Industrial marketers face a rapidly changing distribution landscape. Those who understand the nature of the changes and adopt their strategies accordingly will be the winners as industrial markets continue to shake out.

In the first section of this two-part white paper series, we discussed the changes that are occurring in the industrial marketplace and the four reasons behind these changes:

1. A shrinking customer base and consolidation of power
2. More distributor channels chasing fewer dollars
3. Distributor consolidation
4. Technological sea change

In this paper, we discuss how the marketplace is responding to these changes, the impact these changes have on the manufacturer, and how QDI Strategies can help you strategically deal with the changing dynamics of the marketplace.

The marketplace response lies in five areas:

1. Cost-cutting
2. Strategic partnerships
3. Value-added services
4. e-Commerce / e-Procurement
5. Customer Relationship Management (CRM) / non-traditional channels

In This Article:
Discover the changes occurring in the industrial marketplace, and how to respond to them.
Cost-Cutting Strategies: The Customers

QDI research suggests that large customers have already achieved the easy cost savings. These cost saving measures are comprised of:

- Consolidation in an effort to cut G&A costs and/or to expand into new product & market segments
- Slashing the number of vendors they buy from
- Installation of enterprise systems into their organizations to operational costs

Strategic Partnerships: The Distributors

Strategic partnerships are another way to save money. Given the narrow margins in distribution, there are two strategic partnership strategies used to maintain profitability:

1. Distributors join buying groups, which provide them with access to major brands & help them to maintain margins in a competitive environment through rebates.

2. Distributors form strategic partnerships, either on an ad hoc basis or in a formal structure (such as SupplyForce or McBar), in order to allow them to compete on national contracts and to share costs.

Customers also participate in these strategic relationships. To stay competitive on a global basis, customers continue to reduce suppliers and to buy through formal contracts, such as Integrated Supply and preferred vendor contracts. Our research indicates that the preferred contract strategy is growing in certain markets, at the expense of Integrated Supply. Tri-lateral agreements are also employed to force further margin concessions from the distributors and manufacturers. As corporate purchasing gains power within these large organizations, more products are pushed through the storerooms and are relegated to the status of commodities. As a result, brand franchises (which manufacturers established over the years) are destroyed.

Value-Added Services: The Distributors

Customers are also demanding cost savings that go beyond product. Consequently, distributors acquire the task of the purchasing and inventory management functions, historically performed by their customers. This allows the customer to continue downsizing areas such as purchasing, maintenance, training & engineering. On preferred vendor contracts, only 10-15% of the cost savings come from product cost savings, with the balance coming from the value-added services provided by the distributors. These services become a tool for differentiation, rather than a profit center for the distributor.

According to recent research conducted by QDI in the industrial distribution sector, distributors are targeting smaller customers with vendor managed inventory (VMI) strategies. This is a way for distributors to increase their market opportunities.

Technology: The Customer e-Procurement and e-Commerce

Technology is also providing the customer with other avenues for purchasing products, such as reverse auctions and e-procurement solutions. While QDI finds
that many products do not lend themselves to electronic purchasing, customers will continue to push more products through this process. According to the manufacturers that we talked to, reverse auctions failed to live up to expectations.

According to our research and the findings of other experts in the field, e-procurement (using solutions from firms, such as Ariba) is evolving slowly. Likewise, many distributors are ill-prepared for electronic linkages to customers who are deploying these purchasing systems. According to Aberdeen Research, only 8-10% of the largest 5,000 companies are using e-procurement.

Recent QDI research shows that few industrial companies are implementing e-procurement systems. However, most of the largest say that they will do so in the next five years.

**Implementation of e-Procurement: Corporate Perspective**

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In interviews with Fortune 100 companies across several industrial markets, QDI could not find any company that had completed their e-procurement implementation. Many companies we interviewed were just beginning the process of implementing e-procurement.

![Adoption of e-Procurement by Large Manufacturing Firms](image-url)

Our research also shows that only the largest industrial distributors have begun to implement electronic-commerce solutions. In a recent study with industrial distributors, our interviews revealed that only two distributors (in addition to W.W. Grainger) were mentioned as having e-commerce offerings for their customers. The types of items that will go through e-procurement are:

- High dollar categories
- High frequency items within a category
- Easily categorized – i.e., no engineering input required
- Materials such as:
  - Direct materials – ingredients & chemicals for manufacturing process
  - Indirect materials – power transmission, electrical, safety, mill supplies, pipe valves & fittings
Non-Traditional Channels: The Manufacturer

To reach segments of the market which are not accessible through their traditional channels, Caterpillar and John Deere have built alternative channels. Caterpillar products are now available in their dealer-owned rental stores, in addition to its historical channels. John Deere sells its branded lawn tractors through Home Depot, as well as through traditional equipment dealerships. Likewise, other companies are using e-commerce channels such as Amazon.com and eBay to expand their served markets. QDI believes that industrial manufacturers will also seek alternative channels to reach market segments not adequately serviced by their traditional channels. As distribution consolidation continues and the channel’s focus changes and becomes incompatible with the manufacturer’s strategic direction, companies will be forced to reevaluate their channel strategies.

