



## Research in Action

# Uncover savings in the cost of providing services

NAED research report targets three opportunities for cost improvement.

BY JIM BRAIBISH

Controlling costs in all areas of the distribution business is key to profitability. A recent NAED research study has identified three main areas in which electrical distributors have the potential to achieve a significant amount of cost savings: outside sales, recovery of freight costs, and margins for nonstock items.

These distributor services are among the 55 that were studied in *Value-Added: Assessing Service Offerings of Electrical Distributors*, a research report that was funded by the NAED Education & Research Foundation's Channel Advantage Partnership. This research report was conducted by Scott Benfield of Benfield Consulting.

### Outside sales costs

The costs of outside sales—salary and fringe benefits—averages 3.1% of sales in a typical electrical distributor, the report said. Because the industry bottom-line profit is only 2%, there is substantial opportunity for distributors in rethinking these costs.

Most of the cost challenge is found in the overcoverage of small (\$10,000 and below per year) and medium accounts (\$10,000 to \$50,000 per year). In a typical electrical distribution business, small accounts



## THE ECONOMICS OF A SMALL ACCOUNT:

An example based on a customer placing 50 orders per year at an average of \$200 per order for total purchases of \$10,000 per year.

Net sales	\$200
Gross margin (27%)	54
<b>Direct costs:</b>	
Outside sales*	21
Inside sales	5
Warehouse labor	3
Delivery	35
Other support labor	2
Total direct costs	66
<b>Profit (loss) before overhead expenses</b>	<b>(\$12)</b>

\*Outside sales costs calculated using 12 sales calls per year at \$85 per call assigned to 50 orders.

represent about 60% of account assignments, while medium accounts comprise an additional 25% of business.

The chart to the left communicates how a small account loses \$12 per order on just 12 sales calls per year. According to the *Value-Added* report, sales costs are inordinately high relative to the volume that is being generated.

For smaller accounts, especially those with limited or no growth potential, electrical distributors must begin to think in terms of an increased use of telesales, inside sales, and e-commerce. With a significant change in these areas, the number of outside sales personnel can be reduced, and significant cost reductions have the potential to follow.

### Freight-cost recovery

The freight gap—which is the difference between freight paid to vendors and freight that is billed to customers—can present a significant loss for most distributors. Among the electrical distributors that were included in the survey, freight-cost recovery averaged 60%, leaving a 40% gap. For a \$100 million company with freight costs of \$1.3 million per year, the freight loss amounted to \$520,000 annually.

If the typical company were able to increase freight recovery to 81%—the highest level among the companies



# DIRECT

## NAED News

NAED had record attendance at its Western Region Conference, held in Las Vegas in January. Overall attendance for the 2007 meeting increased 12% over 2006. The attendance was the highest that it had been in a decade.



To help celebrate its 100th anniversary in 2008, NAED has named Malcolm Watson as the honorary chair of the association's Centennial Celebration Committee. Watson is the former president of Watson Electric Supply. He served as chairman of NAED in 1978 and has been a part of electrical distribution for over 50 years. NAED's Centennial Celebration will begin with the 2007 Eastern Region Conference, Nov. 14-17, in Hamilton, Bermuda, and conclude with NAED's 2008 Annual Meeting, May 17-21, in San Francisco.



Response to the 2007 University of Industrial Distribution (UID) was so overwhelming that the program sold out three weeks ahead of its early bird deadline. The packed program was held March 4-7 in Indianapolis. Approximately 475 people attended from more than 25 distribution industries. Contact John Kiso, NAED education program manager, at [jkiso@naed.org](mailto:jkiso@naed.org) to be put on an early notification list for next year's program.

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studied—an annual savings of \$273,000 could be achieved.

The report offered several suggestions to distributors for managing freight costs. One suggestion is to reduce the number of freight vendors so that it is easier to track and rebill these expenses. Another suggestion is that distributors should bill nonstock items from a standard table of freight and handling charges, rather than try to track and match actual expenses.

If a company does not have specific measurements and tight controls on nonproprietary freight expenses, it is probably losing substantial money on them, according to the report.

### Gross margin on nonstock items

Nonstock specials processed through the warehouse are expensive transactions. These transactions end up costing distributors five to seven times more than stock transactions. This happens because these transactions require extra ordering, handling, and freight, and result in a high percentage of warranties and returns. However, nonstock items do generate a lower margin (22.4%) than stock items generate (23.7%). According to the report, this situation is the reverse of what it should be.

The *Value-Added* report suggested using a pricing matrix to set nonstock list prices

so that distributors are able to retain what is considered to be an adequate gross margin.

The funding for this report and other industry research through the NAED Education & Research Foundation is made possible by the Channel Advantage Partnership (CAP) Council and Associates. The CAP Council and Associates groups are composed of more than 40 distributors and manufacturers who work together in order to select, monitor, and review a number of industry research studies.

The *Value-Added: Assessing Service Offerings of Electrical Distributors* report is available on the Web, free of charge to employees of NAED member companies. Those who wish to access an electronic copy of the report may contact NAED Customer Service at 888-791-2512 or via e-mail at [customerservice@naed.org](mailto:customerservice@naed.org). ■■■

*Braibish is the principal of Braibish Communications in St. Louis. He can be reached at [jbairish@sbcglobal.net](mailto:jbairish@sbcglobal.net).*



## Get involved today

SUMMER 2007

### May 5-9: NAED Annual Meeting, Washington, D.C.

✓ This conference is packed with top speakers, education sessions, panels, and the who's-who of the industry. The keynote speaker will be P.J. O'Rourke, best-selling author and political satirist.

### June 20-23: NAED Women in Industry Conference, Charleston, S.C.

✓ This three-day meeting will feature business sessions and networking activities. The keynote speaker will be Dr. Kathryn Newton, professor of industrial distribution, Purdue University.

### July 26-29: NAED LEAD Conference, Chicago

✓ This conference for up-and-coming leaders is sponsored by NAED's Your Emerging Talent (YET) group. It is a unique conference built around small-group sessions with industry leaders.

### Sept. 5-8: NAED Executive Conference, Maui, Hawaii

✓ This exclusive event will feature keynote speaker Chuck Steiner, former owner and chairman of the board of Branch Group. The conference will also include golf, tours, and spouse activities.

## Did you know?...

that the *average* TED reader has been in the electrical industry **23 years**, and more than **65%** of readers are **45** and older?

—Source: TED Magazine National Subscriber Profile Survey, January 2007