

## DON'T DO BUSINESS WITH BROKERS OR DISTRIBUTORS

Finding a Hybrid Supplier

### EXECUTIVE SUMMARY

Manufacturers and distributors play different roles in the markets they serve. A manufacturer's main role is to create or assemble the product. A distributor helps get the product to the right places. Both are important activities, but both of these parties can create inefficiency in the supply chain. The refrain "a distributor is just another mouth to feed" reflects some of this inefficiency. In some industries, however, another type of player called a "hybrid supplier" has emerged. Hybrid suppliers partner up well with manufacturers, addressing their limitations, and offer additional benefit to customers. This paper elaborates on the hybrid model and shows how hybrid suppliers can add tremendous value to a company's supply chain and bottom line.

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## INTRODUCTION

Most industries have multiple players involved in getting the product to the end customer. For years, manufacturers and distributors have each played important roles in keeping store shelves stocked with the right packages. But each of these players can create bias and inefficiency in the supply chain.

Manufacturers are good at making things. But they really like making lots of one thing, selling them to you immediately, and keeping their machines running all the time. Distributors add flexibility to the supply chain by breaking bulk and warehousing product. But distributors face headwinds. Statements like “A distributor is just another mouth to feed” and “I don’t do business with distributors” are made every day, and understandably so. Distributors are “middlemen” and often don’t provide in value what they take in profits.

As customers look to squeeze out inefficiency and get more services for their money, a new “hybrid supplier” model has emerged. Hybrid suppliers take the best elements of manufacturers and distributors and eliminate their potential biases and inefficiencies.

In this paper, we examine the traditional definitions of manufacturers and distributors as well as the pitfalls of each. We then outline and illustrate the hybrid supplier model and show how hybrid suppliers can drive more value to the customer.

First, however, we address the fundamental question of why intermediaries are needed at all.

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## COMPLEX MARKETS NEED INTERMEDIARIES

Markets with many participants – that is, with many sellers and many buyers – are complex. These complex markets often require special mechanisms to run efficiently.

eBay is an example of an intermediary that matches millions of sellers with millions of buyers. eBay adds tremendous value to its entire community of participants and captures some of that value in the fees it charges, which totaled about \$14 billion in 2012.

An eBay-like aggregator is not needed in every market. Indeed, the biggest customers, which are usually the most sophisticated, can form alliances with the biggest suppliers to their market. But for the smaller and emerging players, especially when there are lots of buyers and sellers, using a market facilitator can make sense.

The packaging market provides a great illustration. A lot of packaging is bought by a small group of companies like Coca-Cola, P&G, Merck, and Honeywell. Because of the massive scale of their purchasing, companies like these have direct relationships with the largest packaging manufacturers for their marquee products.

But a huge volume of packaging and a vast number of purchase scenarios don’t fall into this direct-relationship model. For instance:

- There are emerging customers (each with little purchasing power) that want to buy from big packaging manufacturers (who don’t have the time to serve the small guy).

- There are emerging customers that want to buy from smaller, niche packaging manufacturers (who may not have the resources to provide all the services needed).
- There are larger customers with unique needs that are best served by specialty packaging manufacturers (but they may have difficulty finding the right ones).

As a result, tens of thousands of customers and hundreds of manufacturers benefit from having intermediaries in the packaging space. Packaging distributors and brokers have acted as market facilitators. We estimate that \$4-5 billion of rigid packaging in the U.S. flows through distributors every year.

But this doesn't mean that packaging distributors are the best answer. Indeed, packaging distributors are sometimes unsophisticated and add little help for the fees they charge. The smart supply chain executive may see that doing business with a distributor can be a mistake. And the same executive may also see some pitfalls with how manufacturers approach their business as well.

To make this case clearly, we will meet each of the players in the supply chain, starting first with manufacturers.

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## MEET THE TRADITIONAL MANUFACTURER

A traditional manufacturer owns assets – machines and buildings – to generate the output ordered by its customers. These manufacturers are usually expert at selecting the proper machine platform, material, and location to produce an order and in running their machines in the most efficient way.

A manufacturer's physical assets represent a huge amount of invested capital. It's common for total Property, Plant, and Equipment to be over 30% of the total assets of a manufacturer. As a consequence, a manufacturer wants to reap the highest return on these assets and machines.

