

## *What Does a Digital Distributor Look Like?*

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*This is a reference deck, so it is intentionally dense to increase future usability. The expectation is that you will use this deck for an internal discussion with your executive team*

*There are many hot links in this deck that take you to other information sources so a download takes you there with a click instead a typing a long string*

# What Does a Digital Distributor Look Like?

October 16, 2019

10:00 to 11:30 AM

Microsoft Center

Detroit, MI

Session Presenter

**J. Michael Marks**

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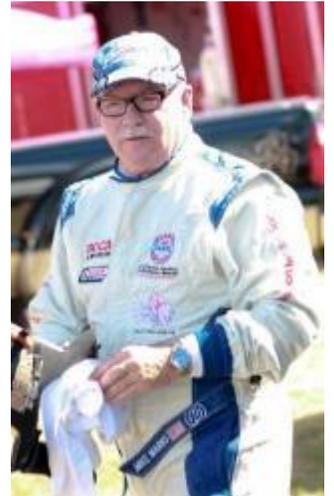
## Your Speaker Today

Indian River Consulting Group has been providing business advisory services for 30+ years

- The focus has always been on market access which aligns investments with real market growth opportunities
- Client revenue size from \$2 M to \$40+ B, private and public, with distributors at 45%, manufacturers at 35% and others at 20%
- Each of our projects are bespoke and conducted within an NDA

My name is Mike Marks and I am the Managing Partner

- Co-founder of the firm, NAW Institute Research Fellow, Graduate adjunct faculty at Texas A&M (past) and Purdue's UID (current)
- Authored/coauthored 6 distribution books published by the NAW
- I currently hold SCCA & PCA road racing competition licenses, a Motorsports Safety Foundation Advanced High Performance Driving Instructor certification, have a Medicare card, two granddaughters, and enjoy competitive shooting, fine tequila, & cigars



## A Very Private Single Question Test

*Consider the last several years of your business compared to a decade ago and rate today's experience on the 1 to 5 scale below*

1. You are working much harder now to just stay even and, if you were objective about it, would say that your competitive position and value proposition may be slipping a bit
2. Same as one except that you are holding your own and not slipping
3. The overall performance of the business remains consistent with the normal ups and downs and your returns are typical for the industry
4. You continue to outperform your competitors, but you are working much harder today to maintain your leadership position
5. You work hard, but you continue to outperform the industry and are increasing your lead over competitors

## Software Is Eating the World

Marc Andreessen wrote an essay that appeared in WSJ back in 2011

The premise of the story was that anything that can become software will become software, it is only a question of when

*Marketshare challengers always win at the expense of marketshare incumbents*

It took 70 years to get everyone with a computer (in your pocket) and also to connect them to each other in the cloud, so consider:

- The music industry\* fought streaming (Napster), so what would you do if your customers were begging to buy product from you in a different way?
- Record Industry revenues shrunk for five years after it flipped but live concert revenue grew 10 times
- Healthcare has a very similar business model\* and when it flips, concierge medicine will explode as care becomes highly automated, like Waze and Facebook, with full Watson integration, DNA mapping, and tiered evaluations\*\* – so humans win

<https://a16z.com/2019/08/16/software-eaten-world-healthcare/>



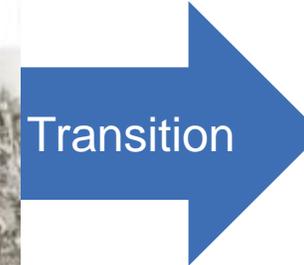
# What Does the Digital Transition Really Mean?



Artisan Vase



1865



1965



2019



All business processes started as artisan processes, but machines replaced factory workers creating replicatable processes  
Digital is doing that for white collar workers

