

Profit from the cloud™

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**2012**

**Parallels SMB Cloud Insights™  
for the United States**

**United States**



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## Executive Summary

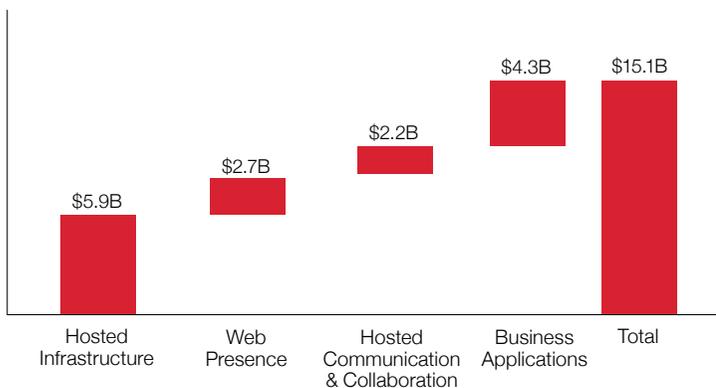
The US cloud market for small and medium businesses (SMBs) is growing rapidly. Increasing numbers of SMBs are rushing to leverage the value of the cloud, which gives them enterprise-level computing power, applications, and services at prices they can afford. In 2011 alone, since Parallels released the first SMB Cloud Insights™ research, more than a million US SMBs have started using cloud services. We expect this growth to continue as more and more SMBs realize the benefits the cloud can bring to their businesses.

Having initially interviewed 400 US SMBs of different sizes and industries about their cloud service consumption, plans, and attitudes in 2010, Parallels refreshed this research for 2011 with new interviews, to determine what changes had taken place in the intervening months. Our research addressed SMBs' usage and attitudes both in general and with respect to four specific categories of cloud services—hosted infrastructure, web presence services, hosted communication and collaboration, and business applications (also known as software-as-a-service, or SaaS). By combining the results of these interviews with our in-depth industry expertise, we have created a comprehensive view of the US SMB market for cloud services in 2012—including an understanding of how the space has grown and evolved over the past year. This paper summarizes our findings, with a focus on providing practical insights and identifying targeted opportunities that will help service providers drive growth in the US SMB cloud market in 2012 and beyond.

Parallels calculated the US SMB market at the end of 2011 to be \$15.1B across all categories of cloud services. As shown in Figure 1, hosted infrastructure contributes \$5.9B to this market, web presence services contributes \$2.7B, hosted communication and collaboration (including premium business e-mail and hosted PBX) adds \$2.2B, and business applications, also known as SaaS, account for the remaining \$4.3B.

Parallels also looked into small businesses without employees (“non-employers”) as a separate market. These businesses spent an additional \$1.6B on cloud services. While non-employer SMBs have a much lower consumption and awareness of cloud services than the rest of the SMB population, their sheer numbers—there are 21M of them—make them an enormous opportunity for service providers who take the time to educate them about the benefits of cloud services.

**Figure 1. SMB cloud services market size in the United States**



To help service providers target their marketing, Parallels has identified three major groups of SMBs that represent cloud service growth opportunities:

- **Cloud Converters.** These SMBs currently have in-house solutions but are either moving or planning to move to hosted services. For example, many SMBs that currently have in-house servers may switch to hosted servers when it comes time to upgrade their infrastructure.
- **Cloud Leapers.** This category consists of SMBs that currently are not using an in-house IT solution (that is, they have no servers, no web server, and no PBX system) and are likely to move straight to the cloud, “leapfrogging” the typical intermediate step of purchasing in-house IT. These companies might have rudimentary IT equipment, such as external hard drives for storage or Excel workbooks for accounting, but they don’t have the in-house infrastructure or software used by the Cloud Converters. This category also includes new SMBs that choose cloud services over traditional in-house IT as they are starting their business.
- **Cloud Expanders.** These SMBs, which are already using some form of cloud services, represent an opportunity for upselling to new and expanded cloud offerings.

In these three opportunity areas, Parallels predicts the US market will grow by \$9.2B over the next three years, reaching \$24.3B in 2014. By becoming familiar with each of these SMB audiences and targeting them with the services they need, service providers will be able to profit from this impressive ongoing growth in the US cloud services market.

## Definitions

This research is focused on the cloud services that matter most to SMBs: hosted infrastructure, web presence services, hosted communication and collaboration, and a general category we refer to as “business applications.” We define each of these cloud service categories as follows:

- **Hosted infrastructure (also known as infrastructure-as-a-service).** This category includes dedicated servers, virtual private servers (VPS), managed hosting, and utility or elastic computing.
- **Web presence.** This category includes third-party web hosting, blogging services, domain registration, SSL and e-commerce add-ons, and site-building tools.
- **Hosted communication and collaboration.** This category consists of business-class e-mail services, including e-mail security, e-mail archiving, and mobility; and hosted phone services, including hosted PBX and voice-over-IP (VoIP).
- **Business applications (also known as SaaS).** This category covers nine major classifications of software applications that can be accessed online—content management, e-mail archiving solutions, file sharing, online accounting, online backup and storage, online CRM, payroll and HR, phone conferencing, and web conferencing.

For each of these cloud service areas, Parallels captured SMBs' current use, attitudes, and future plans. For the hosted infrastructure and web presence markets, we also calculated market size. In future versions of this research, we plan to add market size details for all cloud service categories.

As for our definition of small and medium businesses (SMBs)—also known as small and medium enterprises, or SMEs—we follow other research and academic organizations in defining SMBs as companies with 1 to 1000 employees. There are around 8 million such SMBs in the US today. Sub-categories within the SMB segment include:

- **Micro SMBs** (companies with 1-19 employees)
- **Small SMBs** (companies with 20-99 employees)
- **Medium SMBs** (companies with 100-1000 employees)

Our research also included non-employer SMBs—companies that have no employees. This small but growing portion of the cloud services market comprises a huge number of businesses—21M at the last US census. Our analysis treats the non-employer market separately for each of the major cloud services because we believe that service providers will have the greatest success with this segment by marketing to them as a separate audience.

