2012 Distribution Monitor Report

McGladrey

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Executive summary

Just when it appeared that distributors were looking at growth opportunities after years of recession, the industry is navigating an uncertain business landscape.

Businesses in distribution are still growing in 2012, but that growth — and the optimism that accompanied it — is tempered by a number of influences. Following a relatively positive year for sales performance and expansion, executives of midsize companies find themselves in an uncertain business landscape complicated by faltering economies in Europe and elsewhere, with a growing apprehension that potential changes in U.S. policies and tax rates could have a negative impact on business.

The 2012 Monitor Distribution Report is based on findings from the 2012 NAW Institute/McGladrey Monitor (2012 Monitor Study), presented by the NAW Institute for Distribution Excellence and McGladrey.

Outlook for growth

Distributors are generally optimistic about their own business prospects in the next 12 months, despite concerns about the U.S. and world economies. Most distributors report that their organizations are thriving or holding steady.

In addition, distributor sales generally are still growing, but there is some weakening in both U.S. and non-U.S. sales. U.S. sales hit the targets projected by distributors in the spring 2011 Monitor Study; these sales are expected to keep growing in the next 12 months, albeit at a much lower rate. That performance is echoed in non-U.S. sales growth, which is expected at a much lower rate.

Virtually all distributors now offer value-added services to customers, but the industry as a whole is still focused on products for driving revenue — almost half of distributors report that new products/product lines are extremely important or important to company growth. Distributors that rate new products/product lines as extremely important will spend much more annually on research and development (R&D).

Cost expectations and maintaining margins

Most businesses expect costs in many categories to increase in the next 12 months, particularly in areas such as transportation and fuel costs, equipment and machinery, and energy; some expect transportation and fuel costs to increase by more than 10 percent.

To combat these rising costs, the most common strategies for distributors to maintain profit margins in the next 12 months include focusing on operational improvements and raising prices to offset higher purchase costs.

Inventories also will increase at nearly one-half of distributors, with 7 percent expecting inventories to be increased by more than 10 percent. Yet despite these cost pressures and more inventory, the overall health of the industry is reflected in plans by most distributors to increase capital-equipment spending in the next 12 months. That is being influenced by the low cost of capital and respectable bottom lines at many firms.

Yet there may be some hesitation when it comes to these types of capital investments. As the year enters its final quarter and national elections loom on the horizon, capital expenditure decisions may be made in the fall with more caution than considered in the spring.

A majority of distributors expect net income to rise in the next 12 months, and the average net income increase percentage for distributors will be 13.9 percent. But note that these average figures are skewed considerably upward by a fraction of distributors. In fact, 57 percent of distributors expect net income to rise by 5 percent or less in the next 12 months.

Workforce

A majority of organizations are planning to increase U.S. employment in the next 12 months, and a majority of firms with international employees also will increase their ranks overseas. Finding new hires, though, could pose issues for some distributors. Approximately one-third of distributors report that they find the skilled talent they require only

some of the time or rarely. Many distributors are launching their own training and development programs to address skills gaps.

Nearly half of distributors will focus on adding personnel to customer service/support functions. With a growing workforce comes the expected rise in costs for wages, benefits and other variable compensation.

Process improvement

Few organizations can survive without continuous efforts to improve productivity. Indeed, with workforces so lean, organizations relying on getting more from fewer employees have needed to be as efficient and productive as possible.

Distributors will increase investments in process improvements this year compared to last. Thriving organizations are more likely to increase these investments than firms holding steady or declining. Thriving firms also are more likely to have increased productivity in the past year. The primary objectives cited for improvement initiatives are to reduce costs as well as to improve quality, customer satisfaction and speed. To date, these efforts are having an effect: A majority of distributors say they have improved productivity in the past 12 months. According to a number of sources, including the Bureau of Labor Statistics, U.S. workers are the most productive in the world.

Information technology

Information technology is critical as distributors grow their organizations and broaden their supply chains. Two-thirds of distributors report at least moderate use of business analytics companywide and/or among senior leadership. Business analytics is most likely to be used to forecast customer demand and identify market opportunities.

More than half of distributors use social media, and slightly less than half use cloud computing. And while these and other IT applications can pose new security concerns, surprisingly few distributors believe their information or data is at risk.

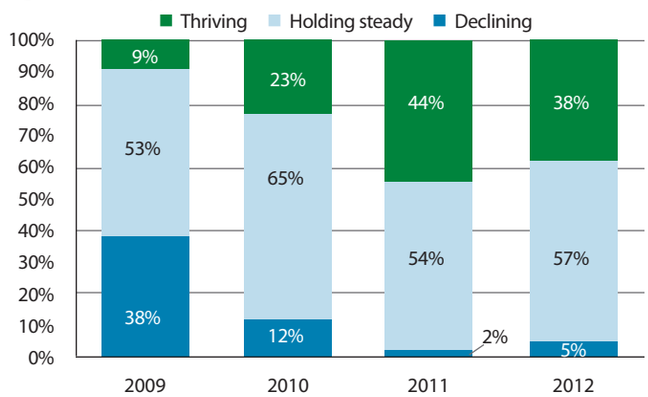
Outlook for growth

Distributors are not as optimistic about their own business prospects in 2012 as they were in 2011. But despite signs of an industry plateau and some pockets of decline, many distributors report that their organizations are healthy, and are taking actions to support growth.

Business conditions

Most distributors report that their businesses are holding steady (57 percent) or thriving (38 percent). Only 5 percent of distributors report that their businesses are declining. Compared to the Monitor Study fielded in spring 2011, the overall condition of the industry has declined only modestly — last year 54 percent reported that they were holding steady, and 44 percent of distributors indicated that their organizations were thriving. The year-to-year trend shows that distributors still are a long way from the levels of decline witnessed during 2009 (Figure 1).

Figure 1. Four-year business conditions



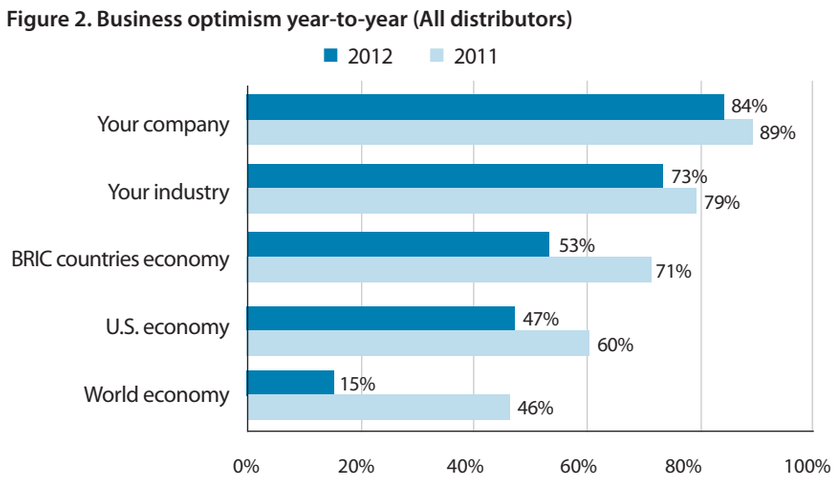
Distributors involved in construction markets were the least likely group to report that their organizations are thriving. Given the slow recovery rate of the housing market, it is not surprising that distributors serving construction markets are the least likely to be thriving.

Some 84 percent of distributors are optimistic when describing the current conditions of their businesses; nearly three quarters are similarly inclined towards optimism regarding the industry (Figure 2). However, their optimism wanes when describing business environments outside of their control. Just under half are optimistic about the U.S. economy; and their view of the world economy plunges to just 15 percent expressing optimism (21 percent of distributors being very pessimistic).

"While it is clear that distributors continue to feel 'steadied' in the wake of the turmoil of the past several years, it is obvious that their confidence in the U.S. and world economies is beginning to decline. Even though a healthy percentage of them are thriving or at least holding their own, they are concerned with the uncertainty that looms in the U.S., given the upcoming elections, as well as the weakening global economy."

Karen L. Kurek , Partner and, National Manufacturing & Distribution Practice Leader, McGladrey LLP, Chicago, Ill.

Figure 2. Business optimism year-to-year (All distributors)



Note: In 2011, BRIC countries were referred to as "Emerging market."

Distributors were asked to identify the corporate objectives most important to their organization in the next 12 months (Figure 3).

Figure 3. Corporate objectives in the next 12 months

	% "extremely important" and "important"
Expand existing facilities(s)/warehouse(s)	22%
Make an acquisition	19
Build or acquire new facilities(s)/warehouse(s)	19
Form a partnership/alliance	15
Close facilities(s)/warehouse(s)	5
Sell the company	4
Divest a business unit	4
Relocate existing U.S. operations overseas (offshoring)	1
Bring existing operations to the United States (onshoring)	1

Notably, expanding existing facilities and building or acquiring new ones were among the most important objectives according to distributors. After putting it off for so long, distributors are investing their capital expenditures in the infrastructure of their organizations. If they are to continue to grow, distributors feel these investments can no longer be put off.

Acquiring new operations is a priority for distributors as well. Merger and acquisition activity appears to be on the rise in the distribution industry. Driven in part by increasing middle-market transactions with predominantly strategic buyers and private equity firms, merger and acquisition activity in distribution has reached near-record levels, according to *Modern Distribution Management*. Acquisitions and consolidations in 2011 and the first half of 2012 led to an impressive rise in growth.

"As private equity firms continue to focus on growing portfolio companies organically and through add-on acquisitions, they need to take a very close look at systems and processes, and implement procedural best practices to minimize the business risks they face every day. We see a growing trend in the industry to develop a strong sense of focus within firms — to keep the deal guys focused on doing deals and to add operating resources to improve performance at the firm's holdings — in order to really optimize value creation."

Bob Jensen, Partner and Great Lakes Region Practice Leader, Private Equity Services, McGladrey LLP, Chicago, Ill.

