2025 State of Distributor Profitability: Distributors’ Action Plan

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In my previous whitepaper, I suggested that distributors need to make improvements in four key areas of their business to increase their profit. This report will build on that by looking at three issues:

1. Is there really a need to change or have we already entered a new era of high profitability?
2. What action plan is necessary to improve profitability?
3. How large of an improvement is needed?

Distributors are in business for one reason: to make a profit. But it's never that simple. Traditionally, distributor profitability has fluctuated with economic cycles. During recessions, profits have dipped, sometimes into losses. In contrast, high demand and inflationary pressures have temporarily driven up margins.

However, long-term averages suggest most distributors operate within a narrow margin range that remains relatively static. While some high-performing companies exceed the overall average, most remain within this threshold.

The challenge for distributors in 2025 is how to move beyond the historical cycle and external pressures to establish sustainable profitability amid evolving pressures. We can do this by leveraging four critical pressure points that apply rigor and intentionality to improve profit margins.

- Sales
- Payroll
- Gross Margin Percentage
- Other-Expense Percentage

The Need for Change – Finding the Baseline

The industry has seen sharp swings in recent years due to inflation, rising labor costs and supply chain disruptions.

Historically, typical profit before taxes margins would fluctuate between 2% and 4%, with recessions pushing those numbers down to -1% to 1%. But the era that followed COVID-19 was marked by strong inflationary numbers, dramatically driving up profit. Expenses did not catch up in the short run, significantly strengthening margins for the typical distributor. But this predictably did not last. Payroll expense caught up, and we've now gone back to the future — and back to historical norms.

The Impact of Making the Mandated Changes

The Old Boring History Era	
Typical	2% to 4%
Recession	-1% to 1%
Strong Growth	3% to 5%

The Masters of the Universe Era	
2022 to 2023	4% to 6%

The Back to the Future Era	
Typical	2% to 4%
Recession	-1% to 1%
Strong Growth	3% to 5%

In the wake of these fluctuations, distributors must define their baseline profitability and determine where to improve. Ask yourself:

- Are our margins improving or declining year over year?
- How do our payroll costs compare to revenue growth?
- Are we leveraging technology such as AI and automation to control operational expenses?
- Are we capitalizing on strategic pricing opportunities to boost gross margins?

It's time to move from reactive decision-making to a proactive strategy for financial stability.

Your Action Plan for Improving Profitability

1. Increase sales by at least the inflation rate.

As long as sales outpace inflation, the potential for higher profit remains strong. Most distributors assume that large increases in sales are required. However, distributors that make even small improvements above the inflationary rate will experience a huge impact.

The key is a systematic and intentional approach to keeping revenue ahead of expenses while supporting sustainable business growth.

2. Force payroll to grow slower than sales to create a sales-payroll wedge.

A closed deal costs money to generate. Distributors must ask: “How much payroll do I have to bite off to generate that sales volume?” That’s a key performance driver. How can you generate more sales without increasing payroll by the same amount? Payroll is by far the largest expense for most distributors, typically consuming two-thirds of total operating costs. To improve profitability, distributors must ensure that payroll grows at a slower rate than sales.

To find this sweet spot, distributors must consider which selling areas generate the highest revenue at the lowest cost. Implementing a gap between sales growth and payroll growth — the “sales-payroll wedge” — helps improve operational efficiency while maintaining financial stability.

There are three specific actions that are necessary to improve profitability.

- **Control or eliminate the problem portion of your sales force.**
  Several new AI and automation tools are available to support your sales teams so they can spend more time selling and less on administrative work. But if you lack the consultative sales talent you need, or if a portion of your sales talent is underperforming, consider your options.

- **Alter order economics.**
  That means more closed sales or increasing the number of lines on every order. The challenge is that these require more analytical work that may be too difficult with our existing systems. However, order economics may be an area where AI can have an impact.