## Key Findings in the Cloud

Our research showed that the US cloud market grew by 25% in 2011, with some services—especially hosted communication and collaboration—growing much faster. Over the next several years, even more SMBs—particularly the micro businesses—will be entering the cloud and expanding their use of cloud services, providing huge opportunities for service providers that are able to reach them with the right services at the right price. Parallels found that different sizes and categories of SMBs have different needs and plans for their cloud service use, meaning that, for service providers to grow their cloud business, it is essential both to know their SMB audiences and to offer them the right services:

### 1. Know Who the IT Decision Makers Are

Sometimes the IT decision maker in a small business is simply the owner or another member of the company's leadership; in other cases, it's an IT consultant or dedicated IT staff member within the company. Our research showed that, to drive new customer adoption, service providers' marketing will need to target the right IT decision maker in each case. As Figure 2 illustrates, our research indicates that the US SMB market consists of three separate decision-making groups:

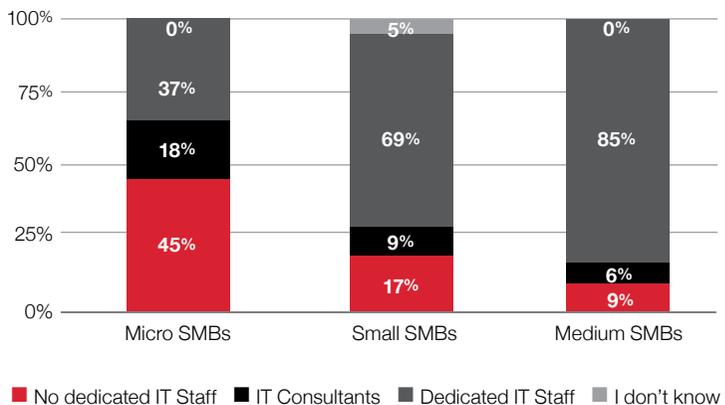
- **SMBs with no IT staff (“do-it-yourselfers”).** Some 45% of US micro SMBs fall into this category, along with 17% of small SMBs and nearly all of the non-employers. For these “do-it-yourselfers,”

the business owner or a senior member of the company handles all purchasing decisions, installation, and maintenance of IT solutions. These SMBs need to know how a cloud service will benefit their business and their bottom line. They also need solutions whose user interface is simple enough to not require detailed IT expertise. Consequently, marketing messages for this group should focus on the business benefits of cloud services, while minimizing the technical complexity behind the solution.

Target the right IT decision maker with the right marketing messages: for SMBs with no IT staff, stress business benefits; for SMBs that hire IT consultants or have dedicated IT staff, stress technical benefits.

- SMBs that hire IT consultants.** Approximately 18% of micro SMBs, 9% of small SMBs, 6% of medium SMBs, and 5% of non-employers use IT consultants. The key target audience in this case is the IT consultant(s) being hired. This is a more technical audience than the do-it-yourselfers. IT consultants want to know about the technical specifications of the cloud service, its configuration and management, best practices, and other technical advice. To successfully reach this target audience, service providers will be well served to have a white-label reseller offering designed for IT consultants, giving them the opportunity to resell cloud services to the SMB end customer without having to manage the infrastructure themselves. It may also be helpful to develop sales and marketing strategies that target the broader IT channel, including distributors, as this is a fertile ground for reaching IT consultants.
- SMBs with a dedicated IT staff.** Some 37% of micro SMBs, 69% of small SMBs, and 85% of medium SMBs have dedicated IT staff. For these SMBs, IT personnel are the primary audience. While the IT personnel need to know the business benefits so they can pass them on to senior management, they are much more concerned with the technical aspects of the solution and whether or not it fits the needs of their company. Clear, detailed documentation about technical specifications, strong support, and cutting-edge technical features will be the key selling points for this audience.

**Figure 2. IT staff reported by size sub-segments of the US SMB market**



## 2. Target Each Opportunity with the Right Services

As mentioned in previously, Parallels has identified three types of opportunities among SMBs: the Cloud Converters, who switch from in-house IT to the corresponding cloud service; the Cloud Leapers, who jump into the cloud directly, rather than initially buying in-house IT; and the Cloud Expanders, who are already in the cloud and will expand both their use of the cloud services they currently consume and their use of new categories of services, such as SaaS or hosted PBX.

The size of SMBs is likely to influence both which cloud usage category they fall into and who their IT decision makers are. For instance, micro SMBs and non-employer SMBs are most likely to be Cloud Leapers and “do-it-yourselfers,” with no dedicated IT staff. SMB size also influences what kinds of services they are most likely to buy. Knowing the size of the opportunity in each SMB category for each type of cloud service will help service providers target their marketing and sales efforts to reach the right audiences.

The following sections examine US SMBs’ use of each of the four categories of cloud services in more detail, describing their current use of these services, how they choose which services to purchase (or not to purchase), and what their future plans for spending are. Throughout these sections, we look at each market sub-segment (micro, small, and medium) as it relates to the above three target SMB audiences (do-it-yourselfers, IT consultants, and dedicated IT staff), detailing the opportunities in each case. We also explain how to best target each opportunity, which are the best services to offer, and how to address the non-employer sub-segment in each case.

Because cloud service purchase decisions differ according to both SMB size and cloud usage category (Cloud Converters, Cloud Leapers, or Cloud Expanders), it’s critical to target each opportunity with the right services.

## Hosted Infrastructure

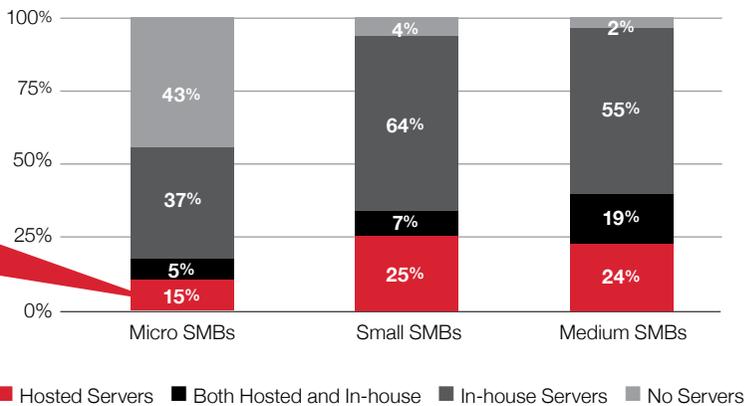
Hosted infrastructure is already well-established among US SMBs, with 22% reporting its use. As Figure 3 illustrates, the hosted server market has grown 20% since our 2010 research, to a current value of \$5.9B, with approximately 3.2M hosted servers in use—and it continues to grow rapidly.

In the hosted infrastructure space, micro SMBs are most likely to be Cloud Leapers, and medium SMBs are most likely to be Cloud Converters.

In the past year, 7% more SMBs entered the server market, including purchasers of both in-house and hosted servers. Of these new market entrants, 60% (the Cloud Leapers) went straight to the cloud, and the remaining 40% purchased in-house servers. The new server adoption trend is especially marked among micro SMBs, where overall server penetration grew by 13%—and these SMBs were three times more likely to go to the cloud than to buy in-house infrastructure.

We also saw market growth among the Cloud Converters—SMBs that switched from in-house servers to hosted servers. Over the past year, approximately 8% of SMBs with in-house servers converted to the cloud—a trend driven mainly by the medium SMB segment, where hosted infrastructure grew by 23%. As service providers educate more small SMBs about the simplicity and lifetime cost savings of cloud services, we expect to see many of these SMBs follow suit.

**Figure 3. Changes in hosted server penetration among US SMBs over 2011**



Overall, 22% of SMBs use hosted servers, growing the market 20% since 2010.

