

Queen  
HD  
9696  
.C63  
C32  
S6  
1995

---

# SOFTWARE PRODUCTS DISTRIBUTION

## TRENDS AND IMPACTS

*"If you don't have a powerful distribution system in place through direct access to customers, retailers or OEMs, it will be difficult to compete in the business."*

Kevin O'Leary, President, Softkey International Inc.

**Industry Canada**

**September, 1995**

---

## TABLE OF CONTENTS

|  |    |
|--|----|
| EXECUTIVE SUMMARY .....  | 4  |
| BACKGROUND .....   | 4  |
| CURRENT USE OF CHANNELS .....  | 4  |
| OVERVIEW OF TRENDS .....   | 4  |
| STRATEGIES FOR SUCCESS .....   | 6  |
| <i>Essentials for Planning an International Channel Expansion</i> .....        | 6  |
| <i>The Most Effective Channels for the Future</i> .....                        | 7  |
| OVERALL CONCLUSIONS & RECOMMENDATIONS .....                                    | 10 |
| INTRODUCTION .....   | 12 |
| CURRENT USE OF CHANNELS .....  | 13 |
| THE CANADIAN PICTURE .....   | 13 |
| <i>Channel Utilization by Company Size</i> .....                               | 13 |
| <i>Channel Utilization by Target Market</i> .....                              | 14 |
| <i>Channel Utilization by Technology Focus</i> .....                           | 16 |
| <i>Channel Utilization by Platform</i> .....                                   | 17 |
| <i>Channel Utilization - A Geographic Comparison</i> .....                     | 18 |
| THE US PICTURE .....   | 19 |
| <i>Channel Utilization by Company Size</i> .....                               | 20 |
| <i>Channel Utilization by Technology Focus</i> .....                           | 21 |
| <i>Channel Utilization by Price of Software</i> .....                          | 22 |
| <i>Buyer Preferences</i> .....   | 23 |
| OVERVIEW OF TRENDS .....   | 24 |
| 1. THE SOFTWARE INDUSTRY COMES OF AGE .....                                    | 24 |
| <i>Impacts of Maturation</i> .....   | 24 |
| 2. THE NEW WAVE: ELECTRONIC DISTRIBUTION .....                                 | 25 |
| <i>Impacts of Electronic Distribution</i> .....                                | 26 |
| 3. CONSOLIDATION EVERYWHERE .....  | 27 |
| <i>Impact of Consolidation of Software Developers</i> .....                    | 28 |
| <i>Impact of Channel Consolidation</i> .....                                   | 28 |
| 4. BITTER SUITE? .....   | 38 |
| <i>Impacts of Software Suites</i> .....  | 29 |
| 5. RETAIL - STILL AN IMPORTANT CHANNEL .....                                   | 29 |
| <i>Impacts of Changes in the Retail Channel</i> .....                          | 30 |
| 6. THE CD-ROM APPROACH .....   | 31 |
| <i>Impacts of CD-ROM</i> .....   | 32 |
| 7. BUNDLING UP .....   | 32 |
| <i>Impacts of Software/ Hardware Bundling</i> .....                            | 33 |
| 8. MAKING USE OF EDI .....   | 33 |
| <i>Impacts of EDI</i> .....  | 34 |
| 9. THE EVOLUTION OF OBJECT-ORIENTED TECHNOLOGY .....                           | 34 |
| <i>Impacts of Object Oriented Technology</i> .....                             | 34 |
| 10. INCREASING FUNCTIONALITY AND POWER OF OPERATING SYSTEMS .....              | 35 |
| <i>Impacts of Increased Power and Functionality of Operating Systems</i> ..... | 35 |
| 11. THE OPEN SOURCING REVOLUTION .....   | 35 |
| <i>Impacts of Open Sourcing</i> .....  | 35 |

|   |           |
|---|-----------|
| 12. CLIENT/SERVER MAKES ITS MARK .....  | 36        |
| <i>Impacts of Client/Server</i> .....   | 36        |
| 13. TELESales AND CATALOGUES - GROWING CHANNELS .....                         | 37        |
| <i>Impacts of Telesales and Catalogue Sales Channels</i> .....                | 37        |
| <b>STRATEGIES FOR SUCCESS</b> .....   | <b>38</b> |
| ESSENTIALS FOR PLANNING A US CHANNEL EXPANSION .....                          | 38        |
| 1. <i>Customer Identification and Lead Profile</i> .....                      | 38        |
| 2. <i>Product Category Life Cycle Issues and Effect on Distribution</i> ..... | 38        |
| 3. <i>Brand Recognition</i> .....   | 41        |
| 4. <i>Existing Channels You Currently Use</i> .....                           | 41        |
| 5. <i>Market and Niche or Vertical Opportunities</i> .....                    | 42        |
| 6. <i>Infrastructure Requirements and Resources Available</i> .....           | 42        |
| 7. <i>Macro-Economic Factors</i> .....  | 42        |
| 8. <i>Marketing and Management Capabilities</i> .....                         | 42        |
| THE MOST EFFECTIVE DISTRIBUTION CHANNELS FOR THE FUTURE .....                 | 43        |
| <i>Packaged Software</i> .....  | 43        |
| <i>Complex Software</i> .....   | 47        |
| KEYS TO EFFECTIVE DISTRIBUTION CHANNELS .....                                 | 51        |
| <i>Retail Channels</i> .....  | 51        |
| <i>Value-Added Channels</i> .....   | 53        |
| <i>Direct Response Channels</i> .....   | 54        |
| OVERALL CONCLUSIONS & RECOMMENDATIONS .....                                   | 55        |
| <b>APPENDIX 1 - BIBLIOGRAPHY</b> .....  | <b>58</b> |
| NEWSPAPERS/ MAGAZINES/ JOURNALS .....   | 58        |
| REPORTS/ BOOKS .....  | 58        |
| <b>APPENDIX 2 - SOFTWARE CATEGORIES</b> .....                                 | <b>59</b> |
| OS & SYSTEM SOFTWARE .....  | 59        |
| OFFICE AUTOMATION .....   | 59        |
| OTHER CROSS INDUSTRY APPLICATIONS .....                                       | 59        |
| APPLICATION DEVELOPMENT TOOLS AND LANGUAGES .....                             | 60        |
| COMMUNICATIONS AND NETWORKING .....   | 60        |
| DATABASE .....  | 60        |
| INDUSTRY APPLICATIONS .....   | 60        |
| <b>APPENDIX 3 - LIST OF USEFUL REFERENCES</b> .....                           | <b>61</b> |
| ORGANIZATIONS REFERRED TO IN THIS REPORT .....                                | 61        |
| TEXT BOOKS .....  | 62        |
| REFERENCE MATERIAL .....  | 63        |
| RESEARCH AND CONSULTING COMPANIES .....                                       | 65        |
| SOURCES OF DIRECTORIES/ MAILING LISTS/ DATABASES .....                        | 66        |
| <b>APPENDIX 4 - THE TOP 50 US RETAILERS</b> .....                             | <b>67</b> |
| <b>APPENDIX 5 - EFFECTIVE SALES CHANNEL DEVELOPMENT</b> .....                 | <b>68</b> |
| <b>APPENDIX 6 - ABOUT THE AUTHORS</b> .....                                   | <b>69</b> |
| BRANHAM GROUP INC. ....   | 69        |
| CHANNEL STRATEGIES, INC. ....   | 69        |

## EXECUTIVE SUMMARY

### BACKGROUND

Between January and March, 1995, the Branham Group Inc. and Channel Strategies, Inc. conducted a study of software products distribution trends on behalf of Industry Canada. The purpose of the study is to provide small and medium-sized Canadian software companies with useful input to their marketing and distribution strategies. The primary focus of this report is on the US market, due to its importance to Canadian companies. In fact, reaching the US market is considered essential to the growth of Canadian software companies. Effective distribution strategies are an essential component of success in the US market. This report is designed to provide information and tools to help Canadian companies develop them. It identifies the trends affecting the distribution of software products in the United States and Canada to the year 2000, assesses their impact on the use and effectiveness of distribution channels, provides general strategies for success, and presents practical conclusions and recommendations.

The report is based upon in-depth literature reviews of relevant research, industry media coverage over the past year, and other relevant literature; personal interviews with representatives of software companies, channel organizations and industry associations in Canada and the US; and in-depth analysis by industry experts at the Branham Group and Channel Strategies.

### CURRENT USE OF CHANNELS

The key findings from the analysis and comparison of the use of software distribution channels by Canadian and US companies highlight the need for Canadian companies to diversify their channel strategies and to access the US market:

- There is still heavy reliance on direct sales as a channel among the smaller companies in both Canada and the US, despite clear evidence that more diverse strategies are more effective. The data shows that the larger and more successful the company, the more diverse and less reliant on direct sales is its channel strategy. The smaller US companies, however, have recognized the need to diversify and are more pro-active in their use of alternate channels than smaller Canadian companies. Canadian software companies must recognise that expansion into the US requires a multiple, indirect channel strategy, regardless of product type.
- Canada's most successful companies have penetrated the US market to such an extent that their revenues generated from the US market outweigh those generated from the Canadian market. Furthermore, the data proves that effective expansion to the US leads to significant revenue increases and greater penetration worldwide.

### OVERVIEW OF TRENDS

There are several changes occurring in market structure and in technology that are affecting the use and effectiveness of distribution channels:

- The software industry is maturing. This means that many product categories are mature, and profit margins are declining. As a result, developers must seek more cost-effective channels, with fewer intermediaries, while maintaining a healthy balance of direct vs. indirect sales.

- Electronic distribution is the newest “must-have” in the software industry and represents a great opportunity for smaller companies. Marketing and distributing products over the Internet is a cost-effective alternative to direct sales that increases sales and mind share, opens up new markets, and levels the playing field for competing against the major, brand name developers.
- Consolidation, both among channel organizations and among software developers, is re-shaping the industry. Smaller companies that could potentially compete against a Microsoft or a Lotus must instead identify niche markets, develop highly innovative products, pursue non-traditional and multiple channels, and/or consider selling their product or company to the “majors”.
- It is no secret that suites of software are all the rage: the market is now relying on three large companies that provide comprehensive suites of software to meet most of their needs - Novell; Microsoft; and Lotus. Smaller developers are thus forced to develop products which complement and interface with suites, develop niche-market products and/or suites, and ensure that their products have a similar look and feel to the major suites.
- Retail is becoming a more viable channel for more and more types of products, particularly in the US market, where a wide range of retail organizations of all types are selling enormous volumes of software. For companies seeking to have their products sold in this highly competitive channel, it is essential to invest dollars into marketing programs, and innovative advertising campaigns.
- The CD-ROM medium is used in a variety of ways both to package and sell software. Encrypted CDs that contain dozens of software programs from a variety of vendors, along with product and pricing information and demonstrations, can be useful sales and marketing tools for volume products, particularly in the home market.
- Bundling of software is an ongoing trend. Bundling is achieved in a variety of ways: hardware and standard software title combinations are pre-packaged for the consumer market; distributors pre-configure hardware and software solutions to-order for their outbound resellers; and software developers engage in bundling deals with other developers. Bundling is considered an effective sales and marketing tool, but it can play havoc on pricing and version control.
- Electronic Data Interchange (EDI) is expected to be heavily adopted by distributors, particularly for selling to their channels in the next year. With this increase in the use of EDI, it is expected that software developers will soon find it necessary to conduct transactions with some of their channels this way.
- With object-oriented technology, it is now possible to sell pieces of functionality instead of complete products. Currently, however no standards exist for distributing objects instead of complete packages, and channels have not been established for marketing objects as products.
- Operating systems may become even more pivotal, with the latest releases promising to offer unprecedented functionality and power. Obviously, this will have a tremendous impact for companies selling similar packages to those that are now included in the operating systems, either by reducing the need for them, or providing opportunities to sell (OEM) them to the operating system suppliers.
- Open sourcing is a major trend in the US software market, whereby resellers are able to purchase and return products to any distributor. Resellers are now more able to dictate to distributors what they sell and how much; while distributors put pressure on software developers to get what they need, when they need it.

- The shift from mainframe to client-server computing environments is changing the ways in which software is developed and distributed. By re-packaging complex products for this environment, many developers are now able to reach new markets and even develop new product lines, thereby opening up new distribution opportunities.
- Direct response channels, like telesales and catalogues, are growing in importance for many types of products. Telesales and catalogues are particularly important channels for fulfillment, after-market sales, upgrades, maintenance, and renewals, rather than first-time buys.

## STRATEGIES FOR SUCCESS

---

### Essentials for Planning an International Channel Expansion

In addition to considering the trends discussed in the previous section, planning an international channel expansion should first be focused. There are eight essential elements that should be considered to minimize risk and target the expansion to the most successful channels<sup>1</sup>. The elements are:

- *Customer Identification and Lead Profile:* Whether a software firm intends to establish direct field sales, electronic sales, or indirect sales channels for products, the firm must know the customer toward whom the channel will be directed.
- *Product Life Cycle Issues and Effect on Distribution:* The effectiveness of channels depends heavily on the stage of the product category in its life cycle.
- *Brand Recognition:* Brand recognition is an important purchasing criterion, especially in the US market. Establishing brand recognition must become a corporate priority, particularly for high volume, packaged and consumer oriented products.
- *Existing Channels You Currently Use:* Describe the functional capabilities of successful channels your company currently uses domestically, for the products you intend to sell in the US. Match the activities the existing channel performs against the capabilities of channels being considered.
- *Market and Niche or Vertical Opportunities:* Markets, niches, and the predominance of one or another vertical market are likely to vary widely by geography. Pay for good market research. Consider joint marketing projects with channel partners in the new geography to establish your brand in a niche market or user-intensive geographic region. For companies with horizontal markets, carve out a presence in a specific market segment, or seek out a partner with a secure position in the market.
- *Infrastructure Requirements and Resources Available:* Success with complex software in a new geography may require the establishment of a local support infrastructure. Determine the cost of providing the same support infrastructure elements you have in Canada. Balance these costs against the activities channel partners should conduct and those your company must conduct to optimize customer satisfaction.

---

<sup>1</sup> Information in this section follows the Channel Strategies channel development methodology and is excerpted from Channel Strategies Inc., *Channel Opportunity Analysis, Book 1, Investigation and Channel Rationalization*, 1994.

- *Macro-Economic Factors:* Overall economic trends in the proposed market should be studied. Are target markets growing, indicating an ability to spend? Are business conditions favorable in the region targeted for initial sales? Evaluate facilities requirements and build a cost profile of each city in which you plan offices. Pay for good market research
- *Marketing and Management Capabilities:* Marketing, technical support, and channel management, are key success factors. Each type of channel requires a specific set of channel marketing and management approaches.

## **The Most Effective Channels for the Future**

The matrices in this section summarize the most effective channels for packaged and complex software over the next five years.

### *Packaged Software*

The following matrix identifies the most effective channels for packaged, or horizontal application software. Some examples of packaged software include well-known office automation programs and packaged software tools and communications programs. The heading "high volume packaged" software includes games, educational, and home use software.

The following key applies to the matrix: + good channels  
 ++ better channels  
 +++fast growing channels  
 - channels less suited

### Channels for Packaged Software

| Channel                                     | High Vol. Packaged              | Office Automation                        | App Dev. Tools/Lang.               | DBMS                            | System/Utilities        | Network / Comm.              | Industry Apps.                           |
|---|---------------------------------|--|------------------------------------|---------------------------------|-------------------------|------------------------------|--|
| Retail, Super Store                         | Micro +++<br>Workstation (WS) + | Micro++<br>WS could be ++ in lg. markets | Micro ++                           | Micro +                         | Micro +                 | Micro +<br>LAN +             | Micro +                                  |
| Corporate SW Resellers (to large companies) | -                               | +++                                      | ++                                 | ++                              | ++                      | ++                           | -  |
| SW Specialty Retail Stores                  | +++                             | ++                                       | Micro+                             | Micro+                          | Micro+                  | Micro+                       | -  |
| Catalog (incl. electronic, paper, disk)     | +                               | +  | +++<br>directed to developers      | +                               | ++<br>esp. utilities    | +                            | +  |
| HDW vendor                                  | -                               | major accts. only                        | -                                  | -                               | + with system bundle    | ++with system sale or bundle | + with VAR/ISV partners                  |
| VAR sales force                             | -                               | +  | -                                  | +                               | + in turnkey offerings  | +                            | + will prefer more complex solution sale |
| SW publisher sales force                    | -                               | major accts.                             | major accts.                       | -                               | -                       | -                            | -  |
| Distributor to 2nd tier                     | ++                              | +++                                      | +                                  | Micro+<br>LAN+                  | +                       | ++<br>with systems           | -  |
| Electronic (AOL, Internet, C'Serve, etc.)   | ++                              | ++                                       | ++                                 | upgrade sales + and information |                         |                              | +  |
| SW OEM and suites                           | game, education suites +        | ++                                       | new opportunity for APP/DEV suites | +                               | +                       |                              | new opportunity                          |
| Telesales                                   | -                               | upgrades; follow on sales                | electronic will replace            | -                               | electronic will replace | -                            | with sales force                         |
| Book Stores                                 | ++                              |  |                                    |                                 |                         |                              |  |
| Office Products Stores                      | ++                              | ++                                       |                                    |                                 |                         |                              | Inexpensive templates for managers       |
| Integrator                                  | -                               | -  | -                                  | +                               | +                       | ++                           | -  |

Source: Channel Strategies, Inc. © 1995



## Complex Software

Complex software, and/or software oriented to vertical markets, typically requires integration with other software, installation and/or installation support by the vendor. Some "packaged" software is bought as if it were complex when widely deployed in a company and when it is integral to the operations of the company. An example of this use is a calendar program used for company calendaring and scheduling, adopted by the company as a "standard" program. In this table, "high volume packaged software" refers to this type of use.

Matrix key: + good channels, ++ better channels, +++ fast growing channels, - channels less suited

### Channels for Complex Software

| Channel   | High Vol. Packaged                    | Office Automation                      | App Dev. Tools/Lang.  | DBMS  | System         | Network/Comm.      | Industry Apps.  |
|---|---------------------------------------|--|---|---|----------------|--------------------|---|
| HDW vendor sales force  | Major Accts.                          | Major accts.                           | With Systems  | With Partners   | With system ++ | With systems ++    | With partners +   |
| VAR sales force   | Only if in a solution                 | ++ Especially Workgroup                | -   | ++  | + With systems | +++                | +++   |
| SW publisher sales force  | -                                     | Major accts.                           | Major accts.  | ++  | -              | +                  | ++  |
| Distributor to 2nd tier VARs, ISVs  | ++                                    | ++                                     | Micro +<br>WS +<br>LAN +<br>(see note below)                                      | Micro+  | +              | + with systems     | -   |
| Electronic marketing and download with integration support; especially to existing customers and upgrades | +<br>Growing use, especially upgrades | ++<br>Growing use, especially upgrades | ++<br>Growing use, especially upgrades and products understood by technical users | + upgrades and information<br>Within companies, electronic upgrades of networked software |                |                    | +<br>Growing use as marketing and delivery tool, but on-site integration usually required |
| OEM   | bundles                               | ++ esp. objects                        | no change   | +   | +              | ++                 | with partners   |
| Consultant  | in projects                           | ++ esp. Notes, workgroup               | with development projects   | ++  | +              | +                  | ++ with customization   |
| Telesales   | + to existing customers               | ++ upgrades; follow on sales           | +   | + in teams w/ sales force   | ++             | -                  | + in teams w/sales force  |
| Integrator  | in projects                           | +++                                    | -   | +   | +              | +++ especially CTI | ++  |
| Catalog (incl. electronic, paper, disk)   | ++                                    | +                                      | +++   | -   | -              | +                  | for existing customers; complementary products  |

Source: Channel Strategies, Inc. © 1995

## OVERALL CONCLUSIONS & RECOMMENDATIONS

---

The current Canadian distribution picture shows a heavy reliance on direct sales, and other traditional channels, particularly among smaller companies. If Canadian companies are serious about establishing a presence in the US market, they must become more innovative in their distribution channel strategies, and in how they view the market for their products. Indirect channels are becoming more viable even for specialized, niche-oriented products; and niche-oriented products can often find a home in broader markets through re-packaging.

