A GTDC study based on independent research and analysis conducted by O’Callaghan Capital, LLC.
How This Study Was Developed

The Global Technology Distribution Council commissioned this study and supporting research to address growing channel and vendor interest in the role of distributors as cloud computing advances in the overall tech industry. To aggregate and analyze the latest cloud-focused distribution industry developments and trends relative to the vendor community – the primary audience for this report – the GTDC engaged O’Callaghan Capital, LLC, led by founder Dave O’Callaghan.

O’Callaghan’s knowledge base comes from both academia and a 28-year career in sales, sales management, channels and distribution roles. He retired in 2011 from Cisco Systems as the Vice President of Worldwide Commercial Sales and today serves as an adjunct business professor at the University of Denver. Cisco is highly regarded for its long-term channel success and strong strategic alliances with tech distributors, including today as the company expands its cloud offerings worldwide. O’Callaghan is credited with leading many related advances during his tenure with Cisco, and his extensive channel experience grew into a full understanding of optimizing ecosystem partnerships from all perspectives.

O’Callaghan Capital conducted primary research through a comprehensive series of interviews and business model analysis covering vendor, distributor and solution provider aspects of the emerging “cloud value chain” detailed in this report. For additional information, contact the GTDC at info@gtdc.org or O’Callaghan Capital at dave@occapital.net.

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Cloud computing has lately raised more questions throughout the tech industry than any other topic. Technology vendors have scrambled to realign or reinvent what they do today for cloud opportunities. End customers are increasingly interested in related value propositions – and equally concerned about corresponding risks as well as what options, if any, make sense for their businesses today.

Public, private and hybrid cloud solutions have emerged, yet many are unproven and inconsistently defined or applied. Business leaders, especially in the SMB space, often scratch their heads about ROI projections, security, customer service impact and other factors associated with the cloud. Solution providers aren’t yet up to full speed about respective business models either; they too question ROI and value propositions. On the other hand, just about everyone with a tech iron in the fire – both physically or virtually – seeks to capitalize on cloud prospects.

Distributors find themselves in familiar territory, as illustrated below. When sea changes or shifting industry dynamics occur, it’s not unusual for distributors to become “pundit prey.” The direct model, for example, has been among the most common perceived threats over the past decade. Instead of facing demise in their indirect hands, however, distributors have actually outpaced the growth and success of many other tech industry business models. Meanwhile, vendor partners typically reap the most rewards when they find new ways to further leverage and strengthen their distribution partnerships.

It’s a pivotal time in the industry, and the expectation is that history will repeat itself. Distributors are already in the cloud. GTDC members have exemplary programs, initiatives and partnerships in place to accelerate channel awareness and adoption of cloud strategies. Vendors on board the cloud with them today are in the best position to ride this next industry wave as it takes off in SMB directions.

Riding the Dinosaur

Distributors have continuously disproven pundit predictions of disintermediation. Vendor partners have actually benefited from distributor channel advances in each of these areas.

2000 Sunset on the Wild Web. Yee-Naw! Distributors have become eCommerce growth engines.

2002 ESD Extinction. Beg yer pardon... distributors actually rode proudly into a full range of services enabling electronic software distribution.


2007 Direct Varmits. Instead of going West, most got wiser and bellied up to the disty bar to quench their SMB thirst.
Throughout the history of the tech industry, one constant has prevailed: multivendor solutions. No single vendor does it all. Most only address a relatively small niche. The reason comes down to a simple premise encompassing both economic and customer satisfaction value.

Vendors that focus on R&D and innovation tend to fare better compared to those that try to be all things to all people (i.e., companies that directly try to reach and serve channel solution providers, for example, or those attempting to bypass distributors and the channel altogether). Either approach is usually ill-advised, given how much solution providers prefer to source from distributors and that no other type of partner delivers such added value.

Whether in the cloud or physical warehouses, distributors excel at serving the channel and providing the multivendor solutions that make all businesses better. From vendor R&D labs to distributor account management and demand-generation services … on through to the end user’s trusted advisors – the local solution providers they engage; when the overall ecosystem clicks, all participants benefit.

Vendor partners that more deeply understand and methodically evolve how they work with distributors are likely to reap greater overall rewards, regardless of the industry dynamics that unfold. In fact, many traditional advantages of distributors, as shown above, have withstood the test of time and morphed well beyond the early days when pick/pack/ship defined their business models. The cloud represents another dimension to the value chain and established ecosystems that characterize today’s industry.
Cloud Deployment Models

Analysts typically agree that three primary cloud computing models exist for customers to choose from today – possibly in combination with one another. VAR interviews conducted for this study reveal growing customer interest in all three models.

**Private Cloud** – Private cloud is cloud infrastructure operated solely for a single organization, whether managed internally or by a third-party and hosted internally or externally.

**Hybrid Cloud** – Hybrid cloud is a composition of two or more clouds (private, community or public) that remain unique entities but are bound together, offering the benefits of multiple deployment models.

**Public Cloud** – Applications, storage, and other resources are made available to the general public by a service provider. Public cloud services may be free or offered on a pay-per-usage model.

