

A STRATEGIC ANALYSIS OF AN ENTERPRISE SOFTWARE COMPANY

by

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ABSTRACT

CRMCo is a software provider that had a clear and distinctive differentiated-value proposition. As the industry grew rapidly in the nineties, CRMCo sought to capitalize by evolving its differentiation to encompass new dimensions of value. The severe downturn following the technology bubble affected CRMCo's financial position and caused it to start cutting costs. The strategic fit deteriorated, as cost pressures put CRMCo's expanded differentiation strategy under increasing strain.

The industry matured and consolidated to create dominant players, while software-as-a-service competitors and Microsoft also emerged as disruptive and growing threats. Now a business unit of a larger concern, CRMCo is trying to focus its internal capabilities on narrower vertical markets to address its strategic vulnerability. This paper assesses CRMCo's evolving strategy by analyzing the industry and CRMCo's internal capabilities. The goal is to identify a sustainable strategy for growth that increases strategic fit and aligns with market opportunities.

DEDICATION

I dedicate this paper to my wife Tracy, whose love and support enabled me to complete the Executive MBA Program; my mother Naima and my two sisters Salma and Sirine who will always be my source of strength; my many friends and colleagues, whose support and encouragement got me through the endless late nights; and my team mates (Cheryl, Joe and Jonathan), whose friendship, strength of character, intellect and spirit made this an immensely enjoyable learning experience. Finally, I wish to dedicate this to my late aunt, Essia, whose memory shall always inspire me to be better.

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GLOSSARY

Application Server	A software platform that provides the services and infrastructure required to develop and deploy middle-tier applications. Middle-tier applications perform the business logic necessary to provide Web clients with access to enterprise information systems. In a multi-tier architecture, an application server sits beside a Web server, or between a Web server and enterprise information systems. Application servers provide the middleware for enterprise systems.
ERP	ERP (Enterprise Resource Planning) is an industry term for the broad set of activities supported by multi-module application software that helps a manufacturer or other business manage the important parts of its business, including product planning, parts purchasing, maintaining inventories, interacting with suppliers, providing customer service, and tracking orders. ERP can also include application modules for the finance and human resources aspects of a business. Typically, an ERP system uses or is integrated with a relational database system. The deployment of an ERP system can involve considerable business process analysis, employee retraining, and new work procedures.
IDE	An IDE (Integrated Development Environment) is a programming environment that has been packaged as an application program, typically consisting of a code editor, a compiler, a debugger, and a graphical user interface (GUI) builder. The IDE may be a standalone application or may be included as part of one or more existing and compatible applications. The BASIC programming language for example, can be used within Microsoft Office applications, which makes it possible to write a WordBasic program within the Microsoft Word application. IDEs provide a user-friendly framework for many modern programming languages, such as Visual Basic, Java, and PowerBuilder.
SCM	SCM (Supply Chain Management) is the management of the entire value-added chain, from the supplier to manufacturer, right through to the retailer and the final customer. SCM has three primary goals: Reduce inventory, increase the transaction speed by exchanging data in real-time, and increase sales by implementing customer requirements more efficiently.
SMB	Small and mid-sized business.
TCO	TCO (Total Cost of Ownership), refers to the cost of a software asset over its lifetime. It includes acquisition, setup, support, ongoing maintenance, service and all other operating expenses.

OASIS

OASIS (Organization for the Advancement of Structured Information Standards) is a not-for-profit, international consortium that drives the development, convergence, and adoption of e-business standards. The consortium produces more Web services standards than any other organization along with standards for security, e-business, and standardization efforts in the public sector and for application-specific markets. Founded in 1993, OASIS has more than 5,000 participants representing over 600 organizations and individual members in 100 countries.

W3C

The World Wide Web Consortium (W3C) is an international consortium where member organizations, a full-time staff, and the public work together to develop Web standards. W3C primarily pursues its mission through the creation of Web standards and guidelines. Since 1994, W3C has published more than ninety such standards, called W3C Recommendations. W3C also engages in education and outreach, develops software, and serves as an open forum for discussion about the Web. In order for the Web to reach its full potential, the most fundamental Web technologies must be compatible with one another and allow any hardware and software used to access the Web to work together. W3C refers to this goal as “Web interoperability.” By publishing open (non-proprietary) standards for Web languages and protocols, W3C seeks to avoid market fragmentation and thus Web fragmentation.

1 OVERVIEW: MARKETS AND PRODUCTS

1.1 Introduction

CRMCo has been a supplier of Customer Relationship Management (CRM) software since the mid-nineties. CRM software is a class of enterprise business applications that aims to help companies manage their customer relationships throughout the customer lifecycle; that is, all the interactions and processes in marketing, sales and service. It is argued by the CRM industry that by enabling a 360-degree view of the customer, companies can gain insight into each customer's needs and provide a personalized level of service that increases satisfaction and fosters loyalty. The value proposition is based on the premise that by managing the customer lifetime value, companies can acquire and retain customers more profitably. CRMCo's stated strategy in the CRM software market is differentiation with a highly-customizable CRM platform, in addition to industry focus with a suite of out-of-the-box applications, purpose-built for the industries it targets.

CRMCo, now a business unit of a larger software concern, faces several strategic issues and challenges. Firstly, as a small vendor with relatively limited resources and a very small market share, how does CRMCo defend its turf in the face of intense competition from much larger companies in a maturing industry? As an established software company with a traditional on-premise business model, how can CRMCo effectively compete against the fast-growing disruptive business models of its on-demand rivals? Does CRMCo's current strategy – including its focus on industry verticals – provide the best chance of success? Has CRMCo created the right conditions in terms of alignment and strategic fit to execute on that strategy successfully? Finally, are there other strategic alternatives that CRMCo can pursue in order to grow profitably?

This paper shall provide an in-depth, multi-dimensional analysis of CRMCo's internal and external environments in order to address the strategic issues facing the company, including those enumerated above. The goal of this paper is to offer thoughtful recommendations for a go-forward strategy for CRMCo. While the value of the analysis is firm-specific, CRMCo also serves as a good example of a small, incumbent business software company in a low-growth market. I hope to also provide the reader with insight into the enterprise software industry and the competitive dynamics that are at play.

1.2 Firm Background and Current Structure

CRMCo was founded in 1994 by two prominent high-tech entrepreneurs who saw a market opportunity created by the need for technology tools to manage the demand side of business. For several years up until that point, enterprise software was focused on helping companies manage the supply side of their business. As companies increasingly invested in automation tools and infrastructure to manage their back-office operations, the gap in their front-office – that is, how they create and manage demand – became obvious. CRMCo was founded as part of an early wave of enterprise application software pioneers focused on addressing the nascent market for what came to be known as Customer Relationship Management (CRM) software.

As the market for CRM software enjoyed double-digit growth, fuelled in part by over-inflated customer expectations and by the technology bubble, CRMCo grew very rapidly, especially after it went public in August of 1999. CRMCo's revenues doubled from US \$25.3 million in 1999, to \$52.9 million in 2000, and they reached \$96.2 million in 2001. Buoyed by the market's fascination with its impressive sales growth, which culminated in a market valuation that exceeded \$1 billion, CRMCo embarked on a major global expansion through

aggressive hiring, relentless marketing and an acquisition spree that saw it acquire three software companies and many more boutique systems integrators in North America and Europe.

In what is now a familiar story, the house of cards finally fell apart, as the high tech bubble burst and the entire market nearly collapsed. In 2002, CRMCo was an unprofitable company, like many of its peers, bleeding cash and competing in a declining, over-crowded CRM market that all of sudden became fraught with high-profile customer implementation failures. In what Gartner calls the “Trough of Disillusionment” in their technology hype cycle, CRM went from market darling and a customer must-have technology to an industry in survival mode. From 2002 to early 2004, CRMCo went through three CEO changes, several rounds of layoffs and a massive cost-cutting and retrenchment program. The strategic direction of the company became increasingly muddled and vague during this period. Competition never abated, the market stagnated and CRMCo’s increasingly precarious financial viability due to dwindling cash and elusive profitability forced it to look at more drastic strategic options.

On February 25 2004, CRMCo was acquired by ParentCo Software Corporation (ParentCo Software), the software unit of ParentCo Corporation. ParentCo Corporation is a holding company. “It operates in 14 countries around the world, and employs approximately 1,800 staff worldwide. It is a diversified enterprise that owns, directly and indirectly, a global family of businesses across three core areas (i) enterprise application software, (ii) IT consulting and services, and (iii) mobile value added services and Internet media services in China. The principal enterprise application software companies owned by the Company include SisterCo2 Systems, Inc., CRMCo, and SisterCo1” (ParentCo, 2006). CRMCo now operates as a semi-autonomous distinct business unit of ParentCo Software. From recent press releases, it appears that ParentCo Software is positioning itself as a global-enterprise applications vendor with an increasingly integrated suite of products, including CRMCo.

1.3 Target Market

Generally, CRMCo targets what is commonly called the mid-market or mid-sized enterprises. There is no universal industry definition for the mid-market, but it generally refers to the tier of companies just below the Fortune 1000 companies. CRMCo defines the mid-market as companies with revenues of between \$50 million and \$1 billion. Gartner, the leading industry analyst, classifies the mid-market in terms of number of employees. What it calls medium-sized businesses (MSBs) are companies between 100 and 999 employees (Anderson, 2004).

CRMCo targets the mid-market because the Fortune 1000 or even the Global 2000 customers (also referred to as the enterprise market) tend to buy CRM from their incumbent, large Enterprise Resource Planning (ERP) software vendors such as SAP and PeopleSoft/Oracle. Traditionally, they also require high degrees of scalability, complex operational sales and support capabilities, and financial stability, all of which are on par with their own. These are all factors that favour large CRM vendors (SAP, Oracle, PeopleSoft and Siebel) and make the so-called enterprise market somewhat unattractive for CRMCo.

In addition to segmentation by size, CRMCo also focuses on business-to-business companies (B2B) and usually shies away from business-to-consumer (B2C) companies. The reason is B2B companies tend to have more complex business models, which to CRMCo means complex customer relationships and complex business processes, whereas B2C companies tend to have high-volume, somewhat standardized set of customer transactions. As will be seen later in this analysis, business model complexity is a good fit for CRMCo's differentiation strategy.

Finally, CRMCo also embraces what the industry refers to as a vertical strategy, which is targeting certain industries and avoiding others. In CRMCo's case, the chosen verticals are financial services, homebuilders and real estate, healthcare and manufacturing. The industry focus has been a controversial strategic choice. For many companies, a vertical strategy is primarily a

go-to-market strategy. It allows the firm to focus its marketing and sales resources on a well-defined and therefore reachable market. For some companies, including CRMCo, a vertical strategy also extends to a product strategy. Indeed, as will be seen in 1.4.1.2 below, CRMCo develops industry solutions that are purpose-built for the needs of that industry. This strategic choice has not been without its detractors because some perceive it as contradictory to CRMCo's core value proposition of flexibility. In any case, strategy sometimes is where the revenue is, so CRMCo has also sold and likely will continue to sell its horizontal solution (the "plain vanilla" solution) to companies outside its industry target market, given the opportunity to do so.

1.4 Products and Services

1.4.1 Products

CRMCo's CRM products closely reflect the typical stages in a customer lifecycle, namely: demand generation, customer acquisition, fulfilment and finally customer service (the terms in which organizations think when they manage the total lifecycle of their customers). Similarly, CRMCo's extensive CRM suite consists of products that break down along the same lines. The products that are not industry-specific are referred to as horizontal products while the industry-specific solutions are called vertical solutions. The distinction between product and solution further conveys the value-added embedded in the vertical solution in the form of industry domain expertise and best practices that are built into the software, and the services that are needed to implement it. I shall first describe the horizontal suite of products then move on to the vertical solutions.

1.4.1.1 Horizontal Products

CRMCo Sales: This has traditionally been CRMCo's strongest functional suite. It consists of modules designed to allow distributed sales organizations with complex processes to manage all aspects of their selling activities in order to increase sales effectiveness, productivity

and forecast accuracy. The major capabilities include sales opportunity management, quote and proposal management, revenue forecasting, team selling, multi-channel sales integration, real-time product configuration, territory management, expense management, and finally, contact and activity management.

CRMCo Marketing: This is a suite of marketing automation applications that enable marketers to manage complex multi-channel marketing campaigns and online customer interactions. The major capabilities include customer segmentation and profile management, sales lead management, content targeting and personalization, as well as workflow management capabilities for automating business process.

CRMCo Service: This is a set of applications that deal with automating and enabling customer service and support activities in an organization including capturing, queuing, distributing, prioritizing, and ultimately resolving customer enquires and complaints. It includes modules for service request and case management, service-level agreement and escalation management, frequently asked questions (FAQ) and knowledge base management, online customer self-service capabilities, as well as call centre and email integration for an integrated multi-channel support experience.

CRMCo Partner Management: This is not a product per se, even though it is marketed as such. Rather, each of the main functional applications (namely marketing, sales and service) provides collaborative components to allow the organization to involve its partners in all aspects of its operations. This in effect extends the enterprise and allows it to scale its resources by selectively exposing customer data and business processes to its partners as a function of their location, scope of services and level of relationship trust, via a partner portal and other programmatic interfaces.

CRMCo Analytics: Every organization that seeks to improve its CRM processes and decides to make the investment in CRM software, ultimately wants to quantify and measure its success, however it defines success. CRMCo Analytics provides a set of integrated tools and pre-packaged reports to allow the generation, customization and distribution of CRM business intelligence. Built-in reports include for example, sales forecasts, customer support resolution rates and marketing campaign effectiveness reports. The business intelligence capabilities extend to deeper analysis tools that allow business users to view and manipulate their data along multiple dimensions and easily run complex drill-downs to gain real business insight.

CRMCo Platform Products: This is the enabling layer of technology that CRMCo applications are built and run on. The platform includes the user clients, customization toolkit, data synchronization engines, application programming interfaces (API) and any other application-agnostic functionality such as integration with Microsoft Outlook. What is important about the platform is that it enables the development and the use of almost any business application. By itself, however, it has no value to a business user.

1.4.1.2 Vertical Solutions

CRMCo's industry-specific solutions extend the base functionality in the horizontal products to meet the specific needs of targeted industry sub-segments. They consist of the following solution suites:

CRMCo CRM for Financial Services: This is a very robust suite of applications designed to help financial services organizations manage their client relationships and maximize their profitability. CRMCo CRM for Financial Services offers discrete CRM offerings for institutional asset management, wholesale asset management (mutual fund wholesaling), capital markets, private banking or wealth management, and commercial banking.

CRMCo CRM for Homebuilders: This is an award-winning suite that provides homebuilder and real estate organizations with customized functionality to streamline marketing, sales and service processes whether these are financing, building, selling, servicing, or managing homes or property.

CRMCo CRM for Healthcare Payers: This is a very comprehensive suite of applications designed to automate processes in health insurance management and create efficiencies in an otherwise paper-based wasteful system. It enables payers to streamline six key areas of their business, including lead management, new business quoting, renewal processing, rating and underwriting, online enrolment, and back office integrations.

CRMCo CRM for Manufacturing: This solution is targeted at discrete manufacturing organizations with complex products lines and complex sales cycles. It is designed to allow sales teams in these organizations to more effectively manage and shorten the sales cycle while bridging the gap between the needs of their customers and the constraints of their supply chain.

1.4.2 Professional Services

At CRMCo, services are referred to as “professional services”. They consist mainly of business consulting, technical account management, implementation and customization services, and training and technical support. These are described in more detail below.

1.4.2.1 Business Consulting Services

Because CRM is more than technology, customer companies sometimes look to CRMCo to provide business consulting in order to design the right CRM strategy and implementation plan for the organization. The consulting engagement maps the goals of the organization to the capabilities of the CRMCo suite, identifies functional and organizational gaps and defines what the performance metrics need to be in order to measure success. This is a crucial step that every

customer should pay a great deal of attention to, in order to maximize future user adoption and align its organization with its CRM goals.

1.4.2.2 Implementation Services

This is the technical part of each CRM project. CRMCo provides implementation services, which consist of project management, installation and configuration, customization, integration with other systems, and performance tuning. These projects typically run in phases with clear deliverables for each phase. They are jointly managed and monitored with the customer project team. Depending on the complexity of the customer requirements and the extent of customizations, these projects can add up to three times the cost of licenses, or sometimes more. Billing for these services is done either using the “time and material” approach, where the customer is billed as the work is being done; or using a “fixed price” approach, where CRMCo provides a well-defined scope of services at a fixed quoted price.

1.4.2.3 Training

CRMCo provides training courses for customers in three ways: on-site, at a CRMCo training facility, or online. These courses range from one-day relatively simple user training to systems administrator training, and to more complex developer training. Some courses are mandatory and are sold with each deal to make sure training is not neglected during the buying stage. A minimum basket of courses is necessary to ensure that customers can at least manage their on-premise system from day to day and get value from their investment.

1.4.2.4 Technical Support

CRMCo provides technical support services to every customer that has a support and maintenance agreement. Normally for enterprise software systems, technical support is a practical requirement because of the impact of downtime on the business. Technical support is provided according to pre-agreed service-level agreements (SLAs), which entitle the customer to contact

support services by phone, email or on the Web, and get resolution to their issues. Sometimes resolution is quick and easy, and sometimes it is escalated through different tiers of support, all the way to research and development (R&D). Technical support services also include access to documentation, product updates, and the CRMCo knowledge base on the customer self-service portal.

1.5 Major Competitors

It would not be an overstatement to say that CRMCo has too many competitors to enumerate in this paper. However, some stand out because they are short listed in the sales cycle with more frequency than others. There are roughly four categories of competitors in this space: very large enterprise suite vendors, software-as-a-service vendors (also known as on-demand vendors), best-of-breed vendors, and mid-market CRM suite vendors.

The large enterprise suite vendors used to be SAP, Oracle, Siebel and PeopleSoft, (although Siebel is technically a CRM pure-play vendor unlike its ERP¹ counterparts). However, last year Oracle acquired both Siebel and PeopleSoft to make this a two-horse race with SAP. These two mega companies, along with Microsoft, captured 60 percent of profits in the overall software industry, all domains combined (Berryman, Jones, Manyika, & Rangaswami, 2006). They are highly diversified and extremely powerful. SAP and Oracle dominate the Fortune 1000 market while Microsoft virtually owns several segments in the small and mid-size business (SMB) market.

The most prominent competitor in the on-demand vendor category is Salesforce.com (SFDC). It primarily provides sales force automation functionality but is growing at close to 80 percent and is using its market momentum to branch out into other CRM functional domains and even beyond. The threat of Salesforce.com threat is growing and their business model is seen

¹ Enterprise Resource Planning, please see Glossary.

as highly disruptive to the prevailing on-premise model. Other notable on-demand competitors to CRMCo include RightNow Technologies, the “Salesforce.com of service and support”, as well as NetSuite, an integrated ERP-CRM in-demand suite that is gaining popularity in the SMB market.

Best-of-breed vendors such as Kana, in contact centre service, and Aprimo or Unica, in Marketing, are also a recurring competitive threat, but only if their particular domain is the primary focus of the customer. They are similar to CRMCo in many ways including size, business model and pedigree.

Finally, in the CRM mid-market suite, CRMCo competes directly with Onyx, and less so with Microsoft, Sage and SSA Global. For many years, Onyx has been the mirror image of CRMCo. They were both started at the same time, grew to be roughly the same size and developed very similar products. Neither has been able to survive as an independent company. CRMCo was acquired by ParentCo, after Onyx made a bid. Onyx is in the process of being acquired by a private equity fund, and now, ironically, ParentCo is trying to outbid the fund. Microsoft emerged as a low-end competitor in 2003. In 2005, Microsoft released the second major version of its CRM product and signalled its intent to compete with CRMCo and others in the upper mid-market and the enterprise. Sage has a full CRM suite, but is primarily focused on the UK market. SSA Global has built a full enterprise suite through acquisitions which included Epiphany in CRM. SSA Global is very strong in analytics and has expanded its footprint in all three functional areas of CRM. It is similar in size and scope to CRMCo.

1.6 Focus and Scope of this Paper

Since its inception, CRMCo has been evolving its differentiation strategy in pursuit of growth. As market conditions changed over the last 10 years, so did CRMCo’s differentiation strategy. The focus of this analysis is to assess the current strategy in the context of the overall

industry and CRMCo's internal capabilities. The goal is to develop strategic recommendations to better align the company with growth opportunities.

An overall industry analysis is outlined in Chapter 2, including a description of the industry value chain, a five-factor analysis of the CRM industry, and key success factors. An internal analysis of CRMCo follows in Chapter 3, which includes a description of the current strategy along with a firm-level value chain in order to assess the quality of strategic fit and the degree to which the internal capabilities support the strategy.

Issues facing the company are discussed and analyzed in Chapter 4, and in Chapter 5 specific strategic recommendations are formulated to address the relevant issues.

2 EXTERNAL ANALYSIS (INDUSTRY ANALYSIS)

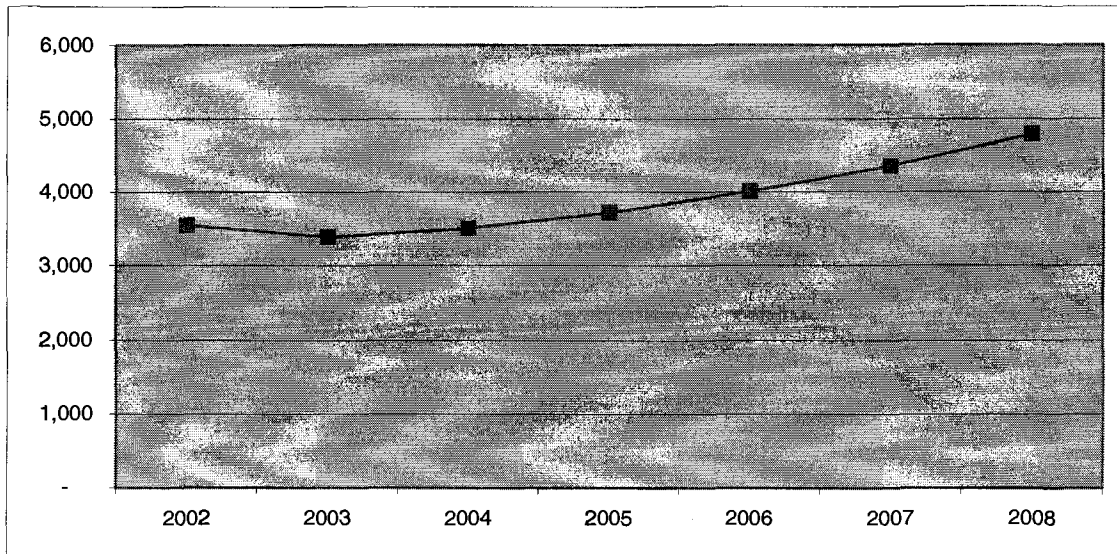
2.1 CRM Software Industry Size and Structure

2.1.1 Industry Size and Growth

In 2006, the industry was projected to exceed \$4 billion in worldwide license revenue, according to Gartner Dataquest, the leading analyst and research firm in the space (Topolinski, 2004). The compound annual growth rate (CAGR) for license revenue, from 2004-2008, was projected to be 7.2 percent (Topolinski). Gartner has traditionally measured sales in terms of new license revenue, which was the prevailing sales model. However, due to the emergence and increasing popularity of open-source software and new buyer consumption models such as software-as-service offerings, Gartner has moved to measure market share and sales data in terms of *total software revenue*. This includes revenue generated from new license, updates, subscriptions and hosting, technical support and maintenance, but not professional services and hardware. As a result, the latest figures from Gartner, following the new market definition of CRM sales, point to an even more robust growth in the industry. In fact, sales in 2005 totalled \$5.7 billion, a 13.7 percent increase from 2004 (Tekrati, 2006).

The service revenue associated with implementing, customizing and maintaining CRM applications by CRM vendors and systems integrators is estimated at \$13 billion, according to Forrester, another leading research firm (Wachter, 2006). Figure 2-1 CRM sales growth 2002-2008, provides historical and future worldwide CRM software license sales from 2002 to 2008.

Figure 2-1 CRM sales growth 2002-2008



Based on Gartner Dataquest report, Forecast: CRM software, worldwide, 2003-2008 (Topolinski, 2004).

Customers of CRM have traditionally been larger businesses that need automated systems to manage their global customer interactions. Nevertheless, the technology adoption has been such that businesses of all sizes, whether they are business-to-business (B2B), or business-to-consumer (B2C), or even governments, are investing in one form or another in customer relationship management. Some industries such as financial services, communication, and manufacturing spend a great deal more on CRM than others. Table 2-1 CRM spending by industry, provides a breakdown of worldwide CRM license sales by industry. It is also important to point out that the size of the customer and sometimes their industry tends to narrow the field of suitable CRM vendors considerably, as some CRM vendors focus on niche segments either by size, industry, or both. As a general rule of thumb, however, the global “Fortune 2000” companies will buy from the larger CRM vendors, now dominated by Oracle and SAP.

Table 2-1 CRM spending by industry

	2004	2005	2006	2007	2008	CAGR (%) 2004-2008
Agriculture, Mining and Construction	18	20	22	24	27	9.8
Manufacturing: Discrete	806	800	823	805	821	0.8
Manufacturing: Process	524	557	606	666	742	7.1
Utilities	154	179	205	226	263	13.8
Wholesale	42	46	51	57	65	10.6
Retail	224	243	281	313	350	10.1
Transportation	63	74	88	114	127	18.8
Communication (Information)	456	494	558	623	690	9.7
Financial Services	538	568	574	620	675	5.3
Healthcare (Provider)	126	137	151	170	196	10.4
Services	210	238	273	318	364	13.6
Educational	48	52	56	61	68	8.0
National and International Government	95	93	98	105	121	6.1
Local and Regional Government	86	93	102	113	128	9.4
Home	114	121	125	137	150	4.6
Total CRM	3,505	3,715	4,012	4,353	4,789	7.2

Based on Gartner Dataquest report, Forecast: CRM software, worldwide, 2003-2008 (Topolinski, 2004).

2.1.2 Industry Structure

The CRM industry has evolved from a handful of vendors of simple contact management in the mid-nineties to a dynamic and sophisticated global ecosystem consisting of hundreds of vendors², and thousands of systems integrators and resellers, in addition to several specialized analyst firms and dedicated media outlets that follow the industry.

The CRM software industry, despite the relentless consolidation over the past few years, (See Appendix 6.1.1, Highlights of CRM Vendor Consolidation Since 2004), remains relatively fragmented and dynamic with a significant number of new niche vendors entering the market. This is primarily due to the broad market definition of CRM software as a set of almost any technology that relates to how organizations manage their customer data, processes and front-office strategies. In addition, the large variations in customer-related business processes, from one industry sub-segment to another, account for the correspondingly large number of vendors that focus on a given underserved market niche.

