

Identifying the gaps

Channel Compliance Contract Practices

April 2014

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Advancing Intellectual Property Protection



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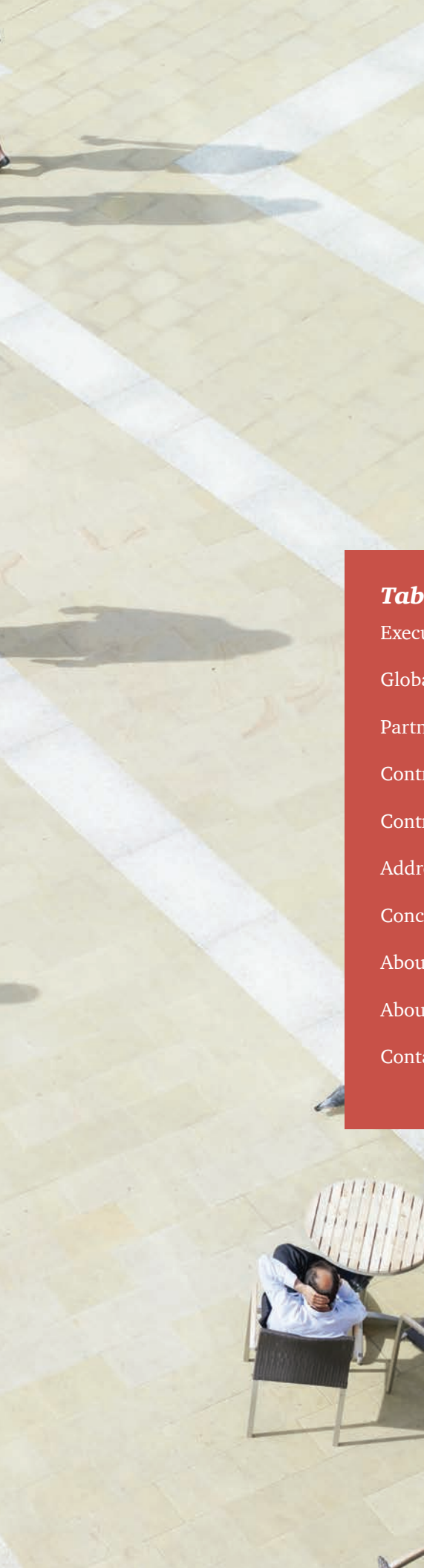


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Executive summary

Contracts serve as the cornerstone to relationships between companies and their partners. They serve as the enforceable commitment companies and partners make to each other. Contracts influence business decisions and are the driving force behind billions of dollars in commerce. Despite the importance of business agreements in the day to day activities of original equipment manufacturers (OEMs) and their channel partners a knowledge gap exists. Little insight exists into common OEM contracting business practices within the channel partner space.

This study was designed to provide insight into OEM channel partner contracting practices and help identify contracting issues OEMs are failing to address. Failing to address channel risks can expose OEMs to monetary losses and regulatory non-compliance that could be mitigated by implementing contracting leading practices.

The study identified several common themes across respondents. First, OEM contracts and contract enforcement practices vary widely across geographies. Contract variability across geographies can result in the increased risk contracts don't align with OEM objectives and place increased burden upon OEM monitoring and enforcement departments. Second, executed partner contracts are not owned by a single department, but rather multiple departments. The lack of a recognized contract owner complicates efforts to determine who is responsible when contract issues arise. Third, some OEMs fail to require their channel partners to extend compliance provisions such as audit rights to 2nd and 3rd tier partners, which may inhibit OEM compliance efforts. Fourth, few OEMs use incentives to entice channel partners to comply with contracts. Those OEMs who do offer incentives most commonly use financial incentives. Lastly, despite OEM efforts to mitigate risks through the use of provisions in channel partner contracts, few OEMs educate channel partners on how to comply with terms and conditions. This results in the decreased likelihood channel partners will undertake the risk mitigating activities OEMs require.

