VOLUME 1, ISSUE 1

DECEMBER 11, 2001

Demand

DEMAND—A MANAGEMENT NEWSLETTER FOR WHOLESALE DISTRIBUTION

Demand: The Inaugural Issue

Demand — Econ. **1.** the desire to purchase, coupled with the power to do so **2.** the quantity of goods that buyers will take at a particular price.

Is demand created or does it simply exist to be satisfied? We'll let you be the judge of that.

Demand's objective is to present management views pertaining to electronic commerce, sales strategy and customer service within wholesale distribution firms. *Demand* seeks to provide unbiased and thoughtful information in a convenient, easy-to-read format.

Stimulate or satisfy, either way…it is all about *Demand.*

Demand — The Fruit of Your Labor

Inside this issue…

- *Why Demand was created*
- *What Demand will do for you*
- *How you can profit from non-stocks*
- *Marketing strategies for distributors*

Special Feature inside:

What Drives Business, Branding or Marketing? *p. 2*

By David Gordon

Non-stock or non-profit? by Scott Benfield

If your mix of business is typical of most distributors, your non-stock/out-of-stock sales continue to grow. As product proliferation continues, catalogs become larger, electronic cataloging (CD-ROM, e-commerce) grows and distributors watch inventories, more pressure will come to bear on the increasing sale of non-stock items. It is not uncommon to find some distributors selling over 50 percent of their volume in non-stock items.

One of the problems with non-stock sales is that they are often priced without consideration of their extra costs. The purpose of this article is to give some practical tools to the industrial distributor to recover added costs in their non-stock pricing.

Added costs of non-stocks

The extra costs of non-stock items are numerous. Increased freight, purchasing, receiving and payment costs are commonly realized in non-stock items. For instance, if the average stock purchase order/receiver/payable transaction costs $100 and lands $2,000 worth of inventory, then the cost ratio is $2,000 to $100, or 20:1. For non-stock items, however, the cost is still $100 to process the paperwork but the inventory value is often $500 or less, making the cost ratio $500 to $100, or 5:1. Inbound freight is another consideration for non-stock items. Freight and handling for stock inventory is typically *(cont'd on p. 4)*

What Drives Business, Branding Or Marketing? by David Gordon

Manufacturers drive awareness, distributors generate sales.

As manufacturers and distributors begin preparing for 2002 joint planning, both sides need to first develop their own marketing and branding plans for 2002.

Manufacturers are now developing their marketing plans, typically using advertising to end-users as a primary communications and marketing tool. While much advertising focuses on the product (promoting features and benefits) manufacturers also try to "create, enhance or reinforce" their brand(s), hence "you should stock our products and increase your commitment to us." Many manufacturers believe that customers request their products. The question is, *who has product "power" in the channel – manufacturers, distributors, or customers?*

Or another way of asking the question is "*Are manufacturer marketing strategies focused on helping you "make the sale"?*

Studies show that distributors significantly influence the products that their customers purchase – according to a 1999 TED survey, 78% of contractor purchases are influenced by distributors and 81.4% of MRO purchases are similarly affected. Additionally, when a distributor says that "If you look at the request for quotes we receive daily, 90% are generic …", you question the advertising ROI for manufacturers.

"Studies show that distributors significantly influence the products that their customers purchase."

Don't get me wrong, advertising is important. It creates awareness of a product and potentially an application for the product. The challenge with most advertising is that there is not a "call to action". Questions like "Why buy? What is different about this item/ this company? Where is it available? What else do I need to know and where can I get the information that I need?" All of this is important to the ad reader. Also, depending upon the audience for the ad, the issues are different – different publications warrant different copy.

While there are some manufacturers who do a good job at promoting their company and their products, most lag in this area. In the opinion of one distributor, "manufacturers are usually good if they are more consumer-oriented." And in reality, aren't our customers consumers during their non-work hours?

One of the issues is identifying the difference between branding and marketing.

Branding, according to the American Heritage Dictionary, is "a trademark or distinctive name identifying a product or a company." **Marketing** is the "commercial functions involved in transferring goods from producer to consumer." While this marketing description is broad, in essence, it focuses on all of the touch points throughout the channel that are required to sell a product. In short, marketing is about integrating strategies and branding is about name awareness, or capturing mind share.

"How many price increases "stick"?

