SMART e enterprise

2001 SMART ENTERPRISE CONFERENCE REPORT

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The report of the 2001 SMART Enterprise Conference, and all previous Enterprise reports and conference information, are available on-line at www.sandhill.com

introduction

The Sand Hill Group and McKinsey & Company are pleased to present this report summarizing the results and perspectives of 2001 SMART Enterprise. The conference, held on October 28, 2001, at Half Moon Bay, provided a forum for over 125 sales and marketing executives to discuss the sales and marketing environment in the enterprise solutions industry. The 2001 SMART Enterprise Conference, sister event of the Enterprise 2001 Conference, was the first sales and marketing event of its type.

Not surprisingly, the discussions and presentations at 2001 SMART Enterprise focused on managing sales and marketing during an economic downturn and in the aftermath of the September 11 tragedies. Participants, speakers, and panelists discussed key industry trends and approaches to weathering the current environment and offered their insights on the need to achieve position within the industry for eventual economic recovery.

This report provides a summary of each of the conference's three main discussions: challenges in the enterprise software industry; selling in the downturn; and marketing in the downturn. For conference participants, we have included an appendix containing benchmarking data from both the Quick Tally survey results at the conference and an on-line pre-survey given to participants.

The key takeaway from the 2001 SMART Enterprise Conference as a whole is that most sales and marketing executives will need to fundamentally rethink their go-to-market approaches if they are to succeed in today's difficult environment. Ray Lane, General Partner Kleiner Perkins Caufield & Byers, summarized this imperative as "the decade will witness the end of the 20th century corporation." The rethink is likely to involve some combination of the following four efforts.

1. REPOSITION SALES AND MARKETING AROUND CUSTOMER VALUE. To succeed in a tough environment, enterprise software companies must focus first and foremost on delivering value to their customers. Companies cannot simply rely on new marketing collateral and catch phrases. They must reorient every facet of the business around creating value for the customer – sales, service, incentives, public relations, and alliances. In addition, companies must take greater responsibility for results. Too often, the industry has adopted the attitude best paraphrased by Bruce Richardson of AMR Research that "I sell exercise equipment to you and if 6 months later you are still fat, that is not my fault." Going forward, software vendors will be held responsible for delivering business results, not just delivering the software.

2. REALIGN BUSINESS MODELS AROUND THAT EMPHASIS ON CUSTOMER VALUE. Business models in the enterprise software industry are in flux. Although the upfront license fee is the primary revenue model for 65 percent of the conference participants, newer models – subscription fees (19 percent) and transaction fees (8 percent) – are gaining in popularity. These models are likely to coexist for the foreseeable future. Regardless of the business model, in the short term, companies must increase pricing flexibility to reduce the costs of trial for new customers. Longer term, business models must better align with customers' interests by linking revenue attainment with customer value attainment.

3. BRING A LASER-SHARP FOCUS TO EXECUTION. In the face of declining demand everything has to be done better – by both the large companies who want to maintain their position and the smaller companies who want to break in. The sales discussions raised the importance of realistic planning, management attention to the details of each deal, rigorous pricing management, and relentless pipeline reviews. Similarly, the marketing participants discussed the importance of helping choose which marketing vehicles to use to eliminate specific bottlenecks along the customer relationship process.

4. INVEST IN INNOVATION AND RELATED SALES AND MARKETING SUPPORT. The economic slowdown has forced many companies to cut back dramatically on their sales, marketing, and development organizations. Although some retrenchment was undoubtedly necessary, companies must be careful not to undermine their ability to compete as markets rebound. The Internet is still in the early stages of its development as an enterprise platform. Portals, real-time applications, advanced analytics, and Web services all provide opportunities to extend and enhance the value of existing infrastructure investments. As Ray Lane said at the conference, "Innovators become leaders," especially in down markets.

We hope you find this report both provocative and practical as you plan and prepare for the challenges confronting your own organization in the coming year.

