CHANNEL PRICING STRATEGY

ARE YOU LEAVING MONEY ON THE TABLE?

Frank Lynn & Associates, Inc.®

MARKET STRATEGY CONSULTANTS

FRANK LYNN & ASSOCIATES is the leading market strategy firm specializing in growing market share, reducing marketing costs, marketing new technologies and developing channel strategies.

We believe that one of the roles of a consulting firm is to advance knowledge in its field. This booklet is designed to keep business management abreast of our current thinking in go-to-market strategies.

The transition from concept to practical application can be difficult, but Frank Lynn & Associates works closely with its clients to master sophisticated management techniques and analytical tools.

We welcome your comments and questions regarding the issues we have raised in this booklet. It is this type of dialogue that continues to advance the field of market strategy.

HOW MUCH ARE YOU SPENDING ON YOUR CHANNEL PRICING SYSTEM?

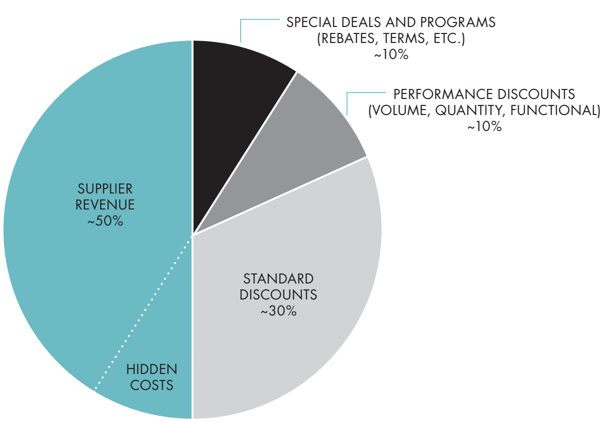
Volume Discounts…Functional Discounts… Growth Incentives…Rebates…Spiffs…Commissions… Trade Funds…Co-op Funds…Special Deals… Promotional Allowances…Markdowns…Loyalty Plans…

The compensation you provide to your channel partners is one of your company's largest costs. As such, it requires rigorous, critical and frequent review.

Channel pricing represents the entire array of prices, discounts, incentives and other benefits that sellers provide to motivate and compensate channel partners. When considered in total, these programs often exceed a seller's total net revenue. Suppliers can materially affect their financial performance by optimizing the deployment of these programs and funds.

In addition, suppliers incur significant hidden costs when these programs are not managed effectively. Hidden costs include sales force time negotiating special deals, excessive customer service or technical support calls, inventory overages or shortages, slow-paying accounts, and invoice deductions, errors and disputes.

TYPICAL CHANNEL PRICING COSTS



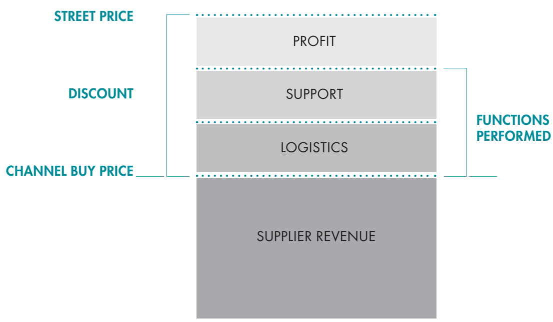
WHAT IS THE PURPOSE OF THE CHANNEL PRICING SYSTEM?

The channel pricing system serves two primary purposes:

- To compensate channel partners for functions performed
- To motivate channel behavior

Channel partners earn a profit through efficient operations.

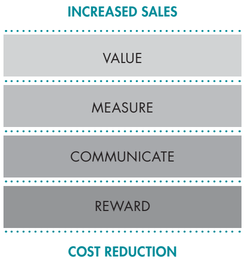
DISCOUNTS COMPENSATE FOR FUNCTIONS PERFORMED



An effective system motivates channel partners to sell more and reduce supply chain costs in alignment with the supplier's objectives.

A supplier must determine its value, measure channel performance, communicate results and reward appropriate behavior.

VMCR TO MOTIVATE BEHAVIOR



WHAT MAJOR MISTAKES DO SUPPLIERS COMMONLY MAKE IN THEIR CHANNEL PRICING SYSTEMS?

For a variety of reasons, suppliers fall victim to channel pricing mistakes that consume valuable resources and reduce marketing effectiveness.

