

# Rewarding added value

Rewarding channels for adding value can move your company's share price by cutting go to market costs, seizing a dominant position or ensuring happier customers. When does it work and what are the pitfalls?

It is not difficult to see what is wrong with simply rewarding volume sales. Ask the skilled specialist who has spent months closing a deal, only to have a box-shifter with low overheads and low skills snatch it at the last moment. Ask the half dozen partners who are all competing on price for the same big order from the same big customer. Ask the consumer who ends up with a low price product, accompanied by poor service and support.

Adam Fein, head of Pembroke Consulting spells it out: "All rewards drive behaviour and the traditional way of rewarding through volume discounts drives volume. Trade promotions can cause great instability leading to higher inventories and distorting the manufacturing cycle. If intermediaries can not make money by selling, then they do so by negotiating extra discounts from the supplier."

In contrast, a model where you reward value-add looks, at first sight, like a no-brainer. Simply define value add in any way you like, and then reward those intermediaries who actually deliver. Want to hit small and medium businesses? Keen to reward intermediaries who really please the customer? Or do you simply want to reward the very efficient?

**"Value add schemes are open to manipulation, even fraud."**

Whatever your goal, you should be able to put in place a system which either completely replaces volume rewards, or sits on top of a volume system.

In practice, rewarding value-add has proved to be extremely difficult. At least volume rewards have the merit of being simple. But how do you objectively measure value add? How do you police a value-add system? And how do you even set about explaining all these new

rewards to your channel? Many suppliers have tried and failed to introduce value add-based reward schemes.

This article looks at when value-add systems are appropriate, their benefits and drawbacks and case-studies several suppliers who have actually implemented such schemes. We also look at how best to implement such systems.

In practice, most suppliers base rewards on sales volume and then add some extra value add rewards on top. Usually, these value add rewards are given in an *ad hoc* way – often on a deal-by-deal basis. Perhaps you give free demonstration kit to any intermediary who adds value by giving you the details of end-customers. Alternatively, you might agree to co-fund a marketing programme which looks as though it will hit your target customers.

Such schemes work reasonably well when you are selling through a few channel players, however, the moment your channel grows beyond a certain size, *ad hoc* solutions hit problems.

*Ad hoc* value add schemes are open to manipulation, even fraud. Large partners will threaten your account managers with a loss of sales unless they agree to pay out extra margin for various spurious activities. Suppliers' account managers can quite easily be sucked into this process. Often these extra margins are simply used to discount your product more heavily.

Stefan Links, head of ComputerLinks, a Pan-European software distributor which adds a lot of value in specialist support and sales skills, says: "Such schemes can easily become a game – distributors will claim they are carrying out certain functions, which they are not in fact doing. Everyone claims to be offering technical support and co-marketing. How value-add

programmes run depends upon the quality of the vendor's management and their ability to employ people who really understand the market and the channel."

The paradox is that the loser is often smaller intermediaries, who don't have the muscle to demand extra funds, but who may be far more skilled and far more proactive than their bigger competitors. So the supplier ends up penalising, rather than rewarding, value add.

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The alternative is to move to systematically rewarding value add. For example, many suppliers are rewarding resellers who are prepared to give early notification of sales. Kevin Vine, head of Ingram Micro UK's networking division, says: "HP, IBM, Cisco and others are paying 5, even 10, extra percentage points for early notification of deals. This gives the value added reseller the chance to match or best box-shifter prices."

Other suppliers have gone further still. Take Cisco and Hewlett-Packard (*see case studies*). In Cisco's case, the value add schemes sit on top of a fairly traditional volume reward scheme. The aim is to reward partners who target product and customer sectors which Cisco regards as priorities. Luca Marinelli, managing director of channels at Cisco EMEA says: "We want to make our channel into an extension of our sales force."

