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CompuSoluciones: COMPETING AGAINST DISINTERMEDIATION

Ken Mark wrote this case under the supervision of Professors Luis Manuel Bonner de la Mora and W. Glenn Rowe solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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“I spoke to an IT analyst who told me that, at this moment, 35 per cent of servers sold are going directly to cloud service providers, mainly Amazon and Google,” said Juan Pablo Medina Mora, chief executive officer (CEO) of CompuSoluciones, a Mexican information technology (IT) distributor. It was June 23, 2016, and Medina Mora was thinking about how to compete against the threat of disintermediation:

That number is forecast to increase to 50 per cent in 2017 and 70 per cent in 2020. This is an issue for us because servers represent about one-fifth of our business. Second, the industry is moving towards a software-as-a-service (SaaS) model. Instead of buying software, customers are being told to rent software. This also has an impact on our business.

Medina Mora needed to determine what CompuSoluciones could do in the next few months to address the threat of disintermediation, either by slowing its progress or by finding a new way to participate in the industry.

**CompuSoluciones**

Based in Guadalajara, with offices in Mexico City and Monterrey, CompuSoluciones was a value-added distributor of IT hardware, software, and services. The company had grown from its origins as a reseller for Hewlett-Packard (HP) to become the second-largest IT distributor in Mexico.

In 1982, HP built a computer manufacturing plant in Guadalajara. HP brought a few managers from its U.S. operations, including José Medina Mora, to run the plant. José Medina Mora had finished his postgraduate studies at Stanford University after earning a degree in civil engineering from Universidad Iberoamericana in Mexico City. He worked for HP for three years before founding CompuSoluciones (initially named Consultores en Informática y Computación, SA de CV) as an equal partnership with Fernando Contreras and José Ignacio Montemayor on May 26, 1985.

In 2015, CompuSoluciones brought in US$246 million in revenues and achieved US$6.2 million in net profit (see Exhibits 1 and 2).[[1]](#footnote-1) Most of its revenues came from reselling products and services produced by global vendors such as HP Inc., Hewlett Packard Enterprise (HPE), Oracle, International Business Machines Corporation (IBM), Lenovo Group Ltd. (Lenovo), VMware Inc., Apple Inc. (Apple), Autodesk Inc., and Microsoft. These vendors relied on distributors such as CompuSoluciones to build a network of resellers to deliver products and services to small- and medium-sized companies.

**Cloud Computing**

Cloud computing could be defined as the provision of computing resources that were not limited to any specific location. For example, Cloud computing included computing infrastructure such as virtual computers and servers, data storage services, network capacity and online IT development tools.

Cloud computing became possible with improvements in processing power and Internet speeds. Cloud computing allowed IT departments to purchase computing infrastructure over the Internet, significantly reducing the need to continually purchase hardware to be installed onsite. As technology improved, the standard practice had been, for end-users, to purchase new hardware and software on a continual basis, perhaps every two to three years. Cloud computing removed the need for these purchases and freed up physical storage space at companies’ offices. Instead, end-users could now “rent” technology services such as storage and processing power from providers.

One of the key advantages of Cloud computing, for end-users, was the ability to scale up or down the amount of storage space and or computing power needed. In the past, end-users would have to purchase additional hardware if they wanted to increase their technology resources beyond a fixed point. Second, with Cloud computing, end-users paid only for the technology resources they used, matching costs to demand. With monthly payments instead of lump sum expenditures every two or three years, end-users could find the financial costs more manageable. Third, by adopting a pay-per-use model in Cloud computing, end-users could have access to a broader selection of data services from providers. Last, end-users could access their data without having to be physically located in their offices. With the help of data encryption, end-users had on-demand access wherever they could find access to the Internet.

From a vendor’s perspective, providing a monthly fee for Cloud computing was a way to attract a larger number of users, as the financial barriers to entry would be lowered: instead of needing to buy a $5,000 server, for example, users could rent the equivalent computing power for $150 a month. As the services were provisioned over the Internet, new entrants could come into the market. For example, Amazon.com launched its Amazon Web Services arm to offer secure storage for users’ data, among other Cloud computing services.

