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"The Manufacturer-Broker Dilemma" - presents one of the core issues in the manufacturer-broker agency model in a new light

"I'm Paying for WHAT?" - railing about the airlines, with a foodservice-related point...

Thanks for reading, and as always, let me know what you think.

Dave

"The law of unintended consequences pushes us ceaselessly through the years, permitting no pause for perspective." - Richard Schickel

This month, I'm taking the opportunity to bring you another excellent commentary by Bruce Merrifield (Merrifield.com).

Bruce works with and writes about wholesale distributors across many industries and channels; I'm often fascinated by how well Bruce's viewpoints apply to our foodservice manufacturing and distribution business. He has given me permission to edit his commentary for the foodservice audience; the entire article can be read by clicking here.

Bruce is a big thinker, so I suggest you take your time with this article and "think along" about the state of our business. There are six "solutions" toward the end of the article, most of which apply to manufacturers as well as distributors. Bruce and I will welcome any comments or observations you care to share.

DISTRIBUTION CHANNEL ROLL-UPS: CONS AND CURES

Consolidating fragmented industries - like independent distributor channels - really took off in the late '90s when earnings growth could be:

- Rapidly bought until size got too big and remaining acquisitions too small.
- Boosted by creative deal-accounting and one-time, centralized cost cuts.
- Enhanced by "growth rebates"
- Eventually monetized by going public in the ever-rising stock market.

Ten years later, these big agglomerations are mostly struggling. The public ones have low stock prices. But, more quietly, the rest of the channel players are suffering from negative, roll-up side-effects. Why weren't "economies of scale" sustainable for roll-ups? What are the side effects for other players? What are the innovative cures?

To stimulate some thinking, here is a partial list of the cause-and-effects conditions sparked by roll-ups that have affected all channel players followed by some solutions and questions.

NEGATIVE SIDE EFFECTS FROM CONSOLIDATING THE PAST

1. A majority of the roll-ups in distribution channels are now struggling to achieve minimal profitability. Some of the "poof companies" of the late '90s went bankrupt; others have been severely milked by two or more successive, private equity owners. The publicized, economies-of-scale, cost savings have been more than offset by: the costs of bureaucracy; the deterioration in local service effectiveness; and, perhaps, the unconscious loss of most profitable, local customers while pursuing big-volume, contract-price ones that are profitless even with growth rebates factored in. ***Volume is vanity, profit is sanity.***

2. The effectiveness of the local profit center manager at roll-ups has dropped as either cashed-out owners were left in place to relax; or, new, shorter-tenure branch managers have focused on the new, make-the-numbers-to-serve-the-debt culture and please the hierarchy instead of reinventing local, service-value creation and retaining most profitable accounts at a greater rate.

3. The (distributor) chains can all do reverse auctions with the (foodservice manufacturer) factories for swing tonnage, but the extra concessions haven't offset the new other inefficiencies. And, "better buying" can lead to chain-wide promotions of most back-end-profitable products, which again distracts from focusing on creating local service value for the best customers in the best customer segments that are peculiar to each branch. In mature markets, winning share of best customers with best total value solutions (that may include some most profitable products) beats pushing products to any and all accounts.

4. The roll-ups have generally continued to capture market share volume (to win those growth rebates!) two ways: a) through acquisitions of independents ("Indies"), who increasingly feel they can't compete and sell out, and b) winning regional/national contract bids using special pricing agreements (aka: contract pricing) But, what if the chains are winning profitless, big bids while losing local share of each "customer segment profit pool?"

5. To offset all of the special pricing deals, manufacturers of commodities have continued to artificially hike "list prices" to ridiculous levels which then serve as advertisements to seek a special price. Every downstream buyer knows that there is always a better discount price, so everyone becomes a more aggressive, thorough price-shopper, and the number and volume of contracts with back end rebate activity has grown rapidly.

