

Small Business, Big Opportunity

The SMB Market for Digitization and Cloud Solutions

Europe and North America represent an €84 billion market with 20% long-term growth. Targeting these customers requires the right commercial approach.

By Nick Padgett, Alexander Rajko, Konstantin Pell, and Nikolaus Lehmann



Small and medium-size businesses (SMBs) are the growth engine of most economies, and they represent a huge opportunity for companies that sell digitization and cloud solutions. But the market is often scattered and hard to quantify, with buying dynamics that are significantly different from enterprise-level software sold to large corporations¹.

McKinsey recently analyzed the SMB market for digitization and cloud services in North America and Europe and surveyed approximately 1,500 SMBs in those regions. Highlights of the analysis include:

- The overall market for digitization and cloud solutions in Europe and North America is sized €84 billion as of 2021, and it will grow more than 20% p.a. through 2026².
- This market momentum breaks down into 8% p.a. of growth from digitization solutions
 - including robust growth from traditional market segments like domains and webhosting, website builder and e-commerce and server hosting and even stronger 27% p.a. of growth for cloud solutions until 2026
- Most SMBs follow a clear digitization journey, starting with domain and web-hosting as the entry point and then adding more services over time as they grow, e.g. multiple domains, website builder (with continuous upgrades), e-commerce solutions, office and emails. Eventually they also add more cloud focused services, like storage, backup and security.

Historically, the digitization solution segment has been the main pillar of the market, but the cloud segment has grown to become the largest share of the market and currently shows faster growth rates—more than 25% per year, compared to roughly 8% for digitization services (Exhibit 1). Among the specific categories of digitization, we see the highest growth coming from website builder and e-commerce segments. Both show projected

growth rates of 13-14% p.a. through 2026, due largely to changing customer preferences for digital sales interactions. Nevertheless, web-hosting and domains and server hosting are the largest segments in absolute terms.

Our analysis also points to specific strategies used by providers to capture the market for SMB customers. Specifically, companies must: 1) offer a comprehensive set of digitization solutions; 2) invest in upselling and cross-selling capabilities; 3) focus on web hosting and other associated digital solutions for the smallest businesses; 4) create a seamless user experience (through both initial set-up and ongoing support) and 5) understand the competitive landscape.

Quantifying the SMB market

From architects to bakers to veterinarians and real estate developers, SMBs represent the full spectrum of economic growth in most markets. They often receive less attention than big corporations but represent a larger share of jobs, job growth, and overall GDP contribution.

For the companies that provide digitization solutions such as web-hosting, the SMB market is attractive because of its sheer size—even small countries have hundreds of thousands of businesses in this category, and the number is growing significantly³. Moreover, these companies follow a fairly predictable pattern in terms of technology services. They typically start with a digital presence that includes a domain name, a place to host, and the ability to create a website. As their business grows, they add other solutions, from professional email to e-commerce, data storage, and later server hosting and cloud solutions. This progression and opportunity to bundle offerings—in addition to higher margins compared to the enterprise software market—leads to increasing customer value for providers (Exhibit 2).

¹ For our market definition within digitization solutions, we see domain & webhosting, website builder & e-commerce, email and office, other value added services as key SMB segments focused on companies with 0-249 FTE. For server hosting and cloud solutions we take a broader definition of SMB customers also including large SBMs with 250-999 FTE (please see page 6 for methodology of market definition)

² Worldwide, the full market potential in 2021 is estimated at 130bn EUR for digitization solutions and 500bn EUR for Cloud (growing at 4% and 5% p.a. respectively until 2026, total market growth 5% p.a.). This assumes a 100% penetration rate with digitization and cloud solutions and considers all company sizes. At current penetration rates (30% web hosting and related categories, around two-thirds for server hosting and 20% for cloud), the worldwide market of 190bn EUR breaks down into 63bn EUR digitization solutions (growing at 7% p.a. 2021-26) and 127bn EUR for Cloud (growing at 29% p.a. 2021-26)

