

Under the Buzz

Back to Basics in e-Business

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Under the Buzz is an electronic "newsletter" authored by Philip Lay, managing director at the Chasm Group, a Silicon Valley strategy consulting firm. It is published each month, and delivered free to subscribers via email. It is also posted on the Chasm Group website at: <http://www.chasmgroup.com/underthebuzz.htm>. Back issues can be downloaded from the site at: http://www.chasmgroup.com/underthebuzz_archives.htm.

In this month's issue:

1. Advice to Microsoft on Commodity Software (article by David Stutz, formerly of Microsoft)

Following his recent departure from the company, David Stutz, an open source expert, presents a fascinating, contrarian point of view about Microsoft's reluctance to really adopt the (internet) network as the center of the computing universe, still insisting on imposing its PC-centric view of the world. Stutz described why this places the Redmond giant in risky waters going forward.

2. Observations on Dealing with Painful Challenges Facing Most Software Companies

This article provides brief notes on five important topics: (1) Understanding and dealing with the 'quadruple whammy' that has hit every high-tech company in the past three years; (2) Maximizing market power - and thus market valuation - by focusing on 'good' revenues and avoiding 'bad' or 'neutral' revenues; (3) For companies marketing new technologies and products in emerging categories - why it is critical to identify and flush out the 'pragmatists in drag', before you waste precious resources courting them for business; (4) When it is important to invent a new category rather than stay in a crowded one; (5) The best recipe for partnering when what you are after is increased deal-flow.

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And you thought surviving in the high-tech business was tough...

The apparent suicide in late February of Bernard Loiseau, one of France's most celebrated chefs, shocked many people and was amply covered in the international press. It was widely speculated that his death resulted from an attack of depression after his famous restaurant - the Cote d'Or in Saulieu, Bourgogne - was downgraded from a 19 (on a scale of 20) to 17 by the respected Gault Millau restaurant guide. Here are a few reactions from people who were close to Loiseau, taken from the story in the Feb. 26 edition of the San Jose Mercury News:

"All these people, all these exceptional beings who give you the impression of so much assurance, they are all very fragile. They all have such strong moments of doubt."

- Dominique Loiseau, wife of Bernard Loiseau

"I think Gault Millau killed him. When you are the leader of the pack, and all of a sudden they cut you down, it's hard to understand. It hit him hard."

- Paul Bocuse, another famous innovator of 'nouvelle cuisine'

"We are in a trade where, behind the façade, there's a lot of pain, a lot of fatigue. What puts us under pressure is the quality that starts in the head, with the combination of commerce and art."

- Pierre Gagnaire, another noted culinary star

In times like these, which have on occasion been particularly dispiriting for high-tech entrepreneurs, executives, and professionals, this unhappy ending to a successful life gives pause for thought to all competitive, ambitious people to consider how easy it is to get too caught up in the cut and thrust of one's work, and forget to put sufficient balance in our lives.

1. Advice to Microsoft on Commodity Software (article by David Stutz, formerly of Microsoft)

David Stutz, former Microsoft open source guru, presents a tough, contrarian point of view of Microsoft's reluctance to really adopt the (internet) network as the center of the computing universe, as it continues to insist on implement its PC-centric view of the world. Stutz describes convincingly why this places the Redmond giant in risky waters going forward.

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The market for shrink-wrap PC software began its slow upmarket ooze into Christensen obsolescence right around the time that Microsoft really hit its stride. That was also the time of the Internet wave, a phenomenon that Microsoft co-opted without ever really internalizing into product wisdom. While those qualified to move the state of the art forward went down in the millennial flames of the dotcom crash, Microsoft's rigorous belief in the physics of business reality saved both the day and the profits. But the tide had turned, and a realization that "the net" was a far more interesting place than "the PC" began to creep into the heads of consumers and enterprises alike.

During this period, most core Microsoft products missed the Internet wave, even while claiming to be leading the parade. Office has yet to move past the document abstraction, despite the world's widespread understanding that websites (HTML, HTTP, various embedded content types, and Apache mods) are very useful things. Windows has yet to move past its PC-centric roots to capture a significant part of the larger network space, although it makes a hell of a good client. Microsoft developer tools have yet to embrace the loosely coupled mindset that today's leading edge developers apply to work and play.

