Changing the Channel

Oncoming Cloud Is Threatening to Storm the Way VARs and Vendors Collaborate

By Jon Lavietes

FOR YEARS, IT VENDORS HAVE RELIED ON third-party Value-Added Resellers (VARs)—a.k.a. “the channel”—to sell their hardware, software, and networking products to customers looking to buy a complete solution rather than engaging in the laborious tasks of shopping for myriad individual components and figuring out if and how they work together. Large IT vendors generally have hundreds if not thousands of VAR partners in their portfolio, and the larger VARs themselves might offer thousands of partner vendor products in their catalog available to them through partnership. Although there is some disagreement on the percentage, it is generally agreed that these relationships tend to be largely transactional for vendors—with a few or none being especially strategic, depending on whom you ask.
“Most technology alliances have traditionally been about getting direct sales teams to collaborate,” said Norma Watenpaugh, CSAP, founding principal of Phoenix Consulting Group, which authored a study of go-to-market alliance best practices that indicated 65 percent of technology alliances utilize the channel as part of their route to market. “Now, we’re finding more and more that companies are taking hardware and software and bundling them in the channel. Companies are paying more attention to the joint solution rather than throwing the pieces over the wall [to a VAR].”

**Clouding the Picture**

Like everything else in technology, the Cloud is having a major impact on this norm. Cloud technologies, defined generally as the delivery of any sort of IT capability as a highly “elastic” or variable service, are shifting how IT vendors and VARs work with each other and driving both to work more collaboratively than they might have had to previously. For years, on-premise hardware and prepackaged software sales have often required many VAR transactions to entail little more than cobbling together a combination of solutions from their partner ecosystem with the aid of a vendor’s technical support and training. When the customer transaction was completed, most of the VAR’s work was done for the moment.

Now, with the Cloud moving into the mainstream—analysts predict Cloud spending will rise anywhere from 20 to 30 percent annually in the next few years—VARs are trying to figure out how to get a piece of the pie. In many cases, they have inserted themselves into Cloud deals by managing a layer of software that helps customers maintain hybrid Cloud solutions that dynamically go back and forth between both traditional on-premise technology and hosted solutions by the hour, or even minute, to optimize resources. Suddenly, VARs need to be much more engaged with their customers and technology partners on several levels before, during, and after pursuit of a deal. These transactions, by and large, have much different dynamics from the familiar license and behind-the-firewall technology sales.

“The challenge for most of the VARs is they are just beginning to learn how to sell IT as a service. They’re optimized for on-prem[ise],” said Tom Halle, CSAP, senior director of global alliances at Savvis.

**Deconstructed Financial Models Threaten to Weaken VAR-Vendor Partnership Foundation**

At the heart of the Cloud challenge for both VARs and many IT vendors is transitioning from the old on-premise financial model, in which revenue for an entire deal could be collected up front, to the subscription model, which parcels out revenue in monthly increments. Now, where an organization could recognize the entirety of a $3.6 million license deal right away, that same customer might force you to collect $100,000 per month over a three-year period if they turn to the Cloud to deliver similar capabilities.

“In terms of the business model, it’s very scary when you run a traditional VAR business and you’re selling a machine a week and delivering services, and you’re doing a billing of $50 to $100 million and making your payroll. Now you’re doing $100 per week for 100 customers, and that’s a big change in the business model,” said Lesley Norris, vice president of global business partners at IBM.

In the short term, this is leading to some less-than-collaborative behavior on the part of some VARs. Oftentimes, a senior executive looking to make quarterly revenue projections may meddle with a negotiation.

“[An executive will say], ‘How excited is the customer about that Cloud deal? Can we flip them back to a more traditional deal?’ There’s a lot of that going on in the VAR community—to every vendor’s frustration,” said Halle.

Decisions are complicated further by the fact that, although it is generally agreed the Cloud is on its way and making tremendous inroads, there is still a lot of money on the table in on-premise deals.

“I haven’t seen any data that says in the next two years 100 percent of the data will be delivered through the Cloud,” said Norris. “I don’t think we’re abandoning the old mindset of buying our own infrastructure.”