Many people have heard of the *Electrical Contractor* studies regarding brand awareness and name recognition. But is knowing, or recalling, a name, enough? Does it generate a purchase? No. The proof is that manufacturers lament the fact that customers will not pay a premium for the product. How many price increases "stick"? *(cont'd on p. 3)*

What Drives Business, Branding Or Marketing? (cont'd from p. 2)

What needs to change?

Manufacturers need to more fully develop integrated marketing strategies that incorporate branding efforts. Also, distributors need to look at themselves and say, "Why does someone buy from me?" and then develop strategies to promote their USP (unique selling proposition) to their customers. Once a distributor understands why people buy from them, they need to conduct joint marketing strategies with key suppliers. The concept of account-specific marketing has been successfully implemented in a number of industries, and can significantly impact distributor sales with participating manufacturers. The key is doing something, and there is manufacturer funding available to assist in these efforts.

"Distributors need to look at themselves and say, "Why does someone buy from me?"

Distributor efforts. Branding is a foreign word for most distributors. Most companies have not taken the time to determine why current customers buy from them and why prospective customers should buy from them. Yes everyone says relationship, quality of people, knowledgeable staff, and access to quality lines - but if everyone says this, doesn't this just level the playing field?

Yes this is a relationship business, but what happens when the people with the relationship leave the company. Distributors need to go beyond "thinking about marketing" and find ways to work with key suppliers to "implement marketing", and grow, their business.

Most distributors consider branding as usage of their logo. According to one distributor, "*branding means that when you see a company logo, or hear the name, you associate it with the company's product or service.*" But branding needs to go beyond t-shirts, hats, mugs and golf balls. While all of these are elements of a branding strategy, more is needed, however, as branding as a standalone activity, will not impact sales or profitability – marketing will.

"The first step is a willingness to understand what value you bring to your customers."

For a branding strategy to be successful, there must be a vision, a top-down commitment and a long-term financial investment to start, and keep, the effort alive. The first step is a willingness to understand the value you bring to your customers. Once a distributor begins this process there are a number of internal and external efforts that are essential to keeping the "brand" alive, one of which is developing a set of metrics to measure yourself against. Two concepts from the automotive industry you may wish to consider, and they are self-defining, are a Customer Satisfaction Index (for post-sale measurement) and a Sales Satisfaction Index (for the sales/quoting process).

Some independent distributors who, in the opinion of other distributors, do a good job of branding include Branch Electric, Brook Electric, Roden Electric and Platt Electric

National chains have name recognition, but is that because of their size and naming consistency (WESCO, GE Supply and Graybar benefit from this, but do CED, Rexel, Sonepar and Hagemeyer?) or due to their efforts to build a brand? And what does their brand mean to customers? to manufacturers?

Overall, distributors do a poor job in branding themselves – most times due to lack of a commitment to market their company. (cont'd on p. 6)

Non-stock or non-profit (cont'd from p. 1)

1 to 2 percent of inventory value. For non-stocks, the figure is 3 percent to 5 percent of sales. Many distributors are surprised that non-stock orders of $100 or less have inbound freight and handling in the double digits as a percent of value.

Doing the math, most non-stock items cost five times or more to process than stock items. For most distributors, this translates into the need to get 7 percent to 10 percent more margin on non-stock items. If you are not realizing gains in this range, you should take a careful look at your non-stock pricing mechanism.

"Many distributors are surprised that non-stock orders of $100 or less have inbound freight and handling in the double digits as a percent of value."

Non-stock pricing mistakes
Most non-stocks are ordered by the inside sales group. Customers make an inquiry about a non-stock item, secure the cost from the inside seller, and place the order, often at a later date. The request for a non-stock price and availability is followed by the inside seller consulting a manufacturer's catalog for model number and a cost figure.

In most instances, the inside seller cost-plus prices, or "bumps," the cost by a factor. For instance, the customer wants a "super zip drive cutting tool" that costs $200. Your seller wants a 25 percent markup, so he multiplies $200 by 1.25 for a price of $250. In the previous transaction, your seller probably made several mistakes.

First, cost-plus pricing is a lousy way to maximize margin. Cost factors are often "rules of thumb" used by your sellers and are very limited. Most inside sellers use less than a handful of cost-plus factors that serve all non-stock orders.

Secondly, cost-plus pricing makes the assumption that buyers are sensitive to your costs or that costs determine market value.