- **Work with the customer to change behavior.**
  About half of distributors' customers are unprofitable. Some are unprofitable because they have too many special orders, too many returns or they pay slowly. Some people say to eliminate these customers. That is a terrible idea. However, eliminating the bottom 2% of customers distributors lose money on isn't unrealistic. Again, this is an area where AI-driven analytics can help, sorting customers into categories so that sales reps can approach each with a similar strategy and improve their performance.

3. Increase the gross margin percentage (not gross margin dollars).

Instead of focusing solely on gross margin dollars, distributors should work toward an increase in gross margin percentage. Gross margin improvements directly impact profitability, and even small percentage increases can translate into substantial financial gains.

Distributors can achieve this through strategic pricing, better supplier terms and capitalizing on high-value product offerings. AI-powered analytics and demand-driven pricing models can help distributors identify where margin improvements are possible without sacrificing customer retention. Companies can dynamically adjust prices based on demand elasticity, customer behavior and market conditions.

Additionally, distributors should work to capture full value from supplier discounts. Many distributors automatically pass savings from vendor price reductions to customers instead of retaining a portion for margin improvement. On the flip side, distributors should capitalize on supplier price increases.

Strategic purchasing can also further bolster margins.

4. Decrease the other-expense percentage (not expense dollars).

Distributors must also control non-payroll expenses — such as logistics, warehousing and administrative overhead. The goal is to decrease these expenses as a percentage of sales annually. Even small changes can dramatically improve the bottom line.

Distributors can accomplish this by reducing waste and operational inefficiencies. For example, optimizing warehouse layouts, improving procurement processes and adopting automated inventory management systems can lower overhead costs. Technology also plays a vital role in cost control. Distributors can streamline administrative functions, reducing the need for manual intervention in processes such as invoicing, customer service and supply chain management.

With disciplined expense management, distributors can maintain profitability even as they scale their operations.

Distributors should exercise caution however when assuming that AI will lower costs across the board and sustainably increase profitability. Over the years, we've seen many technological developments promoted as profit drivers; but relative to the market, none have delivered. New technology is a double-edged sword. If I don't use these tools, I will fall behind. If everyone uses them, we'll stay on the same plane. Long-term, it is often the bare minimum to remain in the game. Ultimately, intentionality is key to leveraging AI or any other technology to grow margins and gain a real edge.

Mandated Changes in Each of Next 5 Years

Net Sales	5%
Gross Margin %	0.2%
Sales-to-Payroll Gap	2%
Other Expenses %	-0.2%
Inventory Turnover	0%
Collection Period	0%

