ALTERNATE DISTRIBUTION CHANNELS

INPUT

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Alternate Distribution Channels

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Abstract

Value-added resellers (VARs) have been an important and influential vehicle for a number of smaller hardware-oriented companies to establish their products in the market. Larger manufacturers use VARs to augment their sales and marketing efforts to reach end users with industry specific application solutions based on their hardware.

INPUT performed research to determine how this channel element—i.e., VAR organizations, could be further utilized. This report, *Alternate Distribution Channels*, discusses the current issues, trends, and developments in the VAR community and considers how other delivery modes are working with the VAR channels that are in place.

This report contains 48 pages and 26 exhibits.

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I

Introduction

I

Introduction

This report is produced as part of INPUT's Market Analysis and Planning Service program for the information services industry.

A

Purpose

This report investigates and examines the use of alternate distribution channels by hardware and software vendors, the role of the value-added reseller (VARs), and the challenges and conflicts VARs must address.

Vendors in the information services market will benefit from this report in the following ways:

- By identifying new markets and product opportunities to complement existing strategies
- By assessing the use of direct and reseller sales strategies to open new and expand existing markets
- By examining the management and resolution of conflicts within the reseller channels

Value-added resellers in the informations services market will benefit from this report in the following ways:

- By understanding how vendors are working with VARs and by identifying the current driving forces in the market
- By learning what other VARs are doing to expand their market penetration

B

Scope

This report reviews the U.S. market for events, issues, and developments that impact the presence and use of alternate distribution channels.

The report is organized into five chapters as follows:

- Chapter I is an introduction and description of the purpose, scope, and methodology of this report.
- Chapter II is an Executive Summary of the material presented in this report. It is designed for the executive or individual who requires the major and/or significant material but does not have time to read the entire report.
- Chapter III presents the most significant trends and issues currently affecting this environment.
- Chapter IV provides an analysis of the types of reseller channels available and the value-added services each brings to the market.
- Chapter V offers an analysis of the vendor and value-added-reseller strategies currently being used in this market.
- Chapter VI summarizes recommendations and issues INPUT feels are significant and useful.

C

Methodology

At INPUT we use a number of research techniques and options. In the preparation of this report, the following research was utilized:

- Specific interviews of vendors and value added resellers in the markets surveyed. This provided a direct interaction and dialogue that is key to an accurate understanding of issues, trends, needs, and developments shaping the market.
- INPUT's extensive data base and library facilities to review events and activities relevant to the market study.

II

Executive Overview

II

Executive Overview

The value-added reseller (VAR) is taking on an interesting and exciting role in the world of information processing. A number of key factors have had a significant impact on the use and maturity of the value-added-reseller channels. Exhibit II-1 identifies some of these factors.

EXHIBIT II-1

KEY FACTORS AFFECTING ALTERNATE DISTRIBUTION CHANNELS

- Impact of the Microprocessor Computer
- Software Developers' Use of VARs
- Competitive and Economic Pressures
- VAR/Vendor Relationships

The technology development over the past two decades has dramatically altered the size, capability, cost, and usability of computers. From the huge dinosauric models, capable of interaction only with highly trained technicians and affordable only to a few of the largest corporations, we now have desk-top, even lap-top, systems affordable to most people and businesses. Technology has evolved this product to the point where only through alternate distribution and reseller channels can vendors effectively market all but the very largest of their products.

Software vendors have been quick to adopt the use of reseller channels as a cost-effective distribution method as well as a means of establishing and/or maintaining market presence. Increasing competition within the reseller markets and shrinking profit margins on systems sales are causing VARs to reexamine their business posture and look for additional sources of new revenue. Consequently, VARs are not only looking at new and additional services, but new markets as well.

Hardware vendors have begun to recognize the valuable and necessary role of the value-added reseller in their overall marketing and distribution capabilities. Adversarial relationships are giving way to one of cooperative ones as hardware vendors increasingly view VARs as an extension of their sales forces.

This report will attempt to examine some of these recent factors.

EXHIBIT II-2

MICROPROCESSOR TECHNOLOGY

- Low-Cost Product and Margins
- New Class of End User

Development of semiconductor technology has been responsible for the emergence of the microprocessor and the ability to produce effective computer systems for the small business user. It is value-added-reseller dealers and agents that have brought these systems to the small business user. The combination of lower prices, smaller profit margins, and the desire for solutions rather than just hardware systems has made the use of a direct sales force quite impractical from a manufacturer/vendor viewpoint in the small business user segment. See Exhibit II-2 for a summary of these comments.

As Prime Computer Inc. indicated in INPUT's recent survey, the cost of sales is what makes alternate distribution channels necessary. To quote the company, "Our VARs provide a greater awareness and ability to reach a larger number of end-users than we can accomplish through a direct sales force".

Though these factors have been in place for several years, there are other, more recent trends that are compacting the value-added reseller channel. The following exhibits briefly highlight some of these factors.

EXHIBIT II-3

SOFTWARE DEVELOPERS AND VARS

- System-Level Software Developers
- Third-Party Application Developers

Exhibit II-3 hsows the types of new users of the VAR channel. One of the more interesting developments has been the growing use of VARs by software companies, including system software developers, third-party application software developers, and generalized software package developers. The system software developers, primarily represented by the relational data base management systems software developers, have clearly identified the value of selling to the application software developers, whether they are system resellers or not. Application software development based on a specific data base management system, for example, is the easiest way to move these packages into the smaller system end-user environment.

Informix Software states, "VARs find us, we do not select VARs. They are looking for a software development platform, and that is what we provide. They are our primary customers as well as a marketing aim. We obviously reach a level of end users that we could not reach directly on our own." These system software vendors continue to sell directly to the larger systems end-user community, as well.

Third-party application software developers, rather than developing a direct marketing sales force, have found the use of industry-oriented VARs and agents a much more effective strategy when selling into the small systems market. Marketing into geographic areas with high market potential can be effective through the use of key VARs that have application knowledge and awareness in the same specific, or similar, industries. The net effect is that VARs are now being courted not only by the traditional hardware vendors, but by the software developers as well.

Timberline Software Corporation, a developer of application software for the construction industry, has made a full commitment to the use of VARs and discontinued its direct sales activity in 1984: "We are fully committed to this concept. We are learning, breaking ground, how to manage this type of channel. We have learned to work with VARs rather than threaten. The principal advantages are all in the cost of doing business. When we were reselling mini systems with our own application software, the margins supported a direct sales force. Now that we are trying to sell to all size businesses, using micros, the only effective means is through resellers."

EXHIBIT II-4

NEW VAR REVENUE SOURCES

- New Services
- Larger Systems
- Customer Base

VARs, in their own right, are concerned about profit margins and increasing cost of sales and are looking for ways to increase their business and stabilize their cash flow. Profit margins on system sales are being squeezed as the costs of sales and operation continue to increase and growing competition forces lower pricing. Consequently, a number of alternatives are being considered. Many VARs are looking at the types and amounts of services they can provide to their customer base. Such alternatives as on-going consulting services, customized programming, additional education and training, and data center operations are being utilized as means of developing ongoing and repeat business revenue sources. Exhibit II-4 summarizes the new VAR revenue sources.

