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Jenel Stelton-Holtmeier
Editor

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Making Money with Small Customers

Smaller customers provide big opportunity for the bottom line

There is often a perception in sales that the smallest accounts are not worth the time and effort to obtain the small amount of sales they provide. But a shift in how these customers are served can result in a significant improvement to the bottom line. In this article, Jonathan Bein of Real Results Marketing provides an overview of how distributors can serve smaller customers and still make money doing so.

By Jonathan Bein

If you give a salesperson 100 accounts to call on, odds are he or she will actively work the top 20 to 30, receive calls from the next 20 to 30 and ignore the remaining accounts. While this salesperson is busy maximizing his or her commission by focusing on the larger accounts, the company is missing significant opportunity in the smaller accounts. When these accounts are acquired and serviced through the proper channels, priced appropriately and managed well, they can increase the bottom line by several margin points. In turn, those margin points often lift net profit more than 50 percent.

At the same time, these smaller accounts cannot be serviced in the same way the largest accounts are if distributors wish to turn this kind of profit. But there are cost-effective ways to serve these small to mid-size customers:

- Sales and marketing channel alignment
- Price improvement
- Cost-to-serve reduction

The net effect of these approaches is to increase revenue and margin while reducing cost to serve such that small and midsize customer segments become attractive. This article provides an overview of these approaches.

Marketing and Sales Channel Alignment

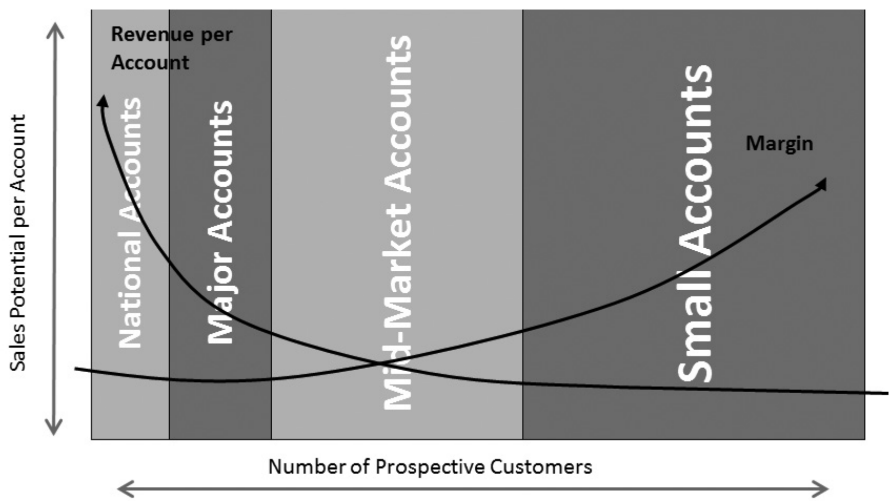
For most distributors, the top 10 percent of customers represent 60 percent to 90 percent of that distributor's revenue. This top decile is almost always managed by field sales representatives who rely on large accounts to make quota.

While there is substantial revenue in large accounts that form the top decile, mid-market and small accounts that make up the other 90 percent of accounts provide an opportunity to get higher gross margin percentage, as shown in **Figure 1**.

There are three main channels that are cost-effective for selling to mid-market and small accounts:

- E-commerce sites that provide easy navigation, good search and great product content.
- Proactive/outbound inside sales which involve account managers interacting al-

Figure 1: Account Potential



most exclusively by telephone rather than face-to-face.

- Direct response marketing programs including traditional print catalogs and flyers, as well as email marketing and marketing automation.

The proper development of any one of these channels can usually deliver 10 percent or more compounded revenue growth among small and mid-market customers over a two- to four-year period. The combination of these channels can achieve a compounded growth rate of 15 percent to 20 percent over a two- to four-year period. The financial impact to the entire company is 2 percent to 8 percent overall growth.

The expansion of sales channels provides for a proactive account management process for every single customer. Without proactive account management, small to mid-size customers are highly susceptible to defection – especially when competitors are prepared to give your customers the attention that you failed to provide. Our research shows that defection rates among customers who are managed by a sales rep are much lower than those with no account management process in place.

The development of small accounts can smooth lumpiness in revenue streams that results from a customer base that is too concentrated. It can also provide diversification and options for when the market shifts. Furthermore, the cultivation of these accounts will always reveal underserved accounts with huge potential that should be transferred to field sales.

Here are some symptoms that marketing and channel alignment could be right for you:

- Top revenue decile represents more than 75 percent of total revenue. This is evidence that your business is too concentrated in a small set of customers.
- High churn rate among lower decile customers suggests that those customers are getting better served by your competitors and moving on.
- Lumpy revenue can occur when your business is too dependent on large accounts or on accounts that have project revenue.
- Low wallet share in your small accounts indicates that the accounts are under-served by you.
- When field sales is the only or primary channel, then it is virtually guaranteed that small accounts are underserved by you.

Price Improvement

Many distributors subscribe to the myth that a principled price improvement initiative will result in losing key customers who are driven away by higher prices. In reality, small and mid-size customers are much less price sensitive than customers in the top revenue decile, particularly for non-core items they purchase infrequently.

Figure 2 plots the size of the customer on the X-axis versus the price they pay relative to list price on the Y-axis. The area highlighted below 1.0 on the Y-axis shows small customers who are purchasing at a significant discount. These discounts are invariably offered for no apparent reason other than force of habit and belief that it is necessary to win or maintain the business.

Some pricing solutions help customers achieve a margin improvement of 1 to 2 points. However, work by Strategic Pricing Associates has repeatedly shown that margin improvement of 2 to 4 points can be achieved by getting small customers to pay another 5 percent to 10 percent on non-core items. This additional margin drops right to the bottom line and often enhances profit by 25 percent to 50 percent.

Here are symptoms that price improvement

Figure 2: Pricing and Customer Size

could be right for you:

- A small spread between the average gross margin percentage of your top revenue decile customers and the rest of your customer base is strong evidence that you need price improvement. The spread should be at least 5 to 10 points and possibly more depending on your business.
- If your business culture tries to please the customer at any cost, then it is nearly certain that you are offering unwarranted discounts. It is essential to be able walk away from customers or transactions that are not good for your business.
- When your business is reacting to pricing moves in the market without any discipline, then price improvement is a great opportunity for you.
- If your value proposition looks like 80 percent of other distributors who tout selection, availability, delivery, and expertise then it means you need to better understand value and value selling, and how to create a differentiated value proposition.
- Frequently there is a vague objective to get more gross margin without a concrete plan to do so. This is yet another indication that price improvement will yield very good results.

Reduce Cost-to-Serve

Waypoint Analytics has detailed cost-to-serve information about the customers and transactions for several hundred distributors. A random sample of 87,000 customers from Waypoint revealed that unless a distributor has undertaken the process to reduce cost-to-serve its customers, it is likely that more than 70 percent of the customers are unprofitable. The business is sustained only by the 30 percent of customers who are profitable. The rest of the customers are breakeven or a drain.

Measuring net profit, including cost-to-serve, at the customer level is a powerful starting point for assessing where customers fall on this spectrum. Plot the peak internal profit (PIP) by starting with the most profitable transaction and proceeding to the least profitable transaction as shown in **Figure 3**.

