

The 2017 State of VAR Profitability

Research Review and Discussion

Continuing Education for IPED Channel Masters






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Perspectives On:

- ✓ Partner business models & economics
- ✓ Consulting business dynamics
- ✓ Building & running a professional services practice

Professional History:

- Consultant / Analyst – ESG Group
- Director, Partner Alliances - Glasshouse Tech.
- VP, Professional Services – Avamar Technologies
- Client Director – EMC
- Director of Marketing & Prof. Services – Articulent/Berkshire
- Product Marketing - Digital Equipment Corp.

-  **Strategic Backdrop for Profitability**
-  **Dissecting VAR Profit and Expenses**
-  **Refining the Value Proposition Around Profitability**

Start with your relative position

Strategic

We are generating a significant amount of revenue with these technology suppliers and are highly involved with them at the sales, marketing and technical levels

Tactical

We generate a significant amount of revenue with these technology suppliers, but product alternatives exist and we are not strategically invested in these lines

Opportunistic

We infrequently buy small amount of products from these technology suppliers, and re-actively based on our customers' demands





Impact to your profitability value proposition

“Not a Strategic Fit”

Not addressing pure-play or hybrid business models

“Commitment Greater than the Opportunity”

Imbalance between SG&A investment and projected gross margins

“ROI Was Less Than Expected”

*Improper expectations for investment time horizon
OR unclear services-attach projections*

“Lower Than Expected Margins”

*Unclear services-attach projections
OR not addressing the right business model(s)*

The impact of profitability: then and now

S U C C E S S

THEN – “Profitable”

- Gross margins
- New customers
- Professional Services growth
- Solvency

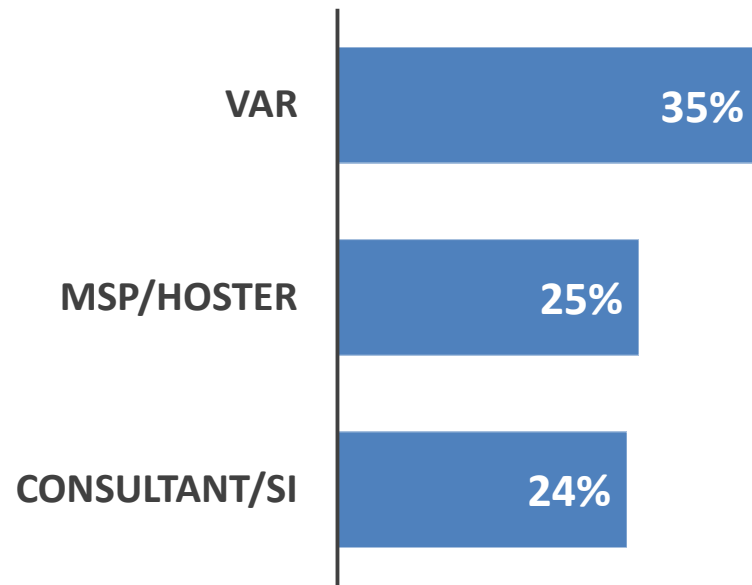


NOW – “Valuable”

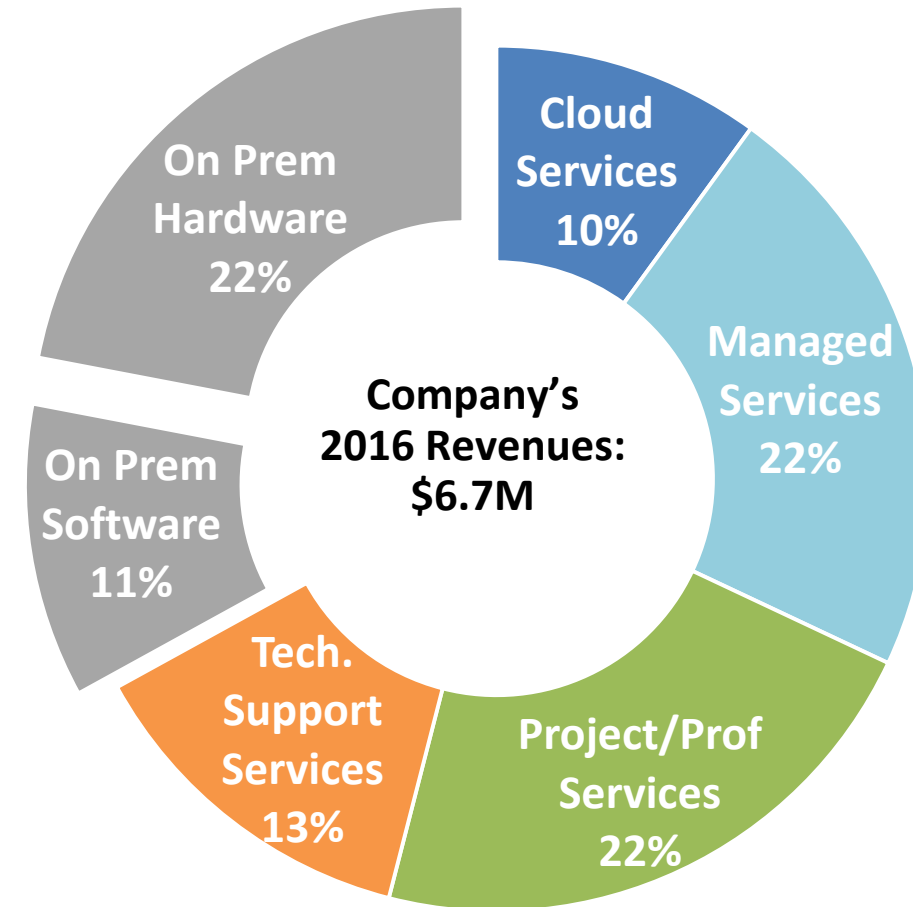
- Intellectual property
- Monthly recurring revenues
- Customer retention and expansion rates
- Vertical insights and LOB relationships
- Services diversity