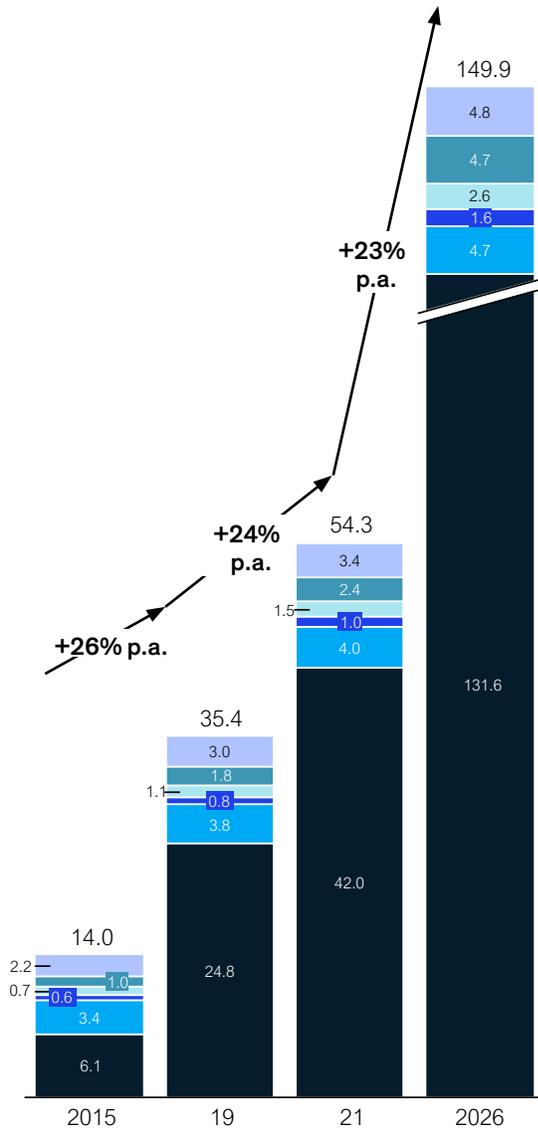
³ As of 2021, there are 34.8 million SMBs in North America and 57.6 million SMBs in Europe. Overall, the number had been growing at 1% p.a. in recent years, with projected growth of 2% p.a. through 2026. These numbers include freelancers

Exhibit 1

Market for digitization and cloud solutions to SMBs shows strong double digit growth rates for the coming five years

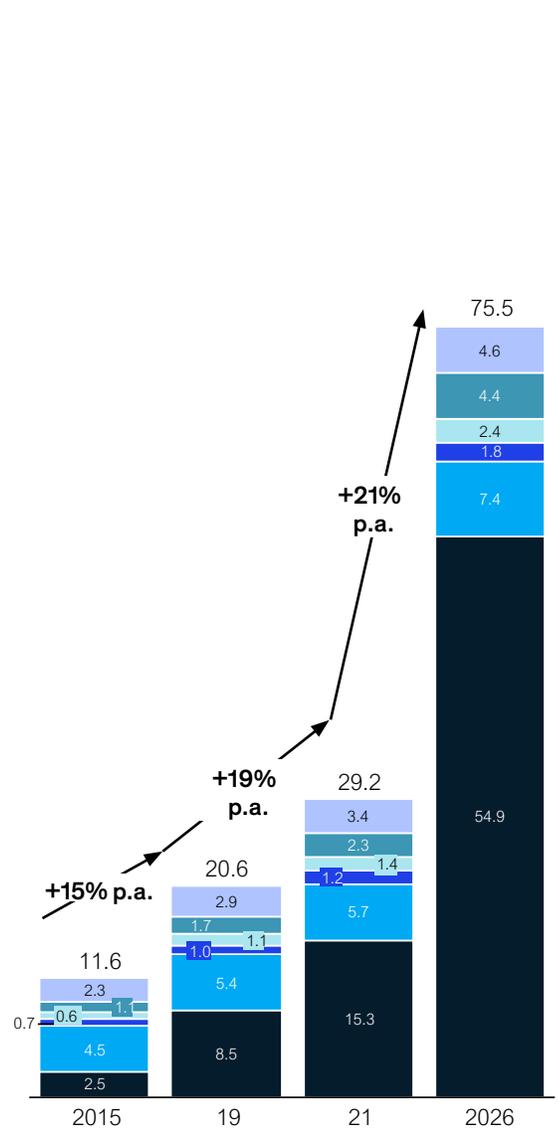
SMB Digitization and cloud solutions market in North America

In EUR billion



SMB Digitization and cloud solutions market in Europe¹

In EUR billion



Total Hosting & Productivity

- Domains & Webhosting
- Website builder & e-commerce
- Email & Office
- Other VAS
- Server hosting