This curve, called a whale curve because of its shape, reaches a point of peak internal profit near the middle. Remaining unprofitable transactions will reduce the peak internal profit. For a typical wholesale distribution company, only 20 percent to 25 percent of their PIP goes to the bottom line

The different parts of the curve include:

- **Core customers** – transactions at the left of the curve that contribute significantly to net profit.
- **Opportunistic customers** – transactions slightly to the left of center that contribute somewhat to net profit.
- **Marginal customers** – transactions slightly to the right of center that subtracting somewhat from net profit.

Figure 3: Small Orders on the Peak Internal Profit Line

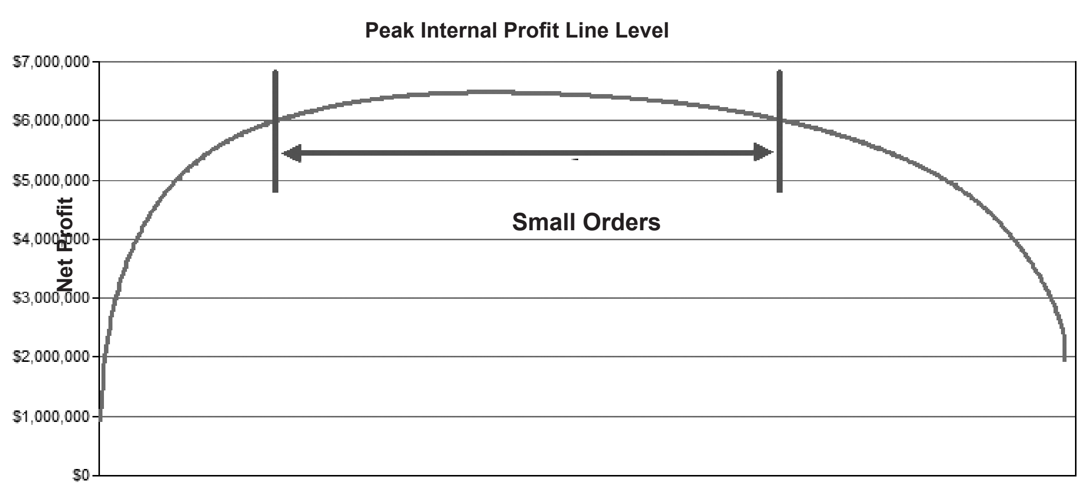
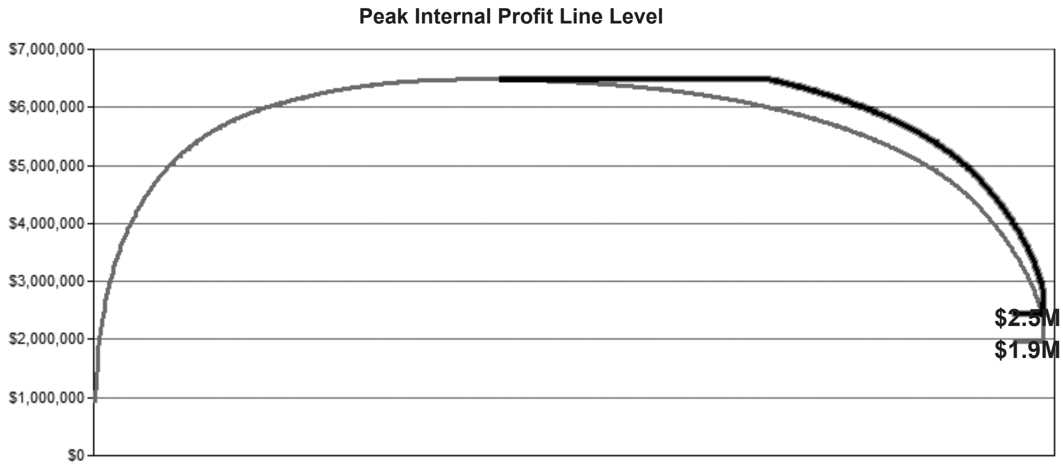


Figure 4: Peak Internal Profit After Cost-to-Serve Reductions



- **Service drain customers** – transactions at the far right that are a significant drain on profit.

When processes are put in place to reduce the cost-to-serve for the small customers in the middle – the opportunistic and marginal customers – the PIP curve is transformed to what is shown in **Figure 4**. The key objective to reduce cost-to-serve is to increase the size of transactions and/or reduce the total number of transactions while keeping revenue constant. In this new curve, the marginal customers are now at breakeven. The result is a company that previously had $1.9 million net profit and now has $2.5 million net profit, a 30 percent gain. This is the conservative view, because increasing the profitability of the opportunistic customers or getting the marginal customers above breakeven will contribute even more to the bottom line.

While it is possible to create an in-house solution to reduce cost-to-serve, for most distributors, getting a third-party solution such as Waypoint Analytics or add-ons to an ERP system is more efficient and effective.

Here are symptoms that indicate that reducing cost-to-serve could be right for you:

- There are too many sales where expenses exceed gross profit.
- Nobody knows where profits are made or lost because it cannot be measured at the transaction or line item level.
- Growth and gains are weak because few companies manage deltas (profit improvements over time).
- Sales people and others are rewarded only on gross profit rather than net profit.
- There is nothing in the current systems or processes to detect, prevent or manage these problems.

Each of these approaches will help distributors make money with small customers; some of the most profitable distributors recognize the potential to make money with small customers by combining these approaches. When used alone, sales and marketing channel alignment can deliver 3 percent to 5 percent compound revenue growth over a several year period; price improvement can provide 2 points to 4 points of margin improvement, which flows through to the bottom line; and cost-to-serve reduction can improve the bottom line by 30 percent or more.

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MDM Special Report: Private Label in Distribution, part 3

Private Label & Channel Conflict

Distributors work to balance national, private brands

While the margin and branding benefits of selling private label products may be attractive to distributors, such a move can create tension in the channel. This article examines the potential challenges and how distributors and manufacturers may be able to mitigate them. MDM also analyzes how distributors are balancing private label and manufacturer brands in their portfolios, and looks at why some manufacturers choose to produce private label for distributors and why others avoid it.

This is the third in a series of articles from MDM on private label in the wholesale distribution industry.

By Jenel Stelton-Holtmeier and Lindsay Konzak

When distributors introduce their own private label brands, they may also introduce "friction" between themselves and their manufacturer partners, says Brent Grover, managing partner at Evergreen Consulting.

The tension springs from many potential flashpoints, including:

- The ongoing pressure on distributor-manufacturer relationships due to shifts in the competitive landscape
- The perception that distributors are "ripping off" manufacturer innovations for their own private brands
- The belief that distributors are giving the manufacturer brands less attention as a result of having their own brands
- The feeling that distributors don't have the skillsets or the capacity to successfully implement a private label strategy
- Inefficiencies and additional cost that may result from retooling production lines to rebrand manufacturer products for a distributor

Whether the above are all true – and it certainly depends on the sector and the distributors or manufacturers involved – the resulting relationships can be uneasy. Introducing a private label product into the mix requires a balancing act for distributors with an eye toward strategic positioning and important decisions on where to dedicate sales resources and support.

"Private label items can be an effective tool if used properly, and manufacturers are generally not opposed to this if they are used in the right way," says Chester Collier, senior vice president, global distribution for manufacturer Walter Surface Technologies in Montreal.

