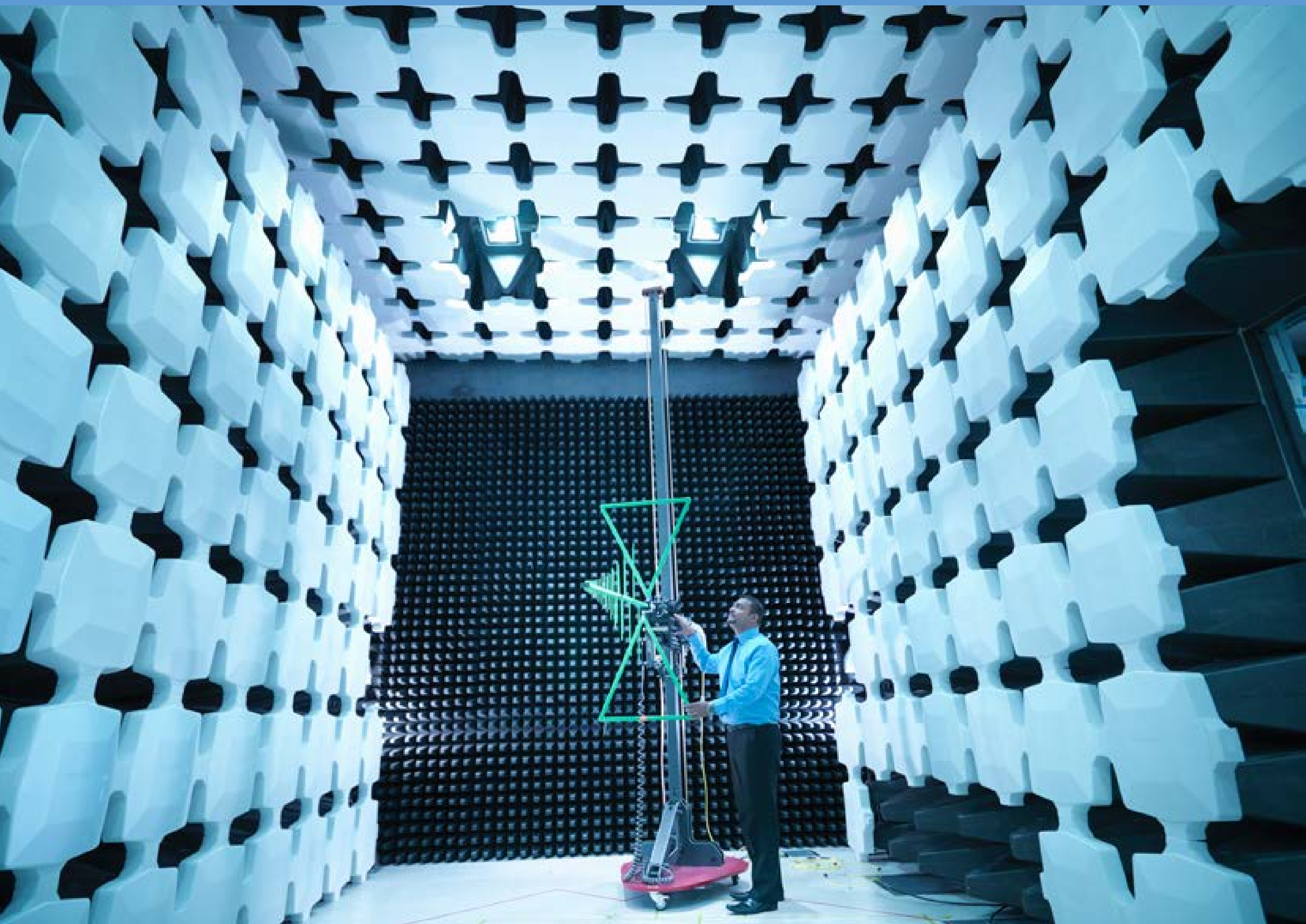
Scaling up through the Channel

Investec
Corporate & Investment Banking

Contents



The pathway to growth

What is the Channel?

The Channel is an ecosystem of sales partners taking technology to market. It can be a distributor, selling product to their network; resellers with an end-user customer base; or IT contractors advising on and implementing technology infrastructure. Consultants and managed services providers also wrap vendor products or services into a comprehensive technology solution, including their own value-added element, for the end customer.

The UK should be very proud of its technology sector. Its deep roots date back to Baird, Bell and Bletchley Park. British companies have been pioneers in personal computing, mobile telephony and artificial intelligence.

Yet, with a few notable exceptions, brilliant technology businesses have failed to scale up to global powerhouse status – leaving the field to US, Japanese, Korean and Chinese rivals.

Despite that, the UK retains an energetic entrepreneurial culture and remains a global leader for technology start-ups in many fields, from machine learning to fintech. It's fourth in the Global Innovation Index; the world's financial centre is still in London; and with four of the world's top 10 universities, the UK has a highly attractive pool of talent for anyone wanting to start, grow and scale up a technology business.

The lobbying and advice network Tech Nation says a quarter of entrepreneurs in the world report having a significant relationship with one or more companies in London (second only to Silicon Valley). London is one of the top three global start-up ecosystems based on company performance, funding, market reach, access to talent and start-up experience.

Investec advises, lends to and invests in hundreds of entrepreneurs in this vibrant sector of UK industry. We are extremely interested in the scale-up challenge – supercharging talent, drive, ecosystems and networks to turn brilliant businesses into world-beating technology players.

In our experience, one route to scaling up that is often overlooked, not fully prepared for and under-exploited is the Partner Channel. This report aims to understand why that is, what we can do about it and how businesses can benefit as a result.

Investec commissioned market research company Vanson Bourne to explore the growth strategies of UK technology businesses and how Channel Partner programmes have affected them. They surveyed 200 senior IT and business decision-makers in vendor companies and 50 decision makers within the Channel across the UK during 2018.