² Gartner estimates that there are about 300 CRM vendors.

The latest publicly available estimates for market share reveal that SAP is still the industry leader, with a 25.9 percent market share, ahead of Siebel's 17 percent and Oracle's 6.4 percent. The increasing market for on-demand provisioning saw revenues at Salesforce.com grow by 77.7 percent between 2004 and 2005, taking it to fourth place with a 4.9 percent market share. CRMCo's market share of the overall CRM license revenue is estimated at just over 0.5 percent.

2.2 Major Industry Trends

2.2.1 Service-oriented Architecture (SOA)

Lack of standards and the resulting complexity of integrating disparate systems have long plagued the enterprise applications software industry and cost customers billions of dollars in complex integration projects. Service-oriented architecture is a grassroots effort and a set of concepts designed to standardize the interfaces and protocols between applications in heterogeneous environments, in order to allow them to "talk to each other." The overarching goal behind SOA is to enable business process integration, across disparate applications, by codifying software-to-software interoperability. Unlike previous efforts to deal with this problem, SOA enjoys the backing of industry heavyweights such as IBM, Microsoft and Oracle in addition to standards-setting bodies like the W3C and OASIS (please see glossary for more details). SOA encompasses a set of software design principles that are beyond the scope of this paper. One highly-relevant principle, however, is the concept of exposing software as a service that can be discovered, invoked and communicated with, over standard Web protocols. This last implication has helped spawn a completely different business model, known as software-as-a-service, which is discussed in the following section.

2.2.2 Software as a Service (SaaS)

This trend, also known as on-demand software, is as much a new technology trend as it is a change in customer buying preferences. The basic premise of this model encompasses three design pillars. First, the software is hosted at the vendor premises and accessed remotely by customers. This is in contrast to the traditional on-premise model where customers install the application in their own data centres. Second, the application is sold in a subscription-based, pay-as-you-go model, resulting in a recurring revenue stream where each user pays a monthly fee. This subscription model is in contrast to the perpetual license model where customers pay for licenses upfront on a one-time basis and then pay a yearly maintenance fee of approximately 15 percent to 24 percent of the original license amount.

Third, and most importantly, the application in a pure on-demand environment is designed to be multi-tenant, which basically means that all the customers share the same application code and the core data model. A significant advantage of this model is that it allows enhancements and upgrades to be introduced constantly and iteratively, and deployed simultaneously to all customers. This reduces the flexibility that each customer has, but it dramatically lowers support costs to the vendors which gives the latter a tremendous cost advantage. The most prominent examples of on-demand CRM companies are Salesforce.com, NetSuite and RightNow Technologies.

It is worthwhile noting that almost all the growth in CRM since 2004 can be attributed to on-demand vendors. Overall, the traditional perpetual license model is stagnant according to most industry analyst reports.

2.2.3 Open Source CRM

Unlike SaaS and SOA, open source models have gained wide mainstream awareness and popular recognition as a thriving ecosystem of software that is freely available to use and to

contribute to. There are currently 114,907 registered open software projects on SourceForge.net that are following the peer-production methods adopted by 1,263,908 open source developers (SourceForge.net, 2006). Of these projects, 161 are dedicated to CRM. Not all open source applications are actually free to use. Several vendors, such as SugarCRM and FreeCRM, have adopted a hybrid model where development follows the open source methods – and hence the source code is freely available – but the solution is sold and supported commercially, albeit at relatively reduced prices.

2.2.4 Capital Flow

As a general trend in the software industry, capital flow is increasing and its sources are changing. The increase, while considerable, is not surprising after the recovery of the technology sector in the last few years. What is surprising is the increasingly assertive presence of private equity funding. According to the *Software 2006 Industry Report*, by Mckinsey & Company, out of the \$11 billion that was invested in the software industry in 2005, private equity-funded mergers and acquisitions (M&A) deals, while few, amounted to over \$6 billion (Berryman et al., 2006). For the first time ever, private equity investment exceeded venture capital investment (See Table 2-2 Global private equity and venture capital investment in software). CRM software companies have not been immune to this trend. Blue Martini, MDSI, the once-mighty BroadVision, and, very recently, Onyx (CRMCo's direct competitor) have all been acquired by private equity concerns. In addition, according to the same report, venture capitalists deployed their funds more cautiously in 2005, favouring later and expansion-stage opportunities over startup and early-stage investments.

Table 2-2 Global private equity and venture capital investment in software

<i>(In \$ Billions)</i>	2002	2003	2004	2005
Private equity				
M&A	0.3	1.1	1.5	6.2
Venture capital				
private placement	4.6	4.6	6.2	5.1

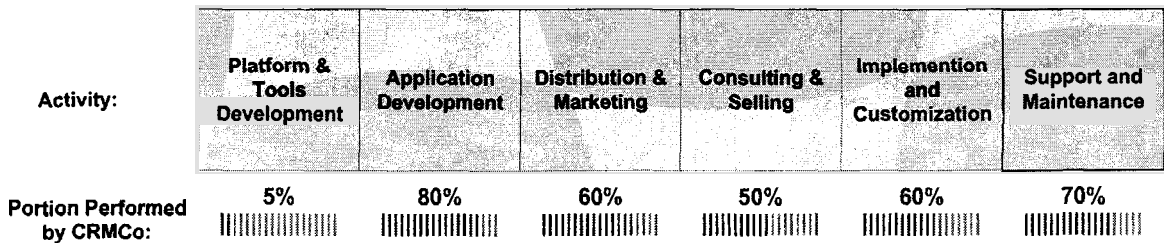
Based on Software Industry 2006 Report, (Berryman et al., 2006).

2.3 Industry Value Chain

The CRM industry value chain is shown in Figure 2-2 CRM industry value chain, below.

Six core activities are shown with a bar underneath each, indicating the degree to which that activity is performed by CRMCo. For example, application development is approximately 80 percent performed by CRMCo, whereas the remaining 20 percent is outsourced to various parties. Each activity shall be described in detail next.

Figure 2-2 CRM industry value chain



Adapted from Ed Bukszar, (2006). BUS607: Business Strategy class notes.

2.3.1 Platform and Tools Development

In this activity, the software platforms CRM applications are built *on*, and the development tools they are built *with*, are produced. Software platforms start with the basic operating systems such as Windows Server, UNIX or Linux, which manage the server hardware resource allocation, network communications and other low-level functions. The second important platform is the database the CRM application will use to store the system data.

Typically, database management systems come from a handful of vendors³ and include a suite of tools to design, query and manage the data. The database software is very central to any enterprise CRM system because the data modelling⁴ can be very complex and the volume of data transactions very large. Third, a host of other platform products are also needed to run the CRM system, but vary from one vendor to another. Typically, there is an application server⁵ and a Web server, as most modern CRM applications are built on multi-tiered Web architectures⁶, and accessed through a Web browser.

Development tools are the other vital input into applications development. These tools consist of programming languages and tools wrapped in Integrated Development Environments (IDE)⁷ that allow the developers to manage the collaborative development process.

CRMCo maintains a small footprint in this area because platform products occupy the bottom layers of the overall software stack, and have far-reaching implications on the entire value chain, from how applications are developed to what interfaces the customers will have access to. Since its inception, CRMCo has made the strategic decision to align with Microsoft platform products and build its applications almost exclusively on the Microsoft stack. Consequently, CRMCo collaborates closely with Microsoft on defining the specifications for next-generation platform products. In addition, CRMCo uses this coveted access to the core development teams at Microsoft to not only ensure compatibility with its own CRM products but also to identify opportunities to build features that leverage innovations on the platform side. Usually, there are also gaps in the Microsoft platform that CRMCo needs to fill by building platform extensions into its products.

³ Microsoft SQL, Oracle, IBM DB2 or Open source such as MySQL.

⁴ How the real world (e.g. Customers, partners, orders) is depicted using a database entity object model.

⁵ See Appendix 6.1.3, N-tiered Application Architecture

⁶ Ibid

⁷ Please Glossary of Terms for a more detailed description.

2.3.2 Application Development

Once the platforms and tools are sourced, the CRM application development activities take place. These include various categories of activities that happen in sequence, but sometimes in parallel depending on the preferred methodologies. Almost invariably though, a combination of requirements capture, analysis, design, coding, and testing is performed to “get products out the door”.

Usually, activities that fall under strategic marketing are performed first by product managers. These activities deal with deciding which products to build for which markets and what the distinctive value proposition needs to be in support of the overall competitive product strategy. The product requirements and plans produced by product management are then translated to high-level design documents by program managers and estimated in terms of development effort and timelines. A give-and-take process follows, whereby the product requirements are pared down to fit available budgets and timelines, and mapped to different product release cycles in the roadmap.

The requirements are translated to detailed architecture and design specifications. Then requirements are grouped in discrete logical categories and assigned to various development teams based on their areas of expertise. For example, the user interface development would be performed by a different team and on a different schedule from that of the application server development. Finally, the code that is produced by the development team is first unit-tested, then assembled and tested as a whole during the quality assurance process.

CRMCo performs the vast majority of its application development using its own resources in its three development centres in Vancouver, Dublin and Bangalore. However, not all products are developed in-house. Some development is outsourced to third-party developers in Russia, whereas other products are licensed from software vendors under OEM agreements.

2.3.3 Distribution and Marketing

CRM software is made by North American companies for the most part and sold worldwide, through hybrid direct and indirect sales channels. The mix varies from one company to another depending on its size and geographical focus, but most companies have a network of resellers that extend their reach in markets where they do not have a direct presence. These tend to be smaller markets. Because the services component of CRM far exceeds the software license sales⁸, some of the integrated resellers, such as Cap Gemini, IBM Global Services and Accenture, are very powerful and have long-standing relationships with large customers. Consequently, CRM vendors tend to develop distribution agreements with these resellers even in the vendor's home territory in order to gain access to the marketing referrals and extend their sphere of influence.

CRMSCo, in the last four years, has preferred to go direct rather than through partners whenever possible. North America, for instance, is almost exclusively direct, while Europe and Asia are a hybrid. In Latin America and parts of Africa, CRMSCo relies exclusively on partners and loose marketing alliances to reach potential prospects and get sales leads.

2.3.4 Consulting and Selling

Once leads are identified, the process of selling starts. While some customers buy lower-end CRM software as a commodity, most large and mid-market prospects view CRM as a strategic, complex buy that demands a consultative selling process. In this set of activities, the customer's needs are analyzed – and sometimes influenced – to identify the best possible match with the right CRM products. The process of analyzing requirements culminates in a request for proposal (RFP) where the customer, either acting alone or more often with the help of a consultant, outlines requirements and then invites CRM vendors to respond. Typically, two to

⁸ Usually by a ratio of three to one.

three vendors are short listed for an in-depth evaluation and further consultation with the customer. Primarily, the technical capabilities are evaluated alongside the vendor's ability to deliver, but other considerations such as the vendor's financial viability may also apply. In the end, the best vendors are also compared, based on their quotes, and a final deal is then negotiated with the winner.

This consulting and selling process is performed by partners if they own the territory, and by CRMCo in most places where it has a direct presence. Accomplished sales people, sales engineers and a team of internal CRM consultants combine to provide the customer with guidance on their CRM strategy and try to position CRMCo as a trusted advisor in addition to a technology vendor. CRMCo consulting has become an integrated part of the selling process and is increasingly performed by account executives alongside contract negotiation and technical evaluation.

2.3.5 Implementation and Customization

This is the set of activities that generates the most amount of revenue in the CRM value chain. In fact, implementation and customization services vary from one to six times license costs in certain cases. CRM vendors have invested heavily in adding features and functionality to their products over the years. In addition, most vendors have adopted a vertical strategy where they focus their development on certain industry clusters in order to meet the nuances and depth of requirements in those industries⁹. Others invest heavily in flexible CRM platforms that are adaptable to a variety of needs. Yet, despite all these investments that are designed to "simplify" the implementation, CRM projects have grown more complex and expensive to implement. Ironically, a great deal of complexity and cost stems from these very features that vendors add with each release.

⁹ Siebel, for example, has 22 industry solutions (Siebel.com, 2006)

In a typical implementation project, a team of developers, a business analyst and a project manager, either on-site or remotely, work closely with the customer to install, customize and integrate the CRM software with other systems. For a phase one implementation, this process can take typically anywhere from three months to a year. Generally, the more complex the customer's product mix is, the more customizable its processes are, the longer and more expensive the CRM project is going to be.

In the CRM industry, as in other types of enterprise application software such as ERP and SCM¹⁰, professional services have traditionally been the domain of systems integrators. Here again however, CRMCo has tried to develop its professional services capabilities to the extent where it can be self-sufficient in North America¹¹. It has a hybrid model in Europe and Asia while its partners in Latin America, Africa and the Middle East perform all the required professional services with occasional support and training from CRMCo.

2.3.6 Support and Maintenance

At this stage of the value chain, the customer has a functioning system and expects the vendor and sometimes the systems integrator – if there was one – to support the software. This support, for which the customer pays a yearly fee of 15-24 percent of the original license value, includes two main components. First, the customer is entitled to technical support following the established service-level agreements (SLAs) which were negotiated during the selling phase. Technical support is used to report bugs in the software and provide fixes and workarounds, locate answers to technical questions and as a general first point of contact.

The second component that customers are entitled to, as long as they are up to date on their support and maintenance agreements, is maintenance. The definition of maintenance varies

¹⁰ Supply Chain Management, please see Glossary.

¹¹ Approximately 50 percent of CRMCo's business is conducted in North America.

from vendor to vendor, but the accepted standard is to provide free access to software updates and patches for the products that the customer owns.

CRMCo is ultimately responsible for providing support and maintenance to all its customers whether they bought and implemented directly, or through a partner. While some partners may – and are in fact encouraged to – provide first-level support internationally, all North American and second-level support worldwide is provided by CRMCo technical support centres in Vancouver, London (UK) and Bangalore, India. CRMCo is also responsible for providing software upgrades as they become available, although it is not legally obligated to produce any. For the portions of development that CRMCo either outsources or OEMs from other parties, software maintenance and upgrades usually also follow suit.

2.4 CRM Industry Five-factor Analysis

The following diagram provides a summary view of the five factors and the pertinent variables within each factor. The direction of impact of each variable is denoted by the (+) or (-) sign.

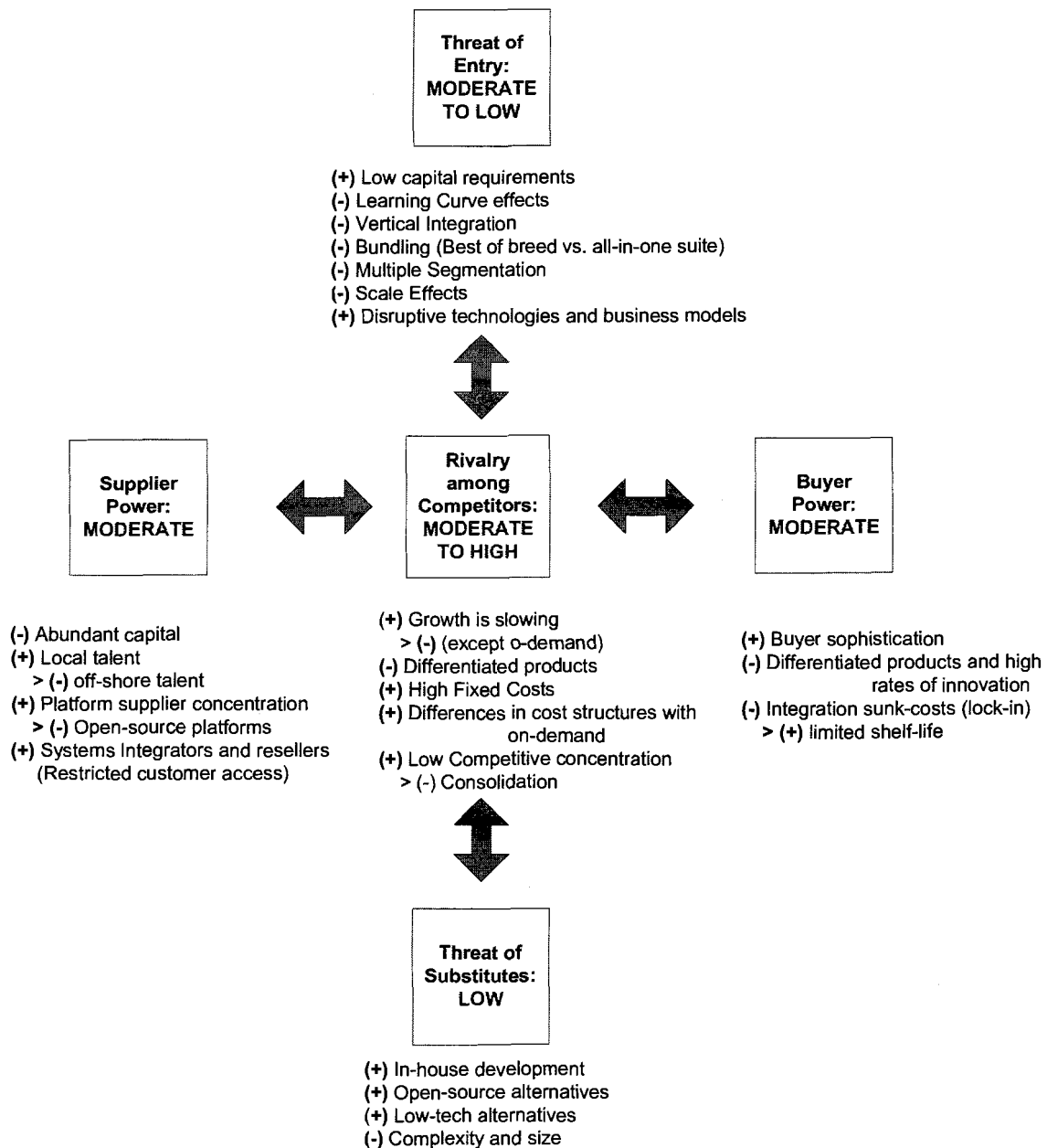
2.4.1 Rivalry among Competitors

Overall, rivalry in the industry is currently high, but growing less intense in the future. The factors affecting rivalry are discussed below.

2.4.1.1 Growth is Slowing

The 7 percent compound annual growth rate (CAGR) forecast by Gartner for CRM sales through 2008, hardly qualifies as slow growth. However the CAGR fails to reveal two important aspects of this aggregate growth. First, the industry actually experienced negative growth in 2002 and again in 2003, to barely recover in 2004 with 3.5 percent.

Figure 2-3 Five-factor analysis summary diagram



Adapted from Ed Bukszar, (2006). BUS607: Business Strategy class notes.

This is a far cry from the double-digit growth the industry became accustomed to, prior to the dot com bust. Second, most if not all the growth, according to most analysts, can be attributed to the phenomenal growth in on-demand CRM which has averaged close to 90 percent in the last few years (Topolinski, 2004), while traditional perpetual license revenue has virtually stagnated.

Since on-demand CRM represents only 10 percent of the overall market (Topolinski, 2004), 90 percent of the industry is competing for market share which intensifies rivalry.

The slow growth in the incumbent perpetual license model has greatly intensified rivalry and has led to a wave of consolidations in 2005 that continues unabated. (See Appendix 6.1.1, Highlights of CRM Vendor Consolidation Since 2004).

2.4.1.2 Differentiated Products and High Switching Costs

Although CRM is maturing in terms of its enabling technologies, it is still somewhat immature in terms of its real-world business applications. For the buying organization, CRM is still first and foremost a customer-centric business strategy that requires a great deal of organizational and business process alignment. Unlike accounting for example, where rules, regulations and codified best practices abound; how to manage one's customers is still a somewhat subjective aspect of running a business. As a result, CRM vendors have managed to keep a moderate degree of differentiation in their approach to delivering CRM solutions.

On the one hand, some companies lead with a brand of CRM that is focused on automating "operational CRM" activities such as those in a call centre, and thus on creating efficiency gains. Others, on the other hand, focus on effectiveness gains by enabling a frictionless interaction platform for "collaborative CRM" that enables disjointed departments to manage the 360-degree customer experience. Others still, choose to emphasize metrics and performance measurement for what is called "analytical CRM".

Finally, not only are the value propositions and corresponding product feature sets different, but so are the underlying technology layers that make up the solution. Data models, programming languages, integration interfaces and overall system architectures also vary from one vendor to another, which makes portability from one vendor to another an expensive

proposition for the customer. Though this is one of the problems SOA aims to solve, it will be a few years before development cycles in most companies catch up with SOA principles.

The differentiated CRM solutions and the resulting high switching costs temper the degree of rivalry in the industry, but only to a certain extent. The reason for this has to do with technology cycles and the presence of on-demand vendors. Because the technology cycle changes significantly every five to seven years, vendors have to upgrade their technology platform within that cycle, or risk obsolescence. Therefore, at the end of that cycle, the cost difference for the customer between upgrading the technology platform of the incumbent vendor and switching to another vendor platform can sometimes be negligible enough to eliminate the lock-in effect. Switching costs are further reduced when the alternative to the on-premise incumbent is an on-demand vendor. Because everything is hosted at the vendor and sold as a subscription, the switch involves no significant capital outlay and may actually reduce operational expenses because less IT infrastructure is required.

In the final analysis, CRM solutions are still differentiated enough to create high switching costs, but the effect on reducing rivalry is tempered by the five-to-seven-year technology innovation cycles, the presence of lower-cost on-demand vendors and the emergence of interoperable architectures.

2.4.1.3 High Fixed Costs

Because CRM products are software products, the variable cost of one additional license or subscription is virtually zero. The fixed costs of developing the software, on the other hand, are extremely high and can run in the tens of million of dollars for each new product, and sometimes for each new version of a product, due to complexity. As a result, the degree of rivalry intensifies. Rivalry is all the more intense because of the recurring maintenance revenue stream that each vendor expects from a new customer acquisition for the subsequent three to five years.

The largest expense in the enterprise software industry is actually incurred in sales and marketing in pursuit of customer acquisition. These typically account for 60 to 70 percent of expenses versus 8 to 12 percent for R&D. For all intents and purposes, these costs are also fixed in the short term. Marketing and selling in this space is a core competence of all the successful rivals, without which the vendor would not survive. Therefore, even in a downturn, reducing go-to-market capabilities and sales coverage is seldom the right thing to do. High fixed costs, therefore, contribute to increasing rivalry among competitors.

2.4.1.4 Differences in Cost Structure and Business Models

On-demand vendors such as Salesforce.com and RightNow have a different business model and have aligned their activities and cost structure to fit their recurring revenue model. On-demand vendors have lower support costs than the incumbents, because at any given time, they only support one version (code set) of the product, whereas traditional vendors have to manage several versions in their install base footprint. In addition, the on-demand model takes advantage of economies of scale in hosting and operations, as costs are shared among the entire customer base. Every new customer contributes to lowering the average costs for supporting all customers.

Moreover, innovation diffusion in on-demand models creates another cost advantage over the incumbent on-premise license model. Every new innovation is “instantly” introduced to all customers at the same time, by performing one system upgrade. This allows the on-demand vendor to amortize the cost over the entire customer base. In contrast, the incumbents take years to upgrade their customer base because they have to perform the upgrade one by one. As a consequence of the difference in cost structure, the on-demand rivals have lower fixed cost and an even lower variable cost than the incumbents, which creates price pressures and intensifies rivalry.

2.4.1.5 Increasing Competitive Concentration

There are at least 300 CRM vendors that are tracked by Gartner and many more that are not. Many analysts and industry experts like to point to this as a sign of just how dynamic the CRM industry is. Certainly, the sheer number of vendors and products on the market and the distribution of licences, as measured by number, seem to support the argument that CRM is indeed a fragmented industry. In reality however, the top four CRM vendors have just over 54 percent market share when measured in terms of dollar value. This view offers a very different perspective on this market and seems to support the counter-argument – some would say the harsh reality – that competitive concentration is indeed increasing.

This is even more apparent in the enterprise Global 2000 market, where the large vendors such as SAP, Siebel and Oracle dominate not only because of their ability to offer more complete, integrated scalable solutions, but also because of their ability to reach and support global customers. Spending in the enterprise segment represents such a large portion of overall CRM spending (See Appendix 6.1.4, CRM Software Applications Spending by Company Size, 2002) that the few large vendors can capture a disproportionately large pool of revenue. Moreover, these same vendors, after years of trial and error, have developed mid-market editions and on-demand versions of their software that are positioning them to extend their dominance to the mid-market.

Traditionally, the mid-market has been the most fragmented and fiercely competitive space in CRM and one where the likes of CRMCo, Onyx and Epiphany have thrived. However, even this segment is now exhibiting more competitive concentration due to three major factors. First, market consolidation as evidenced by the acquisition of the three above-mentioned companies, either by larger rivals or increasingly by private equity investors, has eliminated a great number of weaker competitors. Second, the growing appeal of pure-on-demand vendors and the price pressure they create is forcing even more vendors to retrench into smaller niches, sell out, or go out of business. Finally, the entry of Microsoft in the CRM market a few years ago and

their relentless investment in penetrating the small and mid-market segment by bundling CRM and leveraging their extensive install base is already leading to more commoditization of the space. Microsoft is such a formidable opponent that some vendors, eager to get out of the way, are in fact re-considering their strategies and evaluating whether they should instead partner with Microsoft and rebuild their applications on top of the Microsoft CRM platform.

While strategically the CRM market is headed towards more competitive concentration, service-oriented architecture (SOA) has given the strongest best-of-breed vendors a new lease on life. Indeed SOA makes the choice between best-of-breed and enterprise suites a little more difficult, as the gain from the pre-integrated enterprise suite is somewhat offset by the new interoperable, open architecture. This gives customers, even large ones, the choice to implement CRM at a division, business unit or even department level in order to promote autonomy and achieve results more quickly. In those cases, customers may shy away from an all-encompassing monolithic application due to complexity and costs, and favour instead best-of-breed vendors.

In the end, the industry overall is on a consolidation trajectory. Oddly enough, this is increasing rivalry in the short term as stronger rivals try to squeeze out weaker ones, but in the long run the higher competitive concentration will temper rivalry, especially in the Global 2000 market.

2.4.2 Threat of Entry

Overall, threat of entry is moderate to low in the near term. At the high end of the market (Global 2000) the threat of entry is low, whereas in lower market segments, disruptive technology and business model innovations foster a slightly higher threat of entry. The factors affecting entry are discussed next.

