



NAW Billion \$ CIO Roundtable

Chicago O'Hare Hilton
June 6 2018

Agenda

Topic

Inflection Point & Disruptive Forces

IT and the CIO: Implications & Imperatives

Innovation in WD

Wrap Up

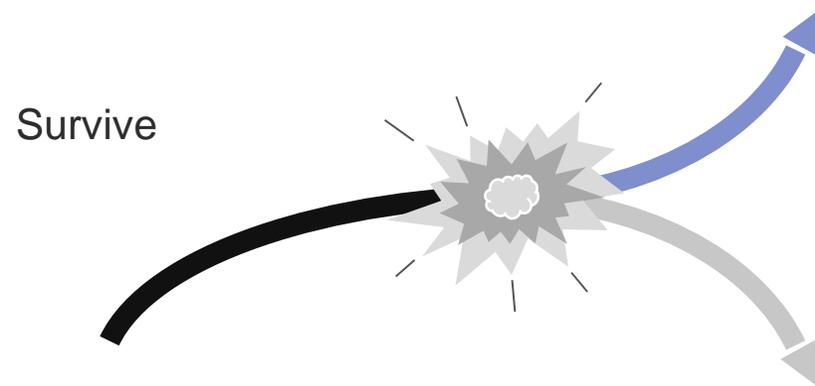
Inflection Point & Disruptive Forces

The wholesale distribution industry is facing a true inflection point

“A strategic inflection point is a time in the life of business when its fundamentals are about to change.

That change can mean an opportunity to rise to new heights.

But it may just as likely signal the beginning of the end ”



Andrew S. Grove, Only the Paranoid

Enabled by advances in digital, disruptive forces are amplifying the inflection point

Wholesale Distribution Industry Disruptions

New Business Models

- Lower barriers to entry, disrupted value chains, and enablement of new business models
- Service and solution centric value propositions
- Expanded offerings from peer distributors
- Emergence of non-traditional competitors

New Customer Demand

- Newly formed, rapidly growing industries, companies and markets
- WD opportunity area but often require new ecosystem of capabilities

Disintermediation

- Suppliers marketing/selling/shipping direct to end customers
- GPOs aggregating customer spend to negotiate price/terms with suppliers
- Self-distributing customers buying direct from suppliers

Product Innovations

- Technology and process advances
- Creation of new products/categories and innovations in manufacturing
- Introducing new suppliers, influencers, and sales channels/cycles

Consumerization

- B2B customer expectations shifting based on B2C experiences
- Transparency of product pricing and availability
- Seamless omni-channel and dynamic fulfillment
- Communities, content and ratings

Disruptive Forces



These disruptive forces will rapidly evolve and interact to reshape the landscape in unpredictable ways

Wholesale Distribution Industry Disruptions

New Business Models

Examples / Enablers:

- Gig economy
- Sharing
- Amazon.com
- As a service
- eMarketplaces
- Ecosystems

75% of industrial buyers purchased via eMarket in 2017, vs. 20% in 2013ⁱ



New Customer Demand

Examples / Enablers:

- Electric vehicles
- Energy storage
- Private space
- Green energy
- Smart Grid
- Drones
- Robotics



Disintermediation

Examples / Enablers:

- GPOs (Dining Alliance)
- Manufacturer direct (Xiameter)
- Self-distribution
- Alternative channels

In 2017 81% of industrial buyers had purchased direct from manufacturer, vs. 64% in 2015ⁱ



Product Innovations

Examples / Enablers:

- LED lighting
- Graphene
- Nano-technology
- 3D Printing
- Non-GMO foods
- IoT

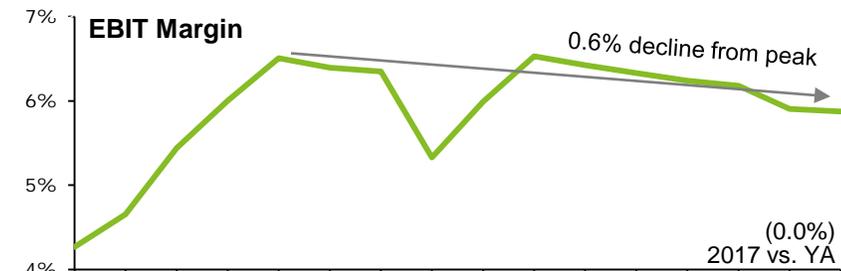
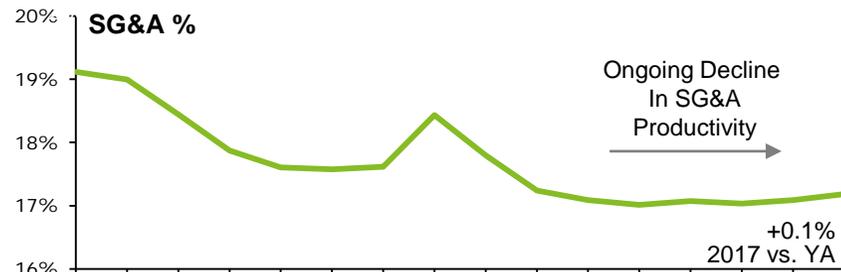
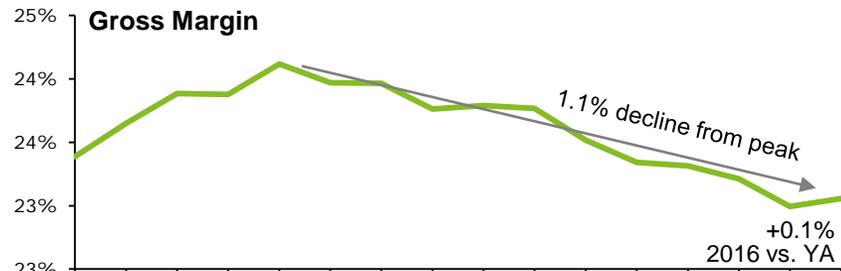
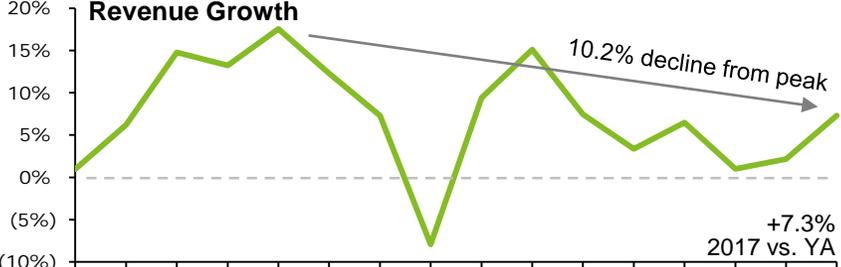
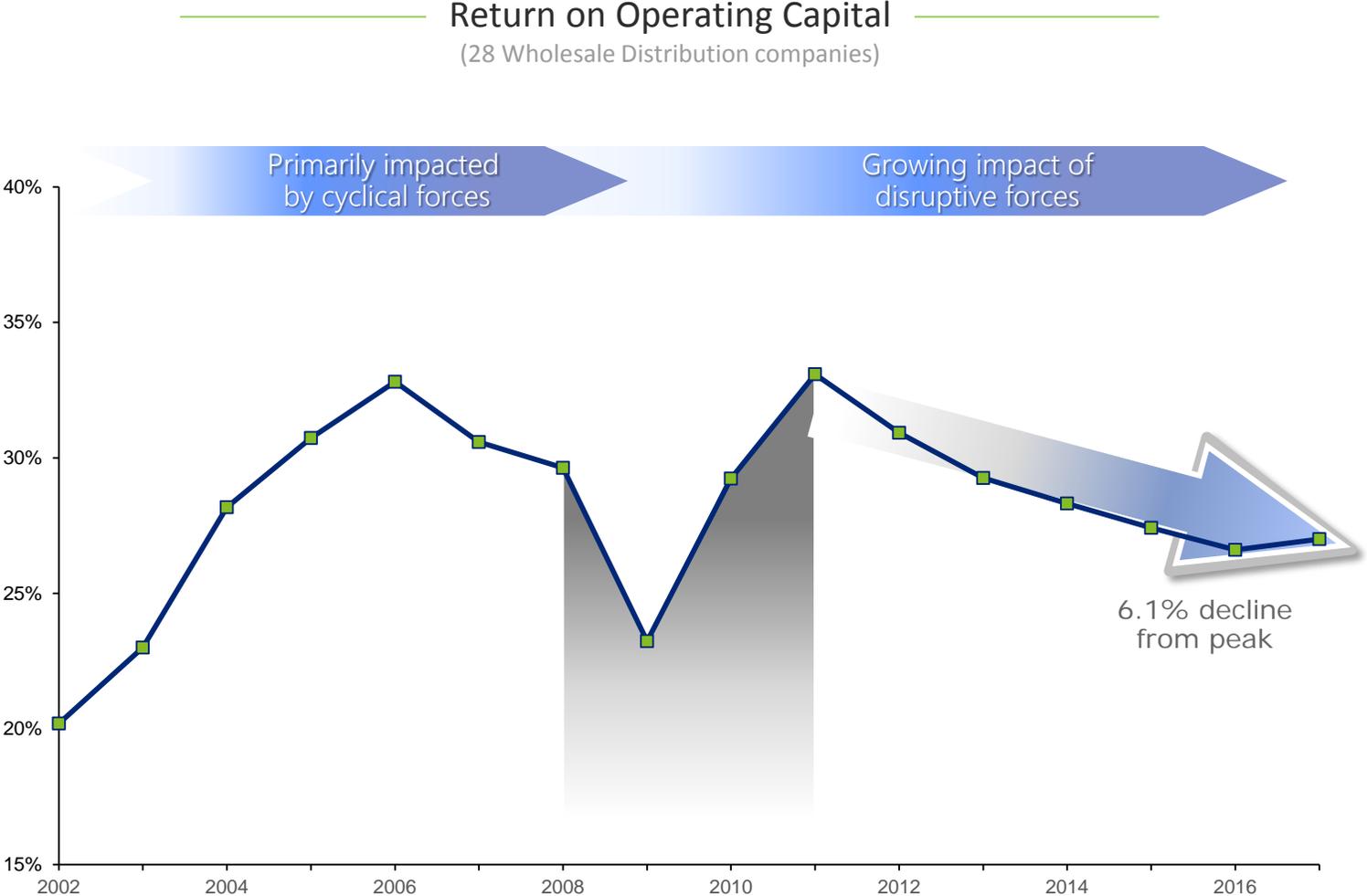


