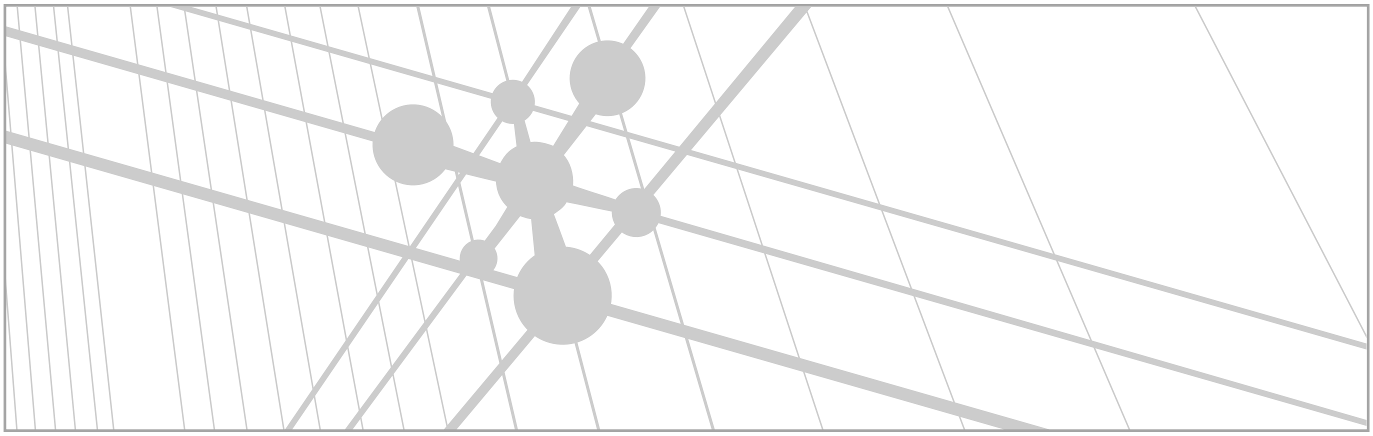

THE PERVASIVE COMPUTING SERIES

# The ASP Survival Guide

## Workflow Solutions for the Small- & Medium-Business Market

ZANTHUS

MACROREPORTS

THE PERVASIVE COMPUTING SERIES

# The ASP Survival Guide

## Workflow Solutions for the Small- & Medium-Business Market

ZANTHUS


David W. Edwards
Founder and CEO

Michael Lehman
President

Jenn L. Lackey
Associate Research Consultant
Syndicated Research Divison
*Principal Analyst*

Vivian L. Schlesinger
Senior Research Consultant
Syndicated Research Division
*Macroreports Editor*



This document was produced by Citizen Graphics.
Document No. M0101-1, Printed in the U.S.A.

# Upcoming Reports

## Examining the U.S. Market for Connected Homes: Poised for Mass Adoption or Backlash?

**For Release: June 2001**

## The ASP Survival Guide: Enterprise Level Workflow Solutions

**For Release: September 2001**

ZANTHUS

120 SW Ankeny Street, Ste. 610 Portland OR 97204 tel. 971 / 404.0275 fax. 971 / 404.0274

# INTRODUCTION

**➜*Pervasive Computing***
*A new paradigm made possible by increasingly powerful combinations of high-speed computers and intelligent devices, all completely interconnected by wired and wireless networks and accessible anywhere in the world, according to authorities at the Indiana University Pervasive Computing Research Initiative.*

The Web's digital well may have been tapped in the short-term, but the medium is far from dry. A much stronger, albeit understated, current of ➜*pervasive computing* remains.

Today in the application service provider (ASP) space, exciting, necessary, fundamental changes are taking place that will lead to invisible computing technology. Today, companies as diverse as IBM and Intel are making tremendous contributions to this future by developing new ways to couple Internet-based, client-server applications and operating systems.

In *The ASP Survival Guide: Workflow Solutions for the Small- & Medium-Business Market*, ZANTHUS fully examines the labyrinth of solutions that together make up this vitally important market as it stands today and in the near-term. Structured by topic in sequential order, the report explores the successes and challenges associated with the ASP model.

