



EXECUTIVE SUMMARY

Given the lingering uncertainty in the economy, wholesaler-distributors must continue to take decisive actions that will position their companies for growth and prosperity. Gone are the days of overly cautious and slow decision-making processes. The business world is moving too fast, and wholesaler-distributors must be informed, intelligent, and nimble enough to make rapid but prudent decisions, and then adjust and iterate as necessary. This newest version of *Facing the Forces of Change®: Decisive Actions for an Uncertain Economy* aims to give wholesaler-distributors the tools to do just that. In the following pages, we will outline the economic challenges that continue to unfold around distributors; the changing and expanding role of services and their importance to wholesale distribution; the importance of analytics as a tool to help distributors differentiate themselves, better serve customers, and prepare for future demands; the value of “human capital” to the wholesale distribution organization; the vital and ever-growing role of information technology (IT); and two important trends shaping wholesaler-distributors of every size and in every line of trade—the “green” movement and the growing role of government.

Chapter 1: Confronting the New Economic Environment

One of the primary ways distributors create value is by aggregating a diversity of products from multiple vendors and selling them to an often fragmented customer base. Operating efficiency and product availability are essential to the profitable execution of this break bulk–focused model. However, with customer demands increasing and competition intensifying, the ability of even the most efficient distributors to rely on this model for profitable, long-term growth has sharply eroded.

In response, many forward-thinking distributors now offer a broad portfolio of value-added services ranging from kitting, to inventory management, to engineering design. Delivering these services adds both complexity and cost to a distributor’s business, with no guarantee of higher margins. What’s more, few distributors have mastered the balancing act required of these two sometimes conflicting requirements (on the one hand, creating an efficient supply chain to sell products, and on the other, building the

capabilities required to offer a set of services). Add to this already challenging operating landscape the lasting effects of a profound economic crisis, and the pressures only intensify.

The recent economic crisis ushered in a new economic environment, the likes of which distributors are largely unfamiliar with and in many cases for which they were wholly unprepared. In this new environment, predictability and stability will largely disappear, replaced by continued volatility and uncertainty and ever-high levels of complexity.

Operating in this new economic climate requires new ways of thinking, innovative business models, and creative leadership. From the assets they own, to the services they offer, to the customers they serve, to the people they deploy and the capabilities they leverage, wholesaler-distributors are entering an extended period of profound transformation. Adjusting to these changes and capitalizing on new opportunities will be essential for survival in this new business climate.

Chapter 2: The Expanding Role of Services

As noted in chapter 1, most distributors already offer some form of services as part of their portfolio of offerings—whether as an element of an integrated product/service bundle or as a discrete offering available regardless of whether or not a product is purchased. Unfortunately, few distributors have yet to truly “crack the code” on services. Capability gaps remain in a number of important areas, including accurately defining the scope of the service, ensuring the service addresses a specific customer or supplier need, managing the portfolio of services as an integral part of the business rather than a side offering, creating a consistent approach for delivering services efficiently (that is, at a cost acceptable to the distributor), and convincing customers of the value being delivered.

In far too many instances there also remain disconnects among (a) the costs associated with delivery of the service, (b) the customer or supplier’s perception of the value the service delivers, and (c) as a consequence, the revenues and margins realized by the distributor from the service. A common underlying problem is that distributors often have only a limited understanding of the true costs of providing individual services, let alone their ultimate profitability.

Some services-related challenges were addressed in the 2007 *Facing the Forces of Change*[®] report—specifically in the chapter on new profit models. That chapter noted that “New compensation methods that will grow in importance include fee-for-service payments from customers ... and fee-for-service payments from suppliers.”¹ While still accurate, this does not fully convey the urgency surrounding distributor services today and the need for distributors to “get it right” going forward.

Wholesaler-distributors must take three decisive actions to overcome this issue: (1) get much closer to customers to understand their processes and service needs, thereby becoming a truly collaborative business partner; (2) develop a services strategy that is adopted and understood company-wide; and (3) actively manage their product and services portfolio to ensure they are providing the right solutions at the right prices with the right profit margins.

