Aligning Channel Structures and Incentives to Promote Profitable Growth: What Works?

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Types of Growth Initiatives

	Existing Customers	New Customers
Existing Products	*Market Penetration* e.g., Pepsico purchased PBG, Pepsi Americas to "grow non-CSD products"	*Product Development* e.g., Hertz purchased Thrify-Dollar to "leverage fleet utilization"
New Products	*Market Development* e.g., Toro purchased USPraxis to "broaden OPE product line"	*Diversification*

➡ Changes in channel task mix, incentive and structure result from these growth initiatives

Primer on Tasks, Incentives and Channels

- We cannot command independent channel partners by fiat; but must induce them to undertake desired tasks.

- Channels' efforts on tasks are not directly observable, so we can only motivate them via incentives.

- Growth initiatives blend channels together, and create more varied task mixes.

Soft versus hard tasks

• A broker exerts effort to get shelf space for a new product on grocery shelves. Output of this **hard** task is captured well by ACV.

• An auto dealer exerts effort to provide quality repair service. Output of this **moderately soft** task is captured imperfectly and noisily by a customer satisfaction survey.

• Microsoft exerted effort to develop PC-DOS, Windows and OS/2 for IBM. Output of this **very soft** task is captured very poorly by KLOCs (thousand lines of code).
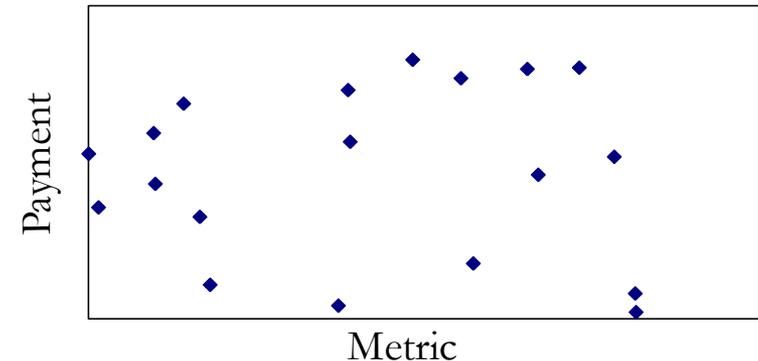
Soft versus hard incentives

Hard/strong incentive payments tied solely to metric. E.g., commission plans.
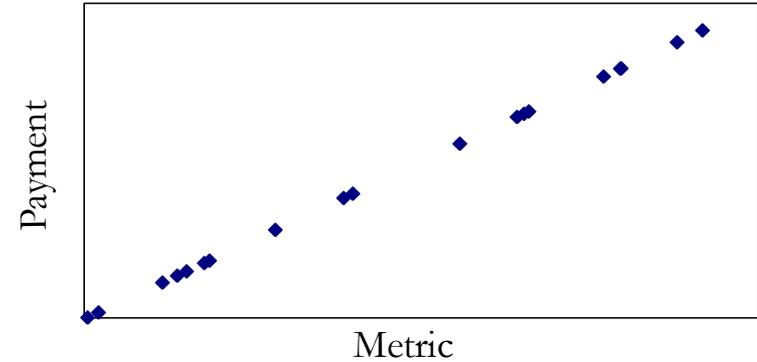
Moderately hard/strong incentive payments tied partially to metric. E.g., salary plus commission plans.
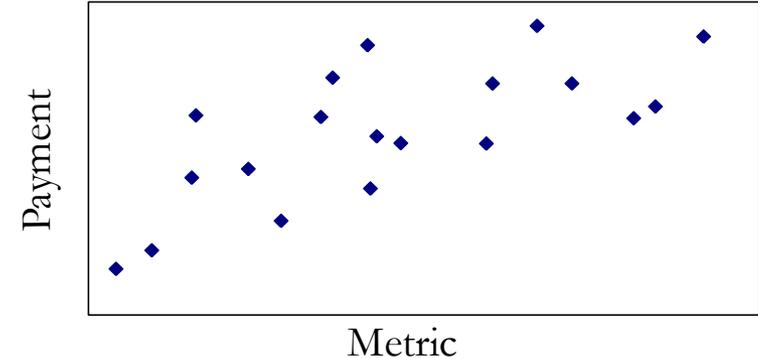
Soft/weak incentive payments are unrelated to metric. E.g., salary plans