Respondents are hybrid VARs and MSP/Consultants leading with professional and managed services, then on-premise hardware

Primary Business Models



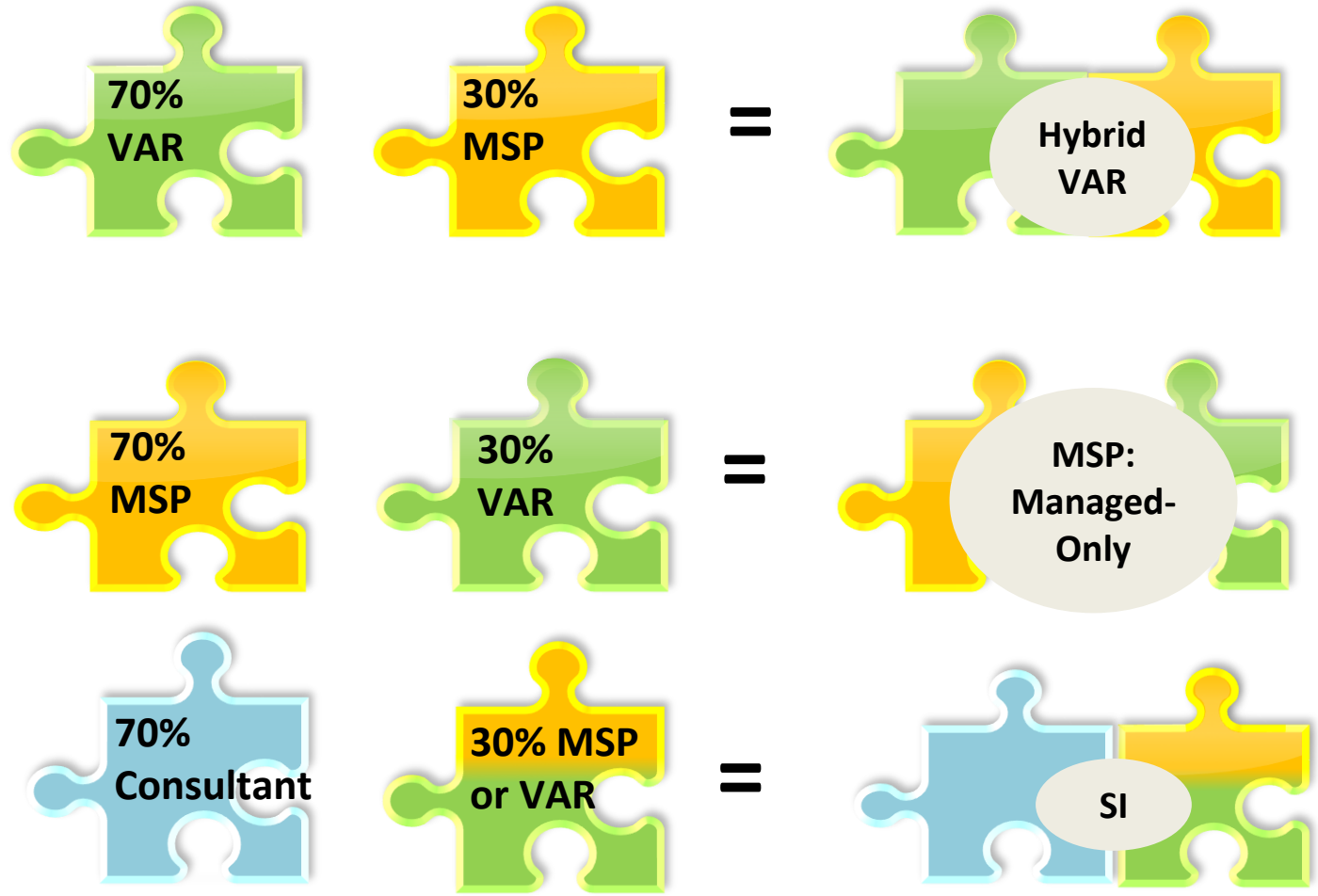
2016 Revenue



Why role-based programs matter: hybrid business models

How to Use These Models:

