

Enterprise Challenges: The VAR vs. the Cloud¹



By Gary Audin, Delphi, Inc.

What's Happening in the IT Market?

As more companies, government agencies and educational institutions move to the cloud, OEM equipment sales through VARs to these organizations are bound to be affected. The OEMs may sell equipment to the cloud providers but the VARS and resellers to enterprises will probably lose business to the cloud.

The enterprise will be challenged. Should the IT and communications functions stay in-house or reside in the cloud? Is a balanced, hybrid solution best? The CIOs job will change and the IT staff may be significantly reduced if cloud services are selected.

The VARs may not all survive. VARS will need to adjust their business models. In any case, the cloud will influence the future of VARs and their customers, the enterprise.

The Many Forms of Cloud Services

Cloud computing is not a technology. It is a form of outsourcing for part or all of the equipment and software that is used by an enterprise. The servers, applications and operational staff are all located at a remote location and managed by a third party organization. This is called a public cloud. It is common that the cloud provider uses virtualization in their server farm supporting multiple enterprises. The user accesses the cloud and its services via the Internet. The services are offered in a variety of forms and are usually pay-as-you-go:

- **IaaS** – Infrastructure as a Service providers offer one or more servers operating on a network which includes data storage and systems software for use by the customer. The IaaS is designed to replace a datacenter. The Amazon Elastic Compute Cloud (EC2) and Verizon Business are only two of many examples.
- **PaaS** – Platform as a Service adds the maintenance of operating systems, server hardware, load balancing and varying compute capacity to the IaaS model. The customer runs their existing applications and can develop new applications with this service model. Microsoft's Azure and Salesforces.com are examples of PaaS.

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- **SaaS** – Software as a Service provides all the functionality of user applications accessible through a Web browser. This eliminates the common concerns of IT such as application development, service backup, storage and archiving of data. Google's Gmail and apps and Salesforce.com are examples.
- **CaaS** – A special case of SaaS is called Communications as a Service, Unified Communications as a Service, Hosted PBX and Virtual PBX. CaaS/UCaaS places hard and/or softphones at the customer's location accessing the CaaS/UCaaS through the Internet. It also provides local and long distance service and connection to the PSTN. There are about 210 CaaS/UCaaS providers offering services in North America.

The Traditional Roles of the VAR and Reseller

An IT Value-Added Reseller (VAR) is a business that adds features and/or services to hardware and then resells it to enterprises as an integrated solution that is delivered turn key to the enterprise. An IT VAR usually bundles software with the supplied hardware. The added value commonly includes professional services such as implementing the solution, integrating the solution with the enterprises' existing environment, customization, consulting, training and supporting managed services.

A reseller is a business that purchases products with the intention of reselling them rather than using them. Selling devices such as telephones, PCs, test equipment, other forms of electronics is common. The reseller does not add any value to the product. A different type of reseller buys used and surplus IT equipment, refurbishes the equipment and then sells and may maintain the equipment. This business does not add any value to the products sold.

VAR Challenges

Enterprises can divest themselves of their IT operations by contracting for cloud services. The cloud can be cheaper to use. Many enterprises do not see IT as their business but only as a tool to support their business. The VARs competition from the cloud will depend on the service the enterprise selects to use. Below are the possible consequences that the VAR will have to adjust in their sales to the enterprise.

- **IaaS** – Hardware sales of servers, storage and related components would be to the IaaS site. That site's VAR would benefit but the VAR servicing the enterprise would lose business. The VAR could offer software to the enterprise. The enterprise would only need workstations, a LAN and WAN access devices to connect to the IaaS site. It may be possible for the VAR to offer IaaS monitoring services to the enterprise.
- **PaaS** – Hardware sales of servers, storage and related components would be to the PaaS site. That site's VAR would benefit but the VAR servicing the enterprise would lose business. The enterprise would only need workstations, a LAN and WAN access devices to connect to the PaaS site. The VAR could offer software to the enterprise. The VAR probably can not offer managed services to the enterprise. The VAR may offer PaaS monitoring service.

- **SaaS** – This service has the biggest potential to compete with the VAR. The VAR would have little hardware and probably no software to sell to the enterprise. There is no opportunity for the VAR to sell managed services.
- **CaaS** – This service is very similar to SaaS. IP PBX, UC and collaboration services and software sales and managed services would all be supported by the CaaS. Endpoint devices such as phones and video devices are the likely hardware that the VAR could offer.

