



COSTS OF IT DISTRIBUTION

Analysis & Conclusions



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Based on independent
research conducted by:

 **21st Century *Equity Research***

September 2008

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Overview



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Five years ago, the [Global Technology Distribution Council](#) (GTDC) commissioned an independent research organization to conduct a study of the costs of IT distribution, by channel, to vendor partners. The detailed findings gave the industry important information to support benchmarking and further analysis as well as insights for optimal cost management.

In response to strong interest from vendor and distributor executives, the GTDC commissioned 21st Century Equity Research to conduct another independent study in 2008 to analyze current costs of IT distribution to vendor business partners. To support this undertaking, 21st Century Equity Research gathered comprehensive related data from a

cross-section of IT companies specializing in systems, storage, peripherals, software, networking and other IT product categories. The approach included analyzing all SG&A data supplied by participating vendors in aggregate ranges pertaining to their U.S. businesses, by channel, over the past year.

This methodical approach leveraged an online questionnaire as well as follow-up interviews with study participants, which included financial and operations personnel of participating companies.

21st Century Equity Research signed non-disclosure agreements to ensure the confidentiality of individual responses. Consequently, all data supporting this study is provided exclusively in aggregate ranges.

Key Focus Areas

The study included, but was not limited to, analyzing the following cost categories:

- o Discount from List
- o Special Bids / Spot Offers
- o Market Development Funds (MDF)
(Soft Dollars, Co-Op Advertising, Rebates)
- o Programs, Promotions, Marketing
- o AR Reserve / Credit Card Fees
- o Price Protection / Inventory Depreciation
- o Direct Sales, Advertising
- o Shipping, Handling, Warehousing
- o Collections
- o Warranty / Returns
- o Inventory / AR Financing Costs

Cost data relative to the above areas was applied across sales channels including, but not limited to:

- o Two-Tier Distribution
- o One-Tier VAR Direct
- o Manufacturer Direct
- o Mail Order / Retail Direct
- o Web

Participating Vendors

AVAYA



lenovo



InFocus
The Big Picture



NORTEL

RICOH

xerox

Many different factors and functions define today's multifaceted and highly integrated supply-chain operations. Detailed analysis is critical to truly understanding associated costs of different routes to markets – in conjunction with delivering high customer satisfaction.

“All things equal, pushing more volume through the Web would likely translate into higher margins yet with significantly higher costs in advertising, promotions, discounts, etc.”

– IT Vendor Finance Manager
(Cost Study Participant)

The IT reseller channel and its SMB-focused solution providers show clear preference for one-stop sourcing, fast delivery on any order size, credit based on aggregate purchases, and services structured to meet their unique requirements. Such two-tier distribution advantages are further reinforced through 21st Century Equity Research's analysis of vendor costs by channel, including these conclusions:

Two-Tier Distribution

- o Lowest cost for B2B and solution sales

Manufacturer Direct

- o Highest Cost, focused on select enterprises
- o Specialized VARs, with distribution support, can deliver multi-vendor solutions more cost effectively to this market

One-Tier VAR Direct and Mail-Order/ Retail Direct

- o Higher-cost channels with average margins and sales dollars per transaction
- o Two-tier opportunity to reduce costs and potentially raise margins

Web

- o Typically higher margin based on selling at list price but limited to consumer-oriented single unit sales
- o Not effective for bundled sales, corporate POs or Government orders
- o Many vendors use 2-tier distributors for cost-effective Web order fulfillment

CHANNEL:	2-Tier Distribution	1-Tier VAR Direct	Mfgr. Direct	Mail Order/ Retail Direct	Web
Discount from List Price (Supply Chain Partner Margin)	7.5% - 12.5%	4% - 8%	0%	5% - 10%	0%
Special Bids/Spot Offers	5% - 10%	2.5% - 7.5%	15% - 20%	2.5% - 7.5%	7.5% - 12.5%
Mrkt Development Funds	3% - 4%	2% - 3%	0%	2% - 3%	0%
Prgms/Promotions/Mrktg	15% - 20%	17.5% - 22.5%	15% - 20%	17.5% - 22.5%	12.5% - 17.5%
AR Reserve/Credit Card Fee	0.5% - 1.5%	1.5% - 2.5%	1% - 2%	1% - 2%	1.5% - 2.5%
Price Protection	1% - 0 2%	0%	0%	1% - 2%	0%
Inventory Depreciation	0%	1% - 2%	1% - 2%	0%	1% - 2%

MOST NOTABLE DISTINCTION: Two-tier distribution efficiently provides strong reseller-focused services and broad market coverage as well as other advantages. While higher in cost in some areas compared to other channels, distribution costs are actually lower in most categories .

