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Wholesale

Break out or get boxed in

Leading strategies for today's food and foodservice distributors

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Break out or get boxed in

Leading strategies for today's food and foodservice distributors

By Guy Blissett, Robin Kahn and Maureen Stancik Boyce

As grocers and restaurant chains handle more of their own distribution and turn to increasingly capable mega-distributors and third-party logistics providers, food distributors are under attack like never before. They're also being squeezed by unprecedented cost pressures, product proliferation and distribution complexity. To remain relevant and avoid getting boxed in, we believe food distributors need an expanded value proposition, data-driven operations and an adaptable business model.

Introduction

Historically, food distributors have provided value primarily through the efficient storage and transportation of goods. But this classic value proposition is no longer sufficient. A top tier of mega-distributors has emerged, outstripping competitors with economies of scale and scope, and, in some cases, swallowing rivals to grow. In addition, third-party logistics providers (3PLs) are blurring traditional industry lines and marketing offerings tailored specifically to food distributors' customers.

Meanwhile, food distributors must contend with record numbers of new product introductions on top of already massive volumes of complex and custom products moving upstream and downstream through a food supply chain that is ever-more global, intricate and broadly scrutinized. Perhaps most ominous, some of distributors' largest customers are self-shipping products, while many of their smaller customers are being forced out of business.

These stark realities demand a dramatically different type of distribution business. To remain competitive, food distributors must:

- *Execute an expanded value proposition* – Excelling at the industry basics remains critically important but is insufficient; leading distributors proactively manage a strategic portfolio of products and services designed to differentiate their brands.

- *Become data-driven* – Distributors that rely on paper-based processes and forecasts calculated in Excel spreadsheets are losing to more nimble competitors. Leaders use realtime data and automated solutions to generate a holistic view of the business and the supply chain, anticipate customer needs, identify opportunities and operate more efficiently.
- *Increase business model agility* – The capabilities necessary to deliver new and innovative services and operate at higher levels of efficiency will not always come from within. Leading distributors partner and collaborate, delivering greater value through targeted investment.

The outlook for future revenue opportunities in the food distribution segment remains bright – but it's unlikely these opportunities will be evenly distributed among today's players. To grow and gain share in this consolidating industry, food distributors must develop differentiating capabilities that really matter to their customers.

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The new realities of food distribution

The customer makes the rules…and changes them regularly

In the retail food industry, the large are becoming larger: together, the top nine grocery retailers now account for more than 50 percent of the U.S. grocery market.[1] With their commanding size and purchasing power, these mega-retailers can dictate prices, demand new services and stipulate ever-higher service levels.

Their massive scale also allows them to effectively and efficiently self-ship products. For example, Target – which now has 175 SuperTargets and more on the way – has announced plans to open its own food distribution centers beginning in August 2008.[2] Wholesale clubs – like BJ's – are using cross docking and direct store delivery to better control their supply chains and increase efficiency.[3]

The continued expansion of these mega-retailers creates another troubling consequence for food distributors: a shrinking customer base. Independently owned grocers and restaurants, traditionally a core customer of food distributors, are finding it more difficult to compete, and, unfortunately, many are going out of business.

Fierce competition and margin pressure among retailers is, in turn, limiting distributors' ability to raise prices and increasing demands for innovation and flexibility. Growing diversity of consumers and importance of the in-store experience is prompting retailers to experiment with new formats and customize assortments for local markets, all in an effort to be more customer-focused and ultimately turn shoppers into advocates.[4] For distributors, this multiplies the complexity of serving each customer and impacts virtually every process – from packaging to delivery to merchandising.

Implications

- Retailers and restaurants are looking for flexible distributors that can tailor product assortments and service levels for particular regions, clusters and even specific stores. For distributors, this involves reevaluating their product mixes, their distribution network configurations and even their sales forces.
- Intense retail competition creates opportunities for distributors to step in with additional services like more in-store product merchandising and special packaging or kitting.
- With little room to raise product prices, distributors will need to grow margins by focusing on efficiency and new sources of revenue.

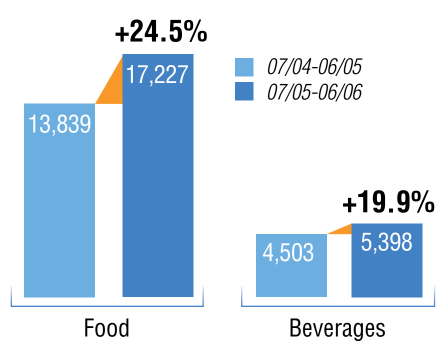
Consumer products companies are introducing record numbers of new products, resulting in shortened product lifecyles and increased supply chain complexity.

