

StepChange

Merchanting: In need or retreat?

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Merchants are caught in the middle between producers and printers. Producers are pressured by rising input costs and the traditional merchant customer by falling demand and prices. The merchant is faced by ever decreasing margins in paper distribution as all participants in the supply chain are struggling.

In this economic environment, StepChange Consulting is conducting a study amongst the stakeholders in paper distribution. The global ongoing study includes paper producers, merchants, paper traders and print-

ers. The current European results are based on over 100 responses and demonstrate the severity of the pressure in the supply chain. A similar study was conducted in 2008, which allows for comparison of the key findings.

Five years ago, most industry players expected a continuation of the ongoing consolidation wave in merchanting. This did – so far – not materialize. On the contrary, the sector is more fragmented than it was then – with four big players and emerging competition from smaller companies picking up divested assets.

Since merchants have not been able to boost profitability through new operating models, earnings for merchants are still from the traditional distribution channels and are relatively modest. While in 2008 merchants expected to achieve EBIT levels of 4 to 6 % by 2013, EBIT reality in 2012 was significantly lower, ranging from minus 5 % to 2 %.

Sobering findings

The European study aimed to answer a few provocative questions. The findings are rather sobering:

1. Does the game need to change?

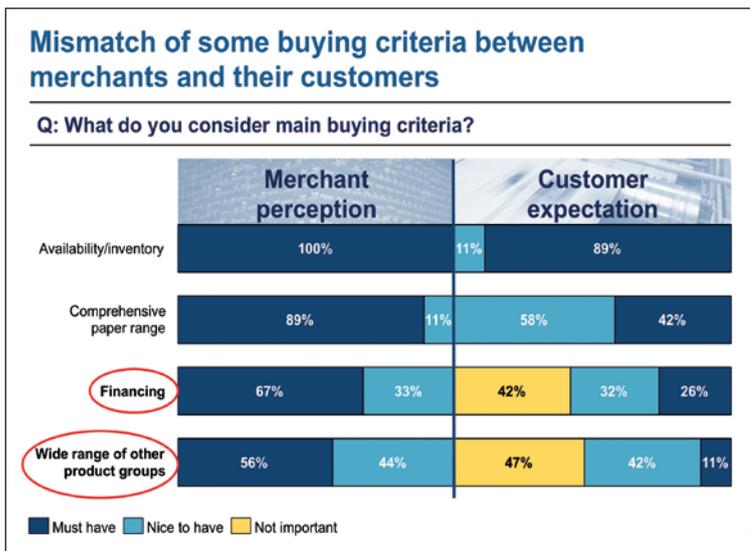
When asked about price trends for the next five years, printers and publishers are generally more bearish than merchants are. Only 15% of customers, but 40% of merchants expect prices to increase. Producers and merchants both seem to overestimate future customer service requirements. All expect substitution through e-media.

2. Have merchants done their homework?

The self-perception of merchants is that they have improved on almost all fronts, ranging from organizational efficiency and price & margin management to supply chain management and attractiveness of product portfolio. Some believe that a deterioration has occurred in the areas of brand building, training, personnel development and technical product support. Customers tend to agree for the most part, but several have highlighted a negative development regarding availability & lead times. FSC/PEFC continues to gain traction, but is considered more relevant by printers and publishers than by producers and merchants.

3. Will merchants become obsolete?

Some 40% of merchants believe their importance will increase over the next 5 years. By contrast, this view is shared by only 3% of producers and 15% of customers.



Mismatch of some buying criteria between merchants and their customers



Potential actions for industry players

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According to merchants, they plan to import more tonnage from Asia. Producers do not see competition from Asia as a threat. 90% of producers believe they will be increasing their direct sales to customers.

4. Do printers need merchants?

Based on the survey results, merchants view many of their services as “must-have” rather than “nice-to-have”. Their customers appear to have a different view. There is a mismatch of what is considered as being key buying criteria between merchants and their customers. The traditional role of the merchant to provide a variety of services and a broad product portfolio is not being perceived as key by print customers. This is also reflected by over 60% of printers indicating they will be increasing their procurement directly from paper producers.

5. No milk and honey but at least some bread and water?

Both merchants and paper producers have named several focus areas for improvements. Both groups mention price and margin management, cost reduction and restructuring & consolidation as priority areas. It also becomes apparent that cash flow & working capital, marketing & customer service and supply chain development is more important to merchants than to producers.

While these priorities certainly are important, merchants will have to increase their pace in achieving improvements to secure their place in the value chain. Ultimately, two strategic options can be formulated for all players within this value chain.

The first can be named “self-centered survival”. Producers, merchants or printers & customers can all attempt to ensure their own survival on a standalone basis. Producers will have to achieve cost leadership by focusing on tier I assets and direct sales, thereby maximizing their margins in a competitive market. Printers and publish-

ers can focus on standardization in niche markets and direct procurement from producers. Merchants similarly need to minimize their cost base. Beyond that, they need to “own the customers” and offer innovative supply chain solutions to strengthen their importance for both producers and customers, respectively. This Darwinist approach will help the best in each field to survive – however, the introvert nature of this strategy will exclude any mutual benefits from cooperation across the supply chain.

The second choice available is more collaborative. Each of the three groups can unlock additional value opportunities through cooperation. Sharing information such as production plans or making pricing completely transparent while entering into value chain partnerships would make producers more attractive while reducing costs and increasing customer loyalty. The Merchant role in extended supply chain collaboration could be as far reaching as the provision of customer service for producers while ensuring procurement support for printers & publishers.

These efforts would have to be supported by e-solutions to improve workflow efficiency. Supply Chain partnerships require each participant to be tier 1 in competitiveness individually in order to create sustainably competitive supply chains.

Either strategy requires competitive cost levels achieved through the highest efficiency and minimization of wastage across all areas of the supply chain. Providing valuable services is critical while ensuring that unnecessary services are avoided to keep costs at bay while maintaining attractiveness as a business partner.

Overall, the evolutionary principle of the free market dictates that business models need to evolve to ensure survival. ■