

# CEO Perspectives on the Intelligent Distributor

## EVOLUTION OF THE INTELLIGENT DISTRIBUTOR

The purpose of this report is to bring you the perspectives that emerged from an extensive survey of CEOs and executives at wholesale and distribution companies. Based on their responses, we offer some observations on today's market and suggest actions that organizations can take. The CEOs and executives who participated in this study are acutely aware and keen to stay abreast of the changing dynamics in the industry and the impact digital is having on their businesses. They demonstrate a clear sense of urgency to get smarter and more agile, and feel the need to expand their prospects and build the business of the future.

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*What keeps me up at night? Are we fast enough, are we agile and nimble enough, are we staying ahead of what's happening with digital and with our industry?*

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15+	CEO interviews
70+	Executive survey responses
15+	Industry articles
10+	Experts and professional

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The era of the intelligent distributor is characterized by adaptation to digital forces and other market dynamics. Leading companies are using digital proactively to innovate, as opposed to struggling reactively to keep up. They are changing from an *inside-out* mentality to an *outside-in* approach, with improved, intense relationships with suppliers and customers.

This report is a synthesis of the rich and insightful perspectives of these executives, along with input from experts, professionals, and extensive research. In it, we offer **four observations** on how distribution is changing and **five critical actions** for companies to consider in the year ahead.

### FOUR OBSERVATIONS ON WHOLESALE AND DISTRIBUTION

Based on the input from the executives who participated in the study and our market research, the following four trends stand out:

- Winners are breaking away, but still driven by focus on the basics
- Acquisitions are coming back, but where "smart" wins out over "scale"
- Technology investments are increasing, but are smarter and nimbler
- Investment in people and talent is a clear priority

The following sections describe how CEOs and executives are thinking about each of these trends and provide the context necessary to support the critical actions that companies should consider.

## Winners are breaking away, but still driven by focus on the basics

Distribution as a sector has been performing well. (See Exhibit 1.) Average shareholder returns have been higher than most relevant industry and market benchmarks for both two- and four-year timelines.

Success in the industry has been driven by performing well on the fundamentals. Revenue growth has been driving the bulk of shareholder return (7.6 percent annualized return), but margin expansion (1.4 percent), valuation multiple increase (2.2 percent), and capital efficiency (2.2 percent) have also contributed to industry growth.

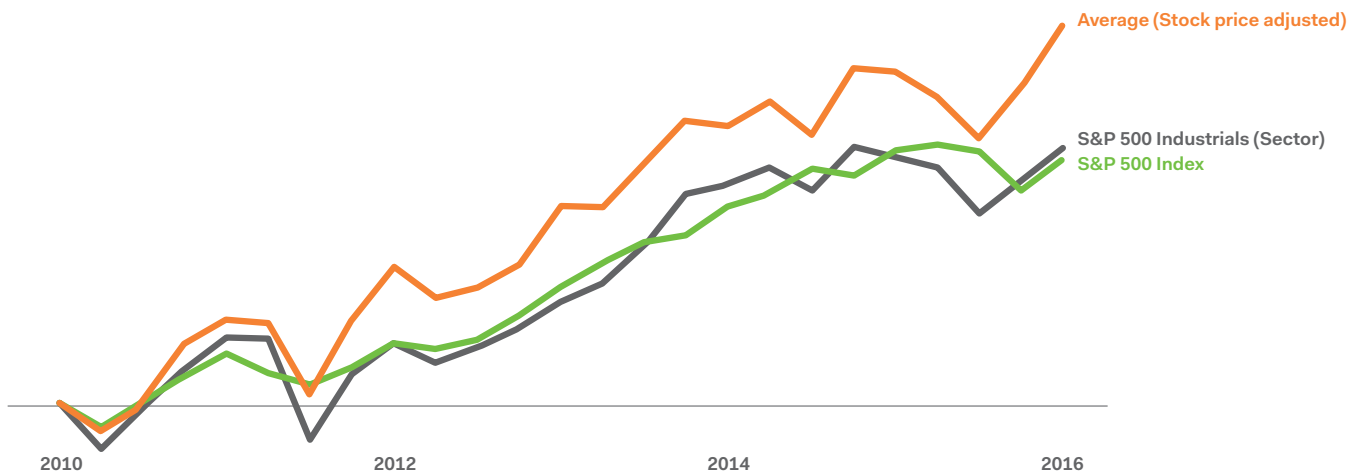
## Acquisitions are coming back, but where “smart” wins out over “scale”

Acquisitions underpin the revenue growth among large distributors. For most wholesalers and distributors, growth and acquisitions have been one and the same – 70 percent of distributor revenue growth in the past 10 years has come from acquisitions. This M&A activity has only continued to surge, with 56 percent of it occurring in the past three years. (See Exhibit 2.)