More products, more players, more complexity

To boost revenues, consumer products (CP) companies continue to introduce record numbers of new products (see Figure 1). Indeed, nearly every product line has seen some sort of extension – new flavors, new packaging or new variants (e.g., reduced sodium, low-fat, gluten-free and organic). Distributors are adding to the volume of new products by launching their own private-label brands. A similar dynamic is evident in the restaurant industry where menus are constantly refined in response to changing consumer preferences and economic realities.

This proliferation of new items is shortening the lifecycles of many products – in part because up to 80 percent of these new products fail.[5] This constant churn makes it extremely difficult for distributors to manage their own inventories, minimize obsolescence and reduce out-of-stocks.

FIGURE 1.
New products are on the rise.



Source: IBM Institute for Business Value analysis; "New Product SKU Counts by Category," BNP Media, http://www.myfoodandpackaging.com/charts2006/p17.htm

As the number of products multiplies, the supply chain itself is also becoming more complex. Ingredients must travel further, more transportation steps are required and regulatory hurdles are rising. And far more players are involved due to increased levels of outsourcing and specialization.

Meanwhile, the industry continues to struggle with food safety, straining the supply chain with a stream of high-profile recalls across a wide range of product categories. As just one example, beef recalls related to E. coli quadrupled between 2005 and 2007, from 5 to more than 20.[6] Retailers, regulators and consumers are all demanding greater visibility and enhanced product safety. Effective tracking and tracing of ingredients and products continues to be complicated by a supply chain that is more global, outsourced and specialized.

Many retailers and suppliers are leveraging technology to manage this escalating supply chain complexity. In fact, more than one-quarter of CP companies' IT capital spending – which is by far the largest share – is devoted to the supply chain.[7] And according to a consumer products logistics study, 84 percent of consumer products companies view enhanced customer visibility as one of their top three priorities for improving trading relationships.[8]

To date many distributors have moved slowly in this critical area; now however 42 percent identify "supply chain visibility" as a strategic priority. Additional IT investment will likely be needed to deliver on this priority, especially since distributors' spending has lagged that of their trading partners. Wholesalers – regardless of segment – spend less on IT as a percentage of revenue than CP companies, retailers and logistics providers (see Figure 2).

FIGURE 2.
2007 US IT spending as a percentage of revenues.

INDUSTRY	WEIGHTED AVERAGE *Forrester* and IW 500***	INDUSTRY	WEIGHTED AVERAGE *Forrester* and IW 500***
Manufacturing	**2.3%**	**Media, entertainment and leisure**	**3.7%**
Primary production	1.0%	**Utilities and telecommunications**	**3.6%**
Consumer products	2.3%	*Utilities*	2.6%
Chemicals and petroleum	2.2%	*Telecommunications*	5.2%
High-tech products	3.3%	**Finance and insurance**	**5.4%**
Industrial products	1.7%	*Financial services*	7.2%
Retail and wholesale trade	**1.4%**	*Insurance*	3.4%
Retail	1.5%	**Public sector**	**4.4%**
Wholesale trade	1.4%	*Public services*	3.3%
Business services	**3.0%**	*Government*	5.0%
Transportation and logistics	2.4%	**Weighted average for all industries; totals for number of respondents**	**2.9%**
Professional services	4.1%		
Construction and engineering	1.1%		

*Note: *Base: 296 IT executives at North American enterprise. **Base: 500 US companies that are innovative users of technology, as determined by* InformationWeek.
Source: Bartels, Andrew, "US IT Spending Benchmarks For 2007," Forrester Research Inc., November 13, 2007.

Implications

- Rising complexity – without fundamental changes to business operations – will likely mean higher costs for distributors. Future success demands a combination of flexibility and focus.
- As retailers, suppliers and competitors make strides with technology, pressure will mount for distributors to achieve similar levels of sophistication. Weak links in the chain risk disintermediation.
- Customization demands, shorter product lifecycles, recalls, legislation and mandates are putting a premium on sophisticated supply chain management capabilities that many food distributors lack. On the flip side, those that can meet the challenges have an opportunity to truly distinguish themselves.

Competition on all sides

In the United States, grocery and food-service distribution is largely comprised of small and mid-sized companies, about 24,000 of them, most with fewer than 100 employees.[10] While this industry segment remains highly fragmented, it is consolidating. And a top tier of mega-distributors has already emerged.

