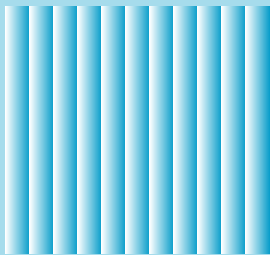


ROI | INCOME STATEMENT | EXPENSES IN RELATIONSHIP TO GROSS MARGIN | BALANCE SHEET
| FINANCIAL RATIOS | ASSET PRODUCTIVITY RATIOS | MERCHANDISING PROFILE | EMPLOYEE
PRODUCTIVITY RATIOS | SALES VOLUME ANALYSIS | REGIONAL ANALYSIS | TREND ANALYSIS

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Profit Improvement Report

“The Datings Game”

Sponsored By the Door and Hardware Institute
and the Foundation for the Advancement of Life Safety and Security

Profit Improvement Report

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The Datings Game

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In the current troubled economic environment, firms throughout the supply chain are making hard decisions about their relationships with other members of the chain. Many of the decisions have significant financial implications.

One of the most important considerations is the degree to which suppliers offer their distributor partners cash discounts and datings on the merchandise purchased. In a tight-credit/lowered-profit world, every supplier should review their terms of sale. To do otherwise would be to violate a fiduciary responsibility.

However, even modest changes in the terms of sale can have an extremely negative impact on the financial results of distributors—both in cash flow and profitability. Everybody in the supply chain needs to understand how these revised terms work through the distributor organization.

This report examines the datings/cash discount issue from two different perspectives:

- **Impact on Financial Performance**—Most suppliers, and even many distributors themselves, are not fully aware of the extent to which small changes in the cash discounts and datings offered impact results. This section will examine how such changes impact the firm.
- **Working with Suppliers**—There must be specific programs in place to make sure the entire channel is working together for the best possible financial results for all concerned.

Impact on Financial Performance

The link between changes in supplier terms and overall financial results is outlined in Exhibit 1. The first column presents results for the typical DHI member based upon the latest PROFIT Report. As can be seen in the exhibit, the typical firm generates sales of \$10,000,000, and produces a pre-tax profit of 3.0% of sales or \$300,000. The firm pays its bills in 28 days and receives a 2.0% cash discount on purchases.

The second column of numbers assumes that the payment period is cut in half, from 28 days to 14 days. The impact, shown at the very bottom of the column, is to cut accounts payable in half, from \$550,000 to only \$275,000. The effect on profit is relatively modest as the firm must pay interest on the reduction in accounts payable. Assuming a 6.0% interest rate, profit only falls by \$16,500.

The real impact is on the firm's cash position. With less accounts payable, the firm has less cash. The result is to drive the firm's cash position negative to -\$200,000. Obviously, the firm would have to use its line of credit to overcome this situation, something easier said than done today.

The third column of numbers looks at the loss of the cash discount. Here the relationship is exactly the opposite of what it was for a reduction in datings. Namely, profit is reduced dramatically, but the firm's cash position is unchanged.

For ease of calculation, any changes in inventory levels are ignored and purchases are assumed to be equal to Cost of Goods Sold. With a loss of 2.0% of purchases, profit plummets from \$300,000 to \$160,000, a decline of 46.7%.

Exhibit 1
The Impact of Cutting Inbound Terms and Cash Discount Rates
On the Firm's Overall Financial Results

Income Statement--\$	Current Results	Cutting Terms in Half	Eliminating The Cash Discount	Both Actions Simultaneously
Net Sales	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000
Cost of Goods Sold	<u>7,000,000</u>	<u>7,000,000</u>	<u>7,000,000</u>	<u>7,000,000</u>
Gross Margin	3,000,000	3,000,000	3,000,000	3,000,000
Normal Expenses	2,700,000	2,700,000	2,700,000	2,700,000
Additional Interest	0	16,500	0	16,500
Discounts Lost	<u>0</u>	<u>0</u>	<u>140,000</u>	<u>140,000</u>
Total Expenses	<u>2,700,000</u>	<u>2,716,500</u>	<u>2,840,000</u>	<u>2,856,500</u>
Profit Before Taxes	\$300,000	\$283,500	\$160,000	\$143,500
Investment				
Cash	\$75,000	-\$200,000	\$75,000	-\$200,000
Accounts Payable	\$550,000	\$275,000	\$550,000	\$275,000

The final column of numbers simply takes the analysis to its logical conclusion and considers both changes at the same time. Both the firm's cash position and its profit level are moved into an untenable position.

