

o Channel Optimization

Are you giving the channel too much?

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Given the squeeze-play on end-user prices, increased channel competition, and investor demands for steady—if not increasing—earnings, it is hard to believe that many companies have an untapped source of additional profits on current business.

In a recent worldwide channel economics study, Rubicon analyzed industry giants like Microsoft, Symantec, Apple and Macromedia, as well as their top channel partners, and discovered that each, in their own way, was leaving money—profits—on the table. Neither the channel nor the vendor was using their channel investments optimally to bring products to market. The Rubicon study found that the investments many companies make in the channel fail to reverse loss of mindshare or improve returns. Most importantly, the study exposed that channel economics are changing in ways that challenge conventional wisdom.

What kind of impact, you say? We are talking about small changes that make a sizable impact. A dollar saved in the channel is a dollar that flows directly to your bottom line. A \$1 billion+ software company client of Rubicon expects to see earnings jump by \$10 million dollars from optimizing a single point in channel spending. Not bad you think, but follow through on the logic. If the company earns a five percent return, the channel optimization results in a 20% earnings increase, a result welcomed by any investor or analyst.

Here are some insights from our research that you can immediately apply at your company.

o Think holistically

Most companies fail to optimize their channel spending because they fail to view it with enough of a macro perspective. The key is to look at all forms of payment to the channel—not just margin, but direct, indirect and “soft dollar” spending—making sure each component is being used effectively to achieve your goals and not being lost or thrown away.

A proper view of channel economics must, at the very least, include the following expenses and investments towards the channel:

- Discounts (both the amount a vendor “provides” and the amount channel partners keep)
- MDF / Marketing spending
- Rebates / SPIFs
- Headcount placed in the account
- Sales and marketing headcount to manage the channel.

So, why don't companies do this already? The primary reason is that at most companies no single executive controls all these programs, there is no single “eye in the sky”. Some programs may even be part of individual or department performance metrics, meaning that efforts to adjust one at the

expense of another risks igniting an internal turf war between corporate Sales, Marketing and the field. A holistic view is needed to focus on benefits to the entire company.

◦ **Stop focusing on discounts**

One issue vendors get hung up on is the channel discount—that is, the sales margin. If you can move past the rhetoric, however, channel partners care about aggregate profit, not the individual components that contribute to it. In this way, their interests are more aligned with your interests than you might think. Reseller sales reps increasingly are paid on profitability rather than product or vendor margin alone, so it is the overall contribution, not the form of contribution, that your product makes that is most important.

Contribution is the sum of all payments retained by the channel partner. It is important to consider total contribution because at the end of the day, that is what determines reseller profitability and the channel's on-going ability to create and support sales.

	Purchase discount (intended margin)
—	Additional discount given to customers by channel
+	Additional payments and support (MDF, Rebates, etc.)
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	Contribution margin

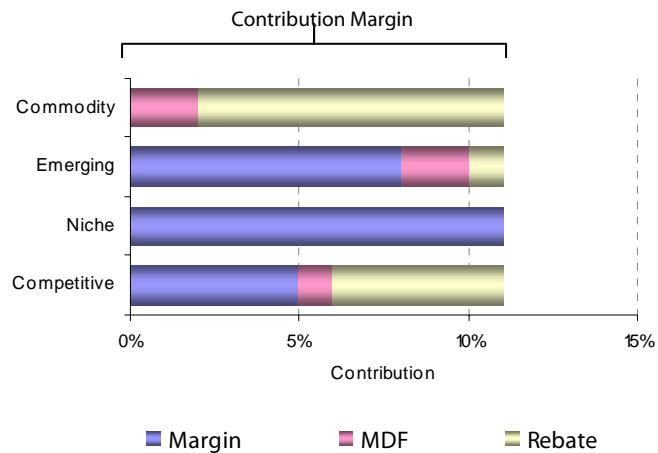
- ⇒ Leave just enough margin on the table to hit your desired street price.
- ⇒ Use soft dollar programs to accomplish your goals.

