Optimizing Channel Compensation

Best Practices in Demonstrating Value and Creating Fair Compensation for Channel Partners
RESULTS FROM PREVIOUS CONSORTIA
Optimizing Growth and Market Share
“T’ve attended Texas A&M distribution consortium sessions, and I’ve found them to be among the best, most thought-provoking gatherings I’ve ever experienced in all my years in the distribution business.”

Byron Potter, CEO, Dallas Wholesale Builders Supply

Optimizing Distributor Profitability
“A picture is worth 1,000 words and A&M’s Distributor Profitability Framework chart is worth 100,000 words!”

Ron Cedruly, CFO, Henrietta Building Supplies

Pricing Optimization
“Given the complexity of pricing, Texas A&M’s Pricing Optimization program has gone a long way to specifying all the relevant elements and, more importantly, putting them in terms that can be quantified and managed.”

Lawrence Mohr, Ph.D., Senior Vice President (retired), F.W. Webb Company

Sales and Marketing Optimization
“Womack Machine Supply literally owes much of its success to Texas A&M’s Industrial Distribution program. We have successfully used the university’s consortia and research projects to improve profitability, operations and supply chain management practices.”

Mike Rowlett, CEO, Womack Machine Supply
What Is a Research Consortium?
A Research Consortium is a collaboration of multiple companies, associations, universities or government agencies to conduct research with the objective of developing solutions to a problem or a challenge common to everyone by pooling their resources for achieving a common goal.

Why Join a Research Consortium?
Many times companies cannot afford to invest in some research and development due to high cost and/or lack of knowledge resources required to conduct the research. Research Consortia are an economical path to low-cost, high-quality research and development that is essential to the growth of companies. Consortia also allow for the sharing of best practices and strategies among the cutting-edge organizations that invest in such efforts.

Who Should Join this Research Consortium?
This Research Consortium will be beneficial to:

- Distributors, Manufacturers who go to market through Distributors
- Technology Providers who serve Wholesaler-Distributors and Manufacturers.

What Are the Benefits?
The benefits to consortium members include the opportunity to actively participate in groundbreaking research into one of the most crucial and timely challenges facing the industry. Each member of the consortium will also be able to direct the scope of the research so that the results are actionable and sustainable. Additionally, members of the consortium will have an 18-month head start on competitors in
understanding and implementing the new best practices developed in this consortium as well as a far deeper understanding of the practices from workshops conducted directly on their organizations with the research team. Finally, consortium members will have the opportunity to send up to 10 people from their organizations to one of the two educational programs delivered at Texas A&M University for no cost other than travel expenses during the 2013 sessions. The educational programs will be scheduled following the conclusion of the research.

Deliverables
In addition to the body of knowledge resulting from this research, the following tangible outcomes will include:

• An implementation strategy, tools and methodologies for member firms to optimize their compensation in the channel, specific to each company, based on workshops conducted with their teams
• A one-day workshop at Texas A&M
• A two-day educational seminar aimed at providing firms with knowledge into how they can apply the concepts, tools and techniques identified in the research
• 10 free seats in the above educational program.

Consortium Structure and Fees
The membership fee is $25,000 per company in the consortium. The fee will cover attendance in consortium meetings hosted by the Global Supply Chain Laboratory at Texas A&M University and workshops with member firms to design the research solutions personalized to their needs.
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Overview and Need

Distributors and their manufacturer partners are being asked to bring new value to the supply chain. Customers require new services and innovative products to move to the next level of competitiveness. For manufacturers, these innovative products are experiencing a shorter life cycle. To be efficient, they must create new offerings and get them up the growth curve faster than the competition so that economies of scale can be captured before the product drops to commodity status.

For distributors, the challenge is more complex. They must assist suppliers in new product development through more advanced and targeted market intelligence and spearhead an advanced rapid deployment to get the product to market. This requires an even stronger sales and marketing capability directed at supporting suppliers. Distributors have traditionally spread their sales efforts across many, often competing manufacturers to hold down costs. A focused effort requires new skills and more resources. Customers, meanwhile, are showing less interest in this process and are even pushing back on distributors’ outside sales efforts.

