Epicor® White Paper

Six Habits of High Gross Margin Distributors

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Abstract

The path forward for growth in distribution has shifted. Market forces distributors face on their everchanging path to improve margins include:

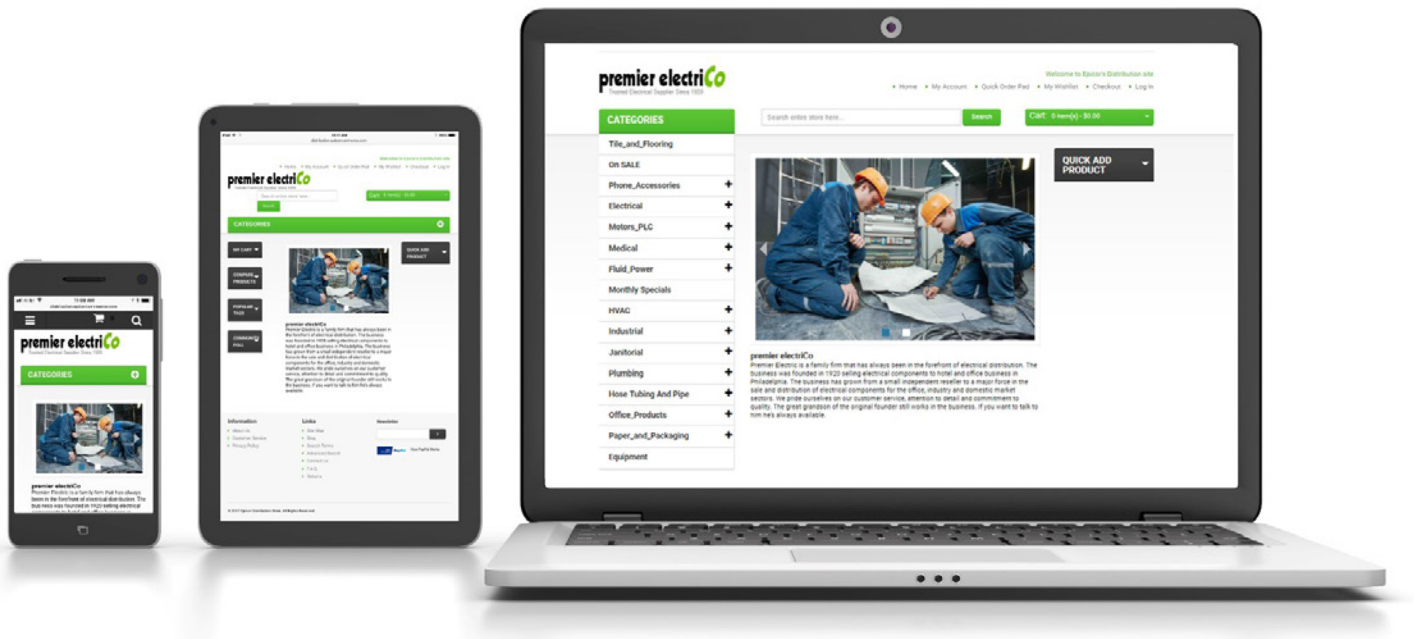
- Intense competition, (as large competitors strive to edge out smaller players in market)
- eCommerce for omnichannel sales
- Customer behavior to self-service and shop digitally
- Consideration of technology investments for automation
- Constant pressure to lower the cost of doing business
- Use of technology to free up people to be more strategic and innovative
- Connectivity and real-time insights in both directions of the supply chain, i.e. with suppliers and customers.

As a distributor, if you want to improve margins, you need to start asking some hard questions and then change what isn't working to beat your competitors. This change isn't a one-time pivot either, it must be an ongoing strategy to stay ahead. What are some attributes of those companies that succeed in this ever-changing landscape, and continue to drive revenue? How do they stay ahead and keep growing? In this white paper, we'll cover the top six habits exhibited by distributors that achieve high gross margins.

1 Segment Customers by Margin

There's no doubt repeat business from an existing customer is good business. However, there's also no doubt that every customer is unique. Your sales team shouldn't spend the same amount of time on a customer that repeatedly buys a $500, lower margin product as on a customer that regularly buys an expensive custom configured product. So how do you lower the cost to serve customers that fall into this segment? This is where eCommerce can provide a strong advantage. Distributors that strive to shake off big competitors and improve their margins are actively looking to eCommerce to provide a differentiated strategy to customers based on their order size and margin impact. With eCommerce it's easy to let customers with smaller average order sizes self-serve and shop digitally. It's even possible to provide portals to larger customers for low margin repeat business items. This frees up your most expensive resource i.e. your people, to focus on larger, custom orders. With an eCommerce system that has bi-directional data flow with your ERP and allows for online trading with portals that include management of orders, invoices, quotes and shipments, you can guarantee customer satisfaction because customers know what is in your inventory and track the status of their order. Your repeat lower margin business customers will keep buying from you while you lower your cost of doing business with them!

