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How Do I Love Thee? Let Me Count 10 *Ways*

IF MANUFACTURERS TREAT WHOLESALERS AND RETAILERS AS CUSTOMERS RATHER THAN JUST AS DISTRIBUTION CHANNELS, THEY WILL SEE LARGER PROFITS

A SALESMAN FROM A MAJOR COMPUTER MANUFACTURER sat in the office of a software company that also marketed computer hardware and services to complement its software. The salesman said he was pleased to announce that the software company qualified as a channel to market for the manufacturer's products. He went on to offer recognition of the software company as an intermediary — a value-added reseller or VAR, a type of distributor. The salesman described the computer manufacturer's unique vision and its differentiated products.

But the software company considered itself independent and not part of any company's channel. It believed its customers did not see the manufacturer or their computers in that way.

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The computer salesman described hardware's critical role in the customer's purchase decision, but the software company viewed software to be the key driver. With differing perspectives on many fronts, the meeting ended. In the period that followed, the hardware vendor never did establish a distribution relationship with the software company, which went on to sell considerable volumes of other companies' machines. The opportunity was there for the manufacturer, but it missed it because it saw the intermediary as its conduit to market, not as a customer. This was a real situation; I represented the software company at the meeting.

The terms intermediary or channel member are usually used to describe companies that take title to manufacturers' products and then resell these products to other companies or individuals. Intermediaries include dealers, retailers, wholesalers, distributors and value added resellers, or VARs.

Vendors who treat distribution intermediaries as channels to market rather than as customers can miss opportunities and create openings for new or existing competitors. One example: Cott Beverages has grown rapidly by serving retailers with house brands, something vendors of brand names resisted doing. In another case, Fuji was among the first to sell private label photographic film and benefitted from the growth of the retailers it supplied, including Blacks, a company Fuji now owns.

Vendors should recognize the importance of mutual respect as a basic precondition for building the relationship. Respect may never be fully developed or may erode when either party considers the other to be weaker or inferior. For example, manufacturers sometimes deride unsupportive intermediaries. But if they investigate the underlying reasons for the intermediaries' lack of support, they may find that the manufacturer's attitudes are partially responsible. Some manufacturers consider intermediaries as short term in orientation — contrasted with the manufacturer's strategic view of the world — and even as order takers who add limited value to the product. One computer supplier has been heard referring to its dealers as box pushers. Some of these manufacturers experience persistent difficulty in growing their businesses through distribution channels and can resort to requiring compliant behaviors from intermediaries or even looking for more direct channel control, such as through ownership positions. Closing the gaps in perception and reality between supplier and channel member can offer potential for sales growth and improved profit for both.

BUILD THE RELATIONSHIP

Manufacturers prefer channel members to operate in the manufacturer's service, ideally with committed rather than just compliant intermediaries. Ten suggestions for manufacturers to consider to help build intermediaries' commitment and the quality of the working relationships are:

1. Treat intermediaries as customers

In many of today's oversupplied industries, intermediaries have broad product and supplier options and are often quite willing to exercise them, particularly when faced with onerous or one-sided supplier policies. Some retailers have strategies that include operating as the purchasing agents for their customers, making them a proxy for customers — a sort of "virtual customer" for their suppliers. Example: Loblaws has a philosophy similar to this, which may have led them to develop the President's Choice line of contract manufactured products, and weaken some branded products in the process.

Ignoring or pressuring the intermediary can be equivalent to doing the same to the final customer, with resulting exclusion or inattention at the intermediary level.

2. Think of intermediaries as the independent businesses they are

The distribution channels concept exists to aid manufacturers to bring their products to market. As long as manufacturers view the channel as a series of exchanges between arm's length organizations before the final consumer purchases the product, the behaviors of suppliers and intermediate customers are likely to be appropriate. The problem arises when manufacturers talk in terms of *their* channel, and try to drive compliance or even control to enforce attainment of objectives that may be at odds with those of their intermediaries.

Many intermediary businesses are owner operated, and have the associated independent characteristics that might be expected of owners. When vendors and channel members disagree about matters such as account control, making investments for the long term, loyalty and support for the vendor and its strategies, the issue of arm's length operation and the right to independent decision making is often at the heart of the disagreement.

