IDC
Analyze the Future

Global Headquarters: 5 Speen Street Framingham, MA 01701 USA P.508.872.8200 F.508.935.4015 www.idc.com

EXECUTIVE SUMMARY

Microsoft Competencies: Partner Pathway to Business Performance

Sponsored by: Microsoft

Matthew Lawton Stephen Graham

February 2006

Synopsis

Through an in-depth study conducted from June through August 2005, IDC found that Microsoft partners who have earned a Microsoft Competency in Advanced Infrastructure (AI) Solutions or Information Worker (IW) Solutions outperform comparable industry benchmarks on 12 of the 14 key performance indicators (KPIs) we measured. IDC also found that a sample of Microsoft partners focused on Mobility Solutions using Microsoft technology are experiencing strong business performance. These study findings suggest there is significant business value for partners earning one or more of these recently introduced Microsoft Competencies. Our findings also challenge some commonly held perceptions in the industry about what contributes to a company's business performance.

The Study

Slower revenue growth across the IT industry since the blazing pace of the '90s has focused attention on bottom-line performance and the many factors, both large and small, that contribute to partners' performance. IT vendors increasingly recognize that the business health of their partner community is critical to their success. In this context, Microsoft commissioned IDC to research the performance of Microsoft partners who have earned specific Microsoft-defined Competencies relative to the performance of comparable companies in the industry.

From June through August 2005, IDC conducted extensive research involving more than 1,000 value-added resellers (VARs), systems integrators, and consultants in the United States, the United Kingdom, and Germany. This Executive Summary provides an overview of the results of our research. The study methodology is briefly described in Appendix A, and details of the study are published in three companion IDC White Papers:

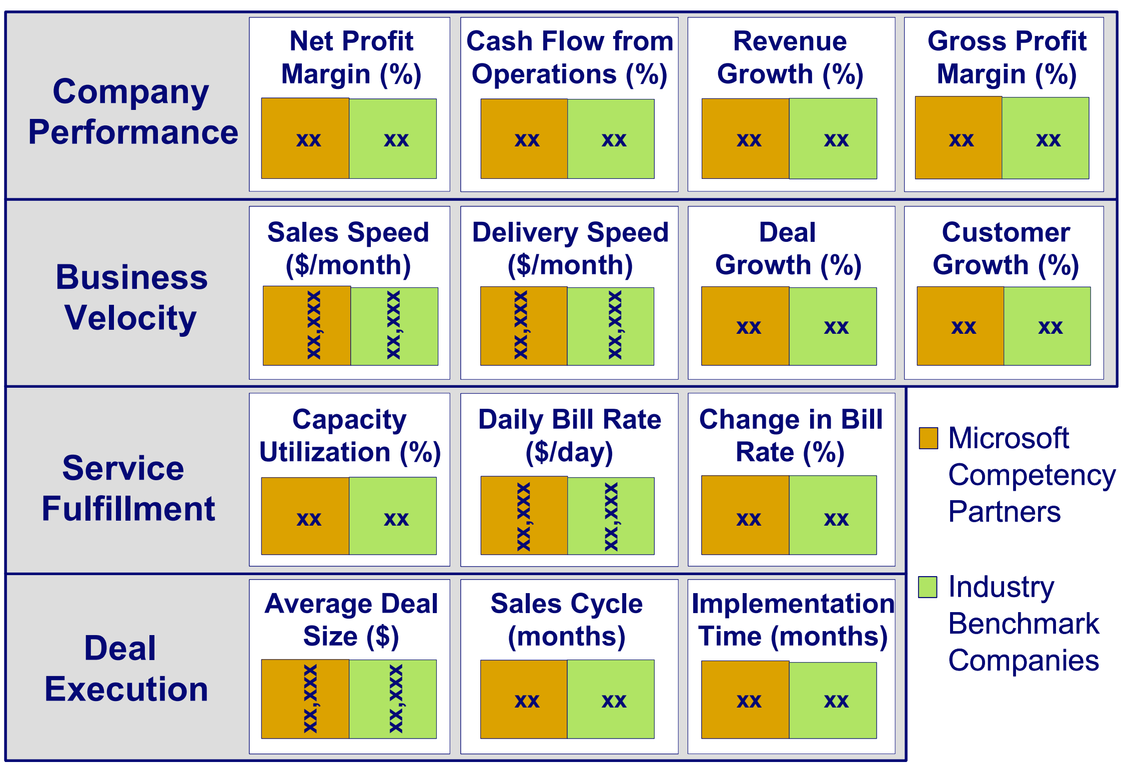
- Microsoft Information Worker Solutions Competency: Partner Pathway to Business Performance (#200601, February 2006)
- Microsoft Advanced Infrastructure Solutions Competency: Partner Pathway to Business Performance (#200287, February 2006)
- Microsoft Mobility Solutions Competency: Partner Pathway to Business Performance (#2717, November 2005)

