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Wholesale Distribution

White Paper



The Times are changing for Distribution

The distribution enterprise applications space is poised to take off, but it may need a midcourse correction to reach its destination. For several years now, this market has lagged behind the buoyant manufacturing-centric Enterprise Resource Planning (ERP) applications market.

While manufacturing and trading were going ahead with sophisticated ERP and Supply Chain Management (SCM) applications, distributors were reluctant to spend on Information Technology (IT).

Distributors did not have much reason for investing in Information Technology

Until recently, distributors had little reason for investing in enterprise applications. On the supply side, vendors serving this market relied on proprietary technologies, sold custom development projects delivering limited functionality, provided little customer support and offered ill-defined migration paths. None had established a commanding presence or offered a compelling vision to create a new market for their software—something SAP (Walldorf, Germany), Manugistics (Rockville, MD), i2 Technologies (Irving, TX) and others have done, among manufacturers.

On the demand side, distributors could point to the following reasons to justify their low IT spending:

- Thin margins
- A stable business environment harboring few new competitive threats
- Business processes fixed around the *Buy-Hold-Sell* (BHS) model of distribution, where a distributor buys product in advance, holding it until it is sold

New Products and Changing Markets are now driving distributors to invest in Information Technology

Today, all of this is beginning to change. On the supply side, enterprise application vendors, with deep roots serving the distribution market and others with pedigrees in financial and manufacturing applications, see a broad underserved vertical market. ERP vendors are introducing better products and true packaged applications to serve this market.

Built on open systems and industry-standard technologies, these systems offer deeper, broader and better-integrated functionality. Some are beginning to provide Web-based capability. Others are providing deeper functionality in purchasing, inventory, warehouse and order management—core functionality to handle the traditional requirements of distribution. A few others are extending their product offering into Customer Relationship Management (CRM).



To deliver improved functionality, vendors are building their own applications while others are licensing in components and acquiring smaller vendors that have already built such components but lack market channels. These applications are easier to use and maintain, as compared to the traditional fare in this area.

The distributor's attitude is now changing

The low margins that the distributors had been talking about, as an excuse for reduced IT spending, is now turning to be a reason for an optimized IT spending.

There is a realization that integrated enterprise solutions actually help them reduce their inventory, control costs, increase revenue and improve customer service. They continue to do what they were doing in the past, only more efficiently.

More than that, the distributors are essentially seen as middlemen. The diminishing role of middlemen is another factor that is driving distributors to revamp their business. The transition is being made from the traditional Build, Hold and Sell model, to Sell, Source and Ship concept.

In the Sell, Source and Ship model, the distributor holds as less stock as he can in advance and chooses to take inventory on consignment, or quickly source and ship, after he gets the order from the customer.

According to AMR, there is a fundamental shift in the distribution process models. Ramco proposes to address this in the following way.

- 'Managing inventory that you do not own or handle is better than taking title and including cost and risk'.

Addressed efficiently by the consignment purchase order and sales order business processes.

- 'Having a strong infrastructure, comprising work flow based information system, is more important than being good at sales'

Supported by the powerful workflow management system, which is capable of providing timely alerts and reminders, thereby resulting in effective decision-making.

- Focusing on business model innovation, an element you can control, rather than relying on product innovation, an element you are unable to control.

Given the flexibility in deployment of components and collaborations with other applications, the distributor has the choice of opting for any optimum business model deployment.

Distribution-Centric Software advantages

During the recent years, some wholesale distributors have implemented application software from billion-dollar vendors that not only specialize in manufacturing software, but also offer distribution software solutions. Often the installations have been extremely difficult and expensive, sometimes leading to bankruptcy of the distributor. By comparison, software packages that specialize in satisfying the requirements of wholesale distributors have had much higher success rates. There are probably good reasons for this disparity.

It is natural that software companies with MRP (Manufacturing Requirements Planning) systems, also sometimes called ERP (Enterprise Resource Planning), should offer a solution to wholesale distributors. After all, every manufacturing company is also into distributing products. Therefore, every MRP / ERP solution also contains sales order processing and purchasing, among other capabilities.

