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MDM Special Report:

The Shifting Competitive Landscape

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MODERN DISTRIBUTION MANAGEMENT

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■ *Introduction*

Think Differently About 'Competition'

Most have heard the classic tale of Blockbuster, once the king of the video rental market, not responding to online rental service Netflix until it was too late. Or Sony's failure to recognize the shift to digital music from tapes and CDs, moving Apple into mobile music market leadership with the iPod.

These stories remain some of the clearest examples of what can happen when your competitive focus is too narrow.

No company should outright ignore its traditional and long-standing competitors. But an ever-increasing pace of change, thanks in part to technology, dictates that distributors think outside of the competitive box when considering their next moves.

Many companies view the market from the top down, by looking at the flow of goods through the channel, according to David Gordon of Channel Marketing Group. In other words, they think in terms of a product moving from manufacturer to distributor to the end-user. This could be considered the "traditional" channel.

But when you view the markets through the eyes of the customer, Gordon says, it may reveal multiple ways to market and a much different competitive landscape. "Customers may be buying from multiple channels or entities that are easier to buy from for various reasons," Gordon says, including ease of use, technical expertise, convenience or end-market expertise.

Take newer technologies, such as LED lighting. Gordon says the niche suppliers of LED products are more likely to sell direct to the end-user or even sell through alternate distribution channels, including the seemingly unrelated sectors of medical supply and petroleum. "That distributor is focusing on a particular customer segment," Gordon says. "He's asking his customer 'What else do you need?' The customer wants to order on the path of least resistance." That's a challenge to the electrical distribution channel.

For years, distributors have been expanding their products and services reach beyond their traditional expertise. But the idea of a shifting competitive landscape goes beyond converging channels, though that is part of the story. As MDM Publisher Tom Gale wrote back in 2005, there are enough diverse customer segments to support a range of models. This is even truer today, thanks to the rise of e-commerce, which has had a profound impact on the channel.

No matter the decision you make on how to react to an emerging trend or competitor, it should be based in the reality of the markets. It shouldn't be viewed as a threat; it should be an opportunity to rethink how you can better serve the customer.

In this series, MDM takes a look at the shifting competitive landscape and what it means for independent distributors.

According to Stuart Mechlin of Real Results Marketing, former senior vice president of Affiliated Distributors' Industrial Supply Division, when it comes to thinking about nontraditional competition, companies need to think beyond just Amazon.

"You're going to have people becoming competitors in this field who are coming from very different disciplines," Mechlin says. As an example from another industry, he referenced successful businessman Richard Branson's diverse group of companies, which started with a focus on music and record stores but now includes a cell phone business and an airline, Virgin Atlantic Airways.

Look beyond the product to the other elements of the distributor's value proposition, including logistics, process, expertise and financial services. Just as logistics was taken over by UPS and FedEx decades ago, Mike Marks of Indian River Consulting Group says that technology has fueled a "refragmentation" of traditional distribution functions, allowing someone to sell products or services and compete without ever having to carry inventory. "There's a whole economy going on that a lot of distributors are clueless about," Marks says.

While no distributor can predict what might happen next, it's critical to take a closer look at what could affect your business in the next five to 10 years and what you're doing to remain relevant in an increasingly busy marketplace. "If you're out there innovating, it's an opportunity," Marks says. "If you're not, it's a threat."

Collaboration Builds Local Value, Influence

Distributors work together to strengthen their positions in local markets

The case studies on the following pages feature distributors who are collaborating to compete more effectively.

These distributors are adding value to customer relationships by partnering with competing or complementary distributors to meet customers' needs more effectively and efficiently. The collaboration includes integration across a wide spectrum, from selling another distributor's inventory to opening branches together.

This growing interest in collaboration among distributors is changing the competitive landscape. If done right, it builds on the distributors' value propositions and expands their influence in their local markets. This can pose a threat to competitors who may underestimate the impact such collaboration can have, not only through greater efficiencies, but also through increased revenues and greater stickiness with customers.

On a broader front, partnerships on a local level potentially take the edge off national distributors' advantages of scale and product diversity.

In fact, interest in collaboration has grown enough that one of the largest marketing groups in the industry – Affiliated Distributors – is starting a program called Co-Ventures, playing match-maker for AD distributors across sectors. The poster child for that effort is a partnership between plumbing supplies distributor APR Supply, electrical distributor Schaedler Yesco and PVF distributor Industrial Piping Systems in Pennsylvania. In the article starting on page 5, Associate Editor Jenel Stelton-Holtmeier provides a closer look at that effort and the factors that have made it successful.

Evan Rosen, author of *The Culture of Collaboration*, says that there seems to be a growing realization across industries that people must work together to create value, whether working for the same organization, a complementary one or a competitor. "Organizations are waking up and realizing that they can create infinitely greater value by collaborating toward a common goal rather than working at cross purposes," he says.

Rosen has done extensive research on the interplay of culture, environment and technology to support collaboration. In an interview with MDM, Rosen talked about the benefits and challenges to consider before forming an alliance with another business.

MDM: You write that value creation opportunities should drive any collaborative efforts. Is there a framework that companies should follow when deciding whether to collaborate with another company?

Evan Rosen: Value creation should drive any collaboration whether it's internal or external. Collaborating with partners and competitors requires mutual creation of value. If only one party derives value, the collaboration will fail. The framework for collaboration must be built on trust and common goals. Why share ideas, information and data with another company if there's suspicion and hidden agendas?

MDM: What are the challenges that companies face when they collaborate with a competitor or with a non-competing but complementary business? Are there different challenges in each situation?

Rosen: Collaboration among competitors or with partners makes sense only if the collaboration creates value for all parties. Collaboration among companies can reduce costs by eliminating redundancy and increasing efficiency.

The key to collaborating with a competitor is to identify non-differentiating processes. These are processes that are not part of the perception of a company's products or brand. Non-differentiating processes include packaging, delivery, order fulfillment, purchasing and warehousing.

For a hot sauce company, the non-differentiating process might be bottling. Two competitors can achieve cost savings by combining their bottling operations. Bottling is a non-differentiating process because how the hot sauce gets bottled is not obvious to the customer.

For collaborating competitors in the automotive industry, many parts under the hood are non-differentiating. In the aerospace and automobile industries, there are consortiums for purchasing. Purchasing is a critical process, but it's non-differentiating in the marketplace in that it's typically not part of the product or brand perception.

MDM: Which types of collaboration in your experiences seem to be most successful?

Rosen: Well-defined collaboration is the most successful. Some companies put out a joint news release about cooperating, and they call this collaboration. The goals and roles of each party are murky, and very little collaboration happens. Instead, identify specific processes that through collaboration will create value for both parties. Build trust, develop common goals, and the collaboration will likely succeed.

