
“Critical Components for Success in Chemical Distribution—In Good Times and Bad Times”



**Presented at the NACD Southern Region Meeting
May, 2009
Nassau, Bahamas**

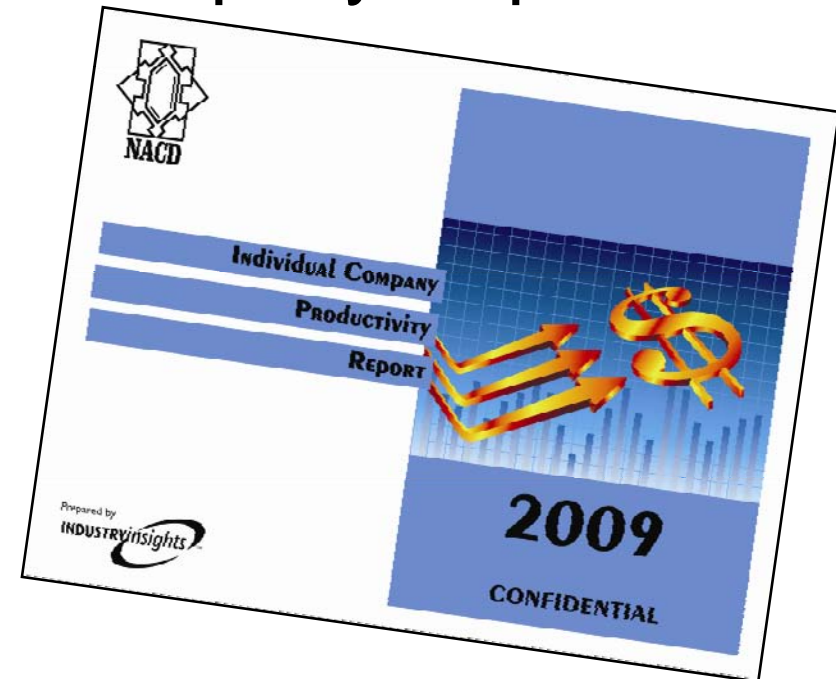
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Session Outline: “Critical Components for Success”

- Using “Benchmarking” Performance Measures for Better Business Control
 - Recent Economic Perspectives
 - Highlights of Chemical Distributor Performance and Profit Leader Results
 - What We Have Learned—Keys to Successful Performance!
 - Applying Industry Benchmarks to Your Own Company--Case Example of a Hypothetical Chemical Distributor
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NACD “Company Productivity Report” and “Compensation & Benefits Report”

- Overall Industry Report
- Confidential Individual Company Report



Why is “Benchmarking” Important?

- Financial Information is More Useful as a Ratio Than an Absolute Figure
 - Ratios Need to be “Benchmarked” Against Some Standard (i.e., Industry Peers, Company’s Historical Performance, Company Budgets or Plans, etc.) to be Meaningful
 - NACD Benchmarking Reports Should be Regarded as “Guidelines” Rather Than Absolute Standards
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Why is “Benchmarking” Important?

- Major Deviations Between Your Own Firm’s Performance and Industry Norms Are Not Necessarily Good or Bad, But are Signals of Areas for Further Analysis
 - ***Even Relatively Simple Analysis Can Result in Significant Insights About Your Business***
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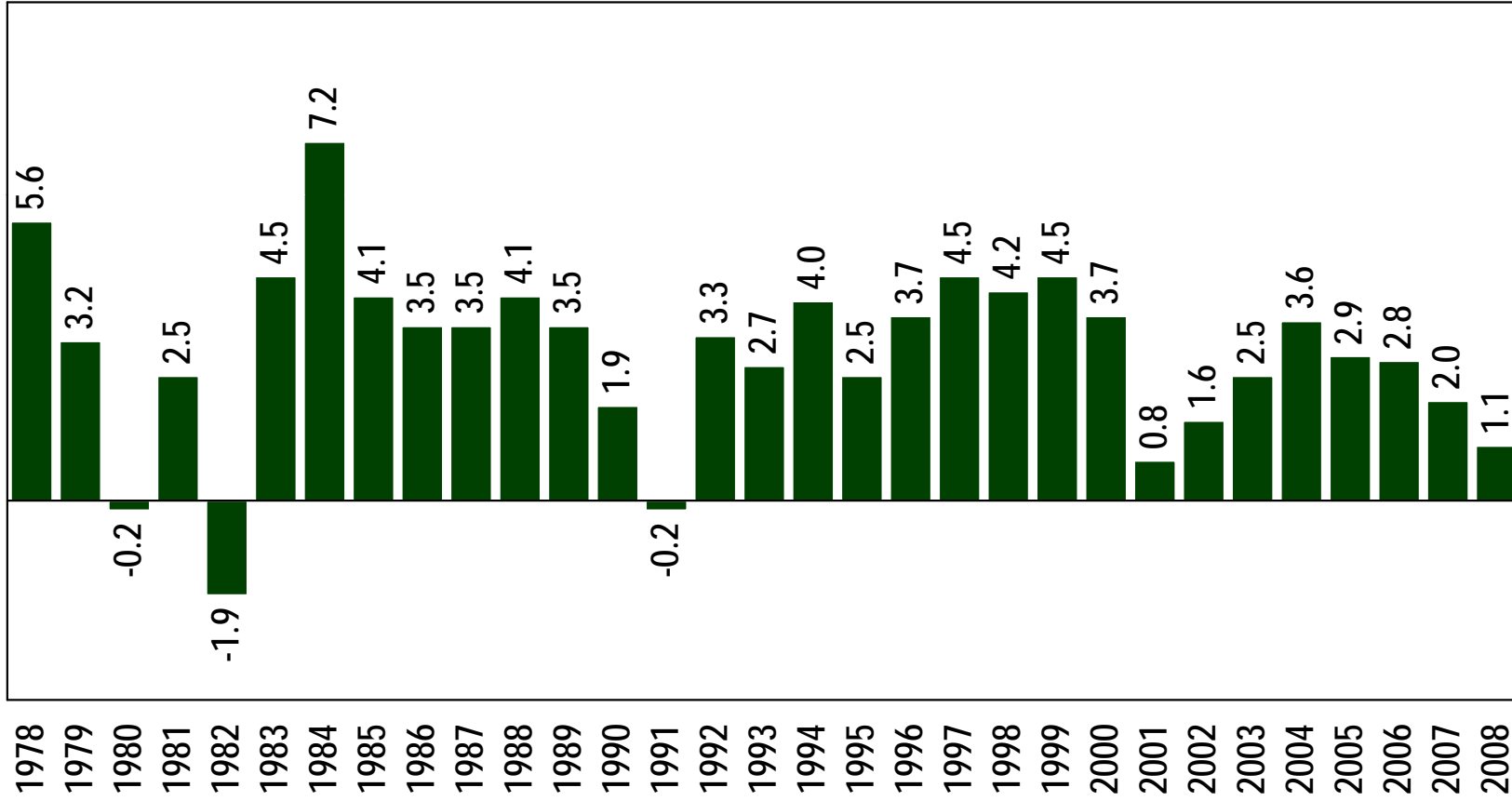
NACD “Benchmarking” Reports

