Most chip manufacturers work with one or more distributors, often maintaining close, long-term relationships. It seems like a mutually beneficial situation: semiconductor companies get to reach customers around the world, including small businesses that might otherwise be overlooked, while distributors receive compensation for their expertise. So why are many chip makers now reevaluating their distribution partnerships?

The answer lies in recent semiconductor-industry trends. Over the past few years, the customer base has consolidated, costs have soared, and margins have shown limited growth. In response, manufacturers have been closely analyzing all expenses and revenue streams, and many have concluded that they are not capturing full value from distribution. Some problems arise because manufacturers do not fully understand their customers and thus do not deploy resources appropriately. Other issues occur because manufacturers fail to provide distributors with appropriate support and incentives.

To improve the situation, manufacturers need to take a more analytical, collaborative approach to distribution. They should closely examine all distribution data, including detailed sales information for individual regions, products, and customers. They must also reexamine their working relationships to determine if they are providing distributors with appropriate incentives and support. This article will help manufacturers achieve these goals by discussing strategies that can lead to more fact-based decision making and stronger working partnerships with distributors.
relationships with distributors. It begins by describing the evolving distribution landscape to provide context and then discusses various improvement levers in detail.

A rapidly evolving landscape
Distributors handle 24 percent of the semiconductor industry’s revenues. They often provide the most effective way for manufacturers to reach the “long tail” in many countries—the tens of thousands of small customers whose orders would be more expensive to serve with a full-time, in-house sales force. Many manufacturers also have distributors manage mature customers and product lines that do not require internal sales or technical support, since they provide a low-cost solution for maintaining the business.

Use of the distribution channel varies by company, with some obtaining more than half their revenues from it and others much less. Some manufacturers concentrate on direct sales for legitimate reasons, such as a focus on large customers who can be most efficiently served by the internal sales force. In other cases, however, companies may be overlooking important opportunities to reach more customers and provide better service through distributors.

Geographic variations in use of distributors
Several geographic patterns are obvious when looking at distribution. For instance, distributors account for more sales in China than in other countries or regions, and their influence has been growing. We expect this trend to continue, mainly because logistical challenges, language barriers, and customs requirements often make it difficult to reach Chinese customers directly (see sidebar, “The challenges of distribution in China”). By contrast, Japan has recently experienced a sharp drop in distributor revenues in response to the declining yen and high price competition. Distributor revenues have been mostly stable in other Asia–Pacific countries; Europe, the Middle East, and Africa; and the United States (Exhibit 1).

There are three major distributors globally, but their market share varies by geography. According to Gartner research, Arrow Electronics and Avnet obtain 70 percent of distributor revenues in the Americas and 63 percent in Europe, making them the top two companies in these regions. They have gained much of their strength by acquiring smaller companies, but further market consolidation is unlikely because few American and European targets remain.

Gartner research also suggests that WPG Holdings leads the market in the Asia–Pacific region (excluding Japan), accounting for 22 percent of revenues. Avnet is second at 8 percent, and Arrow comes in third with 3 percent. The distributor market is far more fragmented in the Asia–Pacific region because language and customs barriers often make it difficult for foreign companies to establish a presence, leaving small local players in a stronger position. While Asia–Pacific may see more mergers and acquisitions in the future, the trend toward consolidation has not yet taken off.

How should semiconductor companies and distributors work together in the future?
While the distribution channel is crucial to most manufacturers, serious problems often impede its use. We see these as four major areas for concern:

- **A lack of customer insights.** Manufacturers may not use distributors efficiently, because they lack a detailed understanding of their customers, including how their needs vary by project or region.

- **A myopic view of the distributor relationship.** Manufacturers may be unfamiliar with distributor operations and thus fail to provide appropriate incentives or support. All too often, they just focus on decreasing distributor margins—a strategy that could alienate loyal partners.

- **Insufficient product insights.** Many companies set their distribution policies at the portfolio level,
establishing price lists or implementing design-registration changes for entire product lines. But so much heterogeneity exists within the portfolio and customer base that such blanket decisions often result in value loss.

- **Intermittent attention.** Even when distribution strategies are initially effective, problems may occur if manufacturers fail to reevaluate them periodically. For instance, a customer’s need for technical support may change. Other challenges arise because distributors’ capabilities are constantly evolving. They may stop investing in a particular product line or hire new field-application engineers to specialize in a particular end market.

