

# Competing and Winning with Value-Added Services

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By Frank Hurtte



*Distributors provide a lot of services. Many of these are “old-school” base services such as local inventory, credit and sales teams, while others are more complex and offer additional value to customers. Distributors tend to add services frivolously in response to customer needs, competitive situations and to fill gaps in the market. In most cases, services are deployed without a definable, long-term strategy and are given out free of charge as part of a wider product package.*

Although this technique was part of the distributor playbook for many years, distributors can no longer afford to give their services away for free. Economic and market conditions have changed in the past decade. To maximize success, grow profitability and protect their core business from new competitors, distributors must develop a better strategy for managing their services portfolio.

This whitepaper will explore why value-added services are table stakes and how you can reorient your service strategy to improve profit and reduce unnecessary costs. To do this, we will look at:

- The history of value-added services and why so many distributors give them away for free
- Why value-added services are essential and why you should be charging for them
- How to calculate the cost of your services
- Methods for migrating from “free” to “fee”
- Gaining buy-in from your sales teams
- How to use value-added services to differentiate your business

## **A Historical Perspective on Services in Distribution**

Distributors have always offered services to their customers in some capacity. Traditionally, those services mainly consisted of local inventory, credit terms and a delivery mechanism. In the mid-1970s, easier shipping, driven by logistics companies like UPS, diminished the importance of local inventory and made it easier for customers to shop from suppliers in nearby cities.

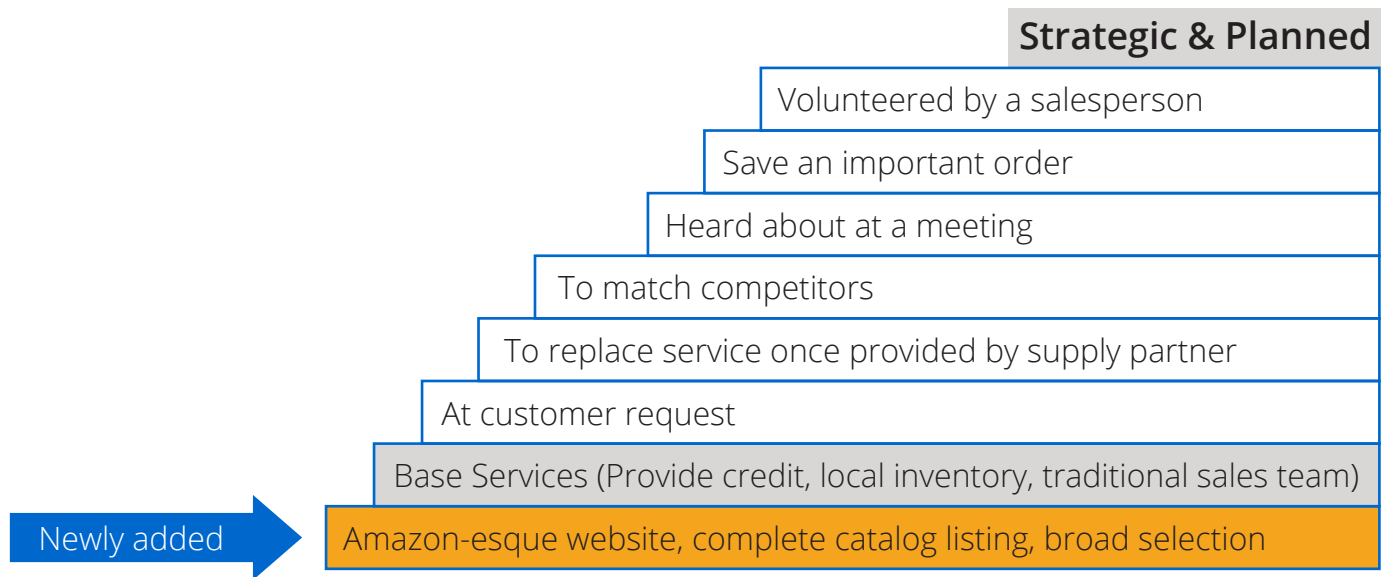
A decade later, the popularity of fax machines enabled customers to further broaden their network of distribution suppliers. As more competition affected a larger share of the customer base, price pressures became a concern.

