LINE PROFITABILITY ANALYSIS

By Gene Foster, Scott Lindberg, CPMR, and Bob Parsons

Regardless of the size of your representative firm, knowing and understanding each line's profitability is a must. Without this knowledge, you may be focusing your company's efforts in the wrong direction. Any method of analysis can be used, separately or together with others, but some measure should be used and used proactively. Having a better understanding of what lines are profitable is essential to the success and growth of any representative firm and should become a part of the culture of your firm. The analysis should be conducted on an annual basis at the minimum and on a quarterly basis if possible.

The knowledge you gain from a profitability analysis can do nothing but increase your awareness of what each line represents to your firm and how a line's relative importance changes from year to year. From the analysis, you should be able to determine: if you are truly making a profit on an individual line; which lines are paying the bills; if you are spending too much time on a particular line; if the amount of time spent on a line is an asset or detriment to your firm; which lines are slipping in terms of commission; and which lines are "high pain and high maintenance."

A better understanding of line profitability will also help improve your relationships with principals. Your awareness of bow important they are to your firm will be beneficial to all. In addition, you can use the analysis to focus your salespeople on selling what is profitable for them and the company.

Profitability can be measured many ways, to one degree of accuracy or another. In the final analysis, however, you can relate a line's profitability to bow much time the line demands per dollar earned and how well it fits with the rest of your line list.

Lines can be categorized into three distinct groups: majors; rock solid regulars; and fillers. Most representatives have all three, and each serves a purpose in the overall profit picture. A look at all three types of lines is appropriate in this overview of line profitability.

The Fillers

A survey of representatives determined that up to 65 percent of their income came from their top three lines. This doesn't leave much for the rest of a representative's line structure to produce. Yet, fillers help pay the bills. Most representatives have two or three of these lines and seldom think about what it costs them to carry the lines because they demand so little attention. Probably the reason the filler remains on a line card is benign lack of attention, i.e., most of the representative's attention and activity are focused on the top few lines that generate the bulk of the firm's income.

On the surface, there would seem to be little, if any, harm in carrying these lines. In reality, they can cost a representative access to larger, better-established principals who sell the same or very nearly the same products. A competitor to one of your fillers does not know that the line is a filler and often assumes that you would not consider giving up an established line.

There is another kind of filler, not usually carried on a representative's line card, i.e., "hip pocket" lines. They have a very narrow customer base of usually only one or two, and the representative firm owner often has a close advocate at the customer level. These can be very profitable, but they are hardly the stuff upon which companies are built.

Once in a while, a filler is really a "comer." We] I- established representative firms of all sizes tend to shy away from pioneering lines, but occasionally one comes along that you just cannot resist. Be careful when considering these lines. They are the most costly to represent, demand the most time and planning, and the rewards (once you take the line on) are at least 18 months away. Be particularly careful to be honest when one turns out well. The line gods have blessed you. Don't push it.

The Rock Solid Regulars

These lines may be third or fourth on a representative's earnings "totem pole." They are often easy to work with, and their demands are as reasonable as are their people. They are almost "transparent" as far as your profitability analysis goes and relatively easy to forecast. The temptation with these regulars is to service them to the limit, but wise representatives know that these lines also need aggressive selling attention.

A representative's future often lies with this group. These "secondary" lines can become leaders with aggressive development. Remember that the nature of the representative business demands that you be constantly prepared for change (e.g., lines gaining or losing strength, new technology giving competitors an edge, principals going direct or moving to a larger representative firm). If your firm is to grow, you must be alert and ready to accept change. You must be certain that every line you are carrying is contributing to your planned growth.

Sometimes, these secondary lines are on the way down. For whatever reason, their market share is declining. Part of the alertness mentioned above is to know when and if one should resign such a line. Good lines don't stay down forever and can come back with a vengeance.

Without aggressive selling, rock solid regulars can become former lines. Such principals only remain rock solid when they receive the sales attention they deserve. In fact, they can be the most subject to trouble of all the lines a representative carries. Your profitability analysis should quickly tell you how well these lines perform. Don't be surprised if you start paying a lot more attention to these companies solely as a result of your newfound awareness of how profitable they really are!

The Majors

Relative progress as a representative can be measured by the stature of a firm's major lines. They usually supply the bulk of any given representative's income, i.e., as much as 20 percent or more. Because of the dominance of a major line as an income producer, however, the representative often fails to review the line's cost of operation. It is just assumed that the line is profitable.