### Setting up mutually beneficial partnerships with distributors

Semiconductor companies can mitigate or eliminate many of the problems inherent in distributor relationships by developing a detailed understanding of their individual product and customer needs. But they also need to understand their distributors—the capabilities they possess, the incentives that motivate them, and the support they need to succeed.

### Obtaining detailed insights about products and customers

As a first step to improving distributor relationships, manufacturers should create an extensive fact base that includes detailed information on individual products, such as data on total and served available...
market. But looking at spreadsheets alone is not enough, since in-house sales and technical staff have important insights about different subregions, including the role that distributors should play in the go-to-market strategy for individual products or customers.

Manufacturers will also need to decide whether distributors should be used for fulfillment, demand creation, or both. With demand creation—which is associated with higher margins—manufacturers might benefit by developing a heat map that classifies customers based on strategic importance, sales and marketing needs, and penetration. For instance, a customer that has repeatedly purchased a product is unlikely to require additional technical-support services unless the design has materially changed. In such cases, distributors should only be asked to provide order-fulfillment services, rather than be encouraged to create demand. By contrast, manufacturers may want to encourage distributors to create demand in subregions where customers are unfamiliar with their products. To achieve the right level of detail, the map should include data for individual product lines and regions (Exhibit 2).

One integrated-circuit manufacturer that reexamined its distribution strategy discovered that it was assigning distributors to create demand at accounts where the direct sales force already had a strong presence. Meanwhile, distributors were not giving sufficient coverage to accounts where the direct sales force spent little time because the margins were too low. After concluding that the distribution support provided for 58 percent of the products in its portfolio was inappropriate, the manufacturer adjusted its strategy.

Picking the right partner and creating a more effective alliance

When selecting a partner, manufacturers should consider the results of their earlier analyses, in which they determined where distributors could add value by customer, product, and geography. They should then select a distributor who has the strengths and expertise most aligned with those needs. To ensure that they make an accurate and objective choice, manufacturers should assess potential distributors on a market-by-market basis using the following three core criteria:

- **Customer relationships.** What is the distributor’s local market share relative to others? How well positioned is it to reach the long tail? What growth has it demonstrated over the past few years?

- **Product knowledge.** Is the distributor seen by local customers as a leader in the category? Can it provide expert technical support on both the current and likely future portfolio?

- **Sales capabilities.** Have the manufacturers with which the distributor works achieved strong sales in the region? Does the distributor have capacity to provide the desired levels of customer outreach and relationship management?

For all distributors, regardless of market, manufacturers should also assess operational excellence—the ability to service customers quickly and efficiently with minimal risk of supply disruption. It is also essential to identify products that distributors sell for other manufacturers, assessing whether these offerings are complementary or could pose a competitive challenge.

As with earlier analyses, manufacturers should gather insights from internal teams as well as external sources. For instance, they could ask customers if distributors are able to answer all their product questions or else consult local industry experts about demand trends in their region. An examination of the distributor’s organization, such as the number of field-application engineers it has for a particular product category, can also provide insights about their capabilities.
One manufacturer decided to take a close look at the four distributors that handled its sales, examining the criteria described above. The analysis revealed that the distributors often lacked the capabilities or geographic reach necessary to deliver optimal service. Some, for instance, had limited expertise with particular products or lacked the engineering skills needed to assist customers with the design process. To address these gaps, the manufacturer expanded its network to include 35 distributors that together had all necessary skills. The new strategy paid off, with distribution revenues growing more than 12 percent within the first year.

Creating mutual benefits through incentives

After identifying the right partner, manufacturers must create appropriate incentives that encourage distributors to focus on target products, customers, and geographies. For instance, companies could specify that distributors will only receive compensation.
for increasing sales in a particular product category where the manufacturer is struggling or where new competitors have begun to take the lead for design registrations. Incentive programs should also ensure that distributors complement in-house sales efforts, rather than replicate them or provide supplemental services that add little value. Targeting underserved geographies and customer segments is far more likely to yield significant returns than attempting to supercharge existing efforts for a blockbuster product in a major market, where the manufacturer’s own sales and technical resources may already be approaching the saturation point for customer outreach.

Manufacturers should not change the incentive system in any way that would penalize distributors, such as by compressing margins to achieve short-term gains. Instead, they should focus on designing incentives that help distributors reprioritize their efforts and identify gaps in the sales landscape, such as customers who are not receiving sufficient coverage. This approach produces mutual benefits: manufacturers are more likely to achieve their specific goals across the entire product portfolio, and distributors will know exactly what they need to do to maximize their compensation.

