WESTPAC ECONOMIC BULLETIN

Wholesaling in New Zealand.

17 October 2022

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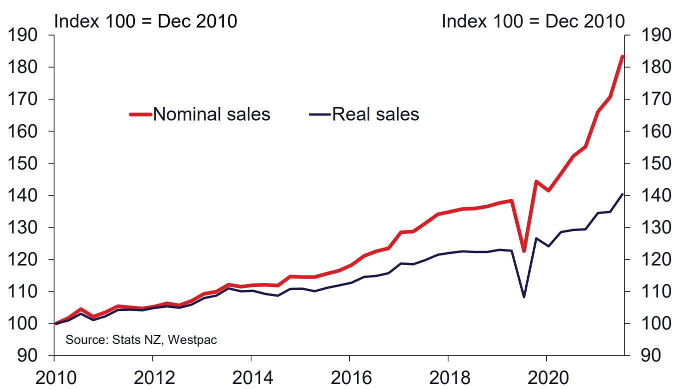
Pushing the digital limits.

- Disintermediation, increasing new market entrants and growing customer expectations, shaped by the success of Amazon in offshore markets, will increase competition in the New Zealand wholesale sector.
- To compete, wholesalers will increasingly have to leverage off their unique strengths to deliver additional services that others cannot easily provide.
- To achieve that, wholesalers will have to ramp up their eCommerce capabilities to make it easier for customers to transact with them.
- They will also need to automate and integrate their order fulfilment processes with forward and backward linkages along the supply chain.
- Wholesalers will also need to invest in analytics to gain a better understanding of customer needs, market positioning and operational performance. That should help them deliver more value-added services and improve responsiveness to changes in their operating environment.

A big profitable sector.

New Zealand's wholesale sector is huge. The 16,700 firms that operate in this sector generated sales of $138bn for the year ending June 2022, accounting for about 20% of total sales economy wide. Sales have accelerated in recent years as customers have sought to secure supplies amid Covid related supply shocks.

Figure 1: Wholesale trade sales



It is also profitable. The sector typically generates EBITDA margins of about 4% year. According to Stats NZ, wholesaling margins rose from 3.7% in 2020 to 4.8% in 2021, while return on equity jumped from 19% to 23% over the same period. That is comparable to the US where EBITDA margins rose from 4.2% in 2020 to 4.6% in 2021. The widening of profit margins more recently reflects the ability of wholesalers to pass on higher costs to downstream customers during Covid. According to an industry source, wholesalers with large inventories onshore were particularly well placed during this period.

But lacking competitive dynamism.

However, profitability in the sector also reflects a lack of competitive dynamism.

Wholesaling in New Zealand is dominated by small-to-medium sized firms that play in specific product niches, where location infers a competitive advantage. The majority operate a traditional wholesale model, which means they own and operate their own warehouses, manage their own inventories, and oversee associated transport/logistics operations.

Business practices tend to be old school. Face-to-face interactions are still the most preferred way of transacting in New Zealand. That is despite the growing popularity of eCommerce and a hybrid model of transacting, which marries the comfort and familiarity of traditional face-to-face relationships, with the speed, efficiency, and convenience of digital.

The Covid pandemic has supported this shift, although industry sources suggest that with the lifting of social distancing requirements, many customers have opted go back to the old ways of transacting.

Competitive forces in the sector are generally weak. That is reflected in the many cosy and long-standing relationships that exist between wholesalers, suppliers, and customers within various product niches. The lack of a disruptor like Amazon, has not helped in this regard. According to an industry source, competition is further undermined by contractually enforceable distribution agreements, but that is limited to specific product lines and brands. What competition does exist is based on price, a proven ability to fulfil orders according to standards and timeframes, as well as reputation. Cost minimisation is a key focus for all traditional wholesalers in New Zealand.

Lagging offshore developments.

The closeted nature of wholesaling in New Zealand has meant that it has been less affected by some of the factors that are disrupting the sector offshore.

Among the most significant has been the entry of Amazon into the B2B space, and the effect that this has had on wholesaling in countries where it has established a physical presence. Its absence here is often cited as a key reason why wholesaling in New Zealand lags its offshore peers.

