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Expect more value add from distributors

By Jim Carbone -- 10/23/2003

In the 1990s value-added services were a way for distributors to differentiate themselves. During the current industry downturn VA has helped some distributors survive. In the next upturn, which some analysts say has already begun, VA services will help distributors take their businesses to the next level.

Most distributors offer some value-added services ranging from simple parts labeling and kitting to complex supply chain management services that help OEMs and contract manufacturers manage their supply base and inventory levels. When component sales dropped for distributors during the downturn, so did demand for value added service, but at a lower rate than the sales decline, according to distributors.

Most distributors expect that when the upturn shifts into high gear, demand for value-added services will also boom but at a greater rate than component sales.

Rob Gray, executive vice president of the National Electronics Distributors Association (NEDA), says many distributors recognized what value-added services meant to their business during the downturn.

"A lot of distributors have been evaluating their business determining their core competency and where they can be profitable in the future," says Gray. "They took a hard look at their business and their business model and said 'I'm losing money here with components and the long-term outlook for component sales does not look.'"

"If anything, distributors are de-emphasizing the component sales and emphasizing value added operations," says Gray. "Value added operations remain profitable for distributors even though their component business is depressed. As a result a lot of distributors are focusing on value add manufacturing," he says.

A degree of separation

Gray says some distributors have set up two operations, one for components and one for value-added manufacturing such as wire and cable assembly. "It's stuff that distributors have always done, but the VA business has grown so much and remains profitable and the market is not yet saturated," says Gray.

Some distributors have de-emphasized components or shut down the component side of the business. For some cases distributors have a component business to feed their value added operations. Gray says AESCO Electronics in Akron, Ohio and Glynn Electronics in Middleboro, Mass. are examples of distributors who are focusing on value-added services and have de-emphasized components. Both companies have extensive value-added operations.

Reptron and Kent sold off their component businesses, notes Gray. Reptron is a contract manufacturer and "Kent morphed into K*tec," also a contract manufacturer. Pioneer Standard sold off their component business and now focuses on computer systems," says Gray.

Gray says the trend toward value added manufacturing is a good opportunity for small distributors. "It is not volume business, it is customized work. It's profitability over commodity."

A value-added service that is a volume business at least for large distributors is IC programming. Large distributors such as Arrow and Avnet have large programming centers that are often used by large OEMs.

Unbundling programming

Until recently OEM and electronics manufacturing services providers (EMS) customers would have to buy parts from the distributor to take advantage of the distributor's programming services. But that is changing. Large distributors are offering programming even if a customer buys the IC directly from the part manufacturer.

By unbundling the service from the component sale, distributors are attracting large OEM customers such as computer and automotive companies, according to Bill Goebes, vice president of marketing and sales for Arrow's global programming services.

He says an automotive OEM may order programmable semiconductors from a chip manufacturer and ask the supplier to program them. However, the IC manufacturer is not interested in programming because it is not a core competency. The supplier will suggest to the auto company to have the parts programmed by a third-party programming house.

"The OEM didn't think of going to distribution because the OEM didn't buy from distribution," says Goebes. "However, we have a broad capability in programming and are telling the OEM direct customers 'it's ok that you didn't buy the component from us. We will sell you just the programming service.' If over time that evolves into some types of silicon sales for us so much the better," he says.

Goebes adds the auto industry represents a huge opportunity for Arrow's and other distributors' programming businesses. "There are as many as 40 different programmable devices under the hood that control global positioning systems, modules that make the motor burn fuel more efficiently, automatic seat controls even cell phones in cars," says Goebes.

Arrow's global programming services group was recently awarded TS 16949 certification in North America. TS 16949 is a new, international automotive quality management specification. The spec was developed with input from the four established automotive standards: QS-9000 in the U.S. VDA6.1 (Germany), EAQF (France) and AVSQ (Italy). Most major automotive industries worldwide subscribe to TS 16949, and it will likely supersede QS-9000. "To my knowledge we are the only distributor that has the spec right now," says Goebes.

Besides the auto industry, Arrow expects to do more programming for the military, medical and industrial control industries in the coming years.

