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Soft•letter
BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS

Open Source and the SaaS Development Connection

In our last issue of Softletter we published research from our recent SaaS survey indicating that SaaS software firms, particularly smaller ones, were turning to Open Source to build their products. We were curious to discover more about this trend and spoke to Wayne Hom, CTO of Augmentum, a major outsourcer and development house focusing on resources from China. Augmentum recently finished a major development effort for Etology, a SaaS-based firm that creates a virtual ad marketplace for niche publications (such as Softletter).

Wayne, our recent Softletter SaaS survey indicated that almost 50% of SaaS companies under $1M in revenue were basing their products on Open Source software. What is your take on this trend?

Open Source can definitely assist a startup in getting to market faster. With SaaS, time to market and reliable delivery of services is key because of the extended ramp up to profitability.

Where Open Source truly shines is in its ability to function as a community-driven store of components that can drive a new product's underlying architecture. In this sense, Open Source replicates, but on a non-proprietary scale, the platforms being assembled by firms such as Salesforce.com and Netsuite. A new company looking to get up and running can rummage through a vast array of Open Source projects and often find valuable resources that can substantially speed their initial development efforts.

How do you know you'll be able to find what you need from the Open Source parts bin?

Open Source is very dynamic. Our business focus is on China because of the number of new engineers and architect-level personnel being turned out by their educational system. In terms of sheer volume, China is 10X India in the technical resources it's producing. We have a dedicated team at Augmentum dedicated to tracking the Chinese market in terms of Open Source technology;

(continued on page three)

Our CEO compensation survey portends changes in the industry
See pages 4-6.

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The Winning Business Models: Innovation vs. Invention

by Bruce Lafetra, Rubicon Consulting

Invention is the classic way to build a successful company. However, invention is much harder for a mature company or a mature technology. Business model innovation is an attractive option in many cases as a way to differentiate an offer, improve profitability or both. Below are five emerging business models.

 # 1—Crowd-Sourcing. Threadless (www.threadless.com) sells T-shirts in a whole new way. People submit their own shirt designs—125 per day—and the Threadless community votes on which designs get produced. The result: the winning designs get sold at a premium and there are no duds. The winning designers get $2000 and Threadless gets a low-overhead design process. It might take some thinking, but the crowd-source concept can apply to nearly any consumer product.

#2—Community Support. If you are looking for a way to lower support costs while creating good influencer buzz, check out McAfee (http://forums.mcafeehelp.com/). They've co-opted customers to support each other, and sing their praises in the process. McAfee has figured out how to use this to reduce their support costs and facilitate real-life answers to real-life problems. Any doubts about the viability of this approach evaporate when you look at the number of daily posts, both for individuals and in aggregate. One person averages 17 posts a day.

#3—Customer Advocacy. Sierra Snowboard: (http://www.sierrasnowboard.com/) is a snowboard shop in Sacramento, CA. They've created a community of outdoor enthusiasts that act as online advocates. Think of them as unpaid sales associates. What McAfee has done for customer support, Sierra Snowboards has done for the sales process. A grandmother might post a question about what to buy her grandson, and the community suggests just the right thing. You don't have to make the purchase at Sierra Snowboards, but why wouldn't you? The net result is great evangelism of products and great brand.

#4—Community Localization. We all know about Open Source product development, but 37 Signals (http://www.37signals.com/) engages volunteers to localize their product into 100+ languages. This is no accident, but a core element of the 37 Signals business model. They deliberately developed their application so it is easy to localize. The result is that a five person company was able to generate global reach and tons more revenue than for an English-only application. They even manage to get their users to translate collateral and help create local enthusiasts.

#5— Platform. The fundamental idea is to figure out how to get a vast "ecosystem" supporting your standard so that ultimately the whole ecosystem has to die for you to die. Big companies do this all the time: think Microsoft Windows, SAP R/3 or Intuit's Quicken franchise. On a smaller scale, Salesforce.com, Shutterfly, Second Life and others have built business models around the platform concept.