SAND HILL GROUP LLC

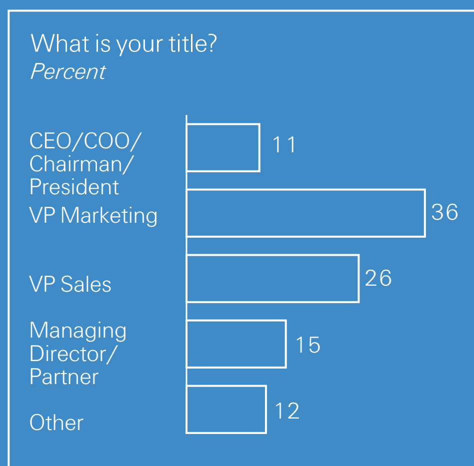
M. R. Rangaswami (mr@sandhill.com)

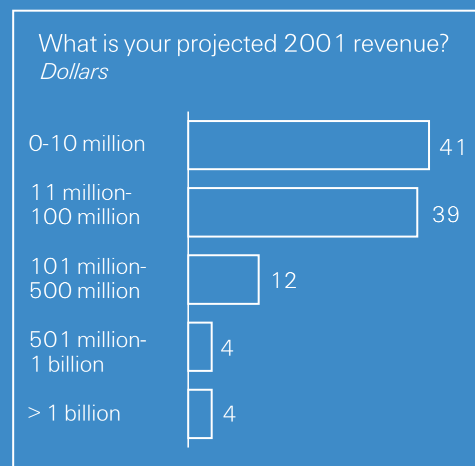
McKINSEY & COMPANY

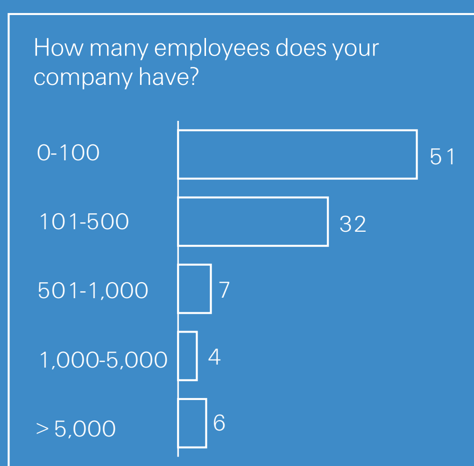
Kathleen Hogan (kathleen_hogan@mckinsey.com)

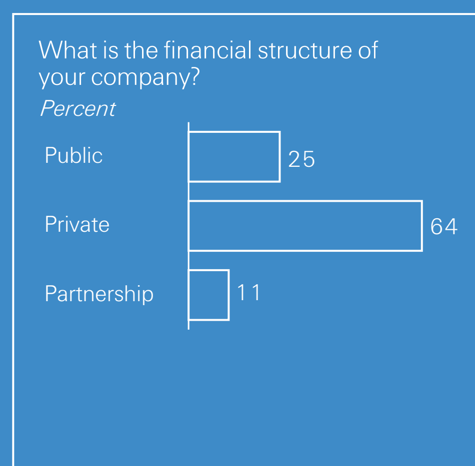
the participants

The overwhelming majority of individuals attending the 2001 SMART Enterprise Conference were sales and marketing vice presidents. The mix of companies represented was very similar to that of the 2001 Enterprise CEO Conference – in revenue, number of employees, and ownership structure. The top software sectors represented were supply chain management (31 percent of companies represented), CRM (17 percent), and enterprise infrastructure (17 percent).





