So You Want to Distribute?

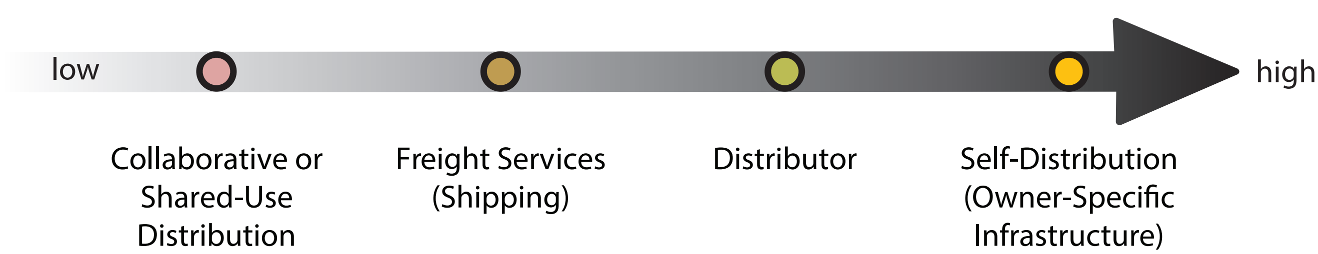
Examining the Basics of Distribution in Vermont

Making the right distribution decisions for your business isn't easy. This FAQ sheet summarizes the benefits and drawbacks of distribution options available.

When exploring distribution options think about the stage and scale of your business, and the markets you would like to access—remember that "place", where you want to sell, is one of the 4ps of marketing so the decisions you make about distribution have implications for successfully implementing your business and marketing plan.

The starting distribution model for many small-scale producers is self-delivery with a personal vehicle, "the Subaru Model" as it's affectionately known. However, using a personal vehicle is just one of many options. This FAQ sheet can help you make more informed decisions about all of your distribution options. The FAQ also identies ways that the separate Distribution Financial Analysis tool can help you analyze and compare the distribution options covered in this document. The options are sequenced to follow the capital investment continuum below, from low capital investment to high capital investment. Note that it's assumed that capital investment is high for distributors because establishing the typically required pre-existing level of sales to work with a distributor will require capital investment in farm infrastructure to scale the business that is not required when using shipping services or collaborative or shared-use models.

Level of Capital Investment



COLLABORATIVE OR SHARED-USE DISTRIBUTION

Collaborative distribution is often valuable during early and start-up phases of a business when size and scale make infrastructure cost prohibitive and unproven market share limits access to conventional distribution channels. While on the surface collaborative arrangements may seem informal, and this is part of their appeal, it's advised to approach them as any other formal business relationship: they still require capable man-agement, commitment and reliability of the participants (if delivery times are missed or arranging pick-ups is taking too long, the transaction costs of doing business in this way are unsustainable), adherence to guidelines for product safety and product requirements, and shared values and mutual respect. Collaborative distribution arrangements often have a natural lifespan as partners needs change. At the onset of any collaboration, be upfront and transparent about your business goals and plans for growth so that pro-spective partners have realistic expectations for how long the collaboration will last and can plan in advance for its end.

PROS:

- Reduces expenses for partners
- Flexible to changing needs
- Good way for producers to piggy-back on others access to larger or more distant markets without having to work through a distributor

CONS:

- Subject to the whims and wills of personalities
- Services may not be as professional as those provided by freight service or distributors
- Liability concerns for owners, and poor health and safety practices can jeopardize everyone
- Requires attention to scheduling, planning, coordination amongst mutltiple entitites, and reliability of partners to deliver on time

HOW THE DISTRIBUTION FINANCIAL ANALYSIS TOOL CAN HELP

The financial analysis tool can help you better assess collaborative distribution by:

- Helping you assess what 'll need to charge to cover costs and maintain margins if distributing for others.
- Helping you better understand the value of distribution services provided by your collaborative partners and negotiate terms that are fair for both parties.

SHIPPING SERVICES
(BILL OF LADING (BOL), FREIGHT SHIPPING, DIRECT STORE DELIVERY (DSD) ETC.)

A shipping service is different than distributors in that it is a point-to-point shipping service where the shipper is simply picking-up and dropping off product for a fee—the shipper is not purchasing your product for resale as distributors do. Examples of shipping services include FedEx, UPS, Green Mountain Messenger, and Farm Connex.

