Communiquè

Channel Compensation – A Channel Management Tool

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With the year just ended many manufacturers[1] are probably asking …

"Are we getting what we pay for from our channel partners?"

Most manufacturers utilize a volume discount structure or growth rebate to motivate their partners to buy more product. And these programs do change the channel's behavior, as many loaded up in December to take advantage of these incentives.

However, this bump to December's sales likely required a steep discount simply to move the volume forward a week or two. Furthermore, the increase in December sales will very likely be followed by lower sales in January, leading management to ask …

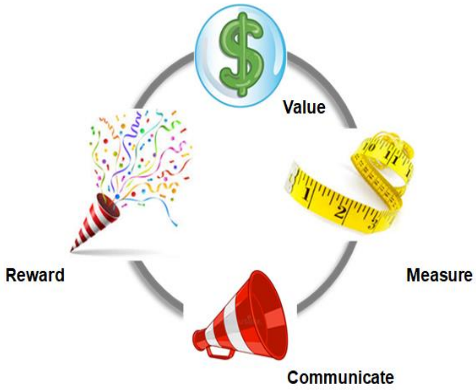
"Why are we providing such large discounts when it seems that many partners aren't really influencing the sale?"

But just as incentives can be used to change a partner's buying behavior, they can also be used to change a partner's selling behavior. Channel compensation, when viewed from this perspective, can serve as a channel management tool to measure your partners on a number of factors. The factors should include the partner's selling, marketing, logistics and technical skills, their willingness to invest in the supplier's brand, and their ability to deliver high levels of customer satisfaction.

VMCR

Frank Lynn & Associates uses a framework called VMCR (VMCR is an acronym for – Value-Measure-Communicate-Reward) to design channel compensation structures that align with our clients' channel management goals. This framework goes beyond volume and growth incentives to define the activities most desired by the manufacturer. The manufacturer can then assess each reseller's performance based on how well the partner performs these activities. With these metrics in mind the manufacturer can then design a reseller compensation structure that rewards the best performing partners, where volume can still be one of the performance measures, but not the only one.

VMCR provides a structured approach to channel compensation design and channel management based on measuring key activities performed by the partners. If manufacturers manage their resellers solely based on volume or growth, they have no basis for evaluating the partner's performance of the functions that CREATE volume and growth.



[1] A note about terminology – throughout this article we refer to manufacturers and suppliers synonymously. The same holds true for partner and reseller (or some people prefer "distributor")

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VALUE
The first step in this channel compensation design approach is determining which partner activities the manufacturer, and the end-customer, value most highly.

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

Similarly, a manufacturer must establish its own values in dealing with channel partners. For example, partners can behave in ways that are either very costly or very efficient for the supplier. A manufacturer must articulate, in a structured way, the behavior that takes costs out of the supply chain. Examples might include electronic ordering, point-of-sale information, pallet item quantities and weekly orders. Manufacturers may also value partner "loyalty," trained sales staff, etc. The manufacturer must evaluate its partners on the extent to which the partners perform in relation to these values. Once a manufacturer identifies its values, from both an internal and the customer's perspective, it has taken the first step toward a structured channel compensation 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 a critical step towards upgrading partner skill sets and their investment in the manufacturer's brand.

Suppliers typically rely on the easiest indicators of performance - volume and growth.
These outcomes are easy to measure because sales volume and growth rates are regularly tracked by the supplier's accounting systems. More difficult to measure are the activities that lead to volume and growth (efficiency and customer satisfaction). For example, how much inventory should a reseller stock? How many salespeople does a reseller need for adequate coverage of a given market area? Furthermore, how should the manufacturer measure performance – for example, should the measurement be at the branch level or at the company-wide level? Also, should the manufacturer measure all partners similarly? For example, should manufacturers evaluate resellers with distribution centers the same way they measure resellers that take orders directly into their branches? If a manufacturer does not measure distributor performance, effective channel management is impossible.

Channel partners measure their suppliers too. What's fair for the goose is fair for the gander. Most large, sophisticated resellers formally evaluate their suppliers on elements such as fill rate, invoice quality, and on-time delivery. These evaluations clearly give resellers some power with the manufacturer when negotiating.

COMMUNICATE
With values identified and performance measured, the next step is communicating performance to the channel. Manufacturers can change behavior 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 to claim a free flight or reach a higher status level.

Similarly, an effective way to communicate with channel partners is through a report card. The report card approach offers a formal, structured method for providing objective data relative to the partner's performance, and the data, in turn, is a critical element for upgrading the partner's 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 channel partners. Second, the report card is an effective tool for the manufacturer's sales force that calls on the partners. It clearly identifies where the partner needs to improve and provides a communication mechanism for the field. Third, the report card speaks directly to partners informing them about their performance relative to the manufacturer's and customers' values.

REWARD
The value-measure-communicate approach can change behavior. If the manufacturer knows what it values, measures performance, and communicates that performance, over time the partner might comply. To guarantee partner performance, accelerate the process or to get increased focus from partners, the manufacturer needs to provide definitive rewards or incentives.

The most powerful form of incentive is financial compensation. For partners, this means activity-based discounts or rebates. The most common example of activity-based compensation is the manufacturer's payment terms. If a reseller pays within 10 days, it gets a 2% discount (reward) for performing the valued activity. If the partner advertises, it gets paid in the form of co-op advertising dollars. These are traditional rewards.

Today, it is common for manufacturers to measure and reward partners based on all the activities that are highly-valued by the end user and the manufacturer. Companies can measure and reward partners for each activity individually, but more often, today's best-in-class channel compensation programs combine activities to define program tiers – the so-called "Gold-Silver-Bronze" approach.

These tiered programs make it easy to align channel management with channel compensation. The tiers allow manufacturers to quickly and clearly communicate the highly-valued activities to the partners. And, compensation is automatically higher for the best performing resellers ("Gold") by either tracking last year's performance or gaining a commitment for the next year.

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Manufacturers do not always have to offer direct financial rewards. 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 partners with non-financial benefits such as enhanced marketing programs, qualified leads, early access to new products or more sales support.

The least expensive reward is simply partner recognition. Recognition goes a long way toward reinforcing the manufacturer's values. Manufacturers can recognize top performers for reaching the highest level or tier and present them with plaques at the annual distributor meeting.

Partners are NOT all equal. Some support a given manufacturer much more than others either because of the partner’s skills and capabilities or out of a sense of loyalty and commitment. A compensation structure that recognizes and rewards these differences not only makes good business sense but are valued by the better resellers. A compensation program that communicates what the supplier values from the channel is an effective channel management tool. The manufacturer’s salesforce can hold a meaningful discussion with each partner regarding which activities the partner must perform to raise its program status and its compensation. The VMCR framework can help suppliers link channel management and channel compensation. The result will be increased end-user satisfaction and increase market share.

If you need to re-evaluate your current channel discount program and/or wish to better align channel compensation with channel management, we can assist you to develop a structured VMCR solution.

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