- **Company Productivity Report**—Measures of: Profitability; Expense Management; Profit Margin Management; Gross Margin Performance; Departmental Expenses and Productivity; Asset Management; Inventory Management; Accounts Receivable; Financial Management & Liquidity; Worker’s Compensation; Other Measures
 - **Compensation & Benefits Report**---Measures of: Salaries, Commissions, & Bonuses by Employee Position; Detailed Fringe Benefits Information
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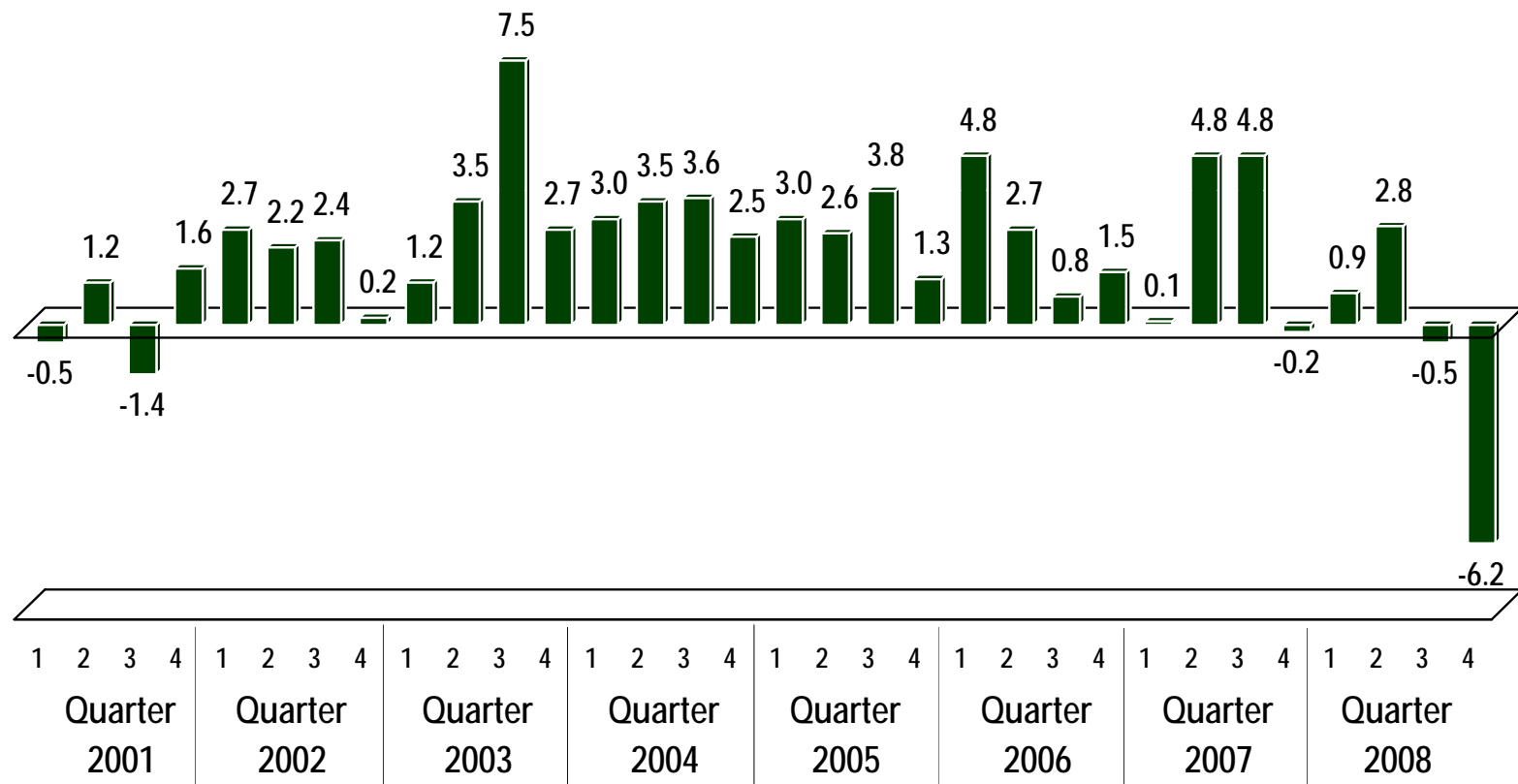
NACD “Benchmarking” Reports

