Vendor Monies Across the Supply Chain

Marketplace Advantage in North American Wholesale Distribution

Research by Industrial Supply Magazine, Channel Marketing Group and Benfield Consulting*

October 2018

Executive Summary

- 70% of respondents are V- and C-level executives; *page 2*
- Finance, Sales, and Marketing manage 77% of all vendor funds; *page 2*
- 40% of distributors believe vendor funds will grow; *page 3, Exhibit I*
- Volume rebates are used by 90% of distributors and SPAs are used by 77% of all distributors; *page 4, Exhibit II*
- Top or above average performers have 16% of COGS as funds, average performers have 7% of COGS as funds and below average performers have 2.4% of COGS as funds; *page 4, Exhibit III*
- Funds supplied by vendors, direct to distributors, outnumber funds supplied by buying groups, or proprietary negotiation by distributors; *Exhibit IV, page 5*
- SPAs are managed primarily by Sales Management (43%), followed by Purchasing (27%); *Exhibit V, page 6*
- Half of distributors agree that they "use and manage their funds carefully," while 21% say they have ". . .no strategy for their use"; *Exhibit VII, page 8*
- Distributors that use specialized funds management software have 5% more in funds as a percent of COGS than firms that use spreadsheets or mixed systems of ERP, Spreadsheets, Vendor Portals, etc.; *Exhibit VIII, page 9*
- Executives place a premium on rebates believing they are "sheltered income" that directly improves operating profit; *Exhibit IX, page 10*
- 57% of distributors don't maximize funds, leaving a significant amount of money on the table; *page 10*
- 74% of distributors Somewhat Agree/Agree SPAs will grow and 77% Somewhat Agree/Agree an increase in funds will come from direct negotiation with the vendor; *Agree Statements, page 11*
- Industry type has no bearing on the usage of funds; *Cross-Tabulations page 12*
- Philosophy of funds usage (i.e. wholesalers that testify to carefully tracking and managing funds) versus those that admit to having no strategy for their usage, show no difference in fund maximization; *Cross-Tabulations, page 12*

Vendor Monies Across the Supply Chain

Vendor, or manufacturer, monies that support distributor growth is a decades-old subject. Vendors have long supported distribution, a thin-profit business, with funds that include volume rebates, marketing development funds, and co-op (dollar for dollar) funds. In the last decade or so, Special Pricing Allowances, or SPAs, have appeared that are widely used across industry verticals.

Our interest in the subject of vendor monies arose because there has been little, if any, critical research and review of funds in wholesale distribution. There is limited critical, comparative measure of these funds across distributors and little review of best practice. Much of fund performance, best practice, and effective usage is limited to casual conversations about them at distributor management venues. Metaphorically, these funds are like coffee at breakfast, expected to be there, expected to be palatable, and with a handful of options for their consumption.

The Research Project

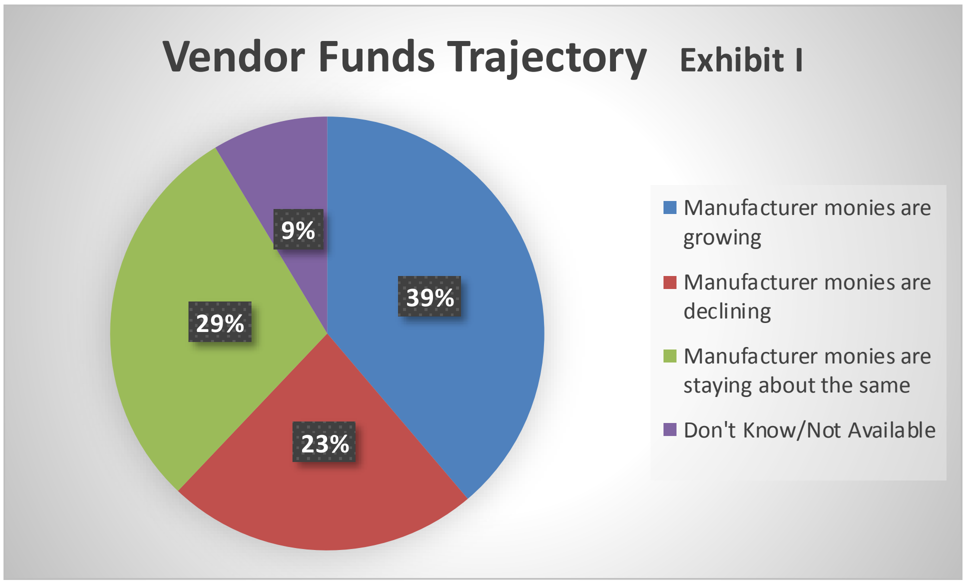
Our research project was conceived in the summer of 2018. We assembled a group of industry service providers covering a wide-range of vertical markets across the B2B Wholesale-Distribution space. (Note: We use wholesaler and distributor as synonyms in the research). These firms have served distribution markets in capacities of media services, strategy review, and consulting for more than 50 combined years. Our approach was market research on the usage, tracking, administration, financial success, and future projections on these funds. We also had designs on understanding the generation, maximization, effectiveness (ROI), and efficiency of these funds. Overall, we had responses from 15 broad sectors, totaling 120 respondents. The vertical markets represent some $500B in sales of the approximately $3T North American B2B distribution sector. Additional respondent demographics include:

- Firms ranging in size from under $50M to over $1B in sales
- 70% of responses were from C- and V-level executives
- 90% of funds are managed by four functions respectively (Finance 30%, Sales 25%, Marketing 22% and Operations 13%)

When asked about current trends of vendor monies, respondents gave us the information shown in Exhibit I. The question regards the trajectory of vendor monies as growing, in decline, or in stasis. The research finds that 39% of respondents believe the monies are growing, 30% in stasis, and 23% believe they are in decline.

Regardless of one's personal experience with vendor funds, it's significant that four out of 10 respondents believe that funds are growing. Why? Distribution is a slow-growth, mature sector of the economy. It grows, more often than not, with inflation at a pace of approximately 2.5%

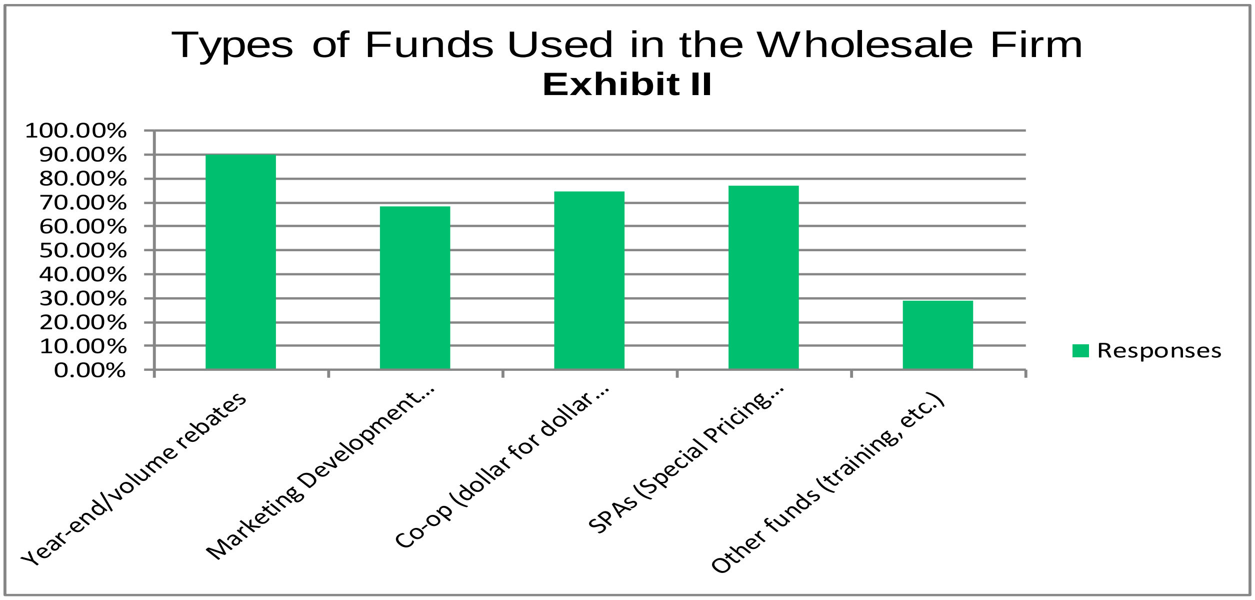
per year. It makes little sense for manufacturers to grow these funds in the current environment. However, the advent of B2B e-commerce, which is growing at 8% per year, has made an impact. As we explore further in the research, the ability of the distributor's customer to research price, availability and application is unparalleled. This drives vendors to increase partner funds to secure the sale.