**2010-2011 Hosted Server Penetration Growth Rate**

+31%

+7%

+23%

## Targeting the Opportunity

Despite the maturity of the hosted infrastructure market among US SMBs, Parallels sees room for continued growth—particularly across the micro and small SMB segments, where Cloud Converters and Cloud Leapers will drive the opportunity. Parallels estimates that this market will have a compound annual growth rate (CAGR) of 13% in 2014, becoming an \$8.5B market by the end of that year. Following is a breakdown of the growth within each of the three cloud usage categories.

**Cloud Converters.** A key opportunity in the US SMB market is the replacement of in-house servers with hosted servers, which could add 2.4M new hosted servers to the market in the next three years.

This opportunity is especially strong among SMBs without dedicated IT staff or IT consultants: the do-it-yourselfers. For these SMBs, hosted servers have the advantage of not requiring maintenance effort or technical expertise.

Micro SMBs, which mostly fall into the do-it-yourself IT category, represent an especially significant opportunity, as 6.5M SMBs fall into this size segment. As Figure 3 shows, 37% of these companies currently use in-house servers. Of those, our research indicates that 38% either definitely plan to switch to hosted servers in the next three years or are considering doing so. Small SMBs, the second largest group in the do-it-yourself category, also represent a good opportunity. Currently, 64% of these companies have in-house servers, and 56% of those are either definitely planning to switch to hosted servers in the next three years or considering doing so. To succeed in moving both micro and small SMBs to the cloud, service providers should emphasize the business benefits of their hosted server offerings.

The medium SMB segment will also continue to convert from in-house servers to the cloud, with 47% of this segment reporting that they are considering moving to the cloud in the next three years. In marketing to SMBs in this segment, most of whom have dedicated IT staff, focus on the technical advantages of hosted infrastructure.

**Cloud Leapers.** New adopters of IT infrastructure also represent a strong opportunity among US SMBs. These SMBs do not currently use servers, but, as they decide to add them, they will go directly to the cloud, rather than taking the intermediate step of buying in-house servers. Of these new adopters, micro SMBs represent the best opportunity, with a substantial 43% of them currently not using servers of any kind, and 46% of those reporting that they either definitely plan to add a hosted server in the next three years or are considering doing so. This opportunity could add an additional 2.5M hosted servers to the market.

**Cloud Expanders.** The hosted infrastructure market also has room for upselling SMBs that are already using hosted infrastructure, but are looking both to expand their use of hosted servers and to purchase more value-added services, such as control panels and back-up and security services. This opportunity is largest among small and medium SMBs, where 24% and 38%, respectively, of current hosted infrastructure users plan to increase their spending in the next three years.

Among Cloud Converters, micro and small do-it-yourselfers and medium SMBs with dedicated IT staff represent the best opportunities for growing the hosted infrastructure base.

Among Cloud Leapers, micro SMBs represent the best opportunity for hosted infrastructure; among Cloud Expanders, small and medium SMBs represent the best opportunity.

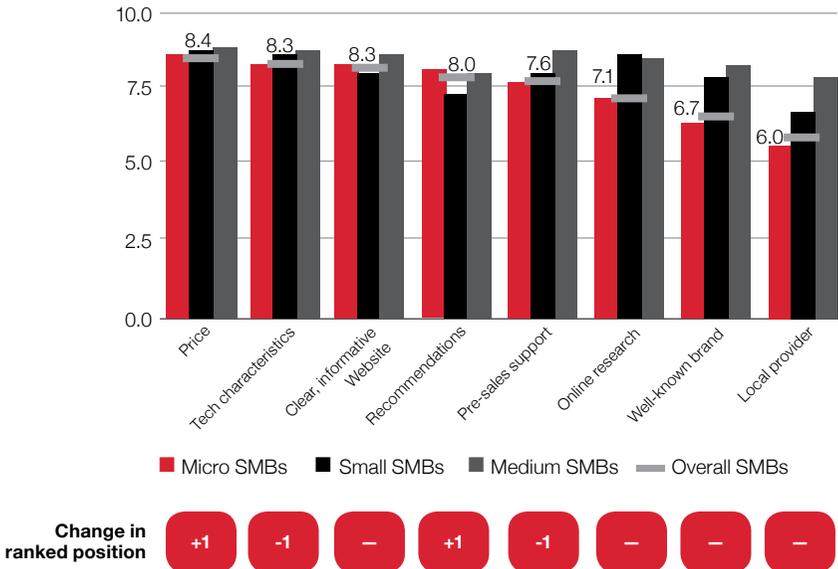
## Offering the Right Services

Because price is now SMBs' most important purchase criterion for hosted infrastructure, low-cost options such as VPS and use-based pricing options like cloud infrastructure are the best choices.

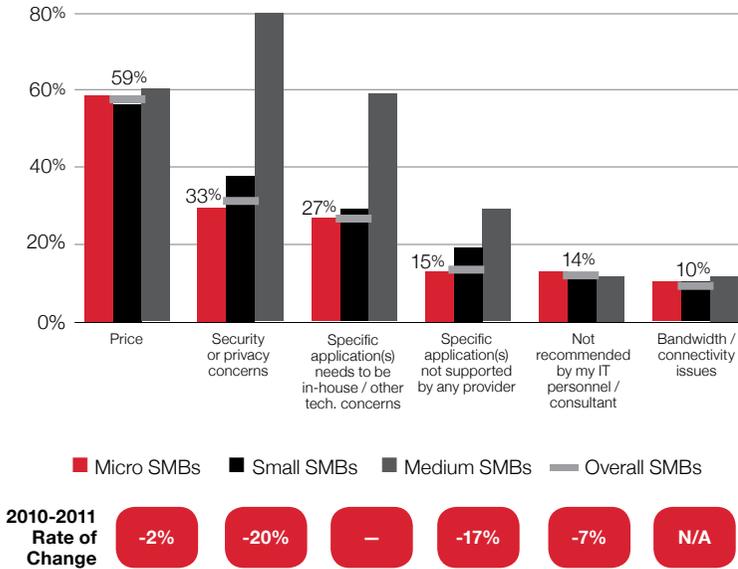
In tailoring hosted infrastructure offerings to SMBs, service providers need to both include the features that are most important to them and overcome any concerns they have about adopting the service. Following are some of the approaches that our research shows will be most successful in encouraging SMBs to adopt hosted infrastructure:

- Offer low cost options—VPS and cloud infrastructure.** Our most recent research shows that price is now the most important criterion for SMBs purchasing hosted infrastructure, overtaking technical characteristics, which was the top-ranked criterion in 2010 (see Figure 4). Price is also SMBs' leading reason to keep servers in-house, as shown in Figure 5. Educating SMBs on the true cost of owning an in-house server, while also offering them lower-priced hosted infrastructure options, will help encourage adoption. VPS offerings are a good option for price-sensitive SMBs, as they deliver all the security and isolation benefits of a dedicated server at a fraction of the cost. Cloud infrastructure—with its use-based pricing model—is also an excellent option for price-sensitive SMBs.

**Figure 4. Changes in US SMBs' key purchase criteria for hosted infrastructure**



**Figure 5. Changes in US SMBs' reasons to keep servers in-house**



- Provide top-notch technical features.** Technical features are ranked as SMBs' second most important purchase criterion for hosted infrastructure (see Figure 4). Particularly in the case of SMBs with dedicated IT staff or IT consultants, service providers should focus on the technical characteristics that differentiate their offerings from those of their competitors, while also clarifying that hosted servers provide all the same features as in-house options.

