

Customer Profitability: Management & Action

Prepared For

HARDI

Prepared By

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Objectives of the Session

- Review the Profit Structure of the Industry
- Identify the Key Profit Pressure Points for Distributors
- Examine How it Might be Possible to “Manage Customers”

Exhibit 1

Profit Planning Group

Financial Results for Mountain View, Inc.

<u>Income Statement</u>		<u>Balance Sheet</u>	
Net Sales	30,000,000	Cash	115,000
Cost of Goods Sold	<u>21,900,000</u>	Accounts Receivable	3,698,630
Gross Margin	8,100,000	Inventory	6,441,176
Payroll & Fringes	4,500,000	Other Current Assets	<u>57,500</u>
All Other Expenses	<u>2,550,000</u>	Total Current Assets	10,312,307
Total Expenses	<u>7,050,000</u>	Fixed Assets	<u>1,187,693</u>
Profit Before Taxes	1,050,000	Total Assets	11,500,000
Income Taxes	<u>315,000</u>		
Profit After Taxes	735,000	Accounts Payable	1,800,000

Return on Assets = Profit Before Taxes/Total Assets

Exhibit 2

Profit Planning Group

The Recent Trend in Return on Assets

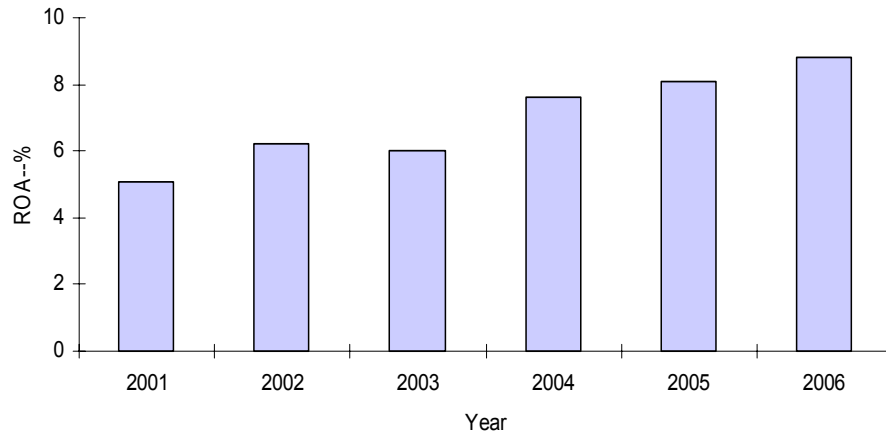


Exhibit 3

Profit Planning Group

ROA by Industry

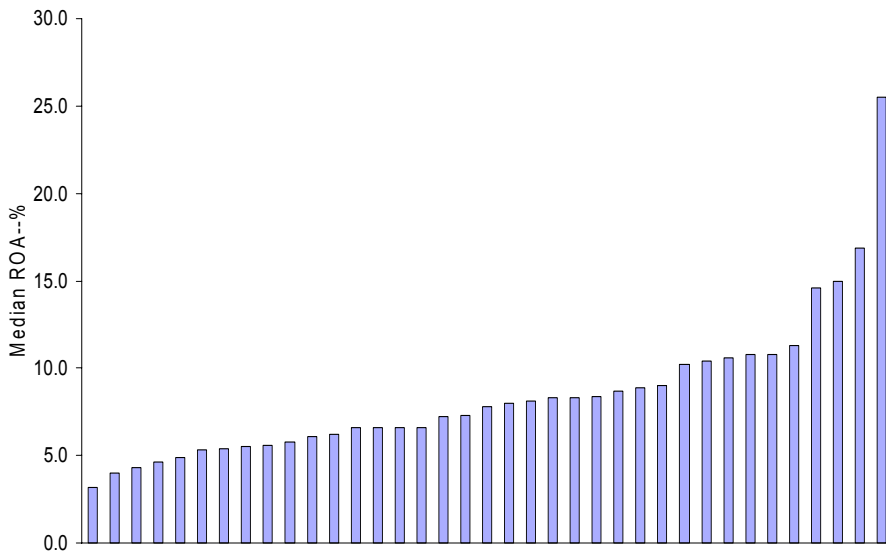


Exhibit 4

Profit Planning Group

The Three Issues That Distributors Need to Worry About With Regard to Customers

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-
-

Exhibit 5

Profit Planning Group

The Personnel Productivity Ratio--PPR

The Percent of Each Gross Margin Dollar
That Must Be Devoted to Payroll

Salaries and Fringe Benefits
Gross Margin

=

4,500,000
8,100,000

=

Exhibit 6

Profit Planning Group

**The Profitable Sales Response:
A Moderate Growth Plan**

<u>Summary Income Statement</u>	<u>Current</u>	<u>Potential</u>	<u>Percent Change</u>
Net Sales	30,000,000	31,500,000	5.0
