Sold on MRR: 3 Strategies to Get to Recurring Revenue Nirvana

By James Anderson

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Table of Contents

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About the Author

JAMES ANDERSON serves as news editor for Channel Partners. He is in his third year with the publication and recently graduated with a degree in journalism from Arizona State University. His beats with Channel Partners include SD-WAN and large telecommunications providers. He has served as a moderator for multiple panels at Channel Partners events.

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Sold on Recurring Revenue

DISRUPTION ISN'T JUST FOR TECHNOLOGY AND BUSINESS STRATEGIES.

Channel sales proessionals who may have spent their entire careers making big paydays on physical products sold in a one-time transaction model also feel the heat. Seems like everything is now "as-a-service" — as one telecommunications executive puts it, solutions sold on a subscription basis are "in vogue."

MRR vs. Capex

For channel-facing companies up and down the chain, it's time to ask: "Are we properly incentivizing our people to sell on a monthly recurring revenue basis?"

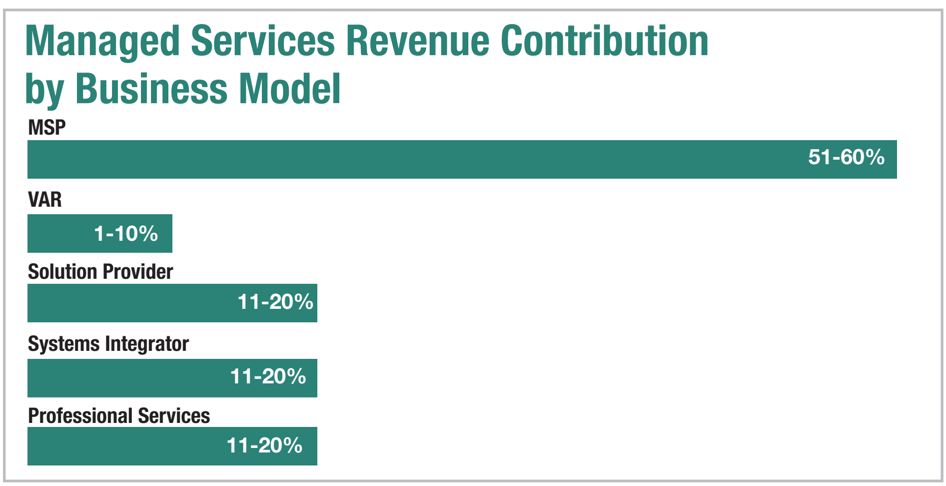
"I'm literally fielding personal calls from people who have been in completely different verticals," says Drew Lydecker, president of Avant Communications, a Chicago-based distributor specializing in cloud, colocation and connectivity. "I just took a call from someone who was in the energy industry. He said 'I want to get into the cloud colo/connectivity game that's happening today. I want to utilize the relationships that I have, and I want to get plugged into your ecosystem."

Lydecker, who co-founded Avant eight years ago after leaving CDW, says he had to work hard to draw in organizations that traditionally sold fixed physical assets in one-time deals. But Lydecker says the resistance has decreased, and the M&A trends among hardware companies signals that shift.

"Getting large capex organizations excited about where we thought the market was going was not easy," he says. "Now it's become extremely vogue, and everybody wants in the game."

It helps that cloud has matured. AWS just hit $4 billion in quarterly revenue, and Microsoft is making no bones about the fact that its partners need to be all-in on Azure. Gartner says the overall worldwide public cloud services market will grow 18 percent in 2017 to total $246.8 billion, up from $209.2 billion in 2016. While the consultancy sees the highest growth rate coming from IaaS, which is projected to grow 36.8 percent in 2017 to $34.6 billion, SaaS is actually a richer market, growing 20.1 percent to reach $46.3 billion.

That makes it all the more surprising that some corners of the channel aren't selling for recurring revenue. A recent study conducted by The 2112 Group for Intronis found that while more than half of MSP revenue is recurring , that is the case for less than 10 percent of VARs. And it makes sense that plenty of resellers are more comfortable with the capex model.



Source: The 2112 Group for Intronis MSP Solutions, "The State of North America Managed Services"

Why?

