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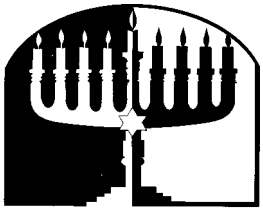
Soft•letter

BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS

Happy Hanukkah and Happy Holidays from Softletter to all our subscribers!



Stock options still light the financial way for CEOs (but shareholders are standing in the way of big pay increases at public companies) *See pages 4-6.*

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SaaS Sales Compensation Models: Another Approach, Part I of II

In the August, 15th issue of ***Softletter****, we profiled Distance Learning, a company selling hosted content and community systems and raised the issue of how do you compensate a sales force focused on selling SaaS products and services? The issue is becoming of increasing importance to publishers as the SaaS model continues to take hold.*

We turned for some answers to Bob Conlin of Centive. Centive sells "Compel," a SaaS system that automates the process of tracking and paying compensation to commissioned sales forces. We were introduced to the company via our participation in this year's CODIES (http://www.siia.net/codies/2005/finalists.asp) and were both impressed and intrigued by what we saw. Executive compensation systems aren't new, but this is the first time we've seen the concept used in SaaS. But the question that immediately arose in our minds was "How was a software firm specializing in sales compensation software paying its own personnel in a SaaS model?" We turned to Bob Conlin, Centive's chief marketing officer, to find out.

Bob, in a previous article in Softletter, we discussed how Distance Learning, publisher of ScribeStudio, had adopted a compensation model for its sales reps that paid them a higher commission upfront, as high as 40%, to compensate for the fact that their average opening sales tended to be small and grew over time. Is this the model you're using?

No. We pay our commissions upfront once a contract is signed, with commissions applied to the first year of the sale. We do realize this presents several challenges to the traditional viewpoint on how these things are done because we can't recognize that revenue until it's paid.

In terms of commissions, our rates range from 3% to 7% and we do offer additional incentives for multi-year deals; these range from between 1% to 3%. We structure our compensation plan so that if the contract is canceled within a twelve-month period, we back that commission out of a future sale. Our per list price starts at $70/seat/month and goes down from there using a tiered pricing structure based on number of seats and term of contract (12, 24 or 36 months). That price includes support and, of course, as a SaaS system, all enhancements and upgrades. *(continued on page three)*

Advisory Board

Minimizing Online Sales Fraud

by Craig Ross, Nexternal Systems

It is important for online merchants to use E-commerce software that minimizes the possibility and probability of online fraud. Although this concept is very simple, many businesses do not have E-commerce systems that provide adequate fraud prevention or worse, treat fraud issues as an afterthought. This invariably will create issues for the merchant that will distract them from growing their business.

Merchants should choose an E-commerce system that has the following characteristics:

- Authorizing credit cards at the time the order is placed. This greatly reduces the number of fraudulent orders received since the card will need to pass address validation requirements, be a valid number and have adequate funds available.

- Passes CVV Value to the gateway. Requiring the CVV value (the 3 or 4 digit code on the back of the credit card) is an effective method to ensure that the customer has a physical card, not just a credit card number.

- Alerts merchants when a customer's IP location does not match their ship to location. While their may be circumstances where it is legitimate when the country where an order is placed does not match the ship to location, they are in the minority.

- Limit authorization attempts, usually to no more than three per transaction. A merchant should be able to limit the amount of credit card authorization attempts allowed in their store. This prevents their store from having the ability to be used as a test bed for a list of stolen credit card numbers.

- Limit IP addresses. Many fraudulent orders appear to come from certain parts of the world. Although a merchant needs to take great care, they should be able to block IP address from certain countries and even individual IP addresses should the need arise. There is no need to make a store easily accessible to people who have the wrong intentions.

- Choose an E-commerce solution that integrates with fraud-conscience payment gateways. Many payment gateways such as Authorize.net have fraud detection programs in place. Using such a system adds yet another fraud prevention layer to your order process.