At the recent 68th ADAPSO Management Conference, a round-table discussion involving several VAR executives identified the fact that "the amount of channel conflict varies from vendor to vendor and rises and falls with time." Trying to combat channel conflict is frustrating and can be costly. The best solution is to reduce the potential for conflict. Instead of focusing on hardware sales, VARs should concentrate on services, consulting, and customized software.

Networking Computer Corporation is one VAR offering more services than in the past in order to diversify. Users Inc. is actively trying to develop additional custom work and consulting services within its customer base. Federal Sources Inc. and the Williamson Group are examples of VARs that include consulting as a major part of their business.

"Selling solutions rather than installing standalone products creates opportunities for VARs to get involved in creating systems they can remain part of and profit from many years down the road," according to the Williamson Group.

Another trend, is the attempt by VARs to increase the size, or dollar amount, of their average system sale. This is being accomplished by several means, including larger systems, more sophisticated application software, non-industry-specific application software, and generalized packages providing typical word processing, calender, and other such functions. VARs are also looking to other VARs and to other software developers to enhance the value-added software offering they have to market to their end-user customer base.

As Datatel stated at the ADAPSO conference and confirmed in our interviews, it is trying to significantly increase the average sales price. By resisting pressures to lower costs and move down the pricing scale, Datatel has increased its average sales price to $350,000 through more complex and expensive systems.

Historically, repeat business has been a relatively small percentage of a VAR's revenue flow, typically in the range of 20-25%. VARs are trying to increase this into the 50-60% range. This sort of regular, ongoing cash flow will allow VARs to develop and retain skilled people to support new services for the existing customer base, and will also provide a greater sense of stability and capability that will enhance new business prospects. VARs are realizing that a key asset is their installed base.

Users Inc. has focused on boosting sales to existing customers. The company has doubled its revenue from its installed base from 30% to 60%. This has had a big effect on improving profit margins, because revenues are coming more and more from software and services and less and less from hardware.

Though super, or master, VARs have existed for a number of years, ongoing refinements in the use of their market position and function have resulted in new and exciting marketing strategies. These VARs are expected to open new market opportunities by providing entry not into geographic or industry-specific markets, but rather into product and functional areas. This strategy facilitates the entry into new markets and new products, with minimum, if any, additional sales efforts on the part of the vendor.

EXHIBIT II-5

NEW VAR/VENDOR RELATIONSHIPS

- Extension of Vendors Sales Force
- Sales and Product Training

The relationships between the traditional hardware vendors that have long used the value-added-reseller channel to move the great bulk of their product has also undergone new and sometimes subtle but still significant changes. Whereas the VAR has long been looked at, and sometimes treated as, the poor relative, tolerated but not necessarily loved, most hardware and software vendors now recognize them as a key element and necessary part of their distribution capability. These vendors are recognizing that the capability of the reseller to understand and represent their product to the end-user reflects directly back to them. Consequently, a much closer working relationship is evolving between the vendors and their resellers, to the point where the reseller is looked at as an extension of the vendor sales force. The sales and training programs used internally by the vendor are being made available to the reseller. In some instances, this training may be required and spelled out in the contract with the reseller; in other instances, the training is available but optional. Vendors often offer training to VARs free or at prices substantially below those offered to the vendors' customers. Exhibit II-5 depicts the new VAR/Vendor relationships.

Sales training programs are one of the key support services that hardware vendors can provide to VARs. Data General, Prime, and Altos are examples of vendors that give VARs the same, if not more intensive sales training programs they give their own direct sales force. Data General indicates that it now looks at VARs as extensions of its own sales force and provides VARs with free training in product, communications, and competition. All new VARs get up to three weeks training and have access to additional training programs at a discount. Altos will have a program for VARs covering sales skills, product training, and market strategies for specific niche markets.

In summary, value-added resellers have become a necessary and integral part of the distribution capability of vendors in all delivery modes to effectively reach smaller users. Though national distributors continue to exist and provide distribution of product to small resellers and dealers, the relationship with the VARs has grown in stature and relative importance to the various vendors. There continues to be real and potential conflict between alternate distribution channels, including the direct sales forces and agents. However, as one vendor put it, "Our objective is not necessarily to eliminate channel conflict, but to recognize that it exists and manage it. The VAR is too important in our distribution methodologies to allow channel conflicts to become a problem any more than we allow conflicts within our own sales force to become a problem."

III

Trends and Issues

III

Trends and Issues

A

Channel Conflict—Management vs. Avoidance

Management, as opposed to avoidance, is the key to handling the conflicts that arise when alternate reseller channels, agents, and direct sales forces exist in the marketplace. The questions of territorial rights, account responsibility, and who got there first are the same problems that have existed for years. As Data General responded when interviewed in our recent survey, “Channel conflict is a given. Selling to Fortune 1000 customers (with a direct sales force) is found to bring some conflicts. We try to manage conflict. The approach to handling them is what’s new.” Exhibit III-1 and Exhibit III-2 address these issues and resolutions.

EXHIBIT III-1

RESELLER CONFLICTS

- Vendors Sales Force
- Agents/Brokers
- Dealers

The growing awareness and acceptance of value-added resellers, agents, and dealers as a necessary and important segment of the marketing function is bringing a “we have a problem to resolve” philosophy as opposed to the “you” concept. Vendors are providing compensation to their direct salespeople for various reseller and agent sales in their territories. Additionally, major account managers are often compensated for reseller sales into other sites or divisions of their major account corporations. This compensation issue has generally been the most significant problem that VARs have had to confront in maintaining cooperative dealings with the vendors' local sales presence. It is difficult for a direct salesperson to help a VAR in a sales situation if such help is not rewarded ad adversely affects the salesperson income.

Wang Laboratories Inc. recently announced changes designed to reduce conflict and encourage greater support and cooperation between its VARs and its direct sales force. The changes, seen as another step in understanding the importance of alternate distribution channels, affected the manner in which district sales offices are credited for sales by VARs.

Unisys has also taken several steps to revise their VAR programs. Substantial reductions in the number of distributors will be an obvious step in the reduction of channel conflict. Unisys is also revising its commission plan by increasing commissions paid to sales regions for VAR sales in their territories.

Vendors' use of a direct sales forces has been one of the main conflicts since the beginning. VARs alone cannot provide as complete a market coverage as a vendor needs, and of course, the presence of a direct sales force in the same geographic area cannot avoid overlapping into a VAR's market. Vendors, for the most part, have been caught in a "dammed if we do and dammed if we don't" situation.

The use of agents and/or brokers by vendors as an extension of their sales forces, creates as much, if not more, of a potential confrontation with VARs. The agent is often another attempt to reach the same type of industry-specific end user as the VAR is. In many situations, the agent was at one time selling for the VAR. The agent is essentially a market-knowledgeable salesperson that competes directly with the VARs for the same customers.

GEIS, for example, uses agents to sell its EDI* Express into smaller businesses, but these agents are not looked at as resellers in the standard fashion. Agents are selected primarily on the basis of existing EDI product and knowledge and industry presence. These agents must have some complimentary EDI hardware and software products plus an industry presence. The agents sell to suppliers and vendors that interact with the large corporations to which GEIS has previously sold EDI* Express. The agents sell EDI* Express interfaces, usually imbedded in their own product, usually implemented on PCs or other small systems.