Going forward, distributors must not only view services as important, but as *the* most strategically important component of their value proposition—the one they *must* master to succeed. This holds true even in situations where services currently represent a relatively small proportion of total revenues. Underlying this is an important shift in the nature of supplier-distributor-customer relations. It must be the distributor—not the customer or the supplier—who conducts the analysis, identifies opportunities, and defines the service(s). Distributors unable to achieve the required level of mastery may well still be profitable, but their ability to influence those profits will likely diminish. In such cases, the distributor's customers and suppliers will largely dictate profitability.

Chapter 3: Differentiating with Analytics

Successful distributors continuously refine and enhance their ability to negotiate the best deals with vendors, identify and address areas of operational inefficiency, determine a fair price for products, manage inventory levels, and motivate and reward those individuals who help distinguish the business with customers and suppliers. Each of these activities leverages analytics. From a business perspective, the effective *application* of analytics enables distributors to deepen their customer insights, improve and accelerate decision making, identify and respond to market dynamics, and operate more efficiently.

These capabilities will be especially relevant and differentiating going forward, as distributors of every size and in every line of trade look to manage the lingering effects of the economic crisis, an intense competitive environment, and ever-increasing customer expectations. Add to this agenda an increasingly complex portfolio of products and services and a more global and integrated supply chain, and the pressures on the business are, indeed, immense.

A growing number of distributors have already embraced and leveraged a variety of analytical tools and approaches, including Lean and Six Sigma principles; price and inventory optimization; and advanced segmentations of customers, products, and suppliers. In the future, wholesaler-distributors will need to further develop and expand on these capabilities, aggregating the rapidly growing amounts of data from across and beyond the organization, conducting the required analyses on an accelerated time frame, communicating role-specific insights and actions based on the results, and then analyzing the results of the actions and refining future actions as needed.

Always important, analytics are now a required core competency that must be embedded within the distributor organization, elevated to a strategic level, and play a crucial role in leveraging complexity and improving decision making. And although analytic technologies and tools (such as price optimization and activity-based costing) can be of great value, it is equally important that a distributor's *people* and *processes* adapt to and embrace analytics. This is a key human capital issue, as many wholesaler-distributor employees will be challenged as they are required to adapt to new ways of working and new approaches to problem solving. Indeed, as we highlight in Chapter 4: Leveraging Human Capital, analytical skills will be a sought-after capability and source of competition going forward.

For distributors already on the road to becoming analytically driven businesses, complacency is not an option in today's uncertain economy. For those beginning the journey, it's not too late—but they will have some catching up to do.

Chapter 4: Leveraging Human Capital

After an extended period of growth and relative stability, the economic crisis forced many distributors—some for the first time—to make painful headcount reductions to stabilize and protect their businesses. For some distributors, this was their first time taking such action, and for many it highlighted gaps in their ability to target underperformers, identify high-potential employees, and align workforce-related decisions with their business strategy. If they haven't already, distributors must now focus on acquiring and building those skills that will differentiate them in today's hyper-competitive environment. Although other issues continue to consume executives' time and attention, developing and leveraging the organization's human capital must also be a top priority.

The term “human capital” may seem overly formal and perhaps even a little clinical, especially for an industry still characterized by relationship-driven sales and strong ties to its employees. However, we use the term to highlight the critical implications of recruiting, training, managing, assessing, enabling, and rewarding employees, and to reinforce the need for a more rigorous approach to managing this component of the business. The 2007 *Facing the Forces of Change*[®] report touched on a variety of human capital-related issues, citing the importance of identifying personnel gaps, sharing knowledge, retaining valued employees, and investing in technologies that enhance worker productivity. Since then, the importance of human capital management has risen to become a truly strategic issue for distributors, regardless of their size, product line, or customer type.

As much as distribution is about products, services, customers, and vendors, it is also about human capital, which is at the heart of a distributor's capabilities. In spite of the growing acceptance of online communication tools, *people* represent an essential part of a distributor's capital base and a source of key capabilities. Indeed, the growing accep-

tance of online tools actually increases the importance of the human dimension by freeing employees from repetitive, routine non-value-added activities—allowing them to focus on tasks that can add value and differentiate the business.

Human capital represents a significant financial investment for every wholesaler-distributor. It is an asset they must thoughtfully, actively manage and develop if they are to realize the most benefits in terms of productivity, effectiveness, value, and, ultimately, profitability. In addition to exploring various approaches to managing employees (directing attention to focal jobs, for example), distributors' tactical decisions about where to recruit, who to hire, what training to offer, and how to assess and reward employees must be guided by a long-term human capital strategy.

