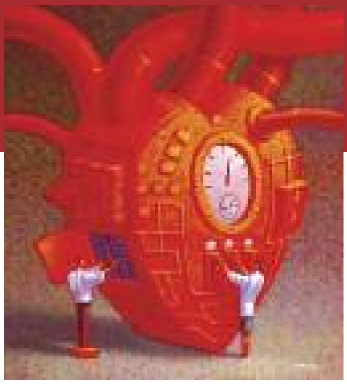

HOW HEALTHY
IS YOUR COMPANY?

A Question of Profitability Part II

TRX Integration Inc.'s Glen Juliano on Managing Growing Pains

Smaller distributors need to work on building a sustainable infrastructure to help them get to the next level, he says.

By Stacy Ward, Managing Editor
fedastacy@verizon.net

There's good growth and there's bad growth. When you have processes in place to handle it, that's good growth. And when you don't, a surge in sales can make an inefficient company even more inefficient, trigger profit loss and, in a worst case scenario, lead to an out-of-business sign on the door. In other words, if you're not prepared for the headaches that often tag along with growth, you could end up losing more than you make, particularly if you're a smaller company, says longtime entrepreneur and systems consultant Glen Juliano. They are more vulnerable than their larger counterparts, he believes, because many have not laid the ground work to transition to the next level, or simply do not have the infrastructure—meaning the layers of management, manpower, systems or processes—to effectively manage growth. Although, throughout his 26 years in business, he's seen his share of Goliaths stumble, most notably a $200 million company that initially experienced years of double-digit growth but was later ravaged by mismanagement and nepotism.

"If you're not paying attention to the economic health of your company…looking at transactional costs, working to pinpoint where you're making money and not making money or diligently tracking your inventory…then you could be looking at financial statements all day long, looking profitable and be out of money," says Juliano, the president of the Clearwater, Fla.-based, systems provider TRX Integration Inc.

He should know. In one form or another, he has had his hand in the internal processes of companies across industry lines ever since starting his own consulting firm TRX Integration Inc. in the early 90s. Short for transaction processing integration (the key in his mind to "managing to win"), TRX initially started as a consulting firm specializing in large-scale custom jobs for clients such as the Department of Defense, ValPak, which hired it to rewrite its franchise system in oracle, and Beltram Foodservice Group, the Tampa-based E&S distributor that nudged TRX into the E&S industry.

The story behind the Beltram account is an interesting one, says Juliano. "It all started with a dare. Danny Beltram told me I couldn't do an AutoQuotes interface; I told him I could."

The end result was TRX Enterprises™, an integrated suite of software that handles accounting, inventory price and cost, sales orders, point of sale, purchasing, contract management, service and used equipment refurbishing. There's also an AutoQuotes Interface module. Beltram, and a handful of other distributors, approved and signed on. Then the bottom fell out of the custom software market a year later.

"I lost 70 percent of my sales in one year," says Juliano, "so I decided to reinvent myself and focus on one industry. I could have done screen printing and embroidery or I could have done boat trailer manufacturing but I chose food equipment. I had already been to a few FEDA meetings and I really enjoyed the market."

Ten years later, the one customer has ballooned into 50 and TRX appears to be flourishing in its handpicked niche, in large part due to Juliano's push to immerse himself, and his company, into his customers' world. His years of accounting experience and his grandfather's genes (another successful entrepreneur) also have served him well in zeroing in on profit-altering particulars

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like what a customer should be carrying and, more importantly, what they shouldn't. Think free freight on steroids.

"As I walk through a warehouse, I look for something that's clearly overstocked, although it's more evident in the showroom," says Juliano. "Right away, I can tell if someone is getting too much free freight, which is very common in a lot of dealerships. Usually it happens when purchasing agents buy based on a gut feel instead of relying on purchasing tools. Purchasing tools create orders based on the PAR level and your actual inventory.

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"But what usually happens in a lot of dealerships is that the purchasing agent does an update order and sees he needs to buy just $100 more to get free freight so he buys some colanders. The next time he's $40 away from free freight and he buys more colanders. The problem is when purchasing decisions are based on free freight instead of empirical data you can end up with two years worth of colanders, a lifetime supply of salt shakers that will be obsolete by next year, or a truckload of refrigerators.

"Free freight saves a lot of money but I would argue that sometimes you can't afford to save that amount of money. A truckload of refrigerators is a lot of product and if you buy one of those and you're a smaller dealer, you can be sitting on it awhile. Sometimes your carrying costs outweigh your savings."

In his mind, the all-too-common practice is a symptom of a handful of bigger issues—poor inventory management, mistrust of financials, an emphasis on sales or gross profit per transaction at the expense of efficient operational procedures and processes. Recently, *News & Views* sat down with Juliano to get his thoughts on what he calls "the elephant in the room," and its impact on the economic health of the distributor. Below are three missteps he believes are fueling the divide between sales and profitability. Getting them under control is the key to overall operational health, which is a must, he says, in these current economic times.

Focusing Too Much on Gross Profit Per Transaction

If economic health is the key to long-term success and stability, why is it a back-burner issue for some distributors? Some would say it's because of a shortage of acumen, but Juliano has a different theory.

