

How Distributors Can Close the Gap with Amazon Business

Amazon Business: Advanced Technology, Unconventional Leadership



How Can I Close the Gap?

For more than 50 years, MDM has advised senior executives across many verticals in the distribution industry. Today, one of the most common questions we hear became the impetus for this paper. CEOs and other senior executives frequently ask us, “How can I close the gaps between my company and Amazon Business?”

We find that the “question behind the question” is usually, “What technology do I need so I can succeed online, too?” That means the distribution leaders we interact with assume that the primary gaps they need to close require technical solutions, e-commerce expertise and supporting processes like managing product and customer data, recasting sales roles and reconciling pricing inconsistencies between channels.

These are all real issues – and we will address them in this document. However, even if distributors solved every single one of these challenges and achieved world-class performance as an e-commerce company, they would not close the gaps separating most major corporations from Amazon (and, by extension, Amazon Business).

First, no distributor can match either the technical sophistication or incredible product assortment Amazon offers through Amazon Business. The company’s scale and competencies as a technology company outstrip any distributor. Also, Amazon’s use of marketplaces (i.e., platforms through which third-party companies, including many distributors, sell) creates an unbeatable number of products.

But another important difference between Amazon and all of its many competitors across dozens of industries is not about any of these issues. It’s about the leadership practices the company has developed. In addition to wielding the most advanced online selling and marketing tools available, Amazon also follows a set of Leadership Principles that we believe differentiate it not just from distribution companies but from major corporations in many industries. At the end of this document, we will examine these principles and recommend how distributors might apply them, too.

Four Steps in Closing Gaps with Amazon Business

This white paper is organized into four main sections:

1. **Understand the Digital Advantages of Amazon Business.** Here, we discuss the people, processes and systems that enable Amazon Business to offer a robust value proposition to business customers.
2. **Understand the Digital Capabilities Distributors Need.** This section identifies the people, processes and systems required to build competitive online selling capabilities to compete with Amazon Business.
3. **Build Product and Service Moats.** In this section, we provide an overview of why and how you can offer your customers products and services that are difficult to sell without the involvement of people, making these sales hard to digitize and thus difficult for pure digital players to duplicate.
4. **Adapt Amazon’s Leadership Principles to Your Own Business.** In this section, we review what Amazon has identified as the fourteen traits of a leader, offer some analysis based on MDM’s decades of experience in the industry and make recommendations for distribution executives.

Distribution leaders must address the technology gaps. However, for many companies, combining the right investments in technology, building value-added services as moats and then adapting Amazon's proven set of leadership guidelines to their businesses will speed up decision-making, drive more experimentation and innovation and create better business results. But let's start with the technology.

1. Understand the Digital Advantages of Amazon Business

In the 20+ years since Amazon was founded by Jeff Bezos, distribution leaders have remained skeptical that the company could succeed in selling to B2B buyers. Unlike transactions in distribution, selling books is simple: Customers ordered them online with no need for product expertise or contact with another human being. Then, the orders were transmitted to a warehouse, where they were picked, packed and shipped on a small package common carrier.

Amazon soon expanded into other types of consumer products, but the buying and selling requirements remained the same. The narrative from distribution executives went something like this: "Distribution is far more complex. Our products can't be easily turned into bits and bytes of digital code; they require special knowledge and are often hard to ship. The purchasing cycle is unique, businesses buy differently than consumers, and you need sales reps and product experts to make a dent in this market."

But just three years after its founding, Amazon Business, the part of Amazon that is focused on B2B, has grown to \$10B in annual revenue. According to the company's blog, "In the U.S. alone, Amazon Business serves nearly 80% of the 100 largest enrollment education organizations, 55 of the Fortune 100 companies, more than half of the 100 biggest hospital systems and more than 40% of the 100 most populous local governments. Amazon Business also offers access to nearly 150,000 U.S. business sellers – hundreds of thousands globally -- and hundreds of millions of products."

Wholesale distribution is a \$6 trillion industry in the U.S. alone, if Amazon Business takes just 10 percent of this market, it will reach \$600 billion in sales.

Since wholesale distribution is a \$6T industry in the U.S. alone, if Amazon Business takes just 10 percent of this market, it will reach \$600B in sales. However, unlike the vast majority of distributors, Amazon Business is rapidly expanding globally. In addition to the U.S., the company does business in France, Italy, Spain, Germany, the U.K., Japan and India. It's easy to see why the company is pouring resources into competing with wholesale distributors: it's a huge market, defended by a large and fragmented set of competitors, most of which are small and have relatively poor technological capabilities.

Amazon Business has developed substantial digital advantages that are working to attract business away from incumbents. This is a shift in market share because, unlike manufacturers, distributors cannot do much to create demand. Instead, they compete for a fixed pool of sales, meaning the revenues that Amazon Business is earning are coming out of competitors' pockets.

The Amazon Business Value Proposition

So how does Amazon do it? Amazon’s sweet spot is taking an order electronically and then moving relatively simple consumable items without (or with very limited) human interaction via standard carrier to customers. But Amazon takes this approach much deeper by using its best-in-the-world digital and data capabilities to figure out how to:

- Grow with technology instead of by adding people – this allows it to build efficiencies of scale as it grows
- Grow sales with cash from sources other than the company’s balance sheet
- Move deeper vertically (both up and down) into the supply chain
- Move faster and be far more efficient

Make no mistake, a formidable competitor has entered into the B2B world of distribution and is adamant on disrupting and consolidating this highly fragmented industry. At this point, it appears there are few reasons they would need to acquire any company from this industry. They already have access to most suppliers, customers are coming to them and they have access to millions of SKUs from their own distribution centers and from third-party sellers. Amazon Business is well-positioned to take market share.

Why Do Customers Come to Amazon Business?

