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Soft•letter

BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS

Softletter Case Study: Working with the Analysts



Software companies seem to have been working hard to fix their profitability based on our recent operating profit per employee benchmarks See pages 4-5.

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In the 80s and through most of the 90s, analyst groups functioned mainly as purveyors of data for software and high-tech companies and/or their customers. However, as many software markets reached maturity and the industry's emphasis turned to selling higher-end and enterprise-class applications, the analysts began to gain increasing power in the product recommendation process, supplanting the press in many market categories in terms of their ability to influence purchase decisions. When making a decision to deploy a CRM package, a favorable analysis of a company by Gartner will far surpass the impact of an excellent product review in InfoWorld.

In 1997 Massachusetts firm Perseus Development (editor's note: Softletter uses SurveySolution to carry out our surveys), a pioneer in developing web-based survey software, introduced SurveySolution, and became the leader in this new software category. Perseus is an industry success story, named by "Inc Magazine" as one of the 25 fastest-growing private software companies in the US. The company's clients include such firms as Caterpillar and the US Coast Guard. But by 2003 Perseus faced competition from over 140 companies and products, both desktop and web-based. Worried that the company would get lost in the crowd, Perseus decided in February of 2005 to reposition SurveySolution as an enterprise feedback management (EFM) solution.

Recategorizing a product is always a difficult task and most efforts ultimately fail because most publishers do not have the credibility, influence, and perseverance to convince the public of the category's validity. But the analysts, particularly Gartner, can persuade corporate evaluators and buyers that a new category is valid. In the case of EFM, Perseus was ultimately successful in convincing Gartner that EFM was a valid category (<http://mediaproducts.gartner.com/reprints/perseus/126781.html>). We spoke with Perseus' Vice President of Marketing Dwight Galler on what the effort entailed and what he thinks the impact of Gartner's endorsement of the EFM category will have on sales of SurveySolution.

- **On developing an appropriate "TLA" (three letter acronym) for the new category.** "Members of upper management brainstormed for about six weeks on the appropriate TLA for the new category. We went through about 30 names before zeroing in on 'Enterprise Feedback Management.' The entire process took about six weeks with all members *(continued on page three)*

The Rebate Recoil

Rebates are a favorite promotional weapon often resorted to by ISVs who compete in today's brutal retail software market. But though widely used, rebates are just as likely to misfire in the hand of an unexperienced marketer as increase sales. A quick glance at retail websites reveals that rebates are still in wide use, though Best Buy has recently announced it will discontinue carrying products with rebates attached. Whether the consumer electronics giant has the clout to make the rest of the industry fall in line is debatable; a buyer we spoke to at CompUSA says that rebates will remain in their marketing development funds (MDF) arsenal.

From the standpoint of consumers, the principal source of unhappiness is the inevitable "please allow six to 12 weeks for fulfillment" proviso built into the programs. People aren't stupid; no one believes it takes that long to cut a rebate check. Nonetheless, cash flow issues make it impractical to speed up the process. To quote one software publisher who actively participates in rebate promotions:

If I sell in 1000 units of a retail package through distribution at \$22 with a "suggested" SRP of \$30 per unit and a \$10 rebate attached, I can anticipate being paid no earlier than 120 days. I can anticipate a 50% to 70% redemption rate on those units, meaning that if I pay out rebates within thirty days, I'm expected to hand over checks in the amount of \$5000 to \$7000 about eight weeks before I get paid. I can't afford to do that. On top of this, if I use a third party to handle rebate fulfillment, I have to factor in an additional \$1.15 to \$3.00 per check, depending on the options I pick, i.e. live operator calls, E-mail tracking, E-mail notification, etc.

Another problem facing unprepared ISVs is unrealistic expectations on rebate redemption rates. Some publishers expect that only 10% to 20% of purchasers will pursue their rebate checks. This expectation is unrealistic according to an impromptu survey of 10 companies in the retail arena who we queried about redemption percentages. The bad news is below.

