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Analyze the Future

WHITE PAPER

Building a Successful Microsoft Business Productivity Online Services Practice

Sponsored by: Microsoft

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EXECUTIVE SUMMARY

The information technology business is undergoing one of its rare disruptive shifts that impact and shape the industry. Cloud computing is enabling new scenarios and empowering organizations and users to leverage applications on their terms. But at the dawn of this cloud disruption has been a fundamental disconnect between the changing needs of customers and the existing offers from suppliers. However, this gap is beginning to be addressed.

IDC's research of Microsoft cloud-focused partners shows that Microsoft Business Productivity Online Services (BPOS) is a cloud service that can create opportunities for suppliers and partners to profitably reconnect with their customers.

IDC's research of successful Microsoft BPOS partners shows that they are not treating cloud computing as "business as usual." Evolution and adaptation are taking place in the areas of sales, marketing, delivery, and business strategy. Two recurring strategic elements of successful partners from the research are:

- **Commitment.** Solution providers that are committed to cloud computing, and that treat BPOS as a lead product or at least equal to other offerings, are seeing greater success.

- **Creativity.** Success is also driven by solution providers that realize greater profitability will come from either creative go-to-market strategies or creative value-added services that build on top of BPOS.

BPOS is seen by many Microsoft partners as a product that will accelerate the cloud computing shift. Companies that learn to evolve and adapt to this new model first will lead the way.

CLOUD SHIFT

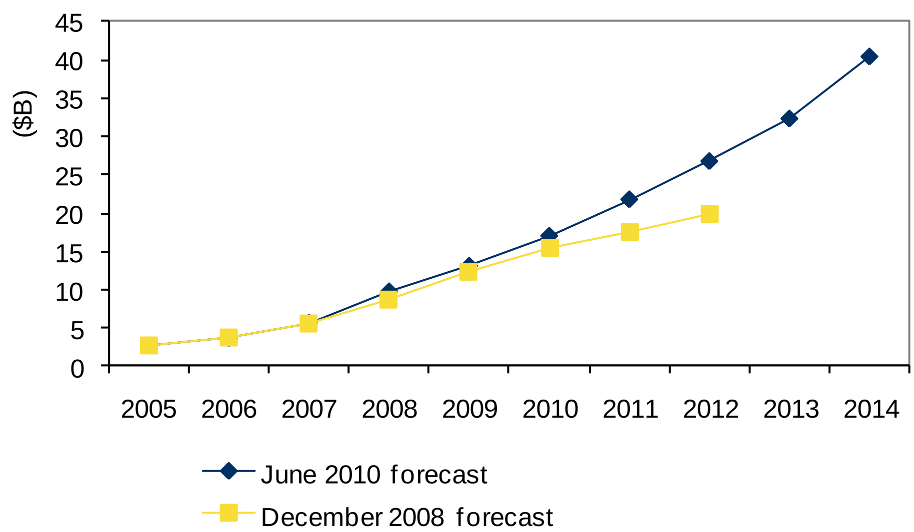
Industry Shift Causes Buyer/Supplier Disconnect

IT is a business that lives with a higher level of change than most, with new products and periodic release cycles creating opportunities along the way. Despite this constant change, most of the time, the changes are small. They may be about refining or enhancing the current way of doing things, without questioning the core delivery model (i.e., slightly faster, more integrated, increased scale, more features). These changes are typically driven by the IT supplier to create some form of differentiation in the market.

But occasionally, external factors create drivers within the customer that lead to a questioning of the fundamental tenets of the existing model. There have been a number of these drivers over the past 50 years of the IT industry. The exact number is open to debate depending on the experts who are asked, although a general agreement would probably be reached around mainframe, client/server, and cloud computing. Figure 1 shows the strong growth of software-as-a-service (SaaS) revenue, a major component of cloud computing revenue.

FIGURE 1

Worldwide SaaS Revenue Forecast, 2005–2014



Source: IDC, 2010

The recent and current external drivers (among others) that are affecting IT vendors, solution providers, and end-user organizations include:

- The global financial crisis
- A heightened need to have organizational flexibility, including how assets are paid for
- Increasing global reach as businesses become more geographically dispersed
- Political drivers to deliver "knowledge economies"
- Reliable and functional online services available within the consumer/home environment
- The arrival of the digital native within the workplace

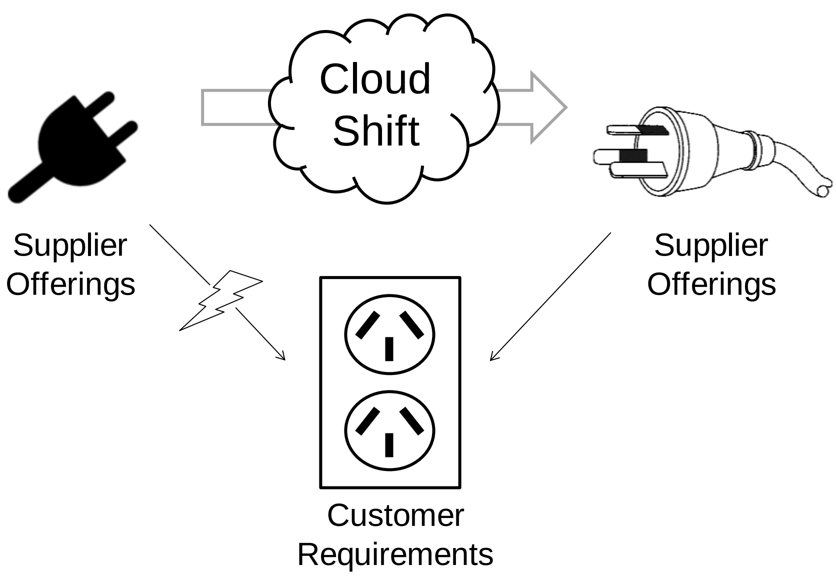
These forces are leading customers to question established ideas of not only how IT should be consumed but also who should be involved in the buying process. Many customers are asking:

- Is IT a core service or a utility service for the business?
- Are deep IT skills required?
- Is direct ownership of the assets necessary?
- In a distributed business environment, is the location of services relevant?
- Is lowest predictable cost *or* flexibility at a premium the right driver?
- Are there alternative payment options that we should consider?