Some distributors offer shipping service as a secondary business. Black River Produce and Upper Valley Produce for example offer BOL service. When considering shipping services shop around for rates and set-up commercial accounts with providers that offer it. Also, purchase liability insurance, and look to see if the shipper has a contract that upholds specific product conditions during the chain of custody.

+ PROS:

- Shipping services offer an efficient and convenient way to gain market penetration and leave logistics and trucking in the hands of businesses whose core competency is to provide shipping services.
- Producers maintain control over their product which allows them to ensure optimal customer service by engaging directly with accounts, ensuring timely order delivery and fulfillment, and minimizing risk and liability of product loss or product quality issues arising in transit by having direct oversight over packaging and packaing quality control while having safeguards provided by professional shippers against in-transit liability claims.

− CONS:

- Costs of shipping services can be expensive
- Maintaining control over product requires active involvement in sales, marketing, inventory management, and product packaging and packing.

HOW THE DISTRIBUTION FINANCIAL ANALYSIS TOOL CAN HELP

The financial analysis tool can help you understand the cost of shipping services, and help you compare that cost with using a distributor, or owning or leasing a truck on a cost per year and cost per case basis. To find out the cost of using shipping:

- Enter the number of cases you plan to ship per year
- Enter either the quoted cost per case or pallet, or mark-up quoted by the shipping service
- Enter the value per case of your product

SELF-DISTRIBUTION

WITH LEASED OR OWNED COMMERCIAL-GRADE TRUCKING

Many producers incur a significant cost to purchase and maintain an asset in order to self distribute. It provides confidence in the supply chain and quality of customer service. However, often the decision to self-distribute is made without assessing the financial and logistical implications, and before exploring the cost-benefit of alternative options. For example, not including labor or the annual cost of ownership (debt service), the annual cost to operate a refrigerated box truck in Vermont (e.g., maintenance and inspection, fuel, insurance) can average $17,000. While owning the infrastructure may be the best solution, leasing may, in many cases be an even better solution, and using a shipping service or distributor might be better than self-distribution entirely.Recent studiesfound that in Vermont leasing is likely to be advantageous over owning if miles travelled is above 15,000 mi/year or Total Cost of Ownership (operating expense + annual costs of ownership) is above $1.30/mile.

+ PROS:

- Producer retains full control, with a higher degree of oversight and confidence in the chain of custody, end product, and brand integrity.

− CONS:

- Requires producer to be a logistics expert.
- Requires a back-up plan for customer service for on-road break-downs (See Lease Or Own sidebar)
- Requires access to truck and refrigeration maintenance and repair experts (See Lease Or Own sidebar)
- Can be inefficient and expensive in comparison to alternative options such as shipping service providers or distributors
- Ensuring sufficient utilization of the asset to reduce cost per unit for shipping can be difficult to manage and may require other users to achieve optimal utilization.
- Can draw time away from core competencies and stretch operational capacity thin—adding distribution means another layer of staff and management that may be better spent in production, or sales and marketing for example.

Lease or Own?

While owning a vehicle provides the user with greater flexibility to use the truck as they wish, and not within the constraints imposed by a lease, there are a few factors to consider that can tip the scales to leasing rather than owning:

- Maintenance costs: Refrigerated trucks can be costly to maintain. Cash flow constrained organizations may find it prudent to lease due to set monthly payments that reduce variable cost risk that comes with unanticipated repairs.
- Maintenance access: Maintain refrigerated trucks requires skilled and experienced service technicians. With a leased vehicle maintenance and repairs, along with access to well-maintained vhicles and qualified technicians, are guaranteed by the leasing entity.
- System redundancy: Breakdowns happen. With a lease the leasing company provides roadside assistance to ensure your products get ot their destination. In an ownership model the owner must consider how to handle breakdowns.