Business environment

The 2012 Monitor Study asked distributors what poses the greatest risk to their companies and business continuity in the next 12 months. Distributors responded with a litany of concerns: rising commodity prices; financial turmoil in Europe; competition from low-cost-country vendors; and the continued housing crisis. Yet the most common worry by far is uncertainty regarding government regulations, health care law and which administration will lead the country in 2013.

Many business executives are awaiting the end of 2012 — and with it, the possible expiration of Bush-era tax cuts (Figure 4). Distributors are particularly distressed about expiration of personal income tax cuts, with 54 percent reporting the change would harm their businesses (19 percent believe expiration of the income tax cuts will cause major harm).

This issue is of particular concern to distributors, since many in the United States are organized as pass-through entities (i.e., partnerships, LLCs or S-Corps) and are taxed at individual rates.

The pending cuts in defense spending under the Budget Control Act of 2011 are expected to have an impact on the industry, including the loss of jobs at defense contractors due to a decrease in purchases for equipment, supplies and services, as well as at firms that supply these contractors.

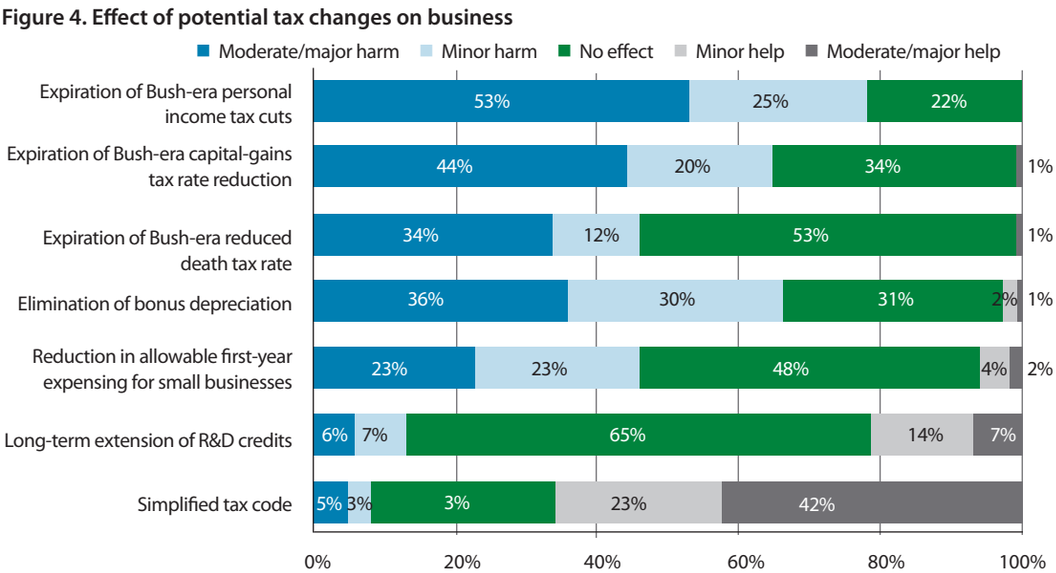
It is not surprising that two-thirds of distributors also report that expiration of the Bush-era capital gains tax and elimination of bonus depreciation would harm their businesses. Two-thirds of distributors report that a simplified tax code would help their businesses (18 percent believe a simplified tax code will be a major help).

Distributors are less concerned about a long-term extension of R&D credits (65 percent report it would have no effect on their businesses) or a reduction in allowable first-year expensing for small business (48 percent report it would not affect their businesses).

"With the terms 'taxmageddon,' 'fiscal cliff' and 'budget deficit' often heard these days, midsize distributors and their owners may be wondering about the ultimate resolution of expiring tax cuts and extenders and the consequent tax effects. It will not be possible to determine the precise impact on any taxpayer until sometime after the Congressional and Presidential elections have occurred and Congress has done some major work on those matters."

Bob Adams, Partner, Washington National Tax, McGladrey LLP, Washington, D.C.

Figure 4. Effect of potential tax changes on business



Sales performance and projections

Although many distributors enjoyed rising sales last year, many are concerned about the impact of economic uncertainty over the next 12 months and sales projections reflect those concerns. The non-U.S. sales environment is particularly worrisome given global economic conditions.

The vast majority of distributors (81 percent) increased U.S. sales in the past 12 months, and are expecting their U.S. sales to increase in the next 12 months. On average, distributors increased U.S. sales by 9.5 percent in the past 12 months, and expect an average increase of 8 percent in the next 12 months (Figure 5).

Far fewer distributors achieved sales gains outside the United States in the past 12 months, and just 41 percent expect non-U.S. sales to increase in the next 12 months. The average increase for non-U.S. sales was a soft 6.9 percent in the past 12 months, and the outlook for the next 12 months is even lower at 5.1 percent (Figure 5).

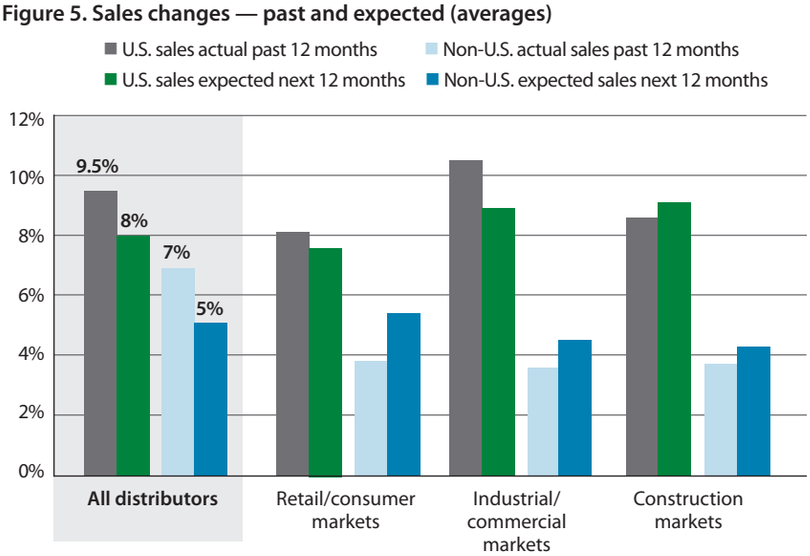
Distributors with a history of non-U.S. sales were, not surprisingly, more likely to increase non-U.S. sales: 51 percent increased non-U.S. sales in the past 12 months (average increase of 10.3 percent), and 59 percent expect non-U.S. sales to increase in the next 12 months (average increase of 7.5 percent).

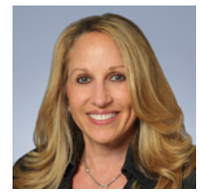
Given the expense of establishing sales outside the United States, it is likely that companies that are not already engaged in non-U.S. sales activities are not planning to do so.

But within these findings are significant differences among distributors — some recording substantial sales increases while others' sales remain flat or decline — driven by specific products, customers, and geographies. For example, for the next 12 months, 38 percent of distributors expect U.S. sales to increase by 10 percent or higher, and 18 percent of distributors expect non-U.S. sales to increase by 10 percent or higher. Of those distributors with non-U.S. sales, 16 percent expect increases of 10 percent or higher.

It is interesting to note that distributors involved in retail/consumer markets have the lowest projected increase for U.S. sales, giving further strength to the argument that consumer spending is tepid in the United States.

Figure 5. Sales changes — past and expected (averages)





"Consumer spending patterns are shifting as rising health care and transportation costs capture a larger portion of the consumer's wallet. Retailers and companies supplying products to those retailers must focus on their value proposition to draw consumers in to spend their hard-earned cash."

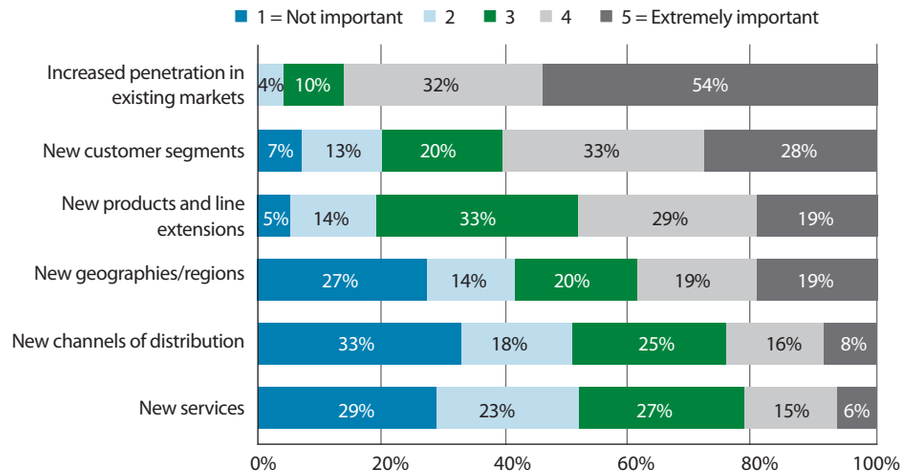
Carol C. Lapidus, Partner and Consumer Products National Leader, McGladrey LLP, New York, N.Y.

The 2012 Monitor Study asked distributors to report their most important sales strategies in the next 12 months. A range of answers were reported, from better use of information technologies to better/more sales training. Yet the most common answers among distributors dealt, in part or in whole, with the theme of capturing more business from existing customers:

- *"Increasing sales and services to our current business partners."*
- *"Increasing market share with existing customers/channels with new product categories."*
- *"Cross-selling new product lines to existing customers, [and] offering private label packaging."*
- *"Attempting to sell more products to existing customers and also increase margins at existing accounts."*

Distributors were asked to rate their sales strategies (Figure 6). The top sales strategy among distributors to drive growth in the next 12 months is to increase penetration in existing markets. Finding new customer segments also is an important strategy for nearly two-thirds of distributors.

