CONTRACTORS' DISCOUNTS

There are no guarantees, but understanding how the distribution system works can help you make better deals

by Paul Fisette

Coffee cups shook and silverware rattled as a local builder slammed his fist down, wagged his finger, and warned, "Wait until I get hold of that salesman. Imagine, quoting my customer a price on cabinets that is $200 less than the price he quoted me."

Observing this scene at a diner one morning reminded me that we all get burned. It hurts — not only because builders depend on material discounts for income, but because we feel cheated when we don't receive them. We are led to believe that we get contractors' discounts. But do these discounts really exist?

Paying Early Pays Off

There are thousands of different building materials on the market and, perhaps, thousands of ways to buy and sell each of them. But most products travel along the same route from manufacturer to distributor to dealer to builder. Sometimes an extra wholesaler or retailer squeezes into the chain. Other times a distributor or dealer is yanked from it. But one fact remains constant in all distribution networks: dealers want to get paid as soon as possible. During good times, lumberyards carry their accounts for 35 to 45 days before they are paid. Suppliers wait 60 to 65 days in bad times (like now). Dealers will typically discount purchases if they are paid ahead of schedule.

Building material dealers divide sales into three groups: cash and carry, open charge, and contractor sales. Cash and carry customers pay the most for the goods they receive – on average, about 10% more than builders who haggle at the contractor sales desk. The high volume of materials sold to contractors justifies a lower profit margin on each item sold to them. But dealers offer discounts to encourage builders to settle their accounts promptly.

The industry standard for anyone who buys on account is 2/10 net 30, which means that you get a 2% discount if you pay within 10 days (payment is expected no later than 30 days). Some dealers offer more creative terms like 2/20-3/10 net 30. A 2% or 3% discount may not seem like much, but it can add up to a tidy sum over the course of a year. Many sales representatives like to wheel and deal. Talk to them about establishing an aggressive pay-back plan in exchange for deeper discounts.

Margins

The size of a dealer's profit margin depends on cost and volume. Most suppliers must mark up their goods at least 22% over cost to survive. Specialty items like laminated beams, special locksets, or products bought in quantities, are marked up the greatest amount, typically around 40%. Windows, doors, siding, and trim come next. And then you drop down to the lowest margin item – lumber. Some dealers are so desperate they will sell lumber at 3% above cost just to move material out the front door. They count on volume to buoy their bottom line. Commodity items like lumber and drywall are considered to be "part of the package," but not the crown jewel of the balance sheet.

A lot of money goes to windows and doors. These are either commodity or specialty items depending on what types you consider. And the discounts afforded to builders on these products are extremely variable. High-end custom windows cost more than stock windows for a good reason. Here a sales rep invests a considerable amount of time and effort in determining the size, style, options, and so on. And often this up front work goes without a sale, meaning the cost is absorbed by those who complete sales.

All window and door manufacturers publish a suggested retail price list. Ask your dealer for a schedule and find out what percentage of the manufacturer's suggested retail you will be asked to pay. Go to competing dealers and do the same thing. Be sure to compare apples to apples. Make sure you get the same manufacturer's price list from each dealer. There are some tricky operations out there. Here is a perfect example: A leading manufacturer of high-end stock windows will not sell its windows to any dealer for less than 54% of the suggested retail price. Yet, a New York dealer recently advertised these windows for retail sale at 52% of list. The dealer merely published its own suggested retail price list and offered artificial discounts. The manufacturer's suggested price list wasn't used.

When it comes to custom windows and doors, dealers who display the product pay a few percentage points less for their products than do non-displaying dealers. A well-known custom window manufacturer sells its windows to distributors for around 45% of the suggested list price. These distributors in turn sell the windows to displaying dealers for 63% of list while charging non-displaying dealers 66%. Builders will have better luck, therefore, in bargaining with a displaying dealer.

When buying stock windows and doors, on the other hand, you're better off dealing with a "stocking" dealer – one who stocks the item. On stock items, a dealer who merely displays, and must order every item, pays more than a stocking dealer. Manufacturers of stock windows reward dealers who carry an inventory of boxed units.

Stock windows are discounted more readily because they are on hand. Purchase more than $3,000 worth of stock windows in one order and you can expect to receive an additional 5% to 10% off the suggested list price. The best deals are usually offered by dealers who stock. They get the best prices from manufacturers, and they want to move their inventory.

Factory Direct

As we all know, handling costs are passed on to the consumer. This fact presents builders with a unique opportunity to save money: Buy materials factory-direct. Place the order with the dealer (most manufacturers will not sell directly to a builder) and the dealer arranges for the materials to be shipped directly from the factory to the job site. Dealers or builders must place large orders to purchase factory direct, but the 10% cut you receive off many building materials may make it worthwhile to make the extra effort to organize large orders.

