

# **Under the Buzz**

## *Commentary on Business Strategy Issues for Executives in Enterprise Systems & Software Companies*

March 27, 2006 - Vol. 7, Number 1

*Under the Buzz* is an email "newsletter" authored by Philip Lay, managing director at TCG Advisors, a Silicon Valley-based firm that helps to *catalyze* the innovation and transformation efforts of executive teams in systems and software companies. This journal is published periodically and delivered free to subscribers via email. It is also posted on TCG Advisors' website (<http://www.tcg-advisors.com/Library/utb/utb.htm>), back issues are also available.

*Message to readers:* If by chance you have noticed that no issues of the 'Buzz' have dropped into your inbox during the past couple of months, do not be concerned - we haven't gone away. In fact, during the next several weeks you are in danger of receiving another one or even two new editions besides this one - there are still plenty of pressing strategic and management issues for us to comment on!

Topics in this issue:

- 1. "The Four D's: Critical Segmentation Criteria for Targeting SMBs**
- 2. The Problem of Being Careless with Important Words**
- 3. Leadership and Strategy, Strategy and Leadership**

### **1. The Four D's: Critical Segmentation Criteria for Targeting SMBs**

Virtually every tech company today, whether focused on enterprise, small business or consumer customers, is struggling to find customers in the notorious no man's land that goes by the uninviting name of "SMB" – Small-Medium (sized) Businesses. The reason for this struggle is contained in the fact that neither of the two predominant types of business architecture in the IT industry sees 'SMB' as its sweet spot. For example, the sweet spot for complex systems companies (IBM or SAP, for example) is composed of enterprise organizations with whom they develop consultative relationships in order to help them address complex business problems. In contrast, the classic sweet spot for volume operations companies (read Intuit or Microsoft) is individual customers or consumers. Every other customer type gets short shrift from these two types of company because they are not interesting either in terms of size of potential deal (complex systems) or number of transactions. In reality, small and medium businesses often have problems essentially as complex as those of large organizations, but behave like consumers with respect to what they are willing to pay or do in order to solve them. In case you are wondering, this tends not to be a profitable proposition for either type.

As stated earlier, what we have learned about this massive but underserved portion of the market for IT products and services is that (a) it has been misunderstood and mistreated for decades and (b) consequently, virtually no vendor allocates the right mindset or resources to serving it effectively. Success stories are few and far between and often they are anonymous – except for companies such as Dell, Intuit, Great Plains (before being smothered by the Microsoft machine) and, more recently, promising young companies with refreshing new approaches, such as Salesforce.com, RightNow, and others.

Examples of the most important segmentation criteria we have identified are contained in the following checklist of four categories each with four main criteria to be at least briefly considered. To my eternal surprise, classic segmentation approaches adopted by most companies generally start and end with a definition based on between two and three of the Dimension criteria below, and little or no consideration whatever of the other categories.

One further lesson we have learned is that it is usually better to adopt a contrarian approach and start from the opposite direction than the one that is likely to be adopted by most of your competitors. Therefore, instead of using Dimensions such as physical size, financial parameter, geography, or vertical segment as your *initial* guideposts, I strongly recommend starting with a look at (a) customer organizational *department* (or *behavior*), (b) then industry and market *dynamics*, followed by (c) industry and business *demographics* and only at the end, (d) *dimensions*. Only after you have seen which criteria lead you most directly to a fertile set of potential customers should you give weight to attributes in one or other of the first three groups.

Let me be clear: I am not suggesting that the Dimensions category is necessarily unimportant as an important source of relevant criteria, just that you stand a much better chance of discovering a fertile target segment opportunity that your company can serve effectively if you begin with Department and progress through Dynamics and Demographic before alighting on the more obvious one, Dimensions.