This industry shift has resulted in IT suppliers' existing "offers" becoming disconnected from the benefits and associated needs being identified by customers (see Figure 2). This has created opportunities for new high-growth software vendors to enter the market with new and disruptive propositions. Complex solutions are being commoditized, high-cost applications are becoming affordable, and new classes of business problems can now be solved.

FIGURE 2

Buyer/Supplier Disconnect



Source: IDC, 2010

Despite appearances, the business drivers for change and the basis for the technology solutions have not transpired overnight. And few, if any, of the underlying ideas are genuinely new. The combination of the business drivers, the technology solutions, and a move from early adopter to a broader customer awareness has created the disruption.

This gap still exists but is being narrowed as IT suppliers are becoming more savvy about it. There are many examples of cloud software offerings that either have bridged or are close to bridging this gap.

Microsoft's Cloud Services Response

Two of the largest software franchises in the world are Microsoft Windows and Microsoft Office.[1] Therefore, if any company has a reason to feel threatened by the cloud shift, then it should be Microsoft. Despite this, Microsoft has made clear statements of intent about cloud and supported them with significant investments. This activity peaked during 2010 with Steve Ballmer's speech at Washington University,[2] when he stated that Microsoft is "all in," and at the Worldwide Partner Conference where the emphasis on cloud was repeated throughout the entire event.

"We believe that choosing a platform benefits the business of your customers. We believe Microsoft has the best platform there is, the most extensive and thorough platform there is." SI, Netherlands, 120 employees

There may also be an impression that Microsoft is in some way late to the "cloud party." Certainly there are a number of start-ups and early adopters that have gained significant visibility and traction. However, across the major established vendors, and even start-ups, Microsoft's cloud story is one of the most mature:

- Hotmail online email since 1997
- Windows Live services, most notably Windows Live Messenger, which was formerly MSN Messenger launched in 1999
- Services Provider License Agreement (aka SPLA), which allows Microsoft partners to host software and bill on a consumption basis (official launch 2001)
- Xbox Live collaborative gaming over the Internet since 2002
- Global Foundation Services (Global Data Center infrastructure)
- Major business initiatives with Microsoft Online (BPOS, CRM Online,[3] Azure)
- New services appearing regularly (90% of Microsoft resources focused on cloud by 2011)[4]

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[1] Microsoft FY2010 revenue for Windows and Windows Live = $18.49B, Microsoft Business Division = $18.64B (Microsoft FY10 Q4 Earnings Report)

[2] http://www.microsoft.com/presspass/exec/steve/2010/03-04Cloud.mspx

[3] At time of publication, available only in United States, Canada, and Puerto Rico

[4] http://www.microsoft.com/presspass/exec/steve/2010/03-04Cloud.mspx

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The Solution Provider Challenge

The overall challenge for solution providers is that change represents risk, especially when the change is disruptive. Partners have made investments to support the existing model. These investments are not simply tangible assets or people skills but can run to the heart of a company's operating ethos, the style that drives the way a company thinks and acts. This can lead to the paradoxical position where successful partners that have made the greatest investments in the existing model are exposed to the greatest risk and are therefore the most resistant to change.

Typical concerns expressed by partners that need to be addressed include:

- Does cloud computing have credibility with my customers yet?
- Is Microsoft seen as credible in the cloud space?
- Will there be enough customer demand for me to start a practice?
- Will Microsoft Online cannibalize my existing business?
- Do I have the skills in-house (commercial, operational, technical) necessary to evolve?
- What will happen to my existing investments?
- What business structure should I adopt (separate or integrated with my existing business)?
- What commercial models do I need to have for these new offers?

As with any business decision, the more of these questions that remain unanswered, the more likely it is for the business to carry on with its existing operations. But at some point, a solution provider either will have enough information to be comfortable or will take a calculated risk on what it hopes is a winner. The following sections help solution providers address some of these concerns and provide them with a clearer picture of what it's like to run a successful Microsoft Online Services business practice.

THE MICROSOFT ONLINE SERVICES OPPORTUNITY

Microsoft Business Productivity Online Services

While we have been talking at a high level about cloud computing, and Microsoft's broad offerings, this white paper focuses on the opportunity with Microsoft Business Productivity Online Services (BPOS), the flagship online business offering from the software vendor.

Microsoft Business Productivity Online Services is the name for Microsoft's business-focused cloud service offering that currently includes:

- Microsoft Exchange Online, including Forefront for Exchange (hosted email plus security)
- Microsoft SharePoint Online (collaborative portals, intranets, Web sites)
- Microsoft Office Live Meeting (Web meetings)
- Microsoft Office Communications Online (chat and related services)

As noted earlier, significant research and development efforts are under way and new services will be added to Microsoft Online and BPOS during FY2011 (e.g., Windows Intune, Microsoft Project Online, and wider availability of Microsoft CRM Online).

BPOS not only is a new way to consume software but also represents a new way for solution providers to go to market with Microsoft. Traditionally, Microsoft partners have been able to "resell" a product. Typically, Microsoft would sell a software product to a distributor for a certain amount; the distributor in turn would sell it to a reseller for a little more; and the reseller in turn would sell it to a customer for even more, with each party making a margin along the way. In this model, the reseller receives the full amount that the customer pays (before passing on the requisite amount).

