Microsoft Partner Cloud Adoption
The Realities on the Ground

A Proprietary Survey

conducted by:
Dana Willmer, MBA

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CLOUDSPEED
Adapt to a Cloud-first world. Fast.

Table of Contents

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Executive Summary

Over the last five years, CloudSpeed has been engaged in Cloud-related discussions with hundreds of Microsoft Partners worldwide. In so doing, it has formed relationships with numerous owners, founders, and CEOs, taken the pulse of their transition to the Cloud, and helped accelerate their journey.

In an effort to add value to the Partner community and crystalize this experience into a more detailed snapshot of the “realities on the ground” of Cloud transition, a handful of Partners were invited to participate in a proprietary survey. In almost all cases, they were owners, founders or CEOs. No compensation was received either by CloudSpeed or Partners for this.

In the end, some 29 leading Microsoft Partners from Europe, North America, South Africa and Australia stepped forward to be interviewed[1]. This survey chronicles their perspectives, experiences, and opinions.

Key findings of this survey include:

- Average revenue growth is strong, but not stellar. The average revenue growth reported by survey participants was 21.7%, compared against an average growth in Cloud demand of 19.5%[2] in participants’ markets. However, of 29 participants, fully half were not matching the rate of Cloud demand in their markets, and only five were posting revenue growth of 30% or better.
- External capital is not being tapped to spur growth. Instead, most participants were taking a “measured” approach to adapting their business model to the Cloud, funded by operating profits and retained earnings. Of 29 participants, only five accessed external capital to accelerate their Cloud transition.
- Sales and marketing expenditures lag behind broader industry averages. Only six survey participants reported spending 20% of revenue or more on sales and marketing.
- Recurring revenue levels remain low. Although most survey participants felt themselves at least halfway along their journey to the Cloud, many business models continue to be largely professional services-based. Only eight participants reported recurring revenue levels greater than 50% of total revenue.

[1] see Survey Participants
[2] source is IDC e-book, Part 1, The Booming Cloud Opportunity

- Differentiation remains a challenge. Broadly speaking, participants seemed to favor one of two differentiation approaches – niche specialization (often developing own IP), or broad "Cloud solution curation" (essentially a one-stop-shop in the Cloud).

- Lifetime customer value remains an unrealized asset. Few participants had formal programs in place to maximize lifetime customer revenue, but most acknowledged this needed to be a key area of focus going forward.

Survey Format

Although planned in its approach, the survey followed more of a discussion format in which the following topics were covered:

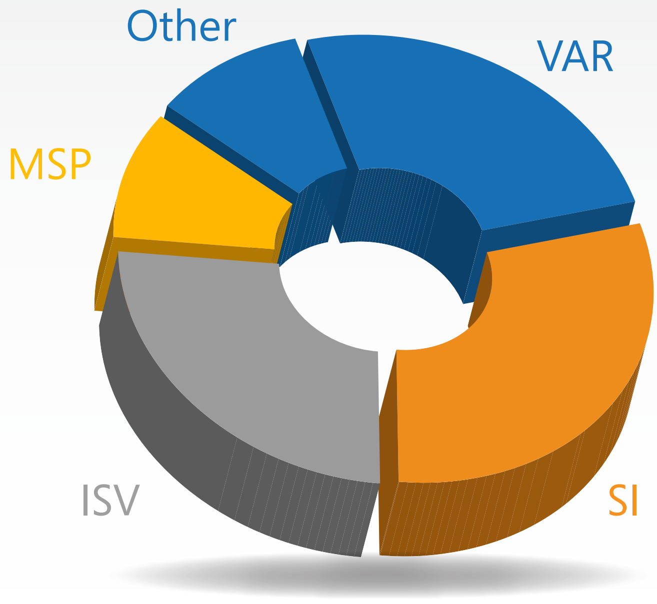
- The financial impact Partners had experienced in adapting to the Cloud
- How Partners were differentiating themselves
- How Partners had configured their sales and marketing activities
- The operational retooling Partners had engaged in
- How Partners were creating or looking to create customer lifetime value
- Where Partners saw Microsoft most able to create leverage for them in accelerating their adaptation to a Cloud-first world

