Frank Lynn & Associates, Inc.
MARKET STRATEGY CONSULTANTS

Effective Channel Selection:
The Number One Success Factor Identified

By:

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It's All About Channels

There is probably no area in the entire marketing field that is as obscure as the marketing of products through distributors, dealers, wholesalers, jobbers, etc. The factor that makes this kind of marketing so complex and difficult to understand is that an independent business operation (i.e., the distributor or dealer) "sits" between you, the manufacturer[1] and your customers. As a result, you are continually frustrated by your limited ability to directly impact your marketplace.

Through the course of our consulting assignments, we at Frank Lynn & Associates have devised an analytical process to assist our clients in effectively managing their marketplace. It is designed to help understand the market's dynamics and its economic relationships. It begins with the concept of *channels*[2].

Simply stated, channels are vehicles that move a product[3] from the finished goods inventory of a manufacturer to the ultimate customer. There are two types of channels—*direct* and *indirect*. Direct channels are controlled by the manufacturer and support the manufacturer's product exclusively. Indirect channels can only be influenced by the manufacturer and sell other brands of product and other product lines as well.

Examples of direct and indirect channels are:

Direct	**Indirect**
Direct sales force: • National account sales	Retailer
Internal sales department	Wholesaler
Direct mail	Distributor
Telemarketing by manufacturer	Dealer
Manufacturer's catalog	Systems integrator
Advertising	Value-added reseller (VAR)
	Original equipment manufacturer (OEM)
	Manufacturer's representative
	Catalog published by channel
	Telemarketing by channel

1. We have designated "manufacturer" to be any marketer or producer of a product or service.
2. Whenever we refer to "channel," we include direct and indirect channels, unless specifically noted.
3. We have designated "product" to encompass both "product" and "service."

About Channel Selection

Over the years, Frank Lynn & Associates has developed a model for viewing the marketing process from the perspective of selecting and using appropriate channels. It is based on the premise that effective channel management is the key to the success of all product marketing—*growing market share and maximizing profitability.* Our channel selection process has been rigorously tested and validated through hundreds of "real-life" consulting assignments and can be a valuable resource because:

- It outlines a logical, disciplined approach to assessing the fit and capabilities of any new or existing channel
- It identifies the types of information needed to thoroughly evaluate channel alternatives
- It identifies the support that each channel alternative requires to be successful with different products
- It allows companies to focus resources on activities of importance and identifies where to eliminate wasted effort
- It allows coverage of the market without overlapping channels or duplicating support efforts and costs
- It can help reduce the risk of being rejected by the market by giving companies a logical set of guidelines against which to select channels and measure their performance
- It is market-driven, not product-driven
- It is flexible enough to accommodate unique product and market characteristics while providing rigorous guidelines of universal applicability

Proper channel selection is the key to your success in the marketplace—regardless of how simple or sophisticated your product or marketplace may be. Poor channel selection will negate the competitive advantages of a superior product offering. In fact, channel selection analysis should be considered if any of the following are true:

- You are introducing a new product
- You want to perform a "sanity check" for an existing product
- Your product is maturing to the point where you want to investigate expanding beyond your direct channels and use an indirect channel for the first time
- Your product is maturing to the point where the efforts of technical specialists are no longer valued by the marketplace
- As your product continues to mature, customer[4] expectations are changing
- Your market share is eroding, and you are uncertain why
- Your profitability is slipping, and you are uncertain why

4. We have designated "customer" to be any end user of a product or service.

The "Big Picture"—Understanding the Market Life Cycle

The "Rosetta Stone" of the channel selection process is the market life cycle. What is a market life cycle? How does it differ from a product life cycle?

At the most basic level, product life cycles are driven by changes in product technology, and market life cycles are driven by changes in customer needs and behavior. For example, the market life cycle is an accurate way to reflect changes in customer needs and behavior as an innovative new technology enters the marketplace and customers learn how to utilize this innovation. This process of customer internalization of technical expertise has an impact on marketing factors, including:

- The amount of technical support the customer requires, both prior to the sale and after it is made
- The type of channel from which the customer purchases the product
- The buying process the customer uses to purchase the product
- The price the customer is willing to pay for the product

Throughout the market life cycle, new products are introduced that reflect changing customer needs. Each new product has a product life cycle of its own, but the functional nature of each of these new products is shaped by the stages of the market life cycle. For example, during the growth stage of the market life cycle, new product designs tend to expand applications by increasing the number of new models and basic variations; during the mature stage of the market life cycle, product designs tend toward standardization to reduce product cost. Therefore, throughout the market life cycle of a technical innovation, many product life cycles come and go.