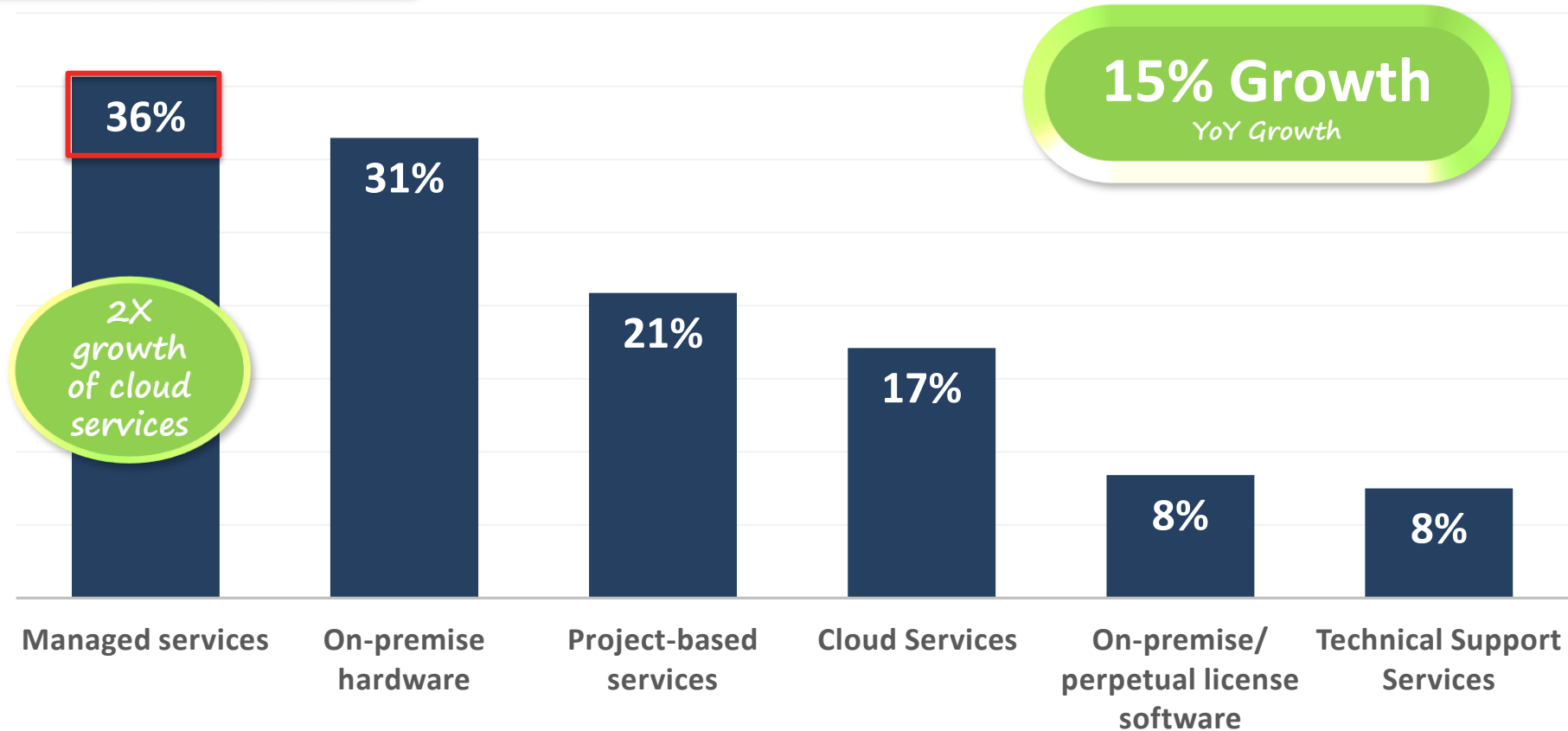
- Dissect your ideal partner profile
- VAR, MSP and Consultant models are the 3 pureplay roles
- Factor in the correct percentage of the 3 pure models to achieve the hybrid mix of your ideal partner profile
- Then benchmark partner needs to your program



- Illustrative -

Respondents grew 15% in topline sales in 2016; plan to drive topline growth in 2017 from MSP services and on-premise hardware sales

