

# **Relationship and Incentives in Marketing Channels of Agricultural Inputs**

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## ***Abstract***

This article brings the importance of creating the right set of marketing incentives as a way to foster the relationship with distributors, and consequently offering to final clients the highest possible value. To understand how marketing incentives may be used, it is needed first to conceptualize marketing channels and understand the nature of supplier-distributor relationships, to bring different ways suppliers have to achieve a good performance. The article presents a theoretical essay on marketing channels and analyzes empirically some cases on the agricultural input industry in Brazil, where dealers commercialize inputs with the existence of marketing incentive programs created by suppliers for distributors. As a contribution, the paper suggests a new method for the creation of incentives programs with distributors.

## **1. Introduction**

Why is it important to develop cooperation with distributors? A distributor is the one who takes the product until the final consumer, making it available and in a good condition for him. It is definitely a fundamental part of the marketing effort. Thinking of an agricultural input industry, a well coordinated group of distributors may indicate an important source of competitive advantage based on services, in a scenario where products are more and more equal.

The distribution variable in the marketing mix, when badly designed, does not allow the firm to succeed its objectives related to consumer satisfaction and retention. For necessity, firms use distributors. However, it is always important to remember that a distributor is a different firm, most commonly composed of different vision, values, and skills. Thus, for enabling cooperation between two interdependent firms (supplier and its distributor) is needed the creation of the right set of mechanisms. This paper explores ways to create cooperation and how a supplier must work towards it.

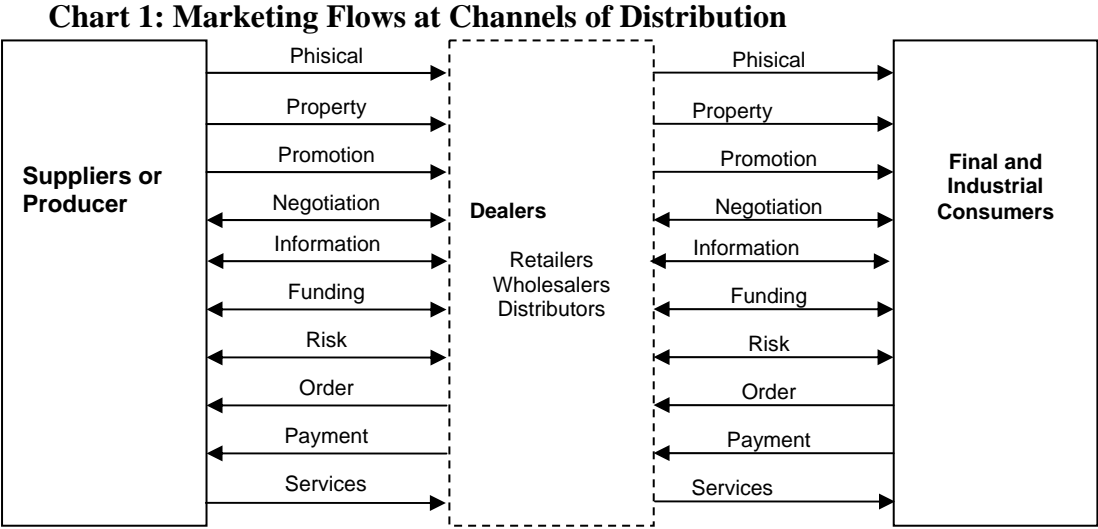
In the following theoretical introduction, first marketing channels and their functions are conceptualized. Second, a reflection is made regarding the existence of indirect marketing channels, and thirdly, a characterization of the relationship between supplier and distributor is made in order to understand the motivations behind it, for both sides. Finally, it is showed the relationship and networks perspective together with marketing incentives.

### ***Marketing Channels and Their Functions***

Marketing channels are defined according to Coughlan et al (2002) as “a set of interdependent organizations involved in the process of making available a product or service for use or consumption”.

By this definition, it can be noticed marketing channels are a set of interdependent organizations. It is not just one organization making its best, but several firms involved in many activities in a certain channel structure. Each marketing channel member depends on others to develop its function efficiently. Therefore, making the product available in an efficient way is the purpose of the “process” highlighted by Coughlan.

