Dynamics 365 Business Central

The Partner Financial Opportunity

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CLOUDSPEED

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Executive Summary

Dynamics 365 Business Central represents an unprecedented financial opportunity for Partners, provided they understand the fundamental economic drivers of success, and the operational changes they must make to their business model in order to produce high levels of annual recurring revenue and strong customer lifetime value. By following the guidance in this whitepaper and leveraging its related assets, Partners can ensure they fully and profitably monetize the Dynamics 365 opportunity and generate strong gains in shareholder value.

Introduction

Few if any Dynamics Partners would today question that the demand for Cloud solutions is strong and growing, both for new as well as existing customers. Indeed, in a recent CloudSpeed survey of leading Microsoft Partners, Cloud subscriptions were the fastest growing revenue category[1].

Increasingly, the Cloud is the customer's first choice. The truth is that the future of a Partner business is at serious risk if they do not participate in Dynamics 365 Business Central, and supplement their portfolio with strong Cloud-based offerings.

Yet many Partners are still uncertain as to how they finance this business shift, and drive long term profitability. This whitepaper provides a "roadmap" to Dynamics 365 Business Central success, by outlining the economic drivers in the Cloud, the business transition model, and the financial impacts a Partner must anticipate.

Economic Drivers

From a financial viewpoint, capitalizing on Cloud demand is something of a "balancing act" for a Dynamics Partner, where the focus shifts from individual deal value and contribution margin to annual recurring revenue and customer lifetime value. Success lies in ensuring simultaneous attention is paid to the following core business levers:

[1] for more detail on ecosystem revenue growth, margin levels, and valuation impacts, download the latest CloudSpeed Realities on the Ground Study.

Existing Customer Migration

The starting point for success in the Cloud is to ensure that a Partner captures all available Dynamics 365 Business Central demand and does not lose existing customers to the competition. With the average ERP replacement cycle now around 10 years, it is a certainty that a Partner will have current customers considering Dynamics 365. In addition, getting customers who today pay maintenance on perpetual licenses to instead subscribe to Dynamics 365 is key to "locking in" the long term recurring revenue streams that sustain the Partner business and drive high company valuations.

New Customer Acquisition

Customer retention in the Cloud is important, but so is achieving adequate growth. With overall Cloud demand is projected to grow by 21% annually, and reach $266 billion by 2021[2], any Partner not growing at that rate is clearly losing market share. So a Partner must both migrate existing customers to Dynamics 365, and ensure adequate resources are devoted to acquiring *new* Dynamics 365 customers. Overcommitting to "traditional" perpetual customer acquisition will mean the opportunity to build a more valuable business based on recurring revenue is impaired.

Working Capital Adequacy

Inherently, the Cloud requires a Partner have greater working capital levels, because many costs are upfront, while revenue comes in over time. One of the potential sources of additional working capital will in fact come from migrating existing customers to Dynamics 365 subscriptions. As illustrated later in this white paper, careful attention here can often allow a Partner to avoid the need for additional capital injections.

[2] source is IDC Worldwide Public Cloud Spending Forecast

Customer Acquisition Cost

Efficiency and cost-effectiveness in both Marketing and Sales play a key role in Cloud success, to drive the lowest acquisition cost payback periods and minimize cash flow disruptions. Digital demand generation and remote selling capabilities are king.

Services Attach

No Partner business model could ever sustain itself with reselling margins alone, and in this respect the Cloud is no different. Although the services a Partner attaches to Dynamics 365 subscriptions are different from the on-prem world, they are still an important driver of profitability, cash flow and company valuations. Particularly if they are recurring.

Own IP Attach

From the customer perspective, Cloud demand is fundamentally about consuming "productized" offerings rather than extensive customizations. Particularly as it relates to succeeding in vertical or diagonal markets, a Partner's own IP is pivotal both to revenue generation and profitability. It also allows for far more targeted and therefore cost-effective customer acquisition.

ISV Attach

As with Partner own IP, it will often make sense for a Partner to include functionality provided by ISV's to field the complete, out-of-the-box solutions customers demand. This both relieves the need for customization as well as adds to the overall deal margin and recurring revenue levels.

Customer Lifecycle Management

In the Cloud, achieving low subscription churn levels is critical to financial success. Building a customer's revenue profile over time through active cross-selling is also key. Ensuring a customer has the highest possible "lifetime value" requires active and ongoing customer lifecycle management.

