

Unlocking the Value of Service Provider Assets to Win the SMB Customer

SMB Connected Office and the Channel Experience

Author

Seanan Murphy
Service Provider Practice

May 2009



Cisco Internet Business Solutions Group (IBSG)

Unlocking the Value of Service Provider Assets to Win the SMB Customer

SMB Connected Office and the Channel Experience

As telecommunications service providers (SPs¹) attempt to offset declines in legacy revenues by moving into adjacent segments such as enterprise IT services, they may be overlooking an attractive and underserved market: the small- and medium-sized business (SMB²) sector. To date, SPs have focused their efforts in the highly competitive market for enterprise IT services to build critical mass for service offerings. Nevertheless, SMB customers have the makings of an attractive market for IT providers and SPs due to their:

- Growing need for services as the IT environment increases in complexity
- Lack of IT legacy that would complicate the situation for SPs
- High adoption rates for both IP and mobile technologies
- Limited do-it-yourself substitution

The SMB customer, however, often is viewed as difficult to serve, with small pools of addressable spend per customer, a significant amount of vertical diversity, and often wide geographic dispersion. These characteristics can raise sales and marketing expenses as well as make it difficult to meet the variety of needs within this segment.

Some IT service providers, such as IBM, have achieved a measure of success in the SMB market by creating repeatable, prepackaged plays using price to attract customers while relying on partners to sell their services.³ According to IBM, packaged services are approximately one-third the price of traditional, labor-based consulting engagements.⁴

In the context of telecommunications, large service providers often address SMB customer needs through simple extensions of existing consumer offerings or slightly repurposed enterprise services. Little effort has been devoted to taking advantage of incumbent providers' SMB customer touchpoints. Apart from fixed and mobile voice, SPs have struggled to crack the code of scaling managed services for SMB customers. Solving this issue will unlock the door to a large proportion of total global IT spending.

1. Telecommunications service providers are referred to as SPs throughout this white paper.

2. SMBs are defined as firms employing between 20 and 999 employees. Firms outside this range are "small office home office" (SOHO) or enterprise.

3. "IT Outsourcing and Managed Services, A Triple Tree Industry Analysis," Triple Tree, 2005.

4. Technology Business Research (TBR), IBM Global Services, Fourth Calendar Quarter 2006, page 9.

A “new breed” of third-party providers with offerings such as software-as-a-service (SaaS), infrastructure-as-a-service (IaaS),⁵ and platform-as-a-service (PaaS) is beginning to penetrate the SMB market through increased scale, “one-stop shop” delivery of services, and intense focus on customer experience. Increasingly, the network is becoming the delivery platform for this next generation of services. The growing consumption of multitenant, on-demand infrastructure and applications creates an opportunity for integrated SPs to address SMB customers in new ways. Providers can capitalize on their impressive selection of offerings and extensive customer touchpoints, in addition to placing their core assets—wireline and wireless networks—at the center of on-demand offerings.

To position themselves best, SPs need to address this emerging opportunity. First, they must architect compelling—and extensible—offers built around SMB customers’ need for collaboration-centric solutions, “anywhere accessibility,” and their rising adoption of SaaS. One example of such offers is what we call the “Connected Office,” which we discuss in more detail (see Figure 4). Second, SPs must rigorously focus on their SMB customer relationships, expand their view of customer touchpoints, increase channel productivity, and become the channel of choice for next-generation SPs. These two aspects are mutually reinforcing, with a well-constructed offer making it easier to sell, and increased channel productivity attracting the third-party providers that could further extend the offer and monetize channel investment while improving customer experience.

SMB: An Attractive Segment

Due to their need to be lean operators, SMBs lack the do-it-yourself IT competition of enterprise customers; this is especially true as the size of the customer decreases. At the same time, the SMB needs technology to stay connected with its customer base and to operate the business. SMBs’ need to stay lean and keep headcount low—coupled with a requirement for technology—drives them to seek third-party provided services and easy-to-integrate solutions (see Figure 1). This is reflected in the fact that services represent 40 percent of total U.S. medium-sized business IT spending.⁶