When software that applies to distribution of product exists, why shouldn't this be marketed to the distribution industry? While this makes sense from the software vendor's viewpoint, there is significant appeal from the wholesale distributor's viewpoint as well. The reason being that software can be purchased from a billion dollar software provider, instead of the smaller companies that specialize in wholesale distribution software.

There are fundamental differences between the manufacturer's position in the supply chain and the wholesale distributor's position in the supply chain. These differences are reflected in the software requirements and software package capabilities. The manufacturer has significant control over their outbound supply chain and also exercises significant influence over the inbound supply chain.

With regard to the outbound supply chain, if the manufacturer has either brand recognition or a low cost product that justifies purchases by distributors and other customers in the supply chain, the distributors and customers will accommodate the manufacturer's rules to place a purchase order. They will be willing to wait until the product arrives. Generally they will order a product that the manufacturer intended to manufacture and not the non-stock "special order" products.

On the other hand, wholesale distributors often are caught between billion-dollar manufacturers and customers. At the transactional level, even billion-dollar distribution companies are caught between powerful manufacturers and demanding customers. The wholesale distributor has limited power to do anything except acquire the product the customer needs and ship it to the customer. This requires application software with tremendous flexibility. Such flexibility is provided by distribution-centric software packages and is not a requirement of the distribution module of an MRP software product.

For example, the customer may need a product that the distributor does not have in stock. The distributor, to satisfy the customer's requirement, may need to modify the product in stock

or transfer from another branch, or purchase the product specifically for the customer. It may be a non-stock product that has not even existed in the distributor's system prior to the transaction.

The distributor needs to record the requirement in a quotation, source the product and quote the product along with others from stock/other vendors, to the customer. If the customer accepts the quote, the distributor needs to purchase the product and either ship it directly from the vendor to the customer, or receive it in and combine it with other products to be shipped to the customer. The cost from the vendor plus freight needs to pass through, from the Purchase Order to the Sales Order, automatically. Commissions need to be calculated, based on gross profit.

None of these requirements generally apply to the distribution operations of a manufacturer. But they are all critical to successful operations of most wholesale distributors.

Additional important distinctions exist, if a distributor also performs value added assembly operations. MRP generally involves production of quantities of standard products, in predetermined configurations. Repetitive production of quantities of multiple products, with multi-level bills of material that share subassemblies with other production schedules, requires MRP. MRP involves significant complexity and tremendous discipline. It also involves a level of inflexibility in terms of satisfying customer demands, that operate on shorter cycles than the current production schedule.

By contrast, wholesale distributors who perform light manufacturing operations have an entirely different environment. They may have multi-level bills of material, but these are usually for production of single units or a few units on short notice. Generally, they do not have repetitive scheduled production of multiple units of the same product or subassemblies shared with other products, on other repetitive production schedules. Therefore, distributors do not require MRP and will suffer, if their value-added operations are burdened with the complexity and rigidity of an MRP system.

MRP systems are not useful for producing single units customized for a single customer, possibly in a unique or rare configuration, which is the rule in value added industrial distribution operations. Distributors require flexibility and correct association of actual costs with resulting revenues. This requires use of average cost plus labor and overhead allocation, not standard cost accounting associated with MRP / ERP systems.

Thus, distributors need to be careful in their software selection process, so as to be sure the flexibility they require, is handled by the software. Processes that might be required by them but not required by manufacturing enterprises should be given due attention. These could include weighted average cost, LIFO, FIFO, non-stock items with separate "actual cost", customer quotations integrated with supplier quotations for the same product, "special" sales orders integrated with purchase orders for the non-stock products, returned goods claims from customers integrated with vendor claims and numerous other requirements.

If the software does not satisfy these and other distribution-centric requirements, manual processing will result in unnecessary costs and inefficiencies. Consequently, when a wholesale distributor selects an MRP/ERP solution, the result is often either a failure or a long-term inefficiency. Thus it is vital that distributors learn to recognize the difference between distribution-centric software and manufacturing-oriented software, in order to bring about efficiency in their processes.

