QDI STRATEGIES

20/20 Vision for Marketing Breakthroughs

Are You Prepared for the Changing Landscape of Industrial Marketing?

By Karl M. Beide

The nature of life is change. Darwin called this process evolution. Businesses that think they can continue to practice the same strategies they practiced ten years ago run counter to this evolutionary theorem. This especially holds true in the industrial manufacturing sector and its distribution channels. The playing field is changing dramatically, and the companies that understand and plan for these changes will likely be the ones that win the game.

This paper will discuss the changes that are occurring in the industrial marketplace and the reasons behind these changes. A second paper, "Industrial Marketing: Response to the Changing Landscape," shows how the marketplace responds to these changes, their impact on the manufacturer and how QDI Strategies can help you strategically deal with the changing dynamics of the marketplace.

There are four components comprising the current changes in the marketplace. They are:

1. A shrinking customer base and consolidation of power
2. More distributor channels chasing fewer dollars
3. Distributor consolidation
4. Technological sea change

In This Article:
Discover the changes occurring in the industrial marketplace, and how to respond to them.

Shrinking Customer Base

Industrial markets are experiencing miniscule growth, and its customer base continues to consolidate. Many companies look to gain market efficiencies by moving to countries with lower labor costs. The manufacturing sector in the United States, therefore, shows little growth. According to the U.S. Department of Commerce Economic Census, the number of manufacturing facilities grew by just 1.9% between 1992 and 1997, while employment growth in this sector was only 3.6%.

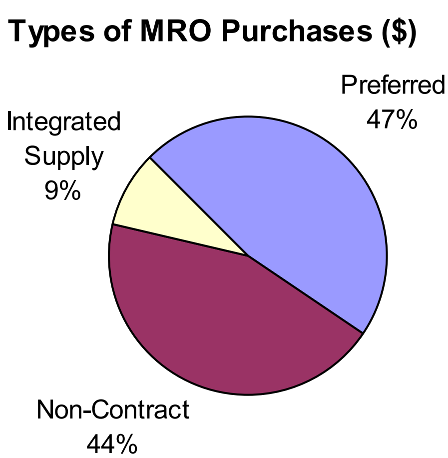
At the same time, the concentration of buying power increased dramatically, with the top companies accounting for most of the purchases. The merger frenzy of the 1990s contributed to this concentration of buying power through the consolidation of numerous corporations. As more companies strived to increase top line growth, profitability and market share, they acquired or merged with companies that expanded their product offering, or allowed them to quickly access new markets. The 1997 Economic Census showed that the largest 200 companies accounted for 40% of the value of shipments in 1997. In 1992, the top 3% of establishments represented 61% of value-added content by manufacturers.

More Channels, Fewer Dollars, More Competition for Each Dollar

During that same period, according to the U.S. Economic Census, industrial distribution grew 7.6% in establishments and 16.1% in employment. While their major customer base – the manufacturing segment – failed to grow significantly, the channels that serve those markets have increased significantly. This disparity clearly shifted power to the large customer and contributed to the margin erosion within distribution.

Our research shows that in the industrial pipe, valve and fitting market, as much as 53% of the distributors' MRO sales are on contract, and this segment of business is growing. In other markets, it is likely that this percentage is greater, due to the increasing amount of standardization of many industrial products.

Contractual Purchases



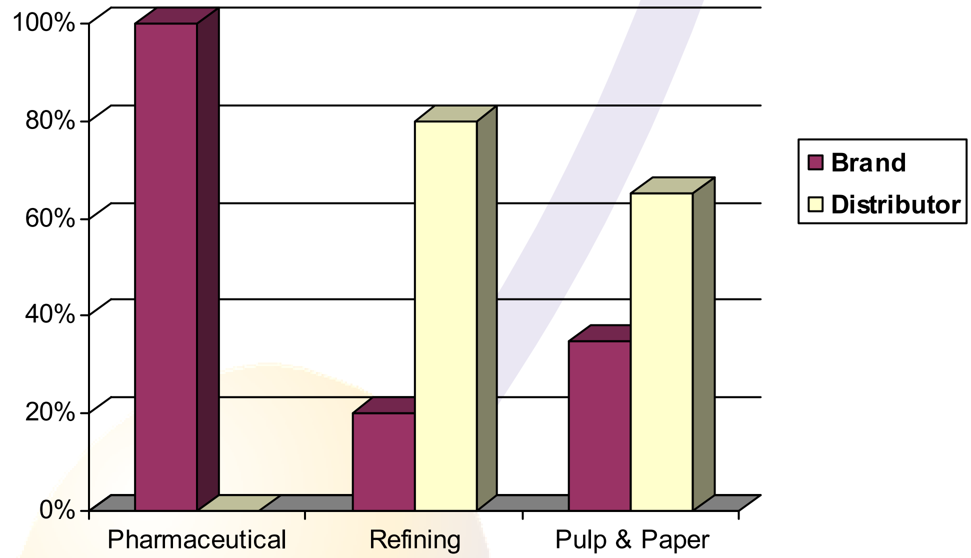
Distributors have two types of contracts. One is as the Integrator in an integrated supply program. The second is when the firm is a preferred vendor. Together these account of 56% of the large distributors' sales (in the PVF market—percentages vary somewhat in other industries).

