Enabling the Transformation to a Software Focused Business Model

White Paper

ARROW

The Hardware Model Shift

Recently published research from IDC shows that 75% of enterprises indicate the vendor's ecosystem of ISVs as one of their most important digital infrastructure and cloud services selection criteria[1].

Businesses that historically spread their energy and resources across software and hardware are reassessing their go-to-market strategies to create a new value chain they can scale at speed. In doing so, they are considering a variety of software delivery models with anything from shedding hardware to taking software as a service (SaaS) subscription approach to delivery. Regardless of the model, the general trend is to transition to a software-centric business model to capitalize on growing business opportunities, meet customer demands and enhance their financial position.

This shift in trend is driving many independent software vendors (ISVs) and software-focused original equipment manufacturers (OEMs) to search for alternative routes to market. Neither of these types of businesses is new to reinventing business models. They have ridden the waves of perpetual licensing, guided hardware, and reference architecture support right up to developing purpose-built hardware appliances to bundle with their software packages. However, more recently, it has become evident that many of these companies do not have the scale of in-house technical expertise nor the financial profile to manage hardware directly and continue to grow. Shifting focus to provide delivery flexibility of their offering to meet customer needs and focus on software means that ISVs have the opportunity to establish a recurring revenue structure as one of the key objectives of business transformation.

According to Forrester, the number of ISVs is exploding and is expected to reach 1 million by 2027, demonstrating the urgency of differentiating, bringing value, and remaining relevant in the marketplace[2]. This number may indicate why more companies are opting to transfer hardware management to a specialized solution provider that assumes the control and financial implications of the hardware.

Delivering an integrated hardware/software solution based on a leading technology provider's hardware platform is proving to be a successful go-to-market approach for those ISVs and software OEMs that previously provided proprietary hardware. The hardware appliance management model is somewhat diffused across the industry. Those new to the approach are inquisitive about making the software delivery, outsourced hardware component, and operations work effectively together to deliver that seamless customer experience while focusing internal investment on software and increasing overall profitability.

Source: [1]https://blogs.idc.com/2022/01/24/enterprise-digital-infrastructure-buyers-transforming-strategic-vendor-relationships-in-2022/
[2]https://www.forrester.com/blogs/the-channel-software-stack-a-comprehensive-and-critical-look-at-the-future-of-the-industry/

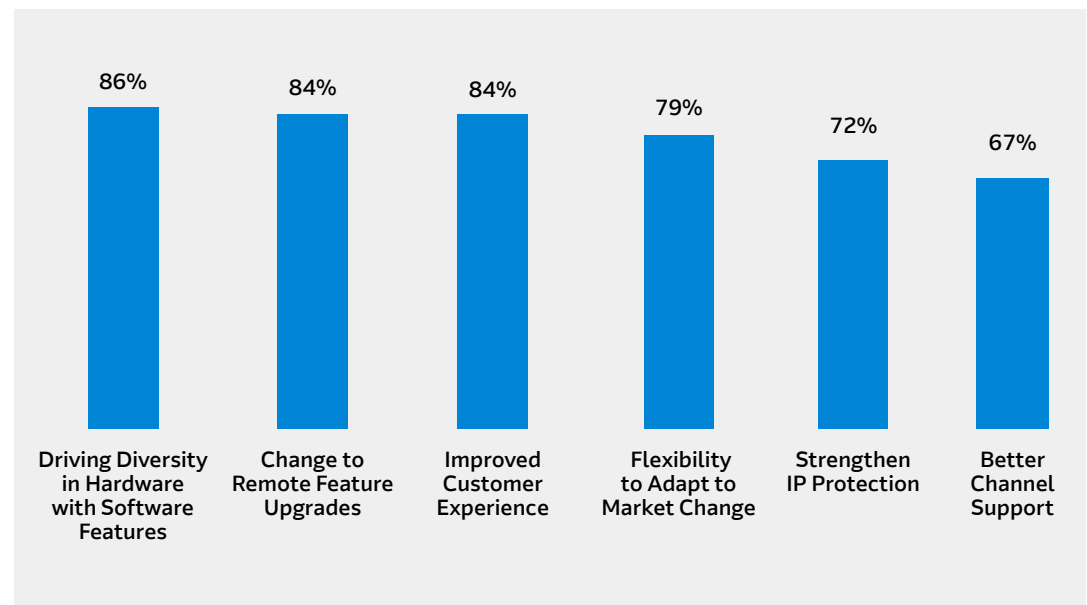# Benefits of Moving Towards Software-Based Models

Recent research conducted by Thales Group shows that four in ten (37%) organizations have already shifted their business model to software rather than hardware-centric. The trend is set to continue, with the majority (84%) of other organizations in the process of changing and 14% plan to start in the future[4].

