



Your Amazon Business Playbook

A Strategic Evaluation for Distributors



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About this Report

This report, focusing on distribution's omnichannel future, follows Amazon's rise as it rapidly built the competencies needed to master B2B distribution the way it mastered the online bookstore. This report examines the threats that Amazon poses, the rise of Amazon Business – formerly AmazonSupply – and why it presents a clear threat to today's distributor. We explore where we think Amazon Business is heading with its adaptive model and why its threat to your business has turned from disintermediation to displacement.

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Overview: The Threat

The purpose of this MDM report is to help you take your Amazon response strategy from best guess to a more analytical approach. In the absence of a clear Amazon B2B strategic roadmap, it's critical for distributors to build a customized response – now – based on known facts, the historic record of Amazon's exploitation of other mature industries and a strategic calculation on how your company can continue to grow as Amazon Business pushes into B2B procurement.

From a broader industry perspective, many executives have adopted a wait-and-see approach to Amazon's potential impact, which has been appropriate up to now – there has been relatively little circumstantial evidence to do otherwise.

In 2018, our view is that the industry as a whole has to shift quickly from a fear-based, defensive position to a more proactive stance. The industry has to find ways to proactively address Amazon's displacement strategy that we outline in this report. Up to now, the platform has been

smoldering; the smoke has grown quickly in 2017. It's time to lead from a clear sense of distress about the need to change the current state that's deeper than a fear of Amazon.

Responding effectively to Amazon Business will likely require a more aggressive approach to collaboration. Because Amazon is a software development company, a logistics powerhouse, a retailer and a world-class user of data and artificial intelligence, the distribution industry may need to enroll companies with those capabilities in its efforts to compete in the long term.

Someone was going to disrupt distribution, just as many other mature industries have been disrupted. Netflix killed Blockbuster. Uber and Lyft decimated taxi companies. Barnes & Noble missed the opportunity that Amazon saw clearly. The riskiest strategy is to maintain the status quo by underestimating the fast-developing threat of Amazon Business. This is the time to be proactive and aggressive in your strategy, not reactive.

Key Takeaways on Amazon Business

- Amazon Business did not emerge from the smoke of the Internet two years ago. Amazon acquired Smallparts.com in 2005 and changed its name in 2012 to AmazonSupply, which then transitioned to Amazon Business in 2015. It sold 500,000 SKUs in 2015; at the start of 2018, including its marketplace, Amazon offers more than 500 million.
- The company has leveraged more than a decade of research into B2B and distribution verticals into a rapidly accelerating and self-improving model that partners and competes with traditional distribution models at the same time.
- Wholesale distribution executives are putting too much weight on Amazon Business' impact in the short term, and probably not enough in the long term. The vast majority of distributors won't experience a direct assault from Amazon Business. But just about every distributor will feel a "death-by-a-thousand-paper-cuts" impact, where many easy-to-ship and commodity items will be increasingly price-shopped.
- A well-founded concern about Amazon is not just their stellar logistics and supply chain expertise at this point in B2B, but the depth of their pockets and lower profit percentage expectations from Wall Street. They are operating under entirely different laws of economic viability than their competitors due to their scale, model and long-term orientation.
- Their current build-out in industrial and construction verticals is similar to the strategy they started with books, music, toys, gifts, video, etc. This strategy is outlined in Jeff Bezos' 1999 letter to shareholders (archive of shareholder letters at this [slideshare.net link](#)). Note the key points in the section, Goals for 2000. The company has not changed significantly in its approach to each vertical, and while hugely successful in some sectors, has faced challenges in others.

- A positive impact of the recent hype-fest has been to get the industry's attention. But it's important to focus on a single word: multichannel. Search and research it on our site. Be concerned if managers in your company are still saying, "Our customers aren't shopping or buying with apps or mobile sites, email or Web; we serve them personally between the hours of 7 a.m. and 5 p.m." These are the companies Amazon is targeting with its brand of customer service.
- Amazon Business has expanded beyond an initial strategy to capture "long-tail" unplanned purchases to the much larger e-procurement indirect materials purchasing market segment.

Amazon's Strategies and Capabilities

The current environment in B2B e-commerce

In 2017, 44 percent of all online sales in the United States went through Amazon. Traditional retailers that sell everything from motorcycle gear to general merchandise to fashion apparel feel the pressure. Iconic companies like Sears are supposedly on the verge of going out of business and even Walmart acknowledged Amazon's growing threat by paying \$3 billion for Jet.com, a company that had never turned a profit but could act as a foundation for future e-commerce pursuits.

To some degree, this is all just history playing out all over again. Many years ago, Sears, Roebuck & Co. wiped out countless local general merchandise stores. Various companies have dominated general retail since then, so the emergence of Amazon is nothing new.

Or is it? This battle feels different because it is different. As those of us in B2B distribution know, Amazon poses a big threat in channels where previous retail stalwarts never ventured. The company is competing with everyone – Best Buy in electronics, Google and Apple in artificial intelligence, 20th Century Fox in entertainment, McKesson in pharmaceuticals, Apple and Netflix in media distribution. It is even wielding devices like the Kindle against hardware from Google, Apple, Samsung and Motorola.

In addition to competing with every single retailer.

Jeff Bezos has ignored all of the basic rules of strategic planning – he doesn't "stick to the knitting," he doesn't mind moving into non-adjacent industries (see: Whole Foods) and he apparently has no short-term concerns about generating a "competitive" return on the company's sales, preferring to focus on driving the stock value through relentless growth. If you think your business isn't threatened by Jeff Bezos' behemoth, you are either naïve or in possession of a strong set of competitive advantages.

Bezos has broken all of the paradigms of

business planning and thus built a juggernaut that's as unconventional as it is threatening. That means we have to disregard much of what we have learned about running distribution companies if we want to compete.

What's at stake? B2B distribution moves more than \$5 trillion in products through the U.S. economy annually, roughly 30 percent of GDP. If Amazon Business scoops up 10 percent of that market using the same "ease-of-buying" approach it built in consumer markets and then picks up another \$500 billion in retail, AWS and other markets, it could become a trillion-dollar company, primarily on the backs of distributors. That doesn't count B2B revenues it is already actively growing in many other countries.

Amazon will likely report sales in excess of \$170 billion in 2017; to keep growing it needs large markets poorly defended by incumbents. Given that Amazon is many times the size of most distributors and immeasurably better at leveraging technology, wholesale distribution is likely to remain in the company's bull's-eye for a long time.

