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the
DISTRIBUTION
BUSINESS MODEL

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EDN
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Electronic
BUSINESS

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Letter from the publishers

TIMES ARE CERTAINLY CHANGING

This is especially true when you compare where the electronics industry is today to where it was a year ago—we find ourselves in a less-than-desirable place and are all eagerly awaiting an economic recovery. This is also true when you look at the historical changes that have taken place since the components distribution industry was born as an outgrowth of surplus radio parts in the years after the world ended its war, and contrast it to today's industry of ultra-sophisticated players with state-of-the-art services available essentially twenty-four hours each day.

One thing that hasn't changed in all this time is the distribution business model: a 50-year-old model that is at odds with the demands of the New Economy. And while current economic conditions suggest perhaps that we all should focus on the respective business at hand, the publishers within the Cahners Electronics Group of magazines felt this topic was too important to be delayed.

The three important topics we chose to cover in our 2001 Distribution Supplement focus on the distribution financial model, activity-based costing, and engineering services. In **Changing Rules for a Changing Market**, we look at how distributors are working to catch the favorable eye of Wall Street investors—a crucial facet of today's corporate reality. In **Money for Something**, we see how distributors are slowly moving toward charging for services to recoup costs. And, in **Not Middlemen, Partners**, we outline how closely distribution companies work with their OEM customers to create product designs.

Take advantage of this special supplement to EDN, Electronic Business, Electronic News and ECN. Learn how to get the most out of your distributor relationships and discover that the best distributors are not just vendors, but partners. Those of us in the Cahners Electronics Group are also your partners...providing critical information to help you be more effective in your job. So, let us know what you liked, didn't like, and future topics you would like to see covered in our special focused supplements. Send your comments to Cindy Morgan at cmorgan@cahners.com.

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The Distribution Financial Model

CHANGING RULES FOR A CHANGING MARKET

The evolving distributor role demands à la carte pricing.

By Margaret Mary McGovern

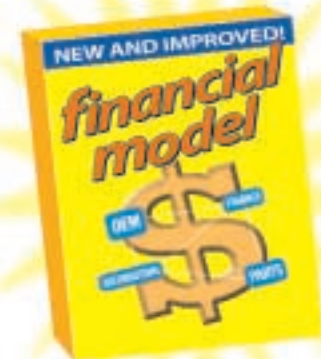
One are the days when electronics distributors were simply middlemen between parts producers and OEMs. Distribution is now part of the design process, encompassing value-added services such as kitting, programming, bar coding, supply chain management, and more. Reflecting the distribution industry's changing role, the old pricing system—the broker, or "parts for dollars" financial model—is changing to a demand-creation model that reflects the importance of distributors in the new industrial age.

But that change is slow in coming, say industry observers. The slow pace is largely the result of the gradual evolution of the relationships among suppliers, distributors, and customers.

In the post-war era, the commercial electronics distribution industry grew from simply supplying radio parts to supplying the emerging television industry of the 1950s and 1960s. It grew even further with the advent of computers and electronic office equipment in the 1970s. Still, distributors merely acted like sales reps,

taking orders and shipping parts.

In the 1980s, global competition placed increasing design and production strains on OEMs. In response, the role of the distributor saw an increasing focus on value-added services and design skills. By the 1990s, distributors



discovered new design opportunities and supply chain logistics. The industry had not just grown; it had evolved.

"In the 1950s, there were few publicly traded distribution companies and little interest in them from Wall Street," according to Roy Vallee, chairman and CEO of Avnet, Inc. of Phoenix, AZ. "The industry itself was fragmented

among a number of small players, many of which, like Avnet, were diversified holding companies, not strictly distributors of electronic components. In the ensuing decades, distributors gained market share as their ranks were consolidated, ultimately creating billion-dollar-plus, publicly traded distribution companies and thus getting more notice from Wall Street," Vallee says.

But the old financial model of the middleman was not built to sustain all the changes and developments in the distribution industry. The costs of engineering services, design facilities, development tools and the like were not easily incorporated in a simple price mark-up.

That difficulty was reflected in the performance of distributors' stock. Early on, "distribution was thought to be a poor cousin to the manufacturing entity and as such held in little regard by Wall Street," says Ernest Schilling, Sr., president of Powell Electronics Inc., Philadelphia, PA, a distributor of interconnect and switch devices.

