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Standing Up in a Down Economy:

Six Strategies for Improving Operations and Profits

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ABSTRACT

These are difficult and unprecedented economic times. For the vast majority of businesses, the economic downturn will be painful, but not fatal. Success will depend on being able to respond proactively to the many regulatory and market changes that are coming. It will require the ability to take successful practices from the past and adjust them for new realities. The successful distributor of tomorrow will need to build on what has worked, be willing to shed things that no longer work, and be open to new ways of doing everything.

The good news is that there are a number of techniques that a distributor can use to increase productivity and lay the foundation for a more profitable future. These “fixes” are not untested or unproved. Some are from other industries and some have been around but unused. In high growth times, many opportunities for efficiency may have been delayed or overlooked as not necessary or of a high enough priority to allocate resources. Now the world has changed and it is a good time to consider how some of these capabilities may be used to improve operations.

Consider the current downturn as an opportunity to change the way things are done. Customers and suppliers are all open to new ideas and are willing to try new things. The leaders in each industry will take advantage of the environment to modify what is being done, to streamline operations, and to establish new realities that will have long term effects.

It is a good time to think about redirecting investment of time and effort to create a sustainable future. The ownership of our companies must lead the way to make sure management and employees do the right things. In the following pages, trends and the status quo will be examined. Processes will be questioned and replacements suggested.

A realistic and honest appraisal of each organization’s strengths, weaknesses, opportunities and threats is required. Then direct and deliberate steps are needed to take advantage of technologies and techniques that will propel the operation into the future. That is the secret for surviving the current downturn and laying the foundation for future success.

INTRODUCTION

The US and world markets are facing dramatic economic challenges. While there have been downturns, recessions, and other business problems over the last century, many believe that this time will be one of the most difficult. If that is going to be the case, it may be time to question whether the business practices that worked in the past will continue to provide the same levels of profitability.

Most companies will be able to take advantage of new techniques to improve their operations or profitability. In order to get started, it is important to understand where each company stands and the potential directions to move. A very simple chart can identify where we are and where we should be.

EXECUTION/ MANAGEMENT	STRATEGY/LEADERSHIP: Do the wrong things	STRATEGY/LEADERSHIP: Do the right things
Do it right	Efficient failure	Success and Survival
Do it wrong	Total failure	Effective failure

In the lower left quadrant, we find organization that have both leadership and management issues. The strategy is wrong, but it hardly matters because there is no execution. This is an operation that may have made a profit in spite of itself when the economy was booming. But it was just a matter of time before it crashed.

The upper left quadrant is where we do things that do not move the enterprise forward, although we do them well. The company may spend time and resources on tasks and operations that do not advance its mission. This situation is a leadership issue.

The bottom right quadrant is where the leadership knows what to do, but implementation is a problem. This is a management issue, where execution of the plans and strategies is missing.

The majority of this paper will examine what it takes to be in or move to the upper right quadrant. That is where most companies will be able to find a sustainable operation that will survive in the short term and be profitable in the long run.

THREE LESSONS FOR EVERY DISTRIBUTOR

The economy has tightened and is in a recession. Some economists are worried about deflation (a steep decline in prices that is not a result of improved productivity or disruptive innovation). A few even worry about a 1930's style depression.

As one looks globally, the symptoms are not evenly distributed across all sub-verticals or geographies. For example, construction related distribution is strong along the gulf coast where rebuilding is a primary driver of business. Some businesses are more recession proof. According to *Newsweek Magazine* (October 16, 2008) small indulgences, education (at some level), medical care, and video game technology are not feeling the pinch. Other businesses have niches that are still growing, although at a slower pace. Even so, there are three important lessons to be learned by executives in all areas of industrial distribution and from small to large corporations.

Lesson 1: **Nothing is forever**. Businesses of all kinds, in all geographies, and in many different markets have learned that inefficiencies and ineffective strategies can bring them down as soon as there is any slowing of growth. What got us to today will not necessarily get us to tomorrow.

It is often said that humans do not like change. That is not necessarily so. What is true is that change at times of stress is not often welcomed. It is more comfortable to hold onto known quantities when everything around you is in flux. This is where leadership becomes most important. The leaders of a company need to rally the troops and prepare them for change. They must set the example when jettisoning traditional ways of doing things and replacing them with newer methods that will improve results.

It is important that business owners be willing to learn, to change, and to lead their organizations. These are activities that will move a company to the right side of the success chart. Continuing to do something just "because we have always done it that way" can be a sure path to failure.