Cost of Goods	<u>21,900,000</u>	<u>22,995,000</u>	<u>5.0</u>
Gross Margin	8,100,000	8,505,000	5.0
Payroll & Fringes	4,500,000	4,554,900	1.2
All Other Expenses	<u>2,550,000</u>	<u>2,677,500</u>	<u>5.0</u>
Total Expenses	<u>7,050,000</u>	<u>7,232,400</u>	<u>2.6</u>
Profit	1,050,000	1,272,600	21.2

Exhibit 7

Profit Planning Group

**Sales Volume Sensitivity:
A Negative View**

<u>Summary Income Statement</u>	<u>Current</u>	<u>Potential</u>	<u>Percent Change</u>
Net Sales	30,000,000	31,500,000	5.0
Cost of Goods	<u>21,900,000</u>	<u>22,995,000</u>	5.0
Gross Margin	8,100,000	8,505,000	5.0
Payroll and Fringes	4,500,000	4,895,100	8.8
All Other Expenses	<u>2,550,000</u>	<u>2,677,500</u>	5.0
Total Expenses	<u>7,050,000</u>	<u>7,572,600</u>	7.4
Profit	1,050,000	932,400	-11.2
PPR	55.6%	57.6%	
Other	8.5%	8.5%	

Exhibit 8

Profit Planning Group

The Relationship Between a PPR Reduction and Return on Assets

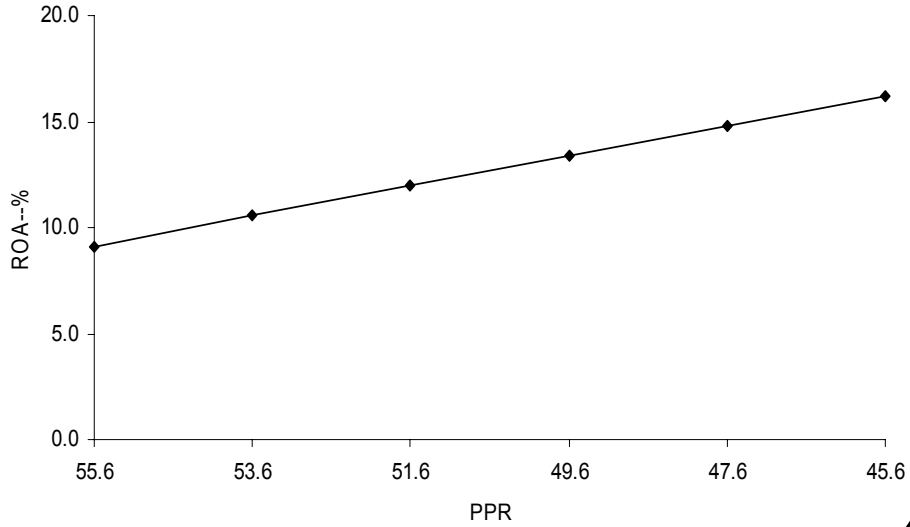


Exhibit 9

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Profitability in Relationship to Workload

	<u>Total Firm</u>	<u>Order</u>	<u>Line</u>	<u>Customer</u>
Net Sales	30,000,000	300.00	100.00	24,000
Gross Margin	8,100,000	81.00	27.00	6,480
Total Expenses	7,050,000	70.50	23.50	5,640
Profit Before Taxes	1,050,000			

Exhibit 10

Profit Planning Group

Velocity Code Analysis for Customers

	Percentage Mix of	
	<u>Customers</u>	<u>Profits</u>
A	15%	
B	15	
C	35	
D	35	

Exhibit 11

Profit Planning Group

How Customers Impact Profitability

- Inadequate Gross Margin
- Inadequate Sales Volume
- Excessive Cost of Servicing the Account
- Excessive Sales Costs
- Slow Payment Practices

Exhibit 12

Profit Planning Group

The Two Global Options for Improving Customer Profitability

- Fire 'em
- Change Their Behavior Patterns

Exhibit 13

Profit Planning Group

Who Do We Blame?

