Stop the Static

Tuning in to your sales channels can help you satisfy customers without sacrificing margins

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Executive Summary

Sales channels are the tactical delivery arm of any business and need to be aligned with market conditions, customer needs, and company-specific objectives. But too often, misalignment between customer needs and the ability of the sales channels to meet them can create performance gaps that can threaten a company's financial performance. Why the threat to the bottom line? Because of the costs associated with delivering "value" as well as poor sales performance caused by loss of customers, competitors seizing market share, and unfavorable channel partners.

Performance excellence can be achieved, however, through a process often referred to as "channel optimization." This entails identifying the most appropriate level of service for each customer and the most efficient delivery model for that service, an approach that should result in the most profitable relationship possible.

We believe companies that seize the opportunity to improve their channel performance can enhance their financial results and rise above the competition. The European division of a global manufacturing company benefited from an innovative channel optimization approach. The company faced numerous issues that were keeping it from growing. But by understanding what customers truly value, measuring the cost to serve customers, and selecting the most efficient route to market, the company was able to achieve a 3 percent revenue increase for the first year following implementation, far exceeding its initial financial goals.

Are Your Sales Channels Tuned In or Out?

Your organization is losing key customers. You don't have a good feel for what your customers really need, and they don't seem to recognize the unique value of your offerings. Your competitors are making innovative changes to their sales strategies and seizing market share. Your channel partners are complaining that you're not driving enough business in their direction. Meanwhile, you're dissatisfied with their lackluster performance.

If this sounds familiar, your organization likely needs to take a fresh look at its channel strategy. "Channel optimization" is an approach to examine how you serve customers. The key concept of any channel optimization approach is to improve your customer value propositions,[1] fine tune your channel[2] performance, and deliver each value proposition through the most efficient channel. The first step is to understand the pitfalls of an ineffective channel design. The second step is to examine what your company can do to better satisfy customers without sacrificing margins.

Resolving Three Key Issues

To understand how your business can improve its value propositions through the most efficient channel, you must first be able to answer three key questions:

- What do my customers really value?
- How effectively do my channels meet customer needs?

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- What does it really cost to serve my customers?

The answers and insights from each of these three questions will help you develop an effective channel strategy.

Issue 1: What do my customers really value?
Understanding what your customers value is critical, because a business wins when it addresses customer needs better than its competition. It can also enable a business to adjust each customer's service to the appropriate level. For example, one customer may value a sales representative visit while another prefers to place orders by phone. Unfortunately, without direct feedback from their customers, many companies rely on internal biases or outdated practices in serving customers, such as a "one size fits all" approach or a simple customer segmentation using internal measures such as revenue and growth to determine service levels. This can lead to under- or over-serving customers. Under-serving can cause customers to feel neglected and migrate to the competition. The costs of over-serving hit your bottom line and can prevent your sales force from going after new business opportunities.

Issue 2: How effectively do my channels meet customer needs?
Without a well-defined view of channel capabilities, a company cannot fully understand how well their channels satisfy customer needs. Channels can provide value to customers in many forms, such as:

- Product information
- Informal consultative advice
- Technical support access
- Transactional support

Within these areas, each channel will likely have different levels of capability. The challenge is defining *what* these capabilities are, *when* services should be provided, and to *which* customers. Effectively meeting your customer needs should lead to a higher level of customer satisfaction and better use each channel's core competencies.

Issue 3: What does it really cost to serve my customers?
Companies measure their overall business performance on revenue and profit margin. Unfortunately, a company can show an overall increase in profitability, yet still be leaking margins in serving certain customers. This is because they probably do not understand the *true cost* of serving their individual customers. While financial systems typically capture the sales revenue and gross margin for each customer, they often do not capture other costs that impact profitability, such as:

- Cost of sales visits (e.g., sales resource time and expenses)
- Freight costs
- Product testing
- Payment terms

Poor understanding and management of the true cost to serve a customer can keep them from being a profitable customer.

