

Executive Outlook

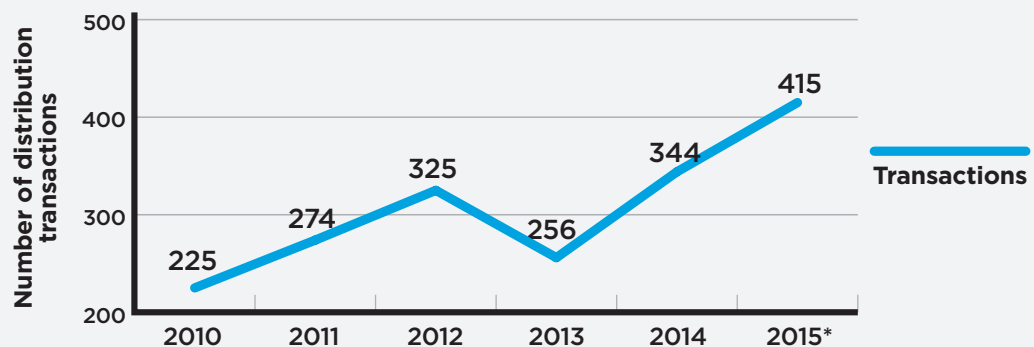
Disruption, high demand for distribution leaders

Where will private equity firms find the right leaders for thousands of industrial distribution businesses they are acquiring?

Talent challenges in the disrupted distribution business.

Acquisitions of industrial distribution businesses by private equity firms are approaching historic high rates. Since 2009, the deal value has risen steadily, going from \$142 billion at the onset of the great recession to nearly \$331 billion in 2014. Transaction volume remains strong with more than 400 deals in 2015 up to Sept. 30¹ (see Figure 1) at an average multiple of 11.7x in 2014 versus 10.7x in 2009.² To make good on these investments, buyers need to find great leaders who can take these acquired businesses to the next level, generate superior financial results, and work comfortably in a private equity environment.

Figure 1
Sector transaction volume 2010-2015.*



*2015 data as of Sept. 30

Source: Supply Chain Equity Partners
www.supplychainequity.com Data used with permission.

But finding the leadership talent for these businesses can be difficult, especially for buyers who restrict their search to the distribution sector. Why?

- ▶ First, the white-hot pace of acquisitions has increased the competition for top talent. The many private equity firms seeking to appoint leaders of their own choosing are all vying for talent from the same limited pool.
- ▶ Second, many small- and mid-sized distribution businesses have not been developing the kind of world-class leaders that private equity firms demand. Because many of these businesses are owned by families whose exit strategy is to sell after one or two generations, they have devoted little time and effort to leadership development or succession planning.
- ▶ Third, competitive trends and technology developments—most importantly e-commerce—have dramatically increased the challenges for distribution leaders, further reducing the number of people who are up to the job.

¹ Supply Chain Equity Partners (www.supplychainequity.com). Data used with permission.

² William Blair, Supply Chain Services Sector, May 2015 Industry Update.

Outstanding leaders are certainly found among distribution companies. But private equity buyers of these companies can ensure they are getting the best available talent by widening their search to include leaders from the logistics sector.

Although distribution businesses have multiple models serving many sectors, at their core they resemble the logistics businesses of today: they are largely route based and network oriented. They operate warehouse networks and distribution centers, moving large volumes of products and managing a large hourly workforce. And they have invested both energy and resources to enhance their competitive edge and customer “stickiness” with differentiating service offerings, including last-mile delivery with in-house installation, demand forecasting through predictive mathematics, significantly compressed order-to-delivery cycle, and more. Distributors and logistics providers alike help customers bring the right products to market at the right time and in the right quantity.

There are differences, however. Distributors source, buy, stock, sell, and manage the delivery of a large number of products, referred to in the business as stock-keeping units (SKUs), and they generate a margin on the trade. Logistics service providers typically do not take ownership of inventory and instead focus on profitably meeting service-level agreements. Despite these differences, the two sectors continue to converge, and at their intersection, the cross-pollination of talent could be just what a private equity-owned company needs. Because the most efficient supply chain accounts for much of a distributor’s success, the right logistics professional could be the most effective leader.

Distribution and logistics leaders also share many of the same skills. Both must understand operations strategy, excel at planning and execution, and be able to drive continuous process improvement—skills that are critical for reducing costs and improving the bottom line. But beyond those basics, leaders must know how to achieve profitable growth by linking supply chains to value chains. Moreover, innovation and creativity are key leadership traits required to continue contributing to customers’ success. Leaders therefore must be able to evolve existing business models and create new ones that not only simply aim to increase volume but also enable the company to move up the value chain through higher value-added products and services.