What's the real risk? For many years, analysts predicted distributors were at risk of disintermediation, removed from the supply chain by manufacturers leveraging digital platforms to cost-effectively sell directly to users. That risk never materialized, but Amazon Business has crafted a deeper value proposition that threatens *displacement* – removing distributors from the primary customer relationship or at least pushing them into the role of second-tier suppliers. Every indicator in 2017 is that Amazon's eProcurement strategy is accelerating.

All the talk about disintermediation may have lulled the industry into complacency but displacement is a genuine and immediate threat.



What's the game-changer? One of the world's leading technology companies that also happens to have one of the largest assortments of products anywhere has become a new kind of competitor: software company, artificial intelligence expert, online marketplace, logistics and distribution powerhouse.

Distributors look at competition through a product lens. Putting vending machines in customer facilities is an example of how distributors are attempting to "build moats" to keep out competitors. In contrast, Amazon is using a combination of capabilities to position its B2B unit as an overwhelming choice to be the first source for any purchase. Only if the company does not have the product or appropriate capabilities will the buyer be directed to another source.

Amazon Business plans to build electronic walls around your customers and overwhelm the

moat you've built to protect your value proposition. Compare the size and power of a moat to the size and power of the Amazon River. That's the battle you're engaged in. Amazon is going to use artificial intelligence for voice ordering from Alexa and input from sensors and devices across the customer's enterprise to understand and predict their needs before you even know about them – and in many cases before the customer knows about them.

Strategies to compete

So, how do we understand the Amazon effect in distribution, separating the actions that actually threaten distributors (selling products to businesses) vs. those that don't (Amazon Music streaming)? More importantly, why is Amazon so focused on the B2B distribution market?

B2B distribution is a massive market, es-

Commentary: Amazon Attacks Industries, Not Companies

Amazon isn't focused specifically on beating your company in the marketplace. Amazon is focused on beating you and all other B2B distributors in the marketplace. Amazon Business is bringing a new distribution model to bear; what if your customers really do prefer it for a large portion of their purchases? What will you do then?

There's a popular post circulating on LinkedIn that goes like this:

- Amazon did not kill the retail industry. They did it to themselves with bad customer service.
- Netflix did not kill Blockbuster. They did it to themselves with ridiculous late fees.
- Uber did not kill the taxi business. They did it to themselves with a limited number of taxis and fare control.
- Apple did not kill the music industry. They did it to themselves by forcing people to buy full-length albums.
- Airbnb did not kill the hotel industry. They did it to themselves with limited availability and pricing options.
- Technology itself is not the real disrupter.
- Being non-customer centric is the biggest threat to any business.

Ignoring the hyperbole (of the alleged victims noted above, only Blockbuster is actually "dead"), this post is provocative because it looks at the issue of innovation through the lens of customer focus instead of technology. Many people love this post and have shared it on LinkedIn many times.

Here's the problem: This post is wrong and highly misleading. Amazon, Netflix, Uber, Apple and Airbnb utilized technology to build entirely new value propositions that simply offer better solutions for some customers than the traditional business models they displaced.

Blockbuster could have had the finest customer service in the world and no late fees and the world was still going to stream movies instead of renting tapes or discs.

Technology is absolutely the disrupter in all of these examples. Amazon Business is using technology to build a new value proposition and the company is attacking traditional B2B distribution with it.

It's possible that the collective, individual responses of distribution companies will be insufficient to battle this new competitive threat. Since Amazon is attacking the distribution industry, the industry must work together to fight back. This will require an unusual set of alliances and some paradigm-busting thinking that results in new value propositions that combine online and offline capabilities.



estimated as a \$6-trillion industry in the United States. The market is made up of relatively small companies that buy from lots of suppliers and sell to lots of customers, all while managing an increasingly complex supply chain. For a gigantic company like Amazon that is really good at buying and selling, and needs to grow for a long time, the market is big enough to provide expansion opportunities for decades.

They're coming at us hard and determined to win

While Amazon's capabilities are constantly expanding, it is not very good today at some things where you can have a clearly differentiated advantage with your customers. But you're going to need to invest in those advantages to resist the onslaught and grow your own business.

As attributed to a banner in Walmart's headquarters long ago, the first rule of this particular war is: "You can't out-Amazon Amazon." Some distributors have carefully watched what Amazon has done and attempted to become just like them, which is logical but also wrong.

At its core, what Amazon does better than anyone is:

1. Offer a wide variety of non-customer-specific products for sale on a great website
2. Stock these products in large quantities at distribution centers all over the U.S. and make even more products available from third parties who drop ship on their behalf
3. Fulfill these orders rapidly, primarily on common carriers (mostly USPS and UPS)

If, in an attempt to become the Amazon of your industry, you have built this business model – thinking you were learning from the best and applying the lessons effectively – what you did

instead, and by accident, was put your company right into Amazon's crosshairs. You will not be better than Amazon at items 1-3. Instead, you need a new plan – fast.

Preparing to fight

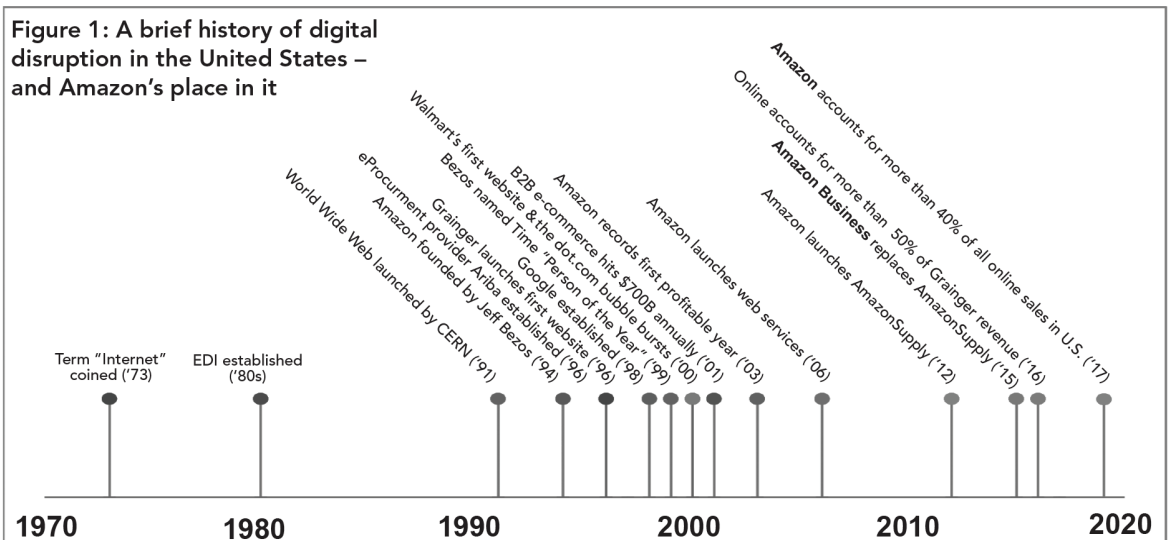
We human beings have a tendency to oversimplify all activities into a single number, and in distribution a general measure of success is, "What percentage of your sales are online?" Grainger claims that 60 percent of its sales come from online purchases and projects that number to grow to 80 percent by 2022; this is broadly recognized as enviable.

