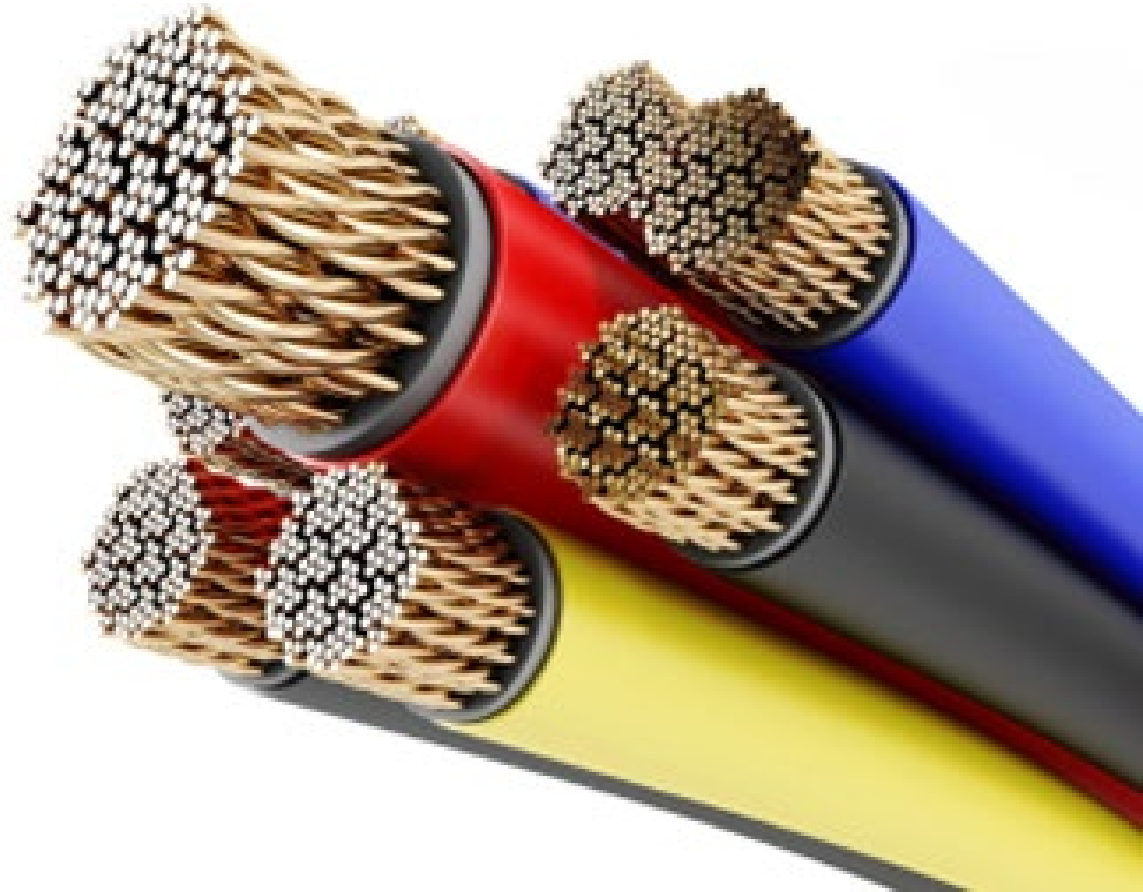
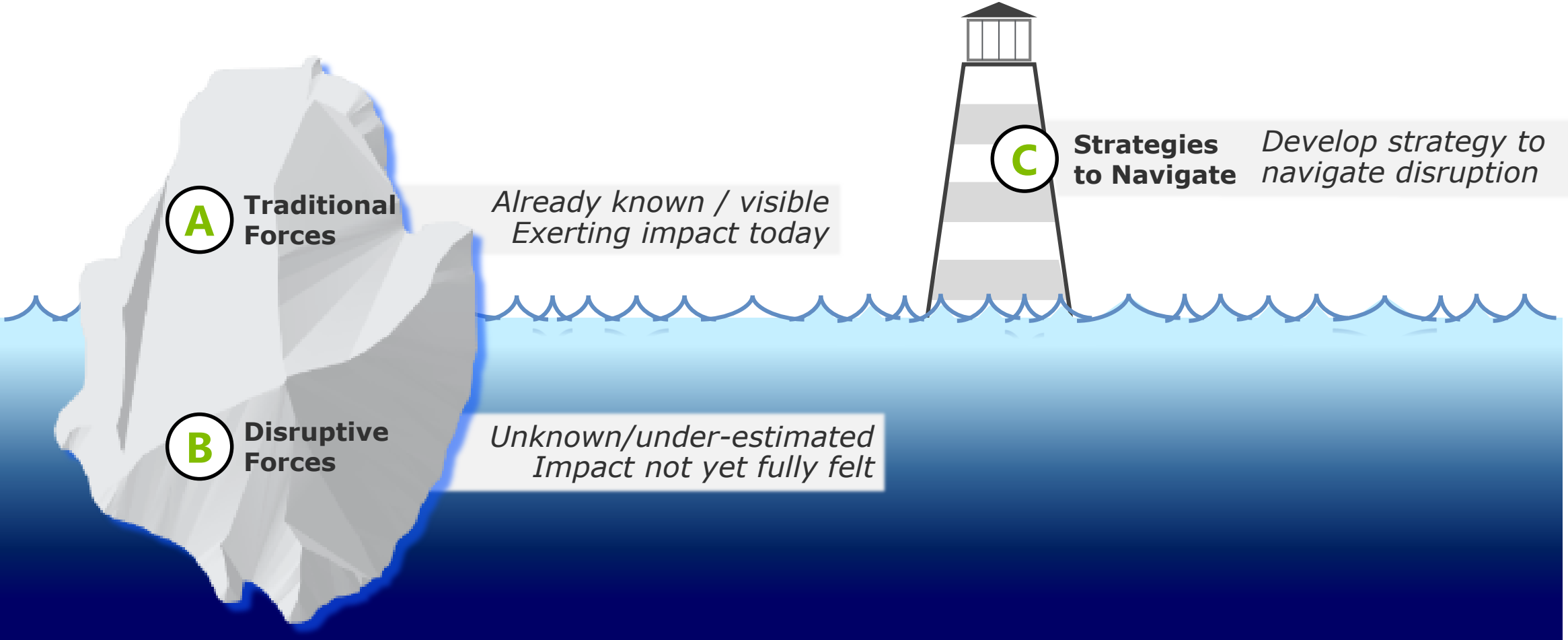


## NAW Billion \$ CIO Roundtable

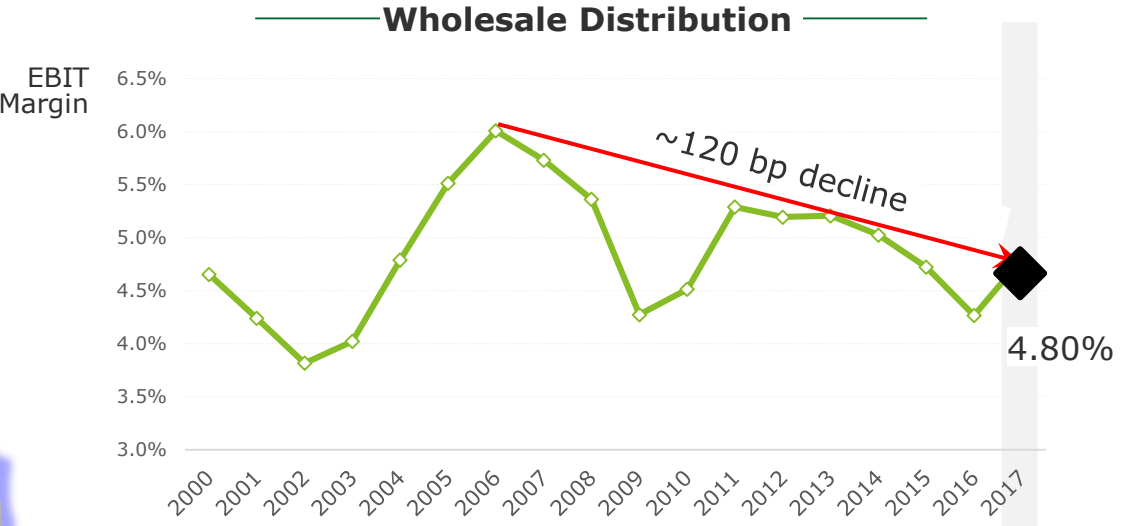
Chicago O'Hare Hilton  
December 12 2018



