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A 3-Step Process to Mitigate Supply Chain Shock Waves

Plan for volatile and unpredictable patterns of supply and demand

Failure to monitor automated supply chain replenishment could result in a vicious cycle with companies throughout the supply chain experiencing warehouses full of the wrong products and little cash to rectify it.

By Jonathan Byrnes and John Wass

Supply chains throughout our economy will experience volatile shock waves of product supply and demand over the next year or more.
The automated supply chain systems of most companies are incapable of handling this level of volatility. This will create chaos in both customer fulfillment and supplier replenishment unless managers adopt a completely different way of managing their supply chains.

Huge Disruption

Today's supply chain shock waves reflect the wide variety of companies and consumers throughout each industry. Because each company and individual has a unique demand and supply pattern, and each entity will be shutting down and ramping up in a different way; the net effect will be chaotic. This will last for at least a year or more, especially as the economy restarts in a non-uniform way.

This is further exacerbated by the nature of consumption after the economy restarts. In the past month, more than 22 million people have become unemployed. In the pre-crisis period, our economy was buoyed by strong consumption fueled by debt and a pervasive lack of retirement savings.

In the great depression, a generation of formerly unemployed workers became "depression babies," focused on saving and afraid to spend money. The same effect will shape our economy for years to come.

The net effect of this economic situation is to create extremely volatile and unpredictable patterns of supply and demand in supply chains throughout our economy.

Most of these supply chains have been designed over the past decade to be extremely "lean" — with just-in-time and other innovations aimed at compressing cycle time, reducing safety stock inventories, and boosting intercompany coordination to lower costs.

These lean supply chains require that the information exchanged between customers and suppliers be highly accurate, and that the product flow remain within a relatively small range of variance, often 5% to 10%.

Without rapid, accurate forecasts and controlled product flow, a just-in-time supply chain quickly becomes a "just-in-case" supply chain, often with three times the safety stock needed to meet uncertain demand.

This situation has created a perfect storm in which radically increased supply and demand volatility has generated constant streams of shock waves in supply chains throughout our economy.

Our existing supply chain systems and processes simply cannot handle this level of unpredictability and disruption.

Propagating Shock Waves

Consider the example of a company facing rapidly declining demand. In order to save cash, management draws down its inventories, especially for slow-moving products.

After weeks of drawing down these inventories, the company is forced to

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INSIDE

PERSPECTIVE ▪ Commentary by Thomas P. Gale

Distribution's Value: Rebuilding for the Next Normal

For the past seven weeks, I've had the honor to host a weekly program, MDM LIVE, an ongoing discussion with distribution leaders on the impacts the coronavirus epidemic is having on their teams, operations, customers and suppliers. These calls have been incredibly inspiring. To me it feels like they are part of a conversation and a process for how each of us is creating what the future of distribution will look like, and how companies adapt quickly to redefine how they can help customers across every sector of our economy ramp up as quickly as possible.

Each conversation has been a mix of management strategy, responsiveness to unprecedented market conditions, protective measures for the health of employees and incredibly difficult triage to ensure the future of the company. We all are looking for ideas, triangulation of data, insights into what's working for others, and insights to build the next playbook that will make each of our companies leaner, more productive and successful far into the "next normal."

Some safety and JanSan products distributors we've interviewed have shared incredible stories of the ways they are serving frontline workers and managing supply shortages; others have seen their customers all but shut down. Many have taken aggressive and difficult measures to furlough team members to stay viable. What we all share in common is that none of us have experienced this level of isolation, economic deceleration and disruption to the "normal" ways of operating a business.

This is not a story you will see in the mainstream media. It's not a "gotcha" story to attract eyeballs, such as the one that CNBC produced a few weeks ago on Grainger's government contract for DuPont Tyvek suits. But it is an essential story about the incredible unseen and hidden value that independent distribution channels provide to create the most flexible economy in the world.

And that's why I'm optimistic that over the next several months distribution will play such a critical role in getting our economy off its back and to fully functioning capacity as quickly as possible.

It's also why I'm committed for our team to keep researching and highlighting over the next several months why North America's distributors, through which 30% of annual U.S. GDP flows, is the reason why the U.S. economy will recover as quickly as it does.

We intentionally built this May 10 issue of MDM Premium to provide three key reports for distribution leaders to rethink how and where their teams can create opportunities to build a stronger and more adaptive company going forward. I'm so thankful during this time to have relationships with so many thought leaders across distribution who are thinking forward for the best short- and long-term moves to make to build deeper value in the future.

I wish you the best as you navigate these incredibly challenging times. Please contact me at tom@mdm.com with your ideas on how MDM can help you in these coming months.

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Supply Chain Shock Waves
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replenish its stock. Its automated replenishment system requisitions double its normal order so it can rebuild its safety stock while meeting current demand.

