

Asia-Pacific IT Channel Dynamics



By Cindy Payne, Managing Director, Asia-Pacific Connections Ltd.

Like most of the IT markets around the world, the marketplace in Asia-Pacific has become more global in the last few years. Consumers across the region—be it in one of the major metropolises like Tokyo, Hong Kong, Singapore, or Sydney, or in a hill tribe village in Myanmar—can dial up on the Internet their favorite U.S. mail order house to buy the latest IT products. The growing sophistication of the Asia-Pacific users and the wide availability of products from overseas channels has placed enormous pressure on the distribution channels in the region to ensure at least comparable, if not cheaper, solutions with value-added local service and support. PC growth across the region has exploded in the last few years totaling 44% from 1994-1995 and 36% from 1995-1996, according to IDC. This PC growth is in response to the booming small office/home office (SOHO) and home markets on the one hand, and the wildfire pace of infrastructure development on the other. To compensate, vendors and all channel members have been forced to change the way they do business.

The following is an analysis based on interviews conducted by Asia-Pacific Connections Ltd. with a number of key players across the Asia-Pacific IT industry. The research included discussions

with vendors, distributors, dealers, retailers and research companies to assess the key changes occurring in the channels, to understand how all parties have been affected, and to define what specific tactics have been necessary in order to stay ahead of the pack.

Broad-based distribution

First of all, there is no such beast as a true pan Asia-Pacific distributor today. The closest models you will find are the large tier-one distributors who have multiple offices across the region, namely Tech Pacific, SiS and ACA Pacific. But even these companies have not been successful in venturing into the large markets of north Asia like Japan, Korea and Taiwan because these markets are dominated by large, local distributors. The barriers to entry are significantly lower in most of the other markets in the region, and these top distributors have been battling for expanded product ranges and regional market reach over the last decade.

Traditionally, vendors were able to count on even the largest distributors in Asia-Pacific to act as their local sales and marketing arm, taking care of everything from product launches and training to marketing promotions and tech support. Long

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gone are those days as these large distributors now carry everything from the latest computer systems and complex networking products to all the commodity and application software and the plethora of peripherals available in the market today. The sheer volume of products running through these distribution houses has forced these mainstream distributors to become logistics experts with sophisticated MIS systems while keeping an eye on their overhead in order to keep their heads above water.

With increased volume in the channel and increased competition, both from emerging boutique-style distributors within the region and from global players, the Asia-Pacific distributors have been plagued with falling margins. Gross margins now run somewhere around 4-8%, depending on the market. If overhead creeps up to 4%, it is almost impossible to survive. With the advent of vendor rebates, the distributors now have the opportunity to earn up to another four margin points from the vendors, though most of this gets passed along to other channel players "down stream", such as the dealers and retailers.

With razor-thin margins, it has become increasingly difficult for the distributors to add value to the channel, not to mention service to the end users. However, the ever-demanding consumer base now requires more training and support from the resellers. The evolution has come full circle and these distributors are now placing the responsibility of training programs, marketing campaigns and much of the technical support back on the vendors. Vendors are also expected to provide stock rotation and price protection, as the distributors must do the same for their resellers. Although it can be wise to offer a distributor exclusive rights during the initial stage of market introduction to encourage the distributor to assist in building brand awareness, most vendors opt for multiple distribution partners once their company's products are estab-

lished. Some vendors even segment their channel by product line, while others allow all distributors to carry all products. Not surprisingly, distributors today have less incentive to invest in pre- and post-sales activities.

The retail marketplace

One of the sources of increased pressure on distributors and vendors is the growing support required by the multitude of retailers vying for the explosive home and SOHO business. Not only does the home market today account for more than 25% of all PCs sold across the

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region, according to Dataquest, but users are becoming more sophisticated. They want the latest Pentium PC with a 2 gigabyte drive, a high-speed modem, a CD-ROM, and a number of software applications. Retailers must cope with the fact that more and more complex technologies are rapidly becoming commodity in scope. They have had to respond by not only carrying stock of these high-end products, but having well-trained staff fluent in the latest technologies. The high volume of products now carried by retailers reduces the amount of mind share devoted to each line, once again bringing the responsibility back to the vendor to not only provide training, but also merchandising, point-of-sale materials and

market development funds (often through the distributor).