Dealers continue to provide alternative and additional sources for acquisition of both hardware and non-industry specific software products. VARs that do not continue to service their customer base and provide additional products other than the industry-specific application systems force the end user to look elsewhere. Dealers usually offer a wider range of products at prices that VARs find difficult, if not impossible, to match.

3COM Corporation recently announced two new indirect reseller channels, one a national distribution channel for PC LAN products and the second a Dealer Associated VAR channel. The DAVAR program is designed to encourage relationships among VARs by allowing the dealer/distributor VAR to sell 3COM LAN products to smaller VARs that cannot meet the monthly run rates established by 3COM for its VARs. The national distributor channel is designed to sell 3COM products to vertical niche VARs that are not currently 3COM-authorized VARs.

EXHIBIT III-2

PROBLEM RESOLUTION

- Management
- Avoidance
- End-User Concerns

The key to the resolution of these conflicts is ultimately management rather than avoidance. The latter tends to create too many gaps and can lead to uncovered market potential, while the former requires some planning and a willingness and energy not previously demonstrated.

Management of distribution channels has grown from the initial concepts of signing various and sundry resellers to one of implementing sales plans and strategies to meet specific objectives. Vendors have gone full circle in their efforts to establish and maintain market share—from direct sales only, to combinations of resellers and direct sales, to resellers only, and back again to direct sales. The fundamental issue of how to balance and manage the sales effort requires a knowledge of, and planning for, overlapping sales efforts and strategies. The key elements to manage revolve around compensation and competition.

Compensation drives the sales force, as well as the resellers, and is critical to a cohesive sales effort. Interaction and cooperation between resellers and a direct sales force are critical to market success and must be supported by a policy that compensates the sales force for reseller (VAR) activity in a shared market or account.

Competition drives the market and the product, promoting both the vendor and end-user interests. VARs offering unique solutions to specific industries have an early advantage. Service to the account becomes critical to add-on sales efforts from the standpoint of customer satisfaction and awareness of users' needs. Vendors must have VARs that can compete, selling the services and support they can bring to the small business oriented end-user. Vendors must provide the product, training, and flexibility necessary to support such activity.

Avoidance of conflict may be an objective, but it cannot be achieved without the loss of market share. Strategies utilizing resellers in geographic areas not covered by a direct sales force may avoid one element of conflict, but they do not ensure a maximum level of coverage unless multiple resellers are utilized. VARs looking to avoid conflict may seek vendors that do not have a direct sales force but usually will find other resellers within their market. Exclusivity of market and product may satisfy the reseller but may in turn leave the vendor without the coverage and market presence it would like.

The end user also has an interest in this arena of conflict and avoidance. Most of the larger, more sophisticated Fortune-500 users recognize the value of choice and competition. The markets served by the reseller may include some such types of customers, but for the most part, the customers they sell to are smaller and somewhat more dependent on their supplier; but these customers still want and deserve competitive product and pricing. Service and support have been and will continue to be the key and differentiating factors for the end users. These elements tend to thrive when competition, hence conflict, exists. Avoidance is not the solution; management is.

B

Master VARs and National Distribution

The use of master VARs by hardware vendors to handle distribution and sales to smaller-volume resellers has been in existence for many years. The advantage to the smaller VARs is that they can get better discounts from the master VAR than from the vendor. The master VARs receive larger volume discounts from the vendor, and can actually pass on a lower price to the smaller VARs than they can get direct from the vendor. The vendor, of course, benefits from having to deal with a reduced number of resellers in terms of contracts, purchase orders, etc. A recent development is the use of established national distribution firms with specific functional market niches as master VARs to resell software products into vendors' end-user and reseller markets.

The recent announcements from Oracle and DRI about recently implemented master VAR programs will represent a significant step forward in VAR distribution strategies for software developers. The master-VAR plans and subsequent master-VAR agreements announced by Oracle will provide entry into significant new and expanded markets. The three master VARs each bring a new and distinct market presence to Oracle's current distribution strategies. Tech Data Corporation of Clearwater, Florida. distributes a variety of computer-related hardware products and local-area networks to system houses, VARs, and retailers across the country. Southwest Data Products of Houston, Texas will market and support Oracle's PC products to their national client base of PC VARs. Southwest Data Products has a national distribution network for UNIX-based AT&T computer systems. Costa Distributing, of Mountain View, California, will remarket Oracle products into their national network of Local Area Networks (LAN) resellers.

The strategic use of established distributors to provide coverage into their markets and customers will, in effect, open new markets without any increase in the vendors' sales forces and will allow vendors to reach a broad base of customers, which otherwise they could not economically accomplish. The immediate presence and industry knowledge provided by the master VARs are advantages that vendors would not be able to effectively provide without substantial increases in operation and distribution costs. Exhibit III-3 lists the major master-VAR benefits to the distribution channel.

EXHIBIT III-3

MASTER VAR BENEFITS

- Large Presence
- Industry Knowledge
- More Focus
- Handles Small Resellers

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C
Cross-Matching

Cross-matching, in the value-added reseller arena, is the seeking out of additional software products that enrich and increase the marketability of a reseller's system. This has been previously limited primarily to the vendors and their direct sales efforts, but VARs are now discovering there are additional sales opportunities and revenue sources as well.

A digression from the "not invented here" syndrome, as experienced by most software developers, has been the recent active searching out of additional software products by VARs. These efforts are intended to enhance their turnkey systems, open additional markets, and provide additional tools and capabilities that can be marketed to a new as well as existing customer base. VARs are dealing with other VARs, software houses, third-party application developers, and vendors for products they can use to increase sales revenue. They are looking for sales into their existing customer base, as well as additional sales activity into new but related industry markets. Exhibit III-4 addresses the three types of software VARs may select to enhance existing markets or open new markets.

EXHIBIT III-4

CROSS-MATCHING PRODUCT TYPES

- Complementary
- Cross-Industry
- New Industry

The types of product include everything from utility to applications-specific products. Typically, VARs are looking to provide some additional capabilities in the form of word processors, spreadsheets, etc.

In some instances, VARs are also looking for new application software that complements their existing solutions and/or can be marketed into the same industry group. In this vein, VARs are looking for different application software that provides solutions to users within the industry group. For example, a VAR selling application solutions to health-care or medical clinics for patient billing may look for other application software, for laboratory testing or in-house patient care for example, that could be marketed to the same customer base. This approach still capitalizes on the existing industry expertise and end-user relationships. VARs are also looking for cross-industry applications such as accounting and payroll packages that can be used with their primary industry-specific application system.

Pacific Western Information Systems is an example of a VAR looking to enhance its product offering to its end users. Initially providing application software primarily in the public sector to medical examiners and coroners offices, it has begun offering cross-industry application packages. To quote the company, "We will basically examine what our customers tell us they need and then evaluate application products to meet those needs." Most recent has been a word-processing package. Pacific Western is also looking into new, but somewhat related, industry-specific markets. The company's interest is in new and evolutionary products for dental identification.

