

# Make Your Dealers Your Partners

by Donald V. Fites

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**A** decade ago, many observers predicted that Caterpillar would join the long list of U.S. corporations that had fallen to the Japanese. Doomsayers on Wall Street, at business schools, and in the press focused particularly on the rivalry between Caterpillar and Komatsu. With Komatsu boasting tremendous cost advantages (as much as 40% in some product lines) and excellent products, they accepted as a foregone conclusion that Komatsu would fulfill its vow to “encircle Cat” and become the dominant producer in our industry.

Like many predictions, this one fell short. Despite determined efforts by Komatsu, Hitachi, Kobelco, and others, our overall share of the world market for construction and mining equipment is the highest in our history. We have maintained our strong position in Japan through Shin Caterpillar Mitsubishi, our 33-year-old joint venture with Mitsubishi Heavy Industries. And after suffering some fearsome losses in 5 of the 11 years from 1982 through 1992, we have rebounded financially with record profits and a return on equity in the mid to high thirties.

I’m often asked how Caterpillar rose to the challenge. Several factors played a part. They include the tremendous value of our brand name; the excellent quality of our products; the high resale value of our machines; a reorganization of the corporation to push decision making down into the organization to make the company flatter, leaner, and more responsive to customers’ needs; big investments to revamp and streamline manufacturing operations, resulting in the most competitive factories in our industry; more frequent and timely new-product introductions; a heightened focus on costs; and the weakening of the dollar relative to the yen.

But the biggest reason for Caterpillar's success has been our system of distribution and product support and the close customer relationships it fosters. Don't get me wrong: We think we are better engineers and manufacturers than our competitors. But we are convinced that our single greatest advantage over our competition was and still is our system of distribution and product support. The backbone of that system is our 186 independent dealers around the world who sell and service our machines and diesel engines. They have played a pivotal role in helping us build and maintain close relationships with customers and gain insights into how we can improve our products and services to better fill customers' needs.

Many features of Caterpillar's distribution system are tailored to meet the unique characteristics of our industry. For instance, our industry's sales volume is relatively low: Global sales of earthmoving equipment average 200,000 to 300,000 units per year. A relatively small number of dealers sell those machines. Even though we might customize some features, such as the operator's cab or the paint job, the same standard product can be sold throughout the world. The machines are expensive, but they stay in service for 10 to 12 years on average; many operate for 20 to 30 years. And finally, because these products operate in extremely tough environments, even the best-made, most durable machines wear out and have parts that must be rebuilt or replaced, which requires an organization that can service products quickly to minimize downtime.

Nevertheless, I believe the tight working relationships we have forged with our independent dealers to meet our customers' needs hold lessons for other manufacturers of relatively standard big-ticket products that require after-sales service and support. The lessons include the following:

## Independent dealers know more about their customers' needs than Caterpillar ever could.

- Local dealers who are long-established members of their communities can get closer to customers than a global company can on its own; but to tap the full potential of such dealers, a company must forge extremely close ties with them and integrate them into its critical business systems. When treated in this way, dealers can serve as sources of market information and intelligence, as proxies for customers, as consultants, and as problem solvers. Indeed, our dealers play a vital role in almost every aspect of our business, including product design and delivery, service and field support, and the management of replacement-part inventories.

- Dealers can be much more than a channel to customers. They can play an important role in providing customers with a wide range of services before and after the sale. Those services include advice on the selection and application of a product, financing, insurance, operator training, maintenance and repair, and help in deciding when it makes economic sense to replace a machine.
- Creating an outstanding distribution organization requires significant investments by both the company and its independent dealers. Although those investments take the usual forms of money and capital assets, they also include softer assets such as training and developing a common understanding of what it takes to provide superior customer service.
- The quality of the relationship between a company and its dealers is much more important than the contractual agreements or the techniques and tactics that make the relationship work on the surface. What matters is mutual trust, and that is fostered by observing a few simple rules: Share gain as well as pain; strive for continuity in relationships and consistency in policies; and communicate constantly. For a company that relies on independent dealers to present one face to its customers around the world, it must have uniform practices and performance standards for dealers and treat them all with equal consideration while recognizing that they are independent and unique in many ways.
- When a company is deciding which new products to add to its line, it should consider two key factors: First, which new product contenders best fit its distribution system, and second, whether the distribution system will add value to the product in the eyes of the end user.

