



IDC TECHNOLOGY SPOTLIGHT

Key Drivers and Considerations for the Emerging Cloud PBX Market

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The benefits of cloud delivery models are driving usage of managed and cloud-based communications solutions such as hosted voice over IP (VoIP), unified communications (UC), and UC as a service (UCaaS). Hosted VoIP represents an opportunity to eliminate redundant infrastructure, manage all voice and data communications via a single Internet network with a single provider, and deploy the same telephony solution in some or all branch offices. For many organizations, VoIP and UC implementations can be complex and challenging to manage; thus, having a solution managed by a communications service provider (CSP), systems integrator, reseller, or other provider helps remove the complexity and alleviates the need for internal investments in IT staff to manage and maintain the solution. IDC anticipates that business adoption of hosted VoIP and UC will continue to expand as CSPs continue to ramp up their efforts around marketing, promoting, and expanding the features and functionality available with their hosted VoIP and UCaaS solutions. This Technology Spotlight examines these trends and discusses the role that solutions from ESI are playing in the hosted VoIP and UC market.

Introduction

Business communications are rapidly being transformed from legacy telephony systems to VoIP solutions. At the same time, growing comfort with cloud services and delivery models is also driving business interest in and usage of managed and cloud-based communications solutions, including hosted VoIP, UC, and UCaaS.

The manner in which businesses communicate is also evolving and becoming more mobile, spurred on by the proliferation of mobile devices, the bring-your-own-device (BYOD) phenomenon, and an increasingly mobile and remote workforce. As a result, most businesses are seeking to more effectively manage complexity, reduce costs, and increase employee productivity and collaboration, with the goal of enabling real-time integrated communications across a range of platforms and devices.

Migration from legacy voice services to VoIP is a growing trend among businesses of all types and sizes. Business migration to VoIP has expanded dramatically in the past several years, driven by business desire to gain key business advantages such as reducing costs, decreasing complexity, and increasing productivity.

Deployment Models

A key challenge for businesses looking to adopt VoIP is identifying which type of VoIP implementation is best suited to meet the needs of the organization. The primary options are:

- **Premises-based VoIP.** VoIP capabilities are delivered via dedicated infrastructure located at the customer's premises, and functionality is delivered via IP PBX systems.

- **Hosted/cloud-based VoIP services.** VoIP capabilities are network-embedded services delivered via shared infrastructure hosted by a CSP at its central office or datacenter or delivered in a cloud-based/as-a-service model.
- **Dedicated hosted/managed VoIP.** The infrastructure, which can be customer owned or leased, is managed by a third-party CSP and housed either in the CSP's datacenter (dedicated/hosted) or on the customer's premises (managed).

In the past few years, CSPs have invested heavily in managed, hosted, and cloud-based services offerings to give businesses more flexible delivery and deployment options for VoIP. As a result, solutions sold as part of a hosted or cloud services environment are challenging and will continue to challenge premises-based solutions.

The Rise of Hosted VoIP

One of the fastest-growing VoIP services segments is hosted/cloud-based VoIP or hosted PBX services. Hosted VoIP is a fully managed hosted/cloud-based IP voice solution positioned by a CSP as an alternative to premises-based systems. It is a scalable, multitenant solution shared across a number of users and businesses and is typically targeted to businesses that want the functionalities of a premises system without the associated capital expenditure, lease, or management and maintenance costs of an on-premises solution.

Hosted VoIP adoption has accelerated in the past 12–18 months because such solutions provide measurable cost savings, simplify the delivery and management of communications, and facilitate migration to a converged network. Moreover, the tremendous capital investment involved in implementing, maintaining, and managing a premises-based solution has led to hosted VoIP services quickly gaining in popularity across all segments of the enterprise market.

Several hosted VoIP deployment models coexist and contribute to the highly fragmented nature of the market, with no one solution or model dominating the market. Deployment models include the following:

- Network-based hosted or cloud VoIP solutions are being offered by facilities-based providers. Network-based hosted VoIP solutions typically "bundle" Internet/data connectivity and may include service level agreements (SLAs) and quality-of-service (QoS) guarantees.
- Over-the-top (OTT) hosted VoIP services require that customers bring their own bandwidth or Internet connection. OTT hosted VoIP is considered a "best effort" service and does not include SLAs or QoS guarantees.
- Premises-based vendors have been expanding their business models to encompass and embrace the cloud. Consequently, they have expanded their product portfolios to include hosted VoIP and UC offerings that complement their existing on-premises solutions.

