

Fine-Tuning Your Operations

Here are 16 ideas you can use to expand your business in a slow-growth market.

Reports from distributors throughout the country are signaling a slow-growth economy. The residential market has significantly changed. Light commercial is slowing as a tangent to the residential market. Some segments of large commercial construction market are still growing steadily, as is the industrial market. The educational and healthcare arenas also still represent growth opportunities.

However, we are entering an era of slower growth. According to Herm Isenstein, president, DISC Corp., Orange, Conn., 2008 and 2009 look to be slow-growth years, with electrical industry revenues only growing in the low single digits (in deflated sales dollars). Prospering in these times takes perseverance, ingenuity, access to capital and a focus on the bottom line — the basics of how all successful electrical distributors are founded and built.

Three areas will warrant most of your attention: your business operations, the need to differentiate your company with a growth strategy; and your ability to identify profitable niches. Over the next few months, we'll share some ideas to help stimulate your thinking for growth strategies in these areas.

Recent conversations with distributors and manufacturers' reps have revealed three disturbing trends that many portend problems for distributors. A recurring theme in our conversations

with reps is excess distributor capacity. Despite the expected economic slowdown, some distributors are aggressively opening new branches. Consider US Electrical Services (USESI) Exton, Pa., which was acquired recently by Consolidated Electrical Distributors Inc. (CED), Westlake Village, Calif. Its Connecticut-based Electrical Wholesalers

business recently opened a number of branches in Florida, Maryland and other parts of New England. City Electric Supply Co. Orlando, Fla., continues to expand into new markets by opening multiple "twig" branches. It employed this strategy when it moved into cities such as Columbus, Ohio; Kansas City and St. Louis, Mo.; and the Baltimore-Washington, D.C. metropolitan area.

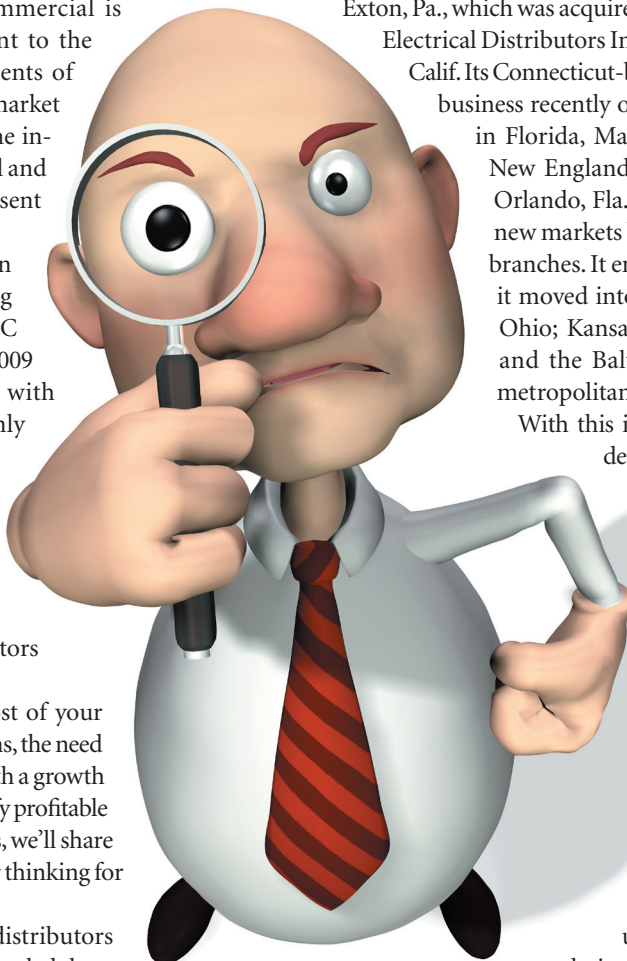
With this increased capacity comes a desire by all distributors in that

market to grow, or defend, their market share. Customers know this, and margins erode as distributors fight for business

and salespeople attempt to retain orders by using price as their weapon of choice. Additionally, the increased

use of non-branded products has deteriorated revenues for many and forced a number of distributors to reduce gross margins to compete.

