Out of the Fire

After the fire, it's time to clean up and rebuild. Article three in a four-part series.

After a forest fire, the strongest trees remain alive. Having survived the economic inferno, you look around and find you're left with a lot of dead stuff – broken processes, a scorched staff and non-moving products that you need to get rid of and turn into some cash.

The first order of business must be to generate profit as soon as possible, which means launching productivity and growth initiatives simultaneously, with minimum staffing. When assets and productivity are in tough shape, you need to get the army's "rear elements" in order. That comes directly from Sun Tzu's *The Art of War,* and we dare not question the master's wisdom.

We will discuss how to see growth opportunities in a whole new framework in the next article. For now, let's generate some cash and productivity.

DEALING WITH A SUDDEN CHANGE IN VELOCITY

Booms increase the velocity of business, increasing the pace and productivity of your salespeople, inventory, receivables, delivery vehicles and warehouse investment. This stimulates asset turnover and people productivity. Few distributors take care during a boom period to stir up slow-moving inventory, receivables, SPA credit delays or people productivity. Underlying weaknesses hide.

When things slow down, marginally profitable salespeople become grossly unprofitable. Some A items become B items. Some C items become dead items. Customers that pay in 30 days now pay in 60 days. Suppliers issue SPA credits slower, accept fewer returns, approve fewer items for credit and enforce the fine print of distributor SPA agreements to the letter.

You probably didn't stay vigilant by stirring

By Neil Gillespie and Allen Ray

up slower moving assets and improving productivity during the boom. Increased velocity made things good enough. A decrease in velocity is ugly, though. You get stuck with more dollars in slower velocity brackets. People productivity plummets from reduced demand. You wish for the boom days again. But be careful what you wish for: A sudden return to growth could kill you with increased cash requirements, and this time the banker's windows are closed up tight.

THE STARTING POINT: CASH AND PRODUCTIVITY

If you're on credit hold, having trouble making payroll or if you've skipped a paycheck to yourself lately, you're in a cash crisis. You need to immediately take action to generate cash before doing anything else.

If you're in great shape with asset turns and productivity, you could probably stand a tune-up while simultaneously discovering new growth opportunities. Take Sun Tzu's advice and start with the rear elements: cash generation and productivity.

EIGHT GREAT PRODUCTIVITY DRIVERS

1. Increase the speed of SPA (rebate) collections. If you do a significant amount of business requiring special pricing authorizations (SPAs) and you process these claims manually, this could be the single biggest source of uncollected cash in your entire company. (Having 30 percent of your sales dependent on SPAs at an average discount of 40 percent or more from book prices would be significant.) The symptoms of the problem won't show up directly in your PAR report or financial ratios, either, so don't look there.

Think about it. If you claim your SPA rebates once a month, that's a 16-day average lag. You submit your claims manually, so manufacturers must process them manually. That takes another 60 days, for a total of 76 days. You can short-circuit this whole lag to six days by cleaning up your product data, matching it to the manufacturer's data, making sure you entered your SPA prices correctly, claiming electronically once per week and getting paid just a few days later. Depending on how much SPA volume and the depth of the discounts, you could generate anywhere from one percent to seven percent of revenues in instant cash. Is that worth the effort?

2. Increase the Velocity of Current Assets.

The problem with inventory. Think of current assets like a pond fed by a spring. If the spring slows down, some areas of the pond don't get agitated — those areas will die. In a downturn, inventory movement slows down, and product items slip a bracket or two. As become Bs, and Cs become dead and the dead starts to rot. Your mix of inventory may now contain 50 percent or more dollars of slow-moving items versus A and B items, which self-adjust with reduced purchasing activity.

The solution: Use your business system to report how much you have in each velocity bracket in dollars to shock yourself to attention. Then start computing days of inventory and dollars by unit in each of those brackets. Consider anything without a sale for six months as a possible dead item for removal. You can organize returns for some inventory that is returnable. You can auction off other items that are truly dead to generate cash if you're really in a crisis. Finally, you can write things off and save taxes if you're in the black. The worst thing to do with a lot of dead and near-dead items is nothing.

The problem with receivables. Most distributors stay on top of this one better than they do inventory velocity, but the problem is the same. Reduced demand diminishes your customers' ability to pay, and payers slip into lower-performing brackets.

