



Facing the Forces of Change®

Reimagining Distribution in a Connected World—updated

IBM Institute for Business Value
in conjunction with
NAW Institute for Distribution Excellence

Executive Report

Consumer Products and Goods – Distribution

Develop a customer-centric business model to build enduring brands

For more than a century, IBM has been providing businesses with the expertise needed to help companies win in the marketplace. Our researchers and consultants create innovative solutions that help clients become more customer-centric to deliver compelling brand experiences, collaborate more effectively with channel partners and most profitably align demand and supply.

Differentiation in the digital age

Globalization, consolidation, competition and the persistent threat of disintermediation are affecting distributors both large and small, prompting industry leaders to transform their supply chains and business models. In the process, they will need to shift costs, reallocate resources and seek new sources of competitive advantage. Adding to the challenge of navigating this dynamic environment is the complexity, volatility and uncertainty that continue to characterize the business and economic landscape. In this addendum to the Facing the Forces of Change®: Reimagining Distribution in a Connected World research report by the NAW Institute for Distribution Excellence, published in 2013 (full report available at <http://www.naw.org/ftf13>), we examine some of the more recent challenges distributors face in the digital age and offer suggestions for differentiation.

Executive summary

Facing the Forces of Change®, a research study that analyzes the future of wholesale distribution within multiple lines of trade, provides insights about the overall future of wholesale distribution and the role of wholesaler-distributors. First published in 1982, the tenth and current edition of the report — *Facing the Forces of Change®: Reimagining Distribution in a Connected World* — revealed that while many segments of the wholesale distribution industry were enjoying relatively good times, they continued to be challenged by increasingly complex and disruptive change.

Fast forward to today, and, if anything, the volume and pace of change have accelerated faster than predicted. Rapidly evolving technology, an ever-growing mountain of data and the increasing need for global integration make it difficult for even the most forward-thinking companies to keep up with constant change.

This executive report provides an update to the latest report and presents new ideas that can help organizations meet the continuing challenges of change. Additionally, we will provide updates to some of the trends and statistics presented in *Facing the Forces of Change: Reimagining Distribution in a Connected World*, as well as a selection of key points worth repeating, a review of action ideas, additional examples of distributors taking action, an update on 3D printing, and a new development — the Internet of Things.

While there is no lack of “forces of change” that will impact distributors over the next few years, there is, as well, no shortage of opportunities for distributors to embrace and leverage these forces to help improve their competitive position.

In today's world, organizations must constantly remind customers of the value they provide.

Reimagining the role of the distributor

If you do not continuously remind customers of the value you are providing, customers can easily start to take it for granted. For example, another provider offering a lower product price can lead to a customer defection, even though, in the end, the customer's new total acquisition cost might be higher. It's important to make sure the customer understands this before the decision to switch.

For example, Andrew Berlin, Chairman and CEO, Berlin Packaging, said during the NAW 2014 Executive Summit, that organizations need to continuously remind customers about the value they are providing. He noted that Berlin Packaging is more than just a supplier of packaging. It also acts as an agent to help customers increase sales, reduce expenses and improve productivity — packaging is just the currency used to unlock these benefits. Its inventory-management acumen and 99-plus percent on-time delivery performance are two ways the company provides these benefits. Berlin Packaging quantifies its performance with bi-annual customer reviews. Andrew Berlin notes “over the last three years, our customers have earned \$200 million of incremental profit as a unique consequence of working with Berlin Packaging.”¹

In a recent video by Manufacturing Business Technology titled “How Much Money Is Tied Up In Your Inventory?,” Brian Norris and Kevin Hartler of W.W. Grainger, Inc. reveal that the cost to buy a \$10 item actually approaches \$75, with the additional expense created by people and time.² Additionally, they estimate that about half the items in a customer's maintenance, repair and operation (MRO) inventory never get used or are inactive, and that 40 percent of resource time is taken up in the “shopping” exercise. They liken the cost of MRO inventory to an iceberg. The price of the item is what you see above water; the cost of acquisition is what is below the waterline.

One of the factors that makes it difficult to discuss the overall cost of acquisition is the measurement and reward system for customers. How often are purchasing agents incented to drive the purchase price of the product as low as possible without any regard for the overall cost of acquisition? Changing the mindset or internal workings of customers is not an easy task. It is usually accomplished at levels well above the purchasing agent or sales representative level. For the largest customers, it is often wise to include members of the finance teams of both parties in the discussion. This can have considerable impact. When was the last time your CFO met with a customer?

