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First of a series of articles on the future of networking channels

The future of the networking integrator is bleak, primarily because the core competencies of the integrator are becoming eroded. The relationship between integrator and customers is under threat from the very vendors that are represented. Furthermore service revenues are under attack from multi-vendor service specialists. Equally detrimental, while perhaps less surprising, is the fact that integrators are also threatened by the emerging networking channels such as the Telcos, Internet Service Providers (ISPs) and corporate resellers.

The business model of a networking integrator has never stacked up. The integrator must possess a combination of efficient logistics in the supplying of products, the consultancy skills of a dedicated consultancy firm and a high degree of specialist service capabilities. All these characteristics are necessary along with the management skills, sales and marketing prowess and the administration infrastructure that any large company requires.

Maybe salvation lies in convergence. Peter George, the VP of Bay Networks EMEA, said recently that more and more companies in Europe would outsource their data networks as they have already done with voice traffic. "You will see that PTTs (Telcos), ISPs and emerging PTTs and ISPs will want to obtain core technologies in this area and you do that by training your own people, by a strategic partnership or by acquiring somebody," he said.

This might account for the interest that telecom equipment suppliers have been showing in their datacoms peers, such as Northern Telecom in Bay Networks, Nokia in Ipsilon, Lucent in Yurie and Livingston, Ericsson in ACC or Alcatel in Packet Engines.

However, it is up to the channel players to spot the winning combination and ensure that theirs is the main route to market rather than the telecom equipment channels.

There is no doubt that the PTTs are increasingly likely to threaten the livelihood of the integrator because they have the better customer database. In fact EuroLAN Research predicts that the networking products sold via PTTs will double to 14% by the year 2000, but as Peter George indicated there will not be enough trained staff within the PTTs to carry out implementation and channel involvement will again become necessary. However, being a partner in implementing networks does nothing to expand the service model described in the previous EuroLAN articles, whereas a new opportunity lies in providing a complete solution integrating voice and data. We believe that the PTTs will outsource the majority of the installation work. In fact EuroLAN contacted British Telecom (which has a ten-year lead in terms of liberalisation) as an experiment, in response to an advertisement by BT in a national newspaper promoting local area networks. EuroLAN was subsequently contacted by a reseller, acting on behalf of BT.

EuroLAN Research believes that this is just the type of opportunity that networking integrators must look to if they are to avoid the "squeeze" from consultants through vendors on pre-sales and post-sales services. The solution today may be CTI (Computer/Telephony Integration) and tomorrow VoIP (Voice over IP), but the future shape of the network integrator is set to change forever and we will examine in what way over the next series of articles.

Vendors insistence on End to end

There is pressure being brought to bear on channel partners, which is limiting the Systems Integrator's (SI) ability to be "vendor independent". This is the large networking vendor's insistence that the SI adopt a preferred vendor status in all the product areas represented by that vendor. For example, Bay Networks and Cisco Systems are pressurising its channel partners to adopt a "More Bay" or "Full Cisco" model and to propose its products exclusively at a client's site.

While Systems Integrators often claim vendor independence this is best seen as market positioning for the clients benefit. It is very rare for a Systems Integrator to achieve a level of competence in selling and supporting more than the top two or three networking vendors. Only a Systems Integrator as large as Siemens is able to achieve the highest levels of certification for 3Com, Bay Networks, Cabletron and Cisco and because of the investment it is not prepared to expand its product line beyond these four vendors.

And the cost is significant. A national SI, with strong pan-European aspirations, which is accredited at the highest level with 3Com and Bay Networks, recently decided to add Cisco accreditation. The SI estimated the cost of reaching the first level of accreditation as £30,000.

Encouragement is frequently offered to focus on a vendor's products at the exclusion of its competitors' products. In offering a loyalty reward – an additional discount or a rebate based on the commitment to lead with that vendor's products – other benefits accrue, such as the vendors sales force being prepared to work on opportunities in a partnership arrangement. And leading networking vendors have up to 25 salesmen in United Kingdom so partnering with them can generate a lot of business. These "direct touch" salesmen are rewarded for sales generated by them but fulfilled through channel partners.

However the vendors salesmen are not always involved in a sale. A Systems Integrator explained to me recently that in today's major markets the channel partner has to compete with the vendors' competitors and then compete with the vendors' channel partners. Some vendors have the more short-term aim of winning the business regardless of which SI wins the deal. The vendor maintains its margin either way.

According to Cisco Systems, its customers are demanding "end to end" solutions. In North America 60% of Cisco's customers are considering a single supplier according to John Chambers, President and CEO. In fact Chambers takes it further and claims that only one of all the customers that he spoke to last year (actually he named Bloomberg as the company - the investment company) is adamant that it requires best of breed products and that it wants multiple sources of equipment.

