The channel partner challenge

About the Author

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The fortunes of vendors' channel partners will obviously rise and fall with the fortunes of their customers, the end users of computer hardware, software and telecommunications products and services (Article 2, Figure 4).

The objective of this article is to outline the impacts that a deflationary economy has on channel partners and their businesses. The article also outlines what actions channel partner managers should be encouraged to take in the face of the current economic pressure. Throughout this article it will be clear to the reader that vendor personnel must understand the economics and business dynamics of their channel partners in order to be effective. ChannelCorp's program *Channel Management: the business dynamic* provides the required skills. The article is divided into two sections:

impacts

action

Impacts

The real impact of deflation hits channel partners as growth in the various sectors of their domestic economies slow down, or in some cases stop. Channel partners, for the most part unable to export their way back to prosperity, will need to be very disciplined and very focused to survive in challenging domestic economies.

Revenue will be the first area of the channel partner's business to show signs of strain. Revenue levels will be reduced as product/service purchases are

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delayed by cash- and credit-poor end users. Some "sure thing" sales will vaporize as customers and their IT projects simply drop off the screen. Unit volumes will also drop, especially if the product prices reflect a requirement to buy $U.S. with devalued currencies. Reduced unit volumes will, in some channel partners, reduce SSTC revenue because the number of units purchased drives the amount of non-product revenue generated by a transaction.

Expenses will be impacted by several changes brought on primarily by the effects of currency devaluations. Cost of Goods Sold will increase as the price of product purchased with U.S. dollars will skyrocket when converted into deflated local currency. Rising domestic interest rates, in addition to keeping investment in country, will cause interest expenses in channel partners' income statements to swell. For those channel partners who have borrowed in U.S. dollars, paying interest with devalued local currency will dramatically increase interest expenses as a percentage of revenues.

The combination of Revenue impacts and Expense impacts will result in lower profitability, lower cash flow from operations, and reduced ability to finance growth from internally-generated sources.

Cash flow will be dramatically impacted by the Revenue/Expense disruptions noted above. Reductions in revenues, gross margin percentages and gross margin dollars generated will hammer profits and cash flow down. Poor quality customers, themselves hit by the effects of deflation, will slow down the payment of their accounts because of their own cash flow problems. In many cases, channel partners will be forced to write off accounts receivable owed by past clients as bankruptcy eventually takes its toll on the lower quality or highly leveraged businesses in the economy (see Figures 178–180). As a result of restricted cash flow, channel partners will slow down their payments to their suppliers. This will include their key distributors and key vendors. In some channel partners, the catastrophic event of having all loans called for payment at once by nervous bankers will crush the business. With asset prices depressed and cash flow tight, very few businesses will be able to meet the cash demands of nervous bankers through asset sales or liquidation.

Asset levels will take a battering. Cash levels in channel partners will drop to precipitously low levels as account receivables stretch out and vendors, distributors and other suppliers begin to demand Cash On Delivery (COD) or prepayment. Accounts Receivable, which in most channel partners already run 45–60 days outstanding, will easily go to 60–120 days if not watched closely. Due to high interest costs, carrying inventory will be prohibitively expensive. In addition, many channel partners will not be able to obtain the credit to purchase inventory. Holding real assets, such as inventory, is risky during periods of asset value deflation. The combination of high inventory carrying costs and the risk of real asset devaluations will suppress inventory investment levels dramatically.

Liabilities, primarily debt, will increase in those channel partners that remain creditworthy and drop in those channel partners with questionable ability to repay. Better quality channel partners, with low levels of pre-existing debt and/or abundant assets to provide security, will be able to borrow to bridge the cash flow gap and to grow. Poor quality channel partners, with high levels of

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pre-existing debt, will be cut off from most conventional credit sources. Banks will reduce credit lines as the value of assets pledged as security drops to below allowable levels. In some cases, troubled banks will call loans, setting off catastrophic events in some channel partners.

Figure 1 provides a summary of the impacts that deflation will have on the various components of the average channel partner business.

