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Soft•letter
BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS

And Merry Christmas and Happy New Year!

When looking at software VC, you have to be sensitive to undercounting; software is doing even better than a first glance at the numbers indicate
See pages 4-5.

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Four Critical Success Factors for Your Products

*by Brian Lawley, The 280 Group, author, **Expert Product Management***

Build a great product and you'll take the market by storm, right? That's the myth perpetuated in Silicon Valley, and that it's not true is a difficult lesson that many entrepreneurs and even seasoned companies end up learning the hard way. Yes, some products seem to be blessed with fairy marketing magic, with everything seeming to fall easily into place on the road to success. But the odds of that happening are thousands to one. The overwhelming majority of successful software companies combine good marketing and sales planning and execution with great products. Marketing comprises many elements but of all the factors you must juggle, during my twenty year career in product management, I've found these four to be the most critical to success.

The first critical factor for success is building a well-thought out, prioritized product roadmap. Product roadmaps often mean the difference between success and failure when delivering and marketing products. Done correctly, they can guide the engineering and strategic planning efforts of a company. They can help your company and partners plan and execute more effectively to maximize your marketing efforts and revenues. They can help win and keep large customers and partners. They can communicate to the press and the analysts your vision and where you are headed, giving you added credibility. And they can be a very effective tool for helping to raise your next round of funding.

A product roadmap communicates what the priorities are for the product. This includes what features are being developed, when the different releases will be delivered and what the long-term vision is. Without having a prioritized roadmap in place, even if you do have a successful release of a product, you risk losing focus and delivering the wrong features in the next version.

I am always surprised at how few companies I've worked with have no roadmaps in place and no process for gathering and prioritizing product requirements. As a result, most product roadmaps are created "on-the-fly" and under pressure when sales or upper management make last-minute requests. Because they aren't well thought out, they don't have the impact they should. And they can be a source of tremendous trouble if you aren't careful *(continued on page three)*

Advisory Board

Winning Business Models: New Products or Markets Often Require New Business Models (SAP)

by Bruce Lafetra, Rubicon Consulting

Many people think choosing a winning business model means selecting from a list of “proven” or “emerging” models such as “SaaS,” “Open Source,” or “Traditional.” A business model is much more than the way you collect money from customers, it also drives development, marketing, sales, deployment, support, accounting and all the other functions I forgot to list. A winning business model incorporates all parts of a business holistically. Making significant changes in any part of your business should drive an examination of the other areas as well. Choosing the right business model is a strategic decision, but it is more than that. The business model is fundamentally both strategic and tactical, and allows companies to do entirely new things, not simply charge people a different way.

In what many are calling the most significant announcement since R/3, SAP has announced Business ByDesign (BBD), a completely new offering for mid-sized businesses. BBD represents as big a technological leap as the jump from R/2 (mainframe) to R/3 (client-server). On the business model front, it’s probably an even bigger change to SAP’s internal operating structure. SAP’s sales force is designed around selling big deals to a (relatively) small number of sophisticated IT buyers who invest heavily in deployment supported by a third-party eco-system.

By contrast, BBD targets smaller deals from customers demanding rapid implementation. SAP currently lacks a volume channel that can sell BBD, and they have moved much of the functionality and services away from the R/3 eco-system. BBD requires entirely new sales, implementation and support channels. I say channels because SAP would be foolish—and we will all be waiting a long time—if they try to do it all by themselves.

BBD also introduces a new financial model. SAP is used to a big payment up front, followed by annual maintenance payments. Often these payments are guaranteed for 2 to 3 years. SaaS offerings such as BBD generate much lower monthly payments contracted for on a month-to-month basis. For SAP, this means less cash up front—and probably less customer tolerance for lengthy or painful implementations. For some companies, the new cash flow profile is material and requires investor acquiescence.