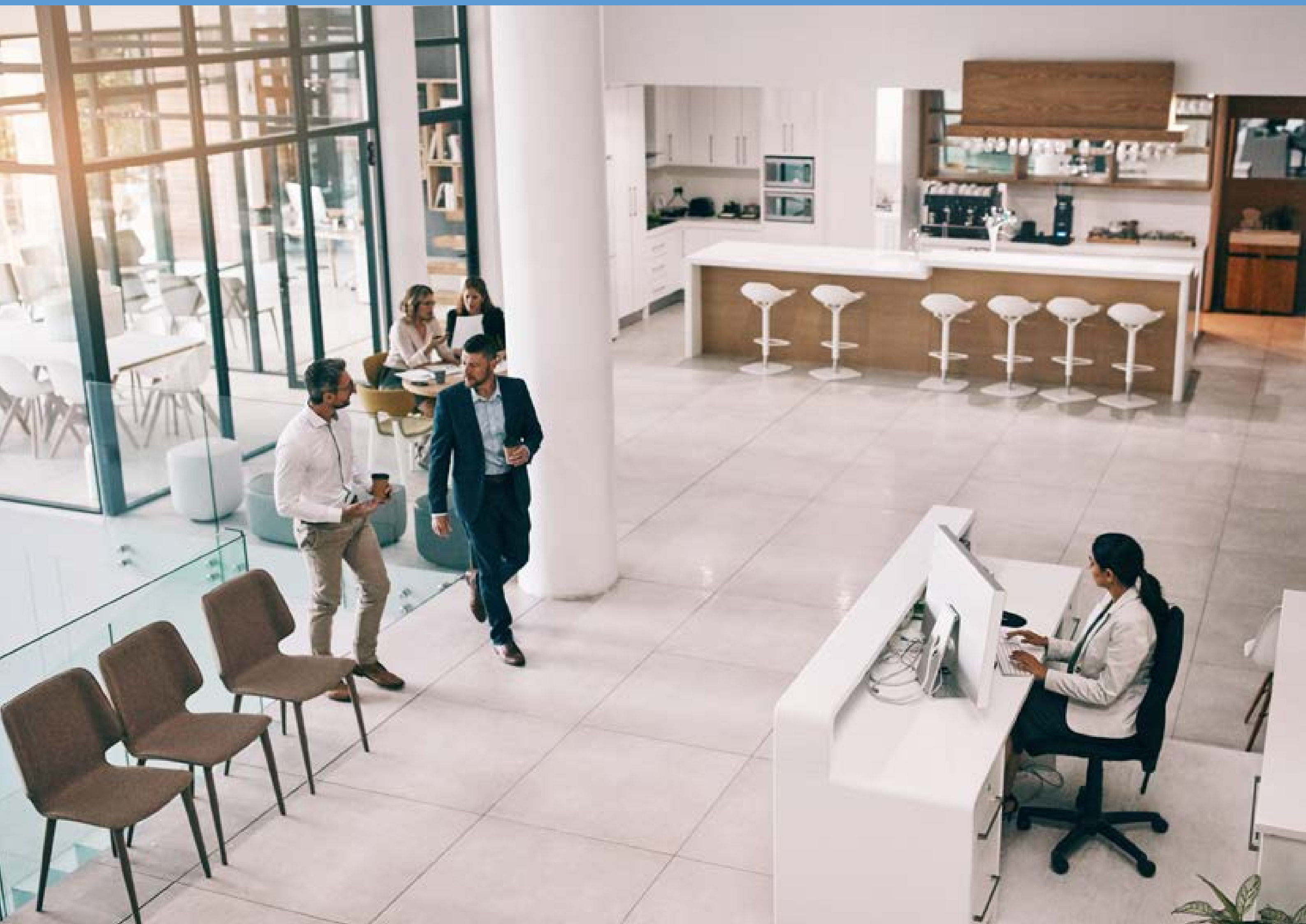
The results confirm that seeing Partner Channel sales as a cop-out or a loss of control means companies miss out on significant revenue, depriving them of incredibly valuable market intelligence, development potential and customer insight.

"The Partner Channel offers UK scale-ups a highly effective and efficient route to market, if executed well," says Junya Iwamoto, Associate Director, TMT Corporate Finance at Investec. "What separates the winners from the also-rans is the extent to which they've invested in the people, processes and infrastructure, enabling a true two-way partnership with their Channel Partners."

True Channel Partnerships can be the difference between being a smart but ultimately modest technology start-up and scaling to be a key player in the fast-emerging technology ecosystems that will shape our world.

SOURCE: globalinnovationindex.org, topuniversities.com, technation.io

1
Opportunities



Up to speed

The scale-up opportunities for UK technology

Research takeaways

- **UK technology businesses are serious about growth and confident of success.**

- **Average annualised growth for the next three years is forecasted at 8%.**

42%

Are 'highly confident' they will hit growth targets.

91%

Aim to expand into new geographies.

41%

Plan to use the channel to exploit new vertical markets.

SOURCE: technation.io

Finding UK technology scale-ups
A 'scale-up business' is defined by the Organisation for Economic Co-operation and Development as one with average annualised growth of at least 20% in each of the past three years. In our research, only 4% of technology companies report growth at this level; the average growth over the past three years is just 5%. That echoes Tech Nation's data: the UK technology sector grew from £160 billion to £184 billion between 2016 and 2018.

Survey respondents are far more optimistic about the future for their scale-up ambitions. Their forecasted annual growth for the next three years is a more robust 8% – with 42% stating they are 'highly confident' and 52% 'somewhat confident' of hitting their targets.

But, in aggregate, that's still well short of the definition of scale-up. So what's going on?

First, not all businesses can reach scale-up growth. Some operate in mature markets. Some have already reached a size where annualised growth of 20% is not feasible.

