Street Smart Distribution Business Skills Series

Distribution Self-Study Program

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Clicking on a chapter title will open that chapter. The same is true for each chapter quiz. You will also find links at the end of each chapter.

How to use the self study program

The information is presented in sections each of which is followed by a set of quiz questions. We recommend that you read the sections in the order they are presented. Some chapters refer to earlier information in the presentation of ideas and concepts. Without the earlier references, some of the ideas and information may be more difficult to understand.

Throughout the chapters, we've tried to emphasize key information with bold type. We also recommend that you make notes on material you find interesting or less easy to understand. That will make it easier to review in preparation for the final exam at the end of this guide.

As you finish a chapter, try to answer the quiz questions, immediately. Your success at answering the questions will provide a measure of your understanding of the material contained in the chapter. If you are unable to answer more than a question or two, re-read the chapter with special attention to the bold face type.

Since there is a great deal of information contained here, try to break your study time into several sessions. A chapter or two at a time well studied will be better than attempting to master all of the ideas and information in one session.

1-What is distribution?

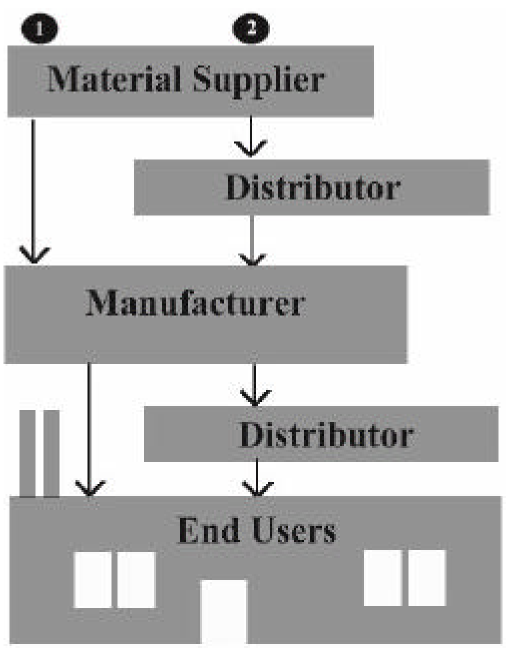
This chapter provides an introduction to distribution for those new to the industry while serving as a refresher on the basic functions for those who are more experienced.

Distribution is the function of **moving products from producer to user.** Many people think of distribution only in connection with finished goods being channeled from manufacturer to end user. However, products being distributed could be raw materials or feed stocks going to a processor or manufacturer such as coils of wire to a manufacturing plant. They might also be component parts, such as fasteners made from the wire, which are used by another manufacturer as part of the final assembly of a product.

The distribution function takes place through a variety of routes or channels. Some channels are short and somewhat direct, while others are longer with several intermediate steps. **Intermediaries in the channels provide services and usually make the movement of goods more efficient.** They satisfy the needs of manufacturers and customers better than if a direct connection were made.

Intermediaries differ from one another by the services they offer and whether or not they take title to goods as they move through the channel. **Brokers are a type of intermediary who arrange the sale of goods** to a customer by a manufacturer without actually owning them. Typically the broker arranges for the sale of large lots of goods.

A distributor, on the other hand, usually does take title and owns the goods. A distributor will also be more likely to deal in smaller lots than a broker.



The appropriate channel is the one which offers the most efficient movement of goods from the originator to the end user. Fig. 1-1 shows a simplified diagram of alternate distribution paths. The most direct (1) shows raw materials moving directly to the manufacturer and from there to end users as finished products. The other path (2) shows intermediaries through which products move when the most direct path is undesirable or less efficient. For instance, if the order quantities or lead times make direct sales uneconomical for either the seller or buyer, a distributor serves as the most efficient channel.

Channels of distribution exist largely because of the value they add to products as those products move to the end user. For example, stockpiled coils of wire at the mill offer a somewhat low level of value unless they reach a producer and become finished fastener products. In the same way, fasteners acquire greater value as part of a product assembly than they have as inventory at the fastener company. Distribution helps increase product value by continually moving goods along on their journey to higher levels of satisfaction as they get closer to their ultimate value that is typically with the end user.

Distributors, in one form or another, have played a role in moving goods throughout history. However, the type of distributor organization we are most familiar with came about with the industrial revolution and the rise of manufacturing.

As manufacturers developed new techniques for producing goods, intermediaries came into existence to help move those goods from the manufacturer to the user. They served as a vital link in a world where the mail was the basic form of communication, and where transportation was nowhere near as fast and reliable as today. They were an essential service for customers who were often widely scattered.

Industrial distributors have evolved, as the years passed, from generalists who had some of everything under one roof to those who **focus on a single marketplace.** They have specialized in such areas as power transmission; fasteners; fluid power; specialty tool; heavy-duty truck parts; or the automotive aftermarket.

Distribution is big business. In a recent year, wholesale distributors represented nearly one and one-half trillion dollars in sales. **Distributors accounted for the majority of the total wholesale trade** as compared to agents, brokers and direct sales from manufacturers. That business is spread among a reported 28,000 distributors in the United States.

Wholesale distribution continues to be a force in the economy. While it lagged behind the Gross Domestic Product (GDP) in the 1987-90 years, it's projected to show equal growth in the 1992-95 period. **Distribution is projected to continue the same growth trend between now and the end of the century.**

Why is that? Manufacturers choose to market through distributors for a variety of reasons (Fig. 1-2). An important one is that **selling direct to end users means a substantial increase in people and facilities** to equal the coverage. It also means the **loss of local market knowledge and familiarity.** Without distributors, the manufacturer must try to replace some **extensive networks of personal relationships that exist between many distributors and customers.** Distributors offer **flexibility, fast response to customer needs and consistency of service**, all of which is harder to provide without a local distributor presence.

If manufacturers didn't use distributors they would:
1) Need increased people & facilities
2) Lose local market knowledge
3) Lose customer contact
4) Lose flexibility & fast response

Fig. 1-2

Distributors play a vital role in the U.S. economy. They often serve as a "one-stop shopping" source for customers. They add efficiency and value-added services to help customers increase their competitive advantage.

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CHAPTER 1 QUIZ

1) True or False? Distribution is only used for the movement of goods from manufacturers to end users.

2) True or False? A distribution channel is chosen for its service level and efficiency.

3) True or False? "Intermediaries" is the term used for distributors and brokers.

4) True or False? Today's distributors are likely to focus on a single marketplace rather than having something for everyone.

5) If the channel of distribution is chosen carefully, the goods that flow through it will:
   A) Retain the same value
   B) Lose value
   C) Gain value

6) True or False? Wholesale distribution is an insignificant portion of the Gross Domestic Product (GDP).

7) True or False? One reason that distributors came into being was that they served a population that was widely scattered.

8) True or False? A distributor usually takes title to merchandise.

9) True or False? Customers often find distributors are a good source of product information and solutions to problems.

10) True or False? Distributors account for a tiny fraction of total wholesale trade.

11) True or False? Manufacturer direct sales are always the most efficient and cost-effective approach.

12) True or False? "One-stop shopping" is a prime reason that many customers elect to buy from distributors.

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2-How Distributors Work

In this chapter you will learn how distributors function and some of the trends in distributor operations.

Distributors satisfy a number of needs. Even if distributors were eliminated, those needs would still exist and would have to be satisfied. Without distributors, producers would likely face the need to fill the distribution function and **incur substantially higher costs.** Buyers would also find it **more difficult to get the goods they needed**, when and where they were needed. **Acquisition costs would be substantially higher**, as well.

Distributors exist because they solve problems that occur in marketing products. Problems such as distance between producer and buyer. In a country the size of the U.S. or Canada, it's unlikely that the source of goods is close to all the buyers of those goods. **Distance is an impediment to easy, convenient transfer between the two parties.** Distributors satisfy a need by having goods close by.

Another factor is the need to have the right products on hand. Buyers often have very different needs from manufacturers as well as **different needs from each other.** Buyers' needs vary from one location to another.

This leads to "discrepancies" in supply that need to be solved.

For instance, there are so called **quantity discrepancies.** Manufacturers want to make large numbers of units to take advantage of the economies that come from longer production runs. Buyers though, may need only a few pieces of a particular product.

Assortment discrepancies exist because different buyers need a dissimilar mix of products. Often they require goods from a variety of producers to satisfy their needs.

The role that a distributor plays, in the first instance, is to provide **time and place utility.**

Some manufacturers require long lead times in order to process orders and manufacture product. Distributors keep goods that customers need on-hand and accessible instantly. That availability very often makes the distributor a backup for or an extension of the customer's own inventory system. In breakdown emergencies and other unplanned repairs or maintenance, distributors are an invaluable resource for supplying products that minimize downtime. Taken together that provides **time utility.**

Typically distributors are located in areas where customers and potential customers are concentrated. That usually means the distributor is more conveniently located than the producer, so transfer of goods is facilitated. Being closer to customers provides **place utility.**

Time and place utility is not the only characteristic that provides an advantage for customers.

Another key function is **“breaking” lots.** This provides solutions to the quantity discrepancies mentioned above. In this function, the distributor takes in a large quantity of product–a "lot"–and supplies it to customers in smaller quantities, or "lots." The size of the distributor's purchase satisfies the producer's need for the efficiency and economies which are available when they manufacture and ship in sufficiently large quantities.

Access by customers to smaller lots of the same product satisfies their need to receive quantities that more closely match their rate of consumption, reduces the need for inventory storage space, and reduces inventory investment.

Similarly, distributors play another role in solving assortment discrepancies. They **"aggregate supply."**

Customers seldom require such a short range of products that they are available from a single producer. Typically, they have need for the output of many different ones. Communicating with each individual supplier would require a large number of transactions--a costly, time-consuming process.

Distributors arrange transactions with manufacturers that brings together, under one roof, a large number of products from a variety of producers. They bring them together or "aggregate" them for the benefit of their customers. Then, customers can place one order and avoid multiple transactions with a large number of suppliers. This **"one-stop shopping"** opportunity is a key advantage offered by distributors.

Distributors also perform other related functions within the marketing system. They take on a portion of the marketing responsibility at the local level not easily or economically done by manufacturers. These are often services that add value either by supporting customers, manufacturers, or both.

Distributor employees contact customers with greater frequency than manufacturers. They may be the only contact and are in a position to perform a number of vital communications tasks (Fig. 2-1).

Distributors provide services to customers & manufacturers
1) Have frequent customer contact
2) Distribute new product information
3) Provide training
4) Solve problems
5) Stay tuned to local market
6) Contribute new product ideas

Fig. 2-1

For one, **they bring new product or product improvement news** directly to interested parties within customer organizations. That action supports advertising and other promotional activities by producers.

Another is to **provide training to users** for products available through the distributor. This function adds value to the product because the efficiency gained through training can help make customers more competitive in their markets and their operations more profitable.

More often, today, **distributors are looked to for solutions to problems.** As more and more advanced products come into the market, customers expect distributors to become well versed in the customer's operations and help find better, more efficient approaches to product function, maintenance and repairs.

Distributors are able to **keep abreast of local market conditions and competitive developments** that could impact a product or an entire line. Distributors can be the **source of new product ideas by passing along the needs they encounter among customers.** Because of their involvement at the local level, they furnish manufacturers with information faster and in greater detail than virtually any other source.

The function of the distributor will continue to be important if the focus on time and place utility, lot breaking, aggregating supply, training and problem solving are focused upon meeting the needs of customers. **If customers believe that they or the manufacturers can perform these services more effectively and at lower cost, the business will flow to a new channel.**

Similarly, **customers will continue to buy and will buy more if they are convinced that the distributor has demonstrated the ability to perform value adding services more efficiently than other channels.** Distributors must also make customers more competitive and lower customers' ownership costs. Customers also must receive services they are not receiving anywhere else.

