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CHANNEL STRATEGIES FOR SUCCESS IN THE CLOUD AGE

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Introduction

Cloud Computing is perhaps one of the biggest shifts in the technology industry in a generation. Alongside the technology shifts involved in Cloud, there is also a significant change in the way technology will be supplied, implemented and delivered going forward.

While this shift offers real benefits to consumers in terms of reduced costs and increased agility, it creates challenges for those organizations whose business relies on providing services to integrate disparate systems or adding value on top of underlying technologies. These organizations, collectively known as "The Indirect Channel,"[1] are in some cases fearful that Cloud Computing will reduce their opportunities to add value and they will need to find new alternative offerings.

This paper describes the status quo for channel partners, identifies where threats to their existing revenues might lie in the future and provides some best practice guidelines that channel organizations can utilize to thrive in the Cloud Age.

The Cloud is a Revolution

Cloud Computing is a revolutionary development within IT. This revolution is enabled by a unique combination of technology shifts alongside new business models. As we detailed in a previous CloudU report[2], Cloud Computing is enabling an IT revolution through a number of means:

- Virtualization – The ability to increase computing efficiency
- Democratization of computing – Bringing enterprise scale infrastructure to small and medium businesses
- Scalability and fast provisioning – Bringing web scale IT at a rapid pace
- Commoditization of infrastructure – Enabling IT to focus on the strategic aspects of its role

Importantly, Cloud Computing is enabling an entire new class of services to emerge as companies large and small come to grips with how to leverage Cloud Computing for all parts of their business. It is these opportunities and challenges, bought to light and powered by the Cloud, that are forcing organizations to change the way they think and the way they operate.

For a deeper background into what exactly Cloud Computing is, we recommend spending some time exploring the content developed for the CloudU Cloud Computing certificate[3], but with a basic understanding of Cloud Computing out of the way, we will now describe how the distribution channel works traditionally within IT and what effect Cloud Computing is having on it.

The Impact of Cloud on Channel Partners

The term "channel partner" is a generic term that encompasses a variety of different types of business-to-business companies involved in the sales, distribution and implementation of a technology vendor's products and services to customers.

Within the heading of channel partner exists a number of different approaches to partnership:

- Systems Integrators (SI) – these organizations specialize in the integration of disparate technology solutions within an organization.
- Value Added Resellers (VAR) – as the name implies, a value added reseller is a company that adds features or services to an existing product and then resells the integrated product to customers.
- Independent Software Vendors (ISV) – these create specific applications that will often run on the platforms of larger technology vendors. As it relates to the channel, they create the highly niche software products that individual organizations need and are therefore an important part of the broader channel ecosystem.

The selling proposition for both SIs and VARs relies on software being difficult to integrate with different systems and difficult to customize to the particular requirements of the organization.

Cloud Computing has a marked effect on these sorts of partners as Cloud tends to enable customers to interface directly with technology suppliers. Cloud Computing has some distinct impacts on two of the main classes of channel partners:

Systems Integrators

Systems integrators tend to have reduced opportunities as the rise of pre-integrated platforms and Application Programming Interfaces (APIs) tends to reduce the complexity and difficulty of integrations. While there is a reduced opportunity on the one hand, the Cloud could actually accelerate their opportunity to provide value added services elsewhere.

Independent Software Vendors

The rise of platform solutions means that an entire ecosystem of vendors are now creating third party software solutions that are pre-integrated with large software suites. Software platforms from vendors such as Salesforce, NetSuite and Google allow discrete applications to be created with native integrations in place from the outset. Further to this, the rise of Platform as a Service (PaaS) has put software development into the hands of non-technical staff. It is now possible for a worker within a business unit to create a specific application to fulfill a particular functional requirement thereby reducing the opportunities that ISVs might have previously had.

These various impacts create a significant threat but at the same time significant opportunities for channel partners. In a recent blog post[4] Tom Bittman from Gartner stated that:

> *"*Two things are becoming increasingly clear to me: the channel will be critical in broader adoption of cloud computing (and private cloud), and the channel is not ready to do this. The channel needs to be rebooted. Until [it is], the midmarket, in particular, will leverage cloud computing in a slipshod and hit-or-miss manner. Likewise, channel partners who don't reboot and adjust to the new reality (that more and more IT capabilities purchased by the midmarket will be coming from the cloud, and not through hardware and software sales) won't survive for long.*"*

We strongly agree with Bittman and, while we accept that the traditional models of channel partnership will continue to exist for a long while yet, the growth opportunities are dissipating rapidly. With that in mind, channel organizations should think deeply where the opportunities for growth now lie.

Can Existing Channel Partners Survive in the Cloud Era?