While SAP’s brand and development resources are enormous assets, SAP’s operations—the very way it does business—must be re-thought for BBD and the changes required for success are fundamental in every sense. SAP needs to re-think its sales, services, integration, support, development and revenue models. The enterprise sales force is too expensive to address mid-sized customers and the R/3 eco-system is ill-suited to address BBD deployment. Even the SaaS revenue stream will require major adjustments.

BBD is a very ambitious play. The big challenges are less about whether SAP can deliver useful solutions, but more about whether they can do so profitably. Time will tell not only how well SAP executes, but also how well they understand the extent to which BBD fundamentally changes SAP’s business model.

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about how they are disclosed because customers (and your company) tend to view them as firm product commitments. The bottom line is that if you learn how to gather requirements, prioritize them, and create roadmaps, you have a much higher likelihood of success.

The second critical factor is planning and executing successful beta programs to ensure that real-world customers adequately test your products prior to their release. This ensures that you can be confident the product will deliver a good customer experience when it becomes available. If you don't run a thorough beta program, you run the risk of your product shipping with serious problems. If you release a poor-quality product, customers may never forgive you, and you may not be able to recover from the mess you've unleashed.

Beta programs also provide you with crucial customer testimonials and references to add credibility when you release the product. By having multiple customers who are willing to endorse your product at launch, you dramatically increase your chances of success and of getting press coverage.

Most beta programs fail because companies drastically underestimate the amount of time and resources they take. A good beta program needs to run for several weeks at minimum, allowing customers enough time to install and use the product, provide feedback, upgrade to new versions with bug fixes and use the final candidate software for a few days to ensure no other problems are found. Additionally, a thorough beta program requires a dedicated person working on it at least half their time for several months prior to launch. Setting goals, locating the right participants for the program, distributing the beta product, gathering ongoing feedback, solving problems that arise, and communicating with the beta customers takes a significant amount of time and hours. If you don't have the resources to dedicate to it, hire a contractor—that way you won't reach the end of the beta program and wonder whether or not the product is really ready to ship.

The third critical factor for success is planning and running a successful product launch. This process needs to begin at least three to four months prior to the availability of the product. You'll need that much time to write the launch plan, determine the budget, get the positioning and pricing finalized, define the activities list, and create all of the deliverables (press kit, white papers, testimonials, brochures, marketing materials, marketing and partner programs, etc.). In order to obtain effective press coverage that runs concurrent with product availability, you need to go on a press tour two-and-a-half to three months prior to the product shipping (to give the long-lead-time publications such as magazines time to plan for coverage). Fail to give yourself time to plan and you'll find yourself in the situation of having a product that's available and shipping but not selling nearly as well as it could be (with corresponding damage to your revenue projections).

(continued on page six)

In addition to a lack of planning and execution many companies,

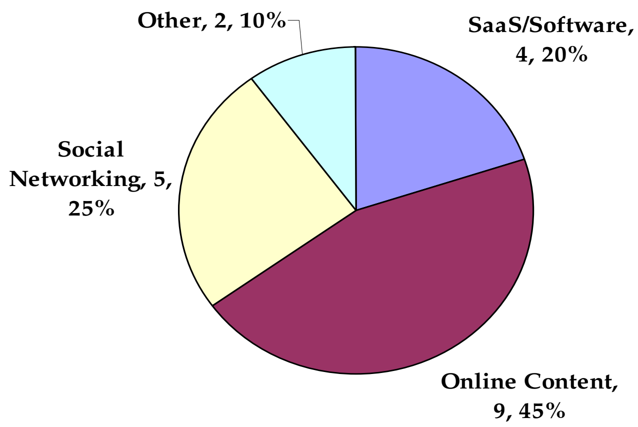
"Don't fool yourself. When considering reviews, the blogs can be important, but print still has greater credibility in most markets."

*—Brian Lawley The 280 Group, author, **Expert Product Management***

"Beta in a SaaS environment is critical for the initial product launch. If your initial product isn't solid and you haven't had a lot of people testing it hands on, you run the risk of tarnishing your reputation when you go live. If customers try the product and have a bad experience they simply won't come back. The other critical time for Beta testing in SaaS is if you are doing a major upgrade that a large number of customers will be using and/or an upgrade that doesn't allow you to easily switch back to the previous version."