- Avoid "return" fraud (someone claims they never receive a package when they did or attempts to return something long after your stated returns window) by ensuring that your E-commerce system integrates with the major shipping carriers (FedEx, UPS, USPS, DHL) and that they provide integrated tracking that is available to the customer and the merchant; this allows a merchant to easily check to see if a package was delivered and when. A merchant can also require signature delivery using UPS, FedEx, and USPS and/or insure their packages for further protection. With some systems, a merchant can include a legal disclaimer that appears right above the "submit order" button in their store. The merchant can even require an "I agree" check box. This legal disclaimer can be used to enforce the return policy.

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Implementation is an additional fee.

An important point I need to make is that we don't compensate on renewals; our model is not based on the account manager approach, where the customer represents an annuity stream for the salesperson.

How does that affect your sales force's morale?

This approach provide incentives to our sales group to sell "good contracts." Our product, Centive Compel, is aimed at mid-sized companies. We define a good contract as one sold to a company between $10M to $50M in revenue with between 50 to 500 sales personnel. At the low end, the revenue value of a contract is in the $40K range; at the high end, $250K and up. Of course, we'll look at smaller deals if they represent a "foot in the door" opportunity.

"We don't feel the account manager model to compensating sales personnel in a SaaS environment will prove to be the best approach as the market matures."

—Bob Conlin Centive

Another element of a good contract is that the client has gone through our five-step sales process, which consists of:

- Qualifying. (I've already discussed our target audience.)
- Solution development (we use the CustomerCentric methodology).
- Proof of capability. This often incorporates a demonstration of Compel's functionality and is usually developed by an SE or the services group.
- Proposal preparation and presentation.
- A win/lose analysis.

We've found that for this model to work, our sales people have to be domain experts in the area of sales compensation in addition to being well versed in our system's capabilities. Also key to a successful contract is early involvement with an executive sponsor. Since our product touches a key business process and can be rolled out quickly, this is critical to a successful sale.

How quickly can your system be up and running?

Usually in four weeks. In fact, we offer a "live at 55" guarantee; if the product is not deployed and ready for use in 55 days, you don't pay for the services' portion of the contract. This is a very important point; we find the SaaS model moves quickly in terms of the sales cycle. A typical $100K+ sale under the standard license model usually takes from nine to 12 months; in SaaS, the norm we're experiencing is one to three months; SaaS sales represent less risk and overhead for the customer.

"I attribute the speed of closing business in the SaaS model to the fact that there's simply less risk and far less up front overhead in deploying a SaaS product; it's inherent in the model. Of course, the downside to this is that it's easier for the customer to migrate away from you if they're not happy, a pont your earlier article also made."

—Bob Conlin Centive

The speed of account development also impacts the type of sales people we need. Probably 80% of our sales are developed via the phone. That means we need people who can work well in a telesales environment, are very intelligent, and can understand the customer's needs quickly.