Microsoft's reluctance to adopt networked ways is understandable. Their advantaged position has been built over the years by adhering to the tenet that software running on a PC is the natural point at which to integrate hardware and applications. Unfortunately, network protocols have turned out to be a far better fit for this middleman role, and Microsoft, intent on propping up the PC franchise, has had to resist fully embracing the network integration model. This corporate case of denial has left a vacuum, of course, into which hardware companies, enterprises, and disgruntled Microsoft wannabes have poured huge quantities of often inferior, but nonetheless requirements-driven, open source software. Microsoft still builds the world's best client software, but the biggest opportunity is no longer the client. It still commands the biggest margin, but networked software will eventually eclipse client-only software.

As networked computing infrastructure matures, the PC client business will remain important in the same way that automotive manufacturers, rail carriers, and phone companies remained important while their own networks matured. The PC form factor will push forward; the Pocket PC, the Tablet PC, and other forms will emerge. But automakers, railroads, and phone companies actually manufacture their products, rather than selling intangible bits on a CD to hardware partners. Will Microsoft continue to convince its partners that software is distinctly valuable by itself? Or will the commodity nature of software turn the industry on its head? The

hardware companies, who actually manufacture the machines, smell blood in the water, and the open source software movement is the result.

Especially in a maturing market, software expertise still matters, and Microsoft may very well be able to sidestep irrelevance as it has in the past. The term "PC franchise" is not just a soundbite; the number of programs written for the PC that do something useful (drive a loom, control a milling machine, create a spreadsheet template, edit a recording...) is tremendous. But to continue leading the pack, Microsoft must innovate quickly. If the PC is all that the future holds, then growth prospects are bleak. I've spent a lot of time during the last few years participating in damage-control of various sorts, and I respect the need for serious adult supervision. Recovering from current external perceptions of Microsoft as a paranoid, untrustworthy, greedy, petty, and politically inept organization will take years. Being the lowest cost commodity producer during such a recovery will be arduous, and will have the side-effect of changing Microsoft into a place where creative managers and accountants, rather than visionaries, will call the shots.

If Microsoft is unable to innovate quickly enough, or to adapt to embrace network-based integration, the threat that it faces is the erosion of the economic value of software being caused by the open source software movement. This is not just Linux. Linux is certainly a threat to Microsoft's less-than-perfect server software right now (and to its desktop in the not-too-distant future), but open source software in general, running especially on the Windows operating system, is a much bigger threat. As the quality of this software improves, there will be less and less reason to pay for core software-only assets that have become stylized categories over the years: Microsoft sells OFFICE (the suite) while people may only need a small part of Word or a bit of Access. Microsoft sells WINDOWS (the platform) but a small org might just need a website, or a fileserver. It no longer fits Microsoft's business model to have many individual offerings and to innovate with new application software. Unfortunately, this is exactly where free software excels and is making inroads. One-size-fits-all, one-app-is-all-you-need, one-api-and-damn-the-torpedoes has turned out to be an imperfect strategy for the long haul.

Digging in against open source commoditization won't work - it would be like digging in against the Internet, which Microsoft tried for a while before getting wise. Any move towards cutting off alternatives by limiting interoperability or integration options would be fraught with danger, since it would enrage customers, accelerate the divergence of the open source platform, and have other undesirable results. Despite this, Microsoft is at risk of following this path, due to the corporate delusion that goes by many names: "better together," "unified platform," and "integrated software." There is false hope in Redmond that these outmoded approaches to software integration will attract and keep international markets, governments, academics, and most importantly, innovators, safely within the Microsoft sphere of influence. But they won't.

