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IS YOUR PROFIT STREAM SHIFTING?

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More and more today, construction equipment manufacturers are faced with ever shrinking profits as global competition, rising material costs and unstable energy prices take a bite out of bottom line profits. Unfortunately, manufacturers have not been able to absorb or pass all of these increases along to its channel partners or end customers.

Over the last several years, many manufacturers like Ingersoll-Rand, Volvo, Atlas Copco, Godwin Pumps, Metso Minerals, Komatsu and Sandvik Mining & Construction have taken a real hard look at their channels to market and are choosing to establish company-owned stores to offset some of this profit shrink from weak or underperforming market areas.

The results of establishing company-owned stores are mixed to date. Ingersoll-Rand has not found them to be profitable. Volvo continues to acquire and/or set up its own company-owned sales offices and rental stores. And many others are still making decisions or waiting to better analyze their profitability. Success depends on how committed the manufacturer is to absorbing the normal operating costs a distributor typically covers while supporting the product.

Identify All Business Costs

The biggest value and benefit a manufacturer receives from a company-owned store is its 100 percent brand focus, but at what cost?



Example of how a manufacturer might define territory coverage parameters for distributors and company-owned stores to avoid reputation negativity.

Before a decision to open a company-owned store can be fully implemented, a manufacturer needs to understand the value and cost of their existing channel partners. A good first step is to force rank your distributors utilizing a Value Stream Cost Analysis process. From the manufacturing cost to the end customer, what truly makes up the value of a product? Identifying and understanding all of the costs associated with taking on the responsibility of servicing a local market is critical before an informed business plan can be developed and a definitive decision made.

Some obvious infrastructure expenses include:

- Establishing a place of business
- Hiring a work force (inside and outside sales, customer service, warranty support, accounting support)
- Stocking sufficient inventory to serve the intended market
- Establishing a service department to ensure customer satisfaction
- Establishing a successful sales force to fit the market opportunity
- Local pricing/margin feasibility
- Tax liability

Some less obvious expenses that are often forgotten include:

- Promotional/advertising support
- Customer development support
- Office equipment
- Company vehicles
- Training costs
- Employee benefit costs
- Monthly operating costs (water, heating, cooling, refuge, phone service)

Once you have identified the operating costs, the next critical step is to assess the reaction of your existing channel partners—even if your plan is to open company-owned stores in non-competing territories. If you currently deal with exclusive dealers, do you risk them picking up your competitors' products, will they shift their sales forces mindshare to selling other non-competitive products, or will they walk away from you entirely? Losing successful dealers could have an adverse effect on what you are trying to accomplish with company-owned stores.

Maintaining a distributor network has a lot of intrinsic value over operating company-owned stores. Distributors, for the most part, give the manufacturer an expanded reach into the markets they service. They act as ambassadors, establishing relationships with a far greater number of end customers than a manufacturer can expect to reach on its own. They provide local inventory support and service for the products they sell and become the manufacturer's face to the customer. All of these values must be considered before selecting a model that includes company-owned stores.

Perform A Value Stream Cost Analysis

Distributors generally expect to achieve a 20-25 percent gross margin (company-owned stores should also have this expectation), depending on the complexity of the products and the selling cycle needed to close a sale. Operating expenses, including payroll, facilities, inventory and taxes in many cases leave earnings in the single digits for most distributors. Understanding the entire value stream is an important element in defining whether taking on channel partners or opening company-owned stores is right for a manufacturer.

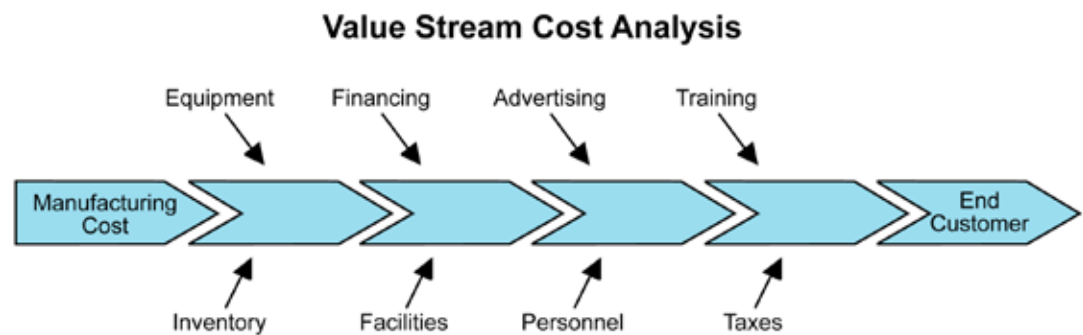
Some other things to keep in mind when considering a company-owned store:

- If the product you manufacture requires financing in order to compete, the typical cost of these programs can be as much as 3-5 percent—depending on the number of flooring days extended.

- Payment terms of 30-60 days with early pay discounts of up to two percent could also be part of your selling costs to the end customer.
- How does your freight policy affect the competitiveness of your products? With the volatile price swings of fuel during the past year, focusing on ways to maximize your shipments could be critical to the bottom line.

The manufacturer must be prepared to support a company-owned store like it would a distributor and either share or absorb these costs with continuous product training and technical support to stay current with the needs

of the market. The cost of training, including time, materials and travel—depending on the complexity of the product—is normally absorbed by both the manufacturer and distributor.



Define & Maintain Your Great Brand

Other costs the manufacturer must be ready to assist a company-owned store with, or absorb, are advertising, promotion and the development of a consistent brand message to gain the mindshare of their mutual customers, just as they do with distributors but on a deeper level. These costs typically run between 2-4 percent of sales to support a local market area and reach your customers.

Finally, the manufacturer must be prepared to define the parameters of the market and territory coverage whether they choose to go through a distributor or company-owned store. As with a distributor, company-owned stores should have a clear agreement that defines the market, territory, sales quotas, inventory requirements, aftermarket support and promotional advertising expectations. This agreement, when structured properly, will avoid future conflicts or misunderstandings between the manufacturer and an existing dealer network if a company-owned store is selected. Keeping the peace is a critical aspect in a healthy manufacturer/distributor relationship.

So when considering company-owned stores, carefully evaluate all of your costs from a financial, customer and dealer relationship view before changing your business model. Choosing the wrong channel model could create serious problems for years to come.



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