To combat this disturbing trend, distributors are seeking closer customer relationships where distributors’ customer contact personnel are viewed as adding value to customers (consultative selling). Customers, however, continue to put pressure on distributor margins, demonstrating a poor appreciation for the value these new services provide. The result has been an increased need for distributors to seek compensation from suppliers and find new ways to be compensated directly by customers (fee for service). The transition is causing channel disruptions.

Manufacturers who sell through distributors have a great deal at stake. If distributors are unable to make the transition and remain profitable, manufacturers may see the channels consolidate to a few “big boxes” with narrow margins, little to no sales effort on behalf of manufacturers, and a tremendous purchasing power wielded against manufacturers.
The only defense once the distribution channel consolidates would be manufacturer-owned distribution. Besides the many well-documented issues and failures associated with this “captive” distribution model, many manufacturers may be taken out of their core competencies. This inability to focus on new product design, introduction and efficient manufacturing will put many firms at risk. For the distributor, the option to a broken relationship is to create a “captive” manufacturing arm by taking on design responsibility and in-house or outsourced manufacturing. This process could put distributors at risk as they try to manage long supply chains and take them away from their core competencies (customer relationship management).

Those manufacturers and distributors currently using “captive” processes will need to manage their more complex supply chains with the same best practices from this consortium. They will need to balance their supply chains so that distribution or manufacturing processes are not suboptimized beyond gains from the other divisions. In most “captive” environments, the strongest player tends to dominate the weaker one with damaging and sometimes fatal results.

- Determining how service models are changing and how distributors are being compensated for new processes
- Capturing best practices in manufacturer-distributor collaborations when taking new products to market and speeding new product introductions
- Examining and documenting distributor compensation models in terms of traditional product margin (distributor-driven), fee for service (customer-driven), incentive based (manufacturer-driven) and hybrid models
- Determining the role, value and cost of new sales and marketing models
- Documenting best practices in distributor compensation models.

The current distribution model is not being threatened with extinction but rather with rapid change. Manufacturer partners who understand and support positive change will not only help their distributors to succeed, but will also protect their own profitability. Understanding the new environments in a proactive way, rather than responding to change reactively, is more critical now than in the past.

Why Compensation Must Be Addressed
A great deal of pressure is being brought to bear on channel members. Continuous pricing pressure has driven many distributors to seek volume over specialization. Many customers go around distributors to directly negotiate with suppliers, and this puts the entire burden for compensating distributors on suppliers. This volume-driven mentality leads to a lack of focus on new product introductions and service innovations. The process leads to customers calling the shots on services and deciding what and how distributors should be paid.

> Don Schalk, President and COO, C.H. Briggs Company

“Customer stratification has the power to enable us to transform our company from being product-driven to customer-driven. It has helped us understand our customers in greater detail, enabling us to optimize our selling resources, which will result in an improved ROI.”

![Figure 1] The Innovation and Execution Cycle
The innovation process needs careful management throughout the product or service life cycle (see Figure 1). The process begins in the upper left corner with the sales force introducing new offerings to the customer. In the upper right corner the distributor’s and manufacturer’s operations collaborate to create and deliver the offering while the sales and marketing team works on the value proposition. In the lower right, operations optimizes the offering, and sales perfects the value proposition. The final, very important phase is the lower left where the sales and marketing team continues to support the optimized offering and captures superior earnings for the distributor and the supplier.

The process has many opportunities for collaboration and differing compensation levels at each phase. If the distributor is not compensated and is not partnering with the supplier correctly, the distributor will be forced to support those parts of the cycle (lower right and left) where it can do the most volume. The supplier will have to make the first two sectors successful. The process will lead to a weak customer relationship for the distributor and a high cost of new product introductions for the supplier (sales efforts and product failures).

Thus, optimizing channel compensation has a direct impact on aligning three key resources (supplier—distributor—customer) of a supply chain (see Figure 2), which leads to successful and sustainable collaboration in the long term.

[Figure 2] Supplier-Distributor-Customer Alignment

Solution Approach

Best practices will be established and tested for:

- Compensating distributors for new product and service offerings
- Collaboration between manufacturers and distributors protecting profitability for each
- Development of value propositions under rapidly changing service and product offerings
- Documentation of best practices in compensation equity in the supply chain.