One custom window manufacturer requires a minimum 100-unit purchase to qualify for a factory direct delivery. Most builders find it difficult to buy 100 windows at one time, but a factory direct order can be made by pooling the smaller orders of several clients as long as the composite order is delivered to one location at one time. To make this work, you'll need to work closely with your sales rep so he can coordinate your window schedule with other contractors. By pooling the sales, the rep can accumulate "purchase points" good for a 5% to 10% savings that he can pass on to you. But this procedure takes time and cooperation. Be prepared to wait six or seven weeks for this type of deal to come together.

Who to Deal With

Contractors are usually better off dealing with an outside sales representative. They get paid when the money for the sale is collected, so it is in their best interest to keep you happy. A good rep will make sure your delivery arrives on time and the quality of the material you receive is exactly what you ordered. They are effective advocates, especially during hard times. Reps really hustle when sales are hard to come by – offering builders discounts, good service, and notice of upcoming price specials.

Even if you work with reliable sales reps, you need to keep them honest. Sales reps get pressured just like you and me. The boss might ask them to "sharpen their pencil," or they might see a new boat that would look good on the lake. As a result, the margin may increase a bit. To guard against this, shop your material list around for comparison. Keep checking your numbers, but don't forget about the services you are getting as part of the deal: takeoffs, good quality, timely delivery, good selection, etc. Good service is in effect a discount.

You should buy as much of your building materials as possible from one dealer. Sure you might be able to buy 2x4 studs 54¢ cheaper and roll roofing for $4/square less down the road. But put your package all together and the difference becomes minimal. The savings are insignificant when you discover that the 2x4s are bowed or the roll roofing doesn't arrive on time. It's best to break out several groups of materials and shop each group for competitive prices.

- Commodity items (lumber, drywall, roofing, etc.);
- Windows and exterior doors;
- Interior doors, flooring, and trim;
- Cabinets and specialty items.

Box Scores

There are two major categories of cabinets: stock and custom. Stock cabinets capture the largest share of the market, hands down. Typically the manufacturer of stock cabinets sells directly to a stocking distributor who then sells to dealers. The dealers in turn sell their wares to whomever will buy them – homeowners, builders or installers. Ordinarily, distributors will not sell directly to homeowners, but many will sell directly to builders.

When shopping for cabinets, remember, every manufacturer provides a suggested retail price list to its distributors. The distributor or dealer may deny that they get such a price list, but in fact they are charged for the cabinets on a percentage of list basis. The following represents a typical scenario.

Distributors of many American made stock cabinets will pay around 33% of the list price for the cabinets they purchase. The distributors' sales reps get the cabinets at a break even cost of 41% or 42% of the suggested list price and sell cabinets to dealers for around 45% of the list (for single kitchens). Builders can expect to pay upward from 50% of the suggested list price for single kitchen purchases. Dealers and builders who buy multiple kitchens can expect to get another 2% or 3% off the list price when their orders exceed $4,000 or $5,000. If they buy an entire truck load (20 good-sized kitchens) the price drops to around 43% of list.

A distributor's sales rep may break even at 42%, but builders beware. Many sales reps can sell the cabinets for whatever the market will bear – list price if possible (or below cost if the rep is a little dull and wants to subsidize the goods out of his pocket). So be prepared to deal. And don't assume that you will always get the best deal buying direct from distributors. True, dealers are middlemen. And middlemen have their fingers in the pot. But a dealer may be hungry and willing to sell to you at a very short profit margin, especially if the dealer will get the installation job or doesn't have to carry the cabinets in inventory.

Custom cabinets are proved differently than stock cabinets. There are many more options available, and the units are not manufactured until an accurately measured layout has been established. This means that a lot of work and a big commitment must be made by the sales rep before an order is made. And many item layouts are drawn and the sale is not consummated. In the end, margins on custom cabinets are greater than stock cabinets because there is more time and work involved in the total sale.

Manufacturers of custom cabinets also have a suggested retail price book and sell to dealers at a percentage of list (plus freight). It is not uncommon for a dealer to purchase custom cabinets from a manufacturer for 50% of suggested list and sell the cabinets to builders for 75% to 80% of list.

It is nearly impossible, however, to compare apples to apples when you talk about custom cabinets because there are a million "up-charges" to consider: moldings, finished ends, laminate up-charges, toe kicks, hardware, and on and on. Your custom cabinet customers will probably want fussy service, so service from your dealer will be important.

There is no formula telling you what you should pay for stock or custom cabinets. Although it's tempting to say that you should never pay more than 55% of list for stock cabinets and 80% for custom, these numbers won't always hold up. Different manufacturers have different price structures, and they change them from time to time for competitive reasons. But once you know what brand or brands of cabinet you want, you can still shop apples to apples and deal effectively. Here's how:

- Demand a manufacturer's suggested price list from your distributor or dealer.
- Ask your sales rep what percentage of list you will be paying.
- Shop around – compare manufacturer's list with two or three dealers of the same cabinet line, asking them to quote you a percentage of the suggested list price.
- See what service the representative will perform: layouts, arrange for delivery, etc.
- Pay on time.
- Be honest and up-front with your sales rep.

The trick with any purchase is to shop. Get a factory price list and ask what percentage you are paying. Ask what you are getting for your money, and see that you get it. If you are smart, you will check prices regularly. ■

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