MODERN DISTRIBUTION MANAGEMENT

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3 Keys to Downsizing in a Period of Crashing Demand

Prior practices are inadequate for compressed response times

By focusing your resources on your profit core, and emphasizing your key people and relationships, you can make sure that your initiatives and actions are both practical and timely under today's fast-changing conditions.

By Jonathan Byrnes and John Wass

Today's crisis era of coronavirus containment and crashing economic demand present top managers with a truly historic challenge. They face both enormous financial and operating difficulties, and at the same time, they have an historic opportunity to reshape their companies to produce vast benefits for years to come.

Downsizing is one of the most important factors that can either weaken or strengthen your company — both during the crisis and for years after — depending on how you do it.

Downsizing has become rampant almost overnight. Major layoffs and furloughs are nearly everywhere. Managers must develop and implement effective responses in real time, without any of the planning lead time formerly available.

Faced with rapidly diminishing resources, managers have to get started right away and move quickly. If they get this right, they will own the best customers and leave their competitors in the dust. If they get this wrong, they will face years of struggle trying to catch up.

To succeed in threading the needle, managers need to use different rules to make these decisions — rules which will enable them to be successful in the waves of economic disruption that will continue to flow throughout the economy for at least the next six to 12 months, and for the prolonged readjustment period that follows.

An Historic Challenge

Virtually without warning, many businesses today are being forced to deal with unprecedented, externally driven sales declines without nearly enough time to bring expenses into alignment with available revenues. This combination is placing survival-threatening burdens on cash flow and financial reserves.

The greatest danger in responding lies in the inability to focus reduced resources on targets that offer the greatest potential for success. Weakly focused or unfocused broad-brush responses are almost certain to fail or to produce inadequate results.

Creative new approaches are essential. What worked in the past will not work now. Three key principles provide the foundation for success:

1. Focus on your profit core.
2. Emphasize people and relationships.
3. Concentrate on practicality and rapid implementation.

1. Focus on Your Profit Core

In virtually all companies, 10%-20% of the customers, products, employees and operational activities produce 150% or more of the profits. The most important management imperative today is to focus your resources on doubling down on this core strength.

Companies that divide their customers into profit peaks (large, high-profit), profit drains (large, low-profit/loss) and profit deserts (small, low-profit), typically find that about 10%-20% of their customers are producing about 150% or more of their profits; while 10%-30% are draining 40%-50% or more of this amount; and fully 50%-80% of their customers are consuming over half of their resources while produc-

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competitive intelligence for wholesale distribution

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PERSPECTIVE ■ Commentary by Elizabeth Galentine

To Build Your Business in Any Climate, Seize on What You Can Control

I went into journalism because I love the news. I love to know what's going on but I also feel a sense of duty to document and inform others. That said, even with this lifelong internal motivation, the news these days can be too much for me. In thinking beyond the surface-level reasons why, I land on the concept of learned helplessness that comes from repeated exposure to things we cannot control. So, what can we control? How can we be empowered?

At MDM, I know we can control avoiding hackneyed phrases like "in these uncertain times" and reinforcing a narrative of powerlessness by instead lasering-in on what distributors can do now to strengthen their business and market position.

Now nine weeks into our weekly MDM Live webcasts, MDM's Tom Gale and Mike Marks of Indian River Consulting Group have spoken with nearly three dozen distributors and industry experts who are leveraging today's environment to reexamine long-term business practices and explore new ways to improve efficiency, save costs and create a truly customer-centric experience. I encourage you to view any episodes you may have missed at mdm.com/mdmlive.

If you're feeling stuck in your ways, you'll learn from distributors like Eric Dillion, VP of Operations at Dillon Supply, who, in the most recent MDM Live, explained how the industrial distributor has brought on between 200-300 new online customers in the last couple of months. The 106-year-old company has many employees — including on the sales team — who have been with the business for more than 35 years. Although used to decades of in-person interactions, they have been able to successfully pivot to virtual selling and other contactless interactions.

Dillion also noted how now can be an opportune time to tackle the talent recruitment issue that has faced the industry for years now. He recently brought on a new team member who was furloughed from another job. "Our people have been second to none in keeping our business up," he said. "It's a combination of both your current personnel but also realizing that there are good people out there now."

If you're looking for a way to calculate your company's capacity to take advantage of recruiting top talent who suddenly find themselves available, or to retain as many existing leaders in your business as possible, or to just see how long your runway is before the company may be in financial trouble, you'll find a roadmap in the series we're currently running in MDM Premium from Distribution Performance Project's Al Bates.

Get caught up with Bates' step-by-step process starting with the May 10 issue, "An Action Plan to Improve Long-Term Financial Performance," where he breaks down how to outline a financial appraisal of where your firm stands from a profit perspective. Then, read part two in this issue, "How to Calculate Your Profit Drivers and Profit Drains," to recognize and avoid key mistakes distributors make over and over again in a down economy. Part three, coming out June 10, will provide you with the tools to position your company for future strength.