We find that manufacturers often "misread" the market life cycle when they introduce a product based on technology that is new to them but is not new to the marketplace. If the marketplace already knows how to use a product technology, then the market life cycle is already underway and the manufacturer should employ strategies that successfully launch the product and take this into account.

Typically, market life cycles fall into three reasonably distinct stages as shown in Exhibit I on page 5. Understanding these stages can help you determine where you are in a market and, therefore, what kind of direct sales force and indirect channel marketing programs you need to effectively support your target customers.

Introduction Stage

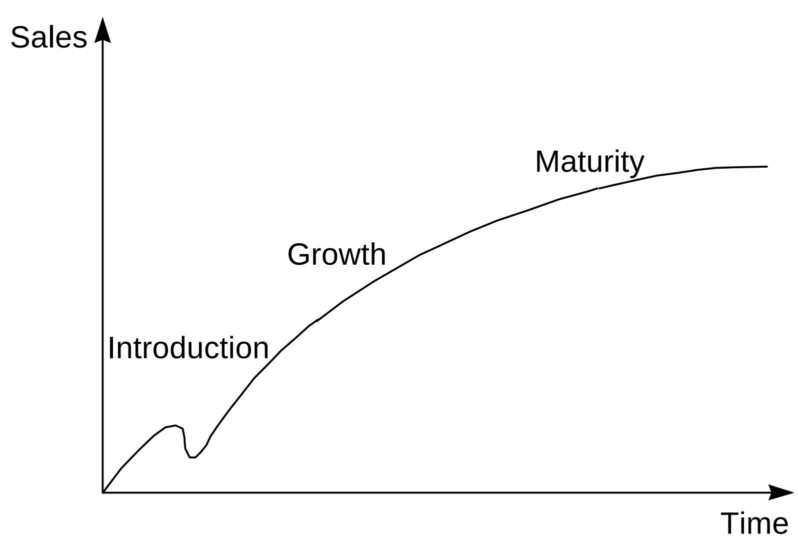
A market life cycle usually begins when an innovative new technology is introduced into the marketplace. Since customers typically know very little about this new technology and its use, this stage of the life cycle is characterized by high levels of presale and postsale technical support. Because the buying process is heavily technology-focused, we find that direct selling is the most effective channel, with indirect channels serving only a limited role. Also, large customers are normally the early purchasers of a new technological innovation, and they are relatively easy for a direct sales force to target and manage. This is particularly true for capital equipment products, since the buying process is long, sales costs are high and indirect channels are not able to make this kind of long-term investment in market development.

This direct sales requirement is often overridden when the customer purchases two or more new technologies simultaneously. In these circumstances, it is not unusual to see a systems integrator channel in the buying process. The systems integrator channel allows the customer to buy this new technology "package" from a single source and thereby focus performance responsibilities in one place. (The value-added reseller channel for small computer/software purchases is one example of a systems integrator channel.) Although systems integrators may purchase the product from the manufacturer, this channel does not normally perform much of an inventory function and usually generates most of its profit from the engineering services it provides in conjunction with the technology integration process. The systems integrator channel tends to disappear from the marketplace as the customer internalizes the technology within its business and begins to unbundle (split apart) the product and other services and support in its purchase process.

Other characteristics of the marketplace during the introduction stage of the market life cycle are:

- Large customers are normally the initial buyers during this phase, and they undergo a rigorous test and evaluation process to evaluate the usefulness and economic viability of a new technology. This occurs because the benefits of new technologies are often over-promised, and their constraints and limitations are not well-understood

