

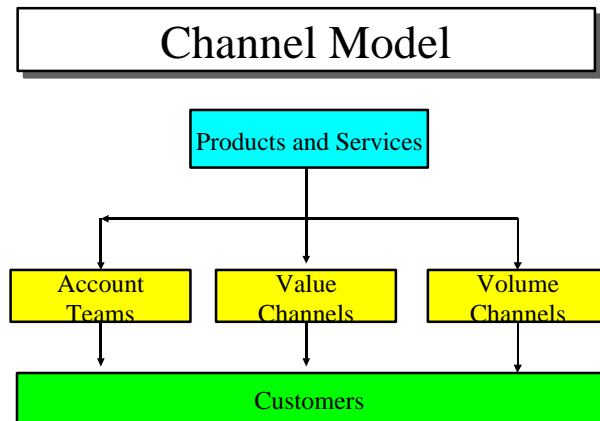
# Channel Strategy

Strategic partners and channels of distribution are critical to the success of most companies. Most product and service sales are through channel partners.

View yourself as a customer. If you are planning a family vacation in Europe, you would probably prefer to deal with a helpful travel agent who could understand your needs, research, recommend, then book the best airline flights, hotels, trains, rental cars and more. That travel agent is a channel of distribution for several travel services and companies. The same can be true when you are shopping for gifts, insurance, financial services, business services and more.

Channel partners can be broadly viewed as being either value partners, or volume partners. The best value partners are customer or creative leaders. The best volume partners are cost focused, being very efficient at fulfilling demand at the right price. Value partners are often best at helping create demand for your products and services in specific markets.

Successful companies optimize the right mix of value partners, volume partners, direct sales teams and eCommerce. Other companies probably view your company as a partner. You personally have your favorite partners that help you solve customer problems, make more sales and leverage your time.



## Value partners

Information technology (IT) is often sold through value partners. A computer by itself does not do any good. Its value is in being part of a networked solution which achieves business goals. Companies often buy networks of computers from solution integrators

and value-added resellers who take responsibility to make everything work: computers, network switches, operating systems, databases, office software and application servers. Sales often include consulting and 24x7 services. Solution integrators do not simply fulfill demand. Integrators offer added value.

Solution integrators are often large global firms who generate most of their revenues from professional services. They have recognized names such as EDS, Accenture, Price Waterhouse Coopers, and Computer Sciences. The largest of them all is IBM. They may integrate complex systems for a fixed price, or charge by the hour. Sometimes they take full responsibility for running a company's data centers, transfer thousands of the customer's employees to their payroll. The best solution integrators are customer leaders.

Value Added Resellers (VARs) typically generate 20 to 50% of their revenue from services, with the rest from the resale of products. They are often focused on market segments such as an industry, an application, a set of suppliers, or geographies. There are thousands of successful VARs.

Oracle is the world's largest database software company. For years, both Microsoft and IBM have been intensely competitive in trying to beat Oracle, and consistently unsuccessful. Oracle uses a wide range of channel partners. One is the OEM channel, which takes core Oracle products and embeds them in other products. The Oracle database engine could be part of a software application for hospitals, lumber yards, streaming video on demand or a HP server appliance. The best of these OEM value partners are creative leaders in their market segments.

International distributors often have a very similar business model to VARs. They represent several suppliers of hardware. They work with their suppliers to have professional consultants and engineers trained on products to a level of certification. They often provide consulting, service and product training to the final customer. Their presence in the country, contacts and ability to agree to local contract terms often make them the only way to sell products in many parts of the world. They may be allowed to distribute products to other resellers, although global distributors increasingly are handling this.

## Volume partners

Siemens Business Services (SBS) is a large IT volume partner. Many corporations prefer to buy everything from SBS including computers, software and networking products, rather than buy directly from the manufacturers. SBS makes it easier to buy all IT products, saving customer purchasing group from placing hundreds of separate orders. SBS is an expert at fulfillment as a cost leader.

## Direct Sales Teams

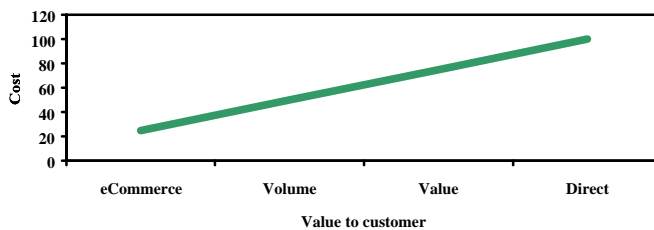
With direct coverage you need a team of people. Your team could include a sales executive, an inside sales person and a system engineer. Direct sales coverage is the most expensive way to sell and support customers. For the right customers, it is the best approach.

Direct sales coverage has many benefits. A direct account manager can better manage global relationships with a global 1000 account than a local channel partner. A direct sales team can patiently develop and execute a long-range plan with an account. A channel partner tends to be more focused on immediate revenue. A direct team can afford to lose money nurturing a breakthrough product from beta to completion. Channel partners focus on proven products with established market demand.

