Arrow electronics: gaining new business essay

ASSIGN BUSTER

RECOMMENDATION The entrance of Express Parts in the electronics components distribution market threatens to abruptly change the flow of the channel operations that Arrow electronics is used to. Arrow is faced with a tough, time-constrained decision of making a choice – Should it incorporate Express in it's distribution channel or not? After a careful examination of the market dynamics that Arrow electronics operates under, it is my recommendation that Arrow Electronics take the following course of action 1. If possible, devise the Express Parts Internet distribution service for the market segment of X86 only and maintain the traditional Arrow style of distribution system for the rest of the markets. If that is not possible, decline signing onto express Part's new internet brokerage service.

2. Strengthen a home-grown web portal and offer it as a registered service to existing customers. This means creating their own internet presence and developing a long-term strategy of using the internet as a direct channel for their customers. It is my belief that by executing the above mentioned plan, Arrow would be able to capitalize on it's existing strengths and neutralize the looming threat that Express presents.

SUPPORT The Arrow electronics case is a classic example of a third-party delegated channel system in which the supplier(semiconductor manufacturers like Intel, Texas Instruments etc) relies at least partially on a partner (Arrow – an electronic components distributor) to perform the demand generation and fulfillment value chain functions, without having a direct connection to customers all the time. The value proposition that Arrow presents to it's customers is in the form of the distinct value-added services it provides them. These include credit arrangements, delivery of components

in small quantities with little lead-time, programming support for certain devices for individual customers and supplying complete kits for production to contract manufacturers. At the same time, it provides the suppliers with a platform to publicize their standardized parts and assists them with engineering manpower to secure a spot for their proprietary devices in the customer's new products. In return, the suppliers offer Arrow an unbeatable price for design wins and limited return facilities. The synergy in between Arrow and it's suppliers and customers are depicted in Figure 1.

The imminent entry of Express Parts Inc which intends to function as an internet-based distribution system in which several distributors can advertise their wares over the internet to a pool of customers (as shown in Figure 2) presents a clear challenge to Arrow's business model. There is a very clear threat of disintermediation of Arrow electronics as a distributor with this model as consumers (OEM's) might be tempted to use Express's web site as a shopping portal for the lowest price that distributors can offer. This would cut down Arrow ' s profit as an intermediary and undermine the very value proposition that Arrow electronics presents to it's customers. On the surface, the advantages offered by signing on with Express Parts Inc might sound very tempting. Arrow would then potentially be able to get new customers in markets that it does not currently serve; part of the promotional responsibilities would fall on Express, there might be a potential reduction in inventory and logistical costs and Arrow could gain information on parts from other distributors. However a detailed investigation presents little justification and far less rosy prospects for a partnership with Express Parts Inc 1.

If Arrow A/S partners with Express, the gross operating margins decrease from 16. 67% to 15. 9% in a pessimistic scenario as shown by Exhibit 1. With expenses running at 11%, this translates into a 23% drop in operating profits. Express would have to provide Arrow with a 23% increase in sales ($) to make up for that. This is tough to do.

2. Signing up for Express will create a potential trade-off in between gaining new customers and losing existing customers who may drift away into choosing products from alternate channels. 3. Express exists only in response to demand. They cannot create demand as they lack any kind of personal contacts with the end-customer.

It is very likely that the service that Excel offers ends up as a bargaining portal for transactional customers for BAS products. From Exhibit 4 (case), it is clear that the trend shows VA sales as taking a great majority of sales in the coming years. VA sales are immune to the Express effect. This makes Express less important to Arrow's future. 4. It is clear that the factor that feeds and perpetuates the channel existence is the symbiosis in between Arrow, it's suppliers and customers.

Arrow adds value to the suppliers by carrying inventory, paying the bills and ensuring sufficient volume. The suppliers all have a vested interest in ensuring stable prices through the channel, keeping track of who uses the products and wanting their distributors to perform value-added services. Similarly the customers would still want Arrow to provide parts in small volume with less lead and assemble full kits so that the production lines can run without interruption. The addition of Express in the channel makes Arrow

less attractive and major suppliers may very well disfranchise Arrow. Similarly, signing on with Express would make Arrow’s sales force lose their “ quality of service and personal contact” trump-card with their customers. 5.

At the time of the case discussion, the Internet was still immature. The internet had not been proven to reduce costs or expand revenues for businesses. It is also difficult to judge whether the information provided by the internet could be positively monetized for Arrow. It is clear that Express Parts would not be a good partner. Arrow (and other suppliers) would be best served by rejecting Express to avoid large-scale price wars and margin erosions. If at all Arrow A/S wants to test out the waters at Express, it could quote X86 parts from Intel only on the system since most of the customers here are credit plus BAS type of customers with whom Arrow A/S would have little long-term relationships.

Also Arrow Inc already has a website and should introduce purchasing capabilities over the web site to serve the most price-sensitive customers. The relationships with established customers should be nurtured by maintaining a personalized line of communication. Exhibit 1 – Mathematical analysis of the impact of Express on Arrow Electronics sales and profits From Exhibit 7 in HBS case, Total business and sales = $2, 310 million. From page 8 in HBS case, Sales from transactional customers = 25% of total sales = $578 million. Sales from relationship customers = 2310-578 = $1, 732 million. Arrow electronics ships both kinds of products, BAS as well as VA products to both kinds of customers, transactional as well as relationship.

From page 11 in HBS case, in the optimistic scenario all of the transactional customers would switch their purchase from Arrow to Express. According to Exhibit 7 in the case, the value-added business is immune to internet cannibalization and a total worth of $293 million would be cannibalized. This means that only BAS products sold to transactional customers would be affected. From this, we can infer that transactional customer buy a total of 578-293 = $285 million of value added products. Transactional customer sales ($578M) = BAS products ($293M) + VA products ($285M).

From Exhibit 7 in case, there is a total of $1443 million in VA sales generated. The portion of this VA sales generated by relationship customers must be equal to 1443-285 = $1158 million. Hence, the amount of BAS sales generated by relationship customers = 1732-1158 = $574 million. Relationship customer sales ($1732M) = BAS products ($574M) + VA products ($1158M). So the total amount of BAS product sales = 293+574 = $867M and VA product sales = 285+1158 = $1443M We approximate the gross margin for BAS products to be 23% (Page 6 – in between 20% and 25%) and that for VA products to be 13% (Page 8 – in between 10% and 15%). Total margin if Express were not there at all = [(0.

3*867)+(0. 13*1443)]/2310 = 16. 67%. Assumption – Arrow signs on with express and manages to sell components with same margins and sells only the same dollar sales in electronic components In optimistic scenario all the BAS business with transactional customers ($293M) will be lost. Then, Margin = [(0.

23*574)+(0. 17*293)+(0. 13*1443)]/2310 = 16% In pessimistic scenario, all the BAS business with transactional customers as well as 40% of the BAS sales with relationship customers would be lost. So Margin = [0.

23*(574*0. 6)+0. 17*(293+574*0. 4)+(0. 13*1443)]/2310 = 15.

9% All these margins are above the minimum targets of 15% that have been set by Mr. Kaufman for Arrow A/S (though it barely exceeds the target). What is the minimum additional sales dollars that a partnership with Express parts Inc should provide to make sense for Arrow Electronics? 0. 23*867 = 0. 23*(574*0. 6) + 0.

17*x. From this x = 707. Additional sales revenue from the collaboration with Express must be at least 707-293-574*0. 4 = $184. 4M for the operating margins to come together to their old value. This must come exclusively from BAS sales, that is an increase of 184/867 = 22% which is somewhat challenging ?