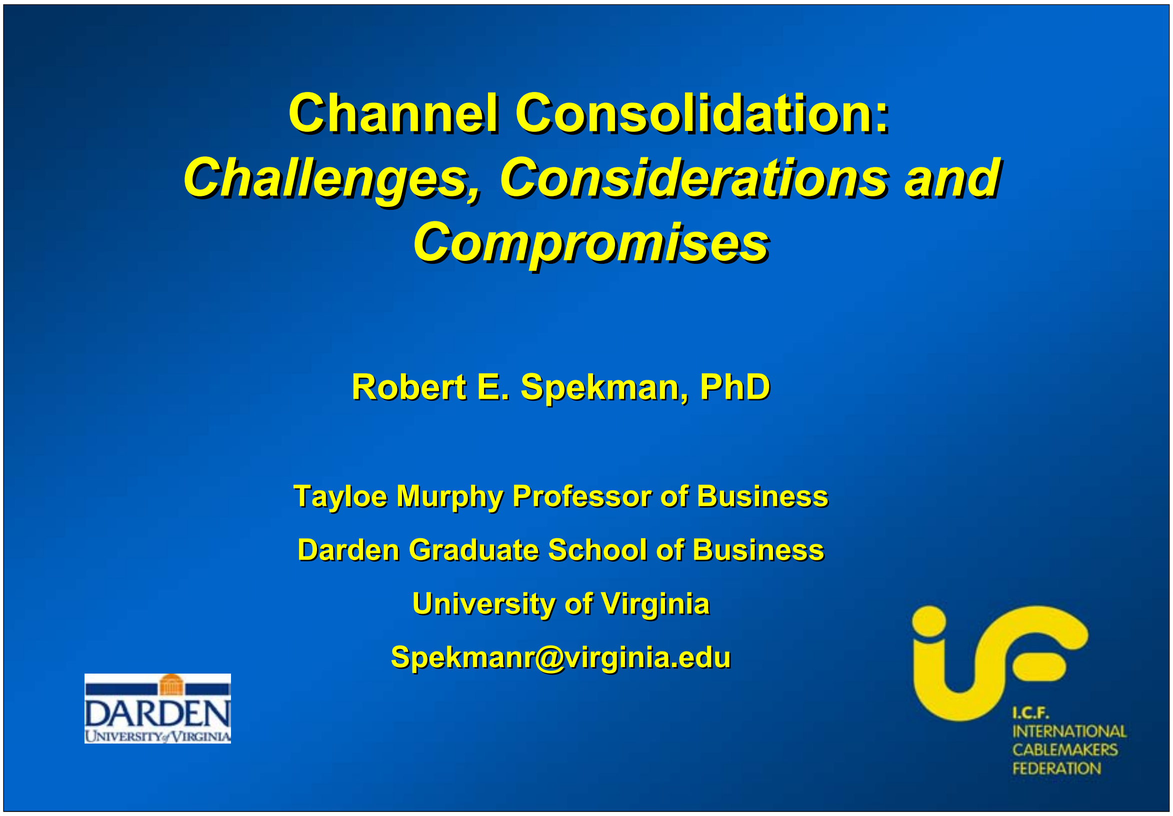



Ladies and gentlemen,

Let me take a moment to position myself. I would not consider myself presenting only an academic perspective here. I am not an economist and I define an economist as somebody, who looks at something in reality and wonders if it works in theory.

It is always tough to be the third speaker, after you have two very good talkers. The worst situation I ever had was last year. I followed Sally Ride, who is an astronaut, after she spoke. Whether she is a good speaker or not is not the issue. Her photographs of the earth from out of space just cannot be matched by any slide that you may have. So I will have a challenge here ahead of me.

## Outline for Today

- What is a channel of distribution?
- What do I see as the current state of wholesale distribution in the US?
- What does this mean for Manufacturers?
  - What are the challenges?
  - What are the tensions?
  - What are the options?
- What can you do?
- Can you say partnerships?

I hope today to give you some answers to the questions outlined above. We will also spend some time talking about, what it means to be a partner within the channel of distribution. Something that the earlier speakers mentioned.

# The Key Responsibility of Channel Management

To maximize market share through the coordinated efforts of all marketing disciplines toward common goals

When I talk about common goals, I talk about it from a couple of perspectives, primarily, meeting the needs of customers, having manufacturers and their channel of distribution cooperating in such a way to accomplish that. That does not always happen.

## Channel Management Challenge

Find the best combination of channels that supports the business strategy by:

- **Balancing responsiveness to customer**
  - **…with total channel cost incurred**
  - **…while retaining adequate control**
  - **…to ensure satisfactory cooperation**
  - **…among all levels in the channel network**

It is a combination of being able to be responsive to customers with concern for cost and control to ensure cooperation among all levels in the channel of distribution.

Let me share with you a conversation I once had with the Vice President of sales in a General Electric division which competes with Square D. The gentleman told me that GE goes to market through a number of different channels. They go direct, they go indirect, they own a wholesale operation. His sales people would rather loose a sale to Square D than loose to another one of their channels of distribution. This may not be the most ridiculous statement ever made. But when the person who made the most ridiculous statement dies that is a candidate. What that suggests to me is that the level of conflict that existed in the channel of distribution was harboring on pathological.

## Trends In Wholesale Distribution

- Consolidation continues
- Suppliers fight reverse auctions (online auctions up 1st Q03 24% vs. 4th Q02 19%)
- Partner Relationship Management – oversold and under deliver
- e-Procurement in place but without a more strategic view of procurement does not deliver

Consolidation continues at all levels in the channel of distribution. Manufacturers are consolidating, wholesalers are consolidating, customers are getting bigger. Bob talked earlier a little bit about the use of the web and the internet, not seeing a lot of it within your world. But reverse auctions are on the rise. This suggests to me that buyers are saying: Let me buy direct at times. Let me use the power that I have and bypassing channels of distribution, because reverse auctions work. How many of you use them on your buying side?  How many of you are victims of it on the marketing side? I am surprised that you have not learned to use more of it on the buying side.

You better watch this in motion. I have seen these markets in action. From the starting bell the price drops like a rock. As buyers recognize that they have power over multiple divisions multinationally and they are looking to buy globally, they are able to exert this power in a big way.

As we have been ERPed (Enterprise Resource Planning) to death, we have been CRMed (Customer Relationship Management)  to death as well, and the jury is still out on this. The systems tend to be oversold and they tend to under deliver both for ERP and CRM. They cause massive changes to the firm and can be very disruptive.

We see that e-procurement is starting to work, but where it is starting to fail is, when it is not tied to a more strategic view of procurement.

## Trends in Wholesale Distribution

- Internet's impact on distribution begins to make sense
- Movement to strategic supplier selection and impact on their business (not rebates and discounts)
- Inventory is still an issue (don't want it when the music stops!)
- Who knows what about what and who is linked to whom

If you are just looking to buy off the web, it is not enough. It has to have strategic implications and the role of wholesale distribution may or may not play significantly there. The internet's impact on distribution is beginning to make sense. I just came back from the UK working with Wolseley plc, a large retailer in the UK. They are finding that many of their customers are moving to the internet as a way of buying, because they can do it at 3 o'clock in the morning. I can shop my competition to find out who offers lowest amounts, etc. Movement towards strategic supplier selection and the impact on their business refers to the extent on rebates and discounts. I served on the board of a food wholesaler in the US. The only way they made money each year was on rebates back from the manufacturers. The margins were extraordinarily low and if rebates were not there they did not make money. Inventory is kind of like musical chairs. When the music stops I do not want to hold the inventory. Where is that inventory going to be? In the automotive reseller market for spare parts this is the deal. They want 98% in stock all the time. You manage the inventory at store level and they begin the invoicing process upon scanning of the goods. You get paid 180 days later. Not a bad business!? The manufacturers have to factor their inventory, so they can pay their suppliers. Compare this with Dell, who gets paid in 4 days and pays their suppliers in 30 days. When you talk about supply chains, you talk about networks of cooperating companies, who at times do not know who is linked to whom. People may be linked to competitors. It becomes important not only for flows of goods but for flows of information, which equally become important, when you manage a supply chain. I do not only want to know how much the goods will cost me, but I like to know where they are at any moment in time.


