to see where they made money on a line-item basis. This meant that, among other things, they could evaluate their customers in terms of profitability.

With that new knowledge in hand, the most profitable distributors have been refining (or even redesigning) their organizations. Although all distributors have access to the same systems which would let them spot inefficiencies in their organizations, only the super-performers have truly been willing and able to give up those inefficiencies. In turn, they've gained a tremendous edge over their competitors.

All of this changed with the advent of high-end analytical software that suddenly allowed distributors to see where they made money on a line-item basis.

Today, these systems are out there and readily available to all distributors. It's up to each company – to executives like yourself – to decide whether or not to use them to change your business. If you've ever wondered why your company only averages a 3-4% Net Before Taxes (NBT) bottom line in a nominal year when other companies run at 9-10% NBT, analytics can give you the answer and help to create a road map for your company's improvement.

In fact, with analytics you can help your company reach a higher level and, with consistent effort, your company could join the ranks of the super-performing distribution companies who operate so efficiently that they return a 20%+ NBT.

The Move to Efficiency

Once you've chosen to take advantage of information gained through advanced analytics to make changes within your organization (and, when the alternative is to become increasingly irrelevant until you someday fade away, what choice is there?), it's time to work on your operational efficiency. This means getting away from putting out the day-to-day dumpster fires so you can spend your time thinking about how you can improve the way you do business.

For example, the super-performing companies we've examined are all very efficient when it comes to the core competencies (or functions) of a wholesale distribution company, the core competencies being, of course, obtaining product from vendors, breaking it up, re-packing it, and selling it to customers.

But, let's define those competencies in terms of efficiency. By definition, efficiency involves trying to get the best possible result for your investment of time, money, and energy. If you're spending a dollar in delivery, you want to get as much as you can from it. Likewise, you want to get the best possible result for your sales dollars and your warehouse dollars when it comes to picking, packing, and shipping product.

While distributors have always aspired to improve in these areas, it wasn't until recently that we’ve had the technology and reporting capabilities to pinpoint where inefficiencies were occurring. Because today we have access to tools that many hadn't dreamed possible decades ago, the insights available allow distributors to improve their operations in previously unimaginable ways.

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If you're a NASCAR fan, you're familiar with the expression that races are won and lost in the pits. There's certainly a lot of wisdom behind that idea. Within any NASCAR race, cars spend a lot of time out on the track going as fast as they can in an attempt to outrun the competition. Because any amount of time spent in the pits takes away from the race (and thus from whatever lead a racer might achieve), the pit crew has to make every second count.

NASCAR teams are constantly looking for ways to allow their cars to spend less time in the pits, whether it's changing a tire faster or using different components; because the difference between coming in first and second can sometimes be measured in milliseconds.

As a distribution executive, you need to do the same thing. Take a look at each part of your business to determine what you're getting for your investment of dollars, time, headcount, and so on. This requires not only comparing different parts of your company to see how they perform, but being able to pull in analytics regarding industry averages to see how you stack up against other companies in your same field.

Paying Attention to Your Gross Profit Margin

Conversions and balance are two important terms when it comes to translating the insights discovered through analytics into improved performance.

While your company's mission statement may be to provide customers with high-quality products and services, your company's purpose is to convert revenue into bottom-line profit. To figure out why your company's NBT is only 3-5% and how you can improve that number, examine all the conversions that occur in your company.

One of the earliest conversions involves your gross profit margin, where revenue becomes gross profit dollars. The gross margin percentage is a measure of how efficiently the company sets pricing to convert revenue into operating cash. Your gross profit dollars are the operating cash for your company. It's the money you use to spend on operations in order to generate profit.

Re-Balancing Your Customer-Base

The second major consideration is one of balance. Once you start using analytics, you'll probably notice that you have a LOT of profit-draining accounts. These are customers whose unprofitable transactions are draining from your bottom line rather than contributing to it.

In theory, if these profit-draining accounts were gone, your business would automatically be far

more profitable. However, we live in the real world. Firing all of your unprofitable customers at once would very likely devastate your company. Instead, the best solution is to shift the balance by bringing on profitable accounts while gradually scaling down on unprofitable ones.

Keep in mind that it's a balance. You'll never get your unprofitable transactions all the way down to zero. Even the best companies can't do that. However, where the average company loses money on 62.5% of its transactions, a super-performing company only loses money on 40% of its transactions. Again, it's not zero, but it makes a significant difference when it comes to their bottom lines.

Shifting this balance can result in almost unbelievable improvements. We've seen companies increase their bottom lines by 400%, 500%, and even 600%. These changes don't come from doing everything perfectly; rather, they come from shifting your company's balance in the right direction while improving a lot of smaller things that contribute to the performance of your company.

Just moving from having 62.5% of your transactions lose money to 40% has the potential to turn a low-performing distributor into a super-performer. We've seen many distribution companies do it, and you can do it in your organization, too.

