Under the Buzz

Back to Basics in e-Business

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In this month's issue:

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1. Timely Quotes, and Notable Comments on Current Affairs …

Reference to fanatics and terrorists:
"Martyrdom – the only way a man can become famous without ability."

- George Bernard Shaw

Reminder about Argentina:
"What's the quickest way to make a small fortune? Start with a large one."

- Brazilian saying

On Enron, Microsoft, and others:
"Make money and the whole world will conspire to call you a gentleman."

- Mark Twain

On entrepreneurship and entrepreneurs:
"Entrepreneurship is the last refuge of the troubled individual."

- James K. Glassman

"The eccentric, the driven, and the strange – in other words, tomorrow's brilliant entrepreneurs…"

- Michael Parsons, Red Herring magazine, January 2002

On the state of some venture capital portfolios:
"It's embarrassing to look at the portfolios of some major VCs, like going through a friend's wardrobe and reviewing some really bad fashion decisions. You bought this? And you paid how much?… After the dot-coms, the tech wreck, the WAP debacle, 3G, terrorism, and war, there's a sense of amused incredulity: OK, what else you got? A plague of locusts? …

- Michael Parsons, Red Herring magazine, Jan. 2002

On the crisis of confidence among VC firms:

"All of us should just ignore these folks (the VCs), as they are feeling not so much the pain of our broader economic times as the excesses of their own behavior. … The bottom line is that the VC industry is facing a crisis of confidence that really has nothing to do with the rest of us." - Anthony Perkins in Red Herring magazine (Jan. 2002) quoting prominent venture capitalists from Kleiner Perkins, Sequoia capital, and Accel Partners, in addition to a series of surveys of VC sentiment, mostly forecasting a continued downturn through the end of 2002.

On the Internet, the supposed demise of the New Economy, and today's economic downturn:
"To say the new economy is over is like somebody in London in 1830 saying the industrial revolution is over because some textile manufacturers went broke. … Few companies managed to make money <u>*on*</u> *the railroad; many early operators went bankrupt in the panics of 1857 and 1893. Yet by slashing transportation costs, railroads had what economists call "spillover effects" on the economy at large."*

- Alvin Toffler, quoted on Business 2.0, Aug-Sept. 2001

*"Recession or not, the Internet has transformed the way the world does business. And the key tenets of corporate survival strategies from previous downturns – hunkering down, shelving new projects, and sticking to basics – no longer make sense. While cost-cutting is appropriate, today it must be achieved along with unprecedented business-model innovation and corporate agility. … Many traditional firms are still thriving and succeeding by transforming their core business architectures around the Net. The classic vertically integrated corporation is no longer the most effective vehicle for value creation. Because the Internet slashes the cost of sharing knowledge, collaborating, and meshing business processes among corporations, smart companies focus on their core competencies and partner or outsource for the rest." (The author then provides examples of Enron – yes!- Siebel Systems, Herman Miller, Dow Chemical, Schwab, GE, Boeing, Amazon, Travelocity, eBay, and E*Trade to make his point.)*

- Don Tapscott, author of "Digital Capital: Harnessing the Power of Business Webs" (HBS, 2000), in the Wall Street Journal.

On the reasons for the internal divergences regarding the HP-Compaq merger:
"I think the foundation has very particular interests. They are focused, as a foundation, on wealth preservation. And we as a company, and I as the CEO, have to be focused on value creation and industry leadership. In this case, those are divergent objectives from each other."
- Carly Fiorina, CEO of HP, responding to the question, "Were you surprised by the decision of the Packard Foundation to oppose the Compaq deal?" as quoted in BusinessWeek magazine, 12.24.01.