In 1984, selling guru Tom Reilly published a groundbreaking book called "Value-Added Selling," in which Reilly proposed that distributors should combine services with products to create a value package. This package structure would include more than the traditional services distributors were accustomed to – it would expand their service offering to include new and innovative services that would differentiate their brand and positively affect customers' bottom lines.

The book swept through the distribution community and drastically altered the distributor business model. Many used the techniques outlined by the book to develop dozens of extra services they would bundle with product offerings.

Most distributors still operate by this model; to gain wallet share, they give services away for free. The problem with this strategy is that the costs of providing services often far outweigh the financial benefits of garnering more sales. Unfortunately, distributors don't even realize it.

## The birth of distributor services



## Why Are Value-Added Services Important?

Essential services aren't enough to differentiate your business; today, they are table stakes. Consider Amazon: It is the largest marketplace in the world and checks off all the same boxes as traditional distributors – it offers shipping, credit and local inventory plus digital shopping options and a nearly limitless selection of products. If you provide the same basic services as Amazon, you will have no chance of competing.

Returning to our first statement: Distributors already provide services. Now is the time to assign value. Distributors must move from “parts purveyor” to customer partner and provide unique solutions that positively impact the customers' bottom line. Although transitioning your services to a fee-based model will take time (and will undoubtedly be met with pushback), it is the only way to set your business up for sustainable long-term profitability.

### Examples of value-added services

Material Management	Business Services	Technical Expertise
Customized Labeling for Internal User	Processing Rebates	Engineering Support
Customized Labeling for Resale	Processing Governmental Incentives	Start-up Commissioning
Customer-Specific Catalog Numbers	Credit Services	Efficiency Evaluations
Specialized Packaging	Extended Terms of Payment	Layout Designs
Landfill-Friendly Packaging Materials	Financing Beyond Credit Terms	Cost-Saving Alternatives
Material Scheduling and Staging	Leasing Services	Energy Audits
Kitting (for later assembly)	Summarized Billing	Consulting Services
Product Grouping	Customized Catalog or Price Book	Predictive Maintenance
Customized Packaging	Extended Warranty Periods	Project Cleanup
Project Management	Product-Usage Summaries	Technical Support
Inventory Consignment	Cost-Reduction Analysis	Panel Building
Just-in-Time Delivery		Special Wiring Harnesses
Bar Coding/RFID Labeling of Parts	Employee Improvement	Creating Sub-Assemblies
Surplus Inventory Reduction	Skill Evaluations	
Warehouse/Storeroom Management	Preemployment Skills	Logistics
Warranty Management	Recruiting Assistance	Expediting
Repairs>Returns Management	New Product Introduction	Locating and Procuring "Oddball Items"
Overseas Brokerage of Parts	Product Training	Loading or Unloading Equipment
Restocking of Service Trucks	Application-Based Training	
Jobsite Trailers	One-on-One Coaching	
Jobsite Security Measures		
After-Hours Inventory Access		

## The Benefits of Value-Added Services

Customers think of services with fees differently. Not only does charging a fee encourage customers to view your service in a more professional light, but it will enable the person providing the service to view themselves in a more accomplished light and spur them to provide a higher quality of care.

Fee-based services also open the door to new customer contacts. Because services are not necessarily tied to traditional distribution models, a customer outside your purview may hire you to perform a service, opening the door for future connections. Similarly, fee-based services can expose customer issues which are not generally discussed with a salesperson.

Fee-based services enable distributors to focus on customer pain points rather than on selling a portfolio of products. Over time, this change moves us closer to a solution-selling framework.

## The Cost of Giving Services Away

Well-designed value-added services benefit both the customer and distributor. For instance, most services have the potential to simultaneously provide economic value for the customer and a competitive edge for the distributor.

