

# “Under the Buzz”

## Insights into B2B Net Markets

September 2000 - Vol. 1, Number 5

*Under the Buzz* is an electronic “viewletter” authored by Philip Lay, managing director at the Chasm Group, a Silicon Valley strategy consulting firm. It is published each month and delivered free to subscribers via e-mail. It is also posted on the Chasm Group website at: <http://www.chasmgroup.com>. Back issues can be downloaded from the site at: [http://www.chasmgroup.com/underthebuzz\\_archives.htm](http://www.chasmgroup.com/underthebuzz_archives.htm).

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### **Preface**

In the first four editions of *Under the Buzz*, we have focused attention on evolving business models and strategic market development issues faced by online markets in their current chasm-crossing transition. In this edition, we have decided to shine the spotlight on ASP adoption, as well as on an important, but widely misunderstood, topic – market segmentation – that is of extreme relevance to all e-business companies. In the next edition, we shall return to the subject of digital markets and their continuing search for liquidity, analyzing in some detail the results achieved by a fast-developing value chain integrator – eMerge Interactive.

### **1. Why ASP Adoption is No Slam Dunk**

Since most B2B e-commerce companies market products and services that run in hosted environments, successful ASP adoption is a topic of interest to virtually every IT vendor, service provider, or potential customer today. Interestingly, the last several ASP market forecasts I have seen suggest that ASP adoption is proceeding at a slower rate of adoption than any of us might have anticipated when the ASP wave first hit the market a couple of years ago. Why should this be if, as we all assumed, renting or leasing software makes so much more sense than buying it? Surely, the opportunity to rent one or more applications today for a limited group of users, then add as many users as we want *when* we want, then at a future date be able to return it if we spot a better alternative, would tempt even the most conservative customer away from the old licensing model. After all, in the latter situation customers run all the risks associated with making a wayward decision, besides incurring the costs of acquiring the application, installing the in-house infrastructure, depreciating it over several years, then eventually replacing it with a newer system.

A recent survey by IDC suggests that the strongest demand is from professional services firms, followed by insurance/finance, telecom and government organizations. The most in-demand applications appear to be “collaborative,” then sales and marketing, followed by HR, and finally

customer services and support. Despite the approximate nature of these survey results – not unusual in the early formation of technology markets – there are, I believe some clear pointers regarding how we need to think about value propositions and market development strategy for ASPs in order to accelerate their adoption.

A key point to recognize is that technology innovation tends to follow a somewhat predictable path to adoption, starting with early market adoption by visionary buyers who make big bets, and accompanied by pragmatists who tend to make small bets or no bets, because they are waiting for clear evidence of a match between their needs and the product(s) resulting from the new technology. Despite this big-picture predictability, however, there are often particularities with each technology that determine the speed of adoption and cause bumps in the road, as potential customers balk at giving up their familiar ways of doing things in favor of the “new new thing” (to quote the phrase coined by Michael Lewis, in his recent biography of Jim Clark). In the case of ASP adoption, I think there are some intriguing factors that are influencing current adoption. Here for your consideration are two lists containing some of these inhibitors, followed by some suggestions to speed adoption up: (a) top five reasons why ASP adoption has been so sluggish, followed by (b) top five recommendations to accelerate ASP adoption.

