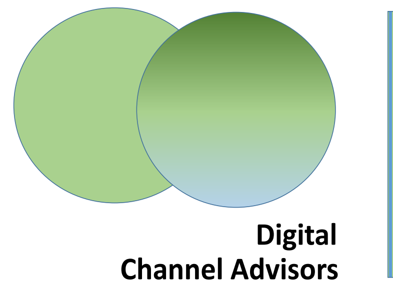

Distributors Lose Sales or Make B2B E-Commerce Work

Benfield, Griffith, Martin, Yezbak

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The authors' research finds that distributors, in 2016/17, began to lose sales online and this shows no signs of abating. Despite distributor executives' acclaimed differences between retail and wholesale, distributors' online struggles very much parallel leading retail firms. To correct the problem, distribution executives will need to look well beyond software to the fundamental structure of the firm and the way business has been done.

E-commerce has been present in distribution markets for two decades. However, it is in the last 10 years that software, specific to the complexities of B2B relationships, allowed firms to excel online. Today, the commonly accepted software suite of transaction platform, PIM, punch-out, faceted search and online quote has progressed to the point where customers can self-serve with accuracy and confidence. However, after a decade of progressive software development, growth in the pool of ecommerce professionals, and research and documentation of best practices, the wholesale distribution sector is, by most measures, underrepresented in number and performance for online sales growth and is losing sales to other members of the omni-channel.

Our 2016 research found that 60% of distributors transacted less than 5% of total revenues online and many firms were deficient in software and management investment in e-commerce.[1] Successful ecommerce firms represent a Pareto Distribution of all distributors with 20% of firms doing 80% of the online volume which, today, is approximately 15% of all sales in the $3 Trillion USD Durable Goods (broad) wholesale sector. Furthermore, our field work and contacts in the sector find that new firms, often started within the last 15 years and not identifying as wholesaler-distributors, are taking share from established firms with novel uses of online technology and new business models. Additionally, there are more manufacturers bypassing distributors and selling direct. At a 7% growth CAGR, 3.5 times the overall distribution sector growth, e-commerce will represent one in four items sold by 2025. Firms

that do not, today, benchmark their online performance in total sales and annual growth, will risk losing significant sales as B2B e-commerce will become the dominant mode of interaction in the next 15 years.

Wholesale Distribution, Over A Hundred Years of Successful Brick and Mortar. . .Just Like Retail

The general consensus, in the retail sector, is that the brick and mortar model replete with floor sellers and merchandising is in trouble. Notable firms including Borders, Blockbuster, Radio Shack, and Toys “R” Us, have gone the way of bankruptcy with stalwart retailers such as Macy’s and JC Penny, moving quickly to close stores in shopping malls that, too often, resemble ghost towns. The iconic American retailer, Sears, has recently announced need for significant cash infusion or it will have to close its doors.[2] Started in Chicago in 1893 as Sears and Roebuck, the company was the star of retailing done right as it dominated a broad line of consumer goods for most of 20th Century America. Today, Sears locations in major metropolitan areas stand empty, leaving only remembrances for retired citizens who purchased Kenmore appliances and Craftsman tools.

It is important to note that, for the most part, these retail firms sold quality products, with knowledgeable floor sales people, backed by reliable service. For the retail experience, most did things well and grew their sales. However, they were upended by technology that gave the customer more convenience, easier comparison shopping, perfect price information, prior user ratings, and all from a laptop without making a trip to the store. Existing retailers tried to adapt to e-commerce and poured tens of millions of dollars into e-commerce sites, only to fail.

Wholesale distribution grew up in the Gilded Age as America industrialized post-Civil War. Notable firms such as Graybar (1863), Noland Company (1915-Now owned by Winnelson) and Grainger (1927) have their roots in the industrialization of the continental U.S. These entities often identified with a vertical industry and skilled trades including electrical, plumbing, plant maintenance, etc. As they expanded, their model of business included local brick and mortar branches, branch managers, back-office administration including accounting, IT, and purchasing, and inside and outside sales. Beginning in the 1970s with computerization, many of the back-office functions were consolidated, leaving local branches with branch managers, sales staff, and warehouse staff. Distribution has, since the 1980s, consolidated at a frenetic pace. Today, the top 20 firms are often over a billion dollars in sales and often public or ESOP type ownership. Rounding out a vertical sector top 50 are a combination of public, ESOP and generational family firms that, typically, find it difficult to move past the $250MM in sales threshold.

Distribution executives argue that their business model is very different from retail. Their relationships are long-lived, involve large sums, are complex with numerous SKUs, and have applications that require some reasonable technical experience. Additionally, some products are heavy, bulky and have to be stored close to the final application. Hence, unlike retailers, the B2B wholesaler has barriers of financial risk, product knowledge, vendor relationships, and proximity of storage that can’t be easily disrupted by e-commerce. The argument makes sense at the 40,000-foot level, however, we are daily reminded that firms such as Amazon Business, Zoro Tool, Sustainable Supply, and Civic Solar were nonexistent in wholesale markets within the past decade or so. Today, research and press clippings show that these firms are growing against traditional wholesaler-distributors. And they grow with less brick and mortar and, often, less sales support—much like “new age” online retailers. A recent MIT

study of global e-commerce sales found that 47% of global e-commerce was fulfilled by firms new to the online space, which supports our observation that new firms are a force in B2B wholesale markets.[3]

As e-commerce grows in B2B supply chains, the changes to distribution firms and portent for their future will become clearer. Today, with 15% of sales online, distributors with nominal e-commerce sales are not necessarily showing a perceptible loss. Our research with end users and manufacturers, however, points to growth in online sales with a Pareto Distribution of distributors or manufacturer-direct sales. Fundamentally, customers prefer e-commerce over the sales-assisted transaction. While the B2B buying experience is different from retail, commodity purchases and less complex transactions count for a significant amount of the annual buy and can be consummated online, often at a better price. Commodities make up a range of 50% to 70% of all sales. This part of the distribution channel is at risk and is where lessons from retail offer the most meaningful parallels.