# Wholesale distribution industry dynamics



# The wholesale distribution industry is facing a true inflection point



**“A strategic inflection point is a time in the life of business when its fundamentals are about to change**

**That change can mean an opportunity to rise to new heights.**

**But it may just as likely signal the beginning of the end”**

Andrew S. Grove  
Only the Paranoid Survive

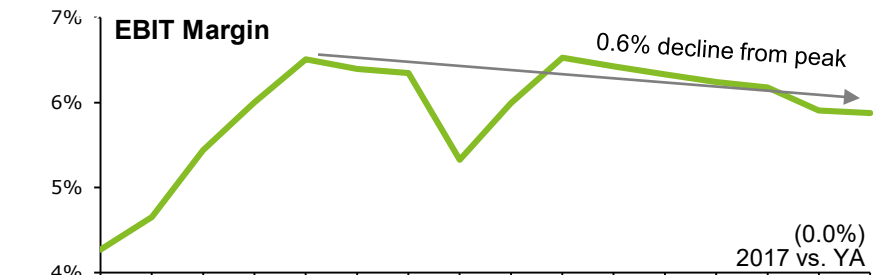
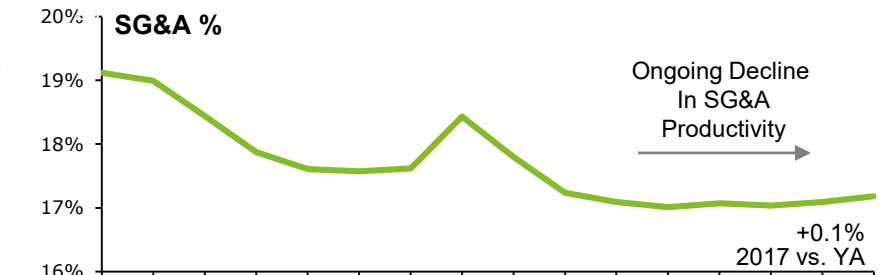
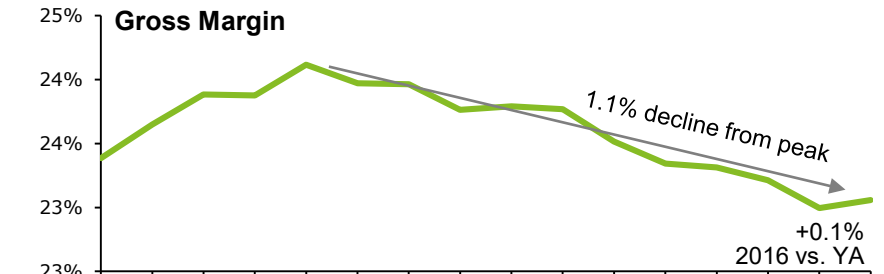
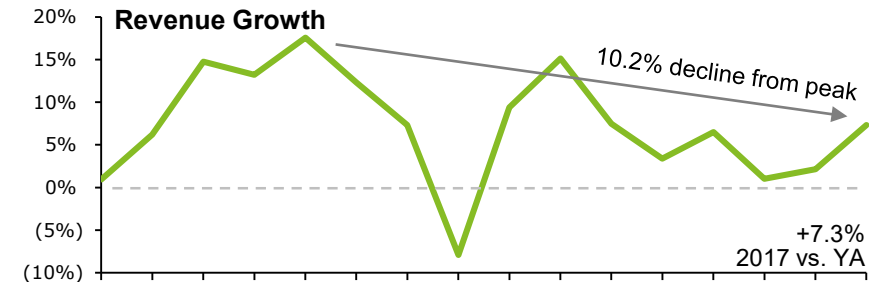
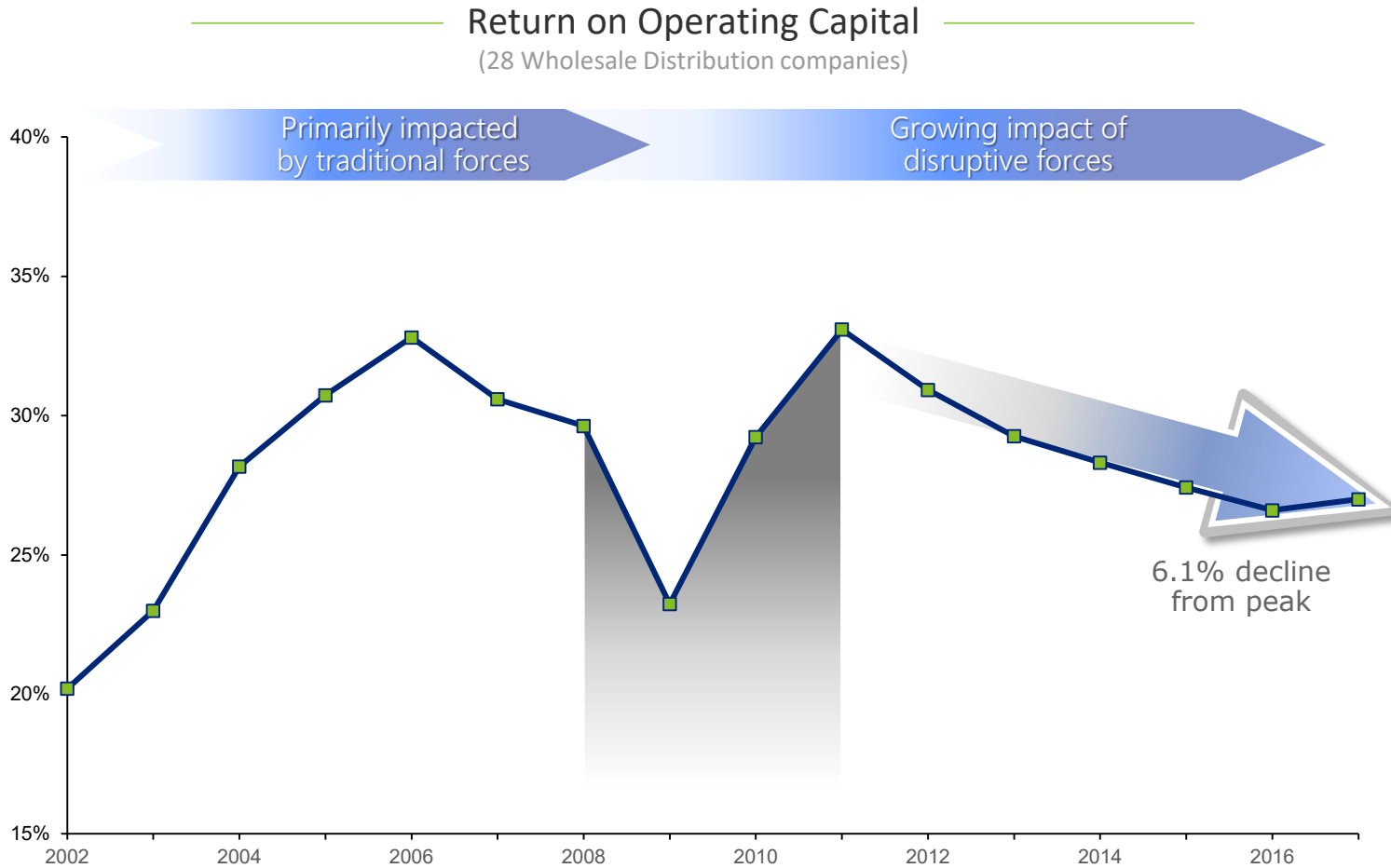
2018

2020

?

