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REPORT ON BUSINESS

S&P/TSX	DJ Ind.	Nasdaq	Dollar	Gold
11,826.44	11,069.06	2,262.96	87.18c (U.S.)	\$556.60 (U.S.)
-39.32	-46.26	-19.40	Unchanged	+2.00
Energy stocks lead first decline in four sessions	Interest rate worries undermine blue chips	Chip stocks drop as Citigroup cuts recommendation	Rate concerns in U.S. and Canada squeeze loonie	Renewed inflation concern underpins bullion gain

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The Direct v. Channel Sales Debate



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There is a famous maxim that says "The shortest distance between two points is a straight line" and while no doubt a truism, the shortest distance is not always the best route to take. The same can be said for sales roll-outs with regard to the decision between building an internal sales force, and leveraging a pre-existing group of resellers.

Every entrepreneur dreams of the day when their sales rocket up from \$500,000 to \$35,000,000. Along the way however, every entrepreneur is faced with a key strategic sales decision: ramping up firm sales by building an internal sales force (the Direct Sales Model), v. leveraging third-party market intermediaries to sell on your behalf (the Channel Sales Model). In pondering this decision, founders need to ask themselves several key questions, including:

- On what criteria should you base that decision?
- When does one approach beat the other?
- If I choose one, do I have to stick with it, or does it evolve over time?
- When do you need to make that decision?

To tackle some of these issues, I sat down with Les Hansen, Vice-President of Sales & Marketing for Gavel & Gown Software, a venture capital-backed software firm selling enterprise solutions to the legal profession. Since joining Gavel & Gown, Les has managed to triple G&G's customer base to over 20,000 law firms in over 50 countries around the world. G&G have sold more than 250,000 licenses through a well-managed sales and distribution

program, which leverages both a small dedicated internal sales team, and a small army of resellers around the globe. Les shared with me "The 5 C's" - which he believes entrepreneurs need to consider when pondering the Direct v. Channel sales decision.

Cost: What's the best way to spend your money?

The cost of building a direct sales force internally can be daunting. Not only do you have to hire, train, and support them, you also have to allocate additional funds for draws, employee benefits, and sales support. In addition, you must do all of this before a single unit of product is sold. Giving up a percentage of future sales revenue in the form of reseller margin may seem cheap in comparison, but "you must think this through," cautions Hansen. "You need to first calculate the breakeven point on the direct cost of a sales force vs. the margin cost of the channel," says this experienced sales strategist. "Remember that, for the most part, direct sales costs are fixed (apart from the commission component), and channel costs are variable. This also means that direct sales costs can be leveraged while channel margin costs cannot."

In this way, you need to be able to look at the long-term picture; seeing not only the short-term sales costs, but also the long-term revenue potential. You also need to allocate fixed costs to areas where you can get the highest ROI. It is in those areas where you get the most bang for your buck. R&D into new products is a must. So, you have to ask yourself: should I allocate salary to more developers, or to more internal sales people? You can scale the returns on the R&D team much better, so that may be a better place to spend your employee dollars.

Customer: How much customer interaction do you need?

Finding a customer that is willing to buy is hard. Building a relationship that will ensure they continue to buy - much more so. Channel partners provide your venture with a much larger reach, but you need to balance the channel's ability to leverage pre-existing relationships, with your need to access direct customer feedback - especially in the early days of product development and beta testing, when customer feedback is vital to ensure long-term

viability of the product. However, in the end, you need to weigh the long-term impact of keeping your customers at arms' length v. the ability to have a larger number of feet on the street hawking your product.

Calendar: How long do you have?

Building an internal sales force takes time. Even once you have them hired and trained raring to go, it will take still more time for them to go out, meet customers, qualify targets, build leverageable relationships, and establish enough customer credibility to actually close a sale. Do you as a start-up have that much time, or do you need to leverage a channel that is already selling similar products to your target audience?

Investors want scalability (the ability to ramp up revenue fast, and to do so without proportionately ramping up costs) and maximizing scalability often means deploying a channel sales force.

"Without those extra feet on the street, most VC's will have a lot harder time believing in a venture's ability to scale up to \$35M+ in 3-5 years. It just takes too long to scale up internally, and without scalability, the VC will have a hard time getting their head around an investment," confirms Phil Reddon, a VP with Covington Capital, a venture capital fund with more than \$500-million under management.

Complexity

The more complex the product is, the harder it will be to drive sales through a channel, or so one might think. "There's a myth out there that if your product is complex, you have to sell it direct. But that simply isn't an absolute truth," says Hansen. "In many cases, when the product is complex, you need channel partners to not only sell the product, but also to integrate the product into the client's existing infrastructure, to service and update the product on an ongoing basis and to provide end-user training on functionality."