It will be essential for Canadian companies to develop strong US distribution strategies using established methodologies, and combine this with a forward-thinking approach that incorporates market and technology trends, and the following suggestions on how to make the most of them:

- *Industry maturation will continue to impact distribution.* Innovative, adaptable multiple-channel strategies will be essential to success, by helping to reduce costs, gain mind share, achieve brand recognition and maximize coverage.
- *Reliance on direct sales is diminishing.* Direct sales should remain a component of the channel strategy, especially in product introduction stages and primarily for new product categories, but with decreasing importance over time. Now, more than ever, it is essential to achieve an appropriate balance between direct and indirect sales.
- *Electronic marketing and distribution are musts!* The Internet is quickly becoming a standard marketing and distribution tool. All software companies, regardless of product type or target market, should start now, by offering on-line product information, demonstrations, service and support, product ordering capabilities, and eventually full product distribution, including downloading and payment. This will be an important opportunity for smaller companies to generate sales and mind share at a low cost and will make it more feasible to compete with the major developers.
- *Consolidation will continue to put pressure on smaller companies.* Instead of competing against the major developers, smaller companies should pursue niche market opportunities, multiple and non-traditional channels, and relationships with the major developers. Companies must also make major investments in marketing, advertising and promotion.
- *The influence of, and demand for, software suites will increase.* The major suites have created high expectations in users. Smaller companies should avoid competing where software suites exist, but should investigate developing suites for niche areas. Smaller companies should also ensure that their products are capable of interfacing with the major suites.
- *The retail channel continues to play an important role.* Software companies should regularly assess the viability of the retail channel for their products, and think of ingenious ways to sell where people buy. Often, in order to break in, companies typically need the support of a major distributor, and this means a major and focused investment in planning, marketing and advertising. Another investment in informative and captivating packaging is essential.
- *CD-ROM and bundling offer less traditional distribution opportunities.* To further develop mind share, consider the "try and buy" CD, bundling products with hardware on a custom or pre-packaged basis, selling your software products or objects to other companies for inclusion or embedding in their solutions.

- *Shifts to client/server and object-oriented technology are changing the face of software development and distribution.* Software developers should always look ahead at new ways to package and distribute their products or components thereof. This ability to adapt and innovate will be essential as the market continues to mature, and the major players become further entrenched.
- *Products no longer need to be tied to single platforms and operating systems.* Developers should always consider how they can re-package existing products for new markets, platforms and operating systems. In so doing, you should always revise your channel strategies, and explore new channel opportunities.
- *Direct response channels are becoming more viable.* To remain competitive and achieve successful and cost-effective US distribution, companies must explore direct response channels, which are effective for more and more types of products, especially in the US.
- *There is an increasing opportunity to sell or license products to major players.* Companies should seriously consider selling or licensing their products to established players, and ask yourselves: "Would I rather be rich, or famous?" It may be more difficult to achieve the latter without a little of the former.
- *The US Market Consists of Several Smaller Markets.* Instead of approaching the US market as a larger version of Canada's, and copying your domestic distribution strategy, look at it regionally, and pay for some good market and channel research in the geographic regions you choose to target.

## INTRODUCTION

Canadian software companies are gaining recognition throughout the world as producers of high quality, leading edge products. Yet this recognition is still a far cry from what is deserved. Despite their proven excellence in software innovation and quality, on the whole Canadian software companies are not entrenched in the world-wide arena. The exceptions, like Corel Corporation, Cognos Inc., and Delrina Corporation, to name a few, have succeeded by moving beyond Canada's borders and making their mark in the global marketplace.

In fact, due to our relatively small local market, it is essential for Canadian software companies to effectively reach export markets, in order to achieve growth and acquire market share. While many of Canada's smaller software companies are still focusing on local markets, export markets typically account for well over 60% of product sales among Canada's larger and most successful software companies.

While a world-wide presence is the ultimate goal, the US market represents the most immediate and logical opportunity. Barriers related to language, trade, and standards are minimal compared, for example, to Europe and Asia. Furthermore, this market not only represents enormous revenue generating potential, it has a voice that is heard throughout the world. Products that are successful in the US typically have more chance to succeed elsewhere. Market acceptance of a product in the US means almost instant recognition worldwide. The strategic importance of the US market is fully understood in the Canadian industry, but what is less obvious is how to succeed and continue to succeed in it. One major challenge is to have in place effective distribution channels.

Between January and March, 1995, the Branham Group Inc. and Channel Strategies Inc. conducted a study of software products distribution trends on behalf of Industry Canada. The purpose of this study is to provide small and medium-sized Canadian software companies with useful input to their marketing and distribution strategies, by identifying the trends affecting the distribution of software products in the United States and Canada to the year 2000, assessing their impact on the use and effectiveness of distribution channels, developing strategies for success, and practical conclusions and recommendations. The results are based upon in-depth secondary research, interviews with representatives of software companies, channel organizations and industry associations in Canada and the US, as well as analysis by industry experts at the Branham Group and Channel Strategies. The primary focus of this report is on the US market, due to its importance to Canadian companies.

## CURRENT USE OF CHANNELS

This section describes the channels currently used by Canadian and US companies. For a description of technology focus categories, please refer to Appendix 5, Software Categories.

### THE CANADIAN PICTURE

The analysis of Canadian companies was based on the Branham500 database, Branham's database of the top 400 independent software, and top 100 professional IT services companies in Canada. The 400 software companies (companies generating more than 50% of their revenues from software products) were included in this analysis. Any companies that did not report specific information relevant to the analysis of channels were excluded.

### Channel Utilization by Company Size

Exhibit 1 represents the percent of the total number of companies in each size category that use each of the channels. It shows that regardless of size, most software companies employ multiple-channel strategies. Reliance on direct sales is still remarkably high, yet it is less significant for larger companies. The retail, system integrator/ consultant, and VAR channels are the strongest indirect channels in the distribution strategies of Canadian companies.

*Exhibit 1. Percent of Companies Using Each Channel By Company Size - Worldwide Channels*

| Company Size                | Direct | Retail | Whole-sale | Mfgs. Agent | OEM | SI/ Consulting | VAR | Other | # of Cos. |
|-----------------------------|--------|--------|------------|-------------|-----|----------------|-----|-------|-----------|
| Up to \$1,000,000           | 88%    | 23%    | 12%        | 8%          | 6%  | 22%            | 15% | 5%    | 65        |
| \$1000,001 to \$3,000,000   | 93%    | 21%    | 8%         | 13%         | 4%  | 18%            | 14% | 6%    | 101       |
| 3,000,001-\$5,000,000       | 90%    | 21%    | 5%         | 13%         | 8%  | 23%            | 15% | 8%    | 39        |
| \$5,000,001 to \$10,000,000 | 86%    | 19%    | 12%        | 19%         | 12% | 19%            | 19% | 5%    | 43        |
| \$10,000,0001-\$25,000,000  | 68%    | 11%    | 7%         | 4%          | 11% | 11%            | 11% | 7%    | 28        |
| \$25,000,001 - \$50,000,000 | 88%    | 13%    | 13%        | 13%         | 25% | 25%            | 13% | 0%    | 8         |
| Over \$50,000,000           | 75%    | 38%    | 13%        | 0%          | 13% | 0%             | 13% | 0%    | 8         |

Data reported for FY 1993-94. 292 Respondents - Multiple Channels Possible - Source: The Branham500 Database, Branham Group Inc. - March 1995

The Branham500 does not reflect sales generated through catalogues and telesales. This is primarily due to the fact that Canadian companies are not yet using these channels to any significant extent. The interviews conducted for this report indicated, however, that Canadian companies are now beginning to see the importance of these channels, and that we will see Canadian companies increasing their use of these channels over the next few years.

Company size was also analysed according to the percent of revenues generated by channel, as presented in Exhibit 2. The latter analysis shows the importance of reducing reliance on direct sales. Revenues generated through direct sales decreases dramatically as the size of company increases. While over 75% of revenues were generated from direct sales by companies with annual revenues of less than \$50 million, this figure was only 30% for companies generating annual revenues over \$50 million. While 75% of these large companies reported using direct sales as a component of their distribution strategy, direct sales represent only a small part of the overall model.

*Exhibit 2. Percent of Revenues Generated by Channel and Size of Company - Worldwide Channels:*

| Company Size                | Direct | In-direct: | Retail | Wholesale | Mfgs. Agent | OEM | SI/Cons. | VAR | Other | # of Cos. |
|-----------------------------|--------|------------|--------|-----------|-------------|-----|----------|-----|-------|-----------|
| Up to \$1,000,000           | 77%    | 23%        | 8%     | 5%        | 2%          | 1%  | 4%       | 2%  | 1%    | 65        |
| \$1000,001 to \$3,000,000   | 79%    | 21%        | 7%     | 1%        | 3%          | 1%  | 3%       | 6%  | 1%    | 101       |
| 3,000,001-\$5,000,000       | 72%    | 28%        | 7%     | 1%        | 4%          | 2%  | 5%       | 6%  | 2%    | 39        |
| \$5,000,001 to \$10,000,000 | 74%    | 27%        | 3%     | 6%        | 4%          | 3%  | 3%       | 5%  | 2%    | 43        |
| \$10,000,0001-\$25,000,000  | 77%    | 23%        | 5%     | 2%        | 1%          | 3%  | 2%       | 6%  | 6%    | 28        |
| \$25,000,001 - \$50,000,000 | 76%    | 24%        | 7%     | 1%        | 3%          | 4%  | 8%       | 1%  | 0%    | 8         |
| Over \$50,000,000           | 30%    | 70%        | 50%    | 5%        | 0%          | 8%  | 0%       | 8%  | 0%    | 8         |

Data reported for FY 1993-94. 292 Respondents - Source: The Branham500 Database, Branham Group Inc. - March 1995

Exhibit 2 also shows that half of all revenues generated by the largest companies come from the retail channel. This is not surprising, since most of these larger companies sell high volume, packaged products at least as one component of their product offerings. It also confirms the finding discussed later on, that the retail channel will only take a company seriously when it can show substantial revenues (greater than \$50 million). Clearly, it is important for Canadian companies to cross this chasm quickly.

### **Channel Utilization by Target Market**

Exhibit 3 shows the percentage of companies using each channel by the companies' target markets. It does not reveal any significant trends regarding channels employed for specific target markets, but does reconfirm the heavy reliance on direct sales.

*Exhibit 3. Percent of Companies Using Each Channel By Target Market - Worldwide Channels (1993-94)*

| Target Market                         | Direct | Retail | Wholesale | Mfgs. Agent | OEM | SI/ Consulting | VAR | Other | # of Cos. |
|---------------------------------------|--------|--------|-----------|-------------|-----|----------------|-----|-------|-----------|
| Resource Industry                     | 87%    | 13%    | 6%        | 9%          | 3%  | 16%            | 12% | 6%    | 77        |
| Mfg. & Processing                     | 85%    | 20%    | 7%        | 14%         | 9%  | 16%            | 17% | 7%    | 148       |
| Service                               | 86%    | 16%    | 6%        | 10%         | 5%  | 17%            | 9%  | 4%    | 187       |
| Professional Offices                  | 85%    | 17%    | 5%        | 10%         | 6%  | 21%            | 21% | 3%    | 86        |
| Government & Education                | 88%    | 20%    | 4%        | 9%          | 3%  | 19%            | 10% | 6%    | 137       |
| Other                                 | 77%    | 20%    | 10%       | 7%          | 10% | 13%            | 13% | 13%   | 30        |
| General, Not Specific To Any Industry | 88%    | 22%    | 11%       | 10%         | 9%  | 14%            | 16% | 6%    | 140       |

Data reported for FY 1993-94. 367 Respondents - Multiple Channels Possible - Source: The Branham500 Database, Branham Group Inc. - March 1995

Exhibit 4 provides the percentage of revenues generated by target market. It confirms the point that channels vary little by target market, and that direct sales account for a disproportionate amount of revenues.

*Exhibit 4. Percent of Companies Using Each Channel By Target Market - Worldwide Channels (1993-94)*

| Target Market                         | Direct | Indirect: | Retail | Wholesale | Mfgs. Agent | OEM | SI/ Consulting | VAR | Other |
|---------------------------------------|--------|-----------|--------|-----------|-------------|-----|----------------|-----|-------|
| Resource Industry                     | 78%    | 22%       | 7%     | 1%        | 3%          | 1%  | 4%             | 2%  | 3%    |
| Mfg. & Processing                     | 73%    | 27%       | 8%     | 2%        | 4%          | 2%  | 5%             | 5%  | 2%    |
| Service                               | 79%    | 21%       | 6%     | 2%        | 3%          | 1%  | 4%             | 5%  | 1%    |
| Professional Offices                  | 73%    | 27%       | 8%     | 1%        | 3%          | 1%  | 6%             | 8%  | 1%    |
| Government & Education                | 76%    | 24%       | 8%     | 2%        | 4%          | 1%  | 5%             | 3%  | 2%    |
| Other                                 | 70%    | 30%       | 7%     | 2%        | 3%          | 4%  | 4%             | 7%  | 4%    |
| General, Not Specific To Any Industry | 74%    | 26%       | 7%     | 4%        | 3%          | 2%  | 3%             | 5%  | 2%    |

Data reported for FY 1993-94. 367 Respondents - Source: The Branham500 Database, Branham Group Inc. - March 1995

## Channel Utilization by Technology Focus

Exhibit 5 represents the percent of companies that use each channel, by technology focus, or type of product. Note that companies that offer several categories of products did not differentiate channels by product type. This table again confirms the heavy use of the direct, VAR, SI and retail channels.

*Exhibit 5. Percent of Companies Using Each Channel By Technology Focus -Worldwide Channels*

| Technology Focus                            | Direct | Retail | Wholesale | Mfgs. Agent | OEM | SI/ Consultant | VAR | Other | # of Cos. |
|---|--------|--------|-----------|-------------|-----|----------------|-----|-------|-----------|
| OS and System                               | 85%    | 15%    | 4%        | 13%         | 8%  | 18%            | 12% | 9%    | 78        |
| Cross Industry Apps.                        | 86%    | 20%    | 6%        | 9%          | 4%  | 13%            | 12% | 5%    | 158       |
| Industry Apps.                              | 89%    | 16%    | 7%        | 10%         | 5%  | 16%            | 13% | 6%    | 152       |
| Application Development Tools and Languages | 86%    | 20%    | 9%        | 11%         | 10% | 16%            | 15% | 6%    | 147       |
| Communication and Networking                | 84%    | 19%    | 9%        | 9%          | 9%  | 18%            | 14% | 5%    | 102       |
| Database                                    | 90%    | 21%    | 5%        | 11%         | 7%  | 21%            | 13% | 5%    | 62        |
| Office Automation                           | 90%    | 16%    | 8%        | 8%          | 4%  | 16%            | 13% | 6%    | 214       |

Data reported for FY 1993-94. 367 Respondents - Multiple Channels Possible - Source: The Branham500 Database, Branham Group Inc. - March 1995

The analysis of percent of revenues generated by technology focus presented in Exhibit 6 shows that Canadian companies rely more heavily on direct sales for database and office automation products; and are more likely to employ some form of indirect channels for operating system and system software, and communications and networking products.

*Exhibit 6. Percent of Revenues Generated By Technology Focus - Worldwide Channels*

| Technology Focus                            | Direct | Indirect: | Retail | Wholesale | Mfgs. Agent | OEM | SI/ Consulting | VAR | Other |
|---|--------|-----------|--------|-----------|-------------|-----|----------------|-----|-------|
| OS and System                               | 74%    | 26%       | 7%     | 2%        | 4%          | 1%  | 5%             | 4%  | 3%    |
| Cross Industry Apps.                        | 77%    | 24%       | 8%     | 2%        | 4%          | 1%  | 4%             | 3%  | 1%    |
| Industry Apps.                              | 77%    | 23%       | 7%     | 2%        | 3%          | 1%  | 4%             | 5%  | 2%    |
| Application Development Tools and Languages | 76%    | 24%       | 7%     | 3%        | 3%          | 2%  | 4%             | 5%  | 2%    |
| Communications and Networking               | 74%    | 26%       | 6%     | 3%        | 3%          | 2%  | 6%             | 4%  | 3%    |
| Database                                    | 81%    | 19%       | 6%     | 0%        | 3%          | 1%  | 5%             | 4%  | 1%    |
| Office Automation                           | 80%    | 20%       | 5%     | 3%        | 1%          | 1%  | 4%             | 5%  | 1%    |

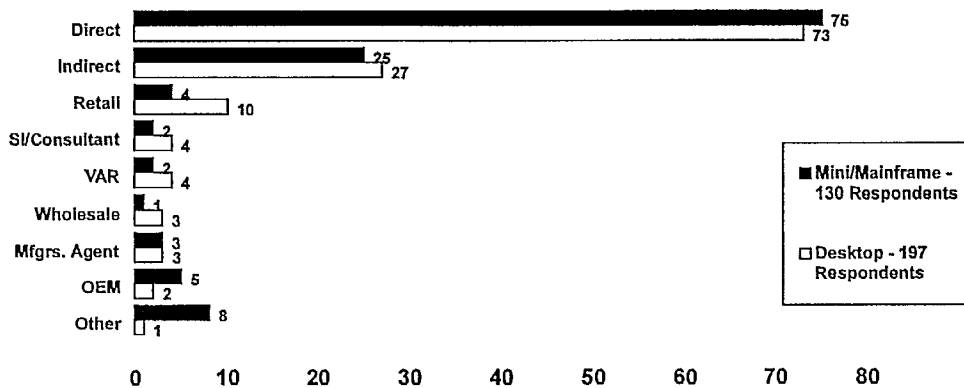
Data reported for FY 1993-94. 367 Respondents - Multiple Channels Possible - Source: The Branham500 Database, Branham Group Inc. - March 1995



### Channel Utilization by Platform

Exhibit 7 shows the channels used for desktop applications (Windows, Windows NT, MS DOS & MacOS) vs. mainframe and mini applications (UNIX, VMS, MVS, OS/2, etc.). To some extent, this also represents the respective difference between volume/horizontal and niche/vertical applications. The fact that the figures are very similar again confirms that Canadian companies in general are tied to direct sales regardless of product type or target market. It also shows higher use of the retail channel for desktop applications, and heavier use of value-added channels for high-end applications.

*Exhibit 7. Percent of Revenues Generated by Platform*



Data reported by FY 1993-1994 - Source: The Branham500 Database, Branham Group Inc. - March 1995

## Channel Utilization - A Geographic Comparison

The percent of Canadian companies using direct and indirect channels in Canada and the US is shown in Exhibit 8. Not surprisingly, this shows the use of indirect sales increasing by size of company, and demonstrates that indirect channels are relied upon more heavily for reaching the US market.

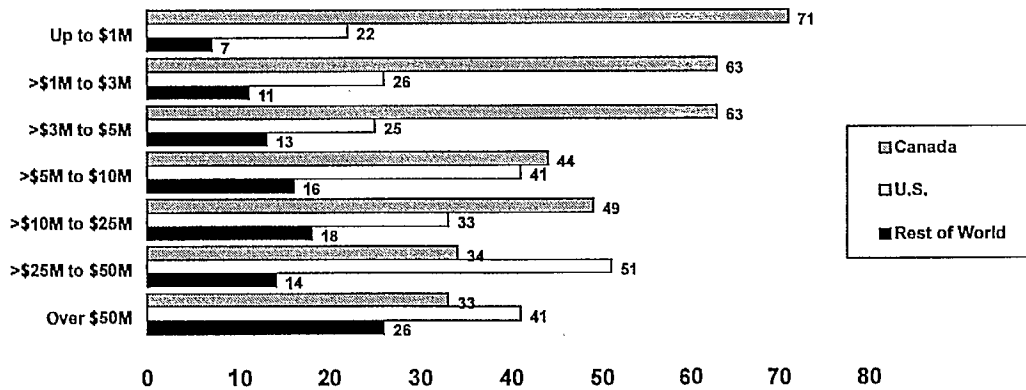
*Exhibit 8. Percent of Canadian Companies Using Direct Versus Indirect Channels, by Size of Company - Canadian and US Sales Channels Only*

| Company Size                | Canada |          | US     |          | # of Cos. |
|-----------------------------|--------|----------|--------|----------|-----------|
|                             | Direct | Indirect | Direct | Indirect |           |
| Up to \$1,000,000           | 91%    | 41%      | 85%    | 53%      | 65        |
| \$1,000,001 to \$3,000,000  | 96%    | 27%      | 90%    | 40%      | 101       |
| \$3,000,001-\$5,000,000     | 94%    | 35%      | 89%    | 50%      | 39        |
| \$5,000,001 to \$10,000,000 | 97%    | 34%      | 97%    | 44%      | 43        |
| \$10,000,001-\$25,000,000   | 86%    | 38%      | 94%    | 44%      | 28        |
| \$25,000,001 - \$50,000,000 | 100%   | 33%      | 100%   | 50%      | 8         |
| Over \$50,000,000           | 100%   | 67%      | 83%    | 83%      | 8         |

Data reported for FY 1993-94. 292 Respondents - includes percentage for Canada and US channels only, rest of world is excluded - Source: The Branham500 Database, Branham Group Inc. - March 1995

There is a definite positive correlation between revenue size and participation in export markets, as shown in Exhibit 9. This table presents the percentage of overall revenues generated, by size of company and geographic market. In fact, in Canada's largest software companies, the percent of revenues generated from the US market outweighs the percent generated from the Canadian market.