Among suppliers, retailers, wholesalers, and the final consumer, several activities are performed in order to make available the product at the right time, place, condition, and a competitive price. For understanding these activities, the simple marketing system (KOTLER; ARMSTRONG, 1998), and the networks for delivering value (PORTER, 1985) are good theoretical models, together with the so-called concept of marketing flows (COUGHLAN, 2002). These flows can be seen at the chart below.



Source: Elaborated by the authors based on Lewis (1968), Rosenbloom (1999) and Coughlan et al. (2002).

The dashed line indicates the flows may be performed from the producer to the dealer, from the dealer to the producer or shared between them. These shared responsibilities of agents in the development of marketing flows means the supplier will have to decide which activities he will perform by himself and which activities he will outsource from partners, mainly considering channel members. These marketing flows may be seen at a more detailed level, investigating the existence of indirect channels, at the next topic.

***The Existence of Indirect Marketing Channels***

Alderson (1954), Stern, El-Ansary and Coughlan (1996) and Coughlan et al. (2002) point out the importance of the channels existence relating specific activities linked to the distribution

function and satisfaction of the final users' needs. These reasons may be divided in two sides, being the demand and the supply perspectives.

From the demand's side, factors such as (a) the search's facilitation stand out, where the intermediaries help to reduce the uncertainties in the distribution process (necessity, market and transaction's uncertainties) (PELTON, STRUTTON, LUMPKIN, 1997) and (b) the adjustment of assortment's discrepancies. From the supply's side, what stand out are (c) the creation of a transaction's routine (d) the reduction in the number of contacts and (e) the facilitation in the transmission and the exchange of information. In short, Coughlan et al. (2002) show that the intermediaries take part into the channel's effort because they aggregate value and help reducing the channel's costs.

It must be understood that one producer who adopts indirect marketing channels for necessity (in another words, not selling directly to the final consumer) is composing the marketing mix (the place variable) with another organization. This firm also depends on others' work (external agents) to reach the equilibrium and integration among marketing variables. Thinking of positioning, as said by Ries and Trout (1995), the place variable need to be consistent with the firm's unique value proposition. This synchrony is even more fundamental at the execution of the business concept, as the case of agricultural inputs, where the dealer has a fundamental role in delivering value to the final client.

Thinking of distribution needed tasks, the supplier when contracts external distributors outsourced some of the tasks as delivering services to final clients, promoting product characteristics, capturing local market information. When directly accessing the market, all the distribution tasks would be performed all by himself. Outsourcing distribution functions is discussed as a "make or buy decision" in Anderson and Weitz (1989), helping the decision when and when not contract outside is a correct decision.

At establishing an agreement with a distributor is expected the supplier rely on him for the needed activities and executing the positioning policy. Hence, this is related to a model where the parts are interdependent and influence the results of each other. This important interaction is often forgotten when the marketing plan is written. This has to do with successfully implement marketing policies counting on distributors' work.

### ***O Relationship Supplier-Distributor***

A distributor wants supplier's products to create people traffic in his store, also he wants good sales related to the needed sale effort related to the supplier products. Also a distributor expects good margins related to the supplier's products and prestige at having the products available for the clients. The distributor also wants the supplier to invest in promotion at its region to empower even more branding image for his store. The distributor wants the support of the supplier in training programs on products, and specific materials for sales promotions (COUGHLAN et al. 2002).

On the other hand, the supplier wants the distributor to develop efforts in selling its products in that particular region. The supplier wants the distributor give technical assistance to particular clients related to his products. Also the supplier wants the distributor to focus on the

promotion of its products and not losing time with other activities, in order to explore as much as possible the sales potential of the region (COUGHLAN et al. 2002).

There may be specific investments in the transaction between the supplier and the distributor, as discussed by Anderson e Weitz (1989). Both parts may develop specific activities related to the other that may be understood as specific investments, with low salvage value. Taking as an example, the training program for the sales team of a distributor regarding unique characteristics of a specific suppliers products. The supplier-distributor relationship once finished, the salvage value for the supplier in zero. Therefore, the discussion is whom will be responsible for making the specific investments in the transaction for good sales performance. Another simpler example is the investment in lay out for characterizing a specific suppliers distributor. Once the distribution contract is broken, what to do with all the specific material? This material developed for that particular region and distributor will be worthless. For this reason, there is a potential interdependent relationship that can be empowered mostly by performing specific investments by one part or the other, hoping both will reach their objectives in the partnership.

