Best Practices for the Channel

Grow your end-customer and partner revenue: The future of incentive and rebate programs in the channel

Executive Summary

Can you target the vertical markets in the channel that need your product?

You struggle to know your end-customers or their markets, you don't know which partners are serving those markets and you can't create effective incentive programs to grow those markets. What is a channel manager to do?

According to the 112 experienced channel sales, marketing and operations people at leading high tech companies who answered our Best Practices survey only one-third of enterprises really know who their end-customers are and their vertical market. Enterprises rely on their partners to penetrate specific markets, but less than half know the vertical markets that their partners serve. Given this, how can you develop and implement effective incentive programs that target specific markets? Three-quarters of respondents believe following Best Practices for incentive programs is important, but only one-third are satisfied with their implementation of Best Practices in their incentive programs.

Model N has identified Best Practices for partner and end-customer market segmentation as well as for developing and implementing incentive programs. The key is visibility into accurate, complete and standardized data. Without visibility into transaction data or incentive program metrics, decision-making is, at best, guessing. It is time to stop guessing.

Introduction

Growth — revenue, new customers, new partners, new markets. Why is it so elusive?

Model N posed that question, and others to the Baptie Channel Focus Community. The resulting answers were not surprising, it turns out that the old adage "knowledge is power" is still true. What was surprising is that after all this time using the indirect sales channel we still struggle to grow business through the channel.

Companies have long been aware of the potential of indirect sales channels to expand their sales reach. They are now recognizing the strategic differentiation that a well-run indirect sales channel brings to their ability to expand sales, marketing and inventory positioning. This highly targeted functionality augments the efforts of their direct sales teams. Just ask HP, Oracle, and Adobe.

To succeed in the channel, just as to succeed in direct sales, organizations must be able to identify new potential end-customers and growth market segments. They then need to be able to apply best practices to the way they drive business in the channel to maximize their ROI. Incentive programs and discount strategies must be targeted to attract and grow those new customers and markets. In addition, channel sales managers must be able to identify the partners that serve these end-customers and target markets, and focus their channel marketing activities at these partners. Success depends on enabling the right partners with effective incentive programs, special pricing discounts and marketing activities.

To find the right partners and implement effective programs requires accurate, complete and segmented data – available in real-time. It isn't enough to just have a partner name. Vendors must know the role the partner plays in the supply chain, the geographies they serve and their vertical market orientation. Incentive programs should be targeted at the end-customers and markets

where there is the most growth potential. Investing in a market that is already saturated could waste limited resources. It is much more effective to use those funds to penetrate a new, untapped, high potential market. Too often companies do not have visibility into the markets served by their channel. The result is that channel managers are making decisions on flawed and stale data. Crucial investment decisions about incentive programs, partners and end-customers are based on little more than guesswork.

Business Issue

Obtaining accurate, complete and segmented data is critical for organizations that rely on channel sales data to make key business decisions, effectively allocate resources, and forecast sales. Without timely, accurate and complete data to drive the creation of business strategies, organizations are forced to resort to guesswork.

Several questions arise when considering the best way to gather and analyze data about market segmentation and effective incentive programs.

- Do organizations have visibility into the market segmentation information they need to make decisions?

- Is the information available accurate enough to drive effective strategy?

- Do organizations know which incentive programs are working?

- Do they have the detailed results needed to improve incentive programs in real-time?

Lack of actionable data leads to significant knowledge gaps in key areas including customer market segmentation, partner vertical market expertise, and the effectiveness of incentive programs. It can be surprisingly difficult to find this data.

Best Practices Survey Demographics

In March and April 2011, Model N surveyed 112 members of the Baptie Channel Focus Community representing both large and mid-sized companies. Respondents were nearly evenly split in terms of company size – 53% have annual revenues over $1B, the remainder was under $1B, with average revenues of $600M. Half of these companies derive more than 60% of their revenue from the channel. We polled Sales, Marketing, and Channel Operations members in high-tech and software industries to learn how they manage incentive programs and end customer market segmentation, as well as how these processes can be improved by implementing best practices in both areas.

Identifying End Customers and Their Market Segmentation: Do You Know Your Customers?

Segmentation is the practice of dividing a customer base into target markets based on various criteria such as industry, demographics, product line, channel affiliation, or number of partners. Without the ability to identify end customer market segments an organization does not know where a product is being sold, why the customer wants that product, product preferences of specific industry market segments, or which price points or incentives are most effective.