There has always been tension between manufacturers and distributors. That has been axiomatic. The issue is not if there is conflict, the question is: How bad? In the past they have seen each other as almost competitors. The real issue becomes, whose customer is it? The manufacturer who tends to be a little bit removed from the customer. Many times you do not even know who the end user of your product is. Markets are slow. DREF (Distribution Research and Education Foundation) is part of the National Association of Wholesaler Distributors (NAW). They do studies, where areas of conflict and disagreement are. Productivity and quality must exist at all levels of distribution. Functions have to be repeated, because people do not trust each other. They want to make sure that things get done.

A point made earlier, there is a value chain. Certain functions carry higher margins and more importance in the minds of the buyers. The issue becomes who is going to conduct those and who gets to keep the cash. Cash, as we know, is king.

# There Has Always Been Tension But Now…

- Buyers are more sophisticated
- Think of the beer game- transparency of information
- Power base is shifting and maybe the wrong questions are being asked
- Manufactures need to know more about
  - Customers
  - Competitors
  - Value chains and where margins are earned

Buyers start to get more sophisticated. They look at total cost of ownership, at ways in which to leverage their dollars as best as they can. Many wholesalers are moving beyond just flows of goods or managing inventory or the supply, the buyer has. They offloaded that responsibility, the outsourcing, etc.

Power base is shifting. We used to ask whose customer is it? Now the question ought to be: How can we best serve that customer and not fight over whose customer is it.

Manufacturers need to have more information. Who is the end user customer? What is this value equation? Who are their competitors? At many times the competing set is changing. We don't often know who it is. Buyers are still focusing on the price. When it gets squeezed down, people are blaming the buyer. Let me take slightly another perspective here. If you do not understand the value equation and what is important to your customers, you let them treat you like a commodity. As a result of that they will focus only on price.

Let me make somewhat of an outrageous statement here. The channel of distribution is never a customer. At best, it is a partner in meeting the needs of the end users. But if you ratchet your business around your channels, you will do things ultimately that is not in your best interest.

## Common Mistakes

1. The Channel is your customer.
2. I make my plans and then tell my channel.
3. Take my inventory, it is the end of the quarter.
4. No conflict,  not enough channels.
5. The door swings one way.
6. Each man for himself.
7. I have all the answers, I am the manufacturer!

One example for that is Milliken Fabrics, they are a large US manufacturer. They have a large business in walkon-walkoff-mats, the charcoal-grey ugly mat that lies in the lobby of the building. You walk on it, wipe off your shoes and then you walk off. Most of them are the same color. They have the capability of embossing that mat with your logo on it. Their major channel of distribution is industrial laundry. When they come to your facility to pick up your uniforms and various other things, they roll up your charcoal-grey mat and put it into the truck, take out another mat and so on. The logistics on that is very simple, because one mat is as good as the next mat. However, if one mat has Spekman Inc. on it and the other one has Jones Inc. on it, it becomes a logistical nightmare for the laundries. Thus the laundries told Milliken, if you enter this business, we will not carry your product. Milliken decided not to enter and let their channel of distribution make their strategic decision for them.

If you talk about supply chain partnership between levels of distribution, it is important to share information. The closer the partnership, I need to tell you what my plans are. IT is an enabler. The other T word is trust. I was on the board of a small telecom manufacturer who went mostly through distribution. To take the inventory at the end of a quarter, we made a deal with a major distributor. We need to make our numbers, would you take some orders in advance, and after the quarter ends, if you need to ship some of it back, go ahead and do that. We sold $4 million worth of products, took back $8.5 million worth of products. The CEO and the head of marketing lost their jobs and we had to restate earnings with the FCC.

You hear manufacturers talk about the fact that if I don’t have conflict I don’t have enough distribution. If you believe that I have some oceanfront land in Arizona, that I would like to sell to you. For me that is bad channel management. You as the distributor share information with me, but I as the manufacturer will not share information with you. Recognizing that as long as I make my margin, I don’t care what is happening in that channel. All of these things you should not be doing.

Humility is not a word to be used when we talk about big multinational manufacturers or distributors. Don’t believe for a minute that you have all the information, you are removed from the market place.

## The Only People Who Know What and How the Customer Will Buy are the Customer

- **There are a number of channel alternatives and the different ways in which to form relationships with customers.**
- **Questions to ask:**
  - **How does the customer want to do business?**
  - **What sets the playing field?**
  - **Given the range of channel options, what is our goal?**
- **Ultimately we want to attract and keep the most desirable customers, while attaining profits and growth, and the lowest (realistic) cost.**

The only person who really knows how and why they buy is the customer. I got a silly kind of notion that you ought to be talking to them and asking them questions. You build channels of distribution from the customer out. Customers want to go through multiple channels of distribution. They may want the capability of ordering on the internet, but you cannot do fulfillment.

There is an argument that can be made: If you are focusing on market share, that could be a mistake. You should be focusing on profitability. Focusing on sales alone is probably the wrong idea.

After getting my MBA and before I got my PhD I spend 4 years in retail, I worked for the Stop and Shop companies in the Eastern parts of the US, managing a food store, that is where the cash register is and where you learn the business. It was not exactly the high point of my working career, but I spent a year there. My last assignment was to set up a wholly owned wholesale operation that served common inventory to the 5 mercantile divisions that the company had. When I left, it was about a $150 million operation. One of the things, I learned very early on, was that you don't make it up in volume.

## Customer Experience
## – Ask and You Shall Learn

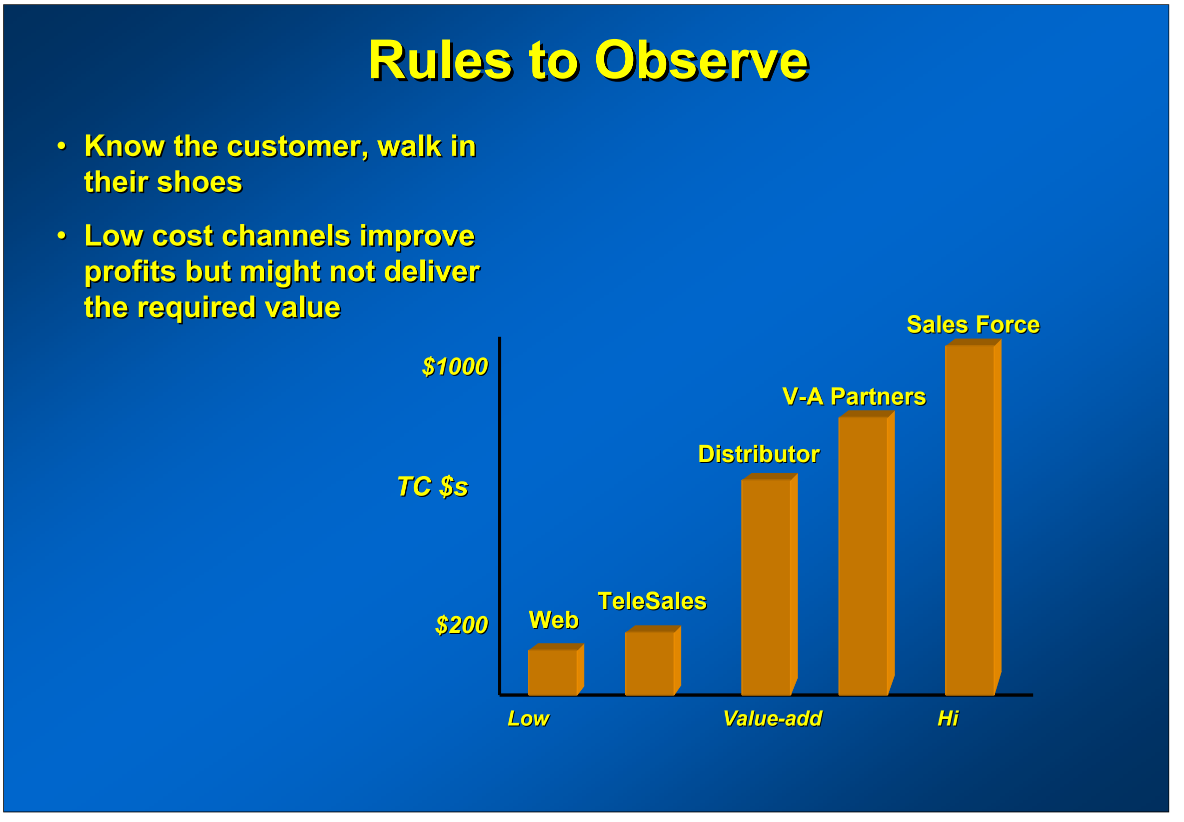
- What factors do you look for in a supplier? In a distributor? What is important to you?
- What is it like doing business with my company? Where are we strong? Weak? What one thing should we change?
- What suppliers provide the best overall solution to your firm? What does the value equation look like?
- Are personal relationships important to you? At what discount from purchase price do they become less important?

