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4 ways software companies can improve financials when deploying with hardware

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ENTERPRISES ARE SHIFTING TO ALTERNATIVE SOFTWARE CONSUMPTION MODELS — AND CREATING CHALLENGES FOR SOFTWARE COMPANIES

Enterprises are shifting more of their applications and workloads from traditional on-premise appliances to alternative consumption models including to the cloud, as a service, and software only on-premise.

According to Gartner, IT teams can spend as much as 75% of budgets maintaining internal systems. The cloud and software-as-a-service (SaaS) offer rapid scale and reliability, usually with a lower upfront cost, making them attractive and affordable solutions for a variety of businesses. Alternatively, reference architectures can offer IT teams more freedom of hardware choice and cost flexibility.

However, not all applications can or should run exclusively in the cloud or on reference architecture. Nor do all enterprise IT departments wish to consume cloud-based applications via SaaS. A few reasons why:

- Data-heavy workloads can be incredibly expensive and less financially viable to run in the cloud vs. locally
- Some data and networks are ultrasensitive and mandate on-premise solutions
- Smaller enterprises lack the resources internally to bring these on-premise reference architecture solutions to life

THE DOWNSIDE OF EXCLUSIVE SAAS DELIVERY

Software companies developing SaaS applications are increasingly focused on enhancing their financial performance through recurring revenue streams. Many publicly traded companies that have led the charge to software-delivery-only models have demonstrated growth and have seen a positive increase in valuation.

But software companies must be mindful of the varied ways customers prefer to consume their applications, thus preventing unintended financial consequences from such deployment models.

Most software companies aren't interested in offering a plug-and-play on-premise solution — or in absorbing the additional costs and drag on margins that result. What's more, relying on reference architecture rather than validated and configured server-based solutions can decrease customer satisfaction and increase support costs due to lack of control over the hardware.

FOUR KEY PAIN POINTS ILLUSTRATING THE ADDED COSTS OF DEPLOYING WITH HARDWARE

1. **Transacting hardware with your application decreases margins**
   Gross margins in the sale of software applications often exceed 100%, as they are the core intellectual property (IP) of a software company. The transacting of hardware brings unique challenges, the least of which is margin erosion.

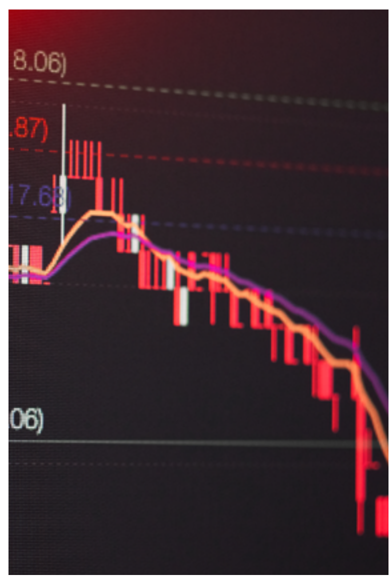
   Hardware often cannot be marked up to the same extent as the software IP, so it decreases profit margins. If hardware is marked up significantly to minimize this impact, the total appliance solution may become cost prohibitive for a customer, pricing the solution out of the market. The software company must address this challenge while striving to retain a healthy gross profit margin (GPM). In addition, offering hardware can tie up the software company's capital in inventory and engineering resources to manage validation, production and engineering.

   One option for the software company is to transact solely in software, adopting a SaaS business model. This leaves hardware selection to the user, who may not follow system recommendations. This can impede performance of the IP, creating higher support costs and negatively affecting customer satisfaction.

   Fortunately, an alternative ensures margins do not face erosion while still delivering the benefits of a validated, pre-configured hardware solution. This option requires close partnership with a hardware integration partner that can procure and configure hardware and integrate the software application on your behalf. That partner would then transact the entire solution, including the hardware (and software, if necessary) with the software company's end-customer or reseller on their behalf. The software company would recognize only the high-margin transaction of its application, while the integration partner would recognize the lower-margin hardware transaction.

2. **Not offering plug-and-play hardware solutions can slow sales cycle, limiting market reach**
   Developing a plug-and-play hardware solution for use in application delivery has many benefits. It addresses the challenge of customers that lack the knowledge or staff resources to manage the integration of the software themselves. Relying on the end-user to purchase the correct hardware separately can slow the sales cycle, because the end-user might choose to delay the software purchase until the hardware is procured and in place. A strong segment of customers in many markets with varying workloads prefer to purchase server-based solutions with integrated software. Even if a server-based solution is not the primary business model, when a customer does not see this option, they may look to a competitor that does offer an appliance version of its application. In addition, relying on the end-customer to procure the proper hardware can lead to negative customer experiences. This is often the case when companies deviate from hardware guidelines, leading to performance issues, increased support costs and lost future sales.

