



The power of expense management

It is universally understood that expense control is an important part of financial management for dealerships. However, as with all universally understood concepts, it is not always practiced. An important cultural question surfaces about the value of actions to drive financial performance. Is it better to focus on expense management or on revenue development? (Strive for both.)

Often this question is focused more culturally as a proactive initiative (revenue development), or a reactive initiative (expense management). You've heard the phrase, "You can't cut your way to profitability." Emotionally, entrepreneurs and their organizations like the image of being proactive as opposed to reactive. However, let's examine real world data.

Currie Management Consultants, Inc. has conducted best practices groups (20 Groups) for more than 20 years and has data on 300 to 400 dealers, mostly from the U.S. and Canada, but also from our European work. We studied 148 dealers, where we have data for more than 10 years, to examine the issues of expense management, sales growth and gross profit improvements on profit before tax contribution of these businesses. The data indicates an unusually high correlation between expense management and net before tax. That correlation was in the 90 percent range. No other factor was close to this high correlation, most other factors only scored in the 30 percent range. What this means is 90 percent of the time, dealers with excellent expense management had excellent profit contribution. More specifically, those dealers with benchmark expense management also produced benchmark net before tax. Those dealers with benchmark gross profit produced benchmark net before tax in only 30 percent of the cases.

The top 20 percent of dealers in this sample had a net before tax percentage at Currie's benchmark level. So these were not simply the best of a poor performing sample, they were benchmark performers. The bottom 20 percent (net before tax) were significantly out of line on expense management (nearly 10 percentage points) as opposed to marginally out of line on gross profit percentage. So, the data is dramatic – expense management *drives* net profit contributions.

To establish benchmark expense levels and net profit before tax contribution, use our diagnostic tool for ag dealers at www.curriemanagement.com/products-services/diagnostic-tools/.

The most critical element for managing your business is the culture with which you implement the benchmark level expense performance. If your culture continues to be dominated by a belief that there is no expense problem that more volume won't solve, you have a cultural barrier and a "cognitive distortion" about the way businesses, specifically distribution businesses, produce net before tax returns.

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The culture should start with expense control "beliefs."

1. All expenses are variable.

From a macroeconomic point of view, all expenses are variable. Over time, even businesses with high fixed expense will see a step up or down as sales revenues increase or decrease. In distribution companies, these step situations are so small and of such short duration they don't affect the long term curve with regard to fixed versus variable expense. For example, we often hear that a new sales rep is a fixed expense until they become productive. In fact, the fixed expense issue only relates to the period in anticipation of productivity. If a new sales rep can reach minimum productivity standards in three months, the "fixed" cost burden is only for that three months. If you allow a new sales rep to take 24 or 36 months to become productive, you are increasing the "fixed" expense period and creating a situation where you compromise your ability to produce net before tax. Your culture should be one of "variablizing" expenses continuously, addressing "onboarding" of new hires so their contributions (productivity) begin early.

2. Expense control management should be communicated well.

How you phrase questions or statements is important in effective communications at the executive, manager or operational level. With regard to expense management, challenge managers with careful word choice. If you ask a manager, "Why are we not at benchmark expense levels?" If his/her explanation is elegant and convincing, the manager does not have to make changes, which is *not* the desired outcome. However, if you ask a manager, "What do we need to do to achieve benchmark expenses?" the burden is on the manager to make changes to move your expense percentage to benchmark. It is natural for the manager to counter your first question with an explanation as to why they didn't achieve the number. Instead, insist they answer the question *you* choose. This is a cultural change that yields specific actions that will lower expenses.

It has been validated in our study of 148 dealers... expense management is critical to net before tax profit development. You need the right benchmarks and the cultural drivers to ensure effective communication with regard to expense control. ■

BOB CURRIE is the president of Currie Management Consultants. His firm works with dealers and manufacturers of industrial products to streamline operations, improve performance and create success and is active in dealer consolidations, mergers and divestitures. Visit www.curriemanagement.com to learn more.