While consolidating local share remains the primary M&A driver, it has been harder to find and execute large acquisitions. Geographic expansion also remains an

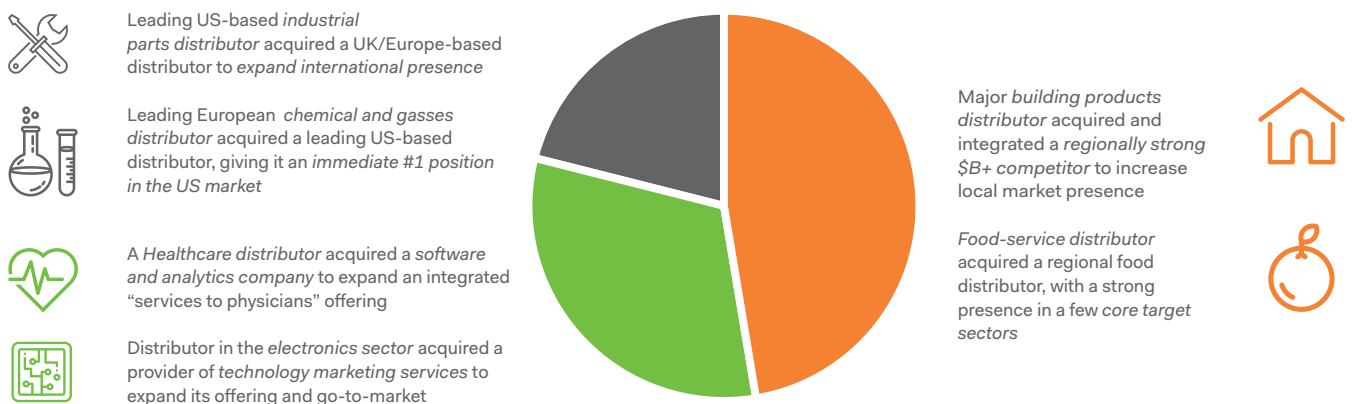
important driver of acquisition activity, and several companies have made major strides in this strategy. But doing acquisitions so as to expand the offering is a third important rationale that is growing in importance. With this type of “smart” M&A activity, businesses are focused on adding capabilities as opposed to expanding their footprint.

Exhibit 1: Annualized shareholder return  
\$BN Distributors



Note: Dividend adjusted shareholder return for basket of distributors > \$2 BN revenue as of Q1 2010

Exhibit 2: Rationale for wholesale and distribution acquisitions in the past five years  
Count of \$100 BN+ acquisitions



Source: Oliver Wyman analysis

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**We have underinvested in technology (IT, ERP) for many years... We still need to be cost-effective, but we need to be spending more to catch up and give the business what it needs**

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*What keeps me up at night, what the foundation is, it's really all about talent...and the right talent is only getting harder [to find]...we need to be more creative*

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## Technology investment: more, smarter, and nimbler

A recent survey of technology spend across sectors found that distribution is seeing one of the largest growth rates in that area. (See Exhibit 3.) Much of this investment has come in the form of “smart” acquisitions as described above.

CEOs in wholesale and distribution are aware that technology is advancing more and more rapidly, and they need to spend to keep up. Many companies have underinvested in their IT and ERP systems, and being cost-effective in some areas is not enough to support the investment needed in technology to catch up.

It's no longer enough for performance to be merely adequate. Investing in technology is not only about staying par for the course; rather, CEOs recognize the need to become leaders in their industry, evolve the offering to their customers, and realize the potential to optimize operations.

