The e-Changing Face of Wholesale Distribution

By Greg Girard

The rush toward an Internet-centric economy leads some to conclude that wholesale distribution—a critical supply chain component in many business sectors—lies at the edge of extinction. Chatter about channel disintermediation and virtual inventory management suggests that wholesale distribution is an outdated, declining vestige of yesterday's economy.

If you buy such a view, then wholesale distribution is a dinosaur and the Internet represents the cataclysmic meteor that altered the climate and led to the beast's extinction. Although the Internet certainly will dent the business world as we know it and lead to a radical transformation of wholesale distribution, it won't cause its extinction. Remember: evolutionary theory now recognizes that reptilian dinosaurs evolved into the birds that still thrive today in an ecosystem dominated by mammals. The Internet, new expectations of channel masters, and evolving business models will transform wholesale distribution just as thoroughly. Soon, e-Commerce-compliant wholesale distribution will resemble its industrial-age ancestor about as much as modern birds resemble the dinosaurs of the Jurassic Period.

Enterprise applications and enabling technologies are in the forefront of this transformation.

> Information technology is enabling the emergence of a new "Sell-Source-Ship" business model.

Traditional Roles Threatened

Some have called wholesale distribution the lost continent of industrial economies. A glance at the economic data, however, reveals that this business sector is large and vigorous. It accounted for 6.9 percent of total U.S. economic output in 1997, about the same share held by nondurable goods manufacturing. And at an annual average rate of 5.5 percent since 1992, it's been growing faster than manufacturing (5.2 percent) since the current economic expansion began in 1992. A few years ago, more companies and sites were engaged in wholesale distribution than in manufacturing. As world trade expands and newly industrialized economies increase their share of traded manufactured goods, wholesale distribution growth rates will continue to outstrip manufacturing rates in mature industrial economies.

Traditionally, distribution played four value-adding roles in moving finished product from manufacturers to points of consumption in consumer and industrial channels:

1. An aggregator of demand buffering manufacturers from orders too small and too logistically complex for them to handle.
2. A consolidator of multiple, often competing

suppliers that offered customers one-stop shopping for complementary products, kits, and accessories.

3. A deployment point, putting each manufacturer's inventory closer to consumption for faster customer delivery.

4. A local contact point for billing, technical product and application information, and other customer services.

Distributors now are starting to apply e-Commerce, supply chain management techniques, and enterprise applications to gain competitive advantage.

Today, the traditional roles are threatened as the result of the wrenching changes brought on by information technology (IT), innovative business processes, and new channel participants. The Chinese character for crisis translates literally as dangerous opportunity. For distributors, the translation perfectly describes how the Internet is transforming their business environment—and simultaneously affording them (and some would-be competitors) the means to redefine traditional roles consistent with new distribution realities. Customer-facing e-Commerce order entry increases the need for demand aggregation. Web-based available-to-deliver functionality linked to a supplier's order management and logistics systems extends the distributor's capability to offer one-stop shopping and deploy inventory virtually closer to demand. Finally, product- and application-centric knowledge management engines—coupled with personalized Web-based customer self-service facilities—cost-effectively enhance the distributor's role in customer service.

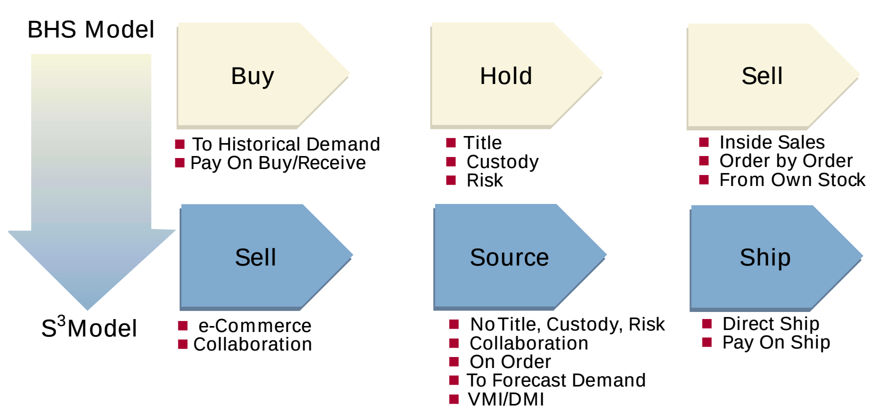
Evolving business models such as real-time trading exchanges, hub-based trading exchanges, and vertical trading communities provide alternatives to traditional wholesale distribution. Although not yet at critical mass, these models are attracting sellers and buyers for their reach and low transaction and channel costs. Soon they will attract others for their volume, reliability, and security—in effect, acquiring attributes of branded service providers.