MODERN DISTRIBUTION MANAGEMENT

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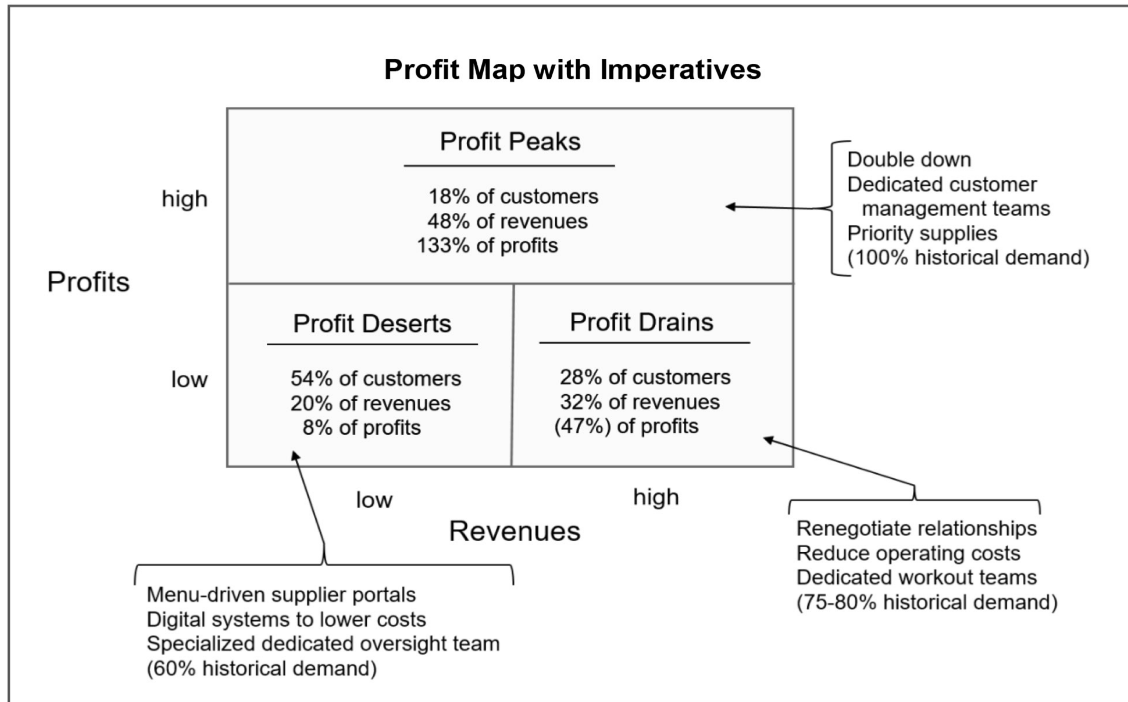
ing no profits at all.

The chart below, which we call a profit map, illustrates this profitability segmentation for a company's customers.

The same profitability segmentation characterizes your products, employees and used measures of profitability, seldom predicts net profits because operating costs are so important.

2. Emphasize People and Relationships

Crisis times require a renewed emphasis on people and relationships rather than the recent trend toward impersonal systems and related



operational activities. The most important thing you can do is to focus your resources on your profit core by locking this business into place, converting profit drains into profit peaks, and matching the cost to serve profit deserts with their profit potential. You can do this even with a reduced workforce and shrinking revenues by managing your profit core using both more powerful metrics and sharply focused efforts.

More powerful metrics are the essential starting point. To measure real profitability, you must be able to analyze your company at the fundamental business level of each individual sales transaction (i.e. invoice line). Higher-level aggregations typically available today hide vital information about cost drivers and their interrelationships.

Cost-to-serve provides a good example of where most systems do not disaggregate major cost items, and so distort the true cost and profit picture. For example, in our experience analyzing tens of billions of dollars of client revenues, we have consistently found that gross margin, which is one of the most commonly

digital transformations. Systems may be more cost effective in certain high-volume applications, but they cannot deal with the human concerns, questions and complex intercompany coordination challenges that dominate in crisis.

This can be seen clearly in three key areas: customers, suppliers, and operations and supply chain.

Customers

Effective customer management requires fundamentally different programs for profit peak customers, profit drain customers and profit desert customers.

Profit peak customers. Your objective for your profit peak customers is twofold: 1) to systematically build the efficiency of your day-to-day coordination, while 2) taking targeted steps to develop a more integrated operating relationship featuring win-win mechanisms like joint forecasting, focused vendor-managed inventory, and coordinated category management.

