A Forrester Total Economic Impact™
Study Commissioned By Microsoft
June 2020

# The Partner Opportunity For Microsoft Business Applications ISVs

A Total Economic Impact™
Partner Opportunity Analysis

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## Key Outcomes For Microsoft Business Applications ISVs

Up to **75%**
faster development of minimum viable product (using Power Platform)

Up to **92%**
more frequent innovation

Over **100%**
year-over-year subscription growth (Years 1 to 3)

# Executive Summary

As software-as-a-service (SaaS) adoption of critical business applications, such as enterprise resource planning (ERP) and customer relationship management (CRM) matures, today's business applications independent software vendors (ISVs) must offer their customers more than just an infrastructure solution. Modern businesses want the flexibility and agility of SaaS but without having to constantly deal with issues related to technical debt, customization, and governance.[1] These businesses must carefully evaluate the applications they choose and prioritize those that are nimble, innovative, and revolve around open ecosystems.

Microsoft commissioned Forrester Consulting to conduct a Total Economic Impact™ (TEI) study to examine the potential business opportunity and return on investment (ROI) ISVs may realize by building and scaling a Microsoft Business Applications practice. The purpose of this study is to provide potential and existing ISV partners with a framework to evaluate the potential business opportunity associated with building, managing, and selling Business Applications as part of the Microsoft partner ecosystem.

To better understand the revenue streams, investments, and risks associated with a Business Applications ISV practice, Forrester interviewed 12 existing Business Applications ISVs with years of experience collaborating with Microsoft to build or innovate and ultimately sell and scale their business applications. These ISVs ranged from long-standing Microsoft partners that started as systems integrators or as traditional on-premises ISVs to those with net-new, "born-in-the-cloud" applications. To illustrate the financial impact and subsequent partner business opportunity for Business Applications ISVs, Forrester aggregated the characteristics of these 12 partners to create a single composite organization.

## Business Applications ISV Revenue Opportunities

The composite ISV organization captures the following revenue streams, which are representative of those experienced by the companies interviewed:

- **Business Application subscription revenue.** ISVs leveraged a combination of direct sales and account teams, Microsoft cosell, and third-party partners to generate app leads, with direct and cosell leads generally being more profitable than third-party partner leads. ISVs relied on Microsoft for its expansive partner network and access to its large customer install base, and over time, these constituents collaborated with increasing effectiveness, allowing ISVs to tap into new markets while minimizing lead generation costs. Nearly all ISVs reported or forecasted growing their subscription bases by at least double each year in the first three years of operations. Over our three-year analysis, Business Application subscription revenue contributes 83% of the composite ISV's total gross profits.



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**ROI**
**90%**

**Gross Margin (Year 3)**
**51%**

**Operating margin (Year 3)**
**32%**

**Payback**
**15 months**

- **Direct implementation revenue.** Given the complexity of many CRM and ERP implementations, ISVs often directly delivered implementation services for a subset of total subscription customers, with some ISVs delivering up to 100% of all customer implementations. The strategic value of implementations also varied across ISVs, with some ISVs absorbing the bulk of implementation costs to win subscription customers and other ISVs using IP as a lead-in to higher-value implementation services. Over our three-year analysis, direct implementation revenue contributes 17% of the composite ISV's total gross profits.

## Practice Profitability Metrics

| Monthly recurring SaaS revenue | Gross profit (over three years) | NPV (over three years) |
|---|---|---|
| **$1.4M** | **$13.6M** | **$6.5M** |

Business Applications ISV Pro Forma Revenue And Margin Opportunity: Three-Year Analysis (USD)

| REF. | Metric | Calculation | Year 1 | Year 2 | Year 3 |
|---|---|---|---|---|---|
| PL1 | Direct subscription revenue | A8 | $1,536,000 | $4,800,000 | $9,984,000 |
| PL2 | Indirect subscription revenue | A9 | $960,000 | $3,264,000 | $6,528,000 |
| PL3 | Total SaaS revenue | PL1+PL2 | $2,496,000 | $8,064,000 | $16,512,000 |
| PL4 | Total SaaS gross profit | At | $1,324,800 | $4,272,000 | $8,755,200 |
| PL5 | Total SaaS gross margin | PL4/PL3 | 53% | 53% | 53% |
| PL6 | Direct implementation revenue | B4 | $1,200,000 | $2,400,000 | $3,600,000 |
| PL7 | Implementation gross profit | Bt | $360,000 | $960,000 | $1,584,000 |
| PL8 | Implementation gross margin | PL7/PL6 | 30% | 40% | 44% |
| PL9 | Business Applications practice revenue | PL3+PL6 | $3,696,000 | $10,464,000 | $20,112,000 |
| PL10 | Business Applications practice gross profit | PL4+PL7 | $1,684,800 | $5,232,000 | $10,339,200 |
| PL11 | Business Applications practice gross margin | PL10/PL9 | 46% | 50% | 51% |
| PL12 | Research and development | Ct | $1,165,000 | $594,375 | $810,676 |
| PL13 | Sales and channel enablement | Dt | $500,000 | $772,500 | $1,326,125 |
| PL14 | General and administrative (G&A) | Et | $525,000 | $669,500 | $954,808 |
| PL15 | Marketing | Ft | $147,840 | $418,560 | $804,480 |
| PL16 | Total operating expenses | PL12+PL13+ PL14+PL15 | $2,337,840 | $2,454,935 | $3,896,089 |
| PL17 | Operating income | PL10-PL16 | -$653,040 | $2,777,065 | $6,443,111 |
| PL18 | Operating margin | PL17/PL9 | -18% | 27% | 32% |

## ISV Practice Investments

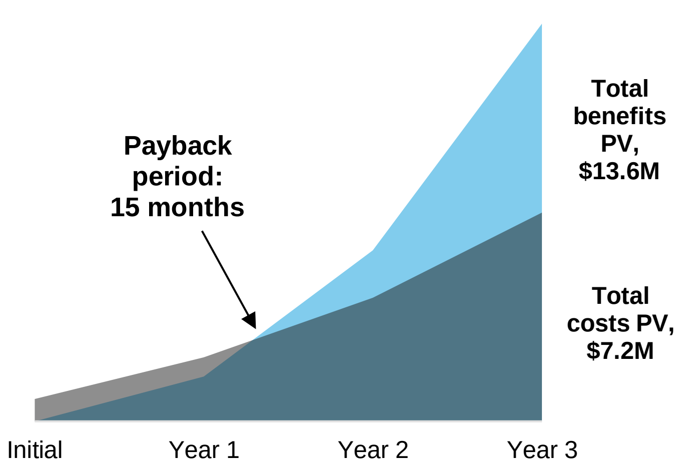
Aside from direct SaaS cost of goods sold, which includes revenue-sharing fees to Microsoft, customer demo and tooling costs, and sales or partner commissions, which are embedded in the gross margin calculations of each revenue stream, ISVs also significantly invested in foundational areas that simultaneously drove business growth while allowing operations to scale. These investments include:

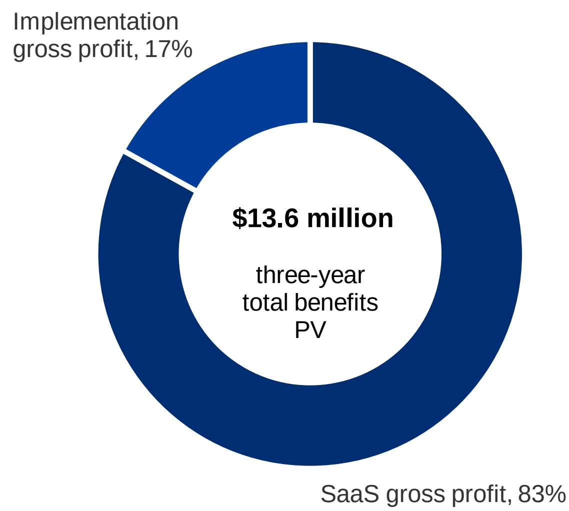
- **Research and development.** Initial investments prior to going live consisted of application development and testing costs, which include the cost of development FTEs as well as development platform and consumption fees. On average, minimum viable product builds took place over a period of between six and 12 months, depending on the type and complexity of the application and development platform and tools used. Those building their applications with PowerApps and the broader Power Platform experienced the shortest build times, averaging six months. Furthermore, after going live, ISVs also dedicated a number of FTEs to creating, refining, and executing on their product innovation roadmaps and integrating Microsoft's latest features and capabilities into their own applications.
- **Sales, account management, and channel enablement.** To cover all bases when going to market, ISVs invested in outbound sales, account management, and partner enablement resources. These FTEs worked closely with Microsoft and its partners to generate and qualify leads, ultimately bringing them to a point where they could be closed by technical delivery leads.
- **General and administrative.** Despite being considered cost centers, product management and back-office support were instrumental components of successful ISV practices. In particular, dedicated customer technical support and success teams were deemed increasingly necessary as subscription bases grew, making it difficult for product teams to support these accounts alone.
- **Marketing.** While marketing was not a significant driver of lead generation for any of the interviewed ISVs, these organizations nonetheless made table-stakes investments in digital marketing, with some ISVs also spending a portion of budgets on search advertising and conference participation. ISVs also further minimized their marketing expenses by leveraging templated Microsoft go-to-market resources and collateral. These efforts built awareness around the ISVs' applications and ensured that prospects had access to the right types of content and landing areas at each step of the buying journey.

## ISV Partner Business Outcomes

Forrester's interviews with 12 Microsoft Business Applications ISVs and subsequent financial analysis found that a composite ISV partner organization based on the interviewed ISVs experiences total present value-adjusted gross profits of $13.6 million over three years versus present-value adjusted investment and overhead expenses of $7.2 million, totaling a net present value (NPV) of $6.5 million and an ROI of 90%.

**Financial Summary**



## TEI Framework And Methodology

From the information provided in the interviews, Forrester has constructed a Total Economic Impact™ (TEI) framework for those ISVs considering building and growing a Microsoft Business Applications practice.

The objective of the framework is to identify the revenue streams, investments, flexibility, and risk factors that affect the investment decision. Forrester took a multistep approach to evaluate the holistic opportunity for ISVs building and growing a Microsoft Business Applications practice:

The TEI methodology helps companies demonstrate, justify, and realize the tangible value of IT initiatives to both senior management and other key business stakeholders.

**DUE DILIGENCE**
Interviewed Microsoft stakeholders and Forrester analysts to gather data relative to Business Applications.

**CUSTOMER INTERVIEWS**
Interviewed 12 ISVs with existing Business Applications practices to obtain data with respect to revenues, investments, and risks.

**COMPOSITE ISV ORGANIZATION**
Designed a composite ISV organization based on characteristics of the interviewed ISVs.

**FINANCIAL MODEL FRAMEWORK**
Constructed a financial model representative of the interviews using the TEI methodology.

**CASE STUDY**
Employed four fundamental elements of TEI in modeling the impact of a Business Applications ISV practice: revenues, investments, flexibility, and risks. Given the increasing sophistication that enterprises have regarding ROI analyses related to IT investments, Forrester's TEI methodology serves to provide a complete picture of the total economic impact of investment and partnership decisions. Please see Appendix A for additional information on the TEI methodology.

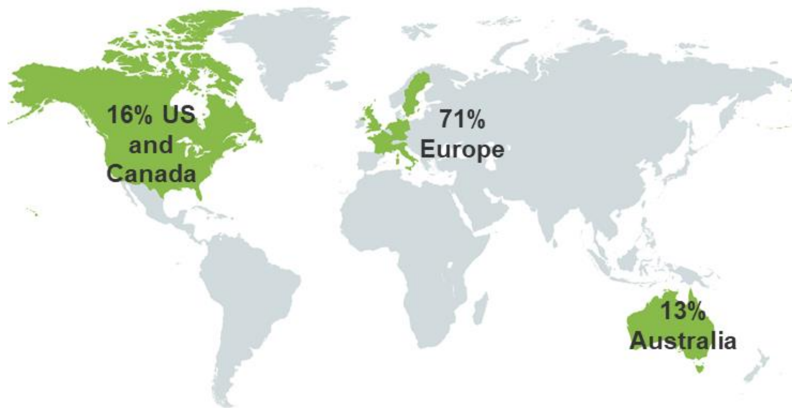
# Market Overview

**Surveyed Respondents**

To preempt the analysis on the Business Applications ISV opportunity, Forrester conducted a quantitative survey of 300 IT and operations decision makers within existing Microsoft Business Applications ISVs to gauge the market.

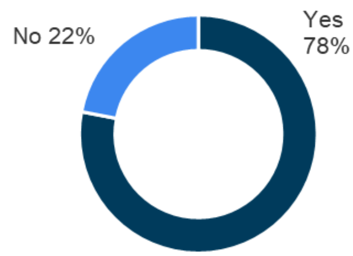
**Firmographics.** Forrester surveyed respondents from companies in the United States, Canada, Australia, France, Germany, Italy, Sweden, the Netherlands, and the United Kingdom. Roughly a third of respondents came from companies with fewer than 150 employees fewer, and two-thirds represent companies with 150 to 1,000 employees. The main industries serviced by respondents' organizations were technology (software vendor), business or professional services, financial services and insurance, technology (hardware vendor), telecommunications services, consumer services, and retail. Seventy-eight percent of respondents were currently participating in the ISV Connect program.

