

Understanding the Technology Distribution Business

A Guide to Optimizing Partnerships and Bottom-Line Value



GLOBAL
TECHNOLOGY
DISTRIBUTION
COUNCIL



VIA
routes to market

Based on Independent Research Conducted by VIA International

About this Report

Priming Your IT Distribution Business / Overview

The Global Technology Distribution Council (GTDC) commissioned the independent development of this guide to help all types of companies optimize business and partnership with IT distributors throughout the world. Whether you are interested in or already partnering with distributors, the content and analysis here can make a profound difference.

VIA International, a leading management consultancy exclusively focused on marketing, distribution and sales channels, objectively researched and produced all of the analysis and recommendations provided here. Their deep understanding of the technology channel business is based on 20 years of experience working closely with distributors, vendors and solution providers across all markets and product categories.

Although the authors and GTDC cannot assume responsibility for the outcome and impact of decisions made based on information within this guide, your distribution industry results will likely be far more successful when corresponding best practices are regularly and methodically leveraged or integrated as part of a comprehensive channel business strategy.

Learn More

For more information on VIA International or the GTDC – an industry consortium of IT distributors driving more than \$100 billion in annual worldwide sales – we encourage you to visit us online at: www.viaint.com and www.gtdc.org, or [click here](#) for detailed contact information.



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What are your perceptions? Are they changing – for better or worse? It's time to clear up any misconceptions. We give you the definitive view while helping you concentrate efforts on the core advantages that IT distributors enable.

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Have you ever committed the same offenses – perhaps repeatedly, at least in the distributor's eyes? Avoid the pitfalls, and get to the bottom of what your distributors may view as incomprehensible actions that should change.



Introduction

Here's a complete perspective on who will most likely benefit the most – and how – from the deep analysis, best practices and other recommendations covered in this guide.

Primary Target Audiences

This “primer” is intended for anyone within a vendor organization whose role touches technology distributors. If your role and responsibilities involve determining the role of distribution in your channel mix, managing relationships with distributors or designing programs that involve distributors or indeed their value chain or ecosystem, then this booklet should be useful.

If you are a vendor partner account manager, partner business manager, channel manager, sales manager, or program manager, you need to understand the way your distributor's business works and to be able to demonstrate the commercial value of your relationships with distribution. In all cases, there is some aspect of your role which involves building business through distributors. Just as with any other channel partner, understanding the distributor business model is critical:

- It allows you to play an effective role as trusted business advisor to your partner
- It gives you insight into the levers available to you and how to connect your value proposition to those levers
- It provides a perspective on the model inside your partner:
 - Showing how the business model for your products/services looks inside their model
 - Allowing you to understand the role you as a vendor play within their business: are you a drag or an enabler?

Why this “Primer” was Developed

Members of the GTDC and leading edge suppliers into technology distribution saw the opportunity to broaden understanding of distribution – its role, benefits and business model – among the vendor community. This content is intended to provide everyone who interacts with distribution a common understanding of how the core distribution business model works. Obviously, there are many variations of the business, but the underlying model is common. The information will allow both supplying vendors and distributor personnel to master the detail of the business model and provide them a common language and understanding of how to work successfully together.



The Role of the Distributor

Wherever you see a need or opportunity for IT distribution, it is critical to understand that most successful models are based on mutually beneficial partnerships. Build on a solid foundation that leverages what distributors do best.

For most major technology vendors, distribution is their principal route to market, typically representing as much as 80% of their revenues, with distributors playing a key role in providing extensive market reach and coverage. The value of this role grows exponentially in fragmented markets, even more so in emerging markets which may be new to vendors. Wherever the vendor sees a role for distribution, it is important to understand that the most successful model is one of partnership, whether optimizing joint supply chains in mature, consolidated markets, or sharing credit and business risk in more fragmented, emerging markets.

Role for Customers

Distributors serve a huge range of customers on behalf of vendors. These customers range in size from small, independent resellers to large multinational retailers, but all have the common requirement of a “one-stop shop,” where they can source products and services from the hundreds of suppliers whose products are part of their own offering to end customers.

It is more efficient for these “final-tier” players to be able to work with a limited number of distributors with whom they can establish trading relationships that meet most of their needs. And on the distributor side, there are a number of services they can offer which leverage their own economies of scale – either as part of their core offering or as optional services their customers can choose to use. *See the table at right.*

The distributor plays a critical role in selecting the right vendors and products to enable this **one-stop shopping** and to facilitate customers’ business growth. Core to this element is **availability**: the distributor’s ability to provide a significant proportion of products on demand, saving many of its customers the need to carry stock themselves. IT distribution is particularly strong in this domain, providing same-day shipping of thousands of SKUs to customers who are widely dispersed across geographies.

The second key role performed by distribution – for both customers and suppliers – is that of **breaking bulk**: in simple terms receiving truckloads and pallets of product and breaking them down into quantities that are closer to the requirements of end users, of resellers or of individual stores in a retailer’s portfolio. Effectively, many of the distributor’s customers are trading “back-to-back,” i.e., buying in the small quantities required by individual end customers, often shopping around on price and availability and placing their orders after trading off convenience, cost and credit.