2.4.2.1 Low Capital Requirements

Well known software companies, such as Microsoft and many others, have been started by “two guys in a garage.” This is primarily the result of low capital requirements needed to develop a version 1 software product. The factors of production are all encapsulated in the intellectual property which only requires skilled and creative people. This is even truer today than it was 10 years ago.

The Internet has also made knowledge sharing and collaboration that much easier. The open source community is a great example of the new model where skilled developers, in their spare time, are creating software products that rival in some instances those made by the industry heavyweights. Examples such as the operating system Linux, the Firefox Web browser, the Apache Web server and SugarCRM illustrate how effective this collaborative, peer-driven co-development model has become. The absence of capital requirements therefore, removes an otherwise significant barrier to entry.

2.4.2.2 Learning Curves

Learning curves in software development can be a significant competitive advantage, and thus act as an entry barrier. The learning effects manifest themselves in the vendor’s ability to refine the development process, and create methodologies and best practices that are hard to replicate. This constant refinement of complex, highly-collaborative and increasingly distributed development projects leads to a cost advantage in bringing new products to market. Ironically, the large ERP vendors such as Oracle and SAP used the learning curve advantage (in addition to acquisitions) to actually enter the CRM market in the first place. However, now that they have entered, the same advantage now acts as an entry barrier.

To the extent that development methodologies are established and do not undergo a disruptive change, the larger competitors who have invested in harnessing the learning curve

effects can block entry to new entrants who want to compete in their turf. However, methodologies and technologies do change, as was proven by the open source community, and therefore they can disrupt the learning curve advantage. Overall however, learning curves do inhibit entry in certain high-end segments of the market.

2.4.2.3 Vertical Integration

Some companies in the CRM space are vertically integrated. Oracle for example, not only provides the underlying database and application server on which to run the CRM application, but also has a direct sales and delivery capability across the world. This can represent a considerable advantage, because some customers prefer to deal with one vendor instead of several. However, even Oracle relies on systems integrators and resellers across the world in order to scale.

Most new entrants struggle with delivery capabilities and have to rely on partnering with system integrators to deliver value to their customers. Building delivery capabilities themselves when they are strapped for cash is sometimes not an option. This leaves them vulnerable to channel pressures from their partners, decreasing margins and execution risk. Several new entrants do not survive long because they cannot manage the professional services delivery effectively. Consequently, a tapered vertical integration strategy is followed by most incumbents to varying degrees, and creates entry barriers for new companies.

2.4.2.4 Bundling (Best of Breed vs. All in One)

This is another advantage that larger vendors use, in conjunction with learning curves, to raise the entry barrier. Here again, ERP vendors have used bundling to enter the CRM market – by practically throwing in CRM free if the customer bought their ERP solution – only to use it as barrier once they established a foothold in the market. Since integrating CRM with ERP was

always seen as a necessary but expensive implementation phase, a pre-integrated solution from the likes of Oracle or SAP removed that concern in the selling cycle.

Until service-oriented architecture came along, buying an all-in-one suite made sense from an integration perspective. However, with new interoperable SOA-based architectures on their way from best-of-breed vendors, this type of bundling will lose some of its value and help lower the entry barrier. At the present time, however, it is still a meaningful barrier to entry.

2.4.2.5 Multiple Segmentation

Several competitors in CRM use multiple segmentation strategies to create market segments that are harder to penetrate simultaneously with one product by a new entrant. For example, Oracle has CRM products for the enterprise market, the mid market and for small business. Microsoft follows the same strategy, although their track record in the enterprise is unproven. In addition to segments based on customer size, in the last three to four years, CRM vendors have developed and marketed CRM products tailored to the needs of each industry. Siebel for instance, which is now part of Oracle, has 22 vertical solutions (Siebel Systems Inc., 2006) for each major industry.

A new entrant, as a result, has two entry choices: either develop a horizontal solution with no particular industry focus, or choose an industry to develop a niche product for. In either case, it becomes increasingly difficult to displace an incumbent whose footprint is in multiple segments, assuming that this multiple-segmentation strategy is well managed and does not spread the incumbent too thin. CRMCo, for example, despite having a highly-flexible CRM platform that can adapt to almost any industry, has chosen to develop industry-specific solutions to compete effectively in those industries. Overall, a multi-segmentation strategy, especially when combined with the scale to be able to achieve it, is an effective strategy to reduce the threat of entry.

2.4.2.6 Scale

Scale in CRM is not related to production in the traditional sense, since making more copies of software has near-zero marginal cost at any scale. Scale in the broader sense, relates to the R&D, marketing, sales, and service capabilities of the vendor. The reason has to do with customer acquisition and product development costs. A large CRM vendor would have extensive sales and marketing channels, both online and offline; a recognized brand; and automated operational capabilities such as call centres, so that in the end the marginal cost of a new customer acquisition is lower than it would be for a smaller vendor without these capabilities. Similarly, a large CRM vendor would have development capacity to support new product development initiatives, especially activities such as documentation and quality assurance, which tend to be more factory-like.

In addition, scale positively correlates with high market share. This, in turn, means that the vendor has a healthy recurring support and maintenance revenue stream that can help sustain the company through downturns, not to mention help fund ongoing new product development. This helps in part to explain why several consolidations have taken place in the industry. From a financial perspective, the maintenance revenue stream is often the attractive acquisition asset.

To the extent that scale is applicable in this industry, I believe that it presents a considerable entry barrier, in a zero-sum market such as the enterprise CRM market.

2.4.2.7 Disruptive Technologies and Business Models

CRM is a maturing industry, but it is still built on technology foundations that change every few years, or risk obsolescence. As a result, technology innovations spawn new business models that, when combined effectively, can create a disruptive force large enough to open up significant market opportunities for new entrants. Several examples exist to illustrate this phenomenon.

First, a few years ago, the technology for hosting application software in remote data centres finally matured thanks to improving network connectivity and declining costs, as well as improvements in software architecture with the introduction of multi-tenant architectures and Web services. This created an opening for new entrants such as Salesforce.com to go to market with an entirely new proposition: “No Software!” This was a novel concept because it advocated that CRM solutions are business services that are meant to be consumed and subscribed to, rather than owned, installed, and maintained in-house by expensive IT staff. Entry for on-demand was extremely successful, to the point where they now lead the market in growth.

Second, open source CRM is another example of a disruptive business model that is facilitating entry. Peer-based development and the culture of participation in and co-ownership of the intellectual property is a very novel concept in enterprise software. Yet, it has been successful to some extent and is expected to grow threefold according to Gartner (Thompson et al., 2005), albeit for a combined market share of 0.5 percent in 2006.

Changes in the technology cycles create vulnerabilities in the incumbent pool of rivals. Consequently, new entrants, who are able to develop business models to take advantage of the technology inflection points, can wedge their way into the market more easily. If this paper were written just two years ago, I would have classified on-demand vendors as substitutes not rivals. However, they managed to not only enter the market, but also force the incumbents Oracle, Siebel, Microsoft and lately SAP (Kawamoto, 2006) to adopt hybrid on-demand/on-premise strategies.

2.4.3 Threat of Substitutes

The threat of substitutes is low overall. The larger the customer, the less attractive the substitutes are. Factors affecting the threat of substitutes are discussed next.

2.4.3.1 In-house Development

Every business considering CRM also has to consider the build-versus-buy decision. However sophisticated CRM applications have become, some potential customers still feel that their business needs are so unique that no packaged application can meet them. The IT culture in the customer company also plays a major role in making the build-it-yourself option a viable substitute. In fact, some companies have such an entrenched culture of “if-it’s-not-built-here-it’s-no-good” that business decisions are seldom made based on objective criteria.

However, the increasing sophistication of packaged CRM applications and the frustration with IT bottlenecks in corporations around the world, contribute to reducing the threat of in-house development as a substitute. From a strategic standpoint, it is easy to see why CRM software development is not a core competence for customers and therefore should not be attempted. In the end, it is still a meaningful substitute, but one that appears to be in decline.

2.4.3.2 Open Source

Open source CRM is another substitute to packaged CRM applications. Although it is not considered a serious alternative yet, due to a lack of sophisticated features, it has grown threefold in 2006, according to Gartner (Thompson et al., 2005). Interestingly, open source CRM applications enjoy a great deal of appeal in the custom-development crowd and may actually be a more serious substitute to in-house development than to packaged CRM.

Open source is almost the reverse of in-house development. At 0.5 percent of spending compared to packaged CRM (Thompson et al., 2005), it is still a negligible threat as a serious substitute. However, if other markets are anything to judge by, innovation in open source CRM and its market acceptance will accelerate, as the customer and developer community grows. The threat from Open source as a substitute is small but growing.

2.4.3.3 Low-tech Manual Processes

As a substitute to implementing any CRM technology whatsoever, small businesses will always consider a “manual” process for tracking customers. This can be anything from a paper-based process to spreadsheets or simple contact management in Microsoft Outlook. For each business, its technology adoption profile as well as the frequency and complexity of its customer processes will dictate whether CRM software is the right choice. On the whole, the low-tech option will always be a meaningful substitution threat, but only in the lower segment of the market.

2.4.4 Supplier Power

Supplier power in the CRM industry is moderate. Four major factors affecting supplier power are discussed next.

2.4.4.1 Abundant Capital

Equity markets provide plenty of capital for CRM companies with which to fund their growth. From first-time financing by venture capital, to the IPO and M&A markets there is no shortage of capital. In 2004, for example, Salesforce.com and RightNow technologies successfully went public, despite a lacklustre IPO market. On the venture side, it is difficult to get data on CRM alone, but the larger software category continues to attract a great deal of venture capital. In 2005, according to a report published by PriceWaterhouseCoopers (2006), “the Software industry attracted the most first-time activity (first-time financing) of any industry with \$1.2 billion going to 238 companies. In total, all stages combined, software investments slipped 10 percent in 2005 to \$4.7 billion in 840 deals. However, software easily held its position as the largest single industry category with 22 percent of total dollars and 29 percent of all deals.” Venture capital and private equity funding for software and software-related companies have grown by over 32 percent annually since 2002 (Berryman et al., 2006).

Overall, the power of capital suppliers is probably moderate to weak, given the abundant supply of capital and the history of high returns by the software industry.

2.4.4.2 Local and Offshore Talent

CRM software companies face the same labour pressures as other software companies. Despite a recession of sorts in 2002-2003, the industry, which is mostly US-based, still faces skilled labour shortages in local software engineering talent. The offshore supply of qualified IT developers, particularly from India, has certainly had deflationary effects on wages in the US, but globally, shortages continue.

A 2004 survey of outsourcing by The Economist (2004) states that “wage inflation at Wipro and Infosys, two leading Indian IT services firms, is running at 15-17 percent a year, and is likely to worsen.” According to the same article, “India produces about 300,000 IT engineering graduates every year, against America's 50,000. But the quality is mixed. Assuming a supply of 40,000 decent Indian IT engineers a year, McKinsey's Diana Farrell thinks that India will not even come close to meeting the demand for one million offshore IT and software workers her company forecasts for 2008” (The Economist, 2004).

Overall, the supply of skilled labour to the software industry, and by extension the CRM industry, will continue to be tight, as the forecasted demographic gaps due to aging populations exacerbate the shortages. The power of labour suppliers, especially skilled technical resources, will continue to be considerable for the foreseeable future.

2.4.4.3 Open Source and Traditional Platform Suppliers

Every CRM vendor, with the exception of Microsoft, and to some extent Oracle, has to rely on platform products and software development tools from third-party suppliers. To simplify the analysis here, I will focus on database management tools as a proxy for other platform

products such as Web servers, application servers, and software development tools. According to a 2003 Gartner study, the leading relational database management systems (RDBMS) used in business are Oracle, IBM's DB2, and Microsoft's SQL Server, with a 43 percent, 24 percent, and 23 percent market share respectively (Graham & Strange, 2003). This highly concentrated supply leaves the CRM vendors facing moderate to high supplier power. However, not unlike other areas of the enterprise software stack, there is an open-source alternative, MySQL, that has been gaining popularity in the last few years and recently reached the 8-million-installation milestone (MySQL AB).

MySQL is a key part of LAMP (Linux, Apache, MySQL, PHP / Perl / Python), a fast growing open source enterprise software stack. More and more companies are using LAMP as an alternative to expensive proprietary software stacks because of its lower cost and freedom from lock-in. As adoption of these open source alternatives is expected to grow, I believe the power that platform suppliers wield today, will decline over time.

2.4.4.4 Systems Integrators and Resellers

Analyst group Forrester Research estimates that total worldwide spending on CRM services will have hit \$13 billion in 2005, over three times the market for the software itself. The services supplier landscape includes global service giants such as market-leading Accenture, with its multi-billion-dollar CRM practice (Wachter, 2006).

Services suppliers, be they systems integrators or resellers, are typically the gatekeepers to the customer through trusted personal relationships and geographic proximity. This customer access and coveted advisor role are then leveraged to gain a high-enough degree of power over the software providers.

2.4.5 Buyer Power

Traditionally, buyers have not had a great deal of power in CRM due to information asymmetry. Now that information is more readily available, buyer power can be characterized as moderate. Factors that affect buyer power are discussed next.

2.4.5.1 Buyer Sophistication

The CRM industry has matured considerably since the pioneering days of the early nineties. In the decade since the early adopters, there has been a great deal of press coverage and there have been analyst reports on all aspects of CRM. Indeed, all the major analyst firms such as Gartner, Forrester and IDC cover CRM from a vendor as well as a buyer perspective. The analysts offer a plethora of educational resources covering vendor ratings, technology hype cycles, best practices, and CRM strategy thought leadership. Analysts also provide advisory services to the IT and business buyers of CRM. Media coverage is quite extensive and includes general business and high-tech media outlets such as CNET, BusinessWeek and CMP media. In addition, there are CRM-specific media such as CRM magazine, destinationCRM.com and CRMtoday.com.

The growing body of so-called expert knowledge about CRM combined with the sharing of real-world experiences within the IT and business communities have reduced information asymmetry and created a growing pool of sophisticated buyers and users of CRM. The end result has been a much better informed buyer, who is much less prone to accepting the promises of CRM vendors at face value. The balance of power, on information symmetry grounds, is finally shifting towards the buyer.

2.4.5.2 Differentiated Products and High Rates of Innovation

Informed though the buyer may be, CRM products are still differentiated enough to create some obfuscation, due to a dizzying array of choices that do not lend themselves to

straightforward comparisons. As covered in the sub-section, Differentiated Products and High Switching Costs, in the rivalry discussion, the heterogeneity of CRM products not only decreases rivalry, but also reduces buyer power. Buyers, in the process of considering answers to their requests for proposals (RFPs), often find themselves contemplating trade-offs that are hard to choose from. For example, an on-demand vendor may offer reduced functionality, but the upfront costs required will be limited. A more established license vendor will accommodate all the functional requirements, but at a price premium and considerable implementation risk.

Furthermore, every time a body of conventional wisdom emerges about a certain number of CRM choices, technology and business model innovation cycles change the paradigm enough to upset the status quo. Innovation-driven heterogeneity of CRM products, therefore, reduces the power of buyers enough to create a constant ebb and flow between information symmetry on one hand and obfuscation on the other. This is particularly true for the early adopters and innovators among buyers, whereas technology laggards tend to wait to learn from the experience of others.

2.4.5.3 Sunk Costs in Integrations Promote Lock-in

Two technical characteristics of CRM systems have a great deal of impact on buyer power. First, CRM systems, especially in large and mid-size companies, need to be integrated with other back-office systems in order to be effective. These integrations, as covered in earlier sections, are usually very complex and costly. This results in a powerful lock-in barrier that reduces buyer power after the initial purchase, which is all the more significant when dealing with an enterprise applications suite that is already pre-integrated.

The second important technical characteristic of a CRM system is its shelf-life, which typically spans three to seven years. At the end of the system's shelf-life, the buyer can find itself in a position of strength, if the vendor does not provide an easy migration path to its new platform, assuming there is one to begin with. If the migration path, due to technology changes, is

very cumbersome, the trade-off between upgrading the current system and switching to a new competitive offering may go either way. Additionally, the customer will have had the opportunity to study the return on investment from the CRM system and may decide that the current vendor has not lived up to its promises, further reducing the lock-in pressures.

Because CRM is not a one-time buy, the lock-in effects of sunk integration costs may prove insufficient to retain the customer and reduce buyer power. In fact, technology cycles and customer satisfaction greatly impact the decision to stay with the same vendor or switch to a competitor, which in turn helps restore some buyer power.

2.5 Industry Attractiveness

The preceding five-factor analysis paints a profile of an industry that is moderately attractive mainly because of moderate market growth, but one that is getting less attractive over time. Supplier and buyer powers are both moderate and the threat of entry remains low especially in the upper market segment where most of the spending is. The threat of substitutes is also currently low, even as open-source models are a growing threat. However, the current consolidation trends will continue unabated as the underlying drivers of commoditization, price-pressure and the importance of operational efficiencies and financial viability gain more importance. While rivalry will remain intense in the next few years as the market shakes out, the long term outlook will likely favour fewer dominant vendors that will co-exist with best-of-breed and innovative niche vendors.

When CRM was a high-growth industry, it was fuelled partly by hype and the false comfort that implementing CRM technology would somehow result in a competitive advantage. Some parallels with how the ERP market has evolved, are evident. Indeed, the growth of CRM is largely due to the fact that as the ERP market in the mid-nineties began to mature, customers and vendors went looking for the next big thing. Customers realized considerable productivity and

efficiency gains from automating their operational, financial and manufacturing processes with ERP. The associated knowledge eventually became codified and encapsulated in the software as out-of-the-box, standard best practices embedded in the application. Competitive convergence eventually set in and what used to be a differentiator became a baseline requirement to just be in the game. Hardly any company today thinks it can gain any advantage simply by implementing a standard ERP package, or innovating the way it handles accounts payable, for instance.

A similar maturity path is taking shape in CRM, although at a slower pace. Certainly, there are companies that draw their competitive advantage from the efficiency of their operations and the frictionless flow of inter-dependent inputs through their supply chain. In those cases, ERP systems are crucial to the organization's success. Still, it is how the technology is used and aligned with the business strategy that ultimately creates any value. The same argument can be said for CRM. The core software technology is indeed maturing. The capabilities that are provided in the three functional pillars of CRM, namely sales force automation, marketing automation, and customer service applications, are becoming more and more standardized. Additionally, the once-disparate technology platforms are also converging towards a common service-oriented architecture. A growing number of CRM-enabled business processes and related success metrics in a majority of industries are heading towards standardization as well.

Critics of the maturing CRM industry argument point to the phenomenal growth of on-demand vendors as proof that the industry is still in its early phases of development and far from a being mature one. The problem with this argument is that the very presence of on-demand vendors is a sure sign of commoditization of the space. The software-as-a-service proposition has standardization as one of its most fundamental premises, which is evidenced by the limitations of deep customization capabilities in on-demand offerings. Without a high degree of standardization, on-demand vendors cannot achieve economies of scale in their operations and hence gain a cost advantage over their traditional rivals.

All of these indicators lead to one conclusion: CRM technology is no longer a black box or a panacea for customers, but rather just another tool box for organizations to use in enabling, automating and supporting their business strategies. Furthermore, the indicators point to a maturing industry whose dynamics are exhibiting the same characteristics of previous technology waves that are now widely regarded as mature industries.

2.6 Key Success Factors

Key success factors, especially given the general trends towards a maturing industry, vary depending on the category of vendors. Four types of vendors will be examined: Large enterprise suite vendors, software-as-a-service vendors, best-of-breed vendors and finally mid-market CRM suite vendors such as CRMCo.

2.6.1 Levers for Large Enterprise Suite Vendors

The dynamics of a maturing industry undoubtedly favour larger vendors that have a meaningful share of the market and the scale necessary to serve that market profitably. SAP and the Oracle/PeopleSoft/Siebel combination account for just over half the total CRM software market. Their success will largely depend on three key factors. First, they *need to continuously improve their operational efficiency to reduce their own costs, while providing a high level of service to their global enterprise customers*. Their profitability depends on their ability to protect their maintenance and service revenue – their cash cow – in the top tier of the market. Scale efficiencies in their service operations are a key requirement to increasing their already high margins.

Second, as their customers become more sophisticated users of CRM, the enterprise vendors *need to provide domain expertise in terms of industry-specific best practices and business process support in their applications*. This is necessary in order to help their customers

wring value from their considerable investments in software and infrastructure and promote lock-in.

Last, but not least, they *need to develop competencies to sustain a steady stream of acquisitions and integrations of smaller companies* to either gain more market share or to fill their product development pipeline. For example, Oracle has its work cut out for the next few years trying to integrate the massive applications from PeopleSoft and Siebel with its own, and converge them to a common software platform. Even as it struggles with the largest such project in the history of enterprise software, it is still signalling its intent to acquire yet more companies, especially in the on-demand space.

2.6.2 Levers for Software-as-a-service Vendors

On-demand CRM is a very high-growth segment of the market so the key success factors for on-demand players such as Salesforce.com, RightNow Technologies and NetSuite are different. Delivering software built on a multi-tenant architecture as a service, in a hosted mode, through a pay-as-you-go subscription model has enjoyed a great deal of appeal in the marketplace. The key levers for companies in this space, in my view, are the following two.

First, extending the model beyond the original functional scope (sales, service or marketing), or even beyond CRM as a whole *is the first lever to generate more revenue and grow the subscriber base*. The three leading on-demand vendors are doing just that. Salesforce.com has initially focused on sales automation and then quickly expanded into service and support. It has now opened up its development platform to OEM partners to build any complementary application and extend the offering in a shared revenue model. RightNow, a customer service application recently acquired SalesNet, an SFA on-demand provider. NetSuite has grown out of ERP on-demand and is now a full enterprise suite offering CRM and other business capabilities.

The second lever is to relentlessly *drive down their operational costs*, to increase their gross margins. Unlike on-premise CRM, every time an on-demand user touches the software, it costs the vendor money. Creating scale efficiencies starting with multi-tenant architecture and developing world-class operational excellence in provisioning, maintenance, billing, and support are crucial to reduce their costs and improve margins. Further, on-demand vendors must carefully align their cost drivers with their pricing models so they can maintain profitability across different ranges of usage.

2.6.3 Levers for Best-of-breed Vendors

Best-of-breed vendors have chosen to focus on a particular functional domain of CRM, an industry niche, or a combination of both. Kana, for example, focuses on customer service and multi-channel customer interaction management. Unica, on the other hand, focuses on enterprise marketing automation. Amdocs is a leading CRM provider for the telecommunications industry. The success of these vendors quite simply depends on their ability to stay ahead of the curve in their chosen domains and offer a compelling reason for customers to choose them over broader, integrated solutions. The key levers for these companies to succeed should therefore be straightforward.

In my view, these companies first and foremost need to maintain a single-minded focus on *continuous product innovation*. Best-of-breed would simply be an untenable position with an inferior product set. It follows that these companies must invest in and maintain a strong R&D culture.

In addition, maintaining innovation does not always equate to delivering value, so the other competency that these companies must also possess is *access to the customer*, or what is known as *customer intimacy*. Without a deep knowledge of the problems their customers face and

the limitations of the current technology, these vendors cannot direct their product development efforts in the right direction.

Lastly, these companies must develop *products that are interoperable with others* in an enterprise IT environment. For those customers who see value in buying best-of-breed systems, the single biggest obstacle is the total cost of ownership due to integration complexity. Thanks to SOA, vendors in this category can eliminate or at least mitigate this as a sales objection from their customers.

2.6.4 Levers for CRM Mid-market Suite Vendors

Unlike their best-of-breed rivals, this class of vendors offer a full suite of products in the three typical CRM functional pillars of marketing, sales and service. With the acquisition of Siebel by Oracle, these vendors also share one other thing in common: They are all focused on the mid-market. CRMCo, Onyx, Sage and now Microsoft have been the most prominent vendors in this category. The mid-market for CRM, however, is in a state of flux. Even the very market definition of this segment is a subject of debate as the criteria for inclusion or exclusion are quite fuzzy. Most vendors use customer revenue ranges of anywhere between \$50 million and \$1 billion as the boundary for defining the mid-market with the assumption that there are enough commonalities between customers in that revenue range to constitute a well-defined market.

These issues will be examined more closely in chapters 3 and 4, but at this stage it is important to point out that there are no clear leaders in this space with the exception of an emerging Microsoft. It is no wonder that on-demand vendors have successfully penetrated this market, not to mention that a number of mid-market vendors such as CRMCo and Onyx have been acquired. It is much easier to articulate the challenges these vendors face than it is to articulate the key success factors. Nonetheless, the levers have to do with differentiation in some form or another, along several dimensions. They can be summarized as follows.

First, mid-market suite vendors need to intelligently *rationalize the broad and deep functionality offered by their enterprise rivals across a wide range of applications*. It is a fallacy that mid-market customers – as measured by their revenue – always have simpler product requirements, because experience has proven that they do not. Since the larger rivals have the resources to invest in their diversified product portfolios, the mid-market suite vendors somehow need to keep pace, while constrained by financial resources.

Second, these vendors need to also *differentiate against their on-demand rivals on the total cost of ownership (TCO) dimension of their value proposition*. Mid-market customers are notoriously demanding in terms of product depth and breadth but are also very cost-sensitive. Mid-market suite vendors used to compete against enterprise rivals, largely based on cost-of-ownership arguments. Now that on-demand models offer a compelling case for low TCO, differentiation is no longer straightforward.

Third, even though Microsoft is technically part of this group, it is unique because of its financial resources, its dominant position in the SMB market and its ability to cross-subsidize relentlessly until it drives competitors out of the market. Because it is so dominant, a key success factor for the other players in this category is *how to differentiate against Microsoft*.

2.6.5 Key Success Factors Conclusions

Key success factors among the four categories of rivals are different in some ways and similar in others. While some factors apply to all of them because of general industry dynamics, differences do arise as a result of the variation in their positioning.

Enterprise vendors for instance, are competing in the most mature segment of the market, where growth is slowest. As a result, their success factors relate to scale in one way or another. It is scale that allows these vendors to achieve efficiencies in their operations, which are required to

make their maintenance revenue streams even more profitable. It is also scale that allows enterprise vendors to pursue multiple-segmentation and bundling strategies in order to reach their “Fortune 1000” customers across the globe and across industry verticals. It is scale, finally, that enables these vendors to sustain an acquisition strategy to penetrate the lower tiers of the market and gain access to emerging product innovations.

Best-of-breed vendors on the other hand, because of their very positioning, must instead focus on product innovation in well defined markets, or product segments. Their strategy rests on their ability to take advantage of learning curves in their chosen areas of focus to stay ahead of their larger, presumably slower rivals. Unlike their enterprise rivals, revenue growth for best-of-breed vendors is more closely tied to license sales than maintenance revenue which makes product innovation – coupled with customer intimacy – the determining factor of their success.