# The industry's financial performance provides evidence for a change in its fundamentals

## A Traditional Forces



Notes: Average of 26 wholesale distribution companies with data available from 2002-2016; ROC = EBIT / (NFA + NWC)  
 1) ~50% of the decline in ROC from 2011-2016 is due declining EBIT margins and ~50% to lengthening of the cash conversion cycle and other balance sheet items  
 Source: Deloitte Consulting Analysis, CapIQ, BLS, Federal Reserve

# Disruptive forces are rapidly reshaping the distribution landscape in dramatic and somewhat unpredictable ways... amplifying the inflection point

## B Disruptive Forces

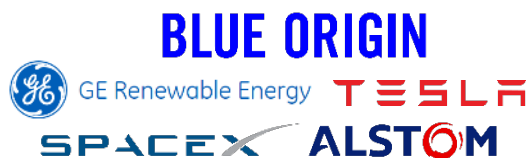
### Wholesale Distribution Industry Disruptions

#### New Business Models

- Digitally enabled
- Marketplaces
- Ecosystems



75% of industrial buyers purchased via eMarket in 2017, vs. 20% in 2013<sup>i</sup>



#### New & Shifting Customer Demand

- Meal-kits/food trucks
- Plant-based meats
- Electric vehicles
- Private space
- Green energy
- Energy storage
- Drones / robotics
- LED Lighting

Space industry will be worth over \$1 Trillion by 2040... up from \$350B in 2017

#### Disintermediation 2.0

- Manufacturer direct
- Self-distribution
- GPOs
- 3D Printing / Additive Manufacturing

In 2017 81% of industrial buyers had purchased direct from manufacturer, vs. 64% in 2015<sup>i</sup>



**Disruptive Forces**



#### Exponential Technologies

- RPA
- Blockchain
- Drones / Robotics
- AR / VR
- IoT
- AI / Machine Learning

Kroger partners with Ocado to build 20 fully automated eCommerce fulfillment centers

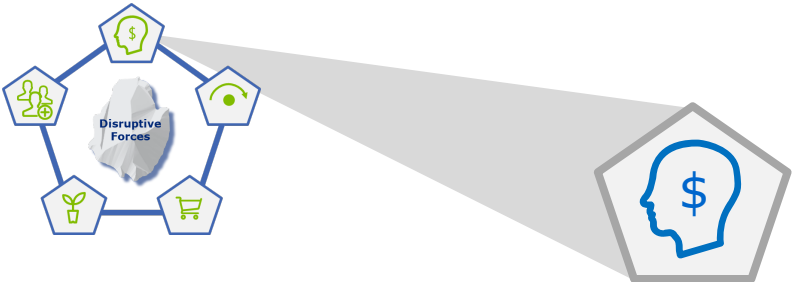


#### Consumerization

- Rich Customer Experience
- Price and inventory transparency
- Omni-channel fulfillment

Grainger creates web price for 1.5 million items to win with mid-size customers

# Digital tools and technologies enable proliferation of start-ups and new competitors that leverage new business models and change the basis of competition



## New Business Models

**Digitally enabled**

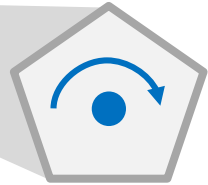
**UBER**  
**UBER EATS**  
**UBER FREIGHT**  
**ATG**

Mobile enabled peer to peer ridesharing, food delivery, and freight capacity business

To date >5 billion rides have been completed via the various Uber products (e.g., UberX)

Developing autonomous vehicle capabilities through Uber ATG – hired ~50 top robotics engineers from Carnegie Mellon

Digital tools also make it easier for buyers to collaborate and aggregate spend, and lower costs for manufacturers to sell direct to and serve end customers



## Disintermediation 2.0

### Manufacturer Direct



To expand 7% share of \$2.7 Trillion aircraft replacement parts and services revenue stream Boeing...

... investing heavily in B2B eCommerce and eMarketplace sites MyBoeingFleet, ILS, and Aviall,

... created replacement parts business unit within its Global Services BU, and

... in 2018 Boeing acquired KLX, leading distributor of aerospace bearings and fasteners

Lines between B2B and B2C continue to blur with expectations formed via leaders in the B2C segment rapidly influencing B2B



**Omni-channel Fulfillment**



- BOPIS:** buy online pickup in-store
- BORIS:** buy online return to store
- BODFS:** buy online deliver from store

- 45% of online purchases picked up in-store, and 85% of online order returns completed in-store
- Installing lockers in the front of stores to provide a self-service option for BOPIS customers, and adding delivery choices such as same-day and time-definite options
- Opening zero inventory stores to serve as last-mile delivery centers for appliance and B2B orders
- Deployed DC network for both direct-to-customer fulfillment orders and store replenishment, which serves



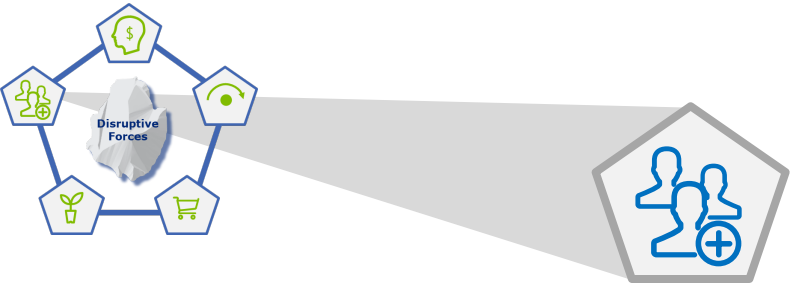
# Breakthrough technology innovations are creating new opportunities for distributors within their own operations and as new potential sources of revenue



## Exponential Technologies

<p><b>Augmented / Virtual Reality</b></p>		<p>BP deploying real-time augmented reality across all its Lower 48 operations</p> <p>Pilot project reduced production losses, well downtime, and travel expenses by field personnel</p>
<p><b>Robotics</b></p>		<p>Ocado operates ~600 robots to pick and pack &gt;65,000 orders / week</p> <p>Amazon estimated to use 100,000 robots at its various distribution centers</p>
<p><b>Drones</b></p>		<p>Electrical supplies distributor partners with drone services company for utility infrastructure inspection and maintenance offering</p>

For distributors shifts in end customer demand and the rise of new industries creates exciting opportunities... but often require new capabilities and agile strategies



### New & Shifting Customer Demand

## LED Lighting



Enable new business models such as Lighting as a Service - forecast to grow at 52% CAGR to \$1.6B by 2025

Expand the potential bill of materials and opens broader industrial control systems opportunities