In the non-contract business, the distributor may still be the preferred supplier, but there is no written contract.

keting Breakthroughs

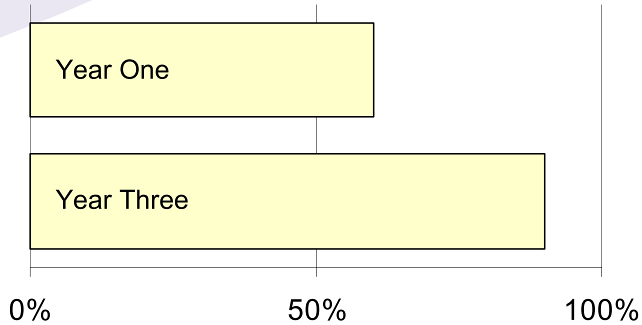
These contractual agreements also begin to call into question the importance of the distributor versus the manufacturer's brand. Increasingly, the distributor is becoming more important than the brand.

QDI research shows that distributors are more important in commodity markets, while the brand or product dominates highly-regulated industries such as pharmaceuticals.



This is due to the "commoditization" of products and to the customers' focus on the procurement efficiencies that customers achieve through their contractual agreements with their distributors. In a recent benchmark study in the industrial pipe, valve and fitting market, we found that when corporate purchasing had a contract with an industrial distributor, the purchasing department would often go with an alternative brand rather than purchase from an unauthorized distributor. Our research also found that the preferred distributors were able to increase their share of certain product categories from 50% to 90% over the life of the contract. This ability to get control of a product category shows the increasing importance of the distributor relationship versus the product brand.

Preferred suppliers expect to grow their share of the customer's business.



These distributors report that they will grow their share of the average customer's businesses over the life of the contract from about 40-60% to 90%

Distribution Consolidation

This difficult environment has also provided impetus for distributor channels to consolidate. The latest government data shows that the top 50 industrial supply firms account for 17% of the total locations and for 20% of the employment within that industry. You only have to count through the top 5% of the firms to find 40% of the sales revenue! Over the past 10 years, mergers and ac-

acquisitions (within industrial distribution) have been significant in many markets. Larger distributors have acquired many strong local and regional distributors in a quest to expand geographically and to establish economies of scale that promote participation in customer contract agreements.

This has often led to changes in the regional distributor's manner of conducting business, much to the dismay of their suppliers. For example, one of the large distributors we spoke with recently de-emphasized the technical selling activities, for which the recently acquired local distributor had been known. While this streamlined costs, it upset many of the distributor's traditional vendors and customers.

Fewer distributors are controlling larger portions of the market—and they are increasing their ability to dictate terms to their vendors

Technology

The final sea change is in the area of technology. QDI research shows that many of the industrial markets and players are behind the curve when it comes to electronic commerce. Much of the communications and business transactions still occur by phone, fax and personal interaction. Very few distributors whom we interviewed over the past couple of years extensively employ either EDI or Web-based technologies. The exception is with their largest customers and largest vendors. The cost and time requirement of implementing this strategy, and the complexity of maintaining the records (such as in electronic catalogs), inhibits this effort.

QDI believes that it is only a matter of time before this picture will change. Large, sophisticated customers will demand electronic transactions and communications, and since they will only be dealing with a limited number of distributors, that will be the "ante" for the distributors: just to play the game. GE already practices this in its purchasing strategies.

When distributors become technologically sophisticated, they will demand electronic communication with their vendors. This communication could include order placement, access to vendor inventory, shipping updates and pricing verification, configurations for product specification, electronic catalogs and electronic funds transfer.

These forces are changing the face of industrial distribution. So, what are the right strategies for you? In our next white paper, "Industrial Marketing: Response to the Changing Landscape," we will review our research into how marketers are responding to these market changes. This research shows what leading organizations are doing to continue to be market leaders in spite of the changes that are moving market power away from the manufacturer.

QDI STRATEGIES, INC.
1580 S. Milwaukee Ave. Ste. 620
Libertyville, Illinois 60048
Tel 847-566-2020
Fax 847-281-9723
www.qdistrategies.com