| List of channels | use NOW | will use FUTURE | Channel Shift |
|---|---|---|---|
| …… | | | |

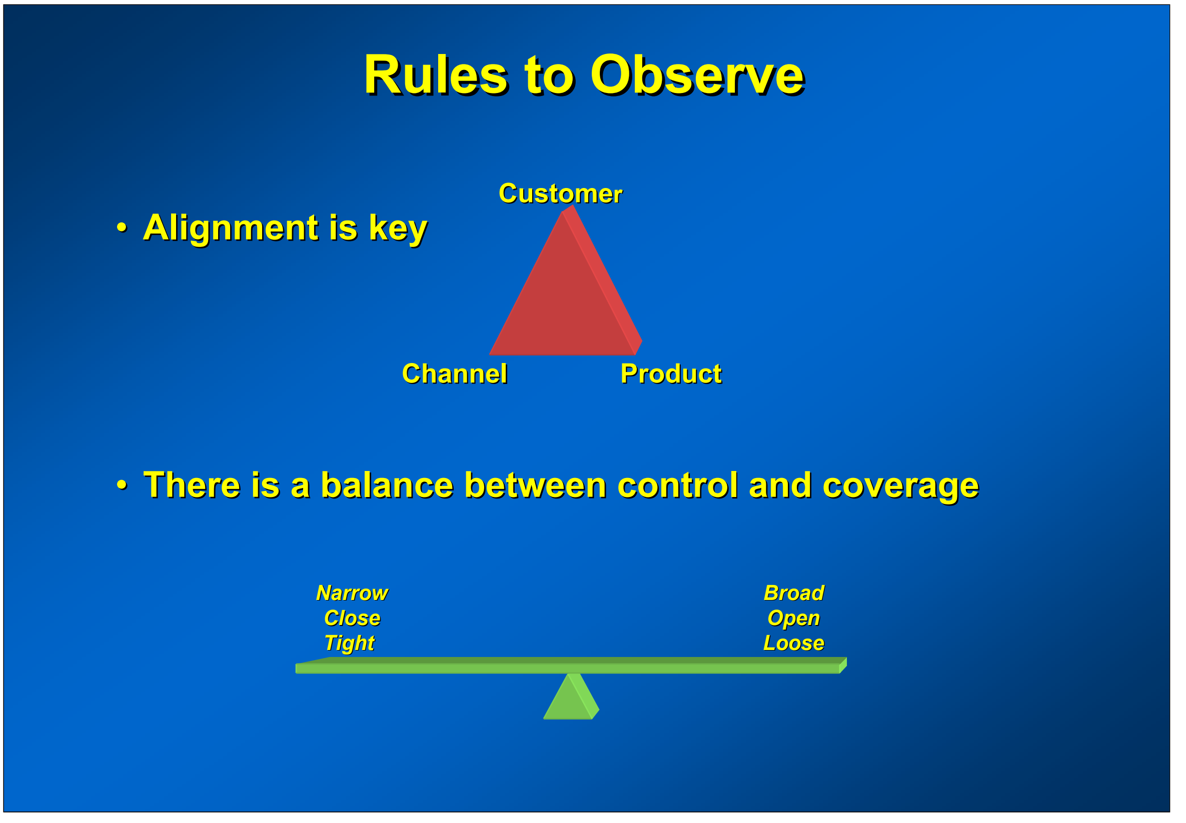
If you go to your customers and ask them above mentioned questions, you will invariably get very useful information that will provide insight as to how you should change and how you interface with your customer

When you look at customer loyalty, it is based on good relationship.

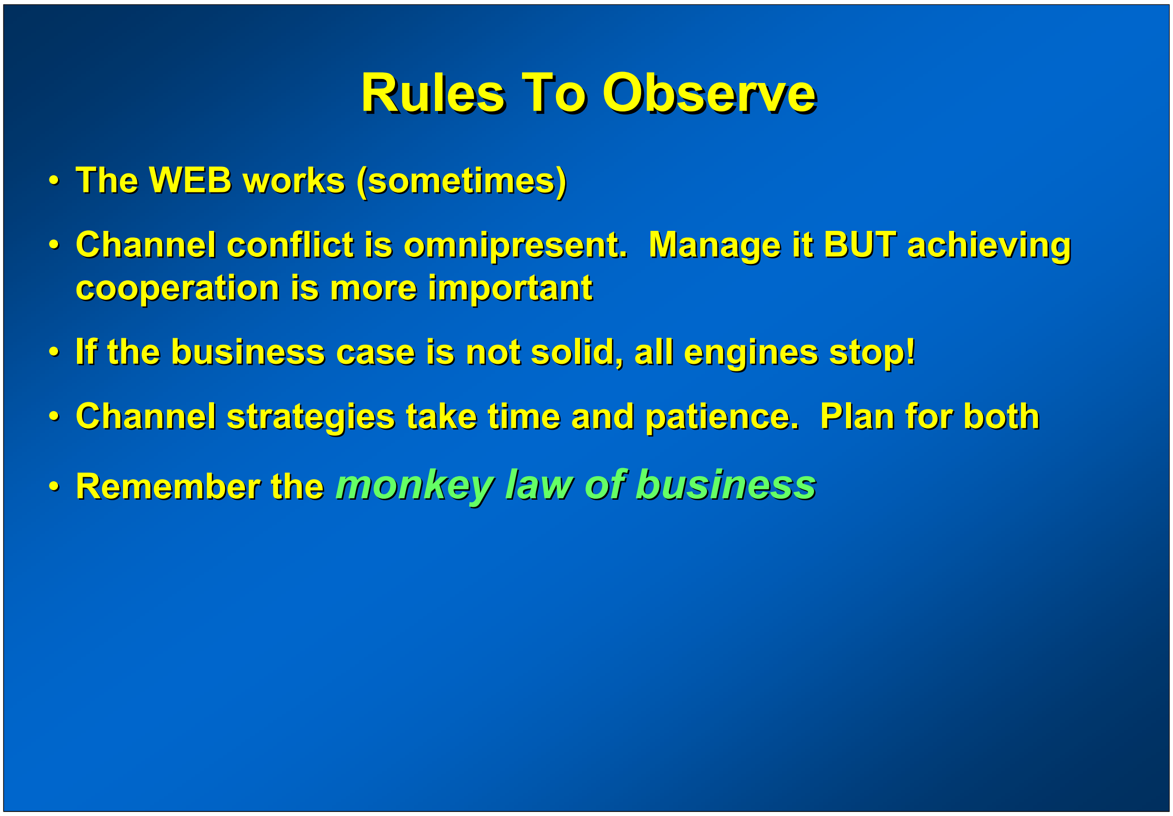
The list on the bottom gives an understanding of how the channel of distribution is shifting. I will come back to this when I talk about the monkey law of business.




Know the customer in the biblical sense of the term. You need to be intimate, understand how they buy, what their value equation is, what they are looking for. You can see that people use a whole array of ways going to market. The web is the least costly, as you would expect, fully loaded about $200, compared to a sales force, which can range as high as $1000. Yet, low cost is not enough, one needs to look for the role played by each channel in the selling process




Understand how the customer, the product and the channel fit together. You could be aligned on 2 not on 1, finding out you are loosing sale. There is a balance that needs to be achieved between control and coverage. You cannot have it both ways. The wider your distribution the less likely you will be able to exercise control, i.e. your ability to influence their decision making. This connotes a more adversarial kind of relationship. If I shift to partner like thinking, then I come to something I call the extended enterprise, which is the entire supply chain in competition with other supply chains. So you as manufacturers are as successful as your entire supply chain competing against other supply chains, that would be the extended enterprise. In those situations you cannot control what you don't own. Then the word control becomes less meaningful.




