CDW and PC purchases by small and medium-sized business buyers: Channel functions and equity principle insights

Sidebar 2-1 profiled the computer systems reseller CDW and its success in serving small and mediumsized business buyers through its superior provision of service outputs. Its ability to do so rests on its performance of key channel functions in a more efficient (lower cost) and effective (better at producing service outputs) manner than other channel partners can. The channel functions in which CDW plays a key role are *physical possession, promotion, negotiation, financing,* and *risk.* In addition, CDW offers flexibility to its buyers, so that not all buyers must pay for and consume all of the functions that CDW offers. Through this mechanism, CDW effectively offers differentiated "packages" of function performance to the market, through one umbrella channel structure.

CDW's Role in Bearing Channel Function Costs

Table 3-1 summarizes CDW's participation in key marketing channel functions. Each has specific implications for channel efficiency (cost management) and/or channel effectiveness (minimizing total channel costs, subject to the maintenance of desired service output levels).

As a channel intermediary, CDW performs *physical possession.* As the entries in Table 3-1 indicate, CDW takes on a significant portion of the costly burden of holding inventory (in its 400,000-square-foot warehouse and through its large-volume purchases). The enthes also suggest that CDW's participation in the physical possession function lowers the total channel cost of inventory holding. In particular, CDW ships 99 percent of orders the day they are received, suggesting i; has expertise in interpreting demand forecasts, which minimizes its inventory holding costs. Furthermore, CDW's investment in "asset tagging" for its government buyers constitutes a costly channel function investment that aims to reduce subsequent physical possession costs, through its ability to provide quick information to both CDW and its buyers about the location of inventory (e.g., to schedule routine service and maintenance calls, to reduce product theft or loss). CDW's large-volume purchases also reduce systemwide inventory holding costs, accompanied by reduced wholesale prices from suppliers The implication here is that taking large volumes of product all at once actually lowers the supplier's cost of selling to the market. Not only does it pass those savings on to CDW, but it also enjoys improved channel efficiency overall.

CDW's promotional investments in the channel are also extensive (Table 3-1). It trains its salespeople for several months when they start their jobs, thus providing its channel partners with experienced promotional agents who can sell their products. It devotes a salesperson to every account—even small, new accounts that initially generate low revenues. The company recognizes it cannot afford to have salespeople call on such accounts in person, so it serves them through phone or e-mail contacts, which helps control its promotional channel function costs. But the salesperson remains available to answer customer questions, providing a well-trained sales conduit to each account A customer with an existing relationship with a CDW salesperson is likely to buy more from CDW, in response to the relatively high-touch relationship (despite initially small purchase levels). Through these investments, CDW reaps reduced promotional costs from the long-tenured sales force it employs and keeps; a salesperson with three or more years of tenure on the job generates approximately $30,000 in sales per day on average, twice as much as someone with two years of experience and ten times as much as a salesperson with less than six months of experience!

Another interesting example of clever management stems from the negotiation function in Table 3-1. CDW's government arm (CDW-G) established a small-business consortium to help small computer services firms compete for U S. government IT contracts. These small firms benefit from the government directive to award approximately 20 percent of ts procurement contracts to small businesses (i.e., small firms already have a negotiation advantage with the government as a buyer) Yet they still must offer competitive price bids, which is difficult if they only purchase small product quantities to develop their system solutions. By pro- to its small-firm partners, so that they in turn could viding both expertise and more competitive whole-generate greater sales. For CDW, the benefits are sale prices on computer equipment to small firms, obvious, in that it could not have qualified as a small CDW enabled them to compete on price. In this business in government contracting. This arrange- sense, CDW offered superior *negotiating* capability ment offers a fine example of complementary

TABLE 3-1 CDW'S participation in various channel functions

Channel Function	CDW's Investments in the Function
Physical possession	a) 400,000 square foot warehouse. b) Ships 99 percent of orders the day they are received. c) For government buyers, CDW has instituted an "asset tagging" system that lets buyers track which product is going woere; product is scanned into both buyer and CDW databases, for later ease in tracking products (e g., service calls) d) Buys product in *large volumes* from manufacturers, receiving approximately eight trailer-loads of product from various suppliers every day, in bulk, with few added services.
Promotion	a) Devotes a salesperson to every account (even small, new ones), so that end-users can always talk to a real person about technology needs, system configurations, postsales service, and so on. b) Salespeople go through 6 Vi weeks of basic training, then six months of on-the-job coaching, then a year of monthly training sessions. c) New hires are assigned to small business accounts to get more opportunities to close sales. d) Salespeople contact clients *not* through in-person sales calls (too expensive) but through phone/e-mail. e) Has longer-tenured salespeople than its competitors.
Negotiation	CDW-G started a small business consortium to help small firms compete more effectively for federal IT contracts. It gives small business partners lower prices on computers than they could otherwise get, business leads, and access to CDW's help desk and product tools. It a'so handles shipping and billing, reducing the channel function burden from the small business partner. In return, CDW gains access to contracts it could not otherwise get.
Financing	Collects receivables in just 32 days; turns inventories twice per month; and has no debt
Risk	"We're a kind of chief technical officer for many smaller firms" CDW is authorized as a Cisco Systems Premier (CSP) partner, for serving the commercial customer market.