Matching Tasks with Incentives

Task	Metric	Weak incentive (pay unrelated to output measure)	Intermediate incentive (pay related partly to output measure)	Strong incentive (pay solely on output measure)
Shelf space for new product	ACV	$ per hour worked by broker	$ per hour plus pay per ACV point	$ per ACV point
Dealer service quality	ACSI	Fixed monthly fee to dealer	Monthly fee plus bonus based on ACSI	$ per ACSI point
OS Development	KLOC	Time & Materials contract	Time & Materials plus $/KLOC	$ per KLOC

Research insight: Match softer tasks with softer incentives (but more control)
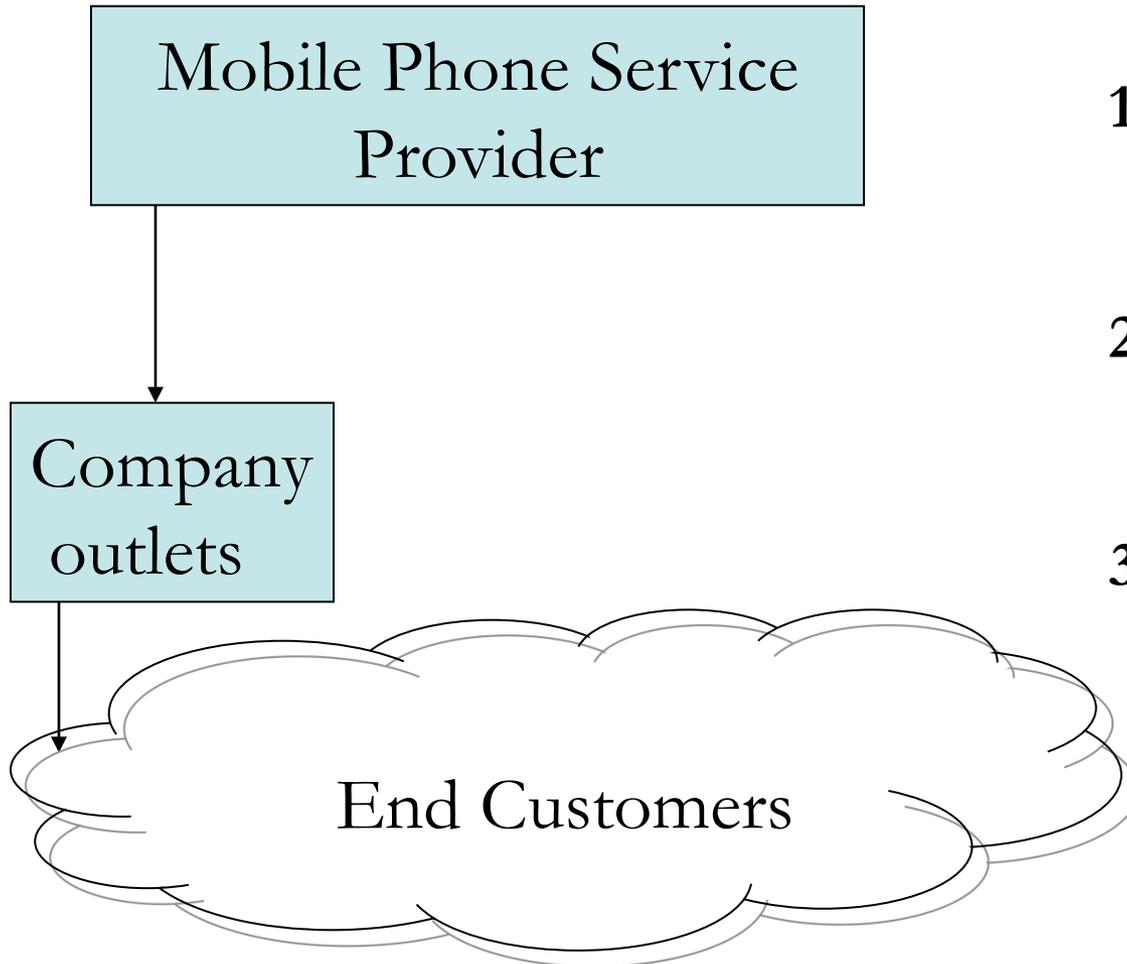
Mismatch of Tasks and Incentives