MDM: What's the potential impact on the culture of organizations when you collaborate with either a competitor or with a complementary business? Are there considerations to keep in mind on the culture front?

Rosen: I wrote a book called *The Culture of Collaboration* that discusses the huge role of culture in collaborating. The internal culture of each collaborating organization impacts cross-organizational collaboration. If a company promotes hierarchy, information hoarding and internal competition internally, what are the chances that the company will collaborate effectively externally? Zero. Companies with collaborative cultures are far more likely to collaborate effectively with partners and competitors. So a company that wants to create value through collaborating with partners and competitors should begin by collaborating internally.

MDM: Are there any legal liabilities that companies should be aware of when they decide to collaborate?

Rosen: When two lovers move in together, often there is no plan for the length of the relationship and each person's role. To avoid a similar situation, collaborating organizations need structure and clarity at the outset. The collaborators must determine how they will use each other's intellectual property and how, when and for what purpose each collaborator will use any jointly-created intellectual property. Also, guidelines and agreements should spell out the tools the collaborators will use and how and when to terminate collaboration. There is too much at stake to leave guidelines to chance.

Evan Rosen is the author of The Culture of Collaboration. Learn more about Rosen and the book at www.thecultureofcollaboration.com.

Case Study: Sharing Branches, Best Practices

APR Supply, Schaedler Yesco & Industrial Piping Systems inspire AD program

One of the most popular examples of a collaboration between distributors that has worked is that of APR Supply, Schaedler Yesco and Industrial Piping Systems in Pennsylvania. The three have 11 locations together, and continue to uncover new opportunities to benefit from the arrangement. They've inspired a new program from Affiliated Distributors called Co-Ventures. This article looks at why the distributors' collaboration has worked and what to consider when going down a similar path.

By Jenel Stelton-Holtmeier

Jim Hoffman saw a common thread in his first three clients after he launched his consulting business. "By the end of my first year working in those three companies, I thought, 'Except for what's in the boxes, they're in the same business,'" he said. If he could get them to work together, he thought they could accomplish great things.

More than six years later, the co-venture between plumbing supplies distributor APR Supply Co., electrical distributor Schaedler Yesco and PVF distributor Industrial Piping Systems continues to grow. The three distributors also continue to uncover new ways to benefit from working together.

Today, the companies have 11 shared branches in Pennsylvania – some housing two of the partners, others with all three – and more planned.

Inspired by the success of its three affiliates, marketing group Affiliated Distributors announced a new Co-Ventures initiative in October, with Hoffman in the position of director. Through the program, AD will become a matchmaker of sorts, pairing companies in common markets across industries and providing support for the collaborations.

"There's no question that these companies are significantly stronger, bigger and more successful than they would be (without this co-venture)," says Bill Weisberg, CEO of AD. "And this isn't a pet project of one or two people at their companies. Their Co-Venture drives strategy and delivers everyday value for their entire organizations."

The Original Co-Venture

Jim Schaedler, CEO of Schaedler Yesco, Harrisburg, PA, and Scott Weaver, president of APR Supply Co., Lebanon, PA, agree that Hoffman instigated the plan. But both were intrigued by the possibilities.

"Selfishly we thought it would be a beneficial concept in growing our business at a location where we currently were not," Schaedler says. "It would be a less expensive, easier geographic expansion than it would have been to do on our own."

But everyone quickly learned they had to check their egos at the door. "If you think of it just in terms of what's best for you, we wouldn't have gone past that first venture. It wouldn't have worked," Schaedler says.

The "courting process" – as Hoffman refers to it – began in early 2006, with Schaedler Yesco, APR and Industrial Piping Systems, York, PA, officially opening their first joint location in Chambersburg, PA, in November of that year.

The biggest challenge in some ways was getting everyone to slow down, Hoffman says. "If you rush into it, I wouldn't be surprised if you have a bad result."

The relationship is not a formal joint venture; no legal documents bind the companies together beyond lease agreements at the individual locations. And the three companies often refer to the arrangement as cohabitation. "We're not married, we just live together," is one of the sayings the companies use to describe it.

In some ways, this kind of alliance is "more than a marriage," says Brent Grover of Evergreen Consulting. In a marriage you decide who takes out the trash or who does the dishes, he says. "This is a lot more complicated than that." Grover has no direct connection to this alliance, but is an expert on strategic planning in wholesale distribution and has worked with several companies to develop ways to improve their competitive edge.

Lessons Learned

APR, Schaedler Yesco and IPS have managed to keep lawyers out of the arrangement for the most part, but the model of continuous communication between the parties keeps them working together. The lack of binding contracts to continue doing business together means that getting out can be as simple as letting a lease expire and moving on, Weaver says.

"Because we have agreed to disagree at any time, we've also agreed to listen to each other and trust each other all of the time to make it work," Weaver says. "Because it's so easy to get out, it keeps us in."

"I don't want to sugarcoat it too much, but there really haven't been that many challenges," Hoffman says, "probably because we spent so much time in the beginning really getting to know each other."

The process laid out by Hoffman starts much like a dating process: "You have lunch together, then you have breakfast together, then you start visiting their locations and talking with their management teams," even sharing financials with each other, he says. "You have to take the time to build trust."

When it comes to decision making, "We compromise hundreds of little decisions because the big decision to be business partners is so much more important," Weaver says. And that value must be communicated throughout the entire organization.

Employees have an inherent desire to protect the company they work for, Weaver says. "Their inclination is to make decisions that are best for us. But if everyone makes decisions that way, it just doesn't work," he says. "The partnership will disappear as quickly as it began."

It may not be an intentional decision, but it happens. And it needs to be addressed quickly. There were two cases of employees who weren't entirely on-board with the collaboration early on, Hoffman says. But management stepped in and made it clear: "This partnership is more valuable than any one person in any of the organizations. It's more important than me, it's more important than you," Hoffman says. "It was a not-so-subtle message of get on-board or you may not have a place here."

In addition to trust and communication, culture has to be aligned. "All companies service their customers; that's what they're in business for," Schaedler says. "But the truth is, some distributors view servicing customers differently than other distributors. You have to make sure that you all have the same philosophy about it."

Grover agrees: "It takes a pretty unusual set of circumstances to make this work."

The Measures of Success

But if you can make it work, as these three companies have for six years, the benefits may exceed expectations.

"We had two goals when we entered this venture: entrance into a new market and, if the partnership worked, finding other ways to improve our efficiency by working together," Schaedler says.