The Partner types participating in the CloudSpeed survey were:

- Value Added Resellers (VARs) – predominantly working with Dynamics ERP solutions.
- Systems Integrators (SIs) – predominantly working with Azure, Office 365, and SharePoint.
- Independent Software Vendors (ISVs) – predominantly offering vertically-specific Dynamics or Business Intelligence solutions.
- Managed Services Providers (MSPs) – predominantly acting as outsourced IT providers for small and medium businesses.
- Others – a mixture of Application Services Providers, Peer Networks, and Master VARs.

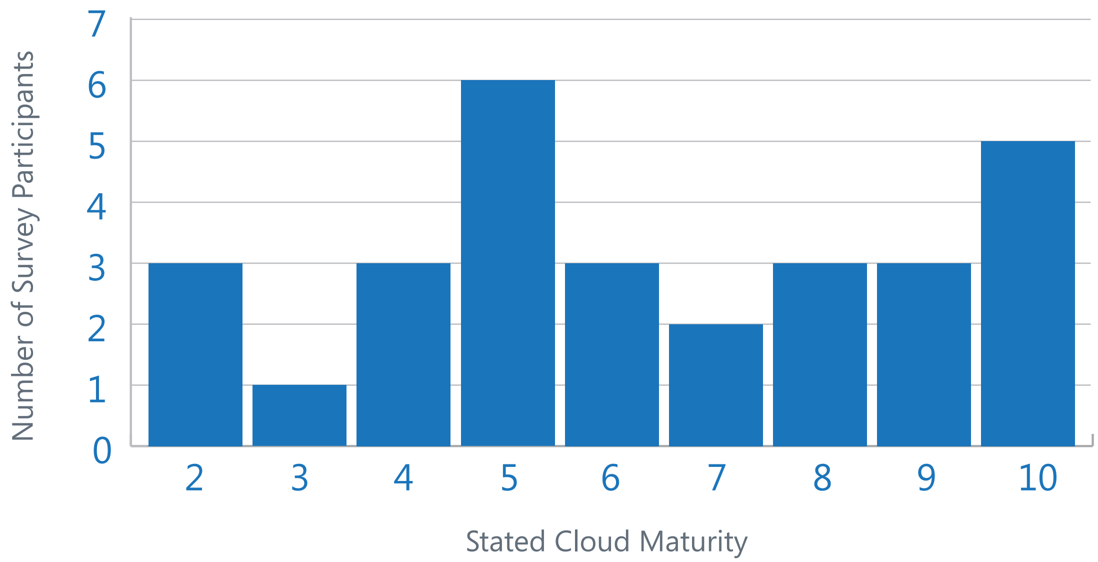
Survey Participants

Overall, the participant group was comprised as follows:



Cloud Maturity Levels

Survey participants were first asked how fully adapted they considered their business to be to the Cloud, on a scale from 1 to 10. This was largely a subjective measure on the part of owners, with 10 indicating they felt fully adapted to the Cloud. Note that this does not necessarily mean that all revenue was Cloud-related, but that the underlying business model was considered fully competitive in a Cloud-first world. The following graph illustrates the breakdown of owner responses.



Overall, the group as a whole felt themselves to be in various stages of adapting to the Cloud, with some further along than others. Interestingly, the biggest concentrations were those Partners who felt their business model fully adapted, and those who felt they were roughly halfway along that path.

Financial Impact

By and large, most survey participants were taking a “measured” approach to adapting their business model to the Cloud, funded by operating profits. The average annual revenue growth reported by the group overall was 21.7%. This is higher than the overall ecosystem average, but fully half of the survey participants were not matching the rate of Cloud demand in their markets, and only five were posting revenue growth of 30% or better.

