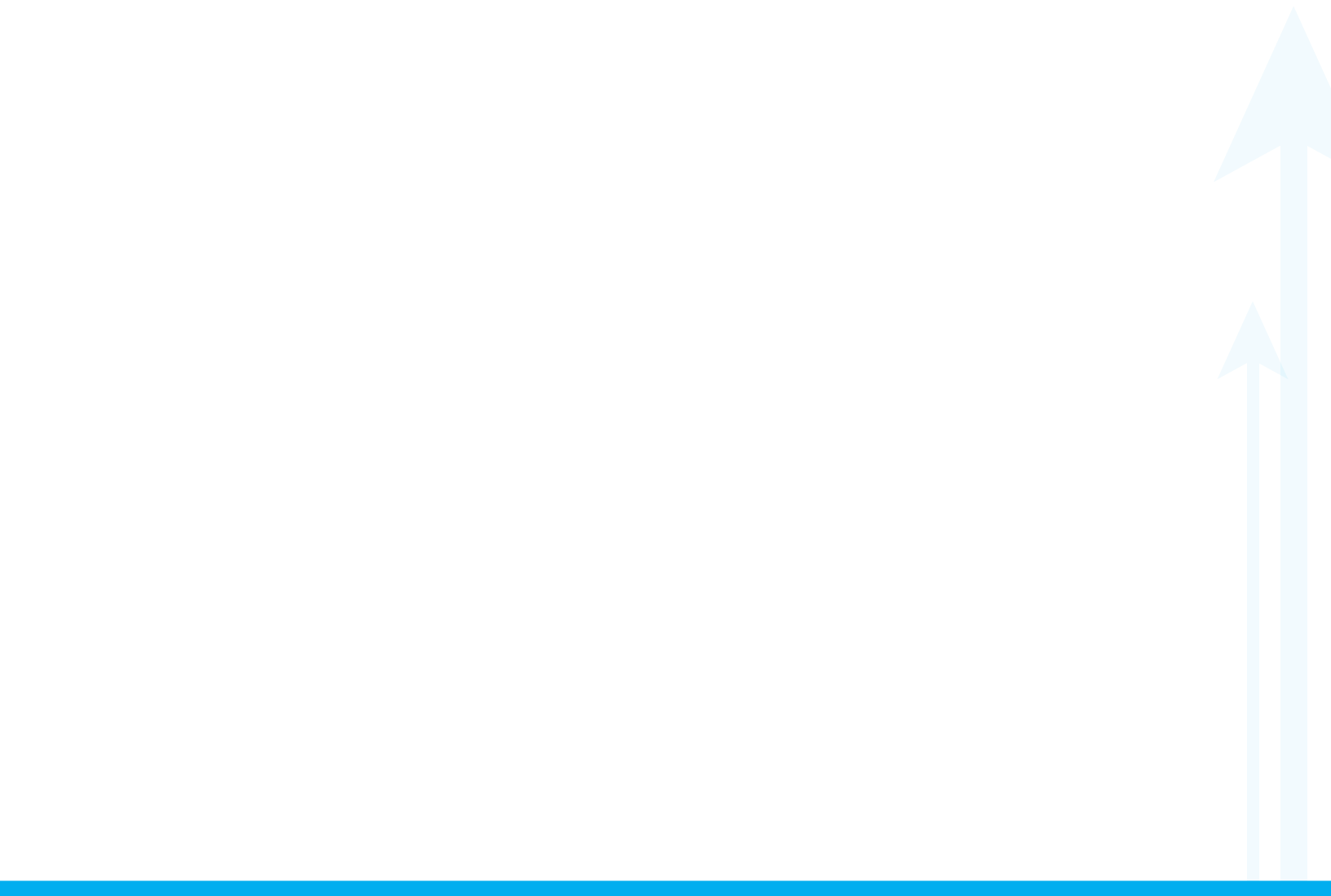


FROM PRACTICES TO PROFIT

EXECUTIVE SUMMARY



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Introduction

Business practices and operational structures used by distributors to meet the needs of customers can vary widely by region, size of the company, type of customers and other factors. This project was designed to establish baseline practices for electrical distributors. Through the course of our research and engagement with the membership at various on-site visits and meetings, our team has identified looming challenges to the electrical distribution channel. These challenges can be addressed through improving business practices and empowering members to take steps needed to protect their market share.

In interviews, many NAED members discussed attempting to compete with Amazon and other online aggregators "on their field", by investing in equipment and technology to push high-volume throughput. Others were not concerned with digital competition, choosing to rely on experience instead of adaptation. One said, "Big box stores didn't put us out of business, why should Amazon?" Except for very few companies, NAED's members seemed less concerned with impending disruption from a generational changeover in their customers and their own staffs.