Model N's survey initially examined two aspects of market segmentation – the methodology used to identify end-customers and their industry vertical in indirect sales, and the methodology used to segment sales revenue by channel partner type.

As Figure 1 illustrates, 67% of respondents can usually or always identify the end-customer in their indirect sales; however, of those, only 51% can usually or always identify the end-customer market segmentation as well. This means that only 34% have actionable (accurate, timely, and complete) end- customer data. Of equal significance is that 10% rarely or never know who their end-customers are. When considered in terms of channel revenue, that means that on average, respondents do not know where nearly $32M in product ends up. In addition to the missed opportunity to upsell into these customers, this could potentially pose a serious and costly compliance issue.
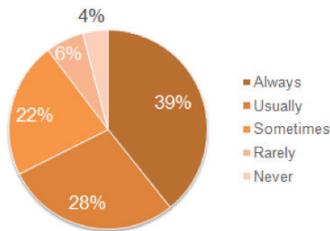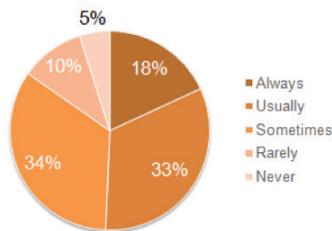
Figure 1: Identifying End-customer and Segmentation in Indirect Sales

How Organizations Identify End-customers and Market Segment

When it comes to identifying end-customers and market segmentation, organizations use a few different approaches, but the majority relies heavily on self-reporting (end customer self-description) and internal team research. Only a small minority relies on 3rd party services to identify market segmentation. See Figure 2.
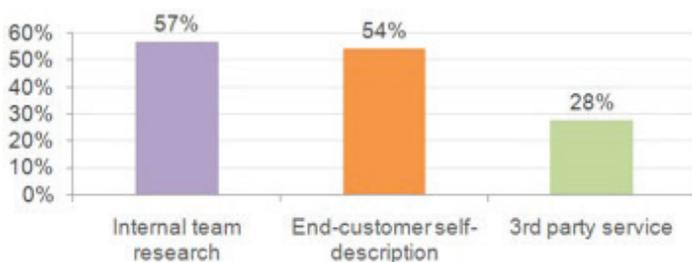
Figure 2: How Organizations Identify End-customer Segmentation

The lesson here is that while internal research may be a good choice for identifying end-customer market segments, it's also likely to be resource-intensive. Self-reporting requires fewer internal resources, but is generally less reliable since end-customers have no incentive to report their demographics.

Identifying Channel Sales Partners and Market Segment

Respondents were able to identify who their partners are, but not necessarily whom their partners serve or the target markets represented. As Figure 3 illustrates, respondents are confident that they can identify who their partners are; 87% can always or usually segment their channel revenue by partner type (distributor, reseller, VAR, retailer, e-tailer). But they could not always determine (of those resellers) the industry vertical of their end-customers (i.e. healthcare, finance, manufacturing).
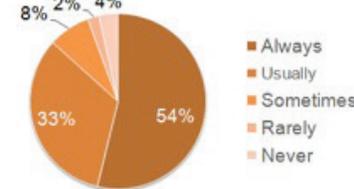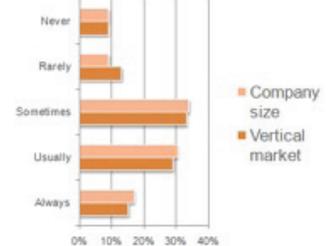

Figure 3: Identifying Channel Partner Types and Segments

How do Organizations Identify Channel Partners and Market Segmentation?

Further investigation reveals that 74% of respondents rely on channel partner self-description in identifying market segments targeted. This data can be unreliable, since partners may claim they cover more end market verticals than they actually do. Only 43% analyze their actual POS data to determine market segment. Model N's conclusion is that the best practice is to examine POS data, since this provides the clearest indication of a partner's business segment. See Figure 4.
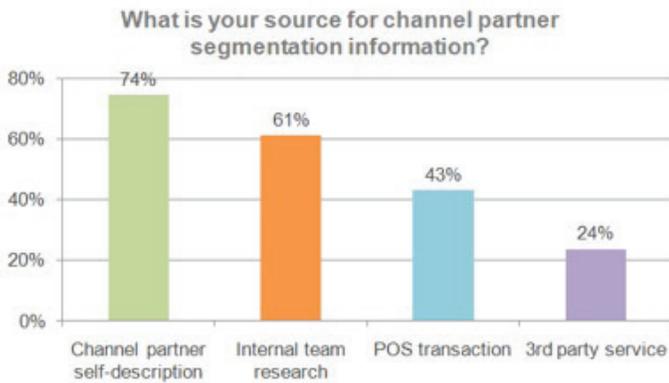
Figure 4. How Organizations Identify Channel Partner Segmentation

Segmentation Best Practices: How Important Are They?