The Impact of Making the Mandated Changes

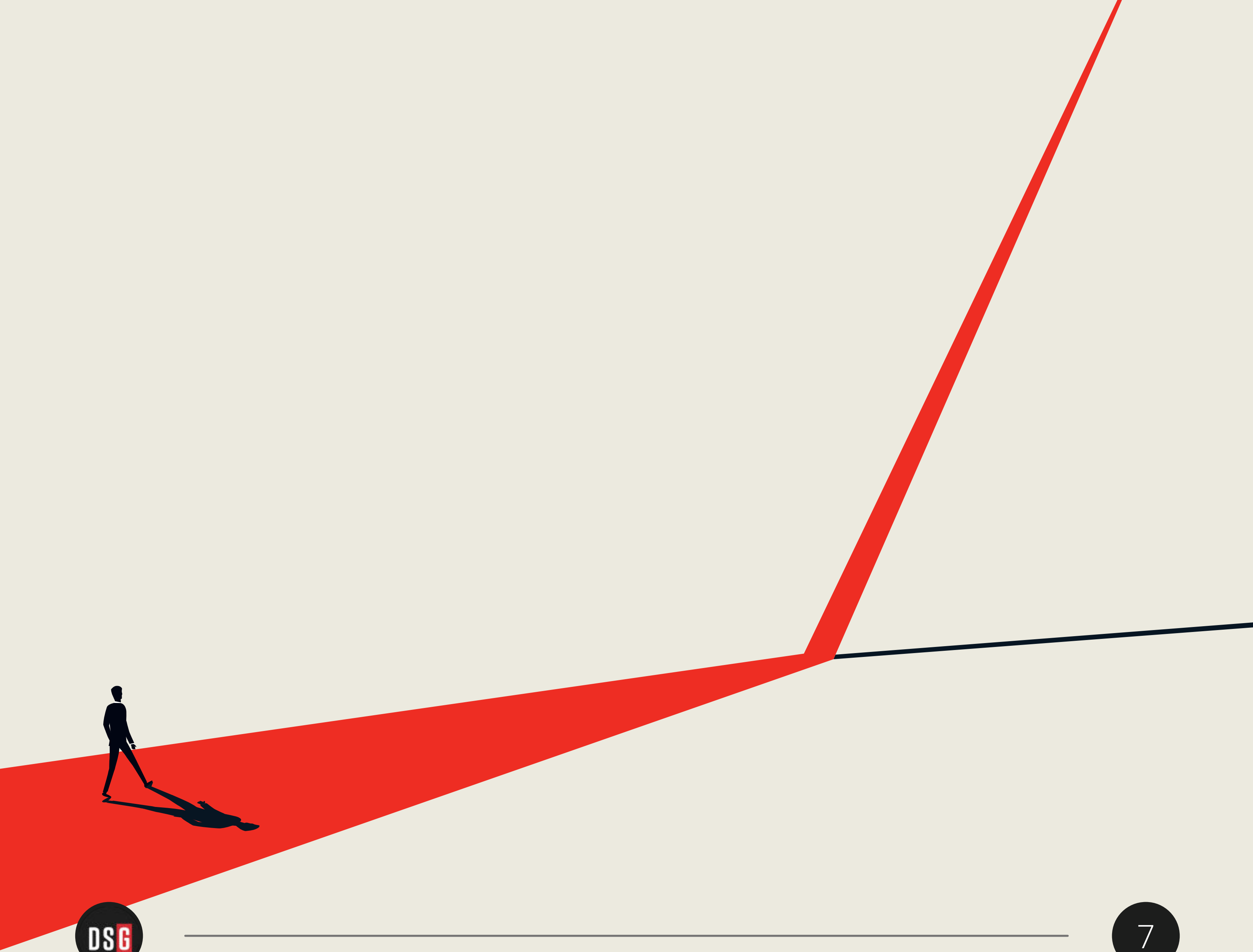
	2025	**2026**	**2030**
Net Sales	50,000,000	52,500,000	63,814,078
Cost of Goods Sold	37,500,000	39,270,000	47,222,418
Gross Margin	12,500,000	13,230,000	16,591,660
Payroll and Fringes	7,500,000	7,725,000	8,694,556
All Other Expenses	3,500,000	3,570,000	3,828,845
Total Expenses	11,000,000	11,295,000	12,523,400
Profit Before Taxes	**1,500,000**	**1,935,000**	**4,068,260**
Net Sales	100%	100%	100%
Cost of Goods Sold	75%	74.8%	74%
Gross Margin	25%	25.2%	26%
Payroll and Fringes	15%	14.7%	13.6%
All Other Expenses	7%	6.8%	6%
Total Expenses	22%	21.5%	19.6%
Profit Before Taxes	**3%**	**3.7%**	**6.4%**

The Path to Profitability is in Your Hands

Even modest changes — such as 5% annual sales growth combined with a slight improvement in gross margins and controlled payroll expansion — can double profitability within a relatively short period.

The distribution industry in 2025 is at a crossroads. The distributors that take decisive action — optimizing pricing, controlling payroll growth and intentionally leveraging technology to outpace the competition — will break free from the 3% profit trap. Small, strategic shifts can double profitability over time, but only for those willing to step up and execute.