### **Top 5 Reasons Why ASP Adoption is So Sluggish**

- (1) *Value proposition:* As currently defined and positioned in many cases, the ASP category seems to have a limited, and relatively unexciting, value proposition – i.e., rent/lease vs. buy your IT applications. At the same time, there has been a wild proliferation of “xSPs,” making it difficult for customers to differentiate between the value propositions of neighboring, but different, service offerings – including CSPs such as Exodus, not to mention BPO’s such as USi/KPMG.
- (2) *Degree of discontinuity:* In their anxiety to gain widespread adoption of the ASP service by large, medium, and small companies everywhere, ASP vendors, SI consultants, pundits, and so on, all insist that it’s a no-brainer – much more attractive than buying the technology (unless you have recently done so!), easy to do to, and of course, inexpensive – and thus not at all disruptive to companies. Unfortunately, today’s street-smart technology customers refuse to buy this “no-brainer” marketing argument and they feel unsure about possible hidden factors, such as reliability, confidentiality, and so on.
- (3) *Key applications:* In many cases, despite the potentially compelling self-service attributes of many online applications, ASPs have tended to rely on economic arguments, expecting companies to either port their current applications to the externally hosted environment, rent/lease different makes of the same applications, or lease new ones.
- (4) *Go-to-market strategy:* Following this “low-disruption” line of thinking, ASPs have tended to adopt a horizontal go-to-market strategy, in which they offer their standard service to everyone. Whenever they have targeted specific groups of customers, they have tended to do so without really driving to match the offer to a truly compelling problem that needs solving.
- (5) *Organizational impact of implied change:* Like so many technology innovations before this one, vendors have tended to want to ignore the effect of hidden costs and inertial factors such as: required changes in customers’ internal workflows and processes, mutual obligations to be defined in service level agreements, and even perceived threats to job security among IT professionals posed by this new outsourcing proposition.

### **Top 5 Recommendations to Accelerate ASP Adoption**

- (1) *Value proposition*: Either the value proposition of ASPs must be turned into something a lot crisper, or the category itself needs to morph into something more compelling. One possibility is that pure play ASPs should team with BPOs (or build their own equivalent capabilities if this is feasible) to effectively turn into BSPs (Business Systems Providers). This potential new category would provide new hosted applications that companies have never implemented in house to any significant degree, but in specific terms it would bring to market on-line implementation of *connected* applications aimed at providing net-new solutions to painful problems not previously addressed on the client/server platform.
- (2) *Degree of discontinuity*: By recognizing that this more ambitious ASP/BSP proposition is discontinuous for most organizations, vendors are more able to attract the primary early customers for such innovations – initially, visionary customers who see competitive advantage in adopting early, followed by pragmatist customers who suffer acute discomfort in their organizations in areas addressed by the new technology.
- (3) *Key applications*: One current example of a simple-to-conceive potential “killer app” is self-service travel expense management via enterprise (or outsourced) portals, connected to existing payroll applications. As reported in a recent eWeek article, a number of ASPs, including a small company called Outtask, are going to market in alliance with BPO divisions of major consulting and SI companies with this application. While on the road, they can initiate the process of expense reimbursement online, and receive reimbursements with their pay checks.
- (4) *Go-to-market strategy*: Find niche markets that have a compelling problem matching this more powerful value proposition. One possible broad target market to start with, if the IDC survey is anything to go by, is professional services. Mobile telecommuters tend to travel intensively, causing high T&E expenses. In fact, travel expense management is not only highly inefficient in most companies, it can often cause poor morale and even high attrition, in a sector where recruiting new talent is at harder than ever. Using online travel expense management, consultants can submit expense reimbursement requests online, allow approvals to be entered along the way, and receive reimbursements with their paychecks. In case this application does not appear sufficiently attention-getting, just remember large companies managed indirect-materials purchasing before Ariba and others produced a compelling way for large companies to achieve significant savings in unnecessary or non-standard purchases by providing MRO applications online.
- (5) *Impact of implied change*: By aligning with consulting firms, or building their own consulting resources, technology-focused ASPs/BSPs can learn how to support their customers by providing services – and, notably, appropriate service level agreements – that minimize the disruption and concomitant resistance to ASP-stimulated change inside corporate organizations and government departments.

## 2. Market Segmentation for E-Business: Industry Verticals vs. Target Markets

In Under the Buzz #4, we discussed the need for market makers, infrastructure providers, and all Internet application service providers to focus on satisfying the needs of an *identified* primary target customer. Our assumption is that, in seller-oriented marketplaces, the primary target customer is a specific group of sellers, whereas in buyer-oriented marketplaces the primary target is a specific group of buyers. Since many of the current industry verticals being explored by competing trading exchanges and online marketplaces are extremely large and/or broad, we urge companies to deliberately *reduce* the size of their immediate target market. This temporary concession needs to be made in order to enable a market maker or any other e-business company to (a) understand the exact requirements of a smaller subset of self-referencing customers, and (b) set out to provide them with a fully satisfactory solution to those problems, thus achieving density (as opposed to volume) – which in turn helps to generate profitable liquidity over time.

