

The Partner Opportunity in Transitioning from Data Center- Hosted Services to Microsoft Azure

A Total Economic Impact™ Partner Opportunity Analysis

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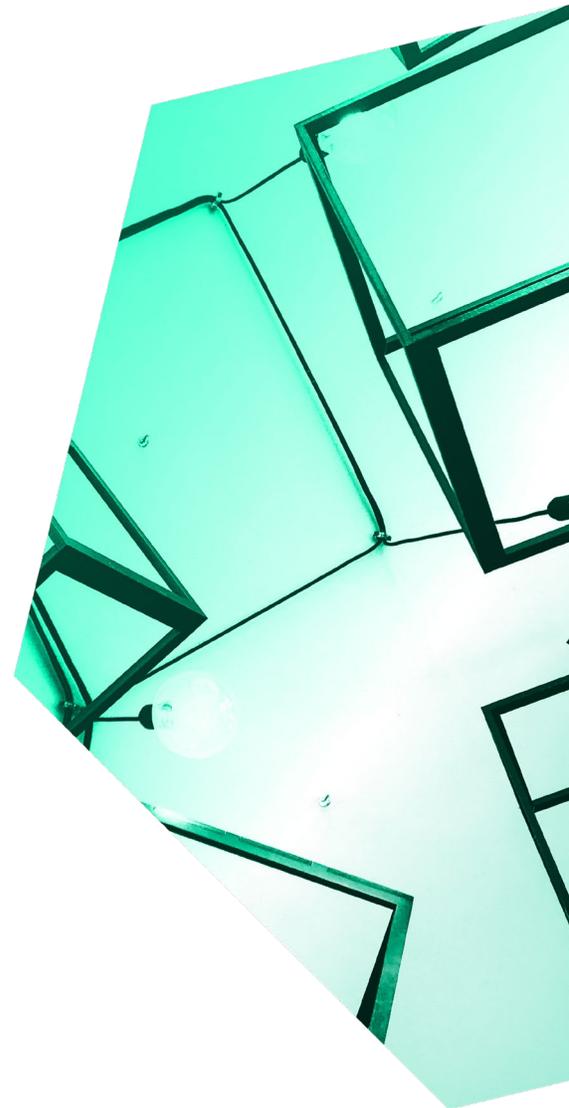
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Executive Summary

Traditional data center-based managed service providers (MSPs) face declining demand as organizations move to realize the scalability and agility benefits of the public cloud. To align with this opportunity, MSPs are transitioning workloads to the cloud and building new cloud-based managed and professional services. It requires an investment in a different business model, but MSPs who commit to the transition are discovering accelerated growth, profitable innovation, and a positive return for the business.

The [Microsoft Azure Cloud](#) platform offers hundreds of products and services that allow organizations to tap into the benefits of operating in the cloud to address their unique situations and challenges. Microsoft Azure partners work with their client organizations to move workloads to the cloud and to help them unlock its potential.

Microsoft commissioned Forrester Consulting to conduct a Total Economic Impact™ (TEI) study to examine the potential business opportunity and return on investment (ROI) partners may realize by building and scaling a Microsoft Azure practice.¹ The purpose of this study is to provide potential and existing partners with a framework to evaluate the potential business opportunity associated with using Azure to build, manage, and grow a cloud-centric managed service practice as part of the Microsoft partner ecosystem.

To better understand the revenue streams, investments, and risks associated with an Azure cloud services practice, Forrester interviewed nine decision-makers at five existing Azure partners which have experience collaborating with Microsoft to build or innovate and ultimately sell and scale their Azure services business. To illustrate the financial impact and subsequent partner business opportunity for Azure cloud services partners, Forrester aggregated the characteristics of these interviewees and combined the results into a single [composite organization](#).

KEY STATISTICS (three-year timeframe)



Return on investment
(ROI)
76%



Net present value
(NPV)
\$41.0M

KEY FINDINGS

Revenue opportunities. Forrester's model indicates that a \$100 million composite partner organization captures the following revenue streams over the course of three years, which are representative of those experienced by the interviewed organizations' decision-makers:

- **Data center-based MSP revenue generates \$35.9 million in gross profit.** The composite partner's strategy of pivoting its core business toward public cloud still leaves it with a sizeable (but shrinking) base of traditional customers and attractive gross margins.
- **Azure-based managed services revenue generates gross profit of \$41.7 million.** The composite partner's public cloud customer base grows rapidly, driven by new customer acquisition and existing customer migration.

“Previously we were more focused on keeping the business and applications running. Now we’ve shifted more to an advisory role.”

— Partner, EMEA

- **Professional services associated with public cloud customers contribute \$14.4 million in gross profit.** The partner’s cloud-based business opens up new possibilities for profitable service offerings, including infrastructure, security, data analytics and other services.
- **Partner-owned SaaS products generate gross profits of \$3.2 million.** Based on its cloud skills, deep understanding of customer needs, and relationship with Microsoft, the composite partner begins to develop and sell its own SaaS products. This delivers highly profitable ongoing subscription revenue.

Key outcomes. Benefits that are not quantified for this study include:

- **Increased valuation.** Interviewees generally agreed that becoming a cloud-based managed services provider had a positive impact on the overall value of their companies. One organization had, in fact, recently recapitalized and saw that its valuation was significantly higher than before its transformation.

- **Improved agility and modernization.** Partner organizations benefitted from the same scale and agility benefits as the customers they were migrating to the cloud.
- **Better success in hiring top talent.** A related benefit of modernization is that it makes the partner a more attractive employer in a very tight technical labor market.

Investments. Beyond the cost of cloud consumption and service delivery personnel, which are embedded in the gross margin calculations of each revenue stream, partners also invested in:

- **Staff reskilling is a \$2.0 million investment.** Since selling and managing public cloud services requires different skills from those involved managing and marketing in-house data center services, the composite partner organization invests to retrain operations and sales staff. This cost is primarily in paid nonbillable hours.
- **Sales costs of \$16.0 million.** The composite partner organization leverages its existing reskilled salesforce to build its public cloud

business. However, maintaining and providing incentives for that salesforce is still a major part of its overall cost of doing business. This expense accounts for that.