In HP's case the ambition behind the scheme, entitled Partner One, was to re-work the entire channel so as to make it far more efficient and effective. As Jos Brenkel at HP puts it: "we wanted to achieve direct-like agility and

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# Making value add schemes work

## 1) Pay rebates, not discounts

The Cisco scheme works because the resellers get a rebate which is dependent upon customer satisfaction surveys. As they can't be sure they will get it at the time of the sale, they can't give it away to the customer as a discount!

## 2) Be targeted

One major supplier who is considering value add schemes is worried that they will simply mean giving extra discounts to those intermediaries who are already adding value.

One answer is to define the goals very precisely. Cisco, for instance, is using value add schemes for a closely defined set of new products and new customers. This degree of precision also keeps down the price tag for Cisco. As one source commented: "Even on a voice over IP installation, maybe half the kit sold will be infrastructure products which will not qualify for the extra premium."

## 3) Define value add clearly and carefully

Many partners will seek to do the absolute bare minimum to achieve any extra rebate which is going. So it is vital to define precisely what you mean by value-add very clearly and to have systems in place to measure it objectively.

Cisco uses a third party to conduct customer satisfaction surveys before paying the value-add rebate. This makes the process measurable, independent and ties it into the ultimate arbiter of value add – the customer!

## 4) Try, try and try again

Julian Dent at VIA says: "With these programmes there will often be unforeseen implications that you can't anticipate. You have to be willing to change." After less than 18 months, Cisco is already on the third iteration of its first value programme. Marinelli says that you have to be ready to tweak such schemes

several times to maximise effectiveness. Cisco, for instance, has doubled the reward for resellers selling voice over IP products.

HP has also made several changes to its programme. Such changes are not a sign of weakness, but of a willingness to make value add schemes work.

It is important to recognise that there almost certainly will be further changes and to present these to your channel as a sign of evolution and commitment rather than panic! Marinelli says it is vital to pilot schemes, maybe in one or two countries, before full launch.

## 5) Ensure you have the right infrastructure

If you are going to reward resellers who bring you new customers, then you have to have a reliable database of all your existing customers. That sounds obvious, but, in practice, few IT companies have this.

And unless you have robust online ordering systems, implementing value-based systems is likely to prove extremely expensive.

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very precisely."

Cisco can implement and run value-add systems precisely because it has invested heavily over the last eight years in powerful partner relationship management tools.

Marinelli says: "We are able to manage everything through a web portal. So we can log on and look at the progress made by an individual reseller on a daily basis."

## 6) Keep it simple

Fein says: "In our experience we find that the programmes which work are straightforward, easily explicable and are linked to real changes in the market."

There are plenty of examples of schemes which are so complex that channels simply failed to grasp them. Compaq hit problems in its last year partly because it failed to explain how its value-add scheme would work in practice. Dent says: "If these programmes are hard to communicate and explain, then the channel will not understand them and will look for loopholes to subvert them." HP carried out a major simplification six months into its launch of Partner One.

"It is vital to plot schemes."

## 7) Understand your partners' business model

You cannot reward value add unless you have a crystal clear understanding of your partners' business model.

Such an analysis was particularly important in the case of HP, as it was replacing straight commission payments with payments linked to the level of service.

So VIA went into each of HP's major partners and measured their costs. Dent said: "This allowed HP to know precisely what fee it should pay for each activity." He says the exercise also threw up some interesting anomalies. "It rapidly became clear that some distributors had cost structures which were way out of line." The analysis acted as an early warning system for these players.

## 8) Make training easy to access

If you want to reward added value, then it is important that training should be relatively low cost and easy to access.

Cisco now trains 20,000 to 30,000 individuals online every year. Marinelli says this costs less than 25pc of classroom teaching. Engineers can configure virtual routers and other products online rather than having to book time on expensive, real products.

operational efficiency with channel reach and convenience." This led to a wholesale re-engineering of HP's channel. Many distributors who were shifting hundreds of millions of dollars of HP kit lost their logistics status.

