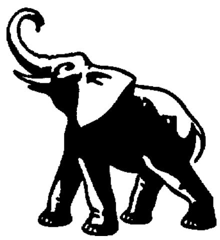
Thursday, June. 30, 2005
Vol. 21, No. 12

Soft•letter
BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS

ASP/SaaS Pricing Models, Part II of II

In the last issue we saw how providing big-company technology for smaller companies via ASP services lends itself to complex pricing and examined the matrix of ways the ISV can generate revenue via the ASP model. In part two we examine further the issues of complexity, commoditization and channels as they impact ASP pricing approaches.



Very big remains better in 2004 when it comes to sales and marketing efficiency
See pages 4-5.

Complexity and Pricing

Complexity is necessary because pricing based on seats or flat subscription rates does not relate use and benefit for the customer; the most effective and persuasive pricing enables the customer to see the value of the usage: this is on-demand pricing. Simpler rates were used only because the ISVs were not yet ready to meter usage in any other way. On-demand usage and pricing join cost and value in the customer's mind (http://news.com.com/2100-1011_3-5075629.html).

Threshold Digital Research Labs (www.threshold-digital.com) provides animation services and uses IBM to supply as many as 2,000 server processors on an as-needed basis for rendering [http://news.com.com/2100-1011_3-5075629.html]. Threshold claims its IT savings are 20 percent. Lego (http://www.lego.com) has a seasonal business (Christmas) and so uses IBM the same way. From the vendor point of view, assembling a balanced portfolio of customers to even out demand to ensure full use of assets would be efficient; fireworks (peak 4 July) could balance toys (peak 25 December). Sun, HP, and IBM all offer such on-demand off-site processing.

Complex pricing and clear usage/benefit also get the vendor past the typical objection of customers to multi-year, fixed-price contracts. Because they know that multi-year fixed-price contracts benefit the seller (who enjoys declining fixed costs), customers will want these contracts to include pricing reviews. If an ISV is going to use a fixed-price, it would be wise to forestall these objections by allowing the customer to share the benefits of the lowered costs by lowering the price over time and thus sharing the savings. In any case, a higher initial price enables faster recouping of the upfront costs than would a flat structure. Flat structures may still be demanded by cautious businesses who want to know exactly what their costs will be, and are unpersuaded that increased use and cost will bring increased revenues. In any case, ASPs convey a *(continued on page three)*

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Rules for Effective Business Blogging

When making the decision on whether your company should start a business blog, don't look at the decision in isolation but rather in the context of what the blog's objective will be and the role it will play in supporting sales and marketing. (The desire of the CEO to take an ego trip or muse about the industry doesn't count as meeting these objectives; this is a "consumer" blog, a very different animal.) Despite the hullabaloo, blogs are not that unique, and much of the furor over them comes from a consumer "golly, gee-wiz" reaction to a blog's ability to bring the utility of the web to a larger, nontechnical audience.

If you make the decision to create a business blog, these guidelines will help insure your effort is a successful one:

- Avoid creating too much irrelevant content (no matter how funny you think you are and how witty your musings). The danger of being of being perceived as a lightweight is always there and once developed, stereotypes carry over to other communications channels. People in upper management sometimes think their opinions on topics outside their sphere of knowledge are of interest to others. They aren't; take a lesson from the various celebrities who pontificate about politics to general disinterest.

- Allow readers to provide feedback and contribute and be prepared to take the time to monitor and edit comments—otherwise, they'll have a tendency to spin out of control (e.g., like F**company.com = pure crap). Also remember that if a feedback capability is provided and there is little or no feedback, a visitor quickly draws the conclusion that the blog is irrelevant.

- Avoid the usual deadly chronological blog organization—business people don't want to sort through all that verbiage. Organize your blog so a reader can scan it quickly and see if they want to explore any of the topics - a visitor is often not really interested in pure 'brain droppings'. In my experience, the format that works best is similar to the front page of a newspaper with headlines and story leads which then jump to a page on the topic; this in turn helps interested parties find the blog with conventional Google searches (the Google ranking algorithm looks for multiple mentions of keywords on different pages of a web site).

