



Introduction

Wholesaler-distributors are unique in the degree to which decision-making is dispersed throughout the organization. For example, most distributors operate in a branch mode. The typical branch manager makes not only hiring and firing decisions, but ultimately is responsible for product selection in the local market, pricing policies, and possibly even credit and collection decisions.

Similarly, in many instances both inside and outside salespeople make pricing decisions, often on the fly. Further, the outside sales force makes decisions about which products to emphasize with individual customers. To an extent, that kind of decision-making is unheard of outside of the wholesale distribution industry.

The list of employees who make myriad decisions could be expanded to include merchandisers, credit managers, and a wide array of other individuals across the company. Obviously, all of those decisions have major financial implications for the firm.

Profit Myths in Wholesale Distribution

Two serious problems arise when a multitude of individuals make decisions with financial implications. These involve the quality of the decision-making and the consistency of those decisions. Let's look at both:

- ▶ **Decision quality.** It is an incredibly cheap shot to say that some individuals make poor decisions. Everybody makes bad decisions in his or her business and personal lives. The real issue in a distribution firm is why those individuals continue to make bad decisions with regard to financial issues. Put another way, why don't they start making better decisions?
- ▶ **Decision consistency.** In many instances, half of the distribution firm may be moving left, while the other half is moving right. For example, the sales force may be aggressively targeting new accounts, while the credit department is trying to lower the investment in accounts receivable. Once again, the issue is not so much that inconsistencies arise, but why they arise, especially in the financial area.

The fundamental premise of this book is that both decision quality and decision consistency are influenced by some very bad information. The problem is exacerbated by the fact that the bad information sure looks good on the surface. To understand how this can possibly be, it is useful to look at a couple of real-world situations in distribution. Both of the examples used here are covered in detail in this book.

Sales Management

The sales manager of a distribution firm may attend a daylong training program on targeting new accounts. Since targeting new accounts is a somewhat costly undertaking, the seminar leader

includes a few financial examples that demonstrate the impact new accounts can have on profitability. In this way, the investment can be cost justified.

The examples suggest that new accounts generate incremental volume and that the margin on that volume goes “straight to the bottom line.” The sales manager now has an economic rationale for attacking new accounts with a vengeance. The fact that the rationale is based on an unrealistic financial example never comes to light.

The seminar leader is not evil or conniving. Instead, he is simultaneously marketing to the financially literate and financially illiterate in his training seminar. The reason he fervently believes incremental volume goes straight to the bottom line is because he once attended a seminar in which yet another seminar leader indicated that new gross margin dollars go straight to the bottom line. Everybody in the chain of seminar participants is simply passing along conventional wisdom.

Credit Management

At the same time, the credit manager is attending a seminar on credit and collections. As part of that training program, the seminar leader reviews how much sales volume is required to offset a bad debt loss. Her answer is that even a small bad debt loss requires a huge increase in volume to offset it. That means that bad debt losses must be eliminated from the face of the earth. The credit manager now has an economic rationale for tightening restrictions on credit.

Sad to say, but this seminar leader is also relying on bad information that she obtained in another seminar years ago. Just like the sales seminar leader, she is passing along conventional wisdom.

Profit Myths in Wholesale Distribution

At this point both the sales manager and the credit manager are working as hard as they can, using the knowledge they have at hand, to help the firm improve its profits. Unfortunately, because they both are basing their decisions on bad information, they are not making decisions that increase profits. They also are working at cross-purposes: the sales manager drives incremental volume, while the credit manager tightens credit policies.

The reason conventional wisdom leads to so many bad decisions is that it comes in all types—good, bad, and ugly. Discerning among the different types is inordinately difficult. The situation is compounded by the fact that there appears to be a variation of Gresham's Law at work with conventional wisdom. Namely, bad wisdom chases out the good.

In practice, this means that the easier the financial concept is to understand, the more likely it is to be wrong. In the case of the examples, incremental volume goes to the bottom line and bad debt losses are almost impossible to overcome. Both of these concepts are incredibly easy to understand, and both are deadly wrong.

This book is an effort to replace conventional wisdom with a combination of some rather sophisticated analysis and empirical information. This replacement process requires one important commitment on the part of you, the reader: you must accept the premise that much, if not most, of what you have been told about distribution finance issues is wrong. If you can accept this premise, then reading this book will be an eye-opening experience. It will help you *greatly increase* the profits of your operation. If you cannot accept this premise, then this book will make a handsome, but unread, addition to your bookshelf.

As a final note of caution: This book doesn't just have a lot of financial examples—it is littered with financial examples. These

examples require your time for careful review. For some examples, the review process will be lengthy. Three rules are suggested:

1. Read no more than one or two chapters per day.
2. Set enough time aside to “through-read” the entire book in a few days; that is, read the entire book in a relatively short period of time. Ideally, you read this book from cover to cover in 1 week. Setting aside 2 days in May followed by 2 days in July to read this book will devalue your experience.
3. Apply these examples to your firm.

Number 3 is crucial. All examples in this book are for a representative firm that we are calling Mountain View Distributing. We’ve developed these examples so that the concepts will apply to all firms. However, every firm is unique in terms of its financial structure. Ideally, we would recommend that you view these examples in the context of your firm.

A Microsoft[®] Excel file accompanies this book. It allows you to enter data for your firm. You can then print every exhibit in this book with results for your specific firm. These customized exhibits should serve as a valuable tool in understanding how the conclusions in this book impact your firm.

With that said, it is now time to start deconstructing the conventional wisdom in the quest for higher profit. Enjoy the journey.