**Respondent demographics**



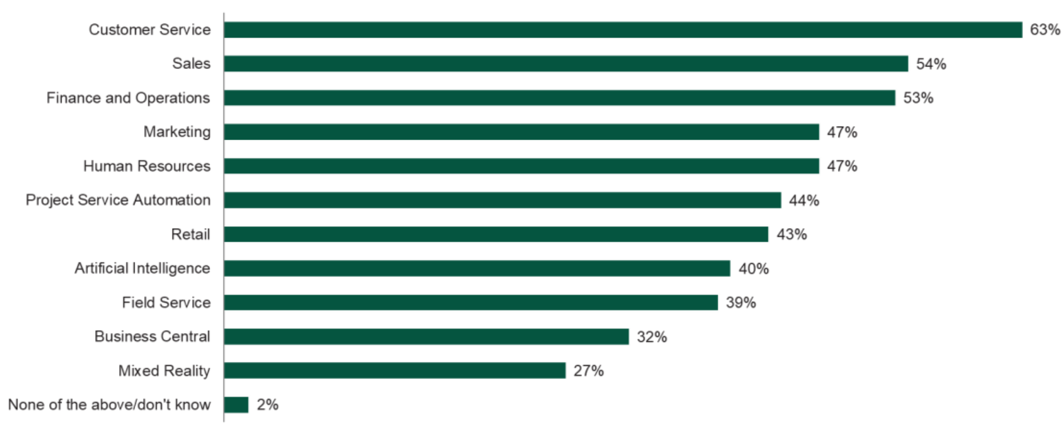

**Demographics.** All respondents were manager-level or higher within the IT department at their organizations. Sixty-two percent of the respondents were the primary decision makers for developing Microsoft ISV solutions at their firms. At the same time, 54.3% were the primary decision makers for the management of their firms' ISV business portfolios.

**"Is your organization a member of Microsoft's ISV Connect program?"**




**ISV portfolio.** Most respondents either extended first-party applications (85%) or built applications on the Power Platform (73%); additionally, half of the respondents connected existing applications to either first-party applications or PowerApps. Over 70% of respondents had been live with their Business Applications for over six months, with 39% of respondents having an application live on the marketplace for at least one year. ISVs' applications leveraged numerous D365 solutions, with Customer Service, Sales, and Finance and Operations being the most popular.

**"Which of the following Dynamics 365 CRM or ERP modules does your application leverage?"**



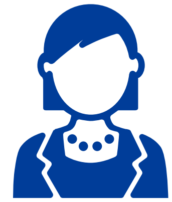

Base: 300 Microsoft ISVs that build applications that leverage, compliment, or extend the capabilities of Microsoft's Business Applications

Source: A commissioned study conducted by Forrester Consulting on behalf of Microsoft, March 2020

**Decision drivers and experience.** The surveyed respondents partnered with Microsoft for several reasons. Most (64%) believed they could simplify the development process and accelerate their time-to-market by leveraging the Microsoft Business Application ecosystem. These organizations hoped to leverage low-code frameworks to empower their developers, removing development bottlenecks and speeding up build cycles.

An equal percentage of respondents also believed that working with Microsoft would allow them to maximize their addressable market potential. These respondents pointed to Microsoft's cosell program and its ecosystem of customers and partners as key elements to unlocking this market. Once live, 53% of respondents also expected to benefit from Microsoft's go-to-market benefits and resources to propel continued growth.

Most (59%) respondents also believed that the Microsoft Business Applications ecosystem would allow them to innovate in ways that other platforms could not. From a technology perspective, respondents were drawn to the diversity of solutions available and the synergies across those solutions. From a development perspective, these respondents expected SaaS delivery of applications to free up the development time and resources needed to focus on innovation.



**84%**

**of ISVs have had a positive experience as a Microsoft Business Applications partner.**

**"Why did your organization decide to invest in building a Microsoft Business Applications (e.g., D365 CRM and ERP) ISV practice rather than an alternative ISV practice (i.e., on behalf of another vendor)?"**


Base: 300 Microsoft ISVs who build applications that leverage, compliment, or extend the capabilities of Microsoft's Business Applications
Source: A commissioned study conducted by Forrester Consulting on behalf of Microsoft, March 2020



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# The Business Applications ISV Journey

**BEFORE AND AFTER THE BUSINESS APPLICATIONS INVESTMENT**

## Interviewed Organizations

For this study, Forrester conducted 12 interviews with Microsoft Business Applications ISVs, which ranged broadly in size and background and engaged with the Business Applications ecosystem in one of three ways:

- Extending existing Microsoft first-party Dynamics 365 applications.
- Building unique stand-alone applications directly on PowerApps, Flow, and the Common Data Service (CDS).
- Connecting existing applications to any of Microsoft's first-party Dynamics 365 applications and/or PowerApps.

Interviewed ISVs include the following:

| OPERATING CHARACTERISTICS | ENGAGEMENT MODEL | APPLICATION ARCHITECTURE | APPLICATION FUNCTION | INTERVIEWEE |
|---|---|---|---|---|
| Global ISV $100M to $250M revenue | Connect | Born-in-the-cloud | Configure price quotes (CPQ) and contract lifecycle management (CLM) | Chief marketing officer |
| EMEA ISV <$1M revenue | Connect | Born-in-the-cloud | Asset optimization (e.g., for property or asset managers) | Chief operating officer |
| APAC ISV $1M to $10M revenue | Connect | Originally on-premises solution; later connected to D365 | Sponsorship management, grants management, events management | Chief executive officer |
| Global ISV $1M to $10M revenue | Connect | Born-in-the-cloud | B2B cloud communications | Chief financial officer |
| North America ISV $100M to $250M revenue | Extend | Hybrid solution | CRM mixed with AI, machine learning, and analytics for higher education | Director of business applications |
| Global ISV $10M to $100M revenue | Extend | Originally on-premises solution; later extended directly from D365 | Full lifecycle ERP and CRM for companies in the auto industry | Director of global accounts |
| Americas/EMEA ISV $10M to $100M revenue | Extend | Born-in-the-cloud | Supply chain and warehousing optimization | Chief executive officer |
| Global ISV $10M to $100M revenue | Extend | Originally on-premises solution; later extended directly from D365 | Trade revenue management for supply chains | Chief executive officer |
| Global ISV $1M to $10M revenue | Extend | Originally on-premises solution; later extended directly from D365 | IT asset management for IT service management (ITSM) | Chief executive officer |
| Global ISV $10M to $100M revenue | Extend | Originally on-premises solution; later extended directly from D365 | Loan origination and branch automation | Managing director |
| Global ISV $10M to $100M revenue | Build | Born-in-the-cloud | Call center, scheduling, and appointments | Corporate vice president |
| EMEA ISV $10M to $100M revenue | Build | Born-in-the-cloud | Metering and contract management | Chief commercial officer |



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## ISV Goals, Challenges, And Drivers

Interviewed ISVs were diverse in size, background, functional and vertical specializations, and type and degree of engagement with Microsoft. These ISVs partnered with Microsoft to build and scale their Business Applications practices for a myriad of reasons, as noted below:

- **Customer demand for scalable and flexible SaaS-based Business Applications.** Customers increasingly expect their business applications to be tailored to their specific industries, use cases, and needs from both a technology and licensing perspective. For ISVs, this means that these applications must be able to easily integrate the customer's existing stack and provide a frictionless experience when the time comes for software upgrades. Furthermore, given the diversity of business models covered by business applications, several ISVs had customers that required flexible pricing structures that deviated from standard user-based monthly pricing and could effectively scale up or down based on a unique set of KPIs.
- **The burden of supporting on-premises customers.** For legacy on-premises ISVs, having to create, maintain, and upgrade distinct versions of software for each customer left no time to think about innovation or margin improvement. One CEO explained: "Going back to a perpetual model where you had overlay code, the investment costs for us in terms of developing our applications were massive because every time the vendor released a new version, we had to release a new version. We literally had no money left to enhance our application."
- **The ability to reach a new audience.** While some ISVs had existing pools of loyal customers and significant market demand for their solutions, other ISVs had minimal market adoption before joining the Microsoft ecosystem. Both of these ISV types benefitted significantly from Microsoft cosell, with the former accessing new geographies and market segments and the latter acquiring net-new go-to-market capabilities and leads without significant upfront investment. ISVs also looked to target customers outside of the realm of traditional ERP and CRM by leveraging integrations with different Microsoft products.