- Upsell with value-added services.** As mentioned above, 24% of small SMBs and 38% of medium SMBs plan to increase their hosted infrastructure spending over the next three years. Offering value-added services such as backup, security, and control panels will help them improve the security and usability of their infrastructure.

- Continue to educate SMBs.** SMBs' security and privacy concerns about hosted infrastructure are down by 20% since last year, as shown in Figure 5, indicating that service providers' educational efforts about the security of hosted infrastructure have had some success. However, with 33% of SMBs that have in-house infrastructure still worried about the security of hosted offerings, and 15% erroneously believing that specific applications cannot be run on hosted servers, more education is clearly needed. One of the best ways to reach SMBs is through clear and informative website, as this is SMBs' third most popular criterion when choosing hosted infrastructure (see Figure 4).

## Addressing the Non-Employer Segment

Non-employers constitute a large Cloud Leaper opportunity, but price and education are both key in marketing to this group.

Currently, only 4% of non-employers are using hosted infrastructure, with a total market size of \$725M. However, non-employers constitute a large group of US SMBs, and 18% of them are considering adding hosted servers in the next three years, making this group a sizable Cloud Leaper opportunity. In addition, some very technology-focused non-employers have in-house servers, and 30% of these companies are considering converting to the cloud.

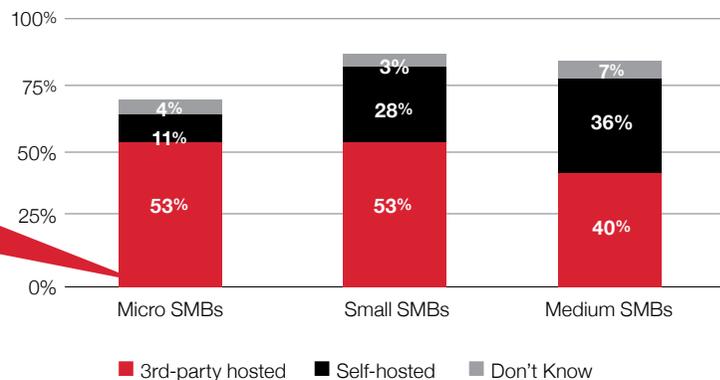
Education will be key to driving growth in the non-employer segment, since 50% of them have security and privacy concerns about hosted server offerings—a higher percentage than any other SMB segment. Price is also important, with non-employers citing price both as their top purchase criterion and as their top reason to keep in-house servers. These price concerns make VPS an ideal offering for the non-employer segment.

## Web Presence

Website use continued to grow over the course of 2011, as more SMBs built out their web presence (see Figure 6). By the end of 2011, 70% of US SMBs had a website, and 53% of these were using a service provider to host it. Overall, the web presence services market grew by 17% in 2011, to \$2.7B, driven both by new entrants to the market and by upselling existing web presence users. Our research indicates that the overall market will grow 10% year-over-year, reaching \$3.6B in 2014.

Most of the growth in this area came from micro SMBs, who are increasingly adding websites to their businesses. Use of websites by this segment grew by 13% in 2011. In addition, spending on web presence services is up by nearly 40% on average since our 2010 research, indicating the increasing importance of upselling in this mature cloud services space.

**Figure 6. Changes in use of web presence services among US SMBs**



Overall, 70% of SMBs have a website and 53% are 3rd-party hosted, growing the market 17% since 2010.

2010-2011 Web Presence Growth

+13%

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## Targeting the Opportunity

While growth in web presence services is slowing down overall, Parallels sees room for continued growth, particularly in micro SMBs in both the Cloud Converter and Cloud Leaper categories. Opportunities also exist for upselling service providers' existing customers—the Cloud Expanders.

**Cloud Converters.** Currently, 11% of micro SMBs and 28% of small SMBs have self-hosted websites—an expensive and technically complex solution when compared to the inexpensive stand-alone web hosting plans that are readily available. In fact, 70% and 66% of these micro and small SMBs, respectively, say they either are already planning to switch to third-party web hosting plans in the next three years or are considering doing so. This opportunity could add 670,000 hosted websites to the current market.

**Cloud Leapers.** While the market for websites is becoming saturated for larger SMBs, there still is plenty of opportunity to convince micro SMBs that don't currently have websites to go straight to the cloud to build their web presence. In fact, a full 50% of micro SMBs without websites reported that they plan to add websites using a third-party service provider in the next three years—an opportunity that could add one million new web hosting plans to the market.

**Cloud Expanders.** The largest opportunity in US SMB web presence, however, lies in upselling the existing customer base. Across the country, SMBs currently account for over 3 million web hosting accounts. Some 31% of all SMBs using a stand-alone web hosting plan intend to increase their spending in the next three years—and this number is as high as 68% among medium SMBs. By offering value-added tools and services to all SMB web presence customers, service providers can significantly increase average revenue per user (ARPU) and decrease customer churn.

## Offering the Right Services

Following are some of the approaches that our research shows will be most successful in growing web presence services:

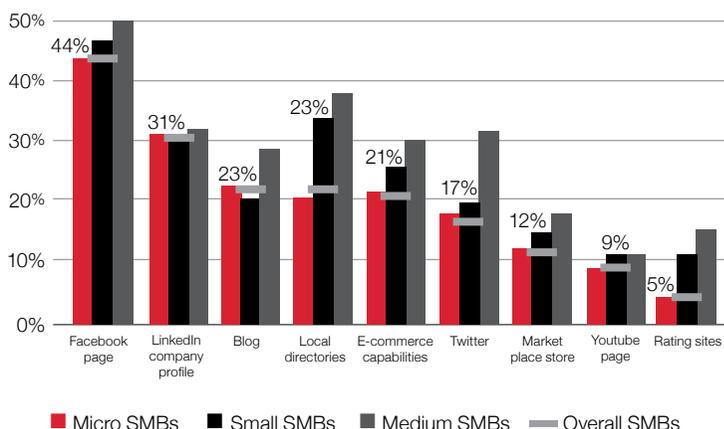
- **Upsell existing customers with the value-added tools they need.** The top two web presence services to offer SMBs are:
  - **Website design tools.** Currently, some 50% of US SMBs design their websites in-house. By offering website design tools, service providers can help these SMBs create more sophisticated websites in-house without a significant outlay of cash.
  - **Social media.** US SMBs are increasingly using social media to boost their web presence (see Figure 7). Facebook page use is still the leading form of web presence outside of websites, used by 44% of SMBs. LinkedIn pages and blogging are also increasingly popular, and Twitter has gathered a large following among medium SMBs. Service providers can capitalize on the social media trend by enhancing their stand-alone web hosting offerings

To grow their web presence business, service providers should focus on micro SMBs in both the Cloud Converter and Cloud Leaper categories, and on upselling their existing customer base across all size segments.