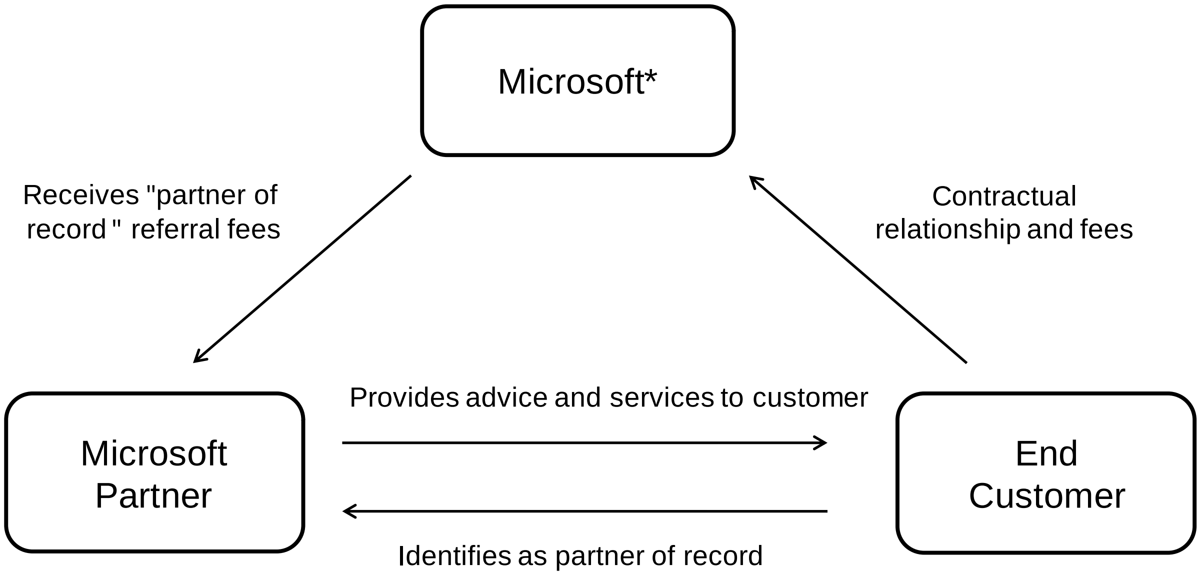
Though there are a couple of different models, Microsoft typically invoices the customer directly for the BPOS service and provides a "fee" to the partner that identified the customer. That fee works out to 18% of the first-year billings and 6% of subsequent year billings.

The commercial relationship between Microsoft, the customer, and the partner is shown in the Figure 3.

"The amount of growth and profitability we have seen from BPOS made us say, 'Let's change the whole business focus and be a cloud integrator and differentiate ourselves in the market.'" SI, Australia, 150 employees

FIGURE 3

Partner and Customer Relationships for Microsoft Online



* Typically Microsoft itself, but in some countries, Microsoft designates a master partner

Source: IDC, 2010

This modified commercial relationship is critical to thinking about profitability when considering a BPOS practice.

Customer Opportunity

One of the first concerns from partners is that there may not be any real demand or interest from the typical customer for BPOS. However, successful BPOS partners told IDC that there is customer interest in the following areas:

BPOS Reduces Costs

Many customers are seeing substantial cost savings from BPOS, and cost reduction was the number 1 reason heard by partners. Linked to cost reduction was the desire to move away from up-front capital expenditure to spend that is linked to operational budgets (i.e., preference to spend opex versus capex).

"Customers are interested when we talk about overseas branch office deployment. They do not have to worry about setting up on-premise installations with capital costs. They just provide the overseas office with a cloud solution like BPOS." VAR, Singapore, 100 employees

BPOS Reduces Complexity

Customers have indicated that they are looking to reduce administrative and management complexity and the associated direct cost. This is driven by both the avoidance of the need for resources as a business grows and the desire to maintain or reduce the size of the existing IT department.

BPOS Improves Availability, Reliability, and Stability

Customers are recognizing that pooled and focused resources in global data centers can provide significant benefits. Comparing the efficiency and overall service availability of BPOS with the reliability of local resources is very compelling.

Quality of Product

The Microsoft products that underpin BPOS, such as Microsoft Exchange and SharePoint, are well known and liked. The integration of the products across BPOS, compared with other competitive offerings, was valued by customers.

BPOS Enables New Scenarios

Some customers indicated that the value of BPOS is its ability to support business scenarios that were previously either not possible or cost prohibitive. Common themes were organizations that need to support multiple locations and those with high mobile worker scenarios.

Partner Drivers for Working with BPOS

On top of the reasons customers are asking for BPOS, partners will have their own unique take on the value of BPOS and where the opportunities and threats for their business will appear. That said, the research shows that for those partners actively in market, there are a number of common themes.

Cloud Is the Future; BPOS Is the Beginning

The overwhelming theme from partners is that they believe Microsoft has rightly identified the cloud as the next industry shift and that online applications are the future. Though fast-growing SaaS start-ups have already shown success, partners we spoke to saw BPOS as the real beginning of that vision. They also wanted to be in line with the huge commitment that Microsoft is making in this space.

"It is a phenomenal value. I think it is an unmatched value. I think this is a $200 laptop with 15,000 gigs of RAM." VAR, United States, <10 employees

BPOS Extends a Partner's Reach

Where partners are managing complex on-premise assets at customer sites, there are always certain resource and geographical constraints. The ability for cloud services to be managed remotely, with no responsibility for the underlying assets, removes a number of these barriers and also reduces the geographic limitations. BPOS creates the opportunity to increase geographic reach with reduced resource requirements.

By providing enterprise-like capability on a shared or dedicated model, BPOS also opens the opportunity to cost-effectively sell all the way from very small to very large organizations.

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Microsoft Brand

Despite a sometimes rocky past few years, the Microsoft brand is still very strong with customers.[5] Solution providers therefore see a clear benefit in associating with the logo. The quality, recognition, and integrated nature of the products underlying BPOS, such as Exchange or SharePoint, are also seen as beneficial.

The fact that Microsoft is providing the underlying infrastructure has been highlighted by some partners as a challenge. However, the partners IDC interviewed did not see it this way. On the contrary, the fact that Microsoft, a trusted brand, is providing the infrastructure behind BPOS has allowed the partners to focus on their value-added services rather than have to justify the quality of their hosting platform. Making the massive investment of a top-grade data center is simply not something that most companies can entertain in the first place.

Foot in the Door

Customers are curious about cloud computing today, and BPOS creates an opportunity for a solution provider to open a conversation with them. (Refer back to the Customer Opportunity section for reasons why customers are interested in BPOS.) Whether for new prospects or existing customers, BPOS has a strong value proposition that can be used to open the door for further conversations. That could lead to a deal for online services or even other projects.