- Your blog needs to be searchable; at minimum, add the free Google search bar, which can be set up just to search the site, and then add topics (keywords) that are addressed by the bloggers so the visitor has some idea of what's covered on the blog.

- Skip the "gonzo" writing style—Hunter S Thompson could get away with it, but few others can pull it off. And don't blog if you can't write; just because you can type doesn't mean you can express ideas with the written word.

- If you're going to launch a blog, develop a plan to encourage as many companies as possible to link to it if high search engine rankings are important to you. The joke in the industry right now is that blog is an acronym for ''better listing on Google." Blogs can take the place of those infamous "link farms" that can you get you blacklisted on Google and other search engines.

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solid benefit to any business by freeing it from worrying about license compliance, either from the standpoint of avoiding the license police by zealous monitoring of purchases, receipts, certificates, and use, or from the standpoint of demonstrating best business practices compliance in the case of other audits, notably Sarbanes-Oxley, section 404. These burdens lie on the vendor and the ISV.

"Commodity products are not candidates for ISV ASPs because they do not offer otherwise unaffordable technology to customers."

—Don Rosenberg
Stromian

The ISV, on his side, has one solid benefit, the same one he wishes to sell to his customers. He controls the environment in which his applications run, and controls their integration to suit himself. He can also take advantage of free Open Source resources on the Internet, provided he is willing to refine them, tune them, and integrate them. Currently there is great interest in LAMP (http://en.wikipedia.org/wiki/LAMP), the Open Source stack (OS, Web server, database, application logic). Users can download and integrate all the pieces themselves, or buy a tuned version from an ISV like SpikeSource (http://spikesource.com/). Or an ISV could do all this work and host the platform on his own servers, offering not only use of the software, but integration and hosting services. Additionally, if he reads the fine print of the current GNU GPL, he would discover that because he is not distributing his particular tweaks and improvements (but merely making them remotely available to users), **he need not share their source code**.

On the other hand, all this centralization and control leads to a heavy responsibility for the ISV: he must maintain the highest levels of Internet connectivity, and if he is serious about recruiting well-paying customers, he must provide for liquidated damages in compensation for uptime failures, or disclaimers allowing only a very small amount of downtime. One component of pricing will be the strength of these guarantees: the stronger they are, the higher the price. It is services like these that differentiate products and maintain their higher prices in the face of the eventual fate of all maturing goods: commoditization.