- CPR Data Organized By:
 - Type of Chemical Distributor (i.e., LIQ, FPP; BPM)
 - Sales Volume Size of Company
 - High Performers
 - Other Relevant Groupings
 - Compensation & Benefits Data Organized by:
 - Sales Volume Size of Company
 - Geographic Region
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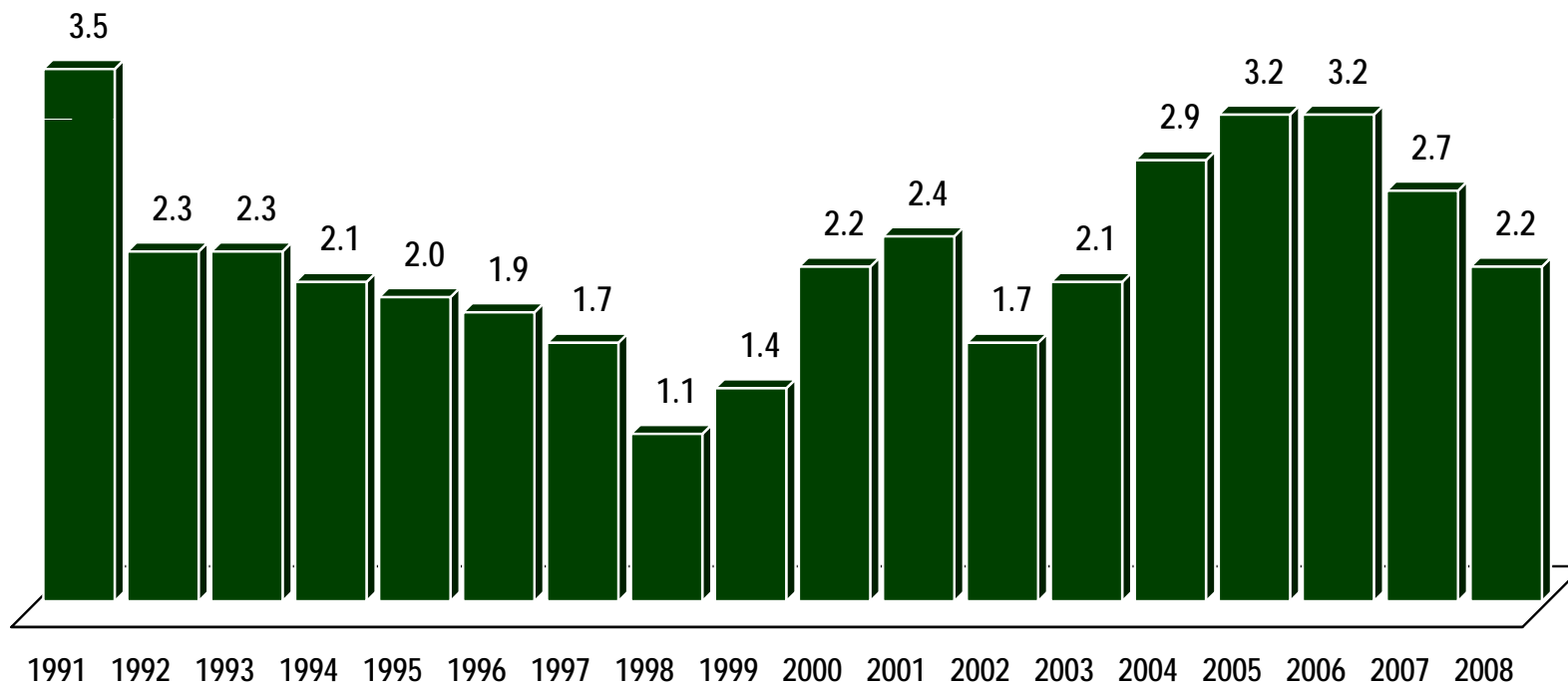
“Real” Gross Domestic Product (Annual Inflation Adjusted % Changes) (% Change from Prior Year)



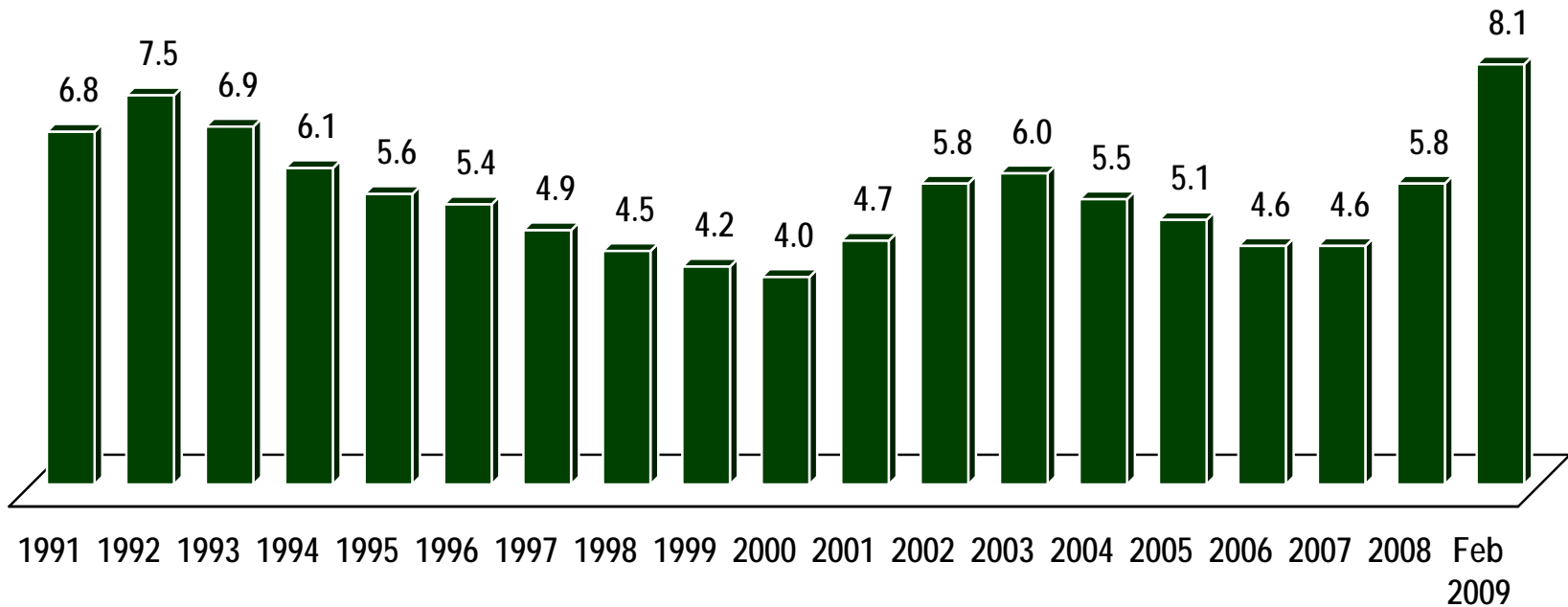
“Real” Gross Domestic Product (Percent Change from Preceding Quarter)



Inflation (Gross Domestic Product Deflator) (Annual % Change)

