

Under the Buzz

Commentary on Strategy & Management Issues for Executives & Professionals in Enterprise Systems & Software Companies

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Under the Buzz is an electronic "viewsletter" authored by Philip Lay, managing director at TCG Advisors, a Silicon Valley-based firm that helps to *catalyze* the strategy and transformation efforts of its enterprise systems and software clients. This journal is published periodically and delivered free to subscribers via email. It is also posted on the TCG Advisors website at: <http://www.tcg-advisors.com/Library/utb/utb.htm>. Back issues are available at the same address.

Articles in this issue:

1. **The Plight of the Midsized Tech Company**
2. **Comments on Recent M&A Activity**

Editor's Note:

This is the 50th(*) edition of *Under the Buzz* to see the light of day since the inaugural issue of May 2000. At that time, I had come to the reluctant conclusion that unfashionable attributes such as sound business sense and disciplined execution were in danger of extinction in the tech industry. Even the best entrepreneurs and management teams had got distracted by what they thought was a permanent up-market, free of the natural forces associated with business cycles. After the almighty crash of technology stocks in March-April 2000, I was convinced that people were eventually going to sober up and get serious about building their businesses the good old-fashioned way, i.e., by finding real customers with real problems to solve, and helping them to do so by implementing products that actually worked as described. So I decided to do my small part to help entrepreneurs, executives, and managers to adapt to the new business environment, and I came out with this new email-based 'viewsletter.'

Just over four and a half years later – yes, it has been that long! – it is still painful to see how much of an 'adjustment' there remains for many tech companies to make if they are to give themselves a real chance of surviving and thriving into the 2000s. This may sound like a pretty severe judgment, in light of the efforts that many entrepreneurs and management teams have made to revise their business strategies and organizations since the bubble burst. Unfortunately, I think this assessment is, if anything, on the charitable side. While it is true that the vast majority of the entrepreneurs and managers I meet in this business are smart, passionate about their business, and diligent about executing their specific duties, I think it is also true to say that, in terms of strategic thinking and operational management, many of them are trapped in outmoded ideas about such fundamentals as what business they are really in, what really motivates market adoption and customer buying behavior, and how to make relationships with enterprise customers mutually beneficial and profitable. Besides these few shortcomings, they're in great shape!

That is why the main article in this issue, at the turn of the year and almost half-way through the new decade, is about the desperate situation of 75% or more of the enterprise systems and software companies in business today. On one hand, I believe they fail to realize the real opportunities they have before them; on the other hand, they seem to lack critical qualities required to secure an 'unfair' share of the pie for their organizations in a crowded and increasingly competitive marketplace. Contrary to some people's prognostications, I do not believe that the IT industry is at the end of its growth curve and into a depressing 'maturity.' Far from it: I believe IT is at a far more exciting stage, which I describe as the *beginning* of its maturation, with plenty of potential to continue growing and to create prosperity for decades to come. Think about how long the automotive industry, the aerospace industry, the telecoms industry, even the pharmaceutical industry, all of them continually enabled by technology, have been in existence and how they continue to insert new techniques and technologies into their core product and service offerings. They have been at various stages of maturation for 50 years or more, and the well-run companies to be found in them are both viable and vibrant. IT is a mere babe in comparison with these 'crusty' industries.

(*) See bottom of last page for listing of issues of *Under the Buzz* since its original launch.

1. The Plight of the Midsized Tech Company

*"Remember when you were young, you shone like the sun. Shine on, you crazy diamond.
Now there's a look in your eyes, like black holes in the sky. Shine on, you crazy diamond.
You were caught in the cross fire of childhood and stardom, blown on the steel breeze.
Come on you target for faraway laughter, come on you stranger, you legend, you martyr, and shine!*

*You reached for the secret too soon, you cried for the moon. Shine on, you crazy diamond.
Threatened by shadows at night, and exposed in the light. Shine on, you crazy diamond.
Well you wore out your welcome with random precision, rode on the steel breeze.
Come on you raver, you seer of visions, come on you painter, you piper, you prisoner, and shine!"*

- From "Shine On You Crazy Diamond," Pink Floyd, Wish You Were Here, July 1975

It's not news to anyone today that most enterprise systems and software technology companies have lost the luster that the IT industry enjoyed throughout the 1990s, and are now in a real bind. Today, if a company's main product offering is not in an established or emerging category that is regarded as 'investable' by customers as something they need to use and thus by investors as something with real market value, and if they don't occupy the number 1 or number 2 position in that category, they have a devil of a time competing sufficiently well to assure their investors of sustained growth and/or profitability.

