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AT&T AND IBM'S PRIVATE CLOUD PARTNERSHIP: FROM COMPETITION TO COOPETITION

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INTRODUCTION¹

On October 9, 2012, AT&T and IBM announced a partnership to combine the private network capabilities of the former and the private cloud offering of the latter, to offer a comprehensive network-enabled, hosted private cloud offering. The partnership brings together AT&T's global multiprotocol label switched virtual private network (MPLS VPN) and IBM's SmartCloud Enterprise+ cloud solution, which is a fully managed, security-rich and production-ready cloud environment, designed to ensure enterprise-class performance and availability. The integrated solution is targeted at global Fortune 1000 companies that have put off migration to cloud due to concerns over end-to-end security and reliability. AT&T-IBM's partnership addresses those concerns by offering a completely private network with a private cloud solution.

As defined by the two companies, this future private cloud solution will be sold independently by both companies and managed through a joint program office. In this manner, there will be a single customer interface for service procurement, problem resolution, monitoring, and management of this end-to-end cloud solution, regardless of whether AT&T or IBM initiates the sale. The company selling the offering will be responsible for managing the solution, and will take on the complete responsibility of service management for the customer. This is different from other similar initiatives, wherein performance management of cloud and network elements is managed by the individual providers.

The joint solution is expected to become available in the first quarter of 2013; it will be rolled out in the U.S., with plans to expand globally at a later stage. However, the announcement has already created quite a buzz in the industry, as two market leaders—AT&T in network services and IBM in IT services—have joined forces to create a compelling network-enabled private cloud offering, despite the fact that they compete in other segments of the cloud market.

This SPIE will evaluate what the partnership means to AT&T and IBM, and, ultimately, to the customers in the hosted private cloud market.

¹ In preparing this report, Stratecast conducted interviews with the following representatives of AT&T and IBM:

- AT&T – Chris Costello, AVP Hosting and Cloud Services; and Don Parente, Director Product Development
- IBM – Dennis Quan, VP of IBM SmartCloud Infrastructure

Please note that the insights and opinions expressed in this assessment are those of Stratecast and have been developed through the Stratecast research and analysis process. These expressed insights and opinions do not necessarily reflect the views of the company executives interviewed.

MARKET TRENDS DRIVING DEMAND FOR PRIVATE HOSTED CLOUD SOLUTIONS

Fortune 1000 companies, like most enterprises, are evaluating cloud computing as a means to buy IT infrastructure as a utility service. With cloud solutions, enterprises can easily scale their workloads up or down, as business needs change, and shift spending from CAPEX to OPEX. However, concerns over data and network security, application performance and reliability, and loss of control are inhibiting cloud adoption by this segment.

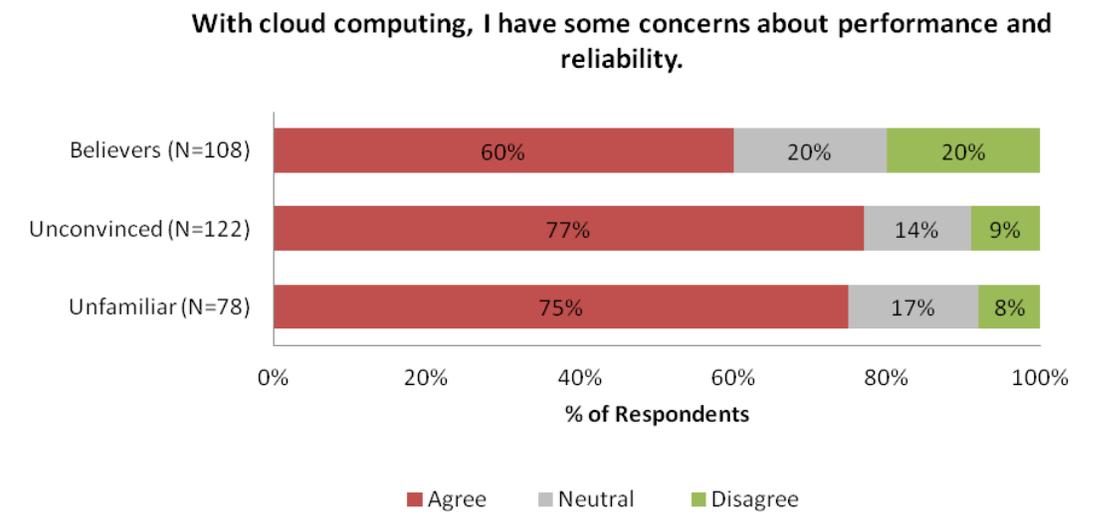
Based on Frost & Sullivan's 2012 survey of 308 U.S. enterprise IT decision makers regarding cloud IaaS adoption trends, Stratecast has categorized respondents into three segments:²