<u>2. 2001 Snapshot and 2002 Outlook …</u>

Among other memories, 2001 was the year that …

- … A medieval version of Hitler provoked the most significant global geo-political realignment in over fifty years, transforming both national and personal security into paramount concerns for Americans, as the U.S. officially joined the global terrorism-afflicted world … The power crisis in California proved that the state had rejoined the "developing world", as the state government hurriedly contracted electrical power from surprising sources such as Mexico … Jacques Nasser and Carly Fiorina got ahead of themselves, and forgot to take into account the needs, wants, and wills of influential founding-family shareholders … Microsoft, condemned in the courts for abusing its monopolistic power, was let off practically scot free by the new Bush administration ... Enron and Napster, winners of the MIT Sloan e-Business Awards for 2001, hit separate walls – Napster proved it was a phenomenon but not a business, while Enron became the largest, most sudden and most spectacular bankruptcy ever, proving that it was both a business and a phenomenon (though a byzantine and corrupted one) … Financial securities analysts and their investment bank employers got trapped in their conflicts of interest, then fought to ward off press criticism and investor lawsuits, as their 1999-2000 internet and telecom darlings got pummeled by capital market investors … As a result of investors' rapid disenchantment with internet and telecom companies, stock prices of most public companies on the Nasdaq completed declines of 80%-95%, and valuations of private companies suffered equally, making it hard to close new rounds of funding. In fact, many public companies received valuations way below the amount of cash in hand … Certain well-known technology CEOs lost their way in the fog caused by the dotcom and telecom meltdowns and, in their perplexity, refused to take responsibility for forecasting their company's quarterly sales … New technologies aimed at bringing enterprises closer together via the internet – including private trading exchanges, collaborative design and manufacturing applications, peer-to-peer workgroup collaboration, content delivery networks, and real-time application and data integration technologies - struggled to traverse the chasm between early market adoption and mainstream markets (and some even struggled with finding their very first customers!) … The venerable ERP super-category experienced a renaissance, as enterprises sought to prepare themselves for heavier investments in inter-enterprise e-commerce: valuations of Peoplesoft, SAP, Lawson, JDA Software, and many others, recovered impressively, while some of the "ERP-replacement" brigade, headed by i2, CommerceOne, and Ariba were severely wounded in the crossfire … Meanwhile the glamorous CRM super-category hit its first road-bump, with too many vendors competing in each sub-category and customers beginning to doubt the hyped benefits of market intelligence, one-to-one marketing, etc. … Some product categories experienced growth spurts resulting from the 9.11 attacks; these included web conferencing, e-learning, disaster recovery systems, security software, systems management utilities, and storage systems … A new phenomenon called "web services" (standardizing enterprise business processes by providing automated components to web users) was touted as the great new hope among software companies, though corporate customers still looked skeptical …

As we look forward into 2002, what are some of the developments that we can anticipate? ….

- … The perceived threat of massive state and non-state sponsored global terrorism continues to recede in the face of the U.S. and allies' resolution to stamp it out, and confidence slowly returns to the markets … Erstwhile terrorism sponsors such as Iran, Syria and Iraq start to behave themselves in a more moderate manner, in order to avoid the same fate as the Taliban … The new alliance between Russia and the West leads to wider agreements for the U.S. to import oil and gas, permitting a reduced dependence on imports from repressive Arab regimes such as Saudi Arabia and Yemen … The clean-up of nineties business excesses – especially in technology businesses - continues, and the U.S. economy slowly recovers its forward momentum; in particular, credible B-to-B technology companies begin to demonstrate real market penetration in significant volumes, resulting in a slow return of stock prices from the low single digits to the late teens and beyond … Microsoft continues to fend off pressure in the form of threatened and actual lawsuits from states and blocs (e.g., Europe) … Industry analysts will recover some of their influence in getting investors' and customer's attention, as securities analysts and VCs lick their wounds and regroup … Corporate executives and CIOs will continue to exercise caution in buying technology from startups, as a result of getting burned by companies that perished as a result of the high failure rate of internet companies during the past eighteen months. Vendors in important software categories, who understand how to present real ROI to address mission-critical problems *before* asking for the contract, will continue to do well … Chastened by the experiences of 2000-2001, technology-company CEOs will start to talk more sense to the market. In particular, they will pay more attention to building a sustainable high-growth business by focusing on their target customers, rather than attempting to increase valuations by hyping their company to industry and financial analysts … Web-centric ERP applications (led by SAP, PeopleSoft and JDA Software), supply chain performance management (led by Manugistics and SeeCommerce, among others), enterprise content management (led by Vignette, Documentum, and Interwoven), collaborative inter-enterprise applications (led by companies such as Agile Software, MatrixOne, and Retek), and private trading network software (led by FreeMarkets and others) should be among the categories that thrive, while web services will experience uneven early adoption, accompanied by aggressive marketing and PR led by the likes of IBM, Sun Microsystems, Microsoft, and BEA Systems …

3. The Psychology of Market Development: Create an Epidemic vs. Chase Every Prospect

"The best way to understand the emergence of fashion trends, … the transformation of unknown books into bestsellers, … the phenomena of word-of-mouth … is to think of them as epidemics. Ideas and products and messages and behaviors spread just like viruses do."

