

## SETTING UP YOUR DISTRIBUTION CHANNELS



In this third in a series of articles, CAD Dealer sales and marketing correspondent, Nick Vasilieff, examines the key issues behind distribution and building a successful international marketing strategy

In my last article I touched on some basic concepts for entering international markets. With recognition that doing business internationally may seem daunting, I identified several different concepts that will help you start building an international marketing strategy. Key to building an international marketing strategy was the initial step of performing basic market research. The significant elements of such research are:

- Select a company with experience in doing research for technical products,
- Limit the information you need to know to that basic market demographic which directly affects your product and market potential,
- Work with a company or consultant that can assist with proper analysis of the resulting data.

Assuming you have done the required market research and the results indicate that the target market is appropriate for your products, the next step I identified was to build your marketing plan. The business/marketing plan will allow you to introduce your product in the most cost-effective manner. This plan must have specific goals, measurable milestones, and move you in the direction of capturing market share. I devoted the remainder of the article to a discussion of marketing and the key elements of developing product **Awareness, Need, and Supply**. As promised, this article will focus on the third element of that equation, Supply. More specifically - distribution.

Getting product to market has always been a difficult task. Selling direct; selling through dealers or distributors; establishing strategic partnerships, OEM agreements, product representatives, retail stores; and now selling through the Internet are ways to move product to the consumer. For technical products (software /hardware) the traditional channel has been the distributor/dealer network.

### Distributor / Dealer Channel

In the early days of computers, distributors/dealers made their profit by selling hardware, and bundling software as an add-on to the sale. The profit was in the hardware, the software was often superfluous to the sale. Today, hardware and some platform software, have become very low margin commodities. Dealers are increasingly finding the profits are found in add-on (industry specific) software products, and services, such as technical support, customisation, and training. This shift in focus means that some technical applications can now find receptive distributor/ dealer channels for distribution. The trick is to understand how the channel works, what resellers are looking for, and how each application fits into that formula.

Additionally, it is important to understand what distribution types work best for what products.

Deciding which distribution style is best for a product is partly a function of price, market demographic, and user requirements. The remainder of this article looks at each distribution type, where they are best suited, and how they benefit the producer and distributor/dealer.

### Direct Sales

Under a Direct Sales distribution concept the producer sells directly to the consumer. Some of the primary determining factors in choosing Direct Sales are:

- Lower product pricing (under \$500 to \$700 USD, depending on the market),
- product is easy to learn and use,
- product requires little or no support,
- end user can easily identify the functionality and benefit of the product from a written brochure or demo.

As you can see from this brief list, the main requirement is that it be an easy sale. The user must be able to identify the benefits quickly and easily, and the product must require little or no training and support. Also, the price must be in a range that I call the "no-brainer" range. In other words, the end-user must be able to make a buying decision without much thought. That always requires a very favourable benefit-to-price ratio, which means high benefit and low price. Another factor relating to lower priced products is that most products priced under the \$500 to \$700 range are not profitable enough for many distributors or dealers to handle. Although we are not dealing with product pricing strategies in this article, this is one of the factors that must be considered in establishing a price point for a product. The fact is that, because of a low price point, the only distribution channel available for many products is Direct Sales.

The characteristics of Direct Sales are:

- the producer receives 100% of the sales revenue,
- the producer maintains direct contact with the end-user,
- the producer often maintains more control over all aspects of product distribution,
- the producer is responsible for all marketing and sales of the product, which often requires the building of a staff for these activities,
- management of marketing and sales activities distracts the producer from his main activity, which is producing (developing) product.

Direct Sales models are:

- Mail order
- Catalog
- Telesales
- Internet

Mailorder, Catalog, and Telesales all require that you be able to reach your market in a timely manner, in a local language, and deliver product easily. These three are therefore usually limited to local markets (Note that a local market may include one or more countries). The Internet, on the other hand, has features that allow for Direct Sales outside of the local market.

### **Traditional Direct Sales**

For this article, the three traditional Direct Sales vehicles are Mail Order, Catalog, and Telesales. They are in a sense three different styles of the same concept. Mail order is an old term used for orders placed from direct mailings or advertising. Customers phone or mail in their response, and place their orders directly with the producer. Catalog is a similar concept but used when a producer has many products that are contained in a company catalog.

Customers are mailed the catalog and orders are received by phone or mail.

Telesales is a pro-active form of sales in which the producer has a sales team contact current or prospective customers with an offer for new or upgraded product. Again, orders are taken by phone directly by the producer. Because most companies

are familiar with these forms of Direct Sales, I will focus on the newest addition to this category - the Internet.

The Internet is the most versatile Direct Sales vehicle available to producers. With the Internet, product can be offered to anyone, anywhere in the world. Customers can access the web site at any time, obtain information in one or more languages, order, and even take delivery of product right from their own office or home. This latest technology means any company can sell product anywhere in the world -- theoretically.