- **Research and development investment of \$18.9 million.** Developing its own intellectual property (IP) is a completely new endeavor for the composite partner organization. This means it requires a relatively heavy and front-loaded investment in product development. This includes paid nonbillable hours for developers, cloud consumption spending, and other resources developers need to create this new revenue stream for the organization.
- **General and administrative costs total \$8.9 million.** Ongoing costs for administrative personnel, building, and business systems are budgeted at 3% of total revenue.
- **Marketing support increases to \$8.5 million.** This investment in lead generation activities such as workshops, white papers, and CRM drives the growth of the cloud services business, along with differentiating factors such as earning advanced specializations.

The decision-maker interviews and financial analysis showed that a composite partner organization experiences total present value (PV) gross profits of \$95.17 million over three years versus investments and overhead expenses of \$54.18 million, adding up to a net present value (NPV) of \$41.0 million and an ROI of 76%.

Azure Partner Pro Forma Revenue And Margin Opportunity: Three-Year Analysis (USD)

Ref.	Metric	Source	Year 1	Year 2	Year 3
PL1	Data center-based managed services revenue	A5	\$54,360,000	\$39,600,000	\$27,000,000
PL2	Gross margin %	A6	35%	35%	35%
PL3	Data center-based managed services gross profit	A5*A6	\$19,026,000	\$13,860,000	\$9,450,000
PL4	Azure-based managed services revenue	B6	\$35,078,400	\$57,288,000	\$94,500,000
PL5	Gross margin %	B5	27%	27%	28%
PL6	Azure-based managed services gross profits	B5*B6	\$9,487,611	\$15,753,270	\$26,716,500
PL7	Professional services revenue	C4	\$8,000,000	\$15,000,000	\$25,500,000
PL8	Gross margin %	C5	33%	35%	40%
PL9	Professional services gross profits	C4*C5	\$2,640,000	\$5,250,000	\$10,200,000
PL10	Partner SaaS revenue	D3	\$500,000	\$1,900,000	\$4,500,000
PL11	Gross margin %	D4	10%	50%	70%
PL12	Partner SaaS gross profits	D3*D4	\$50,000	\$950,000	\$3,150,000
PL14	Total gross profits	PL3+PL6+PL9+PL12	\$31,203,611	\$35,813,270	\$49,516,500
PL15	Average gross margin	PL14/(PL1+PL4+PL7+PL10)	32%	31%	33%
PL16	Staff reskilling	Et	\$696,000	\$732,000	\$1,001,000
PL17	Sales costs	Ft	\$4,750,000	\$6,184,500	\$8,693,254
PL18	Research and development	Gt	\$7,835,072	\$7,077,280	\$7,825,000
PL19	General and administrative	Ht	\$2,938,152	\$3,413,640	\$4,545,000
PL20	Marketing	It	\$2,546,398	\$3,413,640	\$3,939,000
PL21	Total investments	PL16:PL20	\$18,765,622	\$20,365,908	\$26,003,254
PL22	Operating income	PL14-PL21	\$12,437,989	\$15,447,362	\$26,003,254
PL10	Operating margin	PL22/(PL1+PL4+PL7+PL10)	13%	14%	16%



ROI
76%



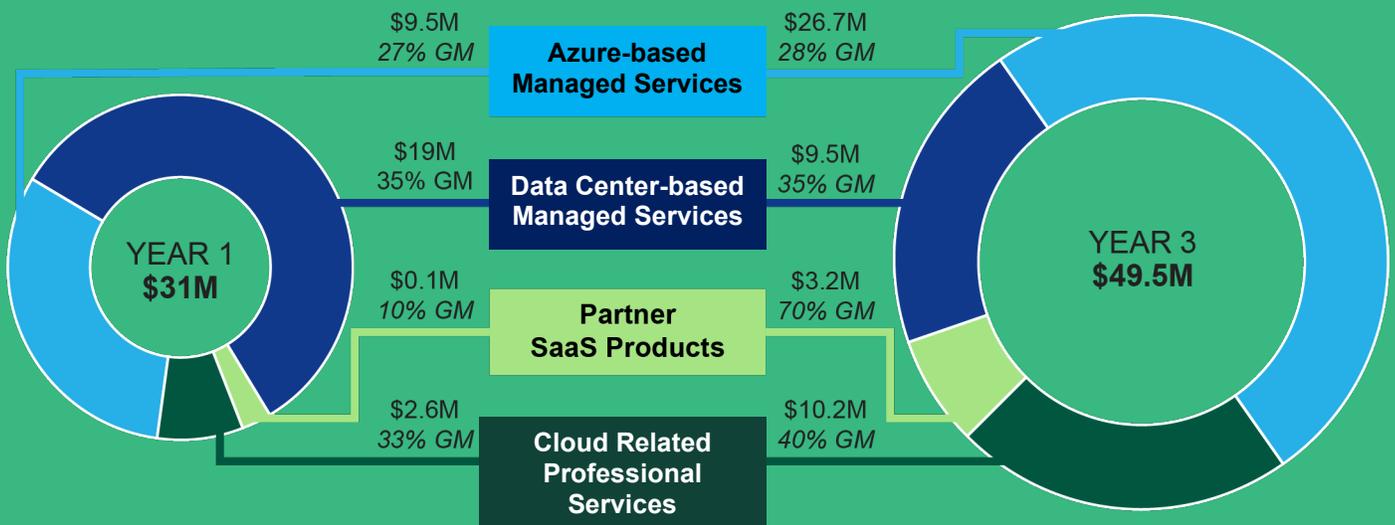
GROSS MARGIN
32%



OPERATING MARGIN
14%

Revenue Streams and Profitability

GM = Gross Margin



TEI FRAMEWORK AND METHODOLOGY

From the information provided in the interviews, Forrester constructed a Total Economic Impact™ framework for those partners considering building and growing a Microsoft Azure managed services practice.

