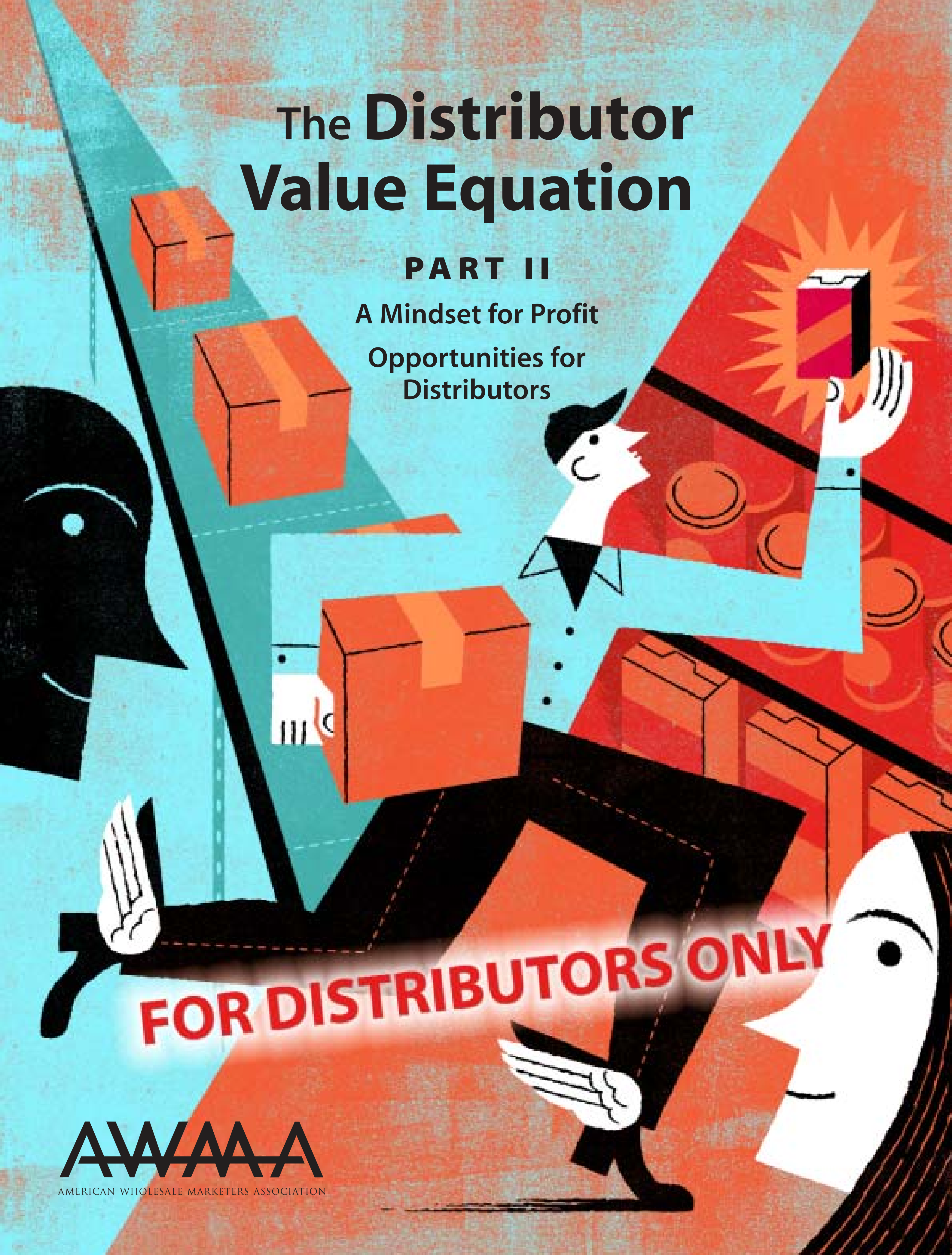
The Distributor Value Equation

PART II

A Mindset for Profit

Opportunities for Distributors



FOR DISTRIBUTORS ONLY

AWMA

AMERICAN WHOLESALE MARKETERS ASSOCIATION

The Distributor Value Equation

PART II

A Mindset for Profit Opportunities for Distributors

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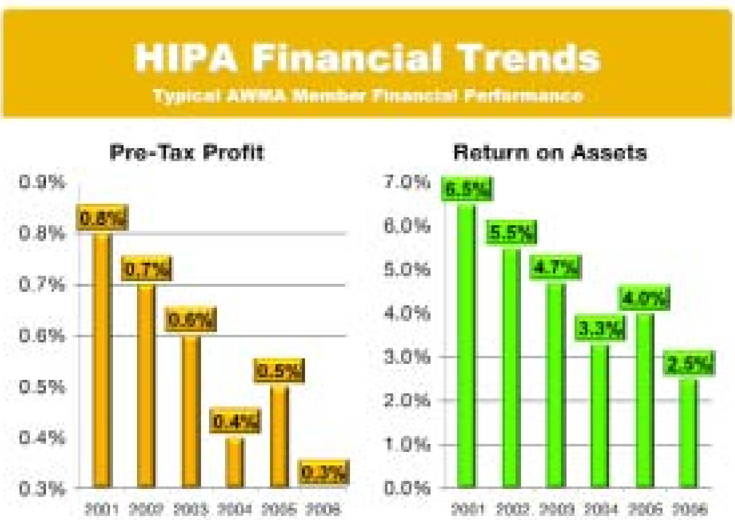
Preface

Part I of *The Distributor Value Equation* clearly defined distributors as the *essential link* for manufacturers and retailers, and quantified the remarkable value that they bring to the supply chain. The study also confirmed the financial crisis faced by the distribution community caused by lost cigarette subsidies, and revealed a major flaw in the cost-plus pricing model commonly used across all categories. The bottom line: The system is broken and a new pricing model must be embraced, reflecting just what it costs to perform the services that they provide—including the supply chain costs related to individual products, categories and customers.