Some of the most common channel pricing mistakes are:

- "Training" channel partners to wait for end-of-period special deals
- Allowing large volume resellers to significantly undercut high-support channels
- Not aligning pricing programs across multiple channels
- Overlooking non-price benefits that can be used to motivate channel behavior
- Sticking with a program after it is clear that the market has changed
- Allowing pricing spreads between channel partners that encourage gray market activity
- Not aligning the brand, channel, sales and pricing strategies
- Not enforcing program policies, terms and conditions

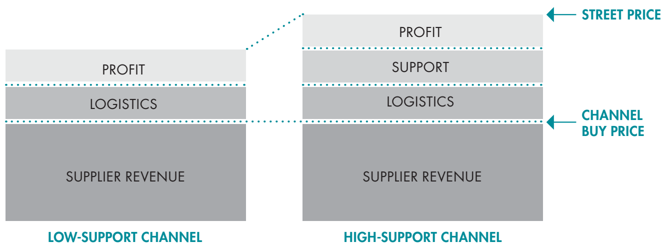
SHOULD A SUPPLIER USE ITS PRICING STRUCTURE TO MANAGE CHANNEL CONFLICT?

A supplier should use functional (activity-based) discounts to protect a high-support channel under the following circumstances:

- A significant portion of the customer base requires the high-support services
- A low-support channel emerges and drives down street price in the market

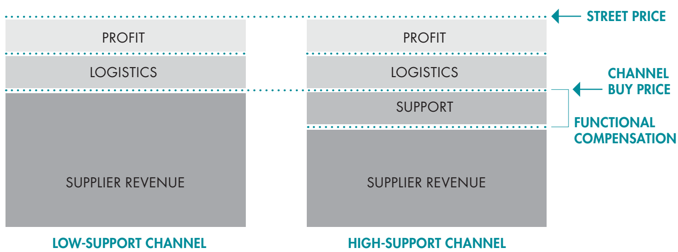
Do not use functional discounts to subsidize inefficient channel partners.

LOW-SUPPORT CHANNEL DRIVES DOWN STREET PRICE



Shouldn't the end user pay more for high support?
Yes, but it does not always work in practice. The low-support channel often sets the street price, and the market does not accept higher pricing or unbundling of the high-support service. In the absence of a functional discount program, high-support services will disappear.

FUNCTIONAL DISCOUNTS CAN LEVEL THE PLAYING FIELD



HOW CAN SUPPLIERS DISCOURAGE CHANNEL PARTNERS FROM CHERRY PICKING THEIR LINE?

Suppliers can use channel pricing to leverage their market power and to motivate loyalty if:

- The supplier has a unique, high-demand offering
- The supplier has a broad line and represents a significant share of the channel partner's overall business

Under these circumstances, a supplier should use rebates, discounts and pricing policies as offensive tools against weaker or single-line competitors.

Types of loyalty incentives:

- Exclusivity discounts
- Full-line rebates
- Lead-line programs
- Share-of-account incentives
- Situation-specific plans
- Frequent-buyer programs

These programs will help to keep channel partners focused on your brand.

SHOULD SUPPLIERS USE VOLUME DISCOUNTS TO REWARD LARGE BUYERS?

Volume discounts of any kind (annual, per order, etc.) may result in negative, unintended consequences. In many cases, they may also violate antitrust laws. However, volume discounts are standard practice in many industries and are sometimes required to "meet competition," but beware of the negative behavior they can create.

Order quantity discounts require manual intervention by the channel to configure orders to the supplier's needs. They also change the channel's purchase price with each order, which is something most channels despise. They also cause billing errors and credit disputes.

Other volume discounts do not reflect market demand; they increase the channel's inventory costs and result in lower channel resale margins. They can cause excessive forward buying and "gray marketing," often resulting in a reduction in the street price of your product.

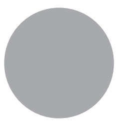
QUANTITY DISCOUNT PROGRAM

SHOULD COMPANIES OFFER COMMISSIONS, REBATES, DISCOUNTS OR PAY FEES-FOR-SERVICE?

Yes, commissions, rebates, discounts or fees are important tools for motivating partners.

However, each tool has a specific use.