- **Believers**, representing 35 percent of all respondents, are those who indicated they are familiar with IaaS and are currently using or planning to implement it within two years. These respondents are educated about the cloud and have accepted its value.
- **The Unconvinced**, at 40 percent of the total, represents the largest percentage of respondents. These respondents indicated they are familiar with IaaS and have chosen *not* to implement it.
- **The Unfamiliar**, comprising the smallest sector, at 25 percent, represents the shrinking number of decision makers who indicated they are somewhat or not at all familiar with IaaS.

As shown below in Figure 1 and Figure 2, respectively, 60 percent of "Believers" expressed concerns over public cloud's performance and reliability; and 52 percent of them expressed concerns over security risk to their data.

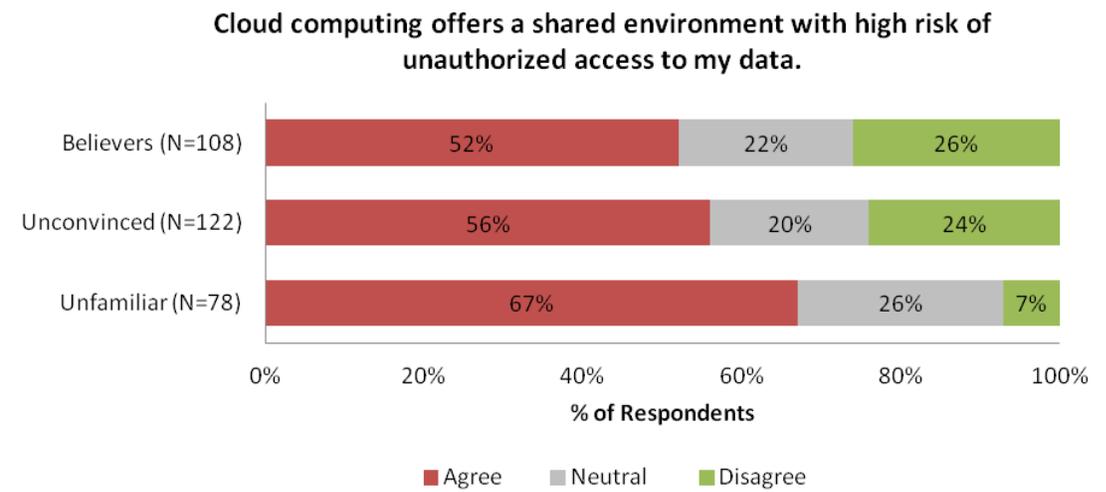
² See CC 2-3: *2012 Cloud User Survey: How Understanding Market Perceptions Can Help Providers Turn Cloud Skeptics into Adopters* (June 2012).

Figure 1: Perceptions Regarding Performance and Reliability



Source: Stratecast

Figure 2: Perceptions Regarding Security Risk



Source: Stratecast

To address these concerns, while still taking advantage of the economies promised by a cloud model, Fortune 1000 companies and large enterprises are going beyond the public cloud (shared and virtualized servers accessed over the public Internet) and considering a hosted private cloud (hosted dedicated virtualized servers, often accessed via private networks).

In the same survey, 68 percent of survey respondents agreed with the statement, “I am concerned about relying on the public Internet to access cloud applications;” and 65

percent agreed with the statement, “I would be interested only in a private cloud.” Together, these two statements point to a strong market opportunity for hosted private clouds that are tightly integrated with private networks.

To guarantee end-to-end application performance, large enterprises are starting to evaluate cloud services in a more holistic manner—a cloud architecture that combines network and IT infrastructure to ensure a truly integrated, consistent, secure, and performance-guaranteed service. Through the AT&T and IBM partnership, enterprise customers should get the best of both worlds—a fully managed, hosted private cloud solution that delivers necessary levels of security, network scalability and managed services demanded by this customer segment.

WHAT DOES THIS PARTNERSHIP MEAN FOR AT&T?

AT&T's MPLS VPN offering is one of the best in the industry—in terms of network reach and service level agreements (SLAs)—and has helped the company establish itself as the market leader in the U.S. MPLS VPN services market.³ AT&T's global MPLS VPN network spans 143 countries, with over 4,000 nodes and more than 360,000 MPLS managed customer ports, worldwide. Approximately 85 percent of these customer ports are in the U.S., thus making AT&T the largest MPLS/IP VPN services provider in the U.S. market.