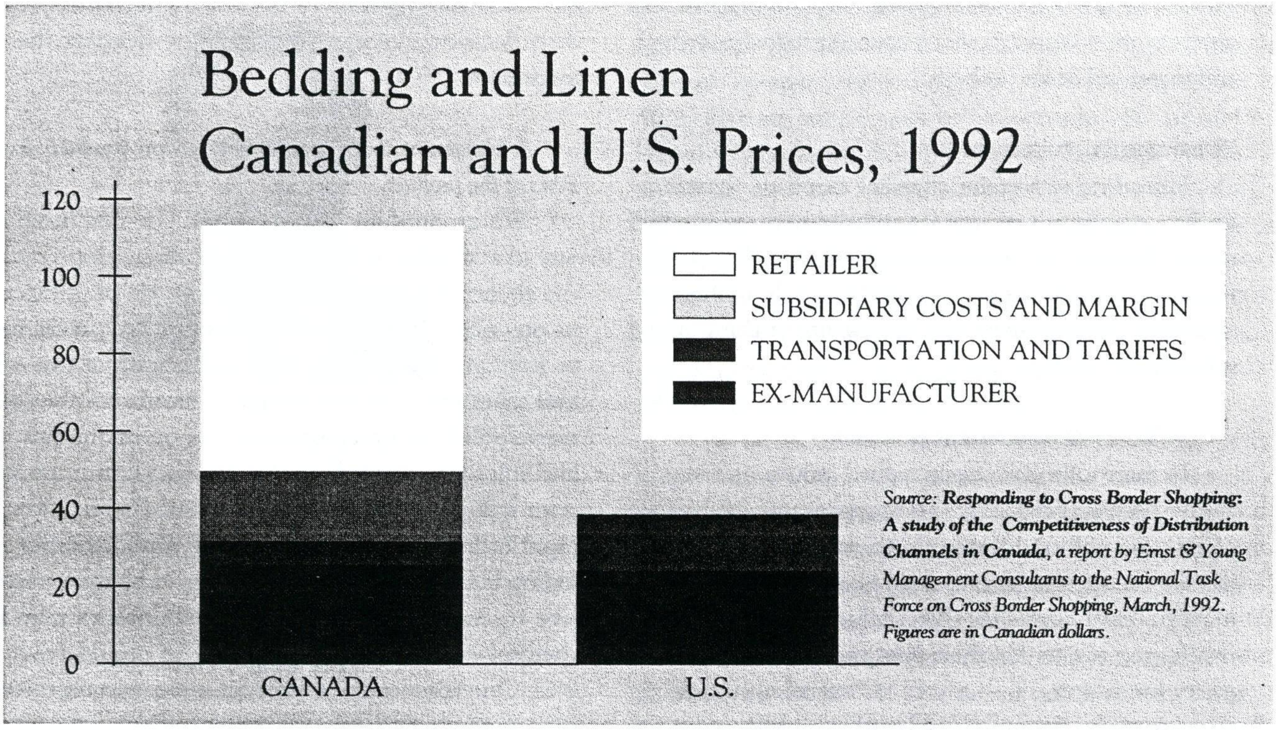
3. Augment the service or other non-product dimensions of the product

Where product differentiation has declined, one way to add value is in non-product dimensions, such as the shopping experience, the knowledge of salespeople in pre-sales consulting, after sales support, credit terms or software. The intermediary adds much of this value and takes much of the margin. Manufacturers able to create value for end-customers in non-traditional ways and willing to share this value creation with intermediaries will likely secure close alignment. For example, rapid order fulfillment may enable intermediaries providing business-to-business products to be more responsive to customers, but these intermediaries may find themselves with higher inventory to provide this service. One approach would be for some manufacturers to offer smaller and more frequent shipments without cost penalty to the intermediary, and online access to their warehouse inventory system to guide customers on availability.

4. Plan together and work the plan

Imagine this situation. As an intermediary for computer hardware you deal with two main suppliers. One of the two insists that you meet contracted volume commitments. It requires compliance, but offers you little help to build revenues or cut costs. The second vendor works hard to build the business by making investments in many places, openly sharing its strategic plans as a prelude to joint planning, and offers, for example, factory tours and training to your staff, loaner units, benchmarking services and configuration assistance. It accepts responsibility for performance obligations in the intermediary's proposals and in many other ways. The price performance ratios of its products are more competitive. Customers are happy with their products and prices. With which company would you build your relationship?