SRP	Rebate Amount	Redemption Rate
\$49.95	\$30	90%
	\$20	70%
	\$10	50%
Typical Rebate Redemption Percentages		

The news is worse for net-to-zero programs; expect redemption rates to reach **99%** on software being sold at \$39.95 and higher and no less than **95%** regardless of your pricing.

There is some good news associated with rebate programs. Our survey respondents report that after a rebate program has ended, expect to see a sales slump the following week, then a "bounce back" effect that can push sales to as much as 10% over previous levels for as long as one quarter. However, this effect can be canceled by other factors (such as a competitor launching a rebate program immediately after yours has ended).

Our advice if you want to play the rebate game? Instead of standard rebates, do an "instant rebate" and offer customers a cash discount that's taken off immediately at the register. Your administrative overhead will be lower and in some cases the reseller may absorb some of the rebate cost based on your accrued MDF.

of senior management participating. The goal of the process was to allow us to begin the process of positioning EFM to Gartner.”

- **On why develop a TLA?** “We decided to follow precedent. In the last 10 years, most of the major new product categories seemed to have been associated with a TLA. CRM, ERP, BPM, etc.”
- **On the follow-up activities Perseus conducted after completing their TLA work:** “We developed a white paper and a PowerPoint presentation. In addition, we incorporated the TLA into a new release of SurveySolutions: “SurveySolutions, EFM.”
- **On why Perseus decided to target Gartner:** “We’re Gartner clients and while reading through their abstracts we focused on Esteban Kolsky’s analyses of the survey software market. After reading them, we felt he’d understand where we were going with EFM. His work made the point that customers were increasingly looking for survey products that could be deployed across the entire enterprise and were capable of consolidating customer feedback into repositories that could be accessed and used strategically.”

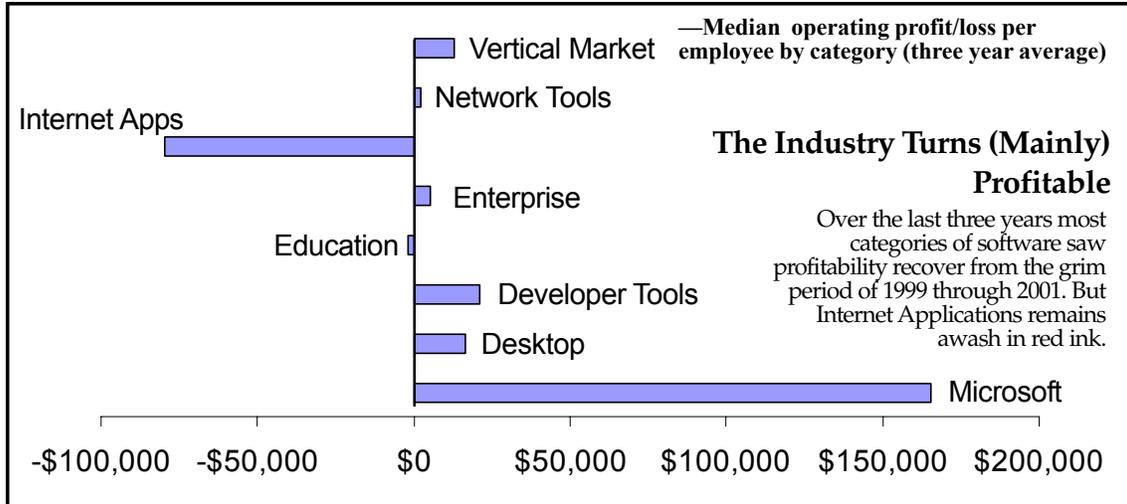
“For instance, most companies think of survey software as something that’s sent simply to people outside the company or perhaps current customers. But EFM products also encompass the ability to survey HR department, internal groups, and aggregate and track this information. I called him to discuss the EFM concept and found him interested in it.

“We did brief Forrester and tried to brief IDC on the EFM concept but didn’t have much luck; it didn’t resonate with them. We needed to find someone who thought EFM made sense.