Clearly, the profitability of distributors as discussed in Part I of this study, and reinforced in the 2007 Hershey Industry Performance Analysis (HIPA) report, is unacceptable. Companies cannot survive and prepare for the future with a steadily sinking net profit margin, one that declined industry-wide to 0.3% in 2006, down from 0.5% a year ago, and a return on pre-tax assets of 2.5%, which also declined from 4.0% over the past year following reductions in previous years.



This document will present a new vision for the future and a roadmap to increased profitability, including achievable, specific benchmark goals. It will discuss specific steps companies can take—today—to get there; steps that can help lead to restored profitability and long-term viability. But action must begin at the top of each company, where leaders must set new financial standards and hold their organizations accountable for their implementation. That means a major change of mindset, including burying the "volume at any cost" mentality.

A set of new profit standards must be established. Performance measurements and a pricing approach must be implemented to assure profitability as the convenience industry evolves and product mix changes.

As one distributor commented, "Guess what? I don't work for free any more."

Clearly, the profitability of distributors as discussed in Part I of this study, and reinforced in the 2007 Hershey Industry Performance Analysis (HIPA) report, is unacceptable.

Profit Expectations & Issues

"For the retailer in a bid situation, it's like fish in a barrel. It is so easy to play one distributor against another, it's pathetic. It's pure retailer-driven competitive pressure."

The initial study found that many distributors have low-profit expectations and identified that as one of the most significant reasons for the profit crisis confronting them today. If executive leaders do not expect better results, they will not get them. Decisions that could improve profits and ROA will not be made.

Not only do some distributors blame themselves for setting their sights too low, they blame some of their competitors for being willing to do about anything to land a customer, regardless of whether or not it makes economic sense. Many distributors face competitors who lack a real understanding of their true costs of doing business and are willing to cut prices to the bone—as long as they cover expenses, meet payroll and make a small profit. Such a "volume at any cost" approach has considerable impact on distributors who do set profit goals high enough to allow for growth and investment in the future.

Besides having to deal with unrealistic pricing in the marketplace, more business-focused distributors face difficult challenges in negotiations with convenience retailers who understand these dynamics and take advantage of them when negotiating terms with distributors.

Said one regional distributor in the Midwest: *"For the retailer in a bid situation, it's like fish in a barrel. It is so easy to play one distributor against another, it's pathetic. It's pure retailer-driven competitive pressure."*

That is hardly a prescription for success. Smart distributors invest in systems that will help them improve both efficiency and service for the long-term benefit of their companies, their customers and manufacturer partners.

Commented one large national distributor: *"Incrementally, you want to be in a position to reinvest and have the funds to investigate business opportunities that require capital, so you can have an outcome that becomes more favorable."*

Benchmark for the Future; Steps to Success

Good distribution companies deserve a reasonable return on their investment in this industry. Currently, they are not achieving it and determined, well-reasoned action must be taken.

It is essential that distributors establish a clear goal for immediate improved results with strategies to achieve it and dramatically improve today's industry average net 0.3% net profit margin.

If distributors take the right steps to improve their operations and practices, it is entirely possible to achieve a 1.5% profit margin by 2009. Such a result would generate a 12.5% return on assets, compared to 2.5% today. That should be the industry's goal, and every company should embrace it.

Foodservice distributors, which mirror convenience distributors in many ways, currently generate a 2.7% average profit margin. There is no reason that convenience distributors cannot achieve such a result—if they embrace the concept that higher profits are possible and are entirely achievable if the right strategies are put in place.

What are the key steps to success?

- A new **Mindset of Profitability** must be embraced, changing attitudes and embracing the concept that reasonable profits must be achieved.
- New **Profit Standards and Measurements** must be put in place to achieve those improved those results.
- New **Pricing Methodologies** based on "cost-to-serve" must be established and implemented. These can be developed in stages and can result in significant, immediate, profit improvements.
- **Communications & Collaboration** with industry trading partners must become the standard if companies are to deliver measurable value to all concerned.

It is essential that distributors establish a clear goal for immediate improved results with strategies to achieve it and dramatically improve today's industry average net 0.3% net profit margin.

A New Mindset of Profitability

As we discussed in Part I of this study, the major manufacturers, retailers and the states all have increased their per unit cigarette dollar shares, while distributors receive less cents per carton.

Distributors must be willing to change if the industry's disastrous course of declining profits is to be reversed and if they wish to operate successfully into the future. Their mindset should be framed around these thoughts:

- We as distributors are solely responsible for our profitability and must take whatever actions are necessary to assure its sustainability.
- We will no longer run our business based on the lowest common denominator of pricing in the marketplace and our pricing practices must be driven by cost-to-serve.
- We will develop higher standards for profitability and measure our results as they pertain to our company, customers, products and vendors.
- We will sell the value of our business-building programs, resources and execution; measuring the growth and success of our trading partners.
- We are willing to walk away from unprofitable business if we have exhausted all attempts to make it profitable.
- We will constantly strive to be more efficient and effective, lowering our cost of doing business and eliminating non-value adding activities.
- We will communicate these principles to all associates in our organization and equip them to better compete in the future.

Distributors can also learn from one of their primary sources of income over the years, the major cigarette manufacturers who must always focus on maintaining shareholder value and do not hesitate to make the hard decisions necessary for the long-term sustainability of their brands and profitability.