There are three key performance points on which customers judge distributors. They are also the factors that must be kept in mind when attempting to maximize business:

Reliability–does the distributor come through, consistently?
Timeliness–are the goods there when the customer needs them?
Accuracy–is it the right product in the right quantity?

There are many influences that will shape the future for distributors. For instance, the **Just In Time (JIT) delivery concept has changed the way many companies view their inventory needs.** They rely much more heavily on a dependable supply line instead of maintaining large inventories. That means a close partnership with suppliers who have little or no margin for error in their operations in these new relationships.

How will successful distributors respond to these challenges? There are several keys to success:

One is a move toward **more and better planning.** Simply assembling the information for planning can be a source of valuable insights. The process helps everyone to focus on the key issues like competition, market shifts, customer needs and other critical issues.

A plan provides the framework for decision-making. It also makes it easier to perform consistently and move the business in the right direction.

Another key move is to **strategically implement technology that helps increase efficiency and productivity for both distributors and customers.** Technologies such as **Electronic Data Interchange (EDI), bar coding and scanning, online order entry and others, will become more and more common in successful distribution companies.** This technology will enable them to create closer ties with customers, many of whom are also implementing the same new technologies.

TQM (Total Quality Management) is another avenue but only if **achieving ever-better quality levels is done in areas that are of value to customers.** Some examples of valuable quality initiatives are those such as raising order fill rates, eliminating mistakes and anticipating customer wants and needs.

Along the same lines is the implementation of a **"Best Practices"** approach to business. The "Best Practices" approach is a process of **identifying and making certain that all of a distributor's business activities serve a useful purpose and are aligned with the customer's needs.** It involves an honest appraisal of all activities to identify any that may be taking place but are inefficient, unproductive or non-value adding. To be effective, the process often includes comparing the company's activities with other businesses to learn from those who are doing a particular function better (Fig. 2-2).

Keys to success for distribution companies
1) Strategic planning
2) Use of technology
3) TQM
4) Best practices approach

Fig. 2-2

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CHAPTER 2 QUIZ

1) True or False? If distributors were eliminated, buyers would find it easier and less expensive to acquire products.

2) Quantity discrepancies exist when:
A) Orders are not filled completely
B) Cartons contain too much product
C) Manufacturers want to sell in larger lots than customers want to buy

3) True or False? Time and place utility is easier for manufacturers to provide than distributors.

4) Breaking lots means:
A) Product is too fragile
B) Breaking down large shipments for sale to customers in smaller quantities
C) Manufacturers sell only to small customers

5) Distributors aggregate supply by:
A) Selling in small quantities
B) Packing products together for shipment
C) Bringing together product from many manufacturers

6) Which of the following is not a cause of assortment discrepancies:
A) The wrong products are packed for delivery
B) Buyers require a variety of products
C) Buyers need products from various manufacturers

7) Three of the basic factors on which customers judge distributors are reliability, timeliness and:
A) Friendliness
B) Accuracy
C) Civic mindedness

8) True or False? Planning is an activity which is only to be undertaken if something goes terribly wrong with the business.

9) True or False? A "Best Practices" approach to business is a process of identifying and making certain that all of a distributor's business activities serve a useful purpose and are aligned with customer needs.

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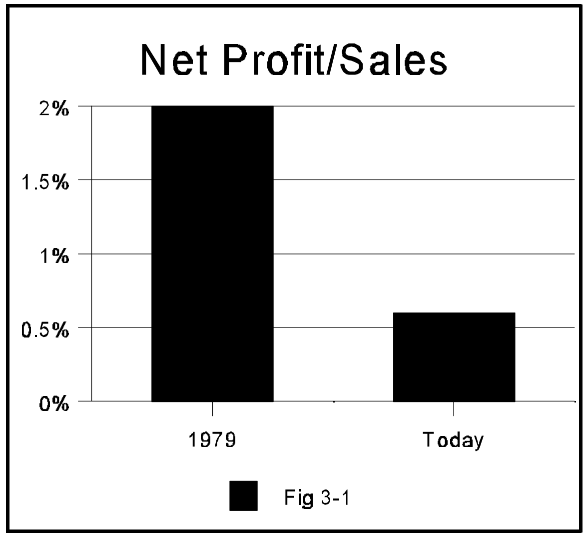
3-Distributor Economics

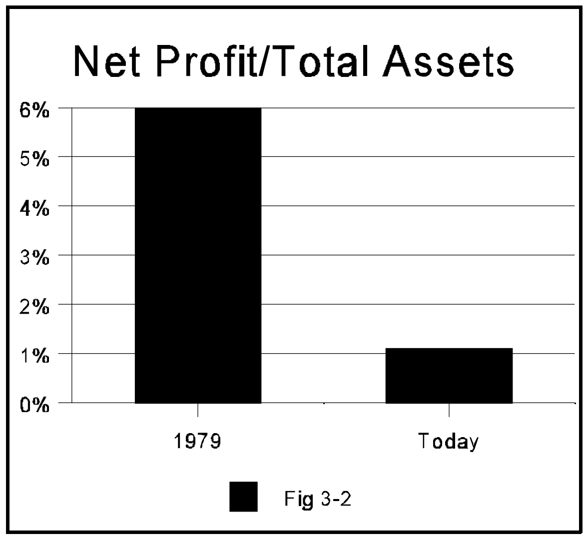
This is one of the most important chapters. It provides an understanding of Markup, Margins and the importance of inventory turnover to the economic health of a distribution business.

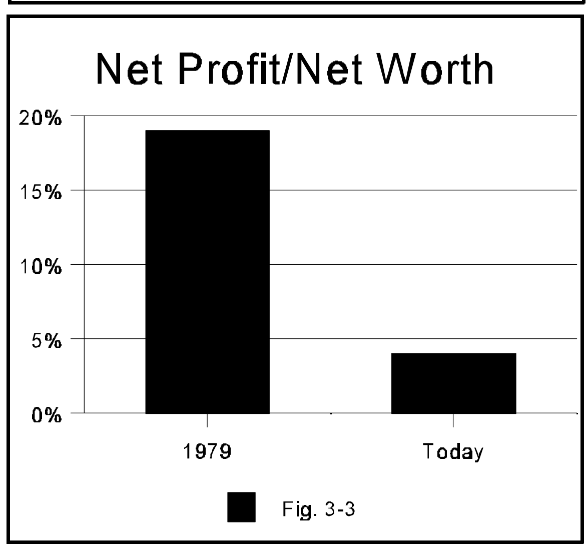
At the heart of every business is a set of economic realities which must be recognized and understood. The distribution business is no exception.

The phrase "bottom line" is commonly used to indicate **Net Profit,** the end result of business operations over some period of time, usually a year. It represents what's left over after everything else is paid.

During the '80s and '90s, distribution companies have seen a steady erosion of Net Profit. That fact is a key indicator of the competitive nature of the marketplace and a clear call for action to improve efficiency and productivity throughout the operation. It also serves as a benchmark for improvement.







There are several ways to compare the Net Profit to other values in a business:

Net Profit/Sales–This ratio compares Net Profit with the total sales of the company. In the late '70s, for instance, Net Profit was just over 2% of sales, compared with slightly over a half of one percent in the '90s–a decline of nearly 74%. (Fig. 3-1).

Net Profit/Total Assets–Total assets represent the value invested in all the assets used to generate sales. Assets can be inventory, delivery trucks, buildings, etc. The percentage of Total Assets that Net Profit represents has dropped to just over 1 % in the '90s from over 6.5% in the late seventies (Fig. 3-2).

Net Profit/Net Worth–The Net Worth of a business is the value that is left if liabilities (everything owed such as bank loans, taxes, mortgages, etc.) are subtracted from the value of the assets. The percentage of Net Worth represented by the Net Profit also dropped significantly from over 19% to just over 4% when the '90s are compared to the late '70s (Fig. 3-3).

While there were many reasons for these developments, not the least of them was the operating climate that distributors found themselves in prior to World War II. After the war and **until the '80s, the economy was, with few exceptions, friendly toward businesses**. There were up and down cycles, but for most businesses, it was a period of relative stability and growth.

Financial controls were mostly a matter of making certain that income levels remained healthy and showed steady growth. In general, if the financial factors fell out of balance, there was time to adjust and recover. Generating greater sales volume and raising prices were the primary means of generating better financial results.

Today all that has changed.

Distributors are competing in a mature marketplace against extremely heavier competition. Both traditional competitors and alternative channels of distribution are stronger. The economy still has its ups and downs, but it is less and less predictable. The old ways just won't work in today's environment.

One other factor has significantly changed over the years as well. Today **everyone in a distributor organization has a direct, noticeable impact on the economic health of the company.** Every action taken (or not taken) to minimize cost or increase profitable sales makes a difference.

The first step to having a positive impact is to understand some basic financial concepts. These principles are basic to many businesses and especially to distributors.

The first is **Profit.** Simply defined, it is the dollar amount left over from the selling price after costs are deducted (Fig. 3-4). But to really understand profitability, you have to look much closer.

Sale Price
- Costs

= Profit

($10 - $9.50 = 50¢ profit)

Fig. 3-4

Gross Profit is a way of measuring the return on a sales transaction. **It's determined by subtracting the cost of a product from the selling price.** Gross Profit is a fundamental concept to understand because it's used in two other important calculations (Fig. 3-5).

Sale price
- Product cost

= Gross Profit $

($150 - $100 = $50 Gross Profit)

Fig. 3-5

One is **Mark-up.** Mark-up is a way of comparing Gross Profit to the Net Cost of the product (Fig. 3-6). Net Cost includes freight and other factors in addition to the actual cost of product. It's expressed as a percentage of the Net Cost and is **determined by dividing the Gross Profit by the Net Cost.** Generally, the higher the Mark-up the better, since it reflects a more favorable spread between selling piece and cost.

$$\frac{\textbf{Gross Profit}}{\textbf{Net Cost}} = \textbf{Mark-Up}$$

($50 / $100 = 50% GPM)

Fig. 3-6

The Mark-up concept can be used **to set prices** as well as compare them with Net Cost. To set a price using a particular Mark-up percentage simply **multiply the Net Cost by the Mark-up percentage and add the resulting dollar amount to the Net Cost.**

Gross Profit Margin is a comparison of Gross Profit dollars to Gross Sales dollars expressed as a percentage (Fig. 3-7). It can be compared easily to Cost of Goods, Operating Expenses, etc. when expressed as percentages of Gross Sales. **GPM is calculated by dividing Gross Profit dollars by Gross Sales dollars.**

$$\frac{\textbf{Gross Profit}}{\textbf{Gross Sales}} = \textbf{GPM}$$

(\$50 / \$150 = 33.3% GPM)

Fig. 3-7

It's important to note here that **Mark-up is not the same as Gross Profit Margin** although both are expressed as a percentage and use Gross Profit as part of the calculation. An easy distinction is that Mark-up calculations use Net Cost dollars while Gross Margin calculations use Gross Sale dollars.

Setting prices using a consistent **Gross Margin** percent may also be desirable. To do that, simply **divide the cost by 100 % minus the desired Gross Profit percentage.** For instance, the formula on the right shows the process for setting a price on a \$100 cost item which will yield a 33.3 % GPM (Fig. 3-8).

$$\frac{\textbf{Cost}}{\textbf{100\% - GPM\%}} = \textbf{Sell Price}$$

(\$100 / 100% - 33.3% [66.7%] = \$149.93)

Fig. 3-8

The relationship between Mark-up and Gross Profit Margin can be expressed on a chart (Fig. 3-9) to make pricing and analysis easier. **To determine an approximate Mark-up percent, divide the Gross Profit Margin by 1 minus the Mark-up percent and round off to the nearest whole percent.** For example, to arrive at a Mark-up percent that yields a 33.3% Gross Margin, divide 33.3% (.333) by 1 minus 33.3% (.667) and round to the nearest whole percent (.333 divided by .667= 50%).