6. The back end rebate activity has grown into a business by itself. The costs of - the manual rebate paperwork process; auditing for distribution cheating; not getting rightfully earned rebates; and negotiations over year-end differences of opinions - are collectively big and growing. Turning the dysfunctional, rebate problem into a core competency, most (distributor) chains have created special departments for: soliciting contract pricing; processing rebates; and negotiating year-end rebate discrepancies. Indies can't deal with these new costs which encourages them to sell out, which, in turn, reinforces problems 1 - 3 above into a vicious cycle. If both growth and contract rebates stimulate perverse behaviors that in turn fuel consolidation and no primary demand for the products, what can (manufacturer) factories do to level the playing field for strategically-effective contract pricing through all distributors regardless of size?

7. Most of the surviving "Indies" have not been innovating past these problems. Many continue, instead, to compete with the traditional, full-service, distribution model that includes the costs for: outside sales reps; inside sales reps to take orders; people to pick, pack and deliver goods; and trade credit for all. Because people costs continue to rise without offsetting personnel productivity, an increasing number of full-service accounts cost more to serve than they pay in margin dollars. Indies that have not segmented customers by segment and strata to re-serve and re-price/term them differently (like banks and casinos do) will discover from activity-based-costing studies of customer profitability that about 70 to 90% of their active account base will be anywhere from mildly to large profit losers. Over-serving small, growing nowhere accounts at a loss may be the single biggest reason that - across all independent distribution channels - the "average distributor" in any channel does not make a pre-tax return on assets equal to its cost of capital. Many, in fact, borrow money at a rate that exceeds their internal return on the debt for a negative leverage effect.

8. Alternative-channel competitors have steadily added the best moving items found in many different, full-service specialty channels. By stripping out most of the people-service costs, selling at higher margins and outsourcing trade credit to the credit card companies the "alternate channels" have grown faster and more profitably serving all of the full-service distributors' active accounts for spot, downtime-is-money buys when a customer is within a convenient drive time of a store

9. In an effort to buy better, most Indies, in a number of channels, have joined buying groups or co-ops that offer group purchasing power with suppliers as well as sourcing and marketing lower-priced, higher-margin, private-label lines increasingly from Asia against the wishes of domestic factory "partners."

10. The race to outsource private-label goods from China was, however, a one-time, ten-year, cost-arbitrage game that has run its course. The initial "high-margins" have been competed away leaving all distributors with two, redundant lines - brand names and private labels - both typically made in Asia with little to no profit left in them. Because the Asian clone products sell for every-day, much lower prices, the brand name suppliers' list prices stimulate requests for contract pricing deals, and suppliers have been rapidly reducing channel support programs. ***Brand name producers must either restructure to be every-day-lower-price competitive, or meaningfully reinvent product categories or supply chain economics that wrap their products.***

11. As the Asian import game has matured, the local distribution center (DC) that is plugged into the best total supply chain with master distribution center (MDC) hubs will beat competitors. Buying containers (or Truckloads) less frequently on a direct basis may have lower factory prices, but the hidden costs of uneven, local inventory on items within a line are greater. The ultimate priorities at the local DC should be in descending order: highest everyday fill-rates; best turn-earn; and then lowest land cost. Best local fill-rate economics are, in turn, a function of being able to re-order as frequently as possible. Wal-Mart stores, for example, maintain 99% fill-rates by replenishing all commodity items from its MDCs daily! What group of importing suppliers or distributors will figure out how to partner to build the lowest, total-cost supply chain that will beat all of the one-off, supply chains for single factories and importing chains?

12. In some channels, there exist Master Wholesalers that only sell re-sellers. But, will they be able to figure out how to reinvent/sell themselves as the cost-plus, sole-supplier (MDC) solution for all A through D items as wholesalers in the grocery, drug and hardware channels did starting in the early '80s? And, will Indies still persist in trying to buy A and B items/lines direct - whenever possible - for a better "price" (or, bigger margin percent) not realizing the hidden-cost hit that they take for lower turn-earn and fill-rate metrics.
If Wal-Mart, Grainger, Fastenal, MSC Industrial, etc. all thrive by using internal, two-step distribution, why can't wholesalers and Indies "re-configure out" this opportunity together?