AGMA conducted a survey to gain insight into channel compliance contracting practices. The surveys and interviews were supplemented with PwC's extensive experience assisting OEMs to mitigate their channel compliance risks.

Global contracting and enforcement practices

Channel partners play an important role in helping companies extend their footprint throughout the world by creating opportunities in territories and industry segments that wouldn't otherwise be economically practical. The study sought to understand the commonalities and differences in contracting and contract administration that exist within companies who utilize channel partners.

The study found that for 73 percent of the respondents the agreements channel partners are required to sign vary based on partner geographic location. This demonstrates the important role geography plays when companies contract with their partners. The study delved deeper into the role geography plays by asking respondents about the extent to which agreements vary based on partner location.

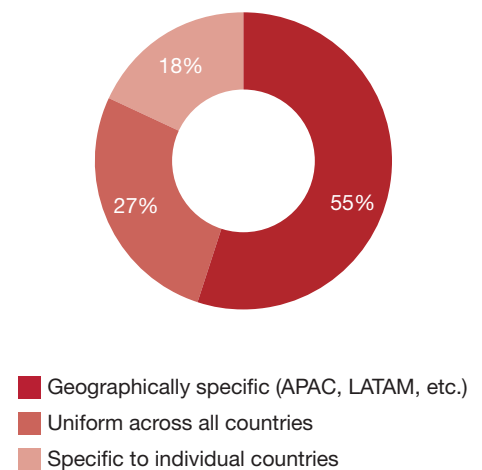
More than half of all respondents indicated terms and conditions in their partner agreements vary by major geographic location such as AsiaPacific (APAC), Latin America (LATAM), etc. Utilizing geographic specific terms and conditions could result in companies administering agreements unique to five different geographies when the common corporate geographies of North America, Europe and Middle East/Africa are included. The nearly one in five respondents whose partner

agreements have terms and conditions specific to individual countries likely have an even larger variety of unique partner agreements to administer.

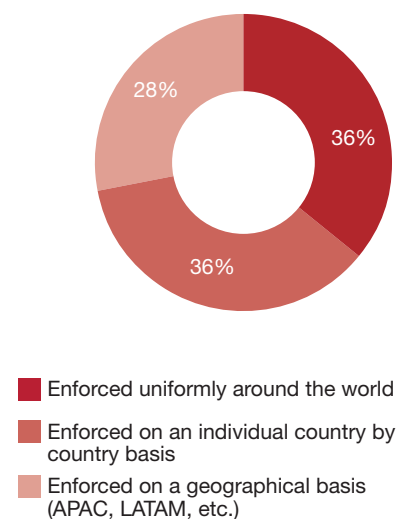
As the number of geographic specific agreements that companies administer grow so too can the difficulty of maintaining consistent terms and conditions among agreements. A lack of consistency increases the risk that agreements won't align with a company's corporate objectives such as channel compliance. The use of geographic specific terms and conditions also places increased burden on corporate contracting, monitoring and enforcement departments as they develop processes and procedures for administering each unique agreement.

Respondents reported that they enforce partner terms and conditions differently throughout the world. This is highlighted by 36 percent of respondents who enforce terms and conditions on a country by country basis and 28 percent of respondents who enforce terms and conditions on a major geography (APAC, LATAM, etc.) basis. This geographic based enforcement approach allows companies to accommodate local business and legal issues, but increases the likelihood channel partners in other geographies will take exception to differential treatment.

Question 1: Are the terms and conditions in partner agreements uniform across all countries or are they geographically specific?



Question 2: Are partner contract terms and conditions enforced uniformly around the world or are they enforced differently?