Third, in the case of contractors or other resellers, price requests often are part of a larger bid so the end customer can be quoted a price. Most inside sellers interpret these requests as the customer "shopping price," when in reality they (the immediate customer) are getting a price to quote their customer. And last, the price often does not consider the extra costs of processing and freight to be recovered.

"The best means to cover non-stock pricing is by using a list and discount mechanism."

To overcome these mistakes, the marketing manager needs to institute changes in pricing policy on non-stock items to procure needed margin.

Fixing non-stock pricing
The first step in fixing non-stock pricing is to change the cost-plus pricing rules of thumb. Understand that covering the increased costs of non-stock processing is not an endorsement of cost-plus pricing. Extra processing costs can be covered by mechanisms other than cost-plus pricing.

The best means to cover non-stock pricing is by using a list and discount mechanism. The simple use of a list price less a discount often yields higher margins than cost-plus pricing. Why? The reasons are complex but have to do with the ability of the marketer *(cont'd on p. 5)*

Non-stock or non-profit (cont'd from page 4)

to control discount structures through programmed pricing matrices and the loftier markups afforded by price lists. Often, the inside seller has access to costs, not list prices. If this is the case, as it often is, recovering extra processing costs is paramount.

To recover processing charges in cost-plus pricing, try placing a cost adder on the item before it is bumped. For example, if the item costs $100 and the cost adders are 5 percent, then program your pricing system to cost the item at $105. If the typical markup is 25 percent, then the cost-plus price will be approximately $130, which reflects the extra processing costs. In programming this cost adder, be sure not to link the inflated cost to the purchasing or payables files.

"…many customers don't think twice about paying reasonable inbound freight and handling charges. They view the non-stock purchase as a value-added service."

If you are not keen on a cost adder, you may choose to bill the added costs as shipping and handling charges. Depending on the customer segment and industry practice, shipping and handling charges for non-stocks may be a cinch or an impossibility.

I recommend billing a reasonable percentage, calling it inbound freight and handling charge and informing the customer of the charge.

I also don't advise gouging customers on freight and handling charges. Too many managers see the category as a chance to make a premium and don't realize the customer is easily offended by exorbitant charges.

In my experience, many customers don't think twice about paying reasonable inbound freight and handling charges. They view the non-stock purchase as a value-added service. It's always better to test pricing assumptions, however, before global implementation.

Future challenges

As the categories of non-stocks and directs grow, so will the need to monitor and manage their pricing. Too often, inside sales or outside sales are left with these responsibilities. If you are letting sales command pricing, then don't be surprised when profitability suffers. Most salespeople don't have the analytical tools and segment perspective to maximize pricing margin. Whenever possible, use your MIS system to automate pricing. Use list and discount structures over cost-plus mechanisms and assign overall responsibility of pricing to marketing and finance. Also, have a well-documented policy of pricing discounts and keep a tight lid on exceptions to maximum discounts.

These simple rules are often the difference between an acceptable year and a bad year on your bottom line.

Scott Benfield is a consultant, freelance writer, and marketing manager for distribution. His book , **Capturing Value Through Pricing Strategy***, is for wholesaling businesses and can be ordered at www.nawpubs.org. He can be reached by email at bnfldgp@aol.com.*

What Drives Business, Branding Or Marketing? (cont'd from p. 3)

Bottom Line

For distributors consider:

1. How you can measurably differentiate your company from your competition
2. Invest in understanding your customers' desires
3. Develop strategic marketing plans
4. Identify those manufacturers who will support you in multiple ways
5. Measure the overall value of a manufacturer to your business (perhaps a manufacturer support index?)

Remember, branding is not just logos on line cards and t-shirts. Branding is about defining yourself, determining the customer experience and promoting your values.

Through effective channel marketing strategies, distributors can together grow their businesses, and in an economy where everyone is looking for the upturn, statistics, and history, show that those companies that maintain, or increase, their marketing efforts typically come out of a downturn sooner and experience significantly higher market growth.

"…companies that maintain, or increase, their marketing efforts typically come out of a downturn sooner and experience higher market growth."

David Gordon is a principal in Channel Marketing Group, www.channelmkt.com, a marketing consulting firm specializing in channel marketing strategies for distributors and manufacturers. He can be reached at 919-488-8635 or by email at dgordon@channelmkt.com.

DEMAND—A MANAGEMENT NEWSLETTER FOR WHOLESALE DISTRIBUTION

www.oxinternational.com

For information about subscribing to *Demand*, please call Mark Warnken at 713-895-6616 or email demand@oxinternational.com