The solution: You have to "stir up the pond" to stimulate life and more cash. Use your business system's aging reports to manage this as usual. There's really no rocket science here, but you do need to guard against an increasingly common trick: Some businesses will wait until you yell, like when they're 60 days past due. Then they'll pay with a credit card. Your fees go up, and combined with the cost of money on the 60 days, this trick can wipe out your meager net profit on the sale. You might as well flag the customers that do this and get them on credit card to begin with. That way, at least you get the cash up front.

EIGHT GREAT PRODUCTIVITY DRIVERS

	Functional productivity	7. Become a power user of your business system	8. Maintain accurate up-to-date product and price data
1.	SPA (rebate) collection velocity		
2.	Current asset velocity Inventory Receivables		
3.	Back room velocity Purchasing Accounts payable Warehouse Accounts receivable		
4.	Pricing productivity		
5.	Sales productivity		
6.	Gross profit per order		

You can only boost productivity of the six areas to the left by mastering your business system's capabilities and feeding it accurate synchronized product and price data.

3. Increase productivity in the back room.

Purchasing. No purchasing agent can outperform a computer's ability to generate stock replenishment orders and manage inventory. But many purchasing managers are not entrusted with managing inventory. That's a problem.

Another problem is that purchasing managers don't understand how different purchasing models work: Economic Order Quantity (EOQ), Min-Max with Order Points and SCM (variously defined as Supply Chain Management or Seasonal Cost Management) models. Your business system's consultants can teach your people to use these methods in appropriate situations. It can also reduce the number of people required to handle your purchasing. Using these systems knowledgably, purchasing managers can handle more suppliers and generate more line items per person, per year. Switch to generating automatic replenishment orders using electronic data interchange (EDI) or similar methods and you can reduce purchasing personnel up to 75 percent while increasing customer service levels.

Warehouse. The best measure of logistical efficiency is cost per line-item delivered. Receiving, stocking and picking are the lion's share of that. You can increase efficiency by managing shifts and using wireless technology to receive stock and pick items. Wireless warehouse management and bar code utilization reduces the "warehouse walk" while reducing put-away and picking errors as well. Depending on the size and sophistication of your operation you may be able to reduce your warehouse force by 20 percent to 40 percent, and you won't need people with a deep and broad product background anymore. All that spells dramatically lower warehouse costs.

Accounts Payable. If you've done your homework, cleaned up your data and synced to manufacturer data, you're almost ready for a miracle. If you send your orders via EDI and obtain electronic receiving documents and an invoice via EDI, you can set tolerances for errors on invoices before involving a clerk to fix them. The computer looks at all the line-items for price, quantity and item errors and omissions. For example: Don't even look at an invoice unless errors total more than $75 or 5 percent of the invoice. Why? It probably costs $75 to look at an invoice and fix it manually. Pay all the other invoices via electronic funds transfer or an outside payment (automated clearinghouse or ACH) service. The computer checks them, not your clerk. This can reduce personnel costs up to 75 percent.

Invoicing. What's the best way to send invoices through the mail? That's easy: don't do it. Snail mail means labor that either somebody else could perform more cheaply, or not perform at all. You can bill using e-mail manually. You can also bolt on payment systems that save customer billing preferences such as paying by invoice online via ACH draft, email invoice or paying by statement online with an ACH draft. Billtrust, Jamesburg, N.J., is one proven solution that has been well accepted in the electrical distribution market. Whatever you use, let the computer do the work unless you've got outstanding invoices and need to intervene. Wouldn't you like to allocate personnel to making collections instead of sending invoices?

SPA COLLECTIONS: WHY SPEED MATTERS

	$000'S
Total revenues	$100,000
Percent SPA revenues	30%
SPA revenues	$30,000
Gross profit @ 20%	$6,000
Cost of goods sold at SPA price level	$24,000
Average SPA discount from Distributor Net	40%
Price paid into stock	$40,000
Annual SPA credits	$16,000
Average days lag from claiming monthly	16
Average days to collect from manufacturer	60
Total cash flow days uncollected SPAs	76
Total cash tied up	$3,332
Average days lag from claiming weekly on Friday and collecting on Monday	6
Reduction in cash flow days tied up	70
Cash generated from automating SPAs	$3,068
Percent of revenues	3.1%

4. Drive pricing productivity. Part of your market identity is defined by perceived price level. Normally, you are perceived as the low-price player, a competitive player, or a high-price/high-service player. There's not a lot of room for the third category today except as a niche player. You need to be competitive on the right items or you're out of the game. But which items? That's only one problem.