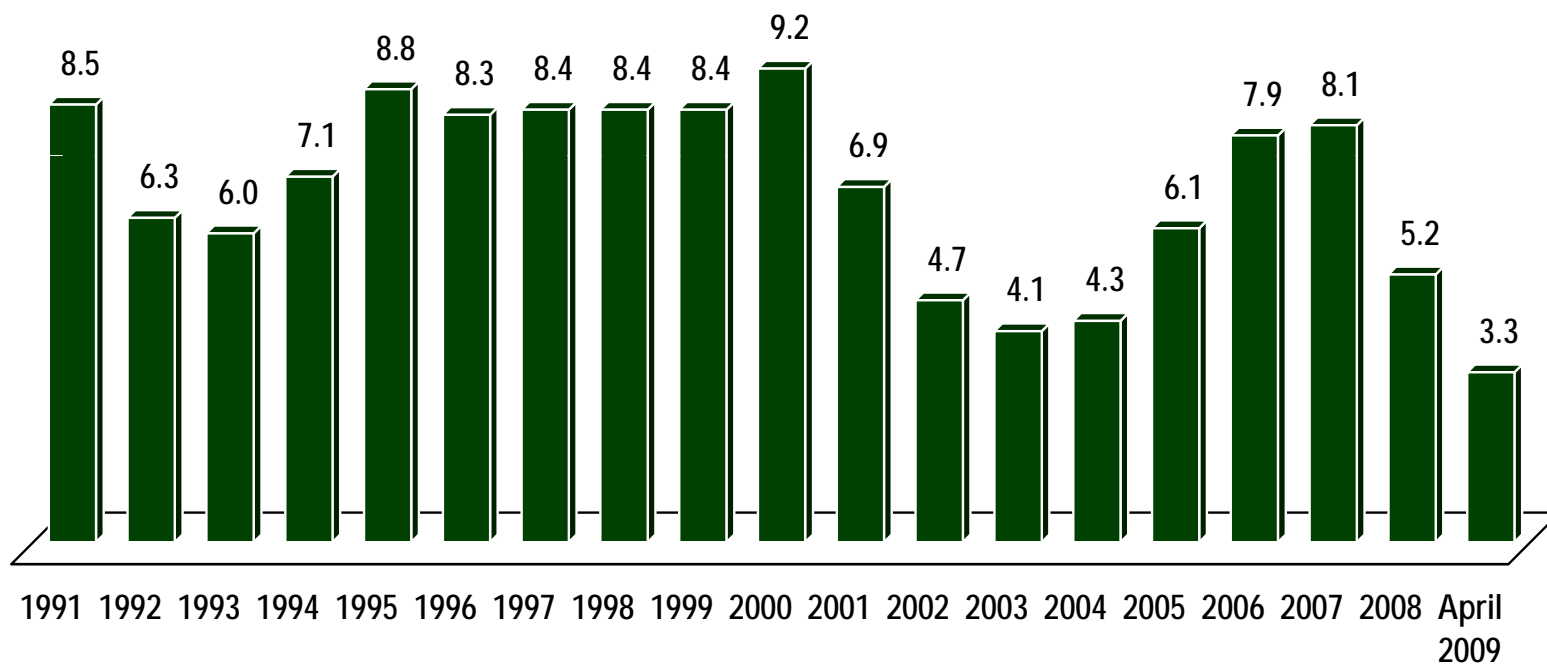


Average Annual Unemployment Rates (%)*



*All Civilian Workers

Prime Rate (%)



Other Perspectives

Current Unemployment Rate: 8.5% (Mar. 2009)

Expected 2009-2010 Monthly Peak: 10.5% to 10.9%

Peak Monthly Unemployment Rates During Other Post WWII Recessions:

1949	7.9%	1982	10.8%
1958	7.5%	1983	10.4%
1975	9.0%	1992	7.8%
1980	7.8%	2003	6.3%
1981	8.5%		

. . . We have been here before!!!

Highlights of Chemical Distributor Performance

LIQ

FPP

BPM

	All	High Profit	All	High Profit	All	High Profit
Total Return on Assets (Before Interest & Tax)	8.2%	18.6%	11.2%	19.0%	10.8%	16.5%
Before Tax Return on Net Worth	23.6%	33.6%	20.6%	42.5%	16.8%	33.5%
Asset Turnover (Sales/Total Assets)	3.4X	4.0X	3.6X	4.2X	3.2X	3.8X
Leverage (Total Assets/Net Worth)	3.9X	3.9X	3.0X	2.8X	2.2X	2.3X
Inventory Turnover	9.6X	11.6X	6.3X	6.2X	7.1X	6.5X
Accounts Receivable Days Outstanding	42.8	40.2	44.0	40.4	43.0	42.5

Highlights of Chemical Distributor Performance

	LIQ		FPP		BPM	
	All	High Profit	All	High Profit	All	High Profit
Sales Growth (based on \$)	2.7%	7.0%	-1.4%	-1.4%	1.6%	2.8%
Sales Growth (based on pounds without 3rd party)	-5.1%	9.1%	0.2%	1.0%	0.6%	1.4%
Payroll Expense (as a % of gross margin)	53.3%	45.8%	50.9%	43.0%	46.2%	46.3%
Gross Margin After Commissions (as a % of sales)	21.8%	23.5%	18.8%	17.8%	18.5%	19.0%
Total Operating Expense (% of sales)	20.0%	18.9%	16.0%	13.1%	15.2%	14.9%
Net Profit Before Tax (% of sales)	1.8%	4.0%	1.9%	3.6%	2.4%	3.8%

Representative Employee Compensation

(Based on “Total Compensation”)

(All Companies Responding) (Based on 2007 study)

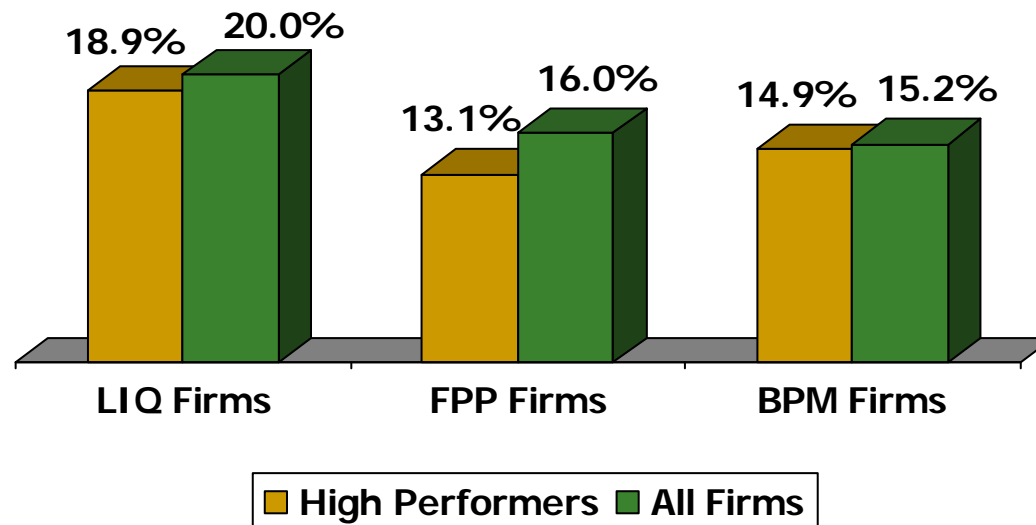
	Average	Median
President/CEO	\$316,502	\$211,960
Executive VP, COO	\$184,244	\$182,820
Top Financial Officer	\$138,443	\$129,331
Accountant	\$53,908	\$50,958
Human Resources Manager	\$62,469	\$60,000
Purchasing Agent	\$48,564	\$47,925
Top Sales/Marketing Executive	\$174,476	\$157,000
Sales Rep.	\$97,110	\$85,350
Bookkeeper	\$16.34/hr	\$16.04/hr
Secretary	\$17.56/hr.	\$17.67/hr
Receptionist	\$13.08/hr.	\$12.56/hr.
Fork Lift Operator	\$16.39/hr.	\$15.43/hr.
Truck Driver	\$17.87/hr.	\$18.10/hr.