Second, many technology firms in the UK suffer from under-productisation. "Lots of small-caps on the market have great blue-sky stories – they've spotted a viable total addressable market, they have differentiated intellectual property and maybe even a sales plan," says Roger Phillips, Technology Equity Analyst at Investec. "But they never quite package the product or service in the right way."

Third, they're stuck in a niche with no hope of breaking out. And it's here that Channel Partners offer the opportunity to scale revenue growth without a proportional rise in costs. Both our research and our first-hand experience of supporting scale-up technology businesses suggest this delivers growth in two ways: new geographies and new verticals.

Effective use of Channel Partners solves the first two problems – market maturity and productisation. But our research also discovered that 94% of technology businesses accept they need to modify their roster of Channel Partners to satisfy their growth plans; 46% say the change will need to be 'significant'. So what's the upside of looking again at the Channel?

New geographies
Expanding into new regions brings with it many challenges. Even if a technology business can overcome the language barrier, there are usually regulatory hurdles, the cost of setting up sales and support operations *in situ* and understanding the nuances of local customers. The right Channel Partner can solve all these problems.

In our research, 91% of respondents identify new geographies as part of their growth strategy, even though most of the companies already have international exposure – averaging five countries in their operational base. Only 16% of the technology businesses operate in just one country. The large enterprises average seven countries, while SMEs' average four. And larger businesses tend to have more ambitious international expansion plans, on average wanting to move into four new territories compared to three for SMEs.

So it's surprising that only 42% of technology businesses say expansion into new territories was a specific benefit of their channel programme.

A Channel Partner can be the most effective and low risk way to break new geographies. For example, they can help tweak products, services and associated support systems to address local conditions. A partner's existing footprint and sales team de-risks the process, too.

But this is rarely, if ever, a 'fire-and-forget' approach of simply signing a deal with a Channel Partner in a target country.

"The US is a good example," says Phillips. "Culturally, they see themselves as the best at technology, so there's a risk of 'not-invented-here' syndrome. A Channel Partner can help overcome that to some extent. But a vendor might need to get boots on the ground, too, to show willing."

Get the channel approach right, however, and partners can massively accelerate international expansion. For example, many big-ticket consultancies operate in multiple countries and cater to multinational customers who can pathfind into new geographies.

New verticals

Many technology businesses set out with a focus on solving problems specific to one industry, or even a particular task within it. Scale-up opportunities blossom if they find new applications for the technologies underpinning their solution. But only 35% of respondents say new verticals are an objective of their channel programme. Among SMEs, it's a mere 22%, compared to 47% of large enterprises. What are they missing?

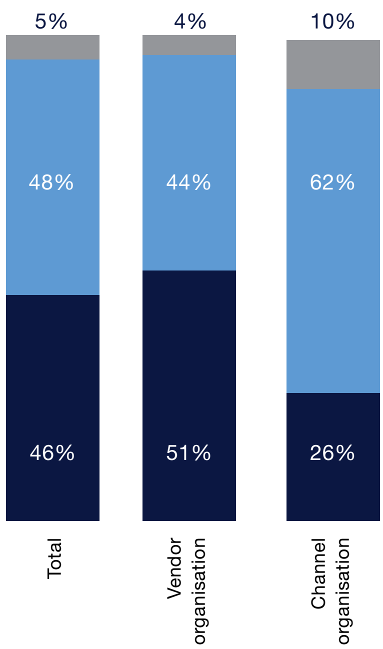
First, having an 'in' with a customer as a technology supplier doesn't guarantee scale. Just because they break one corporate, doesn't mean others in the sector will see the potential. Working with a Channel Partner means the software or service will have an 'in' with all their other

"Will you modify your channel roster to gain access to new opportunities?"

Yes - we will need to significantly modify our partner roster to meet our planned expanded portfolio.

Yes - we will need to partially modify our partner roster to meet our planned expanded portfolio.

No - our existing partners will be able to serve our needs over the next three years.



clients in that vertical – and other verticals too.

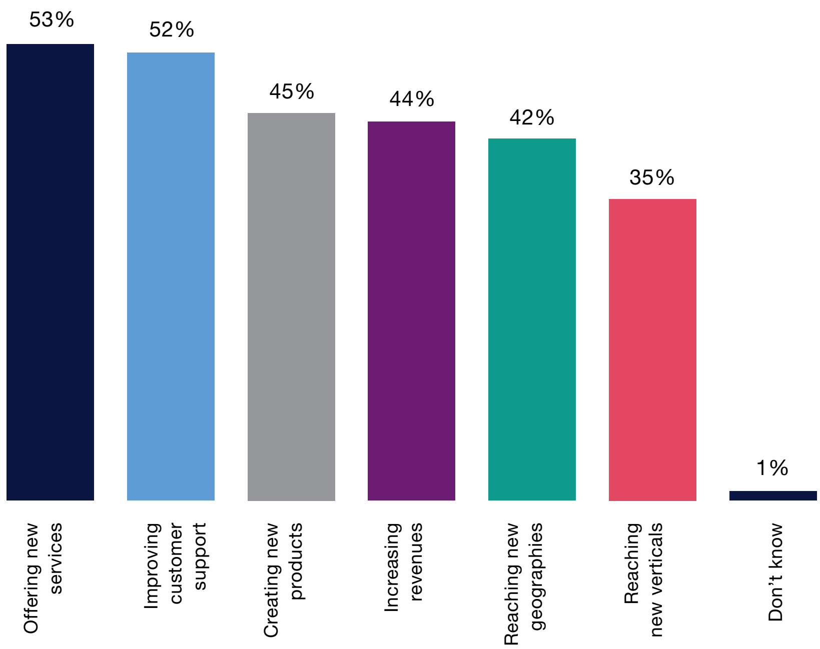
Phillips has another caveat, however. “Small software companies can be hampered by big Channel Partners having their own siloed structure,” he warns. “A lot of small businesses fail because they only have one or two people in the partner organisation batting for them – so they miss out on influencing other verticals, for example, and they’re vulnerable if those champions move on.” These relationships require on-going maintenance and, to put it bluntly, continual up-selling.