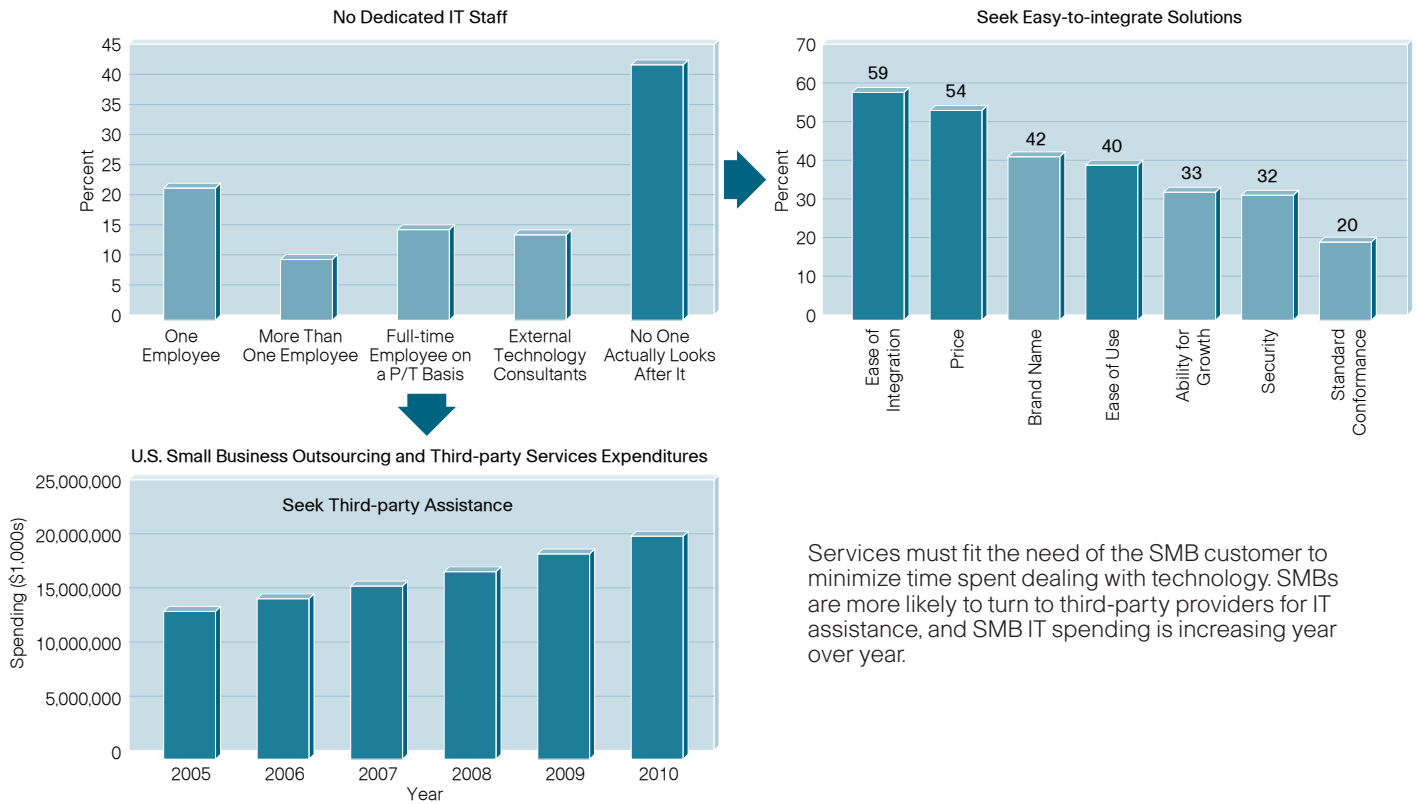
As a whole, SMBs account for 48 percent of total information technology spending (including telecommunications)—and their yearly spending is growing faster (8.1 percent) than that of enterprises (estimated at 7 percent, but more recently revised downward).⁷ At the same time, the composition of SMB spending is shifting away from traditional telecommunications services to IP, mobility, and IT.

5. Infrastructure-as-a-service is sometimes referred to as utility compute and storage and, more recently, as a service component of cloud computing.

6. “2006–2007 U.S. Medium Business Overview and Market Assessment,” AMI Partners, 2007. Note that “medium business” is defined as between 100–999 employees. The ratio is close to 50 percent of IT spend once telecommunication services spend (minutes and bytes) is excluded.

7. “Economic Crisis Response: Worldwide IT Spending 2008-2012 Forecast Update,” J.F. Gantz, S. Monton, A. Toncheva, IDC, 2008; “Economic Impact on IT Spending: Market Dynamics & Insights on US IT Spending,” K. Burney, Compass Intelligence, 2008.

Figure 1. SMBs Turn to Third-party Providers for IT Assistance



Services must fit the need of the SMB customer to minimize time spent dealing with technology. SMBs are more likely to turn to third-party providers for IT assistance, and SMB IT spending is increasing year over year.