"Going back to a perpetual model where you had overlay code, the investment costs for us in terms of developing our applications were massive because every time the vendor released a new version, we had to release a new version. We literally had no money left to enhance our application."

*CEO, global ISV*

"We were spending $2 million a year on software maintenance back when our revenue was less than $10 million, and that's not an exaggeration. It was a war of attrition, and only the strong could survive."

*CEO, global ISV*



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## Selecting The Right Partner Program

In choosing a partner and platform to build their Business Applications solutions around, interviewed ISVs emphasized the importance of the following factors:

- **Platform investments and strategic direction.** Because of the magnitude of investment involved in creating a new practice, ISVs carefully considered factors such as a vendor's existing technology capabilities, commitment and resources available for reinvesting in those technologies, and future roadmap and vision. With Microsoft, many ISV partners highlighted the benefits of rarely having to worry about issues such as scaling (from an infrastructure perspective) and "future-proofing" their applications. Furthermore, ISVs looked to Microsoft to pave the way forward from an innovation perspective, ultimately allowing these ISVs to adopt and integrate the latest emerging technologies into their own applications without having to create these capabilities from scratch. The CEO of a global ISV said: "One of the great benefits of being on Microsoft's platform is that we're not worried about the platform — the bottom of the application layers — whether it's security, scalability, or innovative technologies such as AI. We employ fewer than a hundred people, but Microsoft has over 5,000 Ph.D.s in AI. So instead of spending our money here, our investment goes into the usability and the business scenarios that you want to enable as an application, and that's very compelling."
- **Ecosystem characteristics.** ISVs looked to partner with a vendor with a large and growing install base of customers that fit the profile of the ISV's target market, with one interviewed ISV projecting that accessing Microsoft's existing install base alone could increase the ISV's addressable market potential by a minimum of 30%. Interviewees also mentioned synergies across adjacent solutions within the broader Microsoft ecosystem, as some ISV applications were deployed through integrations with products such as Office 365. Finally, these ISVs were drawn to Microsoft because of its robust ecosystem of third-party partners as these partners would be pivotal in adopting the ISV's applications, building and delivering services around them, and ultimately unlocking any opportunities with Microsoft customers.

"One of the great benefits of being on Microsoft's platform is that we're not worried about the platform — the bottom of the application layers — whether it's security, scalability, or innovative technologies such as AI. We employ fewer than a hundred people, but Microsoft has over 5,000 Ph.D.s in AI. So instead of spending our money here, our investment goes into the usability and the business scenarios that you want to enable as an application, and that's very compelling."

*CEO, global ISV*

## Key Results

The interviews revealed that key results from the Business Applications investment include:

- **Shifting from an operational to a forward-looking mindset.** With Microsoft Business Applications natively running on the cloud on Azure, end customers benefitted from rapid software upgrades that followed Microsoft's own product release cycle. For ISVs, this meant that a significant portion of time spent maintaining individual customer software versions could now be redeployed to developing additional features or capabilities for their own applications. An ISV that extended its IP off of one of Microsoft's first-party D365 applications said, "Now that we have an extension-based architecture, we're finally able to take some level of control over our strategic roadmap in terms of product development." Additionally, these ISVs increased the overall pace of innovation, with some ISVs going from as few as one major product release every three years (for on-premises releases) to now a minimum release cycle of once every three months.

"We've significantly increased our capabilities and the speed of our development cycles because we can now take advantage of the way Microsoft continues to evolve their own platform. For example, we were going to build out an entirely new solution to manage the fulfillment of entitlements, and now we can simply use Teams."

*CEO, APAC ISV*



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- **Faster payback and profit realization.** Most ISVs were able to break even on their initial practice startup investments within 12 to 18 months. Two primary factors that drove this rapid payback period were 1) Microsoft's Business Application engagement models and 2) Microsoft's cosell program. ISVs building their applications from scratch on the Business Applications platform did so leveraging PowerApps and the Power Platform, which allowed application teams to focus on front-end rather than full-stack development, ultimately slashing the time-to-develop a minimum viable product down to an average of just six months. Other ISVs with existing applications could engage with the Microsoft Business Applications ecosystem just as easily by connecting to (via connectors and APIs) or extending from one of Microsoft's first-party D365 applications. Furthermore, once live on the market, ISVs minimized their sales and marketing investments by utilizing Microsoft cosell teams and go-to-market resources. Because of the smaller initial commitment to research and development (R&D), sales, and marketing, ISVs felt empowered to explore new ideas and applications, quickly test the market, and decide whether to pull the plug or continue investing in growing the business.
- **Triple-digit growth in initial years.** As a consequence of the factors discussed above, nearly all ISVs experienced year-over-year subscription growth of at least 100% in the first three years of operations. While a percentage of these revenues were shared back with Microsoft, most ISVs felt this was heavily outweighed by the benefits and market potential realized through the partnership. One corporate VP posited: "What would you rather have: 100% of a million or 80% of 10 million? It's a no-brainer."

"From an ISV perspective, this has been, without a doubt, one of the most significant initiatives in the last decade. One of the biggest challenges in the past has been alignment within Microsoft, and they have solved that. They've aligned the sales teams with incentives, they've aligned the organization with KPIs, and they've aligned the executive team with performance expectations. It's relentless."

*CEO, global ISV*

"What would you rather have: 100% of a million or 80% of 10 million? It's a no-brainer."

*Corporate VP, global ISV*

## Composite Organization

Based on the interviews, Forrester constructed a TEI framework, a composite ISV, and an associated ROI analysis that illustrates the areas financially affected. The composite organization is representative of the 12 ISVs that Forrester interviewed and is used to present the aggregate financial analysis in the next section. The composite ISV that Forrester synthesized has the following characteristics:

- The ISV has a 12-year-old, legacy, on-premises, revenue management software and is headquartered in North America with a global customer base spanning North America, EMEA, and East Asia.
- The ISV's primary business model is building and selling business applications subscriptions. However, it also directly delivers a quarter of total implementations for its business applications solution.
- The ISV builds its Microsoft Business Application on PowerApps using features of the Power Platform. This new, cloud-native application offers similar revenue management capabilities to the original on-premises product but leverages cloud-based predictive AI and dashboarding capabilities to forecast demand and create optimal pricing recommendations.
- The ISV has an average win rate of 25% on this new business application with an average annual contract value (ACV) per customer of $192,000. The ISV offers multiple subscription tiers for different user types, but the average customer represents 160 users at an average per-seat price of $100.

