

## Chapter 1

# Introduction To Wholesale Distribution

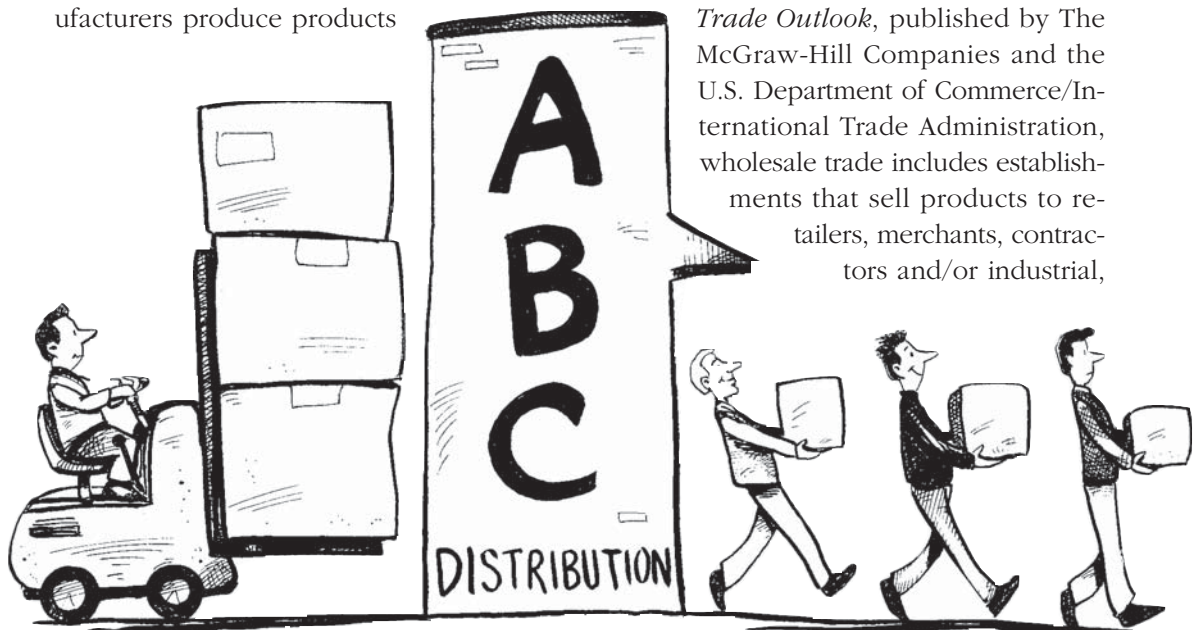
*So you want to start a wholesale distributorship. Whether you're currently a white-collar professional, a manager worried about being downsized, or bored with your current job, this may be the right business for you. Much like the merchant traders of the 18th century, you'll be trading goods for profit.* And while the romantic notion of standing on a dock in the dead of night haggling over a tea shipment may be a bit far-fetched, the modern-day wholesale distributor evolved from those hardy traders who bought and sold goods hundreds of years ago.

### **The Distributor's Role**

As you probably know, manufacturers produce products

and retailers sell them to end users. A can of motor oil, for example, is manufactured and packaged, then sold to automobile owners through retail outlets and/or repair shops. In between, however, there are a few key operators—also known as distributors—that serve to move the product from manufacturer to market. Some are retail distributors, the kind that sell directly to consumers (end users). Others are known as merchant wholesale distributors; they buy products from the manufacturer or other source, then move them from their warehouses to companies that either want to resell the products to end users or use them in their own operations.

According to *U.S. Industry and Trade Outlook*, published by The McGraw-Hill Companies and the U.S. Department of Commerce/International Trade Administration, wholesale trade includes establishments that sell products to retailers, merchants, contractors and/or industrial,



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institutional and commercial users. Wholesale distribution firms, which sell both durable goods (furniture, office equipment, industrial supplies and other goods that can be used repeatedly) and nondurable goods (printing and writing paper, groceries, chemicals and periodicals), don't sell to ultimate household consumers.

Three types of operations can perform the functions of wholesale trade: wholesale distributors; manufacturers' sales branches and offices; and agents, brokers and commission agents. As a wholesale distributor, you will probably run an independently owned and operated firm that buys and sells products of which you have taken ownership. Generally, such operations are run from one or more warehouses where inventory goods are received and later shipped to customers.

Put simply, as the owner of a wholesale distributorship, you will be buying goods to sell at a profit, much like a retailer would. The only difference is that you'll be working in a business-to-business realm by selling to retail companies and other wholesale firms like your own, and not to the buying public. This is, however, somewhat of a traditional definition. For example, companies like Sam's Club and BJ's Warehouse have been using warehouse membership clubs, where consumers are able to buy at what appear to be wholesale prices, for some time now, thus blurring the lines. However, the traditional wholesale distributor is still the one who buys "from the source" and sells to a reseller.