To upsell existing web presence customers, offer value-added website design tools and tools for integrating their social media presence with their websites.

with tools that give SMBs the ability to create Facebook pages and other forms of social media and cross-link them to their own websites. The recent integration of Parallels Web Presence Builder with Facebook will allow SMBs to do just that.

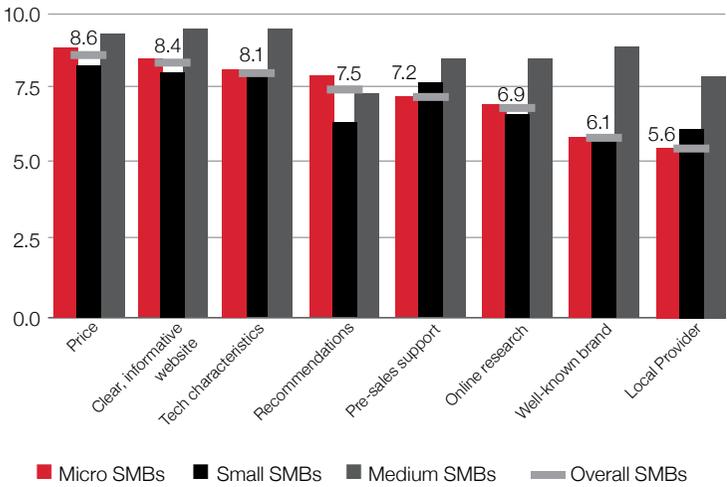
**Figure 7. Use of online presence among US SMBs**



Use web hosting plans to drive sales in other areas, such as web presence applications, communication and collaboration services, and business applications.

- Drive profitability through add-on services, not web hosting plans.** Price is now US SMBs' top-ranked purchase criterion for web hosting plans, up from second place in 2010 (see Figure 8). Even though web hosting margins are already lean, SMBs continue to search for the least expensive provider. Parallels believes in the near future web hosting will become a loss leader and be used to drive sales in other areas of cloud services. The best opportunity for profitability in web presence services will come from offering the value-added services that SMBs are increasingly demanding, such as web presence applications, communication and collaboration, and business applications. Expanding services in these areas will help service providers stay on top in the web hosting business.

**Figure 8. Changes in key web presence purchase criteria for US SMBs (scale of 0 to 10)**



## Addressing the Non-Employer Segment

Non-employer SMBs will be the main source of significant numbers of new web hosting accounts in the upcoming years. Currently, only 34% of non-employers have a website, and almost all of them use web hosting. Because there are still nearly 14M US non-employer SMBs without websites, the current \$720M market has significant room to grow.

As with larger SMBs, price is the top purchase criterion—but with the non-employer segment, the upsell opportunity could be huge. For example, 77% of these companies design their websites in-house, making them excellent candidates for site-building add-ons. The try-before-you-buy approach available with Parallels Web Presence Builder gives service providers a great opportunity to inexpensively acquire new customers in this size segment.

Non-employer SMBs are also heavy users of social media: 45% have Facebook pages (the same percentage as the larger SMB segments), 18% tweet, and 17% blog. Consequently, social media integration tools will be a key way to upsell these SMBs.

Non-employer SMBs represent a huge web presence opportunity—both for web hosting, as more of them create websites, and for site-building and social media add-on tools.

## Hosted Communication and Collaboration

Parallels focused its hosted communication and collaboration research on two areas: premium business e-mail and hosted PBX. The overall market for these two services in the US is smaller but growing fast, with 18% of SMBs paying for premium e-mail and 10% purchasing hosted PBX. In upcoming years, we expect these two services to be among the highest growth areas in cloud services.

## Hosted E-mail

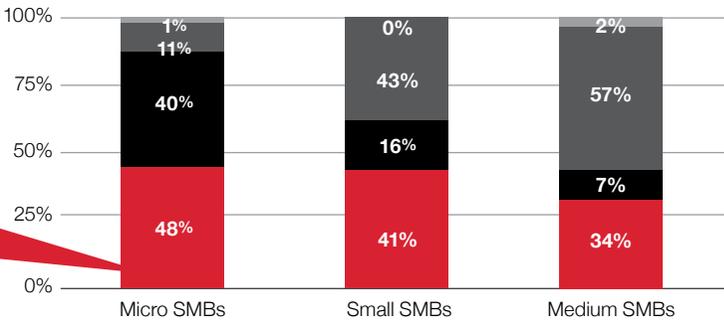
Premium business e-mail includes such added features such as team collaboration, shared calendars, e-mail archiving, mobility, and security. Compared with the overall e-mail market—which includes free accounts through ISPs or providers like Google, in-house e-mail servers, and free hosted e-mail—the premium business e-mail market is relatively small, but growing rapidly. The current size of the premium business e-mail market among US SMBs is \$800M—an increase of 30% over the previous year.

The best opportunities for premium hosted e-mail involve micro SMBs currently using in-house e-mail servers and small and medium SMBs currently using free hosted e-mail.

The e-mail market composition has shifted quite a bit in the past year, as shown in Figure 9. Among micro SMBs, growth in the premium business e-mail sector has been fueled primarily by Cloud Converters—SMBs switching from in-house e-mail servers to the cloud. In-house e-mail use is down by 30% among micro SMBs compared with the previous year, and premium e-mail use is up by an equivalent amount.

In the small and medium SMB segments, many businesses are shifting from free e-mail accounts through ISPs and providers like Google to either in-house e-mail servers or premium hosted e-mail. This shift is most impressive among medium SMBs, whose use of premium hosted e-mail grew 110% in the past year as these companies upgraded from free e-mail.

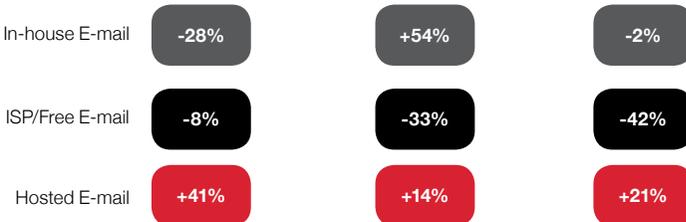
**Figure 9. Changes in distribution of different types of e-mail accounts among US SMBs**



Overall, the premium hosted e-mail market grew by over 30% since 2010.

■ Hosted service provider ■ ISP or Free e-mail provider ■ In-house server ■ No E-mail

### Percent change in e-mail use since 2010



## Targeting the Opportunity

We expect many of the past year's trends in the e-mail market to continue. Our research indicates that the overall market for premium hosted e-mail will grow to \$1.8B in 2014, with a CAGR of 30%. We see medium SMBs, in particular, driving huge growth in this space, although usage by micro and small SMBs will grow as well—and both Cloud Converters and Cloud Expanders represent sizeable opportunities.