The objective of the framework is to identify the revenue streams, investments, flexibility, and risk factors that affect the investment decision. Forrester took a multistep approach to evaluate the holistic opportunity for partners building and growing a Microsoft Azure managed services practice.

DISCLOSURES

Readers should be aware of the following:

This study is commissioned by Microsoft and delivered by Forrester Consulting. It is not meant to be used as a competitive analysis.

Forrester makes no assumptions as to the potential ROI that other organizations will receive. Forrester strongly advises that readers use their own estimates within the framework provided in the study to determine the appropriateness of an investment in an Azure managed services practice.

Microsoft reviewed and provided feedback to Forrester, but Forrester maintains editorial control over the study and its findings and does not accept changes to the study that contradict Forrester's findings or obscure the meaning of the study.

Microsoft provided the partner names for the interviews but did not participate in the interviews.



DUE DILIGENCE

Interviewed Microsoft stakeholders and Forrester analysts to gather data relative to the Azure CSP.



DECISION-MAKER INTERVIEWS

Interviewed nine decision-makers at five partner organizations with existing Azure CSP practices to obtain data with respect to costs, benefits, and risks.



COMPOSITE ORGANIZATION

Designed a composite partner organization based on characteristics of the interviewees' organizations.



FINANCIAL MODEL FRAMEWORK

Constructed a financial model representative of the interviews using the TEI methodology and risk-adjusted the financial model based on issues and concerns of the decision-makers.



CASE STUDY

Employed four fundamental elements of TEI in modeling the impact of an Azure- managed services practice: revenue, investments, flexibility, and risks. Given the increasing sophistication of ROI analyses related to IT investments, Forrester's TEI methodology provides a complete picture of the total economic impact of investment and partnership decisions. Please see Appendix A for additional information on the TEI methodology.

The Microsoft Azure Managed Services Partner Journey

■ Drivers leading to the Azure managed services practice investment

Interviewed Decision-Makers			
Interviewee	Cloud Hosting Maturity	Region	Estimated Revenues
CMO	Advanced, Azure only	North America	\$100 million
VP, global alliances	Advanced, Azure only	North America	\$100 million
Managing partner	Hybrid Data Center / Azure	EMEA	\$33 million
Program manager	Hybrid Data Center / Azure	EMEA	\$33 million
Global head, cloud	Global systems integrator (GSI), vendor-agnostic	Asia Pacific	\$15 billion
Senior principal and practice leader	GSI, vendor agnostic	Asia Pacific	\$15 billion
Solution lead, cloud enablement and operations	Intermediate, multiple vendors	EMEA	\$500 million
Partner	Intermediate, multiple vendors	EMEA	\$500 million
CEO	Cloud-native, Azure only	EMEA	\$15 million

PARTNER GOALS, CHALLENGES, AND DRIVERS

The partners investigated for this study vary in size from a \$14 million regional business to a \$15 billion global one; their business models include a cloud-native provider as well as others in various degrees of transitioning from a data center-based MSP to a public cloud-centric provider. All the partners except one, started as data center-based service providers. Together, they do business in almost every country in the world, but individually they are headquartered in North America, Europe, and Asia.

As hyperscalers began offering public cloud access, the interviewed decision-makers' organizations approached the issue in different ways. Some partner companies' management saw the power of this model, decided it was the business of the future, and they became an early cloud service provider. Other provider partners became aware over time that their customers wanted to take advantage of the scalability and agility offered by the cloud, but still required outside resources to manage their workloads and

applications. These partners' awareness of their customers' growing needs led them to commit to building a cloud service provider business.

As the CMO of a North American-based partner explained: "The demand for public cloud services is so great that we no longer market any kind of private or hybrid cloud services. We've made a real commitment to be all in on the public cloud."

In addition to the carrot of market opportunity that public cloud provided, partners also foresaw the stick of operational challenges in their legacy MSP business. They faced losing customers to competitive providers who were in a better position to assist with the cloud migration, application modernization, and ongoing operation those customers demanded.

MSPs were also finding it increasingly difficult to recruit and hire technical staff with the necessary legacy skillset for their traditional private or hybrid cloud operations. These forces degraded their margins and threatened their ability to fulfill agreed service-level agreements.

“ I feel like the market really can't sustain just being a traditional MSP; customers want and need to modernize to the cloud. ”

CMO, North America

SELECTING THE RIGHT PARTNER PROGRAM

In choosing a partner and platform for their cloud service solutions, decision-makers emphasized the importance of working with a partner that:

- **Holds customer recognition and trust.** The task of selling a major digital transformation is difficult, but it is almost impossible when it involves an unknown or suspect cloud provider. In their trusted advisor role, partners want customers to see them doing business with and introducing them to proven technology leaders.
- **Values the role of partners in the ecosystem.** Interviewees told Forrester they prefer to work with partners who value their role and will work with them to create win-win proposals.
- **Provides opportunities for its partners to leverage its customer base.** The opportunity to leverage a vendor's current customer satisfaction with its other products, or to receive leads to the vendor's own client base, is highly attractive.

MAKING THE TRANSITION

Having made the decision to build a cloud-based managed services practice, almost all the interviewed executives said that their management teams committed to transitioning their business model. This included clearly communicating that vision to the organization, reskilling employees to succeed in a cloud-based environment, even turning away data center-based MSP business and focusing new business efforts on cloud-based services prospects only. While partners did not walk away from current clients, of course, they encouraged those clients to move workloads to the cloud. Within a few years, their DC-hosted business was a small enough portion of the total that they used a third party to manage it.

Interviewees acknowledged that the transition period required some “intestinal fortitude,” as lower margins on cloud consumption resale resulted in lower margins on the managed services business. They credited their success to having management buy-in to the future business plan where rapid growth and the addition of high margin offerings such as professional services and SaaS products resulted in

a much healthier and more profitable business in the long term.