This requires that you deploy a set of highly skilled, dedicated multifunctional customer

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management teams comprised of managers from sales, supply chain, finance and IT, who can link with their profit-peak customer counterparts. The prime requirement is to staff the teams with skilled managers who can work together to manage change in the customer. Supporting systems are a secondary need. Here, reducing costs by downsizing the teams would be enormously counterproductive, and in fact, adding selected resources is a great investment.

Your customer management teams have both weekly and monthly tasks. They must meet weekly (by phone, Zoom, etc.) with their customer counterparts to review critical product forecasts in light of changing actual needs, work through substitutions where necessary, take measures to generate immediate cash and coordinate on other immediate concerns.

On a monthly basis, they need to join with their customer counterparts to manage near-term issues like reviewing forecasts, adapting product mix to rapidly changing supply and demand trends, ensuring that replenishment systems are working properly, and installing interim coordinative mechanisms like partial vendor-managed inventory for volatile key products.

Your relationships with your profit peak customers are where you should invest your people and resources, especially in tight times. You cannot do this everywhere, so identifying and bonding with your profit peak customers is a life or death issue.

Profit drain customers. Your objectives for profit drain customers also are two-fold: 1) to generate cash by plugging the specific problems that are causing their profit and cash drains, and 2) developing mutual operating cost reductions that increase these customers' profits and convert these large customers into profit peaks. Offering access to secure supplies of scarce products can provide a strong incentive for these customers to renegotiate their relationships with you.

Success requires that you deploy a different set of highly skilled dedicated multifunctional teams to focus on reducing the joint supplier-customer operating costs in order to reduce immediate cash drain outflows while creating a lasting profit-peak level of profitability, and lock this in with long-term contracts. Using a parallel team approach featuring weekly and monthly meetings enables you to leverage all of your relevant skill sets, especially finance and supply chain, to manage both cash and inventory.

Both profit drain and profit peak customer management teams need to establish weekly coordination meetings with their customer counterparts to address rapidly changing supply-demand mismatches and other immediate concerns.

The monthly coordination meetings with your profit drain customers, however, are very different. While near-term forecasting and related activities are important, the team should place its prime emphasis on changing the underlying problems that are causing the profit and cash drains. Here, the customer's all-in individual P&L, built from its transaction P&Ls, is the critical metric.

This metric will show exactly where the drains occur — surprisingly often in hidden but essential elements like order pattern. For example, the customer may be ordering daily rather than weekly, which is common practice in crisis situations where inventory reduction is across the board. In this case, the customer's visible inventory saving is dwarfed by the supplier's fulfillment cost (and by the customer's own hidden receiving cost). By adjusting the price a little, this destructive behavior can be reversed at relatively small cost, moving the profit drain customer into profit peak status.

The supporting systems are not particularly complex, although the analytical tools like all-in transaction-based profit mapping are all-important. The most important companion element is assembling capable teams that can form new relationships with their counterparts in the customers' organizations. Just as in the case of the profit peak customers, downsizing this group would be disastrous.

Profit desert customers. Your prime objective for profit desert customers is to reduce your operating costs and lower their priority for allocated product. This is where your downsizing should occur: it is critical to lower your cost to serve to match their profit potential by moving them to more efficient engagement modes.

These customers comprise the segment that is most amenable to systems improvements. Here, you need to understand the cost to serve for these customers to be sure that you are charging correctly for the services you offer. Price discounting should be the exception, not the rule.

Similarly, you need to use digital marketing to communicate with and manage these customers.

It is prohibitively costly to attempt to develop personal relationships with the

numerous customers in this segment. Instead, you should create a 'menu-based' set of service offerings, and enforce your rules of engagement carefully. This is where your most productive downsizing should occur.

Note, however, that a few profit desert customers are large companies for whom you are a minor supplier. You may be able to offer to fully meet their needs in return for a larger share of wallet and long-term contract. These are prime prospects to be developed into profit peaks.

For these customers, a combination of digital systems and skilled managers is essential to success. The first step is to deploy a digital marketing probe process to identify these customers, and the second step is to use a combination of digital marketing and direct sales by profit peaks customer teams to grow your relationships with them. However, the expected value of these efforts is low compared to working with your profit peak and profit drain customers, so be sure to place a strict time limit on these efforts.

Suppliers

The most effective program for transforming your suppliers is directly parallel to the one that is best for your customers.

Your profit peaks suppliers provide your most profitable products. These suppliers warrant dedicated teams of managers who are highly skilled at developing and growing productive relationships featuring both weekly coordination meetings and monthly forecasting and planning meetings (along with selected early steps to build integrated processes in supply chain management, category management, and product development). The systems required are relatively standard.

Profit drain suppliers have high enough revenues to warrant dedicated teams of managers who can partner with their supplier counterparts to reduce joint operating costs. It will likely take more work with these suppliers to maintain your supply, but it is crucial to long-term success, especially if your customers prefer these products.

