

Profit Drains

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expenses, which may be extremely lacking.

The top line on the chart represents gross margin. "It is the single biggest driver of profitability that we have," says Bates. "When we start talking about improving profits, we're going to have to talk about getting more margin, controlling expenses and also driving more sales."

The Price Cut Temptation

Once a distribution company has their benchmarking data and a basic understanding of profit variables, it is necessary to recognize the commonly made mistakes that still follow, thanks to human nature, Bates says. One of the biggest, he says, is price cutting.

The chart at the bottom of p.8 in the white section, "The Increase in Unit Sales Required to Exactly Offset a Price Reduction," illustrates for a company with \$500,000 PBT like Mountain View, for every 1% price cut represented across the X axis, the company will have to increase unit sales — not dollars — by the corresponding percentage represented on the Y axis. For example, a 5% price cut needs 30% more unit activity or roughly 35% more dollar volume. "This exhibit says, for the overwhelming major-

ity of distributors, you cannot make it up with volume. But we tend to cut price whenever there's a recession," says Bates. "When they're not buying, they're not buying. To what extent you can use a price cut to drive volume, my guess is if you drive more volume, you're going to have people who are your customers loading up on the lower price and then not buying when things get back to normal."

What happens when suppliers are the ones to cut prices first? One way a distributor can try to mitigate the impact of a supplier price cut is through the economics of price adjustments by velocity code. Break your product line into A's, B's, C's and D's, Bates recommends.

- A's are tonnage items, probably about 60% of your sales volume. They tend to be commodities.
- B's are basic items, good, nice solid items, 20% of sales.
- C's are slow sellers, 15% of sales.
- D's are really slow specialty items, 5% of sales.

If your competition cuts price 5% but you only lower the price of the competitive A category, in order to maintain your gross margin percentage (25% for Mountain View) you would still have to raise the B's 5%, raise the C's 6.7% and the D's 20%.

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Calculation of MDM Inflation Index for April 2020								
		BLS	BLS	BLS		Weighted	%	%
		Price	Price	Price	%	Indices	Change	Change
		Indices	Indices	Indices	Sales	Apr '20	Apr '20	Apr '20
		Apr '20	Mar '20	Apr '20	Weight	(1)X(4)	Mar '20	Apr '19
1136	Abr. Prod.	637.6	635.3	621.3	19.1	121.79	0.37	2.63
1135	Cutting Tools	536.9	536.3	533.1	18.9	101.47	0.10	0.71
1145	Power Trans.	882.9	881.9	867.6	15.4	135.96	0.11	1.76
1081	Fasteners	572.8	572.3	563.1	9.0	51.55	0.09	1.73
1149.01	Valves, etc.	1082.6	1090.0	1073.5	7.6	82.28	-0.68	0.84
1132	Power Tools	400.6	400.1	395.2	6.5	26.04	0.11	1.35
1144	Mat. Handling	656.8	657.7	644.2	6.2	40.72	-0.13	1.96
0713.03	Belting	970.2	969.5	927.7	6.1	59.18	0.07	4.58
1042	Hand Tools	842.5	840.8	825.8	8.1	68.24	0.20	2.02
108	Misc. Metal	503.7	503.1	506.2	3.1	15.61	0.11	-0.50
"New" Apr Index		367.2	April Inflation Index			702.85	0.05	1.85
"New" Mar Index		367.0	March Inflation Index			702.50		
			April 2019 Inflation Index			690.10		

New index reflects 1977-100 base other #: 1967 To convert multiply by .52247