Success Component #1: The Importance of Expense Management

- Of all the factors that influence bottom line profitability, expense control is the most important.
 - “Expense creep” is a silent profitability threat facing all chemical distributors.
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Success Component #1: The Importance of Expense Management

Total Operating Expenses--% of Sales

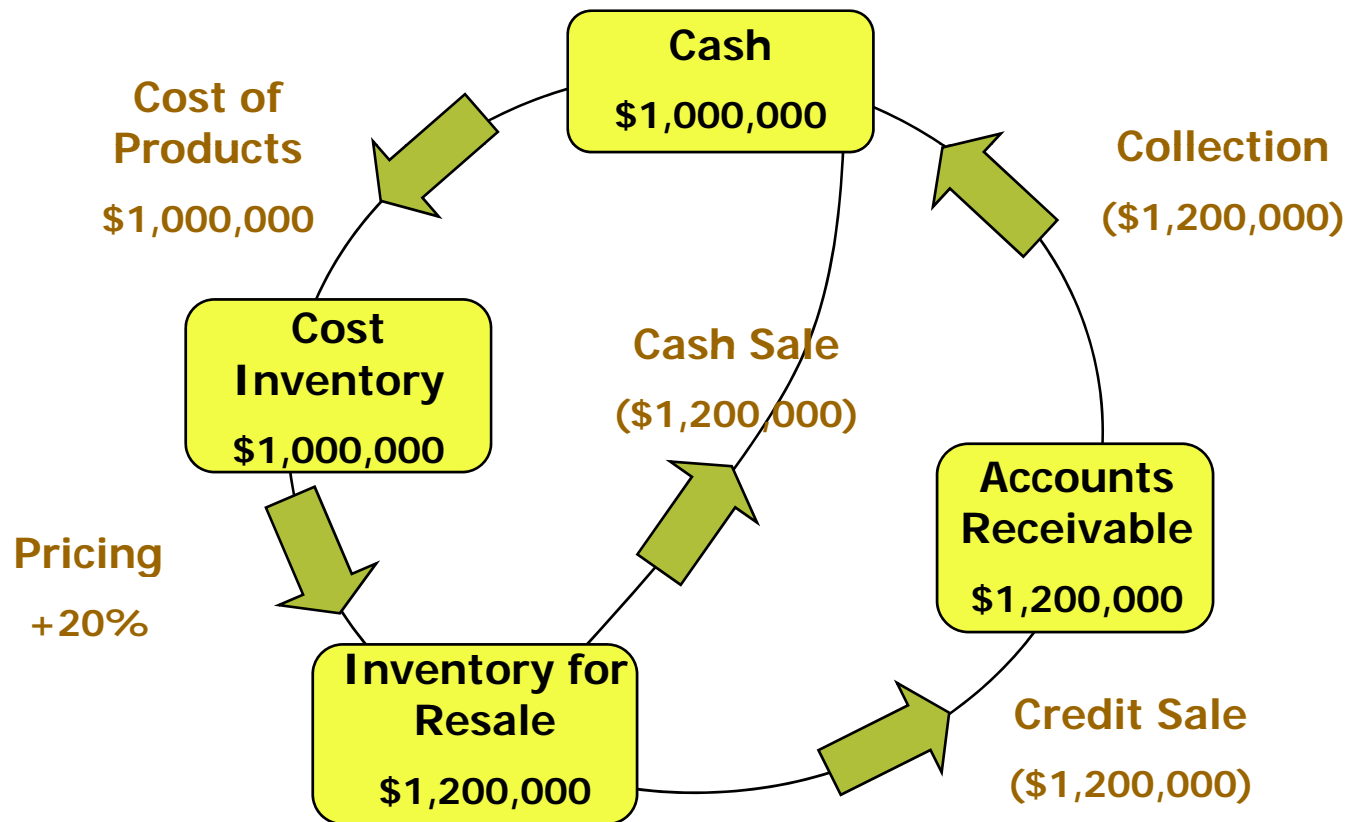


Success Component #2: The Importance of Cash Flow Management

- **Profits are important but “Cash is King” (“Cash flow management is effectively satisfying short-term cash obligations relative to available cash”)**
 - **Cash flow is the lifeblood of any business**
 - **Poor cash flow is not a problem. It is a symptom. However, poor cash flow planning is a problem.**
 - **Poor cash management is a major cause of business failures.**
-

Success Component #2: The Importance of Cash Flow Management

THE CURRENT ASSETS CYCLE



Success Component #2: The Importance of Cash Flow Management

Basic Steps of Controlling Cash Flow

Step 1: Forecast sales over time

Step 2: Forecast cash resources to be received over time

Step 3: Forecast the monthly (or quarterly) outflows over time

Step 4: Subtract the cash outflows from the cash inflows in order to determine cash needs or excess cash

Success Component #2: The Importance of Cash Flow Management

SAMPLE CASH FLOW PLANNING WORKSHEET

	Month 1	Month 2	Month 3	...	Month 12	Total
CASH RECEIPTS:						
Cash Sales						
Accts. Rec. Collections						
Sales of Fixed Assets						
New Debt or Equity						
Decrease in Other Assets						
Total Receipts						
CASH PAYMENTS:						
Accts. Payable Payments						
Salaries and Fringes						
Fixed Asset Purchases						
Debt Repayments						
Total Payments						
Net Cash Flow (Receipts Minus Payments)						
Beginning of Period Cash						
End of Period Cash (Beginning Cash plus or minus Net Cash Flow)						

Success Component #3: Effective Inventory Management

INVENTORY IS IMPORTANT...