*The ASP Survival Guide* is the result of a comprehensive, six-month study that includes in-depth interviews with a wide range of key industry players, including C-level executives from star performers. Leading venture capital firms and noted industry analysts have also been tapped to bring you valuable information about this space and combine it with the best insights of ZANTHUS analysts. Content is organized by topic in ten sections:

- 1.0 Fully defines the ASP model in the context of a rapidly evolving market
- 2.0 Reveals how leading ASPs are differentiating themselves
- 3.0 A portrait of the market niche
- 4.0 Customers sound off about what they want, need and are not getting
- 5.0 Requirements for mass adoption in the SMB space
- 6.0 Challenges directly ahead for market players
- 7.0 Venture capitalists provide direction for strong growth
- 8.0 ASP self-assessment
- 9.0 Moving your ASP business forward
- 10.1 Case Study: The two-pronged approach of Open Air
- 10.2 Case Study: Rivio, success through partnership
- 10.3 Case Study: HotOffice & the hard lessons of defeat
- 10.4 Case Study: Agiliti, an evolving brand

Industry terms are defined in columns for easy understanding. Suggested strategies, or survival tips, are also off set in columns. Key ideas and section summaries are separated in expanded size for quick scanning. An index is provided for searches by company and respondent name.

Among the upcoming volumes in the ZANTHUS "Pervasive Computing Series" is a report showcasing enterprise ASPs such as Corio, US Internetworking and Qwest Cyber.Solutions. Due for release this Fall, *The ASP Survival Guide: Enterprise Level Workflow Solutions*, highlights the unique ways these and other companies are developing the infrastructure that will bring us one step closer to a time when computing technology is invisible.

Jenn L. Lackey
Associate Research Consultant
Syndicated Research Division
ZANTHUS

# TABLE OF CONTENTS

# FOREWARD

The Internet stock mania of the last several years has invited a host of historical parallels, perhaps most notably, the 'Mississippi bond scheme' of post-Louis XIV France. As detailed in Charles Mackay's 1841 classic *Extraordinary Popular Delusions and the Madness of Crowds*, the bond scheme created a two-year financial 'bubble.' Briefly, the scheme was initiated in 1719 by the French Regent, who issued an edict "granting to the Mississippi Company the exclusive privilege of trading to the East Indies, China and the South Seas," among other landed possessions of the French East India Company. Shares in the new company, dubbed the Company of the Indies, were valued to ensure holders an estimated 120% profit. Officially at least, the edict was part of a larger financial plan to reduce the government's weighty debt.

As might be expected, the public received this edict with open arms and, as Mackay recounts with sardonic wit, embarked on a riot of crass fortune-seeking and profligacy. Soon after the shares were distributed, Mackay notes, "the highest and lowest classes were alike filled with a vision of boundless wealth. There was not a person of note among the aristocracy, with the exception of the Duke of St. Simon and Marshal Villars, who was not engaged in the buying and selling of stock. People of every age and sex, and condition in life, speculated in the rise and fall of the Mississippi bonds."

Just as in the late-90s dotcom-driven stock market, the "price of shares sometimes rose ten or twenty percent in the course of a few hours, and many persons in the humbler walks of life, who had risen poor in the morning, went to bed in affluence." This aspect of the bond frenzy assumes an absurd dimension in Mackay's account when the coachman for the English author of the scheme, suddenly made wealthy, not only quits his employer, but takes a coachman of his own.

Early in 1720, however, the plan started to go horribly awry. The massive influx of paper money invariably took its toll on the economy as suspicions mounted about the true value of the Mississippi stock and some prominent and enterprising stock jobbers traded their paper for hard currency. The Regent worsened the situation by trying to set the relative value of paper and coin by *fiat*. The market rapidly punished the Mississippi stock, and "coin, which it was the object of the Regent to depreciate, rose in value on every fresh attempt to diminish it." By spring, the French government teetered on the edge of bankruptcy.

The popular press has generally used this farcical incident to browbeat dotcommers about their formerly wild spending sprees on infrastructure, personnel, marketing, opulent parties and who knows what. Sure, the parallels to our dotcom age invite any number of somber platitudes about the superficial cleverness of some entrepreneurs and the temporary enthusiasms of a wanna-get-rich-quick public. The crucial difference, though, is that some Internet-based businesses have a compelling rationale. The Mississippi bond scheme? Almost pure fabrication.

