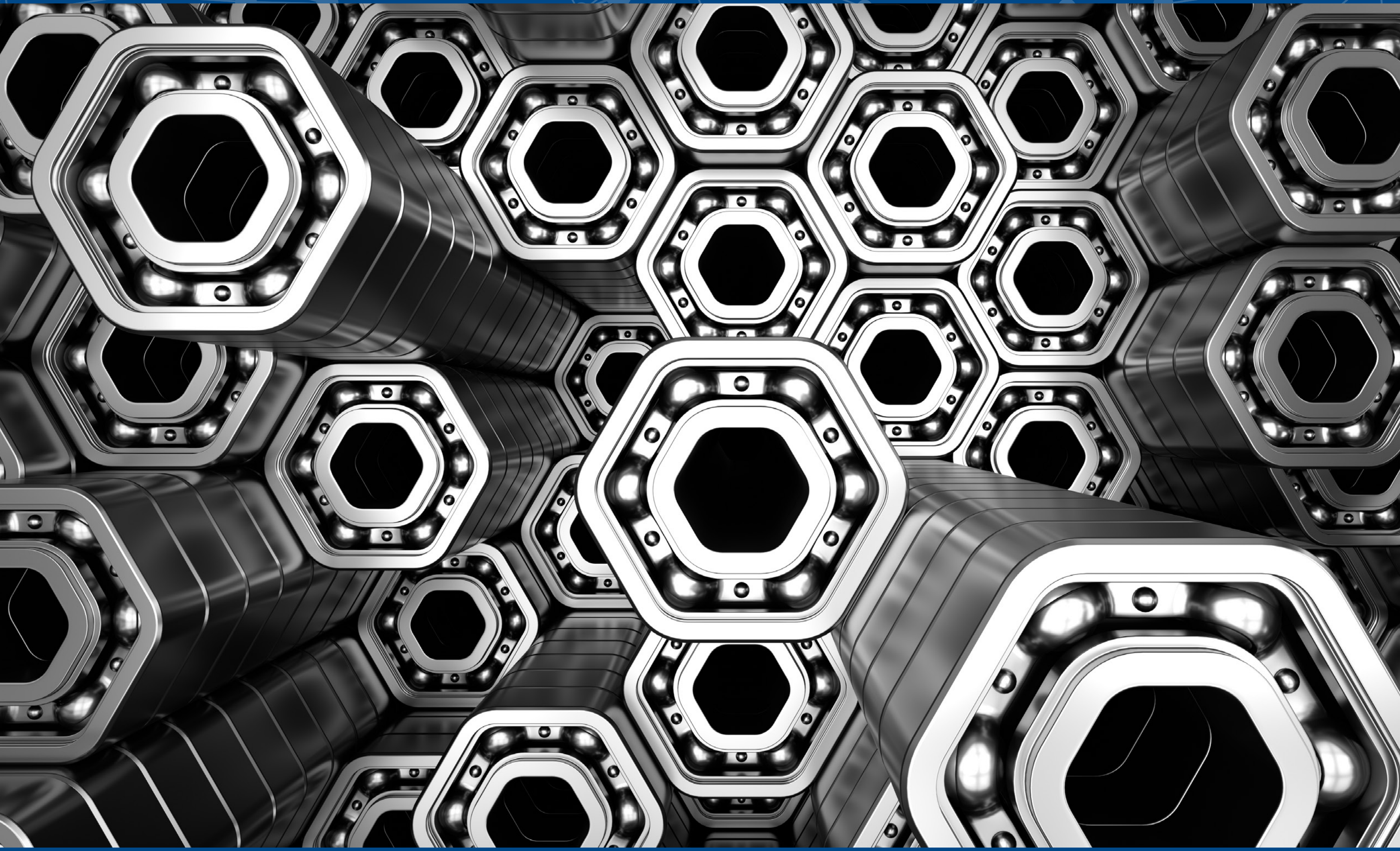
THE DISTRIBUTION EXPERTS™
Fortna Thought Leadership Series

Industrial Distributors: How to Gain Competitive Advantage from Market Disruptions



Visit fortna.com

While there are some positive indicators of growth in the industrial sector and many industrial distributors are seeing good results, a number of challenges continue to have impacts that could affect competitiveness for years to come. The changing digital landscape, coupled with outdated distribution networks, inventory forecasting accuracy problems, increased merger and acquisition activity and labor challenges are just a few of the issues industrial distributors grapple with daily. Add to that the recent impacts from a pandemic, the cause and effect of which will soon be a business case study on the concerns of single sourcing and the complexity of supply chains. Business continuity and redundancy on a global scale will likely be a key focus for the foreseeable future to establish with confidence that the organization is positioned to survive no matter what the future brings. Whether these challenges can be translated to opportunity for stronger long-term growth depends largely on how you choose to respond. In this article, we'll discuss the five trends that are currently impacting industrial distributors' success and how to overcome these challenges.