Each organization will have its own set of objectives and desired outcomes when approaching a business model transformation, however it is highly likely that customer experience, market evolution, and monetization underpin the top drivers in some way.

Those companies that have transitioned their business models to focus on software have reported significant benefits across the board, with the vast majority experiencing an increase in revenue, higher profit margins, and a longer-term expectation of upward growth.

It is essential that whatever your objectives for transitioning to a software-centric business model are, you select a hardware appliance partner and model that aligns with your short and long-term strategy.

Software-Based Model Benefits

Benefit	Percentage
Driving Diversity in Hardware with Software Features	86%
Change to Remote Feature Upgrades	84%
Improved Customer Experience	84%
Flexibility to Adapt to Market Change	79%
Strengthen IP Protection	72%
Better Channel Support	67%

Source: [4]https://www3.thalesgroup.com/hardware-to-software/pdf/report.pdf

Partner Engagement Models

According to McKinsey, investors will reward business models with a higher enterprise value that can consistently demonstrate that revenue is recurring in a manner that's disconnected from the life cycle of the hardware, and that is subject to low customer churn while sustaining or expanding profit margins[3].

There is no one-size-fits-all software-centric business model. Each ISV and OEM has unique elements to its business. Rightly or not, hardware has become somewhat a commodity; hence, the appliance itself is no longer key to driving differentiation or competitive advantage to software-driven companies. Nonetheless, the opportunity to capitalize on the digital transformation era means that software is "King", and now is the right time to transition. However, the right hardware remains a critical element in delivering software solutions. It speeds time to deployment and means the customer is not deterred by having to separately source and test hardware with the software, making for a more consolidated hassle-free purchase that a single supplier can service.

Engaging a partner to assume complete ownership of the hardware production, associated operations (including the sale of the hardware appliance), and logistics gives ISVs increased capability to provide a complete service to customers while removing the economic risk from the balance sheet and dilutive effect on the P&L.

There are multiple ways ISVs and OEMs can engage a hardware partner and balance control and investment while working through a transition. Hardware partner models can take on a range of forms, including:
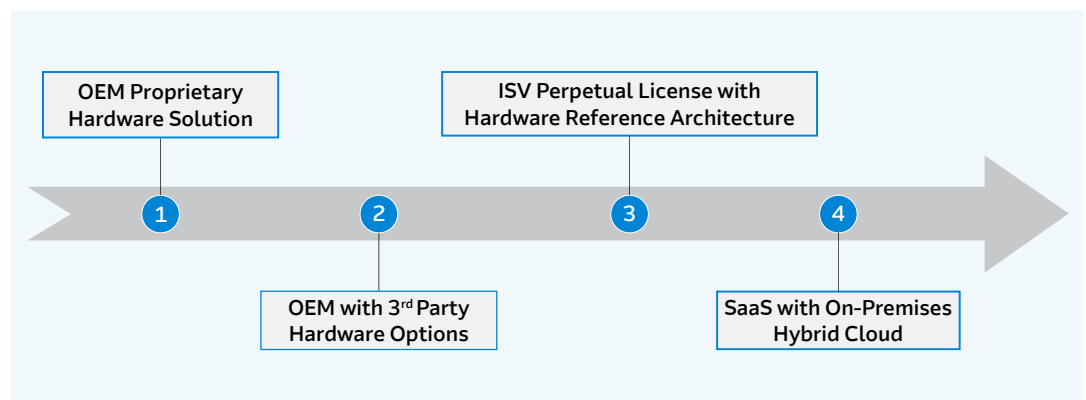
- An advisory role in assessing and recommending new cost-value and productized solutions for direct sale
- A traditional ISV model where you continue to sell software to your channel while the partner takes over ownership and sells the hardware appliance (also known as a meet-in-the-channel model)
- Full transition of hardware appliance ownership to the partner who acts as a single point of sale for hardware and software

Source: [3]https://www.mckinsey.com/industries/technology-media-and-telecommunications/our-insights/hardwares-business-model-shift-finding-a-new-path-forward

ISV Business Model Transition Path

Many software companies transforming to an ISV model do so while concurrently redefining how to sell their software. The figure below shows the typical path that organizations are following through to full-scale transition.