But a high percentage of online sales not accompanied by strong non-digital capabilities may be a warning sign that your business is easy to digitize and more vulnerable to Amazon. Conversely, a business model that's difficult to digitize helps insulate it from a pure online seller like Amazon.

That doesn't mean you don't need to have great online capabilities. Customers want the opportunity to transact electronically. You should be selling a substantial amount online, but it's not as simple as "the higher the percentage of online sales, the better."

The ideal combination is to have highly competent digital capabilities that drive lots of online sales along with a set of offline capabilities that ensure you are maintaining strong relationships and delivering other value to customers. A combination of other capabilities that may include strong sales relationships, a dedicated delivery fleet, customer-specific products, private label goods, training, local will call, specified goods, excellent phone support and other initiatives can provide benefits that both

Figure 1: A brief history of digital disruption in the United States – and Amazon's place in it



Amazon Business: Growing List of Powerful Capabilities

The Amazon Business value proposition is extensive and growing. Here's some of what Amazon Business is offering your customers today:

- **Free, two-day shipping** on orders of eligible products through Business Prime, which costs \$499 per year for a maximum of 10 users, \$1,299 per year for up to 100 users and \$10,099 per year for "Enterprise" customers with more than 100 users
- **Inside sales reps**
- **Multiple users** for a single account with shared payment methods and approval workflows
- **Search page** tailored by industry
- **Offers from multiple sellers** on one page
- **Reviews** from other customers
- **Help with technical questions** utilizing the "Live Expert" button that allows you to chat or email with product experts from manufacturers
- **Pricing and products available only to registered Amazon Business users**, including quantity pricing
- **Email confirmation** with projected delivery date
- **Specialized seller options** – minority owned, women owned, small business
- **Amazon.com corporate credit** – approved accounts buy by PO with 55 day, no-interest terms. If you qualify for this, you also get a dedicated Account Manager. Customers also have options for a revolving line of credit with a 12.99 percent APR and purchasing cards.
- **Tax exemption** on qualified purchases
- **Detailed, customizable analytics** with information downloadable and sorted by user, organization, product category, etc.
- **Punchout support** offered for at least 54 purchasing systems like Ariba, Coupa, BuyerQuest, Oracle iProcure, SAP-SRM, etc. Integration is configured via a drop-down menu and instructions to walk you through the process.
- **Integration with other business purchasing systems** such as ExpenseWatch to help businesses monitor and manage spend and expense reports.
- **A "combined value proposition" for "Channel Associates"** – such as group purchasing organizations, associations, etc.
- **More than 500 million products** in the U.S.

enhance your online sales efforts and provide barriers to entry for pure-online competitors.

Grainger is distribution's poster child of a company that has leapt into online selling, and while it's easy to criticize them for it, this was a rational and profitable decision at one time, given what we all knew about Amazon. Amazon had put Borders out of business and had put a serious whipping on Barnes & Noble, and it really looked like spending your precious capital on retail-style environments was not a good idea when you could leverage a website, distribution centers and common carriers to get a superior return.

Indeed, 10 years ago, many industry observers were praising Grainger for becoming the "Amazon of distribution." Few anticipated that Amazon would decide to become the Amazon of distribution. Once it did, Grainger suddenly found it had a business model much like Amazon's. Except less effective because no one does it better than Amazon, and distributors' historically successful cost structures and tiered pricing

practices came under intensive fire from Amazon's "new" cost-to-serve and one-price-for-all business model.

Thus, the aggressive price-cutting plan Grainger is implementing. The company receives a lot of criticism for this but we believe it has no choice and is now playing the "long game" that Amazon has played for much longer.

In retrospect, it looks like instead of closing down branches, firing sales people, reducing investments in sourcing and other capabilities, distributors should have enhanced these services in ways that would have preserved and improved their differentiation from pure online players. You can't out-Amazon Amazon, but you can make it hard for Amazon to be a better distributor than you.

The disrupter becomes the disrupted

Just about every juggernaut eventually runs into a competitor or a market that it can't dominate.

Walmart never figured out how to beat Target, who thrived while Kmart was crushed. Cost-



co stood up to Sam's Club (Walmart's wholesale division) and thrived as well. Motorola was once the absolute dominant player in mobile phones and then was crushed by Nokia, which was subsequently destroyed by Apple – which then invented the tablet (iPad) only to find that Microsoft (which initially dismissed the tablet computer) is making huge inroads into corporate markets with its Surface products. Google+ never challenged Facebook despite the nearly-unlimited capital of its parent company.

The competitive environment keeps changing. Huge corporations like Amazon that decide to “pick fights” with an enormous set of powerful competitors tend to narrow their focus over time. If smart distributors make good decisions to protect their core businesses and make it expensive and difficult for Amazon to succeed, perhaps we can slow it down or drive it into a niche.

It's not surprising that Amazon has jumped into B2B distribution; after all, the company has entered a variety of industries, including hardware, entertainment, cloud-based storage and others. But distribution is more similar to Amazon's traditional retail business, allowing it to make rapid progress and setting it up for long-term growth in sales and market share.

An increasingly digital market

Amazon is pursuing a market that is already moving in its direction. In February 2017, Deloitte released its annual survey of chief procurement officers and found that “75 percent of CPOs believe that procurement's role in delivering digital strategy will increase in the future,” and that “technology will impact all procurement processes to some degree.”

The survey claimed analytics would be the technology area with the most impact over the next two years. The study also concluded that the “main barriers to effective application of digital are data, systems and people (skills).”