The Role of Unified Communications

Until recently, business adoption of UC solutions lagged industry expectations, largely because of the perceived complexity of implementing VoIP and UC as well as confusion and uncertainty about the value proposition and use case for UC. However, CSPs spent much of 2012 and 2013 refining and expanding their existing hosted VoIP and cloud-based UC and UCaaS capabilities. They did this by integrating unified messaging (email, voice, and fax messaging), IM, conferencing (Web, audio, and video), presence, mobility, and communications-enabled business processes with the underlying advanced telephony and call management capabilities already resident on the hosted VoIP platform.

As a result, growing enterprise awareness of and interest in UC are helping drive uptake of hosted VoIP because it is often viewed as a key foundation for UC. Many businesses see UC in their future and have begun laying the foundation for implementing it. In fact, some IT managers are deploying hosted and cloud-based UC or UCaaS not because they believe their users will leverage the advanced features and functionality immediately but because they are able to deploy the solution in a cost-effective manner today, with the realization that the added features and functionality will be there when they are eventually needed. Enterprises are also considering how UC can enable new applications and help solve business process and collaboration challenges.

Business VoIP Trends

Over the past several years, VoIP solutions including hosted or cloud-based VoIP services have moved well beyond the early adopter phase and into the mainstream. Several factors are influencing the rapid development of the hosted VoIP market. Business migration from TDM-based legacy voice is fueling most of the growth as businesses reevaluate their existing solutions and explore the potential benefits of moving to a hosted or cloud-based voice model.

Until recently, businesses have predominantly implemented capital-intensive, premises-based platforms; however, growing business comfort with cloud service delivery models, coupled with investments by CSPs to expand and promote their managed, hosted, and cloud-based product portfolios, has led to faster-than-expected uptake of hosted/cloud-based VoIP and UC solutions.

Examining the Survey Data

IDC survey data supports this trend. Among organizations that have deployed VoIP, one-third of respondents reported they have deployed a hosted VoIP solution, and an additional 29.6% of respondents said they plan to implement hosted VoIP in the future. Additionally, among organizations that intend to deploy UC, 71% of respondents said they plan to implement a hosted, cloud, or managed UC/UCaaS solution, compared with 29% of respondents who said they intend to implement on-premises UC. Businesses are also expressing a growing interest in hybrid UC, a combination of premises and cloud-based solutions — 10% of current UC users said they had deployed a hybrid solution, while 13% of UC intenders said they planned to implement a hybrid solution in 2014.

IDC forecasts that business hosted VoIP services will expand from 2.5 million seats in 2013 to more than 6 million seats by the end of 2017, growing at a compound annual growth rate (CAGR) of 24.8%. In addition, hosted VoIP services will generate more than \$2.8 billion in revenue for CSPs by 2017, compared with nearly \$1.4 billion in 2013. The average number of seats per site will remain relatively constant, but monthly revenue per site will gradually decrease over the forecast period as a result of pricing compression.

Market Segmentation

Hosted IP voice services initially appealed to and were targeted by CSPs to small and medium-sized businesses (SMBs) ranging in size from single-site companies with 1–5 employees to medium-sized, multisite companies with 500 employees. However, a shift has occurred whereby many medium-sized businesses and large enterprises, particularly those with distributed workforces and thousands of employees in hundreds of sites, are showing increased interest in hosted VoIP solutions.

Most organizations that have adopted hosted VoIP have done so because of the cost savings associated with such a service. Many businesses realize immediate cost savings by outsourcing the management and maintenance of their phone system and by reducing their spending on voice calling because of efficiencies achieved by moving to IP-based voice.

Other drivers include reducing or eliminating challenges related to dealing with multiple vendors and inefficient service and support processes. Hosted VoIP also represents an opportunity to eliminate redundant infrastructure, manage all voice and data communications via a single Internet network with a single provider, and deploy the same telephony solution in some or all branch offices.

Businesses are also increasingly taking a hybrid approach to hosted VoIP, implementing the service in branch offices or smaller sites or in select business units while deploying a premises-based solution in the corporate or main office. In other scenarios, organizations are taking a more measured approach, implementing a hybrid solution in the interim with the intention of migrating entirely to a cloud services delivery model over time.

Additionally, customization is shifting from the exception to the norm, with much of it influenced by the hybridization of hosted VoIP into larger enterprises' premises-based solutions. This trend will expand and result in shifting emphasis toward more demand-centric solutions that will quickly gather momentum as the market becomes more competitive.