*—Brian Lawley The 280 Group, author, **Expert Product Management***

When analyzing software VC, adjust for undercounts. This analysis of the top 20 deals in the Pricewaterhouse Cooper survey of the Media and Entertainment segment reveals 20% (4) of these are software deals



Benchmarks: Q3 2007 Venture Capital Investments

The third quarter of 2007 was been a good one for the software industry, as it beat out its nearest competitor, Biotechnology, by $187m. The $1.1b spent on software companies went into 187 ventures; 15 more than for Biotechnology and Medical Devices combined. But though this was a strong quarter for software, it was down from last quarter in which $1.5b went into 253 deals—a six year high for the industry. On the other hand, a quick look through some of the other sectors tracked by PricewaterhouseCoopers reflects some confusion on their part of what should be regarded as software.

For example, in their Computers and Peripherals section they've ranked Mark Logic as the number one VC investment, with $15m coming in from Lehman and Sequoia. The only trouble with this is that Mark Logic is a software firm that provides XML server systems; it should be added to the software segment. The same issue applies to the Business Products and Services segment, with number seven CornerstoneOnDemand listing itself on its website as a provider of software for compliance management and training. We estimate that an additional 10 to 15 companies should be added to the official 253 number.

For software companies looking for first time investments, the third quarter showed a slow in venture capital momentum. In all industries, first time deals fell from $1.4b into 305 deals; a drop from last quarter's $1.7b into 395 deals. This 15% investment drop accounted for a decrease in the percentage of total early stage deal volume from 40% last quarter to 34% this quarter. Expansion stage dollars showed a 16% increase in investment dollars, however the number of deals decreased in the third quarter. Later stage deals fell in both categories with $3b going into 288 deals—a small drop from last quarter's $3.2b into 303 deals.

The material in this report is drawn largely from the Money Tree Survey by PricewaterhouseCoopers and generally confirmed, modified, or supplemented by other sources.

