Second- and Third-Generation Ecommerce

A Strategic Investment for Growth in Wholesale Distribution

A Special Report from Benfield Consulting

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Executive Summary

Many wholesale distributors increasingly recognize the critical importance of ecommerce to growth and customer satisfaction. In fact, implementing or expanding ecommerce capabilities was the top-ranked technology priority in 2013 for distributors surveyed by Modern Distribution Management, cited by 44% of respondents, just ahead of CRM.[1]

Other distributors, however, especially in the small and mid-sized market, have yet to introduce ecommerce, or labor ahead with first-generation platforms that lack the capabilities to meet rapidly changing B2B customer demands. While figures vary, many studies have estimated that only about 30% of wholesale distributors have legitimate ecommerce capabilities in place.

Understanding the evolution of ecommerce in wholesale distribution, and the distinctions between systems deployed a decade ago and today's leading technology, is essential for wholesale distributors to take full advantage of the ecommerce channel to power growth by entering new markets and meeting B2B customer demand for a B2C-like buying experience.

From B2C to B2B: First- to Second-Generation Functionality

Wholesalers began adopting ecommerce in the mid to late 1990s, along with other B2B sectors, with steady growth over the past 15 years. Today, Forrester estimates the B2B market size in the U.S. at $559 billion versus $252 billion for B2C ecommerce.[2] The percentage of wholesaler sales that have migrated to ecommerce is estimated at approximately 25% of total revenues.[3]

Originally, many wholesalers deployed first-generation ecommerce platforms geared for B2C markets and adapted them to their business. While B2C platforms have evolved over the years, they have not kept pace with the complexity that's intrinsic in B2B markets. For instance, in customer ordering, the B2C format is open—anyone with a valid credit card can order.

In B2B environments, however, order values are often large and budgets can go into the millions for products ordered from wholesalers and rarely use credit cards as a payment method. To minimize risk, second-generation B2B ecommerce platforms enable both buyers and distributors to view and control purchasing activity with such techniques as access codes for authorized individuals at buyer organizations.

Similarly, a B2B ecommerce platform needs functionality to assign products to certain geographies to comply with manufacturer restrictions on geographic distribution. B2B ecommerce software typically has a zip code match to manufacturer-approved territories. Without exact territory approvals, wholesalers can violate agreements with manufacturers on distribution rights and risk punitive fees, litigation and loss of resale privileges.

Second-generation ecommerce functionality for real-time inventory management is also critical for wholesale distributors, as delays can cost a buyer thousands of dollars a day in certain time-critical projects. As B2B relationships are ideally long-term and based on value and service, a lapse in inventory availability or another misstep can mean more than a lost sale—it can mean a lost account worth millions of dollars.

[1] *Modern Distribution Management and NetSuite, "The Outlook for Wholesale Distribution 2013," January 25, 2013.*

[2] *Forrester Research, "U.S. B2B Ecommerce Sales to Reach $559 Billion by the End of 2013," blog post, October 18, 2012.*

[3] *U.S. Census Bureau E-Stats, 2011 at: http://www.census.gov/econ/estats/2011reportfinal.pdf*

To sustain and grow business relationships, leading wholesale distributors leverage technology to simplify and automate information exchange and transactions with buyers. Ecommerce is often augmented with "punch-out" technology that connects the distributor's product catalog with the buyer's procurement application, and with electronic data interchange (EDI) to facilitate transactions and information exchange.

Beyond back-office inventory management and information exchange, wholesale distributors have to address unique and complex B2B requirements in pricing, shipping, returns and credit.

Pricing

Pricing in B2B markets is more complex than in B2C markets, in which prices are often established by product category and price changes are made through coupons or mass discounts. Wholesaler pricing can vary by any number of events or classifications, including customer type, customer size, product category, SKU sales rank and special considerations, among others. Linking complex pricing algorithms to customer purchases is essential for profitability. Most wholesale distribution companies average just 2% to 3% return on sales, making pricing mistakes in a razor-thin margin business extremely costly.

Shipping

In B2C environments, shipping options are straightforward with the vast majority of shipments going to the buyer's residence by a vendor-selected shipper. In B2B markets, shipments can go to any number of locations including headquarters, field offices, manufacturing plants and job sites. Shipping options are similarly complex depending on customer needs and shipment size and value. Drop-shipments account for 10% to 20% of shipping, but options such as customer pick-up from the vendor also are common.

Depending on the physical properties of the product, parcel post, LTL (less than truckload) delivery, emergency shipment or air freight are often used. To the extent these choices can be automated and included in the ecommerce checkout, the better and more complete the customer experience becomes.

Returns

The most expensive process in wholesale distribution is reverse flow operations. Returned goods make up the majority of reverse flow movement of goods, typically costing 3x to 5x more than standard ordering. In second-generation ecommerce platforms, customers can request return material authorizations (RMAs), provide reasons for the return (ordered wrong, wrong specifications, defective, etc.) and select the return shipment mode.