In most manufacturing industries, distribution and product support remain underappreciated strategic assets. That situation will soon change because the global winners over the next 10 to 20 years are going to be the companies with the best distribution organizations that also provide superb customer support. Engineering excellence, manufacturing efficiency, and quality are rapidly becoming givens; everyone is going to need them to be a player. Indeed, most companies deficient in those areas have already disappeared.

Although many Japanese companies had the early advantage in manufacturing excellence, U.S. companies may have the edge this time around. Why? Because they know more about distribution than anyone else. Whether we're talking about financial services or servicing products, U.S. companies have a real strength in service. So this is a revolution they can really capitalize on if they

treat distribution as if it were as integral to their businesses as product design and manufacturing. That's one reason I feel very bullish about my own company. We know how to do it. We have already built true partnerships with our dealers.

Quite frankly, distribution traditionally has not been a strength of Japanese companies. Marketing people and salespeople historically have been looked down upon in Japanese society. I saw that firsthand when I lived there in the 1970s. We worked diligently with Mitsubishi Heavy Industries, our joint venture partner, to help them understand the importance that we placed on the distribution side of our business. At the time, a sales position just didn't have the same status in the social or company hierarchy as an engineering or accounting position. I think that feeling still prevails in many Japanese companies.

Many companies do not put a great deal of emphasis on after-sales service. One possible reason for that in Japan is that the automobile and consumer electronics industries (and many others) strive to make their products so well that they don't require parts or service. That approach, however, just doesn't work in our business, where machines are subjected to intense use. Caterpillar's approach to product design and support recognizes this fact. A critical design criterion for our machines is that they can be repaired economically and conveniently. And our highly integrated manufacturing and distribution systems are designed so that we can replace a part in any machine anywhere in the world within 48 hours. In the vast majority of cases, our dealers can provide the replacement part on the spot. Our competitors cannot match that kind of consistent performance; it is not unusual for one of their customers to have to wait four or five days for a part.

One possible reason for the disparity is that few companies have integrated their dealers into their business systems to the degree we have. Everyone in the business world talks about the importance of the trust that exists between Japanese manufacturers and their suppliers. But, in our industry, I don't see that same level of trust in their relationships with their distributors.

It is not uncommon for our competitors to bypass their distributors and sell directly to the customer if they think a deal is important enough. We'd sooner cut off our right arm than do that. Caterpillar sells directly to customers only in the newly opened markets of formerly socialist countries and to original-equipment manufacturers and the U.S. government. And in almost all those cases, our dealers, not the company, provide the after-sales service and support.

# We'd sooner cut off our right arm than sell directly to customers and bypass our dealers.

Over the years, people have said to me, “Isn’t it expensive to have all those independent dealers? Couldn’t you make more money if you distributed and serviced Caterpillar machines yourself?” I have always answered that the knowledge of the local market and the close relations with customers that our dealers provide are worth every penny. Our independent dealer in Novi, Michigan, or in Bangkok, Thailand, knows so much more about the requirements of customers in those locations than a huge corporation like Caterpillar could. Our dealers tend to be prominent business leaders in their service territories who are deeply involved in community activities and who are committed to living in the area. Their reputations and long-term relationships are important because selling our products is a personal business. As a result, Caterpillar never appears as a remote presence or as the overseas branch of a foreign multinational. (Two-thirds of our dealerships are located outside North America, and the vast majority are privately held companies.)

After a product leaves our door, the dealers take over. They are the ones on the front line. They’re the ones who live with a product for its lifetime. They’re the ones the customers see. Although we offer financing and insurance, they arrange those deals for the customers. They’re out there making sure that when a machine is delivered, it’s in the condition it’s supposed to be in. They’re out there training a customer’s operators. They service a product frequently throughout its life, carefully monitoring a machine’s health and scheduling repairs to prevent costly downtime.

The customer, the end user, knows that there is a \$16 billion-plus company called Caterpillar. But the dealer creates the image of a company that doesn’t just stand behind its products but *with* its products anywhere in the world. Our dealers are the reason that our motto—Buy the Iron, Get the Company—is not an empty slogan.

A piece of construction equipment or a heavy-duty engine is a major capital asset, and owners want a healthy return on their investment. Many of our customers will pay a premium for machines they can count on. For example, high in the mountains on the Indonesian province of Irian Jaya, Freeport-McMoRan operates one of the largest copper and gold mines in the world, 24 hours a day, 365 days a year. At an altitude of more than 13,000 feet, the mine is accessible only by aerial cableway or helicopter, and the ore is slurried through pipelines to loading docks along the coast.