"US B2B eCommerce Will Hit $1.8 Trillion by 2023" Landscape: The B2B eCommerce Playbook for 2020, Forrester Brief



2 Set Margin Goals and Provide Visibility to Margin Goals

High-gross margin distributors not only set margin goals but also provide visibility to those goals. Since you're a distributor that is looking to increase margins, aside from setting a margin goal, you must cascade this goal down to the rest of the organization. Does your sales team know about your margin improvement goal of, say 1.5%, and can they track to your target? Has this also been communicated to your purchasing and operations teams? Distributors that attain margin goals know their business fluctuates daily and they use advanced, cost-effective data analytics tools to enable faster, informed decision-making based on actionable intelligence. They then confidently take steps to reduce the cost of running their business and pursue cost saving initiatives. Armed with data insights they are equipped to uncover new business opportunities and come up with ideas for cost-cutting innovations.

Your ERP data serves as one source single source of truth to make decisions that improve cash flow, increase business capabilities and simplify processes across the board. By applying data analytics tools to your ERP data, you can make use of interactive dashboards with visual displays to track margin relevant KPIs and stay up to date on the daily changes within your business.

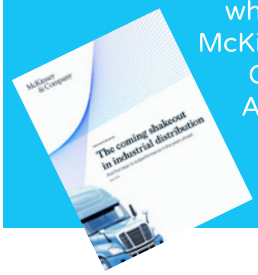
With visibility to your margin growth goals, your team can take the right actions to align to your margin objectives. For example, by analyzing and then optimizing inventory allocation by branch location, you can reduce shipment costs. When you take a closer look at what is on order for open POs, what are your delivery and lag times from vendors and whether you have hit your rebate volumes with vendors, your teams can proactively maximize the effectiveness of your purchase spending. Dashboards around sales results will show performance by geography, address improvements needed around average sales and gross margins by invoice line, and reveal who has stopped buying a product that they used to regularly purchase. Most importantly, a set, visible margin goal fosters collaboration and communication amongst your teams.

3 Invest in Cloud Technology

"In industry after industry, companies that move quickly and decisively to transform and enhance their go-to-market approaches, processes, and culture through digitization and advanced analytics outperform competitors who neglect such investments. For distributors, critical capabilities such as eCommerce platforms, mobile tools, real-time product availability, and delivery tracking set the winners apart."[1]

Digital transformation is a prevalent term in the distribution industry often interpreted as the integration of technology into all areas of a business, fundamentally changing how companies operate and deliver customer value. It involves an increased use of technology to improve the experience of your organization's employees, customers, suppliers, partners and stakeholders. Top performing distributors are well into their digital transformation journey with cloud technology at the forefront. They experience margin growth due to the various benefits that cloud technology provides such as reducing total cost of ownership of IT assets.

For example, mobile access to data analytics becomes easier in the cloud. Your team is never disconnected from your information with responsive mobile access. They can be more productive and easily respond quickly to the needs of your business. Some of our customers are making use of intelligent, scalable, affordable technologies, such as Artificial Intelligence and voice technologies, that leverage the cloud to turnaround orders for single-line quotes during customer meetings. They don't have to contact a call center to check on inventory and delay sending a quote. Cloud technology investment in your ERP means that your IT team doesn't have to focus on upgrades, license maintenance and hardware refreshes. Your technology is always current because the vendor you sourced it from keeps you current. Now your IT team can be more strategic and help front line management solve business problems and achieve margin objectives. They can focus on ways to advance technology adoption with the organization and find innovative ways to connect into your supply chain, both with your suppliers and customers. Furthermore, high-value growth initiatives like eCommerce can become their priority. Overall, your total cost of technology ownership is lowered; you can simplify your application and infrastructure strategy to scale as your business needs require.



The coming shakeout in industrial distribution; whitepaper, McKinsey and Company, April 2019

"The key advantage to cloud services is the ability of IT organizations to shift IT resources from maintenance to new initiatives. This leads to new business revenue and competitiveness as well as creates new opportunities for IT vendors in SMB and emerging markets."

— IDC, Worldwide Enterprise Applications Software Forecast, 2019–2023 (IDC #US45709619, Dec 2019)

4 Determining Online Pricing

The traditional distributor has always put a strong emphasis on the customer relationship. We mentioned that distributors who achieve margin growth strategically segment customers that should be serviced online. But what prices do they show online? And should they show prices for all their products online? Top performing distributors recognize that prices should be set on competitive factors, specific to the customer and the nature of the transaction. They already utilize ERP pricing data and ERP pricing functionality to set prices in various ways such as:

- Tailor prices to their customers and the transaction with multi-level pricing hierarchy (contracts, pricing matrices, default pricing) for complex pricing
- Base prices on margin of the last sale to maintain consistent margins from sale to sale to a customer
- Manage special pricing on customer contracts with quantity limits, for example set the first 100 pieces for a special price of $X, but after that the price reverts to standard pricing.