Sales Generation	Us: Them: Cherry Picking
Gross Margin	Us: Them: Still Cherry Picking
Expenses	Us: Them: Over Ordering
Accounts Rec.	Us: Them: Possible Lack of Concern

Exhibit 14

Profit Planning Group

Don't Ever Forget This Exhibit:
The Increase in Sales Required Offset a Price Cut

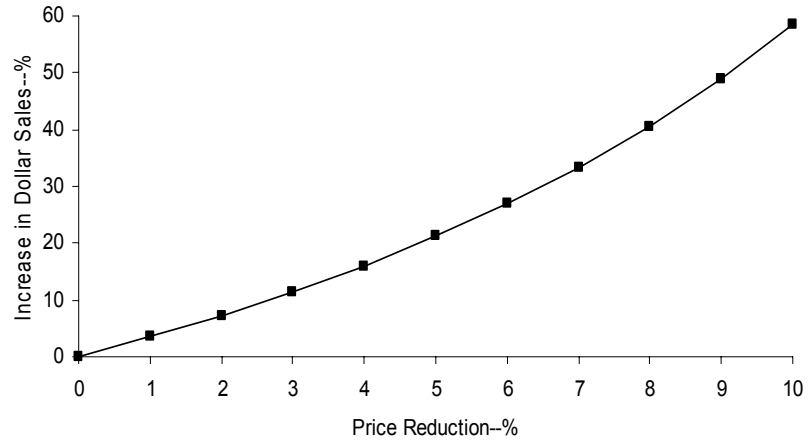


Exhibit 15

Profit Planning Group

The Relationship Between
Gross Margin and Return on Assets

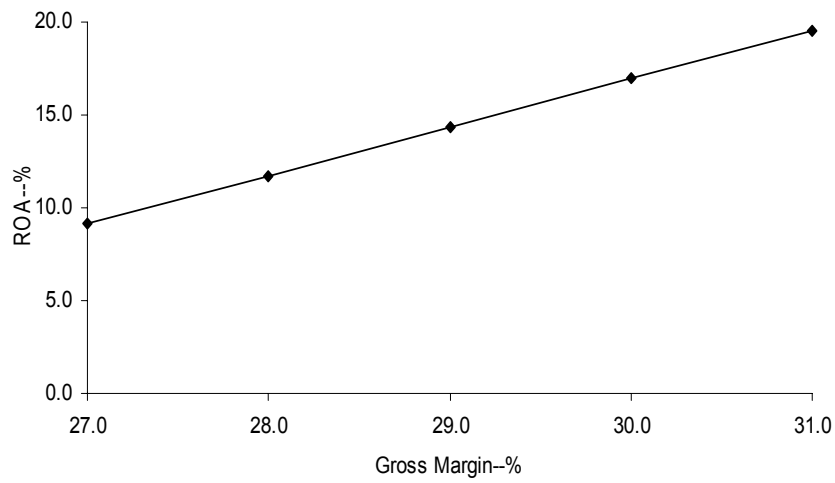


Exhibit 16

Profit Planning Group

The Impact of Gross Margin on the PPR

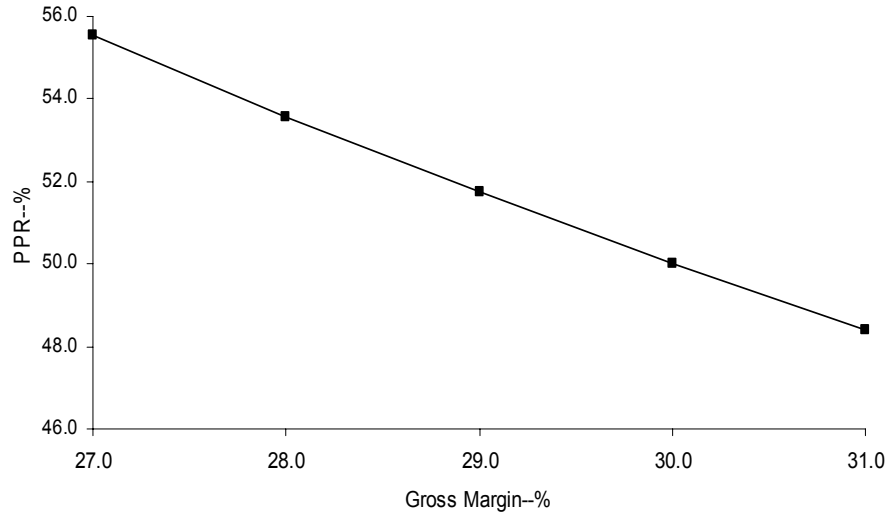


Exhibit 17

Profit Planning Group

Why Does the PPR Fall?

Summary			
<u>Income Statement</u>	<u>Current</u>	<u>Potential</u>	<u>Percent Change</u>
Net Sales	30,000,000	30,000,000	0.0
Cost of Goods	<u>21,900,000</u>	<u>21,600,000</u>	-1.4
Gross Margin	8,100,000		3.7
Payroll & Fringes	4,500,000	4,500,000	0.0
All Other Expenses	<u>2,550,000</u>	<u>2,550,000</u>	0.0
Total Expenses	<u>7,050,000</u>	<u>7,050,000</u>	0.0
Profit	1,050,000		28.6
Gross Margin	27.0%	28.0%	
PPR	55.6%	53.6%	

Exhibit 18

Profit Planning Group

Impacting Gross Margin With Product Mix

Velocity Code	<u>Sales</u>	<u>GM%</u>	<u>Gross Margin</u>	<u>Potential Sales</u>	<u>Gross Margin</u>
A	18,000,000	20.0	3,600,000	18,000,000	3,600,000
B	6,000,000	30.0	1,800,000	6,000,000	1,800,000
C	4,500,000	40.0	1,800,000	4,500,000	1,800,000
D	<u>1,500,000</u>	<u>60.0</u>	<u>900,000</u>		
Total	30,000,000	27.0	8,100,000		

Exhibit 19

Profit Planning Group

Impacting Gross Margin With Blind-Item Pricing