The operation relies on more than 500 pieces of Caterpillar mining and construction equipment—a total investment worth several hundred million dollars—including loaders, track-type tractors, and mammoth 240-ton, 2,000-plus-horsepower trucks. Many of these machines cost well over \$1 million apiece. The mine also depends on Caterpillar diesel-engine generators as its sole source of electric power. If this equipment breaks down for any length of time, the company doesn't move ore. When that happens, it loses money, and fast.

At the other end of the spectrum, the stakes are also high for the small-business owner or independent contractor whose livelihood depends on a \$50,000, 79-horsepower backhoe loader. If that machine doesn't function, work doesn't get done, deadlines are missed, related tasks have to be rescheduled, customers and subcontractors get angry, reputations are affected, opportunities open up for competitors, and money is lost.

To put it succinctly, our mission is to convince customers that our company and our distribution organization are the best ones to keep their equipment running in top condition. They have to believe that thanks to the way we design, manufacture, and service our machines, they will have a higher percentage of uptime than they would with a competitor's product; thus they can reduce costs and make more money than they could using another company's equipment.

Obviously, Caterpillar bears great responsibility for designing and manufacturing equipment that is durable and easily repaired, and over the past decade, we have greatly improved our equipment in this regard. We have made our systems more modular so that when, for example, a transmission needs to be serviced or repaired, it can be removed much more quickly than before. And to speed the process further, it often will be replaced with a new or remanufactured exchange transmission from a dealer's parts inventory.

Caterpillar also has developed the fastest and most comprehensive parts-delivery system in any industry that I'm aware of. Although we have long guaranteed delivery of any part anywhere in the world within 48 hours, our dealers now provide more than 80% of the parts a customer wants immediately. And Caterpillar ships more than 99% of the parts that a dealer does not have on hand the same day the order is placed. Compare that to the automobile industry, in which the average wait for a part that a dealer does not have in stock is likely to be from two to seven days. Moreover, we have maintained this performance during a period—the last ten years—when the number of parts

that we service has more than doubled because of explosive growth in our product line. In the past five years alone, we have completely revamped our product line; in 1995, we introduced 49 new models, more than twice the number we introduced in 1991.

We maintain 22 parts facilities around the world, with more than 10 million square feet of warehouse storage. We service 480,000 line items (different part numbers), of which we stock 320,000. (Caterpillar's and its suppliers' factories make the remaining 160,000 on demand.) We ship 84,000 items per day, or about one per second every day of the year.

In addition, our dealers, each of whom typically stocks between 40,000 and 50,000 line items, have made huge investments in parts inventories, warehouses, fleets of trucks, service bays, diagnostic and service equipment, sophisticated information technology, and highly trained people. Indeed, our dealers, whose investments in their individual businesses range from \$10 million to more than \$100 million, collectively surpass our might. Their combined net worth is about \$5 billion, or about 1.5 times Caterpillar's stockholders' equity. They collectively employ 73,600 people, about 19,000 more than Caterpillar. And while their average revenues are about \$150 million, several dealers have annual revenues in the neighborhood of \$1 billion.

It is somewhat misleading, however, to talk about "us" and "them," because we genuinely treat our system and theirs as one. Our joint distribution operations are all linked by a worldwide computer network. I can turn to the computer on my desk and find out how many machines in the world are waiting for a part. On this particular day, it's about 1,300, which is pretty good considering that there are hundreds of thousands of Caterpillar machines out there.

But we aren't resting on our laurels. We are now putting in place an information system that will permit us to deliver a part *before* a customer even realizes that he or she needs it. The system will monitor machines remotely and notify the local dealer when a part is beginning to show signs of an impending failure so that we can arrange to replace it before it fails. (See the insert "Making Global Connections at Caterpillar.")

We are putting in place a system to deliver parts *before* customers realize they need them.

## **Making Global Connections at Caterpillar by: Steven E. Prokesch**

Imagine the following scenario. A part on a Caterpillar machine operating at a copper mine in Chile begins to deteriorate. A district center that continuously monitors the health of all the Caterpillar machines in its area by remotely reading the sensors on each machine automatically spots a problem in the making and sends an electronic alert to the local dealer's field technician through his portable computer. The message tells him the identity and location of the machine and sends his computer the data that sparked the alert and its diagnosis. Then, with the aid of the computer, the technician validates the diagnosis and determines the service or repair required, the cost of labor and parts, and the risks of not performing the work.