On occasion, VARs may opt for a new industry approach. This decision is usually based on an interest or awareness of the potential of this new market, or the conviction that the application solution provides a clear advantage over currently available system solutions.

Polygen Corporation, as described in a recent article, has provided an excellent example of taking the things that have worked for you and applying them into a new market. First identifying the characteristics of a previous niche market, now overcrowded and peaking in its growth rate, they looked for the same attributes in a new market, found them in an area of physical science research done by many chemical and drug companies, and went after it. Polygen designed systems to work on a variety of hardware platforms, allow researchers to simulate experiments, make incremental changes, and share results with other researchers. Polygen identified the market, then developed the product that meets the needs.

Vendors are also providing their VARs with access to additional software products. By maintaining an index of other application, system, and general software products available on their systems, vendors provide a listing of available software products. Through their vendor(s), VARs can get assistance in locating various types of software products to meet end users' needs as well as to enhance their general product offerings.

D

Agents

A relatively recent development in the value-added reseller channel has been the emergence of the agent/broker concept. Agents have a market knowledge either of a specific industry or geographic area, upon which they are able to bring to bear various hardware systems and/or software products and applications from a variety of suppliers. The agent usually works as an extension of, and often times with, the sales and support people from the vendors, both hardware and software, to provide a total solution package to the end user. One of the key differences in the agent sale is that the end user contracts directly with the hardware and/or software vendor, where the agent performs as an extension of the vendor's sales force. Unlike the VAR, the agent does not take title to the system.

Although agents differ significantly from VARs in their relationships with end users and vendors, their use by both hardware and software vendors to sell products and services into the computer and information processing markets is increasing. Agents differ from VARs in that their relationship with the end user is different. When a vendor uses an agent, the vendor interacts with the end user and, in fact, is the provider of the product to the end user.

The agent acts primarily as an extension of the vendor, VAR, or other information system provider's sales force. The agent typically brings a unique knowledge, usually industry specific, that augments and enhances the market coverage that the vendor already has in place. Often, an agent and a vendor salesperson will make a joint sales call to an end user.

In many situations, agents are used to sell into the smaller but industry-related end users to provide capability and/or compatibility with products sold by the vendor into the larger, usually Fortune-500 or -1000 end users. Agents may also sell to VARs that sell into similar small end user businesses that need the ability to communicate and be compatible with products used by larger end users. Agents are also being used to provide geographical coverage of areas that do not have vendor direct sales offices.

New areas of conflict are now arising from the emergence of an increasing number of agents and/or brokers in the market. Many of these agents come from the reseller community, where they were successful salespeople for the VARs, and are now working for themselves. The vendors are caught in the middle, since they know that the key to a sale is as much a knowledgeable salesperson as the packaged solution. In that the agent knows the VAR's clients and products, the vendor is caught up in negotiating settlements and working agreements between VAR and agent, as well as between VAR, agent, and itself.

IV

Distribution/Channels and Service Levels

IV

Distribution/Channels and Service Levels

The degree and types of service offered by the various value-added resellers are key to understanding the presence of and relationship between the different distribution channels. Exhibit IV-1 depicts the increasing levels of service and/or value-added capabilities offered to the end users by the different resellers.

The levels and types of value-added services are basically enriched as you move across the chart from left to right. There is a degree of overlap in these services from reseller to reseller, but for the most part, each can be depicted as providing a new level of value-added service or capability. The type, extent, and relative value to the customer, of the services provided by the resellers are depicted on the vertical aspect of the chart. The value-added service, as provided by the vendor, declines somewhat from that of the turnkey reseller, based primarily on the fact that the vendor does not normally modify hardware or provide customized programming services for their customers.

The following exhibits, IV-2 through IV-8, identify the characteristics of each of the resellers.

EXHIBIT IV-1

DISTRIBUTION/SERVICES PROVIDERS

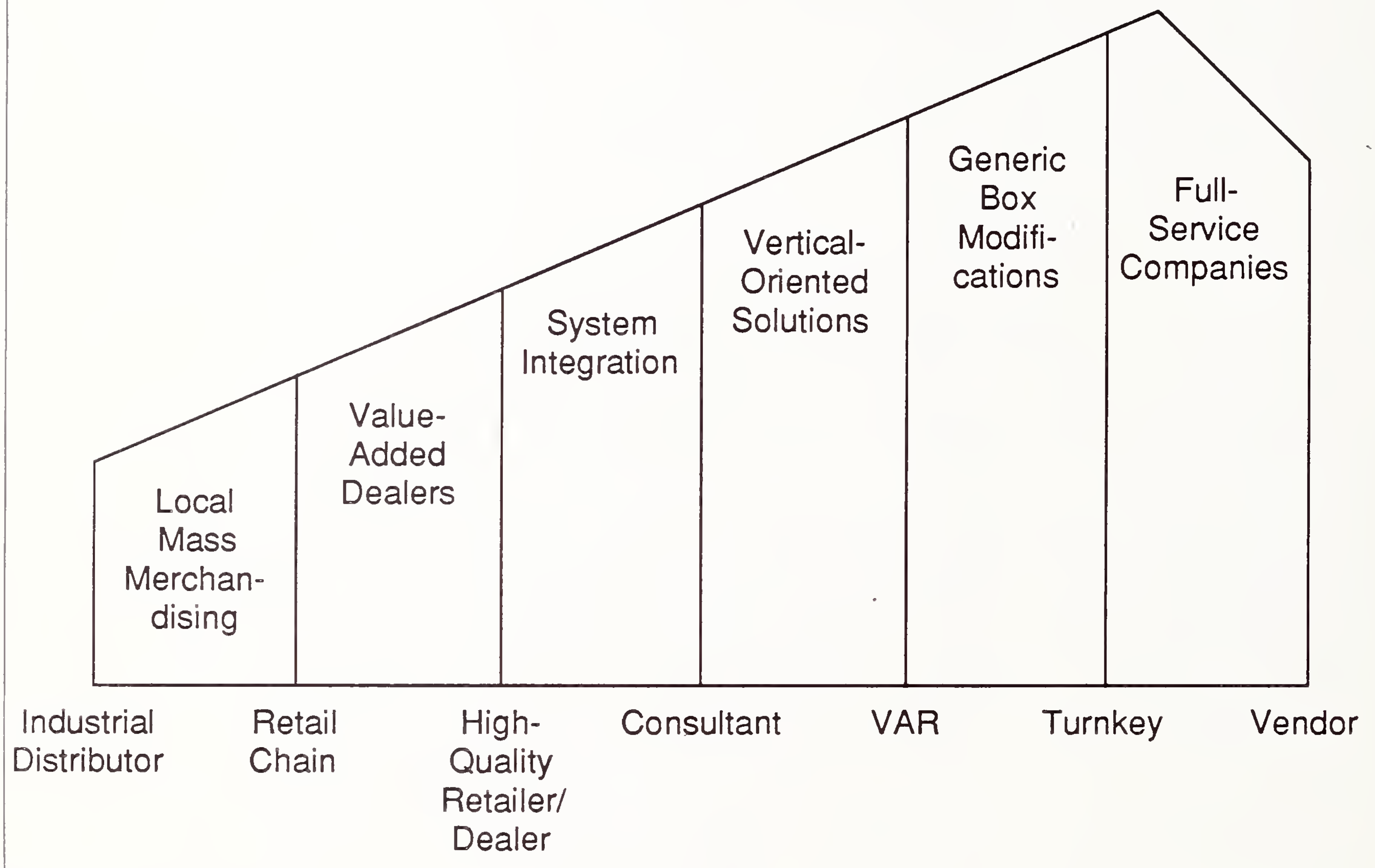

Local Mass Merchandising
Value-Added Dealers
System Integration
Vertical-Oriented Solutions
Generic Box Modifications
Full-Service Companies
Industrial Distributor
Retail Chain
High-Quality Retailer/Dealer
Consultant
VAR
Turnkey
Vendor