Business Transition Model

Business Management

To start with, a Partner must think of Dynamics 365 Business Central as a separate department or division within their current business. Little success will be gained from a "dual portfolio scenario" (on premise resources selling and servicing cloud customers). They are fundamentally different business models and require very different resourcing. Lower delivery costs are central to success with Dynamics 365, and this cannot be achieved with the more senior resource pool Partners today have. New talent must be recruited, that are not only more cost-effective but that also follow more "templatized" implementation approaches.

Financing and Admin

As earlier stated, working capital adequacy is a key economic driver in the Cloud. Depending on the investments a Partner is required to make acquiring customers and potentially developing IP, a cash flow trough of some kind must be anticipated by the Partner to maximize their long-term Dynamics 365 opportunity. Funding mechanisms must be planned, sourced, put in place, and acutely managed on an ongoing basis.

One of the key mechanisms to improve cash flow is by selling annual subscription contracts to the customer, while paying Microsoft monthly for the underlying Dynamics 365 licenses. Packaging and pricing service components properly can also offset cash flow deficits.

Marketing

Cost-effective digital demand generation is a must for Cloud success, and for most Partners this will require building out or outsourcing additional capabilities. The level of investment required will depend on a Partner's current marketing infrastructure and staffing levels. A Partner must also be reasonably certain of what their variable cost of acquiring a qualified lead will be. Detailed guidance on customer acquisition strategy, tactics and costs can be found in Ready to Go Program Materials.

Sales

Just as the customer journey in buying Cloud solutions starts online, it also largely stays there. Sales process should be designed to close business remotely in the vast majority of cases, and a Partner must not only employ a different type of salesperson in the Cloud, but must also rigorously track their performance and provide compensation structures that incent superior results. Typically, a seasoned on-premise Dynamics sales professional is the wrong candidate for this role as they see all opportunities through the lens of on-premise deployments. Success in Cloud sales is achieved through a very different methodology. Guidance with respect to this is contained on the Microsoft Partner Network.

Service Delivery

Automation and repeatability are core requirements in the Cloud, because the customer expects lower overall costs for services or fixed-fee implementations. AppSource today contains offers that are far cheaper than similar deployments on premise, and this sets the standard. Bottom line, the customer will likely pay no more than 1-2 times the annual Dynamics 365 license cost for implementations, and in many cases less.

Low cost resources are also required for any remaining labor components of the overall Partner Dynamics 365 offering. This almost invariably means that a Partner must use separate resources for Dynamics 365, both to keep costs in line as well as to avoid inefficiencies arising from delivery resources splitting their focus between traditional and Cloud deployments. Ideally, a Partner wanting success with Dynamics 365 Business Central would allocate a senior delivery resource to form and lead a new group that followed more "templatized" processes that simultaneously reduce costs and increase customer satisfaction. In this regard, onboarding specialists and training resources will be key alongside a lower reliance on consultants, analysts and programmers.

Product Development and Management

In order to deliver the "productized" solutions customers demand, a Partner must cost-effectively develop and maintain some amount of their own IP[3]. This requires they do 3 basic things:

- Identify a market focus (ideally vertical or diagonal) that has financial potential and leverages existing Partner expertise.
- Find and work with an "anchor" customer or two to ensure development efforts are spent on offerings that add real business value, and to at minimum co-fund IP development.
- Leverage all project work to produce "repeatable" code or objects that can be resold with limited cost.

The market opportunity with Dynamics 365 Business Central is so vast that a Partner's potential to monetize their own IP is outstanding no matter what their IP focus. And the financial impact of monetizing some form of Partner own IP can not be overstated. Even relatively small monthly recurring revenue amounts and low penetration rates can have huge impacts on profitability and company valuations[4].

Financial Impacts

Deal Anatomy

To start with, Partners can generally expect a material increase in both revenue and margin from pro-actively migrating and upgrading their existing customer base to Dynamics 365 subscriptions. This arises from the fact that subscription pricing is be higher than the maintenance a customer pays today, and because there will be a "gross-up" associated with the move from concurrent to named users.