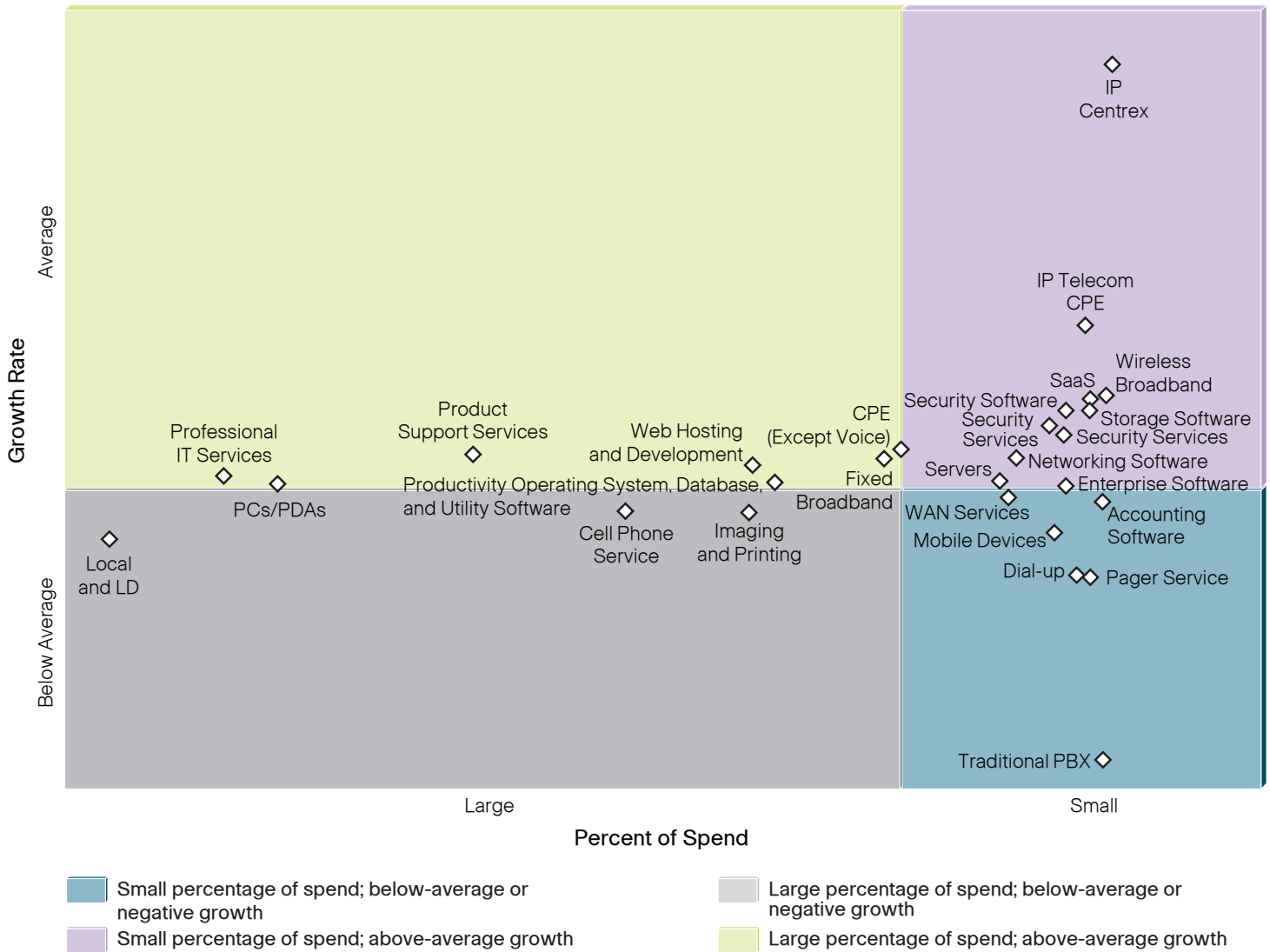
Sources: "Ease of Integration for Routers, Switches and Hubs Is Top SMB Purchase Driver," Yankee Group, 2004; "U.S. Small Business Outsourcing," Compass Intelligence, 2005; "U.S. Small Business Overview," AMI Partners, 2005-2006

Capturing SMB Segment Value: Barriers to Success

Achieving significant penetration of IT services within the SMB segment is a challenge for large-scale providers that also serve enterprise customers. Services more frequently are provided by local, value-added resellers or small-scale IT shops. IT services often are offered using a "high touch" model, which is largely driven through application labor utilization instead of through operational leverage. In contrast, SPs typically have had greater success in this segment due to the relatively undifferentiated nature of the product offering as well as operational leverage.

The IT services market has traditionally regarded the SMB segment as too difficult and too expensive to address profitably with the typical "high touch" IT approach to services. An individual SMB's IT budget is extremely small when compared to the average enterprise spend. SMBs have a much higher business failure rate and tend to be geographically dispersed, adding to the lack of attraction. As a result, SMBs' IT needs often go unmet and the opportunity remains untapped.