In this important declining category, manufacturers have made many unpopular decisions that have affected distributor and retail profits, but these changes were deemed necessary for long-term profits. Manufacturers were willing to have the necessary difficult conversations with trading partners and to make the appropriate changes. Clearly, these manufacturers are reinventing themselves; distributors must follow suit.

As we discussed in Part I of this study, the major manufacturers, retailers and the states all have increased their per unit cigarette dollar shares, while distributors receive less cents per carton. Like the cigarette manufacturers, distributors must embrace the mindset of profitability, be willing to engage their trading partners in the "uncomfortable conversations" that are necessary, and take the actions required to protect their businesses and assure viability for the future.

The Lesson of Beverages

There is evidence that, since Part I of this report was presented in September 2006, this mindset of profitability is being adopted by a number of distributors in a variety of ways.

One leading distributor tackled a major problem area identified in the study, the cost of delivering beverages. The company shifted from the old cost-plus system to one based on weight after an Activity Based Costing (ABC) analysis showed the company was delivering beverage products for 3 cents per case. That company distributed 48.5 million cases in 2006, or 35,000 truckloads.

The new system initiated by that distributor was based on weight with a minimum charge to suppliers, as well as increased prices to retailers. While that arrangement was subsequently modified to a fixed cents-per-case markup, it served as the impetus for a new pricing policy that provides for profitability in a difficult category. Other distributors have since independently implemented similar policies to effectively cope with a traditionally troubling product category. Bottom line: a reasonable profit has replaced losses that were continuing to mount.

"We as an industry do not react to changes in our own environment," commented one distribution company executive. *"Change is needed by everyone in this industry."*

Another distributor explained the situation this way in a letter to beverage manufacturers: *"Our skyrocketing costs of distributing these products can no longer be borne by our traditional pricing model to the retail trade . . . We must recoup the expenses associated with your products or ask you to find another method of distribution of your products to retail."*

Certainly, courage is required to take such a stand. However, as increased numbers of distributors do so, a new policy will be established for the channel and a significant step taken to improve the profit picture. Moreover, as changes are implemented, distributors often find less resistance from customers than they anticipated—especially if customers understand the pricing and profit realities that exist.

"Our skyrocketing costs of distributing these products can no longer be borne by our traditional pricing model to the retail trade."

There also is a significant opportunity to work with beverage manufacturers to obtain increased share of space, optimize the cooler set with warehouse-delivered beverage products and take advantage of higher margins for those products.

Distributors have been losing significant amounts of money because of the traditional cost-plus pricing system that has been in place for many years. It is a system that is particularly ineffective with regard to beverages because of their weight and cube.
But that same problem affects other products and other categories.

As firm action based on an understanding of cost-to-serve in the beverage category is now benefiting some distributors, so can similar actions help to eliminate or reduce the profit drain in other categories. The same principles also can be applied to low weight/low cost/high cube products on which there is significant cost and little profit.
In fact, future pricing should be a combination of cost, weight and cube.

Profit Standards & Pricing

Achieving improved bottom line results means that distributors must be willing to establish their own set of standards that will lead to profitability, and they must be able to measure those results so they know where they stand. Pricing policies must be implemented that will lead to profit.

Every action must have this objective in mind. Every opportunity to create profit, either by achieving savings through efficiency or increased revenue through improved pricing, needs to be explored.

For example, a common headache for distributors comes with small-quantity orders, including single-picks. While quantity pricing is often offered, as well as special pricing for single-picks, it generally remains an area of cost, not profit.

Many distributors recognize that convenience stores are just that—*convenience* stores—and that they routinely carry small quantities of certain items simply for the convenience of customers who need something at the last minute. They readily provide these products, but there must be adequate compensation.

The costly practice of selling one of any item to a retailer and delivering it to the store has increased in recent years as distributors sought to offer the best possible service to their customers and provide them with the products they want to receive.

But this practice of "single-pick" is hugely expensive for distributors, many of whom fail to understand the real costs being incurred. It is essential that distributors carefully examine just what single-pick products make sense and are necessary—and under what circumstances—because the practice flies in the face of other efforts to change the pricing model with the objective of improving distributor profits.

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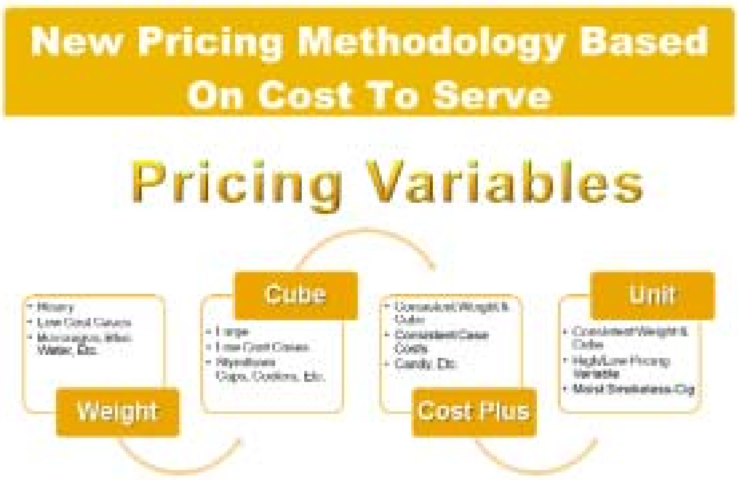

Many retailers enjoy a significant subsidy from their distributors on single-pick items, but they would doubtlessly alter their inventory practices if the real price were included, since the decision to carry the product is based on its delivered cost. If their charges and the resulting retail price reflected actual costs, the item likely would gather dust on the shelf because of its uncompetitive retail cost. Then, of course, the question for retailer becomes this: Are those single item products really necessary in the overall store set?

