Under the Buzz

Back to Basics in e-Business

April 2003 - Vol. 4, Number 4

Under the Buzz is an electronic "viewsletter" 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. **The Strategic Value of Maintenance (Yes, I'm Serious!)**

   Almost universally, tech companies treat maintenance as an afterthought, and real customer satisfaction levels and revenues suffer as a result. This article describes why maintenance contracts provide a strategic opportunity to fortify customer relationships and ramp up revenues, in addition to serving the tactical purpose of providing much needed cash during a general or company-specific downturn, when a real turnaround strategy becomes crucial.

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Note from Author

For those readers who care about such things, this month's edition is number thirty-six in the series since Under the Buzz was first published in May 2000 - just a month after the internet bubble finally burst with the crash of the Nasdaq. At the time it seemed to me that almost a decade of frenetic buying by enterprise and other customers had drawn almost everyone in high tech into a pattern of behavior in which a strikingly absent feature was plain old common sense. Such was the nonsense I saw happening almost everywhere in the marketplace, embodied in the euphoric attitudes of company executives, financial analysts, venture capitalists, and many others, that I decided to make my own small contribution to the restoration of good sense. Three years later, I believe the same 'raison d'etre' remains relevant. Therefore, I expect to maintain my focus on presenting ideas and hints on strategic issues and sound management practices that seem to me critical to the recovery of our maturing – but still immature – industry.

Quotes from a Fascinating New Book on the Role of the Company in Western Economies

Countering widespread concerns today about the adverse effects of corporate malfeasance on individual prosperity and collective freedoms, a recent new book convincingly extols the virtues of a 19th century invention that most of us take for granted – and some even revile – today. I am referring to the joint-stock limited-liability company. The authors, John Micklethwait and Adrian Wooldridge, are journalists on the staff of the Economist magazine. In their book, *The Company: A Short History of a Revolutionary Idea*, they talk about the role of the company in unleashing capital from the constraints of family partnerships or state control, *"revolutionizing productivity, showering consumers with a relentless series of innovations and driving the first great age of globalization."* In a related Wall Street Journal op-ed article dated April 9, 2003 and entitled "The Company Way," the same authors point out how *"the much-vilified private-sector company has been the West's secret weapon"* in establishing enduring strategic advantages against earlier civilizations such as the Chinese or Ottoman empires, or against recent approaches such as the centrally-planned, state-controlled systems of socialism and communism:

"Hegel predicted that the basic unit of modern society would be the state, Marx that it would be the commune, and Lenin and Hitler that it would be the political party. Before that, a succession

of saints and sages claimed the same thing for parish church, the feudal manor, and the monarchy. But they have all been proved wrong. The most important organization in the world is the company, the basis of the prosperity of the West and the best hope for the future of the rest of the world. Indeed, for most of us, the company's only real rival for our time and energy is the one that is taken for granted: -- the family."

- "The Company: A Short History of a Revolutionary Idea" by John Micklethwait & Adrian Wooldridge

"The limited-liability corporation is the greatest single discovery of modern times. Even steam and electricity would be reduced to comparative impotence without it."

- Nicholas Murray Butler, sage of the Progressive Era, quoted in "The Company: A Short History of a Revolutionary Idea" by John Micklethwait & Adrian Wooldridge

"The joint-stock company was the first autonomous institution in hundreds of years, the first to create a power center that was within society yet independent of the central government of the nation state."

- Peter Drucker, quoted in "The Company Way," The Wall Street Journal op-ed article by John Micklethwait & Adrian Wooldridge

1. The Strategic Value of Maintenance

Imagine if you will an industry slump so abrupt that virtually every participant in it becomes to some degree a 'turnaround opportunity', or – if you prefer slightly less drastic language – a 'business reinvention' opportunity. Of course, you'd have to have lived in a cave for the past three years not to be hyper-aware that we are in the middle of just such a downturn. In fact, most enterprise software, systems and services businesses are still experiencing the spasms of the post-2000 quake. This manifests itself in the fact that as many as 90% of these companies are saddled by chronically weak new-business pipelines, often not covering more than 80% of their target revenues and usually containing (among other defects) a large percentage of apparently qualified though virtually uncloseable deals.

