# A PLAN TO STAY INDEPENDENT

by Joseph Sullivan

Planning the independent future of an electrical distributorship seems to require advance knowledge of where the market will go, how the economy will perform, and what the needs of the future owners will be. That's a pretty tall order in a business where this month's sales and gross profit are still a mystery on the 15th of the month. In fact, it is impossible. Fortunately, it is also untrue. Every independent distributor has the ability to take powerful steps to make the next generation of ownership and management masters of their own destinies.

photo by Doug McKay

“A job well begun is a job half done,” said Benjamin Franklin. A good beginning to the job of planning for future independence is the realization that serious thought and planning is actually needed. Many a proud distribution nameplate has gone on the sale block because its owners or executives focused too exclusively on the pressing business of the day. Many companies have been sold for disappointing prices for the same reason. The solution is to actually schedule time for planning—perhaps in manageable small blocks each month—and give that time top priority.

As discussed in the April issue’s article on this subject, planning begins with the big questions of succession, control, liquidity, and fairness. It begins there because those issues have the power to destroy companies that do everything else well.

And while planning begins there, it must not stop there. The question of who runs and controls an outmoded business is a bit irrelevant. Distributors, especially independent ones, must define themselves. They must focus on a business model or, from the customer’s point of view, a value proposition that makes money and distinguishes them in the marketplace. Independent distributors have a window of opportunity in which to define themselves—and that window is wide open.

For the most part, the post-WW2 model of full-line distribution is worn out. It was a very good model—the distribution channel built upon it was the envy of the world—but times have changed, and so must independent distributors. Everyone knows the reasons why: Big box competitors, national chains with national accounts, market saturation, and price and margin pressure—however it is viewed, the business has changed. For the independent supply house, the only effective response is to focus the business and develop a clear, specific service identity backed up by solid performance.

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The question is, how? At the risk of outraging some fine manufacturers, the answer isn’t product—after all, in the broad view, “parts is parts.” Except for the Rockwell/Allen Bradley limited distribution model, it is pretty hard for a distributor to stand out purely on the basis of a line card. Full-line depth of stock might be a competitive advantage, but only if customers want to buy all the stuff kept in stock. If they don’t, precious cash will get tied up in dead and slow-moving stock—a situation that can put a distributor on the fast track to hard times. And while service is important to the value proposition, it is possible to go broke with a high-service model if customers are not willing to pay for it.

The key concept that jumps out of the last paragraph is what customers want. Do they want depth? Do they want service? If the answers are “yes,” what do they mean by depth? What kind of service do they want? The interesting fact is that customers answer these questions every day—with their checkbooks.

Interpreting what customers want takes a bit of practice and may require some mental readjustment. Here are two big adjustments to kick things off:

1. Forget overall sales volume
2. Forget overall market share

Here’s the point: the only volume that counts is profitable volume.

What is profitable volume? For that matter, what is a profitable customer? These look like simple questions, but few distributors know the answers. Those who already have the ability to determine profitability by customer are way ahead of the game—if the approach is valid. Be very careful, though. Some of the formulae that the academics suggest can be very misleading. Likewise some software systems, with the best of intentions, offer customer profitability computations based on algorithms that really do not do the job. Whether it’s done on a spreadsheet or via a main business system, it is vital to know, in detail, exactly what computations are being done to generate the report.

To calculate customer profitability on a spreadsheet or database program, begin with gross profit by customer and subtract all identifiable variable costs. It may be possible to download various bits of the data needed in a format that can be plugged in without additional data entry.

Whatever the case, stick to specific costs—even if they must be estimated. Above all, beware of averaging of costs, and be especially worried about allocation of fixed overhead. Occupancy costs, electricity, overall telephone service, center office charges, vehicle leases, etc., should not be deducted. Tip: Direct contribution analysis based on variable costs and reasonable assignment of certain fixed personnel costs (like inside sales) is almost always more meaningful than profitability analysis based on full allocation.

When the calculations are done and a list has been generated, rank customers according to profitability. Put the most profitable customers at the top of the list. Look hard at the top 20% to 30%—the prime customers. Focus on them. Build a value proposition around them. Who are they? How do they do business? What kinds of service do they prefer? What inventory is required to meet their needs with a high level of service? What can be done to better understand their needs?

The next step is to find more customers like them. The most effective method is to buy information from DUNS or one of the other business data providers. The cost can be anywhere from a few cents to as much as a dollar or so per name depending on how much detail is desired, so count on spending about $.25 per name.

With the list in hand, pre-qualify the credit of the ones who look the best and send the sales force out to find those who have been determined to be the best.

There are lots of other sales management techniques, some quite powerful, that are facilitated by the development of a list like this. For example, sales potential can be estimated by customer: Rank current customers and prospects in order of potential and allocate sales calls on the basis of potential.

So, there are three steps to developing a unique market identity around a targeted value proposition. They are:

1. Identify the customers on which good money is made.

2. Profile these customers as to service needs, inventory needs, and preferred ways of doing business.

3. Orient business toward them, and find more like them.

Doing these three things allows customers to define what full-service, full-line means to them. This can greatly enhance a company's competitive position—and likely lower the line items of inventory carried, therefore reducing the need for working capital. All of this equals a company that is stronger, more adaptable, and a formidable competitor for many years to come. ■■■

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## A few things that should or should not be figured into customer profitability:

| ALLOCATE THESE ITEMS | DO NOT ALLOCATE THESE ITEMS |
|---|---|
| Salesperson's time | Occupancy |
| Inside sales' time | Utilities |
| Delivery mileage and other specific delivery costs | Non-specific telephone |
| Interest on customer-specific inventory stocked | Corporate or general overhead |
| Interest on slow accounts receivable | Non-specific interest |
| Returns | |
| Entertainment | |

*NOTE: This is not a complete list*