Consider that single-pick usually generates only an estimated one-third of the margin dollars necessary to cover costs, including warehousing and transportation. The number of single-pick items sold is extraordinary and is one of the biggest contributing factors to the profit challenge facing distributors today.

While single-pick may make sense in some of the smaller, slower-turn items such as HBC and GM, when it comes to the grocery category, many distributors offer duplication to satisfy the perceived needs of retail customers. This duplication, much of which is really unnecessary, should offer an easy target for distributors who are ready to deal with the single-pick problem.

One major distributor, because of discussions in Part 1 of this study regarding the single-pick issue, launched a company-wide analysis of its policies. They discovered that it was providing 1,850 products to customers in this manner, compared to 800 four years ago. The company's analysis uncovered an average 8 cents per unit loss every time one of these products was delivered to the store.

After this discovery, the company notified customers it was eliminating 30% of those 1,850 products available for purchase as single items. They included grocery, bagged candy, HBC, general merchandise; products that would no longer be available in singles. Surprised by the general acceptance of that new policy by customers, the company immediately prepared to eliminate additional products from single-pick availability. Clearly, once customers understood the economic realities, most were willing to adapt their own purchasing practices to comply with the new distributor requirements.

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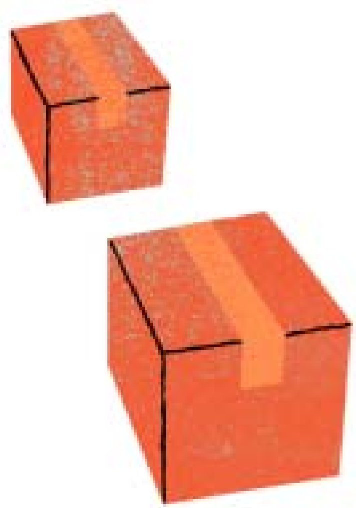


At retail, each product must be a profit contributor or serve a strategic purpose.

"I expected more push-back from our customers than I am getting," the distributor commented. *"Of course, we went after the low-hanging fruit—the ones that were dispensable. I think this is an area of significant potential. It takes more money to the bank and doesn't disrupt the retailer's perspective."*

The average convenience store carries 3000 to 3500 SKUs. Distributors must set their sights and base their requirements on selling more than one unit a week. Those who fail to do that have a serious problem with their in-store strategy, and certainly cannot expect to make a profit on those items.

Another successful approach has been to impose minimum item number requirements for less than case order selection. For example, if the minimum pick standard is 3, and the customer orders 1, 2, or 3, he receives and is charged for 3. If the customer orders more than the minimum, the quantity ordered is selected and invoiced. By using such a tactic, the single-item ordering problem is minimized, and the number of items offered as "eaches" is greatly reduced.

One AWMA member imposes this requirement on all of its 2500 grocery SKUs, and also includes a 10-cent per item surcharge for products purchased through its single-pick program. The company serves a large number of rural, out-of-the-way retailers, country stores, many of whom rely on this service. But the distributor makes sure he is covering costs and reports a gross margin of about 16% on grocery items overall.

"It gets us in a lot of stores that we wouldn't otherwise be in," the CEO reports. *"It gives us a competitive advantage against distributors who are unable to provide this service."*

Clearly, individual solutions must be tailored to the needs of individual markets. It is critical to understand the requirements of the marketplace and of targeted customers. Companies that do provide a single-pick program must be sure they are doing so efficiently and that they are pricing it for profitability.

Generally, however, the issue of single-pick is typical of this industry over the years. Distributors tend to do whatever the customer requests in order to obtain and retain the business. That mindset of acquiescence must change. It is impossible to overstate the cost implications of single-pick practices for distributors in most cases, and how seriously it drains overall profitability. It is, in fact, the next area to examine if distributors are to improve their profit picture.

To achieve maximum efficiency, minimum quantities need to be enforced. One manufacturer executive offered this advice: *"The distributor has to tell his retailer customer that if he is not delivering x-number of cases per week, he will no longer stock that item. And challenge the manufacturers to get more stores involved to make carrying that item worthwhile."*

At retail, each product must be a profit contributor or serve a strategic purpose. In the supply chain, distributors should reflect a fair price based on the true costs of handling the products they sell. Distributors create a buildup of total supply chain costs when they try to help the customer by managing subsidies on the supply side. It doesn't work, and that practice needs to be eliminated if we are to provide the most cost effective supply chain based on cost-to-serve.

Sales and Value

How do you sell? In the past, the primary method of attracting customers has been to compare invoices. Who is cheaper? That must change if a distribution company is to successfully implement a rational and effective system based on the cost-to-serve. So how do companies reinvent their sales organizations so they sell value as well as price, and always within the financial obligations and requirements of the company?

Owners and key executives must convince the sales team why they must help in the effort to improve today's dismal profit picture. Sales executives and associates must be trained to sell this new approach and they must believe in it.

Companies should consider changing methods of compensation so sales personnel benefit from this new approach. And, of course, there must be sound training in how to sell the promise and execution of value.