It is a well-known fact that the IT industry today is responsible for as much as 50% of all business investment by U.S. companies and public-sector organizations. Though the percentage is less in most other countries, IT still represents an increasingly expressive portion of total business investment. And, as most people now realize, the most significant change in this ratio occurred during the decade of the nineties, when IT was purveyed as the principal source of improved business and organizational productivity. Now, enterprise customers are feeling as if they over-invested in IT, they are getting much more choosy about their software, hardware, and network investments, causing a cycle of rapid consolidation among vendors. But is this consolidation really such a threat to every vendor, especially if you look at the opportunities that midsized tech companies still enjoy in terms of growth?

Firstly, What Does 'Midsized' Mean?

Let's start by defining what we mean by 'midsized': In enterprise software, I define midsized companies as ranging from about \$80M to approximately \$800M in revenues (a difference equivalent to a factor of ten in revenue terms); in enterprise systems (comprising hardware, software, and services as fundamental lines of business), we are talking about companies with revenues of between, say, as little as \$300M and as much as \$3B or so (again, using ten as the multiplier between the smallest and the largest in this grouping).

In enterprise software, more or less the fifth to tenth largest ERP players, the third to tenth ranked CRM companies, the second to eighth BI (business intelligence) businesses, the second to sixth app server / middleware companies, and the first to fifth ranked PLM (product lifecycle management) vendors – the latter category not yet being a fully established one – are all experiencing growth and/or profitability challenges, in particular with respect to assuring their sustainability as independent units. This is without mentioning the leading players in many other 'emerging' or established categories such as supply chain visibility, portals, contract or project management, content management, knowledge management, and so on. In enterprise systems, there are smaller networking, storage, and semiconductor companies, whereas the larger firms tend to include conglomerates like Agilent, chip/microprocessor suppliers such as AMD, and equipment vendors such as 3COM.

The factor-of-ten multiple between the smallest and largest of each group cited above is not a rigid rule. At each end of the spectrum in both these groupings are companies with smaller or larger revenues that are buffeted in some measure by the same pressures as the companies defined within these boundaries. Thus, for example, enterprise software companies with as little

as \$50M or as much as \$1B in annual revenues are not necessarily free of the same problems as the mainstream mid-sized organizations. Well-known companies at the higher end of this group include BEA and Cognos.

The Penalty of Not Facing the Brutal Facts

Before companies can do something to solve the painful growth challenges they are experiencing in a market that today can no longer be easily seduced by the latest technology or a newer software or other product, management must face up to sometimes painful realities about what's not working in their current de facto operating strategies, and swap them for more effective approaches. Among the ritualized beliefs that somehow manage to remain part of the repertoire despite most often leading to frustration and failure are these two:

- Do more of everything, as fast as possible: The strategy of most tech companies when confronting stubborn obstacles in their path to growth seems to be to 'pedal faster and/or pedal harder.' Whenever you hear management say that their main problem is 'execution,' you can be sure that they are in this camp, their belief being that by doing more of everything they will get out of the trough. Executives in these cases are failing to face up to what is really preventing them from succeeding, and most often it's not solved by pushing harder. My colleague Geoffrey Moore describes it this way in his soon-to-be-published book, Darwin & the Demon: "*Sadly, the answer is, we were afraid. We were afraid of assuming the risks required to truly differentiate ourselves. We wanted to be great, but we were unwilling to give up anything to become great. Like novices at a roulette table in Las Vegas, we put a chip on every betting square we could so that we would be guaranteed of winning at least something. Ironically, that is the only strategy that is guaranteed to lose everything.*"
- Wish Fulfillment Fantasy: Besides resorting to fire drills including all manner of short-lived programs and promotions to try to tempt customers to renew their confidence and commit their budgets, they generally make unsustainable claims that have little to do with who they really are and what they are really capable of. Examples include announcing grand new products or 'suites' (nowadays the trend is to think up a three-word name along the lines of "Enterprise *Something* Management"), customer-friendly 'initiatives' that don't last more than a quarter or two, or special product or support pricing offers, all of which still fail to provide what customers are really asking for.