# Old Definitions of Manufacturing and Distribution Are Meaningless Today

## Unbundling Improves Efficiency- So Expect To See More

**4** Do what you do best and buy the rest  
You must sell to users the way they want to buy- it is changing rapidly

**1**

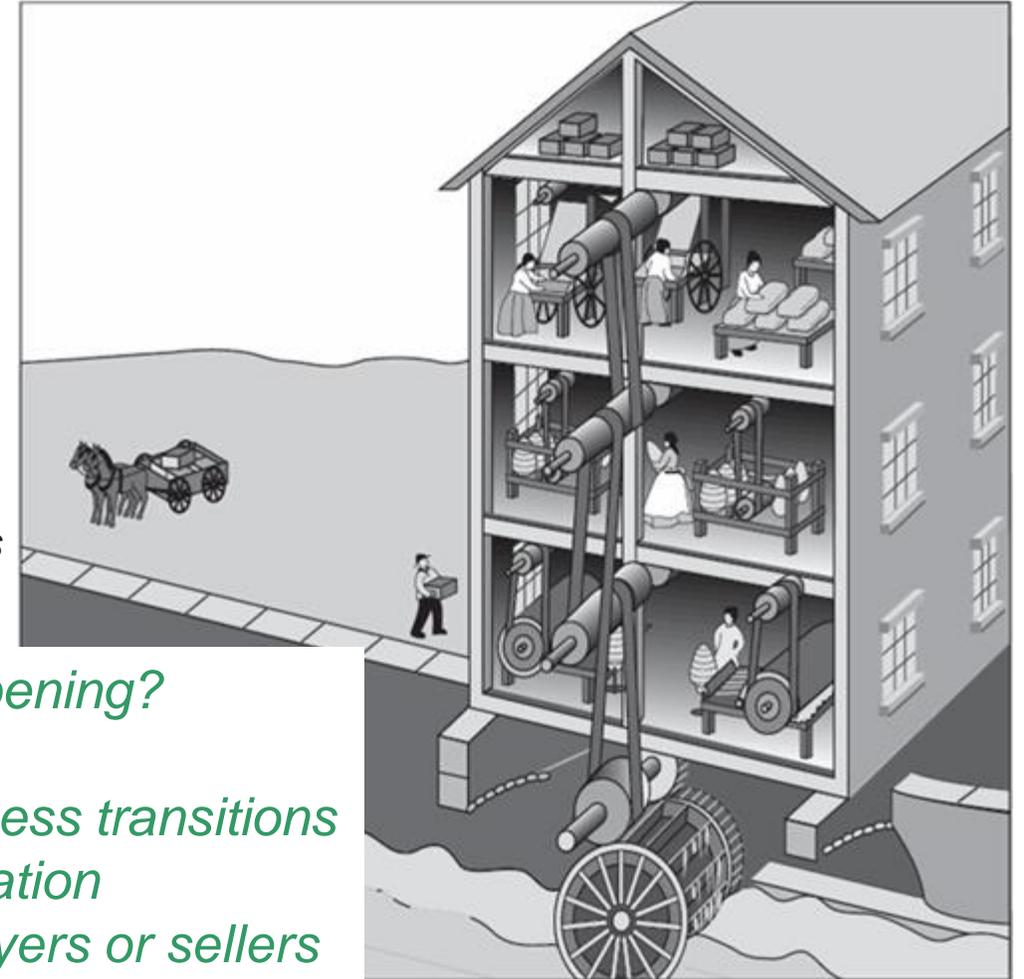
**2**

The world's largest taxi company, owns no vehicles.	<b>Uber</b>
The world's most popular media owner, creates no content.	<b>Facebook</b>
The most valuable retailer, has no inventory.	<b>Alibaba</b>
The world's largest accommodation provider, owns no real estate.	<b>Airbnb</b>

Something interesting is happening.  
TOM GOODWIN

wetpoint  
creative digital solutions

Gen 1 Unbundler's  
VISA  
UPS  
NBC  
Early switchboards



*Why is this happening?*

- *Analog to digital process transitions*
- *Improved asset utilization*
- *“Zero” cost to find buyers or sellers*

# This Is Actually How to Best Describe Differences Between Competitors

## Amazon And The Business Model Canvas

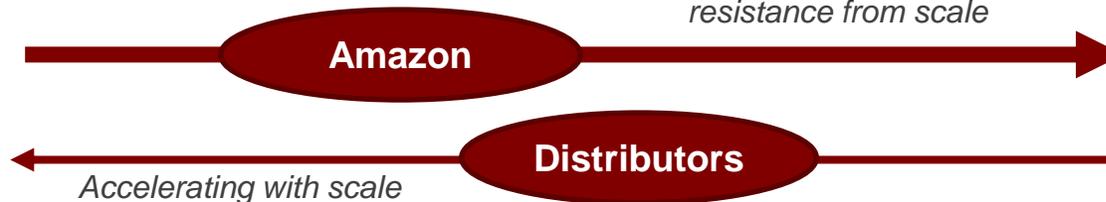
- Today every firm is trying to differentiate their business from others in the minds of customers
- Almost every distributor is migrating from being a generalist to focusing on a few focused market niches with a specialized value offering
- Before you can segment your customers, you must understand why they choose you over other alternatives



