



**SAP White Paper
Wholesale Distribution**

DRIVING OPERATIONAL EXCELLENCE AND PROFITABLE GROWTH

THE BEST-RUN BUSINESSES RUN SAP™



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EXECUTIVE SUMMARY

Wholesale distributors work hard to build profitable growth while also contending with rising customer expectations and the often disruptive complexities of mergers and acquisitions. Many rightly see operational excellence as the key to meeting these challenges – but too often, fragmented IT landscapes make it difficult to improve processes, control costs, and create the efficiencies needed to succeed in a competitive industry.

In response, a growing number of wholesale distributors are exploring the use of enterprise systems, which enable companies to replace their patchwork of systems with a single, comprehensive solution. These technologies have evolved to where midsize enterprises and large corporations alike can implement them cost-effectively, with relative speed and reduced risk.

Some enterprise solutions provide industry-specific tools designed for wholesale distributors. These are powerful analytical tools that not only track but also drive performance and profitability, integrating information with business processes and enabling better monitoring and control.

To make the most of today's enterprise systems, industry executives must understand how the technology has evolved to fit the needs of distributors and determine how it can help meet the needs of customers, streamline mergers and acquisitions, and then drive the implementation from a clear business perspective. Overall, enterprise technologies have the potential to be powerful tools, quickly reacting to shifting market forces in a consolidating industry, achieving operational excellence and solid, profitable growth.

GROWTH, COMPLEXITY, AND PROFITS

While today's wholesale distributors endeavor to drive growth in the face of growing competition, they are finding that the key to keeping and acquiring customers is operational excellence. Customers expect high-quality service and flexibility, online access to timely information about availability and delivery, and the ability to draw on value-added services such as customer information management and call-center support.

A key element in today's growth strategies is acquisition. In a recent Webinar survey conducted by *Industrial Distribution* magazine, 41% of respondents said that their companies had acquired another distributor in the last three years. What's more, according to a recent *Purchasing* magazine study, roughly one-quarter of distributors are actively seeking to acquire another company. Through such acquisitions, distributors are expanding into new territories or broadening their product lines with the acquired companies' complementary offerings.

Since consolidation typically brings new problems of its own, acquisitive growth isn't always as smooth as distributors would like. Indeed, in a recent Russell Reynolds survey, consolidation ranked highest among the challenges faced by distributors, with 48% citing it as an issue.

The problem is that acquisitions not only create larger organizations – which can require greater management sophistication; they also increase complexity by bringing together new people, products, and processes. In particular, mergers and acquisitions often leave the organization with numerous and disparate legacy systems, including custom applications, point solutions, and various operating systems and platforms. The following consequences can result:

- Fragmented and disconnected data, resulting in less useful information about operations, finance, and customers
- Less flexible systems, which slow a company's reaction to changing business conditions
- High IT costs – both technological and human – to integrate and maintain numerous systems

Such problems are reflected in the Russell Reynolds survey, in which distributors ranked IT as the factor most likely to give them a competitive advantage. And yet at the same time, they cited IT as their second-greatest challenge. A fragmented IT landscape makes it difficult to streamline processes, control costs, and operate efficiently and effectively. Ultimately, mergers and acquisitions often lead to **disruptive** growth, rather than profitable growth.

To address that issue, distributors are exploring the use of enterprise systems, which can replace their patchwork of systems with a single, comprehensive solution. As they do so, they are finding that today's enterprise systems can be powerful tools in the effort to react to shifting market forces in a consolidating industry, achieve operational excellence, and move beyond disruptive change to drive solid, profitable growth.

EVOLVING WITH THE INDUSTRY

Until now, enterprise systems have not been widely used by wholesale distributors, who tended to view them as out of reach and designed solely for FORTUNE 500 companies. But the technology has evolved to where midsize companies can easily and cost-effectively implement and manage enterprise systems. In fact, SAP estimates that a distribution company with US\$25 million or more in revenue can typically benefit from such systems.

