GROENEWOUT

How does a wholesaler make money on orders?

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Is the customer king?

Any wholesaler or trading company is in business to make profit, not turnover. Yet it's just not done to turn a customer away. From a trader's day-to-day perspective, every euro of sales is gratefully received. After all, customers pay the bills – or do they? There is no such thing as the 'typical' customer. Customer segmentation will unavoidably be somewhat arbitrary but it is nevertheless important because different types of customers require different logistics approaches and services. One customer might be focused on receiving faultless and reliable just-in-time delivery at the lowest possible price but generates high volumes in return, for instance. Meanwhile another customer wants a decent price and as much convenience as possible, such as deliveries within 24 hours and regional presence for urgent cases. And for yet another customer, the price is no object as long as 24/7 availability and immediate deliveries are guaranteed. Different customer requirements result in different cost levels. This rational aspect needs to be factored in alongside the emotional element within the customer relationship.

First step: insight into costs

Within trading companies and wholesalers, sales managers, logistics managers and controllers are always aware of certain key data. For a sales manager, this tends to be general sales figures, market share details and customers numbers, the logistics manager knows the number of order pick lines, number of shipments and SKUs, and the controller knows the company's operating costs and inventory value. However, there is often a lack of insight into correlations between these key figures: what is the cost of an order, what is the break-even point for inventory, what should we charge for a logistics service, and is a particular customer profitable?
I can almost hear you sigh: is this yet another article about activity-based costing? Setting up and managing an activity-based costing system involves a lot of time and is always somewhat arbitrary because of the way costs have to be assigned to activities and cost drivers. That's why such systems, which originated in manufacturing, are still rarely used to manage wholesaling processes. But what could be a first, and simple, step towards increasing your profitability?
Logistics costs account for a considerable proportion of a wholesaler's total costs. The logistics costs of a typical technical wholesaler are given below to illustrate the opportunities for improvement as clearly as possible:

(1) warehouse handling costs
(2) distribution costs (outbound)
(3) inventory costs
(4) facility costs (rent, maintenance and energy)
(5) other costs.

The costs of warehouse handling (1) and outbound distribution (2) often each make up between 2 and 4% of the cost price of turnover. Inbound distribution costs are (unfortunately) almost always an integral part of the purchase price. The inventory costs (3) can be difficult to extract from the financial accounts but, based on a fictitious yield factor plus an extra amount for write-off charges/risk, these often account for 1 to 2% of the cost price of turnover. Finally, the categories of facility

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costs (4) and other costs (5) each account for 0.5 to 1%. These ranges (amounting to a total of between 6 and 12% of the cost price of turnover) are intended to serve only as a guideline and can vary considerably from one company to another.
When the total profit margin is just a few percent, the impact of logistics improvements is indisputably significant. You should be able to obtain details of the costs for your company fairly easily from your accounting department.

From cost insights to improvements
Unless you use cost insights to identify improvements, their benefit is limited. However, it is not always easy to determine where potential improvements lie, which is where benchmarking can be helpful. The list below contains examples of situations which are definitely or highly likely to be unprofitable. The need for improvement is clear, and the quick wins often have a surprisingly substantial impact. It is a matter of gathering information on both sales and purchasing order lines and stock and item-level data for your company.

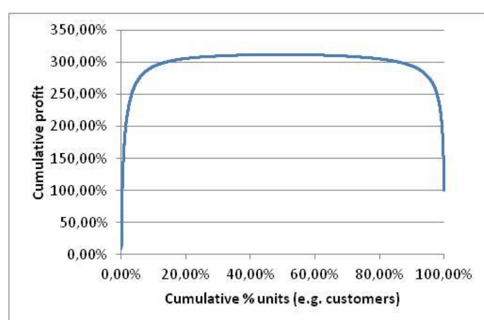
1. **Warehouse handling costs:** The lower the average value per order line, the more important warehouse efficiency is. There are probably even some lines with a lower line value than the warehouse’s average handling costs. Warehouse productivity is essential but it often requires company-specific analysis. To achieve a quick win, look at increasing the lowest order quantities for both the sale and purchase of cheap items, or apply a cost surcharge to low-value products.
2. **Distribution costs:** If your order value is low, the distribution costs alone probably mean that you are unlikely to make any profit unless you subject customers to a surcharge. Here, too, some orders probably have a lower order value than the average distribution costs per order. Although customers may not like delivery charges or minimum order levels, they often accept them in return for having more control over the value of their orders. Furthermore, you can make significant gains for both yourself and the customer with a delivery schedule: you discuss and agree about (ideally supported by a WMS/ERP system) the day/days of the week on which you will make deliveries to them. Urgent deliveries or specific time windows can be offered in a separate agreement.
3. **Inventory costs:** Draw up rules for deciding which products to hold in stock and determine the required service level (from stock on hand) for each one. In technical wholesale, a service level of at least 97% within 24 hours is the norm for inventory products. A useful rule of thumb in wholesale is that, at product group level, the inventory turnover multiplied by the average sales margin should be at least 1.2 to remain within the cost bracket. The activities required at individual item level depend on value and inventory turnover. Products with a high purchase value and high inventory turnover benefit from a fast delivery time (from the supplier), a high order frequency and accurate

demand forecasting. Products with a high value and low inventory turnover preferably should not form part of the inventory range, but if they do they benefit from clear return agreements with suppliers and/or accurate demand forecasting. In the case of low-value items, it is possible to achieve a quick win by working with a higher inventory level or higher order quantity (based on Camp's formula, for instance).

4. **Facility costs (rent/maintenance/energy):** A building's rent depends largely on its location and physical construction (e.g. height). Likewise, the energy costs are related to the construction and insulation of the premises. While it can often be difficult to make short-term changes to the building itself due to contractual agreements, there is nothing stopping you improving the facility's turnover value (compactness of storage and efficiency of order processing) per square meter. How this can be done in practice depends on the company in question. If the technical wholesaler's turnover (at cost price) is less than 7,500 euro per year per m2 the facility costs are comparatively high, making further optimization worthwhile.

The logical next steps: the customer is king

These initial insights into costs have not shown us whether each customer is profitable. To discover this, we need to obtain more data about margins per customer and to consider other cost areas within the company in addition to logistics. In this second phase, the activity-based costing approach mentioned earlier can be used. It is also worth following up any insights gained in this phase with targeted actions. This does not mean blindly casting off unprofitable customers, products or suppliers. A 'whale curve' chart (a Pareto-type distribution analysis of the cumulative profitability of customers, products or suppliers) can help you to prioritize, set targets and negotiate.



Example of a whale curve chart.

The third step sees you expanding the potential for improvement by actively involving suppliers, customers and third-party support partners and working together with them to optimise the entire supply chain. If you continue to make money on orders in this way, your customers will remain king. In fact, you will have enough resources at your

disposal to be able to meet their every need and treat them not just like a king, but like an emperor.

If you have any questions or feedback regarding this article, please contact Arthur Zondervan, Zondervan@groenewout.com or +31 76 533 0440.