1. This first stage of transitioning to a software-centric business model commonly focuses on the hardware with a traditional OEM model approach. In this first phase, the software company has a purpose-built proprietary hardware solution that is sold in tandem with their perpetually licensed hardware. At this stage, engagement with a partner revolves around integration, fulfillment services, and distribution scale for the finished appliances.

2. The next phase of the transition comes when the market demand for software on leading branded hardware strengthens. The signals come when large end-user accounts require the software to run on the same machines their IT staff uses for the rest of their IT infrastructure. At this stage, the partner works with software companies to develop an adequate solution, which means working through product validation processes, optimization, reduction of product introduction costs, and additional measures for making the broader product line-up available through distribution.

3. Stage three of the journey is where the software company becomes an ISV predominately by eliminating the proprietary hardware offering or slowly phasing it out of the business model. These software companies use a partner as the de-facto OEM of the hardware and either sell the software bundled with the hardware through their hardware appliance partner or pre-loaded but activated through a separate sales channel. The software company still needs to provide an appliance-like experience to the customer by delivering their perpetual license to meet the reference hardware in the channel.

4. The final phase of the path to becoming a fully software-centric ISV is shifting from a perpetual license model to a recurring revenue model through SaaS. Hardware appliance partners assist here by providing validated edge computing solutions and simplifying the SaaS transformation through their cloud enablement capabilities. At this final stage, the software company has limited involvement in the hardware while still having the need addressed and can focus on its core software development competency.

OEM Proprietary
Hardware Solution

ISV Perpetual License with
Hardware Reference Architecture

1   2   3   4

OEM with 3rd Party
Hardware Options

SaaS with On-Premises
Hybrid Cloud

What Should You Look for in a Strategic Partner?

It is essential to consider a range of capabilities to deliver an end-to-end solution including order fulfillment, supply chain, logistics, after-sales support, full lifecycle services, and market demand generation.

Considering transitioning to a software-centric business model with the support of a hardware appliance partner understandably comes with questions and uncertainty around the suitable model for the unique aspects of your business. For some ISVs, working with a hardware partner will mean reengineering proprietary appliances and the associated software application, while for others, it will mean creating a platform from scratch. A partner with a strong engineering foundation is vital and forms the basis of a well-designed, fit-for-purpose, and price-competitive solution.

The transition, however, is not just of the physical hardware itself. It is essential to consider a range of capabilities to deliver an end-to-end solution, including order fulfillment, supply chain, logistics, after-sales support, full life-cycle services, and market demand generation. A solid partner will support you to bring not only a competitive product to market but also look at helping you capitalize on new markets and revenue streams. You can then work on selecting the blocks that serve you and build the model that best suits your business objectives.

What to Look for in a Strategic Partner

Engineering	Supply Chain	Order Fulfillment	Routes to Market	Post Sales Support
Design	Forecast	Quote	Global	Installation
Validation	Suppliers	Order	Indirect/Direct	Triage
NPI	Materials	Fulfillment	Multi Vendor Solutions	Warranty
ECO	Integration	Invoice	3PM	Repair
Lifecycle	Logistics	Financing	Customer Financing Solutions	Recovery

The Top 5 Elements to Look for in a Strategic Partner

1. Design and Engineering Capabilities

Design and engineering are the foundation of competitive value-based appliances with market appeal. Partner engineering teams have the expertise and deep knowledge of leading hardware technology platforms and managing product life cycles to keep long-term requirements top of mind during the design process. The partner engineering group will need a comprehensive technical understanding of your software, deployment environments, and specifications to establish a portfolio of appliance options suited to customer use-case environments. The final product portfolio can cover anything from productized solutions and reference designs to custom solutions. Hardware and configuration testing is a crucial part of the process and must happen before the NPI and production process begins. However, the engineering function should not end with production. It must continue reviewing processes and technology to make improvement recommendations throughout the portfolio lifecycle.