Amazon Business is clearly building a B2B distribution model designed to appeal to a CPO's need to implement digital purchasing:

- Amazon Business is easy to use and familiar to people with regular Amazon accounts, meaning it takes no special skills – it will be simple to train employees how to use it (and train buying professionals how to administer purchases)
- Amazon Business promises to simplify data challenges with extensive, standardized product attribution

- The Amazon Business/procurement system integration configurator appears to be simple, with clear instructions

These characteristics, along with its enormous marketplace, have allowed the company to build momentum quickly. Amazon formally launched a B2B initiative in 2012 with AmazonSupply and leveraged its learnings into Amazon Business in April 2015.

In July 2016, little more than a year after the repositioning, Amazon Business had signed up more than 45,000 suppliers, 400,000 business customers and surpassed a billion dollars in sales. By July 2017, Amazon Business claimed 85,000 suppliers and 1 million business customers. The company also said that more than half of its transactions came from “third-party” sellers (many of them distributors), meaning the same model that has worked for consumers appears to be working in the B2B market.

Amazon doesn't break out revenue and expenses for its segments, but the company has shown a willingness to invest heavily in its Business division, having expanded into Germany in December 2016 and other countries, including the United Kingdom, in 2017.

Amazon's “customer obsession”

Perhaps what we learned about strategy over the years was wrong – or at least less than ideal. Jeff Bezos is not constrained by theories, focusing instead on consistent customer-centric thinking — often putting customers' benefits ahead of the company's.

This is not new. In a July 2010 interview with PBS, Bezos said, “Our profitability is not our customers' problem. We don't take the point of view that we're going to price products at a particular margin for ourselves. We say we're going to price products competitively and if that means on that product that we lose money, that's OK because we need to take care of the customer, and earn trust, and we'll figure it out over time, and if we find we can't ever make money with that product, we'll stop selling it. But we're not going to make customers pay for any of our inefficiencies.”

Regarding new initiatives, he said, “Most (new) businesses have either no impact on our financials for the first five to seven years or a negative ... and we do a lot of new things. The company is very healthy financially and we're doing very well. It's an outcome of customer obsession.”



Targeting Grainger & Beyond

Follow the long tail to Amazon's eProcurement strategy

In September 2016, RBC Analyst Deane Dray reviewed transcripts from antitrust litigation on the proposed Office Depot and Staples merger (which was ultimately blocked by a federal court). He wrote that during depositions, Amazon Business head Prentis Wilson identified Grainger and Staples as his business unit's primary competitors. Dray concluded that Wilson singled out Grainger because the company sold to many small and medium-sized businesses, which was apparently Amazon Business' target market.

We think that's too narrow a view of where Amazon Business is going. There's more at stake here – much more. Amazon Business is aggressively pursuing large procurement organizations – including Siemens, Stanford University and countless others. The way this plays out over the next few years will impact every type and size of distributor.

Amazon strategy tea leaves

Since the man responsible for driving Amazon's B2B strategy specifically identified Grainger as a primary competitor, let's consider the history of that well-known industrial distributor.

B2B distribution has evolved based on serving highly fragmented customer markets, with discrete product verticals developing to serve them. But while most distributors historically specialized in relatively few specific industries or product categories, Grainger diversified to become the broadest of the broadline distributors. At one time, its network of more than 600 branches gave it a stocking location within a 25-mile radius of most U.S. businesses.

Twenty years ago, Grainger differentiated its value proposition by focusing not on industries or product categories but by purchasing situations common to businesses of all sizes:

1. **Speed and convenience:** when customers needed products quickly and with no hassle
 2. **Long-tail revenue:** where Grainger wanted to get a little revenue out of every customer, while most distributors tried to get a lot of revenue out of a small number of customers
 3. **Low-complexity products:** which required little or no technical expertise to sell
- Over time, Grainger's strategy evolved. The company began to focus on the purchasing organizations of larger businesses, agencies and

institutions. It developed and acquired the capabilities required to sell more complex product categories such as lighting, material handling and safety.

The result of this evolution is that about 60 percent of Grainger's 2016 revenue of \$10.1 billion was in its U.S. large business segment (\$6.1 billion). Medium-sized businesses made up 9 percent of revenue, while its U.S. small customer business was about 10 percent (see Figure 2).

Figure 2

W.W. Grainger 2016 Revenue Segmentation

	\$ Billions	%
U.S. Large	6.1	60%
U.S. Medium	0.9	9%
Small/Single Channel	1.1	11%
Canada	0.7	7%
International	0.8	8%
Specialty Brands*	0.5	5%
Total	10.1	100%

*Specialty brands includes E&R Industrial, Imperial Supplies, Techni-Tool.

Source: 2017 Grainger Fact Book

Amazon Business has effectively attacked Grainger's traditional capabilities: it built a model to win speed and convenience purchases from every type of business and will likely never "specialize" in an industry or product category. That means the company does not sell complex products, continues to rapidly expand its assortment, focuses aggressively on customer acquisition, delivers via a powerhouse logistics model and makes it extremely easy for customers to place orders. Of course, if the parallels continue, Amazon Business is likely to get into more complex products over time.

These are Grainger-like attributes, but Amazon Business is not like Grainger in important ways. Amazon also:

- Created a "third-party seller" model that allowed it to expand its assortment to hundreds of times the size of Grainger's, which gives it a powerful advantage to access long-tail revenue

- Wields a vastly larger supply chain
- Offers lower pricing (generally)
- Operates at a lower cost basis
- Drives its stock valuation through breathtaking revenue growth instead of breathtaking EBITDA margins.

You've heard that you can't "out-Amazon Amazon," but Amazon Business seems determined to "out-Grainger Grainger." Even if you have never viewed Grainger as a direct competitor, you are still vulnerable to Amazon Business because it is going to efficiently capture long-tail sales that often account for a significant percentage of many distributors' high-margin revenues. The company will also likely wield its best-in-the-world capabilities in artificial intelligence to sell complex products in ways distributors can't match.

Purchasing power

When Amazon Business announced in July that it had reached 1 million customers, the press release quoted Drake Praben, director of IT procurement, Siemens Corp. (U.S.), who said, "Our teams may need tools delivered in a matter of hours, large amounts of office supplies, or big pieces of machinery for our factories. With Amazon Business, we're able to automate a lot of orders and give our employees, divisions and factories the products they need to complete their jobs in a timely manner. We are looking forward to expanding our procurement capabilities with Amazon Business."