The **provision of credit** is a core benefit from distribution, allowing customers to supply, configure and install products without having to finance their entire work-in-progress and receivables from the end customer. These are significant sums where products are incorporated into resource-intensive solution-based projects which cost many times more to deliver than the price of the products themselves. In the case of resellers, this working capital liquidity is often multiplied by sourcing from multiple distributors in order to

Key Distribution Facts and Figures (North America)

- 5 Billion+ of credit extended to the IT channel each year
- 5 Million+ inbound calls annually
- 2 Million+ configurations annually
- 50,000+ individual customers monthly
- 150 Million+ items shipped each year
- 100 Million+ software licenses managed annually

Source: North American GTDC Member Data

benefit from multiple credit lines. For retailers, on the other hand, distributor credit lines allow them to finance their inventories, which when combined with the cash payments from consumers leaves them with a cash-positive business.

The final “classic” role attributed to distribution is the provision of **delivery logistics**. With very few exceptions, most customers rely on the distributor to deliver their orders either to their own business premises or, in many cases, to their customers’ premises in the form of a “drop shipment” (which can also carry the reseller’s brand on labels and packing slips). Where products are out of stock or not carried as standard, the customer expects the distributor to order them from the vendor and ship them once they arrive. Gauging the right level of delivery charge to levy – recovering as much of the cost as possible while not alienating customers – is a key challenge for distributors. One mechanism which helps distributors manage this to the customer’s advantage is **order consolidation**, where delivery charges for all can be minimized by waiting until a complete order of products from different vendors is ready to ship. Additional services of this type take consolidation to the next level: for value-added resellers, for example, this might include managing the coordination of multiple suppliers, products and locations over the lifetime of a project.

For many resellers in most markets, distribution is also the main provider of pre-sale **technical support**, particularly

for the constant stream of innovative new products generated by the IT industry. Such support ranges from a simple “what is the difference between product X and Product Y, what are the specs and does it work with other components?” through to more complex configuration questions. Post-sale, this can take the form of troubleshooting or resolving mis-supply and configuration issues, or of more comprehensive post-sales support or technical training.

Linked to technical support is a range of what are effectively outsourced **product marketing** services, extending from the production of simple product marketing collateral – whether physical or virtual – through activities which allow the distributor to leverage their scale such as full catalogue production or website provision on behalf of their customers.

Finally, it is important to recognize the more strategic role played by distributors in providing customers with **market and business intelligence**, enabling their resellers to make smarter strategic decisions and facilitating the growth of their businesses.

Over time, as technology distribution has matured, more and more of the standard services have been built into the margin on the product, with frequent innovations by distribution to create augmented services and add new sources of profitability.

Typical Core Offering and Optional Services Distributors Provide to their *Customers*

Typical Core Offering

- One-stop shop – range and availability
- Bulk breaking
- Credit
- First level technical support (pre-sales)
- Logistics – delivery
- Order consolidation
- Product information collateral

Typical Optional Services

- Sourcing of products
- Back to back ordering
- Simplified supply logistics
- Consignment stocking
- Repackaging
- Extended credit, project finance
- Second-level technical support (post sales) – effectively acting as an outsourced provider of support
- Technical training
- Logistics – drop shipment to ultimate customer
- Project management – coordinating the supply of several suppliers and shipping to multiple locations
- Marketing services – effectively acting as an outsourced provider

Role for Vendors

Mirroring the roles distributors play for their customers are the roles they play for vendors. Ultimately, their role is as a route to market for vendors seeking to reach a specific segment of the market or an entire market. In broad terms, this role translates into activities in four main areas (See table):

Market Knowledge and Access – Distributors provide vendors with detailed knowledge about the specific markets in which they operate. Building a relationship with a distributor in a given market brings not just a set of relationships with resellers within that market, but also a wealth of insight into how to use those resellers to access the different parts of the end customer base. This role is usually backed up with reporting: sales out and inventory reporting, updated weekly or daily, provide a key window onto the marketplace for vendors. In addition, distributors may provide data on the state of the market, on the competitive environment, on lost sales, and similar.

Demand Generation & Outsourced Front Office – One main way in which distributors can leverage their market knowledge is in demand generation activity, working their existing network of resellers, recruiting new resellers, and actively driving awareness and sales capability amongst them in order to promote sales amongst end customers. For vendors, the market data, marketing tools and marketing resources a distributor can make available provide a highly efficient mechanism for generating demand for their products, and are therefore an attractive investment for market development funds. However, beyond these fundamental aspects of demand generation, distributors can also provide more extensive front office services, either supporting a local office in a new market or taking on the local agent/vendor representative role, providing channel development and account management services, running end-customer marketing or lead-generation/management programs, or administering channel programs and funds on behalf of the vendor.

