

# The IT Services Market

## Time for Change



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## Table of Contents

Executive Summary .....	1
Introduction .....	1
Customers .....	2
IT Professionals .....	4
IT Resellers .....	4
IT Vendors/Distributors .....	6
Lessons from Other Industries.....	8



## Executive Summary

In this digital age, the IT services market is not working effectively for any stakeholder group – Customers, IT Professionals, IT Resellers, IT Vendors, and Distributors alike. Each remain exposed to critical risks and fail to realize the full promise of digital transformation.

Moreover, the risks and economic rewards are likely unbalanced in the face of this market shift. Customers need more predictable outcomes and tangible business value from their technology investments. The IT Professionals and IT Resellers who deliver them deserve to reap superior economic rewards. IT Vendors and Distributors need to preferentially support those who best advance everyone’s interests, including their own.

In short, all industry players need to better serve customers, while helping themselves achieve superior business outcomes. Lessons from digital frontrunners in other industries strongly suggest that increased transparency and visibility is a vital requirement, and overdue.

## Introduction

We live in an age of technological disruption. The cumulative impact of cloud computing, big data, IoT, mobile, social, AI, and machine learning has dramatically changed the landscape of available technologies and created many new exciting possibilities for organizations of all sizes. Digital technology now impacts virtually all aspects of how businesses and institutions must operate to effectively and efficiently serve the needs of customers and stakeholders, in the process rendering many existing business models and approaches obsolete. In short, “digital transformation” is key to survival in the modern age.

At the same time, the customer has rewritten their rules of engagement with the IT industry. Fundamentally, they wish to pay for technology only as and when



they realize concrete business value<sup>1</sup>. They increasingly reject outdated modes of technology consumption and seek to transfer the risk of technology selection and implementation to IT Resellers<sup>2</sup>.

This fundamentally alters the economic logic for the entire IT industry, yet the way in which IT services are procured and delivered has changed very little. With rare exceptions, IT Reseller margins and profitability are consequently at all-time lows, and in many cases still falling. In a recent study, CloudSpeed found nearly half of the respondents were posting *negative* EBITDA levels<sup>3</sup>. This indicates that Resellers simply cannot absorb the risk that customers are seeking to transfer to them.

This paper will outline the key issues faced by 4 key stakeholder groups – Customers, IT Professionals, IT Resellers, and IT Vendors/Distributors in this era of technological disruption – as well as explore how the status quo must change to simultaneously serve the needs and interests of each in the digital age.

## Customers

The use of technology today is ubiquitous. And all technology must be periodically maintained, upgraded, or replaced. This inevitably requires engaging an IT Reseller, which in turn exposes the Customer to risk.

This risk is substantial, particularly in an era of digital transformation. IDC research has found IT project failure rates as high as a 70%<sup>4</sup>, with vendor sourcing a significant contributor. All too often, the Customer commits large sums upfront, and with no real guarantee of achieving *any* return on investment, much less an acceptable one.

How does this happen?

Online research is the common starting point for a Customer seeking to identify a suitable technology provider. But this only identifies IT Resellers with massive marketing budgets, since the cost of online advertising is prohibitive



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<sup>1</sup> for further detail, see Consumption Economics: The New Rules of Tech, by J.B. Wood

<sup>2</sup> Ibid

<sup>3</sup> source is CloudSpeed Partner Strategy Survey, March 2018. n=107

<sup>4</sup> source is [IDC FutureScape, 2016](#)

for the vast majority of Resellers. In the US for example, intercepting any of the 40,000 monthly Google searches for “Microsoft Azure” would today cost a Reseller over \$8 per click<sup>5</sup>. Surfacing for “Dynamics NAV” would cost over \$55 per click<sup>6</sup>. As a means of customer acquisition, these costs are well beyond the reach of almost every Reseller budget, leaving the most suitable resources for a Customer often too deeply buried in search engine results to readily locate online. Only find the very biggest Resellers will surface instead. Whether they possess the capabilities a Customer really needs or not.

Customers can also tap professional networks to identify Resellers, but that typically casts too narrow a net and often leaves the best potential resources undiscovered.

In the end, the Customer’s selection process most often defaults to a lengthy and expensive “beauty contest” of potential IT Resellers. But salespeople are hardly reliable sources of information as to Reseller capabilities, pursuing economic interests of their own. References from short-list candidates are unsurprisingly positive, and so provide little real guidance. What follows is dissatisfaction, disappointment, and often outright failure due to the lack of a reliable, objective mechanism to assess potential Resellers.