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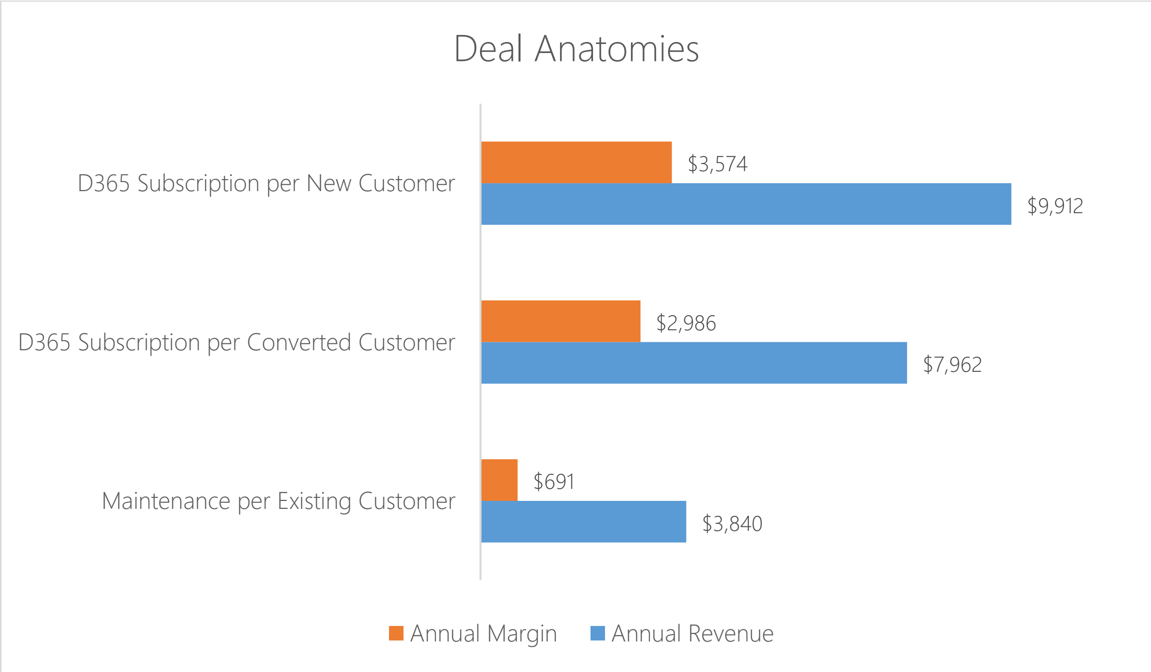
[3] for more detail on building out Partner own IP, refer to the IP Staircase and Packaged Offer Development Keys ebooks
[4] for more detail on Partner profitability and valuation impacts, download the latest CloudSpeed Realities on the Ground Study.

To take an example, a Partner with an average existing customer size of 8 users today might expect to as much as *double* their revenue and *quadruple* their net margin[5] for every customer they migrate to Dynamics 365 Business Central.

Secondly, a Partner can expect an increase in total ERP seats sold for new customer adds, because the "limited" user is very attractively priced. This delivers an even bigger positive financial impact for the Partner, potentially generating up to 20% more revenue and margin than an existing customer conversion.

Based on an "average[6]" scenario, the respective deal anatomies would look like this:



[5] a Partner can model their own specific financial impacts by downloading and populating the [Dynamics 365 Financial Model]

[6] core assumptions – current average customer size = 8 users, concurrent/named user gross-up = 1.3x, new customer adds of 11 limited users, 7 full users.

Sample P&L Transition

The precise P&L transition a Partner might expect depends on several variables, contained in the Dynamics 365 Financial Model. Each Partner should take the time to calibrate the model for their own specific circumstance, and build their own transition roadmap using it, but a "sample" P&L transition might look like this[7]:

		Today	% of revenue	Year 1	% of revenue	Year 2	% of revenue	Year 3	% of revenue	Year 4	% of revenue
Revenue	Software										
	Perpetual Licenses	$1,000,000	15.6%	$950,000	14.0%	$902,500	12.5%	$857,375	10.7%	$814,506	9.2%
	Dynamics Maintenance	$1,400,000	21.9%	$1,552,000	22.9%	$1,696,400	23.4%	$1,833,580	22.8%	$1,963,901	22.3%
	Dynamics 365 & ISV Subscriptions	$0	0.0%	$137,570	2.0%	$439,955	6.1%	$930,466	11.6%	$1,545,499	17.5%
	Own IP Subscriptions	$0	0.0%	$0	0.0%	$0	0.0%	$0	0.0%	$0	0.0%
	Services										
	Project Services	$4,000,000	62.5%	$4,150,000	61.1%	$4,203,750	58.0%	$4,425,313	55.0%	$4,483,125	50.9%
COGS	Software										
	Perpetual Licenses	$650,000	10.2%	$617,500	9.1%	$586,625	8.1%	$557,294	6.9%	$529,429	6.0%
	Dynamics Maintenance	$1,148,000	17.9%	$1,272,640	18.7%	$1,391,048	19.2%	$1,503,536	18.7%	$1,610,399	18.3%
	Dynamics 365 & ISV Subscriptions	$0	0.0%	$86,289	1.3%	$275,878	3.8%	$593,931	7.4%	$1,002,707	11.4%
	Lost Perpetual Maintenance	$0	0.0%	$2,621	0.0%	$9,331	0.1%	$18,749	0.2%	$29,117	0.3%
	Services										
	Solution Delivery	$2,400,000	37.5%	$2,465,000	36.3%	$2,595,000	35.8%	$2,815,000	35.0%	$2,870,000	32.6%
OPEX	Customer Acquisition Costs	$768,000	12.0%	$942,824	13.9%	$987,451	13.6%	$1,174,427	14.6%	$1,344,988	15.3%
	R&D	$0	0.0%	$0	0.0%	$0	0.0%	$0	0.0%	$0	0.0%
	G&A	$1,100,000	17.2%	$1,100,000	16.2%	$1,100,000	15.2%	$1,100,000	13.7%	$1,100,000	12.5%
	Total Revenues	$6,400,000		$6,789,570		$7,242,605		$8,046,733		$8,807,032	
	Total Expenses	$6,066,000		$6,486,874		$6,945,333		$7,762,936		$8,486,639	
	Operating Margin	$334,000		$302,696		$297,272		$283,798		$320,392	
	EBITDA	5.2%		4.5%		4.1%		3.5%		3.6%	

This example is without consideration of any ISV functionality or Partner own IP added to converted customers.

Partner Transition Scorecard

In the long run, a Partner's ability to successfully monetize the Dynamics 365 Business Central opportunity will be determined by the attractiveness and maturity of their Cloud offers, and their ability to cost-effectively acquire customers. The Dynamics 365 Partner Transition Scorecard can be used to identify where an individual Partner may be at, and what they will want to work on to fully capture the Dynamics 365 opportunity.

[7] core assumptions – current average customer size = 8 users, concurrent/named user gross-up = 1.3x, 50 customers converted over 4 years

Next Steps

To best form an individual plan for capitalizing on the Dynamics 365 Business Central opportunity, the following steps are recommended for Partners:

1. Download and complete the Dynamics 365 Partner Transition Scorecard to "benchmark" their Customer Acquisition Capability and Cloud Solution Maturity overall, as well as identify areas that they will want to focus on improving (the amber and red highlighted cells).
2. Download the Dynamics 365 Financial Model and change the "base" assumptions (numbers in red) to understand the impact of the core economic drivers discussed earlier, paying particular attention to:
    a. Annual Perpetual Customers Converted (cells F3:J3 on the Key Business Variables tab)
    b. New Customer Add Metrics (cells C12:C13 on the Key Business Variables tab)
    c. Upfront and Ongoing Project Fees (cells C15:C16 on the Key Business Variables tab)
    d. Own IP Attach Rate (slider bar that populates cell J23 on the Key Business Variables tab)
    e. ISV Attach Rate (slider bar that populates cell J26 on the Key Business Variables tab)
    f. Annual D365 Customer Adds (cells F5:J5 on the Key Business Variables tab)
    g. Resourcing (cells F7:J13 on the Key Business Variables tab)

    As each variable is changed, the model calculates the P&L impact, anticipated business valuation impact, and recommended working capital at the bottom right of the Key Business Variables tab. The Cash Flow Impact, Deal Anatomy and P&L Impact tabs provide further detail.

3. Build a Partner-specific financial blueprint for maximizing the Dynamics 365 opportunity by adjusting any remaining variables in the Current Customer Base Metrics, Resource Costs, Customer Acquisition and Retention, and Other Fixed Investments sections of the Key Business Variables tab.

Conclusion

With the demand for Cloud solutions strong and growing both for new and existing customers, Partners must act now to seize the Dynamics 365 Business Central opportunity, or risk losing existing customers to the competition.

By following the guidance in this whitepaper and leveraging its related assets, Partners can ensure they fully and profitably monetize the Dynamics 365 opportunity and generate strong gains in shareholder value.