The revenue growth a Partner was experiencing seemed most closely linked to:

- Their level of Cloud maturity, particularly among SIs. In many ways, this seems a classic example of first-mover’s advantage; those early in tend to have established themselves as “go-to” Cloud organizations in their chosen markets, and their revenue momentum reflects that as demand is “pulled” towards them. This was especially prevalent for Partners serving upper market segments. It remains to be seen, of course, how sustainable continued revenue growth will be in these cases.

- The degree to which the business had sourced and deployed outside capital, particularly among those who have significantly pivoted their business away from services and towards “productized” offerings. Having retreated from the horizontal services fray into niches, revenue had most often initially declined and then greater growth momentum was re-established as awareness built in their chosen area of focus. In some cases, these productized offerings were vertically specific, while others were more oriented towards business functions that cross industries.

As regards the initial impact on margins and profitability from Cloud transition, experiences varied widely from little noticeable effect on the P&L to a significant initial drop in revenue and contribution margin. In the main, the degree of overall financial impact seemed primarily driven by two factors:

- The speed of Partner transition to the Cloud. Some had chosen to more aggressively pursue the Cloud opportunity than others, giving rise to the need to fund faster retooling of their business model.

- The magnitude of change in the underlying business model. Some had fundamentally pivoted their business from a project services to a product or managed service focus, resulting in significant short term P&L degradation.

For the most part, the degree of margin impact varied according to the revenue stream involved, as follows:

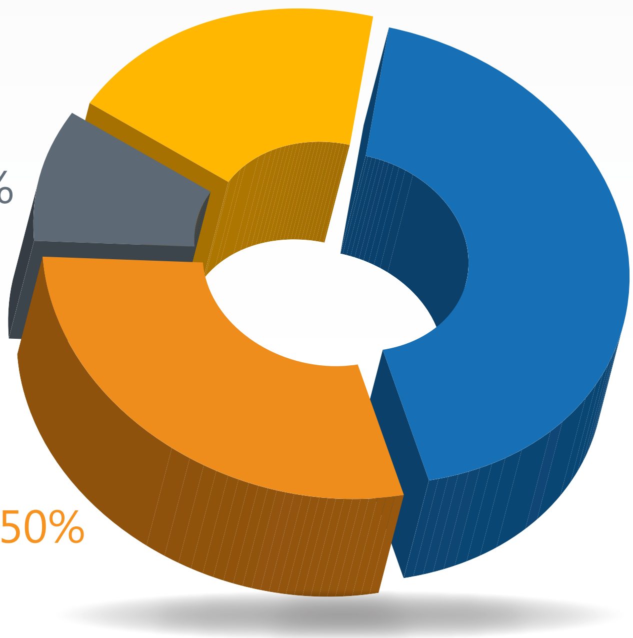
- Professional services margins, unless specialized through vertical expertise or otherwise high value-add, were almost universally under pressure. The more mature the market, the greater this pressure seemed to be. Few were reporting gross margins over 40%.
- Managed services margins were generally under less pressure, usually some 5-10% better than professional services, but reskilling was typically required to field a Cloud-specific managed services offering.
- Packaged IP typically carried 70% margins or better, and was subject to the least downward pressure, but monetizing it in subscription form carried cash flow consequences.

Indeed, many Partners experienced an initial drop in cash flow as they transitioned to the Cloud, largely related to the speed of their transition. On average, these cash flow “troughs” tended to range between 15%-25% of starting revenue, and last for roughly 18 months. But there was significant variation in Partner experiences, depending on how fast customer demand pulled them towards the Cloud, how aggressively they pursued this demand shift, and their core business focus. To mitigate cash flow impact, a common tactic used was to take annual payments in advance for Cloud subscriptions.

Cash flow shortfalls were most often financed out of operating profits or retained earnings, but in some cases outside capital was sourced. Of the 29 Partners interviewed, five had taken in capital injections. In some cases, bank financing was obtained, often secured by receivables. In others, private equity or venture capital was tapped, and the amounts raised were as high as several million dollars (or euros). Those beginning Cloud-based business models from scratch were the most likely to raise outside capital.

