QDI Strategies

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20/20 Vision for Marketing Breakthroughs

Will Your Channels Fail You -

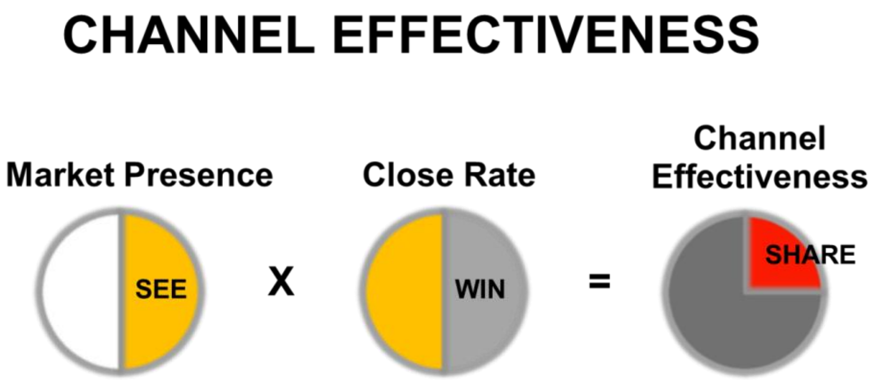
Given the Changing Channel Landscape and Impact of Technology?

By Steve Bassill

For over 20 years Mr. Bassill has helped companies develop channel strategies that build market power in changing market landscapes.

Learn how to assess your **CHANNEL EFFECTIVENESS** – as they become technology solutions providers and marketers

For you to meet your three and five year business objectives, your distribution channels must be able to do their part of the job. They have to see enough market opportunity and present your products and services often enough (MARKET PRESENCE), and win often enough (CLOSE RATE) to meet your sales objectives. Their performance is your "Channel Effectiveness." The more effective your channels, the greater your share will be of your addressed market.



If your channels cannot or will not do what is necessary to meet your business objectives, you have to make a change. However, changes in channel strategy are among the most difficult business decisions for managers to make and execute. The reasons for this are many, but can be classified into two categories – risk and conflict.

RISK

First, the need to make a change is often not obvious. Markets are not homogeneous. Thus, changes happen at different times to different market segments.

Second, the urgency for a change is not apparent. The sky is not falling. Generally, sales are still growing and profits are acceptable.

Third, the "right" decision is often not apparent. How well will the new channel strategy work? What will we lose by implementing it? Will the gain be great enough to offset the loss?

Any combination of these factors can lead to channel paralysis. No one in your organization sees a great enough reason to change to take on the challenge of change.

CONFLICT

First, when you make changes in your distribution, you can be sure someone will be unhappy. You will either upset the existing distributors or customers who have to change the way they buy because you changed the way you sell. Additionally, some of these channels many have been developed a long time ago by the company's most senior executives. Changes may upset these executives.

Second, your sales force hates managing change. As one sales manager said when he had to implement a channel change, "I'm scared to death, but I know we have to do it."

Often, the change creates a conflict situation where the sales manager has to work with both the old and the new channels that see themselves as competitors.

Third, the organization will nearly have to reinvent itself to effectively serve a new channel. In one case, a company moving from traditional wholesalers to mass merchandisers had to make the following changes to even have a chance at success:

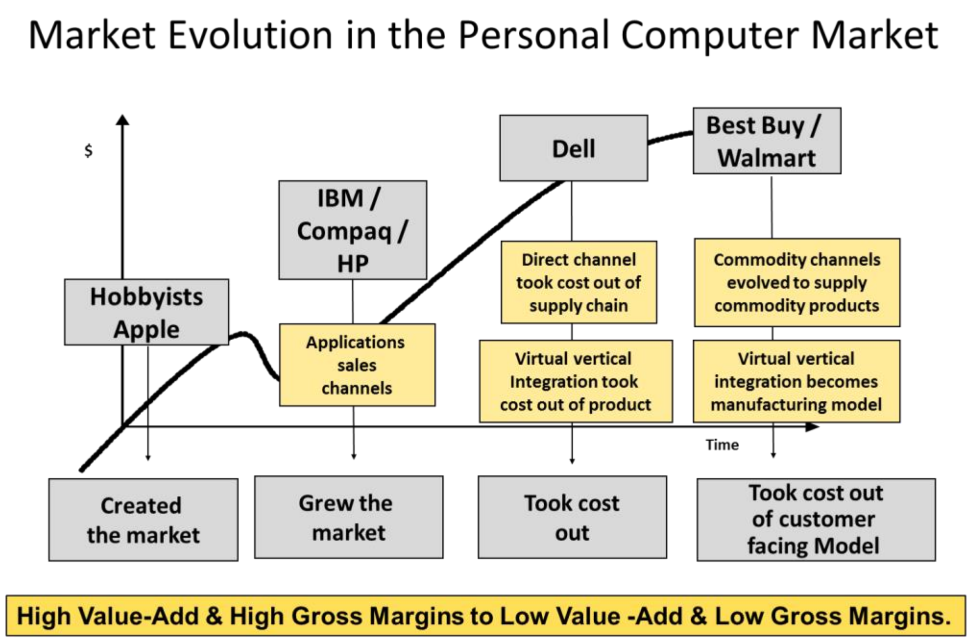
- Change the pallet size
- Establish EDI capability
- Reduce the pallet's stacking height
- Build a store level support organization
- Change measurements and compensation levels, etc.

