

# Introduction

## Wholesale Distribution's Evolving Future

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The wholesale distribution industry continues to evolve and adapt. Pembroke Consulting estimates that revenues of wholesaler-distributors will reach \$4.8 trillion in 2009, marking another year of positive performance but a slowdown in growth rate from recent years. However, conditions continue to vary sharply among individual subsectors of the industry. Some sectors are experiencing rapid top-line growth due in part to surging commodity prices, although profits have not always kept pace with these revenue increases. Wholesale distribution of building materials remains far below the levels from just a few years ago. Business for wholesaler-distributors that supply exporting companies remains healthy, even though overall manufacturing activity has slowed down.

Despite variations in economic conditions, many of the trends described in 2007's *Facing the Forces of Change®: Lead the Way in*

*the Supply Chain* are becoming more relevant to the wholesale distribution industry. Customers are seeking lower-cost alternatives in a weakening economic environment, creating demand for private label products from wholesaler-distributors. Supply chain efficiencies are leading to increased interest in demand-driven initiatives, while many wholesaler-distributors are actively engaging in strategies to build new profit streams within their companies. Business customer use of the Internet is deepening, creating both new opportunities and new challenges for wholesale distribution intermediaries.

The NAW Institute for Distribution Excellence and Pembroke Consulting put together this book to give wholesale distribution executives an interim update on the key issues identified in *Facing the Forces of Change*, the industry trends report published in March 2007. Like our prior successful *OUTLOOK* collections, *OUTLOOK 2009: An Executive's Companion to Facing the Forces of Change* is a diverse and powerful collection of insights from 10 wholesale distribution analysts, authors, educators, and consultants. Each contributor uses *Facing the Forces of Change* as a starting point for analyzing the year ahead.

I worked with each of the contributors to help them augment our original research with their own experiences and ideas. The chapters provide you with the authors' assessments and predictions about a particular topic along with specific action steps and recommendations for your business.

*OUTLOOK 2009* will provide the greatest value to your company when read in conjunction with *Facing the Forces of Change*. We recommend that you purchase the report as a reference and guide. It is available online at [www.naw.org/ftf07](http://www.naw.org/ftf07). The dialogue in *OUTLOOK 2009* will also continue online at my Distribution Trends blog, [www.DistributionTrends.com](http://www.DistributionTrends.com).

## **TRENDS FOR WHOLESALE DISTRIBUTION**

The four major trends in *Facing the Forces of Change* are reaching critical mass in many sectors of the wholesale distribution industry.

### **Trend 1: Private Label Products**

The use of private label strategies by wholesaler-distributors will expand substantially over the next few years. Private label products—products branded by a wholesaler-distributor—represent a break from the more traditional wholesale distribution approach of reselling manufacturers' branded products. Global sourcing from Asia and South America provides a source of low-cost manufacturing capacity for distributors looking to offer their own private label products.

The impact of private labels on channel relationships is an especially controversial topic. Private labels will strengthen wholesaler-distributors' relationships with their customers and grow in categories where a manufacturer's brand does not add enough value to the customer. However, this growth will strain wholesaler-distributors' relationships with their suppliers by challenging the channel's traditional role as an extension of a manufacturer's sales and marketing activities. For example, a private label strategy requires the courage to walk away from supplier rebates on selected products in favor of increased margins from customers and buy-side sourcing activities.

Wholesaler-distributors will need to build new capabilities in manufacturing and design to create products with unique, premium benefits. They will also have to select the right opportunities for private labels and manage the new supply chain risks associated with their own products.

### **Trend 2: Demand-Driven Channels**

The term *demand-driven* refers to the idea that products are pulled down the supply chain to the market based on actual customer

demand data. It also represents a contrast from the more traditional notion of products in a marketing channel being pushed by manufacturers toward the customer. Both manufacturers and distributors will be able to manage their respective inventories better when demand-based information is shared.

The enabling factors for a demand-driven channel will become more prominent over the next 5 years, thereby creating the conditions for demand-driven channels in many wholesale distribution lines of trade.

The trend toward more data sharing between channel partners challenges many preconceptions about the wholesale distribution industry. Moving from the traditional structure to a demand-driven channel requires innovation at every level of the supply chain. Wholesaler-distributors need to send information electronically to suppliers, while simultaneously accepting a new level of visibility and transparency into their operations. Many wholesaler-distributors recoil from the idea of sharing customer information with suppliers, because they fear disintermediation due to direct sales by manufacturers.