In fact, large lines can be very costly to maintain. Support people are in the territory more frequently than others, and because of the line's activity, they dominate their representative's planning time. Further, odds are that the larger lines are more commodity in nature, selling product into a larger share of the available customer base in the territory. This can expose the representative to off-shore manufacturing and/or outsourcing to turn-key assembly operation. At best, the representative faces a split or shared credit (commission) with another representative. At worst, he loses track of the business completely.

A line profitability analysis, such as the ones included in this section, will go a long way toward determining bow much time and effort a major line is consuming versus how much commission revenue is being produced. Often, a representative must weigh: 1) the value of keeping a large, highly productive line that demands too much attention against 2) the effort necessary to replace the income from that line via other existing or newly acquired lines.

Synergism

Finally, consider synergism. A filler can be elevated to the status of a regular line if it is synergistic with one or two or three majors on your line card. Large representative firms often have completely synergistic line structures. Smaller firms may have two or even three "pockets of synergism." Any more should be cause for concern. The profitability of a representative's top line is improved when all the other lines "tag along" in synergistic single file. And in turn, each of the tag along lines becomes more profitable.

Basic Premises

There are several basic premises or assumptions underlying this overview of line profitability analysis, i.e.: it is necessary to know whether a given line is profitable; the commission income on each line is known; time (sales personnel, secretarial, customer service, management) is one of the most valuable (if not most valuable) assets of a representative firm; expenses are usually directly proportionate to the time expended on behalf of each line.

The "Spur of the Moment" Process

A very simple form of evaluation is what many managers describe as "gut feeling." As accurate as this evaluation may be at times, it is virtually useless in discussing line profitability with a principal. The following pages describe a relatively accurate method that is based upon "spur of the moment" time use analysis. While not a perfect system, this method will provide accurate indications with a minimum amount of time and effort - almost as simple as using "gut feeling" but probably more reliable. Here are the instructions.

1. Prepare an analysis sheet similar to the sample (Exhibit A) that follows this article. Be certain that every line is included.

2. At a routine company meeting of all employees and managers, distribute the analysis sheets. Tell your employees that they are about to do a "spur of the moment" line profitability analysis. Let them know that their totals need not add up to 100 percent, but they should try to come close. Give them five minutes to complete the form and turn it in.

3. Using the results, make a matrix similar to Exhibit B. Before entering results on the matrix, adjust each set of inputs so that each totals to 100 percent. (See Exhibit C to help you accomplish this task. First total each employee's percentages. Then divide the individual percentages by the total to get an adjusted percentage to enter into Exhibit B.) The average totals on the matrix can be weighted if you wish, but this is not necessary. From the matrix, you will see how your employees feel they are spending their time.

4. Follow steps 1 through 3 once to get the "feel" of the process, then twice again at intervals of 30-45 days. Each run-through should not consume more than 45-60 minutes of your time. Average the results of the three surveys, and you will have a completed survey with which to begin your line profitability analysis.

5. Convert the percentages of time for each principal into expense dollars per line by multiplying your total expenses for the time period by the percentage of time for each line (Exhibit D).proportionate to the time expended on behalf of each line.

6. Compare the figures in "D" with your commission income figures for the same period to set your profit loss analysis (Exhibit E).

7. Make sound business decisions based upon your findings.

As you are reviewing the results of your "spur of the moment" analysis, keep these points in mind:

- A "marginally" profitable line may be desirable for several reasons, e.g.: it is prestigious; it is synergistic and produces leads for other lines; you are in the process of building this line; you have represented this principal for years (once a major line) and you have "political" ties.

- "Pain level" may not be accurately measured by this method of analysis.

- Many good representatives and managers use this method in combination with the "gut feeling" method.

- When you find you have a "marginally profitable" line or one which is showing a loss, you can: talk to the principal about your analysis; talk to other representatives of the principal to determine if they are having similar problems; use the Rep Council concept to improve the principal, give the process some time; redo the survey to see if the same results are yielded. If all else fails, you may choose to resign the line and refer it to one of your competitors. No two representative firms are the same, and another company may be able to turn the line into a profitable venture.

You will find that this type of line profitability analysis produces a valuable side benefit. You and your employees will become increasingly aware of how time is spent (or misspent).