Finally, even organizations that see the need for change often don't have the stomach for the fight. The top executives in these organizations have to be ready for the battle. There will be many obstacles to overcome when making a channel change, both externally and internally. The top executives should expect to face daily conflict. The battle will be difficult. The temptations to back off the change will be great. Staying the course takes courageous leaders.

Regardless of the risk and conflict, at some point in time, this is a decision all executives have to face. In fact, the executives who face the decision sooner, rather than later, are the ones who ultimately are the big winners.

CHANGNING REASONS FOR CHANGE

The historic reason channel changes are required is well known. Markets evolve, the customers know more and more about how to buy, use and support the product. As a result, the channels' roles have to change. As shown in the exhibit on the next page, historic change is an evolution from high value add and high gross margins to low value add and low gross margins.



The historic problem for managers is that their channel organizations have not evolved with the market. While the market may require a low value added channel, or a high value added channel in the event new technologies are brought to the market, the average distributor, sales representative or retailer does not change. Instead, they find other things to sell which require the same type of selling they always did.

The result is that your product line, if still in those channels, will start to lose market share. Since markets do not all change at the same time, it may be hard to determine that a fundamental shift is taking place in the market. You lose share gradually, not all at once. Thus, it is difficult to determine that a change is really necessary.

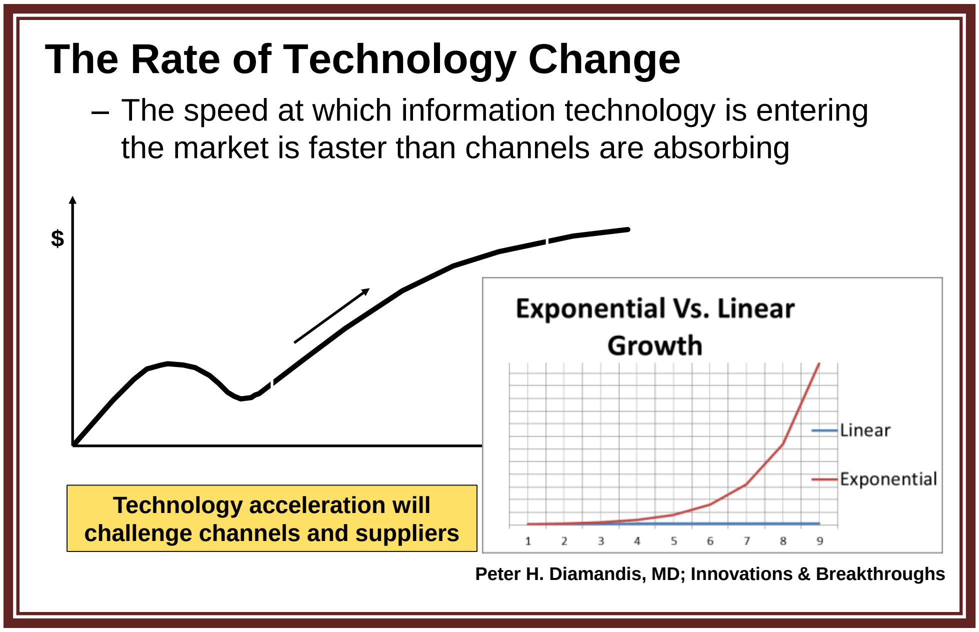
Twenty-First Century Challenges

Two twenty-first century evolutions TECHNOLOGY and DISTRIBUTION ROLE are creating new levels of complication for channel managers.