A Balancing Act

But if the private label is designed to replace a manufacturer brand or does not have a clear position within a distributor's suite of offerings, it may strain the relationship.

Even when distributors say the purpose of their private brand products is to fill holes in product offerings or in the market, balancing the interests of each party in the channel can be difficult. Many distributors don't balance private label and national brands well, Grover says.

"The obvious slippery slope is when does your partner become too much of a competitor?" asks a manufacturer in the recent quarterly MDM-Baird Distribution Survey, in which MDM asked about manufacturer involvement in and opinion on private label production.

"The tension is that manufacturers often think that distributors unfairly rip off their innovations," says JB Steenkamp, author of *Private Label Strategy: How to Meet the Store Brand Challenge.* "… The manufacturers feel that they take all the risk and that the distributors essentially piggyback on the risk-taking behavior of the manufacturers."

Resentment also exists on the distributor side, says David Gordon of Channel Marketing Group. Gordon has conducted research on private label in the electrical distribution sector. "Some of them actually found that they got less support from manufacturers and reps on the branded items," he says. "They'd want to go and do private labeling on A and B items and rely on the manufacturers for the Cs and Ds. "As sales go down, would a rep really want to support that distributor as much?"

Building Sourcing Partnerships

Distributors use a mix of suppliers to produce private label products, including importing from overseas, contracting with manufacturers that only produce private label products and working with existing branded manufacturers that allocate excess capacity for the task. Manufacturers aren't making money when their machines aren't producing, Gordon says.

Working with existing suppliers can also provide an opportunity for manufacturers to supply product at a tier they are unwilling to position premium brands in. "In some cases we're building partnerships with existing suppliers where they have the volume base to provide the product," says Michael Flink, president of ADI, a security and low-voltage products distributor with more than 200 branch locations.

It allows suppliers to build volume in their manufacturing plants without having to reposition their own products.

MSC Industrial Supply, Melville, NY, sources its private brands domestically and internationally. In its early private branding years, the MRO and metalworking supplies distributor bought from the biggest manufacturers, purchasing their "third shifts," a cost-effective approach. But more large manufacturers have shied away from private branding over time, according to Greg Polli, vice president of product management and global sourcing for MSC.

"We still use some of the big manufacturers, but we have found that those with high-volume capacity and strong quality that are not necessarily tier one players seem to be the best partners," Polli says. The distributor sets multi-year agreements with its suppliers.

"One of the keys in our private branding, well with any brand, is consistency, so the more we can lock in with a high-quality effective-cost manufacturer, we do so, and we try to do so for many years to keep that consistency," Polli says. "Those that work effectively with us, we want to continue a long and mutually healthy relationship."

The Decision to Supply Private Label

Many branded manufacturers say they feel obligated to provide contract manufacturing services for distributors' private brands. In the MDM-Baird Distribution Survey, 59 percent of manufacturer respondents said they provided contract manufacturing for distributor private brands. Several said they do so because distributor customers require it.

In some distribution sectors, including paper products and janitorial supplies, branded manufacturers have long worked with distributors to produce their private label products. While in some cases those products are different, in others, distributors ask manufacturers to put their distributor brands on the same products. For example, a distributor may want its name on individually wrapped toilet paper rolls, as well as the boxes they are delivered in.

This may disrupt branded manufacturer processes and decrease efficiency for potentially not a lot in return for the suppliers, according to Grover, because distributors may not sell more of the product after private-branding it than they did before. While many manufacturers tolerate that, it does add to tension in the channel. Some manufacturers' fear of losing business drives them to provide contract manufacture services. "There is a growing private label market," one manufacturer survey respondent wrote. "Unless we participate, we will lose that share of the revenue and possibly see share erosion."

"If they don't bid, someone else will, and there goes that business," Gordon says.

On the other hand, agreeing to manufacture private brands can help "get our branded products placed, as well," wrote one survey respondent. "(It's) not as profitable as other parts of our business but helps to deepen relationships with distributor partners," another respondent said. Another wrote that providing that service to distributors provides "immediate access to markets we would otherwise not support well." For another, "It is an opportunity to participate in a bigger share of the overall business."

The most cited reason in the survey for manufacturers not getting involved in contract manufacturing is lack of desire to compete with their own products. "Brand recognition is an important part of our success," one survey respondent wrote.

Others said they don't make money on contract business. "We used to, but as distributors gain more knowledge, they tend to take the business direct and then drop us as a private label supplier," one manufacturer wrote. "Low margins are also an issue, as well as branding issues."

Brand Strategies

The general perception is that a distributor's gain with private label is the manufacturer's loss. But distributors and manufacturers should not think of private label brands and national brands as a zero-sum game, Steenkamp says. It's not always one brand over the other.

"In some categories – in growing categories – it can be that the distributor brand can help grow the category by adding more price-sensitive people on-board," Steenkamp says.

"Manufacturers realize that not every customer wants or needs their brand," Collier says. "… If the private label brand is designed to help the distributor acquire or keep a customer, then it is acceptable as a viable alternative." But there has to be an understanding that the manufacturer will also have access to that customer to try and upsell his product.

"In this fashion, the partnership actually can become stronger, as the increase in the private label sales to new customers provides a steady stream of new opportunities for the manufacturer," he says.

The goal should be one of long-term mutual benefit, Gordon says.

"It can be a challenge," says Ted Stark of janitorial supplies distributor Dalco Enterprises. "I think it really comes down to what is the best solution for the end-user?" In some cases, including national contracts, distributors are bound to provide a branded solution, driven by large purchasing organizations or a large customer's desire to have consistent product nationwide.

For Dalco, the trick is not going into an account with a "predetermined preference," Stark says. "We do try to go in and determine the customer's need and take an unbiased approach of what will be best for them," he says. "We believe we've got a good quality product in our private brand, and it's less expensive than most of the national brands, but it won't work for every customer situation."

For some distributors, private brands have evolved not just based on the features in individual products but how they are sold. That changes the role that private label plays in the distributor's portfolio. Chicago-based Grainger, which has more than 40,000 products that fall under its Exclusive Brands portfolio, found that smaller customers did not want a particular brand that was packaged with more than 100 to a box.

"Spending money on something where they got 120 of something was not a good use of their money," says Deb Oler, vice president and general manager of the Grainger Brand. "Our private label was about how many was in the box. … Sometimes the innovation is not about the actual development of the product." But while Grainger's line of Exclusive Brands is extensive, it also recognizes that there are places where its own brand is not needed; what is already available in the market is enough.

"If you figure out what the market needs, and you have the right offer that fits the needs of your market, you actually end up selling more of those products," Oler says. "There haven't been many times that we have added private label and the entire segment hasn't gone up. "The challenge and the opportunity is teaching your sales force and your customers what means what."

She says that when done well, private label and manufacturer brands can co-exist. "We think private label and national branded products should sit hand-in-hand with each other, and they are part of our total solution for market."

The Changing Channel

The reality is that if distributors want to pursue a private label strategy, they will do it with or without the support of their existing manufacturing relationships, Gordon says.

And private label is only one of the factors at play straining channel relationships.