Moreover, for on-demand vendors, the key success factors are actually quite similar to the previous two categories of rivals, albeit within a high-growth context. Operational efficiency, for example, applies to SaaS vendors because their profitability relies to a great degree on their ability to gain economies of scale in their technology operations such as hosting, provisioning and billing. In addition, innovation for SaaS vendors is not focused on the product dimension of value, but rather on the delivery dimension. While they pursue a rapid follower strategy for product features and functions, they put a great deal of emphasis on creative destruction in the consumption models for software. Their growth is therefore closely tied to growing their subscriber base in order to amortize their high fixed operational costs over a wider base, while extending their alternative consumption model to new areas of enterprise software.

Whereas the key success factors for enterprise, best-of-breed and SaaS vendors are relatively straightforward, those for mid-market suite vendors are much more ambiguous. Their success factors are actually combinations of those of their rivals across categories. In fact, the

basic dilemma mid-market vendors face stems from the uncertainty of the assumptions they have to make about their customers' needs. The first difficulty has to do with just how much functionality their customers require. If in fact, the business requirements of mid-market customers are neither as broad nor as deep as their enterprise counterparts, how does the vendor find the right mix of products to satisfy demand? The second challenge stems from the mid-market customers' limited ability to pay even for the right product mix. It follows that mid-market vendors have to somehow lower the total cost of ownership for their customers while providing them with the right product mix in terms of features and capabilities. The last key success factor for this category of vendors is a result of size and capacity limitations. Since mid-market vendors, with the exception of Microsoft, have limited resources, a key success factor becomes their ability to focus their resources on certain markets either by geography or industry segment in order to compete effectively. The presence of Microsoft, which does not suffer from such constraints, further complicates the issue.

3 INTERNAL ANALYSIS AND CAPABILITIES

Having analyzed the industry, how it has evolved and what the key success factors are for CRMCo and its rivals, I now shall focus on analyzing CRMCo's overall strategy, its internal capabilities, and how it goes about creating value in order to compete.

3.1 Strategic Fit Analysis

As expected, CRMCo's stated strategy in the CRM software market is differentiation. In reality, however, differentiation for CRMCo is an ambiguous and complex proposition that has evolved over the years. The value, real or perceived, that CRMCo wants to provide, encompasses three main thrusts. First, flexibility: The CRMCo solution needs to offer superior customization capabilities in order to adapt to the individual enterprise client needs and fit their unique business processes. Second, cost-effectiveness: Customization in the CRMCo environment needs to be low cost, contributing to a low total cost of ownership (TCO). Third, adequate functionality: The CRMCo CRM suite should provide enough depth and breadth of out-of-the-box functionality to meet the needs of the mid-market.

In the last few years, CRMCo has added another new element to its strategy. Like many of its rivals, CRMCo has adopted an industry-focused go-to-market strategy, supported by products that are tailored to those industries it targets.

In the following sections, I shall first analyze how CRMCo has sought to align the different variables, as outlined in the Bukszar framework (2006) to achieve strategic fit. I shall also analyze the quality of this fit as well as its stability. I shall place greater emphasis on those variables that are more pertinent to CRMCo's case. Finally, my approach is to show the evolution

of strategic fit that paralleled CRMCo's evolving differentiation strategy over the years. The following chart situates CRMCo along the dimensions of the strategic fit model (Bukszar, 2006) and provides a summary view of the analysis that follows.

Figure 3-1 Strategic fit chart

	Cost-Based	1	2	3	4	5	6	7	8	9	10	Differentiation
Product Strategy	Rapid Follower						**					Innovative
R&D Expense	Low R&D						**					High R&D
Structure	Centralized						**					Decentralized
Decision Making	Less Autonomy							**				Autonomy
Manufacturing	Economies of Scale									**		Economies of Scope/Flexibility
Labour	Mass Production								**			Highly Skilled /Flexibility
Marketing	Comparative /Push									**		High-Cost Pioneering / Pull
Risk Profile	Low Risk								**			High Risk
Capital Structure	Leveraged										**	Conservative

Adapted from Ed Bukszar, (2006). BUS607: Business Strategy class notes.

3.1.1 Product Strategy

CRMCo's original product strategy was to be an "innovator". Real innovation in the enterprise software space is surprisingly uncommon. A great deal of innovative thinking goes towards adding more functional features to already-complex products and managing the product lifecycle against an ever-expanding product footprint. CRMCo's traditional stake in innovation has been the product's flexibility and the low-cost framework to enable that flexibility. In other words, CRMCo's original focus, indeed its core competence, has traditionally been the extent to which customers can adapt its software to fit their business processes in a cost-effective way.

As a result, CRMCo has invested a great deal in developing simple but powerful visual tools (part of a customization toolkit) to enable high degrees of flexibility in a cost-effective framework for the customer. As a result of its early strategic focus, CRMCo has pioneered what came to be known as “metadata-driven architecture”. This was very innovative because it created a structured and systematic way to describe, track and manage complex customizations that otherwise would happen completely ad-hoc. It is important in this discussion to not confuse cost-effective flexibility as a value proposition to the customer, with a low-cost strategy on CRMCo’s part. To the contrary, CRMCo has invested a great deal of R&D resources in breaking the natural trade-off between flexibility and cost-effectiveness, by developing innovative technology.

However, a few years ago, CRMCo decided to expand its value proposition in order to compete with much-larger rivals like SAP, Siebel and Oracle; committing the company to two major strategic changes in the process. The first was to embark on a capability and feature race with these competitors. Since this was not CRMCo’s core competence, it became a follower rather than an innovator in this new dimension of the value proposition. The second implication of the decision was that CRMCo’s architecture, built to optimize customization flexibility at low cost, was no longer suited for feature-driven value. As a result, and again to pursue competitive parity, CRMCo switched to a new architecture that was more industry standard. In so doing, CRMCo managed to maintain the same level of flexibility, but lost the second component of its value proposition, cost-effectiveness.

This is the reason why CRMCo is at the 6-7 level on the innovation dimension continuum, with momentum headed towards a follower product strategy. CRMCo’s product strategy lost its single-minded focus on cost-effective flexibility.

3.1.2 R&D Expenses

CRMCo is a software company. Its entire business model rests on its ability to develop software and sell enough software licenses and professional services (implementation, customization, training, and technical support) to generate good returns. Up until 2004, CRMCo was spending just between 20-30 percent of revenue on R&D, or about \$16 million a year. In the last quarter before it was acquired by ParentCo, at the low of the financial downturn for CRMCo, R&D expenses were at \$2.8 a quarter, or a 30 percent decrease over the 2001-2003 average. The ParentCo average for 2004 (the only figure publicly available) is at about 7.5 percent of revenue. This is not high by software industry standards. For example, Siebel spends about 20 percent at the high end, whereas Oracle and SAP spend about 12-13 percent. Why does CRMCo/ParentCo spend so little and how does that affect strategic fit?

First, it is important to point out that the percentage by itself fails to capture the entire picture. CRMCo has been one of the first enterprise software companies to embrace the offshore development model. In fact, CRMCo has a significant development centre in India. The difference in salaries¹² as compared to local North American resources accounts for the lower spending percentage. Second, it is also worthwhile pointing out that on the whole, India-based resources are lower cost but not necessarily lower quality. For the most part, the same caliber of talent exists for most aspects of software development. Also, the true cost of sustaining the offshore model is hidden under G&A expenses. As a result, CRMCo may spend less than some of its competitors on R&D, but it may very well be getting more for its money.

The second point in the R&D expense analysis deals with the adequacy of the level of investment, even if the actual returns are higher than the numbers suggest. Indeed, an important question is whether CRMCo is spending enough to sustain its product development strategy in

¹² Estimates vary, but my own analysis of fully-burdened costs suggests a three to one cost advantage in favour of India-based resources. This advantage is increasingly under pressure from intense competition for qualified resources in India.

support of differentiation. R&D dollars are precious but a large portion of the spending is actually allocated to maintenance of existing products, and third-level customer support. This has been made necessary for a number of reasons. To begin with, product flexibility allows customers to be creative in how they leverage the CRMCo platform to customize the application, or even build new ones.

When CRMCo switched architectures to be more standard in response to competitive pressures, it lost the controlled framework for performing these customizations. As a result, each customer implementation takes the product in new directions, expanding the product footprint in the process. This creates a runaway footprint effect that complicates support and maintenance, as no two implementations look alike. So support, essentially, becomes a markets-of-one business. In addition, emphasis on achieving parity in features and functionality created complexity that only highly qualified R&D developers could support.

For the reasons mentioned above, CRMCo needed to spend a great deal more than it did on R&D in order to sustain support as well as new innovations. With constrained budgets, day-to-day support of “red” customer accounts took precedence over innovation. The ever-expanding product footprint also meant that rolling out innovations was extremely complex and expensive for customers. Therefore, adoption of new innovations slowed down, further constraining the sales funnel necessary to fund innovation. This spiral effect choked R&D budgets to a point where differentiation as CRMCo defines it became more difficult.

3.1.3 Structure

I ranked CRMCo as a 6 on the centralization-decentralization continuum, with movement towards more centralization, which may point to inconsistency with a differentiated strategy. Indeed, the basic problem that CRMCo faces in terms of structure is the fact that its customers are spread all over the world. Since they are for the most part high-touch customers, whose

relationships need involved management, CRMCo operations need to be geographically close to where they are.

CRMCo has constantly struggled to optimize its operations and manage its costs while maximizing its reach and proximity to customers. As a result, CRMCo maintains offices in key geographic regions around the world, and partners with systems integrators and value-added resellers to represent it in smaller markets where it cannot justify having a direct presence. For the most part, this has worked well. However, cost cutting has put pressure on CRMCo to centralize by closing satellite offices and offering remote service and support. The downside, in addition to lower service levels, is the negative impact on future sales in that region. This vicious circle exacerbates the need to cut costs even further by more centralization. The net effect is a fragile balance that strategically does not fully support fit.

3.1.4 Decision Making

I ranked CRMCo as a 5 on the autonomy scale with movement towards less autonomy. This is an aggregate score which also points to inconsistency with a differentiated strategy. However, not all areas of the business have the same level of autonomy.

The sales organization, for example, has a high level of autonomy. The quota-carrying direct sales reps as well as distribution channel resellers understandably behave very opportunistically and independently. Because the value proposition shifted from a flexibility focus towards a be-all-things-to-all-people proposition, there are now ambiguous evaluation criteria to qualify prospects in order to determine fit. This means that new customers are brought on board with highly-inflated expectations that CRMCo's product cannot always meet without a great deal of professional services, negotiation, and backtracking.

The problem arises because the delivery capabilities of the organization, such as operations, IT and professional services, which were managed centrally, do not have the same level of autonomy and are therefore less responsive to the client needs. This dichotomy sometimes results in difficult implementation projects and a disjointed customer experience.

Ultimately, this disconnect between high autonomy on the sales side, on the one hand, and process-driven low-autonomy delivery capabilities on the other hand, creates friction that impedes strategic fit.

3.1.5 Development and Production

Software development by its very nature is about economies of scope. Duplicating the same software has a marginal cost of zero, for all intents and purposes, at any scale. Economies of scope, however, are very real in the software industry. For many years, the industry – and CRMCo is no exception – has struggled with the concept of reuse. Essentially, a software developer such as CRMCo needs to leverage valuable insight and reuse existing code and domain knowledge to develop new applications without starting from scratch every time. CRMCo has done a reasonably good job of achieving economies of scope in its development by emphasizing both process and architecture.

The development teams follow collaborative processes throughout the lifecycle of the product, from requirements to design, to coding, and to quality assurance. This has allowed the different teams to work closely together and share their collective experiences and best practices. The code each team develops is managed and organized in such a way that other teams can gain easy access to it, and through common documentation standards, quickly identify what the code does and how it can be re-used. Furthermore, CRMCo is very disciplined and consistent in adhering to common architectural standards for development. CRMCo has standardized all

development on the Microsoft platform which allows the different software modules to be portable from one application to the next without the need to recode.

However, this consistency was somewhat upset with the introduction of new products through acquisitions in the last few years. Again, because these acquisitions were done opportunistically, some of the new products were built on different software architectures (Java) which hindered the potential for re-use in the long run. Even though these acquisitions reduced CRMCo's ability to maximize economies of scope to the fullest, this problem plagued all software companies in the industry. Still, CRMCo ranks high on this variable thanks to its disciplined collaborative process.

3.1.6 Labour

It is common knowledge at CRMCo that people are not only its greatest asset; they are its only asset. CRMCo's success depends on its people's ability to innovate and implement software solutions for complex problems. The shelf-life of any software asset is very short and its usefulness on its own is quite insignificant. All the value is in the skill of the people who make it, sell it, implement it and support it.

This was not lost on CRMCo. Consequently, CRMCo recruited only highly skilled individuals in all facets of its business. Indeed, not only were the local development resources of an exceptionally high caliber, but CRMCo actively recruited people from all over the world to fill demanding positions where skill and experience were scarce. This was often a very costly but necessary proposition.

Additionally, talent in other areas of the organization also needed to be of very high quality. The sales cycle is complex; customers are extremely demanding and competition is very fierce. Therefore, all the marketing, sales and service personnel also needed to be highly skilled,

highly motivated, creative, and collaborative. CRMCo understood that and managed the business accordingly for several years.

In the last few years, however, CRMCo started to be very cost-conscious, and began dabbling with migrating some business functions to lower-cost offshore resources. For the most part, these resources are also highly skilled in the hard skills category, but not so in the soft skills arena, at least by North American standards. In addition, the decreasing levels of autonomy, especially after the acquisition by ParentCo, created tension within the CRMCo talent pool. Creative, highly-skilled people need an environment where they are afforded a high degree of freedom, in order to feel valued and appreciated. This is the reason why I situated CRMCo as an 8 on the labour dimension and not a perfect 10.

3.1.7 Marketing

As previously mentioned, CRMCo's value proposition is complex. Prospective companies are not necessarily looking for CRM solutions and, even when they are, obfuscation is quite common, as competitors flood the market with jargon-laden marketing messages. The marketing at CRMCo faces several challenges. For example, how to identify those companies that would be a good fit for the products and services? How to translate the flexibility value proposition into a tangible benefit that customers can relate to? How to articulate the differences between CRMCo and competitors to distinguish its offerings when everybody more or less makes the same claims?

The task of marketing CRMCo CRM has always followed a high-cost, high-touch, pull strategy. Direct marketing is the preferred method. Email and direct mail marketing, trade-shows and targeted event sponsorships are the preferred vehicles. A great deal of effort and expense is devoted to database marketing where profile-driven, personalized, one-to-one communication is

sustained over long periods of time to generate demand. The goal is to market to enough prospects in order to deliver qualified leads to the sales force and fill the sales pipeline.

This is a very expensive and complex proposition. However, it is necessary in order to communicate the differentiated value effectively. Overall, marketing is aligned with the strategy but lacks some of the resources necessary to achieve coverage and sustain demand generation over the long haul.

3.1.8 Risk Profile

As CRM started to gain mainstream acceptance, the risk profile of the industry overall began to decrease. However, several high-profile CRM implementations failed spectacularly and received a great deal of negative press, tainting the entire industry in the process. The dot com bust contributed to buyer apprehension and spread skepticism about the claims made by industry.

CRMCo's original focus on flexibility as its key differentiator left it vulnerable to being cast as a development platform instead of an out-of-the-box business solution. CRMCo felt its positioning was high-risk and that the maturing sector was being increasingly commoditized. CRMCo, therefore, sought to reduce its risk profile by casting itself as a full-featured CRM suite of applications, much like its larger competitors, but at a lower cost. Flexibility was still important, but it ceased to become the focal point of value.

This lowered the risk profile somewhat, but ultimately pushed CRMCo more towards a stuck-in-the-middle strategy. In trying to minimize market and technology risk, the race was on to match features and capabilities, further eroding CRMCo's coveted positioning as the flexible CRM solution, and therefore increasing its strategic risk.

3.1.9 Capital Structure

CRMCo's capital structure has always been equity-based with no debt. When CRMCo was a private company, it was funded by venture capital in exchange for equity. Then, in August 1999, CRMCo announced the initial public offering of 3,500,000 common shares at a price of US \$12 per share, listed on the NADAQ stock exchange under the ticker symbol PVTL. Since its initial IPO, CRMCo's only other major source of external funding was an equity private placement of US \$55 million in 2000 (CRMCo, 2000). Since CRMCo is not a capital-intensive business, has somewhat unpredictable cash flows and a high risk-reward profile, equity is really the only source of capital available. Until private equity firms recently started financing M&A activity by leveraging the cash flows of established mature software companies, this used to be the norm in the industry. So in that respect, CRMCo is no exception. Of course, as time wore on, all sources of capital dried up as CRMCo continued to struggle with profitability and depleting cash reserves. Under ParentCo, CRMCo is now part of a larger, well-funded organization. It too has a conservative capital structure that is funded through equity markets.

3.1.10 Strategic Fit Analysis Conclusion

This analysis provides a mixed picture in terms of strategic fit at CRMCo between the early years and the last few years. The original focus on flexibility as the key value differentiator was a clear strategic choice that CRMCo aligned with very well in the early years. However, management gave in to short-term thinking, driven by the promise of high valuations during the dot com boom, and started to manage the business more opportunistically. This opportunism caused the company to reject the trade-offs of a disciplined differentiation strategy and instead pursue a desire – certainly not a strategy – to be all things to all people. The strategic confusion manifested itself in several ways that are all related to the inherent tension between a differentiation strategy and cost pressures.

First, CRMCo's choice of markets was not disciplined enough. There is natural desire by the company managers, perhaps driven by ego, perhaps driven by the demands of quarterly results, to go after the enterprise market. Certainly, large clients mean large deals and a great amount of PR value. However, large customers also demand a large support infrastructure, which CRMCo could ill-afford once the downturn took hold.

Second, CRMCo's choice of value – in terms of products and services – was also not disciplined enough. The initial positioning of a flexible CRM platform that is cost-effective to customize became muddled with the desire to offer a full-featured CRM suite. As the value chain analysis will show in greater detail, this expansion of value also stretched the organization to the point where it struggled to cope with a runaway product footprint.

A keen observer of the CRM market might argue that this analysis is not fair to CRMCo. After all, CRMCo was not alone in pursuing the path of becoming a CRM suite. So were Onyx, Epiphany, Sage and many others. However, that is precisely why differentiation is important; to distinguish the value for which CRMCo stood from that of its competitors in the eyes of the customer. By not focusing relentlessly on deepening the flexibility advantage and expanding in ways that were consistent with that advantage, CRMCo became an also-ran. Once again, cost pressures exposed the weaknesses of pursuing a fully-featured CRM suite strategy, because maintaining that course would also be an expensive proposition.

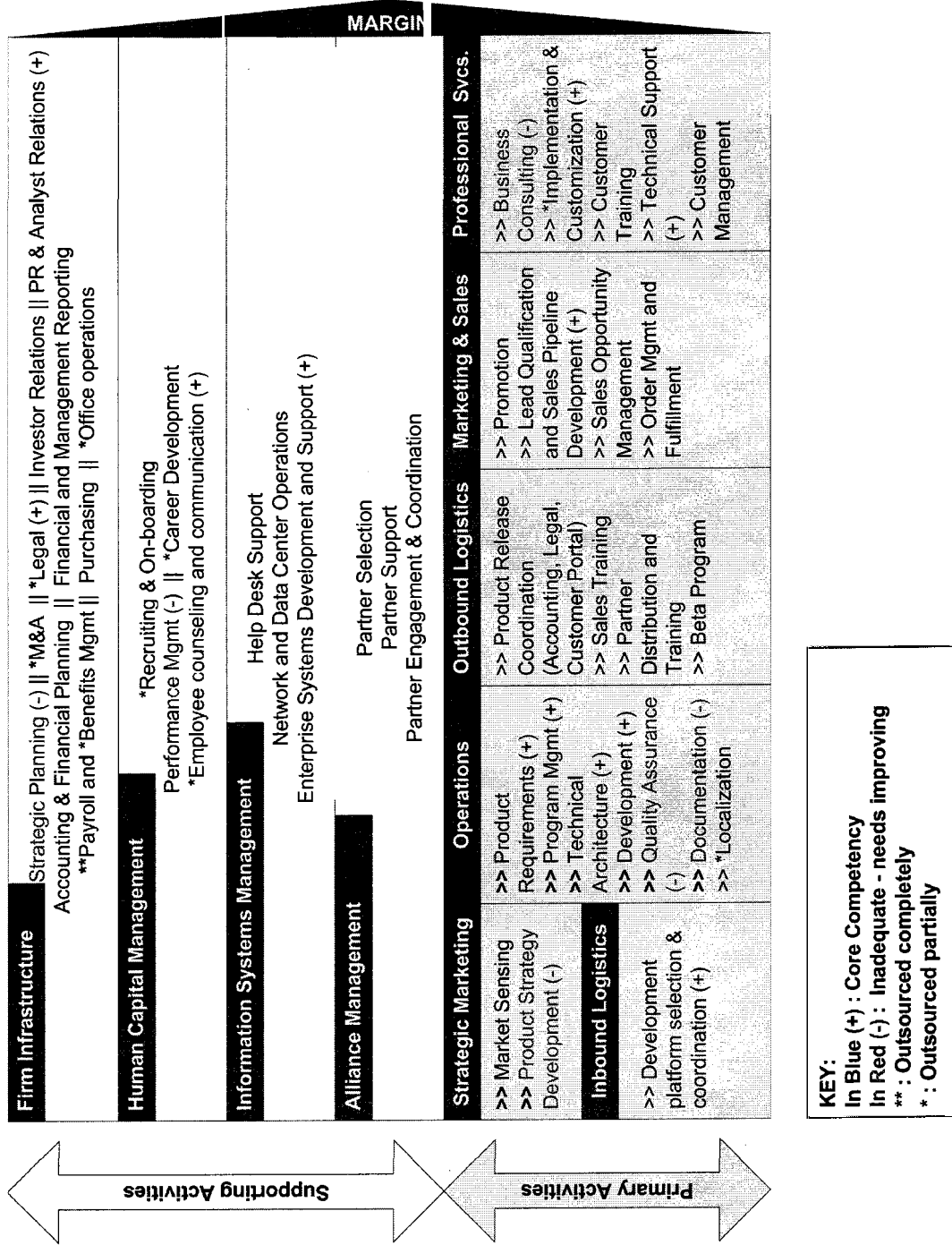
The increasing ambiguity of CRMCo's positioning has diluted its differentiation strategy. Ultimately, this strategic drift has resulted in decreasing levels of fit, to the point of vulnerability. This has been reflected in CRMCo's financial performance and led to its acquisition by ParentCo software. The strategic vulnerability is even more apparent in light of the key success factors discussion which identified finding the right product mix and lowering total cost of ownership as two determining aspects of a successful strategy for mid-market vendors such as CRMCo. In fact,

CRMCo's strategy, because of past opportunism and cost pressures, has not fully achieved either of these success factors and is particularly vulnerable on the total cost of ownership dimension. In recent years, however, the strategic drift has been rectified to some extent by an increasing focus on specific vertical markets. This has allowed CRMCo to better align its previous lead in flexibility, with the quest to build features and capabilities, by narrowing down the scope of those features in line with the limited resources of the company. In the process, CRMCo has begun to effectively address, market focus, the last key success factor identified in the previous discussion, and by extension the task of finding the right product mix. Still, differentiation is somewhat ambiguous and ill-supported by the firm's structure and approach to innovation, R&D spending, autonomy, and centralization.

3.2 Firm-level Value chain

The preceding strategic fit analysis provided one framework for assessing CRMCo's competitive differentiation strategy. The following value chain analysis should provide further insight into the implications of the strategic choices that CRMCo made on its ability to create value for its customers. The firm-level value chain for CRMCo, shown in Figure 3-2 Firm-level value chain for CRMCo, provides a summary view of the primary and supporting activities performed at CRMCo. A detailed description and analysis of each pertinent activity is provided next.

Figure 3-2 Firm-level value chain for CRMCo



Adapted from Ed Bukazar, (2006). BUS607: Business Strategy class notes.

3.2.1 Primary Activities

3.2.1.1 Strategic Marketing

This is the domain of product managers, senior managers in the R&D organization and the executive team. Strategic marketing consists of a set of activities whose ultimate purpose is to identify and assess market opportunities and choose the value proposition that CRMCo will ultimately build and market, in order to compete for those market opportunities effectively. Inherent in all these activities is the support and enhancement of CRMCo's differentiation strategy, as far as the products are concerned. Strategic marketing can be broken down into market sensing and product strategy.

The primary purpose of market sensing activities is to analyze different market inputs and identify market opportunities to be rationalized and assessed, using other inputs. The first and most important source of insight is the customer base. Product managers use different channels to gain customer insight, and what CRMCo calls "customer intimacy". CRMCo's own CRM system and the related analytical tools that help mine the customer data, provide a valuable source of information on sales history, satisfaction levels and customer interest, broken down by customer category, industry and product. The analytical business intelligence tools allow product managers to 'slice and dice' the data to answer key questions about actual customer behaviour. Using these tools, a product manager can identify, for instance, if certain products are creating real value for customers, or if instead, the support and maintenance strain they cause negates whatever perceived value they add. Similarly, data mining tools and techniques also allow CRMCo to identify and even predict trends. For example, the data can reveal up-selling and cross-selling opportunities by observing the buying behaviour of early adopters in a technology-savvy industry such as financial services.

Another equally important source of customer intimacy is direct dialogue with customers either in a one-on-one setting or in the context of user groups and customer seminars. Whereas the previous source of data was largely quantitative, this type of insight is rather qualitative. Conversations with customers allow CRMCo product managers to gain a level of insight not easily captured in structured data formats and “get in the head of the customer” to understand not only how they feel about the current products and services, but what problems they wish CRMCo could help them solve. Of course, institutionalizing these practices and the resulting knowledge demands a level of discipline across the entire organization that is not easily sustainable when resources are stretched due to cost-cutting and increasing day-to-day operational constraints. Indeed, several opportunities to practice what CRMCo preaches as a CRM company are missed for lack of resources.

The second source of market-sensing intelligence is the secondary research that is provided primarily by industry analysts and the media. CRMCo subscribes to several analyst programs – most notably Gartner Dataquest, the foremost analyst firm in CRM – to get additional qualitative and quantitative information on market trends and business drivers in the market that CRMCo serves. Analyst reports for example, include competitive data, market size and growth projections, hype and adoption cycles of new technologies, as well as aggregate customer surveys, to identify the changing buyer behaviour and underlying business drivers.