A number of today's enterprise systems are designed to meet the needs of the wholesale industry while providing the flexibility needed to work well for a specific company. Systems differ, of course, but in general, distributors should look for qualities such as the following:

- **Comprehensive support for industry processes.** Some systems provide support not only for a broad range of general business processes but also for industry-specific processes ranging from purchase-order and inventory management to supplier-managed inventory and chargeback management. Because the full range of processes is handled on a single platform, the “siloeing” of information and processes that can impair operational performance is greatly reduced – giving decision makers a single, unified view of key information across diverse divisions and branches.
- **A modular system that fits with the business.** Today's enterprise systems are not monolithic applications but rather suites or “stacks” of applications that can be deployed in a modular fashion. A company can implement a few applications to meet its most pressing business needs – perhaps logistics or finance – and then, as desired, add more applications to support Internet sales and customer interaction centers, strate-

gic sourcing, and other requirements. In addition, a growing number of systems are standards-based and support solid integration with third-party and custom-made systems, which means distributors can continue to use specialized or home-grown applications that meet specific needs, easily weaving those systems into the overall enterprise.

- **Simplified, fast implementation.** Compared to just a few years ago, enterprise system implementations are streamlined and accelerated; it's possible for a full system to be in place in just a few months. That speed is possible in part because implementation methodologies have matured and are now well understood. But just as important, some solutions are preconfigured – that is, they incorporate industry best practices developed by distributors and systems vendors with years of experience. In general, about 80% of an industry enterprise system can be used by distributors without modification, allowing them to focus on the other 20%, which typically involves company-specific and differentiating processes.



ENABLING OPERATIONAL IMPROVEMENTS

With an enterprise system in place, a distributor is in position to drive greater operational efficiency and profitability. For example, the technology enables companies to centralize control over operations, reduce redundancies in back-office and logistics processes, and establish shared service centers that provide enterprise-wide support for business processes, such as human resources and finance. In the IT department itself, such systems can reduce or eliminate the high costs traditionally associated with developing, mapping, and maintaining the legacy and best-of-breed systems that so often result from acquisitions.

Some enterprise systems also provide customer relationship management tools and functions that help distributors meet rising customer expectations and efficiently offer value-added services, such as customer information management, repackaging, direct sales from trucks, direct store delivery, and supplier-managed inventory – all of which boost revenues. In an era when many customers are consolidating their supplier base and looking for greater levels of collaboration, a single enterprise platform enables distributors to more easily share information with, and extend processes to, external partners, ultimately strengthening customer relationships.



A BETTER UNDERSTANDING OF PROFITABILITY

A key development in enterprise systems is the use of analytical tools to identify trends and patterns in a variety of areas, including operations and profitability. The ability to gain a deeper understanding of profitability is especially important for wholesale distributors. It is increasingly difficult to gain an advantage or achieve high margins on the basis of products alone, according to Bruce Merrifield, president of Merrifield Consulting Group, because products are available from so many sources and to a large extent are becoming commoditized. “There is nothing in your warehouse that will give you a strategic advantage,” he explains, adding that the search for greater profitability has shifted its focus from carrying the right products to keeping the right customers.

With today’s enterprise-based analytical tools, distributors can do a better job of maintaining that focus. They can have a complete and concise picture of each customer relationship and gain an accurate view of each customer’s spending contrasted with the cost to service that customer. Merrifield explains that companies will typically see “huge skewing” in customer profitability. “You may find that 1% of your customers generate 35% of the operating profit, and the bottom 1% of the accounts may destroy about 20% of your operating profit,” he says. “These are customers that you’re losing \$15,000 to \$150,000 a year on because you have numerous small orders but no margin in it at all.”

Armed with such insight, distributors can use analytical tools to better understand why high-profit customers buy from them and how they can better serve those customers. They can also analyze information and test different scenarios to see if they can improve the profitability of relationships with loss-driving, low-end customers – or if it makes better business sense to drop those customers.

Going through that kind of exercise can produce significant benefits, according to Merrifield:

Most distributors could get breakthrough results . . . by rethinking customer niche strategies around the account's profit before interest and tax (PBIT) contribution and splitting each segment into A,B,C, and D strata to be sold, served, priced, and termed in a significantly different manner. Too many customers are treated the same. This includes many that are overserved and unprofitable and a very few that are underserved and could be the company's future.