Another problem is velocity slippage. If the relative investment for an item increases because the volume has decreased, you need to increase the price to compensate in order to hit your target return on investment (ROI). Think about this. If you're going to be smaller for a while, your turns will naturally slip and relative investment will rise. That means your overall gross margin percentage needs to increase to hit ROI targets. If you need to be competitive on certain items more than ever, which items should you increase?

Determine your "everyday low price" items. Follow the market daily on these and adjust your prices tactically. Look at B, C and D items carefully for opportunities to raise prices incrementally to affect the overall gross profit percentage increase you need for the higher relative inventory investment.

Another problem is failing to increase prices as soon as your manufacturers raise theirs. If you want to have enough cash to handle the next incoming shipment, you need to increase prices promptly.

5. Drive sales productivity. The recession slowed things down. It made marginally profitable salespeople unprofitable. Although most companies measure total sales, sales variances, gross profit percentages and the like, these are woefully incomplete measures of your sales force. You need to measure Return on Sales Expense by computing a ratio of gross profit dollars generated versus sales expenses. Total up all the salaries, commissions, bonuses, training, insurance, benefits, car expenses, travel and living and any other expenses you pay on behalf of salespeople. Do this for each salesperson, each sales force, each region and for the whole company. Take action on performance issues.

Inside salespeople don't have discretion to spend money, so measure their output, such as line items produced per period, per person. You can also measure gross profit percentage, especially on nonstock items, where there is a strong tendency to price things low because salespeople think carrying costs are low. This ignores costs of returns, which can exceed $60 per event. Keep "nonstick" gross profit levels at 30 percent or more.

Counter people can make or break counter profitability with tie-in selling. Gauge this with the average number of line-items per order. You might even reward for performance increases in this measure to drive tie-in selling behavior.

6. Drive gross profit dollars per order. This measure is the single biggest determinant of customer profitability. Why is that? Each transaction type has relatively fixed activity costs. Additional gross profit dollars on an order go mostly to the bottom line. Measuring this alone doesn't change behavior, though. You need to promote a broader mix of products and drive sales behavior to sell a broader mix to each customer and on each order.

7. Become a power user of your business system. Business system vendors often lament that their user base makes use of less than 30 percent of the available functions that can improve a distributor's business results. Many distributors make use of basic order, shipping, billing and accounts payable functions to the exclusion of most other functions.

However, maybe that's only part of the problem. The objective is to use your business system to drive the business and to generate more profit by using the right techniques. If you don't know the techniques, you won't see the value of applying a broader range of your system's capabilities and neither will your people, which is the real problem.

Whether you use Activant, Infor, SAP or any other provider, they have consultants that can teach your people both the theory and the application of the system's various functions. Your job is to measure your performance in each area and decide your priorities, then start learning. You don't have to write any code. You just need to learn to manipulate the controls on the dashboard. After you learn to do these things, you need to tell suppliers that don't transact electronically you'll be selecting another supplier very soon.

8. Maintain accurate and current product and price data. It amazes us how conceptually simple this is and how fundamental it is to making money, yet hardly anyone does this well. All you really need to do is get the UPC number, unit of measure, description and price correct in your database to make line items match in your computer and the manufacturer's computer. Do this right and transactions will flow uninterrupted, untouched by human hands for the lowest possible cost of transacting business.

Clean product data and application of EDI or other electronic transaction techniques can add 2 percent to 4 percent to your bottom line, except for SPA claims, which can add significantly more. Using database management tools like SQL, Oracle, Microsoft Access or the database built in to your system, all you have to do is match your database to a correct database on the aforementioned variables, kick out the unmatched items and fix them. Don't feed your computer bad data.

If you haven't figured out what we're saying by now, we'll just come right out and say it. It's all about the cash. Yours may be hiding in the ashes after the fire.

Next month... Growth vision: Expanding your view of opportunity.

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