Measuring Business Performance

When discussing the business performance of their partners, IT vendors often think in terms of partner profitability. However, partners typically have several measures of business health that they commonly include in assessing their own performance. Therefore, in developing IDC's approach to analyzing partner business performance, we formed a suite of measures focused on pragmatic business issues such as cash flow, deal size, sales cycle time, and services margin, in addition to net profit margin. We identified 14 KPIs that represent a comprehensive view of business performance for the type of IT solution companies being analyzed. Although it is unlikely that any single manager would use all 14 measures in making business decisions, our research indicates that we have identified the most important measures. In the companion IDC White Papers for Microsoft's AI and IW Solutions Competencies, we present these KPIs visually in a partner performance dashboard, an outline of which is displayed in Figure 1. We believe the dashboard is a useful vehicle for communicating and contrasting partner performance in a concise yet holistic way.

FIGURE 1

The Partner Performance Dashboard



Source: IDC, 2006

The Business Value of Microsoft's Competencies

IDC's research found that Microsoft's partners who have earned the Advanced Infrastructure Solutions Competency designation (Microsoft AI Partners) or Information Worker Solutions Competency designation (Microsoft IW Partners) exceed comparative industry benchmarks for 12 of 14 KPIs measured by IDC. Our research also found that companies earning the recently launched Microsoft Mobility Solutions Competency designation (Microsoft Mobility Partners) are well positioned to take advantage of both an emerging high-growth market and increasing Microsoft market commitment. Note that we found fewer companies focused on mobility solutions than infrastructure or knowledge worker solutions, reflecting the early stage of the mobility market overall. This prevented us from making direct comparisons between Microsoft Mobility Partners and appropriate industry benchmarks.

Key findings of the study include:

- Performance of Microsoft AI Partners exceeds industry benchmarks consisting of partners who focus on selling infrastructure solutions (but generally have not earned the Advanced Infrastructure Solutions Competency designation) and who identified either Linux (Linux Benchmark) or Windows (Windows Benchmark) as their primary operating environment. Some examples follow:
  - Revenue growth of Microsoft AI Partners is almost double that of both Linux Benchmark and Windows Benchmark companies.
  - Service capacity utilization of Microsoft AI Partners is, on average, 10% higher than that of the Linux Benchmark and Windows Benchmark companies. Service capacity utilization is the percentage of total service delivery capacity a company has used (i.e., sold) over the course of a year. Higher capacity utilization indicates better resource efficiency (ability to generate more revenue and/or lower costs).
  - Average deal sizes of Microsoft AI Partners are at least 67% higher than the benchmarks, while sales cycles and implementation times are 17% to 36% shorter. By closing business more quickly and implementing the resulting projects more quickly, Microsoft AI Partners appear to be leveraging *business velocity* to outperform both the Linux and Windows Benchmarks.
- Performance of Microsoft IW Partners also exceeds the industry benchmark of partners who focus on selling knowledge worker solutions (but generally have not earned the Information Worker Solutions Competency designation). Examples include:
  - Revenue growth and deal growth are over two times greater for Microsoft IW Partners, and customer growth is nearly twice that of benchmark companies.
  - Service capacity utilization of Microsoft IW Partners is also 10% higher than that of the benchmark companies, enabling Microsoft IW Partners to keep nonproductive resource costs in check and keep net profit margins higher.