## Investment in people and talent is finally a clear priority

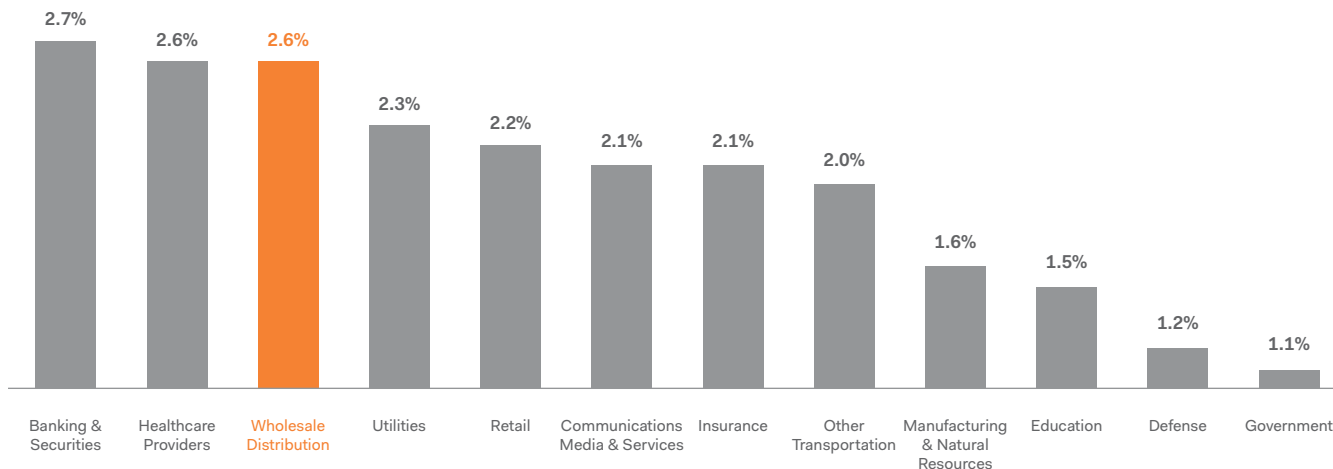
Acquisitions and investment in technology have been key trends in distribution and wholesale, but underpinning everything is the need for talent. CEOs state that it is getting more difficult to find the right talent and that there is more competition for those employees. People are the foundation of any company, and the work environment and culture must be attractive to find and retain talent.

Wholesale and distribution are feeling an immediate talent shortage in some areas. In 2016, there was a 100 percent annual turnover rate, marking an all-time high, with an estimated shortfall of 48,000 drivers, according to the American Trucking Association. With the average age of a truck driver currently 49-years-old, it is projected that there will be a shortfall of 175,000 drivers by 2024.

Emerging technologies may solve some of these issues, but they will also create the need for new skills at wholesale and distribution companies. Self-driving trucks may address the truck driver shortage, enabling driving times of 24-hours per day as opposed to 11 hours for human drivers. This technology will go far beyond simply solving this worker shortage: In addition to potential savings on fuel costs of 10 percent due to platooning (Oliver Wyman, *Self-Driving Freight in the Fast Lane*, 2015), the freight industry will save up to \$168 billion thanks to self-driving trucks (Morgan Stanley, *Self-Driving the New Auto Industry Paradigm*, 2013).

Recognizing the potential of this emerging technology, Uber spent \$10 million per engineer in its *acquire* of self-driving truck company Otto. Additionally, organizations are realizing that they can invest time in drivers now, but eventually the focus will be on delivery people in driverless trucks. As wholesale and distribution companies exhibit a similar focus on new people with the right skill sets, the makeup of their organizations will ultimately shift from pickers, drivers, buyers, and salespeople, to programmers, technicians, analytics teams, and e-commerce marketers.

Exhibit 3: Technology Investments (CAGR: 2008-2016)



Source: Gartner Market Statistics, 2008-2016



## FIVE CRITICAL ACTIONS FOR WHOLESALERS AND DISTRIBUTORS

It is important to consider what tangible action can be taken in light of these observations. Taking into account the need to foster an outside-in approach – focusing on customer experience and value creation first – we would like to offer five critical actions for the CEO agenda:

- Deepen customer intimacy
- Provide solutions, not just distribution
- Continuously improve pricing and sourcing
- Be bold in rethinking your people strategy
- Take a two-speed approach to technology

The following sections describe each of these actions and provide tangible, actionable insights that emerged from our conversations with CEOs and executives.