While returns are less than 2% of total sales piece volume, optimizing their handling is critical because of their costliness and importance in customer satisfaction.[4]

Credit

Extending credit to customers is an important function for wholesale distributors and, unlike B2C environments, customer credit balances can run in the tens of thousands of dollars or more. Because of the monetary risk of large credit balances, and thin margins that require careful management of working capital, wholesale distributors are in constant contact with customers regarding account balances.

A well designed ecommerce system gives both customers and distributors complete, easily understandable information to manage credit and avoid disputes. The account balance should supply line-by-line detail on a complete history of orders, pricing, returns and disputes, as well as discounts and special charges. A robust payment history makes it easier for the customer to pay without taxing internal accounting resources of the wholesaler.

[4] *MBenfield, S., Griffith, S. Disruption in the Channel, Power Publishing, pg. 60, 2007.*

B2C vs. B2B Ecommerce Requirements

Functional Area	B2C	B2B
Ordering	Open purchasing	Approved ID for account purchases
Product coverage	No restrictions	Manufacturer-approved territories
Product specs	Limited information	Detailed specifications and cross-references
Purchase history	Basic amount and order date	Detailed history with complete product, pricing and delivery information
Inventory availability	Approximate information	Real-time quantities available
Pricing	Simple, standardized pricing	Complex pricing customized to accounts
Terms	Simple, standardized terms	Highly specific and customized for each company
Shipping	Basic, usually the vendor's choice	Numerous options for shippers, addresses, drop-shipments selected by customer
Returns	Notice of return to retailer	Complex with RMAs to vendor, pick-up instructions, restock and freight charges
Payment history	Limited invoicing, payment by credit card or PayPal	Complete history, dating and discount terms, late charges, notations on disputes and returns

Figure1. *Critical differences in requirements and processes for B2C and B2B commerce.*

In summary, the needs of the B2B customer for ecommerce solutions are substantially more complex than can be met by first-generation B2C systems, while today's best B2B ecommerce systems obsolete the early B2B ecommerce models introduced 15 or so years ago.

Many wholesalers, however, are saddled with old technology ecommerce platforms cobbled out of yesterday's B2C models. Those running outdated systems are often at a strategic disadvantage in their ecommerce sales, transactional capabilities and ability to meet the demands of modern customers.

Third-Generation Functionality and Beyond: A New Playing Field

While wholesale distribution firms recognize the importance of ecommerce, many view it as predominantly a transaction engine rather than a strategy that can disrupt markets and open new avenues to competitive advantage. For instance, a recent Benfield Consulting study found that 60% of wholesalers agreed with the statement, "ecommerce is predominantly a transaction technology."

Leading wholesale distributors, however, have long treated ecommerce as a top strategic priority, and continue to do so. Consider the Fortune 500 industrial supply company W.W. Grainger. Launching its ecommerce website in 1995, Grainger has grown online sales to 30% of its $9 billion in 2012 revenues.[5] Not resting on success, the Chicago-based company in spring 2013 announced 300 new hires dedicated to IT and ecommerce.[6]

Meanwhile, big box retailers are winning business from traditional wholesale distributors, in part because of their comparatively advanced ecommerce capabilities. One research study found that contractors are making nearly half their tool and building supply purchases from big box retailers, up significantly from the past.[7] Still, contractors rank distributors higher on customer service, knowledge and relationships, the study found.

To better compete, wholesale distributors are increasing their investments in ecommerce. Like the Modern Distribution Management survey, research by Benfield Consulting finds that a large community of distributors in the $25 million to $250 million in sales and above range is planning to upgrade or adopt ecommerce functionality.

Wholesaler distributors entering ecommerce today have significant advantages over the intrepid firms that pioneered the technology in the early years. Rather than struggling with limited functionality and jury-rigging B2C platforms for B2B markets like the pioneers, distributors can leapfrog competitors by leveraging proven B2B ecommerce technology that has evolved toward a third generation of capabilities.

The third generation of B2B ecommerce technology is characterized by integration with ERP and CRM, cloud-based technology and advanced applications such as cross-referencing and catalog extensions.

Integration with ERP and CRM

In first- and second-generation ecommerce deployments, distributors were forced into costly, time-consuming custom integrations between an ecommerce storefront and back-office financials, as well as CRM if a system was in place, with many having four or more bolt-on applications in place. If a distributor tried to run without integration, staff spent inordinate time rekeying data across systems, sapping resources that could be better spent on innovation and customer service.

Today's best B2B ecommerce systems can be deployed as part of an integrated solution that includes ERP and CRM, eliminating IT maintenance and administrative overhead while giving the distributor a single, reliable data set that updates in real time. Properly implemented, these pre-integrated systems can dramatically improve business visibility and control to optimize pricing, ensure adequate stock, streamline manufacturer relationships and satisfy customers.