The Model Close Up

"The old business model no longer serves us well because the basic pricing mechanism is inadequate," says Francis M. Scricco, president and CEO of Arrow Electronics, Inc. of Melville, NY.

"Twenty years ago, buyers would call a distributor and say 'I need 100 parts, do you have them and what is the cost?' If we had them, we would mark them up by X percent and ship them. This was and still is the only way for a distributor to get paid for the value it provides. It was a market based on an arms-length buy-sell relationship," Scricco says.

Once electronic products became more pervasive in American society, both manufacturing and distribution grew at a quick rate. "It was no longer a

Mom-and-Pop operation when you had to sell and ship hundreds of parts at a time," Powell's Schilling says. A need arose that wasn't being met and the original broker-based business grew into a new model as the industry changed.

Tom Pitera, president of Industrial Electronics Division at Pioneer-Standard Electronics, Inc. of Cleveland, OH, says distributors, "moved to a demand-creation model in 1985, working with customers to help incorporate their needs into designs and get customers to production and market quicker."

The changes, according to Pitera, were in synch with the way the economy changed from an industrial one to a service economy. Over the years, Pitera says distribution has moved from being a parts business to being an extension of sales and marketing, providing more and more information to both manufacturers and customers.

Arrow's Scricco agrees. "Distribution's participation is not just in purchasing but in all aspects of the customer's supply chain, from design through manufacturing." To that end, his company employs some 550 field application engineers to help with design and more than 1,000 people to physically alter products to customer specifications. "Both customers and suppliers have asked for more, and we've obliged them," he says.

He calls it a win-win result. "It's a win for suppliers because they avoided adding their own field engineers and sales people and a win for customers because they avoid adding factory, warehouse and material-handling people plus expeditors."

But these new bundled services have added cost to the distributors. Though Arrow has coped by growing, acquiring new companies and gaining more volume, the

payback hasn't always been immediate.

Does the Model Still Work?

"The whole industry needs a massive rethink," Scricco says, referring to the idea of un-bundling and getting compensated for services supplied. To recover the cost of any new services, he believes the new costs must be charged for separately and explicitly.

Scricco touts the recent introduction of Arrow Digital Solutions,



"Educating everyone and letting them make tradeoffs on exactly what they want and how much it costs is the answer."

—Francis M. Scricco
President and CEO
Arrow Electronics, Inc.

a suite of web-based decision-making tools, as a good first step in the direction of a la carte pricing. Access to those tools is on a per-fee basis. While the company will still make catalog-style information available for free, its new emerging distributor financial model includes selling not just parts but expertise and proprietary information over the Internet, available 24 hours a day, seven days a week to customers at a separate charge. "You can get more for more, less for less, but not more for less," the Arrow CEO says.

Avnet's Vallee feels distributors have shown their adaptability and kept up with changes in the tech industry. "We are in the 'sweet spot' between suppliers, OEMs and contract manufacturers giving us broad visibility and insight into industry trends," Vallee said. He cites Avnet's investments in IT, warehousing, asset management and materials logistics that broaden the company's service base.

"As the electronics industry

has grown as a whole, and the role of contract manufacturers exploded, distribution has grown even faster than the total and gained DTAM [data transfer, access and manipulation] share as a result."

In the electronic components industry, distribution currently represents about 20 percent of the worldwide market, according to an April 20, 2001 report on technology distribution by Tucker Anthony Sutro Capital Markets.

And International Data Corp., Framingham, MA expects that number to grow to 23 percent over the next several years.

Comparing Models

How does the distribution financial model compare to other business models?

"Unlike the car-parts industry where neither the model nor customer needs have changed, pharmaceuticals had to change a lot like distribution [has] because of changes in the health care industry, customer needs and outside forces like HMOs," says Stephen P. Kaufman, Chairman of the Board at Arrow, and now a senior lecturer at Harvard University.

"Distributors have developed over time to find value-producing services that customers will pay for," Kaufman says. "In the old days the margins were 25% and inventory turned four times a year, but today profit percent on sales is lower at about 15% to 20% and inventory turns six or seven times a year."

(Continued on page S16)

"This industry is not static; it keeps migrating in different ways," Kaufman said.

Powell's Schilling brings in a historical view. "Look at Fortune 500 in 1932 and look at it today, only about eight or nine of the companies are left, like Exxon and General Motors," Schilling pointed out. "So the world is changing but the distribution industry is well ahead of most of the manufacturers," he said, adding that the model has been responsive to the demands of the customer base.