The degree of recurring revenue for a Partner did not necessarily mirror their stated level of Cloud adaptation. Some Partners had significantly higher levels of recurring revenue pre-Cloud, while others had created new business models from scratch, or aggressively pivoted the business towards productized IP subscriptions. Overall, the group was distributed as follows in terms of recurring revenue levels.

% Of Revenue Recurring



As recurring revenue levels rose, revenue per employee tended to as well, bringing up overall core profitability levels. Several were targeting revenue/employee levels of $300k or better (compared to an ecosystem average[3] under $200k), and gross margins of 50% or better. These Partner business models were inevitably more product than labor focused.

Finally, when asked how much of the time customers specifically request Cloud-based solutions, or at least want to consider one, most respondents indicated that this was the case 50% of the time or more. This varied according to the degree of Cloud adoption generally in the local market served, and the degree of Cloud adaptation by the Partner themselves. For those Partners who had aggressively pursued a Cloud focus, and operated in more mature markets, not surprisingly prospects request Cloud solutions virtually 100% of the time.

[3] based on CloudSpeed benchmarking data

Differentiation Approach

Differentiation approaches varied widely among survey participants, and tended to depend firstly on whether the business was inherently product or services focused.

Obviously, the ISVs interviewed differentiate themselves through their own IP. Newer entrants in particular found it critical to keep their product simple. Their experience is that today's customer wants specific business problems solved "neatly", and that less is often more. Their goal was getting a minimum viable product to market quickly, and then iterating. A key finding, from this survey but also the author's broader experience, is that the greatest rate of packaged IP development often comes from smaller Partners, who have seen their traditional services-based business come under severe pressure, and feel pivoting their business towards IP development is their only real way forward.

It is also worth noting that several services-oriented Partners interviewed had IP development on their radar, as a means of both revenue expansion and customer retention. Many contemplated vertical IP, but some saw opportunities with functional IP as well, largely as modules within SharePoint or Azure that streamlined and automated business processes, making them less costly and more predictable, thereby reducing risk. Whatever the IP focus, it had to deliver a measureable business impact to the customer.

Among those whose business was service rather than product, a variety of market positionings were in play, such as:

- Virtual Cloud IT Director
- Cloud Adoption as a Service
- Cloud Productivity Coaches
- Cloud Productivity Architects

Some saw their differentiation in deployment approaches as being where they leveraged automation and landed business value in customers' hands quickly. This was often associated with a technical focus on CRM Online or Azure.

For others, the choice was to offer “solution depth” on the Microsoft platform, in effect becoming a “one stop shop”. This was most prevalent among those concentrated in the small and mid market segments. In essence, this was a 3-legged stool that required the following components:

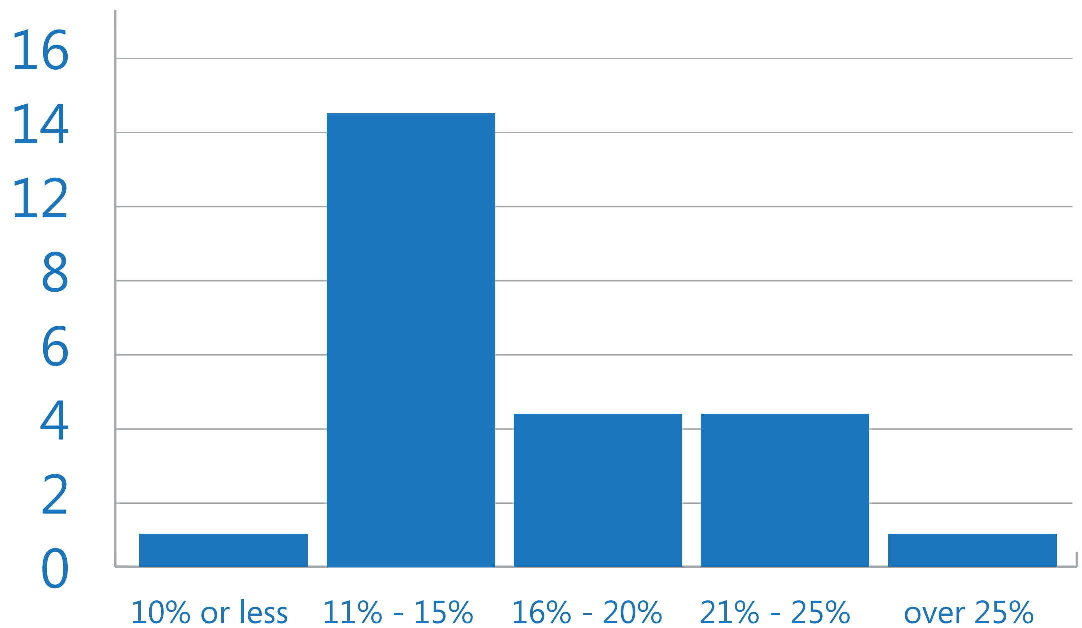
1. Understanding a breadth of products (CRM, O365, Azure)
2. Layering services over Microsoft offerings (primarily training and support)
3. Developing own IP (sometimes working with outside developers)