- **On trademarking EFM.** “We didn’t. In fact, we encourage other companies to use it. We identified eight companies using the term and sent a brief message to Esteban when we did. Gartner identified several other companies also adopting the term.”
- **On the value of having an analyst talk to another analyst:** “I was an analyst with a West Coast firm in the 80s and found it was very useful in establishing a relationship with Esteban. I would definitely recommend that if someone in your company has worked as an analyst, you add them to your team.”
- **On why Perseus didn’t use their PR firm to establish initial contact with Gartner and other analysts:** “We felt that senior management was the right group to handle this relationship. Also, working with analysts is time consuming and hard work; I’ve found PR firms are often not inclined to work hard.”
- **On how long the process took before Gartner announced its acceptance of the EFM category:** “From the time we began developing the TLA to Gartner’s acceptance of the new category, 15 months, from the first
(continued on page six)

“Some of the runner ups to EFM included: “Acquisition of Constituent Knowledge,” “Answer Management System,” “Customer Feedback Management,” “Ecosystem Value Measurement,” “Feedback Project Solution,” “Panoramic Feedback,” “Measurement,” “Survey Knowledge Management,” and “Total Feedback Management.” The finalists were “Total Feedback Management” and “Enterprise Feedback Management.”

—Dwight Galler
Perseus



Benchmarks: Operating Profit per Employee

Revenue per employee is the industry’s most popular measure of productivity but smart executives need to be wary of putting too much reliance on it; a company can have good RPE figures and still be unprofitable. Operating profit per employee (OPPE) is, in our opinion, just as important when measuring your firm’s performance since this ratio shows how much individual employees are contributing to the overall financial success of your business.

Our recent profit per employee study shows a fairly dramatic swing back to profitability as compared to our last study in 2001. In that study, only two categories, Desktop Applications and Vertical Markets showed positive OPPE numbers in contrast with this study, which shows only two categories, Internet Applications (heavily) and Education (just barely) in the red. Particularly notable is the contrast in number in the Enterprise category: 2001’s abysmal -\$100,408 vs. 2004’s far more hopeful \$5,335. But the news remains grim for Internet Applications: 2004’s -\$79,756 is even worse than 2001’s -\$51,973. Interwoven and NetIQ are particularly dark standouts in this category, though 2004 saw the bleeding staunched somewhat.

We believe the basic profit turnaround can be attributed to three factors. The first is consolidation. The last few years have been hard on the software industry as various segments consolidated and reached “mid-life” status. As a result, weaker performers have disappeared or been absorbed by the competition and many of the price cutting orgies that distinguished the early years of the new millennium have subsided (to many IT departments dismay). The second is the economy fully recovered from the double whammy of 9/11 and the dot.com bubble in 2000. The third is that salaries and income expectations have returned to earth, driven by slower growth in the industry and the pressures of outsourcing.

As previously noted in our other studies, Microsoft’s performance in every profitability and revenue benchmark remains impressive.