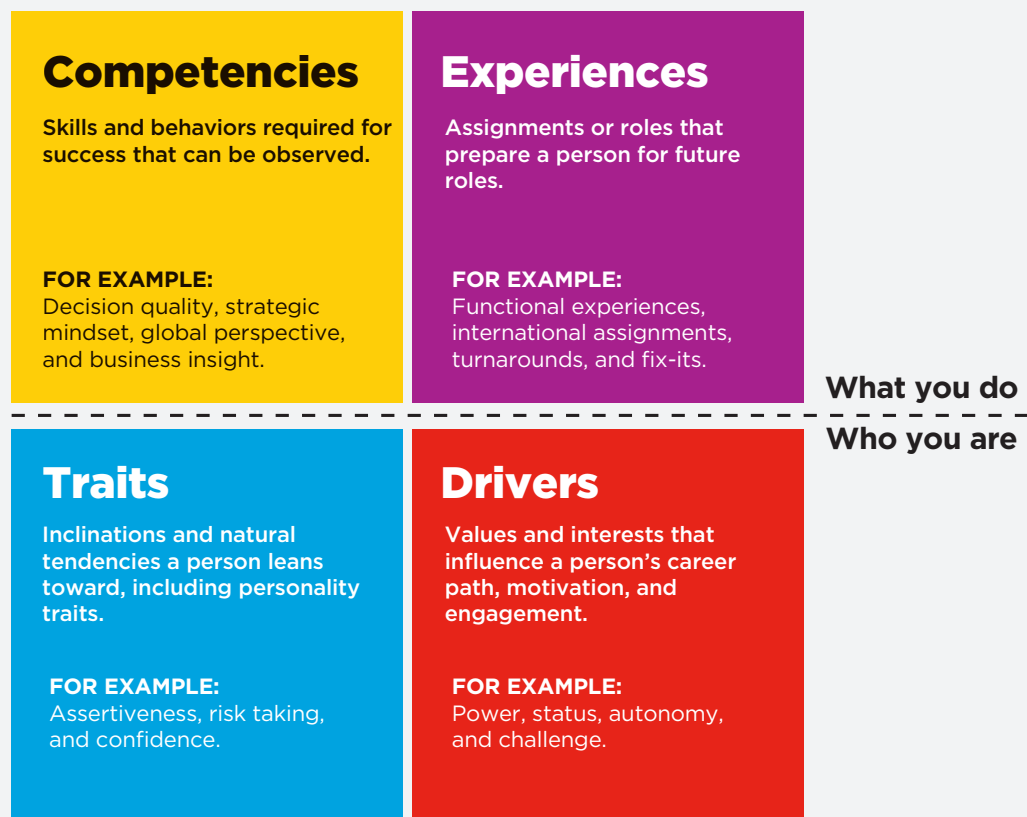
Leaders who can develop and execute those superior business models are always hard to find, and they will be more critical than ever in the rapidly changing competitive landscape. The dynamics of this landscape, detailed in Korn Ferry International's 2016 Third-Party Logistics Study (conducted in association with Capgemini Consulting, Penn State, and Penske), demand increasing agility and responsiveness. Customers want complete visibility throughout their supply chains, interactive analytics, omnichannel fulfillment, and real-time services that are customized and integrated. Meeting these customer demands requires providers to apply information and technology strategically, not just tactically.

Furthermore, some of the largest and most sophisticated technology companies in the world, including Google and Amazon, have entered the logistics and related distribution businesses. No one is better at taking the kind of massive amounts of data generated by operations and turning it into valuable knowledge. These companies largely invented cloud computing, which has become central for lowering costs and meeting customer demands in logistics and distribution. And they have repeatedly demonstrated their ability to create innovative business models.

How logistics executives stack up on leadership.

The quality of top leadership can make all the difference between an acquisition that generates superior returns and an acquisition that disappoints. From decades of research and practice, Korn Ferry has identified Four Dimensions of Leadership and Talent (KF4D) and the many factors that constitute each (see Figure 2). The KF4D can provide valuable insights about distribution talent and leaders' prospects for success in the sector based on their competencies, experiences, traits, and drivers.

Figure 2
KF4D



Because the logistics and distribution sectors are so similar, many logistics leaders have acquired experience and expertise that is easily transportable. Just as important, many logistics leaders perform as well as or better in distribution than their counterparts do along the other three dimensions of leadership.

Executing and getting results.

Korn Ferry research shows that in nearly all 20 leadership competencies, logistics leaders hold their own with distribution executives, including the ability to understand the business, create the new and different, and take initiative. Leaders from both sectors also are more likely than comparable executives to score well on managing execution. That's unsurprising, given the heavily operational aspects of both types of business. But logistics leaders, also like their distribution counterparts, tend to be especially adept at getting results, which is doubly important in a private equity-backed setting with its tight time frame and high expectations for returns.