The company's distributor sees several weeks of no demand for these products, followed by a more than double amount of demand. The distributor is unable to infer the actual demand, so it ships all of its stock to this customer. Its replenishment system interprets this as a major spike in demand, so it raises its internal demand forecast and safety stock, then sends the resulting increased order to its supplier, a manufacturer.

The manufacturer's system interprets this greatly increased demand as a trend so it changes the factory's production schedule to urgently make much more of these slow-moving products. This reduces its capacity for making its faster-moving products, creating stockouts throughout the downstream supply chain.

The distributors and their customers panic because these fast-moving products generate most of their remaining cash flow, so they give urgent reorders to their suppliers, who in turn, are unable to fulfill them.

This lack of available fast-moving products causes their systems to double their reorders, eventually creating a pile-up of products throughout the supply chain with companies hoarding all available stock.

The result of this vicious cycle is that the companies throughout the supply chain will wind up with warehouses full of the wrong products and little cash to rectify their situations. Because the ultimate demand does not stabilize, the imbalance gets worse and worse, sending larger and larger shock waves throughout the supply chain.

Supply Chain System Limitations

Most automated supply chain replenishment and order acceptance systems are unable to handle the supply chain shock waves that are roiling our economy today because they are designed to operate with relatively small demand variance.

Data throughout today's supply chains fail to reflect actual underlying demand. Moreover, to the extent that the end consumers are hoarding scarce goods, their purchasing habits fail to reflect their actual consumption, making the problem worse. Recent reports of food, cleaning product and toilet paper hoarding illustrate this issue.

For companies with thousands of customers and products, the demand pattern and replenishment calculations are extremely complex. Supply chain managers, no matter how experienced, are unable to make effective ad hoc manual adjustments to enable the systems to operate acceptably.

This leads them to fall back on failed old rules of thumb like first-come first-served, resulting in customers perceiving that getting fulfilled orders is a random event, leading them, in turn, to chronically over-order and hoard products.

This chaotic situation has become the "new normal" in industry after industry, and it will stay that way for a year or more. It will take a long time for consumption patterns to stabilize and for supply chains to be reconfigured.

Managing Your Shock Waves

Companies can manage their supply chain shock waves and avoid being overwhelmed by them by adopting a three-step process:

1. Plan for paradigmatic supply chain change
2. Prioritize your customers and suppliers
3. Adjust your current systems

Managers can deploy this practical process rapidly, but all parts of their companies' organizations must become involved.

Plan for Paradigmatic Supply Chain Change

In order to effectively manage a company's supply chain shock waves, its top management team must understand the strategic nature of the problem — how supply chain shock waves are generated, and the concrete steps needed to master them.

This is extremely urgent today, when demand volatility is accelerating rapidly. Without this understanding, events will simply overwhelm managers throughout the economy, freezing their ability to respond effectively.

In a nutshell, managers must supplement their automated systems with a process that:

- prioritizes customer and supplier segments,
- focuses manual interventions only on selected priority customer segments, and
- sets customer order allocations to reflect segment priority. This requires both organizational and system changes.

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The most effective mechanism for creating and overseeing this process is a top-level team comprised of the heads of sales, supply chain, supplier/product management and finance. Together, they will be able to manage and coordinate the actions that will enable their company to successfully tame its supply chain shock waves, and position itself for success both in the immediate crisis and in the prolonged recovery period that follows.

Prioritize Your Customers and Suppliers

The starting point in prioritization is to segment your customers by profitability. By developing a full P&L on every transaction (needed because prices and costs vary widely from customer to customer and product to product, even within customers), managers can identify:

- their profit peak customers (large, high-profit),
- profit drain customers (large, money-losing), and
- profit desert customers (small, little-profit).

Typically, profit peak customer represent about 10%-20% of the customers and contribute 150% or more of the profits; profit drain customers represent about 15%-30% of the customers and drain perhaps 40%-50% of the profit peak customers' contribution; and profit desert customers account for fully 50%-75% of the customers but do not contribute significant profits.

Your profit peak customers warrant allocations of 100% of historical demand. However, their replenishment systems probably are over-ordering, so company managers need to meet with them weekly (by phone or online) to review the situation and agree on orders.

Profit drain customers are prime candidates for cost reduction, often through costless operational adjustments, so company managers should also meet with them weekly to review and agree on orders — with allocations of perhaps 75%-80% of historical demand if costs are not reduced, but full historical demand if they become profit peaks.

The profit desert customers should be served through automated systems, with menu offerings, and they should get perhaps 60% of historical demand.

This prioritization aligns your fulfillment allocation commitments with each profit-based customer segment's importance, while it systematizes and minimizes the need for manual system interventions.

However, once you have agreed with a customer on allocation amounts, it is very important to be extremely reliable. The essence of great customer service is to always keep your promises, but you do not have to make the same promise to every customer.