Exhibit A

Date ______________________

Spur of the Moment Time Analysis

In the next five minutes, please write in below the percentage of your time you have spent on each of the following lines. Your first impression is all that is wanted, and it is not important for all individual percentages to add to 100 percent.

Line	% of Time
AAA	______%
BBB	______%
CCC	______%
DDD	______%
EEE	______%
FFF	______%
GGG	______%
HHH	______%
I I I	______%

____
Signed

Exhibit B

Adjusting to 100 Percent

			Adjust
	AAA	12%	12/120 = 10%
	BBB	15%	15/120 = 12.5%
	CCC	25%	25/120 = 20.8%
	DDD	30%	30/120 = 25%
	EEE	10%	10/120 = 8.3%
	FFF	5%	5/120 = 4.2%
	GGG	8%	8/120 = 6.7%
	HHH	5%	5/120 = 4.2%
	I I I	10%	10/120 = 8.3%
Total:		**120%**	**100%**

Exhibit C

MATRIX

Employee									**Principal**	**Average ***
A	B	C	D	E	F	G	H	I		
___	___	___	___	___	___	___	___	___	AAA	________ %
___	___	___	___	___	___	___	___	___	BBB	________ %
___	___	___	___	___	___	___	___	___	CCC	________ %
___	___	___	___	___	___	___	___	___	DDD	________ %
___	___	___	___	___	___	___	___	___	EEE	________ %
___	___	___	___	___	___	___	___	___	FFF	________ %
___	___	___	___	___	___	___	___	___	GGG	________ %
___	___	___	___	___	___	___	___	___	HHH	________ %
___	___	___	___	___	___	___	___	___	I I I	________ %
------------------- All Totals 100% -------------------									**Total**	**100%**

* Average = Total of A-I divided by 9.

Exhibit D

Percentage of Expenses Converted to Period Covered

Principal	Percentage	Expense $
AAA	________	________
BBB	________	________
CCC	________	________
DDD	________	________
EEE	________	________
FFF	________	________
GGG	________	________
HHH	________	________
I I I	________	________
Total	**100%**	**$ ________**

Exhibit E

Line Profitability Analysis

Principal	**Commission $**	**Expense $**	**Delta ±**
AAA	$ _______	$ _______	±
BBB	$ _______	$ _______	±
CCC	$ _______	$ _______	±
DDD	$ _______	$ _______	±
EEE	$ _______	$ _______	±
FFF	$ _______	$ _______	±
GGG	$ _______	$ _______	±
HHH	$ _______	$ _______	±
I I I	$ _______	$ _______	±
Totals	$ _______	$ _______	±

AN ALTERNATE APPROACH TO LINE PROFITABILITY ANALYSIS

By Joe N. Yore, CPMR

This article represents an alternate approach to line profitability analysis that a line's profitability can be related to how much time the line demands per dollar earned and how well it fits with the rest of a firm's line card. The strength of your agency, your income potential and the income potential of your employees is determined by the profitability of your lines. Major lines obviously have a larger influence, but lines large and small are critical.

There are several assumptions underlying this overview of line profitability analysis, i.e.: if you were not in business, your expenses would be zero; you are in business and during a certain time period you generate x dollars in expenses; it is valid to allocate the percentage of expenses to each line equal to the percentage of time your agency spends on a line. Lines may be classified in one of two ways. Either they are profitable or they are not profitable. You may be surprised to find that as many as 50 to 75 percent of the lines you represent are unprofitable (i.e., generate more expenses than income).

There are various reasons to represent or not represent profitable or unprofitable lines. Some of the "yes" reasons for choosing to represent profitable lines may include the fact that a particular line generates cash for: strength; income for representative firm principals; income for employees; retirement programs; growth of the representative firm; reinvestment and other types of positives. On the other hand, one may choose to not represent a profitable line because: the principal wants exclusive representation; the line is expanding into areas that compete with another major line; or the line may be blocking representation of a prospective new line that is more desirable.

A representative firm may elect to continue to carry an unprofitable line because- it is highly synergistic with other lines; it fills a void in the firm's product offerings; it keeps a firm in a product area until a premier competitor becomes available; or it is an emerging growth line with a good future. There may be many additional reasons for carrying an unprofitable line. Those reasons must be balanced against the reasons for dropping a line. Those reasons may include: the line is a drain on the firm's total resources; it takes the profits of other principals to supplement the line's presence on the line card; the unprofitable line may weaken the financial position of the representative firm; it may lower the firm's income potential as well as the income potential of the firm's employees.