This is a good opportunity to improve your relationships with your profit drain suppliers, and drive them toward profit peak behavior. Your suppliers will appreciate how well your teams work with them in these difficult times. Your supplier-specific all-in P&L will show you exactly where the profit drains are occurring and which profit-improvement actions will plug the cash and profit drains. In our experience, reducing joint operating costs is a surprisingly effective, although often hidden, profit lever.

Downsizing either of these sets of teams would be very counterproductive.

Your profit desert suppliers are the "long tail" of your supplier revenue distribution. A small team should manage these suppliers, and every effort should be used to get them on supplier portals with standard terms and low human resource requirements. You will not have the resources to directly manage the bulk of your small, low-profit suppliers. This is where you will need systems to lower your costs, and again, this is where aggressive downsizing will be most productive.

Operations and Supply Chain

Beyond your core supply chain systems (e.g. warehouse management, transportation management, inventory management), highly skilled managers are much more essential than complex systems.

In tight supply situations, it is important that you make decisions about customer product allocations in advance, and communicate them broadly. All too often, companies do this in real-time, leading to a scramble for inventory with everyone attempting to support his or her own customer priorities. This leads to the default situation: no priorities at all, and first-come first-served policies.

During crisis times, traditional supply chain decisions can no longer be made by supply chain managers alone. In product-constrained environments like today's, these decisions are strategic and must be handled at the company level by the multifunctional teams overseeing and managing the company's key segments: profit peaks, profit drains and profit deserts.

In a crisis period, key managers throughout the company have to be able to judge the nature of both supply and demand. One important component is overall market shrinkage and growth, while a second critical component is the allocation of scarce products inbound from suppliers and outbound to customers.

The second component is particularly difficult, as it requires monitoring both supplier and customer status. Your profit peak suppliers probably will give you some preference, especially if you have taken measures to reduce your joint operating costs, making you a profit peak customer to them. Looking downstream, your profit peak customers warrant full allocations of product, while your profit drain customers

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may only get 75%-80% of needs, and your profit desert customers may get a mere 60%.

In manufacturing companies, high-level inter-functional coordination is especially critical. Shortages of particular parts or components may block the production of certain sets of products. The all-important decisions on which products to produce and market requires both supply chain and marketing expertise and knowledge.

This determination requires sound judgement from managers in all functional areas working together based on their years of experience, rather than systems. Losing this capability to downsizing would be extremely problematic.

3. Concentrate on Practicality and Rapid Implementation

Profit segmentation must form the practical, critical core of your financial planning and analysis process. This starts with developing an understanding of your profit peaks, profit drains and profit deserts. It continues with creating an integrated set of programs for each segment — with each reflecting the right balance of people and systems. Finally, you need to separately and carefully monitor the performance, and risk, of each profit segment — being thoughtful about where to build your human resource capabilities, and where downsizing will provide a net benefit.

This is the wrong time to manage by using aggregate metrics and broad across-the-board corrective measures like general downsizing based on "fairness" (in which each department takes the same percent force reduction). The companies that not only survive but will lead in the post-coronavirus markets are those that use the right metrics and surgical decisions about resources to ensure that they have the cash flow and profits to capture the best customers while responding to today's rapidly changing world.

In our experience, forming dedicated teams focused on each key profit segment — profit peaks, profit drains and profit deserts — at both the upper-management planning and oversight level, and at the operational management and execution level, will ensure that you deploy your resources wisely and maximize both your company's near-term survival and its long-term profitable growth.

At the same time, it is important balance this with selectively continuing your strategic investments in areas like product development and new technology that will be critical to your success after the current crisis abates.

Managers have no choice in terms of timing since today's crisis is externally-driven. The timeframe for effective action is very short. Those who act quickly before the situation takes over and the range of options swiftly decreases will create life-preserving cash flow and harvest enormous market share gains from competitors who move too slowly to make a difference.

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

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How to Calculate Your Profit Drivers and Profit Drains

A data-backed plan from Distribution Performance Project's Al Bates

This is the second article in a three-part series for distributors to improve long-term financial performance. Part one addressed first steps to create a financial appraisal of your firm's current financial position. Part two tackles profit improvement variables and key mistakes distributors make.

By Elizabeth Galentine

As noted in part one of this series, Al Bates, principal with distribution research group Distribution Performance Project, in an exclusive MDM webcast described how to begin outlining a financial appraisal of your distribution company from a position of profit. Here, Bates continues the discussion with how to examine the company's cash position, followed by how to recognize repeated mistakes in order to avoid making them again.

Bates illustrates the example through fictional distribution company Mountain View, Inc., with a financial statement he estimates would cover up to 75% of U.S. distributors today. The distributor has $20 million in net annual sales with a 25% gross margin. (See chart below.)