Channel Optimization to the Rescue
In spite of the challenges these issues pose, a systematic channel optimization approach can lead to higher revenue and margin improvements. The next few sections help unravel the issues and provide some ideas on how to cash in on the benefits.

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Insight 1: What do my customers really value?

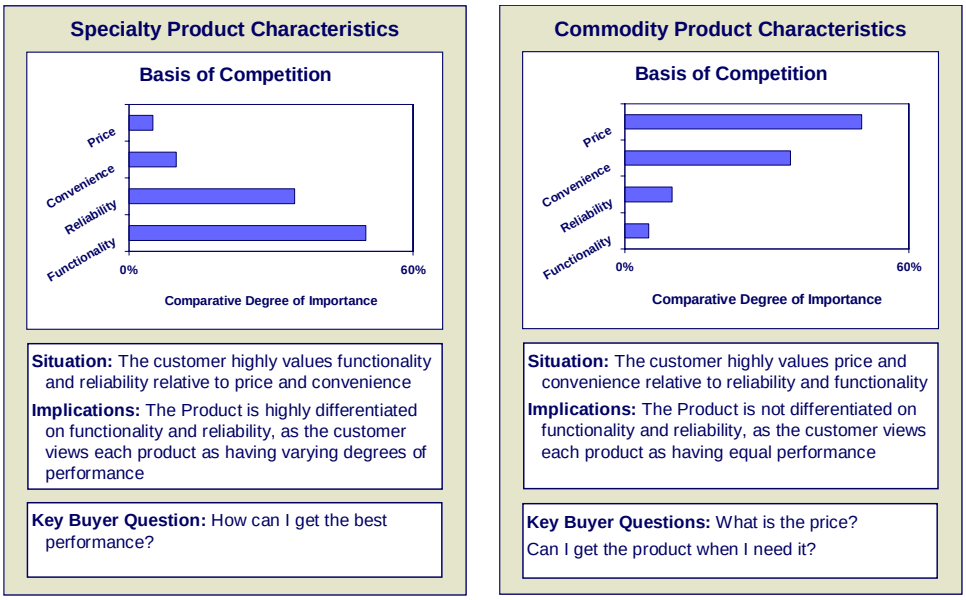
A first step to understand what customers truly value is to evaluate your company's product portfolio from a market perspective. In many industries, products can be categorized as specialty or commodity products.[3] The test for gauging a product's "commoditization" is to identify how customers rate the importance of four attributes: functionality, reliability, convenience, and price. At one end of the spectrum, buyers of specialty products highly value functionality and reliability relative to price. At the other end, buyers of commodity products highly value price and convenience relative to other attributes (see Figure 1).

What's the market view of your product portfolio? Ask your customers. Voice-of-the-customer information is a key input into the customer segmentation approach. Effective customer segmentation provides a clear understanding of the types and levels of support each customer requires. It provides a range of information, such as what customers value, what they are willing to pay for, and whether they would be satisfied with service from a telesales representative.

Conjoint analysis—a statistical technique that analyzes preferences for various combinations of attributes[4]—provides insight into customer preferences and purchasing criteria. It forces the customer to choose among various options (e.g., Do you prefer to order in person with a sales rep, by phone, or by Internet?), thereby helping a company to better understand what customers do and do not value. As customers evaluate multiple combinations of price, features, and service, a trade-off decision emerge. As a result, companies should be able to identify several categories, or segments, of customers.

Overall, a product portfolio assessment provide a reality check on your products and services. In conjunction with conjoint analysis, it can help your company align its products and services with your customers' preferences.

Figure 1: Specialty and Commodity Product and Buyer Characteristics



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Insight 2: How effectively do my channels meet customer needs?