Not all of these concepts work for every situation, but that's not the point. The point is that innovative business models are powerful enablers.

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we're almost always able to find useful components and systems for our clients.

We've discussed Etology; how did you use Open Source to speed up their time to market?

The key technology underlying their entire system is an ad server. We used phpAdsNew (now OpenX) as the basic server engine. There wasn't a good proprietary technology we could use and if we'd had to write an ad server from scratch, it would have taken approximately six months. From the time the project was spec'd out to launch was 45 days.

Was the product in its original configuration suitable for commercial use?

No, and that's a critical point when considering using Open Source to get to market more quickly. Open Source can save you time and money when you're thinking about acquiring customer one, prototyping, or building a proof-of-concept version of your system for funding efforts. But I have never seen a single instance where an Open Source technology didn't need substantial reworking and proprietary extension for commercial use.

For example, phpAdsNew in its original configuration didn't have strong fraud detection capabilities; we had to rip out that part of the product and put in something new. Even more significant is that while the product performed OK, it couldn't scale sufficiently as Etology's business grew. By the time the company's website was serving two billion ad impressions per day, we had rewritten the entire system in C++ for performance.

In our experience, while Open Source can get you to market more quickly, once you're up and running, ongoing maintenance/development costs are no different from commercial software.

"When considering using an Open Source technology for a project, you should remember that while the functionality may be there and the cost is very attractive, once you crack open the code, you may find it's not very good. This is not a criticism of the programmers per se. The group or person involved may have wanted to prove a concept or arrive at a quick and dirty solution to a problem. If there was no incentive or reason for them to spend time optimizing their work, you should assume it hasn't been. This is particularly true of smaller and less well publicized Open Source projects."

—Wayne Hom
Augmentum

What about leveraging the Open Source community as the product in its original configuration suitable for commercial use?

There are practical problems with this. One is that companies do not want to contribute back to the community; they want to take, not give. Interestingly enough, they'd love to pay in many cases for the technology. Avoiding the GPL is not usually a question of greed; it's driven more by a desire to focus on business and avoid the distractions and legal issues the GPL introduces into a business.

The other issue facing community use is that even once you've contributed back, Open Source development is a meandering process. The community may or may not contribute and they'll focus on what interests them, not on your business priorities.

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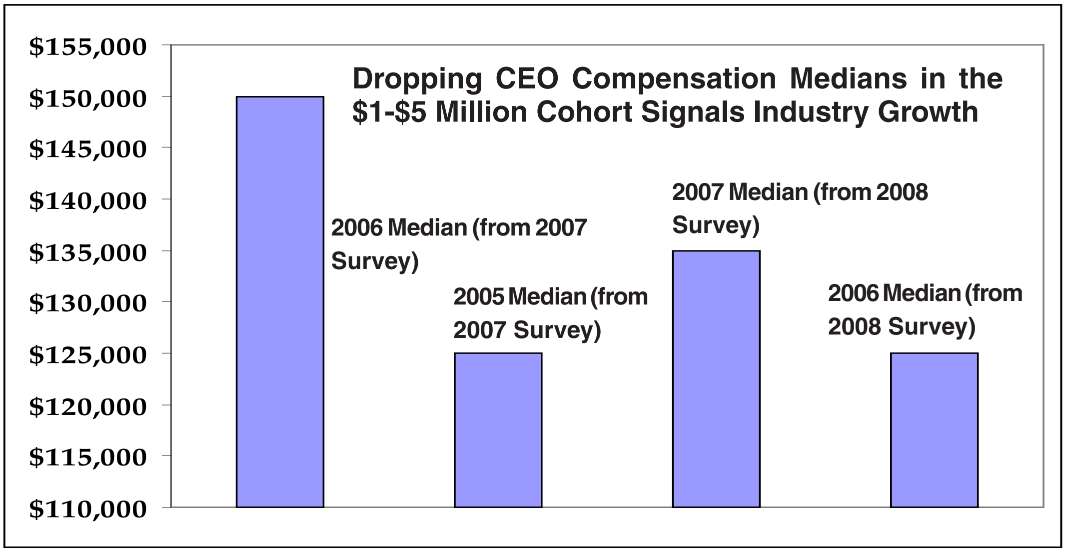