Velocity Code	<u>Sales</u>	<u>GM%</u>	<u>Gross Margin</u>	<u>Potential Sales</u>	<u>Gross Margin</u>
A	18,000,000	20.0	3,600,000	18,000,000	3,600,000
B	6,000,000	30.0	1,800,000	6,000,000	1,800,000
C	4,500,000	40.0	1,800,000	4,500,000	1,800,000
D	<u>1,500,000</u>	<u>60.0</u>	<u>900,000</u>		
Total	30,000,000	27.0	8,100,000		

Exhibit 20

Profit Planning Group

The Excel Template

Company Section Series of Total Firm Entries Following the PAR Survey

Customer Section Customer by Customer Input

Exhibit 21

Profit Planning Group

A Typical Set of Company Input Factors: Following the PAR Format

A. Summary Information From Your PAR Questionnaire	
Net Sales	\$20,000,000
Cost of Goods Sold (Including Freight-in, Less Purchase Discounts)	\$14,600,000
Gross Profit (Calculates Automatically)	\$5,400,000
Operating Expenses	\$4,600,000
Operating Profit (Calculates Automatically)	\$800,000
Interest Expense	\$200,000
Average Accounts Receivable	\$2,400,000

B. Operating Expense Breakouts	
This Section Will Allocate Your Operating Expenses, Which Were:	\$4,600,000

<u>Payroll Expenses</u>	
Executive Salaries and Bonuses	\$400,000
Sales Executive Salaries/Commissions & Bonuses (Include Branch Managers)	220,000
Outside Sales Salaries/Commissions & Bonuses	440,000
Inside Sales Salaries/Commissions & Bonuses (Include Counter Sales)	560,000
Warehouse Salaries/Wages & Bonuses	340,000
Delivery Salaries/Wages & Bonuses	140,000
All Other Salaries/Wages & Bonuses (Office, G & A., etc.)	420,000
Total Salaries/Wages/Commissions & Bonuses (Calculates Automatically)	\$2,520,000