GPM/Mark-Up Chart

For A GPM of:	Use a Mark-Up Percentage of:
95	**1900**
90	**900**
85	**567**
80	**400**
75	**300**
70	**233**
65	**186**
60	**150**
55	**122**
50	**100**
45	**82**
40	**67**
35	**54**
33	**50**
30	**43**
25	**33**
20	**25**
15	**18**

Fig. 3-9

With a chart of your own, you can quickly convert Gross Profit Margin to Mark-up without the need for extensive calculations. That makes setting prices to generate a particular Gross Margin easier and faster.

Since **inventory is likely to be one of the largest, if not the largest investment a distributor makes,** careful attention should be paid to monitoring that part of the business. There are some **measures which help analyze how well the inventory is "working" hard enough and if the investment is providing an adequate return** on the inventory investment.

A key measure is the number of times a year the inventory **"turns over ".** The **inventory turns are calculated by dividing the Cost of Goods Sold for the year by the inventory value at cost.** That provides a number which represents the inventory **"turns"** for that year (Fig. 3-10). The higher the number (up to a point) the better since that indicates that stock is not simply sitting on the shelf but is coming in and being moved out to customers at a healthy pace.

$$\frac{\textbf{Cost of Goods}}{\textbf{Inventory Value}} = \textbf{Turns}$$

($500,000 / $125,000 = 4 Turns)

Fig. 3-10

Another is the **Gross Margin Return On Inventory or GMROI.** This calculation provides a measure of the Gross Profit earned in a year for each dollar of inventory investment (Fig. 3-11). **GMROI is calculated by dividing the total Gross Profit dollars by the total inventory dollars.**

$$\frac{\textbf{Gross Profit \$}}{\textbf{Inventory \$}} = \textbf{GMROI}$$

($155,000 / $125,000 = 1.24 GMROI)

Fig. 3-11

Although there is no "right" number, **any GMROI result of 1.2 or less indicates an unhealthy return on money invested** in inventory. Low GMROI numbers can be compared to keeping your savings in a bank which pays little or no interest. It's really a poor investment.

Low GMROI can be an indication that Gross Profit dollars have been lost–because of under-pricing, for instance. It could also mean that the **inventory is too large when compared to sales,** even with healthy Gross Profit margins.

Another measure is the **Earn & Turn (E&T) index.** The E&T index is calculated by multiplying the average Gross Profit Margin (GPM) by the number of inventory turns in a year (Fig. 3-12).

Gross Profit Margin
x Inventory Turns

= E&T Index

(30% x 4 = 1.2 E&T Index)

Fig. 3-12

This measure combines the Gross Profit Margin performance with the inventory turns to present **a picture of how well the inventory has been used to generate profits.** Although opinions differ on what an acceptable E&T number is, most agree that the further below 100 it is, the less healthy the situation. **A low number could mean for example that the Gross Profit percentage is low because of under-pricing. The reverse could also be true–that the inventory was moving too slowly to be healthy. Or both could be true.** In any case the E&T index should be a valuable measurement of performance.

One of the most basic reports in any business is the **Profit & Loss (P&L) or Income Statement. The P&L shows the results of business operations over a period of time.** Typically the reporting periods are month, a quarter or a year. A P&L can be very detailed–broken down to show every segment of income and every type of expense incurred over the period–with hundreds of lines or more. Or it could be as simple as five lines. The intent is the same: to show the relationship between income and expenses and whether there was a profit or loss for the period.

A simple P&L (Fig. 3-13) has a line for **Sales**, the "top line". The next line, **Cost of Goods** represents the cost of the products sold, and is subtracted from the Sales number. The result is shown on the **Gross Profit** line.

The next line is **Operating Expenses** which represents salaries, rent, insurance, delivery costs, etc. **Some say that the expenses are the key determining factor for company profitability.** The result of subtracting Expenses from Gross Profit is shown on the following Net Profit (or Loss) Before Taxes also known as the **Operating Profit** line. This is the amount on which the company will pay taxes. The amount of taxes paid or estimated is entered on the Taxes line and subtracted from the line above.

Sales
– Cost of Goods
= Gross Profit
– Operating Expenses
= Operating Profit
– Taxes
= Net Profit

Fig. 3-13

The last line is the **Net Profit After Taxes** often referred to as **the famous "Bottom Line".** This is the amount left for repayment of loans, reinvestment in the business, dividends to stockholders, etc.

This example (Fig. 3-14) shows a simplified distributor P&L. For this example we're using just Pre-tax Profit or Operating Profit. The sales and costs combine to yield a $20,000 Profit at the bottom. The percentages show the proportion of sales which each of the lines represents. This is an analysis tool for comparing the line items within the same statement and from one statement to the next.

Sales	**$500,000**	**100%**
– Cost of Goods	**335,000**	**67%**
= Gross Profit	**165,000**	**33%**
– Op. Expenses	**145,000**	**29%**
= Operating Profit	**$20,000**	**4%**

Fig. 3-14

As you can see, the Cost of Sales takes a large portion of the Sales amount. **The Gross Profit amount is what's left to pay all the rest of the expenses and a profit.**

The Expenses take a large portion of the Gross Profit. With large amounts already gone, **Operating Profit represents a relatively small proportion of Sales.**

This example (Fig. 3-15) shows greater Sales at the top. The Operating Profit, however, is less than on the first example. By comparing the percentages from the earlier P&L with this one, it's apparent that **the Operating Expenses, as a proportion of Sales, have gone up significantly.** This indicates that closer attention must be paid to controlling the expenses because the increased Sales have not only yielded no profit, but have cost the bottom line.

Sales	**$600,000**	**100%**
– Cost of Goods	**402,000**	**67%**
= Gross Profit	**198,000**	**33%**
– Op. Expenses	**180,000**	**30%**
= Operating Profit	**$18,000**	**3%**

Fig. 3-15

A much better result is shown m the third example (Fig. 3-16). The increase in Sales is enhanced by a two percent decrease in Operating Expenses. **That allows the bottom line to grow and become much more rewarding than if the proportions had remained constant.**

Sales	**$600,000**	**100%**
– Cost of Goods	**402,000**	**67%**
= Gross Profit	**198,000**	**33%**
– Op. Expenses	**168,000**	**28%**
= Operating Profit	**$30,000**	**5%**

Fig. 3-16

CHAPTER 3 QUIZ

1) The phrase "Bottom Line" refers to:
   A) Net Profit
   B) Sales minus product cost
   C) Expenses minus net profit

2) True or False? Generally speaking, since 1980 distributors have been seeing greater Net Profits each year.

3) Gross Profit is determined by:
   A) Subtracting expenses and product cost from sales
   B) Adding expenses and product cost
   C) Subtracting product costs from Sales

4) True or False? Inventory is not a significant investment for most distributors.

5) An unhealthy GMROI is anything below:
   A) 8.5
   B) 1.2
   C) 3.7

6) The Earn & Turn Index provides a key indication of:
   A) The Net Profit level
   B) How well inventory has been used to generate profit
   C) The ability of a company to rotate inventory

7) True or False? Keeping expenses under control is a key to maximizing profitability.

8) True or False? Operating Profit is the profit before taxes are subtracted.

9) True or False? Mark-up is determined by dividing Gross Profit by Net Cost.

10) If prices remain the same, which statement below is not true:
   A) Profit dollars will likely increase if Sales go up, Cost of Goods remains the same and Expenses remain constant.
   B) If Sales stay constant, Cost of Goods stays constant and expenses drop, Profit dollars will most likely increase.
   C) If Sales stay constant, Cost of Goods stays constant and Expenses remain unchanged, Profit dollars will increase.

☞ **Answer key** ☞ **Table of Contents** ☞ **Next Chapter**

4-Setting Prices for Profit

This chapter addresses setting prices that generate maximum return from each transaction. The information includes an approach that emphasizes adding value as a way to de-emphasize price as the determining factor for customers.

Smart pricing is really a matter of getting into the right frame of mind. It may even mean changing the way you look at serving customers. It requires becoming a resource for your customers, helping advance their success and adding to their competitive advantage.

Smart pricing isn't easy. It's tough and it takes substantial effort. But, when you put in the effort, the rewards can also be substantial. How do you know when you are successful in your smart pricing efforts? You'll know it's working when you get maximum value from every transaction–and your customers are convinced that they are, too!

"Smart" pricing could be deemed as setting a price for your products that covers the cost of the product as well as a proportionate share of the expenses of the business. It also means prices that have enough left over after expenses to provide a reasonable return on the money invested in the company (Fig. 4-1). Smart pricing also gets the order.

Cost of Goods
+ Expenses
+ Profit

= A Smart Price

Fig. 4-1

In competitive markets, getting the order too often outweighs everything else in setting prices. A review of the economics of a sale shows why that can be an unhealthy and even dangerous approach to pricing.

Out of each sales dollar (Fig. 4-2), a large proportion is needed to cover the **Product Cost.** The remainder, the **Gross Profit,** although it may seem substantial, must be used to cover all the rest of the expenses of running the business. Things such as salaries, benefits, rent, supplies, equipment, training, taxes, environmental costs, and on and on. **All of the expenses must be deducted from the Gross Profit.**

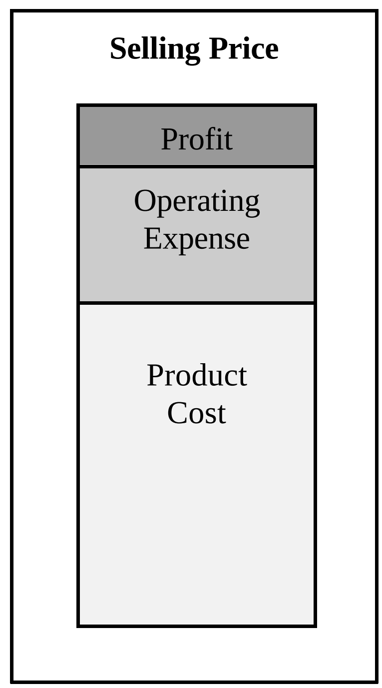


Fig. 4-2

The amount remaining (if there is one) is the **Net Profit** on that dollar of sales. **Net Profit** is the only source for debt repayment, reinvestment to expand the business and return on the money already invested in the company by the owners and shareholders.

If the sale price is set too low, there win not be enough Gross Profit to pay expenses, to say nothing of a Net Profit. If that's the case, anything not paid for will have to be paid out of the return on other transactions (Fig. 4-3, next page).

Consistently low Gross Profits will eventually hurt any business. Expenses will have to be cut in order to bring them into line with the money available to pay them. **If the Net Profit is too low or non-existent, the operation might even be judged a bad risk and closed.**

Fig. 4-3

Prices must be set to generate a return large enough to cover all the costs and expenses while providing a net profit which delivers a reasonable return on investment.

There are three key pricing factors that are like the pillars which support a building. One pillar alone won't support a building. In the same way, all three factors play a role in determining prices.

First is cost. In a very real way, the **cost of a product together with the expenses of running the business determine the "floor" price that can be charged.** Prices at or below that level result in a loss or at best a breakeven with no profit or return on investment. **No company can afford to sell at cost or below for long.** At best, **transactions at prices which barely recover product cost rob other sales of their profit margin** and require substantially more work for the same amount of Gross Profit dollars.