The release also quoted chief procurement officers from Stanford University, King County, WA, and a variety of other organizations now buying from Amazon Business. Internet searches reveal dozens of entities announcing purchasing relationships with Amazon Business – some simple procurement card arrangements but many with deeper eProcurement system functionality like punch-out and customer-specific pricing.

It's no surprise that Amazon Business appeals to small companies; their purchasing habits are similar to the consumers the company has targeted for years. Midsize companies are more likely to have centralized purchasing and various controls around their buying; Amazon has developed solutions for these customers as well.

On the other hand, it seems surprising to many that Amazon Business is aggressively signing up some of the largest corporations in North America. These are the types of customers coveted by major industrial distributors. What strategy has allowed this relatively new player to

appeal to thousands of large purchasing organizations without the traditional strategic-account selling paradigm successfully used by distribution companies for decades? Just as urgent a question: How should distributors respond?

Amazon Business seems to be following the Grainger strategy up-market in eProcurement as well. Grainger has been at the leading edge of digital selling and strategic procurement since the early 1990s. The company rapidly expanded its product assortment, product data and system integration capabilities to capture long-tail purchases from thousands of major corporations, agencies and establishments – these are situations where customers quickly need countless miscellaneous products that have a sporadic demand pattern but are difficult and time-consuming to source.

In these situations, customers don't need high levels of technical support; they require high levels of services around purchasing controls, sourcing, ordering and fulfillment. Amazon checks these boxes.

These customers tend to be less price-sensitive; since Grainger is among distributors with the easiest ordering, top-notch integration capabilities, best supply chain network and broadest assortment, it was only natural for major procurement organizations to rely on the company for long-tail needs. By offering great solutions for these requirements, Grainger became a market share leader in MRO while maintaining enviably high gross margins.

Until now. As evident from Amazon Business' rapid growth and Grainger's recent price-cutting actions, the competitive landscape is shifting quickly.

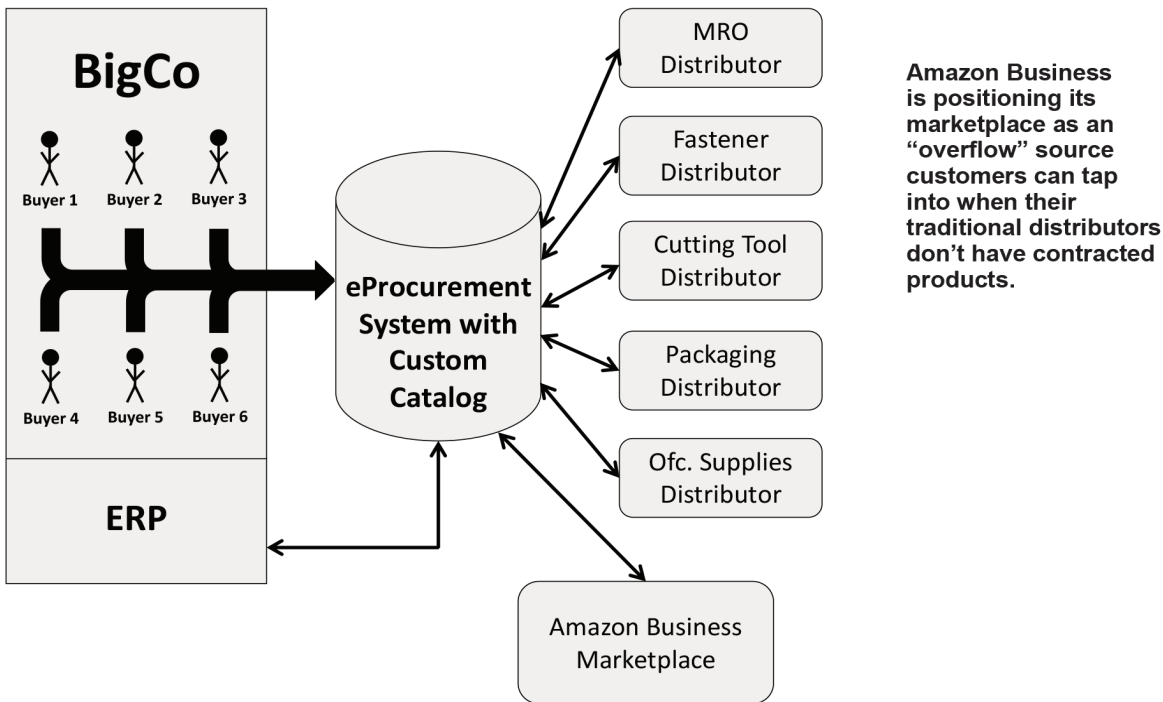
An eProcurement Trojan Horse

Amazon Business has replicated Grainger's features across these dimensions, often at lower prices and cost models and most certainly at lower profitability thresholds. The Amazon Business eProcurement selling model today looks something like this (see **Figure 3**):

"BigCo" (a fictional company) already uses a large set of traditional distributors to support its needs through contract agreements. The company has configured an eProcurement software system like Coupa, Ariba or BuyerQuest. It has spent a lot of time and money building a clean database for tens of thousands of SKUs from distributors to support its diverse set of buyers.

But no matter how many distributors and SKUs the company adds to its internal catalog

Figure 3: Amazon Business Today



Amazon Business is positioning its marketplace as an “overflow” source customers can tap into when their traditional distributors don’t have contracted products.

(or via punchout), buyers regularly complain that they can’t find items. This is frustrating for users and embarrassing for the purchasing professional responsible for maintaining the catalog.

In addition, it’s expensive and difficult to install these eProcurement systems and cumbersome for distributors to integrate into them. Part of Grainger’s advantage has been its deep technical expertise that enables the company to provide strong IT support to resource-limited procurement executives. Since procurement is a “back end” activity, IT departments tend to focus their resources on installing and developing systems more closely-related to the company’s money-making activities (e.g., manufacturing).

Currently, Amazon Business’ approach is simply to add its marketplace to the existing eProcurement model – through a simple configurator that eliminates some of the technical challenges. This solves the “item not found” problem; the Amazon marketplace includes more than 500 million SKUs and continues to grow. Most buyers can find anything they’re looking for, anytime, forever. That’s long-tail on steroids.