As Figure 5 illustrates, Model N identified the six best practices below for segmentation and asked respondents to rate each on its importance and indicate how satisfied they are in implementing each practice. The rating scale was from 1 to 5 with 1 being unimportant or unsatisfied and 5 being very important or very satisfied.

- Compare end-customer segment growth to industry benchmarks
- Target incentive programs to specific end-customer segments
- Determine optimal partner coverage by market segment
- Prioritize channel partners to drop
- Prioritize channel partners to retain
- Prioritize channel partners to invest in
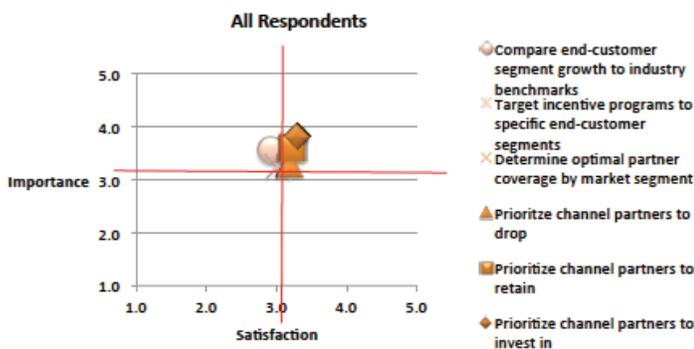
Figure 5: The Importance of Segmentation Best Practices

The majority of respondents were in agreement that our identified best practices for end-customer and partner segmentation are important or very important. Yet, on

average, only 39% were somewhat or very satisfied with their ability to identify and use partner or end-customer segmentation data. Respondents rated the three most critical practices as determining the optimal partner coverage by market segment, using segmentation to prioritize which channel partners to invest in and comparing end-customer segment sales growth to industry segment growth benchmarks.

Figure 6 shows that of the respondents who rated segmentation best practices very or somewhat important, an average of 46.5% are already using segmentation best practices to prioritize which channel partners to invest in and retain. Another 42% follows best practices when determining the optimal partner coverage by market segment. But for even these respondents who consider these best practices important, they remain only somewhat satisfied with their ability to implement them.
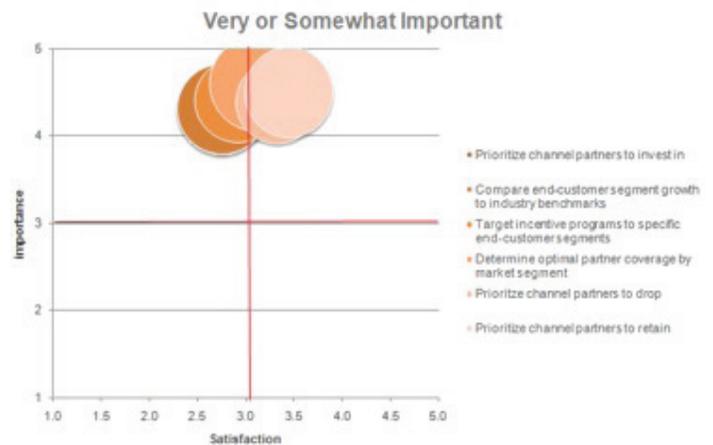

Figure 6: Importance of Segmentation Best Practices

Segmentation Best Practices are Lacking

While it's clear that segmentation best practices are important to respondents, it's also apparent that many respondents were not very satisfied with their ability to attain these best practices.

Our findings revealed that only 34% of respondents have accurate, complete and standardized end-customer data, providing a strong indicator that actionable data is not available when customers need it to make critical business decisions. When identifying partners and end-customers, the majority of organizations rely on self-reporting by partners and end customers. The majority of respondents can always or usually segment their channel revenue by partner type, but 54% are unable to identify

end customer segments, which is critical in determining how to grow partners in accordance with vertical industry strategy. And while 66% believe it is important or very important to use partner and end- customer data in planning and decision-making, only 39% are somewhat or very satisfied with their ability to implement those best practices.