The Benefits of Cloud-Based VoIP

Among the main appeals of a hosted VoIP solution are the benefits of simplification and convergence. Other benefits include ease of use and management, improved employee productivity and collaboration, and increased feature functionality. For many organizations, VoIP and UC implementations can be complex and challenging to manage; thus, having a solution managed by a CSP, systems integrator, reseller, or other provider helps remove the complexity and alleviates the need for internal investments in IT staff to manage and maintain the solution.

Hosted IP voice's fortunes have also increased as a direct result of the economic recession. One of the key advantages of a hosted VoIP service over a premises-based solution is that it provides measurable cost savings because of the lack of capital expenditures required. Additionally, a hosted offering simplifies the delivery and management of communications, making maintenance contracts unnecessary because management is fully outsourced to a secure central location.

CSP and Reseller Strategies

CSPs have focused on marketing to and educating businesses about the benefits of cloud services delivery models; consequently, the delivery and deployment options available today have expanded beyond the predominantly premises-based solutions that existed a few years ago to include managed, hosted, and cloud-based offerings as well as hybrid solutions. After years of slower-than-anticipated adoption, businesses finally moved beyond the exploration and trial phase that characterized the past several years and began deploying hosted VoIP and UC in earnest in 2014.

IDC anticipates that business adoption of hosted VoIP and UC will continue to expand as CSPs continue to ramp up their efforts around marketing, promoting, and expanding the features and functionality available with their hosted VoIP and UCaaS solutions.

Cloud-based solutions are also attractive to resellers because they can quickly begin seeing an impact on their bottom line in two ways:

- **Reduction in truck rolls:** After installation, resellers are able to conduct troubleshooting and maintenance remotely, thereby reducing the need to send a technician to the customer's site.
- **New prospects:** The cloud's elastic pricing offers a new source of revenue and a new market that can be targeted immediately.

Some CSPs are also working with resellers, educating and training them on the benefits of cloud services delivery models and providing them with the knowledge, tools, and training needed to sell "total solutions" rather than individual products to end-user customers.

Choosing a Hosted VoIP Solution

Implementing VoIP and UC can be daunting. Key challenges include identifying the technologies, features, and services that are most appropriate for the business and important to users; educating employees on how to use the solution; and developing a business case that justifies the investment. Equally important is determining which sources to turn to for deployment of the solution (i.e., CSP, vendor, or reseller/integrator). IDC survey data supports these challenges. According to a recent survey, among organizations that had deployed UC, the top barriers to usage of the solution were cost (i.e., too expensive to justify the investment or fully extend the necessary capabilities); too complex/difficult to implement; IT staff lacked the skills/time necessary to deploy and support UC; and lack of end-user training on how to use the solution.

Thus, businesses planning to implement a hosted VoIP or UC solution should consider the following:

- When is the right time — should changes be made gradually or at the same time? Can existing investments in premises-based systems be protected and leveraged (i.e., a hybrid deployment in the interim)? What incremental steps can the business take to continue forward progress but at a decreased cost and/or pace?
- What business benefits is the organization looking to achieve by moving to a hosted/cloud-based services delivery model? Does the solution/product align with the organization's current and future priorities and objectives?
- Are the features and functionality critical to the business available as part of the solution? Are they available a la carte and/or for an additional fee? How flexible are the service plans (i.e., is there any room for customization and are different user profiles available)?
- Is the solution scalable and flexible (i.e., how many users can it support, can users/lines be added, deleted, or changed easily to accommodate growth or changes in the organization's business)?
- Is technical and/or customer support available? What does it encompass (i.e., pre-installation, post-installation, voice quality, service outages, multiple locations)? For network-based solutions, does the CSP proactively support and monitor the network? Are SLAs and QoS guarantees available?

Considering ESI's Cloud-Based PBX

Estech Systems Inc. (ESI) provides high-performance business telephone systems and cloud services to business customers of all sizes. ESI is a privately held corporation with headquarters in Plano, Texas. As a provider of cloud- and premises-based UC solutions, the company offers integrated systems designed to enable its channel partners to deliver differentiated and affordable VoIP communications.

ESI sells product and service offerings through a network of hundreds of certified resellers. Given this go-to-market approach, the company has a major stake in how resellers effectively update their businesses by adding cloud offerings to their existing portfolios. However, selling cloud-based offerings requires a different business model. Traditionally, a reseller's business model has relied on up-front payment from the sale of a CPE phone system, which delivers immediate revenue gains but can cause unpredictable sales cycles and inconsistent revenue recognition over the longer term. In contrast, cloud solutions are typically billed on a monthly recurring per-seat or per-user basis, providing resellers with a steady stream of predictable income. To effectively incorporate cloud-based VoIP and UC solutions into their portfolios, resellers need to adjust their business models and do so in a way that benefits both themselves and their customers.