Figure 6. Top sales strategies to drive growth in the next 12 months

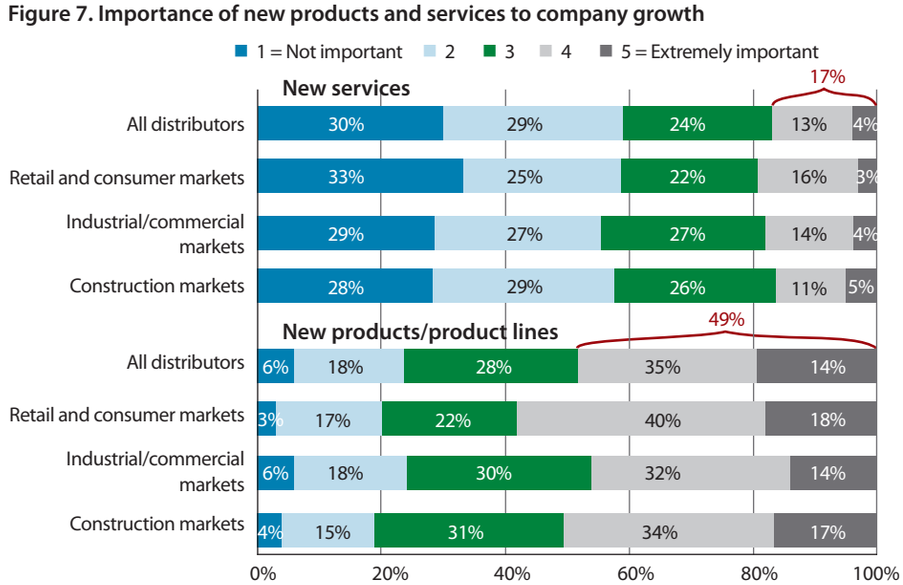


New products and services

When Monitor participants were asked about their priorities for company growth and strategies to expand sales, both new products and new services were given as important drivers.

Despite assumptions to the contrary that new services are their highest priorities, distributors are focused on products. While some rate new services as extremely important or important to company growth, nearly half say that new products/product lines are extremely important or important (Figure 7). This gap may reflect the greater risk for distributors associated with launching new services as compared to taking on a new product line or extension.

Figure 7. Importance of new products and services to company growth



While it may be commonly believed that distributors focus on value-added services as a primary revenue-generating activity, the Monitor confirms that the reality is somewhat different. Introducing new products/product lines is the most likely means for distributors to generate revenues in the next 12 months (Figure 8). Also a priority is introducing existing products into new markets or industries and introducing line enhancements. Distributors participating in retail/consumer markets were more likely than the other two market groups to rate new products and line enhancements as a priority.

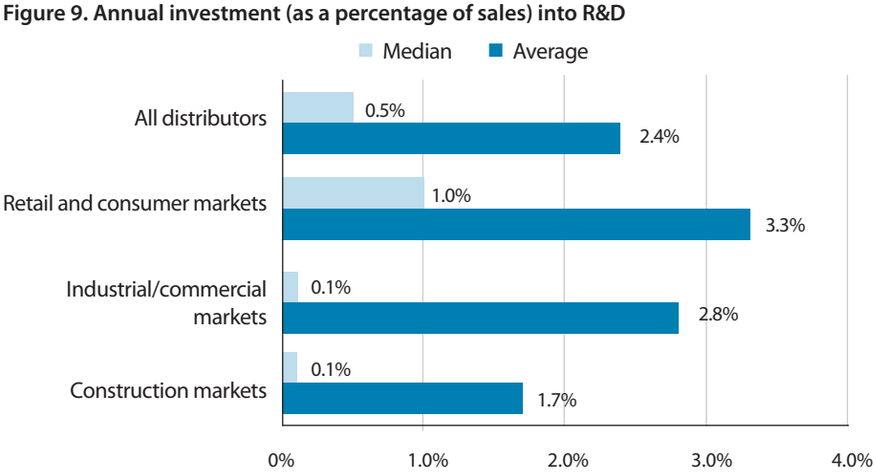
Although lower on the list of revenue-generating activities, introducing new value-added services is an important strategy of a third of the respondents. For value-added services to customers, the five most commonly offered are product returns; kitting/assembly; sequencing of orders to customers schedule; warranty/product returns; and relabeling/repackaging.

Figure 8. Revenue-generating activities in next 12 months

Revenue-generating activities in next 12 months	% "extremely important" and "important"
Introducing new products/product lines	50%
Introducing existing products in new markets or industries	46
Introducing line enhancements	45
Introducing new value-added services	34
Introducing new technologies	29
Introducing existing products in new countries/regions	24
Introducing new generic or private-label products	20

Distributors spend on average 2.4 percent of their annual sales on R&D (Figure 9). But most distributors spend significantly less on R&D than the average figure: median[1] spending is just 0.5 percent of annual sales, and 46 percent of distributors spend nothing on R&D; another 16 percent spend only 1 percent or less. The R&D spending data also appears high because of distributors that also manufacture products: among the group of "mostly distributors, some manufacturing" R&D spending is 3.8 percent of sales (average) and 2 percent of sales (median).

Figure 9. Annual investment (as a percentage of sales) into R&D



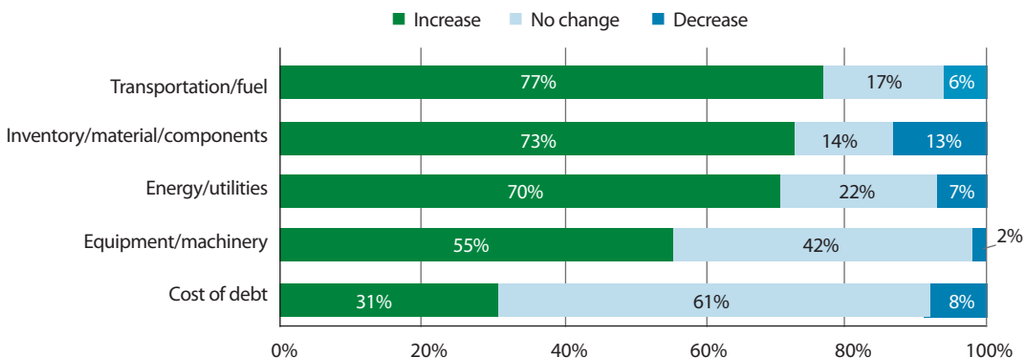
[1] Half of distributors report above 5 percent and half of distributors report below 5 percent.

Cost expectations

A majority of distributors anticipate that all costs listed on the 2012 Monitor Study questionnaire will increase in the next 12 months (Figure 10). Three-quarters of distributors expect transportation/fuel costs to rise — with one in 10 expecting an increase of more than 10 percent. Most distribution groups are anticipating comparable cost increases. Distributors of retail/consumer products are more likely to expect an increase in transportation fuel costs (80 percent expect an increase).

Yet with the Federal Reserve continuing to keep the interest rates at an all-time low, it's not surprising that the exception to these rising expectations is the cost of debt.

Figure 10. Anticipated cost changes in next 12 months (all distributors)



The most common strategy to maintain profit margins amid the current economy is lowering costs through operational efficiencies. Many distributors are working with suppliers and/or customers to improve processes and costs.

Maintaining margins

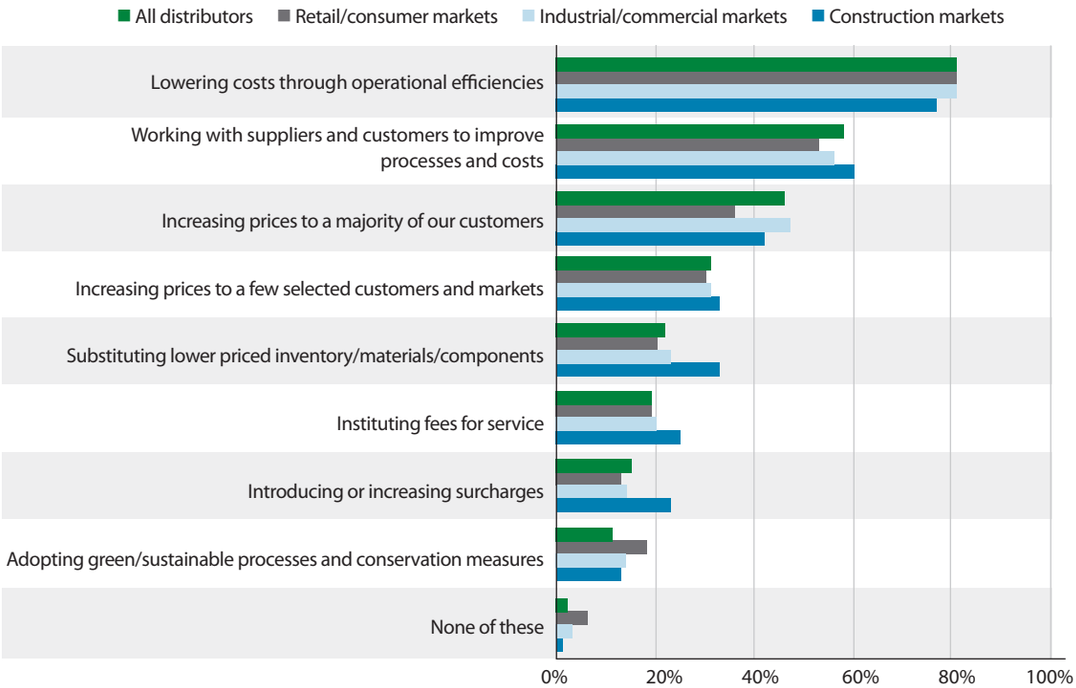
With these expected costs increases, distributors are implementing a number of tactics to maintain profitability.

The most common strategy to maintain profit margins amid the current economy is lowering costs through operational efficiencies — in place at 81 percent of organizations (Figure 11). More than half of distributors also are working with suppliers and/or customers to improve processes and costs (58 percent of distributors) and/or increasing prices to a majority of customers (46 percent of distributors).