**Key assumptions**

- Legacy on-premises ISV looking to build a cloud-native business application
- ACV: $192,000
- 160 users/customer
- $100 per user/month



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# Analysis Of ISV Revenue Streams

**QUANTIFIED BENEFIT DATA AS APPLIED TO THE COMPOSITE**

## Revenue Streams And Gross Profits

| REF. | REVENUE STREAM | YEAR 1 | YEAR 2 | YEAR 3 | TOTAL | PRESENT VALUE |
|---|---|---|---|---|---|---|
| At | Business Applications subscriptions | $1,324,800 | $4,272,000 | $8,755,200 | $14,352,000 | $11,312,853 |
| Bt | Business Applications implementation services | $360,000 | $960,000 | $1,584,000 | $2,904,000 | $2,310,744 |
| | Total gross profits (risk-adjusted) | $1,684,800 | $5,232,000 | $10,339,200 | $17,256,000 | $13,623,597 |

The table above shows the total of all gross profits across the areas listed below, as well as present values (PVs) discounted at 10%. Over three years, the composite organization expects risk-adjusted total gross profits to be a PV of more than $13.6 million.

## Business Applications Subscriptions

ISV business applications ranged widely, from large-scale core ERP applications to cloud communications solutions designed to augment an existing CRM experience. Annual subscription revenue per customer also varied significantly, starting from $50K for niche applications targeted toward a specific department or functional group to upward of $400K for transformational business applications. To maximize these contract values, ISVs experimented with different pricing structures and strategies, such as value-based pricing, which would allow subscription fees to scale based on metrics relevant to the customer's unique industry and use cases. Regardless of business application type, all interviewed ISVs experienced significant growth in the initial years of their practices, with most ISVs growing in excess of 100% each year in the first three years of operations.

The Microsoft ecosystem played an instrumental role to each ISV's subscription growth. In addition to leveraging their direct sales teams, ISVs also collaborated with Microsoft cosell teams and third-party partners to maximize potential leads. With Microsoft's cosell program, ISVs utilized Microsoft's existing relationships with technology buyers to unlock pockets of revenue across different buyer types and even geographies where the ISV did not have an existing operating presence. With implementation partners, ISVs took creative approaches to structuring their partnerships, with some ISVs sharing as much as 15% of ongoing IP licenses with partners and others instead receiving a percentage of implementation deals from their partners. Often, the partnership economics would differ deal by deal depending on the role and involvement of the ISV's IP and technical team in closing the deal.

"In the last couple of months, we've seen tremendous engagement while working on shared target account strategies with Microsoft. Leads are now coming from all over the place — Vancouver, Asia, Africa — we get so many that we've actually been having to turn them down."

*CFO, global ISV*

Across ISVs, the average gross margins on IP subscriptions ranged from 50% to 55%. ISVs gave up 10% or 20% of gross revenues to Microsoft (depending on the size of the application) as part of the cosell program, 15% to 25% of gross revenues on customer-specific demos and any third-party tooling embedded in the ISV's IP, and 10% to 15% and 5% to 10% of gross revenues as commission to implementation partners or direct sales, respectively.

To model subscription gross profits for the composite ISV over three years, Forrester assumes:

- Leads start at eight in the first month, grow at a compound monthly growth rate of 5%, and convert to deals at a win rate of 25%. These figures are on the conservative end of what interviewed ISVs experienced.
- Average monthly churn is 5%. Most ISVs reported very few, if any, instances of churn. Several ISVs mentioned that the only time a customer might churn would be after an acquisition.
- Pricing is based on subscription tier and number of users, with an average of 160 users per customer paying an average of $100 per user, per month.
- Gross margins are 55% and 50% for direct and partner-driven leads, respectively.

Over the three-year analysis, the composite ISV generates total discounted gross profits on its Business Applications subscriptions of over $11.3M.

> "As many as 60% of our leads are now generated by Microsoft, and 80% of deals that close have involved a Microsoft field person at some point in the sales process or another."
>
> *CEO, global ISV*

**Business Applications Subscriptions: Calculation Table**

| REF. | METRIC | CALC. | YEAR 1 | YEAR 2 | YEAR 3 |
|---|---|---|---|---|---|
| A1 | Total customer accounts (IP deals) | | 14 | 44 | 90 |
| A2 | Churned customer accounts | Assumes 5% monthly churn | 1 | 2 | 4 |
| A3 | Total customer accounts (IP deals), net of churn | A1-A2 | 13 | 42 | 86 |
| A4 | Deals attributed to direct sales or Microsoft cosell | A3*60% (rounded) | 8 | 25 | 52 |
| A5 | Deals attributed to indirect third-party partners | A3*40% (rounded) | 5 | 17 | 34 |
| A6 | Average annual IP revenue per customer | 160 users per customer at $100 per user, per month | $192,000 | $192,000 | $192,000 |
| A7 | Annual IP subscription revenue | A6*(A4+A5) | $2,496,000 | $8,064,000 | $16,512,000 |
| A8 | Gross IP licensing revenue (direct) | A4*A6 | $1,536,000 | $4,800,000 | $9,984,000 |
| A9 | Gross IP licensing revenue (indirect) | A5*A6 | $960,000 | $3,264,000 | $6,528,000 |
| A10 | Gross margin (direct) | | 55% | 55% | 55% |
| A11 | Gross margin (indirect) | | 50% | 50% | 50% |
| At | Business Applications subscriptions | (A8*A10)+(A9*A11) | $1,324,800 | $4,272,000 | $8,755,200 |

## Business Applications Implementation Services

Given the complexity of business applications implementations, most ISVs relied heavily on implementation partners with the resources and experience to effectively deliver these implementations at scale. At the same time, these ISVs still played an important support role for implementation partners, particularly in the first several months to years of adding the ISV's application to their portfolios. Furthermore, the degree of ISV involvement in implementations was typically a result of the ISV's broader background as a partner. ISVs that started as systems integrators, for instance, typically had a higher ratio of services to IP, and some even viewed their SaaS applications as a lead-in to higher-value implementation services. Most interviewed ISVs, however, were looking to either maintain or gradually wind down their services business in favor of reinvesting in their SaaS businesses.

To model implementation services gross profits for the composite ISV over three years, Forrester assumes:

- Stand-alone implementations that are not part of a broader technology or solution package represent 25% of all implementations. The ISV directly delivers all of these implementations.
- The average implementation deal size is $300K. Implementation deal sizes varied significantly by ISV solution and customer, with out-of-the-box implementations grossing as little as $10K and taking as few as several days to phased implementations as part of larger digital transformational deals grossing in the millions and spanning over two to three years.
- Average gross margins start at 30% in Year 1 of operations and improve to 44% by Year 3. All ISVs that delivered implementations reported significantly lower margins in Year 1 due to a learning curve. These margins improved in each subsequent year of operations as ISVs developed the templates, tools, scripts, and experience to deliver these implementations more quickly and with less rework.