Second, Channel Partners often bring expertise in the minutiae of other sectors. They can understand the language, culture and quirks of new verticals, enabling much faster iteration of products and services to meet their needs. This benefit can only be accrued if the relationship with the Channel Partner is a genuine dialogue – but it’s an opportunity to scale that no niche software house would be able to deliver spontaneously.

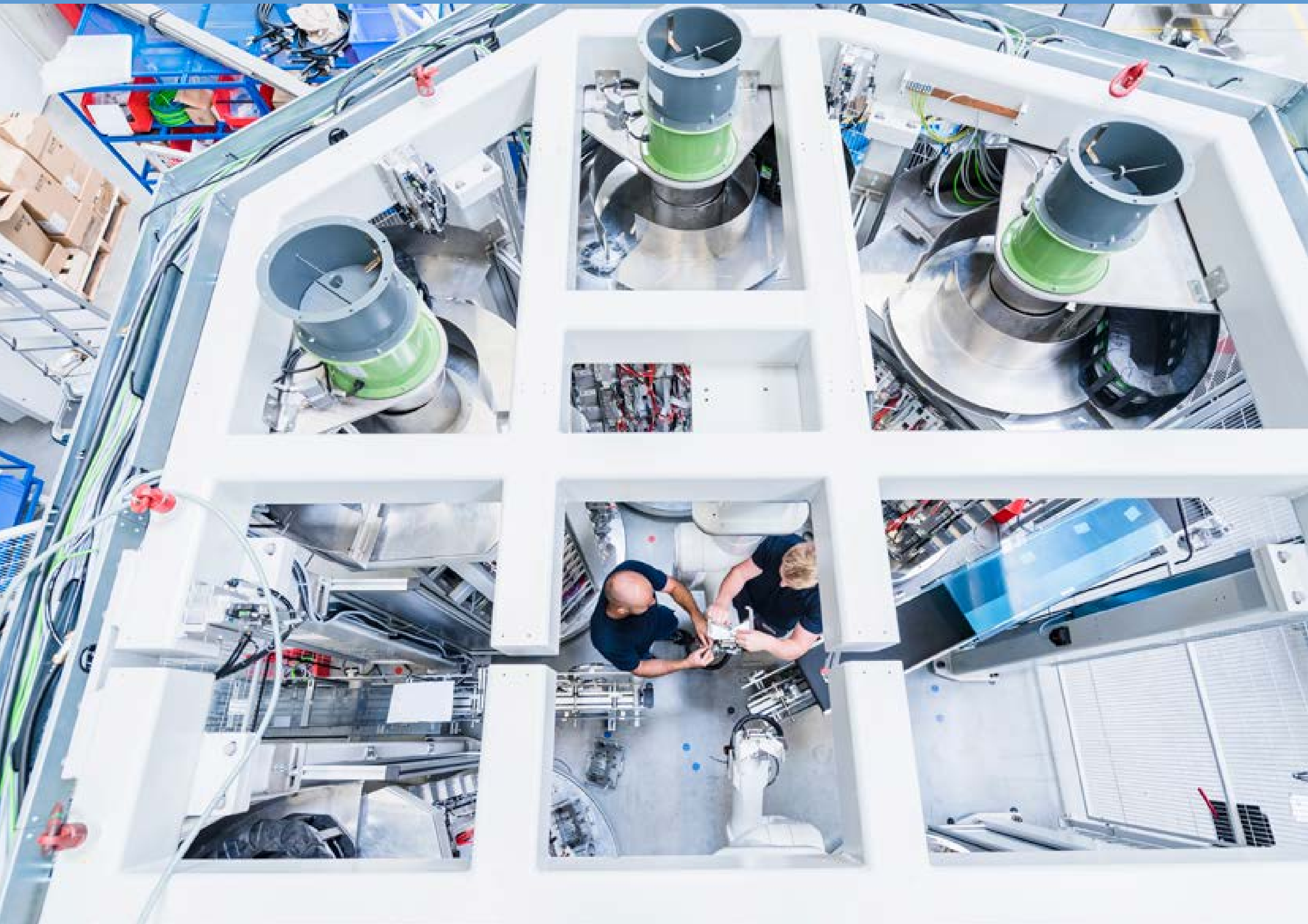
“UK scale-ups have ambitious growth targets and can see the benefits Channel Partners bring,” notes Iwamoto. “However, they’re not a panacea for growth. It takes investment to optimise results, and entrepreneurs should be asking themselves what success looks like and how they’ll build working relationships with Channel Partners towards those goals. It’s hugely valuable to have realistic expectations.”

Benefits of Channel Partner programmes

We asked...
“What benefits does your organisation currently experience or anticipate experiencing from having one or more Channel Partner programmes?”



2
Success



Escape velocity

How the Channel accelerates success

Research takeaways

- **Many UK tech firms are desperate to improve their under-performing channel programme.**

32%

Of firms say they can hit or exceeded their channel growth targets without struggles.

95%

Agree that their channel programme could be improved.

93%

Say they face barriers to improved channel performance – for 30% a key problem is simple lack of knowledge on how to optimise the channel.

There is a compelling logic to using Channel Partners to scale any business, particularly a technology one. Their contacts, sales teams and support networks enable vendors to take advantage of existing downstream sales relationships, reach larger clients who would otherwise not take smaller vendor offers seriously, and generally de-risk growth in new markets.

Respondents to our survey with a channel programme they rate as 'successful' derive significantly higher revenues – as you might expect – than those unhappy with their partner programme (see chart, next page).