The Benchmark 50: Operating Profit per Employee

	2002	Employees 2003	2004	Operating Income/Employees Avg.			
				2002	2003	2004	'02-'04
Microsoft	50,500	55,000	57,000	\$163,802	\$173,545	\$158,491	\$165,280
Desktop Applications				-\$29	\$8,192	\$40,796	\$16,320
Adobe	3,341	3,507	3,142	\$85,911	\$108,197	\$188,349	\$127,486
IMSI	62	41	105	-\$29	-\$63,659	-\$35,914	-\$33,201
Intuit	6,500	6,700	6,700	\$7,769	\$51,229	\$62,735	\$40,578
Macromedia	1,216	1,085	1,213	-\$196,189	\$1,534	\$40,796	-\$51,287
Scansoft	489	806	832	-\$34,624	\$8,192	-\$7,767	-\$11,399
Smith Micro	56	55	52	-\$109,304	-\$31,345	-\$17,019	-\$52,556
Symantec	3,900	4,300	5,300	\$2,062	\$79,421	\$96,903	\$59,462
Vertical Market Applications				\$15,861	\$8,679	\$13,374	\$12,638
Advent	981	764	752	\$100,075	\$32,673	\$141,273	\$91,340
Ansys	450	600	550	\$92,000	-\$25,888	-\$72,107	-\$1,999
Autodesk	3,498	3,493	3,477	\$7,740	\$8,679	\$13,223	\$9,881
Dendrite	1,559	2,524	2,549	\$15,861	\$13,797	\$18,762	\$16,140
Kronos	2,200	2,400	2,500	\$31,915	\$34,413	\$36,394	\$34,241
MapInfo	681	708	800	-\$6,232	-\$2,942	\$13,374	\$1,400
Moldflow	246	246	291	-\$7,264	-\$362	\$10,148	\$841
Enterprise Applications				-\$4,081	\$2,454	\$17,633	\$5,335
Business Objects	2,162	3,924	3,834	\$22,070	\$9,989	\$21,323	\$17,794
Concur	338	313	350	-\$36,849	\$2,454	\$4,997	-\$9,799
Manhattan Associates	955	1,117	1,400	\$38,511	\$27,327	\$22,441	\$29,426
Mercury Interactive	1,822	2,322	2,659	\$37,263	\$20,919	\$35,224	\$31,135
ServiceWare Technologies	67	51	106	-\$476,642	-\$110,608	-\$9,491	-\$198,913
SPSS	1,263	1,252	1,165	-\$13,514	\$102	\$5,645	-\$2,589
Witness Systems	309	497	485	-\$4,081	-\$43,390	\$17,633	-\$9,946
Internet Applications				-\$164,820	-\$46,703	-\$27,745	-\$79,756
Cryptologic	139	175	291	-\$164,820	-\$46,703	-\$38,914	-\$83,479
Centra	268	258	208	\$67,455	-\$8,252	\$45,389	\$34,864
Interwoven	608	696	696	-\$252,462	-\$71,639	-\$35,066	-\$119,723
NetIQ	1,253	1,364	1,322	-\$585,354	-\$247,906	-\$142,394	-\$325,218
RealNetworks	689	740	819	-\$45,942	-\$28,193	-\$27,745	-\$33,960
Ultimate Software Group	415	433	456	-\$34,754	-\$20,903	-\$11,243	-\$22,300
Verisign	3,200	2,500	3,206	-\$1,500,510	-\$91,300	\$41,088	-\$516,907
Network Tools				-\$2,597	-\$813	\$9,311	\$1,967
Citrix Systems	1,670	1,885	2,656	-\$366	\$6,781	\$9,311	\$5,242
McAfee (Network Associates)	3,800	3,700	2,950	\$27,332	\$41,727	\$53,895	\$40,985
NetManage	350	236	225	\$438,523	\$486,131	\$291,791	\$405,482
Novell	6,524	5,734	6,186	-\$2,597	-\$813	\$244	-\$1,055
Spescom (Altiris)	424	600	750	-\$160,672	-\$46,370	\$77,589	-\$39,818
Tarantella	147	90	100	-\$100,565	-\$102,900	-\$159,500	-\$120,988
Tumbleweed	133	250	270	-\$150,459	-\$39,640	-\$28,496	-\$72,865
Developer Tools				\$11,897	\$26,421	\$25,054	\$21,124
BEA Systems	3,063	3,122	3,353	-\$6,069	\$42,836	\$52,102	\$29,623
Borland Software	1,608	1,358	1,361	\$11,897	-\$29,406	\$13,721	-\$1,263
Pervasive Software	40	160	245	\$146,650	\$42,094	\$31,718	\$73,487
Progress Software	1,291	1,391	1,552	\$21,862	\$26,421	\$29,874	\$26,052
Raining Data	145	150	142	-\$112,179	-\$180	-\$1,324	-\$37,894
Red Hat	566	681	940	-\$238,131	-\$25,402	\$3,134	-\$86,800
Sybase	3,917	3,660	3,568	\$14,597	\$28,505	\$25,054	\$22,719
Education				-\$2,225	-\$3,020	-\$112	-\$1,786
American Education Corp.	72	65	70	\$1,750	\$17,523	\$13,843	\$11,039
Apollo Group	5,857	8,036	10,487	\$43,342	\$48,191	\$41,787	\$44,440
Click2Learn	356	243	308	-\$31,031	-\$42,486	-\$19,140	-\$30,885
Docent	224	166	149	-\$285,978	-\$147,114	-\$72,826	-\$168,639
Plato Learning	493	750	787	-\$2,225	-\$3,020	-\$112	-\$1,786
Renaissance Learning	997	988	942	\$47,634	\$48,832	\$36,514	\$44,327
Saba Software	333	285	258	-\$76,102	-\$61,189	-\$47,946	-\$61,746
All companies				-\$2,411	-\$39	\$13,547	\$3,699