Exciting new networked applications are being written. Time is not standing still. Microsoft must survive and prosper by learning from the open source software movement and by borrowing from and improving its techniques. Open source software is as large and powerful a wave as the Internet was, and is rapidly accreting into a legitimate alternative to Windows. It can and should be harnessed. To avoid dire consequences, Microsoft should favor an approach that tolerates and embraces the diversity of the open source approach, especially when network-based integration is involved. There are many clever and motivated people out there, who have many different reasons to avoid buying directly into a Microsoft proprietary stack. Microsoft must employ diplomacy to woo these accounts; stubborn insistence will be both counterproductive and ineffective. Microsoft cannot prosper during the open source wave as an island, with a defenses built out of litigation and proprietary protocols.

Why be distracted into looking backwards by the commodity cloners of open source? Useful as cloning may be for price-sensitive consumers, the commodity business is low-margin and high-risk. There is a new frontier, where software "collectives" are being built with ad hoc protocols and with clustered devices. Robotics and automation of all sorts is exposing a demand for

sophisticated new ways of thinking. Consumers have an unslackable thirst for new forms of entertainment. And hardware vendors continue to push towards architectures that will fundamentally change the way that software is built by introducing fine-grained concurrency that simply cannot be ignored. There is no clear consensus on systems or application models for these areas. Useful software written above the level of the single device will command high margins for a long time to come.

Stop looking over your shoulder and invent something!

2. Observations on Dealing with Painful Challenges Facing Most Software Companies

This section provides some brief thoughts on how to deal with a range of commonly found challenges confronting companies during the current prolonged economic downturn, which - lest we forget - began three years ago on March 10, 2000, at the apocalyptic point when the Nasdaq hit its peak of over 5,000 for the only, and last, time. In one or two cases, I am reprising themes and comments made in past issues of Under the Buzz, simply because I still see many cases where the advice dispensed months ago has not yet been heard or absorbed.

(a) Dealing with the “Quadruple Whammy” Impacting Every High-Tech Company

As a young or maturing public enterprise software or systems company, you have been judged guilty by disenchanted investors of deriving your leverage from an Asset Class (stocks) that is now thought to be of ill repute. Even if you are in a privately funded company, you have been buffeted by the same winds. Furthermore, your Industry Sector (enterprise software or systems) is seen by investors today as still excessively volatile while becoming a ‘mature’ and less-exciting industry; thirdly, your specific Category (be it a vertical, functional or horizontal application, or an infrastructure offering) is increasingly seen as something either unclear and not compelling, or clear but not necessarily critical to enterprise customers - no matter how exciting or groundbreaking you are convinced that it is; finally, your Company (as a player in its given Category, Industry Sector, and Asset Class) is being harshly second-guessed on every aspect of your performance, be it traction with customers, share of desirable target markets, license vs. service/other revenues, growth rate vs. closest competitors, profitability, and stock price. Consequently, in many cases your market cap more-than-sucks; even more humiliating, your valuation on the ‘enterprise value’ chart (this metric is calculated by subtracting cash from market cap) could be zero or negative. What reward for several years toiling to build a product, close deals with some customers, and support demanding implementations!

If this is not enough to wear down any remaining optimists in the ranks of today’s tech companies, you must be a proper masochist! Not surprisingly, many executives and professionals with whom I interact in my daily business are tending to exhibit clear signs of ‘battle fatigue’ (after all, no one is made of steel!), and above are some of the reasons why. All this, without considering the existential and career questions we all ask on a personal level from time to time, such as: Am I in the right job? Do I still have what it takes to be successful in this situation? Am I in an organization that can come through this challenging time as unscathed and intact as possible, ready to thrive in a more forgiving atmosphere? And so on.

Besides commiserating, how can you turn this protracted drama to your advantage? Well, to begin with, keep in mind what you already know at a rational level (but may have emotionally forgotten): i.e., that this situation isn’t ‘personal’, every company in high tech is undergoing the same torture. Secondly, keep in mind that this type of ‘nuclear winter’ tends to flush out all the flaky businesses and people that managed to thrive during the over-forgiving good times, so survival in this stage will almost certainly lead to some kind of ‘thrival’ when things turn upwards.