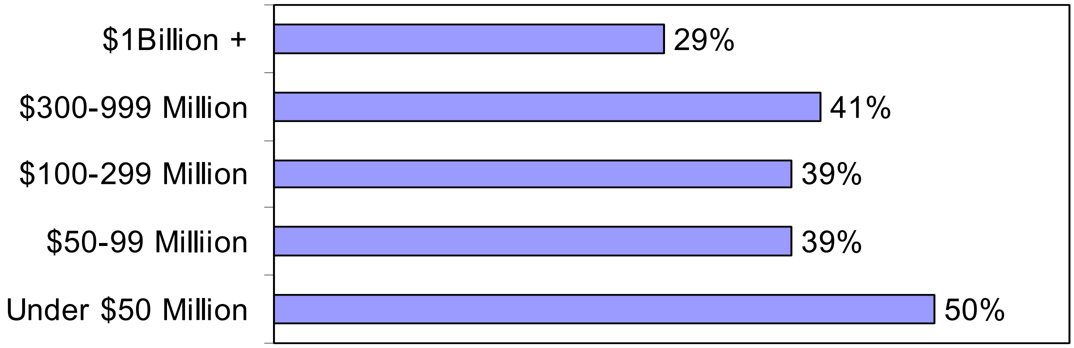
Commoditization, the Desktop and ASPs

As previously explained, commodity products are not candidates for ISV ASPs because they do not offer otherwise unaffordable technology to customers. The current flirting with remote desktop software (office suites on PCs used as terminals) may make sense in larger companies seeking to standardize desktops and to simplify their administration, but we know of no company offering ASP office suite services. There have, however, been free Open Source projects that offer such services, primarily as a vehicle to experiment with and show off Linux capabilities. Sun offers large companies their choice of OS (Solaris or Linux) for $50/year/seat, and their StarOffice suite for the same price. These could either be installed directly on desktops or served to them. The flat pricing (cheaper if done on a pure employee headcount) reflects their commodity status.

Can we expect to see prices for ASP CRM and ERM products decline? Such a decline is already appearing in *(continued page six)*

A Stable Picture

Sales and marketing costs remained stable from 2003's figures; the largest companies ($1B+) continue to enjoy a significant advantage over smaller competitors



Benchmarks: Sales and Marketing

Current S&M/Revenue ratios for this year are substantially the same as last. The largest firms continue to enjoy a significant S&M percentage advantage over their smaller rivals; the overall trend shows that software firms have slightly improved their S&M dollar ratios.

While Microsoft skews total figures for the Benchmark 50 to an average of 26% S&M/Revenue ratio, without Microsoft the figure is 33%; the mean (including Microsoft) is 38%. The very small general improvement in the ratio indicates that firms have already squeezed out most of the waste in the past few years. Categories showing the greatest continuing improvement are Desktop Applications, Vertical Market Applications, Enterprise Applications, and Education.

Incremental improvements in marketing can save small sums, but a look at outliers shows that strategic changes can have a major impact. Both Docent and Click2learn reduced their S&M ratio over this period as a result of their 2003 merger agreement; doubling the company's size moved them from the <$50m size category to the more efficient <$100m category.

In a small company like Smith Micro, the addition of a single large OEM customer like Verizon can significantly raise revenues while S&M expense remains relatively constant. In addition, Smith Micro's withdrawal from channel sales during this period lowered their S&M expense, as did cutting advertising expenditures by 83%.

Apollo Group (University of Phoenix) has grown aggressively in the distance learning market. Continued aggressive growth in the face of emerging competition and overseas expansion account for its S&M ratio; it is already 24% in the latest 10-Q, though the company continues to stand out for its relative marketing efficiency vis a vis its competitive group.

Data for this analysis has been drawn from the Benchmark 50, a group of 50 public software companies whose financial results are broadly representative of trends in the software marketplace. The 50 companies are divided into seven product- and market-related segments, plus Microsoft in a category of its own.