But our survey suggests that many technology businesses don't know how to exploit the Channel opportunity. "There's a risk they see their Channel Partner as just an add-on to their own sales team," says Phillips. "They have to invest time and effort to make it work and derive the scale-up benefit. It's not something you just tack on."

Businesses such as Blue Prism, a specialist in robotic process automation that Investec has worked with very closely, prioritised and optimised their channel by putting many different elements together. (See our separate Blue Prism case study to find out more.)

"They put a lot of thought into productisation, making it easy for Channel Partners to generate value from their idea," says Phillips. "They also developed an accreditation programme to help Channel Partners impress their customers; and an online training programme to help them refine their offer. That made them feel 'mature' even when they only had 50 customers. They've made it easy for the Channel to drive new sales with a best practice methodology and a 'shrink-wrapped' product that's easy to roll out."

So what else have we learned about using the channel properly to scale?

Know the partner, share their pain
We asked technology businesses and their partners about the barriers to better channel performance. The number one reason? Lack of knowledge on how to maximise value from the partnership. When we analysed our findings by the level of success of the relationship, we confirmed a correlation around the level of mutual understanding. Among 'highly successful' programmes, 66% cite 'full understanding' as the norm; in unsuccessful ones, it's just 26%.

This offers two key lessons for vendors keen to scale up using the Channel.

First, look for ways to structure products and services in a straightforward way. "Don't just bring cool technology – they might like it, and even work out how to sell it," says Phillips. "But a 'shrink-wrapped' product with a well-developed training and support structure is better. Then listen to their advice on building those, too. Any small company has to show their technology can help partners differentiate their own offering – which means understanding what that is."

Technology businesses should also settle on an optimal number of Channel

Partners. There's always a risk of overconcentration with a small number of key partners. Equally, having scores of small Channel Partners each serving a handful of end users adds cost and reduces the gearing advantages that make the Channel attractive.

Where to focus

Shared understanding and enlightened incentives are great first steps. But, in the research, three-quarters of respondents agree that constantly changing technology makes it difficult to develop long-term relationships with Channel Partners. This reinforces the need for the channel relationship to be a two-way street, with customer-facing partners feeding back on implementation, support and features, while vendors tweak support structures such as training and upgrades.

That demands specialist skills within both types of organisation. Direct sales people, for example, tend to be hunters, seeking the next deal. Channel relationships need to be farmed and long-term relationships cultivated.

For technology firms, the Channel might be the best way to scale, but it also means up-front investment in infrastructure and support. Our research uncovered six key areas:

- **Online platforms** to help channel sales teams engage with the product.
- **R&D teams** able to evolve product offerings based on channel feedback.
- **Marketing support** for Channel Partners to reach potential customers.
- **Continuous training** for Channel Partners to give them confidence in the product and it's potential applications.
- **Partner accreditation** schemes to help partners differentiate their offer.
- **A distributed salesforce** to work with all parts of the Channel where needed.

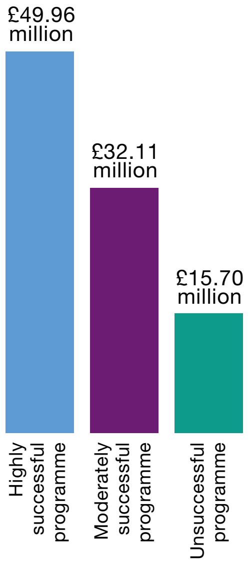
There's a clear correlation between organisations stating their channel programme has these six infrastructure elements in place and being deemed 'successful'.

Scale-up lessons from larger firms

Our research reveals large enterprises' channel programmes tend to be more successful, deliver more revenue and enable greater business growth – 38% of them call their programme 'highly successful', compared to just 26% of SMEs. As expected, SMEs have fewer resources, face more risk and have to work harder to win over both Channel

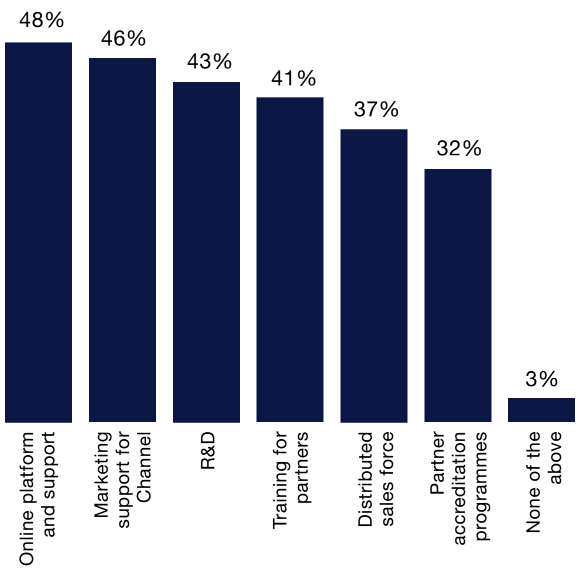
The value of success

Average revenue firms have achieved from their top five vendor/ Channel Partners relationships in the last financial year.



Areas for improvement

"Which elements of your vendor/ Channel Partner programme do you feel requires improvement?"



Partners and end customers.
So what can SMEs learn from larger firms about channel sales and how to scale to their level? To find out, we asked about the biggest challenges to channel success, all of which were ranked lower by large enterprises.

First, study the Channel, its key players and their potential end users. Almost a third of respondents told us a lack of knowledge or expertise in how to maximise the value of partners is the top challenge they faced. Transparency and simplicity also drive the quality of the relationship: half of large enterprises reported that their Channel Partners had a full understanding of their business, compared to just 34% of SMEs.

Second, plan to invest heavily: 29% cited a lack of funding and resources as a reason for underperformance. "There is a cost to setting up channel support – so it can create losses up front, even though it could be key to that scale-up growth later," says Phillips. "In the long term, companies ought to be able to scale Channel Partners with the same support network."

In our research, large enterprises report spending an average of £300,000 to develop a channel relationship; for SMEs the figure was much lower, at just over £100,000.