Many leading global multinational companies (MNCs) and large enterprises currently use AT&T's MPLS VPN network to run converged applications—voice, video and data—to ensure that corporate applications use AT&T's secure and private IP network rather than the “public” Internet. With the emergence of cloud computing, those same enterprises are keen to take advantage of the benefits of the ‘on-demand’ model of buying IT services. At the same time, these organizations remain concerned about possible security and reliability issues associated with a public cloud. There is a clear demand from large enterprises for a private cloud solution that incorporates security, both at the IT application level and the network level—a truly end-to-end hosted private cloud. Both AT&T and IBM realize this, and, hence, established the partnership to address this market need.

With this partnership, AT&T will be in a position to combine the enterprise-grade cloud offering (SmartCloud Enterprise+) from IBM with its own industry leading MPLS VPN services, to target Fortune 1000 customers. In fact, this is the first time AT&T will be opening its network control plane to a third-party data center. AT&T will connect its MPLS networks to IBM cloud data centers that host the SmartCloud Enterprise+ platform. This arrangement enables cloud customers to move applications and data among their own data centers and IBM data centers, in a secure and dynamic fashion, while maintaining predictable performance characteristics.

This is the first time AT&T will open its network control plane to a third-party data center. AT&T will connect its MPLS networks to IBM cloud data centers (which host the SmartCloud Enterprise+ platform) to enable private cloud customers to move applications between their own data centers and IBM data centers, in a secure and dynamic fashion.

³ AT&T has been ranked #1 in Frost & Sullivan's market share analysis (based on revenues) of the U.S. MPLS VPN Services Market for the years 2009, 2010 and 2011.

Frost & Sullivan believes this is a smart move by AT&T, and benefits the company in the following ways:

- By choosing to partner with a leading IT service provider, AT&T positions itself to compete effectively for high value deals from global Fortune 1000 companies in the hosted private cloud market.
- By focusing on what it does best—offering network and managed services; and partnering with IBM to marry the networks with cloud—AT&T is creating a new revenue stream for its MPLS VPN services.
- AT&T has the opportunity to penetrate deeper into enterprise network operations, and showcase its professional services capabilities.

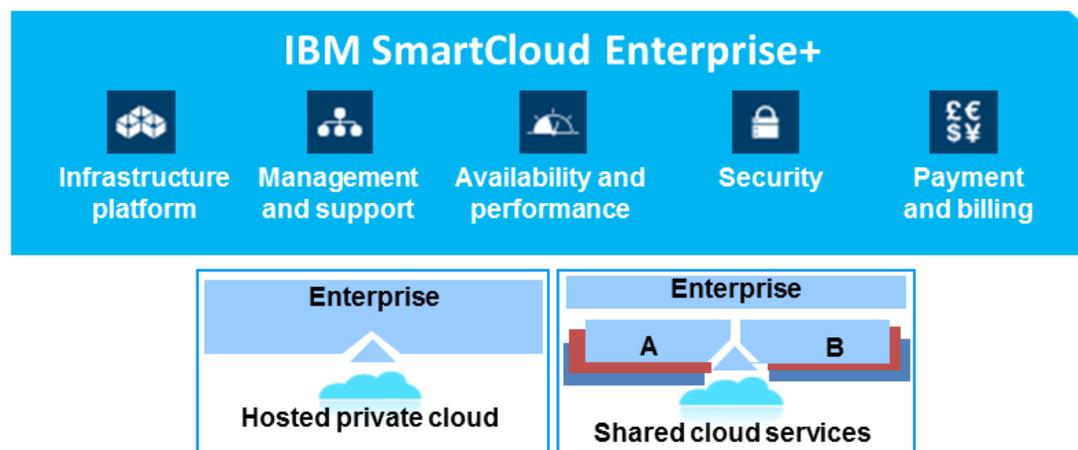
But why partner with IBM? Why not just offer its own private hosted cloud offering? The fundamental reason is that AT&T understands the decision-making process and mentality involved when large enterprises choose their IT vendors. While AT&T is in a position to be an obvious network service provider within this customer segment, many Fortune 1000 customers still prefer to purchase IT services from an ‘IT company’ like IBM. Many of these companies also have an existing relationship with IBM; and adding cloud services is perceived as an extension of the existing IT solutions portfolio.