VAR community opinion indicates that enterprise customers are most focused on private cloud deployments – mainly due to security and technology risk perceptions prior to evaluating and adopting hybrid or public cloud deployments. SMB customers reportedly show much more willingness to adopt public cloud solutions for business critical applications and services. Caution and somewhat limited deployments portray the state of affairs on all levels.

Cloud Channel Business Models

Manufacturers have positioned three business models to sell to, through and with the channel.

**Cloud Builder** – a model where the reseller can utilize the vendor technology to build the cloud in a private, hybrid or public offering.

**Cloud Provider** – a model where the reseller can actually build the cloud on their premise, then offer the manufacturers’ solutions (e.g., Saas, IaaS, PaaS, etc.).

**Cloud Reseller** – a model for the historical resale agent to offer the annuity oriented cloud solutions on a sku basis.

Distributors are rapidly adopting the application of the three models above. Distributors have long supported the Cloud Builder model as it is most similar to the historical role of the distributor’s transactional support of a hardware or software sku sale.

Resellers are also more intently evaluating and adopting practices to support cloud business models. Generally, resellers are comfortable in their skills and expertise supporting private cloud deployments as it represents an extension of current customer relationships.

Reseller focus today largely centers on the risk/reward scenario of building cloud provisioning services as the investments are significant to both build the infrastructure and maintain the environment. Similarly, reselling cloud offerings needs vetting to ensure the reseller’s trusted relationships either stay intact or, ideally, increase in value. The resellers see great opportunity for their distributor partner to both vet manufacturer cloud offerings and build scale with hosting models.

"Cloud computing is the delivery of computing as a service rather than a product, whereby shared resources, software, and information are provided to computers and other devices as a utility over a network".

Source: [en.wikipedia.org/wiki/Cloud_computing](en.wikipedia.org/wiki/Cloud_computing)
Primary research for this study concludes that the value chain will not fundamentally change due to cloud implementations. Vendors will continue to focus on product innovation and growth expansion horizontally into additional product and service areas. The distributor's role will potentially be expanded with the addition of services to manage a virtual warehouse, electronic software delivery (ESD), cloud-aggregated billing and other financial and technical support “white label” services for vendors and resellers.

The example below illustrates a customer cloud-based model optimized based on the core competencies of each value-chain participant. The solution addresses the need for “a mobile, secure, CRM implementation.” To implement Salesforce.com across a secure network in a public cloud Infrastructure-as-a-Service, the reseller will need access to more than five vendors’ line cards and hundreds of skus, along with white-label monthly billing and technical support.

Cloud Hard Facts:
- Manufacturers’ core competency has been – and will continue to be – product research and development.
- The manufacturer monetizes the product sale through transaction gross margin (and limited warranty services).
- Distributors have provided warehousing, financing and go-to-market capabilities to sell these products.
- Distributors monetize the sale through transaction gross margin, manufacturer rebates, inventory turns and Return on Working Capital (ROWC).
- Resellers represent the local extension of the manufacturer relationship, providing high-touch value / customer management.
- Resellers monetize the sale through transaction gross margin, vendor rebates and value-added services.
- Customers have ordered products with limited services and grown IT departments to source and manage the success of IT projects.
Customers requiring aggregated cloud solutions will need their VAR to provide the end-to-end solution. In the example on the previous page, depicting a mobile, secure CRM platform for a sales department, the customer may require SaaS from Salesforce.com, IaaS from an infrastructure hosting firm, network and mobility solutions from Cisco, security from McAfee, and other manufacturer components. The customer may also require one monthly bill for the entire bundle of four manufacturers and more than fifteen product families.

When provided this scenario during primary research interviews for this report, no vendor showed interest in being the “general contractor” across the vendor community, nor did any wish to support financing and billing services in a white-label manner. Similarly, corresponding reseller interviews reflected a high level of uncertainty to independently accept the responsibilities of a general contractor for the entire solution.

Both manufacturer and reseller gross profit profiles limit their appetite for adding the estimated 10% gross-profit business model associated with cloud-aggregated billing and technical support business models.

**Distributors Stepping Up to the Challenge**

The distributor layer is the logical place in both the value chain roles and financial business models to support the aggregation of the cloud products and services -- on behalf of the manufacturer and the reseller. The research interviews revealed that all distributors surveyed are evaluating and implementing offerings to address such opportunities.

The industry is beginning to create categories of cloud offerings. These categories are differentiated from one another and create the ability to evaluate how the distributor can participate in the cloud value chain.

Each of the distributors participating in this research has launched cloud offerings. The distributors have branded and organized to support these offerings.

**Reseller Business Model Review**

Reseller interviews were conducted to gain perspective on their view of the cloud and the value chain supporting their needs. Fundamentally, the Value Added Reseller’s core competency is customer loyalty and professional services supplied to the end customer. The reseller has long leveraged vendors for product and service innovation. They have concurrently leveraged the distributor for product fulfillment, credit and channel enablement training.