The application service provider (ASP) market is a perfect case in point. Like many Internet-based business models, when the ASP model started gaining traction in the latter half of 1998, its inherent promise spurred hopelessly inflated expectations. Many, like consulting mainstay EDS, proclaimed the model a "basic paradigm shift." Overly optimistic market forecasts varied dramatically, from US$20 billion to upwards of US$50 billion in spending on ASP services

**➜Small-to-Medium-size Business (SMB)**
*A company with at least five, but fewer than 5,000 employees.*

annually before 2005. While few verifiable sales numbers exist, most industry observers agree the market lags far behind these estimates.

But you don't have to believe the hype to buy into the model. ZANTHUS believes the ASP model is as sound as ever, offering considerable competitive advantages for ➜*small-to-medium-size businesses* and enterprise companies alike. For these customers, the model promises lower, more predictable IT costs, faster application deployment, more time to devote to core competencies and more. At least as far as ASPs are concerned, the dotcom boom wasn't an isolated soap bubble so much as a rising bubble on the surface of a backcountry river. The bubble may dissolve into air, but the river goes on.

Beyond its immediate benefits, the ASP model is consistent with the notion of pervasive computing. We regard pervasive computing—anytime, anywhere access to information—as the ultimate consequence of a next-generation Internet. Along with information appliances and reliable wireless access to the Internet, we think ASP services are an integral part of a future environment where computing is ubiquitous and largely in the background.

This report, the first in a projected two-volume series on the ASP industry, focuses on ASPs that provide business administration (or workflow) applications for the SMB market. Throughout, we have endeavored to keep the larger business landscape in view. In this way, we hope to play the role of Chancellor D'Aguesseau in the Mississippi bond scheme. Dismissed in 1718 for his opposition to some of the risky pre-Mississippi bond projects, D'Aguesseau was later recalled to help restore France's credit. We turn a similarly sober gaze on the ASP market. Hopefully, we can restore some of the luster to the model without the extraneous gilding.

David W. Edwards
Founder & CEO
ZANTHUS

# 1.0 THE MEANING OF 'ASP' IN AN EVER-SHIFTING LANDSCAPE

In Lewis Carroll's *Alice's Adventures In Wonderland* (1865), language follows its own laws, spinning worlds that exist only in words. Much to Alice's dismay, Humpty Dumpty claims he can make words mean anything he wants, saying, "When I use a word, it means just what I choose it to mean—neither more nor less." He defines 'glory,' for instance, as "a nice knock-down argument."

Though not quite so extreme, the high-tech industry is plagued with similar semantic disorders. When asked to define 'ASP' in simple terms, leading industry analyst Arthur Williams of the Giga Information Group isn't afraid to say there's no easy answer. "The simple answer is too inclusive. There are so many functions to be outsourced and so many styles to do the outsourcing. You have lots of people offering different things, testing the waters for various services within this context."

The confusion arises from a number of factors, most prominently, the diversity of companies covered by the ASP label. Internet service providers, Web-hosting firms offering managed services, Web-based application providers, traditional software developers repurposing their wares for the Web and systems integrators, among others, may reasonably be considered ASPs.

Moreover, ASPs in the SMB space provide a dizzying variety of application packages. One ASP may provide extensive ecommerce applications, including basic accounting and HR software, while another may offer extensive HR applications, with only a few additional programs and no ecommerce capabilities whatsoever. In many cases, the specific mix of applications is based primarily on technological know-how rather than target customers' needs.

Even among companies in similar lines of business, many have developed their own unique terms in an effort to mark their territory. Some companies that fall into the ASP camp describe themselves as ➜*business process outsourcers* (BPOs), ➜*Internet business service providers* (IBSPs), ➜*commerce service providers* (CSPs) and in other, equally tendentious terms. These labels are like the identifying tags of graffiti artists: messy, overlapping, noted in passing and then soon forgotten.

Redmond, Washington-based vJungle, a mid-market provider of hosted, integrated Web-based applications competing in the ASP space, describes itself as an ➜'*ASP integrator*.'

"Our definition of an application service provider is anyone who is providing Internet-based solutions—specifically business solutions or technical solutions—to their customer base," says the company's director of product planning, Abhijeet Rane. "Now, the applications themselves or the services themselves don't have to be purely Web-based. They can be any combination of Web-based, plus a client piece [residing on the customer's servers]."