Customer Relationship Management (CRM) is also being used by some companies to integrate traditional direct marketing (direct mail and telemarketing) activities, with those of the direct sales force and distributors. Most industrial firms are just learning how to use these new tools. To date, deployment has been expensive and slow. Nevertheless, Fortune 100 industrial firms are aggressively using these technologies to create more effective, lower cost channels.

Customer Relationship Management requires that marketers use a new perspective to design their channel organizations. To this end, QDI has developed a “Workflow Model” of Channel Marketing. Instead of viewing distribution as a vertical market flow model where the manufacturer hands off marketing functions to a distributor, the workflow model has the manufacturer controlling the flow of activities from the introduction of a concept through purchase, adoption and ultimate product disposal.

QDI’s Marketing Workflow Model

This model leverages the power of new technology to keep the marketer closer to the customer and to enable the marketer to build power in the channels, rather than to see his power erode.
**Marketing Breakthroughs**

**Strategies to Cope with Change**

Any strategy to create new channels requires a thorough understanding of the various segments that make up the end-user market and of the capabilities and desires of the channels to adequately service those segments. It is one thing to know and recognize the changes occurring in the marketplace; it is another thing to try to evolve with the marketplace. There are numerous ways to cope with these changes:

- Understand the changes
- Maximize your brands & reduce supply chain costs
- Increase your share via segment analysis
- Maximize sales force activity & value
- Reevaluate terms & conditions for channels

**Understand the Changes**

The first step to survival in this changing marketplace is to develop a thorough understanding of the changes that are occurring (in both your customer base & distribution channel) and to assess the impact that these changes will have on your business. How are customers changing their buying processes & selection criteria for the brands & sales channels for your products? As our research indicates, certain specialty distributors will survive and, in fact, thrive in some industrial markets. Do your products fit in to those channels? Is that how your key customers want to buy your products? By asking yourself these questions, you will be better equipped to look at ways to maximize your brands and to reduce supply chain costs.

**Maximize Your Brands and Reduce Supply Chain Costs**

In some cases, it makes sense for manufacturers to maximize their brand franchise, while in other situations the marketplace has already moved the product group to a commodity status. You have to realistically evaluate where your product fits in order to spend your sales and marketing dollars judiciously. The way in which the market views your products will also indicate what channels can best deliver your sales and marketing goals, and how much power you will wield in the marketing equation.

Since vendors are scrutinized as closely on their ability to reduce supply chain costs as they are in delivering product quality, it is critical to understand how profitable your product is to the distributor. Many of the more sophisticated distributors look at financial ratios, such as gross margin return on inventory investment (GMROI), when reviewing product lines. They have moved beyond the criteria of gross margin and are closely evaluating inventory turns, returned goods policies, etc. They are also looking at ways their vendors can help them demonstrate cost savings to customers while on contract. Technology at the distributor level will only enhance their ability to evaluate their vendors’ performance in these areas.

**Increase Share via Segment Analysis**

When conducting this analysis, it is critical to do so on a segment-by-segment basis. For example, engineered products sold into the process side of the pharmaceutical market are viewed in a much
different way than if they are viewed by the utility side of a chemical plant. Vendor requirements and channels may very well differ between segments. These must be understood to avoid wasting marketing dollars on services that customers fail to need or value.

Maximize Sales Force Activity & Value

One of the implications of the above discussion is that the role of the sales force will have to change. At a cost of $120,000 per rep and $250 per sales call, a manufacturer cannot afford to have its sales force performing functions that are of no value to either the distributor or the customer. Given the changing market landscape, how your sales force spends its time may also change. Is time best spent with the distributor or end-user? If it’s the end-user, should you focus on plants or corporate offices? Additionally, our work with clients often finds that sales force activity in the field is frequently different than what is perceived by sales management. Before changes can be made, however, a fresh understanding of marketplace behavior and dynamics must be developed.

Re-Evaluate Terms & Conditions for Channels

In addition to changes in sales force activity, terms and conditions for channels must be examined closely. Thus, manufacturers must also look at the services that their channels perform and adjust the channel agreements accordingly. If channels continue to perform services that customers no longer need, the manufacturer should not reimburse channels for these extraneous services. Likewise, if channels perform services that customers value and if customers outsource those services, manufacturers should support and possibly compensate their channels for these services. This suggests that functional discounts may be more relevant in today’s environment than in the standard volume discount approach.

How QDI Strategies Can Help

QDI Strategies has years of experience in helping clients redirect their efforts to meet the never-ending challenges of the changing business environment. We have worked with clients in over 100 industries, and each of our principals brings over 20 years of experience to each assignment. Our interactive, team-oriented approach to marketing assignments produces meaningful answers and insights for clients.

To get started, we offer a free half-day session with our senior staff members to explore your issues. We then develop a list of key considerations that your company needs to address and a business proposal that specifically outlines how we can help you meet these challenges. The decision to use QDI Strategies in this important effort is yours to make!

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