Besides hundreds of millions of products, what else is Amazon Business offering your customers to take them away? The following is a list of benefits from the company’s website as of November 9, 2018. We suggest you fill in the column on the right to see how you compare:

Value Proposition	What Is It?	Amazon	You
Business-only prices	Amazon Business offers price discounts for businesses on millions of products.	X	
Quantity pricing	Save more when you buy more. Price breaks on multi-unit purchases on millions of products.	X	
Compare offers	Satisfy your sourcing requirements. View multiple offers from a variety of sellers on a single page.	X	
Business Prime	Free same-day, one-day, and two-day shipping on eligible items.	X	
Amazon fulfillment	Benefit from Amazon’s world-class logistics network. Choose how and when you want your order delivered.	X	
FREE shipping	All orders of \$25 or more of eligible items across any product category qualify for free shipping.	X	
Pallet shipping	If your order qualifies, Amazon will deliver it on a pallet to your receiving dock or doorstep. In either case, with pallet shipping, you receive one consolidated delivery.	X	

Business-only products	Amazon’s suppliers now make a growing number of their products available exclusively to businesses.	X	
Amazon’s selection	From IT to janitorial, from office to restaurant supplies, Amazon has hundreds of millions of products to choose from.	X	
Integrated purchasing system	Amazon Business is enabled as a catalog on more than 30 leading systems.	X	
Seller credentials	Discover sellers with attributes such as small business, women owned and minority owned.	X	
Multi-user accounts	Connect your team, create purchasing groups to match your org structure and share payment methods.	X	
Approval workflows	Customize your order approvals, set spending limits and manage your organization’s buying.	X	
Reporting and analytics	Track and monitor spending by your organization with dynamic charts and data tables.	X	
Amazon Business Card	Choose to earn rewards or take more time to pay interest-free on U.S. purchases.	X	
Amazon.com Corporate Credit	Amazon’s corporate credit lines offer expanded user and management options. Authorize multiple buyers on a single account, download order history reports, and pay by purchase order.	X	
Tax-exempt purchasing	If eligible, can enroll for tax-exempt purchasing.	X	
Purchasing cards	Share payment methods, including your company’s existing purchasing cards, with a few users or your whole team.	X	

The company continues to add new features constantly, so you need to compare your value proposition to theirs on a regular basis. This is just one indicator that they are truly listening to distribution’s customers and are learning the business. How does your value proposition compare to this one? How often are you adding new and better value to your customers? What is holding you back?

2. Understand the Digital Capabilities Distributors Need

Given Amazon’s vast resources and technical superiority, why should you invest in digital capabilities at all? It’s not possible to outspend Amazon Business and close digital gaps entirely. So, what’s the point?

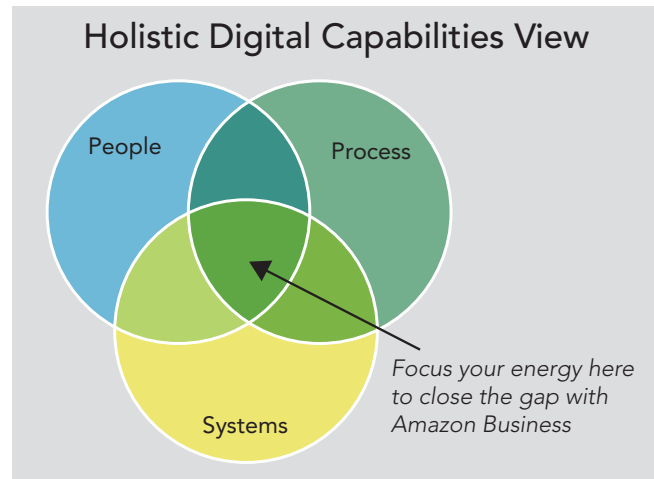
Not taking action is the worst decision. For years, some distributors have had better digital capabilities than others but the technology laggards have found ways of competing anyway. However, since customer expectations around online services have increased, distributors must meet certain minimum

requirements to compete. While Amazon Business is certainly raising the bar on what customers expect (and, more importantly, will expect in the future), that doesn't mean you need to match them feature for feature but it does mean you need to meet a certain threshold of online functionality to remain competitive.

Jonathan Bein of Real Results Marketing describes it this way: If you owned a hardware store, you'd go to work every day knowing you could never build a chain of enormous stores to match Home Depot's. But that wouldn't mean you didn't need a store at all. You'd still need to build something differentiated from Home Depot that had basic, essential capabilities: an order-processing system, inventory-management tools, a good assortment, clean and orderly merchandising, etc. Similarly, while you can't build the online tools that Amazon Business offers, you still need capabilities that meet the expectations of your customers even though you may choose to differentiate in ways pure digital players can't match.

What System will Work Best?

So, what digital capabilities do you need to compete effectively? We suggest that you think about your digital capabilities holistically. That is to say, while the "systems", (i.e., hardware and software) are a key component to building out your capabilities, you should put greater emphasis on thinking about the "people" (both leadership and staff) as well as the "processes" you have in place to ensure the systems work as intended. We'll talk about each of these three key elements below in order of importance: people, process and systems.



The People Element

It Starts with Leadership: The first elements of the equation are leadership's understanding of and commitment to technology and the skills and appetite for change of the current staff. The second section of this white paper covers Amazon's leadership principles in depth, but let's look at why digital leadership has become a survival skill for distribution companies.

Long gone are the days of taking a "wait and see" strategy with digital. Amazon Business has already proven that e-commerce works well and is growing very fast in distribution. The former leadership of Borders, reflecting on the company's sudden and painful death, said in retrospect that by the time they heard of Amazon it was already too late. Many executives, either out of denial or lack of expertise, do not release enough capital into the organization fast enough. We hear leaders say things like, "After all, my largest customer is hardly buying anything online right now." Over the years, we have heard similar observations from leaders at Borders, Circuit City, Sears and many other retailers. Leadership must fundamentally change its philosophy and adopt the mindset that technology is critical to their survival.

Given Amazon Business's incredible speed in getting to \$10B in annual revenue, it's apparent that the old belief that B2B is too complex for a pure digital solution has been proven wrong, at least for a large portion of available purchases. It's highly critical to understand how generational change in the

workforce is driving the market towards these digital players. Millennials are now the largest single generation in the workforce and the following group, Generation Z, is growing rapidly. Meanwhile, the Baby Boomers are mostly retired and the Generation X'ers are reaching the ends of their careers.