### ***Relationship and Networks***

Rocha (2006) says “Relationship marketing is a organizational function and a set of processes, based on marketing orientation, that tries to establish a deep and long relationship with target consumers, as a way to obtain sustainable competitive advantage”. This definition, based in other definitions, suggests a form to organize processes, which is a very important concept to deal with distributors, when different processes are involved.

The evolution of the concept of relationship has been worked by the Industrial Marketing and Purchasing Group (IMP). The studies of this group have been characterized by the use of a network perspective. Networks are defined as a set of firms and relationships among them. This perspective has three principles. First, instead of seeing the seller firm as the active part and the buyer firm as the passive or reactive part, the network perspective sees both companies belonging to a net of businesses composed of a large number of active and heterogeneous firms, which interact to each other and search for solutions for their problems. Second, the firms are interdependent for selling, buying, information gathering, technology development and for accessing other firms in the network. Third, instead of considering the firm capable of having all the needed resources, abilities and technologies to develop its strategy, the network perspective says the firm totally depends on the interaction with other organizations, even competitors (GEMUNDEN, 1997, FORD et al., 2002).

The network perspective is very coherent with the proposal of this article because shows at its three principles the need for a wise interaction, in this case between supplier and distributor. The marketing incentive may be a form to provoke this wise interaction, discussed at the next topic.

### ***Marketing Incentives and Objectives Alignment with Distributors***

According to Crescitelli (2002) marketing incentive is a way to stimulate higher productivity of the sales team through prize offering. According to him, it may be applied in several publics as salespeople, employees, distributors and distributors` salespeople.

Faced as a simple game, the incentive program may be faced as rewards by something done, typically prizes for sales volume. The bad side of it, it may create addiction to the incentive program, and not creating the expected effect of creating cooperation among parts. For this reason, the vision must be wider. The American Marketing Association (AMA) defines marketing Incentives as the following way:

*“An event offering rewards or inducements to stimulate the salesforce or channel members to achieve predetermined sales, profit, distribution, or other goals”*

By this definition, it may be concluded about the possibility to work with incentives to induce or stimulate the distributors to work into the direction desired by the supplier. By AMA definition it can be perceived this possibilities by the expression “other objectives”, but a focus in sales and profits.

Crescitelli (2002) suggests marketing incentives programs may be used to enhance the global performance of the marketing channel, not just the financial result. The definition on what is the global development of the distributor may be posed as the distributor functions and marketing flows seen at the topics above. Getting together this literature is one of the objectives of this article.

## **2. Objectives and Method**

The central objective of this paper is ***to propose a sequence of steps for designing marketing incentives for marketing channels.***

To reach this objective the paper relates marketing channels with marketing incentives. It explores the marketing relationship theory oriented to relationship marketing and networks. It checks how incentive programs have been applied in the Brazilian ag-input industry and intends to understand how marketing incentives may increment the relationship with marketing channels.

About the method, the paper makes a theoretical review on marketing channels, networks and relationship, and marketing incentives. After that, multiple case studies are developed in the ag-input industry. The selection of this industry to discuss this subject is regarded to the emergence of several marketing incentive programs for the last five years. Four cases are analyzed bringing comparison variables like processes asked by suppliers, how suppliers evaluate and control the distributor performance, and finally what is offered in reward for the good performers. This discussion is presented at the topic 3.

Finally, with the theoretical contributions and the evidences from the case studies, a proposition is made to build a sequence of steps for the creation of a marketing incentive program for marketing channels of the agricultural input industry.