This creates some bias and inefficiency that can be at odds with the best interests of the customer. To get the highest return on assets, the manufacturer wants to run his machines all the time with minimal downtime. For the customer, this means either buying a stock product (which doesn't help the customer stand out in the market) or committing to long production runs or inopportune lead times. And since the manufacturer has so much capital tied up, he's reluctant to add more buildings to house inventory (even for a limited time) for customers. So he wants to ship product as soon as it comes off the production line. For most customers, this is not ideal since it means *they* have to invest in warehousing and bear extensive inventory carrying costs and negative impacts to cash flow. Furthermore, as manufacturers strive to eke the last efficiencies out of their operations, they tend to scrimp on value-added services and customer support.

So unless you are a huge customer with very long production runs, you will pay higher prices, get uneven service, and be offered "take it or leave it" propositions from most manufacturers. This is why many customers turn to distributors for some more flexibility.

## MEET THE TRADITIONAL DISTRIBUTOR

A traditional distributor “breaks bulk.” They make one large purchase (allowing the manufacturer to enjoy long production runs), and then they break up these truckloads/pallets/cases and make many smaller “sells” from this one purchase. This model adds value by creating convenient quantities and by having items in stock.

A related model is that of a broker. Brokers usually don’t take title to the product; they simply act as an agent who matches buyers and sellers.

Both of these intermediaries earn modest profit margins; this “extra mouth to feed” is evident. Distributors and brokers capitalize on the inefficiencies of the marketplace. The problem for buyers is that not all distributors are looking out for your best interest. They want to sell you what they have in stock. After all, having all that cash tied up in inventory and buildings is expensive.

Distributors live deal-to-deal and, notwithstanding the margins they earn, are usually running a precarious business. A recent study from Georgia Tech’s Financial Analysis Lab looked at how revenue growth in different industries related to cash flow.<sup>1</sup> Out of 44 industries, distribution ranked third from the bottom in its ability to generate free cash flow. Shipbuilding, construction materials, and agriculture (sectors that aren’t known for high margins or operational excellence) all placed higher than distribution on the list.

As a result, most distributors either resist or have trouble investing for the future. They generally don’t innovate, offer customers attractive payment terms, hire the best (and more expensive) people, or look for ways to offer their customers anything better than a slightly more convenient proposition than does a manufacturer.

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## MEET THE HYBRID SUPPLIER

The term “hybrid” means combining elements from different things and making a mixture. A hybrid car takes the best characteristics from both gasoline (long-range operation) and electric (less pollution, quieter operation) propulsion systems. A hybrid corn plant can generate sweeter taste while also being resistant to pests.

**In the fog in which traditional manufacturers and distributors operate, a hybrid supplier is a beacon for the customer. Hybrid suppliers combine the best of what manufacturers and distributors have to offer along with services and customer care that help boost their customers’ bottom-line growth. And they do so without the biases and inefficiencies often exhibited by the traditional participants.**

Hybrid suppliers bring together three fundamental elements that make them indispensable in the supply chain.

### **First, they have the best elements of a manufacturer.**

They are highly trained product experts; they oversee production; they can engineer custom

<sup>1</sup> For more information, see [The Free Cash Profile: Insight into the Cash Flow Implications of Growth: An Analysis Using 2011 Data, located at Scheller.gatech.edu/fac\\_research/centers\\_initiatives/finlab/reports/finlab\\_reports\\_2012.html](http://The Free Cash Profile: Insight into the Cash Flow Implications of Growth: An Analysis Using 2011 Data, located at Scheller.gatech.edu/fac_research/centers_initiatives/finlab/reports/finlab_reports_2012.html).

solutions; they have in-house quality teams. Hybrid suppliers, however, don't own manufacturing assets and machines. Instead, they contract out manufacturing as needed to the manufacturer best suited to the project. This means that hybrid suppliers don't get bogged down with keeping a specific machine busy or with force-fitting customers into molds that are currently available. As a result, hybrid suppliers effectively have unlimited capacity and are not handcuffed to specific technology or equipment or tools.

### **Second, they perform distribution and logistics services.**

They have warehouses; they manage inventory; they handle inbound and outbound logistics; they deliver when you need it. Hybrid suppliers go beyond the traditional distributor model with superior inventory acumen and proven operational excellence. A hybrid supplier seeks to lower total system costs by consolidating inventory across the entire supply chain, including taking inventory off of customers' floors. A hybrid supplier has a core competence in inventory management that can help customers control inventory levels and expenses and can deliver to customers on a just-in-time basis. Hybrid suppliers can also provide data to prove their operational and cost-saving track record.

### **Third, they provide extra services and value-added offerings.**

They consider ways to improve their customers' revenues, lower their customers' costs, and improve their suppliers' results as well. Every sector will have a different set of opportunities that a hybrid supplier will embrace.