The Importance of an Online Culture

Firms that include Grainger, MSC, and, recently, Ferguson, have moved a significant amount of existing sales online within the structure of the full-service firm. However, many wholesalers have built out a competitive software suite only to sell nominal amounts online. We call this a Digital Washout. The failure to migrate accounts online is most often an issue of culture and cost. Many wholesaler executives see e-commerce as another way of transacting the sale (Transaction Perspective) and not as an enabling technology to change the business model and gain share by offering a different value proposition. The Transaction Perspective was an early part of the retail chains' online problem, where executives added site(s) as an extension to the existing business platform—but this failed miserably. A notable example was Walmart's failure online and its eventual purchase of Jet.com.

Today's full-service wholesalers have mimicked their retailer counterparts. They build out a successful software platform, hire a vetted team of competent professionals, and place the e-commerce technology on top of the existing business like a cherry on a sundae. Notable billion-dollar distributors have gone this path and our work and research has found many washouts, especially in contractor sectors.

Our view of placing e-commerce technology on top of the full-service firm is that it often, but not always, will yield disappointing results. Why? The answer is both culture and cost. In our field work, we have observed:

- The sales culture is threatened by e-commerce and will hesitate to recommend it to customers for fear of losing their jobs
- Traditional sales people often undercut the established online price, which drives the customer to the old method of transacting the sale
- The full-service firm's culture doesn't believe and support e-commerce and stays with old processes
- Sellers don't get credit for e-commerce sales, stonewall online progress, which creates conflict between e-commerce personnel and other members of the firm

- Customers get different messages from a firm's management, who want to grow e-commerce and field sales, yet trash-mouth the technology. This often results in customer defection to another e-commerce provider without open cultural conflict.

Many wholesalers try to work around these conflicts by giving sellers full credit for the e-commerce sale. The problem with this approach is three-fold:

1) Survey after survey finds that one reason B2B buyers move online is the convenience of ordering on their own time and not being limited to the 9 to 5 sales-assisted transaction
2) Experienced B2B buyers, especially for commodities, don't need to see sellers or need sales assistance and many don't want to pay for the sales expense for rote-ordered products
3) The insistence by distribution executives on full sales forces and brick and mortar is 180 degrees opposite the long-term advantages of the technology to the customer. These advantages are a simplification of interactive supply chain processes, taking cost out through self-service, and sharing in cost savings from redundant supply chain supports inclusive of too many sellers and too much brick and mortar.

Distribution execs who insist on taking the full-service firm online, generally, are headed for a "middling" performance at best and, more often, a digital washout.

To create the online culture, executives should consider that marketing the full-service firm may not be the best strategy. We have cataloged entities called Segment Platforms which are thin-sliced segments served by online entities of full-service wholesalers.[4] These platforms use the administration and back-office resources of the full-service firm, but have a separate online presence and often entirely different marketing staff and physical location. They have few, if any, sellers and very limited branch locations. Their costs are low and they take that advantage to market. Notably, Grainger has three "single channel" platforms in Zoro Tool, Monota RO, and Acklands-Grainger. From all reports, these firms are growing, often in double digits, and their contribution to operating profit, as a percent of sales, is often more than the full-service parent. To effectively thin-slice a segment and develop a platform takes excellent marketing, a function that is notoriously weak in traditional distribution. Our consulting work in marketing for the past two decades in B2B supply chains finds that the position is generally underfunded, misunderstood, and subservient to sales. Hence, for distributors to successfully develop dynamic platforms, they will need to upgrade the marketing department or outsource platform development.

Regardless of whether distribution executives attempt to move the full-service platform online or create thin-slice segment entities, there is substantial change required. We are reminded of the struggle of Grainger, one of the largest and most success distributors in the industry, as it adapts to the digitalization of the MRO/Institutional/Industrial sector. Grainger is reducing list price with a visible downward effect on margins and the company's stock price. Without this action, however, Grainger risks being underpriced by a growing list of non-traditional firms that go to market with a reduced operating platform and a very good price. To compensate, in addition to list price reduction, full-service Grainger is significantly paring back brick and mortar branches, reducing branch personnel, and adding

“single channel” platforms such as Zoro Tool. Our experience is that, to make the full-service platform work online, the distributor will need to:

- Carefully review brick and mortar locations and reduce redundancies wherever possible
- Use outside logistics firms over proprietary fleets, especially for small package orders
- Migrate as many accounts online as possible, especially activity-negative performers
- Work through new sales allocation models including coverage of Pareto accounts only, different deployment models by skillset, or segment-based coverage with the express purpose of reducing the geographically deployed sales complement
- Look to develop segment platforms along with reductions in brick and mortar and sales force costs

Outside of these recommendations, distributors should be familiar with the tenets of organizational change as they will become instrumental in taking the firm into the digital age.

Changing the Full-Service Model to Succeed Online

Two significant organizational behavior issues face the firm looking to change its business from traditional brick and mortar to an online oriented model. There should be no doubt that this change is significant and one that has been attempted, too often, with less than optimum results. We need only to look at retailing for appropriate examples. Sears, Penney’s and a host of others have failed to make the transition. Walmart has been distinctly unsuccessful heretofore and has announced a partnership with Macy’s, which is seen as the beginning of Walmart’s attempt to become an online mall to rival Amazon.

The first issue to consider is the difficulty of implementing and carrying out significant organizational change. Clark Gilbert tells us that organizations facing significant change are faced with two major types of resistance and inertia. The first source of resistance is known as Resource Inertia. Simply put, this is inertia and resistance to change arising from preexisting attachment to resources that supported the existing, and no longer adequate, business model. This attachment can be financially based, as in the reluctance to discard previously valuable assets, or psychologically based, as in the resistance to discard an old and familiar way of doing business. Newspapers are a prime example of this resistance. They have been distinctly less than successful in moving into the era of digital media. They are loathe to discard the substantial investments in printing facilities and the logistical facilities necessary to distribute print. Management and employees also display a significant resistance to parting with habits, values, and even the comfort, of producing a physically printed product. Many managers grew up in print media and find it difficult to move on. In addition, the need to produce a physical product created a powerful barrier to entry, which limited the ability of upstarts to be considered “real journalists.” In today’s world, anyone with a computer and a website or blog can produce content, albeit, widely varying.

