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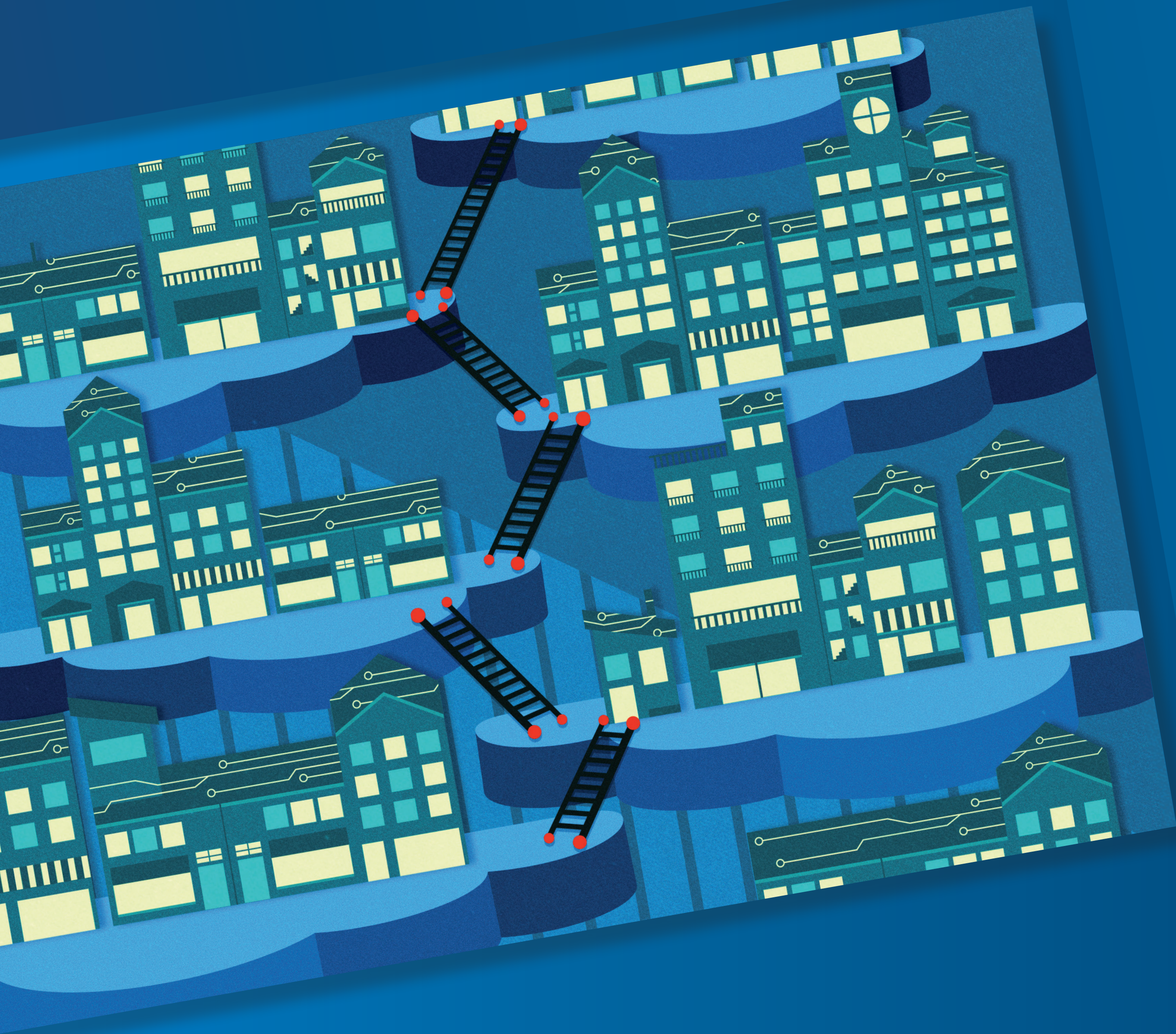

Big business in small business: Cloud services for SMBs

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Cloud services are gaining ground in all segments, but small and medium-sized businesses present a unique opportunity. Understanding and addressing what sets them apart is the key to success.

Small and medium-sized businesses (SMBs) are playing a growing role in the rise of the market for cloud services. By 2015, their share in the market is expected to reach USD 28 billion – with an expected profit pool of USD 3.5 billion – representing 40 to 50 percent of the total cloud market opportunity. In a McKinsey survey of SMB leaders, 60 percent of respondents indicated they have already purchased at least one cloud service and about 30 percent have purchased five or more.