Sell-Source-Ship Model Emerges

The emergence of alternative distribution channels and the transforming power of e-Commerce are giving distributors reason to test long-held assumptions about their own businesses, the markets they serve, and the competitors they face. The most daring among them—Jack Welchs in their own right—are destroying their businesses before their competitors do it for them. For many of these daring visionaries, the emerging Sell-Source-Ship (S3) model represents a compelling alternative to the Buy-Hold-Sell (BHS) model distributors traditionally used. (Exhibit 1 compares the two approaches.)

Under the Sell-Source-Ship model, a distributor buys-to-stock as little as possible, choosing instead to source and ship product for quick delivery on the date promised when the goods were sold. Distributors' reliance on marketing groups and co-ops, distributor-managed inventory, and pay-on-use inventory consignment programs are driving adoption of the S3 model. Collaborative demand planning, time-bucketed demand signals driven off collaborative demand forecasts, and scientific inventory-management practices also support the transition to Sell-Source-Ship. Verticals such as computer equipment and electronic components, aerospace and defense, utilities, pharmaceuticals, and automotive lead in adoption of S3 distribution—just as they did with e-Commerce. Of

EXHIBIT 1 The Operational Paradigm Shift



Source: AMR Research

course, S3 will never completely displace Buy-Hold-Sell distribution. Soon, however, it will become the norm, not the exception.

Indian River Consulting Group, a boutique firm focused on wholesale distribution, says that distributors face a complementary paradigm shift in their financial model. (See Exhibit 2.) Specifically, they must shift from a world in which price could be increased to cover cost to an environment in which cost must be reduced to support market price.

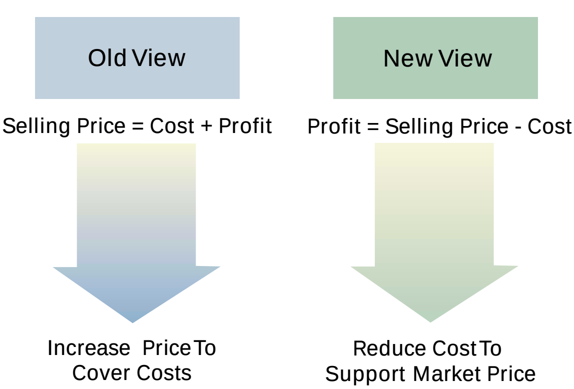
Distributors Need Enterprise Applications

In responding to the challenges—to defend their traditional roles and define new sources of value—distributors are starting to apply e-Commerce, supply chain management techniques, and enterprise applications to gain competitive advantage. Until recently, they were reluctant to invest in IT. And for the most part, there was little to buy. Vendors servicing the market relied on proprietary technologies, sold custom development projects, delivered limited functionality, provided little customer support, and offered ill-defined migration paths. None had established a commanding presence or compelling vision to create demand for a wholly new class of software—something SAP, i2 Technologies, Ariba, Seibel, and others have done among manufacturers. Furthermore, the distributors had even less reason to buy. Thin margins, a stable business environment, and business processes fixed around Buy-Hold-Sell justified low IT spending.

Today, both sides of the equation are changing. Vendors are introducing packaged applications built on open systems and industry-standard technologies. They offer deeper, broader, better integrated, and easier-to-use functionality. This functionality includes customer- and supplier-facing Web-based capabilities as well as standard product migration paths. At the same time, the shift to S3 distribution has channel participants flipping the traditional low-margin argument on its head as they realize low margins are a good reason for increasing IT spending. Most top-tier (and many leading mid-tier) distributors already see information technology as a key driver in their business transformation. For them, packaged enterprise applications provide the infrastructure for pursuing new markets, opening new channels, expanding to new geographies, improving customer service, and reducing complexity.

Others take a more traditional view, adopting technology in response to market conditions. They see that enterprise applications can help them reduce inventory, control costs, grow revenue, and improve customer service as they seek to defend and possibly expand their margins.

EXHIBIT 2 Financial Paradigm Shift in Wholesale Distribution



Source: Indian River Consulting Group

Setting Stretch Goals and Realistic Expectations

It's no longer business as usual in wholesale distribution. Consolidation, disintermediation, new channel participants, and changing business models—all abetted one way or another by the Internet—create an imperative for radical change that incumbents ignore at their own risk. The shift to S3 distribution calls for more than marginal improvements to existing business practices. If efficiency gains can be had, then take them. But understand that they only buy time and don't ready the business for looming radical changes.

Effecting radical change demands bold solutions ... or at least a vision and commitment to develop those solutions. How bold? Think in terms of 100-fold increases in the information you provide your customer, 10-fold increases in inventory turns, 100-percent accuracy in all customer transactions, 100-percent custom pricing, and 360-degree visibility of all available-to-promise positions and product and order flows. And by the way, imagine achieving all of this at a 10-percent reduction in operating costs!

Challenges of this magnitude could be met only with the aid of IT that pushes the boundaries of the possible. Success will come well before any of the goals are completely accomplished. And thinking outside of the box and implementing business process innovations will drive that success.