Segmentation Recommendations

Enterprises can benefit most from their partner and end-customer market segmentation knowledge by implementing the following Best Practices:

- Identify resellers from POS transaction data. POS data is the best way to understand how your resellers are actually performing.

- Tie end-customers to vertical markets to better understand their needs and how you can pursue them.

- Compare end-customer vertical sales to industry benchmarks to identify how you are performing and potential areas for growth.

Making Channel Incentive Programs Work More Efficiently

Now that we have an understanding of Best Practices for market segmentation, let's examine an area that can benefit from targeted segmentation information – channel incentive programs.

Our first question explored the types of incentives programs that respondents implement. We discovered that the majority of organizations (93%) base their incentive programs on performance factors such as year over year growth, or quota attainment. The next most popular type of program is based on objectives, such as increased attach rates or new customer acquisition). See Figure 7. This is a gratifying result as the industry has moved the majority of their programs to performance based as compared to flat incentive programs that pay on each dollar shipped regardless of goal achievement.
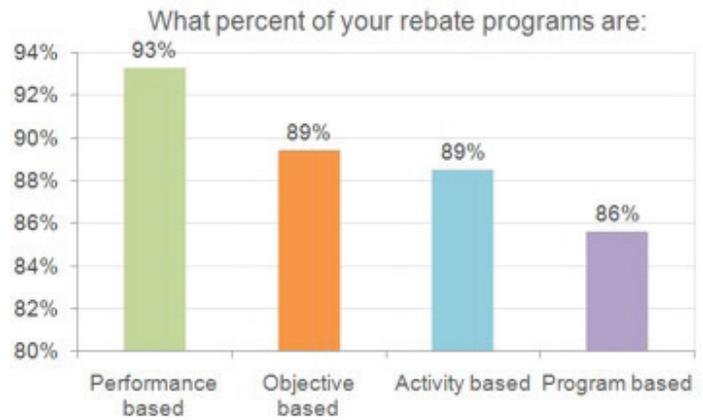

Figure 7: Performance-based Incentive Programs Dominate

Figure 8 indicates that respondents believe that 86% of incentive programs meet or exceed incentive goals at least some of the time. However, only 28% are actually achieving their goals all or most of the time. These figures indicate that there is still significant room for improvement in this area.
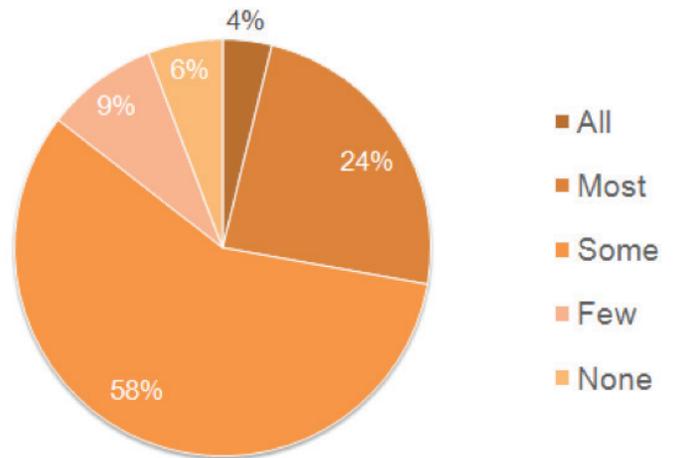

Figure 8: Meeting Your Performance Goals

Goals: What is Your ROI?

Figure 9 shows that only 38% of respondents calculate ROI on incentive spending, which means that a surprising majority are not engaging in any ROI calculation. This further brings into question the findings in Figure 8 regarding incentive programs achieving their goals. If an organization is not calculating ROI on incentive spent, can the benefit of the incentive program truly be measured? Without information regarding incentive program cost and payout, it is possible that an organization is losing revenue and eroding margin unbeknownst to them. Three vital pieces of information are needed to calculate ROI: current performance, performance as a result of the program and cost of program, without that critical information, it is difficult to reach a valid conclusion about whether incentive programs are working as intended. In order to effectively calculate ROI, this information must be captured at the partner or program level.

We also see from Figure 9 that only about half of companies test their programs before launch. Testing has two significant benefits. First, it is valuable to confirm that the incentive calculations are delivering the correct result. This is especially true, as programs get more complex with different eligible products and partners as well as complex goal attainment payout percentages. Secondly, testing a program before it is run provides a baseline to determine a program's effectiveness and ultimately calculate the programs ROI.