The emerging generations are digital natives – that is, they have used Internet tools their entire lives and they prefer buying online. This is eroding the power of the personal relationships many traditional distributors rely on, meaning there is a coming inflection point: companies like Amazon Business keep building bigger advantages in online capabilities vs. traditional players while at the same time the workforce is evolving to prefer buying online. If you are a traditional distributor, that means that an increasing number of your customers inherently prefer digitally driven value propositions while your competitors who offer them are simultaneously increasing their digital advantages over you.

That means that you do not have the option of doing business like you have in the past. You cannot invent technology like Amazon Business can, but you can set a goal of becoming a “fast follower” in delivering capabilities customers increasingly demand. But this is still difficult, expensive and takes visionary and brave leaders to achieve.

What kind of talent do I need to become digitally competent? Now that you have thought about your own approach and orientation to business as the leader, you can begin to look at your current labor force.

We are not suggesting you follow Amazon’s model of minimizing person-to-person contact with your customers. Indeed, we believe relationships still matter to many customers and that people can provide services and value that pure digital solutions cannot.

Many executives ask, “Do we have the right people on the bus?” While you need the right skill sets, even more important is getting and retaining people with the right aptitude, employees business guru Jim Collins describes as “A-level people willing to put out A-plus effort.” In many cases, this means retaining the employees who have deep industry expertise and augmenting the team with additional top performers who bring in the digital skills you may lack.

*Executives must ask:
Do we have the right people on the bus?
– Right skills?
– Right aptitude?*

Some people will just not be hardwired for this new environment. But the right people will embrace streamlined processes and new, efficient systems, giving you the ability to re-deploy your team to build competitive digital capabilities while offering value-added services Amazon Business can’t match.

The Process Element

Although there are many types of processes you need in order to become effective online, the starting point is data about customers (including prospects) and products. One of the key strengths of strong digital competitors is their ability to build robust, complete and flexible databases of customer and product attributes. You must bring the same rigor to managing data that you apply to managing working capital:

- Develop defined processes for collecting product and customer data
- Ensure that your team regards data as the lifeblood of your information technology capabilities
- Assign a few specialists to review, standardize and approve data for release into your systems rather than building many checkpoints and including a large group of people

- Centralizing inventory provides enormous benefits, and so does centralizing your databases and eliminating disparate data sources – your customer and product data should each have a “single source of truth” that propagates into all other systems
- Build connections between applications and databases so data flows quickly and easy through your systems
- Look for pools of data residing in Excel spreadsheets, Outlook Contacts, CRM systems, note cards and other places where it is disconnected and not leveraged
- Establish protocols for data quality and maintenance

If possible, complete all of these data tasks and others within your current system architecture before defining requirements for new technologies. This work can be frustrating, slow and intensely laborious. More than likely, no one person will have line of sight to all the processes, so you will need to bring in the people who really know what is going on to help describe the process. A benefit of this approach is that everyone involved will quickly understand the problems and opportunities you face due to poor data management.

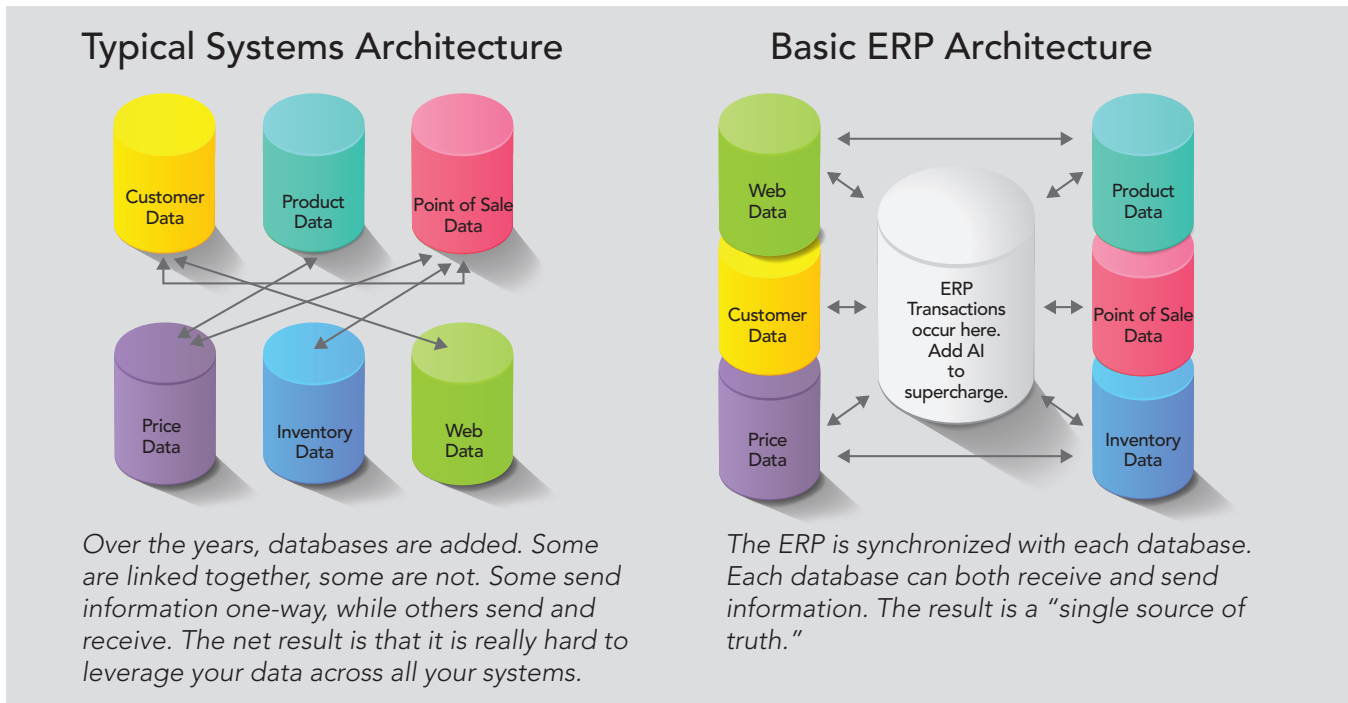
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The drive to use technology to improve productivity, profitability, and competitiveness comes from the top of the organization, and you will find opportunities for improvement in many parts of the company. Here is a real example we found at a distributor. An employee we'll call George was the only person who could approve customer credit applications. He did this activity in a batch each Friday for applications received over the prior seven days. This was very efficient for George. However, the net result was that the average cycle time to approve customers for lines of credit was several days.

