

Manufacturer-Distributor Disconnect Study

December 2011

Primary Research and Market Observations

DISTRIBUTORS: RESEARCH & SITUATION OVERVIEW

OVERALL

- ✓ Caution still pervades the distribution environment and distributors are finding themselves doing more for customers while battling for less business post-recession
- ✓ Distributors cut staff and costs in 2009 and focused on implementing productivity initiatives
- ✓ Primary concerns include economic conditions (58%); Price competition (43.6%); Increased operation costs (37.4%); Distributor competition (32.7%); Mfrs selling direct (24.9%) and customers going out of business (19%).

OPERATIONAL TRENDS

- ✓ “A lot of manufacturers don’t understand distribution inventory management.” Still need to cut their inventory exposure
- ✓ Distributors slashed inventory to historic lows in 2009 but are building back up again using more strategic inventory management.
- ✓ Companies are looking to keep inventory investment low while maintaining customer service levels and avoiding stock outs (a fine line to walk)
- ✓ There is less market speculation occurring even when price increases are scheduled to go into effect. Focus on inventory turns and increasing the number of opportunities to earn a profit from every dollar [already] invested in inventory. Want to minimize total inventory investment
- ✓ Goal is to streamline inventory operations and be as lean as possible. Many distributors moving to a central warehouse model, maintaining minimal stock at individual branches and replenishing more frequently from the “master warehouse”
- ✓ Offering Inventory management and other services have grown in importance ... Services added include consigned inventory, improved online support, training videos, repairs, more technical knowledge, integrated supply services, tool crib management, specialized kitting, next day delivery, VMI programs (vendor managed inventory)

GROWTH TRENDS

- ✓ Those distributors faced with shrinking customer bases have diversified their focus
- ✓ Distributors continue to diversify and add product lines. Safety and Jansan are both complementary growth areas particularly for MRO distributors
- ✓ Post-recession, more distributors of all sizes say they recognize the need to prioritize diversification into new markets or product types to buffer their companies from cyclical ups and downs. Goal is for new areas to grow faster than distributor's core business.
- ✓ Distributors add product lines that complement the traditional, core.

PRODUCT LINE EXPANSION TRENDS

- ✓ Over 60% of distributors continued to expand their product lines in 2010. On average large distributors tend to carry more product lines than small and mid-level distributors,
- ✓ Channel partners are more likely to emphasize and invest in the products of industrial manufacturers that have compelling value propositions
- ✓ Companies [considering] introducing new products and product lines are keeping product expansion decisions focused directly on the needs of the customer
- ✓ Brands matter to their channel partners

WEB ENABLEMENT TRENDS

- ✓ E-Commerce is becoming a bigger and more important part of strategies: re-vamping websites, a focus on e-Commerce capabilities, more distributors considering moving their catalogs online
- ✓ A variety of sources report that Industrial distributors expanded and improved their websites (2009-2011)
- ✓ One key study reported that the general consensus for technology usage is that distributors want to improve the capabilities of their websites. 78% considered their web presence vital to the future success of their business, however the smaller the distributorship the less importance they place on their website
- ✓ Unfortunately, many customers, suppliers and competitors have more mature, sophisticated IT infrastructures and capabilities than their distributor counterparts. A great many distributors continue to operate with fragmented legacy systems that are unable to keep pace with demands placed on them
- ✓ Distributors with highly technical product and services lines are less interested in e-Commerce capabilities. ("We don't sell from a catalog, and we don't sell off the shelf")

MANUFACTURER: DISTRIBUTOR DYNAMICS

- ✓ For manufacturers, effective product portfolio management relies on marketplace insights; industrial distributors are uniquely positioned to provide those insights and have a vested interest in doing so. Distributors can provide such insights as:
 - Market Opportunities
 - Necessary portfolio breadth (the right categories)
 - Necessary portfolio depth (the right sizes, shapes, coatings)

- Performance problems
 - Product discontinuations
 - Appropriate new product launch approach
- ✓ Brands matter to distributor channel partners:
- Channel partners know that the brands they carry reflect on them ... positively or negatively
 - Being a distributor of strong, well-known brands can open doors to prospective customers that otherwise may not be open
 - Strong brands can reduce the effort/investment required in the selling process as prospects often need less convincing to purchase
 - Provide clear and consistent branding and brand messaging
 - Invest in the brand and its messaging
 - Show an adequate level of participation in industry events
 - Ensure channel partners have the ability to also support and promote the brand

PROFILE OF A DISTRIBUTION NETWORK – NB: COMBINED MFRs, DISTs, 3PLs

- ✓ On average the typical distribution network is made up of more than three (3) buildings, however: 30% have one building; 20% have two; 12% have three. The average is pushed by 38% reporting more than three buildings in network. *“One of the clearest trends seen to unfold over the past several years is the number of DCs (distribution centers) that make up typical networks.”*
- ✓ Most commonly a “Global” area of service is reported (31%). This contrasts to:
- Entire US 25%
 - Multi-State Region 22%
 - Single Metro Region 13%
 - Western Hemisphere 4%
 - “Half” if the US 3%
- ✓ The most typical number of SKUs reported was 5,000 to 9,999 at 13% but almost all other volume breakouts reported between 8 and 12%. Recompiled:
- Up to 999 SKUs 32%
 - 1,000 to 9,999 SKUs 37%
 - 10,000 or more SKUs 30%

MANUFACTURERS: RESEARCH & SITUATION OVERVIEW

OVERALL:

- ✓ Budgets continue to be tight and reports from the field (Thomas sales reps) are not positive. Concerns over declining traffic to ThomasNet.com have impacted confidence levels. However, renewal rates are good and new offerings for (manufacturers (custom and product) are met with optimism.