These partners used those incremental profits, along with continuing profits from the higher margin DC-based business, to finance below-the-line investments such as product development, marketing, technical training and other activities to support their new cloud-based business.

All but one of the interviewed partners had migrated the majority of their customer workloads and revenue to the cloud. These interviewees reported that their businesses were more innovative, agile and vital than when they were primarily a data center-based MSP.

COMPOSITE ORGANIZATION

Based on the interviews, Forrester constructed a TEI framework, a composite partner, and an ROI analysis of the pivot to cloud-based services. The composite organization is representative of the five organizations from which Forrester interviewed nine decision-makers and is used to present the aggregate financial analysis. It is a \$100 million company with approximately 500 customers and employs 200 people. In the year before the period analyzed in the model, its DC-hosted MSP business is roughly 60% of revenue going into the three-year period of the model.

Key assumptions

- **\$100 million revenues**
- **200 employees**
- **500 customers**
- **60% DC-hosted MSP**

Analysis Of Partner Revenue Streams

■ Quantified revenue data as applied to the composite

Revenue Streams And Gross Profits						
Ref.	Revenue Streams	Year 1	Year 2	Year 3	Total	Present Value
Atr	Data center-based managed services	\$19,026,000	\$13,860,000	\$9,450,000	\$42,336,000	\$35,850,834
Btr	Azure-based managed services	\$9,487,611	\$15,753,270	\$26,716,500	\$51,957,381	\$41,716,834
Ctr	Professional services	\$2,640,000	\$5,250,000	\$10,200,000	\$18,090,000	\$14,402,254
Dtr	Partner SaaS products	\$50,000	\$950,000	\$3,150,000	\$4,150,000	\$3,197,220
	Total gross profit (risk-adjusted)	\$31,203,611	\$35,813,270	\$49,516,500	\$116,533,381	\$95,167,142

DATA CENTER-BASED MANAGED SERVICES

Evidence and data. Except for the cloud-native partner in EMEA, the interviewed decision-makers' organizations had successful businesses focused on delivering managed services to their customers — often for decades — via private or hybrid cloud. They had loyal customer bases and profitable margins, although their growth rates were slowing.

Once management teams decided to commit to delivering managed services in the public cloud, the interviewees' organizations worked quickly to migrate customers that had been exploring a move to cloud and began selling other customers on the scalability

“It’s a big investment. We had a private cloud business we could use as a cash cow to invest in really developing a different practice on Azure.”

Managing partner, EMEA

and agility benefits of public cloud. The CMO of the North American partner told Forrester: “When I say we went all in, we really did. We moved the lion’s share of our customers over to the cloud. It wasn’t all at once, there were certainly some where it was easier to make the case for that leap and others that were a little more laggard.”

Most interviewees told Forrester that their customer bases shifted from mostly data center-based to mostly cloud-based in a matter of a few years as they migrated their current customers and brought on new customers looking to shift their operations to cloud computing.

Modeling and assumptions. Forrester makes the following assumptions in modeling this revenue stream:

- The partner begins with 300 traditional MSP customers. Over the course of the three years, half of them migrate to the cloud, leaving 150 customers by the third year.
 - As a result, DC-based customers drop from 60% of the mix to 25% over the modeling period.

- On average, each customer spends \$15,000 per month on managed services.
- The average gross margin on the data center-based MSP business is 35%.

Results. Forrester’s model shows three-year total PV gross profits (discounted at 10%) of almost \$35.9 million.

Data Center-Based Managed Services

Ref.	Metric	Source	Year 1	Year 2	Year 3
A1	Total customer base	Composite	505	530	600
A2	Percent data center-based MSP	Interviews	60%	42%	25%
A3	Data center-based MSP customers	A1*A2	302	220	150
A4	Average revenue per month	Composite	\$15,000	\$15,000	\$15,000
A5	Annual data center-based MSP revenues	A3*(A4*12)	\$54,360,000	\$39,600,000	\$27,000,000
A6	Average data center-based MSP Margin	Interviews	35%	35%	35%
At	Data center-based managed services	A5*A6	\$19,026,000	\$13,860,000	\$9,450,000
Three-year total: \$42,336,000			Three-year present value: \$35,850,834		

AZURE-BASED MANAGED SERVICES

Evidence and data. Almost every partner in the study aggressively moved their revenue bases to cloud services, and interviewees agreed this was a customer-driven phenomenon. While there were investments the partners had to make in their

portfolios, people, go-to-market strategies, and business systems to succeed as cloud-based service providers, there was plenty of demand. Their customers were demanding the business benefits of working in the cloud and their management teams were committed to focusing on meeting that demand.

“Cost was something that was pitched early — and it’s still obviously a consideration — but the real driver of customer demand is the overall business benefits of being able to scale and to create more agility in your team.”

CMO, North America

- The solution lead, cloud enablement and operations respondent from a partner headquartered in EMEA echoed this idea: “On-premises solutions is approximately 1% of our business. We take care of it with another partner. It’s really customer demand and we don’t push the traditional business proactively anymore. All of our customers are on a cloud journey supported by us.”
- The CEO of one partner in EMEA recounted: “In 2014 or 2015 we said, ‘We’re going all in on Azure, so everyone needs to ramp up their skills in Azure.’ And we didn’t take on any more

customers who didn't want to work on Azure." This position was certainly not the rule among interviewees. For this interviewed partner, though, drawing a bright line to demonstrate to employees and customers the company's strategic decision to move to the cloud enabled faster success.

- Partners also found that moving to the cloud opened up the opportunity to sell advanced cloud services offered on Azure, a low-investment way for them to build monthly service revenues.

Modeling and assumptions. Forrester used the following assumptions to quantify the value of this revenue stream:

- The Azure customer base grows from 203 in the first year of the model to 450 in Year 3 as the

organization both migrates current customers to the cloud and wins new cloud customers.