System Integrators are questioning the return on the investment in gaining accreditation and although customers may see the logic in "end to end solutions" at their sites they may be questioning whether representing one vendor can be understood as systems integration?

The Service Conundrum

In the third of a series of articles focussing on the challenges facing VARs specialising in networking, Humphreys looks at the move to increasing reliance of services

Over the last four years EuroLAN Research has studied a large cross section of network integrators and networking value added resellers (VARs). A noticeable change in the profile of a typical channel partner is the increasing proportion of revenue that service represents. In 1993 service represented 30 percent of the total revenue of network integrators in Europe while today this figure is 35 percent of the total revenue.

This increase in service is attributable not only to the need to replace lost margin on computer hardware, software and networking products but also because it "bunny hooks the customer". This phrase, used by an American gentleman from Cabletron, describes account control perfectly. Customer dependency allows the channel partner to maximise upon the relationship in order to gain incremental business or "farming rather than hunting" in sales terms.

However adopting a largely services based model requires a different business plan to that which may have been originally conceived. The original business plan relied heavily reselling a manufacturers networking products and making a return on those products. Services is much more people based and requires a high initial investment in recruiting, training and the on-going cost of staff. The danger is in making the investment and then losing the service revenue. Not through under achieving in the rate of return but from areas not in the channel partners direct control.

There are several threats. The first is from networking vendor that the channel partner represents. The very source of revenue for the last four years is under threat. In post-sales support the vendors are increasingly competing with the channel partner in the area of maintenance or break/fix provisioning as the vendors like to call it. The major networking vendors charge its channel partners a fee or service levy to gain access to technical support and to handle parts replacement. Some, like 3Com and Nortel Networks, negotiate a fee however others, like Cisco Systems, charge a fixed percentage for all products. Cisco has now adopted a more flexible approach and has just announced the unbundling of the 3x3 service levy (3% over the first three years) for some or all of the partners customers. The downside is that it allows Cisco control of the account which the integrator opts out of supporting.

The major threat is from the service orientated companies that are emerging, such as Unisys and Wang. These specialists often win major bids because of the global presence offered. The ability to provide "man in a van" on-site support within two hours of a network failure is the attraction combined with the provision of multi-platform support.

So integrators have threats which emanate from the model adopted internally and from external threats largely out of their control.

The Consultants are Coming!

As if there aren't enough threats already facing network integrators today their pre-sales service revenues are under even more threat than post-sales. This is more of loss to the business than threat from post-sales services. Pre-sales services are the major differentiator between the network integrator and other resellers of network product . It is the pre-sales skills offered by the network integrator which attracts and maintains clients.

The first threat is from the traditional audit-based service companies with consultancy divisions, such as PriceWaterhouseCoopers. Then there are the specialists consultants such as Logica or Cap Gemini and also there is the treat from the networking vendors themselves who are able to offer its own consultancy staff, and it is possibly they who pose the greatest immediate threat.

The large networking vendors offer large companies pre-sales consultancy services ranging from project definition, network design and network configuration. These are precisely the skills that network integrators have specialised in and in which they have made substantial investments in both time and money. The integrators have often operated at a loss in offering pre-sales services and are therefore relieved to let the vendors offer this assistance. However this is the network integrators core competition which is being undermined, albeit unintentionally, by the vendors. The vendor is keen to work directly with the large companies in order to ensure maximum penetration within a large networking projects.

Cisco, for example, implemented a "High Touch" sales model. John Chambers, Cisco System's CEO and President stated recently that this model has a dramatic effect on Cisco's gross margin as integrators would never propose the "Full Cisco" model and sell Cisco "end to end". Cisco takes this to the logical conclusion by using its consultants to perform the services for this "High Touch" sales force rather than relying on partnering to ensure that the "Full Cisco" model is delivered.

However, at the other end of the scale, and charging premium prices for their work, the audit-based service companies are moving into network consultancy and integration services to. Consulting is growing faster than audit-based work, as customers are demanding a whole range of services from one organisation. The major strength of the consultants is the vendor independence and impartiality in designing networks which contrasts markedly with the end to end position taken by the major vendors.

There are a few factors keeping the audit-based service companies from mounting a concerted challenge at the moment. They have their hands full with implementing Euro accountancy compliance, Year 2000 issues and internal problems of merger (Price Waterhouse/Coopers and Lybrand), failed mergers (Ernst and Young/KMPG) and de-mergers (Andersen Consulting).

However, in two years time, expect them to have too many staff and not enough projects to maintain them. If the consultancy companies start to look more seriously to systems and networking integration it will be the network integrators who are the hardest hit but it is their fault in defocusing on their key core competencies and losing the real hold that they had on their clients.

Telecommunication Service Providers - an opportunity and a threat

EuroLAN Research estimates that Telecommunications companies (Telcos) currently account for 8% of all the networking sales revenue across Europe. EuroLAN Research expects the Telcos market penetration to double by the end of the year 2000 across Europe as deregulation continues.