There are services required to be a player in the market – the table stakes of being in business. Others present opportunities for new distributor revenue streams. All services cost the distributor money to perform. This brings us to three driving questions:

1. Does the distributor receive the proper ROI in the form of Gross Margin?
2. Does the customer receive an benefit (ROI) from the service?
3. Is the exchange fair to both parties?

With rising costs to provide many of these services, the fair exchange portion of the equation often dictates that a fee be tied to the service provided. Sadly, only a few distributors take the time to consider the customer value derived from the work. Take a moment to consider what your services are worth to customers. Your services can bring value to the equation in eight ways:

- Replacement of internal labor
- Reduction in services from third parties (external labor)
- Reduction in overall expenses
- Reduction of assets

- Increases in revenue
- Improvement in market position
- Safety/workplace improvement
- Greater company culture

If the services provided have the potential to drive out costs, improve revenue and enhance operational efficiency for your customers, those benefits are worth more to customers than any traditional baseline cost savings (ie price-cutting from a competitor).

Are you still on the fence regarding services? Consider the fees you pay in the course of your day. For instance, the electrical contractor who originally wired your building charges between \$70-\$100 per hour with a service charge of \$75 just to show up. The company who sold you that really cool copy machine charges \$105 per hour (in hour increments). The accounting firm who does your tax work charges \$225 per hour if you have a mid-year question. Why do you pay these fees without question? Well, because you don't expect services for free, and nor do your customers.

Hopefully, you are beginning to consider the validity of charging at least some of your customers for some of your services. Let's push these thoughts forward.

## Common everyday services

Profession	Standard Cost per Hour	Notes
<b>Bicycle Mechanic</b>	\$78/hr	Local bike shop
<b>Electrician</b>	\$65-77/hr	Union shop rate
<b>Plumber</b>	\$74/hr	Local plumber
<b>Copy Machine Repairman</b>	\$105/hr	Min 1 hour charge
<b>Auto Mechanic at Chevy Dealership</b>	\$79/hr	Local shop
<b>Automation Mfg.</b>	\$225/hr	With travel time
<b>Accountant</b>	\$225/hr	CPA
<b>Attorney</b>	\$250/hr	Billed in 30-minute increments

Service fees: Davenport, IA

## How Do You Begin the Journey Toward Fee-Based Services?

Start by taking inventory of your services. Brainstorm with your team to determine what you provide to customers besides a product shipped in a plain brown box. Consider which services are expected and ask yourself the following questions:

- Are services “just” the cost of doing business?
- Can any of these be automated to drive down costs?
- Have market changes created more/less demand for these services?
- Are competitors providing better than you? How can you improve?
- Who provides these services in your organization?
- What happens if you discontinue a service?

Distributors typically undervalue their services. This is because most have yet to develop a value metric skillset when dealing with customers and don't consider what other service providers charge. Because distributors' traditional customer contacts don't know the financials of their suppliers' business, and purchasing/procurement groups are trained to downplay the value distributors provide, most distributors have given up the idea of charging for services. Instead, they have settled on the idea that services are just a cost of doing business. But, this doesn't have to be the case.

Look at each service that you provide and ask yourself if that service is really necessary. If your customers don't want the service, or find the service irrelevant, why are you still offering it? This type of service drains money from your profits. And it doesn't create competitive advantage. Are you offering it out of force of habit?

It is important to remember the value your service provides is not always about saving the customer money. Instead, the most significant opportunities come from revenue increases. If your service allows the customer to be more productive in their own enterprise, that service provides massive value.

After taking inventory of your services, consider the ones that are the most differentiating or provide the most customer value. If your customers can't function without that service, what happens if you stop performing it?

One of three things will happen if you stop offering a service:

- The customer will perform it themselves, at a cost to their own operation.
- The customer will hire a third party who will charge for that service.
- A competitor will provide the service instead.

In the first two scenarios, the customer is paying for the service regardless of whether you or somebody else provides it. If your competitor charges for the service, your customer will pay them instead of you.

If your competitor doesn't charge for the service, consider their motivation. Do they have some insight you don't have? Is their service a lower quality? Or are they leaving money on the table by not charging?