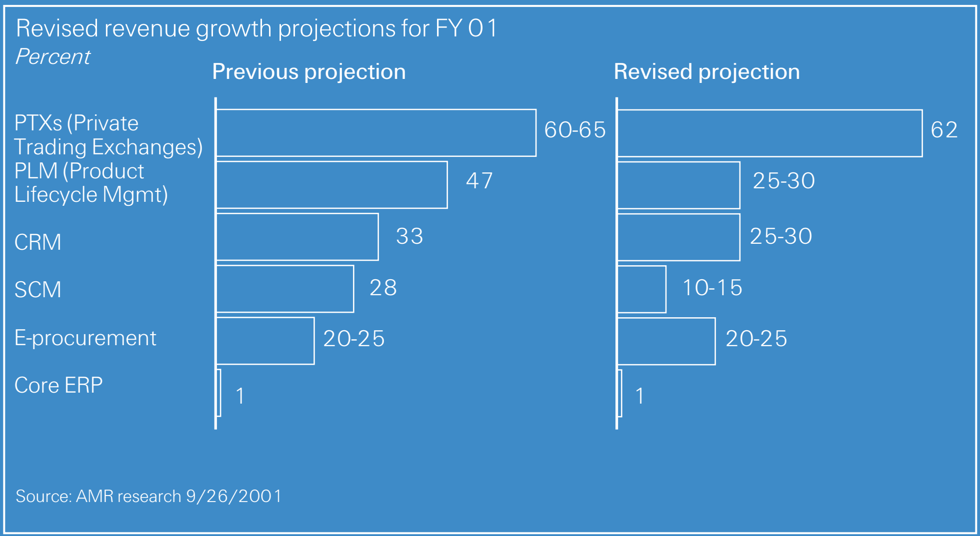




challenges in the enterprise software industry

The enterprise software industry, like all sectors within high-tech, has been deeply affected by the overall economic climate in 2001. Growth has slowed from 35 percent in 1998 to 11 percent last year, and overall software industry revenue was down 5 percent year-to-year in the second quarter. Analysts have cut their growth forecasts, and the majority of conference participants (68 percent) do not expect economic recovery before the second half of 2002 or even 2003 (25 percent).

Behind this general picture lie four very specific challenges for enterprise software players. Customers are spending less overall; demand for business value, particularly productivity improvements, is increasing; competitive structure is increasingly favoring a few large players on both the market and the investment side; and new influencers have increasing control over IT spend decisions.



CUSTOMER SPEND ON IT PROJECTS IS SHRINKING

Customer spending on enterprise software has slowed significantly over the past year. More than half the CIOs in a recent Morgan Stanley CIO survey report budget cuts and note that they are taking longer to make purchasing decisions. As one conference participant put it, “The biggest competitor is ‘no decision.’” Instead of buying major new systems, companies are making it a priority to capture the value of past infrastructure investments. In the words of Bruce Richardson, “CIOs are sitting on 5 years’ worth of investments and don’t have to buy new software.” As a consequence, according to another conference speaker, “The elephant hunting days are over – IT producers will need a land-and-expand model – quick ROI, flexible licenses." Customers are focusing on smaller upgrades rather than on major new spending initiatives. Customers are also buying more frequently from their current vendors and less often from new ones.