EXHIBIT IV-2

INDUSTRIAL DISTRIBUTORS

- Offer Mass Merchandising
- Discount Pricing

Industrial distributors (Exhibit IV-2) provide discount pricing and shopping or availability convenience as the initial service elements of the reseller market strategy. Typically stores and other types of industrial outlets are found in the metropolitan areas. Mail-order catalogs are also found in this segment, advertising primarily in various trade and industry publications. The types of product offered through this type of reseller may include components or fully assembled products, but do not normally include complete or integrated systems. The storefront outlets tend to be found in small as well as very large shopping centers.

EXHIBIT IV-3

RETAIL CHAINS (DEALERS)

- Local Outlets
- Some Product Knowledge
- Low-Priced Systems

Retail chains and dealers (Exhibit IV-3) provide the next level of value-added service. They provide multiple local outlets in most metropolitan and smaller cities. They normally offer a lower-priced range of products primarily for individual usage. These products, typically known as personal computers or PCs, are typically used at home for fun, games, and some other personal uses, such as limited word processing, spreadsheets, budgeting, and financial-planning applications. Depending on the type of retail outlet or dealer, the sales staff may have a limited product knowledge and training to assist in identifying various features, functions, and benefits.

EXHIBIT IV-4

HIGH-QUALITY RETAILERS (DEALERS)

- Trained Sales Staff
- Discuss User Requirements
- Provide Integrated Systems
- Provide Some User Training

High-quality retailers, also referred to as dealers, though still providing local outlets in metropolitan and some smaller cities, tend to be specialized computer outlets. Their sales staffs are trained and understand some of the basic elements of computer systems. Some of the sales staff may have some programming knowledge as well and may be able to recommend component elements of a system based on a user description of its intended purpose and volume estimates. High-quality retailers are able to provide integrated systems, combining the processing, storage, and printer requirements. Some user training involving operation and basic programming may be offered. The computer systems and peripheral equipment sold through these dealers tend to be of the individual and small-system-based microprocessor types.

EXHIBIT IV-5

CONSULTANTS

- Study User Requirements
- Recommend System Solutions
- Some May:
    - Provide the System
    - Provide/Offer Application Software
    - Offer Programming Services

Consultant services (Exhibit IV-5) begin a new level of service, one that is typically brought to the customer as opposed to the customer going to the service. The consultant offers a value-added service that usually brings a significant level of product knowledge and/or industry experience to the customer. The service usually involves a study of the customer's specific business characteristics and requirements, and results in recommendations that are unique and specific to the end user. Recommendations may include specific software applications and an integrated computer system designed to meet the specific needs. The size of the systems recommended may be anything from a single-user system to a much larger multiuser environment, with mass storage and printer requirements. Since the demand has increased for consultants to stand behind their recommendations and provide the services necessary to implement the recommendations, many will now provide the hardware systems and software to complete the service. Many have the ability to provide either packaged or customized software, along with the programming staff to support these services.

EXHIBIT IV-6

VALUE-ADDED RESELLERS (VAR)

- Provide Industry-Specific Solution:
- Including:
    - Hardware System
    - Application Software
    - Installation

- Some May Offer:
    - Consulting Dervices
    - Custom Programming
    - Maintenance Services
    - Data-Center Management

The value-added reseller (Exhibit IV-6) provides turnkey system solutions in an industry-specific market niche. This typically includes a hardware system, purchased from another vendor or super VAR, and the industry-specific software application unique to that market niche. The application software, typically developed by the VAR, requires an industry knowledge and awareness that enables the VAR to understand and provide the end user's requirements. This type of VAR has tended to be somewhat regional in its coverage.

The need to develop additional revenue sources has caused many VARs to offer additional services, normally within their existing customer base and/or industry. These services include consulting, education and training, custom programming, maintenance, and even data-center management for larger system installations.

EXHIBIT IV-7

TURNKEY PROVIDERS

- Provide Custom Box
  - Modified Hardware
  - Horizontal Applications

- Provide Industry-Specific Solution:
  - Including:
    Hardware System
    Application Software
    Installation

  - Some may offer:
    Consulting Services
    Custom Programming
    Maintenance Services
    Data-Center Management

Turnkey providers (Exhibit IV-7) differ from VARs primarily in two areas. One, they tend to have an OEM arrangement with their hardware supplier and may do hardware modifications and/or additions to the system. Consequently, they may sell the hardware system under a different name than the original vendor. Secondly, the application and/or system software tends to be horizontal in nature rather than an industry-specific solution. In effect, the uniqueness of the system is applicable to any user in any industry that has a need for the function served. The functions served are many and varied and include such features as greater memory capacity, greater peripheral connectivity, or the ability to handle a larger number of data-entry stations and input volumes. Because of the modifications to hardware normally associated with these resellers, they tend to provide more maintenance services than other resellers.

EXHIBIT IV-8

VENDORS

- Integrated Systems
- Application Software
- Maintenance Services

Vendors (Exhibit IV-8) are obviously not resellers when they use their own direct sales forces. However, vendors normally provide a very high level of service to their customers, and the comparisons are worth noting. Vendors provide fully integrated systems to the customers, backed up by system-level software, generalized application software, and both hardware and software maintenance services. In addition, education-and-training programs across a wide range of products and programming environments are offered in a wide range of skill and technical levels. One of the value-added features not available from a vendor is hardware and/or software modifications. The availability of and interest in providing consulting and customized programming services are not up to the level of some of the other value-added resellers.

The type of distributor best qualified to meet end-user requirements quite often depends on the size and expertise of the end user, as well as the type of business it is. Typically, large and medium-size businesses with some data-processing expertise deal directly with vendors and to some extent with industrial or retail distributors. They may also work through consultants in the determination and/or design of application software systems, but usually have their own in-house staffs for such activity. The primary difference between these end users and others is in the size and/or number of their data processor system(s) and staff.

Small businesses usually look to turnkey- and/or VAR-type purchases when the specific needs of their businesses are met through the specialized hardware and/or application software provided by these type of distributors. Normally, small businesses do not have staffs dedicated to and knowledgeable of data processing, and such businesses look to these distributors and consultant services to provide the analysis, recommendations, and programming services they require.

