The Next Generation Ecosystem— Making the Big Channel Bets

Value-added resellers face "an extinction event" in the traditional information technology channel, but smart vendors and their VARs are retooling their partnering strategies, ecosystem, and business models to thrive in the cloud.

By Norma Watenpaugh, CSAP

The traditional information technology (ITC) or value-added reseller (VAR) channel is undergoing tremendous change and turmoil; some have called it an extinction event. While 70 to 80 percent of information technology (IT) products and services are sold through partners, the number of partners has been steadily declining. Some 30 percent of VARs have disappeared from practice since 2008, according to the 2016 CompTIA State of the Channel study, and this trend will continue as many owners exit into retirement. One might think the survivors are more profitable, but that's not the case. Product margins have been under continual pressure, and the shift to cloud has changed the revenue model to a slim drip feed on recurring subscriptions.

Business model disruption

Many VARs have shifted their business model to services-oriented managed services providers (MSPs). But even the hybrid MSPs and the pure-play MSPs are seeing margin pressure and a lackluster market opportunity in on-premise computing. Many MSPs are still providing operational services, such as backup and restore or PC help desk services to on-premise computing resources. So there is mounting competition for a market space that is declining in growth and will soon be declining in size.

New technology purchases are happening almost entirely in the cloud. On-prem computing will be around for quite a while as companies want to maximize their investment in capital equipment already on the books. Some highly sensitive applications may always reside in on-prem data centers.

One data point illustrates this quite clearly. Some $10 billion of Amazon Web Services revenue displaces $30 to $40 billion in traditional IT revenues, according to Baird Equity Research. Bad news for the traditional supply chain, but a great boon and cost savings to the consumers of cloud computing.

So as the traditional partner ecosystem model is displaced, what is taking its place?

Phoenix Consulting Group has done extensive research into this transitioning landscape with interviews and conversations with 29 ITC channel chiefs and alliance executives. Most recently, we had the opportuntiy to do a comprehensive survey with the industry's largest distributors, Arrow, TechData, Synnex, Ingram, and Westcon, which validated these trends, but also pointed to the future of the next-generation partner ecosystem. And it truly is the next generation. The partner community is shifting from the baby boomer generation, which benefited immensely over the past 30 years from the ascendance of information technology, to the new generation of born-in-the-cloud millennials. Some 75 percent of channel owners will be millennials by 2024, according to the 2016 CompTIA study.

The large distributors each cover hundreds of vendors and thousands of partners, so their perspective is of a large cross-section of the industry. They are also most at risk of disruptive changes and have the most to lose in the shift to the cloud. Cloud distribution doesn't require a warehouse or drop-ship logistics. And the impact is beginning to be felt in tangible ways. In September, TechData took a massive 19 percent hit to its stock price because the company missed Q2 profitability targets, even though revenues were solid. The profitability hit was attributed to a shortfall in vendor rebates, which are paid out based on hitting performance targets. This was a warning signal that vendors are no longer going to subsidize partner profitability through back-end rebates.

So what are these big bets?

For the most part distributors, including TechData, have not been sitting around like the proverbial frog in the pot. Distributors have been making massive bets on the new cloud ecosystem and new opportunities arising from the Internet of Things (IoT) and digital transformation. Based on the size of the ecosystems they serve, they have an ability to influence and shape the next generation—perhaps moreso than even the large vendors they support.

Selling to the new buyer

The customer relationship becomes even more valuable. Since the channel partner is the customer-facing relationship, they have an enormous opportunity in building customer intimacy. The sustaining role for the channel partner is that of the trusted advisor. This requires a depth of knowledge of the customer business and an ability to manage the customer experience. We've seen a shift from customer support services with focus on break/fix services to customer success management. These services maintain a continual, deepening contact with the client, ensuring that they are using the technology and services effectively, providing additional help as needed, and always being aware of opportunities for up-sell and cross-sell. The value of the channel partner becomes less about

TRANSFORMING THE BUSINESS MODEL

The business model transformation from transactional sales to recurring services is a tough transition. The vanishing VAR typically counted on product resale margins to generate profit. Most VARs have incorporated more services into their business, but it is difficult to make a complete transition. It takes two to three years, and in those years they are often operating at a loss as product sales drop off and services slowly ramp. At some point, the services can become quite profitable and sustainable, which is the beauty of recurring revenue. It becomes like an annuity, though companies will need the resolve and financing to weather the trough during the transition. Investing in IP innovation generates another revenue stream that adds incremental customer value to the mix and perhaps a competitive differentiation that would facilitate customer retention and promote renewals.

selling "stuff" and more about insight into the customer business, solving customer problems, providing specialized skills, and enabling right business outcomes. This is a new muscle for many channel partners who have typically been selling to the IT function, or in some cases, have positioned themselves as virtual chief information officers.

Distributors often are commissioned to deliver sales and sales-enablement to channel partners. Some have specifically shifted the sales content to equipping channel partners to sell business outcomes to the line of business (LOB) buyer, addressing the issues that keep them up at night and offering well-integrated solutions that can be provisioned from the cloud.