### Getting Into The Game

Today, total U.S. wholesale distributor sales are approximately \$3.2 trillion. Since 1987, wholesale distributors' share of U.S. private industry gross domestic product (GDP) has remained steady at 7 percent, with segments ranging from grocery and food-service distributors (which make up

### **Beware!**

Remember that as a wholesale distributor, your customers have their own customers to satisfy. Because of this, they have more at stake than the typical customer who is shopping at a discount distributor that serves mainstream consumers.



13 percent of the total, or \$424.7 billion in revenues) to furniture and home furnishings wholesalers (comprising 2 percent of the total, or \$48.7 billion in revenues). That's a big chunk of change, and one that you can tap into with the help of this book.

The field of wholesale distribution is a true buying and selling game—one that requires good negotiation skills, a nose for sniffing out the next "hot" item in your particular category, and keen salesmanship. The idea is to buy the product at a low price, then make a profit by tacking on a dollar amount that still makes the deal attractive to your customer.

Experts agree that to succeed in the wholesale distribution business, an individual should possess a varied job background. Most experts feel a sales background is necessary, as are the "people skills" that go with being an outside salesperson who hits the streets and/or picks up the phone and goes on a cold-calling spree to search for new customers.

In addition to sales skills, the owner of a new wholesale distribution company will need the operational skills necessary for running such a company. For example, finance and business management skills and experience are necessary, as is the ability to handle the "back end" (those activities that go on behind the scenes, like ware-

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house setup and organization, shipping and receiving, customer service, etc.). Of course, these back-end functions can also be handled by employees with experience in these areas if your budget allows.

“Operating very efficiently and turning your inventory over quickly are the keys to making money,” says Adam Fein, president of Pembroke Consulting Inc., a Philadelphia strategic consulting firm. “It’s a service business that deals with business customers, as opposed to general consumers. The startup entrepreneur must be able to understand customer needs and learn how to serve them well.”

According to Fein, hundreds of new wholesale distribution businesses are started every year, typically by ex-salespeople from larger distributors who break out on their own with a few clients in tow. “Whether they can grow the firm and really become a long-term entity is the much more difficult guess,” says Fein. “Success in wholesale distribution involves moving from a customer service/sales orientation to the operational process of managing a very complex business.” Luckily, the book in your hands will help take the guesswork out of this transition by giving you the tools you need to succeed.

### Setting Up Shop

When it comes to setting up shop, your needs will vary according to what type of product you choose to specialize in. Someone could conceivably run a successful wholesale distribution business from their basement, but storage needs would eventually hamper the company’s success. “If you’re running a distribution company from home, then you’re much more of a broker than a distributor,” says Fein, noting that while a distributor takes title and legal ownership of the products, a broker simply facilitates the transfer of products. “However, through the use of the internet, there are

some very interesting alternatives to becoming a distributor [who takes] physical possession of the product.” (Read more about using the internet in your operations in Chapter 10 of this book.)

According to Fein, wholesale distribution companies are frequently started in areas where land is not too expensive and where buying or renting warehouse space is affordable. “Generally, wholesale distributors are not located in downtown shopping areas, but off the beaten path,” says Fein. “If, for example, you’re serving building or electrical contractors, you’ll need to choose a location in close proximity to them in order to be accessible as they go about their jobs.”

### Finding Your Niche

Upon opening the doors of your wholesale distribution business, you will certainly find yourself in good company. To date, there are approximately 300,000 distributors in the United States, representing \$3.2 trillion in annual revenues. Wholesale distribution contributes 7 percent to the value of the nation’s private industry GDP, and most distribution channels are still highly fragmented and comprise many small, privately held companies. “My research shows that there are only 2,000 distributors in the

#### **Beware!**

Consolidation is running rampant in many industries. Before choosing your niche, do some market research on your customer base (especially if you’re going to limit yourself to a particular region) to be sure those customers aren’t ripe for consolidation. If they are, you could see your client base shrink quickly.



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United States with revenues greater than \$100 million,” comments Fein.

And that’s not all: Every year, U.S. retail cash registers and online merchants ring up about \$3.6 trillion in sales, and of that, about a quarter comes from general merchandise, apparel and furniture sales (GAF). This is a positive for wholesale distributors, who rely heavily on retailers as customers. To measure the scope of GAF, try to imagine every consumer item sold, then remove the cars, building materials and food. The rest, including computers, clothing, sports equipment and other items, fall into the GAF total. Such goods come directly from manufacturers or through wholesalers and brokers. Then they are sold in department, high-volume and specialty stores—all of which will make up your client base once you open the doors of your wholesale distribution firm.