Figure 2. IT, IP, and Services Drive SMB Spending Growth (Relative Spending and Growth, 2008–2010)



Source: Cisco IBSG analysis (2007) of AMI Global Model, 1H 2006

Next Generation of IT SPs Cracks the Code

The next generation of IT service providers takes direct aim at the bread-and-butter activities of IT services firms—namely installation and customization, integration, and operations, making it possible to offer IT services at a low incremental cost per customer. Next-generation providers offer multitenant, hosted solutions over the Internet, typically with a simple online sales process, on-demand provisioning, and rapid time to productivity through deployment of basic productivity tools, collaboration applications, and seamless application enhancements.⁸ This low-cost, high-touch

8. "Software as a Service Update," Triple Tree Industry Analysis, Spotlight Report, Q4 2006.

combination is successfully attracting SMB customers. Next-generation providers of services such as IaaS, SaaS, and PaaS are not only disrupting the software industry, but changing expectations for the way IT services will be provided.

Three key characteristics of next-generation services allow SPs to crack the code of the SMB market:

Scale—Next-generation models scale across customers. Their unique characteristics—sharing infrastructure and software across customers—drive the low incremental cost per customer typical of a largely fixed capital investment. Providers make significant up-front investment in capabilities (research and development in software creation or providing a good customer experience on the Internet requires a sophisticated infrastructure). In contrast, traditional IT service providers operate largely variable-cost businesses. These differences turn the model on its head, requiring next-generation providers to sign up as many customers as possible instead of seeking large pools of spending.⁹

One-stop Shop—Next-generation providers also tend to “preintegrate” with an ecosystem of partners or offer easy integration through APIs. A preintegrated ecosystem of services offers the SMB customer a “one-stop shop” for IT, all of which can be purchased on a monthly basis or through advertising-supported models. As a result, SMB customers reduce or eliminate time spent finding, negotiating, installing, integrating, or operating their IT infrastructure, and can focus on core business activities.¹⁰ For example, Circle L, a commercial roofing company in Florida with 800 employees in 10 locations, used SaaS solutions and reduced its IT headcount from 15 to 2. It also eliminated redundant business processes, increased productivity by 50 percent, and reduced manual reconciliation and auditor time expense by more than \$100,000 a year. Circle L implemented SaaS in one week, which yielded immediate return on investment.¹¹

Customer Experience—Although next-generation providers take advantage of software and infrastructure sharing to drive the cost of service down, they also maintain an intense focus on customer experience. These providers recognize that an outage can have serious business impacts¹² and that ease of use is essential to adoption. Many provide web-based training and detailed information online about their offerings.¹³ At the same time, they address the significant transaction costs¹⁴ that may be associated with a services contract by making it easy for customers to adopt these services; customers can adopt some of these solutions without ever speaking

9. For a good discussion of these characteristics and their impact on the business model, see “SaaS Success,” Treb Ryan, CEO, Opsource, Inc., *Upgrade*, Software & Information Industry Assn., October/November, 2007.

10. For a good discussion on the impact that reducing these costs may have on the attractiveness of SaaS relative to commercial, off-the-shelf options, see “The Business Model of ‘Software-as-a-Service,’” Dan Ma, School of Information Systems, Singapore Management University, 2007 IEEE International Conference on Services Computing (SCC 2007).

11. <http://us.intacct.com/customers/#circle>

12. In 2005 and again in 2006, Salesforce.com experienced a much-talked-about service disruption (“Salesforce.com Outage Cuts Users Off,” Stacy Crowley, IDG News Service, *Infoworld*, December 20, 2005). Since that time, Salesforce.com provides online system status, both real-time and historical, at <http://trust.salesforce.com>

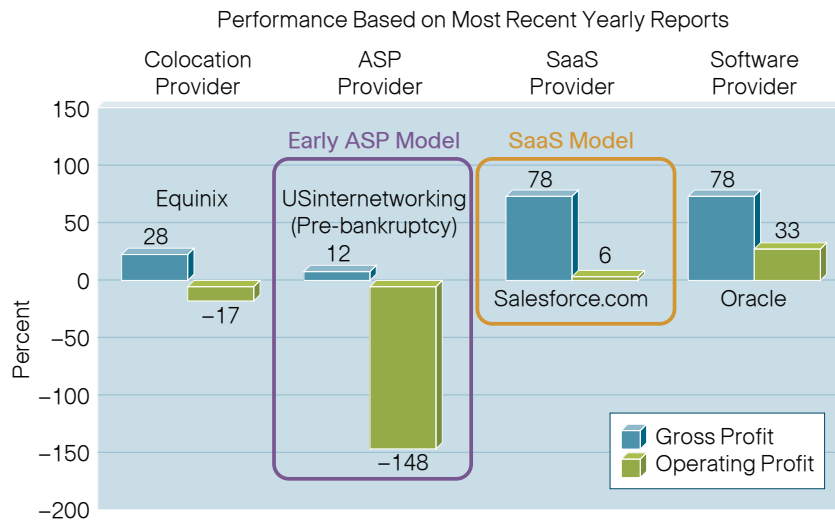
13. For example, WebEx provides robust online training on WebEx University: <http://university.Webex.com/training/student/content/welcome.do>

14. For a good discussion of transaction costs and IT services, see “Production and Transaction Economies and IS Outsourcing: A Study of the U.S. Banking Industry,” Ang, S., & Straub, D. W., *MIS Quarterly*, 535-552, 1998.; transaction costs refer to “the effort, time, and costs incurred in searching, creating, negotiating, monitoring, and enforcing a service contract.”

to a sales representative, and use sophisticated IT services within a day (for small businesses), or a week or two for larger operations.