Exhibit I



The "Big Picture"—Understanding the Market Life Cycle

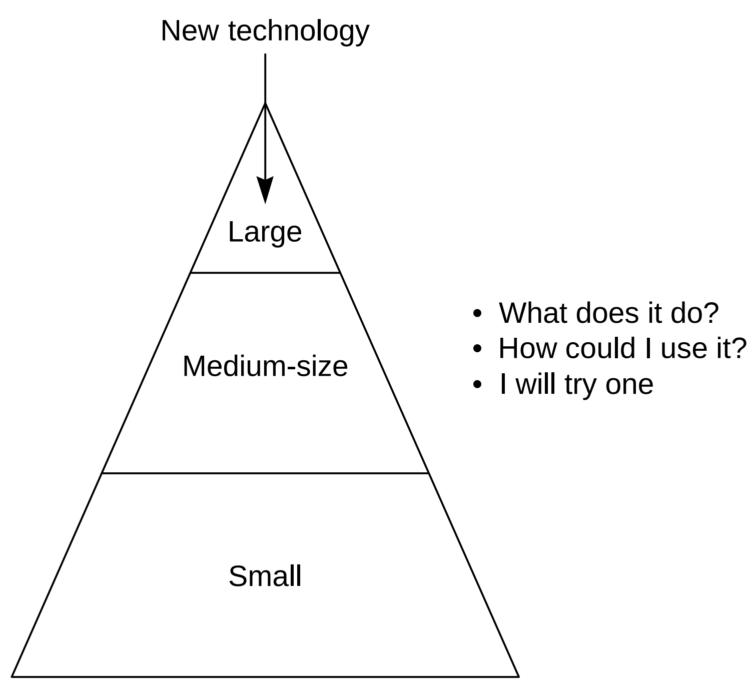
- Premium prices are normal during this stage, and large margins are required to fund the high cost of market development
- Initially, there are limited suppliers, but this may change rapidly if the basic technology is readily accessible

The key to success or failure during this stage of the market life cycle is delivering high levels of customer satisfaction. It is absolutely vital that companies manage customer satisfaction during this introduction phase and not abandon the responsibility to the direct sales force—or to a systems integrator channel. If initial customers are not happy with the product provided, or the way it has been provided, they will not continue to purchase that product. This can also result in gaining a poor reputation throughout the marketplace by word of mouth.

Growth Stage

The growth stage of the market life cycle takes place when a new technology or technological innovation begins to move into the marketplace and finds new applications (see Exhibit II). At the same time, the technology

Exhibit II



Customer Size

The "Big Picture"—Understanding the Market Life Cycle

moves from the large customers to medium-size and smaller ones. As a result, market growth is quite rapid during this stage. In fact, it is not unusual to find sales growing substantially at the same time the manufacturer's market share is eroding because the market is growing more rapidly than the manufacturer's actual sales.

The key to success or failure during this growth stage is simultaneously managing market coverage, product coverage and customer satisfaction. As new applications are developed, products must be developed to fit them. The personal computer market offers an example of the problem of product coverage. Initially, the personal computer was a single-product market. Applications that required greater memory and faster processing speeds were developed very quickly. As a result, to remain competitive, manufacturers had to quickly broaden their product lines from a single model to multiple models that provided not only greater memory and operating speed but also included portable and laptop models as well. Smaller manufacturers, which were unable to finance the cost of this product-line expansion, found themselves losing market share and, in some instances, were forced to withdraw from the market entirely.

> ***"Indirect channels have a key role in obtaining market coverage in this growth stage of the market life cycle, particularly in high-technology markets where a new technology may have only a three- to five-year life."***

Managing expanding product line coverage is difficult because it requires ever-increasing commitments of financial resources for product development and manufacturing capabilities. This, however, is not the whole story since product line coverage by itself will not ensure success during the growth stage. The other variable that must be managed carefully is market coverage—if your product is not present for sale to the customer, you will never make the sale. Managing market coverage is a much more difficult marketing task than managing product line coverage, since market coverage takes place outside the four walls of your business. We often see companies ultimately lose the market share battle, despite a good job of managing product line coverage, because of poor market coverage.

Indirect channels have a key role in obtaining market coverage in this growth stage of the market life cycle, particularly in high-technology markets where a new technology may have only a three- to five-year life. Since customers need high levels of technical presale and postsale support, it is essential that the indirect channels delivering these products can also deliver the levels of technical support required.

If not, customers become dissatisfied with both the channel and the manufacturer, and the product will lose its foothold in the marketplace.

Channels that offer high levels of technical support to customers are known as technical specialists. With good training from the manufacturer, technical specialists are able to provide customer support that is on par with the service delivered by a direct sales force—and they can provide it locally. Because technical support entails high sales/support costs and the manufacturer has to compensate the technical specialist for these higher costs, these specialists require high margins from the manufacturer.

The key to this stage of the market life cycle is assembling a network of technical specialists to cover all segments of a growing market. Manufacturers often opt to cover the large customers with a direct sales force and rely on technical specialists to cover the remainder of the market. In some cases, however, large customers are comfortable buying from technical specialists, and they should be allowed to continue to do so. It is also important for manufacturers to recognize that different types of customers may prefer to buy from different types of technical specialists, so it may be necessary to market through several specialist channels simultaneously to obtain adequate market coverage. As a rule, any market coverage strategy that is based on the manufacturer telling the customer where to buy its product is a risky one.