With increased capacity, the decline of the residential mar-



By David Gordon and Allen Ray

ket and slowness in the economy, daily sales outstanding (DSOs) are increasing for many distributors. This hampers their cash flow and forces them to become friendlier with their local bank or extend supplier receivables.

For several years, many distributors have improved their operating margins, frequently without paying attention to their inventory, pricing strategies, special pricing authorization (SPA), collections and DSOs. In many instances, they have let their matrix pricing slide over into the corner to be reviewed another day. With the market's growth rate slowing down, what is a distributor to do?

To ensure that your bottom line does not evaporate and to improve your company's margins in a tightening market, you must be proactive. These ideas will get you started.

1. Get your DSOs under control.

Increase your collection activity, and if you have to file liens, file them. Don't let them slide. We all have friends in the business who cry, "I need to get paid first." But if they can't pay a friend first, who will they pay? Tighten their credit to prevent falling in deeper with them. If you are important to them, they find a way to pay you first.

2. Review how you classify your inventory.

If you use the ABC method to classify the speed at which products flow through your inventory, you might want to review your "B" and "C" items. Prices change and the velocity that products move through these groups can change over the course of a year. This is the time to check your system's re-order points. If business is slowing, you do not want your system ordering more material than you need. You must keep your turns and margins up. Some distributors will also reduce their inventory as well. Many companies take the time to get rid of their "X" items and many of their "D" items, opting to recoup money in place of holding dead inventory.

3. Review your compensation strategies.

Many distributors' sales

compensation programs reward salespeople for gross margin generated on any order. But are all orders profitable orders? Consider strategies to focus your salespeople on profitable business rather than on being a customer advocate. Motivate them to improve margins by rewarding them for margin improvement above a benchmark and "disincent" them for accepting low/no margin business (unless you make an executive exception).

4. Make sure that your "net into stock prices" are correct.

Software products like epaCube, Dallas, or Advanous, Richmond, Va., can help you manage your margins on the front end as you receive price updates. Study these software offerings, because margin enhancement is what it's all about. Even in a tight market, enhancing your margins is worth the effort.

5. Consider price enhancement.

On certain items or groups of items, consider raising the price. This may sound like a repeat of the previous point, but it's not. You may want to change the prices of the companion items that go along with your "A" items. For instance, consider raising the price of screws, straps and plates. You probably have a better idea of the products or product groups where you can increase prices. Impulse items at the counter might be one area to consider. The important thing here is to take action. In a business of pennies, every cent counts.

6. Stay away from the metal market.

Unless you have been playing the metal market for a while and try to time your copper purchases, this is not the time to start. Over the past few months, the copper market has fluctuated significantly. Inflating your inventory with the hope that you can make money by stocking up is not a long-term business strategy. It's more effective to determine how to sell rather than how to buy to make your business grow.

Most successful distributors buy commodity products in smaller quan-

ties. Forecasting copper pricing into next year is a gambler's game. Is this an area where you want to bet your company, especially with hedge funds and Chinese demand having so much influence on metals pricing? For many companies, the best strategy will be to stay close to their suppliers and check pricing early and often.

7. Scrutinize the benefits that buying/marketing groups offer.

These groups offer significant value to their members. For many distributors, the rebate they get from their buying/marketing group can represent 33 percent to 50 percent of their total net profit. Additionally, the networking and marketing benefits can make them better organizations. However, recent changes in the marketplace highlight opportunities outside the groups. Aggressive distributors are negotiating deals beyond the group deals, and others use group rebates to negotiate better deals with non-group manufacturers. Some distributors are negotiating net pricing or sourcing non-branded lines to reduce their product acquisition costs and to increase gross margins.

