

WHOLESALE DISTRIBUTION: DIGITAL ECONOMY IMPACT AND SURVIVAL

April 2016

This report will examine the challenges facing Wholesale Distributors as a result of the Digital Economy, which has driven B2B and B2C Convergence, plus the ensuing impacts of the Amazon effect. We will review how the business model requirements have changed, fundamental capabilities, and where performance gaps exist for operational readiness.

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Wholesale distributors are seeing challenges from multiple sides in the new digital economy. eCommerce has created new competition, and in many cases, completely destroyed traditional channels of distribution. Today's distributors find themselves managing their traditional B2B business, their eCommerce site, and now, even their customer's eCommerce business.

Our research has shown B2B and B2C convergence puts tremendous pressure on distributors to find new ways to offset increasing costs or reinvent themselves in some way ([B2B & B2C Convergence: A Call to Action](#)).

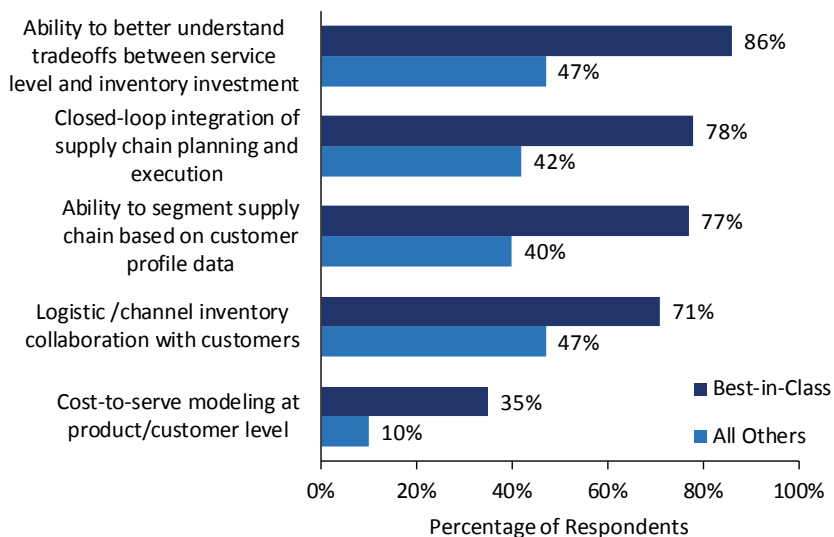
87% of wholesale distributors report "more challenging and complex fulfillment requirements – eCommerce and multi-channel or cross-channel demand impacts." This comes as a result of the B2B & B2C convergence trying to serve many masters.

The challenges extend from the shifting order channels, all the way to the warehouse and fulfillment operations in terms of disruptions and challenges. Adopting more efficient warehouse processes and responding profitably to these changes was the most-cited pressure (70% overall) for managers looking to address the reduction of operating expenses. 50% of all companies, on average, seek to “improve labor efficiency and workforce productivity by reassessing management software,” and 63% of these leaders are improving throughput capacity. The pressure continues to mount as the promise of same-day and next-day service are heavily advertised, becoming the expectation of the end customer. The net result is that wholesale distributors are under siege, and must change how they operate if they hope to successfully compete in the future.

Wholesale Distributors: Key Capabilities in the Digital Economy

Figure 1 indicates key capabilities that are critical to success in the new digital economy. Best-in-Class (sidebar definition) companies are much better prepared compared to the competition in each one of these critical areas.

Figure 1: Wholesale Distributor Readiness



Best-in-Class Definition:

- *Best-in-Class* - Top 20%
- *Industry Average* - Middle 50%
- *Laggards* - Bottom 30%
- *All Others* - Bottom 80% (Sum of Industry Average and Laggards)

Impacts of B2B/B2C Convergence

- **80%** of wholesale distributors say that they are concerned about the impact to **costs and profitability with the increase of B2C orders**
- **Increase in order density** and the growth in B2C order types
- **Labor/shipping costs** due to the introduction of more split case quantity fulfillment and parcel delivery
- **Compression in the order to delivery cycle time** that comes with matching same day and two-day delivery for the new B2C orders
- **Manual and special offline processing**, as traditional B2B EDI systems are supplanted by more complex manual flows like email/fax and phone orders

86%

of Best-in-Class companies are better able to understand tradeoffs between service level and inventory investment.

→ [Read the full report](#),
“B2B & B2C
Convergence: A Call to
Action”

→ [Related Research](#):
“Digital Economy in
Wholesale: Customers,
Suppliers & the
Workforce”

Understanding Tradeoffs – Service vs. Inventory

One of the fundamental decisions that distributors must make is: *What do they need to compete in terms of service?* If their business is not significantly impacted by eCommerce, then “*business as usual*” may apply, but as the research indicates, 87% report more complex and challenging fulfillment flows. However, that does not necessarily mean they must offer same- or next-day service, except in special circumstances. The decision on response time will drive the inventory and need for innovative approaches.