You can get either commitment or compliance from your distribution. I am interested in commitment. If you are playing the price game, what you will do is, you get compliance.

I can change the price any moment. That is not a strategy, it is a tactic.

The monkey law of business: Have you ever noticed, when a monkey swings through the jungle? Before it releases one vine, its hand is fully grafting the other vine. When you think about changing your channel of distribution, don’t let go your existing channel, until your hands are firmly on your new channel. Because if you do, you might bet your business, it is very risky.

## To Market, To Market, To Find The Right Market

- The majority fallacy – “boy, this market is huge!”
- The allure of the new market – “this is a terrific, new opportunity”
- Don’t believe all you read –


**What Criteria Make Sense**

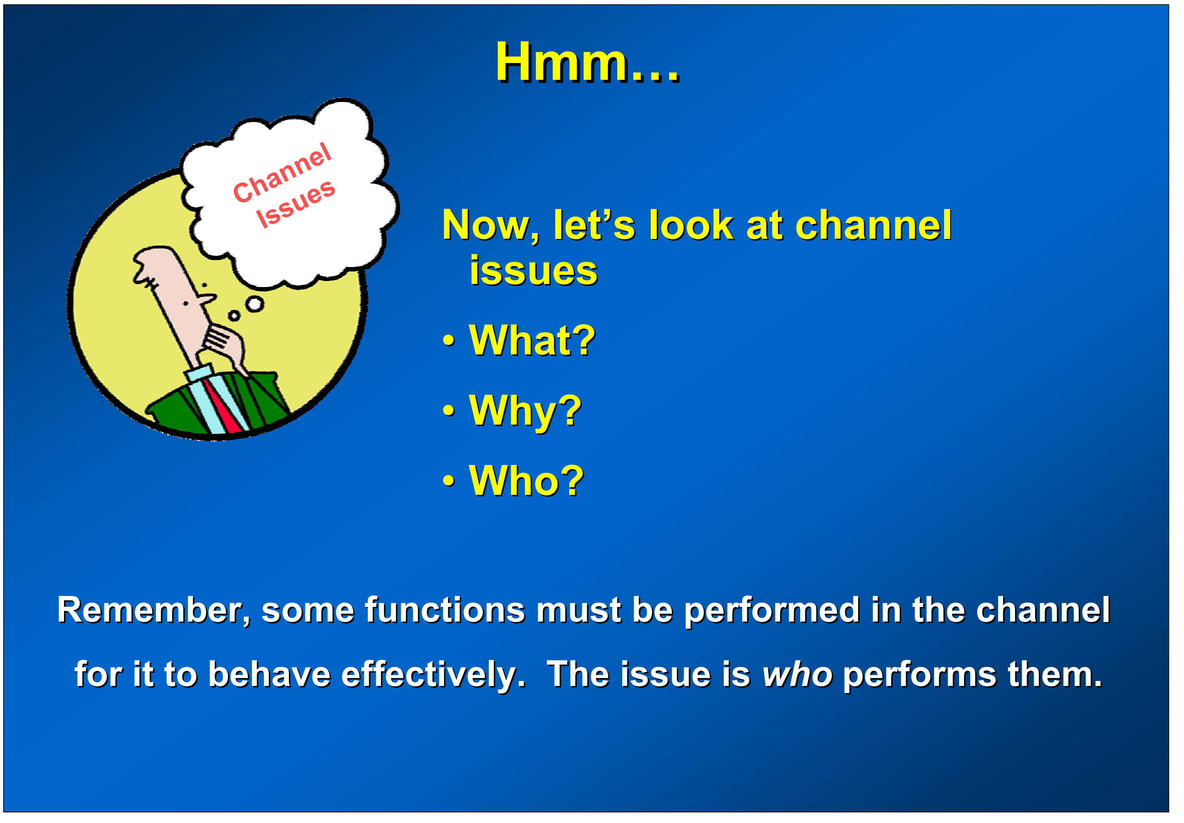
1. Size
2. Growth
3. Can we make a difference
4. Cost of entry / cost to serve
5. Channel Access
6. Strategic Fit

I am reminded of the market in China. This is a huge market place. The difficulty is, that it is a majority fallacy. That is also where the competition is. What you need to look at it is the expected value of a win.

What you find is that the demand of that new market is different from what you can deliver. Since switching channels is tough to do, your channel partner may not have that expertise in that market, also.

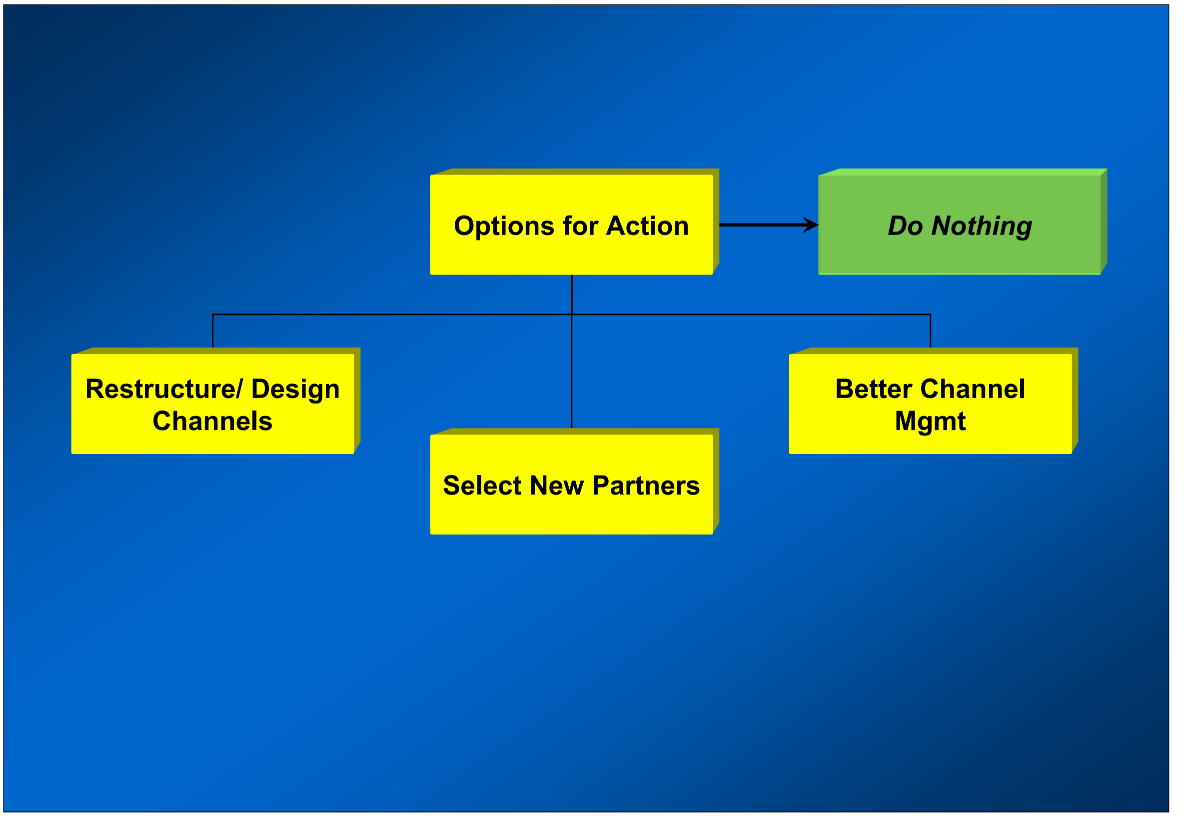
When you talk about shifting markets, market potential is one thing. But you have to look at the available market and its size. Several years ago the FTC in the US was going to sue the cereal industry to have a shared monopoly. 3 manufacturers controlled 87% market share, hence the term shared monopoly. The government was going to separate them out, so Kellogs would have to sell cornflakes and 2 of its market leaders. I could have bought them. The 87% market share was from the ready to eat cereal market. In the morning people do not only eat cereal, but eggs, doughnuts, etc. The cereal industry argued that the market is much bigger than what the government looked at. It should consist of the entire food, people eat in the morning. The market potential would be much larger than what the served market is.