The only ‘bad’ risk to avoid, to my mind, is staying in an organization where you cannot avoid feeling as if you are standing still, or going backwards - not in material terms, but in terms of learning new skills and having rich experiences. In other words, make sure you are involved in

meaty challenges that get your blood flowing, and avoid the dead spots in your company, your business, or your industry.

(b) Maximizing Market Power by Avoiding Bad Revenues and Focusing on Good Revenues

One of the most common tendencies that affect most of us when we are under pressure to produce revenues 'at any cost' is that we do just that: in being so desperate to succeed, we become excessively tactical, accepting any deal, and even any opportunity to compete for a deal. And, today's climate is more pressured than most. So we may end up competing in response to an RFP (Request for Proposal) - always a questionable idea, in my view - and doing anything short of selling our children to close it, even if we suspect that we shall be hard put to deliver what the customer is asking for on time and on spec. But, I would ask, isn't this exactly the time to say no to deals in which we have not done anything to prove our unique value, and, therefore, we shouldn't be doing - either because we're being crucified on price, or because we're being unbearably stretched for resource to deliver the solution? On the other hand, doesn't my line of questioning fly in the face of the conventional wisdom that preaches the need to be customer-driven, sales-focused and so on - isn't any deal in a downturn a good deal, as long as it pays you money?

Well, I must emphasize that it is critical at *all* times, *especially* in lean times, to avoid 'bad-revenue' deals, or even 'neutral-revenue' ones. What exactly might these undesirable deals look like, you might ask? Well, in line with the discussion above about RFP-based opportunities, bad revenue can result when we compete for a large, attractive deal that in reality we have no hope of implementing successfully, that might eventually result in disputes with the customer, and even losing the customer's future business. The implications of committing this mistake can also be considerable: for example, while we are closing or implementing a deal we cannot rightfully deliver on, we are missing other opportunities to close good-revenue business; we are also wearing out our resources to service the customer and so on. Other examples of bad-revenue business are deals sold below cost, thus generating a loss, or deals that take way too long to close, thus generating high cost of sales (often unmeasured, but nonetheless deadly), or deals closed with poorly qualified customers, that can result in delayed implementation. The list goes on.

Neutral revenue may not sound so threatening, but if you consider that most high-tech companies - especially in a downturn - are 'opportunity rich, resource poor', the risk to the business of spending valuable resources on the wrong objective can often be slowly catastrophic. For start-ups and other young companies, the cost of pursuing and closing a deal with a customer (or many customers) in markets where this deal does not make it *measurably easier* to close the next similar deal, and thus lead towards leading or dominant share in that market segment, might result in neutral revenues. In committing to winning business in any market, the company risks committing precious engineering, implementation, and support resources in a way that prevents you allocating them to a more leverageable customer situation later on.

Thus I would claim that it is the single most important responsibility of every high-tech executive team to ensure that their company establishes clear dominance in a specific target market that the world cares about. I would argue that this is the single most powerful source of sustainable competitive advantage for most tech companies. The other types of competitive power - category power, industry power, and offer power - are respectively more risky or fleeting (category power), more difficult to conquer (industry power), or more subject to constant leapfrogging (offer power). I shall say more on these different elements of competitive power in a future edition.

(c) When it is better to invent a new category rather than inhabiting a crowded one

If your company is marketing a product that is testifiably superior in functionality to all others in a category that happens to be overcrowded with competing claimants to category leadership,

should you focus on (a) differentiating your product against the other products in the category, (b) 'hijacking' another existing category, or (c) championing a new category?

My answer to this question is...it depends. If, for example, the crowded category is regarded by the marketplace as highly investable and established (a good metric for judging this is that customers will have a budget in place for making purchases of products in this category, and they may already have made acquisitions in the past), then you should probably consider remaining in the category and paying a lot of attention to differentiating your offering vs. those of your competitors, either by virtue of your functionality, the completeness of your solution for specific customer sets, or whatever. Unless, that is, there is already a dominant 'gorilla' player winning a large percentage (50%-70%) of all closed deals.