Typical Core Offering and Optional Services Distributors Provide to *Vendors*

Typical Core Offering

- Market knowledge and access
 - Sales out reporting
 - Channel intelligence
- Demand generation
 - Channel recruitment
 - Channel accounts and database
 - Marketing fund deployment
 - Special pricing management
 - Teleweb outbound/inbound sales
 - Regular marketing mailings
 - “Spiff” sales promotions
 - Channel conferences
 - Channel training
 - Channel financing through credit provision
 - In-market product management
 - Front-line technical support
- Supply fulfillment
 - Bulk breaking
 - Outbound Logistics
 - Reverse logistics
 - Channel credit risk
- Outsourced services

Typical Specialized Services

- Market knowledge and access
 - Channel research
 - End-customer research
- Demand generation
 - Channel account management
 - Program management
 - Co-op fund management
 - Special channel financing and credit offerings
 - End-customer marketing and lead generation programs
 - Conference and exhibition services
- Supply fulfillment
 - Consignment stocking
 - Vendor managed inventories
 - Vendor stock warehousing
- Outsourced services
 - Warranty management
 - Break-fix operations
 - Second level and post-sales technical support
 - In-market representation
 - Trademark registration & protection

Supply Fulfillment & Outsourced Back Office –

Complementing the demand distributors can generate is a set of supply fulfillment activities they perform on behalf of vendors. With the extensive range of SKUs from most IT vendors, distributors perform a key role in stocking a complete or close-to-complete range of SKUs on the vendor’s behalf, and assuring back-orders are handled promptly where SKUs are not in stock. With price volatility a common industry condition, the costs of holding this inventory can be high, in particular where vendor special pricing into the channel is not backed up by price protection.

The distributor’s role for vendors regarding these SKUs mirrors that played for customers, i.e., breaking bulk, providing delivery logistics, and providing reverse logistics (e.g., taking back returned products), where required. In addition, they may provide additional services related to fulfillment, such as vendor stock warehousing, dedicated vendor inventories for major retail customers, or consignment stocking on behalf of vendors.

As highlighted in the section relating to customers, a second core fulfillment function of distribution is to take on and manage on the vendor’s behalf the significant credit risk of thousands of reseller and retailer customers. This is a role which requires the application of all of the distributor’s local market insight to a set of rigorous credit control processes to minimize credit exposure and the cost of bad debts. In addition to the costs saved by having a single, simple

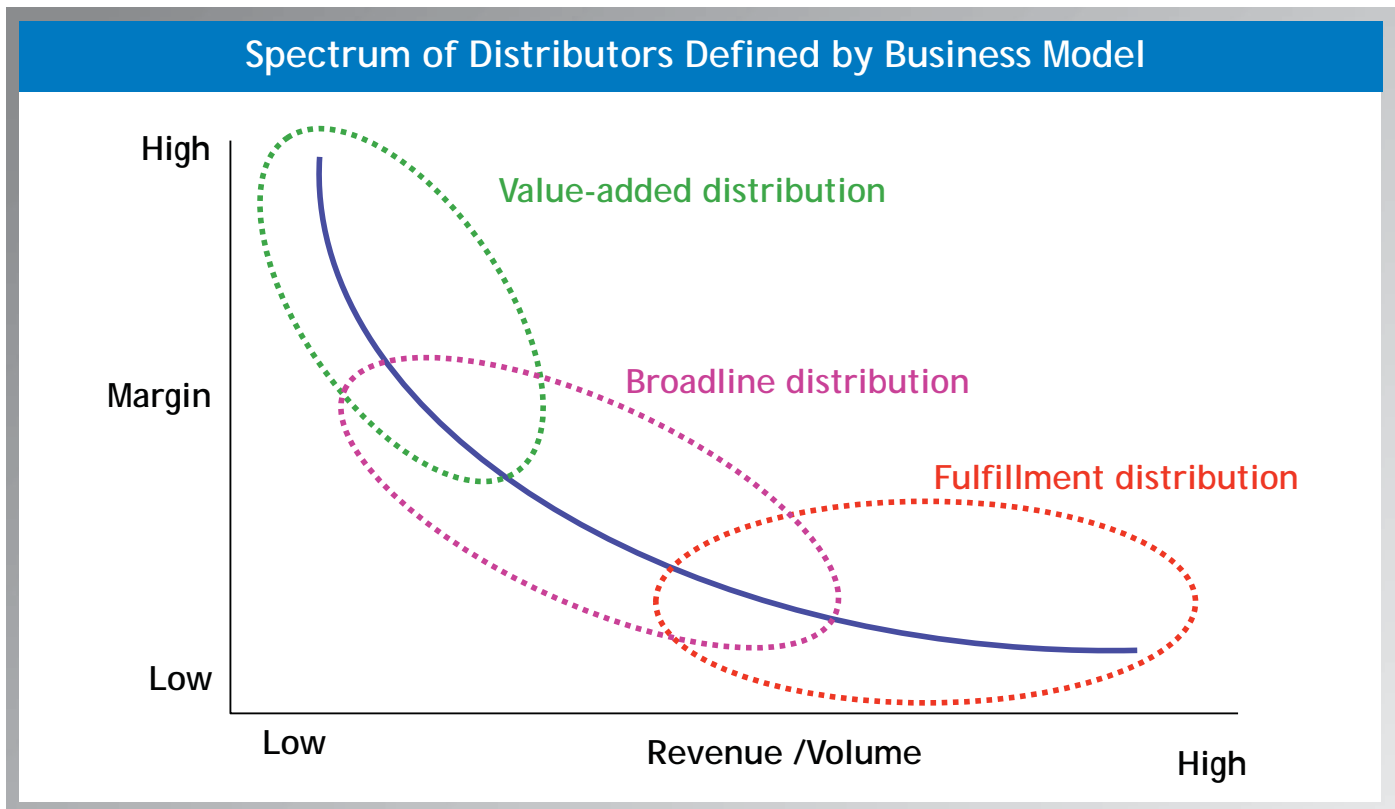
credit function for the vendor, it is clear that there is real value in managing this credit exposure: the more risky the market or market segment, the greater value to the vendor.

