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Is the channel on track for a successful transition?

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The Global Channel Ecosystem

On the right lines

In this CRN Special Report we focus in on the challenges channel companies are facing in migrating to new service-oriented and subscription-based business models, adapting their processes for managing customer accounts and crucially, ensuring they can secure renewals and repeat revenues

Many channel businesses are currently in a period of transition. They are moving away from business models that depend on generating margin from product sales towards renewable services and subscription income generated by managed services, 'as-a-service' delivery of IT and cloud-based solutions.

Eventually, almost all users will be running hybrid infrastructures and a good proportion may go further and put all their systems into the cloud.

As a result, in the future, reseller/service provider businesses will find themselves in a very different position – both commercially and operationally – to the one they occupy today. While they will continue to physically supply software and hardware as part of complete solutions, the terms on which those products and solutions are supplied will have changed completely – from an outright capital purchase to a subscription or rental/lease-purchase arrangement.

They can expect to continue providing support and maintenance of software and systems for their customers. But they will also find themselves monitoring and managing IT services remotely from a distance. In addition, they will need to keep track of their customers' consumption of all kinds of IT services – from productivity software to compute power and storage.

A real issue

We know from the anecdotal feedback we receive from resellers that monitoring consumption and billing for cloud services is a real issue for many of them. And with many different vendors, distributors and service providers to deal with – and resellers offering their own services too – bringing together all the different strands of an evolving services value proposition is going to pose a real challenge.

In addition, they will have to keep track of when the multiple services that most customers use are due for renewal. This is vitally important. In the era of hybrid and cloud-based infrastructures, almost all reseller/service provider businesses will be run on a model that depends on recurring monthly income. Maximising renewals and re-subscriptions, therefore, will be vital to the long-term health and profitability of the business.

Key vendors are already preaching the gospel of activation and life cycle management. Speaking to *Channelnomics Europe* in November 2018, Cisco's channel boss Oliver Tuszik said that the company would look to grow its recurring revenue business through partners by incentivising them to sell across the life cycle of its products.

Tuszik stated: "It is more than just adding some services somewhere. It is more about how the customer can get the full advantage of our solution, so they don't only buy the product and install it, but they see the value and then activate additional functionality.

"For the partner, it leads to more bookings and products but also additional services, because it is a rollout and adaptation process. And when the renewal comes up in the future, it becomes a product that customers not only use, but they love. And if they love it, the chance of renewals will be pretty high – far higher than a case where they never use it."

Balancing act

But while renewals will be absolutely in the future, first of all the number of customers on subscription contracts needs to be ramped up. The whole channel is having to meet the challenge of driving higher levels of customer engagement and putting more focus on the services and subscription life cycle, while also continuing to meet →

the needs of those customers who want – for the moment at least – to stick to a more 'traditional' approach to purchasing and managing IT.

This adds to the complexity of the challenge, as resellers will be seeing less income from capital sales but still have to cover the cost of managing 'traditional' customers, while transitioning to what will, ultimately, be a more stable business model, supported by a customer base that pays a small monthly fee for every service they subscribe to and/or consume.

Finding their way through this period of transition will be a fine balancing act. But they will need to move swiftly, according to Scott Frew, chief executive at iasset.com, the specialist provider of cloud-based customer life cycle and renewals management solutions. He believes resellers that still have a 'legacy' business need to act urgently, because the market is changing quickly and they will soon be overtaken or subsumed by born-in-the cloud, service provider businesses.

"Legacy resellers are struggling or even shrinking as they haven't or can't adapt to the new world. Service providers, on the other hand, were built with consumption at their core and are generally growing aggressively, especially not having the legacy systems or perhaps, more importantly, culture," he said.

Can resellers that have not already started to adapt catch up? Perhaps, said Frew, but they will need to change the way they sell with some urgency.

"For a reseller, the challenge is how do you continue paying expensive salespeople, who are used to landing those whales [capex sales] when you are now selling minnows [subscriptions]?" he said. "The new type of salesperson will need to be a lot more operationally attuned to their customers' business needs and work on building a waterfall of consumption revenue and offering relevant reporting and assistance to their end customer."