- Malcolm Gladwell, "The Tipping Point" (Little, Brown & Co., 2000)

One of my career-long frustrations has been with the habit of high-tech marketers to employ an essentially promiscuous approach in their early-market development strategy. Most of the time you can ignore all the claims about being "focused on providing solutions to leading companies in X, Y, and Z industries" and assume that any customer organization with a pulse and some money to spend is going to be treated as a qualified prospect. Perhaps it is part of the tradition of being "sales-focused", which is so frequently confused with being actually customer-focused. Perhaps I am being unfair to some companies - but not to the majority.

This "strategy" is especially damaging when the challenge is related to market formation, either when a company launches a new technology in the marketplace, or when it seeks to find its first target segment of "pragmatist" customers. At these stages, you have to wonder why companies should be so ready to drop their elaborate strategies, in favor of chasing everything in sight, when it simply doesn't work? The answer I have come up with, after twenty-five years in this business, that companies get afflicted by what Mel Brooks referred to as "high anxiety". In other words, almost all startups (and more mature organizations as well) experience varying degrees of angst, leading them to throw every marketing tactic within their grasp behind the launch of their hot new product. Look back at the past few years of internet froth, and you will see far too many companies that have failed and, worse still, some are still continuing to fail, with the cost being as high as going out of business, often after spending all their hard-won funding. Not surprisingly, this explains largely why public and private internet software and telecom company valuations being as discredited as they are today.

It would be okay if this type of behavior was effective; unfortunately, however, it is a virtual rule that, when marketing innovative products that aim to significantly alter the way people and companies operate, you simply cannot succeed by pursuing every vaguely interested "prospect" who agrees to a meeting, visits your conference stand, or attends your demo. We all know in our bones, if not from bitter experience – or exposure to the Chasm Group's Technology Adoption Life Cycle and models such as Clayton Christensen's ideas about the Innovator's Dilemma - that no disruptive new technology is going to appeal to the majority of potential target customers enough to make them buy it while it is still unfamiliar and unproven, no matter how attractive the promised benefits appear to be.

So, what better strategy is there to lower your risk of failure and raise your chances of success? Well, despite the irreverence of Groucho Marx's famous quip ("I wouldn't join any club that would have me as a member") or another, even more ironic, definition I have heard recently ("that cruelest and most powerful of traditional English social structures: the club. If your name's not down, you're not coming in."), I believe it makes much more sense, psychologically, to create a "club" or "crowded restaurant" dynamic. Remember the empty, disappointed feeling you get when, as a customer, you find yourself in an empty night club or restaurant, compared to your willingness to fight tooth and nail for a table in a crowded club or restaurant? Well, I am convinced that this analogy describes the correct psychology to employ in early-market formation.

An even more eloquent and colorful metaphor, perhaps, is the one about creating social epidemics, as described by Malcolm Gladwell in his excellent book, "The Tipping Point" (Little, Brown & Co., 2000). Gladwell's thesis for creating a social epidemic provides an excellent vocabulary and syntax for generating "epidemics" around new products, thus providing a suitable vehicle for generating a powerful "club" dynamic in your market formation process. The Tipping Point is based on three rules: the Law of the Few, the Stickiness Factor, and the Power of Context. In essence, the Law of the Few describes three types of individuals who exert a disproportionate amount of influence on the development of any kind of epidemic – Connectors, Mavens, and Salesmen. In business terms, the Stickiness Factor refers to a product's capacity to find traction with customers (i.e., by solving real problems and preferences), and the Power of Context can describe a product's relevance in given situations (where, for example, customers who have had some of their critical problems solved by the new technology form a powerful peer pressure influence on their more conservative colleagues). All of these factors can be translated to the situation of a vendor's search to find suitable customers for its products, and they all relate to a psychology more in line with creating a field of attraction (a pull model, in other words), rather than employing direct pressure tactics (equivalent to a push model). In reality, the former approach is vital to early market acceptance, and to enable vendors to "cross the chasm" (roughly analogous to reaching a tipping point in demand creation). Furthermore, as every technology company knows, these early stages are the most critical and challenging stages to succeed at; unfortunately, the "push" or pressure model is absolutely antithetical to customer's interests in the early market, and is in fact only suitable once the basic demand (or epidemic) has been created.