**The challenges of distribution in China**

The distribution market in Asia, particularly China, contains myriad subdistributors and resale networks, with tier-one distributors frequently selling products to tier-two distributors or resellers, who then connect with end customers. Manufacturers thus have many options for the distribution channel. They can work with tier-one distributors who sell to customers, or to those tier-one companies that sell to tier-two distributors or resellers. Alternatively, manufacturers can work directly with tier-two distributors—even having them serve the entire customer base or restricting their efforts to established customers.

With so many potential distributors, including small players without established reputations, manufacturers must conduct a detailed analysis of all their options, considering both benefits and risks. For instance, a small distributor might sell products through channels that are legal but not part of a manufacturer’s traditional strategy, making them part of the gray market. Other important considerations include margin stacking—the cost or profit margin that each distributor or other member of the supply chain contributes—and the quality of a distributor’s customer service.

**Going beyond incentives to optimize distributor relationships**

In addition to high margins, the following factors may help manufacturers improve their interactions with distributors:

- **An emphasis on capability building.** Since sales representatives deal with many different product lines, including some that may be outside their area of expertise, they appreciate manufacturers that help build their knowledge and capabilities. For instance, they may respond favorably if manufacturers provide technical and support staff to help them run programs to certify field-application engineers. Ideally, manufacturers will provide in-person training using a field-and-forum approach, in which sales representatives attend a classroom or online session and then apply their skills in the workplace before returning for more instruction. Whenever possible, manufacturers should supplement these sessions with remote training, such as online modules with tests that representatives can complete at their convenience.
Availability of frontline coaching. The easiest way to lose customers is by appearing slow or unresponsive to their questions, including requests for price quotes. Manufacturers can help distributors provide rapid answers by holding real-time chat sessions or by placing employees on site at the distributor to work directly with sales representatives. Some manufacturers have also created small teams to support distributors in specific regions, allowing them to respond to customer questions within 24 hours.

Strong supporting materials. Manufacturers should create a variety of supporting materials, such as sheets with frequently asked questions, brochures, videos, and podcasts. Case studies and white papers that describe how distributors can provide full solutions are particularly important. All materials should be easily accessible through online portals or other means.

Clear expectations. Service-level agreements should establish clear expectations, such as the number of field-application engineers that a distributor will send to a client. Manufacturers should also be straightforward about the benefits that they are willing to provide, including the percent margin that a distributor will receive for demand creation and fulfillment.

Appropriate organizational and IT systems. Manufacturers should reexamine their organizational structures when determining how they can improve distributor relationships. For instance, they may need to create new roles or hire additional personnel to manage the distribution channel. All IT systems should be easy for both end customers and distributors to use, and they should be capable of handling a large volume of transactions.

A willingness to assist with marketing. The best sales efforts will involve marketing from both sides, with the distributor interacting directly with customers to push sales and manufacturers attempting to stimulate general demand through various measures, including social media. Texas Instruments, for instance, has a variety of blogs on its website. Each contains articles that discuss technical topics and provide links to matching products. Whenever marketing, manufacturers should be careful to ensure that they are supporting distributors, rather than circumventing them by directing customers to other purchasing options.

In combination with other improvement levers, manufacturers can significantly increase margins by providing distributors with the type of support described above. Consider the results obtained by a midsize manufacturer that closely examined its distribution channel. For each product, it analyzed market size, growth trends, customer needs, relative market share, and other important metrics. The manufacturer also assessed the capabilities and track records of all distributors. Based on this information, it adjusted distributor margins and made other changes. One important shift involved increasing marketing support for some products and regions. Together, the strategic shifts allowed the manufacturer to increase its gross margins for the distribution channel by nearly 6 percent without hurting sales. Meanwhile, distributors received higher revenues because their sales efforts were more effective.

As the semiconductor industry matures, manufacturers can no longer maintain a business-as-usual posture about distribution. If they do not reexamine all aspects of their relationships through an objective, fact-based analysis, they could lose value and miss important
opportunities. The most successful manufacturers will consider exactly what they want from a partnership, which distributors are best positioned to provide it, and how such arrangements can benefit both parties. And once a partnership is established, manufacturers must remain fully committed and lend their full support to distributors. This means sharing product knowledge, providing advice, and helping the sales force reach its full potential—efforts that go far beyond signing a contract and providing financial compensation.

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