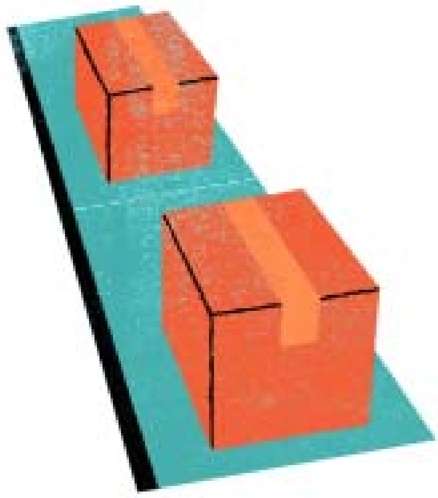
Sales personnel must be able to help retailers understand the advantages of having a better balance between the absolute cost of goods—who can do it cheaper—and how distributors can help them grow their businesses. It is worth a premium for retailers to choose a distributor who can deliver the best overall value and help achieve their goals for business growth. Some distributors emphasize the importance of training sales personnel so that they understand which customers are profitable and which are not.

Explained one distributor: *"If your sales force is focused on gross margin rather than net margin, that is wrong. They have got to think about the cost to serve a customer. Part of it is getting distributors to link sales compensation systems. If they are tied to gross margins, they are not providing education about the cost to serve. It becomes very perverted. We need to have people thinking about what brings value and what does not."*

Several years ago, one distributor recognized that it was a mistake to have the same person developing new business and maintaining existing accounts. There is an inherent conflict that can result, he said.

Regardless, the key to sales success will be executing on the promises that are made. It is easy to talk about providing value, but it's another matter to produce and deliver the value that you promote. No matter how compensation of your sales personnel is changed or what new sales techniques and strategies are employed, value not delivered cannot be sold.

Six months after the promises are made, the retailer will want to know what progress has been made. Consequently, distributors must be able to capture the necessary data to justify selling at a higher price. They must be able to prove their value to the customer by having detailed performance reviews, benchmarking sales and margin growth against themselves and the National Association of Convenience Stores (NACS) State of the industry (SOI) numbers. Otherwise, distributors will not receive the credit for the value that they, indeed, have provided. And ultimately, their efforts to change the profitless paradigm will not succeed.



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“We invested in Palm units for our retailers, and we provided training for our retailers to use them. It’s more accurate than having a sales person there to fill out the order.”

Key Steps

What does the wholesaler need to look like to operate in a value position vs. a price position in the marketplace? Here are some steps distributors are taking today to improve profits and ROA:

- Increase the use of technology for warehouse management, inventory control and category management
- Reduce warehouse SKUs to eliminate slow movers and duplicates
- Seek new profit centers, such as foodservice, to compensate for reduced profits from declining categories
- Impose surcharges or minimum fees for handling low-profit, high-cube items
- Train sales personnel to focus on net margin provided by each customer
- Enforce minimum purchasing requirements on customers and provide incentives to encourage exclusivity
- Assess “value” provided by customers, and eliminate those that do not contribute to profit or cannot be profitable over time
- Leverage multi-vendor merchandising opportunities (AWMA Warehouse-Delivered Snacks MVE)
- Seek increased compensation for more frequent deliveries
- Plan and implement strategies for growth, including acquisitions where they make sense and are feasible
- Seek new opportunities outside the convenience channel that can utilize plant and equipment

Technology

Clearly, in the face of continued low profits, efficiencies must be found, and advances in warehouse management, inventory management, and other uses of technology, including the Internet, are helping to meet this need.

Many distributors believe that if category management is right in the stores, and if warehouse inventory is related to that effectively, then the right products to maximize sales will be on hand for their customers. With out-of-stocks kept to a minimum, they are convinced higher profits will follow.

Decisions regarding the optimum inventory mix can be difficult, but they are critical to success. The correct balance must be reached, and distributors must understand the actual cost of bringing in another line of products into the warehouse. They must be able to price that line for a profit-particularly if those products result in low-volume sales.

Some distributors supply their retailers with handheld Palm-type units so they can scan products in the store and help to build their orders. The units also provide data that can be used to determine the profitability of individual products and whether specific items should be continued or replaced.

One distributor explained the rationale for this investment: *“We invested in Palm units for our retailers, and we provided training for our retailers to use them. It’s more accurate than having a sales person there to fill out the order. It’s working out very well. That’s an investment we made so we don’t have to go by there every week. They call in their orders.”*

A regional distributor in the Southeast went a step further. The company developed proprietary software to help retail customers, including those that do not have scanning, track inventory, purchasing history and products on order. It provides pricing information, including profit margin for each SKU. The handheld Palm units are provided to each retail location for a small weekly payment to help cover software development and improvement costs. The system is a differentiator, the distributor says, and retailers that use it agree.

Retailers say they value the planograming assistance provided by distributors, and distributors that have invested in the necessary tools to make this possible believe they have a competitive advantage.

A regional distributor that has a substantial focus on technology said he believes there is a sizeable opportunity for wholesalers to provide these services for independent c-store operators, but the challenge is to get them to take the time to learn about it. Almost all of that company's chain store customers attend the distributor's trade show where those services are explained, but less than 20 percent of independent operators attend. So the distributor established an online "shopping basket" service to help them.

Explained one distributor: *"The resources and the tools that are provided are probably the most consequential to the retailer's success. What you want to do is take action on what's sold and understand that, so your next order can reflect that experience. You must have the best ordering system that is the most time efficient in recognizing trends, and then use it in supply chain management."*

Distributors are working to improve their forecasting capability so they can prevent out-of-stocks, while avoiding over-purchasing and unnecessary inventory. Distributors regularly talk of routinely providing a 98% in-stock position for their customers; some even broach the idea of achieving 99.9%.