The technician's computer also tells him exactly which parts and tools he will need to make the repair. Then, with a touch of a key, the technician ties into Caterpillar's worldwide information system, which links dealers, Caterpillar's parts-distribution facilities, Cat's and its suppliers' factories, and large customers' inventory systems. He instantly determines the best sources of the parts and the times when each source can deliver them to the dealer's drop-off point.

Next, the technician sends a proposal to the customer by computer or phone, and the customer tells him the best time to carry out the repair. With a few more keystrokes, the technician orders the parts. The electronic order instantly goes to the factories or warehouses that can supply the parts in time. At the factories

Significantly, Caterpillar does not view its distribution system as a one-way channel from the factory to the customer. Rather, information about the customer constantly feeds back into the system and drives new product development and enhancements in service.

For example, a dealer advisory group recently helped us fine-tune the design of a new line of motor graders under development. It pointed out that if the graders were manufactured according to the original design, people would get mud on their pants when reaching for a toolbox; moreover, operators taller than six feet two would hit their heads when they stood up if the side panel was raised to service or repair the machine. In response, we changed the location of the toolbox and redesigned the panel so that it opens sideways.

We also work with dealers to survey every purchaser of a Cat machine at least three times during the first two years after the sale. In addition, we survey customers about delivery of parts and service. (We send out nearly 90,000 surveys each year and get a response rate of about 40%.) The data is enormously useful both to the company and to dealers because it enables us to refine our targets and strive for constant improvement along a variety of dimensions. For example, the survey results helped persuade



and warehouses, the message triggers the printing of an order ticket and perhaps automatically sets into motion an automated crane that retrieves the parts from a storage rack. Soon the parts are on their way to the dealer's pick-up site.

Within hours of the initial alert, the technician is repairing the machine. An interactive manual on his computer guides him, providing him with the latest best-practice procedures for carrying out the repair. The repair completed, the technician closes the work order, prints out an invoice, collects by credit card, and electronically updates the machine's history. That information is added to Caterpillar's databases, which helps the company spot any common problems that a particular model might have and thereby continually improve its machines' designs.

Sound like science fiction? It isn't. Caterpillar hopes to have such a system capable of monitoring all its machines around the world within several years. Most of the pieces are already in place: the sensors in the machines; computers that diagnose problems and instruct technicians in how to make repairs; and the information system that ties together Caterpillar's factories, distribution centers, dealers, and large customers. The system currently links some 1,000 locations across 23 time zones and 160 countries.

Only two pieces are missing: the remote monitoring system and the worldwide sharing of inventories by Caterpillar and its dealers and suppliers. But even those pieces are within reach, Caterpillar executives say. Indeed, Cat is already testing a prototype of the monitoring system.

some dealers to change their inventory practices to ensure that they always had the full range of batteries and fan belts on hand.

We also involve dealers and customers in programs on product quality, cost reduction, and other manufacturing issues. Our Partners in Quality program, for example, links personnel at a factory responsible for building a particular machine with people at selected high-volume dealerships. They meet quarterly to discuss quality issues. In addition, those dealers audit each machine they receive from the plant, and if there's something wrong, they feed that information back to the plant immediately. The idea is to catch problems as early as we can—ideally, before they become problems the customer sees.

For example, one dealer discovered that hoses in a new model of motor grader had been installed incorrectly. When the dealer alerted the factory in Decatur, Illinois, we retrained the assembler, fixed the machines still in the factory, and notified other dealers to fix the machines that we had already shipped, thus correcting the problem before any machines had gone to customers. Similarly, our dealer in Thailand felt that a pump in a new line of hydraulic excavators was not durable enough for the rigors to which it was being subjected in that part of the world. The

The global information system is a critical part of Caterpillar's drive to expand its industry-leading position by minimizing the downtime and cost of operating and servicing its machines. The system promises to help Caterpillar and its dealers do an even better job of heading off major machine failures. For example, it will help a dealer spot and repair a transmission before it has been ruined and needs to be totally replaced.