The second vendor was Motorola, a manufacturer committed to quality in word and deed. Motorola ensures that the boundaries between supplier and intermediary blur. For example, it has reduced the companies it supplies with computers to those that are aligned



with their business strategy and then works hard to make the joint strategy a success. Its sales staff operate seamlessly and in a complementary way with those of the intermediary, and do not compete with intermediaries. In one case, Motorola offered to establish relationships with its international subsidiaries on behalf of a VAR wanting to expand into new geographic markets. Other vendors find themselves talking of partnering to achieve success, but intermediaries dealing with Motorola see little need to change.

5. *Add value*

Where Canadian subsidiaries of U.S. companies have added limited value to products, the gray market has grown. One example: a subsidiary that performed mainly an inventory management function in Canada found that its customers were buying in the U.S. directly, because these customers considered the prices charged by the subsidiary to be excessive. To stem the importing, the subsidiary harmonized prices with its U.S. parent, creating a continental pricing strategy. Had the subsidiary not done this, not only would its volumes have continued to decline, but the parent firm may well have questioned the value of the subsidiary and integrated it more directly into North American operations.

The subsidiary of a U.S. or offshore parent is effectively another link in the value chain as the product moves from production to consumption. The subsidiary itself is a member of the distribution channel for the manufacturer. As such, it should be treated as a customer by its suppliers, even though it is not at arm's length. Subsidiaries should add value for their customers. If they do not, the distribution channel might be delayered, with customers bypassing them. They might be forced to by competition. Price Costco, for example, which often buys from non-Canadian sources, sometimes bypasses sources in Canada for products in the same category or even the same brand. For example, Price Club sells Huffy bicycles, which are made in the U.S., rather than bicycles made, assembled or independently imported by Canadian firms.

Even when value is added, high levels of markup by importers or subsidiaries can cause some intermediaries or customers to look elsewhere for their suppliers. For example, in 1992, Canadian distribution channels for bedding and linen were charging higher prices than their U.S. counterparts. On bedding and linen imported into Canada from U.S. manufacturers and then sold directly by the importer to a major retailer, the price difference was significant — $70 on bedding priced at

$112 at retail in Canada, excluding PST and GST. Of this, the retailer accounted for 60% of the price difference, and the importer accounted for 29%. This difference led to a variety of responses, including the emergence of stores focused on lower price bedding and linen, and direct sourcing from manufacturers by some Canadian retailers, which bypassed Canadian intermediaries.

6. *Help to take out costs from the entire system*

The principles of improving business processes or reengineering aspects of an entire business are regularly being applied in corporations, but opportunities remain for many firms to reengineer processes associated with the forward and backward supply chains to secure and share system benefits. There is a large potential to benefit from redefining or improving the system comprising manufacturers and their suppliers, subsidiaries of the manufacturer and intermediaries. For many goods, consumers can pay one dollar to channel participants for every dollar the manufacturer receives. This recognition alone could spur some manufacturers to look beyond their own business operations for cost savings.

One company seeking to increase the efficiency and effectiveness of the total business system comprising itself and its dealers is Apple Canada. Apple has implemented a system called Apple Reseller Information System, which allows dealers, through their computer and a phone line, to order products and parts, review inventory levels in Apple's warehouse and confirm pricing for all products. Apple's main benefit is the lowering of labor content compared to the manual approaches previously in place. Dealers benefit by freeing working capital from inventory and reducing discounting obsolete inventory, while retaining a broad product selection. The system also gives dealers 2 1/2 hours longer access to Apple. Now they can go online to Apple until 8:00 p.m., an especially important benefit for Western-based dealers. Companies in the retail food industry and auto manufacturing also have been quick to adopt electronic data interchange to speed order processing and bills payment.

Improvements such as these can lead to lasting relationships and barriers to switching suppliers, both financial and psychological, the latter being the case once the intermediaries are trained and have invested in new systems and procedures.

"For many goods, consumers can pay one dollar to channel participants for every dollar the manufacturer receives."

7. *Target channel members against specific markets or customers*

If there is value to be gained by the end-user from so doing, manufacturers may reduce the number of their intermediaries and work more effectively with those that remain. If intermediaries can lever their capabilities such as knowledge, capital, relationships or complementary product lines in specific markets, they may be able to add more value for customers and suppliers if they do not have much competition. Because the business case for those intermediaries that remain can be enhanced, they will likely be more loyal and more effective in the service of their supplier. For example, Digital Equipment Corporation has focused distribution of its computers to the U.S. library industry principally on Data Research Associates Inc., a developer of library automation software with widespread relationships in libraries. This alignment has led to more effective co-marketing between the two firms.