Here are some examples of computer-based services distributors are providing to assist customers:

- **Order replenishment for cigarettes.** Customers report inventory on hand and the system calculates what is needed.
- **Internet access to information.** System allows customers to view, on a secure web site, invoices and credits issued over time, improving customer service and reducing cost of providing that information manually.

Retailers say they value the planograming assistance provided by distributors.

Computer generated images can help retail customers visualize shelf sets recommended to maximize category sales.

"Cigarette money used to cover a lot of sins in the grocery products area that are draining on a company."

- **Monthly sales tracking** allows retailers, even those without scanning, to use "what ifs" for category management.
- **Daily sales reporting**, allowing customers to track accruals and promotions.
- **Online access to real-time information.** Allows customers to view inventory on hand, costs, and maintain retails over the Internet. Customers can authorize or de-authorize items themselves.
- **Speed-to-market.** Listings of new items and schedules of availability are e-mailed to customers or may be viewed on the Internet.

In the initial study, *The Distributor Value Equation*, the "Distributor Challenges" chapter discusses numerous initiatives by c-store distributors to reduce the number of SKUs in their warehouses. Many believe this is an important initiative if they are to control costs. It is, of course, tied directly to their ability to implement effective category management in their customers' stores.

Distributors also use various warehouse management systems to maximize the efficiency of warehouse operations, and some use on-board fleet technology to reduce transportation and labor costs. One distributor that recently installed a voice-pick system with its warehouse management system claims an 80% reduction in mispicks and a 60% reduction in shorts, resulting in $80,000 in savings every month. The increased efficiencies helped fund an improved incentive plan for selectors, and now turnover is one-tenth its previous rate.

Voice-activated picking systems can result in substantial reduction in errors and improved bottom line.

Foodservice Opportunities

Many distributors recognize that new profit centers must be created to compensate for declining sales and profit from cigarettes.

One distributor put it like this: *"Cigarette money used to cover a lot of sins in the grocery products area that are draining on a company. A lot of people lost sight of that."* Today, however, successful c-store distributors have recognized that situation and are acting to overcome it.

Foodservice is becoming an increasingly popular area of focus for distributors as they respond to growing retailer interest. Some distributors report that there is less focus on price in this category than in grocery, snacks or other traditional categories.

Said a distributor in the Midwest: *"What I'm experiencing is they still look at cigarettes, candy, grocery and snacks when it comes to price competition. They do in foodservice, too, but I haven't had anybody compare the price of my bistro soup against anybody else's."*

That, said the distributor, suggests that c-store distributors can take advantage of today's hurried consumer lifestyles and the desire of their convenience store customers to meet those needs.

For example, a c-store distributor in the south has grown its foodservice operation to more than 10% of the company's gross sales, and it reports much higher profit margins for foodservice products. The company not only supplies the necessary products, but it also offers equipment and systems for its customers. Beyond enhancing sales, that distributor is convinced there is another major advantage: clear differentiation against the competition.

A c-store distributor in the Northwest has established a proprietary foodservice operation, offering a line of freshly made sandwiches, pizza and Mexican food. The distributor reports that the program allows the company to increase sales with higher profit against declining gasoline and tobacco margins.

"We are trying to diversify ourselves so we are not so completely dependent on cigarettes for profit. You have to give people a reason to shop in that store, and foodservice offers a high-margin opportunity to do that," the company's CEO explained. *"Our customers say they need more inside sales to stay viable. We believe this is a great way for many of them to achieve that."*

Meanwhile, Canadian convenience distributors have seen their cigarette profits destroyed as the largest cigarette manufacturer in Canada moved their distribution to DSD. Distributors that relied heavily on cigarettes and candy are struggling to survive. While this move created great financial pressure for all distributors, those that had expanded their offer and invested in foodservice, offering a broader scope of products to expanded classes of trade, were much better positioned to deal with the new environment than those that failed to respond.

AWMA distributors that provide foodservice offer many services and products, ranging from slush drinks and roller programs to full-service programs that include equipment, space, kiosks, branded and non-branded concepts, item selection, menu planning and sales specialists. Frozen beverages, hot beverages, prepared sandwiches, salads, pizza, meats, bakery items and produce are just a few of the products available.

Success, however, doesn't just happen. Distributors whose foodservice operations are contributing nicely to the bottom line invest time, effort and resources in equipment, training for their customers, and in developing a strategy and workable plan to drive sales and profit.

"We are trying to diversify ourselves so we are not so completely dependent on cigarettes for profit."

Wholesaler-created proprietary foodservice program can help boost sales and increase profits for retailer and distributor alike.

A sore spot for many wholesalers is being asked by retailer customers to take back products that they purchased elsewhere but did not sell.

Surcharges & Fees

Imposing fuel surcharges to compensate for higher energy fleet costs has become commonplace and generally understood and accepted by retailers. In fact, one regional distributor suggested that this experience might be instructive for distributors who seek additional compensation for other increased expenses. *"Maybe we can use this to teach ourselves that we have to go to our customers to replace these added costs,"* he said. *"Maybe we can learn something from this fuel situation."*

A number of distributors reported that they have sought to impose, or have imposed, additional fees for out-of-the-ordinary deliveries. A common problem, however, is that often competitors will turn up and offer to make those extra deliveries at no additional cost.

A distributor explained the situation like this: *"We go into all areas pretty much twice a week. We have made emergency deliveries, and they are willing to pay us a little more. But don't put us in a position where we have to do that every week. If we are, then we have to sit down with them and ask for better compensation."*

While some distributors consider providing shelf tags and placing them to be part of their service, others charge for those tags and for that placement service.