Additional back-office functions distributors perform beyond credit management include the running of debit notes, providing quotation support, and managing pass-through funds on vendors’ behalf (often advancing funds).

Outsourced Services – Finally, there are other more specialized outsourced services which IT distributors provide, including warranty management, break-fix, post-sales support, or specialist legal services which leverage local knowledge, such as trademark registration and protection.

Different Business Models for Different Roles

Which of the sets of services above a distributor actually provides to a vendor – the exact nature of the distributor’s “route to market” role – depends on a range of factors: the presence of the vendor in the marketplace, the segment of the market being addressed, the maturity of the product categories in question, the stage in the product lifecycle and the nature of the final-tier in the marketplace and distribution system. In simple terms, there is a spectrum of (overlapping) services a distributor may provide, ranging from Value-Added Services through Broadline Services to



Fulfillment Services, which can be mapped by margin and volume, and which often relate to the position of the product category on the Technology Adoption LifeCycle (TALC).

Value Added Distribution Services –Typically focused on taking to market newer, higher-value technologies such as data centers, virtualization, secure networking and Open Source and supporting services delivered to larger and Enterprise-level customers, Value Added Distribution services involve recruiting, developing and supporting the specialist final-tier players who reach and service this end of the market, typically by planning and delivering complex IT projects. This, in turn, requires significant investments of time and resources in mastering products from a technical and marketing perspective, and in building infrastructure for services ranging from demand building, proactive sales, consultancy, extensive technical and sales training and certification, coupled with comprehensive pre- and post-sales technical support. With investments of this nature, significant numbers of highly-skilled, high-cost personnel, and an overall lower volume of sales, distributors providing Value Added Distribution services look to earn high margins and to receive compensation for the services they provide.

Broadline Distribution Services – Providing the mainstream market coverage to allow vendors to access and service dealers who address the vast SMB segment, distributors who provide Broadline Distribution Services need to cover most or all of the channels vendors need by establishing and supporting trading relationships with a full range of dealers within each segment. Market access is clearly core to the offering, along with the provision of proven marketing and communication tools such as catalogs, mailers and websites. With several providers of these services in each market, this marketplace is typically highly competitive, with prices and margins under greater pressure, meaning that process efficiency and cost control are essential, along with the volume discounts and rebates which reward scale. As a result, the additional costs of activities such as placement in marketing tools or sales promotions will typically be recovered from suppliers since they cannot be absorbed into the normal trading margin. In addition, given the scale of such a business, efficient management of working capital and cash is key, with the role of credit provider often extending beyond product into the domains of marketing and promotional funding. Scale is key, both for the distributor offering these services and for the supplying vendor.

Fulfillment Distribution Services – In markets where products are bought rather than sold, such as consumables, or where other players drive marketing and sales activity, such as retail, distribution performs the role of logistics engine on behalf of the vendor. With the vendor or final-tier retailer taking on most of the marketing activity, the core of this model is a high-volume, high-efficiency logistics operation, focused on stripping out any redundant cost in

order for margins to cover infrastructure and operating costs. In many respects, this model is comparable to that of a pure logistics provider such as FedEx or DHL, with two major differences: first, the distributor providing these services typically bears a stocking risk, leveraging their expertise in inventory management to balance demand and supply; second, the distributor also bears the credit risk. In this model, compensation can be either through trading margin as in other models or on a fee-per-transaction basis which reflects the fact that the distribution and handling costs are standardized and unrelated to the selling price.

Logistics and Special Service Distribution – The final, hybrid model, blends elements of all three models above into special service distribution. In domains such as telecoms, distribution may combine high-value configuration services with pack-out and branding services, repair and refurbishment with retail store fulfillment, category and shelf management.

Which of these roles your distribution partners play for you, and which services they provide, will determine the exact nature of their business model. This primer will not go into detail on how the business model varies for each type of role, although that may be the subject of future GTDC publications.

Future Roles, Evolution and the Cloud

As markets and technologies evolve, new roles for distribution are emerging and will continue to emerge. Although the core roles will remain, it is likely that disruptive technologies and discontinuous developments (such as cloud computing) will once again lay down the challenge for distributors and vendors of defining how the distribution role – and therefore business model and compensation model – will need to change.

What Does This Mean for the Vendor?

Each of the roles and services listed above has an impact on the distributor business model: the choice of whether it is provided or not, and to what degree, is determined by the specific role the vendor is looking for the distributor to play. As such, it is reflected in vendor contracts, in margin structures, in compensation schemes and in activity-based fees. The challenge for vendors is to be clear on what is required of distribution, which distributors are fulfilling the requirements and to what degree, and how that activity is to be compensated.

Ultimately, anyone in a vendor organization who needs to justify the use of or quantify the value of distribution, should work through these checklists – from a customer and a vendor perspective – and answer the question “Which of these activities do I need performing, which of them should my distribution partners perform for me, and what would it cost my own organization to provide these services?”