The Benchmark 50: Sales and Marketing

	Revenues (000)			Sales & Marketing			Avg.
	2002	2003	2004	2002	2003	2004	'02-'04
Microsoft	$28,365,000	$32,187,000	$36,835,000	**22%**	**23%**	**23%**	**23%**
Desktop Applications				**37%**	**36%**	**35%**	**36%**
Intuit	$1,312,228	$1,650,743	$1,867,663	20%	20%	20%	20%
Macromedia	$336,913	$369,786	$436,168	43%	42%	42%	42%
Adobe	$1,164,788	$1,294,749	$1,666,581	33%	33%	31%	32%
Symantec	$1,071,438	$1,406,946	$1,870,129	40%	37%	35%	37%
IMSI (Int'l Microcomputer)	$8,484	$8,095	$11,985	30%	32%	43%	35%
*Scansoft	$62,717	$106,619	$135,399	40%	41%	48%	43%
Smith Micro	$7,131	$7,216	$13,316	31%	23%	11%	22%
Vertical Market Applications				**38%**	**36%**	**34%**	**36%**
Autodesk	$824,945	$951,643	$1,233,767	43%	41%	37%	41%
Moldflow	$35,088	$36,625	$48,673	52%	51%	41%	48%
Ansys	$91,011	$113,535	$134,539	22%	22%	19%	21%
Advent	$159,436	$137,159	$137,159	35%	33%	28%	32%
*Dendrite	$225,756	$321,107	$399,197	34%	34%	33%	34%
MapInfo	$92,598	$106,255	$124,673	42%	39%	34%	38%
Kronos	$342,377	$397,355	$450,694	32%	31%	29%	31%
Enterprise Applications				47%	44%	43%	44%
Concur	$45,097	$56,737	$56,550	37%	26%	25%	29%
Manhattan Associates	$175,721	$196,814	$214,919	15%	16%	16%	16%
ServiceWare Technologies	$12,502	$11,511	$10,158	43%	44%	47%	45%
Mercury Interactive	$400,122	$506,473	$685,547	48%	47%	46%	47%
*Witness Systems	$67,686	$108,037	$141,335	60%	56%	46%	54%
SPSS	$208,480	$208,367	$224,074	63%	59%	58%	60%
Business Objects	$454,799	$560,825	$925,631	49%	45%	44%	46%
Internet Applications				**29%**	**28%**	**30%**	**29%**
Cryptologic	$43,550	$34,427	$44,211				0%
RealNetworks	$182,679	$202,377	$266,719	40%	38%	36%	38%
NetIQ	$278,239	$310,224	$261,645	39%	43%	47%	43%
Verisign	$1,221,668	$1,054,780	$1,166,455	20%	19%	22%	20%
Ultimate Software Group	$55,149	$60,416	$72,028	32%	29%	29%	30%
Centra	$33,400	$43,041	$38,064	63%	51%	59%	58%
Interwoven	$126,832	$111,512	$160,388	58%	52%	44%	51%
Network Tools				**38%**	**38%**	**38%**	**38%**
Citrix Systems	$527,448	$588,625	$741,157	45%	43%	46%	44%
McAfee (Network Associates)	$1,043,044	$936,336	$910,542	38%	34%	39%	37%
*Tarantella	$14,220	$14,006	$12,488	138%	108%	149%	132%
Novell	$1,134,320	$1,105,496	$1,165,917	32%	34%	31%	32%
Spescom Software	$6,970	$7,362	$9,002	50%	33%	33%	39%
Tumbleweed	$25,525	$30,595	$43,438	72%	52%	53%	59%
NetManage	$65,740	$50,663	$47,666	54%	50%	49%	51%
Developer Tools				**38%**	**38%**	**37%**	**38%**
Raining Data	$19,267	$21,006	$22,297	33%	22%	26%	27%
Pervasive Software	$37,197	$39,205	$49,608	33%	35%	37%	35%
Progress Software	$273,123	$309,060	$362,662	38%	41%	40%	40%
*Borland Software	$244,579	$295,236	$309,548	51%	58%	54%	54%
Sybase	$829,861	$778,062	$788,536	33%	31%	31%	31%
Red Hat	$90,275	$124,737	$196,466	36%	32%	31%	33%
BEA Systems	$934,058	$1,012,492	$1,080,094	39%	38%	38%	38%
Education				**27%**	**25%**	**25%**	**25%**
Renaissance Learning	$131,232	$130,544	$114,048	24%	23%	29%	25%
Apollo Group	$1,009,455	$1,339,517	$1,798,423	20%	20%	21%	20%
Saba Software	$55,648	$44,416	$34,471	55%	59%	52%	55%
American Education Corp.	$8,483	$8,599	$10,400	31%	28%	35%	31%
Docent	$29,011	$27,792	$30,238	163%	77%	54%	98%
Plato Learning	$74,391	$82,192	$141,801	50%	48%	43%	47%
Click2Learn	$31,209	$30,477	$29,487	59%	54%	47%	54%
All companies				**27%**	**27%**	**26%**	**27%**

Note: "Years" may not correspond to company fiscal years. An asterisk indicates companies that report combined S&M and G&A costs.

enterprise CRM as ASP competitors come into the market. If such products become viable offerings for small customers to take in house, the ASP market for them will obviously decline.