Over the three-year analysis, the composite ISV generates total discounted gross profits on its Business Applications implementation services of over $2.3M.

"In our sector, an 18- to 24-month implementation was considered fast. Now, our projects are done in nine to 12 months and sometimes as few as three months for those looking for out-of-the-box functionality. It's much easier to do things like setting up training environments, showcasing functionality, and provisioning infrastructure."

*Chief commercial officer, EMEA ISV*

**Business Applications Implementation Services: Calculation Table**

| REF. | METRIC | CALC. | YEAR 1 | YEAR 2 | YEAR 3 |
|---|---|---|---|---|---|
| B1 | Total Business Applications implementations | $A1_{CY}$-$A1_{PY}$ | 14 | 30 | 46 |
| B2 | Business Applications implementations delivered directly | B1*25% (rounded) | 4 | 8 | 12 |
| B3 | Average standalone implementation deal size | | $300,000 | $300,000 | $300,000 |
| B4 | Implementation services revenue | B3*B4 | $1,200,000 | $2,400,000 | $3,600,000 |
| B5 | Gross margin | | 30% | 40% | 44% |
| Bt | Business Applications implementation services | B4*B5 | $360,000 | $960,000 | $1,584,000 |

## Flexibility

The value of flexibility is clearly unique to each ISV, and the measure of its value varies from organization to organization. For Business Applications ISVs, unlocking potential synergies across the Microsoft ecosystem was a crucial long-term goal. Among other avenues, interviewed ISVs were in the process of exploring integrations with Microsoft solutions such as Teams and M365, AI capabilities with Power BI and Customer Insights, and internet-of-things (IoT) features with Azure. ISVs expect these synergies to enhance the customer experience and add new capabilities and revenue streams to their practices.

Flexibility would also be quantified when evaluated as part of a specific project (described in more detail in Appendix A).

Flexibility, as defined by TEI, represents an investment in additional capacity or capability that could be turned into business benefit for a future additional investment. This provides an organization with the "right" or the ability to engage in future initiatives but not the obligation to do so.

# Analysis Of ISV Investments

**QUANTIFIED COST DATA AS APPLIED TO THE COMPOSITE**

## Total Investments

| REF. | COST | INITIAL | YEAR 1 | YEAR 2 | YEAR 3 | TOTAL | PRESENT VALUE |
|---|---|---|---|---|---|---|---|
| Ct | Research and development | $775,000 | $390,000 | $594,375 | $810,676 | $2,570,051 | $2,229,837 |
| Dt | Sales, account management, and channel enablement | $0 | $500,000 | $772,500 | $1,326,125 | $2,598,625 | $2,089,313 |
| Et | General and administrative | $0 | $525,000 | $669,500 | $954,808 | $2,149,308 | $1,747,940 |
| Ft | Marketing | $0 | $147,840 | $418,560 | $804,480 | $1,370,880 | $1,084,735 |
| | Total investments (risk-adjusted) | $775,000 | $1,562,840 | $2,454,935 | $3,896,089 | $8,688,864 | $7,151,825 |

The table above shows the total of all investments across the areas listed below, as well as present values (PVs) discounted at 10%. Over three years, the composite ISV organization expects risk-adjusted total investments to be a PV of almost $7.2 million.

## Research And Development

Investments in product development included the costs involved in developing a minimum viable product and ongoing research to add and integrate Microsoft upgrades as well as proprietary features and functionality into the ISV's applications. Because of Microsoft's diverse engagement models (connect, extend, build), many Microsoft Business Applications ISVs significantly reduced their initial development times as ISVs porting their existing IP could avoid heavy application refactoring by leveraging built-in APIs and connectors, and ISVs building and testing new applications could do so by extending off of Microsoft's own first-party applications or building from scratch with the Power Platform. Across these different engagement types, ISVs could reduce the time required to develop a minimum viable product by as much as 75%.

Once applications launched, ISVs dedicated a fraction of initial development efforts to ongoing R&D. Initially, this primarily entailed keeping up with Microsoft's frequent innovation and release cycles for its own first-party applications, but over time, ISVs allocated more resources for running simulations around integrating tools such as Power BI or other third-party functionalities into their applications.

To model research and development investments made by the composite ISV over three years, Forrester assumes:

- The composite ISV dedicates incremental R&D headcount for its Business Applications practice, which can be seen in row C1 in the table below. ISVs typically kept 20% to 30% of initial development FTEs engaged in ongoing R&D in Year 1. This number continues to increase incrementally as the composite ISV reaches profitability and improves its overall practice margins.
- The average fully burdened, blended annual salary for development FTEs can be found in row C2 in the table below and includes a 25% uplift to account for benefit overhead. Forrester applies an annual increase of 3% to Years 2 and 3 salary rates.

"We never take more than six months to get a minimum viable product out to quickly test in the market. That's how powerful PowerApps is by every definition. What would have taken us two years to do in the past can now be done in six months at a fraction of the investment."

*Corporate VP, global ISV*

- The initial build time for the composite ISV's business application is six months. Interviewed ISVs building natively on PowerApps and using the Power Platform all targeted a six-month build cycle.
- Consumption and platform fees for tests and simulations typically ran at $20K to $30K for the initial build cycle and between $10K and $20K for ongoing R&D. Some ISVs were granted Azure credits from Microsoft or participated in accelerator programs that covered a portion of these costs.

Over the three-year analysis, the composite ISV makes present-value adjusted investments in research and development of over $2.2M.

"We can now think about products that we might release in two years' time or three years' time whereas in the past, we'd always just be living hand-to-mouth"

*CEO, global ISV*

**Research And Development: Calculation Table**

| REF. | METRIC | CALC. | INITIAL | YEAR 1 | YEAR 2 | YEAR 3 |
|---|---|---|---|---|---|---|
| C1 | Number of development FTEs required for initial and ongoing development | | 8 | 2 | 3 | 4 |
| C2 | Fully burdened, blended annual salary per development FTE | | $187,500 | $187,500 | $193,125 | $198,919 |
| C3 | Number of months spent on initial and ongoing development, maintenance, and management | | 6 | 12 | 12 | 12 |
| C4 | Platform and consumption fees for initial product development and ongoing innovation | | $25,000 | $15,000 | $15,000 | $15,000 |
| Ct | Research and development | C1*C2*(C3/12)+C4 | $775,000 | $390,000 | $594,375 | $810,676 |

## Sales, Account Management, And Channel Enablement

Because of the benefits of Microsoft cosell and the Microsoft ecosystem, ISVs did not need to invest as heavily in direct go-to-market headcount for their Microsoft Business Applications practices as they did for their other ISV practices. This did not mean that go-to-market was not as important, but rather that the focus of it would shift from outbound sales to partnerships and cosell. Rapidly growing ISVs leveraged the entire Microsoft ecosystem, including Microsoft field and cosell teams as well as partners within the Microsoft Partner Network (MPN), and deals often involved both constituents as well as the ISV's own account teams. However, regardless of the source of the lead, once leads were qualified and developed sufficiently, they would be taken to the ISV's technical and product teams, which would typically "close" the deal.