Benchmarks: Chief Executive Officer Compensation

Our 2008 survey generated 118 valid responses with all but two respondents providing titles that correspond to CEO or a variant thereof. Over the last several years our compensation surveys have been fairly smooth, with steady increases in medians and sensible increases in baseline figures showing up from year to year. Not this year. Our 2008 figures show shifts and instabilities in our medians and bases that only appear when the industry is undergoing fundamental changes.

For example, in 2007 our 2006 and 2005 figures showed base medians of $150,000 and $125,000, in the $1-$5 million cohort, respectively. This year, medians came in at $135,000 and $122,500. The reason for this decline lies in the number of new SaaS and "Web 2.0" companies rushing to market (and participating in our surveys). Drill down research into the companies that participated in the survey showed many companies with CEOs who are awarding themselves "bootstrap" wages as they attempt to build their companies and revenues. Since recurring revenue firms take longer to reach profitability than firms employing the licensed model, cash must be carefully preserved as the firm grows. In such an environment, lavish executive salaries must be deferred. We expect to see this pressure on executive salaries in smaller companies to continue for the next two to three years; salaries for companies further along the development path will show much more robust growth.

One change we've made in our survey is that we now list annual option and stock grants in our yearly compensation figures. Our rationale is that this will provide a more trackable and consistent look at compensation trends over time. We will cover executive exercising of options and stock cash-ins in a separate report in future issues of Softletter.

Our breakdown of public figures show, as in past years, that it's good to be the CEO, with Larry Ellison leading the pack again with a total 2007 compensation package of almost $36,000,000—this includes base, variable, and stock/option figures. For all public companies, the median base pay figure was $512,084, with the variable pay median coming in at $106,611. The combined median for base and variable was $690,878. These figures demonstrate the appeal of going public; by contrast, combined median pay for CEOs of companies in the $10-$99 million segment comes in at $335,000.

Overall Compensation—CEO*	Median	Top 25%	Bottom 25%	Raise in
Base Pay—current	$175,000	$300,000	$98,560	16.6%
Base Pay—last year	$150,000	$275,000	$90,000	
Variable Pay—current	$40,000	$125,000	30,000	33%
Variable Pay—last year	$30,000	$125,000	$15,000	
Total Pay—current	$215,000	$425,000	$128,560	19.4%
Total Pay—last year	$180,000	$400,000	$105,580	

* Number of respondents = 118 for "current," 117 for "last year."

CEO Pay by Company Size*	Base Pay	Variable	Total	Raise
Under $1 million—current	$90,000	$16,000	$106,000	1%
Under $1 million—last year	$90,000	$15,000	$105,000	
$1-$5 million—current	$135,000	$25,000	$160,000	12.3%
$1-$5 million—last year	$122,500	$20,000	$142,500	
$5-$10 million—current	$199,500	$45,000	$244,500	25.4%
$5-$10 million—last year	$165,000	$30,000	$195,000	
$10-$99 million—current	$240,000	$95,000	$335,000	.3%
$10-$99 million—last year	$235,000	$99,000	$334,000	
$100+ million—current	n/m	n/m	n/m	n/m
$100+ million—last year	n/m	n/m	n/m	

* Number of respondents = 13 for Under $1 million, 45 for $1-$5 million, 27 for $5-$10 million, 27 for $10-$99 million, and 1 for $100+ million.