## Private Space

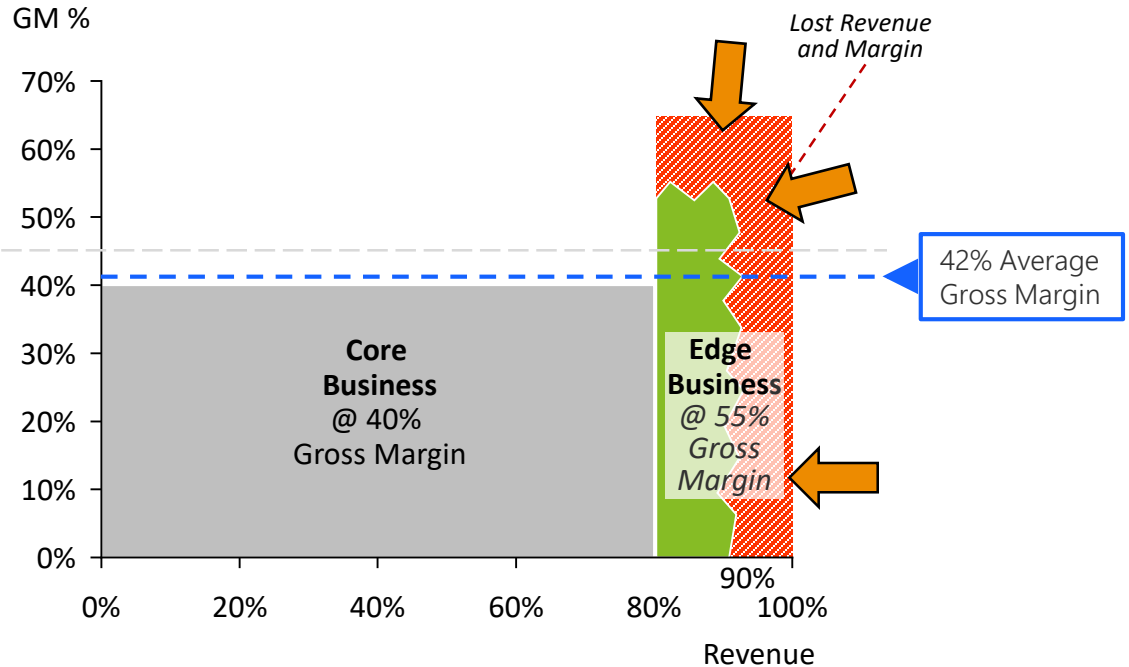
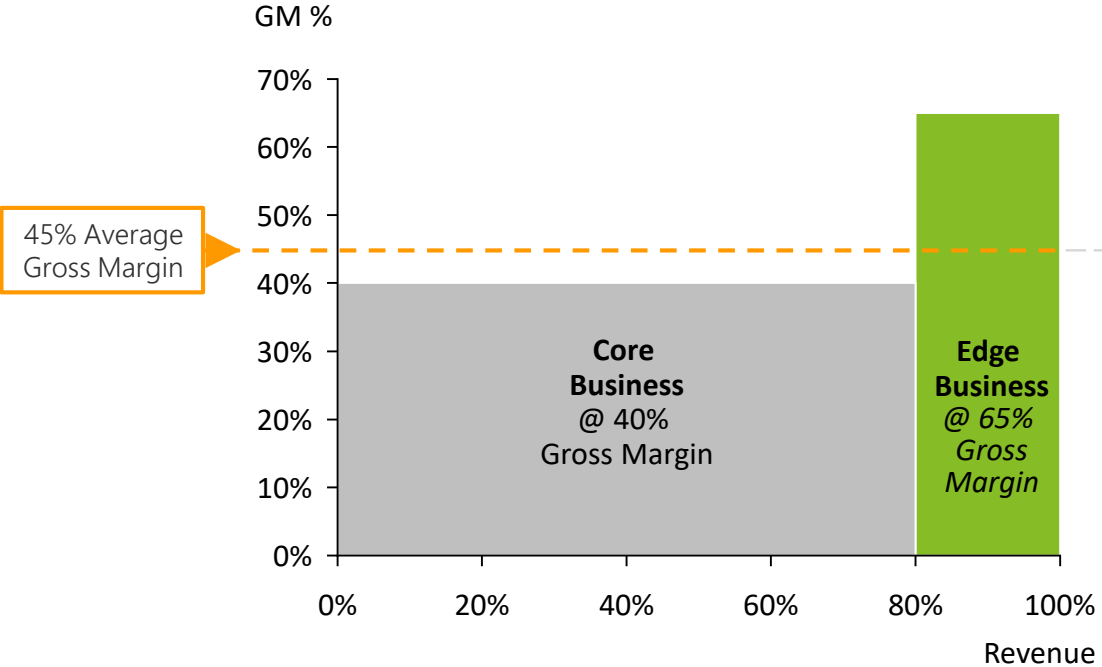


Space industry will be worth over \$1 Trillion by 2040... up from \$350B in 2017

SpaceX completed 18 launches in 2017, and as of March 2018, had >100 launches on its manifest = \$12B in contract revenue

# Competitors have become adept at targeting high margin segments at the edges of the distributor's business - driving an outsized impact on overall profitability

## Impact at the Edges



### For a Wholesale Distributor

- Revenues: \$5B
- Average GM: 45%
- \$2.25B GM

### For a Wholesale Distributor

- Revenues: \$4.5B
- Average GM: 41.7%
- \$1.88B GM

↓ 10%

↓ 330 bps

↓ 17%

➤

Impact

# Impact at the Edges is already playing out in foodservice distribution as well as other lines of trade

## TRADITIONAL DISTRIBUTORS



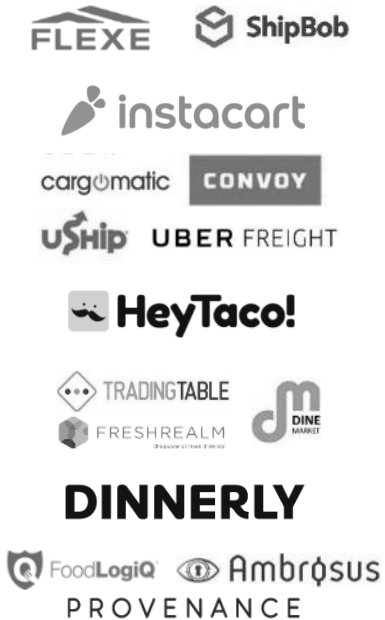
## NON-TRADITIONAL COMPETITORS



## AMAZON



## "ANKLE BITTERS"

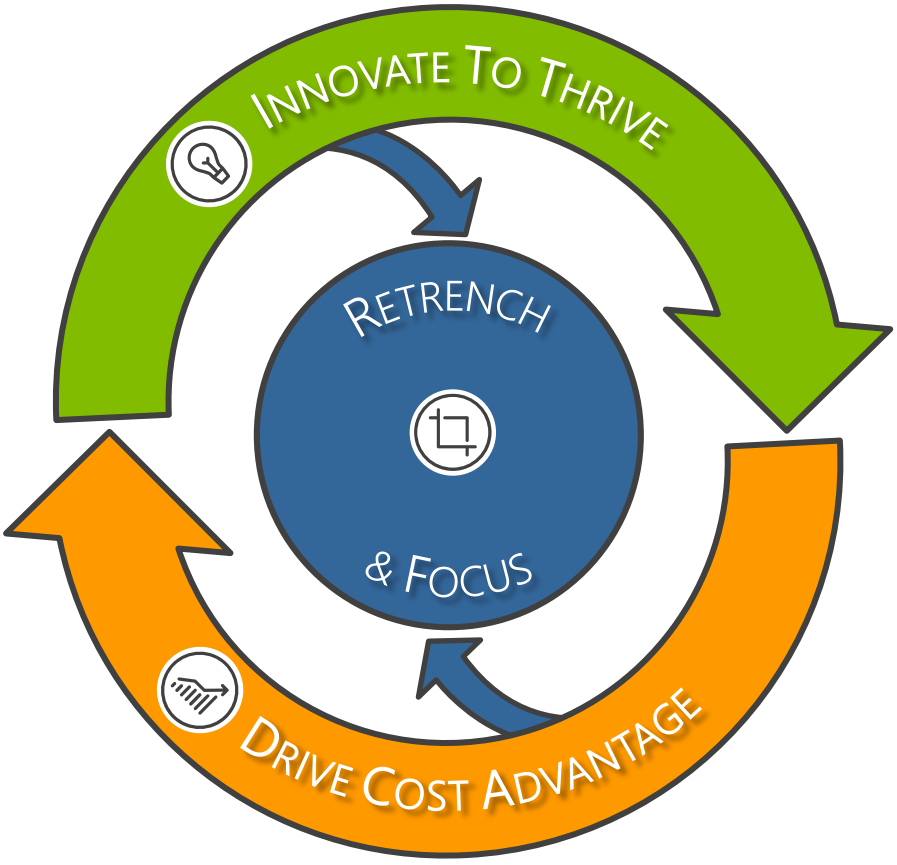



To compete distributors must develop strategies that exploit opportunities, leverage strengths, and focus scarce resources

**C Strategies to Navigate**

**Strategic Options**

 <b>RETRENCH &amp; FOCUS</b>	
<ul style="list-style-type: none"> <li>• Narrow focus to more defensible business segments (e.g., geography, customer, product)</li> <li>• Deepen competitive advantage in focus segments via targeted investment</li> </ul>	
 <b>DRIVE COST ADVANTAGE</b>	
<ul style="list-style-type: none"> <li>• Drive compelling cost advantage by increasing operational scale and realizing efficiencies                             <ul style="list-style-type: none"> <li>- Leverage transformation M&amp;A to achieve scale advantage</li> <li>- Extract synergies from prior M&amp;A</li> </ul> </li> </ul>	
Transformational M&A	Fix the Base



 <b>INNOVATE TO THRIVE</b>	
<ul style="list-style-type: none"> <li>• Invest in a portfolio of innovations to shift the basis of competition</li> <li>• Pilot new technologies to validate potential sources of incremental value</li> </ul>	