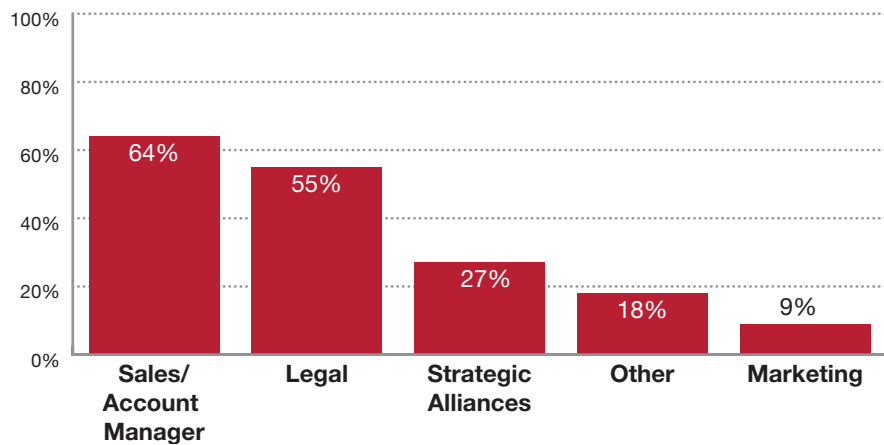
Partner contract ownership and change management

Given the important role partner agreements play in channel partner relationships, one area of focus the study addressed was to understand who is viewed as owning partner agreements and the process for maintaining their relevancy.

In the study, respondents were asked to identify which group or groups within their organization have ultimate responsibility for executed partner contracts. The most common responses of Sales/Account Managers and Legal both had a response rate of over 50 percent. The results indicate the lack of a perceived single contract owner and lead to the question of who is ultimately responsible for partner contracts? The lack of a recognized contract owner complicates efforts to maintain consistency across contracts and determine who is responsible when contract issues arise.

According to respondents, the departments responsible for reviewing changes to the terms and conditions in partner contracts mirror those viewed as owning partner contracts. Respondents identified Legal and Sales with 100 percent and 64 percent, respectively, as those most likely to review changes. Conversely, the departments least likely to review contract changes, Compliance/

Question 3: Who within your company is considered to be the owner or has ultimate responsibility for executed partner contracts? (Select all responses that apply)



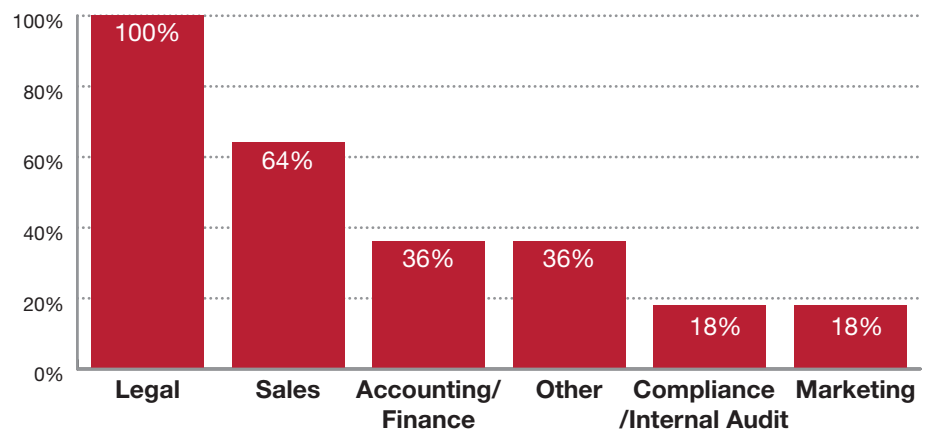
Internal Audit, are typically the ones responsible for monitoring and enforcing contract terms and conditions. This response highlights a potential disconnect between the departments reviewing contract changes and those enforcing contract

terms. The low likelihood Compliance/Internal Audit departments review changes to standard terms and conditions increases the need for Legal and Sales to advocate the importance of maintaining effective compliance language in partner contracts.