Consumerization

Examples / Enablers:

- Rich User Experience
- Transparent price
- Social and peer (Farmers Business)
- Rapid fulfillment
- Omni-channel capabilities

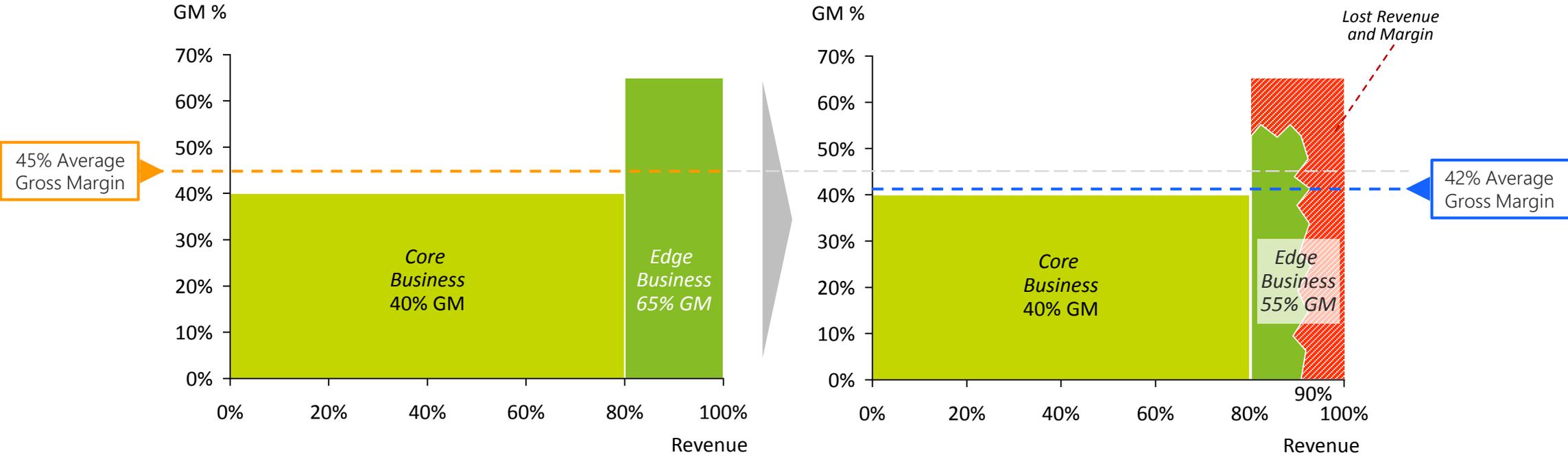
The industry's financial performance provides evidence for a change in its fundamentals



Notes: Average of 26 wholesale distribution companies with data available from 2002-2016; ROC = EBIT / (NFA + NWC)
 1) ~50% of the decline in ROC from 2011-2016 is due declining EBIT margins and ~50% to lengthening of the cash conversion cycle and other balance sheet items
 Source: Deloitte Consulting Analysis, CapiQ, BLS, Federal Reserve

Competitors have become adept at targeting high margin segments at the edges of the distributor's business - driving an outsized impact on overall profitability

Impact at the Edges



For a Wholesale Distributor

- Revenues: \$5B
- Average GM: 45%
- \$2.25B GM

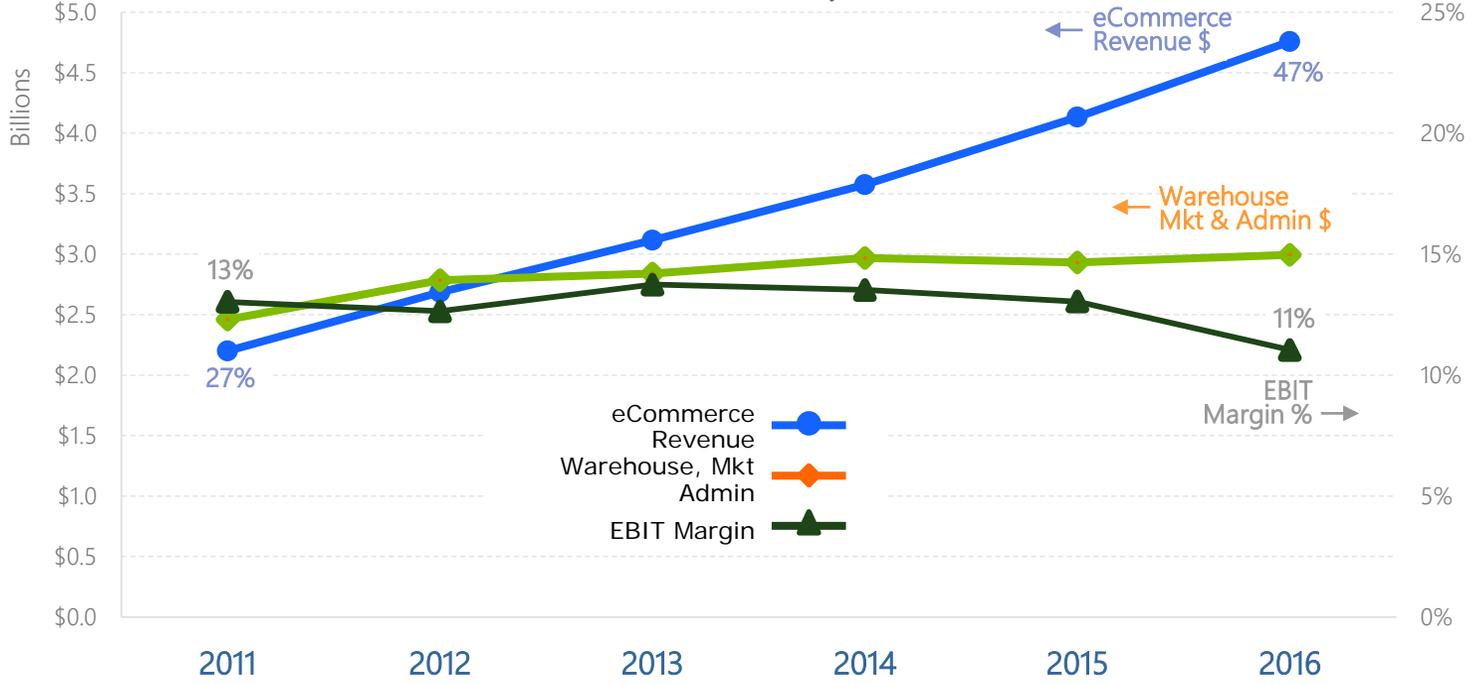
For a Wholesale Distributor

- Revenues: \$4.5B ↓ **10%**
- Average GM: 41.7% ↓ **330 bps**
- \$1.88B GM ↓ **17%**

Distributor profitability has also been impacted by the duplicate costs of building a robust eCommerce business while maintaining legacy go to market infrastructure

W.W. Grainger, Inc.

eCommerce Journey



Order Origination Mix & Trends

Order Origination	2016 Line Mix	5 Year CAGR
KeepStock	20%	24%
EDI / ePro	18%	16%
Online	29%	8%
Counter	11%	-7%
Phone	22%	-13%

Impact of dual cost structure during digital transition:

- eCommerce revenues have grown from 27% of total in 2011, to 47% in 2016
- >56% of sales originated via 'all digital channels' (e.g., Grainger.com, KeepStock® and EDI/ePro)¹
- Grainger's EBIT margin has eroded 2.0% since 2011
- No efficiencies in Warehouse, Marketing & Administrative, with expenses flat at ~30% of revenues

In light of the disruptive forces, distributors must more effectively leverage their strengths and rapidly exploit opportunities

RETRENCH & FOCUS	DRIVE COST ADVANTAGE	INNOVATE TO THRIVE				
<ul style="list-style-type: none"> Narrow business focus to less competitive, more defensible segments Segments could be business, market, geography, customer, and/or product Deepen competitive advantage in focus segments via targeted investments 	<ul style="list-style-type: none"> Drive compelling cost advantage by increasing operational scale and/or realizing efficiencies Achieve desired scale via a combination of organic and inorganic (i.e., M&A) growth Streamline processes and operations Leverage resulting cost advantage to drive additional share gains and revenue growth 	<ul style="list-style-type: none"> Invest in a portfolio of innovations (e.g., business model, channel, technology enabled services, platforms, pricing,) to shift the basis of value capture and competition Explore options to drive revenue growth, margin expansion, and operating efficiency 				
		Value Added Services	Channel	Profit & Pricing Models	eMarkets / Platforms	New Products & Demand
		<ul style="list-style-type: none"> Kitting/customize Outsourced procurement Design Manage inventory Technology enabled 	<ul style="list-style-type: none"> Industrial vending On job/construction site Embedded in customer operations 	<ul style="list-style-type: none"> Subscription As a service Gain sharing Alliance contracts 	<ul style="list-style-type: none"> Endless aisle Own vs. 3rd party Open vs. closed 	<ul style="list-style-type: none"> Meal kits Electric vehicles Private space Drones 3D printing LED lighting

CASE STUDY:

GM

Situation: Competition, legacy cost structure, and unwieldy portfolio of brands...