"No matter how well a company is managed, it is still tied to the underlying growth of the product it sells," explains Robert Damron, a financial analyst with Tucker Anthony Sutro Capital Markets, Milwaukee, WI, when asked about the unique position of the distribution financial model. "The only way to reduce the correlation to the industry is to diversify into other products or markets."

"Traditionally the models of the electronic-component manufacturers and OEMs have produced much higher profit margins than those enjoyed by the distribution industry that supports them," says Avnet's Vallee. "As the [distribution] industry plays more and more of a role, [its] proportion of working capital in the supply chain has increased."

While there is still undervaluation in the equity markets, Avnet's Vallee predicts, "When return on capital reaches the mid-teens and return on equity reaches the high teens, the value of distribution companies will be acknowledged as we achieve double-digit P/E ratios."

What About the Stocks?

Are distribution stocks really undervalued? "Absolutely," says Pioneer's Pitera, "we get lumped into that cyclicality of business."

Schilling agrees, "Today, Wall Street sees distribution as a veloci-

ty-of-money machine with a modest return on investment and with great volatility and inconsistent earnings." He feels that the industry is misunderstood by Wall Street.

Shelby A. Fleck, an analyst with Morgan Stanley Dean Witter in New York, outlines the industry's current situation: "In prior cycles, when electronics distributors' sales and profit margins have been under pressure, the stocks have traded down to book value.

"The major challenge is for the industry to be sensitive to the emerging needs of both customers and suppliers and even predict their needs."

—Stephen P. Kaufman
Chairman
Arrow Electronics, Inc.

Currently, Avnet is trading near its book value, so the downside risk seems limited."

"Most technology distribution stocks are trading at the low end of their trading ranges," says Tucker's Damron. "We believe the downside from here is minimal. Although business is still soft today, investors must anticipate the upturn in the industry by at least six months to make money in these stocks."

Though distributors have continued to gain share from direct sales, Damron feels that, "Wall Street wants to see the industry charge more appropriately their new services in order to improve

returns for the shareholders."

Today, a recent Merrill Lynch report indicates the leading distributors have been transformed into service organizations that are focused on providing a complete value package to reduce the time it takes a customer to get its product to market. This has proved a boon for some of the industry's leaders.

"Consolidation for both Arrow and Avnet should allow them to be more selective in pursuing business from certain companies and bypassing others," says Steven B. Fox of Merrill Lynch in New York. He says Merrill is cautious on stocks in the near-term, 6-to-month period, but hopeful on the 18- to 24-month window.

James Toppen, Ph.d, coordinator of the Industrial Distribution Program at East Carolina University in Greenville, NC, sees the situation from another angle. "Because the Distribution Industry as a whole is almost unknown except by the companies that use [it], they are an unknown stock quantity.

"When I recruit at high schools I always ask students if they know what industrial distribution is and they don't have a clue. If you ask the average person on the street, 'Who is Arrow or Avnet?' They don't have a clue either—and those are the two largest electronic distributors in the world," Toppen says. "This is part of the reason for undervalued stock."

"Cyclicality tends to devalue stocks," says Pioneer's Pitera, adding that the pricing model is under-paid. "The price of a part is one thing, cost of ownership is another," he contends, citing value-added services like bar coding which must be priced into a customer's bill.

The Untangled Web

Despite the present industry downturn, the future looks bright for the electronics distribution industry.



"There have been many threats to the distribution model over the years, most recently the growing influence of the Internet and contract manufacturers in the supply chain," explains Tucker's Damron. "The distributors with forward-thinking management teams have not only survived these new influences in the industry, but have used them to their advantage."

According to Avnet's Vallee, "Distributors still remain a largely misunderstood and undervalued group. In the 1990s we faced a test: Would distributors be, as widely predicted, disintermediated by the fast-multiplying dot.com companies? The answer, as Wall Street figured out, was a resounding 'No.' The distributors proved themselves a vital, integral link in the electronic components chain."

"Last year there were investor concerns about certain Internet business models and exchanges potentially disintermediating electronics distributors," explains Morgan-Stanley's Fleck. Since then, she says, "Most of the distributors have developed their own websites and e-commerce initiatives to provide a range of services to their customers, such as the ability to reschedule or change orders, check order status, component availability or get technical information." These initiatives on the part of established distributors have lessened the threat from the upstarts. Thus, "in our view, electronics distribution will remain an important part of the component supply chain," Fleck says.