"This cosell program made absolute sense to us because we needed a route to market. Now we have one and we didn't need to load up the car in terms of our own sales and marketing to get it."

*CFO, global ISV*

To model sales, account management, and channel enablement investments made by the composite ISV over three years, Forrester assumes:

- The composite ISV dedicates incremental account management and partner enablement headcount for its Business Applications practice, which can be seen in rows D1 and D2 in the table below. Headcount growth is commensurate to overall customer growth.
- Average fully burdened salaries for account management and partner enablement FTEs can be found in rows D3 and D4 in the table below and include a 25% uplift to account for benefit overhead. Forrester applies an annual increase of 3% to Years 2 and 3 salary rates.

Over the three-year analysis, the composite ISV makes present-value adjusted investments in sales, account management, and channel enablement of $2.1M.

**Sales, Account Management, And Channel Enablement: Calculation Table**

| REF. | METRIC | CALC. | INITIAL | YEAR 1 | YEAR 2 | YEAR 3 |
|---|---|---|---|---|---|---|
| D1 | Incremental sales and account management FTEs employed | | | 2 | 3 | 5 |
| D2 | Incremental partner management and enablement FTEs employed | | | 2 | 3 | 5 |
| D3 | Fully burdened, blended annual salary per sales and account management FTE | | | $137,500 | $141,625 | $145,874 |
| D4 | Fully burdened, blended annual salary per partner management and enablement FTE | | | $112,500 | $115,875 | $119,351 |
| Dt | Sales, account management, and channel enablement | (D1*D3)+(D2*D4) | $0 | $500,000 | $772,500 | $1,326,125 |

## General And Administrative

ISVs operated with lean overhead expenses, particularly in early years where investments were more heavily weighted toward product development. Additionally, ISVs with existing practices spread their overhead costs across their different product lines, further reducing the need to make incremental hires. Only two roles consistently required dedicated staffing across interviewed ISVs: product management and customer support, with customer support, in particular, becoming increasingly essential as practices scaled beyond their first handful of customers. A robust customer support team with high availability was a key value proposition for several ISVs as these resources facilitated everything from customer onboarding to technical support.

To model general and administrative investments made by the composite ISV over three years, Forrester assumes:

- The composite ISV dedicates incremental product management and customer support headcount for its Business Applications practice, which can be seen in rows E1 and E2 in the table below. The number of product managers remains consistent throughout the evaluated three-year investment period while customer support headcount grows commensurately to overall customer growth.
- Average fully burdened salaries for product management and customer support FTEs can be found in rows E3 and E4 in the table below and include a 25% uplift to account for benefit overhead. Forrester applies an annual increase of 3% to Years 2 and 3 salary rates.

Over the three-year analysis, the composite ISV makes present-value adjusted investments in general and administrative overhead of over $1.7M.

"Perhaps the area where we'll see the most growth in headcount is in client services. This is because a large number of our business applications customers are actually existing customers from our other product lines."

*Director of business applications, North America ISV*

| General And Administrative: Calculation Table | | | | | | |
|---|---|---|---|---|---|---|
| **REF.** | **METRIC** | **CALC.** | **INITIAL** | **YEAR 1** | **YEAR 2** | **YEAR 3** |
| E1 | Incremental product and practice management FTEs employed | | | 2 | 2 | 2 |
| E2 | Incremental customer support FTEs employed | | | 2 | 4 | 8 |
| E3 | Fully burdened, blended annual salary per product and practice management FTE | | | $200,000 | $206,000 | $212,180 |
| E4 | Fully burdened, blended annual salary per customer support FTE | | | $62,500 | $64,375 | $66,306 |
| Et | General and administrative | (E1*E3)*(E2*E4) | | $525,000 | $669,500 | $954,808 |

## Marketing

For most ISVs, marketing was the smallest investment area but also one of two areas, alongside R&D, that ISVs felt could have an outsized impact with incremental investments and a targeted strategy and roadmap. Marketing was not a key source of lead generation for any of the ISVs but nonetheless played an important role in moving customers through the buying cycle. ISVs invested in creating marketing and thought leadership collateral, landing assets and platforms, and digital marketing content to generate awareness and establish themselves as best-in-class providers in their respective markets. ISVs also noted that partnering with Microsoft reduced overall marketing expenditures as these ISVs could use templated go-to-market resources offered as part of the ISV Connect program and post their applications on Microsoft's own application marketplaces, such as AppSource.

Beyond these table-stakes activities, some ISVs invested a portion of their marketing budgets in digital and search engine optimization (SEO) advertising while others frequently participated in industry conferences with the help of Microsoft marketing development funds. Combined, ISV marketing investments typically ranged between 3% and 5% of gross Business Applications practice revenues. Over the three-year analysis, the composite ISV makes present-value adjusted investments in marketing of $1.1M.

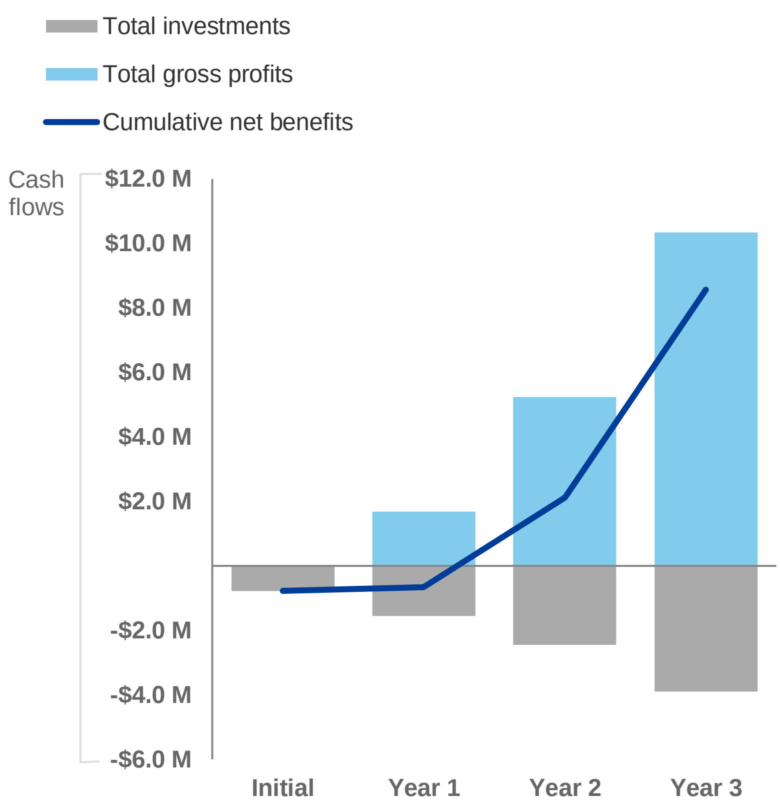
> "In our industry, leads are generated by word-of-mouth or peer referral, not ads. And so when it comes to marketing, we're mainly investing in industry conferences and publishing whitepapers in partnership with professional associations."
>
> *Director of business applications, North America ISV*

| Marketing: Calculation Table | | | | | | |
|---|---|---|---|---|---|---|
| **REF.** | **METRIC** | **CALC.** | **INITIAL** | **YEAR 1** | **YEAR 2** | **YEAR 3** |
| F1 | Gross annual Business Applications practice revenues | A7+B4 | | $3,696,000 | $10,464,000 | $20,112,000 |
| F2 | Marketing expenditure (% of gross practice revenues) | | | 4% | 4% | 4% |
| Ft | Marketing | F1*F2 | | $147,840 | $418,560 | $804,480 |

# Financial Summary

**CONSOLIDATED THREE-YEAR RISK-ADJUSTED METRICS**

## Cash Flow Chart (Risk-Adjusted)




The financial results calculated in the Revenue Streams and Investments sections can be used to determine the ROI, NPV, and payback period for the composite ISV organization's practice. Forrester assumes a yearly discount rate of 10% for this analysis.

