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Every step in the supply chain ultimately impacts the end price of a product, which is bad news for consumers.

by Mark Ross

BUYING DIRECT

A Smart Choice in Today's Business World

Purchasing electrical products through distribution has been the supply chain business model in the electrical industry for more than 50 years. While distribution provides advantages for some sellers and buyers, and continues to serve some commoditized products, the evolution of the Internet, business management software, virtual staffing and worldwide express shipping has facilitated the option of buying direct from the manufacturer. In today's business world, with the struggling economy, it may be time to take another look at buying direct.

Flaws in the Distribution Model

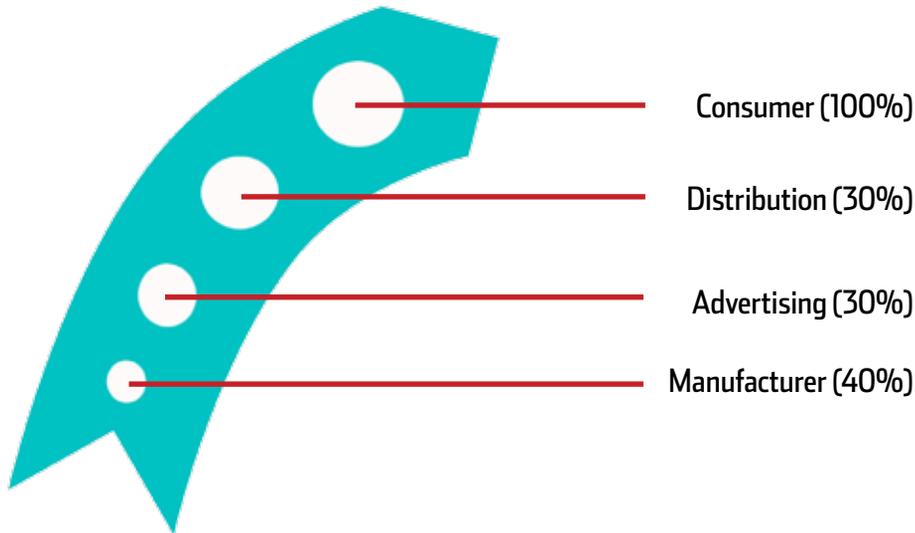
When the electrical and information technology systems (ITS) industries first began buying and selling products, it made perfect sense to use a local distributor as a one-stop shop. Contractors needing to buy several different products for a project could ease logistics by picking up everything they needed at one location. With most distributors selling a wide variety of brands, contractors also had better product selection.

In the beginning, selling through distribution also made sense for the manufacturer—it was a way to penetrate widely-dispersed markets. This was especially beneficial for new manufacturers with limited contacts and only localized market penetration, or for those manufacturers that did not have the means to stock and manage inventory. Having distributors to purchase products also allowed manufacturers to confidently invest in developing new products because they knew they could quickly recoup the cost of manufacturing. With so many manufacturers turning to this model of selling, buying through distribution became virtually inevitable for the contractor.

Over time, problems with the distribution selling model have surfaced. Many distributors are now mainly concerned with profit margins and focus their operations on the business of buying and selling, rather than customer service. Conflicts of interest have emerged, as distributors prefer to stock popular, fast-moving products that reap the most margin. Consequently, they have also



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developed more loyal relationships with some manufacturers, causing some products to take a back seat and making it difficult for new manufacturers to enter the marketplace. This could negatively impact the introduction of new, innovative products, which typically start off with lower demand.

Many distributors also developed more loyal relationships with “favored” contractors, awarding lower prices to them. Awarding different pricing essentially puts the distributor in the position of determining which contractor will win a bid, making it difficult for new contractors to enter the marketplace.

Distributors, by nature, have loyal relationships with certain manufacturers. This is not an advantage to the contractor. “Competition is healthy, and without it, the buyer ultimately ends up paying the price,” says Bob Eskew, CEO of Automated Systems Design, Inc.

Lower Prices Direct from the Manufacturer

Distributors claim they are providing a service, and they have to charge for that service. As a result, products purchased through distribution include some mark-up. However, today there

are manufacturers that provide an equal or greater level of service at a fraction of the cost.

“I worked with distribution for many years. At first, I was skeptical about buying direct from the manufacturer. To my delight, I now get better service, support and pricing through my manufacturer partners,” says David Swan of Swan Electric Company, Inc.

Every step in the supply chain ultimately impacts the end price of a product, which is bad news for consumers. Distribution is precisely why a consumer pays more than \$100 for a pair of sneakers that cost about \$5 to manufacture. This holds true across all industries that use distribution, including the ITS industry.

Manufacturers already pay large sums of money to advertise their products. They then spend more money on distribution—money that does not enhance the overall quality of the product. In the end, those costs are passed on to the contractor at a price of about 20 to 30 percent higher on average than if they had bought direct from the manufacturer. That means that an electrical contracting firm spending \$1 million each year on a product could gain a potential savings of \$300,000

annually by purchasing direct from the manufacturer.

