

# A direct threat

*Should distributors be concerned about manufacturers selling direct?* By Richard Trombly, Associate Editor

**R**ECENT STUDIES HAVE INDICATED that manufacturer-distributor relationships are poor and distributors are worried about their manufacturers selling direct to customers in their territories. Selling direct was selected by 38 percent of distributors as one of their top three concerns, according to the Cahners Research/ INDUSTRIAL DISTRIBUTION 55th Annual Survey of Distributor Operations. But this threat is hardly new.

In May 1907, the American Supply and Machinery Manufacturers Assn. held a joint session with the Southern Supply and Machinery Dealers Assn. and the National Supply and Machinery Dealers Assn. in Cincinnati, Ohio. At this meeting, SSMDA president J.A. Reichman indicated that manufacturers selling direct was a major complaint received during the previous years.

"The complaints of the greatest importance and which cause the most demoralization are against those manufacturers who sell [to] small dealers and repair shops on an equal basis as ourselves," said Reichman. "Also those manufacturers who have branch houses ... who do not properly classify their trade."

He also reported concern with the discounts offered to syndicate buyers, purchasing agencies and catalog houses. Of course, it is not fair to place all of the blame upon manufacturers, added Reichman.

"The manufacturer is no worse than the [distributor] in many respects with reference to unfair and unbusinesslike dealings," he said. "Our greatest difficulties are encountered through lack of understanding of conditions under which we both operate."

Reichman called for "a better understanding and closer relationship with the men whose products we sell."

Nearly a century later, the same problems and same lack of understanding persist. Industrial Distribution Assn. executive director Garry Buffington points out that the situation now is no worse than it has ever been.

The 2001 Trends in Industrial Distribution study sponsored by the Industrial Supply Manufacturers Assn. and I.D.A. indicates that nearly 35 percent of manufacturer revenue comes from general line or industrial supply distributors and another 18 percent comes from specialty distributors. Only 12 percent comes from direct sales to end-users and only 26 percent of customers expect direct sales to increase.



ILLUSTRATIONS BY SEAN KAPTAIN

However, distributors' concerns aren't unwarranted. The study also shows that 48 percent of manufacturers expect direct sales to increase within the next two years. Primary reasons given by customers were lower price or cost and better product knowledge.

"It is clear that distribution has a problem getting across to the end-user the understanding of distributor value," says Buffington.

## A real threat

Wistech Controls has experienced the manufacturer selling direct. The Phoenix, Ariz.-based fluid power distributor had been recognized as one valve manufacturer's top 10, in part due to sales with a major OEM, says president Jim Platt.



"We were cancelled by the manufacturer and they took that OEM customer's sales direct," says Platt. "We understand that some manufacturers have a sales force to sell direct to large national accounts, but I would like to see distributors kept in the loop."

Other manufacturers have factory specialists to pursue sales in a particular industry or sales to major resellers, catalog houses and large national distributors, which increases the competition small distributors face, says Platt.

"If manufacturers would keep open lines of communication, we could reach agreements which we all approve of," he says. "Our greatest value is that we are local and can provide emergency support, while a rep from the factory may take days to respond."

Platt says one OEM even asked him to solve a problem after they started buying direct. He referred them to the manufacturer since he no longer carried that product.

"Manufacturers tell us they need to sell direct because their competitors do it and



their customers demand it," says Platt. "If a customer wants to go direct, a manufacturer should com-

**Manufacturers tell us they need to sell direct because their competitors do it and their customers demand it.** — **Jim Platt, Wistech Controls**

municate with the distributor."

He says that is the perfect time for a joint sales call. The manufacturer and distributor can contact the customer and educate them on the total value a distributor brings to the supply chain, says Platt.

"The distributor relationship is valued by some manufacturers," adds Platt. "Some have had customer requests to sell direct and have informed the customer that they can't do that."

#### **Facing the threat**

Los Angeles-based The Schwartz Profitability Group helps manufacturers and

distributors "improve their profitability through creating and monitoring of more efficient supply chain processes," says principal Lee Schwartz. He says there is considerable concern about manufacturer direct sales among distributors.

"There are manufacturers that have set up Web sites that are transaction-enabled. In one case a manufacturer rep firm set up a transactional site, and there are 'virtual companies' which take orders but never touch the product and are receiving the same discounts as distributors — without offering services," he says.

In addition, smaller ticket and commodity items are increasingly sold direct, says Schwartz. Selling direct also may be a marketing decision made as some family-owned manufacturers take on a more corporate model.

"When distributors approach manufacturers they often get little satisfaction or no audience at all," says Schwartz. "But distributors don't take the threat of direct sales lying down."

Schwartz says with even the rumor of direct sales, many distributors will investigate new product lines and will change if necessary. He suggests a more moderate strategy.

"Concentrate on your strengths," he says. "By providing value and service to the customer, you will maintain relation-

ships with customers who appreciate that value while increasing your value in the supply chain to the manufacturer."

Schwartz says smaller shops will continue to be serviced by local distributors the old fashioned way. Distributors of highly technical products that must be demonstrated or who provide engineered solutions will also continue to find distribution opportunities. Long-term relationships are another value that distributors bring, he adds.

"For example, not just anyone can sell and maintain a multi-thousand dollar machine," says Schwartz. "Manufactur-

ers of these machines understand that if they lose the distributor, they lose his resources and support."

#### **High-tech threat**

The birth of e-commerce brought with it the threat of disintermediation. Many experts predicted that distributors would



be removed from the supply chain. For many reasons, this never came to pass. Like integrated supply, vendor managed inventory, catalog houses, and retail competition, e-commerce is now just one of the facts of business for distributors.