Hybrid suppliers go far beyond what a classic manufacturer or distributor does. The difference is driven by what their balance sheets look like as well as by their expertise and attitude. **Hybrid suppliers embrace innovation, efficiency, and a maniacal focus on customer thrill.**

## **CASE STUDY: HYBRID SUPPLIERS IN ACTION**

Described below are examples of hybrid suppliers across various industries. Both buyers from and suppliers to these companies win. Buyers get one-stop-shop convenience, and suppliers get a way of reaching many more customers than they otherwise could connect with efficiently.

***FASTENAL***<sup>®</sup>

INDUSTRIAL & CONSTRUCTION SUPPLIES

Fastenal is an industrial distributor primarily focused on fasteners (e.g., nuts and bolts) and cutting tools (e.g., drill bits). Fastenal has been tremendously successful since it was incorporated in 1968. By the end of 2011, the company was the biggest gainer among about 400 stocks in the Russell 1000 index that had been trading for at least 25 years; its shares were up over 38,000% since 1987.

Fastenal has a number of advantages that have helped it succeed. First, it has fantastic breadth of product that it has stitched together across many suppliers. Second, it has purchasing clout and can demand low costs from its suppliers. Third, it is close to its customers, with over 2,600 outlets around the world and a robust web site. Fourth, it has deep, customer-oriented expertise

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in its sales force of over 11,000 people. Fifth, it has a culture of innovation. The company offers services such as inventory management and custom fastener manufacturing that add value to its customers.

Fastenal adds so much value that other intermediaries such as the traditional distributor have a tough time competing.



*MWI Veterinary Supply*

MWI distributes veterinary and animal health supplies to over 25,000 vets in the U.S. and U.K. The company is large (\$2 billion in revenue) and growing quickly (+33% in 2012).

MWI is a successful hybrid supplier for a number of reasons. First, it provides tremendous breadth of product. Offering over 35,000 products from 600 vendors, it's a convenient one-stop shop for its customers. Second, it offers an array of value-added services – including inventory management, equipment procurement consultation, and pet cremation – that closely integrate MWI into its customers' operations. Third, it has a strong sales team of more than 400 people who work with customers to find the best solutions. These sales resources are augmented with detailed product catalogs as well as an easy online ordering channel. Fourth, MWI has continued to invest in technology and information systems, which allow it to excel in operational excellence and get the most out of its 12 distribution centers.

The market for animal health products is over \$7 billion in the U.S. MWI has taken significant share of this market, and MWI has room to gain additional share as it continues to refine its hybrid approach.



While Fastenal and MWI are great examples of business-to-business suppliers, Amazon is primarily a business-to-consumer supplier. However, Amazon is now expanding into B2B spaces (e.g., its Industrial & Scientific storefront) as it looks for more growth.

Amazon's success is regularly reported by the media – with \$61 billion in 2012 revenue, revenue growing by 27%, 140 million customers, two million vendors, and higher brand equity than Walmart.

The culture that Amazon CEO Jeff Bezos has established explains Amazon's rapid growth. The company has a bold mission: to build the world's most customer-centric company where people can find and discover virtually anything they want to buy online. And, in addition to the vastness

of the product offering, the company grows by removing purchase barriers as well as providing aggressive assistance in product selection. For example, the Amazon Prime service eliminates shipping charges, allowing buyers to transact as often as they like and just pay the item's price. Amazon's "recommendation engine" helps shoppers discover new products based on other items they've bought and enjoyed. And Amazon shows buyer feedback – the positive and the negative – on all the items it sells to ensure that shoppers pick the best items for themselves. Sellers gain, too, since Amazon aggregates millions of shoppers in one place; it's a true destination for commerce.

## HYBRID SUPPLIERS BOOST SUPPLY CHAIN PERFORMANCE

As the above examples demonstrate, hybrid suppliers can transform industries. Integrating a hybrid supplier into the supply chain can yield benefits to both buyers and manufacturers.

### Hybrid Suppliers improve cash flow for buyers.

Companies can see their income statements and balance sheets improve as a consequence of buying from hybrid suppliers.