Another cost concern is distributor discounting. Distributors start with the manufacturers’ list prices, mark them up, and then offer various discounts to their customers. With competition and a struggling economy, sometimes these discounts can get out of hand. This puts pressure on manufacturers to lower their list prices and impacts distributor-manufacturer relationships. For distribution to survive, distributors must sell product for more than they pay for it. In reality, only the manufacturer can provide the lowest price.

Since price is the greatest factor in the bid process, nine out of ten times contractors will choose the discounted product from the distributor. What they often fail to remember is that all products purchased through distribution are marked up. Even if the contractor thinks he is getting a deal, the product price would still likely be lower if purchased directly from the manufacturer. Furthermore, contractors miss out on the opportunity to negotiate directly with the manufacturer, who might be willing to beat price on a competing product. Many distributors also offer package pricing on certain types of products, which can mean hidden costs for the contractor and the inability to compare apples to apples. Many industry experts recommend that contractors ask distributors to break out the pricing and provide better transparency in their estimating.

Better Customer Service and Relationships

Manufacturers know their products better than any distributor. When contractors buy through distribution, they are not directly connected to the manufacturer that can offer specific information about the product, provide installation guidance and suggest value-engineering alternatives. Distributors

are typically too busy pulling together pricing from several catalogs and marking up the cost to really look at the project specification and offer an alternative product that might be better suited for an application.

Only the manufacturer of a product can offer customized solutions. When a customer works directly with the manufacturer and can discuss the specifics of a project, the manufacturer can make product suggestions or even consider developing a custom solution that helps meet the specific needs of an application.

"The closer the solution is to the problem, the quicker the problem gets solved," says Eskew. "Having to go through the rep firm and then the distributor to get to the manufacturer for a resolution is a lot of bureaucracy for the contractor."

Buying direct establishes a stronger relationship between the customer and the manufacturer. For the manufacturer, this can mean better supply chain management, repeat business and the potential to co-develop innovative, customized product solutions with individuals who work in the field and witness challenges firsthand. For the customer, this means having someone they can trust for expert technical support, application and product advice, and lower cost.

"Contrary to initial concerns, contractors may find that the level of service, support and product knowledge provided by some manufacturers far exceeds the level offered by distribution," said Jordan Handler, president of MonoSystems, Inc.

A Growing Trend

While some commoditized products that are easy to stock, manage and reorder may remain well served through a distribution selling model, products that are not considered shelf items, like raceway, cable tray, power

poles, poke-throughs, desk pedestals, racks and cabinets typically have to be ordered anyway when buying through distribution due to inventory costs. Furthermore, many distributors today have done away with warehousing and tend to order nearly all products from the manufacturer rather than stocking inventory.

The concept of selling direct is not new—it has been around since the days when farmers began selling their produce at the local marketplace. While distribution took hold many years ago in the electrical and ITS industries, times are changing. Advances in technology have enabled more manufacturers to sell direct to the customer, and downturns in the economy are causing consumers to take notice.

Before the advent of smartphones, customers needed to stop in at the distributorship to ask questions and acquire pricing. Now, through the Internet and enhanced communications, manufacturers and customers can collaborate any time, any place—they can easily share images and videos of job sites, specifications and drawings. Manufacturer websites are also more comprehensive, serving as a place where customers can get all of the product information they need, as well as other online resources like e-learning, price quotes, specifications and even online technical support. The direct selling model used by computer-maker Dell got a big boost from the Internet, and the company became the world's largest computer seller. The Internet also allowed Dell to gather detailed information from its customer base to better predict market trends and gather real-time information from suppliers to shorten manufacturing lead times.

The same technology that has enhanced the manufacturer-customer relationship has changed how product is shipped. Today's shipping services allow for fast, trackable shipping to one job

site from several different locations. The need for all products to be in one place has disappeared. Manufacturers can easily ship product directly to the job site or the contractor location, removing the middleman cost of shipping to the distributor. Technology has also enabled manufacturers to implement more efficient inventory management systems, customer databases and processes that make it easier to sell direct, eliminating the need for distribution.

A Tough Model to Change

Despite the obvious advantages of buying direct, the current distribution model continues to dominate the electrical and ITS industries. Manufacturers who have partnered with distributors are essentially trapped in this selling model.

"Because distributors control the industry, they also create fear, uncertainty and doubt surrounding manufacturers that choose to sell direct, claiming that the products are less expensive because they are not as reliable. The truth is that all of our products go through the same testing and verification as those purchased through distributors," says Eskew.

It takes progressive manufacturers with the willingness to sell direct, establish quality relationships and build confidence in their products to begin breaking down the current distribution model. Buying direct is a win-win situation for contractors and manufacturers and, ultimately, end users. Contractors interested in significant cost savings and higher levels of services should consider breaking decade-old habits and look to source products from manufacturers that sell direct.

Handler adds, "Contractors are realizing that the partnerships gained when working directly with manufacturers quickly overshadow any preconceived notion that the only way to buy is through distribution." ■