Chapter 5: The Transformative Role of Information Technology

As distributors look to position themselves for future growth opportunities—including online—they must further elevate the profile of the IT function and create a bold IT strategy to guide investments in IT infrastructure and capabilities.

Unfortunately, many customers, suppliers, and competitors have more mature, sophisticated IT infrastructures and capabilities than their distributor counterparts. Indeed, a great many wholesaler-distributors continue to operate with fragmented, legacy systems that are unable to keep pace with the demands placed on them by customers, suppliers, and supply chains. This dynamic must change if distributors hope to carve out a truly value-added, differentiating role in the supply chain.

Individual information technologies have become a pervasive and integral component of wholesaler-distributor operations—automating low-value, repetitive activities; increasing visibility into and across the supply chain; and creating a common, updated view of the business. In doing so, IT applications have freed resources for other, more productive and valuable activities, reduced errors and rework, and enabled better decision making. As distributors further develop their e-commerce capabilities, expand their web-enabled services, and leverage advanced analytics to gain insights from the vast amounts of data within their organizations, IT will further cement its position as a business differentiator.

At the same time, new information technologies and business trends are creating truly transformative business opportunities for innovative distributors. Offerings such as cloud computing, software as a service (SaaS), infrastructure hosting and outsourcing, and virtualization provide distributors with low-cost, flexible access to the latest technologies. Also, social networking, location-based services, and new ways of collaborating and sharing information online are changing the ways individuals and organizations interact. Leading distributors will understand, prioritize, and harness these trends, where it makes sense, to transform their business and create lasting competitive advantage.

As with other investments, IT expenditures require careful consideration and planning, however now is *not* the time for undue caution or risk aversion. As long-term, profitable growth again becomes a realistic expectation, distributors *must* prioritize strategic investments in IT. Those that create an agile, insight-driven, differentiated organization will be best positioned to thrive in our increasingly complex, volatile, and unpredictable economic environment.

Chapter 6: Capitalizing on Key Trends

Given the lingering amount of uncertainty, unpredictability, and volatility in the global and domestic economy, making predictions of any sort is likely to be a risky proposition. However, two trends that appear to have sufficient breadth and depth to maintain their relevance to wholesale distribution are as follows:

- The continued expansion of the broadly defined “green business segment,” including renewable energy generation; energy efficiency; carbon and water efficiency; waste reduction; recycling; and, in the food sector, organics and sustainability
- An expanded role of government in areas such as environmental, labor, and safety regulations; international and domestic trade; and, of course, taxes and tax incentives.

These trends are more relevant than ever to wholesale distribution—both in terms of opportunities and challenges—and therefore must capture a share of management’s attention and investment going forward. Capitalizing on these trends now can help distributors gain a substantial competitive advantage down the road.

Distributors of every size, in every line of trade, and servicing every type of customer are seeing opportunities in green business segments. These trends fall primarily into two areas: (1) external growth-related opportunities from both product sales and services revenues, and (2) internal cost and efficiency-related opportunities as distributors embrace more of these same green products and services. On the government side, the size of the U.S. government in terms of payroll and budget, and its role in business and society, has been expanding for many years. Governments everywhere are now playing a highly influential role in regulating areas such as supply chains, capital flows, labor markets, and environmental impacts.

We also note with concern the magnitude of recent changes in the structure of U.S. government spending. The U.S. government deficit grew from just 1.14% of GDP in fiscal 2007 to 9.9% of GDP in 2009 and is estimated to climb further to 10.65% of GDP in fiscal 2010. At the same time, U.S. government debt grew from just over \$9 trillion in September 2007 to over \$11.9 trillion in September 2009. Both of these levels are the highest since World War II.

Interestingly, there are multiple areas of overlap between our two trends. Indeed, government incentives are playing a significant role in spurring green business investments, and environmentally focused initiatives have received allocations under various economic stimulus packages. The hope is obviously that green business can serve as a catalyst for the broader economy and in the future help reduce U.S. dependence on imported oil.

Finally, these trends are incremental to the three trends highlighted in the 2007 *Facing the Forces of Change*[®] report, namely: acquisition activity, the changing U.S. workforce, and a slowdown in commodity prices. Before we begin our discussion of the two most current trends, we will begin this chapter by looking back at these three and assessing their evolution since 2007.