Recurring License Revenue

Although the partner of record (PoR) referral fees may be relatively less than the comparable on-premise software license deals (i.e., the percentage fee is high in the first year but low ongoing, and it's based on a lower deal size overall), they are nevertheless interesting to partners we spoke to. Partners like the idea of a recurring revenue stream that remains after the "professional services" engagement. The ongoing fees also assist in maintaining the focus on the ongoing customer relationship. If the customer is unhappy, then it may discontinue the service or move its partner of record to another company. Thus, it is in the interest of the partner to maintain the level of customer satisfaction.

Leverage Existing Skills

For solution providers to take advantage of competitive cloud offerings, there is often likely to be a need for the acquisition of new skills. Because many Microsoft partners are already familiar with the underlying technologies used for BPOS, they can leverage their existing knowledge, skills, and experience.

The wide solution ecosystem around Microsoft products means that BPOS can be integrated with not only other Microsoft products but also many other partner-provided software offerings.

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[5] Number 3 in the 2010 Interbrand "Best Global Brands" survey (http://www.interbrand.com/best_global_brands.aspx)

BUILDING A SUCCESSFUL BPOS PRACTICE

Partner Commitment and Creativity

With a background of change, opportunity, and risk, it is understandable that while certain concerns still exist, many partners will be in a state of flux. The rest of this section shares common and best practices from Microsoft partners that are already in market with a business practice around BPOS and related products and services.

To be clear, there is no simple, single bullet that will lead to success in the cloud and BPOS market. Each company has its own unique set of assets and existing start conditions. That said, two key success factors emerged after IDC interviewed many BPOS partners from around the world: commitment and creativity.

Commitment, Not Experiment

The first key success factor is the willingness to commit to the changes required to reconnect the buyer/supplier model — or, in other words, commit to the cloud model. Most successful businesses during any period of disruptive change have recognized the disconnect and then made a clear commitment to meeting the new customer needs.

Solution provider executives need to have a belief and commitment to lead with the cloud. The temptation to fall back on tried and tested methods (e.g., at the end-of-quarter push for the up-front license sale) needs to be resisted because it will lead to confusion for all parties. This can be especially true for organizations that have successfully created a culture and way of working based on the on-premise model.

This does not mean that the cloud will be right for all customers and all situations and, by association, the partners that serve them. But there needs to be clarity at the leadership level that once a move to the cloud is made, then, irrespective of the overall portfolio of offerings, the focus will be the cloud, which will mean that some business is no longer good business.

Another way of looking at the concept of commitment is that BPOS should be considered, at minimum, an equal of the other customer offers available. It is when BPOS and other online offerings are seen as a last alternative that the lack of commitment to cloud is obvious.

The research has shown that the business model is secondary to the commitment to online services. That said, three differing models are seen to align with this commitment within successful partners, one of which does not work long term.

The Start-Up

This is the classic model during disruptive times when new players enter a market and appear to have overnight success. These businesses have little or no existing investment and by definition have to be committed to one or a few offerings as this is their only business and they are not constrained as they have everything to gain.

Establishment of a Separate Business Unit

In this model, there is a recognition of the cloud shift but also a desire to protect existing revenue streams (i.e., the cloud will not replace everything). A separate business unit removes the internal conflict but still provides access to the resources of the parent (e.g., accounting, payroll, development resources). Upon success, the business unit may fold itself back into the parent and bring the new skills with it, continue as an independent business unit, or be let go completely from the parent.

Embedded into Existing Business Model

Typically, these businesses base their market success around consulting offerings. They make their money from a consultative approach, leading to recommendation to the customer of the appropriate solution. BPOS is a natural fit for these solution providers provided it is considered as at least an equal of other offerings being considered.

The Experimenter

This is normally an acceptable model for a company just starting to think about adding online services to its business. This type of company is overly cautious about the new product offering and essentially demotes it to an experimental basis while focusing on traditional business. Those that experiment over the long term will never see the success that those that show focus and commitment will see.

Creative Value-Add

As most solution providers are comfortable with and proficient in the old model, and the new cloud model has limitations (e.g., potentially smaller deal sizes, fees versus resale), it's important to keep an open mind about what the opportunities could be. It is important for partners to perhaps start questioning some of the "givens."

For BPOS in particular, a partner quickly realizes that value-added creativity is important to make money. The PoR fee itself is an interesting "extra" that can be used in creative ways, but on its own, it's not really the basis for a business plan. Profitability is driven from the value-added offerings by the partner on top of the BPOS platform.

Many of the following sections highlight interesting and creative practices from established BPOS partners.

Drivers of BPOS Practice Profitability

For those partners that overcome their concerns regarding the credibility of the cloud and the related customer demand, the obvious next question will be around guidance on what drives profitability. The following are six recurring suggestions from the discussions IDC held with partners in how to drive further profit from BPOS-related deals.

Additional Services Margin

Despite the hype of a completely new cloud business model, most solution providers will still make the majority of their profit from professional services work that adds value to the core offering. The removal of the ongoing cost of maintaining the complex on-premise infrastructure while still maintaining "service contracts" should increase margins. The removal of infrastructure maintenance, which is technically complex but has a low perceived value, will also create opportunities to offer services closer to the line of business. For example, training, adoption, supporting business process improvement, and customizing services to drive business value will bring the partner closer to the business and add service opportunities and increase margins.

"We see that the return of investment is of interest to the end customer because of easier management and fewer support incidences. And also it means for us to have ongoing revenue as a percentage of the total sales on that business." VAR, France, 80 employees

Customer Adds

Although the BPOS PoR fees on a deal-by-deal basis are not necessarily impressive, if a sufficiently large base of customers can be achieved, then there will be a reasonable recurring revenue stream. Having a larger base of customers than in the past was very attractive to many partners interviewed because of the opportunities it presented.

Some partners were being creative in their use of the PoR fees, such as sharing them with joint delivery partners, reinvesting in demand generation, and targeting operational costs.