When competitors provide a service for free that you feel should be fee-based, the decision as to whether to charge becomes very similar to the competitor attacking your business with price. In price-attack scenarios, progressive distributors ask these questions:

- Apples to apples: Is the service the same quality as yours or some cheaper version?
- Does the competitor possess some technology or tool which allows them to provide the service without the same cost?
- Does the competitor have some strategic reason to provide the service for free?
- Is the customer's gross margin high enough you could provide the service for free? This is akin to matching the competitor's price.
- How do you know the information you have is real?

The answer to each of these questions, especially the final one, all follow a strategy similar to a price-driven attack.



## Service levels

### Complexity and Difficulty to Duplicate

Expected Services	Systemized Value-Added	Process-Driven	Custom Embedded
<ul style="list-style-type: none"> <li>Expected by all reasonable customers</li> <li>Offered by direct competitors</li> </ul>	<ul style="list-style-type: none"> <li>Makes your customer's life easier</li> <li>Few competitors offer</li> </ul>	<ul style="list-style-type: none"> <li>Valuable to customers but only offered to a few as a competitive measure</li> </ul>	<ul style="list-style-type: none"> <li>Developed to embed and lock in your company over the long haul</li> </ul>
<b>Examples...</b>			
<ul style="list-style-type: none"> <li>Credit – Standard Terms</li> <li>Order Entry</li> <li>Online Ordering</li> <li>Standard Shipping</li> <li>Inventory</li> <li>Product Expertise</li> </ul>	<ul style="list-style-type: none"> <li>Summary Billing</li> <li>Usage Summaries</li> <li>Advanced Expediting</li> <li>Shipping – Special</li> <li>Reserved Stock</li> <li>Kitting</li> <li>General Training</li> </ul>	<ul style="list-style-type: none"> <li>Leasing Plans</li> <li>Equipment Rental</li> <li>Project-Related Payment</li> <li>Just-in-Time</li> <li>Application Training</li> <li>One-on-One Training</li> </ul>	<ul style="list-style-type: none"> <li>Payment Based on Performance</li> <li>Embedded Procurement</li> <li>Management of Contract Suppliers</li> </ul>

When evaluating your services, think about how difficult they would be to replicate. For instance, services like shipping and order entry are provided by all competitors. It's not difficult for customers to find a distributor who offers these services. On the other hand, the more complex and customized your services are, the more valuable you will be to your customer and the harder it will be for them to replace you.

## Migrating from Free to Fee

It's simple enough to charge for new services, but how can you migrate existing services to a fee model? You have three options:

**Gradual Migration:** With this approach, a limited number of services will be fee-based. Some customers will receive vouchers for free services, and very large customers may not pay fees for a long time. All new services will have a fee attached. Although gradual migration may lessen pushback from customers, the drawback is that it will take considerable time to see a financial impact.

**Improved/Branded Offerings:** This approach aims to improve the services already offered. For instance, you may create a new service which expands your existing services' professionalism while still offering an older service model for free. The key to this option is to stress the difference between the improved and older service

models to make paying for the newer model seem like a no-brainer. You will need a higher upfront investment for this path, but your revenue flow will increase more rapidly.

**Customer Earned:** This approach limits free services to customers who meet a certain financial threshold or other set metrics. For example, although you will begin charging, tell customers they will have a chance to earn back their free services. Give them a threshold they must reach, such as spending \$1 million per year with you, to incentivize them to earn their way to free services. A point of caution, you must be careful with this approach as sales volume does not always equate to profit.

## Free to fee

Gradual Migration	Improved/Branded Offerings	Customer Earned
<ul style="list-style-type: none"> <li>Limited number of services are fee-based</li> <li>Some customers receive vouchers for free services</li> <li>Fees charged on all new services developed</li> <li>Services quoted with a price tag but waived for select customers</li> </ul>	<ul style="list-style-type: none"> <li>Create a new service offering that extends the professionalism of existing services</li> <li>Stress differentiation over free</li> <li>Add certifications, documentation, advanced warranties</li> <li>Easier to schedule than free</li> </ul>	<ul style="list-style-type: none"> <li>Limit free services to customers based on purchases or other metrics</li> <li>Entice customers to earn their way to free</li> </ul>
<p>—————▶ <b>Considerations</b> ◀—————</p>		
<ul style="list-style-type: none"> <li>Takes longer to make a financial impact at your company</li> </ul>	<ul style="list-style-type: none"> <li>An investment early on but will accelerate the revenue flow to your company</li> </ul>	<ul style="list-style-type: none"> <li>Sales volume does not necessarily equate to profit</li> </ul>

