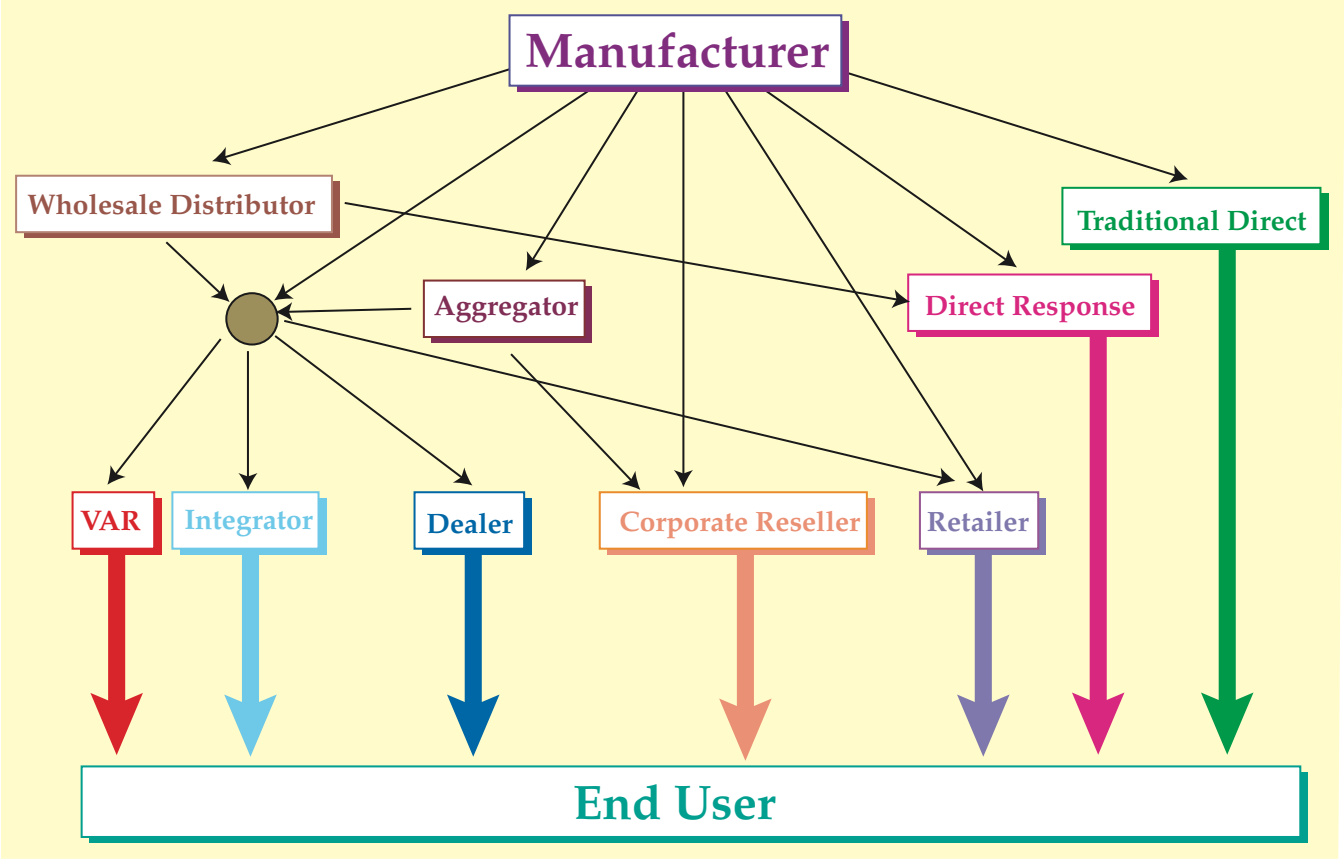