*Exhibit 9. Percent of Revenues Generated by Geographic Market and Size of Company*



Data reported for FY 1993-94, 292 Respondents - Source: The Branham500 Database, Branham Group Inc., March 1995

The chart also confirms the belief that increased penetration of the US market tends to lead to greater penetration worldwide, and lowered reliance on the Canadian market. These observations highlight the need for Canadian software developers of all sizes to penetrate the US market, and thus to establish effective US distribution channels.

## THE US PICTURE

To compile a similar picture of the use of distribution channels by US companies, a variety of sources were consulted. There is no equivalent to the Branham500 for US companies, and to gather such comprehensive information through primary research was beyond the scope of this project. Thus, the information presented below is a compilation of data from a variety of existing sources. Note that the revenue sizes for US companies do not match the sizes used for Canadian companies, to reflect the generally larger size of US companies. Note also that the channels presented here do not directly match the Canadian picture. This is because the primary channels used by US companies are slightly different than Canadian companies. In fact, some of the emerging channels used by US companies, such as electronic distribution, catalogue, and telesales are currently used by only a negligible number of Canadian companies. The latter point is an important finding and demonstrates the need for Canadian companies to diversify, expand, and exercise more innovation in, their distribution strategies.

## Channel Utilization by Company Size

As shown in Exhibit 10, direct sales are also a major channel for US companies, yet there is heavier utilization of alternative, indirect, channels. Smaller software companies tend to use the relatively inexpensive catalogue sales channel more heavily than larger companies. These smaller US companies, more than their Canadian counterparts, seem to recognise the relatively poor cost-performance of direct sales, and other more expensive channels, and use the most viable alternatives. It may also reflect that the catalogue channel is more effective in reaching US buyers at this time.

The largest companies can afford telesales, and use it heavily. In fact, Channel Strategies has found that there is a trend toward increasing use of telesales by all sizes of US companies. Software companies are now finding that as buyers become more technically savvy, they will buy all types of products from these channels - even expensive and complex products. The largest companies use VARs as often as telesales, and more than they use system integrators. Note that the Culpepper study quoted here had few retail-oriented respondents in the sample, and was focused on companies with more complex software.

*Exhibit 10. Percent of Companies Using Each Channel by Size of Company*

| Software Company Size (\$ US) | Direct | Tele-sales | VAR | SI  | Retail Dealer | Distributor | Electronic | Catalogue | Nat. Acct. | # of Cos. |
|-------------------------------|--------|------------|-----|-----|---------------|-------------|------------|-----------|------------|-----------|
| Up to \$3,000,000             | 80%    | 50%        | 25% | 25% | 0%            | 25%         | 0%         | 25%       | 50%        | 5         |
| \$3,000,001 to 10,000,000     | 90%    | 40%        | 44% | 60% | 10%           | 60%         | 10%        | 20%       | 44%        | 10        |
| \$10,000,001 to \$30,000,000  | 94%    | 50%        | 40% | 35% | 12%           | 53%         | 0%         | 6%        | 27%        | 18        |
| \$30,000,001 to \$100,000,000 | 100%   | 59%        | 67% | 56% | 7%            | 60%         | 7%         | 7%        | 50%        | 16        |
| Over \$100,000,000            | 100%   | 67%        | 67% | 33% | 0%            | 33%         | 33%        | 0%        | 33%        | 4         |

Source: "Software Marketing Practices", Culpepper and Associates, 1994

Although this data represents a relatively small sample size, based on additional literature reviews, results of the interviews conducted for this study, and our understanding of the marketplace, the authors consider it to accurately reflect the overall US situation for more complex software.

To further augment the data on complex systems presented above, we reviewed a 1994 survey of 1,096 microcomputer software companies for the report "A Current View of the Industry - 1994 Software Business Practices Survey" (Price Waterhouse, LLP). This study asked microcomputer (PC) software companies through what channels they were selling software. Exhibit 11 shows increasing percentages from each channel as the size of company increases. This confirms the finding from the Canadian Picture that shows that the more financially successful the company, the more diverse the channel strategy, and vice versa.

*Exhibit 11. Percent of Microcomputer Companies Distributing Software Through Various Channels, by Annual Revenues*

|                                 | Less than<br>\$1,000,000 | \$1,000,001 to<br>10,000,000 | More than<br>10,000,000 | Size not<br>Specified |
|---------------------------------|--------------------------|------------------------------|-------------------------|-----------------------|
| Computer Dealer                 | 17%                      | 22%                          | 25%                     | 25%                   |
| Mass Merchant                   | 7%                       | 9%                           | 18%                     | 6%                    |
| Software-only stores            | 10%                      | 14%                          | 23%                     | 7%                    |
| Superstores                     | 7%                       | 9%                           | 22%                     | 7%                    |
| Wholesalers                     | 9%                       | 13%                          | 23%                     | 4%                    |
| Direct Field Sales              | 55%                      | 65%                          | 81%                     | 64%                   |
| Direct Mail                     | 57%                      | 54%                          | 54%                     | 50%                   |
| Direct Response<br>Advertising  | 39%                      | 34%                          | 38%                     | 42%                   |
| In-house catalogue              | 7%                       | 9%                           | 11%                     | 11%                   |
| In-house telesales              | 25%                      | 36%                          | 47%                     | 25%                   |
| Outside reps                    | 21%                      | 26%                          | 19%                     | 21%                   |
| Hardware Manufacturers          | 8%                       | 14%                          | 20%                     | 11%                   |
| Independent Software<br>Vendors | 13%                      | 20%                          | 14%                     | 15%                   |
| Other OEMs                      | 10%                      | 13%                          | 19%                     | 8%                    |
| Reseller                        | 20%                      | 33%                          | 33%                     | 24%                   |
| System Integrators              | 15%                      | 21%                          | 25%                     | 19%                   |
| Other                           | 7%                       | 6%                           | 0%                      | 7%                    |
| # of Companies                  | 504                      | 276                          | 79                      | 72                    |

Source: "A Current View of the Industry: 1994 Software Business Practices Survey", Price Waterhouse, LLP

The table above still shows the heaviest reliance on direct sales, but this reliance is slightly less than for the vendors of more complex systems represented in the previous tables. Also of importance is the fact that direct mail, direct response advertising and telesales are very popular channels for US companies, which is distinctly different from the Canadian picture.

### **Channel Utilization by Technology Focus**

Exhibit 12 confirms that most software companies in the US still have a heavy dependence on direct sales if they sell complex applications and tools. Indirect channels are typically used in combination to field sales representatives (direct sales), with a very strong showing for telesales, VAR and System Integrator channels. National account sales forces and teams are common. Multiple sales channels are the norm.

*Exhibit 12. Percent of Companies Using Each Channel By Technology Focus*

| Technology Focus                            | Direct | Tele-sales | VAR  | SI  | Retail | Distributor | Electronic | Catalogue | Nat'l Acct. | # of Cos. |
|---|--------|------------|------|-----|--------|-------------|------------|-----------|-------------|-----------|
| OS and System                               | 100%   | 50%        | 100% | 50% | 25%    | 25%         | 25%        | 25%       | 50%         | 7         |
| Cross Industry Apps.                        | 100%   | 45%        | 60%  | 64% | 14%    | 14%         | 11%        | 15%       | 37%         | 30        |
| Industry Apps.                              | 94%    | 53%        | 25%  | 24% | 0%     | 0%          | 0%         | 6%        | 31%         | 28        |
| Application Development Tools and Languages | 71%    | 71%        | 50%  | 43% | 0%     | 0%          | 0%         | 0%        | 67%         | 10        |

Source: "Software Marketing Practices", Culpepper and Associates, 1994

### Channel Utilization by Price of Software

Exhibit 13 shows the channels used by price of software. It captures all software under \$10K in its lowest category, and reflects relatively complex software sales. It is interesting to note that 25% of the respondents who sell software that costs \$11 - 30,000 sell at least some of it via retail dealers. Note that electronic distribution is well-entrenched in the higher price categories. Also note very heavy usage of VAR and system integrator channels for products that cost up to \$30K. Virtually all respondents having products in the lower price categories use these indirect channels and fewer use direct field sales.

*Exhibit 13. Percent of Companies Using Channels by Average New Sales Size (Price of Software)*

| Average Price of Software - Average New Sales Size | Direct Field Sales | VAR  | SI   | Retail Dealer | Distributor | Electronic | Catalogue | National Account |
|--|--------------------|------|------|---------------|-------------|------------|-----------|------------------|
| Up to \$10,000                                     | 67%                | 100% | 100% | 33%           | 67%         | 0%         | 33%       | 50%              |
| \$11,000 to \$30,000                               | 88%                | 33%  | 13%  | 25%           | 50%         | 17%        | 33%       | 50%              |
| \$31,000 to \$100,000                              | 94%                | 71%  | 71%  | 6%            | 88%         | 6%         | 13%       | 50%              |
| \$101,000 to \$300,000                             | 100%               | 36%  | 42%  | 0%            | 42%         | 0%         | 0%        | 18%              |
| Over \$300,000                                     | 100%               | 33%  | 22%  | 0%            | 11%         | 11%        | 0%        | 44%              |

Source: "Software Marketing Practices", Culpepper and Associates, 1994

To further augment this data, particularly for lower-priced software, we consulted the results of the personal interviews that were conducted for this study. Although this was not a representative sample, the data showed some definite trends by price of software:

- For software under \$100, diverse multiple-channel strategies were employed. These were characterised by master distributors, retail, catalogues, mail order, telesales and OEM channels. Direct sales were also employed to sell to specific markets, like the government sector, but were considered a declining channel.
- For software between \$100 and \$500, multiple channels were again a key element of the strategy. Mass retail came out as the major channel, along with (necessarily) master distributors. VARs, OEM, telesales, catalogues and direct mail were also important channels. Direct selling still plays a role in

most organizations, but again, there is a conscious decrease in reliance on this channel.

- For software from \$500 to \$5,000, there is a definite reliance on value-added channels such as VARs and system integrators, as well as direct sales. Some respondents selling products in this price range indicated that their products were too complex for indirect sales.
- For products over \$5,000, there was a much heavier reliance on direct sales and the system integrator channel.
- In general, there was a heavier reliance on direct sales for niche-oriented and complex products, yet even companies in these areas were using or looking for more cost-effective channels.

The interview data shows that, the more complex and high-priced the software, the more focused and value-added-oriented a company is in its choice of channels. On the other hand, lower-priced, and less complex software lends itself to a more diverse channel strategy, with less need to rely on value-added channels and direct sales.

### Buyer Preferences

One challenge for software companies is to target their usage of channels to those that will actually be used by buyers. Exhibit 14, from a 1993 IDG report entitled "Buying IT in the 90's", examines buyer preferences for products at the PC, Notebook PC, printer, application software, and LAN Level. Buyers did not discriminate between VARs and System Integrators.

#### Exhibit 14. Percentage of Buyers Who Prefer Various PC and LAN Software Channels

(a) If All Channels Offered Same Brands

(b) If All Channels Offered Same Brands at Same Price

| Class of Software Being Purchased<br>Buyer Preference | Developer Sales Staff (direct) | Catalogue or Mail Order | VAR  | Retail Dealer | Retail Superstore | Office Supply/warehouse Clubs | Consumer Electronics | Software Specialty Stores |
|---|--------------------------------|-------------------------|------|---------------|-------------------|-------------------------------|----------------------|---------------------------|
| Application Software                                  |                                |                         |      |               |                   |                               |                      |                           |
| a)  | 16%                            | 24%                     | 10%  | 10%           | 11%               | 6%                            | 1%                   | 23%                       |
| b)  | 18%                            | 19%                     | 13%  | 13%           | 10%               | 5%                            | 0%                   | 22%                       |
| Communications and Networking LANs Only               |                                |                         |      |               |                   |                               |                      |                           |
| a)  | 28%                            | 12%                     | 30 % | 17%           | 7%                | 3%                            | 2%                   | 1%                        |
| b)  | 32%                            | 10%                     | 30 % | 18%           | 6%                | 1%                            | 1%                   | 2%                        |

Source: International Data Group - "Buying IT in the 90's", January, 1993

Note that buyers would move to more traditional and value-added channels, such as direct sales staff, VARs, and retail dealers if the price were equal in all channels. This shows that buyers believe that they receive more benefit from these channels, but are not necessarily willing to pay for it.

## OVERVIEW OF TRENDS

A company needs to plan its channel development as a business development activity, using the best information, a clear strategy, and the best minds in the company. Industry trends must be assessed and integrated into this overall strategy. Current trends related to market structure and technology advancements that will affect the use and effectiveness of software distribution channels over the next 5 years are summarized in this section.

### 1. THE SOFTWARE INDUSTRY COMES OF AGE

---

It is essential first to understand the current stage of development of the software industry in general, in order to establish an overall context for the trends identified.

In short, the software industry is coming of age, particularly in the US, and is therefore subject to the normal changes affecting any maturing industry. This means that channels are in place which provide product and service distribution. Companies have established marketing approaches and methods of communicating with customers. There are known ways to provide support and services, and there are well-established trade shows, magazines, trade journals, and outlets for information. There are professional sales forces, coordinated programs for marketing, sales, and post-sale support, and organizational systems and infrastructure to manage companies. From this standpoint, Canadian companies entering the US market will find many elements of physical distribution, marketing, and sales to be mature.

On the other hand, by the nature of the software business, and the innovation that drives it, some specific technology segments are far from mature. The stage of a product category in its life cycle, which is discussed in the section entitled Essentials for Planning a Channel Expansion, will affect how a company approaches the maturing infrastructure of the industry and whether the existing structures must be augmented or changed to meet the needs of products depending on their stages of life.

#### Impacts of maturation

As an industry matures, the following impacts occur, and US software distribution is no exception:

- Vendors remove intermediaries from their channels to try to conserve margins, as all prices for a class of technology tend to decrease over time. This margin conservation effort causes vendors to rely on lower cost, more direct channels to their customers (not to be confused with a direct sales force). In our industry, the most obvious result has been an increase in direct marketing, telesales, catalogue, and electronic channels.
- Intermediaries, such as distributors, try to differentiate themselves by adding services so they will not lose favored vendors' products, and frequently offer a "menu" approach of products, services, and marketing support to their downstream resellers. Distributors may take on two or more business models. One model is a broad line, extensive inventory approach, such as the approach of Ingram Micro. Another model is a service and specialty differentiated approach, employed by companies like Access Graphics. A new trend, the independent sales agent model, offers another way of differentiating to hold both reseller and vendor loyalty.
- Price erosion, across all classes of products, results when more and more buyers become more educated



and familiar with products, and no longer value service differentiators. Buyers will purchase products previously considered complex from retail channels, telesales, catalogues and electronic services.

- Niche providers seek ever-narrower customer segments in which they can dominate. This can be an important factor for companies seeking US penetration.
- All vendors and channel companies seek to lower costs to preserve margins in a generally more price sensitive marketplace. They find that customers are willing to pay high prices for only the most innovative, complex, and leading edge solutions to their problems. This drives vendors to seek lower cost channels, more joint marketing to leverage their partners' investments, and OEM agreements in which a vendor is willing to forego brand recognition in order to gain immediate access to markets at a lower capital cost. Vendors who have sold primarily through direct sales forces must question the value of that sales force when prices no longer can support the involvement of a high-priced sales person. In fact, almost all of the software developers interviewed for this study indicated that they were actively reducing their reliance on direct sales. Pressures to change or augment channels to lower cost can be significant, and yet software companies know they must balance both direct and indirect sales to meet their cost objectives while retaining customer loyalty.

## 2. THE NEW WAVE: ELECTRONIC DISTRIBUTION

---

Electronic distribution is the hot topic in the distribution channel arena. It is the newest "must-have" for software companies. Much of the latest media literature covering software distribution issues relates to this emerging method of distribution. The companies interviewed for this report agree: marketing and distributing products over the Internet or bulletin board systems is a great opportunity for increasing sales and mind share, and opening up new markets. Furthermore, unlike the retail channel and CD-ROM distribution, electronic media are seen as having widespread applicability to all types of niche/vertical and volume/horizontal products.

The use of electronic media is rapidly evolving. Although a large proportion of software developers are leveraging this medium, most are still using it mainly as a marketing tool, to inform users, demonstrate their products, and to provide on-line service and support. Software developers are gaining mind share and reaching new markets by taking part in electronic malls, and World Wide Web "Home Pages" on the Internet. Cyberspace Corp. has even opened a software superstore, entitled software.net, a World Wide Web page offering more than 8,000 software titles from a variety of publishers. This superstore provides product information, demonstrations, reviews, on-line support and, in some cases, full on-line distribution.

Still only a small proportion of companies using the Internet as a sales and marketing tool are actually distributing their products electronically, for buyers to download directly onto their systems. This is simply because the infrastructure is not sufficiently developed to allow for efficient downloading and payment transaction (it can cost the buyer more in on-line per minute charges to download the package than the actual price of the package). It is more common for product upgrades to be distributed electronically.

Most commonly, buyers order products over the Internet, and the shrink-wrapped products are then drop-shipped to the customer, with payment made either by mail, or by credit card over the telephone or on-line. Buyers are still shy about providing their credit card number on-line. Software developers, however, are now partnering with banks and credit card companies to make true electronic distribution and money exchange possible. Such infrastructure advancements will result in an increase in the amount of software distributed electronically in the near future.

In addition, some new companies such as Open Market, are offering turnkey services to assist manufacturers of all kinds to distribute their products over the Internet.

Distributors are somewhat threatened by the advent of the Internet as a distribution channel. It is seen as having potential to reduce the need for their services. Distributors are actively seeking ways to turn this threat into an opportunity, by identifying services they may be able to offer through this medium.

### Impacts of Electronic Distribution

- Like most emerging opportunities in this industry, electronic marketing, and eventually distribution are predicted to become "must-haves" in the very near future. Companies that don't at least market using this medium will quickly lose their footing. Some products, particularly complex products requiring extensive customization, are not suitable for on-line distribution, but this does not prohibit developers from providing on-line product information, demonstrations, service, and support. The good news is that companies using this method are finding it highly cost-effective, despite some initial infrastructure challenges.
- It is expected that electronic distribution will alleviate some of the problems that smaller companies have encountered by not being able to engage indirect channels. It will serve as a cost-effective alternative to direct sales, to which many companies are now bound. When implemented effectively, the sales and mind share generated from this channel will help in attracting other channels.
- Distributors are seeing electronic distribution as a potential threat to their business, eliminating the need for them in some cases. We will see distributors finding innovative ways to enhance their services through this medium. The potential benefit to developers is that they may soon find themselves gaining back some power over the distributor.
- Currently, electronic media are more effective for marketing and mind-share than distribution and sales, but this is expected to change quickly, as the infrastructure evolves.
- Companies must learn how to market over the Internet, as this is a new medium with tremendous potential. Standard marketing approaches and product literature will not suffice on this interactive medium. Information must be presented in highly innovative, and visually impactful ways, without being so memory intensive as to impact speed of delivery. Software developers must devote solid marketing talent to devise ways of differentiating and drawing attention to themselves, as the medium will soon be clogged by competitors.
- Users employ this medium to access all kinds of corporate information, not just for product information. Companies should be prepared to provide all publicly available corporate information via this medium.
- Security of financial transactions is still an issue that must be overcome. Even as this medium becomes more secure for financial transactions, it will take much convincing for buyers to believe this. It will be important for suppliers to continue to offer alternatives to on-line transactions.
- Many developers are concerned about increased potential for software piracy. New methods of registering and protecting software must be developed.
- Since there is no tangible deliverable, this method of distribution is playing havoc with product pricing. It will be essential for the industry to develop pricing standards. In the US, the Software Publishers' Association (SPA) and the Information Technology Association of America (ITAA) are two associations whose members are addressing this issue.
- Vendors' systems are not typically set up to deal with associated licensing issues, transaction recording, and the potential flood of inquiries and orders. Developers must be prepared to respond to exponential

increases in calls and orders that may occur at any time of the day or night.