"The whole industry was accustomed to doing business in one way but customer and supplier needs have evolved dramatically and we're doing a lot more for them today," says Arrow's Scricco. "Educating everyone and letting them make tradeoffs on exactly what they want and how much it costs is the answer."

For Arrow and others,

"unbundling" may be the way to go. Scricco compares the new model to restaurant pricing". In most restaurants there is not a single price for a meal. Customers pay for exactly what they want, no more and no less. The approach is fairer for the customer and for the restaurant owner." Given the growth in services offered by distributors, the same thinking will have to apply to the electronics industry. In the future, you'll get what you pay for. "For us to be able to afford to continue to meet the customers' and suppliers' needs, we must get more sophisticated in how we offer services, just like restaurants," Scricco says.

A Model Future—It's Global

"As distribution evolves, our survival is assured," Powell's Schilling says, adding that the global opportunities are infinite. He warns against any missteps, however, citing the complex computer platforms that distributors will need to stay on top of customer demands.

Professor Toppen sees the long-term survival of the sector as "very stable, or as stable as the overall economy." But, he says, "Customer-service changes need to continue to be made. Sales is still a customer-service business and there are cheaper ways to do business. Most of these changes and cost savers may come in the logistics end of distribution, especially in lowering the cost of warehousing product and reducing the need for warehousing."

The industry's long-term survival prospects seem "absolutely outstanding" to Tom Pitera. "As the needs of contract manufacturers grow, so do we." He cites examples such as web-based demand chain management and other technologies that help customers understand reusability, i.e., to recognize how parts being used in current products can be used in new designs. Pitera feels that

information and information technology will be paramount as the distribution industry continues to evolve.

"The business has been around for 65 to 70 years; it will continue to be around," says Kaufman. But, he warns, "the long-term survival structures have changed dramatically," adding, "The two large leaders, Arrow and Avnet, will continue with everyone else pretty small. Some midsize broadline companies may get squeezed out but not the industry."

"Distribution is a model that is here for the long term as it has proven it is the most efficient provider of supply-chain services in the industry," according to Tucker's Damron. He warns, however, "It needs to modernize how it prices for services. Rather than just marking up products, Distribution needs to begin charging for the services they provide on a fee-for-service basis."

Avnet's Vallee is equally optimistic. "Distributors will continue to be a vital, integral participant in the electronic-components supply chain. Business migrates to the most efficient provider, and there are functions within the supply chain where distribution is, without question, the most efficient provider."

But Changes Are Still Needed

The industry consolidation that took place over the last decade was needed to create the global footprint necessary to serve the needs of suppliers and customers, says Vallee. Though there will be more consolidation, he feels it is largely complete. "Now, distributors must take advantage of their global scope and scale to improve overall return on capital, to create shareholder value, and to improve access to the capital markets. And we must continue to deliver value and charge for that value." ■

*Activity-Based Costing***MONEY**
FOR SOMETHING

Initiating fee-based services requires sophistication and education.

By Aimee Kalnoskas

Until recently, distributors' costs associated with value-added services were recouped primarily by increasing volume with a customer—an "I'll scratch your back; you scratch mine" arrangement. But with per-part margins low and revenues shrinking, distributors are increasingly looking to implement direct fees for such services. Dubbed Activity-Based Costing (ABC), the concept requires a change in mindset among suppliers, distributors and manufacturers alike.

When Stephen Kaufman, chairman of Arrow Electronics, Inc., Melville, NY, broached the subject at last spring's Electronic

unbundled and paid for separately. But customers who had never seen the additional costs embedded into the piece-price of their orders were unsettled by the concept of paying for services that had previously been "free."

Reaction to Kaufman's speech points to the psychological and fiscal hurdles distributors will have to

customers about the value it represents. It won't be easy.

Insiders say the time is ripe for ABC. Industry leaders Arrow and Avnet, Inc. (Phoenix, AZ) are projecting that nearly two-thirds of annual revenues will soon be derived from specialized products and value-added services. If a customer feels a service is truly valuable, then a fee-based model can work. Customer understanding of true transactions costs, coupled with sophisticated, unique and evolving services, is a critical component to Activity Based Costing.

The Numbers Game

The basic pricing mechanism in the industry has been a markup from cost.