Companies can narrow their focus to defensible segments thereby optimizing scarce resources, leveraging digital to identify the segments and deliver the value proposition

RETRENCH & FOCUS



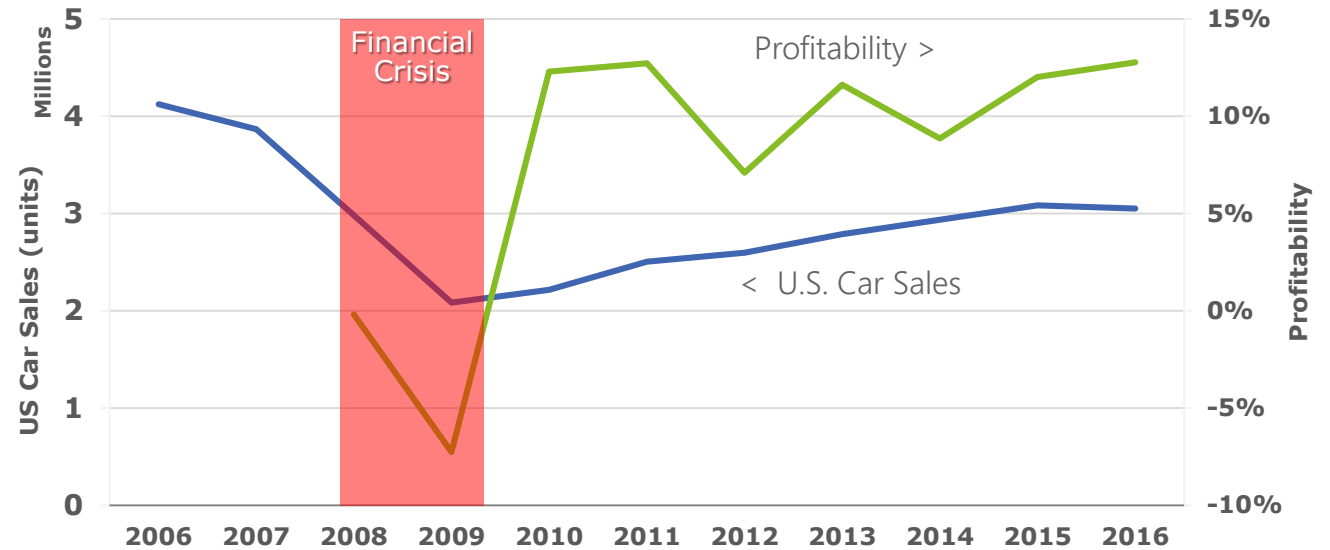
CASE STUDY:

**Situation:**

- Intense competition from Asian producers
- Legacy operating costs and fixed overhead
- High operating leverage slipping unit volumes
- Poor track record of innovation
- Unwieldy portfolio of overlapping brands and disparate businesses

**Retrenchment:**

- Aggressively discontinued and divested brands
- Reorganized in bankruptcy and received government bailout of both GM and GMAC
- Shuttered plants and closed over 1,000 dealerships
- Reduced workforce by ~10,000



Shuttered



10,000 Headcount  
1,100 Dealers

Sold



# Distributors can also access multiple levers to drive sustainable cost advantage...

## DRIVE COST ADVANTAGE

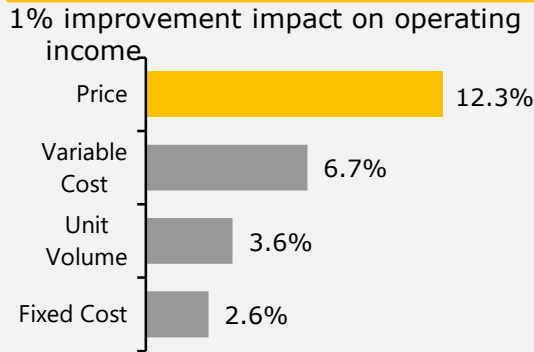
### Gross Margin



**Pricing**



**SKU Management**



# SKU on Amazon Business  
 2012: 500 thousand  
 2014: 1 million  
 2018: >500 million

### Operating Expenses



**Sales Effectiveness**

### Working Capital



**Network Rationalization**

1 million (20%) fewer B2B salespeople by 2020 \*

W.W. Grainger has closed 1/3 of its branches since 2008



**Rebates**



**Cross-Sell / Upsell**



**Shared Services / Outsourcing**



**Inventory**

#### Traditional Distributor

EBIT Margin	Rebates as % of Revenues
~6%	5-10%

One leading distributor is currently only effectively cross-selling with 4% of its customers

Wholesaler-distributors lag manufacturers in their centralization and outsourcing of support functions

SKU proliferation adds cost and complexity:

- Good-better-best
- Private label
- New categories
- Customer specific
- Channel specific

# Distributors are investing in innovations like IoT, analytics, AI, and marketplace platforms to create new, defensible value propositions

## INNOVATE TO THRIVE

Distributors already explicitly investing in innovation

**FERGUSON**

**GraybaR**

**HENRY SCHEIN**

**GRAINGER**  
FOR THE ONES WHO GET IT DONE

Good things  
come from  
**SYSCO**

**ANIRW**

**BRENNTAG**

## SERVICES:

### Automated Replenishment with IoT:



**MINIBULK**  
Part of the Univar Network



- Leading chemical companies offer sensor-enabled, automated replenishment for bulk products
- Telemetry on storage tanks monitors usage and signals for replenishment. Allows for optimization of fulfillment, guaranteed service levels, and 'as a service' pricing models.

## PRICING:

### As a service:

Commercial flooring, lighting, automobiles, material handling equipment, and jet engines offered with 'as a service' or subscription-based pricing. Other alternative pricing models tie compensation to savings, effectiveness, and/or efficiency targets.