## Ensuring a Successful Migration

Your plan must be well-documented to be successful. In addition, you should have someone reasonably high in your organization who will be responsible for managing your new fee-based services model. This person will oversee the quality of services provided, the profitability of work performed and the integration efforts with sales management.

Remember that internal communication is critical. Explain to your employees why you are moving forward with fee-based services and how it will affect the company. This is especially important for your sales teams. If your salespeople haven't bought into the change or don't understand it, they will continue to give services away for free to maintain their commissions.

Expect pushback from both your customers and employees. Change can be intimidating for salespeople. They may not understand the costs of providing a service to their customer or have no experience selling services. In addition, an overestimation of competitive pressures may create an environment of fear and lead to salespeople giving services away to avoid losing customers.

To minimize resistance, prioritize open communication and change management. Tell employees why you are making a change and help them understand the importance of charging for services, including the economic costs of giving them away for free. In addition, be sure to define expectations from the start. Will sales reps receive additional compensation for selling services? Will giving services away count against their total compensation?

### **Marketing Your Value-Added Services**

Marketing is critical. Most distributors lean on their supply partners for marketing. However, as you begin to branch out and offer services not attached to any particular product or brand, you will need to have a solid marketing strategy. Be sure to develop a brand around your services and create your own competitive differentiators – especially when competitors may offer similar services.

Successful marketing will involve using sales aids and materials to:

- Demonstrate and prove your expertise with education, certification and other credentials.
- Address and remove risks associated with your service.
- Document and describe what is included in the service.
- Prove the value of the service.

### **Training**

Training is special enough to be considered as a category of its own. Universally, customers throughout the developed world are short on skilled workers. Further, most distributors have the intellectual capital on staff to help fill this knowledge gap. Providing training (at a cost) builds intimacy with customers while providing thought leadership and expertise.

Training opens doors to new and deeper understanding of customer issues. In a training environment, customer contacts will tell you much more than in what they perceive to be a selling situation. In addition, training expands the number of contacts you can reach in an organization. Many distributors that conduct customer training

classes view the exercise as marketing. Don't gate your services to paying customers. Instead, provide training and support to everyone. Offering services to companies that are not yet customers will give you a foot in the door and provide a window into unique buyer issues that you may be able to address better than their current supplier.

## Takeaways

Transitioning from a free service model to a fee-based one can feel intimidating. This process requires time, training and monetary investment. However, it is important to remember that all services cost you money. Giving your services away for free is not sustainable for long-term growth.

Begin by identifying which services are most important to your customers and discontinue the ones they don't want or need. As you evaluate your service model, remember that the services that are embedded create the longest lasting competitive advantage. Complex, embedded services made it difficult for competitors to replace your efforts.

After your initial evaluation, determine how you will move to a fee-based structure and elect someone to be in charge of your efforts. Remember that communication, both internal and external, is essential. Otherwise, customers will not understand why you are changing your business model, and salespeople will continue giving services away for free.



## About the Author

Frank Hurtte, Founding Partner of River Heights Consulting brings 28 years of distribution industry experience and a lifetime of sales background. Frank grew up in a family-owned business where he was selling car and truck tires wholesale before he turned 14. During his career, Hurtte has gone through nearly every aspect of the wholesale business. He served as manager of a rapidly growing start-up location, ran a cluster of branches where he worked to develop future leaders and was called on to build a winning team after the merger of two companies with dissimilar cultures. Frank successfully established sale strategies in emerging markets and coordinated the efforts of a diverse group of distributor specialists to establish a corporate-wide blueprint for success. In his role as VP Technical Sales, Frank developed and implemented a model for tracking and measuring the “value-adds” provided to customers and pivoting the company to a fee-based services model.

