

Under the Buzz

Back to Basics in e-Business

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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.

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Among the latest rash of software-industry M&A moves, Oracle's attempt to gate-crash PeopleSoft's planned J.D. Edwards acquisition party is one that threatens to turn really nasty. How will Larry Ellison's latest gambit turn out? And, will it liven up a sector that is still recovering from its post-2000 hangover? Also, what does it mean for the competitive landscape in ERP going forward?

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Is the enterprise software sector as mature and unexciting, as so many pundits claim? Or, are there new, as yet untapped opportunities for rapid growth? This article describes five key characteristics to look for in the next iteration of enterprise software offerings for 2004 and beyond.

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1. "Gentlemen, Start Your M&A Engines!"

Taking the lead from IBM's acquisition in late 2002 of Rational Software, a number of tech companies have announced M&A transactions in recent weeks. What does this tell us about the long-awaited consolidation in the software industry? This article provides some useful hints.

"Companies are tired of the complexity of dealing with hundreds of different vendors. ... The stage has been set for consolidation. The old model of growth can't be sustained. For mid-tier companies, either they buy or get bought."

- M.R. Rangaswami, co-founder – Sand Hill Group consulting firm

As early harbingers of an apparent new M&A trend, IBM acquired Rational for a 30% premium at the end of last year, and around the same time Microsoft announced the acquisition of Danish ERP software company Navision, to augment its earlier acquisition of Great Plains Software. More recently, we heard that Palm was buying its prodigal child, Handspring, and the perennial dark horse Mercury Interactive announced the acquisition of Kintana. Beyond these isolated cases, even stolid companies like SAS confirmed publicly that they are hot on the acquisition trail, citing a string of four sub-\$50M acquisitions in the past few months. On June 2, PeopleSoft woke the still-slumbering enterprise software sector up with a decision to acquire Denver-based J.D. Edwards for \$1.7B, a move that would thrust it above Oracle in the ERP market share rankings. Just four days later, Larry Ellison pulled Oracle's little-used trigger and jumped in with a hostile -

and apparently quite predatory - bid for PeopleSoft that looked as if it was designed just to spoil the PeopleSoft-JDE party.

However the Oracle/PeopleSoft/JDE 'love triangle' (as I have heard it referred to by competitors) turns out, it seems as if the race is now on for the most aggressive players to start acquiring desirable 'properties.' The major acquirers in enterprise IT systems and software - IBM, Intel, Cisco, Oracle (assuming they ever consummate a significant deal!), Microsoft, CA, HP, and other lesser players - must be licking their chops at the opportunity to fortify their competitive positions and, in the process, provide a hygienic 'clean-up' service for the industry in the process. Most observers agree that there are way too many start-ups and more mature enterprise software and networking companies chasing way too few customer and market opportunities. Eventually, most of them will need to give in to the realization that their pre-2001 dreams of meteoric growth were just that - dreams. Now that the public capital markets have provided evidence of stable, and in some cases even growing, valuations for more than two consecutive months since the Iraq conflict died down to a mere conflagration, companies that have both the appetite and wherewithal to start making acquisitions feel that they have some solid ground on which to base valuations of target companies. Furthermore, valuations are creeping above levels that were thought to be too low for 'acquirees' to accept, in many cases being substantially below cash reserves.

So my guess, along with that of many others, is that we should start seeing an accelerating rush of M&A transactions in coming weeks and months. Despite this trend, however, I would encourage companies not to get into a panic to acquire or be acquired without due thought and planning. Indeed, those that have a solid business with reasonable growth and predictable profits should remain focused on building value in their business, as their markets become more responsive in this slightly improving economic climate. In fact, on the 'acquiree' side of things, I would argue that those companies that have clear leadership positions in specific (niche) markets should stay the course with a defined M&A strategy, starting with a definition of which target acquirer(s) they intend to methodically attract. Potential acquirers, on the other hand, should really study the so-called synergies (mainly in terms of complementary factors) in target markets, domain expertise, organizational structure, culture, technology and products, and services, before charging in with their bid.