When you look at other markets, you look at size, growth and can we make a difference. If the answer is no, you will compete like a commodity. The only nice thing about competing as a commodity is when you stop.

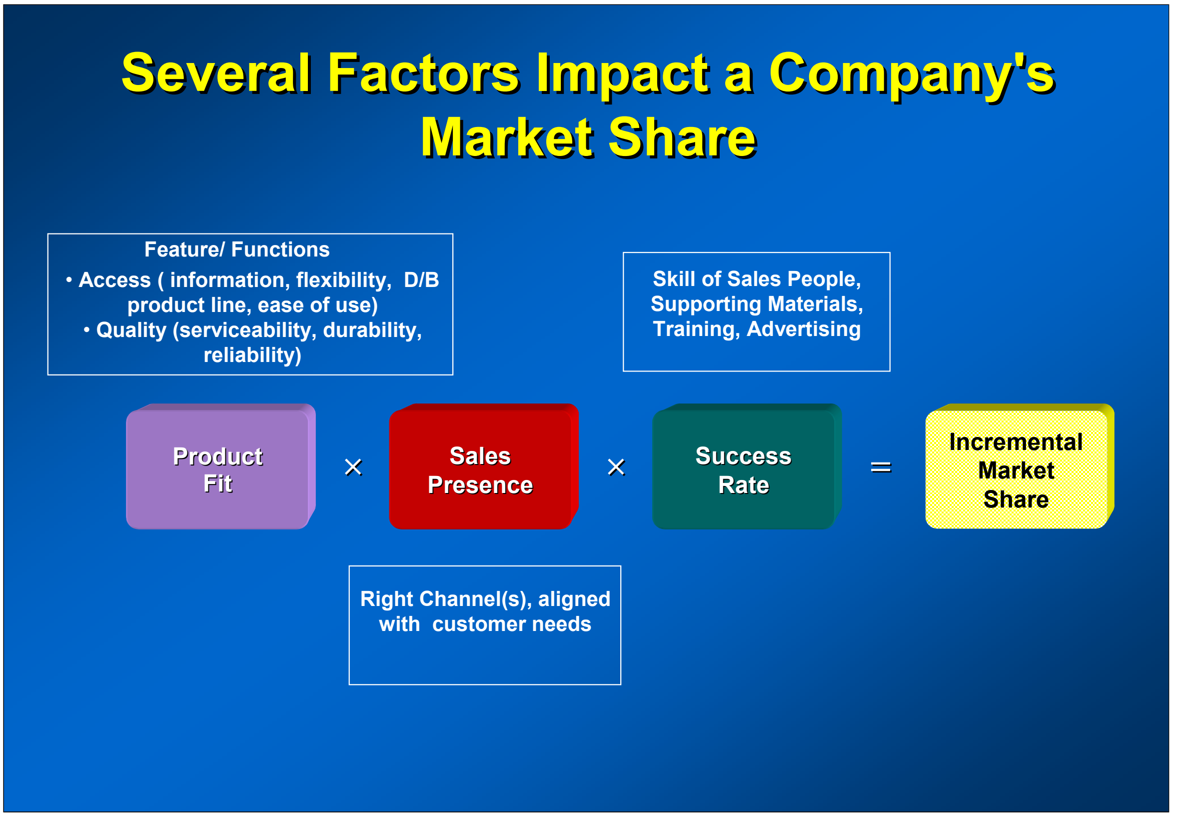



In order for channels to perform effectively, certain functions must happen. I don't care who does them. If you do it, it increases your selling cost, if your channel does it, it decreases your margin.

Who is best to perform those functions? If the functions go away, you have an inefficient channel of distribution. Let me stop here and say that I am a big fan of functional discounting. I want to reward for activities performed. I don't want to just reward for volume purchases.




The options for actions are shown above. I will discuss them as I go further into this talk



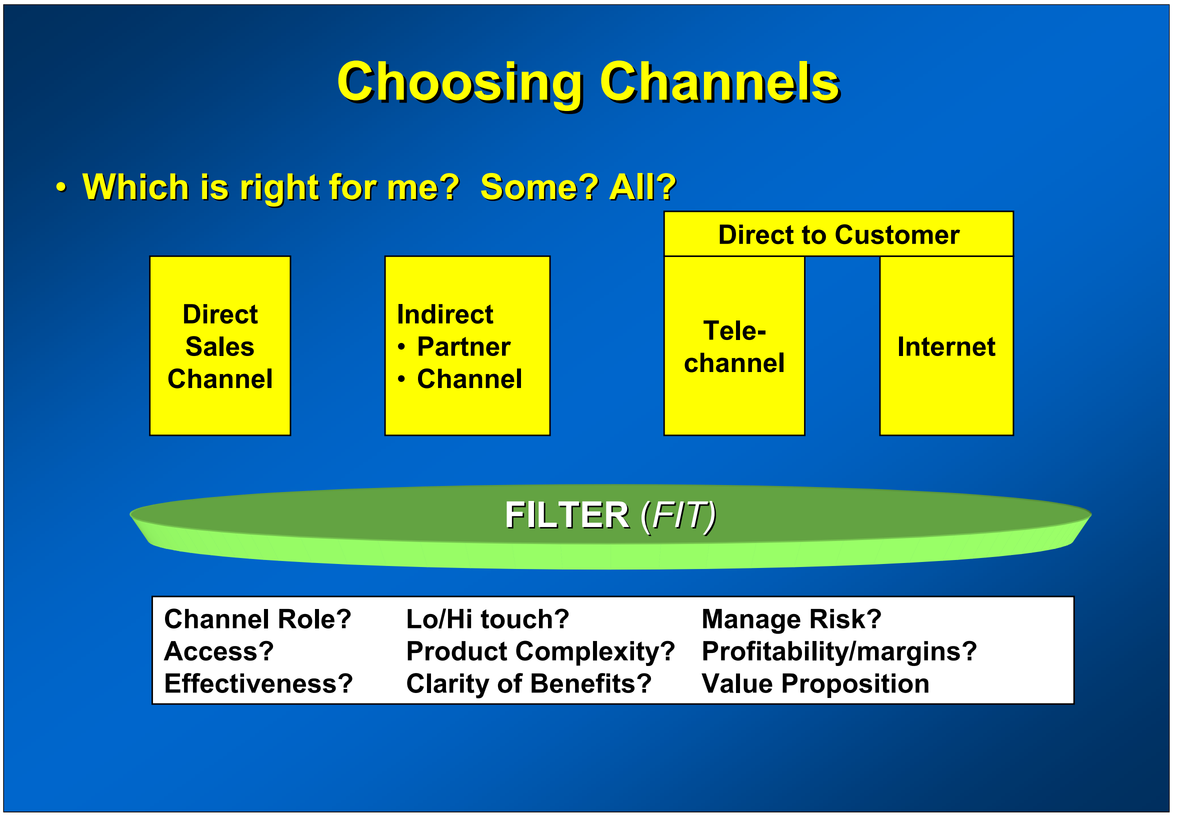

Which factors influence the market share?

Does the product we have fit the needs of the market place?

The second question is, are we in the right channel of distribution? Are we aligned with customer needs?

The third issue is, what are the skills of the sales people and the supporting function we perform? Multiply those all out, you are going to get a sense of what your market share would be. You could be in the right channel with the right product, but your sales people don't have the capability.

Yesterday, I was with a telecom provider. Basically they are moving towards systems solutions. They are not selling boxes anymore, they are selling systems. Their sales force is very good at selling boxes, not selling systems. Their channel of distribution is even worse, because it is a tougher sale, it is a longer selling cycle. They do not get paid, until they sell. So waiting 8 months for the selling cycle makes it a little bit difficult. They are in the right channel with the right products but their share will suffer because of ineffective sales people. If they were better at selling systems; all of this would lead to incremental market share.




Which channel is right for me? The fact is, it is not one size fits all, many may be useful for you but for different reasons. We can talk about a dual channel of distribution, when you go to market through multiple channels, a hybrid channel of distribution, where different functions are performed by different channels. The Tele-channel in the internet may be a lead generating channel only. Packets are handed off to the distributors as a hot lead and they complete the sale. The direct sales could be for large enterprise customers, indirect for smaller. When you start, asking all the questions I list on the bottom here, you get a notion which channel makes sense but from the customer's perspective.

