ON THE MARK
Marketing Consultancy

Understanding your channel's business model

WHY CARE ABOUT YOUR CHANNEL PARTNER'S BOTTOM LINE?

Successful channel partner relationships require much more than just filling their orders as they arrive. In some cases, the level of management attention focused on channel partners should be nearly on par with the level focused on an internal sales force.

Why? Because channel partners represent you; they sell your products to your customers. If your channels partners' sales are down, your sales are down.

Don't just mind your own business

Channels typically sell several companies' products. Imagine trying to sell five or ten times more products than you currently do. It's like trying to raise 20 children–you only have so much time and attention for each. To become your channel partner's favorite child–to help them become enthusiastic experts at selling your products–you must proactively support them. You need to understand their business model, specifically you need to understand:

- How their business operates
- How they make decisions
- How your decisions impact their business

Avoid lose-lose scenario

Let's say you are aggressively using discounts to encourage a channel partner to order larger quantities of your products. You may actually be hurting yourself in the long run by eroding that channel's return on working capital (if their inventory levels are creeping up), and ultimately diminishing their interest in your products.

You may be better served by providing marketing materials or marketing campaigns that help them turn (sell) their inventory of your product. But how would you know that if you didn't have a deep understanding of their business?

In the absence of that deeper understanding, the conversation will invariably fall back to price. They will always want a lower one, which will jeopardize your gross margins. Focusing exclusively on price is a short-sighted, zero-sum game–for you to win, they must lose. It also weakens your ability to manage the strategic direction of your products in the channel, and may ultimately threaten your future with the channel.

WHAT IS A CHANNEL BUSINESS MODEL?

Understanding your channel partners means learning all you can about their business models. A business model is what a business is trying to do and how it plans on doing it. In general, business models include items such as:

The what:

- Financial goals
- Market goals
- Structural goals

The how:

- Strategies and plans for achieving and sustaining profitability
- Operational guidelines for creating customer value
- Administrative processes for managing costs

Typical channel partner goals

Financial metrics tend to be the most important goals to channel partners.

- Gross profit margin (sales minus cost of goods sold) is the primary financial metric for most channel businesses. Others include:
- Working capital efficiency, with particular attention paid to inventory turnover
- Cost control, including identification of fixed and variable costs and calculation of breakeven points (company-wide and sometimes by manufacturer and/or product)

Market goals may include metrics for customer satisfaction, geographic coverage, and market share. And structural goals typically include employee versus sub-contracting, online versus storefront, and franchise versus company-owned ratios.

Typical channel partner strategies and plans

Like any business, channels have a lot of decisions to make, including:

- Which target markets, customer segments, and geographic areas will be most favorable to sell into?
- How much should they enhance or modify the products they sell?
- What level of service must they provide to create customer value?
- What prices and discounts should they set to both meet customer expectations and achieve profitability targets?
- What inventory management policies (regarding purchasing, financing, payment terms, storage, shipping, and return activities) should they implement to help optimize inventory turnover?
- Which pre-sales, transaction, and post-sales processes will help maintain customer satisfaction and meet expense targets? How much online versus storefront business should be targeted?

Whether explicitly documented or simply in management's heads, strategies and plans are developed to answer the above questions and drive the operational focus of the business.

THE DISCOVERY PROCESS

First, focus on your channel partner's primary goal: financial metrics. In discovery, your ultimate goal is to understand the channel partner's entire revenue and expense structure so you can offer ideas for improving various aspects of their business.

But don't try to do everything all at once; it's best to start small. Begin by focusing on how your products are currently affecting their gross margins and inventory turnover. Request the following basic information:

- Targeted average gross margins
- Actual average gross margins
- Targeted inventory turnover goals (if available)
- Actual inventory turnover (or the following two inputs which will allow you to calculate it)
- Cost of sales per month
- Average daily inventory levels per month

Company-wide versus product-specific

Ideally, the above information would be provided for both the entire company and for your products in particular; then you can determine the impact of your products on their overall business.

If product-level data is not available, estimate it based on reasonable assumptions. Develop the assumptions in consultation with your channel partner so they will accept the resulting estimates.

Asking the right way

Large channels will typically understand their business deeply and recognize the value in sharing it with you. All you have to do is ask.

Smaller channels may be less sophisticated and need to be coached through the information sharing process. They may also be more reluctant to participate. In these cases it's vital to ask in a manner that demonstrates your desire to help the channel partner–not just yourself.

Example request

Frame your inquiries from your channel's perspective and at the big-picture level, and lead with information you already know.

- "I know you're concerned about business growth, margins, and working capital. But I don't know whether my products are impacting your overall returns positively or negatively. Shall we try to sort that out?"

INVENTORY TURNOVER DEFINED

Inventory turnover ratios (or turns) are central to almost any what-if analysis because of their substantial impact on your channel partner's profitability. They help answer the question: Does the channel have too much money tied up in inventory?

- Inventory turn ratio formula: Cost of sales for one month/average daily inventory value held during that month

Both of the inputs are based on what the channel paid for the products they sold, not the price they sold them for.

What's it all mean?

As a rule, the lower the inventory turn ratio the better. It means the inventory is being managed well. An exception would be if inventory levels were so low they were causing delivery delays. But in general:

- **GOOD NEWS:** Your inventory turn ratios are lower than those of the other manufacturers' the channel partner carries.
- **BAD NEWS:** The inventory turn ratios of your products are increasing over time.

TIME TO ANALYZE

Once you have gathered this basic financial information, you can begin creating what-if scenarios. Evaluate various win-win ideas for reducing your channel's inventory turnover ratio and improving their gross margins.

For example, how would our sales and costs change if we:

- Delivered twice a month instead of once?
- Established a drop shipment program for larger customers?
- Provided advanced product training to your sales staff to improve their productivity?

Ideas that effectively reduce inventory turns and improve gross margins will demonstrate your commitment and lay the foundation for a deeper relationship.

MOVING BEYOND THE BASIC UNDERSTANDING

Once your channel believes you have their best interests in mind, you will be allowed—if not encouraged—to explore improvements to other aspects of your channel partner's business model. One such area would likely be value creation, such as trying to determine:

- The effect that additional services or product enhancements (provided by the channel partner) might have on sales and profitability.
- The market segments that are (or would be) most profitable for your channel partner. Good information will help focus new campaigns to better penetrate existing markets and expand into new ones.
- The impacts that various pricing and promotional changes might have on working capital utilization and overall sales and profitability.

In summary

- Understanding your channel partner's business model is vital to creating a long and profitable relationship.
- Developing that understanding requires due diligence and commitment; schedule ongoing time for channel management and develop metrics to measure your success.
- Make your channel partner part of the process at every step.
- Start with a base-level understanding by focusing on gross margin and inventory turn analyses; don't take on the whole business model at once.
- After initial success move to another part of the business model.
- Win-win results are always the goal.

MORE ABOUT ON THE MARK

On The Mark marketing consultants elevate your team's business impact by accelerating marketing program development and execution. Our hand-selected consortium of consultants is known for:

- **Envisioning possibilities:** Super-smart, competent marketing consultants
- **Raising the bar:** Experienced leaders that continuously deliver innovative yet meaningful business impact
- **Making it happen:** Driven, accountable marketing experts that are focused on results...not our egos

On The Mark's full-time and part-time consultants strategize, plan, and execute a wide range of business-to-business marketing programs. Our conscientious, can-do approach combined with our extensive marketing expertise make us smart and fast on our feet. Clients rave about our results and how easy and hassle-free it is to do business with us. If you'd like to learn more, please contact us at Connect@OTMmarketing.com.

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