### Deepen customer intimacy

Many of the executives identified an urgent need to aggressively improve customer intimacy. This action is set against the backdrop of an important development: the consumerization of B2B.

Increasingly, many businesses are starting to view business customers as consumers and are tailoring their offers to cater to the unique interactions their customers demand.

(See Exhibit 4.) Parallels can be drawn to the retail and consumer industries, where data-driven specialization and increased customer intimacy has been a major trend over the past decade. There's an acute need to go from just traditional sales calls and delivery reps to a multitude of interactions. E-commerce, mobile apps, specialized product experts and technical support, and interactive vending machines are all methods that can be used to drive more intimacy.

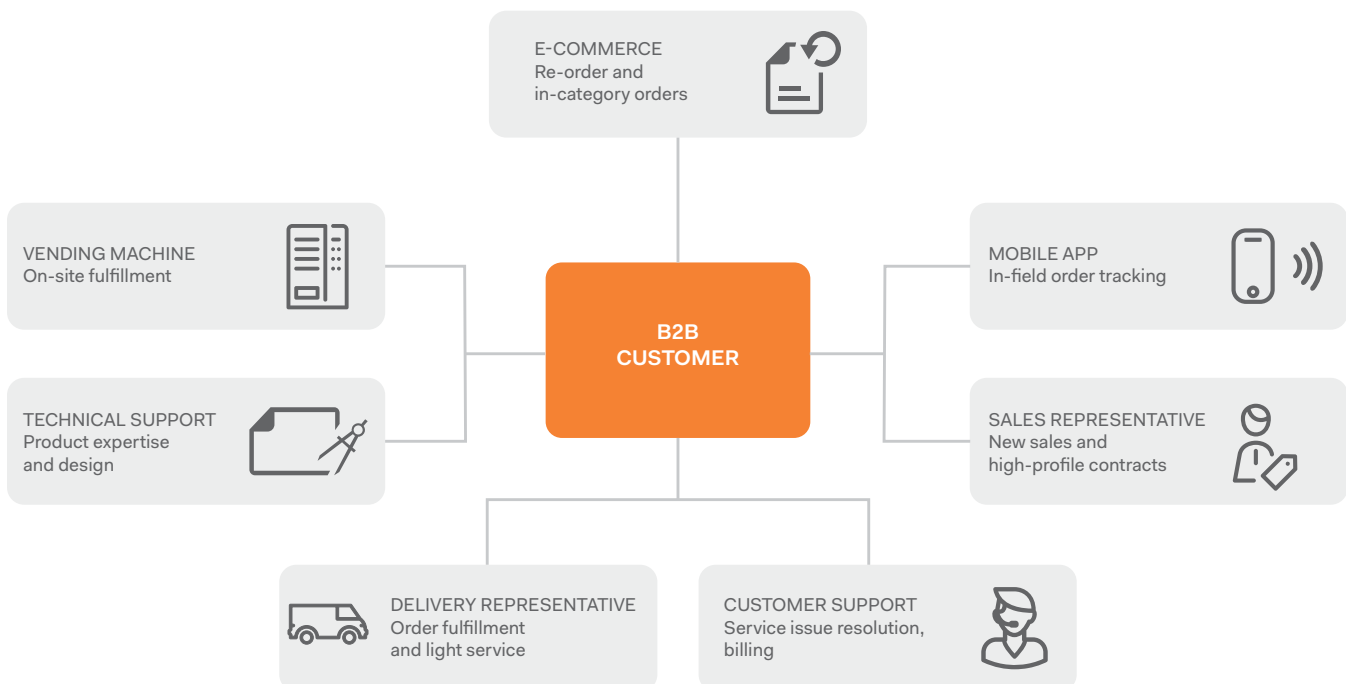
The advice from this study on customer intimacy is to create a virtuous cycle focusing on three things:

- Create **many more touch points** with customers
- Use new touch points and associated data to **better understand** customers
- Use this understanding to better **serve customers** and develop **new offerings**

### Provide solutions, not just distribution

This theme gets to the fundamentals of understanding what business you are in. It is interesting to see the transformation many in wholesale and distribution appear to be going through: the advice here is that firms should not simply be in the distribution businesses, but should actually be in the solutions business.