The Top 50: Software Venture Capital Investments—Q3, 2007

Company	Business Focus	Lead Investor	Investment
SmartDrive Systems. Inc.	Driver risk management	Oak Investment Partners, Undisclosed firm	$41,000,000
TradeBeam, Inc.	GTM software and services	Camden Partners, Inc., The Carlyle Group	$29,000,000
ONSTOR, Inc.	Network file systems	Comventures, Foundation Capital	$27,000,100
Splunk, Inc.	Navigation/centralization of IT infrastructures	August Capital Management, Ignition Partners	$25,000,100
Time Domain Co.	Radar positioning/wireless communications	Pharos Capital Group, Undisclosed investor	$25,000,000
Atempo, Inc.	Data protection software solutions	Intel Capital, Ridgewood Capital Management	$21,999,900
ConSentry Networks, Inc.	Enterprise security solutions	Accel Partners, Duff Ackerman & Goodrich	$21,000,000
Workday, Inc.	Alternative to enterprise resource planning	Greylock Partners	$20,250,000
Carefx Corporation	Context management healthcare providers	Appian Ventures, CB Health Ventures	$17,851,000
Dust Networks, Inc.	Llow power wireless mesh networks	Cargill Ventures, Crescendo VC Management	$17,033,200
PeopleCube	On-demand calendaring	Big Bang Ventures CVA, Truffle Venture	$17,000,000
Copan Systems, Inc.	Nearline storage software	Austin Ventures, L.P., Battery Ventures, L.P.	$16,000,200
nCircle Network Security, Inc.	Security risk and compliance	Alta Partners, BV Capital	$15,962,000
Action Engine Corporation	Platform for web-enabled wireless devices	Baker Capital Corp., Northwest Venture Ass.	$15,623,100
LucidEra, Inc.	Business intelligence solutions	Benchmark Capital, Crosslink Capital	$15,618,900
Moka5, Inc.	Desktop virtualization technology	Highland Capital Partners, Individuals	$15,237,000
VideoEgg, Inc.	Web-based video publishing solutions	August Capital Management, First Round Cap.	$15,000,100
EzRez Software, Inc.	Online travel solutions	Azure Capital Partners, Canaan Partners	$15,000,000
Akorri, Inc.	Analytics software	BlueStream Ventures. Globespan Capital Part.	$15,000,000
Jive Software	Software solutions	Sequoia Capital	$15,000,000
Virtual Iron Software, Inc.	Enterprise software solutions	Brookside International, Inc., Goldman, Sachs	$13,038,800
Demandware, Inc.	E-commerce enabling software	General Catalyst Part., North Bridge V. Part.	$13,000,000
Orchestria Corporation	Electronic communication security solution	Benchmark Capital, Constellation Ventures	$13,000,000
Pacific Star Communications, Inc.	Encrypted voice, data, security, video technology	Benaroya Capital Company, Chart Venture Part.	$12,300,000
Apprion, Inc.	Wireless management software	Advanced Technology Ventures, Allegis Capital	$12,000,000
Voltage Security, Inc.	Security solutions for business communications	Humer Winblad Venture Partners, JAFCO Vent.	$11,870,200
Xangati	Rapid problem identification	Alloy Ventures, Walden International	$10,700,000
MediaBank LLC	Integrated procurement for advertisers	New Enterprise Associates	$10,500,000
Diligent Technologies Corporation	Enterprise data protection	Accel Partners, Eastward Capital	$10,500,000
StoredIQ, Inc.	Storage management software	Techxas Ventures, Undisclosed Venture Firm	$10,363,000
Kontera Technologies, Inc.	In-text advertising solutions	Carmel Ventures, Lehman Brothers	$10,299,900
CBG Holdings, Inc.	Software for the banking industry	Adams Street Partners, Undisclosed Investor	$10,250,100
Undisclosed Company	Undisclosed	Benchmark Capital, HIG Capital Management	$10,145,000
CoWare, Inc.	System-level electronic design automation	Foundation Capital, GIMV N.V.	$10,000,200
GoldenGate Software, Inc.	Transactional data management platform	Summit Partners	$10,000,000
VaST System Technologies	CAD services	Allen & Buckeridge Pty, Foundation Capital	$10,000,000
SupplyScape Corporation	Safeguard pharmaceutical supply chain	IDG Ventures Boston, North Bridge Venture Part.	$10,000,000
Sipera Systems, Inc.	VOIP security software	Austin Ventures, L.P., DTEC	$10,000,000
DeviceVM, Inc.	Software development services	DragonVenture, Inc., Harbinger Vent. Mgmt.	$9,999,900
Octavian, Inc.	Wealth and investment management problems	Carmel Ventures, Gemini Capital Fund Mgmt.	$9,999,900
Qlusters, Inc.	Linux datacenter management	Benchmark Capital, Charles River Vent.	$9,954,400
Sherwood Information Partners, Inc.	Data storage solutions	Aweida Capital Management, Undisclosed Firm	$9,500,000
Ecrio, Inc.	Wireless applications and infrastructure	CSK Venture Capital Co., DoCoMo Capital	$9,499,700
Infopia Inc.	E-commerce for online business	Humer Winblad Venture Partners, Individuals	$9,437,200
Media Machines Inc.	Virtual world tools and content services	Mohr Davidow Ventures	$9,363,900
BlueRoads Corporation	Channel management software	Angels' Forum and the Halo Fund, ArrowPath	$9,271,000
WideOrbit, Inc.	Software to facilitate media transactions	Greycroft Partners, Hearst Corporation	$9,173,000
Seatab Software, Inc.	Software for small and medium business	Emergence Capital Partners, Trident Capital	$9,000,000
Vanu, Inc.	Waveform software and design consulting	Charles River Ventures, Individuals	$8,999,900