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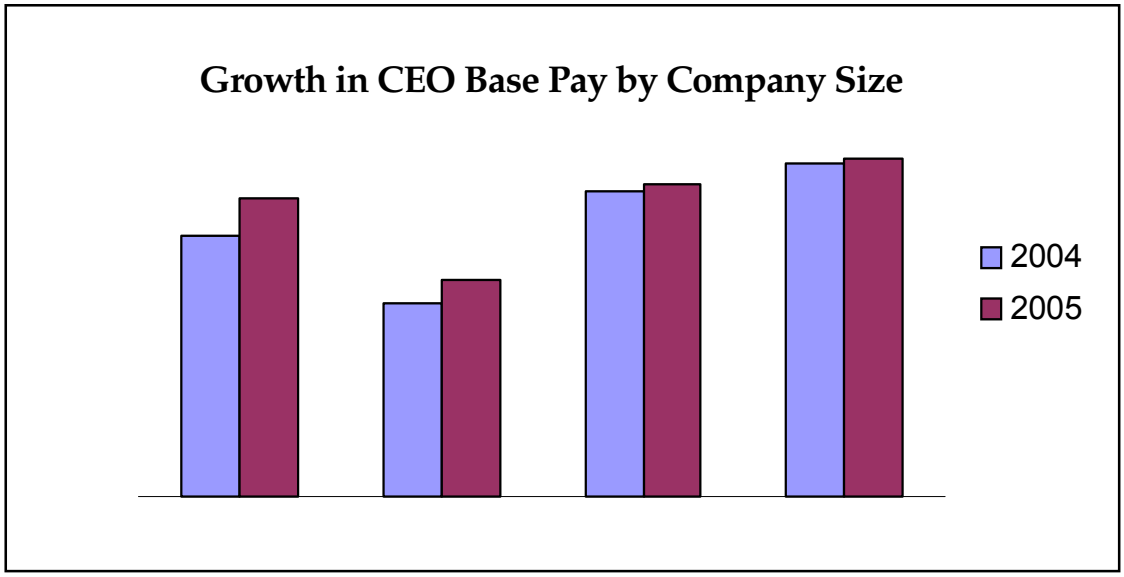

Benchmarks: Chief Executive Officer Compensation

Overall CEO compensation: The 15% rise in median base pay of all CEOs polled is more generous than those (for instance) of the CMOs (10%) and CFOs (8%) in our surveys. Median variable pay matched it with a 16% rise. But the real money for CEOs still lies in cashing in stock options (see Softletter's Top 50 on page 6, under Long-Term).

CEO pay by company size: Although the CEOs of larger firms earn vastly more than those of smaller enterprises, these titans have not been receiving the largest raises. As we have noticed in other compensation surveys, the raises are larger at the lower end of the scale. The $1-5 million revenue category received median raises of 12%, while $5-10 million group received only 2% and $10-99 million only 1%. While responses from the $100+ million category were too few to be significant, what we saw showed a sharp *drop* in total compensation. This fits with the 2004 CEO compensation survey's observation that shareholder brakes were being applied to CEO compensation at large public companies.

CEO pay by development stage: As in the 2004 CEO survey, we find that the larger CEO pay raises are at the earlier development stages, and even more restrained this year than last. In 2004, privately-owned and –funded firms' CEOs received 14% raises; this year it is 8%. Private VC-funded firms' CEOs received 1% raises last year, and none this year. Public firms' CEOs, meanwhile, received 3% raises last year and 5% this year.

The Top 50: Median base pay for the Top 50 was $380,000, and median variable pay was $209,205. But those at the top of the Top 50 do a lot better than those at the bottom; the total of variable pay was nearly twice the total of base pay. Similarly, while 49 of the Top 50 CEOs received variable pay, only 18 took long-term compensation by cashing in stock options. And of this 18, two took home 80% of the kitty, which amounted to four times the base pay of the entire group.

Overall CEO Compensation*	Median	Top 25%	Bottom 25%	Raise
Base Pay—current	$172,500	$210,000	$125,000	15%
Base Pay—last year	$150,000	$200,000	$110,000	
Variable Pay—current	$25,000	$78,750	$5,000	16%
Variable Pay—last year	$21,500	$75,000	$n/m	
Total Pay—current	$200,000	$275,000	$150,000	13%
Total Pay—last year	$176,705	$250,000	$133,000	

* Number of respondents = 68

CEO Pay by Company Size*	Base Pay	Variable	Total	Raise
Under $1 million—current	n/m	n/m	n/m	n/m
Under $1 million—last year	n/m	n/m	n/m	
$1-$5 million—current	$125,000	$15,000	$155,000	12%
$1-$5 million—last year	$112,000	$ 8,750	$134,750	
$5-$10 million—current	$180,000	$50,000	$250,000	2%
$5-$10 million—last year	$176,410	$50,000	$200,000	
$10-$99 million—current	$195,000	$37,500	$237,500	1%
$10-$99 million—last year	$192,500	$62,500	$230,000	
$100+ million—current	n/m	n/m	n/m	n/m
$100+ million—last year	n/m	n/m	n/m	

* Number of respondents = 3 for Under $1 million, 22 for $1-$5 million, 15 for $5-$10 million, 16 for $10-$99 million, and 2 for $100+ million. Values are medians. n/m = Sample size too small for accurate comparisons.