Now, among the notions inspired by the recent explosion of interest in digital marketplaces, there is a much-misunderstood one: as soon as each “vertical” has been claimed by the first one or two market makers in its space, it will mean game over for any other pretenders to the same marketplace. I have heard various estimates to the effect that this indicates there will be no more than a handful – anywhere from fifteen to fifty – of survivors when all is said and done. Part of this fear stems from illogical parallels drawn from recent B2C examples, notably eBay (in auctions of collectibles) and Amazon (in books), where we saw one first-mover in each market space stake their claim and establish strong network effects into the bargain, while their competitors struggled to find a viable niche in the same marketplace.

Of course, the problem with these comparisons between consumer and business markets is that the two behave so differently. As most people now recognize, the build-out of B2B marketplaces to provide real solutions to meaty corporate problems is so demanding that first movers have only a relative advantage, and – as occurred in countless cases during earlier technology booms – first *provers* will often win out (except where they are one and the same). Nonetheless, there remain one or two myths to be punctured, among which is a general misconception about market segmentation: many people in our industry, from high-tech executives to VCs, and even to marketing types who should know better, seem to think that verticals – such as “manufacturing,” “retail,” “healthcare,” “telecommunications,” “computing,” “semiconductors,” “consumer packaged goods,” and so on – *equate* to addressable market segments. In truth, they can do, but more often they don’t.

The key lies in approaching the problem of developing a market *from the point of view of your target customer’s compelling problems*, rather than from your own perspective as a marketer anxious to foist your goods or services on a helpless victim. Especially so, if we define our target customer as those companies and individuals who would benefit most from your using your product or service, and would therefore tend to feel the most acute urgency to respond to your approach. The approach that I urge executive teams to adopt in thinking about suitable target markets early on in the market development cycle is based on tried-and-true principles from earlier days in addition to more recent thinking, and it looks like this:

**Goal:** Achieve 40% penetration of target market segment within twelve months or less. This degree of penetration equates to achieving density, making you a powerful player in your general marketplace – i.e., potential customers in other markets will start to pull you into their space.

**Strategy:**

“Need”: Target a sub-segment of self-referencing target customers who are suffering acute competitive (or regulatory, or other) stress. Note that there are literally thousands of possible target sub-segments, as opposed to relatively few “verticals.”

“Money”: Make sure your individual target customer is authorized to invest sufficient funds in a suitable solution, and that the company has the required vitality to pursue the plan.

“Trust”: Commit to provide the complete solution to that stress point, marshalling whatever partners are necessary to ensure the array of products and services.

“Hurry”: Seeing a solution that exactly matches their acute problem, your qualified target customer should have sufficient motivation to make a decision in a foreseeable timeframe.

**Gotchas:** There are various potential gotchas in this process, among which are these three:

*Addressable target market:* If you do the math above, your target market cannot be larger than your capacity to deliver the promised complete solution to them. Failure to fulfill your promises

will result in rejection by the customer group, because negative references will spread. Although this is acceptable at an intellectual level, management teams tend to resist emotionally “letting go” even temporarily of the right to pursue every possible deal in their broad market space.

*Severity of problems:* The art here is to identify “severed artery” type problems that need urgent solution, but have not completely debilitated the prospective group of customers - otherwise you face a frustrating time closing business.

*Both/and, not either/or:* One of the main difficulties preventing the success of target market strategies is the question of how to deal with business-as-usual opportunities while also trying to succeed in the target market. Within reason, both types of business have their place in the revenue plan. The secret lies in developing simple rules of engagement that distinguish our commitments to target customers, vs. opportunistic business, so that you over-invest to support target customers and under-invest in supporting opportunistic business. I call this playing to compete (opportunistic) vs. playing to win (strategic).

Arguably the most damaging heritage of past B2C market strategies (remember Netscape?) to afflict B2B has been the tendency to want to give away the farm when introducing a dramatically new and discontinuous innovation. Unfortunately, this approach is never aligned with the early market customer’s needs and anxieties. In particular, it especially alienates the visionary customer, who sees in giveaway tactics the insecurities of anxious vendors who want to unload their products at any cost, and who may not be around when the project gets interesting.