The second factor is demand. Just as cost establishes the lower place limit, **demand sets the upper limit.** The key to demand is satisfaction. **The more needs and expectations a product or service is perceived by the buyer to satisfy, the more demand there is for it. Low customer satisfaction value means little or no demand.** In that case, no price is low enough. Knowing customer needs and expectations is a prerequisite for effective price setting.

Third is competition. Competition may be **direct and come from traditional competitors or indirect as when a non-traditional source offers new ways of satisfying customer needs.** If all sources are seen by a customer as being essentially equal, they will be compared simply in terms of selling price. When that happens, the only question asked is, "What's your price?" **Value and great customer service are the key to satisfaction among buyers and for setting you apart from other competitors in the marketplace.**

While cost is primarily an internal factor, both the **demand and competitive factors are based upon customer perceptions.** A key element in pricing then is to determine the level of demand.

There are several factors to be considered. **Is the expressed need a high priority with the**

customer? Is a high level of customer satisfaction possible if the need is answered? Or is there little or no satisfaction possible? Demand affects the price in either direction.

Competition in the market place requires you to set yourself apart in some way other than price. Knowing who your customers are and what they want is the basis for that. Armed with that information, you can determine the type and extent of customer needs and assemble the best mix of services and products to meet them. Remember, the most effective way to set yourself apart from the competition is to **position yourself as a value-adding resource for your customer.**

Typically, setting prices doesn't happen in a vacuum. There are several general objectives that often guide pricing decisions. Any one or a combination of them may have an effect on the strategy used.

One objective may be to try to increase sales using price as the lever. That typically means reducing pieces with the hope that the expenses can be spread over more and larger transactions. In principle that appears to be a valid approach. However, **it only works if competitors hold their prices.** If they lower prices, there are no guarantees that sales will increase enough to offset the lower gross margins resulting from lower prices.

Also, the lower **prices may become the "normal" level, making profits even more difficult to generate if increased business doesn't materialize.** The strategy of lowering prices to generate business backfires if raising them back to their original level is postponed due to customer resistance.

Another objective is competitive pricing. With this approach, prices are set at levels which:

> **1) meet prices of existing competitors;**
> **2) discourage new competitors from entering a market;**
> **3) drive competitors away.**

Competitive pricing most often means lowering prices with the goal of holding market share or eliminating competitors. In this situation, too, lower prices may become the "normal" level even after attempts to raise prices back to previous levels. Customer pressure slows or prevents upward adjustments. **Since competitive pricing rarely results in permanently reduced competition, everyone in the market suffers.**

Having a profit objective in mind helps create a healthy pricing strategy. A profit objective means that **each transaction must be considered in light of what it adds to overall profitability**–the bottom line. This approach allows tailoring prices to achieve increased sales or to exploit a competitive situation whenever appropriate without giving away profit--the key to a healthy business.

By focusing on profitability as an objective, the price setter must look at more than reducing price and **find the underlying values that buyers are willing to pay for.**

A fair price, it's said, is the one that rewards both you and your customer. But, all too often, **the sales process is seen as a win/lose contest between seller and buyer** where mutually rewarding sales transactions are not possible.

From that point of view, it's easy to see why the emphasis is on price first, foremost and always. **Products are seen as commodities to be purchased at the lowest apparent cost.** From the seller's perspective, the transaction is structured to minimize the service costs in order to preserve what profit margin that may remain.

Another option is to look at the sales process from a totally different perspective: **selling the value that you add, as much or more than the products themselves.** Selling just products alone will almost always result in competitors and customers forcing you to compete solely on price. **If that happens, you'll be in the unenviable position of losing sales if you don't have the lowest price. If you do have the lowest price, you stand a good chance of losing profit.**

Customers will lose an opportunity to gain an advantage over their competitors **because the only improvement to their operations will come from a reduced acquisition cost.** Customers gain a competitive advantage only if you provide them the benefits of your experience and expertise to reduce their overall cost of acquisition and use.

It's up to you to wrap the products you sell in added value, know what that value is and charge for it. The best customers you can have are those who see the value you add as a good investment. **It must be relevant to their operations and ultimately provide substantially more return on their investment than they can realize by squeezing another few percent from the price.**

If you do that, customers will come to rely on your added value services and the support they provide. **When you have proved your dependability as a resource, customers will not want to do without it.**

It's easy to back away from selling value since it does take a serious continent and some effort. **There are those who say that while they accept the "theory" of added value selling, they continue to sell on price because their customers' operations are a mystery to them.** They feel that they would have to know as much or more about the customer's operations than the customers themselves in order to deliver added value to them.

Those who have this perception risk having an **"ignorance penalty"** placed upon their sales and margins. If you don't know your customer, you'll be reduced to selling commodities instead of value.

The possibility of selling on value exists no matter what the market and/or product. There are two qualifying questions to be asked:

1) **What support can I provide to customers that helps them gain, increase or hold a competitive advantage?**
2) **What can I do to minimize their overall costs of ownership and enhance their revenues, profits or market share?**

Armed with answers to those questions, you can begin to develop an added value approach to pricing.

One important point to understand is that price and value are not necessarily the same. No matter what price you put on a product or service, end-users will judge the value by evaluating the advantage they gain from the purchase.

A replacement part to a customer can take on the value that a customer places on having idle equipment up and running. **If the production from that equipment represents a substantial income stream, the value of that part to the customer is likely to be high.** That's especially true if it was supplied as part of a "package" of services that help minimize or avoid downtime "wrapped around" the product--rapid delivery, reliable service, problem solving solutions and other qualities.

In this example, by helping get the equipment up and running, you've increased the end-user's competitive advantage. Their edge in the market. Having that advantage means they can enjoy increased revenues and earnings. **The cost of the part in this case, even when priced to reflect the added value, is a small fraction of the benefit the end-user enjoys.**

From the added-value perspective, the price of products you supply can be seen as an investment on the part of the buyer. If seen as an investment, the piece can be considered in terms of payback ... like any other investment. Using the product provides **a return on the investment which restores the original amount paid out for the product. After that point the continuing return provides a value "bonus" for the user.**

When the cost of doing business with you (the user's investment) is subtracted from the benefits and advantages (the return on investment) gained from the purchase, what's left over is the value you offer. **If the return on the investment is consistent, significant and substantial, you stand a good chance of developing a profitable, long term relationship with your customers.** You become a valued resource to them.

And that makes sense. **From your customer's point of view, adding to their competitive advantage is the reason you exist.** The same is true of product quality and technological features. They're only important to the extent that they offer some direct benefit to the user.

The key to smart pricing is to determine how you can add to your customer's competitive advantage. That's what your customers value. Bundle those qualities with the products you sell and set your prices to reflect the value you add.

A smart price is one that rewards both you and your customers. It makes possible a return on the "investment" your customer makes in the products/services you supply. And since it is based upon value, it's much more likely that you'll receive the maximum return in the transaction.

Simply **adding an arbitrary mark-up on cost could mean leaving "money on the table"**–not getting all that is possible in a transaction because the mark-up doesn't represent the real value. It could also be that an arbitrary mark-up results in a price which exceeds the value to the customer who rejects your price out-of-hand.

The smart pricing process is both easy and complex. **Since a value-based price promises to deliver more benefit than competing sources, it will be judged on two basic considerations:**

First, does purchase of the product from you offer lower overall costs of ownership? For example, does your solution to getting the idle equipment back in operation, offer longer service life than the alternatives? If it does, the extended life lowers the cost of repairs, and represents a better value.

Second, does the purchase offer enhanced revenues and earnings to the user? For example, does your solution offer shorter downtime and faster return to productive operation? If the answer is yes, that means that the equipment is back making money sooner and your solution has a real value to the user.

Smart pricing is a search for the right "hot button" that a customer will respond to. Once you've found it and exceeded your competitors' value in the eyes of your customer, you will have a great foundation for maximizing the profit from every transaction.

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CHAPTER 4 QUIZ

1) True or False? Getting the order is the only factor to consider when setting prices.

2) Which of the following is not paid for out of Gross Profit?
A) Salaries
B) Cost of Goods
C) Rent

3) True or False? If Net Profit is consistently too low or missing altogether, a business will usually not survive long.

4) Which of the following is usually not a factor in setting prices?
A) Competition
B) Corporate tax rate
C) Product cost
D) Demand

5) "Leaving money on the table" means:
A) Not maximizing the profit potential of a transaction
B) Having expenses that are too large
C) Being the victim of competitive pricing

6) Competitive pricing often means setting prices to:
A) Show how the market can support more competitors
B) Drive competitors away
C) Find price equilibrium

7) Which of the following is least important?
A) Adding to a customer's competitive advantage
B) Enhancing a customer's revenues or market share
C) Increasing a customer's self-esteem

8) The purchase of a product can be seen by a customer as an investment. The value received from the product can be considered:
A) Cost of goods
B) Return on investment
C) Return on expenses

9) True or False? The "ignorance penalty" is the price you pay for not understanding your customers' business operations.

10) True or False? Prices lowered for "competitive" reasons may become the "normal" price in the minds of customers.

☞ **Answer Key** ☞ **Table of Contents** ☞ **Next Chapter**

5-Why Price Cutting Hurts

Cutting prices can have an extremely negative effect on the health of any business. In this chapter, you will learn what happens when even relatively small discounts are given.

There are many factors which impact pricing decisions. But the overriding fact is that, **no matter what else is involved, the long-term health of a company is dependent upon generating sufficient Gross Profit margins to pay the expenses of running the business plus a realistic return on investment. Without those two things, the business has no reason to exist.**

In the normal flow of business, there are variations in the amount of Gross Profit generated from one product to another and from one customer to the next. These variations are normal and expected. Supply and demand, availability of product or substitutes, the number of competitors in the market, and other factors have an influence on prices and therefore Gross Profit.

With that in mind, however, it's important to understand that there is a danger in letting "the market" dictate prices. It can create a lot of extra work and under the right conditions threaten the financial health of the company.

The danger? Letting down your guard and **allowing the normal give-and-take pricing process to deteriorate into an attempt to "buy business" with price cuts.**

It's easy to see how that can happen. **Maximizing Gross Profit requires constant effort to seek out and attach the added value which accounts for much of the premium realized on sales.** It requires consistent and timely customer service and attention to the needs of customers which if satisfied will lead to repeat sales with maximum profit on each transaction.

On the other hand, **the pressure for allowing a sale to go through with a lower Gross Profit margin is often hard to resist–especially if it seems like the only way to close the sale or if the compromise promises to open the door to future sales.** "Give up a little to gain a lot" is only a good strategy if the gain is real. If it isn't, the Gross Profit drops and if the expenses remain the same, the remaining Net Profit is diminished.

The specific cause of lower average Gross Profit is often hard to pin down. Comparisons are difficult to make. But the effect is not hard to understand.

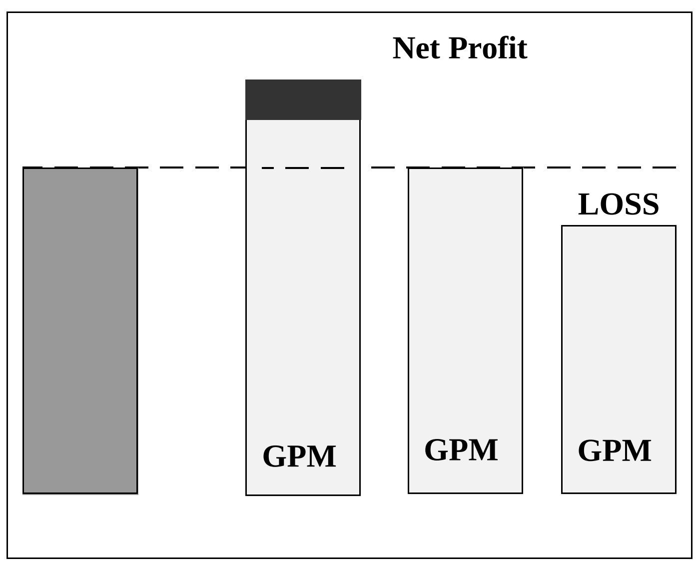

Fig. 5-1

As the Gross Profit declines, expenses, even though they might remain at the same level, take a larger proportion of the GP. Net Profit declines and may even disappear completely if the Gross Profit drops too far (Fig. 5-1). When the Gross Profit falls below expenses, a loss occurs which must be made up on some other transaction.