Then 29% said lack of awareness within their own organisation was holding back their channel programmes. For example, if there's conflict between channel support and a direct sales team, management needs to ensure the development of a shared understanding of how each will help the business scale and make clear any boundaries or 'off-limits' territories for either side.

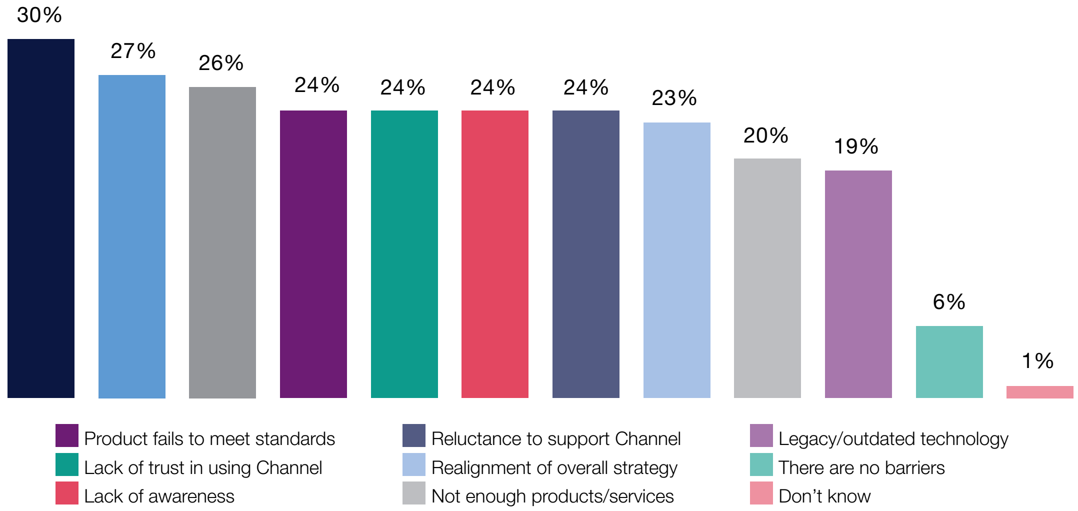
The SMEs we surveyed also identified some essential areas that could improve their Channel Partner programmes – and these ought to be the priorities for existing and new relationships:

- 35% improved communication
- 36% greater efficiency
- 28% faster launch to market

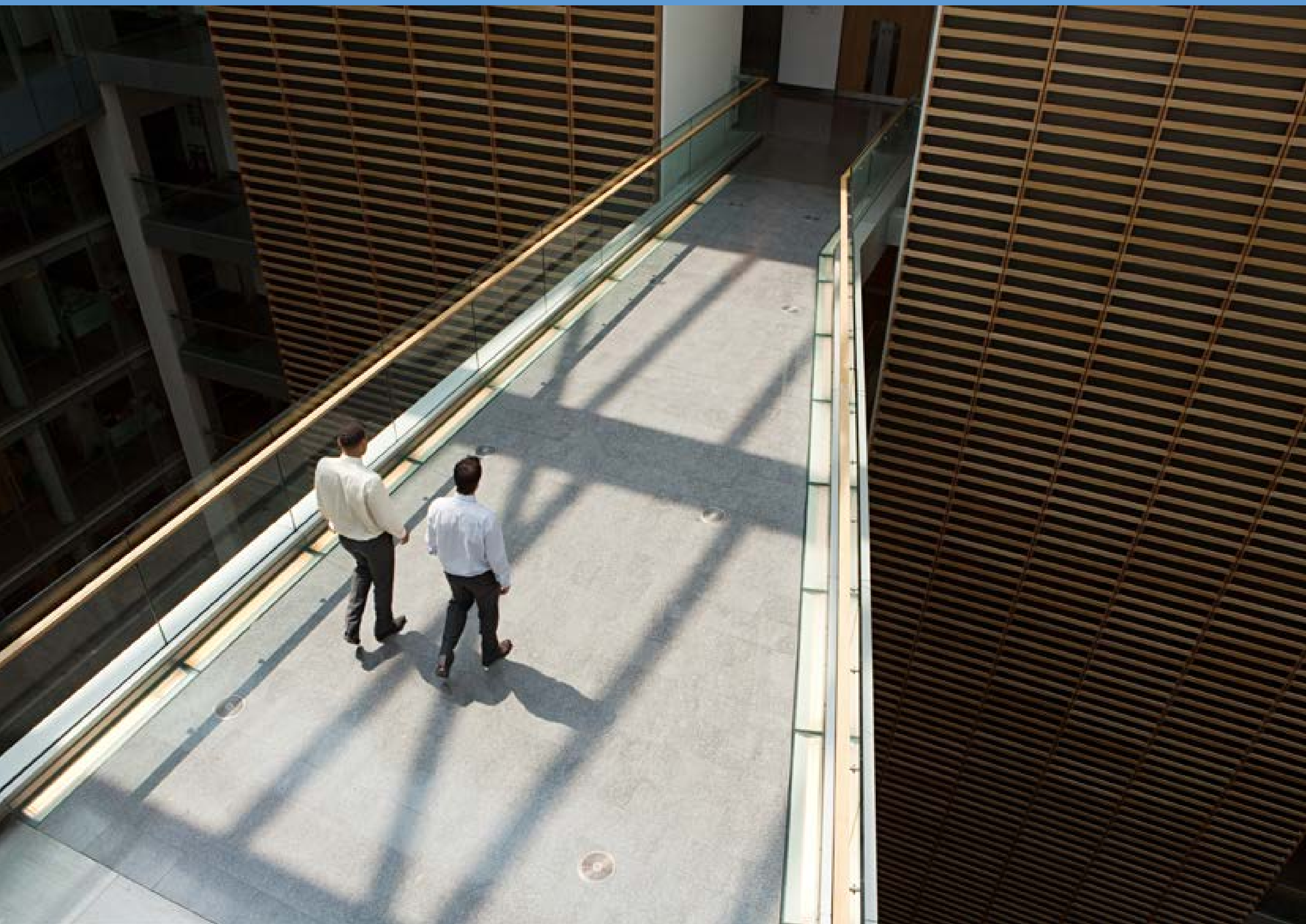
"Entrepreneurs often forecast significant sales growth from the Channel," says Iwamoto. "But if their investment in Channel Partner infrastructure is lacking, those partners won't be able to deliver results. And for entrepreneurs looking at their next round of funding, it's precisely this kind of investment that differentiates risk and potential upside in the eyes of investors."