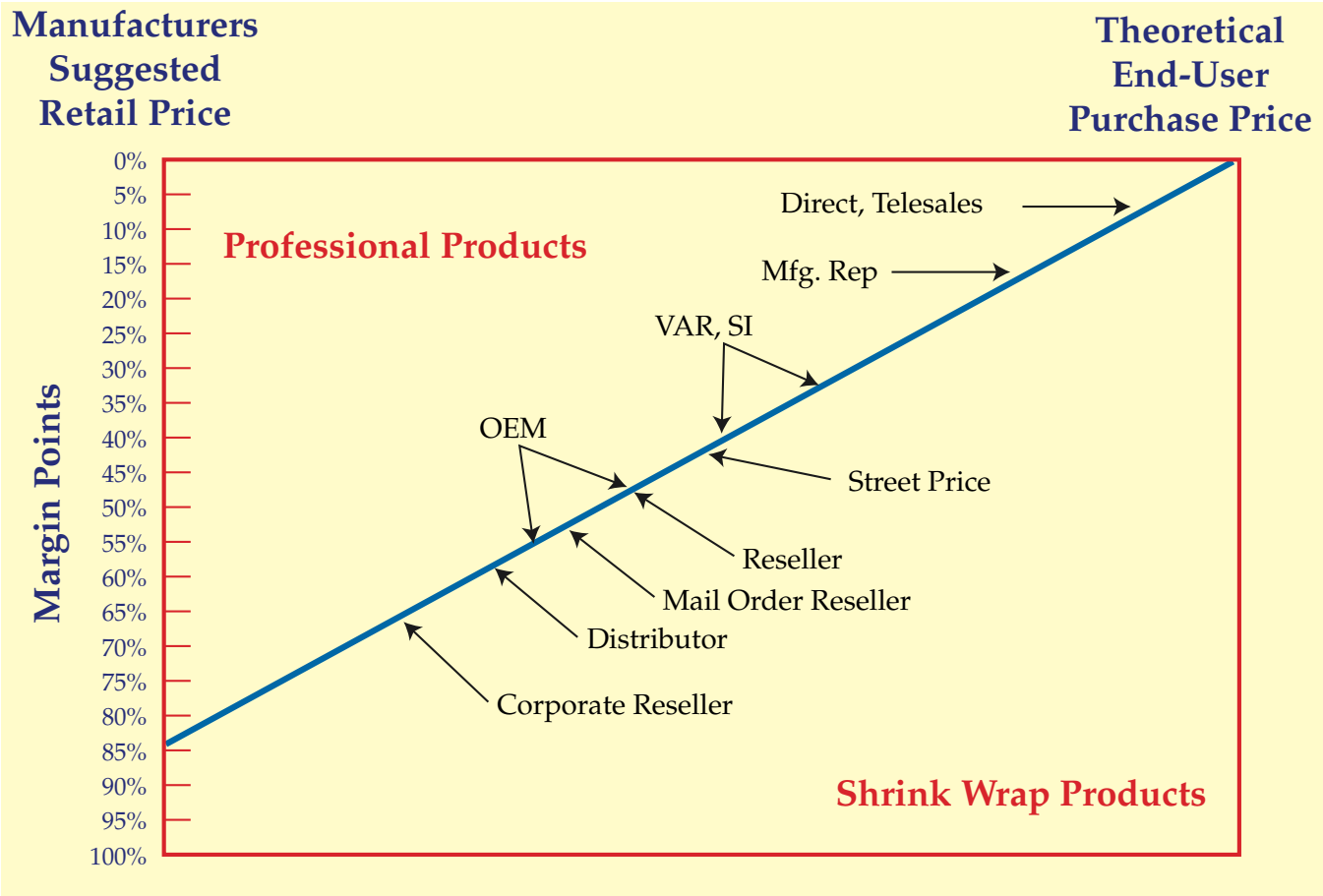
Channels