Blockbuster is another example of this resistance. After creating the largest network of video rental stores and viewing them as a major competitive asset base, it was blindsided by the advent of digital streaming. Seemingly overnight, the assets previously viewed as an advantage and productive investment became a drain on profitability and suffered under what had become a high-cost model with a large, unneeded asset base. Ironically, Netflix approached Blockbuster with a proposal to enter into a

partnership. Netflix was rebuffed as Blockbuster management could not mentally shift to a new business model. Netflix prospers in the new digital world while Blockbuster entered the world of bankruptcy, restructuring, and asset sales.

Gilbert argues that the ultimate example of this rigidity is a reluctance to implement new business structure which will cannibalize the existing model. Kodak is probably the most widely known example. Its desire to preserve the hugely profitable film and processing photographic businesses kept it from moving into digital photography. Ironically, Kodak owned some of the original patents on which digital photography is based. Sony, Nikon, Olympus and a host of others, unattached to a legacy business and unconcerned with the effects of cannibalization, moved aggressively into this business, displacing Kodak from the world of commercial and consumer photography. The lesson is clear although hard to accept. Cannibalize yourself before someone else does. Indeed, Gilbert argues that firms which have successfully transitioned into radically new business models have done so by creating new business units. Members of these units view the change as an opportunity rather than a threat to an existing model and are willing to move more aggressively. Employees of existing brick and mortar operations see the new online model as a threat and reluctantly support it. The existing culture acts as a type of immune system to the new model of business, regardless of customer preference.

The second source of inertia and rigidity is, according to Gilbert, routine rigidity. Think of this as the proverbial "deer in the headlights" syndrome. Managers and employees see the existing business model beginning to fray. There is a visible lack of decisive action on the part of the senior leaders. The rank and file retreat into rote performance, not rocking the boat, as concern for their jobs and livelihood becomes paramount. Hunkering down just when the firm needs bold action and innovation, they simply want to stay out of the way and avoid attracting attention.

Making Change Work

Combatting these sources of rigidity and resistance requires a concerted effort to reduce the organization's resistance to change. Armenakis, Harris and Mossholder[5] have developed a particularly useful model and methodology for managers to use to prepare an organization for a substantial change. They argue that members of the organization must internalize several key beliefs before the resistance to change can be mitigated.

First among these beliefs is that of **Discrepancy**. Members must believe that the current organizational or competitive situation is no longer adequate or sustainable and must be changed. The discrepancy is simply the difference between the current situation and a future, more desirable situation. Creating this belief among members of the organization is clearly the function of leadership. Leaders must frankly communicate the issues and problems of the current state or business model to the organization and must do it frequently and powerfully. Failing to do so will result in an organization whose members do not accept the need to change or who hope that outside forces will miraculously result in an improved situation. As they say, "hope is not a plan" and "results are seldom miracles."

The second set of beliefs is **Appropriateness**. Simply put, members must come to believe that the proposed changes will address the Discrepancy. They must believe that the actions laid out by leadership are appropriate solutions to the problem. Again, creating this set of beliefs is the responsibility of management and is a function of frank, open and frequent communication.

The third essential belief is that of **Efficacy**. This is the belief that change can be successfully implemented. This belief can be separated into two portions. The first level is organizational efficacy, which is the belief that the organization can carry out the change. If your organization has attempted to implement a number of initiatives that the employees have come to call the "program of the month" you have a distinct problem. Employees are likely to view this as just another program they can ignore until it goes away. Again, effective communication is key to establishing this belief. Communication must be two-way and must engage employees in plans designed to implement the change. Change promulgated from the top rarely works and, in rare cases when it does, takes longer to implement and involves false starts.

The second portion of Efficacy is individual efficacy. This is the belief on the part of individuals in the organization that they will be able to successfully implement the change. This is particularly problematic when the change, as in a new business model, requires the abandonment of old skills and positions and the creation of new functions requiring new skills. In the case at hand, this may involve the reduction in the number of outside sales personnel as their functions are moved to the online environment. In a perfect world, employers will seek to create this belief by assuring that training and development will be available to ease the transition. Unfortunately, we do not live in a perfect world, and some functions are likely to be eliminated and some individuals will not have or be able to acquire the skills necessary to navigate the change. In this case, individuals must believe that they will be afforded the support required to make a successful career transition.

The fourth required belief is **Valence**. In a fashion similar to Efficacy, members of the organization must believe that the organization and employees will benefit from the change. Leaders must convince members, through communication, again, that there is a reasonable likelihood of success and that the new model will bring success. They must also endeavor to paint a picture of future opportunities for those employees willing and able to change.

The elephant in the room, in terms of both Efficacy and Valence, is that a portion of the employee base cannot change or are unwilling to do so. Allowing them to remain indefinitely will result in a distinct reduction in the organization's readiness to change. They should be separated from the company in a manner that preserves their dignity and cushions the blow. They must be able to honestly say that, while the experience was not pleasant, they were treated with respect and landed on their feet. If this is not the case, those remaining behind, the "Unwilling Survivors," will lose their trust in the organization, their belief that the change is advantageous to them will decline and they will become increasingly resistant to the change effort.