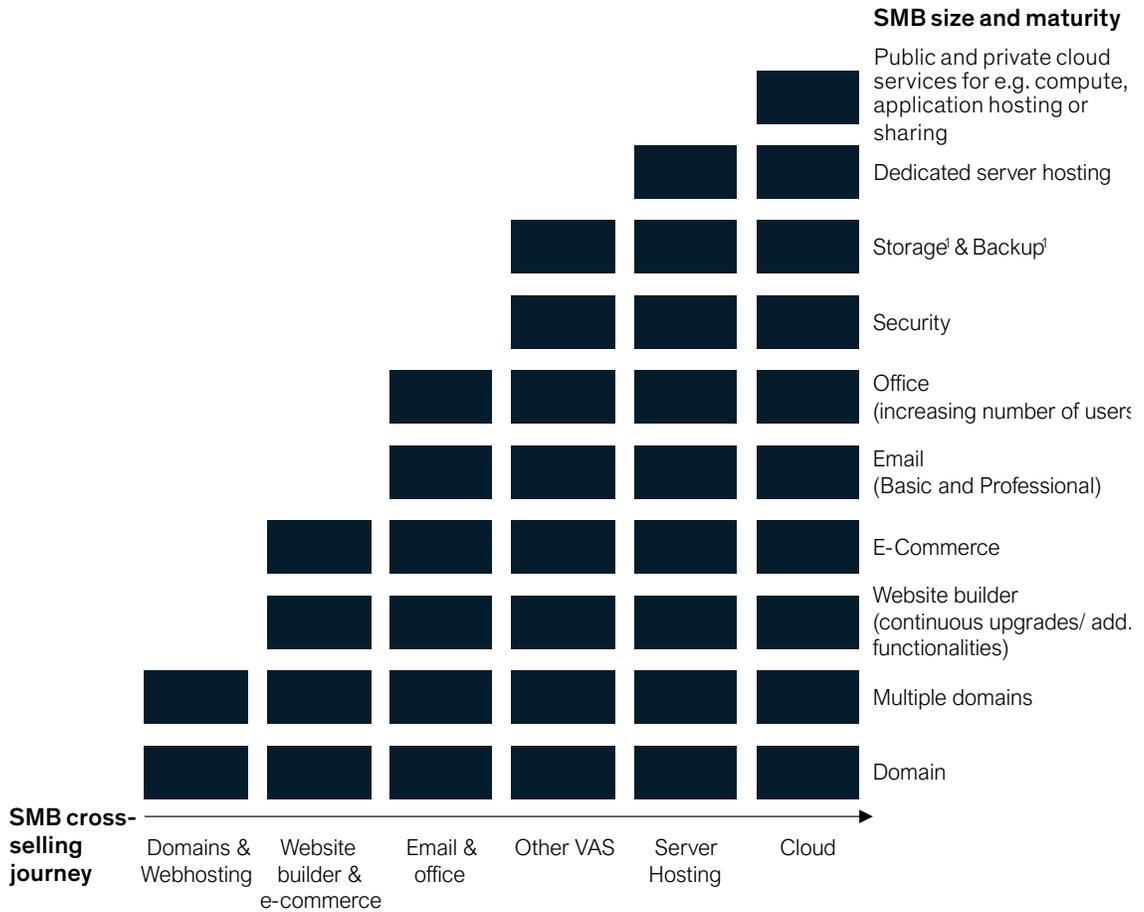
Total Cloud

- Total Cloud

¹ Incl. the EU-27 member states + United Kingdom, Switzerland
Source: McKinsey market model

Exhibit 2

More than just suppliers, SMBs need true partners to manage and expand alongside the digitization journey



1. Non-cloud back-up and storage software and solutions
Source: Expert interviews; McKinsey team analysis

As with other aspects of digitization, the pandemic has added momentum to these trends by boosting e-commerce and catalyzing the need for businesses to establish a web presence. For example, many restaurants added technology for online ordering or delivery services, and other types of SMBs launched e-commerce platforms.

For example, for domains and webhosting, an important growth driver is the still increasing service penetration rate – esp. for small SMBs (see Exhibit 3). Furthermore, there is still a strong movement towards e-commerce digitization

solutions within SMBs, from historic penetration growth of 6% p.a. (from 18% 2015 to 23% penetration 2019) now even accelerating to 9% p.a. (to 27% penetration in 2021) respectively to 8% p.a. (to 41% penetration in 2026), based on our customer research⁴. Overall, we see SMBs increasingly shifting to utilize online presence for customer interaction and acquisition.