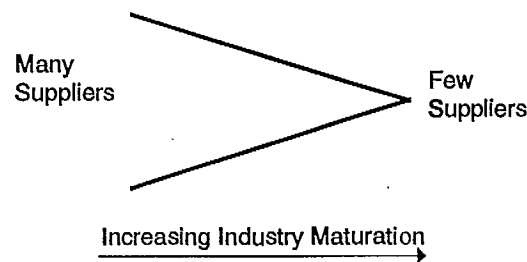
- It is difficult and time consuming to download software programs due to the size of files. This can add cost to the buyer because of on-line per minute charges. It is unlikely that this will remain a major deterrent as technology advancements are made, and people generally become more savvy with this medium.
- A key use of Internet and other on-line services will be to support channel partners with on-line distribution, information and services.
- The underlying message is to move quickly but carefully into this medium. Start by using it as a marketing and support tool, and eventually evolve toward distribution. It is important to ensure that the corporate infrastructure is in place to respond to inquiries and orders, or this could become a liability rather than an asset.

### 3. CONSOLIDATION EVERYWHERE

---

Everywhere we look in the software industry, we are reading and hearing about mergers and acquisitions. Consolidation is happening both among channel organizations and among software developers themselves. Recent acquisitions in the distribution arena include Merisel's acquisition of Computerland's franchise & distribution business, and Tech Data's purchase of Software Resource Inc. On the developers' front, one of the most significant examples of consolidation is Novell's acquisition of WordPerfect. This flurry of activity signals an overall re-structuring of the industry primarily caused by the declining prices and shrinking profits typical of a maturing industry.

As a result of this ongoing consolidation, the industry is moving from a position of many suppliers (software developers and distribution channels), to a few larger ones:



Consolidation is a way for both software developers and channel organizations (major distributors in particular) to buy markets and expand their capabilities, either from a service and support, or a technology/ product perspective. Software developers can now buy a company, technology, or rights to a specific product, rather than create it in-house. This means that major software companies, like Novell, Microsoft and Lotus are achieving dominance by offering broader sets of products or integrated sets of products; while major distributors are flexing their muscles by buying customers, expertise and partners. Some smaller distributors are being edged out or must become sub-distributors to the larger ones. In short, it is re-shaping the industry.

## Impact of Consolidation of Software Developers

- It is more and more difficult, and potentially futile, to compete against the major developers, particularly for standard software packages. Smaller companies with products that could potentially compete against a Microsoft or a Lotus must identify niche markets, highly innovative products, or non-traditional and multiple channels to gain recognition.
- Another option is to sell the product or company to these "majors". This is seen by some companies as an opportunity to generate the cash flow needed to develop mind share and future products. On the negative side, others view it as a way of allowing someone else to get the credit for their innovations.
- Smaller companies will have fewer options for distributing against competitors. As these majors become more and more entrenched in the industry, they will have more power over the channel. While the majors can pick and choose their channels, smaller companies with lesser known products struggle for position. Again, non-traditional channels must be explored.

## Impact of Channel Consolidation

- There is a marked increase in competition among distributors. The major distributors are seeking new ways to differentiate themselves. Since rock-bottom pricing has become standard, and there is very little room to move on margins, some distributors are differentiating by increasing and innovating their services and support. With the need for differentiation and decreasing margins, it is generally expected that there will be some losers among the major distributors, and only a few will remain in the next 5 years, compounding the impacts of consolidation.
- Product pricing is a major focus for distributors, forcing developers to cut prices and introduce rebating schemes, which affects their profitability.
- Large distributors have increasing power over smaller software developers. Large distributors dictate whether, where, when and how a smaller company's product is distributed. Lesser known companies are finding relations with distributors increasingly difficult.
- Brand recognition is becoming a requirement in order for the distributor to carry a product. Distributors will make exception and take on an unknown product, but it must either be of unparalleled quality, be highly innovative, or must address a need that has not yet been addressed by another software product, and have significant market potential.
- Regardless of the size of the developer, the product quality or level of innovation, a significant investment in product marketing and advertising is required in order to be taken seriously by major distributors.

## 4. BITTER SUITE?

---

It is no secret that suites of software are all the rage. Buying an integrated set of software packages is convenient and cost-effective for software buyers. Effectively, the market is now relying on three large companies that provide comprehensive suites of software to meet most of their needs: Novell (Perfect Office); Microsoft (Microsoft Office); and Lotus (SmartSuite). Furthermore, many of the organizations interviewed for this report indicated that they are at least investigating the potential for developing suites of software in their niche markets. Thus suites are no longer limited to standard functionality like word processing, spreadsheet, and presentation tools, but are beginning to affect all areas of software development.

## Impacts of Software Suites

- Smaller companies see software suites as a way for the larger, brand name companies to reduce their competition. This trend is essentially another form of consolidation in the industry, and is putting further pressure on the lesser-knowns, and increasing the dominance of a few.
- These highly integrated and highly functional products are raising the bar in the industry, with the leaders setting users expectations at a level that smaller developers find hard to match.
- Smaller developers are thus forced to focus on niche-market products and/or products which complement rather than compete with suite products.
- Smaller companies should ensure that their products are capable of interfacing with the major suites. A consistent interface with similar menu structures and icons in the same places in each component of the program will also be major selling features.
- Smaller companies developing suites for niche markets must expend much of their development efforts on making the suite look and feel as seamless and integrated as the mainstream suites. Buyers expect this integration, regardless of, and in addition to, power, quality and functionality. Again, such suites should handle the interface in the same way as the mainstream suites, leveraging a formula that works, and that users demand.
- Again, there is some potential for companies to sell their products, or components thereof, to these large software corporations for inclusion in their software suites. This is a means of generating cash flow.
- Smaller companies must adopt strategies which emphasize multiple channels, to maximize penetration and mind share.
- Smaller companies must clearly define market size and opportunity and develop rational, targeted, yet broad-sweeping channel strategies.

## 5. RETAIL - STILL AN IMPORTANT CHANNEL

---

As the industry matures, and buyers become more knowledgeable about technology, retail is becoming a more viable channel for more and more types of products. While retail is still primarily a channel for packaged, high volume products, some forms of retail will become appropriate for niche-oriented products in the future. Retail is particularly prevalent in the US market, where traditional computer dealers, corporate resellers, computer superstores, software specialty retail stores, and even department stores and discount stores are selling enormous volumes of software. In Canada, retail is taking off in a similar way and only slightly more slowly, but on a smaller scale: the main difference is the size of the stores and the volume of products being sold. The overall impacts are the same in both countries, but will occur slightly later in Canada.

Most retail stores that sell software limit themselves to only a few brands and products, and brand recognition is essential in this channel. Some US stores will only sell products listed in the Software Publisher's Associations Top 50 selling software products - products that will sell several thousands of units per store per week. This leads to a vicious cycle, where only the top selling products will be represented.

There is an increasing trend in the software industry to sell where people want to buy, and not just where they want to buy software, but where they want to shop in general. The industry no longer dictates where

software is sold - the people buying it do. Thus, while technology super-stores, like Fry's are major players, especially in the US; non-technology retail outlets, like bookstores, toy stores, and department stores (Sears, Walmart) are also becoming serious software channels.

In retail, the focus is on the mass market. Merchandising is the key to success and the ability of the developer to create market demand drives interest in products from the channel. The retail channel buys largely through distributors or aggregators. Distribution likes to see at least \$25,000 per month sold per title, so the cost of creating demand is high, especially when the number of retail stores may be large. Participating in a marketing campaign through a superstore like CompUSA can require tens of thousands of dollars for a company-wide promotion. Distributors want sure sales. Distributors are becoming more important in selling to resellers because they are taking on the role of merchandiser. Many retail buyers defer to the distributor for choices of titles to stock, and distributors offer this advice as a service.

Developers selling through retail need well conceived merchandising plans. They must also pay for good packaging, point of purchase displays, in-store signage, and promotions, understand the price points, develop detailed marketing plans, market to the resellers, and continue to help keep the product moving.

Following are some of the characteristics affecting the retail channel:

- In the superstore, and non-technology focused store formats, sales staff are not typically trained in technology.
- Consumers are increasingly more computer literate, but at the same time, are less technically competent than typical business buyers.
- Major distributors have significant impact on what products are sold in this channel. Distributors are the main supplier to this channel.
- Retailers are installing wireless point-of-sale systems, for quick access to technical product information, to enhance speed and level of customer service.
- For high volume, packaged software, purchasing criteria begin with brand, then price, then channel. Once they make their general product decision, consumers more than any other group base their choice on price

### **Impacts of Changes in the Retail Channel**

- Pricing is a key decision-making factor for products sold in this channel, and thus developers are continually forced to reduce price and introduce rebating schemes. This affects profit margins. Product differentiation is therefore critical in order to justify higher product costs.
- Due to the nature of mass retail outlets, and the lack of technically trained staff, product packaging must be emphasized. Packages must be highly informative because the box is essentially giving the sales pitch.
- Also, many distributors and retailers are introducing strict limitations as to the size and dimensions of product packages, to ensure that they conform to the retail space. Developers must conform to these standards.
- For companies seeking to have their products sold through a retail channel, it is essential to invest dollars into educating the market through marketing programs, and innovative advertising campaigns to create pull. Distributors demand this investment because they understand that people insist upon recognised products with known brand names.

- Product returns are increasing due to the less savvy sales forces and the fact that, although customers are more educated and comfortable with technology than ever before, they still lack in-depth knowledge. They often find that the product they purchased was not what they expected, or is not compatible with their system. These high levels of product returns are negatively impacting both distributors and developers, who must incur the cost of returns. Many vendors have expressed concerns about piracy, since customers could copy the software before returning it to the retail outlet.
- There is a general perception that it is less expensive to buy from superstores rather than boutiques, but this is not always the case. Some specialty shops are negatively impacted because buyers go to them for product and technical information, and then make their purchase where they perceive the price to be cheaper. Independent software retailers (boutiques) are losing out to mass retailers and are struggling to find differentiating elements.
- While retail is still primarily a channel for packaged, high volume products, companies with other types of niche products must continually monitor its applicability for their products in the future, and break into this channel when the time is right.
- As large mass retailers such as Sears become increasingly involved in the sale of software, they will begin to look for products to license under a private brand label, much in the same way they do with household appliances.
- As electronic distribution begins to take hold, the viability of the retail channel will be threatened. Out of necessity, the retail channel will become more service and support oriented, and will offer a more diverse portfolio of products.
- Companies entering the US market may want to leverage the brand recognition of an established US developer. While most Canadian developers ultimately want to publish their "own" brand in the US, cash flow can be substantial from products that can be re-branded or bundled with the products of an established partner. This type of early-entry can fund a later entry for the developer's own brand of product, and act as a testimonial to attract resellers.

## 6. THE CD-ROM APPROACH

---

The CD-ROM medium is used in a variety of ways both to package and sell software. For example, companies like Softbank, a CD distributor, produce encrypted CDs that contain dozens of software programs from a variety of vendors, along with product and pricing information and demonstrations. Although arrangements vary, developers typically pay the CD distributor for space on the CD, and users either pay a nominal fee or are provided the encrypted CD free of charge. The user simply accesses the demos and when they decide which products they wish to purchase, call the vendor to make a credit card transaction, and receive a key to "unlock" the chosen programs. Similarly, some larger developers are producing encrypted CDs of complete lines of products, that operate under the same premise as the multiple-vendor CD, but focus on a single vendor's products. Other examples include:

- CD clubs, like KidSoft Inc., a software club and magazine combination that provides over 30 interactive demos of popular titles for children, on a quarterly basis for an annual membership fee of less than \$30; and
- CD-ROM shareware collections, that provide access to thousands of free or low-cost software programs, with a wide range of applications, for under \$100.

Commonly called "try and buy", this distribution method is still being tested, and remains to be proven as an effective distribution method. Although it is theoretically an excellent way for developers to increase product visibility, and for buyers to test products at their leisure, the penetration of CD-ROM drives may still be too low to make the encrypted CD a great success in the short term. This method is not considered viable for complex products, but may have applicability in less complex niche products.

CD-ROM is also being used by software developers to package one or more of their software products, including the product documentation. It is a more convenient packaging method than multiple diskettes, as only one CD is required. There have been mixed reviews about providing product documentation in this format, as users tend to prefer having access to a hard copy manual, but it is otherwise considered a convenient packaging method.

### Impacts of CD-ROM

- "Try and buy" is one way of getting around the lack of technically trained staff at mass retail outlets, since it allows users to personally conduct a detailed review of the product.
- The success of the encrypted CD depends on a variety of factors, including the increased adoption of CD players. Developers considering this method should identify whether it is suitable for reaching their specific target market.
- Home computer users are more likely to have a CD-ROM drive on their PCs, than office workers.
- If it takes off, the "try and buy" CD is expected to reduce the proportion of returns at the retail site, and therefore costs to developers and distributors.
- There is still room for innovation in this area. No clear leader in CD-ROM distribution has emerged. Software developers should contact companies that offer CD distribution services to determine the viability for their products.
- Developers employing this method must ensure that they implement the appropriate fulfillment infrastructure. They may experience a rapid increase in product orders, and since many of these CDs target home users, a large proportion of these orders may occur outside of normal office hours. Staff, production and shipping systems must be capable of handling these issues.
- As a packaging medium, the CD is practical, convenient and cost-effective but again, not all users possess CD-ROM players, so it is important to assess the demand for this format, and continue to offer diskette packaging in addition to the CD format.

## 7. BUNDLING UP

---

Experiences related to the bundling of software titles into hardware have received mixed reviews. Methods of bundling vary. In the consumer market, standard software titles, operating systems and games are pre-configured into personal computers, to make them more attractive to the buyer. In this scenario, bundling is seen as a low-cost marketing tool, that helps build product mind share.

Many software developers are pursuing bundling deals with other developers, a variation on the OEM model. In fact, the majority of respondents to the interviews indicated that technology integration alliances will be a critical success factor and key business focus over the next 5 years. One company that has successfully implemented the bundling model is Eicon Technology of Montreal. Eicon provides Microsoft



BackOffice support with its WAN Services for Windows NT product. BackOffice bundles SNA Server, Windows NT Server, Systems Management Server, SQL Server and Exchange Server.

In the business market, distributors are pre-configuring hardware and software solutions to order, on behalf of outbound resellers. Resellers provide the technical advice to buyers, and once a decision is made, they simply place the order with their distributor. The distributor drop-ships the configured system directly to the customer. In this scenario, the need for warehousing at the reseller site is essentially eliminated. For example, SynOptics Communications Inc.'s LattisEngine Solution Partner Program incorporates several applications, communications and network management program developers (including Lotus, Intel, Oracle, Eicon and Sync Research). These developers' products are integrated and configured by value-added distributors who bundle customized packages for customers.

### **Impacts of Software/ Hardware Bundling**

- Some criticism of bundling in the consumer market has emerged of late, with accusations of vendors bundling in software products that don't sell well, and that users don't really want on their hardware. This may become a less popular feature to buyers in the future and developers should consider this before jumping into consumer-oriented bundling deals. This may lead to an increase in demand for build-to-order systems rather than bundling in advance of the purchase.
- Build-to-order programs for the desktop market are a popular means of reducing reseller inventories. In some cases, resellers may not have to touch products. They will provide customer sales advice, service and support, while the distributors will take the orders from resellers, configure the systems and directly drop-ship to the buyer.
- Bundling is a useful way for software manufacturers to build mind share, but it can bring rise to pricing conflicts. It is essential for software developers to carefully manage pricing models to avoid undercutting channels.
- Although bundling reduces the value of the sale of the first package, manufacturers and resellers will generate revenues from selling licenses and product upgrades.
- Bundling/ technology integration can cause other headaches related to new version releases. It is difficult to coordinate new version development and release among several players, thereby creating a wide range of technical concerns.
- Bundling requires strong account management. Build-to-order bundling will likely lead to increased use of EDI to coordinate data among the players.
- Software to software bundling integration can be an important strategy for some product types more than others. It is particularly effective for products designed to support or extend applications. For example, connectivity software, as shown in the Eicon case, presents a logical bundling opportunity. Companies should assess the opportunities for bundling based on their specific products, and aggressively pursue appropriate partners.

## **8. MAKING USE OF EDI**

---

Electronic Data Interchange (EDI) certainly has its place in software distribution. EDI is used to complete business transactions, allowing for the electronic transmission of business data between trading partners, such as suppliers and purchasers. In the software industry, EDI is expected to be heavily adopted by distributors, particularly for selling to their channels in the next year.

For example, Merisel announced the formation of the Information Company, a distribution entity which will provide a variety of interactive/real-time EDI services. In fact, most of the major distributors will deliver on-line ordering and information services to resellers, to cut sales costs, secure customer loyalty and provide yet another information vehicle. Some of the features offered by distributors systems include the ability for resellers to select products, obtain pricing information, build purchase orders, check warehouse inventory, create catalogues, generate electronic forms, track order-shipments and return merchandise authorization request forms. Distributors plan to continue to roll out new systems that will give the resellers instant access to a variety of information as well as allow them to look into distributor's warehouses.

With this increase in the use of EDI, it is expected that software developers will soon find it necessary to conduct transactions with their channels this way, particularly those dealing with the large distributors.

### **Impacts of EDI**

- EDI will be used increasingly to conduct software transactions. This will begin with transactions between major distributors and their resellers, but will eventually become pervasive throughout the industry to include developers.
- The use of EDI helps to reduce warehousing costs, since ordering and inventory verification can be conducted on-line.
- Software developers are advised to be prepared to implement EDI systems and expertise. In fact, distributors may begin to exercise their clout to get their suppliers (software developers) and resellers to use EDI, by making it prohibitively expensive not to.
- Software developers implementing EDI should use caution, ensuring that they comply with existing standards employed by their partners, and not to re-invent the wheel.

## **9. THE EVOLUTION OF OBJECT-ORIENTED TECHNOLOGY**

---

Object-oriented technology is a vast topic, impacting the way software is developed and sold. With object-oriented technology, it is now possible to sell pieces of functionality instead of complete products. These "objects" can then be integrated by other developers into their products to add certain functionality, via OEM arrangements. They can also be used by value added resellers to integrate specific functionality into custom development and integration projects. In the future, it is expected that users themselves will be able buy object "buttons" (single objects or groups of objects) to add specific pieces of functionality to their systems.

### **Impacts of Object Oriented Technology**

- Currently, no standards exist for distributing objects instead of complete packages, and channels have not been established for marketing objects as products. This will be a challenge for companies seeking to do this. Objects must be made to fit channels.
- In the future, kits of objects may be sold to end-users. Developers that wish to sell objects to the end-user community must package them using plain, user-oriented, descriptive language.
- There is some question as to how to legally protect objects. There will also be licensing issues that must be overcome.

- Resellers will use objects as part of their solutions. They will build to order, using objects to allow for more customization.

## 10. INCREASING FUNCTIONALITY AND POWER OF OPERATING SYSTEMS

---

Operating system platform has always been an important purchasing criteria. Operating systems have been purchased on the basis of "real" functionality versus perceived functionality and ease of use. Now, however, operating systems may become even more pivotal as Windows 95 eventually rolls out, UNIX usage expands, and OS/2 Warp makes head way into the market, while MAC OS becomes available on the IBM Power PC platform. These operating systems are promising to offer unprecedented functionality and power. In future, more applications, like calendaring, back-up utilities and database access software may become part of the operating system when it is delivered.

### Impacts of Increased Power and Functionality of Operating Systems

- Obviously, this will have a tremendous impact for companies selling similar packages to those included in the operating systems either by reducing the need for them, or providing opportunities to sell (OEM) them to the operating system suppliers.
- The jury is still out as to which operating systems will win on each platform, so developers should monitor this and develop their products accordingly. On one hand, resellers will choose whether or not to represent a product depending upon the operating systems supported. On the hand, the number of developers choosing to offer products on a given operating system will determine the long-term viability of the operating system.

## 11. THE OPEN SOURCING REVOLUTION

---

Open sourcing is a major trend in the US software market. Open sourcing is an emerging business practice whereby resellers are able to purchase and return products to any distributor. In the past, resellers were tied to specific distributors from whom they were required to obtain all products, service, and support, and return products. Now, to maximize service to the customer, resellers can, for example, purchase from whichever distributor has the desired product in stock, and return it to the most convenient location, regardless of whether it is the same distributor from which it was purchased. This ensures that customers get the products they need, when they need them. Open sourcing is a phenomenon of both the retail and VAR channels. IBM has limited open sourcing to its VARs.