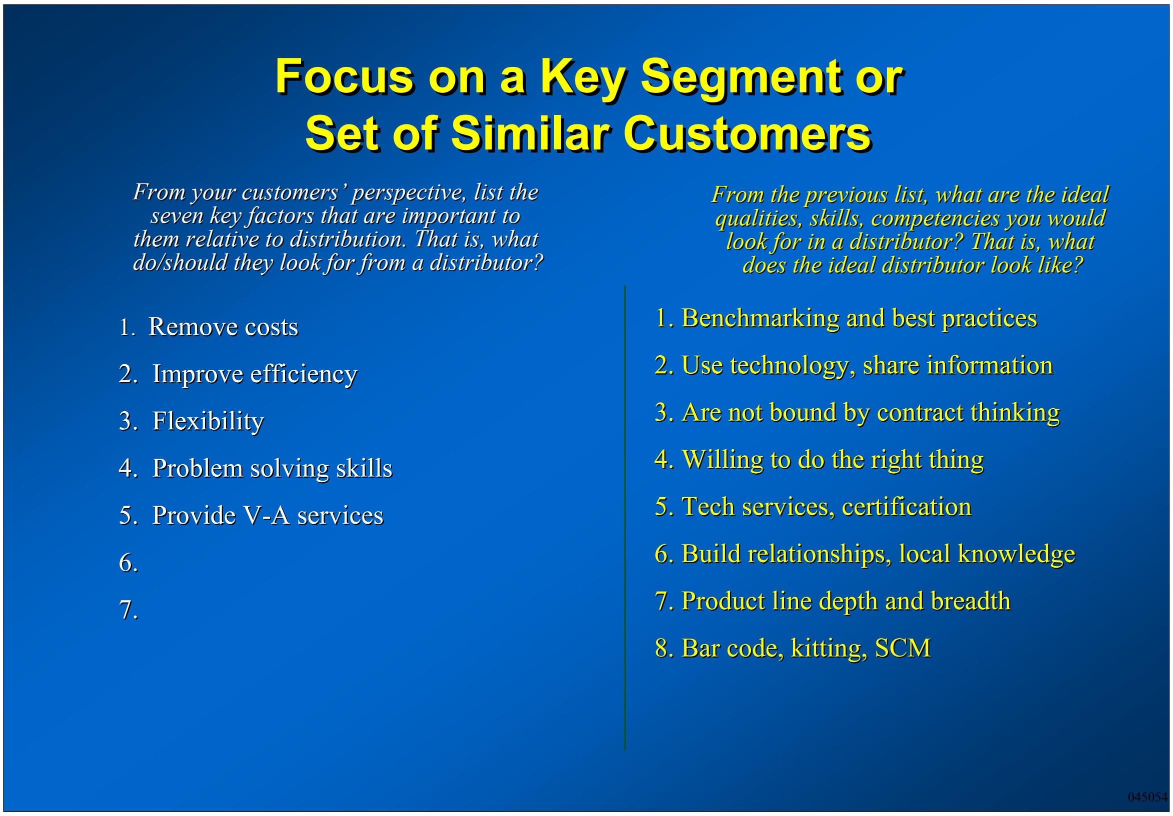
# Customer Analysis

**Market Needs Summary:**

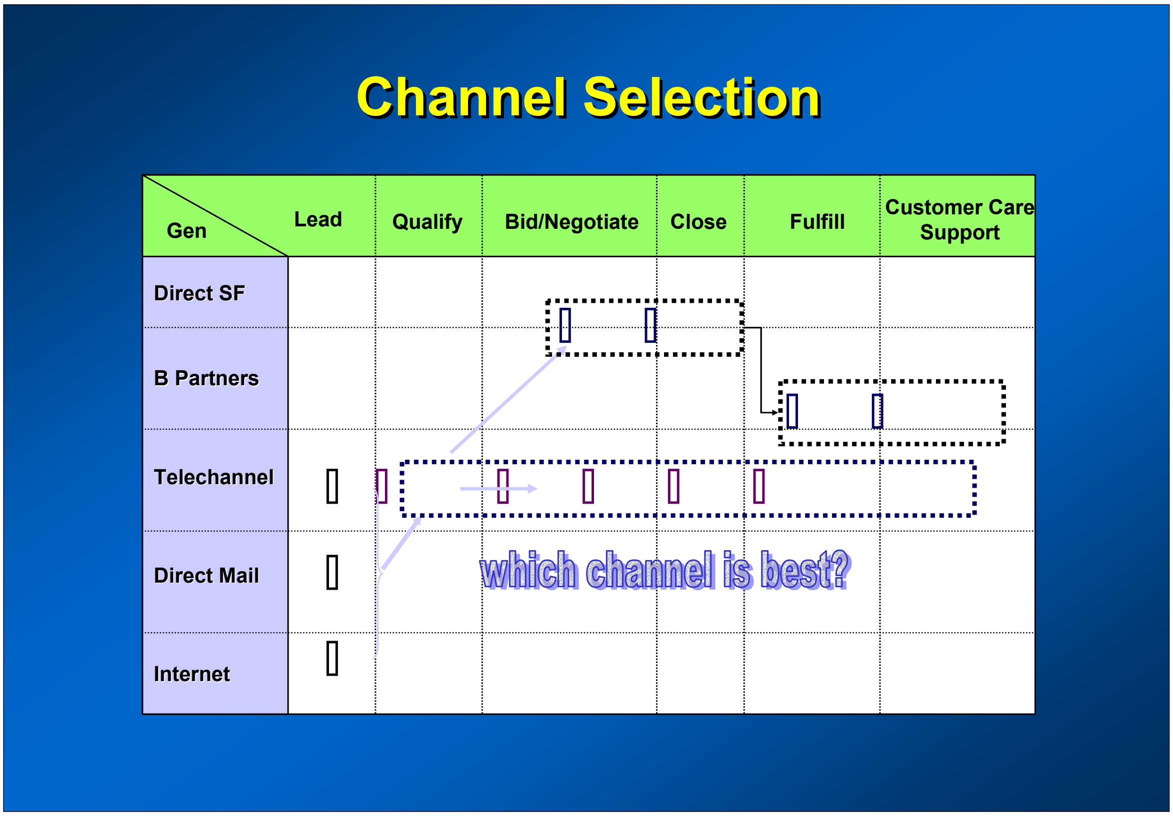
**Competitive Analysis:**

| Top Five Competitors (Rank) | Current Annual Sales ($M) | Current Mkt. Share (% Total Mkt) | TREND | Differentiation Factors (Marketing Mix) | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Product Line Characteristics | Price Strategies and Policies | Distribution Channels and Methods | Promotion Policies and Activities | Key Differential Advantage (if any) |
| | | | | | | | | |
| Your Company | | | | | | | | |
| All Others | | | | | | | | |
| Total | | | | | | | | |

When you do a customer analysis, gain as much information about that customer as possible. So you can understand how they want to be met in the market place. If you know more about your customer and can segment more completely, you can provide richer solutions and demonstrate that you KNOW their business




For example, you may want to list the important factors for them in distribution. From those factors you can look at skills and competencies, that you would want with your distributors. For example, they may want to remove cost, improve efficiency. That is what they are looking for. But on the right side are listed the qualities and criteria, upon which you may want to evaluate your channel of distribution. From this you get a sense what your ideal distribution would be. Then you look at your current distribution and the question becomes, how do you fill that gap? The difficulty is, we have baggage. We have been dealing with distributors for a long time. We have relationships with them. Changing channels is very is very difficult to do.




This is an example of many ways to go to market. I am not saying that the Tele-channel is best. Don’t misread the slide. If you look at certain functions (horizontal items) that need to be performed, there is a number of ways in which you can do that. Ask which channel is best for which activity.

As you know large multinational corporations are heading up Tele-channels in India, Ireland and other parts of the world to serve markets within the US and elsewhere. These are low cost channels but might not be good at providing certain important parts of the customer interaction.


We have conflict in the way, we define our role. The manufacturer says, I do this, the distributor says, wait a minute, I do those things as well. The objective function of both does not tend to be the same.