It will be important for partners to ensure that customer satisfaction remains high; otherwise, the customer may choose to move its PoR to another partner. However, no partner expected the PoR fees to contribute more than a small percentage of overall revenue (2–5%).

Large Account Sales

While "high volume sales" is the strategy most often associated with SaaS, it is not the only successful approach. Many enterprise-focused partners prefer to take on fewer, larger deals with higher services components. These are typically businesses that have consulting-led offerings, where the quality of advice comes first. The ability of cloud services to change the dynamics in terms of either cost or technical viability creates an opportunity to engage with customers. A review of the strategic goals for the business, how IT currently supports these goals, and how the cloud shift may help address any identified gaps becomes possible.

External Education and Events

Although the key attributes of the cloud shift have come from changing drivers within businesses, the awareness of cloud computing as a solution to these drivers is still growing. Partners advise that it is increasing rapidly; however, awareness of BPOS as a specific solution is still low. Partners therefore are finding that education is often a precursor to sales. For some partners (especially the consulting-led ones), this is a revenue opportunity as well as a chance to establish themselves as thought leaders.

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Fixed Price Offers

Although it is important not to position BPOS as the "cheap" option, it is also clear that services need to be in keeping with the value the customer can recognize. Offering fixed price services in core areas such as migration is seen as more attractive than open-ended time and materials. Good project management and automation of standard processes are critical in achieving the efficiency needed to be profitable.

Telesales and Telemarketing

BPOS offers the opportunity for a broader reach and access to lower-value accounts. For these lower-value opportunities, the "cost of sale" becomes a key metric and makes high-touch engagement through a traditional field sales force challenging.

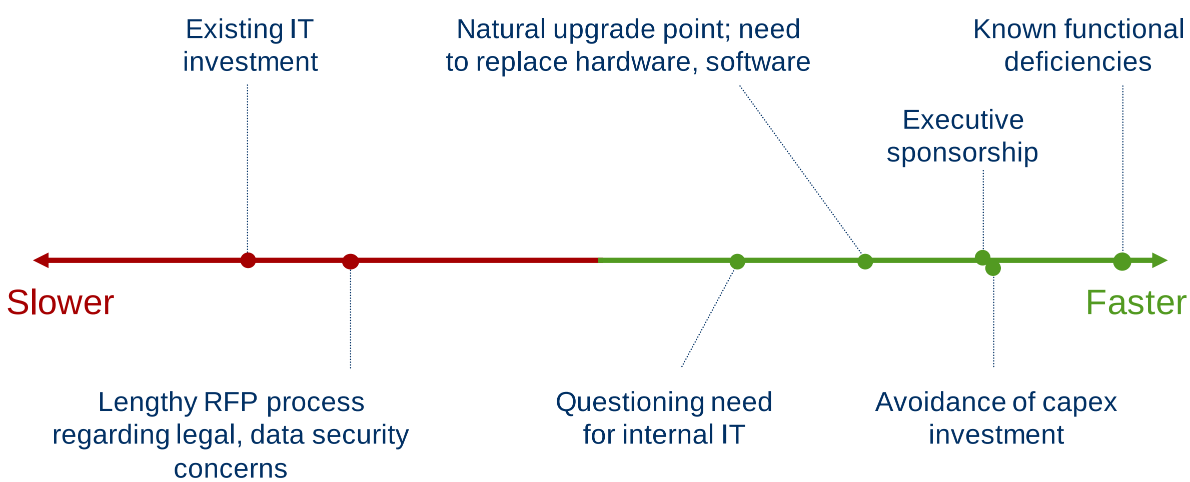
Telemarketing and telesales have been successful, although the feedback is that there needs to be clear messaging and a focus to identify high-probability clients (see the Focus on Low-Hanging Fruit entry in the Sales Strategies section).

Accelerating Deals

In addition to the profitability drivers noted in the preceding section, partners were asked to identify areas that accelerated or slowed down the sales process. Figure 4 captures the feedback and is intended to be illustrative rather than precisely to scale. The key message is to focus on deals where the factors on the right-hand side of the figure are present and be aware if the factors on the left of the diagram become apparent.

FIGURE 4

Factors That May Accelerate or Slow Down BPOS Sales Cycles



Note: Placement is not to scale but is in line with partner feedback.

Source: IDC, 2010

Marketing Strategies

For many partners considering BPOS as a business opportunity, formal marketing will not necessarily have been central to their existing success. However, to raise awareness that BPOS is now part of the business offer or that, as a start-up, they exist, partners will need some form of outreach. Marketing is especially important for those solution providers that decide to pursue a strategy of winning a volume of customer adds. Most importantly, because cloud represents a transformative shift, marketing/education on the concept will often be needed before a customer is interested in hearing about product offerings.

"I guess you could say our strategy right now is education." SI, United States, 200 employees

Clear and Focused Messaging

With such a large potential opportunity, it is important that there be a focus in areas where the partner can offer clear and justifiable value-add. Marketing messages should then be targeted in this direction. A clear message from all partners interviewed was that BPOS should not be messaged as "the cheap option."

Incorporate BPOS Outreach into the Rhythm of the Business

In line with the "commit don't experiment" mantra, momentum must be built through the use of continuous outreach rather than ad hoc or disjointed campaigns. For example, one partner runs weekly Webinars, walking though BPOS scenarios, to about 8 to 15 people at a time. The Webinars are promoted with weekly email blasts targeting executives at companies with 250 to 1,000 employees (its target market).

Build Community Through Social Media and Multiple Touch Points

"Webinars are effective. I think they move the sales cycle forward. They necessarily don't close it, but they do move it along." VAR, United States, 15 employees

With customers increasingly self-educating through the Web before you even contact them, it is important that you engage with them in the "places they go." If your target market is a specific industry, then there are likely to be forums, Web sites, or online user groups where you could engage. The received wisdom for these interactions is to engage in the conversation and provide thought leadership but avoid direct selling. Some partners have reported success with sites such as Facebook, Twitter, and LinkedIn Groups. One partner has a constant dialogue with potential customers after building a cloud computing user group.