### Impacts of Open Sourcing

- With open sourcing, street-level resellers must now seriously question the need to carry inventory.
- Where previously, distributors and wholesalers had the right to exclusively distribute specific products, they no longer have this captive distribution network. Master distributors, as well as wholesale distributors, are re-positioned to compete head-on with master (outbound) resellers, blurring the distinction between these channels.
- The open-sourcing phenomenon has created a market-share war between distributors and master resellers that has driven down gross profit margins. Most sources agree that open sourcing will result in significant swings in market share to the strongest channels.

- Open-sourcing is creating tension in the channel. Resellers are now more able to dictate to distributors what they sell and how much. In turn, distributors put pressure on software developers to get what they need, when they need it.
- Carried one step further, it is possible to foresee the continued consolidation of distributors, further compounding the impacts of this trend.

## **12. CLIENT/SERVER MAKES ITS MARK**

---

Client/server is becoming less of a buzzword and more of a reality. It is no secret that the corporate world is moving its traditionally mainframe-based computing infrastructures to client/server environments. Major corporate systems are now operating on, or being moved to client/server platforms. As the shift to client/server progresses, the industry grapples with the complexities of making diverse technologies work together, and with finding the right mechanisms with the necessary expertise to deliver and implement them. Buyers typically require the assistance of system integrators and consultants to implement client/server systems.

The client/server environment has a whole new look and feel, and traditional mainframe-based applications are being tailored and re-packaged for this environment. A major finding from our interviews was that software developers that originally developed high-end, complex, mainframe-based applications are now required to re-develop their products to fit into a client/server environment. With this re-packaging, developers are focusing more on intuitive front-ends and generally more easily integrated products. Companies that previously developed products requiring a high level of customization are attempting to develop more turnkey applications. As a result, not only are developers meeting user demand for client/server applications, but they are uncovering new market opportunities. By re-packaging complex products, typically limited to the Fortune/ Financial Post 500, mainframe world, many developers are now able to reach smaller companies with less complex computing environments.

Furthermore, through this effort, some developers are able to go one step further and develop new "lower-end" product lines - packaged products with similar functionality for use on PC and workstation platforms.

### **Impacts of Client/Server**

- For developers focusing on the client/server environment, it is necessary in most instances to adopt hybrid channels, and develop a wide range of partnerships. This is particularly true for companies attempting to penetrate the US market for the first time. Due to the complexity of client/server integration, it is difficult for one company to have all the expertise needed. A US-based service and support organization, a US system integrator or consultant partner, or a US office are considered essential for this market.
- Since the client/server shift is often tied into a business process re-engineering initiative, it is essential for developers, and their channels to understand the customer's business as well as technology requirements.
- On the other hand, for software developers that are re-packaging products for turnkey implementation into the client/server environment, and/or developing lower-end products for other less complex platforms, new channel opportunities open up. Where a product has been successfully re-packaged and is targeting lower-end requirements, less technically savvy channels are required. This means that more, new and less complex channel relationships are possible, and channel strategies must be completely re-

assessed. Where system integrators and consultants are the most likely channels for more complex products, less value-added channels will apply to lower end products.

### **13. TELESALLES AND CATALOGUES - GROWING CHANNELS**

---

Direct response channels, like telesales and catalogues, are growing in importance, and are particularly strong in the US. US software developers are embracing telesales and catalogue sales for product distribution, and Canadian companies are beginning to see the benefits of these methods. This is for the same reason that the retail channel is more and more viable: end-users are becoming more sophisticated, and don't need the support and advice they required a few years ago. A wide range of broad-based and niche-oriented catalogues are available in all kinds of formats, from traditional paper to CD-ROM, to electronic (e-mails).

This is a fast-growing and increasingly accepted channel both for consumers and businesses. In a recent IDG survey conducted for the report entitled "Buying IT in the 90's," 62% of people surveyed bought packaged software through telesales or catalogue sales. Although these channels are generally considered most appropriate for standard, horizontal-market, packaged software, all levels of software can be sold this way, including complex mainframe applications. The prerequisite, that is more frequently being met, is that buyers must know what they are looking for. By their nature, telesales and catalogues are particularly important channels for fulfillment, after-market sales, upgrades, maintenance, and renewals, rather than first-time buys.

#### **Impacts of Telesales and Catalogue Sales Channels**

- For companies seeking to distribute packaged software products in the US, telesales and catalogue sales are very important channels to be considered. They are excellent means of generating sales and mind-share.
- Telesales coupled with telemarketing is a growing and successful model. Companies implementing telesales for the first time must ensure that their telesales staff possess the appropriate skill sets and direct field sales experience essential to making it a success.
- Catalogue sales may also be viable for more complex, high-end products and niche-oriented products, but it is essential for the developer to research which catalogues are best suited to specific products and niche markets.
- Any company considering catalogue sales should conduct an assessment to determine which are most appropriate for their specific needs. A good source of related information is the Direct Marketing Association.

## STRATEGIES FOR SUCCESS

### ESSENTIALS FOR PLANNING A US CHANNEL EXPANSION

---

In addition to considering the trends discussed in the previous section, planning a US channel expansion should first be focused. There are eight essential elements that should be considered to minimize risk and target the expansion to the most successful channels<sup>1</sup>. The elements are:

- Customer Identification and Lead Profile
- Product Life Cycle Issues and Effect on Distribution
- Brand Recognition
- Existing Channels You Currently Use
- Market and Niche or Vertical Opportunities
- Infrastructure Requirements and Resources Available
- Macro-Economic Factors
- Marketing and Management Capabilities

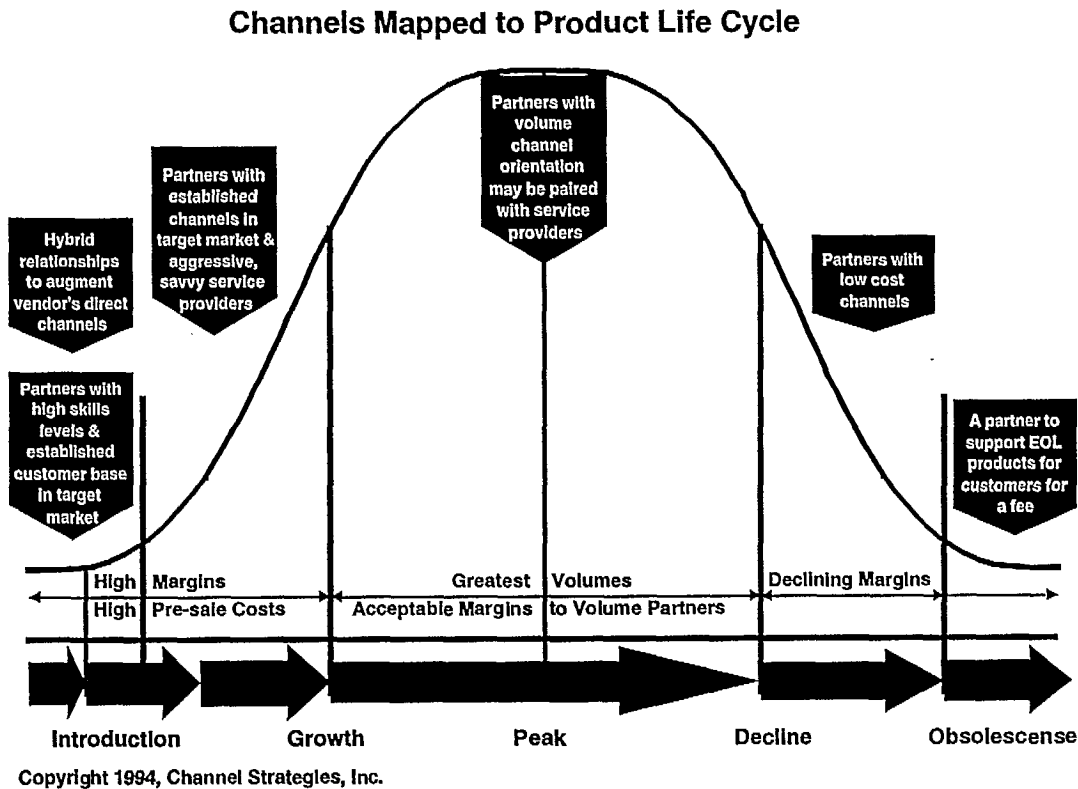
#### 1. Customer Identification and Lead Profile

Whether a software firm intends to establish direct field sales, electronic sales, or indirect sales channels for products, the firm must know the customer toward whom the channel will be directed. Some basic principles apply to finding customers. Generally speaking, customers are not accounts, they are people. That is, accounts are companies within which many potential customers may exist. The first step, then, is to identify clearly the profile of the customer and the process by which the customer buys the product. Where does the customer buy products similar to yours? Does the customer require specific services or support capabilities from the channels from whom the product is purchased? Can the customer be located on a particular list? Profile the customer carefully, and base the profile on the factors that will help you locate, qualify, and communicate with the customer. This is invaluable information because it can be cross-matched with the customers that a potential channel serves, thus acting as a filter for the channel's suitability. The profile will be used for marketing both for brand awareness and for channel sales.

#### 2. Product Category Life Cycle Issues and Effect on Distribution

The effectiveness of channels depends heavily on the stage of the product category (for example, network management software as a category, not a company's individual network management package) in its life cycle. Note the illustration below which describes the product life cycle and the capabilities that a channel must typically provide when selling and marketing products at a given stage in the cycle.

Exhibit 15. Channel Capability Requirements Based on Life Cycle



*Life Cycle/Channel:*

The following principles should be observed in selecting channels for each portion of the product life cycle:

1. In the early stages of the product life cycle [Concept to Introduction, and shortly after First Customer Ship (FCS) for the category] when no demand has been established for the product, channels must either:
  - be selected for their ability to fulfill demand creation requirements in addition to product support and sales requirements, or
  - be heavily augmented by demand creation from the vendor.

The role of the vendor is always to support its brand and create pull from the customer through the channel. Therefore, software developers should not depend upon channels for any significant measure of demand. It is necessary to invest heavily in establishing product and brand name recognition among target customers. This effort will increase sales for all channels. Don't depend on Early Adopters to carry the message. They may not represent the type of buyer for which the channels are being built. The Early Majority, on the other hand, is likely to have responded to the company's marketing and sales force or that of a channel partner, such as an OEM, and form a good early base of buyers.

2. In the Introduction to Growth Phase, when Early Adopters and Early Majority are buying, channel sales training, good pre-sales technical support, selection and training of channel partners, and most importantly, pull marketing, are clearly the keys to reaching growth. The channel goal is to gain coverage in the chosen markets while providing excellent service for products that are not well known. Select partners who closely meet customer requirements and have excellent coverage through their own channels. Provide fast access to pre-sale support and product support. Select a marketing strategy that either focuses on a niche market, or that leverages your or a partner's brand and reputation with customers. A transition should take place during this time to a greater number of partners or direct channels across all geographies to achieve greater coverage and prepare for the Growth Phase.
3. In the Early Growth stage, vendors often have to pay additional fees or offer greater discounts to volume channel partners who might not otherwise be willing to take on a product that has relatively low numbers of sales. However, the partner's participation may be key to getting the large number of sales and good margins available in the Growth to Peak stage. In this stage, as more products are moved, the vendor should be receiving the best return on channel investments. Select partners with good coverage who meet the majority of customers' channel preferences. Provide appropriate marketing materials, training and pre-sales support to channel partners who will be the volume sales partners. This type of support is key, even before these partners begin to sell very much. The goal in the Growth stage is to (a) reach the greatest number of buyers for the offering, and (b) create a strategy to extend the growth phase as long as possible by innovating, selecting additional niches, or expanding distribution. In many cases, the requirements of the later growth stage, where prices may drop quickly and more competitors enter the market, will demand a change in channel strategy. Plan for this move early, so that channel partners know, for example, that you and they may need to move to telesales rather than face-to-face sales, or to retail channels that sell at steep discounts. Prepare with the partners for this transition. Plan new products for them to sell and/or match services and new market niches with them for joint promotion.
4. Generally, the goal is to extend the Growth to Decline stage as long as reasonable by establishing the brand, securing excellent sales channel partners, and placing complementary and extension products in the channel to maintain margins and brand equity as long as possible. For products which must depend on volume sales, aggressive pricing, promotion, fast delivery, and fast fulfillment are essential. Retail, phone, electronic, and other channels that collapse costs should be used from the outset. In markets with volumes that explode very fast and then decline very fast, companies must move very quickly to insert newer, more differentiated products in the market. Sometimes the only way a small software company can accomplish this is to offer its products on a royalty basis to companies which already have the channel presence. When entering a new geographic market, this should be considered.
5. The key is to prepare new products to follow the older ones before the time that a change in channel must take place. Select partners with lower cost channels who are able to make a bit of margin in the Decline stage, when margins are low. If good, new products with building demand will be available, one's higher margin volume channel partners will gladly surrender the lower volume, lower margin older products and begin to sell the newer ones.
6. In End of Life, take the product out of the channel. The company may have inventory protection issues. If products are critical to some customers, find a partner who will either (1) take the products and support them for a fee that is less than the current maintenance contract, (2) buy and continue to support the product, or (3) investigate whether to add a few features and re-introduce the product at a lower price, in a less mature market in a different geography with a partner thereby undercutting competitors in that market at little cost.



### 3. Brand Recognition

In the study entitled "Buying IT in the 90s", concerning buyer preferences for PC software, IDG found that the majority of buyers would switch channels to buy the brand they prefer. Recent CSI interviews conducted in UNIX software markets confirmed that this phenomenon is also true for complex software. This tendency to switch channel to get a preferred vendor's products is a key element in building US distribution. Brand recognition is considered a major criterion for being successful in the US marketplace:

1. The company must establish brand recognition, much in the same way as companies like Corel and Delrina have done, by making this a priority. This requires innovative and intensive marketing programs. Once brand recognition is accomplished, the customer will actually go to the channels where the product is available because they prefer the brand. Brand recognition is particularly important for high volume, packaged and consumer oriented products.
2. Where brand recognition has not yet been solidified, the brand of the partner/ channel must be so important and recognised that it will "carry" the less-well-known brand of the developer. For example, a developer might sell products through another software developer in the US, sell through a preferred system integrator, or through a VAR whose name is well known in a specific vertical market.
3. Where there is no clear brand preference for a product, and the customer typically only knows a general category of software that is wanted, the name recognition or reputation of the channel must be highly valued. For example, a retail customer might not know what screen saver is wanted, but will go to a CompUSA or Egghead store to buy because they value the store's reputation.

Once the first three essentials (Customer Identification and Lead Profile, Product Life Cycle Issues and Brand Recognition) have been considered, it is time to do some work:

### 4. Existing Channels You Currently Use

Describe the functional capabilities of successful channels your company currently uses domestically, for the products you intend to sell in the US. List and describe the activities the channel performs in the following segments of the sales cycle:

- Pre-Sale
- Inventory and operations management
- Sale
- Post Sale Installation
- Post Sale Support
- Customization

Once this list has been created, it can be matched against the capabilities of local channels in another country. Armed with this list, your company can seek channel partners who have similar capabilities, even if channel names are different. In some countries, more than one partner may be required to perform all the functions needed to complete the work that a single channel did in another country.

Also, gather the metrics for your existing channels. These should include:

- Sales cycle length for an average sale
- Partner's expected margins or discounts
- Size of an average sale
- Inventory requirements per partner or retail outlet
- Ramp time (the time it took from signing the partner until the partner was generating revenue at an acceptable rate)

- Average revenue per partner or retail outlet
- Costs to support the partner as a percentage of revenue

Evaluate channels in the target country by discussing costs with some software publishers who do not compete directly with your company. Determine if the similar channels will have widely divergent metrics from those of your existing channels and prepare tactics to manage the differences.

## **5. Market and Niche or Vertical Opportunities**

Markets, niches, and the predominance of one or another vertical market are likely to vary widely by geography. Pay for good market research. Consider joint marketing projects with channel partners in the new geography to establish your brand in a niche market or user-intensive geographic region so the partner can be successful in that niche. For companies with horizontal markets, carve out a presence in a specific market segment, rather than trying to attack the entire US market at one time, or seek out a partner with a secure position in the market. Be prepared to pay, with discounts or other incentives, for a partner who has already established a market presence that you can leverage. Spend time creating a strategy to attack the market. Consult industry analysts in the geographic location or other segment being targeted.

## **6. Infrastructure Requirements and Resources Available**

Success with complex software in a new geography may require the establishment of a local support infrastructure. Customers for large database products, for example, may not buy unless a system engineer from the software developer is involved in the installation. In the US, more companies are outsourcing support to channel partners for packaged software, so this is an option. Other infrastructure requirements may include administrative systems that allow partners to communicate electronically, partner account managers to help partners learn to sell and support products in the early stages of market development, physical facilities, permits, establishing relationships for local marketing support, literature and product fulfillment, and training facilities. List the infrastructure elements you have in Canada. Determine the cost of providing the same elements in the US. Balance these costs against the activities channel partners should conduct and those your company must conduct to optimize customer satisfaction.

## **7. Macro-Economic Factors**

Overall economic trends in the proposed market should be studied. Are target markets growing, indicating ability to spend? Are business conditions favorable in the region targeted for initial sales? Evaluate facilities requirements and build a cost profile of each city in which you plan offices.

## **8. Marketing and Management Capabilities**

Marketing, technical support, and channel management, are key success factors. Each type of channel requires a specific set of channel marketing and management approaches. These are described in more detail, by channel, in the section entitled Keys to Effective Distribution Channels.

## THE MOST EFFECTIVE DISTRIBUTION CHANNELS FOR THE FUTURE

Combining the trends identified in this study, with the essentials for planning a channel expansion described above, we have developed matrices and illustrations which identify channels that Canadian companies should investigate when deciding to enter the US market, based on the types of products they offer. Although it remains essential to conduct a complete analysis and to develop a comprehensive strategy tailored to the individual company and each product, these tools should be employed in order to focus this analysis. They should be used to help determine the strengths of each channel relative to the designated category of software.

### Packaged Software

Exhibit 16 describes the key characteristics of packaged software, that tend to affect the viability of channels utilized.

#### *Exhibit 16. Key Characteristics of Packaged Software*

| Indicators   | Characteristics of Packaged Software  |
|--|---|
| Product Price Range  | \$39 (edutainment) to \$700 (DBMS, publishing, project management, etc.)  |
| Product Complexity   | Simple to Moderate  |
| Sales Cycle Time   | Minutes - over 75% of customers know what they intend to buy  |
| Decision Making Process  | <ul style="list-style-type: none"> <li>• Consumer - impulse, or brand-focused</li> <li>• Business - brand-focused, or company standard, or market leader</li> </ul> |
| Training Requirements  | Via provided tutorials or classes available from third parties, or none   |
| Customer Product Knowledge   | Either limited knowledge required, or product category is mature and widely understood  |
| Vendor brand and promotional and in-store marketing support required | High to Very High   |
| Number of Customers  | Large number of potential customers   |

The following matrix (Exhibit 17) identifies the most effective channels for packaged, or horizontal application software. Examples of categories that fit the Packaged software model include well-known office automation programs and packaged software tools and communications programs. The heading "high volume packaged" software includes games, educational, and home use software. The table demonstrates the need to tailor the channel to the product: while some channels will be extremely hot for certain types of packaged software, they will be less useful for others. Channels that are viable for all types of packaged software include retail, catalogue, and electronic.