As the reseller evaluates the cloud within the context of their legacy business model core competency, it is not generally attractive for them to build cloud-hosting facilities. The high financial barrier of entry, and long-term financial sustainability with a limited set of customers drives the reseller to leverage cloud offerings from other places in the value chain that can be trusted with sensitive customer data.

The distributor is logically the most trusted partner to the VAR. Resellers expressed concern over manufacturers becoming too entitled into their customer with direct cloud offerings. Resellers expressed far greater comfort with the distributor(s) they have a financial partnership with over many years – providing the aggregated white label services necessary for the reseller to be successful in the eyes of the end customer. Manufacturers, with their singular focus on their solution, failed to see the big picture business solution the customer demands. Therefore, the distributor becomes an even greater trusted advisor and partner with the reseller in the cloud builder, provider and reseller models.

**Distributor Service Offerings in the Cloud**

- Network Security and Monitoring
- Virtual Desktop
- Collaboration Hosting
- SaaS
- IaaS
- Web Hosting
- Application Hosting and Management
Hardware Vendor Business Model Review

Server, storage and network vendors interviewed for this study see great opportunity to expand their offerings to include public, hybrid and private cloud options. Those surveyed are building product capability and go-to-market strategies to position themselves within each of the cloud offering models.

Conversely, hardware vendors with relatively rich margins (46% GM consolidated), are reluctant to participate in cloud service models for technical support, aggregated multivendor solutions and white-label services that VARs require for annuity business. Incurs substantial operating expense to support the needed services would diminish the operating margins from today’s level (16% OM consolidated). Hardware vendors are more likely to leverage those services in other places in the value chain.

Software Vendor Business Model Review

Similar to the hardware vendors interviewed, software companies see great opportunity in the cloud environment. They invest heavily in R&D to continually improve the high margin (64% consolidated GM) software products and services associated with their core businesses. It is equally unlikely that software vendors will look to build the aggregation models needed in the cloud value chain.

Multivendor technical support and white-label financial practices are significantly outside of the application software vendor’s core competency and business model margins. Application software vendors are much more likely to leverage other places in the value chain for needed cloud aggregation services.

Cloud provider models are being supported by many distributors as resellers seek to scale investments in infrastructure across many hybrid and public cloud customers. Few resellers view their own network operating centers (NOC) as sustainable versus large-scale deployments at Amazon Web Services or Rackspace, for example. Distributors occupy a natural noncompetitive, complementary place in the value chain for resellers to leverage.

The cloud reseller model for the VAR is an easy accretive annuity business for the VAR. Our VAR interviews suggest they are evaluating offers from vendors on cloud resale, but are quickly overwhelmed by the need to vet the various offerings against one another. The distributor has historically played this role for the VAR in hardware, and is now a natural place for cloud applications to be vetted.

Conclusions

The interest in, and the market for, cloud computing is large and growing. Secondary research by Goldman Sachs, Gartner Group and others confirm that cloud is a top priority for the tech industry. This study evaluated the historical value chain business models for sustainability in the era of cloud computing. Secondary research included the financial performance of multiple manufacturers, distributors and resellers. Primary research interviews were conducted across the value chain to validate the role of each component.

Our research confirms that hardware and software leaders will continue to focus on product innovation. Cloud models requiring significant multivendor integration services are not attractive for the manufacturer to engage in as a general contractor. At the other end of the value chain, resellers also see requirements for significant vetting of cloud solutions and cloud white label services, but have no appetite to participate in those types of endeavors. Distributors are building integration capability, along with white label services that will fill the need for both vendors and resellers.
The cloud is here today. Distribution partners are well-positioned to help drive, support and enable channel success on this front. As a channel leader, you are in a unique position during these formative times for the overall tech industry’s future. Your company may already have cloud practices under way with distributors. Ask if they go far enough. Explore how to take them further. Take a methodical approach that puts your company in the best overall position to maximize cloud success.

Here’s a checklist to help ensure your company is on the right channel cloud track:

- Distribution/channel strategy in place for volume business cloud-based solutions
- Education & enablement approaches identified, planned and implemented
- Service infrastructure evaluation conducted with corporate headquarters to ensure clear understanding of how distribution can further advance overall cloud business
- Comprehensive ecosystem development, measurement and continuous improvement through industry best practices

Whether on premise in a private cloud environment, via a public cloud solution or hybrid offering, distributors can bring unprecedented channel value your way. Today, far too many “point products” address only a portion of the comprehensive cloud solutions that will gain momentum in the months and years ahead. Your distributors can provide the business and technical guidance as well as the infrastructure to aggregate your offerings in cohesive integrated cloud programs.

Now is the time to advance your distribution partnerships in the cloud – and properly educate the reseller and SMB community. The stakes are high, and the wait-and-see approach will likely leave you behind more proactive competitors. Distributors know from profound experience what it takes to drive results as industry dynamics change and new opportunities emerge. You’ll want their added value and reach on your side no matter what cloud path you choose!

Key Finding:
The cloud does not fundamentally change the Value Chain from manufacturer to distributor, distributor to reseller and reseller to end customer. In fact, the research shows additional opportunity and benefit for all parties. Most significantly, the distributor role may expand exponentially as an aggregator and support specialist in the cloud.