

**Version 2**

**Date: 2018/11/05**

Abstract

**The objective of this document is to describe the requirement to manage corporate Gross Profit as a percentage and by value and propose a strategy going forward. Also, it is required to seek approval from all parties involved**

Gross Profit Improvement Management Strategy

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# Document approval and distribution list

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| Prepared by |  |  |  |
| Reviewed by |  |  |  |
| Approved by |  |  |  |

# Audience

Corporate management

Purchasing & pricing

Catalogue department

Sales department and customer representatives

Finance

# Executive summary

Maintaining a healthy profitability is of paramount concern for any business. For Engineparts the concern is ***achieving and maintaining*** a targeted gross profit (GP), by % and value.

The ***pricing and discount structures*** within the Engineparts system is designed to cater for a variety of customer profiles / business verticals to attract ***profitable*** business in a highly competitive market space.

Engineparts is faced with several competitors each vying for the same business where, given availability, ***the best price survives***.

Managing discount structures may be ***changed strategically*** to compensate for transient supply and demand market space activities and ***probably not reverted appropriately***, causing a GP erosion to pass unmanaged.

GP is constantly under pressure due to opposition opportunistically changing pricing for a variety of reasons

To ***exploit market supply and demand*** shifts by ***increasing GP opportunistically*** should receive greater attention through good information from sales staff and industry sources.

Due to competitors pricing strategy, goods sold by Engineparts at good margin may be returned in favour of ***re-ordering from the cheaper supplier***.

Key to managing GP is information, both formal and informal. This document aims at laying the foundation and motivation for a formal source of information that is anticipated to change the Engineparts perspective around managing GP end to end. This document proposes a solution to achieve this notion.

By empowering the pricing staff with active information, the targeted ***GP of 28.5%*** can be achieved, translating into an increase in GP value by ***R330,000 per month***

To empower the staff with a solution to actively manage GP anticipates an ***investment requirement of R108,000*** which is a translation of current ***staffing costs already employed in Engineparts (Jaco)***. However, some consulting fees may be needed to ***fast track*** the project

Additionally, it is anticipated that through daily active management of the GP could yield greater GP than the targeted 28.5%. ***With a .5% increase the anticipated increased benefit could be R110,000 per month.***

This notion totally supports the need to empower the admin staff with tools to actively manage the GP.

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# Introduction

Business and related management have set a Gross Profit (GP) benchmark to be attained and maintained to ensure business profitability and meeting with shareholders expectations.

Engineparts management have expressed their need to for information to assist in understanding the reasons for GP erosion, as expressed.

However, more importantly, the objective should be to manage all aspects of GP using the information-based tactics supported by best of breed management dashboards.

This document is aimed at presenting a strategic business case why the suggested approach is one of the optimal methodologies to follow.

# Issues and perceived influencers

The following items need to be considered for this dissertation as an awareness factor and need not be expanded in detail. Currently, there is insufficient data to factualise the real reasons from an influencer aspect

* 1. Opinionated influencers
* Customer discount
* Customer operating vertical (service centre, general spares, etc.)
* Product discount structures
* Opposition product price shifts
* Product line – end of life – stock on hand no demand
* Discount structure changes are made on a basis of ‘fire and forget’ with no active monitoring
* Opposition marketing campaigns at reduced (temporary) pricing
* New stock at elevated cost price will increase sales price and drop customer demand given that competitors still have ‘old stock’.
  1. Contributors to the GP erosion - assumptive.
* The GP is determined by various discount matrixes in the ePart system and lean towards being complex to manage.
* In some instances, a specific discount change can have a marked influence on profitability and in some cases unexpectedly so causing abnormal / unexpected sales and GP trends to occur. These are currently largely unmanaged in a formal manner
* Although not researched, it may well be that ***temporary*** changes to discount structures needed for improved demand are not changed back to an equitable state due to a (perceived) lack of active feedback
* ***To note is that regular small changes to the GP*** could go un-noticed as the granularity is very low. However, over time the impact could become significant hence the need to micro-manage this trend. However, it is proposed that information should be available for various date ranges where such trends will be reflected and offer opportunity to rectify.
* Ad-hoc cost price adjustments within the Imperial group supply chain impacts on selling price fluctuations consequently poor customer experience.
* It is well recognised that the supply and demand profile is sensitive to pricing. However, opportunistic improvement / reduction of GP is not being explored at this time.