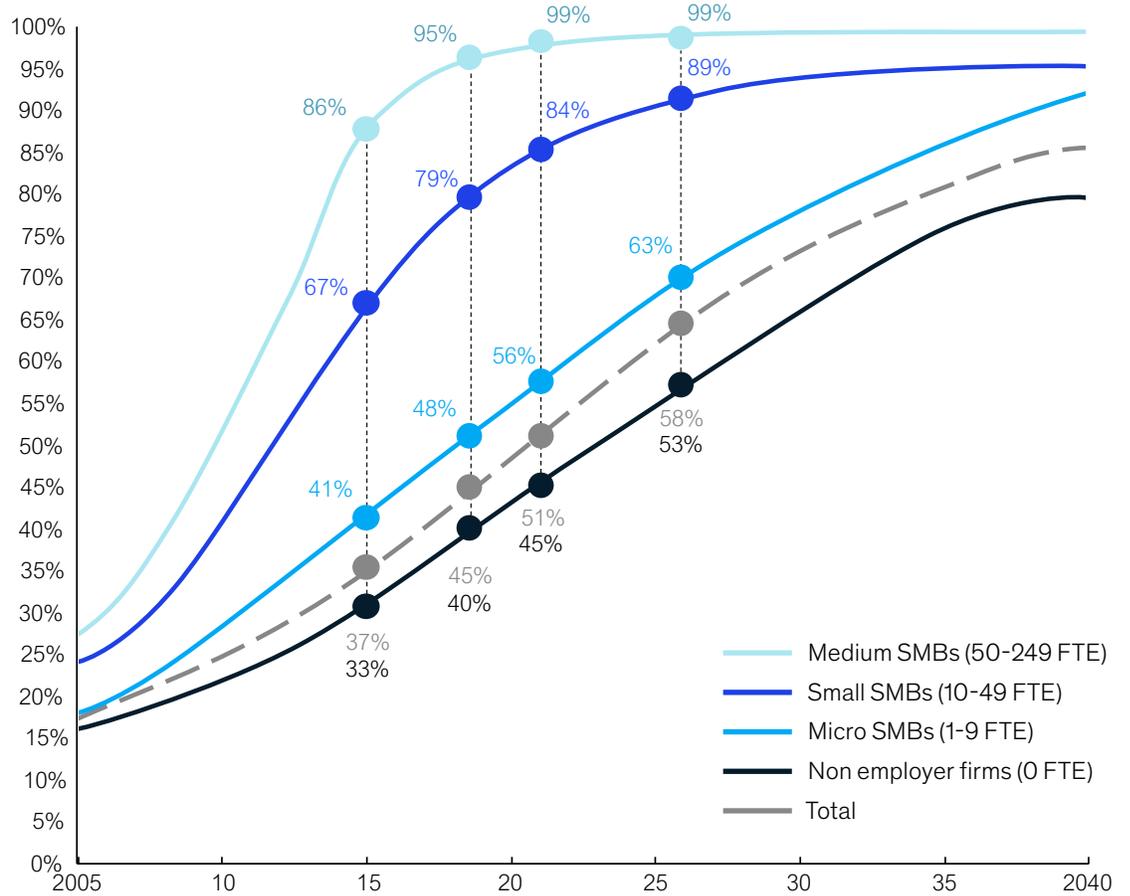
⁴ Referring to Europe only, for companies that already have a website

Exhibit 3

Significant upside for website adoption remains within small SMBs, micro SMBs and non employer firms

Domain and webhosting market: Share of companies with a website in Europe, 2005-2040

Percent



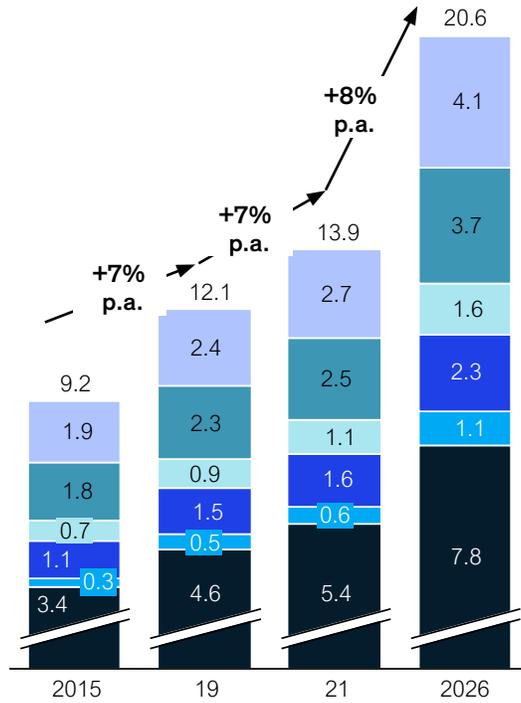
Source: McKinsey market model

Moreover, we see strong SMB digitization market growth across selected European markets with 8-14% p.a. overall growth outlook and 6-11% p.a. for domain and webhosting, which will become the biggest market sub segment with EUR 4.8bn by 2026. Some Eastern European markets such as Poland have significant catch-up effects based on still lower penetration levels (see Exhibit 4). Additionally, GDP growth and economic expansion adds to market growth.