Overall, despite the current belief in a new era of dramatic consolidation among software, networking, and other tech companies, I have a sneaking suspicion that it is too early to declare that the enterprise apps game is essentially 'over.' What is 'over' in my opinion is discussed in the third article in this issue, where I shall suggest how the future of the software business might evolve to its next stage of value. Before that, I want to offer some comments on the unfolding Oracle-PeopleSoft-JDE story.

2. Strategic Implications of the Oracle/PeopleSoft/J.D. Edwards Triangle

Among the latest rash of software-industry M&A moves, Oracle's attempt to gate-crash PeopleSoft's planned J.D. Edwards acquisition party is one that threatens to turn really nasty. How will Larry Ellison's latest gambit turn out? And, will it liven up a sector that is still recovering from its post-2000 hangover? Also, what does it mean for the competitive landscape in ERP going forward?

Articles in recent issues of the Wall Street Journal, New York Times, San Francisco Chronicle, San Jose Mercury News, and other publications provide interesting quotes by different parties involved in the current M&A kerfuffle involving Oracle, PeopleSoft and J.D. Edwards:

"Our company has made the investment in PeopleSoft already. If Oracle succeeds in buying PeopleSoft, that's not good for us. ... Consolidation at the level of PeopleSoft and J. D. Edwards was a good thing, because they had something to add. (The Oracle takeover attempt) gets back to a monopoly thing."

- Angelo Privetera, CIO of HDR Inc., an architectural consulting firm based in Omaha, Nebraska
(quoted in the New York Times - June 17, 2003)

*"We didn't come to an agreement (to merge our applications businesses), so we made this offer.
... The Peoplesoft-JDE deal is a very risky merger. Oracle's all-cash offer is a safer road for
Peoplesoft shareholders."*

- Larry Ellison, Oracle Chairman & CEO

*"There is no condition that I can even remotely imagine where Peoplesoft would be sold to
Oracle."*

- Craig Conway, CEO of PeopleSoft

"It's about critical mass. We need to bulk up and gain marketshare against SAP and Microsoft."

- Chuck Phillips, EVP for Strategy, Oracle Corporation

*"We believe the proposed J.D. Edwards acquisition is the ultimate poison pill. It increases the
cost of PeopleSoft to Oracle dramatically."*

- Tom Burnett, president of merger advisory firm Merger Insight

After almost three years of a deadening downturn, the deep slumber of the brashest of tech-centric regions - Silicon Valley, no less - has at last been disturbed by a return to bombast and noise by one of its more celebrated spokespersons. When Larry Ellison surprised almost everyone by jumping in to bid for PeopleSoft *sans* J.D. Edwards, it was difficult to gauge whether he was intent on destroying value or creating it. Coming just four days after PeopleSoft's announcement, it looked too coincidental with the JDE situation to make sense as a value-creating move to strengthen Oracle's hand against the competitors Ellison truly fears - Microsoft and SAP.

Of course, Ellison disavowed anyone from the idea that he was actually attempting to accumulate value from the potential synergies between the two (or three) companies by immediately declaring that Oracle would discontinue PeopleSoft product development and, by implication, get rid of many or most of its people - leaving PeopleSoft's customers in an interesting quandary. Among all the invective exchanged thus far in these negotiations, I am still puzzled as to why on earth Ellison felt it necessary to swing his weight around in such a risky and macho way - particularly as he has already been forced to backtrack on this statement, in the face of massive rejection by PeopleSoft customers, and the PeopleSoft Board's understandable rejection of Oracle's hastily sweetened bid of \$6.3B.

Early on in this saga, we already heard colorful reactions to Oracle's hostile offer from the other principal protagonist, none other than PeopleSoft's CEO, Craig Conway, according to whom, "I think Larry saw there was a wedding and he showed up with a shotgun because he wasn't invited. It's a page straight out of Genghis Khan." Past comments by Conway have even included the characterization of Oracle as "the sociopathic company." All this makes it sound an awful lot as if Ellison has - to use a sporting expression - got inside Conway's head. This display of bravado among members of the occasionally dysfunctional Oracle family is hardly new; another 'prodigal son,' Tom Siebel, has often vented his anti-Ellison sentiments in his public utterances.

