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FASTENAL: LOSING ITS FAST GROWTH TO AMAZON BUSINESS?[1]

Arpita Agnihotri and Saurabh Bhattacharya wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

The Fastenal Company (Fastenal), established in 1967 and based in Minnesota, United States, was North America's largest distributor of fasteners; it was also the most efficient single source for a wide variety of industrial and construction products, such as metal cutting tools and blades, abrasives, material handling tools, and gloves.[2] In 2008, Fastenal pioneered the concept of industrial vending machines, which helped its clients reduce their supplies costs by 40 per cent.[3] In 2015, Fastenal was ranked 44th on Forbes' list of the World's Most Innovative Companies,[4] and in January 2017, it was ranked 10th on Industrial Distribution's Big 50 List.[5] In Minnesota, Fastenal was one of the 20 largest public companies, with a total employee strength of 19,624 and revenue of US$3.96 billion[6] by the end of 2016 (see Exhibits 1 and 2).[7] Fastenal was also known for providing the best customer service in the industrial supply sector.[8] Fastenal's employees believed that one of the key drivers of the company's success was their decentralized and empowering organizational culture, in which employees close to customers made decisions.[9] These features helped Fastenal become one of the rare companies to leap from 100th position on Harvard Business Review's 2014 list of the Best-Performing CEOs in the World to 33rd position on the 2015 list.[10]

Although Fastenal enjoyed a high profit margin and different awards, its competitive edge was threatened when Amazon Business entered the industrial supply business in 2012.[11] Amazon Business's impact on Fastenal was visible when, within two years of its entry, Fastenal's performance began to decline. The announcement of Amazon Business's inception itself reduced Fastenal's share price by 15.76 per cent.[12] Further, Fastenal had not reported any significant increase in its gross profit or operating income as a percentage of sales since 2014. Growth in earnings per share was also in decline (see Exhibit 2). Competition became even more challenging when in May 2017, Amazon Business pioneered a supply chain innovation and applied for patents for aerial drones.

Did Fastenal have any competitive advantage over Amazon Business or was its survival likely to be threatened by Amazon Business? What strategies should Fastenal take to contend with Amazon Business: should it focus on differentiation to outpace the competitive threat posed by Amazon Business or resort to a price war through a strategy of low costs to save its market? Would Fastenal be able to regain its growth trajectory given the competition from a dominant player like Amazon Business?

BACKGROUND

In 1967, Bob Kierlin, along with four of his friends, pooled $30,000 to open the first Fastenal store, located in Winona, Minnesota. Initially, Fastenal mainly supplied fasteners such as nuts, bolts, and screws. Their first retail store was 1,000 square feet (93 square metres).

From Fastenal's beginning, Kierlin advocated the motto of "Growth through Customer Service,"[13] which guided employees in working closely with Fastenal's clients to keep them supplied with what they needed and drive clients' business improvement. The company's website proclaimed, "We don't just make a sale—we align with our customers to make them more successful."[14]

Kierlin already had experience working in a hardware store. He had observed that many customers came to Fastenal for simple products, like nuts and bolts, and in 1967, thought of making these simple products available through vending machines.[15] However, Kierlin soon realized that this was an expensive proposition, and much ahead of its time.[16]

Nevertheless, the business gradually flourished.[17] In 1987, the company launched its initial public offering, making Fastenal a listed company. In 1994, Fastenal took its first step toward internationalization, opening stores in Canada. By 2001, Fastenal had also expanded to Mexico and Singapore. By 2008, with its continuous growth effort, Fastenal was incorporated in the S&P 500 Index.[18] By the end of 2016, it had 2,503 stores across 21 countries,[19] although most of Fastenal's revenue came from the United States (see Exhibit 3).

During this time, Fastenal also paid special attention to human capital development, and in 1999, launched the Fastenal School of Business for company employees.

PRODUCT LINES AND PERFORMANCE DRIVERS

Fastenal's business had two components: industrial production and maintenance. The industrial production business supplied nuts and bolts, screws, and studs, which were used as components of products manufactured by its industrial clients. Fastenal referred to the industrial production business as original equipment manufacturing (OEM). Fastenal offered a total of 12 product categories under its OEM business (see Exhibit 4).