All this is good news for the startup entrepreneur looking to launch a wholesale distribution company. However, there are a few dangers that you should be aware of. For starters, consolidation is rampant in this industry. Some sectors are contracting more quickly than others. For example, pharmaceutical wholesaling has consolidated more than just about any other sector, according to Fein. Since 1975, mergers and acquisitions have reduced the number of U.S. companies in that sector from 200 to about 50. And the largest four companies control more than 80 percent of the distribution market.

To combat the consolidation trend, many independent distributors are turning to the specialty market. “Many entrepreneurs are finding success by picking up the golden crumbs that are left on the table by the national companies,” Fein says. “As distribution has evolved from a local to a regional to a national business, the national companies [can’t or don’t want to] cost-effectively service certain types of customers. Of-

ten, small customers get left behind or are just not [profitable] for the large distributors to serve.”

In addition to consolidating, the wholesale distribution industry is also evolving rapidly, which translates to both positive and negative changes. For instance, there are indications of disintermediation trends across various industries. Several years ago, strategists and futurists began predicting that companies would increasingly sell directly to consumers, cutting out distributors and any other distribution intermediaries, including some retailers. The predicted change was given a fancy term: disintermediation. It has yet to happen, but the threat persists as an increasing number of manufacturers and end users find one another directly. However, no matter what changes may be in store, smart wholesale distributors will always find a way to adapt.

### The Technological Edge

Today, more than 800 million people around the globe have access to the internet. This is good news for the wholesale distributor who is willing to be flexible in the information age. While traditional players once felt threatened by the internet as a growing sales channel, the startups will be more apt to grab technology by the horns and use it to their advantage.

#### Bright Idea

You can take a trip on the information super-highway to visit a few of your potential competitors. Key the words “wholesale distributor” into your favorite search engine, or narrow it down geographically by adding your city and/or state to the search string.



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### Ride The High-Tech Wave

**It's no secret that technology** has become a major force in the world, so why not try your hand at reselling computers and related equipment? While some computer manufacturers, like Gateway and Dell, prefer to sell direct to the consumer, many others rely on the wholesale distribution channel to get their products to market. The numbers look good: According to a recent Accenture study, the majority of business and information technology (IT) executives in the United States anticipate increases in IT expenditures between 2005 and 2007. The investment is sure to include a mix of hardware (such as computers or telecommunications equipment) and software, both of which present opportunities for new wholesale distributors looking for a high-tech niche.

As e-commerce has evolved into more than just a business opportunity, traditional "brick and mortar" businesses are no longer able to rely on traditional forms of selling products to their customers. Product distribution and delivery trends have been impacted as the internet has grown in popularity. They must also be available to their customers via the internet. For this reason, wholesale distributors—like their vendors—can grab the opportunity to position themselves as internet-savvy firms. Most have set up their own informational websites; others have listed their companies and offerings on mall-type sites devoted to wholesale distributors; and many more have created e-commerce-enabled sites where customers can buy directly through the web.

E-commerce is undoubtedly a major consideration for all wholesale distributors. The Gartner Group, an information technology advisory firm in Stamford, Connecticut, has outlined two possible scenarios to describe how the internet could negatively affect wholesalers:

**1.** Manufacturers post products on the internet with a bulletin board system, thus letting customers source globally with online search engines.

**2.** Manufacturers use the internet to gain direct access to customers, thus bypassing the wholesale distributor altogether.

As with fighting the trend toward consolidation, a smart wholesaler can combat both of these scenarios with a bit of ingenuity and creativity. Finding a unique niche is one sharp move, whether it's serving a group of consumers that manufacturers or larger distributors can't be bothered with, or perhaps buying in bulk and then selling reduced quantities to smaller firms that don't want to make big inventory investments.

Including value-added services can also give you a competitive edge. These include (but are not limited to): simplifying the transfer of product, helping smooth out possible glitches in the information flow, and making transfer of payment easier. In other words, rather than going directly to the manufacturer—who is often more concerned with producing the hard goods than dealing with customer needs—retailers and other distributors can deal with a wholesaler who specializes in customer needs. Wholesalers can also make themselves valuable by keeping goods on hand for customers who would otherwise have to deal with long lead times when buying direct. "That availability very often makes the

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### **Beware!**

If you're planning to start a wholesale distribution business from home, check with your local zoning board about the legality of shipping and receiving merchandise at your home. For example, many cities do not allow the delivery of goods from vehicles like tractor-trailers in residential neighborhoods.

wholesale distributor a backup for, and extension of, the customer's own inventory system," says Fein. And e-commerce itself can be a boon to the wholesale distributor, especially when it comes to finding new customers and hunting down new product manufacturers and vendors to buy from.

### **Starting Out**

For entrepreneurs looking to start their own wholesale distributorship, there are basically three avenues to choose from: buy an existing business, start from scratch or buy into a business opportunity. Buying an existing business can be costly and may even be risky, depending on the level of success and reputation of the distributorship you want to buy. The positive side of buying a business is that you can probably tap into the seller's knowledge bank, and you may even inherit his or her existing client base, which could prove extremely valuable.