The top seven food distributors together share nearly 20 percent of the market.[11] In fact, the two largest players – SYSCO Corporation and U.S. Foodservice – accounted for 12 percent of the segment's 2006 revenues.[12]

These mega-distributors have some distinct advantages. Their scale gives them pricing leverage with suppliers. A sizable top line funds improvements in technology and

Mega-distributors are leveraging scale and scope to cost-efficiently deliver high value services.

marketing and branding capabilities. And as they establish common processes and systems, they can assume the role of consolidator – acquiring a stream of competitors with complementary capabilities, useful assets or, perhaps most important, target customers.

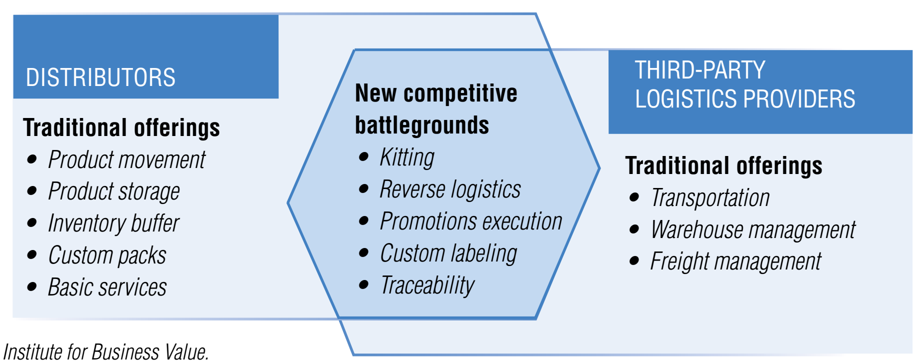
The threat of acquisition, however, is not confined to industry insiders: outside investors are driving consolidation as well. Since 1999, the number of private equity groups with a stated interest in acquiring distribution companies has doubled.[13] The grocery and food-service segment is no exception. In 2007, Royal Ahold sold U.S. Foodservice to Clayton, Dubilier and Rice and KKR.[14] And in January 2008, Performance Food Group signed a merger agreement with Blackstone Group and Wellspring Capital Management.[15]

Private equity investors see opportunities to consolidate this highly fragmented industry and capitalize on economies of scale. Their outsider perspective leads them to question industry "norms" and to discard outdated, untenable business strategies. And because many small and mid-tier distributors are well behind the technology curve, investors can often gain substantial efficiencies through strategic IT investment.

In addition to industry rivals and outside investors, food distributors face intense competition from rapidly expanding 3PLs. Although 3PLs and distributors have historically focused on meeting different customer needs, which required different capabilities, they now find themselves competitors as they both expand their offerings (see Figure 3).

Aggressive investment in technology has allowed forward-thinking 3PLs to provide increasingly sophisticated services. Already, 80 percent of the 200 largest logistics companies offer pick, pack and ship services that compete directly with wholesale distributors.[16] In the grocery and food-service segment for example, DHL offers CP companies services such as co-packing, price labeling, promotional material handling, reverse logistics, stock take and automatic/targeted release of blocked goods.[17]

FIGURE 3.
Third-party logistics providers are increasingly competing with distributors.



Source: IBM Institute for Business Value.

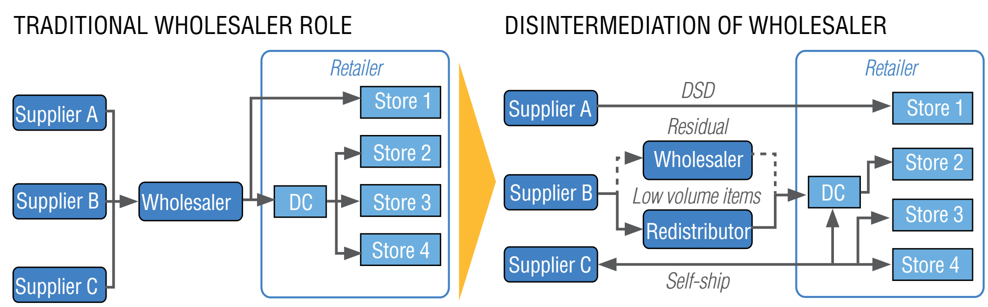
Even mid-market 3PLs are making competitive inroads by filling niches and developing creative solutions to long-standing customer challenges. Los Angeles-based CaseStack is one example. It targets mid-sized CP companies, offering them transportation and warehousing capabilities equivalent to their larger competitors without huge investments in assets and technology. One of its most popular services is a retailer consolidation program that combines multiple vendors' orders, helping smaller suppliers comply with rigorous requirements of large retailers, such as full truckloads.[18]

While the challenge posed by 3PLs is daunting, perhaps the most unsettling threat comes from distributors' own customers and suppliers. Suppliers are exploring direct-store-delivery (DSD) models to get products on shelves quicker and improve merchandising and promotion execution. At the same time, large retailers are buying directly from manufacturers, capitalizing on factory gate pricing and self-shipping to reduce costs and gain greater inventory visibility (see Figure 4).