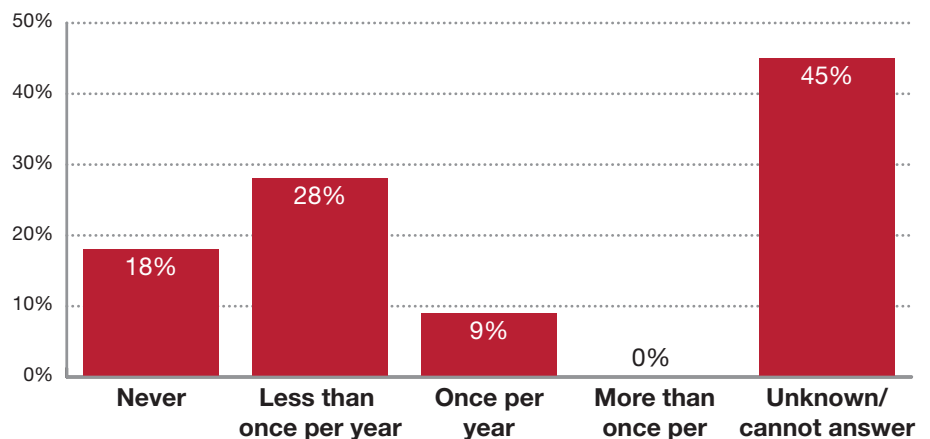
More than 50% of respondents consider Sales/Account Managers or Legal as having ultimate responsibility for executed partner contracts.

Companies often times have formalized means by which they assess the relevancy of their product and service offerings. The study inquired as to whether similar scrutiny is applied to partner contracts. The study revealed respondents infrequently review the terms and conditions in partner agreements to ensure they align with channel integrity goals and objectives. Forty-six percent of respondents formally review partner contracts less than once a year. The failure to formally review terms and conditions at least once a year increases the likelihood contracts are no longer aligned with corporate objectives including channel compliance. Also concerning is that 45 percent of respondents are unaware if contract terms and conditions are reviewed at all. This could be an indication of a lack of formalized agreement monitoring.

Question 4: List the departments required to review changes to the terms and conditions in partner contracts.



Question 5: How often are partner contracts formally reviewed to ensure the terms and conditions align with channel integrity goals and objectives?

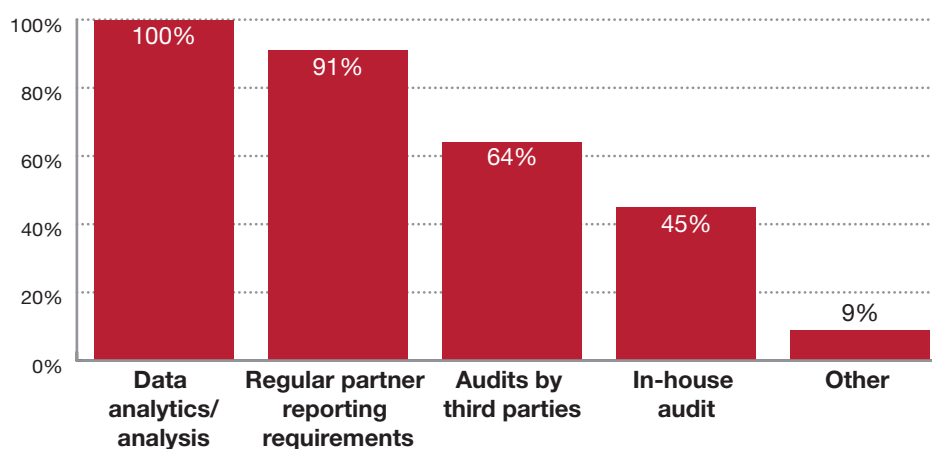


Contracting and compliance

Partner contracts often contain terms which address compliance requirements. Companies often use these terms to help monitor compliance with their partner contracts. Requiring partners to submit monthly channel sales reports is one example of a compliance requirement. The importance of such a requirement is evidenced by the fact that all respondents indicated their partner contracts contain a reporting clause.

Respondents indicated they use a variety of methods to monitor compliance with contract terms and conditions. All respondents utilize data analytics/analysis and nearly all respondents, 91 percent, also rely on partner reporting. Partner compliance audits are another commonly used method to monitor compliance. Nearly two out of three respondents use third party auditors while approximately half use in-house auditors.