particularly startups, are unrealistic about what kind of budget it takes to create significant product awareness and demand. As I've noted, in very rare circumstances, a product is so compelling that a company is able to get away with doing little or no marketing. But for the other 99.9% of products, you need to be realistic about what you need to spend. Unfortunately, too many companies are sure they fit into the .01% group. For example, in one case a client inquired about hiring my firm to help them run their product launch. This company had spent approximately $1.5m developing their product, and management was forecasting $10m in revenues the first year. When we asked them what they had budgeted for the launch and ongoing marketing, they told us they wanted to spend about $25k. *(Editor's note: Softletter research indicates that privately held software companies typically spend between 15% to 20% of gross revenue on sales and marketing activities; publicly-held companies typically spend twice these numbers because of the need to reach revenue projections that drive stock valuations).* We told them that with this budget, they were unlikely to hit their revenue target (they eventually allocated $350k to marketing and sales).

One way to do a reality check on your launch budget is to use a return on marketing and sales investment (ROI) calculator (there is a free one at www.280group.com in the resources section). A good ROI calculator lets you enter in costs for each marketing program, then lets you set assumptions about how many leads it will generate, how many of those will become prospects, and how many will close. From there you can use a profit per sale calculation to obtain a preliminary ROI estimates and use these to guide your budget allocation.

The fourth and final critical success factor is planning and executing an effective product review program. Earning excellent reviews for your product can be the difference between sales success and failure. Reviews carry far more weight and credibility than **any** marketing material your company can create because they are unbiased (ostensibly) reference points that potential customers can rely on to make critical decisions. Other than positive word of mouth, very few marketing programs have the potential to impact your product success more than positive reviews. On the flip side, if you receive a terrible product review it may stall or entirely kill products sales; bad reviews can allow your competitors to steal a market from under you. And because it is almost impossible to get a publication to reverse its opinion after a bad review is published (or to alert readers to the fact that they have done so), you have to live with the results for a long time. The Internet makes the problem even worse; in the age of print, while bad reviews always lingered for a period of time, gaining access to them became steadily harder over time. On the web, information is permanently **and** quickly available; as a result, your sales force will be staring at printouts and links to that bad review till the end of time.

It's easy to stack the review deck in your product's favor **if** you plan ahead and spend the time and effort to do it right. Provide the reviewer with everything they need (a reviewer's guide, white papers on the technology, a foolproof demo, FAQs, screen shots, photos, customer references, etc.). Make it as easy as possible for them to have a great experience. Involve upper management directly (if they have the temperament) in contacting and working with the reviewers directly when possible. Build a relationship with them and be ultra-responsive if they have questions or issues. If you do, they just may cut you some slack if they have an issue with your product and not highlight it in the final article. When companies end up with bad reviews (or no reviews), it's almost always because the program created to manage the process is either an afterthought or has been assigned to a junior person who doesn't have the time or expertise to do the job properly.

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Equities

Not All Revenue Is Created Equal, Part I of III

By Mark S. Reed, Corum Group

Valuation is often quoted as a multiple of annual revenue. While this is a useful metric for understanding valuation ranges, it also can be misleading. Companies of similar size in the same market may have quite different valuations based on many factors. One such factor is the composition of a company's revenue.

Software companies generate revenue in many ways. Some examples include the sale of perpetual licenses, annual maintenance fees, professional services, hardware sales, subscription fees, and long term licenses. Each of these has two characteristics that are relevant to a buyer's valuation model: (1) predictability/risk, and (2) profit margin. Valuation is driven up by increases in predictability (and therefore reduction in risk) and profitability (and therefore higher ROI). Without putting a valuation multiple on each type of revenue, let's examine how typical buyers look at different kinds of revenues.

Hardware: Your customers may appreciate receiving a turnkey hardware/software solution, but revenue from hardware sales will typically be given little value by a software buyer because they consider hardware a commodity business.