Lesson 2: **Execution is critical** to implementing any new idea (or even an old one). All of the great ideas in the world do no good if they are not implemented and become part of day-to-day operations.

Successful execution requires that companies know what success looks like, know how to measure progress, and have a willingness to hold the top executives responsible for moving the company forward. This is where management comes into play. Proper execution of ideas moves a company toward the top of the success chart.

Lesson 3: **The time is now**. In every time of disruption, there are leaders, followers, and Luddites. Leaders seize the moment. They claim the leading edge (sometimes referred to as the bleeding edge since success is not always guaranteed). Their businesses take advantage of disruption to enhance their position. For example, when others are hunkering down, they will go out and raid competitors for the best employees. They will invest in new technology and resources to prepare for the eventual recovery.

A case can be made for followers who wait to see what works and what fails. The problem is how long does one wait and how sure must they be before acting. The longer the delay, the greater the possibility that the business will not gain the advantage that was possible.

Finally are the Luddites (named for a group of British textile workers in the 1800s who would destroy mechanical looms because they were afraid the industrial revolution would take away their jobs). Anyone who refuses to believe change can be positive will have a more difficult time competing in the future. Especially when it comes to adoption of new techniques made possible by technology.

Now is the time to take advantage of the economic disruption and weakened competition. There are many opportunities that will allow strong companies to build the foundation to do better than the average when this downturn ends. Following are a number of strategies that will help companies prepare and prosper. Some of the ideas may be considered common sense, but it is amazing how often they are overlooked.

BUSINESS 101 STILL WORKS

Knowing your mission and the business you are in should be a top priority. Academic research and anecdotal evidence constantly report on how often companies do not have a good understanding of the business they are in. One classic business school example is Hertz. They became a much stronger competitor once the company decided they were no longer in the car rental business. Instead, they invented the "get out of the airport fast" business. Business people in a hurry were willing to pay extra to have the car ready (with the key and rental agreement), the location noted, and all the customer had to do is stop at the exit and show their driver's license.

In a business that is filled with look-a-like companies, differentiation is an imperative, especially as competition increases. How can the lesson that Hertz learned be applied to industrial distribution? Anyone can distribute MRO parts. To be different, a company may need to become "the partner that keeps plants operating" with stocks of MRO products based on specific plant needs and profiles. If a company provides engineering support, do not ignore it because everyone can do it. Make it a differentiator. Become "your engineering support staff" to customers around the globe (or around the corner).

There are hundreds of distributors selling to construction sites. Many have portable warehouses (vans) that show up everyday to replenish consumables and fix broken equipment. This is no longer a differentiator. Being different requires understanding what the ultimate consumer wants. If the answer is a faster response to needs, then it is up to the distributor to find a way to make that happen.

For larger projects, it may be possible to eliminate transportation costs and rush hour delays by "becoming your construction partner with an onsite warehouse." This may provide a new business model. Using a trailer that is replenished on a schedule based on the project plan and material requirements could provide differentiation, a competitive advantage, and potential branding opportunities. If a number of manufacturers underwrote some of the inventory cost, then a warehouse trailer could be painted with advertisements for the stocked brands and the distributor. Without daily deliveries, the cost of supplying the site is reduced. By stocking to projected needs based on construction plans the distributor becomes the "onsite warehouse."

Find your uniqueness. What makes you better and different from the rest of your competitors? If the answer is not clear in the minds of your employees, think through the question carefully. Ask the owners, peers, and even your best customers. Find out what they think. Why do they buy?

Work at finding and then advertising the answers. Publicize this brand to your prospects and customers. Make sure your employees understand, promote, and live it. Make it real and the company will have taken a giant step toward sustainability.

Once an organization knows who it is (or wants to be), filter all new ideas through that lens. If a new method, product, or other idea does not advance the business purpose, do not do it, no matter how good it sounds. The most successful business people learned a long time ago, you cannot be everything to everyone. It is a recipe for failure.

Developing an understanding of who you are and using it as a filter should be the next step toward the right side of the chart: doing the right thing.

VALUE ADDED IS NOT JUST A SLOGAN

It is important to work on the specifics of what the company does and how it is done to advance the mission. One of the simplest ways to make sure that limited resources are allocated to procedures that will help a business survive is to ask: What value does it (any process or procedure) add to the end customer? If the answer is none, eliminate it.

It may take some research, but gaining an understanding of what makes a great customer is time well spent. Stored in most distributor's information systems is a treasure trove of data that can help identify and define their best customers.