- The average customer spends \$3,000 per month on cloud consumption licenses and fees which the partner resells at a 7.5% gross margin (narrowing slightly in Year 3 to 7.0%).
- Customers continue buying managed services from the partner and, in Year 2 and 3, begin to add incremental services the partner now offers using Azure PaaS solutions. Average monthly revenue per customer starts at \$11,400, but it accelerates to \$14,500 by Year 3.
- The margin for these services averages 34%.

Results. Forrester models the value of this revenue stream at a three-year total PV gross profit of \$41.7 million.

Azure-Based Managed Services					
Ref.	Metric	Source	Year 1	Year 2	Year 3
B1	Azure customer base	Composite	203	310	450
B2	Average monthly Azure resale revenue	Interviews	\$3,000	\$3,000	\$3,000
B3	Average resale gross margin	Interviews	7.5%	7.5%	7.0%
B4	Average Azure-based managed services revenue per month	Interviews	\$11,400	\$12,400	\$14,500
B5	Average managed services margin	Interviews	34%	34%	34%
B6	Azure-based managed services revenue	$((B1*B2) + (B1*B4))*12$	\$35,078,400	\$57,288,000	\$94,500,000
Bt	Azure-based managed services gross profit	$((B1*B2*B3) + (B1*B4*B5))*12$	\$9,487,611	\$15,753,270	\$26,716,500
Three-year total: \$51,957,381			Three-year present value: \$41,715,834		

PROFESSIONAL SERVICES

Evidence and data. Interviewees recalled that their organizations saw opportunities for professional services almost immediately after their customers moved to the cloud. The attractive margins on these projects helped offset the interviewees' organizations'

transitions to somewhat lower-margin cloud-resale revenue and the upfront investments the partners were making.

In these interviews, the term professional services referred to a range of consulting, advisory, and other

post-implementation projects. Examples that interviewees highlighted included cloud infrastructure services, integration services, app modernization, data lake creation, and anything else that helped customers get the most value out of their move to the cloud. For any given customer, the partner could be engaged for an almost unlimited number of projects

“You have to start by building a portfolio of workshops, projects, consultancy services, and recurring and managed services.”

Managing partner, EMEA

over multiple years as the customer continued their cloud journey.

Interviewed executives pointed out that this revenue stream, which came to represent 20% to 30% of their business, was a large, high-growth, and profitable one that was only enabled by becoming a cloud-managed services partner. In fact, a partner at a firm in EMEA stated: “In margin percentage, I would say

cloud managed services were typically lower than the rest of our business. However, in the long run they allow us to target and deliver new services which are way more profitable.”

Modeling and assumptions. Forrester uses the following assumptions about the composite partner to construct the model for this revenue stream:

- The partner begins delivering professional services in Year 1.
- Approximately 20% of cloud-hosted customers engage the partner for these mostly project-based services.
- The average project delivers \$100,000 in revenue.
- The average customer buys two projects in the first year. This number climbs to three by Year 3 as the partner gets better at recognizing opportunities and selling/delivering services.
- Likewise, the gross profit from these services grows from 33% to 40% as the partner optimizes its own workflows through familiarity, upskilling, and automation. The partner can also charge a bit more as its experience and credibility grow.

Professional Services

Ref.	Metric	Source	Year 1	Year 2	Year 3
C1	Consulting Customers	Composite	40	60	85
C2	Average project value	Interviews	\$100,000	\$100,000	\$100,000
C3	Average projects per year	Composite	2.0	2.5	3.0
C4	Total professional services revenues	C1*C2*C3	\$8,000,000	\$15,000,000	\$25,500,000
C5	Average project gross margins	Interviews	33%	35%	40%
Ct	Professional services gross profit	C4*C5	\$2,640,000	\$5,250,000	\$10,200,000

Three-year total: \$18,090,000

Three-year present value: \$14,402,254

Results. Forrester estimates three-year, total PV gross profit of over \$14.4 million in professional services.

PARTNER SAAS PRODUCTS

Evidence and data. The final and most profitable revenue stream interviewees identified was subscription SaaS products based on their own intellectual property. The partners that participated in the study were at different stages of developing, introducing, and profiting from these products, and the interviewees all agreed this was the most difficult and risky element of their organizations' transformation.

It was difficult because it demanded an entirely new set of skills to innovate and nurture new product ideas. It was risky (just as all new product launches are) because they faced strong competition from many corners. Even so, they pointed out that it was critical to capturing the full value of their organizations' new strategy.

“The margin profile for the SaaS model is significantly higher because you have already invested in the platform. It has its own flywheel effect, so margin improves as you move up the layers.”

VP, global head of cloud, Asia Pacific

Interviewees told Forrester that their product development efforts:

- Required upfront market research to understand what customers needed, what was already in the market, and how to price their potential solution.

- Needed the right technical skills to create and develop solutions internally, so they became the partner's own IP.
- Ran the risk of other cloud service providers or ISVs beating them to market.

The ultimate promise of the SaaS solution was a recurring, profitable, subscription-based revenue stream that involved very little sales or technical effort after the initial sale. However, the VP, global head of

“We talk to the customer and say, ‘Hey, your per-member cost is very high. We can help you reduce that by bringing on this platform we have.’”

VP global head of cloud, Asia Pacific

cloud interviewee at a GSI in Asia Pacific opined: “Not every customer understands giving away control to a SaaS. It's also something they may not be comfortable with, so your sales effort is high.”

Modeling and assumptions. Forrester determined the value of this revenue stream using several assumptions.

- The partner brings its first SaaS product to market in Year 1 (having invested in research and product development the previous year).
- During the first year, they work with a select few of their cloud-based customers to operationalize and optimize the product.