In discussing threats and opportunities for channel partners with a number of people, we were often faced with a dire prognosis for existing channel partners. This is summed up best by Michael Cohn, Founder of Cloud Sherpas, a Google channel partner who said that:

> "I don't personally know of a single traditional channel partner that has successfully transitioned their legacy business to the cloud. Among the top competitors we run up against nearly all are firms that were "born on the cloud," so to speak. Transitioning from selling/integrating on-prem to cloud is very difficult. Everything is different, beginning (and some would argue, ending) with sales and sales compensation."

The challenges that Cohn refers to with regards to sales compensation relate to the fact that Cloud Computing is generally paid for on a subscription basis with sales partners earning a commission of this subscription. Given this fact, it is obvious that the traditional large up-front investment for traditional hardware and software, and corresponding large sales compensation check, do not exist in a Cloud ecosystem. Rather channel partners need to grow accustomed to small commissions, often paid on an ongoing basis. This change in the monetization model means that the risk of software acquisition is moved away from the end customer, who can now make software buying decisions on a month-by-month basis, and is instead placed with the software vendor and the channel partner.

Joel York explains the channel conundrum succinctly in the following excerpt:[5]

> "Acting as a risk buffer is a long-standing value added service of the channel. Some channels exist almost solely to absorb risk, like wholesalers and investment bankers. Enterprise SaaS and software channel partners invest in sales, service and support capacity in advance, absorbing the risk of fluctuating demand. Sitting as it does between the customer and the vendor, the channel can absorb risk from either direction. The problem arises when SaaS vendors try to apply licensed software math to SaaS channel compensation. Traditionally, enterprise channel partners net a portion of the license fee, anywhere from 10% to 70% depending on the scope of their services. Simple application of this margin-based compensation

model to the SaaS channel can put a SaaS channel partner in the unpleasant position of having to make 100% of the up-front investment in customer acquisition and on-boarding, while only netting a fraction of the recurring revenue stream. Risk shifts from the SaaS customer to the SaaS vendor and right back onto the SaaS channel partner." **"**

It should be noted that software vendors are recognizing that channel partners need a different compensation model and are using innovative programs to help existing resellers move to Cloud products. As an example we wrote[6] about a program that NetSuite has introduced that sees resellers earn 100% of a new customer's first year revenue, with a lesser percentage of subsequent years' subscription revenue.

While programs such as the one above will go some way to give resellers assistance to move to Cloud products, we believe that it is critical for channel partners to overhaul their businesses beyond simply a revenue shift – to this end we have identified a number of best practice guidelines that channel partners should look to when moving to Cloud.

Strategies for Successful Cloud Channel Partnership

After interviewing a number of different Cloud channel partners, it became apparent that the practices that assure success for Cloud partners are very different from those utilized by traditional partners.

We recognize that existing compensation methodologies make it problematic to simply move to subscription selling in one move, however we also recognize that some of the key changes that channel partners need to make to succeed in the Cloud go far beyond sales approaches and instead impact on the organization as a whole.

Our recommendations include the following areas:

Help Clarify a Muddy World

The world of Cloud Computing is increasingly muddied by a multitude of vendors all selling different products promising a variety of benefits. Channel partners have the ability to be a trusted gatekeeper for businesses and to help them navigate an increasingly complex market. As such channel partners should consider themselves mentors to organizations and actively help their customers to take advantage of the agility, economics and flexibility that Cloud Computing can offer them.

Vendor-neutral education and certificate programs like CloudU provide the tools that enable channel partners to get started positioning themselves as subject-matter experts for their customers. By holding Cloud Computing workshops with customers and prospects, channel partners can earn trust and become the go-to resource for technology advice to the businesses they serve. The CloudU website[7] is a great resource that channel partners can use to educate their network of businesses. On there you will find the CloudU certificate as well as explanatory videos and presentations that can be used for holding educational workshops.

Productize a Service

Successful Cloud channel partners have tended towards "productizing" their service. A good example of this is Cloud Sherpas who have created a specific product offering called SherpaTools to aid in the migration of customers to

Google applications. Michael Cohn from Cloud Sherpas is of the opinion that in order to make up for lower reseller revenues (when compared to traditional channel partnerships) the creation of a product aimed at different market segments helps to make up for the differential in margins.

We note that, despite vendor claims that applications can readily be integrated without third party help, one of the primary roles of channel partners is now in the integration of discrete applications. One strategy that we believe resellers should pursue is to spend time building an understanding of a host of discrete software products – in this way they are more likely to be able to offer a comprehensive and well integrated product selection to customers. This strategy is often called "eating one's own dog food" and it is important when dealing with customers who want to talk with a reseller who understands the tools they're trying to sell.

Proactively Sell, Don't Rely on Vendor Referrals

It is important for Cloud channel partners to actively sell products and not simply rely on sales referrals from Cloud vendors. This is the case more than with traditional IT products since Cloud vendors have a tendency to pursue direct sales and channel sales approaches at the same time. As such reliance on vendor referrals is unlikely to generate viable income for a reseller over time.