Technology is playing out in three dimensions within distribution.

1. Information technology: This has been evolving since the days of the mini-computers in the 70's and accelerating with PC's and now smart-phones and tablets. New developments have made it possible to completely computerize inventory and logistics management increasing inventory turns and reducing

inventory investments. The old marketing adage of "filling the distributor's shelves so he will sell your product" is outdated and self-defeating. Information technology also increases the flow of information between manufacturers and distributors, distributors and customers, resulting in streamlined logistics flows that enable every member of the supply chain to profit from less inventory.



2. Web-technology: The internet and now the cloud have exploded the ability to interact electronically. The net effect is that it makes it easier for customers to connect directly with manufacturers. Does that mean that the value of the distributor as a source of information would be eroded? Certainly that would be an effect, but this access to information has also resulted into customers being less willing to spend time talking to manufacturers or distributors. Some manufacturers worry that the internet is basically turning everything into commodities.

   Customers may simply be saying "don't waste my time. Tell us only what impacts our businesses." Thus distributors who bring their customers more services and are willing to spend more time helping them solve problems are moving closer to the customers. The web has displaced the old manufacturer-to-distributor-to-customer flow of spec sheets and opened new opportunities for the manufacturer, distributor, and customer to share information in new ways.

3. Product technology: Smart connected products comprise the third layer of technology which is providing information about product status and use to improve productivity and product life. Because we now have the data that allows us to talk about the specific performance of individual products, such as

the number of cycles a valve or positioner has opened, we can make maintenance recommendations based on these measured values rather than industry averages. The result is that these smart products will have a large impact on customer value by enabling customers to extend product life or catch problems before failure, while creating new linkages between customers and suppliers to manage this information. The impact on distribution is that now the channels must understand software, diagnostics, wireless networks, communications protocols and how to get information out of the system.

The difference between the market evolution of the 21st century and that of the computer market of the last century is that technology is making existing product categories smarter in addition to creating new product categories. So where the 20th century technology explosion created new channels to bring the technology to market, the technology explosions of the 21st century are affecting the existing channels and forcing change at a rate they are not used to and possibly resistant to.

While technology is forcing changes in the fabric of distribution, distribution has changed dramatically to react to the demands of its customers. Simply put, distributors are on a migration from a “sales role” to a “service role.” **Historically, distributors were viewed as “resellers for manufacturers.” However, over the last 40 years they have morphed into “service agents” for their customers.**

Both manufacturers and distributors are consolidating. Manufacturers are growing the breadth of their product offerings by acquiring other manufacturers. Distributors are expanding their market coverage, both geographically and in terms of service capabilities as they acquire other distributors. All this is in reaction to the customers’ push for higher value from their suppliers. Customers are looking to reduce cost and streamline operations; resulting in more outsourcing of functions they consider low value. To do this they are increasingly leveraging their suppliers’ technical and logistical capabilities.

Distributors, who are often closer to their customers, both geographically and relationally, are leading the way by expanding the services they provide and capturing the additional margins from these services. For example Hamilton Avnet an electronics distributor offers the following logistics services:

- Consulting
- Planning
- Warehousing
- Transportation
- Postponement (moving differentiation closer to customer – by having distributors do sub-assembly / customization work)
- Programming services

Each of these services is helping their customers take cost out of their business and at the same time making Hamilton Avnet a more valuable partner to the customer. As this trend continues, distributors like Hamilton Avnet will develop stronger relationships with their customers than their suppliers have with the same customers.

These changes in the distributors' business model from "manufacturer reseller" to "customer service partner" create both threats and opportunities for manufacturers. Seeing this trend and reacting to it become the challenges for today's manufacturers.

Some Managers Make the Change and Others Wait Too Long

What separates the companies that are the leaders in channel change from the followers? Discussion with executives who have made these difficult decisions determined that there is only once reason to make a channel change.

- Their existing channel strategy (structure/ organization) would not deliver their three or five year business objectives.

QDI has helped many clients create breakthrough channel strategies by helping clients answer three sets of questions that lead to channel strategy decisions.

1. The first set of questions asks a company to assess its channels' effectiveness and how that will change over the planning period.

2. The second set of questions asks a company to identify what it plans to do to assure the channels' performance.

3. The final set of questions asks the company to assess the marketplace to determine how changes in the end-user market will change the distribution channels structure.