Integrate Outside Leads for Seamless Customer Experience

Many initial leads may come from external parties such as Microsoft itself. It is important to have a built-in process that can move these opportunities forward quickly. If follow-up is slow, not only will you risk being seen in a poor light by the third party (Microsoft), but more importantly, the decision-making cycle for BPOS is much quicker than that of a traditional on-premise sale, and you may simply miss out on a deal (driven by compelling need, executive involvement, and reduced up-front cost). One partner contracts outside telemarketing staff to call the leads immediately and attempt to schedule a phone appointment with the CEO.

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Sales Strategies

BPOS Is the Thin Edge of the Wedge

Part of the "commitment" to the cloud is ensuring that online service offerings are treated as at least equal to on-premise services. One of the most consistent messages heard from partner interviews was that positioning BPOS first is an excellent way into a new company or a new division of a client. From either the sales conversation alone or following the BPOS implementation, partners repeatedly said that they grew their business inside those accounts.

Existing Customers

The old adage that it is easier to sell to existing customers than to find new ones is reinforced by partner feedback. Similar to the preceding point, BPOS provides an excellent opportunity to open a discussion with existing customers:

- Explore new business opportunities
- Revisit opportunities that had previously been considered too expensive
- Replace infrastructure that is becoming less reliable or out of support

Sales Force Mix: Combine Low Touch–High Touch

It is important to segment your customer base and determine the appropriate level of engagement. Typically, this means a low-touch model for smaller businesses and a higher/direct touch for larger opportunities. The more profitable partners were seen to be successfully combining these two approaches.

"We probably have only met 4 or 5 of our 45 SMB customers. We use Live Meeting a lot. We are able to demo, sell, and deliver all on the phone." VAR, United States, <10 employees

Irrespective of the level of touch, the major change identified was a shift from a technical-based sale (typically with the person responsible for IT such as the CIO) to a business process improvement sale (with a business line owner).

Focus on Low-Hanging Fruit

Focus on the hot areas. Partner skills will influence what is "hot"; however, the following elements of customers/deals were repeated across the partner interviews:

- Natural point in upgrade cycle (e.g., ready to replace Exchange 2003)
- Known gap between business need and technology provision
- Businesses with distributed offices (e.g., branches, franchises)
- High-growth or volatile workforce (e.g., seasonal)
- Highly mobile workforce
- Recent infrastructure failures

Also refer back to the Accelerating Deals section for a review of factors that help accelerate and slow down the sales process.

Sales Cycle Analysis

There are lots of potential opportunities out there. However, the initial up-front revenue per deal for BPOS is typically smaller. The ability to disqualify an opportunity quickly and then politely move on was a key success factor for a number of partners.

"Our ability to quickly qualify a customer is another thing that I think distinguishes us. We have developed the tools and the questionnaires to qualify a customer very quickly and identify what the gotchas might be and work with the customer to find out whether or not they are insurmountable or not." SI, United States, 100 employees

One partner has a taken a "limited time only" approach to each stage of the sales cycle with clear criteria to justify spending more time on the opportunity. If the maximum time was going to be exceeded, the partner cut its losses and moved onto the next deal.

Sales Compensation — Hunting over Farming

Sales compensation around cloud computing has emerged as one of the toughest challenges for business owners and executives. There is a key trade-off at play. The partner management wants to build a "book of business." It is very beneficial for executives to know where a given percentage of their revenue is coming from in the next year. As for salespeople, they want to max out sales compensation today. The problem is that with cloud computing deals, the money coming in is spread out over time. The key question is, Do you compensate salespeople in the same manner as you receive money, which will motivate them to maintain an ongoing relationship? Or do you compensate salespeople more up front and less in the future to motivate finding new accounts (aka "hunting" behavior)?

The research shows that many solution providers are still exploring this issue. Several of those with an opinion tend to be opting to compensate more up front when possible for two reasons. One, to motivate finding new accounts (hunting behavior) with the offer of more money sooner. Two, in many situations, the sales rep will have the choice of positioning an on-premise license deal or a cloud deal. In that case, the closer the rep's potential payout is on either deal, the more neutral he or she can be with the client.

To further motivate "hunting," savvy partners suggested offering a bonus for the first six or eight deals in order to hone sales techniques and approach. This was also a quick way to ramp and develop a playbook of references.

Another key tenet of cloud sales compensation is to base it on gross margin and not revenue. As revenue from individual cloud deals can be smaller than revenue from traditional deals, it's important to focus on the gross profit contribution to the company. For instance, some partners are using PoR fees to help compensate the sales reps because the fees are 100% gross profit (i.e., no cost of goods sold). For example: A salesperson gets 10% of all the service-related deployment revenue plus the same percentage of Microsoft PoR fees for the first year.