DEGREE OF SUPPLIER CONTROL



COMMISSIONS
HIGH

- Use commissions to take the business direct and pay the channel for functions performed

REBATES
MEDIUM/HIGH

- Use rebates when the channel controls the business but you require proof-of-performance

FEES
MEDIUM

- Use fees to outsource functions to the channel

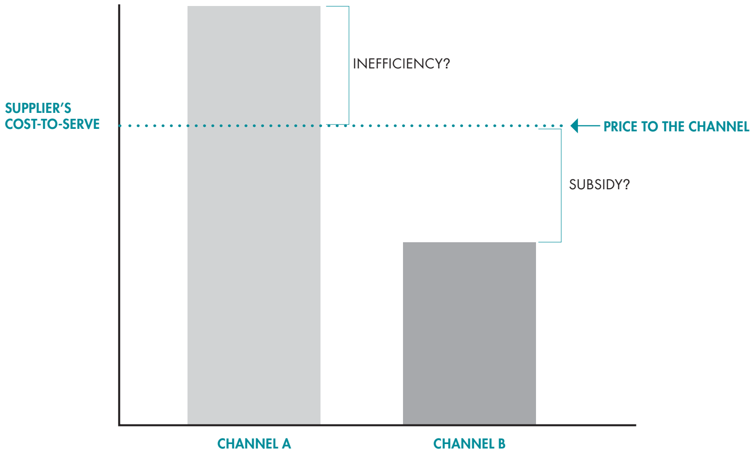
DISCOUNTS
LOW

- Use discounts to remain competitive and effectively motivate desired channel behavior

SHOULD SUPPLIERS INCREASE DISCOUNTS WHEN ITS COSTS TO SUPPORT A CHANNEL ARE LESS?

Yes, in general, suppliers should provide incentives for channel partners to behave in ways that reduce supply chain costs. For example, prompt payment terms lower financing costs; electronic order incentives lower order-processing costs. Look for other costs that you can lower by motivating channel behavior with discounts, rebates or fees.

MOTIVATE CHANNELS TO LOWER SUPPLY CHAIN COSTS



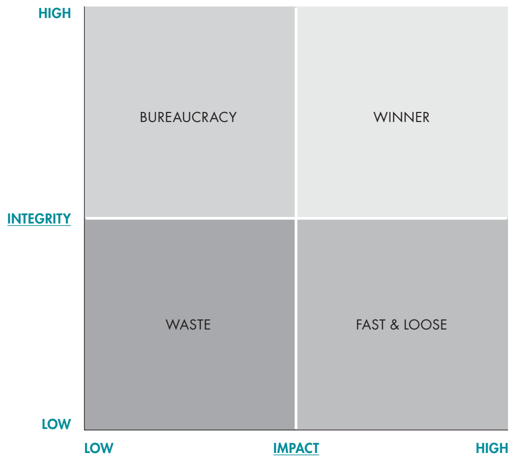
HOW DO YOU KNOW IF YOU ARE LEAVING MONEY ON THE TABLE?

Your channel pricing system is a winner if it leverages your market power and profitably influences channel behavior in a fair and consistent manner. Too often, suppliers get stuck in low-impact programs and are unable to change. Other suppliers generate impact but let profits leak out of their systems by playing fast and loose with rebates, discounts and allowances.

You may be leaving money on the table by paying channel partners for functions or activities that you could perform more efficiently yourself.

Channel pricing is one of your company's greatest costs. You should rigorously review the effectiveness of channel pricing programs on an ongoing basis.

PROGRAM EVALUATION



WHY NOT JUST SELL TO ALL CHANNEL PARTNERS AT THE SAME PRICE?

Actually, this would be an improvement for many suppliers who have let volume discounts, promotional allowances and special deals get out of hand — destroying their market integrity and profitability.

An "equal playing field" sounds great, but only if all channel partners provide equal services. And, they don't! Offering equal prices ignores opportunities that suppliers have to drive channel activities that generate demand, improve loyalty, reduce supply chain costs and manage channel conflict.

For example, you might want to encourage partners to hire more qualified sales or technical personnel, or provide you with customer point-of-sale information. You might want to use discounts or rebates to protect the hard work of value-added partners from last-minute price poachers.

Designing fair, but "unequal" pricing systems creates the motivation that drives channel partners forward.

WHAT ARE THE NEXT STEPS?

After developing a viable channel pricing program, suppliers must continually ensure that this program is consistent with their marketing objectives and the evolving needs of customers and markets. Otherwise, programs simply waste resources or become an entitlement for the channel.

We invite you to meet with our senior consultants in Chicago to discuss:

- The benefits of a revised channel pricing strategy to your business
- Your company's specific business problems or issues
- The application of our diagnostic tools to access your programs' effectiveness

For more information, please see our website www.franklynn.com

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