## **3. Incentive Programs at the Ag-Input Industry in Brazil**

Following, it is showed a table mapping incentive programs used by four firms, which are industries from the ag-input sector in Brazil. First, the table presents the central product offered by the ag-input supplier firm, the use of formal contracting with their distributors (written contracts, formalizing the relationship supplier-distributor) and the inclusion or not of exclusive territorial rights clauses (this topic is central for distribution agreements, because delimits selling rights). After this general information the chart split up in two parts. The first one, presents what is evaluated by the supplier and the second one presents what is offered back by the supplier to reward the distributor, once the distributor achieve the required performance level.

What can be seen, analysing carefully the table bellow, is how suppliers use what they want (formulated objectives for the distributors) and how suppliers may initiate their behavior (what can the suppliers offer as a reward for the good performers).

**Table 1: Mapping Incentives Programs in the Ag-Input Industry**

<b>Supplier</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>
Product	Defensives	Seeds	Defensives	Fertilizers
Formal Contracting?	NO	YES	NO	NO
Exclusive Territorial rights ?	NO	YES	NO	NO
Relationship programs ?	YES	YES	YES	YES
<b>What is asked to the distributor (yes/ no):</b>				
Sales Volume	YES	YES	YES	YES
Margin	YES	YES	NO	NO
Sales of a Product Mix	YES	YES	NO	NO
Quality of the Sales Efforts	YES	YES	NO	NO
Services offered to final clients	YES	YES	NO	NO
Local Promotion	NO	NO	NO	YES
Stock levels	YES	YES	NO	YES
Good Lay Out	YES	NO	NAO	NAO
Information gatheirng and transmission	NO	YES	YES	NO
<b>Others:</b>				
<b>What is offered (yes/no)?</b>				
Price Discounts	YES	YES	YES	YES
Product Bonification	YES	YES	YES	YES
Support for local promotional activities	YES	YES	YES	YES
Consultancy for management improvement	YES	YES	NO	NO
Training	YES	YES	YES	YES
Promocional Material				
Rebate (prizes in money)	YES	YES	YES	YES

**Source: Elaborated by the authors**

As could be seen at the table above, it shows four multinational firms from the Agricultural Input Industry, all of them with incentive mechanisms for their marketing channels.

Just one of them uses formalized contracts, delimiting product lines and regions, that can be worked by the distributor. The other firms, these topics are important but are not formalized in written contracts, they are just reinforced by incentive programs and are left more vaguely in the

relationship. This obviously gives a greater flexibility, but on the other hand, may be a relevant source of conflicts.

It is important to see in three cases total absence of any kind of contract that formalize these procedures, with the exception of the seed case. Why is that will certainly be a good research question.

Most firms use prizes in money, products and support in local promotion. The better the firms results are on the related topics of the incentive program, the larger are the benefits, as listed in the lower part of the table 1.

There is the possibility to classify the incentives and their requisites inside the marketing flows framework. If one reflects about what is asked and offered, it may be concluded they all may be understood as activities inside marketing flows, as offered products and services, the level of communication, information gathering, orders collection and financial results. Therefore this simple theoretical model, explained at the introduction, is highly pertinent to organize the incentive schemes in marketing channels.

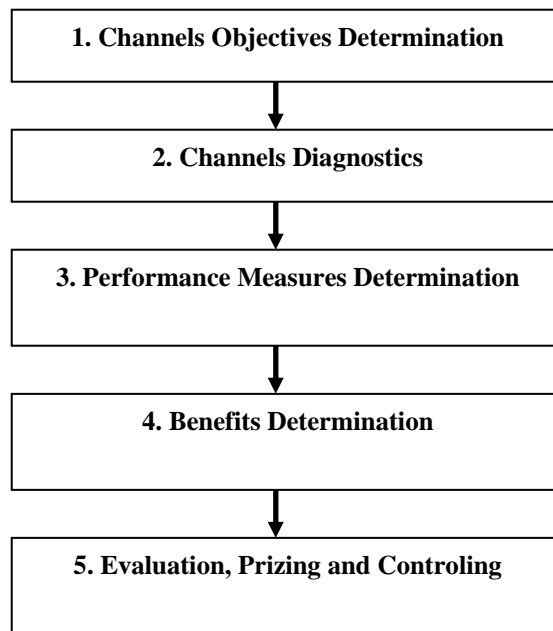
Although the incentive programs are not formally stated in contracts, the four company differ as the way they implement it. Some use more rationally for a more long run orientation and other implement it more punctually, for a particular sales campaign or another. Definitely improvements are reached in those partnerships built for a longer run, typically delineating a win-win partnership, as suggested by Crescitelli (2002).