The two approaches are very different, said Greg Lockton at Ingram Micro: "Cisco is very directional in its relationship with its channel. It more or less decides who will work with which end-user. HP's scheme is much more remote control. Partner One works by broadly rewarding certain types of behaviour."

Have the value-add schemes worked?

The evidence from Cisco seems to be a resounding yes, says Keith Humphreys who runs a consultancy called EuroLAN Research.

He recently carried out a survey of the dealer customers of a large UK networking distributor. "We asked them which suppliers' kit they were recommending in the new, fast-growth product areas. We are finding that half

the time they are recommending Cisco in these areas. That is surprising to me, as Cisco is not really leading product innovation in these sectors." He suggests that Cisco's success reflects the new value add programmes it has put in place, which pay extra rewards to resellers who sell leading edge products such as IP telephony and security.

**"Unless you can police them, such schemes end in tears."**

Certainly, take up has been good. Ingram Micro says that around 60% of Cisco resellers have already signed up for the new small and medium business scheme.

Marinelli says: "Our resellers love these schemes. As we are giving them a rebate, they can not discount the products to end-users. So the profits stay in their business." But Humphreys says that some resellers remain unsure. "Those who like to negotiate special payments for marketing programmes, find the

approach inflexible. Other resellers love it because they know that Cisco won't give the guy down the road any extra discretionary discount, so they won't be undercut."

It is perhaps harder to assess the impact of the HP programme. Certainly, it led to many initial squeals of pain – particularly from distributors who found themselves losing the logistics function. On balance, Greg Lockton at Ingram Micro reckons Partner One has succeeded. "Following the merger with Compaq, many expected HP would lose market share in PCs and notebooks, but this has not happened."

So when, and how, should suppliers introduce value add schemes?

Julian Dent at VIA says that it is vital that suppliers really understand why they are introducing such schemes. "You have to think this through very carefully, and sometimes value-add schemes are inappropriate."

He adds: "Much depends upon where you are

## Cisco: Pioneering value add

Cisco is a long-term pioneer of a channel model which rewards value, rather than volume. Discounts increase with the reseller's skills. The rules are simple – you can sell a million products as a silver reseller and you will still get a smaller discount than the gold reseller who shifts one. Instead, Cisco rewards value which it ultimately measures by the end-customer experience.

Over the last 15 months it has started to launch new value programmes which reward Cisco resellers who sell particular products or sell into particular markets where Cisco needs to build a strong position.

First off the block was Cisco's Value Incentive Programme (VIP). This gives resellers an extra 20 percentage points of margin on voiceover IP and 10 points on security products. To qualify, resellers have to demonstrate specialist skills and there is also, in fact, a minimum booking

target which varies according to the size of the national market. Marinelli shies away from describing this as a commitment to sell a certain volume of product in a specific timespan, but to cover administration costs it is important that the resellers demonstrates a willingness to sell more than a couple of systems.

**"Cisco rewards value measured by end-customer experience."**

To win the reward, a reseller simply has to log the opportunity with Cisco, implement the system and then wait until a third party has conducted a customer satisfaction survey. If this stacks up, the reseller gets the extra money, which is paid as a back-end rebate.

Cisco is in the last stages of piloting Opportunity Incentive Programme (OIP). This, says Marinelli, rewards resellers who bring in

new customers. Intriguingly, Marinelli also sees OIP as a way of providing some protection to partners who first spot an opportunity as these are the only ones who will qualify for the rebate. He says OIP has been "deeply checked and is fully compliant with European law."

Cisco is also keen to reward resellers who sell an entire solution to the end-customer, rather than simply fulfilling an order by providing a product or even integrating network infrastructure.

Marinelli explains: "Customers want specific solutions and we want to reach different vertical markets." He quotes the example of a Dublin hotel where the partner was able to demonstrate the value to the hotelier of putting IP telephony into every room." This third programme is very much under development but expect to hear more over this summer.

in the product cycle. If you are in a dash to win market share, then you may well want to reward sales volumes, rather than anything else. You may want to see your intermediaries discounting your product furiously and selling it at the lowest possible price. This was the case in the land grab in the early days of mobile telephony."