Retrenchment: ... sold and cut brands, closed plants and dealerships, and reduced workforce

Closed

Oldsmobile PONTIAC SATURN. 10,000 Headcount 1,100 Dealers

Sold

GMAC SAAB HUMMER VAUXHALL

2000 **2016**

US Car Sales Profitability

Cautious note: At times the magnitude and pace of disruption is such that retrenchment and/or Bulk-Up strategies are unable to effectively apply to their long-term survival.

• Blackberry • A

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CASE STUDY:

Oil & Gas Industry

Situation: Oil price drops from \$40 per barrel in 1990 to \$10 per barrel in 1999...

Bulk-Up: ... wave of consolidation that reshaped the structure of the entire industry

Crude Price Amex Oil Index Mergers

EXXON + Mobil BP + AMOCO CHEVRON + TEXACO

CASE STUDY:

FASTENAL

Innovated go to market channel with industrial vending, reconfiguring its branch network, and aligning its fulfillment operations.

Has driven top line sales, preserved gross margin, improved SG&A efficiency, and boosted customer retention.

Sales (\$ Billions) Gross Margin % # Vending

7,453 21,095 33,920 46,855 55,510 62,800

Deloitte

Implications for wholesale distributors...

Disruptive forces are driving a new capabilities requirements

Disruptions



Business Implications

Distributors need to...

- ... better understand cost-to-serve and cost-to-carry, and the underlying drivers
- ... derive new segmentation schemes for customers and suppliers
- ... deliver customer intimacy and self-service capabilities
- ... support new business, operating, revenue and service delivery models
- ... prove their value as preferred route to market for suppliers
- ... drive new levels of efficiency as a source of competitive advantage
- ... innovate!

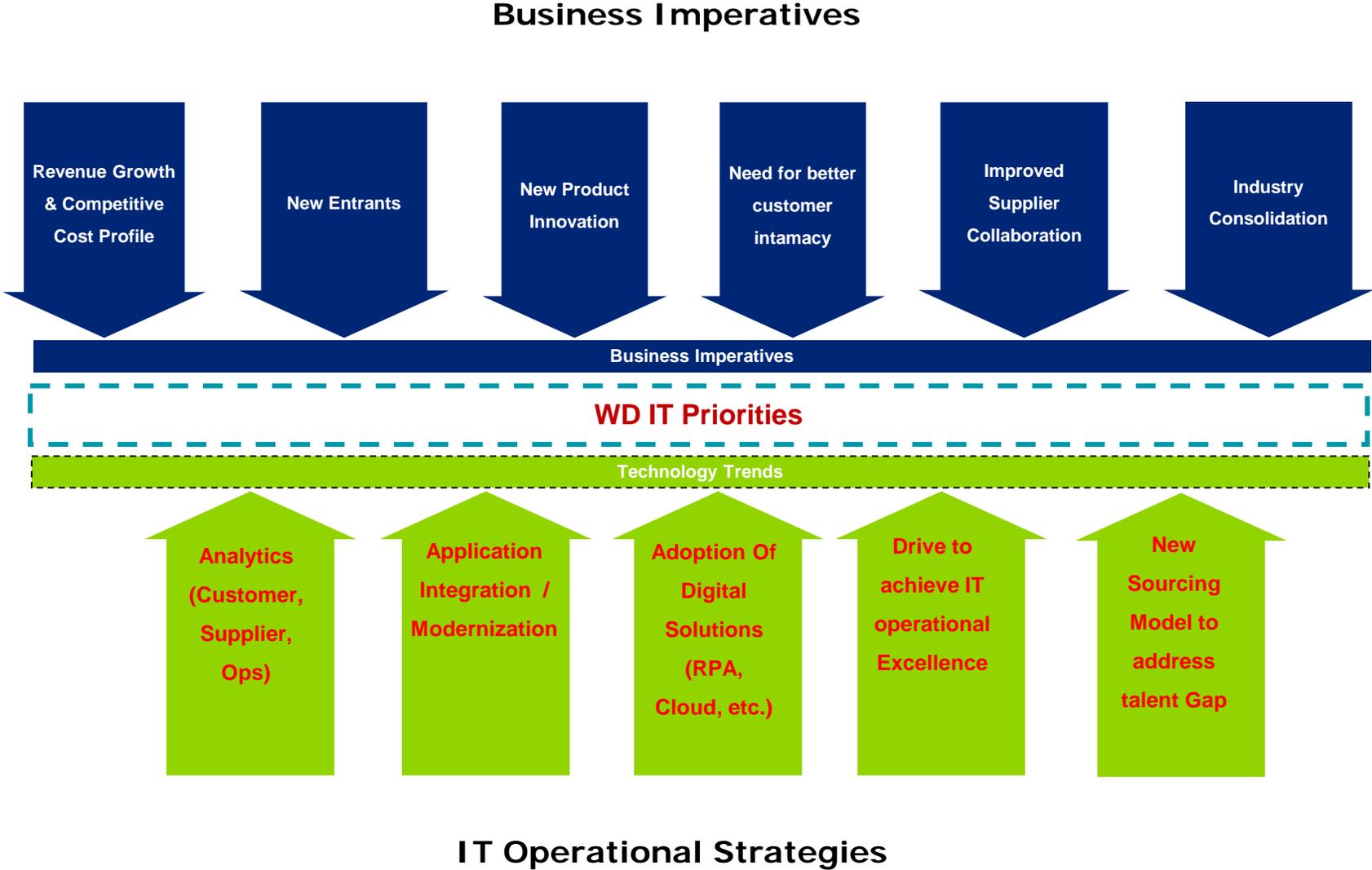
IT Realities

Many distributors hindered by...

- ... complicated, legacy IT infrastructure and landscape - exacerbated by ongoing M&A
- ... Talent gap challenges in accessing talent in emerging capability areas (e.g., analytics, IoT, digital)
- ... predominantly in-house IT delivery model tied to corporate HQ
- ... continued pressure on IT capital and operating budgets
- ... customer and supplier adoption
- ... persistence of business-IT silo
- ... corporate culture and reward system that discouraged true risk taking

IT and the CIO: Implications & Imperatives

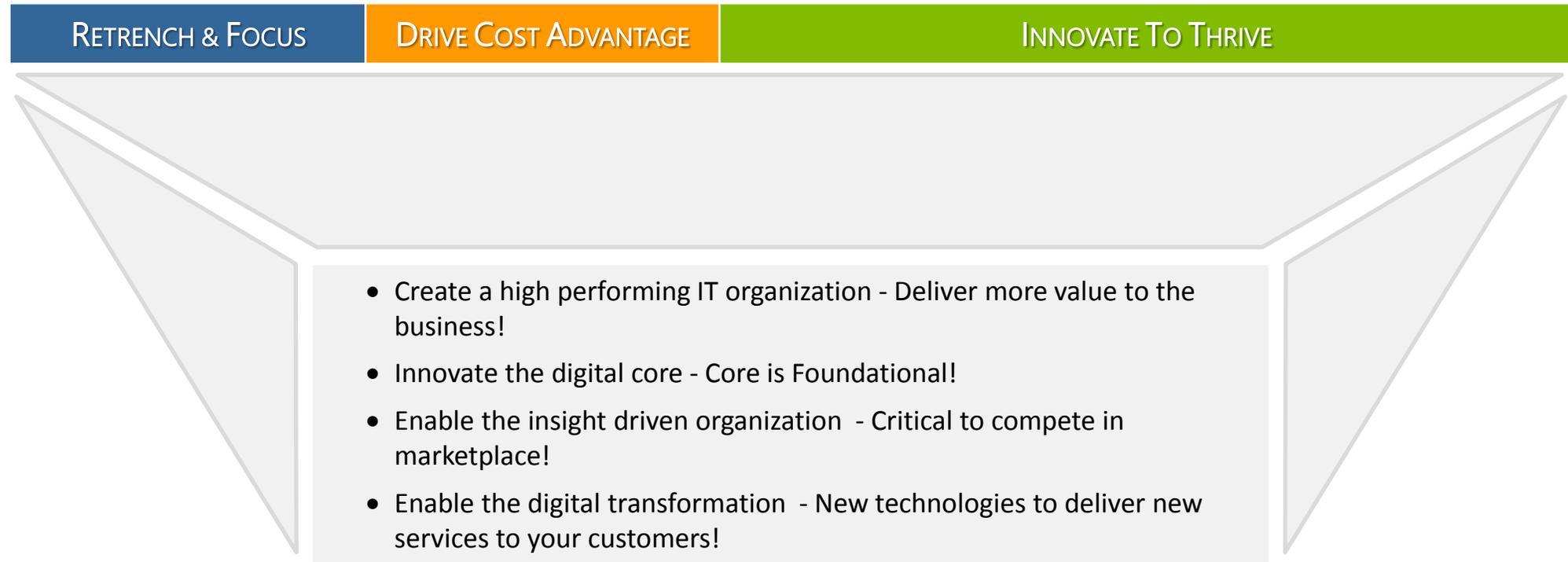
To meet these external forces, WD IT organizations are adopting several operational strategies