Adjust Your Current Systems

Some existing supply chain systems are capable of specifying order fulfillment gates, such as limiting fulfillment of orders from specific customers if they are above a certain percent of the customer's historical demand (without manual override).

Similarly, some systems have the capability for specifying replenishment requisition gates such as preventing requisitions to certain suppliers of amounts exceeding a particular percentage of historical supply requests from these suppliers (again, without manual override).

Most supply chain managers are not familiar with these system capabilities, as they are rarely used in the normal course of business.

It is imperative that a company's systems experts be urgently assigned to investigate whether the company's order fulfillment and replenishment requisition systems have this capability and if so, to actively manage these settings.

Companies with systems that do not have this gating capability need to urgently assign their best systems experts and operating managers to develop a set of ad hoc procedures that will accomplish the same gating capability, with the ability to change settings as events unfold.

In crisis, supply chain managers quickly encounter a dilemma: their automated supply chain systems cannot operate without extensive manual interventions, but the business is too complex for managers to constantly intervene on an ad hoc basis in every order from every customer for every product. Instead, they need to organize and prioritize this process.

With this prioritization and agreed-upon weekly orders, customers can submit orders at agreed amounts, and the company's automated systems should accept these orders. By getting ahead of the key customers' order-development process, a company's supply chain managers will be able to regain control over the situation.

Managing the Process

Implementing this management process is complex. It affects nearly every part of a company's organization, and has many moving parts: teams working with profit peak customers, other teams working with profit drain customers, and yet others working with profit desert customers. A set of parallel teams have to work with the three analogous sets of suppliers.

This interaction must occur on both a weekly, and a longer-term basis — tracking and managing both individual customer and supplier situations, as well as following and reacting to longer-term secular trends.

This process is very practical and manageable, and it can be developed relatively quickly. Managers who accomplish this will ensure their company's success and their customers' loyalty both in today's period of crisis, and in the years beyond.

John Wass is CEO of Profit Isle, a profit acceleration SaaS company, www.profitisle.com. Jonathan Byrnes is a senior lecturer at MIT and founding chairman of Profit Isle. They are co-authors of the forthcoming McGraw Hill book, "Choose your Customer: How to Compete Against the Digital Giants and Thrive."

Revenue Recovery: Transition Your Sales Team to Remote Selling

Rethink the typical recessionary response in this unique environment

Four critical actions to take for an effective transition of sales teams to this new environment include reassurances about compensation, addressing performance gaps, elevating customer conversations and training on new customer interactions.

By Senthil Gunasekaran

As we enter the second month of lockdown in response to COVID-19, distributors are looking beyond the short-term response and shifting focus to the long road to recovery, with an eye on course corrections for the mid-term, or the next eight to 12 weeks.

Distributors are facing revenue declines that started in the second half of March across verticals, with a few exceptions like jan-san, healthcare and select chemical products. This abrupt fall forced many distributors to lay off or furlough employees in order to align cash flow with reduced revenue levels.

Demand has shrunk across many verticals, with some declines expected to remain in double digits for the second half of 2020.

A typical recessionary response is to cut prices and extend terms to get orders. In these instances, unless the distributor proactively sets guidelines for the upcoming exceptions, revenue recovery will be rocky and could put customers' margin expectations at risk in the long term.

Further, this recessionary response may not be optimal due to the foundational constraint of this recession: social distancing. This factor affects face-to-face sales directly. The effective transition of sales teams is going to be the deciding factor for revenue recovery in this unique environment.

Transition Your Sales Team by Enabling Skill and Will

Though everyone is influenced emotionally during this crisis, the sales team faces challenges on two fronts: skill and will.

On the skill side, they are unable to do what they are trained to do professionally: influence customers through face-to-face meetings. For most of us, the environment (office to home) has changed, but we can deploy our skills, assuming we learn how to use the virtual tools.

However, when salespeople must perform their professional duties in a constrained environment, performance is going to suffer, at least in the short term. This causes significant concern for their compensation, leading to potential harm to their motivation — and will.

Therefore, an effective transition should address both skill and will. Upon further research, we identified four critical actions (will: reassure and renew; skill: retool and retrain) for an effective transition of sales teams to this new environment. They are:

1) Reassure: Update sales force compensation to alleviate concerns over income levels, freeing their mindshare for selling efforts.

2) Renew: Change the focus of sales management from exclusively digging into performance gaps to holistically addressing people (individual salesperson concerns), process (evolving sales process), and performance (resulting performance outcomes).

3) Retool: Help salespersons elevate the customer conversation by increasing the granularity of customer-specific information (past performance and future opportunity) provided for customer calls.