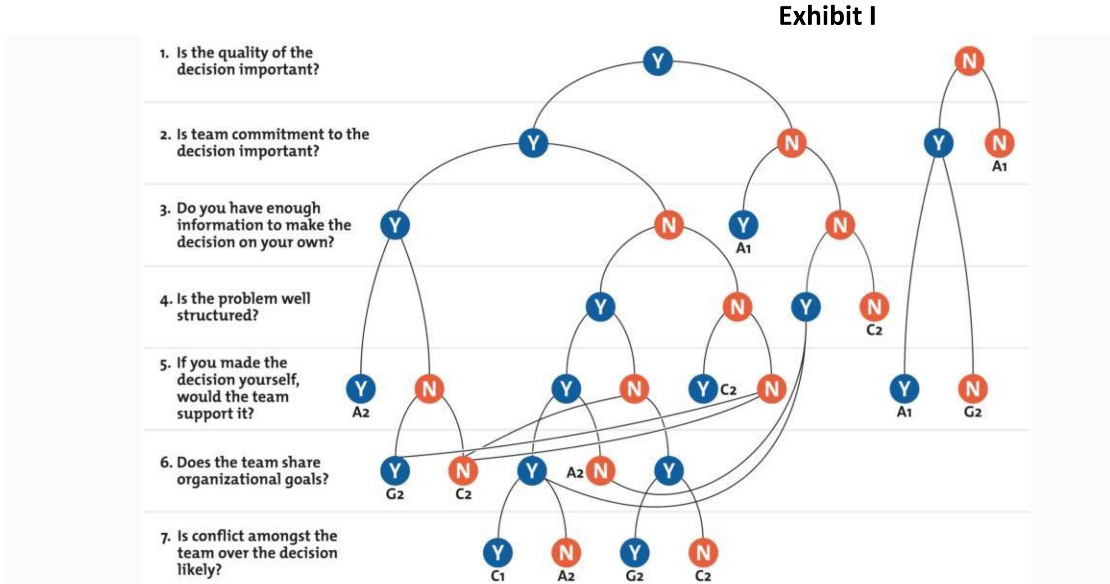
The final belief necessary for successful change is that of **Leader Support**. It is absolutely essential that leaders in the organization, both formal leaders occupying established leadership positions and those who are informal leaders in the organization, support change and voice this at every opportunity. As soon as a leader voices concern or opposition, organizational resistance to change will increase and members of the organization are likely to assume at least a passive role, waiting for the change effort to pass. In the worst case, they are likely to become actively resistant to the change and begin spreading doubts and concerns throughout the informal communication network of the organization. Finally, the method in which the decision to proceed with a significant change can have a major impact on the commitment of the organization to change. Victor Vroom and Philip Yetton proposed a decision-making

model where seven considerations determine the method of decision making most appropriate to the need at hand:

- Is the quality of the decision important? Clearly this is case when a major change to a business model is under consideration.
- Is team commitment(s) to the decision important? Again, this is clearly the case when a business model change is under consideration.
- Do you have enough information to make the decision on your own? Probably not in this case as there is no prior experience.
- Is the problem well structured? In this case, the problem is well structured but the solution may not be.
- If you made the decision yourself, would the team support it? We would argue that they would not in this case.
- Does the team share organizational goals? We suspect that, at the outset of a potential change in the business model, this is not likely to be the case.
- Is conflict amongst the team over the decision likely? Again, at least in the early stages of discussion, there is likely to be significant conflict.

Exhibit I below represents a decision tree model that may be used to arrive at the most effective decision-making approach. Entering the model at the top, you proceed downward answering the questions until you arrive at an alphanumeric code. These codes represent the five decision styles below:

Exhibit I



The Vroom-Yetton Decision Tree: Adapted from Leadership and Decision Making by Victor H. Vroom and Philip W. Yetton by permission of the University of Pittsburgh Press. Copyright © 1973 University of Pittsburgh Press.

- Autocratic (A1): You use the information that you already have to make the decision without requiring additional input from others.
- Autocratic (A2): You consult with others to gain specific information and then you make the final decision.
- Consultative (C1): You solicit input and opinions from members of the team on an individual basis. You make the final decision.
- Consultative (C2): You assemble others for a group discussion and seek inputs, and suggestions but you make the final decision.

Collaborative (G2): You work with the responsible team to reach a group consensus.
You primarily facilitate the process.

While collaborative sounds ideal, it is unlikely that a complete consensus will be reached. Leaders are paid to make tough decisions, often with input from others but they should not shrink from the need to make decisions and take action.

In conclusion, it must be said that preparing the organization for the change is as important as implementing the actual change. Few organizations do this and, as a result, too many change efforts lack full impact.

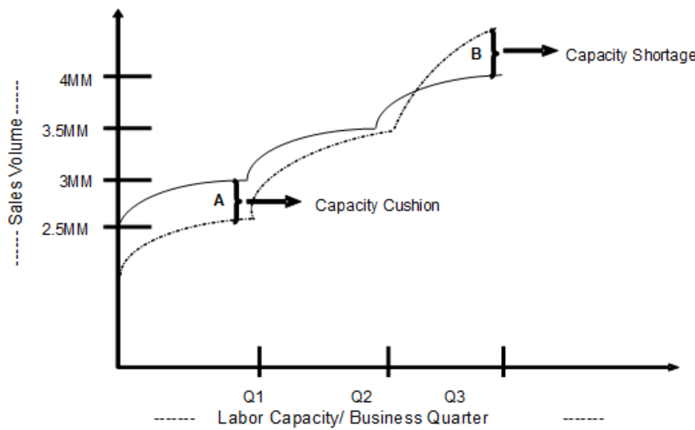
The Business Structure and Cost to Serve Problem

Distribution firms have consolidated significantly over the past several decades. It is not unusual to find the predominance of a vertical market's revenues controlled by firms with sales in the billions to hundreds of millions of dollars. Billion-dollar firms favor public or ESOP structures, with many private/ regional firms controlled by multigenerational families. Consolidation has broadened market scope with many distributors serving parallel sectors such as Jan/San and Office Supplies, Plumbing/HVAC/ Electrical, and MRO/Fluid Power/Power Transmission. As market scopes broaden, so does complexity. Firms have many different things to do and often specific to the order and account. There is a constant incongruence in the business structure. Outside sales are compensated on margin dollars but increasingly move further into the value chain and differentiate by services which are not captured in gross margin. These "below the line" services can be simple differences in shipping, billing, vendor preference to more complex preferences on assembly, light-manufacturing, or inventory management services. Furthermore, these services can differentiate by account, by order, and at different times. For large accounts, the service permutations, over thousands of orders, can greatly increase the workload, sap operating capacity, and grow cost-to-serve without much, if any, effect on margin dollars. The problem is illustrated in Exhibit II. The firm secures a new account that, from Q1 to Q3 moves from $3MM in sales with $660k margin dollars to $4MM in sales and $800k margin dollars. However, labor cost moves from $460k at 70% capacity to $632k at 125% capacity with the 25% over capacity being fulfilled by overtime labor and temporary labor which is less efficient and higher cost per unit. The

operating profit effect is that the incremental $1MM yields $32k less in contribution to operating profit because the extra costs of labor grew faster than the margin dollars (capacity cushion A vs capacity shortage B). It is almost impossible to estimate incremental labor needed on large accounts and incremental business as the permutations of services and special needs are many.