Complete alignment can lead to vertical integration in the channel and more account control than was previously exercised. Fuji's supplying Blacks and then acquiring Blacks is a good example.

8. *Help intermediaries to innovate*

Canadian intermediaries have seen U.S. retail and wholesale operations repeatedly implement innovations. Examples include warehouse clubs, such as Price Costco, Sam's Club (owned by Wal-Mart) and Pace (K Mart); specialized large-scale operations (Toys-R-Us, Home Depot); and specialized mall outlets, such as The Gap. The warehouse club format is perhaps the most financially appealing concept in retail wholesale today, in part because of its focus on inventory turns (three times the average for department stores) and high levels of sales per square foot (six times the average).

In addition, undercapitalized and overstretched, few Canadian intermediaries have the resources to match their U.S. counterparts. For example, Molson elected to sell its Aikenhead's Home Improvement Warehouse chain to Home Depot Inc. to avoid direct competition with the U.S. hardware company. Making the announcement of this decision, Molson President and CEO Marshall Cohen told *The Financial Post*, "(Home Depot is) a very good company, and it just made more sense to join them than fight them." With sales only 2-3% that of Home Depot, it likely would have been difficult for Aikenhead's to compete with the scale and purchasing power of Home Depot. If faced with a similar situation, Canadian intermediaries in other sectors may find it at least as difficult to remain independent, especially where they do not have access to deep and patient pockets.

The vendor has a potential role to play in helping the intermediary position itself for growth. For example:

- Manufacturers can provide advice on issues such as business profitability, inventory levels and obsolescence, and help by reducing high markup/high markdown cycles where prevalent. Manufacturers can help intermediaries keep abreast of advances in technology, product assortment, market positioning, training, competitor performance, benchmarks and best practices.
- Manufacturers can support selective investments to adopt innovation, providing a capital base for the business or extending trade terms to permit deployment of funds for advantage. It is better for such investment to be planned and proactive than to be a required response to prop up failing intermediaries.
- Manufacturers can explain their experience with new formats, perhaps in countries other than Canada, and guide the intermediary to innovate. For example, factory outlets are still relatively rare in this country. Manufacturers with experience with these concepts elsewhere could work with intermediaries to develop the ideas here.

9. *Visit with the intermediary even when the benefit cannot be identified in advance*

Managing independent businesses leaves little time for shmoozing, but regular visits between suppliers and intermediaries that are planned, with formal agendas and minutes, action items, timing and responsibilities, are useful to both parties as they establish a process for cooperation. Items usually surface during the meeting that enable both parties to benefit — a new business opportunity, a request for proposal that might have just arrived and service or support issues.

The meetings also offer an opportunity for each side to surprise the other with an item of unexpected goodwill. A challenge can be established for each to present the other with an opportunity at every meeting, which can help build a purposeful relationship.

10. Be consistent

The intermediary's competitors are often the manufacturer's distribution channel. If the manufacturer resists alignment or other approaches to build the intermediary's business case, it may at least wish to be consistent in the way it applies its current policies. Inconsistency can lead some intermediaries to believe competitors are being favored, even if this is not the case, and the relationship can be weakened. For example, one dealer we know was convinced the manufacturer did indeed have inventory when it said it was out of stock. The dealer then tied up the manufacturer's order desk with multiple requests for product, and many of the manufacturer's employees were contacted to find out if the product could somehow be sourced on a rush basis. Only when standardized policies were established with a centralized, computerized order desk and call handling, which ensured that all calls were methodically taken and logged, and response actions noted, was the intermediary convinced that its supplier was operating consistently.

Pricing policies are another area in which consistency and reasonableness should be maintained. One manufacturer constantly changes policy and sets new break points in volume expectations. These changes cause dealers to seek higher and higher volumes in search of increased discounts, and for some dealers these volumes are impractical or impossible. The result has been happy, large dealers whose growth have been aided by the manufacturer's pricing policies, while medium and small dealers have discussed forming buying groups and other approaches to compete. Ultimately, the manufacturer may find all their customers are in the highest discount category.

"The intermediary's competitors are after the manufacturer's distribution channel."

PERSISTENCE WILL PAY

Ensuring that the supplier and the distribution channel operate for mutual value creation can be an important component of the supplier's business strategy. It takes time and effort to build and maintain the relationships, but the payoff is there for those who persist in treating intermediaries as customers. BQ

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