The low incremental cost of offering these services, “no touch” provisioning, minimization of customization and integration, and ease of use make it economical to serve the needs of SMB customers. This next generation of IT service providers solved the problem of how to serve the SMB customer, and built critical mass in a long-underserved market, setting the stage for business-model disruption of the IT services market (see Figure 3).

Figure 3. Financial Model Comparison: SaaS versus ASPs



Sources: Cisco IBSG analysis of company financial data for Equinix 10K, December 31, 2005; USInternetworking 10K, December 31, 2000 (last year reporting); Salesforce.com 10K, January 2006; Oracle 10K, December 2005.

A number of factors will boost adoption of this next generation of services:

- Increased availability of connectivity through broadband wireless
- Investments in increased security and flexibility of data storage options
- Ease of customization and integration through APIs and “mashups”
- Entry of a younger, Internet-savvy generation into the workforce

Software-as-a-service in the United States is expected to grow to \$11.5 billion per annum by 2011,¹⁵ with some estimates as high as 25 percent of total enterprise application spending per annum by 2011,¹⁶ which could represent \$186 billion¹⁷ in total global spending.

15. “SaaS Demand Set to Outpace Enterprise Application Software Market Growth,” Gartner, Inc., 2007. A more recent Gartner study expects the market to grow to \$14.8 billion in 2012 (“Gartner Says Worldwide SaaS Revenue in the Enterprise Application Markets Will Grow 27 Per Cent in 2008,” Gartner Research, October 22, 2008. Retrieved December 12, 2008, from Gartner: <http://www.gartner.com/it/page.jsp?id=783212>)

16. “Saugatuck Insights on SaaS and On-Demand Infrastructure Adoption,” Charlie Burns, Mike West, Saugatuck Technology, Westport, CT, 2008. These estimates are underscored by a recent study conducted by McKinsey & Company and SandHill Group, in which enterprise customers expected to allocate 21 percent of their application budgets to subscription-based and on-demand software models (“Enterprise Software Customer Survey,” Dubey, A., Mohluddin, J., Baljal, A., & Rangaswami, M., McKinsey & Company, SandHill Group, 2008). Similarly, Merrill Lynch estimated that 12 percent of the total software market, estimated at \$744 billion by 2011, would shift to “cloud” providers, creating a \$95 billion market (excluding advertising revenues) by 2011. If potential advertising revenues are included, the number climbs to \$160 billion (“The Cloud Wars: \$100+ Billion at Stake,” Merrill Lynch, 2008).

17. For the top end of our estimates in Figure 6 (below), we use the more conservative estimate of \$95 billion in 2011 from “The Cloud Wars: \$100+ Billion at Stake,” Merrill Lynch, 2008.

The Network Is the Platform—SPs Can Capitalize on the Shift

The shift to providing services over the network instead of on premises will benefit SPs as the next generation of service providers strives to expand its reach to the business customer, spending 30 to 60 percent of its revenues on reaching the market and shifting delivery of IT onto the Internet instead of on premises.¹⁸ SPs' product portfolio of wireline, wireless, and IT services, as well as their extensive customer touchpoints, position providers to take advantage of this shift and retain their base of small- to medium-sized business customers.

To address the three characteristics described in the previous section (scale, one-stop shop, and customer experience), SPs will need to:

- Architect more holistic, easy-to-use, highly scalable service offerings targeted toward the SMB customer, with highly attractive, collaborative offerings at the core
- Attract next-generation service providers as partners to monetize touchpoints
- Invest in creating a better customer experience across their customer touchpoints

These investments are mutually reinforcing, as they enable a platform for the creation of organic ecosystems to integrate SPs' services easily into applications through mashups.