I often ask manufactures, when your sales people in their company car go out to call on their distributor, what type of car do they see in the parking lot? If the answer is Jaguar, BMW, that is a perfect indication of goals being misaligned.

You can talk about channel design, channel policy. One of the ways you can minimize some of the conflicts is not making the same items available in the same channel of distribution. Certain customers are buying certain things from certain channels.

You may want to leverage your name in the marketplace. All the patents, on Nylon, Dacron and all the -ons DuPont sells, have expired. They are commodity goods. Yet DuPont still gets 10% to 15% more in the marketplace selling commodity products than their competition does. You go to Wilmington, Delaware, and ask them, how do they do that, and they say: It is the oval, the DuPont logo.

## Where Does Conflict Arise? What to Watch out for?

1. Are different channels going after the same customers?
2. Are actions misinterpreted, is cooperation viewed as competition?
3. Is decline in profits inefficiency or channel failure?
4. Is the channel pulling your profits down?
5. Looking for forest fires tends to ignore the bush fires that can degrade performance
6. Issues over how to grow the pie are different from splitting the pie

You tend to say that our direct people go after these customers, our indirect people go after these customers, and based on market saturation or whatever reason, distributors start to migrate up market, your sales people start to migrate down market. You run into difficulties.

When every manufacturer initially went to the web and offered an assortment on the web, their channel of distribution automatically is thought as a substitute as supposed to a complementor.

Margins go down. Issues over growing the pie are not the same between you and the distributor.

## Channel Management's Dilemma– Oops, we have problems

- Unhappy users
- Costs are increasing in the channel but service and quality is not
- Shares are falling and growth opportunity has diminished
- Unexplored new channels- re define standards and expectations
- Competitors are gaining in finding better ways to market

We have problems.

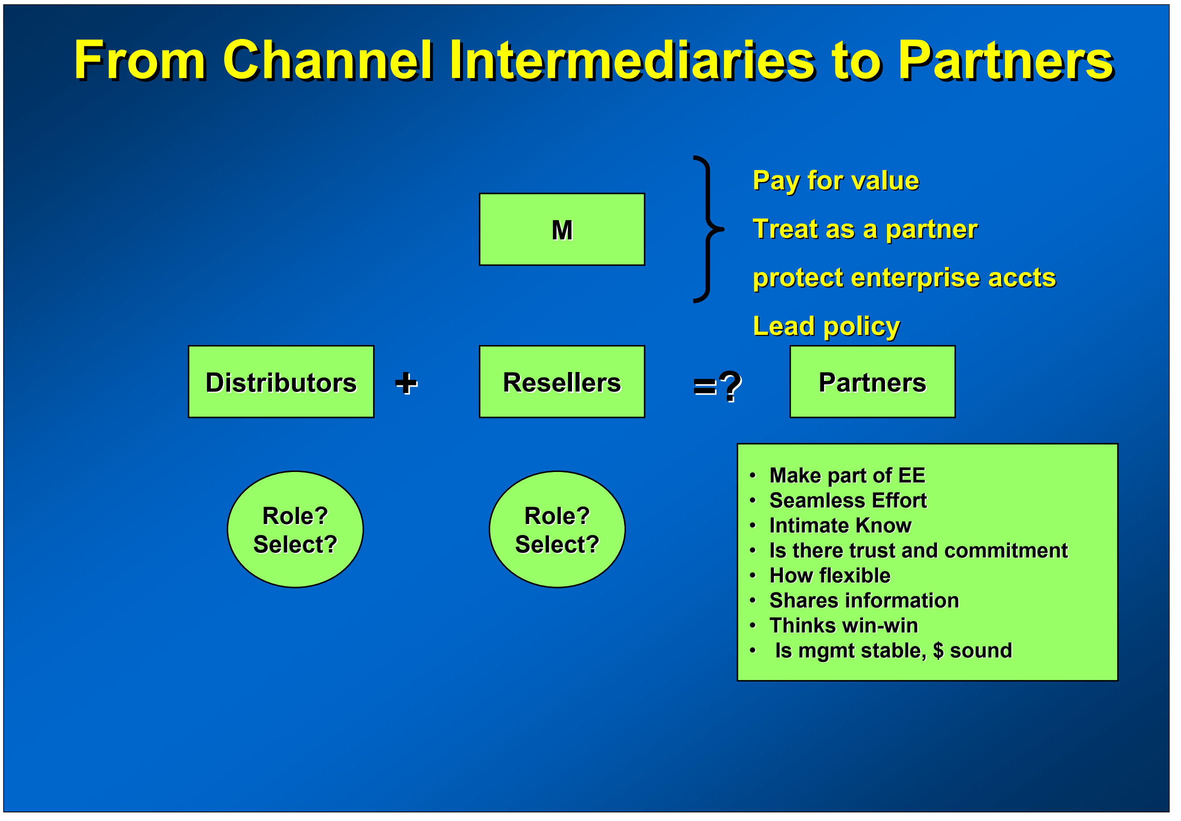
Competition is finding a better way to go to market. What are we doing? We do the same old story.

All of these would be issues relative to channel management and where there is conflict.

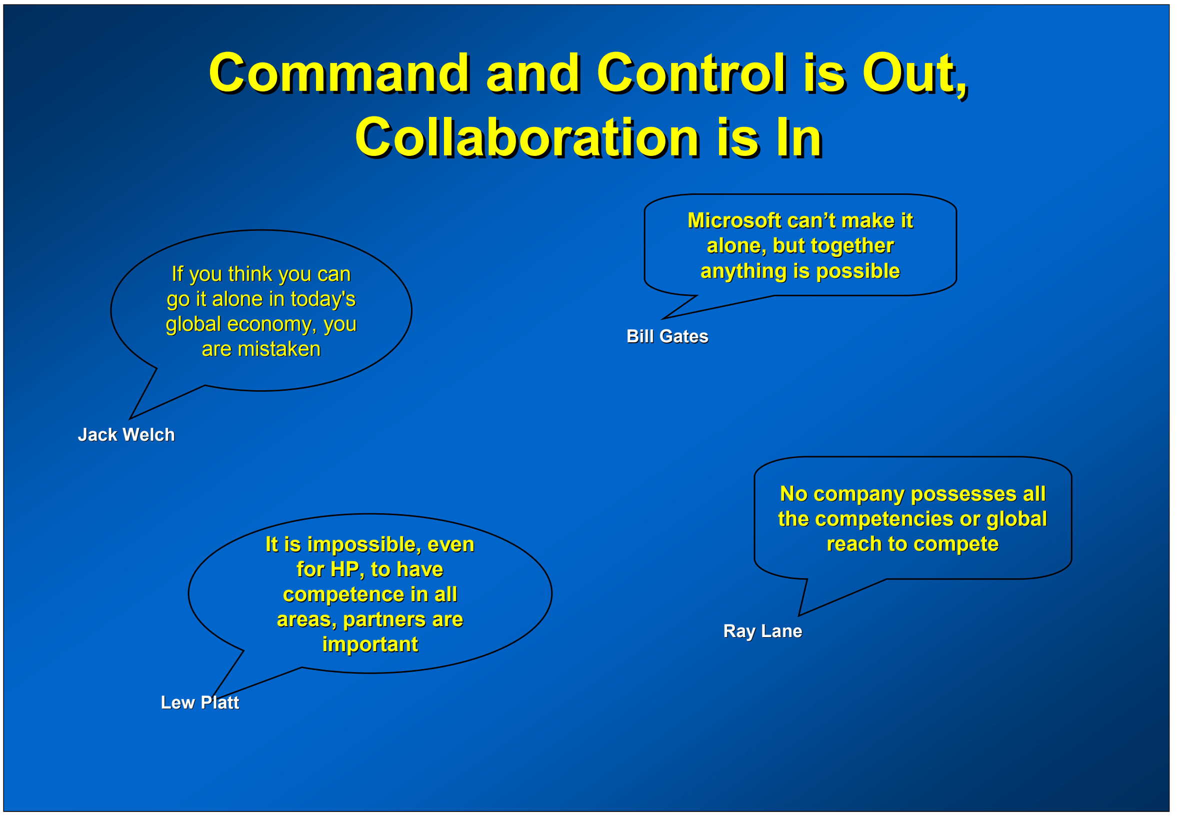
## Channel Management's Dilemma– Oops, we have problems

- Gaps in market coverage- channels tend to serve segments and sometimes cracks appear
- Pricing exceptions have become the rule
- System economics fall apart -
- Complacent intermediaries -
- Relationships with distributors are deteriorating
- Information systems mandate changes- improves interface

Information systems become very important. They cannot be ignored.