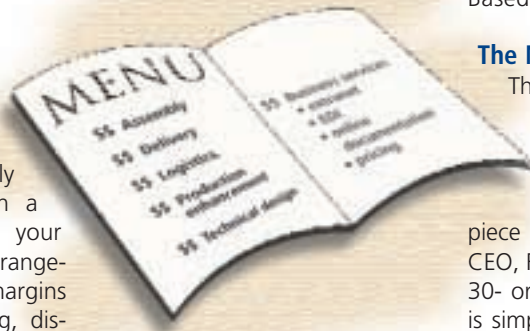
Value-added services are bundled into the piece price. Arrow's President and CEO, Francis M. Scricco argues this 30- or 40-year-old business model is simply not working in the present where services have grown to include assembly, delivery, logistics, business services (e.g. extranet, EDI, online documentation and pricing), production enhancement and technical design.

For example, last year in North America alone, Arrow had 750 customer engagements where forecasts were handled electronically. "Our computers were manipulating the forecasts, and doing some very sophisticated materials management. This was all paid for in the markup of the price," says Scricco. "But bundling all that value means that you are undercharging some people and overcharging others.

"What we've got going on is massive averaging. Averages are totally inadequate," he says. "We have to move away from averages to the specifics of a given situation."

Differentiation Always

If the distribution industry wants to make a sustainable market for its



"Once the customer understands the costs, they can do a lot."

—Cynthia Bova
Vice President for Marketing
and Consulting Services
Suphlystream, Inc.

Distribution Show, reaction was mixed. Many distributors welcomed public acknowledgement that increasingly sophisticated value-added services should be

overcome to make ABC a reality. To do it, distributors will have to demonstrate the sophistication of their contribution to modern electronic design and educate their



services, the challenge lies in identifying just which services are unique and valuable. If a distributor charges for a service that seems trivial, it risks alienating the customer. If the service is easily duplicated by a competitor willing to play by the old rules, the distributor may find itself losing the contract. Wally York, vice president, marketing for Pioneer-Standard Electronics, Cleveland, OH, says the question boils down to "just 'how different' are the services and 'for how long' can they stay different?"

York does not believe that Pioneer will be able to provide a fee-based value-added program unless it significantly differentiates itself from anything else that is offered in the market. But the opportunities are there and the company is exploring them.

"I think that the Internet is the one area that will allow that opportunity to charge for services to happen," says York. He feels that the potential exists to offer even more sophisticated online design tools using the database of parametrics, part attributes and trends that Pioneer-Standard has developed over the years. But he cautions that engineers need to feel that they are not being forced into a decision. They have to feel that paying for services is in the best interest of their design and their company.

For Arrow, differentiating its value-added services meant spending millions of dollars developing a database that features real and currently manufactured parts. Using a databook, datasheet or online database that is not current could spell disaster to companies with tight production schedules. Says Scricco, "In this day and age, if you are going to be 60 days behind on a product you might as well be 100 years behind."

Volume players like Arrow or Avnet are not the only distributors contemplating a non-traditional price scheme for value-added serv-

"We have to move away from averages to the specifics of a given situation."

—Francis M. Scricco
President and CEO
Arrow Electronics

ices. Newark Electronics, the catalog distribution division of Premier Farnell plc (Leeds, UK), has launched programs to manage the utilization of stockroom inventories.

While many of the Newark's

value-added services are currently built into the cost of the indirect materials they are working with, CEO Mike Ruprich does see Activity Based Costing as the next major trend in distribution. Whether or not the customers will accept it, he says, depends on the sophistication of the customer. But the education is happening now. "I think customers are beginning to see that an Arrow or Avnet can add value and in many cases it is more than just the cost of the part but the overall procurement costs," he says.

Sophisticated Services— Sophisticated Customers

So how can the industry take customers from wanting—and getting—something for nothing to paying a fee for additional value-added services? "This is huge problem in distribution right now," notes Ray Horner, director of distribution sales & marketing for connector-maker Tyco Electronics, Harrisburg, PA. "Thirty percent of our domestic business goes through distribution so, naturally, it becomes a problem for Tyco."

According to Horner, Activity Based Costing can be good for manufacturers because it separates the product from the service, allowing the product to stand on its own. For example, two OEMs can be charged two different

(Continued on page S22)

*Engineering Services***NOT MIDDLEMEN,
PARTNERS**

Design, engineering, and support services give distributors a vital role.