This makes sense to me, as a direct sales force, which just makes commissions on moving sales units, may not focus on after-sale support. "In complex sales, you may need your channel to not only sell your product, but to also sell additional products and services that, when packaged

with your product, create a complete solution offering for the customer," Les shares: "This can be a real advantage for you. Many channel resellers will make 5 to 10 times as much money on the consulting services they sell alongside your product as they do on the margin you give them. This means that they will have significant incentive to sell your product, and it can save you margin dollars. It also allows you to focus on your core competency. If you are not an integrator you shouldn't try to be one. You should partner with someone who is."

Control: Who owns the customer?

Another key sales maxim is: "He who is closest to the customer owns the customer." This means that down the road, your channel partners may own your customers and therefore, if they walk, so may some of your customers. So you need to consider the impact of this. Is this a business risk that you can live with? While customer poaching does happen when internal sales reps switch to a competing firm, the terms of most employment contracts can mitigate this significantly. Accept that you will have much less control over your channel partners than you would over a direct sales force, which can be a challenge. Will you be able to exert enough influence over your channel partners, to comfortably achieve your business objectives? If not, can you live with this?

Control also addresses your ability to make adjustments on the fly and to influence the sales messaging quickly when needed, according to Hansen. "In start-up software sales, you may not get your go to Market plan and message perfect right out of the gate, so you need to be flexible and be able to respond quickly. It is a lot easier to control your external communication through a sales team that reports directly to you, than through a channel with which you have an arm's length relationship. Managing a message through a channel can sometimes be a lot like that game 'broken telephone'. You need to be concise and clear, or the message may get distorted as it disseminates."

So, there you have it - "Hansen's 5 C's" - which outline the key matters you should consider before choosing a go to market strategy; but what about the timing of the decision?

Evolving the Approach

In the venture capital world,

where scalability and rapid growth are prerequisites for investment, the channel sales model seems to be preferred. "From a VC perspective, I like to see companies which can leverage other people's sales forces to grow. Yes, your company will give up some points in margin and also lose some control over customer relationships, but will hopefully make up for it in terms of more volume," posts Ed Sim, Managing Director at New York City's Dawntreder Ventures, in his blog *BEYOND VC*.

Stephen Pollack, CEO of the Toronto based venture backed PlateSpin and an IT Veteran with a wealth of experience in creating and delivering software and software service, agrees with Sim: "We found that establishing a global business model was only possible through a channel approach. That was a main driver for us along with the desire to work through trusted sources (that) the customer can rely on instead of a 'startup in some far away place'. We now have 1000 customers spread all over the world through our channel model"

Therefore, if you decide on building channels, the question then becomes when to focus on such. Covington's Reddon comments: "Companies need to land, usually via direct-initiatives, commercial reference-able customers first. Then once they have enough proof of concept installs, they can turn to channelizing the process." Mike Green, President, Greenco Investments Corp. (and former Chair of the Toronto Angel Group who now works closely with several young software companies on issues including sales rollouts), echoes this notion: "There is no point in moving to an indirect channel until AFTER you have got it right with your own direct sales efforts. Once you understand what it takes to sell ... can communicate the typical sales cycle, your key selling points, and ... handle the standard sales objections, then you are ready to give the indirect sales channel the ammunition they need to be successful...but not before!"

Tips for Managing Channel Sales:

Once you've got the ammunition and information from those first 20+ reference-able customers, you are ready to start building out your channels. To do this, Les says that the fastest way is to find a group of like-minded individuals who are already in deep with your target customer base. The best way to do that? "Ride someone else's channel. Never build when you can borrow," Hansen comments. "Take a look at the products that your target customers are already buying, and find out

who they're buying them from. Chances are that someone has an established distribution channel into the market segment you want to get to." Remember - if you have a product and are looking for a channel, somebody out there probably has a channel and they are looking to push more products through that existing channel. Even better - if you can establish integration between your product and theirs you can improve the revenue generating capability of a single sales call, allowing the sales reps to 'double-dip' their commissions.

However, channel management does not end here. Once you have the channel, you not only need to maintain it - you need to motivate it. Hansen gives three pieces of advice to future channel managers: "Be fair - your channel partners expect it. Be consistent - your channel partners will talk to each other, so accept it. Be friendly - relationships go a long way, so invest in them."

The Bottom Line

There are definitely pros and cons on both sides of the Direct v. Channel debate. A direct sales force allows you more customer interactivity, but may cost more (in terms of both time and money). Harnessing a channel sales approach allows you to leverage on pre-existing relationships, but does not offer up as much control. Neither model is perfect, nor can either be applied in all cases. The shortest distance between two points may be a straight line, but the shortest distance is not the only route to take - and it certainly is not the best route to pursue under all circumstances.

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