Supporting omni-channel demand fulfillment is not a volumetric problem, as much as it is a data-driven inventory placement challenge. The demand planning and segmentation model must be sensitive enough to pick up and identify exceptions to existing channels, so that decisions can be made on how to handle the order requirement. To determine the inventory and service impact tradeoffs, an inventory optimization solution is required in order to be predictive when identifying service-level impacts, given the demand variability. Best-in-Class companies are 83% more likely to have this capability in place.

Distributors should also consider alternatives not previously in play to meet required service demands. For example, it's possible that some of their products offered lend themselves to 3D printing, or last-minute configuration, that allows postponement strategies to work effectively. There may be external options to “turn on” distribution points virtually to augment their current stocking network to resolve a specific service/fulfillment demand. There is no *silver bullet* that addresses all needs, but thinking outside the box is critical.

Closed-Loop Integration – Planning Execution

The digital economy demands process speed and real-time decisions in order to satisfy same- and next-day requirements.

Batch operations and handoffs between systems are obstacles that must be eliminated to compete with eCommerce providers. Having closed-loop integration between planning and execution is a must-have capability to minimize any process latencies due to system handoffs. Inventory deployment strategies can be used to buffer fulfillment points, which can buy some time, but deciding the level at which the organization intends to compete is the fundamental question. It may be that second-day service will be the standard guaranteed, and next-day service is available in certain locations on certain products. Same-day service may not be offered. Those decisions depend on the type of product and competitive position for each distributor, but having closed-loop integration between planning and execution can only help the competitive position with improved process speed.

Segmenting the Supply Chain Based on Customer Profile Data

A fundamental need for visibility, in order to pick up on omni-channel impacts, is the ability to segment and really drill down into the drivers behind shifting demand patterns. This is the precursor required to effectively establish an inventory policy to support their service level mandates. Without some direction on where inventory will be needed, it becomes a guess, and overstocking will occur to cover all eventualities. In addition to picking up new patterns, segmentation can identify the customers, channels, and products that are not changing. Without this visibility, overreacting can be a risk and an unnecessary expense if not required.

Collaboration with Logistics partners and customers related to inventory execution

Even after all the internal modeling and policies have been put in place, fine-tuning the process through tighter customer collaboration can really help to cement the relationship and get

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buy-in to service efforts. Timing of changes and orders may be just the extra piece of intelligence to minimize surprises. When surprises do happen, collaboration can often mitigate the problem by working directly with a customer to include their inventory or in-transit shipments as part of the response.

Cost-to-Serve

The Best-in-Class have a clear advantage in having cost-to-serve at the item/customer/channel level compared to the competition, but even they have work to do at 35% adoption levels. Given the increased complexity that wholesale distributors face, the bottom line is – "can they do this profitably?" Knowing their true cost-to-serve is the key. All Others lag behind severely, and as the 10% indicates, they struggle to know where they stand regarding their cost-to-serve, and represent 80% of the companies out there.

Knowing the financial tradeoffs for proposed solutions may dictate the level of responsiveness and support that a company can afford. This may force the business model to change, or at least better define where investment is required to remain viable. Not knowing their true cost-to-serve is a big part of “why” some companies are still reluctant to invest.

Summary and Key Takeaways

Wholesale Distribution is under tremendous competitive pressure to modify their business model, and take on all the challenges thrown at them for support by their customers. How their model evolves and the degree to which each distributor is willing to change will vary, but there are core processes that can determine how effective they will be.

They must segment and understand how their business has changed and then make a determination of what level of service is required for each critical segment. Tightening up their

processes and closing the loop between planning and execution will add speed and responsiveness. Establishing the tools to know their true cost-to-serve is fundamental to determining their profitability and properly evaluating their options. The Best-in-Class companies are further ahead in preparation, but they too struggle with cost-to-serve, given all the changes they face and improvements they try to make. However, not addressing the issues at hand, and recognizing that their business model must evolve, is a threat to their business. Distributors should act now...before it's too late.

About Aberdeen Group

Since 1988, Aberdeen Group has published research that helps businesses worldwide improve their performance. Our analysts derive fact-based, vendor-agnostic insights from a proprietary analytical framework, which identifies Best-in-Class organizations from primary research conducted with industry practitioners. The resulting research content is used by hundreds of thousands of business professionals to drive smarter decision-making and improve business strategy. Aberdeen Group is headquartered in Boston, MA.

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