By *Diane Trommer*

In an effort to stem the tide of shrinking margins, the distribution industry has spent much of the past decade searching for new ways to enhance the value they offer to both OEM customers and the component manufacturers they represent. As a result of these efforts, distribution has evolved from its roots and is now solidly positioned as a source of expertise not only in fulfillment, but in the various aspects of supply chain management as well.

But increasing competitive pressures are forcing many in the industry to seek additional ways of proving their value. So today, many distributors are taking the next steps in the industry's ongoing evolution, tackling yet another portion of the supply equation—the demand chain. Through a variety of engineering and design-support programs, distributors are seeking to help fill the void of tier-two and -three accounts which suppliers do not have the resources to directly cover themselves.

"It's all about human bandwidth, both on the supplier side and the OEM side," says Greg

Provenzano, president and CEO, Insight Electronics LLC, San Diego, CA. "The complexity of products that we are involved with is high and getting higher and there are a lot of tools and resources you need that most customers don't have." So, by bolstering their technical offerings and resources, distributors are better able to represent suppliers to a wider range of cus-



Insight Engineers Jay Seashore (seated) and Donny Saveski examine a Modelsim waveform simulation of a TxPhy.

tomers. At the same time, they're providing OEMs with information and support that the suppliers cannot afford to offer.

And unlike other efforts the distribution industry has made to enhance its value by expanding its reach into the supply chain—like the movement to get into contract manufacturing in the mid-90s—

distributors contend that supporting OEMs' engineering and design service needs is more in line with their core competency.

"These efforts are focused on creating demand for products, understanding products and having experience about what the market is doing relative to these products," says Wally York, vice president of marketing, Industrial Electronics Division, Pioneer-Standard Electronics, Inc., Cleveland, OH. While Pioneer-Standard has always recognized the need to support the engineering community, York stresses the company's belief that putting additional emphasis on engineering and design-support services will provide the distributor with a "sustainable competitive advantage" going forward.

"It is a whole new opportunity for cutting down time-to-market in the most efficient way for the customer and that is really what we have been doing—especially those of us who are focused on the technical side as well as the fulfillment side of the distribution business," York says.

Pioneer-Standard's current engineering and design-support initiatives include a partnership with National Semiconductor Inc. and Vishay Intertechnology to offer engineers a tool to design power-supply prototypes online.

Originally developed by National Semiconductor, the WebBench technology allows engineers to design, simulate and test power supplies online. This technology is linked with Pioneer's Web-based distribution databases, providing users with a complete bill of materials. Once the user competes the design process



online, Pioneer can then deliver a prototype kit to the engineer within 72 hours.

By early fall, Pioneer plans to upgrade this service, offering users the option of having the board assembled and tested by a contract manufacturer working with Pioneer, which would be delivered to the OEM within five days or less.

In addition to its Web-based offerings, Pioneer-Standard also maintains a staff of some 300 to 400 technical support personnel, including field application engineers and EE-degreed sales representatives, York reports.

Taking the demand-creation strategy a step further, Insight Electronics offers Insight Design Services which provides customers with design consulting services for programmable logic and LSI Logic ASICs.

Currently, Insight maintains 11 programmable-logic design centers throughout North America that support the Xilinx product family and are staffed with over 40 CPLD and FPGA designers, as well as ASIC design centers in Los Angeles and Toronto that support the LSI Logic ASIC design-flow methodology.

Providing outsourced design expertise to OEMs is a natural extension of Insight's strategy as a technical distributor, according to Insight president and CEO Greg Provenzano.

"We have always been a very engineering-oriented company," says Provenzano. "If our customers need design services, it makes sense for them to come to us, rather than an independent design house because, with us, they can also get the fulfillment piece and more visibility throughout the supply chain into key factors like lead time and end-of-life issues."

OEMs will most commonly outsource their design needs to Insight when their on-staff experts

are tied up with other projects, Provenzano explains. "It's all about time-to-market," he says. "Rather than wasting valuable development time having their own staff engineers come up to speed on a particular technology, they can use our designers." As part of its value-added-service



"Engineering services is a whole new opportunity for cutting down time-to-market in the most efficient way for the customer."

—Wally York
Vice President of Marketing,
Industrial Electronics Division
Pioneer-Standard Electronics, Inc.

offerings, Insight has approximately 150 FAEs on staff who are certified across 12 to 15 lines, and the distributor has a corporate group that produces reference designs for customers.

"So, if a customer decides they want to do Voice over IP, for example, we already have a pre-designed board that can perform that function," Provenzano says.