Implications

- Distributors must leverage their core competencies to address customer needs. They can no longer afford to invest in areas that are not differentiating.
- The need to differentiate significantly raises the requirement for informed, and sometimes difficult, portfolio decisions – which products, services and capabilities to offer and which customers to serve.
- New capabilities will be required – and the most effective way to obtain those capabilities may be through partnering and collaboration, perhaps even with competitors.

FIGURE 4.
With a growing number of retailers self-shipping and suppliers exploring DSD models, wholesalers risk disintermediation.



Source: IBM Institute for Business Value.

To create an expanded value proposition, food distributors need a systematic method for evaluating options and optimizing portfolios.

Delivering greater value as a distributor

Today's unforgiving business environment demands that food distributors apply a deep understanding of customer and market needs to deliver greater value. We believe three imperatives will be critical:

- *Execute an expanded value proposition* – Choices such as which customers to serve, which suppliers to represent, whether to sell private-label goods and which services to offer are growing more complex and critical. Food distributors need a systematic method for evaluating their options and optimizing their portfolios.
- *Become data-driven* – Food distributors can no longer afford to act on intuition; they need facts. Their success depends on capturing, storing and communicating the right data and analyzing it to manage all aspects of the business. Indeed, if distributors cannot catch up to their suppliers and customers in this vital area, they'll continue to lose business to more progressive competitors.
- *Increase business model agility* – Business is changing more quickly than ever. According to the 2008 IBM Global CEO Study, 83 percent of CEOs indicated they expect significant change over the next three years, as compared to 65 percent in 2006.[19] To capitalize on emerging opportunities and flex with market fluctuations, food distributors need more adaptable business models that leverage partnerships and collaboration. The "own everything" approach, which has long dominated the industry, is no longer sustainable.

Execute an expanded value proposition

Unfocused distributors that try to be "all things to all customers" risk under-serving the customers they value most, and may well find their brands undifferentiated as competition intensifies.

Leading distributors are much more targeted. They maintain a portfolio of products (both branded and private-label), services (both free and fee) and service levels (100-percent availability, no minimum order quantity and such) that is based on the needs of their target customers and strategically aligned with their own brands.

This is not to imply they abandon their core capabilities. On the contrary, leading distributors still provide transportation and storage services, but they do so in more sophisticated and profitable ways. They leverage rich operational data together with activity-based costing to identify revenue and cost drivers and efficiency opportunities. Performing the basics with excellence helps them move from transactional customer relationships to strategic partnerships.

Products

The proliferation of products, store formats and consumer segments complicates distributors' product portfolio decisions. Distributors must become much more sophisticated about selecting the products they sell – both manufacturer and private-label brands.

A deep understanding of which products and which suppliers drive revenue growth and contribute to customer satisfaction is essential to today's distributor. Leading distributors undertake "cost to carry" analysis to determine the profitability impact of factors such as minimum order size, pricing structures, payment terms, logistics performance, and shipment and configuration options. This analysis, when coupled with an understanding of customer needs, allows distributors to model how product and supplier changes affect revenues and profits.

Retailers have long recognized the power of private-label products, which help increase brand awareness, market share and margins. Similar opportunities exist for forward-thinking distributors. In fact, most leading food distributors have launched such offerings. Performance Food Group, for example, offers proprietary product lines that span a wide range of price points and products – including meats, fish and bakery goods.[20]