### **The Four D's of Segmentation**

#### Department(\*):

- Leadership or management style of the target sponsor (prospective customer)
- Decision-making processes in the organization
- Adoption strategy of key decision makers (visionary, pragmatist or conservative)
- In-house IT resources - existence, professional level and quantity thereof

#### Dynamics:

- Growth rate of the peer group (i.e., the same industry sector or vertical)
- Competitive pressures (caveat: vital signs are key)
- Expansion, consolidation or shrinkage of the sector
- Regulation or deregulation forces (industry-specific and general, such as SOX)

#### Demographics:

- Type of business or function (e.g., wholesale distributor or online retail store)
- Volume of transactions (few complex projects vs. many simple transactions)
- Complexity of business processes (such as quote to order, or invoice to cash)
- Value chain (e.g., wine distributors) or ecosystem (e.g., Ford automobile dealers)

#### Dimensions:

- Industry verticals or sectors
- Geographic location
- Financial parameters (revenues, profits, market valuation, etc.)
- Physical size (number of employees, subsidiaries/locations, countries, etc.)

*(\*) Clarification: In normal circumstances "behavior" would probably be a more likely synonym for department to use here. However, since behavior starts with a 'b' instead of a 'd,' I thought it would better to use department in order to preserve the alliteration and thus make the categories easier to remember.*

In a real-life market segmentation exercise, you should expect to look at all these 16 or so criteria - and perhaps even some that aren't on the list - on the way toward settling on anywhere between four and eight criteria in total, just two to three of which are likely to be the key ones. The more they relate to real, organic issues that smaller businesses deal with, the better. One example is generational change of management, from founding parent to MBA-qualified son or daughter. Another is complexity of the business, independent of its size. Yet another is reliance on external influences such as outsourced service providers, anchor customers, or a trading network or association.

Two examples below should help to illustrate the glaring difference between setting your company up for certain non-differentiation versus possible success. While you review these examples, remember why segmentation is necessary in the first place. The number one purpose of segmenting the market is to establish an addressable set of target customers who share a common problem that you can help to solve effectively differently and better than any of your competitors, in reward for which you benefit from the virtuous self-referencing dynamic that makes new customers give preference to your company. Needless to say, this kind of outcome tends to lower your marketing and sales expenses dramatically and impact revenues and profitability quite favorably.

That said, market segmentation tends to apply in one of two main situations: (i) if you're in the early market, the chasm, the bowling alley or on main street, and you need to build demand for the category and/or for your offer, or (ii) if you're in the tornado and you need to prioritize your resources for markets where you can win an unfair share of the business that is flowing to you and your competitors.

Example A: Here's what I would call for most demand-creation situations a fairly typical but nonetheless very poor use of the segmentation criteria at one's disposal:

- Target segment definition: *U.S.-based small-medium sized companies with annual revenues up to \$1B* - that's it, just two segmentation criteria from the Dimensions list - geography and revenue size.
- Vices of this definition: This is just *not* a cogent description of an addressable target market with common needs and a strong self-referencing tendency. The simple criterion stated is not only primitive and predictable (and has been used by vendors everywhere who think more deeply about their product than about which customers are likely to need it and why they will give them their preference if they do need something like it), but it lumps millions of extremely diverse businesses together in a nonsensical grouping that the prospective customers feel no identification with. This makes it difficult or impossible to reward you for segmenting in the first place. Bear in mind that whatever vacuum is left by marketing's inability or unwillingness to define has to be compensated for by creativity and heroics in the field. The problem, as we all know, with relying on the heroic behavior of salespeople (or channel partners) is that their exploits are not in the end measurable, repeatable, or scalable.

