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BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS

Our SaaS survey drill downs reveal valuable insights into Open Source and SaaS and multi-tenanting
See pages 4-6.

Publisher &
Managing Editor
Merrill R. Chapman
rickchapman@softletter.com
860/663-0552

Research Editor
Lilith R. Chapman
lilith@softletter.com
860/663-0552

Editorial office
Soft•letter
34 Sugar Hill Rd.
Killingworth, Conn.
06419
Voice: 860/663-0552

Subscription office
Aegis Resources
34 Sugar Hill Rd.
Killingworth, Conn.
06419
Voice:860/663-0552
Fax: 860/663-0553
info@softletter.com

www.softletter.com

The 2007 Codies: Views and Observations

by Merrill R. (Rick) Chapman, Softletter

Since 2004 I've been a Codie Awards judge (technically, it's not "Codies" though everyone pronounces it that way), a job which consists of sitting through twenty to thirty product demonstrations once a year and evaluating them for a Codie award (the name is derived from "code"). The Codie Awards are the software industry's equivalent of an Oscar, and winning one does provide a definite kick to a company's marketing efforts (though how definite is hard to quantify. The effectiveness of Codie participation will be part of our upcoming marketing effectiveness survey). Codie judges are not paid for their labors (sigh) and we do not determine the final winners of the awards, though our votes determine who will move on to the finals and also comprise 50% of the final tally that picks the winners.

The reason I agreed to become a judge is that the job puts me in position to see first hand where the industry is moving to and how fast. It was my stint as a judge in 2004 (where I evaluated close to 50! different systems) that hammered home my earlier belief that the failed ASP movement of the 1999—2001 was crawling back from the grave and reanimating at a rapid clip.

This year I was one of the judges in the **Best Business Productivity** and **Best SaaS Solution** categories. Interestingly enough, only two of the applications I evaluated in **Business Producutivity** were non-SaaS software. (I also need to note that my observations here do not indicate which products I voted for to reach the finals.) In no particular order, these are the contestants that caught my attention.

XIFIN. XIFIN is an example of the ability of SaaS to penetrate niche markets. This application is aimed at the health care industry, a segment that over the last four years has seen the introduction of many new SaaS systems. XIFIN automates and manages the process of billing for lab tests. My wife has worked as a billing specialist in the health care industry and I've learned how tedious, complex, and financially vital this process is.

But that's not what particularly caught my attention, robust and useful as the application *(continued on page three)*

Advisory Board

Winning Business Models: Relationships

by Bruce Lafetra, Rubicon Consulting

If you have elementary school-age children, you're probably familiar with Knowledge Adventure Studios (KA) and its Jump Start line of educational software. KA's Jump Start titles combine games and educational content into a computer-based adventure world that makes it fun for kids to learn. Historically, KA sold software the traditional way: parents bought the grade-appropriate version for their child at retail, installed the application and KA hoped that the parent would repeat the process the following year with the next grade level.

A variety of free web sites offering educational programming for children threatened to undermine KA's business model. Recognizing that the situation was not going to get better and that the traditional model carried with it increasing costs and decreasing returns, KA decided to shake things up in terms of how and when it collects revenue, its relationship with customers, and how it sells and supports its products. In the process, they've fundamentally changed their business model.

KA used to sell a grade level application once per year for around $29, but this has fallen to $19 in recent years. In May 2007, KA introduced a new model. Now they sell a base application, Jump Start World, with 12 learning adventures. Each adventure is designed to take a typical kid about a month to complete. KA maintained the initial purchase price covering the base application and the first two adventures at $19.99 even though the application is much more engaging.

This modle drives trial and initial adoption and helps KA compete against free alternatives. In a razors and blades type model, KA makes its money by selling the additional 10 adventure modules for $8 each over the course of the year. Ideally, parents set it up so a new adventure is downloaded each time their child completes an adventure. When the child is ready for the next grade level, KA is dealing with a current customer and an on-going direct relationship rather than a 12-month-cold retail customer.