CEO Pay by Development Stage*	Base Pay	Variable	Total	Raise
No significant customer revenue—current	120,000	n/m	n/m	n/m
No significant customer revenue—last year	120,000	n/m	n/m	
Privately owned, privately funded—current	$150,500	$30,000	$180,000	10.8%
Privately owned, privately funded—last year	$140,000	$22,500	$162,500	
Privately owned, venture funded—current	$200,000	$75,000	$275,000	7%
Privately owned, venture funded—last year	$190,500	$67,000	$257,000	
Public—current	$190,000	$140,600	$330,600	12.8%
Public—last year	$185,000	$108,000	$293,000	

* Number of respondents = 5 for No significant customer revenue, 72 for Privately owned, privately funded, 31 for Privately Owned, venture funded, and 7 for Public. Values are medians. n/m = Sample size too small for accurate comparisons.

The Top 50: Highest Paid Public Company CEOs

		Base Pay	Variable Pay	Total	Stock/Options
1	**Lawrence Ellison**, Oracle	$1,000,000	$11,093,424	$12,093,424	$23,874,680
2	**Henning Kagerman**, SAP AG	$1,079,000	$4,058,000	$5,137,000	$7,099,000
3	**Robert Beauchamp**, BMC Software	$919,712	$4,085,502	$5,005,214	$2,757,763
4	**Stephen Bennett**, Intuit	$1,100,000	$3,740,995	$4,840,995	$7,885,024
5	**Gary Butler**, Automatic Data Processing	$850,005	$3,504,970	$4,354,975	$5,152,482
6	**David Carlucci**, IMS Health	$801,250	$3,218,464	$4,019,714	$2,965,773
7	**Bruce Chizen**, Adobe Systems	$1,606,000	$2,312,500	$3,918,500	$3,683,971
8	**Michael Fister**, Cadence Design Systems	$1,000,000	$2,841,656	$3,841,656	$9,277,836
9	**John Swainson**, CA	$1,000,000	$1,644,013	$2,644,013	$5,842,603
10	**A.L. Giannopoulis**, Micros Systems	$1,500,000	$1,130,770	$2,630,770	$1,197,486
11	**John Chen**, Sybase	$990,000	$1,394,058	$2,384,058	$6,872,812
12	**Alfred Chuang**, BEA Systems	$862,500	$1,356,606	$2,219,106	$3,609,923
13	**Peter Karmanos Jr.**, Compuware	$999,475	$1,200,000	$2,199,475	$2,201,837
14	**George Pederson**, ManTech International	$1,271,158	$887,593	$2,158,751	
15	**John Schwarz**, Business Objects SA	$750,000	$965,935	$1,715,935	$3,772,101
16	**Aart de Geus**, Synopsys	$450,000	$1,259,860	$1,709,860	$290,000
17	**Jack Noonan**, SPSS	$450,000	$1,245,734	$1,695,734	$1,402,457
18	**Carl Bass**, Autodesk	$643,750	$1,003,500	$1,647,250	$4,435,427
19	**Jerre Stead**, IHS	$483,654	$820,000	$1,303,654	
20	**Steven Ballmer**, Microsoft Corporation	$620,000	$659,821	$1,279,821	
21	**Mark E. Fusco**, Aspen Technology	$400,000	$900,000	$1,300,000	$500,00
22	**John Thompson**, Symantec	$800,000	$458,611	$1,258,611	$3,523,104
23	**Judson Green**, NAVTEQ	$630,000	$623,169	$1,253,169	$362,645
24	**L. George Klaus**, Epicor	$736,403	$516,582	$1,252,985	$1,516,255
25	**James E. Cashman III**, Ansys	$440,000	$685,529	$1,125,529	$1,502,900
26	**David Dougherty**, Convergys	$964,000	$142,311	$1,106,311	$7,511,850
27	**Alfred Amoroso**, Macrovison	$500,000	$562,466	$1,062,466	$1,910,207
28	**Matthew Szulik**, Red Hat	$504,167	$551,280	$1,055,447	$4,175,536
29	**Marc Chardon**, Blackbaud	$525,000	$471,548	$996,548	$5,011,561
30	**Tony Aquila**, Solera Holdings	$475,000	$442,684	$917,684	$1,514,463
31	**Kenneth Klein**, Wind River	$650,000	$256,550	$906,550	$5,486,414
32	**S. Steven Singh**, Concur Technologies	$361,875	$487,500	$849,375	$417,682
33	**Jeffrey Yabuki**, Fiserv	$840,000	$2,100	$842,100	$3,570,069
34	**John Shackleton**, Open Text	$400,000	$429,201	$829,201	$368,007
35	**Harry Debes**, Lawson Software	$502,946	$265,089	$768,035	$1,665,845
36	**Vivek Ranadive**, Tibco Software	$500,000	$256,550	$756,550	$1,143,331
37	**Sohaib Abbasi**, Informatica	$450,000	$278,438	$728,438	$3,082,029
38	**Paul Ricci**, Nuance Communications	$524,750	$180,810	$705,560	$6,968,463
39	**Joseph Alsop**, Progress Software	$350,000	$345,587	$695,587	$180,000
40	**Francisco D'Souza**, Cognizant Technology Solutions	$360,000	$335,480	$695,480	$937,831
41	**Stephanie DiMarco**, Advent Software	$371,325	$243,848	$615,173	$657,033
42	**Netsuite**, Zach Nelson	$375,000	$225,000	$600,000	
43	**Aron Ain**, Kronos	$480,000	$105,823	$585,823	$873,671
44	**Eric Schmidt**, Google	$1	$557,466	$557,467	$3,772,101
45	**Alan Herrick**, Sapient	$300,000	$257,094	$557,094	$355,531
46	**Gene Hodges**, Websense	$494,712	$43,212	$537,924	$3,839,958
47	**C. Richard Harrison**, Parametric Technology	$520,000	$8,529	$528,529	$5,050,319
48	**Vincent Smith**, Quest Software	$150,000	$340,708	$490,708	
49	**Joshua James**, Omniture	$230,682	$218,212	$448,894	$193,142
50	**James Truchard**, National Instruments	$200,000	$28,960	$228,960	