From a strategic perspective, it is slightly disappointing - though perhaps not surprising, in light of the emotions aroused by this situation - that, instead of taking advantage of the opportunity to go on the attack in a positive way, the PeopleSoft management team has thus far expended more energy in bolstering a shaky 'anti-trust' defense, and maintaining a constant flow of allegations

about Oracle's bad motivations for making its bid. This tends to indicate that Conway and his team have been sucked into Ellison's adversarial game, which started when Ellison made a point of declaring that he had no intention whatever of maintaining PeopleSoft's product development commitments. Wouldn't it have made more sense to use the attention garnered by Ellison's initial offer, to trumpet the synergies associated with the JDE acquisition, as well as the virtues of PeopleSoft's product strategy and market leadership position? Sure, Ellison's gambit looked at first more like an assault by an unfriendly suitor with little or no pretension to create shareholder value, but how could the PeopleSoft Board be so easily drawn into such a linear response?

As for how things will develop from here until the final *denouement*, I was anticipating that Oracle might hold firm to their \$16-a-share tender offer as the June 30 quarter end approached, in order to see how PeopleSoft's stock price holds up to unfolding news about significant licensing deals being confirmed or deferred as a result of the doubts regarding PeopleSoft's future; of course, the more deals that get deferred, resulting in lower-than-anticipated earnings, the lower the stock would be likely to go. On this point, I had heard a range of opinions from analysts, some going as low as \$12.50 a share by early July - in which case, the \$16 price from Oracle could look increasingly attractive to PeopleSoft's major stockholders and its board. Alternatively, many people think (or hope) that the negative fallout among PeopleSoft's customers and other constituencies by Oracle's lowball offer and vicious timing (i.e., after the end of its own fiscal year, and just before PeopleSoft's Q2 end) could lead to a kind of "Save PeopleSoft" popular movement.

In case you think this is too far-fetched, consider what Bruce Richardson, head of the respected AMR Research firm, told the San Jose Mercury News on June 17 about Oracle's strategy for closing the acquisition: "One mistake I think Oracle made was treating them (PeopleSoft customers) as if they were nothing more than a checkbook. Oracle needs to make sure that PeopleSoft customers are happy. Why would anyone want to go into a hostile customer base?"

That said, on June 18 Oracle surprised those whom thought that Ellison might not be serious by increasing its offer by 22% to \$19.50 a share, partly in response to pressure from PeopleSoft customers and financial analysts, and partly due to concerns about PeopleSoft's decision to clear the path for an accelerated close of its acquisition of J.D. Edwards. With this new bid affording a premium 10% or so above PeopleSoft's June 18 closing stock price of \$17.93, it unclear whether or not Oracle could prevail, but it was certain to get the attention of the PeopleSoft Board, and some of its major shareholders. Indeed, the PeopleSoft Board considered it for a day before issuing a second rebuffal.

Who knows how this frenetic situation will turn out? One thing for sure, love him or hate him, Larry Ellison is once again making life interesting for all of us who were feeling bored in the current lackluster environment! And, independently of how this saga unfolds, the long-awaited increase in M&A activity is virtually certain to accelerate as a result of the noise generated around this triangular drama. One constituency we should spare a thought for is PeopleSoft's customers who, among other things, probably chose PeopleSoft's ERP solution over Oracle's in order to take refuge from Oracle's well-known adversarial business practices. Should Oracle have its way with this acquisition, they may have good reason to tremble in their boots, as it appears that Oracle is serious about executing on its intention to discontinue PeopleSoft's R&D and engineering efforts and put customers on notice that they will soon be asked to 'upgrade' to Oracle products - some of which are reputed to be complicated and unwieldy to implement.