**Cash Flow Table (Risk-Adjusted)**

| | INITIAL | YEAR 1 | YEAR 2 | YEAR 3 | TOTAL | PRESENT VALUE |
|---|---|---|---|---|---|---|
| Total investments | ($775,000) | ($1,562,840) | ($2,454,935) | ($3,896,089) | ($8,688,864) | ($7,151,825) |
| Total gross profits | $0 | $1,684,800 | $5,232,000 | $10,339,200 | $17,256,000 | $13,623,597 |
| Net benefits | ($775,000) | $121,960 | $2,777,065 | $6,443,111 | $8,567,136 | $6,471,772 |
| ROI | | | | | | 90% |
| Payback period | | | | | | 15.0 months |

# Microsoft Business Applications: Overview

The following information is provided by Microsoft. Forrester has not validated any claims and does not endorse Microsoft or its offerings.

**Customer demand drives growth of ISV applications business**

More than ever, organizations need to innovate and adapt to change rapidly. This is only possible when customers can unlock their business data—from customer history to transactional, observational, and analytical—and unify that data on a modern, intelligence-infused cloud platform.

Microsoft stands alone in its ability to help customers unlock this innovation by combining marketing, finance, sales, service, talent, retail, and operations applications with an analytics, application, and workflow platform that all relies on the Microsoft common data model. Furthermore, Microsoft makes it possible for customers to connect their data assets across Microsoft 365 (M365), Azure, LinkedIn, and 3rd party ecosystems to optimize the systems and solutions they already have in place.

ISVs that build on Microsoft Dynamics 365 and PowerApps can offer their customers innovative apps they couldn't build elsewhere using connections to industry-leading cloud services on Azure and developer tools built just for them. The Business Applications ISV Connect Program from Microsoft brings together platform and program benefits created especially for ISVs to support their success.

Only with Microsoft technologies could we orchestrate this level of synchronization and take our solutions forward."

—Syed Fahad, Co-founder and Corporate VP, Mazik Global

**The Microsoft Business Applications ISV Connect Program**

We have designed the Microsoft Business Applications ISV Connect Program to help you better serve our joint customers by providing enhanced tools and services for application development, improving your marketplace publishing experience, and committing to a more effective and predictable Go-To-Market engagement.

"This is the first time I've ever seen a true, transparent, open, and fair partnership program. We've already benefited from well qualified leads, prospect intelligence, and increased sales."

—John Colgan, CEO and Co-founder, Solgari

All new and existing Dynamics 365 and PowerApps applications must enroll in the program, be certified, and listed on AppSource. The program applies to apps that use or extend the following Business Application workloads: Dynamics 365 for Customer Service, Field Service, Sales, Talent, Marketing, Retail, Finance and Operations, and PowerApps. All apps that build on, extend to, or connect with Dynamics 365 applications, PowerApps or CDS by deploying in the customer's tenant through a package/solution or API equivalent must participate in the program.

"ISV Connect has allowed us to be highly focused, drive profitability, drive good growth, and not dilute our value proposition when reaching customers in new markets."

—Trevor Nimegeers, Managing Director, ITRAK 365

The Microsoft Business Applications ISV Connect Program lays the path to a stronger partnership through a revenue sharing model that ensures on-going platform investments, Pro Developer tooling enhancements, and go-to-market (GTM) benefits intended to help you grow your business. As you grow and increase your success with Microsoft, we will increase our reinvestment with you. This is done to ensure both of us are committed to mutual success and ultimately to customer success. To learn more about the Microsoft Business Applications ISV Connect Program please visit [https://partner.microsoft.com/en-us/solutions/business-applications/isv-overview](https://partner.microsoft.com/en-us/solutions/business-applications/isv-overview).

# Appendix A: Total Economic Impact

Total Economic Impact is a methodology developed by Forrester Research that enhances a company's technology decision-making processes and assists vendors in communicating the value proposition of their products and services to clients. The TEI methodology helps companies demonstrate, justify, and realize the tangible value of IT initiatives to both senior management and other key business stakeholders.

## Total Economic Impact Approach

**Benefits** represent the value delivered to the business by the product. The TEI methodology places equal weight on the measure of benefits and the measure of costs, allowing for a full examination of the effect of the technology on the entire organization.

**Costs** consider all expenses necessary to deliver the proposed value, or benefits, of the product. The cost category within TEI captures incremental costs over the existing environment for ongoing costs associated with the solution.

**Flexibility** represents the strategic value that can be obtained for some future additional investment building on top of the initial investment already made. Having the ability to capture that benefit has a PV that can be estimated.

**Risks** measure the uncertainty of benefit and cost estimates given: 1) the likelihood that estimates will meet original projections and 2) the likelihood that estimates will be tracked over time. TEI risk factors are based on "triangular distribution."

The initial investment column contains costs incurred at "time 0" or at the beginning of Year 1 that are not discounted. All other cash flows are discounted using the discount rate at the end of the year. PV calculations are calculated for each total cost and benefit estimate. NPV calculations in the summary tables are the sum of the initial investment and the discounted cash flows in each year. Sums and present value calculations of the Total Benefits, Total Costs, and Cash Flow tables may not exactly add up, as some rounding may occur.

**Present value (PV)**

The present or current value of (discounted) cost and benefit estimates given at an interest rate (the discount rate). The PV of costs and benefits feed into the total NPV of cash flows.

**Net present value (NPV)**

The present or current value of (discounted) future net cash flows given an interest rate (the discount rate). A positive project NPV normally indicates that the investment should be made, unless other projects have higher NPVs.

**Return on investment (ROI)**

A project's expected return in percentage terms. ROI is calculated by dividing net benefits (benefits less costs) by costs.

**Discount rate**

The interest rate used in cash flow analysis to take into account the time value of money. Organizations typically use discount rates between 8% and 16%.

**Payback period**

The breakeven point for an investment. This is the point in time at which net benefits (benefits minus costs) equal initial investment or cost.

# Appendix B: Endnotes

[1] Source: “Create A Modern Software Strategy With AI-Driven Platforms And Their Ecosystems,” Forrester Research, Inc., March 21, 2019.