Top performers not only look at the above dynamics for pricing, they recognize that setting the right online prices requires collaboration with marketing or product category managers, finance and sales. They test paths to better online conversions, make sure products can be searched for and found, and provide suggestions for complementary products or substitutes to increase average online order size to garner a return from an investment in an eCommerce tool.

[1] The coming shakeout in industrial distribution; whitepaper, McKinsey and Company, April 2019

5 Offer Value-added Services, Priced Appropriately

You may offer value-added services with a product and designated specific pricing. However, many of these services can't be sold online and need to be priced separately from the product. Also, given that Amazon offers Prime members complimentary one-day shipping, it is imperative that a distributor provides differentiated value-added services. Distributors with robus margin growth spend time to price these services accurately. The right approach to value-added services begins with a customer segmentation model, much like for eCommerce. Top performing distributors determine which customers have the highest potential for margin growth and should receive the most sales coverage and people-intensive services. These distributors then successfully provide value-added services as bundles of customer support, technical consulting and manufacturing services etc. by building on their brand and stellar reputation. When exploring how to price value-added services, you must look at the value of the service itself, the market standard, and what the customer is willing to pay. You should consider the voice of the customer to rate your services. If you're considering charging for something you had previously rolled into a product price, you'll want to analyze your strategy based on these aspects—while factoring in your goals.

There is real value in providing extraordinary customer service, and—like value-added services—you can command a premium for doing this right. No one wants to feel stuck with a distributor that doesn't treat them well. Delivering excellent customer service in today's competitive market is not a nice to have, it is paramount. If it's not delivered consistently, customers will look for alternatives—even if that means they may pay more for goods and services. Alternatively, distributors that provide exceptional customer service will see better customer retention rates and may find that they don't need to provide discounts or incentives to keep their customers coming back.

6 Know When to Walk Away

This may be the hardest part of being a distributor. There are going to be times when you need to walk away from business because the relationship just doesn't make sense anymore financially. It's vital to realize that low-margin business—even when it may be profitable on an order-by-order basis—has the potential to erode margins. If this is the case, you need to make the decision to transition away from these customers. Unfortunately, this is definitely easier said than done. You probably have long-standing relationships with the customers that these changes would impact. You may feel like this strategy will harm that relationship and you'll lose the customer—and maybe even other customers in the process.

There are many ways to plan and implement these types of changes, but the best thing you can do to retain customers and keep relationships strong is to clearly communicate changes and set realistic expectations. In a perfect world, customer relationships are strong, and your level of customer service makes up for enacting these changes. If this isn't the case, start working to solidify customer relationships now while you're in the planning phase of the strategy.

Although practicing these habits may seem extensive, the good news is you likely already are doing many of them. Or perhaps you tried them and have found that they aren't right for your business, or your strategic goals at this time. The key is to remind yourself how they can help, and if you see value in them, but they fell out of practice, implement them with greater rigor. Practicing them will help you drive to high growth margins and drive competitive differentiation in a sea of competition.

Change is rampant in today's landscape and it's vital to keep reminding yourself of things you can do—or confirm things you're already doing—to help improve your profit margins by incorporating technology in your pursuit of margin growth.

Living the Six Habits With Epicor® Prophet 21®

In today's highly competitive marketplace, it's important for distributors to grow, thrive and compete. Maintaining or improving gross margin is vital to achieving those results. If we consider the ways in which distributors can improve their bottom line—growing sales, reducing costs of goods sold, reducing operating expenses, or increasing gross margins—increasing gross margins can have the largest impact on your bottom line. The results can be truly game changing for any distributor.

To employ the habits that enable higher gross margins and maximum profitability, you need a business system that supports the unique processes of a wholesale distributor. Epicor can support your unique needs. Born in Distribution, with over 5 decades of distribution experience, cloud-based solutions from Epicor reflect unique understanding and deep industry expertise for your vertical, with innovative features that drive successful business outcomes so that you can meet the challenges and demands of a global marketplace in the digital age.

Visit www.epicor.com/distribution to learn how Epicor Software ERP solutions can help you grow, thrive, and compete in the everchanging distribution landscape.

About Epicor

Epicor Software Corporation drives business growth. We provide flexible, industry-specific software designed to fit the precise needs of our manufacturing, distribution, retail, and service industry customers. More than 45 years of experience with our customers' unique business processes and operational requirements are built into every solution—in the cloud or on-premises. With this deep understanding of your industry, Epicor solutions dramatically improve performance and profitability while easing complexity so you can focus on growth. For more information, connect with Epicor or visit www.epicor.com.

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Contact us today info@epicor.com www.epicor.com