#### **4. Proposition of a Method for Designing Incentives for Distributors**

This topic intends to contribute at suggesting a method of analysis, which should be done for the development of the right set of incentives for distributors. As discussed at the introduction of this article, the literature is rich at ways of creating incentives for sales forces. In this paper, this literature is applied on marketing channels. The contribution of this article is developing a strategy to align the objectives of marketing channels and their supplier and improve the chain performance.

It is proposed a sequence of 5 steps. First, it is important to define the objectives of the supplier with the channel member. Second, a diagnostic of the actual situation of the channel members might be done, assuming a supplier perspective. Third, the performance measures should be created and the fourth step, the benefits related to the achievement of the performance measures, should be created. The final step, the supplier should communicate the incentive program and implement and control it.

Figure 2: A Sequence for Designing Incentives for Distributors



Source: Authors

#### **4.1 Defining Objectives with Channel Members**

An analysis is done related to what is expected from the channel members at performing marketing flows, being, product and services, communication, information, sales volume, funding, among other discussed at the introduction of the paper.

For this analysis a more detailed list of each marketing flow is important, functioning as a check list for the supplier. If the listed activity should or should not, or better, could or could not be performed by the distributor. If this is so, a second decision is if this particular activity deserves a specific incentive. The detailed list of marketing flows along with the reasoning for building the incentive program is showed at the table bellow.

#### **4.2 Diagnostic of Actual Channel Member Performance at a Supplier Perspective**

Once the supplier has a clear understanding of what is expected from the distributor, it is important to understand the actual situation, and obviously see the distance from a perfect situation.

The long way from an actual situation to a deserved situation is exactly the path that the incentive program has to motivate the distributor to follow.

### 4.3 Designing Performance Measures

Between an ideal situation and a desired one related to several requisites, there will be certainly a set of improvements developed by the distributor. What is an unsatisfactory, reasonable, good or excellent performance should be thought previously by the supplier. The supplier should sign clearly to the distributor the performance requisites and their levels of achievement and consequently the retribution for it.

Certainly, as more quantitative and observable a performance measure is, lower is the subjective judgment presented in the incentive programs. However, some activities as contribution on marketing information gathering are difficult to make it operational in a quantitative measure. Other like sales volume or margin are easily evaluated quantitatively.

The definition of a performance measure might suppose some distributors are weak on that criteria, other are reasonable and other are very strong. The question is what is a weak, reasonable and strong performance in a certain criteria? How can the supplier transform this performance expectation in measures easily communicated to the distributor?

At the table below, some marketing flows are showed in a more detailed way, as suggested by Neves (2003). After that, for each activity there is a questioning for those who are creating the incentive program, following the proposed steps. What is the expected performance and consequently the objective in such an activity (4.1), what is the current situation (4.2) and finally what are the requisites or measures for that activity.

**Table 2 – Objectives, Actual Situation and Performance Measures for Activities related to Marketing Flows in Marketing Channels**

FUNCTION	What is the Objective?	What is the Actual Situation?	Which are the performance measures?
<b>Product and Services Flow Variables</b>			
Management and inventory levels (An Example)	A high level of inventory for the supplier products.	Very heterogeneous. Missing important lines.	Certain amount of tons for each product line every month is excellent, 10% less than this is good, 20% reasonable, 30% is bad, 40% is terrible.
Product transportation			
Product modification			
Product line and variety			
Evaluation of new products			
Predicted volume of sales (performance)			
Technical support of explanation/installation			
After- sale service			
Providing of sales (team) service			
Training: scope and costs			
Maintenance and product repair			
Packaging subjects/specifications			
Brand subjects			
Exclusivity details found in the contract			