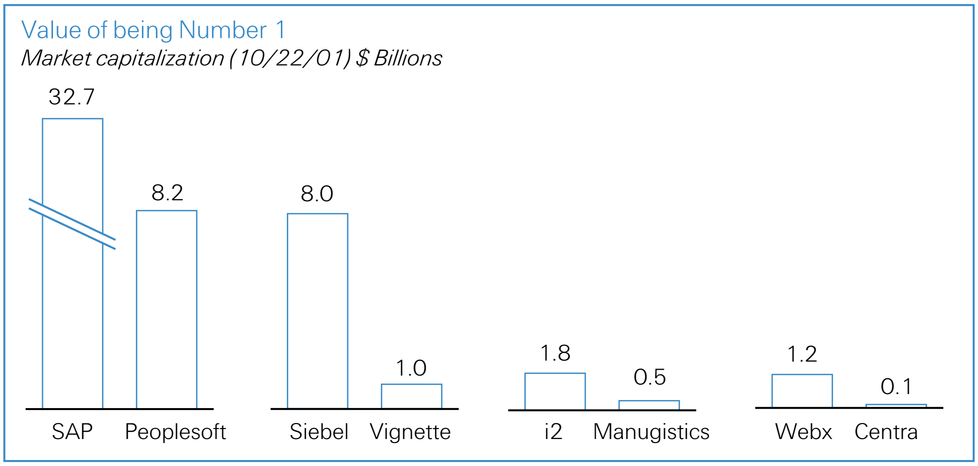
DEMAND FOR BUSINESS VALUE, PARTICULARLY PRODUCTIVITY, IS INCREASING

The economic downturn, and resulting pressure on budgets, is precipitating a change in enterprise IT decision making. Capturing business value, particularly productivity, from existing IT investments is increasingly an imperative for companies. Few industry sectors and companies have realized significant productivity improvements as a result of their IT spending over the past 5 years. Enterprises are "swearing off" huge, all-encompassing IT projects in favor of smaller stand-alone IT investments, often with payback requirements of 12 months or less. These changes have placed pressure on sales and marketing performance and will require significant shifts in the type of sales skills needed to sell to line-of-business buyers, new relationships with integrators and services companies, and new revenue models focused on delivering value upfront. This challenge was aptly summarized by one conference speaker: "Our industry is built on getting customers to make long-term commitments to a particular technology even if they do not need it; today, we need to work with our clients to drive value from what they have."

COMPETITIVE STRUCTURE IS INCREASINGLY FAVORING A FEW LARGE PLAYERS

With the economic downturn increasing competitive pressure on the enterprise software industry as a whole, it has become a fact of industry life that the one or two leaders in any segment fast crowd out the also-rans. The value of "owning" a market is significant. The market capitalization of a market leader in a segment can be five or ten times greater than that of the Number 2 player. Consequently, the number of software companies in the market, which skyrocketed from around 50 in the early 1990s to more than 2,500 a few years ago, is now dwindling rapidly.

For start-ups, competition for capital is paralleling market competition. For new entrants, the bar for attracting capital is rising. Exit options are becoming more difficult. The number of VC-backed IPOs in 2000 was 21 percent lower than the 1999 number. While abundant capital is still available, valuations have dropped significantly, requiring firms to manage cash more closely and to avoid investing ahead of demand, including for sales resources and marketing program spending.



NEW INFLUENCERS HAVE INCREASING CONTROL OF IT SPEND

The influence of systems integrators and other channel partners is increasing dramatically. Recent analysis shows that partner channels influence 35 percent of sales, and this number is expected to grow sharply over the next few years. In addition, the CIO is no longer the final decisionmaker on many software purchases. Studies show that more than half of IT spending is already controlled by line-of-business/CXO buyers, and that their spending is growing while the IT-controlled spending is flat or shrinking.

The sales presentations, panels, and discussions focused on five actions that salesforces and sales management need to take to help their companies succeed in an environment of declining demand, more demanding customers, increased competition, and new influencers. Sales groups in both large and small companies need to:

1. Take a value-based selling approach
2. Bring a laser-sharp focus to execution
3. Align salesforce incentives with the value-based approach
4. Align revenue models with the value focus
5. Expand the alliance "ecosystem."

1. TAKE A VALUE-BASED SELLING APPROACH

Given customers' increasing demand for value, their buying factors are increasingly moving away from a focus on features and functionality to a focus on value, ROI, and bottom-line impact. Obviously, effective selling approaches will have to mirror this shift. Salespeople must increasingly be able to demonstrate the value of their offerings. The customer cost/value ratio has changed – customers are looking for more proofs of concept, more ratability versus upfront deals, and more value upfront.

Some version of a "supply chain opportunity assessment" (SOA), the methodology pioneered by i2, is now used by about one-third of the companies represented at the SMART Enterprise Conference (based on attendees self-reported results). Users characterize benefits as increased average selling price, improved predictability of conversions, access to CXOs with a compelling story, improved account penetration, and more seamless collaboration with systems integrators and consultants.

The balance of the group's discussions on value-based selling focused on the critical factors for successful implementation. Obtaining customer commitment to participate in the creation of an individual business case (the "value assessment") is the most challenging element of value-based selling. A well-executed assessment will lead to having something to say at the CXO meeting and will be full of insider knowledge and insights into the organization. An assessment can also improve alignment with other consultants and systems integrators who are active in the account.