Perspectives

The Local VAR

Matt Brunk (nojitter.com blogger) is President of Telecomworx www.telecomworx.com. Telecomworx is a Maryland interconnect company offering traditional and VoIP commercial telephone and voice mail systems. They provide network installation, automated data backup systems, email security, firewall protection, LAN/WAN products, battery backups, paging equipment, call accounting software, music-on-hold announcers & productions, power protection, email security, conference telephones and headsets.

Matt said the negative aspects to Telecomworx of the cloud competition are:

- The less than 10 station communications market is going to the cloud. As companies mature and grow, they may not come to Telecomworx or another dealer/VAR but stay with the cloud.
- The cloud offers click and pick convenience.
- The allure to the business is lower CAPEX.

Matt also feels there is a positive side to the cloud:

- Cloud users sooner or later will need help locally from a company like Telecomworx.
- Telecomworx's best selling cloud service is MXLogic/McAfee (security)
- There will be cloud customer churn. The customers that are unhappy and leave cloud/hosted services want a solid solution. They will come back to someone with a premise solution.
- OPEX for the cloud is out of control.

Matt goes on to say "What I can't understand is how any rationale business will spend more money on a hosted solution that after 24 months could have purchased or leased a system and been less expensive. We've lost some deals that clearly showed this.

On the other hand, we have customers that if they move into SIP trunks, they would go from \$600/month down to \$130/month for their telephony solution. However the cost of getting in, even with a promotional rate (lease to own 13 months with an effective interest rate of .0825%), they still choose to do nothing. During that 13 month period they would pay \$780/month but after that, down to \$130/month and the system investment has a 7-year factory warranty. So they are cash tight, hosted dazzled or something else? The same hosted solution costs \$450 per month (not including bandwidth) and does not include infrastructure improvements.

I think we are losing sales short term and there is a strong focus only on CAPEX.”

The Regional VAR

Jeremy Benoit is the Network Integration Services Manager at CNP Technologies www.cnp.net. CNP Technologies provides Unified Communications, Network Integration & Support in the Southeast, and Hosted services to clients throughout the United States. CNP is an IP Telephony systems provider and eight-time Circle of Excellence Award winner as well as a Microsoft Gold Partner with a focus on virtualization technologies.

CNP has small to medium size customers. CNP has not seen a major shift to hosted/cloud based services in the past 3 year's offering such services. They do offer Office 365 by Microsoft and other third party private label services. Many of their customers are still asking “What is the cloud and what does it do for me?” Internally, many in CNP see the cloud as a variation of outsourcing, something that is not new. Most customers still want to buy their systems from CNP.

Hosted Microsoft Exchange and providing backup services are their primary hosted services. Their hosted customers have nearly all renewed their agreements with CNP. Some customers are opting for private clouds and embracing virtualization provided by CNP.

Jeremy does not foresee any internal staff changes nor a modification of the CNP business model in response to the growth of hosted/cloud services.

The Distributor

Ingram Micro Inc. is the world's largest worldwide technology distributor for the IT industry. Ingram Micro creates sales and profitability opportunities for vendors and resellers through marketing programs, outsourced logistics services, technical support, financial services and product aggregation and distribution.

Renee Bergeron, VP of Managed Services and Cloud Computing spoke at the recent Ingram Micro Cloud Services Summit. Bergeron views cloud services as complex and believes that the reseller has a significant place in the cloud services market. She expects enterprises to rely heavily of the VAR as a trusted advisor. She believes that “the role of distributors and resellers will be reinforced by cloud services integration.”

She cautioned that there will be challenges faced by VARs to entering the cloud services market. These include locating the right providers, protecting the VAR's revenue and

training the VAR sales force. Bergeron believes VARs should get into the cloud business early or they could be left behind.

The Used/Refurbished IT Vendor

Hank Laws is the Business Development VP for KruseCom. www.krusecom.com. KruseCom offers solutions for I.T. Asset Management. Their specialties include Secure and Certified Onsite Data Erasure, Data Center Maintenance, and End-of-Lifecycle Services for everything in Information Technology. KruseCom is a market maker of used and refurbished technology.

Hank believes his business will be flexible enough to weather the changes that will occur with the growth of cloud services. KruseCom has evolved into a brokerage operation that has little inventory in the warehouse. He says that “there will always be a market for used equipment whether an SMB, enterprise or cloud provider. As equipment reaches its end of life, the market eventually dies out for particular equipment except for those customers who for one reason or another need to maintain older equipment. The parts market then becomes very profitable even though the equipment itself has little value except for parts”. Hank believes that their business model will continue to evolve and that the cloud services industry will not adversely affect KruseCom.