Our experience in the industry: WD CIO's priorities are focusing on specific strategies to improve costs, capabilities, stakeholder alignment, and talent management

Primary Priorities	Description
Alignment / Partner with Business	<ul style="list-style-type: none"> • Deliver applications to achieve business objectives • Leverage new technologies to solve business problems • Improved governance / demand management • Increase business participation in IT planning
Organizational Collaboration	<ul style="list-style-type: none"> • Greater collaboration across business units and functions • Modify organization structure to be aligned more closely to business • Hire new "business minded" IT professionals • Improve communication with operating groups
Analytics / Information Mining	<ul style="list-style-type: none"> • Provide all aspects of the business the right information to make better decisions faster • Integrate complex application layer (ERP's) to service the business
Application Modernization Core and Extended	<ul style="list-style-type: none"> • Adopt new technologies to improve performance • Leverage new tools to improve efficiency • Implement new engineering systems
Digital Solutions	<ul style="list-style-type: none"> • Incubate emerging technologies focusing on only highest ROI solutions • Adopt new technologies • Leverage new tools
Talent Acquisition / New Sourcing Models	<ul style="list-style-type: none"> • Develop effective talent management strategies • Respond to talent availability challenges • Considering different sourcing models
IT Affordability	<ul style="list-style-type: none"> • Make IT more affordable to business • Increase standardization to improve efficiency • Increase utilization of managed services

Regardless of the strategic direction, distributors must energize the business with a robust IT core – CIO priorities are aligned to four major themes



Creating a High performing IT organization

CIOs and the business tell us... does this sound familiar?

"Manual processes are highly inefficient"

"IT is very reactive"

"We need better transparency in prioritization"

"It's always them against us"

"Our IT organization does not understand our business needs and objectives"

"Delivery could be more consistent"

"It would be great for IT to be more of a **business partner**, working alongside and understanding the needs across all four businesses in manufacturing."

"There are challenges in resource management and allocation. IT gets more pull from customers/users than available bandwidth."

"We need more IT professionals with higher business acumen"

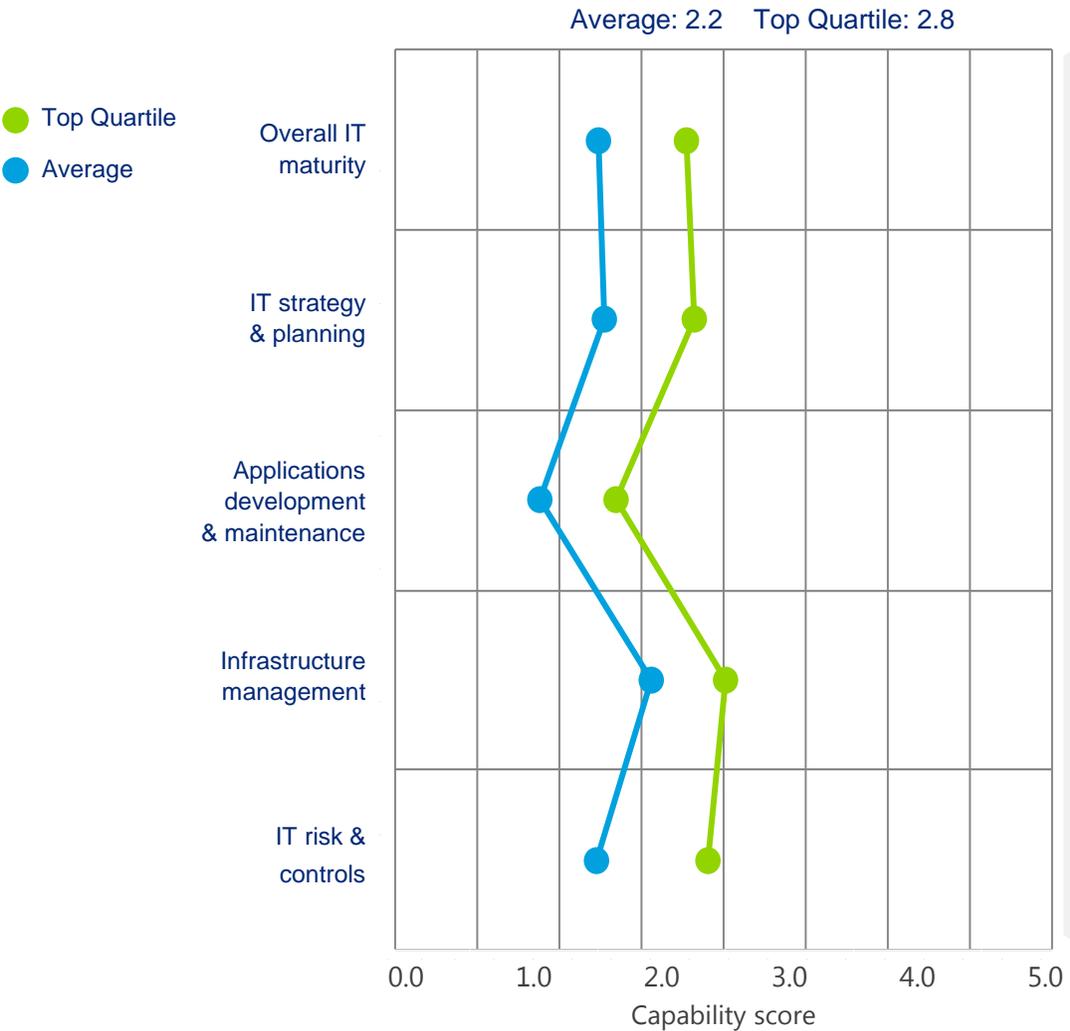
"IT will benefit by building better relationships with customers at all levels"

"We don't know what we are getting for our money"

"We have to deal with multiple data sources"

"Getting the right talent is getting harder and harder"

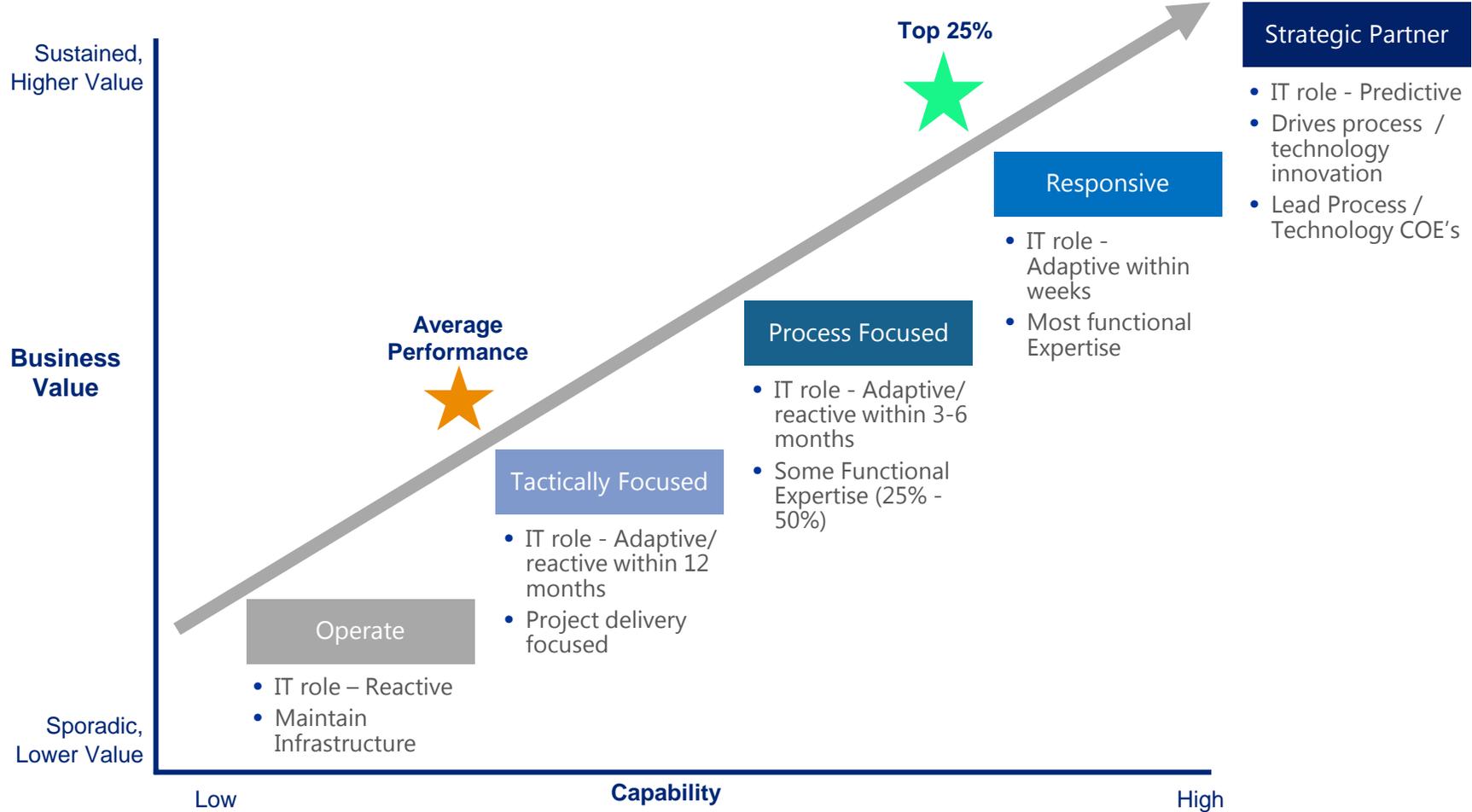
Many IT organizations do a good job of managing the fundamentals of IT operations; However taken as a whole business stakeholders are not fully satisfied