If you were to ask me what would be the one promise I would make to you as you read this article, it is this: if you can influence your Board of Directors, Board of Advisors, VC partnership, management team, marketer and salesperson to today throw the switch, and adopt the Club idea and the Epidemic modus operandi as a basis for implementing an effective "pull" strategy, you will see immediate and significant gains, such as: less time and resources spent pursuing the wrong customers, larger deals with the right customers, shorter sales cycles, a real chance for the company to achieve category leadership and/or market dominance – in short, ensuring survival, then thrival as a fast-growing and profitable business. Go ahead: throw the switch and let me know how it turns out! I look forward to the day when more companies in each category achieve fast-growing and sustainable valuations, providing them with suitable currencies to purse their ongoing growth strategies, whether organic, and/or M&A-based.

4. Early Market Competitive Advantage: Crimes vs. Misdemeanors in Project Pricing

In my work with clients who are driving toward early market adoption of their technologies, much of our discussions focus on developing a project-focused pricing strategy to use in their deals with large enterprise customers. Companies that learn how to determine the price of such projects based on a reasonable percentage (i.e., 10%) of the customer's anticipated gain in terms of increased competitive advantage (measured eventually in revenue and/or market share increase), can quickly achieve four significant benefits:

1. The company's position in the eyes of their customers is immediately upgraded: if before they were focused on "selling their technology" - often to non-decision-makers who did not have access to all the project and investment parameters - they now act like a problem-solving "project" company, they will rapidly get the attention of decision-makers in the customer organization.

2. Even if they do not adopt a comprehensive structure for pricing out the entire project - and as a result, are still not able to charge for each component of value-add that they are delivering - they get much closer to closing seven-figure deals, rather than the low hundred-thousand dollar software licenses that they typically might have been expecting before they adopted this approach.

3. Because they are now dealing with the decision-makers, they have much greater visibility into the sales cycle for each deal, and will manage to accelerate the close on their first major deal(s) by as much as several months, as a direct result of this more "business-like" posture.

4. They no longer waste time and resources on potential projects that demand prototype after prototype, and demo after demo, without seemingly ever reaching closure.

Readers of this journal may recall past editions of Under the Buzz (specifically, February 2001 - vol.2, nbr.2 - and March 2001 - vol.2, nbr.3) in which I wrote about the risks of trying to form new markets the wrong way, focusing specifically on what I described in terms often dangers, which I repeat below:

<u>The Ten Dangers of Early Market Selling</u>

1. Ignoring the key goals of Early Market sales
2. Not understanding the psychographics you are dealing with
3. Employing ineffective qualification (ie, segmentation) criteria
4. Asking the wrong people in your organization to find and close the first few deals
5. Not knowing where to find likely visionary buyers
6. Failing to align with the visionary's goals and requirements
7. Mistaking "pragmatists in drag" for visionaries
8. **Not charging for custom R&D and/or implementation services**
9. **Structuring each deal as a product sale rather than a "whole project"**
10. Failing to see when/how to cross the chasm (and avoid the plunge!)

All of these factors influence a company's readiness to charge appropriately for their early-market projects, because pricing is a key test of perceived value, and software companies usually focus only on the perceived value of the technology they are promising to deliver. Unfortunately, this is only part of the equation, and it often misses the mark as far as the visionary customer is concerned. I placed points #8 and #9 above in bold because they more explicitly refer to pricing factors.

My reasons for bringing this issue to the fore once more is that throughout the past twelve months I have been struck by how many young startups and mature companies have continued to seriously "low-ball" their early-market project pricing, in an often vain attempt to accelerate sales. The irony, of course, is this painful reality: rather than accelerate closing deals, pricing only the technology you are selling, and giving away (most of) the services and customization, does not in fact accelerate or facilitate your success – instead, it actually delays it, and may even put it on permanent hold, especially in a harsh funding environment. When your alternative sources of funding - angels, VCs and other third-parties - dry up, you are generally left with two other possible sources: either the first party (your customer), or the second party (you, the technology company). How much of the benefits to be realized by your early-market customer should you really be funding? Furthermore, do you realize that visionary customers are in fact much more results-sensitive than price-sensitive? If you ignore these signs, and steam on with your hard-sell approach, who do you think is going to blink first - the large enterprise customer or you, the (smaller) technology startup?