Steve Rabin, chief technology officer with New York, N.Y.-based eB2B Commerce, Inc. says distributors should embrace collaborative partnerships with their manufacturers. He says the benefits of sharing information far outweigh the risks.

"Many of the exchanges that were created failed because of the complexities involved," says Rabin. "And their services weren't robust enough."

He says the focus was on sales rather than supply chain efficiency and trading partner collaboration. It is these aspects that are most compelling for manufacturer, distributor and customer alike, says Rabin.

"Besides, if a manufacturer decides to go direct, you can't stop them," he says. "Pick your partners carefully and start with pilot programs to reduce the risks."

To reap the benefits of improved information flow, Rabin says there must be sophisticated business rules that take into account the individual relationships. He says the free flow of business information can provide a rapid ROI while enhancing the relationships of trading partners.

#### **Customer choice**

Everyone in the supply chain is trying to provide customer value, says professor John Nevin of the Grainger Center for Supply Chain Management at the Uni-



versity of Wisconsin-Madison. Manufacturer direct sales are based on how the customer wants to be served and what they perceive as value.

He says that manufacturers often have a sales force to sell to their largest accounts. Many see this as an end run around distributors, he says, but in the end it is the customer who decides.

"Especially with consolidation, a customer in many geographies may want a single supply agreement," says Nevin. "Many buying groups also make contracts with manufacturers and insist manufacturers sell through their distributors."

The channel has evolved to provide the product at the lowest cost, says Nevin. In some cases that involves selling direct to a large account.

"With today's information, communication and transportation systems, a manufacturer can easily service a larger customer," says Nevin. "With the speed of transportation, a manufacturer can provide product nearly as quickly as a local distributor."

Distributors still have their value, however. For multiple, smaller customers ordering a wide range of products there would be a fortune in transaction and transportation costs alone, adds Nevin.

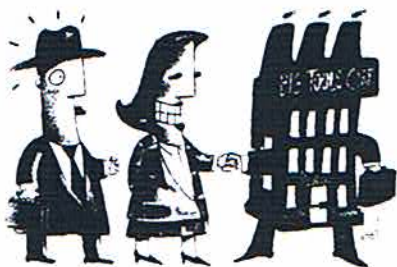
"Direct sales are often customer driven by the short-sighted goal of reducing acquisition costs," says Robert Nadeau of Northfield, Ill.-based Industrial Performance Group, Inc. "These decisions are based on not knowing the real costs and not comprehending the difference between price and cost."

Nadeau says if the distributor is removed from the channel, it will cost more to maintain products and to get application assistance. The true channel costs and returns must be examined and fully understood, he says.

"Some manufacturers are also unaware of the true costs in going to market," he says. "Some think that if the distributor gets a 25 point discount, then selling direct will put those 25 points to profit."

He points out that direct sales involve hiring an increased sales force or independent representative firms and require the manufacturer to take on the warehousing, logistics and support functions that the distributor provides.

"Manufacturers are good at making



products," says Nadeau. "They are often not good at selling products."

He says decisions must not be made logically or emotionally, but entirely on an economic basis. He says distributors can secure their position by sitting down with manufacturers and looking at the real costs and determining what can be done to increase customer satisfaction.

"I recently asked a small group of

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manufacturers if they would like to sell direct," says Mort Harris, vice president of sales and marketing at Minnesota Industrial Tool, Inc. "They said 'no.' When asked why, they replied, 'The logistics!' in unison."

Harris says integrated supply can provide an answer to the threat of selling

direct. Eden Prairie, Minn.-based MIT credits 83 percent of its sales to integrated supply and does not face problems with direct sales, he says.

"If the volume demand is large enough, a manufacturer may go direct," says Harris. "However, in integrated supply, simply the invoices and sales and service calls would be numerous."

Harris says many customers used to

hold large amounts of inventory but that is changing in the face of JIT inventory and activity-based costing.

"Functions within the supply chain can't be redundant," he says. "Manufacturers make their profit by producing and selling at the lowest cost."

Distributors, to remain viable, have to do more than say they provide services, says Harris. They have to demonstrate customer cost savings and added value. One way to do that is to automate supply chain functions to reduce costs, he says.

### Welding relationships

A manufacturer's Web site can be a source of threat to distributors. Some manufacturers choose to have transactional Web sites while others use their site to direct customers to distributors in their area.

"Distribution is the centerpiece of our business," says The Lincoln Electric Co. manager of e-business Jim Appledorn. "The vast majority of our sales go through the distribution channel."

Appledorn says Lincoln Electric looked at what competitors were doing and considered making a transactional Web site. Before doing this, the company decided to discuss this with some distributors, he says.

"We challenged the preconceived notion that the Internet is only for direct sales," Appledorn says. "We decided to support distributors and listened to what they need and want."

He says this was the force behind the customer extranet [www.mylincolnelectric.com](http://www.mylincolnelectric.com), a part of Lincoln Electric's access:Lincoln network.

"We have had rave reviews," says e-business systems development manager George Slogik. "It has the online catalog, but it also incorporates tools that are useful on a daily basis and allows our sales staff to get information to the distributor immediately."

Slogik says most information is available around the clock so that distributors can do online sourcing and off-line buying. This is how most distributors want it, he says.

"With the access:Lincoln network, we envision a whole suite of tools including Web enabled training and learning for customers' shop personnel as well as distributors," says Slogik. "The company is committed to growing this in cooperation with our distributors."

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