Simpata, an ASP providing human resource applications, also has adopted the course of avoiding the term 'ASP' to prevent potential customers from

➜***Business Process Outsourcer (BPO)***
*A company that provides business-to-business managed application services on a subscription basis over the Web.*
*Synonym: MSP*

➜***Internet Business Service Provider (IBSP)***
*A company that delivers proprietary business applications to multiple users on a subscription basis over the Web.*
*Synonym: ASP*

➜***Commerce Service Provider (CSP)***
*A company that provides ecommerce applications and technology services to businesses selling products via the Web.*
*Synonym: ecommerce ASP*

➜***ASP Integrator***
*A company that offers platform applications that enhance the operation of a customer's network infrastructure.*
*Synonym: ASP infrastructure provider*

confusing it with other, radically different companies. " 'ASP' is actually used to define different things," says Chuck Moxley, vice president of marketing. "We consider ourselves an ASP, but don't use the term very often. The term we have developed is 100% Internet. We are a 100% Internet, HR benefits, payroll solution."

THE MEANING OF 'ASP'

For the purposes of this report, we define the term in accordance with the ASP Industry Consortium, an international advocacy group that promotes the business model. According to its definition, an ASP "deploys, hosts and manages access to a packaged application to multiple parties from a centrally-managed facility. The applications are delivered over networks on a subscription basis. This delivery model speeds implementation, minimizes the expenses and risks incurred across the application life cycle and overcomes the chronic shortage of qualified technical personnel available in-house." The two main features of this definition are: 1) ASPs offer a one-to-many application solution over the Web; and 2) customers rent these solutions rather than own them outright.

*AN ASP "DEPLOYS, HOSTS AND MANAGES ACCESS TO A PACKAGED APPLICATION TO MULTIPLE PARTIES FROM A CENTRALLY-MANAGED FACILITY.*

"Our definition is the simplest definition based on what we believe an ASP solution encapsulates," says ASP Industry Consortium representative Jim O'Reilly. "We do find that because there's a great deal of confusion out there in the industry, you have to go a little bit further sometimes with the definition, just to make sure everyone is clear. So we hope it encompasses the type of services provided under an ASP model but is still narrow enough to have meaning in the market space."

In many respects, the ASP model harkens back to the days of time-shared computing—the days before the advent of ARPANET, the precursor to today's Internet. Time-sharing arose in the mid-60s, beginning with the Rand Corporation's Johnniac, because batch turnaround times impeded the solution of problems. Mainframes like Johnniac were ultimately superseded by personal computers in the 1980s, when relatively powerful and inexpensive computers like Apple's Macintosh led briefly to professional work environments replete with stand-alone computers.

Not long after, the cost savings afforded by local Ethernet networks (pioneered by Xerox PARC engineer Robert Metcalfe in 1973) tipped the scales in favor of the now-prevalent client-server solution. Client-server environments, however, have their own problems; most notably, they require considerable application-deployment and maintenance costs. Taking advantage of the ubiquity of the Internet, the ASP model promises a return to a faster, always-on subscription computing environment.

This historical analogy suggests that for software at least, the Internet is mainly a distribution channel, not a whole business in and of itself. In other words, ASPs need to provide more than just software in order to be considered anything other than commodity dealers—an insight reinforced by one of BusinessWeek's 25 most influential people in e-Business, 2000, Dr. Mohanbir Sawhney, McCormick Tribune Professor of Electronic Commerce & Technology, and director, Center for Research on Technology, Innovation and E-commerce at Northwestern University's Kellogg Graduate School of Management. "The traditional application service division model is essentially taking a piece of software or a software application and having someone run that software for you," says Sawhney. "But that has to be supplemented with a range of services, which include integration and/or consulting services, evolving towards managed operations."

# 2.0 STRIVING FOR DISTINCTION: ASP BUSINESS MODELS

The number and variety of companies that fall into the ASP category, broadly defined, makes developing an authoritative classification scheme difficult. There's no easy taxonomy, no visual shortcut that suddenly clarifies everything that's gone before. There are simply too many attributes to take into account. There are, however, a number of critical attributes that help define the players.

**RANGE OF APPLICATIONS**

The number and type of applications ASPs offer vary dramatically. Companies tend to offer applications either à la carte or as a complete package. Some provide a narrow range of applications related to human resources, sales management, accounting or procurement, while others provide a selection of integrated or otherwise bundled applications.