The Connected Office: The Next-generation SP Offering

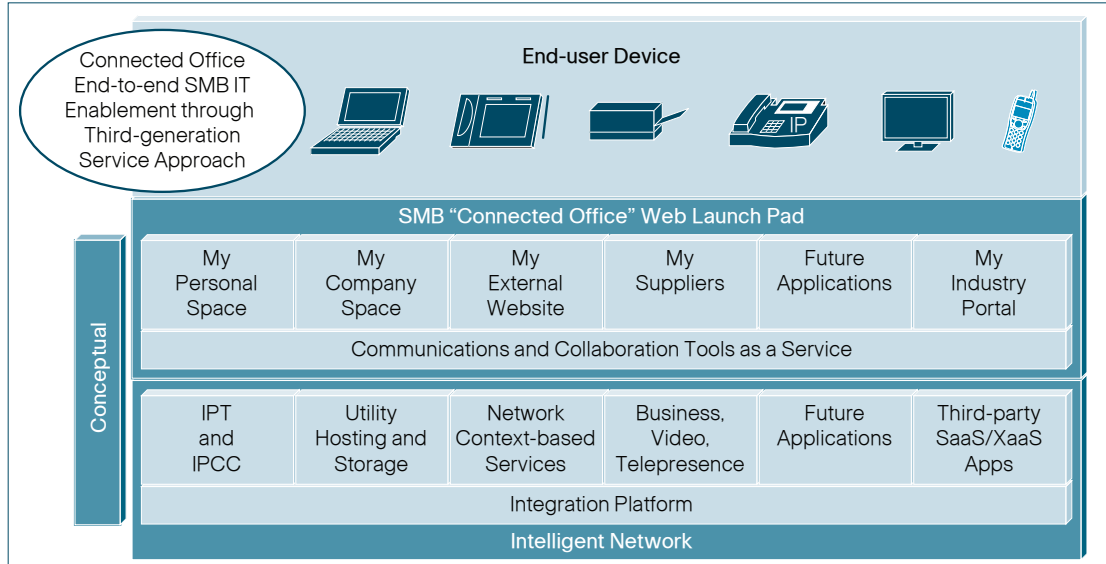
The Connected Office is a foundational set of services that can be extended through partner-provided applications and services to meet the specific needs of particular SMB segments or verticals. These foundational services not only must include the right components (from a service perspective), but also must collectively and individually be offered as extensible services using web services or other service-oriented architecture (SOA). Extensibility will enable these components to integrate directly into applications through mashups. Finding ways to truly integrate these products in a value-added way—not just bundling them—is important to reducing churn.

The Connected Office (Figure 4) is a collaboration-centric solution¹⁹ that extends to mobile devices and integrates into the SP's portfolio of offerings, which may include network context services (presence, location-based services), e-commerce platforms and hosted sites, hosted IP contact centers, and third-party applications.

18. For example, in the most recent Salesforce.com 10K, sales and marketing expenses (in thousands of dollars) are \$376,480, while total revenues for the year were \$748,700. Sales and marketing expenses represent 50 percent of total revenues. See Form 10-K, Salesforce.com Inc., filed February 29, 2008 for the period ending January 31, 2008. Netsuite incurred (in thousands of dollars) \$57932 in sales and marketing expenses relative to their revenues of \$108,541, representing approximately 53 percent of revenues. See Form 10-K, Netsuite Inc., filed March 26, 2008 for the period ending December 31, 2007. The high percentage of revenues spent on sales and marketing is a function of these companies being "new entrants" into the IT market and seeking to gain share. But this spending must be balanced against continued product development and other priorities. Thus, highly productive routes to market are critical.

19. Gartner estimates that content, communications, and collaboration markets are the single largest contributor to SaaS markets. "Gartner Says Worldwide SaaS Revenue in the Enterprise Application Markets Will Grow 27 Per Cent in 2008," Gartner Research, October 22, 2008. Retrieved December 12, 2008, from Gartner: <http://www.gartner.com/it/page.jsp?id=783212>

Figure 4. The Connected Office: SMB Services Market Represents “White Space” for SPs



Effectively constructing a Connected Office vision and roadmap requires an understanding of the most attractive core service components of a compelling SMB offer (such as collaboration and mobility), the synergies among core components (fixed and marginal costs), and the most attractive offer structure (a la carte, basic/premium, all-in-one, and so forth).

