European Access
Strategic planning brief

ARROSYS LTD
DEVELOPING SALES IN EUROPE
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As a continent, Europe is the largest single economy in the world, however the diversity and economic differences between countries poses a myriad of challenges as well as opportunities for IT manufacturers & developers seeking to exploit it. The successful execution of the optimum entry and expansion strategy will be the difference between success and failure. This whitepaper has been produced as a guide for IT companies seeking to expand their business in Europe as part of an entry or expansion plan.

Europe:

The European Union termed EU27 as of 1st January 2007 consists of 27 member countries and uses 23 official languages. When considered as a single unit, EU27 has the largest economy in the world. Europe's largest national economy is that of Germany, which ranks third globally in nominal GDP, and fifth in purchasing power parity (PPP) GDP. Second largest is that of the United Kingdom, which ranks fifth globally in nominal GDP and sixth in PPP GDP. In 2006 the combined European Union GDP was 12.769 trillion euro. As a continent, Europe comprises of more than 710 million people across 48 different states/countries. The wealth of Europe's states varies, although the poorest are well above the poorest states of other continents in terms of GDP and living standards.

Successful business entry and expansion requires knowledge of the market and needs to encompass the language, cultural and economic variations between the countries. IT manufacturers and developers need to build and execute engagement/entry plans that consider these diversities and the opportunities presented. Typically, companies will consider one of the below commencement strategies. A more recent fourth strategy identified later in this document provides a fourth alternative that should also be considered.

- Remote management
  - Out of country/region recruitment and management of partners within the target geography
- Sales agents and development agencies
  - Contract agents and/or agencies within the target geography
- Physical presence
  - Obtain your own staff and facilities within the target geography

Remote management

Many companies prior to engaging in a European entry/expansion strategy will commence in this mode. Invariably, the precursor to any managed entry strategy is ad-hoc product enquiries received from potential customers and partners in Europe. Additionally, some of the company's existing domestic market customers might well have remote office locations within Europe which require supply and support. Over a period of time, products are purchased and then deployed by these ad-hoc opportunistic partners. Sales and post-sales support is typically provided remotely from the company's domestic market. The natural adoption of this remotely managed in-direct selling strategy often draws the conclusion that remotely recruiting additional partners including distributors etc is a low-cost entry method to expand and grow.

In our experience the continued expansion by remote management seldom proves successful in providing appreciable growth in revenue. The direct costs might well be minimised, but hidden costs are increased. The cost in travel expenses, time and diversion of resources normally focussed on the domestic market should also be considered. There can of course be exceptions, particularly where the product is simple to install & use and the demand from end-customers/consumers is compelling. In this scenario reduced time and effort is required to recruit and develop the partners. In reality partners will naturally follow the trends of supply and demand. Should this be the case then a strategy of remote management and a higher spend in end customer/consumer marketing is a viable approach. Seldom though is this the case. The reality is, without a local resource presence, results will be weak. Our observations include; non-existent end-customer control, elongated sales cycles, poor forecasting and a struggle to achieve early market traction. The lack of direct end-customer control will often double and sometimes triple the time it takes to establish key early reference customers. Potential European partners will view the lack of a direct presence as high risk to them and will elect to work with the lower risk company with local sales and technical support personnel. Many companies falsely believe that the offer of significant channel margins is all conquering and will turn any partner from an incumbent competitor offering. The truth today rests with far more than just product margin. Partners elect to work with a company based upon many factors, margin alone is not sufficient. A competitor with local people, demand generation and technical support will out weigh the higher risk more difficult to work with unknown remote manufacturer who just offers increased product margin.

An argument often rallied by companies embarking on a remote management approach is to recruit some distributors and then use them to build and develop the underlying infrastructure of resellers, VAR's and integrators. Ten - fifteen years ago this strategy might well have been successful, the reality today is very different. Distributors are fundamentally "market enablers" and not "market builders". Good distributors today provide excellent logistics & finance plus a channel marketing engine. These deliverables are important aspects in any go-to-market model but by themselves they do not create the market. Local stock, easy purchasing, good credit facilities and tactical channel marketing campaigns are important benefits offered by distribution but are actually enabling/supporting functions within a go-to-market model. These functions are often particularly important immediately following the initial "beach head" establishment of reference wins and early reseller & VAR recruitment successes. What is surprising is that so many overseas companies with their own local market knowledge of distributors should then believe that distributors in Europe offer more. Distributor margins have reduced greatly over the past ten years. Consolidation of European distributors with large overseas rival distributors has been a big contributing factor in margin reduction. These large distributors have huge purchasing, logistics and finance engines and have business models designed for low cost, high volume sales. Smaller, local country distributors are forced to compete with a portfolio of lower volume manufacturer products into a reseller, VAR and integrator market whose pricing expectations are dictated by the larger organisations. The reality is, that these local country distributors adopt the low cost, low value selling techniques of their larger counterparts. Those few obscure distributors with a modicum of higher cost of sales external resource and technical capability are so small that the ideal resellers, VAR's and integrators are oblivious to them and are not able to obtain the required levels of credit or product availability to warrant considering their offerings. Due to margin pressure they will also attempt to sell directly bypassing the channel and creating channel conflict and an environment where partner recruitment becomes impossible.