As illustrated by Figure 1, a capability that is differentiating provides the potential to gain unique competitive advantage. In contrast, if it is non-differentiating and industry generic (lower-left quadrant), it is likely something that needs to be done, but perhaps more effectively accomplished by an outside partner. For example, it is unlikely a customer will ever make a purchase because you have the best payroll system.

What functions in the lower left quadrant of the figure do your customers perform out of necessity? Are these tasks part of your core competence, or capabilities upon which you could expand to generate additional revenue? A common example is vendor-managed inventory, or VMI. Another example is procurement. You may have streamlined processes for these functions that are far more efficient than those of your suppliers or customers. These processes can take VMI a level deeper so that the distributor takes over the procurement function for the customer.

For example, C&S Wholesale Grocers provides warehouse, transportation and procurement services for Associated Food Stores, the Hewlett, N.Y.-based retailer that licenses the Associated, Compare, Met, Met Fresh and Metropolitan City Markets banners to more than 350 independently owned and operated supermarkets in metro New York.³

Figure 1

Distributors can often develop capabilities to provide non-core functions for their customers



Source: IBM Institute for Business Value.

Companies are starting to rethink their value propositions around these four capabilities. For instance, United Stationers Inc., a leading supplier of workplace essentials, with 2014 net sales of \$5.3 billion, announced in February 2015 its intent to reposition under a single brand, Essendant. Cody Phipps, former President and CEO of United Stationers, said, "Our industry is changing rapidly and we must be proactive in positioning our company for future success.

Our current brands, while leaders in their respective industries, do not truly capture the strength we have as one team with one goal. Our strategy is based on a broader definition for our company and, along with the new brand, provides a clear vision: To supply the essentials that unlock the potential of our partners and those they serve.”⁴

Following are some action items that can get you started.

Action Ideas

Near term (1–12 months)

1. Assess your company’s activities and capabilities by exploring their degree of importance to business and strategy, relative importance to customers/suppliers, level of differentiation, required investments and availability of supporting skills. Assess customer and supplier activities and capabilities by exploring their degree of importance to your business and strategy, level of differentiation, required investments and availability of supporting skills.
2. Assess sales performance across both productivity (covering more accounts, surfacing new accounts and opportunities, responding to more proposals) and effectiveness (hitting sales targets) dimensions and develop segmentation model(s) that include metrics and compensation considerations. Assess functional executive leadership and managers for their ability to deliver required next-generation skills and capabilities.
3. If you haven’t done so already, invest the necessary time and other resources to develop a value proposition and define your business strategy. Your strategy should answer the following questions: Where are we? Where do we want to go? How do we plan to get there? What are we going to do now? Also, if not already accomplished, develop a value-added services strategy component to your overall business strategy.

4. Assess your company's IT infrastructure for opportunities to leverage alternative delivery and pricing models (for instance, cloud, SaaS, outsourcing) and evaluate options for joint ventures, partnerships and other collaborative arrangements to (a) access new markets, (b) broaden your portfolio of products and services and (c) realize efficiencies.

In the medium term (12 – 36 months)

1. Initiate discussions with third parties (or internally, if appropriate) regarding outsourcing, joint ventures, shared services or other models to access needed but non-differentiating skills or capabilities (for example, accounting, taxes, treasury, payroll, IT infrastructure).
2. Reevaluate your value-added services portfolio from relevance, cost-to-serve and capabilities required to deliver perspectives.
3. Evaluate opportunities for overseas expansion.

In the longer term (beyond 36 months)

1. Reevaluate your value-added services portfolio from relevance, cost-to-serve and capabilities required to deliver perspectives.

Thriving in a connected world

The disruptive forces facing distributors are continuing and, in many cases, accelerating. For example, moving transactions from traditional methods to web-based electronic commerce continues to increase, as evidenced by major distributors such as MSC Industrial Supply and Grainger. Both have experienced solid increases in digital transactions since 2013.⁵

Sales via Electronic Commerce	2013	Today
Grainger	30%	33% ⁶
MSC Industrial Supply	43%	54.5% ⁷

It is not just transactions that have increased, but interactions as well. For example, Grainger now has over 139,000 likes on Facebook, a 375-percent increase since 2013.⁸ Social media can be a tremendous asset for finding new potential associates, or to help them find you. As one plumbing distributor said, “Selling toilets may not be considered exciting, but working for a forward-thinking company that sells toilets can be.”

Similar to the progression of the use of facsimile machines, web sites have progressed from a luxury to a necessity. They have evolved from company history and product brochures to full-function electronic commerce sites. Early sites provided product specifications, availability, list price and some order status capability. Today, the expectation is that a web site will provide the ability to place orders, provide delivery status and location, offer custom pricing, show order and payment history and more.