Channels are the means by which sales and marketing move product. Channels may be in-house, in the form of direct sales in-house mail order, or telemarketing. But in reaching the mass market, they more typically are indirect, using distributors, resellers, VARs, and other merchants to actually sell the product to the customer.



Professional products typically require one-on-one sales contacts, whereas shrink-wrap products are often purchased directly from catalogs and floor displays. Typically a professional product are sold for higher prices than shrink-wrap products, hence channels servicing these products can operate at lower margin points.



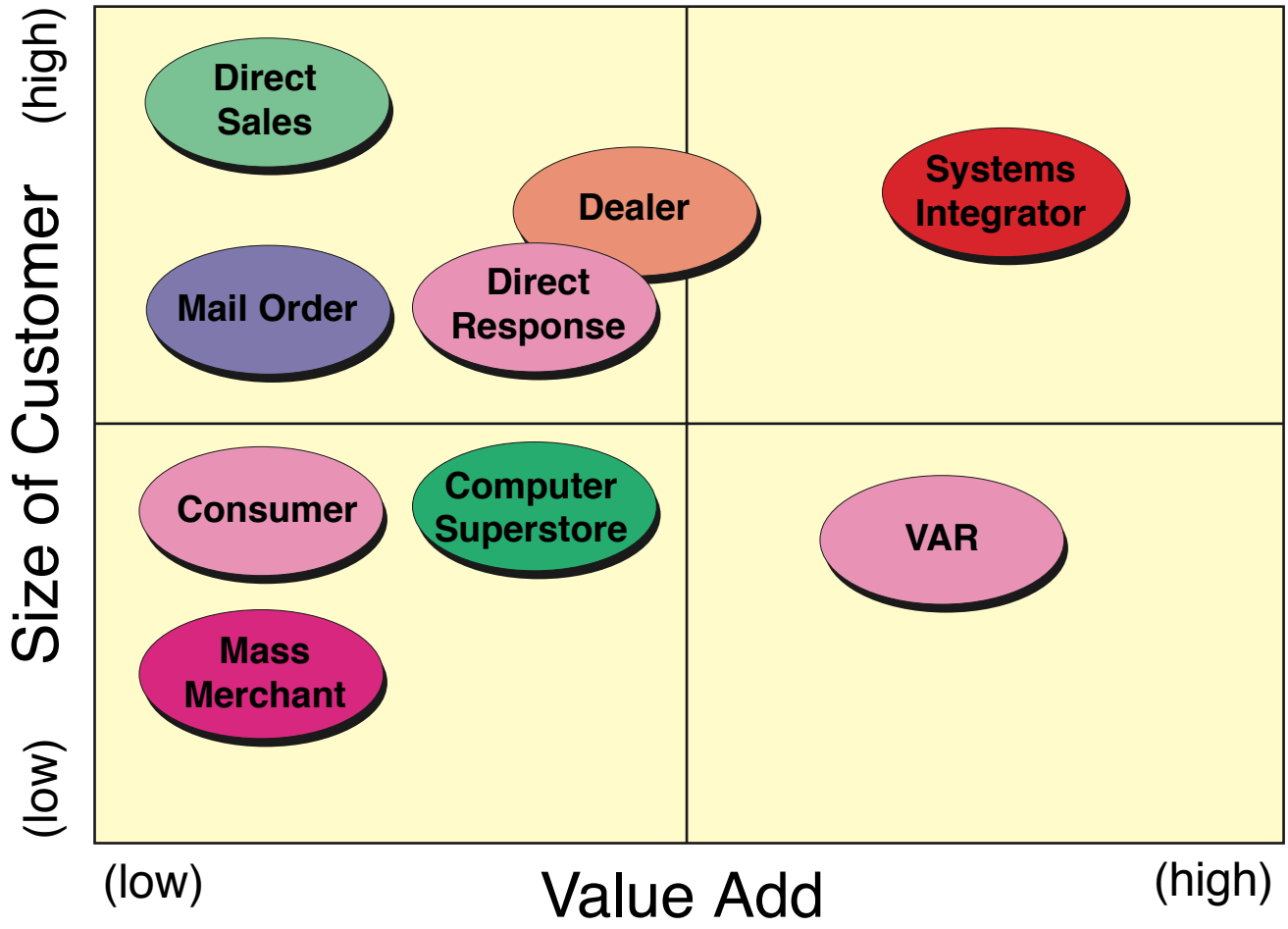
Channel Atributes

Some other differences between channels are shown in the following table:

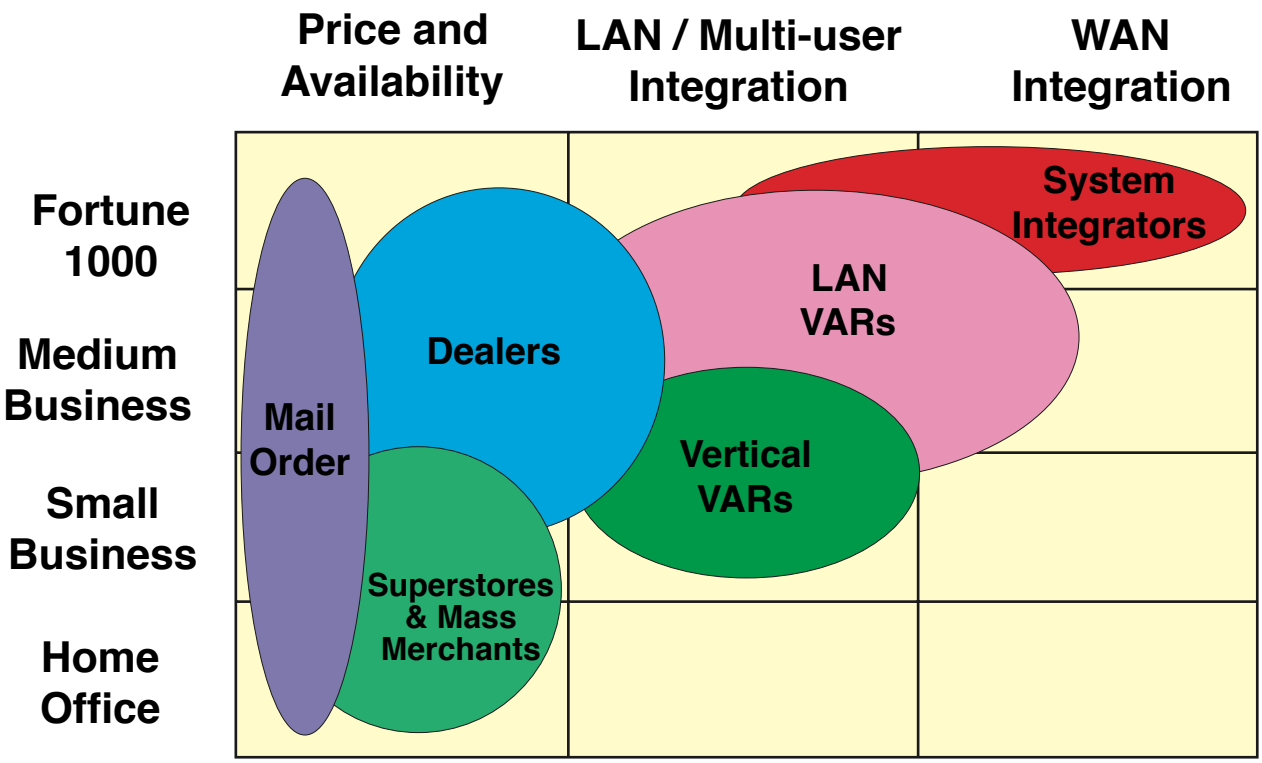
Factor	Direct	OEM	VAR	SI	Distributor	Dealer	Rep
Discount	Low	High	Mid	Mid	High	Mid	Low
Price Control	High	Mid	Mid	Mid	Low	Low	High
Customer/Manufacturer	High	Low	Mid	Mid	Mid	Low	High
Customer/Channel	High	High	High	Mid	Low	Mid	High
Support Burden to End User	High	Mid	Low	Low	High	High	High
Training Requirement	Mid	Low	Mid	Mid	Mid	Mid	Mid
Technical Sophistication	Mid	High	Mid	High	Low	Mid	Low
Co-op Advt, Lead Generation	High	Low	Mid	Mid	High	High	High
Allegiance	High	Mid	Mid	Mid	Low	Low	High

Typically system integrators and VARs provide the highest amount of value add, i.e. they typically integrate hardware and software to provide a turnkey solution. Mass merchants typically sell to the individual and typically offer little service beyond an immediate exchange for defective units.

Channel Segmentation



A direct in-person sales force has the highest overhead and thus requires a large customer sales to support their expense, yet provides the highest amount of account control. Retailers tend to be very effective at selling to small customers and have much lower overheads, but provide no account control. In terms of actually providing applications that meet the needs of a customer, VARs and system integrators are the primary method of providing such added value. The top row on the second chart shows the major buying decision, e.g. the system integrator provides LAN / WAN / multi-user integration to large customers, while superstores focus on customers driven by price and availability.