### The Amazon Silver Lining - 2019

*Remember Xerox or DEC*

Flawless  
Efficiency



*Over time things get easier for distributors and harder for Amazon*

Flawless Mass  
Customization

*“Every King has his reign, and then he dies.” – Prometheus. Distribution will not vanish*

# If All Products Were Free, Why Would a Customer Buy from You?

## Amazon Is Helping Customers To Buy, Not Selling Them

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*“Switchboards serve as connectors, traffic routers and – if you choose not to go through their services – communication blockers. They also demonstrate the considerable market power of “human laziness.” Habit drives customer retention. You can’t scale up a digital business unless you control its switchboard, but once a switchboard achieves market dominance, it becomes difficult to dislodge. Customers habitually return to services they know.”*

*Vaporized” by Robert Tercek, 2015*

*“We see our customers as invited guests to a party, and we are the hosts. It's our job every day to make every important aspect of the customer experience a little bit better.”*

*Jeff Bezos*

The 1997 letter to shareholders marked out the strategy you see today

[http://media.corporate-ir.net/media\\_files/irol/97/97664/reports/Shareholderletter97.pdf](http://media.corporate-ir.net/media_files/irol/97/97664/reports/Shareholderletter97.pdf)



# Very Visible Price Gaps Create Showrooming as Customers Self Select

## Cost-To-Serve Gaps Lead To Market Price Gaps

Service Outputs Supplied To the Market	Amazon	Legacy Wholesale Distributor
Provide capital services by offering credit	Visa and “gold” B2B only so DSO is <10 days	Carry 30 to 60 days that is increasing and also annual write offs
Break bulk for customers	Get others to do it unless perfect scale first so accretive on day one	Run warehouses with front end investment and cost
Make markets for suppliers	Profit Stream: They counsel suppliers and show them how to grow by paying Amazon more money	Invest in specialists and driving the attention of a field sales force
Provide proximity , fast delivery	Set the standard via digitally-enabled multiple logistic alternatives, UPS, USPS, UBER	Do the best we can ourselves, mostly in-house or a minor player in outsourcing
Provide field sales and other personal services	Profit Stream: They provide links to service experts and get paid by the service experts (~30% for 1 <sup>st</sup> contact)	Provide self directed commission salespeople at a total selling cost of > 25% of total gross profit
Carry inventory	Outsourced to others, on consignment for suppliers, producing negative working capital so growth generates, not uses, cash	Carry 1 to 4 months supply with 1 month of payables
Who do you serve?	Only customers and a shareholder that doesn't need SBU* profit	Balance between customers, suppliers, and shareholders
Provide special order services	Endless aisle, so not needed	Often provided with personal service and cost
Build trust with customer	Other peer customer evaluations and ratings	Building personal relationships, “Trust me, I am in sales”
Returns	Automatic and online no permission needed	Each event is a discussion that creates labor costs and a manual transaction
Provision of pre sales technical advice	Full links to suppliers site, YouTube, and other insight sources and the customer doesn't expect them to do it	Personal service is expected from and provided at the cost to the distributor

## Defining A Digital Distributor In 2022 on a Five Point Scale

*This distributor buys right, selling at margins in the teens, driving old school distributors out of business because their SG&A expenses are less than 10% and their EBITDA margins average 8%+ over the economic cycle*

### **Internal adoption of digital processes (Insert your score = \_\_)**

*#5 Definition: Generalist field sales reps have migrated to multichannel specialist models that rely on robust CRM systems where quoting, pricing, customer service, purchasing, and supply chain activities have been digitized and managed centrally along with >90% LOOP\* rate on all purchasing & shipping activity*

### **Digital process adoption with customers (Insert your score = \_\_ relative to customers)**

*#5 Definition: Customers deal with you primarily through punchouts using their I-Phones and tablets relying on their custom reorder catalogs, BIM drawings and project management support, live GPS location of their deliveries, and all their transaction activities while your \$100,000/year in SEO provides a great growth return*