Presumably, procurement organizations are instructing buyers to search for items through contract agreements with distributors first – and

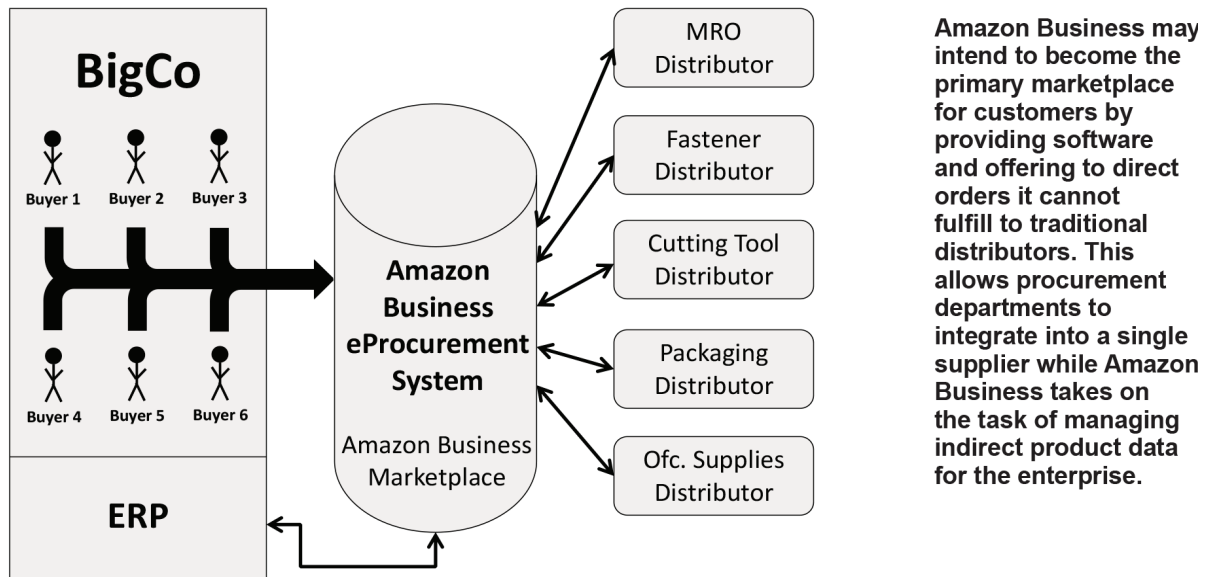
then turn to Amazon Business only if they cannot source them “on contract” (per language to this effect on the procurement websites of some institutions). If Amazon Business limited its strategy to this approach, it would position itself to become an enormous B2B distributor, a supercharged version of the model Grainger employed for many years.

However, we don’t think that’s the end game for Amazon Business. And it’s important to note at this point that no one really knows what Amazon’s strategy is, regardless of how many consultants want you to think they have the answer. There is no lack of conjecture.

As we pointed out previously, Amazon has built a unique set of capabilities: it’s a software company, an online marketplace, a logistics company, an artificial intelligence leader and a distributor while essentially all other players (and competitors) in eProcurement are one of the above. That enables Amazon to be more than a back-up supplier for long-tail purchases – it can become the primary procurement partner for large entities by providing its own software and then using customer leverage to drive other suppliers (including distributors) to sell through it.

Here’s what that model may look like in the

Figure 4: How Amazon Business Could Disrupt eProcurement



Amazon Business may intend to become the primary marketplace for customers by providing software and offering to direct orders it cannot fulfill to traditional distributors. This allows procurement departments to integrate into a single supplier while Amazon Business takes on the task of managing indirect product data for the enterprise.

future. In this model (see Figure 4), Amazon provides the procurement software to major purchasing organizations either at low cost or for free. Its marketplace becomes the first choice for non-complex products while specialized, customized, specified or highly-technical purchases make it through to other sellers, like distributors. Customers only have to integrate one supplier into its eProcurement platform and ERP; Amazon Business will manage the product data and relationships with other distributors.

This is why Amazon Business is a likely threat to your business even if Grainger is not. If a customer implements this eProcurement solution, Amazon Business will own the primary eProcurement relationship that allows them to capture long-tail purchases and direct the more complex filtered purchases they control because of their position at the top of the supplier hierarchy.

Building a new e-procurement paradigm

Amazon's value proposition is getting stronger. Amazon has hired numerous executives with experience in procurement software companies such as Ariba, Coupa, SciQuest and others including a former senior vice president of Solution Delivery from BuyerQuest.

Amazon has developed its own taxonomy called "Amazon Standard Identification Numbers" and the company continues to expand its assortment into categories that were previously

the exclusive domain of traditional distributors.

In addition, Amazon Business has announced procurement deals with organizations like the purchasing cooperative U.S. Communities and the University of Washington, and has presented at the Government Contract Management Symposium.

The Amazon Business blog, which launched in July 2016, discusses purchasing topics like "digital procurement transformation," solving "tail spend challenges" and others that are familiar to the leaders of major distribution companies that dominate the large-scale procurement supply chain.

Amazon's advantage, of course, is that while distributors buy and sell products and procurement system providers develop software, Amazon does both. That means its recent entry into electronic procurement may be just the start of an increasing set of capabilities that tie the company more closely to the purchasing departments of major corporations.

It's possible the company will provide its own procurement software at little or no cost, which would allow it to sign up countless purchasing departments and plug the Amazon marketplace into all of them. Perhaps Amazon plans to concede complex product sales to traditional distributors but pursue the "tail spend" business from large buying organizations in North America.

How to Respond: Options for Distributors

Is it time for the industry to compete with Amazon – or capitulate?

Distribution companies face a tough decision regarding their relationship to Amazon Business. Should your company resist the onslaught of this juggernaut or should you sign up to be part of its supply network?

The case for collaboration with Amazon Business is compelling, particularly in the short-term. Amazon has unbelievable momentum in B2B distribution due to its unmatched capabilities in technology, ease-of-use and distribution. Distributors have traditionally focused their investments in working capital, facilities and people. Part of the brilliance of the Amazon Business marketplace model is that it leverages the investments its partner distributors have made in these areas. This relieves Amazon of some of the capital and working capital costs typically required to stock and deliver products.

Combining Amazon's powerhouse ability to generate demand and process orders with distributors' capabilities creates an entirely new value proposition for customers. For many distributors, Amazon seems like an irresistible force, so what's the point of resistance?

Let's be clear that this is not an ethical problem. Executives are charged with driving long-term profitability for stakeholders; if partnering with Amazon Business is the best way to achieve that goal, then it's hard to argue that it's the wrong decision.

Adding to the temptation is the growing belief that eventually *some* major distributors will, in fact, announce formal collaborations with Amazon Business. Companies that make the first move will enjoy a huge advantage, at least in the short term, versus distributors that don't. Most large distributors are resisting that temptation today, but as Amazon Business builds momentum selling to major customers and exerts more leadership in eProcurement, it will get more difficult not to participate in the Amazon marketplace.

