Distributor POV: Stuck In The Middle

This article first appeared in IMPO's May 2012 issue.

If there is one consistent element in an inconsistent market, its supplier price increases. The question here is not if prices from suppliers are increasing (this much has been obvious), however what is being done to remedy the costs. For an overwhelming majority of ID survey respondents, price increases were being passed along down the chain to the customer base. Permitted to “check all that apply,” 34 percent of survey takers also cited negotiation tactics as a way of buffering purchasing price issues so they were no longer significant. In addition, 33 percent said their company has also responded by absorbing these price increases themselves. While this strategy certainly stretches already tight margins, it could be the only way for some to weather out the swings while retaining key customers (See Figure 1).

One respondent said that, instead of employing any of the above methods, they’ve turned to private label products so they can “control the market.” Another cited a strategy where the company increased their inventory levels on specific products before the price increased.

Distributor Pricing and Customer Relationships

Price increases inevitably come from a few sources, with 68 percent of survey respondents citing raw material price increases as a driving force affecting their own company’s pricing.

Tight profit margins often force distributors to simply pass supplier increases on down to the customer since they lack the ability to absorb the swings. The most damaging effects here lie in the increasing tensions from a customer standpoint that come with price increases. 61 percent of survey takers said price fluctuations have created tension, while 9 percent said they weren’t sure. For those who saw more customer tension, a whopping 97 percent said the result has been doubling their efforts in order to retain this existing business. 21 percent said they also have been dropped by customers altogether based on these issues.

When it comes to pricing, the majority of readers use a formula to determine what to charge for their goods. An additional 18 percent said they track competitor pricing and try to stay at or below those numbers. What’s interesting here were the number of write-in responses in response to questions about pricing strategies. It seems many distributors are increasingly taking a creative approach to this aspect of the business, likely trying to hedge against these aforementioned fluctuations while still keeping the customer happy. Some other interesting highlights:

One said that their pricing structure depends on the customers and “our level of support,” suggesting this distributor’s ability to charge, whether outright or through higher product line rates, for value added services.

One respondent said “whatever the customer will accept,” suggesting some currently lack leverage in these business relationships. Another said he/she will “price based on what we feel will get us the business.”

Another cited an attempt by his or her business to offer large quantity discounts to encourage customers to increase their own inventories. It’s arguable we may see more of this type of strategy as distributors try to unburden themselves of some of the increased carrying costs that fell to them during the worst of the recession years.

Evaluation

The survey results also pointed to an interesting trend towards increasing evaluation of supply chain partners — both on the supplier and customer side. According to the survey respondents, 41 percent evaluate their supplier base more than once per year, a figure that stands in stark contrast to those who say they “never” reevaluate their supplier base (5 percent). A large number – 33 percent – conduct this task about once per year, and 21 percent say “every few years” (See Figure 2).

Perhaps more interesting are the results to the question “How often do you evaluate your customer base?” For 17 percent of respondents, a customer is a customer and they can’t afford to lose any. But as their value propositions improve, another 17 percent say they reevaluate their customer base every few years. 19 percent say some customers are not worth the costs, and therefore they reevaluate once per year. Interestingly, 47 percent say they are constantly evaluating this area of their businesses. This trend perhaps indicates an evolving disconnect as distributors struggle to relay their value proposition to their customers, and customers continue to push the envelope in terms of their expectations. When inventory demands, services, and account management create more output than can be regained in customer spend, it could be time to cut some of these accounts loose—something many survey respondents say they’re not afraid to do.

So despite the fact that most are coming off a solid year of profitability, there is still much to be seen in terms of how this will be sustained, and how much the market will bear in terms of raw materials and finished goods price fluctuations. The good thing is that industrial distributors are getting creative, and it’s likely we’ll see more aggressive approaches to managing internal costs, especially relative to inventory issues, managing customer demands, and assessing the supplier and customer base on a regular basis in order to determine which holds true value, and which business relationships might be better off dissolved.

This survey was distributed via email to a list of Industrial Distribution subscribers. Respondents are C-level executives, purchasing, or sales/sales management professionals in North American distributorships. Industrial Distribution is a sister publication of IMPO.