More specifically, there are six key success factors for value-based selling:

- Ensure that your solution provides an ROI proof point using customer references. Ideally, that proof point also relates to the CXO's top agenda items.
- Do not shortcut the value assessment, as this will lead to delays or added pricing pressure later in the sales cycle. Also, charge the customer at least a nominal fee for the assessment to ensure that the resulting business case will have an audience.
- Maintain a consistent value focus throughout the sales cycle. Once the conversation shifts from value to price or features and functionality, it is very hard to get back to value. Consequently, do not quote a specific price before the assessment is complete, as a price that is not linked to value can derail the conversation.
- Create a new position (business consultant) with a value-based selling focus to support the salesforce. The existing salesforce often lacks the customer business process knowledge or the business acumen needed to conduct an assessment. In these cases, companies must find ways to bring in consultant-like resources to conduct the value assessment, often hired from the outside. In McKinsey's experience, only 15 to 20 percent of the members of a typical salesforce have the necessary solution-selling skills.
- Leverage the customer's employees who participated in the value assessment to do some of the selling for you.
- Follow up by measuring impact with your customers, creating a reinforcing cycle.

2. BRING A LASER-SHARP FOCUS TO EXECUTION

Obviously in the face of declining demand everything has to be done better – both by the large companies who want to maintain their position and the smaller companies who want to break in. To that end, the conference participants discussed the importance of realistic planning, management attention to the details of each deal, rigorous pricing management, and relentless pipeline reviews.

Develop realistic sales plans

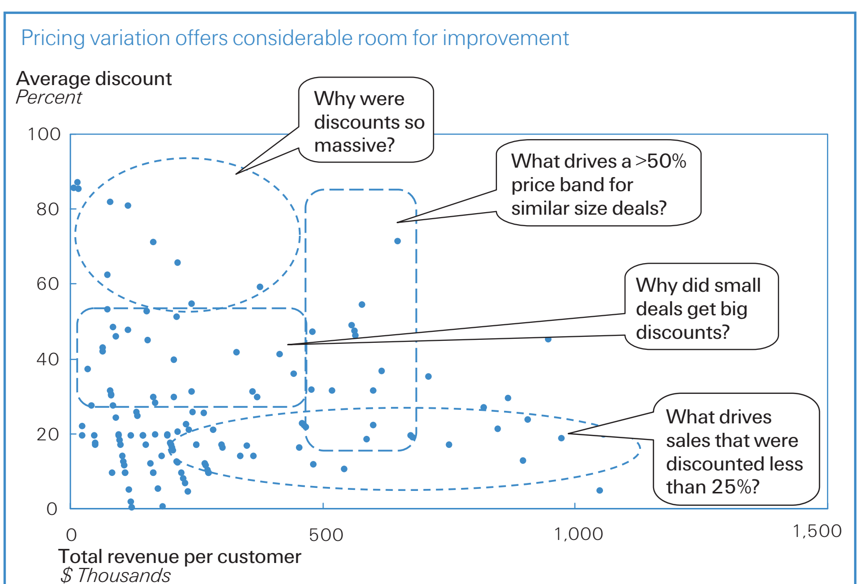
In planning for the next year, for most companies, budgets and forecasts based on historic revenue will fail and investing ahead of projected demand will prove a trap. Instead, presenters recommended starting with current salesforce productivity and generating a conservative resource plan. Should sales improve, companies can then hire from the baseline resource level. Should sales stay flat, companies will have been spared multiple rounds of layoffs and the associated turbulence and motivational issues. Not investing ahead of demand is especially important for cash-strapped start-ups, as venture capital funding is increasingly tight. In addition to conservative resource planning, tiering service and support levels based on customers' future sales opportunities and moving from a pure face-to-face (FTF) sales model to hybrid models that combine FTF, telesales, and the Web can achieve significant efficiencies. In McKinsey's experience, these innovations in sales and service models can yield up to a 40 percent cost advantage over one-size-fits-all FTF models.

