WHITE PAPER

Analysing Your Supply Chain Profitability:

Is Your Business Software Hurting Your Decision Making?

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Introduction

Understanding product cost is imperative when assessing a business' profitability. But what's surprising to many distribution businesses are the hidden costs that are not directly tied to product production, yet, these costs have significant impact on profitability. Retailers often impose a variety of charges that will skew a distributor's profitability. Missed shipment dates, inaccurate carton labels or missing any of the items in the book of shipping rules, all factor into a company's true profitability. Other categories that often include additional costs are marketing allowances, placement charges and display fees. The actual cost of the product from the supplier can be a rather small part of the true cost.

It's not uncommon for a company to see the large retailers as its biggest and most important customers. But when they calculate all these hidden costs, large retailers may actually be money-losing customers. This is why distributors need to understand their true profitability. By understanding this, they can get a better sense of where they are making a profit, which products are performing well and which are the areas where improvement is needed.

The following paper outlines exactly what true profitability is and the best way for companies to discover their true profitability, including software solution types, and the benefits of a vertical ERP software partner. This paper will focus on the distribution channel of the consumer goods supply chain industry.

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Understanding Your True Profitability

It all starts with the system that provides financial data. As companies look for supply chain management solutions, oftentimes the focus is on high-level solutions to pain points that are much easier to see operationally. What they fail to look for, or is often undervalued, is obtaining a solution that provides the true profitability of their customers and products.

Traditionally, distributors have used items on purchase orders and freight to calculate the cost of goods sold. In some instances, they will add some fixed or variable overhead costs based on the product, as well. This is where many distributors' profitability calculations end. But adding in the many costs involved when companies buy overseas and sell to mass merchants and various other actual costs such as invoice deductions, marketing allowances, and display fees, the actual cost of the product from the supplier may only be a small part of the sum.

This is why it's important for companies to determine and understand their true profitability.

When companies analyse their true profitability, they are able to see which of their customers, buyers, suppliers, sales people and products are truly providing income. Establishing true profitability also allows companies to identify internal problems such as looking at the profitability of a specific buyer. The difference between those that are assumed to be most profitable, and the reality, may surprise many.

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By obtaining and using this data, management can begin cutting costs. Knowing the profitability by customer, buyer, supplier and product can help a company track down the problems and then fix or eliminate the source. An example of this would be using air freight, which is typically placed into a variance account since it's not normal. However, this leads to many questions. Why was air freight used? Was it the customer, supplier or buyer that caused it? Exposing the real cost or problem is important because it allows a company to address it promptly.

Horizontal, Best-of-Breed ERP vs. Vertical, Industry Specific ERP

So how does a company go about determining its true profitability? While horizontal ERPs are a popular choice, an integrated, vertical ERP is the optimal solution for companies as they seek out their true profitability.

Getting to the true profitability means including every cost on behalf of the customer, product and/or supplier. Doing this tends to be a major challenge for companies if they're using a horizontal system – or a different ERP system that isn't able to include and calculate all these costs. Horizontal ERP systems are built to work in many industries, not specifically for distribution. They typically do not collect and manage the huge variety of costs involved with importing consumer products and selling those products to retailers. Using these horizontal applications requires spreadsheets or third party software to collect all the costs associated with a product, buyer, customer and supplier. But even after this data is captured separately, the challenge then becomes how to integrate this data seamlessly into the management information system – centralising all business data.

Challenges like these can be avoided if a company chooses a vertical ERP solution, one that includes tools specifically for importers who sell to retailers. Using an industry specific, vertical ERP solution can lead to a more accurate profitability analysis and better management of those costs and profits.

An industry specific, vertical ERP solution can gather data such as commissions, royalties, invoice deductions and other associated costs from all parts of the system and compile it into one, centralised and easily accessible location.

A way to help with visibility into business profitability is by creating enquiries, reports and scorecards from within the ERP solution. This type of feature lets companies compare customers, buyers, sales people, suppliers and products to see which are performing well versus others. Similarly, companies have the ability to track these components individually and see in which areas they are trending up and down.

Reporting using a vertical ERP solution is easier, as a company can pull and update all the numbers from the system. All revenue and cost numbers will be hosted within the same application, which means they can be updated in real time. The real-time data plays a crucial role by letting a company understand the profitability that each of its customers, buyers, sales people, suppliers and products are truly bringing. Along with reporting, invoice deductions are much easier to monitor with a vertical ERP solution, and eventually through continued use, invoice deductions can be greatly reduced.

A fully integrated, vertical ERP solution will encompass everything from sales, importing and financials to warehouse management, business intelligence and forecasting, and make this data easily accessible within the management system. This is different from a horizontal system, which adds extra costs and time to an ERP project due to the need for connecting third-party solutions or creating significant modifications in order to collect all pertinent data.

Working with an industry-specific ERP provider will allow a company to get started much more quickly, as the provider will have a better understanding of what the company might need and how the industry's supply chain works. The ERP solution can be implemented quicker, more seamlessly and with fewer modifications as it will have been fully designed with the unique features and requirements needed for that business.

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The knowledge an industry-specific ERP provider can bring may ultimately be the most important – and hidden – benefit over a horizontal solution. The partnership should foster conversations about best practices for operating within the industry and ways to improve a company's supply chain management process. This is a truly unique feature of an industry-specific ERP partner that could provide ample results.

Summary

The ability to pull the multiple and varied product costs from all areas of the business is critical in determining true profitability. When companies can fully analyse their true profitability, they are able to see which of their customers, buyers, suppliers, sales people and products are truly providing income. Understanding this can help businesses become more efficient and more profitable. It's also important to have the right business management software in place, and understanding the differences between vertical and horizontal ERP software solutions can help a businesses best choose what's right for their needs.

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When deciding between an industry specific, vertical ERP and a horizontal solution, companies should understand that determining true profitability is only one area to examine. While horizontal ERP systems are more easily transferable across industry sectors, this can also be their weakness, especially for wholesalers and distributors that sell products to retail stores.

Because of their full-featured, industry specific nature, vertical ERP solutions are best suited for true profitability analysis and can seamlessly integrate all cost data into the management information system for easy, centralised access. Vertical ERP solutions are a functionally better fit because they're designed to meet specific business requirements – building key features into the solution as opposed to bolting on software attachments that may not feed the core management system. For consumer goods distribution, some of these features would include warehouse management, EDI, invoice deduction management and demand planning/forecasting. And because of their industry focus, vertical ERP providers will have teams that are highly knowledgeable about the industry, business operations and common pain points.

In today's competitive landscape, distributors need to find the right business management tools to help them efficiently run and grow their business. Understanding true profitability can help make it a reality.

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