presentation to Esteban, 13 months.”

- **On the process of briefing and building a relationship with Esteban:** “We made two formal presentations to Esteban over the 13 months, each presentation lasting approximately one hour. He works out of an office in Phoenix so both sessions were conducted via web seminars. These presentations were very high level and focused on breaking down the development of the market into various adoption states and looking at future growth and trends in EFM. The only features we demonstrated were key capabilities that reinforced the EFM positioning. In the interim, we called him approximately every two months, and E-mailed him monthly. We also cc’d him regularly on information that pertained to EFM and its adoption by the market. The key to this is to provide an analyst with as much advance information and industry knowledge as possible; it’s their stock in trade.”

“Gartner did broaden our definition of EFM. We picked “feedback” as a synonym for surveys; they’ve expanded the market to include what they call ‘unstructured data streams.’ So EFM would include conducting text analysis on the E-mail streams to tech support and to sales, for instance. An interesting expansion.”

—Dwight Galler
Perseus

- **On the power of analysts to influence sales in enterprise software markets:** “It’s huge. We anticipate the Gartner endorsement of EFM will help us double sales this year. It’s comparable to what an endorsement by a major PC publication can do for a low-end product. In 2000, we received *PC Magazine’s* Editor’s Choice award and sales doubled. The Gartner endorsement also has had a strong impact on our PR efforts. Since their EFM announcement, we’ve had five calls with major IT and business publications who want to write about the category and us.

“But analysts are also a very important channel of communications between customers and ISVs. In a week’s work an analyst can talk to several companies that might be interested in purchasing our products and make direct recommendations to evaluate our product before making a purchasing decision: ultimate word of mouth.”

- **On marketing activities post Gartner’s endorsement of EFM:** “We’re integrating Gartner’s statements into all of our marketing and sales collateral and are developing web seminars based on the EFM category. We also purchased from Gartner merchandising rights to the report; this gives us the right to give it away. The cost is about \$5K for 2500 copies.”
- **On Perseus’ biggest mistake in the process.** “Because I was an analyst myself, I didn’t realize how much Gartner had changed or how powerful their endorsement had become. We should have become customers years before we did. In my opinion, yes, Gartner does have a strong separation between church and state and you’re not going to buy a category endorsement by becoming a client. But before you rush into this, understand it’s a \$40K to \$100K investment. It’s tough for a small company to afford it.”

- **On when a software company should initiate an analyst relations program.** “If you’re an enterprise company, from day one.”

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What Will Kill the Current Boom in Software M&A

By Bill Montgomery, Corum Group

In the first quarter, M&A Activity was perhaps the strongest in five years and most observers forecast continued strong activity through 2005, clearly an improvement over the last several years. Activity and software company valuations are in the range of historical norms and are no longer influenced by "bubble equity." However, the M&A recovery and software industry valuations are driven by the overall health of the capital markets and corporate IT spending, neither of which are on a steady track.

Historically, M&A activity tracks closely with the stock market's performance. This is due in part because publicly owned technology companies, the likeliest buyers of software companies, prefer to use highly priced stocks as currency for deals. Another driving factor is that good earning performance tends to drive stock prices and generate kudos from analysts evaluating a company's M&A deals.