- In Years 2 and 3 they grow the subscription customer base quickly to approximately 10% of their cloud-based customers.
- The fee for the subscription product is \$100,000 per year.
- While the partner’s SaaS business will eventually deliver steady gross margins of around 70%,

heavy customer acquisition costs (including discounted pricing for the beta customers) hold margins to 10% in Year 1 and 50% in Year 2.

Results. The financial model indicates that the composite organization’s own SaaS products produce a total PV gross profit of almost \$3.2 million.

Partner SaaS Products					
Ref.	Metric	Source	Year 1	Year 2	Year 3
D1	IP subscription customers	Composite	5	19	45
D2	Average annual subscription revenue	Interviews	\$100,000	\$100,000	\$100,000
D3	Total subscription revenue	D1*D2	\$500,000	\$1,900,000	\$4,500,000
D4	Average IP subscription margins	Interviews	10%	50%	70%
Dt	Partner SaaS products gross profit	D3*D4	\$50,000	\$950,000	\$3,150,000
Three-year total: \$4,150,000			Three-year present value: \$3,197,220		

UNQUANTIFIED BENEFITS

Additional benefits that partners experienced but were not able to quantify include:

“It moved the conversation away from valuation based just on EBITDA. The valuation is driven by the ability to scale, and you have more of an infinite ability to scale on public cloud. So, it naturally takes the net valuation number up, to almost double in some cases.”

CMO, North America

Increased valuation. While the interviewed executives all agreed that the move to cloud-managed services improved their organization’s

growth and profitability, decision makers at one partner in particular spoke to its positive impact on the overall value of their company. This organization went through a recapitalization exercise after its shift to Azure service provider where the value of the company was estimated by investors. The interviewees’ organization’s value was set at a significantly higher level than before its transformation.

Improved agility and modernization. The partner organizations generally found they benefitted from the same scale and agility benefits as the customers they were migrating to the cloud. As a managing partner in EMEA related, “All the innovation we needed to become a public cloud MSP, the existing business benefitted from that.”

Better success in hiring top talent. A related benefit of modernization is that it made the partners more attractive employers in a very tight technical labor market. The CEO of a partner in EMEA pointed

out, “If you want to grow and attract new people but you don’t use new technology, like cloud computing, why would somebody new from school or from a different company who is looking for advancement look to you as a potential new employer?”

Analysis Of Partner Investments

■ Quantified investment data as applied to the composite

Total Investments							
Ref.	Investments	Initial	Year 1	Year 2	Year 3	Total	Present Value
Et	Staff reskilling	\$0	\$696,000	\$732,000	\$1,001,000	\$2,429,000	\$1,989,752
Ft	Sales costs	\$0	\$4,750,000	\$6,184,500	\$8,693,254	\$19,627,754	\$15,960,709
Gt	Research and development	\$0	\$7,835,072	\$7,077,280	\$7,825,000	\$22,737,352	\$18,850,823
Ht	General and administrative	\$0	\$2,938,152	\$3,413,640	\$4,545,000	\$10,896,792	\$8,906,963
It	Marketing	\$750,000	\$2,546,398	\$2,958,488	\$3,939,000	\$10,193,886	\$8,469,368
	Total investments	\$750,000	\$18,765,622	\$20,365,908	\$26,003,254	\$65,884,784	\$54,177,615

STAFF RESKILLING

Evidence and data. Interviewees reported that they generally did not need to hire a lot of new talent to build their cloud services business. There was some churn as team members started to learn new skills. Additionally, most interviewees' organizations did expand their sales and technical staff, but not to the extent they would have if they were starting up a standalone cloud- services business.

“We saw a churn in our commercial team because the more classic salespeople struggled with the new paradigm of public cloud and what type of conversation they needed to have with customers. It’s very different than trying to sell them a server with so much storage.”

Program manager, EMEA

The CMO of a partner in North America reported, “On the go-to-market sales and marketing side of [the business], what’s been interesting is that we really didn’t have to significantly expand the overall amount of salespeople.”

Interviewees confirmed, however, that the new business model required significant change from virtually every employee in their companies. This included employees in sales, developers, operational team, back office, and management roles.

The interviewed solution lead of cloud enablement and operations at a partner in EMEA explained, “We are always hiring at full speed, but we also focused on skilling the people we already had because we saw more and more of our existing customers choosing cloud.”

Modeling and assumptions. Forrester makes the following assumptions in modeling the value of this investment.

- Approximately half of the partner’s employees are sales and technical staff who must learn different skills as the business pivots.

- This employee base expands over the years, but not as rapidly as revenues. This is because certain revenue streams (e.g., cloud license resale, SaaS subscriptions) require fewer sales and/or technical resources.
- Each of these employees spends 80 nonbillable hours per year building their skillset with training courses, certifications, or other company-sponsored education.
- As new employees join the firm, they receive an additional 160 hours in training in their first year.
- The average salary of the sales and technical staff is \$90,000 per year, plus 35% for benefits. With 2,080 working hours per year, this translates to \$58 per hour.
- Salaries increase by 5% to 7% a year (slightly higher for technical staff and slightly lower for sales staff) to retain this scarce resource.

Results. Forrester’s model indicates a three-year total PV investment of almost \$2.0 million.

Service Delivery Staff Reskilling						
Ref.	Metric	Source	Initial	Year 1	Year 2	Year 3
E1	Total sales and technical staff	Composite	100	125	138	165
E2	Newly hired sales and technical employees	E1 of the previous year	0	25	13	28
E3	Average fully burdened hourly salary	TEI standard	\$0	\$58	\$61	\$65
E4	Nonbillable hours per person for certification/upskilling/education	Interviews	0	80	80	80
E5	Additional nonbillable hours per person for newly hired employees	Interviews	0	160	160	160
Et	Staff reskilling	$(E1 * E3) + (E2 * E4) * E5$	\$0	\$696,000	\$732,000	\$1,001,000
Three-year total: \$2,429,000			Three-year present value: \$1,989,752			

SALES COSTS

Evidence and data. While the salaries and benefits for staff who delivered products and services to customers are accounted for in the model as costs in the calculation of the gross margin, the same is not true for salespeople. This is an investment the participating partners continued making to keep the business running. Forrester accounted for in this section.