Best customers are the ones a company makes the most profit on. It is not just gross margin, but bottom line profit after taking into consideration all of the support activities and ancillary costs. So a customer who orders a great deal of merchandise but requires hours of handholding, is always late on payments, returns many items, does not pick up half of their "will call" items may not be as profitable as a much smaller customer who costs little to service.

Companies need to create a complete customer profile that measures all of the costs of a customer. Then the company can sort, not by gross sales, but by bottom line contribution to profits. The difference between the two lists may be surprising.

Given an accurate definition, it is possible to provide support and services that they want and will pay for. Every action must provide value to the end customer or it needs to be eliminated.

Take accounts receivable as a good example. Value can be added to the customer by making it easy for them to keep their accounts up-to-date. Customer portals (to be discussed later) provide one simple method for publishing the data in an easy to retrieve format. When communications is improved, the cost of doing business is reduced. Software is available that will allow many different concepts to be implemented. The discussion below is one example.

More sophisticated trading partners in business today are using a technique called "Evaluated Receipts Settlement" (ERS). In this process, the customer is rewarded with a larger than normal discount for paying on receipt of product at their warehouse or place of business. Without an invoice, they calculate the amount due by multiplying the number of items received by the agreed to price on the purchase order. That is the amount to be paid, and frequently, it is paid electronically.

This process is not for everyone. It requires a solid, trusting relationship between companies. The easiest method of implementation requires the use of technology (usually EDI) that is available in all modern computer systems.

THE MOST COMMON QUESTIONS THAT ARISE WHEN DISCUSSING ERS ARE:

1. What about the float?
2. Don't I need an invoice?
3. What if the PO is out of date?
4. What if the customer pays for less than was shipped?

First, the float today is not worth that much. Overnight rates are at historic lows. If the discount offered for electronic payment on receipt is higher than the cost of borrowing the money to make it possible, everyone wins.

Second, there is no need for an invoice. The auto industry, large retailers, and other sophisticated companies have been doing this for years. The process has been approved by all of the major accounting and auditing firms.

Third, it is the responsibility of the trading partners to make sure all of the electronic documents are current. It is easier than it seems- Enterprise Resource Planning (ERP) packages provide the necessary checks and balances.

Fourth, there will always be customers who cheat. It is something to watch for and then react quickly when a problem occurs. There are numerous methods in application systems today to track, report, and resolve issues of receipt. As was said earlier, this is not for every customer, just for the best ones.

Consider the added value to your customer. They no longer have to receive, match, file, lose, find, and retrieve invoices and receiving reports in order to pay the money that they owe. They save on personnel costs, file cabinets, and earn a greater return on their investments (due to the discount).

Then be selfish and consider the added return to your business. ERS eliminates creating the invoice, tracking payments that are often lumped together without documentation, collection calls, and a point of friction in many distributor/customer relationships.

This is a perfect example of moving to the top right of the chart. Leadership stands behind a way to improve customer profitability by reducing the customer's cost of doing business. The distributor realizes cost savings as well. Service levels are perceived to be higher and an electronically integrated customer is much harder to steal. Utilizing available software and hardware, it is possible to implement and gain the advantages with minimal investment. The resultant processing is sustainable and (with proper management) expandable to the rest of the customer base.

A RADICAL IDEA – CARRY LESS INVENTORY

Inventory is the major cost for most distributors. Over the years, a great deal of effort has been expended to buy better, to measure and manage inventory turns, and in general to smooth out the purchasing process. While these activities have produced positive results, it may now be the right time to challenge the way it has always been done.

One possibility is to determine if there are products that do not have to be kept in stock. Review what is in the warehouse and do not be afraid to ask: "Does having this inventory in the warehouse increase or decrease profits?"

A good starting point is the "D" inventory. These are normally products that turn less than once per year. Some "D" items will be left over from previous needs, some were needed once, some are due to over purchasing (often to get free freight), and some are there because a "best" customer might ask for it.

These are not usually good reasons to carry "D" items. Most companies would be better served by eliminating all "D" items from the warehouse. Then that capital, space, and time could be put to much more productive use.

There are numerous stories about companies who could not find a "D" item when it was finally sold and then had to order more anyway. After the delivery, someone eventually finds the missing item. The company now has more inventory than they need and saved nothing by having that product on the shelf.

When a "D" item is required, there are many sources of supply where most such items can be purchased with short lead times. The cost of the product will be higher, and the gross margin may be less (depending on how it is priced), but overall, most companies will make more money by eliminating "D" stock.

Of course there are exceptions to every rule. For an "A" customer who has asked that a "long lead time" MRO part be kept in stock "just in case" - hold on to it. However, this is the exception and not the rule.