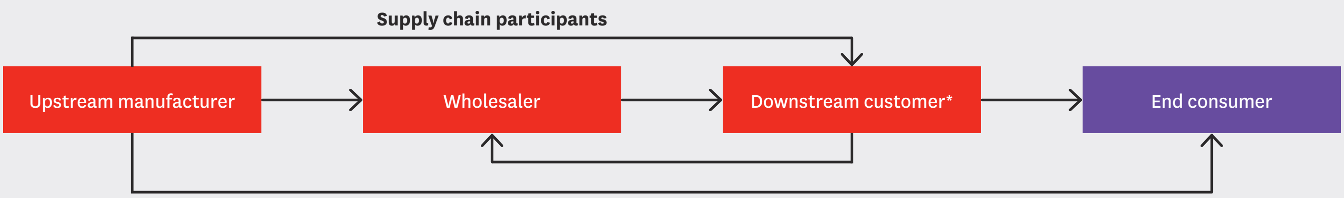
Already the world's largest B2C eCommerce provider, Amazon has set the benchmark in terms of its responsiveness to customer demands, superior product presentation and delivery capabilities. That is especially true for commoditised products, where customers look for the fastest, easiest, and most affordable way to procure them.

That in turn has raised the bar on customer expectations. Because of Amazon, customers today now expect to be able to get any product they want, when they want it, through whatever channel they choose, and all at a competitive price. And if they are not happy, they are more than open to sharing their experiences online to all and sundry.

What is a wholesaler?

The traditional role of wholesalers has been to bulk purchase goods from suppliers, typically manufacturers, break them down into smaller quantities, before selling them to customers, be they retailers, other manufacturers, and even other wholesalers. Together with retailers, they form the interface between the goods producing sectors of the economy and consumers.

Figure 2: Simplified wholesale supply chain



* Downstream customers include manufacturers, retailers, other wholesalers
Source: tutor2u, Westpac

Definitions.

Business-to-business (B2B)	Where supply chain participants transact directly with each other but not with the end consumer. That may or may not involve the wholesaler.
Business-to-customer (B2C)	Where downstream customers transact directly with the end consumer. Examples include supermarket retailers, such as Countdown that sell directly to households and individuals.
Direct-to-customer (D2C)	A form of B2C where supply chain participants further upstream transact directly with the end consumer. Examples include sportswear manufacturer Nike, which has dramatically increased revenues from selling direct to the end consumer.

However, customer expectations of wholesaling are not just being shaped by the likes of Amazon. Business customers, responding to the demands coming from their own customer base, are increasingly opting for wholesalers that align to their own values and ethics, and are more open to switching to a competitor if they do not. To that end, the alignment of environmental, social and governance (ESG) credentials is becoming a necessity for wholesalers that sell into the B2B market.

The digital era and the rise of the smart consumer has resulted in a shift where supply-driven businesses no longer rule the world.

Advances in new digital technologies, which make it easier for businesses to transact with each other is another key factor disrupting wholesaling activity in offshore markets. Artificial Intelligence (AI), Bots and Blockchain are some of the technologies which are revolutionising the capabilities of self-service internet portals and new online marketplaces, making it easier for suppliers and customers to skip the middleman and transact directly with each other.

B2B marketplaces.

B2B eCommerce solutions range from self-service internet portals to social media and online marketplaces.

Just as with B2C, online marketplaces are the dominant outlet for digital B2B sales in the US, with 94% of buyers actively using them. Over the next 5 years, marketplaces are expected to account for 75% of all B2B transactions.

While general B2B marketplaces, such as Amazon Business and Alibaba.com, are the largest and most well-known, new ones are popping up every day, offering an ever-larger assortment of products and aggressive pricing. New Zealand examples are few and far between but would include Canterbury based Saleshoo.

B2B marketplaces represent a big threat to traditional wholesalers. Not only do they provide a direct low-cost route to the customer, but the firms that operate them typically offer fulfilment services and a customer buying experience that traditional wholesalers find hard to match.

That is set to continue. According to Gartner, 15% of mid-to-large B2B brands in the US will have launched their own marketplace by the end of 2023.

Again, New Zealand lags in this regard – given the state of competition in the sector and without the threat of a game changer like Amazon, there has been little incentive to invest in new digital technologies. However, that does not mean that disintermediation does not exist in New Zealand. Indeed, according to one industry source, missing out the middleman has long been a feature of wholesaling in New Zealand, with suppliers and customers always on the lookout for ways to strip out costs and ensure their own competitiveness.

Advances in the digital space are also lowering barriers to entry. New non-traditional digital savvy entrants are moving into the wholesale space, using technologies such as Internet of Things (IoT), AI and sensing devices to tap into supplier/partner ecosystems that enable them to provide lightning quick turnarounds and product delivery options that traditional wholesalers just cannot match. According to one industry source, these low-cost operators, unencumbered by a lack of physical infrastructure and having minimal labour requirements, are becoming more prominent in New Zealand.