Despite the fact that there were systems that could better judge creditworthiness, George felt it was his responsibility to do this task. In comparison, Amazon will approve credit in minutes. If the company leader demands that her team find ways of rapidly reviewing credit applications using technology, they will find a way that is both better and faster while simultaneously freeing up George to do more value-added work.

You will get immediate benefits from building state-of-the-art processes for managing customer and product data. Your employees will have consistent, accurate information at their fingertips when talking to customers. You will improve your fulfillment performance, increase inventory turns and satisfy customers more effectively by eliminating duplicate SKUs. And you will find that getting this data fixed greatly improves your ability to manage pricing and margins.

All digital distributors are built on strong foundations of accurate data. Once you have completed this step, you can start working on processes to build better web capabilities, offer new information and services to your customers and define requirements for new technologies. But if the data's not right, your subsequent steps will be flawed, too.



The Systems Element

You should address the third element of the equation that unlocks digital only after you have put the right people and processes in place. In order to compete with Amazon Business, you need a "tech stack" that enable digital capabilities.

At one time, systems were not well integrated and IT personnel would set them up to pass "flat files" (large, organized databases) periodically. These days, most distributors of any scale install ERPs and then connect other software using application protocol interfaces (API's) that provide fast, relatively low-cost and often immediate data sharing.

There are many choices for applications you can "bolt on" to your ERP. Note that the ERP may come with basic versions of all of these modules but building a bundle that complements your core system's functionality with third-party applications often yields better capabilities and results. Here is a basic tech stack for a distributor:

- **ERP:** The foundation for your technology is a solid Enterprise Resource Planning (ERP) system
- **Product Database:** You must build centralized databases that hold your core product data, pricing, inventory, supplier data and more. Large companies should consider a specialized database called a PIM, or Product Information Management system. We explore this in greater depth below
- **Customer Database:** Your master repository and single source of truth for all information you hold about customers and prospects
- **Customer Relationship Management (CRM) system:** While the CRM and customer dataset share information, they are not usually the same thing. The CRM is a sales-enablement tool that helps your account managers sell more by giving them detailed information about their accounts. CRM is more about process and change management than it is about which system

you choose. CRMs simplify the sales reps' efforts in entering customer information, which then feeds back to the customer data. The main benefit of the CRM is that it is more user friendly than the ERP (or the customer database, which doesn't usually have much of an end-user interface) and can convert customer data into useful information

- **Pricing Optimization Software:** No matter how you wish to compete in terms of overall pricing, you cannot optimize gross margins across a large number of SKUs without software to help you set prices. The best price-optimization software can consider many types of inputs, including cost, competitive pricing, customer type, size, history and even variables such as seasonality and commodity fluctuations. Recent developments in AI have made these systems better than ever at helping you manage margins.
- **Marketing Automation System:** These systems allow you to administer real-time, automated marketing campaigns to your customers. By evaluating data about customers – like transaction history, industry, company size, etc. – marketing automation platforms allow you to generate offers to customers in response to their behaviors and what you know about them. A common example is for distributors to send follow-up emails after customers make purchases by suggesting related products. For example, a customer buying a drill might receive an email offer afterwards promoting drill bits, safety glasses and other complementary products

Product Data and PIM Systems for Large Distributors

If you have a very large product mix, or if your products are technical, or if you want your staff and/or customers to be able to search for your products efficiently, then you should seriously consider a Product Information Management (PIM) system to plug into your ERP. This system will allow you to quickly bring in enormous amount of product data and configure it into valuable information.

Many distributors simply take the basic description that a manufacturer provides. Amazon takes this approach. Some distributors find a third-party firm to add value to the data (i.e., writing meaningful descriptions, etc.). In our opinion, the best results happen when the distributor does the hard work themselves and spends time developing great product information to feed the system. That is to say, the people who really, really know the product and the people who know the customer should collaborate and develop the best sales messages with the right information.

This approach not only guarantees you will have original data that Google can search and thus get you a higher ranking on searches (Search Engine Optimization), it also distinguishes you from other competitors as well as Amazon, which currently does not invest human capital into any part of the process. Since this product data is yours, your suppliers can't use this superior information for sales through other distributors, including Amazon Business. As a side benefit, it shows your manufacturers that you are adding value.

It's essential that your products rank high in search results. A very high percentage of purchases start with a digital search rather than with a sales representative. Take the time to write great copy about your products that distinguishes you from all the others. Not only will the search engines recognize the effort and rank you higher (by following certain guidelines) but more importantly, your customers will be delighted.

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While thinking about content, consider what you want to develop. Great copy sells, but depending on your product mix, so do pictures, rotating pictures, 3D images, videos, customer testimonials, CAD-CAM drawings, exploded diagrams, how-to information, and much more. You do not need to go after all of these, just the content your customers need.

This work is never done. New and better ways to search products are always being developed. Two relatively new methods are voice recognition (“Hey Alexa, order me...”) and the Internet of Things (IoT) (computers telling other computers to re-order parts via sensors). Both of these search methods will affect the content you need to develop in the near future and can have profound implications on how relevant your products are to the various search engines.