Another way to better manage inventory levels is through demand planning and collaborative forecasting. These methods are based on the ability to improve the accuracy of forecasts by exchanging more information, more often, and gathering data as close to the source as possible.

The successful implementation requires tighter communications with suppliers and customers to more accurately predict needs and plan production/delivery schedules. Properly implemented, it is possible to create more aggressive pricing with "A" customers based on advanced purchasing coordinated with the supplier. Where a customer is willing to sign up for long term contracts, it becomes possible to offer even better deals.

All of this relies on accurate information from processes like Activity Based Costing. The right systems used the right way will allow profitability to rise without relying on price increases or staffing decreases.

ARE DELIVERY TRUCKS WORTHWHILE?

A business capability that gets a great deal of attention today is delivery services. This is an area of great opportunity. The cost associated with purchasing, maintaining, operating, and insuring vehicles is rising at a furious pace. Even in areas where free delivery has been an expected service, customers are accepting new rules and surcharges.

Even though gas prices have returned to a more rational level in January of 2009, they will rise again – and significantly. Proper planning in this area can pay large dividends now and in the future.

Route planning has become a must have system enhancement for many distributors with delivery operations. Although the number of companies that maintain their own fleet of trucks is declining, for those in the logistics or delivery business, there are many costs that can be reduced by maximizing the delivery potential (how much can be delivered in a single truck driving an efficient route) of every trip.

An easy cost reduction strategy is to allow the system to plan for the most efficient routes possible (not always the shortest). Given a list of product to be delivered with weights, cubes (amount of space it takes up in the truck), and customer locations, it is possible to calculate the "least cost routing" possible. The savings in time and fuel can be impressive.

Integrated with most routing programs is truck loading. The computer will provide instructions on how to load product in the truck to make maximum use of the space within weight limits. More importantly, the inventory is loaded in the right order to make deliveries as quick and error free as possible.

If delivery is a service that is important to the business, look carefully at the actual costs and the return on investment. A company does not have to treat all customers equally. It is acceptable to add delivery charges based on the size of the order, the value of the customer, and the cost to deliver.

When delivery is provided at no cost, leading companies track the cost and are able to measure the customer's contribution to profit at the end of the year. This allows management to reevaluate how much free service any specific customer has earned. It is also a great tool to have when discussing a customer's value and negotiating future deals.

E-COMMERCE, E-BUSINESS, OR E-NOUGH?

Today, it is difficult to have a conversation about improving operations without a discussion of the Internet, its possibilities and benefits. Online capabilities can range from an information source about a company and its products; to an online ordering capability; to interactive portals for customers and vendors. Distributors need to decide where their company should fit on this spectrum and which Web applications are good investments.

Start out by first determining the mission for an online presence. It may be defensive (all of our competitors have it); or it may be offensive (we want to take business away from competitors who are stuck in the past). It may be passive (brochure wear and educational information), or interactive (online ordering and other applications that help define needs). Finally, it may be customer focused, supplier focused, or both.

Companies moving onto the Internet without a solid goal and plan to back it up, waste a great deal of time and money for limited, if any, return. The most important questions relate to the purpose of the site. If it is educational and not interactive (sales, design, support, etc.) the cost and complexity are significantly less.

On the other hand, an interactive site must be carefully integrated with back office systems if it is to succeed. This often becomes a perfect example of failure by lack of management. The company knows what they want to accomplish, but are unable to make it happen. One reason is they may abdicate responsibility to outside contractors who do not have the same desire to successfully complete the work. A modern ERP application with "hooks" to the internet makes it much easier to successfully implement interactive sites.

There are two major functions that have great positive effect on results using an interactive Internet presence. The first is using the concept of portals and the second is related to storefront or customer facing sites to increase sales.

A CUSTOM SITE FOR EACH TRADING PARTNER? YOU HAVE TO BE KIDDING!

Web portals can provide each customer (and each vendor if the company really wants to gain the greatest advantage) with the ability to use the web to inspect their own records and activity. Customers can see current open orders, the status of each, open invoices, payment history, and order history – reducing the number of times they have to call to have you look something up.

On the plus side, portals make it easier for the trading partner to stay on top of what is happening. By eliminating unnecessary contact, it will reduce the cost of customer support. On the negative side, your customer is on top of what is happening and that may include negative results. Remember, everything is more visible. Another consideration is that while you become the easiest distributor to deal with and reduce your cost of support; you may lose valuable human contact (because it is not needed).