Recent Gartner estimates place annual worldwide IT services spending at nearly US\$1 trillion in 2018<sup>7</sup>. With a significant portion of that spent on IT services that ultimately fail to deliver concrete and valuable business outcomes according to IDC<sup>8</sup>, it is a massive problem for *all* concerned.



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<sup>5</sup> source is SEMrush, July 2018

<sup>6</sup> Ibid.

<sup>7</sup> source is <https://www.gartner.com/technology/research/it-spending-forecast/>

<sup>8</sup> source is [IDC FutureScape, 2016](#)

## IT Professionals

The emergence of the digital economy has given rise to burgeoning numbers of independent workers. In the US, just over a third<sup>9</sup> of the workforce are now freelancers. In Europe, they make up 25%<sup>10</sup> of those delivering professional services broadly and are the fastest growing group in the EU labour market<sup>11</sup>. But while independent IT Professionals increasingly deliver technology services, most small and mid-market Customers do not want to recruit and train their own teams, preferring instead to delegate that responsibility to an IT Reseller. But this strategy is only successful when Resellers recruit, train and retain enough of the right people with enough of the right skills. Yet Customers have no visibility into who an IT Reseller employs and because of profitability challenges earlier mentioned Resellers today spend a bare minimum on training and professional development – and IT Vendors only require minimums in terms of certification.

Whether as independents or employees, IT Professionals face the critical challenge of demonstrating their value. That value is principally defined by an IT Reseller as the achieved day rate and utilization. These take no real account of the Reseller's ability to premium-price an IT Professional's labor based on specific skillsets, project track record, or domain expertise. Certifications are important but only a partial proxy, and do not by themselves paint a full picture of individual contribution or potential. Consequently, IT Professionals find it difficult to frame the value they bring to the Reseller they work for.

In the end, the IT Professional struggles to realize their full economic *and* professional potential.

## IT Resellers

In an era of technological disruption, profitability is often the first casualty. Recent CloudSpeed research indicates that over half of all IT Resellers are now posting marginal or negative EBITDA<sup>12</sup> as they adapt their business models for survival in a Cloud-first world.



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<sup>9</sup> source is [Freelancing in America: A National Survey of the New Workforce](#)

<sup>10</sup> Source is [Future Working: The Rise of European's Independent Professionals](#)

<sup>11</sup> Ibid.

<sup>12</sup> source is CloudSpeed Partner Strategy Survey, March 2018. n=107

This is often because they find themselves competing with others offering the same product at the core of their solution, as much as half the time<sup>13</sup>. To win these deals, discounts of up to 25%<sup>14</sup> have become increasingly routine, and charge-out rates have consequently come under significant and increasing pressure.

Superior utilization and differentiation are the only remedies for a Reseller caught in the grip of shrinking services margins, and since the customer now demands concrete business *outcomes*<sup>15</sup> rather than technology itself, Resellers must provide a tangible demonstration of specific capabilities to prospects and existing customers alike to justify higher bill-out rates and achieve sustained profitability.

The question is, how?

In the end, there are only 3 dimensions on which a Reseller can effectively differentiate a services business – by the depth, breadth, or quality of its expertise. All need to be substantiated to be effective.

Common Reseller tactics are no longer effective. Convincingly illustrating superior depth or breadth of expertise is more than a matter of showcasing technical certifications, since most Resellers have them. Superior expertise quality cannot be fully conveyed by case studies alone. And since it is easy to *claim* expertise whether a Reseller possesses it or not, the Customer has no way of validating what a Reseller asserts. No real differentiation results.

Staff retention and advancement are also critical to sustained profitability. As Richard Branson has pointed out, “Your company should act as a



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<sup>13</sup> source is CloudSpeed Capital Adequacy Study, 2018

<sup>14</sup> *ibid*

<sup>15</sup> for further detail, see Consumption Economics: The New Rules of Tech, by J.B. Wood

springboard for ambitious employees, not a set of shackles.<sup>16</sup> Truth be told, few Resellers today can credibly claim that status.

Finally, forming strategic alliances or making strategic acquisitions to achieve meaningful differentiation requires a Reseller conducting extensive due diligence to validate the “expertise synergies” being sought, and avoid damaging a Reseller’s reputation or making an inappropriate purchase of another firm.

Across the industry, critical shortfalls in the visibility and transparency of IT Reseller capabilities inhibit the best Resellers’ ability to differentiate themselves, win and retain customers and staff, form appropriate strategic alliances, and improve their profitability.

## IT Vendors/Distributors

IT Vendors and Distributors know their success hinges on that of their channel. In the digital age, that is a function of how fast and well their channels transform.