Exhibit II

Capacity and Profits
Bringing in Transaction Intensive Sales



	Q1	Q2	Q3
Sales Revenue	$ 3,000,000.00	$ 3,500,000.00	$ 4,000,000.00
Gross Margin Percent	22%	21%	20%
Margin Dollars	$ 660,000.00	$ 735,000.00	$ 800,000.00
Labor Cost	$ 460,000.00	$ 460,000.00	$ 632,000.00
Labor Capacity	70%	98%	125%
Margin Dollars (Labor Cost)	$ 200,000.00	$ 275,000.00	$ 168,000.00

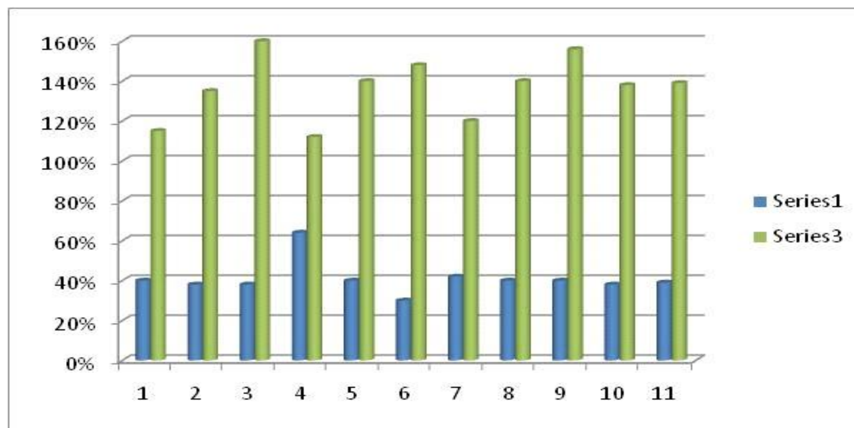
Most wholesale firms are familiar with the problem. But there is little, practically, that can be done about it in the current structure with incongruence in sales compensation, operating profit, and new business service demands. Account profitability efforts can help in the short term but, in the long run, substantial new business brings with it risk of a capacity shortage. In acquisitions, the capacity problem and goal congruence to increase operating profits commensurate with additional sales volume is compounded.

The effects of parallel industry acquisition, increased revenue size and branch footprint, movement further into the value chain with expanded service promise, and goal incongruence between sales compensation and operating profit contribution, have formed firms that are complex and inefficient. They are strategically vulnerable to models of business that take cost out with technology and limit the service promise with a predictable set of core services. Since 2002, we've tracked firms called Transactional distributors. These firms limit sales support and brick and mortar and give part of the cost advantage to the customer as inducement to purchase. Our modeling of these entities finds they can go

to market for 10% or so less in price and deliver a higher operating profit, as a percent of sales, than full service distribution. They typically carry the Pareto inventory, operate a few brick and mortar locations, and use outside shipping. Their service promise excludes specialized services for the most part. For traditional distributors, brick and mortar and sales costs can total a common range of 9% to 12% of sales. What is difficult to find is the cost of complexity of the large, full-service, wholesale firm.

Exhibit III

Number of Accounts to Maximum Transaction Profits



Key: Series 1=Percent of Accounts, Series 3 =Total Transaction Profits On Average, 41% of Accounts are 137% of Transaction Profits. Benfield Consulting Records 2006 -2011.

However, our records of 11 separate activity profit audits in Exhibit III, using transaction-based activity costing and capacity estimates, finds that 41% of accounts account for 137% of activity profits. On average, these firms delivered 4% ROS before tax and 40% of accounts are negative for activity profit producers with another 19% being nominal activity profit producers. The upshot of the typical account portfolio for full-service distributors, is that the firm absolutely depends on 41% of accounts to drive profitability. The remainder either sap profit, where their returns approach break even, or are negative profit. The makeup of the account portfolio leaves the full-service model vulnerable, as low-cost models can target activity profitable customers and Pareto inventory with significant price reductions. A loss of enough of these accounts leaves the full-service firm in a financial bind as they are left with marginal or activity-negative accounts. Exacerbating the portfolio weaknesses of the full-service distributor is the design and culture of the sales force which will need to change for the wholesale firm to succeed in a more efficient and lower cost digital environment.

The Sales Force and Sales Culture Problem

Inside and outside sales forces are constants in full-service distribution. Despite predictions of a decrease in number, most wholesalers have kept full sales complements and deploy outside sellers geographically while basing a significant part of their compensation on margin dollars. B2B e-commerce research finds that the overwhelming majority of B2B firms (81%) agree that it is either very or somewhat important for the e-commerce business goal to reduce the cost of sales. And, 74% of respondents strongly agree or somewhat agree that cost savings in sales will be passed to customers.[6] Our work and research find that there is scant value conferred by assigning sales support to commodity purchases or for areas where the customer can self-serve with proper software. Additionally, where these resources are deployed, we find distributors often lose sales versus competitors with online presence but limited sales resources. Two recent research projects of industrial buyers using e-commerce and a distributor-focused research project found distributors losing ground to manufacturer-direct sales, to firms that were not traditional wholesalers, or "mature" distributor online efforts losing year-over-year online sales.[7] In both end-user projects, traditional manufacturers or non-traditional suppliers did not, as a rule, call on the end customer with outside sales forces.