Savings come from shared buildings, shared equipment in the warehouse, even shared coffee service in the lobby, Hoffman says. And the expense of expanding into a new market can be cut nearly in half by sharing the start-up costs between partners – and by needing to have fewer of your employees at the new location “to cover lunches and breaks and the like,” Hoffman says.

While all of the companies have seen financial benefits from sharing overhead costs, “those are dollars and cents,” Weaver says. “But it pales in comparison to the other benefits.”

One of the greatest benefits is the ability to share – and build – best practices based on the experiences of the other companies, Weaver and Schaedler say. Through an all-day “management exchange program,” managers from different departments can get together with their counterparts at the other companies to discuss best practices.

“We started it two years ago,” Weaver says, “but we should have started five years ago.” In addition to developing best practices, the discussions have accelerated the understanding between the companies and helped to build the trust.

Another benefit for APR Supply was its introduction to Affiliated Distributors by the other two partner companies. “That was one of the examples of best practices that came out of this for us,” Weaver says. Previously, APR had been part of another group and hadn’t thought of looking elsewhere until it became part of this venture.

The companies are also looking at ways to further cut costs by improving joint logistics, Schaedler says. “We’re not a transportation company, and we don’t want to be a transportation company,” but covering deliveries for partners in select geographies is one of the newest pieces of this co-venture.

Looking Ahead

In the month following the announcement of the new AD Co-Ventures initiative, 40 companies signed up to be a part of the AD database. “And we already identified three potential matches,” Hoffman says. The goal is to have six co-ventures in place by the end of 2013 and to keep building from there, he says.

The announcement of AD’s Co-Ventures program garnered mixed responses from Schaedler and Weaver.

“If it’s something that can benefit the industry as much as it’s benefited us, then it’s a great move,” Schaedler says.

Weaver is more measured in his response. “It’s just so powerful, it’s just been so good for us,” he says. “How much of that do we really want to share? Now that it’s in print, someone can buy a manual and take our experience, and potentially become a competitor with us someday. We don’t have control over who gets that information.”

That said, it also creates motivation to keep innovating and to always stay ahead of that potential competition, he says. “We’ve had six years of experience with this already. If we rest on our laurels and let them catch us, shame on us,” he says.

“Even after six years, I don’t think we’ve uncovered all the value that can come out of a co-venture,” Hoffman says.

Case Study: Expanding Product Mix

Labbatt Food Service, Ace Mart alliance strengthens position in market

To expand the products it could sell without the expense of carrying inventory, San Antonio-based Labbatt Food Service collaborated with Ace Mart, a restaurant equipment and supplies distributor. This case study looks at how the two approached the collaboration and the challenges that have gone with it. It also looks at a collaboration Labbatt built to serve customers moving to new geographic areas.

By Angela Poulson

Restaurant equipment and supplies distributor Ace Mart’s original relationship with San Antonio, TX-based Labbatt Food Service was as a traditional supplier and an occasional provider of special-order items. About six years ago, Ace Mart, which is based primarily online, proposed a way to simplify how customers can order Ace Mart products through Labbatt.

Labbatt’s customers are now able to browse and select Ace Mart items through Labbatt’s online catalog, consolidating their orders from the two distributors.

Labbatt Food Service President Blair Labbatt says this enables his company to offer customers a wider array of products "without us actually having to stock those products and be in that business. We've outsourced it," he says. Ace Mart primarily sells restaurant equipment and supplies, which complements Labbatt's foodservice offerings.

The alliance helps Labbatt be more competitive with larger distributors without incurring the expense of carrying more products. Ace Mart picks and ships each order placed on the shared site directly to Labbatt, who through an "in-and-out" cross-docking system delivers the products to customers.

Labbatt says it makes sense to use a business that is a specialist to be able to offer more products, but the alliance formed between the two companies hasn't been without its challenges. Labbatt says orders that incorporate Ace Mart products tend to have a higher level of returns, which has increased Labbatt's handling costs. "That's the biggest difficulty in doing it ... so that's something we've had to monitor really closely," he says.

There were also challenges to establishing systems that worked for both companies. "Getting something like that off the ground is an IT issue more than anything else," Labbatt says. "You've got to get the two software systems to work together." Labbatt gives Ace Mart credit for committing substantial resources toward the development of the system.

Whether a similar alliance could work for other companies is, Labbatt says, "the classic question of whether a distributor should grow by expanding product lines, by vertically integrating or by outsourcing."

For companies considering an alliance, Labbatt says "there needs to be a top-to-top contact, but there also need to be multi-strand relationships to make sure things stay on course day-to-day." An Ace Mart representative works at Labbatt essentially full-time, and other workers at all levels are in "continuous contact."

The rapport between business leaders is also a key ingredient. "All of that is essential to any supplier 'marriage,' if you like, particularly if it's a close one like this."

In a separate alliance, Labbatt collaborates with other distributors to meet customers' needs nationwide. When a customer expands to a new region that Labbatt doesn't serve, the distributor connects with a distributor in that region to serve the account.

Though Labbatt doesn't take a cut of partners' profits serving the same accounts, the distributor says it benefits because the move helps retain customers.

To police pricing among distributors delivering to the same accounts, Labbatt helped create Distribunet. The software enables Labbatt to line up distributors with common items and pricing for customers that extend outside of Labbatt's geographic reach, and to set and monitor the pricing they offer.

"Instead of us trying to be a national firm and build bricks and mortar all over the country, we've basically done it virtually with other independent companies that we don't own," he says.

Distributor partner programs facilitated by Labbatt involve as many as 10 different independent distribution companies and span as many as 25 states.

More Collaboration Case Studies

PM Industrial Supply: Sharing Inventory with Competitors

Collaboration with competition can be a sensitive area, but for some distributors, it can help them serve their customers more effectively and efficiently. PM Industrial Supply Co., Chatsworth, CA, works with two "friendly competitors" in the area to get products they don't carry, such as certain cutting tools.

"It really helps us compete with larger distributors, because it helps us be more of a one-stop shop for our customers," says Zack Gerin, IT and marketing manager.

The service is not an advertised benefit to customers, but it allows the distributor to respond quickly when customers call looking for something that's not normally stocked. The arrangement means that PM Industrial doesn't have to place special orders with manufacturers for those items and doesn't have to send that customer to another distributor.

The companies don't share resources, only product. Gerin says PM Industrial actually places daily orders through the arrangement. The participating companies have a verbal agreement for how much they will pay above cost for the products they order.

It's a seamless transaction for the customer. Customer information isn't shared among the cooperating companies, and the customer only receives one invoice.

As with all collaborations, trust is the key to success, Gerin says. “Make sure you work with a company with integrity, and be sure to stick to the terms you originally agreed to,” he says. Even though the prices are based on a verbal agreement, honor that as though it were in writing, he says.