3. **Providing financing for your products creates risk and reduces cash flow**
   Regardless of the manner of hardware and/or software deployment offered for application delivery, the costs can remain high. This presents the risks of credit liability and a potentially negative impact to your balance sheet. A customer can miss payments for many reasons, all of which can erode your GPM. By outsourcing the transaction to a proven Fortune 500 technology and financial partner, you can safeguard your revenue streams and avoid undue financial risk and costly collections processes.



4. **Not offering a subscription version of your product can negatively impact sales**
   Many businesses would benefit from adopting a subscription-based model, which can boost consumption of their IP. Trial periods for your IP can deliver valuable sales and marketing data and allow customers to better gauge the value of your solution. The subscription model can open additional licenses, ensuring long-term revenue streams and enabling customers to gain the benefit of your IP solution without the upfront costs. Offering this option to customers that are private companies also allows for the potential for your application and/or appliance to be recognized as an operating expense versus a capital expense. Some enterprises are looking to consume not only software, but also hardware as a service to reduce the upfront operational expense required to add or upgrade services.

THE VALUE OF OFFERING FLEXIBLE CONSUMPTION MODELS

A one-size-fits-all approach does not meet the needs of most software companies these days because of the multitude of ways enterprises consume applications. The best approach is to have the flexibility and the capability to meet the diverse needs of the market. Each transaction model brings its own set of unique challenges and benefits. Aligning with a global technology partner can boost financial metrics, extend market reach and provide the right answers to tough problems.

Improve gross profit margins

One option to improve margins is to offer a plug-and-play solution that includes hardware to meet the demands of that market segment. The requirement for this option is to recognize only the software transaction while relying on an integration partner to transact the lower-margin hardware. This delivers the benefits of a complete appliance solution, including lower support costs, increased customer satisfaction and a broader available market — while improving the software company's profitability.

Another benefit is that often, the integration partner would not need to mark up the hardware as high as the software company would. The removal of the double markup from the integration partner and software company would result in lower total cost to the enterprise customer — and a more cost-competitive offering from the software company.

Increase revenue opportunities

If the software company does not currently offer a hardware solution due to the potential negative impacts on profit margins, it could employ the previously explained method to offer a fully integrated plug-and-play hardware solution through a partner — without damaging margins. This way, the software company could expand its total available market (TAM) to include enterprises that prefer this consumption model.

Similarly, offering a subscription-based model for both software and hardware enables software companies to expand their TAM to include end-users that consume the application and hardware at a recurring monthly rate.

Reduce risk and liabilities, while increasing cashflow

Working with a technology partner enables software companies to reach more customers profitably, but also reduces risk and frees cash for investments in further development of their IP. The technology partner can assume not only the transaction of the lower margin hardware, but also the transaction of your software applications. Choosing a stable, proven partner removes the risk of not getting paid for any sale. This limits expensive accounts receivable resources, collections and bad debt write-offs as that liability moves from your balance sheet to that of the technology partner.

Speed time to revenue/shorten sales cycle

The ability to successfully address the diverse consumption needs of end-users with validated and configured hardware solutions has numerous benefits, such as a shortened sales cycle, reduced time to revenue and greater overall customer satisfaction. In addition to design, integration and supply chain efficiencies, outsourcing also provides the complementary services your customers require and expect from a first-tier provider. Such services include expertise in installation, warranties, maintenance and even data migration.

FINDING A PARTNER TO HELP PROVIDE FLEXIBLE DEPLOYMENT MODELS AND BOOST FINANCIAL PERFORMANCE

Avnet Integrated offers unique financial solutions to software companies, enabling them to then offer flexible consumption models to their customers while increasing profitability and reducing risks. What's more, we're a global leader in integration and professional services.

Across our ten Global Technology Campuses, our engineers work with leading software companies to identify and validate the perfect hardware solutions for their applications and integrate in their software with server technologies. We handle every aspect from design to delivery — including supply chain management, solution integration and testing, custom branding and packaging, and drop shipping to your customers and installing your solution.

Avnet Integrated's Direct Connect program digitally transforms the businesses of software companies with a complete suite of hardware, financial, data and service solutions. The program was designed specifically to enable software companies to focus more of their resources on the further development of their IP, with Avnet handling design, integration, transaction and service. Avnet Direct Connect's digital offering includes custom-branded storefronts, creating a seamless digital portal where resellers, enterprises and the sales teams of a software company can configure, quote and purchase quality integrated solutions and support directly from Avnet.

CONCLUSION

Valuations for businesses with recurring revenue streams grow two to four times on average, fueling both success and growth. By partnering with a trusted global technology partner, valuable resources can be better focused on intellectual property innovation, delivering a strong competitive edge. The partnership can improve business outcomes and customer journeys by offering flexible hardware and software consumption models that boost customer satisfaction. It's a powerful combination that helps deliver long-term revenue streams.

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