When it comes to who will provide these services to SMBs, it is still very early in the cloud game: no single vendor type has a dominant market position. While pure-play IaaS/SaaS companies may currently be the preferred vendors in developed markets, this perception is hardly set in stone. In fact, telecoms players and IT service providers are seen as highly credible cloud service providers in emerging markets. Significant opportunity is out there for all players from the largest incumbent ISVs to local IT providers to telecoms vendors.

The unique cloud challenges of SMBs

Almost everyone agrees there is an important cloud opportunity beyond large enterprises, but the majority of providers have not yet cracked the SMB code. SMBs are a unique group of businesses – in many ways, more dynamic than the consumer and large enterprise markets. It is this uniqueness that gives rise to several challenges.

Difficult economics. SMBs need a greater customization and more servicing than consumers, but have limited resources compared with enterprises. Thus, cloud services are a smart option for SMBs, but the associated subscription model is new, demanding territory for traditional providers.

Significant variability. While they may be united by their relatively small size, SMBs vary greatly in terms of their cloud needs and preferences. A standardized go-to-market approach might work for individual consumers and large enterprises, but there is no such one-size-fits-all approach for providers of cloud services to SMBs.

Shifting buying model. Half of SMB cloud service purchases are now directly from the cloud service provider. This shift toward self-service has made resellers less necessary in the eyes of SMBs. Simultaneously, this has repositioned a VAR's traditional partners as its competitors.

SMBs are a diverse market

The overarching topics described above may well be where the similarities end among SMBs. Businesses in this category may have a few things in common, but they remain highly diverse. Addressing the cloud SMB market requires accepting that it comprises micromarkets with differing needs. Building the unique value proposition means first segmenting the potential customer base. Segments will typically have differentiated value proposition needs, financial potential, and go-to-market approaches. World-class segmentation combines attitudes and needs with firmographics and behaviors.

McKinsey research into SMBs reveals four distinct, cloud-services-focused segments. In general, these segments apply globally, although their respective shares may differ by country and over time (e.g., Germany currently has more risk minimizers, Spain has more cost optimizers). Taking the US as an example, the distribution of SMB cloud consumers is as follows.

Cost Optimizers (29 percent). After identifying the core functionality required, this group will look for the lowest-priced offering available – across vendors and across bundles. They perceive additional features as extraneous and will at times prioritize acquisition price over total cost of ownership (TCO). Cost optimizers are typically companies with limited or no internal IT function and IT budgets of less than USD 20,000.

Feature Seekers (25 percent). These SMBs seek someone to take the IT burden off their shoulders, preferring to work with fewer vendors. They require "always-on" service with advanced security and mobile features. Convenience takes priority over customization. Feature seekers are companies at least five years old, with 20 to 49 employees and IT budgets of USD 20,000 to 100,000.

Risk Minimizers (18 percent). Migrating to the cloud entails risks – and this group wants a worry-free service. They seek best-in-class uptime, reliability, security, and low TCO. The objective is to ensure uninterrupted business; for non-owner IT professionals, that their jobs are secure. Risk minimizers are companies with international reach and IT budgets greater than USD 100,000.

IT Sophisticates (28 percent). These power users want state-of-the-art administrative capabilities and the ability to customize solutions to fit their needs. They view IT as an enabler that can add value to their business. They consider cost and non-technology factors secondary. Looking for something that can increase their competitiveness, they do not mind working with multiple vendors. IT sophisticates are companies with internal IT expertise and IT budgets of USD 100,000 to 500,000.

The actual segments will differ by service type, requiring tailored segmentation to tease out the nuances. Generally, elements of the four segments above can be found across all SMBs. Certain providers will have advantages with certain segments. Small providers who, for example, offer white-glove migration, aftersales support, and superior administrative capabilities can appeal to Feature Seekers and IT Sophisticates; vendors with a self-service model and a recognized brand, to Risk Minimizers. Providers offering basic services at the lowest price will attract Cost Optimizers.