While these programs may help OEMs and suppliers, the question is whether distributors can afford to invest in the additional resources to support these efforts at a time when they are struggling to streamline and become more cost-efficient.

While neither Pioneer-Standard nor Insight could specify the exact cost of these programs or the return that they get from them, both insist that the emphasis on demand creation is a move that they can't afford not to make.

"There is no doubt that the more value we add, the better the return on investment we make," says Provenzano. Last year, Insight had 31,000 design wins across its line card, which provides some evidence of the importance of its engineering staff to the company's

bottom line.

Similarly, Pioneer-Standard's York contends that the technical competency it demonstrates to customers enables it to increase the level of content of its suppliers' products in the OEM's products. "The primary way in which we get compensated today is via the

increased volume of purchases we get because the customer recognizes the value proposition we bring to them," says York. "When we provide value-added services for customers there is a long-term position that shows we are more profitable."

Like distributors, component suppliers report that it is difficult to quantify the benefits they reap as a result of the distributors' demand-creation efforts. However, the value they place on these programs is demonstrated by the level of support suppliers offer distributors.

Insight's Provenzano reports that device manufacturers support distributors in a variety of ways including gross-margin advantages, design-win fees and rebates. Some suppliers may even co-op FAEs, paying for half their salary. Suppliers also provide extensive training for distributor FAEs to assure that their products are expertly represented to potential customers.

"The trick is in the training," says Dave Bondurant, VP Marketing for Ramtron International Corp., Colorado Springs, CO. "We try to make support of our products easy for the distribu-

NOT MIDDLEMEN, PARTNERS

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tors' sales and application people by providing a quality web site for documentation, product summaries and application information. The bottom line is that if we don't provide them with adequate training, then they can not provide adequate support."

Even suppliers like National Semiconductor, which has taken the lead in the industry in creating online design tools to directly support a greater portion of its customer base,

"There is no doubt that the more value we add, the better the return on investment we make."

—Greg Provenzano
President and CEO
Insight Electronics LLC

continues to recognize the value of the distribution channel in helping to bring in new customers and service existing accounts.

"The fact is, 90% of our end customers and half of our corporate revenue still goes through the

channel," said Phil Gibson, vice president, Web Business & Sales Automation for National Semiconductor Corp., Santa Clara, CA. "So we appreciate every bit of distribution attention we get on the design side." ■

MONEY FOR SOMETHING

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prices for a part because of the variety of services built into it. "It's the bidding over prices that gets very convoluted," says Horner. "It convolutes what the true value of a supplier's part is."

Customers differentiating between the price of the product and the price of the service—and deciding just what services, if any, would make their final product more cost effective—is another level of education where the industry has only made baby steps.

"As long as we don't understand true costs or how it is calculated into piece price we are comfortable saying [we] deserve it for nothing," contends Cynthia Bova, vice president for marketing and consulting services at Supplystream, Inc., Penn Yan, NY, developers of supply chain management tools. The key, says Bova, is to allow customers to look not only at the piece price but at the total acquisition costs based on the value-added services provided to them.

Figuring out transaction costs is a hurdle that many customers just don't have the resources or desire to cross. Until now, customers didn't really know what value-added service provided for them, says Bova. They knew there were cost savings but they couldn't define where the savings were or how to tap into them. "Once the customer understands the costs, they can do a lot."

Bova believes that distributors would welcome an educated customer who is able to define the transactions costs in its own organization and she predicts the development of additional optimization tools that will help do this. If customers can then see the benefits and the cost savings in black and white, they should not have to ask for price reductions from the distributor in order to justify the purchase to management.

Giving customers a better understanding of true costs benefits the distributor, who is then seen by customers as a partner in the quoting, procurement or inventory management of their product.

But the supplier or manufacturer also benefits. Customers educated about transaction cost and the worth of value-added services will not expect to pay the same price for a product whether they buy it from a distributor or manufacturer. It is generally the distributor who is adding the services, not the supplier. Performing these services is not the core competency of manufacturers, maintains Tyco's Horner, but it is becoming the core competency of the distributor.

Given the obvious benefits of Activity Based Costing, the distribution industry could be entering a time of rebirth and rejuvenation. Despite—and perhaps because of—this sluggish economy, distributors are making major investments in services that can only come at a price to the customer if the industry is to grow. To make it work, these services must continually evolve if the market is to accept and maintain the fee-based model. In addition, distributors must also educate the customer about why they are paying for what they are getting. ■