According to TechTarget, an online technology-specific website, there were three types of Cloud computing services:[[2]](#footnote-2)

Cloud computing services could be private, public or hybrid. Private cloud services were delivered from a private data centre exclusively to internal users. This model offered versatility and convenience, while preserving management, control and security. Internal customers may or may not be billed for services through IT chargeback.

In the public cloud model, a third-party provider delivered the cloud service over the Internet. Public cloud services were sold on demand, typically by the minute or the hour. Customers only paid for the CPU cycles, storage or bandwidth they consumed, sharing the infrastructure they use and its cost. Leading public cloud service providers included Amazon Web Services (AWS), Microsoft Azure, IBM/SoftLayer and Google Compute Engine. There was a third model, a hybrid cloud model that combined both private cloud and public cloud services, and included software that allowed computing workloads to move between both cloud environments. In a hybrid model, more critical data and processes—concerning sales and other transaction information—would be hosted on the private cloud, and less sensitive requirements—website analytics, for example, would be handled by the public cloud.

The market for cloud computing services for small- to medium-sized businesses in Mexico was estimated to be worth $700 million in 2015.

**Software as a Service**

Software-as-a-Service (SaaS) could be defined as any software application that end-users relied on, that was not installed onsite. Unlike computing infrastructure, SaaS included programs such as word processing, data analytics programs, and database management software that were created by vendors such as Microsoft, Salesforce.com, and Oracle, for example. These SaaS programs would be delivered to users online, but were hosted by their respective brand owners. Thus, SaaS was a subset of Cloud computing, but was distinctive in the sense that end-users were using software applications, not computing infrastructure.

The benefits to SaaS, for end-users, was that they had the ability to test and use a wide variety of software programs by paying a monthly subscription fee, instead of having to purchase a licence in full. In addition, as SaaS programs were delivered over the Internet, IT departments did not have to ensure that the software was compatible with a firm’s current hardware infrastructure, nor did they have to allocate resources to evaluate and install the software. There would be no need to monitor vendors’ sites for updates, because SaaS programs were hosted on vendors’ servers and updated as needed. Users could access the SaaS programs over the Internet, and did not need to be physically located on site to use key programs.

For vendors, having users’ data hosted on site allowed them to interact directly with them, with the potential for cross-selling them new software services and products. Direct interaction typically meant that vendors could circumvent resellers and other distribution partners in the value chain, reducing the need to pay distribution fees to third-party firms.

According to TechTarget, an online technology-specific website, there were potential disadvantages with SaaS:[[3]](#footnote-3)

Businesses needed to rely on outside vendors to provide the software, keep that software up and running, track and report accurate billing and facilitate a secure environment for the business’ data. Providers that experienced service disruptions, imposed unwanted changes to service offerings, experienced a security breach or any other issue could have a profound effect on the customers’ ability to use those SaaS offerings. As a result, users needed to understand their SaaS providers’ service-level agreement, and make sure it was enforced.

SaaS was closely related to the ASP (application service provider) and on-demand computing software delivery models. The hosted application management model of SaaS was similar to ASP: the provider hosted the customer’s software and delivered it to approved end-users over the internet. In the software on-demand SaaS model, the provider gave customers network-based access to a single copy of an application that the provider created specifically for SaaS distribution. The application’s source code was the same for all customers and when new features and functionalities were rolled out, they were rolled out to all customers. Depending upon the service-level agreement (SLA), the customer’s data for each model could be stored locally, in the cloud or both locally and in the cloud. In some cases organizations could integrate SaaS applications with other software using application programming interfaces (APIs). For example, a business could write its own software tools and use the SaaS provider’s APIs to integrate those tools with the SaaS offering.

**The Current Value Chain at CompuSoluciones**

CompuSoluciones worked closely with resellers, acting as an intermediary between these local operators and large vendors such as HP, Oracle, IBM, Apple, and Microsoft. Resellers were often small, owner-operated companies of 10 to 15 people. There were about 20,000 resellers in total in the Mexican market; they operated locally and maintained close contacts with businesses and individual consumers in their cities and regions.

CompuSoluciones provided administrative consultancy to its resellers as well as credit, which it provided either directly or through financial institutions. Supporting and nurturing these resellers was key to CompuSoluciones’s success.