Exhibit 4: Consumerizing B2B with an integrated channel strategy



Traditionally, businesses have focused on expanding into adjacent products, but that is not the only option. For example, your organization may be able to help customers cut the cost of doing business, generate demand for your suppliers, reduce suppliers' risk, and provide suppliers with data and insight on their markets. Some businesses have already begun thinking about monetizing their data and providing solutions that share data and information products with customers and vendors.

Leading companies have a structured and organized process for innovation and solution development. For these companies, developing new solutions is not extra credit – it is their bread and butter. They have an organized process to source ideas, plan concepts, develop, test, and launch solutions. (See Exhibit 5.) Many wholesale and distribution CEOs and executives feel that this approach needs to be emerging in the industry.

The advice from this study on providing solutions is to focus on three approaches:

- Adopt a **formal process** for solution development
- Drive a **culture** of experimentation
- Create the **incentives** to innovate

## Continuously improve pricing and sourcing

Many executives see pricing and sourcing as a core area and have done a lot to address it over the past few years. Two out of three executives have undertaken some sort of initiative in pricing, and half have carried out some effort in purchasing and sourcing.

Despite these efforts, many have a clear feeling that there is still significant room for improvement and that much value is being left on the table across the supply web. Even companies with a cost-efficient mindset feel there is money to be had, and there is a desire to better use data to make these decisions.

We think three factors are creating opportunity for improvement:

### Changing commercial structures:

Suppliers and customers are getting more and more sophisticated about how they enter into commercial arrangements. Contracts are becoming more complex, specific, and tailored, with risks embedded, and a range of models, from on premise to subscription.

**Higher price transparency:** B2C is driving demand for higher transparency, and despite resistance it is bleeding into B2B interactions as well. There is a growing understanding that data is available and must be better used.

**Oil and commodity inflation cycles:** Costs that are critical to wholesale and distribution, such as oil and commodity prices, are constantly changing, which requires

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*We changed our name to get rid of the word “distributor” because it’s too simplistic a term. We’re calling ourselves a **technology solutions provider***

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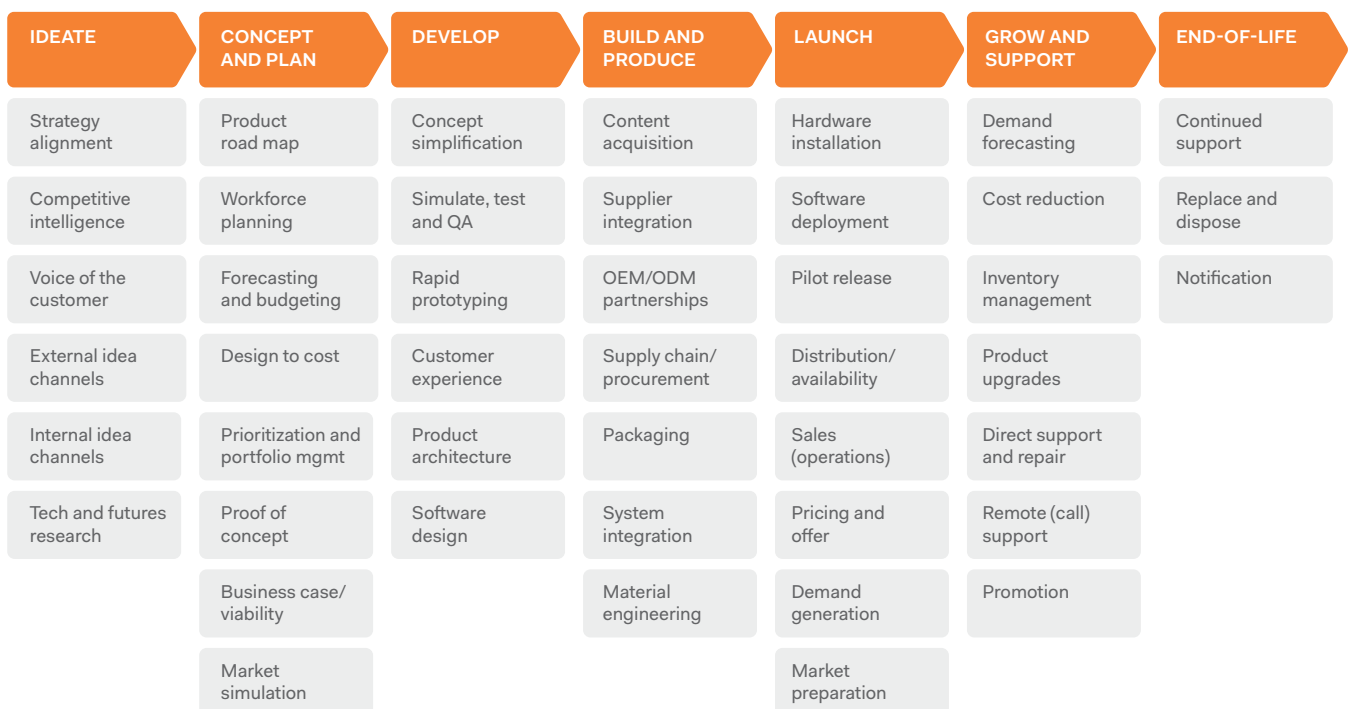