Five winning SMB cloud strategies

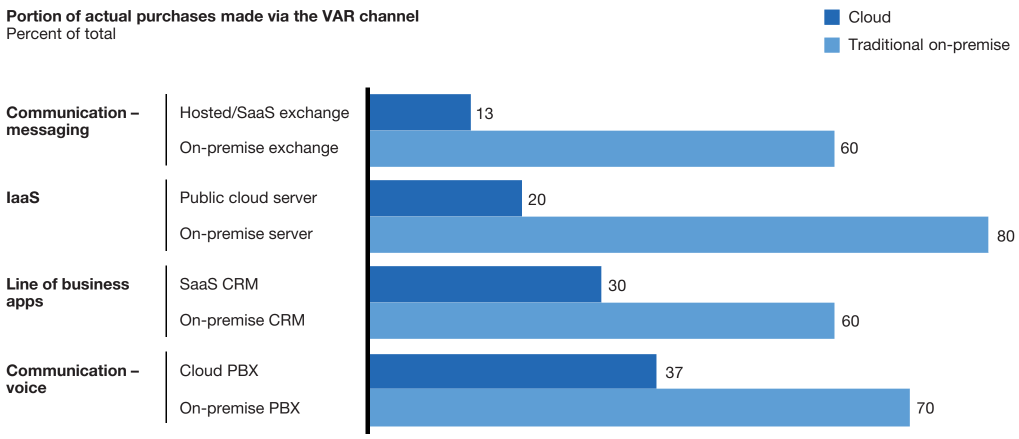
To meet the unique challenges of the SMB market head-on, cloud service providers targeting SMBs need to take on new perspectives and strategies when approaching this market.

Strategy 1: Think "anchor" and "satellites." Cloud purchases should not be considered discrete services where purchase decisions are made independently. Among IT Sophisticates in particular, customers typically purchase multiple services over time, starting with an anchor service then continuing with satellite services.

McKinsey analyzed this cloud journey to discover that nearly half of all SMBs (approximately 45 percent) begin their cloud journeys with either a communication/collaboration service (e.g., e-mail) or a content management service (e.g., backup) as their first cloud solution. Horizontal business applications such as CRM are a close third as far as anchor services go. As SMBs become more familiar (and more satisfied) with their first cloud service purchase, they begin to add satellite services to the mix. For the services mentioned above, when an SMB chooses one as its cloud anchor, the other two are likely to become satellite services for that business down the road. There is also a significant likelihood – but not a certainty – that an SMB will choose satellite services from the same company providing its anchor service. This means vendors need to lead with appropriate anchors, then cross-sell the satellites along this journey and/or intelligently bundle services at the anchor service point of sale.

Most SMB cloud customers begin with an anchor service, then add on satellite services over time

Cloud solutions are severely challenging traditional channels



SOURCE: McKinsey SMB IT Decision Journey Survey (US, 2012)

Exhibit 1

E-mail, for example, can serve as an anchor SaaS offering, generating around USD 5 to 7 ARPU each month. Cloud e-mail customers have demonstrated high propensity (40 to 60 percent depending on the service offering) to buy additional offerings (e.g., add-ons like archiving, voice-based services, IaaS capacity) from the same vendor. Adding up the value of add-ons, the combined basket can more than double to USD 12 in ARPU per month. Akin to how telecoms made significant profits from value-added services (e.g., call waiting), these add-ons generate considerable incremental profits.

Strategy 2: Rethink partner roles and relationships. Many traditional VAR partners come from a hardware/technology background. Up to now, they haven't needed extensive knowledge of the business or processes affected by the technology solution. But with cloud SMB purchases being driven ever further into the business (no longer confined to IT), VARs are losing ground to channel partners with deeper business understanding (Exhibit 1).

Beyond this, a new breed of channel partners comprising pure-play cloud consultants and system integrators (SIs) is becoming increasingly critical in the early stages of influencing customers on vendor choices. 26 percent of SMB customers cite these providers as being the most influential in driving consideration of cloud solutions they were looking to purchase – second only to peers and industry events. These and other cloud service providers hold significant sway in getting companies to adopt their services, so building partnerships with this new breed of channel players becomes critical to drive service adoption.

Strategy 3: Optimize post-purchase experience. The post-purchase experience can be a key differentiator in cloud for two reasons. First, cloud's inherent scalability makes it simpler for customers to switch vendors. Second, SMBs are frequently evangelists for services they like. Among the SMB cloud customers surveyed, 60 percent shared feedback on their purchases and 18 percent actively referred other customers based on their own purchases. Given how powerful customer references can be when compared with other marketing devices, vendors should place heavy emphasis on cultivating evangelists.