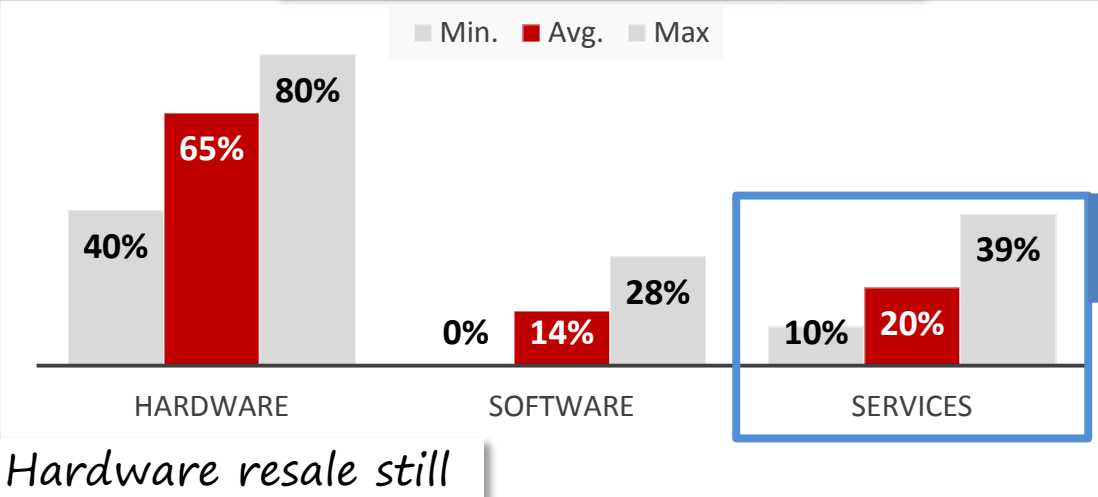
Growth Impact Ranking



Q: From which categories do you expect to gain the majority of your topline sales growth in 2017? (Please rank in order of source of growth)