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Before a company can change its channel model based on customer needs and preferences, it needs to understand the current state—how effectively do today's channels serve customer needs and respond to the prevalent market conditions. This means understanding:

- Customer touch-points
- Current market conditions and customer trends
- Current channel value propositions
- Current channel capabilities

Customer interaction should be evaluated by multiple touch-points throughout the life cycle of the relationship (see Figure 2). A comparative analysis through customer interviews can help a company determine how competitors stack up in each touch-point. In addition, at each stage of the life cycle, the value a company needs to deliver to satisfy customers varies, a well-developed value proposition helps a company identify the level of service currently provided through each sales channel. A company can then use a scorecard approach to assess the capabilities of each channel, rating not only delivery and performance, but also identifying capability gaps and opportunities for improvement (see Figure 3).

Having a comprehensive understanding of customer touch-points and the channel capabilities required at each touch-point is critical, because it can help explain current margin loss.

Figure 2: Customer Touch-Point Framework

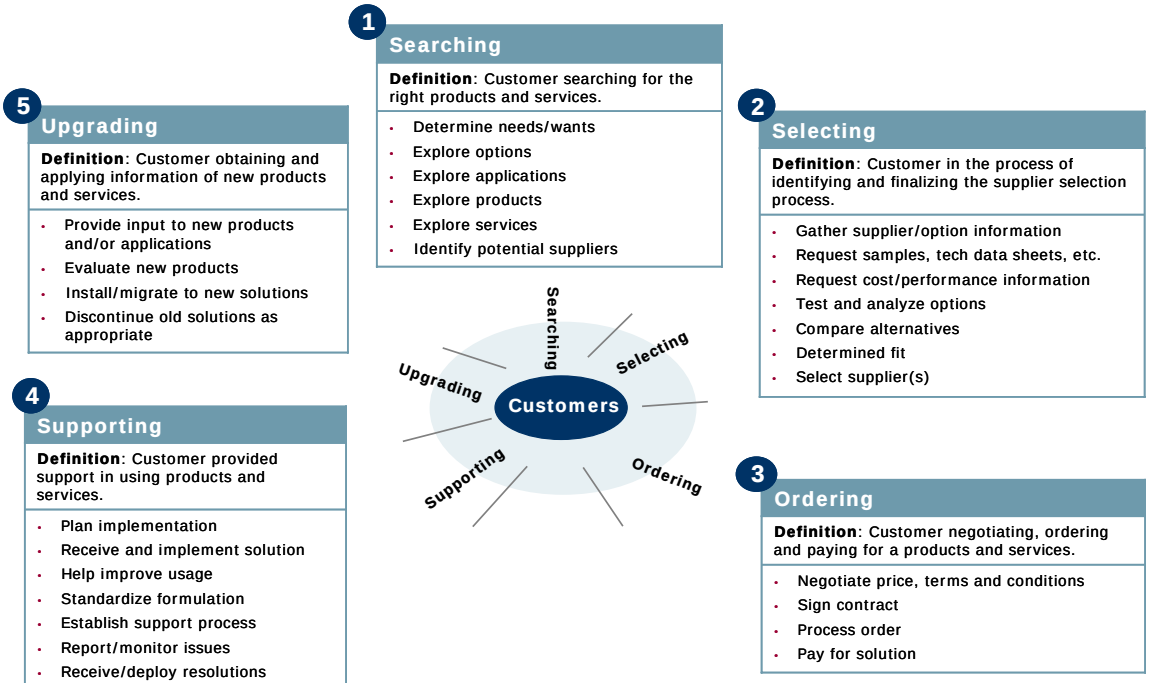

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Figure 3: A Sample Channel Capability Scorecard