Corporate spending on IT also depends to some degree on the capital markets; this in turn directly influences software M&A activity. When enterprise customers are spending on IT, public software companies look for new technology and products to acquire for competitive differentiation and incremental revenue. About the only thing that can safely be predicted about the stock market in 2005 and 2006 is its direction will remain unpredictable. Pessimists point to the war, the price of oil, serious offshore competition and modestly increasing IT budgets as threats to the M&A recovery.

However, the law of "increasing returns" in the software business is likely to keep the current momentum going for two reasons unless the economy tanks. First, customers prefer to buy from fewer vendors with comprehensive product suites. This allows them to mitigate risk and take advantage of easier integration and staff training. Second, many software niches are fragmented, that is, the four biggest competitors together have less than 50% of the market. Fragmented markets are unstable and market leaders tend to absorb their competitors in order to obtain customers and technology.

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Company/Description	Acquired by	Price/Terms	Revenues	Multiple
ABAQUS, Inc • Engineering simulation software	Dassault Sys. (DASTY)	\$413,000,000 <i>Terms: All cash</i>	\$100,000,000	4.13
Acterna (ACTN) • Broadband/optical test gear for networks	JDS Uniphase (JDSU)	\$760,000,000 <i>Terms: All stock</i>	\$410,000,000	1.85
Arche Communication SAS • Network security services	Telindus NV	\$59,000,000 <i>Terms: All cash</i>	\$119,300,000	0.49
Retail Store Systems • System integrator selling to retail industry	Torex Retail	\$27,900,000 <i>Terms: Cash/stock¹</i>	\$41,700,000	0.67

1. Undisclosed

Analyst Analysis Sites and Information

- **Alan Weinkranzt** (<http://alanweinkrantz.typepad.com>): PR blog that offers some useful information on dealing with the analysts.
- **Analyst Views** (www.analystviews.com): Tracks the views and research of nearly 200 IT analyst firms. Also publishes the Analyst Views Top 50. Offers an exhaustive directory of firms.
- **The Knowledge Capital Group** (www.knowledgedecap.com): Firm specializes in working with high tech industry analysts; site contains useful information on the analysts and their mindset.
- **SoftwareMarketSolution.com** (www.softwaremarketsolution.com): Site hosts an article by the editor on analyzing the analysts.
- **TheTekrati** (www.tekrati.com): Offers analyst relations staffing, consulting and referral services plus global analyst news, conferences and directory. Clients include high tech vendors, IT professionals, research buyers and PR/marketing agencies.

ZIFF-DAVIS REPORTER DAVID BERLIND on Microsoft's entry into the anti-virus market: "For example, if Microsoft gave away OneCare for free, or if it takes advantage of its dominance in desktop and notebook computers to promote the service in ways that other anti-malware cannot, the entire desktop security software sector might go running to the trustbusters. By charging for the service, Microsoft keeps itself on an equal playing field with the rest of the solution providers and is therefore playing fair." (Quoted on <http://blogs.zdnet.com/BTL/?p=1380&tag=nl.e539>, 05/13/2005)

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GARBAN INTERCAPITAL ANALYST RICHARD WILLIAMS on the fate of McAfee and Symantec: "This could be devastating to McAfee and Symantec. The market currently occupied by McAfee and Symantec will shrink significantly. Much like Apple, they will still have a business but their market share will be permanently small." (Quoted on Good Morning Silicon Valley, 05/16/2005)

MICROSOFT CEO BILL GATES ON THE IPOD: "I don't think the success of the iPod can continue in the long term, however good Apple may be. I think you can draw parallels here with the computer—here, too, Apple was once extremely strong with its Macintosh and graphic user interface, like with the iPod today, and then lost its position." (Quoted on Frankfurter Allgemeine Zeitung, 05/12/2005)

DUKE PROFESSOR OWEN ASTRACHAN on the current status of US education and the computer sciences. "The slope shows an unbelievable decline in computer science majors. There are smart people no longer even signing up to take our introductory courses. We need to fix it, or there's not going to be a US work force in computer sciences." (Quoted in The Herald-Sun, 05/17/2005)