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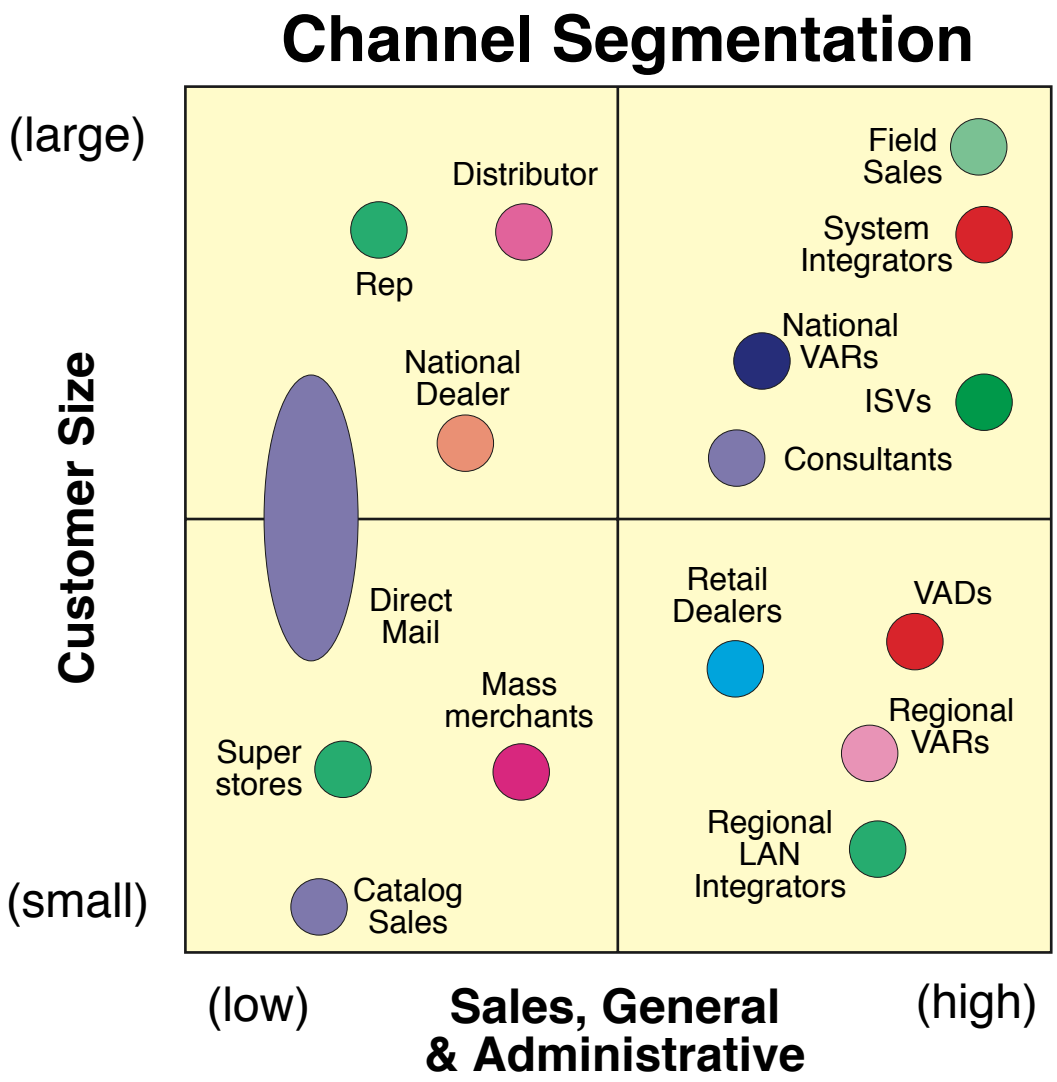
Primary Channel Buying Consideration

Often multiple channels will need to be used in order to reach all desired customers, i.e. a direct sales force is used to sell to a Fortune 500 customer, and VARs are used to sell to small- to medium-sized customers. When a company has multiple channels, solving channel conflict problems is a never ending problem. Each channel wants to have a set of unique products, to avoid having a different channel undercut them with prices that they can't compete against. The last chart reflects the amount of "overhead" a given channel will expend to make a sale, and the size of customer that they focus upon.