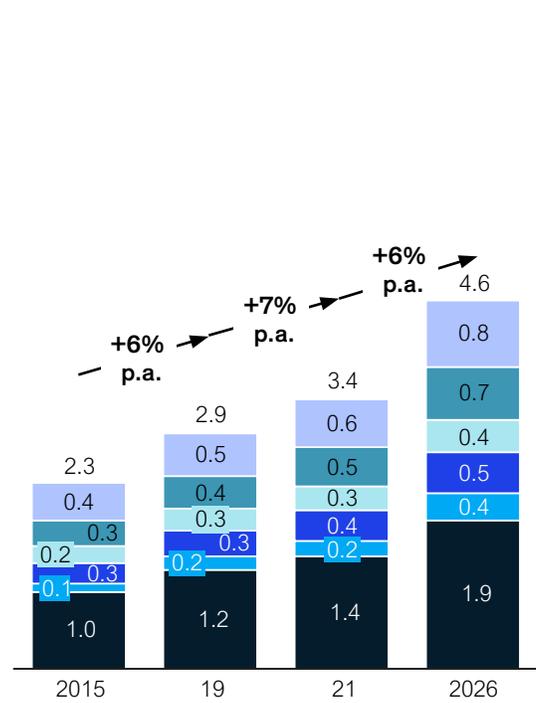
Exhibit 4

Strong market growth outlook in selected European markets for 2026

SMB digitization excl. cloud solutions market
In EUR billion



SMB domain and webhosting market
In EUR billion



Germany

UK

Spain

France

Poland

Rest of Europe¹

1. Incl. the EU-27 member states + United Kingdom, Switzerland
Source: McKinsey market model

Methodology

For this study, we distinguished among non-employer firms (freelancers or sole proprietorships), micro SMBs (up to 9 full-time employees), small SMBs (10 to 49 FTEs), medium SMBs (50 to 249 FTEs) and large SMBs (250 to 999 FTEs)⁵. We developed a bottom-up model to size the market, taking the service penetration across the

various SMB sizes into account in particular for hosting services. We focused on Europe and North America and considered the number of companies, penetration levels for specific services, and service fees.

For SMB cloud services, we relied on established market intelligence and lever-

aged the “Worldwide Semiannual Public Cloud Services Tracker, '21 to 25” from IDC that we adjusted by selected geographical focus (Europe and North America), technology (IaaS and PaaS) and company sizes (for cloud we look at SMBs up to 999 FTE and include the public sector).