Full lifecycle leasing of commercial flooring



Usage-based leasing of forklift capacity



Commercial lighting billed as a saved energy rate



'Power by the hour' pricing for jet engines



Monthly subscription for automobile access



Chemical Leasing

## PLATFORMS:

### Marketplaces:

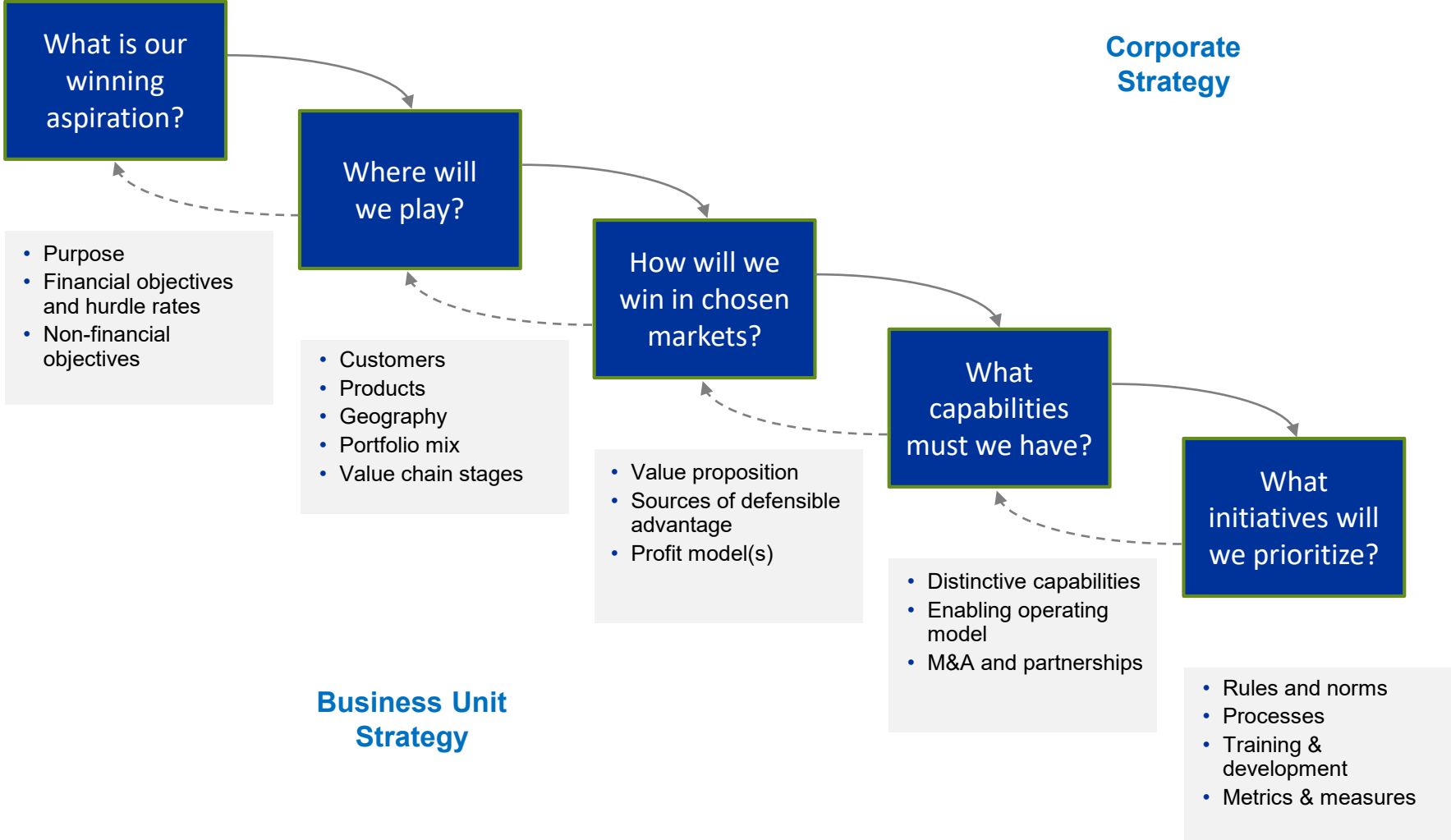
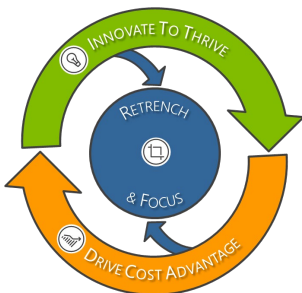
Rapidly growing number of open and closed marketplaces for products, services and information. Capitalize on digital enabled ease of transacting, accessing information, and offering self-service capabilities.

Closed Marketplaces





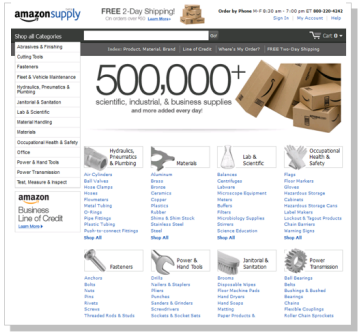
Strategy can best be expressed as a series of interdependent and self-reinforcing choices... many distributors don't do this well



# Since the launch of Amazon Supply in April 2012 distributors have tracked its developments and implicitly questioned where to play and how to win

2014

Amazon's April 2012 launch of Amazon Supply disrupted the B2B marketplace



**Facets of the Amazon Supply offer:**

- Broad selection of categories
- Deep product inventory
- ~10,000 private label products
- Navigate by category, product, brand,
- Familiar interface
- No minimum order size
- Competitive, standard pricing
- Free 2-day shipping on orders >\$50
- Lines of credit with net 45+ terms
- 365 day return policy

“For an independent brick and mortar distributor, non-traditional competition is a serious concern”

Since its launch Amazon Supply has aggressively expanded its product catalog, categories and portfolio of brands



Timeline of Amazon Supply's product catalog growth:

- June 2012: 500,000+
- July 2013: 750,000+
- September 2013: 1,000,000+
- March 2014: 1,250,000+
- May 2014: 2,250,000+

Additional features highlighted:


- amazon Business Line of Credit
- 365 day returns
- FREE 2-Day Shipping! On orders over \$50

Shop all Categories:

- 3D Printing
- Abrasives & Finishing
- Cutting Tools
- Fasteners
- Food Service & Grocery
- Fleet & Vehicle Maintenance
- Hydraulics, Pneumatics & Plumbing
- Industrial Electrical
- Square D Circuit Breakers
- Dorian Mill Holders
- Georgia Pacific Towels

2018

Home » Blogs » Distribution Technology » Distribution Industry Launches Competitor to Amazon Business\*

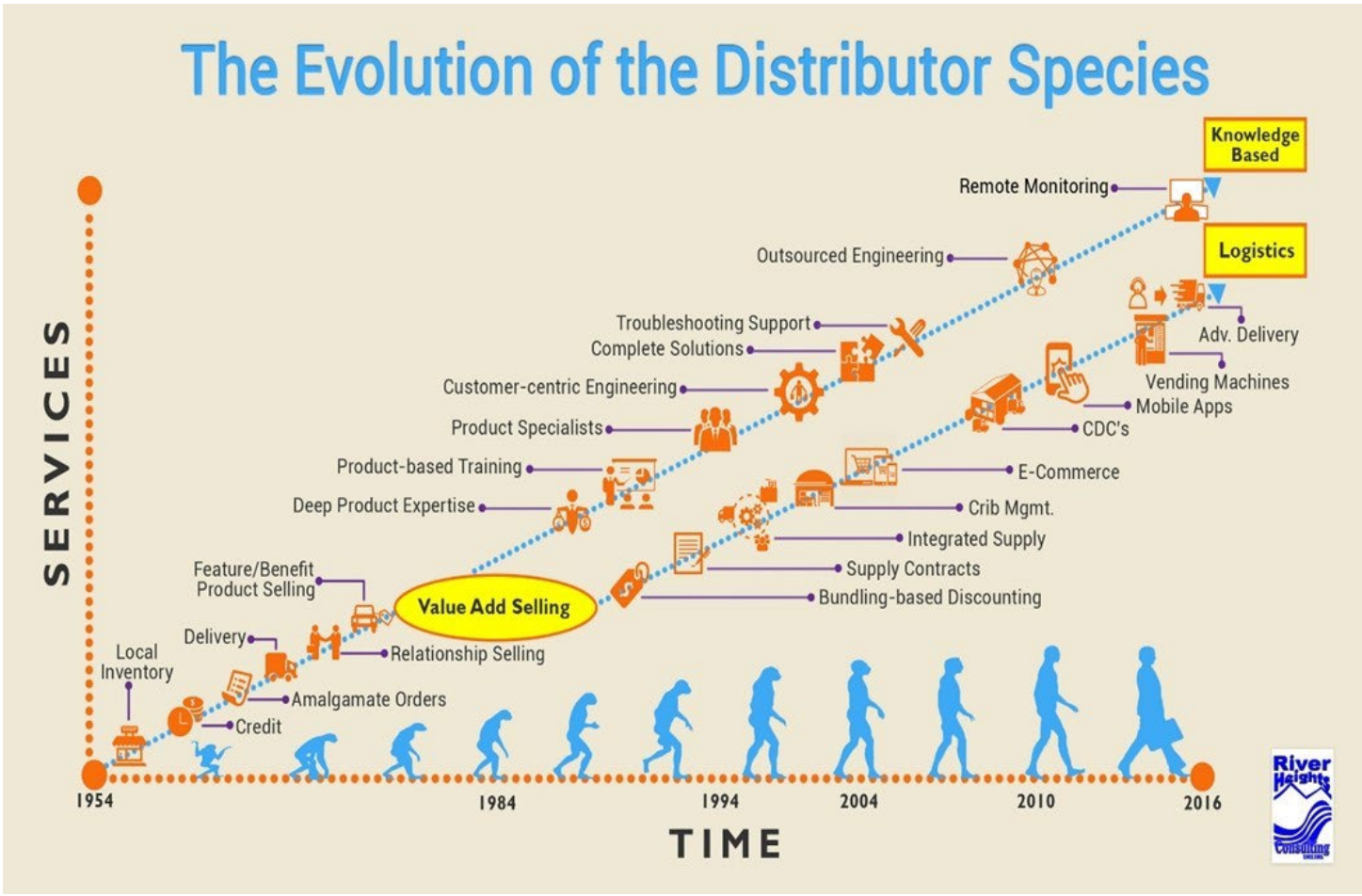


**Distribution Industry Launches Competitor to Amazon Business\***  
 December 10, 2018 | Ian Heller  
 More About: [Distribution Technology](#) / [Distribution Management & Strategy](#)

Editor's note: We share this bit of creative writing to generate some interest in the distribution industry about a platform alternative to Amazon Business. However, it's dated six months from now – perhaps it will come true by then.