The research divides funds into four common types:

1) **Vendor Rebates** - Called volume rebates or year-end rebates, these are given by a vendor during a fiscal time period as a percent of purchases. Often, they are offered as a goal over prior year or "sweetened" for growth.
2) **Co-op Funds** - These are dollar-for-dollar funds used by distributors for a vendor-specific marketing or sales event. Often, new product introductions, or selling an existing product to a new segment, are "co-oped" events. The idea of a co-op is that the vendor matches a dollar for every approved dollar the distributor spends on a specific event.
3) **Marketing Development Funds (MDF)** - These are funds designated for a specific marketing event. They can be an annual amount or rewarded as a percent of sales volume.
4) **SPAs or Special Pricing Allowances** - These are discount(s) on products for sales in competitive events. They are often issued as approved products are sold and as a percent of purchase price.

Fund types are identified as Back Door (Rebates), rewarded on purchases, and Front Door (Co-op, MDF, SPA), that support an identified sales or marketing event.



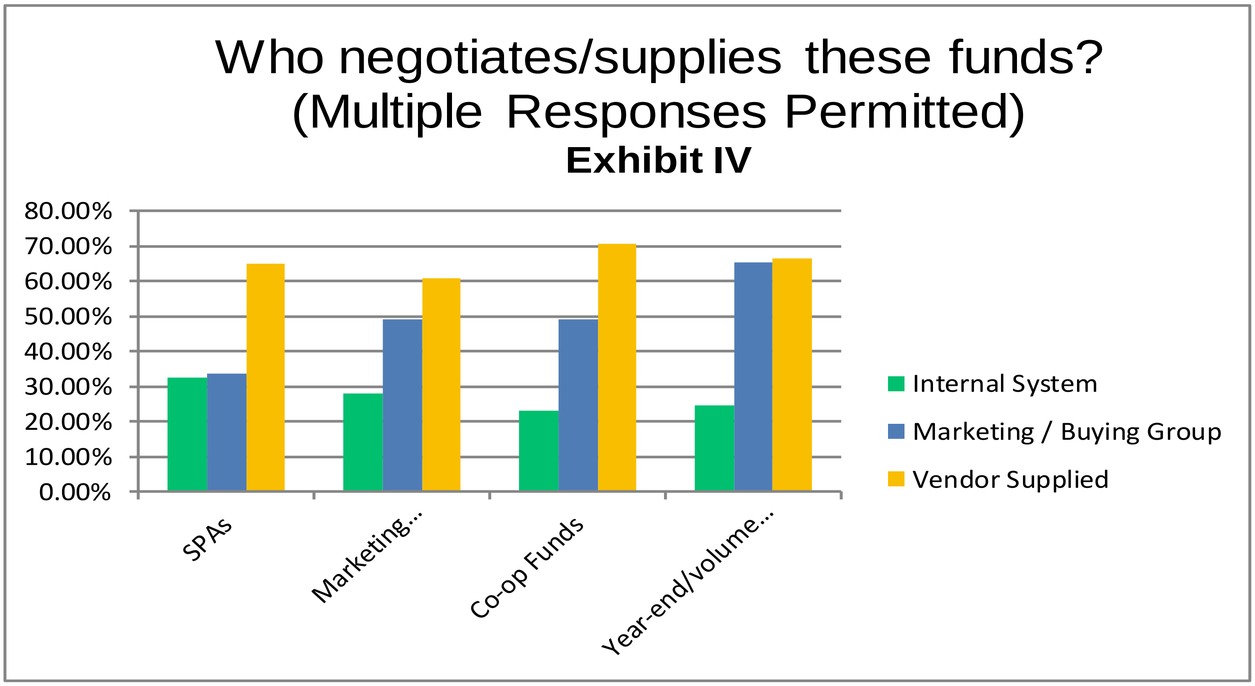
As shown in Exhibit II, Volume Rebates are used by 90% of all firms, followed by SPAs, used by 77% of firms, and co-op and MDF funds, which are used by 75% and 68% of firms, respectively. Additional funds for training, promotional events, trip programs, etc., are used by 30% of firms. Because of their widespread use, the total monies are substantial in volume, measured as a percent of annual cost of goods. The choice of cost of goods as a denominator was deliberate, because most funds are awarded on purchase dollar amount and not on distributor sales. This makes financial sense for the vendor since manufacturers don't base fund calculation inclusive of distributor gross margin.