Focus management attention on the details of each deal in the pipeline

Management plays an especially important role in the current sales environment and managers need to pay attention to the details of each sale. Early in a deal, management needs to ensure that the potential customer has been vetted and deemed financially viable, that the sales team has communicated ROI messages, that the approval, contracting, and funding process for a sale is thoroughly understood on both sides, and that all necessary senior people are brought into the deal early, since they can only give away margin if they engage too late. In addition, management will have to help orchestrate the collaboration with systems integrators and consultants. Also participants underscored the need for management to focus on the mouth of the funnel versus closing deals, since a natural inclination in tough times is to get involved in final negotiations.

Manage pricing rigorously

When salesforces are hungry, pricing management becomes critical. Understanding pocket margins, the net amount of money left in your pocket after all the on- and off-invoice discounts have been accounted for, will lead to an initial set of improvement levers. For example, discount sizes and deal sizes are often unrelated (see scattergram below). Determining the causes of this variability (e.g., specific regions, salespeople, or sales approaches) enables companies to identify and employ countermeasures. Implementing best practice pricing leads to bottom-line return-on-sales improvements of 2 to 7 percentage points in McKinsey's experience.



Source:McKinsey

Conduct regular pipeline reviews

Successful companies "live and die by pipeline reviews." Pipeline reviews need to be disciplined, executed weekly, and focused on moving opportunities through the pipeline. Senior management must be involved in the reviews. In the case of start-ups sometimes even the board needs to be involved. Consistent focus on opportunities, not just at the beginning of the quarter, smoothes demand and lets companies escape the end-of-the-quarter phenomenon where 60 percent or more of revenue closes in the last 2 or 3 weeks of the quarter.

Half of the attendees' companies have deployed a CRM system and view automation as "mandatory," especially for managing large pipelines. However, even a small, simple solution can be sufficient. Maximum benefit will come from a holistic approach that integrates customer service and CRM .

3. ALIGN SALESFORCE INCENTIVES WITH THE VALUE-BASED APPROACH

Compensation principles also need to be revised to align with marketplace trends and customer needs. As one conference speaker put it, "The traditional approach was to get sales reps to sell something, even if the customer did not need it today; this will need to change toward focusing on providing customer value and ensuring overall customer satisfaction." Customer satisfaction is in fact rapidly gaining importance as a compensation element. One company said it ties half of a salesperson's bonus to an element of customer satisfaction, and another provides customer satisfaction incentives to everyone, including developers.

In addition, companies must continue to find ways to properly motivate their salesforces with financial and nonfinancial incentives.

On the financial side, it is unrealistic and discouraging for the salesforce to revise overall revenue expectations downward without changing sales plans. Salesforces have increasingly learned to live with sales plans that change during the year, so now may be the time to revise plans downward. In addition, some SMART Enterprise participants mentioned that their companies are exploring offering higher upside potential on top of adjusted plans.

On the nonfinancial side, participants favored encouraging sales teams by celebrating every win through internal PR, leveraging customer testimonials, providing details of competitive wins, and reviewing actual ROI achieved.

Finally, companies should rigorously review the performance of their key sales personnel. Over the past few years, strong demand and rapid growth have led to a frenzied hiring environment. In many cases, companies were forced to hire candidates with less experience at higher salaries than they had initially planned. The industry slowdown, while painful, offers companies an opportunity to reevaluate the entire team to ensure that "A" players fill key roles.

4. ALIGN REVENUE MODELS WITH THE VALUE FOCUS

Eighty-five percent of the conference participants mentioned that they were actively "morphing" or repositioning their company, and 33 percent said they had changed their primary revenue model within the past year. Although the most prevalent primary revenue model is still the upfront license fee (65 percent), a significant number of companies are leveraging newer pricing models, including subscription fees (19 percent), and transaction fees (8 percent). Participants expect the current multitude of models to continue to coexist.

Aside from new software/service delivery vehicles such as portals, Web services, and software releases that are installed by the vendor behind a customer's firewall, the majority of business model changes discussed related to adapting to the changed customer demands and market environment. Smaller deals and quicker ROI demands mean that investment payback sometimes has to materialize in the same customer budgeting period as the investment itself. This requires major flexibility in vendors' approaches – e.g., using launch-and-expand strategies that build beachheads and demonstrate quick ROI at moderate entry prices, adopting a customer life cycle/NPV view, or creating flexible service agreements and bundles.