More sales alone won't save you. Efficiency will. The winners in this new era will be the distributors who ensure every dollar works harder. Don't wait for profitability to happen — engineer it.



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About the Author

Dr. Albert Bates is Principal of the Distribution Performance Project, a research and education entity focusing on distribution. He makes about 100 presentations each year on topics such as Improving the Bottom Line, Doing More with Less and Pricing for Profit. He also heads the firm's investigation into profitability research for over 50 different trade associations. He has published widely in both the professional and trade press, including in the Harvard Business Review and the California Management Review. He has also authored eight books on financial planning for businesses.

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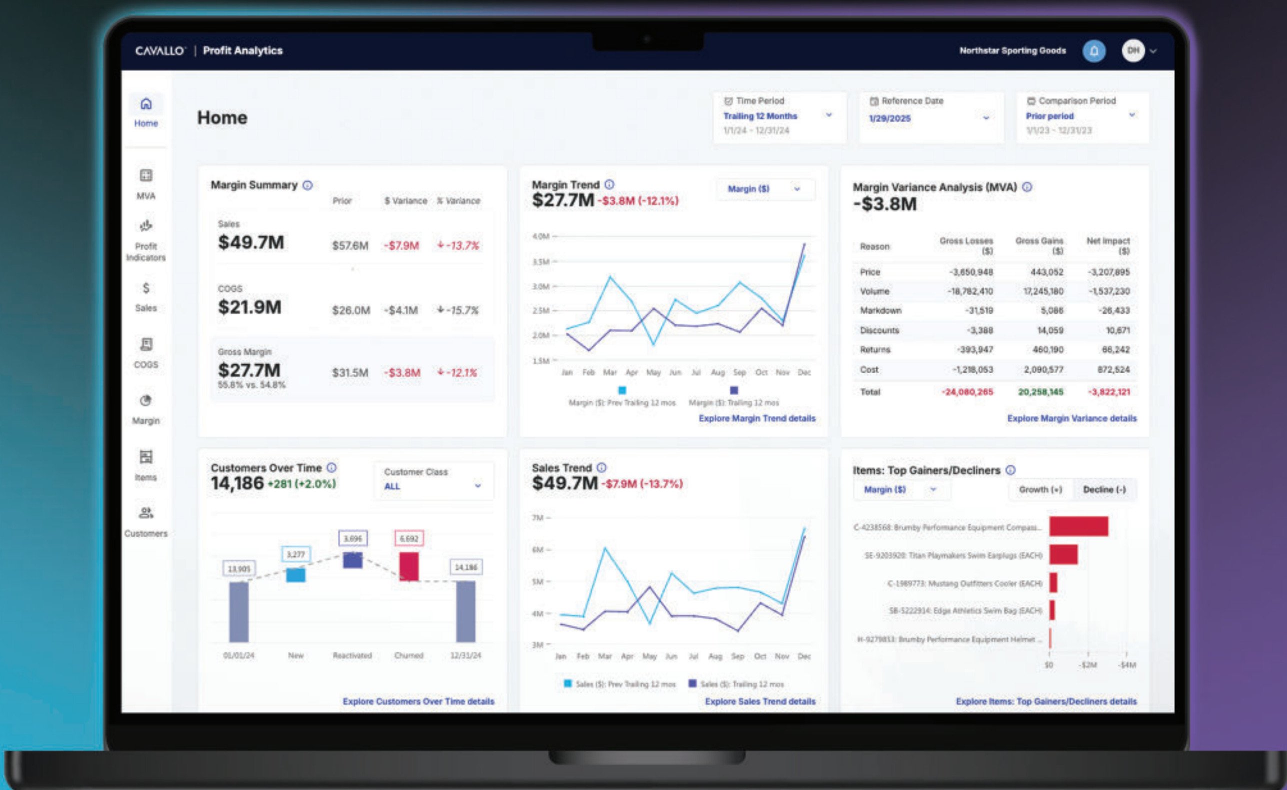

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