2. Order Fulfillment Capabilities

Market readiness efforts are crucial to getting a product to market seamlessly. A strategic partner needs to provide flexibility and support a range of fulfillment models for hardware, software, and associated services. An essential part of this is the partner's ability to fulfill and transact orders into global markets with a combination of regional fulfillment and global trade solutions capabilities. Determining a commercial model aligned with the end customer and sales channel preferences is equally important. Single purchase order (PO) or dual PO models are commonly used with indirect channel and distribution partners often opting for a single PO model by consolidating the procurement of the software and the integrated hardware platforms. The ideal partner has the ability and expertise to support both indirect and direct sales channels. You should be able to rely on their fulfillment capabilities to support all of your sales channels.

3. Supply Chain and Logistics Networks

Choose a partner with global infrastructure and supply chain capabilities to ensure a consistent, competitive, and reliable customer experience. Product supply chain, integration workflows, and logistics are integral operational elements that can determine the overall success of an appliance-based partner model. It is also fundamental that the partner has the experience and global alliances with top hardware technology suppliers supported by their global infrastructure to facilitate your growth and expansion into new markets.

4. Post-Sales Support

Customer demands for unwavering and near-immediate post-sales support can put pressure on resources and take away from expanding your business further but are a crucial pillar of the customer experience, creating loyalty and driving repeat sales. Ideally, your partner will manage installation, technical support, repair, and maintenance services. It is also wise to ensure that they can provide both hardware and software service support capabilities.

5. Route to Market Execution

A solid partner can support multiple global sales channels and provide complimentary services to enhance the ISV's demand generation and sales enablement of your solutions. Some providers already manage channel sales programs for complementary technology providers, giving them the capability to deliver your offering as part of a multi-vendor solution and assist channel partners in positioning and selling to target markets.
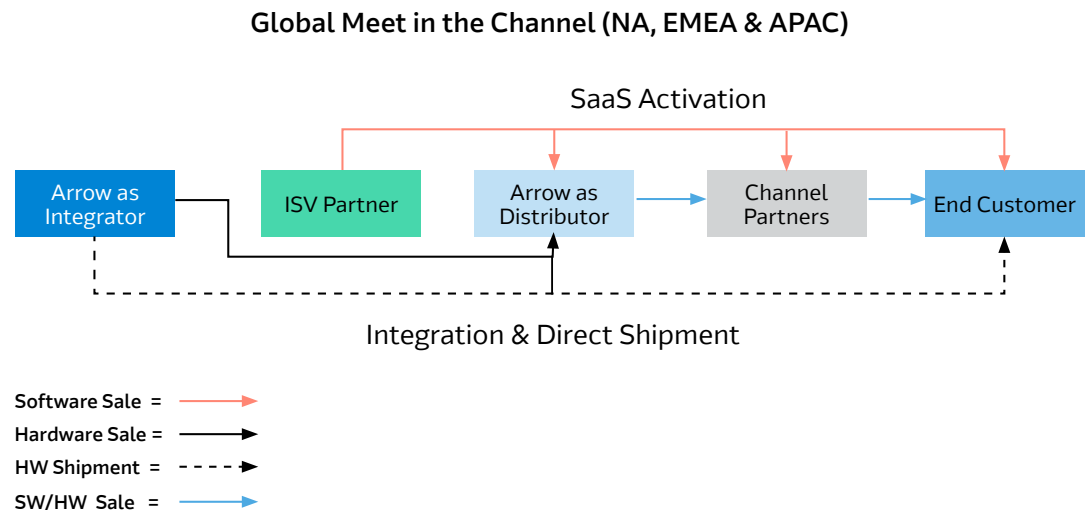
Order Fulfillment Model
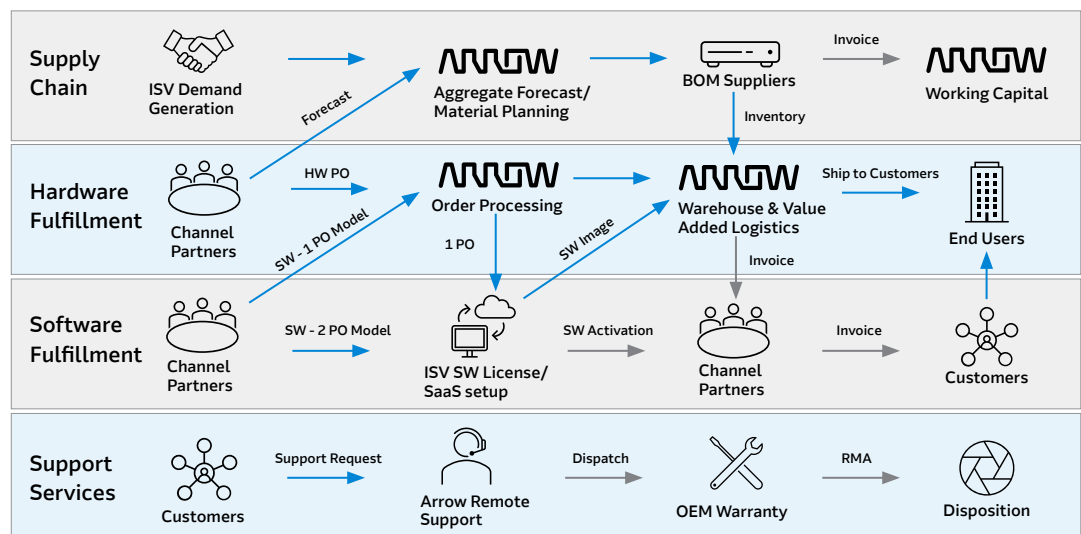
Companies that Have Successfully Partnered with Arrow