"For growing companies," he says, "the key element is cash flow and most entrepreneurs will ignore the economic health and true profit potential just to get to the next level based on cash flow and gross margin. I'm not sure who said it but it's worth repeating: 'Profitability is like your health. It's a good thing if you're healthy and/or profitable. But cash is your blood. If you run out, you're dead!" So it makes sense that many would be more concerned about gross profit on each sale opposed to reducing the cost of processing an order, job or service ticket. Without it, you can't pay your bills."

The problem is without an eye on your profit levers, it's difficult to determine your true profit picture.

"You can do a $200,000 job and make $100,000 profit, which sounds pretty good until you run the numbers," says Juliano. "It costs you $70,000 a month to run the company; it took you three months to complete that $200,000 job. You just spent $210,000 to make $100,000."

Infrastructure is another hurdle for the growing distributor, according to the president of TRX. "In larger organizations like a TriMark or Wasserstrom, management can look at the overall health of a company because they have a lot of people who can concentrate on one area and do it extremely well," he says. "They have inherent control points and they trust 'the system.' When you're at $10,000,000 and under, you're doing what I'm doing—selling one day; turning a wrench the other day."

Which is not necessarily a drawback as long as growth is contained, notes Juliano. The problem occurs when it begins to outpace a distributor's ability to manage it. At $6 million or $7 million, the owner can keep it all in his head, he says. "And they're usually great entrepreneurs who make a lot of money. But as you continue to grow and get larger, you eventually reach a point where you have to start investing in infrastructure to survive. Unfortunately, you may not be big enough to invest in that infrastructure but you're starting to get to the point where it's costing you too much money to do business without it."

Take for example a simple illustration using 10 sales orders. If you were doing 10 sales orders a day with five line items on each order that wouldn't be a problem, says Juliano. "That's 50 line items. The order comes in, the salesperson runs down to the warehouse to ask if it's in stock. They say, yes, it's here and you ship it or you have to run back to your desk and order it. That's a small company—you've got one warehouse guy who also drives the truck and does five other things and the owner does everything from placing the orders to shipping. And that works fine until those orders jump from 10 to 50. Now you've got people running back and forth and it becomes horribly inefficient. That's the Catch-22 some distributors find themselves in during certain phases of growth."

The solution? According to TRX's president, there are two options. Shrink back to $6 million and "make a lot of money" or buy a system that's totally integrated to improve inefficiencies. This is where it becomes difficult not to promote his product, since he believes an integrated system (like TRX Enterprise™)) is the key to successfully transitioning from one level to the next. He calls it operating like a bigger company but readily admits that many are not ready to hear what he has to say.

"When we implement TRX Enterprise™), every transaction entered from receiving inventory to billing to sales orders affects every other area of the software," he says. "This frightens many because they think it will slow them down. In reality, it forces them to all

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work in SYNCH and improves the efficiency of the entire organization. The smaller the company, the more worried they are about this. But at the point where worry is outweighed by a lack of efficiency, it's time to take the plunge."

Operating Without Control Points

Even so, if you're still not ready to invest in overhauling your system, a good place to start is your control points, since they ultimately determine the effectiveness of your processes—not to mention actively weed out inaccuracies. Periodically doing cycle counts to keep your inventory in check is a good example of a control point as well as having someone on staff charged with the task of finding out why the computer says you have 14 cases of Libbey glassware in stock, when you really have 10 on the shelf.

"Unfortunately in the fast-paced world of warehousing, discrepancies like these are often temporarily bandaged and propped on the shelf for the next person to deal with," says Juliano, adding that doing so could throw an entire system out of whack, sub ledgers and all. "Whenever your numbers are off, you have to figure out why because it's a strong indication that you have a larger operational problem, not just an accounting problem," he says. "You could have people who can't count or product going through the back door without paperwork. That's another huge control point.

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TRX's Glen Juliano

Inventory should never come in or leave without paperwork. There are salespeople who will just grab product off the shelf to go make a delivery without filling out any paperwork. So the product is gone but it's still in the system. I don't care if you're the owner, you should never take anything off the shelf without paperwork. That's the kind of discipline that's missing from a lot of smaller companies. Without it, it's impossible to properly manage your inventory."

You Can't Trust Your Inventory

That brings us to the elephant—the nuisance Juliano believes is having its way in far too many warehouses.

"At many dealerships, the elephant in the room is the inventory value," he says. "Some guys don't even know where there inventory is—often times because of a lack of operational discipline. Part of it is training on the dealer side. Some don't understand how to set items up with the unit of measure. Others have issues with software systems that are either underutilized, again, due to inadequate training or certain software systems simply do not perform in this area. A system like Peachtree is not designed to manage a million dollars worth of inventory.

"The bad news for most dealers is that a majority of their money is tied up in their inventory. So, if you don't have an accurate inventory count or tracking system, you don't have an accurate picture of your financials. That's why so many rely on gross margin and not financials until the end of the year."

How do you know if your system is a candidate for change? Outside of the obvious issues with turns, Juliano sites two other red flags.

"This is an incredibly widespread problem," he says about the inherent inefficiencies he often sees on site visits. "If your software can't tie inventory on hand to the balance sheet, it's time to upgrade. If you can print a report that shows every item on hand and extends the quantity cost (an inventory value report), but then can't look at your balance sheet's inventory value to match them, it's time to get new software. When you're content with not having supporting schedules for your balance sheet, you're really saying, 'I know there is something wrong, but I don't want to deal with it right now because it's too hard.'

"Most people have a tough time believing they will ever be able to control their inventory—or trust it for that matter. That's the first false premise. Get over it; you can." ❑