This leads even the best-intentioned VARs to try to figure out how much of that familiar short-term on-premise opportunity to sacrifice to prepare for an on-demand world in the long term.

“VARs have the option of selling on-premise equipment or private Cloud or services in a virtual environment. They’re conflicted about which way to go,” said Watenpaugh.

**The Technical Challenge**

In addition to its effects on financial and business models, the Cloud has impacted how things work on the technology side as well. With the Cloud requiring more players integrating more technologies, vendors of all types are getting more involved in what they provide VARs to sell. In turn, the onus is on VARs to get their hands a little dirtier in the design stage of the solution than they have normally been accustomed to.

“VARs really do [have to get into designing technology],” said Halle. “You have to get involved in solving customer business problems. You have to get involved in vendor selection. Picking a Cloud vendor is nightmarish because there’s so many of them and they’re all optimized for different things.”

“What is [the VARs] value-add going forward? If all you’re doing is selling products and taking a percentage, that’s not going to last,” said Watenpaugh.
Toni Adams, vice president of global partner and alliance marketing at VMware.

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Resellers that start engagements addressing customer challenges and help design innovative solutions that solve them will reap better rewards from their vendor partners. VMware, for example, said that it is prioritizing “solution providers”—the company’s term for VARs—that demonstrate strategic value ahead of those who simply ring the cash register more times closing more straightforward deals.

“The big change in the industry is going from a volume model to a value model. The partners that played in the top tier of that pyramid [five years ago] would be partners that sold a lot of stuff. Now, we reward the partners bringing the most value to the company, which might not be necessarily, say, the partners that sell the most volume,” said Toni Adams, vice president of global partner and alliance marketing at VMware.

They also have to get knee-deep in the technology itself. Solution providers that earn VMware Solution Competencies to strengthen their knowledge, and translate it into strategic value for customers, will be differentiated and rewarded, Adams said.

“The way you move through the tiers is not only based on revenue. It’s going to be based on your competencies. It’s going to be based on the investment you’ve made on the vendor front. Yes, that changes the behavior of the partner radically in them saying, ‘For me to get more benefit and differentiation from the vendor, I have to invest more in enablement. I’ve got to get skills up,’” added Adams.

Vendors’ Role in Bringing VARs Along

Likewise, vendors recognize that they must practice what they preach and take collaboration to a new level. They are taking a number of steps to help their channel partners make the transition to selling Cloud solutions. For one, vendors are taking an even more active role in helping VARs reengineer their financial model.

“What people are doing is pouring money into programs to educate the channel,” said Halle.

In addition to educating their own reps on how to help the channel with the transition, some vendors are incentivizing their reps to drive the best deal for the customer with service providers and VARs, regardless of whether it’s on-premise or Cloud, by instituting “comp neutrality”—the practice of compensating reps the same no matter how a solution is sold, which entails a significant up-front investment on the part of the vendor.

Internal Obstacles Within Vendors Remain

Even with these procedures in place, there are still many individual sales reps who will try to avoid the Cloud as long as they can, particularly when traditional deals are still paying bills.

“It’s very hard to teach old dogs new tricks. Reps are always going to lead with what they know, but the savvier ones, if they’re on the verge of losing the deal, will say, ‘OK, I’m going to work with a service provider on this thing. It’s very new and I don’t understand it,’” said Halle.

That sales mentality should also serve as a caution to vendors who think it will be easier to sidestep VARs and sell their own Cloud solutions.

“They don’t know how to fix channel models, so they say, ‘I’m going to do it myself,’” said Halle. “If they think they’re sidestepping the problem, they’re kidding themselves. They’ll have the same problem in their own organization.”

Besides, there is an even bigger risk to circumventing VARs, added Halle. Resellers still hold a trump card in their hands—they cover that last mile to the customer.

“They’re the ones that take the time to build the long-term relationship with the customer, understand their business requirements, understand the particular requirements of that vertical or regulatory regime, be that customer’s advocate out to the various providers of technology.”