There are no plans to expand this arrangement right now, because the companies have been able to fulfill customer needs. In addition, the three companies have an established relationship that doesn’t exist with other distributors in the area, Gerin says.

EDGE Investment Partners: Expanding Global Reach

Demand has increased for distributors to have global reach. That’s not always possible if a distributor has to do it alone. In June 2012, 11 electrical distributors joined together to form EDGE Investment Partners LLC to meet this demand.

The focus of the group is to “build a network of distribution company partners outside of North America,” according to the press release announcing the group’s formation. The group is based in Milwaukee, WI.

EDGE, an acronym for Electrical Distribution Global Enterprise, completed its first acquisition in July when it took a majority interest in Brazilian distributor Ladder Automação Industrial LTDA. Ladder operates primarily in the Brazilian states of Sao Paulo and Rio de Janeiro.

The acquisition provided EDGE with a foundation for growth in Latin America, an area that has experienced significant growth in recent years.

“We are excited to create this new opportunity for the members while taking advantage of our strengths to work with potential distribution partners and suppliers to advance our industry globally,” said board member John Burke, president, Kirby Risk Corp.

EDGE includes French Gerleman Electric Co.; Gerrie Electric Wholesale International Inc.; Horizon Solutions LLC; Kendall Electric Inc.; Kirby Risk Corp.; McNaughton-McKay Electric Co.; North Coast Electric Co.; Revere Electric Supply Co.; The Reynolds Company; Van Meter Industrial Inc.; and Werner Electric Supply Co.

Beyond Amazon: E-Commerce’s Impact

Online platforms evolve, expand distributors’ reach and capabilities

E-commerce in distribution is no longer just “nice to have”: It’s “need to have.” And the proliferation of e-commerce as an essential part of doing business – from the simplest forms to complex systems – has changed how some distributors view the market. This article examines the impact of e-commerce on the wholesale distribution channel.

By Jenel Stelton-Holtmeier

There’s general consensus in the business-to-business space that e-commerce is now a “need-to-have” platform as opposed to just “nice-to-have.” Acceptance and adoption of e-commerce in distribution has grown over the past three years, but today’s e-commerce – and the role e-commerce plays in distribution – is different.

Today’s e-commerce platform goes beyond placing orders online, as with the Amazon.com model, and for success, distributors “must tear down the silos of what they’ve done with e-commerce in the past,” says Linda Taddonio, chief e-commerce strategy officer at Insite Software.

E-commerce has also changed how distributors view their marketplace. Geographic boundaries do not have the same meaning they did just a few years ago, and distributors can now reach a broader customer base – customers they may have never thought of in the past.

E-Commerce Today

More distributors are growing revenue from e-commerce than in 2009, when MDM first asked readers about their use of online platforms. And adoption seems to be rapidly increasing. Get more details on how distributors are using e-commerce and how it’s changed in “The State of E-Commerce” on page 4 of this issue.

In another survey in fall 2012, the National Association of Electrical Distributors and Electro-Federation Canada surveyed their members on how they use technology. Nearly all respondents (97.6 percent) said they had a website, but the functionality of that website varied greatly.

Most respondents’ websites had basic functionality such as location information, links to manufacturer websites and basic search capability. Fewer than half included current stock levels, quote capability or online help options. And only 6 percent were able to suggest other items for purchase, one of the most desired features from Amazon.com.

In its recent report, "Key Trends in B2B E-Commerce for 2013," Forrester Research estimates that business-to-business e-commerce will reach $559 billion in U.S. sales by the end of 2013. But the report also noted the increasing channel conflict between direct sales organizations and e-commerce operations, an oft-cited fear for distributors when discussing e-commerce.

A Changing View of Markets

As more selling takes place online, geographic boundaries don't seem to carry as much weight as they once did. Customers from outside your traditional selling area can peruse your offerings, and as more manufacturers offer direct sales through their sites, traditional suppliers may start looking to cut out the middle man for certain transactions or customer segments.

That said, manufacturers still have to manage the process, and most haven't figured out how to manage small orders effectively, says Stuart Mechlin, former senior vice president of Affiliated Distributors' Industrial Supply Division who now works with distributors on profitability and growth strategy.

Geography will still play a part in who you can serve, Taddonio says. After all, you still have to consider delivery capabilities or customers' proximity to a physical location to pick up the ordered items.

But an e-commerce platform may change how you serve those customers in that geography. That was one of the drivers behind NEFCO Corp.'s launch of a new e-commerce-enabled website at the beginning of 2013.

"A lot of the things e-commerce brings, a lot of people desire: information in real-time," says Matthew Gelles, director of e-commerce and business development for the regional industrial and construction supply distributor based in East Hartford, CT. "Our tagline for the new site is 'Always on, always connected.'" Salespeople always have access to customer information, which helps improve the sales process and helps those salespeople better understand customer needs.

Response to the new site was positive in the first week, Gelles says. Existing customers purchased items they had never bought from NEFCO before. "We have feet on the street trying to do that every day, to let the customers know we have these other items, but the website has done it organically for us," he says, which strengthens the relationship.

Connecting Nationwide

The Internet has also allowed for distributors to better serve their local markets by connecting them with other distributors who can provide inventory that they might not have on hand. Rick Rogers, CEO of B.W. Rogers, Akron, OH, helped form DistraNet with other Parker distributors about 10 years ago. The 30 members have minimal overlap in geographies, but each can access other members' inventories whenever a customer submits an order or an inquiry.

"The one real value of it is that if you have a customer on the line that needs something urgently, you have access collectively to about $100 million worth of inventory across North America," Rogers says.

Last year B.W. Rogers shipped about $600,000 worth of product through a lot of small transactions on the network, Rogers says. "That may not seem like a lot, but we would normally try and supply our customers through our own inventory, or if there was time, order it through the manufacturer," he says. "… So it really gives us a competitive advantage in our local market."

The geographic breadth of the network also allows smaller companies to compete with national distributors for national accounts.

Customer Demand

Broader geographic reach is certainly a benefit, but for many that may still be considered "nice-to-have." Where "need to have" comes into play is with customers who demand online access to product and account information.

"We're talking to an organization now that two years ago was just going to dip a toe in the water with e-commerce to see if it would work," says Brian Strojny, CEO of Insite Software. "They were notified this year that if they didn't have an e-commerce portal they were going to lose a $700 million government contract … in 30 days."

While an extreme example, it's clear that customers of all sizes are looking for ways to do business in an easier and more transparent manner.