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

Cash Status

To establish the company's cash position requires two ratios. First, the collection period (DSO). How many days does a typical customer take to pay? Most distributors do not look at their collections per day, but Bates says you will need this information to calculate the DSO. How much money comes in each day from past credit sales? For Mountain View, Inc., the collections per day equal $54,795 ($20 million net sales divided by 365 days in a year).

To calculate the DSO, take accounts receivable (discussed in part 1 to be $2 million for Mountain View), and divide it by $54,795 collections per day. This equals about 37 days collecting $54,795 every day until AR reaches zero. Having this number allows a distributor to calculate its collection sensitivity ratio, which is cash on hand divided by collections per day. "What I'm really asking myself is, how much slower could people pay us before we eat up the cash?," Bates explains.

With $200,000 cash on hand, divided by the collections per day total of $54,795, Mountain View will run out of cash in about 3.7 days. This represents a 10% gap (3.7 days divided by the 37-day collection period). Although 20% would be "the magic number," Bates says not to panic if your company, like the fictional Mountain View, comes in below that threshold. Other factors like line of credit and slower supplier payments can potentially help make up the gap.

Profit Improvement Variables

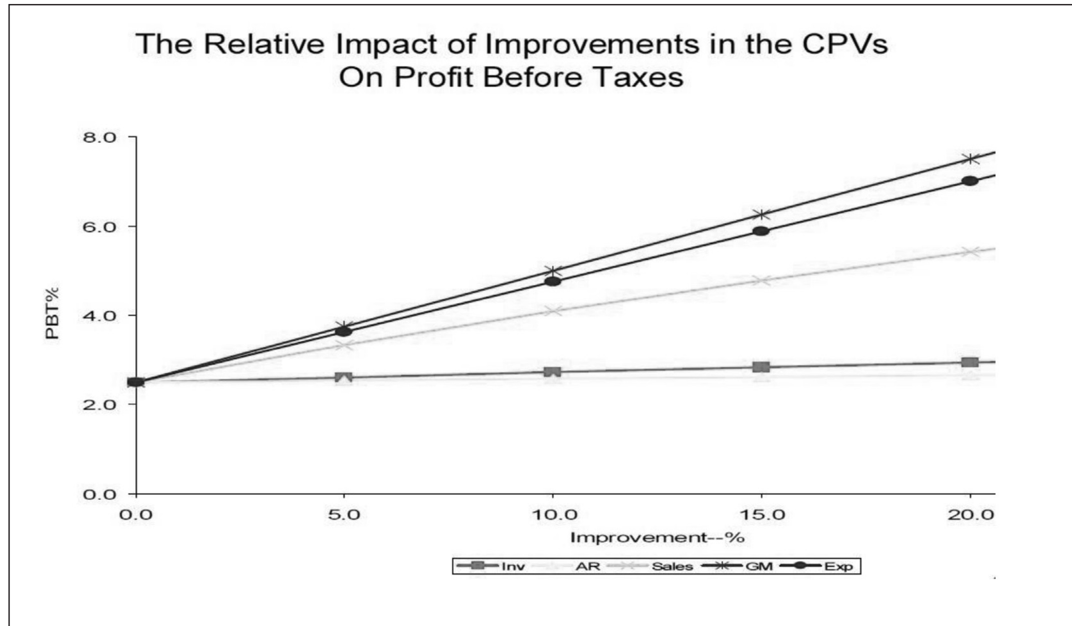
In most industries, Bates says, companies fall into three profit categories:

1) Typical: 2.5 % profit margin, with sales decline leading to break even at 12.5%

2) High profit: 5% profit margin, with sales decline leading to break even at 25%

3) Low profit: 1% profit margin, with sales decline leading to break even at 5%

Roughly the top 20% of companies fall into the high-profit category that would allow them to take a 25% hit. The goal is to reach that 20%. To start making your way (or stay) there, Bates



recommends monitoring the relative impact of improvements in critical profit variables (CPVs) on profit before taxes (PBT).

Five key CPVs to monitor are:

1) sales
2) gross margin
3) expenses
4) inventory
5) accounts receivable

Starting with inventory and accounts receivable representing the bottom two lines in the chart above, if you improve them (by reducing them), you will notice that your PBT doesn't go up at all. "Inventory and accounts receivable have a gigantic impact on cash but a very small impact on profit," Bates says. "If we have a cash problem, I can focus on inventory and AR, but if I have a profit problem, I've got to focus somewhere else."

The next line up from bottom of the chart is sales. A nice driver, but not as steep as the final two, due to variable expenses lessening their positive impact.