Revisiting business practices is a way to encourage firms to adapt by focusing on profit, an element common to all businesses. Throughout our work with businesses of all sizes, profit is the universal that each can grasp and build upon. By working back to the basics rather than more abstract principles such as market spend or warehouse modernization, we can encourage businesses to build resilient models from their foundations. Owners and managers can then naturally begin to account for challenges and disruptors. For those that already have strong basics, re-assessing regularly is a way to address challenges in the model before their impact is catastrophic.

This project includes several parts: collections of findings from the basis of our understanding of the market, a guide to the business practice assessment tools, and the assessment tool itself. Our objective is to empower each NAED member and manager to make decisions within the firm that gear them toward long-term sustainability. Self-assessments are cost-effective, useful tools that get managers acting on this path.



The Current Picture Among NAED's Membership

The project team, through site visits and interviews with several of NAED members, noted elements of the current NAED environment. This picture includes what we perceive as the major challenges, the typical business practices, industry trends and the strong and weak practices that can be found among the membership.

CHALLENGES

The largest challenge observed within the electrical distribution industry is the need for the members to adapt their proven support to a new generation of buyers and employees. NAED members' customers are looking for additional integration and expert support. Industry leaders are developing training centers and program management capability to help those customers track project phases and match product delivery (and storage) through the phases of each client project.

The threat from large, omnichannel competitors is primarily with the simple-stock, easy-buy items - those items that require no additional technical support or advice. These items are the bread and butter of most NAED members, selling high volumes at mid-range margins. They require little in the area of handling and are ordered in large volumes (i.e., wire, standard switches, standard fixtures, etc.). These commodities are necessary stock that members must offer in order to secure higher-margin portions of the client business, and the focus should be on using them to sell the more complicated, higher-margin orders.

Close management of commodity items is even more important in the electrical distribution market than other channels given that most sales, more than 50 percent by number and more than 60 percent by revenue, are by email or mobile application. Push-button ordering removes sales/expertise contacts and raises the risk of losing customers by removing brand awareness and add-on support, even if it's just timely delivery. A company's competitive advantage with its customer base is typically the client's trust that their products will be priced reasonably and delivered on time in the quantity and quality ordered. That trust, which can be eroded by using cost-effectiveness measures like drop-shipping, must be rebuilt at every client engagement, reminding the client that the drop-shipped order was to meet their timeline as orchestrated by the company.

This threat is increased by companies' lack of supply chain strategies. A supply chain strategy lays out how a company intends to fulfill client demand while fortifying brand awareness and managing costs. Without a strategy, companies operate at the risk of a supplier base unaligned with the company's needs and a delivery function (i.e., the firm's own trucks, FedEx, etc.) often selected and paid for on a spot market price instead of a long-term strategy to improve performance and manage costs. One piece of a supply chain strategy is utilizing preferred vendors. The advantages of creating accounts with preferred vendors (for product or services) include price cuts and rebates,

even for the smallest of distributors. It also allows company leadership to see the risks of only having one vendor or having to manage eight vendors for the same items. This information allows the companies to better prioritize spend and manage the risks of underperformance or cost increases.

NAED's research has identified key observations across the industry and within our members that include better practices for overcoming these challenges and poor practices to avoid.

CURRENT BUSINESS PRACTICES

The challenges listed stem from the industry's transit from traditional wholesale distribution to customer-intimate, tailored services backed by on-hand or quick-to-stock inventory. While this concept was known to everyone we spoke interviewed, it has not permeated the management approach through to the business practice. This transition is not often reflected in the management reports of businesses and often still lumps the strategic advantage of client-intimacy (i.e., client management and consulting) under one cost line item of "sales." This hides the amount of money spent investing in client relationships with consultative support. Sales teams are providing their customers additional services daily, and these services are combined with time spent driving to the client site and simply introducing new product lines.

By tracking these value-add services as sales, the value of the differentiator between the local distributor and Amazon or Alibaba (Johnson, 2017) is not being managed. If this value is hidden from management, it cannot be invested in. As customer-intimate operations become more vital to the industry, companies will need to understand the importance of spending on and managing activities to build strong customer loyalty.