But mimicking Amazon.com – or its industrial and scientific supplies platform, AmazonSupply.com – may not be the right approach. "We hear it all the time, 'We want to be like Amazon,'" Taddonio says. "But that's actually rather limiting. … And we have the capability now to go far beyond what Amazon has to offer."

Analytics of e-commerce sites, for example, can guide distributors on where to expand geographically and with product lines. This data can highlight what customers are looking at and where they are coming from. "I don't know if a lot of people look at e-commerce in that way yet," Gelles says.

Those analytics can tell you what your customers want that you're not already offering, and help you identify what your customers may not know they want – a key part of Grainger's e-commerce strategy.

Avoiding Price Wars

One challenge in creating an effective e-commerce strategy is the demand for the B-to-B experience to be as fluid and familiar as in the business-to-consumer environment. But because of the influence of B-to-C e-commerce on B-to-B, some distributors fear that other elements of B-to-C e-commerce will creep into the B-to-B space, especially trends such as "showrooming" or the demand for price-matching.

E-commerce has changed the cost structure of distribution, according to Mike Marks of Indian River Consulting Group. The industry has seen a rise in "virtual distributors," he says, companies that don't need a brick-and-mortar presence but who act as facilitators of sales with master distributors coordinating drop-ships of product.

"You can make money without even taking title to the inventory," Marks says.

But, "there is no reason to allow e-commerce to push us toward lower prices," Todd Youngblood, CEO of The YPS Group, Inc., wrote in MDM's LinkedIn group. "It's meek acceptance of the traditional definition of 'e-commerce' that makes it so."

Most distributors will say they're not in the business to compete on price; they're selling expertise and service along with the products. Youngblood advises to keep that message front of mind. And the new definition of e-commerce lays the groundwork for selling that message to current and potential customers.

There will always be a competitor willing to beat you on price, but that strategy has a limited growth trajectory. "Any distributor still in business stays in business by providing a lot of intellectual capital along with the tangible products," Youngblood says.

Global Competition on a Local Level

European distributors increase focus on U.S. as growth market

Cross-border M&A in wholesale distribution has accelerated in recent years, adding to an increasingly busy competitive landscape. The U.S. market continues to be attractive to Europe-based distributors seeking growth outside of their traditional markets. This article looks at this trend and the impact it has had on the market.

By Lindsay Konzak

In recent years, Europe-based distributors have accelerated their expansion in the U.S. As a result, local and regional distributors are increasingly facing local competitors backed by resources they did not have access to previously.

"As Thomas Friedman says, the world is truly flat," says Robert Stolz, who leads Wurth Group's North American industrial and fastener distribution operations. "We really compete in a worldwide marketplace – not just products and sales, but for people."

Netherlands-based industrial distributor ERIKS more than doubled its sales in North America over the past two years via acquisition and has called North America its most important growth market. The distributor, with more than 65 companies in 27 countries, is a subsidiary of family-owned SHV Holdings N.V., which had sales of US$24.1 billion in 2011.

UK-based Wolseley plc has continued to invest in acquisitions through its U.S.-based Ferguson Enterprises despite paring some of its European operations.

"Cross-border is becoming a larger part of distribution M&A," says Jay Greyson, managing director and principal of investment banking firm Vetus Partners and a principal for distribution-focused Supply Chain Equity Partners.

Most of the cross-border acquisitions are strategic – large distribution companies, private or public, looking to new markets for growth.

Drivers of Expansion

European distributors have targeted the U.S. for growth in part due to the weakened economic state in their traditional markets. "They're not getting the growth they need from that market," says Brad Keyworth, director and senior member of investment bank Lincoln International's distribution team. "Distributors need to look outside of their domestic market to generate growth."

The U.S. is in recovery and a number of economic indicators are trending up, including housing starts, consumer spending and business investment. Combined with growth in emerging markets, North America is an attractive market for these companies, he says, and interest continues to grow.

Many have also followed European manufacturers that have moved into the U.S. and other markets beyond their traditional borders. "They need a sales channel and presence in multiple countries to support global customers," Greyson says.

And just as U.S.-based distributors have followed customers overseas, many European distributors have cross-border customers, so they are following the food chain to the U.S. The end goal: to increase wallet share.

"These are formidable competitors that can bring resources to the market that aren't going to go away," says David Gordon of Channel Marketing Group and the blog ElectricalTrends.com.

Impact on Competitive Landscape

European distributors have primarily used acquisitions as their tool for expansion in the U.S. One of the most obvious impacts on the competitive landscape has been the infusion of additional resources that allow acquired companies to compete more effectively.

"We don't buy companies that are broken," Wurth's Stolz says. "We only bring companies into the group that are healthy performing and profitable. … Our strategy is to provide more capital to the businesses." The focus is on encouraging innovation and improving technology, he says. "We want them to expand."

When private equity-owned industrial rubber products distributor Lewis-Goetz and Co., Pittsburgh, PA, was acquired by Netherlands-based industrial distributor ERIKS in 2011, it had $400 million in annual sales, more than doubling ERIKS' presence in North America. The acquisition put Lewis-Goetz in a stronger position financially and strategically, Lewis-Goetz CEO Jeffrey Crane told MDM at the time. ERIKS has already made two acquisitions in the U.S. in 2013, adding reach for its subsidiaries Industrial Controls and Rawson Inc.

Greyson says that the impact of more distributors expanding in the U.S. should be considered on a sector-by-sector and market-by-market basis. For example, in the electrical distribution sector, two of the top three electrical distributors on MDM's Top 25 Electrical Distributors list for the fiscal year 2011 were based in Europe. Both Paris-based, Rexel ($4.8 billion in North America) and Sonepar (est. $6.7 billion in North American sales) have continued to expand in the U.S. in the past couple of years.

Rexel bought Platt Electric Supply, Beaverton, OR, in 2012, adding nearly $400 million in sales and 111 branches in seven states to its U.S. portfolio. At the time, Rexel said that the acquisition supported one of Rexel's top growth priorities: strengthening its market share in mature markets where it is already present.

"We think it made a very strong statement to the world and other North American distributors as to their commitment to the U.S. and North America as a broader scope," Greyson says.

Platt Electric Supply was already a strong player in the Northwest U.S. But, Greyson says, the acquisition put Rexel's advantages behind Platt, including buying power, service offering capabilities and the potential to serve global accounts. "If you're a smaller distributor you have to sit back and look to refine your value proposition as the competitors in your local neighborhood are getting larger and stronger."

Pricing competition may ramp up in markets where global distributors have made acquisitions. MDM heard from industry observers that some acquired companies have become much more aggressive on the pricing front than they could have been pre-acquisition, allowing them to win more contracts and attract more customers.