4) Retrain: Enable sales teams to grow (rather than just go) through the crisis by training them on customer invitation/access (becoming comfortable with virtual tools), customer interaction (connecting with customers emotionally), customer insight (leveraging customer analytics to grow revenue) and customer influence (reinforcing value creation through new lenses).

Let's take a closer look at each of these.

Reassure

Most sales teams in the B2B industry have a higher variable component as part of their total sales compensation. That variable could come in the form of sales commissions, bonuses or other incentives based on sales and profit targets. Because sales teams are significantly handicapped in performing their usual tasks (in-person meetings and conversations), their ability to generate revenue is limited as well, leading to major concerns over their income levels for the rest of the year. If their compensation concerns dominate their thinking, their mindshare for virtual or remote sales efforts will be constrained as well. Your first step can be to perform a quick review of current sales compensation plans and adjust the mix of fixed (salary) and variable (commission) portions.

One industrial distributor's compensation plan had a mix of 74% (variable) and 26% (fixed). The distributor's sales were down by 14% after three weeks of lockdown. They surveyed their top 40 accounts to understand their operational level and the demand outlook. They also got input from their sales team. After a quick analysis forecasting the financial impact, they decided to increase the fixed component of their salesforce compensation to 66% for the remaining three quarters, contingent on a few KPIs and revised revenue targets. This action mitigated the risk for their sales team. Most importantly, the compensation revision reassured their team that management recognized their unique constraints and was willing to support them.

Renew

Sales management processes come in different forms across the industry, ranging from informal weekly check-ins to highly structured coaching and guidance. Regardless of structure, most sales managers focus on performance gaps or quota variance during their periodic check-ins.

Why is sales management reduced to this narrow scope? The reasons are multifold, but two stand out. First, distributors rely on sales force compensation (with a high variable component) as a sales management tool. Second, most distributors don't have a full-time sales manager role. Instead, an experienced salesperson (designated as sales manager) checks in with the sales team while also managing their own accounts.

In managing the current scenario, distributors might consider paying more attention to sales management as a process. The sales manager needs to look beyond symptoms (performance gaps) and focus on the root causes (people and process) during this transition. As sales teams manage the challenge of virtual or remote selling, they are learning and experimenting with many new things: learning virtual technical tools, adjusting their value propositions, and accessing key decision-makers differently, to name a few. They need far more support and guidance both at the sales process level and on a personal level. The sales manager should be prepared to acknowledge and empathize with any individual salesperson's circumstances resulting from the public health challenge. Structured sales management — focusing on people and sales process — does not have to be an elaborate mechanism. Rather, it can be a simple mental routine.

A building materials distributor observed a wide variance in performance spread across its salespersons. The needs of each member in the sales team were — and are — so different, that a general training program was not effective in improving performance. So, they adopted a simple but proven coaching model, GROW, as guidance for sales managers.

The GROW model prescribes four actions to help sales managers get to root causes systematically, starting with a symptom.

1) Reset goals for each salesperson's territory, accounting for customer closures and revised economic- and industry-level forecasts.

2) Assess the reality of the current selling environment and identify obstacles in both process and skill level.

3) Identify the options and priorities for improving or solving for those obstacles.

4) Convert those options into action steps to provide a way forward for the salesperson.

It's a straightforward process, but the distributor created playbooks to help the sales manager apply the four actions, rather than get stuck on the first step in pre-crisis mode.

Retool

How does remote or virtual selling handicap a salesperson? The biggest challenge is the loss of access to field data. When a salesperson visits a customer in their plant, job site, restaurant or medical facility, he or she usually assesses the site for field data like competitor items and stock level on the shelves. They now have to account for the lack of access to this crucial data in their remote customer calls.

Now, step back and ask yourself: What kind of customer-specific information do we typically provide to the sales team as part of their customer calls? In many cases, it's limited to the recent purchase history of the customer. A select few proactive salespeople spend extra time understanding this report, but most do not. However, those who weren't incorporating reports like this before may not have that luxury anymore. Sales teams now operate in a vacuum in the absence of field data. How do we enable them with what we do have?

Distributors might consider increasing the granularity of customer-specific information without overwhelming the salesperson. There are two types of information that provide customer insights: past (a customer-specific dashboard that summarizes key metrics in terms of revenue, product mix, margin trend and cost-to-serve), and future (a customer-specific profile that highlights item-level sales recommendations and margin enhancement opportunities).

A chemical distributor deployed this strategy as part of its remote sales effort. The distributor had performed customer stratification as part of its strategic initiatives during the last year. One of the key applications is the 'customer X-ray' snapshot. The X-ray view distills customer KPIs into four buckets:

1) customer volume mix,
2) penetration,
3) margin and
4) cost-to-serve.