The Hosting Service Provider

Ken DiSessa is Vice President of Blue Hill Data Services www.bluehilldata.com. Blue Hill Data Services provides IBM mainframe, iSeries and server based hosting services from a fully redundant data center in Pearl River, NY. They offer a suite of managed services including full operating system support, network management, backups and disaster recovery. The mid size enterprise, for example with 150 servers, is a prime candidate for their hosting service, so are enterprises with IBM mainframes and AS/400 systems. Blue Hill mostly supports PaaS.

Ken says “the cloud is slightly different than hosting. Hosting has been around for many years. The difference he has observed is that virtualization has boosted efficiency and made hosting even more attractive. The enterprise that sees no advantage to owning their IT data center comes to them for service.”

When asked how hosting would affect the VAR, Ken said “they, Blue Hill, still has to buy hardware and software. So the VAR may be selling more frequently to hosting companies than to enterprises, but the VAR will still be in business”

The Media View

Doug Green is the publisher of The Telecom Reseller and UC Networks. www.telecomreseller.com. Telecom Reseller reports on Unified Communications for enterprises and SMBs. Telecom Reseller reports extensively on both customer premises based solutions such as Hybrid and IP-PBX as well as cloud based and hosted platforms. It is available in print and online.

Doug took a business model view of the VAR vs. the cloud. Doug believes that the competition from the cloud/host community will force more VARs to sell cloud/hosted

services. VARs make their money up front with the sales of hardware and software. The payments from cloud and hosted services companies may be a commission similar to the profit from traditional sales, although the margin can be smaller.

Doug believes that since premises based systems do in fact have a future, the VARs will have a future in selling and installing them. However, cloud service providers will want to sign up VARs to offer cloud services where the cloud makes sense for the customer. This means both the VARs and cloud providers will have to make changes. Providers might consider payment plans where the VAR receives more money up front to approximate the reward the VAR normally receives for selling premises based solutions. This would be a way of not letting the VAR hold all of the implied risk. At the same time, VARs need to find ways to change their cost structure so they can more afford to live with stretched out payments for services verses the one big payday they have built their business model around.

The Consultant View

Byron W. Battles (www.battlesgroup.com), Past President of the Society of Telecommunications Consultants, is an independent telecom consultant who helps clients find the appropriate communications solutions to support their business objectives. His clients have included healthcare, banking/financial, government, publishing, manufacturing, associations, museums, professional services, and telecommunications manufacturers and distributors.

Byron believes that if the enterprise looks at a short turnover of technology, typically 3 years, then hosting total cost of ownership (TCO) looks attractive. However, if the enterprise considers a 4 to 5 year plan or longer, then opting for an owned or leased premises solution TCO looks better. The breakeven point between hosted and premise solutions is usually at 4 to 5 years.

He has had a few enterprises in the SMB range migrate from premise to hosted solutions. One did not want to own IT anymore and wants to "use cloud services" as much as possible. Another client was at the end of life for its IP PBX and did not want to continue support. Hosting was easier to manage and "let someone else take care of dial tone." He believes "dealers want stuff that is easy to sell with continuing revenue." If hosting is easier, then that is what the dealer will tend to pursue.

The Effects on the Enterprise

The enterprise has four choices moving forward:

- Stay with the VAR and implement their systems on site
- Move everything to one or more cloud services
- Create a hybrid solution that is a combination of onsite and cloud services
- Create a private cloud within the enterprise

No matter what course the enterprise selects cloud services have to be investigated. The CIO needs to justify the solution independently of which of the four directions is selected. If a hybrid or full cloud solution is recommended to enterprise management, the CIO has to deal not only with the financial issues but what affect the cloud solution will have on the IT organization and staff.

Assuming some or all the IT functions are moved to the public cloud, the enterprise's CIO and IT staff will encounter one or more of the following questions and situations:

- The CIO's role will change into managing contracts and monitoring cloud services.
- Will managing IT be reduced to a management level and there will be no need for a C level person for IT?
- The CIO will become much more of a financial manager constantly reviewing market rates looking for cost competitive services.
- The CIO and enterprise will no longer own the IT assets.
- The enterprise now has to formally create a mechanism to measure the effectiveness of the CIO and the contracted service provider(s).
- There will be staff reduction for operations personnel. How will the CIO and enterprise handle the staff reduction?
- Once an enterprise moves to cloud services, it will be difficult, time consuming and expensive to bring the services back in house. So moving to the cloud is much more of a total business decision that needs to be supported by other C level executives.
- How does the CIO prevent provider lock-in?
- Can the CIO move to another VAR that sells the same services?
- Are the applications portable to another SaaS? Moving from a PaaS or IaaS is less difficult because the enterprise controls the applications.
- Moving from one CaaS/UCaaS may only mean a change in the telephone and/or softphone software and some user training.
- The IT staff will deal more with the internal customers, providing advice, supporting training and dealing with service problems.
- The enterprise is the customer but who is the provider. The VAR may be a private label reseller. Is the VAR the provider when problems or changes occur? Does the private label provider working through the VAR have any direct responsibility when the enterprise has issues with the service?