V

Value-Added Reseller/ Vendor Strategies

V

Value-Added Reseller/ Vendor Strategies

Though there are continuing concerns about eroding profit margins and channel conflicts within the VAR community, there are also healthy new signs of growing usage, acceptance, and recognized value by the vendors utilizing, or expecting to utilize, these capabilities and services.

A

Value-Added Resellers

The concerns of the VARs have been, and continue to be, to fully capitalize on the business opportunities that exist and can be developed. In simpler terms, this translates into how to increase revenues and profits. Among the opportunities available to accomplish this, VARs tend to pick and choose from the services, products and opportunities shown in Exhibit V-1.

EXHIBIT V-1

VALUE ADDED RESELLER DIRECTIONS I

Provide New/Additional Services

- Consulting
- Customized Programming
- Additional Training/Education
- Data-Center Management

One of the principal advantages to the ability to provide additional services is that it facilitates repeat business with the existing customer base. The efforts required to sell to an existing customer are much less than those required for a new customer because both parties know and understand each other. The effort to establish yourself and your credibility is already accomplished. Maintaining ongoing consultant relationships can provide a steady revenue flow that can be utilized to stabilize a sales and support group that can withstand the peaks and valleys experienced with new-name sales activity. It provides an early awareness of additional potential sales based on new and/or changing needs in the customers' businesses. Most small businesses do not have the resources or the interest to maintain an awareness of the rapidly changing data processing industry and would benefit from such services if provided on a regular and reasonable basis.

Another service that VARs have been developing is that of acting as the MIS manager for their end-user customers. In fact, what they are providing, for an ongoing consulting contract, is knowledge of data center operations, new industry software applications and developments, new products, computer systems, peripherals, and terminals, as well as reviewing the ongoing usage, performance, and requirements of the installed system. They are able to recommend additional equipment and/or additional system capacity as required by the growth and volume of business the customer is experiencing. This type of service is of value to both the VAR and the end user. The VAR is able to develop a continuing revenue stream based on the ongoing consulting activities, and the end user is able to gain insight and awareness of new activities, products, trends, etc. in the data processing arena that can be of great advantage.

Another area of service being explored by a number of VARs is actual data center management. Alliance Data Systems is a new VAR that is developing a market strategy based on this concept. Primarily directed toward the small business client, Alliance is offering Premise Management Services. PMS is Alliance's program for having an ongoing relationship with its customers by providing data center operations at the customer's site. Alliance is able to maintain close daily contact, be aware of new and changing needs as they occur, and have a decided edge when the customer decides to upgrade or replace its system.

EXHIBIT V-2

VALUE-ADDED RESELLER DIRECTIONS II

Increase Typical System Size/Price

- Enhance Product Offering
- Sell Larger Systems

The ability to sell larger systems, usually higher-priced systems, is a function of both the hardware and the value-added software and/or services. For the most part, VARs have tended to sell the lower-end hardware systems, typically in the $10,000 to $50,000 range and rarely above the $250,000 range, for several reasons. The vendors could not afford to effectively sell the low-priced systems directly to the end user, and conversely, they felt the VARs did not have the ability to sell larger systems with their attendant longer sell campaigns and required support. (Also, the margins were sufficient to support their own efforts at this level). The key, then, to selling larger, more-expensive systems is dependent upon additional value-added products and services. Enhancing the sales means offering additional products—i.e., enhanced applications specific products, cross-industry applications, RDBMS and other utility software, and other hardware products, including terminals, disks, et al. Increased sales prices can also include packaged or customized consulting services as well.

EXHIBIT V-3

VALUE-ADDED RESELLER DIRECTIONS III

Expand Industry Coverage

- Related Opportunities within Current Industry
- New/Additional Industry Markets

Expanded industry coverage includes the opportunity to sell additional products that complement and augment a specific market niche, may include new market niches that exist within the same general industry, and may also include totally unrelated markets that are open and have growth opportunity. Though the ability to use and capitalize on existing skills and market awareness in closely related new markets is helpful, moving into new industry markets can and will provide the opportunity to not only increase revenues, but diversify and perhaps provide buffers for withstanding down periods in one industry with growth and activity in another.

B

Software Developers

VARs have often been the resultant partnership of a software business that recognized the value and opportunity of remarketing a "turnkey" system. Other software companies, both system-level and application software developers, are recognizing the value of utilizing their somewhat different but not too distant relative, the VAR.

EXHIBIT V-4

SOFTWARE DISTRIBUTION STRATEGIES

System Software Developers

- VAR Internal Use
  - Development Platforms
  - New Functionality
- VAR End User
  - Expanded Base
  - New Features
- Super VARs
  - New Markets
  - Enhanced Product Offering

System level software developers and the RDBMS developers in particular have discovered that selling to VARs directly, and to other third-party software developers, extends the market for their product to a much greater end user population than they alone could effectively reach. The use of a RDBMS as a development platform by the VAR and/or third-party software developers for their own application development effort results in an extended end user customer base with interests and requirements to support additional needs such as ad-hoc report generation capabilities. The use of the RDBMS by other software developers facilitates the update and/or rewrite of existing application packages by utilizing data-base-entry and inquiry capabilities. The updated version, or release, can than be remarketed to the existing customer base due to the enriched functionality provided by the RDBMS. The enhanced performance and functionality of systems marketed by VARs provided by the RDBMS products involve such capabilities as file integrity, transaction security, and random inquiry. Most software developers provide both VAR and end user with support in resolving any problems.

SYBASE, for example, looks to use strategic partners in its VAR program: "We look for strategic partners, who will develop tools or other products that work with our RDBMS, and then we do joint marketing." Sybase is also looking for other VARs, primarily based on an interest and/or need for their product. The type of applications and market niche help to determine that need, and therefore identify the VAR potential.

The use of super VARs, discussed in Section III, is a new strategy for software distribution and the opening of new markets. The software developer gains from the presence and existing customer base of the super VAR, while the VAR gains a unique and possibly differentiating competitive edge by providing an industry leading-edge product in conjunction with its own mainstream products.

EXHIBIT V-5

THIRD-PARTY APPLICATION SOFTWARE DEVELOPERS

Cross-Matching
- Complements VAR Product
- Opens New Prospects

Cross-Industry
- Adds Value
- Enhances Relationship

Third-party application developers are also looking to VARs to either extend and, in some instances, replace their direct sales force. Typically, industry-specific application software developers are looking for VARs with a knowledge of and a presence in their specific industry. In most instances, VARs are primarily interested in the remarketing of application packages that are complementary to their existing applications and markets. Such products allow the VAR to provide additional applications to their existing base, or to extend the market prospects by providing similar application software to an industry related prospect.

Cross-industry application, i.e., horizontal application, developers are also looking to VARs for remarketing to the end user. Recognizing that the need for the cross-industry applications, i.e., accounting, payroll, personnel, exists for all the VAR end users, the best way to reach them as through their original resellers.

C

Hardware Vendors

The traditional users of alternate distribution channels, the hardware vendors, are also undergoing new and somewhat controversial relationships with VARs. The downward movement of system size and prices have brought the realities of a direct sales force, in terms of selling costs and market penetration, to the table. The use of reseller channels is the only practical way to sell micro-based products into the small business environment.