The following key applies to the matrix:

- + good channels
- ++ better channels
- +++ fast growing channels
- channels less suited

### Exhibit 17. Channels for Packaged Software

| Channel                                     | High Vol. Packaged              | Office Automation                           | App Dev. Tools/Lang.               | DBMS                            | System & Utilities      | Network & Comm.              | Industry Apps.                           |
|---|---------------------------------|---|------------------------------------|---------------------------------|-------------------------|------------------------------|--|
| Retail, Super Store                         | Micro +++<br>Workstation (WS) + | Micro++<br>WS could be ++<br>in lg. markets | Micro ++                           | Micro +                         | Micro +                 | Micro +<br>LAN +             | Micro +                                  |
| Corporate SW Resellers (to large companies) | -                               | +++   | ++                                 | ++                              | ++                      | ++                           | -  |
| SW Specialty Retail Stores                  | +++                             | ++  | Micro+                             | Micro+                          | Micro+                  | Micro+                       | -  |
| Catalog (incl. electronic, paper, disk)     | +                               | +   | +++<br>directed to developers      | +                               | ++<br>esp. utilities    | +                            | +  |
| HDW vendor                                  | -                               | major accts. only                           | -                                  | -                               | + with system bundle    | ++with system sale or bundle | + with VAR/ISV partners                  |
| VAR sales force                             | -                               | +   | -                                  | +                               | + in turnkey offerings  | +                            | + will prefer more complex solution sale |
| SW Publisher sales force                    | -                               | major accts.                                | major accts.                       | -                               | -                       | -                            | -  |
| Distributor to 2nd tier                     | ++                              | +++   | +                                  | Micro+<br>LAN+                  | +                       | ++<br>with systems           | -  |
| Electronic (AOL, Internet, C'Serve, etc.)*  | ++                              | ++  | ++                                 | upgrade sales + and information |                         |                              | +  |
| SW OEM and suites                           | game, education suites +        | ++  | new opportunity for APP/DEV suites | +                               | +                       |                              | new opportunity                          |
| Telesales                                   | -                               | upgrades; follow on sales                   | electronic will replace            | -                               | electronic will replace | -                            | with sales force                         |
| Book Stores                                 | ++                              |   |                                    |                                 |                         |                              |  |
| Office Products Stores                      | ++                              | ++  |                                    |                                 |                         |                              | Inexpensive templates for managers       |
| Integrator                                  | -                               | -   | -                                  | +                               | +                       | ++                           | -  |

Source: Channel Strategies, Inc. © 1995

\* Fulfillment may be by FedEx or mail rather than downloading.

Exhibit 18 graphically depicts the most appropriate channel mix for packaged software, by target market. It demonstrates that channel viability depends not only on the type of product, but also on its intended market. While retail channels are suitable for all types of packaged software, they are less viable if you are targeting large enterprises. Electronic distribution is viable for all product types and markets.

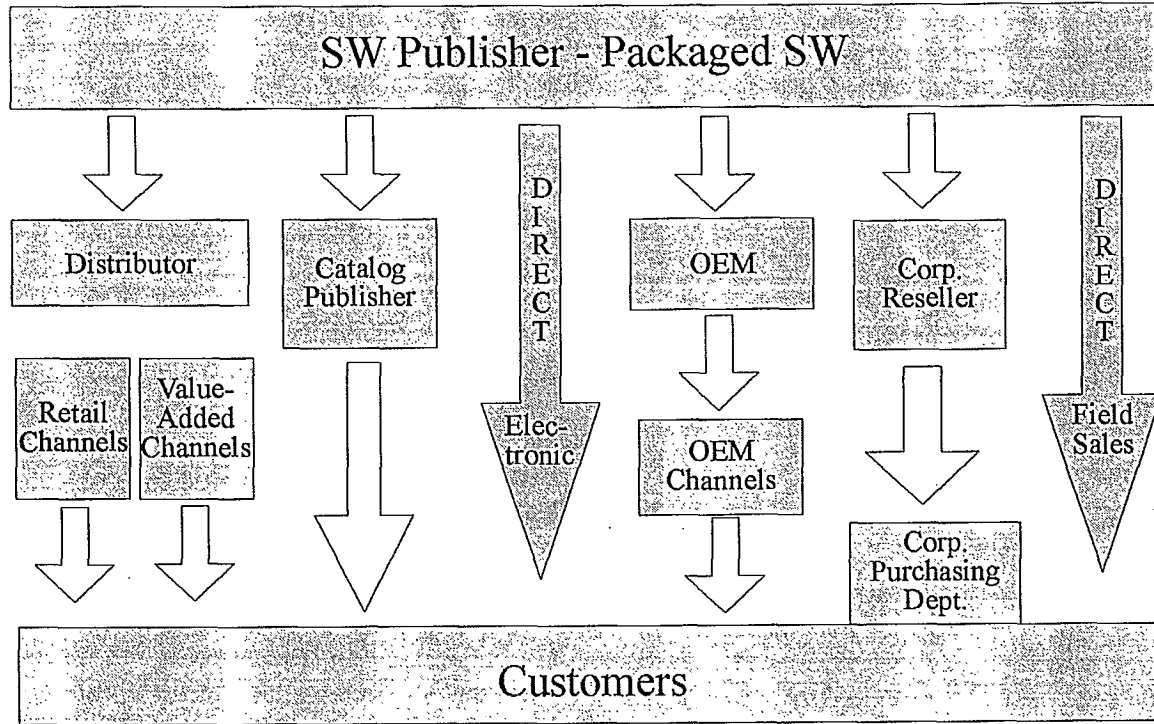
**Exhibit 18. Channel Mix for Packaged Software**

|               | Individual/Home  | Small Enterprise   | Large Enterprise   |
|---------------|--|--|--|
| Business App. | SW Speciality Store<br>Office Products Store<br>College/Univ. Bookstore<br>Computer Superstore<br>HDW Vendor Bundles | VARs (if added to turnkey system)<br>Computer Dealer Super Store<br>Office Products Stores               | Corporate SW Reseller & Dealer corporate sales<br>SW Publisher VPA<br>SI (in projects)<br>VAR (if added to turnkey system) |
| Edu-tainment  | Retail book store<br>SW specialty, toy store, discount store, superstore, catalog                                    | Electronic (Internet, C'Serve, etc.) and Catalog for application development, system utilities, upgrades |  |
| Game          |  |  |  |

Retail and Electronic overlap both home and small enterprise

Exhibit 19 below illustrates the flow of packaged software from the supplier, through various channels, and to the customer:

Exhibit 19. Illustration of Distribution Model for Packaged Software



## Complex Software

Exhibit 20 describes the characteristics of complex software that affect the viability of distribution channels.

### *Exhibit 20. Characteristics of Complex Software*

| Indicators   | Characteristics of Complex Software Sold Via Value-Added Channels  |
|--|--|
| Product Price Range  | \$1,000 - \$100,000, usually over \$5K   |
| Product Complexity   | Moderate to Extremely Complex, Integrated  |
| Sales Cycle Time   | 3 - 12 months  |
| Decision Making Process  | Multiple decision makers at multiple corporate levels or departments   |
| Training Requirements  | From vendor or 3rd party classroom training to extensive custom training   |
| Customer Product Knowledge and Technical Support Requirement         | Customer may need medium to high level of knowledge, or product may be early in category life cycle and vendor has product knowledge and customer acquires it; maintenance and hotline support are critical                  |
| Vendor brand and promotional and in-store marketing support required | Usually low to medium; technical sale requires more explanation and "push"; brand reputation is a definite plus, especially in new product category where vendor's reputation may be primary risk-reduction factor for buyer |
| Number of Customers  | Well defined group of customer targets   |

Complex software, and/or software oriented to vertical markets, typically requires integration with other software, installation and/or installation support by the vendor. The sale cycle is longer than for packaged "shrink-wrapped" software. The buying entity is a business, not a consumer, and the software is expected to perform in a business environment. Some "packaged" software is bought as if it were complex when widely deployed in a company and when it is integral to the operations of the company. An example of this use is a calendar program used for company calendaring and scheduling, adopted by the company as a "standard" program. In this table, "high volume packaged software" refers to this type of use. Although the viability of channels depends on the nature of the product, channels are viable for most complex products include system integrators, electronic, and OEM relationships.

Matrix key:     +               good channels  
                   ++              better channels  
                   +++             fast growing channels  
                   -               channels less suited

*Exhibit 21. Channels for Complex Software*

| Channel   | High Vol. Packaged                 | Office Automation                   | App Dev. Tools/Lang.   | DBMS   | System         | Network & Comm.                               | Industry Apps.   |
|---|------------------------------------|-------------------------------------|--|--|----------------|---|--|
| HDW vendor sales force  | Major Accts.                       | Major accts.                        | With Systems   | With Partners  | With system ++ | With systems ++                               | With partners +  |
| VAR sales force   | Only If in a solution              | ++ Especially Workgroup             | -  | ++   | + With systems | +++   | +++  |
| SW Publisher sales force  | -                                  | Major accts.                        | Major accts.   | ++   | -              | +   | ++   |
| Distributor to 2nd tier VARs, ISVs  | ++                                 | ++                                  | Micro + WS + LAN + (see note below)  | Micro+   | +              | + with systems                                | -  |
| Electronic marketing and download with integration support; especially to existing customers and upgrades | + Growing use, especially upgrades | ++ Growing use, especially upgrades | ++ Growing use, especially upgrades and products understood by technical users | + upgrades and information Within companies, electronic upgrades of networked software |                |   | + Growing use as marketing and delivery tool, but on-site integration usually required |
| OEM*  | bundles                            | ++ esp. objects                     | no change  | +  | +              | ++  | with partners  |
| Consultant  | in projects                        | ++ esp. Notes, workgroup            | with development projects  | ++   | +              | +   | ++ with customization  |
| Telesales   | + to existing customers            | ++ upgrades; follow on sales        | +  | + in teams with sales force  | ++             | -   | + in teams with sales force  |
| Integrator  | in projects                        | +++                                 | -  | +  | +              | +++ especially computer/telephony integration | ++   |
| Catalog (incl. electronic, paper, disk)   | ++                                 | +                                   | +++  | -  | -              | +   | for existing customers; complementary products   |

Source: Channel Strategies, Inc. © 1995

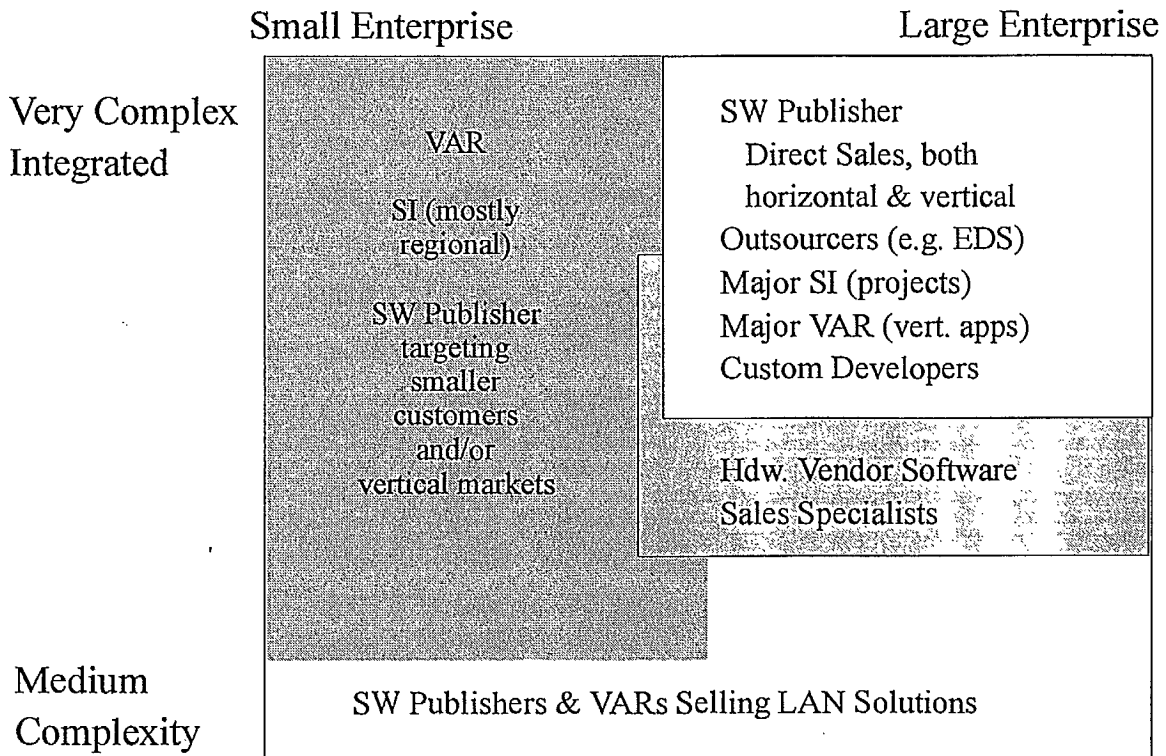


\*OEM is a company which includes the product of another publisher in the OEM's product, and applies the OEM's brand to the product. Another OEM usage is to bundle the software of another publisher in a suite or combination. This usage often allows both publishers to leverage each others' brands and distribution channels.

Note: Application and system development tools and languages are sold via distributors to VARs, developers and integrators. Relatively little of that software is then sold through to an end user customer. The VAR or publisher is more likely to be the user, not a channel. In a recent engagement, CSI discovered that less than 20% of application and system development tools were actually sold by the VARs or software publishers who ordered them from distribution. Fewer than 10% of VARs purchasing software tools were expecting the sale of those tools to be an important source of income to them. Therefore, while this is an efficient distribution channel to sell software to VARs, publishers, and integrators, it provides less margin to the original publisher (because of the distributor's typically steep discount) than a more direct channel might provide.

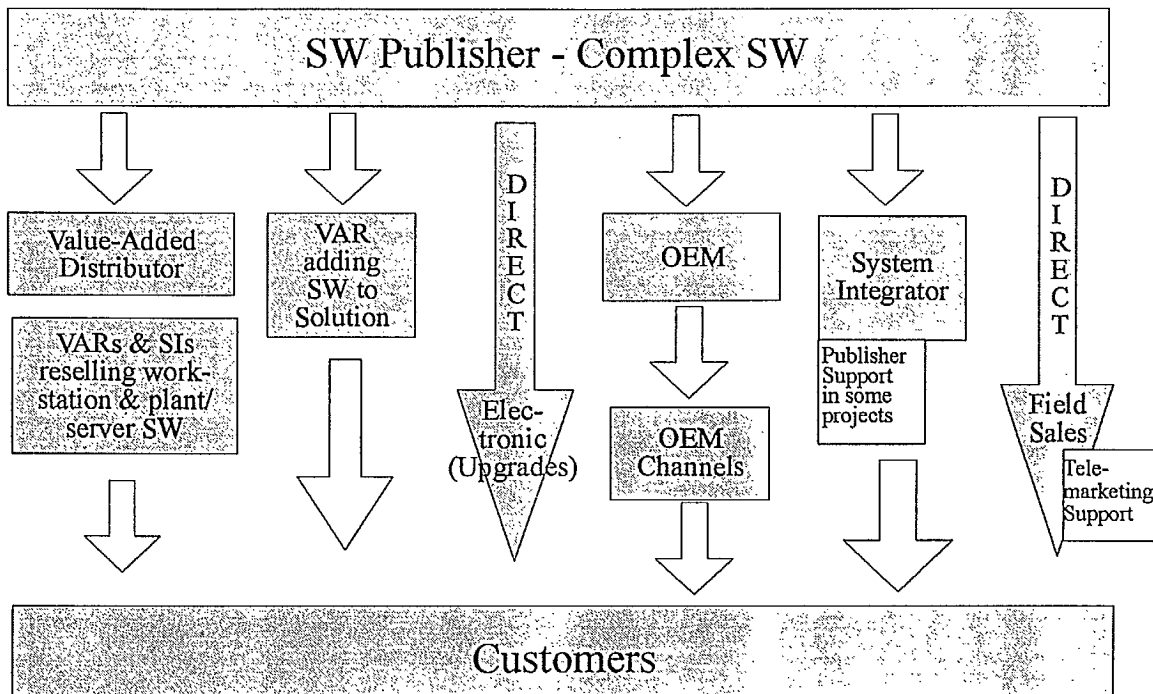
Exhibit 22 graphically depicts the channel mix required for complex products, and demonstrates that channel viability is determined by the level of product complexity and the size of targeted enterprises. Not surprisingly, large enterprises with complex solutions will require major system integrator and outsourcer channels, while various types of VARs are suitable for less complex solutions and/or smaller enterprises.

Exhibit 22. Channel Mix for Complex Software



The flow of complex software products from the supplier, through the channel and to the customer is described in Exhibit 23.

*Exhibit 23. Illustration of Distribution Model for Complex Software*



## KEYS TO EFFECTIVE DISTRIBUTION CHANNELS

Now that the more effective channels have been identified for different types of software, this section provides helpful hints about how to effectively market to and manage the different types of channels. It is divided into three channel categories: Retail Channels, Value Added Channels, and Direct Response Channels; and provides general descriptions of the channels within each category.

### Retail Channels

Retail channels in the US include traditional computer dealers, corporate resellers, computer superstores, software specialty retail stores, and even department stores and discount stores. Less and less retail space is available to newcomers. The addition of the entire Microsoft Home set of titles has further reduced space for others. Retail channels are supported by strong marketing programs, brand recognition, advertising, a good marketing plan, and shelf space management. Good graphics, packaging, self-running demos, point of purchase information, promotions to sales people in the retail outlets - all these elements help. If moving into US retail for the first time, consider a strategy that focuses on one or two retail chains, prepare a marketing plan that shows how you intend to drive volume through their stores, and focus on building name recognition and pull for those outlets in local areas.

Partnering with an established US software company may smooth your way into retail. Account management and marketing support for retail outlets is important, but several Canadian software companies might agree to allow a single account manager to handle all their products to leverage their channel

management dollars. Technical support for customers must be good; the telephone systems reliable; and replacement products fulfilled promptly. If no distributor will handle the products because the vendor's name is not well known, consider Just In Time (JIT) fulfillment through a US wholesaler for a fee. JIT is a system in which products are ordered and delivered just when they are needed.

Examples of retail channels follow.

### *Computer Dealer/Aggregator*

Also commonly called "reseller" or "retailer." Refers to a business that has a storefront operation and provides computer products and related services in a retail business model. Products sold through the dealer must be very simple to demonstrate and sell. The strength of the dealer channel lies in the variety of locations nationwide (coverage). ComputerLand is an example of a computer dealer.

### *Mass Merchants*

Suppliers who carry discounted merchandise, at times seasonal in nature, and have a centralized checkout. Their strategy of providing product presentation and display, brand diversity and customer service results in sometimes higher prices than other retail channels. Generally have a somewhat knowledgeable staff to assist in the sale of such products as copies, facsimile and personal computers. Examples of mass merchants include Circuit City and Silo.

### *Office Equipment/NOMDA Dealers - now the Business Technology Association (BTA)*

Refers to suppliers of office equipment, such as copiers, typewriters and facsimile machines. Similar to computer dealers in size, staffing and customer base. They typically carry products from only a few manufacturers. They are expected to move into high growth categories such as PCs, peripherals, and consumables. They rely on services for a large percentage of their revenue, offering complementary service and maintenance agreements and on-site repair.

### *Office Equipment Superstores*

A discount office equipment supplier, much like a computer super store. Offers a limited selection of a product category and purchases it in volume, thus offering product at below-competition prices. Unlike computer super stores, they provide only limited sales help, warehouse-style floor planning and centralized regional distribution points to keep costs down. Larger suppliers, such as OfficeMax and BizMart provide commission sales staff to handle the more advanced computer equipment.

### *Software Specialty Stores*

Suppliers who sell primarily software and computer accessories, such as modems and disk storage. With a knowledgeable corporate sales staff and discounted prices, they are attractive to companies seeking an easy-access computer channel for its employees. Egghead and Software Etc. are examples of this channel.

### *Super Store*

A discount computer products dealer that carries substantial inventory at low prices. Typically located in population centers where high volumes of computer purchases could be anticipated. Similar to a mass merchandiser, this channel focuses on retailing expertise, not technological expertise. Superstores are the high volume channel for computer products. Any product placed in that channel will, by inference, be considered a "high volume" product and likely will result in lower street prices. Volumes, however, promise to be significant as the stores reach a greater share of urban buyers.

### *Warehouse/Wholesale Clubs*

Generally are the most aggressive price-setters in the industry, relying heavily on membership fees to make profit. Generally found in industrial warehouse locations with open shelving, concrete floors and minimum sales assistance. Examples include Sam's Warehouse, Costco, and Price Club.

### **Value-Added Channels**

Value-added channels include VARs, system integrators, ISVs (software publishers), hardware vendors, service partners, and consultants. These channels are characterized by a business model that includes a substantial portion of revenue derived from services, as well as hardware and software sales. Create a business case to show a value-added partner how they will make money by selling, supporting and providing services for your products to their clients. Your customers must match their customers. Your technology must complement their technology. The price of your products must be able to sustain a margin attractive to a company that may sell through a direct sales force. Marketing programs are customer focused. Name recognition in the niche market should be secured with very targeted, focused marketing promotions. Trade shows, good demos, and seminars are important because information can be passed to customers easily, even for complex products. Technical support is critical and must be provided at a highly competent level, since the partner is a technical organization as well.

Examples of value-added channels follow.

#### *Distributor or Master Reseller*

Refers to a type of company that supports a business model similar to that of a wholesale distributor, but which may integrate systems, add product to systems, or test product/system configurations for customer. The strength of the distributor channel is in materials management, system integration, and volume product fulfillment.