Barriers to effective programmes

"What barriers stop your organisation from having effective vendor/Channel Partner programmes or having more than they have currently?"



3
Partnership

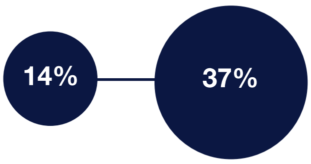


A two-way street

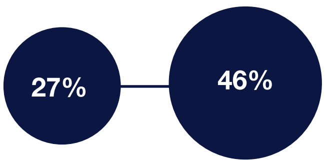
The Channel as true Partnership

Research takeaways

- **We found several areas where there is a mismatch of expectations and intentions between vendor and channel. Greater alignment of interests should boost programme success.**



- **14% of channel companies say their partnership has been highly successful, compared to 37% of vendors.**



- **27% of channel companies are 'highly confident' of achieving their growth targets, compared to 46% of vendors.**

- **Lack of knowledge, trust and awareness hamper success. But good communication is the best way to make the Channel Partnership work.**

Too many vendors, we discovered in our research, view the Channel merely as a means of distribution. Too often their channel KPIs are simply costs and sales – which means, for them, 'success' just looks like 'revenue'. No wonder the proportion of Channel Partners saying their relationships are 'highly successful' is so much lower than vendors.

Technology businesses need to see their partners as an extension to their company – eyes and ears on how their customers use their product. Our research shows why: 46% of vendors are extremely confident of achieving their financial growth plans over the next three years – but only 27% of channel organisations say the same.

Based on our experience with vendors and their partners, one explanation is that the channel sees much more clearly what customers want and how well vendors' products and services are meeting their needs. Vendors who don't have a nuanced dialogue with their channel are more likely to simply extrapolate growth numbers; but the channel knows when a product isn't landing or is running low on shelf life.

Lots of vendors react by blaming their Channel Partners: 52% told us they will need to significantly modify their existing partner roster to meet planned business needs. If it really was a two-way street, you'd expect similar levels on both sides, but only 26% of channel companies felt the same.

And there is a risk that simply switching partners won't fix the core problem – which is a need to build trust, awareness and dialogue. The Channel is a two-way street where transparency, strategic alignment and mutual support are the real sources of value.

Listen, iterate, grow

We know from working closely with the leaders of technology companies that they spend time and energy building a vision, developing intellectual property and getting viable products to market. That laser-like focus means it can be hard to shift mind-set and accept feedback from third parties. That doesn't just hamper scale-up opportunities, it can hurt existing business relationships.

In our research, for example, 24% of respondents say products or services that fail to continue to meet required standards are a key barrier to an effective channel sales programme, suggesting partners will struggle to meet organisational needs and adapt to a changing market.

Those who see the Channel as a two-way street understand partners can contextualise opportunities and suggest new products and services that will reveal scale-up opportunities. It might be extra functionality, new ways to support sales, roll-outs or systems integration. Or it could be investment opportunities to open new verticals or geographies.

Listening is one thing – acting is another, and our research shows less than half of channel programmes have a dedicated R&D team in place. Among the 'unsuccessful' programmes, it was

just 26%. Being able to act – often with agility – on channel feedback is vital.

Share the wealth

Companies with scale-up ambitions want to maximise revenue and margin. Those are legitimate objectives for any technology entrepreneur. For those with a brand new or unique product, pricing can be hard at first. But we often see vendors engage with Channel Partners, then become distressed when a reseller or consultancy marks up their product leaving them feeling cut out of the financial upside.

"Vendors have to consider the services multiplier – is their partner able to get more out of working with their product?" asks Phillips. "Often they simply have to embrace the fact that a lot of the value from the end customer is going to the partners. That keeps them engaged and excited by the product. Big consultancies, in particular, will want to be able to use your product as part of a bigger strategy to deliver more value."

Allied to clear communications and responsiveness to feedback, an enlightened approach to channel wins is the smart long-term play. "With direct sales, revenue is shackled to sales and support resources," adds Phillips. "With partners, there's a gearing – the same structures can serve a lot more volume, so your margins improve over time."

Breadth and depth

A solid initial partnership agreement is key. But unless the integration between vendor and channel is broad and deep, it won't deliver true scale-up potential.

The internal structure and size of a Channel Partner is a massive factor. We've already seen how the siloed nature of big consultancies can limit cross-vertical scale-up opportunities. Vendors also need to ask: what happens if my primary contact moves on? Having multiple points of contact at main Channel Partners defrays that risk.

Balance is important. Vendors need a sustainable number of partners (and contacts within them) while avoiding too much concentration risk. "They can have 1,000 partners taking their product to customers – but that's 1,000 different ways they might need to bespoke their software," says Phillips. "They also need to be careful it's not too few. But having big 'vanguard' partners – Accenture was a huge supporter of Blue Prism, for example – can supercharge growth."

Then, how deep is the commitment? "An accreditation scheme, continuous online training programmes and a best practice methodology are three basic building blocks that we often see many small vendors don't consider until too late," says Phillips.

"There are lots of ways to deepen the offer – white papers and ROI studies, for example. The demo needs to be compelling, too. Case studies are brilliant. This kind of content is hugely valuable. Then partner conferences are vital for technical updates, but also sharing war stories about what lands well for both the product and the customer base. Channel Partners need the same kinds of materials and support an in-house team would get."