Digital technologies in offshore markets have reduced barriers to entry, and that is encouraging new non-traditional market entrants.

Changing basis of competition.

While wholesaling in New Zealand is likely to lag, we think that many of the factors disrupting offshore wholesaling will eventually make their way here.

Indeed, even without the physical presence of Amazon, customer expectations of wholesaling, informed partly by developments offshore, but increasingly their own B2B experiences at home, are set to rise as they face off against increased competitive pressures in their own markets. An industry source suggested that advances in technology which allow customers to compare and buy products directly from offshore wholesalers will further support this trend.

That in turn is expected to increase competitive pressures in the sector.

To compete in this environment, wholesalers will still have to execute well. Service execution means making sure that the supply chain is functioning well, inventories are being properly managed, and products get to the right customer where and when they want them, at lowest possible cost.

However, as digital technologies begin to reduce barriers to entry, encouraging new market entrants and creating scope for further disintermediation, wholesalers in New Zealand will increasingly look to leverage off their unique strengths, delivering extra value that their erstwhile competitors find difficult to copy. That means providing unique insights on industry/customer trends and in-depth product expertise, as well as value added services such as end-to-end supply chain visibility, product tracking, customer inventory/sales monitoring and automatic onsite restocking.

Wholesalers are also going to have to deliver a superior purchasing experience, one that is personalised to the needs of the customer. New market entrants might be able to offer personalization in the form of algorithm-driven recommendations and analysis, but they cannot compete with traditional wholesalers that have established relationships and are much more attuned to their customer pain points. According to Wunderman Thompson, 46% of B2B customers rank product customisation as the top purchasing factor.

Successful wholesalers will be those that execute well, can add extra value to the supply chain and deliver services tailored to customer needs.

Critical success factors.

Given the above, we think there are four things that wholesalers in New Zealand have to get right if they are to be successful now and in the future.

Expand into eCommerce.

It is critical that wholesalers provide transaction channels that customers find convenient, easy to use and deliver cost savings.

As digital technologies advance and tech savvy B2B customers begin to shift away from in-person interactions, eCommerce capabilities are set become a key point of differentiation.

That includes sophisticated online customer portals, with self-service and engagement options, which are already popular overseas. In addition to transacting capabilities, many of these portals offer additional services such as a knowledge base, training videos, order and invoice document archiving, and even AI enabled webchat, all accessible through different devices.

It also includes wholesalers setting up their own AI enabled B2B marketplaces that provide a platform for erstwhile competitors, i.e., suppliers and other wholesalers, to promote and sell their products in return for a commission. While these operate very much along the lines of Amazon and Alibaba, there is a difference, as they generally specialise in product categories. Prominent examples of wholesalers setting up their own marketplaces include US based United National Foods, Kroger, and United Outfitters.

Meanwhile, wholesalers are also looking to social media to gain a competitive edge. Much like their retail counterparts, they are leveraging off the advertising muscle and reach of social media sites, like Facebook, Twitter, and YouTube to a) raise their profile as a conduit for suppliers; and b) get their products in front of a much bigger audience than would have been the case had they just relied on their transactional eCommerce offering.

Add to that search engine optimisation (SEO), which involves improving the quality and volume of potential customer traffic to eCommerce enabled websites. SEO is now considered an important area for investment, with 40% of digitally enabled wholesalers in the US planning to invest in AI-powered search capabilities for personalised results.

Hybrid interaction models.

Research by McKinsey showed that when given the choice of in-person and eCommerce channels, B2B buyers typically express a desire for both.

McKinsey also found that the top three most effective B2B sales channels in 2021 were eCommerce (47%), in-person (37%), and video (31%).

B2B eCommerce use.

According to Wunderman Thomson, 49% of B2B purchases in the US, UK, and China in 2021 were made online.

A 2021 survey by Frost & Sullivan showed that 81% of B2B eCommerce customers in the US now demand self-service where they can solve problems themselves.

B2B eCommerce transactions rose 24% during Covid, with Gartner expecting it to account for 80% of all ordering and replenishment activity by 2024.

McKinsey estimates that by 2025, 80% of all B2B transactions globally will be done via a digital channel. By 2027, eCommerce worldwide is forecast to surpass US$20trn, growing at an annual rate of 17.5%.