Another obvious advantage is that by treating their inventories as one, Caterpillar and its suppliers, dealers, and customers will be able to slash their combined inventories significantly. (Caterpillar and its dealers currently have a total of about \$2 billion worth of parts in their inventories.) Even bigger savings could flow from reductions in the time that technicians require to diagnose and repair machines. "The amount of time that will be saved is probably in the range of 20% to 30%," says James W. Baldwin, vice president of the Parts and Service Support Division. "When you consider that field service workers are billed out at \$20 to \$50 an hour, that's a significant savings."

With Caterpillar's models proliferating and becoming more complex, and with business outside the United States accounting for more than half its sales, the company believes that its ambitious information system is a necessity, not a luxury. "It is as important for the mechanic at a dealership in New Delhi to be able to walk over to his interactive computer screen and get the information on how to service a new model as it is for a mechanic at a dealership in San Francisco," says Donald V. Fites, Caterpillar's chairman.

dealer persuaded us to use a different pump on the machines until we could redesign the one in question.

Besides helping us manufacture better products, our dealer network also generates extraordinary and timely market intelligence. It's a rich source of information that enables us to introduce new products and support services successfully. We were especially thankful for that network when we introduced the D9L track-type tractor in the early 1980s.

The D9L, a machine weighing well over 100,000 pounds, is used primarily in mining and heavy construction. It was one of our first tractors to utilize a new design: an elevated sprocket that alters the shape of the track undercarriage from a traditional oval to a triangle. The new design achieves a variety of objectives: improved traction, reduced stress on the undercarriage and other fast-wearing parts, easier and faster repairs, and improved productivity. Accordingly, we priced the machine above competitors' tractors that had more traditional designs.

We began shipping the D9L in 1981. Our timing was hardly great. The U.S. mining industry was in the doldrums. To make matters worse, Komatsu had recently entered the U.S. market with aggressive pricing and a particular focus on

Adds Baldwin: “We’re spending in excess of \$250 million on the system, and that does not include our dealers’ investments. That is a lot of money for our competitors to try to match. Will they be able to copy our system eventually? Sure, it’s possible, but it will take them considerable time. And we’ll continue to move ahead, making it tough for them to catch up.”

mining customers; it was also trying to penetrate the Middle East, another major opportunity for the D9L.

In mid-1982, when we had several hundred machines operating throughout the world, a potential disaster struck. As the machines approached 2,500 hours of operation, they began to fail. It turned out that a variety of parts—ranging from undercarriage components to water

pumps to fan drives—were not as durable as we had thought. Our dealers quickly identified and reported the problems, and within weeks after the first machines had failed, we realized that we were facing a major crisis. The reputation of the D9L, customers’ acceptance of the new design, and our leadership in the large-tractor business were at stake.

Our dealers then helped us create and implement a comprehensive program for repairing machines, replacing the culprit parts in machines that had not yet failed, and assuring unhappy customers that we were on top of the problem. For instance, several dealers, including Whayne Supply, based in Louisville, Kentucky, and Bowmaker (now Finning) in the United Kingdom, assigned some of their mechanics to serve on SWAT teams that repaired the machines quickly—often during the night. Bowmaker dispatched teams of mechanics to assist Zahid, our dealer in Saudi Arabia. And Whayne quickly provided extraordinary service that prevented some important mining customers in Kentucky and southern Indiana from bolting to competitors.

By mid-1983, just a year after we had first learned of the problems, virtually all the D9Ls had been repaired. The result: We minimized downtime, customer dissatisfaction evaporated, the D9L turned into a popular product, and the elevated-sprocket tractor gave us an overwhelming advantage.

Even if Caterpillar is not the first to market with a product, our dealer network allows the company to be a fast follower. For instance, our distribution system made it possible for us to become one of the leading players in backhoe loaders, a business we entered in the mid 1980s. A backhoe loader is a small tractor with a hydraulic boom and excavation bucket mounted on the rear of the vehicle, and

a loader bucket in front. Like hydraulic excavators, the machines are versatile and used for many different kinds of work. They are especially popular with building-construction and utility contractors, who were not our traditional customers.

After a rocky start, we have established a strong sales position, surging past several entrenched competitors to capture the number two position in the worldwide industry. It was not just our product but also our dealers that made those gains possible. Not only did they invest in inventories of replacement parts needed to support the new product, they also invested sizable sums in rental fleets when it became clear that many small contractors preferred to rent, rather than buy, the machines. In addition, they aggressively added salespeople to call on these smaller customers, with whom we hadn't traditionally had much contact.