Finally, by analyzing the external data from customers, analysts and the media, product managers can identify and quantify market opportunities that may be available to CRMCo. In consultations with other stakeholders, they then analyze whether CRMCo can develop the value needed to pursue those opportunities using its current assets and core competencies, or if it is worthwhile to invest additional resources in acquiring those competencies. Often, financial models are developed to help rationalize these market opportunities using return-on-investment (ROI), or cost-benefit analysis models.

In reality, however, too many assumptions are needed to make sense of these opportunities, which leaves the door open for bias and discord. In fact, this is one of the areas where most strategic debate at a senior level takes place. For instance, should CRMCo pursue a strict industry focus, or should it offer horizontal CRM capabilities for all industries? Should CRMCo – in line with its traditional competitors – also invest in an on-demand CRM strategy, to offer its products in a software-as-a-service (SaaS) model? Questions such as these fall under product and company strategy which, prior to the ParentCo acquisition, had been dominated by strategic opportunism and an aversion to making the necessary trade-offs, as covered in the strategic fit analysis. In my experience, in spite of all the market sensing and analysis that CRMCo undertakes, most strategic marketing decisions are made outside of any strict analytical framework. Senior management coalitions, often led by sales pressure and competitive parity concerns, end up pulling the company in short-term directions and use the data and analysis to support the original bias. Product management in the true sense of the word is only effective at a lower level; that is, the level of a product point release where features and functionality bubble up to the priority list, usually based on rational decision making. As a result, a great deal of value is dissipated in strategic marketing activities because the decision-making process constrains the potential value-add that market research and analysis could actually produce.

3.2.1.2 Inbound Logistics

Inbound logistics at CRMCo are very straightforward as far as logistics go. In addition to ongoing sourcing and upgrading of development tools – mostly Microsoft Visual Studio –, the main activity is to actively collaborate with various groups at Microsoft to secure access to and some influence over the development of platform products. To that end, CRMCo is a Gold Certified Partner of Microsoft, which gives CRMCo a baseline access to the resources within Microsoft.

Since this certification is neither special nor all that meaningful, CRMCo also participates in several exclusive technical programs, usually under TAP (Technology Adoption Program) for the various Microsoft platform products that CRMCo builds on. For example, CRMCo sends developers to the Redmond campus for extended periods of time to be part of the early design, development and testing of key products such as the SQL 2005 database, or the Windows server franchise. These activities are supported by the alliance management group (covered under supporting activities) who work to secure visibility at higher levels of the Microsoft organization. Since CRMCo decided to also support the Oracle database platform in addition to the Microsoft database platform, in pursuit of larger customers who are said to prefer Oracle, coveted access to Microsoft has been strained. For that matter, so has CRMCo's ability to credibly allocate resources to both efforts.

Overall, CRMCo's inbound logistics activities are viewed as strategic because of the all-important strategic alignment with Microsoft and its products roadmap. For that reason, strategic marketing and inbound logistics are not only pursued in parallel, and sometimes by the same product managers, but are also closely interrelated.

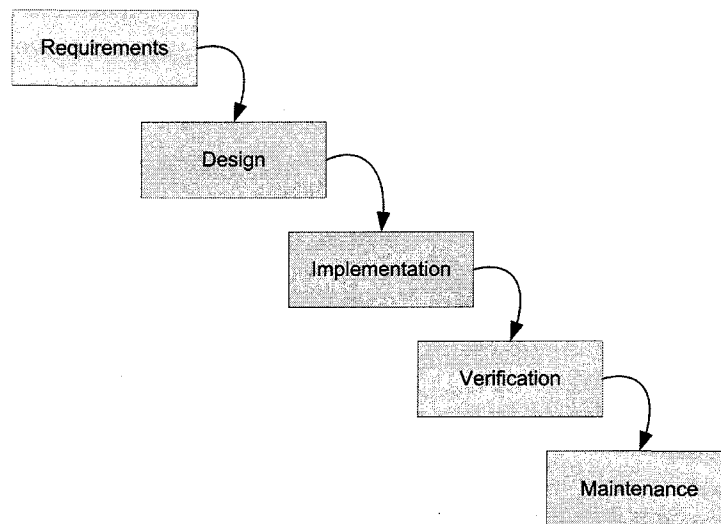
3.2.1.3 Operations

This is the set of activities most closely related to the core of being a software company: Making the actual software. The outcome of outbound logistics and strategic marketing is a product roadmap and high-level product requirement document (PRD) for each CRMCo product. Even though the CRM suite is viewed as one product, it actually consists of several related but distinct business applications – three for Sales, Marketing and Service – and a set of enabling baseline software, grouped under the “CRMCo platform”. The platform includes the different user clients (Windows-based user client, browser-based client and an extranet client), the

customization toolkit, the application programming interface (API) for integrations, as well as the data synchronization engines to enable offline user access and distributed computing.

The CRMCo development methodology follows the waterfall approach. This is an iterative, planned and sequential approach to software development that despite its rigidity is still prevalent in large-scale distributed software development projects. Figure 3-3 The Waterfall software development model, illustrates a typical waterfall approach. The next three subsections provide more detail on how CRMCo goes about developing products.

Figure 3-3 The Waterfall software development model



3.2.1.3.1 Requirements, Design and Architecture

In essence, product requirements are produced by product managers, and then negotiated with program managers who can translate market requirements into technical specifications and quantify the scope of work. This feedback loop also includes the architecture team, which weighs in on the high-level design principles that govern how the software would be built. Architecture is extremely important because it will ultimately allow or prevent the system from meeting its behavioural, performance, and life-cycle requirements. This phase of the development process is

intensely collaborative and volatile. Indeed, rarely is the final outcome of these activities predictable. At this stage, a very bright, passionate and diverse group of people engage in intense debates during seemingly-endless white-board sessions and eventually a picture of the next wave of innovation starts to emerge from these interactions. Lofty ideas of the we-are-going-to-change-the-world variety characterize the early outcome at this stage.

Once the work is quantified, however, reality sets in and what were previously must-have requirements are reclassified as nice-to-haves till the scope starts to feel more manageable. Normally, it is assumed that resources are fixed and so are general release schedules which tend to be dictated by competitive market pressures. In close collaboration between product managers, program managers and development managers, the final requirements, product specifications and high-level design are eventually produced at the end of this stage. Most decisions are debated in a product release committee made up off the three groups, but ultimately the final decisions are made by the head of the R&D organization, usually either the chief technology officer (CTO) or the vice president of R&D.

3.2.1.3.2 Development

The next major stage is to hand over the actual development to the different product development groups. The overall process is managed by a senior director of development with oversight from the head of R&D. Whereas the previous three groups are all located in Vancouver, product development teams are usually geographically split between Vancouver and other development centres in Bangalore, Dublin and elsewhere. The development managers are, in effect, project managers for their portion of the development. They follow stricter, more rigorous development methods because they operate under more rigid constraints than the other groups. In fact, they have to adhere to the architectural guidelines set by the architecture team, create the outcomes outlined in the requirements document, and follow the high-level design that program managers create. While they have a great deal of input in the latter, they typically operate within a

much smaller box with the added pressure of meeting the budget and timelines allocated. In addition to the above constraints, the development teams also have to adhere to strict coding standards that are designed to ensure two critical requirements: readability and interoperability.

First, readability is a way to structure and document code so that it can be easily shared and re-used with other teams who are not as intimately familiar with the work. This is a major requirement of achieving economies of scope in development by creating a common knowledge pool and “snippets” of re-usable, modular software code. Second, interoperability is a way to write autonomous pieces of software that can “talk” to each other through predefined interfaces and protocols. The architecture team defines the framework for interoperability while the development teams actually implement and coordinate the different interfaces between the modules that will need to be assembled later.

The final outcome from this development phase is called a software build. It is an assembly of compiled code that can actually be installed and tested. To help with testing, the development teams also create test scripts to hand over to the quality assurance (QA) teams.

3.2.1.3.3 Documentation, QA and Localization

The development process is not complete until the software is tested, documented for the ultimate customer, and localized for the different languages and regional settings where CRMCo customers are.

Localization at CRMCo is usually done offshore, where a culturally diverse group of developers with mastery of different languages and country-specific subtleties adapt the software to work natively in different countries. The documentation is also translated, an activity which is sometimes outsourced to third parties.

Documentation used to be performed on site, where the developers were. Due to cost-cutting activities, however, all documentation is now performed offshore with only remote, asynchronous collaboration with the key developers. The overall documentation team is also smaller than it used to be. Lack of close collaboration, fewer resources and an abrupt transition to the offshore model have impacted the overall quality and usefulness of the documentation. This problem is not unique to CRMCo, as most users of software products can attest to. Nonetheless, the CRMCo user guides, installation guides, admin and customization guides are very important to the customers and, if done properly, can minimize the pain of implementing the products and allowing the customers to be self-sufficient.

Last but not least, quality assurance is the last phase of development. Quality assurance, or QA for short, is a very complex and tedious phase in enterprise software development. QA engineers have to test the software along several dimensions and under a dizzying array of conditions and environments. First, they have to certify that the code does what is expected. In that regard, they test against the specifications, the requirement documents and the notes embedded in the code to see if the actual outcomes are the desired outcomes. Second, they test the software on several versions of the supported platforms, under several life-like use cases. These test scenarios closely mirror real life environments where the software will be installed. In addition, a great deal of effort in QA is expended testing backwards compatibility of various components and the resulting complexity in upgrading from one version to another. In short, QA is a complex, expensive and time-consuming exercise. The on-premise model, the strategic opportunism that broadens the market scope of the products, combine with pressure to reduce QA costs to create a growing vulnerability in managing this all-important process.

For example, one of the drawbacks of the on-premise model that CRMCo follows (as opposed to the on-demand, software-as-a-service model) is the proliferation of product footprints at each customer site. Not all customers follow the same upgrade path which necessitates testing

several permutations of product versions during the QA process. Second, in its quest to appeal to more prospects, CRMCo has decided to support a multitude of software and hardware platforms, which further exacerbates the testing and development. Lastly, when faced with escalating QA costs because of the afore-mentioned self-inflicted cost drivers, CRMCo struggled to cope. So it tried to cut costs by relocating most QA resources to lower-cost offshore centres. This is the strategy that most technology vendors are adopting. It is also a relatively new strategy and most organizations, CRMCo included, must balance and refine by trial and error over time.

The factors explained above, have resulted in a QA organization that is ill-equipped to adequately handle the complexity and volume of work that it needs to. Pressure to release products further compounds the problem and results in product releases that do not always meet the high quality standards that CRMCo aspires to and that customers expect. This, as will be seen later, is not a cost avoidance strategy as much as it is a cost deferral to the technical support organization. Finally, this challenge is neither unique to CRMCo nor a sign of bad development practices and management. It is simply another manifestation of the conflict between strategic opportunism, which creates a large market scope and a runaway product footprint on one hand, and cost pressures, which limit the resources that can handle that scope, on the other.

3.2.1.4 Outbound Logistics

Outbound logistics are fairly straightforward and routine for CRMCo. To begin with, for each new release, sales contracts and legal license terms may have to change to reflect the new software stack. Product managers work with the in-house legal team to update the contracts accordingly. In addition, the internal ERP and CRM Systems where these products are tracked also need to be updated with new product names, versions and prices. The latter activity is a collaboration between product managers and the internal sales operations team.

Moreover, with each new release, the direct sales force and partner channel receive new training and educational information on what the new products are and the differences in functionality, value and price. Training sessions are usually delivered remotely via a series of online seminars and related documentation. Furthermore, the customer extranet, the Web portal that only customers have access to, is also updated with new information on the new release. The software installation files are also posted for download on the customer and partner sites. CRMCo no longer ships CDs to customers as the Web provides a more cost-effective and efficient distribution channel for digital content.

Finally, product managers also try to find customers who are willing to install the software prior to its final release. This managed Beta program, provides the organization with limited but important early feedback on the release before it becomes generally available to all customers. Often, however, customers are not engaged early enough in the process to provide meaningful and actionable feedback. Instead, Beta customers unusually serve as credible testimonials for marketing endorsements later.

3.2.1.5 Marketing and Sales

Marketing and sales is where CRMCo and the rest of the industry spend most heavily. It is not unusual to spend twice to five times more on marketing and sales as on R&D. The activities in this stage are designed to generate enough demand in the market place to feed the sales pipeline, qualify the right leads into sales opportunities, further pursue opportunities throughout the sales cycle and close them to generate new sales.

3.2.1.5.1 Demand Generation

CRMCo has perfected the art of creating and managing demand using direct marketing. Partly because it does not rely on partner channels as much as its competitors do, partly because it

makes the very marketing automation software it uses, CRMCo focuses most of its marketing on direct, database-driven marketing.

CRMCo is constantly building and growing a database of prospect companies, mid-market companies and divisions of Global 2000 companies in the industries that CRMCo focuses on. Data sources for this database vary from affiliate online marketing programs with technology-oriented sites, to industry trade shows, and to lead registrations on CRMCo.com for events and content. Invariably, whatever the source, CRMCo gets contact information for a prospect and an expression of interest in one or more areas of its CRM offering.

These leads go into CRMCo's own CRM system. They are then automatically scored and vetted using qualification criteria that CRMCo has set up. The closer the profile of the prospect to the ideal customer profile, and the more pronounced the prospect's expression of interest, the more weighting the leads receive. Leads are then followed up on, in order of priority, by the inside sales team over the telephone to further qualify, based on intensity and urgency of interest and degree of fit. This process can take several interactions, all of which are recorded if not automated in the CRM system, to produce what CRMCo calls a sales opportunity. This is then passed on to the sales representatives, using sophisticated distribution rules based on geography, product and industry. The leads that are not passed on to sales go into nurturing marketing campaigns that are designed to grow the interest of the prospect and provide more opportunity for interaction and further qualification. The process is very elaborate and includes content personalization and extensive tracking. In doing this, CRMCo gets to be its own best customer and frequently uses this core competency as a good example of marketing automation excellence.

3.2.1.5.2 Opportunity Management

Once the sales executives are notified of new opportunities that are assigned to them, they complete one more round of initial qualification. At this stage, the sales representatives,

most of whom are seasoned enterprise software sales people, use their gut feeling and a few conversations with the prospect to gauge the size and fit of the opportunity and the likelihood of winning it within the quota period. Often, opportunities get returned for further qualification or nurturing because they fail this acid test.

Sales representatives, with the help of sales engineers, then engage in a relatively long and complex process of identifying the key decision makers in the prospect company, understanding their business needs and positioning CRMCo products as a good fit in the eyes of the prospect. All the while, sales representatives manage and update their opportunities and aggregate sales forecast in the CRM system. This aggregate forecast helps senior managers predict future revenue and intervene as necessary to keep sales in line with targets. The CRM system also helps the different CRMCo resources collaborate and engage to perform demos, complete RFPs, conduct requirement sessions or provide business consulting as it relates to the prospect's CRM strategy. The intermediate goal of opportunity management is to get short-listed with one or two other competitors.

Towards the end, the sales representative, sometimes with the active involvement of senior executives at CRMCo (Sales VP, CEO and CFO) has to provide multiple quotes, assurances and customized terms to the prospect in order to stay competitive. Buyer power, especially towards quarter end, is considerable in most cases and rivalry is intense, making successful negotiation a very difficult feat. Under pressure to perform, sales representatives often make promises that are hard to keep, given the limitations of the product and the delivery capabilities of the organization. These promises create problems down the road, but are incredibly hard to break when sources of revenue are so scarce and given that CRMCo's differentiated strategy is based on flexibility above all else. The average deal is in the few hundreds of thousands with a significant upside potential for services and ongoing maintenance revenue. For a \$60 million company, these deals are very meaningful.

3.2.1.5.3 Order Management and Fulfillment

Once the final quote is accepted, a series of activities ensues to ship the software and finalize the contract based on the negotiated terms. This often involves a great deal of adjustments to the standard operating procedures because every deal is closer to a custom deal than it is to the template. A group of people in sales operations coordinate with the legal and finance departments to finish the paperwork and set up the new customer for the next phase in the lifecycle.

The operational marketing and sales processes described above can involve partners instead of direct sales people, with no significant variation in the overall steps. The CRM system, again, enables the extending of these processes outside the enterprise.

3.2.1.6 Professional Services

This set of post-sales activities is where CRMCo generates two thirds of its revenue and in theory the greatest added value to the customer. It is also the most people-intensive aspect of its business. Installing, implementing, customizing and supporting the CRM suite is how the CRMCo solution goes from a generic CRM application to a business solution. A typical enterprise deal of \$150,000 in software licenses and \$300,000 in services will be used in the following analysis to illustrate the breakdown of professional services value in a client engagement.

3.2.1.6.1 Business Consulting

CRM projects are in essence business transformation initiatives, at least at the enterprise level. They are large, risky investments requiring a clear customer strategy that is aligned with the overall business strategy. To achieve CRM success, customers look for “thought leadership” and guidance from the experts to help them implement best practices, enable differentiation if appropriate, and guide the change management exercise required to implement CRM solutions.

As a result of drastic cost-cutting measures after the dot com bust, CRMCo provides little of these value-added services, and does not usually partner with anybody to fill that gap. This reduces the potential impact that CRMCo can have on the client's business and cedes strategic control of the CRM initiative back to the customer. This is also a reflection of the industry as a whole because customers are becoming more sophisticated and are wary of implementing vendor-biased strategies.

3.2.1.6.2 Installation and Implementation

CRMCo CRM is an enterprise suite of software products that can require a complex operational server environment to work as designed. The first step in running CRMCo involves a somewhat complex installation process on multiple servers at the customer data center. If the customer has geographically-distributed sites, the software is either installed at each of those sites, or remote access from those sites to the main servers is enabled. Typically, in larger deployments, CRMCo systems engineers either go on site or work remotely with the customer IT team to install and configure the software. This can be a tedious and frustrating process, although at its simplest, the tasks are similar to installing a desktop program on a PC. Installing and configuring enterprise software is much more complex, however, as it involves multiple interdependent programs, from different vendors, running on multiple servers. Usually, this is done in a server test environment first, until the bugs are worked out and the customer IT team is comfortable with the day-to-day administration of the application. The system is then installed on the production environment where it officially becomes part of the customer's IT systems infrastructure.

Once the software is installed and configured, several rounds of tweaking are required to optimize system performance and reliability based on the customer requirements and the unique configurations of their network infrastructure. The need for professional services is heightened because the installation documentation can be incomplete, and sometimes even misleading, as

mentioned previously. The installation process typically accounts for 10 percent of the services bill.

3.2.1.6.3 Customization

Even though CRMCo produces industry specific applications for financial services, homebuilders, healthcare payers and manufacturers, every customer wants to customize at least parts of the application to suit their internal processes. Furthermore, because the software has a reputation for being flexible, some customers buy it to enable and automate processes that are simply not part of the out-of-the-box capabilities.

A customization engagement starts with a fairly extensive business requirements analysis phase. During this phase, a CRMCo business analyst – and sometimes several – work with the client teams to map the processes, identify gaps in the software and design how the application will be modified. A scope of services is then completed based on the requirements and a project plan is established. Typically, the customization project is implemented in phases with measurable and logical milestones. The CRMCo professional services team, with varying degrees of involvement by systems integrator partners, goes about implementing the client requirements along several dimensions. Customization always involves changes to the underlying data model, business logic and the user interface. In addition, there are usually integration requirements as CRM systems need to be integrated with ERP systems or other enterprise systems in the client's environment. Billing for the project is time-and-material, fixed-fee or milestone-based.

Customization and integration work normally accounts for 70 percent of a typical professional services engagement, which could add up to \$210,000, using our sample deal. Unlike licenses, however, where margins are very high, professional services have an average of 20 percent margins. Customizations, because of complexity and pressure to stay on time and on budget (especially in a fixed-fee contract), may also introduce a great deal of code quality issues

later. Since this is a people-intensive business, utilization of resources cannot be fully optimized at all times. As a result, in downturns CRMCo loses quality developers, and then struggles to hire inexperienced ones during upswings in the business. This issue is somewhat mitigated by offshore resources in India, but turnover in India is also high, further affecting quality and impacting technical support later on.

3.2.1.6.4 Training

Training is delivered to two sets of users. Business users receive user training which familiarizes them with how to use the application, whereas technical users receive deep system administration and customization courses, so that they can be more self-sufficient in the future. Training is delivered on-site, or via remote Web-conferencing systems. Some customers also pay for and receive customized training depending on their needs.

CRMCo also manages a certification program for partners so they can credibly deliver CRMCo solutions in indirect deals. This program, however, has fallen victim to cost-cutting and overall quality in partner-led deals has suffered as a result.

3.2.1.6.5 Technical Support

Once the solution is rolled out into production, the client is then transitioned to the technical support organization for day-to-day support, bug reporting and fixes, escalation, and as a general first point of contact for any customer issues.

Technical support is spread over three centres: in Vancouver, Luton England and Bangalore India. All three support teams share the same call centre and application infrastructure to enable, automate and measure the delivery of customer support. First-level support is delivered over the phone or via the customer portal, where issues are logged in a queue. Based on triage criteria such as problem severity and product type, the support incident is then prioritized and routed to a support specialist with deep knowledge in the product. The specialist, through a series

of interactions diagnoses the problem and develops a solution or a workaround. When the issue is due to a software bug, the specialist escalates the incident to the R&D group where it is investigated and potentially included in the next service patch release.

The effect of any quality issues in the original product, or in the subsequent customization is inevitably felt at this stage. Incidents related to software bugs are not only expensive to diagnose and eventually fix, but they can also be a source of extreme frustration for customers. Overall customer satisfaction is most strongly correlated with support experience. Despite cut-backs and the inherently complex task of supporting enterprise software products, the global technical support organization at CRMCo manages to add value to the customers' experiences and provide high levels of support. In fact, customer satisfaction with CRMCo technical support exceeds 92 percent, based on over 1700 customer surveys (CRMCo, n.d.).

3.2.2 Supporting Activities

In this section I shall provide a description and an analysis of the secondary activities that support the primary value-creating activities described earlier. I shall emphasize those activities that add a great deal of value or those that, on the contrary, dissipate value. Neutral activities that are common and straightforward will be described only briefly.

3.2.2.1 Alliance Management

CRMCo relies a great deal on partners to deliver the ultimate value to the customers in several facets of its business. First, the product development relies on platform partners and OEM products that are embedded and sold in the CRMCo solutions. None are more important than Microsoft. The CRMCo-Microsoft relationship is complex. Microsoft is perceived to encroach on CRMCo's business by pushing the limit of where their platform ends and CRMCo's applications begin. This has led to the embrace-and-extend mantra which CRMCo has maintained throughout the years. However, Microsoft finally decided to build its own CRM offering, initially targeted at

small business. This “coopetition” relationship greatly complicates the alliance management; certain divisions at Microsoft are close allies while others are competitors. Managing this relationship is the single most important aspect of alliance management and has dedicated director-level support. For the most part, the alliance team has successfully managed to position CRMCo as a strategic partner at Microsoft and despite the apparent conflict and its small size, CRMCo enjoys dedicated support from the Microsoft platform group.

Whereas on the product side, alliance management is primarily focused on sustained strategic engagement and day-to-day interactions; on the sales side, the focus is on recruitment. Cutbacks have adversely affected the sales alliance program in the last few years to the point where CRMCo has a weak partner channel in North America in contrast to its international network. This, expectedly, has hurt indirect sales.

On the implementation side, several systems integrators, particularly outside of North America are still active and play an important role in extending the professional services organization internationally. The alliance management for these partners falls under the different country managers who coordinate the partner technical support and training. In larger international deals, CRMCo resources will actively partner with the systems integrator to deliver the services needed.

3.2.2.2 Information Systems Management

IT at CRMCo plays an important role in supporting a global organization with complex sales cycles, service and support processes and limited resources. CRMCo is also a “technology-happy” company with a propensity for early adoption of new technologies. In addition to the help desk which provides user and desktop support globally, CRMCo IT is also responsible for the infrastructure build-out and maintenance to support the geographic reach of the organization. However, network and data centre infrastructure have been scaled back dramatically since the

tech bubble burst and most applications have been centralized in Vancouver to cut costs. Nonetheless, three critical IT hubs in Vancouver, India and Luton (England) are still maintained.

It is in business applications that CRMCo IT still maintains a robust and sophisticated infrastructure. Not surprisingly, the crown jewel of systems infrastructure is CRMCo's own CRM implementation. It is not a stretch to say that CRMCo runs on the system. All the activities described under marketing, sales, support, service, and even R&D are enabled, automated and tracked using a highly-customized implementation of CRMCo software. Not only does the CRM system support CRMCo's business processes and ultimately its differentiation strategy, but it is also used as an eat-your-own-dog-food example. Innovations that are developed internally out of real-world needs coupled with ongoing internal beta-testing serve as a feedback loop into product development.

While IT is generally perceived as a bottleneck in most organizations including CRMCo, it has nonetheless allowed CRMCo to scale and better cope with the resource constraints by improving its productivity. A great deal of customer management activities are automated and delivered in self-service mode to enhance the customer experience while reducing costs. CRMCo CRM technology has been instrumental in enabling this productivity boost and is often used as an example of the business value of CRMCo CRM to similar resource-constrained organizations that need to maintain a complex business.

3.2.2.3 Human Capital Management

Human resources (HR) at CRMCo play a key role in recruiting, retaining and motivating employees. CRMCo competes for talent and acknowledges that its only sustainable enduring asset is its people. Consequently, a great deal of effort and expenses go towards recruiting. CRMCo recruits around the world, directly through advertising on its Web site and job sites, but also contracts several agencies to source and pre-qualify candidates. The interview process is

quite extensive and usually involves at least four interviews, the first of which is always done by HR to determine fit with the organization's culture of openness, flexibility, collaboration and innovation. No fit means no more interviews.

The on-boarding process follows, where a new employee is introduced to his or her team, job training, and the administrative aspect of employee set up. This is an area that has not been managed and structured beyond a one-day introduction seminar. However, the collaborative culture usually helps new recruits adapt to their new surroundings quickly without the need for too much process.

HR is also responsible for performance management and employee reviews. In theory, this should be an on-going process where feedback is constant and where objectives are clearly outlined and measured. In reality, however, CRMCo falls short of other well-managed organizations in this area. Partly because it is not large enough to justify the investment, and partly because there is no overall strategic planning to establish specific company-wide goals, performance management has largely been an ad-hoc process that provides little value, unless the manager takes the initiative of setting goals and providing feedback.