### **Digital process adoption with suppliers (Your score = \_\_)**

*#5 Definition: They have top quartile fill rate and inventory turns with stagnant <1.0% with all transaction and warrantee management performed electronically, or at least the distributor is capable, even if the supplier isn't; suppliers pay money for market information as the distributor has leveraged their big data capability*

# The Digital Roadmap Answers, “What Should I Do First?”

*This roadmap only defines the next couple of steps that just happen to be the most important things to do because they have the lowest cost to implement and the highest financial benefit to your company building a foundation for the next steps*

1. Decide how much you are willing and able to invest over your next planning horizon
2. Determine whether to invest the resources externally or internally  
*Assess whether you are ahead or behind your customers and competitors, and if you are current, invest it internally to lower your recurring SG&A expenses*
3. Put identified alternatives on a heat map and invest the funds identified in #1 above  
*The axes are: Potential to grow and Cost to grow*
4. Execute

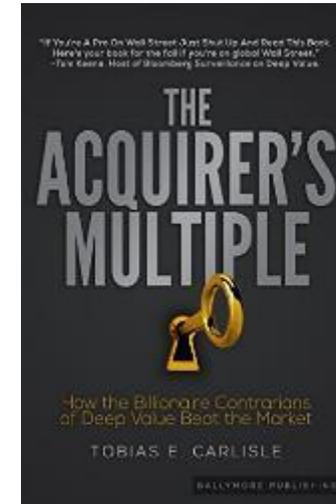
For Most Of You, Your Willingness To Invest Is Much Less Than Your Ability

# 1. This Is Your Digital Credit Line: Margin Of Safety (MOS)

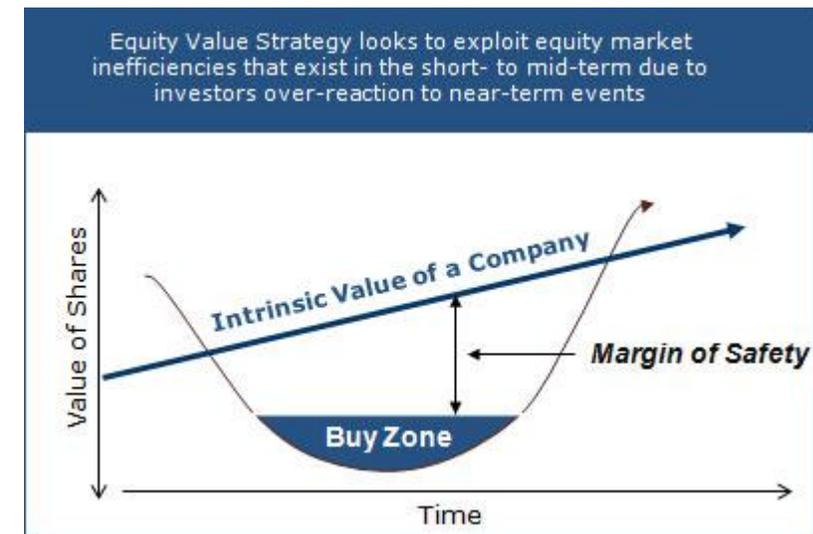
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*Warren Buffett – Ben Graham’s most famous and most successful disciple – compares margin of safety to driving across a bridge:*

*“You have to have the knowledge to enable you to make a very general estimate about the value of the underlying business. But you do not cut it close. That is what Ben Graham meant by having a margin of safety. You don’t try to buy businesses worth \$83 million for \$80 million. You leave yourself an enormous margin. When you build a bridge, you insist it can carry 30,000 pounds, but you only drive 10,000 pound trucks across it. And that same principle works in investing.”*



[https://smile.amazon.com/Acquirers-Multiple-Billionaire-Contrarians-Market-ebook/dp/B076GS7WF9/ref=sr\\_1\\_1?crid=2AVW7WFR3XRLW&keywords=acquirers+multiple&qid=1566254108&s=gateway&prefix=acquirers+multiple%2Caps%2C160&sr=8-1](https://smile.amazon.com/Acquirers-Multiple-Billionaire-Contrarians-Market-ebook/dp/B076GS7WF9/ref=sr_1_1?crid=2AVW7WFR3XRLW&keywords=acquirers+multiple&qid=1566254108&s=gateway&prefix=acquirers+multiple%2Caps%2C160&sr=8-1)