**Cloud Converters.** Encouraging micro and small SMBs currently using in-house e-mail servers to convert to premium hosted e-mail could result in significant growth in this market. As shown in Figure 9, 11% of micro SMBs and 43% of small SMBs currently use in-house e-mail servers—an expensive and complicated solution for small companies, particularly those without dedicated IT staff. Our research found that, of these SMBs, 50% of micro and 55% of small SMBs either definitely plan to switch from in-house servers to paid, hosted e-mail in the next three years or are thinking of doing so. This opportunity could add up to 8.8M paid hosted mailboxes to the market.

**Cloud Expanders.** In the hosted e-mail space, SMBs that upgrade from free hosted e-mail to premium hosted e-mail are considered to be Cloud Expanders, even though their current use of the cloud service is free. Parallels believes the best opportunity with regard to Cloud Expanders lies in upselling the 22% small SMBs and 13% of medium SMBs that are currently using free hosted e-mail. Upselling these SMBs to premium hosted e-mail should be easy, since they can benefit both from the team collaboration aspects of a premium hosted e-mail offering and from a “pay-per-seat” pricing model. Currently, 63% of small SMBs and an incredible 91% of medium SMBs either definitely plan to add premium hosted e-mail in the next three years or are considering doing so—an opportunity that could add 7M paid hosted mailboxes to the market. The best way to target this opportunity is to focus on the dedicated IT audience and make sure marketing messages have a strong technical orientation.

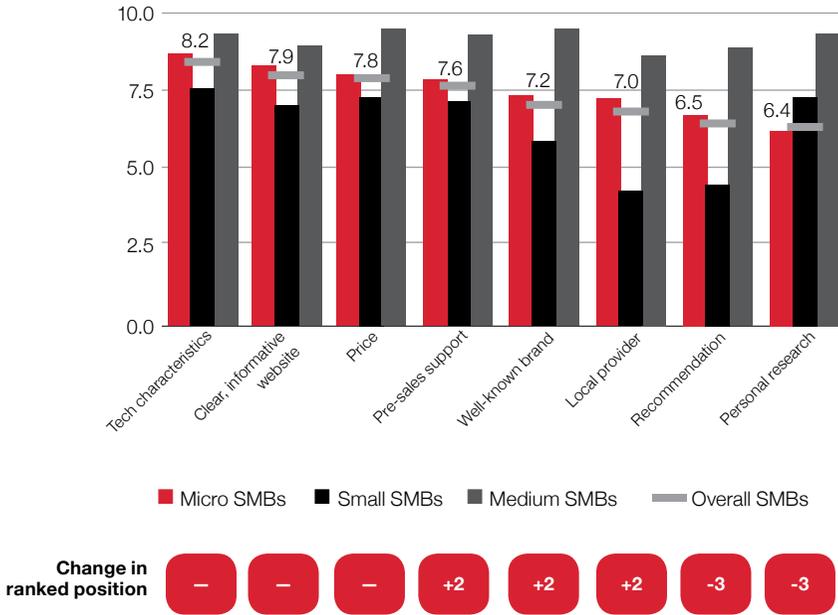
## Offering the Right Services

Over the past year, US SMBs' top purchase criteria for premium hosted e-mail remain unchanged, with technical characteristics, a clear and informative website, and price still rounding out the top three criteria (see Figure 10). However, we did identify one new purchase criterion that has become more important over the past year: **well-known brand**. This criterion has climbed two spots in the ranking for SMBs overall and now serves as the top criterion for the medium SMB segment. In light of this new development, building a strong brand as an email provider will be important for capturing the substantial growth occurring in this market.

The market for premium hosted e-mail will grow by 30% to \$1.8B in 2014, with medium SMBs driving much of the growth, and opportunities among both Cloud Converters and Cloud Expanders.

Well-known brand is an increasingly important purchase criterion for premium hosted e-mail offerings. Technical characteristics, informative website, and price remain important as well.

**Figure 10. US SMBs' key purchase criteria for premium hosted e-mail**



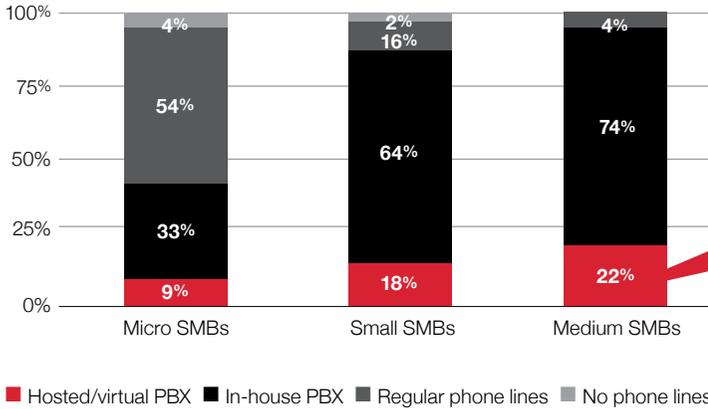
## Addressing the Non-Employer Segment

For the most part, the non-employer segment doesn't have a need for the advanced collaboration and security features of premium e-mail offerings. However, a handful of more technically oriented non-employers are using this service, giving premium hosted e-mail a 2% penetration rate and \$90M market size in this segment. Some Cloud Expander opportunity exists among non-employers over the next three years, with 16% of those currently using free hosted e-mail considering upgrading to premium services. The key purchase criteria for non-employers are price, online research, and a clear and informative website, so focusing on these areas will help service providers profit from the growth in this segment.

## Hosted PBX

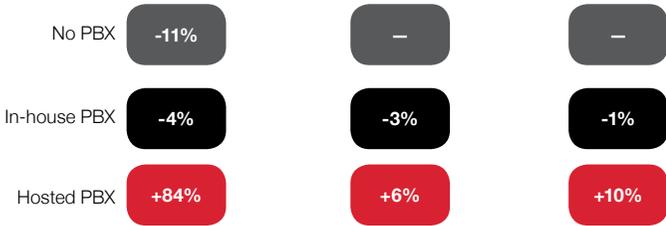
The emerging hosted PBX market has grown faster than any other SMB cloud service during 2011. Over the past year, the market grew 75% in size, reaching \$1.4B (see Figure 11). Our research indicates that hosted PBX will continue to outpace the other cloud services in growth over the next three years, making it a service that service providers will definitely want to add to their offerings.

**Figure 11. Changes in office phone use by US SMBs (excludes mobile lines)**



Overall, the hosted PBX market grew 75% in size, reaching \$1.4B.

**Percent change in PBX use since 2010**



Nearly all of the hosted PBX market growth in 2011 came from micro SMB Cloud Leapers. Micro SMBs generally can't afford in-house PBX systems, and if they don't have dedicated IT staff, they also can't install or maintain them, as PBX server installation is extremely complex even for SMB owners with some technical know-how. Therefore, in 2011 many micro SMBs took advantage of the opportunity to have enterprise-level phone systems at a reasonable monthly rate, without the hassle of installation and maintenance. We expect to see this trend increase further in the years to come, as hosted PBX becomes more widely known.

For small and medium SMBs, growth was more modest and came primarily from Cloud Converters—SMBs switching from their in-house PBX systems to the cloud. This trend too, will continue and will contribute to the blistering pace of growth in the hosted PBX market.