Social media.

Gartner found that 46% of B2B buyers use social media to learn about products, 40% use it to make comparisons, and 35% use it for need-to-know information before they complete a purchase.

Expanding eCommerce capabilities is critical for growth in the New Zealand wholesale sector.

Make it easier to transact.

Wholesalers are not just expanding the range of channels they use to interact with customers.

They are also looking at how to integrate these channels, so that their customers can interact with them whenever and wherever they want, and through whatever means they choose as they progress along their procurement journey.

The rise of mobile, increased social media engagement, and growing affinity for self-service among B2B customers is likely to further underline the importance of being able to offer a seamless, cohesive omnichannel experience. With customer expectations on the rise, failure here is likely to result in a loss of market share.

Add to that the fact that an increasing number of decision makers that work for these B2B customers are Millennials, at ease with transacting in the digital world. Already familiar with B2C omnichannel capabilities, these B2B buyers increasingly expect their wholesalers to deliver a similar B2B offering.

Omnichannel is set to become the cornerstone of B2B sales. It will become the new standard in New Zealand rather than the exception.

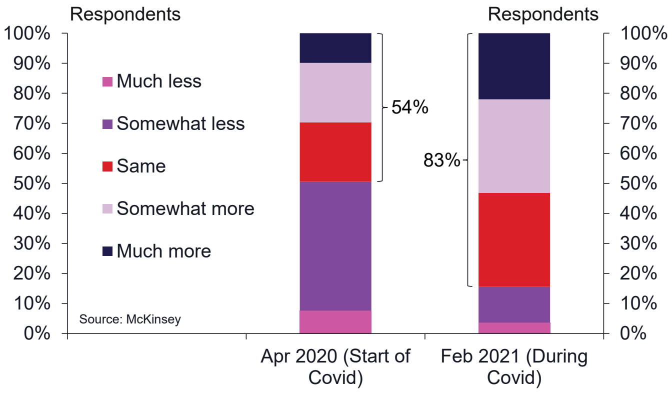
B2B omnichannel.

Omnichannel wholesaling is a multichannel approach that focuses on providing a seamless purchasing experience irrespective of whether the customer is interacting online from a mobile phone or a computer, by email or in-person.

According to McKinsey, omnichannel is becoming the new standard with 80% of B2B firms endorsing it over traditional single and multi-channel approaches, with 64% planning to increase hybrid sales in 2022.

With omnichannel based purchases increasing by 43% in 2020, B2B sellers are not the only ones embracing the new model. Buyers, too, are adopting omnichannel and are more willing to make large purchases via a remote/digital sales model, with 20% now comfortable making larger purchases via this non-traditional channel.

Figure 3: Effectiveness of omnichannel sales servicing B2B customers during Covid



Many wholesalers will find it difficult to deliver an omnichannel capability. There are two reasons for that. Firstly, it will require a big change in mindset – historically wholesalers have never really had to worry about how their customers wanted to transact. Secondly, it will require significant investment, which is likely to be well beyond the reach of the many small wholesalers that operate in New Zealand.

For those that can, investment is likely to focus on the digital infrastructure needed to better capture data and make B2B interactions feel as personal and insightful as in-person demos or meetings.

To that end, wholesalers will look to continually mix and combine applications with existing technology to create systems for each customer segment. That is likely to mean a heavy reliance on Application Programming Interfaces (APIs) to seamlessly connect all these systems together. This approach also provides the flexibility to adopt new technologies, such as augmented reality, new digital payments, the next generation of AI-driven chatbots, and whatever else the future has in store.

Automate and integrate the order fulfilment process.

Historically wholesalers have competed on their ability to fulfil orders. In its simplest form that means delivering goods and value added services when and where the customer wants them and to do so at minimum cost.

But in an environment where customer expectations are growing and wholesalers are under increasing threat from disintermediation and new market entrants, they need to do this better and faster than ever before.

A key limiting factor here are the legacy systems and levels of manual processing that currently dominate the New Zealand wholesaling landscape. In short, these systems cannot deliver the operational efficiencies as well as levels of accuracy, speed, agility, and responsiveness needed to ensure a best-in-class order fulfilment process.

To address this requirement, wholesalers need to automate their inventory and supply chain processes by investing in new digital enabled machinery and equipment. Examples include automatic storage and retrieval systems (AS/RS), autonomous guided vehicles (AGV) and robots (AMR), Goods to Person systems (GTP), shuttle/sorting equipment, and unmanned aerial vehicles (UAV), all of which are now possible because of advances in digital technology.