On the other hand, if this category has not yet become investable, or has fallen on relatively hard times after a promising start, as many internet-software categories have done (including strategic or MRO procurement/sourcing software, eCRM applications, content management, knowledge management, EAI, and many others), you should seriously consider hijacking an adjacent category, or even defining your own new category. However, in order for this not be simply an exercise in delusional wish-fulfillment, or the inspiration for a lengthy and expensive exercise in 'positioning', one relatively simple and practical way of reaching a productive outcome is to identify the most serious customer problems (broken mission-critical processes being the top of the heap in this regard) that your product is capable of solving, and name the category after the problem. This relatively 'uncreative' approach is nonetheless completely in tune with how pragmatic customers, who represent the main voting block among all potential customers to determine whether you have a viable category (or business), think in terms of their worst problems and the IT solutions they are looking for to solve them.

Thus, you should not be surprised if the best category names at this stage sound like applications rather than technologies: for example, a business analytics or a knowledge management technology - two categories that have spent some time in the chasm - might be used to help large enterprise call centers to deploy a call resolution application, where the latter name becomes the category name for the time being. This does not prevent the company from applying their technology to solving critical enterprise business problems in different areas later on, but it does serve as a tangible iteration of value created for a given set of customers. Therefore, the main priority in the early stage of proving the investability of a new category is to target it at a set of customers who have a corresponding broken, mission-critical process that can take full advantage of what the new technology allows customers to do.

(d) For Companies in Emerging Product Categories - Flushing out the 'Pragmatist in Drag'

If a company's primary product category - or, for companies with a portfolio of products, if one of their more important product categories - looks like it is in the Early Market adoption stage, one of the most critical risks to beware of is when you have to deal with 'faux visionaries', or what I call 'pragmatists in drag'. These are the individuals to be found among any group of more adventurous types who show early interest in buying new technologies, either because they are willing to attend a new-product seminar or high-tech conference, or because they are willing to take a vendor's call in order to discuss how a new-ish technology can help them. Often they are in the majority at any forum, simply because there are always many more pragmatists and conservatives in any grouping than there are visionaries. Not that there's anything inherently wrong with being a pragmatist - so I shall not suggest that vendors should marginalize or otherwise 'penalize' this class of potential customer. In reality, the vendor's role in these situations is to provide early relief to an individual who has no expectation of buying the new thing at all. In fact, they are just checking it out for future reference, to make sure that they are not being left behind by the people they consider to be their peers in terms of IT investment. Occasionally, they feel compelled to convince themselves that they are ready to buy, but in fact they are not. Thus, their posturing behavior is merely a defense mechanism against looking

foolish. In my view, it is the vendor's job to save them the trouble and, in doing so, conserve the vendor's own precious resources.

In support of this analysis, I hope it's clear that pragmatists will almost never make an IT investment decision based on an 'upside' advantage; instead, the motivation that pushes them over the edge into a purchase decision is exclusively to solve a 'downside' risk or actual problem. So, as you listen to their statements about making IT investments in aggressive pursuit of 'strategic competitive advantage', you can be sure that sooner or later they will reveal their true selves. How, you might ask? Well, almost invariably they will get to their favorite question, which is asked with a worried look on their face, "So, who else is doing this?" What they are expecting to hear is an elaborate lie from the vendor executive or salesperson, to the effect that there are a number of committed customers. The problem is none of these customers are seen as equals by the pragmatist in question. (In contrast, the true visionary asks the same question with a look of anticipation, as they wait for the vendor to confirm that, 'there are only one or two other customers just like you, but no one in your specific market segment', so they can still imagine getting ahead of their competitors by making this investment).

After you have confirmed that your category (not just *your* product, but the overall category to which your product belongs) is indeed in the early market stage of adoption, it is imperative that you vaccinate every executive, marketing/sales manager, and sales person in the company against jumping to the conclusion that, just because they talk like a visionary, they will act as one. A simple, but foolproof way of double-checking whether they really are a visionary buyer or not is to ask them about their 'vision' for using the new technology. Whereas a bona fide visionary will immediately launch into a description of the risky, but groundbreaking project that they have in mind, pragmatists wearing drag will inevitably have no answer to this challenge other than to allege unconvincingly, "we are evaluating all the alternatives, blah, blah, blah..." In fact, you should not be surprised if they appear irritated or flustered by your question, because what you are actually doing is calling their bluff. Once they have admitted to the lack of any established purpose for using this new type of technology or product, you can be sure that all they are doing is reconnoitering.