EXHIBIT V-6

HARDWARE DISTRIBUTION STRATEGIES
PARTNERS VS. ADVERSARIES

- Extension of Sales Force
- Product and Sales Training
- Trade and Industry Shows

Vendors no longer look upon VARs with negative feelings. VARs are, for the most part, now looked on as partners and as an extension of the vendor's sales force. Consequently, a much better level of support, resolution of conflicts, and overall attitude exists and is resulting in closer and more cooperative working relationships. Some companies are actually expressing awareness of the channel conflict problems are are appointing senior managers to focus on how to manage and minimize these conflicts. Unisys, in fact, has an active program of wooing other vendors' VARs to add a particular area of business application focus. Unisys is actively attempting to know all the VARs, brokers, and agents, even those sold through other VARs, to show its interest and desire in achieving mutual success.

Although AT&T's new direct sales force will compete with VARs for a portion of the business at the large end-user level, it is still dedicated to the use of VARs at the lower end. The AT&T reimplementation of a direct sales force is a statement to the effect that indirect sales channels will not, in themselves, be sufficient to drive the market. However, AT&T's attempt to refer leads to VARs is a commitment to that channel.

Vendors' participation at various national and regional trade shows is shared with their VARs, where they depend on the resellers to present a solution's image to the public. The idea expressed by more than one hardware vendor is, "While we possess a great deal of ability to design and manufacturer computer systems, and in most cases, operating system software, we do not have the expertise, time, or interest to develop our own applications software packages." Consistent with this approach is the increasing attendance and participation by VARs at the vendor user-based meetings.

Apple Computer's expansion of its VAR channels is directed toward vertical market opportunities. Recognizing its inability to penetrate certain vertical markets, Apple has concentrated its VAR activity in that direction using vehicles such as COMDEX. Apple is targeting large dealers able to produce application software for these targeted industries.

VI

Recommendations and Conclusions

VI

Recommendations and Conclusions

A

To VAR or Not to VAR

The majority of hardware vendors that have ventured into the use of alternate distribution channels and the value-added resellers over the past years have tended to stay with this type of distribution. The number, type, and size of their VAR programs have undoubtedly changed over the years, but the decision has been to revise rather than reject the distribution methodology. As depicted in Exhibit VI-1, vendors are constantly undergoing revision and, in some cases, revolution in their distribution strategies.

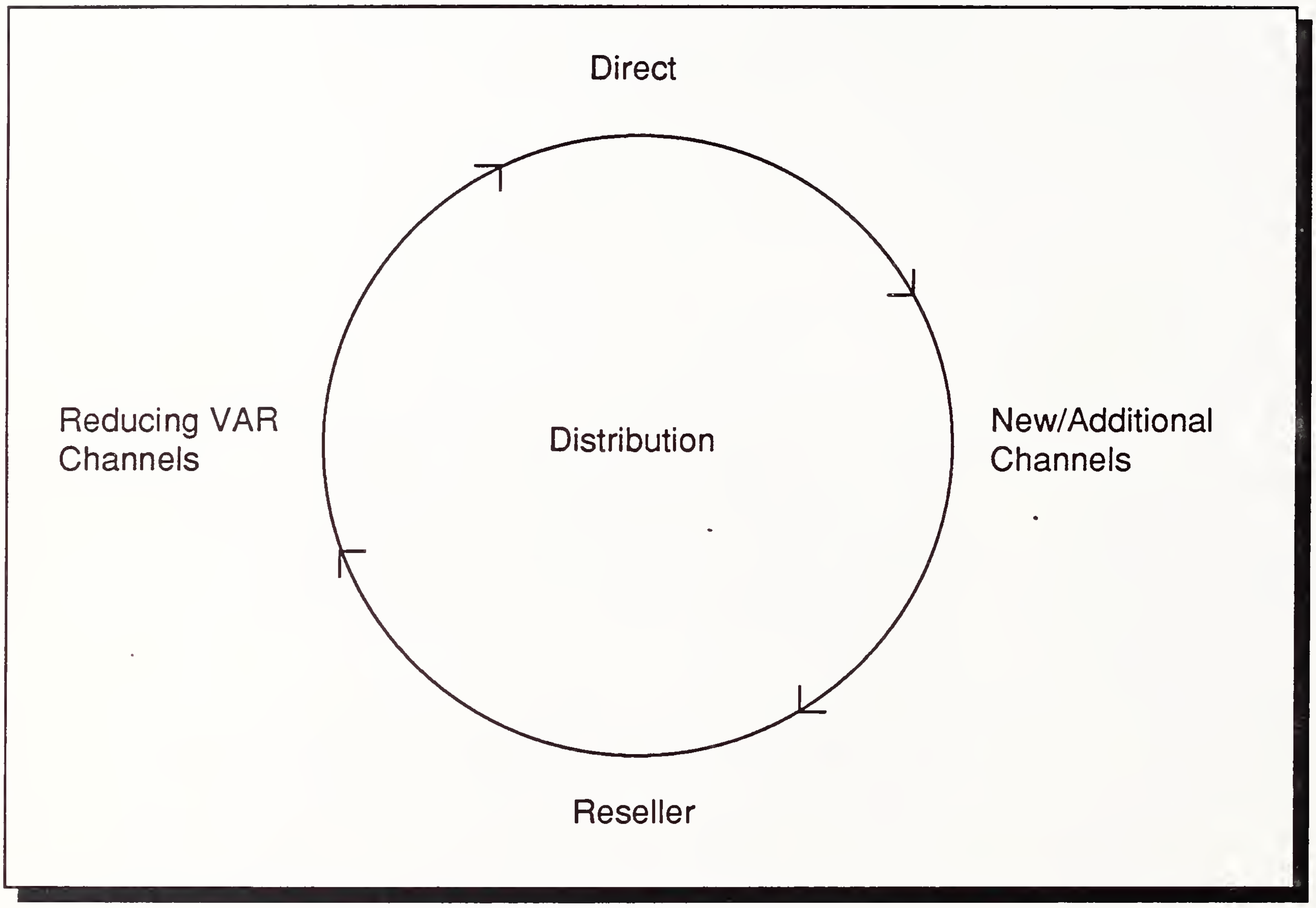
Though most hardware vendors started out with direct sales force strategies, usually a carryover from the 'Big Iron' and high-prices days, the combination of new hardware architecture and competitive prices required a more cost-effective method of market coverage. Initially, these vendors developed a distribution strategy involving value-added resellers in addition to their own direct sales forces. The resultant conflicts were offset, to a degree, by the greater market penetration achieved by a larger number of resellers. As new vendors came into the marketplace, most of them implemented reseller market strategies in addition to a direct sales force. Some, however, went so far as to rely fully on reseller channels, without the use of a direct end-user sales force. A few of these companies, such as Altos and Ultimate, have stayed with this strategy, while others, such as Convergent, have opted to augment their reseller programs with a recently implemented direct sales force.

Certainly the early blush of reseller strategies has been tempered with the awareness and growing concern over market, territorial, and account conflicts. Many companies have cut back and/or become selective in their implementation of reseller strategies. All have recognized the need for management and partnershiplike sharing in the reseller channels.