Wholesaler-distributors can succeed with demand-driven channels by developing appropriate supply chain data transmission standards in their lines of trade, evaluating new profit streams from data transmissions to suppliers, and applying demand-driven concepts to their own businesses. Some wholesaler-distributors have even developed equitable quid pro quo arrangements for data sharing that provide new sales or training benefits to their companies. Nevertheless, many wholesale distribution executives do not fully trust their suppliers with demand data. Getting over this trust hurdle typically requires well-established business relationships with a manufacturer.

### **Trend 3: New Profit Models**

Manufacturers will increase their share of a wholesaler-distributor's profit margin from product distribution, leading to greater use of

pay-for-performance channel compensation models by manufacturers. Wholesaler-distributors will need to understand whether their companies are truly profitable partners because channel compensation is becoming more data based and performance oriented.

Nevertheless, wholesaler-distributors can benefit from better measurement of performance and can derive new profit streams in the supply chain. Innovative, successful wholesaler-distributors are willing to provide data conveniently to suppliers so that the supply chain can provide customers with the best fulfillment at the lowest costs. Leaders will welcome a more rigorous approach to channel management by their suppliers, because they recognize the opportunity to further improve their market share and performance.

Many wholesaler-distributors are now successfully selling fee-based services and positioning themselves as suppliers of products with related services instead of only reliably providing goods. One example is outsourced fulfillment as a fee-based service to traditional suppliers. This allows distributors to beat back the threat from logistics companies. Similarly, the recognition that certain core services have become commoditized has led innovative wholesaler-distributors to position themselves as suppliers of products with related services instead of only reliably providing goods. Their creative actions will ensure a place in the supply chains of tomorrow.

Ongoing success will require wholesaler-distributors to master the financial dynamics of a services business, which are different from a product distribution business. Wholesaler-distributors will also need to monitor new developments at competing logistics companies and avoid their overconfidence in the unique value of their own logistics prowess.

### **Trend 4: Connected Customers**

Wholesaler-distributors must fully embrace the Internet in their business activities now that it is a normal part of everyday life in the

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United States and Canada. The Internet-driven connectedness is simultaneously enhancing and challenging the traditional ways that wholesaler-distributors make money.

Customers will continue to question the value added by wholesaler-distributors due to the ready availability of information and more sophisticated sourcing techniques as the Internet becomes fully integrated into society. Just consider the rapid growth in online networked communities of business-to-business customers that is occurring with limited involvement from wholesale distribution suppliers. Well-connected, highly informed customers are able to cherry-pick the products and services they need, thereby undermining the basic economic model of a wholesale distribution company.

Innovative wholesaler-distributors are leading in the supply chain by using technology to become more, not less, relevant to their customers. Online collaboration tools, such as online work spaces and virtual tradeshow, will emerge as new ways for wholesaler-distributors to interact with their customers. Adoption of self-service technologies, which has grown significantly in the past 3 years, will continue, so wholesaler-distributors must allow customers to gain information, place an order, and solve simple problems themselves when appropriate.

Success in the ever-evolving online business environment will require wholesaler-distributors to use their Web sites as an effective sales lead-generation tool and information resource to respond to their customers and to teach their sales reps to sell and communicate using new technologies. In contrast, less-innovative distributors will have an increasingly hard time convincing Internet-savvy customers of their ability to provide support through the entire buying process, from research to service.

### **Emerging Trends**

The wholesale distribution industry is going through a very active wave of merger and acquisition activity that is led by both strategic

buyers and financial buyers, such as private equity firms. Although executives in most markets expect continued acquisition activity, there is little consensus about the ultimate impact on the wholesale distribution industry.

The U.S. workforce is becoming older and more diverse as the baby boom generation ages, mirroring broader changes in the U.S. population. These demographic changes could have substantial impacts on the wholesale distribution industry, although there will not be a single point in time when these demographic changes trigger a particular crisis in the wholesale distribution industry. Wholesaler-distributors may face the retirement of their most knowledgeable and seasoned employees, while simultaneously competing more aggressively to attract the next generation of junior and middle managers to their companies.

Wholesale distribution executives must also recognize that unusually high commodity price inflation has made revenue growth much easier to achieve. Wholesaler-distributors are going to have to work harder for real growth as the commodity cycle changes, and this will require a more strategic and focused approach. Wholesaler-distributors will benefit by using demand-driven models and evaluating new profit sources.

### **INSIGHTS FROM OUTLOOK 2009**

This book is structured around the major and emerging trends identified in *Facing the Forces of Change*. In addition to the research from the main report, we conducted a brief survey of wholesale distribution executives in spring 2008. The results of these new data, which represent the views of about 200 executives, are discussed within each chapter and referred to as the Outlook 2009 survey.