On the other hand, we are careful not to misuse our distribution system. We don't design and manufacture something and then think about distribution; instead, we consider it a critical part of our value equation. Because we understand the competitive advantage provided by our dealers, the first questions we always ask when considering which new products to add are, How else can we leverage our distribution system around the world, and can our system add value? If the answer to the latter is yes, then customers, dealers, and Caterpillar will all benefit. That's why we got into truck engines and the big 6,000-kilowatt generator sets. And that's one of the reasons we recently entered the agricultural equipment business with our rubber-belted Challenger series of tractors.

When considering which new products to add, we always ask how we can leverage our distribution system.

We haven't changed; the agricultural equipment business has, and now it fits our distribution organization. Thirty or 40 years ago, manufacturers needed a mom-and-pop dealership in every town to compete. That is no longer true. The farmers out there today are sophisticated businesspeople. They don't care whether there's a dealer in their home-town; they'll buy from centers within 150 miles of their farms when they can get products of superior technology and the high level of service and parts support that our dealers offer. And so we see a real growth opportunity in agricultural equipment.

Highway-truck engines provide another case in point. Although we sell these engines directly to original-equipment manufacturers, our dealers invest time and money to influence truck owners to ask for Cat engines. That makes sense for all involved because parts-and-service support for our engines is conducted by or channeled through Caterpillar dealers. Once again, our distribution system adds value and the end user benefits.

We have good relationships with dealers not just because they like us but because the investment is good for them and for Caterpillar, and because both parties work to strengthen the relationship. Both parties invest heavily in maintaining a relationship built on trust, confidence, and shared interests and rewards. The rules don't change, so everyone knows what to expect of one another. We expect our dealers to be industry leaders, to provide the best customer support, and to demonstrate leadership in their communities. And they expect the highest-value products and services from us.

I hear a lot of talk about trust between manufacturers and their suppliers and distributors, but few companies really put the talk into practice. The kind of trust that exists between Caterpillar and its dealers is something that could be built up only over generations. Our dealership agreements are documents that run just a few pages. They have no expiration date, and either party can terminate without cause on 90 days' notice. But turnover is rare because we recognize that we're in this together. The final decision either to terminate or to appoint any dealer in the world rests with the CEO of this company; no one else at Caterpillar can make that decision.

The foundation of our relationship is that both sides profit from their respective investments in the distribution system. Our dealers are entrepreneurs who know how to make money. They also know very well that Caterpillar is much more than just a good account—we are a valuable long-term business associate.

Our tight relationships are based on a handful of principles and practices. They include the following:

**We don't gouge our dealers.** When times get tough, many companies turn on their dealers to prop up their own profits. Similarly, when a particularly lucrative opportunity presents itself, many companies will try to grab all the riches for themselves. We won't bypass our dealers for short-term gain or turn on them to avoid short-term pain.

We won't bypass our dealers in good times for short-term gain or turn on them in bad times to avoid short-term pain.

During the 1970s, when the Alaskan pipeline was built, the pipeline consortium demanded that we sell directly to them or else they would buy from our competitors. We refused. In the end, the consortium did buy our equipment—from a joint venture between our Alaskan dealer and a Missouri dealer with a proven record of performance serving pipeline customers.

Even more telling are the sacrifices we made to keep our distribution organization financially viable during the 1980s and during an industry slump in the early 1990s. Caterpillar's challenges during the 1980s stemmed from the collective impact of several trends. The energy shock that followed the Iranian revolution triggered a deep global recession that affected customers in every part of the world; unit sales in the industry dropped about 40% around the world in one year. Japanese and European competitors aggressively targeted North America. Compounding Caterpillar's difficulties, our costs were too high, the value of the dollar began to soar, especially against the yen, and competitors were establishing higher standards for manufacturing and product development processes. We had work to do.

But it wasn't our dealers' fault that we were not more competitive. We didn't want them to bear the brunt of our problems, so we decided to shoulder most of the burden. Strategically, that was the right thing to do, but it was painful. For three straight years—1982, 1983, and 1984—we lost about a million dollars a day, or \$953 million in total. But I don't think we lost a single dealer around the world.

