

MODERN DISTRIBUTION MANAGEMENT

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How to Build Service Value Propositions

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Your big winners can teach you how to hold onto their business and how to make your company more profitable.

Lessons learned from the fastest growing, most profitable customer segments ignite the process of innovating profitable, sustainable value propositions. Using customer profitability information, you can rethink current sales and business policies to create new ones that help transform marginal accounts into profit contributors. Here's how to create a customer-centric distributorship in the top performance quartile.

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Distributors develop value propositions – products, services or a combination of both – by listening to their big winners. Product development is, of course, primarily the domain of the distributors' manufacturer-suppliers. The product development function for many wholesaler-distributors is a continuous search for new products to fill specific customer requests or for promising new product lines. Ideally, suppliers rely heavily on input from their most innovative distributors (and their distributors' best customers) for new product ideas.

Distributors are on their own when it comes to development of new services. Value propositions based on new services are the mark of an innovative distributor, and can be developed in a systematic way. The following examples show how distributors in various industries created value propositions to respond to the needs of their most profitable customers. Each of these service-based value propositions proved valuable to the customer, profitable for the distributor and sustainable for several years.

Retail supplies distributor. The top purchasing executive at a national retail chain divided his store-supplies business geographically between two distributors. He confronted the two distributors about the nearly \$2 million he felt was wasted each year on small and rush deliveries.

One distributor argued that the customer's freight information was wrong and that the cause of the small orders was errors by the retailer's staff. The other distributor listened to the customer. He offered to set up a public warehouse near each of the retailer's four distribution centers, along with a cross-docking system, JIT delivery and a web-based catalog/order entry system.

The concept eliminated the expense of small/rush deliveries and most errors and reduced the order cycle time from two weeks to four hours. The distributor perfected the system, captured 100% of the business and added numerous additional product lines. Then the distributor successfully used the same system at other customers and prospects.

Automotive production supplies distributor. Purchasing management at a Big Three automaker was challenged by corporate directives to eliminate all errors in shipping and labeling and to slash the costs of inspection and testing. Some of the automaker's suppliers argued that the errors were unavoidable and that quality problems were the result of the manufacturer's excessively rigid standards. Listening to the customer, another distributor offered to perform the needed quality inspections at his locations. The automaker eliminated its inspection function...and the distributor eliminated the competition. This value proposition protected and expanded the business at a profitable account and led to new opportunities.

Industrial parts manufacturer/distributor consortium. Management at several large manufacturing plants struggled with

corporate-wide directives to reduce their number of suppliers. Local plant managers wanted to maintain technical support from qualified local wholesaler-distributors. A national manufacturer of industrial parts, committed to its loyal distributors but sensitive to customer needs, established and funded a new business venture. After listening to the customers, the new venture formed teams of local distributors in major industrial markets in the United States. Each distribution team consisted of the parts supplier's distributor and the best-in-class distributor in five or six major product categories. The distributor team was linked to the customer using advanced software systems, enabling the team to look and feel like a single company to the customer while preserving the desired local technical support. This value proposition led to long-term contracts with numerous large industrial customers, protecting the parts manufacturer's distributors and creating new opportunities.

Recorded entertainment distributor. As the jukebox industry made the transition from 45 RPM records to compact disks, operators needed to reduce the product and labor costs of purchasing and handling CD albums. An attentive distributor, listening to the customer, licensed the most popular jukebox selections. The distributor produced special CDs consisting of only the music jukebox operators wanted. That value proposition helped him become a leading national supplier to a niche industry.

Medical imaging supplies distributor. A large regional distributor of medical imaging products such as x-ray film to large hospitals observed his customers struggling with managing and storing bulky, heavy containers of film processing chemicals. Distributor management listened to the customer and developed a bag-in-a-box packaging concept. The distributor invested in equipment to mix the processing chemicals at his distribution locations. He was able to deliver small quantities of chemicals, along with film and supplies, on a just-in-time basis. This value proposition enabled the distributor to expand his market share to over 50% in key markets and to add high-margin business to his product mix.

Packaging distributor. A regional packaging distributor added the capability of processing plastic cushioning "peanuts." Although the product line was highly successful, the distributor's largest customers needed to either dramatically reduce the cost of handling individual bags of these peanuts or they would be forced to find another packaging method. Listening to the customers, distribution management sold processing equipment and technical services to the largest of them to enable them to process their own cushioning. The distributor built custom delivery equipment to deliver peanuts in bulk to large users who didn't want to purchase processing equipment. These value propositions enabled the distributor to hang on to its most profitable customers and to become the dominant supplier in its markets.

Build a system

The objective of distributor R&D is new value propositions (services and products) for customers. To be successful, distributor value propositions need to meet the following criteria:

- **Valued by the customer** (customer willing to pay for).
- **Profitable to the distributor** (increases revenues more than it increases operating costs).
- **Sustainable** and not easily copied (will be useful and profitable for a reasonable period of time before it becomes obsolete).

The criteria apply whether the value proposition is a service, a product or both. The type of R&D distributors engage in is often informal and somewhat haphazard. Distributors don't have the budget to equip laboratories staffed with scientists. Even though wholesaler-distributors are not creating adhesive formulas or inventing miracle drugs, the value proposition development process for distributors would yield more and better results if it were systematic.

Most wholesaler-distributors do not have a systematic, focused method to match known customer needs with available solutions. Here is an example of a disciplined approach to developing value propositions.