The end-user arguably has more power than ever before, and competition for the end-user's attention is coming from more directions. "The channel is more blurred in certain product categories now as manufacturers seek other channels to market," Gordon says. Distributors are building different identities through online platforms. "E-distributors," such as AmazonSupply.com, are also complicating the path to market.

This means distributors and manufacturers have to re-evaluate how they approach the market. Traditional volume discount models and other structures may not fully address today's market dynamics.

Some distributors would argue that manufacturers have increasingly become brand-brokers themselves, shifting their focus from manufacturing to marketing and product development.

Distributors will continue to look for ways to maintain customer mindshare, and private label is one of those ways.

A lot of challenges come with pursuing a private label strategy, and Grover says that market factors will likely continue to drive private label's growth in the industry. "As distributors consolidate and become bigger and bigger, I think the temptation to have their own brands is only growing," he says.

Guy Blissett, author of the National Association of Wholesaler-Distributors' book *Facing the Forces of Change: Reimagining Distribution in a Connected World*, encourages distributors to think of all potential impacts of private label, including relationships with existing suppliers. "I think you really need to have a deep understanding going in as to what you're trying to do with these private label products, who's going to buy them and how your suppliers might react to you making that decision."

Angela Poulson also contributed to this report.

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Top 10 Trends to Watch in 2015

The most critical issues that matter to distributors going into the new year

This article, based on the 2014 MDM Industry Outlook Survey, outlines and analyzes key trends and issues affecting how distributors will do business in 2015.

By MDM Editors

2014 started slow, as harsh winter weather curbed activity across much of the United States. But as time marched on, prospects brightened, and many distributors ended the year with more optimism about what the future holds.

But with that optimism comes a renewed sense of caution. In the 2014 MDM Industry Outlook Survey, many distributors noted that there is still work to be done to be prepared for the new year. Many are turning a keener eye toward making sure they have the right talent and tools in place to take advantage of improving conditions and attitudes.

Here is a look at the top 10 trends to watch in 2015.

1. **Mostly favorable economic climate presents opportunities for growth.**

When the MDM Industrial Outlook Survey sought the top three industry-wide concerns for 2015, one respondent's answer of "economy, economy, economy" perfectly summed up how distributors' fortunes and fears revolve around the U.S. financial climate.

But while the economy will always keep company owners awake at night, optimism pervades wholesale distribution and manufacturing as 2014 draws to a close. Recent earnings reports show increased sales and substantial profit growth from companies across all sectors. Surveys show executive are bullish on both the nation's and the industry's economic well-being. And a flourishing M&A market points toward robust company valuations.

Though end-of-year data aren't available, industrial distribution has plenty of momentum heading into 2015, as evidenced by results of the third-quarter MDM/Baird Distribution Survey. Excluding acquisitions, revenue growth was 4.4 percent year-over-year for the quarter, marking wholesale distribution's best performance since 3Q12.

Although many said they expected business to cool slightly in the fourth quarter, with a projected growth of just 3.8 percent, most were cautiously optimistic for the longer term. Respondents forecasted an average of 4.1 percent revenue growth in 2015.

Also, a recent Deloitte poll revealed a strong level of optimism for the economy in 2015. A wide majority – 87.8 percent – of respondents said they expected the U.S. economy to grow, and 47.3 percent of them expected M&A activity to increase.

2. Talent gap widens as distributors struggle to find "qualified workers."

One of distributors' most critical industry-wide concerns for 2015 is finding qualified candidates to fill open positions. In the MDM Industry Outlook Survey, respondents repeatedly referred to the growing talent gap in wholesale distribution, using terms such as "labor shortage," "shortage of qualified/skilled workers," "access to affordable talent" or "shrinking talent pool" to describe their plight.

The struggle to recruit and retain millennials – the generation that will comprise 75 percent of the U.S. work force by 2025 – will continue to be a hot topic for wholesale distributors, as well as manufacturers, in the new year. Yet as baby boomers retire or plan to retire in the next decade, they aren't actively seeking ways to bring them on board.

Attracting talent, especially young talent, requires a strategic approach. One tactic for distributors is to align with an institution – such as a college with an industrial distribution degree – and its students, to get an inside track to recruitment.

"The thing that I can't underscore enough, if companies want to be successful in their recruiting efforts, is aligning themselves with institutions that fit culturally with their organization, and then taking the time and energy to increase the level of familiarity with the students, so they really know what they're getting," Kyle Buxton, area leader for WinWholesale, told MDM earlier this year.

Compensation, philanthropy and access to training (another trend to watch in 2015) are factors millennials consider when looking at an industry, something distributors must keep in mind when lamenting a lack of qualified candidates. Not only does the inability to find talented workers effect the short term, it could be disastrous for the industry as it looks go groom the next generation of leaders.

3. Companies that devote time and resources to training will continue to surge ahead.

Employee training remains top of mind for distributors and manufacturers, who ranked it as the third key business priority for 2015 – behind only the perennial concerns of revenue growth and increasing profitability – in this year's MDM Industry Outlook Survey.

Forty-two percent of respondents said training is a priority for their companies in the new year. They understand that providing access to the right training opportunities is critical for companies to remain relevant in a competitive market as well as recruit and retain top talent.

John Jacobsen, vice president of sales and marketing at DGI Supply, estimates that 80 percent of training in the wholesale distribution industry is focused on product and technical instruction, meaning distributors aren't placing enough emphasis on improving the sales, leadership and general business skills of their employees to prepare them for C-level positions.

For companies whose 2015 resolutions include training, several associations, including the Industrial Supply Association and the National Association of Electrical Distributors, offer training programs to meet both the product/technical needs of companies as well as professional development options. In addition, industry events such as the University of Innovative Distribution could be a good resource for providing cost-effective training programs without having to develop them in house.

4. Companies that fail to plan are planning to fail.

If distributors are having problems finding talent to fill open positions, as detailed above, then they are in real trouble when it comes to succession planning.

Respondents to the MDM Industry Outlook Survey said they are dealing with the "continued loss of experienced people through retirement and lack of viable replacements," and that they aren't having much luck "finding that next level of talent to replace those leaving the work force."

Like training, succession planning involves investment in technology. Bill Mansfield, senior vice president of sales and marketing for Graybar, St. Louis, MO, told MDM earlier this year the company uses its technology platforms to monitor employee training and notify employees when new training is available. The training system, however, is not only for onboarding new employees. Mansfield says it helps develop employees at all levels within the company. "It really helps us track our goals, identify development needs and keep our leadership succession plans on track," he says.

5. Need for a broader digital strategy emerges.

Concerns about Amazon and AmazonSupply.com appear to have faded, but the focus on e-commerce continues to grow for distributors. As Court Carruthers, senior vice president & group president, Americas for Grainger, says, Amazon has become "representative" of one of "a number" of players in a very competitive online space.

In the MDM Industry Outlook Survey, only customer relationship management (41 percent) topped e-commerce (40 percent) for technologies to explore in 2015. But the reasons behind the two selections were very similar – to serve the customer better. And that means being available 24/7, several respondents noted.

The way customers interact with businesses isn't changing; it has changed, says Philippa

Gamse, a professor at Hult International Business School.

But there's still a barrier to doing it well, according to Linda Taddonio, co-founder and e-commerce strategy officer of InsiteCommerce, when she spoke in an MDM Webcast earlier this year. "Only one-third of executives believe that their (digital strategy) approach is correct, and just 21 percent believe that the right people are setting the strategy in the first place," she says.