TREND 1: CHANGES IN THE LABOR LANDSCAPE

The safety and health of workers has always been a priority, but it has taken on new meaning for employers considering recent events. PPE equipment (masks/gloves), sanitation stations, adequate distancing and break areas reconfigured to ensure employees are provided with the appropriate equipment and environment to perform their jobs while properly protecting themselves. All of which will increase operating costs. At the same time minimum wage and healthcare costs are adding to labor costs.

> **"The labor availability and absenteeism issues that topped supply chain leaders' list of concerns pre-COVID have become one of labor risk mitigation."**

The coronavirus pandemic forced the fastest reallocation of labor since the early 1940's. Virtually overnight, employment went from less than 4% in the U.S. to nearly 15% in some areas. Similar dynamics in the U.K. and Europe have dramatically accelerated structural adjustments and disruptions that were already underway.

Despite an increase in labor availability for a time immediately following the crisis, the disruption from COVID-19 revealed stress points in many distribution operations and serves as a driver for increased automation. The increased cost of labor in terms of turnover, training, wages and health care costs and the increased risk of relying on labor in the case of similar or related future health crises makes throwing labor at the problem an unsustainable option for the long term. Add to that the problems of increased congestion, reduced productivity and physical distancing requirements to keep workers healthy and you have a recipe for adding cost without benefit.

The labor availability and absenteeism issues that topped supply chain leaders' list of concerns pre-COVID have become one of labor risk mitigation. This has accelerated the need for and improved business case justification of automated solutions that enable increased throughput, capacity and productivity AND safer environments for workers.

TREND 2: ACCELERATED SHIFT TO ECOMMERCE

The need for physical distancing has highlighted the importance of scaling up and strengthening digital capabilities. We are seeing an accelerated shift to eCommerce. This is driving not only a change in order profiles and channel mix, but also a shift in customer expectations around speed and convenience.

Omnichannel capabilities will define distribution operations as customer behaviors evolve and drive more volume in eCommerce and direct-to-consumer (DTC) channels. Operations must now transform to handle a growing number of channels and fulfillment nodes – branch, catalogs, online, mobile apps, etc. and accelerate service as a key differentiator. As eCommerce continues to expand, smaller, more frequent orders shift from pallet and case to custom-packs and each picks.

With increasing acceptance of remote work there comes a growing trend toward online ordering. Fulfillment and distribution must be geared to support that. And remember that the digital channel represents more than sales – it's influence. The digital channel influences offline sales, as customers seek information and inventory online and complete transactions in more traditional ways. However, it all must be consistent, seamless, and frictionless. You must adjust to the new reality that you are now selling around the clock every day of the year through your online presence. The information customers see online should match what the branch or customer service representative can deliver in

" With increasing acceptance of remote work there comes a growing trend toward online ordering. Fulfillment and distribution must be geared to support that."

terms of inventory, price, and service levels. Failure can cause loss of trust and erode confidence in the brand.

With increased competition from Amazon in the U.S. and Europe, customers' expectations around speed will continue to increase and create a different set of order profiles as B2C experiences drive B2B buyer expectations. Shorter order-to-delivery cycles, such as next-day or same-day delivery, are no longer nice to have – they have become baseline customer expectations. Customers now desire a one-stop shopping experience that requires a broader array of products and value-added services. Alas, B2B order processing is more complex than B2C, requiring purchase orders, negotiated discounts and more.

To meet these demands, you need robust back-end systems integrated with sophisticated front-end systems. These projects take a long time to implement and require a roadmap to ensure alignment along the way. Those who are not taking first steps now will be left behind. Commitment to a long-term strategy, while making short-term changes, takes vision and resolve.

TREND 3: INVENTORY VISIBILITY AND OPTIMIZATION

Visibility to inventory has been a major challenge for supply chain leaders, but with the increase in eCommerce orders it's more crucial than ever. Better (and more profitable) decision-making hinges on the need for real-time inventory data. The real-time data needed is not limited to inventory located in the warehouse, but also inventory levels in stores and en route -- on trucks, ships and at the manufacturing site.

"Initially, increased safety stock will be needed to mitigate the risk of disruption to single source or geo-concentrated suppliers. Longer term, a review of sourcing and inventory strategy will be critical for increasing confidence that organization is positioned to survive another major value chain disruption."

Industrial distributors have joined the ranks of essential businesses, and future success as such depends on the ability to adjust product lines and strategies to expand and procure beyond their core SKUs. The challenges brough forth by COVID-19 present a great opportunity for a holistic evaluation of an organization's inventory position and visibility. Otherwise, too much inventory will increase capital expense and poison profits, and too little inventory will starve revenue and cost you customers.

In addition, the need to add new products to attract and keep customers or increase sales can be a struggle. SKU lifecycles are being compressed by changes in product form or functionality resulting from advances in technology.

Companies unwilling or unable to eliminate excessive inventory will find themselves with ever-higher SKU counts. More SKUs add complexity and costs to distribution operations.

To improve inventory performance, consider inventory segmentation and the reduction of non-critical inventory. The key is to accurately plan and forecast inventory requirements and then remain disciplined using statistical inventory methods, such as economic order quantities, replenishment set points and statistical inventory targets. In addition, all obsolete, damaged, and slow-moving inventory should be centralized or removed from the warehouse to create room for active inventory. Don't forget to rationalize the SKU base, reducing any non-productive inventory or old product.