- Infrastructure management is by far the most mature function
- IT does an excellent job in basic blocking and tackling; They score highly in “keeping lights on”
- General business expectations are that IT will provide more innovative solutions to help stakeholders achieve their business objectives
- IT teams, at a middle-manager level, have an opportunity to engage business stakeholders to better appreciate business strategy and enable alignment
- Some mature IT organizations have created the role of a Business Partner or Relationship Manager to foster improved business-IT alignment
- Overall, IT has an opportunity to transform from a reactive support organization to a proactive business partner
- T orgs have an opportunity to define standard application development and maintenance methodologies to improve predictability, consistency and quality
- IT orgs need to improve controls and security processes to safeguard against cyber threats, data loss, and other potential risks

Overall the industry is tactically focused, companies that achieve higher performance have greater functional expertise in IT and governance

Five Levels of an IT Organization



Actionable steps to becoming high performing IT organization

Lower IT Capability

Mission

- Highest priority Manage technologies efficiently

Vision

- Aligned with business planning budget cycle

Goals

- Reduce costs - and rewarded

Business Strategy & Alignment

- Senior management views IT as a cost center or overhead
- Business desires more value from IT, but unwilling to invest
- IT has little input and is seen as an "order taker" – keep lights on

Management & Governance

- Federated model w/significant autonomy unclear decision rights between the central and BU's
- Decisions are typically formed by consensus from the business

Portfolio & Financial

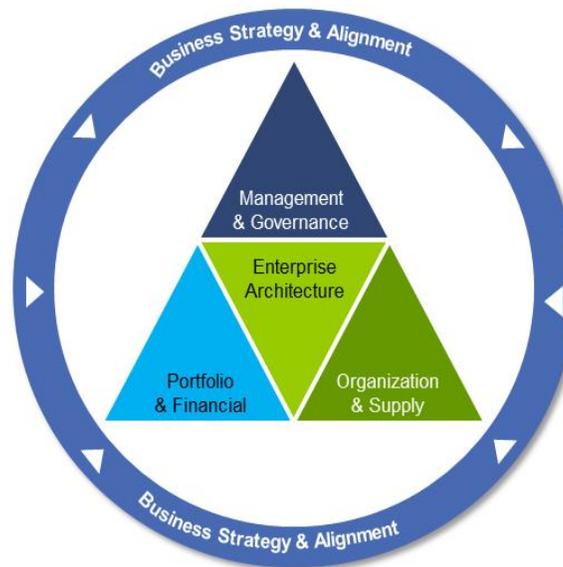
- Operational objectives emphasize cost reduction

Enterprise Architecture

- Less clear roles & responsibilities and decision rights

Organization & Supply

- Staff generally plays multiple roles and is primarily consumed with "keeping the lights on"



Higher IT Capability

Mission

- Initiate technology changes and/or use technology to achieve business goals
- Close tie to business

Vision

- Long/Medium term – process to introduce innovation

Goals

- Drive business possibilities and meet business objectives

Business Strategy & Alignment

- IT is viewed as a "partner" - analysis and Centers of Excellence (CoEs) add value and thought leadership

Management & Governance

- Federated organizational model with clear decision rights between central and federated IT depts.

Portfolio & Financial

- Mature controlling mechanisms over capital, assets, resources and demand

Enterprise Architecture

- Desire to standardize infrastructure and application portfolio

Organization & Supply

- Strong governance model with authority at center with input from BU
- IT and the business collaborate when prioritizing demand

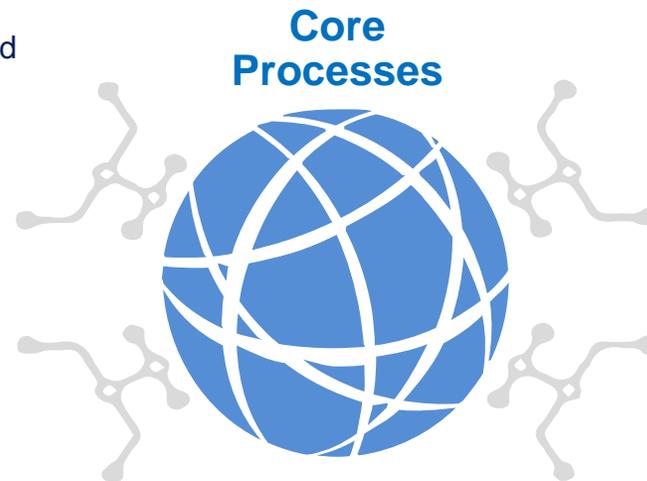
Innovate the Digital Core

ERPs have significantly evolved into a true “Digital Core”, enabling a transformation in traditional Back Office capabilities

- 1 The **entire value chain is digitized, including the core** that serves as the foundation for business transformation, innovation and optimization.
- 2 The digital enterprise **interconnects** all aspects of the value chain to **drive and anticipate business outcomes in real time**.
- 3 Enterprises are leading the digital transformation by completely **reimagining business models, business processes, and work**.

- Standardized and automated processes and improved performance
- Integration of workflow that facilitates optimized processes and throughput improving cycle time

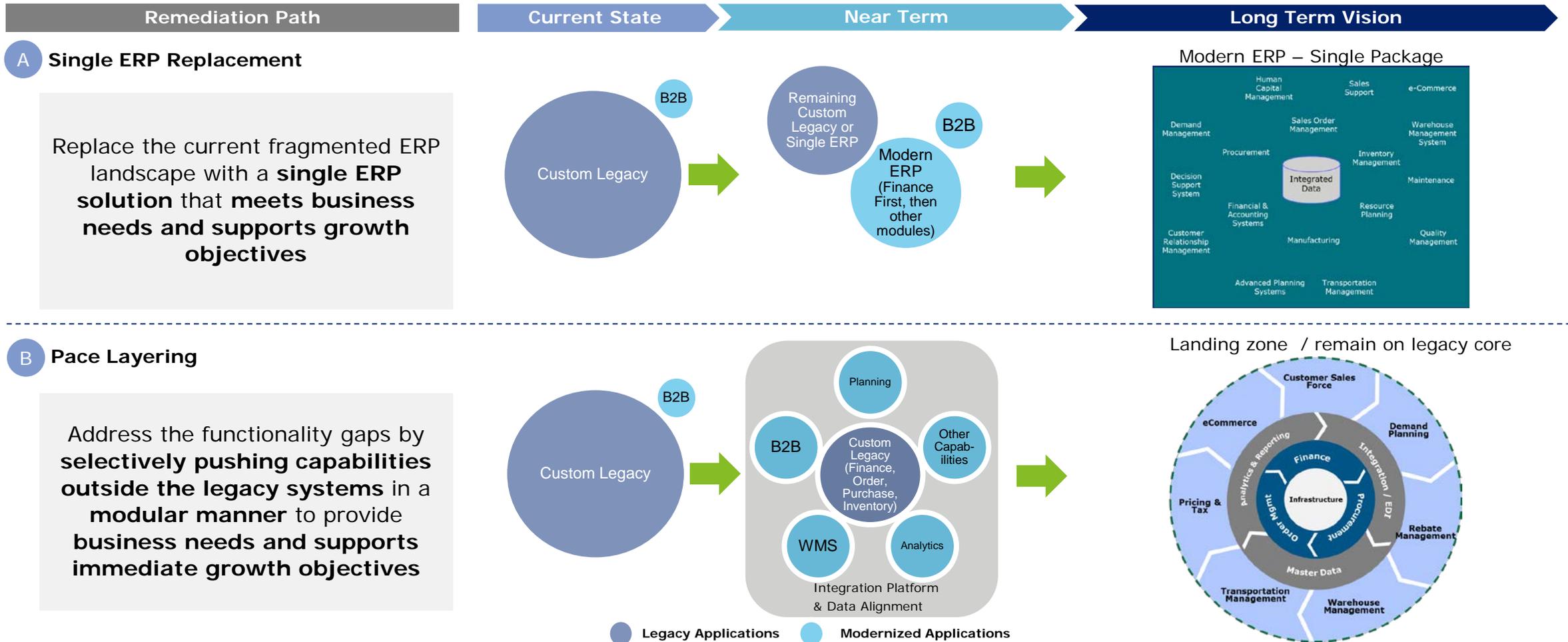
- Elimination of dual data entry
- Improved accuracy, consistency and security of data



- Improved visibility and communication across organizational boundaries
- Increased customer satisfaction by providing the right information at the right time ... the “perfect order”

- Consistent answers to reporting questions ... “one source of truth”
- Enhanced data driven decision making in real time

In WD two primary options for technology modernization have evolved



Approaches to ERP Modernization

Distributors are leveraging agile and modular solutions to modernize their technology landscape and provide the business with on-demand capabilities

Maintain Legacy & Add-in Cloud/Digital Solutions

A large industrial products Distributor's approach is to reduce heavily manual processes running on legacy mainframe via an outside-in approach. Initial focus was CRM, eCommerce and Business Intelligence. They are currently evaluating options to modernize their financial system of record.