Question 6: How does your company monitor whether the terms and conditions in partner contracts are followed or complied with? (Select all responses that apply)



Looking deeper into the topic of partner reporting, the study indicated nearly two out of three respondents have partner contracts that specify the level of reporting detail partners are required to submit. Our interviews indicated the detailed reporting data is often used when performing the data analytics/analysis noted in Question 6.

Channel distribution models often consist of multiple sales tiers. OEMs sell to their channel partners who

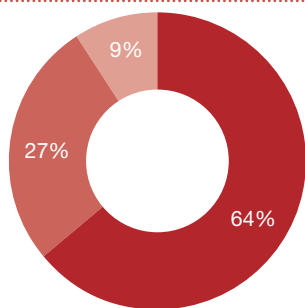
then distribute or resell products and services through to their channel partners. As products and services are sold through the channel OEMs can lose transparency into subsequent transactions. The study revealed a small percentage of respondents, 18 percent, include a requirement in their channel partner agreements that audit rights extend through the channel to 2nd and 3rd tier partners.

The small number of respondents who indicated in question 8 that they utilize pass through audit language, experience mixed results having the audit language in the channel partner's agreements. Only 9 percent of respondents are sometimes effective in having the pass through audit requirement included in their partner's contract.

Respondents were asked to identify the important elements for effective enforcement of partner contract terms and conditions. Respondents were provided a free text field to input their responses. The two most frequent responses were "performing channel partner audits" and "executive buy-in to enforcement actions". Whereas data analysis/analytics can help identify issues that warrant further

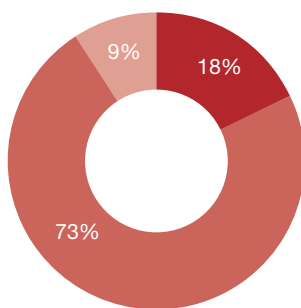
investigation, audits can be used to confirm whether terms and conditions are not being adhered to. Executive buy-in to enforcement actions sets the tone at the top of an organization that channel compliance is an important part of an organization. Establishing the tone at the top helps compliance programs overcome internal obstacles and realize compliance enforcement objectives.

Question 7: If your partner contracts contain reporting requirements, is the level of reporting detail (serial number, part number, etc.) specified in the contracts?



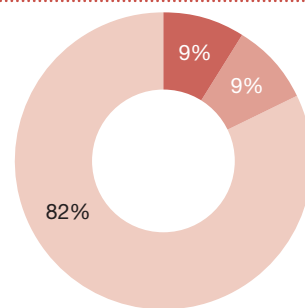
■ Yes
■ No
■ Unknown/cannot answer

Question 8: Do partner contracts include a requirement for partners to extend audit rights to their 2nd and 3rd tier partners?



■ Yes
■ No
■ Unknown/cannot answer

Question 9: If your partner contracts require partners to extend audit rights, how often is this requirement included in their agreements with their 2nd and 3rd tier partners?



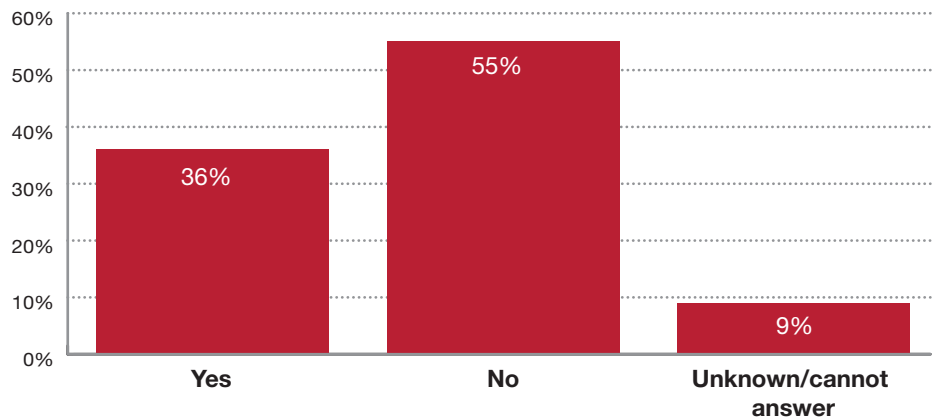
■ Always 0%
■ Sometimes
■ Never
■ Unknown/cannot answer

