

# Under the Buzz

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

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*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.

### Dead Mantras - #1: "Managing for Shareholder Value"

Okay, let me come out and say it: I have sinned. For many years, I have espoused "managing for shareholder value" as the quintessential commitment of executives in any serious business organization. The problem with this particular corporate mantra is that, like a cracked glass, it no longer holds water. Why? Simple: there are very few share *holders* left in the public or private markets.

The world has changed, and today many investors, from hedge funds and mutual funds to employees on stock option plans, talk and act more like share *flippers*. Among the many consequences of this shift is the difficulty that public tech companies have when they get in the "penalty box" with Wall Street due to a downturn in their fortunes. It's very difficult for companies in these situations to escape an ever-tightening noose, and going private or being absorbed into another more successful company becomes the inevitable preferred outcome.

Not only does "managing for share-flipper value" not have much of a ring to it, but it wouldn't pass the first sniff test. In contrast with its more noble-sounding predecessor, this one comes right out and emphasizes loud and clear that long-term value creation is not even on the radar screen as a corporate mantra.

That said, there may or may not be anything particularly wrong with the idea of managing for share-flipper value, judging from the prevailing mentality of many boards, CEOs, and executives. But let's at least call it what it is.

### Why On-Demand and Hosted Solutions Are Not the Same Thing

Try these two somewhat cynical statements on for size:

1. On-demand software as a service (SaaS) is what large and medium-sized corporate organizations are asking their existing vendors for when they feel the pressure to at least check out what all the fuss is about.
2. Managed hosted services - on a hastily improvised basis - is what enterprise software companies do when they want their customers to think that they have joined the on-demand revolution, and thus are once again cool enough to do business with.

Not that there is anything necessarily wrong with either of these aspirations. The problem is that because both sides are speaking and hearing different things, a number of costly misunderstandings and wrongheaded investments are taking place throughout the enterprise IT marketplace.

By way of clarification, arguing the case for or against on-demand computing is not my purpose here. On one hand, there appears to be increasing evidence that on-demand solutions are

earning their place in the market by providing a new delivery and business model that will serve the hitherto underserved masses of small and medium businesses, regional offices, subsidiaries, and so on better than traditional on-premise software providers have done. On the other hand, there still seems to be a definite role for on-premise software implementations by businesses as well as by consumers, even though software-based services are increasingly prevalent.

My basic argument is that, more likely than the incumbent models being eliminated by the new insurgent model, the market for all three models will grow, though in different ways. All waves of platform innovation so far have found their place in the market - think about mainframes, minicomputers/servers, and PCs, or about enterprise software and consumer software, now being joined by software delivered as an on-tap utility service.

The single-minded mission of this journal for the eight years since its founding has been to restore some sanity while all around are losing theirs – in other words, to remove the unreasonable buzz – or hype – from the rhetoric that in our adolescent industry seems to invariably accompany every new wave. It seems that we never grow tired of pre-announcing the end of something or other, and the advent of some other thing or another. My goal here is to suggest that complex systems companies should refrain from doing what doesn't come naturally – i.e., force fit an on-demand architecture onto their business model – because with very few exceptions it just won't work.

In contrast, volume-focused software companies can attempt to adopt this model as long as they really comprehend what it takes to be successful in an off-premise mode as opposed to their classic packaged-software-plus-upgrades model. Indeed, the most successful companies to date in on-demand are demonstrating that this is more like a third business architecture trying to muscle its way in-between the two reigning models in tech – complex systems and volume operations.

Let's look at the unfolding differences between one man's "on-demand" solution and another's:

<b>Attribute</b>	<b>Managed/hosted service offering</b>	<b>On-demand service offering</b>
<i>Tenancy</i>	Single-tenant architecture	Multi-tenant architecture
<i>Customization</i>	1:1 customization via professional services	One-too-many mass customization via configurability
<i>Key value discipline</i>	Customer intimacy	Operational excellence
<i>Target market segment</i>	Large companies in target verticals	Departments, regional offices, or small-to-medium businesses
<i>Target customer</i>	LOB executive / CIO	Business owner or dept manager / end-user
<i>Management's compelling reason to buy</i>	Outsource data center operations without sacrificing tailored application benefits	Outsource application and data center operations to avoid having to implement in-house
<i>Key whole product attributes</i>	Domain expertise, strong SLAs for all service & support commitments	Standardized functionality, user-friendly interface, bulletproof 24x7 performance
<i>Key partners &amp; allies</i>	Data center service provider	Other on-demand SaaS vendors
<i>Pricing &amp; contractual model</i>	Enterprise-based subscription plus license/implementation fees; fixed-term contract	User-based subscriptions; annual or other fixed-term contract, renewable

On the first point above, related to the question of "tenancy" (whether the system is architected to operate for one client or for many simultaneous clients), allow me to quote an eminent industry analyst:

*"It is no trivial matter to design and code multi-tenancy into an existing enterprise software code base built to serve the needs of one company per implementation."*

You can say that again.

This analyst's comment makes clear that SaaS is something more than just a "delivery model," as many people affirm today. Agreed, the majority of SaaS-delivered applications do not generally aim – at least not yet – to introduce brand-new functionality; instead, they focus their disruptive approach on maximizing the rapid payback and lower risk attached to providing a pay-for-use service, as opposed to the pay-a-lot-upfront "promise" of on-premise software vendors. However, it cannot be overstated that multi-tenancy is a fundamental architectural principle that cannot be easily mimicked in a converted on-premise code base that was architected for one customer at a time.

There are a number of reasonably well understood reasons why a corporate customer, accustomed as they might be to on-premise systems, might decide to contract a true on-demand service, including (a) it helps them to respond quickly to user demand for a departmental application for which they have insufficient IT systems development resources, or (b) it provides lower risk and a quicker payback than an internally developed system would be expected to provide.

But there are also one or two less well understood reasons why these same organizations might reject a hosted solution in favor of the on-demand alternative. One interesting reason that I have heard occurring in several situations is the perception that they are less at risk of being held hostage to a capricious or malfunctioning service if the SaaS vendor is contractually obliged to guarantee 24x7 uptime for many other customers. Where large enterprises prefer a hosted solution, it is likely to be because they want to experiment with this form of outsourced offering as a pilot, or as a temporary way of managing a migration in their in-house systems.

One word of advice for enterprise software organizations: Today, service-oriented architecture (SOA) is a MUCH more important focus area for enterprise software companies to invest in than on-demand service offerings, unless their natural market is the so-called "SMB" universe - which by the way includes departments, regional offices or distribution centers that are part of larger corporate organizations. By implementing SOA in their system architecture going forward, today's enterprise software companies stand a better chance of regaining relevance by playing a critical role in enabling inter-enterprise collaboration between companies in the same business network than by making a futile effort to jump on the SaaS/on-demand bandwagon.

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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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