- ✓ Thomas' Industry Market Barometer (IMB) results are positive and tell a story of growth and investment through the first half of the year. Since the results were tallied, the macro-economic story has been more volatile. We are preparing to field another IMB to see if the confidence we found at the start of 2011 held up. But the experiences we hear directly from industrial businesses across the country keep us optimistic that it will.
 - In terms of growth, 45 percent of respondents said their companies grew during the second half of 2010.
 - As a sector-wide sign of confidence, 7 out of 10 expected to continue growth through June.
(We'll confirm if this is the case in our upcoming IMB)
- ✓ As **68%** say their top challenge is customers cutting back or going out of business, **66%** focused on customer retention and service.

INVESTMENT TRENDS:

- ✓ As a further sign of confidence, companies are putting their money where their mouths are, so to speak. The IMB maps investments to priorities, and reveals where businesses are spending across the supply chain to support several strategies:
 - Increasing production capacity (**80 percent of respondents**).
 - Adding new lines of products and services (**63 percent**).
 - Managing their costs to "grow smart." (**88 percent**).
- ✓ Most are spending on technology (**51 percent**):
 - Of those focused on managing inventory (**61 percent**), nearly half will buy software.
- ✓ To ratchet up production capacity or develop more products/services, they are also investing in capital equipment.
- ✓ Others report investments in facilities improvements.
- ✓ They're adding jobs too; **37 percent** plan to hire through the first half of 2011
 - In addition: customer service (**31 percent**) and sales/marketing staff (**38 percent**).

GROWTH TRENDS:

- ✓ With greater competition from home (**46 percent**) and abroad (**29 percent**), they are competing more aggressively in core markets. In addition, **7 out of 10** say they are pursuing business in new industries.
 - ✓ Competition is also driving companies to develop new/innovative products/services.
- To enable these strategies to succeed, companies are using the Internet more strategically:**
- ✓ Three-quarters of IMB respondents (**76 percent**) report that their websites made a contribution to their growth during the second half of 2010.
 - ✓ Nearly 9 out of 10 of respondents that reported past and predicted future growth said their websites helped them to increase revenues, open new sources of business, compete more aggressively in core markets and serve customers better or more efficiently

SPECIFIC PRODUCT SHARING ISSUES:

Our conversations with manufacturers, as well as their distributors and OEM partners show there are some major obstacles to creating and sharing this precious product information.

- ✓ First, manufacturers are hard-pressed to keep all the information up-to-date and digitized, particularly when they have hundreds, and even thousands of products. Often, much of the data is still paper-based in print catalogs and brochures, or different pieces of information may reside in different departments or systems, from engineering to purchasing.
- ✓ Secondly, once the information is digitized, manufacturers still struggle with how best to share it throughout their organizations and with their partners. Whether it's a spreadsheet, PDF or ERP system, sharing information in a format multiple parties can use can be a challenge. Without a standard format, manufacturers struggle to make this information usable by all of their various sales and distribution channels. While a manufacturer will distribute product data and specifications in spreadsheets to its internal sales team, the same format often won't integrate automatically into its distributors' systems. Instead, each distributor has unique formatting requirements and its own product classification taxonomies. Some distributors will flag the issue so it can be corrected, while others may not even notice, so the valuable product data never gets shared and the manufacturer's products never get offered.
- ✓ The disconnect between what manufacturers have available and what their partners need is resulting in lost sales opportunities. Distributors and channel partners aren't able to pick up the slack, either; if a manufacturer isn't providing comprehensive data from the start, its partners will only sell a fraction of its products.

DISTRIBUTOR RELATIONSHIP TRENDS:

- ✓ Supporting channel partners by supplying comprehensive, up-to-date product information has been a huge challenge for manufacturers.
- ✓ Product information is in a variety of formats (some print, some in databases) – not in one central place where it can be pushed anywhere and everywhere to support various inventory, marketing, sales and customer service requirements.
- ✓ For the majority of distributors the process of uploading product data is reported as “manual,” “laborious,” “time-consuming” and inefficient.
- ✓ All large distributors upload thousands of suppliers' product data into their own unique data management systems such as SAP's MDM (Master Data Management) system...not to be confused with standardized backend inventory systems such as PPIF (Product Information Pricing Format) utilized in the motion control/power transmission industry.
 - Data needs to meet the distributor's requirements in order to be in their system.
 - Manufacturers who don't make their product information available according to these requirements will not be considered as a channel partner.