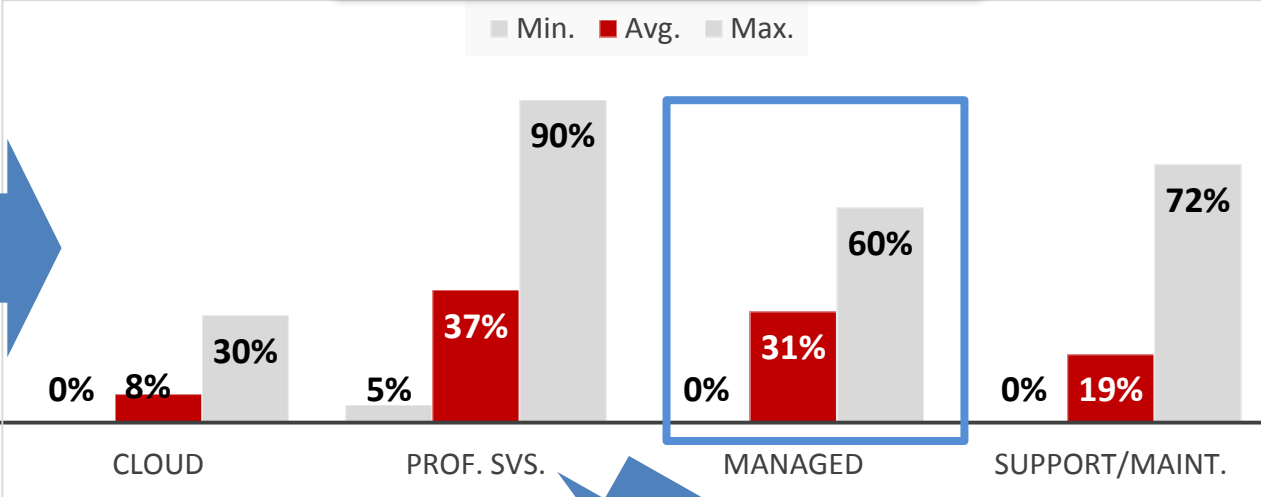
Revenue Mix: VARs

MIX OF TOTAL REVENUES



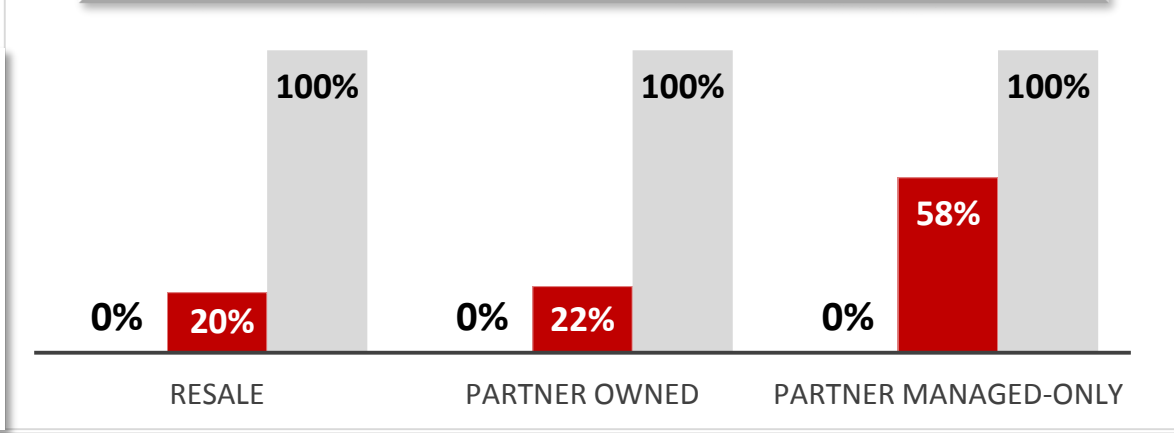
Hardware resale still dominate revenues

SERVICES MIX - % of REVENUE



Professional services remains leading services element, with managed services close behind

MANAGED SERVICES REVENUE by DELIVERY TYPE



Reselling managed services alone yields insufficient margins.

VARs don't frequently own hosting infrastructure

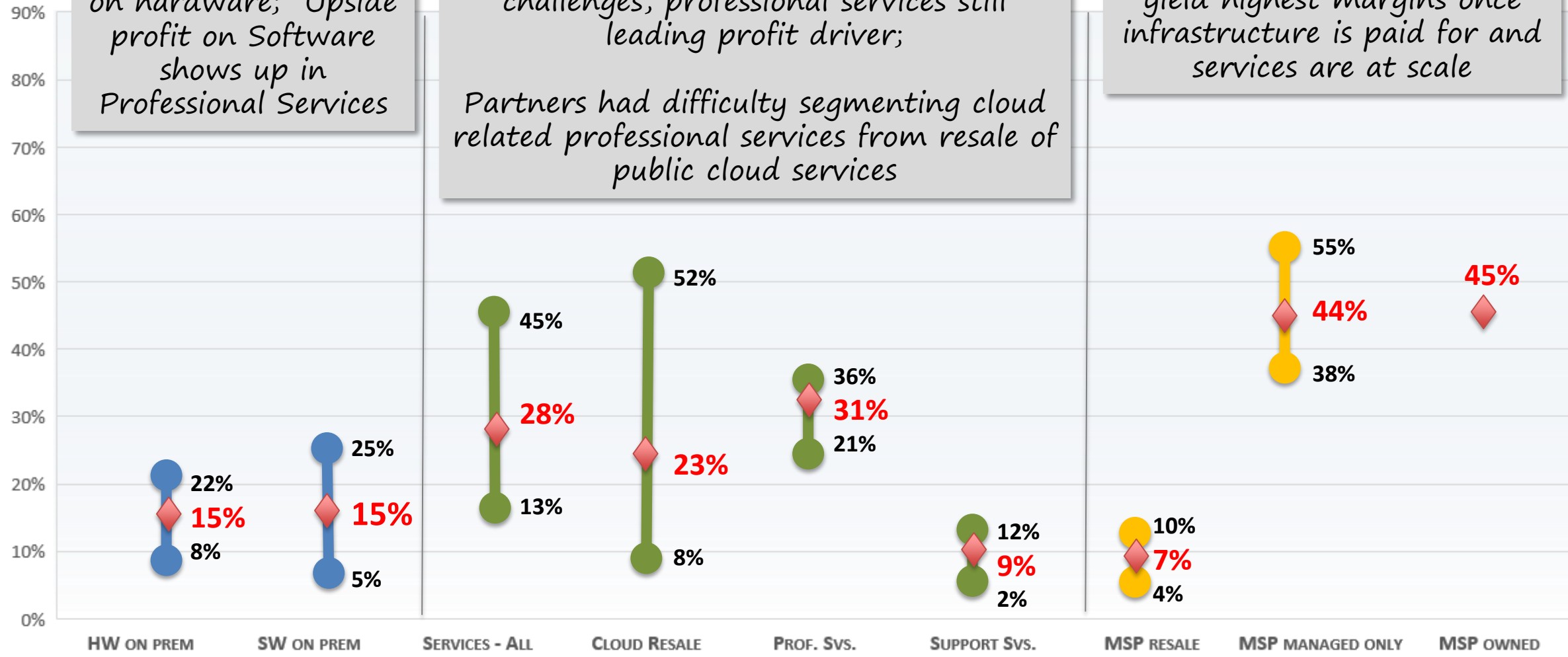
Gross Margin Ranges: VARs



Wide range of profits on hardware; Upside profit on Software shows up in Professional Services

Despite scalability and utilization challenges, professional services still leading profit driver; Partners had difficulty segmenting cloud related professional services from resale of public cloud services

MSP owned services only yield highest margins once infrastructure is paid for and services are at scale



MSP portion of VAR business is focused largely on Partner-Managed Services

MSP

“Our revenue mix used to be 25% recurring and 75% project services mix; but it’s got to be at least 30% plus recurring. This allows me to cover costs with recurring revenues.”