Exhibit 22

Profit Planning Group

A Typical Set of Company Input Factors: Pushing Beyond the PAR Format

A. Customers and Orders	
Number of Customers	1,250
<u>All of the Following Are For a Full Year</u>	
Total Number of Customer Orders	85,000
Total Number of Customer Order Lines	225,000
Number of Deliveries to Customers	30,000
Number of Customer Return Lines	2,500

Exhibit 23

Profit Planning Group

Customer Analysis: Different Sophistication Levels to Chose From

Worksheet Five: Analysis Set Up These Factors Will Be Used In Assigning Costs to Customers

Sales	Yes
Gross Margin	Yes
Number of Orders	Yes
Number of Order Lines	Yes
Number of Return Lines	Yes
Number of Deliveries	Yes
Accounts Receivable	Yes

Note
Use the Drop Down Boxes to Set These Items to Either Yes or No

Exhibit 24

Profit Planning Group

Customer Input: Moving Beyond PAR Somewhat

Worksheet Seven: Data Entry for Individual Customers

1. You may enter information for up to 1,500 different customers in this worksheet.
2. All data must be for a full year.
3. All information **MUST** be entered in the proper file sequence, starting in cell B20.
4. Information must be entered in every cell. If you don't track an item by customer, enter zero.
5. You may enter data by hand or by pasting from another Excel spreadsheet, an Access database, etc.
6. It is not possible to sort the information once it is entered here. This will be done on later sheets.
7. There are comments associated with some of the cells to help.
8. Before entering any data for a new group of customers, you **MUST** click on the button below to delete prior information that may get in the way of the new analysis.

Click here to delete ALL customers

Note! The delete button runs a macro. Your Excel macros must be enabled for it to work.

Customer Number	Customer Name	Net Sales	Gross Margin	Outside Comm?	Accounts Rec.	Number of Orders	Number of Order Lines	Number of Deliveries	Number of Return Lines
58	Typical Customer	16000	4000	1	1920	68	180	24	2
a68	Nice Profit	10000	5000	1	1000	34	150	24	5
29-14j	Loser	5000	1500	0	200	34	200	0	2

Exhibit 25

Profit Planning Group

Looking at Customers as a Group

Sort Settings (click each one to change setting)
Customer Order: Profit Percent Ascending

Click here to sort customers using the sort settings

Note! The sort button runs a macro. Your Excel macros must be ENABLED or the button will not work.

Customer Number	Customer Name	-----Dollar Figures-----					-----Percent of Sales-----			
		Sales	Gross Margin	Direct Expenses	Overhead Expenses	Profit	Gross Margin Percent	Direct Expenses Percent	Overhead Expenses Percent	Profit Percent
29-14j	Loser	5,000	1,500	728	1,187	-415	30.0	14.6	23.7	-8.3
58	Typical Customer	16,000	4,000	1,591	2,156	253	25.0	9.9	13.5	1.6
a68	Nice Profit	10,000	5,000	1,052	1,628	2,320	50.0	10.5	16.3	23.2

Exhibit 26

Profit Planning Group

Looking At Customers Individually

Customer Selection		Typical Customer	
A Customer Profitability Overview			
	Dollars	Percent	
Net Sales	16,000	100.0	
Cost of Goods Sold	12,000	75.0	
Gross Margin	4,000	25.0	
Direct Expenses	1,591	9.9	
Contribution Margin	2,409	15.1	
Overhead Expenses	2,156	13.5	
Net Profit	253	1.6	
"What If" Analysis for This Customer			
Variables	Current	Target	
Net Sales	16,000	\$	16,000
Gross Margin Percentage	25.0		26.0 %
Number of Orders	68		60
Number of Order Lines	180		180
Number of Deliveries	24		18
Number of Returns	2		2
Days Sales Outstanding	43.8		43.8 Days
Net Profit	253		600