IBM paid Microsoft under a strong incentive contract for a very soft task like OS development ($ per KLOC)

Source: Ballmer interview on PBS

Mobile Phone Service Provider

Company outlets

End Customers

Task mix

1. **Acquire** (sign up) customers.

2. **Match** customer needs to right plan.

3. **Respond** to customer enquiries and complaints.

Desired Task-Incentive Match

| Nature of Task	Possible Metric	Weakest incentive ($ per hour)	Intermediate incentive ($ per hour plus $ per customer signed up	Strong incentive ($ per customer signed up)
Acquire customers. Hardest task.	Number of sign ups (available)			$/sign up
Match plan to customers. Moderately soft task.	LTV (not available)		$/hour plus $/ sign up	
Respond to complaints. Softest task.	Customer Satisfaction (not available)	$/hour		

Problem of Multitask Portfolio

Important Research insight: **Strength of incentives limited by softest task in portfolio.**

Hence, if outlets were paid a commission for customer acquisition, the two uncompensated tasks (matching and responding) will be ignored.

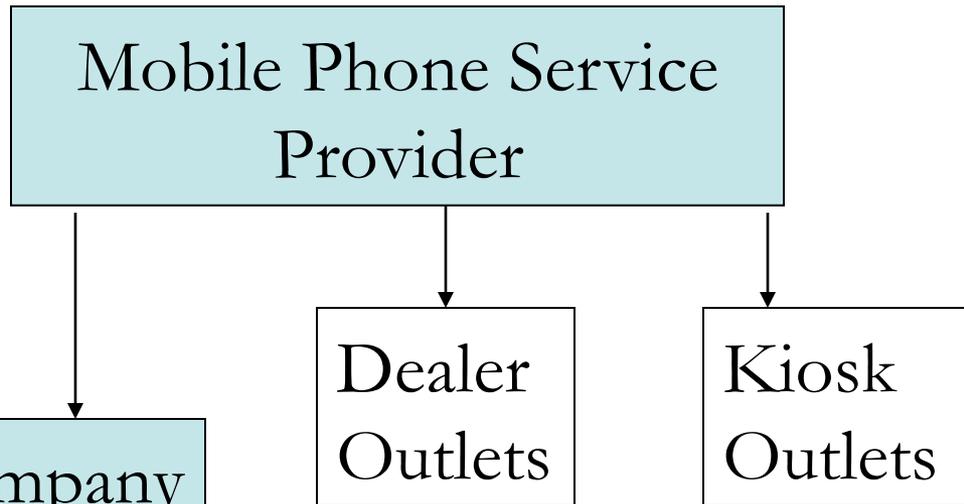Hence, best we can do is pay $ per hour (and exert control directly).
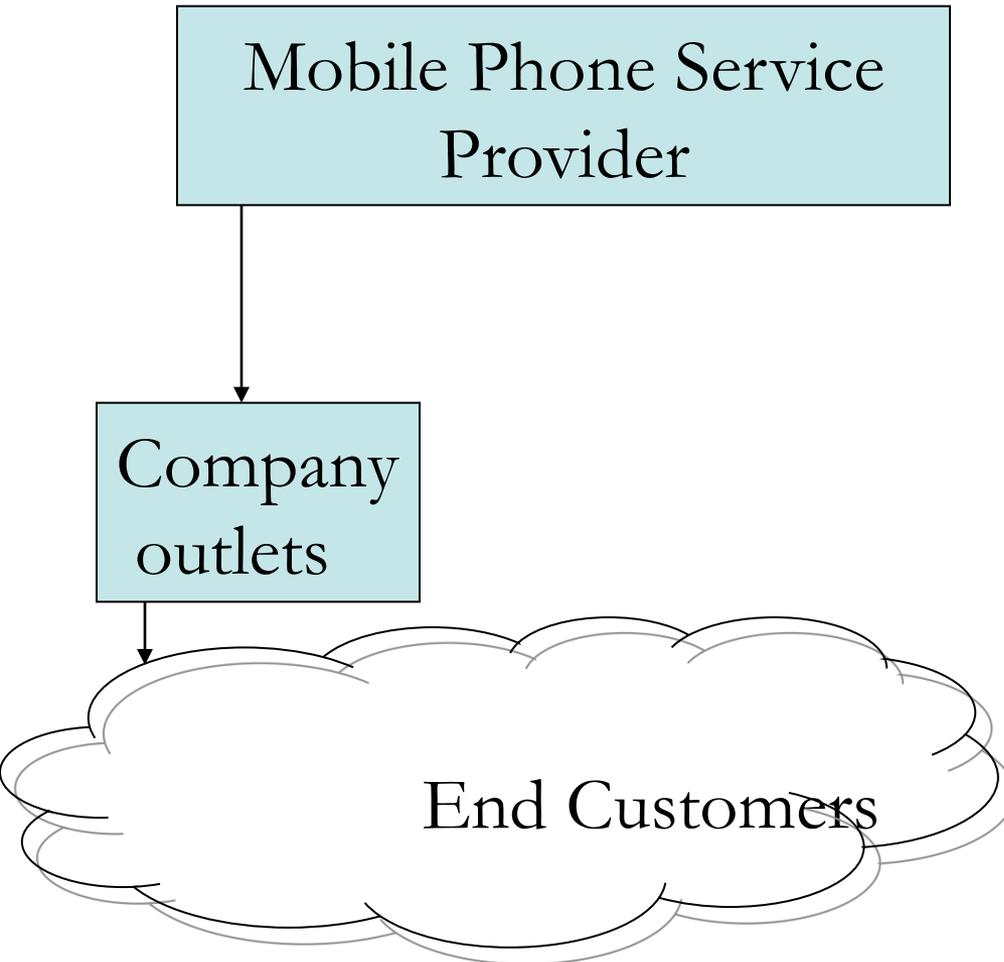
Outlet employees are paid $ per hour; asked to perform all 3 tasks