Table 2.1 (beginning on the following page) details the scope of the applications available from various ASPs targeting the SMB market. While many ASPs offer a variety of the services listed in the table, to date, no single company offers everything as a one-stop shop.

**RANGE OF SERVICES**

The range of services varies substantially from one ASP to another. Typical services include application hosting, upgrading, systems integration and related IT consulting.

**DELIVERY CHANNEL**

Based on structure alone, there are two types of ASPs: ➜*wholesale providers* and ➜*retail providers*. By wholesale providers, we mean companies like telecommunications and Internet service providers that have established access to target customers. These firms already have the necessary infrastructure to provide services as an ASP, and given their mixed fortunes of late, the incentive to add these services to fatten their bottom line. Generally, wholesale providers don't develop their own Web-based applications; rather, they purchase them from ➜*independent software vendors* (ISVs) or rent them from other ASPs.

Retail providers or ➜*retail ASPs*, on the other hand, are ASPs that offer services directly to customers. Some, especially at the enterprise level, partner with firms providing systems integration and consulting services to avoid bearing the risk of implementation and ongoing maintenance themselves. The primary focus of this report is on a specific set of retail providers using a variety of distribution strategies, which will become evident later.

ⓘ SURVIVAL TIP:
Today's retail ASPs are closest in structure to the heritage ASP model.

➜***Wholesale Providers***
*Telecommunication and Internet service providers or network service companies that already have established access to potential ASP customers and have the necessary infrastructure in place to either become an ASP or act as a distribution channel for one.*

➜***Independent Software Vendor (ISV)***
*A company that develops proprietary software in-house.*

➜***Retail ASP***
*An ASP that offers services directly to customers.*

**MARKET FOCUS**

There are two dimensions involved here: the size of the target market and the industry focus. The former encompasses two fundamental size-classes: small and medium-size businesses (SMBs), and large companies, popularly referred to as enterprises. This report describes the landscape for ASPs targeting the SMB market. For the purposes of this report, we consider companies with anywhere from five to 5,000 employees as part of this market, though we define the 'sweet spot' as companies with between 20 and 100 employees.

The industry focus dimension refers to the degree to which ASPs have a vertical or horizontal customer target. ASPs like OpenAir are after a specific industry niche (in the case of OpenAir, professional services), while others target companies in a general size-class, regardless of market sector.



# 2.1 Application and Service Landscape

Table 2.1 details the scope of the applications and technical services available from various ASPs targeting the SMB market.

## ASP APPLICATIONS

### Customer Relationship Management

Customer service apps providing customer history, account, shipping and tracking status and other customer service info.

### Sales & Marketing

Apps for tracking sales, producing and distributing sales reports, managing past and prospective sales contacts. Direct mail and design apps for advertising and marketing needs.

### Contact Management

Access and organization apps for company, including phone lists, project contact names and other contact details.

### Scheduling

Calendar and apps for project time management.

### Bulletin Board

A place for posting ideas and events.

### Intranet

An internal network accessible only by internal authorization allowing employees to share company info securely.

### Extranet

Allows authorized outside access to various parts of an Intranet for collaboration and document sharing with outside clients or personnel.

### Accounting

Payroll, payables and receivables, timesheet and expense tracking.

## ASP TECHNICAL SERVICES

### Basic Customer Support

Commonly 24 X 7 email and phone assistance.

### Extended Support

Additional support beyond basic customer support services. Can include: third party support from ASP partners, in-service support and training or ongoing monitoring of service level agreements.

### Security & Back Up

Regular remote data back-up, and secure data storage.

### Storage

Remote data storage can include remote access.

### Maintenance

Remote monitoring of servers and or applications; application and server upgrades.

### Email & Internet Access

Reliable, high speed access.

### Extended Communication Service

Wireless communication access via WAP or handheld device (PalmPilot for example).

### Web Hosting

Maintaining capacity on a remote server for a domain name: Domain name registration and traffic assessment.

(continued on following page)

## 2.1 Application and Service Landscape (continued)

Table 2.1 details the scope of the applications and technical services available from various ASPs targeting the SMB market.

### ASP APPLICATIONS

#### Financing

Banking and financing apps, often providing banking service through portals.