These newer models can help companies increase flexibility and value orientation. For example, new customers can reduce their costs of trial by signing up for a 3-month subscription for a new software application and then switching over to a longer term license once the technology has proven its value. In addition, subscription, transaction, and other ratable pricing models can better link revenues with the customers' value attainment.

These models can also provide greater visibility and reduce end-of-quarter discounting. Companies must carefully plan business model changes, however. Switching from an upfront license model to a subscription/ratable revenue recognition model, for example, will have a large impact on reported earnings during the transition. In addition, these new models have significant cash flow implications, and many smaller companies will need to tightly match expenses to revenue to avoid a liquidity crunch. Finally, these models have wide ranging implications for how companies manage themselves. Compensation models must be revamped and companies will have to rethink how they market, sell, and support the new models.

5. EXPAND THE ALLIANCE "ECOSYSTEM"

Building and mobilizing a diverse, integrated network of technology partners, systems integrators, and other partners is becoming increasingly critical for success in the enterprise software industry. The industry is seeing an increase in the number of channels, renewed customer focus on preferred partners, a move to multipartner relationships, and a shift in mindset from marketing partnerships to strategic relationships. Recent analysis shows that partner channels influence 35 percent of sales (Ernst & Young's Technology Partnering Conference Report, 2001), and this number is expected to grow sharply over the next few years. In particular, systems integrators are fundamental to scaling software businesses. Channel partners can also provide cost-effective leverage bringing both more leads from existing customer relationships and specialized skills in specific products, solutions, and services.

Participants offered five tips for building effective alliances:

- Seek a few but best-in-class alliances based on business objectives; start with building a partner taxonomy – who adds value, where, what, and how
- Establish rules for sharing IP (intellectual property,) especially with nonexclusive partners, but leverage partners back in to product design
- Don't rely on "rules of engagement" alone; provide incentives to all players – direct and indirect – to "team"; for example, some companies pay salespeople a greater commission for sales booked through channel partners
- Avoid cookie cutter solutions; balance effectiveness in delivering customer value with complexity of channel network
- Manage partners like your salesforce – pick top players, invest in capabilities, set clear objectives, and practice strict quality control; understand that recruiting, developing, and managing partners are three very different skill sets.

The marketing presentations, panels, and discussions focused on four actions that marketing groups need to take to help their companies succeed in the face of declining demand, more demanding customers, increased competition, and new influencers. Marketing groups of both large and small companies need to:

1. "Own" the market
2. Identify and remove marketing bottlenecks
3. Invest in reference customers
4. Measure marketing performance against quantifiable metrics.

1. "OWN" THE MARKET

Enterprise software companies can rarely differentiate themselves in technology, particularly as product lines mature. A company will almost never be able to maintain differentiation from me-too competitors by consistently leading in product development, nor will it be able to sell itself to sales leadership, due to high cost and low scalability of high-performing sales reps. Successful marketing must establish ownership of a specific market segment and thereby create pull that the salesforce can leverage. Marketing's success in creating product pull will be seen in the reduced amount of "hand-to-hand combat" in which sales has to engage. Over time, Number 1 and Number 2 players in a space succeed; most if not all other players fail. Marketing must develop the thought leadership and value propositions that resonate with target segments. In other words, according to the familiar phrase, "market the vision, sell the product." To do this, marketing must sell internally as much as externally.

To own a market segment, marketing must lead the strategy development process. Beginning with a clear understanding and articulation of the customer problem at hand, marketing must synthesize business and technical benefits into a value proposition that candidly acknowledges the company's strengths and weaknesses. For companies in competitive categories, marketing must detail how the company's approach is superior to the competition's. This does not mean a feature war, but rather a reasonable explanation of why the company's model solves the problem better. For new categories, the challenge is explaining why competitors are not addressing the situation/opportunity adequately.