CEO Pay by Development Stage*	Base Pay	Variable	Total	Raise
No significant customer revenue—current	n/m	n/m	n/m	n/m
No significant customer revenue—last year	n/m	n/m	n/m	
Privately owned, privately funded—current	$135,000	$25,000	$175,000	8%
Privately owned, privately funded—last year	$125,000	$20,000	$160,000	
Privately owned, venture funded—current	$180,000	$50,000	$250,000	0%
Privately owned, venture funded—last year	$180,000	$ 8,000	$200,000	
Public—current	$297,610	$155,650	$443,150	5%
Public—last year	$283,205	$266,500	$549,000	

* Number of respondents = 0 for No significant customer revenue, 35 for Privately owned, privately funded, 17 for Privately owned, venture funded, and 8 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	Long-Term
1	**Lawrence J. Ellison**, Oracle	$975,000	$7,460,200	$8,435,200	$66,891,118
2	**John A. Swainson**, Computer Associates	$359,853	$5,745,672	$6,105,525	
3	**Henning Kagermann**, SAP AG	$702,000	$3,601,260	$4,303,260	
4	**Stephen M. Bennett**, Intuit	$990,000	$3,233,114	$4,223,114	
5	**Jack Noonan**, SPSS	$3,345,000	$94,000	$3,439,000	$139,792
6	**Bruce R. Chizen**, Adobe Systems	$912,500	$1,312,537	$2,225,037	$15,780,095
7	**Peter Karmanos, Jr.**, Compuware	$635,925	$1,463,915	$2,099,840	
8	**J. Michael Lawrie**, Siebel Systems	$666,667	$1,402,891	$2,069,558	
9	**Jack L. Messman**, Novell	$950,037	$1,030,088	$1,980,125	
10	**Robert G. Ashe**, Cognos	$397,390	$1,311,224	$1,708,614	$1,123,323
11	**John S. Chen**, Sybase	$950,000	$624,536	$1,574,536	$3,595,224
12	**L. George Klaus**, Epicor Software	$694,720	$708,682	$1,403,402	
13	**Woodson Hobbs**, Intellisync	$375,000	$1,000,000	$1,375,000	
14	**Robert E. Beauchamp**, BMC Software	$695,128	$622,792	$1,317,920	
15	**Dale L. Fuller**, Borland Software	$1,209,231	$13,119	$1,222,350	$335,236
16	**William C. Stone**, SS&C Technologies	$490,110	$703,440	$1,193,550	
17	**John J. Coughlan**, Lawson Software	$450,000	$568,905	$1,018,905	$1,567,246
18	**Steven A. Ballmer**, Microsoft	$600,000	$409,073	$1,009,073	
19	**Gunther Than**, View Systems	$72,000	$900,000	$972,000	
20	**Godfrey R. Sullivan**, Hyperion Solutions	$493,371	$451,628	$944,999	$3,743,266
21	**Lloyd a. Carney**, Micromuse	$400,000	$491,667	$891,667	
22	**Joseph W. Alsop**, Progress Software	$350,000	$347,234	$697,234	$4,622,040
23	**John E. Bailye, Dendrite International**	$497,500	$198,650	$696,150	$1,912,566
24	**Norman E. Drapeau, Jr.**, MRO Software	$350,000	$343,987	$693,987	$150,223
25	**Stephanie Di Marco**, Advent Softtware	$360,000	$265,115	$625,115	
26	**Peter I. Cittadini**, Acutuate	$400,000	$217,983	$617,983	$18,667
27	**David Gould**, Witness Systems	$340,000	$205,373	$545,373	
28	**Zvi Alon**, NetManage	$441,000	$68,437	$509,437	
29	**James C. Edenfield**, American Software	$434,500	$73,313	$507,813	$350,468
30	**James R. Oyler**, Evans & Sutherland Computer	$391,100	$114,241	$505,341	
31	**Joseph L. Mullen**, Bottomline Technologies	$285,796	$209,205	$495,001	$649,760
32	**Albert E. Sisto**, Phoenix Technologies	$400,000	$88,505	$488,505	
33	**Janice P. Anderson**, Onyx Software	$199,007	$288,134	$487,141	
34	**Karl F. Lopker**, QAD	$300,000	$143,847	$443,847	
35	**Michael D. Andereck**, Docucorp International	$385,000	$31,792	$416,792	
36	**Carlton H. Baab**, Raining Data	$248,000	$165,210	$413,210	
37	**Greg R. Gianforte**, Rightnow Technologies	$250,000	$157,481	$407,481	
38	**Reynolds C. Bish**, Captiva Software	$287,500	$101,520	$389,020	$147,800
39	**Paul A. Ricci**, Nuance Communications	$300,000	$80,250	$380,250	$1,756,945
40	**David C. Mahoney**, Applix	$250,000	$127,160	$377,160	$10,000
41	**Nick Ordon**, Versant	$270,000	$77,666	$347,666	
42	**Eric J.Pulaski**, BindView Development	$236,892	$106,050	$342,942	
43	**William P. Lyons**, ASX-One	$271,282	$60,921	$332,203	
44	**Anna M. Chagnon**, Bitstream	$230,000	$93,075	$323,075	
45	**David Sikora**, Pervasive Software	$311,538	$685	$312,223	
46	**Joseph L. Cowan**, Manugistics Group	$244,102	$45,861	$289,963	
47	**S. James Miller, Jr.**, ImageWare Systems	$284,441	$1,023	$285,464	
48	**C. Wayne Cape**, Optio Software	$274,500		$274,500	
49	**John L. McGannon**, Document Sciences	$226,000	$45,718	$271,718	$132,510
50	**William W. Smith, Jr.**, Smith Micro	$224,927	$46,102	$271,029	