HR is also responsible for employee retention. This is often dependent on providing star performers with a career path and opportunities for advancement and meaningful work. Although HR has led several initiatives, including funding technical and management training, budget constraints have often curtailed their best intentions. What CRMCo has lacked in institutionalized programs, however, is offset by the open-door policy of HR professionals in the company and the overall supportive culture of the company. Under strong leadership, HR provides active counseling to employees, personalized attention and support, and consistently displays genuine care for the well-being of employees. Their care is supported by employee-friendly disability

programs, paid counseling, and any other quality of life services employees might need from time to time.

3.2.2.4 Firm Infrastructure

3.2.2.4.1 Strategic Planning

Strategic planning is one area that has been chronically lacking at CRMCo. As discussed in the strategic fit paper, CRMCo's strategy, although differentiated, has been characterized by strategic opportunism and lack of focus. As a result, any strategic planning, if it exists at all, tends to be short-lived and undisciplined in its execution. The ripple effect is felt throughout the organization because short-term goals in the different lines of business are uncoordinated and sometimes in conflict. More than anything else, a great deal of value dissipation is a direct result of deficiencies in this activity. As resources were cut, the lack of strategic focus became all the more wasteful.

Only in the last few years did CRMCo's focus on verticals and access to funding after the ParentCo acquisition start to mitigate this problem. It remains, however, a deficient activity when compared with other larger and better-managed organizations.

3.2.2.4.2 Finance

This area encompasses several aspects of CRMCo's business, namely, accounting, financial reporting, investor relations, mergers and acquisitions, payroll and benefits. The accounting department handles the basic accounting functions of accounts payable, accounts receivable, tax accounting and inter-company transactions. The complexity in accounting at CRMCo stems from the global nature of its operations and the legacy systems from multiple mergers and acquisitions of smaller companies over the years. Another layer of complexity that requires constant supervision is revenue recognition, especially with Sarbanes-Oxley legislation

and variations in the larger client contracts where results-based contractual guarantees have become the norm.

Since its acquisition by ParentCo Software, investor relations are no longer part of CRMCo's responsibility. Mergers and acquisition (M&A) activity, an area where CRMCo had been active in the past, is also being managed from ParentCo headquarters. In the past, M&A was largely outsourced to investment banks and outside legal counsel under the supervision of CRMCo's CFO and CEO. Prior to ParentCo, selection of acquisition targets was driven by strategic product gaps, whereas under ParentCo, emphasis is primarily on acquiring revenue streams.

Finally, payroll and benefits administration has also been largely outsourced to ADP, and handled at the country level. Minimal day-to-day involvement was necessary on CRMCo's part, but HR and the executive team were very involved in enhancing the benefits package within the financial limitations of the company. The primary compensation benefit was the stock options grant, which decreased steadily in value post-2001, and eventually the program was practically terminated under ParentCo. Lack of financial upside incentives runs contrary to the collectivist culture of CRMCo where everybody shares – albeit to varying degrees – in the risk-reward equation.

3.2.2.4.3 General Administration

In the past, CRMCo maintained in-house and outsourced capabilities in legal services, office operations and purchasing. Office operations and purchasing are corporate functions that CRMCo manages adequately. During the global expansion post-IPO in 2000-2001, these activities were highly visible and accelerated, but in the cost-cutting years since, these activities tended to wind down and focus remains on what is strictly necessary to run the business while managing costs.

Legal services on the other hand, have always been an area that CRMCo needed a great deal of expertise in. Flexibility, complexity, and a fast-changing environment contribute to putting a lot of strain on the legal department. Increasingly risk-averse and well-informed customers – who are more powerful customers – have become very astute contract negotiators, upping the ante on the legal side. Intellectual property issues, partnership agreements, as well as a long history of mergers and acquisitions have also demanded that CRMCo maintain highly competent and motivated in-house counsels and legal support teams. The volume of work has also demanded that a great deal of legal work be outsourced to outside firms according to their specialty. Overall, until recently under ParentCo, legal services have been a well-funded and staffed core competency at CRMCo.

3.2.2.4.4 Public Relations

This is another area where CRMCo has maintained a core competency throughout the years. The public relations (PR) and communications team generates newsworthy stories and announcements to get and sustain the interest of US-based media and obtain “free” coverage. This is not trivial by any means considering that CRMCo is a mid-size player based in Canada. In addition, CRMCo has a program in place to influence, ever so slightly, the opinions and perceptions of the key analysts such as Gartner that cover the industry, by demonstrating thought leadership and customer success stories. This has helped position CRMCo favourably in the all-important vendor rankings issued by analysts. Considering the limited financial resources that CRMCo has had to work with, relative to its much larger rivals, the skill and passion of the small PR team at CRMCo has been instrumental in securing positive coverage. In the last year or so, however, this program has also struggled to cope with cost pressures, the result of which will be discussed in section 3.4, Performance Indicators.

3.2.3 Value Chain Conclusions

CRMCo has managed to perform its core value-creating activities well enough to have survived the devastating downturn in CRM from 2001-2003. A review and analysis of its value chain reveal certain inadequacies that have prevented it from maximizing value-creation with its available resources and are leaving it somewhat vulnerable in an increasingly robust competitive environment. Most of these inadequacies stem from its rather ambiguous differentiation strategy that has been exacerbated by cost-pressures in a maturing industry.

To begin with, the business model, as encapsulated in the industry value chain, is an on-premise license model that by definition creates an ever-expanding product footprint over time. This leads to an increasing shift of firm resources away from software development to support. It also inhibits the firm's ability to roll out innovations quickly enough to amortize the cost of development. This model is in stark contrast to the software-as-a-service model which puts CRMCo at a considerable strategic disadvantage, especially since mid-market customers have been very receptive to the SaaS model. The shifting of resources towards maintenance has the added effect of choking the organization's capacity to invest development resources in lowering the total cost of ownership to the customers, a previously-identified key success factor.

In addition to the business model, lack of strategic planning as a core competence at CRMCo has meant that a great deal of value is dissipated in activities that do not create strategic fit and end up being wasteful. The opportunistic approach to product and company strategy that has characterized CRMCo's approach over the 2001-2004 period has put a great deal of strain on its resources. For example, CRMCo's ill-fated attempt to go after the contact center market was, in hindsight, a very wasteful and avoidable mistake. If CRMCo had a disciplined approach to product strategy, it could have realized that its target market sweet spot –B2B companies with complex business processes – typically demand personalization and customization but do not require high-volume contact centers. Weakness in his key internal capability prevents the

company from developing the best product mix for its customers which is another critical success factor previously identified. Considering its limited resources, CRMCo can ill-afford to develop products that do not maximize value for its customers.

Finally, cost pressures resulted in lack of funding for those activities that support the core flexibility proposition that CRMCo is built on. To deliver cost-effective flexibility while also developing a full-featured CRM suite requires continuous investments in R&D to deal with the increasing product complexity. It also requires investment in quality assurance, documentation, training, technical support and marketing. The financial reality however, meant that CRMCo could no longer sustain that infrastructure. The mistake was to maintain the same scope of activities while reducing staff and funding in order to reduce costs. This, in turn, had a negative effect on quality in several key areas, and put the company on a slippery slope that is inconsistent with its positioning.

Fortunately, CRMCo's core competencies in software development, marketing and customer service, while under increasing strain, have not been significantly compromised. This is in no small part thanks to the quality of its people. However, even the most dedicated and talented people have their limits. This is important to note because, as other adjacent or supporting areas of the value chain are weakened if not practically eliminated, the entire creation and flow of value is being upset, to the point where organizational resiliency may fail to cope in the long term. Access to capital through ParentCo and a focus on vertical markets may in theory allow CRMCo to start addressing this problem.

3.3 Company Culture

The culture at CRMCo has evolved significantly over the years. An entire paper can be dedicated to this topic alone, but in the context of this strategic analysis, it is useful to highlight some of the major cultural shifts that have characterized CRMCo's evolution as a company. In

order to structure this discussion, I shall use the Wexler Wheel framework (2006) to describe and rationalize these changes within the overall strategic context for the company.

3.3.1 A Brief Introduction of the Wexler Wheel

Mark Wexler has created a contextual framework for analyzing and understanding leadership and organizational change issues. Central in this model is the concept of four worldviews that make up the four quadrants of the wheel (See Figure 3-4 CRMCo's footprint evolution along the Wexler Wheel model). These worldviews are delineated by the control-versus-flexibility vertical axis and the inward-versus-outward orientation horizontal axis.

The "Regulatory Worldview" in the top-left quadrant (high control, high inward focus) essentially describes the bureaucratic "built-to-last" story. This worldview strives for "greater achievement and reliability" and is driven by uncertainty reduction. The "Entrepreneurial Worldview", in the top-right quadrant (high control, high outward focus) essentially describes the "money-talks" story which is characterized by the struggle "for wealth, power and control" and is driven by short-term profit-maximization. The "Network Worldview" in the bottom-right quadrant (high flexibility, high outward focus) is the "portal-to-a-new-world" story. This worldview is preoccupied with "making the future with the application of technology and innovation" and is driven by novelty and adventure. Finally, the "Communitarian Worldview" which occupies the bottom-left quadrant (high flexibility, high inward focus) describes what Wexler refers to as the "cooperation-pays" story. This worldview is driven by the search for "meaningful existence" where the concern is the quest for "authority through self and self-other relationships" (Wexler, 2006).

In this model, organizations have a footprint in one or more quadrants that reflects the weighting of each worldview in the make up of that organization. They also follow a change trajectory over time that describes the evolution of the organizational footprint along one or both

axes. This is the model that I shall use in describing the culture at CRMCo and how it has changed over the years.

3.3.2 The Early Years: Idealism and Innovation

As a high-technology start-up in the mid to late nineties, CRMCo's footprint was predominantly in the Network worldview. The early years were characterized by high degrees of innovation, change and creativity. The culture was highly collaborative, open, and free of any meaningful structure. The collective challenge was to explore leading-edge ideas and create the next software breakthrough. As a result, the organization was flat and fluid. The communitarian worldview was also present in terms of the shared values of inclusion, open dialogue, and personal growth. Since the intellectual capital also had a profit motive, CRMCo's footprint extended to the entrepreneurial worldview represented by venture capital funding, generous employee stock-option grants and the dream of making it big.

During these years, CRMCo was essentially a product-development organization where people enjoyed a great deal of freedom and flexibility, but also shared the sacrifice of long working hours in pursuit of an ideal. Technical innovation was valued above all else much to the delight of R&D developers. The oval denoted by the number "1" in Figure 3-4 illustrates CRMCo's footprint on the Wexler Wheel during this period.

3.3.3 The Middle Years: Market Success and Revenue Growth

When CRMCo went public in 1999, the organization was thrust into a trajectory towards a much greater outwardly orientation (competition) and slightly more control. The focus on commercializing the intellectual capital became much more pronounced and so the organizational focus shifted away from pure product development towards marketing and sales.

Imbued by the injection of cash following the IPO, CRMCo shifted gears towards becoming a global contender in CRM and capitalizing on the explosive growth of the Internet. Product innovation was still important, but was now increasingly being driven by marketing. This market-driven orientation and the rapid global expansion signaled a period of significant culture changes at CRMCo. The idealism of the early years took a back seat to the unforgiving reality of winning deals, building the brand and growing revenue, almost at any cost. Accountability increased and so did the degree of management control.

However, the tremendous success that CRMCo enjoyed from 1999 to 2001 in the marketplace and in the stock market helped create a sense that CRMCo was at the forefront of a dramatic industry change and that the employees were all part of something special. Even as the pressure, expectations, and competitiveness intensified, the people at CRMCo shared a “brothers-in-arms” type of bond. Leadership at the time was very effective in creating a hype machine internally and externally that fuelled the creative intensity in people and created an us-against-the-world culture. People at CRMCo were united in the pursuit of market success and did not pay much attention to the decreasing levels of flexibility and individual freedoms.

During these years, CRMCo became a market-led, opportunistic software company where people were still very valued as long as they fitted into the intense, take-no-prisoners entrepreneurial worldview. The true communitarian footprint disappeared, but that was effectively masked by the collective pursuit of wealth creation and inter-dependent self-interest. The oval denoted by the number “2” in Figure 3-4 depicts CRMCo’s footprint on the Wexler Wheel during this period and the arrow between numbers “1” and “2” its trajectory from the early years.

3.3.4 The Recent Years: Survival and Systems Maintenance

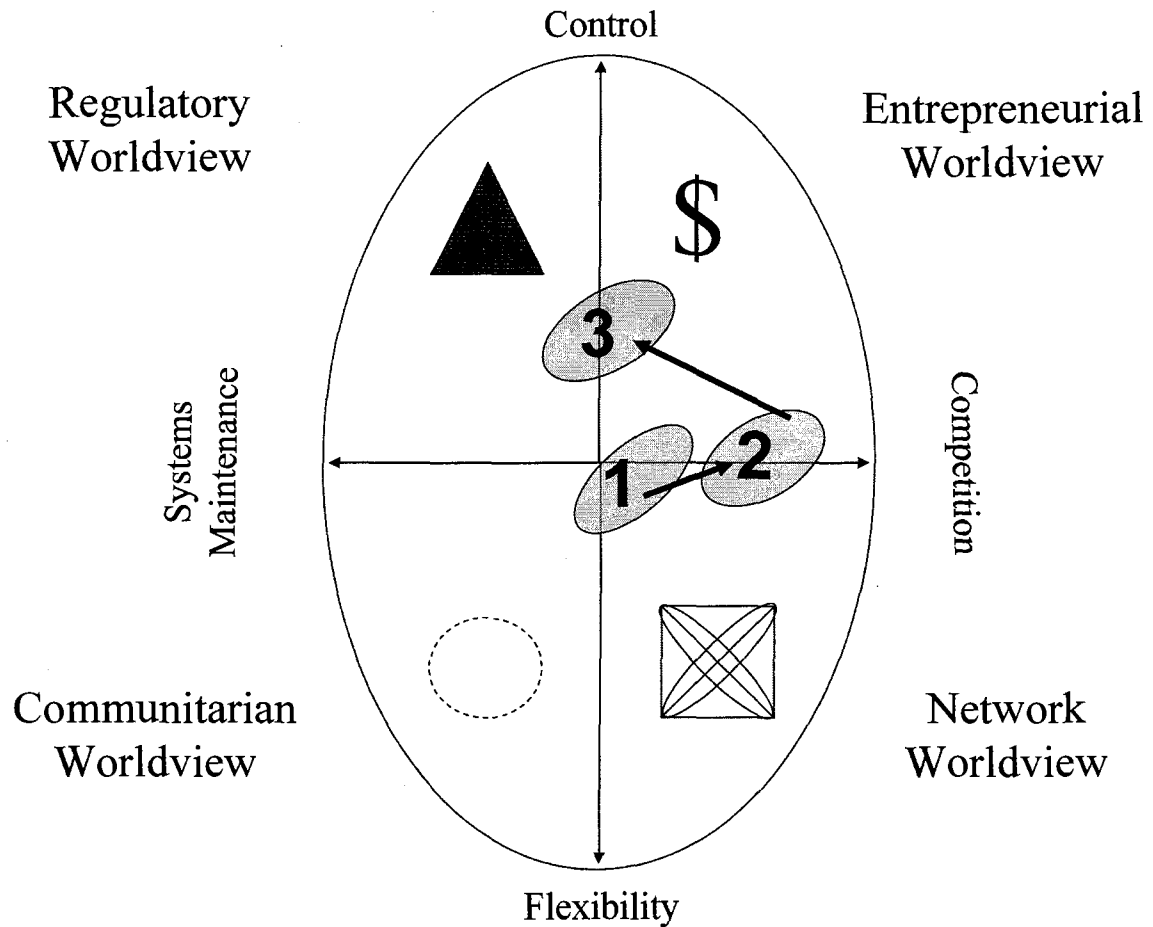
In 2001, the dot com crash marked yet another change trigger in CRMCo's culture. As the reality set in, that the path to riches was no longer in sight; the organizational focus shifted markedly towards survival. The tight-knit culture and the genuine affinity that people felt for each other was about to be severely tested.

CRMCo, along with the industry as a whole, struggled with a sudden and steep decline in revenue matched by an equally steep decline in its stock market valuation. For the first time in CRMCo's history, people became a cost. As such, several rounds of layoffs became necessary. The pursuit of innovation and growth was replaced by the need to survive, maintain and minimize risk. This translated to a shift towards systems maintenance (inward focus) in the organizational footprint. The once-creative, open and risk-taking culture had to adopt the new values of prudence, stability and duty. In addition, as market conditions worsened, uncertainty over CRMCo's future and financial viability increased. This also led to a sharp increase in management control in order to instill and maintain operational efficiency and reduce costs. The free-wheeling culture was predictably and relatively quickly replaced by policies, procedures and systems. This is seen in the upwards trajectory of CRMCo's footprint on the Wexler wheel. The oval denoted by the number "3" in Figure 3-4 depicts CRMCo's current footprint on the Wexler Wheel and the arrow between numbers "2" and "3" its trajectory since the dot com crash.

By 2003, CRMCo, understandably, became a different company. The loss of friends, colleagues, flexibility and a realistic hope for an extraordinary collective future greatly muted the passion and creativity of the employees. Nonetheless, those who were still part of the organization believed that the new order was necessary and were prepared to endure it. Even as some jobs were moving to India, the culture remained open, respectful and relatively flat. However, following CRMCo's acquisition by ParentCo, it became increasingly clear that the game has changed forever. As is common in these types of acquisitions in a maturing industry,

the emphasis on systems maintenance and operational control only increased. There was no core purpose that inspired people anymore, nor was there great leadership to bind them together. What was once a dream career motivated by innovation, success and shared wealth became simply, a job.

Figure 3-4 CRMCo's footprint evolution along the Wexler Wheel model



Adapted from Mark Wexler, (2005). Leadership in context - the four faces of capitalism.

3.4 Performance Indicators

CRMCo's internal analysis so far paints the portrait of a company that was under increasing strain to sustain a clear differentiation strategy and create value for its customers, under tight operational and financial constraints. In this part of the analysis, I shall examine three

leading indicators of company performance to gain more insight into CRMCo's current assessment. I rely on publicly available data in three areas of CRMCo's business: financial performance, product innovation, and market visibility.

3.4.1 Financial Performance

CRMCo's financial data was readily available until the end of 2003. The last published quarterly results date back to the first calendar quarter of 2004, just prior to CRMCo's acquisition by ParentCo. Since then, only scant information about CRMCo's financial performance is available. The press releases issued by ParentCo usually deal with the combined enterprise software division (SisterCo2, CRMCo and SisterCo1) and provide few clues about the specific numbers that relate to CRMCo's revenue. Nonetheless, based on the November 25, 2005 release (ParentCo) which gave specific revenue data and growth percentages for the first nine months of the year, we can estimate the 2005 and 2004 revenue numbers with some reasonable assumptions¹³. The published yearly results prior to the acquisition and my revenue estimates for 2004 and 2005 are shown in Figure 3-5 CRMCo financials, 2001-2005 in thousands of US \$, below. Based on this financial picture, three points of interest are worth further discussion and analysis as they provide some insightful clues about CRMCo's business, past and future.

¹³ Please see estimation method in Appendix 6.2.2, Revenue Estimation Method for 2004 and 2005.

Figure 3-5 CRMCo financials, 2001-2005 in thousands of US \$

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004 Estimate.</u>	<u>2005 Estimate.</u>
Revenue					
Lic rev	\$ 58,510	\$ 29,282	\$ 18,917	na	\$ 17,997
Maintenance & Service Rev.	\$ 37,644	\$ 40,334	\$ 37,160	na	\$ 43,192
% of Services to Total revenue	39%	58%	66%	na	71%
Total Rev	\$ 96,154	\$ 69,616	\$ 56,077	\$ 57,226	\$ 61,189
Total Cost of rev	\$ 24,830	\$ 26,696	\$ 21,422		
Gross Profit	\$ 71,324	\$ 42,920	\$ 34,655		
Operating Expenses					
Sales and Marketing	\$ 51,118	\$ 41,359	\$ 26,888		
R&D	\$ 18,280	\$ 16,963	\$ 16,397		
G&A	\$ 13,567	\$ 12,820	\$ 8,328		
Restructuring	\$ -	\$ 53,136	\$ 9,015		
Amortization of Good will	\$ 24,012	\$ 16,848	\$ -		
Amortization of intangibles	\$ 622	\$ 488	\$ 379		
Total Operating Expenses	\$ 107,599	\$ 141,614	\$ 61,007	na	na
Loss from Operations	\$ (36,275)	\$ (98,694)	\$ (26,352)	na	na
Net Income	\$ (33,915)	\$ (99,035)	\$ (27,623)	na	na
Loss per share	\$ (1.46)	\$ (4.12)	\$ (1.10)		

Based on CRMCo's published financial results (2001-2003) and estimates gleaned from ParentCo press releases since 2004.

To begin with, the 2001-2003 results illustrate just how badly the CRM market slowdown affected CRMCo. Cumulative losses from operations in those three years exceeded US \$150 million while in parallel, revenue decreased from US \$96 in 2001 to US \$56 million in 2003. License revenue in particular, which is a good measure of new customer acquisitions and repeat purchases from existing customers decreased by over 66 percent between 2001 and 2003. As a result of losses, in its last financial results press release as an independent company, in January 2004 (CRMCo), CRMCo's unrestricted cash was just \$5.4 million while its total current assets were \$20.9 million. CRMCo is not unique among its peers in this regard, but the losses were nonetheless considerable and show the extent to which CRMCo badly needed to find a financial backer.

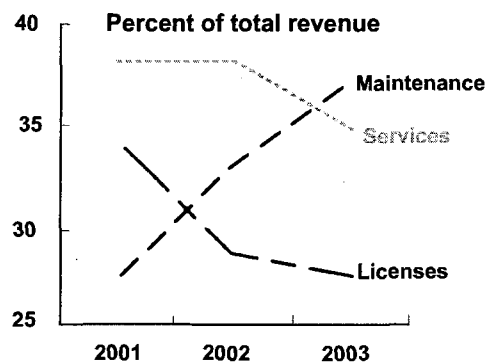
The second observation is that, since the ParentCo acquisition, the minor estimated growth in top line revenue shows a slight improvement, but does not signal any dramatic turnaround. I estimated total CRMCo revenue growth from 2004 to 2005 at 6.9 percent and license growth at 4 percent based on performance in the first nine months of 2005 (ParentCo, 2005). This is a respectable growth rate in absolute terms. However, Gartner estimates that total CRM software growth in 2005 was 13.7 percent. Therefore, relative to the industry, CRMCo's growth is less than a third. Since most of the growth is in on-demand models, CRMCo's performance may very well be on par with its on-premise counterparts. Onyx, its closest rival, offers a mixed picture of relative performance. Compared to Onyx's confirmed 4.8 percent total revenue growth (Onyx Software Corporation, 2006) over the same period, CRMCo achieved superior overall performance. However, Onyx registered a 26 percent license sales growth year over year, compared to CRMCo's estimated 4 percent. This may reflect Onyx's superior performance over the same period, or it may be a result of worse-than-average performance in the previous period.

The third and final notable observation is the steady growth of maintenance and service revenue as a percentage of total revenue. It has grown from 39 percent in 2001 to 71 percent (est.) in 2005. Overall, the ParentCo enterprise software unit generated 76 percent of its revenue from maintenance and consulting (ParentCo, 2006). This is slightly higher than the industry average (See Figure 3-6 License, maintenance and service revenue trends, below) and may signal future problems for CRMCo, if my estimate of license sales at 29 percent proves to be too optimistic. As a rule of thumb, most successful vendors earn one-third of their revenue from license sales, one-third from maintenance fees and one-third from services. License revenue is, however, the leading indicator of future performance. If 24 percent of revenue is from license sales, it could be a sign that the company is not innovative. My estimate of 29 percent of revenue from license

sales would provide less cause for concern. Indeed, Onyx's license sales percentage, for example, was 28.5 percent whereas Oracle's and SAP's were 35 percent and 33 percent respectively.

The future trend of this key metric will provide a good indication of CRMCo's strategy and its ability to execute. An increase in license sales percentage would indicate that product innovation, sales execution, and customer satisfaction, combined, are improving. In contrast, a downward trend would signal that one or more of these three leading performance indicators are compromising future success. This metric would also provide clues about ParentCo's overall strategy. A disproportionate emphasis on maintenance revenues may very well improve the financial picture in the short term, given the high margins of 80 to 90 percent usually associated with these revenues (Ricciuti, 2004). However, if customers do not see a sustained investment in the platform and product set, such a strategy would backfire in the long term. Here again, ParentCo-CRMCo is not unique. This is the balance that several private equity investors, attracted by the high-margin maintenance cash flows of companies they are acquiring, must strike.

Figure 3-6 License, maintenance and service revenue trends



Based on CNET article, (Ricciuti, 2004).

3.4.2 Product Innovation: Release Cycles

It is difficult to gauge CRMCo's performance in terms of its ability to launch new products, which is a proxy for its ability to innovate and deliver value to the market. To begin

with, not all product launches are made public. Further, when they are, it is not always possible to distinguish between a significant release and a minor one. Ultimately, license revenue from new and exiting customers is the best and most objective way to assess this leading performance indicator for a traditional software company. Nevertheless, a qualitative analysis of CRMCo's product release scope and frequency based on publicly-available data should provide more insightful clues about CRMCo's performance. Since CRMCo's products cover an array of horizontal, generic-CRM products and industry-specific solutions (See 1.4.1 above), it would be necessary to look at performance in both areas.

The pivotal 5.x platform was first launched in April 2003, followed by version 5.1 in June, 2004. "In May 2005, CRMCo introduced CRMCo Sales 5.7, an upgraded module within CRMCo CRM, providing enhanced integration with Microsoft Outlook email, improved analytics functionality, Unicode CRM data support and enhanced .NET customization and application development capabilities. In December 2005, CRMCo introduced CRMCo Interaction Connector – Universal Edition 5.7, a standardized, vendor-agnostic API that can be used to integrate the CRMCo CRM system to almost any brand of contact center hardware or infrastructure equipment." (ParentCo, 2006). As discussed in the value chain analysis, a minor release such as an upgrade from 5.0 to 5.1 usually means enhanced functionality and possibly new minor platform capabilities. It does not include a major technology upgrade or a new application module.

Three years on the same major platform may have been unthinkable years ago but not now. The rate of innovation at CRMCo in terms of generic application software releases has certainly slowed down as evidenced by the once-a-year minor release cycle. However, CRMCo is not unique in that regard. According to Frost & Sullivan, a leading industry research analyst, "the software industry grew dramatically when the client-server platform replaced mainframes, and when the Web replaced the client-server [platform]. Although there's some growth in systems

migration, upgrades and niche applications, there's been no change in software platform by and large" (Tan, 2006). Even service-oriented architecture and Web services are being adopted incrementally along an evolutionary, not a revolutionary path. Due to enterprise software complexity, inherent technology diffusion limitations in the on-premise model and the high cost to the customer of just maintaining legacy applications¹⁴, vendors in the industry are not rushing to release new products. Neither is CRMCo.