The goal for distributors going forward is creating a comprehensive digital strategy that includes e-commerce but focuses on providing the right information at the right time. "More and more customers are using e-com and the Web to research and sometimes buy products, although the research side is more important to us at this time," one survey respondent noted.

And that may not look exactly like what the big players, such as Grainger or MSC Industrial Supply, are offering. Distributors have to "understand the digital body language" of their customers, Gerry Helbig, president of plastics distributor Curbell Plastics, told MDM. The Internet is increasingly transforming how business purchases are made, but that doesn't seem to be killing traditional business in the way many people were predicting.

Distributors are also starting to recognize that having an efficient and functional e-commerce platform can have significant impact on their profitability in the long run – even if it requires a bit more investment up front. "Technology CAN decrease operating costs," one survey respondent noted. "It can also drive revenue growth."

6. Staying up-to-date on technology more important, but more challenging than ever before. E-commerce isn't the only technology challenging distributors going into 2015. There are more options available seemingly every day to help with every aspect of business. But so many options can be a barrier in and of itself. As one distributor noted in the survey: "We need new software. Which one?"

There's ready acknowledgement that much of the software and hardware distributors use today is outdated. In the MDM Industry Outlook Survey, 53 percent of respondents were already in the process of upgrading technology. In contrast, only 14 percent had no plans for upgrades in the next two years.

But knowing that today's upgrades will be outdated in just a few years is frustrating. As one survey respondent noted, it's difficult to "stay current at an affordable price."

Many survey respondents also noted that integrating diverse systems is a big challenge going into 2015. Demand for better, more actionable data from computer systems means those systems need to be communicating with each other, whether it is synchronization between the CRM and the ERP to provide accurate information to a customer or even between the payment center and the store to ensure the right prices are being charged.

This requires having the right team in place to spearhead the initiatives and identify – and, in turn, overcome these barriers, Taddonio says. She recommends distributors create a digital innovation team composed of three or four stakeholders from inside the company, specifically from the technology, marketing, operations and finance departments. It also requires outside stakeholders – what she called "passionate experts" – in technology, marketing and operations.

This team can evaluate the company's needs and identify a plan for making sure the critical systems can be integrated before huge capital outlays are made.

But even if a distributor has all the technology pieces in place, technology aversion is still a problem for many. As one distributor noted in the Industry Outlook Survey, they still have to "pull people that are technology zeroes along." As noted above, training will be more important than ever for success in the coming years.

7. Merger & acquisition activity, along with spinoffs, will continue to dominate headlines. A host of wholesale distribution deals last year across all sectors and of varying size deepened the industry's consolidation story, which should become even more compelling in 2015 thanks to a ripening merger and acquisition market nationally and abroad. Readers in the MDM Industry Outlook Survey frequently cited M&A and its impact as a top industry concern, and this past year presented some clues as to what might happen moving forward.

Sonepar's purchase of Industrial Distribution Group and HD Supply's sale of Hardware Solutions highlighted the banner year for M&A and divestiture, but the health of the industry – public companies reported solid quarters throughout the year as valuations stabilized and grew – portends similarly notable deals in 2015.

Multiple surveys and reports published in the fourth quarter also point to more activity next year. The M&A market for mid-sized, privately held companies is expected to be "improving" or "very aggressive" in the next 12 months, according to 43.8 percent of respondents to a Deloitte poll. And nearly half of them (46.4 percent) say their companies are prepared to entertain an offer immediately from a hypothetical "perfect buyer."

And plenty of buyers seem prepared to pounce when the time is right. For example, MSC Industrial Direct President and CEO Erik Gershwind told analysts during the company's fiscal year 2014 earnings call that he feels "very good about how MSC is positioned to succeed in the next decade as the consolidation story accelerates."

8. Port slowdown, truck driver shortage causing inventory management disruptions. Receiving and delivering shipments in a timely manner is an obvious priority for any company in the supply chain, and two problematic pain points that emerged this year have made shipping and logistics a key trend to watch in 2015. Seventeen percent of respondents in MDM's Industry Outlook Survey said better transportation/freight/logistics management is a business priority for next year – and that number could rise if a labor dispute on the West Coast and a national truck driver shortage endure.

The fourth quarter of 2014 began on a dour note when congestion at ports from Washington to California slowed the movement of cargo from container ships to freight trains and then to distributors and manufacturers. Because a labor deal could be struck at any time, which would eliminate the disruption, it might not rank as a long-term concern for companies the same way they fret over succession planning or overcoming the talent shortage. But until then, an ongoing delay in labor talks could mean rerouting shipments to Gulf or East coast ports or moving more freight via air, both of which add cost.

Andy Mitchell, director of supply chain and marketing at jan-san and safety equipment distributor CCP Industries, which imports 80 to 100 containers each month from China and Malaysia, said recently that his company has been experiencing delays of two to four weeks because of the slowdown.

"It has been very challenging on our supply chain, causing back orders and increased investment in inventory levels," says Mitchell, who worries that the disruption could have a devastating and lasting effect nationally. "Shipping lines were expecting things to improve in October 2014 and they did not. And with an improved U.S. economy forecast for 2015 and continued tight capacity, there is no light at the end of the tunnel."

Adding to shipping and logistics woes, the ongoing truck driver shortage will continue to disrupt distributors, with many respondents listing it as a top concern for 2015.

9. Channel blurring shows no sign of slowing. Readers expressed anxiety over the blurring of sales channels on a variety of survey questions, claiming their top industry concerns for 2015 included "losing manufacturing lines," "competition from outside the normal distribution channel" and "shifting channels by manufacturing from classic distribution."

Fear of disintermediation – or manufacturers bypassing distributors to sell directly to end customers – has grown in recent years, with increased adoption of e-commerce making such a move appear more feasible than in the past. As a result, distributors are faced with an increased need to prove their value to both manufacturers and customers or risk being viewed as simply an added, superfluous cost in the chain.

Rod MacKenzie, owner of Green Building Resources, Atlanta, GA, said that speed is one of the best places to compete with disintermediators. For the customer that needs a tight turnaround, a well-connected distributor is often the best, fastest answer to the problem. But, he says, it'll cost them.

In addition, distributors continue to expand their product lines in order to capture more of their customers' spend. For example, Sonepar's acquisition of IDG expanded the global electrical distributor's presence in the industrial product space, in addition to growing its integrated supply opportunity. Kaman's acquisition of B.W. Rogers is another good example, with the power transmission distributor building a fluid power platform on the acquired company.

10. Rampant regulations?

Survey respondents raised concerns about new regulations going into effect in the next year, as well as continued concerns about the rising costs of health care – often attributed to the Affordable Care Act, which continues to have features rolled out. Labor-related regulations and workplace safety rules also have the potential to significantly impact how business is done over the next year.

The November election returned the Senate to Republican control after eight years of a Democratic majority, which leaves both houses of Congress in opposition to the White House. But what that means for the regulatory environment remains to be seen.

In addition, many state legislatures flipped alignment in the November elections, meaning changes may be afoot at the state level. For example, in West Virginia, the new legislature is already discussing changes to tough environmental standards passed in the wake of last year's chemical spill that impacted drinking water around Charleston.