How can they expect to regenerate growth in an environment where maintaining flat revenues is seen as a true accomplishment? Not surprisingly, most companies have recognized sooner or later that much (or most) of what they were doing in the bubble years will no longer work today, especially the hit-and-run, product-focused sales approach that was prevalent in the nineties. Inevitably, one of the first targets for review is the company's market growth strategy for selling new products and services, followed by a review of their sales strategy, usually to render it more consultative. Of course, with rare exceptions new go-to-market initiatives tend to take two quarters or more before beginning to bear real fruit, and in any case relying too heavily on new-business generation is risky during a time when deals tend to take longer to close. In the other direction, a Wall Street Journal article published yesterday (04.21.03) highlighted the debate about Oracle's increasing reliance on software maintenance revenues (which grew 16% vs. a 4% decline in new-business licenses, and represented no less than a whopping 43% of fiscal third quarter $2.31B in revenues) and its increasingly negative effects on the company's valuation multiples. Since Oracle's maturing database and ERP businesses tend to skew the ratios that most younger companies would consider healthy for valuations, I would argue that a desirable objective for companies spanning the growth spectrum should be to generate annual maintenance revenues equivalent to 20%-40% of total revenues. A direct revenue share of this magnitude contributes crucially to paying fixed operating expenses, leaving new-business licenses and implementation services to drive real growth. Without knowing exactly how Oracle manages its maintenance business, it does at least look like the company takes the business seriously. The case I want to make here advocates not only managing maintenance as a true, almost separate, line of business with its own recurring-revenue business model, but maximizing the strategic leverage it provides for (a) optimizing customer relationships and (b) as a direct consequence, generating a host of other new revenues. In order to identify how to achieve results in the short-term as well as increase the overall health of the business, I suggest we look at the revenue problem from two related but distinct angles.

First question: What is arguably the most neglected revenue source and opportunity in most software-centric technology businesses? Can you imagine any more mismanaged business commitment than the maintenance contract, normally an afterthought left to administrative and legal people to take care of, almost invariably on a reactive basis, when customers bring up concerns about support, or when they query the value of their legally binding commitments to software investments that come under the microscope? Of the 30 or 40 software companies I know well, I can think of only a handful that take proper care of this critical activity, and none that address it as the bona fide cross-selling or up-selling opportunity that it can quickly become, assuming upgrade commitments and support requests fulfill customers' expectations over time.

In reality, there seems to be so much negative baggage to take account of in the fog of post-bubbledom that it might take years before your average enterprise software management team starts treating this apparent back-office activity as, in effect, a line of business to be leveraged as a tool for business generation – quite apart from its potential value in driving increased customer satisfaction. My own reasons for being so convinced about this relate to past experience in my own company during the 1980's (when a previous era of flakiness was ushered in by the PC/LAN revolution), as well as my time as a country manager in the once-successful overseas subsidiary of a major mainframe DBMS/ERP software company where we managed to pull off a dramatic turnaround, in large part as a result of our decision to address maintenance contracts as our first order of priorities for ramping up revenues. What many executives seem to forget today is that, depending on the exact percentage charged, maintenance commonly represents a second investment equivalent to the initial license fee over five years or so; and, in fact, this is how savvy enterprise customers measure their IT investments – they are paying the vendor twice over for the same software, and expect to be taken care of during the entire life of the investment, with regular upgrades and responsive support. [Author's note: Although the structure of maintenance agreements tends to vary – some include upgrades as well as support, others only include support and keep upgrades separate – for the purposes of this article, I am defining both software upgrades and ongoing support as the two key components of the maintenance relationship, independently of how they are charged or delivered.]