A strategy should be evolved where selling price should be adjusted to find a level where best market resistance / acceptance is understood resulting in optimised GP level

* 1. GP % may be OK but the GP value contribution may be eroding (reduced sales)
* A decrease in customer discounts should lead to improved GP to Engineparts. However, this can also lead to reduced turnover and consequently a reduction in profitable revenue where operating costs are not adequately cared for.
* Information is required to monitor the monetary GP contribution profile in various formats from which informed conclusions / actions can be made

# Operational influencers

* Although not a red flag issue, it may well be a good strategy to review the changes made to ePart to participate in the Sage X3 integration as an assurance that financial entries are reflected correctly in the various sub-ledgers between ePart and Sage X3 implementations.
* Engineparts is known for its efficient delivery of customer orders and willingness to receive returns almost without question.

From time to time it has surfaced that customers will order the same part from multiple suppliers.

The first part to arrive is used no matter the price. If the used part is more expensive, a swap with the less expensive part is made and the more expensive transaction part returned unethically.

It may very well be that these incidents are limited in their occurrence but still needs to be reviewed to find innovative ways to curtail the practice without unrealistically expand cost to manage.

Importantly, this unethical practice is known to Engineparts and does receive a measure of attention. The unknown is to what extent this is affecting the GP.

* A perennial issue in the automotive aftermarket is the aspect of controlling returning goods for credit.

This aspect has of the business has received many detailed reviews to curtail without achieving significant benefits.

Many scenarios are at play, one is where Engineparts customers may issue stock orders to find that the same product from competitors have a lesser price. It should be anticipated that such occurrences could result in goods being returned for credit negating the GP position of the organisation

# Proposed GP management strategy

* 1. The proposed strategy would be to Micro-manage GP and GP trend deviations

As a priority analyse a consistent downward GP trend, to understand why and to apply adjustments accordingly.

As a second priority contributors where the GP % is OK but the value contribution is small. Management is obligated to review these item profiles against the customer base and the need to retain these stocking items as a deal-closers. Having these items ensures that the customer paces an order with Engineparts rather than the opposition.

As a third priority test the market by increasing the GP speculatively and to monitor the impact.

It is a known strategy in the industry to ‘tune’ some items to be attractive (lower GP) to attract customer to purchase and gain complimentary purchasing from same customers

***It is important that the changes are recorded in such a manner that it will assist in assessing the impact it has had on changing trends.***

* 1. There is a thought that some of the selling price can be adjusted ***automatically*** based on a set of defined business rules with some governance limits.
* An increase in unit sales with an on-hand quantity of a given quantity can trigger an increase in selling price.

The increase to be automatically applied within bounds otherwise, manual intervention is required.

* A lack of sales with an on-hand quantity can trigger a reduction in selling price

This can be automated if within defined bounds otherwise manual intervention is required

* 1. There will be occasions where specific items will be in short supply throughout the industry whilst Engineparts may have adequate stock on hand. In such instances, there is an opportunity to increase the selling price without alienating customers

To uncover such opportunities needs active focus.

One method would be to use the proposed dashboard to view sales volume as a trend where the automated price increase proposal will cover this as a requirement and reduce the price as soon as unit sales trend drops.

* 1. A caveat to this proposal is that a more frequent price adjustment will lead to poor customer experiences. However, this is an opportunity that needs to be explored in depth and not summarily discounted as impractical.

***It is opinionated that this could have a marked influence on managing sound corporate GP profile where the business rules are managed rather than the individual discount structures.***

* 1. Although the objective of this proposal is to focus more on optimising the selling price against the cost pricing, there is a implied aspect of purchase price negotiation that should be considered as well. Should the basic principals of this proposal be acceptable, time should be set aside at the appropriate time to reflect on supplier price negotiation against the sales experience.