Commented one such distributor: *"I think the value is much greater than the charge to do that. Some manufacturers complain about those tags, but they are paid for on the first reorder. I'm the one who is always complaining that we're not charging enough!"*

A sore spot for many wholesalers is being asked by retailer customers to take back products that they purchased elsewhere but did not sell. Often distributors accommodate their customers even though they do not receive credit from the manufacturer. As much as they prefer not to take back products that they didn't supply, they feel it is a problem not to do so. Obviously, establishing a clear returns policy and sticking to it would help stem those losses.

Some distributors report instituting restocking fees for returned goods, while others believe it is a competitive advantage not to do so.

Unprofitable Customers

Many distributors agree that customers whose only objective is to obtain their products as cheaply as possible may not be worth the trouble. Numerous distributors have policies in place to screen out such customers so they can focus on those who value their overall service, not just price.

"We need to do a better job of recognizing the retailer that makes no sense for us to serve because they don't value the benefits that we provide," said one distribution company executive. *"If their main focus is on price, then we don't want them. We've moved away from the paradigm that any business is good business."*

Another distributor put it like this: *"Every customer has different issues. If their main focus is on price, then we don't want them. Price drags everything else down to a lower level. They don't want to be in the selling business; they want to be in the buying business. You can't buy a rotten tomato too cheap. It is not very smart to buy stuff cheap if you don't have the right products to sell."*

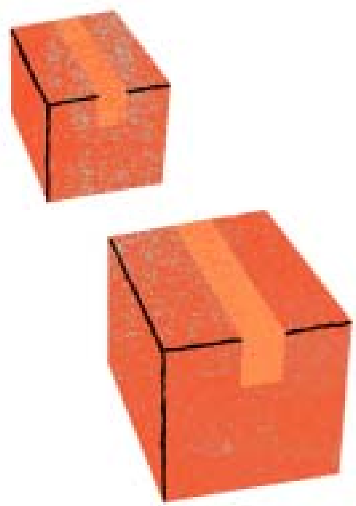
Often there is resistance to shedding customers, particularly when personal relationships have been established over time. It is difficult to say, *"Sorry, you're not profitable enough."* But there may come a time when that conversation must take place.

Many convenience store distributors are family-owned companies with traditions and reputations that serve them well when marketing to new customers. However, those same family traditions may work against some companies that are reluctant to change policies that may have been in place for decades for fear of upsetting long-time customers.

Many owners will say, *"We've always done it this way, so why should we change?"* But as one distributor pointed out: *"If you do things the way you always do, you will get the same results you've always gotten."*

Another distributor put it like this: *"If there is no value inherent to this service, it's time to change. You can have this discussion with customers, and it all works fine until a less knowledgeable distributor comes in and says he'll provide those extra deliveries at no cost. But if we can get the industry to understand what's at stake, we can increase our margins. We've got to look at the cost side of the business-the cost to serve."*

"If you do things the way you always do, you will get the same results you've always gotten."



Cooperation, Collaboration & Communication

When the manufacturer, distributor and retailer all work together, new opportunity opens up.

While suppliers and manufacturers must work with retailers to determine the real supply chain cost of single pick, actual needs, and reduce the number of items available for purchase in this manner, all trading partners must also consider the opportunities of even more widespread cooperation and information sharing, within the bounds of antitrust laws.

The first step, of course, is for distributors to address their own economics. Over the long-term, there are opportunities to remove additional costs from the system and enable distributors to achieve a reasonable return on the value they provide. But pricing metrics must reflect true cost and to allow retailers, manufacturers and distributors to make decisions together that can improve the efficiency and effectiveness of the entire supply chain.

Through collaboration and cooperation there is a significant opportunity for distributors to achieve an equitable share of in-store space based on their efficiency, and move more products away from direct store delivery (DSD). Because of the scale created in the distribution system, eliminating all of the duplicative cost-points resulting from multiple DSD deliveries is a possibility for the future. Moving more products through the supply chain creates greater value for the retailer, the consumer, and ultimately the manufacturers who participate in this channel.

That scenario plays out every time distributors meet with their suppliers and their customers. It is essential to determine who expects what. What role does the manufacturer expect of the distributor in what circumstance? Is there a willingness to use the talents and expertise of the distributor to help improve efficiency for all concerned?

One distributor CEO made this point: *"Retailers are getting a little worn out by four cigar companies and four snuff companies coming at them, and three chocolate manufacturers and three gum companies. They are looking for some combined way to deal with all of that."*

Of course, a solid and experienced distributor can provide that solution.

He also pointed out: *"Many manufacturers don't want to give up control (of the shelf-set) because they feel they will lose. We've got to get over that. We've got to represent all candy, all gum, all mints, and if we represent what truthfully is created in the marketplace, we shouldn't be afraid of that."*

When the manufacturer, distributor and retailer all work together, new opportunity opens up. Meaningful change and decisions can result and benefit all concerned, including the ultimate consumer.

The distributor must continue to do those things that make him more efficient—taking advantage of technology, reducing out-of-stocks, paying attention to new products and the issues involved, etc. But they still must commit to developing a relative framework for profit, and that needs to be a standard for the industry. The distributor must continue to seek every way possible to be efficient, to upgrade, and to take costs out of the system.

Consolidation & Growth

There are many ways to grow a business, including attracting existing customers from the competition, acquiring the competition and generating new business in previously unserved channels.

Study participants were asked if further consolidation among convenience store distributors is the answer to the poor financial performance confronting may companies. Would companies be stronger if there were fewer but larger competitors in the marketplace?