My second question is this: What is the quickest way to gain executive-level attention, especially in existing customer organizations? If, like most enterprise software companies, your company is aiming to gain access to senior executives, in order (among other things) to gauge the current level of satisfaction in the account and identify new opportunities for follow-on sales, what quicker way is there of gaining executive-level attention than requesting a meeting to discuss your customer's level of satisfaction with support services received and potential new requirements, within the context of their existing maintenance contract? Although the most likely person to respond may not be your preferred target executive for their business requirements, you will unfailingly get the attention of the CFO, controller, or legal counsel. And this can be used as a start toward gaining access to the interested departments or lines of business that most use or need your company's products or services.

The strategy I am about to recommend does of course presuppose that you have an existing business, with an installed base of customers who have in-force maintenance contracts, even if they are – as is often the case – in some state of neglect. In cases where such contracts have lapsed or been canceled, the situation is often still recoverable, assuming it is addressed with the appropriate level of seriousness, including a suitable apology by the vendor company, if necessary. Plainly put, I would argue that *proactively managing maintenance presents the second quickest source of profit growth, and the quickest source of revenue growth*, in many situations. If you further consider the dire straits in which so many tech companies find themselves today, especially with respect to their ability to close business and drive increased revenues, it doesn't take long to see how valuable a role something so apparently banal as maintenance can assume in sanitizing a company's business and, more importantly, leveraging new growth.

Example of a Business Recovery Strategy – Main Priorities

So, with the current economic climate in mind, let's consider where taking care of maintenance relationships would fit in the possible order of priorities for any executive team that is seeking to eliminate losses and regenerate sales in an enterprise software or systems company with customer base that may have suffered neglect (even slight) with respect to its existing implementation and/or ongoing technical support:

1. Define the new business vision: In particular, as I have mentioned in prior issues, the executive team should redefine the company's vision and mission in terms of the mission-critical problems that your company helps enterprise and government customers to solve, rather than in terms of the products you make. It's important here to restate the company's commitment to serving existing as well as new customers, making sure not to stop at the rhetoric (if truth be told, most software companies still tend to favor the latter over the former except when they need positive references to help close a deal with a new customer).
2. Define the recovery strategy and action plan in distinct stages:
    a. Stem the losses by reducing operating expenses, new/ongoing investments, etc.
    b. *Revamp your customer relationship management approach, starting by cleaning up maintenance relationships.*
    c. Scrub the pipeline, review qualification criteria, recompose account teams as necessary to revitalize slow-moving sales opportunities, conduct win/loss assessments to clean up the business-as-usual practices, and so on.
    d. Exploit high-growth opportunities from existing or new high-growth potential products and focused target market initiatives.
3. Define the success criteria you intend to be measured by:
    a. *Quantitative metrics for 2b*: Increased opt-in rates, increased percentage of maximum achievable maintenance revenues, increased percentage of total revenues within optimal range, direct leverage for other lines of business, influence on increased revenues overall, influence on stock price or valuation (due to resulting business stability), etc.
    b. *Qualitative metrics for 2b*: Increased levels of customer satisfaction, improved credibility with customer executives, visible linkage to decisions to buy new products or services, increases in partner commitment, clear impact on improved employee morale.

Note in priority 2 that the main drivers of increased profits and revenues are listed in order of priority with respect to *when* they can be expected to produce results. Recognizing that reductions in operating expenses and ongoing investments are usually the first order of the day in any turnaround – and companies have focused heavily on this item in the past three years – I want to draw your attention to item 2b because of the relatively untapped opportunity it represents in both tactical and strategic terms for many companies: *"Revamp your customer relationship management approach, starting by cleaning up maintenance relationships."* Notice my suggestion that this 'clean-up' program needs to be driven from within a larger vision that reframes its purpose in terms of the problems that it helps specific groups of customers to solve. There are two powerful reasons for this: first, I have yet to see a tech company fail when as a matter of routine it really takes care of its customers in a businesslike way, and for the right reasons; second, the most frequent recourse for getting a company out of the doldrums (i.e., announcing a new market initiative) is not usually aimed specifically at regenerating confidence and loyalty among your most precious existing market 'assets' – in other words, the customers 'that brung you here'.