New measurements and analytics are used to evaluate net promoter scores, conversion rates, abandoned shopping carts, bounce rates, click-throughs, cost per transaction and other customer satisfaction metrics. Some sites, such as Border States Electric Supply, have a pop-up link to facilitate feedback about the online experience and suggest improvements. Distributors have enabled their sites to cross-sell and up-sell; offer good, better, best options; as well as, when necessary, provide substitute products.

Social business, in general, provides numerous opportunities, such as the Internet, Twitter, LinkedIn and more that enable organizations to introduce new products, post job openings, launch promotions, announce events, share industry product or market information, initiate discussions with customers and build customer networks. If you have not already established a social media presence, now is a good time to begin. Following are some action items that can get you started.

Near term (1–12 months)

1. Make sure your company has a well-defined value proposition and business strategy that embraces the potential of social media, e-commerce and mobility that includes a clearly delineated value proposition.
2. Once a social strategy is in place, begin establishing a social media presence. Twitter is a good place to start, as is LinkedIn. Once in place, create a process for benchmarking, continuous review and improvement.
3. Develop an integrated omni-channel strategy that creates a seamless experience across all customer touch points (face-to-face, online, mobile and other channels), as well as a roadmap that encompasses pricing, promotions and analysis/optimization of both.

In the medium term (12 – 36 months)

1. Engage with customers, suppliers and other stakeholders to assess what they would like to see from your e-commerce and mobile presence. How can you improve? What functionality are you missing?
2. Assess the performance and results of your e-commerce and social media activities. Engage in cross-functional discussions internally to review and revise your business strategy. As well, conduct benchmarking and incorporate best practices by sharing visits with other distributors and companies.
3. Stay ahead of technology and business model developments and innovations within both wholesale distribution and other industries through roundtables and peer meetings.

In the long term (beyond 36 months)

1. Review and revise your business and IT strategy based on technology and business model innovations, competitive landscape and customer demands.
2. Set goals that will serve as benchmarks for measuring your progress online. What is your goal for the number of online transactions by 2017, for instance? Add these goals to quarterly and yearly strategy meetings.

Analyzing and optimizing everything

Leading distributors are embracing a broad array of increasingly sophisticated analytics for sustainable competitive advantage by converting data into insights and insights into action. Three steps are necessary to effectively apply analytics in your business:

1. Use business acumen to identify an area to explore and ask the questions that will lead to insights.
2. Answer the question(s) with appropriate data sources and analysis and glean insights.
There are several software companies, consultants and solution providers that can assist in this step.
3. Turn the insights into action.

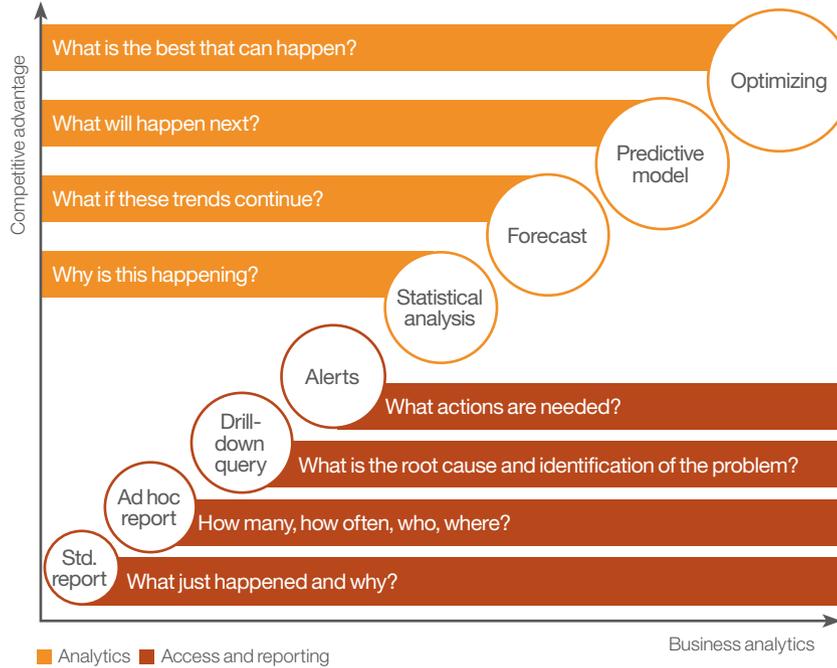
Analytical skills are in demand in today's work environment. They may exist in your current work force, and the opportunity exists to canvass the skills of employees, some of which have many years of service and business acumen developed over time.