2. IDENTIFY AND REMOVE MARKETING BOTTLENECKS

In the current environment, marketing's primary responsibility is to generate leads. Over half the marketing executives at the conference said that generating leads was their primary objective for 2002. Working backward from revenue goals, the marketing organization is responsible for developing programs to build the pipeline of potential customers, active leads, and current negotiations needed to meet these goals. This pipeline is called the "customer relationship funnel." Marketing activities help customers move through the stages of awareness, consideration, conversion, and retention. Every company must determine where in this process it is disadvantaged relative to the competition and then determine which marketing vehicles to use to eliminate the bottlenecks. For example, a company may consistently make it to the short list in deals but is chosen much less often than its two leading competitors. In this case, investment resources should be rebalanced from awareness or consideration toward conversion (e.g., through improved references or ROI tools).

In practice, the decisions about which marketing vehicle to use have been driven more by art and budget than by science. For example, one company reduced trade show expenditures in favor of referral programs. Several other companies increased their investments in converting active leads through joint programs attended by reference accounts and potential customers.

3. INVEST IN REFERENCE CUSTOMERS

Customer references are increasingly critical in generating new sales. One of marketing's primary responsibilities is to provide sales with reference customers and case examples to use in the sales process. Eighty percent of the conference participants view customer references as the most effective customer acquisition tool. However, strong references do not just happen. Companies must actively work with their accounts to ensure that the software is successfully implemented and delivers the promised benefits. In today's ROI-driven sales environment, the ability to cite true value creation requires both ensuring and tracking implementation success. Professional services is therefore marketing's primary partner in identifying and creating compelling customer case studies.

SMART Enterprise marketing panelists provided some practical approaches for getting customers to agree to be referenced. Several companies stated that they "compensate" customers for the right to reference and define expectations in the contract. Some provide points or credits that customers can use for professional services in return for agreeing to provide references. Others build metrics to be tracked into the contract, even including the "points of reference" explicitly.

Compensating the salesforce for creating customer references is a challenge, but increased incentives can be provided. For example, one company pays a higher commission where customers are willing to provide references and testimonials.

Companies are also experimenting with new ways of delivering customer testimonials and proof points. A few companies have had particular success with Web conferences. Other participants said that hosting joint events for prospects with reference accounts can be a very effective way to demonstrate ROI and customer satisfaction.

4. MEASURE MARKETING PERFORMANCE AGAINST QUANTIFIABLE METRICS

Although marketing may be at times more art than science, many companies are setting quantifiable metrics for measuring and improving marketing performance. Sales can directly evaluate marketing program effectiveness in lead generation and the materials and tools used to close those leads. The relationship is symbiotic; if the sales needs are met, marketing's requests for added resources will be supported.

Ideally sales would like marketing to deliver:

- A company and product strategy that doesn't change daily
- Market awareness of the company and its products
- Readily available reference accounts and success stories
- Sales training that improves efficiency (better customer targeting) and close rates (clear value propositions)
- Pricing plans that enable the sales team to close deals competitively and deliver profit in a way that customers perceive the value
- Partnerships that can close the holes in solutions demanded by customers and channel partners that create leads/demand
- Support during the sales cycle, including competitive analysis on demand.

When marketing and sales jointly develop a compelling view of customer needs, marketing can then influence the development of superior products. To that end, marketing must own the win/loss reports to ensure that this information is captured and plugged into the product management process. Without this insertion of the customer into the process, development will turn into "feature creatures" that push out more and more functionality without a tie to needs. Contrary to widely held beliefs, even PR effectiveness can be measured, by lead-tracking systems, share-of-voice analysis, perceptual audits, or counting references or reports. In addition, some companies mentioned that they have instituted quotas for lead generation and other activities.

conclusion

The first SMART Enterprise Conference was indeed timely. With the economy in a downturn and customer expectations changing, sales and marketing organizations face substantial challenges. The presentations and debates at the conference focused on practical ways to address these challenges.

We will meet again in Half Moon Bay on October 13-15, 2002, to discuss the events of the preceding year and what we expect will happen in the coming year. We are hopeful that in a year's time we can focus on managing sales and marketing for renewed growth.