Distributors that have the backing of larger global organizations such as Sonepar, Rexel and Wurth, may also have the resources to shift what the M&A landscape looks like. "There are few opportunities that they could not afford to go after," Gordon says.

Another impact: Organizations have also turned their eyes to Canada. "All of a sudden, the national chains are no longer just national," Gordon says. "Certain customer segments could be exploited in this way." For example, customers in oil and gas, as well as the automotive industry, may find a distributor's presence in the U.S. and Canada attractive. Many U.S.-based distributors have also made Canada a prime target for growth in recent years.

Best Practices

Another potential benefit global distributors expanding in the North American market bring is a deeper trough of best practices to tap. Wurth, with more than US$11 billion in global sales and 400 companies in 84 countries, has set up a network to do just that.

"If they are doing something innovative, within 45 days that innovation can be spread all over the company," Stolz says. The network includes online forums where employees share information and ideas.

More informal structures have also been set up, including the use of YouTube, for example, to show how a product can be used in a different way. Stolz says that the use of social media usually results in good ideas "spreading like wildfire."

And new companies that join Wurth jump right into learning from and contributing to this pool of ideas. Take New Orleans, LA-based Oliver H. Van Horn Co., which was acquired by Wurth in 2010. CEO Lee Eagan traveled to Norway to present new sales initiatives to Wurth's worldwide oil and gas division. "He did that this fall, and I don't think his telephone has stopped ringing," Stolz says.

"That's an example of someone fairly new to the group who brings a 109-year tradition of Oliver Van Horn and is able to spread it throughout the world."

When done well, training is also a strength for many of these global companies. Wolseley's Ferguson is well-known for its management training programs. Wurth has developed a young professional training program, which provides not only functional training but also training on how to work across cultures. "The reports I get back is that they just can't get enough of it. They really enjoy that," Stolz says.

Supplier Impacts

Access to new product lines is another edge newly acquired companies may have when they join global distribution companies.

"Because we're sourcing such a large dollar amount around the world, when someone joins the group they can jump right into that sourcing pool," says Wurth's Stolz. He says that working with manufacturers is critical to their global expansion success. "Working with our partners may be the most important aspect of bringing companies into the group."

On the other side, manufacturers have to consider how they'll respond when one of their distributors is acquired. Depending on the sector, do they continue to authorize them as a distributor or do they pull line?

But some manufacturers are starting to consider the impact of this beyond just the local markets they are trying to reach. If they were to pull the line, it may affect what could happen for the business globally.

Global Expansion, Local Impact

Most distributors and industry observers would argue that distribution in most segments remains a local business, no matter where the owners are based. This means there is opportunity for both the large and the small in any particular market.

Even the large companies recognize this dynamic. "One of our core beliefs is that business is done locally," Stolz says. "When we go to California or Washington state, our business is set up with Californians and Washingtonians running the business. We believe in local autonomy."

Sonepar also approaches acquisitions this way, retaining local names and management when it acquires new companies.

Gordon, who focuses mostly on the electrical distribution segment, says that if distributors focus on their local markets and invest in the right resources – what's needed to service their customers – they can survive and even thrive.

"This industry is more driven not just by relationships but around local needs and local support and knowledge," he says. "… If these companies don't make those investments and have quality people, that will leave an opportunity for someone else.

"It's going to come down to people, it's going to come down to technology and it's going to come down to utilization of those resources."

Greyson agrees. "Strengthen that value proposition and make it as deep as you can to serve customers to protect yourself against the economies of scale that are being developed today."

The 'New' Distribution Company

Market entrants challenge traditional distribution models

New companies competing in the distribution industry are proving that there's still room in the market for entrepreneurs. Through technology improvements and increased sources of supply, some have even been able to grow without big investments in inventory and physical locations. This article features new distributors, including a private equity-backed platform, distributors focused on niche markets, online-only businesses and a distributor that restarted his business after selling to a consolidator.

By Lindsay Konzak

Consolidation and aggressive expansion over the past few decades in wholesale distribution channels have resulted in tougher competition for the local independent from regional, national and even international distributors.

But a growing number of new companies are finding success, bringing a flexible business model and a fresh perspective on what it takes to compete in today's wholesale distribution markets. Some distributors founded in the past decade have carved out a niche based on past experience in the industry or filling a product or service need that may not previously have been met.

Some believe strongly in the advantage a small, local distributor can have in the market.

Others are taking advantage of new technology platforms, including the cloud and e-commerce, to build a business with lower overhead. Even the smallest of companies can now reach potential customers around the world and access technology that previously was only available to larger businesses. What's more, master distributors and drop-ship services mean that distributors don't have to stock everything they sell.

These new entrants are challenging what it means to be a distributor and compete in today's fast-changing market.

The 'New' Distributors

Some new companies in the industry, like BlackHawk Industrial, start with strong financial backing, utilizing private equity investment in the industry to implement a buy-and-build strategy. BlackHawk was founded in 2010 with a goal of building a portfolio of smaller independent distributors that already have a track record of success.

BlackHawk had revenues of $260 million in 2011, up 136.4 percent from the year before thanks to ongoing growth via acquisition.

On the flipside, brand new companies like Baystate Tool Supply and I.A.M. Supplies are building businesses from the ground up.

Brad Colby, president and CEO of Baystate Tool Supply, formally incorporated his business in December 2012. He previously worked in sales for a large regional distributor in New England but was laid off during the recession. He's now using the relationships he built to launch his own distribution business.

He has two other salespeople and hopes to be able to hire two more by the end of the year – depending on how sales go. "I don't think that's out of the realm of possibility," he says.

Colby plans to build his website to be a resource for customers; he also hopes to gain an edge by hiring salespeople that understand technology's role.

Industrial supplies company I.A.M. Supplies, also started at the end of 2012, was formed with plans to serve as procurement specialists in B-to-B markets. The company will also be building out an e-commerce platform.

Co-founder Maria Lugo says that the company uses master distributors that ship product with I.A.M. Supplies branding. For technical questions, she's able to work with customer service specialists at master distributors who help customers find the right solution. "I don't have to touch (the product)," Lugo says.

"You can make a lot of money without even taking title to the inventory. You're really just getting a commission," says Mike Marks of Indian River Consulting Group.

In between the large and the very small are businesses that are in growth mode, banking on new and growing product niches to differentiate in an already busy distribution market.

"They are focused on the knowledge and the information they have," says Ranga Bodla, director, industry marketing, for cloud IT provider NetSuite. "That becomes the unique differentiator of what they deliver and it enables them to compete."

Denver, CO-based Clean Energy Distribution was started because as an installer, its founder could not find a consistent supplier of solar products. The distributor now sells everything from photovoltaic panels to inverters to solar thermal components.