The second option, starting from scratch, can also be costly, but it allows for a true "make or break it yourself" scenario that is guaranteed not to be preceded by an existing owner's reputation. On the downside, you will be building a reputation from scratch, which means lots of sales and marketing for at least the first two years or un-

til your client base is large enough to reach critical mass.

The last option is perhaps the most risky, as all business opportunities must be thoroughly explored before any money or precious time is invested. However, the right opportunity can mean support, training and quick success if the originating company has already proven itself to be profitable, reputable and durable.

Regardless of which avenue you choose, a new distributorship will require a few key pieces of equipment to get started. In the office, a personal computer, several phone lines, a fax machine and access to a reliable shipping method will all be necessary. Most wholesalers drop-ship their products through the use of shipping services (UPS, Airborne, FedEx, etc.), though some who deliver to their local areas use their own leased or purchased delivery vehicles. In the end, it truly depends on the product, lead times and proximity of your customer base. With the exception of the entrepreneur who is wholesaling T-shirts from his or her basement, a generous amount of warehouse space will be necessary, as will a location that is in close

### **Dollar Stretcher**



To avoid spending excess money during the startup phase, list everything you think you need and then ask yourself: Why do I need this item? How will it help me be more productive? Can I do without it for six months or a year while my business is getting started? Do this for every purchase, and you'll avoid the urge to spend on impulse items.

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proximity to your customers.

During the startup process, you'll also need to assess your own financial situation and decide if you're going to start your business on a full- or part-time basis. A full-time commitment probably means quicker success, mainly because you will be devoting all your time to the new company's success.

Because the amount of startup capital necessary will be highly dependent on what you choose to sell, the numbers vary. For instance, an Ohio-based wholesale distributor of men's ties and belts started his company with \$700 worth of closeout ties bought from the manufacturer and a few basic pieces of office equipment. At the higher end of the spectrum, a Virginia-based distributor of fine wines started with \$1.5 million used mainly for inventory, a large warehouse, internal necessities (pallet rack-

ing, pallets, forklift), and a few Chevrolet Astro vans for delivery.

Like most startups, the average wholesale distributor will need to be in business two to five years to be profitable. There are exceptions, of course. Take, for example, the ambitious entrepreneur who sets up his garage as a warehouse to stock full of small hand tools. Using his own vehicle and relying on the low overhead that his home provides, he could conceivably start making money within six to 12 months.

"Wholesale distribution is a very large segment of the economy and constitutes about 7 percent of the nation's GDP," says Pembroke Consulting Inc.'s Fein. "That said, there are many different subsegments and industries within the realm of wholesale distribution, and some offer much greater opportunities than others."

### Industry At A Glance

*This trend report indicates the number of U.S. wholesale distribution companies, by company size, from 1995 to 2004.*

Total for Year	Number of Employees							Total Companies	Total Employees
	1 to 9	10 to 19	20 to 49	50 to 99	100 to 499	500 to 999	1,000 or More		
1995	572,087	75,719	44,028	11,305	6,232	304	148	709,823	6,546,287
1996	551,596	74,567	43,394	11,223	6,175	301	130	687,386	6,338,918
1997	502,523	66,723	39,371	10,332	5,760	285	124	625,118	5,783,284
1998	556,346	74,846	44,751	11,916	6,758	338	156	695,111	6,572,421
1999	528,831	75,494	45,193	12,167	6,874	383	165	669,107	6,632,553
2000	507,456	75,960	46,423	12,629	7,331	423	225	650,447	6,779,307
2001	517,556	77,103	47,043	12,770	7,415	430	225	662,542	6,873,837
2002	565,443	78,339	48,802	13,465	8,067	515	243	714,874	7,253,593
2003	529,415	74,651	47,015	13,007	7,633	432	181	672,334	6,726,645
2004	525,212	74,512	46,364	12,481	7,367	433	163	666,532	6,578,696
<b>% Change 1995-2004</b>	<b>+7%</b>	<b>-2%</b>	<b>+5%</b>	<b>+9%</b>	<b>+20%</b>	<b>+25%</b>	<b>+7%</b>	<b>+7%</b>	<b>+3%</b>

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Among those subsegments are wholesale distributors that specialize in a unique niche (e.g., the distributor that sells specialty foods to grocery stores), larger distributors that sell everything from soup to nuts (e.g., the distributor with warehouses nationwide and a large stock of various, unrelated closeout items), and midsized distributors who choose an industry (hand

tools, for example) and offer a variety of products to myriad customers.

Regardless of which subsegment you choose, this book will give you the information you need to realize your dreams of owning a wholesale distribution business. In the next chapter, we'll examine the operational aspect of owning a wholesale distribution business.