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Industrial Channel Management in the Downturn

Developing a systematic approach to channel optimization can protect margin without sacrificing the top line.

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From light duty MRO and construction materials suppliers to heavy equipment manufacturers, the industrial manufacturing sector is suffering its worst decline in decades. This decline is placing an unprecedented level of pressure on industrial distribution channels. As marketers realign their operations to adjust to a lower level of demand, they will face a number of difficult choices. Decisions taken today will have a major impact on customers and channel partners both in the near-term and in the long-term. It is essential that marketers get these decisions right and are able to execute them cost-effectively while avoiding lapses in customer service.

While many companies are implementing reductions across the board (i.e. spreading fewer people and marketing funds across their network), others are taking a more fact-based, systematic approach to channel optimization. Such an approach, if executed well, can help: identify the most profitable customer segments; select the strongest channel partners to serve those segments; and determine the most optimal mix of marketing programs on which to focus reduced resources.

A Management Challenge

The industrial distribution network has many players, and manufacturers can choose from a multitude of internal and external distribution channels. Internal channels include the Internet, direct sales forces and key account teams. External channels include small distributors, large distributors (both low- and high-service) as well as exclusive or semi-exclusive dealers for branded manufactured products.

Despites its fragmentation, the industrial distribution system is also very mature with a number of entrenched practices and relationships developed over many years. Modifications to the status quo must be managed carefully as relationships and reputations, once disrupted, can be difficult to repair.

Optimizing Distribution Channels -- Getting It Right and Making It Work

Based on our experience, maximizing the potential of distribution channels and marketing programs in today's economic environment involves taking three key action steps:

1. Identify the best partners. The first step involves taking a hard look at current channel design. Companies need to understand their most profitable and highest potential customer segments and how well those segments align with existing channels. This understanding requires a clear perspective of how units, revenue and profitability flow across sales channels, products and regions. It also requires a strong knowledge of how well a company's value proposition aligns with channel partners in addition to end-users.

Building a "profit map" is a useful exercise for conducting this analysis. A profit map is an evaluation tool which helps companies balance market opportunities against their cost-to-serve. In developing a profit map, it is important to understand not only unit volume and revenue but also the complete contribution margin of each channel to the manufacturer. The most significant costs to serve specific channel accounts -- freight and returns, sales and service costs, customer and channel-specific discounts and incentives -- must be understood and quantified to determine true profitability.

Third-party market research on current and potential market segments can then be integrated with internal data analyses to identify where additional value exists in the marketplace (e.g. new regions or product/service categories). Done correctly, this analysis shows where the most profitable segments of a company's market exist and how successful they have been at capturing that value.

After identifying the most profitable and promising segments, it important to determine how well current channel partners align with those segments. In evaluating channel partners, first determine how well each partner aligns with the company's value proposition and the most profitable customer segments. Secondly, given the current environment, also pay particular attention to a potential partner's financial strength and strategic position. All else equal, companies will want to place their bets with channel partners that will be around for the long term.

2. Get the most out of your marketing. The second step consists of a review of marketing programs in the context of key target segments. Determine which specific demand generation programs and promotions (e.g. direct mail, trade advertising, broadcast advertising, incentives) have worked better than others at generating and converting qualified customer leads. Evaluate the performance of various marketing programs in different regions, segments and markets and how well sales results have correlated with those efforts. Based on a careful review of what has worked best, opportunities will emerge to rationalize some of these marketing programs.

Look for opportunities to renegotiate terms with channel partners as well as other sales support relationships (e.g. PR agencies, advertising firms, printing companies). Channel partners may be willing to offer better sales terms or improved product positioning, including increased "shelf share" or even product exclusivity. Sales support providers may be amenable to renegotiating pricing arrangements to maintain business relationships.

3. Manage the transition. Once channel design and resource allocation have been addressed, implementation needs to be carefully planned. In many cases local market variations will require significant adjustments to the overall direction. Some channel partners are likely to require more support than others as they take on new customers with potentially different service requirements. Throughout any transition, communicating closely with target partners is essential to manage channel conflict and minimize negative customer impact.

In times like these, it's common to see these critical transitions under-resourced due to financial constraints. Given the magnitude of the near and long-term impact on the top line, it's important to avoid this trap.

Getting Going

Armed with a clear understanding of the highest potential customer segments aligned with the best channels partners and the most effective marketing programs, transforming industrial channels for significantly better result can be pursued with a high degree of confidence. Managing transitions can be challenging, but having a systematic change process is the best way to maintain top line growth in tough economic times.

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