In general, almost every Partner interviewed experienced a decline in traditional professional services (project) revenue, and sought to compensate by way of adding either a managed services or product (packaged IP). It tended to be a binary choice. The complexity and cost associated with pursuing both simultaneously was felt onerous and overly risky (although it is important to note that those who bolstered or created managed services offerings initially were often opportunistically looking to develop IP as well).

On a more practical note regarding IP development, unless already an ISV, most found it necessary to consider it a segregated activity. It was not necessarily spun off as a separate division (especially among smaller Partners), but it did have dedicated resources. In many cases, these resources were previously consultants doing project work, but with an aptitude (and willingness) to work on product development. In practice, this was a small subset of a Partner’s pre-existing consultant pool. Most traditional consultants do not transition well to this role, so finding those that do and splitting them out was key to success. In some cases, IP development was outsourced, but in the main it was felt that the best way to keep packaged IP proprietary was to leverage previous project learnings and keep development in-house.

Sales and Marketing Configuration

Overall, sales and marketing configurations among survey participants had the most commonality in terms of both strategy and tactics, although there were variations in execution depending largely on market segment served. The total amount spent on sales and marketing among survey participants, however, rarely exceeded 20% of revenue, as illustrated in the following graph. Moreover, although the mix was shifting in favor of spending more on marketing, sales costs were typically at least 2/3 of overall sales and marketing spending.



The universal experience was that traditional direct sales and outbound calling no longer really work. Everyone acknowledged that the prospect now wants to be in control of their buying process rather than subjected to someone's sales cycle. They want to talk to a salesperson only when they're ready, and therefore this occurs later in their buying process. Some had shifted their spending away from sales and towards marketing more aggressively than others, and one suspects this trend will only accelerate.

The shift away from selling to technical audiences and towards having business value-based conversations with C-level line of business owners was also universal. In many cases, it is consultants who actually do much of the selling, since they are the best able to have these conversations. The traditional salesperson seems almost a complete anachronism. For those concentrating in lower market segments, it often continues to be the Partner owner(s) who are responsible for revenue generation.

From a marketing perspective, the focus has also shifted. Where the initial focus often continues to be lead generation through technical Search Engine Optimization (frequently outsourced) and Pay per Click campaigns, these in the main are becoming less effective.

In place of these tactics, Partners are concentrating more on content development, blogging, and working social media channels. Most also conducted webinars. Some are making forays into video, particularly for testimonials. Those with vertically-specific packaged IP offerings are also concentrating on attending industry events and working with industry associations. Often, their costs are very low even though revenue growth was high.

It seemed that a “minimum” marketing team of 2-3 people has become the standard, to continuously generate the content needed both for a Partner’s website as well as its blogging and social media work. LinkedIn is generally found to be the most universally relevant social channel, with few stating results from Twitter and Facebook directly.

The use of tools also figures prominently in most Partner’s marketing approach. HubSpot tops the list of most-used tools, but there is also use of Click Dimensions, LinkedIn Lead Accelerator, Crazy Egg and Google Analytics. CRM is also often used, but is generally considered more a sales than a marketing tool.