Despite what we consider to be mounting research evidence, we find little in the way of traditional full-service distributors' propensity to trim back sales efforts. If anything, it appears that distributors are more committed to their sales efforts in face of e-commerce competition. In effect, they appear to be doubling down on sales assistance and influence, trying to sell their way out of a new way of doing business. We believe this strategy, ultimately and at an increasing rate, will fail. Why? The problem is the cost of the historic sales effort. In Exhibit IV, we have modeled a $500 transaction at common financial ratios of 23% gross margin, 20% of sales operating expenses, and 3% NPBT. We have also

	Costs of Sales Effort		Exhibit IV	
	Full Service vs. E-Commerce			
		Percent of Sales		
Transaction	$500			
Margin	$115	23%		
Operating Expenses (Full)	$100.00	20%		
Operating Expenses (Less Sales)	$60.00	12%		
NPBT Full Operating Expenses	$15.00	3%		
NPBT Less Sales Operating Expenses	$55.00	11%		
Leverage Factor of 40% Sales Cost	20%	40%	50%	60%
Net Savings off Original Order	$8	$16	$20	$24
New Order Cost	$492	$484	$480	$476
Discount	2%	3%	4%	5%

modeled the sales expense at 40% of operating expenses which is common in distribution. We then modeled the effect of moving accounts online at the rate of 20% of purchases, 40%, 50%, etc., reducing the sales force once this is done, and passing the savings on to the customer. At 40% leverage, the

customer savings is 3%, at 50% leverage the savings is 4%, and at 60% the savings is 5%. In short, if a customer purchases $1MM in commodities and can buy 60% of their demand online, the potential savings is $50,000. This calculation does not include the effect on reduced administration costs of the sales effort and lessened brick and mortar costs. Coupled with our experience in low-cost online transaction models with limited sales presence and greatly reduced brick and mortar locations, the ability to reduce the sales effort and pass savings on to the customer can be a powerful financial inducement to customers. Consequently, we do not believe that, financially, wholesalers will be able to field fully-funded, geographically-deployed sales efforts, as they have in the past.

There is little for wholesalers to pattern in the way of successful deployment of the sales effort other than the customary geographic territory with compensation driven by margin dollars. We have advocated movement to other allocation models that would significantly reduce the outside sales effort and, based on outside the industry firms, improve the sales relationship. These models include Enterprise sellers assigned to Pareto accounts, Consultative sellers of both product application and process improvement, New Account and New Technology sales efforts.[8] We will continue to research the distributor sales force, however, the predominance of customer research, financial modeling, and parallel industry experience supports the observation that distributors will need to find ways to offer sales assistance while greatly reducing its cost and passing some or all of the savings on to the customer.

The Technology Bundle and Managerial E-Commerce

Distributors have a varying array of technology solutions for e-commerce. Since the Great Recession, we have witnessed steady improvement in quality and quantity of online software specifically for B2B ecommerce. Today, Forrester and Gartner both review and issue rankings of B2B software in their "Wave" and "Magic Quadrant" reports, respectively. Based on our field work and research, leading wholesalers have a handful of software offerings, within each category, to create a competitive and satisfactory online experience. We've dubbed this the e-commerce bundle or e-commerce software platform and it includes:

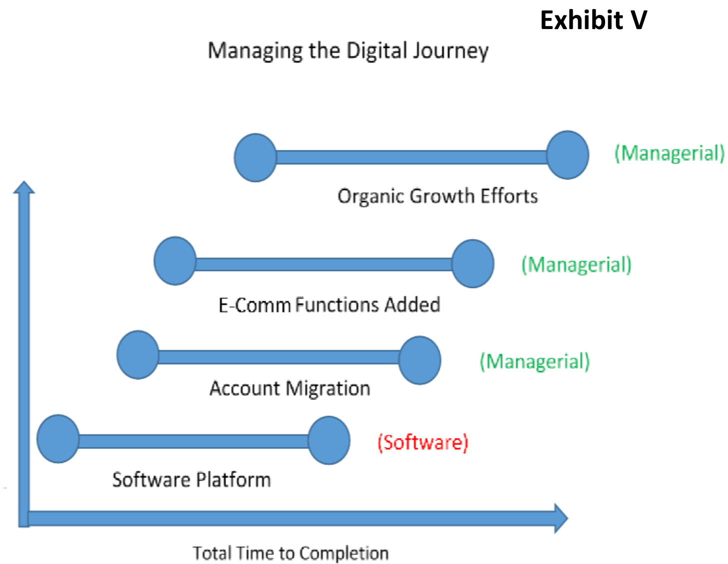
1. **PIM or product information management software**: Allows management of product content and quality content assurance throughout the supply chain from vendor to final customer
2. **Off the shelf transaction platform** (integrated into the ERP system): Gives the customer the ability to transact, specify delivery, check/change order, and manage account financials
3. **Faceted search**: Expands search beyond keywords, to vendors, application, industry jargon, etc.
4. **Punch-out suite**: Gives the customer the ability to order on distributor site and "punch-out" the order to their system
5. **Online quotation software**: Software that manages special pricing process and turns the quote into an order

Our 2016 sponsored research[9] on distributor e-commerce leaders and their practices found that distributors with the e-commerce bundle sold, on average, 3x more online than their competition. Additionally, for distributors that sold over 25% of total volume online, the vast majority had the full software bundle. Hence, we believe that the decision of what software is needed for a competitive

online experience has been largely answered. Distributors, especially smaller and mid-market firms, may need to invest in the software and vendors of their choice, but the type(s) of software appear to be well-established.

Many distributors, and indeed much of the B2B sector, is stuck in the software portion of the online life cycle. To some degree this is understandable, for without the proper software integrated into the ERP system, the future of e-commerce is limited. Accordingly, much of the advice on e-commerce, how to make it work, and who manages the online effort comes from software managers and executives. It is not unusual to find consultants who come from a career of software sales and management and IT executives who are responsible for the entirety of the firm's online efforts.