Contracting to achieve desirable partner behaviors

Predicting the likelihood of channel partner compliance with contract terms and conditions at the time contracts are entered into can be nearly impossible regardless of the partner due diligence performed. Despite the best of efforts to partner with companies committed to fulfilling their contractual relationships, the risk of noncompliance is always present. In an environment where including requirements in contracts is insufficient to garner the desired partner behavior, companies have come to apply various strategies. The interviews conducted as part of the study found companies use a variety of strategies which include written reminders, incentives and penalties. However, the negative connotation associated with penalties can make enforcement difficult or undesirable when considering the potential detrimental impact on channel partner relationships.

As an alternate to penalizing channel partners, the study explored the use of incentives to obtain partner compliance. The study revealed a relatively low number of respondents, only 36 percent, offer partner incentives for complying with contract terms and conditions.

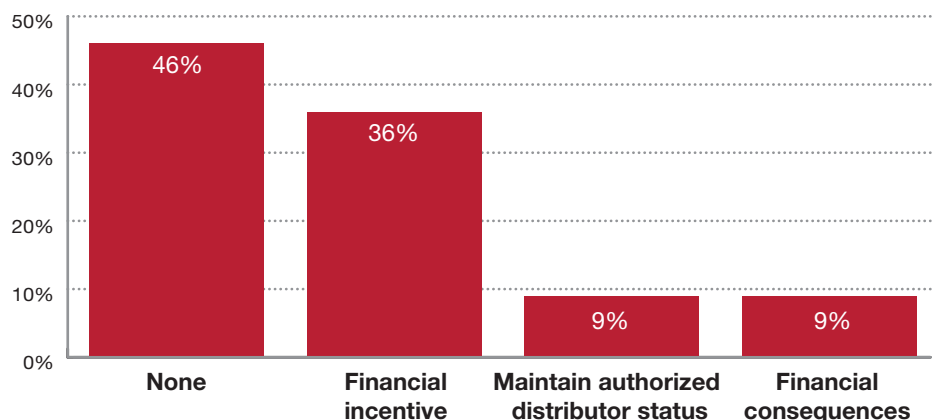
Question 10: Do partners receive incentives for complying with the terms and conditions of their partner contracts?



Channel partner incentives can take a variety of forms depending on the level of compliance sought, difficulty obtaining compliance and types of rewards available to be offered. Depending on the aforementioned criteria, incentives can be monetary such as in the form of rebates or non-monetary such as expanded access to product offerings. The study asked

respondents to identify the types of rewards or benefits primarily offered to channel partners. The most common incentives, offered by 36 percent of respondents, are financial incentives. Whether the use of financial incentives is a byproduct of prior experience or a perceived motivator, the study results suggest channel partners are best incentivized by financial rewards.

Question 11: If partners are incentivized to comply with their partner contracts, what kinds of rewards or benefits are provided?