Incentive misaligned with Task 1 (acquisition) is neglected; market penetration is lower than desired.

Incentive aligned with Task 2 (matching); LTV on par with industry norm.

Incentive aligned with Task 3 (complaint handling) ; customer satisfaction on par with industry norm

Mobile Phone Service Provider

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End Customers

Doing better by adding channels?

Mobile Phone Service Provider

Company outlets

Exclusive dealing outlet at high traffic locations. Paid $/hr. Expected to focus on matching and complaints.

Dealer Outlets

Exclusive dealing outlet at moderate traffic locations. Paid $/hr plus commission on sign-ups. Expected to balance tasks.

Kiosk Outlets

Non-exclusive dealing outlet at low traffic locations. Paid a commission on sign-ups. Expected to focus on acquisition task.

Task mix self-selection aligned with incentives and location to induce more acquisition effort

Growth happened

|	Customer Average Lifetime (months)	Customer LTV ($)	Responsiveness to strong incentive (commissions)
Company Outlets	40	829	N/A
Dealer outlets	35	533	1
Kiosk outlets	32	358	1.5

Conclusions

1. Channels tasks and incentives vary in their "softness".

2. Softer tasks go with softer incentives.

3. Growth initiatives lead to channel mixing and multi-task portfolios, but strength of incentives limited by softest task.