Exhibit V



We believe, however, that instruction, knowledge, and terminal decision-making capacity by those with a software background or predominance of IT experience will fade as online activity matures. Why? The challenge as depicted in Exhibit V is the need to make the software work across the entirety of the firm with managers and bodies of knowledge that were established well before e-commerce came into being. Granted, these bodies of knowledge and their managers may need to change, but it is the integration of digital commerce with existing managers and functions that needs research, exploration, and best-practice procedure. We call this challenge **Managerial E-Commerce**, which has recently gained attention as a needed body of knowledge for B2B firms, especially for those experiencing digital washouts. The Exhibit titled Managing the Digital Journey depicts four major stages of B2B E-Commerce.

They include:

1) Developing the software platform and integrating it into the ERP system
2) Migrating existing accounts online

3) Adding specialized functions and personnel to the online effort and creating a culture that recognizes online efforts as central to the firm's financial future
4) Growing organically through online efforts

Beyond Stage 1, building out the technology platform, are Stages 2 & 3, which differ significantly. In Stage 2, the objective is to move existing accounts online as quickly as possible. As B2B e-commerce grows at 7% per annum, firms that don't get their software suite up and working risk losing existing or potential sales to the competition. This will worsen as the online percentage of all transactions grows and Millennials move into dominance of management functions. We've seen successful online migrations without a full e-commerce suite, but we rarely witness online organic growth without the full ecommerce platform.

Stage 3, establishing an online culture is, for all intents and purposes, the most difficult. It means that employees now view online commerce as the leading engine for future growth. It also means the sales effort has been reconfigured to work in tandem with online efforts. Successful movement of the firm past Stage 2 takes the oversight and direction of the C-Suite; especially the CEO or president. Failure to understand this puts the firm at risk in the long-run. Today, e-commerce is the domain of marketing. However, unless marketing has experience in online commerce, they probably don't have the necessary skills to manage the entirety of the experience.

The acculturation of e-commerce as a new means of business, and completion of Stage 3, is difficult for some to understand. That is, the firm must succeed online and, most often, online sales will dominate as the predominance of B2B is commodity products. The firm will also need specialized positions including managers of digital analytics, product managers responsible for product content, vendor programs, application information, and an online marketing resource. Additionally, logistics and delivery windows will change and operations will work alongside marketing to complete a satisfactory post-sale service.

Stage 4 is concerned with organic growth from the online efforts. Stage 4 efforts include marketing automation, omni-channel opportunities, segment platforms, and value chain restructuring. Marketing automation is the online distribution of the marketing message to grow sales. Omni-channel opportunities involve the access to new channels from e-commerce including marketplaces. Segment platforms are thin-slices of existing segments and act like separate online businesses (Zoro Tool at www.zoro.com or Wilmar at www.wilmar.com are examples). Finally, value chain restructuring involves reworking the value chain for greater value for the customer. Examples include Sustainable Supply at www.sustainablesupply.com and Civic Solar at www.civicsolar.com.

The challenge for long-term success in e-commerce is moving beyond the software to the cultural and business model changes needed for online success. Currently, there is no playbook for this transition; by the time it is written, the distribution firm will likely lose significant sales. It will take executive effort that understands e-commerce technology, how to change the sales culture, rationalization of brick and mortar branches, where and how to develop market viable online strategies, and large-scale organization change management.

Financial Opportunities from Online Efforts

So far, we've gone through an extensive list of how the existing full-service distribution firm will struggle to compete in a digital channel and what it will need to do to change. If you've remained with us, we end with a review of significant opportunities in e-commerce. They are based on our review of what leading full service firms and new channel entrants are doing. For most wholesale firms, there is time left to learn from these efforts and create value streams that can be successful.

New Models for Distributor Growth

Wholesale channels have undergone organic online growth. This is primarily the function of new value propositions or new entities serving "thin-slice" segments. While the full-service model is the predominant online model, for reasons previously discussed, it has not proven to be effective in an online capacity as research has shown. Our research in B2B channels finds that there are four basic models, outside of full-service distribution, that show progress in online sales. In Exhibit VI, we list the models, examples, and probability of online success. First up are segmented models that are platforms off of traditional distributors. These are typically segmented efforts on the full-service firm's site. The segments, typically, have different products, pricing, and services listed specific to the segment. This allows buyers to identify their segment(s) and get a customized marketing mix. An example would be Webstarauntstore.com, which is a distributor of food-service supplies and has segments on their site's homepage banner.

Segment platforms are "thin-slice" segments that platform off of a traditional distribution firm. They use the IT and administrative prowess of the corporate parent while having a model that is, typically, reduced in sellers and brick and mortar. Platforms often go to market with a reduced price over their corporate parent. However, our investigation finds that they grow sales quickly and contribute significantly to the OP line. Examples of successful platforms are Zoro Tool (Div. of WWGrainger) and Wilmar (Interline Brands and Home Depot). The advantage of "thin-slicing" is that it is more granular than traditional segmentation and appeals to a well-defined audience. Additionally, they bypass messy cultural changes that full-service distribution has to go through to move online, including sales conflict, and reduction in brick and mortar locations. Platforms have a "customized feel" to the target audience and, strategically, can solicit large geographies without a lot of brick and mortar cost.

New online entities, often outside traditional distribution, are growing by rearranging the value chain. We call these Enhanced Channel Value sites. They have unique value propositions. Civic Solar is a California-based company that serves the solar industry. It includes job design as part of the basic platform and, once the order is approved, direct-ships the material to the customer. Civic Solar's assets on hand and brick and mortar cost are low, yet it has more focused sellers on the street than full-service wholesalers. Its model allows the company to undersell traditional competition.