MDM/Baird Survey: Playing Catch-Up

After slow start to the first quarter, March 'comes to life'

Robert W. Baird & Co., in partnership with Modern Distribution Management, conducted a survey of about 500 distributors and manufacturers to gauge business trends and the outlook for the distribution industry in diverse sectors. Here is a summary of first-quarter results and distributor and manufacturer expectations for 2014.

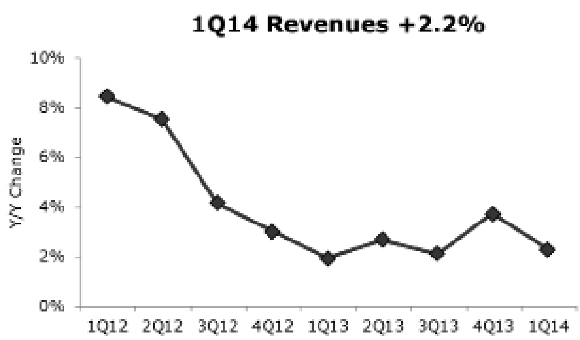
Revenue growth in the first quarter was lower than expected for respondents to the first-quarter 2014 MDM/Baird Distribution Survey. First-quarter revenues, on average, were up 2.2 percent overall, lower than the 4.3 percent growth forecast in the fourth-quarter survey. Respondents expect revenues to grow 4.1 percent in the second quarter of 2014 and 4.9 percent for the full year.

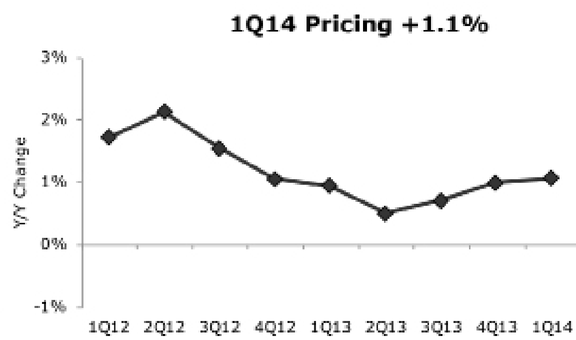
Harsh winter weather during the first quarter may have delayed some expected sales, according to respondents, but many view it as opportunity going forward. As one industrial distributor noted: "March is coming to life; there's a catch-up going on."

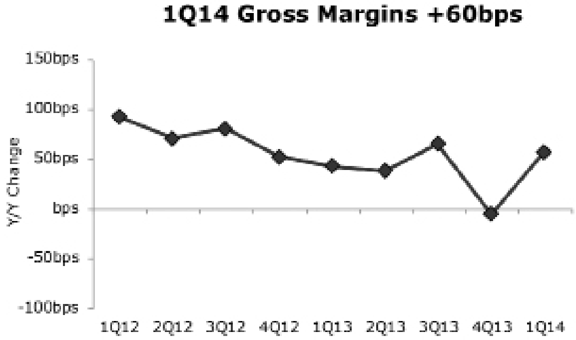
Excluding weather, underlying business trends for most survey respondents were stable (53 percent) or accelerating (36 percent). This result carried across sectors, with 80 percent or more of respondents in most sectors identifying trends as stable to accelerating. PVF - water & sewer was the exception with slightly fewer – 70 percent to 80 percent.

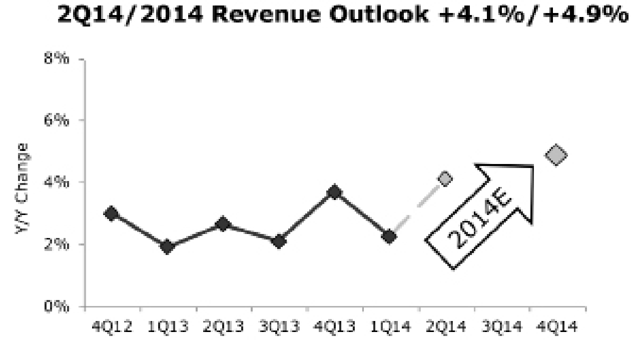
PVF - water & sewer once again posted the strongest revenue growth in the quarter, with average increases of 8.1 percent. Much of the growth in this segment was attributed to depletion of unfinished residential lots, which necessitates new investment.

Two segments reported revenue declines in the first quarter. Fasteners saw the largest decline, falling 1.1 percent in the quarter. Roofing fell 0.6 percent, but respondents in this segment are expecting a much stronger second quarter









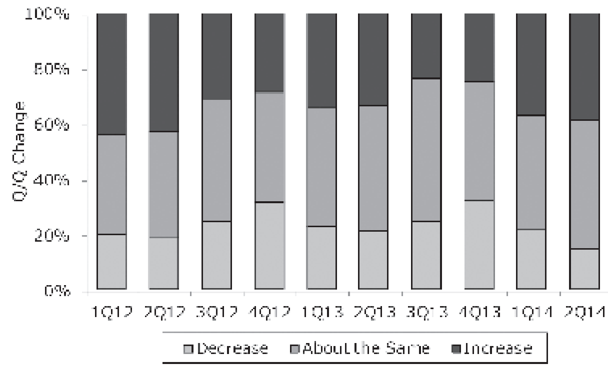
with revenue growth of 6.6 percent on average.

Across segments, gross margins were up by 60 basis points in the first quarter 2014, and pricing was up 1.1 percent.

In line with expectations from the fourth-quarter survey, 37 percent of respondents said they increased inventory levels in the first quarter. Slightly more respondents (21 percent) decreased inventory levels during the quarter than said they anticipated doing so in the prior quarter (18 percent).

In the second quarter, 39 percent of respondents expect to increase inventories, with 15 percent planning to decrease, consistent with normal seasonality and implying a normal ramp-up into the summer season.

Inventory Levels, Historical and Expected



Thirty-seven percent of survey respondents said they increased inventory levels in the first quarter, while 21 percent decreased. Looking ahead, 39 percent plan to increase inventories in the second quarter, with 15 percent expecting to decrease. This expectation is consistent with normal seasonal patterns, implying a normal ramp into the summer selling season.