Software-centric companies focus on developing ever-evolving software solutions, but many also need to provide the hardware that goes with it to satisfy their customer's deployment needs. Here are some examples of how the Arrow team has worked with customers to develop a tailored business model that meets customer transition needs and overall business aspirations.

Example 1: Storage Software Customer

This combined cloud and on-premises storage software provider is a leader in the multi-million dollar, large-sale, unstructured data file management market. Its subscription-based solutions support thousands of end users globally as they navigate their digital transformation journey and look for improved efficiency in capturing, storing, protecting, analyzing, and managing unstructured data. The customer engaged Arrow to enable its transition to become a software driven company. A major transition driver was the need to scale and launch its products to a much larger global market. The key element of the initial project was removing the financial burden associated with managing a hardware portfolio. The customer aspired to migrate to a meet-in-the-channel model, which Arrow was able to facilitate as part of the ISV Appliance Program in conjunction with Arrow's global two-tier commercial IT solutions distributor, enterprise computing solutions (ECS).

This company has completed this transition and is realizing the financial benefits of focusing on software and achieving its global expansion objectives.

Global Meet in the Channel (NA, EMEA & APAC)

SaaS Activation

| Arrow as Integrator | ISV Partner | Arrow as Distributor | Channel Partners | End Customer |

Integration & Direct Shipment

Software Sale = ⟶
Hardware Sale = ⟶
HW Shipment = - - - - ▶
SW/HW Sale = ⟶

Example 2: Digital Communications Customer

A global leader in digital, cloud, and AI communication technology that develops solutions for customer experience and contact center technology turned to Arrow to transition from its existing business model to an ISV model.

The customer is a leader in the Gartner Magic Quadrant and recognized for delivering customer experience at scale.

The customer had initially worked with Arrow in a typical OEM capacity for:

- Distribution
- Full integration
- Supply chain
- Repair service capabilities

The shift to the ISV Appliance Partner model saw the customer expand its relationship with Arrow to transition all operations and direct fulfillment capabilities fully, including:

- Expanding services for exchange and refurbishment
- Integration and fulfillment functions
- Opening an Arrow web store
- Handing over integration and fulfillment, inventory, supply chain, and pre-build functions

The transition to an ISV model has allowed the customer to focus on their core business and be recognized as an all-in-one solution provider while reducing back-end business-running costs.