- Deal sales cycles and implementation times of Microsoft IW Partners are significantly shorter (as much as 50% shorter) than those of industry benchmark companies. Like Microsoft AI Partners, Microsoft IW Partners are leveraging business velocity to their benefit.

- Revenue growth of Microsoft Mobility Partners is strong, with a median growth rate of 30% over the past 12 months. Expected growth rates for the next year were projected by partners in the double digits for all but one firm. Customer growth is also strong, with a median growth rate of 30%. Most partners generated more than 50% of their revenue in the past 12 months from new customers added during that time.

Challenging Some Common Perceptions

In the IT industry there are a number of beliefs or perceptions about what impacts a company's business performance. When analyzing the results of this study, IDC found important relationships that modify or refute these perceptions.

1. Gross Margins

Perception: High gross margins mean business is healthy and profitable.

Reality: A company's gross profit margin bears no relationship to its net profit margin or cash flow from operations.

Companies with high gross profit margins did not necessarily have strong financial performance as measured by their bottom-line profitability or their ability to generate cash. This means that IT solution providers that operate businesses with lower gross margins can and are finding other ways to generate profits and cash. Microsoft AI and IW Partners are proof points, where their gross profit margins are lower than those of the industry benchmark companies, yet almost all other KPIs exceed the benchmarks, including net profit margin and cash flow from operations.

2. Small Deals

Perception: Small-sized deals are less attractive than large-sized deals.

Reality: Although companies having a larger average deal size tend to perform well, companies having a smaller average deal size can perform well if they maximize their *business velocity*.

IDC found that companies having a larger average deal size performed better than companies having a smaller average deal size. However, companies with large-sized deals also tend to have long sales cycles and implementation times for these deals. Companies with small-sized deals can perform well *if they minimize the time it takes to land and deliver these deals*, thereby maximizing their business velocity. Specifically, Microsoft AI and IW Partners having a smaller average deal size still outperformed comparable benchmark companies. We believe they did this in part due to significantly shorter sales cycles and deal implementation times, allowing them to increase the throughput of deals and effectively increase the speed of doing business.

3. Linux-Based Businesses

Perception: Linux is more profitable than Windows.

Reality: The operating system platform has little to do with a company's business performance. Business execution is more important.

We found strong evidence of this when comparing the business performance of Microsoft AI Partners with that of Linux and Windows Benchmark companies. As outlined in the previous section, The Business Value of Microsoft's Competencies, Microsoft AI Partners outperformed these benchmarks in at least 12 of 14 KPIs, demonstrating that any revenue model or cost differences between the two types of platforms pale in comparison with other aspects of business execution where Microsoft AI Partners excel.

4. Business Focus

Perception: Narrow focus in your business helps performance.

Reality: The best approach is diversification in complementary practice areas — what IDC calls a portfolio approach to the key aspects of operating a business.

IDC scored companies on the degree of focus they have in seven different aspects of their business: solutions, technologies, customer size, partnering, vertical industries, types of services offered, and business model. We found that companies that build and base their business on one vertical industry, one solution offering, and one technology tend to perform worse than companies that support more than one of each. In-depth interviews of Microsoft partners revealed that the real benefit of multiple offerings occurs when these offerings are related, for example, in adjacent markets. We call this approach of strategic diversification a portfolio approach to the business.

5. Capacity to Fund New Business Opportunities

Perception: Access to capital is a driver of business performance.