What CRMCo is trying to do, however, is focus its product releases on its industry-vertical applications. The belief is that these applications deliver better value to the customer since they encapsulate industry-specific functionality and best practices. According to ParentCo's 2005 annual report, "in April 2005, CRMCo introduced CRMCo Medical Devices 2.0, an upgraded industry-specific template for CRMCo CRM that addresses unique requirements in the medical devices industry. In August 2005, CRMCo introduced CRMCo Financial Services 3.7, an upgraded industry-specific template for CRMCo CRM that addresses unique requirements in the financial services industries and the capital markets in particular. In December 2005, CRMCo introduced CRMCo Homebuilder 3.6, an upgraded industry-specific template for CRMCo CRM that addresses unique requirements in the construction, homebuilding and real estate industries. The template provides improved sales processes, and neighborhood level interest tracking for leads and contacts" (U.S. Securities and Exchange Commission, 2006).

Although the value in focusing product releases on industry applications is evident, the rate at which these applications are being released seems slightly inadequate. Since CRMCo has the flexible platform that allows it to develop specialized applications more quickly, expect a faster release cycle would be expected, where industry knowledge is captured and diffused back

¹⁴ "Maintenance is also becoming a costly affair, Iyer said, where some CIOs spend up to 75 percent of their IT budgets on maintenance, leaving little money for them to acquire new software products. For example, he noted that while British Petroleum spends US\$2 billion on IT each year, the company spends less than US\$15 million on new software licenses." (Tan, 2006)

into the market more quickly, in the form of products. Unless they are not being announced, a once-a-year point release may be an indicator that product innovation has indeed slowed down across the board, due to strains on the innovative capacity of the organization. Another plausible explanation may be that CRMCo's vertical products are finally maturing. The current product set may be so well attuned to the needs of the industry sub-segments it targets, that it is increasingly difficult to significantly upgrade it with more frequency.

3.4.3 Market Visibility: Analyst and Press Coverage

This is an even more subjective qualitative measure of performance. It can be argued that the media only look for exciting stories to tell and that, since CRMCo is a small and relatively unexciting CRM vendor, it tends to get overlooked. In fact, industry and mainstream media are often accused of participating in creating hype around some of the very companies they cover. A good example of this would be the media frenzy that surrounds every move of Salesforce.com. It has been a media darling, for some years now at the expense of companies such as CRMCo. Furthermore, on the analyst side, the credibility of firms such as Gartner, Forrester and IDC has also been called into question at times. While these firms and others are very well respected as subject matter experts and decision influencers in the IT industry, they are sometimes accused of showing bias towards those vendors that are also clients for their services (Greenemeier and McDougall, 2006). This is a charge that analysts, understandably, refute very strongly.

The objectivity and motives of analysts and media are not really the concern here, nor is the accuracy of their reports. What is relevant in this discussion is their undeniable influence in the market space. Therefore, to the extent that favourable coverage is an indicator of market momentum for any vendor, CRMCo should be concerned. In 2006, there has been a noticeable drop-off in media coverage about the company and some public negative comments by analysts are starting to appear on the Web. The lack of media interest, as well as some analysts' direct

quotes invariably point to a “loss of market visibility” (Collins, 2006) on CRMCo’s part. I do not know whether the issue is due to a sudden neglect in managing and influencing media and analysts as a corporate function, or whether some of the negative analyst opinions are indeed justified. In either case, it does not bode well for CRMCo. As highlighted in the value chain, marketing has been a well-managed and successful supporting activity up until now.

From placement on Gartner’s various recent magic CRM quadrants to several vendor guides and lists that track the CRM industry, to articles about the company, CRMCo seems to be slowly losing ground to competitors in terms of market presence and buyer awareness. To quote an industry analyst (Morphy, 2006) in reference to CRMCo recently, “we don't really see them much anymore”. This is nothing dramatic, but it is another indication of vulnerability. Lack of positive coverage and visibility will not likely impact CRMCo’s business in the short term, but as a small vendor, CRMCo cannot afford to ignore this lever of performance for its longer- term success.

4 ISSUES

Having analyzed both the industry and CRMCo's strategy and its internal capabilities, I shall now synthesize the major issues facing CRMCo. These fall under two categories. The first is about strategy: Specifically, how to align the differentiation strategy with growth opportunities? The second category of issues is people-related: Particularly, how to address employee retention to support the differentiation strategy? Each set of issues shall be examined in detail below. It will quickly be apparent to the reader that these issues are in fact interrelated and, as a result, complex. This is to be expected, because there is no formulaic answer that will magically propel CRMCo to a multi-billion dollar company. This section seeks to articulate the issues, the choices that CRMCo has in addressing them, and the pros and cons of each choice where applicable. Chapter 5 will deal with specific recommendations as they relate to these choices.

4.1 Growth Strategy and Differentiation

Are there growth opportunities in this maturing market? What is the value proposition that is both consistent with CRMCo's strengths and compelling for its chosen markets? CRMCo's choice of markets and value is the essence of its differentiation strategy and is directly related to the three success factors already identified for mid-market suite vendors. CRMCo's choice of markets directly impacts its ability to focus its limited resources and uncover market needs it can effectively address with its products. CRMCo's choice of value on the other hand, must inevitably address finding the right product mix and dealing with the total cost of ownership issue.

In addition, the competitive forces that pose the greatest threats to CRMCo must also be addressed in the issues discussion. Microsoft and on-demand vendors in particular, provide a

value proposition that mid-market customers find attractive. First, their choice of value produces a basket of benefits that is both clear and compelling. Second, they both have defensible positions along the total cost of ownership dimension (See Appendix 6.2.1, Total Cost of Ownership (TCO) Vendor Comparison). Third, Microsoft and the most successful on-demand vendors, such as Salesforce.com, have enough financial resources to be formidable rivals.

An in-depth analysis of these key strategic issues facing CRMCo today is provided in the following sections.

4.1.1 Choice of Markets

The issue is which markets should CRMCo go after? Today, CRMCo pursues global mid-market customers in five industry verticals: Financial services, home building and real estate, healthcare, manufacturing and life sciences. This vertical strategy has evolved over the years, in part to keep up with general industry trends. The debate used to be whether this is a go-to-market strategy; that is a marketing strategy to focus resources on one defined and reachable segment; or whether this was also a product development strategy with focused development resources and parallel product roadmaps. CRMCo has largely settled this question in favour of the latter. However, some questions still need answering.

First, is this the right mix of industry verticals? Second, if they are pursued to the exclusion of others, does that “leave money on the table”? Lastly, whatever verticals are pursued, why not pursue them more broadly instead of focusing on the mid-market where CRMCo is getting squeezed?

With the exception of homebuilders, a small vertical by any measure, four of the five chosen verticals actually map to three industries using standard industry classification: Discrete manufacturing, financial services and healthcare providers. The first two are in the top three

industries in terms of overall CRM spending (See Table 2-1 CRM spending by industry) and the three industries account for \$1.5 billion in aggregate license revenue, or 39 percent of the overall market. From a market-size perspective, these segments are attractive. However, for that same reason, they are also the chosen verticals of many of CRMCo's competitors. Onyx also focuses on the same industries and so does Siebel, to name two. If all or a large enough number of rivals focus on the same industries, what distinguishes CRMCo from the rest? The answer here has to do with the profile of these industries. The prevailing thinking at CRMCo is that companies in these industries have complex relationships with their customers, complex product mixes, and complex business processes as a result. This plays to CRMCo's flexibility advantage which allows customers in these industries to customize the solution to whatever level of complexity they need.

Certainly, this reasoning makes sense when it comes to fit between the core-value proposition and the needs of these industry segments, assuming the industry generalizations are true. However, if business complexity is indeed the driver for customization, and therefore a demand driver for flexible CRM products, would not all differentiators have similar requirements, regardless of industry?

After all, according to the Bukszár strategic fit framework (2006), a differentiation strategy normally requires higher degrees of innovation, decentralization, autonomy, production flexibility and pull-marketing than a cost-based strategy does. It seems to me that differentiators in *any* industry would therefore put a premium on flexible CRM that allows them to customize their customer processes in support of their differentiation strategy. Differentiators, by definition, are customer-focused – as opposed to production focused – and do not seek to emulate the practices of their competitors. Instead, their positioning is based on creating a different kind of value for their chosen markets, and constantly evolving it in order to stay ahead of their competitors and continue to command a price premium. Flexible CRM is a perfect fit to support

that strategy because it would allow the differentiator to gain a deeper understanding of its customers, create and sustain demand, and provide a superior customer experience that justifies the premium.

In contrast, I would argue that a cost-based competitor, in any industry, would instead favour an application that is stable, efficient, packed with industry best practices and can handle high-transaction volumes. Flexibility runs contrary to some of the key attributes of a cost-based strategy, namely centralization, standardization and scale. This is in addition to the fact that a cost-based competitor would likely put more emphasis on manufacturing and production processes, and hence on ERP systems, than on creating demand for new innovative products. When the operating assumption about customers is that they value adequate quality and low cost above all, there is really no compelling reason to invest in providing a superior customer experience. Any standard CRM package that is easy to implement and pay for would do. A supporting observation for this argument can be found by looking at the customers of Salesforce.com. A quick scan of their customer list reveals that customers from every industry, including those that CRMCo targets, have found the proposition of simplified and less-flexible CRM appealing. Whether those customers are the exception rather than the rule remains to be seen.

If this argument is sound, then why does CRMCo focus on these three industries almost to the exclusion of others? In my view, the issue has more to do with the capacity of the organization to go effectively after a broader cross-industry market that shares the same differentiation profile than it does with positioning. Furthermore, even the most ardent and innovative differentiator would not want to buy an application that has no built-in functionality, no matter how flexible it is. Such a differentiator may as well invest in a development platform such as the BEA development platform, and develop the application from scratch. It follows that CRMCo has to build a baseline of functionality into the application, which is next to impossible

unless a common set of requirements is specified. This is much easier to do by targeting specific industry sub-segments because the commonalities are easier to identify. Here again, the issue is capacity.

The last question raised in this discussion was the validity of the mid-market focus. The central questions are if the size of a company has anything to do with its requirement for flexible CRM, and whether it is CRMCo's capacity to service larger enterprise customers that is the real issue, or not. In previous chapters, I have argued that enterprise customers demand a level of sales coverage, support and service infrastructure, financial viability and deep vendor expertise in their global business processes that only large CRM vendors can provide. Being part of ParentCo might give CRMCo access to a larger infrastructure from which it can market to and serve larger customers.

Finally, whether or not CRMCo pursues the enterprise market with more vigor, it has to deal with the squeeze effect from large vendors going down-market while traditional lower SMB vendors such as Microsoft and Salesforce.com are going up-market. If ParentCo can provide the financial and operational platform from which CRMCo can go after the enterprise market, CRMCo might gain access to new growth opportunities and get some breathing room in the mid-market.

4.1.2 Choice of Value – The Product Mix

A great deal of analysis in this paper was devoted to assessing CRMCo's differentiation strategy and its evolving value proposition. The current product mix is central to that proposition and is intricately tied to the choice of markets. Two questions need to be addressed. First, can CRMCo maintain the flexibility advantage while at the same time competing as a full-featured CRM suite vendor with marketing, sales and service applications for different industry segments?

Second, how to address the total cost of ownership issue that was once part of the value proposition but is now increasingly questionable?

On the first issue, there is room for debate. On one hand, the flexibility advantage actually allows CRMCo to target multiple industries with tailored suites of applications faster and cheaper than its competitors can. On the other hand, there is a visible trade-off between flexibility and an ever-expanding set of out-of-the-box features, which create a large product footprint and inevitably result in slowing down flexibility due to complexity. The value chain analysis exposed some of the downsides of flexibility with respect to upgrades and diffusion of innovation. This is primarily a software development problem and one that needs to be addressed at a technical level by bright software developers. As such, it should neither be foreign nor insurmountable for CRMCo, assuming the right people, under the structure, are working to solve it. The flexibility advantage was created in the first place because the early architects of the CRMCo application developed a systematic way to manage customizations. This technical problem should be an evolution along the same vector of innovation.

However solvable the problem is from a technical standpoint, the resource constraints still remain. Since the answer to each problem CRMCo faces cannot be to increase funding, a resource trade-off must be carefully considered. In other words, assuming it is a zero-sum proposition, the issue can be summarized as follows. Are CRMCo technical resources better utilized developing and deepening the flexibility advantage or does developing more industry-specific features generate better returns?

The second major issue under product mix is the total cost of ownership (TCO), or lack of it. A Gartner TCO study of mid-market CRM vendors does not rate CRMCo very highly, as Appendix 6.2.1, Total Cost of Ownership (TCO) Vendor Comparison, illustrates. This leaves CRMCo exposed in the mid-market, after the emergence of on-demand models and Microsoft

CRM, arguably two lower-cost options. Cost-effectiveness as argued in the strategic fit analysis was a key component of CRMCo's value proposition. The TCO issue is relevant, regardless of the product mix and needs to be addressed if CRMCo is to stay competitive.

4.1.3 How to Deal With Microsoft?

This is a question that almost any technology company today must at least consider. Microsoft's market scope is so wide and its resources so considerable that hardly anybody is immune to its influence. CRMCo is no exception. Not only is Microsoft its most important supplier, but it is also its most fearsome competitor strategically, because it is squarely going after CRMCo's market and value proposition. This makes for a complex relationship, as complex as anyone would have dancing with an 800-pound gorilla.

When CRMCo standardized on the Microsoft platform (OS, database, programming languages and server products) back in the mid-nineties, it positioned itself well to penetrate the mid-market. The SMB market is Microsoft's sweet spot because of the relatively low TCO of its products and the availability of a large partner network to service mid-sized and small businesses. This has allowed CRMCo to further penetrate the mid-market with a low TCO positioning. Microsoft, eager to sell platform products, saw in CRMCo – and other similar CRM vendors such as Onyx – as a good partner to generate pull-through revenue. Every license that CRMCo sold translated to a number of licenses for Microsoft products. So CRMCo received a great deal of marketing support and a lot of visibility within the platform products division in Redmond. In short, the partnership worked.

The partnership worked until Microsoft decided that the enterprise software market was just too attractive to leave to partners. After failed attempts at CRM acquisitions, Microsoft decided to make its own CRM product and launched it in 2003. Microsoft CRM, part of the Microsoft Business Solutions (MBS) division that also makes ERP software such as Great Plains

and Navision, was discounted by industry analysts and vendors including CRMCo, as an entry-level product. It was also said that Microsoft was targeting small business and was not ready for the mid-market. Then, in 2005, when Microsoft released MS CRM 3.0, a much more robust product, their intentions became clearer: They are going after the enterprise market, never mind the mid-market. In the words of Bill Gates, "our products can scale up to cover a super, super high percentage of all businesses in the world. When (companies) want to pick a new software application base, we will be in there competing in 95 percent of the cases" (Fried, 2006). This is no way to treat a partner, but it should surprise no one given Microsoft's insatiable appetite for growth beyond its Windows and Office franchises.

Therefore, what does CRMCo do? There are really only three choices: CRMCo competes head to head with Microsoft, finds a market segment where Microsoft does not compete, or embraces and extends the Microsoft CRM platform.

Competing head to head with Microsoft would require the perfect differentiation strategy. Given Microsoft's traditional strength in the developer community and their deep technical knowledge of their own software stack, it would be hard to develop a platform that is more flexible, assuming flexibility was on Microsoft's agenda. It is. Furthermore, differentiation based on a more complete CRM suite, while tenable today, given MS CRM's lack of maturity versus CRMCo's products, is likely to be short lived. Microsoft has committed resources to CRM and is unlikely to stop at the current version. Their history shows a track record of entering markets late, with sub-standard early versions only to dominate those markets later on. Therefore, could industry focus be the path to differentiation? Not so. Microsoft also has an industry builder program, which rewards partners that help tailor its CRM and ERP products for particular industries (Fried, 2006).

At first, it does not look as though competing head to head with Microsoft is a very sound long-term strategy, unless CRMCo out-executes Microsoft. Some companies, such as Intuit, have done it successfully. Most have not. However, enterprise software is relatively new territory for Microsoft. It does not have the direct sales force that is typically needed in this space. Its partners are used to selling pure commodity products to IT professionals, whereas CRM is sold at the business leadership level. On the consulting side, Microsoft does not have a direct professional services capability either, which will limit its ability to service larger customers. Moreover, the complexity of developing such products cannot be underestimated, even for Microsoft. It took two years to release a follow-up to CRM 1.2. Microsoft is indeed a formidable opponent but it is not unbeatable.

What about focusing on markets where Microsoft does not compete? Based on Bill Gates's quote above, Microsoft wants to be in a position to compete on 95 percent of deals. With a large and growing partner network, the chances are that they will achieve a wide-enough market coverage to leave very few loose bricks for CRMCo. They are even targeting their next release for hosted, on-demand models so that their partners, primarily Telcos and Application Service Providers can enter the market with a cost-effective hosted solution and further commoditize the space. Nevertheless, for the same reasons outlined earlier, even Microsoft and its network of partners cannot achieve high market penetration overnight, if at all, partly due to inertia and partly due to the learning curve that Microsoft must go through.

The last option is to embrace and extend Microsoft CRM. The MS CRM 3.0 version certainly provides enough application platform building blocks for independent software vendors (ISVs) to extend the core product and develop vertical applications on top. CRMCo would be exceptionally well positioned to do this. To start with, it already develops on the Microsoft stack and has considerable expertise working with and extending the Microsoft technology stack. Further, if the Microsoft platform is not as flexible as CRMCo's, then it is an opportunity for

CRMCo to innovate and still retain the intellectual property and the incremental revenue. If the Microsoft platform is as flexible, then CRMCo has bigger things to worry about. As importantly, CRMCo would lower its development costs because it would have access to the MS CRM platform and could use that as its starting point instead of duplicating part or all of its components. Finally, it would become Microsoft's largest CRM partner overnight and thus command considerable marketing support. Considering that Microsoft spent \$50 million on an ad campaign to promote its MBS products in 2005 (Fried, 2006), we can see why this would be attractive to CRMCo.

The extend-and-embrace strategy is not without its downside. First, it would limit CRMCo's market scope to a growing but limited pool of MS CRM customers. Microsoft does not release its numbers for CRM license sales, but it claims that customer growth has exceeded 100 percent in 2004 and 2005 to reach 4000 customers and 100,000 users (Wilson, 2005). My educated guess based on qualitative data from various sources is that Microsoft CRM generates somewhere between \$80 million and \$160 million in license revenue a year. CRMCo's license sales are about \$20 million a year so CRMCo would need to capture 12-25 percent of the current MS CRM business to replace that revenue. Second, there would be an indeterminate amount of strategic risk because of loss of control and the dependency on Microsoft's success in CRM, product roadmap evolution and its behaviour as a strategic partner. Last but not least, while it would in theory lower CRMCo's development costs and potentially its marketing and support costs as well, it would also lower its margins since CRMCo would have to share its revenue with Microsoft.

4.1.4 How to Respond to On-demand Models?

On-demand competitors, particularly Salesforce.com, are stealing market share from CRMCo and other on-premise vendors. Dismissing Salesforce.com as a low-end CRM provider

would be foolish on CRMCo's part. Not only is it growing at close to 80 percent year over year, but it is also going up-market, broadening the scope of its offerings through AppExchange (Please see industry analysis) and recently signed an alliance agreement with Accenture (Hines, 2006), the largest CRM systems integrator and consulting firm in the world. Siebel, Oracle, and SAP all have been forced to launch on-demand offerings of their own to counter Salesforce.com and many other pure-play on-demand vendors. CRMCo so far has done nothing. The issue is whether or not it should venture into Software-as-a-service (SaaS) and if so, how?

CRMCo can choose to ignore the fastest-growing segment of the market, but at considerable risk. In its quest for growth, the on-premise model, while it still accounts for 90 percent of the market, is largely stagnant. SaaS is expected to grow at 20 percent annually through 2009 according to most analysts¹⁵. Growing revenues outside of on-demand would be doubly difficult. Not only would CRMCo have to displace other on-premise vendors, but it would have to do so with a similar value proposition to that of the incumbent. The issue here is not an idealistic debate about on-premise versus on-demand which some vendors are only too happy to engage in. Rather, it is simply a pragmatic choice.

On-demand is perceived to deliver lower TCO or at least a predictable cost model and more favourable cash flows for capital-starved customers, faster implementations, a means to overcome internal IT bottlenecks and a lower overall risk profile because it gives the customer an exit strategy. CRMCo has a choice. It needs to either address this value proposition by retooling its solutions to deliver a similar basket of benefits, or articulate how its solutions deliver a different set of benefits and why the buyer should find the CRMCo alternative more appealing.

¹⁵ For example, IDC research indicates that worldwide spending on software-as-a-service stood at US \$4.2 billion in 2004 and is expected to reach US \$10.7 billion by 2009, representing a compound annual growth rate of 21 percent (Knorr & Montalbano, 2006).

If CRMCo chooses to embrace the on-demand proposition, it can do so by developing its own offering, or acquiring a small provider of an on-demand CRM. Developing its own would be a very difficult and costly proposition. CRMCo lacks the core competencies and the organizational structure to achieve it. CRMCo's software engineers, bright as they may be, do not have expertise in developing multi-tenant architectures, which are necessary to achieve economies of scale. Moreover, on-demand models require operational excellence in hosting, provisioning, billing, data and system security and managing high-availability, massively-scaled data center operations. CRMCo does know how to do these. In addition, a subscription-based service would significantly alter the compensation structure for sales people, which may disrupt the revenue engine of the company.

Acquiring an on-demand vendor may be easier on paper, especially considering that there are at least 20 small new vendors on the market today (See Appendix 6.1.2, Companies Delivering CRM SaaS as of April 2006, for a more complete list). Recently, RightNow Technologies acquired Salesnet, an SFA on-demand provider, for \$9 million in cash (Snyder, 2006). Several others are expected to be acquired by larger vendors. Since the parent company ParentCo has signaled its appetite for acquisitions and has the balance sheet to support it, an acquisition is within CRMCo's reach.

In conclusion, central to CRMCo's dilemma in its decision to embrace on-demand or not, is the fact that the flexibility proposition is at odds with standardization. In considering on-demand models, CRMCo also needs to reconcile its flexibility-based positioning with an on-demand offering that is standardization-based.

4.2 Employee Retention

Whatever decisions and choices CRMCo needs to make at a strategic level, it must address the people issues, primarily employee retention. This section examines retention issues in

greater detail. The focus of this discussion is on the Vancouver centre where key company resources in R&D, professional services, and marketing are located.

4.2.1 The Culture

Since the acquisition by ParentCo, it appears that CRMCo has slowly but steadily lost its identity. It has been widely discussed in the Vancouver community that CRMCo has struggled to retain key employees. This is consistent with what Gartner has called “loss of market visibility post-acquisition and the loss of key management personnel” (Collins K., 2006).

To some extent this is to be expected. Part of the rationale for acquisitions in this maturing market is to consolidate executive management and corporate operations at the parent company in order to reduce costs and provide strategic consistency across the family of acquired companies. While this may make sense operationally, or even strategically, it does nothing to build morale and foster a nurturing culture where talent can thrive. Talented people need to be coached, mentored and inspired by competent, credible leaders. They also need to feel part of an organization that has a purpose and a reason for being (Collins and Porras, 1996).

To be fair, prior to the acquisition by ParentCo, CRMCo was already under the strain of cost-cutting measures and increasing market marginalization. To be sure, the shift from high-growth mode to maintenance and maturity mode also affects culture at a macro level that no management team can fully compensate for, no matter how attentive they are to the people issues in their organizations. The cultural changes taking place in the CRM industry are not unique to CRMCo.

Nevertheless, increasing marginalization in the marketplace as a whole and within the ParentCo family of companies in particular (for example, there was barely a mention of CRMCo in any quarter-end press release in 2006), compounded by the apparent lack of visible leadership,

has likely alienated several CRMCo team members and caused them to seek other career opportunities.

4.2.2 The Vancouver Market

The retention problem at CRMCo is all the more problematic because of the robust recovery in the Vancouver high-tech job market. A quick survey of T-NET, the British Columbia High Tech industry portal, shows 1276 open high-tech positions. In the last seven days, 247 positions have been posted (T-NET, 2006). Other job boards and industry insiders characterize the market for talent in Vancouver as very competitive and reminiscent of the high-tech boom of the late nineties, although without the exuberant excesses of that period.

This market is doubly challenging for CRMCo. It makes it much easier for talented CRMCo employees to leave if they wanted to, while it is increasingly difficult to recruit qualified replacements. The war for talent is an issue that CRMCo needs to address, unless its plans are to steadily migrate resources away from high-cost centres and towards low-cost offshore centres.

4.3 Issues Summary

In summary, the issues and choices facing CRMCo can be succinctly stated as follows. In its choice of markets, it must decide to either target differentiators regardless of industries or company size; or instead, keep its current narrower mid-market vertical industry focus. Inherent in this choice are CRMCo's capacity issues in product development, marketing, sales and service.

What follows is the choice of value for those markets. Namely, CRMCo must decide if developing and enhancing the platform flexibility is sustainable, in parallel with feature functionality build out, or if it must recognize the trade-off and choose one over the other. Lowering the total cost of ownership for the customers is also an issue that CRMCo must deal with, regardless of the previous choice.

In terms of its competitive strategy, CRMCo must decide to compete against, run from, or join Microsoft CRM. Ignoring Microsoft and hoping they will go away is not a long-term option. The same goes for on-demand models. To compete, either CRMCo must retool its value proposition to offer similar benefits, or it must reinforce the flexibility dimension to create a clear choice versus more standardized SaaS offerings. In addition, CRMCo may also choose to acquire an on-demand vendor to capture some of the growth in that segment and hedge its bets. Building its own offering is prohibitively expensive and disruptive.

Finally, whatever CRMCo opts to do in its choice of markets, value, and competitive strategy, it must also pay attention to the people issues. The choice in my view is clear. Either CRMCo tries to retain high-caliber talent and foster a culture that can support its differentiation strategy, or it gambles that a systems-maintenance mode coupled with natural attrition and an offsetting gradual relocation to lower-cost centres is the right choice in this maturing industry.