By Ian Heller June 10<sup>th</sup>, 2019

In response, many distributors have evolved their value proposition and capabilities... but in today's digitally disrupted world evolution is insufficient



“Distributor has done a terrible job of knowing where the major buyers are and positioning the best sales reps with each of those buyers”

*National customer of leading distributor (2018)*

Notes: <http://thedistributorchannel.blogspot.com/2016/10/the-future-of-knowledge-based.html>

... and most distributors are not going to 'out Amazon' Amazon

**UPS tracking: "Your package is in X City, USA on a truck driven by Bob and will be at your door at 2:37pm"**

**FedEx: "Your package is somewhere. You'll get it when we give it to you"**

**USPS: "What package?"**

**Amazon: "We are inside your apartment."**

"The notion that distributors can compete with Amazon is patently ridiculous.

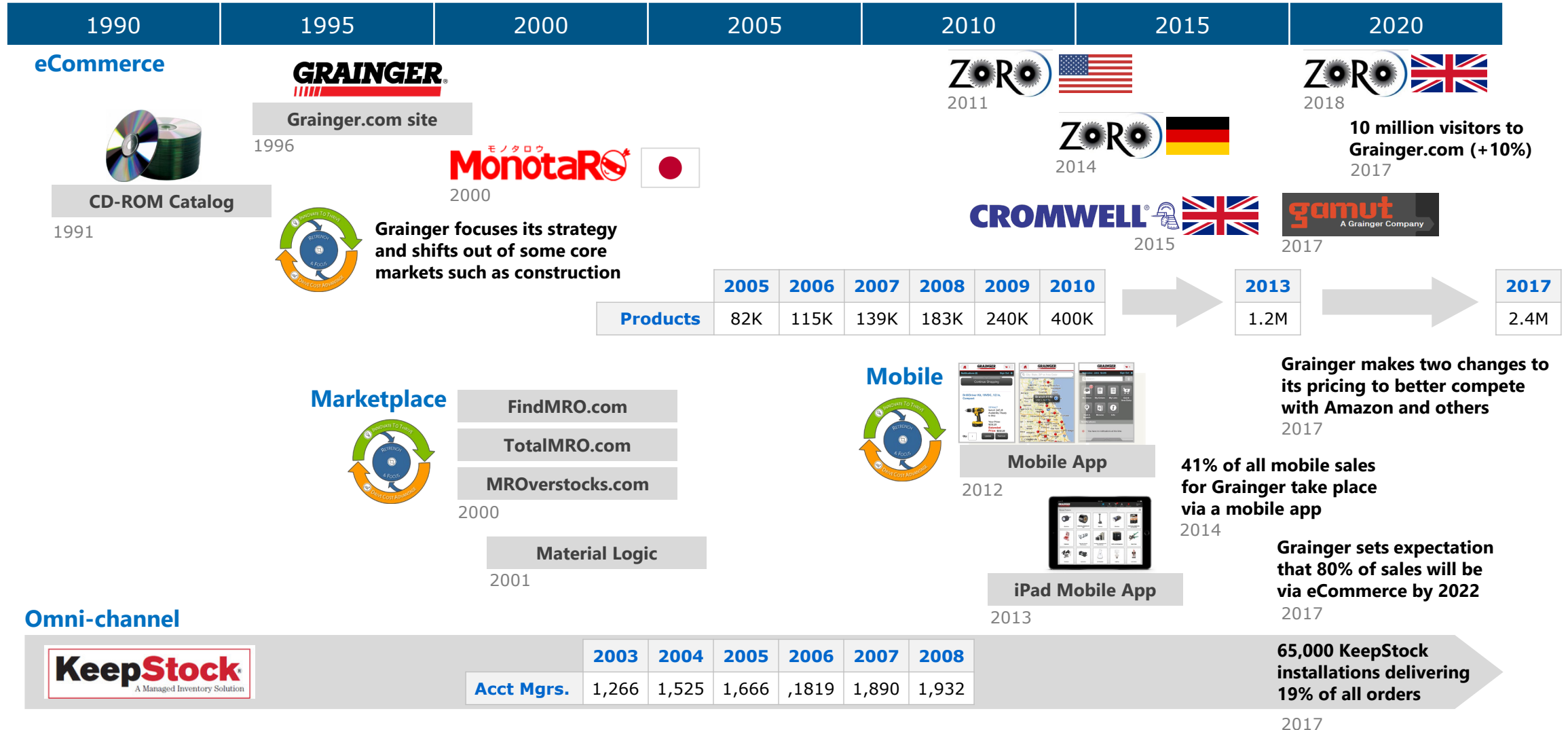
That ship has sailed... and circled the world a couple of times."

"Digital capabilities should be explored in the white spaces where Amazon is not competing"

*Leading supplier to  
electrical and  
industrial distributors  
(Client interview, November 2018)*

# W.W. Grainger competes heavily with Amazon and has innovated throughout their 25 year digital journey... with a relentless focus on where to play and how to win

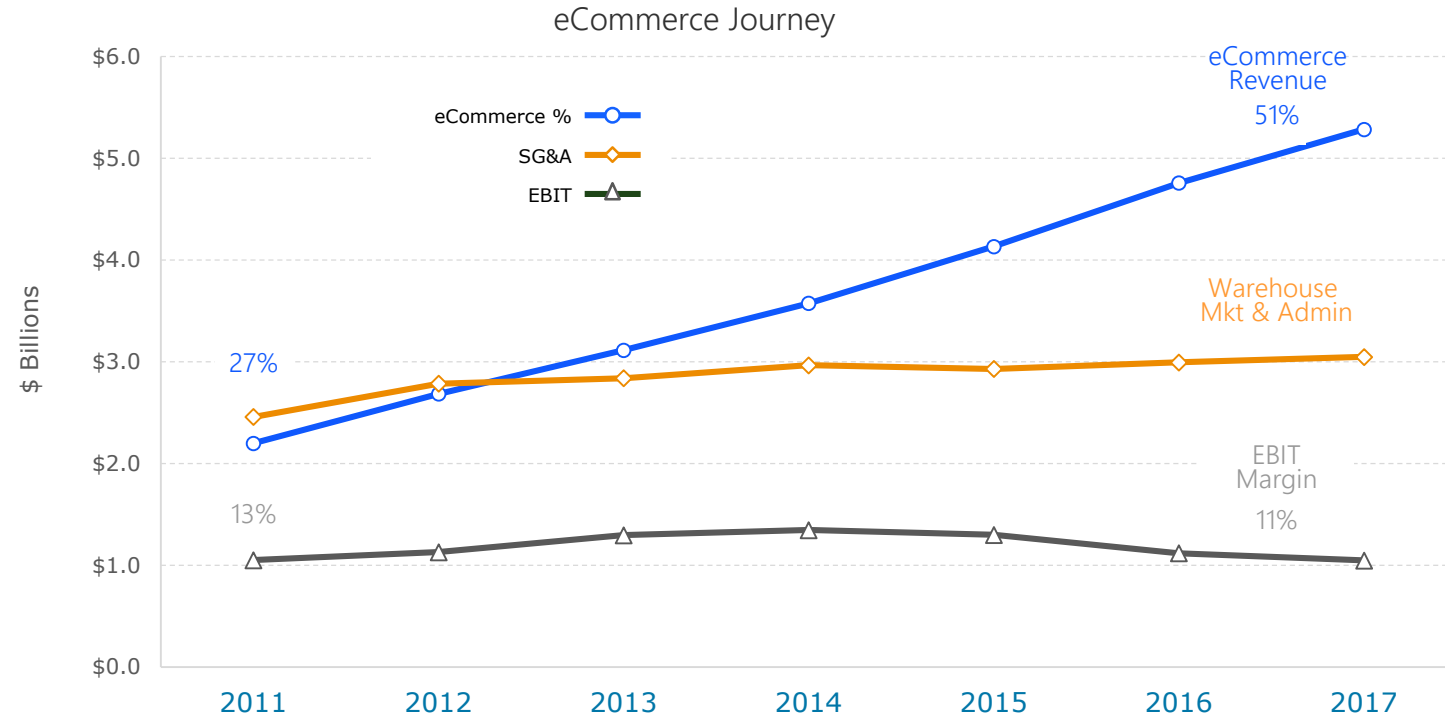
## **GRAINGER**



# For an extended period the duplicate costs of building a robust digital business while maintaining legacy go to market infrastructure negatively impacted profitability



W.W. Grainger, Inc.