ISV Model

Software Sale

Combined Hardware/Software Sale
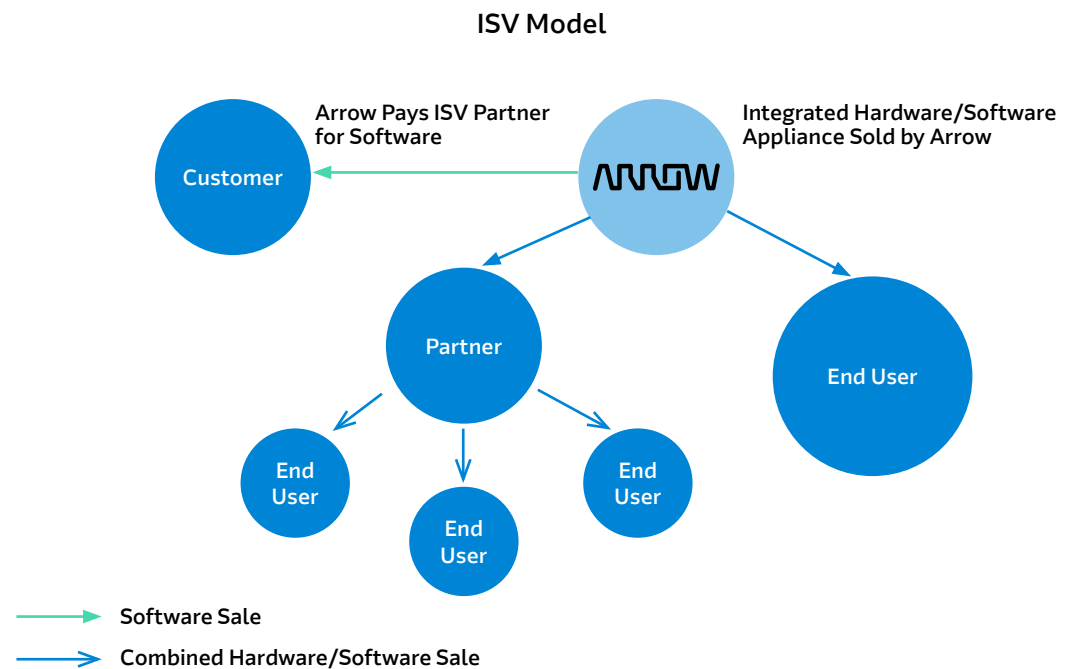
Example 3: Global Data Services Customer

A global provider of enterprise-level backup and recovery solutions engaged Arrow to transition to an ISV business model. This customer has been a Gartner Magic Quadrant leader multiple times and delivers on-premises, hybrid, and multi-cloud software as a service (SaaS), enabling its end users to manage and leverage data short and long term. Its main objective was to shift its focus from a hardware/software-defined business to a software-exclusive model. Simultaneously the customer wanted to continue to go to market with a consolidated hardware/software bundle without the financial responsibility or management associated with the appliance itself. As a result, Arrow enabled the customer to sell the combined solution through Arrow channels while maintaining the existing product branding.

Go-to-Market Model: Today, the customer's global channel partners order the integrated hardware/software solution directly from Arrow. The partner then invoices Arrow for the software component, with Arrow drop-shipping the integrated appliance to the end user or channel partner. The channel partner receives the final integrated solution invoice.

Among the customer drivers for working with Arrow was the ability to globally supply any distributor or end user and overall simplification of operations, allowing the partner to focus on its core software competencies. In this model, Arrow worked with the customer on recommended hardware technologies aligned with the software and end-user deployment scenarios. In addition, the Arrow team has implemented forecasting, supply chain, inventory, integration, and pre-build capabilities to the business model.