Many distributors plan on increasing prices in the coming months; on average, they plan a 5.1 percent price increase for goods and 3.8 percent for services overall. Those in industrial/commercial markets are more likely to raise prices to a majority of customers, while those in construction markets are more likely to substitute lower priced inventory/materials/components and/or introduce or increase surcharges.

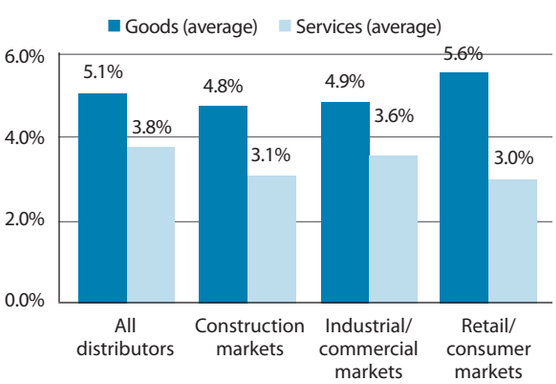
Approximately 90 percent of distributors will increase prices for goods in the next 12 months, and 40 percent of distributors will increase goods prices by 3 percent or less (average change will be a 5.1 percent increase). Approximately 61 percent of distributors will increase prices for services in the same period, and 23 percent of distributors will increase service prices by 3 percent or less (average change will be a 3.8 percent increase) (Figure 12).

Figure 11. Strategies to maintain profit margins given current commodity and service market



Note: No distributors indicated financial hedging against raw-material costs as a strategy in use.
Note: Multiple responses possible

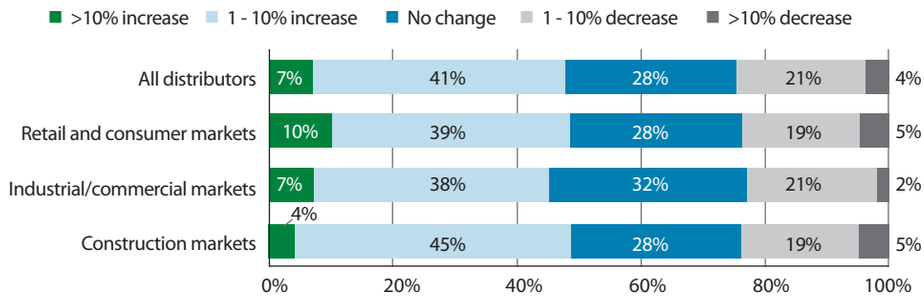
Figure 12. Approximate change in sales prices in next 12 months



Inventory

Almost half of distributors (48 percent) expect to increase inventory levels in the next 12 months; 7 percent of distributors will increase inventory levels by more than 10 percent (Figure 13). But fully one-quarter of distributors will reduce inventories. Fifty-two percent of distributors that expect to increase U.S. sales in the next 12 months also will increase inventory levels.

Figure 13. How will your total inventory levels change in the coming 12 months?



Capital expenditures

Two-thirds of distributors (64 percent) expect to increase their investments in capital equipment in 2012 compared to 2011. Investments in capital equipment will increase by 7.5 percent on average, with the industrial/commercial markets leading that trend (Figure 14). The majority of distributors, though, will increase spending by less than the industry average, as evidenced by a median increase of 5 percent.

The biggest capital expenditure target among distributors in the next 12 months is information technology, where 66 percent of organizations will increase spending; 15 percent of distributors will increase IT spending by more than 10 percent (Figure 15). IT spending is a priority in every distribution market group, as many organizations turn to technology to streamline processes and improve connectivity with suppliers and customers. Among those distributors with a corporate objective to expand existing facilities/warehouses, 74 percent will increase investments for facilities/warehouses. Similarly, 87 percent of distributors that have an objective to build or acquire new facilities/warehouses will increase investments.

Figure 14. Change in capital expenditures this year compared to previous year

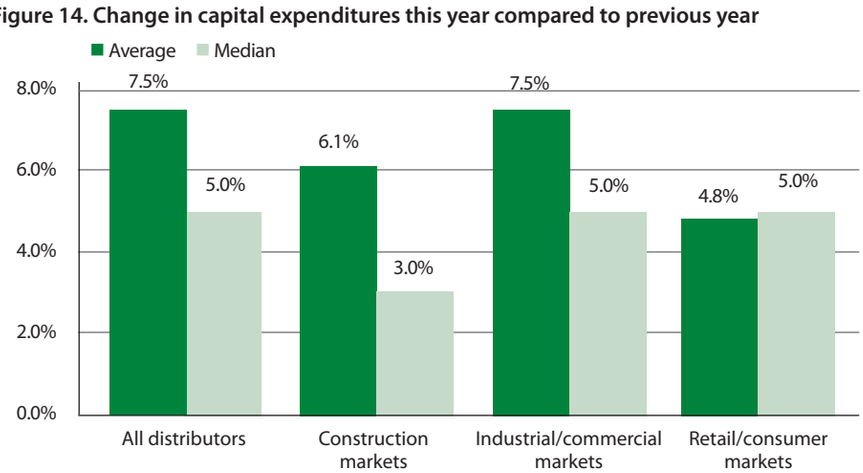
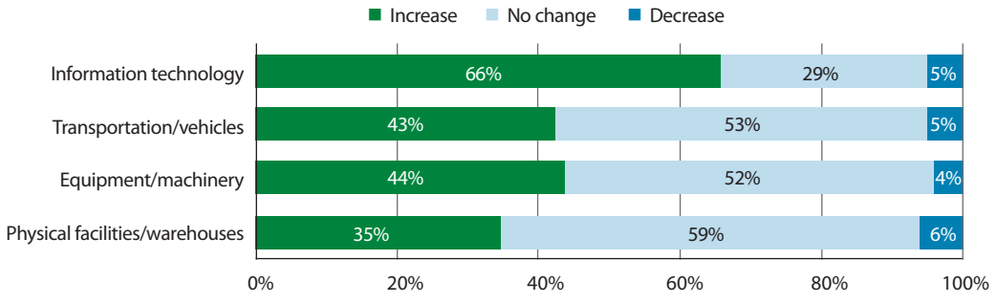


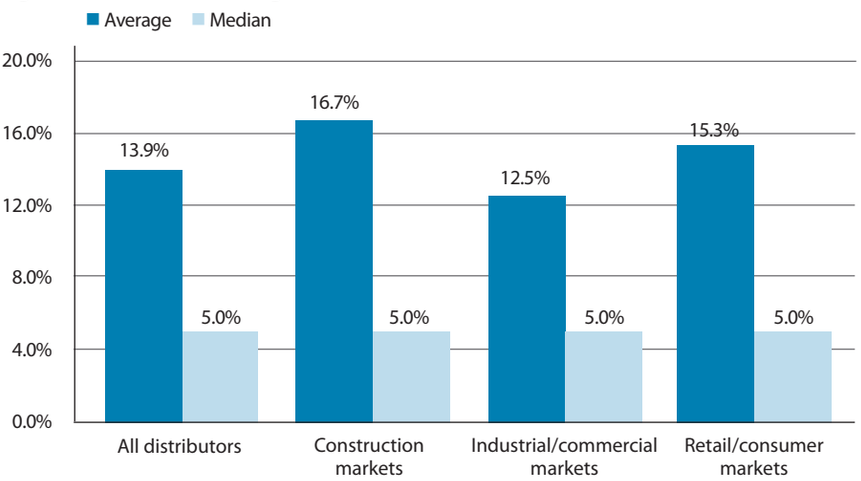
Figure 15. Specific capital-expenditures changes in the next 12 months



Net income

Three-quarters of distributors expect net income to increase in the next 12 months, with an average net income increase of nearly 14 percent (Figure 16). It's important to note that these net-income growth findings are influenced by a few exceptionally successful distributors (some 20 percent of distributors expect net income to rise by 20 percent or more). Median net income change for distributors was a 5 percent increase.

Figure 16. Net income change



Workforce

Distributor workforces

Distributors participating in the 2012 Monitor Study report:

- ***Total employees:*** *670 (average) and 95 (median). At distributors with sales of $1 billion or more, there are 5,260 (average) and 4,150 (median) total employees.*
- ***Employees in the United States:*** *563 (average) and 75 (median).*
- ***Employees outside the United States:*** *94 (average) and 0 (median). Approximately 78 percent of distributors do not have employees outside the United States.*
- ***Part-time employees:*** *52 (average)*
- ***Temporary employees:*** *20 (average)*
- ***Individual independent contractors:*** *12 (average)*

Distributors involved in retail/consumer markets report more employees for all categories of their workforces.

Employment outlook

Two-thirds of distributors (66 percent) report that they will increase their total employee levels in the next 12 months, with increases more likely to occur within the United States — 62 percent will increase U.S. employment (Figure 17). Some 14 percent of distributors expect to increase employment outside the United States but most expect no change. For organizations with employees outside the United States, 55 percent plan to increase their offshore employment.

Distributors have historically been focused on improving their sales and marketing efforts, and their hiring targets reflect that inclination. Distributors are most likely to add employees for their sales and marketing functions and customer service/support (Figure 18). The projected placement of new employees among the three market groups was comparable, although those in construction markets are more likely to add drivers and logistics staff; and those in retail/consumer markets are more likely to add staff for inventory management.