I say theoretically because although the web seems to be the answer to all our dreams, making it work is sometimes problematic. With today's web-site creation programs almost anyone can create a web-site. That means that you can put information on your site that can be accessed by anyone willing or able to reach it. There are two remaining problems. Creating E-commerce on your site, and letting people know about your site. Both can be significant issues.

### **Creating E-Commerce on your WEB site**

E-commerce means that your company has a web site where consumers can view your products, place an order and have the product shipped to them, or download the software application immediately. This sounds quick and easy, but there are many pit-falls for the producer. A recent article in Engineering News Record identified two main problems facing companies wanting to sell product over the Internet: Speed and Security. I will add a third: **Maintenance**.

If you want to start selling your product over the Internet you must first know that your systems are capable of handling the demand that may be generated. Second, if you accept orders over the web, or place software applications on a web-site, you must know that customer information (including credit card information) is secure from theft, and the software applications are secure from theft. Finally, if you develop an E-commerce web site you must be prepared to maintain the site on a daily basis. Product information, pricing, applications, orders, downloads, etc. are all activities that must be managed and maintained. If you decide that Internet sales are for you, then be prepared to devote the resources to maintain and manage the site.

An alternative to building and maintaining your own E-commerce site is to contract with a provider who manages E-commerce sales on the web. This, of course, requires much investigation and on your part. But, if you select a good provider, for 30% to 40% commission on each sale you can have them manage the E-commerce aspect of your on-line sales.

### **Letting people know about your WEB site**

Once you have your E-commerce WEB site on-line, you still have to let people know about it. Most people I talk to these days seem to feel that all they have to do is put their "Meta-Tag" (key words that are located in the header of an HTML file that Search Engines look for when searching the WEB) out on the WEB, and like magic, people will find them and purchase their products. It's not so easy.

First, your competing with millions of products that put out billions of "Meta-Tags" every day. Second, my understanding is that many search engines do not even use meta-tags to locate relevant WEB sites. All search engines, such as America-On-Line, Lycos, or Yahoo, operate the same way. They first search WEB pages for a key word in the title. Pages with the key word in the title are found to be relevant to a search. They will also search for key words near the top of a WEB page, such as in the headline or first few paragraphs. Finally, most will search for key word frequency. Pages with more key words will be prioritized higher than others. From that point on, each search engine has it's own twist on how it

searches for documents. Some search more sites than others, some give higher priority to sites they have reviewed, and some search engines give higher priority to those sites with a large number of "links" pointing to them. Ultimately, your best bet for being found is to stay active on your WEB site, use meta-tags wisely, and link you site to other related sites. If you would like more information on Search Engines, and Web Site management email me at [nickv@thirdpartyintl.com](mailto:nickv@thirdpartyintl.com) and ask for "Web Site Data". I will email you some of the information we have and refer you to an excellent reference WEB site. Another problem is that a lot of people still do not use the WEB. Hard to believe, but even though estimates are that over \$326 billion of all products will be purchased via the WEB by 2002, that's a small percentage of total purchases, and it doesn't mean technical products are a significant part of that total. At this time there is no indication that consumers are ready to purchase technical products over the WEB in large numbers. In fact, to date, I know of no one who has successfully sold large quantities of CAD add-on product via the WEB (If you have a success story about selling over the WEB please let me know. I'd like to look into it). Finally, if you do set up a WEB site with E-commerce, you have current and numerous meta-tags and headers, and you have a potential customer base that is willing to purchase via the WEB, you still have to bring people to your WEB site. That means you will have to market your Web site. So, even with a great WEB site, and a great product, you still need conventional marketing to create Product Awareness and Demand.

Don't think I am against E-commerce. I not only like it, but I use it. My company is, at this time, researching the best ways to manage E-commerce. But, I don't believe our industry is ready to make significant purchases across the WEB. That's not to say that there won't be an increasing amount of product sold over the WEB, and that you shouldn't begin considering the WEB as a part of your future marketing and possibly sales activities. But, right now the WEB should not be seriously considered as the only distribution vehicle for a technical product.

### **Multi-tiered distribution**

Although many programs are best suited for Direct Distribution, there are many situations in which a multi-tiered distribution network can better fit the needs of both the producer and end user. Specific situations are:

- International distribution where localization is required
- Higher priced products
- Highly technical products requiring intensive training or support
- Situations where producer does not want to manage marketing or sales.

### **Two -tiered distribution**

There are two basic types of multi-tiered distribution channels - two tiered, and three tiered distribution. Two tiered distribution is where the producer sells directly to a dealer channel, and the dealers sell directly to the end user. This form of distribution usually requires:

- the producer (developer) manage product development and manage code,
- the producer take primary responsibility for national marketing,
- the producer manage dealer technical support,
- the producer take responsibility for localization of product,
- the producer take responsibility for protection, production, and packaging of product,
- the producer manages the dealer channel.
- the dealer take responsibility for local or regional marketing,

- the dealer manage local or regional sales,
- the dealer manage end user technical support,
- a 30% to 40% discount be given the dealer (depending on value added by dealer).