We weren't being altruistic. We needed our dealers to defend our market leadership. We understood that if we let Komatsu or any other competitor erode our position in the United States, Europe, Asia, or anywhere else, it would cost us five times as much to get it back as it would to defend it. That is the difference between taking a long-term view of business and taking a short-term view.

Our approach was vindicated when the industry recovered. For example, every one of our five dealers in Mexico survived that terrible period. Our competitors' dealers struggled and many failed. When the good times returned, we were the only ones with a viable dealer organization in Mexico,

and we got the vast majority of the business and still have it.

We have continued to operate in the same way. We again protected our dealers when our markets slumped in the early 1990s. In the United States, for example, our dealers remained financially sound throughout the recession and were able to order machines in advance of the upturn in late 1993. In contrast, many of our competitors' dealers went out of business or were financially zapped during the slump and could not get the financing they needed to buy machines.

**We give our dealers extraordinary support.** On the face of it, much of the support that we offer dealers may not sound unusual. Like other manufacturers, Caterpillar helps its dealers finance purchases by customers. It supports dealers in inventory management and control, logistics, equipment management, and maintenance programs. For example, we have long supplied our dealers with sophisticated software that incorporates some of the best practices in those areas. The company also publishes a huge volume of technical material each year and underwrites technical training and support for dealers' personnel in such areas as managing quality, continuous improvement, benchmarking, cost management, and communications. And we are prepared to respond to any need for training that a dealer identifies, whether it be in planning, forecasting, information systems, marketing and advertising, or other business functions.

We also give our dealers wholehearted support when one of our competitors zeroes in on a territory and tries to create a beachhead by offering dramatically low prices. Sometimes that means helping our dealer meet the competition by offering lower prices. At other times, it means helping the dealer fight back with a marketing campaign emphasizing that a Cat machine's lifetime cost is much lower than a competitor's. In still other situations, it might mean helping the dealer cut costs.

**We ensure that our dealerships are well run.** Every year, we review all our dealers' performance—in terms of sales, market position, service capability, organizational structure, and plans for ownership and management continuity—to establish the areas that each dealer needs to work on during the next year. In addition, finance people in each of our sales regions review the dealerships' financials with their principals on a semiannual basis.

When we see particular dealers not performing well, we jump in and help them. We take poor performance seriously—we want dealers to succeed. We'll show a dealer how his or her financial and operating ratios stack up against those of comparable dealers, because generally it's something internal that makes one less profitable than another—such as sloppy inventory management, not enough servicepeople, or too much overhead. We will help him or her develop programs to improve the operation's profitability.

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Although it is a rare occurrence, the hardest situation is when the problem really is the owner's poor leadership. Even in those cases, we won't sit on the sidelines. We try to find a solution that the owner can accept. Maybe it's bringing in a new partner. Maybe it's giving a son or daughter a chance. Maybe it's hiring an outsider to run the business until someone else in the family is ready. Whatever the solution, we will not simply watch while a dealership declines.

**We communicate fully, frequently, and honestly.** There are no secrets between our dealers and us. We have the financial statements and key operating data of every dealer in the world. Dealers wouldn't give us that information if they didn't trust us. In addition, virtually all Caterpillar and dealer employees have real-time access to continually updated databases of service information, sales trends and forecasts, customer satisfaction surveys, and other critical data.

As you would with all valuable business associates, we take pains to keep the dealers fully informed about the key issues facing the company. Top-level Caterpillar managers meet annually with key people from the dealerships at regional conferences, where we discuss our sales goals for each product line and what each party has to do to achieve them. In addition, we periodically invite all 186 dealers to a weeklong conference in Peoria for a comprehensive review of strategy, product plans, and marketing policies.

There is also a lot of routine contact between people at the dealerships and people at all levels of Caterpillar. At lower levels, there is daily communication. But it's also not unusual for dealers' principals and senior corporate staff to speak several times a week. In the last five years in particular,



we have made a conscious effort to increase the exposure of people in our organization to dealers. Our reorganization in 1990 from functional groups into profit centers greatly increased our contacts with dealers. Virtually everyone from the youngest design engineer to the CEO now has contact with somebody in our dealer organizations. We recognize the tremendous value of the market knowledge that our dealers gain from being on the front lines every day with our customers.

**We believe strong business relationships are personal.** It would be easy for an outside observer to assume that the structures we have created—the annual conferences, the strategy meeting, the profit centers, and the dealer advisory councils—are the backbone of the relationship with our dealers. But the form is the easy part. What caused the deep relationships to develop are the close personal ties that have been nurtured. Those ties form a kind of family relationship.