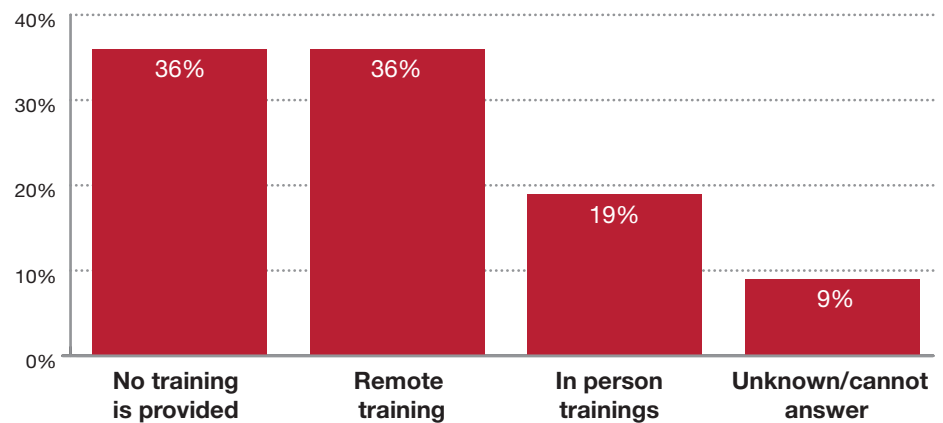


Addressing contract risks

Contracts can expose companies to risks beyond those directly in their control. Mitigating these risks can be accomplished by including provisions in partner contracts meant to prevent or limit risk exposure caused by channel partners. Based on PwC's experience conducting channel compliance inspections we see firsthand the frequency with which channel partners are unfamiliar with the terms and conditions in their OEM contracts. This lack of familiarity makes it unlikely channel partners are taking the contractually required steps OEMs require in order to mitigate the risks beyond their direct control. One way to familiarize channel partners with contract terms and conditions is through education.

The study examined the types of training companies use to educate channel partners on contract terms and conditions. In person or remote trainings are offered by a combined 55 percent of the respondents as compared to 36 percent of respondents that do not educate partners on how to comply with the terms and conditions of channel partner contracts. The study highlights the need for increased partner education in order to close the knowledge gap that exists which in turn can positively impact partner compliance.

Question 12: How does your company educate partners on how to comply with the terms and conditions of partner contracts?

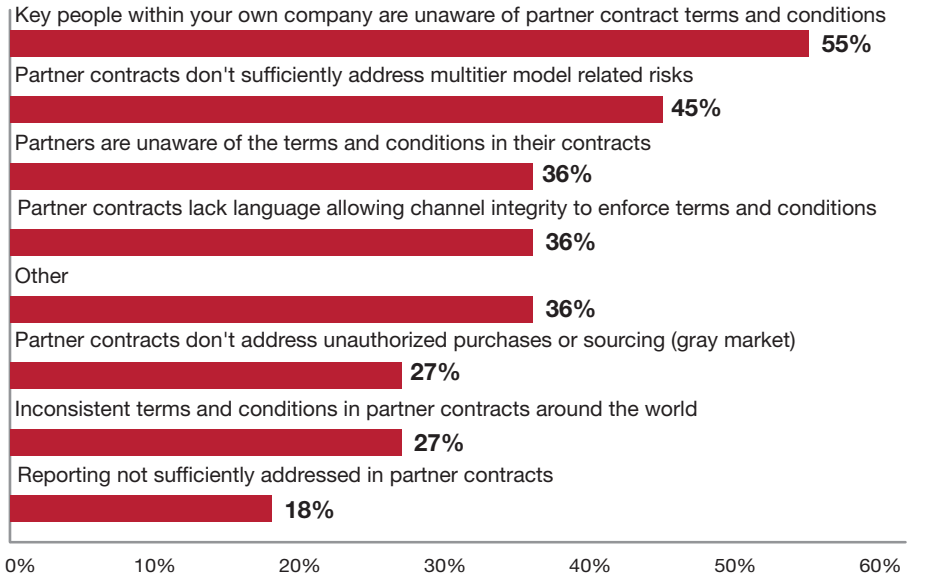


*The study examined the types of training companies use to educate channel partners on contract terms and conditions. In person or remote trainings are offered by a combined **55%** of the respondents as compared to **36%** of respondents that do not educate partners on how to comply with the terms and conditions of channel partner contracts.*