Even those who understood that super-verticals break down into many different vertical segments can be misled. For example, a common error of sales and marketing professionals, in fact, is to simply take the Standard Industry Codes (SIC, for short), and use them to segment the market. While these codes provide a potentially valid option for cutting and slicing the market, they are not sufficient on their own to describe a target niche of prospective customers for a specific offer.

Which brings us to the challenge of how to help B2B e-commerce companies – whether market makers, infrastructure providers, or pure ASPs – to think about target markets in a way that can lead to successful traction in a given space. Below is my list of segmentation criteria, separated into three groups, which management teams can use to brainstorm potential go-to-market strategies. You should expect to utilize as few as five and as many as fifteen of the criteria below, depending on how granular you need to be in your definitions. It is important to bear in mind that industry specialization is just one set of criteria. Alongside the each criterion below you will see a sample answer taken from a fictional case study of a Travel Expense Management ASP’s strategy. Items in bold refer to the criteria that were particularly important in defining this target market.

## Segmentation Criteria for Target Markets

### A. Business needs and applications:

- Business activities Hiring, managing, retaining consultants and contractors
- **Acute problems** **High costs and low morale resulting from poor travel expense mgmt., causing unacceptable levels of attrition in tight labor market**
- **Required solutions** **Effective self-service travel expense mgmt. linked to ERP systems, enabling companies to manage attrition, and keep growing**

## B. Target organizations

### B1. Industry specialization:

- Super-verticals Service providers and outsourcers
- Verticals Professional services firms (vertical market defined at outset)
- **Vertical sub-segments** **IT consulting firms (vs. PEO's or accounting firms)**

### B2. Size, geography, and growth dynamics:

- **Company size** **Top sixty firms, above \$200m. in revenues**
- Employees Not relevant – most company operations outsourced
- **Geographical location** **U.S. and Canada only (Europe next, then Southeast Asia)**
- Customer profile Sell major engagements to large Global 2000 corporations
- **Growth rate** **Top sixty companies have an average growth rate of 40% p.a.**
- **Power dynamics** **Top sixty professional services firms hire 30% of all IT consultants**
- **Competitive pressures** **Competitive pressures causing stress: must sustain high growth**
- Industry size Total revenues/spend of Professional Svces industry: \$xxbn. per annum
- **Current systems** **Current systems not integrated, require manual intervention**
- IT penetration PSO companies invest insufficiently in enterprise IT systems
- Regulatory environment Regulation in labor laws is intensifying, causing escalation in costs

## C. Target customer – who is accountable to solve the problem?

- **Target job title** **CFO, or VP Operations**
- **Secondary sponsor** **CEO**
- Other parties involved Line of business executives, recruitment managers, IT, purchasing

Besides the factors above, additional organizational factors may influence the selection of target markets, and should be used to refine your initial assessment, such as vitality of the industry, maturity of companies, management style and organizational culture.

## 3. Value Chain Integrators: Upcoming Case Studies

The first case study we are aiming to discuss is **eMerge**, the beef industry integrator that is enabling beef products that have always been considered commodities with tightly defined price points, to be sold via the internet at significantly differentiated prices, thus effectively “de-commoditizing” beef. The focus of our study will be in these areas:

- Value proposition / business model – SOM/BOM, Neutral exchange, etc.
- Go-to-market strategy – theory vs. reality
- Value chain integration results, and what the “value web” looks like
- Signs of increasing traction toward liquidity
- Metrics they are finding useful – mapped to those published in Under the Buzz #4
- Lessons learned

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In upcoming issues:

- Market Maker Case Studies Demonstrating Sustainable Liquidity, Leading to Scale
- Key Fulfillment Areas for B2B Commerce: Finance, Supply Chain/Logistics, CRM
- Critical Success Factors: The Need for Strategic Alignment in Internet Startups

*Under the Buzz* offers a monthly commentary on the business-to-business e-commerce sector. The goal is to provide provocative and accurate insights into the latest events and thinking shaping the rapidly evolving business-to-business marketplace. *Under the Buzz* will focus on developments and competition in digital markets and e-infrastructure.

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