- **Is the principal source of revenues.**
 - **Is a significant cost item (i.e., cost of goods sold is approximately 75-85% of sales).**
 - **Is one of the largest asset investment categories.**
 - **Inventory carrying costs represent 20-30% of on-hand inventory value.**
 - **Accounts payable (trade credit) is a significant source of funds.**
-

Success Component #3: Effective Inventory Management

TOO MUCH INVENTORY COSTS MONEY!

Inventory Carrying Costs as a % of Inventory Value

“Typical” Distributor

Obsolescence & Damage	5.5%
Capital costs (i.e., interest)	5.0
Storage (i.e., space) cost	3.0
Shrinkage	1.0
Insurance	1.0
Taxes	1.5
Handling & Distribution	8.0
Total	25.0%

Success Component #3: Effective Inventory Management

TOO MUCH INVENTORY TIES UP MONEY!

- **Results in additional borrowing**
- **Reduces liquidity and cash flow**
- **Restricts expansion opportunities**

\$1,000,000 in “excess” inventory is probably costing between \$200,000 to \$300,000 per year in carrying costs and is hindering cash flow and expansion opportunities.

Success Component #3: Effective Inventory Management

INVENTORY MANAGEMENT MEASURES

	LIQ Firms	FPP Firms	BPM Firms
Gross Margin--% Warehouse (Stock) Sales	22.0%	17.0%	22.3%
Inventory Turnover	9.6x	6.3x	7.1x
Turn & Earn	213%	100%	147%
Gross Margin Return on Inventory	258%	120%	182%

Success Component #3: Effective Inventory Management

NOT ALL INVENTORY IS CREATED EQUALLY

	Warehouse Gross Margin As a % of Sales	x	Inventory Turnover	=	Turn & Earn
Product Line 1	_____		_____		_____
Product Line 2	_____		_____		_____
Product Line 3	_____		_____		_____
Product Line 4	_____		_____		_____
Overall Company	_____		_____		_____

In general: Slower moving products tend to be where inventory is excessive; fast selling products are oftentimes under-inventoried.

Success Component #4: Effective Receivables Management

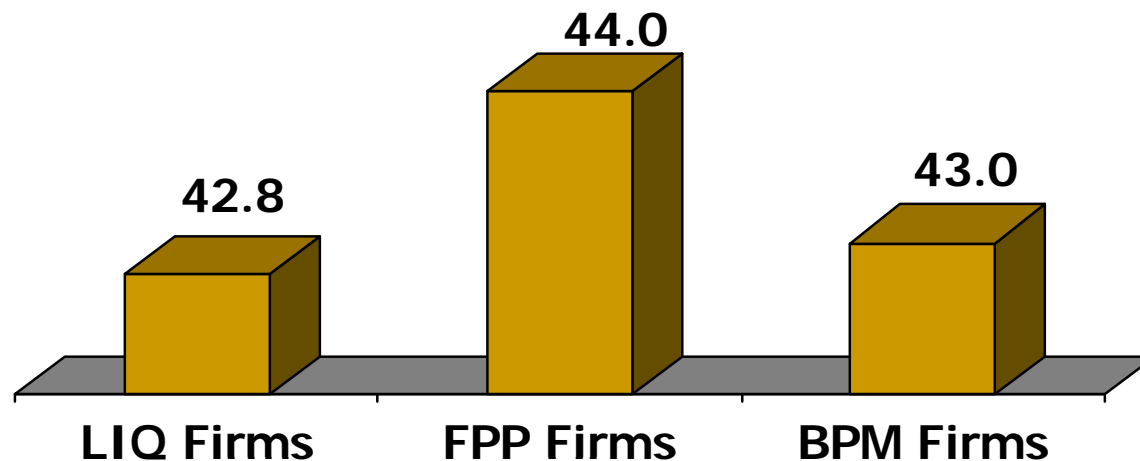
AN OVERDUE RECEIVABLE CAN BE A COSTLY ASSET

- **Bad-debt losses:** **Approximately 0.2% of sales**
 - **Credit Department
Costs (i.e., clerical,
equipment,
supplies, etc.):** **1% to 2% of Sales**
 - **Collection costs:** **50% of amount collected**
 - **Cost of capital:** **5% interest on \$1 million in
receivables is \$50,000/year**
-

Success Component #4: Effective Receivables Management

MEASURING RECEIVABLES

$$\text{Accounts Receivable Days} = \frac{\text{Accounts Receivable} \times 365}{\text{Net Sales (excluding cash \& COD)}}$$



Success Component #4: Effective Receivables Management

CONTROLLING YOUR RECEIVABLES BEFORE THEY CONTROL YOU

- Follow regular, timely and accurate billing procedures
- Quickly convert payments into capital
- Handle past due accounts aggressively and expeditiously
- In all collections, *“The squeaky wheel gets the grease”*

As a general rule, *“attention to detail”* almost always produces positive results in receivables management.

Success Component #5: Effective Employee Compensation Plan

- If all employees are salaried, where's the incentive to produce?
- If all of your sales staff are paid commissions based on gross sales, where's the incentive to be profitable?

High profit firms have higher employee productivity than low profit firms.

Success Component #5: Effective Employee Compensation Plan

PERSONNEL PRODUCTIVITY

	Total Payroll As a % of GM (PPR)	Gross Margin/ Employee (000)	Sales/ Employee (000)
LIQ Firms			
High Performers	45.8%	\$172.8	\$641
Low Performers	55.0%	\$115.8	\$628
FPP Firms			
High Performers	43.0%	\$234.5	\$1,410
Low Performers	57.6%	\$174.5	\$865
BPM Firms			
High Performers	46.3%	\$201.2	\$1,037
Low Performers	46.2%	\$168.2	\$895

Success Component #5: Effective Employee Compensation Plan

Conclusion:

If you want to improve return on assets, you must develop programs to enhance employee productivity.

Possible Actions:

- Pay for performance
 - Pay for “profitable” performance
 - Don’t be a scrooge—take care of your #1 asset—Your employees and they’ll take care of you.
-

Success Component #5: Effective Employee Compensation Plan

High profit firm employees typically have higher compensation than low profit firms.