There are a couple of characteristics of the growth stage that are worth including in this discussion:

- Manufacturers that have broad product line coverage and high levels of market coverage are usually the market share leaders; these positions tend to remain strong as long as the manufacturer does not make major product and marketing mistakes
- Prices decline during this stage as customers internalize the technology and become unwilling to pay for the high levels of technical support that they needed at the beginning of the stage; bid-buying processes become instituted by large customers during this period as a means of forcing price reductions and unbundling the products from unnecessary services

Maturity Stage

The maturity stage of the market life cycle is characterized by a gradual decline in the growth of the market. It is a difficult stage for marketing management for a number of reasons:

- Market positions begin to consolidate over time as marginal competitors are forced to withdraw from the market
- Customer satisfaction requirements may be changing from their initial areas of emphasis and must be fine-tuned
- Serious margin and profit erosion are common, as major manufacturers fight for market share and volume to fill production capacity in their plants

The "Big Picture"—Understanding the Market Life Cycle

- Technical product differences tend to diminish in importance as customers standardize their product performance expectations and manufacturers move toward product standardization to lower production costs
- The role of the sales force changes from technical selling to account management, with a corresponding increase in sales force productivity and a reduction in the size of the direct sales force needed to maintain market coverage of large customer accounts
- Broad-line dealer/distributor channels gradually displace technical specialists as the primary indirect marketing channel

As with all of the market life cycle changes discussed above, the evolution toward broad-line dealer/distributor channels is dictated by marketplace economics and by changes in customer buying behavior. As customers—particularly large accounts—internalize a new technology, they no longer need high levels of presale and postsale technical support. As a result, they force the cost of providing these activities out of the marketplace through competitive bidding and annual contract buying.

Customers that are no longer willing to pay these technical support costs and want to reduce their ordering costs tend to look to buy products from other channels. These low technical support channels are known as broad-line channels because they market a wide range of low-support products. Since the primary focus of broad-line channels is customer servicing and not technical support, they have a lower cost structure than the technical specialist channel. Broad-line channels typically have a distinct price advantage over technical specialist channels, which allows them to acquire greater market share.

This channel shift presents manufacturers with a major dilemma, since strong bonds of loyalty, trust and personal friendship often develop between manufacturers and technical specialists. This leaves the manufacturer with three fundamental choices in a maturing market:

- Remain with the technical specialist channel that has been a key to past success, and risk losing market share in the future
- Shift marketing focus to the broad-line channel, and watch this new channel take business from its loyal technical specialist channel
- Restrict high-support products to technical channels, and distribute low-support products to broad-line channels

It is not unusual to encounter situations in which a manufacturer has either failed to recognize the importance of this channel shift in a maturing market or is unwilling to deal with the emotional consequences of the decision to change channel focus. The result is invariably a significant loss in market share. The marketing strategy for dealing with a channel shift in a maturing market is too complex to discuss here, but even successful programs involve much trauma and stress for all parties.

Applying the Channel Selection Process

To make the channel selection process as useful and straightforward as possible, we have broken it down into a series of eight steps:

Step 1: Identify Product and Perform Customer Segmentation
This initial step allows you to determine exactly what you are selling and then identify your target customer segments. This process gives you the chance to assess a product's potential by evaluating the dollar opportunity represented by each segment.

Step 2: Determine Customer Satisfaction Requirements
Once you have identified the financial opportunities for your product and determined the market segments you want to target to achieve these opportunities, you need to understand what your customers expect from you and the channels that represent you. This is the process of determining customer satisfaction requirements.

> ***"…you need to understand what your customers expect from you and the channels that represent you."***

Step 3: Rank Customer Satisfaction Requirements
After you have identified the set of customer satisfaction requirements, it is necessary to rank these requirements according to which are critical, which are "nice to have" or which are irrelevant to the segment you are considering.

Step 4: Link Customer Satisfaction Requirements
In Step 4, you should determine the extent to which a channel is currently capable of delivering customer satisfaction and the extent to which you will have to complement and/or supplement the channel's efforts with your own if the channel is not performing at the level required by your customers.

Step 5: Determine Marketing Efficiency
This means examining the relationship between the activities necessary to meeting customer satisfaction requirements and the costs associated with doing so.

Step 6: Determine Marketing Effectiveness
This means evaluating whether a channel is focused on most of your market and to what extent the channel has the capacity to tap that market and meet your sales volume objectives.

Step 7: Analyze the Business Relationship
In Step 7, you should evaluate the potential of maintaining a meaningful, productive relationship with the channel.