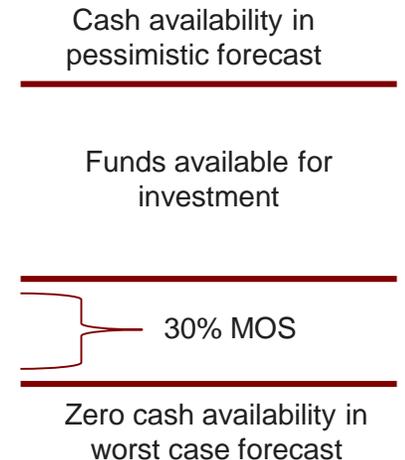


# 1. How To Do the Math

*How fast can we go on driving our digital transition with all the economic, political, and social uncertainty right now, so I don't get killed?*

Determine your MOS using this process applied to cash availability

1. Build three pro forma statements going out to 2022: Optimistic, Realistic, and Pessimistic (this gets you thinking about a wider range of potential outcomes, and don't forget to plug in a recession)
2. Determine the "worst case" pro forma that causes you to run out of cash or trigger a covenant with a lender
3. The cash amount that you can invest is the amount that reduces your MOS to 30% when looking at the difference between your pessimistic and worst-case scenarios



Hope for the optimistic, plan for the pessimistic (with a 30% MOS), and never spend if results take your MOS below 30%

## 1. Six Questions Around How Much Can You Invest?

*This ultimately comes down to a crap shoot. It really depends on if you are playing the game to win or playing it not to lose*

1. What was your 1 to 5 score on the industry disruption scale?
2. Since the real investment return isn't positive until you are one to two years out, can you afford to take this longer-term view?
3. How much should this investment be biased to enhancing your exit position?
4. Do you have the willingness to push this through knowing that the change management pain is often larger than the financial discomfort?
5. If you decide not to make the transition, what are your plans to reposition or exit your business?
6. Knowing that not deciding now is also a decision 'not to decide,' what event are you waiting for that will cause you to decide then?

*Remember that there is no tipping point in a disruption*

## 2A. The External Assessment

How are you viewed in the marketplace that you serve?

- Hire a telemarketing firm (< \$2,000 to \$4,000) to do a broad market survey of potential customers\* in your target SIC or NAICs Codes gaining ~100 validated responses out of 5,000+ phone calls around their use of digital

*Crafting the < six questions should be specific to your market*

What are your important customers doing with technology usage overall, both today in their expectations for the future?

- Design a similar survey for your best customers but have your sales reps complete it with them during an interview and include what they would like in the future

*Many distributors find that they can help their customers get business*

## 2B. The Internal Assessment

Conduct an anonymous survey of your management team and key contributors asking about critical constraints and weaknesses in the firm's performance\*

Look at your SG&A expense levels and start with a 5% reduction target (~23 to 18)

- Identify the processes that create the most embarrassment and or expense
- Source multiple software solutions specific to each process estimating cost savings from each  
*First, make sure that it isn't an unused capability in your existing ERP package or an add-on*
- Estimate the staff disruption challenges and implementation costs, ranking the list by combining change management and cost into a factor called complexity

Plot cost benefit and complexity on a two axis heatmap and choose those with the highest impact and lowest complexity to execute

*\*If you fail to use outsiders (board members, trusted advisors, professors, technology providers, or consultants) in some fashion, you dramatically increase the risks of being blind to your own unique dysfunctions, or just listening to each other in a corporate echo chamber*