A hybrid supplier can help you (the buyer) by:

- **Delivering products that accelerate growth:** With access to a vast array of manufacturers and a mindset around growth, hybrid suppliers can locate the latest innovations and bring them to you. These innovations can help reduce your expenses and/or accelerate your revenue growth.
- **Providing expertise that unlocks profit:** Hybrid suppliers can assemble a portfolio of value-added services (like those mentioned in the examples above) that create differentiation. They can also uncover hidden savings through experience, analysis, and access to a wide array of applications at different customers. All of these capabilities can help you be more efficient and/or boost your growth trajectory.
- **Taking assets off your balance sheet:** With expansive logistics networks, hybrid suppliers can hold inventory and deliver product when you need it. As outlined in our white paper, [Reducing Total Inventory Cost: A Roadmap to Higher ROI](#), moving inventory off your balance sheet frees up cash flow and reduces the risk of obsolescence.
- **Taking expenses off your income statement:** Moving inventory to another party also has the benefit of freeing up the resources that used to be involved with housing, handling, insuring, and administering the inventory. This cost avoidance can be dropped to your bottom line or reinvested for growth.
- **Accumulating volume to lower purchasing costs:** With greater buying power achieved by consolidating volume across many customers, hybrid suppliers earn cost concessions from the manufacturers from whom they purchase. This helps offset the hybrid supplier's operating costs and margin, and can result in a net improvement in pricing to you.



- **Adding flexibility and speed to market:** Hybrid suppliers have lower minimum-order sizes and often have in-stock availability. This allows for faster time-to-market for you.
- **Guaranteeing supply:** Through inventory management and multi-sourced product, hybrid suppliers can provide uninterrupted supply assurance that is often not available from single manufacturers.
- **Delivering turnkey services and coordination:** For customers requiring multiple manufacturers and agents, hybrid suppliers can be the glue that binds the supply chain together. One call can replace many while also limiting quality fluctuations and ensuring accountability. The same consolidation role can benefit geographically-spread organizations, where hybrid suppliers can bring a consistency of offering across a company.
- **Simplifying your operations:** With a wide array of products, valuable services, and flexible solutions, a hybrid supplier can replace many single-purpose vendors. This “one call does it all” approach allows you to cut back on administration and focus on what you do best.

## Hybrid suppliers improve cash flow for manufacturers.

Manufacturers properly see distributors as competitors; a distributor, as it resells product, can overlap with a manufacturer’s selling efforts and create conflicts in the market. A hybrid supplier, however, can bring new sources of value to manufacturers that defuse this conflict and take the issue entirely off the table.

A hybrid supplier can help you (the manufacturer) by:

- **Augmenting feet on the street to accelerate growth:** Hybrid suppliers have more sales and commercial resources than you do, and hybrid suppliers can deploy them more effectively. Instead of focusing on just a small number of large customers (if you have a sales force at all), hybrid suppliers allow you to have a broader group of agents selling your products to a broader group of prospects.
- **Providing access to new channels:** Hybrid suppliers often have presence in web and catalog channels as well as expertise in direct marketing. This opens doors that are locked to most manufacturers because they lack competency in these areas.
- **Providing expertise that unlocks profit:** As with the discussion of buyers above, hybrid suppliers can offer value-added services that help attract and retain customers through differentiation. As a result, hybrid suppliers are able to penetrate and keep accounts that manufacturers can’t.
- **Taking expenses off your income statement and balance sheet:** Most manufacturers don’t like to hold inventory; inventory is a drain on cash and space. Hybrid suppliers can be an important inventory buffer, taking inventory off the floors of both the manufacturer and the ultimate buyer. And hybrid suppliers go further than traditional distributors by excelling at customer service, order management, and logistics activities. For you, this reduction in activity will have a corresponding reduction in people and operating expenses. These benefits can be dropped to your bottom line or reinvested for growth.

In sum, hybrid suppliers can help buyers and manufacturers by letting them focus on their core competencies. Unless your company is expert at both selling and logistics, hybrid suppliers can handle those functions and let you devote your resources to what you do best.

## SPOTLIGHT ON BERLIN PACKAGING

Berlin Packaging is a leading supplier of rigid packaging. Berlin is not a distributor; it's not a manufacturer; and it's not a packaging consultancy. Instead, Berlin is all of these things at the same time.

Berlin has built an enterprise dedicated to helping its customers succeed. It all starts with Berlin's mission: *to increase the net income of its customers through packaging products and services*. Berlin Packaging is in the profit business, and packaging is the currency it uses to deliver the profit to its customers. Berlin knows that it will benefit when its customers make more money, and so will Berlin's suppliers.