Though the superstore model is visible in most major cities in Asia-Pacific, most cities do not have more than one such store and reports are that many of these stores are having a hard time financially. Not only is a 20,000-30,000 square foot store in any major Asian city cost-prohibitive, but the economies of scale are lacking. The most established of such stores include Sejin in Korea, Challenger in Singapore and CompAsia in Kuala Lumpur. The market dynamics are substantially different in Australia which allows Harvey Norman to enjoy the same success as its U.S. counterparts. Instead, the computer shopping mall or arcade model is highly successful in most Asian cities, including Singapore's Funan Center and Sim Lim Square, Hong Kong's Star City, Windsor House, Computer 88 and Golden Arcade, Kuala Lumpur's MB Plaza and Bangkok's Pantip Plaza.

VARs and systems integrators

The VARs and systems integrators (SIs) who used to have the high-end business to themselves have also had to adapt to this channel crowding. With the prevalence of more complex products in the retail channels, VARs and SIs are moving up another few rungs on the ladder, focusing mostly on the larger, more complex corporate and government tenders which generate service as well as product revenue. A major percentage of these tenders involve infrastructure development across the region, a gold mine for those who are well-equipped with solutions, service and support expertise.

The vendor perspective

The flood of vendors pouring into Asia-Pacific are finding that it takes not only investment, but patience and fortitude to become firmly planted in the world's fastest growing IT market. With distributors and resellers requiring vendors to take more responsibility for the marketing and support of their products, those that can afford to are quickly establishing sales offices, training centers and local

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support networks in major markets throughout the region. Companies that cannot fund such an investment up front are wise to fine-tune the effectiveness of remote support tools including BBS, e-mail and Web sites as a first step, followed by putting at least one sales manager in the region.

While some vendors deal directly with the largest corporate and government customers, few deal direct with smaller users and rarely will you find distributors who sell to end users. The direct-selling approach has been initiated by a few PC companies in some markets, most notably Dell with its direct mail/telesales approach. Dell has been very successful in Australia and Japan, where it has increased revenues by more than 100% per year since establishing subsidiaries in those markets in 1993. Moving into the rest of Asia, Dell launched direct selling in Hong Kong, Malaysia, New Zealand and Singapore, whereas the company still relies on channel partners in China, Indonesia, Korea, the Philippines and Taiwan.

While committing more and more to supporting channel partners, vendors must also keep a close watch on channel inventory and credit control. Typical stock turns at the distributor level have increased over the last several years from under 12 per year, to between 12 and 18 per annum. Credit availability and terms vary between markets and among vendors, but in less developed markets it is prudent to stick to cash in advance or letters of credit. Manufacturers with voracious appetites for market share have gotten into trouble by foregoing stringent credit policies in attempts to quickly gain market share. Compaq is the most notable example, having to go to court to collect \$32 million in receivables from one distributor in China after overloading the channel last year in an attempt to unseat market leader AST.

Conclusion

While the changing environment in the Asian IT industry presents consistent challenges to all channel players, the good news is that these changes are the result of record-breaking growth and the region's increasing importance in the global economy. Like any business venture, successful investment in the Asian IT market is one part planning, one part follow-through, and one part timing. By paying attention to the changing needs of the market and addressing those needs with strategic and effective solutions, those venturing into the Asia-Pacific region can reduce their dependence on feng shui and ensure a profitable ride on the region's growth wave into the 21st century. ♦

Note: Cindy Payne is a regular columnist in IT International (formerly Marketscan International), a monthly newsletter covering market developments in Asia-Pacific, Latin America and emerging world markets.

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