Territorial rights found in the contract			
Predictable market coverage			
Duration (period to perform the flows)			
Adaptation to specific laws			
Others (fill in)			
<b>Communications Flow Variables</b>			
Advertisement (all forms)			
Sales promotion (all)			
Public relations actions (all)			
Direct marketing actions			
Providing information about products			
Sharing in communications budget			
Communication within direct sales			
Packaging information			
Others (fill in)			
<b>Information Flow Variables</b>			
Providing information about consumer's market			
Providing information about competitors			
Providing info. about changes in the environment			
Participation in the planning process			
Frequency and quality in information			
Providing complaints information			
Electronic orders			
Others (fill in)			
<b>Payments and Orders Flows</b>			
Order frequency			
Pricing policies and payments			
Margins analysis			
Commissions (volume and frequency)			
Conducting credits to final consumers			
Billing customers			
Search for financing sources			
Pricing guarantees			
Others (fill in)			

**Source: adapted from Neves (2003)**

#### **4.4 Benefits Design**

Once the performance measures are defined and a first evaluation is done, the level of benefits according to the level of success achievement must be clearly defined.

When the supplier states the benefits for the distributor into its expected direction, the supplier is motivating the distributor to improve exactly on the aspects related to the improvement of the relationship supplier-distributor.

To have a strong effect the benefits offered by the supplier have to be of a true value for the distributor. It is important to take a look at the relationship marketing theory applied for the industrial segment, as proposed by Rocha (2006).

The benefits generated might be related to the financial advantages (discounts, better payment conditions, bonus in products), structural advantages (consulting, sales training, promotional material, joint promotion activities) and social (social events, parties, trips, relationship clubs) as proposed by Berry (1983). The supplier firm may elaborate a package of benefits according to the classification of the distributor. Excellent performers, best package of “gold benefits”. Good performers, second best package of “silver benefits”, and so on.

The most important thing is the clear comprehension by the distributor of the path to be followed to become a gold distributor and receive the gold package of benefits. If that is so, all the group of distributors will work to improve their services and activities into the direction desired by the supplier (CRESCITELLI, 2002).

#### **4.5 Implementation, Prizing and Controlling**

Once the performance measures are created, the program must be implemented. According to the classification of the distributor, it may receive a package of benefits (as commented above)

It is important to highlight the instruction role that this incentive program may have. Imagining the distributor has been classified at a lower level of performance and consequently receiving smaller benefits, it is the supplier role to orient and coordinate the distributor to improve and obtain a better package of benefits at the next evaluation. Like this, progressively it starts to happen an improvement effect and the definition of a good partnership among both firms, supplier and distributor. If the incentive program is well formulated the distributor also understands that the improvement on the performance measures is also important to the improvement of the whole firm, besides receiving the benefits from a particular supplier. The supplier has in its sales team a fundamental role at implementing and managing it as discussed by Hutt e Speh (2002) and also Levitt (1983).

#### **5. Conclusions**

As could be discussed in this article it is possible to get together the theory related to marketing channels and incentives for understanding how to develop relationships with distributors and to think in a incentive program to improve all channel members performance as a whole. The theoretical line of marketing channel brings the comprehension of relationships among supplier and distributors and the marketing flows to understand the existent dimensions and functions. Marketing incentives bring how incentives may used to influence the expected behavior, through extrinsic motivation and, finally, relationship marketing brings of ways to create strong and durable ties with valuable clients.

Building cooperation among organizations is a process that might be initiated by one side and the other must have goodwill towards it. This article tried to offer a method from the supplier

to create a logical and rational mechanism to influence the distributors behavior and make their objectives alike the supplier's objectives.

The majority of channel conflicts between suppliers and distributors, apart natural disputes for price bargaining, is related to the different perspectives between both parts and mainly different objectives. This method may work as a way to learn how improving the relationship.

It is worth noting that the supplier-distributor relationship is a result relationship. There are important legal limits for determining performance measures in a commercial relationship. It is important always submit the incentive program for a proper legal revision by lawyers before implementing.

For the agricultural input industry the alignment among suppliers and distributors is fundamental to allow proper service for final consumers, the growers. It is almost always impossible for an ag-input firm to grow totally responsible for its own efforts in final clients attendance. The coordination with distributors and their team may create an important competitive advantage in a market where more and more products stays as commodities.

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