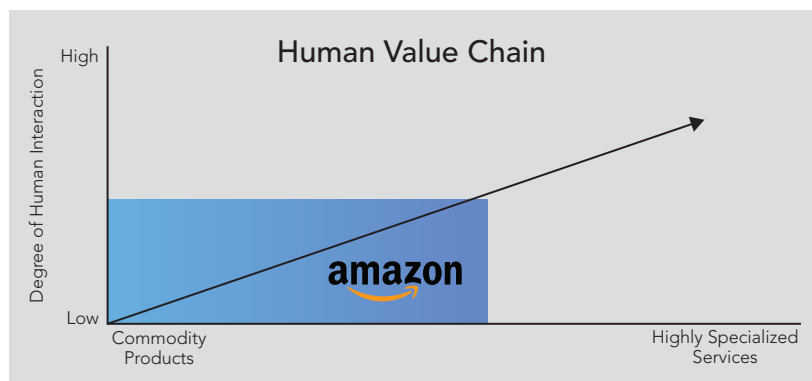
Because Amazon is finding more and more way to conduct business online, your customers are moving online and customer demographics are changing, you must have a desktop and mobile website that customers can use to easily search, select and order products. Anything less than that reflects poorly on your company and is a strong indicator that you may erode market share soon. Customers simply will not tolerate websites that offer browsing but not ordering. Unlike in the past, when it could take months (or years) to install a transactional website, there are vendors available who can get a system up and running in a very short amount of time.

There are many, many more systems that you can plug into your ERP. The good news is that over the past several years, the systems have become more powerful, more reliable, easier to install and easier to learn. In fact, cloud computing significantly reduces the upfront capital needed to purchase technologies and relieves you of worrying about applying patches and updates, monitoring security and many other tasks. Embrace the fact that the digital age is here and that you can do something to preserve and grow your business despite powerful competitors.

3. Build Product and Service Moats

How do you protect your business from Amazon Business? No matter how much you invest in people, processes and systems to build good technology, you will never offer better online capabilities than this best-of-all digital competitors. Instead, you need to seriously look into offering products and services that Amazon can’t easily replicate but that your customers will buy.

Amazon has a long history of leveraging technology rather than people to grow. Which means that if you can find a product or service that requires human interaction, you are offering something that Amazon is unlikely to match. Highly technical products that require pre-sales consultation, products that are custom-configured prior to delivery and large bulk-order items are a few examples. However, based on Amazon’s record, we anticipate that they are trying to figure out how to take these product sales, too. That means you need to keep moving further up the “Human Value Chain.”



How do you know if your products fall into “commodity” status and are thus easily digitized? You can get a sense of your risk exposure to Amazon Business by asking a few simple questions:

- Are your products:
 - Consideration low for the buyer (not a big-budget item)?
 - Relatively small and easy to pull off a shelf?
 - Easy to order on a website?
 - Easily shipped by small-package common carriers?
 - Mass produced and/or made by multiple manufacturers?
 - Reasonably low in technical requirements?
 - Quickly consumed, requiring constant re-ordering?
 - Usually an unplanned purchase by the buyer?
 - Something customers need quickly?

We suggest you sample a set of your own products to estimate which of them meet these criteria. The larger the percentage of your sales they represent, the greater the risk you face from Amazon.

As with specialized products, value-added services are very difficult for Amazon to duplicate. However, keep in mind that they are constantly trying to figure out how to digitize services so they can offer them to your customers, often at low cost and sometimes for free. For example, Amazon Business offers free, detailed purchase analytics to its customers. Remember when customers asked for reports to show who was buying what at their locations? Do you recall how hard it was to extract the information from your system and then have someone remember to produce the data each month? It was probably time-consuming and difficult. Amazon Business provides excellent reports with fantastic graphs that can be sliced in just about any view the customer wants to see with just a few keystrokes.

It's not difficult to create lists of value-added services. Of course, you start with the services you have today, but then you should review the websites of great distribution competitors – large and small – across your industry and others. We believe this will allow you to come up with dozens of alternatives for services you can offer your customers.

Building Moats Your Customers Want

How do you know what is important to your customers? How do you continually identify new products or services? The answer is simple – ask them. Some companies establish formal research departments (with one or two people) to conduct studies. Others hire consultants to conduct this important work. Some organizations make it an agenda item at every sales meeting. A few enterprising organizations have made it into a contest to see which employee (at any level or position) can bring in the most ideas while others require all executives to bring back at least one idea after meeting with customers. But keep in mind that this work is different than customer satisfaction or “Net Promoter Score” research. This is about identifying what you should offer in the future, not how you have performed in the past.

4. Adapt Amazon's Leadership Principles to Your Own Business

Amazon is well known for two things that, although they are not unique to the company, give them an advantage over competitors:

- A consistent and intense focus on customers; Amazon calls this "customer obsession"
- Fervent adherence to a set of Leadership Principles, of which customer obsession is the first, but only one of 14

Developed and occasionally revised over the years, the 14 leadership principles were codified when the company was about 12 years old. People who have interviewed with Amazon report that much of the discussion is around these principles, which are prominent on the company's jobs website: <https://www.amazon.jobs/en/principles>.

Amazon introduces their Leadership Principles with this claim:

"Our Leadership Principles aren't inspirational wall hanging. These Principles work hard, just like we do. Amazonians use them, every day, whether they're discussing ideas for new projects, deciding on the best solution for a customer's problem, or interviewing candidates."

Of course, Amazon's culture is not without controversy. You can find plenty of writers, former employees and others who makes claims like, "One of the biggest problems at Amazon is the so-called 'Leadership Principles,'" or suggest a new principle that "Should go something like this: 'Have Empathy.'" The company has received negative press around its workplace pressure, treatment of women, compensation practices and more.

We have no first-hand data to make judgments about Amazon's workplace environment but anyone can see the spectacular business results the company has achieved. MDM has written extensively about our concerns over Amazon's competitive practices and how its entrance into wholesale distribution will affect markets and competitors. Additionally, we have been candid in our view that selling on Amazon's marketplaces exposes sensitive transactional data that the company could someday use to disintermediate the distributors who sell there.

However, we believe that any discussion around gaps between distributors and Amazon Business must include a review of that company's Leadership Principles and suggest how competitors can learn from them and adapt them to their own advantage. In the section below, we quote Amazon's Leadership Principles directly from the company's website (gray cells) and then offer our analysis and recommendations.

Analysis of Amazon’s Leadership Principles and Recommendations for Distributors

1. Customer Obsession

Leaders start with the customer and work backwards. They work vigorously to earn and keep customer trust. Although leaders pay attention to competitors, they obsess over customers.