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*We do a reasonable job, but I think we can price a lot better **using all the data we have on customers***

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Exhibit 5: Different distribution IT systems have different priorities



businesses to manage these costs and make them more predictable.

The advice from this study on pricing and sourcing suggest the following actions:

- Periodically **benchmark** pricing and sourcing approached
- Invest in central groups or **centers of excellence**
- Task pricing and sourcing teams with **continuous improvement**

## Be bold in rethinking your people strategy

People and talent is the number one issue in this study. It was the top priority of 63 percent of the CEOs and close to half of the chief experience officers (CXOs), as well as being the number one issue discussed in related research.

We think there are three forces that are coming to head and creating a "burning platform" here:

**Rise of the millennials:** In 2005, it was all about the baby boomers. They made up 41 percent of the workforce and managing them was the major concern. Millennials made up a paltry 15 percent of the workforce.

Fast-forward 10 years. In 2015, for the first time, millennials overtook baby boomers in the workforce, comprising 35 percent of employees, according to a Pew Research survey. This is a wakeup call for many organizations.

Three things stand out and present an important set of challenges to executives when it comes to millennials. Millennials are:

- Digitally oriented – how they interact and use digital tools
- Mission oriented – value and need a vision and greater purpose in the workplace to remain motivated
- Short-term experiential oriented vs. long-term career oriented – can leave for different opportunities even if everything is satisfactory at a current position

**Need for digital leaders and culture:** More broadly in wholesale and distribution, there

is a movement to drive a more digital culture from within. Wholesalers and distributors recognize the need to evolve digitally, but have not traditionally attracted employees with the requisite skill sets. These companies are beginning to grow talent from within.

**Need to balance centralization vs.**

**decentralization:** The third force in play is around the balance of centralization vs. decentralization. Historically in wholesale and distribution, the safe option has been to adopt one of the extremes. The first option has been to adopt a heavily decentralized model with a high degree of local autonomy, and to work hard to get the right people running the local centers. The second approach was a heavily centralized model where there is a hard focus on getting standard processes, consistency, and disciplined execution.

More often the choice has been to decentralize, but recently many wholesalers and distributors have been experimenting with more hybrid models. We call these centrally empowered, but locally managed models.

In summary, the advice when it comes to rethinking people strategy is threefold:

- Be bold in experimenting with **new structures**
- Be bold in bringing in **new talent**
- Be bold in empowering **younger leaders**

## Take a two-speed approach to technology

The fifth theme deals with what one CEO calls

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*Our workforce is aging, so we spend a ton of time on culture. We're trying to figure out how to be **the employer of choice, especially among millennials***

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*We need digital leaders in our business to help us **think differently....** It is difficult and expensive for us to get such talent, but we are trying hard*

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*We've gone from almost completely decentralized to about 50-50. Marketing, HR, and technology are all central now, and we are looking to build more centers of excellence. **Digital has allowed us to do this much more effectively***

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his “favorite nightmare”: it is the technology and legacy IT system challenge. Many executives see legacy systems as the number one obstacle to change. These systems are viewed as the biggest weakness within the company, inconsistent in performance throughout the business, and a major barrier to visibility and control.