The hosted PBX market is growing at a blistering pace, with micro SMB Cloud Leapers driving most of the growth and Cloud Converters also a strong growth opportunity.

## Targeting the Opportunity

As mentioned above, the opportunities in the hosted PBX space will be huge for service providers that integrate hosted PBX into their offerings and target the highest-growth SMB segments. Parallels predicts that the overall market will grow with at least a 30% CAGR to \$3.0B in 2014, and we see opportunities among all three cloud user categories.

Huge opportunities exist in hosted PBX, across all types of cloud users and all sizes of SMBs, representing a possible 35.5M new hosted PBX lines over the next three years.

**Cloud Converters.** One of the easiest targets for service providers looking to step into the hosted PBX market is SMBs that currently use in-house PBX systems. In this space, all sizes of SMBs represent good opportunities, as 33% of micro SMBs, 64% of small SMBs, and 74% of medium SMBs currently use in-house PBX systems. Of these, 24% of micro SMBs, 36% of small SMBs, and 78% of medium SMBs are considering adopting hosted PBX in the next three years. This opportunity for replacing in-house PBX systems could add 24.3M hosted PBX lines to the market.

**Cloud Leapers.** Micro SMBs without in-house PBX systems will continue to be one of the hottest areas of growth in this market. Nearly 60% of micro SMBs do not have a PBX system of any kind, and 28% of these companies either plan to add hosted PBX in the next three years or are considering doing so. Small SMBs are also a strong opportunity: 17% of them don't have PBX and 30% might add hosted PBX in the next three years. Taken together, micro and small Cloud Leapers could add 11.2M hosted PBX lines to the market.

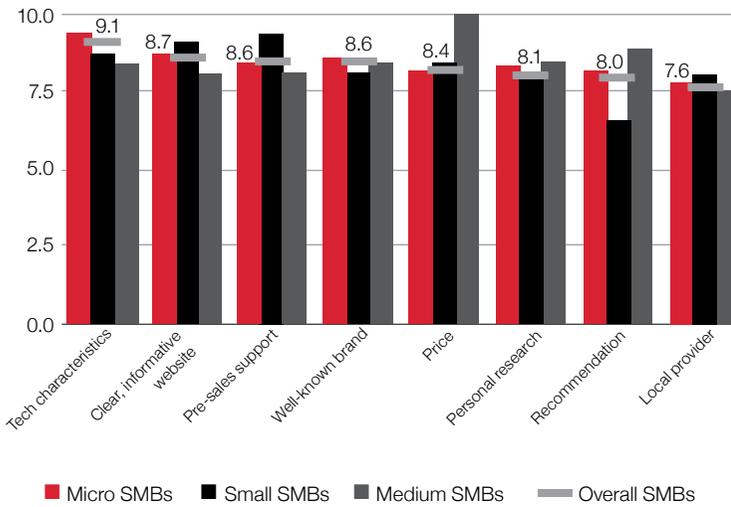
**Cloud Expanders.** Most SMBs currently using hosted PBX seem to be happy with the service, and 39% of them plan to increase their spending over the next three years, making this group of cloud users another growth opportunity.

## Offering the Right Services

Because the hosted PBX market is a new area for many service providers, Parallels has identified three major points that will help service providers successfully sell hosted PBX services:

- **Differentiate and build brand.** While price is still a concern among US SMBs, it has fallen significantly since 2010 in importance relative to other key purchase criteria, such as technical characteristics, pre-sales support, and a well-known brand (see Figure 12). Service providers should still offer small PBX bundles and keep prices low, but differentiating their offering with cutting-edge technical features, excellent support, and strong branding will help attract new customer as well as retain them long-term.

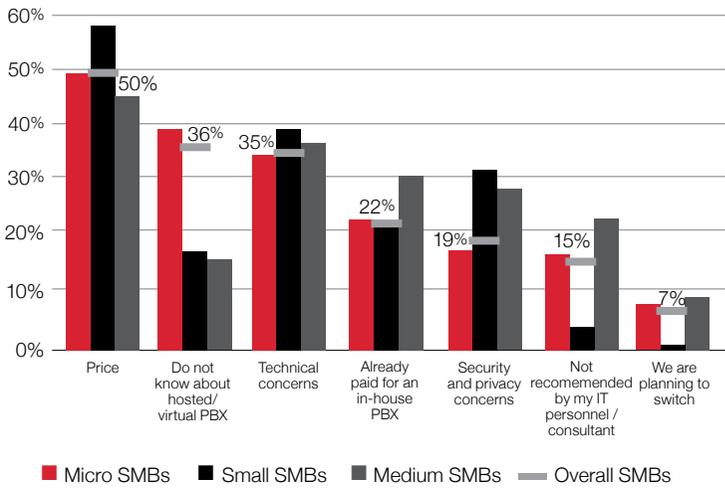
**Figure 12. US SMBs' key purchase criteria for hosted PBX**



- Educate.** As shown in Figure 13, 36% of SMBs still haven't heard of hosted PBX. In addition, when looking at the other reasons that SMBs cite for keeping PBX systems in-house, we see that 35% cite technical concerns and 19% report security and privacy concerns. Since hosted PBX is no different from in-house PBX in any of these areas, these concerns indicate that many US SMBs still have misconceptions about the service. It's clear that service providers' educational efforts are working, since SMBs' security and technical concerns have decreased by 27% and 17%, respectively, since 2010, but more education still needs to be done to capture the full value of this market. For these reasons, we see education through targeted marketing campaigns as being key to spurring continued SMB adoption of hosted PBX.

To successfully sell hosted PBX, service providers should focus on differentiating and building their brand, educating SMBs, and building a strong web presence.

**Figure 13. Changes in US SMBs' reasons not to switch to hosted PBX**



2010-2011 Rate of Change



- Build a strong web presence.** With many SMBs being unfamiliar with hosted PBX, it is not surprising that a clear and informative website ranks second in purchase criteria for this service (see Figure 12). Accordingly, we see a strong web presence as being helpful both in educating SMBs and in assisting them in selecting a service provider.

## Addressing the Non-Employer Segment

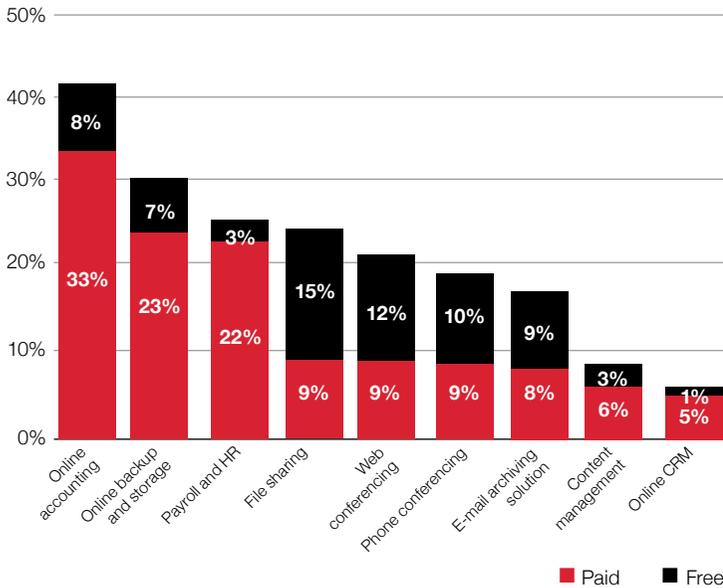
Hosted PBX use is very low in the non-employer segment, with just 1% using the service and a \$120M market size. Only 5% say they plan to start using hosted PBX in the next three years, but this low number is largely due to lack of awareness, as 57% of non-employers say they have never heard of hosted PBX. Focusing on educating these SMBs could spur significant growth in the segment, since many non-employer businesses could benefit from the professionalism and “large-business-appearance” that a hosted PBX system could add to their company.

