Getting to the Financial Light At the End of the Tunnel

Prepared For

NFDA

Prepared By

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Objectives Of The Session

- Outline 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 Mountain View, Inc.

	Dollars	Percent
Net Sales	20,000,000	100.0
Cost of Goods Sold	12,500,000	62.5
Gross Margin	7,500,000	37.5
Payroll and Fringes	4,500,000	22.5
All Other Expenses	2,200,000	11.0
Total Expenses	6,700,000	33.5
Profit Before Taxes	800,000	4.0
Fixed Expenses	5,500,000	
Variable Expenses	1,200,000	6.0

Exhibit 2 Distribution Performance Project

Selected Balance Sheet Items
For the Typical Firm

Cash	$300,000
Accounts Receivable	$2,500,000
Inventory	$5,000,000
Accounts Payable	$2,000,000

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

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

Gross Margin %	=	37.0
$ Fixed Expenses	=	5,400,000
Variable Expense %	=	6.0

Sales Required to Break Even = $\dfrac{\$\text{ Fixed Expenses}}{\text{Gross Margin \% - Variable Expense \%}}$

= $\dfrac{5{,}400{,}000}{31.0}$

= 17,419,355

Exhibit 5 — Distribution Performance Project

What Happened There?

Summary Income Statement	Current	Break Even	Percent Change
Net Sales	20,000,000	17,419,355	-12.9
Cost of Goods Sold	12,600,000	10,974,194	-12.9
Gross Margin	7,400,000	6,445,161	-12.9
Fixed Expenses	5,400,000	5,400,000	0.0
Variable Expenses	1,200,000	1,045,161	-12.9
Total Expenses	6,600,000	6,445,161	-2.3
Profit Before Taxes	800,000	0	-100.0

Exhibit 6 — Distribution Performance Project

Measuring Accounts Receivable Performance

Collections Per Day — Amount Received Each Day From Past Credit Sales

$$\frac{\text{Annual Credit Sales}}{365}$$

$$\frac{20{,}000{,}000}{365} = 54{,}795$$

Collection Period (The DSO) — Number of Days the Typical Credit Customer Takes to Pay

$$\frac{\text{Accounts Receivable}}{\text{Collections Per Day}}$$

$$\frac{2{,}500{,}000}{54{,}795} = 45.63$$

Exhibit 7 — Distribution Performance Project

The Collection Sensitivity Ratio

$$\frac{\text{Cash on Hand}}{\text{Collections per Day}}$$

=

CSR

$$\frac{\$300{,}000}{\$54{,}795}$$

=

Exhibit 8 — Distribution Performance Project

The Volume Sensitivity of Three Profit Groups

Member Category	Current Profit Margin	Sales Decline Leading to Break Even
Typical	4.0%	12.9%
High Profit	8.0%	25.8%
Low Profit	1.0%	3.2%