Frost & Sullivan believes CSPs that are also positioned as cloud service providers (e.g., AT&T, Verizon-Terremark, CenturyLink-Savvis, etc.) are in a favorable position to offer SLAs related to application availability and performance. CSPs can manage the cloud offering, end-to-end, due to their control over the network, and expertise in engineering private IP VPN networks to handle Quality of Service (QoS) for different classes of application traffic. However, this network-centric expertise is a deterrent when asking large enterprises to entrust CSPs with complex IT deployments (hybrid architectures spanning enterprise-owned data centers and hosted private cloud data centers). This could change in the future as the cloud market evolves; but for now, CSPs need strong partnerships to target the IT dollars of Fortune 1000 customers.

WHAT DOES THIS PARTNERSHIP MEAN FOR IBM?

IBM is a leading provider of IT services, and has a history of engineering, implementing and managing complex enterprise IT environments for global Fortune 1000 customers. For years, the company has helped large MNCs strategize, design, implement and manage IT infrastructure using IBM’s hardware, software and managed services. IBM’s SmartCloud Enterprise+ is a natural extension of the company’s IT services offerings in the large enterprise market. SmartCloud Enterprise+, shown in Figure 3 below, is an enterprise-class, managed, hosted IaaS solution offering the security and availability attributes that Fortune 1000 companies are looking for when evaluating cloud services.

For IBM, this partnership is a natural extension of its long standing relationship with AT&T for network services. AT&T’s networks are already a critical part of various IT outsourcing and large system integration projects handled by IBM.

Figure 3: IBM's SmartCloud Enterprise+ Platform

Source: IBM

However, as with most other cloud services, the SLAs offered on IBM SmartCloud Enterprise+ apply only to cloud service availability, with network SLAs connecting the cloud data centers and enterprises to the cloud data center left to be managed by the CSP. This results in friction between providers, and creates a certain amount of uncertainty and unpredictability for the enterprises when trying to achieve high levels of end-to-end application performance.

Having decades of IT experience, IBM understands the IT requirements of Fortune 1000 companies. The partnership with AT&T benefits IBM in the following ways:

- By connecting its hosted cloud data centers to AT&T's MPLS VPN, IBM is now in a position to assure its Fortune 1000 cloud customers that critical applications will never have to traverse the public Internet.
- IBM can extend end-to-end SLAs to its customers, and offer them the ability to dynamically scale network bandwidth based on specific application requirements.

For IBM, this partnership is a natural extension of its long standing relationship with AT&T for network services. AT&T networks are already a critical part of multiple IT outsourcing and large system integration projects delivered by IBM. By continuing to partner with AT&T, IBM delivers what the market needs while strengthening its relationship with a premier connectivity provider.

WHAT DOES THIS PARTNERSHIP MEAN FOR THE TARGET MARKET?

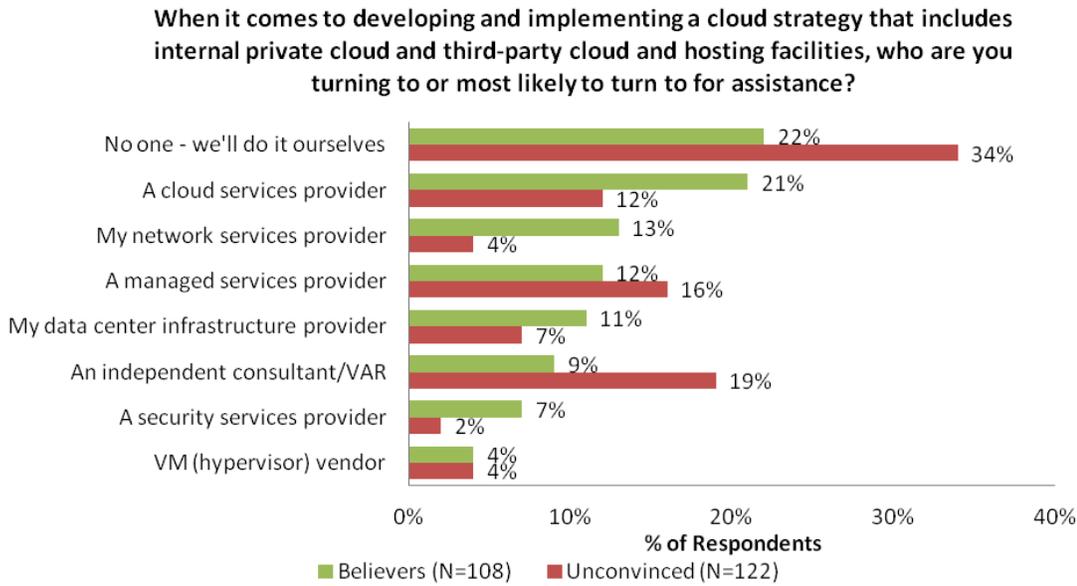
IBM and AT&T's partnership benefits the Fortune 1000 and other large enterprises looking to implement an enterprise-class fully managed private cloud infrastructure in the following ways:

- Customers can take advantage of the managed capabilities of IBM's SmartCloud Enterprise+ to migrate critical applications (such as SAP) to a private hosted cloud, at their own pace.
- Customers are assured of end-to-end security for their applications residing in the cloud, as the transactions never leave the private AT&T MPLS VPN.
- Enterprise customers can be assured of network availability based on strict SLAs offered with AT&T's MPLS VPN, and can further take advantage of the traffic prioritization and class of service (CoS) capability inherent in MPLS networks to prioritize access to applications served through IBM's SmartCloud Enterprise+ Platform.
- Customers can leverage the bandwidth-on-demand option of MPLS networks to scale network bandwidth when required.
- Existing MPLS VPN customers of AT&T that want to implement private hosted cloud service can take advantage of the combined solution offering to balance workloads between private onsite and off-site data centers and private hosted cloud resources.

Most importantly, customers now have a "single throat to choke" in case of failure to deliver the promised SLAs, as the company that is awarded the contract assumes end-to-end responsibility for performance guarantees across the complete service. This creates a compelling and simplified offer for enterprise customers demanding SLAs from a single provider for their cloud solution, rather than juggling multiple contracts from different organizations.

In the 2012 Frost & Sullivan Cloud Survey, we asked respondents who they will most likely turn to for developing and implementing a cloud strategy; and the results are shown in Figure 4 below.

Figure 4: Developing and Implementing a Cloud Strategy



Source: *Stratecast*

To recap:

- 21 percent of the “Believers” indicated they would turn to a “cloud service provider”
- 13 percent of the “Believers” indicated “network service provider”
- 12 percent of the “Believers” indicated “managed network service provider”

Based on these survey responses, AT&T and IBM’s partnership captures the provider preferences of nearly 50 percent of cloud Believers in developing and implementing a cloud strategy.

Stratecast The Last Word

Enterprise cloud adoption is in the growth phase of the product life cycle, which means that the opportunity will continue to expand. Not surprisingly, cloud service providers are eager to grab a piece of this significant revenue opportunity. Stratecast analysis shows that U.S. Infrastructure as a Service (IaaS) revenues could grow at a 50 percent compound annual growth rate through 2015; and cloud providers are already reporting customer growth numbers that, in some cases, are doubling year-over-year.⁴

However, the future enterprise IT infrastructure will be a combination of in-house data centers, dedicated off-site hosting, and private, public, and hybrid cloud solutions. Demand for each of these solutions will depend upon the size of the organization, type of vertical market and, most importantly, the type of IT workloads the organization wishes to place in the cloud.

Frost & Sullivan believes that cloud vendor selection and purchase decisions across different customer segments will be dictated by existing IT and network configurations, established vendor relationships, cost, and complexity of the cloud solution an enterprise plans to implement. For example, while an enterprise wanting to offload test and development workloads to a public cloud could prefer Amazon Web Service, an MNC looking to move SAP applications to the cloud may only want to work with a company like IBM. The trick here is for vendors to recognize the **Segment** of the market they want to address, **Target** the segment with optimally designed solutions, and **Position** their offerings in a compelling manner in the market. **The Segmentation, Targeting and Positioning (STP) strategy will require cooperation with the very same companies suppliers currently compete with. However, recognizing the value of “Coopetition” to bring a holistic solution to market, wherein the whole is greater than the sum of its parts, is critical and will ultimately prove to be a winning strategy.**

Through this partnership, AT&T and IBM have done exactly that. Does this mean that this is going to be a perfect marriage? Of course not. It is fair to assume that there will be initial bottlenecks (with respect to the service delivery and management) as the companies chart out roles and responsibilities of the joint program office. The fact that AT&T and IBM have worked together for many years should help each overcome these initial challenges so they can proceed along the path to market success.

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⁴ See CC 1-5, *U.S. Infrastructure as a Service Market Analysis: On the Road toward Commodity Status* (November 2011).

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