Exhibit III[i]

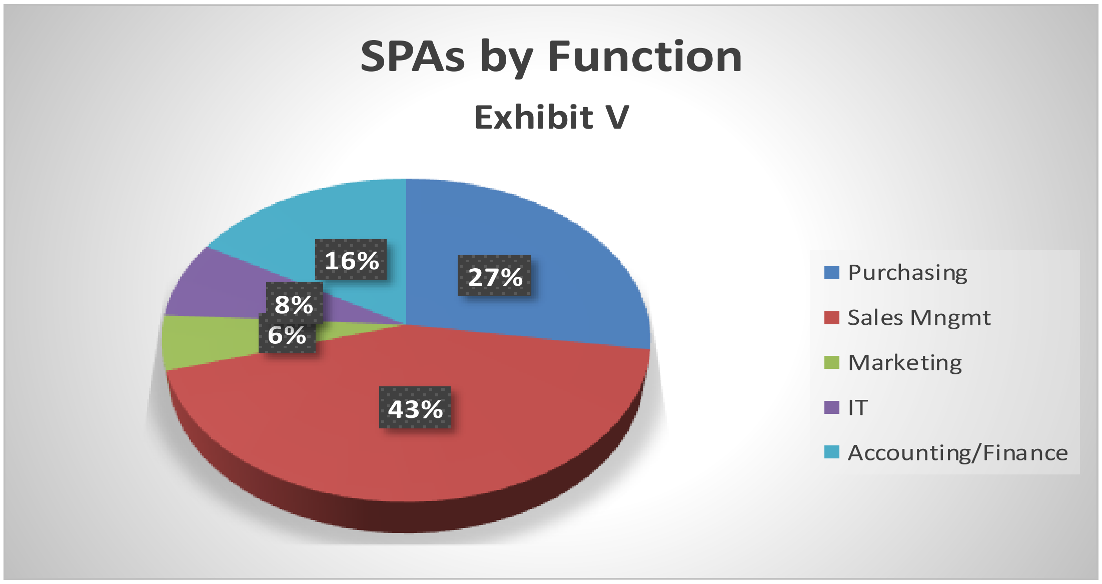
North American Funds Estimate*			
Durable Goods Distributors			
Fund Type	**Top Performers**	**Average Performers**	**Below Average Performers**
Year End Rebates	3.50%	2.70%	0.88%
Co-op Funds	2.70%	0.95%	0.43%
Market Development Funds (MDF)	1.90%	1.10%	0.50%
Special Pricing Allowances (SPAs)	6.70%	2.10%	0.60%
Other Funds	1.50%	0.26%	0%
Total Funds by Category	16.30%	7.11%	2.41%
Category Percent of Sample	18%	66%	16%
*Funds as percent of annual Cost of Goods Sold (COGS)			

Exhibit III lists the fund as a percent of cost of goods sold by fund type and divided into performance categories of top, average and below average performers. The last row of the Exhibit shows the categories as a percent of the respondent sample. Below average performers represented 16% of the responses, average performers totaled 66% of the responses, and top performers accounted for 18% of responses, meaning that they fit a bell-curve configuration. There is significant difference in top, average and below average performers, with top performance at 16.3% of funds as COGS, while average is at 7.11% and below average at 2.41%.

This means that, for each $1M in purchases, the top performer would earn approximately $160,000 in vendor monies compared to $70,000 and $25,000 for average and below average performers, respectively. The difference in fund amounts by category is significant in a business where return on sales (ROS) is in the 3% to 6% range. The difference between the top and average performers, using a 25% margin on sales, is 6.9%, more than most distributors earn in ROS. Finally, the chart shows that the largest difference among fund types by category is SPAs, where top performers earn 4% to 6% more than average and below average performers. SPAs are the newest of fund types but also offer a significant advantage in sales growth and profitability. There are notable differences in wholesalers that maximize funds, especially SPAs, which we cover later in the report.