Five Myths of Distribution

1. I'm Giving Up Margin to the Distributor

Vendors often feel that by going to market through distribution they are giving away margin that they could have kept for themselves. However, this perspective completely ignores the fact that the vendor is also giving up the logistics and credit infrastructure that it would need to deploy to reach the resellers and retailers served by distribution. The recent cost study conducted among vendors by the GTDC shows that the economies of scale achieved by distributors means that the vendors are making cost savings which are considerably higher than the 3 to 5% average additional discount given to distributors

2. Distributors are Just Order Takers

There are very few products that have such strong brand strength and channel profile that the distributor's role can be restricted to simply taking orders for them. Most products need some level of pre- and post-sales technical support, depending on where they are in the technology adoption life cycle. Distribution plays a vital role in ensuring the resellers are fully informed as to the technical specs of products as well as advising on configuration issues and compatibilities. Without this role, many new technologies would move far more slowly through the adoption cycle and resellers would struggle to realize their business potential.

3. The Internet/Cloud has Removed the Need for Distributors

Distributors generate and respond to demand from thousands of resellers of all types, providing a one-stop-shop across hundreds of different vendors. While the migration of information to the Internet and the provision of services through the cloud make these transactions ever more efficient and lower cost, there is no substitute for the specialized skills and capabilities of distributors to drive the sales and fulfillment processes. With the exception of software, IT products require a physical logistical infrastructure, and all products need a credit infrastructure backed by the financial strength and credit insight of distributors to provide the liquidity needed by the channel at the lowest cost.

4. Retailers and Large Resellers Prefer to Deal Direct with Vendors

While it is certainly true that large retailers and resellers want to have a direct relationship with the key vendors, this does not automatically mean that they want the vendor to handle all aspects of the trading relationship. Most retailers have such demanding logistical requirements that they insist on distributors handling the supply chain and providing the related transaction processing infrastructure, including of course credit provision. Large accounts want the ability to connect with vendors at a strategic level backed up with day-to-day account management connections to be able to resolve issues with the right level of priority. In some instances the vendors will also deploy sales support that works directly alongside that of the resellers to develop end-customer relationships and win big or complex deals, but project management and fulfillment will go through distribution.

5. Distributors Move You One More Step Away from Market Signals

Although this might have been true twenty years ago, most vendors now have on-line visibility of "sell-out" data from their distributors through the integration of their IT systems, giving them at least weekly, if not daily or live visibility of market signals. This is to the benefit of both vendors and distributors, ensuring that the supply chain is as lean as possible while holding sufficient inventory to meet demand.



How the Distributor Business Model Works

What are the primary levers and factors that come into play when establishing or growing your partnerships with IT distributors. Not all are created equal, but certain factors and considerations apply across all types of distribution models.

Characteristics of IT Distribution

Given the roles fulfilled by distributors for both customers and vendors, there are some key characteristics to be aware of in the distribution business model.

First, distribution is an inherently difficult business to get right. The fixed costs involved are typically long term, while the visibility of revenues is just the opposite. Distribution businesses are often critically dependent on a very few major relationships, which can change – and be changed – with relatively little notice. For example, a decision by a market-leading vendor to switch to supplying just one or two

major customers directly rather than through distribution can have a significant effect on its distribution partners, removing significant revenues – and the linked profits which were covering fixed costs. Clearly, distributors manage their exposure to such situations, and develop their 'next tier' customers, but there is still a short-term impact.

Second, distribution businesses are fast-moving businesses, consuming significant amounts of capital, or people, or both, and in many cases delivering – or perceived as delivering – relatively low returns on these investments. They are essentially product businesses, and as such they need to be managed in terms of both profitability and asset efficiency.

A Disti Co - Summary Financial Statements

Profit & Loss Account

	\$'000
Sales	19,316
Cost of sales	18,308
Gross profit	1,008
Overheads	952
Operating profit	56
interest	12
Profit before taxation	44
Taxation	16
Profit after taxation	28

Balance Sheet

	\$'000
Fixed assets	423
Current assets	
Inventory	1,408
Accounts receivable	1,897
Cash	401
Total current assets	3,706
Current Liabilities	
Accounts payables	1,550
Other	764
Total Current liabilities	2,314
Net Current Assets	1,392
Long term liabilities	59
Net Assets	1,756
Shareholders funds	1,756

Distribution Business Model

To understand this in more detail, it is worth looking at an example set of distributor financial statements (Profit & Loss Account or Income Statement, and Balance Sheet)

Focusing first on the **balance sheet** (a summary of the assets and liabilities of the business at any given point in time), it is important to note the importance of three numbers:

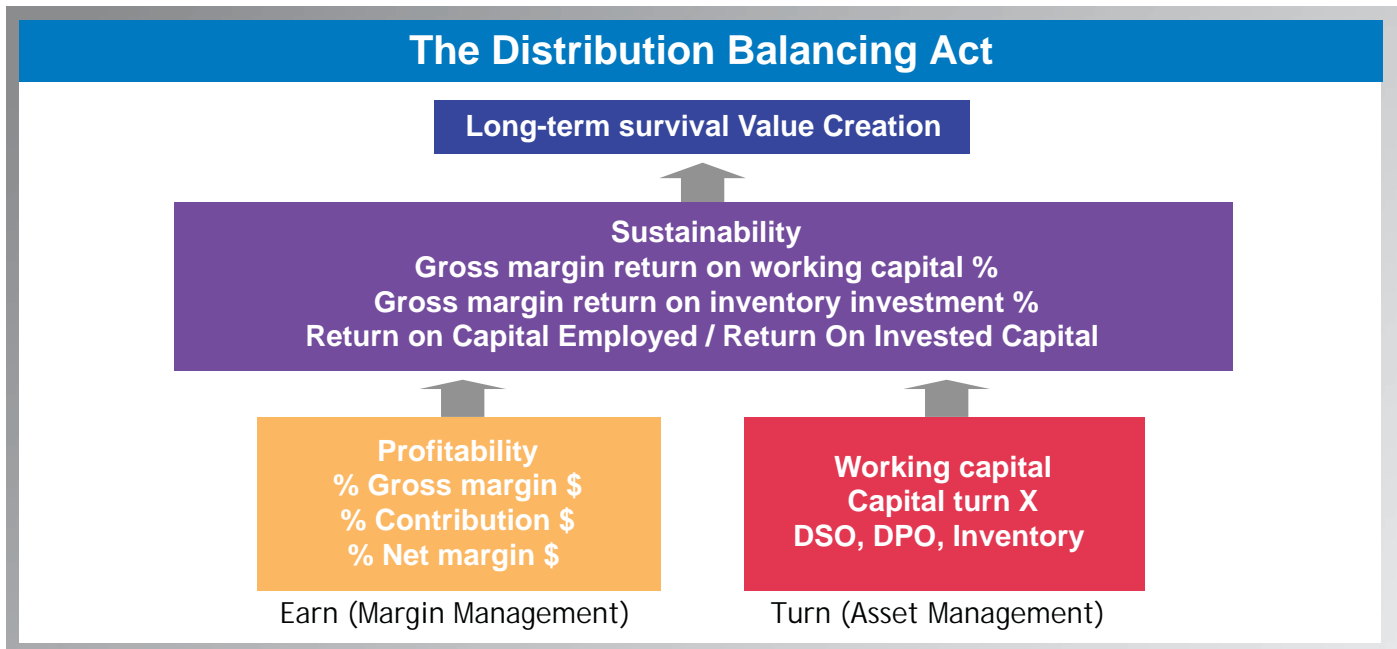
- **Inventory**
Products held for resale
- **Accounts Receivable**
Amounts due from customers for sales made on credit
- **Accounts Payable**
Amounts due to suppliers for products bought on credit

These three items make up the **working capital** required by the distributor, so called because it is the capital needed at any point in time to operate the business (as opposed to capital which may be required to finance the infrastructure). Working capital is calculated by adding inventory and accounts receivable and subtracting accounts payable. The other items in the balance sheet such as **fixed assets** (land, building, warehousing and sales systems, etc.) and **other** balances are relatively unimportant – it is working capital for the most part which determines how much capital a distributor needs to raise to finance its business. Managing working capital is a fine balancing act: too little and the distributor risks stock-outs (running out of inventory) or defaulting on payments to its suppliers while waiting for payments from customers; too much, and the cost of capital – especially the interest paid on any financing – damages the profitability of the business.

The **income statement** (a summary of the distributor's incomes and expenditures over a given period of time) – demonstrates how tight the margins can be in IT distribution. The **gross profit** margin is the difference between the price the distributor pays for its products (the **cost of sales**) and the price it receives for them from its customers (sales). In distribution this is typically a very small number between two very large ones, which explains why it is such an area of focus and the subject of so much negotiation. In addition, the distributor has to pay for all its **overheads** (or SG&A) out of this gross profit, leaving whatever is left over as an **operating profit**. But that is not the final cost to the distributor: as highlighted above, any capital borrowed to finance the business incurs an interest charge, which is also deducted from the margin, leaving a **net profit (or loss)** to the business. After tax is deducted (assuming this is a profit), whatever is left is available to be paid out as a dividend or retained in the balance sheet to finance the bigger working capital balance or additional assets required to grow in the next trading period.

Comparing the gross profits made in this example of \$1,008m with the working capital required to generate it of \$1,775m (\$1,408m + \$1,897m – \$1,550m) highlights the key challenge for distributors: our example company has tied up over \$1.75bn over the year in order to earn just over \$1bn in gross profit ... and only \$44m in net profit! A slim return for such a large outlay.

What's more, the slightest slip in managing this business (for example, overstocking leading to writing down the value of inventory, extending credit to bad- or non-paying customers or investing too soon in additional warehouse space) can wipe out that profit very quickly and turn it into a loss.