The salesperson can access customer-specific information intuitively and instantly. The view lists customer-specific sales recommendations based on its periodic purchases, enabling the salesperson to propose appropriate items. The view integrates a customer's past performance as well as future opportunities. The benefits are numerous for a remote selling model, as it not only helps the salesperson prepare for customer calls but also demonstrates consulting capability, creates value for customers, and minimizes pricing pressures.

Retrain

Most sales force training hours are spent on product training, with the remaining hours dedicated to motivational and general sales training. As the current crisis redefines sales force roles and skill sets, they have to excel in four competencies in this new universe of virtual or remote selling:

1) Customer invitation or access (becoming comfortable with virtual tools)
2) Customer interaction (connecting with customers emotionally)
3) Customer insight (leveraging customer analytics to grow revenue)
4) Customer influence (reinforcing value creation through new lenses)

An industrial distributor quickly redefined all four competencies for its sales team, across 16 branch locations, through specific retraining and coaching. In addressing customer invitation, the distributor understood that the technical maturity of its sales force ranged from low to high based on experience and tenure. So, its IT team rolled out a sales-specific training session to introduce virtual tools that would enable the sales team not only to connect with the customer but also to provide the customer the opportunity to scan or share plant information in return.

Further, the sales leaders recognized the importance of empathy in the overall customer experience. The public health crisis has increased anxiety at an individual level. To help salespeople with these customer interactions, the human resources team researched and created a quick checklist of critical items and brief videos as an aid for sales teams to recognize the role of empathy. This effort helped the sales team navigate difficult conversations using their awareness of the economic and health impact on customers' lives.

The third and fourth competencies — customer insight and influence — are related. As described in the previous section, it's paramount that the sales force leverages analytics to influence customer conversations in remote selling. The sales VP organized two virtual training sessions with the help of the sales analytics team. The first training helped sales managers understand the role of customer analytics in influencing customer calls. The second training was conducted both at the group as well as individual levels. The sessions

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helped salespersons understand the customer X-ray snapshot (customer performance and sales recommendations) and how to use it. Though ActVantage applied advanced analytics to develop these customer X-rays and prescriptive sales recommendations, the sales team was trained to access the information using easy-to-absorb visualizations intuitively and instantly.

The marketing team created a quick infographic documenting recent, value-added services (branch/counter/curbside pick-up, safety, signature texting, etc.) and shared it with core customers. The integrated efforts helped the sales team embrace the new model of virtual/remote selling confidently and collectively, leading to active customer influence.

Follow the Roadmap to Revenue Recovery

Managing sales team transition during this public health challenge is one of the critical deciding factors for distributors as far as how well — and how quickly — they'll recover. The road to revenue recovery is uncertain, and past recessionary reactions may not suffice. Of crisis management, Peter Drucker said, "The greatest danger in times of turbulence is not turbulence itself, but to act with yesterday's logic." As an industry, we can collectively respond in many creative ways and come out stronger on the other side if we lead with courage and compassion.

Senthil Gunasekaran is co-founder of ActVantage, which helps distributors drive profitable growth through analytics and talent development. He has more than 18 years of experience helping hundreds of distributors and manufacturers, while co-authoring seven books for NAW. He also delivers executive education and speaks at industry forums. Prior to ActVantage, Senthil led research and industry projects at Texas A&M's ID program. Reach him at senthil@actvantage.com or visit actvantage.com.

An Action Plan to Improve Long-Term Financial Performance

Distribution Performance Project's Al Bates's roadmap to business planning

This first article in a two-part series will highlight how to methodically create a financial appraisal of your firm's current financial position and determine the amount of financial slowdown the business can tolerate before starting to lose money.

By Elizabeth Galentine

As distribution companies tear up their financial projections originally forecasted for 2020, many are looking for a sound path forward. In an exclusive on-demand webcast for MDM, Al Bates, principal with distribution research group Distribution Performance Project, describes how to start the process. Based on decades of market experience and observations from previous downturns such as post-September 11 and the Great Recession, he recommends a three-step approach to finding your financial footing.

1) Outline a financial appraisal of where the firm stands. Position yourself on the spectrum from panicked to relaxed by focusing on two critical rations: profit and cash position.

2) Identify key mistakes from the past to be avoided. In economic downturns, distributors tend to repeat the same mistakes or bad decisions, Bates notes. Recognize they happened and develop a plan to avoid repeating them.

3) Create an action plan to improve long-term financial performance. Ask yourself, what do we have to do so that we're in a much better position coming out of this than we were going into it? How can we position our company for long-term success, Bates says, knowing that maybe 10 years from now there'll be another challenge that we face?

To begin outlining a financial appraisal of where the company stands, Bates uses a fictional distribution company, Mountain View, Inc., with a financial statement he estimates would cover up to 75% of U.S. distributors today. [See chart on p. 4 of yellow section.] The distributor has $20 million in net annual sales with a 25% gross margin. The crucial point to note and keep in mind, Bates says, is that for virtually every distributor across sectors, about two-thirds of expenses come from payroll. "As we start talking about trying to improve performance in today's environment, we're going to have to have payroll rear its ugly head," Bates says.

