Quantum Profit Gram #8

Gross Margin Management Drives Losses

Nothing makes a bigger bottom-line impact than adding an extra point or two of margin to an already profitable order. The common paradox is that many small orders with high margin percentages are big losers. Despite the high margin percentage, high CTS (Cost-to-Serve) is wiping out the gross profit on the order.

Simple math: Gross Profit dollars (GP) – Cost to Serve (CTS) = Profit Before Interest and Tax (PBIT). Note that there is no margin percentage in the formula!

By over-focusing on margin percentage and not knowing the CTS, distributors lose money in predictable, consistent ways. For example, distributors using Waypoint Analytics (the new system that gives highly-detailed Quantum Profit Management (QPM), CTS and Net Profit reports) have discovered these cases:

- Some reps with the high average-margin percentages for their territories have negative PBIT. (Are losing money, and lots of it.) The problem: orders for important accounts have CTS numbers that are larger than the GP they generate, resulting in huge losses. Worse, the companies lionize these reps for "selling by the book", and pay them higher commissions, thereby compounding the problem. (They're now moving to commission plans based on Net Profit and not GP.)
- Some specialty lines and items that enjoy "high margins" unexpectedly lose money. WayPoint reports show these elements are actually losers because:
  - they turn slowly and have carrying costs that more than offset the higher margins. (An inventory dollar that turns 2X per year must have 6X the carrying costs assigned to it as a dollar invested in an item that turns 12X per year.)
  - many specialty items have low margin dollars, which are exceeded by the transaction and account services costs (CTS), making the orders money-losers. Small-dollar picking requires a cost model like a Netflix DVD center.
- Some companies actually have negative PBIT on total warehouse volume, which is subsidized by profit from their "direct business". Lacking QPM tools that show where their costs are, they've over-emphasized "margin percent" and "margin dollars" in their thinking and incentive programs, so nobody's track○ ing and managing CTS.
- Certain segments of the business that seem good at the macro level are actually made up sub-segments that are money-losers, offset by other highly-profitable sub-segments. Good QPM/CTS analysis exposes the cross-subsidies in ways to readily cure them.

Almost every company has these exact issues, and there are easy fixes for all of them. The first step is to know they exist and identify them. Ask your team what (QPM) tools they have to accurately cost and assess your business at the granular level. If you don't already have a QPM system, get one. (You can learn more about QPM and WayPoint using the links right and below.

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[1]See QP-gram #7 at www.qantumprofitmanagement.com

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