Funds generation is an important subject. Many funds are generated by distributors, vendors, or co-operatives. We reviewed fund generation in the research by fund type, to help distributors understand how to secure them for usage. Exhibit IV lists the fund type along with its source including internal system, marketing/buying group, and vendor-supplied. The designation vendor-supplied is defined as supplied by the vendor to all distributors alike. The differences in fund generation are telling. For instance, 32% of SPAs are generated internally, while 22% of co-op funds, and 25% of volume rebates, are generated internally. Also, volume rebates are largely generated by marketing/buying groups or supplied by the vendor on a direct basis. Co-op funds are the largest fund type supplied by vendors on a direct basis, followed closely by volume rebates, and SPAs. It is important to note that funds generation is not funds maximization. Just because money is available does not predict its usage. In the next section, we discover that funds maximization has much to do with technology.



Different functional areas are charged with managing different funds. Exhibits V and VI depict fund types by the functional area that manages the fund. In Exhibit 5, sales management manages SPAs funds 43% of the time, followed by purchasing at 27%, and accounting/finance at 16%. The area of sales allowances is contentious, as there is an increasing number of distributor sales that use specialized pricing to secure the order. The accounting, tracking, remittance, attribution, and management of these monies is big business and shows signs of significant growth as e-commerce grows.

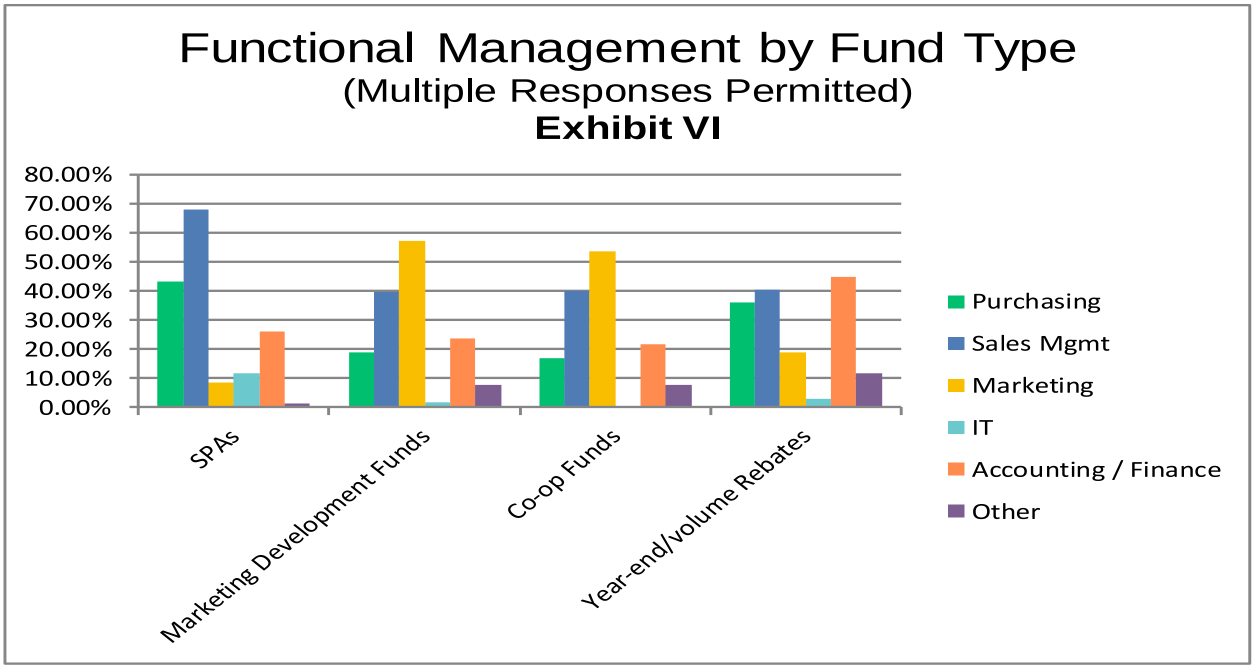


Exhibit VI displays all fund types and the percentages managed by function. Following SPAs, marketing manages marketing development and co-op funds, while volume rebates are managed by accounting/finance, closely followed by sales and purchasing. The concept of fund categories for different purposes is supported here. Why? The fact that different fund types are managed by different functions illustrates the difference in objectives which has implications for wholesalers and manufacturers. For distributors, fund usage, to be effective, should be targeted toward specific functions whether new products, new customers, or existing products to new customers. For manufacturers, it is pivotal for channel managers to be in touch with heads of specific functional areas to maximize funds and increase their ROI.