Program #1 for Transforming Customer Satisfaction Levels and Influencing New Business

Apart from adopting a newly proactive posture toward managing customer relationships, the executive team needs to appoint an experienced ad hoc team containing A players (even if you have to take them away from new-business focused activities) to proactively drive an ongoing program (more on this below). As I've already mentioned, past experience shows that enterprise software companies commonly neglect this side of the business, probably because they see it as a less 'glamorous' activity (although as Wall Street analysts get smarter about how to gauge the performance of tech companies, the health of recurring revenue streams – the main one being maintenance – is becoming a greater point of focus for assessing company performance). In terms of positive results to be achieved from handling maintenance relationships proactively, I would estimate that there are three significant quantitative benefits (quite apart from intangibles such as improved customer loyalty), one being a direct hard-dollar outcome, the other two being levers for increased revenues in other areas and a more stable valuation:

1. **Recovery of lost (or jeopardized) revenues** caused by out-of-norm maintenance contracts: from past experience the shortfall can be as much as 50%-70% below maximum achievable maintenance revenues (shocking, I know, but this indicates the degree of neglect committed by some companies over time). Naturally, the amount of recoverable revenues in the short-term (i.e., one or two quarters) will depend on the mix of imminent and further-out contract renewal dates, but over time it can be as much as 80% of the shortfall, taking into account unrecoverable situations, installation phase outs, and even employee layoffs, which have been a serious concern to software companies during the current recession.

2. **Leveraged-revenue opportunities** resulting from a contract review – these can range from expanded deployments of the installed product and/or sales of new products or services (such as implementation consulting, upgrade management, training, and so on).

3. **Favorable impact on company valuation** provided that maintenance revenues are in balance with other revenue sources appropriate to the profile of each company's business, with respect to categories such as new license fees for emerging and mature products, consulting and training services, and so on.

In most cases the direct revenue-recovery payback is just the tip of the iceberg, because it can be dwarfed by other associated benefits, including contracts that were to be canceled altogether eventually being renewed once the vendor and customer have established a new rapport; revenues from increased deployments as a result of problems being addressed in the maintenance recovery program; and, sales of new products and/or implementation-related services. <u>*Note that overall revenue increases equivalent to 5%-20% of total current revenues are not out of the question in certain cases when all of these benefits are added up*</u>. Even if the results are slightly below these percentages, they are almost invariably well worth the trouble, especially in the current climate of new-business droughts.

Positive Effects on New-Business Revenues

If you haven't actually seen it happen, it can be difficult to recognize just how dramatically a proactive maintenance management program can influence new business but, make no mistake, it can make a big difference. In particular, as enterprise software companies begin to implement practices that get them away from the account *mis*management practices of the nineties, one of the selling barriers that most of them face is how to gain access to 'C' level executives, who currently hold virtually all of the sign-off authority for new IT investments. My argument is this: if you fail to recognize maintenance as potentially the quickest and easiest way of getting executive-level attention in your customer organization, you are indeed looking a gift horse in the mouth.

My experience as a software-company founder and CEO, as well as in a separate stint as a country manager, demonstrated amply how easy it is/was to get a meeting with a CFO, CIO, or even a line-of-business executive sponsor in order to “conduct a brief review of the customer’s current deployment and implementation status and requirements, in the context of the existing contract.” Surprising as it may seem to some readers, as a rule enterprise customers actually *want* a formalized ongoing business relationship with their product and service providers for the important purpose of having assurance of continuity of support and assistance when needed; furthermore, their ‘good corporate citizen’ culture influences them to be in good standing with their preferred vendors, provided they are well served by them. In my own past experience, on a number of occasions we actually helped customer executives to see exactly how out of phase their existing contract was, in terms of contracted licenses vs. actual licenses installed or required (in many cases, they were aware that the deployment had grown informally, and were either concerned to regularize the situation or waiting for us to contact them for a review), and they were quick to sign up for a revised number and pay the difference. Incidentally, paying close attention to maintenance and support is also a powerful antidote against user-driven piracy, especially if you keep the customer’s delegated sponsors actively engaged in managing support activities.