Conventional wisdom says the upfront commissions are substantially larger than they would be for a recurring deal, and it would be a much longer process to get one's money's worth out of a monthly subscription. However, Larry Walsh, chief analyst and CEO of The 2112 Group, chalks that preference up to a matter of perspective.

"If I was a salesperson and I was given the choice between the two, I would absolutely take the recurring revenue model over the capex model, because I know that my paycheck today is going to be small, but I know that at the end of the year my paycheck's going to get larger, and I'm going to get more money for less work," says Walsh.

Many businesses that have successfully made it over to the MRR side now see commission-centric sales as less preferable. Although recurring revenue starts off small, it continues to grow as partners add circuits, bandwidth, storage and compute for their subscribing customers.

"When you're a salesperson in a VAR world, every January first you show up and go, 'Man, I've got to do this all over again.'" says Rich Nowalk, who serves as the chief operating officer of Opex Technologies, which has made recurring revenue its bread and butter. "In our world, January 1 — two to three years after you've made that switch — you go, 'Wow, I have a nice base. Now I get to build off it.'"

For many analysts and suppliers, there is little question about which sales model will win out. Natasha Royer Coons, managing director of Teranova Consulting Group, says MRR is the future, whether channel partners like it or not.

"All these folks that don't have MRR streams are really concerned," Royer Coons says. "I've heard some perspectives out there where they're thinking five years from now nobody is going to care about what kind of equipment they've purchased. As long as it lives in the cloud and it works, that's all they care about."

Building a Program

It's easy to talk about the importance of MRR, but how do vendors and distributors encourage their sales partners to bite the bullet?

The one recommendation that industry voices seem to share is that there is no single right answer. Each source for this report acknowledges that the sales strategy depends on the size, capabilities and offerings of the company in question.

MRR: Not a Simple Calculation

SaaSMetrics has a handy guide to forecast MRR, taking into account challenges such as retention and churn as well as the possibility of upselling.

The formula:

Net New MRR = New MRR + Expansion MRR - Churn MRR

"There is no single magic bullet," Lydecker says. "It really is up to each organization. Some of the largest companies out there become almost like financial institutions that can help pay out quicker, faster out front while receiving the long end of the tail to benefit the firm itself. Some see the annuity aspect of it, and it's become an incredible tool to keep talent."

Channel-facing companies looking to build a strong incentive program for their partners will do well to consider the following three recommendations.

1. Know your product. It's naïve to jump straight to the specifics of MRR without considering what it is you're trying to sell. Considering the price and the depth of the offering can a go a long way in determining incentives.

"Frankly, some subscription-based products aren't even worth it to be part of the recurring revenue," Walsh says. "If it's a complex service that comes with a reasonably good price tag, then you tend to get to a position where having a share of the recurring revenue is worth it."

Walsh and The 2112 Group report that partners typically sell a mix of managed services, cloud, professional services, and legacy hardware and software. That means a menu of incentives within the program, based on what's being sold. A salesperson may be working with different offerings, some one-time, some recurring sales.

"Then I need to have a hybrid compensation model if you only have one type of sales team, or you have to have segregated sales team that are compensated differently even though they're contributing to the same opportunity," he says. "That's where things get complicated."

Worldwide Public Cloud Services Forecast

	2016	2017	2018	2019	2020
Cloud Business Process Services (BPaaS)	40,812	43,772	47,556	51,652	56,176
Cloud Application Infrastructure Services (PaaS)	7,169	8,851	10,616	12,580	14,798
Cloud Application Services (SaaS)	38,567	46,331	55,143	64,870	75,734
Cloud Management and Security Services	7,150	8,768	10,427	12,159	14,004
Cloud System Infrastructure Services (IaaS)	25,290	34,603	45,559	57,897	71,552
Cloud Advertising	90,257	104,516	118,520	133,566	151,091
Total Market	**209,244**	**246,841**	**287,820**	**332,723**	**383,355**

*(Millions of Dollars)
Source: Gartner, February 2017

2. Be creative with compensation. For a salesperson to hunker down for a long-term sale, you'll need to ensure that they catch a glimmer of the payout. "Show me the money" is more than just a memorable Tom Cruise quote.