At an NAW Executive Summit, Tammy Miller, CEO, Border States Electric Supply, discussed how "financial modeling separates the cost to perform service from the cost of the product. It provides transparency to jointly evaluate the service model and eliminates zero value cost adders. Best value can be delivered versus lowest first cost."⁹ Miller went on to say how understanding costs, and sharing this information with customers, permits Border States to win business at agreed upon service levels and get paid for services.

Figure 2 illustrates where your company sits in maturity of various analytics activities.

Figure 2

Analytics capabilities allow organizations to analyze and optimize data to create insights to solve problems and overcome challenges



Source: IBM Institute for Business Value.

As the title of this section states, you are looking to analyze and optimize everything. You are likely to find yourself in multiple maturity levels depending on the area of analysis.

Some of these areas include inventory management, customer segmentation, price optimization, inventory optimization, activity-based costing, risk assessment, fraud detection and e-commerce performance. You can take these to a deeper level. For example, e-commerce performance can include analysis on how visitors arrived on your site, where they went to when they left your site, whether they have been on your site before, what they searched for, how they navigated on your site, how long they spent on each page, which items they put into their shopping carts, which items they removed from their shopping carts, which shopping carts were abandoned and at what stage, average order size, conversion rate and the like.

Competitive advantage and differentiation tend to increase as you progress up maturity levels. To most, optimizing outcomes based on the knowledge of the best possible results is aspirational. However, examples of predictive modeling exist.

In December, 2013, Amazon gained a patent for what it calls “anticipatory shipping,” a method to start delivering packages even before customers click “buy.”¹⁰

Amazon says it may box and ship products it expects customers in a specific area will want — based on previous orders and other factors — but haven’t yet ordered. According to the patent, the packages could wait at the shippers’ hubs or on trucks until an order arrives.

In deciding what to ship, Amazon said it may consider previous orders, product searches, wish lists, shopping-cart contents, returns and even how long an Internet user's cursor hovers over an item.

The patent exemplifies the analytical capability for organizations to anticipate customers' needs, even before customers do. But the patent demonstrates one way Amazon hopes to leverage its vast trove of customer data to edge out rivals.

Action Ideas

In the near term (1–12 months)

1. Initiate internal discussions and education around Big Data:
 - Assigning a person or department to track, manage and basically monitor the topic
 - Engage with functional leaders to identify potential opportunities for its use.
2. Develop a prioritized portfolio of analytic enhancements, as well as an assessment of current data management and governance.
3. Review process for aligning business and IT strategy and assess analytic skills in key functional areas, prioritize deficiency gap areas. Assess IT infrastructure and develop a plan of action for addressing deficiencies and/or gaps.

In the medium term (12–36 months)

1. Develop a strategy for leveraging Big Data and identify pilot opportunities.
2. Build out centers of excellence and competency.
3. Pilot and implement analytic tool upgrades and first-time installations and pilot Big Data analytics in focus areas.

In the longer term (beyond 36 months)

1. Implement a strategy for accessing new sources of data and analytical capabilities, including qualified people:
 - Explore new models for accessing skills, including leveraging offshore resources.
 - Move analytics work to where it is best done, not necessarily where your company is based.
2. Maintain awareness across the organization about new analytical tools and applications (through events, communities of interest and collaboration tools) and reinforce this awareness through continued executive-level engagement.
3. Continue to support the organization across all functional areas in assessing, piloting and refining analytically driven opportunities (especially in Big Data areas).
 - Internally, for efficiency and effectiveness by continuing to drive deeper cross-functional analytics collaboration, for example, between the CIO and the chief marketing officer (CMO), the CFO and the CMO, the CFO and the CIO.
 - Externally, through joint ventures and other collaborative models, both upstream with suppliers and downstream with customers, as potential source of differentiation, retention and revenue.

Developments to watch

3D printing, also known as additive manufacturing

The pillars of modern supply chains — produce, distribute and use — are inexorably linked. The function of distribution has existed for hundreds of years. The disintermediation of the wholesale distribution industry with the coming of age of the Internet has not yet occurred, since the Internet has never had the ability to deliver a product. The types of companies and the names of the companies that provided the distribution function have and will continue to change.

On its face, 3D printing, which translates digital designs into physical objects, could change the fundamentals of the distribution function. A key part of the distributor value proposition has always been the availability of a broad and deep inventory of product, competitively priced and available for rapid delivery to the customer. How does this value proposition change if customers can print the parts or components they need, where and when they are needed, with customization if necessary?