When I see Chappy Chapman, a retired executive vice president who was my boss for a long time, out on the golf course, he always asks about particular dealers or about their children, who may be running the business now. And every time I see those dealers, they inquire, “How’s Chappy?” That’s the sort of relationship we have.

Dealers can call me or any senior corporate officer at any time, and they do. Virtually any dealer in the world is free to walk in my door. I’ll know how much money he made last year and his market position. And I’ll know what is happening in his family. I consider the majority of dealers personal friends. Of course, one reason I know the dealers so well is that I rose through our distribution organization. But my predecessors, who had a variety of backgrounds, understood the importance of distribution, too.

I’m not reluctant to tell dealers what I think they’re doing wrong. And they are not reluctant to tell us where we are lacking.

Don’t get me wrong. There’s no dealer worshiping around here. I say they’re personal friends, but I’m not reluctant to tell them what I think they’re doing wrong in their service territories. And they are not reluctant to tell us where we are lacking. If you’re unsure of each other, you can’t have that kind of honest give-and-take.

**We strive to keep dealerships in the family.** Continuity reinforces mutual trust, limits disputes, encourages sharing of information, and generates larger gains for everyone. To that end, we prefer to work with privately held enterprises, which typically enjoy longer-term management continuity than public companies.

The CEO's tenure at many public companies is five or six years at most. That is not long enough for us. As I noted, the average life span of a piece of construction equipment is 10 to 12 years, and many machines operate for 20 to 30 years. In addition, many of our customers are privately held concerns that value long-term personal relationships.

On average, our dealerships have remained in the hands of the same family or company for more than 50 years. Some of these relationships, including many overseas, predate the 1925 merger that created Caterpillar. And, with rare exceptions, these dealers derive 90% or more of their revenue from selling and supporting our products; for many, it's 100%. From the company's early years, we have believed that an individual with most of his or her wealth tied up in a Caterpillar dealership is going to do a better job than somebody who has little or nothing at risk.

We actively help dealers keep the business in the family. For example, when the principal of a privately held dealership is about 50 years old, we hold seminars for the family on tax issues and succession planning—both financial and management. These seminars are held two or three times during the principal's active working life to ensure that the next generation is ready.

We also take proactive steps to try to interest children of dealership owners in the business. We recently held a conference in Peoria that was attended by 20 to 25 sons and daughters, who ranged in age from 15 to 23. The idea was to introduce them to Caterpillar, to get them interested in the business, and to allow them to meet their peers. We took them to the plants. We let them operate machines. And we talked to them about what we expect of dealer principals.

We also encourage owners to involve their kids in their dealerships from an early age. We help owners orchestrate a range of summer jobs and then full-time jobs when their children graduate from college. We might suggest that a dealer have a son or daughter work as a parts salesperson for

two years, then run the engine business, and next be put in charge of product support. In that way, when the principals are ready to retire, we have seen enough of their children to know what they can do and which ones are capable of taking over the business.

We also strive for management continuity at the small number of Caterpillar dealerships owned by public companies. For example, we encourage their boards to establish long CEO tenures, and we push them to take succession planning seriously. • • •

Of course, our relationships with our dealers are not perfect. The boundaries of service territories, product and pricing policies, and our preference that dealers shun diversification can be sources of friction. But we think we are better than most companies at resolving such conflicts. That's because of our mutual interests and the respect Caterpillar managers and dealers hold for one another. It is also because of our emotional commitment to the business and to one another.

I have worked for Caterpillar for 39 years and have held jobs all over the world. I love the equipment we sell. I feel great when I'm out on a construction job watching our equipment work. It's real. You can be proud of it. It looks good. It performs well. If you look around at the highway system you drive on, the water that flows into your home, the electricity that is supplying you with power, chances are our equipment made it possible somewhere along the way. Plenty of Caterpillar managers and dealers share my feelings.

I'm not so naïve as to think that people would invest their fortunes in a dealership if they did not believe they were going to get an attractive return. But I think there's more to it than that. What people understand about being a Caterpillar dealer is that it transcends the financial reward. There's a camaraderie among our dealers around the world that really makes it more than just a financial arrangement. They feel that what they're doing is good for the world because they are part of an organization that makes, sells, and tends to the machines that make the world work.

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