California-based Monterey Lighting Solutions, featured in an MDM Webcast in 2012, started its business in 2006 as a distributor of energy-efficient lighting and products. The distributor is focused on driving down utility costs; it serves electrical contractors and commercial accounts.

The distributor, with 25 employees, has grown at a rate of 25 percent year-over-year. It was able to kick off the business quickly because of its choice of a cloud-based system, according to President Steve Spitzer.

"As a small company, we had access to that same depth of capability as a large company did," he says. The decision reduced what the company had to invest in-house in software, hardware and servers.

Monterey Lighting has also taken advantage of e-commerce to reach new customers throughout the country.

Its choices in technology – choices that weren't readily available a decade before it launched – have helped keep costs low, according to Spitzer. "We think it gives us an advantage in the market," he says.

Drillspot.com, founded in 2005, sells home improvement and industrial supplies online and, according to the Inc. 5000 list, had 108 percent growth from 2007 to 2010 – from $6.9 million to $14.4 million. More recent sales figures were not available.

The rise of online-only distributors over the past decade is an example of how the Internet has changed the competitive landscape not just by introducing competitors like AmazonSupply but also by making small companies appear larger than they really are. Focusing primarily on e-commerce, these smaller companies can often sell at a more competitive price and still make a healthy margin because of lower overhead.

Many of these companies are targeting a different customer base – many customers are smaller – but even larger, national distributors are finding ways to reach smaller customers with little additional cost or effort.

Starting Again

Another source of new competitors in the industry is the pool of distributor owner-operators who previously sold their businesses to consolidators.

Blazer Electric Supply Co., Colorado Springs, CO, was founded in 2009. The original company, also called Blazer Electric Supply, was sold to Westburne (which was purchased by Paris-based electrical distributor Rexel shortly after) in 1999.

"You don't really know how to do anything else," says Steve Blazer, president, on why he and his brother started the second iteration of the company. Before selling to Westburne, Blazer Electric Supply had grown to four locations and 140 employees over 15 years.

Ten years after selling, the Blazers, who retained the rights to the Blazer Electric Supply name, wanted to build a business for the family. Blazer said he was just 40 when he originally sold the business. "What I want to do is build a nice sustainable business that the next generation can continue to grow however they want to grow it," he says.

Many of Blazer's former employees returned to work for the company, which started with 35 employees in two locations. "Twenty-five of those worked for us in the previous business," Blazer says.

The distributor did face some challenges upon startup, including initial financing and developing vendor relationships, but most of those challenges have gone away.

In an increasingly consolidated market, competing against regional and national distributors, Blazer still saw opportunity. "I don't think there's a substitute for on-site local ownership," Blazer says.

"Even a good branch manager has a hard time duplicating that effort. When it's your own money on the line, you'll act differently than if it's someone else's on the line."

He also saw opportunity in 2009 – in the trough of the Great Recession – to invest when many companies were cutting back.

"We looked at that as an opportunity to jump in with good staff and service levels and go the other direction of our competitors," he says.

The distributor has now grown to 65 employees and is ahead of pro forma sales projections.

The Impact

While the impact of one or two smaller competitors will be minimal, in total, the trend is something to watch. "None of these things are going to be big enough," Marks says. "But when you start having a large number of those and the wave starts, nobody is going to see until it is here." Distributors can also learn from smaller, leaner businesses. Starting from scratch may make it easier for companies to take advantage of new technology and best practices without the challenge of change management. They may also be more willing to take risks.

Bodla says that traditional distributors should not underestimate the impact of newer market entrants, and it's another reason to re-evaluate why customers buy from you.

"I think there's a lot of room for change in the market," Bodla says. "It's no longer adequate to just be a traditional distributor. You really have to have something that differentiates you … What's different about your business and what you offer?"

Responding to the Big-Box Challenge

Some distributors face more competition from retailers, on- and offline

As big box retailers such as Staples, The Home Depot and Lowe's have expanded their online presence and increased their focus on professional markets, some distributors are feeling the impact, not only on sales volume but on profitability as margins are squeezed and customer expectations shift. This article, featuring interviews with distributors, manufacturers and industry experts, takes a look at the effects of the retail channel on the competitive landscape in wholesale distribution.

By Angela Poulson

Distributors in some sectors aren't just competing with another independent down the street – they're competing with big-box stores with billion-dollar brands and a different approach to the market. And for some distributors, that competition is growing.

"Big box's arrival into the B-to-B world has fundamentally changed the way distribution goes to market," says Dennis Riffer, president and CEO for distribution sales and marketing group Afflink.

Janitorial supplies distributor Dalco Enterprises, Minneapolis, MN, is feeling the effects of this shift as office supply retailers like Staples push harder into professional markets. "We are seeing increased pressure and activity from them in the markets we serve," says President Ted Stark.

Stark says Staples has been adding maintenance supplies to its offering for years, but only within the past 12 to 18 months has Dalco really found itself losing business to the retail giant. But even when the distributor wins, it still feels the retailer's influence. "We are finding ourselves bidding against them, so prices are decreasing, and consequently, gross margin is being squeezed," Stark says.

Staples made a big move into B-to-B markets when it increased its focus on contract and delivery by acquiring global office supplies distributor Corporate Express NV in 2008. Distributors in construction supply have also seen the effects of big-box competition with the rise and spread of retailers like The Home Depot and Lowe's in the 1980s and 90s in the U.S. and Canada.

In certain sectors, big-box competition has changed customer expectations and squeezed margins. Retailers' online platforms have exacerbated this dynamic, broadening the scope of what and to whom they can sell.

Channel shifts are inevitable when customers see greater value available through retail stores, says Mike Marks of Indian River Consulting Group. "There's no force in the universe that can stop a channel from becoming more efficient and more effective," Marks says. "If you offer a better value to an end-user, they're going to go." But Marks says distributors can provide that higher value by thinking beyond price and reminding suppliers and end-users of the additional value they provide.

"To remain relevant, distributors must adapt to these changing pressures," Riffer says.

Mixed Impact

The impact of retail's B-to-B focus on wholesaler-distributors depends on the categories they sell and the markets they serve.

Home centers like Lowe's and The Home Depot have carved out a large market share in power tools, at the expense of distributors, according to Joe Smith, who spent 20 years in the power tools business before becoming a general manager for manufacturer SIA Abrasives in Charlotte, NC.

"I think if you go back 20 years, industrial construction distribution was more the destination for power tools, and now Home Depot and Lowe's are the destination. They're pretty broad and deep in the power tool category," he says.