4. Overcome this problem by using multiple channel outlet types aligned with different payment plans.

5. Note that different channels will self-select a different task mix.

Can non–CSD grow via DSD?
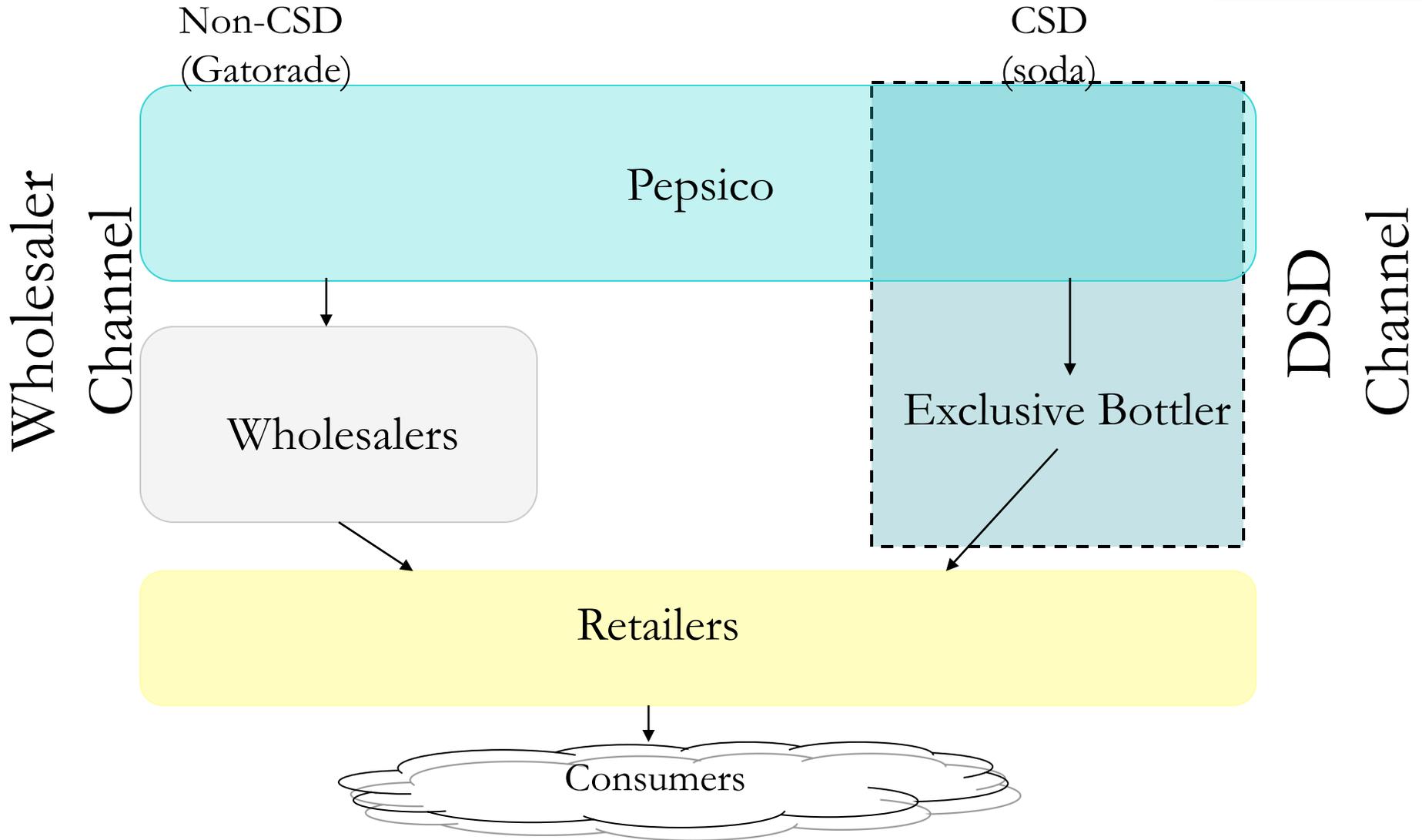
Current task mix and control of DSD and wholesaler channels are very different. Moving Gatorade to DSD makes its task mix broader.
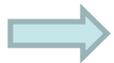
Can Toro's OPE grow via rentals?
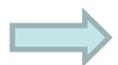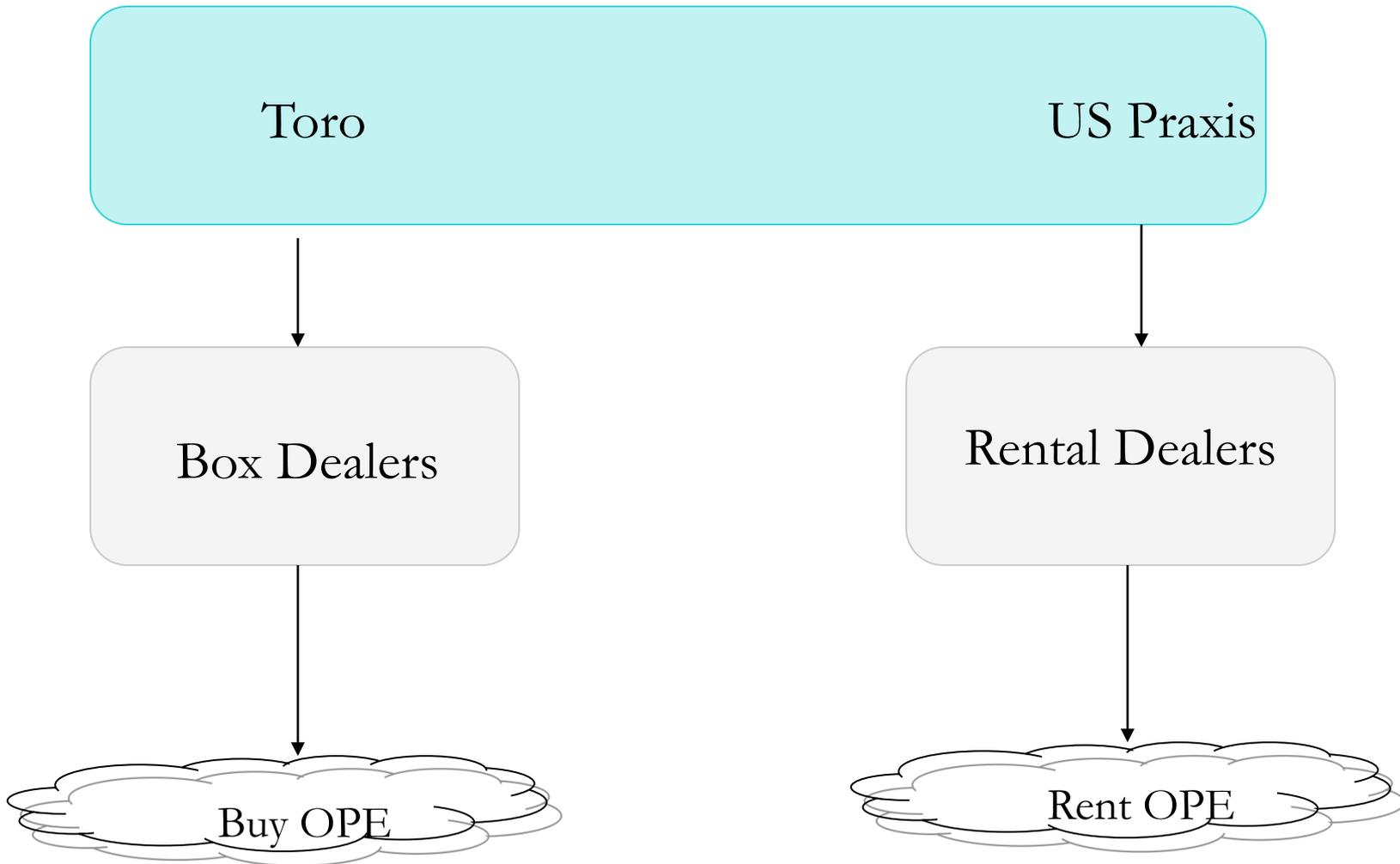
Current task mix of box and rental dealers are very different.
Incentivizing different task mix for same product line is challenging.

Can Hertz grow via lower price point channels?

Brand	% Company owned outlets	Importance of brand (Media spend per outlet $000s)
Hertz	66%	9.07
Dollar	2%	2.04
Thrifty	2.6%	5.22

Source: Lafontaine and Shaw, 2005

Current task mix at Hertz and , Thrifty, Dollar are very different. Combining fleet whilst maintaining task mix is the challenge

Thank you