**% Higher Compensation/Employee
for High vs. Low Performer Firms**

All NACD

Respondents

+12.4%

Success Component #6: Using Adequate Financial Data & Performance Comparatives

PRIMARY PROBLEMS:

- No separate measure of revenue profitability
 - No clear understanding of which measures are most important
 - Inadequate use of industry benchmarks
-

Success Component #6: Using Adequate Financial Data & Performance Comparatives

FIFTEEN SUGGESTED RATIOS TO REGULARLY MONITOR

Sales

% Change

Profit Margin Management

(% of Sales)

Net Profit Before Tax

Gross Profits

Total Operating Expenses

Personnel Productivity

Payroll as a % of Sales

Gross Profit per Employee

Net Sales per Outside Salesperson

Asset Management

Inventory Turnover

**Warehouse Gross Margin Return on
Inventory (GMROI)**

Average Collection Period on Receivables

Overall Asset Turnover

Return on Assets

Financial Management

Total Assets to Net Worth

Liquidity

Current Ratio

Quick Ratio

Success Component #7: Adequately Managing Sales Growth

Fact: Higher sales typically result in larger investments in:

- Inventory
- Accounts receivable
- Fixed assets
- Accounts payable

Challenges:

- Quantifying how fast a firm can grow using internally generated funds.
 - Avoiding the risks of “cashless prosperity” by managing cash flow.
-

Success Component #7: Adequately Managing Sales Growth

ESTIMATING YOUR “SUSTAINABLE GROWTH”

$$\text{Sustainable growth rate} = \frac{\text{Net profit after tax minus dividends}}{\text{Net worth}}$$

or

$$\text{Sustainable growth rate} = \frac{\text{Net profits after taxes}}{\text{Net worth}} \times \text{Percent of Net Profits After Taxes retained in the business}$$

EXAMPLE CALCULATION

■ \$500,000 Profit

■ \$200,000 Dividend

■ \$5,000,000 Net Worth

$$\frac{\$500,000 - \$200,000}{\$5,000,000} = 6\%$$

Success Component #8: Having a Good Succession Plan (i.e., Exit Strategy)

STARTLING STATS:

- 95% of all U.S. corporations are closely-held
 - Only 27% of all businesses have a formal business succession plan
 - 70% of all second generation family businesses fail
 - 88% of all third generation family businesses fail
-

Success Component #8: Having a Good Succession Plan (i.e., Exit Strategy)

WHY OWNERS DO NOT PROVIDE FOR SUCCESSION

- **Procrastination**
 - **Ego**
 - **No interests outside the business; loves working**
 - **Perceived difficulty in finding an able successor**
 - **Difficulty in dealing with family succession issues**
 - **Illusion they will live forever and never lose their edge in business**
-

Success Component #8: Having a Good Succession Plan (i.e., Exit Strategy)

BLUEPRINT FOR SUCCESSION PLANNING

- 1. Convince yourself and be committed to establishing a plan**
 - 2. Establish the necessary wills, trusts, insurance and other estate planning tools in order to minimize (or eliminate) estate taxes.**
 - 3. Have a professionally prepared objective, business valuation appraisal prepared for your company.**
 - 4. Establish a flexible timetable for exiting the business and the necessary action plan to facilitate your planned exit.**
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Success Component #9: “Planning for Profits”

TYPICAL BUDGETING PROCESS: A TOP DOWN APPROACH

Step 1: Forecast sales and gross margin



Step 2: Forecast expenses



Step 3: Profits are what is left over

Success Component #9: “Planning for Profits”

“PLANNING FOR PROFITS” BUDGETING PROCESS: A BOTTOM UP APPROACH

Step 1: Forecast sales dollars for your budget year



Step 2: Estimate gross margin percentages and dollars

Step 5: Break the expense control figure into its various individual accounts



Step 4: Based on the profit requirement of Step 3, a “Total Control” expense figure will result



Step 3: Establish a bottom line profit objective—profits are a “requirement, not a residual”

Success Component #9: “Planning for Profits”

ESTABLISHING A BOTTOM LINE PROFIT OBJECTIVE

- | | |
|---|----------------------|
| 1. Satisfy stockholder risk/return expectations | _____8_____% |
| 2. To finance future growth | _____5_____% |
| 3. To offset inflation | _____3_____% |
| Total RONW Objective | _____16_____% |
-

Success Component #9: “Planning for Profits”

Desired Annual Real Growth Rate \ Inflation Rate	No Inflation (0% per year)	Moderate Inflation (4% per year)	High Inflation 8% per year)
No Growth (0% per year)	8% Return on Net Worth	12% Return on Net Worth	16% Return on Net Worth
Moderate Growth (5% per year)	13% Return on Net Worth	17% Return on Net Worth	21% Return on Net Worth
High Growth (15% per year)	23% Return on Net Worth	27% Return on Net Worth	31% Return on Net Worth

NOTE: At no growth and no inflation, the return on net worth is the “pure” or “real” return of a relatively riskless debt obligation, which is assumed to be 5%, plus an assumed 3% for the risk of being in business.

Success Component #10: Avoiding Mismatched Financing

AS A GENERAL RULE:

Long-term assets (that by definition, convert to cash in a year or longer) should be financed with long-term liabilities, not with short-term lines of credit that have to be paid off within the next 12 months.

Tom's Chemical Distribution Company

Income Statement

Sales	\$58,732,900
Cost of Goods Sold	<u>45,584,420</u>
Gross Margin	13,148,480
Departmental Expense:	
General & Administrative	1,932,830
Occupancy	1,775,040
Distribution (warehouse)	2,379,870
Delivery	1,722,450
Sales	<u>4,391,590</u>
Total Department Expense	12,201,780
Interest Expense	105,156
Other Income/(Expense)	39,450
Net Profit (Loss) Before Tax	880,994

Tom's Chemical Distribution Company

Balance Sheet

Assets

Cash & Equivalent	\$658,150
Receivables	10,459,280
Inventory	12,404,230
All Other Current Assets	140,210
Total Current Assets	23,661,840

Fixed Assets	1,874,170
Total Assets	25,536,040

Liabilities & Net Worth

Current Liabilities	13,918,740
Long-Term Liabilities	3,379,870
Total Liabilities	17,298,610

Net Worth	8,237,430
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Total Liabilities & Net Worth	\$25,536,040
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Tom's Chemical Distribution Company