Given that a distributor will not by themselves create a market for a manufacturer, might they facilitate reseller, VAR and integrator introductions for a company? And then afterwards manage and drive reseller sales activity once recruitment has been completed by the manufacturer? In considering whether distributors can provide these capabilities one has to look more closely at a distributor's selling/supply methodology. The primary customer target for every distributor is the purchasing department within resellers, VAR's and integrators. Introductions to the purchasing department within these partners are certainly far from the ideal but can be argued as a starting point. Very few, if any distributor sales people ever speak or meet with Reseller, VAR and Integrator; Managing Directors, Sales Managers, Technical Managers, Marketing Managers, Systems Engineers and External Sales. All of which are vital components that need to be managed, motivated and supported to deliver the best possible results once recruited. In our experience, companies should use distributors for their strengths in logistics, finance and channel marketing and themselves recruit/develop/manage VAR's & Integrators whilst creating and supporting the demand in End customers.

In summary:

Remote Management benefits:

- Low direct cost
  - The cost of hiring or contracting local staff and facilities is eliminated. In this situation however, partners will most often seek head funding as an incentive to become a partner
- Effective results when high customer demand
  - Where the product is simple to install, use and maintain and customers are compelled to purchase. Partners will naturally follow the market demand and contact the manufacturer directly to become a partner. A simple two-tier distribution model can then be employed and managed remotely until a local market presence is warranted

Remote Management drawbacks:

- Impact on performance in existing domestic market
  - Increased revenues obtained from the remotely managed European market can often be to the detriment of existing domestic market revenues. Remote management activities often impact domestic market resources, reducing the focus of generating revenues within the existing market
- Expense costs rise
  - The cost of travel to and within Europe plus accommodation etc. should not be overlooked as Europe prices are not low
  - The actual time spent travelling to Europe and then between countries negatively effects sales yields
- Engagement period extended
  - Without the knowledge and relationships within the target countries, recruitment periods can be significantly longer. The ideal partners will often be those that require an example of a company's commitment to the region through a local presence prior to committing and actually investing time and focus themselves
- Initial beach head sales wins are difficult and expensive to obtain
  - Larger customers will require confidence in the manufacturer's ability to support them subsequent to purchase. Local manufacturer technical resources are often key in this decision process
  - Larger integrators with in-house technical services capability will require local development and support
  - Initial engagements will rely heavily on marketing and telemarketing agencies to generate introductions and project opportunities. This can prove to be a very costly and sometimes fruitless exercise without local resources driving them

Sales Agents and Agencies

In an effort to obtain the benefits of a local presence some manufacturers enlist the services of individually contracted sales agents or specialist development agencies. In this approach a semblance of local presence can be achieved. Individual agents can have experience and relationships (although not necessarily in the correct technology/market). Agents operate on an hourly/daily rate basis with some reward percentage based upon the revenue achievement. They will often represent several manufacturers simultaneously, the corresponding costs should therefore be based upon a part-time shared individual(s). As an alternative to contracting individuals manufacturers can engage with an agency. There are numerous agencies in Europe, some of which promote an ability to provide total Europe coverage. These agencies have typically expanded from marketing agencies, call centre facilities or recruitment/contract staff placement companies. Some agencies provide little more than a marketing and internal telemarketing/telesales call centre service. Others are often recruitment solution providing contractors. The more advanced will provide access to a small pool of in-house sales personnel that are technology literate but unlikely to be experts in a specific technology sector or target market vertical. Additional sales representatives might then be provided through individual agents contracted by the agency themselves. This removes the burden of managing multiple individual agent contracts and the fact that agencies will typically have one or more office locations, a local European address can be obtained.