Undoubtedly, Chuck Phillips's quote at the beginning of this article points out the strategic opportunity (or threat) that has forced Oracle to make this move, i.e., the need to fortify its position against increasing competition from Microsoft at the low end and SAP at the high end. With respect to the timing that Oracle chose - or that they might say was thrust upon them by PeopleSoft's decision to leapfrog Oracle in the ERP market-share standings by swallowing J.D. Edwards - there's no doubt that, coming as it does in the last few weeks of PeopleSoft's quarter,

Ellison has effectively put Conway's and the PeopleSoft Board's heads in a vise. In Ellison's world, there are only winners and losers, as Peter Bershatsky of M&A network firm TechDealNet, and a former investment banker at Broadview International, observes: "I think from Larry's point of view, this is a win-win scenario - either he eliminates a competitor altogether, or he seriously screws with their quarter in a huge way, and comes away looking like a bigger player than he actually is." In light of the continued struggle that Oracle Apps - in particular the 11i release - has been experiencing for market acceptance as well as implementation success, it's easy to argue that Oracle has little to lose in terms of weakening its position within the ERP and CRM categories.

On PeopleSoft's side, besides doing everything possible to accelerate the JDE acquisition and thus make things itself less 'digestible' from Oracle's point of view, it probably needs to encourage more major customers (both corporate and government) to act to prevent major shareholders from applying pressure on PeopleSoft's Board to take the money and run. The State of Connecticut's lawsuit is just a start - it will probably take one or two major bank and manufacturing customers, plus one or two more state governments, to sway things back in PeopleSoft's favor. As for Ellison's disingenuous statement to PeopleSoft customers on June 20 that their fears about Oracle discontinuing PeopleSoft's products were 'unfounded,' PeopleSoft's customers, shareholders and board members would have to be slightly deluded to fall for that one! For my money, this change of rhetoric on Oracle's part signaled that the advantage had swung back in PeopleSoft's favor - though the activities of the next week or two will undoubtedly produce some new ebbs and flows, in particular with respect to PeopleSoft's end-of-quarter results and its ability to rush through the J.D. Edwards deal.

(Disclosure: The author owns no shares in nor has any current business relationship with any of the above companies.*

3. Does Software Have a Future as a High-Growth Business? You Bet it Does!

Is the enterprise software sector as mature and unexciting, as so many pundits claim? Or, are there new, as yet untapped opportunities for rapid growth? In this article, in which I quote extensively from a recent newsletter by Bill Gurley (Above the Crowd, March 2003), you will read about five key characteristics that I believe companies should look for in the next iteration of enterprise software offerings for 2004 and beyond.

At the risk of way over quoting Larry Ellison in this edition of *Under the Buzz*, I think it's appropriate to kick this article off with a quote from Silicon Valley's self-appointed seer, in an interview published in the Wall Street Journal on April 8:

"What's going on ... is the end of Silicon Valley as we know it. ... There's this bizarre notion in the computer industry that we'll never be a mature industry. (In my view) the industry is as large as it's going to be."

Like the parson's egg, this statement is good in parts. However, I shall argue that the gist of his claim - that the industry's has maxed out in terms of size - is a bunch of hooey. Reassuringly, a number of other CEOs interviewed for the same article disagreed somewhat with Ellison's diagnosis, including Carly Fiorina, Mark Andreessen, Mark Hoffman, Eric Schmidt, and Tom Siebel (who commented: "Maybe Larry missed an appointment with his therapist"). Nonetheless, the first part of Ellison's statement sounds reasonable, if you think about how this forty-year-old adolescent of an industry has increased its 'status' in the past decade or so without demonstrating any real maturity in the way companies operate their businesses. Going back to the days prior to 1990, enterprise software in particular was the preserve of U.S.-based companies, often those that had been bootstrapped or venture-funded since the 1970's. Since then, and particularly in the halcyon and totally irrational late 1990's, there has been a wild over-funding of software companies in response to both the Internet bubble and a lesser recognized phenomenon - continuing advances in India, the emergence of Israel as a high-tech development bed, the breakup of the former USSR, the opening of the Chinese market, all leading to the globalization of software development skills and know-how.

From the perspective of Oracle's own aging technologies - relational databases and classic enterprise applications - I would not be surprised if Ellison wakes up on some mornings thinking that the excitement of driving a high-growth business is a thing of the past. Despite Oracle's flirtation with Internet-based 'e-business' applications in the late 90's, which many observers characterize as short on deliverables, the company as a whole is now trapped in a declining (10% and lower) growth curve that runs a serious risk of accelerating very soon. Not surprisingly, all other enterprise applications vendors, in particular the high-end players such as SAP and PeopleSoft, face a similar dimming of their growth prospects. Only Microsoft, with its acquisition of Great Plains and Navision, together with other niche players in the SME space appear to face a possibly brighter prospect, provided that they can deliver on a simpler, cheaper-to-deploy suite of applications that must increasingly include supply chain management and customer relationship management capabilities inside the core ERP offerings.