About 80 per cent of CompuSoluciones’s business involved integrating value-added solutions to help resellers put together technology packages for customers. This process was managed on a case-by-case basis. The other 20 per cent of the company’s business came from transactional sales of hardware and software.

CompuSoluciones worked with a broad range of vendors, some of whom competed against each other. Within CompuSoluciones, self-contained “cells,” or business units (BUs)—dedicated teams of five to 20 people—worked on projects related to each specific vendor. There were 18 different cells, each with its own profit-and-loss financial statement, and there was no sharing of information between these cells. “We’re like a subway network of business units that work towards a single goal,” remarked Medina Mora.

At the management level, CompuSoluciones was managed by an executive committee of six people: the chairman, the chief executive officer (CEO), the chief financial officer (CFO), and three commercial senior managers. The CFO and the three commercial senior managers reported to the CEO (see Exhibit 3). The executive committee was responsible for building CompuSoluciones’s vision and overseeing the execution of its strategy and adherence to its values (see Exhibit 4).

**Dealing with Disintermediation**

As Medina Mora considered the impact the cloud would have on his business, the following thought occurred to him: “Those who provide cloud computing services buy their technology directly from vendors, or they even build their own servers, buying processors and components from Intel. Do we just concede that one-fifth of our business will go away?”

He noted that CompuSoluciones had been selling cloud services, through its cloud BU, since 2011:

At the beginning, everything that was linked to the cloud was passed to our internal business unit to process. Then cloud became more important. We started noticing that the main topic at many vendor conferences we attended was their cloud strategy. Given that cloud was becoming more important, we restructured our cloud business unit, sending every vendor-related cloud sale to the original cell, leaving them only the Amazon Web Services offering. It took one year to rebuild the business in this slimmed down form. Then Amazon dropped its cloud prices by 50 per cent. For every server, [our cloud BU] had to sell two to get the same revenue and profit margin. Our BU started to struggle.

More importantly, server sales were starting to slow down as more customers migrated to the cloud. Medina Mora explained:

We have to think about what our value-added service is. Traditionally, we sell the product or service and earn a 5 to 15 per cent margin on it. We talk about an internal concept we call “the railroad strategy,” [which refers to products and services as] the wagons behind the train, [or] all the other services we package along with the sale. We may get an 80 per cent margin on other value-added services and 50 per cent on professional services. We are starting to think about how we can wrap more wagons around our cloud offering.

Medina Mora was considering putting together a managed-services offering cell to help mid-sized companies migrate from legacy data centres to a hybrid cloud model. “We would help them to move to the cloud,” he noted, “because if we don’t, then someone else is going to do it for us.” There was a lot of work involved in migrating companies to a cloud model. There were potential consulting contracts that would involve helping organizations identify what information would be best placed in the public or private cloud and helping them determine the optimal design for their data recovery models. CompuSoluciones could also provide ancillary services to assist firms in outlining their core operations (mapping out their business processes) and determining how to secure the data they produced, managed, and stored.

Subscription software accounted for about one-third of CompuSoluciones’s software sales, and Medina Mora noted that there would be changes in this area, as well:

[Regarding] software licencing, the business model was changing. Currently, for a lifetime licence, the customer paid the full licence cost plus about 15 per cent a year in support fees. But the market was moving to the subscription model (SaaS), where the customer typically paid about a third or a fourth of the licence value once a year. But we still bear the same level of costs in order to market SaaS products. We are designing training programs for resellers in order to assist them in their efforts to sell SaaS products.

This was not the first attempt by vendors to go directly to end-users or reduce the number of players in the value chain. In 2013, Microsoft had decided to move to subscription-based sales, which meant it interacted directly with end-users without using distributors or resellers. Then, a year later, it reached out directly to resellers, cutting CompuSoluciones out of the value chain. Microsoft wanted to pay just 2 per cent in total to resellers—one-quarter of what the resellers had been getting for other software solutions.

Later, Microsoft offered to pay CompuSoluciones 5 per cent to manage the relationship, with 3 per cent going to the reseller and the remaining 2 per cent to CompuSoluciones. “We declined that offer because it was too meagre,” said Medina Mora. A year later, Microsoft came back, offering 5 per cent in fees to CompuSoluciones and another 8 per cent to resellers. “That was a good enough offering, and now we’re growing a lot,” said Medina Mora. “And when Adobe came to us four years later with the same strategy of going directly to end-users, we asked them whether they were sure they wanted to do that and pointed to the Microsoft example as proof.” Despite the warning, Adobe continued to press ahead. In fact, Adobe’s business continued to do well because it was targeting designers, who were already used to going online to pay for their software subscriptions. “In contrast, corporate users are less likely to go to a vendor to get a licence,” Medina Mora remarked.