Initially, this approach would seem to be the ideal compromise between remote management and actually employing local staff. Certainly a semblance of local presence, market knowledge, existing relationships and language skills can be obtained at a reduced direct cost to the manufacturer. Given the increased costs over a remote management approach the return on any investment must be measured.

Securing early end-customer reference sites, obtaining and developing key initial partner relationships are critical components of any successful regional growth strategy. Marketing and call-centre sales techniques alone will not provide these necessary beach heads. External generalist sales skills and a “part-time” approach of representing multiple manufacturers simultaneously will reduce the focus and commitment further. Many of these sales resources rarely have the ability, knowledge or focus necessary for direct touch end-customer sales development and key VAR’s and integrators will quickly recognise them to be agents rather than the actual manufacturer. A marketing and sales only approach offered by agencies will need the support of technical resources to complete the engagement and development process. Agents and most agencies do not offer integral technical resources. Technical pre-sales resources will therefore need to be provided and costed by the manufacturer.

In summary:

Sales agents and development agency benefits:

- Reduced direct cost
    - The cost of hiring local staff and renting facilities etc. is eliminated
    - The multiplexing of several manufacturers through each person results in a part time approach, hence a part time cost
- Improved results in the SOHO/SMB markets
    - In the SMB market a distribution and SMB reseller/dealer channel strategy coupled with marketing demand generation in end-customers can be managed and supported effectively via agents and agencies. In this market sector the engagement and

endorsement of the actual manufacturer in the local market is not essential during the entry and growth phase. Key will be obtaining the distributors and creating the demand within end-customers that pulls the business through the abundant SMB resellers and dealers that supply them
    - Knowledge and experience of the channel partners, local culture and language will aid the introduction of a new manufacturer
    - Marketing and call centre capability when correctly integrated within the agency can lead to improved results in marketing/demand creation activities

Sales agents and development agency drawbacks:

- Not effective method of penetrating Enterprise, Service Providers and mid-sized organisations
    - Agencies & individual agents will represent multiple manufacturers simultaneously. Customer and partner engagement is reduced as these organisations will see an agent presence as a lack of support and commitment by the manufacturer
    - Multiplexing of several manufacturer lines by each sales person reduces focus, time and commitment on an individual manufacturer
    - The quality of sales people varies enormously, many have adopted contracting due to un-employment
    - The lack of integral technical services resources within agencies severely impacts the first reference sales cycle and creates delays and obstacles to recruiting and developing channel partners
- Optimum penetration of SOHO/SMB markets is not always obtained
    - The quality of sales people varies enormously, many have adopted contracting due to un-employment
    - Integrated marketing activities will often play a key part in the engagement and penetration process. Direct communications, telemarketing, events, PR etc. need to be an integral part of the selling process. Agencies and contractors lacking this ability will be less effective
- Limited sharing of risk
    - Whilst the initial cost is often minimised a high proportion will be set on an hourly/daily base rate of the agent/agency. Only a nominal proportion will typically be based upon success metrics
    - Agents will simultaneously represent multiple manufacturers, those that are being successful will gain the majority of time. The failure of a new manufacturer in the portfolio has limited impact on the agent
- Reliability
    - Many sales agents and agencies are individuals or small companies. The people are often sales persons between permanent roles. Manufacturer introduction and acceleration is vulnerable and can stall due to their cessation of business as well as capacity, capability and health
- What happens when critical mass is achieved?
    - If everything has been successful and a manufacturer reaches the point where they wish to employ their own resources and establish offices in the region a transition strategy is needed. An ethical transition strategy will be required, one that does not damage the manufacturer business or reputation in the market. Some agents and agencies cannot offer this

Physical Presence

Employing local permanent personnel and obtaining a business location in Europe is the traditional approach often opted by organisations that have significant investment fund. The recruitment of suitably qualified, regionally based direct staff provides a number of longer-term advantages over both remote management and sales agent approaches previously outlined.

Physical manufacturer presence within a target market/country facilitates a faster implementation, higher levels of partner/customer satisfaction, increased awareness and improved rates of revenue. For example the country in which a manufacturer's European HQ is located typically results in being the largest revenue return country within Europe.

Enterprise level and mid-sized customers demand the direct-touch attention of the manufacturer, and channel partners are cautious of investing in a manufacturer that is not prepared to invest in local resources. In some instances manufacturers seek to cover a market using staff in a neighbouring country or from one central European location. This approach is a place-holder at best. Ultimately cultural & language differences, lack of local knowledge, relationships and the travel burden in cost and time become a major hindrance to obtaining anything close to the full potential from a country. We have demonstrated to many manufacturers that the revenues from the accession countries in Eastern Europe can be increased multiple times using local resources rather than attempting to manage from the DACH region or the UK.