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Distribution Strategy Group offers strategic guidance for distributors in the face of disruption, including:

- Independent expert content
- Digital and ecommerce strategy
- Customer lifecycle management strategy
- Customer analytics

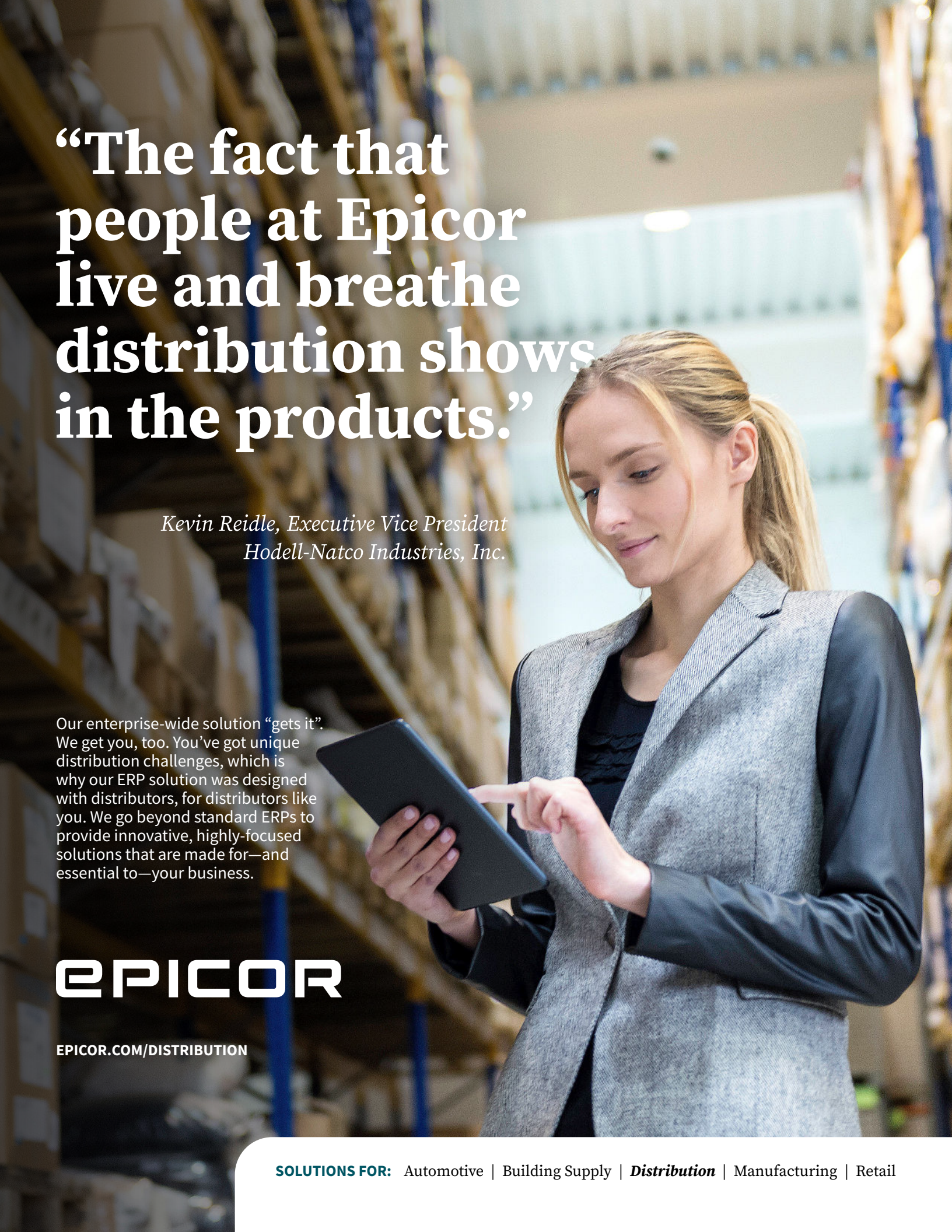
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