As a business model, subscription offers a smoother revenue flow, but in the process it also pushes companies to develop and maintain better customer relationships as customers can cancel at any time. To pull this off, KA must approach the customer relationship very differently from that of a software vendor selling a sub-$20 application. If they do things right, each customer has a lifetime value of $80-$120, so KA provides an amazing level of service and support for the initial purchase price. The customer is wowed when they compare the support to the purchase price, but KA can amortize the cost against a much higher potential value.

The question is: What constitues amazing support? Well, KA reps are reachable, responsive, provide pleasant and concise instructions with appropriate links to drivers and operating system updates. They even follow up! When was the last time you had a software vendor follow up with a personal email (not a satisfaction survey) to a closed incident? If you're like me, never.

Bruce LaFetra, senior marketing consulting, Rubicon Consulting, 101 Church Street, Suite 22, Los Gatos, Calif. 95030; 408 / 395-3910. E-mail: bruce@rubiconconsulting.com.

is—it was its origin. XIFIN was created by people with strong backgrounds in health care financials but very little programming experience. The product was developed to spec by various contractors and outsourcers. This underlines a fundamental shift in the industry driven by SaaS; extensive information about a niche market or specific industry is enough to drive development of complex applications; programming and technologyexpertise is far less important factor.

Collabnet. Collabnet is Open Source's SourceForge all grown up and with a price tag attached. Collabnet is an excellent example of how Open Source companies are making money; they're going proprietary in different ways while still attempting to keep the patina of Open Source approval spread evenly over the corporate corpus. The reason for this is simple; despite all the hoopla over Open Source, no one has ever found a way to make lot's of money off the model (you can make a decent living off Open Source if you're in the right niche and market, but no dating supermodels and no Ferarris) unless a strong proprietary element is introduced into the mix. (Yes, yes, I know, Google. But Google is an advertising company, not an application software firm. Google does not make money from its applications. Applications are there to drive eyeballs to Google, which in turn drives its ad business.) The press has recently been trumpeting the amount of VC being poured into Open Source (which isn't all that much when you look at other industry sectors) but an analysis of the companies receiving venture money such as MySQL with its "we charge if you charge" licensing and SugarCRM, with its proprietary extensions to its basic Open Source product it doesn't really want you to use, shows the path to profits Open Source is taking.

"Open Source and SaaS are more natural partners than people realize. Offering the source code to a SaaS product presents little danger to a software company in terms of the dynamics between a SaaS provider and its customers. What, after all, will the customer do with the code? Install it on the corporate servers? Hire a bevy of developers to extend and improve the code? But isn't avoiding all that the reason the customer bought SaaS in the first place?"

—Rick Chapman
Softletter

Adobe Document Center (ADC). Adobe is one of the kings of the desktop and a retail colossus but it sees the handwriting on the wall. As proof of this, I suggest you take look at ADC. The system functions as a document management and server primarily for PDFs and integrates document tracking, dispersal, analytics and DRM into a tidy and inexpensive package—$19.95 per month, with an unlimited number of documents you can distribute (but you pay more as the number of people who can access the document is increased.) Adobe is aiming this product at SMBs (isn't everyone these days) but I believe the real value of ADC is as an inexpensive E-publishing platform. E-publishing is about two years away from take off (just keep an eye on the price of flash ram and Pixel Qi. Pixel Qi has solved the readability issue that has plagued E-books, creating cheap screen displays that can be read at the 3Bs: bed, bathroom, and the beach).

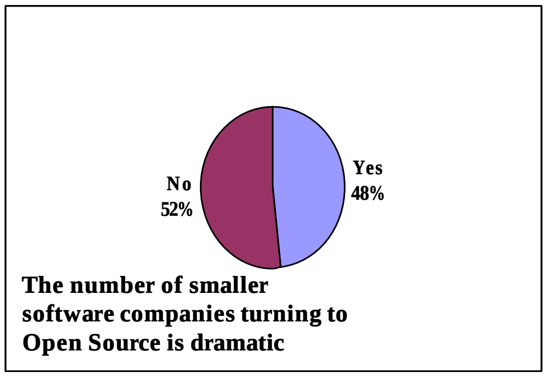
Generate g2. A cross between data systems such as Hoovers and OneSource and Linked-In. g2 allows you to search a robust database of industry figures and establish relationships within the confines of this system. While g2 doesn't let you step into the wild west world of network building a la Facebook and similar systems, it gives you a glimpse into the future of business-based relationship and social management.