The relative importance of the post-purchase depends on the product

Frequency of post-sales service listed as a key decision factor
Percent

Service	Implementation	Training	Support
Communication – messaging	22	28	26
IaaS	25	24	23
Line of business apps	23	32	18
Communication – voice	48	28	24

SOURCE: McKinsey SMB IT Decision Journey Survey (US, 2012)

Exhibit 2

The post-purchase experience consists of three modules: implementation, training, and support – with their relative importance differing slightly by product type (Exhibit 2). In voice communication, for example, 48 percent of SMB customers cite post-purchase implementation as a key factor in the purchase decision. For line of business apps like CRM, training is the most important factor, with 32 percent of customers citing it as a key decision factor. Despite varying importance, vendors need to be cognizant of the overall experience and to whichever postpurchase experience module may be of primary importance based on the service.

SMBs can easily switch vendors without disrupting their other services, making excellent customer experience the key to loyalty

Strategy 4: Adopt a customer lifecycle management (CLM) mindset. Cloud businesses have more in common with subscription businesses – such as a telco's mobile service – than they do with software businesses, making a long-term perspective on future customer needs all the more important. First, acquisition costs run high and are only recouped after months or even years. Second – as mentioned in Strategy 2 – SMB customers will likely return to the same vendor as they add services to their cloud portfolio. Having a single provider to aggregate a set of cloud services gives SMBs the benefit of unified billing, provisioning, identity management, and user experience. Of customers who already bought e-mail, for instance, 29 percent purchased content management services and 21 percent also bought purchased cloud IaaS offerings from the same vendor. Identifying the most likely "next product to buy" based on a variety of customer information can be very powerful in increasing overall ARPU per customer. Third, cloud businesses do experience high churn especially in the SMB segment, where switching providers is easier and since SMBs demonstrate inherent turnover (50 percent of SMB companies do not survive beyond five years). Identifying the customers with the highest propensity to churn and targeting them with proactive offers and a responsive save desk can prove to be highly effective.

Strategy 5: Employ an e-commerce-like marketing and sales model. Information and communication technology vendors have long marketed and sold to business customers via a distinct, sales-force-heavy model that invested significantly in relationships with businesses' chief executives as they sought to provide company-wide solutions to their customers. Today's reality, however, is that business leaders are more than able to compare, test, and purchase these products single-handedly – without ever leaving their own offices – completely bypassing yesterday's instructive, hand-holding approach. This reality particularly applies to cloud services and SMBs.

In many ways, this digital-enabled B2B sales model is remarkably similar to the e-commerce model that has long characterized the B2C world. Given this trend, cloud providers would be well advised to adopt some of the e-commerce tactics in serving their business customers that are already widely deployed among consumers. One such tactic is to use the product as a sales tool, i.e., creating – and giving away – trial versions of the product that let customers test the value proposition before ever speaking with a seller. During the trial period, the provider can run analytics to determine if a customer will convert without additional input, convert with targeted seller attention, or continue as a free user. However, creating pricing tiers and deciding what's included in the trial are crucial: provide too much and customers will never upgrade; give away too little and customers won't experience the product's value. Another tactic is to aggressively shift new customer acquisition spend to digital. Rather than a broad customer acquisition approach, providers should take a page from B2C e-commerce and focus on highly segmented digital acquisition marketing. By analyzing customer needs, e.g., based on referral paths, search terms, conversion rates, industries, and geographies, providers can identify the best prospects at the microsegment level and customize their user experience with personalized landing pages, messaging, pathways, offers, etc.

Companies employing these tactics are achieving twice the revenue growth rates, triple the customer growth rates, and 30 percent higher acquisition efficiency than those businesses that deploy the traditional sales model.

The SMB market for cloud services holds great promise in store, but the market presents a few hurdles. The need for high flexibility coupled with limited budgets, non-standard decision making processes, and a wide range of service preferences are among the go-to-market challenges service providers must tackle first. The key to success will be addressing the uniqueness of the SMB market and not treating it like a larger version of the consumer market or a smaller version of the large enterprise market. Building on SMB segmentation and piloting new sales models will make it possible to create a holistic cloud journey for SMB customers joining the cloud.

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