Certainly all avenues should be pursued to make the line profitable. One key way to increase that bottom line for the representative firm is a joint representative -principal study to reduce transaction costs, lessen time demands for reports and field visits, and decrease customer service requirements to allow increased time for sales activities. (Read most of these avenues to explore as areas where less time would be consumed per revenue dollar generated.)

Procedure for Line Profitability Analysis

Here is a five-step process to analyze line profitability:

1) Collect data (percentage of time spent on each line by all company personnel) (refer to Line Profitability Analysis Form #1 which follows);

2) Convert data to 100 percent (of the company total time) (refer to Line Profitability Analysis Form #1 which follows);

3) 3) Merge all data to arrive at your agency's percent of time allocated to each line; (refer to Line Profitability Analysis Form #2 which follows);

4) Allocate total expenses based on the percentage of time devoted to each line; (refer to Line Profitability Analysis Form #3 which follows);

5) Create a ratio of expenses to revenue (start with expenses allocated to a line, and then divide by revenue produced by that line in the same time period) (refer to Line Profitability Analysis Form #3 which follows).

A basic computer spreadsheet package can be used to matrix all of this information. The process can be completed in a total of 15 minutes average per person of agency time. Using a spreadsheet for this process allows easy "what if" analysis.

Expanded Use of Information

Once the line profitability information is available, the question becomes bow to use the knowledge that has been gained. Other than the obvious uses, don't overlook the value of using that pertinent information when a new line is being evaluated. If a prospective principal is properly interviewed, you may generate enough information to actually plug the prospective line into your matrix for a "read out" on its profitability potential - before the line is even signed on!

(Some things to look for in that interview process include: the quality of the prospect's marketing material, including catalogs; the company's pricing structure, order fill rate and efficiency of engineering support at the factory; the position of the manufacturer among competitors; other forms of sales organizations in your territory; and the number of days factory personnel expect to be in your territory per quarter or per year.)

Line profitability information can also be used to evaluate your major distributors, as well as the minor ones that your firm interfaces with, and evaluate your large customers (end users), as well as your smaller customers, all from a line profitability standpoint.

Line Profitability Analysis Form #1

Company Name ____________________________ Employee's Name ___________________________

Manufacturer's Name	**% Time Spent**	**Adjusted to 100%**
ABC	______%	______%
DEF	______%	______%
GHI	______%	______%
JKL	______%	______%
MNO	______%	______%
PQR	______%	______%
STU	______%	______%
VWX	______%	______%
TOTAL	______**%**	**S/B 100%**

Line Profitability Analysis Form #2

Company Name ____

Percent Time Per Line Aggregate

	Employees								
	A	**B**	**C**	**D**	**E**	**F**	**G**	**H**	**Average**
Mfr. ABC	____%	____%	____%	____%	____%	____%	____%	____%	_______%
Mfr. DEF	____%	____%	____%	____%	____%	____%	____%	____%	_______%
Mfr. GHI	____%	____%	____%	____%	____%	____%	____%	____%	_______%
Mfr. JKL	____%	____%	____%	____%	____%	____%	____%	____%	_______%
Mfr. MNO	____%	____%	____%	____%	____%	____%	____%	____%	_______%
Mfr. PQR	____%	____%	____%	____%	____%	____%	____%	____%	_______%
Mfr. STU	____%	____%	____%	____%	____%	____%	____%	____%	_______%
Mfr. VWX	____%	____%	____%	____%	____%	____%	____%	____%	_______%
							TOTAL		_______**%**

Line Profitability Analysis Form #3

Company Name ____

Revenue / Manufacturer		**Expense / Manufacturer**	**Expense / Revenue Ratio**
ABC	$________________	$__________	$__________
DEF	$________________	$__________	$__________
GHI	$________________	$__________	$__________
JKL	$________________	$__________	$__________
MNO	$________________	$__________	$__________
PQR	$________________	$__________	$__________
STU	$________________	$__________	$__________
VWX	$________________	$__________	$__________
TOTAL EXPENSES		**$**__________	