Too expensive

Avnet also sees growing IC programming demand, says Jim Smith, vice president and director of operations. One reason for the growth is that OEMs and EMS providers are leery to invest in programming equipment because of its expense.

"Companies are looking closely at the investment in new technologies such as programming," says Smith. "They are reluctant to spend that much money when the service is available from other sources and they don't have to incur the capital cost."

"We have the machines with the capacity and are delighted to offer programming for a fee." Smith says while customers don't have to buy parts from Avnet to use programming services, most customers do. In some cases Avnet has agreements with the IC manufacturers to program the parts and Avnet is paid by the supplier.

Smith expects demand for programming services will grow during the upturn for two reasons. The services provide flexibility to OEMs and EMS providers in their production. There are also more programmable parts being designed by IC manufacturers.

"There are more programmable products being designed every day," says Smith. "Many of them need additional equipment and software to program it. He adds OEMs and EMS providers want quicker turnarounds in programming, he says. As a result they will go to distribution to do it because "we have the capacity and ability for quick turnarounds."

He says in a few cases Avnet is seeing an increase in business because some customers' production lines are full. "It is rare, but it some cases we are doing an OEM's programming because they don't have the bandwidth," says Smith.

He adds that with the transition of more manufacturing to China and other Asian countries, Avnet is doing the pre-production runs and transitioning code to operations for customers moving to Asia. "We provide a seamless integration of programming for customers migrating production to Asia," says Smith.

Managing materials

Besides programming, distributors are expecting demand to increase for materials management and supply chain services once the upturn kicks into high gear. Such services include bonded and consigned inventory in-plant stores, proximity hubs and information-based services concerning parts and the supply chain. Such information services help OEMs choose which parts to use for a new design and provide component information during the lifecycle of a product and the status of the supply chain.

"The level of activity about these services has been going like gangbusters in terms of discussions we are having with customers," says Paul Katz, vice president of digital supply chain solutions for Arrow.

A lot of the discussions deal with vendor-managed inventory (VMI) programs which have been in demand during the downturn as OEM and EMS providers look to reduce to reduce costs.

"VMI is growing. It takes a number of forms such as consignment and bonded inventory and in-plant stores," says Katz. "Consignment and inventory bonds are growing. We have in-plant stores, but the number of them isn't growing radically. We have proximity hubs in some regions of the world."

He says there is also growing demand for forecast-sharing technology called electronic customer-originated material planning and scheduling system (ECOMPASS). The tool helps customers share their forecast with their supply chain. "We have about 1,200 customers on it which is up from about 1,000 last year," says Katz.

He says there is also growing demand for online tools which allow users to view the supply chain and to understand the status of alignment between supply and demand.

Katz says value-added and supply chain services will help position Arrow well for the upturn and provide better visibility in the supply chain and help OEMs and EMS customers manage risk better and reduce liability.

Avnet says demand for its materials management services provided by its Integrated Materials Services (IMS) group is on the rise. IMS services include material forecasting, material management such as auto replenishment and in-plant stores, supply chain synchronization and warehousing services such as bonded and consigned inventory.

Revenue declined at the beginning of the downturn but is growing again, according to Greg Frazier, executive vice president of Avnet's supply chain services. "We have over 700 customers. Even during the downturn customers were looking to consolidate their procurement to turn fixed cost to variable cost," he says.

He says there is growing interest in IMS's new product introduction (NPI) service. "We have a new product introduction offering whereby we help our customers get those products to market faster and less expensively," says Frazier.

With the service, Avnet will take a bill of materials (BOM) for a new project and will source the BOM, do the procurement of it and provide logistics in getting it to the production line in a rapid response, according to Frazier.

Demand is also increasing for Promiere services, says Frazier. Promiere services are information-based and provide supply chain data on nine million parts, links the supply chain data to an OEM's engineering process and provides end of life notification on parts. Through Promiere OEMs and contract manufacturers can also manage their excess inventories.

While supply chain services will help OEM and EMS buyers manage risk better, more traditional VA services such as parts labeling, cable assembly and tape and reeling will help them reduce cost.