It's easy to see that cutting prices can be dangerous to the health of a company. But, even without reaching the danger point, cutting prices can have a damaging effect.

One of the most disturbing things is the extreme effect even a seemingly modest discount can have. It's most easily seen through some comparisons between undiscounted and discounted transactions.

A price cut of just 10 % requires that over 66% merchandise must be sold to recover the loss on a modest 25 % Gross Profit margin sale. That means to make up for a discounted sale that **customer or others must buy two-thirds more product just to get back even!**

Cut the price by 20 % and you would need to sell 400 % more product just to get back to the same Gross Profit level. A lot of work for no gain. Another way of looking at the effect of price cuts is to consider the dollar volume. **At the same 25 % Gross Profit margin, a discount of 10 % requires that you sell 50 % more dollars to get back even.**

Cut the price by 20 % and the dollar volume must be increased by 300%.

Even comparatively small discounts can wreak havoc on margins. **"Making it up in volume"** is the usual rationalization for cutting prices to get the business. But as the chart at right (Fig. 5-2) shows, **the effect of even modest cuts can easily overwhelm your ability to compensate through more sales.**

For any group of products you sell, gross margins will vary. The effect of discounting on products with higher Gross Profit Margins is less than on those with lower margins. But the loss in actual profit dollars may be larger because products with high margins often sell for higher prices. **Price cutting always hurts because it's so hard to "make it up in volume".**

If the Gross Profit Margin is 25%...

DISCOUNT	...AND YOU MUST SELL
5%	**25% more merchandise** **19% more dollar volume**
10%	**66.6% more merchandise** **50% more dollar volume**
15%	**150% more merchandise** **112% more dollar volume**
20%	**400% more merchandise** **300% more dollar volume**

Fig. 5-2

For example, if a seal, selling at 25% Gross Margin, is discounted 20%, it requires that you sell 4 more seals **just to make up the profit dollars you gave away!**

In dollars and cents, **ten seals normally selling at $10 each at 25% Gross Margin would give you a total of $25 in profit or $2.50 per seal. If you cut the selling price by 20%, you are left with only $5 profit on the sale–just 50¢ per seal.**

In order to recapture the $20 you gave away, you must sell 40 more seals (40 x 50¢ = $20). That's a lot of work to get back to the original profit level and shows why price cutting is not a good idea.

Even with selling the required amount of product to make up the apparent lost Gross Profit, there can be problems. **Increased low profit sales may result in higher expenses that can further erode margins and profits. The result is a need to sell even more units just to stay even.**

For example, the extra expense involved in carrying the inventory required to support additional sales can be a major factor. It directly raises the amount which must be covered by the Gross Profit. **Even if the product and dollar volume increases are achieved, the extra expense will take a share of the Gross Profit on the additional sales.**

That outcome will continue to weigh down the profitability of the business and act as an anchor to real prosperous growth.

As you can see from the chart at the right (Fig. 5-3), the consequences of carrying inventory are not insignificant. Applying that information to the previous examples paints a bleak, but all too often correct, picture of the effects of piece cutting. Recovery is seldom actually achieved. Even selling the number of seals calculated to recover the loss from discounting doesn't work in the end.

TYPICAL CARRYING COSTS		
Obsolescence	**5.00%**	**$.25**
Physical Depreciation	**5.00%**	**.25**
Handling	**2.50%**	**.13**
Property taxes	**0.50%**	**.03**
Insurance	**0.25%**	**.01**
Storage	**0.75%**	**.04**
SUB-TOTAL	**14.00%**	**$.71**
Interest	**4.00%**	**.20**
TOTAL	**100.00%**	**$.91**

Fig. 5-3

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CHAPTER 5 QUIZ

1) True or False? Buying business with price cuts is a great tactic because it almost always works.

2) The long term health of a company is dependent upon generating enough Gross Profit to pay
   A) Expenses
   B) A realistic return on investment
   C) Both of the above

3) True or False? If Gross Profit declines and expenses remain constant, the expenses eat up a greater proportion of the Gross Profit.

4) True or False? Discounts have to be huge before they have a significant effect on Profits.

5) True or False? On a 25% Gross Margin sale, a 10% discount requires only 25% more merchandise be sold to recover the lost Profits.

6) If a 20% discount is given on a 25% Gross Margin sale, how much more merchandise will have to be sold to make up the lost Profits?
   A) 100%
   B) 625%
   C) 400%

7) True or False? "Making it up in volume" is a sound business strategy because it allows discounting without regard to Profit Margins.

8) If you discount a product that carries a 25% Gross Margin by 20%,how many additional products do you have to sell in order to makeup the lost Margin?
   A) Four
   B) One
   C) Three

9) If you sell 10 items at $10 each and all carry a 25 % Gross Margin, the Gross Profit on the sale is $25. Discount the selling price by 20% and the Gross Profit per item drops to
   A) $.50
   B) $5.00
   C) $1.00

10) True or False? Inventory carrying costs that increase to support additional sales, further erode margins on discounted sales.

☞**Answer Key** ☞**Table of Contents** ☞**Next Chapter**

6-Creating Great Customer Service

Customer service is a success factor of growing importance in virtually every marketplace. This chapter will show you how to create and sustain great value added service that will attract and hold long-term customers.

Delivering great customer service comes down to answering one basic question: **"What have I done to serve my customers better today?"**

The answer to that question depends largely on understanding the role service plays in the competitive marketplace. In fact, **the level of service that customers perceive they are getting is often the key to who they decide to buy from.** But, despite all the studies and experience gained over the years of how important service is, **very often service–the key to success–is forgotten or ignored.**

The perception that a company is not a "service business" is often the culprit. However, Theodore Levitt, a recognized marketing expert and author said, "There are only industries whose service components are greater or less than those of other industries. **Everybody is in service."**

The focus of competition in many markets and industries has indeed shifted to customer service. For many years the contest was in product features and benefits alone. Technological advancement was the major weapon.

Today, few companies have the luxury of exclusive technology for long. Competitors match or surpass the original advancement with one of their own and the advantage shifts. These shifts continue to occur more rapidly.

Quality was another battle ground for some time. Meeting higher and higher standards was a race that some saw as the way to gain an advantage. But, **the so-called quality advantage has disappeared as those who couldn't meet a high level of quality have disappeared** and customers have come to expect high quality standards. High quality is no longer looked upon as an advantage but as **a requirement for participating.**

The customer service component of business is so important today that it is becoming the determining factor on who survives in the marketplace. Those who don't consider it important are **losing enormous amounts of ground** to their service-oriented competitors.

But, **what is customer service?** It can be roughly defined as a **part of the package of value surrounding every product you sell.**

Whether it is satisfactory or not depends on whether the service meets or exceeds the customer's expectations. That is, whether the service received lives up to what the customer expects, fails to meet expectations, or goes beyond them.

Customers, it's said, buy expectations not products. For example, they don't buy repair parts, they buy the expectation that the part will return equipment to production instead of being out of service and idle. That's important because the availability of the part when needed is a valuable customer service. **It takes on value in proportion to the cost of the machine being out of service and not making money.**

Great customer service is a whole cluster of services in reality. They may differ substantially from one customer to the next, or be rather similar depending upon the needs each customer has. It takes study and work to determine those needs. But once begun, the rewards can be substantial.

But, great customer service is not something to be locked in and forgotten. **It is a constantly moving target.** That's because of changing and generally rising customer expectations.

To see how the rise in expectations effects customer service, it's helpful to take note of how Theodore Levitt defines the four levels or "incarnations" of a product.

One is the "core" product. It is the "thing" that has substance in a transaction. With a computer supplier, for instance, it's the computer itself. For an insurance company, it's the coverage provided.

The "expected" product adds the traditional services like delivery, payment terms and other services that are expected of anyone selling in the marketplace.

The "augmented" product adds a bundle of benefits such as training, special inventory arrangements or other services. Augmented services **generally are those which exceed the expectations of the buyer.** Because of that, they generally provide the sort of customer satisfaction which provides customer loyalty.

But in most competitive markets, **the augmented products become the expected** as, after a period of time, those who would compete in those markets begin to offer the services. The original supplier of the augmented product has lost the edge.

At that point, the leader must move on to the "potential" product, according to Levitt. That means anything which can be added and will exceed customer expectation and provide some new customer satisfaction.

With this in mind it becomes easy to see why great **customer service is a constantly evolving process.** As customer expectations rise, the successful supplier must be continually planning how to achieve a new "potential" product which will exceed expectations and create a satisfied customer.

In the distribution business, just having the core product available is no longer enough in most cases. The expected product is high quality inventory in sufficient quantity to meet a customer's needs, and delivered when required. Any supplier not able to at least meet these minimal standards will soon be out of the game.

Some distributors may be seeing more competitors offering the augmented product which reduces the advantage that may have been gained. The augmented offering may well include the expected product along with other services such as technical support, training and special stocking programs or other added value benefits that offer customers a competitive advantage or reduced operating costs.

Market leaders not only offer the augmented product but are always aware of the need to look beyond the current moment to the potential product. They know that, as time goes by, they will inevitably face the fact that what was once considered a service which exceeded expectations has become a part of the core product. In order to maintain their leadership, they will have to create new ways to help customers realize value and satisfaction.

For those who are willing to pursue that service leadership, there are many potential avenues. The trend to just-in-time (JIT) delivery is one.

Customers who use JIT delivery want to operate with minimal inventories on hand. **That calls for a close relationship with their suppliers to make it possible.** They need to have guaranteed quality products available–often within hours of placing an order.

JIT strongly encourages the concept of partnerships between suppliers and customers. These are based to a great extent on the services provided by a supplier as a part of the service "bundle" which surrounds the core product.

As the customer becomes more dependent upon a supplier partner, there is more opportunity to study and understand the customer's operation. That makes possible the development of additional value adding services. Increasing the "bundle" gives a supplier partner an edge over the competition and maintains a continued hold on the business.

Is the emphasis on customer service worth it?

In competitive markets such as distributors compete in, the answer seems to be yes. The advantage comes in two areas: avoiding costs and enjoying higher market share and/or profit margins.

First, delivering great service helps avoid losing customers. Just as avoiding mistakes in manufacturing or other businesses saves the cost of rework and scrap, keeping customers saves the time and money required to win them over time and again. **It's been reported that it costs three to five times as much in marketing costs to win a new customer (or an old customer back) as it does to retain an existing one.**

Customers who remain loyal mean substantial business over the years. Simply taking a customer's purchases over a year and projecting them out for a few years can be an exercise with startling results, especially for larger accounts. Even with smaller accounts, the totals can be surprisingly high. Seen from that perspective, keeping that business is certainly worthwhile.