Use direct teams to cover your most important global accounts. Encourage these teams to only cooperate with partners who add value to these accounts. Do not be afraid of offering large global customers deeper discounts than some of your channel partners. For maximum coverage and profitability, deal with most customers exclusively through channels of distribution.

## Sales coverage model

Every business is different. Some guidelines apply to all. Your decisions about sales coverage are determined by goals about customer satisfaction, market share, revenues, cost and profit. As we will explore later in this book, your product lifecycle is another factor. Direct sales teams are the most expensive way to support customers, eCommerce is the least expensive.



In the long-term you must maximize profits, not revenue. Customers supported with direct sales will buy more than if their only avenue is volume resellers or eCommerce. The gained revenue must be greater than the cost of supporting the customer. Sort your customers by profit potential into four categories:

1. Direct sales
2. Value partners
3. Volume partners
4. eCommerce only

This is your first step in deciding how to provide the most profitable sales coverage. Market segmentation is a key to successful sales coverage. Start by segmenting your

market by product, application, geography, etc. Determine the fewest partners that will cover your forecasted channel revenue. Having fewer partners will lower your sales cost. Fewer partners will provide for better profit margins for your partners, and develop their loyalty to you. The following is a sample high-level segmentation of a network switch firm.

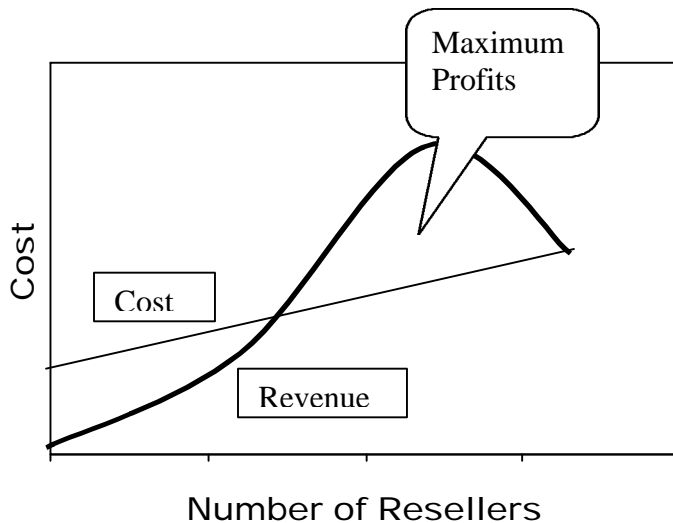
**Product-Market Segment Strategy**  
Switch Manufacturer Example

	Routers	Wireless LAN	Voice Reco	Opti Switch
Top 100	3 telco 5 SI 5 OEM	3 telco 5 SI 5 OEM	Direct Only	Direct Only
Mid-size	5 NSP 5 SI 400 VAR 5 OEM	5 NSP 5 OEM	5 NSP Developers	
Small Biz	30 SP 5 OEM 400 VAR	30 service providers (SP) 5 OEM 400 VAR		
Home	30 SP 100 retailers 5 OEM	30 SP 100 retailers 5 OEM		

With this model, the network switch firm can see where it needs to add partners, and where it may need to eliminate excess channel relationships.

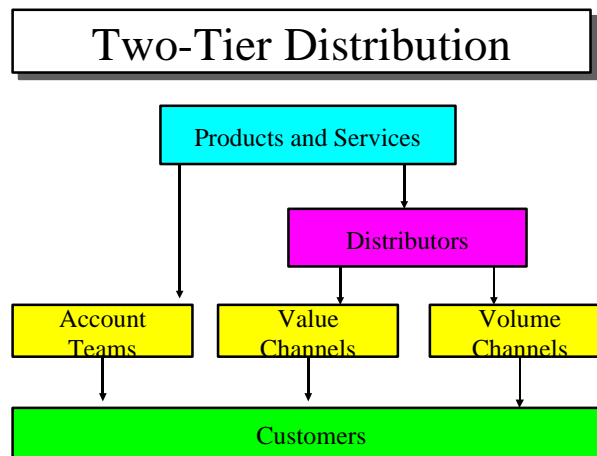
It is tempting to let anyone sell your product. The more, the merrier. More resellers does not guarantee more sales. With too many resellers, profit margins shrink for them to the point

where they drop you and start selling for your competition. There are a lot of hidden costs in supporting channel sales: people, inventory, logistics, training, marketing, information technology and so on. In each market segment, the point of maximum profits looks like this graph.



## Two-tier or not to tier

Suppliers of products and services may, or may not, put distributors between themselves and their channel partners. When they put a distributor, or wholesaler, in the middle, this is called two-tier distribution. In some industries, large companies have complex channels of multiple layers. This is sometimes called “n-tier distribution.”



Distributors can save you a fortune in inventory cost, capital cost and employee expense. A distributor could inventory \$1 billion for a \$10 billion company. The distributor could take orders into the night from thousands of resellers, provide immediate credit and ship overnight. The supplier sees accelerated revenue, lower inventory cost, no extra capital required to handle credit and leases, and saving the need to hire a number of added people.