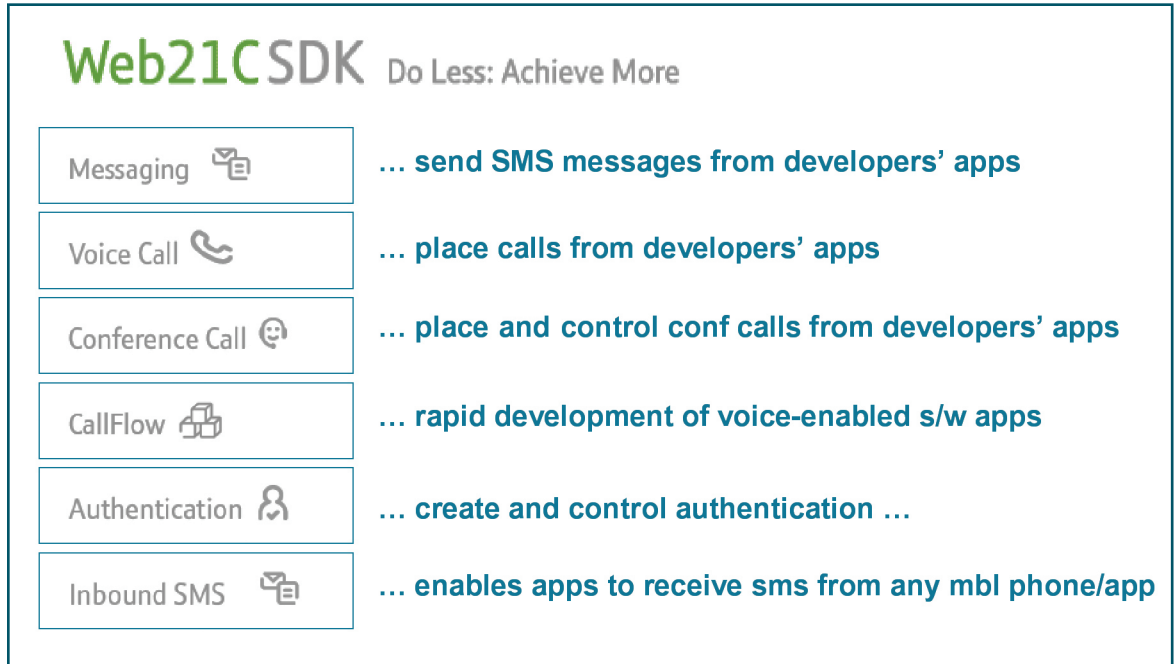
Making it easy for third-party providers to integrate and extend the foundational offer can make the offer a core component of a complete office solution, which raises customer switching costs. Extending the offer requires:

- Opening the foundational offer and telecommunications, compute, and storage capabilities as a platform through APIs, web services, or other SOA
- Creating an easy, low-transaction-cost vehicle for third-party providers to monetize their investment, such as enabling customers to add services to their foundational offer at the click of a button, or sharing advertising revenues

Extensibility through APIs will enable SPs’ components to integrate directly into applications through mashups. Creating a low-cost vehicle for third parties to monetize their investment means that SPs spend less time and take on less risk than is associated with the negotiation-based approach to creating partnerships.

For example, BT has launched Web21C SDK, a set of libraries that makes it simple for developers to consume web services exposed by BT (see Figure 5). In doing so, BT has exposed its network assets to developers, creating an improved customer experience for SMB customers.

Figure 5. BT Web21C SDK Offering: Network-as-a-service—Value Add for Application Providers



Source: BT Website, 2007

As BT Web21C SDK demonstrates, SPs offer the attractive and extensible core offering, distribution platform, infrastructure, network context services, and the go-to-market vehicle for third-party providers. This will enable the creation of an organic ecosystem that can extend SPs' core offering at a low cost.

One-stop Shop: Enabling the Next Generation of SPs

To continue to grow, next-generation providers will need to:

- Continue to drive penetration in fragmented and late-adopter SMB segments
- Expand geographically, and/or
- Begin to address the needs of larger customers

Each of these options will require a forward investment in channel, in continued enhancements of the product, and in operations. Although large next-generation providers (such as Amazon, which has a global brand and presence) may have the "reach to succeed"²⁰ in these expansion strategies, most next-generation providers will not. As a result, providers will seek the best channels to reach the market. Determining which channels are "best" requires an analysis of the potential impact and costs of using a particular channel partner.

20. For example, brand name and global presence.

SPs have characteristics that could make them an attractive go-to-market route for next-generation providers, but SPs need to address some of their own weaknesses to become the “channel of choice.” Their strengths include a broad array of customer touchpoints, foundational offers that are typically attractive to a large percentage of SMB customers (communications, storage, and web hosting), and the ability to distribute applications over fixed or mobile environments.

SPs’ history of partnering with portals such as Yahoo! is instructive. Although portal providers recognized the broad reach of SPs and viewed them as a key channel into the consumer market, they found it difficult to do business with them. First, negotiations were lengthy. Then, once deals were signed, integration between the online and telecommunications providers was complex and often failed due to the complexity of SPs’ operating and business support systems; in some cases, order and billing errors seemed to negate the value of doing the deal. Finally, considering that by 2011, the size of the worldwide SaaS market will be in the range of \$11.5 billion to \$95 billion (exclusive of potential advertising revenues), and that sales and marketing spend by SaaS providers ranges between 30 percent and 60 percent of revenue, effective use of SPs’ channels could deliver a win-win situation to both SPs and SaaS providers (see Figure 6).