Fastenal's maintenance business was known as the maintenance, repair, and operations (MRO) business. It focused on different client service-related needs,[20] providing after sales services and solutions ranging from simple tool repairs to complex engineering support.[21] Fastenal attributed its success largely to its wide variety of product lines. The company's 2016 annual report stated, "We believe our success can be attributed to our ability to offer our customers a full line of products and services from convenient locations, as well as to the high quality of our employees."[22] In 2016, the MRO business contributed 63 per cent of Fastenal's total revenues.[23]

Fastenal's manufacturing plants were placed in nine locations, including Minnesota, California, and Indianapolis, and fulfilled 70,000 orders every year, with each job customized for an individual customer.[24] Fastenal had 14 distribution centres, 11 of them in the United States, serving 2,452 stores in North America and an additional 51 stores outside of North America.[25] Fastenal also had more than 6,000 fully owned delivery vehicles.[26] Its national call centre took care of all customer queries, including hardware and software issues.[27] Each of the Fastenal stores provided customized inventory to its clients and had a high rate of same day service. Fastenal sold to industrial customers through multiple channels, including retail stores, onsite vending machines, and its website, Fastenal.com.[28] For certain product lines like metal cutting tools and blades, Fastenal was itself dependent on suppliers. However, the maximum inventory that Fastenal purchased from a single supplier was no more than 5 per cent.[29]

COMPETITION

Fastenal had the highest profit and operating margin among leading competitors in the industry (see Exhibit 5). The company's major competitors included W. W. Grainger Inc., MSC Industrial Direct Co., and HD Supply, Inc. All other companies were fragmented in the industry. Fastenal had four times as many stores as any of its competitors.[30] Fastenal also opened more than 60 new stores every year until the end of 2015 (see Exhibit 4).[31] By the end of 2016, Fastenal had more than 2,500 stores globally, compared to the 598 stores of W. W. Grainger, one of its closest competitors.[32] One of the key reasons for Fastenal's higher profitability was the location of its stores, which were always near the distribution centres. Fastenal's broad market coverage, with more stores than competitors and a completely owned distribution network, including trucks and other logistics-related supplies, gave Fastenal a competitive advantage. The capital required for such a distribution network deterred other players from competing (see Exhibit 2).[33]

FAST—DISRUPTIVE INNOVATION

In 2008, Fastenal launched its industrial vending system, Fastenal Automated Supply Technology (FAST), with huge success. The Fastenal vending system was an Internet-connected appliance integrated with vending technology, installed at the client's end.

Fastenal provided two versions of the vending machine: FAST 3000 and FAST 5000. These machines had similar functions, but FAST 3000 was physically smaller.[34] The vending machine's integrated video management display resembled that of any snack vending machine, although the machine's software was more complicated. The cloud-based software recorded every transaction, allowing a client's employees access to materials depending on their roles and needs.[35] Employees needed to swipe their identification card or enter an access code to withdraw an item from the vending machine. The vending machine's software allowed a manager to track all stock outflows and the employees taking the stock, which helped to prevent misuse of supplies. When the vending machine ran low on certain items, Fastenal's local store received an automatic notification so that a Fastenal employee could fill the machine, thereby eliminating the cost of stockouts and paper work.[36]

Fastenal's industrial vending service was beneficial for both a client's employees and the client itself. Employees were able to retrieve products themselves, which was especially useful for those working night shift; normally they would have to wait for a supervisor on the next day. As a result, employees could ensure timely maintenance work. The client was able to save costs by closely monitoring inventory and having replenishment orders placed automatically.[37] The automated vending machines helped Fastenal clients reduce their supply consumption by 40–50 per cent.[38]

The vending machines were not standardized; they were customized for each company, usually based on the client's industry type. Thus, a vending machine for a client in the plastic industry was different from a machine for a client in the construction industry. Fastenal searched for industry-specific information to select supply items, 50 per cent of which would usually be safety-related, such as safety glasses or gloves. The remaining supplies included MRO items, such as duct tape, batteries, or utility blades.[39] For items that were heavy and could not fit in the regular vending machines, such as hard hats, power tools, or aerosol cans, Fastenal provided its clients with FAST Auto Lockers, which gave controlled access to employees for these heavy items.[40]

The entire industrial vending system was supported by a network of employees, including a local sales force, machine re-stockers, and regional sales support, which involved fleets of vans to deliver machines and trained FAST specialists to give hands-on demonstrations to Fastenal's industrial clients. Fastenal also had a national distribution and transportation system.