Enterprise Architecture Consulting Group

Identifying *Value Spots* in the Software Industry

Whitepaper

CONTENT

Motivation

While the past decades provided sound revenue opportunities for Software companies the ongoing consolidation and maturity of the market rise barriers to profitability.

But despite growing monopolization and increasing price competition the Software Industry bears still excellent business opportunities. Unmatched scalability and ongoing innovation offer much better chances than many other old fashioned industries. Companies just have to identify their ***Value Spots*** and to adapt to ongoing commoditization.

Market makers like Microsoft already understood the aging of rules and prepare change. They identify ways to build new Value Spots without threatening their existing business. Smaller companies still need to adapt and rethink their value proposition.

This whitepaper introduces the Value Spot Concept. This Concept is a structured approach to gain insights of your own business by viewing it from a different perspective. It will help you to identify ways for your company in a profitable future.

Understand Value Spots

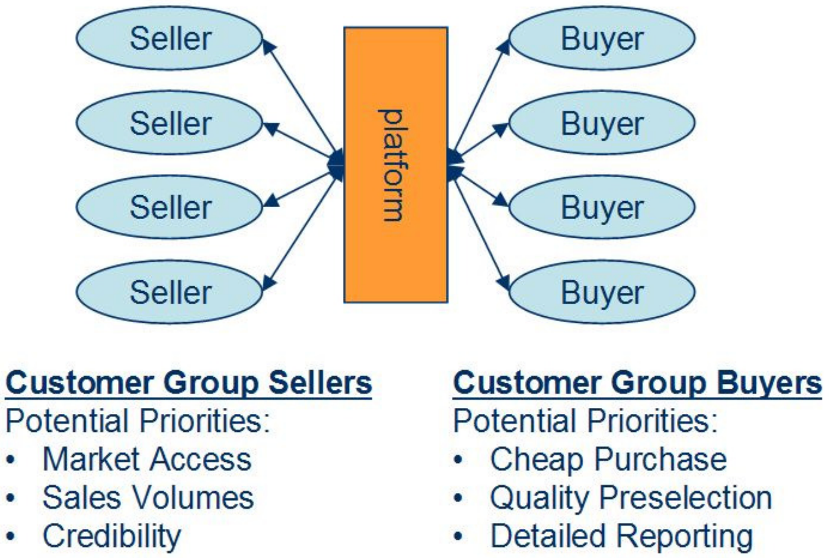
During the Internet Hype market share seamed to be the guarantee for solid revenues. The downturn showed that it pays off to focus on solid earnings instead. Profits returned on the agenda.

But profitability is not simple to sustain. Technology and buyer behavior change, competition erodes value propositions. ***The Value Spots Concept*** provides a viable approach to ensure long term profitability.

A Value Spot defines ***why*** a customer would be willing to pay a premium above competitive services. A Value Spot is achieved by matching market forces and customer's priorities, business model and core competence(s).

A purchase platform for example generates value for the buyer through consolidation of purchase power towards the seller. Typically the prices negotiated improve for each buyer. On the other hand the platform becomes attractive for the sellers as they might reach more buyers with less effort. To achieve attractiveness the platform requires a reasonable amount of users from both sides. In the Retail Industry Aldi would be a well known example using the Platform approach.

Understanding the Value Spot of the Platform Model



It is important not to mix the Value Spot with the Business Model. The later describes how the money is charged, i.e. membership fee or transaction based. The Value Spot identifies the reason, why a customer would be willing to pay the membership fee for this and not another platform.

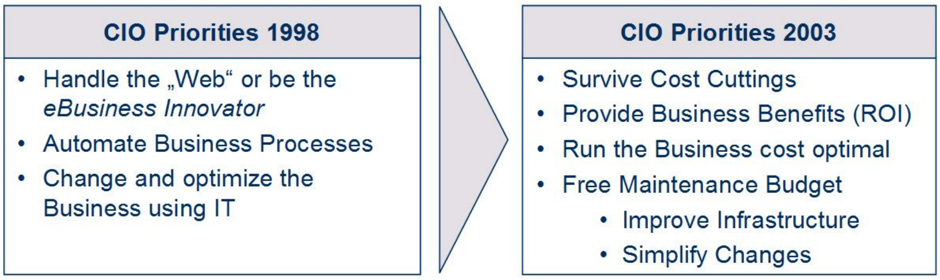
To identify potential Value Spots, it is necessary to understand the customer's priorities. Serving these priorities leads to the Value Spot.

Identify *Value Spots*

SAP was seen as the ERP-company, Oracle as the database company. Both recognized that after the Hype their customer's priorities shifted from "*Getting things automated*" to "*Managing the automation*". A major driver of this change might have been the IS cost cutting as the result of the enthusiastic spending during the Hype.

However, the new priorities identified resulted in new value propositions aligned with new products such as: employee communication (SAP Portals), process efficiency and better information supply (enterprise application integration, SAP Netweaver).

SAP understood adapting to shifts in customer priorities



Based on SAPs core competence "Creating excellent Standard Software" – as well as probably the excellence of technology monitoring and strategic acquisitions – and the understanding of the new customer priorities the new product suit was launched.

But SAP did not just provide new infrastructure components. It also identified a new Value Spot in the form of iViews. iViews are little prepared pieces of code, allowing access of selected R3 information and functionality in the portal.

Backend access is a common functionality of all portals and iViews would have been functional with other portals as well. But iViews on the one hand established the link to the *installed base* of R/3 systems and on the other promised an additional value in form of implementation speed (ROI) of SAP Portals over other professional portals such as BEA.

Addressing shifting customer priorities, typically driven by technology development and changes in the business environment, prevent the dilution of value propositions.