Funds Strategy

Having a strategic direction for fund usage may seem unnecessary, however, there are wholesalers that profess to managing funds and improving their effectiveness and efficiency. We review these elements in the upcoming sections.

Exhibit VII reviews the overall philosophy of fund management. Most wholesalers (50%) believe they measure and manage funds carefully, while another 16% say they need better tools and processes to drive their usage. The second highest response was 21% who admit to using funds as needed but having "no overall strategy for their usage." Finally, a scant 5% admit to approaching vendors for increased funds.

Overall Funds Philosophy	Exhibit VII
We measure and manage these funds carefully	50.00%
We use these funds as we need and there is opportunity but have no overall strategy for their usage	21.05%
We are developing management process and tools to better use these funds	15.79%
We believe these funds are best kept as support for the firm's costs in serving customers and are to be released in the marketplace sparingly	7.89%
We use these funds in total and push vendors for more	5.26%
	100.0%

Fund usage is in its infancy from a managerial and strategy perspective albeit funds have been around for a long time. The reason for our observation is twofold; 1) There is no objective measurement(s) on fund usage, maximization, etc., within and across distribution vertical sectors, and 2) There is a large gap between top and average performers; the gap being enough to confer competitive advantage in sales and market share.

Simply put, many distributors don't know what they don't know about funds. The concentration on vendor funds is prescient largely because of e-commerce. The ability to find instant price, availability and product substitutes, with an increased variation in distributor/vendor source(s), is driving a need for an **Assisted Sale.** We define an **Assisted Sale** as a vendor-supported effort to help the distributor win the sale. We believe funds management, strategy, technology and designation, with best-practices documentation, is a "must-have" discipline.

The processing and administration of funds is often overlooked. However, the ability to accurately, quickly and easily track, remit and attribute funds is key to their maximization. While 63% of respondents admit to having vendor agreements on file, only 43% admitted to "accurately accruing for funds. . .from our records." Looking at these responses another way, 40% of wholesalers have no agreements on file, and of the 60% that do, there is a 20% gap (63%-43%) in using said records for accurate accruing. Combining the 20% gap with 40% of monies that have no records on file, results in a whopping 60% of all vendor funds without an audit trail. Combining this with the fact that 50% of vendors "Measure and manage funds carefully" (Exhibit VII), we are comfortable in saying that somewhere between 50% to 60% of all funds have insufficient information and systems for accurate reimbursement of promised monies.

		Exhibit VIII	
Funds by Type of Tracking/Remittance			
			Category Percent of
Tracking System	**Vendor Rebates**	**SPAs**	**Responses**
Primarily Spreadsheets	3%	4%	40%
Mixed: Spreadsheets, Software,	3%	4%	40%
Vendor Portal, ERP			
Specialized Tracking Software	5%	7%	20%

Funds are tracked and processed in a variety of ways, including spreadsheets, a mix of spreadsheets, ERP and manual methods, and with specialized fund-tracking software. We reviewed the different tracking methods and cross-tabulated them with the amount of funds used by individual respondents. The results are shown in Exhibit VIII, which reviews the fund categories of vendor rebates and SPAs by the type of tracking system. What we found was surprising, in that specialized tracking software gave its users 2% (5%-3%) more in vendor rebates as a percent of COGS and 3% more in SPAs (7%-4%). The overall advantage in funds used, conferred by funds-tracking software, is on the order of 5% for SPAs and vendor rebates or a 60% increase in average funds used. Why software specific to vendor rebates is demonstrably better than other tracking/remittance methods is open to further research. However, our experience with advantages of operations-specific software in high-volume transaction environments is threefold, including:

1) It centralizes operations of a transaction, thereby giving a common process, improving quality, speeding up throughput and reducing processing time
2) It improves visibility of transactions and gives other members of the firm opportunity to maximize usage of funds
3) It documents events from beginning through completion and gives data for managerial analysis and further funds usage improvement in efficiency and effectiveness

Only 20% of distributors have vendor funds tracking software as seen in Exhibit VIII in the far right column, while 80% of distributors use spreadsheets or a mix of spreadsheets, ERP and manual methods to track funds.

