

Intermec, Inc.
Reformulating a Multi-Channel Strategy

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Pat Byrne, Chief Executive Officer of Intermec Technologies (Intermec), sat back in his office chair and stared out the window. He felt uneasy about the firm's future, given its poor financial performance in 2009. One thing was starkly obvious; the number of employee cars in the parking lot had dwindled to an alarmingly low number. The cost cutting measures had kept the firm afloat but he was concerned whether it had turned the corner.

Mr. Byrne, 49 years old, began his tenure as CEO of Intermec in 2007. His most recent experience was with Agilent Technologies' Solutions Group's Wireless unit. Agilent is a \$5.0 billion, bio-analytical and electronic measurement company. He wonders if he made the right move to take over the helm at Intermec during a very challenging and turbulent time.

The Firm

Intermec is a leading manufacturer of mobile computerized devices, used in the Automatic Identification and Data Capture (AIDC) industry. Since first opening its doors in 1966, Intermec established itself as an innovator through introducing a steady stream of technological breakthroughs. As of 2010, Intermec held over 580 patents, as well as numerous copyrights, trademarks and trade secrets (2). Many of today's most common technologies, such as barcode scanning and printing, were invented by Intermec. The headquarters are located in Everett, WA and the firm has a workforce of approximately 1,734 employees (2009). The firm has traded publicly on the NYSE since 1997 under the symbol of IN.

Products and Services

Intermec designs various computerized devices including rugged mobile computers, barcode scanners, wireless barcode printers and radio identification products (RFID). The firm has outsourced all manufacturing to a Singapore firm since 2007. Intermec customers use these devices for mobility initiatives in a variety of applications including asset management, direct store delivery, field service, warehousing, and transportation/ logistics (www.intermec.com). Beyond the hardware, Intermec also earns substantial revenue from selling after-sales repair services.

The Market

The market in which Intermec competes is highly fragmented and rapidly evolving due to changes in technology. There are only a few major market manufacturers, competing for a number of market segments, each of which has its own unique requirements. Intermec's top competitor in the AIDC market is Motorola, Inc., a \$20 billion behemoth. In particular, Intermec competes head-to-head with Motorola's wholly-owned subsidiary, the Enterprise Mobility Solutions unit (formerly Symbol Technologies, Inc., with sales of approximately \$4.6B). Other much smaller competitors include Honeywell, DAP Technologies, Fujitsu Tablet Division, Zebra Technologies, Oneil Product Development, and Datalogic. Virtually all of the competitors in the market utilize the same hybrid marketing channel strategy; a combination of indirect and direct channels. The competitors in the market offer similar technology but differ in either their product breadth or product line depth. Motorola and Intermec offer the broadest product mixes, by far in the market. They also offer the most complete solutions for customer requirements. However,

due to open system architecture (Bluetooth communications on all devices, for instance), customers are free to “mix-and-match” technology from multiple vendors.

Revenues

Intermec is a business-to-business marketer operating in a market space with a total domestic (US) market size of approximately \$8 billion (1). In 2009, Intermec’s share of this available market was approximately 6% (2009 fiscal year gross revenue \$658M) (1). Intermec revenues were trending up over the last few years until it hit a huge bump in the road in 2009: \$849M (2007), \$891M (2008), \$658M (2009). The 26% reduction in revenue from fiscal years 2008 to 2009, resulted in the first net income loss ever for the firm (\$11.8M or \$.19/share). This was a bitter pill to swallow because the \$891M revenue figure in 2008 was a record for the firm. This disastrous collapse was a result of a number of several key factors. These factors included a general contraction in demand for Intermec’s products due to the global slowdown and substantial inroads made by larger competitors. These competitors (Motorola, in particular) were much better suited to weather the financial storm and were hungry enough to offer deep discounts to buyers to secure sales.

Distribution

Intermec sells both its products and services through a hybrid (or multi-channel) distribution channel. This channel is comprised of a direct sales force, an e-commerce website, and a network of resellers and distributors.

Direct Channel

The firm sells its offerings to enterprise-level customers (corporate sales exceeding \$100M) via a direct sales channel that is manned by a professional sales force. The direct sales channel

accounts for approximately 30% of Intermec sales (1). Presently, there are sixty sales representatives, evenly allocated across four geographic territories. Each territory has a territory manager, to whom the sales representatives report. The territory managers report directly to the Vice President of Sales. There are also another twenty-five direct sales representatives (key account executives; KAE) who are assigned to either major accounts (A. C. Neilson, for instance), mission critical industries (RFID) or market segments requiring unique skill sets (government, education, etc.). Each of these KAEs reports directly to the Vice President of Sales. All of the sales representatives and KAEs have decades of experience in this marketplace, are college educated, have very deep and wide contacts in the industry and are very well paid. A representative's compensation package consists of a salary of \$110,000 per year, a 9% commission on gross sales that are closed and booked, a \$5,000 per month expense account (expenses must be qualified and submitted via an expense report) a competitive fringe benefit plan that is valued at 30% of the salary. The average gross margin on a sale through the direct channel is 31%. All sales representatives can sell any product or service in the Intermec catalog; this includes hardware and proprietary software. Representatives are not compensated for selling after-sales service contracts or extended warranties (3- or 5-year). Each representative is assigned either a geographic territory or a specific account focus (market or major account). Sales representatives either operate from their home offices (if in remote regions) or make use of one of Intermec's satellite offices located throughout the United States.

Another, less significant, part of the direct channel is Intermec's corporate website (<http://accessories.intermec.com>). Customers simply log into the website with their customer number and order from the online catalog. Intermec does not actively advertise this option but approximately 15% of all direct sales are obtained online. The average gross margin on sales

from the online catalog is 39%. One of the drawbacks of shopping online is customers must pay for their purchases with a credit card and cannot order items “on account” (trade terms).