**MDM
Analysis:**

We believe that distributors have many opportunities to be closer to their customers than a digital player like Amazon Business. While Amazon Business has built a sales force (“Customer Advisors”), the reality is that distributors interact with the customers that make up most of their revenue in person and very frequently.

That means distributors should understand customer needs better than Amazon Business. Our view is that distributors must do a better job defining those needs, prioritizing them and building a process to develop and implement ongoing initiatives that exceed customer expectations.

As a reference point, consider the process you implement when it’s time for a major IT implementation, such as an ERP. Arguably, the most critical step is clearly defining “user requirements.” This typically means you hire outside experts who meet with all of the individuals who will be using the new system and carefully document what they need from it in order to make the selection, design and implementation of the technology successful.

However, few distributors have a structured process for achieving this level of understanding when they try to develop and improve their value propositions. In our experience, distributors make major decisions about product assortment, services, pricing and other major programs that directly drive long-term levels of competitiveness, revenue and profitability based on anecdotal feedback. To make things worse, this feedback often isn’t directly from customers; it’s from sales reps or relies on executive intuition.

**MDM
Recommendation:**

Put in place state-of-the-art processes to gather direct customer feedback about their needs and preferences so that your strategy and budget allocation around major initiatives align with what drives the greatest improvements in your value proposition. This isn’t just “Net Promoter Score,” which is a measure of satisfaction. It’s also an independent input, not filtered through your employees, that helps you define and prioritize the changes you need to make in order to gain wallet share and market share.

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2. Ownership

Leaders are owners. They think long term and don't sacrifice long-term value for short-term results. They act on behalf of the entire company, beyond just their own team. They never say "that's not my job."

MDM Analysis: This is an obvious and commonly claimed practice among the distributors with which we interact. Many distributors have cultures in which employees feel a strong sense of ownership around the need to serve customers well. Part of how Amazon drives a sense of ownership is through the liberal awarding of "Restricted Stock Units" to regular full-time employees.

MDM Recommendations: Getting this kind of leadership consistency is often about properly aligning rewards systems, which are often in conflict. Account Managers may be rewarded on gross margin dollars while Operations leaders are compensated on working capital performance, for example. Neither of these are matched with executives' compensation, which is more commonly driven by EBITDA.

In GE's most profitable years under Jack Welch, every single business unit was evaluated primarily on net income, whether that division leased railcars or manufactured turbines. That may seem illogical since the paths to net income are so different depending on the business model, but we'd argue that the simple clarity and consistency around an easily understood measurement drove consistency across many businesses.

If you have clear and consistent success measures that drive alignment between functions and levels, you remove much of the conflict that gets in the way of focusing on long-term success and meeting customer needs. It's not good enough to be working in the same general direction – better alignment creates better performance. An aircraft will fly faster, more smoothly and efficiently if the engines are perfectly aligned and not just generally aimed in the same direction.

3. Invent and simplify

Leaders expect and require innovation and invention from their teams and always find ways to simplify. They are externally aware, look for new ideas from everywhere and are not limited by "not invented here." As we do new things, we accept that we may be misunderstood for long periods of time.

MDM Analysis: We believe this is a major gap between Amazon Business and many distributors. According to some sources, in 2017 Amazon was the world leader in R&D spending. By contrast, many distributors announce in their 10K's that R&D spending was "negligible." In fairness, Amazon is also a technology company, so it's only natural that it will spend significantly on R&D.

The problem for distributors is that some of Amazon’s R&D budget results in direct benefits for business customers. Just a few examples include a technology-driven B2B marketplace that allows the addition of millions of SKUs to the Amazon Business assortment at virtually no cost, voice-ordering from Alexa (available today) and autonomous vehicle delivery that keeps down costs (coming soon). Amazon is going to continue to develop tools to enhance its value proposition by introducing innovation-driven benefits that appeal to the generation of workers increasingly entering the workforce. Innovation matters more than ever. Amazon is among the world’s leaders while most distributors are not.

MDM

Recommendations:

Constantly generating new ideas, quickly evaluating them, testing a subset and implementing a handful results in a steady stream of new customer benefits. Distributors need their own mechanism for following this process. By innovating new value-added services, distributors can build a competitive value proposition that is truly differentiated from digital disruptors. And while no distributor can invent technology like Amazon, there are countless technology companies developing new tools you can implement to be a fast follower in technology-driven innovation, too.

4. Are right, a lot

Leaders are right a lot. They have strong business judgment and good instincts. They seek diverse perspectives and work to disconfirm their beliefs.

MDM

Analysis:

Amazon claims to have a culture with a high tolerance for failure. For example, after Amazon’s Fire phone failed and the company wrote off the \$170M investment, Jeff Bezos said, “If you’re going to take bold bets, they’re going to be experiments. Experiments are by their very nature prone to failure.”

So, where does the principle that leaders “are right, a lot” fit in a culture with a high tolerance for failure? We believe the notion that leaders are right a lot is about how they approach major decisions rather than their ability to predict which experiments will work. Innovation is extraordinarily difficult – no human being can reliably predict in advance which new products or services will become winners. However, you can improve your batting average if you have strong judgment and instincts, and do even better if you have the humility to seek opposing opinions and gather diverse points of view.

Additionally, Bezos distinguishes between ideas that fail because they turned out to be wrong vs. failures of execution. In other words, the idea didn’t have a chance because the implementation was flawed. Of the latter, he says, “That’s not a good failure. That’s just bad operational excellence.”

MDM Recommendations: Many leaders say they want to surround themselves with executives who are willing to disagree with them but actually reward the sycophants on their teams. If you primarily reward your direct reports for agreeing with you, then your team can never be “right” more often than you are. On the other hand, if you encourage the team to speak their minds and debate ideas candidly, you can “be right, a lot” more often because the wisdom of the group is better than any individual’s judgment.

We don’t believe this is a particular issue in distribution but rather a fairly common trait across all kinds of organizations. In any case, developing leaders who have sound judgment and good instincts and then supporting them when they disagree with you obviously beats a team of individuals who salute you too quickly, laugh too loudly at your jokes or whose “yes” can be gotten at a bargain price.