- Identify the most profitable, fastest-growing customer segments using customer profitability ranking reports.
- Send teams of salespeople and managers to the most profitable, highest-potential customers to research customer needs.
- Document and prioritize customer needs.
- Deploy teams consisting of both your employees and representatives from your suppliers to develop value propositions that solve customer problems and meet the company's criteria.
- Test the most promising value propositions with the best, most enlightened and progressive customers.
- Refine the value propositions and roll them out among other growing, profitable customers with similar needs.

It is often difficult for a distributor to appear distinctive in terms of product offerings, due to the lack of exclusive—or even

selective—distribution of some product lines. However, some distributors have done a remarkable job of developing proprietary services that make them stand out from competitors who sell essentially the same basket of products.

Furthermore, many of the value-added services offered by distributors don't meet the criteria set out earlier.

- The customer doesn't place much value on the services and is not willing to pay for them. This may be a result of faulty design, poor implementation or simply not understanding the customer's needs or the competition's offering.
- The service is unprofitable. The extra work increases the distributor's operating costs more than it enhances revenues. Even though the service offers real value to the customer, the distributor has failed to properly position the service and communicate its value.
- The service is not sustainable or was easily copied by competitors.

Diagnosis of a poorly implemented value proposition

The following example is about a value proposition that was responsive to a customer need but failed as a result of bad execution.

Medical equipment repair service: A large regional distributor of medical diagnostic equipment decided to get into the equipment maintenance and repair business in a serious way. Qualified technicians were recruited and given factory training. Expensive test devices, tools and vans were put into place. Customers were pleased with the quality of the work. Unfortunately, the business was a financial disaster. Billing rates and parts revenues did not kept pace with costs and the technicians were not productive. What went wrong?

Problem number one: The equipment salesforce was given responsibility for selling maintenance and repair programs. The sales staff regarded equipment sales as their top priority and tended to offer discounted or free service to their largest accounts.

Problem number two: The technicians were managed by a combination of the company's warehouse managers and sales managers. Their utilization rates were low and there was no accountability.

After two years of frustration, the distributor finally acquired a company whose only business was maintaining and repairing medical diagnostic equipment. Separation of the management and sales functions of the two businesses, under experienced management and with accountability, made the service function profitable.

Management had been correct in perceiving a need for dependable service, but implementation was poor. A specific mistake could have been avoided: Customer profitability information would have shown that the company could not afford to offer discounted or free service to its largest equipment customers.

Use customer profitability information

Customer profitability information—such as customer P&L statements and customer profitability ranking reports—provides the basis for rethinking distributor business policies in areas such as these:

- *Order size.* The data show the company's cost of processing various types of orders and what gross profit percentage is needed to generate operating profits at various target levels.
- *Outbound freight.* The data show how much outbound freight cost can be absorbed for different order sizes, order types and ship-to locations.
- *Sales coverage.* The data show the profitability of various geographic markets and the cost of providing alternate levels of sales support.
- *Credit terms.* The data show the actual cost of extending credit to slow-paying accounts and the cost/benefit of providing cash discounts as an incentive for faster payments.
- *Sales commissions.* The data show the cost/savings of making adjustments to the sales compensation plan for specific customers, territories or the entire organization.
- *Small-order charges.* The data show the return on investment potential for small-order charges or other revenue opportunities.
- *Special stock and consignment programs.* The data show the additional cost of carrying slow-moving special stock for customers or for consignment programs.

When evaluating distribution activities key questions are, "How does this extra expense lead to increased profit?" and "If we stopped doing this would our best customers even notice, much less care?" Careful analysis of customer P&L statements directs attention to expenses incurred in providing services that customers don't value as highly as expected. Some value-

added services, intended to match or exceed customer expectations, may overshoot the target by increasing operating expenses but not gross profits. Other services, added at little or no cost, could dramatically reduce overall operating costs. Some examples follow.

- *Rush deliveries.* The data may show that expenses incurred in providing same- or next-day deliveries may be unnecessary.
- *Delivery schedules.* The data may show that scheduled deliveries to some areas are more frequent than actually needed to satisfy customers.
- *Order accumulation.* The data may show that accumulation of customer orders for less frequent delivery would increase order size and reduce operating costs (and reduce customer costs).
- *Order forms.* The data may show that helping the customer organize the replenishment function would reduce costs and increase customer satisfaction.
- *Sales assignments.* The data may show that salespeople are assigned to handle some customers that do not need or use the costly extra service.
- *Web catalogs/ordering.* The data may show that web ordering tools would reduce operating costs and increase customer satisfaction.
- *Premium deliveries.* The data may show that premium delivery services increase costs without adding value for the customer.
- *Consolidated billings.* The data may show that periodic billing to large customers would reduce operating costs for both the distributor and the customer.
- *Sales incentives.* The data may show that sales incentives are paid for unprofitable transactions/customers.
- *Remote warehouses.* The data may show that public warehouses closer to the customer would reduce operating and freight costs, reduce cycle time and increase customer satisfaction.
- *Consignment.* The data may show that consigning inventory to the customer would reduce operating costs and increase customer satisfaction with negligible adverse effect on inventory turns.
- *Pricing for extra services.* The data may show that the extra services are under-priced, causing an increase in expenses in excess of the additional gross profit generated.
- *Bidding.* The data may show that pricing on bid business is undisciplined and results in unprofitable business or that bids are not sensitive to the market and profit opportunities are missed.

The bottom line

Systematic development of value propositions for top customers and business policies in tune with customer needs and profit goals can launch a good distributor into the "great" category: the top quartile. Staying there requires a laser-sharp focus on customer profitability and a customer-centric distributorship.

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