Figure 17. Change in employee levels in next 12 months

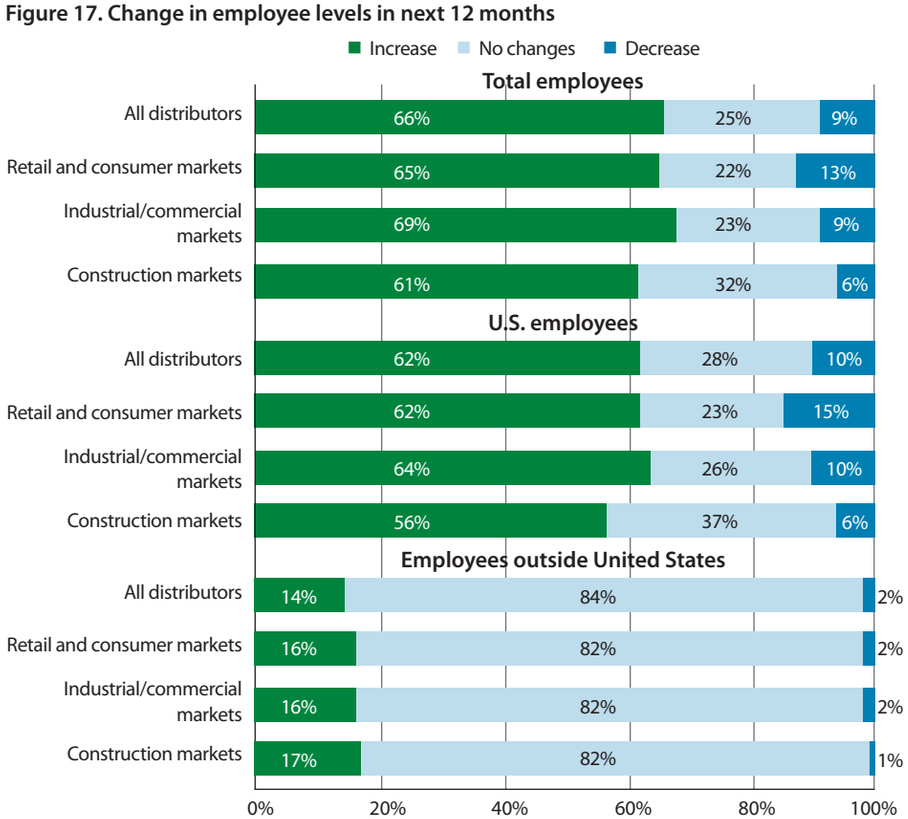
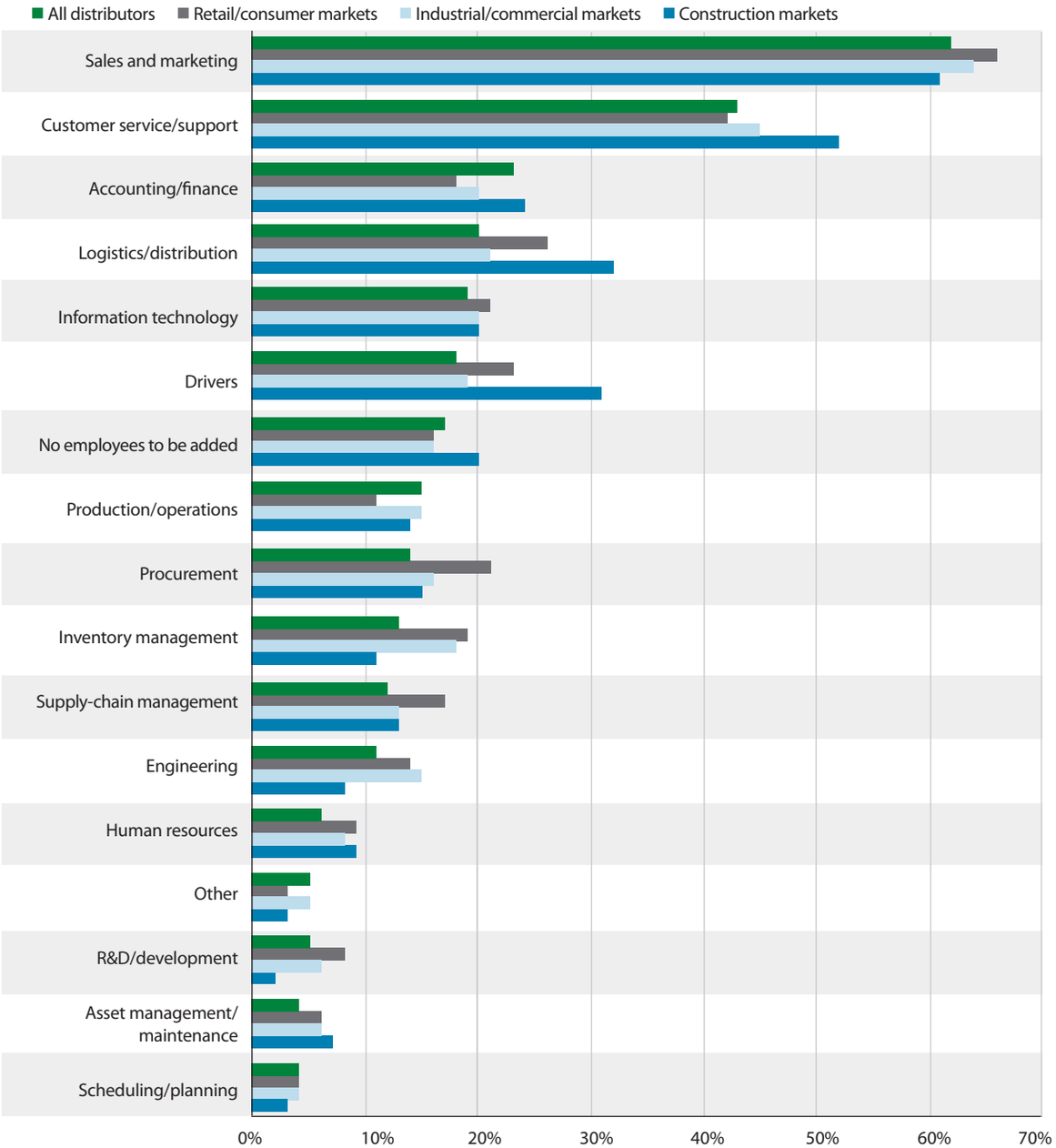
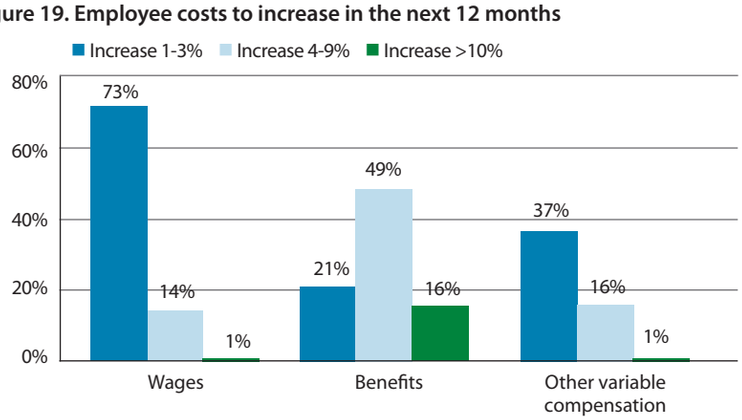


Figure 18. Functions adding employees in the next 12 months



Most distributors expect employee costs for wages, benefits and other variable compensation to rise in the next 12 months (Figure 19). The anticipated increases may be due to a number of factors: certainly, if companies are going to be hiring more workforce personnel, costs will rise for wages; benefits costs are expected to increase due to rising health care costs; and an older workforce will likely mean a growing group receiving retirement benefits.

Figure 19. Employee costs to increase in the next 12 months



Skills gaps

Most distributors find the skilled talent they require — 6 percent always and 57 percent most of the time (Figure 20). But that still leaves more than one-third of distributors that do not consistently land the talent they need: 33 percent only find talent some times, and 5 percent rarely find the talent they need.

Specific function categories hardest to hire are drivers (46 percent of distributors that expect to add employees to this function report that skilled talent is only some times or rarely found), and customer service/support (42 percent of distributors that expect to add employees to this function report that skilled talent is only some times or rarely found) (Figure 21).

"While recruiting top talent in wholesale distribution is a perennial concern, the importance of what distributors do for society positions us as an ideal home for bright and ambitious workers. Our industry trades on the fast-paced action, flexible job roles, personal empowerment and decision making close to the customer that the best candidates so often seek."

Mark Kramer
President/CEO, Laird Plastics, Boca Raton, Fla. and 2012 Chairman of the Board, National Association of Wholesaler-Distributors

Figure 20. Finding skilled talent

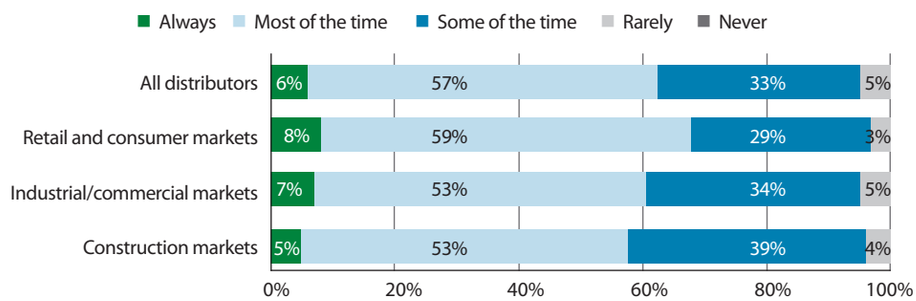


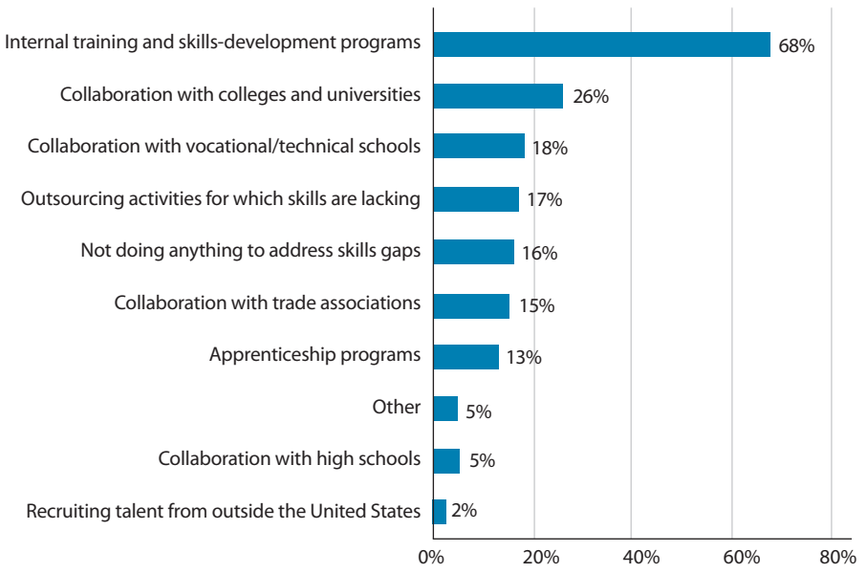
Figure 21. Functions adding staff and difficulty finding skills

Function	Always	Most of the time	Some of the time	Rarely
Drivers	6%	48%	38%	8%
Customer service/support	3	56	35	7
Procurement	8	54	35	2
Accounting/finance	10	53	33	5
Production/operations	7	56	31	6
Engineering	0	63	34	2
Sales and marketing	6	59	32	4
Inventory management	9	57	28	7
Logistics/distribution	7	60	29	4
Information technology	6	63	29	3
Supply-chain management	5	70	26	0

Note: Functions for which more than 30 distributors expect to add staff.