Value Added by Channel



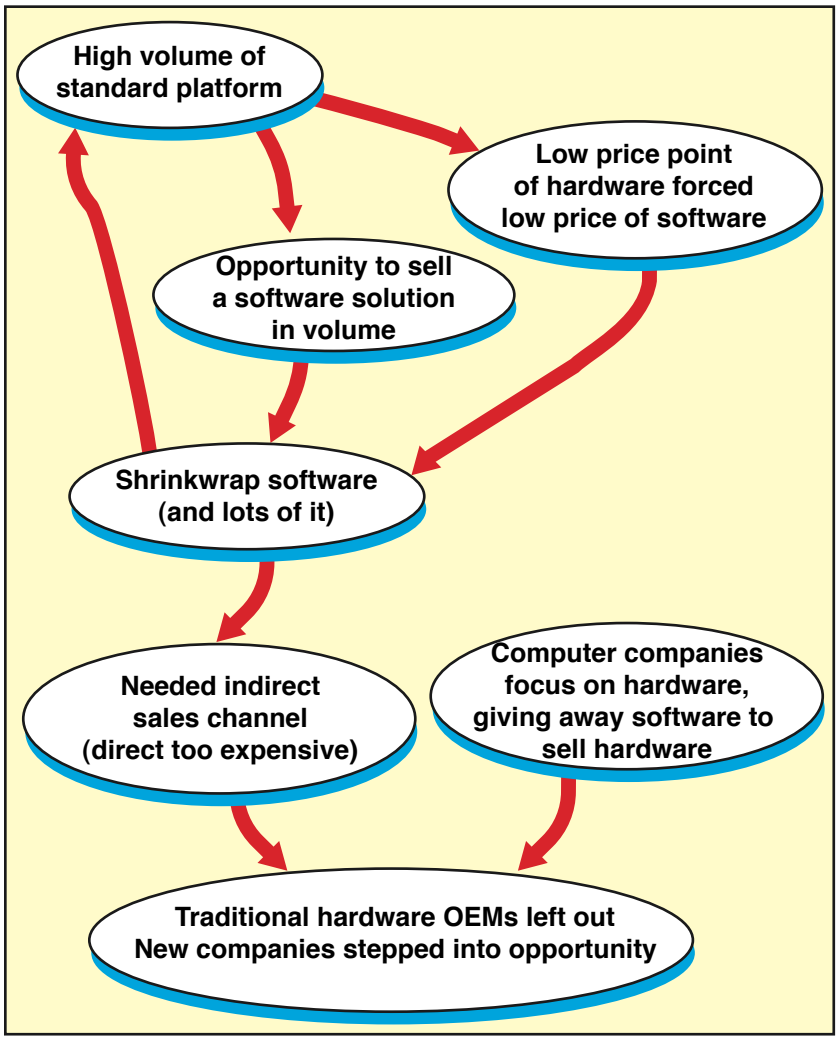
While retailers tend to offer the best pricing and availability, VARs will be preferred when multi-user integration services are required.

Factors Driving Reduction in Software Prices

The mid-1960s saw the first packaged applications being developed for the IBM System 360. By purchasing these off-the-shelf applications, companies could avoid much of the time and cost of writing an application.

The following figure shows the feedback process that has driven the dramatic reductions in software prices.

Software Market Price Dynamics



Introduction of the IBM PC, Macintosh, Atari, and Commodore microcomputers in the 1980s created a large market for standardized software. Availability of this software in turn increased sales of the hardware. As the cost of the integrated circuits and memory required to produce a microcomputer dropped, manufacturers reduced their prices to both attract more customers and obtain a greater market share.

As software prices dropped, cost of a direct sales force could no longer be supported. This situation led to sales of shrink-wrap software in retail stores. Traditional mainframe and minicomputer software companies found it difficult to make the transition into this market. In part, the microcomputer software market evolved so quickly that existing companies were simply unable to react. The net result was the opportunity for new companies like Ashton-Tate, Lotus, Microsoft, and Novell to become the market leaders.

As an example, consider that in 1972, early adopters of $300,000 spreadsheets for mainframes, were sold such software by a direct sales force. With the advent of CP/M systems in the late 1970s, VARs starting selling spreadsheets that could be obtained for $1500 to $2000. The advent of Visicalc and the Apple II found $700 sales occurring through the first computer retailers. And in the 1990s, spreadsheets can be obtained through retailers and direct mail for as little as $70.