Example B: What I would call a *creative* use of the opportunity to differentiate your company by the quality of your segmentation strategy:

- Target segment definition: Pragmatist decision makers, small IT departments (one to five professionals) managing outsourced services, growing rapidly but under increasing threat of price competition, have online retail operations, process thousands of transactions (and cannot suffer outages or breakdowns), located in the U.S. or Canada, with between 30-100 employees.
- Virtues of this definition: To begin with, delving this deeply into several layers of behaviors, dynamics, and demographics (actually, eight in this case) lets you probe for potential problems that might not yet be fully addressed by IT solutions as far as they need to be or could be (Are the outsourced services supporting customers' businesses satisfactorily?, Are growing pains threatening to break the company's critical processes?, How serious are these competitive threats?, What is the cost to the company in lost business or profits of breakdowns or product returns?, How difficult is it to reconcile the demands of employees with those of your customers?, and so on). Pursuing this line of questioning and developing before-and-after scenarios around them could result in the revelation of a golden opportunity that no other vendor is targeting sufficiently well. Above all, conducting this type of assessment equates to thought leadership that is likely to separate you from your closest competitors, allowing you time to refine your value

proposition and customer deliverables, and possibly providing a highly profitable growth opportunity.

Hopefully it is clear that the two examples above represent extremes, because I want to make a point. If your market development strategy doesn't require as many as eight levels of segmentation, don't use that many. But I would also urge you to avoid the no-brainer approach in the first example, because apart from not resonating with prospects within the "segment" (in fact, if anything it tends to alienate them), does nothing to leverage the precious self-referencing dynamic in your company's favor.

In reality it is fair to state that this list describes segmentation criteria for targeting organizations of all types - large, medium, and small. My reason for denominating it as being specifically for targeting SMBs is due to the current failure of most companies' attempts to target self-referencing groups of potential customers effectively. On one hand are the contemptuous-sounding attempts that complex systems make to engage with "lower-end" markets, and on the other are the superficial swags that volume ops companies tend to take when trying to move up to higher-end customers. Someone needs to spend time understanding the needs of this 'great unwashed' that can actually be the source of a sustainable and profitable business - I am referring of course to the legions of young fast-growing businesses or older more established small companies everywhere - be they retail outlets, dealers, warehouses, regional offices, or subsidiaries.

## **2. The Problem of Being Careless with Important Words...**

Don't you just love it when you hear executives take total license with the wonderfully flexible English (American?) language? Naturally, it goes without saying that this would never happen in your company! Take the frequent over-the-top abuse of the heartwarming word "opportunity" as an example.

When does "opportunity" mean (a) "something we haven't done yet (and wouldn't have a bat-in-hell's chance of pulling off)" and when does it actually signify (b) "something we actually could conceivably achieve if we approach it correctly?" The difference might appear a subtle one, but my argument is that people have been taking scandalous liberties with this precious word for far too long. It's got to stop, I say! Furthermore, I insist that the gap in real meaning to which this innocent word is subjected daily by enthusiastic executives and VCs, among others, is too wide to allow one word to be so all-embracing. I'll make my case with the following two examples to demonstrate the contrast:

- (a) "I don't want to hear any more negative talk about our tiny market-share! OK, so we only have a 0.22314% share of the total available market, but the way I see it that means we have a 99.77686% opportunity. So, I want to see us aggressively taking share from our competitors and ratcheting up our growth numbers!" Answer: "Sorry, Big Guy, it just so happens that our two largest competitors own 92.3% of the market and if we so much as dare to take them on they'll squash us like a little bug."

Versus:

- (b) "In light of our current micro share of the market and the stranglehold that Gorilla X and Chimp Y have, I think it's fair to say that we have an opportunity to increase our share by as much as 30% in five years if we just stay out of their way and go after the markets that we can serve better than they can." OK, so the approach cited in this example may or may not tell the whole story - there's probably a viable middle-ground objective to pursue, but it sure isn't a 99.78% "opportunity."

Anyway, I rest my case. Isn't it a shame how this positive word is being mistreated in example (a)? I'm sure you've heard this rhetorical drivel from executives before. In example (a), the word "opportunity" is being confused with the term "we are screwed but let's do anything to avoid facing

up to it”, whereas in (b) it is being used in the way it was intended by nature and serious people to be employed, i.e., to indicate the possibility of a “legitimate opening” in the market.