Modeling and assumptions. Forrester makes the following assumptions in modeling the value of this investment.

- Approximately 40% to 50% of the sales and technical staff are salespeople who do not deliver services. Therefore, their salaries are not included in the gross margin calculations in the revenue section. Their salaries are an investment in the growth and health of the overall business.
- Average fully burdened salary, including commission, for this group is \$95,000.
- These salaries grow at 5% per year in the model.

Results. Forrester’s model indicates a three-year, total PV investment of \$16.0 million.

Sales Costs						
Ref.	Metric	Source	Initial	Year 1	Year 2	Year 3
F1	Sales personnel	Composite	0	50	62	83
F2	Average fully burdened salary	TEI standard	\$0	\$95,000	\$99,750	\$104,738
Ft	Sales costs	F1*F2	\$0	\$4,725,000	\$6,151,950	\$8,647,438
Three-year total: \$19,627,754			Three-year present value: \$15,960,709			

RESEARCH AND DEVELOPMENT

Evidence and data. Developing new products was the key to unlocking the potential of the partners’ move to managed cloud services and was a new undertaking. This investment was top of mind for most of the interviewees. All of them told Forrester their organizations had made a substantial investment in research and product development. This necessary investment was primarily in the form of nonbillable hours, but it could also include cloud consumption or professional fees.

- The interviewed VP global head of cloud at a partner in Asia Pacific explained: “A combination of people from our technology team, our consulting team, and our R&D team [work] together to identify market patterns based on what we are seeing from customers, from the hyperscalers, and our own sales teams. They bring that together and identify a list of opportunities which we can turn into blueprints and work on [products and services] to bring to customers.”
- The CEO of an interviewed partner in EMEA explained that being successful in this area required more than just creating a great product: “In my mind, I see all kinds of different products

spinning out there, but [creating new offerings is] also one of the hardest things to do, right? We need to think through all the details. Describe in-depth what the product does, what its business value is, what the advantages are for the customer, and we need to price it right. It’s our biggest change for the coming year.”

Modeling and assumptions. Forrester makes the following assumptions in modeling the value of this investment.

- The partner begins by investing 8% of its revenue in new product development and associated research.
- This ratio declines over the course of the analysis to a still healthy 5%, as the partner will continue innovating and launching new products on an ongoing basis.
- The partner also invests \$500,000 over the course of Year 2 and Year 3 to innovate its own processes for handling the growth of its new business.

Results. Forrester’s model indicates a three-year, total PV investment of almost \$18.9 million.

Research and Development						
Ref.	Metric	Source	Initial	Year 1	Year 2	Year 3
G1	Percent of revenue invested in research and development	Interviews	0	8.0%	6.0%	5.0%
G2	Annual revenue	Composite	\$0	\$97,938,400	\$113,788,000	\$151,500,000
G3	Research and development investment	G1*G2	\$0	\$7,835,072	\$6,827,280	\$7,575,000
G4	Business system upgrades	Interviews	\$0	\$0	\$250,000	\$250,000
Gt	Research and development	G3+G4	\$0	\$7,835,072	\$7,077,280	\$7,825,000
Three-year total: \$22,737,352			Three-year present value: \$18,850,823			

GENERAL AND ADMINISTRATIVE COSTS

Evidence and data. Interviewees affirmed that their organizations continued to experience general and administrative costs at approximately the same percent of revenue as before their entry into the managed cloud services business. These costs include administrative salaries and real estate and office costs.

Modeling and assumptions. In modeling the value of this ongoing investment, Forrester assumes a standard spend level of 3% of revenues for the composite organization.

Results. Forrester’s model indicates a three-year, total PV investment of \$8.9 million.

General And Administrative						
Ref.	Metric	Source	Initial	Year 1	Year 2	Year 3
H1	General and administrative percent of revenue	TEI standard	0	3%	3%	3%
H2	General & administrative	G2*H1	\$0	\$2,938,152	\$3,413,640	\$4,545,000
Three-year total: \$10,896,792			Three-year present value: \$8,906,963			

MARKETING

Evidence and data. The decision-makers Forrester spoke with confirmed that increased marketing activity was key to the successful transformation of their practice and the launch of new products and services. They shared a number of techniques they use to feed the funnel and nurture prospects.

Most of the partners represented had a well-defined process for generating and nurturing leads. Several were able to cite metrics regarding how many leads

they needed to get a sale and how prospects fell off throughout the process. They also explained that cloud providers’ market development fund (MDF) programs often offset some of these costs.

Modeling and assumptions. Forrester assumes the following in modeling the value of this investment:

- In order to maximize its exposure, credibility, and lead flow as it pivots to a new business, the partner firm invests in the training, auditing, and other prerequisites to qualify for the Azure Expert

designation. This costs \$750,000, primarily in nonbillable hours on the part of the firm’s sales and technical personnel.

- The firm makes a continuing, significant investment in finding new clients for its growing cloud hosting business. This investment is at a rate of 4% of revenue.
- The partner also makes use of matching marketing funds available from Microsoft to offset the cost of approximately one-third of its total lead generation programs.

“We really start with thought leadership and content demonstrating our superpowers — customer validation, case studies, those kinds of things. And then we generate campaigns that are accelerating the top of the funnel.”