We asked respondents about claims maximization, which includes using both existing monies and increasing the monies available. The question used an “agree to statement accuracy” format and the results are shown in Exhibit IX. From the Exhibit, we find that the highest agreement in maximization is in concentrating on the type of fund. Year-end rebates are seen as impacting operating profit directly and often referred to as “sheltered income.” The idea is that rebate dollars are not part of the sales or go-to market process and are part of the purchasing decision, ergo, we regard them as back-door funds. To maximize fund contribution to profit, distributors should concentrate on improving rebate income.

	Exhibit IX
Claims Maximization (Multiple Responses Permitted)	Statement Accuracy
Year end rebates are seen as 'sheltered income' that falls to the operating profit line	61.19%
We maximize vendor monies, in all forms, every year and leave little unused	43.28%
Our sellers aren't familiar with all the SPAs available	28.36%
Our purchasers aren't familiar with all the SPAs available	25.37%
We could secure more funds if we had a centralized, automated process to log, track, and claim-back funds	20.90%
Our sellers aren't encouraged to ask vendors for sales assistance	10.45%
Sales assistance from vendors is controlled outside the selling process	8.96%

Nearly 30% of respondents agreed with the statement that sellers aren't familiar with all the SPAs available, and 25% agreed that purchasers were not familiar with their availability. The problem is that SPAs are voluminous and often enacted by a specific seller. If these allowances are not held within a common ERP repository for access, they cannot be reviewed by other members of the firm. Hence the 30% or so of SPAs captured on spreadsheets are not visible, and often are not available for other members of the firm.

Finally, 43% of respondents agreed with the accuracy of the statement "We maximize vendor monies, in all forms, every year and leave little unused." The flip-side of the statement is that 57% of distributors don't maximize funds and leave a significant amount on the table. This means lost sales, lost operating profit, and less than optimal relationships with vendors.

Claim-back Accuracy, Ease, Timeliness (Exhibit X)	Statement Accuracy
Claims are honored by the vendor as they have a copy of the program and can recall it for reference	55.38%
We have claim credits on file in a central location and submitting claims to the vendor is quick, easy, and accurate	36.92%
Vendor claim-backs are different and credits are time intensive requiring key-stroking into a vendor portal	32.31%
Claims are slow to be honored by the vendor as their systems and records are different and cause disputes over claim amounts	16.92%

We also reviewed claim-back accuracy, as many monies are either denied or delayed by the vendor. Exhibit X shows agreement responses to statements regarding claim-back accuracy, ease and timeliness. From the Exhibit, we find that the highest accuracy is for the statement "Claims are honored by the vendor as they have a copy of the program and can recall it for reference." A problem arises when, if the vendor has no history of the agreement and cannot recall it, a distributor enacting the program and submitting for reimbursement will have the claim denied. We also found that a third of claims (32%) have to be manually keystroked into a vendor-based system portal. This is not only time-consuming, but varies by vendor, which requires familiarity with numerous vendor procedures. While not covered in this research, we advocate for shared software between vendor and distributor for funds management. As more front-door funds are in use, the need for shared POS data is prescient. Today, our records show only 10% to 15% of vendors require and use POS data from their wholesaler partners.

Agree Statements

We finished the survey with a variety of Disagree/Agree statements. Our research has shown that statements with the highest Somewhat Agree/Agree percentage of respondents are the most likely to transpire. The highest percentage of Somewhat Agree/Agree statements follow:

- SPAs are effective only if financial attribution tracking and feedback is timely. 80% Somewhat Agree/Agree
- The ease of tracking programs in real time increases their success. 91% Somewhat Agree/Agree
- The ability to attribute program progress in branch, seller, and account detail increases their success. 89% Somewhat Agree/Agree
- Our SPAs are growing and we expect more vendors to offer them in the future. 74% Somewhat Agree/Agree
- We are increasing proprietary negotiation of rebate programs outside our co-operative. 67% Somewhat Agree/Agree
- We consider volume rebate income as “sheltered income” and do not release it for better pricing. 70% Somewhat Agree/Agree
- We will spend more time analyzing vendor programs and funds as they will increase. 91% Somewhat Agree/Agree
- We can increase the usage of vendor programs by making them easier to administer and track. 91% Somewhat Agree/Agree
- We are increasing our direct negotiation of programs with vendors of interest. 77% Somewhat Agree/Agree

Cross-tabulations

Cross-tabulations are comparisons of one question and its responses versus another for insight. An example is “Does firm size impact the maximization and usage of vendor monies?” To answer this, we compare firm demographics on revenue size to the amount of funds used as a percent of COGS. The output suggests that differences in size on usage and maximization of funds starts at a revenue size of $500M and above where monies used are 1.5X to 2X, on average, more than smaller-sized firms. The reasons for this are diverse, including the observation that larger firms have more financial and managerial resources to capture and use vendor monies.