This channel is becoming increasingly attractive to hardware manufacturers. However, to support the economics of a distributor relationship along with other indirect channels, significant changes must be made in pricing and sales compensation structures. Distributor channels are complicated by the dual role many distributors play in selling both to end-users and channel members. This inevitably leads to channel conflict unless policy, compensation and penalties control the problem.

#### *Original Equipment Manufacturer (OEM)*

A term used to refer to a specific contractual relationship with a type of system vendor or software publisher. Used in a generic sense in the industry to refer to any company which licenses or purchases technology from its owner for incorporation into a combined hardware or system solution that is marketed under the OEM's brand. Example: A company that incorporates another publisher's report generator into an application product owned by the OEM. The strength of the OEM relationship is the diversification of brand recognition and sales channels available through OEMs. The OEM may take products into markets totally unavailable to the publisher/vendor because the publisher/vendor is unknown or less well known than the OEM in that market.

#### *Professional Services*

The Professional Services channel's core competency is consulting. Generally, such firms have four organizational structures: consulting services, education and training, software development and applications management. Unlike Systems Integrators, these firms do not perform integration services. This channel typically is vendor independent since objectivity is key to their credibility. Examples of Professional Services firms are BSG Consulting and independent software development contractors.

### *Software Publisher (ISV)*

The originator and creator of a software product licensed to the public under a brand name registered to the publisher. The software may be licensed by the publisher to other parties for distribution or sub-licensing as (1) part of a bundled software/hardware solution, (2) general distribution to the public, (3) incorporation into other products that are then presented to the public under another brand name registered to the licensing party. Leading examples of this type of company are Computer Associates, Inc., Microsoft, Oracle Corporation. Also called an Independent Software Vendor (ISV) and may have vertical applications.

### *System Integrator*

A company that takes a project approach to the development and installation of a custom automation solution for the customer. An example of such a company is SHL Systemhouse, or ISSC. The strength of this channel is its project management, strategic alliances with other partners who can provide specialized technology, materials procurement capabilities, and specific integration skills.

### *Value-Added Reseller (VAR)*

A label currently in flux. Traditionally taken to mean a company that combined specialized business application product with hardware and services to provide a turnkey systems solution for a specific industry. This channel is now divided into segments. The first segment is the traditional VAR, now sometimes called an "application VAR" with reference to the proprietary application on the VAR's system. The second segment is sometimes called a "horizontal VAR," with reference to the broader audience to which the VAR's solutions are addressed, e.g., database applications. Yet a third segment is called a "LAN VAR" which refers to a group of companies whose primary value added is local area network installation.

### **Direct Response Channels**

Direct response channels include catalogue, telesales (both inbound and outbound), electronic channels, and combinations thereof. Success in direct response depends on accurate, clear, graphically interesting presentations for any channel where people will read about the product. Solid campaigns with demos are important, with good promotions, pricing, and fulfillment capability. Overnight delivery is key. Many catalogues in the US are niche oriented. Retail companies, hardware vendors, and large software companies in the US may have their own catalogues and may welcome advertisers who buy a page and advertise their software, and perform their own fulfillment via a toll-free 800 number. Consider using a partner in the US to manage telemarketing, telesales, and print catalogues. Insert a diskette with demos in a catalogue to reduce the number of catalogues discarded at the customer site. Invest in real marketing capability to enhance your success. Test specific markets, both geographic and vertical. Provide excellent phone technical support, fulfillment, and customer communications for pre-sale questions.

Examples of direct response channels follow.

### *Catalogue Merchants*

Many companies are providing product catalogues to their users. Catalogue selling is a superior after-market sales vehicle, and, to some extent, an excellent demand generator for niche products. The Programmer's Connection that sells to application and systems programmers is a successful case in point.

## *Electronic Media*

Electronic media include the Internet, bulletin board systems, and even CD-ROM can be classified in this category. Electronic media, especially the Internet, are excellent for increasing mind share and reaching new markets. A software company can develop its own marketing and distribution systems via these media, and/or use a service, such as Cybersource's software.net and Open Market for the Internet; or a company like Softbank for CD-ROM distribution.

## *Telesales*

Telesales involves sales conducted via the telephone, in a controlled and planned manner. There are two sides to telesales - incoming and outgoing. Telesales and telemarketing activities go hand in hand. An expanding range of telecom technology is being developed to automate telesales and telemarketing, including automated dialers, voice processing technology and automatic call distributors. As a result, telesales and telemarketing can be costly activities to take on as an in-house function. Smaller Canadian companies will find this method of sales and marketing most cost effective if they use a partner in the US to manage it.

## **OVERALL CONCLUSIONS & RECOMMENDATIONS**

---

The current Canadian distribution picture shows a heavy reliance on direct sales, and other traditional channels, particularly among smaller companies. If Canadian companies are serious about establishing a presence in the US market, they must become more innovative in their distribution channel strategies, and in how they view the market for their products. More and more channels, and variations thereof, are emerging, and even some of the most esoteric products can now be distributed through indirect channels. Furthermore, products developed for niche-markets can often be re-packaged for higher volume sales, as the use of IT in general expands to new markets.

US distribution must be considered a high priority business function and given proper attention. With so many changes occurring in the market, and in technology, traditional models are becoming less viable, and will limit growth and profitability. It will be essential for Canadian companies to develop strong US distribution strategies using established methodologies, and combine this with a forward-thinking approach that incorporates market and technology trends, and the following suggestions on how to make the most of them.

- *Industry maturation will continue to impact distribution.* This will lead to fewer intermediaries and more direct channels. In order to remain viable, existing intermediaries will differentiate themselves by offering services. Price erosion will continue across all types of products. More channels will become viable, and in fact essential, for more products as users become more savvy, prices drop, and developers get better at packaging their products. Continued lowering of margins will make it increasingly difficult for smaller companies to maintain profitability. **Innovative, adaptable multiple-channel strategies will be essential to success by helping to reduce costs, gain mind share, achieve brand recognition and maximize coverage.**
- *Reliance on direct sales is diminishing.* In this maturing industry, for companies of all types and sizes, regardless of product focus, be they high volume, packaged, complex or niche oriented, channel partners will now generally be more cost effective channels than direct sales. In order to maintain profitability and the mind share necessary to generate new sales, all companies must plan to rely less and less on direct sales. **Direct sales should remain a component of the channel strategy, especially in product introduction stages and primarily for new product categories, but with decreasing importance over time. Now, more than ever, it is essential to achieve an appropriate balance between direct and indirect sales.** The direct sales force must make the transition from selling software, to managing channel partners. As one respondent stated "people who write books don't sell them to bookstores, so why should people who write software expect to be successful in selling directly to customers and

stores?"

- *Consolidation will continue to put pressure on smaller companies.* The growth and profitability of small and medium-sized software development companies is seriously threatened by the consolidation of major software developers, and distributors. It is no longer feasible for smaller companies to compete, either for market share or distribution channels, against Microsofts and Lotuses, especially in standard productivity software. **Instead, companies should pursue niche market opportunities, multiple and non-traditional channels, and relationships with the major developers. Companies must also make major investments in marketing, advertising and promotion.**
- *Electronic marketing and distribution are musts!* The Internet is quickly becoming a standard marketing and distribution tool. **All software companies, regardless of product type or target market, should start now, by offering on-line product information, demonstrations, service and support, product ordering capabilities, and eventually full product distribution, including downloading and payment.** It will be essential to ensure that the necessary systems are in place to respond to potential increases in information and product requests, particularly outside of standard office hours. Furthermore, as you establish a presence on electronic media, you will reach new and potentially un-planned for markets. It will be useful to establish systems to monitor the demographics of the people ordering products and information, to identify new market opportunities.
- *The influence of, and demand for, software suites will increase.* The major suites have created high expectations in users. **Smaller companies should avoid competing where software suites exist, but should investigate developing suites for niche areas.** In such cases, the suite must look and feel as seamless and integrated as the mainstream suites. **Smaller companies should also ensure that products are capable of interfacing with the major suites.**
- *The retail channel continues to play an important role.* With buyers becoming more and more familiar with technology, and developers finding new ways to package their products to require less customization, training and support, retail is becoming appropriate for a wider range of products. Retail is no longer limited to a single set of characteristics. The players, and the market to which they cater, vary. Furthermore, each geographical region will have its major independent players. **All companies should regularly assess the retail channel for its viability for their products, and think of ingenious ways to sell where people buy.** Often, in order to break in, companies typically need the support of a major distributor, and this means a major and focused investment in planning, marketing and advertising. **Another investment in informative and captivating packaging is essential.** Canadian companies should also consider partnering with US developers to smooth the way into the retail arena.
- *Major distributors are key players in the US distribution arena.* The major distributors have power, particularly for high volume, packaged software. They influence outbound channels and they are therefore sought after by a large proportion of software companies. They must pick and choose who they represent, and they don't have a lot of time to find out why they should bother with you. Once you've identified the specific channel organizations that best meet your needs, you must market to them. **In the distributor channel, more than any other, it is essential to get noticed, by knowing who influences the decision-makers (press, research firms, and other vendors) and also targeting them.** It is also necessary to ensure that you will be able to meet distributors' demands and fill their orders once you've engaged them.
- *CD-ROM, and bundling offer less traditional distribution opportunities.* **To further develop mind share, consider the "try and buy" CD, bundling products with hardware on a custom or pre-packaged basis, selling your software products or objects to other companies for inclusion or embedding in their solutions, and other related forms of strategic alliances.** These are not just useful tools for high volume products, but can apply to niche-oriented products when implemented properly.



- *Shifts to client/server and object-oriented technology are changing the face of software development and distribution.* The shift to client/server has brought to light the fact that most products, regardless of their purpose and primary target market, can be packaged for higher volume sales. Object oriented development is also leading to new ways in which products are packaged and sold. **Software developers should always look ahead at new ways to package and distribute their products or components thereof.** Developers must shed the traditional thinking that slots them into vertical markets, and determine how to expand a product's scope. This ability to adapt and innovate will be essential as the market continues to mature, and the major players become further entrenched.
- *EDI will become a standard for software transactions.* It is beginning now, with a strong push from major distributors to deal with their resellers this way. Distributors will ultimately expect their suppliers (software developers) to deal via EDI. **It will eventually be to the advantage of developers who deal, or want to deal with the major distributors, to make the EDI investment.** Be aware of this potential future requirement.
- *Products no longer need to be tied to single platforms and operating systems.* Developers should always consider how they can re-package existing products for new markets, platforms and operating systems. In so doing, you should always revise your channel strategies, and explore new channel opportunities.
- *Direct response channels are becoming more viable.* Telesales and catalogue sales have largely been overlooked by Canadian companies until very recently. These are very important channels in the US, both for high-volume packaged, and complex, or niche-oriented products. **To remain competitive and achieve successful and cost-effective US distribution, companies must explore these direct response channels, which are effective for more and more types of products, especially in the US.** Catalogues vary in their product and market focus, so it is essential to take time to research which will be the most appropriate, particularly for niche-oriented and high-end products. It is useful to consider hiring a US company to take over the telesales function.
- *Although the industry is maturing, there is still room for new product categories.* As people become more comfortable and reliant on technology, software is more commonly being viewed as a commodity. Yet, there is still room for innovation. **Developers must focus on innovation and developing software to meet needs for which software applications have not yet been developed.** This is a good way to combat the dominance of major developers. For example, major growth areas are the home market and computer-telephone integration (CTI). Developing for new markets will open up new distribution channel opportunities and the potential for selling new products to the major developers.
- *There is an increasing opportunity to sell or license products to major players.* Canadian companies often view the prospect of selling their products to larger companies, for re-packaging under their name, as giving away their baby. It is understandably difficult to see another company gaining credit for your own innovations. Yet, selling the product, or part of the firm is an excellent way to generate significant cash flow that can be directly fed back into new product development. It is often just what a company needs to get its jump start. **Companies should seriously consider selling or licensing their products to established players, and ask yourselves: "Would I rather be rich, or famous?"** It may be more difficult to achieve the latter without a little of the former.
- *The US Market Consists of Several Smaller Markets.* The US market dwarfs the domestic market, and it is therefore unrealistic to think that it is possible to immediately penetrate the entire US market. According to the Canadian Consulate in Santa Clara's 1990 report 'How to Distribute Software in the USA', "It makes a lot more sense to geographically focus this effort." Even Canada's most successful companies typically divide the US into sales regions. **Instead of thinking of the US market as a**

larger version of Canada's, and copying your domestic distribution strategy, look at it regionally, and pay for some good market and channel research in the geographic regions you choose to target.

## APPENDIX 1 - BIBLIOGRAPHY

In addition to personal interviews, the sources consulted for this report include:

### NEWSPAPERS/ MAGAZINES/ JOURNALS:

---

*Computer Letter*, February, 1994 through February, 1995  
*Computer Marketing & Distribution Report*, February, 1994 through February, 1995  
*Computer Reseller News*, February, 1994 through February, 1995  
*Computer Retail Week*, February, 1994 through February, 1995  
*Computer Shopper*, February, 1994 through February, 1995  
*ComputerWorld*, February, 1994 through February, 1995  
*Digital Media*, February, 1994 through February, 1995  
*Edge*, February, 1994 through February, 1995  
*Information Week*, September, 1994 through February, 1995  
*MacUser*, February, 1994 through February, 1995  
*MacWeek*, February, 1994 through February, 1995  
*Marketing Computers*, February, 1994 through February, 1995  
*Network Computing*, February, 1994 through February, 1995  
*Newsbytes*, February, 1994 through February, 1995  
*PC Magazine*, February, 1994 through February, 1995  
*PC User*, February, 1994 through February, 1995  
*Open Information Systems*, February, 1994 through February, 1995  
*Reseller Management*, September, 1994 through February, 1995  
*Soft-Letter*, February, 1994 through February, 1995  
*Software Magazine*, September, 1994 through February, 1995  
*VARbusiness*, September, 1994 through February, 1995  
*Windows-DOS Developer's Journal*, February, 1994 through February, 1995

### REPORTS/ BOOKS

---

*A Current View of the Industry*, 1994 Software Business Practices Survey, Price Waterhouse  
*Buying IT in the '90s*, International Data Group, January, 1993  
*Competition and Evolution in the Distributive Trades*, Louis P. Bucklin - Prentice Hall Inc., 1972  
*Effective Sales Channel Development*, a Methodology, Channel Strategies Inc., 1991-1995  
*Future Perfect*, Stanley Davis - Addison-Wesley Publishing, 1987  
*Key Factors Affecting the Performance of Canadian Software Companies in the United States, A Summary Report to Industry Canada*, Neil R. Abramson, Simon Fraser University and Henry W. Lane, University of Western Ontario, 1992  
*How to Distribute Software in the USA*, Brian P. Casey, Canadian Consulate, Santa Clara, CA, 1990  
*Software Marketing Practices*, Culpepper and Associates, 1994  
*Technotrends*, Daniel Burrus - HarperCollins, 1993  
*The Internet Society News*, Winter 1994, Vol.2 No. 4  
*The Software Channel Sales Guidebook*, Edition 3.0, Re: Launch, 1994  
*The Software Industry in Canada, Discussion Paper, Vision, Mission and Goals*, Information Technology Association of Canada, 1993  
*The US Telecommunications Industry Marketplace Report*, Advanstar Communications Inc., 1992  
*US Software Channel Marketing & Distribution Guide*, Software Publishers Association, 1994

## APPENDIX 2 - SOFTWARE CATEGORIES

The specific types of software products included in each technology focus category are presented below.

### OS & SYSTEM SOFTWARE

---

Anti Virus  
 Disaster Recovery  
 Operating Systems  
 Security Systems  
 Network Management  
 On-line Transaction Processing

Data Centre Mgmt Sys.  
 Hardware Management  
 Perf. Eval. And Opt.  
 Windowing (GUI)  
 Systems and Utilities Other:

### OFFICE AUTOMATION

---

Merch. And Direct Sales  
 Point of Sale  
 Reservation, Billing  
 Account Payable - Receivable  
 Claims Management  
 Financial Analysis  
 Human Resources Mgmt  
 Integrated Accounting  
 Portfolio Management  
 Fin., Acct., Mgmt., Other  
 Desktop Publishing  
 Electronic Mail  
 Exe. Information Sys. (EIS)  
 Groupware  
 Project Management  
 Scheds, Agenda, Calendar  
 Text Retrieval  
 Word Processing

Order Entry, Inc. Control, Billing  
 Purchasing  
 Marketing and Sales, Other  
 Asset Management  
 Financial Information Systems  
 General Ledger  
 Tax  
 Investment Management  
 Payroll, Benefits  
 Decision Support  
 Document Management  
 Elec. Doc. Interchange (EDI)  
 Forms Design/Forms Filling  
 Personal Information Mgrs.  
 Report Generators  
 Spreadsheets  
 Voice Messaging  
 Office Automation, Other

### OTHER CROSS INDUSTRY APPLICATIONS

---

Animation  
 Graphics Tools, Utilities  
 OCR  
 Virtual Reality  
 Graphics, Multimedia, Other  
 Process Control  
 Computer Based Training  
 Diagnostic

Computer Aided Design  
 Multimedia Sys. and Apps.  
 Presentation Graphics  
 Voice Recognition/Synthesis  
 Instrumentation  
 Real Time Systems, Other  
 Courseware  
 Comp. Based Other

## APPLICATION DEVELOPMENT TOOLS AND LANGUAGES

---

App. Designers, Generators  
 Assemblers, Compilers, Trans.  
 CASE  
 Documenting Generators  
 4 GLs  
 3rd Generation Prog. Lang  
 Screen Generators

Artificial Intelligence Sys.  
 Code Generators  
 Data Capture Tools  
 Expert Systems Shells  
 Object Oriented DBMS  
 Relational DBMS  
 App. Dev. Tools, Other

## COMMUNICATIONS AND NETWORKING

---

Local Area Network  
 Micro-Mainframe Links  
 Comm. and Connectivity, Other

Wide Area Network  
 Terminal Emulation  
 Computer Teleconferencing

## DATABASE

---

Database/DBMS

## INDUSTRY APPLICATIONS

---

Bills of Materials (BOM)  
 Computer Integrated Mfg. (CIM)  
 Dist. Req'ts Planning (DRP)  
 Group Technology  
 Job Order Costing  
 Maintenance  
 Master Prod. Schedule  
 Process Costing  
 Robotics and Automation  
 Scheduling and Routing  
 Manufacturing Simulation  
 Space Systems - Robotics  
 Energy Systems Management  
 Computer Aided Engineering  
 Geographic Info. Systems  
 Mapping  
 Remote Sensing  
 Eng. and Scientific, Other

Computer Aided Mfg. (CAM)  
 Optics  
 Energy Management  
 Inventory Control  
 Just-in-Time (JIT)  
 MRP II  
 MRP  
 Quality Control  
 Sched and Capacity Req'ts  
 Shop Floor Control  
 Manufacturing Soft. Other  
 Space Systems - Comm  
 Analysis  
 Diagnostic Systems  
 Mathematical And Statistical  
 Eng. and Scientific Simulation

## APPENDIX 3 - LIST OF USEFUL REFERENCES

### ORGANIZATIONS REFERRED TO IN THIS REPORT

| Organization Name                             | City            | Telephone, or Internet  |
|---|-----------------|---|
| Branham Group Inc.                            | Ottawa, Ontario | (613) 725-2955  |
| Canadian Consulate                            | Santa Clara, CA | (408) 988-8355  |
| Channel Strategies, Inc.                      | Palo Alto, CA   | (415) 493-8801  |
| Culpepper & Associates                        | Atlanta, GA     | (404) 668-0616  |
| Cybersource Corp.                             | Menlo Park, CA  | (415) 462-5522<br><a href="https://software.net">https://software.net</a> |
| Direct Marketing Association                  | New York, NY    | (212) 768-7277  |
| Information Technology Association of America | Arlington, VA   | (703) 522-5022  |
| Information Technology Association of Canada  | Toronto, ON     | (416) 602-8345  |
| International Data Group                      | Framingham, MA  | (508) 875-5000  |
| KidSoft Inc.                                  | Los Gatos, CA   | (800) 354-6150  |
| Open Market                                   | Cambridge, MA   | <a href="http://www.openmarket.com">http://www.openmarket.com</a>         |
| Price Waterhouse, Software Services Group     | Boston, MA      | (617) 439-4390  |
| Softbank Inc.                                 | Salinas, CA     | (800) 763-8226  |
| Software Publishers Association               | Washington, DC  | (202) 452-1600  |