Note: The 50 individuals here received the highest annual compensation of CEOs of public software companies. "Variable" compensation includes bonuses, commissions, company-paid insurance, relocation and housing allowances, forgiven loans, memberships, profit-sharing contributions, etc. "Long-Term" compensation is income from the exercise of stock options.

Source: Company proxy statements for most recent fiscal years.

The True Value of a M&A Advisor

By Marshall Warwaruk, Corum Group

My first real experience with M&A came in 1989 when as the COO of a small (under $5 million in sales) software company we were approached by a large public software company that wished to enter our market via an acquisition. Our management team was enthusiastic about the prospects that this larger organization offered with its major market presence, customer base and worldwide sales force and confident in our ability to negotiate a good contract. So, we decided to move forward with the deal.

Inspired by the "opportunity" before us, we started off by agreeing to an asset deal because that was what the buyer preferred. We lost sight of the after-tax, take-home value vs. the publicly announced deal consideration, which in the end cost all shareholders some of the upside. We also failed to have other possible buyers lined up and thus had no way to calibrate whether or not the price or structure offered was fair market value. There were times when discussions became contentious and certain individuals on our team took the disputes personally; not too bright given we were hiring our next boss. Integration of the business was not even discussed until after the deal closed.

Then we realized our acquirer's financial motivation and sales skill set was totally wrong for selling our product with the result that we spent the next two years trying to defend our strategy and sales while in the meantime losing significant time and market opportunity.

So what is the true value of a M&A advisor? The **experience** to:

- Provide a competitive bid environment to ensure reasonable market value, not to mention provide added leverage in negotiations.
- Act as a "heat-shield" to deflect personal bias and emotional outbreaks.
- Ensure that all deal structures adequately protect shareholder value.
- Get the deal completed to the benefit of both sides of the transaction.