- **Retire** mainframe based applications and non-core functionality to reduce code base in legacy ERP
- **Revitalize** Sales, eCommerce and other customer facing processes with Salesforce.com cloud solutions and ecommerce improvements
- **Replace** financial systems of record by evaluating modern packaged software solutions.

Modernize the Core ERP Core (financial) & Add Cloud/Digital Solutions

A leading industrial Distributor's objective is to establish a digital core as their Financial System of Record and add new capabilities around the core over their four year roadmap.

- **Replace** system of record by moving Finance into in-memory Financial solution.
- **Replace** HR processes with a leading cloud based solution.
- **Revitalize** their sales processes with leading cloud solution and ecommerce improvements.

Maintain Legacy, Modernize Architecture & Add-in Best-of-Breed Solutions

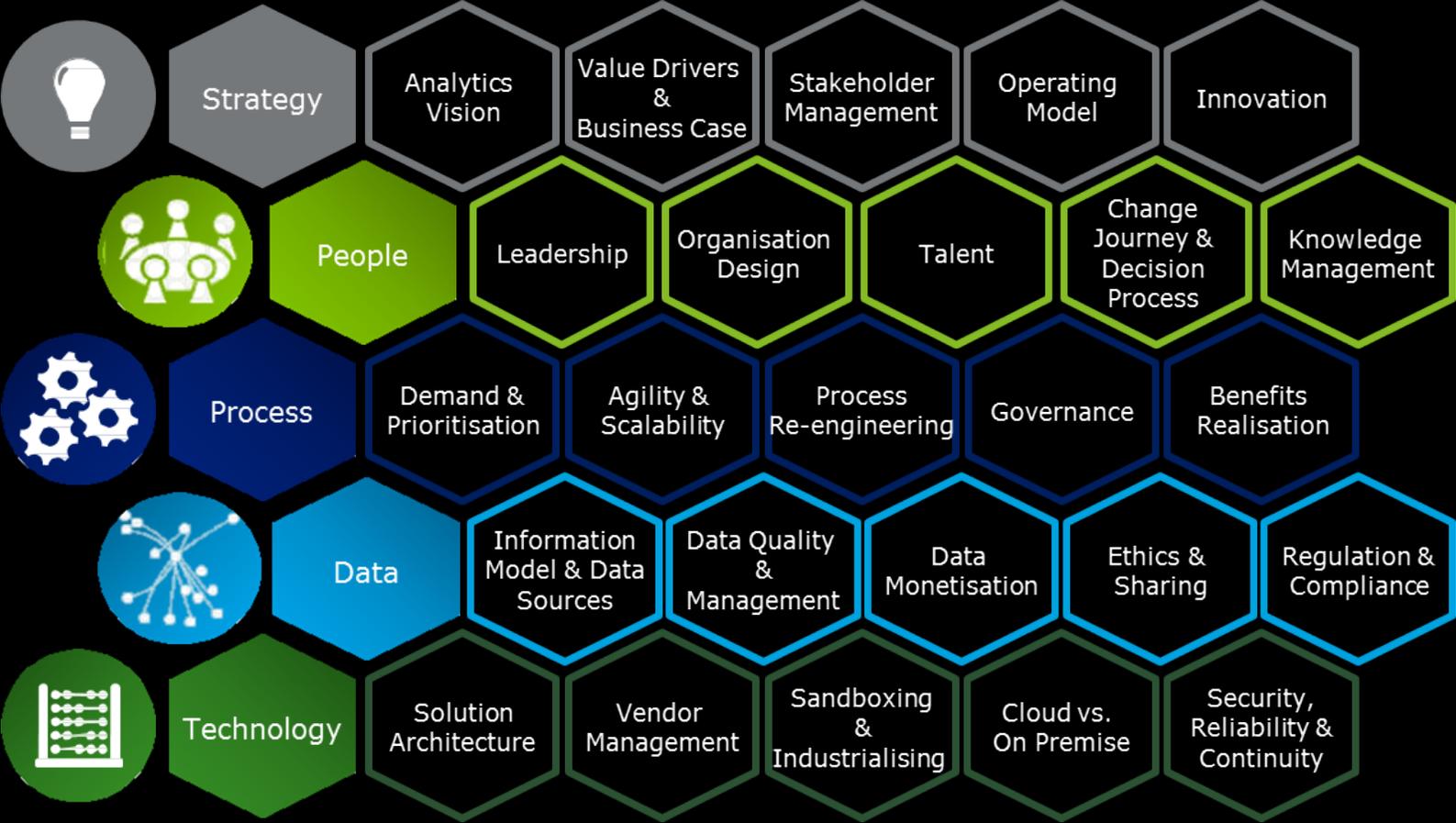
A building supplies Distributor established a roadmap to modernize their BI/analytics, integration, eCommerce, and data management capabilities while maintaining legacy order management and procurement solutions. They are evaluating options to modernize their remaining legacy core.

- **Revitalize** BI/Analytics, integration bus, and data management.
- **Remediate** existing legacy solution to support sales orders management and purchasing.
- **Replace** outdated ecommerce solution, and evaluate modernization of their remaining legacy core.

Insight Driven Organization

What is an Insight Driven Organization

Becoming an IDO relies on the fundamental building blocks of Strategy, People, Process, Data and Technology being in place and informed by an Analytics Strategy. These building blocks can be applied at all stages of the IDO lifecycle



Leveraging new technology & analytics to drive business value

Organizations have leveraged new technology to catalyze enterprise analytics efforts around different business objectives



Robotics & Cognitive Automation



CORNING

OPERATIONAL EFFICIENCY:

Automate “back-office” insight generation and reporting for cost savings



Cognitive Insights



 **DELTA**

CUSTOMER GROWTH:

Unlock deeper customer insights and coordinate a more personalized CX to drive growth



Cognitive Engagement



DAIMLER

BUSINESS MODEL INNOVATION:

Transform the business model into one that focuses on proactive sensing that enable a future view into the lifetime of a vehicle

CALL TO ACTION:

Spotlight on: Cognitive insights

Leveraging Big Data and AI to improve customer experience at a large airline



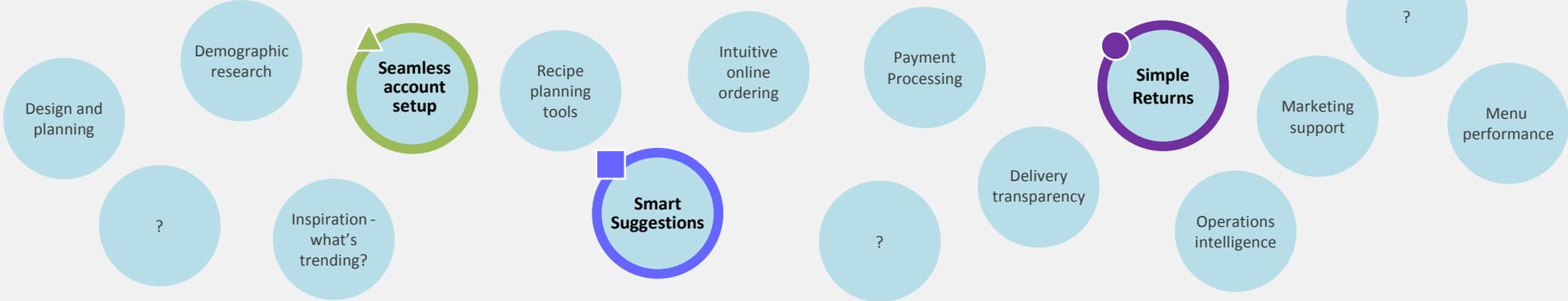
Enable Digital Transformation

Digital impacts on customer journey

A distributor's digital strategy and vision should start with the customer experience and build a rationale for specific investments and activities.



Where can distributor have the largest impact through Digital?
Which touch points have the potential to redefine customer relationships?



*Illustrative
Continued on next page*

Implications for supply chain + beyond

Customer experience initiatives have far-reaching effects up and down the value chain