A well designed portal provides the customer with all of the information they normally need, so the sales force must learn how to stay in regular contact with customers even if they are not calling in. It is still important to maintain a human connection or the ties become easier to break. This requires management discipline. The net result should be a stronger relationship that is much harder to break.

Because the portal is a window into the company's internal systems, it is important that the internal application systems provide a few very important extras. The first is the ability to highlight comments or other data as "non-displayable." No customer likes to read nasty notes about their employees and the problems they cause (even if true).

Second, the data to be displayed must be accurate and easily retrieved. If the trading partner has the ability to sort, filter or even download data, it becomes a more important tool. This strengthens the relationship even more.

From a management side, it is useful to know who is coming to a portal and what data they are examining. That information needs to be shared with the sales force so they are aware of any activity that might suggest a need for an in-person call.

Over time, sales people will learn how to take advantage of the portal. They can leave notes for customers and will get used to reviewing a daily list of customer activity. As the company becomes more sophisticated in their use, the system can highlight changes in use patterns. These are important in being proactive in resolving real or imagined problems.

Many companies worry about security these days. An added support capability is to offer password control and support. In this way, when a customer has turnover, you can make sure their records are not available to competitors through previous employees. It also forces the customer to stay in touch and keep you informed as their business changes.

Online sales are often looked upon as the holy grail of the Internet, but they can have a downside. The one most quickly learned is that lower online prices used to attract new customers can eat into margins from existing customers. Companies must be careful what they wish for.

There is also a misconception that online sales reduce processing costs. That is possible, but not guaranteed. The common model that frequently saves processing costs is in the B2C (business to consumer) environment. Normally there are a small number of line items per order with few or no special instructions. Payment is made at order entry time and there is little follow up required.

For B2B (business to business) world, the saving potential is less clear. In B2B, there may be many line items, for a variety of different products, with different requested ship dates, with different special handling, with – well, the list keeps growing.

If a customer places an order online, the internet site should be set up to send them an electronic confirmation that is usable as input into their purchase order entry system. That way you are not asking them to do double data entry and will not get the kind of acceptance most online marketers hope for.

A common problem with "selling sites" is how well the company integrates the online store with their ERP applications. This integration is not limited to being able to produce picking tickets, it means full integration including pricing updates, inventory and product changes, policy changes (i.e. free shipping requirements), and payment options (including credit holds and minimum order sizes).

Then there are the special requests from many customers. They want to pre-approve what products can be ordered and for what price (and they will ask that the price not be disclosed to the person doing the order). This means that the system is required to identify the customer on sign in, and be able to offer a customizable suite of services tailored to their needs. Implement a system that can provide these capabilities and it is easier to obtain the expected or hoped for results.

The good news is that all of these issues are relatively easy to solve. When properly implemented, an internet site capable of accepting sales all day, every day is a wonderful way to expand hours without increasing costs. It allows the company to reduce expenses and increase service to the customer base.

NOW IS THE TIME TO STAND UP TO THE ECONOMY AND TAKE ACTION

The economy is unpredictable. Spending is fluctuating. Business forecasts are challenging. On top of this, everyone wants costs to be cut. It can be done. There are many opportunities out there. Technology offers one of the best ways to increase productivity while maintaining or even improving services.

The ideas presented in this paper can be implemented today. They do not require "bleeding edge" technology. What is required is recognition of the value that can be added and the dedication to get it done. Those companies willing to challenge themselves to be better and different than everyone else will lead their industries in the future.

Just as many articles related to marketing suggest that a down economy is the worst time to cut a marketing budget, the same is true for technology. Money invested in the right automation will generate significant returns.

Success will require that a company's leadership carefully select the applications that support its mission, fit its brand, and build a point of differentiation. They must allocate the resources and "sell" the necessary changes to their employees.

Then management is responsible for executing on the ideas. They must have budgets and resources to make the desired applications work. The applications (ERP, CRM, etc.) must be capable of supporting the execution. If it is not, there is a greater potential for disappointment when goals are missed.

The concepts presented here all can have a positive effect on operations. Today, that can be important to survive the current downturn (cyclic or otherwise). In the long run, new efficiencies will allow any company to increase the contribution to profits from every sale. Good business practices are good business whether the economy is roaring or slumping. They provide the foundation for sustainability.

Finally, the most important advice that can be given is focus, focus, focus! It is too easy to start a project and then let it slip away. Preparing a company to be sustainable, setting up the leadership and management to succeed takes focus. Rededicate the team to getting the right things done in the right way and the future will take care of itself.

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ABOUT BROWN SMITH WALLACE CONSULTING

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