I have argued in the past that the tech business is maturing, and I hold to that statement. The computer - or IT - industry as generally defined is indeed now a 'mainstream' industry. Evidence of this is that commoditization is increasingly a reality for most product and service vendors; furthermore, software development is no longer a rare skill dominated by U.S.-based companies and professionals, but one that is practiced effectively by people in many countries (India, China, Brazil, Russia, Hungary, to name a few).

However, I would assert that there is a vital distinction between an industry that is maturing around one set of technologies or business models - where new technologies or business models might be able to stimulate an entirely new growth cycle - and one in which there is no further scope for new technologies capable of spawning breakthrough products that get adopted like wildfire, thus generating rapid growth. Perhaps the fun has ended for those who think their industry can afford to treat customers in a cavalier manner, as many tech companies have been able to get away with doing through the adolescent years, but this is not say that all the opportunities for software-based innovation have now been taken. Furthermore, just as Moore's Law has not to my knowledge been repealed just yet, I would argue that the astonishing economics of the software business (in which gross margins can vary between 60% and 90%) remain attractive, in force, and available to what I am defining as the 'next generation' of enterprise software applications. What might be the main characteristics of this new group, you may well ask? Well, I believe they will contain elements of two or more of the items in the following table:

<i>Mainstream Enterprise Applications ...</i>	<i>Emerging Enterprise Applications ...</i>
... Automate business tasks 'statically'	... Automate business processes 'dynamically'
... Ensure functional efficiency	... Enable cross-functional coordination
... Organize structured data only	... Combine structured data with unstructured data
... Process transactions	... Provide context and insight about transactions
... Serve interests of a single organization	... Serve interests of multiple organizations

From automating tasks to automating business processes: In other words, in order to provide breakthroughs in business effectiveness and efficiency going forward, classic enterprise applications (the 'mainstream' scenario in the above table) just don't cut it any more. For one reason, we no longer live in a world where customers are satisfied with functionally focused automation, because this resembles less and less how their organizations have to work. For another, companies capable of providing full functionality around specific tasks, i.e., producing consolidated monthly financial statements, are everywhere. Thus, task automation is mature and

relatively commoditized, especially in standard business applications such as general ledger, payroll, HR benefits, inventory management, shop-floor planning and control, and so on. Not so with business processes, as we shall see in the next paragraph.

From functional efficiency to cross-functional coordination: In contrast, the automation of business processes - for example, *idea to product, market to sell, quote to cash, forecast to delivery, or problem to resolution* - enables functional departments - such as *marketing, R&D, sales, manufacturing, finance, customer service*, etc. - to cooperate in a coordinated way, using their functional expertise in specific parts of each business process. In responding to a reported customer problem, for example, the customer support/service department may have to call on engineering, sales, marketing or finance to provide information or execute tasks that contribute to resolving the work order. Cross-functionally focused applications have yet to really take off in terms of significant product functionality or market adoption, although the first generation of Internet-based 'collaborative' applications, such as project management and product collaboration, for example, has been providing a glimpse of what can be done between dispersed project-team members or design engineers and their outsourced manufacturers. Since processes increasingly need to be modified on the fly, as people find better ways to do their work, it makes sense that the new software tools will mirror this in the way they permit modifications to be applied easily by users or managers.

In the March issue of his monthly email newsletter, *Above the Crowd*, Bill Gurley, a general partner at Benchmark Capital, a Silicon Valley VC firm, recently presented a detailed definition of Business Process Management (BPM), a concept that many experts, including research and consulting firms believe will be the next killer app in enterprise software. BPM - sometimes called BPA (as in Automation) - has been written about for a few years. However, Gurley describes in no uncertain terms the impact he anticipates that BPM will have:

"BPM will not just change the software industry - it will change industry in general. Just like Deming did."