The questions are similar to "peeling more and more layers off the onion." The first layer is your best projection of channel performance and why you believe channels will perform as you project in the future. The second set of questions asks you to identify what you will do to assure the channels perform as you projected. The third set of questions asks you to look at the end-user market to potentially challenge your first set of assumptions about channel effectiveness. As you move through the question sets, you are forced to collect more and more market-based information to validate or refute your beliefs.

QDI Strategies' Channel Assessment Questions

Explicitly answer these questions in enough detail to validate or refute your mental model of your existing channel structure and strategy. This will provide you with the insight necessary to move your channel strategy into the 21st century.

Market Presence:

- How much of the market do you see for your product and how often do you win with your product today?
- Where do you expect to be in 3 to 5 years?
    - What will be the size of the addressed market (the market size for the products/ services you sell today)?
    - What % of the market will you see – present your products to?
    - Have the influencers and decision markers changed?
    - Will this change over the planning period?

Close Rate:

- What are your channels doing today to build their close rate capabilities?
    - What organizational / structural changes are they making to increase the value of their offerings?
    - What investments in training and incentives are they making to increase their close rates?
- In five years:
    - What will be the channel's close rate – what % of the time will you win the sale?
    - What portion of your channel's sales will come from solutions selling related to your products? How do you expect this to change over the next five years?
    - Will yours be the only product line they sell that requires solutions selling?
    - Will you be providing enough revenue and profit to justify this sales effort?

Distributor Roles

- What roles will the distributor play in marketing your product in the future?
  - Has their role changed because of their customer service relationships?
  - Has their role changed because of the adoption or marketing of new technologies?
- What percent of sales and profits will your product account for within the distributor's business? If you expect it to increased or decreased, explain.
  - Have you projected growth in channel effectiveness that is different from the historic trend?
- What is the growth in the number of channel outlets you expect to have in 3-5 years – in the total sales volume of your channels?
  - What have your channels had to do, what investments have they had to make, to meet your revenue targets?
- Have you projected that your product line will become a larger portion of your channels' sales, a smaller portion, or the same over the planning period?
- How has the channel structure changed over the past five years and how do you expect it to change in the next five years?
  - What channel members are growing or shrinking?
  - How is your position in these channels changing?

Channel Support

- What will you do to assure the performance of those channels?
  - What will you do to assure you maintain the level of effectiveness you projected?
  - What product line changes, if any, will you make to assure your product line addresses enough of the market to meet your objectives?
  - What will you be doing to grow the market for your products – such as more applications – more end-user segments?
  - What will you be doing to help your channels effectively migrate to solutions sellers of the "smart products" you will be marketing?
- Will your present channels be capable and motivated to market the products you introduce?

Growth:

- How much do you expect the market to grow per year over the next 3-5 years?
- What did you do to grow it?
    - Will this change over the planning period?
- What is the growth rate of your sales through your channel organizations?
- How do you expect market behavior and structure to change over the planning period?

- Which segments comprise the bulk of the market in five years? How will they buy? What channels will they use? Who will be involved in the purchasing process? What decision criteria will they use? How is this changing? What impact does this have on your channel's effectiveness?

If you can't paint this picture of what your channel structure and channel performance is going to look like 3-5 years out and if you can't be confident that your channels will meet your growth objectives, you have some tough decisions ahead.

Channel decisions are difficult to make. The easiest decision is to remain the same. This is a trap. When you put a frog into a kettle of water and gradually increase the temperature. The frog doesn't try to get out until it is too weak to do so. When you drop a frog into boiling water, he jumps out. This is the trap for distribution.

Market changes are gradual. As a result, the need for channel changes is gradual. Before you know it, you don't have the strength to make the necessary changes to compete effectively.

What's the solution? Regularly assess your channel's ability to deliver your objectives. Make channel effectiveness assessments a regular part of your planning process. Ask yourself, "Is your bonus at risk?" If it is, then it's time to make a channel change. Don't let your channels fail you because you failed to make the tough decisions.

If you want to learn more about the challenges facing channel marketers today, or if you want to learn how QDI Strategies can help you, contact us at the number below.

Where Clients Ask QDI for Help	
New Products / New Markets	Develop market insight to <u>speed</u> launch and ramp-up while <u>reducing the risks</u>
Channel Issues	Provide <u>clarity</u> regarding conflict, performance, and go-to-market options
Share Growth	Discover market drivers and determine <u>strategy opportunities</u>

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