Step 8: Perform the Final Trade-Off Analysis
The final step requires that you integrate the preliminary conclusions reached as you evaluated your channel options against the four key components of customer satisfaction, efficiency, effectiveness and business relationships.

A couple of options are available to you in identifying potential channels:

- Talk to prospective customers to determine the channels from which they purchase similar types of products and why they buy from these channels. Some potential channel types will be identified immediately

Applying the Channel Selection Process

- If competitors are selling through channels, you will probably want to evaluate these channels. If you choose to market through channels that are different from those of your competitors, you should understand what your channels need to do to be effective against your competitors' channels

If you are in a dynamic, growing market, we encourage you to also look for less obvious emerging channels. For example, facsimile machines are sold through "technical" office equipment dealers. Over time, these products will be sold through other channels, such as catalogs, office supply (stationery) stores and office product "superstores" which are broad-line and structured to provide less customer support.

In maturing markets, the major channels for certain types of products will be evident. You might want to start with these channels, but you should also consider developing other channels as well. Good sources for new indirect channels are those that are currently selling to the target customer segment. We have worked with some manufacturers to finesse a gain in market share by designing a unique channel system rather than trying to compete head to head with major competitors in the channels where they are firmly entrenched.

Other sources for building an understanding of potential channels for a new product could be talking to associations and industry or technical experts who are familiar with what a prospective customer might go through to evaluate and buy the new product. These sources, too, might be able to identify similar types of products that have been purchased by your target customers and what channels are successful selling to them.

Summary

There are four key points to remember:

- Channel strategy is rooted in understanding your customer segments—what, how, when and why they buy
- Buyer expectations—or customer satisfaction requirements—determine the activities that will have to be performed by the channel used to sell to each user segment. The extent to which the channel is able and willing to perform them determines, in large part, your success or market share
- These expectations change as the market for your product matures, with a consequent need to reassess channel strategy
- The more sophisticated and varied your segmentation, the more varied your channels will be and the greater the need to manage them to maximize the components of your marketing strategy while minimizing conflict. Indirect channels will very likely play a significant role in your strategy over time

Generally, understanding where your product fits into the market life cycle will allow you to predict both:

- Key buyer expectations

  and

- The most appropriate channel with a good degree of accuracy

Customer satisfaction needs to be maintained, regardless of the market life cycle stage.

Stages in Market Life Cycle	Major Channel Strategy Requirements	Most Likely Channel Options
Introduction	Technical support—high need for presale assistance	Typically direct sales force
Growth	Effectiveness—access to the product by multiple segments	Direct sales force still sells to large customers, and technical specialist distributors sell to the rest of the customers
Maturity	Efficiency—competitive price and overall ease of buying	The very largest customers are still serviced by the direct sales force; if there are still customers left who need the technical expertise and education a technical specialist offers, they will buy from the specialist; all other customers will buy from broad-line distributors

Frank Lynn & Associates can help your company find all the answers you need in order to make informed channel selection decisions. This includes an understanding of your customer segments, buyer expectations and where your product exists along the market life cycle. Based on this understanding, we help clients develop actionable channel marketing strategies.

About Frank Lynn & Associates

Since 1973, Frank Lynn & Associates, Inc., has helped companies like yours examine their market segments and develop approaches to reach them effectively. We bring to each engagement a process of analysis and conceptual tools that helps clients understand customer needs and expectations as well as marketplace dynamics. Given this foundation of understanding, client companies can transform their perspectives and become successful market-driven organizations that meet or exceed client satisfaction requirements by identifying sustainable competitive advantages. Our approach stresses qualitative research and starts with an in-depth understanding of buyer criteria and competitive forces.

We allow for active management involvement without overburdening a client. Our solutions are designed with sensitivity to our clients' internal capabilities, and many clients adopt elements of our tools and processes for evaluation and future planning.

Our expertise is grounded in our understanding of customers—when they buy, what they buy and how they buy—and the role of distribution channels in meeting their needs. We build on this foundation to reveal a multitude of ways our clients can achieve strategic success. We have the experience and business savvy you are looking for. We offer you:

- International consulting capabilities—wherever you need it, help is available
- Qualified, experienced and team-oriented people with the skills to get the job done how you want it and when you want it
- Market-driven approach and proven methodologies that get results
- Actionable programs to achieve your marketing strategy
- Experience in offering the same quality of service to both small and large companies

We would like to learn about your specific business challenges and explore how we can help.

Please contact our Client Services Coordinator at 312.263.7888 to address any questions you may have.