Services Components of the ASP/SaaS Model

Services and branding are the two means of avoiding commodity competition on price alone. By offering services beyond merely renting access to remotely-hosted applications, ISVs can increase revenues and customer ties. ASP ISVs have an initial chance to offer integration to their customers (to get the product up and running), data storage, on-demand equipment, virtualization to tie together ASP and customer resources, and of course all the services that go with keeping a remote network open at both ends, from provisioning and monitoring to reporting and peering arrangements. One add-on revenue winner in the current ASP market is enabling the ASP product to work through the company's wireless system.

There are two paradoxical issues connected with services. The first is standardization: obviously a complete customer-ready ASP operation is easier to deploy if both ends are standardized (HTTP, SOAP, etc.). But increased standardization at the customer site gives them increased ability to consider other vendors. This is becoming a moot point nowadays since customers are increasingly calling for standardization with that very possibility in mind, egged on by concerns over vendor lock-in and by the Open Source movement, which proclaims a belief in interoperability and the ability to easily switch vendors.

The other issue is service delivery: who provides support and other services? The ASP model makes it very easy for the ISV to decide to do all support, including frontline, and to hope that ease of support will increase profits. But some services, such as integration, may need a site visit, and in trying to keep all the money for the ISV, and also trying to cover all services, the ISV can overlook an important component in ASP pricing: the channel.

ASP/SaaS and the Channel

Despite its neat promise of a tight ISV/customer relationship, ASP pricing should include a channel component, for sales to SMBs will depend on an active channel. The channel problem is well known and its solutions are many. Besides pricing in a way that incents resellers while not generating channel conflict, ISVs needs to consider which elements of support and services should be done through its partners. It is likely that you will be able to think of things that dealers could do to build the customer relationship besides cash the checks for their share of the monthly revenues. At the very least, organized contacts by vendors to customers keep the relationship fresh (besides giving the vendor the opportunity to sell additional products). However well the system is operating, the customer should be glad to know that local help is available if needed, and the ISV is reassured that the customer will receive a visit if hands-on help is necessary. (We will be examining the topic of ASPs and the channel in greater detail in an upcoming issue.)

In the endless cycle of moving high-level technology downward, the moment for timesharing or ASP has come again. For a while, because of bandwidth, client/server seemed to be the answer, but that moment has passed. The IT mentality naturally seeks to centralize power the way it was in the old glass houses, but (aside from the question of how secure is corporate data), the business mentality seeks only the most cost-effective solution that delivers the benefits. In the case of high-end computing for SMBs, ASP is the current game, and once again the supplier assumes the risks of equipment obsolescence or seeing the customer acquire local but powerful alternatives.

Equities

The Ten Worst Things You Can Do When Selling Your Software Company, Part I of II

By Mark S. Reed, Corum Group

Successful M&A events require planning and careful execution; these 10 points will help you avoid situations with the potential to radically reduce shareholder value.

1. Wait until your business is in trouble. Watch the market and pay attention if your competitors are acquired. Little harm is done if you test the market early, but if you wait too long it may be too late. The tech world evolves rapidly.

2. Miss your numbers. Buyers expect you to be able to predict your business and to be able to make credible financial projections, at least for the near term. But don't make your projections so optimistic that you miss the numbers. If you do, the buyer will have good reason to disbelieve other rosy claims you make. And make sure your accounting records are clean, accurate and current.

3. Broadcast the news that you're considering a merger/acquisition. Wait until the transaction is well in hand. Telling employees too early can spread FUD and lead to the loss of key staff and employee productivity because of fear for their future.

4. Accept the first offer you get. Test the market to see if there is a better suitor. Working with one buyer limits your negotiating leverage and probably reduces your company's potential value. Following a disciplined "go to market" strategy is the best approach. It provides you with the chance to attract multiple potential buyers, gauge the market's valuation of your company, and negotiate for best terms.