Besides avoiding costs, **great customer service can contribute positively to sales and profitability.** Authors Davidow and Uttal in their book *Total Customer Service* have said, **"In all industries, when competitors are roughly matched, those that stress customer service will win."** They point to a study which showed that businesses which are successful are among those "providing better customer services than competitors." The study also suggests that a comparison of market share in one industry showed that the **winners offered "superior service" to customers and that they continued to upgrade it.**

Delivering great customer service is no accident. It takes some thought and planning.
The first step is to **know who your customers are.** It's difficult to design a strategy for delivering great customer service without knowing something about the type of business and industry they are in. Information about the products and services they provide to their customers can give you valuable insights into the value that they put on customer service.

One way, for example, is to **learn how they view equipment downtime which occurs for repair and maintenance.** Is downtime costly for them because of demands their customers place on them? Do they have a large staff to rely on for technical advice and service or do they depend heavily on outside resources? **Knowing the answers to these types of questions can help you develop an effective customer service approach.**

Find out what customers expect. That may mean going to the users of products within an organization as well as the purchasing agent, for example, to find out what is important. **It's often necessary to find out what's been unsatisfactory with service in the past--maybe even from you or your organization.**

The main goal is to get real information. There is a great temptation, at times, to assume or guess at what customers expect. If that's done, an opportunity could be missed because the service approach was off target.

The next task is to look at your competitors and their service orientation. The amount of service they deliver and how they do it can have an effect on how successful you will be. **It's especially helpful to find out where they are the weakest and specifically target those weaknesses.** A close look at competitors may also suggest some avenues that you've not considered but could leave you vulnerable if not provided for.

The third task is to influence customer expectations. Remember that **customer service is anything which sharpens customer satisfaction. Satisfaction is the difference between a customer's expectations and how he perceives he is being treated.** For example, a customer may have experienced two day delivery in a few instances with three or more days being more common in the marketplace. If you consistently deliver in two days, he will perceive that the service is exceptional and experience a high level of satisfaction with your service.

Consistency is a critical factor. It's important not to over-promise and under-deliver. For example, consistent delivery of technical information overnight, as promised, will avoid the disappointment created when same-day information is promised but inconsistently delivered.

If creating great customer service is a plan for success, the natural conclusion is that eventually everyone will be customer service driven and no one will have an edge. That is unlikely to happen. Because, like so many other situations, there will be leaders at one end of the scale and those who will fall to the wayside at the other.

If divided into categories, there would be four levels of service excellence.

LOSERS. At the lowest level are the organizations which are so very poor at customer service that they simply won't survive. They probably have even more fundamental problems than customer service, but even if they survived, would never be a threat.

SURVIVORS. The next level are those who survive but never really prosper. These organizations often have as their motto "If customers would only stop bothering me, I could get my work done."

COMPETITORS. Level three is home to those companies that recognize the need to make customer service a priority. They have discovered that great customer service can give them a competitive edge and are trying to make it a driving force in their organization.

MASTERS. The highest level are those companies for which great customer service is the driving force. They have progressed to the point that great customer service is paying dividends in greater market share and higher margins. For them it is the focus of their business and makes them formidable competitors in virtually every market they are in.

Why should you be concerned with creating great customer service? Because like so many things, individual effort is at the heart of organizational success. Remember customer service isn't a department, it's a way of doing business. Everyone has a stake in it.

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CHAPTER 6 QUIZ

1) True or False? Delivering great customer service comes down to one basic question: "What can I sell my customers today?"

2) True or False? Distributors are not "service" businesses so their only real concern is to have product on the shelf when customers order.

3) An advantage only exists if a company has an advanced technology to sell. Today competitors meet or surpass a technological advance:
A) Faster than ever before
B) About the same as in the past
C) Much less rapidly than in the past

4) Customers are said to buy:
A) Promises
B) Products
C) Expectations

5) True or False? Customer service expectations are continually rising.

6) According to Theodore Levitt, the physical product, (for example a computer from a computer distributor) is referred to as the:
A) Augmented product
B) Core product
C) Expected product

7) True or False? A company already providing the Augmented product must also be planning how to achieve a new Potential product.

8) In JIT delivery situations, customers usually:
A) Carry minimal inventories
B) Have enough product on hand to cover any need
C) Fax orders instead of mailing them

9) The cost of winning a new customer is:
A) Nearly the same
B) About 2 times as much
C) Three to five times as much

10) Satisfaction can be defined as the difference between a customer's expectations and:
A) Industry standards
B) Their perception of how they are being treated
C) How important they feel your service is

☞ **Answer Key** ☞ **Table of Contents** ☞ **Next Chapter**

7-Raising the Bar on Competitors

Each day brings opportunities to increase the service lead that you have over your competitors. In this chapter you will learn how it's done.

In many forms of competition, the contest is won by being the last player who remains. Players are eliminated as, one-by-one, they drop out when the competition increases beyond their ability level. A prime example is the pole vault where, each round, the bar is set higher until all contestants but one have failed to clear it.

In business, there is a similar competition. **But in this contest, you get to raise the bar for your competitors based upon the value and service you add. Each time you introduce a new innovation or set a new standard for an existing service, you've effectively raised the bar.** That provides you with another advantage and makes catching or surpassing you more difficult.

Raising the bar is essentially based upon understanding what your customer expects as part of the purchase made from you or a competitor–the "expected product" from Levitt's example in chapter 6. Beginning with the customer's expectation, **the goal should be to "augment" the existing service–that is, add a new dimension which goes beyond the expected.** This unexpected enhancement provides a measure of satisfaction for the customer and sets a new standard of service. It raises the bar.

Because of the changing nature of the distribution business, service improvements or innovations (new or unusual approaches) have a period of time during which they are seen as adding value. **In that respect, they follow a pattern somewhat similar to a product life cycle.**

The traditional product lifecycle begins with an idea which is developed and introduced to the marketplace where, if it is found to have value, it is accepted and sales grow and profits peak. When the product idea matures (as others bring similar competing products to market and the market gets saturated) sales peak and profits begin to decline. Then, as newer products reach the market, sales decline and profits tend to trend further downward, as well. **The service lifecycle is similar.** (Fig. 7-1).

Service Lifecycle

RELATIVE COST		
	INNOVATOR (Originator of the idea)	**ADOPTERS (2)** (Others who quickly use the idea)
	FOLLOWERS (4) (Those who are forced to add the service or lose business)	**IMPLEMENTERS (3)** (Those who watch the trend and then decide to join in)

PERCEIVED VALUE

Fig. 7-1

A service innovation begins as an idea for providing greater service for customers. It is developed, implemented and, for a time (sometimes short), provided exclusively by one company. This is the "augmented product" stage. Customers are presented with a service which exceeds their expectations and with which they perceive themselves as being served better than before. That offers a degree of satisfaction that helps gain and hold customers.

The **Service Lifecycle** is a spiral, not a simple circle. Each service innovation "raises the ante." That means those who don't innovate are always playing catch-up.

As the idea becomes known, some competitors begin to consider how they might use the idea. **Although they didn't create the innovation, these competitors (see ADOPTERS) are often quick to adopt it for themselves.**

After a time, the benefits of offering the service (and the penalties for not offering it) become apparent to a large proportion of the competitors in the field (see IMPLEMENTERS). They implement the idea but often at a stage where the advantage of offering the service is not nearly as great as it was for the Innovators and Adopters.

The last stage is reached when the service idea is so universally offered that it has lost its uniqueness. At this point, it is part of the foundation services that customers simply expect anyone in the business to offer. It's required just to be in the business. In Levitt's terms, this is now the "expected product" and doesn't distinguish the provider as adding value (see FOLLOWERS).

Overnight delivery on out-of-stock parts is an example. The earliest providers of this service had a service edge over their competition. Their innovation sharply narrowed the choice of suppliers in cases where time was a critical factor. **As the service became more available, the edge was diminished until the exception now is the company which doesn't provide it.**

The result of service innovation is that the ante is always being raised. Markets are not static. Businesses can't afford to remain static either. In fact, simply reacting to service innovations of others, even early in the process, means just staying even. The advantage only goes to the innovator.

This is the "leapfrog" principle and it means that if a competitor wants to beat you at your game, he can't simply match your service offering. A competitor who wants to use service innovation must come from behind and surpass your mark.

Leapfrogging isn't easy in any case. But it's made even more difficult by what some have termed the **"virtuous circle"** effect. **Customers who are well served tend to be more open to partnering with suppliers. This relationship often makes it easier and less costly to satisfy them and more difficult for competitors to gain a foothold.**

Companies respond to added value and service innovations based upon where they are in their own lifecycle. There are many possible stages to assign in the lifecycle but for clarity, consider three: Start-up; Growth; and Maturity (Fig. 7-3).

CUSTOMER LIFECYCLE

STAGE OF LIFECYCLE	NEEDS
START-UP	Technical support, product advice, problem solving suggestions, etc.
GROWTH	Reliability, service quality, maximization of production, capacity, etc.
MATURE	Cost minimization, avoidance of downtime, labor saving advice, etc.

Fig. 7-3

Start-ups often rely on services like technical support that help them as they develop their own product or service. They look to outside sources for advice and help in avoiding pitfalls at a time when virtually every step taken is taken for the first time. Innovative thinking will find a receptive climate at start-ups. Because money is tight, helping them get more "bang for the buck" helps. The advantage for the distributor is that many start-ups mature into satisfied loyal customers.

Growth companies are in an exciting phase of development. Especially today, just-in-time (JIT) delivery partnerships take hold as reliability and quality of service have a heavy impact on their performance. Maximizing production capacity and avoiding downtime are key opportunities for a distributor to create innovative solutions.

Mature companies focus on cost control and being the low cost producers. Equipment downtime is costly because margins are often lower for mature producers. Innovations which help them avoid unscheduled repairs and minimize periodic maintenance are valued. So are suggestions which help minimize the labor content of their operations.

Raising the bar is the result of analyzing your customers and potential customers to find some key areas which if innovatively addressed will provide unexpected solutions to their needs. That will bring you and your customers closer. And being close to your customer means a far greater chance at a long term, profitable relationship.

Long term success for distributor organizations today is dependent upon many factors. Without question, much of the success is derived from product quality, manufacturers' delivery and support, product training, technical services and other product centered issues.

But the single greatest factor is the distributor's ability to minimize the distance to the customer.

Distance, as used here, doesn't mean a physical measurement. It's really a measurement of how efficiently products move from manufacturers to end-users. The distance gets shorter as the correct product is available when needed to solve a problem or make the customer's operation more efficient and profitable. It means developing and using your skills to be a resource and a problem solver for your customers. It means looking beyond the stated need ("I have to replace this seal ... again") to find out what is the real problem ("It looks like the lubricant is breaking down from the hear") then becoming a part of the solution ("Have you tried the new synthetic lubricants?").

With a little effort, it's possible to provide more than just a replacement part when equipment breaks down. For example , wear caused by improper replacement part selection also resulted in deterioration of performance over time. Failure of a key part takes production down to zero when the worn component fails completely. **Deteriorated performance, downtime and relatively inefficient start-up curve (in this case because of the lack of immediately available, critical parts) result in a substantial loss of production.**

In an enhanced equipment productivity profile, the break in production is similar when the equipment is taken out of service–but this time from a much higher production level. **Downtime is minimized when the distributor understands the machine characteristics, tolerances, lubrication requirements, suggests the best solutions, and has key components available to avoid waiting time.**

With an optimal solution, the start-up curve is steep. Downtime is minimized and production time at high levels of efficiency is maximized. Much of the unpredictability of service interruptions can be eliminated, providing greater control over maintenance costs.

Extended production time and reduced downtime translate directly into dollars and cents. That's added value. It's also an example of minimizing the distance between distributor and customer.

You have an excellent opportunity to shorten the distance between you and your customers. The three historical distributor functions are still seldom challenged by most competitive channels. **Your advantage is the ability to learn, innovate and continuously add value to your product offerings within that framework.**

How can you do that?