Operational Retooling

All Partners made operational changes to their business in adapting to the Cloud. The nature and extent of this operational "retooling" varied according to their core business focus, as follows.

- Those who historically operated as managed services providers in the main found technical retraining to be their biggest priority, supplemented by selective hiring of those who have Cloud-specific skills as well as attrition of "legacy" support engineers. Some chose to lay off staff in their retooling effort as well, although this was not commonplace. Operationally, managed services providers likely have the easiest time pivoting their business to the Cloud. Even so, within this category many peers hesitate in making the transition.

- Those who were originally project services-based and created managed services practices are now investing in provisioning, ticketing, monitoring, and billing infrastructure, or acquired existing managed services practices. The use of CRM for both sales and support is not uncommon, but neither is it universal. Many deploy Microsoft System Center. For those building a managed services capability from the ground up, especially at lower scales, the general sentiment is that keeping things flexible initially is important.

- Those whose business focus has shifted more towards productized IP offerings are actively transitioning consultants to developers, but selectively. In some cases, they have significantly reduced their headcount along the way. Most Partners here are adopting an assembly line approach for implementations, often at fixed prices, and not uncommonly using a separate team. Self service training and online documentation often round out the mix. These Partners tend to spend at least as much effort educating their staff in the business as in the technology. They need to be seen as experts in their chosen area of focus.

Almost all Partners acknowledge paying increased attention to utilization and realization in their transition to the Cloud, anchored in repeatable processes. Very often, success in this is central to funding the transition, at least in significant measure.

Across the board, the scale of automation has certainly increased in recent years. Some have completely automated onboarding, for example, and hired process engineers to develop and support continuous operational streamlining. Others operate with repeatable but not fully automated "templates". The degree of hiring for business process expertise has also broadly increased.

Broadly, infrastructure Partners find the retooling effort associated with working with Azure to be far more complicated and costly than that involved with Office 365.

A final finding relates to operations, sales, and marketing combined. Several Partners feel an anchor element of their Cloud approach is to “eat your own dogfood” in terms of the technology sold. Particularly for infrastructure Partners, selling and delivering measureable business impacts for the end customer meant they needed to first realize these benefits for themselves.

Customer Lifetime Value Creation

When it comes to programmatic approaches in maximizing revenue and margin potential from a customer base over time, it is here that execution lags awareness to the greatest extent.
Some Partners have a specific “land and expand” strategy in place, with an initial beachhead anchored around a particular stack element, and clear ROI arguments in place for incremental sales. But this is still a minority.

The greatest inroads here are perhaps among Partners who position the full range of productivity gains upfront in their selling efforts, so that there is something of a “roadmap” to increased customer usage in place from the beginning. Training is key to driving this, which often is online. But interestingly for some Partners, superior Office 365 activation (as an example) involves onsite training as well.

One of the challenges voiced with respect to more “scientifically” building customer lifetime value is that such value is calibrated based on historical data, which for many Partners has yet to be accumulated. Those who are building these scientific approaches tend to rely on external guidance and metrics found among the VC community, and websites such as SaaStr.

Partners concentrating on packaged IP voiced another constraint – in adopting a niche focus, they become a small element of a far bigger picture. This makes it difficult to credibly broach other opportunities with a customer. For them, building customer lifetime value tends to require Partner-to-Partner associations, although few seem to make significant strides in formalizing these relationships.

Still, it can fairly be said that fielding a broad offering set is a desired destination for most, precisely so that a “land and expand” strategy can be executed.

Momentum Blockers

Survey participants were asked what structural blockers they faced that negatively impacted their market momentum, and how they felt Microsoft could best create leverage for them to accelerate their adaptation to a Cloud-first world.

First of all, there is broad consensus that the consistent messaging around being "all in for the Cloud", starting at WPC 2014, was and remains pivotal to ecosystem transition. Although to somewhat varying degrees, almost every Partner today is experiencing a drop in the traditional revenue and margin on which their business has been historically based. Practically everyone now fully accepts the need to adapt, and there is a growing sense of urgency. At the level of core market demand, there is no longer any real debate – we live in a Cloud-first world. What is of vital importance to Partners, especially frontrunners, is a depth of understanding as to the key executional elements of the overall Microsoft Cloud strategy, so that they may intelligently form and fund their own strategies. It is recognized that this will evolve over time, but a Partner must be forewarned to be forearmed.