SMART SUGGESTIONS

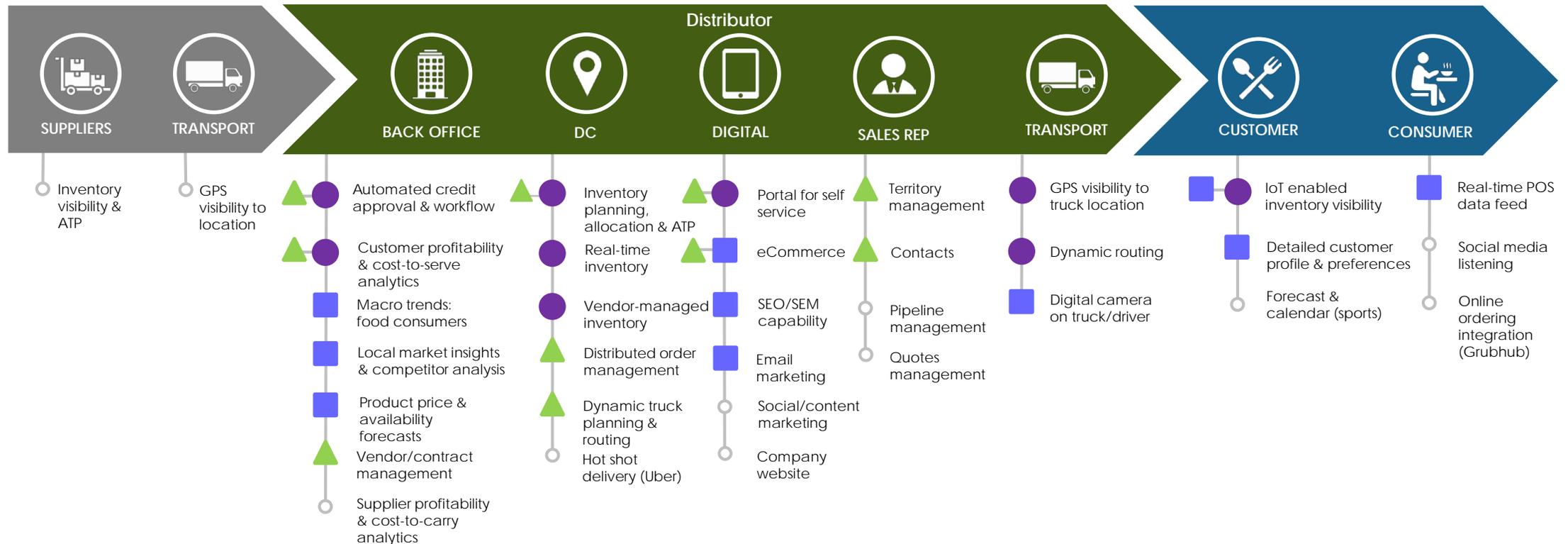
What if distributor could increase customer profitability and retention via delivery of synchronized, tailored, and relevant reorder, cross-sell and upsell recommendations across multiple prioritized digital touchpoints?

SEAMLESS ACCOUNT SET-UP

What if distributor could simplify and automate product returns and credits process via customer self-service portal, back-office automation and workflow, supply chain integration, and real-time customer profitability analysis?

SIMPLE RETURNS

What if distributor could enable customers and sales reps to quickly and easily onboard new accounts via self-service portal capabilities, mobile CRM functionality, and back-office automation and workflow?



A customer-centric digital strategy articulates a portfolio of high-value investments for as a digital enterprise

STRATEGIC PILLARS

-  **Reach New Customers and Markets**
-  **Serve Customers On Their Terms**
-  **Differentiate With Insight-Driven Selling**
-  **Integrate Across the Value Chain**
-  **Adopt A “Being Digital” Mindset**
-  **Infuse Analytics as Both Asset and Utility**

VALUE



DIGITAL ROADMAP

2018 >

- Digital Storefront
- Channel integration
- Advanced Sales Enablement
- Real Time Track & Trace
- Flexible Fulfillment
- Price Transparency
- Vendor Collaboration
- Load Building

Path to Innovation

Which is different than
invention

To our market
or the world

Innovation is the creation of a new, viable business offering.

Creating value for
our customers and
for our enterprise

Ideally going beyond products
to platforms, business models,
and customer experiences

We believe effective innovators follow five important principles

Distributors
investing in
innovation



1

Drive innovation from a **user-centered lens** throughout the process.

2

Be **explicit about innovation ambition**, then organize and execute accordingly.

3

Look **beyond product innovation** to transform other elements of your business system.

4

Don't be fooled by the mythical importance of creativity; **focus on discipline** instead.

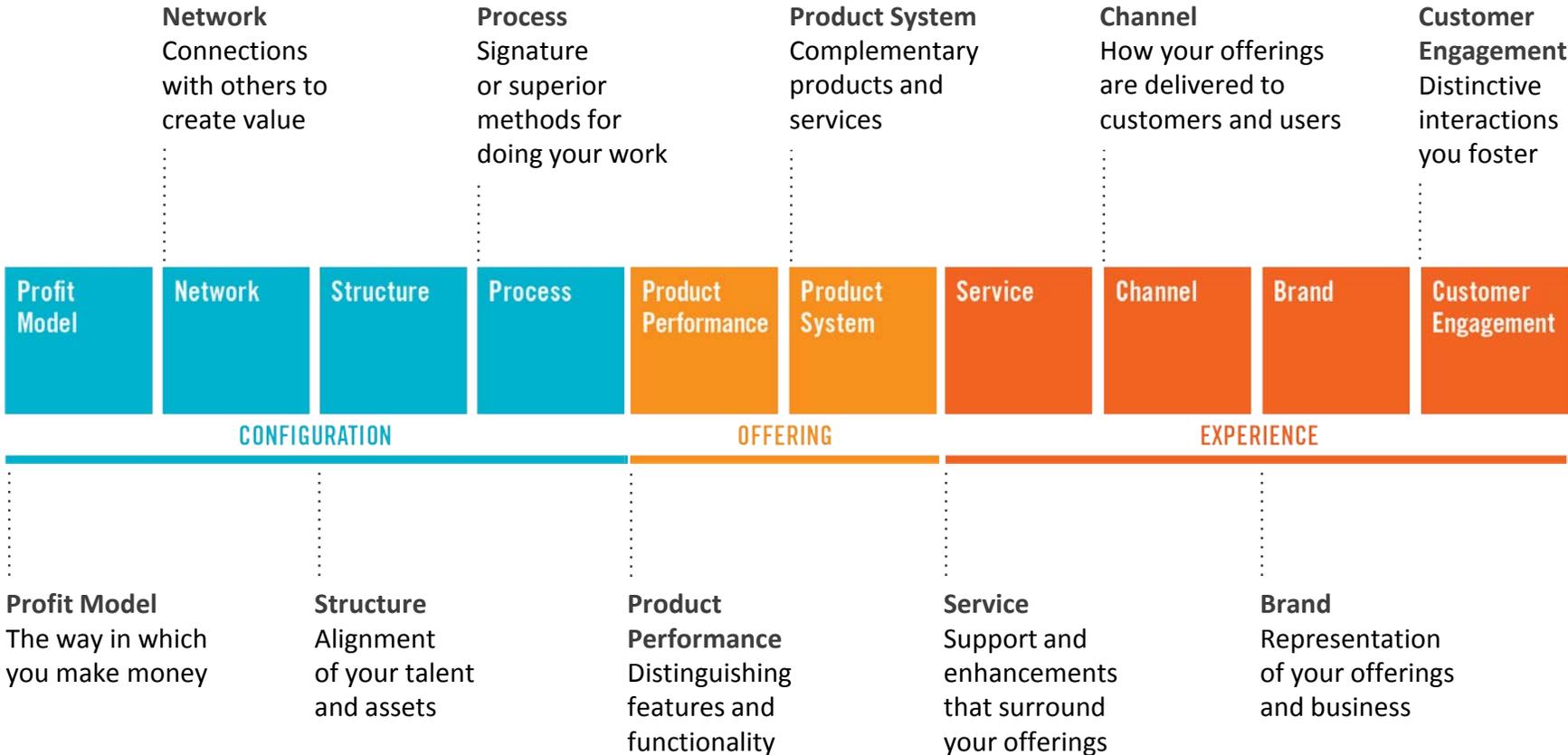
5

Work fast and iterate often, using prototypes to test the value proposition and feasibility.

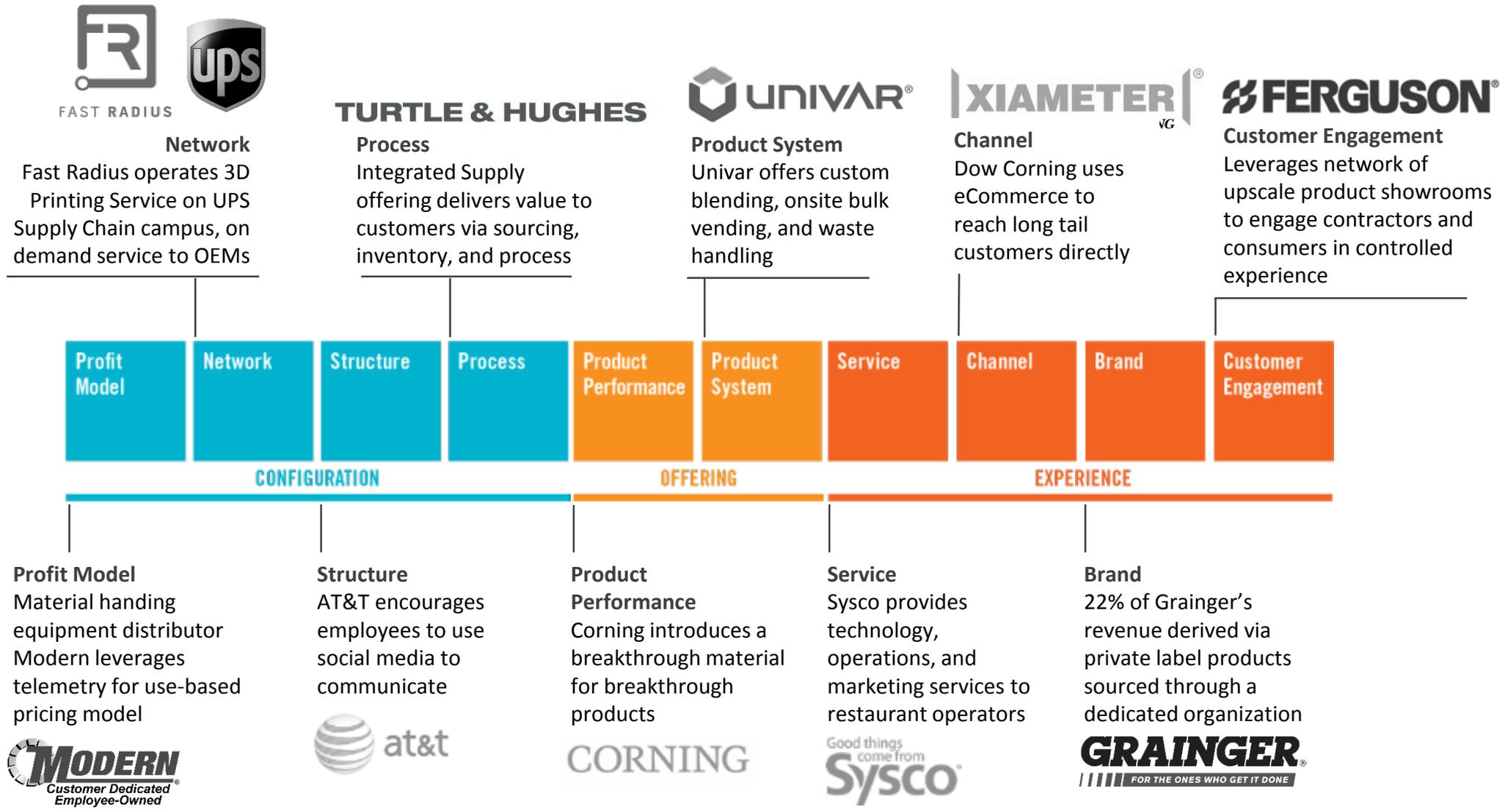
Successful Innovators pursue their efforts in a highly disciplined fashion