Marshall Warwaruk, vice president, Corum Group, 10500 NE Eighth St., Bellevue, Wash. 98004; 425/455-8281. E-mail: mwarwaruk@corumgroup.com.

Company/Description	Acquired by	Price/Terms	Revenues	Multiple
Provide Commerce (PRVD) *• Web sites for perishable products*	Liberty Media (LMC-B)	$477,000,000 *Terms: All cash*	$183,900,000	**2.59**
Cyota *• Online security and anti-fraud products*	RSA Security (RSAS)	$145,000,000 *Terms: All cash*	$22,000,000	**6.59**
Kerridge Computer Co. Ltd. (UK) *• Dealer management systems*	Automatic Data Process. (ADP)	$300,000,000 *Terms: All cash*	$150,000,000	**2.00**
JAMDAT Mobile (JMDT) *• Mobile games*	Electronic Arts (ERTS)	$680,000,000 *Terms: All cash*	$66,200,000	**10.27**

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More Useful Podcast Resources

- **Podcast.net** (www.podcast.net): Site provides a directory of podcasts by topic; also offers promotional opportunities for your own podcast.
- ***Podcast Solutions*** by Michael W. Geoghegan and Dan Klass, Friendsoft, 2005. Excellent book that describes how you can produce your own podcasts. Book covers planning, tools, recording, file preparation, and podcast serving. Includes a CD with more useful content and tools.
- **Thepodcastnetwork.com** (www.thepodcastnetwork.com): Collection of centrally-produced podcast channels that cover dozens of topics from business to technology.
- **This Week in Tech** (www. thisweekintech.com): Site features the TWiT podcasts. Some very funny and insightful listening.
- **The World** (www.theworld.org/technology/podcasts.shtml): BBC site for technology podcasts; interesting information on international issues.
- **Venture Voice:** (www.venturevoice.com): Podcast dedicated to VCs and entrepreneurship.

SAN JOSE MERCURY NEWS COLUMIST DAN GILLMOR ON GOOGLE: "The Wall Street wisdom is that Google is a media company, their business model is advertising, and they have no business or gain in undermining Office. Right. Gmail, Gtalk, Gcal, Gbase, Gdesk. If you believe that, I've got a Gbridge to sell you." (Quoted on http://blogs.zdnet.com/Gillmor/?p=194&tag=nl.e539, 12/18/2005)

"DOES IT MATTER" AUTHOR NICHOLAS CARTER ON SUN: "Sun Microsystems is a funny company. It jumped directly from hyperactive adolescence to midlife crisis, complete with ponytail. Ever since the dot-com crash decimated its free-spending customer base, the company's been on a quest to find itself – and give a jolt to its flat-lining stock price. That quest, dutifully chronicled in the blog of company president Jonathan Schwartz, has looked increasingly desperate of late, as Sun has bounced between marketing pitches like Ricochet Rabbit on a meth jag. One minute it's the Anti-Dell, then it's the Leader in Responsible Computing, then it's the Fastest Chip on Earth company, then it's the Volume Is Everything company, then it's the Free Software company, then it's 'The Dot in Web 2.0,' then it's challenging Steve Jobs to a 'pod duel' – and that's just in the last two months." Quoted on on http://www.roughtype.com/archives/2005/12/data_center_mel.php, 12/10/2005)

LAW FIRM MCCORMICK, PAULDING AND HUBER ON BP PATENTS: "The United States Patent and Trademark Office issued only 282 business method patents last year. This represents only about .0015 of the 187,000 patents issued last year. Business method patents remain rare because they must be useful, concrete, and tangible subject matter. That is, they must be part of computer processes or other systems involving a step-by-step computation and may not be abstractions." (Quoted in ***Intellectually Speaking***, Vol. 5, No. 3, 2005)

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