Physical presence provides an excellent platform to enter and expand in Europe, however, the initial ROI is likely to be poor as recruitment fees are high and it may be many months before individuals are recruited and become truly effective. In addition, recruitment mistakes can result in lost time and potentially very high extraction costs due to residual recruitment fees and national employment laws.

Manufacturers will need to consider the resource levels actually required. Initial entry into Europe can be approached with the “establish a beach head” in a country/region philosophy and then expand once a return on investment has been achieved. The advantage being that the investment cost and corresponding risk is reduced. Yet, even with this strategy the investment cost can still be substantial and the period needed to recruit and setup can mean a time to market opportunity is missed. An investment prior to any revenue return in the first 6 months of greater than €200k euro on 2 staff with recruitment fee costs is the absolute minimum budget. In total, year 1 investment cost will be considerably over €400k euro and that assumes no office or additional staff are required.

Direct employment cost example:

Country / Sales manager minimum salary. *(Assume 100% guarantee typical for the first 3 months)*	**Q1**	**Q2**	**Q3**	**Q4**	**Total year 1**
Fixed	€ 35,000	€ 35,000	€ 35,000	€ 35,000	€ 140,000
Commission	€ 12,250	€ 12,250	€ 12,250	€ 12,250	€ 49,000
Plus government taxes	€ 8,505	€ 8,505	€ 8,505	€ 8,505	€ 34,020
Plus expenses	€ 4,500	€ 4,500	€ 4,500	€ 4,500	€ 18,000
TOTAL COST	€ 60,255	€ 60,255	€ 60,255	€ 60,255	€ 241,020
Systems Engineer typical minimum salary:					
Fixed	€ 17,000	€ 17,000	€ 17,000	€ 17,000	€ 68,000
Commission	€ 2,550	€ 2,550	€ 2,550	€ 2,550	€ 10,200
Plus government taxes	€ 3,519	€ 3,519	€ 3,519	€ 3,519	€ 14,076
Plus expenses	€ 3,000	€ 3,000	€ 3,000	€ 3,000	€ 12,000
TOTAL COST	€ 26,069	€ 26,069	€ 26,069	€ 26,069	€ 104,276
Recruitment fees for above 2 staff at standard rate:	€ 66,800				€ 66,800
	Q1	**Q2**	**Q3**	**Q4**	**Total year 1**
TOTAL not including facilities, office or costs to obtain databases, telemarketing etc.	**€ 153,124**	**€ 86,324**	**€ 86,324**	**€ 86,324**	**€ 412,096**

This example is for two people (1 sales & 1 technical) and excludes facilities, marketing etc. As a first step entry this can be viewed as the minimum requirement unless the manufacturer intends to place a technical resource from their domestic market on secondment within the region. The period of investment return will vary dependant upon the target market profile, established competitors, channel and pricing strategy and any ancillary spend on marketing etc. A full market analysis prior to commencement will provide the data needed to produce and cost an entry strategy and highlight at what point the investment cost will be returned. Our advice is always conduct this analysis, preferably in conjunction with an organisation that has the correct staffing profile to obtain the data, test the market and make recommendations on the optimum entry strategy.

Although this approach involves higher investment costs, with the correct pre-planning and good staff selection the system has a much higher chance of success than the previous approaches, particularly in the Enterprise and mid-sized customer sectors. It will score over contracted agents and most agencies as the market perceives commitment from the manufacturer through European staff and facility investment. Also, once business becomes established there is no staff changes necessary at the handover point.

In summary:

Physical presence benefits:

- Improved business ramp-up period
    - Once staff are employed immediate customer and partner contact can commence. Local resources will understand the competitors, their strengths and vulnerabilities and target accordingly
    - End customers will respond favourably to local knowledgeable resources with reduced fear of purchasing a solution from an unknown manufacturer
    - Channel partners will appreciate the manufacturer commitment and investment in establishing an immediate presence in Europe. Local technical resource we help reduce concerns on their own initial investment costs
    - Ideally sales and technical staff will have legacy relationships that can be leveraged during the introduction phase
- Improved chance of success
    - Improvements in customer and channel engagements will result in a higher success ratio over remote or agent based approaches
- Less disruption once business levels established
    - Once the entry phase has been completed and critical business targets have been achieved additional staff can simply be added to the team without disruption

Physical presence drawbacks:

- High cost approach
    - Costs of staff alone can take a considerable period to recover. Additional spend on marketing, analysis and facilities can mean the investment recovery period is beyond 2 years
    - Initial staff engagements may not be ideal and further recruitment activity might prove necessary causing delays and further costs. Employment laws in Europe can mean protracted and costly terminations
    - Senior sales staff will typically require a minimum 3 month guarantee on target achievement
- High risk
    - Although the chance of success is greatly improved over remote management and agent approaches the initial investment will be considerable
    - Reliable and quality staff are not the responsibility of the recruitment agency. Many manufacturers find that initial staff need to be replaced after 6 - 9 months
- Time-to-entry is often extended
    - The period between decision to enter and then starting to engage and sell can be an extended period. The recruitment process will typically vary from 4 – 6 months for senior sales people due a standard notice period in Europe of 3 months.
- Reliability
    - There is never an insurance against accidents and illness or staff deciding to gain an improved position elsewhere

All 3 approach methods can be viable options. Each has positives and a number of drawbacks which need to be considered during the planning of an entry or expansion strategy. In 2002 after numerous years of accumulated experience building and executing entry and expansion strategies in Europe we decided to form Arrosys, a company focussed on just that. We firmly believed that we could provide an alternative approach which was superior to all three of the models described previously. Having utilised and experienced first hand each of these approaches the Arrosys alternative capitalises on the advantages of each and eliminates or reduces the drawbacks to an absolute minimum.

Arrosys Manufacturer Representation (AMR) - a compelling alternative to remote management, agents, agencies and physical presence.

The Arrosys Manufacturer Representation (AMR) solution provides all of the advantages of being physically located within Europe or a target country without the drawbacks. In fact the benefits offered in business acceleration significantly surpass those obtained by employing staff directly during the entry, acceleration and expansion phases.

Arrosys Manufacturer Representation (AMR) is a hybrid of a large scale agency service organisation combined with actual physical presence. The traditional disadvantages of an agency approach or a physical presence rest in four key areas:

1. Multiplexing of manufacturer lines
    a. Agencies and agents do not provide effective market visibility of the manufacturer
2. Resource infrastructure limitations
    a. Agency and agents provide in-appropriate skill sets that lack an integrated technical & marketing capability
3. High initial costs & investment risk
    a. Physical presence necessitates high investment costs with no guarantee of success
    b. Agent and agency charging methodologies lack risk sharing with client manufacturers
4. Time to success extended
    a. Recruiting staff can take an extended period, absences, terminations etc. result in extensive delays

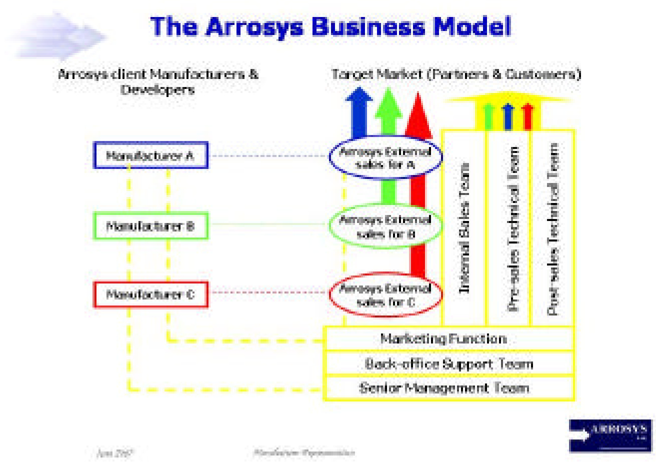
<u>Each of these areas has been addressed within the AMR solution:</u>

1. Manufacturer multiplexing
    a. Although Arrosys simultaneously represent multiple non-competing manufacturers (a clause we also include in any contract) the customer facing external resources are dedicated by manufacturer. The perception within the market at both a customer and partner level is that the manufacturer is physically present through resource and facility branding. The Arrosys name is not branded
2. Resource limitations
    a. Arrosys combine external sales, internal sales, telemarketing, marketing, technical engineers and senior management within the organisation. Direct resource coverage is provided within 7 European countries (including several Eastern Europe accession countries). A further 9 countries are supported via a strategic eco-partner system.