1) Explore ways to **find out the real needs of customers and use the information** to create ways to add value to every transaction.
2) **Take advantage of the value added services provided by manufacturers.** Learn product features and application information through training seminars. Use technical support services to help develop solutions for end-users. Take advantage of assistance provided by catalogs, technical bulletins, promotional and other materials that help you offer effective solutions.
3) **Make the effort.** Get beyond the obvious to find the clues that indicate what the real needs are. Then become part of the solution.
4) **Look for ways to "delight" your customers.** Try to deliver just a little bit more than the customer expects. That keeps you ahead of the game and your competitors trying to catch up!

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CHAPTER 7 QUIZ

1) "Raising the bar" on competitors means:
   A) Making it tougher to match or exceed your performance
   B) Meeting a standard level of service
   C) Increasing prices

2) True or False? In a typical product lifecycle, the greatest profits come at the introduction of the product.

3) True or False? The introduction and growth phases in a typical product lifecycle are marked by climbing sales.

4) The service lifecycle is:
   A) A circle
   B) A spiral
   C) A slightly curved line

5) True or False? "Adopters" in the service lifecycle are those who act quickly to analyze a successful innovation and use it themselves.

6) "Leapfrogging" is the term used to describe:
   A) Moving out ahead of the service leader
   B) Catching up to the service leader
   C) Blocking others from matching your service level

7) The "virtuous circle" refers to:
   A) Your return policy
   B) The partnering relationship between a satisfied customer and distributor
   C) The process of winning and losing accounts

8) True or False? Minimizing the distance usually means finding a location closer to a large customer.

9) In comparison to replacement part cost, downtime cost:
   A) Is usually about the same
   B) Is rarely significant
   C) May be hundreds or even thousands of times greater

10) The best way to build a long term relationship with a customer and make it hard for a competitor to gain an advantage is to:
   A) Find out the real needs of customers and answer them
   B) Do whatever the competitor does but do it sooner
   C) Discount, discount, discount

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8-Using Your Power of One

Even seemingly small changes when you add value, and control expenses can help increase sales and profits, and make a major improvement in the financial health of the business. You have the power to make positive change. The POWER OF ONE!

Throughout this guide there is a great deal of information and a number of suggestions about how to go about adding value, improving service, and enhancing profits in a distribution business. **But, companies without people are nothing more than buildings filled with products. Until you and others like you take action, nothing happens.**

Much of the material in this guide has to do with improvement and change. It's presented as a resource for you on improving your effectiveness and success on the job. **But no amount of information or suggestions will make a difference if you don't make the effort.**

Some people say that individuals don't have the power to make a difference. Don't believe it.

There's a mistaken idea that the only way significant, positive change can occur is when superhuman people make monumental changes.

The reality is that most often it's individuals like you seizing opportunities to make modest, effective but steady improvements which makes for real progress using the power we all possess–the POWER OF ONE.

The basis for the POWER OF ONE lies in some basic concepts:

1) **Everyone in the organization has the power to make a difference.**
2) **Small changes often count heavily because, taken over time, their effect is often huge.**
3) **Positive individual efforts added together tend to reinforce each other and result in even greater positive results.**

Using the POWER OF ONE is a matter of looking at the opportunities that you encounter each day. The next phone call, the next conversation with a customer or the next time you pick up an order offers a new opportunity to make a positive difference.

The effect of the POWER OF ONE on businesses can be massive. **For instance, think what would happen if each sales person is able to increase sales by just one item per order.** Or adds one more "A" account per quarter to the roster.

Think of the time, effort and frustration that reducing order errors by one a day could save. Or if the accounts receivable were collected even a day earlier.

Taking charge, making things happen in the areas we can affect ultimately results in significant change. Things that may seem insignificant alone can have immense impact when combined with other improvements.

The POWER OF ONE is all it takes. The proof is all around.

In fact, it's hard to point to a time in history when there haven't been people taking advantage of the opportunities they've found. Individuals who pushed the limits they encountered in ways that have had a major impact on our lives.

The common thread seems to be their belief in doing what they could, when they could and where they could, no matter how important it might have seemed at the time. **Often they were ordinary people who used their own POWER OF ONE to make a difference that would ultimately have effects that they never dreamed possible.**

Charles Lindbergh, a mail pilot, used existing fuels, engines and airframes, and made modest but important changes. The result was an accomplishment which was a turning point in history.

Marie Curie experimented patiently until able to isolate an element which would give off X-rays. Her approach was to find and test thousands of materials. Though there was no single, spectacular event the result of her search was the discovery of radium. This discovery has created entire industries and made possible many of the life saving uses of X-rays that we use today.

Rudolph Christian Diesel not only saw the opportunity but the necessity for a new power source with greater efficiency than steam and less fuel consumption than a gasoline engine. He took an already explored concept just a little further, used existing technology, and made it work.

Roger Bannister, a distance runner, decided to challenge the common wisdom which said that no one could run a mile in less than four minutes. Bannister made the extra effort, gained a few tenths of a second and changed the sport of distance running forever.

What it comes down to is that you have the power to make a difference, too. No matter what your role is in the organization, even a small positive change in the results you achieve can have a large effect on the bottom line.

The easiest way to see the POWER OF ONE at work is to look at a "profit and loss" or "income" statement. It shows the income and expenses for a period of time and the difference between them which is the "profit" or "loss" for the operation. The profit in this example is the amount before taxes and interest are taken out.

There are several items on the P&L which can be effected by the POWER OF ONE. Relatively small changes at the "Profit Points" (Fig. 8-1) can have a significant impact on the profit line.

Everyone has the ability to influence operating expenses, for instance. Lowering them by 1% can be accomplished by turning off unused lights and saving electricity, avoiding wasted delivery trips and other simple actions.

Sales*
- Cost of Goods Sold*

= Gross Margin
- Operating Expenses*

= Operating Profit

*These profit points are key areas that you can influence and have a major impact on operating profit

Fig. 8-1

By using the POWER OF ONE, you can have a major impact (Fig. 8-2). **For instance in this example a decrease of just 1% in the Operating expense line delivers a major improvement to the bottom line.**

Reducing costs isn't the only way that the POWER OF ONE works, however. For instance in the next example (Fig. 8-3) **see how an increase of just 1% in the amount of product sold has a major change at the bottom.**

As impressive as gains in ONE PROFIT POINT are by themselves, changing more than one at the same time can have an even greater effect.

In the next example, again, no single category has been changed more than 1%. **Sales are increased, expenses are decreased. In some cases, just holding the line can be the same as reducing a PROFIT POINT (Fig. 8-4). Close attention to freight and other factors allowed the Cost of Goods to remain the same.** With these changes, the POWER OF ONE makes a huge difference at the bottom line.

As you can see the POWER OF ONE isn't about trying to make huge swings in the PROFIT POINTS. **The 1% difference is often a matter of making a small extra effort at the right moment–adding one more item to a sale or finding one small way to be more productive.** It might mean taking slightly more care in watching expenses or taking advantage of hundreds of other opportunities to increase efficiency which occur each day.

Try the POWER OF ONE for yourself. Use the sample P&L form in (Fig. 8-5, p.42). **Fill in the blanks in column "A" with numbers that approximate the performance a business your size would generate. Then apply the POWER OF ONE and fill in the fines in**

Sales	$200,000	$200,000
Cost of Goods	148,000	148,000
Gross Margin	52,000	52,000
Op. Expenses	48,000	**47,520**
Operating Profit	$4,000	**$4,480**
	2% of Sales	*2.24% of Sales*

Fig. 8-2

Sales	$200,000	**$202,000**
Cost of Goods	148,000	149,480
Gross Margin	52,000	52,520
Op. Expenses	48,000	**48,000**
Operating Profit	$4,000	**$4,520**
	2% of Sales	*2.24% of Sales*

Fig. 8-3

Sales	$200,000	**$202,000**
Cost of Goods	148,000	**148,000**
Gross Margin	52,000	54,000
Op. Expenses	48,000	**47,520**
Operating Profit	$4,000	**$6,480**
	2% of Sales	*3.21% of Sales*

Fig. 8-4

	A	B	
Sales	_______________	_______________	**Increase Sales by 1%**
Cost of Goods	_______________	_______________	**Decrease COG by 1%**
Gross Margin	_______________	_______________	
Operating Expenses	_______________	_______________	**Decrease expenses by 1%**
Operating Profit	_______________	_______________	**Then watch the improvement to this line...**
	____ % of Sales	____ % of Sales	**...and the improvement here, too!**

Fig. 8-5

column "B". Then see for yourself what the POWER OF ONE can do!

There are lots of ways to use your POWER OF ONE.

Shortening the average time by as little as one day between billing and when payment is received can mean having thousands of dollars more to run the business. Being alert to customer needs and keeping an efficient inventory that turns over one more time per year will also help free up cash and reduce the need for borrowing. Lessening the need for loans reduces another drain on profits and makes more money available at the bottom line.

A little recognized, but persistent source of expense is "shrinkage," a term often used to describe the loss of inventory through error, damage, theft or other non-sale channels. Shrinkage, as used here, refers also to loss of money or other property, as well.

Shrinkage can occur in any department of the company. Inventory is a major one. But other departments suffer from shrinkage as well. Bad debts are a form of shrinkage. Use of supplies or even postage for non-business uses is another.

Some say that shrinkage is a fact of life and as long as it doesn't exceed some arbitrary figure is not a cause for alarm. But it's also an excellent target for the POWER OF ONE.

Shrinkage can be costly (Fig. 8-6). It's especially burdensome when compared to the amount of sales it takes to make up for the loss. Money lost to shrinkage heavily impacts the Net Profit because the cost of shrinkage adds to expenses without supporting sales.

To see the impact, consider a business with a Net Profit that equals 2% of Sales. An accidentally damaged oil seal that costs you $5 which has to be thrown away requires $250 in new sales to make up the loss. A $50 bad debt takes about $2500 in new sales to replace the lost profit. At 2% Net, a $.99 pen takes over $49 in sales--a box of a dozen that disappears equals nearly $600 of sales just to make back the loss!

Use the POWER OF ONE. It can help minimize the loss from shrinkage, increase sales, and reduce expenses. Take charge. Make a difference. Try it:

- **Identify what you can do.**
- **Set goals for yourself.**
- **Know your costs.**
- **Measure your results.**
- **Take action–use the POWER!**

Extra sales required at 2% net profit to offset shrinkage costs

LOSS	SALES
$1	**$50**
$5	**$250**
$10	**$500**
$50	**$2500**
$100	**$5000**
$500	**$25,000**
$1000	**$50,000**

Shrinkage is costly. It takes considerable time and effort to make up for seemingly small losses.

Fig. 8-6

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CHAPTER 8 QUIZ

1) True or False? About half of all people have the Power Of One.

2) Which of the following are basic concepts to keep in mind when considering the Power Of One:
   A) Everyone can make a difference
   B) Small changes often add up to a significant difference
   C) Positive efforts reinforce each other
   D) All of the above

3) True or False? The Power Of One is not a new concept

4) A profit & loss statement compares
   A) Income and expenses for a period of time
   B) Sales to a specific customer
   C) The cost of products from various manufacturers

5) True or False? An increase in Operating Expenses while Sales remain the same typically reduces Operating Profit.

6) Lowering Operating Expenses is least likely to be accomplished by:
   A) Turning off unused lights
   B) Avoiding wasted delivery trips
   C) Discounting prices

7) True or False? Shortening the time between billing and receipt of payment has little or no effect on keeping Operating Expenses down.