Benchmarks: Open Source and SaaS; Multi-Tenancy and SaaS

When preparing the latest release of Softletter's SaaS (Software as a Service) Report we conducted a series of cross-tabs and drill downs into the results and generated some interesting results we'd like to share with you. In the 2006 report only 15.4% of our survey respondents replied that they were using Open Source in their product lines. The numbers changed significantly for the 2007 survey, with 28% reporting they used Open Source in their SaaS systems. But our drill downs uncovered even more interesting trends we'd like you examine.

Is your SaaS product based on Open Source software?

Companies Under $1m in Revenue

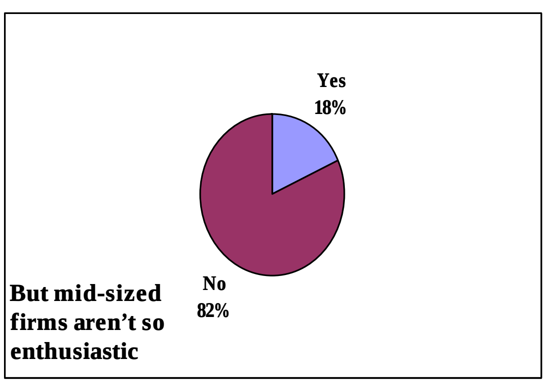


The question is why are smaller SaaS firms turning to Open Source in such large numbers? To gain insight into the issue, we contacted several of our suvey respondents and asked them. The answers broke down into two basic categories: cost savings and time to market.

When we looked at the $1 to $5m cohort, the numbers shifted dramatically down (results for the $5m to $10m and $10m to $99m segments are similar to those for $1 - $5m):

Is your SaaS product based on Open Source software?

Companies $1 - $5m in Revenue

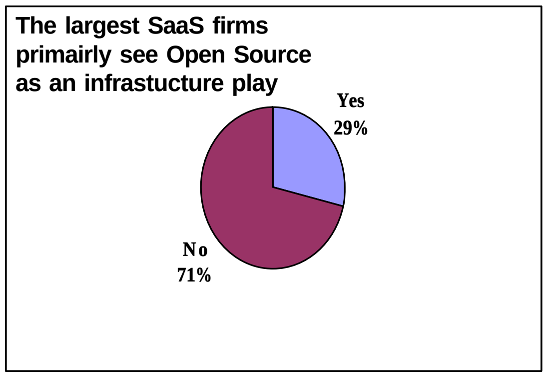


Why the sharp drop off in enthusiasm for Open Source amongst these larger firms? Again we turned to the phones and E-mail. The most common thread running through all the conversations that we had was that these companies had made their technology beds at this point and were focused on growing their customer bases, new releases, and solving various sales and marketing issues.

When we looked at the last cohort we measured, the 100m+ segment, the numbers shifted again in favor of Open Source, though not quite so dramatically as with the under $1m segment. When we spoke to management at several large SaaS firms, a common thread running through our conversations was that these companies saw Open Source as an infrastructure play, a means of shaving cost off server management and application serving. The major secondary reason offered was decreased development and component costs.

Is your SaaS product based on Open Source software?

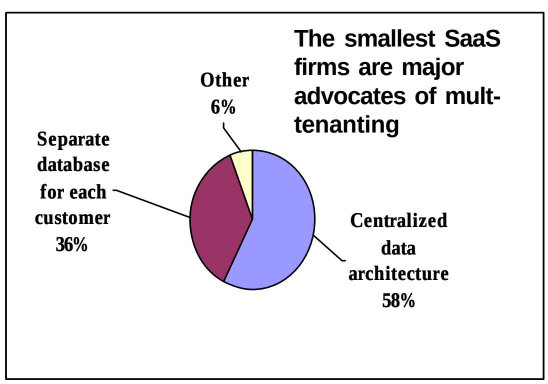
Companies $100m+ in Revenue



Our drill down in the multi-tenancy results also uncovered some interesting trends. In our 2007 survey, 53.5% of respondents reported that their SaaS systems were driven by multi-tenanted architecture, a very significant contrast with 2006's 62.4%. But notice the percentages for the under $1m segment:

Are all your SaaS customers served by a centralized data architecture (multi-tenancy) or do you have separate databases for each customer?

