SUNNY DAYS AHEAD FOR CLOUD COMPUTING

BY JOHN GOLDEN | 2016 GLOBAL PERSPECTIVES
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“The transition from legacy client-server systems to cloud computing architectures will occur much faster than investors anticipate.”

What is cloud computing?
Cloud computing lets enterprises choose between owning their infrastructure and renting/subscribing to the same capabilities from third-party providers. The two major types of cloud computing are Software as a Service (SaaS) and Infrastructure as a Service (IaaS). With SaaS, enterprises outsource the development and hosting of software to third parties such as Salesforce.com and Workday. With IaaS, enterprises write software internally and host the application in third-party data centers such as Amazon Web Services (AWS) and Microsoft’s Azure.

What is driving the growth of cloud computing?
Market expansion. Hundreds of thousands of small businesses and start-ups now have broader access to information technology resources. According to venture capital firm Upfront Ventures, entry IT costs for a start-up or small business decreased to $5,000 in 2011 from approximately $50,000 in 2009, significantly expanding the market.

Ease of use/service on demand. While in the past a company might wait days or even months for traditional IT departments to procure, set up, monitor and secure infrastructure, today developers can now spin up a server in minutes. Businesses can buy computing power and storage capacity to meet spikes in demand driven by seasonal periods, events or even time of day.

Lower cost of ownership. Cloud computing is considerably cheaper than traditional infrastructure for most applications. Large cloud providers run their mega data centers much more efficiently than traditional providers. For example, AWS can manage over 1,000 servers with a single engineer, while traditional enterprises manage approximately 50 servers per engineer.
**Shifting buyer base from central IT.** Today, non-traditional IT buyers (such as line of business leaders and marketing) control as much as 25% of IT purchases. According to Gartner, this percentage will grow to 50% by 2018. These buyers have limited lock-in from incumbent technology vendors and are free to choose the best solution to meet their business objectives.

**Cloud computing: A minor but growing segment of today’s IT market**
We believe the IT market is in the very early stages of the cloud adoption. Our historical S-curve analysis suggests that cloud computing could continue to grow at a 40% compound annual growth rate (CAGR) for the next several years, above industry forecasts of 28% CAGR. In the most recent quarter, AWS grew 78% year-over-year (YoY), reaching an $8 billion run rate, while Microsoft’s Azure grew 135% YoY, far ahead of expectations. SaaS providers continue to grow rapidly as well. For example, Salesforce.com and Workday grew 24% YoY and 50% YoY, respectively. This performance is in stark contrast with legacy client/server infrastructure vendors, which have reported little revenue growth or even revenue declines.

**Legacy client/server infrastructure players reacting, but profit pools will compress**
IBM, Oracle, EMC and Hewlett-Packard all have newer technology and as-a-service segments growing in the 20%–50% YoY range. However, this growth is masked by declines in traditional business lines, and the cost of investing in these growth areas is weighing on their overall earnings growth. Microsoft is the one legacy IT provider where the transition appears to be further along. The company’s as-a-service businesses are now at an $8 billion run rate and the company’s overall margins have begun to expand. Over the next several years, we expect the newer as-a-service offerings to continue to take share from legacy products.
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