Channel Capability Scorecard - Value to Customer

		Channel Capability Score				
Value Proposition Category	Value Proposition Element	Field Sales	Inside Sales	Specialized Distributor	Logistics Distributor	Agent
Product Information and Consultative Support	Discuss products and services offerings through face-to-face meeting through Sales Rep visit	5	3	4	4	5
Product Information and Consultative Support	Offer to develop new (manufacturing) or modified processes for customers through Sales rep visit	4	3	4	3	4
Access to Technical Support	Provide product (FOC or discounted) samples to customer	4	3	3	3	3
Product Information and Consultative Support	Sales rep visit the customer for face-to-face meetings to provide consultative selling (i.e. on-site) (Depends on Distributors and market Segment)	5	3	4	3	4
Access to Technical Support	Access to equipment and labs (FOC)	4	1	1	1	1
Access to Technical Support	Rent equipment, labs etc. to customer to test products	4	3	2	1	1
Access to Technical Support	Develop new products for customer (for applications that show potential and profitibility)	3	2	2	2	2
Access to Technical Support	Provide first point of contact for Technical Support	5	5	5	5	5
Access to Technical Support	Provide product-specific training by Technical Rep	3	1	1	1	1
Access to Technical Support	Offer Joint Development Programs with prospective customer	4	2	2	1	2
Transactional Support	Sales rep negotiates price and terms of sale over the phone	5	5	3	3	3
Transactional Support	Provide Competitive Price Matching (in combination with value pricing techniques)	5	3	3	3	3
Transactional Support	Provide technical development rebate	4	3	4	3	3
Transactional Support	Provide non-standard terms of payment	4	4	2	2	4
Supply chain service support	Provide expedited shipments	3	3	3	3	3
Supply chain service support	Provide consignment stock	3	1	1	1	2

Source: Deloitte Consulting LLP

Insight 3: What does it really cost to serve my customers?
Most companies do not have a clear view of the time and resources spent to serve their customers. A channel optimization approach can help you understand what your customers value and give guidance on how to deliver that value in the most cost-effective way. Without this insight, it is virtually impossible to measure the cost to deliver your services and thereby significantly improve your channels.

The Profit and Loss statement (P&L) is a cornerstone of business performance management. Why not measure your channel performance in the same way? A channel P&L is a breakdown of the revenue and cost in each channel. This breakdown shows businesses where they are losing money from their channels.

Channel profitability is impacted by three types of costs (see Figure 4):

- Cost of the products purchased by customers in that channel.
- Cost associated with the level of service given to customers served by that channel
- Cost directly related to the channel itself

This level of cost detail can help management measure the actual profitability of their channels and identify the root causes of margin leakage. Armed with this information, management can then make better decisions on the most appropriate channel model for their business.

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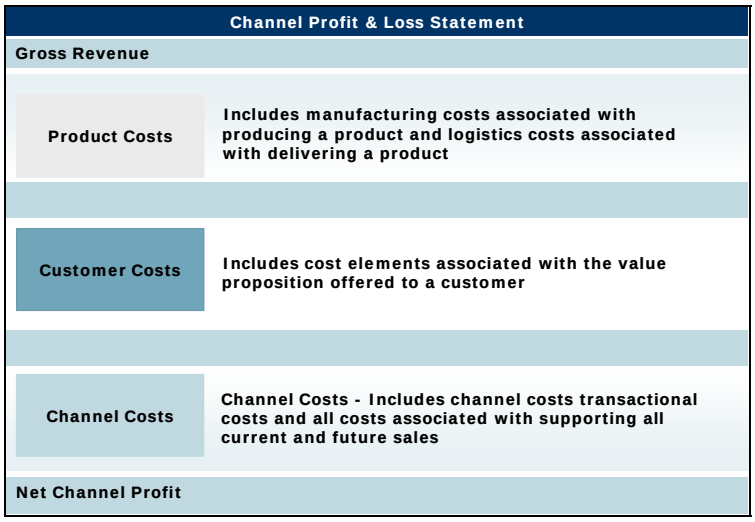
Figure 4: Channel P&L Statement



Source: Deloitte Consulting LLP

Turning Insights into Strategy: Choosing the Most Effective Channel Model
Based on their channel capabilities, channel economics, and the results of the segmentation, businesses will likely need to redefine the product and service combination that most effectively satisfies their customers. However, before redefining and making alterations, companies need to check for intrinsic variations within the two or three customer segments identified in the conjoint analysis. Companies can further split their customer segments by overlaying additional criteria:

- Which customers are particularly profitable?
- Which show potential for growth?