Legacy systems are the source of all these issues. However, many who have taken a re-platforming approach have endured questionable returns and have taken on immense risk. Only 15 percent of projects have made it on time, one in three projects have been terminated, and more than half have failed to meet time, cost, and functional requirements.

The key reflection of this study and of the experiences of many of these companies is that the IT problem should be broken into two separate challenges: can't break and can't wait. (See Exhibit 6.)

**Can't break:** This approach is the more traditional ERP approach and is appropriate for certain portions of IT where there is high criticality. It should be used when mistakes would be very costly and there is the time to go slow, being exhaustive and deliberate. However, given the investment in time and money, this approach should be used only where necessary.

**Can't wait:** The second approach is much

more agile and should be used for lower criticality systems. These projects should not follow a “waterfall” method, but should move quickly with constant iteration. Failures in any phase of a project are smaller scale and have controlled risk. Taking this approach allows the business to move forward with differentiating and profit-driving activities, even as slower “can't break” efforts take place in the background.

Separating into these two speeds allows companies to massively de-risk tackling the legacy system challenge. Newer technologies and products have allowed for more and more needs to be addressed in a “can't wait” manner, with many companies deciding to forego ERP transformations altogether.

This leads us to the advice for technology enablement:

- Break down your systems challenges into **two speeds**
- Put **only essential plumbing** in the first “traditional” speed
- Take an **“agile” approach** wherever possible

## CONCLUSION

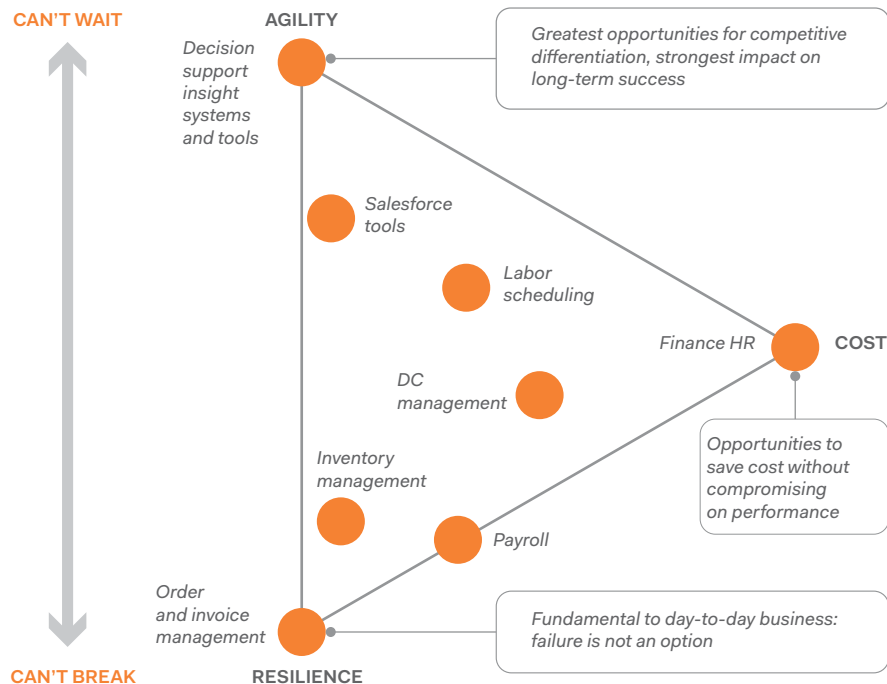
Wholesale and distribution has been performing well, with many large wholesalers and distributors earning good returns

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*We want to use more dashboards to get more visibility, especially customer-facing info, but are **hampered by an inflexible and constrained ERP***

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Exhibit 6: Solutions development process





and making sound investments for the future, but warning clouds are on the horizon. Industry consolidation will create winners and losers, and it will be increasingly difficult to deliver value. Competitive forces will continue to disrupt the industry through e-commerce and omnichannel offerings. If you are not evolving your business and capabilities at an increasingly rapid pace, you could be in trouble.

The good news is there is genuine opportunity to capitalize on the trends in distribution. By taking an outside-in approach and adopting a solutions mindset while continuously improving pricing and sourcing, wholesalers and distributors can drive commercial success. Rounding out these efforts with a refreshed emphasis on a people strategy and a two-speed approach to technology, the CEO can create sustainable competitive advantages for the business.