ESI has allocated significant resources to ensuring its resellers have the necessary knowledge, skills, and tools required to sell and install subscription-based solutions. The company has launched a major initiative aimed at educating its resellers and ensuring they understand the full benefits and issues associated with selling cloud solutions. While ESI acknowledges this education process takes time and requires planning, it believes that this effort is essential to the success of the company and its resellers because resellers need to view cloud PBX as a complement to rather than a replacement for the array of premises-based products they are already selling.

Challenges and Opportunities

The hosted VoIP market is highly fragmented with a large and diverse array of competitors. ESI faces credible near-term threats in the form of not only premise-based vendors but also CSPs, many of which have a broad portfolio of hosted VoIP and UC solutions that puts them squarely in competition with ESI.

While ESI has a sizable installed base of customers, which it believes will be one of its best sources of growth going forward, converting its premises-based customers to the cloud and appealing to new customers requires different sales approaches. With this in mind, ESI is working closely with its partners on developing campaigns designed to convert existing legacy solutions customers to its newer cloud-based offerings, with positive results so far.

ESI recognizes that its reseller partners are critical to its success in terms of converting existing customers to the cloud and even more so in attracting new customers to its cloud-based solutions. The company also realizes the challenges involved in convincing its partners to add cloud to their portfolios, particularly as many still lack the necessary tools, skills, or training to sell and support cloud-based implementations. As a result, ESI has allocated significant resources to educating and helping its partners integrate cloud-based solutions into their portfolios and more importantly transition their business models from a one-time, premises-based sales approach to a recurring, subscription-based model.

Other challenges ESI must overcome are increasing its brand awareness and differentiating its offerings in the crowded, competitive, and feature-rich hosted VoIP market. The company acknowledges that even though it has been around for nearly 30 years, it lacks a strong brand identity. To that end, ESI is actively working to increase awareness of its brand and product portfolio with the launch of several new marketing initiatives. ESI's approach to product differentiation is based on simplicity and flexibility. The company has a legacy of providing customers with a quality user experience based on delivering systems and solutions that are easy to use and manage. Furthermore, rather than assuming a one-size-fits-all approach, ESI allows customers the flexibility to customize their hosted VoIP solution to suit their needs and pay for only the features and functionality that users need, based on discrete employee profiles.

ESI also faces the same challenge confronting other CSPs, namely helping businesses of all sizes successfully transition to the cloud, particularly those with substantial investments in existing solutions. ESI's target market traditionally has been smaller companies, but with its cloud offering, the company is expanding its focus to encompass the midsize and enterprise segments as well. Still, moving more deeply into the larger enterprise sector may be challenging for the provider, particularly given its deep roots in the SMB segment. ESI must also ensure that it isn't perceived as having abandoned its core SMB customer base — both existing legacy and newer cloud customers.

Furthermore, moving to the cloud often requires that businesses scrap some or all of their existing premises-based investments. While many SMBs may be willing to forgo their existing investments in favor of the benefits that a cloud solution offers, medium-sized businesses and enterprises may be more reluctant to do so. However, because ESI is both an equipment manufacturer — it manufactures its own IP phones — and a service provider, it owns both the phone and the PBX solution. Unlike many of its competitors, which connect their hosted VoIP service with a third-party IP phone, ESI is able to integrate its hosted VoIP solution with its own IP phones, which enables ESI to deliver a solution that features a greater degree of integration and functionality than many solutions currently in the market. Additionally, because ESI manufactures its own phones, it is able to bundle the cost of the IP phones into the flat-rate monthly service fee, making it easier for its partners and customers to calculate the total cost of ownership (TCO) of moving to a hosted or cloud-based platform. This is a key differentiator for ESI and one that is likely to resonate well with all businesses — from SMBs to enterprises.

Conclusion

One of the fastest-growing communications market segments is hosted or cloud-based VoIP or hosted PBX services. Hosted VoIP adoption has accelerated because such solutions provide measurable cost savings, simplify the delivery and management of communications, and facilitate migration to a converged network.

As a provider of cloud- and premises-based VoIP and UC solutions, ESI offers integrated systems designed to enable its channel partners to deliver differentiated and affordable VoIP communications. To the extent that ESI can address the challenges outlined in this paper, IDC believes that the company is well positioned for success in the cloud-based VoIP market, particularly because of its track record with premises-based VoIP solutions.

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