- Type of industry has little influence on the total amount of funds used by distributors. Electrical has no more funds used than Industrial and Plumbing as a percent of COGS. There are slightly more funds used in the Jan/San sector than others, but the difference is small. The type of fund shows little usage differential also. SPAs are as widely used in Electrical as they are Industrial, MRO or PHCP.

- Funds "philosophy" has little bearing on the usage of funds. For instance, executives who agree they "measure and manage funds carefully," show no greater usage of funds than those who agree with the statement "We use these funds as we need and there is opportunity, but (we) have no overall strategy for their usage." The natural inclination favors those who "measure and manage funds carefully" to have a higher usage score. However, the reality is that the tools used to manage funds, namely spreadsheets or a mix of spreadsheets, ERP system and manual methods are poor. Only when firms use specialized software for fund maximization, is there any improvement in their usage. Hence, firms that testify to their expertise and performance in fund usage using manual, spreadsheet, or mixed systems for tracking and remittance only think they do a better job than their competitors.

- Distributors that keep claims in a centralized location for processing and remittance seem to have a higher funds usage. Software for claims processing improves this but distributors with an appointed funds management function and process, even if spreadsheet-based, appear to do better than firms with no centralized funds management function.

- Industry sectors that use SPAs show no difference in sales growth from their usage. For instance, Industrial distributor usage of SPAs shows no more sales growth from their usage than MRO, Jan/San, Electrical, etc. Part of this equalization is that distributors have, in the last decade, consolidated across industry verticals, hence, SPA expertise appears to be "level" across different verticals.

- Attribution of funds to a branch, seller, or account has a lesser effect on fund maximization and usage than the "ease of tracking fund(s) progress in real time."

- Point-of-sale (POS) systems have a slightly higher effect on fund usage and maximization in the Industrial vertical over other distributor verticals. The reasons for this are not fully known.

- The marketing function shows a higher usage and maximization of total vendor funds over sales, operations, and finance/accounting. The reasons for this are not fully known.

Summary

Vendor funds are a significant part of a distributor's ongoing financial and sales success. For all intents and purposes, there has been little empirical study of these funds in their entirety; this research is a start in that direction. The research shows that there is substantial variation in funds usage/maximization between distributor firms and, regardless of the industry vertical

(HVAC vs. Industrial, etc.), distributors that enjoy higher fund performance use software dedicated to tracking, remittance, attribution, etc., and their performance is much higher than those that use spreadsheets or a combination of spreadsheets, ERP software, manual efforts.

There is enough of a gap between top, average and below average fund performance categories to confer competitive advantage in both sales growth and ROS. Fund ROI, or direct financial gain from expenditures, has not been fully measured in this research, nor has the working relationship between vendor and distributor on effectiveness of fund expenditures. At maximum fund usage, there are an estimated $300 billion in funds available in the durable goods distribution sector and a similar amount in the non-durable goods distribution sector. Funds are expected to grow in usage with front-door funds of SPAs, Co-op and Marketing Development Funds (MDF) growing over vendor rebates. This represents the "battle" for the sale, due to e-commerce, and is visible and contested by all parties in the channel. Vendor rebates, however, remain popular as they are viewed as improving operating profit more than other fund types. Additionally, negotiation of funds on a proprietary basis is growing over funds offered generically by vendors or through a buying group relationship. Distributors are encouraged to review our research and develop fund management and usage best practices within their industries, associations, buying groups, and inter/intra company relationships.

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[i] Exhibit used with permission from Enable International's "Seeking Competitive Advantage in Funds Usage" September 2018.

*Industrial Supply Magazine is a publication of Direct Business Media; Partner and Editor Rich Vurva, IndustrialSupplyMagazine.com

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