In other instances, the first formal encounter with the customer team often spurred a discussion of new requirements (either for more licenses not previously contemplated, or for a new upgrade or new product), which quickly led to further meetings with the new departments involved, in order to formalize a new contract. Whatever the follow-on benefit, the fact is that when you sit down with a customer executive to discuss their maintenance agreement, you can be virtually certain of (a) getting their attention and (b) initiating discussions on equal terms, as a relatively trusted outsider.

Once you accept that this activity warrants a proactive, programmatic approach, I would recommend a step-by-step process, as described below. After as little as one to three months, with some initial results from a selected pool of target customers under your belt, you can expand the program to include *all existing and new customers*, and then hardwire it into your company’s way of doing business. Besides being an eminently desirable and rewarding thing to do, failure to manage ongoing customer relationships with this level of seriousness will, I would argue, not be an option in the coming age of business process management, when customers’ reliance on their service providers and vendors will be truly mission-critical (and explicitly laid out in detailed SLAs).

Step-by-Step Approach to Managing Maintenance Relationships

Here are the key components of a successful customer relationship management program based on maintenance contract reviews as a key means of gauging current satisfaction levels, existing and new license requirements, and so on:

- <u>Step One</u>: Form a cross-functional Contract Review Team composed of one or two experienced, consultative account managers, plus a business consultant or SE (field technical support engineer), and the CFO, legal counsel and/or contract administrator. Define an initial stretch goal for the team to reduce the maintenance revenue ‘gap’ (between maximum potential and current actual revenues) by, say, 70% in two quarters. This goal can later be amended as appropriate, once the team knows the exact profile of the opportunity and challenge facing it.

- <u>Step Two</u>: Conduct a quick and dirty inventory of key customers in the installed base, including customer satisfaction levels recorded in recent interactions with internal sponsors, lead end users, and so on. Consult account teams as appropriate for detailed information on the customer relationship, their organization, and political dynamics.

- Step Three: Prioritize a target list of 10-20 customers for immediate attention, based on criteria such as size of original license agreement and effective deployment, existence (or absence) of an in-force maintenance contract, potential for future deployments of existing and new products or services, current or potential exposure to competitive activity, influence over other customers in same/other market segments, and length of time as a customer.

- Step Four: For each customer, do some research to determine (a) how closely the pricing of the current maintenance contract reflects book pricing, (b) how closely the current maintenance contract reflects the actual deployment in terms of numbers of seats, etc., (c) if there is no existing contract, why not, (d) what indications the company has received regarding customer satisfaction issues from recent contacts with authorized personnel within the customer's organization, among other important information. *(*) see note below*

- Step Five: Set up meetings with the most senior executives or managers who are accountable for their IT investments and contracts. Make sure the Contract Review Team is well represented – including the 'contract review manager', who can either be a senior financial/legal colleague or experienced account manager, plus optionally an SE or business consultant (who are there to ask questions, and provide color commentary and up-to-date information on the implementation/deployment) – and make sure the customer has two people present if possible, in order for you to be able to have a comprehensive conversation about the customer's entire range of deployment characteristics and ongoing service and support requirements.

- Step Six: Complete each review cycle, review results, and expand the list of customers for new contract reviews.

(*) One issue to look out for: Although customers who make 'noise' about their disenchantment always get the vendor's (reactive) attention, it is always prudent to concern oneself with those customers who make sporadic or no requests for support on their contracts, as this is often a sign of passive discontent or, worse, lack of good faith. Both of these factors can give cause for greater concern than the issues raised by customers you hear from on a regular basis, and they often require close attention over a period of time in order to remedy the situation.

Assuming that companies actually do regard their customer base as an asset to be appreciated and cultivated, rather than as a territory to be raped and pillaged (strange as it may seem, the latter resembles the *de facto* approach of many enterprise software companies), the step-by-step approach I've described above could already be – or at least could rapidly become – a natural part of your modus operandi. That said, in the spirit of enlightened self-interest, tech company executives can expect to sleep better at night if they exploit the tactical benefit of cleaning up their contractual situations and recovering precious 'lost' revenues, as well as the strategic value of looking businesslike to their customers, driving toward significantly enhanced satisfaction, and stimulating new business opportunities in various forms.

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

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