CHANNEL:	2-Tier Distribution	1-Tier VAR Direct	Mfgr. Direct	Mail Order/ Retail Direct	Web
Direct Sales/Advertising	5% - 10%	8% - 12%	10% - 15%	8% - 12%	5% - 10%
Shipping/Handling/Whsing	1% - 2%	4% - 5%	3% - 4%	2% - 3%	5% - 6%
Collections	0.5% - 1.5%	1.5% - 2.5%	1% - 2%	1% - 2%	0%
Warranty>Returns	1% - 2%	2% - 3%	2% - 3%	1.5% - 2.5%	3% - 4%
Inventory Financing	1% - 2%	2% - 3%	1.5% - 2.5%	1.5% - 2.5%	3% - 4%
A/R Financing	1% - 2%	1.5% - 2.5%	2% - 3%	1.5% - 2.5%	1% - 2%

FUELING THE ENGINE: These supply-chain functions further underscore the cost-effectiveness of two-tier distribution. SG&A and interest expense range from just .5% to 2% across each of the categories.

CHANNEL:	2-Tier Distribution	1-Tier VAR Direct	Mfgr. Direct	Mail Order/ Retail Direct	Web
Total Average Costs	55.5%	60.5%	62.5%	58%	50%

B2B / SOLUTION SALES LEADERSHIP: Two-tier distribution is lowest in total average costs for B2B and solution sales. IT company contacts participating in this study indicated that the Web is typically limited to consumer-oriented single-unit sales with IT distributors often handling fulfillment.

Cost Study Methodology

IT companies identified for and agreeing to participation in this exclusive study were asked to provide the name and contact information of their most appropriate internal supply-chain management/operations contact(s) to complete a questionnaire pertaining to the specified cost areas and channels. 21st Century Equity Research compiled and objectively analyzed all responses on an aggregate basis and under non-disclosure agreements with all participating companies. 21st Century Equity Research conducted telephone follow-up interviews with respondents to ensure the most relevant metrics were consistently incorporated by each respondent. Participants were asked to specify low- to high-end cost ranges (excluding product costs) on an overall basis for each of the respective SG&A and channel sales categories analyzed.

Why IT Vendors Rely on Distributors

IT vendors have traditionally relied on distributors for a variety of services, and the reasons today are more pronounced and more diversified than ever. The advantages of two-tier distribution to vendor partners include reduced investment in inventory; lower shipping, handling, and warehousing costs; a credit shield with efficient collection processes from small and mid-size VARs; exceptional service levels to this customer base; and expanded overall market reach.

Distributor business models were built for distinct B2B market purposes in serving the reseller channel and providing comprehensive solution-selling capabilities. The variable infrastructure costs of two-tier distribution enable vendors to serve this market most cost effectively, regardless of the demand environment.

Evaluating ROIC and Channel Preferences

IT suppliers need to fully consider customer groups served by each sales channel. Costs and profitability should be evaluated based on return-on-invested-capital differences between sales channels while also contemplating if differences are significant enough to force customers to shift their buying preferences.

Reseller channel partners source from distributors for compelling reasons that parallel the reasons vendors turn to distribution. They want to source comprehensive solutions from distributors with multivendor product lines while aggregating purchasing power. Independent consultation and technical services represent another important aspect of these partnerships in conjunction with the personalized account services that distributors tailor for this market segment. In the end, every IT company needs to look at its core competencies and competitive advantages and determine if they want to primarily invest in developing products that make a difference — or providing services that IT distributors have honed to ensure high channel service levels and lowest total costs to the entire vendor community.

Terminology Defined

Following are the key terms and definitions used in this cost study.

- Discount from List – Percent discount from suggested retail price.
- Special Bids / Spot Offers – Discounts allocated to specific sales channels by the supplier in unique circumstances, including competitive replacement programs, large volume purchases, and to move certain inventory.
- Market Development Funds (Soft Dollars) – Dollars allocated to specific sales channels by the supplier to help generate incremental demand, including co-op advertising and rebates.
- Programs / Promotions / Marketing – Dollars allocated to specific sales channels by the supplier, including training, marketing support, and product-specific promotions.
- AR Reserve / Credit Card Fees – Reserve to cover uncollectable receivables and transaction fees charged by credit card companies.
- Price Protection / Inventory Depreciation – A credit to sales channel partners when pricing is adjusted by the supplier and the relevant depreciation of a supplier's inventory when price is adjusted.
- Direct Sales / Advertising – Allocation of direct sales support and total advertising dollars by channel.
- Shipping / Handling / Warehousing – Allocation of these expenses by channel.
- Collections – Allocation by channel.
- Warranty / Returns – Allocation by channel.
- Inventory / AR Financing Costs – Suppliers' cost of capital multiplied by inventory and receivable balances allocated by channel.



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