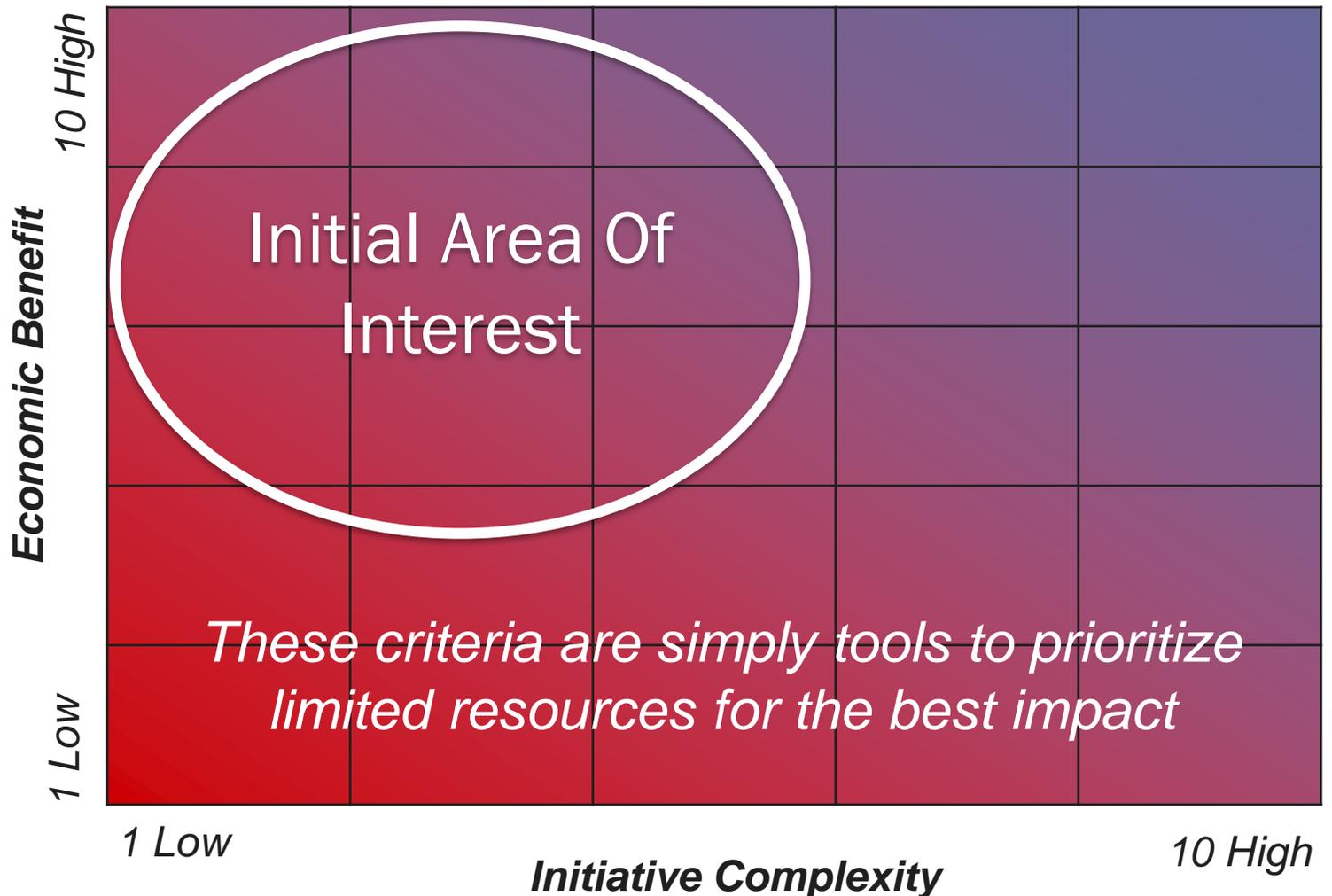
# Targeting Heat Map

Plot external investments required to meet market expectations where you are behind

Plot internal investments that lower your SG&A

*Remember that this tool is being offered to determine where to invest first in your digital transition*

You may also have other higher priorities to consider



Digital Has Created Significant Opportunity For Everyone Who Understands It

## Be Clear On Your Chosen Limitations

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*Decide first if digital is a defensive play or an offensive play in your mind*

There are privately held distributors that earn over 30% EBITDA margins

There are distributors that have negative working capital

There are distributors that grow at four times the market

Your goal is to take prudent investment risks with capital, not avoid them

Take the risks that you understand, never the ones you don't

If you become an industry disrupter then you won't be invited to any distributor advisory councils

Those that get stuck deciding will often sell, but often regret it later

## If I Was Invested In Your Business, I Would...

*I would invest first in strategic pricing, just like every new private equity owner does, using algorithms to set prices and get my sales reps out of the quoting business*

I would use my research insights to look for some real unique activities I could provide to my customers

