



# The Distribution Team

We wrote THE BOOK on Distribution Inventory Management

## **Get on Board the Net Profit Train**

**By Jason Bader, Managing Partner**

I was recently doing a webinar when an interesting question came up. The webinar was on ranking customers by net profit so that we could allocate resources appropriately. The participant wanted to know how to get the employees, particularly the salespeople, thinking in terms of net profit. Her question was extremely relevant for most distributors. We are generally conditioned to think in terms of gross sales revenue.

How many times do you hear a sales person boast, “I just landed a \$500 net profit order!” Isn’t it more exciting to hear that they landed a \$16,000 order? At trade shows, do you hear people talk about net or gross? Net profit is like a closely guarded secret. On occasion, a highly enlightened business owner will talk about moving their net percentage higher. For most hard goods distributors, net profit before taxes is somewhere around 3%. A shift of just 1% is a really big deal.

In order to help our employees understand the mental shift, we need to start talking about it from the top down. We need to teach how net profit is generated in each sale. We need to show the benefits of improved net profit. Finally, we need to use net profit to make better decisions with our limited resources. Over the course of this article, I will give you a few ideas on how to instill a net profit mentality in your company.

### **Open the Kimono**

When I teach this subject in public, I ask the audience how many companies share financials with the employees. A few sheepish hands go up. For some reason, we are afraid to have our employees know too much about the income of the company. Ironically, they are the ones that can create the biggest impact on net profit.

I grew up in family business where financials were shared openly. Specific compensation was not shared, but a general monthly income statement was provided to the employees. They could see sales, gross profit and eventually net profit. This was primarily done to help them understand their profit sharing bonus, but it also showed them where we were spending money. Over my 20 year career there, I never heard about anyone sharing this information with a competitor.

Could your competitors really benefit from seeing a simple income statement? I sincerely doubt it. You could tell someone exactly how you go to business and I doubt they could duplicate it. You have developed a culture that supports your business model. I would take a competitor years to make the transition. We give our competitors way to much credit. They simply can not make the changes necessary to steal your business.

A safe compromise would be to use a projector to show the income statement and a simple graph showing progress. Employ the KISS (keep it simple, stupid) method to these presentations. I often find that financial people tend to get overly complicated. Make it easy for everyone to comprehend. This can be a solid kick off to a monthly business meeting.

### **Tear Up a Dollar Bill**

I often find that people have a difficult time following an income statement the first time it is presented. Most of us are not used to reviewing financial documents, so we may need to review each part so that everyone can get on the same page.

I tend to tear up money to prove a point. When I teach this concept in front of a live audience, I typically ask someone to “invest” in our demonstration. Little do they know that I will be tearing their investment up. I use the dollar to walk the group down a simple distributor income statement.

I start by holding the dollar up and stating that we just sold something for a dollar and we paid 50 cents for the item. How much did we make? The group says 50 cents and I tear the dollar in half and drop one part on the floor. As I hold up the half dollar, I ask the audience what we call this and I usually get the response “gross profit”. One clever gentleman also reminded me that it was a felony. As I hold up our gross profit, I ask if this amount of money goes directly into the owner’s back pocket. You will be surprised at how many people believe this to be true.

The next part is to start talking about the things that come out of the gross profit before it becomes net profit. Ask the group what we pay for. We pay for wages, rent, utilities, freight, benefits, computers, etc. As the items are being stated, continue tearing off chunks of the dollar bill. The goal is to come down to a very small piece of the original dollar. This is net profit in a distribution company. Can you imagine the visual impact if you used a \$100 bill?

The final part is to talk about what happens if net profit falls to zero or below. This doesn’t just impact the owner of the business. Life will get pretty uncomfortable for everyone. Sometimes we have to reduce staff. We ask employees to contribute a greater percentage toward health insurance. 401K programs can’t be funded. Vehicles stay in service longer than their intended life. Things change in a hurry. Net profit affects everyone in the company.

### **Fire Some Customers**

This whole discussion began with a customer profitability analysis based on contribution to net profit. Once everyone understands the impact of net profit, we can start making real changes to the way we conduct business. Since we have a finite amount of money to spend in the name of customer service, a ranking of customers will begin to make sense.

I won’t get into too much detail about this analysis at this time. If you would like an article on how to do the analysis, just send me an email. Suffice it to say that certain customers will no longer be worthy of your service dollars. We may have to fire some customers. By the way, the

easiest way to fire a customer is to raise their prices. We may change our qualifications for delivered product. We may not inventory certain brands for low net profit contributors. This type of change is only possible when our front line net-profit decision makers, the inside sales and material handling people, have a full understanding of the costs.

This type of culture shift is not for the feint of heart. It will require a commitment to education and communication. Arm your employees with the facts. The battle to improve net profit is not made in the executive offices. It is fought in the operational trenches every day. Good luck.

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