Many distributors may court an industry leading supplier. They may agree to give the distributor an added 10% margin above normal reseller margins. In return, the distributor may agree to dedicate a number of people to the supplier, take a large inventory position and implement a number of marketing, training and support programs.

A small supplier may have to offer a distributor an added 15% and advance significant money to get the distributor to implement reseller recruiting, training, marketing and other programs. Even then, they may be too small to get the distributors attention.

When deciding whether to go to 2-tier distribution, evaluate whether your discount costs are less than your cost savings in outsourcing inventory management, sales, support and other cost. Do not be captivated by the distributors size or number of resellers. Expect to drive end-user demand and channel sales.

Ingram is the largest information technology distributor on earth. They are a cost leader. From over 100 countries, over 100,000 computer resellers can configure systems, place

orders at Ingram's secure eCommerce site, talk to a sales or technical person, ask for an expanded credit line, get products shipped, and track the shipment on the Internet. Not only are they often the low cost distributor for over 100,000 products, they also have the efficiency to lower costs in other ways.

Tech Data is Ingram's largest competitor. Tech Data is growing faster through effective global acquisitions, innovative logistics support and by being an effective partner. Both Ingram and Tech Data represent the best of two-tier global distribution. They do not sell to the final customer. They sell to resellers throughout the world.

If distributors compete with its customers, the distributor usually loses. Even the perception of competition can create serious problems.

Computer and network solution integrators often prefer to order from Tech Data, or Ingram, rather than the separate hardware and software firms represented. A complex solution may require hardware and software from a dozen vendors. In buying from a distributor, they get one stop shopping, often with faster delivery.

In the computer field, there was a hybrid model in the USA called an aggregator. Aggregators had one division that acted as a distributor to computer resellers. Another group sold directly to corporate information technology (IT) groups. By competing with their reseller customers, aggregators got into trouble. Wall Street darlings, like Intelligent Electronics (IE), were unable to sustain the hybrid model. Resellers threatened to desert IE. IE bought stock in their key resellers to save the relationship. It did not work. Aggregators disappeared, or wisely transitioned into being either a distributor or corporate reseller, but not both.

This hybrid model is still popular among international distributors. Because of the channel conflict it creates, the hybrid approach will shrink over time.

The problems with being a hybrid are now being learned by Reuters, the largest provider of electronic information in the world. Stockbrokers and banks are its largest customers. Reuters owns most of Instinet, which allows stockbrokers to trade stocks around the clock, even when major exchanges and NASDAQ are closed. Instinet started alienating its big broker customers, when it did business directly with major institutional accounts, such as mutual funds. Instinet, then appeared to compete with broker customers by filing with the SEC plans to offer stock trading, mutual funds and retirement accounts through a new brokerage firm called Instinet.com. Major Reuter's customers such as Schwab, Fidelity, Goldman Sachs, J.P. Morgan Chase, E\*Trade and others retaliated by forming their own electronic communication networks to compete with Instinet.

## Compliment or Compete

Fierce battles rage inside many companies about whether to protect their channel relationships, or compete directly for the business. The Internet has intensified the debate. It is now easier to reach the final consumer of a product on the worldwide web. A good

website can appear more friendly than a reseller with poor product knowledge and selling skills. Financial executives often drive for the cost reductions that can be achieved through bypassing complex two-tier distribution.

The other side of the argument starts with loyalty to the channel partners who have been critical to past success. These partners may have personal relationships with the final customers. In many cases, only the partners know who the final customers are. Your product may be worthless unless it is integrated into a complete solution.



John Addison has been president of OPTIMARK since 1992. OPTIMARK is a leading consulting firm focused on sales channel strategy and development. OPTIMARK is based in Silicon Valley, and works with technology companies globally. Mr. Addison conducts strategic planning. Mr. Addison is on the Advisory Boards of Inclusion and Excambria. Mr. Addison provided early-stage consulting to companies who achieved successful IPOs.

His workshops and speeches are popular in the Americas, Europe and Asia. He has been a keynote speaker about EBusiness and Channel Partner strategy at conferences sponsored by Sun Microsystems, Veritas, varstreet.com and others. Channel partners from over 20

countries have attended Mr. Addison's seminars under Sun Microsystems sponsorship. Mr. Addison is the author of several seminar books dealing with strategy including *Protect and Expand*, *Channel Management Strategy*, *eCommerce Strategy* and *eSales and eChannels*. University of California Santa Cruz Extension, where Mr. Addison teaches, uses several of these workbooks.

Prior to founding OPTIMARK, Mr. Addison was an area channel manager for Sun Microsystems. For three years, he led a sales team to 270% annual growth in 15 states. Mr. Addison is considered one of the early architects of Sun's highly successful channel programs. Mr. Addison has also held management and sales positions with Compaq, Unisys and a software startup.

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