There are substantial risks to collaborating with Amazon Business. Not only is it expensive, but as currently structured, Amazon Business owns the relationship with its end customers; third-party suppliers face tight restrictions over how they market to and communicate with marketplace customers.

Perhaps the biggest risk is giving Amazon the data to "go direct" on much of what you

sell by analyzing your transactions. Retail intelligence firm Upstream Commerce recently conducted a study of women's apparel and determined that Amazon added 25 percent of the "top" products initially offered by third-party sellers to its own assortment within 12 weeks.

However, many distribution executives fear that their main competitors are going to jump into bed with Amazon Business anyway. If that's what you believe, it's hard to resist moving first and working on a longer-term survival strategy that is boosted by cash from Amazon Business marketplace sales. If those competitors go on to record terrific results for the next few years as a result of their cooperation with Amazon Business, distribution leaders who decided not to collaborate will be under huge pressure to explain to stakeholders why they chose to stay on the sidelines.

Is there an alternative?

Amazon Business is NOT a single company; the third-party marketplace makes Amazon simply the lead partner in an alliance of thousands of suppliers, including many distributors, that are empowering it to execute this strategy.

That means Amazon Business is like an entirely new competing *industry* of companies. The distribution industry needs to build a competing alliance to the Amazon Business industry model.

Alliances are nothing new for this industry. From co-marketing to purchasing alliances, various distributors have decided to join forces to gain advantages in the marketplace.

Responding effectively to Amazon Business will likely require a more aggressive approach to collaboration. Because Amazon is many things – a software development company, a logistics powerhouse, a retailer and a world-class user of data and artificial intelligence – the distribution industry may need to enroll companies with those capabilities in its efforts to compete in the long term.

For example, combining assortments with major retailers may be required to build out a marketplace with a competitive product selection. An industry collaboration with leading software companies would provide for faster and more robust development of online capabilities than any individual distributor could build on its own.

Many companies in these various industries view Amazon as a major and potentially unstoppable competitor. Consider an alliance led by Walmart or eBay, which also have large marketplaces in the U.S., joined by major distributors, powered by software from leading companies (e.g., IBM, Oracle, SAP, BuyerQuest) enabled by artificial intelligence supplied by Google or Apple and served by FedEx.

All of these companies view Amazon and Amazon Business as major threats. "The enemy of my enemy is my friend," is an expression dating to the 4th century B.C., but it's perfectly relevant when it comes to building an Amazon Business competitor.

The challenge is that such an alliance seems farfetched. Almost as farfetched as an online bookstore eventually evolving into the biggest threat traditional distributors have ever seen. In our view, given the enormous success and momentum from Amazon Business, it will likely take some collaboration of industries and companies to build a viable rival. Distribution leaders need to apply bold, unconventional, breakthrough thinking. Like Jeff Bezos.

It's hard not to respect what Bezos is building with Amazon Business – the company has developed a strong and new business model that threatens to disrupt distribution because many customers value its capabilities. But no industry is best served by one dominant player; we believe it's time to consider an industry response to Amazon Business because it appears to be an unprecedented challenge.

Adaptive strategies for distributors

Amazon Business has moved swiftly to understand B2B distribution, bring on a large group of experts and refine its value proposition with a long list of new capabilities to make it compelling. Distribution leaders must move swiftly to respond to the new competitive landscape. Here is a series of actions you should consider taking immediately.

1. Quantify your exposure to Amazon Business. It's important to gain as much understanding as possible about the threat level to your niche of B2B distribution.

Transactions that will be more difficult for Amazon Business to displace (for now) include customer-specific products, private brands, orders that are difficult to deliver via common carrier, products that require significant technical expertise, training, consultative selling, fabrication, customization or maintenance, and

products sold through consignment or vending. If you have distribution rights to certain brands that refuse to sell through Amazon, that's obviously a strong layer of protection if you can retain your exclusivity.

Next, look at sales from rentals and services, which may include configuration, engineering, design, repairs, long-term financing and other difficult-to-digitize services (but not "open account" sales; Amazon Business now offers that). Whatever is left over is most at risk; this is your exposure to Amazon Business.

The process of defining your exposure will allow you to identify the capabilities you need to compete with Amazon Business and other online players. More importantly, it will also help you identify the protected revenues you enjoy so that you can invest in growing those capabilities.

As technology and Amazon's capabilities evolve, update your calculated risk exposure on an ongoing basis to understand how it is changing. This will also provide insight as you update your strategy to react quickly to the changes.

2. Invest in research and analytics. Do you have ongoing research in place to get feedback from your customers?

Some distributors do customer satisfaction or net promoter exercises but few perform in-depth research to understand how customers' needs and perceptions are changing over time. This is a good time to build this capability if you don't have it.

Regardless of your company's views of Amazon Business, many customers see it as a valuable supplier, as demonstrated by the company's rapid account and sales growth. What are your customers' views and plans on buying from Amazon? Do they value capabilities from Amazon Business that you can build too?

One of the advantages you enjoy as a distributor is that you are closer than Amazon Business to your customers. Leverage these relationships by getting input on a regular basis on how your best customers are incorporating Amazon Business into their supplier base. A combination of good, ongoing quantitative feedback and regular, anecdotal input from major customers will give you invaluable insight into how to respond to the Amazon Business threat.

In addition, couple this research and feedback with good data analysis. Once you calculate your risk exposure, monitor how customer purchases are changing across your product line, including those you believe are not particularly at risk to Amazon Business. An analysis of mul-



Commentary: An Industry at an Inflection Point

Innovation will alter competitive dynamics. Selling products that are highly technical is a pretty good strategy to keep Amazon Business at bay today. But for how long will that be good enough? That's the type of question every distributor needs to ask right now.

On Nov. 30, Amazon published a blog, "Introducing Alexa for Business," outlining that businesses can "use Alexa to find open meeting rooms, order new supplies, report building problems or notify IT of equipment issues."

Your customers will soon be voice-ordering office supplies, janitorial supplies and basic maintenance products via Alexa – connected to Amazon's marketplace and best-in-the-world logistics and online ordering capabilities. What percentage of orders are simple re-orders? How much of your portfolio can be considered complex purchases?

Distributors tend to define technical expertise as something provided by people who are technical experts. Currently, Alexa would no doubt be stymied to help a technician select a motor starter. That customer would need to work with a distributor – specifically a human being – to get the right technical assistance.