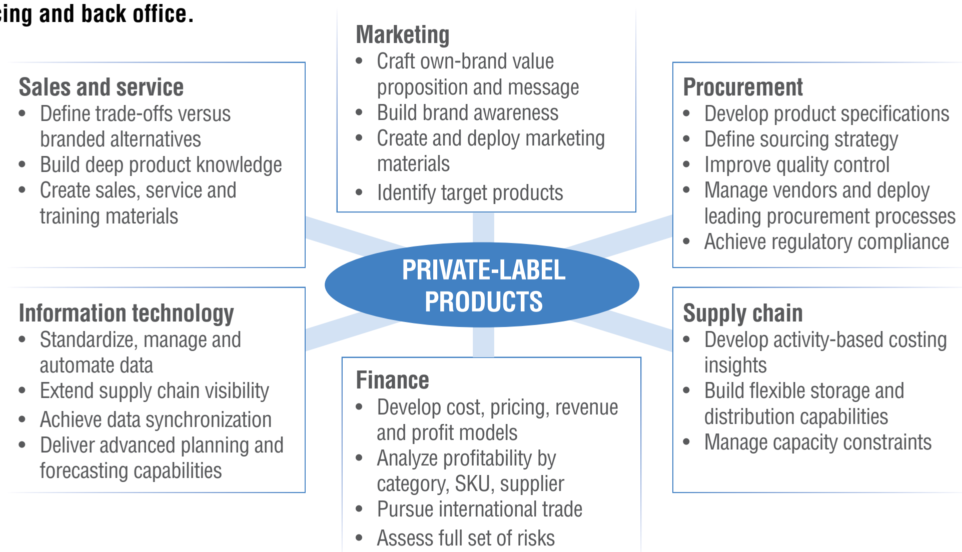
But private-labels are not a panacea. They demand new capabilities – like sourcing, pricing, marketing and selling. And they directly expose distributors to product liability claims and greater inventory risk. For distributors contemplating private-label offerings, it's critical to model the full impact on the business – including the potential negative reaction of key suppliers (see Figure 5).

Services

History has clearly predisposed many food distributor customers to expect "free services" from their suppliers. However, as the services become more sophisticated and costly, distributors increasingly require that restaurants, grocers and institutional customers pay for them.

Distributors' service offerings can be viewed along a continuum – from basic services that

FIGURE 5.
Assessing private-label impact requires an in-depth evaluation across all functional areas, both customer facing and back office.



Source: IBM Institute for Business Value.

customers expect (e.g., on time delivery) to premium offerings that not everyone needs (e.g., specialized merchandising). For example, Core-Mark International, a leading distributor to convenience stores, sells specialized services like Candy Endcap, which is a racked sales program focused on top-selling candy, gum and mints, and Cooler Door, which keeps retailers' cooler space filled with leading beverage brands.[21]

Some leading distributors are stepping further away from the mainstream, offering services in areas such as finance, IT and marketing. SUPERVALU offers consumer and market research, store design, retail technology consulting and its Web portal, SVHarbor, which provides a suite of online business tools.[22]

For many distributors, providing new fee-based services will require additional capabilities and investments. For instance, distributors may need to build market awareness and train their sales forces in consultative and portfolio selling techniques. Their financial capabilities may need upgrading to develop dynamic pricing models and track service offering profitability. And new IT capabilities may be required to actually deliver the service and provide associated online support.

Managing the portfolio as a whole

To keep their portfolios relevant, leading food distributors manage them in an iterative fashion as outlined in Figure 6:

SYSCO: Growth through services

With Texas roots, SYSCO Corporation is now the North American food-service distribution leader, with US$35 billion in annual revenues and roughly 400,000 clients.[23] It provides raw materials for restaurants, hospitals, schools, hotels, company cafeterias and others in the "food-prepared-away-from-home" segment.

In 2002, SYSCO introduced the idea of providing value-added services along with its products.[24] Leveraging its scale and industry knowledge, the company assembled a suite of services it calls iCare to help food-service operators boost sales, raise capital and manage their businesses better. Through iCare, participating customers can obtain training, advice and support in a variety of areas, including marketing, operations, finance and human resources. The program not only offers customers a much broader range of services than they typically could access individually, but also provides the reassurance of working with proven SYSCO-approved partners.[25]

More recently, SYSCO has begun offering customized "Business Reviews," which provide tailored recommendations to help customers increase revenues and profits. The reviews typically consist of expert analysis of menus and advice on operating details, such as inventory control. And on occasion, they might even include food prepared by executive chefs in SYSCO's state-of-the-art kitchens to showcase products.[26]

These business reviews have been a boon for SYSCO, helping it penetrate and grow target accounts and develop a deeper understanding of customers' needs. Indeed, SYSCO management credits these business reviews as a chief driver behind recent sales growth, which incidentally has been brisk.[27] SYSCO's sales have increased at a compound annual growth rate of 8 percent over the past five years.[28]

Leaders are valued as trading partners because they share information and insight – they don't hoard data.

FIGURE 6.
Optimizing the portfolio is an ongoing process in a changing marketplace.

Source: IBM Institute for Business Value.