I would calculate my MOS, but I would use a standard of 50% to start and see how the numbers play out

I would set up a customer and supplier advisory board on technology utilization and have ongoing proof of concept projects with interested customers or suppliers, so we are perceived as leaders

- It could have large impact on your suppliers, and they would send their supply chain and IT folks
- I would host monthly meetings for the Project Management Institute, local university business clubs, and the UNIX Users Group to get these kinds of people involved in my business

Create a real board, or get involved with a Texas A&M consortium, or a Vistage-type group for a source of external insight, and subscribe to MDM.com & NAW Smartbrief

# Group Discussion & Take Aways

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The responsibility for your learning in this activity requires you to listen and be thoughtful



Identify a group leader that has the most total years of being married, where ex's and significant others count as well

*The group leader only makes sure that everyone's opinion is shared*

Discuss these questions sharing views within the group:

1. Every group member shares their initial guess as to whether their digital deficiency is more external or internal
2. What learning can group members share with what they have learned on their own digital journeys?
3. What was each group member's biggest take away from this digital discussion?

# Can You Really Do This Digital Transition?

## **Marcus Aurelius Answers**

*“Yes, you can—if you do everything as if it were the last thing you were doing in your life, and stop being aimless, stop letting your emotions override what your mind tells you, stop being hypocritical, self-centered, irritable.”*

If it's humanly possible, Marcus says elsewhere, then know that you can do it. *Yes you can*. It's not going to be easy. It's going to require some serious changes and sacrifice and self-control. It's going to require a different outlook than the one we naturally have (the one that says we have unlimited time and that if we don't start today, we always have tomorrow), and it's going to require real self-awareness and honesty.

But yes we can. *Yes you can*.

<https://fs.blog/>



# The Algorithm Revolution

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*This is much larger than the industrial revolution, as it has societal implications driven by the decline of value in relationships and the rise of 'too big to fail' corporations*

1. Algorithms replace selling by giving everyone exactly what they want, at the right time and price, on demand
2. It takes dough to grow
3. There is \$2.7 trillion dollars of dry powder in private equity today, so many firms will decide to sell

By the 1960s, antitrust enforcement grew to proportions never seen before, while at the same time the broad middle class grew and prospered, overall levels of inequality fell dramatically, and midsize metro areas across the South, the Midwest, and the West Coast achieved a standard of living that converged with that of America's historically richest cities in the East. Of course, antitrust was not the only cause of the increase in regional equality, but it played a much larger role than most people realize today.

To get a flavor of how thoroughly the federal government managed competition throughout the economy in the 1960s, consider the case of *Brown Shoe Co., Inc. v. United States*, in which the Supreme Court blocked a merger that would have given a single distributor a mere 2 percent share of the national shoe market.

Writing for the majority, Supreme Court Chief Justice Earl Warren explained that the Court was following a clear and long-established desire by Congress to keep many forms of business small and local: "We cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned business. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision."

[http://www.theatlantic.com/business/archive/2015/11/cities-economic-fates-diverge/417372/?utm\\_source=SFFB](http://www.theatlantic.com/business/archive/2015/11/cities-economic-fates-diverge/417372/?utm_source=SFFB)

# Amazon Yesterday Shipping Was a Joke Video

*Algorithms driven by machine learning and artificial intelligence appear to make it real*

So the strategic question for customers is, “What is the right level of technology investment to lead in their adoption efforts?”

Any resources in excess of this requirement get invested in leveraging your existing ERP investments to lower SG&A costs



## Critical Thinking Is the Ante to Play

*This is an iterative process and very different from skills commonly used in executive management*

It is usually a series of three to six meetings that are thoughtful discussions where participants listen to understand, not respond

- Participants answer some questions, but also generate new ones that they think about between meetings, creating homework to complete prior to the next meeting

It is not an echo chamber discussion as external insight is the 'food' that is eaten and digested at each meeting

The answer can't be forced, but it always emerges, and is often a surprise

What costs your customers or suppliers X dollars (think labor and services) that you can do for X-minus dollars with unique activities?

**We can learn a lot, often more, from the work involved in answering a question than from the answer itself.**

*"It's not supposed to be easy. Anyone who finds it easy is stupid."*

*From Charlie Munger*

<https://fs.blog/>