While 3D printers cannot make every imaginable product, the inventory of what can be produced is astonishing. 3D-printed products include those made from materials as diverse as plastic, metal and human tissue and as complex as replacement joints, clothing and engine parts. The number and complexity of products continue to grow rapidly.

In 2012, the market for 3D printers and services was estimated to be worth US\$2.2 billion, but is expected to reach \$6 billion by 2017.¹¹

While 3D printing has the potential to disrupt current supply chains, an opportunity exists for new supply chains to be created. The growing demand for 3D-printed products will result in demand for the distribution of printers, repair parts and 3D-printing cartridges, where supply chains are currently in the infancy stage.

Internet of Things (IoT)

Based on a recent IBM Institute for Business Value report, more than a billion intelligent, connected devices already compose today's "Internet of Things (IoT)." ¹² The expected proliferation of hundreds of billions more devices places us at the threshold of a transformation sweeping across the electronics industry, as well as those that support it, such as wholesale distribution.

Computing is already widespread in many devices, from cars to smart phones, but it is a particular kind of computing that is cheap and scalable, yet inherently limited: application-specific, embedded computing.

What is new and what will power the IoT is the shift from special-purpose computing — often the minimum necessary for device control — to general-purpose computing. General-purpose computers are connected systems with a wide range of capability that can easily be updated and programmed.

The rise of inexpensive general-purpose computing has been accompanied by the availability of inexpensive sensors and actuators that today are inexpensive enough to embed in a device even if they are not used. Tremendous advances in cloud computing enable storage and analytics of vast amounts of data generated by these sensors.

Many industries, such as agriculture, transportation, storage and logistics have not fit well with personal computers that require desks and offices. The IoT can provide capabilities for industries that have not previously considered to be "IT intensive." To date, the first wave of IoT has focused on high-value applications, such as the continuous monitoring of jet engines, automated smart meters and remote healthcare management.

For distributors the opportunity is two-fold. One is for use by distributors, such as warehouse locations reporting capacity, utilization and availability in real-time. The second is providing services such as monitoring inventory at customer and supplier locations. The analysis could provide real-time matching of supply and demand for goods and services. With unsupervised usage of systems and devices, organizations should be able to reduce transaction and marketing costs.

For example, if agriculture could be instrumented and digitized with field sensors, including soil and weather conditions, value could be realized from substantial yield returns for optimized planting and harvesting and cost reductions by optimizing use of fertilizer and water. Distributors serving the agriculture industry would benefit from a steady flow of such data. Distributors serving many other industries would benefit similarly.

One common challenge for both 3D printing and IoT is user acceptance. Will customers be satisfied if their replacement auto parts are from the original equipment manufacturer, an aftermarket or private-label provider or a 3D-printed part?

Similarly, for IoT, consumers may not be ready to embrace monitoring all transactions in their home refrigerators, but business-to-business enterprises should be more willing to embrace technologies that provide value and a demonstrated return on investment.

Action Ideas

1. Determine if you carry products with low turns that could be printed on demand, as well as those products you carry that are the easiest to print.
2. Look at IoT as a different kind of data source. Determine the current cost of acquiring information, such as inventory levels, and compare to the cost of instrumented data collection.
3. Understand the challenges of your customers, as well as the data points that could be created with an IoT device that could be used to alleviate the challenge. Also, look at developing the expertise and positioning your company as an instrumented, interconnected and intelligent provider.

Are you ready for the forces of change?

The *Facing the Forces of Change*® report delivers a view of the evolving business environment, additional ways of connecting and communicating, updated definitions of value, alternate ways to analyze the plethora of information and new opportunities that are emerging. Charting a course for success in such an environment requires a combination of bold initiatives and prudent investment. Thriving in a connected world requires a long-term vision that reimagines the distributor's role in a fast-paced and ever-changing environment.

Assess your progress with the action ideas, determine priorities and take actions to optimize the opportunities.

Questions that may jumpstart your thinking:

- How do you know where the demand is going to be?
- Are you going to be content to fulfill the demand, or are you planning to get ahead of it and create the demand?
- How can you envision desired outcomes for your suppliers and customers, then reimagine ways to provide them?
- If knowledge is becoming the new currency, how rich will you be?

To order *Facing the Forces of Change*®: *Reimagining Distribution in a Connected World*, visit <http://www.naw.org/ftf13>.

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NAW Institute for Distribution Excellence

As the long-range research arm of the National Association of Wholesaler-Distributors (NAW), the NAW Institute for Distribution Excellence sponsors and disseminates research into strategic management issues affecting the wholesale distribution industry. The NAW Institute aims to help merchant wholesaler-distributors remain the most effective and efficient channel in distribution.

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