Typically all resources and relationships will be leveraged during the entry and acceleration phases of a manufacturer client

3. Charging methodology
    a. Arrosys confidence in our ability to succeed means that we are willing to share both the risk and the reward with manufacturer clients. The charging methodology principle ensures the highest proportion of the cost is based upon achievement of results. Any fixed costs are minimised and will be below 50% of the Arrosys resource costs utilised. Over a predetermined period the fixed element will reduce to zero

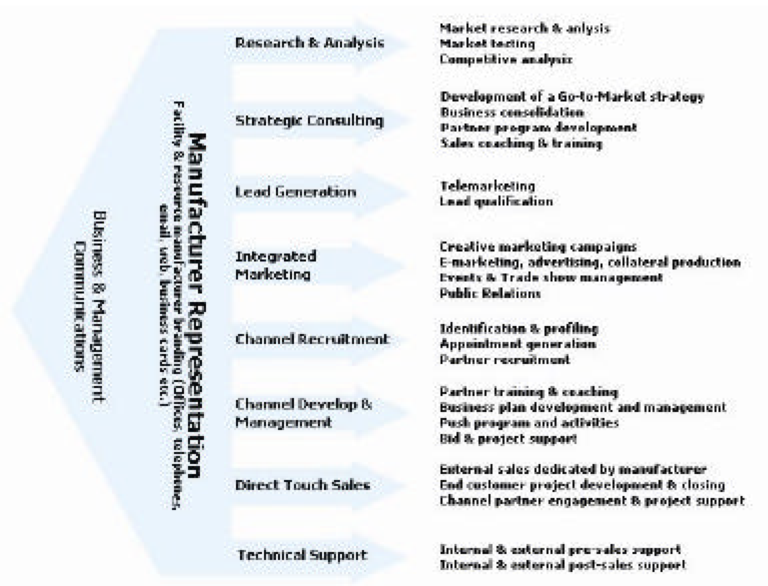
Arrosys have architected a unique internal business model based upon collaborative service units which facilitates these benefits and many more.



In addition to overcoming the drawbacks outlined previously, AMR improves upon the business acceleration benefits of employing a direct physical presence. The diversity, experience and knowledge combined within our tightly integrated infrastructure is harnessed fully and provides a unique business proposition for our manufacturer clients. By employing reference selling techniques the extensive base of existing channel partner and customer relationships can be leveraged fully as part of the introduction and growth of a new manufacturer client. This infrastructure coupled with a policy to represent non-competing manufacturers, enables the combining of different manufacturer's products into "solution sets". These solution sets can then jointly be taken to market by the various teams. Lead generation activities conducted by integrated marketing and telemarketing functions will often identify opportunities out-side of their original targets. These incremental opportunities can then be exploited by one of the other manufacturer sales teams. The leveraging of internal resources, external relationships and the development of solutions sets provides significant acceleration opportunities above that which can be gained by simply employing permanent staff.

Collaborative service

The AMR out-sourcing solution combines multiple collaborative service disciplines which can be tailored dependent upon a Manufacturer's requirement. It is our belief that companies both internally and externally with their partners and suppliers will increasingly seek to function in a collaborative manner. Each discipline or function within a company will be a Collaborative Delivery Unit (CDU). Each CDU will operate within a collaborative framework supporting and obtaining support from peer CDU's and reporting to senior management. Increasingly, companies will also recognise that more and more non-core CDU's within their organisation can be out-sourced in order to gain advantages in cost and performance. The Arrosys business and client engagement models are based upon a collaborative framework. Each CDU provides a range of supporting services internally and externally on behalf of clients. CDU's and their sub-services can be individually utilised by a manufacturer



or combined into more complete solutions. The Arrosys Collaborative Service Model outlines the various Collaborative Service Units that can be combined within a Manufacturer Representation solution.

Summary:

The Arrosys Manufacturer Representation out-sourcing service provides all of the benefits of actually opening an office or multiple offices and employing high calibre experienced personnel without the normal high costs. The risk of investment costs in entering Europe or expanding into an additional country prior to seeing any return in revenue is significantly reduced. Arrosys provide the facilities and management, sales, technical and marketing personnel charging just a small percentage of that cost plus a commission % based upon results. No other out-sourcing/out-tasking alternative can provide the breadth in resources, manufacturer exclusive external focus and a ready to leverage extensive channel partner and potential customer base.

Arrosys fully appreciate what IT manufacturers and developers need to develop a market in Europe and then transition it once milestones/critical mass are achieved. From many years of experience and successfully building businesses within Europe we also know exactly what European partners and customers need. This knowledge and experience has been harnessed within the Arrosys Manufacturer Representation out-sourcing solution a compelling alternative to physically employing staff in target European countries.

For more information about AMR or other services offered by Arrosys please either email: info@arrosys.com or telephone: +44 1908 645619