Exhibit 9 Distribution Performance Project

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

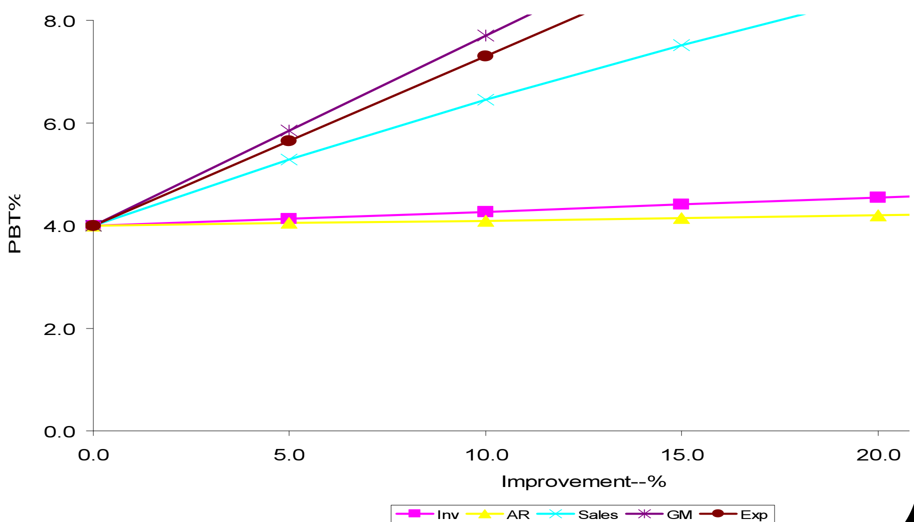

Exhibit 10 Distribution Performance Project

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

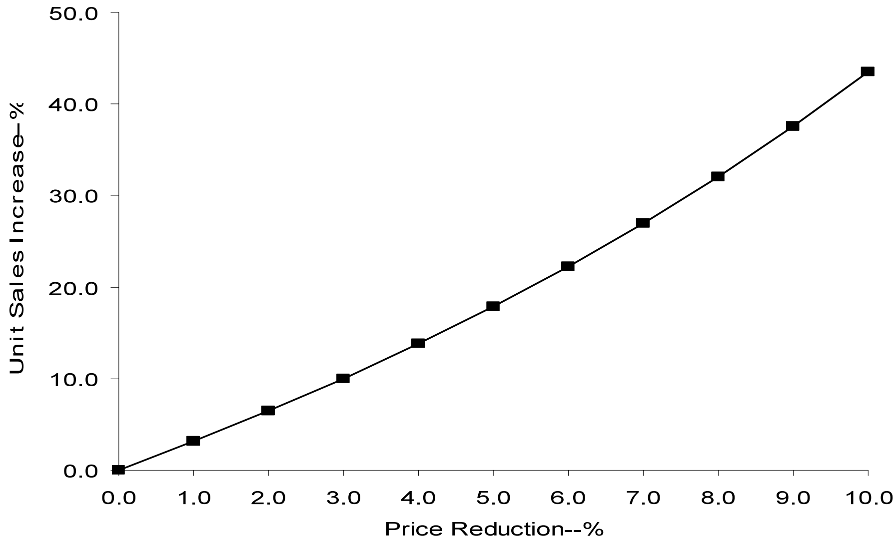

Exhibit 11 — Distribution Performance Project

The Economics of Price Adjustments by Velocity Code

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

Exhibit 12 — Distribution Performance Project

What Does It Mean Financially
To Collect Faster?

1	Collections Per Day	54,795
2	Collection Period Goal	45.6
3	Accounts Receivable Goal [1 X 2]	2,500,000
4	New Collection Period Goal	40.6
5	New Accounts Receivable Goal [1 X 4]	2,224,658
6	Reduction in Accounts Receivable [5 - 3]	275,342
7	Carrying Cost	8.0%
8	Profit Impact [6 X 7]	22,027

Exhibit 13 — Distribution Performance Project

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

New Sales Equals:

$$\frac{\text{Fixed Expenses + Current Profit - Gain from Collections}}{\text{Gross Margin \% - Variable Expense \%}}$$

$$\frac{5{,}400{,}000 \quad + \quad 800{,}000 \quad - \quad 22{,}027}{37.0\% \quad - \quad 6.0\%}$$

$$\frac{6{,}177{,}973}{31.0\%} \quad = \quad 19{,}928{,}944 \quad =$$

Exhibit 14 — Distribution Performance Project

Cash Versus Profit For Inventory Planning

Issue	Provide Customer Service	Financial Stability
Measurement Tool	Fill Rate (Service Level)	Inventory Turnover
Ease of Measurement	Difficult to Impossible	Very Easy
Implication	More Inventory	Less Inventory
Mantra	Can't sell apples from an empty cart	Cash is king

Exhibit 15 Distribution Performance Project

What Do Most Customers Really Want?

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

Exhibit 16 Distribution Performance Project

What's Wrong With This Picture?

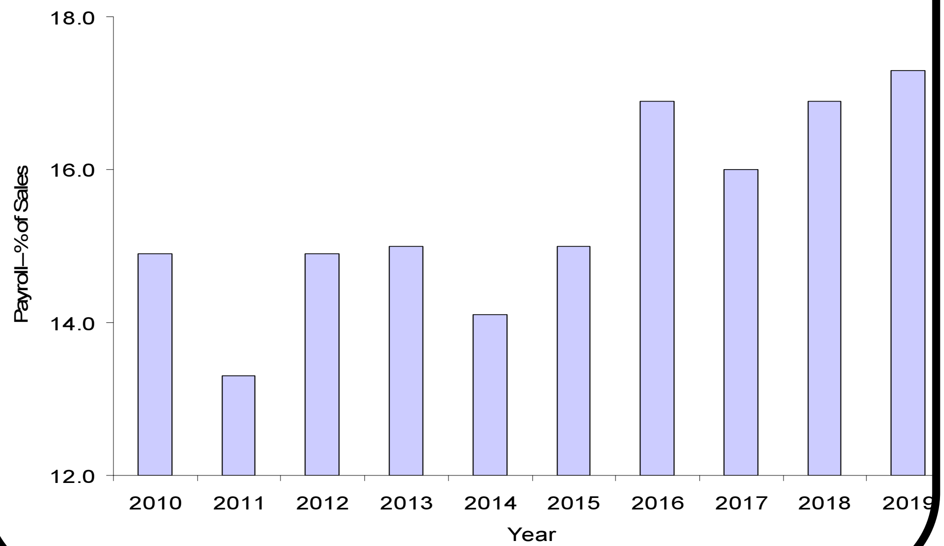

Exhibit 17 Distribution Performance Project

Where Do The Payroll Dollars Go?

Payroll Category	Percent of Sales	Percent of Payroll
Officers/Owners	4.0	17.8
Sales Force	8.0	
Operations	5.5	24.4
All Other	5.0	22.2
Total	22.5	100.0

Exhibit 18 Distribution Performance Project

Enhanced Order Economics:
The Battle for Sales Without Payroll Expense

Lines per Order--1 Star

More Effective Add-on Selling
Product Line Expansion
Customer Education

Average Order Line--2 Stars

Selective Price Increases
Changing the Order Cycle

Exhibit 19 — Distribution Performance Project

The Reality Of Customer Profitability

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

Exhibit 20 — Distribution Performance Project

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

- What If Analysis
- Price Cutting Economics
- Business Valuation
- Understanding the CPVs
- Profit-First Planning

Exhibit 21 Distribution Performance Project

The Conceptual Planning Process

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

Exhibit 22 Distribution Performance Project

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	**600,000**
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 Distribution Performance Project

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 Distribution Performance Project