The nature and magnitude of the change required for a Reseller to be competitive and profitable in a Cloud-first world, and particularly the “subscription economy”, was probably best stated by JB Wood when he pointed out “The most dramatic impact of the Cloud will not be felt in your product line. The true disruption will be to your business model<sup>17</sup>.” IT Vendors and Distributors alike face the imperative of accelerating their channel’s business model transition.

IT Vendors have the benefit of high product-related margins, and strong operating profitability to achieve this. Microsoft, Sage, Oracle, and SAP for instance all post EBITDA levels exceeding 20%<sup>18</sup>.

Distributors, however, exist on wafer-thin margins and miniscule profits.

Ingram Micro, Tech Data, and ALSO for example all currently post EBITDA under 2%<sup>19</sup>.



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<sup>16</sup> from [76 Richard Branson Quotes](#)

<sup>17</sup> Source is Consumption Economics: The New Rules of Tech

<sup>18</sup> source is CloudSpeed financial analysis, June 2018, based on NASDAQ and NYSE data

<sup>19</sup> Ibid.



Although very different beasts economically, IT Vendors and Distributors both know that many in their channel simply will not make the required business model transition, making it critical to identify who is likely to, and concentrate on supporting them.

In the main, both IT Vendors and Distributors focus their channel development efforts on and proactively manage the Resellers who are either the biggest or who shout the loudest. Neither guarantees success – indeed, quite the opposite.

In large part, this is because the technical skills needed in an age of digital transformation are so scarce, and in such demand, that their availability in the IT Reseller community effectively defines the addressable market for an IT Vendor's products. Gaining market momentum for "leading edge" technologies like Artificial Intelligence and Machine Learning, for example, require the support of exceedingly rare data scientists who often work for smaller IT Resellers. Locating them is like finding a needle in a haystack.

Absent a mechanism to match their products with individual Resellers' skillset "inventories", Vendors will almost certainly fail to optimize revenue growth and market share, and Distributors will fail to improve their "share of wallet". The shortfall risks being significant.

Lead distribution is also particularly problematic for both Vendors and Distributors. Generating a marketing qualified lead can cost anywhere between \$200 to \$2,000<sup>20</sup> depending on the type of potential deal sought, and random allocation of such leads means that this investment is totally wasted much of the time.



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<sup>20</sup> source is CloudSpeed research, April 2018

Absent a mechanism for allocating leads among suitable Resellers, marketing funds are significantly misspent. There is a double-jeopardy here as well – lacking an objective basis for lead allocation, Vendors and Distributors often “hedge their bets” and distribute the same lead to multiple Resellers. This has the spillover effect of creating an increased cost of sale at the channel level, and consequently diminished profitability at the very time aggressive revenue growth is being pursued and must be funded.

## Lessons from Other Industries

One of the key disruptive tactics monetized in the digital age is the provision of transparency and visibility of alternatives.

AirBnB now has 4 million listings in 191 countries and boasts a compound annual growth rate of 153% since 2009<sup>21</sup>, without owning a single property. Perhaps more importantly, it has materially added to the economic health of the communities it is active in<sup>22</sup>.

TripAdvisor generates over \$1.5b<sup>23</sup> in annual revenue, has a market capitalization approaching \$8b<sup>24</sup>, and offers up 630 million reviews and opinions on 7.5 million accommodations, airlines, experiences, and restaurants worldwide<sup>25</sup>, to an average 455 million monthly visitors. Again, without owning a single property.

HomeAdvisor is used by over 30m<sup>26</sup> homeowners to locate and screen potential contractors based on over 5m<sup>27</sup> submitted reviews.

[JD Power's online platform](#) aggregates customer data across several industries, simultaneously allowing businesses to better understand their competitive position, and buyers to make more informed purchase decisions.



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<sup>21</sup> source is [iPropertyManagement](#)

<sup>22</sup> for more detail, see [AirBnB Economic Impact](#)

<sup>23</sup> source is [MSN Money](#), June 2018

<sup>24</sup> Ibid.

<sup>25</sup> source is [TripAdvisor Media Center](#)

<sup>26</sup> source is [HomeAdvisor.com](#)

<sup>27</sup> Ibid.

And the list grows daily.

The fact is that such platforms provide immense value to all stakeholders and are becoming increasingly prevalent in almost every industry one can imagine. This is no accident.

While firms like [Gartner](#) and [Forrester](#) provide Customers with insights on technology *products*, there remains a significant gap when it comes to insights on technology *services*.

In this digital age, and in the IT industry, CloudSpeed believes that greater transparency and visibility is pivotal to a revamped and optimized value chain emerging that works for *all* stakeholder groups. Without it Customers, IT Professionals, IT Resellers, and IT Vendors/ Distributors all face material risk and will fail to achieve the full economic potential of digital transformation.