Figure 1 – Channel partner impact summary

Revenue
– product revenue levels ↓
– unit volumes ↓
– SSTC volumes ↓

Expenses
– COGS ↑
– interest expenses ↑
– bad debt expenses ↑

Cash Flow
– internally generated cash ↓
– speed of A/R collection ↓
– A/R write-offs ↑
– speed of payment of A/P ↓

Asset Levels
– cash balances ↓
– A/R period ↑
– inventory investment/value ↓

Debt Levels
– good quality channel partners ↑
– poor quality channel partners ↓

Source: ChannelCorp Management Consultants Inc.

Action

What action should the owners and managers of financially challenged channel partners take? What action should managers from vendors and distributors encourage their channel partners to take? History tells us that the channel partners that take swift, decisive action have a better chance of survival and even growth during challenging economic times. Bold moves by well financed channel partners can result in tremendous growth of market share. Channel partners should take the following steps:

Step 1 – *Base Audit*

Step 2 – *Prioritize sales assignments according to ability to pay*

Step 3 – *Get financial house in order*

Step 4 – *Create a viable sales proposition*

Step 5 – *Execute with focus and discipline*

Step 1 – The first step a channel partner or vendor should take regarding strengthening of their business is to ***perform a Base Audit.*** During a Base Audit, channel partner management attempts to make a determination of the financial strength or quality of various customers. Using whatever data sources are available (including past experience), the companies in the Customer Base are segregated into one of three categories:

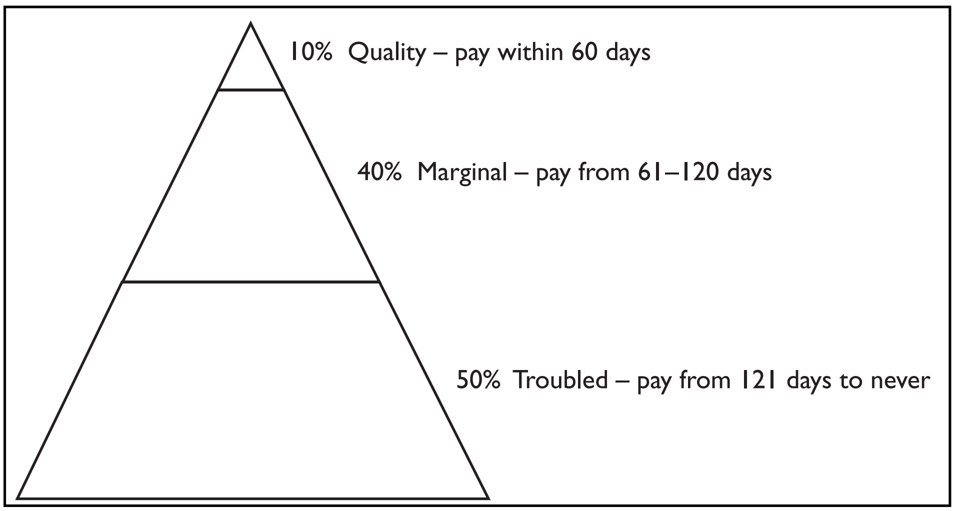
Quality Customers – those customers able to pay for products and services that they contract for in the same amount of time as they had previously taken to pay (0–60 days)

Marginal Customers – those customers not able to pay for purchases or products for up to twice as much time as was previously taken (61 – 120 days)

Troubled Customers – those customers not able to pay for purchases for 120 days or more (121 to never)

The Base Audit is particularly critical to perform on the 20–30% of customers or clients who generate 70–80% of the revenue of the salesforce of the vendor or channel partner. Figure 2 outlines the percentage of companies that are likely to fall into the various categories.