As one of the world's leading companies in artificial intelligence, Amazon is more likely to view growth opportunities through the lens of advanced software that can provide accurate information and answers on-demand. Amazon will eventually convert complex purchases into non-complex purchases.

Imagine a day when a customer holds an item up to a camera or describes it and Amazon-developed artificial intelligence identifies the product. Alexa then steers the buyer to a product solution accompanied by technical documents, installation videos, diagnostic tools, configurators, tech support resources and other tools the customer needs make the product work.

Distribution is a mature industry with fairly low technology thresholds to competitors. Now, one of the world's leading technology companies with one of the largest assortments of products globally has targeted the industry as a competitor as well as a hopeful partner.

Amazon Business is positioned in distribution to do what home centers did to hardware stores or Netflix did to video rental stores. Or what Amazon did to bookstores. Amazon Business is offering your customers an exciting and highly value-added business model to simplify and reduce the cost of their supplier relationships. What are you going to do about it?

multiple years of transaction history, broken down by customer segment and product sub-category, will give you a baseline to compare against current sales data.

There are other approaches of course, but in any case, replace speculation about the threat from Amazon with real data from your own customers and sales history.

3. Build a future-facing digital strategy.

Whatever happens in the future, state-of-the-art online capabilities are essential. Yes, this is difficult and expensive, but it's much easier and cheaper than ever before. Take advantage of new technologies and an abundance of available talent to accelerate your plan.

This should be a top priority for virtually every distributor. If you can't develop a business case that supports this initiative, question your assumptions about the potential sales losses you

will face if you don't build online capabilities. Too many companies try to justify the investment based on projected new revenues alone.

Bring the same rigor to managing your product data that you use to manage your sales force and your inventory. Robust product data is foundational to effective online selling and marketing.

You must have a defined taxonomy, a product information management system and processes to manage data flows from suppliers to customers on an ongoing basis.

Strong digital capabilities are mandatory today regardless of your strategy: whether you build your own capabilities, decide to collaborate with Amazon Business or work with other entities, you cannot sell online effectively without robust product data management processes.



The Critics Tend to Underestimate Amazon

- **May 1997:** Forrester Research cites Barnes & Noble new website as the reason Amazon will soon be “Amazon.toast.”
- **June 1997:** Barron’s Cover story, “Amazon.bomb” predicts Walmart will beat Amazon. “There’s no contest.”
- **December 2011:** “Mercenary Trader” article predicts Amazon stock will decline from \$180/share to \$80. Instead, it continues to climb to \$1,137/share.
- **February 2015:** MarketWatch writes, “I need to see a lot more before I trust this company enough to buy it.” The stock sold for \$380 per share at the time.

4. Define your new model. In a 2016 interview in Crain’s Chicago Business, Grainger’s since-retired CEO, Jim Ryan, said, “Think about our sales reps as consultants to the facilities maintenance process. You can’t be good at providing that type of advice unless you’re hands on.”

In the same article, Petra Schindler-Carter, director and general manager, Amazon Business Marketplace, said the industrial market is “ripe for innovation and we’re uniquely positioned to make this happen.”

However, this isn’t a battle between the old-school approach of outside reps versus the new-fangled online tools. Grainger has both – the company has been a leader in digital capabilities for more than 20 years. Grainger and Amazon Business are betting on powerful online capabilities – the question is whether you also need other sales capabilities like account managers and inside sales reps.

Our view is that there likely remain significant benefits for distributors wielding a strong sales force and offering great service over the phone and at the counter. Quantifying on an ongoing basis how your customers value (and are willing to pay for) those resources is vital to effectively adjusting your investments by channel over time.

As millennials become the predominant part of the workforce, it’s likely you will see declining utilization of sales channels other than the internet. Determine what mix of capabilities you need today; then make incremental adjustments over time as the competitive landscape and your customer segments undergo generational changes.

The time to act is now

Don’t wait to get started. Your company’s future may depend on how well you protect your revenues from Amazon Business by developing capabilities that deliver more sales from hard-to-digitize product categories and transactions. In addition, you will need advanced online selling and marketing capabilities no matter if you try to go it alone or wind up selling through Amazon Business or a new alliance that may develop, such as the one outlined in this article.

Distributors face some tough choices – join Amazon Business, help to build a competing alliance or continuously build out your own moat. Each path requires non-traditional investments because these are unprecedented challenges in the history of wholesale distribution.

Occasionally, a leader with enormous vision and talent emerges to bring startling new thinking to an industry. Jeff Bezos has joined Steve Jobs, Elon Musk and Herb Kelleher, the long-time leader of Southwest Airlines, among the group of legendary CEOs who have revolutionized industries. CEOs with those skills are quite rare and they remake industries in ways that win passionate loyalty from customers. But they are hell to compete against.

It’s your turn to match your ability against an extraordinary leader who has built a formidable competitor. It’s certain that complacency or procrastination are failed strategies. Distribution needs to embrace the challenge and respond vigorously because the stakes are high and inaction is deadly.

Call to Action for 2018

As we wrote earlier in this report, “Just about every juggernaut eventually runs into a competitor or a market that it can’t dominate.” While that will likely be true of Amazon in some market, some day, the company is well-positioned to compete as a leading B2B supplier in the U.S. for a long time.

Its core capabilities – buying from many suppliers and selling to many customers – and its software development skills provide differentiated advantages, primarily for business customers’ “tail spend” needs.

As a leader in distribution, it’s time to develop a plan that recognizes and responds to this new threat for the simple reason that the value Amazon provides is real. Your customers do not see Amazon Business as a threat, but they may see it as an intriguing new supplier that can bring them benefits such as a wider assortment, lower costs, and simpler and better purchasing processes.

And yet there is still room for distributors to grow and thrive if they adapt to this new era of competition. In fact, there are many distributors who feel little or no pressure from Amazon Business currently. Although some analysts have a tendency to group major distribution companies together when they consider the threat Amazon poses to traditional players, the reality is more nuanced.

Some distributors have wide moats in place today; others are positioned to expand their moats quickly. To compete and thrive, you must abandon many of your paradigms around strategy to build a better distribution company than ever before.

Coming soon!

Your Amazon Business Playbook, Vol. 2

Look for our update to this report in the second quarter with all new information on how to respond to Amazon Business.

To be alerted to the publication of our next volume, email info@mdm.com with the subject line: “Amazon Playbook 2”



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