He was alluding, of course, to the continuous improvement-focused quality revolution led by W. Edwards Deming during the 1980s in Japan, then later in the U.S. Gurley goes on to define BPM as a "new programming paradigm ... that leverages browser-based applications, email, global connectivity, and maturing EAI infrastructure" and, by mixing workflow, EAI, domain knowledge, business rules, and application development tools, allows companies to "(1) codify their current processes, (2) automate their execution, (c) monitor their current performance, and (4) make on-the-fly changes to improve current processes."

As Gurley explains, these new applications will use the concept of 'task inboxes' to pass multi-person worksteps through a complete business processes such as purchase order approval and activation. Worker #1 may initiate a purchase order, but if that order is above a predefined limit, the order may be passed to worker #2, that person's supervisor; the supervisor will click on a URL in the inbox, see all the relevant data, then perhaps approve the order; to complete the process, the order may then be passed to the purchasing department, and even then forwarded to the supplier. In order for this type of application to function effectively, Gurley argues that there are six key components that need to exist in any BPM solution, including an integrated process design environment, a process engine, a user directory, diagrammed workflows, process monitoring, and integration with legacy systems.

From structured data to combinations of structured data and unstructured information: Besides an intense focus on automating complete cross-function business processes, next-generation software developers will need to bring together the capabilities of collaborative, real-time applications that capture small bits of 'dynamic' data as they occur in people's email and voice communications, their browser-based applications, and the more static information stored in database records and document management files.

From processing transactions to providing context and insight about transactions: Over and above the benefits realized today by transactional applications such as ERP and CRM, the new cross-functional apps will provide users with context and insight around a given transaction (or set of transactions), thus giving new life to such banal tasks as 'invoice management,' as I was reminded by a client in a recent conversation on this topic. For example, when it is possible to double-click on an invoice transaction and see the recent payment history of that customer, it will be possible for an account manager outside the A/R department to plan their strategy regarding granting credit terms to that customer on new transactions. This is the type of promise that business process reengineering has held out to companies since the early nineties, but that have been somewhat in abeyance until the IT department was able to spend the necessary resources to integrate the requisite ERP and CRM systems to support the cross-functional nature of the application without expensive and time-consuming manual intervention.

From serving the interests of a single organization to serving the interests of multiple organizations in a given value chain: One final facet of this shift toward more versatile and 'intelligent' applications is that they will not only benefit a single company or organization. Instead they will benefit two or more members of a value chain, whether on the demand or the supply side. Thus, vendors will have to learn how to design products that incorporate features and functions that solve the problems of two or more different target constituencies, and they will need to learn how to position their offerings for a 'value-chain sale', making it easier to sell and implement collaborative solutions than it is today, when in most cases vendors still focus on one constituency in the chain - for example, an electronics OEM company such as Dell or HP (where the materials and subassembly suppliers and EMS companies are afforded only reactive support after the sale has been made to the 'anchor' member of the chain).

To refer to Gurley's article one final time, he identifies five types of software vendor that stands to profit from the shift to BPM:

1. Pure-plays such as Savvion, Metastorm and Lombardi;
2. Workflow vendors such as FileNet and StaffWare;
3. EAI vendors such as SeeBeyond, TibCo, and Vitria;
4. ERP vendors who have added BPM capabilities to their suites;
5. Platform vendors such as BEA, IBM and Microsoft.

In order to pursue the substantial implementation service opportunities that this new breed of technologies will provide, the major systems integration firms, such as Accenture, CGEY, and Deloitte & Touche among the independents, or IBM and HP Consulting among the systems companies, will need increasingly to develop skills and resources to deliver the requisite know-how. Above all, companies that aim to succeed in this exciting, but highly complex, new era will have to identify those cross-functional processes that are most broken in large organizations of all types - corporate, governmental, educational, and so on - and that the customers in each case are willing to pay big bucks to fix with the aid of a substantially automated 'BPM' solution, as opposed to a combination of ERP/CRM/PLM/other software implemented on top of a faulty set of subprocesses with lots of manual improvisation to cover up the cracks.

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