Figure 9 also depicts that 72% of incentives are paid on net price after discounts are accounted for. It is critical to only incentives only on the actual value to the vendor and not on a non-adjusted list price. We also see that 73% of companies still require incentive claims to get their rebate while 27% have moved to a "claimless" process. If incentives are calculated accurately, a claimless process can be a strong differentiator with your channel partners.
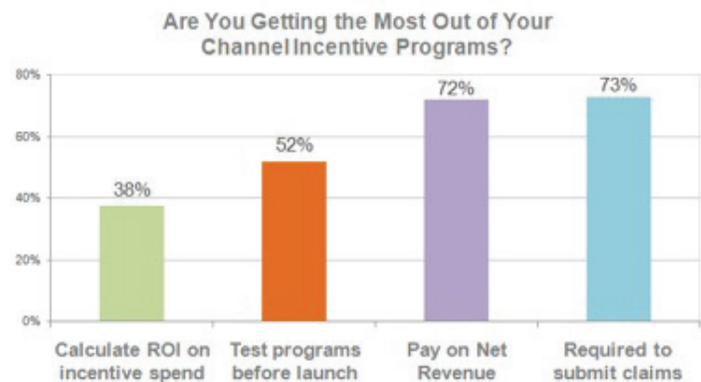

Figure 9: What is the ROI for Incentive Programs?

How Quickly Are Incentives Processed and Paid?

Our survey findings revealed (Figure 10) that there is a wide variety of payment schedules for incentives. Only 56% of respondents pay within 30 days, and a very small percentage (fewer than 7%) pay in 14 days. Distributors and resellers are dependent on "working capital" and prompt incentive payments are critical to their financial health. Incentives payments at 30 to 120 days or longer after claim have a significant impact on your partners. Additionally, these findings indicate that additional problems may arise when partners cannot claim incentives until some period after they are earned. For example, if a partner expects payment within 45 days, but in reality, a claim cannot be submitted until the end of a program, the additional delay in payment can be significant.

Further investigation into incentive payment schedules reveals that late payments may be caused by the inability of an organization to process payments automatically. Only 40% of respondents calculate and process incentive payments automatically all or most of the time. The remaining 60% perform a manual calculation process that is typically very time-intensive and often inaccurate.

As described earlier, some organizations are considering a move toward a "claimless" option, where payment is automatically made based on a predefined calculation. Prompt payment based on rapid, automated incentive calculation can be an opportunity for a channel sales management organization to differentiate itself from its competition.

## Fewer Than 7% Of Respondents Pay Incentives In Under 14 Days
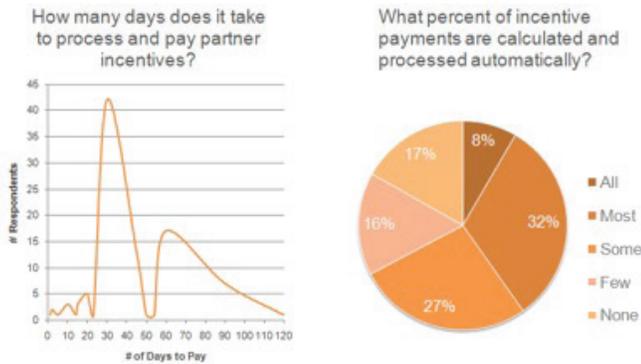
Figure 10: Channel Incentives Return on Investment

How Accurate Are Your Incentive Calculations And Payments?

Respondents run an average of 21 channel incentive programs annually, with an average channel incentive spend of $34.9M, or 11% of channel revenue. As Figure 11 indicates, respondents estimated their incentive program overpayments to total approximately 6% of channel revenue. Based on our respondents' average channel revenue of $318M, this translates to an overpayment of $2.1M. This overpayment represents a significant amount. No one wants to pay for incentives not earned, especially in these day when every dollar spent is scrutinized by finance. Clearly, there is significant room for improvement in this area.
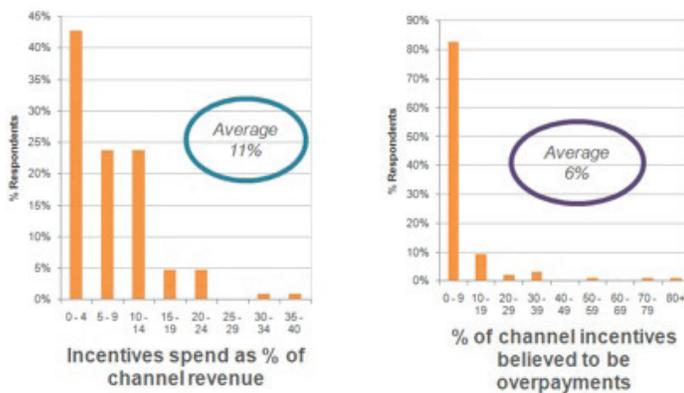