Information sharing	Collects information on which manufacturers' computers can best solve specific customers' needs Store warranty information on each customer's product to facilitate sen/icing

inputs that jointly generate superior negotiating power for channel partners.

CDW performs financing functions efficiently, as Table 3-1 demonstrates, through its enviable inventory turn rate of twice per month (the inventory turn rate measures how frequently a section of shelf space, such as in the CDW warehouse, empties and is replenished with inventory). Furthermore, CDW is efficient in its payment collections, with just a 32-day average receivable figure (which helps it minimize the total financing cost borne in the channel), and the company has no debt (which reduces the financing cost of capital).

Finally, CDW's extensive investments in expertise and information sharing serve to reduce other channel function costs, as well as reduce risk for its buyers. As a manager quoted in Table 3-1 states, "We're kind of chef technical officer for many smaller firms." The small buyer relies on the expertise and knowledge offered by C DW to choose the right systems solutions. Similarly, in serving commercial customers in general, CDW's authorization as a Cisco Systems Premier (CSP) partner signals its expertise with regard to providing full solutions for its commercial customers, not just computer components. A CDW executive explains that this authorization lets CDW act as a "trusted adviser" for the customer, so that CDW can "really talk technical about what a customer is trying to accomplish and really add value to the sale, as opposed to just sending out a box." The channel-level efficiency in managing the cost of risk exists because CDW can learn relevant information and apply it to many customers, rather than each customer having to invest in the knowledge individually. In short, customers benefit from the information gathering economies of scale generated by CDW.

Finally, CDW offers its customers a choice about how much channel function costs they want to transfer to CDW. It routinely performs significant channel functions, but in relationships with end-users that already possess technical service capabilities and with compute-manufacturers, CDW lessens its participation. For example, CDW se-ves the Kellogg School of Management at Northwestern l Jniversity The Kellogg School uses CDW to provide laptop and desktop computers for students, faculty, and staff. Once the machines have been purchased (i.e., when CDW passes physical possession to the Kellogg buyer), the product warranty is with the manufacturer directly, not CDW. The Kellogg School has the technica capability to handle some repairs in-bouse, and it offers loaner machines to faculty and staff when it must ship their computers back to the manufacturer for service. Yet CDW is not responsble for the postsales services that Kellogg students and faculty enjoy when they buy a Kellogg-sanctioned laptop, because the school installs Kellogg-customized software on the machines and tests them oefore handing them over to the ultimate buyer. In this example, we find a buyer that; can perform certain important channel functions itself, and CDW responds flexibly by offering tiered service levels to let the end-user spin off only those channel functions that the end-user cannot or does not want to perform itself.

CDW's Use of the Equity Principle in Function Management and Incentive Creation

In two notab e ways, CDW acts in accordance with the equity principle in its channel function participation and the rewards it offers to channel partners. First, it compensates employee salespeope with a commission rate that is the same regardless of whether the sale is generated person-to-person through the salesperson or through online ordering (both of which CDW offers). As we discussed n relation to the promotion function, every customer is assigned a CDW salesperson, in the hopes that more promotional (sales force) contacts generate greater customer lifetime value. But imagine that the customer interacts with the CDW salesperson periodically for major purchases but buys replacement components (e.g., printer cartridges! and smaller routine purchases online. Is it "fair" to award sales commissions to the salesperson for these online purchases? CDW believes it is, because the online purchases resulted at least in part from the initial sales efforts of the salesperson to build the customer relationship; without the salesperson, the end-user might have made these routine purchases elsewhere. Moreover CDW recognizes that it is not just *how costly the inputs were* that matters, it is also how the customer wants to buy. If the customer prefers to make certain purchases online, perhaps because it seems easier than contacting a salesperson, CDW's internal incentive system supports the customer's freedom of choice. With this equal commission policy, it avoids creating a pernicious sales incentive to "force" the customer to buy in person rather than online.

Second, CDW offers a different fee to the smaller solution providers with which it partners to serve some ultimate end-users, because it relies on them to perform on-site work for the end-user, such as installation, software or hardware customization, provision of postsales customer service, and so forth. The equity principle suggests that these solution providers wojld be unwilling to undertake such costly activities unless they knew they would be compensated for doing them. The fee structure offered by CDW gives them an adequate reward for doing so. By "paying them what they’re worth," CDW embraces the heart of the equity principle.