Therefore it is essential to continuously monitor the customers served and clearly examine their priorities. If the priorities start changing, it is time to redefine the Value Spots.

Analyze Value Dynamics

While the understanding of customer priorities is a prerequisite to identify potential future Value Spots, it is also necessary to understand the Value Dynamics of the business. The Value Dynamics identify the determinants of profitability.

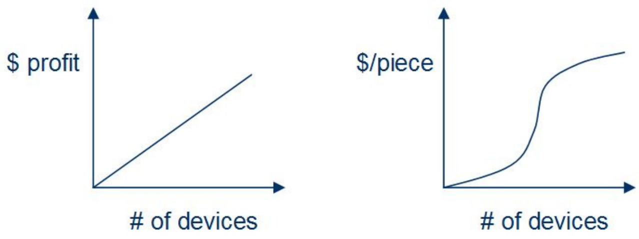
Adobe identified its Value Spot within an authors need to distribute write protected information. The company developed and patent protected a document format covering this need.

But instead selling the Writer *and* the Reader, Adobe understood well the Value Dynamics: Charging for both tools would have limited the circle of users to direct customers. The ***Key Value Determinant*** in this case was the number of existing Reader installations, generating a valuable audience for the Writer. Therefore Adobe sold the Writer charging a premium over other text editing Software but spread the Reader for free.

It does not matter whether the Value Spot follows a time, experience, key asset or whatever based model: To turn each of these models into profitability it is essential to isolate the Key Value Determinants.

Whether HP sells its printers at lower price or Rockefeller provided oil lamps for free. Both aim to increase the amount of devices in the market generating a need. The business model is to sell supplies. The Value Spot is the quality / availability of the supply. The Key Value Determinant is the number of devices out in the market creating the demand.

Understanding the Key Value Determinants is essential for profitability



The Key Value Determinant is identified by searching for the variable that increases the total turnover or even better the price per unit. While the first allows understanding where to focus on (what actually to sell), the second indicates how to influence the Value Dynamics.

Combine Value Spot and Business Model

Having a business model in place, the Value Spot Concept might improve the existing model or indicate the need for change.

During the years the Software Industry saw several business models emerging. The following list briefly describes the most known models and summarizes the Key Value Dynamics of each model.

Value Spots are customer specific, therefore the assignment of corresponding Value Spots is not possible on a generic level. But the combination of trends with the knowledge about the dynamics eases identification of the Value Dynamics:

Business Model: Description	Key Value Determinant
Licences: The user is requested to pay a fee to get the right to use the Software for his purposes. Depending on the licence there might be scaling factors such as concurrent installations, processors or users.	• # of licences sold • $ / license
Maintenance: Licensing is limited to a single payment. To allow continuous revenues the Maintenance model appeared. To be entitled to ask questions and participate in minor updates 12-18% of licence value is charged annually.	• # of licences • $ / license • service category
Open Source Model: FSF and later OSI spread the idea of Software as free good and direct the Value Spot on the need for some service around the tool/product. Typically Service models are less scalable than the licence model but they tend to bear lower entry barriers.	• Depending on combination
Subscription: As long as the user pays a fee per time range, he will be entitled to use the software/service, comparable to a rental agreement.	• # of users • duration
Transaction: Transaction based means to charge either volume based or per amount of transactions. In highly automated environments this model bears high potentials. However, high volume users might prefer other models…	• # of Transactions • Size of Transaction • $ or % / Transaction
Time based: Each time unit the application is used will be billed. While growing bandwidth limits its attractiveness to Telecom providers, it still is important for selling access to i.e. special content.	• $ / minute • Usage
Pay by use (pay on demand): Is a modern term to address one of the above two compensation models. But as those might occur in combination with a subscription fee, this indicates that there is no further charge than per use.	• $ / use • # of users or uses
Commercials: Very popular during the Web Hype this model honours page impressions (show views) or clicks on a logo provided on a page with a fix amount of money.	• $ / show or click • Induce page views

It is absolute essential to have a fit between the Value Spot addressed and the business model. Take for example an IT company relying on the service model (KVD: # of billable hours) that sees it's Value Spot in selling predefined concepts for a lower price. The company limits its Key Value Determinant: time at customer's site.

Besides this fault it would be questionable whether the Value Spot really is chosen carefully. Customers tend to choose service providers over products when they search for individual solutions.

However, if the Value Spot shall be the "predefined concepts", then the KVD would change from billable hours to # of concepts sold. Therefore it would be recommended to restructure the cost side (layoff employees), invest into R&D (to generate valuable concepts) and assess the current marketing and sales approach.

Summary and Conclusion

The Value Spots Concept is a methodology to guide the thinking about business into profitable directions. However, the core challenge of each Software company is to identify the shifting priorities of their customers.

Therefore it is essential to clearly identify your customer groups and assess their priorities one by one. If you are not clear about whom you are serving, it will be hard for you to see a profitable future!

Often especially technically driven companies fail in this step. The sweet illusion that everybody might want to apply their solution is too strong. But those who are not willing to turn into the bowling alley will hardly find a chance to grow.

Growth is possible through your customers only. Combining customer insights, core competence and business model will allow you to identify your sustainable Value Spot.

Those companies spending energy on identifying and implementing Value Spots will be highly rewarded by their customers and gain the relevant strength, to become a valuable player in their market.

Further reading and materials you might find in other Whitepapers of our library concerning Software Industry or Business Architecture at our website, i.e.:

- Consolidation in the SW Industry

Contact:

Enterprise Architecture consulting Group –
EACG GmbH
Schweizer Str. 16
60594 Frankfurt am Main, Germany

T: +49 69 3660 2860
F: +49 69 3660 2857
M: *info@eacg.de*
W: www.*eacg.de*