The insistence of so many management teams on indulging in the behavior described above is indeed quite puzzling. But the collective behavior of human beings, particularly in immature organizations within a stubbornly childlike industry like IT, is full of examples of insanity – especially if one uses the well-known definition of insanity as 'doing the same thing over and over again and expecting different results.' But what are the real causes of this insanity? The best I can come up with is these three possible factors:

- a) Inaccurate concept of their relevance and value: Companies tend to be product-focused to their core, in other words -- trite as it is -- they design their entire business around the holy grail of producing the best mousetrap. When they talk about 'solutions' it's only as a sop to customers when their habitual product-sales approach isn't working;
- b) Simplistic approach to managing the business: They think two-dimensionally about strategy and execution, whereas they need to create a clear distinction between strategic intent (i.e., what they intend to accomplish) and actual strategy (i.e., how they will accomplish their objective);
- c) Functionally-based attitudes to execution: When they do think about actual execution, they tend to shortchange formalized management practices, particularly in customer-focused processes such as complex sales cycles, project planning and implementation,

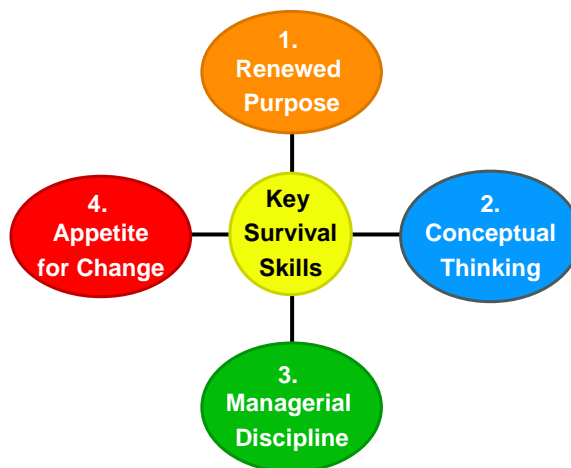
and customer support, all of which need to operate cross-functionally in order to deliver effective results.

From time to time in past editions of this publication, I have written in some detail about these issues. So, what's new for midsized tech companies to think about regarding possible approaches to assuring their future survival and thrival?

Four Critical Survival Skills for Midsized Tech Company Executives to Master

The following list of 'critical managerial effectiveness factors' is not intended to be exclusive, but it does represent four interlinking elements that seem to me to be of great importance. Below the diagram is a description of what I mean by each skill. Note the relative lack of emphasis on technology or product-related factors – this is not accidental. There is still plenty of room in the IT marketplace for well-run medium-sized companies with no more than average quality core technology and products – provided they are willing and able to understand which customers to focus on and how to provide them with suitable 'solutions' to their most troubling problems. Many companies whose immediate destiny is a source of concern today to their customers and investors could easily experience sustainable growth and profitability going forward if their leadership teams out their minds to practicing serious management.

Fig. 1: Four Survival Skills for Executives in Midsized Tech Companies



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Renewed Purpose

The problem in a nutshell:

- In their desire to achieve results that please investors, executives (and board members) cling to aspirational – and sometimes delusional – goals that do not take adequate account of what the company is in business to accomplish and what it can realistically be 'best in the world' at. Furthermore, they treat investors better than their most important constituency, customers.

What to do about it:

- Establish a reality-based view of the enterprise marketplace and the IT industry;

- Define a purpose and a business model that can lead to sustainable results for the company, independently of potential 'exit strategies' (which should be regarded as an eventual outcome rather than a goal);
- Establish a category in which the company's specific product or service offering can become number 1 or number 2 in its target markets;
- If you're not a mass-market gorilla and cannot be one, become a whale – dive to depths that other mammals or fish cannot or will not reach. Find a target market in which you can build 'home field' advantage; midsized players are almost never successful in competing in the open market against the gorilla or chief chimp in their category;
- Understand the various different innovation strategies they can employ when the market for their products is maturing, particularly when vendor consolidation starts taking place. Focusing on product functionality and price will do them no good, especially if they remain thinly spread over a large number of poorly defined markets inhabited by larger and/or more entrenched competitors.