Note: The 50 individuals here received the highest annual compensation of CEOs of public software companies with a current market capitalization of $500 million or more. In a few instances—Salesforce.com, for example—highly-compensated chief executives do not appear on this list because they receive only token salaries but collect substantial long-term gains from options and stock appreciation. "Variable" compensation includes bonuses, "non-equity" compensation, commissions, company-paid insurance, relocation/housing allowances, forgiven loans, memberships, profit-sharing contributions, etc. Source: Company proxy statements for most recent fiscal years.

Equities

Impact of the Sub-Prime Meltdown on Software M&A

By Nat Burgess, Corum Group

The sub-prime mortgage meltdown effects software M&A both directly and indirectly. If buyout debt is expensive or unavailable to buyout firms that rely on leverage, then valuations will go up or deals will evaporate. The busted First Data buyout is an example of a leveraged deal that fell apart when lenders balked at proposed terms. Several other large unannounced transactions were shelved as credit tightened. The collapse of deals like that has a lot to do with the market correcting itself after a huge run-up in debt multiples.

Anecdotally, several PE firms that we worked with in the first half of 2007 have told us that valuations would be roughly 20% lower in today's climate. Busted deals and lower valuations are symptoms of tightening credit and implicate the broader market rather than the consumer mortgage market, but consumer mortgages were the straw that broke the camel's back.

A secondary effect of the sub-prime meltdown will come into play as the battered consumer cries uncle and declines to buy more stuff. Over 100,000 workers in the home building trade have been laid off. Housing prices are in decline. The bar for home equity loans has been raised, even as appetite has diminished. We can expect regulatory intervention aimed at raising the jumbo threshold (which will have the unintended consequences of raising mortgage rates for low end buyers who are most in need of relief), and financial assistance to those on danger of foreclosure. Will these measures be enough to sustain consumer spending, which ultimately sustains corporate growth and confidence, which in turn helps drive risk-taking behaviors such as M&A? Time will tell.