5 RECOMMENDATIONS

Where does CRMCo go from here? How does it go about addressing the issues highlighted in the previous chapter? The discussion now switches from: What choices does it have, to what choices should it make in pursuit of profitable growth and why? In answering this question, I shall start with what CRMCo is trying to do now, and then construct a path towards a more sustainable strategy. All the while, I shall stay grounded in reality and consider only those choices that are realistically achievable within the context of the industry and the parent company.

The current path that CRMCo has embarked on, under the parent company umbrella, is more or less a maintain-the-status-quo strategy, while the parent company pursues growth by acquisition. The latest takeover bid for CRMCo's competitor Onyx is a good example of this direction. In my view, to a large extent, the parent company is acting as a financial investor that acquires companies with steady maintenance revenue (cash flows) and wrings value out of the investments by consolidating operations and achieving economies of scale. This may be a sound financial strategy, which, given the maturing market, may even be necessary for small vendors to survive. However, it is not sufficient in the long term, especially as far as CRMCo is concerned. The consolidation model rests on the premise that revenue streams would be at least maintained over time, even as costs are being cut. To grow or at least maintain revenue in the long term, CRMCo still needs to resolve its strategic differentiation issues in order to create value that its customers and the market are willing to pay for. The adequacy of this strategy is also in large part determined by the competitive landscape. The more companies such as Microsoft,

Salesforce.com, SAP and Oracle/Siebel invest in enhancing their value propositions and market presence, the more CRMCo needs to invest in a clearer differentiation strategy.

Therefore, the first recommendation is to not get caught up in successive waves of mergers and acquisitions, because financial engineering and operational excellence are no substitute for an effective differentiation strategy that would allow CRMCo to create, articulate and deliver differentiated value to the market. If, however, CRMCo chose to stay on its current path without making any meaningful changes, then an acquisition of an on-demand vendor would be the next logical step to grow revenue.

The second recommendation that I am tempted to make is to redefine just what CRMCo's market is. In an influential paper from the 1960s, Theodore Levitt introduced the concept of "Marketing Myopia" where he asserts that every growth industry will ultimately decline, or at least slow down. Therefore, he argues, companies that fail to define the business they are in broadly enough are sooner or later swept by that decline, as they fail to recognize the growth opportunities that do not fit the narrow, product-focused definition of what they do (1975). He cites many examples of such companies in the "railroad" and "oil" business for instance, who did not think of themselves as being in the "transportation" and "energy" business instead. What I find most interesting are the parallels that one can draw with the CRM software industry. It is slowing down, and some segments may already be in decline, as more subscription-based alternative models gain momentum. To paraphrase Levitt's words: "Does CRMCo want to be masters of technologies for which it would seek markets, or masters of markets for which we would seek customer-satisfying products and services" (1975)?

CRM for financial services, homebuilders, and manufacturing does look like a step in the right direction because the focus allows CRMCo to gain a deeper understanding of these markets and use its flexibility advantage to satisfy customer needs in these markets with increasingly

targeted products. However, the real market should be defined by customer needs and problems not just by industry. Certainly, companies in an industry share a common set of problems, but the real problem that CRMCo is solving is *lack of flexibility in implementing and continually refining complex and customized customer processes for a company pursuing a differentiation strategy*. This is true in any industry. Hence, I am tempted to recommend that CRMCo redefine its market in terms of customer strategy orientation – in other words, differentiators – across all industries.

In theory, this market redefinition makes sense and has the potential to expose CRMCo to growth opportunities and increase the perceived value of its offering. The market potential for custom-built CRM applications is estimated at \$24 billion. According to AMR Research, more than 80 percent of the CRM market is made up of companies that want to build their own customized applications (Siebel Systems, 2005). This strategy would, however, require considerable investment on two fronts. First, CRMCo would need to redefine its product mix and invest in product development to support the new market orientation. Second, it would also need to scale up its operational capacity well beyond the current constraints.

The right product strategy to support the new choice of markets would inevitably have to address the product flexibility and total cost of ownership dimensions of the value proposition. To target differentiators in any industry would require simultaneously investing in deepening the flexibility advantage, while improving cost-effectiveness to the customer. The focus would switch from building specific functions and features to building easily customizable, modular capabilities that can be assembled and repurposed to suit customer needs relatively quickly. Therefore, investments would need to be made in strategic marketing as an organizational competence to implement a probe-and-learn model that uncovers customer needs and problems at a granular-enough level to design the right capabilities that satisfy most needs. In addition, product development would also need more high-calibre resources to solve the many complex technical problems inherent in building flexible application platforms and to meet the challenge

of breaking the trade-off between flexibility and cost-effectiveness, just as it did in the late nineties. In short, the right product strategy to support the new market focus would bring innovation back onto the corporate agenda, and innovation cannot be done on the cheap.

On the operations side, CRMCo would need to invest in its go-to-market capabilities and potentially in its service and support capabilities as well. The biggest problem CRMCo would face in this new model would be how to reach the market and effectively articulate the value proposition. How does one reach differentiators in several industries and convince them that CRMCo is the right choice? No established distribution or marketing channels exist to facilitate this. Pull marketing (Kotler, 2003) would be the only way to reach this market and that can be a very costly proposition. In addition, sales cycles are notoriously long for technology products that are intricately tied to the customer's strategy, so there would not be any quick wins either. The marketing and sales organization would need considerable investment.

A possible mitigation strategy against the implementation cost of this differentiation strategy would be to build out an extensive partner channel. CRMCo would need alliances on the product side and on the sales and marketing side. Product partners would sign up to build vertical applications on top of the CRMCo platform and help CRMCo penetrate vertical markets that it does not have exposure to, or domain expertise in. Marketing and sales partners would extend the distribution channels for CRMCo products and use their knowledge of their local markets to identify and mine the right prospect list. However, building out an extensive partner network, one that is in synch with the highly differentiated strategy would not be a trivial exercise. It too would require initial and sustained investment in recruiting, training and coordination. Even then, getting mindshare with partners who are also doing business with CRMCo's much larger competitors would prove exceedingly difficult. CRMCo would need to reverse the effect of years of virtual neglect of its channel partners, particularly in North America. This is yet another area of considerable risk in this strategy.

Incidentally, a differentiation strategy based on a broader definition of the market that CRMCo can effectively serve with a cost-effective, flexible CRM platform, in addition to being defensible, also offers the added benefit of addressing the on-demand issue. By focusing on differentiators that value flexibility, CRMCo would in effect neutralize the threat of on-demand models in its new chosen markets. As long as flexibility is cost-effective for the customer, on-demand alternatives would have little appeal to a differentiator. Why accept less flexibility, more standardization and loss of operational control when the cost trade-off is not even there?

In summary, this differentiation strategy, if properly funded and implemented, would restore strategic fit and create alignment between CRMCo's markets, its core competence in building flexible CRM platforms and its organizational capabilities. This is why I am *tempted* to recommend it as the ultimate strategy for CRMCo. The reason that I do not is because it is also fraught with risk along several dimensions.

Firstly, it exposes CRMCo to market risk. In conceptual terms, differentiators would value flexibility, but a real probe-and-learn model would need to be implemented to uncover what that means exactly. Customer needs are not well defined and may not be consistent or common enough to build products for. CRMCo may find itself pursuing "markets of one" which would erode any leverage in the model.

Secondly, this differentiation strategy also exposes CRMCo to technological risk. There are many complex problems to solve and difficult natural trade-offs to break in order to create the right products for this strategy. Faith in innovation cannot be blind to its complexity and ultimately the uncertainty of success. Thirdly, this strategy requires very large up-front investments. All innovative technology products do, but this one would necessitate a financial leap of faith that is inconsistent with the current corporate direction and emphasis on operational improvement.

Lastly, this strategy is also not unique. Siebel in the on-premise model, Salesforce.com in the on-demand world, and Microsoft as well are all pursuing different variations of the same strategy. While the future at Siebel following the Oracle acquisition is uncertain, Salesforce.com and Microsoft are betting on becoming the CRM platforms of choice. They are, in that regard, well ahead of CRMCo because they have already committed their organizations to this strategy. CRMCo on the other hand, would need another three years before this strategy would start paying off, if at all.

Consequently, this strategy, while sound in theory, is very risky and is therefore unlikely to be supported. The fact that this strategy also puts CRMCo on a direct collision course with Microsoft would further deter even the most optimistic executive. It is Microsoft, in fact, that represents CRMCo's most significant competitive threat in the long term, but in that threat lies an opportunity in disguise.

As a matter of fact, in my view, the best long-term strategy for CRMCo is to join Microsoft and transform itself into a Microsoft CRM partner. The embrace-and-extend model has served CRMCo well in the past, and I believe it is still the right approach and thus, my ultimate recommendation for CRMCo. To go from an independent CRM software provider to a Microsoft CRM partner does not score high on the emotional appeal scale. Not only is it a bruise to the ego, but, at first glance, it would also leave CRMCo even more dependent on Microsoft for its future success. This can be quite unnerving. However, it is better to depend on Microsoft for CRMCo's success than it is for CRMCo's failure. Let us examine the dynamics of this Microsoft-centric strategy.

To begin with, a relationship with Microsoft in this space, although asymmetrical, is characterized more by inter-dependence than by one-way dependence. Microsoft remains essentially a platform company. It may venture into applications such as CRM and ERP and

expand its own footprint in the value chain, but it does so in a very tapered fashion. Its entire business model outside of the consumer space is built around an ecosystem of partners that sell and deliver its solutions. CRM in the mid- and enterprise markets is still a high-touch business that Microsoft would be quite challenged to pursue successfully without partners.

In fact, Microsoft would stand to gain a great deal from a deeper relationship with CRMCo because it would meaningfully enhance its position in the market, on several fronts. CRMCo is a recognized brand in CRM with 1800 customers, the vast majority of whom are also Microsoft customers, since the underlying platform has always been the Microsoft technology stack. CRMCo has also successfully marketed, sold and delivered CRM in the mid-market and to a lesser extent in the enterprise space for many years and has several marquee customers and a solid track record of delivering value. Therefore, as an organization, it is a credible provider of complex business solutions whereas Microsoft is not. For that matter, neither are most of Microsoft's channel partners, who are more adept at selling commoditized IT solutions such as email, security and database systems. It is worth repeating that in order for Microsoft to fully penetrate the upper tiers of the market, it needs partners who can sell CRM at the business level, well clear of technology and technology procurement centres.

In addition to the brand and the organizational capabilities to deliver business value to the market, CRMCo also has extensive product development and domain expertise in its chosen markets. First, CRMCo's R&D resources, instead of competing with Microsoft on the platform side, would instead extend that platform and use the Microsoft product as a new starting point for further innovation. Customer portals, smart clients and marketing automation engines could be just a few of the obvious gaps in the MS CRM solution. Unlike Microsoft's other much smaller CRM partners, CRMCo would bring to bear a world-class development organization that can help bring Microsoft on par with its mature enterprise competitors. The relationship, on the product

side, would actually be quite symbiotic as each organization would focus on its areas of strength and leverage the partnership for a more complete solution.

Finally, CRMCo would help Microsoft penetrate three or four key industry verticals by migrating its deep vertical applications onto the MS platform. Even if Microsoft tried, it could not develop this on its own quickly enough. It takes years of trial and error and a committed investment in one vertical segment to gain the credibility and build out products that address the real needs of customers in that industry. Microsoft would instantly gain another foothold in three of its most coveted industries: financial services, manufacturing and healthcare. It could then use the more credible combined CRM solution to cross-sell its other enterprise server and application products.

The advantages for CRMCo are no less compelling. First of all, a partnership with a surging Microsoft Business Solutions division gives CRMCo a well defined, easily reachable, and growing market to target. The argument that MS CRM customers are too small a pool for CRMCo to play in is a matter of opinion. With a growth rate of 100 percent in 2004 and 2005, it is also a much less defensible opinion over the long term. The small size of the pool, as compared to the overall market, is also offset by the cost-effectiveness of reaching that pool. Not only would MS CRM customers be more easily available to CRMCo, but considerable marketing support would also be provided to reach the broader market, as evidenced by the \$50 million campaign to launch MS CRM 3.0 and other MBS products in 2005. Furthermore, until other software developers join the Microsoft ecosystem, CRMCo still has a great deal of leverage and can further negotiate exclusivity, or at least preferential support in its key vertical markets.

Second of all, CRMCo would gain on the product development side. The need to develop redundant platform components would be eliminated. What is the use of building the same capabilities that Microsoft is building? For example, integration with MS Outlook, or the Office

system would be instantly available in the base product. Building that functionality on its own is a proposition that today carries a high opportunity cost for CRMCo. Anything Microsoft does is considered a commodity by customers. Customers now expect this base functionality and would not be willing to pay extra for it. Microsoft can afford to develop these base capabilities because the high development costs are amortized over a large and growing user base. CRMCo, on the hand, has a much harder time justifying those types of investments. Its resources are better spent developing sophisticated capabilities for its vertical markets and extending what has already been built. In other words, CRMCo resources can focus on developing higher-value technology whether on the platform or application side, and generate better returns overall.

The third compelling reason for CRMCo to seriously consider this strategic alternative has to do with Microsoft's investment in developing an on-demand platform. For the same reasons already mentioned, Microsoft has the deep pockets and expertise to commit to these very costly endeavours. CRMCo cannot, but it can again leverage the existing Microsoft infrastructure to launch into this market. So, the Microsoft-centric strategy has the added benefit of also solving the on-demand dilemma for CRMCo.

The final and most compelling reason in favour of partnering with Microsoft CRM has everything to do with the realistic expected outcomes of all other alternatives. If we accept the premise that, strategically, Microsoft and its partners are going after CRMCo's market, and that whatever advantages CRMCo now enjoys are short-lived, what is the long-term alternative? In two or three years, the product and credibility gap will likely narrow. With each iteration of the Microsoft product and market strategy, CRMCo's options will diminish. The old adage of "if you can't beat them, join them" could not be more true in this case. Now is the time to take a bold approach, leave emotions and false pride aside, and deal with the harsh reality. Today, that reality can still be seen as opportunity in disguise. With the passing of time, there will likely be little need to disguise this as a missed opportunity.

My ultimate recommendation with respect to strategy is to partner with Microsoft. What needs to be addressed, finally, is how this strategy impacts the people issues already identified. More importantly, what is the right HR solution to support this recommendation? It is easy to see why this strategy, on the surface, does not have a great deal of emotional appeal. As a matter of fact, it may seem downright deflating for the morale of the organization to become a competitor's partner, just two years after being acquired. Indeed, to pursue this strategy is to embark on yet another major organizational change initiative. Whereas management is about coping with complexity; coping with change, by contrast, requires leadership (Kotter, 2001). It is in fact Kotter's definition of leadership in the context of change that offers the three major pillars of a credible HR strategy to support this recommendation. In his article, "what leaders really do" (2001) he lays out a system of action that consists of setting direction, aligning people and finally, motivating and inspiring them. This system of action will be adapted to construct the right HR solution in support of the strategic recommendation.

For starters, setting a direction or a vision for CRMCo's Microsoft-centric strategy need not degenerate into the mystical nor try to create a pipe dream. Simply, it would be to plainly articulate what the strategy is, the rationale for it and what success looks like. "The crucial point about vision is not its originality, but how well it serves the interests of important constituencies - customers, shareholders, employees - and how easily it can be translated into a realistic competitive strategy" (Kotter, p. 5). While some employees may be turned off by the lack of a lofty ambition, it could be expected that most would at least recognize that it is viable in the long-term. For this component of the HR solution, the important element is the clarity of vision and the likelihood of success, because it is the belief in the ultimate success of a strategy that would start to secure the employees' commitment. Granted, this vision would fall short of Google's mission to organize the world's information for example, but it would still provide clarity and a sense of purpose. Even if some choose to leave, those who do not would at least form a new core of

people with whom this new mission resonates. The other important component in getting buy-in for this strategy is to emphasize that it does not mean that CRMCo would stop innovating and therefore providing exciting career paths for its people. Rather, it is a new perspective on innovation where the Microsoft CRM product would be its new baseline, or starting point.

The second axis of the HR solution is to create organizational alignment. This part of the solution would focus on sustained two-way communication and new organizational structures. The communication program would include every available channel, every available forum and a mix of formal and informal settings. What is important is for credible leaders in the organization to have an open and ongoing dialogue with staff, peers, and bosses to make sure the overall direction is understood and that concerns are acknowledged and discussed.

In addition to communication, the second component would involve some organizational re-design. In fact, a closer alignment with Microsoft to enable the embrace-and-extend strategy would make a great deal of sense on the people side as well. For example, the technical support team would no longer be completely independent, but would instead work very closely with technical support at Microsoft to coordinate the management and ownership of customer issues. Marketing and sales would also need to be more integrated with their Microsoft counterparts in order to benefit from Microsoft's marketing momentum and participate in the design and execution of go-to-market activities. A joint engagement model would have to be in place in order to minimize friction at the execution level. Because the strategy is mutually beneficial over the long run, there should not be any fundamental conflict at the execution level.

In addition to a more methodical alignment with Microsoft's internal groups, CRMCo would also need to make some structural changes. The alliance management group, for instance, would have to play a much more prominent role in creating and managing this alignment. Therefore, the group would need to be beefed up with experienced business development

professionals and technical architects, some of whom would be located in Redmond where Microsoft is. Furthermore, the platform development group would also be impacted, but not necessarily in a negative way. In fact, their role would be redefined to use the Microsoft CRM product as the new starting point. As identified in the preceding discussions, several major product gaps still exist. From marketing automation capabilities, to customer and partner portals, to a rich desktop client besides MS Outlook, the opportunities are there for the platform group to extend MS CRM in a very meaningful way and still innovate. Finally, this strategy would also be more compatible with the hybrid local and off-shore resource model. This is the path that CRMCo is already pursuing anyway. This strategy would just make it a little more tenable. Off-shore development would be better supported by the existing Microsoft partner resources and infrastructure such as presumably-better documentation and the Microsoft Developer Network (MSDN) Web site. Since CRMCo's value contribution would be more in design and intimacy with its chosen verticals than in actual programming, local resources would also find the new focused scope more sustainable, manageable and a better fit with their location closer to the customers.

The third and final axis of the HR solution consists of motivating employees and securing their commitment. "Just as direction setting identifies an appropriate path for movement and just as effective alignment sets people moving down that path, successful motivation ensures that they will have the energy to overcome obstacles" (Kotter, 2001, p. 9). Motivation would have to include intrinsic and extrinsic components. The extrinsic components would focus on overall compensation, profit-sharing or some other reasonable participation in the expected financial upside, as well as investments in employee development. The overall level of compensation is largely dictated by the local markets, and to that extent CRMCo would need to be in the fiftieth percentile, at the very least. Profit-sharing or pay-for-performance plans would also be necessary, in order to give employees a stake in the ultimate success of the strategy. This is less about

fairness and more about common sense, as pursuing that desired vision would otherwise become a hollow statement. Lastly, skilled employees are far likelier to commit to the organization if it is committed to their career path. A partnership with Microsoft would offer a tremendous opportunity, at least for technical talent, to get deeper training on the Microsoft stack and exposure to exciting new products.

For all the extrinsic motivators, however, there is no substitute for “satisfying basic human needs for achievement, a sense of belonging, recognition, self-esteem , a feeling of control over one’s life and the ability to live up to one’s ideals” (Kotter, p. 9). While these may sound like motherhood-and-apple-pie statements, they are nonetheless true. We live and work in an age of empowerment, and talented employees always have alternatives. Only *skilled* people are able to create value for CRMCo’s customers. Only *motivated* skilled people will. This would suggest that the level of autonomy in the organization overall would need to be increased, in part to compensate for the smaller scope that employees have to play with. In addition, HR-supported programs for recognition, career planning and for fostering a sense of community within the organization would also need to be enhanced, codified, and permanently funded.

Action along the three axes of vision, alignment, and motivation is what CRMCo needs in order to provide the kind of environment that talented people, in a competitive labour market, respond well to. Only if these talented people believe in the company’s vision, understand their role in the company, and can see why they should choose CRMCo when they have other alternatives, will the company be ultimately successful. CRMCo has enough talent and enough leadership potential to right the ship. It is a company with a proud history, incredible human potential, supportive and happy customers, a successful track record and financial backing. Many more companies would envy its position. CRMCo can still do better.

6 APPENDICES

6.1 Appendix 1 – Industry Data

6.1.1 Highlights of CRM Vendor Consolidation Since 2004

Event	Closed
Marketic to Unica	5/16/2003
DataDistilleries to SPSS	11/5/2003
Accpac/eWare to Sage Software	1/19/2004
Ascent to Ciber Acquisition	5/21/2004
Interface to LexisNexis	12/13/2004
KIQ to Chordiant Software	12/21/2004
Primus/Amacis to Art Technology Group (ATG)	12/27/2004
eDocs to Siebel Systems	1/17/2005
Blue Pumpkin to Witness Systems	1/24/2005
ServiceWare Technologies/Kanisa becomes Knova Software (Merger)	2/8/2005
Vidus to @Road	2/22/2005
Team Brendel to SuperOffice	3/14/2005
Apama to Progress Software	4/6/2005
Blue Martini Software to Golden Gate Capital	5/10/2005
PeopleSoft to Oracle	6/1/2005
etalk to Autonomy	6/3/2005
DoubleClick/SmartPath to Aprimo	6/14/2005
Sygnnet Interactive to Nvigorate	6/20/2005
Aims Software to smartFOCUS	7/5/2005
DWL to IBM	9/1/2005
Opus Group to Verint Systems	9/2/2005
FieldCentrix to Astea International	9/21/2005
MDSI Mobile Data Solutions to Vista Equity Partners	9/22/2005
Aspect Software to Concerto (Merger)	9/23/2005
Epiphany to SSA Global	9/29/2005
BroadVision to Vector Capital	NA
Siebel Systems to Oracle	1/31/2006
Intenia International to Lawson Software (Merger)	Apr-06
iFlex investment by Oracle Investment	NA
Regware to Update Software	10/7/2005
Quadstone to Portrait Software	Dec-05
FDV Concept to Coheris	3/3/2006

Based on The Gartner CRM Vendor Guide: 2006, (Maoz et al., 2006).

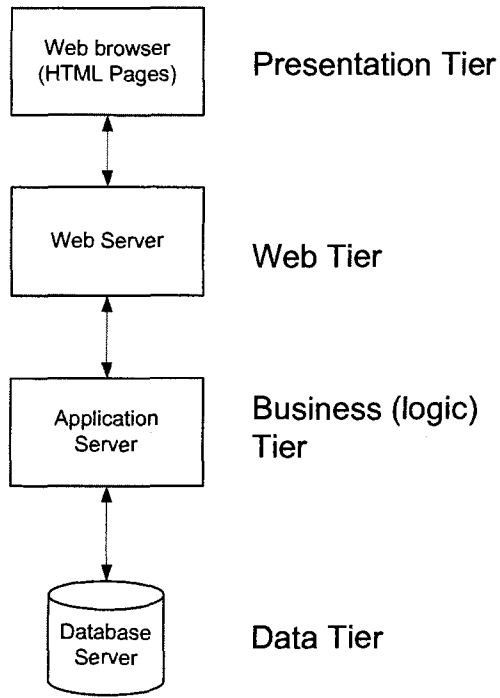
6.1.2 Companies Delivering CRM SaaS as of April 2006

	Marketing	Sales	Service	eCommerce	ASP
ArtTechnology Group (ATG)	x		x	x	
@ Road			x		
BigMachines		x			
Centive		x			
Contactual					x
Demandware				x	
Dendrite International		x			
eGain Communications			x		
Entellium		x			
ForceLogi		x			
Gelco Trade Management		x			
Imano				x	
Innovatia					x
Involve Technology		x			
LightEdge Solutions					x
Mobile Computing Corp.			x		
NetSuite		x		x	
Parature	x	x	x		
RightNow Technologies	x	x	x		
Safeharbor Technology					x
Sage Software		x			
SalesLogi / Sage Software	x	x	x		
Salesforce.com	x	x	x		
Salesnet		x			
SAP		x			
Siebel Systems (Oracle)	x	x	x		
StayinFront		x			
Venda				x	
VeriSync		x			
Xactly		x			

Based on *The Gartner CRM Vendor Guide: 2006*, (Maoz et al., 2006).

6.1.3 N-tiered Application Architecture

The diagram below illustrates a simplified break down of the architecture of a modern enterprise application where tasks are divided along four discrete tiers.



6.1.4 CRM Software Applications Spending by Company Size, 2002

	% of spending
Very Large Business (2,500 or More Employees)	47.3%
Large Business (1,000-2,499 Employees)	26.4%
Midsized Business (100-999 employees)	22.9%
Small Business (1-99 employees)	3.4%

Based on Gartner SMB CRM spending estimates (Topolinski, & Close, 2004).

6.2 Appendix 2 – CRMCo Data

6.2.1 Total Cost of Ownership (TCO) Vendor Comparison

Vendor	Year 1	Year 1	Year 3	3-year Total Cost	3-year Cost per User
Onyx	\$ 660,673	\$ 126,102	\$ 146,102	\$ 932,877	\$ 5,455
Siebel Mid-market Edition	\$ 548,232	\$ 162,496	\$ 199,660	\$ 910,388	\$ 5,324
CRMCo	\$ 592,701	\$ 117,764	\$ 107,864	\$ 818,329	\$ 4,786
Salesforce.com Enterprise Edition	\$ 290,451	\$ 236,875	\$ 236,875	\$ 764,201	\$ 4,469
Microsoft CRM Professional Edition	\$ 502,771	\$ 98,150	\$ 98,150	\$ 699,071	\$ 4,088
SalesLogix	\$ 447,990	\$ 115,410	\$ 98,010	\$ 661,410	\$ 3,868

Based on a TCO study conducted by Gartner which used a typical mid-size business scenario with 170 CRM users. The three-year costs include software and hardware purchases, professional services and the cost of upgrades and maintenance for the buyer (Close, Eisenfeld, Davies, & Bona, 2004).

6.2.2 Revenue Estimation Method for 2004 and 2005

	2005 Revenue	% of total	Increase over 2004	Estimated 2004
licenses (9 month 2005)	\$ 13,000	29.4%	4%	
Maintenance (9months 2005)	\$ 18,000	40.7%	11%	
Services (9 months 2005)	\$ 13,200	29.9%	4%	
Total (9 months 2005)	\$ 44,200		6.9%	:Weighted % change
Q4 2005 total revenue estimate	\$ 16,989	>> 15.9	announced in Q4 2004	plus 6.9%
Total revenue estimate	\$ 61,189	>> Less 6.9% =		\$ 57,266

Based on November 25, 2005 press release (ParentCo, 2005). Numbers in italic and a background colour are estimates. All other numbers are published in the press release. All numbers in thousands \$USD.

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