## TEXT BOOKS

| Author   | Title  | Publisher   | Year |
|--|--|---|------|
| Bowersox, Donald J.<br>Cooper, M. Bixby                            | Strategic Marketing Channel Management               | McGraw-Hill, New York   | 1992 |
| Bucklin, Louis P.  | A Theory of Distribution Channel Structure           | IBER Special Publications, Berkeley, CA                       | 1966 |
| Bucklin, Louis P.  | Competition and Evolution in the Distributive Trades | Prentice-Hall, Inc., Englewood Cliffs, NJ                     | 1972 |
| Burrus, Daniel   | Technotrends   | HarperCollins Publishers, New York, NY                        | 1993 |
| Naisbitt, John<br>Aburdene, Patricia                               | Megatrends 2000                                      | Avon Books, New York, NY                                      | 1991 |
| McCarthy, E. Jerome<br>Perreault, Jr., William D.                  | Essentials of Marketing, 5th Edition                 | Irwin Publishing  | 1991 |
| Hiam, Alexander<br>Schewe, Charles D.                              | The Portable MBA in Marketing                        | John Wiley & Sons, Inc.                                       | 1993 |
| Reis, Al<br>Trout, Jack  | The 22 Immutable Laws of Marketing                   | Harper Business   | 1992 |
| Schultz, Don E.<br>Tannenbaum, Stanley I.<br>Lauterborn, Robert F. | Integrated Marketing Communications                  | NTC Publishing Group, NTC Business Books, Lincolnwood, IL     | 1993 |
| Stern, Louis W.<br>El-Ansary, Adel I.                              | Marketing Channels, 4th ed.                          | Prentice-Hall, Inc.   | 1992 |
| Vaile, R. S.<br>Grether, E. T.<br>Cox, R.                          | Marketing in the American Economy                    | The Ronald Press, New York, NY                                | 1952 |
| Weilbacher, William M.   | Brand Marketing                                      | NTC Publishing Group, NTC Business Books, Lincolnwood, IL     | 1993 |
| McKenna, Regis   | Relationship Marketing                               | Addison-Wesley Publishing Company, Inc.                       | 1991 |
| Tynan, Kevin B.  | Multi-Channel Marketing                              | Probus Publishing Company, Chicago, IL and Cambridge, England | 1994 |
| O'Donnell, Michael   | The Marketing Plan, Step-by-Step                     | Lord Publishing, Inc., Dover, MA                              | 1991 |

## REFERENCE MATERIAL

| Name  | Address  | Phone Number   | Description  |
|---|--|----------------|--|
| Buying IT in the 90's:<br>The Channels  | International Data Group<br>1 Exeter Plaza<br>Boston, MA 02116                                     | (617) 534-1200 | Study of Desktop PC's, Notebook PC's, Printers, Application Software, LAN's for channel awareness, purchase behavior, role of dist. in brand selection, channel pricing, segmentation, analysis, & demographics. |
| Computer Industry Forecasts   | Data Analysis Group<br>5100 Cherry Creek Rd.,<br>Box 128<br>Cloverdale, CA 95425                   | (707) 539-3009 | Quarterly publication of industry forecasts; listed by many categories   |
| <ul style="list-style-type: none"> <li>• Financial Operating Ratios for Software Companies</li> <li>• LAN/UNIX/Workstation Software Pricing Trends, 5th Edition</li> <li>• Client Server Software Pricing Trends, 1994</li> </ul> | The Culpepper Group<br>7000 Peachtree-Dunwoody Road,<br>Building 10<br>Atlanta, GA 30328           | (404) 668-0616 | Annual reports of pricing trends for various categories  |
| Software Industry Factbook - The Software Industry's Annual Report, 1993 Edition  | Digital Information Group<br>Stamford, CT  | (203) 348-2751 |  |
| Understanding Distribution Channel Dynamics, New Rules, New Strategies, New Opportunities   | BIS Strategic Decisions<br>One Longwater Circle<br>Norwell, MA 02061                               | (617) 982-9500 | Title describes publication  |
| US Software Channel Marketing & Distribution Guide  | Software Publishers Association<br>1730 M Street<br>Northwest<br>Suite 700<br>Washington, DC 20036 | (202) 452-1600 | A comprehensive guide to establishing U.S. Distribution  |
| The Software Channel Sales Guidebook, 3rd Edition   | Re:Launch<br>620 Bancroft Way<br>Berkeley, CA 94710  | (510) 649-2920 | A streetwise guide to increasing software sales  |



|   |  |                    |  |
|---|--|--------------------|--|
| VAR Conference V:<br>Strategic Marketing for<br>Emerging<br>Technologies, Sept. 20<br>-22, 93 | CMP Publications<br>Manhasset, NY  |                    | Copies of presentations given at<br>conference   |
| Software Industry<br>Report   | Computer Age<br>Millin Publishing Group<br>3918 Prosperity<br>Avenue, Ste 310<br>Fairfax, VA 22031 | (703) 573-<br>8400 | Published twice a month; Short<br>articles on current happenings in<br>computer industry |
| Computer Industry<br>Update   | IMR Inc.<br>P.O. Box 681<br>Los Altos, CA 94023  | (800) 875-<br>6610 | Published monthly; Concise news<br>capsules for managers and<br>executives               |
| Price Waterhouse LLP  | 160 Federal Street<br>Boston, MA 02110   | (617)439-<br>4390  | A Current View of the Industry:<br>1994 Software Business Practices<br>Survey            |
| The Software<br>Developer's and<br>Marketer's Legal<br>Companion                              | Addison-Wesley<br>Publishing Co.<br>Toronto, ON  | (416)447-<br>6489  | Guide to all major legal issues,<br>including sample contracts on<br>diskette            |
| ComputerLetter  | 120 Wooster St., New<br>York, NY 10012   |                    | US \$695, 40 issues per year   |
| Soft*letter   | 17 Main Street,<br>Watertown, Mass.,<br>02272-9154   |                    | US \$ 345, 24 issues per year  |
| Software Success  | 11300 Rockville Place,<br>Ste. 1100<br>Rockville, MD<br>20852                                      |                    | US \$267, 24 issues per year   |
| The Culpepper Letter  | 7000 Peachtree-<br>Dunwoody Road, Bldg.<br>10, Atlanta, GA 30328                                   |                    | US \$694, 12 issues per year   |

## RESEARCH AND CONSULTING COMPANIES

| Company Name   | Contact Person                     | Address   | Phone Number          | General Services   |
|--|------------------------------------|---|-----------------------|--|
| Romtec plc   | Kate Wilkins                       | Vanwall Road<br>Maidenhead, Berkshire<br>SL6 4UB England                      | +44 (0) 628<br>770077 | <ul style="list-style-type: none"> <li>• Computer Distribution Channel Directories</li> <li>• Custom Research</li> <li>• Channel Research</li> </ul>   |
| ISIS<br>Integrated<br>Strategic<br>Information<br>Services | Marc Limacher                      | 611 Burnett Ave, Suite<br>19<br>San Francisco, CA<br>94131                    | (415) 647-4446        | <ul style="list-style-type: none"> <li>• Partner Identification &amp; Market Entry Research</li> <li>• Market Research</li> <li>• Member of The European Center for Economic Research and Strategy Consulting Prognos AG</li> </ul>  |
| Dataquest<br>Worldwide<br>Services Group                   |                                    | 550 Cochituate Road<br>Framingham, MA<br>01701-9324                           | (508) 370-5555        | <ul style="list-style-type: none"> <li>• Worldwide Market Research Reports on Customers, Competitors and Trends in the High-Tech Services Industry</li> </ul>  |
| International Data<br>Corporation (IDC)                    | Lee Levitt<br>Dorothy<br>Rosenthal | 5 Speen Street<br>Framingham, MA<br>01701                                     | (508) 872-8200        | <ul style="list-style-type: none"> <li>• Custom Distribution Channel Research</li> <li>• Custom Research for High Tech Companies</li> <li>• General Distribution Channel Research</li> </ul>   |
| Sentry Market<br>Research                                  | Janet<br>Engelbrecht               | 188 The Embarcadero<br>Suite 500<br>San Francisco, CA<br>94105                | (415) 979-2370        | <ul style="list-style-type: none"> <li>• Continuous Information Research Program</li> <li>• Research is done from the customers perspective</li> <li>• Software Prospect file</li> </ul>   |
| Input Market<br>Intelligence                               | Paul Kendrick                      | 1881 Landings Drive<br>Mountain View, CA<br>94043                             | (415) 961-3300        | <ul style="list-style-type: none"> <li>• US Information Services Reports in various technology categories</li> <li>• Worldwide Information Services Forecast 1993 - 1998</li> <li>• Offices in Frankfurt, London, New York, Paris, San Francisco, Tokyo, Washington, D.C.</li> </ul> |
| BIS Strategic<br>Decisions                                 |                                    | One Longwater Circle<br>Norwell, MA 02061                                     | (617) 982-9500        | <ul style="list-style-type: none"> <li>• Monthly investigative and analytical reporting on vital peripheral industry new events</li> <li>• Business planning and market research reports on high technology markets – US and European focus</li> </ul>                               |
| Individual (U.K.)  |                                    | Cedar Court<br>9/11 Farinile<br>Henley-on-Thames<br>Oxfordshire RG9 2JR<br>UK | +44 (0) 491<br>579600 | <ul style="list-style-type: none"> <li>• Electronic information services</li> <li>• Heads Up Service; daily fax of abstracts</li> </ul>  |
| Carlson Marketing<br>Group                                 | Julie Johnson                      | Carlson Parkway<br>P.O. Box 59159<br>Minneapolis, MN<br>55459                 | (612) 550-4965        | <ul style="list-style-type: none"> <li>• Custom marketing research project</li> </ul>  |
| Intersearch  | Bob Michaels                       | 132 Welsh Road<br>P.O. Box 189<br>Horsham, PA 19044                           | (215) 657-6400        | <ul style="list-style-type: none"> <li>• Custom primary market research in channels</li> </ul>   |
| Sales & Marketing<br>Solutions, Inc.                       | Gary Johnson                       | 223 Chads Ford Way,<br>Roswell GA 30076                                       | 404-998-2764          | <ul style="list-style-type: none"> <li>• Works with clients to penetrate the retail channel</li> </ul>   |

**SOURCES OF DIRECTORIES/ MAILING LISTS/ DATABASES**

| Company Name                         | Address  | Phone        | Type   |
|--------------------------------------|--|--------------|--|
| CMP                                  | 600 Community Drive,<br>Manhasset, NY            | 516-562-5000 | Publications, subscription lists (e.g. VARbusiness,<br>Computer Reseller News)   |
| Revolution Software, Inc.            | 20 Chester Woods Drive,<br>Chester, NJ 07930     | 908-879-7038 | Direct mail list for many segments of the computer<br>industry (e.g. VARs, SIs, Software Developers, etc.)   |
| Leading Edge<br>Communications, Inc. | 1121 Old Sishiyu Hwy.<br>Ashland, OR 97520       | 503-482-4990 | Directories, buyers' guides, and databases. Regional<br>and state directories  |
| LST Incorporated                     | 320 Northern Blvd. Great Neck,<br>NY 11021       | 516-482-2345 | Over 300 high technology mailing lists (e.g.<br>publications, associations, trade shows and<br>seminars)   |
| CorpTech                             | 12 Alfred Street, Suite 200<br>Woburn, MA        | 617-932-3939 | Corporate technology directories for US. Regional,<br>local and state directories available.   |
| Hugo Dunhill                         | 630 Third Avenue New York,<br>NY 10017           | 212-682-8030 | Catalogue of mailing lists   |
| International Computer<br>Products   | 823 E. Westfield Blvd.<br>Indianapolis, IN 46223 | 317-251-7727 | Database of business, education, and edutainment<br>products and companies. Includes 5,000 vendors<br>and 15,000 products. Available on CD-ROM.<br>Available on CD-ROM and the Internet. |

## APPENDIX 4 - THE TOP 50 US RETAILERS

The following list of the top 50 US software retailers (1994) was provided by Sales & Marketing Solutions, Inc. of Roswell, Georgia.

| Company Name                | Number of Stores | 1994 Software Sales (\$Million) |
|-----------------------------|------------------|---------------------------------|
| Egghead                     | 177              | 750.0                           |
| CompUSA                     | 80               | 545.0                           |
| Best Buys                   | 204              | 200.0                           |
| Computer City               | 66               | 200.0                           |
| Micro Center                | 9                | 175.0                           |
| Software, Etc.              | 385              | 139.2                           |
| Babbages                    | 333              | 109.2                           |
| Sam's Club                  | 432              | 90.0                            |
| Electronics Boutique        | 325              | 87.3                            |
| Wal-Mart                    | 1800             | 80.0                            |
| Office Depot                | 399              | 71.5                            |
| Fry's Electronics           | 6                | 61.0                            |
| Creative Computers          | 4                | 50.0                            |
| CDW Computer Warehouse      | 2                | 45.0                            |
| Elek-Tek                    | 7                | 40.0                            |
| Price Costco                | 182              | 35.0                            |
| Staples                     | 303              | 33.0                            |
| Software City               | 31               | 32.0                            |
| Incredible Universe         | 9                | 32.0                            |
| OfficeMax                   | 388              | 30.0                            |
| Waldensoftware              | 55               | 30.0                            |
| Army & Air Force Exchange   | 145              | 25.0                            |
| Hastings                    | 104              | 25.0                            |
| J&R Computer World          | 1                | 21.5                            |
| Media Play                  | 47               | 20.3                            |
| Radio Shack                 | 4000             | 20.2                            |
| NCA Computer Products       | 5                | 18.0                            |
| Nobody Beats the Wiz        | 50               | 18.0                            |
| Target                      | 125              | 18.0                            |
| Lechmere                    | 28               | 17.0                            |
| Computer Express            | 1                | 12.2                            |
| Circuit City                | 310              | 12.0                            |
| ComputerWare                | 10               | 12.0                            |
| Sears                       | 801              | 12.0                            |
| Whole Earth Access          | 6                | 12.0                            |
| 47th Street Photo           | 2                | 11.3                            |
| Computer Attic Super Center | 1                | 10.6                            |
| ComputerWarehouse           | 2                | 9.0                             |
| Kay-Bee Toys                | 1143             | 8.0                             |
| Micro Access                | 2                | 8.0                             |
| Fred Meyer                  | 90               | 7.7                             |
| Ballard Computers           | 5                | 6.0                             |
| Kmart                       | 2362             | 6.0                             |
| Sun TV & Appliance          | 43               | 6.0                             |
| BJ's Wholesale Club         | 62               | 5.0                             |
| YES!                        | 224              | 5.0                             |
| American TV                 | 8                | 5.0                             |
| Navy Resale & Services      | 38               | 3.4                             |
| Computer Town               | 6                | 3.3                             |
| PC Warehouse                | 90               | 3.0                             |

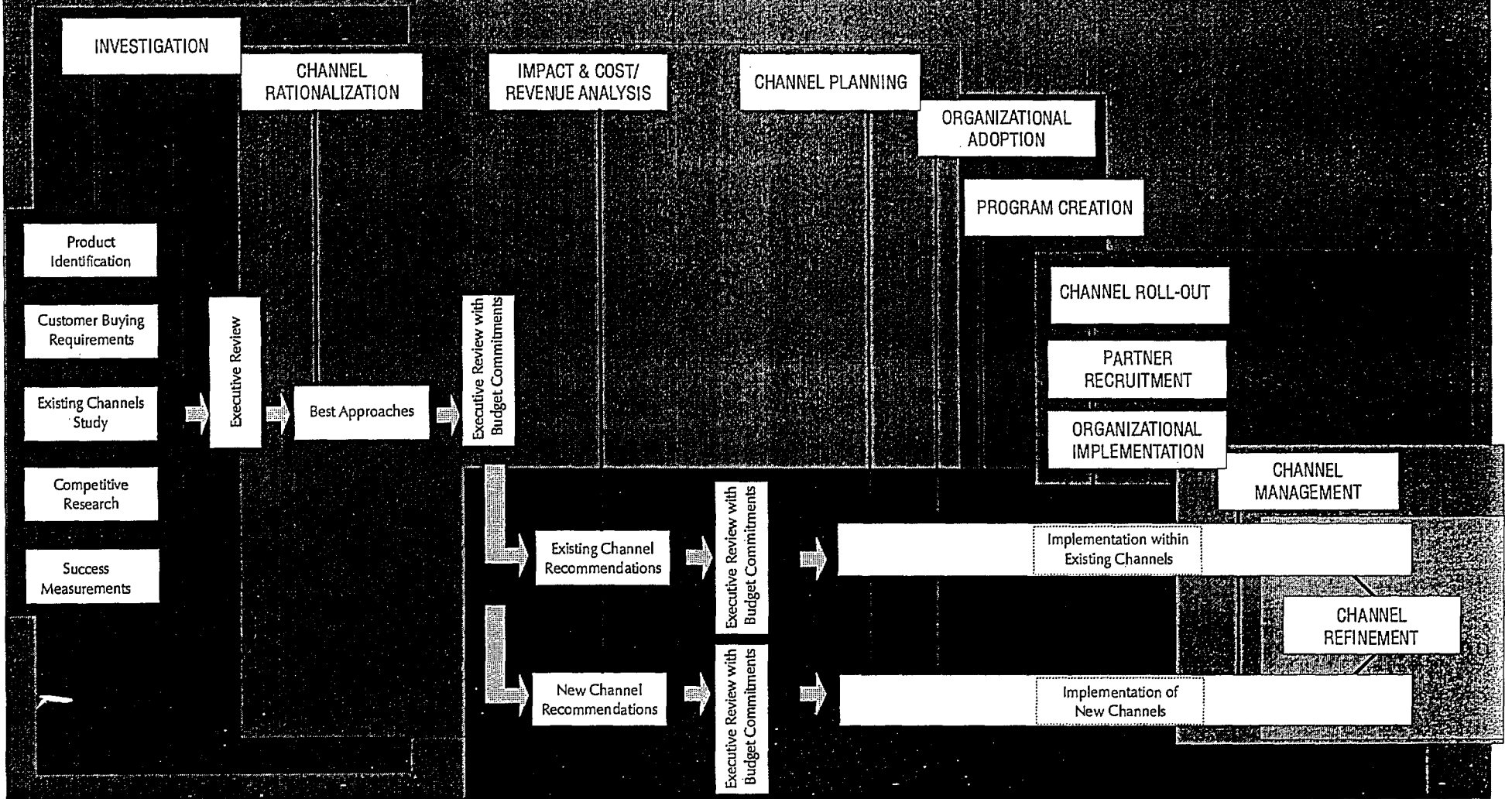
Copyright 1995 - Sales and Marketing Solutions, Inc. - All Rights Reserved

## APPENDIX 5 - EFFECTIVE SALES CHANNEL DEVELOPMENT

The accompanying chart describes the process required to develop effective software sales channels, formulated by Channel Strategies Inc.

# EFFECTIVE SALES CHANNEL DEVELOPMENT

A Business Development Process from *Channel Strategies, Inc.*



## APPENDIX 6 - ABOUT THE AUTHORS

### BRANHAM GROUP INC.

---

The Branham Group Inc. is an internationally recognised management and marketing consultancy for the information technology (IT) industry. Branham's mission is to deliver competitive advantage to IT suppliers, users and policy makers. Branham offers a full range of services, within five core practice areas: Marketing Services; Business Planning; Business Partnering; IT Industry Intelligence; and IT Planning and Use.

Branham is considered the leading market research firm in Canada for comprehensive information on the software and professional services marketplaces. The Branham500 database is the most comprehensive source of information on the leading 100 Canadian professional services and 400 independent software firms. Based in Ottawa, Canada, Branham provides services to organizations worldwide that represent the who's who in the industry, as well as the success stories of the future.

### CHANNEL STRATEGIES, INC.

---

CSI is an internationally recognised channel consulting firm, providing world-wide channel selection, evaluation and planning for clients. CSI has developed a comprehensive methodology entitled Effective Sales Channel Development Methodology which provides a decision support process for companies wishing to plan their channels using proven business development principles. This methodology is used by a team of senior managers in the client company to analyze the markets, customer requirements, available channels, product life cycle issues and financial norms/goals for the client's offerings. The Methodology delivers the best set of channels for the client, including a full cost/benefit analysis, organizational infrastructure requirements, forecast, and pro forma income statement for the proposed channels. CSI is well-respected in the U.S. as an important source of distribution channel strategy intelligence.

<sup>1</sup> Information in this section follows the Channel Strategies channel development methodology and is excerpted from Channel Strategies Inc., *Channel Opportunity Analysis, Book 1, Investigation and Channel Rationalization*, 1994.