Even if salespeople can be persuaded to change their approach, that waterfall of consumption and revenue needs to be managed. But this is not simply a matter of swapping out one kind of system for another. Resellers are also affected by the systems and processes of their suppliers, and both vendors and distributors face challenges of their own in migrating from a model based on the sale of licences and products to one that must be supported by myriad transactions that are much smaller and more frequent.

A cascade of challenges

This is a set of challenges that cascades up and down the channel and is not, it would seem, being addressed in any comprehensive way at any level, said Frew.

"The first challenge any of these businesses face is a drastic drop in revenues as they migrate from sale of equipment and services to subscription or consumption," he said.

"Vendors, especially, have to convince their shareholders it is the right way to go, because it will have an impact on their revenues. Adobe is the role model for consumption-based products but if you look back to when it made that decision, its share price took a hammering."

Adobe compelled its customers to switch to its Creative Cloud platform five years ago in 2013. While other major software companies are yet to follow suit and abandon full-packaged product sales and licensing, the writing is most definitely on the wall. The old way of doing business simply costs too much.

Microsoft has been championing its 'cloud-first' position for some time and pressing its distributor and reseller partners to drive more customers away from traditional licensing and onto its Cloud Solutions Provider programme. Inevitably, this will become the only way in which end customers can consume the company's productivity software.

Many line-of-business solutions are already in the cloud or moving strongly towards it. The classic example is Salesforce.com. SAP and Oracle have also been moving customers in this direction.

And the move to subscription income is not confined to software. Hardware vendors are also moving customers in this direction and getting involved in the cloud. We have noted how Cisco is actively encouraging its resellers to focus on renewals. It has already announced extra incentives to encourage partners to begin investing in a future vision that puts the customer experience first and rewards partners for activation and re-signs.

IBM, which arguably has the greatest hardware legacy of any computer manufacturer, has revived its fortunes by investing in and promoting Infrastructure-as-a-Service (IaaS) and Platform-as-a-Service (PaaS) offerings, and firmly established itself as one of the leaders in that area of the market.

But vendors won't find it easy to switch to subscription-based income. As Frew pointed out, most continue to put the majority of their resources into winning the "net new sale", even though they can derive as much as 40 per cent of their revenues from upselling, renewals and upgrades.

"I suspect until shareholders demand it, many will be reluctant to change and be consumed by the start-ups that were not so much born in the cloud, but born with consumption at their core," he said. →

Getting closer

Distributors, meanwhile, are faced with even more challenges and are having to embrace change quickly, said Frew.

"Distributors have to deal not only with the vendor moving to a consumption-based model, which directly affects the distributor's revenues, but also keep themselves relevant to the channel in those smaller, more frequent transactions," he said.

"To remain profitable, they have to remove as many people [ie costs] from this consumption process as possible. Driving costs out of the business is the only way distributors can protect their profitability and increase their margin spread."

One way they can do this is by aggregating and offering public cloud services and IaaS/PaaS. We've also seen the bundling and marketing of the device-as-a-service (DaaS) approach starting to emerge. Frew sees this as a distinct area of potential for distributors.

However, to make the most of this opportunity, they need to get much closer and more integrated with resellers, so that they can target specific customer groups and drive both uptake of subscriptions and renewals. The current installed base of end users who have bought products through the reseller channel is, effectively, the total available market. This would apply to both hardware and software, so one way or another, more integration and sharing of information between distributors and resellers is required.

But that is almost unthinkable from the reseller's perspective, said Frew. Few if any resellers would be prepared to hand over their detailed customer data to the distributor and rely on them for a prompt when renewals dates are approaching. If they are working with several distributors, the problem is multiplied – and if you extend this challenge up the supply chain, it becomes even more complicated and has profound implications for productivity and cost, he added.

"Most vendors implement or develop systems that make them more efficient. The downside is that the distributor and/or resellers are compelled to use those systems and that has an impact on productivity cost. If a distributor has 30 vendors, then that's 30 different systems their staff have to deal with daily," he explained.