"If, on the other hand, the market is saturated, then you will want to reward those intermediaries who can up-sell customers or deliver some sort of enhanced experience. This is the case in mobile telephony today. So you have to design these programmes in order to achieve your objectives."

For others, transactional value-added schemes can quickly become a straight-jacket. Keith Harris, who has run database software supplier Filemaker for over a decade says: "These schemes tend to be overly-elaborate. People don't understand them and they are out of date the moment they are launched."

Many things have to be in place before value-add schemes will work. Above all, suppliers need powerful partner relationship management tools. Unless you can police these schemes and unless you have a clear idea of who your partners are, what they do and who your end-customers are, such schemes are likely to end in tears.

The key for Cisco has been its ability to develop a really robust platform to process and gather data. Without this, these schemes do not work.

Very few suppliers, at least in IT, have these systems in place. As one large software vendor sheepishly admitted: "Like Cisco we too have Remedy, Oracle databases and Siebel CRM. The difference is that our systems don't really join up. We have too much data and we don't really know how to process it." Cisco can launch schemes like this because it has invested serious money in joining up its channel systems for the past 6-8 years.

Yet there can be no doubt that such

programmes, used properly, can have a major, long-term impact on suppliers' competitive position. Perhaps the key word in the last sentence was "long-term."

Suppliers who are only prepared to implement programmes which will lead to a better profit next quarter are unlikely to implement value-added schemes. But if powerful companies like Cisco are using such programmes to dominate new markets and HP is using them

to guard market-share, you have to ask yourself how long such short-termists will be around for anyway. ■

*Contacts: VIA International has built value add reward schemes for a number of suppliers. Cisco has a consultancy arm built upon its experience and expertise in becoming e-enabled.*

## HP: Re-engineering the channel

Following its merger with Compaq, Hewlett-Packard had a huge and perhaps rather inefficient channel. Across Europe a network of wholesalers sold products on to resellers whilst a few larger resellers bought products directly from HP selling on to large end-customers. The entire edifice was based on volume discounts.

For Jos Brenkel all this led to several problems. Firstly, HP's channel could not compete on price with Dell, its number one competitor who directly sells almost everything it produces. "Too many people were touching the product," he says.

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At the same time middlemen were complaining that, because of competition, the margins they made on HP products were falling. This meant that they were likely to passively fulfil orders, rather than actively seek out new business opportunities. Inevitably, this led to heavy discounting to win orders in competition with other HP resellers and distributors and even sometimes HP itself. And resellers who reached the growing small and medium business market usually bought from distributors, and so were invisible to HP.

For Brenkel the answer was a radical rethink in which the channel was paid not for reselling products, but for fulfilling certain functions.

Working with VIA International, HP identified

three roles. The first is Logistics Service Partners (LSPs) who take orders, deliver products and take title to and manage inventory. LSPs are rewarded with a logistics fee, a cash discount on products, price protection and rewards for performance.

The second role is Channel Development Partners (CDPs) – this means recruiting and building relationships with those resellers who are too small to have a direct relationship with HP. CDPs are rewarded partly for recruiting and working with dealers and partly on the basis of how much product these dealers sold.

As such, they clearly have to let HP know which resellers they are working with and HP has a goal of adding 3,000 dealer names in Europe to its database. The third role is Sales and Service Partners (SSPs) who sell HP products and services direct to end-customers. Here HP has sought to guide dealers away from competing directly with HP in selling to large accounts and to motivate them to sell to the burgeoning small and medium business markets. Dent at VIA said: "HP didn't want to pay resellers to fish in its water."

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Perhaps the biggest impact of the new order has been felt by distributors who traditionally combined both the LSP and CDP role. In fact, around 45 of HP's 50 European distributors have lost the LSP role.