Based on the answers to these questions, a company then defines value propositions for each sub-segment and sales channel to satisfy customer needs at the lowest cost. These value propositions should be distinct enough to serve different customer segments and simple enough to be executable. The ultimate goal is to satisfy customers within their defined segment without sacrificing margins.

A dynamic channel service model can help companies achieve this goal by simulating both the financial and resource-related impact of future channel scenarios. By completing this process, the channel service model helps identify the most effective channel solution for each customer segment.

Case Study: Increasing Revenue through a Channel Optimization Approach

The Situation and Complications
The need for measuring channel profitability, redefining value propositions, and selecting the most efficient delivery model was clearly evident in a division of a multibillion-dollar global chemical company. This company, which serves automotive, high-tech, and food packaging customers in Europe, the Middle East, and Africa, faced many issues that impeded growth. Its products were becoming commoditized and competitors were grabbing market share.

Other factors that were impeding financial success included:

- Highly price-sensitive customers

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- Few recent or upcoming breakthrough products
- Poor deployment of selling resources
- Underperforming channel partners

Identifying the fundamental causes for these issues was not easy. Without regular and structured feedback from the marketplace, the company could not identify the value customers placed on specific product and service attributes. In addition, the company had not fully captured the true cost to serve customers.

The Solution, Insights, and Results

The company's first step was to study and understand the current state, which revealed that a dramatic readjustment of channel coverage and performance would be required to fully exploit growth opportunities in the marketplace.

The cost analysis was very revealing. The majority of selling expenses could be attributed to serving traditional multinational customers. By contrast, little was spent on acquiring new customers and markets. It was unclear whether the dollars spent on existing customers were actually required or simply a legacy of how business had been done over the years.

The conjoint analysis surprised the senior management team. More than 80 percent of customers fell into one of two segments—*price-sensitive* (63 percent valued only price) or *price-quality* (18 percent willing to pay a slightly higher price for consistent quality, but still very price sensitive). Only 19 percent of the customers valued regular interaction with the field sales force, and even this segment showed some degree of price sensitivity.

The company then looked at each customer segment to identify the most profitable customers and greatest growth potential. It concluded that the needs of the *price-sensitive* customers could be met by a "skim" strategy, whereby these customers would be managed by a telesales channel only. The *price-quality* segment would be harvested via a "hybrid" channel strategy, in which customers were primarily served by telesales, with certain customers occasionally supported by field sales reps. The *technical support* segment would be most satisfied through a "cultivate" channel strategy, where field sales reps would offer additional value and services. Within each segment, decisions were made on the relative spend for existing and new customers. See Figure 5 for a detailed description of value propositions by customer segment.

The company now had a strategy to serve these customer segments effectively through the most cost-efficient channels. Based on the new channel assignments, approximately 17 percent of current customers were selected to transition to a new channel. Two-thirds of these customers were transitioned to the telesales group. Based on these new channel assignments, the company identified $13 million in annualized, incremental revenue—a 3 percent revenue increase—for the first year following implementation of this channel optimization approach. The results far exceeded the company's initial financial targets.

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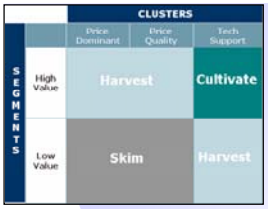
Figure 5: Tactical Value Propositions by Customer Segment