- *Segment customers* – This analysis should consider a variety of dimensions, such as a customer's profitability, products and services preferences, purchasing patterns and even strategic importance.
- *Define offerings* – Offerings fall into two groups: those that are core and integral to the company's operations and brand, and, second, the additional services and capabilities that are priced separately. Distributors must carefully evaluate how much of their portfolio can be pushed into this second category.
- *Determine delivery options* – When deciding how to deliver a particular offering, food distributors should explore a variety of alternatives, including partnerships, outsourcing and brokers. With activity-based costing data and data-driven estimates of adoption, companies can evaluate different methods of delivery and develop flexible pricing models.
- *Assess performance* – Distributors will want to conduct regular assessments of product and service performance. This should include monitoring uptake and customer satisfaction, calculating offering profitability and evaluating competitors' responses.
- *Refine offerings* – Based on these assessments, specific offerings and underlying customer segmentations may need adjustment. But distributors should also reevaluate the portfolio as a whole to identify gaps, reallocate resources and, when necessary, withdraw a failing offering.

The steps demonstrated in Figure 6 are not perfectly sequential or linear. Activity is likely to be ongoing in all areas at all times.

Become data-driven

Leading distributors place a premium on data. It's as integral to running their businesses as trucks, warehouses and forklifts. They invest in capturing and storing information as well as sophisticated analytical tools and capabilities to develop insights they then can apply across the business. Notably, leaders don't hoard data; they're valued as trading partners because they share information and insights.

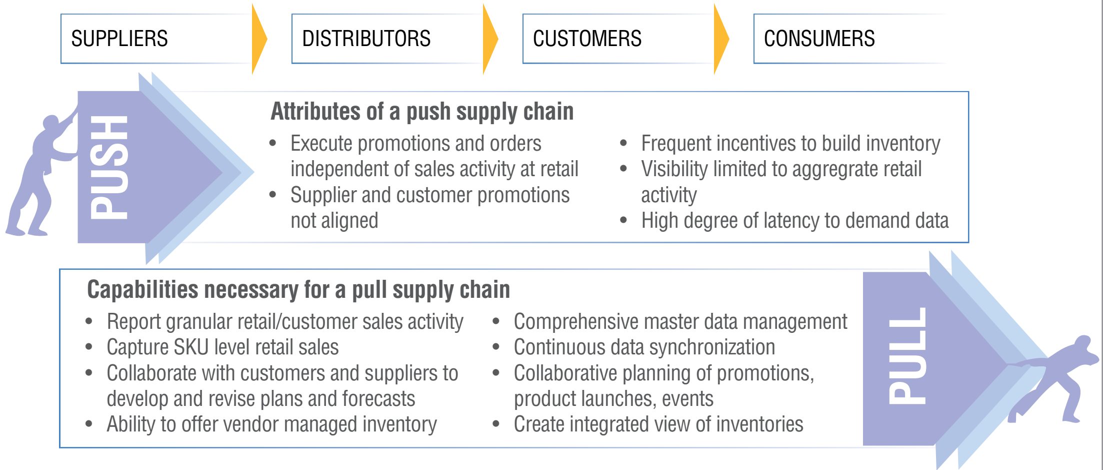
Being data-driven helps food distributors:

- Move from a push to a pull supply chain
- Develop, market and sell more compelling products and services
- Optimize working assets
- Deliver traceability and transparency consistently.

Move from a push to a pull supply chain

Supply chain visibility is the central nervous system of the food distribution business – and the lack of timely, accurate data can be paralyzing. However, data-driven supply chain capabilities help distributors reduce inventories, improve responsiveness, decrease out-of-stocks and increase revenues (see Figure 7).

FIGURE 7.
Being data-driven accelerates a distributor's evolution from a push to a pull supply chain.



Source: IBM Institute for Business Value.

Data-driven wholesalers execute orders based on current retail sales activity – not on manufacturer incentives or best-effort demand forecasts. They use IT to facilitate collaboration among customers and suppliers so that promotions, product launches and events are aligned, synergistic and more effective.

For example, Texas-based McLane Company provides its customers with realtime inventory tools that virtually eliminate out-of-stocks.[29] Handheld devices provide individual stores with a detailed eight-week order and receipt history. An online reporting system allows retailers to analyze their data – in aggregate or by store – in a variety of ways to identify sales trends. With the information McLane provides, chains can keep fast-selling products on shelves – and make better decisions on what items to stock and discontinue. These data-driven capabilities not only strengthen McLane's customer relationships, but also provide valuable product and market insights.

Develop, market and sell more compelling products and services

Customer and consumer insights are critical to data-driven wholesalers. They provide the means to differentiate and deliver value to both customers and suppliers.

When developing insights, leading distributors cast a wide net, collecting sales, market, competitor and customer satisfaction data from numerous sources. After leveraging IT tools to cleanse and align data, they use sophisticated analysis software to segment customers, tailor offerings, optimize prices and market effectively. They also collaborate with their trading partners to develop rich, relevant consumer insights that can be shared upstream and downstream.

Facilitating transparency and traceability throughout the supply chain can be vital to maintaining brand image.