Services: The performance of services may be an important part of your solution sale and a key competitive advantage. Your services group may also be key to maintaining a tight relationship with your customers, which will pay dividends over the years. That's a good story to tell an acquirer, but every hour of services revenue comes with an hour or more of direct cost as well. Typically, profit margins are not as high on services as on software sales,, so don't expect services revenue to be valued as highly as more profitable software sales.

Licenses: The sale of software under a perpetual license has been the historical software business model. License sales can be large and very profitable. However, the sales cycle can also be long, and when large sales slip they can materially affect a company's annual financial performance. Each year the revenue bucket starts empty and needs to be filled with new sales, which may or may not materialize. (We will be discussing the impact of recurring revenue models in part two of this article.)

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Company/Description	Acquired by	Price/Terms	Revenues	Multiple
Gemstar-TV Guide (GMST)	Macrovision (MVSN)	$2,800,000,000	$616,900,000	**4.54**
• Rich data and information delivery		*Terms: Cash and stock*		
BCS Informatica	TOTVS S.A. (Brazil)	$26,700,000	$8,900,000	**3.00**
• Management software for law firms		*Terms: Cash and earnout*		
Vertical Pitch	Edgewater Technology (EDGW)	$20,000,000	$10,000,000	**2.00**
• Corporate performance/business intelligence		*Terms: Cash and stock*		
NSB Retail Systems (NSB, London)	Epicor Software (EPIC)	$318,200,000	$92,400,000	**3.44**
• Specialty retail software		*Terms: Cash*		

CardFile

Speech to Text Resources

(Speech to text abilities are becoming of increasing importance to companies who must adhere to US and international web accessibility standards as they impact the deaf and hearing impaired.)

- **Nuance** (www.nuance.com/naturallyspeaking): Publishes Dragon Naturally Speaking. Used in conjunction with supported digital recorders, this software can function as a useful, fairly inexpensive transcription system.
- **Speech to Text Services Network** (stsn.org): Site provides links to different speech technologies and systems.
- **Speech Technology (www.speechtechmag.com): Web site of Speech Technology Magazine;** site provides a wide variety of links and resources to recent technologies and systems.
- **Ubiqus** (www.ubiqus.com): Well-respected service that provides transcriptions services; very good with digital media.

ROBERT SCOBLE ON WHY BLOGS LIKE TO WRITE ABOUT CONSUMER SOFTWARE: "We're paid to deliver page views. Advertisers call it "CPM" (cost per thousand viewers). Now, what's going to get more of you interested? Consumer software that you actually have a role in adopting or purchasing or enterprise software where some CIO somewhere else in your organization decides on? I know that when I talk about enterprise software the numbers of viewers just don't show up. So, tech bloggers quickly learn that if they talk about enterprise software they aren't going to get many advertising impressions." (Quoted on http://scobleizer.com/2007/12/09/why-enterprise-software-isnt-sexy/, 12/09/2007)

BLOGGER SEAN HEDERMAN ON "UPGRADING" FROM VISTA TO WINDOWS XP: " To be honest there is only one conclusion to be made; Microsoft has really outdone themselves in delivering a brand new operating system that really excels in all the areas where Vista was suboptimal. From my testing, discussions with friends and colleagues, and a review of the material out there on the web there seems to be no doubt whatsoever that that upgrade to XP is well worth the money. Microsoft can really pat themselves on the back for a job well done, delivering an operating system which is much faster and far more reliable than its predecessor. Anyone who thinks there are problems in the Microsoft Windows team need only point to this fantastic release and scoff loudly.

Well done Microsoft!" (Quoted on http://dotnet.org.za/codingsanity/archive/2007/12/14/review-windows-xp.aspx, 12/14/2007)

IDC RESEARCHER DARREN BIBBY ON CHANGES IN THE VAR MODEL UNDER SAAS: "For traditional partners who made their money on finding IT complexity and solving it, a lot of that goes away with Software as a Service." (Quoted on http://www.erpsoftware360.com/var.htm, 12/10/2007)

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