	Distribution Channel		Exhibit VI		
	E-Commerce Models				
Model	**Definition**	**Pros**	**Cons**	**Probability of Success**	**Examples**
Full-Service Firm	Existing brick and mortar firm online	Easy to complete You don't have to think too hard	Unwieldy, not made for online, expensive, difficult to navigate	Low as online sales grow	Most of distribution entities with online sales
Segmented Models Full-Firm w/Segments	Segment overlay to full-firm offerings	Appeals to individual segments-easy to navigate and appeal is high	Takes extra effort in marketing, marketing mix, and upkeep	High as there few competitors	Webstaraunt Store.com
Segment Platforms Thin-Slice segments	Thin-slice segments that are stand-alone entities but often backed by a larger company	Transactional platform elements with reduced operating expenses and a great price plus immediate appeal to granular segment	Extra work in definition and upkeep including management of online marketing mix. Often stand-alone business with cultural differences.	Medium-Takes a lot of marketing expertise but ROS is exceptional as is growth prospects	Zoro Tool and Wilmar-Div of Interline Brands
Enhance Channel Value	Firms who use technology and value mapping to rearrange the value proposition and offer better value for the buck	Value appeal is strong, difficult to copy, ROS and top line growth is good, easy share gains against full-service competition	Extra work in marketing and often a new firm with new management and mission. Risky in early-life of entity.	Medium to High if well defined and structured with professional marketers	Civic Solar and Sustainable Supply
Slice of the Value Chain	Firms who offer a service or narrow defintion of a product market for a percentage or reduced fee. Marketplaces, asset management, and professional services sites are example	Unique business models that, once completed, can be "blown" across large market areas. Often a lengthy process to become self-sufficient.	Large investment in software	Medium to high once established	Kinnek at Kinnek.com, Warehouse Two, HomeAdvisor

Sustainable Supply has forged an expertise in parts for industries such as HVAC, Plumbing, and Industrial MRO. It has an advantage over traditional distributors with detailed parts break downs and cross references. Often, because of the small transaction size and inventory investment, wholesalers are not prone to supply parts in quantity. Additionally, Sustainable drop-ships many parts and, like Civic Solar, has low sales and brick and mortar costs.

Finally, there are firms that create value and take a "slice of the value chain." This includes sites such as Kinnek, which pairs buyer and seller but does not take title to the sale. Instead it receives a fee from the seller. Specialized sites such as Warehouse Two and Home Advisor add value in unique ways. Warehouse Two makes it easier for wholesalers to list and sell slow-moving inventory while Home Advisor connects home owners with contractors. Connecting buyer and seller, selling distressed inventory, and recommending contractors are all services that wholesalers have provided over the years. However, software has made the services more efficient and competitive, and the end user now has choices that are outside the dominance of a wholesale relationship.

The Digital Future for Wholesale Distribution

Wholesale distribution has been a part of the North American B2B channel for three generations. As the model has grown, so has the scope of served markets, products, and services. Today, wholesalers are consolidating and the firms perform a vast array of services for customers. However, the wholesale model is vulnerable; many customers are not profitable and unique services are given away to attract a

commodity sale. The sales force is paid on all product and service sales within a defined territory and usually at the margin dollar level. There is a disconnect, aided by incongruent goals of compensation and operating profit, between the seller and need for bottom-line performance. The upshot is that full-service distribution is expensive and often inefficient compared to online models with limited brick and mortar and sales support. These online competitors are also very efficient; they don't try to serve diverse markets with many different products and services. As such, they can go to market at a substantially lower price than full-service wholesale firms.

In addition to online competitors, manufacturers are taking sales direct and often bypassing the wholesale firm. This creates channel conflict and limits the volume rebates that are fundamental to distributor profitability. To survive, and thrive, full-service wholesalers will need to realize that e-commerce is more than a means of laundering a transaction. It is a fundamental change in the way the firm goes to market and it changes the cost structure of the business by reducing redundant brick and mortar and sales support. The move from traditional full-service distribution to organic growth online is complex and significant. Wholesale management will need to rationalize physical locations, develop new and more efficient sales roles, and create an online culture. Current research finds that the industry is losing the online battle. Like the department store, full-service distribution is struggling to find its online mojo. Time will tell if industry leaders adapt or suffer the fate of their retail counterparts.

*Benfield, Griffith, Martin and Yezbak are an association of B2B consultants aka **Digital Channel Advisors. (See site page at http://www.benfieldconsulting.com/digital-channel-advisors.html).** They were formed to guide distributors and manufacturers through the digital journey from software, account migration, and e-commerce culture to online organic growth. They have significant experience in the distribution and manufacturing sectors, including:*

Scott Benfield was a manager and executive in nationally-ranked wholesalers and Fortune 250 manufacturing firms prior to starting his consultancy in 2000. He has consulted and/or been an interim executive for a variety of Fortune-rated firms and distributors in North America and globally. He has been quoted in Forbes and The Financial Time. His website is www.benfieldconsulting.com*. Scott has an MBA from Wake Forest University. His profile is at: https://www.linkedin.com/in/scottbenfield/.*

Steve Griffith, PhD. is an Associate Professor at the Jack Welch Management Institute, and Univ. of Maryland, among others. Prior to his academic career, he served as V and C level executive for Fortune-rated and midmarket manufacturing firms in North America and globally. He has an MBA from South Dakota and MA/PhD from Indiana Wesleyan. His profile can be seen at: https://www.linkedin.com/in/stevegriffith/.

Skip Martin is former Director of Business Technology at Graybar Electric, where he developed the corporate digital strategy and built the digital platform and organization for $200MM in online sales. He has prior management positions in leading North American manufacturers. Skip has a BSEE from the Univ. of Wisconsin. His Profile can be seen at: https://www.linkedin.com/in/skipmartin/.

George Yezbak is a consultant for distribution firms. Yezbak Consulting (http://www.yezbakconsulting.com) was started in 2014 to serve mid-market distributors in North America. Prior to consulting, George worked in V and C levels in top-ranked distributors in material management and operations. George has an MA and MBA from Appalachian State University. His profile is at:
https://www.linkedin.com/in/george-yezbak-204b7211/

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