SOLUTIONS FOR THESE PROBLEMS?

Here's what 1 to 3% of Indies, who are true perpetual innovators, are doing:

1. Segmenting customers by A-D levels and selling them at different prices and terms to make sure that all customers will (soon) be profitable or will leave to lose money for a competitor

2. Downsizing, upgrading and repurposing the outside sales force. Rank all active accounts by estimated profitability as well as each sales territory; do the current math for full-service selling. What did one Indie conclude? He had 70% more sales call capacity than accounts that could support them. He released over 50% of his sales force to then reassign all accounts doing $400+ in gross margin per month to the remaining, best reps who then - true to their talent - increased sales to existing best accounts by over 20% within six months. The bottom line increased many fold on flat sales for the first year, and 15% sales growth the next year. The mantra was: "Downsize, upgrade, refocus, renew; take two steps back to leap 15 forward with high profits and honest positive cash flow."

3. Spinning-out a "wholetail" store location(s) from the distribution business and encouraging all unprofitable B-D customers to go to the store if they can't meet the new, higher minimum (profitable) order size for full-service (with free or fee-based delivery) from the distribution division.

4. Negotiating a cost-plus, JIT, replenishment contract with the best wholesaler(s) (MDC) in the area to take over as many formerly directly-bought lines as possible for both the distribution and the "wholetail" operations. By fine-tuning the replenishment contract both turn-earn and fill-rate economics benefits increase.

5. Then, figure out how to automate the process with paperless EDI transactions, and encourage the MDC to integrate into the on-demand software platform for the wholetail store format.

6. Opening up new, standalone wholetail stores in both smaller towns and big-city neighborhoods that are replenished daily by a MDC , because the breakthrough, on-demand, IT solution makes them viable between the cracks of already existing channel outlets. Recapture the convenience-store, emergency-spot-buy action from the alternative-channel competitors. And, sell two types of next-day, cross-docked goods from the MDC warehouse: a) even cases of commodities at every day low prices; and b) specialty items. Everything in the MDC's inventory should be virtually salable on a next-day, pick-up basis. ***Dave's Translation: Open GFS Marketplace stores to capture sales that would otherwise be lost to Sam's and Costco.***

LIVE WITH THE RIGHT (SHOCKING) IDEAS TO GROW INTO SOLUTIONS

Most of the "solutions" above will seem radical to many, especially those who have not been a student of what "leading edge" ideas have been occurring in larger-volume and/or more progressive distribution channels. If we don't have the vocabulary and building block concepts to see and understand new business models, then they don't seem, at first, possible. ***If we, on the other hand, don't change, but try harder at the past, what is our future given all of the trends above?***

If we start to ask and live with the right questions, we may grow into them; e.g.:

a. Does our particular channel have a lot of structural, consolidation problems starting with profitability and contract-pricing rebates?

b. Are alternate channels eating into traditional-channel volume?

c. Do manufacturers find it increasingly difficult to push new, niche items through the channel?

d. How can we redefine these problems in a bigger context and see if there are successful supply chain applications for these problems already in existence in other distribution channels?

e. What are cheap experiments that we might try?

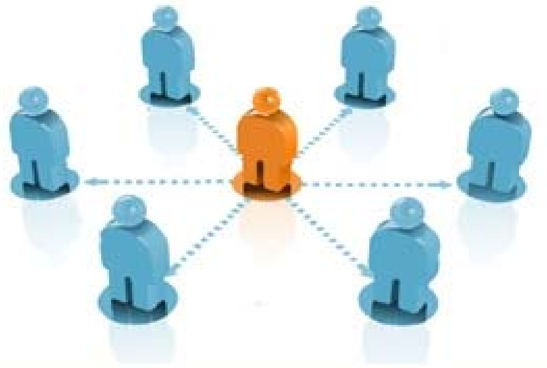
Dave's Take: This is a lot to absorb. But if you're a distributor or manufacturer who is frustrated by the current state of affairs, there are some nuggets to be gathered from the dark mine where Supply Chain realities and Sales and Marketing decisions intersect!