5. Have unrealistic value expectations. Grossly unrealistic price expectations will undermine your credibility. Greed is the single most common deal killer. Use objective, market-based metrics along with your company's actual growth rate and profitability levels to test your valuation objective. Understand the buyer's valuation perspectives and their ability to pay your asking price.

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Company/Description	Acquired by	Price/Terms	Revenues	Multiple
Decru	Network Appliance (NTAP)	$272,000,000	$6,000,000	**45.33**
• *Storage security systems*		*Terms: $55M cash, $217M stock*		
Integrated Data Systems	Online Resources (ORCC)	$5,300,000	$3,200,000	**1.66**
• *Technology provider to credit unions*		*Terms:* $5M cash, $300K in debt		
Financial Data Solutions	Open Solutions (OPEN)	$9,000,000	$6,000,000	**1.50**
• *Remittance processing software*		*Terms: All cash*		
Niku Corporation (NIKU)	Computer Associates (CA)	$283,000,000	$70,800,000	**4.00**
• *IT management and governance software*		*Terms: All cash*		

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Bad Marketing and Business Analysis

- **Best and Worst Marketing** (www.bestandworstmarketing.com): Site offers looks at bad (and good) marketing ideas from a variety of different industries. You can submit your own candidates.
- *Business 2.0's the 101 Dumbest Moments in Business*. The 2005 list can be viewed at www.business2.com/b2/web/dumbest/2005/1/0,22933,,00.html.
- *Cube Farm,* by Bill Blunden. An insiders look at the goings on at Lawson Software; $17.99.
- *Marketing Mistakes and Successes,* by Robert F. Hartley. A well written book that examines some of the classic marketing failures of the 20th century. The prose is dense but the effort is well worth your time; $59.95.
- **The Museum of Stupid High-Tech Marketing** (www.insearchofstupidity.com/Stupid_Marketing/stupid_marketing.html): Site maintained by the managing editor that showcases some of the worst collateral, writing, products, and positioning in software and high-tech.

YANKEE GROUP ANALYST ANDREW JACQUITH on security software: “Security researchers—whether they wear white, gray or black hats—are increasingly less interested in poking holes in desktop operating systems. A more fascinating and profitable area exists in finding vulnerabilities in the products meant to defend against the attacks themselves. It is time for the security vendors to stand up and make their own products more secure before they become preferred conduits for professionally designed malware.” (Quoted on Forbes.com, 06/21/2005)

MYSQL CEO MARTEN MICKOS on Europe’s ability to innovate: “This continent is one of the most conservative places on the planet. Real innovators don’t mind being laughed at. This is perhaps not the place for people with the courage to be different.” (Quoted on Businessweek.com, 06/22/2005)

MORRISON & FOERSTER INTELLECTUAL PROPERTY SPECIALIST JOHN DELANEY on the Supreme Court’s unanimous decision in MGM vs. Grokster: “The Supreme Court appears to dramatically narrow the reach of the ‘substantial noninfringement uses’ holding in its landmark Sony case—this aspect of the case is good news for entertainment companies but must be causing some anxiety among companies that manufacture computers and hand-held devices used to facilitate the unauthorized online distribution of movies and music.” (Quoted 06/27/2005)

MERGER ADVISORY FIRM GLASS, LEWIS & COMPANY on the recently announced Symantec/Veritas merger: “The merger appears to be driven by management’s desire to be bigger for the sake of being bigger. History would indicate that such mergers, especially in the technology world, often fall short of expectations.” (Quoted in the San Jose Mercury News, 06/21/2005)

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Soft•letter is published 24 times per year;

ISSN: 0882-3499.

Subscription rates: $395 worldwide. Subscription office: United Communications Group, 11300 Rockville Pike, #1100, Rockville, Md. 20852-3030; tel 301/287-2718 866/313-0973 customer@softletter.com

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