Current and Expected Revenue and Pricing Levels by Sector

	1Q13 Sales Change	1Q13 Pricing Change	2Q14 Sales Forecast	2014 Sales Forecast	
Building Materials	1.5%	1.5%	5.0%	4.7%	Lumber prices flattish sequentially in 1Q14
Cutting Tools	0.5%	0.9%	3.9%	4.4%	Trends more in-line with Industrial/Mfg MRO
Datacomm	0.5%	1.4%	4.2%	4.0%	Trends appear to remain stuck in neutral for now
Electrical	1.0%	0.3%	3.8%	5.5%	Increased optimism for nonresidential construction
Fasteners	-1.1%	-2.0%	2.5%	2.1%	Pricing on imported product may be set to rise in 2Q
Gases/Cylinder Rental	4.3%	2.2%	5.3%	4.1%	Helium supply vastly improved ex-Air Products
Hoses & Accessories	2.7%	1.1%	5.2%	6.7%	Momentum accelerating after three flat quarters
HVAC	5.6%	2.5%	5.4%	5.4%	Winter weather a benefit despite lost selling days
Mech/Power Trans.	0.4%	-0.7%	1.9%	4.4%	First positive revenue reading since 4Q12
MRO - Industrial/Mfg*	2.4%	0.6%	5.0%	5.4%	Trends in March appear to be reaccelerating
MRO - Non-Mfg*	2.9%	1.1%	3.2%	3.2%	End market growth remains slow, but steady
Plumbing	1.4%	6.5%	1.5%	6.5%	Pent-up demand anticipated after harsh weather
Pool & Spa	0.5%	0.4%	4.7%	7.2%	Underlying industry trends remain broadly positive
PVF - Ind. & Energy	1.9%	1.0%	2.1%	2.8%	2014 revenue forecast essentially unchanged
PVF - Water & Sewer	8.1%	7.1%	7.8%	7.7%	New investment driven by diminishing residential lots
Rental Equipment	3.0%	2.2%	7.3%	6.9%	Feedback suggests increased Spring activity
Roofing	-0.6%	-0.1%	6.6%	7.8%	Increased optimism for summer selling season
Safety	6.9%	1.2%	1.4%	0.9%	Competitive pressures persist; Staples targeting safety?
Welding Hardgoods	2.2%	2.0%	5.1%	5.6%	Uptick in demand for bigger-ticket items
Overall	2.2%	1.1%	4.1%	4.9%	

Here is the breakdown of results:

Industrial supply companies reported mixed results compared with fourth-quarter sales growth. Cutting tools remained the weakest product category, but demonstrated a relatively stable trajectory. Safety was the strongest product category with growth of 6.9 percent. Industrial/manufacturing MRO sales growth slowed during the first quarter with average revenue gains of 2.4 percent, compared with 5.8 percent last quarter.

The end of March marked a shift in sales, as bad weather eased in many areas of the country. "March has taken off pretty strong," one respondent noted. "The activity level has really picked up, even better than sales (results)."

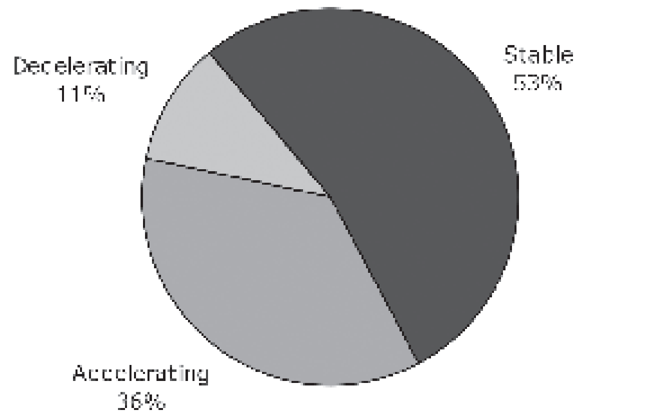
While much attention has been paid to AmazonSupply's recent moves in the industrial space, a new big-box competitor appears to be making more noise now. Respondents have seen Staples "making some noise in safety."

"We've heard that Staples is trying to hire safety specialists," one respondent said, "and they're not being cheap either."

Customers continue to demand more services, according to industrial supply respondents, including vending and other vendor-managed inventory services.

E-commerce remains a focus, but wariness about expanding e-commerce platforms remains. "Ready availability of (online) price comparisons is challenging," one distributor said.

Excluding weather, how would you classify underlying trends in your business?



Industrial supply companies expect a mixed bag for the second quarter. Growth is forecast to accelerate in cutting tools (+3.9 percent) and industrial/manufacturing MRO (+5 percent), while the growth rate is expected to slow significantly in safety products (+1.4 percent).

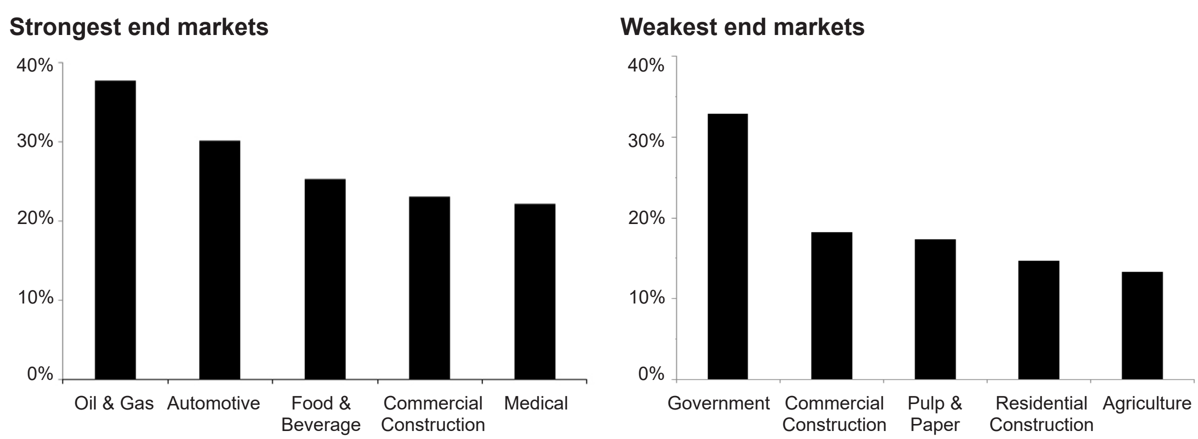
For 2014, safety companies expect revenue growth of 0.9 percent, with industrial/manufacturing MRO companies forecasting an average of 5.4 percent annual growth and cutting tools companies forecasting 4.4 percent annual growth.

In **industrial gases**, gases sales growth outpaced hardgoods for the seventh straight quarter. Gases increased 3.7 percent, while hardgoods increased 1.9 percent.

Pricing increased 2 percent for industrial

In which end markets are you seeing strength and weakness?

Respondents were asked to identify their strongest and weakest end markets. Here are the top five responses to each question.



gases. Prices continue to gravitate higher, but within "normal" ranges. "We went out with a price increase and in general aren't seeing any issues," one respondent said.

Expectations for revenue growth in 2014 are in line with the overall average. Gases companies expect revenue to grow 4.1 percent for the year; hardgoods companies are forecasting growth of 5.6 percent. For the second quarter, gases companies expect growth of 5.3 percent, and hardgoods companies expect growth of 5.1 percent.

Ongoing issues with helium supply are showing signs of leveling off for many respondents, while others still see it as "a headache." "We haven't seen any movement yet," one respondent said.

Customers appear to be investing in their businesses again, as demand for bigger ticket items in the hardgoods category has increased.

In **building products**, HVAC saw strong growth in the first quarter (5.6 percent), albeit lower than the 12.8 percent seen in the fourth quarter. Roofing and pool & spa companies, on the other hand, had a relatively stagnant quarter. Roofing fell 0.6 percent, and pool & spa grew 0.5 percent. Non-manufacturing MRO fared slightly better with average sales growth of 2.9 percent.

Cold weather drove up demand for HVAC products during the quarter, even with the loss of some sales days. That same weather, however, "shut off all demand" in roofing, according to respondents.

For both segments, the outlook for 2014 is positive, with demand for roofing materials expected to "break as soon as the weather does." For 2014, three of the building products segments are expected to grow at a stronger pace than the overall survey results. HVAC companies are forecasting average annual growth of 5.4 percent, roofing companies are forecasting growth of 7.8 percent, and pool & spa companies expect growth of 7.2 percent. Non-manufacturing MRO is expected to remain relatively steady with average annual sales growth of 3.2 percent forecast.