I can summarize my approach to this subject in terms of "*crimes" vs. "misdemeanors"*. I classify crimes as those errors that really compromise the company's chances of success. These include continuing to price only the technology and operate like a classic product sales vendor, for whom the objective is to sell a product. Why can this be a "crime"? Simple: because it puts you completely out of alignment with your target customer, whose objective it is to implement a successful high-risk project that will enable them to leapfrog their closest competitors. And, if you are out of alignment with your customer, they treat you just like what you act like – a vendor – and put you in a box along with other competing product vendors. And, once they've done that, it doesn't take long before they start nickel-and-diming you, because they are concerned that you don't have any real interest in the risks they are facing with their project, and they fear that you might not be able to deliver what they need.

This is exacerbated when you, in your anxiety to get the deal done, start making unnecessary and unsolicited price concessions – after all, they have a lot at stake, and each time you discount your price or agree unconditionally to develop a new custom feature, they wonder how on earth you will manage to deliver (they may also start wondering if you are a business or a registered charity). So, when the technology company makes concessions like these, they not only compromise their chances of closing critical contracts on the right bases, but they also threaten the success of the customer in their risky project – hence my use of the term "crime".

In contrast, one cannot expect any company, especially startups with everything they have at stake on the first few major deals, to get all the pricing structure right. Although I strongly recommend that the technology company follows the example of senior service partners such as Accenture and PWC and charges for every item of value that you develop or adapt for the customer, it is quite understandable – and appropriate in many cases – to agree to provide one or other component at no additional cost, based on a judgment call by one of the executives involved. Importantly, this type of concessions should at no time de made just because, in your anxiety to win the business, you blinked, because this almost always results in a loss of "power" in your relationship with the customer. On the other hand, when done for the right reasons, they can even be a positive. Here are some examples of such concessions, or "misdemeanors":

(a) You decide to charge only a symbolic amount for the project sizing and planning assignment, and also to deduct this amount from the up-front portion of the contract when it is eventually signed.
(b) Among the five or six custom functionality enhancements that the customer needs for the success of their project, you charge market rates for five, but provide one for free even if it theoretically should be chargeable and won't be used in any future deliverables for other customers.
(c) In the same project, you decide to provide free implementation training to the customer's team, though you still make it clear that all future user and implementer training will be chargeable.
(d) Among the project management tasks, you collaborate as project manager with the customer and decide not to charge project management fees – though you still charge market rates for the main project execution tasks such as network infrastructure, application modifications, process and workflow management, and so on.

An important point about these misdemeanors is this: each one taken separately can be, in my view, a justifiable concession not to be considered a misdemeanor at all, on the basis that it enhances the good will in the relationship, does not affect the customer's confidence in the end-result, and does not materially impact the technology company's profitability from the project. When grouped together indiscriminately, on the other hand, these concessions can be counter-productive, because they tend to jeopardize these different factors.

So, in terms of the right approach to adopt, there is a clear choice: act like a typical over-anxious product vendor with early market customers, and you will be treated accordingly; or, act like a consultative project company, and you will greatly increase your chances of succeeding during this stage and preparing your organization to cross the chasm when the time is right.

5. Technology Company CEO: The Best Job in the World - or the Worst?

During the 1990s' bull market expansion, technology companies not only became mainstream investment targets, but they became arguably the principal engine of the record eight-year boom. This placed an enormous amount of unexpected pressure on CEOs, most of whom had no previous training in advanced management techniques, and some of whom were unprepared for anything besides the adulation associated with a glorious ride to success. When times turned tough, the new pressures and demands from VC firms, BoDs, financial analysts, industry analysts, the press, enterprise customers, consumers, partners, and other constituencies, for assurances of results were unexpected and tough to handle. In fact, during 2001, I came into contact with a significant number of software-company CEOs whose hollowed looks betrayed that they had definitely not signed up for the kind of nightmare they were now going through.