Thus, if it’s not already crystal clear: (b) = realistic opportunity, whereas (a) = pipe dream.

### 3. Leadership and Strategy, Strategy and Leadership

Recently I was reminded of the following quote from Peter Drucker by Jim Hays, a consultant whose firm, The Aspire Group, focuses on helping sales teams in tech companies to increase their selling proficiency:

*“The only things that happen naturally in an organization are friction, confusion and malperformance. Everything else is the result of leadership.”*

There are many reasons to take this statement literally, among which is the tendency in tech companies for CEOs and others in a people-leading role to treat strategic decisions in a somewhat cavalier fashion, exemplified by the following comment: “My people are all pretty smart; I like to give them challenges and let them figure it out.”

Perhaps not surprisingly, in a geek-heavy culture such as the tech industry - and even more markedly in Silicon Valley - there is a widespread tendency among executives to overestimate the positive effect of their enthusiastically delivered rhetoric, to underestimate the value of helpful mentoring, and to entirely disregard the need to provide reality-based strategic and tactical guidance to their direct reports.

I have lost count of the CEOs and other senior managers who claim: “Our strategy is pretty clear but somehow our executives and other people don’t seem to be aligned around it nor capable of executing.” Interestingly, the other self-diagnosis we hear most often appears to go in the opposite direction: “Everyone on the team is aligned, but for some reason the strategy isn’t clear to them, so execution is suffering.” Thus, the symptom that is common to both of these contrasting issues is that execution is faulty whether the cause seems to be misalignment or unclear strategy. No prizes for guessing where the real problem is.... It’s all about cause-and-effect: If the strategy is unclear, how can people be aligned; and if they aren’t aligned, how can they execute in a coordinated manner, and thus avoid the “friction, confusion and malperformance” that Drucker alludes to above?

In the end, leadership is absolutely about strategy, and vice versa. And, just to make one final critical point abundantly clear, there is a big difference between a strategy and a declaration of strategic intent. Tech company CEOs and other leaders excel at declaring strategic intent, i.e., “We plan to gain market leadership in yadda-yadda new product category, and we expect to grow revenues 30% annually by helping our major global customers to reduce costs using our solution.” Any such declaration that doesn’t carry a conceptual roadmap based on real opportunities rather than fantasy, to address the big questions of “what offer(s) and differentiation the company expects to leverage,” and “what specific problems it tends to help solve for what market segment(s)” is short of being an actual strategy - it’s just an intent, and probably a smoke-induced one at that.

Another couple of ways of understanding strategy definition are these: Can an intelligent and informed person who has listened to your strategy pitch understand what you are trying to do, and describe in general and credible terms how you intend to achieve it? If not, you may have a strategy, but one that is not sufficiently explicit to enable the right kind of action by your people or partners, nor the desired response by customers. Which brings me to the last point: If it isn’t literally actionable in some clear way, you almost certainly don’t have a strategy, and you may only have intentions. Unless you recognize this and do something to explain what it is that you are offering, which customers you intend to engage with, what business problems you are going to help them to solve, and what solution you are going to marshal, you are almost certainly on the

way to friction, confusion and malperformance. Sooner or later, your people will give up trying to act on their individual interpretation of your intentions because they are not empowered enough to execute the required activities effectively.

The irony is that, the bigger the company, the less explicit the strategy usually is. This is due to what I refer to as the "inner sanctum" problem, whereby only the CEO and their one or two closest cohorts share the secret handshake. Everyone else, especially the hundred or more members of the euphemistically named 'senior leadership team,' is really only expected to be a high-level executor of the company plan.

So for those super-smooth and sophisticated CEOs and managers who think they can rely on their people to "figure it out, because they're all smart people," I would suggest that they think again. The reason that CEOs are paid the big bucks is to provide clear and unambiguous leadership, which includes recognizing when they don't know it all, as well as having a way of describing which hill they want their company to take, how and in what time frame.

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*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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