Smith says retailers will gravitate to product categories that don't require a lot of technical application competence, so categories like cutting tools and coated abrasives are somewhat immune to the channel shift occurring with other products.

Tom Blue, vice president of marketing and affiliate relations for Affiliated Distributors' industrial division, says the distributors in his division that serve contractor and institutional MRO customers are challenged by competition from big boxes. But distributors serving the true industrial MRO and manufacturing segment, he says, are seeing little pressure because many of them are focused on products which require more specialized support than retailers provide.

"So much of the manufacturing world today is about documented cost savings and productivity improvements. That's where the independent distributor is able to win out, because they understand that and have the expertise to address it," Blue says.

"Some products are bought and some products are sold," Marks says. Commodity products, where the knowledge of use lies with the end-user, are bought, so they're easy targets for retailers who have made buying easy for consumers. Products that are associated with health, safety or environmental concerns require more expertise, Marks says, so they resist commoditization.

Kathleen Durbin, CEO of Sun Valley, CA-based General Industrial Tool & Supply, says the increased focus from retailers on B-to-B markets has affected the commodity products the distributor sells.

But the impact goes beyond just sales volume. "It can highlight price as the most important decision versus the total cost of procurement, which should be the most important metric," she says.

At Dalco, reps spend a lot of time on consultative selling, visiting customers and working with them to solve problems. But Stark says he's seen reps get burned after consulting with a customer on a product, often conducting demos and training staff, only to have the customer's purchasing department go online and find a lower price for the product. The rep then loses the sale to a competing retailer. "That only has to happen one time and that sales rep will not sell that product anymore," Stark says.

When this happens often enough, the distributor becomes less motivated to push that product or line. "We have to get paid for that. If the margins get so low that it's not worth a distributor's or sales rep's time, they're not going to do it," Stark says.

Effects on Manufacturers

Stark doesn't expect retailers to start providing those services because of increased costs. "If that's a service that customers value, and the big-box folks won't provide it, and there isn't enough money in the product (for distributors) to do it, the only place left is for the manufacturer to do it themselves," Stark says. "So we could see a shift in who does the sales and marketing for suppliers."

Manufacturers face their share of challenges selling through retail. One of the biggest challenges, according to Smith, is the difficulty of landing and keeping accounts. At Home Depot, for example, he says he's participated in so-called "shoot-outs," a highly competitive process where competing vendors are called in to pitch and defend their products against competitors, as well as haggle on price. The result can be much lower margins, he says.

Smith says selling through the distribution channel provides certain advantages from the manufacturer's perspective, like distributors' willingness to carry a broader offering of their products, including slow-movers. When it comes to leverage with manufacturers, though, Smith says the benefits of selling through industrial distributors must be weighed against the high volumes generated by home centers. "Volume speaks volumes," he says.

Phil Hanson, executive vice president of C.H. Hanson Co., a manufacturer of hand tools, says his company sells many products to big-box stores. But as home centers try to target more customers in the MRO space, they've asked the manufacturer to provide products for sale exclusively via home centers' websites.

"That online business forces us as a manufacturer to spend a lot more time shipping either to the store or direct to the customer," Hanson says. "That's been a real challenge for us in trying to figure out the pricing strategies where it requires more work for us than to ship to the traditional DC."

Unlimited Digital Shelf Space

Blue, of Affiliated Distributors, says buyers' increasing reliance on technology and the greater visibility of products through online retailers is emerging as a bigger threat in the space than the brick-and-mortar locations of the retailers.

Hanson says retailers' e-commerce capabilities allow them to attract customer segments outside the range of their normal bread-and-butter customer segments, like municipalities. "The shelf space required to satisfy that customer would be enormous. But when you have unlimited digital shelf space, you're able to make that available for them online."

Marks says the rise of SoLoMo (social, location and mobile) marketing makes retailers' online presence more disruptive for distributors behind the curve. "SoLoMo is accelerating channel change and channel migration, because it's giving end-users more choice, and it's making our economy more efficient. And if something is more efficient, that means people are getting more value," he says.

The good news for distributors is that improving their own technological capabilities is easier than it was in the past. "It used to be that I had to have huge scale, and I had to put in these great big ERP systems and have all this expensive communication," Marks says. "But now, everything's in the cloud."

Marks says distributors with the vision to figure out how to add more value for the end-user "could be killing retailers just as easily," since scale and capital are no longer a requirement to compete online.

HP Products Executive Vice President Jim Smith has invested in technology to help the Indianapolis, IN-based janitorial supplies, packaging and safety products distributor compete. "We have a whole team of people that do nothing but dedicate themselves to keeping our portal system as up-to-date as we possibly can make it. Because that buying model has changed significantly," he says.

He says while many of his customers used to buy via catalog, about half of his business is now conducted electronically. He says ease of ordering is critical, so HP Products' online system includes features like a favorites list of frequently purchased items to expedite the customer's purchase.

How Distributors Can Compete

Marks says to compete, distributors have to realize that what customers are buying is in many cases not what distributors think they are selling. Some customers are buying a reliable source of supply. Some are buying the ability to bundle. Others are buying convenience, capital services, pre-sale advice or post-sale support.

As markets fragment, distributors need to start segmenting customers not by how much they buy, but by which services they're buying. "They have to start providing differentiated value propositions," Marks says.

Durbin says General Industrial Tool & Supply has been able to identify the types of service that customers are willing to pay for, such as vendor managed inventory programs and blanket purchase agreements for special inventory.

For distributors affected by these channel shifts, the value they already provide may cause some lost business to come back on its own. While retailers have targeted janitorial supplies, HP Products' Jim Smith says big boxes haven't done a good job of serving the space.

He says that because retailers often sell cleaning supplies in bundles of other products, customers often end up with products that don't solve their problems, and may even create new ones.

Product maintenance issues, such as malfunctioning soap or towel dispensers, can also be problematic for customers who don't have access to a distributor's expertise and support.

"You'll have that segment of customers out there that will try to go out and find a product for less money somewhere else, and it ends up creating more headaches than they can imagine," Jim Smith says. "So you don't lose that customer for very long."

When customers do come back, it's up to the distributor to justify the greater cost to them. But Jim Smith says when customers are returning due to problems, it's generally not hard to help them see the return on the additional investment.

Stark says distributors will need to focus on their unique value propositions over and above the product they're selling to compete. But if profit margins continue to shrink, he says, "we could see a trend where distributors start making more of their money off of services as opposed to re-selling product."

To compete with the big box, Joe Smith says the best industrial distributors have learned to add value in some way, through specialization, integrated supply or a commitment to cost reduction through consultative selling.

"These are models that are difficult for Home Depot to crack," he says.