Order Origination Mix & Trends

Order Origination	2017 Line Mix	5 Year CAGR
KeepStock	19%	19%
EDI / ePro	22%	19%
Online	28%	7%
Counter	9%	-9%
Phone	22%	-12%

## Impact of dual cost structure during digital transition:

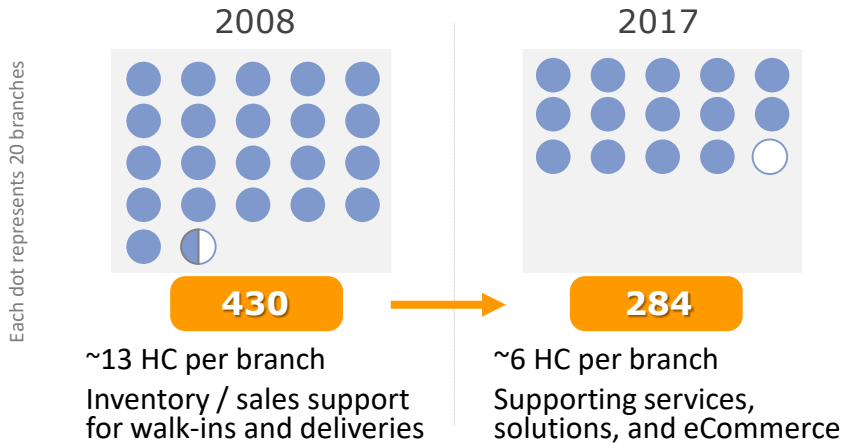
- eCommerce revenues have grown from 27% of total in 2011, to 51% in 2017
- >69% of sales originated via 'all digital channels' (e.g., Grainger.com, KeepStock® and EDI/ePro)<sup>1</sup>
- Grainger's EBIT margin has eroded 2.0% since 2011
- Limited efficiency in Warehouse, Marketing & Administrative (SG&A), with expenses flat at ~30% of revenues

Notes: 1: W.W. Grainger August 2017 Standard Presentation  
 2: eCommerce revenues inclusive of EDI, eCommerce, and electronic Keep Stock vending orders  
 Source: Deloitte Consulting analysis, SEC Form 10-K Annual Filings

# To drive cost advantage Grainger is transforming its operating model



Reduce # of Branches changed their role to better support digital platforms



Shared Services / Offshoring

Moved ~200 back-office positions to Panama shared services:

- Accounts payable
- Order management
- Supplier performance management
- Product sourcing



IT & eCommerce CoE

- ~500+ HC in downtown Chicago innovation hub
- Creates CoE for IT, digital, and eCommerce

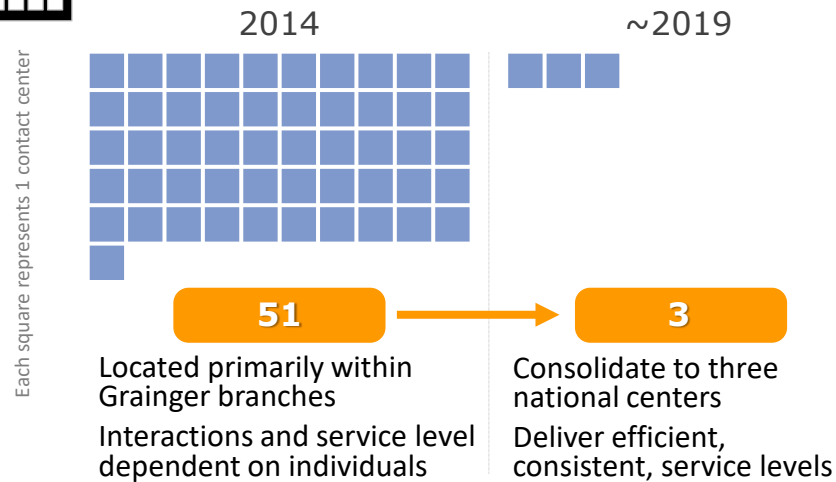


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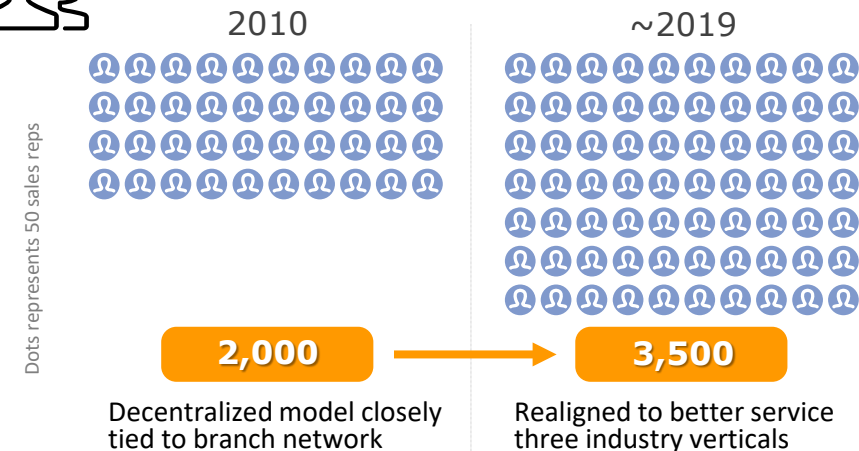
“Enables us to attract the best talent to build upon and enhance our eCommerce platform.”



Consolidated Contact Centers



Number & Role of Sales Reps






and aligning its customer experience and pricing with specific customer segments, while driving further cost advantage and capabilities via its distribution network



Customer Segmentation

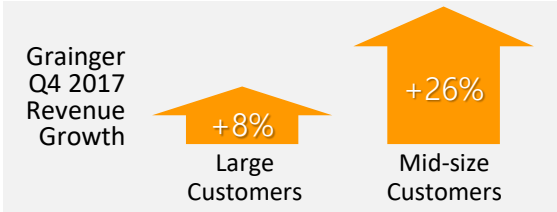
- Customer service, order origination and order fulfillment differentiated by segment

<p><b>Single Channel Online</b></p> <p>Endless assortment at competitive prices.</p> <p>Create value through a simple and consistent experience at competitive prices to help customers with less-complex needs quickly find products.</p>	<p><b>Primarily Digital</b></p>  <p>Digital solutions and marketing to build relationships.</p>
<p><b>High-Touch Multichannel</b></p> <p>Customized offer for more complex customer needs.</p> <p>Create value by building strong relationships, helping customers manage inventory, providing safety and onsite training and ensuring they get the right product for the job.</p>	<p><b>Sales and Service Reps</b></p>  <p><b>Digital</b></p>  <p>Sellers, service representatives and digital solutions drive relationships with purchasers and end users.</p>



Online Pricing

- ~40% of Grainger’s U.S. business uncompetitive on price
- Cuts price on 1/3 of products, deflating prices overall by ~4%
- Creates web price for all 1.5 million items available online... goal is to win with mid-size customers
- Renegotiated large customer contracts to enhance competitiveness of infrequently purchased items
- Stock price initially dropped ~40%... since recovered and now +14% from previous high



Distribution Network

- Enhanced distribution centers in CA, IL, and SC
- 2016: Added a new ~1.3 million SF DC in NJ
- 2017: Adding new DC in KY
- The US distribution center network stocks ~650,000 SKUs shipping most orders complete with next-day delivery



Source: Deloitte Consulting analysis, W.W. Grainger, Inc. SEC Form 10-K Annual Filings, Investor Day Presentations, and Fact Books



Question: What is changing faster...

the behavior of your customer, their  
habits, preferences, and choices

... or your business?



Official Professional Services Sponsor

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