"Compensation drives behavior — period," Lydecker says. "Making sure that the entire organization is compensated in an appropriate way to drive that behavior is the number one goal for every company, because the second it's broken somewhere, you'll quickly find that's the reason why the numbers you had in your head weren't being hit."

In many cases, the elephant in the room is the large commissions that are presumably absent from monthly recurring revenue. Walsh says sometimes upfront commissions with "clawback" provisions are the way to go, and sometimes it is necessary to split both the recurring revenue and the commission.

Royer Coons says the supplier may consider "paying out heavy" during the first three months before gradually reducing the returns.

"They need to maybe frontload it with some heavy commissions and then trail it off for the equipment reps so that it smells more like what they're used to," she says. "They still get a really nice spiff for hopefully not doing a ton of work – just asking the right questions, having it on their radar."

It may even be necessary for VARs, distributors and resellers to take a lower profit in order to motivate people on the equipment side.

3. Don't forget enablement. As you tailor your program to incentivize partners or sales pros to pursue MRR, make sure they're equipped to do the job.

Walsh says that discussing compensation is premature for partners that haven't figured out their sales goals. According to his research, 60 percent don't have solidified sales plans. That's a major problem in Walsh's mind.

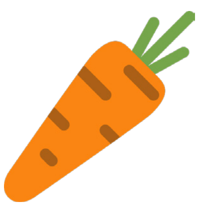
"This conversation is vitally important to the partners, because their future is not in technology," he says. "Their future is in sales. They need to figure out how to transform their businesses to be sales-focused and not technology-focused, and the partners that are able to do that are going to be the ones that win."

Lydecker says enablement is perhaps the most important thing to consider.

"You've got to have a great portfolio, you've got to have a great ecosystem, you've got to have great contracts, all of that. But true enablement — to allow people to get into this game faster and quicker, to be more intelligent, to get up to speed far faster than they are today — that's what we're doing here," he says.

MRR-way or the Highway

Suppliers, distributors and masters have carrots and sticks at their disposal.



Become the bank: Know that recurring revenue doesn't have to be paid out in the same amount every month. Some suppliers pay back the partner quickly and upfront in the same way a financial institution takes the "long end of the tail." Partner firms could do the same for their sales pros.

Be clear that MRR isn't going away: Partners must understand the supplier's commitment to selling as-a-service. Set clear expectations: Yes, it takes time to get returns from MRR, but the transition happening. Come along or be left behind.

The Reseller Side

If the aforementioned advice is for vendors and distributors, what should be said to the channel partners that are in the trenches, making the sales?

Opex Technologies is a technology brokerage and advisory firm based in North Carolina. Nowalk, the company's chief operating officer, says the company has always depended on a recurring model. VARs that want to adapt their businesses have come to Opex looking for advice.

Nowalk's recommendations resemble what Walsh, Lydecker and Royer Coons had to say: The ultimate barrier is patience. Partners may have to start small as they grow their bases, and that can hurt.

"Maybe year one, it's going to be a little painful," Nowalk says. "Maybe even year two, it's going to be a little bit painful. But years three, four, five are going to be worth it."

Convincing partners to be patient takes more than offering comforting platitudes. Opex has taken tangible steps to give its sales team persistence. The company downplays end-of-month evaluations that pressure salespeople to hit certain quotas in a short time frame.

“In our world, knowing that you’ve got a long-term recurring revenue model coming in, it’s not as time sensitive — at least in our business,” Nowalk says. “We don’t play that end-of-month, end-of-quarter game. Because, one, it’s not healthy for the clients we represent. Two, because we have such a long-term view.”

It’s important to reiterate that the specific operational recommendations listed in this report contain strategies that succeeded for specific companies and may not necessarily work for your business. Analysts are hesitant to prescribe a specific formula — that’s due to the multitude of factors that vary per company. As you develop a program to incentivize your channel partners or look for the right company with which to align your sales team, you have an obligation to evaluate your strengths and weaknesses, know what you’re selling and see the big picture view of the sales process.

64% of partners say recurring revenue services are a top growth driver.

Source: The 2112 Group for Intronis MSP Solutions, “The State of North America Managed Services”