Conceptual Thinking

The problem in a nutshell:

- Based on existing, inherited assumptions about their business goals and purpose, executives fail to think in new ways about how they can achieve their objectives in the face of changing circumstances. Eventually, they grow discouraged at their limited success, but remain chained to their habitual thinking about how to run the business, and this vicious cycle keeps reinforcing itself.

What to do about it:

- In times of change, conceptual thinkers always make the best executives; no executive who proves themselves unable to deal with the ambiguity associated with the rapid change that is endemic to the IT industry should remain on the team – they will generally act defensively and get in the way;
- Design your business and the organization around mission-critical problems of your key customers that you can help to solve differently and better than any other company can do. Stop thinking of your company's value contribution in terms of product, and stop investing in any product that does not help customers to solve complex business problems;
- Understand – *really* understand – what it takes to build and deliver a complete product that solves *specific and mission-critical* business problems rather than delivering a general-purpose product or service that only solves part of the problem;
- Adopt a multidimensional approach to your business, in terms of a multilayered business model that recognizes license/acquisition opportunities, process-related and project-focused service opportunities, and maintenance/upgrade/loyalty opportunities;
- If necessary, learn how to become a 'general project contractor' rather than a product vendor and installer, using alliances, channel partners, and other third parties in creative ways to help you achieve your objectives.

Managerial Discipline

The problem in a nutshell:

- Managing by the seat of one's pants is still firmly installed as the preferred mode of operation in high tech. As a result heroism is often rewarded above professionalism. When heroism – which is notoriously unscalable – breaks down it can be hugely expensive in terms of lost opportunities as well as direct costs. Also, due to the complexity of getting their products to work as promised, tech organizations quickly

default to functional silos, and cross-functional processes – all of which focus on serving customer requirements – suffer horribly.

What to do about it:

- Understand and practice managerial discipline in order to achieve optimal results with limited resources. Just to be clear, focus does *not* mean finding a clever way to describe six different company-wide initiatives or seven different market strategies as ‘focused’ – by definition these are resource and attention *dividers*, and the more you attempt to treat each as equally ‘strategic,’ the worse off you will be;
- Make sure to operate via formalized (even if ad hoc) cross-functional collaboration in order to implement all company-critical go-to-market initiatives; nothing good happens for customers without this – for example in producing complete solutions involving core and complementary products, as well as services to facilitate understanding, implementation, and usage;
- Adopt sound managerial process everywhere in the organization, it really won’t hurt. In high tech, it sometimes feels as if executives hate the thought of actually doing things in a premeditated, methodical, and ‘scalable’ fashion, but it really pays off with customers;
- By all means be flexible, but be disciplined about when you should be flexible; being flexible is not automatically a good thing. Sometimes it’s a sign that you don’t know what you want, or that you are willing to do anything to get a deal closed (both of which are – I’m sorry to say to the *any-revenue-is-good-revenue* crowd – generally a bad thing).

Appetite for Change

The problem in a nutshell:

- Many executives and board members signed up for sunnier times in tech and did not anticipate the long hard slog of building a company in a challenging business environment. Boards, heavily populated by VCs who never had to make payroll in their former companies and/or private equity types who invested during the bubble, seem to have little or no idea about what kind of leadership companies need today, and they tend to be at a loss about how to respond with suitable advice and guidance. Eventually, they give up on their investment and look for the quickest exit.

What to do about it:

- Always be ready and eager to adapt to new circumstances – as we all know, the pace and harshness of change is unlikely to slow down, so it’s best to make the most of it;
- Always treat changing circumstances as an opportunity to shake things up in your favor, rather than assuming that the changes are a threat just because they force you to rethink your strategy or your execution plan;
- Develop the art of creative thinking in tight corners; most of your competitors are smart and dedicated, but they are not all able and willing to be creative at such times;
- When your organization turns inward and worries more about its health than the health and well-being of your customers, it’s probably time to renew the leadership team; if you don’t do it soon enough, the marketplace will – you’ll either get swallowed up by another company (not necessarily on terms you would like), marginalized into an irreversible decline, or unceremoniously put out of business;
- If you are an executive, manager, professional, or board member and you find yourself lacking an appetite for dealing with the constant flux that is inherent to this business, opt out of your current assignment, and get a refresh before jumping in to your next one.