Direct

Supporting a direct sales force requires about $60 to $70 thousand per account. This translates to a sales quota of between $1 and $1.25 million per quarter, a cost per salesperson of $250 to $300 thousand, having 25 to 30 prospects at any one time, a six to nine month sales cycle, and winning 50 percent of the business. Why are direct salesforces so expensive? There are several reasons:

- Average on-target earnings (commissions) of $80,000 to $110,000 per salesperson.
- High training and startup costs
- Overhead of office space, insurance, management.
- Travel and entertainment expenses can exceed revenue of the sale just to knock on the customer's door.

Mainframe and mid-range applications typically command a price sufficient to support a direct sales force. These applications are often customized to meet specific customer needs. Pricing is typically a function of the number of concurrent users. Many customers will require 7-day, 24-hour support, due to the mission-critical enterprise nature of the application.

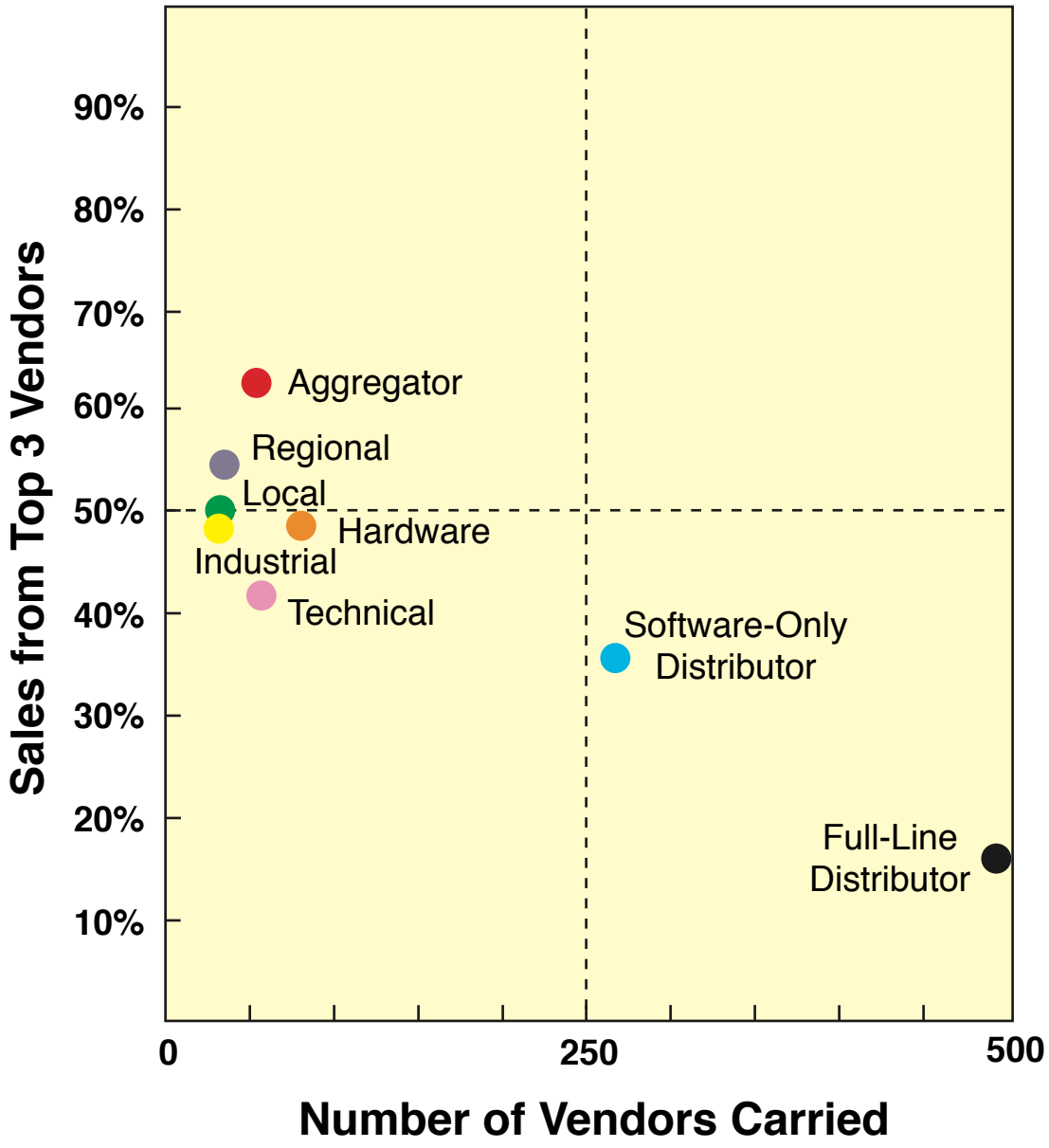
Indirect Channel Costs

Indirect channel sales can be performed through distributors, large chains, or VARs. Typical costs of distribution for these channels are show in the following table:

Channel	Percentage Revenues
Dealer	40%
VAR	35% to 45%
Distributor	20 to 25%

Small dealers typically purchase most of their software products from one or two distributors. This action allows them to consolidate their billing and ordering. The distributor maintains an inventory of software products, but typically does no advertising or promotion of the products to customers, but does advertise to the trade and resellers. For a $100 package, the dealer buys it from the distributor for $60 and makes $40. The distributor buys it from the software company for $45, and makes 25% of $60, or $15.

Large computer chains such as Computerland and Computer Craft ask and pressure for the same discounts obtained by distributors. While they sometimes obtain these discounts, it is only to the extent that they theoretically (and legally seem to) provide a company with the same cost savings that a distributor would provide. This is a requirement of Robinson & Patuare: like resellers must buy at like prices.



VAR - Indirect - One-Tier Distribution

Software specific to a particular vertical market, such as hardware stores, dentists, or doctors, is typically sold through VARs (value-added resellers), who have the necessary trained sales force. VARs typically need to sell between $2 to $10 thousand per account, but preferably between $5 and $10 thousand. By selling locally, a VAR has easier access to prospects, and also is able to make money selling services.

Retail

For products costing under a thousand dollars, you have to go through the retail channel. But at the same time, a product sold through this channel cannot require expertise on the part of the retailer. If it does, it must be priced at a point that will support a VAR. This has led to the term, "shrink-wrap" software, for a product that contains everything an user needs to install, learn, and use the product.

Single-user software for PCs is typically sold through the retail or mail order channels, since historically, these users are extremely price sensitive. Examples of such software include word processors, spreadsheets, and business graphics.

OEM

Selling software through a computer system manufacturer at first sight appears to be a lucrative channel. While a company such as IBM will often pay a substantial up-front porting fee, unfortunately between 50 and 80 points must be given to the OEM for all subsequent sales. Additionally, the OEM sales force often does not understand the software package and has little motivation to sell the software.

Shareware

Many applications can be written by a single talented programmer. In selling a program through two-tier distribution, 55 points will immediate go to the distributor and dealer. Out of the remaining 45 points, will be taken the expenses for sales, marketing, administration, et cetera. This greatly increases the minimum revenue necessary to break-even on a given software product.

Many programmers have decided to sell their programs as shareware instead. They distribute their software via bulletin boards and FTP servers on the Internet. Any user is free to download and use their software. Typically the program contains a nagging reminder, urging the user to send in a fee, usually between $10 to $25 in payment. Some send an encrypted key in return for payment, which typed into the program, removes the nagging reminder.

Internet

The Internet provides the opportunity to instantly provide worldwide access to information and programs to potential customers. The company which has made the most notable use of this channel is Netscape. In less than a year, it achieved the dominant market share in Web browsers. Netscape has achieved this by allowing downloading of its basic browser for free, while charging for an enhanced browser that provides the ability to create web pages, as well as selling Web server software.

Software Publishers Costs

Software publishers are companies that do not do their own software development. Like book publishers, they pay royalties to software developers. This type of company exists for mass-market microcomputer applications only. The following table illustrates the typical cost structure of a software publisher.

Software Publisher Cost Structure

Publisher Costs	% Revenues
Developers' royalties	10% to 15%
Consumer advertising	5% to 10%
Direct response advertising	10% to 15%
Publisher gross profit	50% to 70%

Gray Areas

What do you do in the gray areas between a VAR and direct sales force? You start having to do hybrid things, like have a telemarketing organization do lead qualification, which is fed to the direct sales force.

An example in point has been the Unix market. The many versions of Unix have created a fragmented market that cannot be supported by software distributors or retailers. A combination of direct response advertising and telemarketing is the approach used by many Unix software companies to sell low-end software. Other companies rely upon OEM (original equipment manufacturer) relationships with the salesforces of computer manufacturers to generate leads and sales.