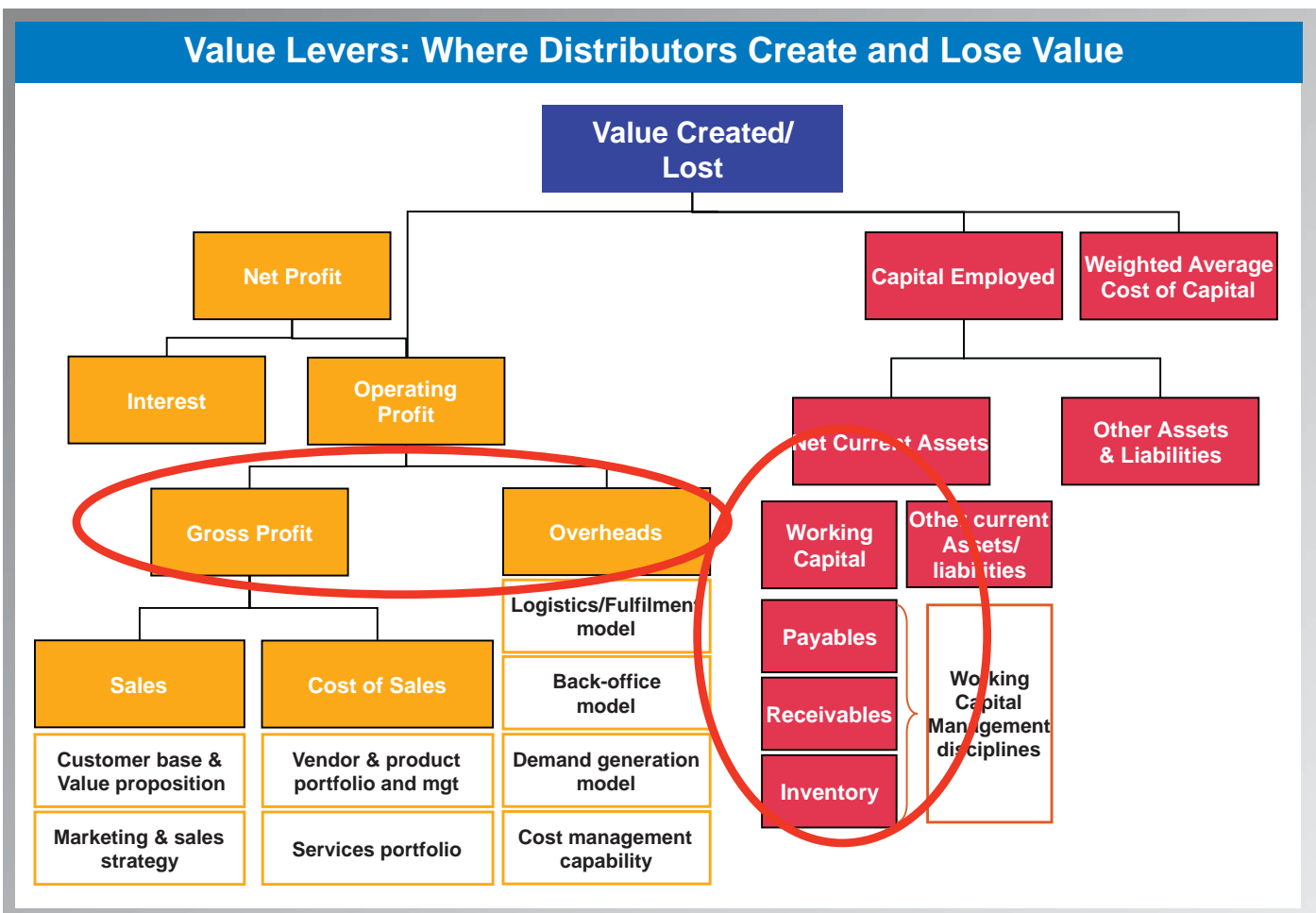
Managing Distribution is a Balancing Act

This balancing of profitability and working capital is the essence of the distributor business model. Ideally, each distributor will have a balance which is right in the context of its value proposition, its mix of the services we referred to earlier and its business model. Each will be pushing to maximize margins and minimize working capital, without affecting the range and availability of products they are offering to customers.

In their **margin management**, most astute distributors use a portfolio approach to blend fast-moving, low margin products with slower-moving but higher margin ones. Their challenge is to match their range and inventory levels with the demands of customers and vendors, all in ways which make sense financially. The 80:20 rule applies throughout the business, with 20% of their products making up 80% of the volumes ... but the probability is that a different 20% of products account for 80% of profits. Similarly, a small set of customers may drive the bulk of revenues, but it is vital for the distributor to know which 20% of customers drive the bulk of their profits.

Optimizing profitability also requires tight overhead control, with many of the distributor's costs being fixed in nature (i.e., not varying directly in line with sales). This means that growth often requires step changes in costs, where the challenge is to avoid pushing up the cost base before sales have grown to cover it – perhaps easier to do when adding new warehouse space (timeframe of months) than investing in new IT systems (timeframe of years). Conversely, in times of downturn, technology distribution has been forced to look at ways of making its cost base more variable by outsourcing elements of infrastructure such as warehouses, transport ... in some cases even call centers. Such decisions involve tough trade-offs between the advantages of greater cost flexibility and the risks of losing control and damaging customer satisfaction.

Managing working capital in distribution is all about managing a finite resource: money tied up in product A is not available to stock product B; cash expected from customer X is not available to extend credit to customer Y; vendor credit limits need to be paid off when reached, before more products can be ordered. In stable periods,