Figure 2 – Evaluate installed base using ability to pay as key criteria



Step 2 – The Base Audit is the key driver of prioritization of the sales or customer focus of the channel partner's salesforce. Sales energy should only be spent where there is a good probability that the customer can pay for the products/services contracted for. Salespeople should be assigned as follows:

Priority 1 Quality customers in the installed base

Priority 2 Marginal customers in the installed base

Priority 3 Quality customers outside of the installed base

Priority 4 Marginal customers outside of the installed base

Priority 5 Troubled customers in the installed base

Priority 6 Troubled customers outside of the installed base

Under no circumstances should type 5 or 6 clients be given priority over clients that are type 1, 2, 3 or 4. The focus of the marketing and sales programs of the channel partner should align with priorities as outlined above. When under pressure, one should always go with strength.

In rare circumstances "Priority 5" customers may need more products and services provided to them before they can pay for prior purchases. Be very

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careful. In may cases the decision to advance more credit is simply "pouring good money after bad" and chances of repayment will be very low.

Step 3 – The third step (actually concurrent with Steps 1 & 2) is to ***get your own financial house in order*** as best you can. Quality customers do not and will not deal with vendors or channel partners that are, or are rumoured to be, in financial difficulty. It is important to strengthen your financial position so that it can be used in a competitive situation as a competitive weapon. The end user will ask this question – two equally qualified sources of products and services – one financially strong and one financially weak – which one to select. Make sure that you will be the financially strong channel partner any time there is a competition. The smart vendors will take an active role in making sure that their best channel partners remain financially strong. In some cases attractive loans will be offered or loans will be guaranteed. In other cases equity will be purchased in the channel partner by the vendor or the in-country designate of the vendor. Arrangements are then made for the vendor to sell the equity back to the channel partner when times are better.

Step 4 – the fourth step in the process is to create a viable sales proposition. As a result of Steps 1 and 2, the channel partner will be focusing on servicing Quality or at worst Marginal customers. Step 3 will assure a strong financial base to market and sell from Step 4 is the process of communicating the sales proposition to the market. The salespeople in the winning channel partners will deliver three key messages:

1. *Channel partner/vendor is strong and will be around to support the customer*
2. *Channel partner/vendor can provide SSTC to extend the useful life of technology that the customer already owns*
3. *Channel partner/vendor can arrange for a lease or the vendor can step in and provide credit*

In return the channel partner/vendor should be able to request deposits and/or progress payments.

Step 5 – the fifth step in the process is to execute with focus and to practice discipline. In times of economic deflation it is sometimes better not to have certain types of poor quality customers. The fundamental definition of a client or customer is the willingness to buy, and the ability to pay. Without both features there is no client or customer. Because deflation reduces the ability of end users to pay, it renders them incomplete as a client or potential client.

Article summary

Channel partners and other customer-facing channel partners who are not of high quality find it difficult to survive dramatic shocks to the economy. Revenue, expense and cash flow problems pound like waves through the channel system. The best managed channel partners get on the problem immediately, hunker down, and do what has to be done. With help from key vendors, these businesses can survive. "Help from key vendors" can take the form of business practices training such as is provided by ChannelCorp to channel partners around the world.

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The next article examines the impact of economic pressure on distributors.

ChannelCorp Education Programs in Singapore – March 2002

We are pleased to announce that two ChannelCorp workshops will be delivered in Singapore March 11–14, 2002. This is ChannelCorp's sixth year of delivering world-class channel education to channel executives in South East Asia.

In 2002 we are offering an important new program. Channel Management: the business dynamic (13/14 March) is unique in the world. It will dramatically increase the business skills and improve performance of quota-carrying personnel such as channel managers, account managers and business development managers. This program will provide two years worth of knowledge and experience in two days.

The ChannelCorp Advanced Channels Workshop (11/12 March) is well known to channel executives in South East Asia. The 2002 Advanced Channels Workshop has been updated to reflect new eChannels findings and the new role of influence channels in the IT industry. This program has SOLD OUT for six straight years.

For more information on either program, go to http://www.channelcorp.com/workshops_01.htm. We can also provide detailed outlines and group pricing details. Simply send a return e-mail requesting data. We hope to see you and your people in Singapore in March.

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