CMO, North America

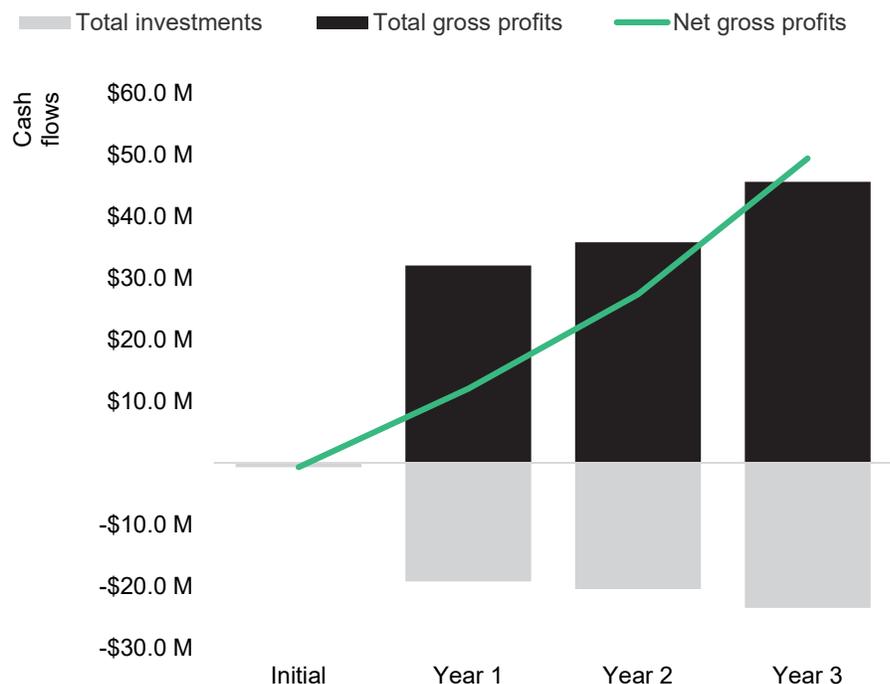
Results. Forrester’s model indicates a three-year, total PV investment of over \$8.4 million.

Marketing						
Ref.	Metric	Source	Initial	Year 1	Year 2	Year 3
I1	Qualification for Azure Expert Designation (nonbillable hours)	Interviews	\$750,000	\$0	\$0	\$0
I2	Marketing activities (percentage of sale)	Interviews		4%	4%	4%
I3	Total Marketing Spend	I2*G2		\$3,917,536	\$4,551,520	\$6,060,000
I4	Portion covered by MDF	Interviews		35%	35%	35%
It	Marketing	I3*(1-I4)+I1	\$750,000	\$2,546,398	\$2,958,488	\$3,939,000
Three-year total: \$10,193,866			Three-year present value: \$8,469,368			

Financial Summary

CONSOLIDATED THREE-YEAR RISK-ADJUSTED METRICS

Cash Flow Chart (Risk-Adjusted)



The financial results calculated in the Revenue Streams and Investments sections can be used to determine the ROI and NPV for the composite organization's investment. Forrester assumes a yearly discount rate of 10% for this analysis.

These risk-adjusted ROI and NPV values are determined by applying risk-adjustment factors to the unadjusted results in each Revenue Stream and Investment section.

Cash Flow Analysis (Risk-Adjusted Estimates)

	Initial	Year 1	Year 2	Year 3	Total	Present Value
Total investments	(\$750,000)	(\$18,765,622)	(\$20,365,908)	(\$26,003,254)	(\$65,884,784)	(\$54,177,615)
Total gross profits	\$0	\$31,203,611	\$35,813,270	\$49,516,500	\$116,533,381	\$95,167,142
Net gross profits	(\$750,000)	\$12,437,989	\$15,447,362	\$23,513,246	\$50,648,597	\$40,989,527
ROI						76%

Appendix A: Total Economic Impact

Total Economic Impact is a methodology developed by Forrester Research that enhances a company's technology decision-making processes and assists vendors in communicating the value proposition of their products and services to clients. The TEI methodology helps companies demonstrate, justify, and realize the tangible value of IT initiatives to both senior management and other key business stakeholders.

TOTAL ECONOMIC IMPACT APPROACH

Benefits represent the value delivered to the business by the product. The TEI methodology places equal weight on the measure of benefits and the measure of costs, allowing for a full examination of the effect of the technology on the entire organization.

Costs consider all expenses necessary to deliver the proposed value, or benefits, of the product. The cost category within TEI captures incremental costs over the existing environment for ongoing costs associated with the solution.

Flexibility represents the strategic value that can be obtained for some future additional investment building on top of the initial investment already made. Having the ability to capture that benefit has a PV that can be estimated.

Risks measure the uncertainty of benefit and cost estimates given: 1) the likelihood that estimates will meet original projections and 2) the likelihood that estimates will be tracked over time. TEI risk factors are based on "triangular distribution."

The initial investment column contains costs incurred at "time 0" or at the beginning of Year 1 that are not discounted. All other cash flows are discounted using the discount rate at the end of the year. PV calculations are calculated for each total cost and benefit estimate. NPV calculations in the summary tables are the sum of the initial investment and the discounted cash flows in each year. Sums and present value calculations of the Total Benefits, Total Costs, and Cash Flow tables may not exactly add up, as some rounding may occur.



PRESENT VALUE (PV)

The present or current value of (discounted) cost and benefit estimates given at an interest rate (the discount rate). The PV of costs and benefits feed into the total NPV of cash flows.



NET PRESENT VALUE (NPV)

The present or current value of (discounted) future net cash flows given an interest rate (the discount rate). A positive project NPV normally indicates that the investment should be made, unless other projects have higher NPVs.



RETURN ON INVESTMENT (ROI)

A project's expected return in percentage terms. ROI is calculated by dividing net benefits (benefits less costs) by costs.



DISCOUNT RATE

The interest rate used in cash flow analysis to take into account the time value of money. Organizations typically use discount rates between 8% and 16%.



PAYBACK PERIOD

The breakeven point for an investment. This is the point in time at which net benefits (benefits minus costs) equal initial investment or cost.

Appendix B: Endnotes

¹ Total Economic Impact is a methodology developed by Forrester Research that enhances a company's technology decision-making processes and assists vendors in communicating the value proposition of their products and services to clients. The TEI methodology helps companies demonstrate, justify, and realize the tangible value of IT initiatives to both senior management and other key business stakeholders.

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