Pay attention

Gene Pfretzschner, director logistics/ value-added services for passives distributor TTI says he expects to see growing demand for VA as the upturn takes hold. He says some customers are preparing for the upturn.

"Customers are paying more attention to the detail. Everyone is sharpening their processes. They are taking a closer look and starting to make requests," says Pfretzschner.

"Some contract manufacturers are looking for more labeling. Some military houses are looking for special packaging of parts. "They want their own part number on the label (rather than the manufacturer's) and have the date code scan-able in the format and sequence they need," he says.

He adds that buyers also want orders processed quicker when they have customized orders. "Our VA service has gone to same day service," says Pfretzschner. In the past VA service would take a day or two. He says quicker turnaround has been achieved through more automation.

Buyers can also expect value-added services from catalog distributors. Case in Point: Newark InOne. The distributor does subassembly builds such as small cable and wire harnesses, says Tony Chien, marketing director at Newark InOne. It also will do sourcing for a customer on a limited basis.

"If we have a bill of materials and it has 100 items on it, there could be 20 that don't fall into our line of products," says Chien. "Maybe the customer wants a disk drive. To support them we'll handle the whole order and source all parts for the customer."

Newark InOne is not the only catalog distributor offering value-added services. Digi-Key derives about 10% of its sales from value-added services. Digi-Key provides value-added services for its prototype business as well as its production business which involves large volumes of parts.

It offers customized tape and reeling for customers. "If parts come 5,000 to a reel and a customer wants 1,600 pieces and they want a leader and a trailer, we reel it for them," says Mark Larson, Digi-Key's president.

"Customers don't want a lot of excess inventory around. If they are building 2,100 boards and they need 2,100 pieces then that's what they want. They don't want a reel of 3,000 or 5,000," he says.

A volume value-add business for Digi-Key is fans for computers. "We are doing tens of thousands of fans being used in computers. We are putting extra leads and special connectors on them. When it leaves here it is not only just in time, it is a plug in," says Larson.

While value-add services are not new, buyers can expect distributors of all sizes to concentrate on them more. With more large volume manufacturers moving to China and other Asian countries, distributors will focus more on their mid-size and smaller accounts. To win business, distributors will beef up their value-added services. While they won't become full-fledged contract manufacturers, distributors will handle more of the light manufacturing that OEMs and EMS providers need. Buyers can also expect smaller distributors to offer supply chain management services.

Top 25 distributors by VA sales (By percent of total sales)

	Company	Percent of sales derived from VA	VA sales ($ mil.)	2002 calendar year ($ mil.)
1.	NRC Electronics	80%	$16.6	$20.8
2.	PEI-Genesis	68%	39.5	58.1
3.	Reptron Electronics	67%	203.7	304.0
4.	Powell Electronics	65%	38.6	59.4
5.	Interstate Connecting Components	65%	9.4	14.5
6.	All American Semiconductor	60%	199.2	332.0
7.	Hammond Electronics	60%	23.9	39.8
8.	Surface Mount Distribution	60%	7.7	12.8
9.	Air Electro	60%	7.5	12.5
10.	Avnet	50%	2,550.0	5,100.0
11.	Nu Horizons Electronics	50%	137.0	274.0
12.	Richardson Electronics	50%	125.4	250.8
13.	Jaco Electronics	50%	102.8	205.5
14.	CAPSCO Materials Management	45%	7.2	16.0
15.	The DAC Group	40%	99.3	248.3
16.	TTI	30%	159.3	531.0
17.	RS Electronics	25%	17.4	69.6
18.	XP Foresight	23%	14.8	64.3
19.	Electro Sonic	20%	13.6	68.0
20.	Peerless Electronics	17%	6.5	38.2
21.	Memec, PLC	15%	112.5	750.0
22.	ESCO LLC	14%	8.4	60.2
23.	Digi-Key	10%	35.0	349.7
24.	Dependable Component Supply	10%	8.6	86.0
25.	Master Distributors	9%	6.1	67.5

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