Meanwhile, awash in bad news about credit, fuel prices, war and recession, we are having one of our best quarters since early 2007. The market is active, companies are preparing for M&A in near record numbers and deals are getting done. If we learn anything from the lessons of 2000, it is that we should run as fast as we can while the track is clear, because it won't last forever.

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Company/Description	Acquired by	Price/Terms	Revenues	Multiple
Apertio	Nokia	$205,900,000	$41.300,000	**4.99**
• Real-time subscriber data platforms		*Terms: Cash and stock*		
Bioscrypt Inc. (Canada)	L-1 Identity Solutions	$43,100,000	$20,000,000	**2.16**
• Enterprise access control		*Terms: Stock for stock*		
Geospatial Information Services	Alliant Techsystems	$1,200,000,000	$500,000,000	**2.40**
• MacDonald, Dettwiler and Associates' divestiture		*Terms: Cash*		
Manatron	Thoma Cressey Bravo	$66,000,000	$42,550,000	**1.55**
• Property tax assessment/billing		*Terms: Cash*		

CardFile

Cloud Top Resources

(Cloud tops are technology systems designed to allow desktop and Internet applications to, in theory, seamlessly exchange data across the Internet "cloud." All of these technologies are in their infancy, but some will survive to support the trend we have written about in the past of creating portable computing environments that "cut away the metal."

- **Adobe Air** (http://tryadobeair.com/?sdid=BDDWM): New SDK that allows developers to create hybrid desktop/Internet applications.
- **Gogle Gears** (http://gears.google.com/): Yet another Google "Beta" system for creating applications that run offline on the desktop; relies heavily on Javascript.
- **OpenLazlo** (www.openlaszlo.org/): Intriguing Open Source framework for developing web applications with a desktop look.
- **Microsoft Silverlight** (www.microsoft.com/silverlight): Described as a "browser plug in" but is actually a new framework for developing desktop/web application hybrids.
- **Mozilla Prism** (http://labs.mozilla.com/2007/10/prism/): Desktop/webtop application system; based on Frontrunner.

NEW YORK TIMES REPORTER RANDALL STROSS ON MICROSOFT AND YAHOO: "If Microsoft thinks this is the right time to try a major acquisition on a scale it has never tried before, it should not pursue Yahoo. Rather, it should acquire another major player in business software, merging Microsoft's strength with that of another. This is more likely to produce a happier outcome than yoking two ailing businesses, Yahoo's and its own online offerings, and hoping for a miracle.

For an illustration of how Microsoft could select targets more judiciously, Mr. Cusumano, who is a professor at the Sloan School of Management at the Massachusetts Institute of Technology, pointed to the Oracle Corporation's strategic acquisitions and its prudent use of capital to 'roll up firms with similar products and customers to its own.'" (Quoted in ***The New York Times***, 02/24/2008)

CHANNEL INSIDER REPORTER LAWRENCE WALSH ON VENDOR AUTHORIZATIONS: "Ingram Micro's Justin Crotty has a strong and surprising message for solution providers: Drop your vendors from your Web sites and marketing materials.

'Services is the key differentiator,' says Crotty, who oversees Ingram's Seismic managed services program. 'I've told the VARs over the past year to take the vendor authorization off their Web sites. They shouldn't define themselves by their vendor authorizations.'

He added: 'All they're indicating is that they're just like the tens of thousands of Microsoft, HP and Cisco partners.' (Quoted on http://www.channelinsider.com/c/a/Commentary/Time-to-Abandon-Vendor-Brands/?kc=CICNWEMNL022208STR4, Quoted on The Channel Insider, 02/13/2008)

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