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Deal Economics

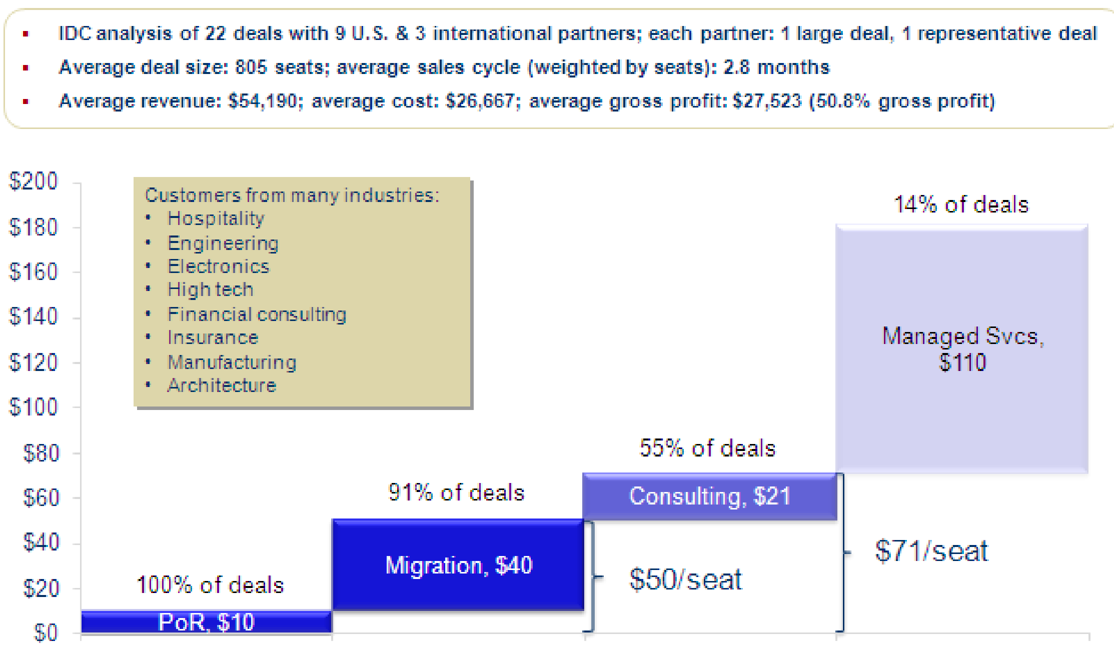
Of course, everything else aside, all solution providers considering building a BPOS practice want to know about the economics of it all. This section provides guidance on revenue and costs for BPOS deals. While not statistically significant, the deal data was gathered from an analysis of 22 BPOS deals across 12 U.S. and international partners with reasonably successful online services practices. IDC asked each partner for one "large" and one "representative" or average deal to be broken down.

"I would probably say in the last six months, it has flipped. We are getting a decent stream from partner of record revenue. And we have learned how to do these engagements. It has become positive to very positive in terms of profitability now."
SI, United States, 100 employees

Figure 5 is a graphical representation of the findings. It shows the average amount of year one revenue per seat across PoR fees, migration and integration fees, consulting and related fees, and managed services fees. The averages for each item are based only on the deals that contained those elements (i.e., there were 12 deals for consulting — the sum of those 12 deals was divided by 12 and not 22, the total number of deals). On top of average revenue per seat, the figure also indicates the frequency with which each deal element occurred, both with a label (e.g., "91% of deals") and through the opacity of the bars.

FIGURE 5

BPOS Year One Revenue per Seat and Frequency



Note: These figures represent averages from this particular basket of deals.

Source: IDC, 2010

Based on this set of deals, partners can expect to receive roughly $50 per seat most of the time and $71 per seat about half the time in year one. Managed services proved to be a lucrative area for a few BPOS deals, but at only 14% of deals, not all partners will realize this opportunity.

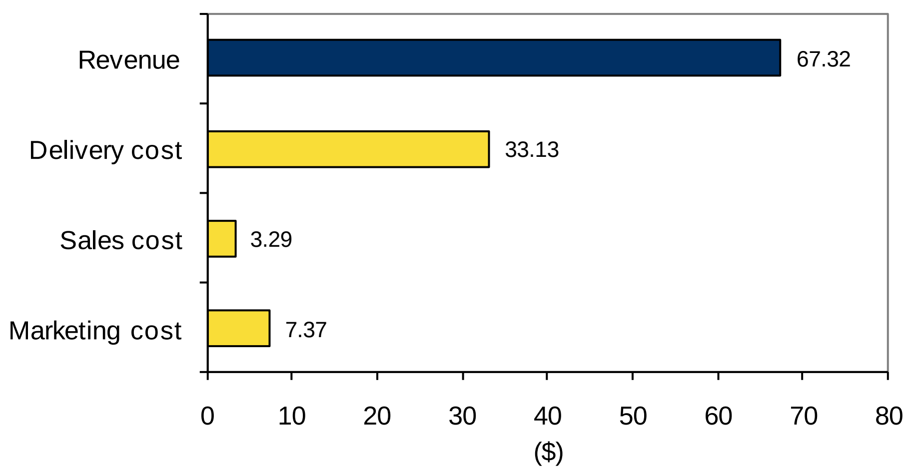
The overall average revenue per seat for year one equaled $67.32. Average delivery cost per seat was $33.13, which meant average gross profit per seat equaled $34.19, or 51% of revenue.

On a per-deal basis, average revenue for this particular basket of large and average deals reviewed amounted to $54,190 with an average delivery cost of $26,667. Average gross profit per deal amounted to $27,523, or, again, 51% of revenue. The average deal size was 805 seats, and the average sales cycle was 2.8 months. While the average deal size in seats is higher than we would expect a normal deal to be, the sales cycle is also longer than typically expected.

Figure 6 shows that average sales cost per seat was estimated at $3.29 while average marketing cost per seat worked out to $7.37.

FIGURE 6

Average BPOS Sales and Marketing Costs per Seat Compared with Year One Revenue



Notes:

Average gross profit per seat for year one is $34.19, or 51% of revenue. Marketing costs per seat are higher than sales costs per seat due to higher education requirements for cloud computing.

These figures represent averages from this particular basket of deals.

Source: IDC, 2010

Partners can also expect to receive ongoing PoR fees from Microsoft in subsequent years. While 6% per year may not seem exciting in year two of an online services practice, it is 100% gross profit and can add up once new deals from years one, two, three, and so on are accounted for. IDC has likened this business model to the often lucrative recurring revenue structures of insurance agents or cellular phone dealers.

Of course, managed services also fall under the recurring opportunities category. Although managed services did not account for a large amount of average revenue in this particular basket of deals, this is an area of significant opportunity for solution providers. BPOS and managed services fit together very well because both are hosted, managed, subscription-based, and flexible offerings that customers are becoming more and more interested in. IDC expects managed services to be a larger revenue opportunity going forward for many BPOS partners.

In addition to recurring revenue, many partners indicated that BPOS was a real door opener and led them to other online and on-premise deals.