Distributors are most likely to address skills gaps with internal training and skills-development programs (Figure 22). When some organizations fail to find the talent they need, they may turn to individuals who lack specific technical skills and then train them to meet those specific needs. To that end, collaboration with colleges and universities and with vocational/technical skills are helpful methods to address skills gaps. Some 16 percent of distributors do nothing to address skills gaps.

Figure 22. Preventing or addressing skills gaps



Note: Multiple responses possible

"Finding qualified, skilled workers continues to be an issue for many distributors. It is encouraging that employers are becoming more proactive about collaboration with educators."

Karen L. Kurek, Partner and, National Manufacturing & Distribution Practice Leader, McGladrey LLP, Chicago, Ill.

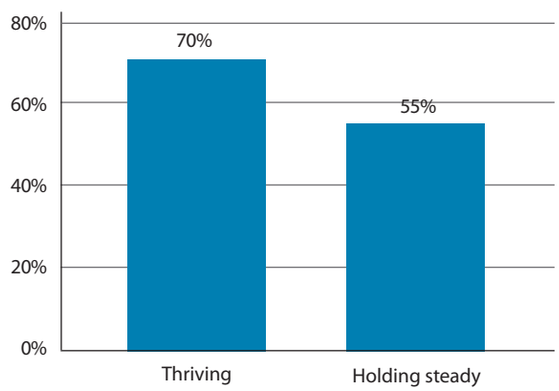
Process improvements

Few organizations can survive without continuous effort to improve productivity. Indeed, with distributor workforces only now beginning to increase, organizations have relied in recent years on getting more from fewer employees. At many organizations, process improvements are the only way to achieve or maintain a competitive advantage.

A majority of distributors will increase investments in process improvements this year compared to last:

- **Increase:** 59 percent of distributors will increase their investments in process-improvement initiatives
- **No change:** 38 percent of distributors will keep investments the same as the previous year
- **Decrease:** 2 percent of distributors will decrease their investments

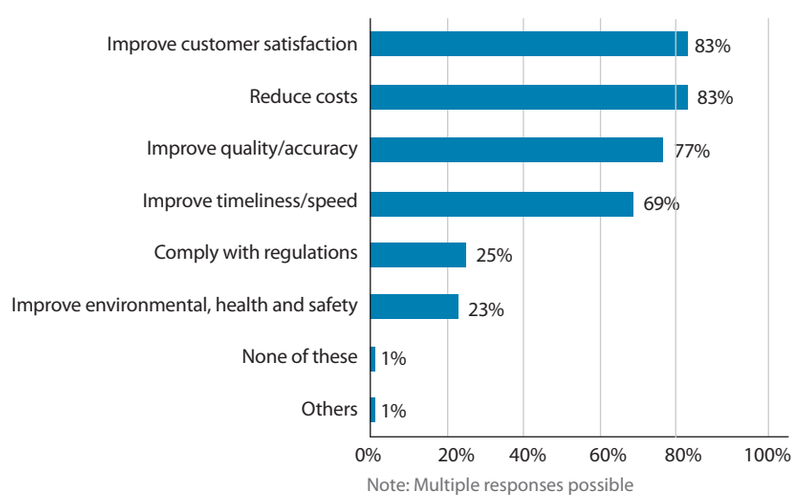
Figure 23. Businesses increasing process improvement investments



Not surprisingly, distributors who report their organizations are thriving are more likely to increase their investments in process improvements: 70 percent of thriving distributors will increase process-improvement investments compared to 55 percent of distributors holding steady that will increase investments (Figure 23).

Primary objectives of improvement initiatives are to improve customer satisfaction, reduce costs, improve quality/accuracy and improve timeliness/speed (Figure 24). Distributors involved in construction markets are more likely to leverage improvements to improve timeliness/speed (72 percent).

Figure 24. Primary objectives of improvement initiatives



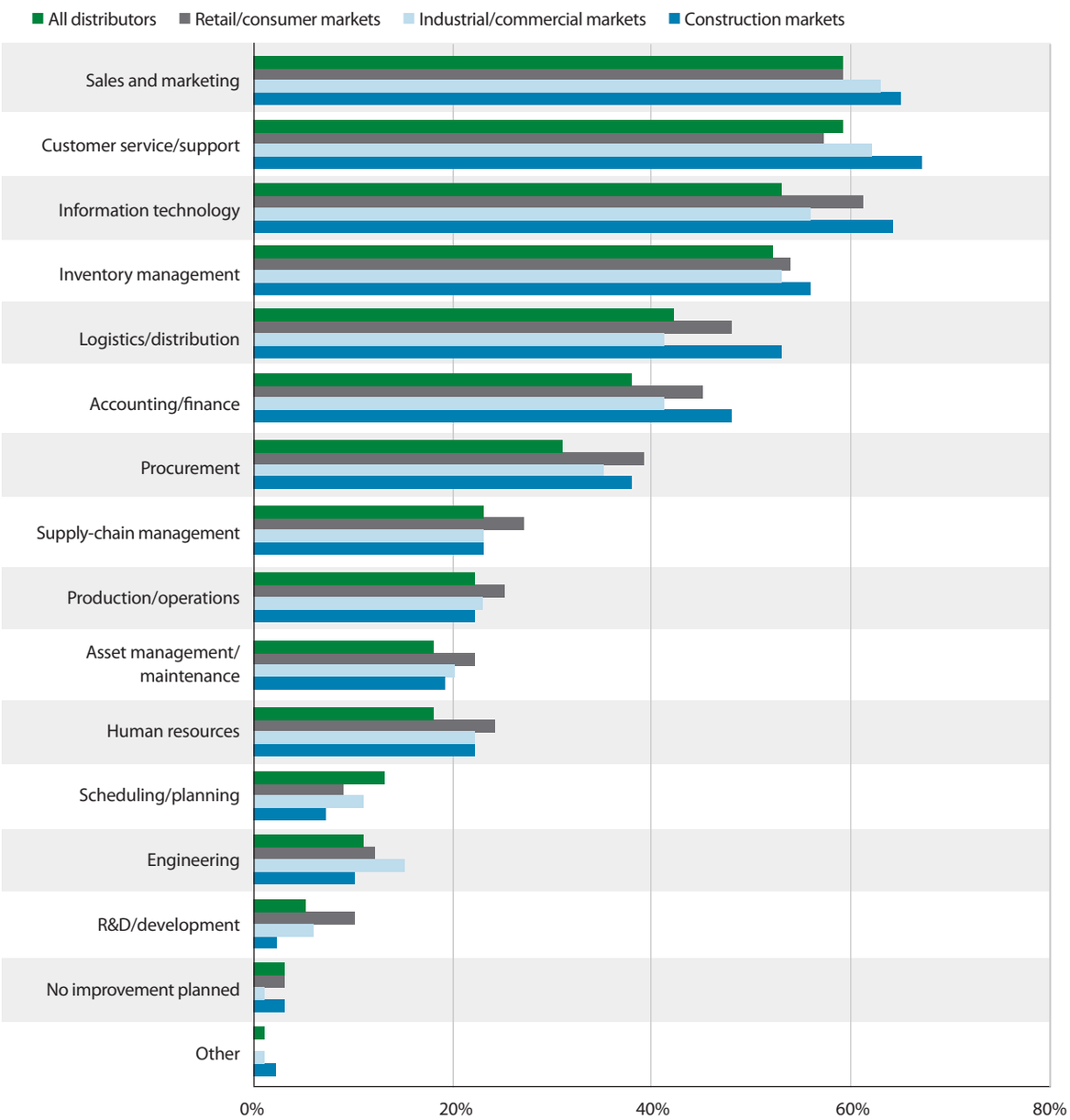
The location or processes where distributors will most likely focus their improvement initiatives in the next 12 months are customer service/support, sales and marketing, information technology, and inventory management (Figure 25).

Distribution is a customer-focused, sales-driven industry, and distributors are looking to improve activities that affect those functions. Note, too, that service/support and sales and marketing are also the functions where distributors are most likely add employees in the next 12 months.

"Process improvement initiatives are oftentimes evaluated and selected based upon a return on investment analysis that can show a short payback cycle. Global competition and pressure to reduce prices from large customers have increased the importance of the cost reduction focus. But most have not imbedded ongoing continuous improvement into the company culture."

Dale Billet, Director, Performance Improvement Consulting, McGladrey LLP, Elkhart, Ind.