DHI members have historically produced reasonable, but unspectacular profits. They also have operated on a very modest cash position. This is because their assets are tied up in inventory and accounts receivable, not cash.

Distributors need to work very hard to maintain their cash position and their profitability. Even small changes can erode results very quickly. At the same time, suppliers must satisfy their own financial requirements. Clearly, a channel-wide view of the situation is needed.

Working with Suppliers

Any potential change in supplier terms will almost certainly be met with the same response. Both sides will scream and yell and pronounce that life is unfair. After that, three specific actions are suggested.

- **Supplier Education**—Suppliers are often accused of not caring about distributor profitability. In almost all instances such suggestions are unwarranted. What is true, though, is that the vast majority of suppliers do not understand distributor profitability. As a result, many well-intentioned programs may be poorly designed.

If suppliers do not understand distributor financial results, it is at least partially the fault of distributors themselves. A very open and honest discussion as to how changes in terms and discount plans affects financial results is needed. An agreement is probably closer than everybody thinks.

- **Commitment to Suppliers**—If terms and discounts are going to be provided by suppliers, then those terms and discounts must be honored by distributors. Terms of 30 days does not mean 35; it doesn't even mean 31.

In addition, suppliers that are willing to work with distributors with regard to their financial position need to be rewarded for doing so. It is called loyalty.

- **Helping Suppliers with Their Financial Challenges**—Just as supplier decisions can impact distributors in negative ways, distributors have the same potential to impact suppliers. Placing fewer, larger orders helps suppliers tremendously, just as does eliminating emergency orders, controlling errors, the using electronic data interchange and a plethora of other factors. Being a good customer never hurts in financial discussions.

Tensions between suppliers and distributors have always existed and always will. However, if both sides approach the present situation with a desire to understand and help the other side improve, such tensions can be diminished.

Moving Forward

Changes in either datings or cash discounts is not a minor issue for DHI members. It is very close to life or death. It is absolutely essential that firms work with their suppliers in an effort to reach an accord that satisfies the financial needs of every channel member.

A Managerial Sidebar: Getting Specific at the Firm Level

Every firm represents a somewhat unique situation. While the examples in this report can help with the educational process, more firm-specific information is always valuable.

An Excel file, "Profit Imp Report_Vol17-4_Excel file attachment.xls" is provided as an attachment for download in the "Distributor Research" section of the DHI Web site: Visit www.dhi.org

This Excel file is provided to help firms work through results for their firm has been posted on the DHI web site. This file allows DHI members to make changes in both datings and cash discount arrangements and see what happens. The following is an example using the Excel file. The items enclosed in boxes can be changed. Everything else calculates automatically.

The Excel file is available at no cost to all DHI members.

Variables	Current Situation	Revised Situation
Average Payment Days	28.0	18.0
Average Cash Discount--%	2.0	1.0
Financial Impact	Current Results	Revised Results-\$
Income Statement		
Net Sales	10,000,000	10,000,000
Cost Of Goods Sold	<u>7,000,000</u>	<u>7,000,000</u>
Gross Margin	3,000,000	3,000,000
Expenses		
Normal Expenses	2,700,000	2,700,000
Interest Impact	0	11,507
Any Discounts Lost	<u>0</u>	<u>70,000</u>
Total Expenses	<u>2,700,000</u>	<u>2,781,507</u>
Profit	300,000	218,493
Assets		
Cash	\$75,000	-\$116,781
Accounts Payable (Imputed Based Upon Credit Terms)	\$536,986	\$345,205



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As the direction of the Foundation has changed, now so has its name. The DHI Education Foundation is now the "Foundation for the Advancement of Life Safety and Security." This name change reflects the work that the Foundation has undertaken on behalf of our industry. The name reflects an area of growth opportunity—security. There is much to be done to provide enhanced security within the buildings we touch.

Along with providing security, we also have an opportunity to play a very important leadership role in life safety - through the fire-door inspection process. If we can achieve increased financial support, the Foundation can begin to implement a program that will raise the awareness level of this important new code change. The fire-door inspection concept is a huge opportunity for the architectural openings community - an opportunity to provide valuable insight into the safety and security of each and every fire-rated door.

The Foundation's core purpose is to raise funds to provide education and research for the advancement of the architectural openings industry and the safety and security of the built environment.



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The Door and Hardware Institute is a professional organization that serves the North American marketplace as the advocate and primary information resource for professional development and certification for the architectural openings industry with a focus on the channels of distribution.

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