INDUSTRY OBSERVATIONS

The industry's evolution to client-dedicated sales representatives, knowledgeable researchers/buyers, an empowered delivery team, and executive engagement supports a customer-intimate strategy. This strategy is critical to the continued success of the members, differentiating them from omnichannel, ecommerce competition. It also provides dedicated engagement in a buying culture trending toward remote transactions (Brohan, 2018). The overall trends for today's buyers are moving in the direction of empowered web-based research and simplified remote transactions. The best example is the ability to see hundreds of reviews for an industrial product on Amazon.com and purchase within 120 seconds. The electrical market is buffered from this trend due to the need for time-consuming research for complex configurations/products and the need to build complex quotes for construction projects. However, for the more commoditized parts, the market already sees orders placed by email or text without the need of research.

NAED members' customer base is aging (Census, 2015-2017), and new hires in procurement are following the trend of increasing remote sales requests. Those facts, combined with the industry's 54 percent of sales from remote sources that don't require face-to-face interaction, including email and web, are the top risks for members. Often these remote sales are fulfilled by drop ship (more than 65 percent) leading to additional distance between the member's brand and the buyer.

As new buyers learn to place orders remotely, they do so without associating those orders with the client manager/sales representative. Even in cases of long bills of materials, automated catalogue and alternative matching is becoming simpler with the robust databases of manufacturer part numbers and SKUs. Without continued client management and marketing reinforcement of the company's brand, those buyers can easily be lured away by simpler, or more familiar, ordering platforms such as ecommerce giants Alibaba and Amazon, etc. (Lunden, 2018). There is added risk regarding diminishing contact in sales, as a large portion of the companies' sales workforces (by sales volumes) is aging out of work at the same time.

As the next generation of buyers and sales staff move to the forefront, companies will benefit from continuing to refine their market strategies, including marketing, client management, and sales approaches to match the generational buying preferences. This eventuality affects each region at differing times. Using effective data analysis and customer surveys will inform leadership of their region's timeline.

OBSERVED BEST PRACTICES

Below are a sample of best practices for fueling a customer-intimate competitive strategy observed or discussed with NAED Members:

Customer Service

- Customer services is the top-priority for all distributors engaged, and those with clean processes and SOPs for stocking and issuing products do so with the least cost and most reliability to the customer.
- Use of voice of the customer surveys.

Marketing

- Brand every shipment coming from the warehouse using branded shipping labels, tape, and pallet wrap.
- Use social media and video content for educating and attracting customers.
- Leverage engaged and experiential marketing through training, both in person and through online platforms (training programs, other webinars, Youtube, etc.). Leading firms offer a customer engagement experience for the younger buyer, providing detailed training (in smart home/office/building design and implementation) and "tips and tricks" or reviews of new products or concepts (i.e., smart hazard detectors, doorbell, internet-of-things (IOT) capabilities).

Sales

- Blend inside and outside sales, providing research support and the ability to respond to client inquiries within the day, if not the hour. The faster the response, the stronger the trust and reliance from the customer on the distributor's service.
- Collaborating with seasoned workforce members allows for effective succession planning. The typical sales culture hoards contacts and information to promote individual sales over team. Leading firms' sales culture represents a best practice in integrating sales associates at all levels into the management of each client.
- Effective sales incentives drive the sales force to collaborate between senior and junior sales experts (inside and outside). This provides a sales force that has multiple person-to-person relationships with each Category-A customer. This is a best practice in customer engagement and client management.
- Communication with the client is evolving rapidly across industries. NAED members are seeing an increase in electronic orders (i.e., order not requiring any human interaction to research or place). This requires continued speed-of-response from the sales force to the client and close collaboration between inside and outside sales representatives. Leading firms have this collaboration, and it is delayed in weaker firms where sales requests only go to one sales resource and not a centralized or shared account.
- NAED members are aware the electrical distribution industry is a tough "sell" to young professionals. However, one of the top trends in millennial purchases are IOT-related devices. Leveraging the company's interest in smart-building concepts and IOT products, many members are positioned well to recruit from leading engineering and technical schools to continually strengthen their expertise pool.
- Provide more seminars and training, to increase customer intimacy.

Warehouse & Inventory Management

- Distributors integrate with clients. This includes running the storeroom for larger buyers, providing on-site storage for large projects (i.e., co-located inventory, checked and re-stocked frequently based on client work plans, etc.). This extended inventory system allows customers to draw stock in real time and provides operational details on the types and amounts of products used and at what rate for key clients.
- Limit deadstock and have an outlet for reducing inventory.
- Dead stock is a concern for all distributors engaged. This wasted expense is driven by a number of factors and scenarios, many of which could never be controlled or eliminated. Strong firms' customer-intimate sales forces and excellent tracking of stock and purchase data allow for continued analysis and development of mitigation strategies (i.e., what caused the over-order and how can it be mitigated in the future).