Some distributors have verticalized their sales and partner support operations in order to be able to support the need for industry expertise in creating a trusted advisor relationship. Vertical expertise is critical to understanding business outcomes relevant to the new LOB buyer and is a core competency as channel partners move to address opportunities in digital transformation and IoT.

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Building practices versus technical enablement

Back to the point that cloud computing is displacing a lot of traditional hardware/software sales and services: Clearly the smart money is in the cloud. A suite of opportunity exists for channel partners embracing this business model as a trusted advisor.

Channel partners have been surprisingly slow to develop the skills needed to thrive in the cloud. These will become fundamental survival skills. While vendors tend to focus on technical enablement that is specific to their product set, as trusted advisors, channel partners will need to address multi-vendor technical solutions that solve business problems. Customers, after all, don't buy a bag of parts.

Small-to-medium enterprises (SMEs) are less invested in heavy data center operations, and moving to the cloud relieves them of managing these operations. But they still need help with understanding what operations can move to the cloud and what is best kept on-prem, at least for now. They need an expert to help them plan what the compute environment should look like for them and to help implement and maintain it.

Cloud management services include assessments of current system capabilities and requirements, implementation and provisioning of new cloud applications, migration of on-prem assets to the cloud, hosting or brokering cloud services, integration of cloud applications, and on-going support and maintenance of the environment.

Here, again, is where distributors are seeking to add value. There is a shift in their technical enablement services from vendor specific, which they still do, to also focusing on broader sets of skills and training to help partners develop comprehensive cloud services practices.

Distributors are also investing in cloud marketplace platforms that support partners in delivering cloud solutions. These platforms enable partners to provision cloud services from multiple cloud providers, i.e., Amazon, Google, Azure, and to provision other cloud infrastructure services, such as cloud-managed security. These platforms can facilitate integration of multi-vendor solution stacks. They also provide billing operations, which is a difficult logistical challenge for most small partners when there are multiple application services with multiple billing models, i.e., annual, quarterly, monthly, and by consumption. By managing the back-end complexity, distributors create a valuable service for partners and customers alike that is not easily displaced. It also enables partners to focus on sales and technical services.

Transforming the channel

Traditionally, vendors segment their partners by business models and support into separate siloed partner programs, i.e., technology partners, which provide complementary capability but don't resell; systems integrators, which provide consulting and services that influence customer buying behavior that may or may not resell; VARs that resell and are in some stage of morphing into managed service providers; cloud service providers, such as Amazon or Google, that are both customer and channel. The traditional designations don't hold up anymore.

The modern partner program breaks down these silos and recognizes that the channel partner may be creating and delivering value in a very diverse business model (see "Transforming the business Model," Page 30). The evolving channel partner is breaking their dependence on product margins, providing services, may be taking a revenue share on the subscription service—and if they are savvy, are creating some of their own IP, either in the managed services delivery or a SaaS application. The silos can't recognize and reward value across the entire value proposition that a partner is providing to the customer.

Partner incentives are also shifting. Vendors once had rich margins, and they could afford to provide rebates and incremental discounts to channel partners. These incentives were based on—and promoted—unit sales. That model fundamentally does not work in a cloud economic model. Instead, vendor trends have pivoted to reward value, investment, commitment, and some volume. Incentive designs are more aligned to rewarding and promoting behavior that drives future growth. These will become more essential as partners make the leap to cloud. Incentives should enable and reward partners who acquire the necessary cloud management skills and specializations in vertical and business domains.

Speaking of nontraditional partners

Quite a bit of speculation exists in the vendor community about whether traditional ITC channel partners are going to make the transition in enough numbers to support vendors' revenue aspirations. Beyond supporting the transition of VARs to cloud solution providers, some vendors have taken to nontraditional partners whose service and sales models are less about technology and more about the functional organizations they serve. For example, Marketo, a lead-nurturing SaaS company, tried going to market through the traditional ITC channel and discovered it just didn't work. Its primary buyer was a chief marketing officer (CMO). Its most successful partners

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Emerson	NVIDIA	TechData
GE	Plantronics	Unidesk
Google	RedHat	Verizon
Guidewire	Saba	VMware
Hyperloop	SAS	Xerox
IBM	Schneider Electric	Zoho

MAKING THE BIG BETS—FOR CHANNEL PARTNERS

1. Know thy customers: Learn their businesses, their vertical industries, the challenges they face to drive new business. Become operationally excellent and digitally competitive.
2. Become the trusted advisor to the line of business (LOB) buyer. Sell business outcomes, not technology.
3. Build practices—comprehensive suites of services that serve the customers' business needs.
4. Specialize or build unique IP to create a differentiated value proposition for your customer.
5. Create a network of partners to source and deliver a complete solution for your customers.

MAKING THE BIG BETS—FOR VENDORS

1. Reward and incent the value a partner brings to a customer that influences sales of your product, recognizing your product actually may be provisioned through a cloud provider.
2. Recruit nontraditional business domain experts who sell to the LOB as new potential partners.
3. Position and differentiate your product in the vocabulary of business outcomes.
4. Invest in enabling P2P relationships. Cloud solutions, digital transformation, and IoT implementations require a complex set of skills, which will require a network of partners to deliver.
5. Create a compelling partner engagement journey to support partners through transition and to accelerate recurring revenue.