[5] *W.W. Grainger, "2013 Fact Book."*

[6] *Chicago Sun-Times, "Grainger Expanding Downtown Offices, Adding Jobs," May 30, 2013.*

[7] *Ireland, B. "Electrical Contractor Purchasing Practices," EC&W Magazine, April 2012 at: http://ecmweb.com/contractor/electrical-contractor-purchasing-practices*

Cloud-Based Technology

Similarly, many first- and second-generation B2B ecommerce systems required expensive on-premise servers and backup systems, and a squadron of IT professionals to maintain them. Besides cost and complexity, these in-house systems posed a significant risk to business continuity should a server fail or the business suffer a natural disaster.

With a cloud approach, software and servers are hosted by a Software-as-a-Service (SaaS) provider, with financial, inventory, manufacturer, customer and other data accessible on demand from any device with a web connection. The cloud obviates costly capital investments, enabling distributors to channel resources into growing the business.

Advanced Applications

New capabilities for such functions as cross-referencing and catalog expansion are characteristic of third-generation B2B ecommerce systems, giving the distributor ability to easily add items to an e-catalog and solicit and sell an expanded portfolio of SKUs without the cost of the outside sales force. Cross-referencing can be an effective way to land new customers from the web, by elevating a distributor's visibility in results to searches on Google or a mega-content provider like the industrial parts search engine WayPart.

Meanwhile, catalog extensions enable distributors to rapidly expand e-catalogs using outside content providers. Often wholesalers display content for less than 20% of the products they are authorized to sell; that number can increase dramatically by showcasing products on an ecommerce site that a distributor may not have in stock, but can access and sell.

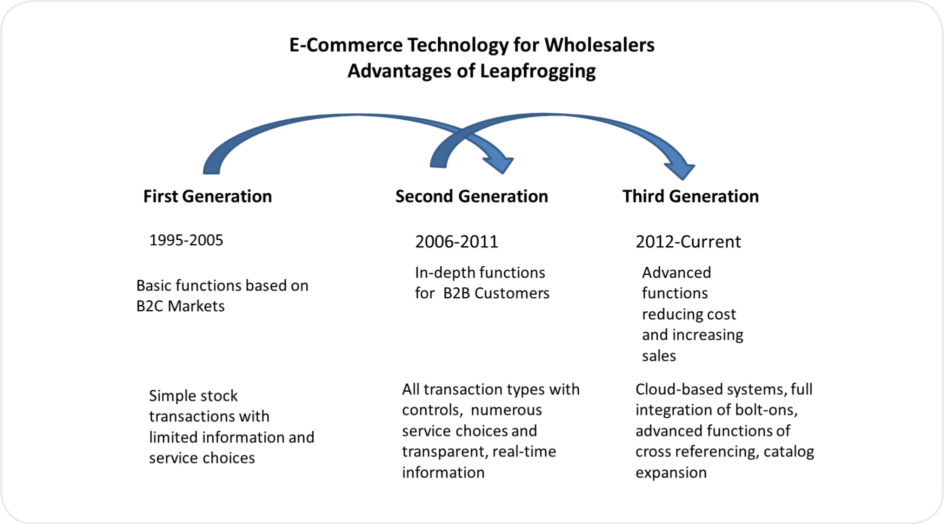

Figure2. *The three generations of B2B ecommerce.*

Wholesalers newly entering the ecommerce space have the advantage of leapfrogging earlier ventures of their competitors. The technology and capabilities of software are increasing and new technology entrants often have significant advantages over existing platforms that were around during the first and even second generation. Wholesalers looking to upgrade from legacy systems minted before the ecommerce revolution began may find it less costly and more strategically viable to adopt new cloud ERP platforms that bundle ecommerce, financials, inventory and CRM in a single application.

Beyond the Third Generation

Many industrial buyers increasingly choose wholesaler suppliers based on the ease of doing business with via ecommerce, and they expect an experience comparable to that of B2C shopping. The reliance of "feet on the street" to differentiate commodity products is past its zenith and in slow decline. Wholesalers have compensated by entering further into the value chain with services and assembled products; however, they need to protect BIBO (box in/box out) sales with a reduced cost platform led by ecommerce technology.

Wholesalers that don't transition toward third-generation ecommerce technology risk loss of a substantial portion of their BIBO sales. Cloud-based applications, full integration with ERP and CRM, catalog expansion, cross-referencing and other third-generation functions offer substantial advantages in a new age in which ecommerce is a necessity. The technology race is full-on to service B2B buyers, and how effectively wholesale distributors meet the challenge will shape their fortunes for years to come.

About the Author

Scott Benfield is President of Benfield Consulting. Scott is the author of six books and numerous research projects for the distribution supply chain. Since 1998, he has consulted for a variety of Fortune rated and smaller B2B firms in sales, marketing and operations. Benfield Consulting is based in Chicago and services can be viewed at www.benfieldconsulting.com.