Being data-driven also allows distributors to equip their sales forces with realtime information about inventory availability, customer order and payment history, product information and incentive pricing structures. This contributes to improved customer service as well as higher revenues.

Integrated master data is essential to many of the new service offerings customers are seeking. Collaborative sales and operations planning, vendor managed inventory and shopper insights are some of the services that depend on realtime data and seamlessly integrated systems.

Optimize working assets

Distribution has historically been an asset-intensive business – requiring physical assets, such as trucks, warehouses and racking systems, as well as financial, intellectual and human capital assets. And while food distribution remains asset intensive, forward-thinking distributors no longer feel obliged to own all these assets and constantly search for ways to deploy capital to best support growth initiatives.

These distributors leverage a rich set of data about their own costs and performance, as well as external factors, to assess areas such as:

- how adjusting inventory levels may impact order fulfillment rates, customer satisfaction and overall profitability
- whether deploying a warehouse management system might facilitate a reduction in storage requirements
- how altering customer payment terms might increase average shipment size, reduce order frequency and accelerate inventory turnover.

Data-driven distributors explore both traditional and nontraditional alternatives to managing asset requirements. To avoid over-investment in physical assets, some leading distributors now assess their logistics requirements in capacity terms (e.g., cubic feet). This approach allows distributors to reduce fixed assets and costs (e.g., trucks and warehouses) by leveraging third-party resources for peak requirements.

Deliver traceability and transparency consistently

Across the food industry, stakeholders are concerned about an expanding list of food safety and corporate responsibility issues. Consumers want to know where ingredients come from, retailers want to know whether food was sourced responsibly and regulators want to know how it was handled throughout the supply chain.[30] Satisfying these concerns is vital to brand image – not only for manufacturers and retailers, but also food distributors.

Grocers and restaurants are passing these demands upstream to supply chain partners. And as these informational needs rise, food distributors must capture and communicate an expanding set of data. As products, ingredients and packaging flow through the supply chain, distributors must track movement, processing activities and attribute changes – and make this information accessible to their trading partners. Each link in this information chain is critical. Without distributor participation, manufacturers and retailers cannot fully satisfy consumer and regulatory traceability requirements.

Performance Food Group: Growing margin through data-driven operations

Performance Food Group is a unified network of food-service distributors headquartered in Richmond, Virginia, that serves all 50 U.S. states and 41 other countries. Since the company went public in 1993, more than a dozen distribution companies have been acquired.[31]

The company is moving rapidly toward a more centralized structure to improve profitability, enhance efficiency and grow its business. It is taking a data-driven approach, adopting standardized metrics and systems and making technology investments that improve not only customer service, but also its operating margins.

These investments include outfitting its delivery fleet with GPS-enabled onboard computers and equipping its sales force with mobile systems for order processing and customer service. The company also uses RFID in its warehouses and computerized systems to route its trucks. A centralized inbound logistics system optimizes deliveries from its suppliers. Standardized product and vendor identifiers allow the company to manage product categories and leverage purchasing power across its distribution network.[32]

Performance Food Group's data-driven strategy is clearly contributing to margin growth. Over the past five years, net profit has increased at a compound annual growth rate of more than 12 percent.[33]

Increase business model agility

CP companies are intensifying their focus on differentiating capabilities like marketing and brand management, and outsourcing other parts of their operations, such as distribution and finance. At the other end of the supply chain, retailers are introducing new store formats and developing advanced segmentation approaches to more efficiently respond to today's empowered and enlightened "Omni Consumer."[34] Other players – like redistributors – are competing based on highly specialized business models.

For distributors in the midst of this business model innovation, flexibility must be the mantra. Indeed, leading distributors are increasing their business model agility by:

- Managing the business as a collection of capabilities… and investing in those that are differentiating
- Partnering, collaborating and outsourcing
- Creating a culture that welcomes change

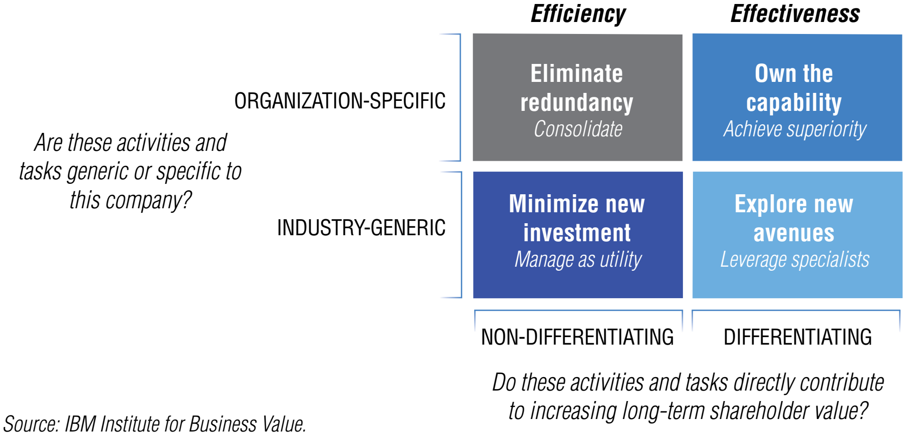
Managing the business as a collection of capabilities… and investing in those that are differentiating