5. Learn and be curious

Leaders are never done learning and always seek to improve themselves. They are curious about new possibilities and act to explore them.

MDM Analysis: Virtually all leaders seem to believe this; it’s really a matter of how well they execute it personally and drive this principle through their companies. We’ve seen a wide range of practices among distributors but find that you have to get past the rhetoric to understand if this is a cultural strength or just spin.

MDM Recommendations: As in many things in business, the truth is in the budget. Leaders who genuinely hold that learning is important invest real money in training and education. The best distributors sponsor not only skills training but also classes and workshops that develop leadership and teamwork traits. These companies tend to have strong tuition reimbursement programs and offer both required and optional training programs at many levels. Additionally, since all organizations take on the traits of their leaders, an intellectually curious CEO makes the company more inquisitive.

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6. Hire and develop the best

Leaders raise the performance bar with every hire and promotion. They recognize exceptional talent, and willingly move them throughout the organization. Leaders develop leaders and take seriously their role in coaching others. We work on behalf of our people to invent mechanisms for development like Career Choice.

MDM Analysis: Perusing Amazon’s open jobs provides fascinating insights into just how aggressively the company pursues talent. Job descriptions are clear and compelling, full of details about ambitious initiatives and designed to intrigue high-performance candidates. In addition (and related to the learning principle above), Amazon advertises that for hourly employees, it pre-pays up to 95 percent of tuition and fees (max of \$12,000/year) for “high demand” jobs whether or not they are relevant to a career at Amazon. There’s no way to objectively compare the quality of coaching, talent development and skill levels between companies but it certainly appears that Amazon pursues stars.

MDM Recommendations: Regardless of industry, high-performing companies almost always have very strong HR development skills, meaning they recruit, coach, compensate and promote talent effectively. We like that Amazon’s ambitious strategy finds its way into the descriptions of its job openings and we believe distributors should be bold both in developing an exciting vision and communicating it to candidates.

Attracting talent is also about building the right culture. We are reminded of a discussion we had with one distribution CEO who complained he could not recruit millennials because “We can’t pay what tech companies pay, we can’t offer the same flexibility and we don’t want a casual dress environment.”

Our point of view is that if you want to attract the talent that will make you competitive in the future, you should decide to fix all of these problems along with whatever else is in the way. This CEO listed items that were totally within his control and then blamed an emerging generation of workers for not accepting jobs at a company that is not competitive in the market for talent. Just like with customers, an attractive value proposition in the labor market is not defined by what you are willing to provide but how you compare to competitors.

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7. Insist on the highest standards

Leaders have relentlessly high standards—many people may think these standards are unreasonably high. Leaders are continually raising the bar and driving their teams to deliver high-quality products, services, and processes. Leaders ensure that defects do not get sent down the line and that problems are fixed so they stay fixed.

MDM Analysis: This is another area where quality companies are competent across industries. Generally, distributors have standard operating procedures, good process measurements and a culture of ongoing improvement.

MDM Recommendations: Whether or not Amazon Business existed, distributors that want to grow need strong process management and defect-prevention programs.

8. Think big

Thinking small is a self-fulfilling prophecy. Leaders create and communicate a bold direction that inspires results. They think differently and look around corners for ways to serve customers.

MDM Analysis: It's hard to imagine a company that thinks bigger than Amazon. Amazon Business has followed suit and has produced results, achieving \$10B in revenue in its third full year in existence. "Think differently" aligns with Apple's long-ago mantra and Amazon has found many ways of adding value in ways no distributor has accomplished.

MDM Recommendations: Our experience is that great distribution companies tend to be run by strong operators – in other words, industry experts who are terrific at managing an organization, from inventory to people to the P&L. However, individuals with this skill set are usually not strong visionaries and to the degree that they have ambitious goals, those goals tend to be around scaling the current business model rather than creating new models.

We believe every sizeable distributor should seek out and hire a visionary who has influence with the CEO. But in order to make "thinking big" work, you have to tolerate failure. Bezos recently said, "We all know that if you swing for the fences, you're going to strike out a lot, but you're also going to hit some home runs. The difference between baseball and business, however, is that baseball has a truncated outcome distribution. When you swing, no matter how well you connect with the ball, the most runs you can get is four. In business, every once in a while, when you step up to the plate, you can score 1,000 runs. This long-tailed distribution of returns is why it's important to be bold. Big winners pay for so many experiments."

You need to tolerate the strikeouts in order to get the huge scores. But you also need a visionary at a senior level who is empowered to help the company generate big ideas. If that's not the CEO (and it doesn't have to be), you need to find someone with the talent and influence to drive the constant testing of big ideas.

9. Bias for action

Speed matters in business. Many decisions and actions are reversible and do not need extensive study. We value calculated risk taking.

**MDM
Analysis:**

In his 2015 letter to shareholders (and if you don't read these annual missives, you should), Bezos writes:

"Some decisions are consequential and irreversible or nearly irreversible – one-way doors – and these decisions must be made methodically, carefully, slowly, with great deliberation and consultation. If you walk through and don't like what you see on the other side, you can't get back to where you were before. We can call these Type 1 decisions.

"But most decisions aren't like that – they are changeable, reversible – they're two-way doors. If you've made a suboptimal Type 2 decision, you don't have to live with the consequences for that long. You can reopen the door and go back through. Type 2 decisions can and should be made quickly by high judgment individuals or small groups.

"As organizations get larger, there seems to be a tendency to use the heavy-weight Type 1 decision-making process on most decisions, including many Type 2 decisions. The end result of this is slowness, unthoughtful risk aversion, failure to experiment sufficiently, and consequently diminished invention. We'll have to figure out how to fight that tendency."

MDM believes this is a highly insightful distinction; companies without a structure like this are more likely to suffer from slow decision-making, particularly in large companies. Big companies set up sign-offs based on budgets and the levels of executives but we haven't seen other companies establish different levels of scrutiny and sign-off depending on something like "Type 1" and "Type 2" decisions.

**MDM
Recommendations:**

Designing and implementing different paths for reversible vs. irreversible decisions will take some planning, but given Amazon's track record, distributors should consider establishing criteria to define each and build the same type of structure. Making decisions quickly is a huge asset and if your competitor has it and you don't, then their speed can kill – you.