Insights into Super-Performance

One of the most significant insights we discovered over the past decade is that nobody achieves a lot of success by trying to manage the product or product lines. The reason is that there's no product that is inherently profitable or unprofitable by itself. In fact, you can look at any product sold in a similar quantity at an identical margin to two different customers and have wildly different profit performances.

Before we had analytics, distributors tended to focus on gross margin as a predictor of profitability. However, gross margin by itself is an exceedingly poor predictor of profitability; in fact, there's no correlation between gross margin and profitability at all because gross margin is only one half of the equation. The other half of the equation is your cost-to-serve, the costs associated with the transaction. No matter how high your gross margin may be, if your cost-to-serve on the transaction is even higher, you'll lose money. In fact, if you don't manage both sides of that equation, you might as well not manage anything at all.

Ultimately it's your customer relationships that determine whether or not the sale of any product will be profitable. Super-performers recognize this and, instead of putting their energy into managing product lines or pricing, they focus their efforts on managing customer relationships.

The best companies have a very deep understanding of their customer base. They recognize that not all customers are equal. Often, depending on how a customer runs their business, that account can be either incredibly profitable or extremely unprofitable.

The absolute best customers are what we refer to as High Efficiency Accounts (HEA). Because these accounts are extremely efficient, they're able to produce above-average profits at a below-average cost-to-serve. That makes them extraordinarily important for growth because they can grow your revenue, operating cash, and bottom-line faster than they increase your expenses (since you need less infrastructure to support them).

Another important group is your High Leverage Accounts (HLA). These are accounts that, when you look at the conversion of revenue to your bottom line, give you four to six times as much profit per incremental dollar sold into them compared to other accounts in your portfolio. You'll get far better returns from HLAs than you would from many of your other customers. They're great when you're looking to increase your penetration.

Ideally, you want a lot of HEAs and HLAs. Once you've identified them, you may even notice certain trends among these accounts that makes finding – and servicing – accounts like them much easier. At the same time, you could try improving some of your under-performing customers by finding ways to reduce your cost-to-serve on those accounts.

Understand and Reducing Your Cost-to-Serve

Earlier I mentioned that gross margin is one half of an equation. The other half is your cost-to-serve; these are the expenses incurred when servicing that account. No matter how high your gross margin is – even if it was 1,000% – you're guaranteed to lose money on that transaction if your cost-to-serve is even higher. For instance, if you were selling a rubber band for $100, you'd still lose money if it cost $101 to get it into the customer's hands.

What are some of the costs associated with an account? First, you have the number of orders. Each order requires paying somebody to input the invoice. Then you have the pick, pack, and ship operations for the order. If you have people running all across your warehouse inefficiently to put together an order, it's going to be more expensive. Next, you have the number of deliveries that need to made. If the order requires more than one delivery, you incur additional expense. And finally, you have a certain number of invoice events to monetize the order.

Ultimately, your relationship with a customer is about how many interactions you have with them. By managing your relationship, you can trim down the number of interactions required to reach the same result (such as suggesting that they combine invoices into larger orders which will ensure that, at the very least, you'll have one fewer invoices to process or perhaps one fewer delivery to make). This reduces your cost-to-serve and, in turn, more profit will reach your bottom-line.

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Once you start to use analytics to examine and measure your customers' efficiencies, you'll find that some accounts are already great when it comes to keeping the total number of interactions low. These accounts are the ones that provide enormous amounts of operating capital while consuming very little of your infrastructure and resources. You'll also notice that some companies – of similar or sometimes greater size – consume a tremendous amount of your infrastructure, likely making them far less profitable.

Your profitability will often come down to a balance between those two kinds of accounts. The more accounts you have that generate great cash flow at very low infrastructure cost, the more profitable your company will be. As you acquire more and more customers with low infrastructure costs while shedding accounts with high costs, you'll gradually find you need less of your existing infrastructure, meaning you'll have more infrastructure available for growth.

Achieving Balance in Your Company

Using analytics software and technology (such as WayPoint Analytics) provides your company with a tremendous visibility into what's really going on in your business. This transparency allows you to gain a much better picture of your customers, allowing you to see which are really contributing the most to your bottom-line, and which are actually taking away from it.

Without this kind of transparency, meaningful change is impossible. You won’t know what you're really looking at, meaning that you won’t have a true understanding of how you should be driving change in your organization. For instance, one of your largest, perhaps most important customers may be bleeding your profits dry with small orders while, at the same time, you're not paying attention to the accounts that are driving a lot of your profits.

You can't stick your head in the sand. If you choose to ignore analytics and to not balance out your customer base, some of your competitors are going to take advantage of the situation and what we’ve just discussed for themselves. And, if you wait too long to take action, these competitors may be able to permanently shift the balance in their favor.

About the Author: Randy MacLean is the President of WayPoint Analytics, the industry’s leading costing system. WayPoint provides its clients with the information they need to regularly realize profit gains of 200% and more. Randy is the best-selling author of three profitability books, and he advises top distribution companies on profit-related best practices.