Many distributors continue to manage their businesses in functional silos: supply chain, information systems, finance, HR and such. However, leading distributors increasingly manage the business as a collection of capabilities that span traditional organizational boundaries. Each capability – such as inbound logistics, customer account servicing or route planning – has a specific purpose and is composed of related tasks and resources.

This approach allows distributors to rethink investment and resource allocations, focusing on areas that are differentiating and value creating (e.g., merchandising) and reducing investment in commodity capabilities (e.g., order processing). Given the high volume of merger and acquisition activity in food distribution, this analysis is particularly beneficial as it facilitates more effective integration and faster realization of synergies.

Resistance to change often becomes the biggest obstacle to making fundamental shifts in value propositions.

FIGURE 8.
Distributors need to assess each capability to determine the most appropriate way to source, invest and manage it.



Source: IBM Institute for Business Value.

A decision-making framework like that depicted in Figure 8 can help distributors determine how best to manage a particular capability and allocate scarce investment funds.

Partnering, collaborating and outsourcing

For many in the food distribution segment, an "own it all" culture still dominates. This mind-set results in high capital expenditures and fixed costs – and a business model that cannot "flex" with economic cycles or exploit new opportunities. Unless distributors can overcome this cultural hurdle, they will struggle to develop relevant products and services and redeploy resources to the highest value customers.

Managing the business as a collection of capabilities highlights areas where partnering, collaborating or outsourcing may offer strategic benefits. These approaches can provide quick access to new capabilities and technologies – often at lower cost and with shared risk. Forward-thinking distributors are working closely with redistributors to cost effectively support the low-volume requirements of their customers, leveraging 3PLs to meet customer-specific requirements (e.g., custom pallets) or to cover regions where their own presence is limited, and partnering with software vendors to offer online services.

Creating a culture that welcomes change

When making such fundamental shifts in their value propositions, food distributors' greatest obstacle may be resistance to change within their own organizations. Business realities demand new ways of working and measuring performance – selling based on value, collaborating with partners, segmenting customers and offering customized services, just to name a few. All of which can be disconcerting for employees.

Leading distributors ease the transition by providing training, tools and incentives. Their executives inspire enthusiasm and build excitement about new opportunities. These distributors' change programs target specific business outcomes, track and communicate results and reward success.

But perhaps most important, amid all the necessary change, these distributors carefully preserve the positive aspects of their current cultures – whether that be a small company atmosphere, deep product knowledge or close customer relationships. These intangible attributes may indeed be some of their strongest differentiators.

Are you ready to break out?

As you look toward the future, is your thinking confined to traditional views and expectations of the distributor within the grocery and foodservice supply chain? Or are you redefining your role and providing greater value to your customers?

The following questions can help you pinpoint areas where your company may need to step up its execution:

- Which of your capabilities matter most to your customers and suppliers?
- How does your strategy leverage your unique position in the supply chain?
- How successful are you at capturing customers and market share during economic booms and downturns?
- Does your portfolio of products and services reflect the changing needs of your customers and suppliers?
- Are you more likely to acquire or be acquired?
- What steps are you taking to meet escalating expectations for supply chain visibility, product traceability and social responsibility?

These are times of unprecedented complexity and change in the food distribution business. The food supply chain has never been more global, more intricate or more closely watched. The competitive pressure on retailers is rippling through to distributors in the form of increased demand for customized solutions and value-added services. And in some unfortunate cases, it's translating into lost business because behemoths are self-shipping and smaller customers are being forced to take down their shingles. Valuable customers are being poached by nationwide mega-distributors. And 3PLs can be friend or foe – or maybe both.

To stake out their positions in this rapidly consolidating segment, food distributors must break out of their traditional roles. We believe the market share winners will be those that execute an expanded value proposition, drive their businesses based on realtime, contextual data and transition to a flexible business model that literally opens a world of possibilities.

For more information on these topics, please contact us at *iibv@us.ibm.com*. To browse through other research by the IBM Institute for Business Value, visit:

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