Even though many distributors may be somewhat familiar with these concepts and may utilize them to some extent, understanding and implementing a holistic approach to date has been achieved by only a select few. The development of tools that will enhance the scientific decision-making capabilities and implementation procedures of firms will be the primary focus of the consortium. The key project steps include:

- The Texas A&M research team will conduct a survey of current channel compensation strategies across wholesaler-distributor vertical marketing channels and conduct ad hoc research to determine best practices.
- The first consortium meeting will bring together member firms to report initial results, share best practices, engage member firms in the research findings and define final deliverables with counsel from the consortium members.
- Through a series of research workshops with member firms and ad hoc research, the research team will
  - Conduct quantitative and qualitative research to identify the most common compensation practices
  - Conduct quantitative and qualitative research to identify and develop best practices
  - Quantify the impact of these strategies and develop methods to incorporate them into compensation
models that can be driven through robust analysis programs based on data and information routinely absorbed by member firms
- Develop a scientific model to determine the optimum of manufacturer-distributor compensation schemes that drive growth for both
- Develop value proposition tools and processes to capture optimal compensation throughout the innovation – execution process.

• The final consortium meeting will share results and capture final feedback and thoughts from member firms.
• Member firms will receive a final report detailing tools and methodologies based on data and scenarios shared and created in the workshop sessions. These findings are confidential to each member firm.
• Texas A&M University will present two consortium member-only education sessions on Optimizing Channel Compensation to which consortium members will receive 10 free seats.

Consortium Deliverables
Consortium members will participate directly in the research and gain a better understanding of the findings. The full report will be issued to each consortium member with all analysis performed on the firm itself with the firm’s data. Direct recommendations will be made for each individual participant firm on

• Creating and developing value propositions for new products and services
• Delivery methods (sales and marketing) for these constantly evolving value propositions
• Optimal compensation schemes that achieve equitable compensation between supply chain partners
• Analysis methods for demonstrating value
• All tools created to complete the study and analysis for the study.

All consortium member results and data shared with researchers will be kept confidential. Only general findings and best practices will be shared with other consortium members. Distributors will benefit from the research findings and from sharing best practices with other cutting-edge firms in the consortium. Manufacturers will benefit from shared and strategy development study with the distribution community.

Value to Members
The consortium members will receive results, methodology and tools developed during this pioneering research in Optimizing Channel Compensation. The key advantage for distributors and manufacturers will be to gain competitive advantage by implementing the scientific Optimizing Channel Compensation methods and using the tools developed to maximize value propositions. The key advantage to technology companies will be to gain the knowledge base, methods and tools that can be implemented in their systems. Apart from shaping research focus and gaining a valuable knowledge base, methodology and tools, each consortium member will be able to send up to 10 people to two educational sessions that will be developed from this research. The educational sessions alone represent a $20,000 value.

Schedule
June – December, 2011: Membership Enrollment and Consortium Formation
February, 2012: Consortium Kick-off Meeting
March – October, 2012: Conduct Research Workshops
November, 2012 – March, 2013: Research and Develop Tools
April, 2013: Final Consortium Meeting
May – July, 2013: Develop Educational Program
October, 2013: Deliver Educational Programs
In January 2009, the NAW Institute for Distribution Excellence and Texas A&M University’s Industrial Distribution Program launched an alliance dedicated to furthering the understanding and application of best practices in wholesale distribution. In doing so, the NAW Institute and Texas A&M combine the research and brand power of two well-known organizations serving wholesaler-distributors. Together, the NAW Institute and Texas A&M have formed a new entity—the Council for Research on Distributor Best Practices or CRDBP.

The field of wholesale distribution continues to experience dramatic change. Distributors have faced challenges in the form of expanding service offerings, pricing pressure, cost controls, and spiraling logistics costs for many years. For more than 50 years, the NAW Institute for Distribution Excellence has provided cutting-edge research and publications for sharing best practices. As the field of distribution continues to become more competitive, the need for higher levels of research to identify and document new best practices becomes ever greater.

The CRDBP is dedicated to furthering the understanding and application of best practices in wholesale distribution. The mission of the CRDBP is to assist wholesaler-distributors and their suppliers through creating strategies for competitive advantage.

Leaders in Distribution Research: Texas A&M’s Global Supply Chain Laboratory (GSCL) is the nation’s premier distribution research lab. We bring cutting-edge distribution and supply chain research solutions to the industry. The Lab provides total solutions for companies by providing research expertise, project execution support, IT implementation assistance, education and training for end users.
RESULTS FROM PREVIOUS CONSORTIA

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