Indirect Channel

The firm also has an indirect channel of distribution. The indirect channel accounts for approximately 70% of Intermec sales (1). This consists of a variety of master distributors and resellers. The master distributors stock a variety of AIDC products and accessories from competing manufacturers. In the US, there are three main master distributors: Scansource (scansource.com), Blue Star (bluestarinc.com) and Ingram Micro (ingrammicro.com). Of the three distributors, Scansource is the most prominent and most dedicated distributor to the AIDC marketplace. Moreover, Scansource is strategically important to Intermec. Scansource accounted for more than 10% of all Intermec sales in 2007 (\$108.7M), 2008 (\$113.8M), and 2009 (\$123.0M) (1). Intermec’s average gross margin on sales to Scansource is 27%.

The indirect channel also includes approximately 300 resellers, integrators and independent software vendors (ISV). These companies have applied and been accepted into Intermec’s Honors Program. The program provides access to training, a discount level based on purchase volume, access to technical and sales support, visibility through Intermec’s partner portal, and access to other partners’ solutions. The ISVs have developed a unique software application designed for a specific industry (route accounting, warehouse management, beverage distribution, etc.). The capabilities of the individual ISVs range from small programming groups that serve a local, niche market to very sophisticated, groups with a national footprint and complete sales staff. Typically, the ISV develops a seamless, add-on module that integrates into a standard enterprise resource planning (ERP) system (such as SAP or Oracle). In the eyes of the

ISV, the application that runs on the mobile device is simply a data collection tool. Once the data is collected in the field, it is downloaded from the mobile device and pulled into the module for processing through an integration interface designed by the ISV. Therefore, the ISV is relatively “hardware agnostic;” that is, they do not really care which manufacturer’s device is used to collect the data. As a reseller, their mobile device buying decision is typically driven by trade discounts, promotional offers, after-sales service/support and the relationship they have with the manufacturer’s sales representative. The ISVs typically represent multiple mobile device manufacturers but might lead with one due to incentives. The ISVs can either purchase equipment through distribution (Scansource, etc.) or directly from Intermec. Only high volume ISVs have the ability to buy direct from Intermec. .If the ISV buys directly from Intermec, it receives a deeper discount than it would get through distribution and Intermec earns an average gross margin of 31%.

The resellers and integrators do not develop their own software applications. They are “solution providers.” They have relationships with local companies and are called on when equipment requirements arise. Resellers represent multiple manufacturers and purchase equipment from the distributors. Small resellers are essentially order takers. When a buyer needs equipment, it contacts various suppliers to get the best price. After being contacted, the reseller gets a price from a distributor and develops a proposal for the buyer. The reseller typically does not get involved with installation, integration, configuration, or after-sales support.

Integrators, on the other hand, pull in other partners to build a complete solution. If software is required, they will bring in an ISV. If installation or configuration is required, the integrator will either handle it or outsource it to a sub-contractor. Often times, the reseller/integrator that wins the bid is the one that can either provide a more complete solution or has the best price.

Since most of the prices from the distributor are the same to all resellers , the winning proposal boils down to who is willing to take the lowest margin on the overall sale. The ISVs and distributors are also able to make additional margin on a sale when they add “service packs.” These are extended warranties, either 3- or 5-year, that are sold at the time any hardware is sold to a customer. These service packs can add as much as 20% of incremental revenue to a sale. The value-added reseller simply sells the service pack, which entitles the purchaser to use the manufacturers’ after-sales service for the time specified. The VAR does not have to be involved with the repair process at all. It becomes the responsibility of the manufacturer. The VAR buys the service pack from distribution, marks it up (usually by 20-30%), and transfers it to the buyer. Intermec earns an average of 32% gross margin on the service packs sold through distributors. Since the ISVs, resellers, and integrators purchase equipment to fill orders through the distributors, they do not have a direct buyer-seller relationship with Intermec. That is, Intermec’s margin on sales through the channel to these partners is the same as it earns selling to a distributor.

The Dilemma

Mr. Byrne has been saddled with the responsibility of righting the ship. The board of directors has indicated it will require Intermec to achieve a minimum of \$900 million in gross revenues for the fiscal year 2012 budget. The overall economy is expected to recover and the BOD is under fire by institutional shareholders to regain the 2008 level of sales. Mr. Byrne has had nearly six months to gather information and make his strategic recommendation to the BOD. He feels strongly that the best way to turn things around rests squarely on a distribution decision. He has developed the following strategic alternatives from which to make his decision:

1. Eliminate the manned direct sales channel (sales representatives and KAEs) and put his faith in the indirect channel partners and distributors. This would reduce costs dramatically but also reduce control of the channel and key strategic accounts.
2. Eliminate all indirect and manned, direct sales channels and push all sales through the online catalog. This would reduce costs substantially throughout the system and make the distribution of products more streamlined.
3. Outsource the manned, direct sales channel to independent manufacturers' representatives and have them work with the present indirect channel structure.
4. Eliminate the distributors (Scansource, etc.) and manage all sales fulfillment from Intermec's corporate headquarters in WA. This would drastically increase margins on all sales and maximize control and visibility of every order.

Discussion Questions:

1. **Mr. Byrne will present a recommendation to the board of directors that revolves the firm's channels of distribution. Do you agree that this is the area of concern? Why or why not?**
2. **Do you think Mr. Byrne's list of strategic channel alternatives is complete? Are there other channel options that he has not considered?**
3. **Regardless of the decision he makes, Mr. Byrne is bound to cause conflict when his decision is implemented. What parties might feel alienated, and why? How can Mr. Byrne minimize this reaction?**

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