Figure 11: Channel Incentives Spending and Overpayment

## Importance And Satisfaction Of Incentive Best Practices
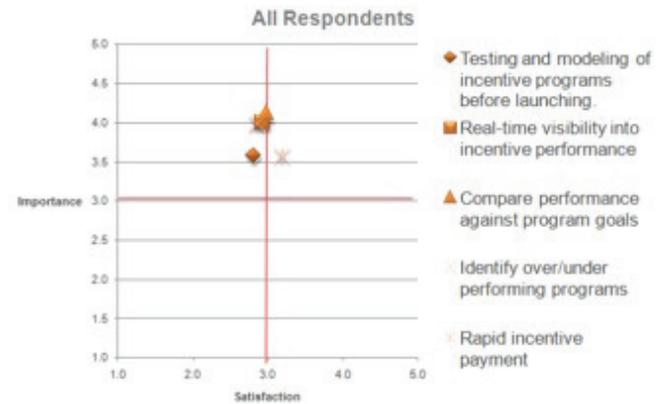
Figure 12: Segmentation Best Practices

How Do Organizations Manage Incentive Programs and Implement Best Practices?

Again, we asked respondents to rate, on a scale from 1 to 5, the importance of certain best practices for incentive programs. Best practices included the following:

- Testing incentive programs before launch

- Real-time visibility into the performance of incentive programs

- Ability to compare performance against preset program goals

- Identification of over/under performing incentive programs

- Ability to pay incentives in a timely manner

Our survey showed (Figure 12) that on average, 75% of respondents found these measures of incentive performance to be important or very important. Yet only 33% are somewhat or very satisfied with incentive performance. The three most important incentive best practices were identified as the ability to compare performance against pre-defined program goals, real-time visibility into incentive program performance, and the ability to identify over and underperforming incentive programs.

Incentive Programs Work But There is Significant Room for Improvement

Let's recap our findings and Best Practices for incentive program performance. 75% consider following Best Practices to be important, but only 33% are satisfied with their implementation of incentive program Best Practices. The vast majority, 93% base Rebate Programs on performance, but only 38% calculate ROI on incentive spend. This discrepancy means that the true cost and margin impact of incentive programs is unknown. Accuracy of payment is also suspect with respondents believing that they overpay on incentive programs by an average of 6%. Additional cause for concern about incentive program effectiveness is highlighted in delayed payments, fewer than 7% pay in less than 14 days which ties up essential partner working capital and can sabotage partner willingness to participate in future programs.

Incentive Recommendations

To maximize the effectiveness of incentive programs, Model N recommends implementing the following best practices:

- Calculate ROI on incentive spend – even if benefits are "soft" like brand improvement

- Speed incentive payments; this is an opportunity to differentiate. Because your partners operate on working capital, the quicker you can pay, the more loyal they'll be and likely to focus on your products, as well as your programs.

- Validate accuracy of incentive payments and implement auto calculation of your programs. No one wants to make un-earned incentive payments. Auto calculation can ensure accurate and timely payments.

- Obtain real-time visibility into incentive program performance. If a program works well, you will know immediately and can invest more heavily and roll it out to other partners and capture additional share.

- Test and model incentive programs on historic data. Make sure calculations are working correctly and that you get a good baseline before you start running the program.

Conclusion

We began by asking the question "Why is so difficult to grow revenue, new customers, new partners, new markets through the channel?"

These are the goals of every channel manager. To achieve these goals you must have visibility into your channel data all the way to your end customers. Using channel data to segment your partners allows you to understand their strengths and weaknesses and use that information to create strategies for partner expansion and development. Similarly, understanding the purchase behaviors and product and service needs of your end-customers allows you to better meet those needs as well.

Incentives can then be created and run to motivate specific partner activities and to accomplish explicit goals, such as targeting SMB customers, growing vertical markets and finding the partners who align with your strategic goals. Doing this is the next level of channel management best practices and will deliver targeted growth and solid program ROI.