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Economic Activity in the Manufacturing Sector Contracted in April

Economic activity in the manufacturing sector contracted in April, and the overall economy contracted after 131 consecutive months of expansion, say the nation's supply executives in the latest Manufacturing ISM Report On Business.

The report was issued by Timothy R. Fiore, CPSM, C.P.M., Chair of the Institute for Supply Management (ISM) Manufacturing Business Survey Committee: "The April PMI registered 41.5%, down 7.6% from the March reading of 49.1%. The New Orders Index registered 27.1%, a decrease of 15.1% from the March reading of 42.2%. The Production Index registered 27.5%, down 20.2% compared to the March reading of 47.7%. The Backlog of Orders Index registered 37.8%, a decrease of 8.1% compared to the March reading of 45.9%. The Employment Index registered 27.5%, a decrease of 16.3% from the March reading of 43.8%. The Supplier Deliveries Index registered 76%, up 11% from the March reading of 65%, limiting the decrease in the composite PMI.

"The Inventories Index registered 49.7%; 2.8% higher than the March reading of 46.9%. The Prices Index registered 35.3%, down 2.1% compared to the March reading of 37.4%. The New Export Orders Index registered 35.3%, a decrease of 11.3% compared to the March reading of 46.6%. The Imports Index registered 42.7%, a 0.6% increase from the March reading of 42.1%.

"Comments from the panel were strongly negative (three negative comments for every one positive comment) regarding the near-term outlook, with sentiment clearly impacted by the coronavirus (COVID-19) pandemic and continuing energy market recession."

Distributor

Amazon.com, Inc. reported sales of $75.4 billion in the first quarter, up 26.4% compared to the same quarter in 2019. Net income was $2.5 billion in the first quarter, down 28.8% in first quarter 2019.

3M, St. Paul, Minnesota, reported first-quarter sales of $8.1 billion, a 2.7% increase compared to the first quarter of 2019. Profit was $1.3 million, a 45% increase compared to the prior year.

PPG Industries, Pittsburgh, reported sales for the first quarter of $3.4 billion, down 7% from the previous year and down nearly 5% in constant currencies. Profit was $243 million, down 22.1% from the first quarter of 2019.

Anixter International Inc., Glenview, Illinois, reported first-quarter sales of $2.1 billion, down 2%. Profit was $35.7 million, down 9% over 2019.

Avery Dennison Corp has reported sales for the first quarter of $1.7 billion, down 1% over the previous year. Organic sales were up 0.3%. The company reported a profit of $134.2 million, compared to a loss of $146.9 million during the same quarter last year.

WESCO International Inc., Pittsburgh, reported sales for the first quarter of 2019 of $2 billion, flat over 2019. Profit was $34.4 million compared to $42 million in 2019. Organic sales fell 1.7%.

Pentair plc, London, reported first-quarter sales of $710 million, a 3% increase compared to the year-ago period. First-quarter profit was $72.7 million, compared to $51.3 million in 2019.

Lawson Products Inc., Chicago, reported first-quarter sales of $91 million, a 0.3% decrease compared to the year-ago period. The company reported profit of $12.5 million, compared to $4.1 million in the same period a year ago.

NOW Inc., Houston, reported first quarter sales of $604 million, down 23.1% compared with the first quarter of 2019. The company reported a loss of $331 million for the quarter, compared with a profit of $18 million a year ago.

Fastenal Co., Winona, Minnesota, reported April sales of $491.5 million, up 6.7% over the year-ago period. The company reported daily sales of $22.3 million, up 6.7% versus a year ago.

Indian River Consulting Group's weekly Pandemic Revenue Index for the work week of April 27-May 1, 2020, indicated a 18.9% decline compared with the same week a year ago.

Economic

Real gross domestic product decreased at an annual rate of 4.8% in the first quarter of 2020, according to the "advance" estimate released by the Bureau of Economic Analysis. In the fourth quarter of 2019, real GDP increased 2.1%.

Total nonfarm payroll employment fell by 20.5 million in April, and the unemployment rate rose to 14.7%, according to the U.S. Bureau of Labor Statistics. This is the highest rate and the largest over-the-month increase in the history of the series.

Financial Light
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Exhibit 2

Income Statement Results for Mountain View, Inc.

	Dollars	Percent
Net Sales	20,000,000	100.0
Cost of Good Sold	15,000,000	75.0
Gross Margin	5,000,000	25.0
Payroll & Fringes	3,000,000	15.0
All Other Expenses	1,500,000	7.5
Total Expenses	4,500,000	22.5
Profit Before Taxes	500,000	2.5%
Fixed Expenses	3,500,000	
Variable Expenses	1,000,000	5.0

As seen in Exhibit 2, the company's expenses subtracted from gross margin result in a profit of $500,000 or a bottom line of 2.5%.