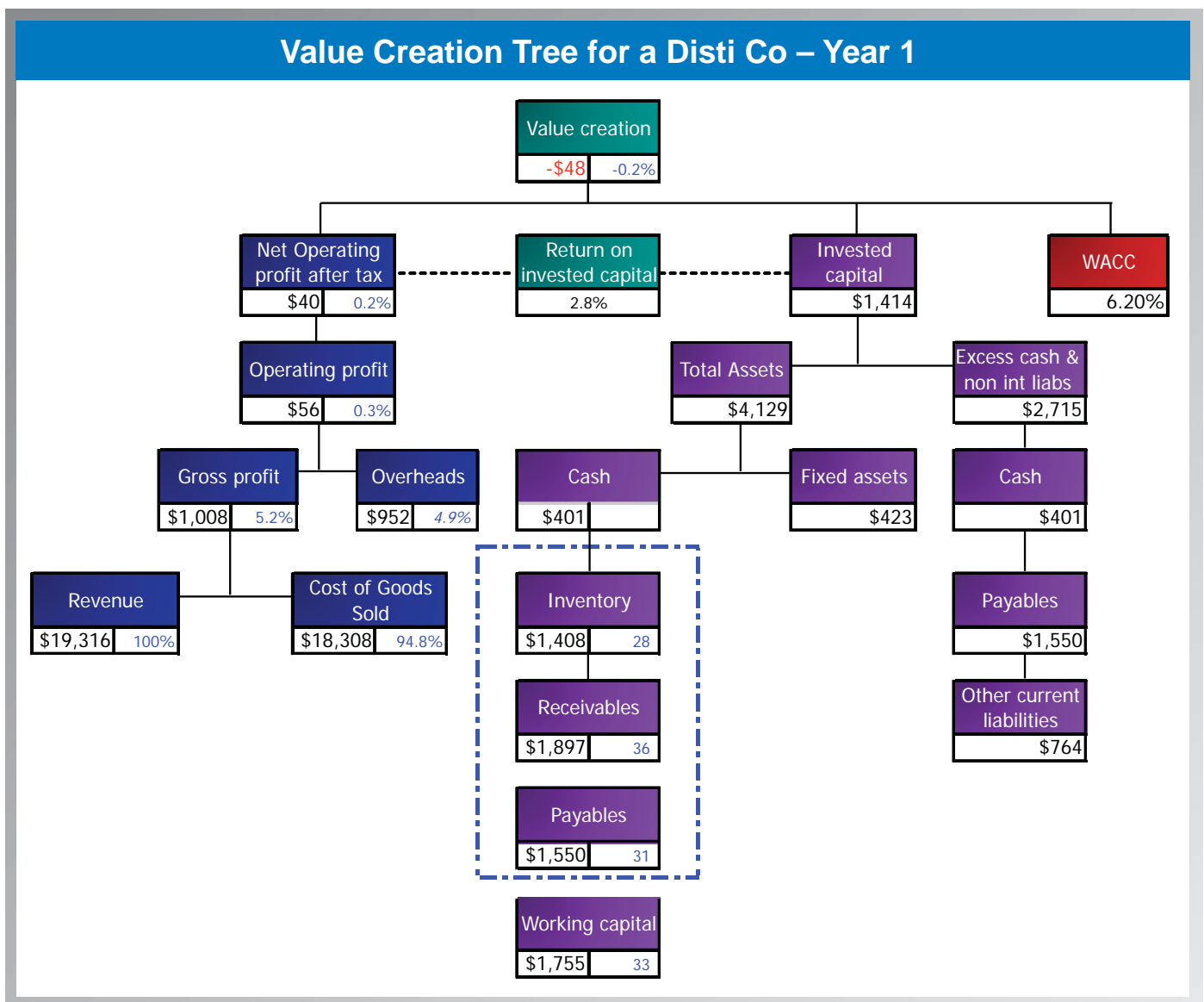
this requires careful management. In times of growth, the additional working capital required presents the distributor with two blunt options: either increase the working capital to match increased trading volumes or improve the cash-to-cash cycle, i.e., the time it takes for money paid out to suppliers for products to convert from inventory into sales on credit to customers who eventually pay for the products.

Taking the first option without careful planning can be extremely dangerous: even with sales and profits growing rapidly, the distributor risks “overtrading,” i.e., doing more business than their capital resources will allow, and ultimately running out of cash. This lack of liquidity has been the downfall of many IT distributors in industry growth periods.

The second option – accelerating the working capital cycle – presents its own challenges: tightening customer credit can lead to loss of sales short-term and customer relationships long-term; reducing inventory levels can result in poor availability, stockouts and incremental costs associated with managing and fulfilling back orders; and asking suppliers for extended credit terms or increased credit limits – can send the wrong message, quite apart from the risk of being met with a refusal.

The Measures that Matter and How to Manage with Them

The measures that matter in a distributor reflect the way the business model works, with tight management of margins, working capital and productivity metrics



(combined margin and working capital) being key to the success – or even survival – of the business.

It can be helpful to view these numbers in the framework of a “tree” or pyramid, where the drivers of each side of the equation – Profitability and Asset efficiency – can be mapped in a way which shows their impact on the overall return on investment or the value created for shareholders.

This view of a distribution business highlights the fact that any change to the key drivers – however small – ultimately has an impact on the performance of the company. From a vendor perspective, it is essential to understand this picture, since every vendor action – adding SKUs, changing prices, offering a given set of T’s & C’s, running a promotion – will affect one or more of these drivers and therefore have an impact on the overall results-.

For our example distributor, A Disti Co, we can map the financial statements in a similar fashion, showing the principal metrics essential to the running of the business and how they relate to each other.

Ultimately, then, the distributor’s business must generate a Return on Capital. There are a number of key drivers: profitability, working capital and productivity. The next sections explore each of these three areas in turn, before going on to examine measures of longer-term sustainability and growth capacity.