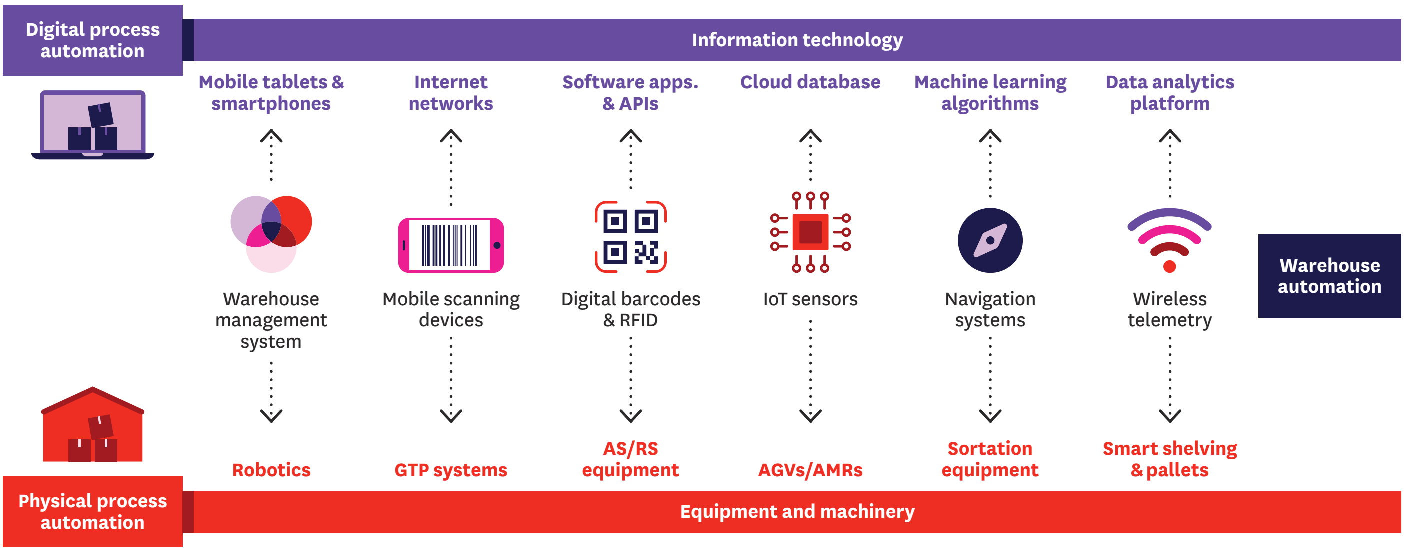
But automation by itself is just a necessary rather than a sufficient condition to maximise operational efficiencies. Getting the best out of automation requires the integration of different automated systems so they can collaborate and share data with each other. Enterprise Resource Planning (ERP) software, which is used to manage and integrate core business processes, such as supply chain and inventory management, quality control, and other back-office activities, can help in this regard. According to Oracle, 95% of business reported process improvements following the implementation of ERP.

Manual versus automated processing.

According to Conexiom, 52% of B2B sales in the US still involve direct human intervention and some sort of paper trail. An industry source suggested that that was likely to be a lot higher in New Zealand.

In 2018, only 35% of warehouses in the US tracked their order cycle times using an automated system; 50% manually, and 19% did not track them at all.

Figure 4: Warehouse automation process technologies



Source: Oracle Netsuite

Cloud based ERP software can also extend well beyond the boundaries of the individual wholesaler, effectively connecting it to all parts of the supplier ecosystem, incorporating manufacturers, logistics providers, shipping partners and customers. That in turn boosts responsiveness, allowing wholesalers to provide on-demand services to customers. Having an end-to-end view of the entire supply chain also allows wholesalers to provide additional value-added services, such as product tracking.

At its core, the automation and integration of order fulfilment processes requires the complete re-engineering of operations and the adoption of new business models. That is easier said than done in New Zealand where most wholesalers still rely on a mix of paper-based systems, Excel spreadsheets, and standalone software that run individual business processes. Having said that, technology improvements do not have to be an all-or-nothing proposition and changes can be made incrementally. Procuring technology services, such as platforms (PAAS) and software (SAAS) as a service, for example, may help to lower this upfront investment hurdle.

Automation in warehouses.

According to ABI Research, over 4 million commercial robots will be installed in more than 50,000 warehouses worldwide by the year 2025 (up from 4,000 warehouses in 2018).