Overall Performance Measures

Overall Performance	Yours	All BPM Distributors
Total Return on Assets (before interest and taxes)	3.5%	10.8%
Before Tax Return on Net Worth	5.5%	16.8%
Asset Turnover	2.3x	3.2x
Sales Change	2.1%	1.6%
Personnel Productivity		
Payroll Expenses (as a % of gross margin)	57.2%	46.2%
Gross Margin Per Employee (\$000)	\$131.1	\$190.6
Sales Per Employee (\$000)	\$585	\$1,022

Tom's Chemical Distribution Company

Overall Performance Measures

	Yours	All BPM Distributors
Inventory Productivity		
Inventory Turnover	3.7x	7.1x
Gross Margin Return on Inventory (GMROI)	106%	182%
Receivables Management		
Accounts Receivables Days	58.2	43.0
Financial Management		
Current Ratio (Current Assets/Current Liabilities)	1.7x	1.9x
Leverage (Total Assets/Net Worth)	3.1x	2.2x

Tom's Chemical Distribution Company

Percent Income Statement (% of sales)

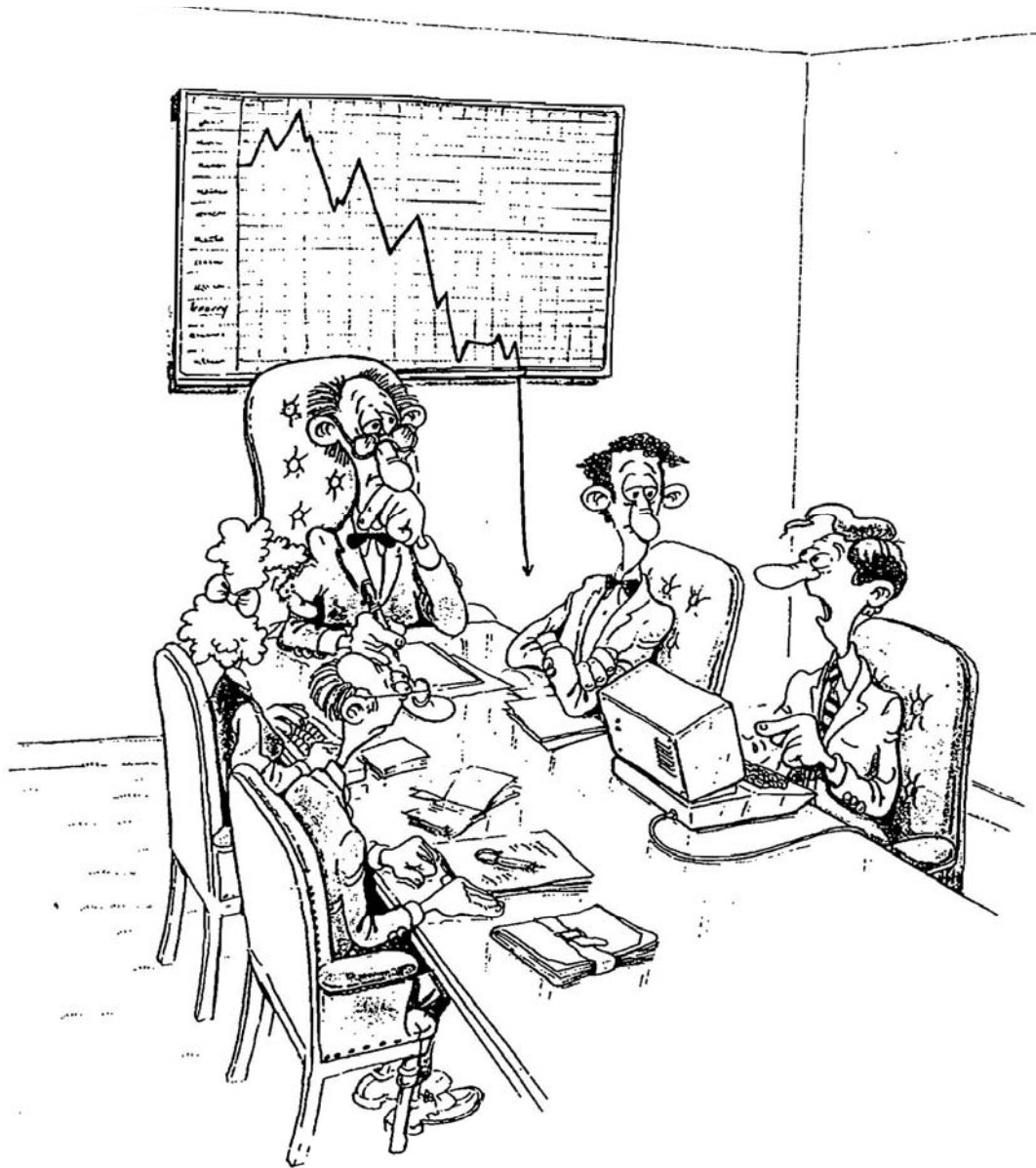
	Yours	All BPM Distributors
Gross Margin	22.4%	18.5%
Departmental Expenses:		
General & Administrative	3.3%	4.2%
Occupancy	3.0%	1.1%
Distribution (warehouse)	4.1%	2.1%
Delivery	2.9%	2.4%
Sales	<u>7.5%</u>	<u>5.5%</u>
Total	20.8%	15.2%
Interest Expense	0.2%	1.0%
Other Income/(Expense)	<u>0.1%</u>	<u>0.1%</u>
Net Profit Before Tax	1.5%	2.4%

Hypothetical Company Case Example

Tom's Chemical Distribution Company

Analysis Conclusions

- Lower profitability due to:
 - Much higher payroll costs
 - Much higher occupancy cost
 - Much higher distribution (warehouse) cost
 - Poor personnel productivity
 - Very high accounts receivable days outstanding
 - Somewhat low liquidity and high leverage
 - Strengths of the company:
 - Higher sales growth
 - Higher gross margin as a % of sales (but much lower inventory turnover and much lower GMROI)
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“According to the computer, we are facing a poor economy, an unfavorable tax ruling, and a change over in accounting methods, all coming together to produce an effect known as ‘The Shit Hitting the Fan.’”

Participation in the 2009 NACD Company Productivity Report and Compensation & Benefits Surveys is Easy

- The Company Productivity Report interactive online survey is at: <https://www.iisecure.com/NACD/Login.asp> (case sensitive)
- The Compensation & Benefits Survey interactive online survey is at: <https://www.iisecure.com/NACDcomp/Login.asp> (case sensitive)

Or, if you prefer, you can simply download and print out the surveys, and fill them out and send them in.