Companies Under $1m in Revenue

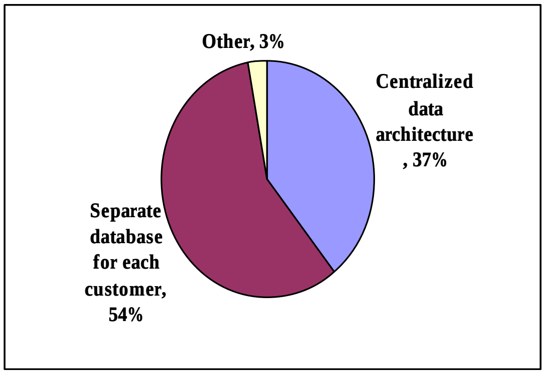


The under $1m out performs every other segment (except one) we analyzed, a surprise given the fact that architecting for multi-tenanting applications is not *(continued on page six)*

a trivial exercise, though it's becoming much easier as new development tools and components are released for SaaS and SOA environments. But as we look at the larger company segments, the numbers show an interesting fall off. Contrast these figures with the $5 - $10m cohort:

Are all your SaaS customers served by a centralized data architecture (multi-tenancy) or do you have separate databases for each customer?

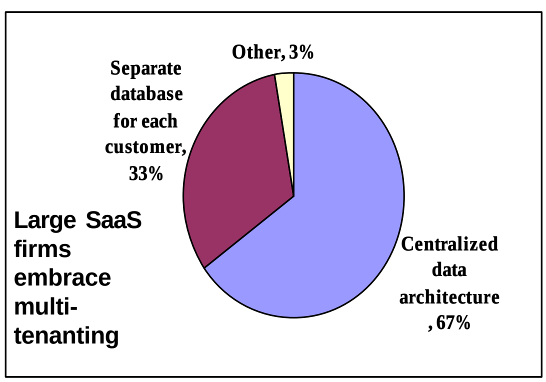
Companies $5 - $10m in Revenue



We interpret the 54% number for this segment of respondents very simply; they represent companies that moved into the market three to four years ago, before the benefits of multi-tenanted architecture were apparent. Individual research **(and personal experience)** into key companies in this segment help reinforce this supposition. But as these companies grow, they quickly discover the difficulties of scaling and move to multi-tenanting, as the following chart illustrates.

Are all your SaaS customers served by a centralized data architecture (multi-tenancy) or do you have separate databases for each customer?

Companies $10 - $99m in Revenue



We interpret the 67% in the segment also very simply; they represent companies that are growing strongly and have been forced by the need to scale to move to a multi-tenanted architecture, a fact we confirmed by talking to several survey participants and listening to a variety of horror stories. Several large firms not deploying multi-tenanting we contacted all told us they are moving to this architecture. We draw from this data the necessity for just about any SaaS company to implement a multi-tenanting strategy early in its life and / or to begin the transformation now.

Equities

When Your Sector Starts to Consolidate

By Ward Carter, Corum Group

With the high activity in software M&A, we are seeing entire sectors consolidating. Sooner or later one of your competitors will be acquired by one of the larger vendors. What are the implications for you and for your future as an M&A candidate?

1) Rather than having one less competitor, you now have one that is more viable, given the brand name and financial strength of the acquirer. Look for your market position to be further challenged.

2) There is now likely one less acquirer for your company, as the buyer has satisfied a strategic need. The buyer may still want you, but only for your user base and maintenance stream, and at a lower valuation than if you were their first strategic choice.

3) The acquisition may be an early indication of consolidation starting to gain momentum in your sector. Study the dynamics of your sector and recognize when the timing is right for an exit. Be ready to act as the market heats up.

4) Maintain your business model, continuing to grow and build the business, even in the face of consolidation. Buyers buy winners, and acquire leaders in a sector. Take care to position yourself so that buyers will find your story as objection free as possible.