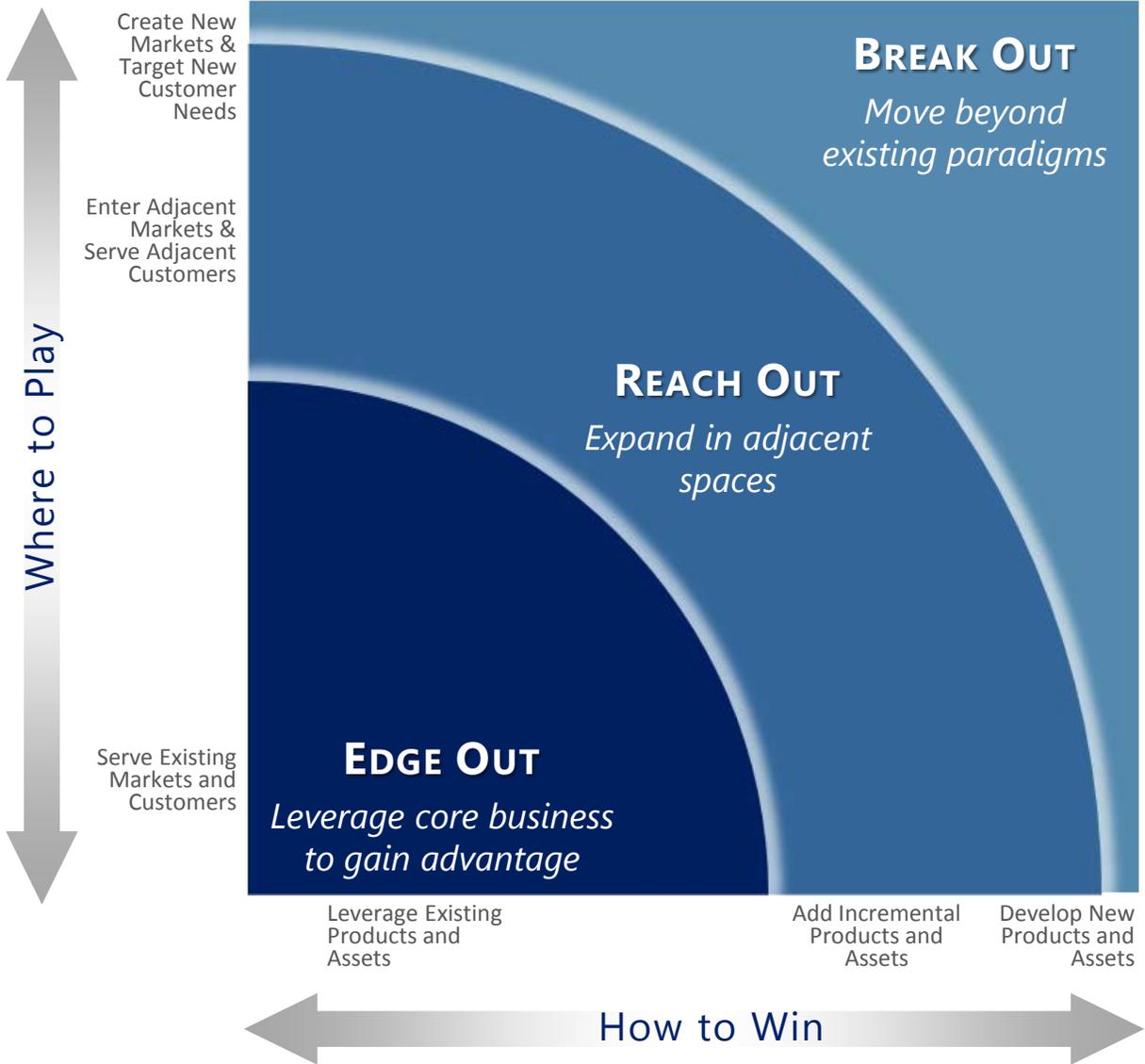
Successful innovators innovate beyond products and integrate multiple types...



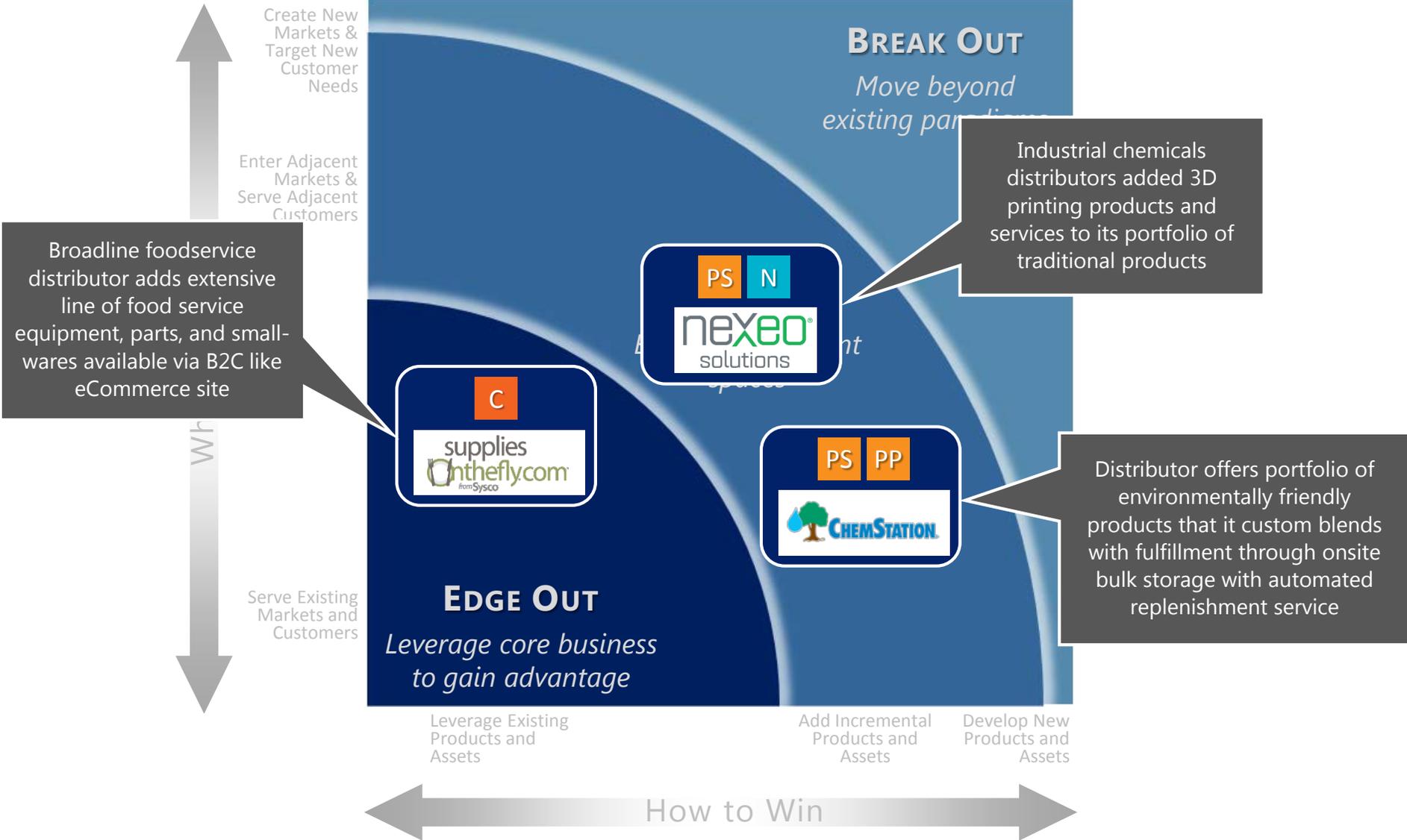
Some classic exemplars in the B2B space...



Successful innovation strategies manage a portfolio of initiatives across various levels of ambition



Examples from across WD





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