	Skim	Harvest	Cultivate
Technical Service	• 1-5 days of tech support (only product quality) • Sere over the phone and email only • Training available only through webcast • Very limited discounted product samples	• 1-10 days of tech support (product quality and process support; limited development) • Serve mainly over phone and email; limited face to face • Live training available on a limited basis • Very limited FOC samples, limited discounted product samples	• 10-20 days of tech support (product quality, process support and development) • Face to Face service • Live training available • FOC samples available
Product Development	• No product or process development available	• Limited process development available	• Product or process development available
Market Development Support	• No marketing development support provided	• Limited sharing leads with customers	• Limited trade show support • Sharing leads with customers • Accompany customers to their customer's sites
Contracts Structure	• Encourage no contracts and limit short term contracts • Restrict volume rebates • Standard terms only	• Encourage short term contracts; limit annual contracts • Offer volume rebates • Strongly discourage non standard terms	• Encourage short term and annual contracts • Offer volume rebates • Discourage non standard terms
Supply Chain	• No expedited lead time for forecasted or unforecasted material • Up charge for LFT shipments • No special packaging • No consignment/ safety stock offered	• Limited expedited lead time for forecasted material • No expedited lead time for unforceasted material • Up charge for LFT shipments • Very limited special packaging • Limited consignment/ safety stock offered	• Limited expedited lead time for forecasted material • No expedited lead time for unforceasted material • Up charge for LFT shipments • Limited special packaging • Limited consignment/ safety stock offered
Products Offered	• Standard products and grades only	• Standard products and grades • Non exclusive innovative products	• Standard products with minor modifications • Limited exclusive products available

Source: Deloitte Consulting LLP

Beyond Manufacturing

While this case study discusses the benefits achieved by a global manufacturer, a channel optimization program can be applied in multiple industries. Characteristics of companies that would benefit from a channel optimization approach are those that:

- Have multiple sales channels
- Can vary product and service levels to customers
- Negotiate prices with their customers

Measuring and Maintaining Channel Performance

Improving channel performance is only the first step in the journey. Ongoing channel maintenance is vital to effectively executing any channel strategy. Key considerations for maintaining channel performance include:

- **Securing organization-wide support.** Ongoing channel management is not limited to the sales function. The Human Resources group can identify employees with the applicable skills to move from field sales to a telesales role to support the new channel model. IT involvement is essential, as technology should support each channel, including inquiry handling, contact management, and transaction support. In addition, Finance needs to be responsible for measuring and reporting channel performance. Consequently, without collaboration across the organization, effective channel management would not be possible.
- **Properly measuring results.** Most companies measure sales performance with revenue targets rather than profitability metrics. If sales force performance is measured on revenue alone, the sales force may look effective in meeting sales goals, but they may be sacrificing margins. Aligning sales performance with profitability targets should drive the

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appropriate sales force behavior. These metrics should extend to channel partners and be evaluated regularly to yield the biggest increases to the bottom line.

- **Practicing ongoing channel management.** Market dynamics and customer needs are constantly evolving, and companies need to react to these changes. In some cases, sales managers can share this responsibility, but many do not have the capacity to dedicate additional time to channel management. To address this problem, many companies have appointed channel managers to oversee channel performance and adapt the sales channels as required. Ongoing channel management can lead to a more effectively run business as the sales force has clear focus and channel partners know their targets. Management has the necessary information to identify underperforming channels and react to changes in the market. All of these contribute to bottom-line growth.

Adapt or Die

As Charles Darwin said, "It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change."

A channel optimization approach can help keep companies constantly listening to their customers and help eliminate static that obscures the conversation. Companies that seize the opportunity to tune in to their customers and improve their channel performance can further enhance their financial results and position themselves to rise above the competition, despite the marketplace challenges and complexities they face every day.

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REEFERENCES:

[1]A Value Propositions is the unique value that an organization offers customers through its operations, products, and services. It describes how an organization differentiates itself to customers, and what particular set of values it will deliver. Source: http://www.google.com/search?hl=en&defl=en&q=define:Value+proposition&sa=X&oi=glossary_definition&ct=title

[2]A Channel performs the work of moving goods from producers to consumers. It overcomes the time, place, and possession gaps that separate goods and services from those who need/want them.

[3]Webster's Dictionary defines a commodity as a "good or service whose wide availability typically leads to smaller profit margins and diminishes the importance of factors (such as brand name, etc) other than price." Specialty products, on the other hand, are defined as something that has "a special mark or quality."

[4]Web Definition of Conjoint Analysis, http://www.google.com/search?hl=en&defl=en&q=define:Conjoint+analysis&sa=X&oi=glossary_definition&ct=title, September 16, 2007.

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