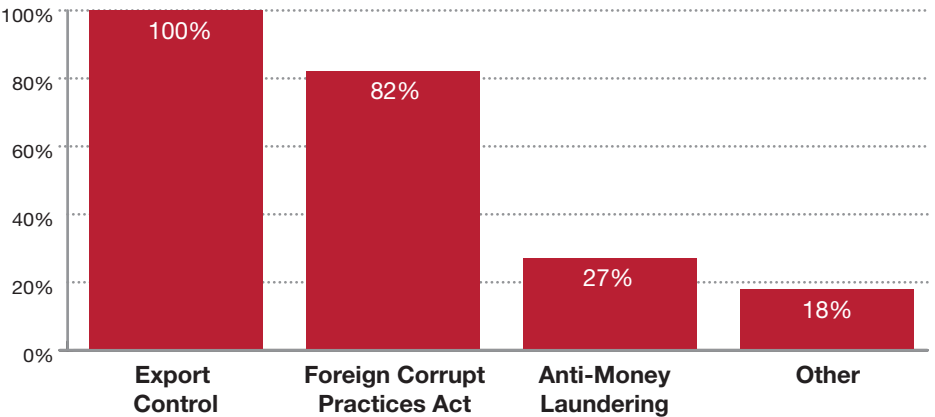
The unfamiliarity with channel partner contracts is not limited to channel partners. Respondents were asked to identify the most significant risk areas related to partner contracts and more than half of all respondents, 55 percent, indicated key people within their own company are unaware of partner contract terms and conditions. Unfamiliarity with contract terms and conditions increases the likelihood contracts are not aligned with OEM objectives and fail to address channel risks.

Channel partners are used by numerous industries with different business models and practices. The need to comply with U.S federal regulatory requirements is common across all OEMs with overseas partners. The need to comply with U.S. federal regulatory requirements including export controls, the Foreign Corrupt Practices Act (FCPA) and anti-money laundering (AML) provisions is common amongst OEMs. The study revealed export controls and FCPA requirements are addressed by all or nearly all respondents as compared to only 27 percent of respondents who address AML in partner contracts. The failure to include AML requirements in partner contracts unnecessarily exposes OEMs to regulatory risk and is particularly surprising when considering OEMs have addressed other regulatory risks such as FCPA and export control.

Question 13: What do you consider to be the most significant risk areas related to partner contracts? (select all responses that apply)



Question 14: Do your partner contracts address any of the following regulatory requirements? (Select all responses that apply)



Conclusion

Contracting practices impact channel compliance programs by enabling OEMs to achieve program goals. As the study identified, differences exist in contracting practices amongst OEMs. This is understandable due to the different risks OEMs face based on factors specific to their businesses, such as product offerings, distribution models, geographic presence, etc. Deficiencies in contracting practices identified by the study serve as a call to action. Failure to address weaknesses and inconsistencies in contracting practices limits the effectiveness of channel compliance programs. This, in turn, results in reduced return on the investment OEMs make in compliance programs.

An effective approach to contracting is paramount to the success of a channel compliance program. An effective approach to contracting aligns business objectives with contractual requirements channel compliance programs can use to monitor and manage partner risks and pursue enforcement for non-compliance, when needed. This alignment allows OEMs to maximize the value received from channel compliance programs.

About AGMA®

The Alliance for Gray Market and Counterfeit Abatement (AGMA®) is a non profit organization comprised of leading high technology companies committed to addressing the global impact of intellectual property rights issues; such as gray market fraud, parallel imports, counterfeiting, software piracy, and service abuse of technology products around the globe. The organization's goals are to protect intellectual property and authorized distribution channels, improve customer satisfaction, and preserve brand integrity. AGMA® uses a variety of avenues to cultivate change in the marketplace including, event speaking, educational initiatives, benchmark studies, industry guidelines, and, where appropriate, public policy advocacy. To learn more about AGMA®'s initiatives or to become a member, please visit <http://www.agmaglobal.org>.

About PwC

PricewaterhouseCoopers (PwC) provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 184,000 people in 157 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

Our Licensing Management & Contract Compliance practice guides companies through channel compliance, contract compliance, licensing management and revenue recovery. We analyze compliance with business agreements and licenses to help companies mitigate risk and realize incremental revenue.

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