Figure 25. Location of improvements initiatives in next 12 months



Note: Multiple responses possible

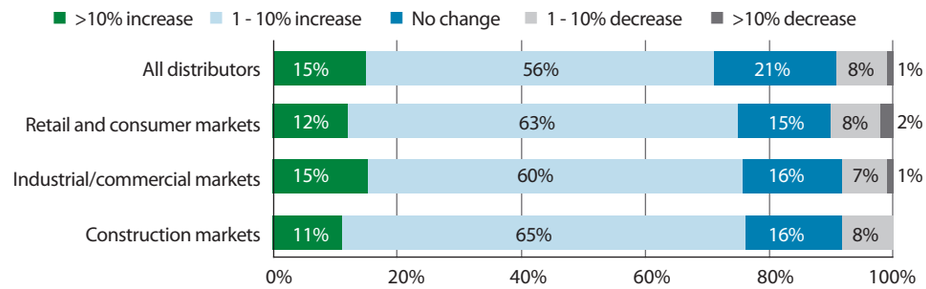
The 2012 Monitor Study asked distributors to name their most significant process improvement in the last 12 months and to describe the impact it had on the company. Responses ranged from application of new equipment, automation, and information technologies to the hiring of new employees. Many responses, though, focused on clear-cut improvement initiatives applicable to most distributors, including:

- *"Reorganization of the warehouses to increase capacity and improve zone-picking efficiencies."*
- *"Reorganized sales administration and support functions to free up sales staff to do more selling and less administration. Sales increased by 10 percent."*
- *"Improved purchasing procedures resulting in lower inventory and [carrying] costs."*
- *"250 kaizen implements (small bursts of improvements) at our company in FY2012."*
- *"Implementation of lean programs in operations for $50 million in savings."*

The majority of distributors (71 percent) have increased productivity (sales per employee) in the past 12 months; only 9 percent of distributors indicate that productivity has decreased (Figure 26)[2]. Approximately 89 percent of thriving distributors increased productivity in the past 12 months.

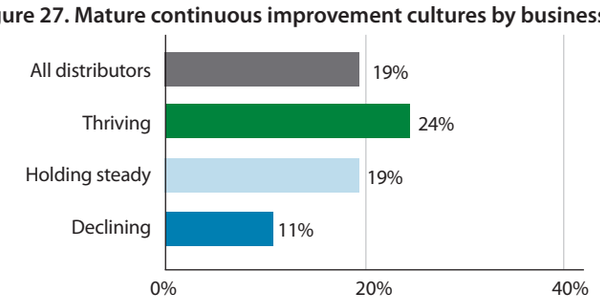
Among distributors who increased productivity, the most likely factors driving the improvements were general process improvements (63 percent of distributors); improved labor utilization (47 percent); investments in information technology (46 percent), and training (32 percent).

Figure 26. Productivity (sales per employee) changed in the past 12 months



The challenge of developing a mature CI culture is illustrated by the fact that thriving businesses are more likely to have a mature CI culture compared to businesses holding steady or declining (Figure 27).

Figure 27. Mature continuous improvement cultures by business condition

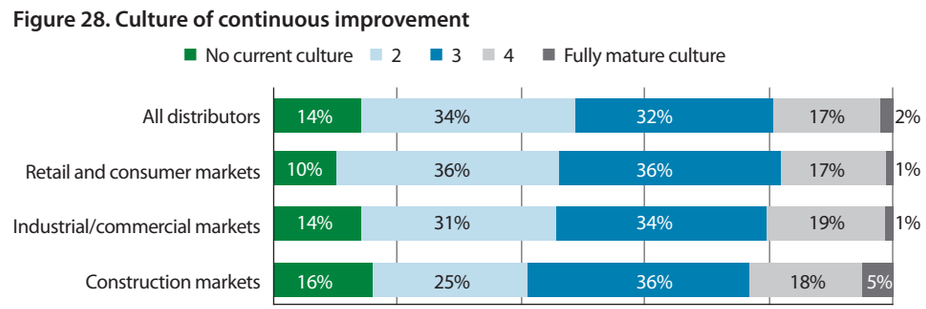


Note: Declining has a sample size of 18.

Despite these improvement efforts, distributors have not made much progress in developing cultures of continuous improvement. Only 2 percent of distributors report having a fully mature continuous-improvement culture (rate 4 or 5 where 5 equals fully mature) (Figure 28).

Similarly, 22 percent of distributors with the most mature CI cultures report that they are very optimistic about economic growth prospects for their business in the next 12 months compared to 19 percent of distributors with less mature CI cultures and 10 percent of distributors with no CI culture.

Figure 28. Culture of continuous improvement



[2] The three distribution market groups had a higher percentage with increased productivity than all distributors because distributors that identified their industry as "other" were not included in the groupings.

Information technology

Distributors continue to focus on information technology to improve productivity, drive growth and manage increasing complex relationships with suppliers and customers.

Business analytics

One technology intended to help distributors make business decisions for both internal operations and supply-chain activities is business analytics. Two-thirds of distributors report at least moderate use of business analytics companywide or among senior leadership — yet one-third of distributors are not widely leveraging the capabilities of this tool (Figure 29).

Distributors are most likely to leverage business analytics to forecast customer demand and to identify market opportunities (Figure 30). Distributors involved in retail/consumer markets are far more likely to use business analytics to forecast customer demand.

Of those distributors with the extensive use of business analytics (companywide or by senior leadership), thriving distributors are more likely to use business analytics than those that are holding steady (Figure 31). Similarly, 25 percent of distributors with extensive use of business analytics report that they are very optimistic about economic growth prospects for their business in the next 12 months compared to 16 percent of other distributors with lesser use of business analytics that report they are very optimistic.

"We are observing more companies using business analytics to quickly make well-informed management decisions. Distributors continue to rely heavily on data for analyzing customer demand and market opportunities."

Gordon Opland, Principal, Consulting Services, McGladrey LLP, Des Moines, Iowa

Figure 29. Use of business analytics (techniques and technologies) to evaluate past performance to inform business planning

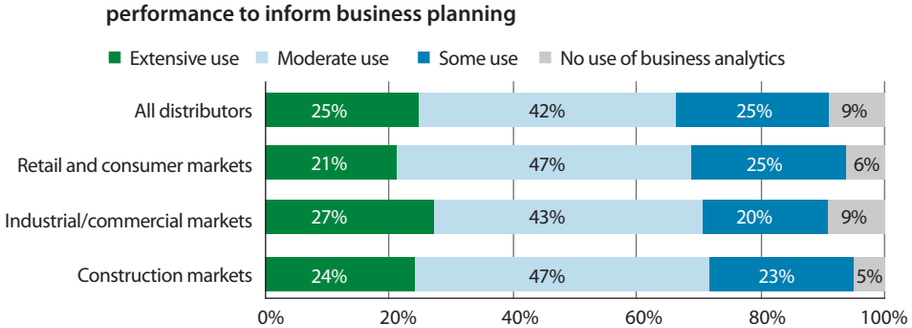
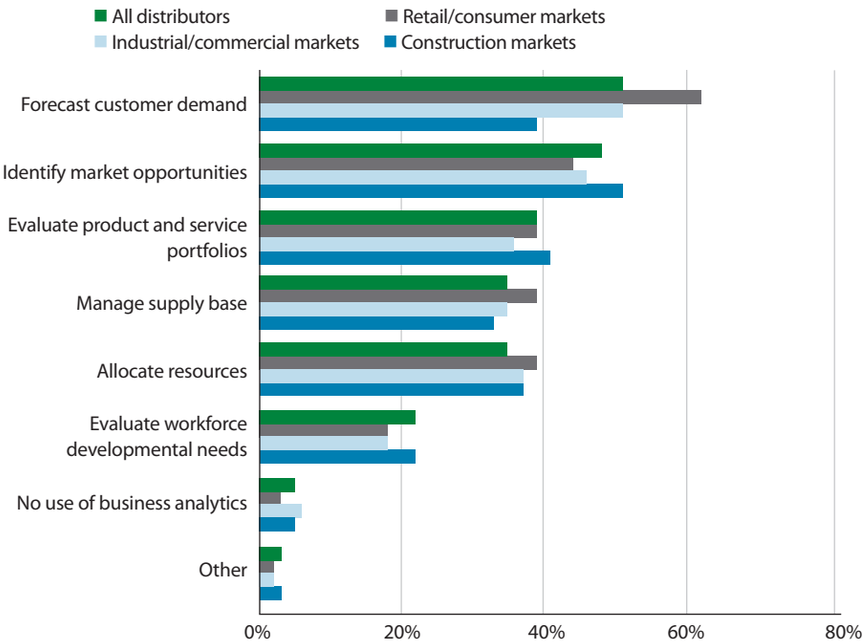
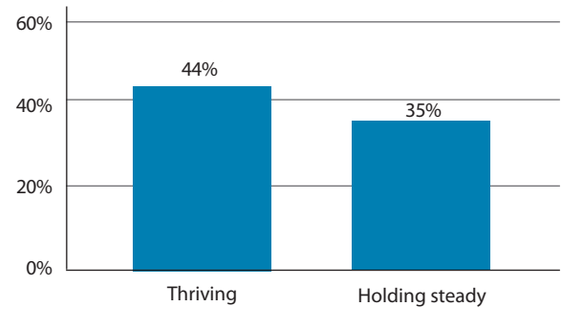


Figure 30. Leveraging business analytics for organizational improvement



Note: multiple responses possible

Figure 31. Businesses with extensive use of business analytics by business condition



Cloud computing and social media

Approximately 43 percent of distributors use cloud computing for IT systems or applications (Figure 32). The most common use is for storage, infrastructure or backup and office productivity systems, such as calendars and collaboration tools. Just 4 percent of distributors are using cloud computing for enterprise resource planning (ERP) or financial systems.

Social media is a hot topic in every industry, and distribution is no different. In fact, 18 percent of distributors make moderate or extensive use of social media (e.g., LinkedIn, Facebook, Twitter), and another 44 percent indicate some use of social media. Only 21 percent of distributors do not plan to use social media. Usage is lowest among distributors involved in construction markets (Figure 33).