Figure 6. Using SPs as a Channel Creates Significant Revenue Opportunities for Both SaaS Providers and SPs

	Worst-case Scenario ¹	Best-case Scenario ²
WW SaaS Market by 2009	US\$40B	US\$150B
Sales and Marketing % Spend of Revenue by SaaS Providers³	30%–60%	30%–60%
Potential Savings by Using SP Channels⁴	\$2.4B–\$4.8B	\$9B–\$18B
Potential Freeing of Cash for Revenue Sharing with SPs⁵	\$1B–\$2B	\$4.5B–\$9B

1 IDC Data (assumes that U.S. market is one-third of worldwide market).

2 Triple Tree Data (assumes that U.S. market is one-third of worldwide market).

3 Triple Tree Data (note that Salesforce.com sales and marketing spend has consistently been >50% of revenue).

4 Assuming that ~20% of sales and marketing spend can be saved by taking advantage of SP channel capacity.

5 Assuming that ~50% of savings can be reinvested with SPs in infrastructure.

SPs will also need to address challenges, however, including suboptimal, stovepiped channels as well as lengthy negotiation, integration, and launch times.

Customer Experience: Reinventing the Channel Experience

Most telecommunications providers have an extensive array of existing touchpoints with SMB customers they could enhance to provide a compelling route to market for third-party application and infrastructure providers. These touchpoints may include provider retail stores, presence in big-box retailers, existing customer relationships across both fixed and mobile services, strong customer brands (especially true for mobile providers), “feet on the street,” online portals for bill pay or other services, value-added resellers, and contact centers.

Such a wide array of touchpoints is expensive to replicate, particularly across a wide geographic region. And the experience with service providers—from a service, support, and sales perspective—is often stovepiped. For example, service offerings such as web hosting and network services may be offered by different sales channels; the retail presence may be disconnected from other channels. This abundant array of touchpoints is an untapped opportunity to provide a connected, consistent, and compelling customer experience, making telecommunications providers the “channel of choice.”

Providers need to identify and prioritize the key channel enhancements to increase awareness of their offerings, monetize their channel assets, and increase channel productivity. To illustrate, SPs could enhance their retail stores to create rich experiences for SMB customers by taking advantage of in-store digital signage and interactive demonstrations. SPs could also invest in virtual sales training to reduce the learning curve, create a commerce platform for third-party providers to reduce dependence on “feet on the street” sales, and take advantage of virtual collaboration solutions to increase sales productivity.

Conclusion: Unlocking the Value of SPs’ Assets

The information technology value chain, of which network services and managed services are a part, is undergoing significant change due to the rising adoption of services-oriented architectures and web-centric, on-demand information technology services. Internet investments of the 1990s and important technology developments since that time have combined to create a new way to offer and consume information technology. Investors who ignore this trend will do so at their peril, given the Internet’s ability to reshape leadership dramatically among enterprise technology companies and business models over the next decade.²¹

Service providers can capitalize on the shift to IT “on demand” by developing innovative ways to link their assets to the developing “on demand” ecosystem, reinvigorating the SMB customer’s experience across all touchpoints, and making investments to facilitate service delivery across all types of access. Service providers can also apply “on demand” approaches to the way their services are sold and offered to yield greater profits; reducing transaction costs and increasing scalability through utility are the keys to changing the economic cost equation.

21. “IT Spending Survey: Mapping 2007.” Goldman Sachs Group, Inc. December 5, 2006.

The bottom line is that providers need to take a hard look at all their assets to become the “channel of choice,” which will open a wide array of revenue-sharing and potential advertising opportunities, and expand the SMB relationship by increasing the breadth of connected solutions that the SMB customer buys through the telecommunications provider.

For more information about how SPs can unlock the value of SMBs, please contact:

Seanan Murphy
Service Provider Practice
Cisco Internet Business Solutions Group
Phone: +1 703 484 0526
E-mail: seanamur@cisco.com

Acknowledgements

Aarti Gurnani
Bryan Mobley
Scott Puopolo
Wagdy Samir
Cisco IBSG Service Provider Practice

More Information

The Cisco Internet Business Solutions Group (IBSG), the global strategic consulting arm of Cisco, helps CXOs and public sector leaders transform their organizations—first by designing innovative business processes, and then by integrating advanced technologies into visionary roadmaps that address key CXO concerns.

For further information about IBSG, visit <http://www.cisco.com/go/ibsg>



Americas Headquarters
Cisco Systems, Inc.
San Jose, CA

Asia Pacific Headquarters
Cisco Systems (USA) Pte. Ltd.
Singapore

Europe Headquarters
Cisco Systems International BV
Amsterdam, The Netherlands

Cisco has more than 200 offices worldwide. Addresses, phone numbers, and fax numbers are listed on the Cisco website at www.cisco.com/go/offices.