⁵ Large SMBs only considered in cloud and server hosting in our market model

Key priorities to reach the SMB market

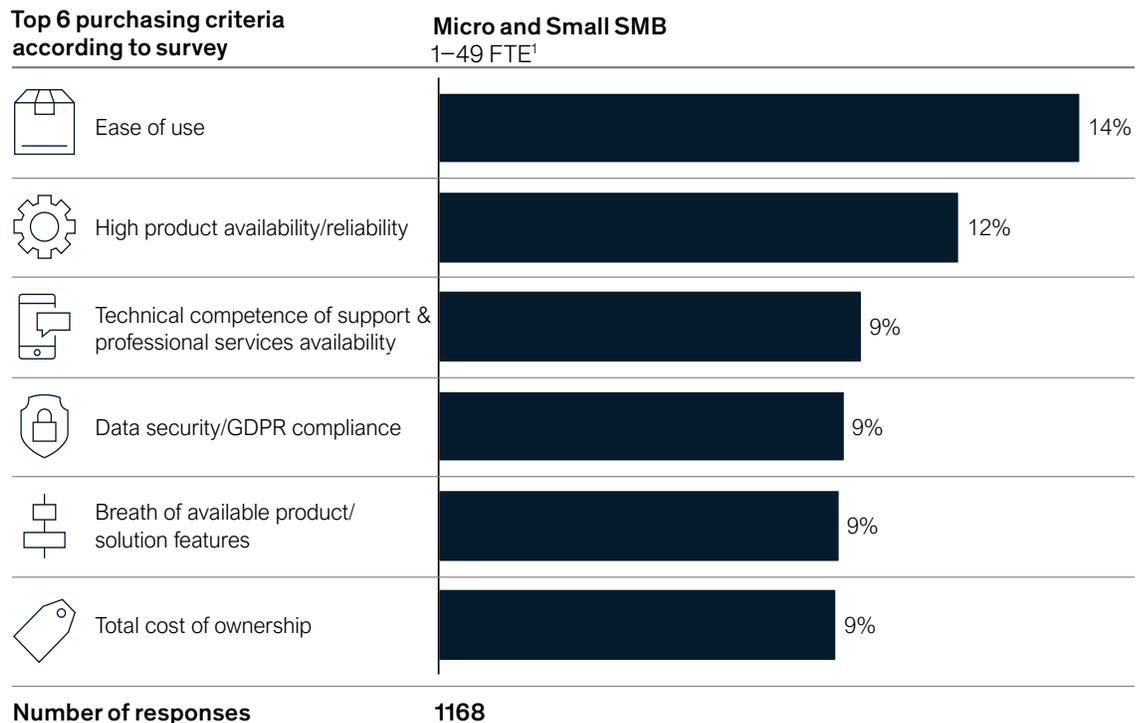
Based on our analysis, we believe that several elements are critical when service providers address the SMB market.

Offer a comprehensive set of solutions. As companies grow in terms of revenue and/or employees—and add incremental IT services—they prefer to stick with a single provider. Accordingly, firms should offer a complete portfolio of offerings, so that they can scale up with growing customers. For firms that don't have a full menu of options, M&A may be one means of building out the portfolio, along with strategic partnerships and/or joint ventures.

Create a seamless user experience. Most SMBs don't have internal IT resources. Instead, technology is handled as a side responsibility by the owner or an employee, who may have limited expertise and even less time to make sense of complex offerings. Most want services that are extremely simple and intuitive, and that can be launched and functional in minutes. Services need to be designed with the user experience paramount. In our survey results, "ease of use" was the top purchasing criteria identified by both micro and small SMBs (Exhibit 5).

Exhibit 5

SMBs identified ease of use and product reliability as key attributes for IT services, along with total cost of ownership



1. Scaled sum of all rankings as either most important, second most important or third most important criteria. Showing only top 6 categories (respondents had more options)

Source: McKinsey SMB Survey October 2021

The same holds true for service and support to existing customers. When a small-business website or email account goes down—for whatever reason—it's a full-fledged crisis. Providers need to invest sufficient resources to build a support team that can provide rapid, friendly service.

Invest in cross-selling and upselling capabilities.

For cloud offerings in particular, companies can use analytics to understand how customers are using their services, where they are delighted, where they get frustrated, and what types of incremental services they are likely to require. In that way, they can proactively identify cross-selling and upselling opportunities.

Stay on top of the competition. Because the SMB market is so dynamic and growing so fast, it is an attractive target, drawing new technologies and new players all the time. Providers need to understand who they are competing against, what types of novel offerings are hitting the market, and what kinds of responses may be warranted. For example, some specialist firms succeed by focusing specifically on web design services.

Diversify across geographic regions. Because of the need to generate scale, operating within a single national market is exceedingly hard. Instead, providers can establish a broader geographic footprint. That requires striking the right balance between shared aspects (such as infrastructure that can function across borders) and strong local brands and service quality. At the same time, providers should identify and expand into fast-growth areas such as Eastern Europe.

When applicable, focus on the base offering.

Even though many SMBs grow and require additional services over time, most of the value is in the low end of the market. Accordingly, some providers will be able to thrive by focusing specifically on basic services such as web-hosting and applying a volume strategy.

SMBs are a unique market for digitization and cloud solutions, with wholly different buying dynamics than enterprise-level software. But as our analysis shows, they are also an attractive market. To thrive, providers need to understand the underlying growth trends among SMBs and the main factors that affect purchasing decisions, and tailor their portfolio of products and services accordingly. In doing so, providers can capture the big opportunity from small business.

Nick Padgett is a partner in McKinsey's London office, **Alexander Rajko** is a partner in the Cologne office, **Konstantin Pell** is a partner in the Vienna office, and **Nikolaus Lehmann** is an associate partner in the Munich office.

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