As you can see from this brief list, the producer maintains responsibility for managing the production of the product, managing marketing, and for managing the distribution channel. The dealer is responsible for selling to a limited regional end user base.

The two tiered distribution channel works well in situations where the product is very technical, requires face-to-face sales, or is support/training intensive. Local or regional dealers are almost always in a better position then the producers to provide hands on sales and support.

Finding the right match between a producer and dealer can be a challenge. One consideration should be to match a new products application with that of a dealers existing product line. This allows the dealer to move the new product into his existing sales and marketing activities, rather than having to build a new campaign specifically for the new product. The result is a shorter product-to-market cycle, and lower sales /marketing costs. In situations where a dealer is taking on a product unlike his current products, the dealer and the producer should anticipate higher product introduction costs, and longer product-to-market cycles.

Both the dealer and producer should also anticipate higher product prices for multi-tiered distribution channels when compared to direct channels. The higher end-user price is required to support the discount offered the dealer, the additional costs of management of the dealer channel, and the cost of marketing to both the end user and the dealer channel.

This form of distribution usually requires:

- the producer (developer) manage product development and manage code,
- the producer manage the distributor,
- the distributor take primary responsibility for national marketing,
- the distributor manage dealer technical support,
- the producer and distributor share the responsibility for localization of product,
- the producer and distributor share responsibility for protection, production, and packaging of product (negotiated prior to agreement being finalized),
- the distributor manages the dealer channel.
- the dealer take responsibility for local or regional marketing,
- the dealer manage local or regional sales
- the dealer manage end user technical support, a 50% to 70% discount be given the distributor (depending on responsibilities of the distributor).

In the three-tiered distribution style the developer is letting go of a significant amount of responsibility, in return for a significant discount on the price of the product. For this reason both the producer and the distributor must take every precaution in selecting and negotiating their working partnership. Over time, both parties will invest significant resources in bringing the product to market. If the relationship does not work, both parties will not only lose the resources invested, but also the time invested in the failed effort. The time and money spent in insuring compatibility of product lines, customer types, and organizational management styles will be returned many times over in the course of the future business relationship.

Once the selection of the distributor, has been made, the next step is negotiating the agreement. There are numerous considerations that go into good agreements, far too many to discuss here. Possibly the most important is understanding that the agreement must be good for both parties. I have negotiated many distributor agreements around the world, and those that are most successful bring benefit to both the producer and distributor, equally. Mutual benefit establishes the foundation for a relationship of mutual honesty and trust.

It is also important to recognise that while commitments are important, actions speak louder than words. Many producers demand purchase commitments from distributors in the belief that the commitment will somehow produce sales. It is far better to negotiate and define the actions that both parties will take to introduce and market a product. An example is a good marketing plan. If the actions are well founded, and performed well, success will be the result.

Finally, understand that the relationship between a producer and distributor is only as good as the personal relationship between the business people involved. It is my experience that lengthy distributor agreements are certainly good for the legal consultants paid to review them, but seldom do they create successful partnerships. The contract is important, but both parties must be committed to making the relationship work, on a personal level. The eye-to-eye contact, the personal handshake, the personal agreement to make-this-work are the fundamental actions through which successful partnerships are built.

### **Alternative Distribution Styles**

Although I have identified only three distribution types, it should be noted that there are many variations on these three basic types.

Some companies have found manufacturers representatives to be an effective sales vehicle, others have found a single dealer who effectively acts as both a dealer and distributor selling to both other dealers and end users, still others license their products to other producers to bundle with their products (OEM agreements). Some companies use management organizations located near or in the market to manage their marketing and/or distribution in that country or region, and others use a management group to build a market, and then build the Two-Tiered or Three-Tiered distribution channel. Whatever the choice, the fundamental concepts we have discussed still apply.

The key is first doing your ground work - research. Learn a little about the market you are entering, and then study the local distribution channels. With a little research you will begin to discover the distributors, dealers, representatives or management organizations that are operating in that region. Then investigate them. Make sure you are dealing with organizations that have experience, good reputations, and qualified staff. Talk to them, make sure you are able to communicate clearly and comfortably with them. Then, ask yourself if you want them as your partner, because that is exactly what they become if you make them your dealer, distributor, or market representative or manager. These comments are equally true for the distributor. Before selecting or accepting a product to distribute, the distributor should perform the same level of careful research. Finally, if everything looks positive, move ahead with a commitment to long term success. Building good distribution channels can hard work, but at the same time very rewarding. In future articles we will discuss critical elements to distribution agreements, what producers are looking for, and what distributor/dealers are looking for. Until then, if you have questions or comments please contact me at [nickv@thirdpartyintl.com](mailto:nickv@thirdpartyintl.com). © CAD Dealer magazine 1999