With the rest of my time I want to talk about moving from calling distributors and resellers only to calling them business partners. They are not the customer. It is important to understand them as potential partners. Making them part of the extended enterprise (EE). Trust and commitment. How flexible is the channel in order to meet the needs of the customers? Is the information flow going back and forth? Is their management stable and financially sound?




You have to watch out for Microsoft. When you have a 110% market share, I mean, you better watch out for them.

If you are going to engage in vertical markets. Many times your channel of distribution is the one that adds the technology and expertise necessary to deal in those markets.

Ray Lane is with Oracle. Let me make a couple of statements about Oracle particularly and Microsoft as well. When they talk about partnership people need to be careful, because they have reputation of being pirates in partner's suits. It is appropriation of technology one has to watch out for. Not that they are bad people, but they are somewhat self-motivated.

## Lessons from the Trenches

Integrate across business processes to gain leverage

R&D and Design → Production → Serving Customers → Channel Strategy

Build initiatives in

- Quality
- Automation
- Supply Chains
- Developed a build to demand framework
- Relied on the partner selection models
- Look at JIT operations and what worked + Enterprise wide software
- Collaborative platforms to connect parts of SC
- Proposed metrics to flow system wide
- e-Business connectivity

When you look at lessons learned, basically what you have to do is integrate across business processes to gain leverage. Let me give you an example: Cardinal, a very large pharmaceutical distributor in the United States. The margins they find in distribution are not very good. What they have done is, they now engage in businesses ranging from drug discovery to contract manufacturing, to working through FDA (Food and Drug Administration) certification. Their hope is, if all we did was focus on distribution, we will be earning our 3% to 6%. Now they offer a complete array of skills to manufacturers, to help them through discovery, through contract manufacturing to introducing to the marketplace.

## More Stable Partnerships are Identified by the Following Characteristics:

- Goal compatibility
- Recognized interdependence
- High levels of coordination
- Trust and commitment
- Symmetry is important
- Open and bi-directional flows of information
- Focus on joint decision making
- Long-term focus (episodic) is important
- Cultural compatibility

When we talk about stable partnerships, there are certain characteristics that must exist. Goals do not have to be the same but they do have to be compatible. Is there a recognized interdependence between them? If the answer is no, one of you will behave opportunistic to your own advantage but to the detriment of your partner. If there is recognized interdependence it is an acknowledgment that everyone is in it together and I will not attempt to gain an advantage at your detriment.

If you don't have trust, you don't have anything. You tell me you are going to do something and I believe that this is going to happen. Some say: Absent trust I need contracts. I am not willing to take it that far.

Symmetry is important, meaning fair dealing. When you are engaged in partnership with your channel of distribution, if you go into these with a banker's mentality (meaning: At the end of the day, before a banker can go home, his cash accounts have to balance), you may not get balanced at any moment in time but there will be balancing over time.

Information has to flow both ways. Both of you are involved in joint decision making.

When I talk about long term focus, I basically talk about what I do in period 1 of sex, what you do in period 2. If I am dealing with distribution in just a straight market sort of commodity mentality, what I do in period 1 has no implications for what happens in period 2.

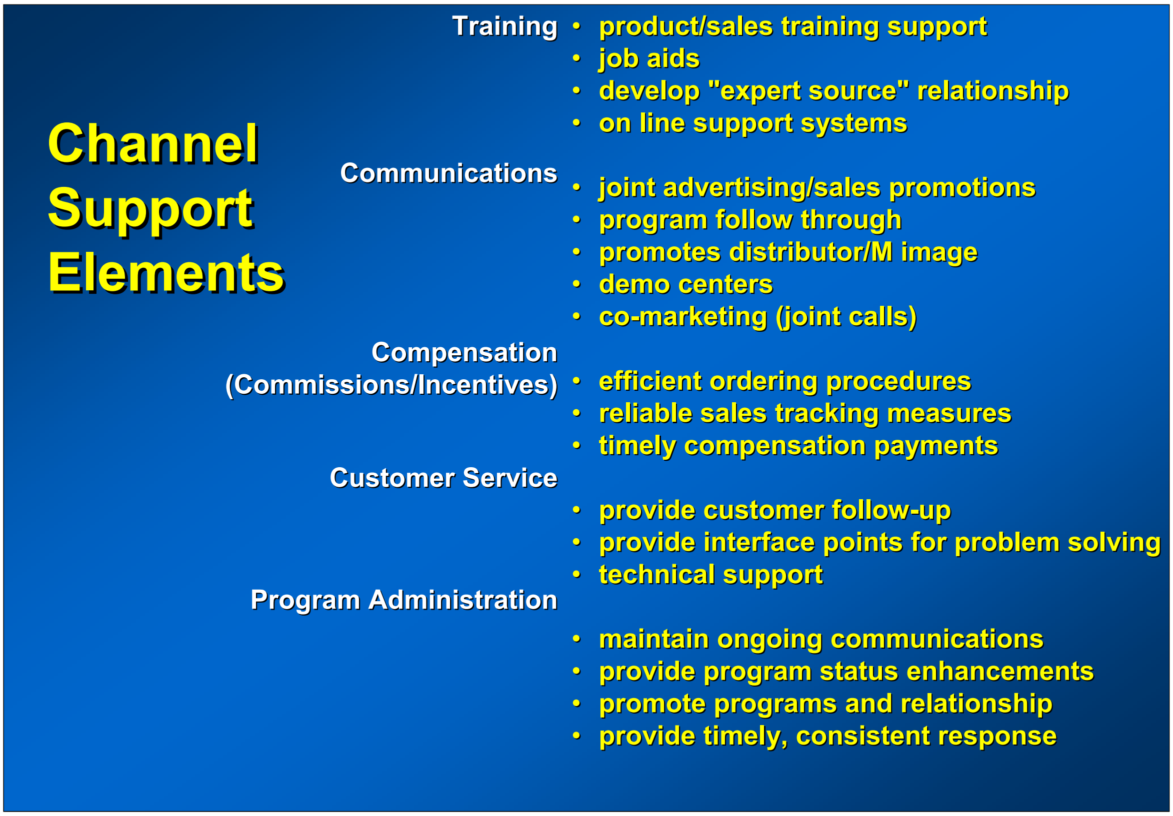
Some manufacturers may move forward into distribution. The economics are not the same. The culture of those businesses are not the same. Most manufacturers who move forward find, that they have to do it out of necessity, that they are going to loose the market, if they don't.


What do I look for, when I attempt to select a channel? Those would be some of the criteria I am looking for. Some of the measures, listed here, are not hard measures.

## Ways to Augment the Market Offering in a Collaborative Relationships

- Pull promotional programs
- Warranty, maintenance and repair agreements
- Cooperative advertising and promotional allowances
- Joint sales calls
- Coordinated cost reduction programs
- technical assistance
- Logistics and delivery systems
- Computer linkages
- Shared expertise programs (communities of interest)
- Value enhancement and co-design programs
- Others? Which do you use? Which are effective? Why? Why not?

Ways in gaining a more collaborative relationship are working with each other, technical assistance, logistics, shared expertise, value enhancement, co-design. This does not go only for manufactures but all the way to end-use buyers. All of this becomes important if you want to deliver a seamless channel of distribution.




We often have asked the question: What can a channel of distribution do for me? I don’t do accent, so I won’t attempt to speak like John F. Kennedy. The question is, not what they can do for you, but also what you can do for them. These kinds of issues become important.


To insure success within channels of distribution, some of the things you should look for are the following:

A rational way of selecting channels of distribution. Have a process in mind. Support that channel of distribution.

Compensation: I am a big fan of functional discounting. I want a reward for behavior and action done. I don't just want a reward for volume bought. Ways of dealing with conflict management becomes very important.

Have ways of measuring and tracking. What gets measured, gets done and compensation works.

Going in with a partner-like attitude becomes very important.

Thank you for your time and attention. I appreciated it.