8. Run a SPA report from your ERP system.

Check that they are being collected, and, ideally, automatically administered through an EDI 844 (SPA Claim), EDI 845 (SPA Quote) and an EDI 849 (SPA Credit). Some distributors make the mistake of thinking once claims are filed they will be collected in full. Our research shows up to 11 percent of claims that get filed are not paid and never followed up on. It's your money. Remember the old saying, "If you want something bad enough, do it yourself."

Consider how you administer SPAs. Early sales frequently go unclaimed. If you are a multi-branch company, consider administering SPAs from corporate instead of through the branches. You are looking for orderly control of administering SPAs and collections. Although some companies may not like SPAs, they are an effective sales and

pricing tool. Look for opportunities to use existing SPAs to get more customers or seek additional SPAs to create sales opportunities.

9. Review your customer segmentation. Look at your customers to make sure you have segmented them correctly. A residential contractor who does very little commercial work should not be classified as a commercial contractor. Then, price them accordingly.

10. Bill for the whole project. If your company focuses on project work, make sure you have billed for the entire project. Some distributors will not invoice for the entire project because of how they set up projects in their ERP systems, or because they are dependent on a salesperson to handle the entire project.

11. Make sure you have the correct unit pricing for the current packaging. It seems so simple, but you'd be surprised at what you might find. Along the same vein, have you walked your warehouse(s) to make sure inventory is in the right location? When distributors do this, they sometimes discover inventory stashed away from view in the back of their warehouses. As strange as it may seem, some of this inventory may or may not have been processed through their receiving department because the intended location was full of current inventory, so the new inventory is stuck back in a corner.

12. Evaluate your personnel. A slowing market is a good time to evaluate your personnel. No one likes to make work-force reductions, but sometimes it must be done when the market turns. Of course, you always want to keep your best personnel, but you should still always be on the lookout for good people in a slow market, too. Invest in people that can help you grow your business.

13. Outsource non-customer-centric activities. Outsourcing saves you on

taxes, benefits and other soft costs. For invoicing, you might want to look at a billing service provider such as Billtrust, Jamesburg, N.J. The service can save you money in the form of paper, envelopes, postage and labor.

14. Consider paperless catalogs. Some distributors don't print paper catalogs anymore because of the cost. E-catalogs can be placed on a customer's desktop, integrated with your ERP order-entry system and offer VoIP com-

For several years,
many distributors
have improved
their operating
margins without
paying attention
to the details.

munications direct to your company. One such offering is E-MobileCat, a maker of hybrid Web 2.0 catalogs in San Antonio, Texas, emobilecat.com.

15. Don't pass along discounts. If you get a really good buy, there is no rule that says you must pass along the deeper discount to your customer, or even tell your sales organization. This is called "margin enhancement." The market may force you to pass along the savings, but take every opportunity to enhance your margin. Some distributors literally have to take back control of the sales price from their salespeople. If your company is low on every deal or quote, something is wrong. The odds are stacked against you making the margin you want if salespeople control margin beyond a reasonable range.

16. Control your purchasing. Your customers frequently request products

from manufacturers that you don't stock, and many companies allow their salespeople to purchase non-stock special orders from manufacturers. What is your criteria for deciding if this acceptable? Before you know it, you may be adding a manufacturer to your supplier list, adding inventory because your salesperson may purchase minimum quantities (or dollars) to meet the new supplier's ordering or pre-paid requirements. Some of the order is sent to that salesperson's customer and the remainder ends up on the shelf in your warehouse. The net result is that your inventory has increased and new supplier costs (payables, entry into your system, etc.) have been added. When business slows down, you must reduce the actual size (read dollars invested) of your inventory.

Conclusion. While slow growth is better than no growth, it's no reason to allow your margins to slip. Dedication to the "back of your house" can help you maintain or strengthen your margins. To get started, consider having key members of your management team research and report on the potential saving each of these areas may offer. If you get stumped in an area, give us a call. Quick action can be the difference between adding, or retaining, dollars on the bottom line and letting your bottom line decline. ■

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