"The problem is exacerbated at the reseller level, where they have multiple distributor and vendor systems to navigate – and the impact can be even more severe if they have to carry deep technical resources and find ways to cover the cost of professional services – again, on a much smaller revenue model. There is also a risk that if the reseller does not invest in systems (acknowledging that there is less revenue already), they will lose control of their data and possibly their end customers."

This seems like an almost impossible scenario and according to Frew, there is only one conceivable and logical solution. "The only real answer to this conundrum is to connect them all, so they only have to deal with their own system internally, which communicates to all others in the ecosystem."

In transition

Creating such an all-encompassing system would be difficult, to say the least. But if that is the case, how are resellers, distributors and vendors managing right now? As the market moves inexorably towards the cloud, they are compelled to take on more subscription customers and they must find a way of managing them efficiently and effectively.

The picture, Frew said, is very mixed – and channel companies know it's not where they should be concentrating their efforts.

"Vendors are generally relying on specialist SaaS companies to help build out their offerings, whether it's CPQ [configure, price, quote], licence management or cloud billing/management. They understand that their resources should be focused on product development rather than internal administrative systems," he said.

"Distributors and, to a lesser extent, resellers are mixed in that some have developed in-house systems, some have acquired their systems and some use SaaS providers. The challenge is always the cost to continue to develop and maintain internal systems and they cannot keep up with dedicated SaaS providers who are adding new functionality every day."

He also noted, however, that many distributors have come a long way and that all the larger players already have their own cloud orchestration and billing systems in place. Many smaller distributors however, ➔

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> **Scott Frew, iasset.com**

are struggling – they cannot afford to build and maintain internal systems and are starved of investment.

There are other channel businesses that have tried to develop their own systems but found it a near impossible challenge. Frew stated: "The companies that have invested heavily in internal systems are now starting to see the real overheads of keeping them operational on shrinking revenues. Most are simply trying to hold together their businesses with legacy CRM or ERP systems that are not built for consumption economics, or worse, holding on to outdated processes that are not relevant today."

This perhaps is the real danger and could prove to be an existential threat to resellers. In trying to manage the transition to subscription-based income generation, some companies are trying to be canny and adapt what they have, only to find those systems are entirely inappropriate to the requirements of subscription and services customers. Or they have plunged in too early and developed systems of their own, having little knowledge or experience of the way that a process for repeatable and managed consumption and renewals needs to work.

Back to basics

The way out of this conundrum is perhaps to go back to the basics. While it may not be necessary to redefine roles within the channel, the modus operandi of channel businesses will need to change.

Frew said: "Most companies have found their niche in the channel. However, now they must determine how to evolve in order to meet the same market they have been servicing – but they also need to re-evaluate their internal systems and processes. They must automate or die."

"With the sheer size of the annuity/subscription and consumption business, and the number of transactions it produces, they can no longer have an individual with a spreadsheet typing manually into an ERP system."

It may already be too late for some companies to put the correct systems and processes in place. "There are only a few large channel players that can afford to design, develop and implement an in-house system. But even if they start today after reading this article, the horse has bolted," said Frew.

"However, the upside is there are existing ISVs with world-class systems that have been in development for some years and also only charge based on consumption. That way, the channel partner incurs a charge only if the annuity/subscription/cloud is purchased, preserving their P&L and allowing them to scale with no capital investment."

There is, it would seem, no simple answer to the problem the entire channel faces in attempting to successfully make the transition from the old world in which it managed fewer but much larger commercial transactions, to the one in which billions of monthly subscriptions will need to be monitored and controlled.

While many vendors, distributors and resellers are trying to muddle their way through, adapting legacy systems or building their own proprietary systems, in the end there will need to be some way to bring them all together.

The ultimate answer perhaps, is to make use of the specialist third parties that do not have any legacy to worry about and have a full grasp of what's needed to take control and make business models based on subscriptions and renewable business, both sustainable and profitable for the long term.

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