However, when importing logistics executives into distribution businesses, private equity firms should ensure that these leaders are financially astute. It is important they know the financial impact and concerns of the companies that make and ultimately sell product, not just how to move items efficiently through the supply chain. They should understand the concepts of merchandising, "inventory carry," working capital, inventory obsolescence, and the different approaches to balance sheet and cash flow management that these entail. They should also be able to translate their experience handling service providers and vendors into handling service providers who, in a distribution environment, are largely manufacturers.

Innovating and acquiring cultural dexterity.

Among the leadership traits, innovation is a strong suit for logistics leaders. That is an invaluable advantage when evolving the business model is critical for sustaining success. Further, technology has revolutionized the way logistics businesses serve markets and customers. Logistics leaders who have participated in this revolution are adept at using technology, as well as data and analytics, to find new ways of doing business—innovations that are highly relevant to distribution.

Logistics leaders are also more likely than comparable executives are to score well on presence—the projection of confidence and competence that is a defining mark of leadership. Unlike distribution company executives, logistics executives typically deal with the senior management level among their blue chip and global customer base. Logistics companies also typically manage larger contracts, and they may be more mission critical to the value chains of their customers and more deeply involved in them. Certainly, that holds true for logistics providers whose supply chain solution-offerings are viewed not as a pure commodity but as a service that helps strategically enhance their customers' competitiveness in the marketplace.

Leaders in both sectors are likely to exhibit high emotional intelligence—the ability to influence others, communicate effectively, and use interpersonal awareness to advance collective goals. Despite the orientation to execution in both types of business, ultimate success is highly dependent on relationships. And when things go wrong, as they inevitably do in both logistics and distribution, the ability to maintain relationships can make all the difference.

Logistics leaders are more likely than distribution leaders are to fall somewhat short in cultural dexterity—the set of skills that enables collaboration, alignment, and communication across multiple dimensions of diversity. In some companies, this competency may matter less than it does in others—purely domestic companies, for example, or companies with a small customer base that is concentrated in one specific industry. In situations where cultural dexterity is more important—global operations and strongly diversified companies across customers, verticals, and service offerings—candidates should be assessed for this competency carefully.

In some cases, someone who lags in cultural dexterity may otherwise be the most qualified and desirable candidate to lead a particular acquisition. The challenge then is to ensure that this prospective leader can acquire those skills quickly and is willing to accept executive coaching or other assistance to do so. Moreover, candidates who exhibit a high degree of emotional intelligence, as leaders from both sectors are likely to do, should be able to master the cultural dexterity to which it is so closely related.

A desire for structure.

Korn Ferry research has found four chief drivers for leaders. These are values and interests that influence their career paths, motivation, and engagement, and include the desire for power, independence, structure, or autonomy. Logistics leaders are likely motivated most by structure, followed by power; in contrast, distribution leaders are most likely to be driven by a desire for independence and very unlikely to be driven by structure or power. The typical logistics leader's desire for structure—and, to a slightly lesser degree, power—offers an appealing combination to private equity firms. On the one hand, the leader's desire for structure fits well with firms that maintain tight control over their portfolio companies. On the other hand, the desire for power helps ensure that the leader will help guarantee that the private equity firm's intentions flow down through the organization.

The downside is that leaders in both sectors are less likely than comparable executives are in other industries to be driven by a desire for challenges. Perhaps because both types of business crucially depend on meeting the day-to-day challenges of execution—in effect, making the trains run on time, satisfying extremely demanding customers—these leaders may be less attuned to big-picture challenges.

Predicting success.

Few industries change as rapidly as logistics changes. Each new wave of technology transforms the operations and business models of customers and hence the industry. Outstanding logistics leaders must continually find ways to contribute to fulfillment models that provide competitive advantages to their customers. They are second to none when it comes to what is perhaps today's most important area of expertise—e-fulfillment. And they are masters at change management, the essential skill for winning in an environment of constant transformation, including the transformation that comes with a change of ownership.

An organization lives or dies by the quality of its leaders. Understanding what they can do, who they are, what drives them, and whether or not they have the right skills to deliver results is a key part of securing business success. Many logistics leaders possess not only the experience but also the competencies, traits, and drivers that predict success in distribution businesses. Given this scientific foundation and comprehensive perspective covering competencies, personality traits, deepest drivers, and experiences, private equity firms neither need to confine their search for distribution company leaders solely to the distribution sector nor accept the compromises that an artificially limited talent pool imposes. They need only ask which candidate is most likely to succeed, and in many cases they will find that the answer is a logistics leader.

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About Korn Ferry

Korn Ferry is the preeminent authority on leadership and talent. For nearly half a century, clients have trusted us to recruit world-class leaders. Today, we are their partner in designing organizational strategy and developing their people to achieve unimaginable success. For more information, visit www.kornferry.com.

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The Korn Ferry Institute, our research and analytics arm, was established to share intelligence and expert points of view on talent and leadership. Through studies, books, and a quarterly magazine, *Briefings*, we aim to increase understanding of how strategic talent decisions contribute to competitive advantage, growth, and success.



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