Andy Pattinson from ProQuest Consulting goes even further than this describing a symbiotic relationship between the vendor and the reseller suggesting that channel partners should actively work to build a strong relationship with the vendor. Pattinson goes so far as to suggest that resellers should take sales prospects back to the vendor – both in order to get vendor-based sales and support, but also to build vendor understanding of the reseller space. We note that in a situation where Cloud vendors are racing to build market share, that they are likely to favor proactive and committed partners in preference to more relaxed ones.

Sweat the Culture

Cloud channel relationships are a way for new and refreshed channel partners to build long term relationships with Cloud vendors. It is important therefore to spend time focusing on company culture and to find vendors that are a good cultural fit for the partner.

This culture extends into product uptake. We suggest that channel partners should use the products they are selling, innovate with them and build a detailed understanding of the capabilities and the limitations of the product. This is all part of being a passionate advocate for the products being sold – it is important to note that Cloud Computing is a new market approach and as such there is an aspect of exploring a new frontier together – a deep partnership between vendor and partner will help to create a strong message in the marketplace.

Vendor Relationships are Key

It is no coincidence that channel partners are full of executives who formerly worked at the vendors whose products the partner sells. Partners should network widely within the vendor – this will enable them to get the best understanding of market strategy, product roadmap and key players.

One of the best ways to do this is to participate with the vendor as often as possible – Cloud vendors are generally keen to showcase partners, write case studies and support customer facing events. We suggest that channel partners look to maximize their involvement in all of these areas to build the highest level of partnership with the vendor as possible.

This extends to using vendor resources widely in the partner's own marketing initiatives – we suggest finding a balance between repurposing vendor materials and adding a partner's own flavor to the material to ensure they portray a differentiated view to the marketplace.

Competitive Intelligence

We note that there are a plethora of sales partners for the more popular Cloud Computing products. As such channel partners need to differentiate their approach. The best way to do this is to research other channel partners to see how they articulate their offering, what products they offer and how they are perceived in the marketplace. This intelligence will enable partners to create a compelling proposition.

Understand the Marketplace, Understand the Metrics

Cloud Computing is a rapidly changing sector, and as such it is doubly important for channel partners to spend time understanding the broader Cloud market.

Beyond understanding the products and services the partner deals with, channel partners should have a relatively deep understanding of that vendor's competitors, their strengths and weaknesses and potential areas of competition and cooperation going forwards. We note that in the technology industry vendors often move from competition to partnership with other vendors. In a rapidly moving space like Cloud this is even more apparent. As such it is important for channel partners to have a deep understanding of the space and potential moves.

Measure Everything

As the velocity of change increases, it is increasingly important for organizations to have an excellent grasp of how they are performing. As mentioned previously, Cloud Computing is a particularly rapidly changing sector and as such partners should closely follow reporting metrics both from an internal perspective but also those on which they will be measured by the vendor. It is important to align processes and procedures within the organization to the particular reporting metrics the vendor will use.

Customer Satisfaction is Everything

In a traditional IT model, licenses are generally paid on an annual basis and so channel partners had a degree of insulation from customer dissatisfaction. Cloud Computing, with its subscription based pricing, changed this and channel partners need to earn their customer's business every billing period. It is important to build deep relationships with end customers to ensure they remain satisfied with the product they are using.

There are a number of different methodologies to measure customer satisfaction. One of the simplest and most popular is the Net Promoter Score (NPS). Administered through a simple survey, NPS asks a single question, "How likely are you to recommend X to a colleague or friend?"[8]

Conclusion

There are those who claim that traditional channel partners will not survive in the Cloud era. While we agree that traditional partners face some fairly significant hurdles in moving to the Cloud, we don't believe it is an insurmountable hurdle.

The key thing for resellers to do is work on their own internal culture, modify their compensation approaches and spend time building strong domain knowledge for the particular products and services they sell. In addition, investing time to create a product built on top of a service offering will ensure more diverse revenue streams across industries and market sectors.

Cloud Computing is an emergent trend and we believe it is vital for anyone involved in the Cloud channel to spend time to understand what the changing technology landscape means for their operations.

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About Diversity Analysis

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Our Offerings: We offer both analysis and consultancy in the areas related to SaaS and Cloud Computing. Our focus is on technology, business strategy, mergers and acquisitions. Our methodology is structured as follows:

- Research Alerts
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About Rackspace

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Ben Kepes is an analyst, an entrepreneur, a commentator and a business adviser. His business interests include a diverse range of industries from manufacturing to property to technology. As a technology commentator he has a broad presence both in the traditional media and extensively online. Ben covers the convergence of technology, mobile, ubiquity and agility, all enabled by the Cloud. His areas of interest extend to enterprise software, software integration, financial/accounting software, platforms and infrastructure as well as articulating technology simply for everyday users. More information on Ben and Diversity Limited can be found at http://diversity.net.nz

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Endnotes

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