How Cloud Computing Has Changed the Buyer Paradigm

By Norma Watenpaugh, CSAP

Cloud computing is a technology consumption model that has fundamentally changed who the buyer is and how they buy. Some 70 percent of the IT budget is no longer in IT, according to Gartner and other IT research and advisory firms. The funds and decision authority reside in functional, operational budgets under the discretion of line-of-business (LOB) buyers. This means that the chief marketing officer (CMO) can select and subscribe to the lead nurturing system or data analytics services that best meet the need of the department. IT may never be involved, and the IT organization struggles to stay relevant. That's not to say IT shouldn't have a role. For example, buying software as a service puts a load on the company network that needs to be considered and managed.

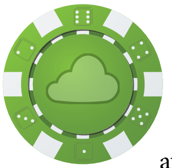
The LOB buyer has very different criteria for making decisions than IT. Take, for example, another kind of CMO—the chief medical officer of a health care facility. That CMO will be looking at how to improve patient care and reduce medical mistakes. Only partners who understand what LOB buyers care about, what they are accountable for, and the trends within their industry will be able to effectively sell these services.

With "everything as a service," there is also elevated expectation on "time to value." When you download a new exercise tracking application to your phone, what is your expectation of when you can begin using that app and getting value from it? Exactly! Instantaneous! Enterprise software services aren't quite instantaneous, but the expectation today is days and weeks, not months and years.

have been digital marketing agencies that also sell to the CMO. The sales model for Marketo can take many forms—a simple referral, white label subscription, or the agency can provide digital marketing services on their own instance of Marketo and bundle the cost in their services. Marketo doesn't much care, as long as its software is provided in the mode that the customer wants to consume.

The same sort of model is evident with Quickbooks. Its primary channel partners are small accounting firms that provide accounting and tax preparation services to small businesses.

Working with a partner with business domain expertise is quite a change for many vendors, even for those who are providing business applications.



Leveraging the ecosystem

When you look at the complexity of selling cloud solutions, especially when you look at the opportunities in digital transformation and IoT enabled by cloud, it's clear that no single company can deliver an end-to-end solution. More than ever, channel partners, vendors, and software/SaaS companies need to collaborate as each brings a piece to the puzzle.

As trusted advisors, channel partners will need to address multi-vendor technical solutions that solve business problems. Customers, after all, don't buy a bag of parts.

There is a strong and growing need for partner-to-partner collaboration for both capability and capacity. Some vendors are providing more services and support for partners to find each other across the ecosystem and to enable them to partner, collaborate, and go to market together as a coordinated unit. IBM pioneered this concept a dozen years ago with its ValueNet program, which enabled solution providers to find SaaS partners through a partner-matching algorithm. The stakes are even higher today as IoT implementations may entail five or more partners to deliver.

The partnering model also needs to adapt. Process-heavy collaborations cannot work fast enough in this new age of digital transformation. A more agile model is needed and is, indeed, evolving. Partners need to find each other quickly, build trust-based relationships quickly, and create customer value at the same pace. Mike Plottier, head of global strategic alliances at Puppet, likens this to a fail-fast model: "In a dynamic environment like ours, speed dictates our approach. It's in everyone's interest to launch go-to-market activities quickly and understand the joint opportunity. If the partner has to adhere to months of business planning before we can start selling, I will have to move on."

Distributors are validating the trend. Arrow Workmarket is a SaaS platform that enables channel partners to connect with each other and other business partners to round out their service capabilities and market expertise. Partners can register their areas of expertise, such as analytics, cloud, mobility, security, e-commerce, etc. Then they can find or be found based on the expertise needed.

Feels like a tipping point

Distributors have reported that cloud sales comprise between 10 and 15 percent of sales, but it's clearly the fastest growing part of their businesses. Some are reporting 200 percent growth year-over-year for the past five years. They also are reporting that the adoption rate is growing. Most of their channel partners have transacted at least one cloud solution. This indicates the pump is primed and ready for the tipping point.

Tremendous opportunity also exists in digital transformation and IoT enabled by the cloud and a host of converging technologies in social, mobile, analytics, and artificial intelligence. McKinsey has projected the IoT economic impact to be as large as $11 trillion by 2025. While there are many lighthouse examples, many businesses are still struggling to understand how they might be affected. Many are fearful they will be "Ubered," outmaneuvered by an upstart with a compelling digital business model. Will they be disruptors or disrupted?

These opportunities are also heading toward a tipping point. The largest component of these new opportunities will be in value-added services reflecting both operational business practices and understanding the application of technology to achieve business benefit. Channel partners and vendors who are prepared when the tipping point triggers will be positioned best to take advantage of the growth. ■

Norma Watenpaugh, CSAP, is the founding principal and CEO of Phoenix Consulting Group *(www.phoenixcg.com)*, which provides partnering and collaboration consulting services with expertise in partnering strategy, multi-channel and alliance management, and ecosystem development. She is also a board member of ASAP and led the United States delegation to the ISO Standards Committee for collaborative business relationship management.