Frank Lynn & Associates, Inc.

Value-Measure-Communicate-Reward
Align Channel Management
with Channel Compensation

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How do you motivate distributors to upgrade their capabilities and invest in your line? So many times we hear manufacturers complain that their distributors are not earning their discount. "Why are we paying so much to our distributors when it seems that all they do is take orders?" If this complaint sounds familiar, then it is time for you to reevaluate the way that you deal with your resellers.

Our goal is to add structure and accountability to channel programs that historically relied solely on volume-based relationships. If distributors keep bringing in the volume —even with a lack of growth — manufacturers tend to overlook all sins. If manufacturers manage distributors solely based on volume or growth, they have no basis for evaluating the distributor's performance if they do not meet their growth or volume objectives.

Utilizing a four-step process, a structured approach to channel management identifies the activities a distributor should perform and then evaluates the distributor's behavior in light of those activities.

Value
The first step in this channel management process is for the manufacturer to determine what it values. We think about values from two perspectives — the manufacturer's and the end-user customer's.

What sets of activities do your end-user customers value from your distributors? If, for example, your customers value local inventory, a well-trained sales force, electronic order processing and warranty support, then suppliers must evaluate their resellers on performing these activities.

Similarly, a supplier must establish its own values in dealing with distributors. Distributors can behave in ways that are either very expensive or very efficient. A supplier must articulate, in a structured way, the behavior that takes costs out of the supply chain. For example, a supplier might value electronic ordering, point-of-sale information, pallet item quantities and weekly orders. The supplier must evaluate its distributors on the extent to which they perform in relation to these values. Once a supplier identifies its values, from both an internal and the customer's perspective, it has taken the first step toward a structured channel management program.

Measure
Identifying values is generally the easiest part of the process. The most difficult element is measuring the channel's performance. However, it is critical if you want to upgrade the distributor's skill set and investment in your line.

Suppliers typically rely on the easiest indicators of performance — volume and growth. These outcomes are easy to measure because we always have access to sales volume and growth rates on our distributors. More difficult to measure are the activities that lead to success in the market. For example, exactly how much inventory should the distributor stock? How many salespeople are required in the distributor's market area? Do we measure performance at the local distributor-branch level or at the company-wide level? What about distributors with distribution centers versus distributors that take orders directly into their branches? If you do not measure distributor performance, effective channel management is impossible.

Distributors measure their suppliers. Most large, sophisticated distributors formally evaluate their suppliers on elements such as fill rate, invoice quality and on-time delivery. These evaluations clearly put the distributor in a leveraged position with the manufacturer when negotiating.

Communicate
Once values are identified and performance is measured, the next step is to communicate performance to the channel. Behavior can be changed through clearly articulated, ongoing communication. The airlines do an effective job of communicating their values through frequent flier statements — we know how many miles we earned and how many we need.

Similarly, an effective way to communicate with distributors is through a report card. The report card approach offers a formal, structured method for providing objective data relative to the distributor's performance and is a critical element for upgrading distributor behavior.

By issuing report cards, manufacturers communicate on three levels. First, from an internal perspective, the report card is a common language for the manufacturer's management team when referring to the distributor. Second, the report card is an effective tool for the manufacturer's sales force that calls on distributors. It clearly identifies what the distributor needs to work on and provides a communication mechanism for the field. Third, the report card speaks directly to distributors and informs them about their performance in relation to the manufacturer's and customer's values.

Reward
Behavior can be changed through the value-measure-communicate approach. If the manufacturer knows what it values, measures performance and communicates that performance, over time the distributor might comply. To accelerate the process or to get increased focus from the distributors, the manufacturer should provide rewards or incentives for high-level performance. There are three primary methods for rewarding distributors: recognition, price and support.

The least expensive reward is simply recognition of the distributor. Recognition goes a long way toward reinforcing the manufacturer's values.

Recognize top performers for reaching the highest level. Hand out plaques at the annual distributor meeting or "Top 20" cruise. Provide a "medallion" for top-tier performers. The medallion is a feather in the distributor's cap and is displayed with pride. Distributors can use the medallion in their marketing efforts to differentiate themselves from their competitors. It keeps the distributor focused on the critical values and creates an incentive for those who did not earn the medallion to upgrade their performance.

A second, more powerful incentive is financial compensation. For distributors, this means activity-based discounts or rebates. The most common example of activity-based compensation is the manufacturer's payment terms. If a distributor pays within 10 days, it gets a 2% discount (reward) for performing the valued activity. If the distributor advertises, it gets paid in the form of co-op advertising dollars. These are traditional rewards. More and more frequently we find manufacturers rewarding for less conventional activities.

One of our clients recently offered an approximate 1% discount to its distributors if the majority of the distributor's sales force completed the manufacturer's training program. The response to the incentive was phenomenal. We expect that over 500 distributor salespeople will complete the manufacturer's training program within the first 12 months. Without the 1% reward, a much smaller fraction of distributor salespeople would have completed the training.

Rewards do not always have to be price-based. Returning to the airline example, frequent flyers are not rewarded with lower-priced airfares. Rather, frequent flyers earn preferential treatment, better seating and free trips. Similarly, manufacturers can compensate distributors with non-financial benefits such as enhanced marketing programs, quick turnaround on orders, lower training costs or more sales support. These non-price rewards reinforce the valued behavior and take the focus off of price.

Manufacturers in mature markets are faced with the challenge of motivating distributors that may have been operating in the same fashion for many years. To take market share in this environment, manufacturers must have distributors that are motivated and committed to their line.

An effective way to achieve this motivation is through a structured approach that values, measures, communicates and rewards behaviors that lead to success.