Exhibit 27

Profit Planning Group

The Major Expense Distinction

Direct Expenses Clearly associated with an individual customer
Examples: commissions, delivery costs

Indirect Expenses Incurred for the total firm
Examples: warehouse rent, management salaries

Exhibit 28

Profit Planning Group

Profitability Analysis for Typical Customer

	Current		Potential	
	Dollars	Percent	Dollars	Percent
Net Sales	\$16,000	100.0	\$16,000	100.0
Cost of Goods Sold	<u>12,000</u>	<u>75.0</u>	<u>11,840</u>	<u>74.0</u>
Gross Margin	4,000	25.0	4,160	26.0
Direct Expenses				
Orders	64	0.4	57	0.4
Order Lines	161	1.0	161	1.0
Deliveries	272	1.7	204	1.3
Returns	32	0.2	32	0.2
Inside Sales	530	3.3	467	2.9
Outside Sales	416	2.6	367	2.3
Accounts Receivable Interest	<u>115</u>	<u>0.7</u>	<u>115</u>	<u>0.7</u>
Total Direct Expenses	<u>1,591</u>	<u>9.9</u>	<u>1,404</u>	<u>8.8</u>
Contribution Margin	2,409	15.1	2,756	17.2
Overhead Expenses				
Sales Based Overhead	1,410	8.8	1,410	8.8
Per Customer Overhead	<u>746</u>	<u>4.7</u>	<u>746</u>	<u>4.7</u>
Total Overhead Expenses	<u>2,156</u>	<u>13.5</u>	<u>2,156</u>	<u>13.5</u>
Net Profit	\$253	1.6	\$600	3.7

The Following Changes Were Made For The Potential Analysis

Sales Increase of	0.0%		
Gross Margin Percentage	25.0%	increases to	26.0%
Number of Orders	68	decreases to	60
Number of Order Lines	180	stays at	180
Number of Deliveries	24	decreases to	18
Number of Return Lines	2	stays at	2
Days Sales Outstanding	44	stays at	44

**The Mandate for Change
During Each of the Next Five Years**

Sales Increase %	5.0
Gross Margin %	0.3
PPR	-2.0
Other Expense %	-0.1
Inventory Turnover	0.0
AR Collection Days	0.0

Exhibit 29

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**The Impact of Making
The Mandated Changes**

	<u>2007</u>	<u>2008</u>	<u>2012</u>
Net Sales	30,000,000	31,500,000	38,288,447
Cost of Goods	<u>21,900,000</u>	<u>22,900,500</u>	<u>27,376,240</u>
Gross Margin	8,100,000	8,599,500	10,912,207
Payroll & Fringes	4,500,000	4,605,510	4,971,117
All Other Expenses	<u>2,550,000</u>	<u>2,646,000</u>	<u>3,063,076</u>
Total Expenses	<u>7,050,000</u>	<u>7,251,510</u>	<u>8,034,192</u>
Profit	1,050,000	1,347,990	2,878,015
Cash	115,000	120,750	146,772
Accounts Receivable	3,698,630	3,883,562	4,720,493
Inventory	6,441,176	6,735,441	8,051,835
Other Current Assets	<u>57,500</u>	<u>57,500</u>	<u>57,500</u>
Total Current Assets	10,312,307	10,797,253	12,976,601
Fixed Assets	<u>1,187,693</u>	<u>1,247,078</u>	<u>1,515,831</u>
Total Assets	11,500,000	12,044,331	14,492,432

Return on Assets

9.1

11.2

Exhibit 30

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Summary and Conclusions

A PDF file of this seminar will be available for one month
on our web site: www.profitplanninggroup.com
Go to the seminars section

Exhibit 31

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He's Back!

Dr. Albert Bates is founder and Chief Sophist (whatever that means) of the Profit Planning Group, a research and education firm headquartered in Boulder, Colorado. The firm works mostly in the area of financial planning.

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.

He can be reached at Profit Planning Group, 303-444-6212, 1790 38th St., Suite 204, Boulder, CO 80301, info@profitplanninggroup.com.

Exhibit 32

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