To make it easier for resellers to sign up new customers via the subscription model, CompuSoluciones developed a new platform called “ClickSubscribe.” Resellers could place their orders directly onto the ClickSubscribe platform, and the orders would go directly to the vendor, who would deliver a link to the end-user, who would then be able to use the software. The vendor invoiced CompuSoluciones, and CompuSoluciones’s ClickSubscribe platform invoiced the reseller.

“We are not sure every vendor will be willing to allow their software to be available on ClickSubscribe,” said Medina Mora. “Some will want to sell directly, for many reasons—one of which is the fact that they can capture customer information when that customer signs up on their site.”

CompuSoluciones’s competitors were also looking at the challenge of SaaS in different ways. One large competitor had a platform that would add vendors such as Microsoft, at a cost of several hundred thousand dollars per vendor. In contrast, the cost to vendors to be added to CompuSoluciones’s ClickSubscribe was minimal. Another SaaS vendor tracked new SaaS customers manually via a frequently updated Excel spreadsheet. “Our ClickSubscribe system—which is automated—is coupled with a series of business processes that monitor customer payments,” noted Medina Mora. “We are notified to take action as soon as a customer does not pay their monthly bill. This is important, because one month’s missed payment is equivalent to about 15 months’ profit on an SaaS subscription.”

As he looked at the issues in front of him, he thought about what CompuSoluciones could do in the next few months to prevent or slow the process of disintermediation or to participate in a different way. “We do not sell directly. We rely on our resellers,” he concluded. “What is our best option going forward?”

**Exhibit 1: CompuSoluciones—Income Statements (US$ thousands)**

**2015**

**2014**

**2013**

**2012**

**2011**

Net revenue

246,422

200,655

154,917

157,484

127,607

Cost of goods sold

223,081

181,457

139,479

142,982

114,282

Gross profit

23,341

19,198

15,438

14,502

13,326

Operating expenses

15,804

12,970

10,402

9,028

8,107

Operating profit

7,536

6,227

5,036

5,475

5,218

Comprehensive cost of financing:

Interest earned, net

193

200

199

407

661

Exchange gain

1,020

77

573

1,268

644

1,213

277

772

1,675

1,305

Other (expenses) income, net

12

−105

−49

81

−45

Income before provisions

8,761

6,399

5,759

7,230

6,479

Provisions for:

Income tax

−2,554

−1,256

−1,329

−1,796

−2,165

**Net Income**

6,207

5,143

4,430

5,434

4,314

Note: These statements were prepared in pesos using Mexican GAAP, which included the recognition of inflation; for presentation purposes, figures were expressed in thousands of U.S. dollars by dividing the pesos by a fixed exchange rate for December 31 of each year; US$1.00 = MX$17.21 on December 31, 2015.

Source: Company files.

**Exhibit 2: CompuSoluciones—Balance Sheets (US$ thousands)**

**ASSETS**

17.2065

**2015**

**2014**

**2013**

**2012**

**2011**

**CURRENT ASSETS**

Cash and cash equivalents

7,534

15,875

6,070

6,025

2,929

Accounts receivable

42,741

37,585

38,142

26,932

37,042

Other current assets

275

467

182

192

145

50,550

53,927

44,394

33,149

40,116

Accrual for bad debts

−628

−898

−986

−1,546

−1,759

49,922

53,029

43,408

31,603

38,357

Inventories

13,645

6,950

6,198

5,304

3,496

**Total current assets**

63,567

59,979

49,605

36,907

41,853

Deferred employee profit sharing

284

277

266

Accounts receivable long term

170

216

237

324

88

Property, plant and equipment:

Machinery and equipment, buildings

12,631

14,609

13,248

13,716

13,946

Other assets

70

100

145

53

80

12,701

14,709

13,392

13,768

14,026

**Total assets**

**76,721**

**75,182**

**63,500**

**51,000**

**55,967**

Note: This statement was prepared in pesos using Mexican GAAP, which included the recognition of inflation; for presentation, figures were expressed in thousands of U.S. dollars by dividing the pesos by a fixed exchange rate for December 31 of each year; US$1.00 = MX$17.21 on December 31, 2015.