HOW THE DISTRIBUTION FINANCIAL ANALYSIS TOOL CAN HELP

The Distribution Financial Analysis Tool can help clarify if either self-distribution, leasing or owning, is the best distribution option to pursue. When comparing leasing vs owning, the tool allows you to:

- Compare costs per year
- Compare costs per case
- Compare operating and capital costs per mile, not including labor
- Compare operating and capital costs per mile, including labor

DISTRIBUTOR

Unlike shipping services, distributors purchase product for resale. It's in the interest of both the producer and the distributor for a product to sell well. However, this does not imply they will make your product their top priority. To help ensure your product does well, you need to remain actively involved in selling and customer service. For example, ask your distributor's sales representative if you can go on the road with them—this is an effective way to meet accounts, reinforce a buyer's mental association between your brand and your distributor, connect each sales representative more intimately with your product and its story, and facilitate your ability to understand how your distributor works.

The 65-35 Rule of Thumb to Understanding Food Industry Margins and Distributor Pricing

In the food industry at each link in the supply chain, the buyer spends on average 65% of their resale price to acquire the item. This reserves 35% of their resale price for overhead and profit. So, if you are trying to assess what your prices should be, look to see if you are adhering to the average: does your overhead add up to 35% or less of your total annual expenses? If so then you can use the 65-35% rule as a guide.

If you want to know what the likely going rate is for your product, work backwards from what you see in the store: the retailer paid 65% of the price you see offered to the consumer, the supplier purchased it for 65% of what the retailer paid, and so on. If you are the one directly supplying the retailer, then you will likely receive 65% of what you see the product priced for on the shelf, if you use a distributor you will likely receive 65% of what someone self-distributing would have received, and so on.

A producer may find that after accounting for the costs associated with distribution and delivery, that selling to a distributor at a price a step or two below what you would have received directly is actually more cost effective and results in a higher net profit.

HOW THE DISTRIBUTION FINANCIAL ANALYSIS TOOL CAN HELP

The financial analysis tool can help you understand the cost of using a distributor, and help you compare that cost with owning or leasing a truck on a cost per year and cost per case basis. To find out the cost of using a distributor:

- Enter the number of cases you plan to ship per year
- Enter either the percent margin or mark-up quoted by the distributor
- Enter the value per case of your product

PROS:

- Optimized time management and operating efficiency—which frees up more time to focus on core business functions (e.g., production efficiencies, sales & marketing). By working with a distributor you make the sale to the distributor not individual accounts, securing larger order from fewer buyers.
- Distributors are more likely to pay and pay timely than individual accounts.
- Increase in market penetration and diversification due to distributors geographic reach and access to multiple accounts
- Increase in profitability if budget analysis demonstrates delegating logistics functions to distributors is cheaper than costs incurred by self-distributing or using freight
- Customer feedback that can come through distributor sales representatives that are in regular contact with buyers.

CONS:

- A common expectation is that once you are working with a distributor they will do all the sales and marketing. A distributor facilitates your ability to reach a customer, it does not ensure sales and marketing to that customer.
- Chargebacks: Some distributors apply "chargebacks" to producers for product that does not sell. Ask distributors about their policy and averages for your product category, and build this cost into your cost of working with a distributor
- Liability Insurance: Some distributors require you to carry liability insurance. Ask distributors about their insurance requirements and be sure to build this cost in to your business plan
- Payment schedules: Many distributors pay on 30 days net, and some may not pay for product until 45 to 60 days after pick-up; a producer must be prepared to accommodate this.
- UPC label: Many distributors require universal product code labels (UPCs) before they will include a product in their inventory. Initial fees start at $250 with a $50 renewal fee for 1-10 product UPCs, with the initial fee and renewal fee increasing as more UPCs are needed. To obtain UPC codes, visit https://www.gs1.org/need-gs1-barcode

Additional Resources

- Northeast Kingdom Agricultural Transportation Feasibility Study
- Storage and Distribution Report for Local Food in the Northeast Kingdom
- UPS Quote Calculator for package and freight (click “Quote” tab)
- FedEx Rates & Transit Time Calculator
- Freightquote.com freight cost comparison and BOL tracking
- Connecting the Dots: Strategies for Aligning Production, Processing, Distribution, and Market Outlets for Vermont’s Food System
- Moving Food Along the Value Chain: Innovations in Regional Food Distribution
- Networking Across the Supply Chain: Transportation Innovations in Local and Regional Food Systems
- Regional Food Hub Resource Guide
- 10 Realities About Working with Food Distributors

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This resource is a project of

VERMONT AGENCY OF AGRICULTURE, FOODS & MARKETS