TREND 4: NETWORK AND VALUE CHAIN OPTIMIZATION

The distribution network also needs to be reviewed for opportunities to determine the right number, size and location(s) of the network. The use of branch, regional or forward nodes can also serve as mixing centers, where products from several banners or third-party suppliers are combined into a single, unified order, fulfilled closer to the customer for improved service levels and/or reduced transportation costs. Systems that allow you to co-mingle inventory play a critical role.

Network optimization becomes a strategic imperative as merger, acquisition and consolidation activities continue to accelerate and distributed order management enables improvements in inventory utilization. Mergers and acquisitions often give rise to duplication of resources, which leads to redundant inventory in multiple locations. An inventory strategy that balances service and cost should support business growth, meet varying needs by geography, provide a localized feel and leverage spend.

Initially, increased safety stock will be needed to mitigate the risk of disruption to single source or geo-concentrated suppliers. Longer term, a review of sourcing and inventory strategy will be critical for increasing confidence that the organization is positioned to survive another major value chain disruption. Supplier diversification, near-shoring, secondary sourcing, and financial health checks for all key suppliers may be in order.

TREND 5: INCREASED COMPETITION FROM AMAZON

Amazon Business' CAGR is 115% over the last three years. This rate of growth exceeds that of its retail and web services businesses. With more than 18 million products listed and 174,000 sellers, the MRO category is the number one vertical for Amazon Business and represents just the tip of the iceberg as Amazon continues its creep across a broader product base. The behemoth continues to drive change in buyers' behaviors and expectations. Customers have grown accustomed to seeing inventory availability and promise-to-deliver dates on screen, in addition to frictionless, one-click ordering and easy payment options. And with technology as a core competence, Amazon could make it very easy to integrate with existing procurement solutions. You must look at your online platform through the lens of the customer and develop a B2C mindset to address these new service expectations.

Amazon's culture is one where innovation is rewarded. They're constantly challenging traditional distribution methods. They take chances to learn from and improve upon each iteration. They do this in service to delighting customers in new ways, which in turn, builds loyalty. For example, Amazon saw the flailing U.S. Postal Service as an opportunity to do something that most people never thought of – enable Sunday delivery. And when parcel carriers ran out of capacity during peak holiday shipping season a couple years back, Amazon decided it was time to take matters into its own hands and launched a plan to create more capacity with its own line of delivery vans, tractor-trailer trucks and cargo planes.

You can differentiate yourself from Amazon and other competitors by adding more services to your offerings. Services that help customers make or save money add value. For instance, one distributor found a way to increase value to the customer by providing vending machines in their customers' facilities. The vending machines help customers manage inventory better, eliminate shrink and obsolescence, and minimize the order function. Their customer is better able to track consumables and gains insight into how those products are being used across the organization. It is now part of the "value basket" for their customers and drives loyalty and "customer stickiness."

Continue to leverage the deep product knowledge and expertise of your associates. Amazon sells products but lacks the depth of knowledge about their products that you can provide. Remember to separate the hype from the real hazards when it comes to Amazon.

SUMMARY

Technology is permeating and disrupting every aspect of distribution today. With new omnichannel expectations, increasing competition from both suppliers and eCommerce challengers and broader array of products to manage through outdated facilities and networks, distributors are challenged on several fronts. Investments will be necessary to ensure that recent growth can be sustained over the long term.

First, take all encompassing look of your business operations – not just focusing on labor, eCommerce, inventory or omnichannel network, but addressing them holistically. Next, develop a strategy to tackle all five areas of threat and answer the "what-if" questions. Determine how distribution operations, service centers and branches should be used and how that integrates into the overall network. Likewise, as explained above, take steps to ensure the entire buying experience is seamless and frictionless, examine ways to reduce the dependence on labor through automation and continue to add to your value basket by bundling services with products to add value that makes it hard for customers to go elsewhere. To mitigate labor risk and higher costs you will need to look more closely at automation solutions that enable increased throughput, capacity, accuracy, and productivity, as well as safer environments for workers.

If you are feeling the impacts of one or more of the five industrial distribution trends covered in this article, it’s time to consider a change in strategy that will help you overcome the challenges and drive competitive advantage.

For more information, contact The Distribution Experts at info@fortna.com.

THE DISTRIBUTION EXPERTS™

Fortna partners with the world’s leading brands to transform their distribution operations to keep pace with digital disruption and growth objectives. Known world-wide as the Distribution Experts, we design and deliver intelligent solutions, powered by FortnaWES™ software, to optimize fast, accurate and cost-effective order fulfillment. Our people, innovative approach and proprietary algorithms and tools, ensure optimal operations design and material and information flow. We deliver exceptional value every day to our clients with comprehensive services including network strategy, distribution center operations, material handling automation, supply chain systems and warehouse software design and implementation.

CONNECT WITH US

Visit fortna.com

Contact info@fortna.com