Delivery Services

- Allowing sales reps to deliver orders to customers – reinforcing the brand.
- Use of delivery teams to observe and report customer needs and project phases.
- Strong companies have developed the right culture with its drivers, highlighting their role as sales staff. Developing a simple, but formal, training program for drivers aids firms in formalizing the drivers' role within the client management process.
- Using third-party carriers (i.e., UPS and FedEx) to deliver products is cost-effective. Most firms ensure their brand is carried in the transaction, by clearly branding the box/tape/label and/or adding tailored marketing material into their packages as they are inspected.

OBSERVED POOR PRACTICES

Below are a sample of poor practices that represent potential risk in NAED member business models:

- Mis-incentivizing sales force to bring in new accounts – all incentives focus on selling more with old accounts.
- Current sales incentives promote legacy client growth only – need a mix of legacy and new client growth.
- No long-term sales forecast – targeting markets and large customers.
- No supply chain strategy, either buying what the customers ask for or what the sales team wants to carry, little focus on rebates and risk reduction.
- Many of the distributors to whom we talked want new business systems to help reduce operational risk. This should be preceded by a process review to ensure all processes are consistent and effective (before they are instantiated in a system and reinforced).
- Not engaging with the customer to understand the project/s for which they are buying to increase the chance of additional sales. Understanding and tracking customer drivers is necessary for customer intimacy. Customer drivers include the project-based work, seasonality (sales and proposals), policy/regulation, etc. By tracking the drivers by all Category-A (and growing Category-B) customers, the sales force can better anticipate the clients' needs and increase the reliance on the member's products and services. This can be done by out-of-the-box customer relationship management (CRM) tools or by inexpensively developing a centralized CRM process (these typically come with commercial IT tools but can be developed using any multi-user database) to track customer drivers and alert sales and marketing to upcoming changes in their needs/buying habits.

Why a Self-Assessment of Business Practices?

Accounting for the many challenges of the current marketplace for NAED members, combined with the low margins industry-wide, a self-assessment tool and routine is the best way to provide immediate impact across members of all sizes. Outside consultants and advisors may have trouble relaying the importance of certain business aspects to owners and managers. Self-assessments place the power in the hands of the businesses themselves and create more incentive for action and growth.

The decision to develop a tool for self-assessment stems from the SCV team's experience in working with hundreds of businesses of all sizes in business practice improvement and growth coaching. When we consult, we are often able to identify impactful challenges and solutions in and across firms, but it is sometimes more palatable (and less expensive) for companies to evaluate these challenges themselves. Self-assessment puts the ownership on the management team. And while a self-assessment can consume valuable time from an owner or manager, it often is a significantly smaller investment than hiring an outside team for review and delivery.

Instead of publishing a paper on practices, NAED wanted to provide members with a tool to help them create value for themselves. Members can see potential impacts of business practices directly and engage in continual thought and improvement encouraging sustainability. This tool is designed to be simple and straightforward enough to be deployed with minimal investment of time by firms interested in improvement. In fact, both the "Best Practices Guide" and "Warehouse Assessment Tools" can be split into discreet segments to be completed individually or entirely.

WHO SHOULD USE THIS TOOL?

In larger firms, logistics managers - typically with insight into both operations and finance - are often ideal resources for completing the self-assessment. In smaller firms, or firms without logistics management staff, managers with visibility into warehouse operations and business/financial management are ideal candidates to complete the assessment.

HOW LONG WILL AN ASSESSMENT TAKE?

For an internal manager, completing an assessment should take an average of 1.5-2 workdays of on-the-ground assessing, not including presentation of findings and pre-assessment prep. It is recommended that assessors spend a half day preparing for the assessment to ensure time is used to maximum effect.

WHAT ARE THE RESULTS OF THE TOOL?

The assessment is presented in a format that allows assessment staff to directly present findings to executive teams; our experts often directly cut and paste assessment pages into PowerPoint decks for presentation to leadership teams.

Conclusion

NAED did a fantastic job highlighting disruptors for its members and now aims to encourage action at a grassroots, business-by-business level. Through years of experience across hundreds of businesses, the SCV team has seen the most success when walking firms back to the foundations - the business model and profitability - and gearing them up to face emerging threats with a strong base to build upon. Our self-assessment tool empowers NAED members to objectively look at their own businesses and start asking questions regarding how they can create the model to sustain their firms and increase their growth despite shifting and moving tides in the marketplace. Self-assessment provides ownership, cost-effective insight, and great value to firms that choose to adopt the tools.



Our Mission

To promote the electrical distribution channel and to provide members with the most valuable and relevant tools, solutions and information so they can thrive now and in the future. We'd like to thank the NAED Foundation's Channel Advantage Partnership members for their generous support of this research.

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