% of MRR revenues

21%

Resale

- Resold another supplier or service providers’ managed services

25% GM 

61%

Partner Managed-Only

- Partner manages customer’s asset (*on customer premise, at someone else’s datacenter or on a public cloud*)

50% GM 

18%

Partner Owned

- Offered your own hosting services on your own data center and managed for a customer

50-60% GM 











VAR 2016 Top Revenue Producing Product Categories



Takeaways:

- Client security software overtakes client hardware devices - common segue to building out an MSP practice
- PCs and client devices still a staple of many solutions, but VARs continue to see margin pressure on volume hardware
- Flash technologies have bolstered sales momentum around NAS storage solutions
- Many VARs have refocused their efforts on server virtualization






Top 5

		<u>GM Trend</u>
1.	 Client security software (firewall, anti-SPAM, anti-virus)	
2.	 PC's/Notebooks/Mobile Computers	
3.	 Enterprise Networking Infrastructure	
4.	 Enterprise Network Storage	
5.	 Mid-Range Servers	

VAR 2016 Top Gross Margin Producing Product Categories

Est. GM%

Top 5

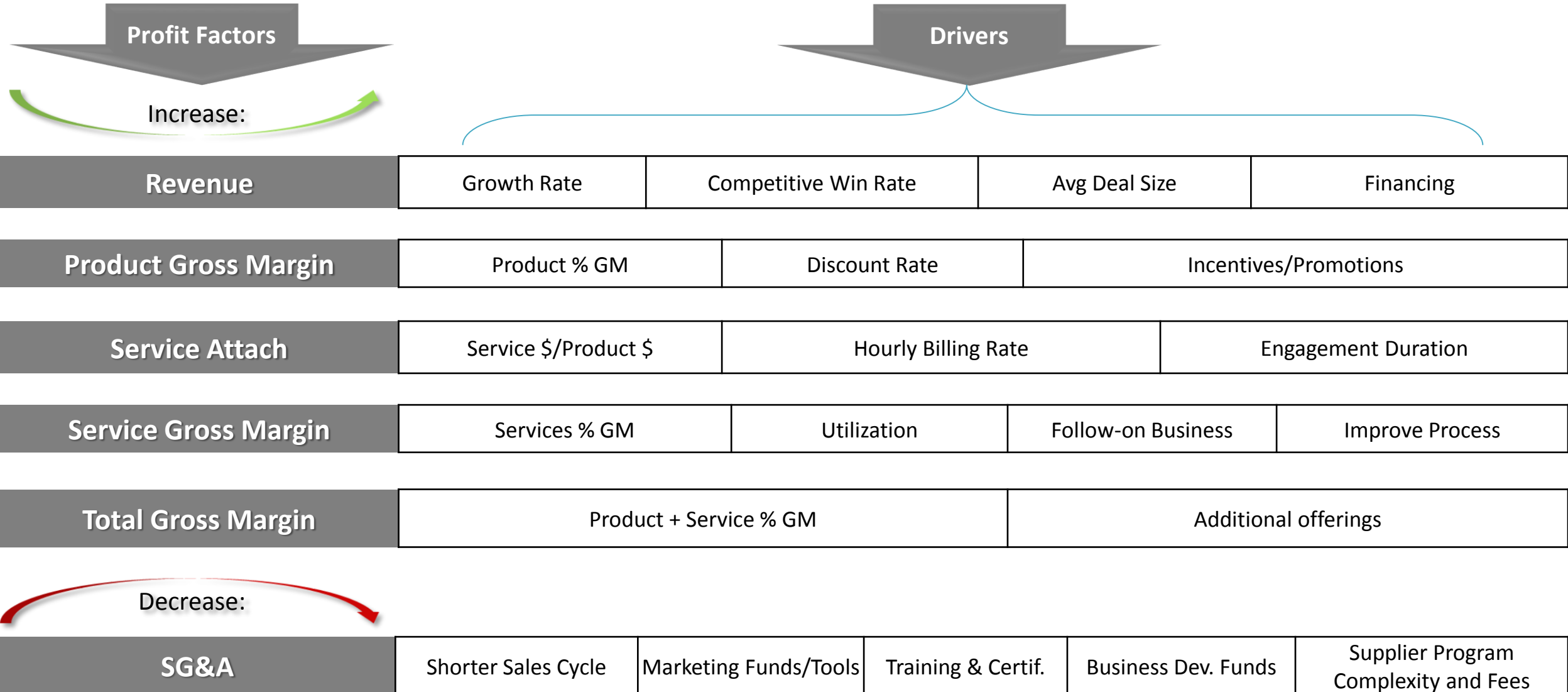
1.		Business Analytics	30%
2.		Client Security Software	22%
3.		Collaboration Software	22%
4.		Network Security Appliances	22%
5.		Converged Infrastructure Systems	21%



Takeaways:

- Business analytic solutions carry the highest gross margins; on par with professional services margins
- Highest margin product categories all in software group
- Volume compute devices carry the lowest gross margins

VAR Profitability Drivers



VAR Profitability Drivers: Key Trends

Increase:



Revenue

- **Revenue volume up, margins down, overall profitability healthy but not keeping up with financial growth**
- More qualified pre-sales staff and consultants result in better services scoping = higher profits

Product Gross Margin

- **Continued margin pressure on volume hardware**
- Highest gross margin product categories are analytics, security, collaboration SW and networking appliances
- Product with fastest declining gross margins are PCs/notebooks, volume servers and processors

Service Attach

- **Professional Services increasingly priced as stand-alone for pre-sales design/assessment; resale must be bundled with professional services to make meaningful profit**
- Despite staffing challenges, Residency Services is a common offering; trying to evolve to a managed service

Service Gross Margin

- **Cloud (public) resale margins alone insufficient to sustain practice; must broker, add professional services**
- With large professional services deals margins are down due to the number of people required to staff the deal

Decrease:



SG&A

- **Services bench utilization still plays large role in realizing services profitability; vendor IP sharing & mentoring can ease this cost burden**
- Cost of facilities remains significant factor, esp. as expanding sales staff and considering DC build-out
- Tighter MDF usage rules are increasing staffing expense; non-MDF opex investment remains low

Levers Of Partner Profitability – VARs: Vendor Support Requirements

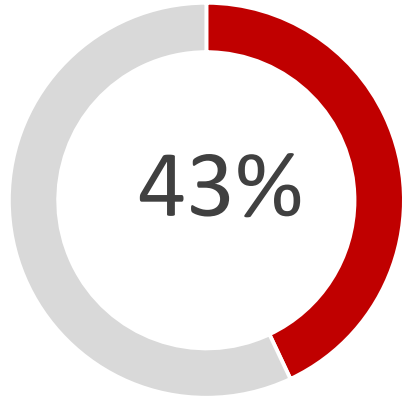
REVENUE

C.O.G.S.

SG&A

Partner P&L Levers	Type	Vendor Tools / Resources	
Sales Velocity	Increase Revenue	Stronger sales tools 23%	
	Increase Revenue	Ability to sell renewals of support contracts 22%	
	Increase Revenue	Extended financing for our customers 18%	
Buying Power	Decrease COGS	Ways to earn higher discounts on resale 34%	
	Decrease COGS	More lucrative front-end incentives for deal registrations 75%	
	Decrease COGS	More lucrative performance based back-end rebates 19%	
Service Delivery Capabilities	Decrease SG&A	More IP to help us build next generation services 13%	
	Decrease SG&A	Field based co-selling resources 7%	
Vendor Enablement and Transaction Support (Program)	Decrease SG&A	Make training and certification more affordable 56%	
	Decrease SG&A	Reduce/Eliminate Channel/Alliance Program Fees 45%	
	Decrease SG&A	<ul style="list-style-type: none"> Automate more of the core channel processes 26% Make programs less complex & time-consuming to administer 23% Make quoting, pricing and transactional process less complex 23% 	
		Decrease SG&A	<ul style="list-style-type: none"> Make marketing funds easier to get access to 20%

All major SG&A expenses up from 2015



Say **longer selling cycles** have increased their selling costs most in 2016

- Different decision makers
- Unpredictable customer demand

All 11 Major SG&A Expense Lines INCREASED from 2015
(71 – 92% response)

**Top 4
Greatest
Changes**

1

Technical staff



3

Business offices



2

Sales staffing



4

Back-office staff



Solution providers feel only ½ of vendor CAMs understand their profitability

 **15%** say
CAM's **fully understand** all the elements of profits and costs

 **29%** say
CAM's **understand most of** the margin and cost factors

 **21%** say
Say CAM's understanding is **limited to transactional gross margins**

 **19%** say
Say CAM's have a **very limited understanding** of both real margins and sales expenses



Q: To what degree do you feel the channel reps who support you from your top IT vendors understand how you make money with their product line(s)? (n=318)

VAR Profitability:



Key Vendor Takeaways

Know your “Vintage” VARs and understand the impact to regional coverage if they don’t evolve

Reselling *enables growth* in other core solution provider functions; growth of managed and professional services

VARs with local *vertical specialties* will continue to be more profitable and are first-movers for building cloud and MSP capabilities beyond resale

Software platform, analytics or app. dev. skills are critical for VARs to cultivate to differentiate and boost profits

Complexity = cost; VARs have the least buffer to net margins when programs impact SG&A expense (e.g., FE margin incentives)

To ease investment hurdle on building managed services and/or doing more marketing, vendor licensing and MDF process complexity must change