Drawing on Past Lessons

Fortunately, there is precedent for a more collaborative relationship with VARs on the technology side of things. Many large vendors have always had a small percentage of channel partners that required a deeper cooperation on technology and business strategy than your typical reseller relationship. Norris insisted the wheel does not have to be reinvented in this regard, and there are plenty of instructive lessons from the past and present. As an ex-
ample, she cited Big Blue’s relationship with one particular partner that sells software solutions based exclusively on IBM to community banks.

“We are basically successful or unsuccessful together in that space. Those are certainly more strategic than the situations where they say, ‘In this particular situation, IBM System X is the right answer.’”

Norris said that IBM has utilized joint account planning, health checks, a charter, and rules of engagement with channel partners for years, and that IBM is no stranger to inviting reseller allies to codevelop business and technology strategies.

“We have regular executive discussions with these companies to talk about what we see in the marketplace, where things are going. Is our relationship improving over time? Are we getting better at collaboration?”

Similarly, VMware convenes regular “partner advisory councils,” a cross-section of partners that discuss the issues they are seeing in the marketplace and generally function as “a proxy for the broader partner base,” according to Adams. Different councils tackle different issues; for example, a marketing council helps shape joint VMware-partner campaigns and programs. Although VMware’s top-of-the-pyramid reseller relationships may not necessitate the complex rules of engagement or intricate governance models required for its strategic technology partnerships, such as the ones it has with Cisco, Dell, EMC, HP, NetApp, and VCE, the company has various high-touch models for the proactive partners hungry for detailed product information. Moreover, the company provides active marketing campaign support for their channel partners that goes beyond the simple self-service portal that contains the latest sales and marketing collateral.

The Future Is Near. But How Near?

So how long do VARs and vendors have to get their ducks in a row? While most in tech agree that the industry as a whole will eventually have to fully embrace the Cloud, no one is sure when. Nevertheless, one thing seems certain: VARs and tech companies have time to figure it out, and forward-thinking vendors and channel partners are preparing for this transition now.

“The way I see them stepping into this is very slowly and in a controlled part of their business where they can start to kind of understand the dynamics surely without going full-bore into a Salesforce.com type of model. I’m not convinced all of our customers want to go there, quite frankly,” said Norris.

“Ultimately, it really depends on the demand and adoption from the customer perspective,” Adams said.

In the meantime, the smarter vendors and their committed channel partners will use the time wisely.

“At the end of the day, competencies and partner capabilities are usually created over many years,” Adams said, and added that the committed ones see the vendors as a boon, not an obstacle in making this transition. “They’re looking for our support in getting them there. How do I get there and what are the implications for me to get there?”

On the flip side, others seriously doubt VARs will be willing and able to adapt.

“I don’t think all of the VARs are going to survive this,” said Watenpaugh. “The VARs that make the transition will be those that build a consultative relationship with their customers, providing advice and guidance on how to effectively leverage Cloud economies and help customers through decisions on what Cloud models best fit.”

Halle estimated that 20 percent of VARs seem to be taking the necessary survival steps, mainly the ones that come from a system integrator-type background that involved plenty of wrapping services around technology solutions.

Adams observed another 80-20 rule, the Pareto Principle; 20 percent of partners may help drive 80 percent of a vendor’s business. In other words, partners that increase their strategic capabilities will elevate their market reach and grow their business far beyond the VARs that do not. In VMware’s case, the company believes it has the programs and incentives to enable the cream to rise to the top and differentiate the partners that are most vital to the company.

“We see [VARs] as solution providers, not just as product resellers,” said Adams.

What does this mean for how these entities partner together? Will the more techno-savvy VARs move up in importance to require more involvement from senior executives—heretofore a rarity in VAR relationships? Will VAR-vendor relationships require more sophisticated governance models, and if so, will technology partners have to coach them along—particularly the smaller resellers that aren’t used to working through complex bureaucracies and may not have the resources to invest in alliance training and enablement?

Either way, change is coming. And VARs and the vendors selling through them would be pretty ignorant if they didn’t have their heads in the Cloud right now.