Wire & cable companies reported a slowing of sales growth in the first quarter, with revenue growth for electrical companies of 1.1 percent still outpacing datacomm (0.5 percent). While optimism about increased sales from non-residential construction has grown, datacomm trends appear to be "stuck in neutral." "The market isn't all that robust," one respondent said. Utilities also appeared to be a strong market in the first quarter.

Pricing trends for both segments were flat to slightly positive on average, but copper prices threaten to be a modest headwind going forward. The outlook for 2014 calls for 4 percent to 6 percent growth.

-Jenel Stelton-Holtmeier

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PERSPECTIVE ■ Commentary by Thomas P. Gale

Scotland, Baseball and Better Sales Models

What sales teams can learn from current events

What can baseball and Scotland possibly have to do with each other? More than you might think. They offer somewhat parallel lessons on analytics, assumptions and biases and how to think differently about selling more effectively and profitably.

The vote for independence in Scotland a few weeks ago supported the status quo – unity with England – with 55 percent against independence and 45 percent in favor. In the final few weeks leading up to the vote, many pollsters had it all wrong, predicting a very close outcome, and in some cases predicting the other side winning.

Because the polls were largely Web-based, rather than exit polls, there were a few different layers of bias and subjective filtering to the analysis. By contrast, the betting markets nailed it, with most odds-makers placing the likelihood of Scotland staying in the UK between 60 percent and 75 percent right before the vote.

Lesson 1: The data won; people put their money where their mouths weren't. People won't always tell you the truth for lots of reasons, especially in sensitive situations.

Lesson 2: If you are getting most of your intelligence about a customer account's potential only from the sales representative, you are getting subjective and filtered input. It can be good or not so good.

October means baseball playoffs, and another endless round of more statistics than 99.9 percent of the world cares about. But remember *Moneyball*? Key performance statistics were more reliable in determining the bottom-line metric – run production – than the subjective evaluation of scouts, who tend to be biased toward high-paid and flashy talent. Scout knowledge hasn't completely been abandoned, but it is now used to augment the available objective data.

Lesson 3: The data won … again.

Lesson 4: "Local" knowledge has a role in refining the data and improving results. The key is to find a data-oriented way to model, benchmark and measure account and market potential. Then add the critically important local knowledge held by the salesperson.

Successful sales organizations are doing the same thing. IBM was an early adopter more than 10 years ago in an effort to gain better understanding of account potential for their IT products. The result is a system sales can use to spend time more effectively to increase their high-potential opportunities, close rate and profitability per sale.

Lesson 5: Show me the money.

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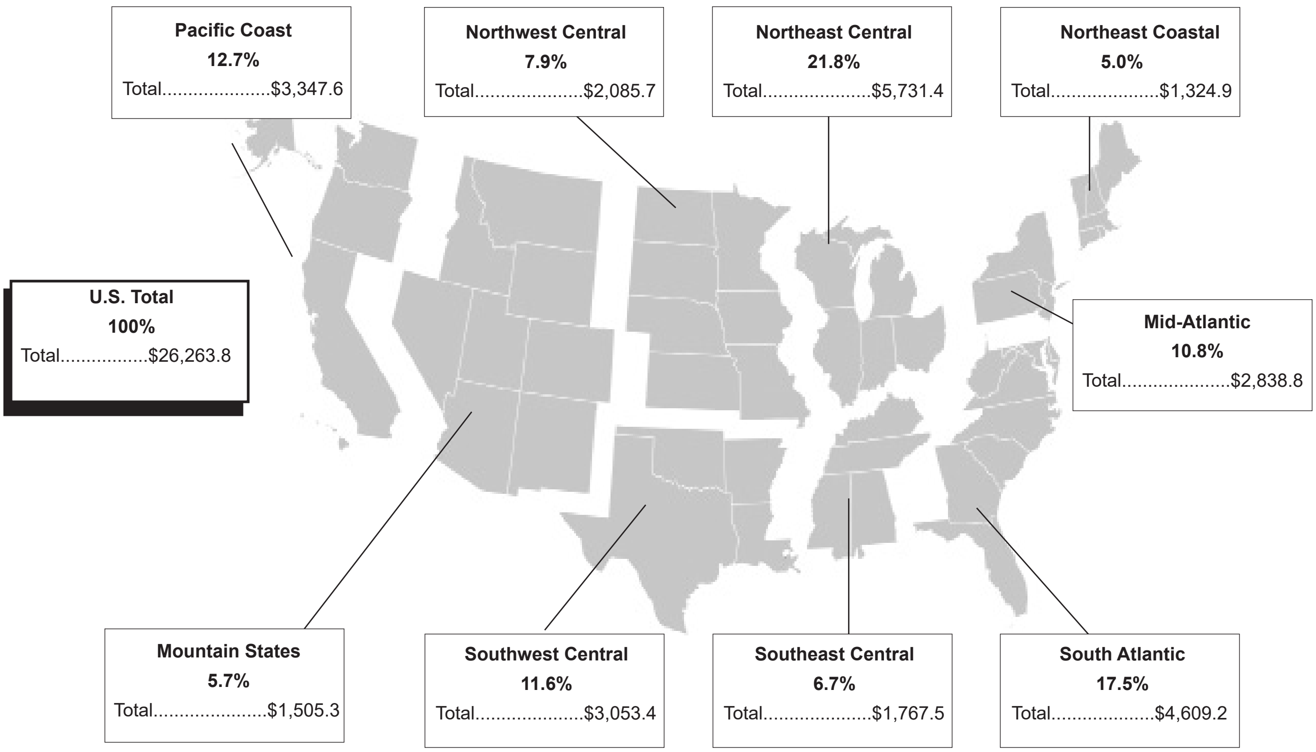
MARKET ANALYSIS: Chemicals Consumption in North America

Consumption of Chemicals in the U.S. was $26.3 billion in 2013, according to data from MDM Analytics (formerly Industrial Market Information).

End-user consumption of Chemicals by region, in millions of $ (2013 estimates).



End-User Consumption of Chemicals in Canada (US$): $3.2 billion

End-User Consumption of Chemicals in Mexico (US$): $2.9 billion

■ U.S. End-User Consumption of Chemicals: Top 10

Top 10 end-markets in $ volume, by NAICS code, consuming Chemicals (2013 estimates)

End User		Estimated Consumption
238320	Painting and Wall Covering Contractors	$1,420.5 million
238220	Plumbing, Heating, and Air-Conditioning Contractors	$848.8 million
237310	Highway, Street, and Bridge Construction	$743.4 million
236220	Commercial and Institutional Building Construction	$715.4 million
336390	Other Motor Vehicle Parts Manufacturing	$616.4 million
238110	Poured Concrete Foundation and Structure Contractors	$450.1 million
336412	Aircraft Engine and Engine Parts Manufacturing	$438.8 million
336111	Automobile Manufacturing	$410.6 million
332710	Machine Shops	$387.9 million
322121	Paper (except Newsprint) Mills	$372.0 million

This market size estimate was compiled by MDM Analytics (formerly Industrial Market Information), Lafayette, CO. Learn more about MDM Analytics at www.mdm.com/analytics.

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