Fixed and Variable Expenses

To move forward and respond to today's market environment, Bates suggests breaking out the expense category — in this example $4.5 million — into two components: Fixed and variable. "Most small companies have never done this, and a lot of large companies have done it but done it incorrectly," he says. "It's absolutely essential to understand what's going to go on as the world changes."

Fixed expenses only change when an action is taken. For example, responding to the current economic situation by actively reducing expenses such as travel and education. This type of reduction would not happen automatically. It needs to be initiated.

In contrast, variable expenses change automatically. When sales go down, variable expenses go down proportionately. Important to note, Bates says, most companies overestimate their variable expenses, assuming that more expenses will go down when sales drop than actually do decline.

Looking at the fictional Mountain View, Inc., balance sheet. The company has:

- $200,000 cash
- $2 million accounts receivable
- $4 million inventory
- $800,000 accounts payable

"Most distributors do not have a lot of cash. Banks have cash. Distributors have something else, namely accounts receivable and inventory," Bates says, noting this company has $6 million tied up in this fashion. "We might want to think about how do we drain those effectively, or even should we drain them at all?"

Under AP, the company owes suppliers $800,000. While many distributors may panic a bit about the $400,000 gap between amount owed and money in the bank, this area is not typically a problem, Bates notes, as payments often flow out throughout the month. "As long as the railroad keeps running, it is not a problem," he says. "It only becomes a problem when the railroad slows down or comes to a halt. Prior to the present situation, I was relaxed about these numbers."

Two Key Survival Ratios

When determining how to deal with a market slowdown, there are many ratios that a distributor can look at, but two of the most important are breakeven point and collection sensitivity ratio, Bates says.

1) Breakeven point. How much of a sales decline can the firm manage without resorting to desperation measures? Desperation measures go beyond cutting typical 'extras' and get into critical infrastructure cuts, Bates says. "My concern is in a down market we cut infrastructure. When the market comes back, we add it. We cut it, we add it, we cut it, we add it. It's dysfunctional," he adds.

2) Collection sensitivity ratio. How much can collections lag before the firm faces a severe cash crisis? The real challenge in the down market, Bates says, is customers begin to pay slower. How much can a distributor afford to have a lag before serious issues arise?

To figure out what happens when sales stop or slow severely, distributors need three numbers, according to Bates:

1) Gross margin percentage
2) Fixed expenses in dollars for the year
3) Variable expenses as a percent of sales

Those numbers create a formula: fixed expenses divided by gross margin percentage minus variable expense percentage. This lays out the fact that every dollar of revenue coming

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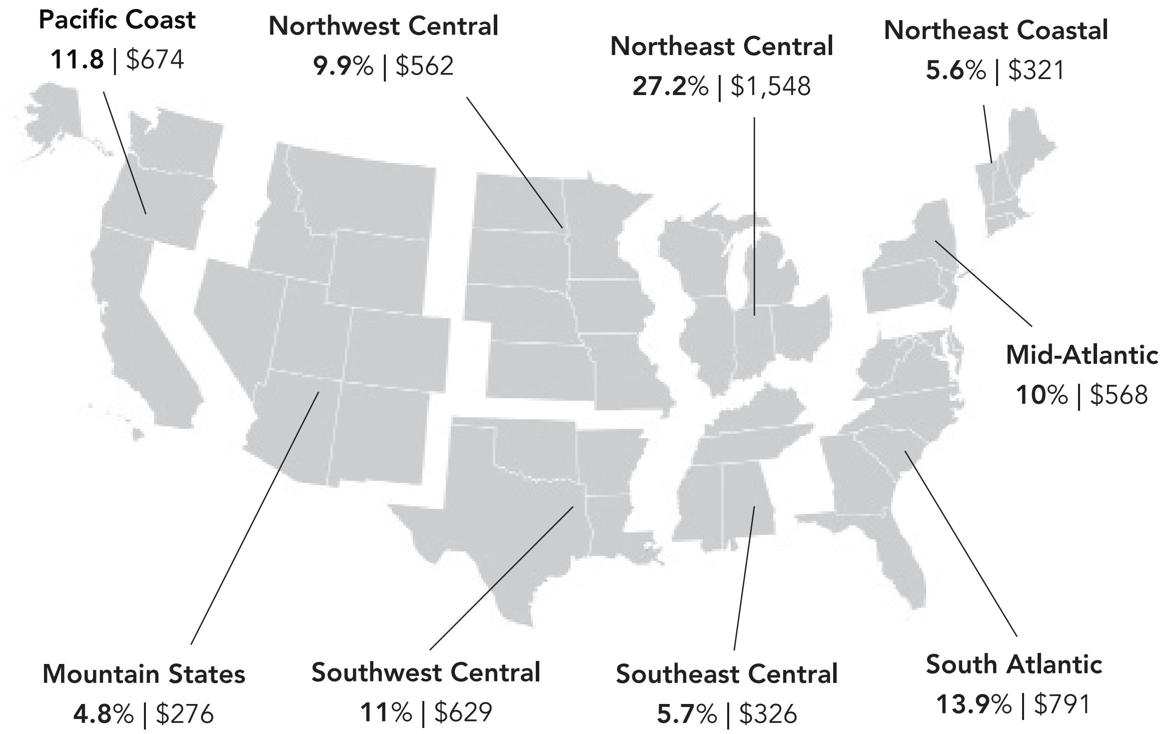
U.S. Cutting Tools Market Demand