Leading Practices from Microsoft Partners

Each interviewed partner was asked to share its top "best practice" tips for its fellow partners. From the responses, we distilled the following suggestions:

"I would say the pricing model — so understanding how to scale a Microsoft migration pricing model. I think being able to boil it down to cost per user, per seat and making that actually happen is pretty important." SI, United States, 10 employees

Sales and Marketing

1. Make working with a subscription pricing model the norm within the business. Be able to price "per user" or "per seat" on a monthly basis. This should not be just licenses but potentially everything you do, including professional services. Charges can be spread over a period of months, which removes the up-front cost objections and increases the ongoing stickiness of the relationship.

2. Be clear that there is a large market opportunity and a limited period to be able to close the sale. The cost of sales cannot overrun the revenue opportunity. Have the efficiency and discipline to qualify opportunities quickly and move on if necessary.

3. Do not position BPOS as the "cheap option" because this devalues all the work that you can do and creates objections within the customer for any additional spend.

4. Sell BPOS as a part of an overall solution and not simply as a hosted service. Incorporate complementary solutions into your overall offer.

5. Don't underestimate the education required as the market matures, but also look for opportunities to monetize this investment.

Delivery

1. Understand that automation is key to cost-effective delivery, especially in the areas required across most engagements (e.g., initial migration).

2. Develop strong project management skills and a well-defined project plan to ensure that delivery costs do not outstrip revenue. Build a feedback process so that the project plan captures "lessons learned."

3. Be aware that "time to value" (i.e., how quickly the customer starts really using BPOS) is an important metric. Therefore, a strong focus on the initial migration and user adoption is recommended.

4. Develop a well-defined remote delivery and support model (leverage Live Meeting and Office Communications Server [OCS] in your own practice).

5. Strengthen your ability to integrate BPOS with other online services and on-premise applications. This will increase the long-term value of the customer and provide deeper engagement.

6. Practice what you preach. Use the internal usage rights and implement BPOS for your own business.

MICROSOFT CHALLENGES

As stated previously, Microsoft has made a strategic statement of intent, and it could be argued that the company is taking the cloud lead among its established competitors. However, just because Microsoft has decided that it is "all in" does not automatically mean that its partner ecosystem is "all in" as well. A number of key challenges still need careful attention:

- **Marketplace awareness of BPOS needs to improve.** Customer awareness of the cloud in general is growing rapidly. However, there is still not a high enough recognition of BPOS in the market, and partners are having to spend too much of the limited available sales time educating the customer rather than selling. As the average deal size is often small, this is an important issue. However, the end-user knowledge level is increasing every day given the attention that cloud generates. Microsoft has also recently ramped up its investments in online advertising and demand generation for BPOS in particular, as evidenced by the "all in" campaign.

- **Microsoft's role needs to change in the sales cycle.** As a product vendor, Microsoft was responsible for promoting the underlying tools it provided to partners. The partners then provided the finished products and were responsible for the value proposition to end customers. Now that Microsoft is delivering the finished product, its role in communicating with the end customer changes from "arm's length" to more "hands on." However, Microsoft should be doing everything possible to allow partners to maintain their trusted advisor roles with these clients. To its credit, Microsoft has endeavored to keep partners involved where possible. Microsoft has created an "Administer On Behalf" tool that allows a specified partner to perform administrative duties for the customer. A dashboard allows partners to more easily manage their BPOS sales cycles, including real-time data on trials, closed deals, fees, and more. And on the communications front, if there is any kind of service update from Microsoft to the customer, the partner of record is always copied on the email. Efforts like this are helpful and need to continue.

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- **Partner objections need to be resolved at the business leadership level.** The owners and leaders of Microsoft partner businesses are understandably concerned about the changes that the cloud and Microsoft's "all in" mantra will create. If these concerns are not managed, the risk of change will be seen to outweigh the opportunity benefits. Microsoft's commitment to the cloud will change some of the dynamics in the partner ecosystem, and not all partners will enjoy the same success as they currently do. Microsoft, and specifically its Partner Account Managers and other field-based resources, will have to partake in some tough "future of the business" conversations with partner owners and executives in the next year.

- **Evolution of existing licensing programs, especially SPLA.[6]** Microsoft has always had a "butterfly effect"[7] with its diverse licensing programs, with a small change in one place having an unexpectedly large impact elsewhere. The shift to cloud licensing with consumption pricing and the underlying hidden product costs will bring into sharp contrast the differences in other areas. The SPLA licensing program could be especially hard hit, with hosting partners finding it hard to compete on an equal footing, even at a licensing level.

- **Equalization of global legal frameworks.** This is outside Microsoft's direct control; however, it will be important to the long-term stability of the cloud model. Brad Smith, Microsoft's Senior Vice President, General Counsel, and Corporate Secretary, has communicated at length on the subject.[8] Without cross border harmonization of data sovereignty (among other legal issues), the logical conclusion is that there will be a drift to increasingly localized service provision. This will break a number of the key cloud benefits.

CONCLUSION

While not everyone is welcoming the industry shift of cloud computing, it's a growing force that will propel forward companies that are prepared for it. BPOS is widely seen by Microsoft partners as one of the flagship products that will accelerate the cloud shift.

But there is no doubt that solution providers will have to adapt and evolve to thrive with cloud computing. This is not business as usual. There are potentially significant changes to be made in sales, marketing, delivery, and other areas of the business.

And yet IDC's research of successful Microsoft BPOS partners shows that profitability and success are attainable. Solution providers that show both commitment to cloud computing and creativity to add value are surging ahead of their peers.

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[6] http://www.microsoft.com/hosting/en/us/licensing/splabenefits.aspx

[7] http://en.wikipedia.org/wiki/Butterfly_effect

[8] http://www.huffingtonpost.com/brad-smith/cloud-computing-for-busin_b_429466.html

APPENDIX

Methodology

IDC held in-depth 60- to 90-minute interviews with 17 Microsoft partners (9 based in the United States and 8 international [including partners based in the United Kingdom, France, Germany, Netherlands, Australia, and Singapore]) from April to June 2010.

Topics discussed included:

- BPOS customer and partner drivers
- Building and growing a BPOS practice
- Sales and marketing strategies
- BPOS deal economics
- Skill sets
- Microsoft relationship

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