

Adam J. Fein: Fee-based services in wholesale distribution

June 2005

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Fee-based services is a hot topic for many wholesaler-distributors. This column takes a look at how fee-based services can provide a new source of profitable growth for your business.

Wholesaler-distributors exist to solve the problems that customers have in sourcing, acquiring, handling, and using products. Historically, distributors have been paid for the value they add in the form of gross profit dollars—the margin added to the cost of the product to cover operating expenses and profit. Support and other services are included in product price, making them seemingly “free” from the customer’s perspective.

However, many distributors have fallen into a trap by giving away services beyond product fulfillment for free to generate competitive advantage and become a preferred supplier. Instead of making up the additional costs through product margin on increased volume, distributors have been squeezed by powerful customers and deflationary product economics.

This is where the fee-based services enter the picture. Creative distributors can offer customers new services and charge for them rather than merely giving away their “value added” and hoping to recoup the costs with product margins. Distributors have an opportunity to become suppliers of customized and differentiated relationships that provide products with related services instead of merely reliably providing goods. As *Facing the Forces of Change: The Road to Opportunity* documents, a clear majority of wholesale distribution executives expect to charge fees for at least some services by 2008.

Despite this optimism, distributors will only succeed by offering new services that directly improve the customer’s profitability and operations. This article provides five strategic guidelines to help distribution executives achieve success with fee-based services.

New fees for old services won’t work. Many distributors still see fees as a new way to charge for something that used to be given away for free. Obviously, customers can be expected to resist paying for something that once was free, even if they acknowledge the economic logic behind the concept. Customers will seek out distributors providing value-added services “for free.” This is another reason to make sure your services offer unique and distinctive value.

Fee-based services must deliver new value to customers. What appears to be a unique or valuable service can become commonplace in a few years as competitors join in. A fee-for-service pricing approach will succeed only if distributors offer services that directly improve the customer's profitability and operations. Success here is not measured by delivery times or fill rates, but rather by customer productivity gains, labor-savings, ergonomic improvements, or a faster time-to-market.

Use service metrics. Distributors measure themselves on traditional reseller metrics, such as inventory turns, gross margins, and sales per employee. However, fee-based services require different metrics, such as personnel utilization rates and the profitability of alternative service lines. Distributors will also need activity-based costing (ABC) software to get a fact-based look at how much it costs to sell, fulfill and provide services.

Prepare for more accountability. Fee-based services will change the customer-distributor relationship by forcing distributors to deliver specific, measurable results as well as maintain excellence in their core activities. Today, distributors can offer high levels of product availability and delivery, but often the only money-back guarantee put forward is the manufacturer's product warranty. Everything else is marketing salesmanship:—"Buy from me because I'm more consistent and reliable than my cross-town rival!" If the customer is not satisfied, the only recourse is to switch distributors.

Let customers help you. Distributors are in an excellent position to capture the services opportunity because they are already on the front lines serving customers every day. You understand the customer's operations and have resources and skills that can be used to drive out costs. Figure out how to make yourself indispensable by taking over some of your customer's more critical tasks. You must talk to customers, understand their business challenges and goals and determine how your competencies and knowledge can drive specific, measurable gains in their business.

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