Now, even in the best of companies and at the best of times, senior managers can get out of touch with the core constituencies of their business: customers, partners, and other third parties. This occurs when organizational demands – including the Board's requirements – begin to require more of their time. An aggravating factor is that, in today's economy, CEOs have too much power, albeit mainly temporal because they can be fired at the drop of a hat, and BoDs as a rule are overstretched and ineffective in over-seeing senior management's activities. With no one close to them willing (or permitted) to tell them what's really going, the CEO has to leap into damage control mode as soon as trouble hits. Perhaps it is understandable that, left to their own devices, CEOs tend to develop cosy or "tame" boards in order to soften the rigors of dealing with the outside world, in particular the voracious appetite of capital market analysts and investors for constant updates about the company's progress.

In order to survive in spite of these problems, I am convinced that a proactive CEO needs to constantly redefine what is core to their role and responsibilities, versus what is context: *core* is anything that can increase their company's market valuation, whereas *context* is any activity or process that, mission-critical or not, can either reduce it or - even if performed optimally - leave it unchanged. So, what are the core activities that CEOs need to keep sight of? Naturally there are many possible answers, but I have reduced the list to three; if a given activity does not fit in these three spheres, then it needs to be "outsourced" to someone else in the organization or outside the company – or, if it has become superfluous over time, it should be jettisoned entirely from the CEO's list of priorities.

(a) Focus on Core Issues: **Competitive advantage, strategy and identity**.

Key focus: Make sure that company's competitive advantage, strategy, and identity keep pace with company's current state of development – see below for detailed questions in each of these three areas. The main risk against executing effectively in these three areas is that the company's prevailing management style will usually lag the demands of a fast-growing organization by as much as two to three years. For example, a 1,000-employee organization generating $250m. or so in revenues may be saddled with a management style and organizational structure suited for a company the size it was three years before – at, say, $50-100m. in revenues and 200-400 employees. Common consequences include management burnout and turnover, employee attrition, customer defection, and other afflictions.

(b) Focus on making sure that context is kept to a minimum, in their own activities, and in the organization as a whole. If possible, context activities must be shed, or at least be carried on the balance sheet of those for whom the activity is core.

In relation to core activities, here are some questions that are applicable to each of the three main areas:

Competitive advantage:
Key questions to answer include: What are our sources of competitive advantage, and how are they changing? To what degree does our competitive power reside in (a) our technology "crown jewels", (b) the value chain we have constructed with key partners, (c) market segments in which we have established dominance, or (d) the range and differentiation of our product/service offers? If none of these apply, we will be seriously vulnerable to the activities of more aggressive competitors.

Strategy:
Key questions to answer: Are we successfully leveraging our basic competitive advantage(s) to create differentiated, and sustainable, value? What are we best at: (i) marketing disruptive innovations to visionary customers, (ii) building whole solutions to solve specific problems in key target markets, (iii) taking standard products rapidly to global mass markets, or (iv) achieving growth and profits with established products? Are we capable of achieving success with more than one of these market development approaches? Is our overall corporate strategy flexible enough to absorb change?

Identity:
Key questions to answer: Do our most important customers, our external partners, our employees, and our other key stakeholders attribute to us the competitive advantage and business value that we claim to have established? If not, why not? Does each key constituency recognize our differentiation vis-à-vis other competing alternatives? How has our identity evolved in the past three years, and how does it need to evolve in the next three years? Are we maintaining our edge, or are we slipping into complacency?

This is not an exhaustive list of priorities for each CEO or senior executive, but I'm sure that if you use these three themes as cornerstones in your thinking on company leadership, you will not be omitting any critical component. In future articles, I shall address these three focal points in greater detail, in addition to addressing how to avoid spending valuable CEO time on contextual activities.

Articles to come in future editions of Under the Buzz 2002:

- Sales Accelerators in a Tough Economic Environment
- Early Market Development Strategy: Watch Out for Faux Visionaries!
- Tough Choices in Product Categories: Playing to Compete vs. Playing to Win
- Designing Your Organization: Goals, Structure, and People – in This Order!
- The Seven Habits of Highly Successful Gorillas

Under the Buzz offers a monthly commentary on the business-to-business e-commerce sector. The goal is to provide provocative and accurate insights into the latest events and thinking shaping the rapidly evolving business-to-business marketplace. *Under the Buzz* also focuses on strategies for building sustainable competitive differentiation and maximizing market valuations.

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