◦ **Use back end payments wisely**

Competitive sales environments drive resellers to give away margin in the form of additional customer discounts. For example, Symantec offers a 20% discount to the channel on one of its security products, but only 5% of that potential margin is retained by resellers due to the highly competitive nature of the market for that product. In contrast, Microsoft provides only a 10% margin upfront for many of its products, electing instead to invest its resources in back end payments and demand generation.

Research by Rubicon Consulting reveals that channel partners earning the same level of profit contribution can come to these funds in many different ways. The chart below shows normalized data for a single reseller selling four very different products that are representative of our research. From the perspective of the reseller, the profitability of all four products is the same.

Gaining and maintaining reseller mindshare for competitive and commodity products is a challenge when purchase discounts are the primary motivator. Competition drives margins down. Resellers will complain, but there is little you can do. Trying to increase channel margins by deepening their discount is folly because all or most of the increase will be passed along to customers due to the competitive nature of the reseller environment. The customer wins, but you and your channel do not. And, except for the effect—wholly unintended in this case—of price elasticity, customers buying at the lower price are the same ones previously buying it at the higher price.



Not making money selling a product is a problem for the channel, and one that you should care about as it results in less mindshare for your company. You need to find another way to compensate, motivate and reward the channel if the indirect channel is to contribute to your sales model.

⇒ Never offer rebates without tying them to specific metrics. Better yet, tie rebates to over-achievement of your goals. If your company's growth target is 10%, tie rebate awards to 15% growth. The channel benefits and so do you.

◦ Understand reseller capabilities

One of the surprises in our research was how quickly market efficiencies are leveling reseller profitability across all classes of trade and regions. This means that corporate resellers are not more profitable—as many people assume—than other classes of trade, and therefore they do not have the resources to drive the levels of demand generation that you may expect. While corporate resellers focus on selling products they know to their existing accounts, mail order / Internet resellers have evolved into very sophisticated marketing machines that aggressively pursue new customers.

⇒ Use MDF only with resellers capable of doing new customer development. Funding channel switching with your money is throwing money away.

◦ Winning big

The big win is not from simply figuring out how to pay the channel more, but making sure the intended margins and payments reinforce desired behaviors in the channel. Increasing MDF payments for a product that will not benefit from additional advertising will only help to subsidize other products. Offering rebates without the appropriate strings turns them into handouts. The additional payments and support should be contingent upon achieving specific results such as increasing revenue or adding new customers.

◦ What you can do

You need to strategically allocate funds based on a holistic view of the channel.

- If the channel is passing along part of their discount, then you should capture a larger share of the customer price. This directly benefits your bottom line.
- Improve reseller profitability—and mindshare—by providing them with a greater and more stable profit contribution

- Maximize channel motivation and responsiveness by tightly linking rewards with specific and challenging goals. If rebates are needed, by all means offer them, but only to resellers that meet specific goals such as a 25% revenue increase for specific products. If rebates become a handout, they will simply be passed on the customers as additional discounts.
- Use the right tools with the right type of reseller. MDF is most effective with mail order resellers; rebates are important for corporate resellers targeting large accounts.
- Make the customer buying experience better by taking the focus off of price and discounting, and putting it more on service, support and addressing the customer's needs.

Your channel optimization program will need to be tuned to *your* situation based on market dynamics and *your* specific objectives. Just remember to do it with a macro lens and use all your tools effectively.

◦ **About Rubicon Consulting**

Rubicon Consulting partners with leaders who want to grow their high-technology businesses with strategic marketing services. Specializing in go-to-market strategies allows Rubicon to develop marketing programs, channel plans, product positioning, and customer targets. We help clients to design, develop, and implement custom, practical solutions that work. Rubicon Consulting is the brainchild of Nilofer Merchant, a 15-year veteran of delivering marketing strategies for world-class companies including Apple, Autodesk, Adobe, HP, VALinux, and others. The garnered experiences led to the acquisition of knowledge, models and practices. In time, with sufficient insight, we've developed the ability to predict the outcome of actions accurately. We bring an unbiased, wise, practical, and fresh perspective to your business. Call us if you could use this.

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