WEIGHING THE BENEFITS

To determine how an enterprise system can help their companies, executives should take a business-oriented view of the technology. To truly understand the return they will get from such systems, they should treat their systems as operating expenses rather than capital investments, says Steve Epner, president of the Brown, Smith, Wallace Consulting Group:

Automation should be looked at as if you were hiring an employee. If you're going to buy \$300,000 worth of [technology] over five years, that will cost you about \$6,000 a month, or the cost of two fully loaded clerical people. So instead of looking at your system as a depreciating asset, look at it as if you had hired two employees – but somebody who is not going to get sick and who does things very accurately. You can step back and ask, "Will this equivalent of two additional people keep me from having to hire other people due to growth?" If that's the case, you've justified your return on investment.



When evaluating enterprise systems, executives should also consider the broader potential bottom-line benefits that distributors are likely to see from improved processes and better control over the business. These include the following:

- **Improved gross margins and reduced cost of goods sold.** Enterprise systems can enable distributors to optimize buying by combining purchase requisitions, provide a better view of profits and spending to drive effective negotiations with suppliers and customers, and reduce days chargebacks outstanding.
- **Increased revenue.** The technology can help distributors get products and invoices out faster, maintain and improve service levels, implement optimal pricing, and provide effective value-added services.
- **Reduced operating expenses.** Systems can help distributors improve the efficiency of accounting and controlling, increase warehouse personnel productivity, improve materials management, and increase inventory turns.



HOW SAP SUPPORTS THE INDUSTRY

SAP has created a portfolio of solutions that embodies the concepts described above and is designed to help distributors achieve operational excellence and profitable growth. This set of solutions – SAP for Wholesale Distribution – gives distributors the ability to implement support for key industry processes in a modular fashion and grow their capabilities as business conditions change.

SAP for Wholesale Distribution enables companies to manage the following business processes:

- **Supply chain planning** with support for operational, medium-term planning efforts, including advanced demand and supply planning, and capacity forecasting for transport fleets
- **Procure-to-pay management** of strategic and operational relationships with suppliers
- **Supply chain execution** with support for highly efficient inbound and outbound processes and warehouse management
- **Order-to-cash management** with tools to manage a range of sales channels and services
- **Enterprise management** with support for financials, human resource management, and business analytics

SAP also makes available the SAP® Best Practices for Wholesale Distribution offering, which provides a variety of preconfigured processes that embody industry best practices. These best practices describe exactly how best to implement various key business processes in SAP software, covering activities such as sales order processing via electronic data interchange, consignment processing, returns and complaints, foreign trade, and enterprise management processes such as product cost planning, sales planning, and overhead cost management.

To further simplify the shift to enterprise systems, SAP has developed the SAP ERP packaged solution for the wholesale distribution industry. Designed to give midsize companies an affordable, world-class enterprise resource planning system, this solution provides rapid implementation – typically 20 weeks – at a fixed price and incorporates best practices based on feedback from more than 1,000 SAP wholesale distribution customers. With this packaged solution, companies can quickly be up and running with core business processes, including supply chain planning, procure-to-pay, supply chain execution, order-to-cash, value-added services, and financial management with profitability analysis. And they can choose to use all or part of the solution, as business needs dictate.

Finally, SAP solutions are built on the SAP NetWeaver® platform, which enables companies to easily and cost-effectively link SAP and non-SAP systems and collaborate with partners and customers. The SAP NetWeaver platform also gives distributors the flexibility to support future business models and strategies, and the use of innovative processes based on technologies such as radio frequency identification and master-data management.

CONCLUSION

As competition continues to grow in the industry, distributors will have to find ways to streamline and rationalize their internal infrastructures and processes and drive the operational excellence demanded by customers. While the complexities of consolidation create significant challenges in that area, today's enterprise systems can play a key role in meeting those challenges.

To take advantage of this empowering technology, executives in the industry should understand how it evolved to fit the needs of distributors – midsize companies to large corporations alike. Enterprise systems now provide a cost-effective alternative to complicated, disparate IT landscapes that many companies struggle with – one that can meet the company's individual needs, implemented with minimal risk.

With such systems, distributors can operate with a unified “single view of the truth” to drive out costs, improve operational performance, and ultimately, move beyond disruptive expansion to achieve solid, profitable growth.

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