What will it mean to resellers of networking products? Today a Telco is not only a user of networking products internally but is increasingly acting as both a service provider and a reseller. In the United Kingdom (UK), which has experienced a liberalised telephone service for over 10 years, 12% of all the networking sales revenue is represented by the telecommunications companies. Today British Telecommunications, the dominant player in the UK with revenues of over £11 billion, is offering a multitude of products that are competing with traditional channel partners. But in the future analysts which follow the Telco market predict that up to 43% of voice traffic will be carried via IP packets by 2003 so it will be "adapt or die" for the traditional carriers.

BT's claim that "our combination of Gold Partner status with Cisco and networking expertise offers the enterprise the opportunity to turnover their entire internetworking operation to BT." A Telco has an advantage over channel partners because of its very presence, it is the first person a company calls on a project that involves networking. At the low end of the market BT have teamed up with 3Com to offer a OfficeConnect Networking Kit, comprising a 3Com hub, three Ethernet/10BaseT NICs, a diskette containing 3Com's OfficeConnect software, and a guide book for installation and management. The kit is sold as a "Do It Yourself" for £299 and uses either Windows '95 or Windows for Workgroups 3.11.

There is no doubt that Telcos are looking to replace revenue lost due to Internet based voice traffic. The revenue received by local connections to Internet Service Providers (ISPs) and Internet Access Providers (IAPs) balances today the revenues lost due to eMail, Internet voice and fax. By the year 2000 however this loss of revenue is estimated to be in excess of £20 million. So BT is looking at value added services to shore up its profits of over £2 billion a year. The channel is bound to suffer because of this competition.

There is a short term opportunity which is to partner with the Telcos, resell the services, such as ISDN, and leverage the ability to discover projects early in the cycle. And in this way resellers can build close relationships with the customer, fully understanding the project needs and its drivers, thereby positioning the reseller to have its products specified.

A good example is AT+T partnering with Cisco Systems in the USA. By using Cisco's resellers AT+T have an immediate distribution channel to sell its managed services and VPN solutions bundled with Cisco's own products. British Telecom currently sells and supports the 3Com SuperStack and OfficeConnect products (and Cisco routers) using its own trained staff but it has seen the benefits of partnering in the past.

The Challenge of Backing a Winner

Network Integrators are used to determining for themselves with which manufacturers to partner. Typically an integrator represents a mainstream product line, one or more of the top four or five manufacturers, and supplements the mainstream manufacturer or manufacturers with products from smaller vendors. The integrator needs these Best of Breed products to fill in any gaps within the mainstream product line. More importantly the integrator needs the differentiation from its competitors which the smaller vendors offer. It needs this differential to make margin on the hardware as the competition on mainstream products is just too great. A large integrator told EuroLAN Research that first it has to compete against the manufacturer's competitors and if it wins that battle, it then has to compete against the manufacturers channel partners.

The integrator often finds itself in a dilemma when a niche vendor is acquired by a major player and may have to face a choice as to where its allegiances lie. This decision has become a major one for some Ascend integrators recently. The acquisition by Lucent, the largest in this market by far, has polarised the market into three distinct groups. These are the vendors with a datacomms background, those with a telecomms background and partnerships of both.

The datacommunications vendors are led by Cisco with 3Com, Cabletron and Xylan et al, following along albeit a long way behind. The telecommunications vendors, the NELAS or Old World players as Cisco refers to them, have all made acquisitions of datacomms equipment manufacturers although not all on the same scale as Nortel and Lucent. NELAS is Cisco's acronym for Nortel, Ericsson, Lucent, Alcatel and Siemens. The partnerships – 3Com and Siemens, 3Com, Siemens and Newbridge, 3Com and Microsoft – appear to be 3Com's favoured method of embracing converged networks.

Cisco is betting the whole show on the world moving to a converged model. If it doesn't move as quickly as Cisco needs it to, it will hurt them badly but if it does, the loss of revenue from FRADs and Multiplexers and voice equipment will really hurt the NELAS. I don't think it will happen quickly - because PBXs have a seven-year life expectancy and companies are not about to ditch them wholesale. There may be more data traffic than voice in the US today but it will be 2003 before we will see a majority enterprise companies adopting converged technologies. However some analysts following telecomms say it will 93% by 2003.

It is critical that the integrators back the right camp and then the correct company. The transition to converged networks would appear to have the most devastating effect on the telecomms equipment suppliers which are traditionally a lot less nimble. However if convergence does not happen at the rate that the datacomms guys are betting on then will loose out in a big way. One can see the attraction in not committing oneself either way.

Lucent has reduced the choice even further and Cabletron is rumoured to have engaged Merill Lynch to help in the search for a buyer.