Hopefully these ‘skills’ will become plentiful in the marketplace before too long. Otherwise, I fear for the continued prosperity of the IT industry. All participants in the IT ecosystem, – customers,

investors, entrepreneurs, executives, professionals, politicians (though they still tend to have a cartoonish level of understanding of what information technology is all about) and even outside consultants of all types – have a vested interest in the ongoing development of products and services that help to keep companies in all other industries competitive and profitable. After all, IT is still recognized as one of the principal sources for this progress. Time is running out for the generations that grew up with the mainframe, the PC, and client/server, most of whom are already in their forties and fifties. Undoubtedly, it will fall to the internet generation and later ones to provide the thoughtful management savvy that will drive the industry forward to a maturity that is still exciting – though differently so – and three times as profitable for everyone involved.

2. Comments on Recent M&A Activity

Among the recent talk of new M&A deals, I noted one priceless comment by Michael Dell on how to execute M&A organically:

“We acquire our competitors one customer at a time.”

- Michael Dell, chairman of Dell Computer, quoted in a 12/05/04 Wall Street Journal article on the acquisition of IBM's PC business by the Chinese company Lenovo.

Michael Dell's statement is a creative twist on Dean Witter's famous saying: “We grow our business one customer at a time” (or words to that effect). Beyond that, it also demonstrates his well-known single-minded focus on what Dell does best and what it doesn't even try to do. Dell Computer is known for favoring organic growth over acquiring other companies, and thus it does not acquire existing companies.

Commentary on Recent Deals

Symantec acquiring Veritas: Easy to understand why Symantec wants to do this, especially given John Thompson's desire to transform Symantec into an enterprise software player, incorporating much of the enterprise systems know-how he acquired while at IBM; that said, the absorption of Veritas could be quite a challenge, in light of its size and its existing Oracle-flavored culture. Symantec is still a volume operations organization, IBM's brand of enterprise systems is all about structured and deliberate account management, while by all accounts Veritas belongs to the hit-and-run school of enterprise sales and account mismanagement.

Oracle finally acquiring PeopleSoft: OK, so Larry Ellison may actually have done the industry a service by proving that a not-so-friendly acquisition is doable after all – but we'll have to wait and see before judging whether Oracle can leverage much more than PeopleSoft's considerable maintenance revenues and, to a limited degree, customer relationships. If Ellison weighs in over Charles Phillips in the absorption process, he will make sure that everything possible is done to eradicate the PeopleSoft identity and culture, which to my mind will be one of many blunders that Oracle will commit in the attempt to digest the acquired organization. If, on the other hand, Phillips can keep Ellison at bay, Oracle may yet pull off a well-executed organizational merger without killing the PeopleSoft culture entirely.

China's Lenovo acquiring IBM's PC business: As explained by Sam Palmisano, IBM's CEO, in the December 2004 issue of Harvard Business Review, the purpose of doing this deal was much more related to strengthening the relationship between IBM and China than simply unloading the business at the best possible price (which, arguably, the \$1.75B may not have been).

(*) Listing of issues of *Under the Buzz* since its original launch:

- Vol. 1: May to December, 2000 – Eight issues (launched as a monthly publication)
- Vol. 2: January to December, 2001 – Twelve issues

- *Vol. 3: January to December, 2002 – Twelve issues*
- *Vol. 4: January to December, 2003 – Twelve issues*
- *Vol. 5: January to December, 2004 – Five issues (converted to a periodical publication)*

Under the Buzz offers commentary on enterprise software and systems business and management issues. The goal is to provide provocative and accurate insights into the latest events and thinking shaping this continually evolving technology sector. *Under the Buzz* also provides commentary on strategies for building sustainable competitive differentiation and maximizing market valuation.

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