An array of supporting capabilities makes this mission come to life, including:

- Deep product and sourcing expertise – billions of components produced under contract with manufacturers annually, overseen by a dedicated team of sourcing experts.
- Large network of manufacturers – over 700 packaging suppliers from around the world.
- In-house quality team – dedicated resources that work proactively and reactively.
- Significant warehouse presence – millions of square feet of space spread over more than 60 warehouses across North America, with a commitment to add locations close to customers as warranted.
- Logistics know-how – over 150,000 annual shipments delivered with over 99% on-time accuracy.
- Wide array of value-added services – custom packaging and graphic design, profit-oriented consulting, and financing services, all offered at no additional charge in exchange for packaging business.

Berlin Packaging is the hybrid supplier in the packaging industry. Berlin has had excellent success with this model, with a long-term growth rate six times that of the packaging industry overall. Year after year, Berlin has been able to win market share away from traditional distributors as well as less nimble manufacturers.

## GETTING STARTED

Whether you have a distributor in your supply chain today or not, there are four questions you can ask to assess the best way to configure your supply chain and the right players to put in each role.

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## Who are all the players in your supply chain today?

Consider all the suppliers, partners, and agents – both upstream and downstream. Think across functions – sales, marketing, manufacturing, operations, finance, etc. This complete list will show you how much you are, or are not, relying on intermediaries and service providers, and it will be the starting point to understand if you’re working with the right players in the right roles.

## What is inhibiting your growth or cash flow?

This is a hard, broad question. Some of the barriers and opportunities may be obvious. But some may be hidden behind broader strategic issues. Having a clear strategic roadmap for your company will make this question easier to answer. For assistance, see our white paper [Designing a Strategy for Growth: Blueprinting in Six Steps](#).

## Are there hybrid suppliers in your industry that can help?

Consider the ways the best hybrid suppliers behave, as described in this paper. Assess if a hybrid supplier could help you take better advantage of your strategic opportunities (to drive profit growth) or reduce the array of partners you work with across the organization (to simplify operations and reduce expenses).

## Which candidates have the right track record?

One simple way to find out is by asking your current and potential partners how well they thrill their customers and constituents. The Net Promoter Score is a useful mechanism to do this, and good hybrid suppliers will be armed with Net Promoter Score data that show how well they engender loyalty with those they serve. For more information on the Net Promoter methodology, visit [NetPromoter.com](#), read [The Ultimate Question](#) by Fred Reichheld, or read our white paper, [Winning With Customers: Establishing a Customer Focused Organization](#).

Of course, any changes to your supply chain should be made carefully. These four questions are a great way to begin the process.

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## SUMMARY

The adage is that “companies don’t compete, supply chains compete.” The imperative, then, is to make your supply chain as powerful as possible by getting rid of inefficient and potentially biased manufacturers and distributors. Whether you are a buyer or a seller, a hybrid supplier can help you boost your bottom line, because hybrid suppliers bring together the best elements of manufacturers, provide top-notch distribution and logistics services, and also deliver a suite of value-added services. You must view your supply chain in the context of your strategic and practical goals – improving internal operations, using the right suppliers and external partners, and making useful acquisitions. In this process, you can select the best partners based on the merits of each player, the strength of the full supply chain, and ultimately your bottom line.

## ABOUT QORPAK

Qorpak, a division of Berlin Packaging, is a leading worldwide supplier of laboratory containers and supplies. For more than 30 years, Qorpak has served laboratory, research, and testing professionals through its own expert sales and service team as well as through an international network of distributors. In addition to thousands of types of containers and closures in plastic, glass, and metal, Qorpak sells commonly used chemicals, supplies, and benchtop equipment. Qorpak is a one-stop shop, with a majority of these products in-stock and ready to ship. Qorpak is a Hybrid Packaging Supplier in the laboratory marketplace, as Qorpak brings together the best elements of manufacturing, distribution, and value-added services. In addition to containers, the company provides kitting, packaging design, financing, consulting, warehousing, and logistics services. The company can be reached at 1.800.922.7558, [Qorpak.com](http://Qorpak.com), and on Twitter and Facebook.

## ABOUT BERLIN PACKAGING

Berlin Packaging is North America's premier Hybrid Packaging Supplier of plastic, glass, and metal containers and closures. With over 33,000 available SKUs, over 120 packaging consultants, and more than 90 sales and warehouse locations across North America, the company has the right products, expertise, and geographic proximity to help customers increase their net income through packaging products and services. Berlin Packaging supplies billions of containers and closures annually as well as warehousing and logistics services for customers of all sizes in all industries. Berlin Packaging also offers an array of services and specialty-product divisions to be the true one-stop shop for rigid packaging. The company can be reached at 1.800.2.BERLIN, [BerlinPackaging.com](http://BerlinPackaging.com), and on LinkedIn and Twitter.