The Seven Limiting Beliefs That Prevent Profits

Too often, what we've been taught or what we think we know prevents us from acting in innovative ways that give a real edge against the competition.

What Got You Here Takes You There

The market abounds with opportunities as vendors, distributors and customers continue to optimize organizational and relationship efficiencies. An optimal business model for 1999, or even 2009, is no match for companies are doing today and planning for tomorrow.

Any standout success in your company's past will not have been due to the change in activities that drove it, but rather in doing whatever it was when the competition didn't.

Winning NASCAR teams are continuously inventing new things to get a small edge. Those that rely only on what was "state-of-the-art" in the past are those who run in the back of the pack. If your company isn't inventing and implementing new and improved procedures and practices, for both sales and operations, every year, you'll have to get used to eating dust.

The key to discovering better practices isn't out in the market, or in a magazines—it's most often found in your own data. This is what analytics are for. There's no place that's more reflective of what your company does, or what your customers want, than in your own data.

It's All About Our Products

In distribution we buy product, sell product, inventory product, and train on product. To our very great detriment, we've become product-oriented.

In reality, no product is inherently profitable on its own. Profits are determined in how products are purchased by customers. For instance, a $25 item sold and delivered by itself is a guaranteed loss, but when sold in quantity or added to a large order, it's a profit enhancer.

You can't manage profit by working directly with products. Profits are driven by working with customers on how products are procured and how much company infrastructure and resources are consumed in doing so. This, again, is what advanced analytics are for.

Yesterday's market advantage from exclusive products or territories has been replaced by operational advantages from exclusive understanding of profit drivers from advanced analytics, and action capitalizing on this knowledge.

You Can Do the Math in Your Head

The reason why everyone is talking about analytics is because simple math can't give you the insights driven by the complex interactions of vendors, products, sales, operations and customers inherent in your business model.

Advanced systems track millions of individual intersections of these elements, delivering surprising (and, often, counter-intuitive) insights into profit-generation, and are coming into broad use because they give companies an edge.

Clearly, adopting profit-driving practices that less-capable competitors fail to recognize confers market advantages, and deep analytics reveals a broad range of these opportunities.

Gross Margin Drives Profits

A decade of experience overseeing tens of billions of dollars in distribution transactions completely refutes this. Gross Margin is almost completely disconnected from profit, and is in no way a reliable indicator of profitability.

There are three elements of a profitable sale: volume, pricing and costs. Gross Margin is a measure of pricing only, so it cannot suggest actual profit in any way because it does not account for volume or costs. It's like trying to measure distance when you know the direction, but not the starting point or the destination—it's impossible. Nobody can get anywhere when your navigation direction is always "West."

This is why gross margin management is a lousy way to run a business, and why initiatives that manage or drive gross profit almost always fail to improve the bottom line.

As an industry, we've mastered the volume and pricing part of the equation, so today's companies are rising to the last challenge by employing advanced analytics to clearly understand what can be done to manage complex interactions that drive costs and therefore profit.

Most Sales Contribute to Profit

This is what I believed ten years ago, when I was also trapped by the belief that profits were gross margins-related. Since our margins were at or above acceptable levels, I felt every sale made a contribution to the bottom line.

This deadly belief leads directly to the biggest misconception in distribution management—that since almost all sales contribute to profit, getting more sales is the path to higher profits. Really, most sales lose money. In fact, our research shows that 62.5% of invoices in distribution are money-losing sales! Statistically, increasing sales will reduce profits rates.

In this shocking statistic is the insight that can almost guarantee substantial profit gains—profits aren't improved by having more sales, they're improved by shifting the balance between money-making and money-losing sales. This one intuition has done more to rocket profits upward than any other. Companies acting on this lead their industries, markets and associations in profit generation. They don't need bank lines and they don't pay interest.

Sales Headcount Drives Profits

If you believe that all sales drive the bottom line, then you also have to believe that the best way the drive those sales is with lots of sales reps. This is a painful hangover from the glory days of opening new markets, when more accounts meant more business.

Today, almost all distribution companies have 1.5x–2x as many sales reps as they need, or can afford. This can easily be seen in territories that have 100+ accounts, most of which are too small to be profitable when commissions are paid. (Rule of thumb: 6 calls/ year @ $100 cost / call @ 25% margin @ 25% commission = $9,600 annual revenue. Accounts below this mark are not likely viable for commissions, yet are the bulk of commissionable accounts in most territories.)

Frankly, having too many reps makes it impossible to pay good reps enough, and this is causing difficulty in hiring the younger reps we desperately need to work effectively with their younger counterparts in customer accounts.

Our ERP System Tracks and Reports Profit

Executives rely heavily on ERP and financial systems that simply aren't designed to calculate detailed cost and profit. At their core, those systems were designed to manage inventory, receivables, and to provide company-wide profit numbers sufficient for the bank and the IRS. That's it. Any branch or territory level profit numbers are based on estimates on a spreadsheet someone cooked up months or years ago, and are no more indicative of real profit numbers in current and future periods than the phases of the moon.

A company can have accurate profit numbers at this level only when they use a cost and profit analytics system designed for the purpose, and then put the numbers it produces back into the accounting system.

WayPoint Analytics is a low-cost, add-on system specifically designed to generate the exact reports needed for effective profit management. It uses a highly detailed and very accurate internal costing system to distribute all your company's operating expenses across the transactions that imposed them, giving the most detailed and accurate cost and profitability information available anywhere.

Armed with precise profit information your team can move quickly to protect and grow the most profitable parts of your business, and to close off profit drains by changing the dynamics of what's dysfunctional.

Usually implemented in only a few weeks, wholesalers and distributors have been using this advanced system for years, and have gained millions in incremental profits without requiring new sales.   You can, too!

Randy MacLean is the founder of WayPoint Analytics, the inventor of Quantum Costing, and the creator of the WayPoint system. His company provides analytical services and advisory services to companies that have become the profit-leaders in distribution.

Randy is a best-selling author, has founded more than a dozen companies and two conferences, and has been presented numerous corporate and industry awards.

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