Figure 32. Cloud computing use for systems or applications

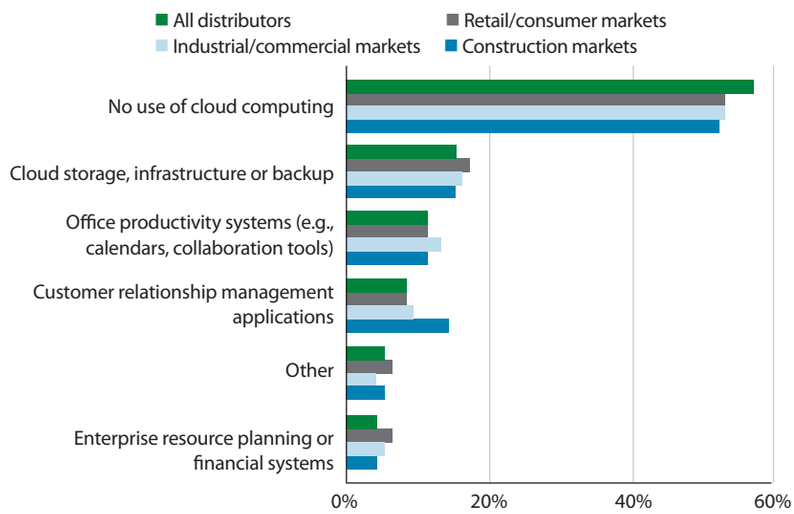
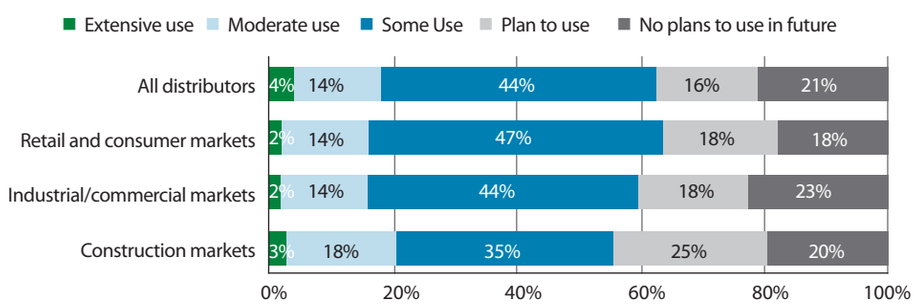


Figure 33. Use of social media for business activities



Corporate IT risks

The vast majority of distributors (79 percent) report that their information/data is not at risk or at little risk (Figure 34). Only 1 percent of distributors report that their information/data is very much at risk. Those distributors expecting large increases in capital-equipment spending for information technology (more than 10 percent increase in spending) are more likely to report that their IT is at risk (9 percent of such distributors rate their IT at risk or near to risk).

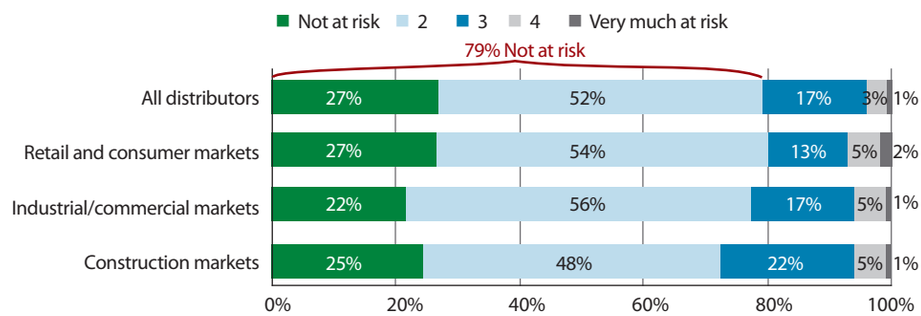
Are distributor IT systems as secure as they believe? The 2012 Monitor Study asked distributors what worries them most about the security of their company's data and information. While most distributors are not troubled about potential IT security risks, some executives voiced their concerns:

- *"No formal disaster recovery plan in place, but it is on the 2012 business plan."*
- *"That hackers will get information about our suppliers and processes that we have spent countless hours developing and refining."*
- *"Quickly changing world of technology; too many points of potential access to data that are difficult to fully protect."*
- *"Virus infiltration and hacking; lack of discipline and training regarding safeguarding information on mobile computers."*
- *"Hackers out there who have nothing else to do."*

"The information security company Symantec reported that they blocked more than 5.5 billion malware attacks (that is, attacks by malicious software) in 2011, an 81 percent increase over 2010. There is a lack of understanding and knowledge of the impact of new technologies and their related information security risks. Company executives should have a high-level assessment performed to understand their information security risks so they can proactively manage them. When it comes to IT security, ignorance is definitely not bliss."

Hussain Hasan, Principal and Practice Leader, Risk Advisory Services McGladrey LLP, Schaumburg, Ill.

Figure 34. Perception of information/data risks



Profile of participants

The following charts provide a profile of distributor participants in the 2012 Monitor Study:

Figure 35. Annual gross revenue for most recent fiscal year

Annual gross revenue	% of respondents
$500 million - $1 billion or more	10%
$100 million - $499.9 million	23
$50 million - $99.9 million	14
$25 million - $49.9 million	20
$15 million - $24.9 million	11
Less than $15 million	22

Figure 36. U.S. region

U.S. region	% of respondents
Great Lakes	27%
Central	25
Southeast	18
Northeast	15
West	11
Other/not disclosed	3

Figure 37. Countries and/or regions in which products sold

Country or region	% of respondents
United States	100%
Canada	46
Mexico	29
United Kingdom	18
Western Europe (excluding Germany and United Kingdom)	15
Central America	15
South America (excluding Brazil and Columbia)	14
Germany	13
Australia and New Zealand	13
Middle East	12
China	11
Brazil	11
Southeast Asia (excluding China, India, Hong Kong and Japan)	11
Japan	10
Eastern Europe	10
Hong Kong	8
India	7
Colombia	7
Africa	6
Russia	5
Central Asia (excluding Russia)	4
Other countries or regions	3

Note: Multiple responses possible

Figure 38. Countries or regions with a physical presence (e.g., offices, warehouses, facilities)

Country or region	% of respondents
United States	99%
Canada	15
China	6
Mexico	6
United Kingdom	5
Germany	4
Hong Kong	4
Western Europe (excluding Germany and United Kingdom)	4
Brazil	3
Australia and New Zealand	3
India	2
Japan	2
Southeast Asia (excluding China, India, Hong Kong and Japan)	2
South America (excluding Brazil and Columbia)	2
Middle East	2
Colombia	1
Other	4

Note: Multiple responses possible

Figure 39. International activities

Percentage of revenues sold to customers outside the United States	
Median	1.0%
Average	8.3
Percentage of physical assets reside outside the United States	
Median	0.0%
Average	5.8

Figure 40. Business activity

Business activity	% of respondents
Mostly distribution, some manufacturing	22%
Distribution	78

Figure 41. Market groups

Market group	% of respondents
Industrial/commercial markets	55%
Retail/consumer markets	32
Construction markets	30

Note: Market groups were formed by placing distributors based on industry into one or more of the three groups

Note: Multiple responses possible

Figure 42. Core customers

Customer type	% of respondents
Retailers	41%
Manufacturers	36
Distributors	27
Government	22
Consumers	18
Service industries	17
Institutional	14
Health care	12
Transportation	9
Other	16

Note: Multiple responses possible

Figure 43. Corporate entity

Corporate entity	% of respondents
Private or closely held business	82%
Private-equity owned business	9
Publicly traded corporation	4
Division of a larger non-U.S.-based company	4
Division of a larger U.S.-based company	1

Figure 44. Title of respondent

Title of respondent	% of respondents
Chief Executive Officer, President, Chairman, Owner	47%
Chief Financial Officer, Senior Finance Executive	33
Other title	11
Chief Operating Officer	5
Principal, Managing Partner, Partner	3
Chief Marketing or Sales Officer	2

Methodology

The 2012 McGladrey Manufacturing & Distribution Monitor was conducted using an online questionnaire that was promoted by McGladrey and various industrial associations to principally U.S.-based manufacturing and distribution organizations.

Distributors were directed to the 2012 NAW Institute/McGladrey Monitor, with messaging and some questions tailored to distributors. The 2012 NAW Institute/McGladrey Monitor was presented by the NAW Institute for Distribution Excellence and McGladrey. There were 924 total valid respondents to the overall 2012 Monitor Study (370 distributor respondents), with completed questionnaires received in May and June 2012. Responses were received by The MPI Group, an independent research firm, and then entered into a database, edited, and cleansed where necessary to ensure answers were plausible. All respondent answers to the 2012 Monitor Study are confidential. As incentive to complete the study, participants are being provided a customized report that shows their responses compared to aggregate groupings of participants.

Some findings in this report exceed 100 percent because the question allowed for multiple responses. In addition, some findings intended to sum to 100 percent may not do so because of rounding of decimals.

About the NAW Institute for Distribution Excellence

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Institute for
DISTRIBUTION
EXCELLENCE

The NAW Institute for Distribution Excellence is the research arm of the National Association of Wholesaler-Distributors (NAW) in Washington, DC. NAW is composed of direct member companies and a federation of international, national, regional, state, and local associations and their member companies, which collectively total more than 40,000 firms. The NAW Institute for Distribution Excellence sponsors and disseminates research into strategic management issues affecting the wholesale distribution industry. The NAW Institute aims to help merchant wholesaler-distributors remain the most effective and efficient channel in distribution. The NAW Institute for Distribution Excellence and McGladrey entered into a formal alliance in 2011. This Distribution Monitor report constitutes the initial output from that partnership.

Special thanks to the NAW Institute for Distribution Excellence Board of Directors — chaired by Joe Nettemeyer, president and CEO, Valin Corporation, Sunnyvale, Calif. — for its foresight in authorizing creation of the Distribution Monitor.

Additional resources

More than 2,000 manufacturing and distribution professionals participated in the McGladrey Manufacturing & Distribution Executive Summits held throughout the country in the fall of 2011. Contact your local McGladrey office or go to www.mcgladrey.com/manufacturing for details on the 2012 Summits and to learn about our other industry events, resources and services.

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