There is also broad agreement that the Cloud Solution Provider (CSP) program provides a solid step in moving the Partner ecosystem in the right direction. And that inevitably, there will initially be executional wrinkles to iron out. Some of the more common "wrinkles" mentioned included:

- Licensing model harmonization, particularly as it relates to Enterprise Agreements. Additionally, restrictions that make it more complicated for Partners to "bundle" their own IP with Microsoft stack elements.
- Digital Partner of Record assignments, ensuring the Partner adding the value gets the credit.
- 1 Tier CSP requirements, ensuring a quality customer experience.
- Extensive and stable APIs, to reduce costs and better enable bundling.

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At a more tactical level, partners identified other points of potential leverage, in no particular order:

- Intensify investments in Cloud frontrunners, so as to not only spur their own progress, but in many ways pave a path for the broader ecosystem to follow. Volume discounts were mentioned in this context by some, but not all frontrunners are necessarily large-scale (particularly as it relates to packaged IP development). Another key comment was to sync incentives to a long-term view, so as to drive sustained commitment.
- Deeper identification of white space, to better quantify addressable markets at a Partner level, form go-to-market strategy, and source needed funding. In this context, non-IP based opportunities were felt important to include as well.
- More detailed guidance and "templates" as it relates to the operational structures needed at different stages of growth, both to accelerate transition as well as to reduce associated risk. Microsoft's move in recent years to provide Partners with more business-oriented (non-technical) assistance is both appreciated by most, and seen as increasing in importance, especially where it incorporates broader industry learnings, metrics, and benchmarks.
- Streamlining the information pipeline. There is a plethora of information available to Partners, but quickly accessing that which is truly relevant is often difficult.
- While the need for accelerated adoption is uncontested, FastTrack has eroded Partner revenue. As an offset, earlier access to new technologies could better position Partners to understand their monetization opportunities and invest accordingly.
- Provision of a marketplace. Especially for those who focus on packaged IP, and given the costs of both direct or channel-based selling, this is seen as a key step to achieving meaningful volumes.

Conclusion

It is beyond debate that Cloud demand is strong and growing, in all markets. The greatest risk to the Microsoft Partner ecosystem may be that it does not adapt fast enough to meet this demand, effectively ceding its future to competitors. Indeed, many Partners report that the rate of Cloud adoption in their market has accelerated faster than they were prepared for. If anything, the ecosystem must move even faster than it has, to capture this market opportunity. Ground lost will be very difficult to later regain.

In order to fully capitalize on Cloud demand, CloudSpeed has the following core recommendations for Partners:

- Align with capital, if you haven't already. Those who have gained the strongest footholds in their chosen market spaces have moved fast and early, and sourced the capital needed to retool their business models and develop strong Cloud revenue momentum. At this juncture, a "measured" approach risks being too little, too late.
- Define your whitespace, and what is needed to get to critical momentum. Partners can exploit a myriad of Cloud-related market opportunities, but they must be focused. They must choose a target market based on their existing strengths, and that has sufficiently compelling economic potential. Once accomplished, they must then configure differentiated offerings to address demand, materially re-pivoting the business if needed.
- Intensify your customer acquisition efforts. A solid offering set is a necessary but not a sufficient condition for success in the Cloud. In order to build optimal shareholder value, Partners must acquire Cloud customers before someone else does. This will require increased marketing and sales investments for almost all Partners.