8) Shrinkage typically refers to:
   A) Loss of customers
   B) Discounting prices
   C) Loss of inventory through error, theft or damage

9) True or False? Shrinkage is especially burdensome because it requires hefty additional sales to make up for the losses.

10) In a business with a 2% Net Profit, how large an increase in sales will it take to pay for $5 in damaged merchandise which has to be discarded?
   A) $100
   B) $250
   C) $10

☞**Answer Key** ☞**Table of Contents** ☞**Final Exam**

Glossary of Distribution Terms

3 of 9--Bar Coding Format

A B C D O S W L T--Commonly used Popularity Codes: A-Top 50%, B-Next 20%, C-Next 15%, D-Next 5%, O-Obsolete, S-Superseded, W-Warehouse Item, L-Local Demand, T-Truck (Or Tractor)

Ad Allowance--A percentage (usually 1 to 3%) of purchases allowed to distributors or retailers for promotional purposes

Ad Slick--Reproduceable art used in advertising

Anticipation Points--A discount in lieu of dating

Baker's Dozen--13 for the price of 12

Bar Code--Electronically readable codes affixed to packages/pallets/shelves

Bin Box--Cardboard or plastic box used to organize small parts on distributor's shelves

Blister Packed--Hard plastic see-thru overwrap (usually on a card)

BO--Back ordered

Boiler Room--A wholesaler who sells direct to jobbers or dealers over the telephone, typically on a national basis

Bobtail--A short line consisting usually of only fast moving parts

Brokerage Commission--Fee paid to Manufacturers Rep (usually 3-10% of sales)

Bulk Pack--Not individually packaged

Buying Group--Group of customers (generally horizontally equal in distribution channel–i.e.: all dealers, all jobbers, etc.) who join purchases to leverage combined volume for favorable price or terms

COD--Collect on delivery

CD (Cash Discount)--Allowance of purchase price for prompt payment (usually 1-5% for payment in 30 days or less)

CIF--Cost Insurance Freight (export term)

CSR--Customer Service Rep

Carded--Product merchandised by affixing to display card (see Blister and Shrink)

Catalog--Basic product listings (i.e.: Applications, Size & Type, Interchange, etc.)

Category--A natural grouping of merchandise with the same broad appeal to and use by customers

Cats & Dogs--Slow moving items

Changeover--Change from one supplier to another (also see lift, relabel, rebox)

Cherry Picking--

1) Also "Creaming"–practice of buying only fast moving parts of product line.
2) Phrase used by retailers to describe common practice of merchandising single fad or seasonal items that are not usually stocked and are often far removed from the store's type of merchandise.

Chicken Wire Warehouse--Consignment stock carried within a traditional WD

Clamshell--An encapsulating blister package made of clear plastic

Classification--Practice of coding individual SKU's by relative movement

Clinic--Training seminar (usually technical) conducted by the manufacturer but sponsored by a distributor for his customers

Consolidator--Freight shipments for individual locations ganged together by freight handler (consolidator) to get the benefit of lower freight rates

Co-op--

1) Funds made available for joint advertising efforts between manufacturers and distributor or retailer
2) Organization of similar distributors or dealers joining to fund a supplying entity (e.g. jobbers join to fund a WD location)

Counterfeit Parts--Parts illegitimately identified through misleading packaging and/or parts marking

Counterman--Counter Service Personnel (usually used in jobber context)

Cross-Over--Substitution of another part number of another brand

Cube--Shelf space a box or card takes at retail or in the warehouse

Customer Service Department-- Manufacturer direct customer interface department (often order entry or "800" service area)

DC--Distribution Center

DIF--Destroy in Field

DIY--Do It Yourself (Consumer/retailer)

DPP--Direct Product Profitability: a method for measuring profitability of individual items in a line

Dating Terms--Extended payment plans usually extended for initial orders or special promotions

Dealer--Professional installer or service provider

Dealer Direct--Direct sales to dealers (by WD or manufacturer)

Delayed Billing--Another form of dating referring to taking the title of goods but not paying until some later date

Distributor--Any link in the distribution channel between manufacturer and final consumer

Drop Shipping--The manufacturer drops a shipment off to each store or jobber rather than one central distribution point

Dual Lines (Dual Sourcing)--carrying and stocking of two lines of the same product

Dump--Sale of merchandise at prices below prevailing market (usually referring to sale of distress/overstock merchandise or practice of foreign manufacturers selling at price below home market prices)

EDI--Electronic Data Interchange

Expeditor--Generally refers to bulk distributor of small value parts

F.O.B. Shipping Point--Freight paid at point of shipment

Factory Numbering System--System of part identification specific to an individual factory (as opposed to industry numbering system--a common identification used by all suppliers of a given product line)

Factory Warehouse (also known as Distribution Center)--Field distribution center operated by factory to support distributor demand

Feeder--Distributor moving product from manufacturer to large retailer (down to store level)

Field Specialists--Usually entry level salesmen (also see Missionary Man)

Fill Rate--Delivery percentage normally calculated on basis of dollars, units or line items filled complete (i.e.: $delivered/$ordered = %fill rate)

Franchise Dealer--A franchise operation is a right granted by a company for a group or an individual to operate that company's name and sell its products in a specified territory

Free Standing--A merchandiser designed to stand alone, such as in the middle of an aisle. May also refer to a free standing store, i.e.: not in a shopping center

Freight Allowed--Pre-payment of freight for orders of a given size

Functional Discount--Discount allowed for performance of specific functions (distribution, promotion, etc.)

GMROI--Gross Margin Return On Investment

GRP--Gross Rating Points, a method of determining advertising efficiency

Gondola--Display fixture in retail store (self-standing shelves)

Gross Margin--The difference between the cost of merchandise and its selling price

Gypsy Parts--Parts manufactured by non-OEM suppliers

HD--Heavy Duty (usually truck parts)

HQA (Headquarters Allowance)--Percentage of sales rebated to group administrators

Hangers--Point-of-Purchase signs hanging from an overhead string or wire in a store

Header Card--A point-of-purchase sign

Hot Licks (Popularity)--Generally fastest moving items in a line

Indented--A retailer who buys direct from overseas manufacturers and sells the product under the house brand

Independent jobber--Jobber not owned by WD

Installers--Professional consumer of parts

Interchange (FFF)--Substitute part based on form/fit/function

J/R--Jobber retailer

Jobber--Redistributing wholesaler

Kalamazoo punching (for Catalogs)--Unique five hole arrangement of holes punched in catalogs to facilitate catalog racks

LTL (Less Than Truckload)--Truck shipment of less than trailer load by cube or weight

Leased Department--A section of a store leased to another company, or sometimes to a division within a company set up as a separate corporation

Leave Behind--Promotional piece designed for seminar or presentation participants to take with them

Ledger Balance--Type of dating wherein merchandise is shipped and memo-billed

Lift--Practice by manufacturer of buying competitive product from distributor for purpose of substituting own line

Line Item Order Fill--Percentage calculation of order fill efficiency: Line items filled complete/line items ordered = line item fill percentage

Loss Leader--Product deliberately sold at cost or below for promotional purposes

Loyalty Discount--Percentage of sales allowed based on purchases of either complete line or additional lines from a given manufacturer

Loader--Promotion aimed at moving merchandise down the channel (usually one level only)

Mail Order House--A retailing company that receives orders and sells by mail

Manufacturers Agent/Rep--Independent contractor acting as factory sales force

Markon--The difference between the cost of the merchandise and its initial retail price, usually expressed as a percentage of the retail price

Mass Merchandiser--Retailer (usually refers to general merchandise retailer)

Master Carton--A standard shipping pack

Memo Billing--Invoice carrying no fixed payment date

Merchandiser--Refers to a stand designed to hold and display a specific company's products

Merchandising--The part of marketing which covers the selection, packaging, pricing, promotion and display of goods, as well as the planning of quantities to be purchased and the timing of their delivery

Mini-Max--A system or indication of the minimum and maximum quantity of an S.K.U. that should be on hand at any one time; A guide to reordering

Missionary Man--Factory entry-level salesman

Missionary Work--Service or jobber level sales support

Mix--Short for product mix, the assortment of products carried by the store

Module Discount--Pricing based on purchases of additional lines from a given manufacturer

NCC--Not cataloged or cross-referenced

NEC--Not elsewhere classified

NOM--Not of our manufacture (usually used as a reason to disallow return credit)

National Account--A central buying authority for a multi-store company with outlets located throughout a large geographical area

OE–Also OEM--Original Equipment Manufacturer

OSO--Original stock order

OTC--Over the Counter (usually sales to DIY)

Obsolescence--Parts no longer in demand (return allowed by factory)

Off-the-Face--Discount allowed at time of invoicing

Open Ledger--Outstanding credits as applied for by jobber, distributor, etc.

Open-To-Buy--A specified amount of dollars available for purchases of a merchandise category within a fixed period of time, determined by the relationship of sales to inventory established in a merchandising plan

POP--Point of Purchase

POS--Point of Sale

Palletize--Banding or shrink wrapping cartons on a pallet

Past Due--Delinquent account, account overdue on payment

Perks--Extra product at no cost to jobbers and distributors for sales promotions to cover losses

Planogram--"Map" showing how to display product in retail setting

Policy Adjustment--Any discount, rebate or allowance made pursuant to sales policy (i.e.: obsolescence, etc.)

Pop Code--Relative popularity ranking within a product line
Pre Pack--Pre-determined jobber or dealer stock (usually used for new lines or changeovers)

Priority Price--See Velocity Pricing

Private Brand--See Private Label

Private Label--Product sold under brand name not belonging to actual manufacturer

Program Distribution--Association of WD's/jobbers/dealers under common promotional banner to provide buying, marketing or operational services

Program Group--Group involved in Programmed Distribution

Promo Flyer--Promotional literature

Promotional Allowance--A percentage (usually 1-10% of purchases) allowed to distributors or retailers to promote a product line

RAN--Return Authorization Number

RGA--Return Goods Authorization

RMI--Return merchandise inventory

ROI--Return On Investment

RSI--Related Selling Items

Rebate--

1) Form of payment of allowances to distributors or retailers at given times during the year (quarterly, etc.)
2) Consumer promotional tactic

Rebill--Inventory a retailer has on the shelf, usually seasonal goods, where a credit is issued and rebilled at a later date

Rebox--Placing competitive merchandise in another company's packaging (usually during a changeover)

Redistributor--Any part of distribution channel selling product other than the final functional customer

Velocity Pricing--Pricing system based upon relative movement within a product line (usually discounting faster moving items more deeply than slow movers)

White Box--Generic product

Zone Manager--Geographic split of sales responsibility

Distribution and the Power of One
Chapter Quiz Answers

Click chapter headings to return to that chapter's quiz.

Chapter 1

1	False
2	True
3	True
4	True
5	C
6	False
7	True
8	True
9	True
10	False
11	False
12	True

Chapter 2

1	False
2	C
3	False
4	B
5	C
6	A
7	B
8	False
9	True

Chapter 3

1	A
2	False
3	C
4	False
5	B
6	B
7	True
8	True
9	True
10	C

Chapter 4

1	False
2	B
3	True
4	B
5	A
6	B
7	C
8	B
9	True
10	True

Chapter 5

1	False
2	C
3	True
4	False
5	False
6	C
7	False
8	A
9	A
10	True

Chapter 6

1	False
2	False
3	A
4	C
5	True
6	B
7	True
8	A
9	C
10	B

Chapter 7

1	A
2	False
3	True
4	B
5	True
6	A
7	B
8	False
9	C
10	A

Chapter 8

1	False
2	D
3	True
4	A
5	True
6	C
7	False
8	C
9	True
10	B

Table of Contents

Final Exam