Single Purchase Order (PO) ISV Model

— Software Sale
— Combined Hardware/Software Sale
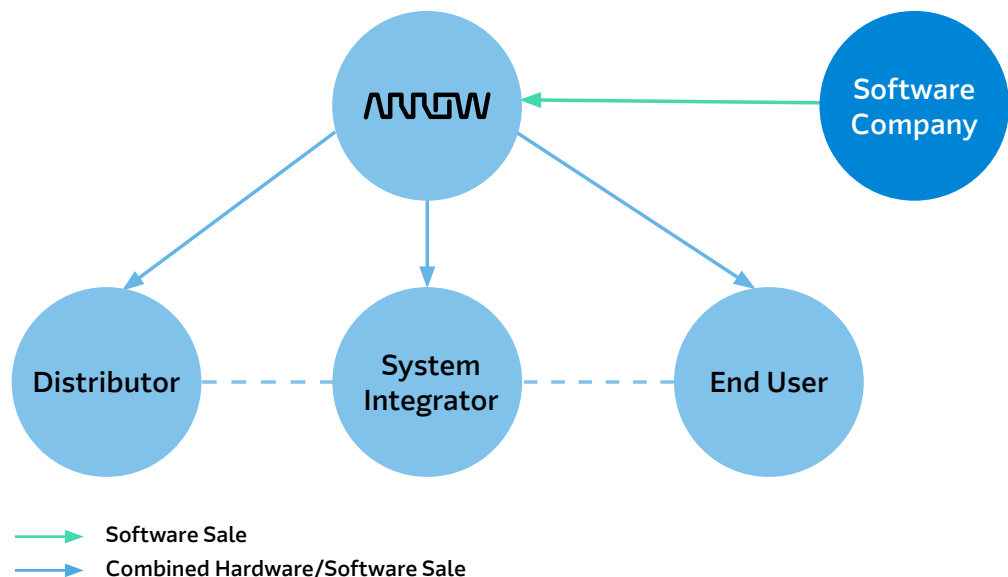
Arrow's ISV Appliance Program
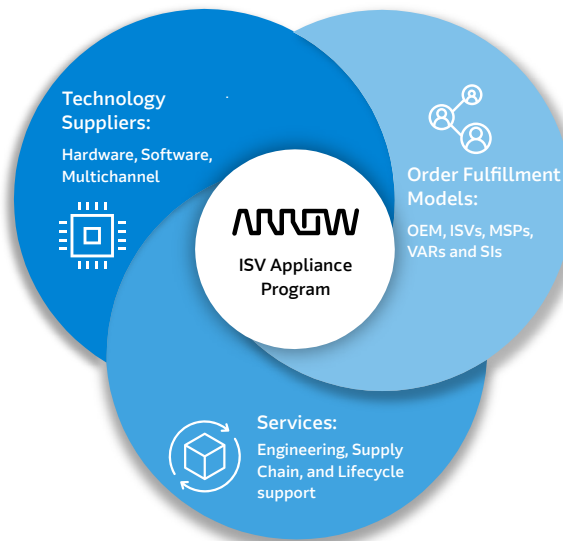
Arrow is a global organization with decades of experience facilitating business transformation and simplifying the technology lifecycle. An early leader in ISV business model transformations, Arrow is uniquely positioned to deliver ISV solutions leveraging experience from enabling business transformations and the management of our proprietary hardware portfolio of (Seneca) OEM products. We have assisted a host of ISVs in becoming software-centric businesses and developed the best appliances and business models to suit their growing needs through our dedicated **ISV Appliance Program**.

The program focuses on fueling growth and giving a competitive edge to our customers. We work with them to develop hardware platforms without the cost or burden of managing end-to-end solutions alone and support them with seamless customer experiences and the opportunity to scale and capitalize on new markets through the channel or direct sales. Customers that join the ISV Program have access to industry-leading technologies from our key technology alliance partners and benefit from:

– Arrow project and product management support expertise
– Proven engineering and product introduction processes
– End-to-end global technology lifecycle capabilities
– Global sales channel management and fulfillment services
– Global inventory and supply chain management
– Optimized TCO and improved offering margins
– Reduced product development times
– "Turnkey" appliances to meet individual needs
– Global after-sales support
– Financial services offerings

To find out more or join the ISV Appliance Program, visit:
https://www.arrow.com/ais/solutions/isv-appliance-program

Arrow Electronics guides innovation forward for over 220,000 leading technology manufacturers and service providers. With 2021 sales of $34.4 billion, Arrow develops technology solutions that improve business and daily life.
Learn more at **arrow.com/fiveyearsout.com**

07_01_2022

ARROW

Five Years Out