Survey Participants

The following is a list of participants in the CloudSpeed survey:

Partner	Website	Partner Type	Location	Survey Participant	Position
Blue Rooster	https://www.bluerooster.com/	SI	USA	Kevin Conroy	CEO
Gestisoft	http://gestisoft.com/	VAR	Canada	Claude Rose	CEO
Printvis	http://printvis.com/	ISV	Denmark	Kasper Tomshoj	Owner
Paradigm Systems	http://www.paradigm-systems.co.uk/	MSP	UK	Mike Brown	CEO
Broadpoint	http://www.broadpoint.net/	VAR	USA	Lee Raesley	CEO
Dynateam	http://dynateam.dk/	VAR	Denmark	Bjarne Soballe	CEO
Createch	http://www.groupecreatech.com/en/	VAR	Canada	Mario Chabot	General Manager
Solver	http://www.solverusa.com/	ISV	USA	Nils Rasmussen	CEO
Net Brinel	http://www.brinel.ro/Home.aspx	SI	Romania	Cristina Mudura	VP Sales
AKA	http://www.akaes.com/	VAR	USA	Jack Ades	Owner
Infoma	http://www.infoma.de/en/	ISV	Germany	Oliver Couvigny	Managing Director
BSquare Solutions	https://www.bsquare.com/	VAR	USA	Marc Olson	Director, IoT
Mibar	http://www.mibar.net/	VAR	USA	Bart Nachimow	CEO
QBS	http://www.qbsgroup.com/uk/home.aspx	Master VAR	Netherlands	Joop van Voorthuijsen	CEO
CloudPeople	http://www.cloud-people.dk/	MSP	Denmark	Finn Krusholm	CEO
Arterian	http://www.arterian.com/	MSP	USA	Jamison West	CEO
EasyStep2lean	http://www.easystep2lean.nl/	VAR	Netherlands	Rick Blom	Owner
Dot Net	http://www.dotnetsolutions.co.uk/	SI	UK	Dan Scarfe	Founder

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Bestborn	http://bestborn.com/	ISV	USA	Martin Kerr	CEO
Industry Built	http://industrybuilt.com/Home.aspx	ISV	Canada	David Pilz	CEO
Rose ASP	http://roseasp.com/	ASP	USA	Linda Rose	CEO
Heartland Technology Group	http://www.htgpeergroups.com/	Peer Network	USA	Arlin Sorenson	CEO
ForceWorks	https://forceworks.com/	ISV	USA	Steve Mordue	CEO
InfoWAN	http://www.infowan.de/	SI	Germany	Lars Riehn	CEO
Qorus Software	https://www.qorusdocs.com/	ISV	South Africa	Ray Meiring	CEO
Axon IT	http://axon-it.com/	VAR	UK	Tim Mears	Managing Director
Wortell	http://www.wortell.nl/	SI	Netherlands	Danny Burlage	CTO
Generation e	https://www.generation-e.com.au/	SI	Australia	Loryan Strant	CTO
Altus Dynamics	http://www.altusdynamics.com/	ISV	Canada	Colin Dickinson	CEO

About the Author

With over 25 years in senior management and consulting roles, Dana has an extensive knowledge of the software industry and the Microsoft ecosystem.

Dana is probably best known as the "financial engineer" of Partner success in the Cloud, and the dominant authority on Partner profitability. He has provided strategic advice to scores of Microsoft partners on four continents, and his Cloud financial models in particular are in widespread use across the ecosystem, pivotal in establishing the Partner business case for Cloud adoption.

Dana also has been extensively engaged in project work for Microsoft over the last decade, helping ensure Microsoft Partners get "the right things right" in their critical business model transition to the Cloud. His work has been consistently regarded as best in class by Microsoft Executives, Partners, and industry analysts alike.

Highlights of his work over the last 10 years include:

- Originator and curator of the Partner Benchmarking Database
- Author of numerous Microsoft Cloud SureStep assets and materials, including Cloud Profitability Models designed for VARs, ISVs, Managed Services Providers, and Systems Integrators
- Anchor author for Dynamics Cloud Partner Profitability Guides (two editions)
- Co-author of Cloud Curriculum for Dynamics Partner Academy
- Active consultant to Microsoft Partners on four continents

Dana can be reached at dana@cloudspeed.co. His full professional bio and client recommendations can be found online at www.linkedin.com/in/dana-willmer-9600862.