"Most people who run a technology company try to stay true to their vision. But you've got to find a balance… and accept criticism and change"

Roger Phillips
Technology Equity Analyst at Investec

In an ideal world…

We asked all the respondents, “What attributes would be in the ideal partner programme for your organisation?”

There was broad agreement about areas such as the importance of support, efficiency in the day-to-day operation of the partnership and agility. But the lessons for both technology vendors and Channel Partners come in the areas of mismatch.

Where vendors should focus
Communication, care and available skills

Channel Partners are much more likely to cite good communications as a key attribute of a partnership – and although more than a third of vendors would prioritise service care, the fact it’s more likely to be highlighted by Channel Partners is a reminder not to neglect it.

What’s more surprising is the gap between vendors and Channel Partners prioritising relevant skills in their partnership. For many Channel Partners, having skills on tap from technology vendors is the surest way to ensure their own customer relationships are well maintained during pitch, roll-out and operational phases. Vendors perhaps underplay the value of skills from their Channel Partners (which could be restricting their own market and product innovation efforts), and they should ensure their own skills are more readily available to support more sophisticated implementations.

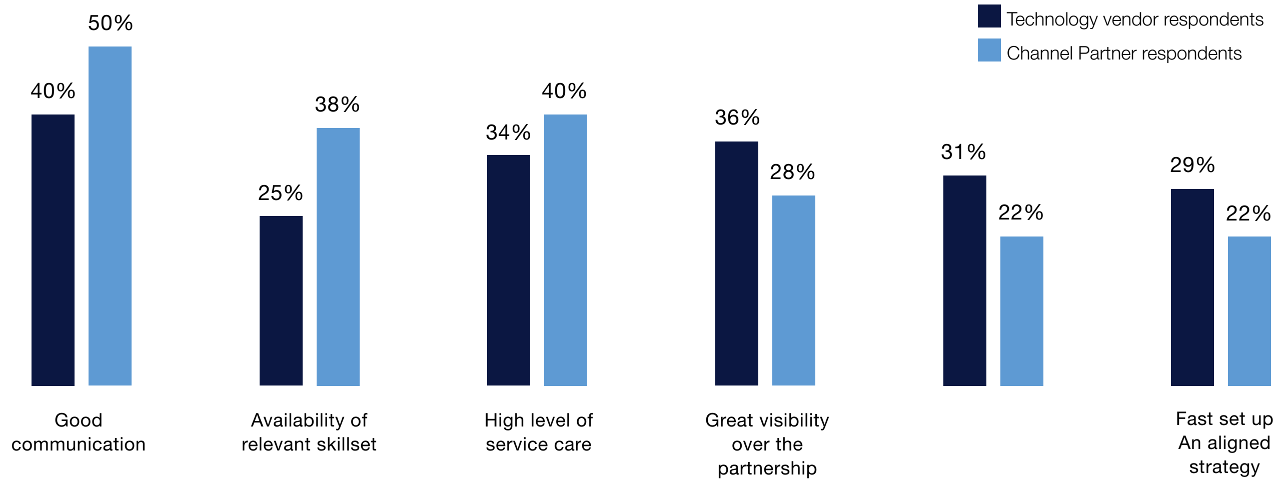
Where the Channel should focus
Visibility, speed and aligned strategy

On the other side, we see more vendors looking for visibility in their partnership. That’s understandable: they want to know how their product is being used and sold. But, in our experience, vendors should exercise caution over Channel margins, for example. If the Channel Partner uses an ‘open book’ approach, it pays to be supportive of a healthy mark-up on products and services to keep them incentivised.

The biggest gap? Set-up speed. Again, it’s natural for vendors to want to get their products into the market as fast as possible, and the Channel could do more to prioritise quick on-boarding. At the same time, vendors should value a considered approach – building up a knowledgeable and confident channel sales team. Better alignment on strategy (plus good communications) ought to help deliver the required balance in both those areas.

The ideal vendor/Channel Partner programme

“What attributes would be in the ideal vendor/Channel Partner programme for your organisation?”



Conclusion

Developing a Channel Partner programme is a proven way to rapidly scale the revenues of technology companies and there are many good examples of successful British businesses that have gone down this route. (See our separate Blue Prism case study for instance.) But there are also many companies who could lift their sights to more ambitious growth and lean on their channel to magnify returns.

Vendors need to grapple with two components to do this. They need to work on the infrastructure – products, processes and support services – that form the basis of working with their Channel Partners. They also need to understand the human dimension to the partnerships that they are trying to create and develop opportunities for interaction, sharing of knowledge and genuine understanding at all levels of the Channel. All too often, this dimension is lacking as the focus remains on great technology and getting products shifted.

There are many different growth strategies that vendors can follow, and an effective channel can be instrumental in all of them. Approaching new vertical and geographic markets, in particular, should be carefully considered by vendors aiming to reach scale-up momentum in their businesses.

The UK consistently demonstrates the strength of its Technology sector, and scale-up entrepreneurs increasingly have access to the tools they need to build world-beating companies – if only they can trust themselves and their ambitions to take their businesses to the next stage of the journey. The findings from Investec's research demonstrate how to best use the Channel to facilitate that ambition.

Get in touch

Investec TMT Team

Andrew Pinder
Junya Iwamoto
Sebastian Lawrence
Roger Phillips
Julian Yates
Shaun Mullins

For any queries regarding this report please contact Junya Iwamoto:
+44 (0)20 7597 5156
junya.iwamoto@investec.co.uk

We are a solutions-led corporate and investment banking business who provide capital and innovative ideas to growth-orientated companies, private equity and institutional investors across markets and sectors.

Investec
Corporate & Investment Banking

Solutions. Capital. Empowered people.

21/02/2019