"Everything we hear is an opinion, not a fact. Everything we see is a perspective, not the truth." - Marcus Aurelius

"The Manufacturer-Broker Dilemma"

The guys at Food Service Enablers are working on some new product offerings, and showed me their marketing materials at the NRA Show.

Under the heading "The Manufacturer-Broker Dilemma," one graphic caught and held my attention. It looks like this:



Simple, but elegant. The graphic and accompanying text articulates the source of the tension that often exists between brokers and manufacturers. The copy reads:

"You have to share your brokers with other manufacturers who don't want to share either. From your view, you stand at the center of a network of Brokers whose business is to sell your products. From the view of the Broker, it's the reverse: they stand at the center of a network of manufacturers, and they have to sell everyone's products. That's the dilemma. Manufacturers all want exclusivity. At least that's what they think they want in order to get the most from their Brokers."

Dave's Take: In fact, the presence of other manufacturer principals is what gives broker agencies the economies of scale that make them an attractive option for most manufacturers.

And as the foodservice business has matured, so have the relationships among manufacturers and their broker agencies. Manufacturers and agencies are asking one another tough questions about goals, results, and value given and received.

Can we reach a point where we not only acknowledge the influence of multiple principals, but learn to leverage the efficiencies inherent in this model for the benefit of all?

Can manufacturers learn new ways to set objectives and measure agency results in a manner which respects:

- The brokers' unique knowledge of his marketplace
- The limited resources which every agency has to deploy against a complex and ever-changing set of objectives
- The reality of other principals' business needs, as well as the agencies' own objectives

Can broker agencies learn new ways of interacting with manufacturers in a manner which recognizes:

- The Region Managers' need to make a number or risk career consequences
- Marketing's hunger for information about operators and what they buy
- Headquarters' need to explain the reasons behind success or failure of Sales Initiatives

I believe we can and will, because we must. A few progressive companies are showing the way, and many others are sure to follow.

What are you doing to improve YOUR manufacturer/agency model?

"I'm Paying for WHAT?"

Let me get this straight. From now on, I'm going to pay extra to check my bag, and then pay extra again to sit in an aisle seat?

I understand and appreciate that the airlines have serious cost issues, and that most are suffering from financial results that are even worse than usual. But calling attention to it by penalizing certain passengers is bad business, and certainly adds to this industry's image problems.

It's reminiscent of our first go-round with fuel surcharges, back around 2004. As energy costs skyrocketed (or so we thought), manufacturers struggled with the question of adding fuel surcharges to their invoices, or just taking a general price increase. Many of those who took the surcharge route found that they merely gave customers an easy target for deductions, as well as something to complain about.

"Fees for Service" and "Menu Pricing" are concepts which look good on paper, and probably have their place in our business as they do in others. The idea of charging users of special services, rather than having everyone subsidize high cost drivers feels right.

But why don't the airlines take everyone's fare up $15 (who would notice?), then offer an allowance to people who don't care where they sit, or don't have carry-on baggage? Similarly, if you're considering charging extra for non-EDI orders, case picking, or special palletizing, perhaps you can turn a negative into a positive while still accomplishing your objectives.

Instead of "menu-pricing" your products based on customers' service needs, why not give tweak your overall prices and provide allowances for the low-cost, efficient orders?

It's the subtle difference between penalizing the behavior you don't want, and rewarding the behavior you do want. And should anyone (other than the airlines) be in the business of penalizing customers?