INPUT believes that the importance of the value-added reseller channels, in terms of their ability to serve industry niche markets and economically get to smaller business prospects, cannot be overlooked or too quickly dismissed by a vendor. A strategy that includes only direct sales capabil-

EXHIBIT VI-1

DISTRIBUTION EVOLUTION



ity restricts the vendor's ability to bring a product into the marketplace and create a level of momentum. INPUT recommends that vendors consider the use of VARs in the distribution of their product line, but not to the exclusion of the direct sales force.

B
What You Don't Know Will Hurt You

One of the consequences of using of alternative distribution channels is the lack of vendor visibility and interaction with end users. Exhibit VI-2 addresses some of the key issues.

As a vendor, there are a number of reasons to want to be aware of who your end-user customers are, what and how your product is doing or not doing well, and what level of support your customers need and/or are getting. As a by-product of good customer relations, a vendor hopes to create a warm, comfortable feeling in its customers and consequently

EXHIBIT VI-2

END-USER AWARENESS

- Concerns
    - Product
    - Support
- Interaction
    - Loyalty
    - Warm Feeling

develop a sense of loyalty meaning the vendor's customers will buy your products again.

Vendors dealing through a multiple layer of value-added resellers and distributors will discover this lack of customer input. The use of vendor-related user groups has provided an excellent vehicle for the exchange of ideas and the discussion of problems and concerns, and has afforded customers the opportunity to interact with a variety of technical and management people they normally do not see. User-group committees have been able to work with vendors to resolve problem areas as well as identify new and enhanced capabilities desired for their systems. As a consequence of these interactions, many customers were made to feel their needs and concerns were important and, of equal importance, vendors were able to establish a greater degree of loyalty in their customer base.

INPUT believes that vendors should maintain interaction with their end users through direct sales efforts and user groups that include a spectrum of VARs and their customers.

C

VARs Desire a Relationship without Conflict

The value-added reseller has often been the man in the middle caught between the expectations and confrontations with the vendor. While wanting and expected to produce sales, VARs have been, and to a degree still are, faced with direct competition with vendors' own sales forces. Resellers were often given little, if any, training relative to product and sales skills. As Exhibit VI-3 depicts, two of the key concerns that must be addressed are the use of a direct sales force and the inclusion of VARs in the vendor's own product and sales training programs.

EXHIBIT VI-3

VAR/VENDOR RELATIONSHIPS

- Direct Sales Force
- Equal Status

VARs started looking for vendors that did not have their own direct sales force or, at a minimum, did not have a direct sales force in the VARs' immediate geographic area. Whether or not the absence of a vendor direct sales force hinders more than it helps is a debatable issue. What seems to make a great deal more sense is the implementation of management plans and policies that reconcile problem situations and recognize that resellers are a necessary and integral part of vendors' distribution capabilities. The presence of vendor sales and support personnel can be an asset to the reseller when it is used to support the VAR's sales activity. Many of the smaller VARs do not have the resources and/or skills that the vendor can bring in support of sales activity. When a vendor has the determination and commitment to compensate its own sales force for such support activity, all parties, including the end user, usually come out ahead.

Recently, more and more vendors have been inviting, if not requiring, their resellers to attend the same product and sales training courses they hold for their own people. This type of support and training will result in better-qualified reseller capabilities, as well as closer working relationships and loyalties. Vendors have also been using resellers in their attendance at various trade and industry shows.

INPUT recommends that vendors continue using their direct sales forces with supportive plans and policies to ensure conflict resolution. In addition, the recognition of VARs as an extension of the vendor's own sales force and the inclusion of VARs in the various product and sales training programs will result in a closer working relationship with VARs and a more satisfied customer.

D

Conclusions

INPUT believes that companies existing within the various delivery modes can benefit from the use of reseller channels as follows:

1. Software companies are using VARs and have found them to be a very necessary and effective means of marketing their products, both system-level and application software products. The use of master VARs, as discussed in this report, is a relatively new and exciting innovation.

2. Providers of networking and processing services appear to have only a limited these channels. The use of agents and possibly master VARs as a means of reaching the smaller business user community would provide some additional market potential.

3. Professional services providers would apparently not gain an obvious or clear advantage by the use of value-added resellers or distribution channels. In fact, they may find that the VARs will begin to compete more into the professional services area as the VARs seek new and additional revenue sources.

A

Appendix: VAR End User Questionnaire

VAR END USER QUESTIONNAIRE

Alternative Distribution Channel (VAR) Project: MADC

1. What are the key factors you look for from a vendor?
    a. Name Recognition
    b. Product Uniqueness
    c. Pricing
    d. Support
    e. Operating Environment
2. Do you handle more than one vendor's hardware?

3. Are you specializing in vertical market?

4. Do you provide any cross industry applications?

5. Do you develop your own software products?

6. Are you interested in any 3rd party software that would enhance your market or offer other market opportunities?

7. What services do you provide?

Training/Education
Product Maintenance/Service
Programming (Application Customization)
Consulting (Application Solutions, H/W Platforms)

8. What support/service do you expect from a vendor?

Product Support/Service
Training
Financial
Sales Material (Spec Sheets, Brochures)
Sales Leads

9. What percentage of your business is from VAR related activities?

10. What are the major problems you face as a VAR?

- Direct Vendor Conflict
- Competition
- Vendor Support
- Economic (Margins, Cost of Sales, Volume)

11. How long have you been in business as a VAR and how many people do you employ in support of the VAR operation?

Additional Questions for VAR's

Sales Expansion Plans

Revenue

Other Vertical Market Opportunities

Use of Other S/W Houses for Services

Use of Cross-Industry S/W Products

Vendor Questionnaire

Alternate Distribution Channels (VAR) Project: MADC

1. a) Do you use VARs as an alternative distribution channel?

b) Do you use any other indirect channels, such as dealers, distributors, OEMs, other?

c) How do you define a VAR?

2. How do you select VARs?

Geographically
Industry Specialization
Distribution Strength (Size)
Complementary H/W S/W

3. What services do you want the VAR to provide:

Value Added S/W (Ind. Applic.)
Education/Training
Product Maintenance/Service

4. How do you support the VAR?

Product/Sales Training
Sales Leads
Product Literature (Specification Sheets, Brochures, etc.)
Financial
Business Management
Other

5. What do you consider to be the key advantage(s) in using VARs?

a) Cost/Pricing

b) Service

c)

6. What are the disadvantages (if any)?

7. Who is responsible for VAR contracts and management?

a) Sales/Marketing

b) Industry Mkt.

c) Special Organization

8. How do you manage the VAR channel?

a) Performance

b) Review

c) Contracts

9. Do you have any contact with your VAR customers?

10. Who does the end-user consider as their vendor?

11. Is there any effect of company recognition as a result of using VAR channels?

12. Do you try to match 3rd party software developers (or H/W vendors) to enhance VAR performance and/or industry offerings?

13. When did you first start using VAR channels?

14. How many VAR outlets do you have?

15. What percent of your sales are through VAR channels?
What changes do you expect?

16. What is the percent of revenue contribution for VAR channel?

17. How effective do you rate the VAR channel as a marketing/distribution vehicle?