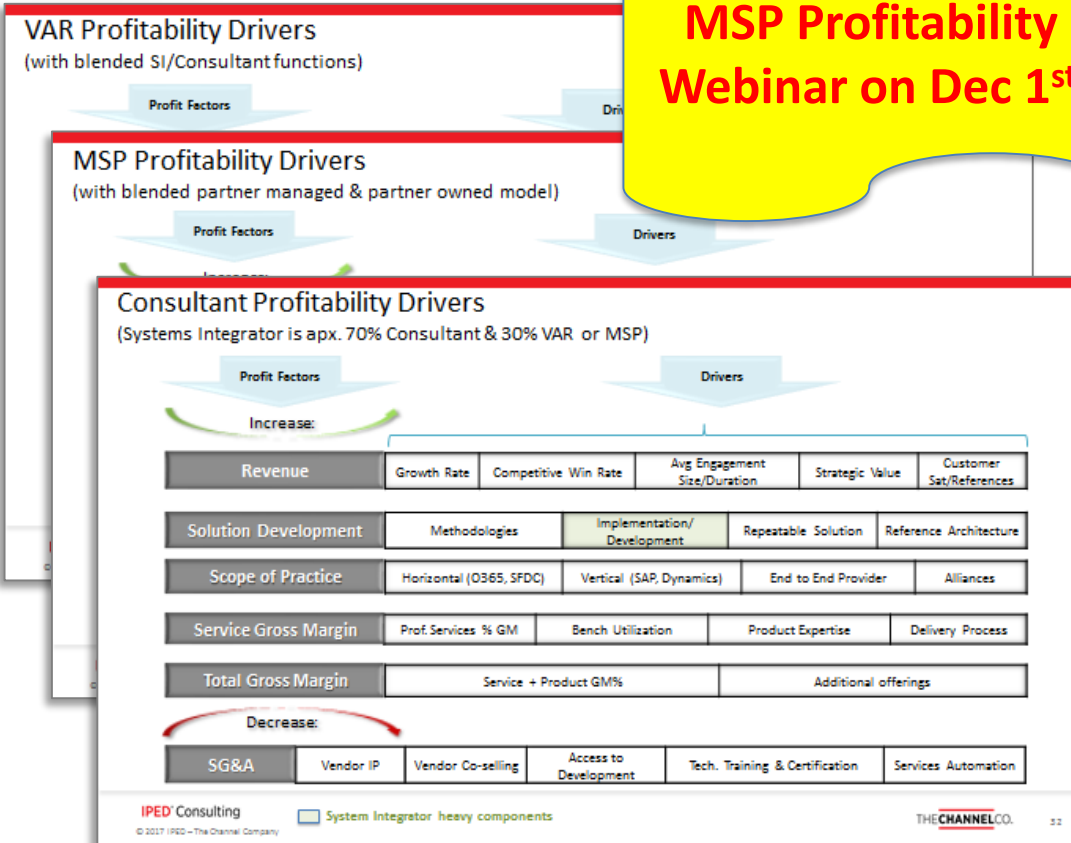
Refining the value proposition around profitability



1. Map your *target partner profile* to hybrid business model & profitability drivers
2. Understand the *complete channel economic picture* for your products
3. Tailor your *value proposition* to speak to profitability impact first
4. Continue to *evolve your partner managers* into business managers, with a keen sense of profit & cost drivers

Three pure-play models from which you can have a granular view of profitability and benchmark your program

Partner Profitability



Vendor Support Needs

Lever of Partner Profitability: VAR

Partner P&L Levers	Type	Vendor Tools / Resources
	Increase Revenue	Stronger sales tools 23%

Lever of Partner Profitability: MSP

Partner P&L Levers	Type	Vendor Tools / Resources
	Increase Revenue	Offer utility based or consumption based pricing 53%
	Decrease SG&A	More marketing visibility as part of vendors MSP partner ecosystem 38%

Lever of Partner Profitability: Consultant/Systems Integrator

Partner P&L Levers	Type	Vendor Tools / Resources
SOLUTION DEVELOPMENT		
Intellectual Property	Increase REVENUE	More IP to help us Architect Next-Generation Services 34%
DELIVERY EFFICIENCY		
Service Delivery Tools	Decrease COGS	Better Access to Service Delivery Tools, Best Practices (Architectures, SOWs, Integration Guides) 30%
STAFFING		
Resources and Development	Decrease SG&A	Easier Access to Field SEs for Joint Engagement 43%
	Decrease COGS	Field Mentoring for Consultants 35%
	Increase REVENUE	Access to Field Salespeople for Joint Engagements 26%
Sales Process	Decrease COGS	Help us Get Access to Certified Technical Talent to Expand our Bench 29%
	Decrease COGS	Better Access to Demo Gear 22%
COST OF SALES		
Sales Process	Decrease SG&A	Sales Influence Fees to Reward Co-selling 26%
Program	Decrease SG&A	Reduce/Eliminate Channel/Alliance Program Fees 47%

REVENUE
C.O.G.S.
SG&A

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Thank You



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