- The smaller the enterprise, the more likely the cloud services will be managed by a single person. This can be dangerous if that person is not competent or leaves the enterprise.

Changing the VAR Business Model

No one can really be sure how the cloud and the VAR markets will coexist. There will be some changes coming. So the following thoughts are possibilities and VAR reactions that may become reality.

- The VAR that waits to see what happens with the cloud market will be too late to take advantage of the potential sales.
- The VAR that packages everything together may win SMB business because the customer wants one bill to pay and one source for the products and cloud services.
- A VAR could lose business to a competing VAR from the same provider. The migration from one VAR to another VAR selling the same service can be easily accomplished. This is called customer poaching.
- The VAR may gain hardware, software and implementation sales if the enterprise decides to create an internal private cloud.
- The VAR may be vulnerable if the cloud provider, especially a large provider, can bypass the VAR and deal directly with the enterprise. It may be safer for the VAR to work with smaller cloud providers.
- The Managed Services business could be reduced by cloud competition.
- If the VAR loses business to a cloud provider, then the VAR implementation and support staffs will have to be reduced. These staff members could move to cloud providers, but the VAR would also be reducing its revenue.
- If the OEMs discover that the VAR sales are reduced, then the discount and profit margins for the VAR will also be reduced.
- If the VAR sells cloud services, the VAR needs to retain some staff for cloud problem resolution and training.
- The proportion of sales staff to support staff will probably increase.
- The big cloud providers will probably force some of the small providers to cease business or buy them. This will affect the VARs relationships with the cloud providers and reduce the leverage the VAR may have had in the past.
- If the VAR is receiving a royalty, then the VAR will wait some months or a year before it can recoup their sales cost for the services sold. This puts the VAR in business with the enterprise. If the service is poor and cancelled or the provider

goes out of business or the enterprise goes out of business, then the VAR is out of luck collecting any more royalties.

- Mergers or acquisitions of either the service provider or enterprise may also jeopardize the royalty payments. The VAR may want to negotiate a higher up front commission before the royalty payments begin to cover the sales cost.
- The business models for the VARs will have to change in order to survive the growth of cloud/hosted services. The VAR may reduce staff to mainly sales personnel and eliminate the technical, installation and implementation personnel.

The Effects on the OEM

There will continue to be a market for the OEMs. They will sell most of their products through VARs. However, the larger VARs especially those supporting cloud providers, may gain a larger market share of the sales while the smaller VARs reduce their purchases from the OEMs. This shift will not significantly change the way OEMs do business. OEMs already support large VARs and distributors.

The smaller VARs may receive less attention and smaller discounts from the OEMs and distributors. It is possible that there will be no room for smaller VARs to support the cloud providers. This will force VARs to increase their sales of services to compensate for the lost system sales.

Will there be a Major VAR Shakeup?

Probably not. There will be a migration to more cloud services which the VARs have to embrace and modify their business models, staff and means of generating revenue. The VARs are creative and will find ways to survive and prosper. The impact on the enterprise IT operations may be harder to predict.

The hype is on the cloud side. If however there are more failures like the recent Amazon EC2 situation in March 2011 where the customers did not have access to the cloud or if there are cloud business failures or the cloud security comes into serious question, then the VARs may be able to still sell many systems.

About Gary Audin

Gary Audin Delphi-inc@att.net has more than 40 years of computer, communications and security consulting and implementation experience. He has planned designed, specified, implemented and operated data, LAN and telephone networks. These have included local area, national and international networks as well as VoIP and IP convergent networks in the U.S., Canada, Europe, Australia, Caribbean and Asia. He has advised domestic and international venture capital and investment bankers in communications, VoIP, and microprocessor technologies.

Gary Audin's many articles can be found on www.webtorials.com, www.telecomreseller.com and www.acuta.org. He writes a weekly blog on communications subjects that can be found at www.nojitter.com and publishes technical tips at www.SearchTelecom.com, www.SearchNetworks.com and www.SearchUnifiedCommunications.com.

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