The line above sales is expenses. As seen on the chart, a 10% reduction (improvement) in expenses puts more money on the company's bottom line and creates a bigger PBT than does 10% more in sales. However, Bates notes, it says nothing about a corresponding impact on market share or employee motivation to cut

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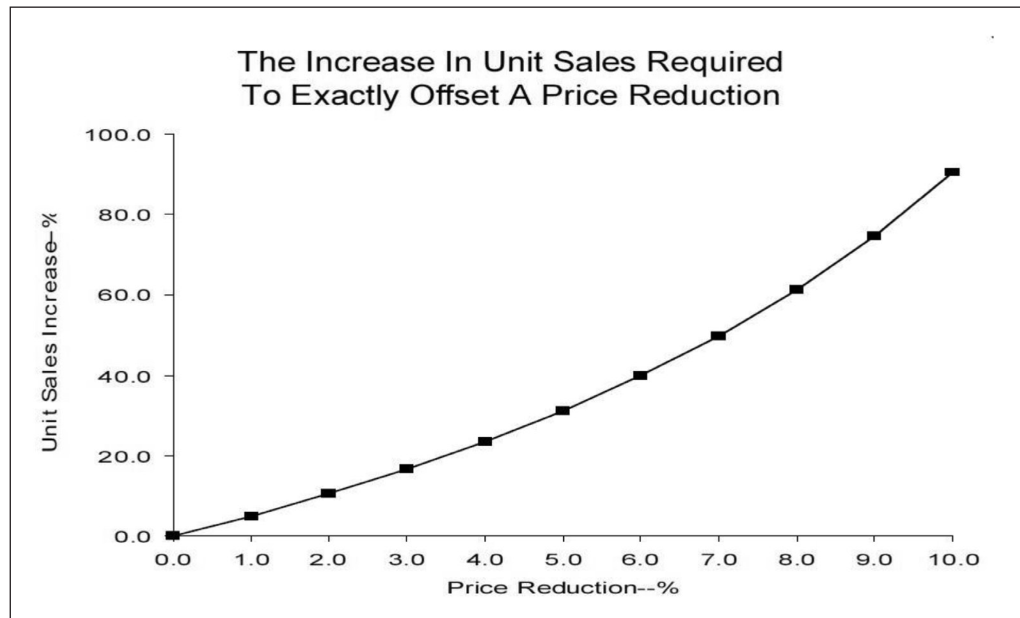

mdm Industrial & Construction Markets Update

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Orders for Manufactured Technology Goods Down 10.3% in March

New orders for manufactured goods in March, down four of the last five months, decreased $51 billion or 10.3% to $445.8 billion, according to the U.S. Census Bureau. This followed a 0.1% February decrease. Shipments, down three consecutive months, decreased $26.2 billion or 5.2% to $473.6 billion. This followed a 0.3% February decrease.

Unfilled orders, down following three consecutive monthly increases, decreased $23.6 billion or 2% to $1,134.9 billion. This followed a 0.1% February increase. The unfilled orders-to-shipments ratio was 6.57, down from 6.62 in February. Inventories, down three consecutive months, decreased $5.8 billion or 0.8% to $693.5 billion. This followed a 0.4% February decrease. The inventories-to-shipments ratio was 1.46, up from 1.40 in February.

New orders for manufactured durable goods in March, down following three consecutive monthly increases, decreased $36.6 billion or 14.7% to $212.6 billion, down from the previously published 14.4% decrease. This followed a 1.1% February increase. Transportation equipment, down two of the last three months, led the decrease, $35.9 billion or 41.3% to $50.9 billion. New orders for manufactured nondurable goods decreased $14.4 billion or 5.8% to $233.2 billion.

Shipments of manufactured durable goods in March, down eight of the last nine months, decreased $11.8 billion or 4.7% to $240.4 billion, down from the previously published 4.5% decrease. This followed a 0.8% February increase.

Distributor

3M, St. Paul, Minnesota, reported sales information for the month of April 2020. The company withdrew its full-year 2020 outlook on April 28, due to the uncertain impact of the COVID-19 pandemic and committed to provide monthly updates until it is better able to forecast future performance.

Industrial distributor **MSC Industrial Direct Co. Inc.**, Melville, New York, reported sales for the fiscal month of April (the second month of the Company's fiscal third quarter) were $235.5 million, a decrease of 10.5% compared to the same period in the prior fiscal year.

Foundation Building Materials Inc, Tustin, California, reported sales for first quarter of 2020 of $524.3 million, an increase of 1.8% compared to the prior year period; average daily net sales increased 0.2%. Profit was $14.4 million, up from $3.5 million the previous year's quarter.

RBC Bearings Inc., Oxford, Connecticut, reported sales for the 2020 fiscal fourth quarter of $185.8 million, up 2% for the quarter. Profit was $33.8 million compared to $31.4 million in the fourth quarter of 2019.

Turtle & Hughes has named Caldwell Hart as senior vice president supply chain, chief procurement officer, and a member of the executive team.