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10. Frugality

Accomplish more with less. Constraints breed resourcefulness, self-sufficiency and invention. There are no extra points for growing headcount, budget size, or fixed expense.

MDM Analysis: In our experience (and with some exceptions), distributors tend to be frugal by nature. Many large distribution companies have roots going back to the Great Depression and these companies tend to be extraordinarily diligent about managing expenses and cash flow. Additionally, distributors tend to watch operating ratios carefully, not just financial measurements like cash conversion and return on net assets, but also productivity metrics like payroll-to-gross-margin dollars, sales per headcount, etc.

MDM Recommendations: We find it interesting that this Leadership Principle mentions the idea of using constraints to drive invention. Working on a process to institutionalize could yield big benefits.

We believe that there are two key roles senior executives can play. First, adopting Amazon’s approach of focusing spending on things that customers notice or care about (value-added services, branch appearance, and website ease-of-use, for example) while minimizing investments in areas that don’t touch customers (e.g., luxurious headquarters buildings). Second, setting examples of frugality. The author of the book, “The Everything Store” claims that Jeff Bezos drove a Honda to work each day as recently as 2013, for example.

11. Earn trust

Leaders listen attentively, speak candidly, and treat others respectfully. They are vocally self-critical, even when doing so is awkward or embarrassing. Leaders do not believe their or their team’s body odor smells of perfume. They benchmark themselves and their teams against the best.

MDM Analysis: While we have worked with many distribution executives who practice genuine “servant leadership,” finding CEOs who are willing to be wrong – and proclaim it loudly – is rare. Herb Kelleher, the legendary CEO who built Southwest Airlines, was famous for not taking himself seriously while winning ferocious devotion built on trust by spending a great deal of time to getting input from employees across the airline, at all levels. Both Southwest and Amazon famously tracked their performance against “the best of the best.” For example, Southwest improved its speed and quality in turning around planes between flights by studying how NASCAR crews worked during pit stops.

MDM Recommendations: We work with many fine CEOs in distribution. The best of the best keep their egos in check and don't worry about adopting a persona of "CEO-ness" when among the troops. They earn trust through their candor about their own performance and how various parts of the company compare to world-class benchmarks and are avid listeners. For these CEOs, field visits are more of an opportunity to learn and serve rather than to talk and direct.

12. Dive deep

Leaders operate at all levels, stay connected to the details, audit frequently, and are skeptical when metrics and anecdote differ. No task is beneath them.

MDM Analysis: Obviously, good advice for any leader and we know many in distribution who practice this. Once again, Amazon hints at the critical role of humility in a leader.

MDM Recommendations: To us, the intriguing and unusual part of this leadership principle is about being "skeptical when metrics and anecdotes differ." Generally, people tend to be driven disproportionately either by metrics or anecdotes. We like how Amazon explicitly values both. In a September 2018 interview, Jeff Bezos said, "If you can make a decision with analysis, you should do so. But it turns out in life that your most important decisions are always made with instinct and intuition, taste, heart." That's surprising coming from the leader of a company that is among the best in the world at managing data but it jives with our experience working with highly successful distribution CEOs.

We think some CEOs should add this to their skill set: It's critical to know the details of your businesses and to "audit" (formally or not) operations frequently. But noticing and responding when the data doesn't resonate with your experience is not as common and makes sense.

13. Have backbone, disagree and commit

Leaders are obligated to respectfully challenge decisions when they disagree, even when doing so is uncomfortable or exhausting. Leaders have conviction and are tenacious. They do not compromise for the sake of social cohesion. Once a decision is determined, they commit wholly.

MDM Analysis: We love this one. In Bezos' 2017 letter to shareholders he describes how Amazon makes some decisions with an unusual rubric. In most companies, when an employee sends up an idea or request, the whole idea is to get the agreement of the executive who must sign off on the project. At Amazon, it's different. In some cases, the project may get approval because the CEO, VP

or whomever agrees with the idea. However, sometimes senior executives disagree with a request or idea but instead of turning it down, they announce that they disagree but commit to it anyway. In other words, you can get the support for an idea without winning over the person who has to approve it. This isn't just a way of selling ideas upwards – leaders ask teams for support with the same wording.

MDM Recommendations: This may sound subtle but we believe other companies, not just distributors, could speed up decision-making and launch many more "Type 2" experiments by creating their version of "disagree and commit." As Bezos says, "'You've worn me down' is an awful decision-making process. It's slow and de-energizing. Go for quick escalation instead – it's better." He points out that, in business, decision velocity is just as important as decision quality. Differentiating between reversible and irreversible decisions and then applying "disagree and commit" can speed up your decision-making without incurring great risk.

14. Deliver results

Leaders focus on the key inputs for their business and deliver them with the right quality and in a timely fashion. Despite setbacks, they rise to the occasion and never settle.

MDM Analysis: Of all of Amazon's Leadership Principles, this maxim seems the most like a platitude. We appreciate that the company needs to include something about the importance of results in any list of important leadership traits but there's nothing new here.

MDM Recommendations: Any good leader has this at a DNA level. Keep going.

Conclusion

Amazon is a very large and formidable competitor. They are growing and learning quickly in the distribution space. Amazon's laser-beam focus on delivering products efficiently (i.e., minimal human interaction) and their unusual application of a "marketplace model" in which other distributors sell through their network allows them to grow exponentially faster than any other competitor in the distribution market.

However, Amazon's success also exposes opportunities and lessons for its competitors. Products and services that require human interaction are currently problematic for Amazon to duplicate. You should leverage these types of product and services with a holistic systems approach that incorporates people, process and systems so that you develop good-quality digital capabilities of your own. We also suggest you review Amazon's Leadership Principles, compare it to your own management philosophy and practices and see if there are ideas you can adapt from one of history's fastest-growing and most successful companies.



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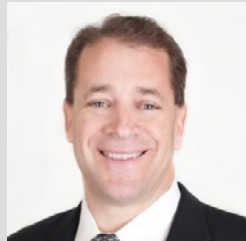
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