## Business Applications

Business applications and other SaaS represent one of the best areas of opportunity in the US SMB cloud services market. Multiple analyst groups predict rapid adoption over the next several years, and our research corroborates these forecasts.

Currently, 78% of US SMBs are using some form of free or paid business applications. As shown in Figure 14, the top online applications are online accounting (used by 41%), online backup and storage (used by 30%), payroll and HR applications (used by 25%), and file sharing (used by 24%). These top applications apply both to SMBs overall and to micro and small SMBs specifically. For medium SMBs, web conferencing and e-mail archiving solutions are also among the top applications.

**Figure 14. Use of online applications by US SMBs**



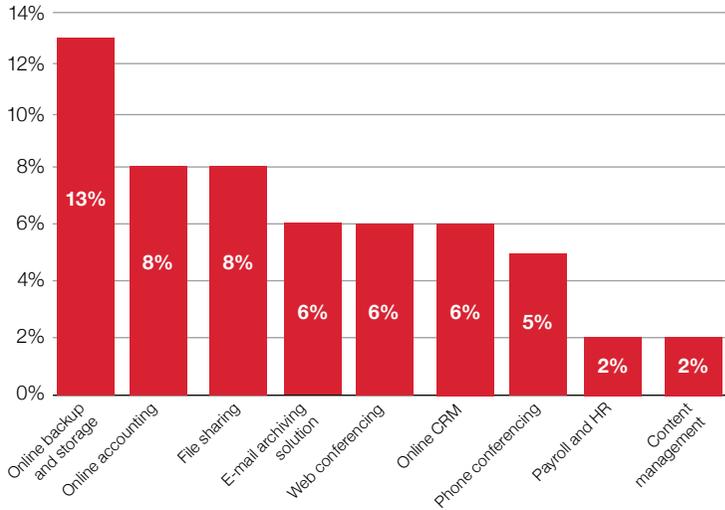
## Targeting the Opportunity

Parallels calculates that, among US SMBs, the 2014 market size for business applications will be \$7.4B, with a 20% year-over-year growth rate. As with the other cloud services, growth will take place among all types of cloud users: Cloud Converters switching from the in-house software to the cloud; Cloud Leapers that have never used the application in-house and are trying it for the first time as a SaaS application; and Cloud Expanders that are increasing their use of SaaS applications, either by upgrading their applications plans, adding more seats, or expanding their SaaS use into additional application categories.

Our research focused primarily on Cloud Expanders, as increasingly, the majority of SaaS growth will come from upselling existing cloud customers. These SMBs are both shifting more of their software use to the cloud and upgrading free applications to premium paid accounts. As Figure 15 shows, the hottest applications over the next three years will be online back-up and storage (with 13% planning to add it), online accounting, and file sharing (with 8% planning to add each of the last two).

Business applications are one of the best growth opportunities, with a 20% growth rate and an estimated market size of \$7.4B by 2014.

**Figure 15. Planned adoption of online applications by US SMBs**



## Offering the Right Services

The growth of the SaaS category offers significant opportunities—especially if service providers target each SMB size segment with the right applications.

Offering the right services is especially important for the business applications category, as integrating endless numbers of SaaS applications into current offerings can be an expensive and complex process for service providers. In this case, the key is to **create the right bundles based on SMB size segment**, since the top applications depend on the size of the SMB. Our research shows the top applications for each size segment over the next three years will be:

- **Micro SMBs:** online backup and storage (11%), online accounting (8%), and file sharing (7%).
- **Small SMBs:** online backup and storage (21%), file sharing (14%), e-mail archiving (14%), and phone conferencing (13%).
- **Medium SMBs:** Web conferencing (27%), phone conferencing (27%), online accounting (23%), and online backup and storage (23%). Other categories with greater than 20% planned rates of adoption in this size segment include file sharing, payroll and HR applications, and online CRM.

Overall, the growth of the business applications category makes it a favorable space to pursue—especially as becoming a full-service provider continues to be the trend in the cloud service market.

## Addressing the Non-Employer Segment

Currently, 47% of non-employer SMBs are using some type of online application, either free or paid, for a current market size of \$1.7B. The top applications used by non-employers include file sharing (with 25% using it), online backup and storage (with 21% using it), and online accounting (with 21% using it).

Parallels expects to see excellent growth in this size segment, fueled by the productivity gains that online applications offer businesses of this size. Our research shows that the top applications that non-employer SMBs plan to add in the next three years are online backup and storage (25% planning to add it), online accounting (15% planning to add it), and web conferencing (10% planning to add it).

Non-employers are a great SaaS opportunity, with online backup and storage, accounting, and web conferencing likely to be the top growth areas for this segment.

## Conclusion

Parallels estimates the size of the current US SMB market for the cloud services at \$15.1B—plus an additional \$1.6B in the growing market for non-employer businesses. By 2014, Parallels predicts the total SMB market will grow to \$24.3B.

The keys to growing cloud service adoption among US SMBs are to:

- **Know the SMB audience**, reaching out to different categories of SMBs with the messages that resonate most with their IT decision-makers. For the non-technical “do-it-yourselfers,” service providers’ focus should be on business benefits; for SMBs with IT consultants or dedicated IT staff, it should be on the technical advantages of the cloud service.
- **Target opportunities with the right services**, with marketing and business development efforts focusing on converting SMBs using in-house IT services and on encouraging SMBs without in-house IT to leap directly to the cloud. Service providers can also drive growth and revenue by increasing their offerings—both by adding new value-added tools to their core cloud services and by expanding their core service base with emerging services, such as other online applications, hosted PBX, and hosted e-mail. These new offerings will not only attract new customers, but will also help service providers upsell their existing customers who are looking to expand their cloud footprint.

As all types of cloud services become mainstream in the US SMB market, service providers who know their SMB customers, target the opportunities, and offer the right services will profit from the \$9.2B in market growth expected over the next three years.

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#### **About Parallels**

Parallels enables service providers to rapidly launch and efficiently deliver the most profitable cloud services by automating the delivery of the broadest set of solutions demanded by small businesses. Founded in 1999, Parallels is a fast-growing company with 800 employees in North America, Europe, and Asia. For more information, please visit [www.parallels.com/spp](http://www.parallels.com/spp).



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