The Prescription for Dealing with Visionaries and Pragmatists During the Early Market:

That said, I am not saying that you cannot or should not try to close sales with pragmatists during this stage. In fact, it is both feasible, desirable, and inevitable that you will market to pragmatists during the early market. What is *unforgivable* is to treat them like visionaries. In other words, you must have two sets of rules of engagement for visionaries and pragmatists during this stage. For visionaries, who are extremely demanding but willing to rely on their own judgment in deciding to invest, you must be prepared to adopt a reasonable 'whatever it takes' approach to satisfying their need to achieve the competitive advantage, including custom feature enhancements, your best consulting and technical support, and so on. In contrast, for pragmatists at this stage, it is essential to set clear rules, starting by defining their type of investment decision as a 'pilot', and structuring your support, training, and pricing accordingly.

Thus, for example, whereas a custom project for a bona fide visionary customer may end up amounting to a \$2M-\$5M investment or more, your typical pilot for pragmatist customers might be priced as a \$100K-\$200K license with some training and support. In most cases, you should let your pragmatist customers know that custom enhancements to the available product cannot be undertaken unless they are fully paid for at custom development rates (and even this may be risky for you to propose, if like most companies your development resources are already heavily subscribed to visionary projects). At all costs, you must not provide them with the same services you accord to visionary customers, because this will result in huge wastage, reflected in interminable sales cycles and unprofitable revenues.

In conclusion, failing to administer this vaccine and implement these distinct rules of engagement will inevitably result in costly, and even fatal, investments in 'big deals' that go nowhere. And, in

today's cruel environment, most young companies (and even more established players) can ill afford to miss out on more than a few of these before they run out of funding.

(e) The best recipe for partnering for deal-flow

Isn't it interesting how most companies use strategic, even flowery language to describe why they want to partner with a given third party, while avoiding plain, to-the-point language such as, "We're interested in seeking a partnership with your organization in order to increase our flow of business; in return, we shall help you to solve the critical problem you have described in the area of....." In other words, as obvious as it is to restate this, it is critical to appeal to the enlightened self-interest of the other side, before you can expect them to commit to any specific, meaningful efforts to benefit your company.

In my experience, tech companies tend to seek marketing alliances in order to secure deal-flow from other companies that are in stronger market positions than they are. Unfortunately, initiating a partnership dialogue by requesting that the third party be willing to bring you into their deals tends to be a non-starter, because in most cases the courted company is operating on a different agenda and timeline, and may not see a clear "WIIFM" (what's in it for me) connection.

On the other hand, in an age of relatively 'open' systems, partnering has become a fundamental business-generation tool for most high-tech companies, so no one doubts that is a reality in our industry. It's just that there is tremendous wastage of effort, and burned relationships along the way. So, in order to avoid wasting everyone's time, what approaches should companies adopt in order to establish a productive alliance?

Recognizing that all business relationships are to some degree a function of *relative power*, it is critical to make an accurate assessment of where your company's power resides, what kind of power you possess (*category power*, or *customer power*, or *industry power*, or *offer power*), and what critical types of power you need, but do not have at your direct disposal. This will give you a rational view of why you need to partner, and with what type of company you should seek a relationship.

Secondly, and perhaps most importantly, it is important to evaluate how much of your real power you are willing to place at the service of your pretended partner, i.e., what will you give them before you expect to receive anything in return. The answer to this question will help you to provide them with a satisfactory response to their "WIIFM" question.

Thirdly, you need to determine what you are going to ask for in return for what you have been willing to give up, making sure to be as realistic as possible about the balance in this deal.

Fourthly, once you have agreed with your partner that the exchange is a fair one, you need to agree on resources, time commitments, and penalties for pursuing your joint/separate objectives.

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