5) Recognize that your value is based not just on technology, but also on your strong domain expertise, the strength of your development and support teams, your distribution, brand, strong user loyalty, partners, etc. All of this, combined with the right business model, has allowed you to grow and build predictable recurring revenue streams. Capitalize on all the aspects of the business, not just on technology.

6) Prepare early in anticipation of an M&A event. (Shameless plug: We'll educate you at our *Selling Up Selling Out* M&A conference.) There are many things you can do in advance of going to market to prepare your company for an exit, and you will also likely end of with a better managed company, exit or not.

Ward Carter, Corum Group, 10500 NE Eighth St., Bellevue, Wash. 98004; 425/455-8281. E-mail: wardc@corumgroup.com.

Company/Description	Acquired by	Price/Terms	Revenues	Multiple
Apertio	Nokia (NOK)	$205,900,000	$41,300,000	**4.99**
• *Real-time subscriber data platforms*		*Terms: Cash and stock*		
Bioscrypt Inc. (Canada) (BYT.TO)	L-1 Identity Solutions (NYQ)	$43,100,000	$20,000,0000	**2.16**
• *Enterprise access control*		*Terms: Stock for stock*		
Geospatial Information Services	Alliant Techsystems (NYSE)	$1,200,000	$500,000	**2.40**
• *MacDonald, Dettwiler and Associates' divestiture*		*Terms: Cash*		
Manatron (MANA)	Thoma Cressey Bravo	$66,000,000	$42,550,000	**1.55**
• *Property Tax Assessment/Billing Software*		*Terms: Cash*		

CORUM
MERGERS & ACQUISITIONS

CardFile

Domain Management and Protection Resources

- **DOMAINFest** (www.domainfest.com): Tradeshow dedicated to the domain name industry.
- **DomainNameNews** (www.domainnamenews.com): Site dedicated to the domain name industry.
- **Expired Domain Sleuth** (www.expireddomainsleuth.com). Software that allows you to monitor expiring domains and purchase them. Like many of these sites, text reads like an infomercial but software is functional.
- **ICANN Article on front running** (http://www.icann.org/committees/security/sac022.pdf): 2007 by ICANN on front running.
- **Questions to Ask Your Domain Registrar** (www.http://about.tucows.com/2007/03/25/questions-to-ask-before-you-pick-your-domain-name-registrar/): Useful article on front running and other tactics name registrars use to lock in business.
- **SnapNames** (www.snapnames.com): Site that conducts continuous auctions for expired domain names; also allows you to auction your own domains.

DOMAINNAMENEWS ON NETWORK SOLUTIONS FRONT RUNNING: "A story is developing regarding domain name registrar Network Solutions front running domains. According to multiple sources on DomainState.com, it appears that domains searched via NSI are being purchased by the registrar thereby preventing a registrant from purchasing it at any other registrar other than NSI. As an example (at the time of this writing), a random domain which DNN searches such as HowDoesThisDomainTasteTaste.com can be seen in this whois search to now be unavailable to register at other registrars but at NSI it can be purchased." (Quoted on http://www.domainnews.com/featured/domain-registrar-network-solutions-front-running-on-whois-searches/1359, 01/08/2008).

*(**Editor's Note**: We have confirmed this story and warn all our readers against using Network Solutions for domain registrations. Obtaining and managing domains is difficult enough without having to deal with this dishonest practice.)*

BLOGGER PAUL MAH ON WINDOWS VISTA FINANCIALS: "Bill Gates may have inadvertently revealed that Microsoft's flagship Windows Vista operating system is faring poorly compared to Windows XP.

Gates, speaking at the CES (Consumer Electronics Show) this week in Las Vegas, boasted that Microsoft has sold more than 100 million copies of the operating system since it was launched in January 2007. Based on previously announced figures for Windows XP, Vista outperforms XP unit sales by 10%.

According to Gartner however, worldwide shipments of PCs have almost doubled from 132.4 million units back in 2002 - where Windows XP was launched, to 255.7 million units last year." (Quoted on http://blogs.techrepublic.com.com/tech-news/?p=1863, 01/08/2008)

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Fax: 860/663-0553
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