# Proposed Operating / Management strategy

Staff that are accountable for sales pricing are to be enabled to constructively care for the GP objectives as defined by management. Such staff need to be provided with management information tools to to ensure that the objectives can be sustainably maintained.

Opinionatedly, the following high-level functionalities are required as a starting objective that can be optimised as experience is gained over time.

From a technology base, the infrastructure needs to be implemented in such a manner that it can modified comfortably to cater for experience-based requirements.

The following list of focus points are proposed as a departure point and are aimed at discovering trends and reasons (on purpose or otherwise) for the trend changes:

* 1. For 7-week period show all items with declining GP %
  2. For 7-week period show all items with declining GP value
  3. Both these information dash boards must have a:
  4. Fine grained view for the immediate past period, say 2 weeks of DAILY sales trends
     1. Prior to this, a weekly granularity for 5 weeks
     2. Some form of awareness of what changes were made to relate to observed trend changes (GP% & demand)

1. Due to the short reporting period it will be important for the trends to be actively monitored – daily to observe effect of recent changes
2. ***Notably, if the erosion is below the reporting filter, the actual erosion over time will be significant yet go undetected.*** Consequently, there needs to be some tool to monitor the long-term erosion of small but cumulative GP downward adjustments.
3. ***Importantly, new stock causing an increase in sales price may cause discounts to be adjusted to remain competitive; however, once opposition increase their pricing, the ePart price is not returned to ‘normal’. This will severely erode ePart GP ....***
4. Each of these reports allow drill down per item to see customer’s with:
   1. Declining turnover (This could be caused by competitor pricing)

or

* 1. Declining GP% with increased turnover (This will tell if there is a discount out of sorts)

# Proposed high level technology strategy

The end-user experience needs to be well supported with near real-time responsive dashboards drilling down from high level views to fine grained detail.

Good experience has been had in the industry with product QlicView which has been introduced to Engineparts very superficially as a proof of technology solution.

To support the stated notion, it is a requirement to extract the required underlying data in summary formats in such a manner that QlicView can digest.

The actual presentation is designed by semi technical people and in this case Jaco van der Westhuizen will do well in this capacity. The QlicView product provides many presentation components, active filters and drill down capabilities making the development cycle a much simpler experience.

The actual information presented will be subject to end-user requirements. However, high-level detail is suggested herewith as a departure point in support of the stated solution

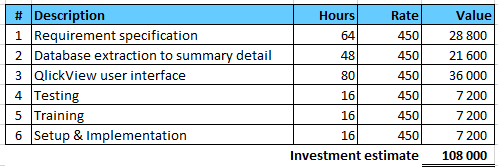
# Investment profile

The investment profile (non-quantitively) is as follows:

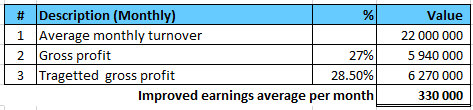
* + Gathering of facts pertaining to the problem statement
  + Defining the opportunistic solutions model with review involving management, related sales staff and pricing determination.
  + Technical solutions documentation
  + Database extraction routines
  + QlicView pricing – currently no direct cost anticipated
  + Consultant participation end to end

The following is a high-level investment expectation to implement the proposed solution:

***Please note that the investment amount is not additional expenditure (other than fast track consulting fees) but rather an extrapolation of time needed of current resources employed in the business (Jaco)***



An opinionated beneficial yield after investing in the proposed solution is as follows:



***Turnover philosophy versus improved GP speculates that a well-balanced business model prefers reduced turnover for a greater or similar earnings. This model is not explored in this document but should form part of the plan to improve gross profit value-based earnings by administrative staff.***

The high-level benefits in this is a reduction of the following elements:

* Stock investment
* Debtors book
* Operational management
* Distribution

# Acceptance

I hereby confirm that I have been fully informed of the documents content and, received training to understand how the detailed instructions are to be applied

Name …………………………………………………………………………….

Job Title ………………………………………………………………………….

Signed ……………………………………………………………………………

Date ………………………………………………………………………………