Market demand for Cutting Tools in the U.S. was $5.7 billion in 2018, according to data from MDM Analytics. All estimates are 2018 end-user demand, in U.S. dollars, including distributor margin.

U.S. Total: $5.7 billion

U.S. End-User Market Demand for Cutting Tools by Region, $ millions (2018 est.)



U.S. End-User Market Demand for Cutting Tools: Top 10 End Markets

Top 10 end markets in $ volume, by NAICS code, consuming Cutting Tools (2018 est.)

End User		Estimated Consumption
336412	Aircraft Engine and Engine Parts Manufacturing	$457,517,240
333120	Construction Machinery Manufacturing	$346,820,566
333111	Farm Machinery and Equipment Manufacturing	$301,446,473
332710	Machine Shops	$282,159,448
336390	Other Motor Vehicle Parts Manufacturing	$265,053,363
333618	Other Engine Equipment Manufacturing	$180,346,045
333517	Machine Tool Manufacturing	$175,784,957
336411	Aircraft Manufacturing	$159,632,277
333914	Measuring, Dispensing and Other Pumping Equipment Manufacturing	$123,784,650
238220	Plumbing, Heating and Air-Conditioning Contractors	$118,192,862

This market size estimate was compiled by MDM Analytics, Niwot, CO.
Learn more about MDM Analytics at www.mdm.com/analytics.

Financial Light
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in isn't actually a dollar. With a 25% gross margin, 75 cents of every sales dollar go to suppliers, plus the 5% variable expenses.

The formula to find the break-even point is as follows:

Using the formula with fictional Mountain View, Inc., the number needed to break even is $17.5 million. Anything below this will wipe out profit.

Exhibit 5

Gross Margin %	=	25.0
$ Fixed Expenses	=	3,500,000
Variable Expense %	=	5.0
Sales Required to Break Even	=	$ Fixed Expenses / (Gross Margin % - Variable Expense %)
	=	3,500,000 / 20.0
	=	17,500,000

Exhibit 2

Implication of the Breakeven Ratio

The majority of distributors can take about a -12.5% sales hit before they begin to go to a negative profit, Bates says. He suggests a 20% safety factor as a goal to strive toward. The percentage comes from observing sales decline during both the September 11 and Great Recession downturns.

"We don't have a 20% safety factor now for most of us, but the next time we have a problem, I want you to take an oath that you're going to reengineer your business so you can take a 20% sales hit and still be marginally profitable," he says.

In this example of finding the breakeven point, Bates notes that fixed expenses do not drop for Mountain View, Inc., while variable expenses decline with sales, lowering total expenses slightly.

However, he recommends individual distributors look at their fix expenses and make a decision, for the year in its entirety, if it might be smart to also reduce fixed expenses. "You've got to decide, in this entire year, what's going to happen to my sales," he says. "You have to decide, what sort of situation do I have with my breakeven point?"

January and February were relatively nice months for many distributors. March was marginal, and April saw some significant declines.

"I want you to decide going forward, are we going to have a bunch of Marches? Are we going to have a bunch of Aprils? Are we going to have a bunch of Januarys or Februarys?," Bates says. Ask yourself, "What am I going to look like? Decide to what extent do I need to begin to hack those fixed expenses — or not hack them? I can only provide the structure. You've got to decide."

In part two, Bates outlines how to take this data to create an action plan to improve long-term performance. Meanwhile, view the on-demand webcast at mdm.com/events.

Exhibit 6

Summary Income Statement	Current	Break Even	Percent Change
Net Sales	20,000,000	17,500,000	-12.5
Cost of Goods Sold	15,000,000	13,125,000	-12.5
Gross Margin	5,000,000	4,375,000	-12.5
Fixed Expenses	3,500,000	3,500,000	0.0
Variable Expenses	1,000,000	875,000	-12.5
Total Expenses	4,500,000	4,375,000	-2.8
Profit Before Taxes	500,000	0	-100.0