Second String

If you can get secondary products off the sidelines and into the sales game, you can significantly boost the bottom line. By Rick Davis

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In my April column, I asserted that the traditional theories of supply and demand do not always explain the dynamics that create pricing in the marketplace. Underlying costs of production—e.g., raw materials, labor, and overhead—are often the most influential factors affecting the price of goods sold, at least for your core products. But in the case of secondary products, you will discover that there is much less correlation between costs of goods and the price at which you sell. Thus, these secondary products represent excellent opportunities to boost the bottom line because the demand for these goods is relatively inelastic.

Elasticity of demand is a classic concept taught in basic economics classes. The demand for a product is said to be "inelastic" when dramatic fluctuations in price do not result in a noticeable impact on sales. At the opposite end of the spectrum, when a slight change in a price creates a significant change in product demand (i.e., purchases), the demand for a product is said to be "elastic."

The core products for building material dealers—e.g., lumber, vinyl siding, roofing—are extremely elastic in their demand. Your prices on core products need not be identical to your competitors, merely close; however, if your company differs noticeably in lumber prices from the competition in the local market, for example, this can affect the demand for that core product at your location. Thus, in order to increase your gross margins, take time to consider the other categories of products you sell and ways to increase margins on these secondary items, which include add-on products, discretionary products, specialty items, and fill-in shipments.

Add-on items include the goods you sell to help contractors install core products, including nails, screws, caulk, glue, hangers, etc. Discretionary products are those that a builder may optionally include in a home as special design features, such as decorative millwork, upgrade hardware, and similar products. Specialty items are those requiring unique product expertise, such as windows and cabinets. Fill-in shipments are the extra, small-quantity deliveries that builders frequently request to complete jobs.

Your sales team should recognize that these secondary products often can increase bottom-line profits in amazing ways. A company that increases its net income by 1 percent to the bottom line—from 3 percent to 4 percent, for example—realizes a 33 percent increase in net profits! This can be achieved by maximizing the margins on secondary items.

How to Score

Teach your salespeople to consider the following ideas to increase the bottom line for your company:

1. Maximize the price on add-on items. Bill, the owner of a lumberyard in the Midwest, achieves margins on nails, hangers, and installation materials as high as 50 percent. If customers complain, Bill happily reminds them that he is entitled to make a profit. He might slightly lower the price on those items on future orders for that customer, but remains vigilant overall about maximizing the margins on this particular category of products.

2. Sell more discretionary products. One Midwestern dealer of polyurethane millwork earns a

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40 percent gross margin on this discretionary product. The dealer's success begins with an educational session for remodeler-customers in which they are taught how to upsell products to the homeowner during a presentation on vinyl siding. When a homeowner expresses an interest in improving the curb appeal of the home, the remodeler demonstrates with photographs how decorative millwork will improve the look of the home. The demand for this millwork, being inelastic, significantly increases the remodeler's profits. The net result for the dealer is a happy customer purchasing a high-margin item.

Margin enhancement is a mind-set that begins at the top and permeates the entire company.

3. Sell more specialty items. In the past, I worked with many LBM dealers that derived as much as 70 percent of their business from lumber. That is now changing, with most savvy dealers working to diversify their product mixes and incorporate more specialty items. As a result, the sales of dimensional lumber for many LBM dealers are now less than 50 percent of the product mix. In order to achieve this type of success, you may need to consider intense training for your salespeople or even a complete restructuring of your business model. Specialty items such as windows, cabinets, and hardware require unique knowledge, and many companies hire detail-oriented product specialists to support the secondary sales effort. The reward is increased sales of high-margin products and a diverse product mix that deepens relationships.

4. Charge for additional shipments. Every lumber salesperson I travel with is bombarded constantly with calls from the field for small-quantity shipments of goods. Dave, a successful lumber salesman in Chicago, marks up those shipments with a 30 percent gross margin. When builders complain, he explains that last-minute orders for small shipments are costly to his company. Then he promises to work with them in the future to manage their purchases better. Charging more for small shipments creates an incentive for builders to plan better and reduce your operating costs. If the builder continues to place small fill-in orders, your margins will increase; if a threat of higher "nuisance" pricing provides the builder incentive to get more organized, your operating costs may improve.

While the previous examples provide direct ways in which your salespeople can enhance the margins of your company by increasing product pricing, there also are some less-obvious ways in which sales behaviors can improve the bottom line.

1. Teach your salespeople to prospect more. The No. 1 threat to gross margins is the fear of a lost sale, which is mitigated by the existence of alternatives. Choice is power. When salespeople have numerous opportunities in their sales pipeline, they increase their customer choices in the marketplace. When salespeople proactively seek an abundance of sales opportunities, they improve their negotiating position.

2. Hunt rabbits. Consolidation is a fact of life in our industry today. According to BUILDER magazine, a sister publication of PROSALES, the top 100 U.S. builders now account for the construction of more than 36 percent of all single-family homes. But the smaller-volume builders that account for the other 64 percent often are more loyal and garner better margins for your business. If your sales are significantly tied to a few large-volume builders, the loss of even one account can create havoc within the organization. An abundance of small accounts creates a stable sales environment at favorable margins.

3. Generate customer leads. I have watched in amazement as homeowners walk in and out of dealer showrooms without a salesperson getting their names and numbers. Invariably, when I ask a salesperson why he or she didn't get the information, the response is that the company "does not sell to homeowners." While this may be true, the fact remains that a valuable lead for your customers has just entered and exited the office, and contractors who receive leads from a dealer are extremely grateful and are more likely to pay a premium price on their purchases. The result for the dealers can be significant growth to the bottom line.

4. No guilt. Sales managers need to teach their salespeople that the primary objective of great Sales Leaders is to achieve profits, not sales volume. Too many salespeople confuse their objectives and end up taking the side of customers during negotiations because they want to do a good job on their behalf. Salespeople should be taught that there are many ways to help customers and achieve loyalty, but sacrificing margins does not have to be one of them.

There are probably hundreds of additional methods you can teach your salespeople to improve their sales margins. Margin enhancement is a mind-set that begins at the top of an organization and permeates the entire company. Give your salespeople the incentive, education, and support to increase margins and they will likely score more business and improve the bottom line. But always remember that when it comes to overall profitability, sometimes it's not whether or not you win the business that matters, it's how you play the margin game that counts. ■