Reality: What is more important is a company's overall capacity to fund new business opportunities, drawing from all sources of cash, including its own ability to generate cash from operations.

IDC found that the most important characteristic associated with top business performance is a company's capacity to fund new business opportunities. Such capacity can be met from internal sources such as cash flow from operations, and accumulated cash on the balance sheet, in addition to external financing opportunities (i.e., "raising capital"). A number of Microsoft partners we interviewed told us that Microsoft provides tactical assistance that, in our observation, helps them either increase revenue or decrease costs. Examples include joint marketing initiatives, prospect referrals, technical support, and presales product information. Most of these partners use internally generated funds to expand their business, and the benefits accrued from their partnership with Microsoft help them generate the cash they need to fund new business opportunities.

6. Business Growth

Perception: After the dot-com bust, growth takes a back seat to cost reduction.

Reality: Although cost management is important, the top performing companies are also the top growth companies.

IDC found a strong positive relationship between a company's revenue and deal growth and both its net profit margin and cash flow from operations. We see this especially when looking at the performance of Microsoft's AI and IW Partners, where revenue growth and deal growth are in some cases more than double the industry benchmarks.

Why Is a Partner's Business Performance Important?

Although IT solution providers have always faced the challenge of building and maintaining profitable companies, only recently has their business performance become a more pressing issue among the IT vendors themselves. Declining revenue growth rates across the IT industry have focused more attention on bottom-line profitability and the many factors, both large and small, that contribute to business performance.

As part of this trend, partners are increasingly making technology adoption decisions based on hard-dollar business rationale. This decision-making environment is in contrast to that of the late 1990s, when partners relied on technology to "sell itself" and decisions were based largely on faith and trust in longstanding vendor relationships. In the past, IT vendors were focused on producing better technology and expected their partners to have the requisite business acumen to develop a successful business around their products. In the new climate, vendors realize that the business health of their partner community is critical to their success.

What It All Means

For partners seeking to set themselves apart from the crowd, Microsoft Competencies provide a vehicle that easily identifies market skills and delivers proven business value. Earning one or more of these Microsoft Competencies opens the door for partners to experience a deeper relationship with Microsoft. As the Microsoft Competencies continue to evolve, partners should remain focused on the areas revealed by this study to impact their performance the most.

Challenges for Microsoft include competitors' focus to increase and broaden their partner incentives over time, scaling its support organization while maintaining high service levels, and ensuring that Microsoft certifications continue at a level of quality and relevance to customers. Microsoft must be willing to address these challenges clearly and quickly to continue building partner momentum.

APPENDIX A

Study Methodology

IDC conducted this research in three phases from June to August 2005. A detailed explanation of the study methodology can be found in the companion IDC White Papers; however, an overview follows:

- In Phase 1, IDC randomly surveyed VARs and services-oriented partners (e.g., systems integrators and consultants) sourced from publicly available lists. This Benchmark Research formed the basis against which we compared Competency-based businesses. The Benchmark Research sample size was 642 companies from the United States, the United Kingdom, and Germany.

- In Phase 2, IDC conducted Targeted Research with Microsoft partners (mainly VARs and services-oriented partners) who have a practice focus in the Microsoft Competencies of AI, IW, or Mobility. These partners were sourced from Microsoft-supplied lists. The Targeted Research sample size for all three Competencies was 375 partners from the United States, the United Kingdom, and Germany.

- In Phase 3, IDC conducted in-depth interviews with executives of Microsoft partners who are engaged in at least one of the three competencies of interest. IDC interviewed a total of 62 partners from the United States, the United Kingdom, and Germany. IDC sourced these partners from the partners who participated in Phase 2 (55 partners) and from Microsoft partners identified by IDC (7 partners).

From the Benchmark and Targeted Research, IDC developed KPIs plus other metrics to better understand potential drivers of business performance and to compare the performance of different groups of companies with that of the Microsoft AI and IW Partners.