Source: Company files.

**Exhibit 2 (Continued)**

**LIABILITIES AND SHAREHOLDERS’ EQUITY**

**2015**

**2014**

**2013**

**2012**

**2011**

**CURRENT LIABILITIES**

Bank loan

9,408

11,719

11,821

8,319

11,482

Other accounts payable

20,862

20,006

14,127

7,370

14,019

Customer advances

10

24

276

837

Taxes payable and accrued expenses

7,184

6,159

5,184

5,614

5,146

Income tax payable

593

834

503

Employee profit sharing

790

486

204

24

21

**Total current liabilities**

38,837

39,214

31,863

21,602

31,505

Deferred employee profit sharing

13

7

Retirement accrual for employees

393

394

332

641

582

Deferred income tax

995

1,145

1,630

1,409

1,076

Income tax for reinvested profits

21

77

1,387

1,539

1,962

2,084

1,742

Shareholders’ investment

Capital stock

247

247

247

251

251

Accumulated profits

36,249

34,182

29,428

27,062

22,469

36,497

34,429

29,675

27,313

22,720

**Total shareholders’ investment**

36,497

34,429

29,675

27,313

22,720

**Total liabilities and shareholders’ equity**

**76,721**

**75,182**

**63,500**

**51,000**

**55,967**

Note: This statement was prepared in pesos using Mexican GAAP, which included the recognition of inflation; for presentation, figures were expressed in thousands of U.S. dollars by dividing the pesos by a fixed exchange rate for December 31 of each year; US$1.00 = MX$17.21 on December 31, 2015.

Source: Company files.

**Exhibit 3: CompuSoluciones—Executive Committee**

* José Medina Mora: Chairman
* Juan Pablo Medina Mora: Chief Executive Officer
* Carlos Juárez-Badillo: Chief Financial Officer
* Maria Eugenia Moreno: Commercial Senior Manager
* HPE & HP Inc. Projects, Cloud, Virtualization & Channel Development
* Ana María Arreola: Commercial Senior Manager
* Transactional sales, Apple, Microsoft, Networking-Collaboration, Mobile, Spaces & Corporate Marketing
* José Luis Cortés: Commercial Senior Manager
* Autodesk, IBM, Lenovo, Oracle, Red Hat, Security & Financial Services

Source: Company files.

**Exhibit 4: CompuSoluciones—Mission, Vision, and Values**

**Our Mission:**

Integrate information technology and communications solutions for the competitiveness of organizations, based on the experience of values and in alliance with complementary companies.

**Our Vision:**

* We give excellent customer service.
* We promote personal and professional development of the employees and of people with whom we interact.
* We work based on principles and ethical values.
* We use cutting-edge technology with flawless procedures.
* We have solid finances.
* We fulfill our legal obligations.
* As a consequence of all this, we make business.

**Our PICSELIN Values:**

* Productivity: Achieve more and better with less.
* Integrity: Be honest and transparent.
* Trust: Generate certainty in every interaction.
* Service: Transform customers into promoters.
* Teamwork: Collaborate with dedication and companionship.
* Loyalty: Build long-term win-win relationships.
* Innovation: Create value-added solutions.

Source: Adapted by case author from “Misión, Visión y Valores,” CompuSoluciones, accessed January 14, 2017, www.compusoluciones.com/quienes-somos/mision-vision-y-valores/.

1. All currency amounts are in US$ unless otherwise specified; MX$ = Mexican pesos; US$1.00 = MX$17.21 on December 31, 2015. [↑](#footnote-ref-1)
2. “Cloud Computing,” TechTarget, October 2016, accessed January 17, 2017, http://searchcloudcomputing.techtarget.com/

   definition/cloud-computing. [↑](#footnote-ref-2)
3. “Software as a Service (SaaS),” TechTarget, May 2016, accessed January 17, 2017, http://searchcloudcomputing.techtarget.com/definition/Software-as-a-Service. [↑](#footnote-ref-3)