The May 11-15 **Pandemic Index from Indian River Consulting Group** shows a sales decline over the same week in 2019 of 14.9%. The sample size for the week of May 11-15 is 10 firms, which is the same as the previous week. The index shows eight weeks of double-digit average declines and five consecutive weeks with declines in the mid-teens.

Kaman Distribution Group, Bloomfield, Connecticut, has named industry veteran Mark Stoneburner as executive vice president and general manager of its Kaman Industrial Technologies (KIT) business unit.

Economic

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.

Manufacturer

Bearings manufacturer **NN Inc.**, Johnson City, Tennessee, reported first quarter sales $199.7 million, down 6.3% compared to $213.3 million for the first quarter of 2019.

Columbus McKinnon Corp., Amherst, New York, has named David J. Wilson as president and chief executive officer effective June 1.

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Profit Drains

Continued from p. 8 of the white section

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 majority 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%.

Continued on p. 4 of this section

Calculation of MDM Inflation Index for April 2020

		BLS Price Indices Apr '20	BLS Price Indices Mar '20	BLS Price Indices Apr '20	% Sales Weight	Weighted Indices Apr '20 (1)X(4)	% Change Apr '20 Mar '20	% Change Apr '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" Index		Inflation Index		% Change Apr '20 Mar '20	% Change Apr '20 Apr '19
"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

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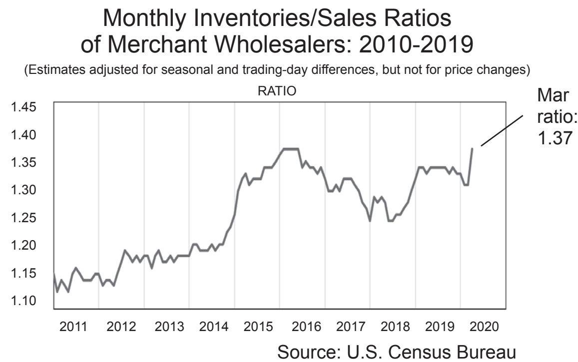
mdm competitive intelligence for wholesale distribution

March 2020 | Monthly Wholesale Trade Data

MARKETS UPDATE SUPPLEMENT P. 3

Wholesale revenues in March were $475 billion, down 5.2% over March 2019 and down 5.2% over February 2020. March sales of durable goods were down 5.5% over the previous month and down 5.9% from a year ago. Sales of nondurable goods were down 4.9% over February and down 4.6% from last March.

Inventories were $650.7 billion at the end of March, down 0.8% from the revised February level and down 2% from last year. March inventories of durable goods were up 0.5% from February and down 1.7% from a year ago. Inventories of nondurable goods were down 2.7% over February and down 2.4% from last March.



Inventories/Sales Ratio. The March inventories/sales ratio for merchant wholesalers was 1.37. The March 2019 ratio was 1.33.

Sales and Inventories Trends: March 2020

NAICS Code	Business Type	Sales $Millions	Inventory $Millions	Stock/ Sales Ratio	% Change Sales 2/20-3/20	% Change Sales 3/19-3/20	% Change Inventory 2/20-3/20	% Change Inventory 3/19-3/20
42	**U.S. Total**	**474,974**	**650,703**	**1.37**	**-5.2**	**-5.2**	**-0.8**	**-2.0**
423	**Durable**	**225,757**	**398,493**	**1.77**	**-5.5**	**-5.9**	**0.5**	**-1.7**
4231	Automotive	34,180	67,837	1.98	-14.3	-11.4	4.4	2.8
4232	Furniture & Home Furnishings	7,684	12,923	1.68	-8.8	-5.6	-1.3	-8.1
4233	Lumber & Other Construction Materials	13,012	19,515	1.50	-0.8	5.2	-1.0	0.5
4234	Prof. & Commercial Equip. & Supplies	44,868	50,457	1.12	0.5	1.0	0.9	1.5
42343	Computer Equipment & Software	24,243	15,344	0.63	10.3	6.9	-1.6	-11.0
4235	Metals & Minerals	12,533	29,983	2.39	-5.9	-18.7	-2.1	-13.1
4236	Electrical Goods	45,171	52,988	1.17	-6.2	-9.2	-1.2	-7.0
4237	Hardware, Plumbing, & Heating Equipment	13,004	27,470	2.11	-2.9	0.8	-0.3	1.9
4238	Machinery, Equipment & Supplies	35,385	106,392	3.01	-7.5	-5.7	0.7	0.9
4239	Miscellaneous Durable	19,920	30,928	1.55	0.8	-3.6	-1.3	-4.6
424	**Nondurable Goods**	**249,217**	**252,210**	**1.01**	**-4.9**	**-4.6**	**-2.7**	**-2.4**
4241	Paper & Paper Products	7,751	9,193	1.19	1.3	0.1	-1.3	-1.7
4242	Drugs	67,079	67,825	1.01	8.7	13.5	-2.3	2.7
4243	Apparel, Piece Goods & Notions	9,565	28,658	3.00	-24.3	-29.9	3.8	-2.6
4244	Groceries & Related Products	58,033	42,352	0.73	-1.4	0.8	-0.8	5.3
4245	Farm-product Raw Materials	16,047	22,265	1.39	-0.6	-1.9	-1.4	-8.7
4246	Chemicals & Allied Products	10,737	12,112	1.13	1.2	-1.2	-1.9	-9.8
4247	Petroleum & Petroleum Products	42,973	14,550	0.34	-26.1	-29.3	-29.0	-35.0
4248	Beer, Wine & Distilled Beverages	13,970	19,373	1.39	2.5	5.5	1.3	8.5
4249	Miscellaneous Nondurable Goods	23,062	35,882	1.56	2.0	5.7	0.8	1.4