Germany's leading online outdoor specialist store Bergfreunde increased picking efficiency by 400% because of investment made in digital technologies. Processing more than 15,000 orders on peak days, lead times from customer order to handover has been reduced to less than 3 hours.

EET Group, Europe's largest supplier of IT accessories, invested in an automated warehouse solution to boost efficiency and scalability. The system enabled EET to obtain a 75% gain in storage capacity.

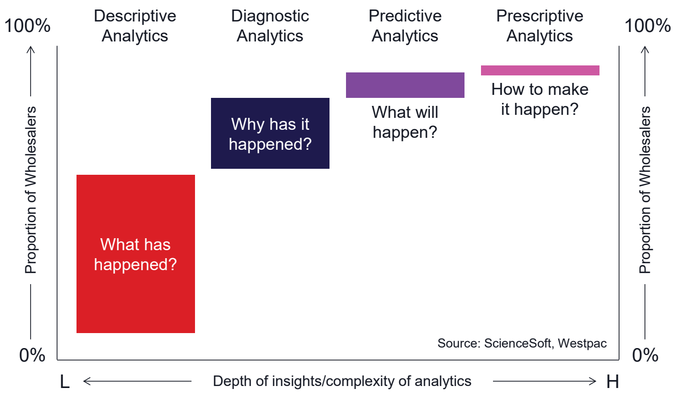
Wholesalers are adopting flexible, connected technologies that help drive an effective delivery system.

Boost analytical maturity.

Analytical maturity refers to the depth of insights that a firm can generate from its data analytics capability. The basic idea is that deeper insights inform better decision making, which leads to actions that deliver a competitive edge.

Analytical maturity covers a continuum, ranging from immature to mature. Immature analytics tend to be descriptive in nature and typically describe what has happened and why it might have happened. By contrast mature analytics focuses more on predicting what is likely to happen in the future and prescribing how to make it happen.

Figure 5: Take up of data analytics in the New Zealand wholesale sector



Source: ScienceSoft, Westpac

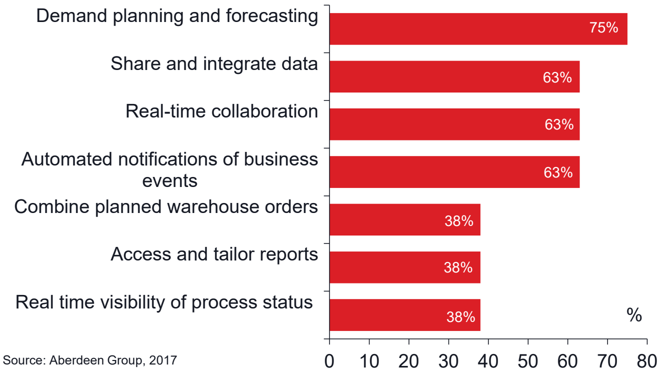
Analytical maturity applies across all aspects of the firm.

At a strategic and tactical level, wholesalers use data generated from different B2B customer touchpoints, including face-to-face interactions, omnichannel digital, social media chatter, and web-based AI powered bots and then combine that with unstructured data to better understand their customer base, forecast future demand, and settle on a value proposition (including which product segments to operate in).

At an operational level, wholesalers use data from order fulfilment processes to deliver real-time analysis of internal performance. That in turn encourages real time collaboration across processes, helps to prevent bottlenecks, and delivers improved agility and responsiveness to changing customer needs.

According to consulting firm Aberdeen Group, wholesalers use data analytics to make better decisions and become more agile.

Figure 6: Use of data analytics in wholesaling



Source: Aberdeen Group, 2017

Most wholesalers in New Zealand are analytically immature. Although a generalisation, most are operationally focused, rely heavily on outdated legacy systems and have little inclination to change. Indeed, only a few wholesalers, typically mid- to large operators as well as newish market entrants, less encumbered by legacy systems, use sophisticated algorithms, complex mathematics, statistics, and AI to identify potential customer/market segments based on predicted demand patterns.

That though will have to change. In an environment where customer expectations are growing and wholesalers are under increasing threat from disintermediation and new market entrants, wholesalers will need to improve their decision making if they are to compete effectively. That will mean moving up the data analytics curve, with a much greater emphasis on predicting what will happen rather than describing what already has. Over time, those that are not able to make this transition face the possibility of losing market share.

To get a competitive edge, wholesalers in New Zealand need to improve their analytical maturity.

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