The book begins with a look at private label products from David Gordon of Channel Marketing Group and Allen Ray of Allen Ray and

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Associates. They outline some pros and cons of private label products that wholesale distribution executives should carefully consider.

Mike Marks of Indian River Consulting Group then examines the growth and development of demand-driven channel relationships between manufacturers and their wholesaler-distributors. Marks suggests that market leaders can use demand-driven channels as a strategic tool to strengthen their competitive position. He also highlights the need to coordinate demand-driven activities within a wholesaler-distributor's organization as well as between channel partners. The ideas in this chapter will also help wholesaler-distributors to proactively manage the risks and benefits of sharing data with suppliers.

Brent Grover of Evergreen Consulting explores the management challenges behind the new profit model of fee-based services. As Grover explains, traditional wholesale distribution management practices do not always translate well to services. Executives must actively manage the conflict between the service department and the sales staff, while also carefully monitoring and managing the financial returns of the service function. After reading Grover's chapter, challenge your management team by asking: "How can we have more profitable relationships with the customers and suppliers who benefit most from working with us?"

Dave Kahle of DaCo Corporation looks at the sales management challenges related to the connected customers trend. He argues that senior sales managers at wholesaler-distributors must insist on a new and evolving set of technologically driven "minimum competencies" for the typical distributor salesperson.

Tom Gale of Modern Distribution Management/Gale Media, Inc., provides a complementary look at the marketing tactics needed when selling to connected customers. Gale suggests that traditional, branch-based wholesaler-distributors must create a comprehensive, integrated approach to online marketing. He also describes the

importance of a corporate Web site as the hub of online marketing efforts. Rather than walking away from traditional marketing efforts, Gale's analyses suggest that wholesaler-distributors should experiment more by allocating time and money to nontraditional online ads and Internet marketing.

Barry Lawrence from Texas A&M University brings together the demand-driven channels and connected customers trends to explore the crucial role of information technology in wholesale distribution. Lawrence also explains how new technologies allow a wholesaler-distributor to take a leadership role in the supply chain. Technology is a key tool for wholesaler-distributors looking to generate significant gains in employee productivity in repetitive processing activities such as order processing, billing, inventory control, and warehouse management.

Jim Miller of Supply Chain Equity and Lindsay Young of Modern Distribution Management/Gale Media, Inc., look at the key forces that have changed the mergers and acquisitions environment since *Facing the Forces of Change* was published in early 2007. Although deal-making has slowed in the wholesale distribution industry, they identify the factors influencing buyers of top-notch wholesaler-distributors. If your company is well run and has access to capital, now could be the time to approach distressed competitors and discuss the value of a combination.

John Salveson of the Salveson Stetson Group highlights the leadership and recruitment challenges created by the changing demographics in the United States. Salveson identifies the general leadership competencies critical for future wholesale distribution executives, while also linking the major trends from *Facing the Forces of Change* to other specific management competencies. Will your company be able to compete effectively for the next generation of employees and leaders? Will you be an employer of choice?

## **ACTION STEPS FOR 2009**

Wholesaler-distributors will face many challenges in the years ahead. Economic conditions are likely to remain uncertain in many sectors, and the political environment is becoming less business friendly. As you read the diverse contributions in this book, make a personal commitment to the following three action steps:

- 1. Analyze how your business can benefit from industry trends.** *Facing the Forces of Change* has a proven track record in predicting important developments in the wholesale distribution industry. Many of these trends will change wholesale distribution in your line of trade, even if these changes are not directly affecting your business today. Don't close your eyes to the market and forget to create a long-term vision for your company.
- 2. Build future leaders.** Use *Facing the Forces of Change* and *OUTLOOK 2009* as tools to help your management team and salespeople better understand the future business environment and get engaged in company strategy. These books can be the starting point for substantive management discussion and leadership development throughout your organization. Some top executives hold monthly meetings based around *Facing the Forces of Change* materials as a way for executives and managers to exchange ideas, thoughts, and vision.
- 3. Invest in profitable success.** There are always opportunities for business development and success, regardless of the external environment. Many of the contributions in *OUTLOOK 2009* encourage wholesaler-distributors to move away from a one-size-fits-all service model and toward a business built around stronger relationships with their most profitable customers and suppliers.

The next edition of *Facing the Forces of Change* will be released in 2010. Between now and then, prepare to make the most of the current environment while building for future success.