U.S. Bureau of the Census, Current Business Reports, Monthly Wholesale Trade, Sales and Inventories Series: MDM compilation and analysis. Adjusted for seasonal and trading day differences. Figures for sales and inventories are preliminary adjusted estimates.

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Profit Drains
Continued from p. 2 of the this section

The Trade Off Between Cash and Profit

The second issue with regard to mistakes distributors might make is failing to understand the tradeoff between cash and profit. What does it mean to collect faster? There are eight factors to consider, using the Mountain View distributor example:

1) Collections per day = $54,795

2) Collection period goal = 36.5 days

3) Accounts receivable goal (No. 1 multiplied by No. 2) = $2 million

4) New collection period goal. Cut the AR by five days to collect five days faster. (With a gigantic assumption that the same sales volume will remain the same, Bates notes.) = 31.5 days

5) New accounts receivable goal (No. 1 multiplied by No. 4) = $1,726,027

6) Reduction in accounts receivable (No. 5 minus No. 3) = $273,973 of AR freed up and turned into cash.

7) Carrying cost (interest, handling, bad debts, etc.) = 8%

8) Profit impact (No. 6 multiplied by No. 7) = $21,918

As noted in part 1, Mountain View only had $200,000 of cash to begin with. While cutting the collection period does frees up a lot of cash, the profit is only up by just under $22,000. The distributor is making $500,000 and only improved by $22,000. But, Bates says, you have to look at the implication on the sales side.

To measure the break-even point for a sales decline, you need to take fixed expenses, $3.5 million for Mountain View (noted in part 1), and add in the profit of $500,000. Then, subtract how much profit is generated by cutting the collection period, $21,918. Divide that number by gross margin percentage, 25%, minus variable expense percentage, 5%. "We're trying to ask ourselves, how much would sales have to go down before we wipe out what we just made?," Bates says.

The formula looks like this:

$$\frac{\textbf{Fixed Expenses + Current Profit – Gain from Collections}}{\textbf{Gross Margin \% – Variable Expense \%}}$$

The answer in this example is -0.5%. What it says is, cutting the collection period five days without reducing sales at all is equivalent to five-tenths of a sales loss. Put another way, if sales go down one half of one percent, it would wipe out five days of improving the collection period. "This is your trade off and you need to understand it," Bates says.

Cash Versus Profit for Inventory Planning

The last mistake distributors tend to make in a down economy is to stop buying. "That is a kiss of death. I'm going to argue long and hard against stopping buying," Bates says.

An argument can be made to raise inventory or lessen inventory in order to drive profit. The higher your inventory, the better your fill rate, the more you can provide customer service. But at the same time, distributors who are trying to achieve financial stability cannot afford to be overstocked, Bates says.

While the fill rate or the service level is "almost impossible to measure," Bates notes it is easy to measure inventory turnover. In a down market, cash is king, so the lower inventory argument tends to win out. Still, Bates argues, "Don't stop buying."

Why? Because people buy from you because you have something they want. Whenever customers are asked in any line of trade what they want from their distributors, the responses are the same, according to Bates. In order of importance, customers will say:

- I want a great fill rate. I want you to have stuff when I need it because I actually needed it three days ago.
- I want depth of assortment. I want one-stop shopping.
- I want speed of delivery because I did forget to order it three days ago.
- I'd like you to actually send me what I ordered — order accuracy.
- And a price would be nice.

"If I stop buying, the first thing I run out of is the good stuff. Ideally, what we'd like to do is get rid of the bad stuff. There's a recession going on. Nobody's buying good stuff, much less bad stuff," Bates says. "Try to hold the line to the extent that you can on the inventory. If you can slowly get it down, that's great. But no 'stop-buying edicts.'"

In part 3, coming in the June 10 issue of Premium, Bates will address an action plan to improve long-term financial performance in order to position your company for long-term success.

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