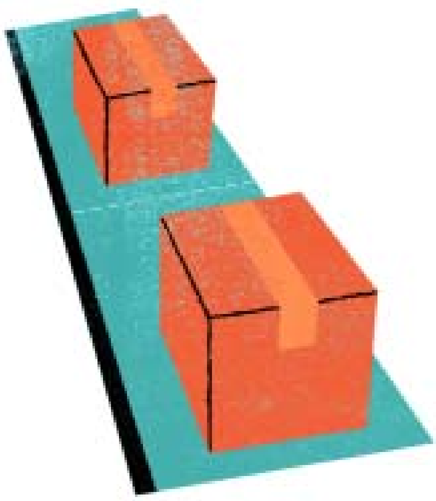
Many distributors—and manufacturers—expect that some consolidation is inevitable and believe it would be a positive development. But most of those same distributors acknowledge that when they consider acquisitions, more often than not the asking price is unattainable. Owners often have unreasonable expectations because, the would-be acquiring companies say, they lack an understanding of the true value of their company. They typically overestimate the value of goodwill, allowing sentiment and emotion to rule at a time when decisions should be based on physical assets and financial results.

One distributor disclosed that he has made four attempts to purchase other companies, all to no avail. *"I marvel at the value they place on their businesses,"* he said. *"We've had to walk away. But three of those four companies are gone-shut down. And the other will be gone soon."*

Other companies confided similar experiences, some saying they essentially are focusing on earning their competitors' customers' business rather than acquiring them by purchasing unneeded plant and equipment.

An executive of one distribution company said his firm would make an acquisition where it makes sense, but is emphasizing "organic growth" and expansion of service to other channels where that adds to the efficiency of using plant and equipment, particularly with respect to transportation.

Many distributors—and manufacturers—expect that some consolidation is inevitable and believe it would be a positive development.



The strong retail performance results of these MVE placements have piqued the interest of retailers and wholesalers throughout the United States and Canada.

Getting a Fair Share

Distributors and manufacturers share challenges and opportunities at retail. They compete for their share of coveted space vs. their DSD competitors. Many times, retailers are encouraged to provide "more space than they deserve" by DSD suppliers with payments for space, rather than rationalizing space based on consumer preferences, gross margin and sales opportunities.

The AWMA Warehouse Delivered Snacks (WDS) Committee has developed an effective solution to promote the benefits of warehouse-delivered snacks: a new Multi-Vendor End Cap featuring the best selling snacks brands to help convenience stores meet consumer demand, while maximizing total snack category performance and driving higher margin sales.

The snack MVE merchandises a great variety of major brands that consumers want on one shared end-cap. By placing the Snacks MVE in optimal impulse locations in the store, sales of SKUs on the Snacks MVE are increased by upwards of 50%–100%, with their accompanying higher gross margin. The result for the retailer has been explosive total snack category growth in sales and gross margins.

The strong retail performance results of these MVE placements have piqued the interest of retailers and wholesalers throughout the United States and Canada. To date, 70 AWMA member distributors have developed a snack MVE program and the interest continues to grow. There are now over 24,000 snack MVEs placed in chain and independent convenience stores across the United States.

Snack Multi-Vendor End Cap helps boost warehouse delivered sales.

The AWMA Warehouse-Delivered Snacks Committee can serve as a great model for collaboration and cooperation between distributors and manufacturers by expanding this compelling approach to other categories and, thus, validate the value proposition of warehouse-delivered solutions.

Conclusion

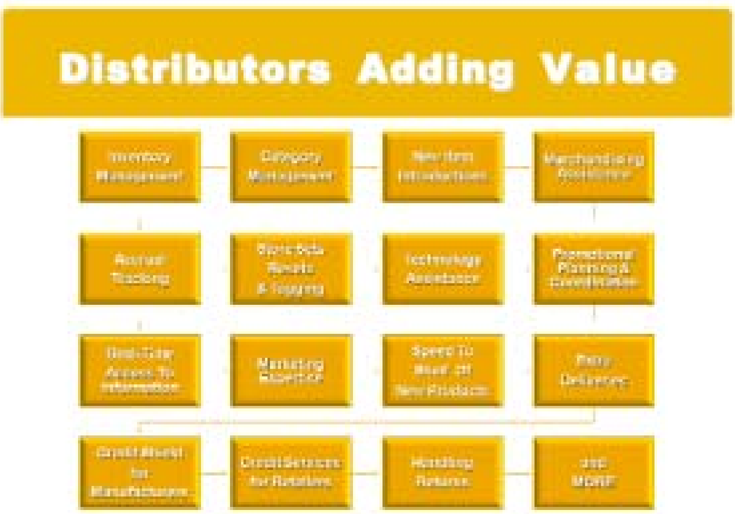
Today's profit picture for the average distributor today is dismal and declining, and if company executives fail to act, it will be the end of the line for many companies that will be unable to continue functioning in the current environment.

But this need not be the case. Distributors have it within their own power to establish a new paradigm for profit. Each company, acting individually, must analyze its own opportunities and change its mindset regarding its profit expectations, pricing, and opportunities for supply chain communication and collaboration.

As discussed above, many distributors have begun to act. They have focused on the beverage category and on single item purchasing as a beginning, and indications are that similar action is ahead in other categories.

But it takes confidence in your business, in the value that your company truly brings to your customers. It takes courage and determination and a willingness to engage in those "uncomfortable conversations" with trading partners. And, it takes a commitment to make certain that every member of your team, top to bottom—and especially those on the sales firing line, understand the mission and are on board.

For those who embrace the vision of value and choose to approach their customers based on the quality of the services they provide, the future can be bright, indeed.



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