#### Benefits

Applications providing forms and procedures for insurance and retirement. (Some ASPs have portals for access to a variety of insurance info.)

#### Hiring

Applications that provide recruitment forms and methods for producing applications and job descriptions.

#### Information Resources

Resources, news and information regarding benefits, employees and HR matters.

#### Liabilities

Access to information and news about laws and employment regulations, etc.

#### Vendors/ Suppliers

Applications that give access to suppliers and vendors that can assist with day-to-day business needs.

### ASP TECHNICAL SERVICES

#### Application Hosting

Providing space and maintenance to host applications, usually for other ASPs or for end user companies.

#### Web Development

Service providers assisting with the development and design of Web sites. Service may include maintenance updates.

#### Customization

Service providers that customize IT networks or applications. Services may include consultation.

Source: © 2001 ZANTHUS

### SOURCE OF APPLICATIONS & SERVICES

Along with market focus, this dimension is one of the most telling attributes of an ASP. This dimension refers to the origin of the applications offered. There are three basic company types as defined by the source of applications:

**Aggregators**

These ASPs deliver applications developed by a third-party—either an ISV or another ASP—usually along with a proprietary bridge technology that allows users to port data from one application to another. The main promise of aggregators is that they provide best-of-breed applications in an integrated computing environment. If aggregators were artists, they would be considered purveyors of collage or perhaps, ‘found art’—repurposed everyday objects.

➜***Infrastructure Provider***
*A company that offers IT or network consulting and infrastructure services. This category includes hardware, storage, applications and Internet service providers.*

Agiliti, an IT ➜*infrastructure provider* in the SMB space, offers a customizable Web-based platform developed in conjunction with its ISV partner, Intershop. The company then aggregates scalable applications from Oracle, Microsoft and Vignette. While Agiliti aggregates software from third parties, it mainly focuses on technical infrastructure logistics and service, leaving application design up to its partners.

**Application hosting providers**

These ASPs offer stand-alone, rentable applications over the Web. In contrast to aggregators, application hosting providers don't offer customization or integration services. Among artists, these ASPs most closely resemble silkscreen experts, providing a routine, template-driven product.

**Original application developers**

These ASPs are primarily known as 'pure-play ASPs' or ASPs that develop their own proprietary applications. This model has the distinct advantage of better ensuring a truly integrated application bundle. Drawing out the artist analogy one last time, original application developers most closely resemble Expressionists intent on using self-made materials and experimental techniques.

One notable player in this field is Rivio (formerly known as Biztro, Inc.), recently selected by Microsoft to contribute small business administration applications to its bCentral workflow hub, a Web portal aimed at small businesses. In reference to aggregators, Maury Domengeaux, the company's senior vice president of marketing says, "It's much harder to pitch other people's applications together than it is to build the ➜*application suites* from the start. We feel the strength of an application is its ability to be aware of other existing or third-party applications." The company's platform supports the transfer of data from popular third-party applications like QuickBooks to its accounting application.

➜***Application Suite***
*An integrated group of applications designed to function and to be sold as a bundle. Some application suites include Web-based software designed by third parties with an integration bridge that allows the applications to work together.*

This type of flexibility appealed to B2P, an ASP focused on the non-profit sector that resells Rivio's applications. Founder and CEO of B2P, Jason Saul, describes Rivio as "particularly strong in the flexibility of its technology." He adds, "Their system has open ports that you can plug things into. We're able to integrate virtually anything we want into their platform and they willingly accommodate partner requests."

As in many of these areas, differences along this dimension have blurred as companies have pursued multiple strategies in a hectic quest for profitability. Some original application developers have adopted a two-pronged strategy of selling their wares both directly and through an aggregator. Late last year, OpenAir partnered with the leading aggregator, Jamcracker.

vJungle offers an even more dramatic example. In 1999, when the company first entered the ASP arena, it called itself an iASP (integrated application service provider) and emphasized its own proprietary applications. The firm's original Web site was clearly geared to small business customers. More recently, however, vJungle has adopted an aggregator model and started heavily promoting its proprietary integration technology, OpenEX. The company, billing itself as a "leading application infrastructure provider," now clearly targets other ASPs.

Cataloging ASPs according to any one of these attributes would amount to stacking books according to the colors of their covers. No single attribute gets at the heart of things. That's what makes describing the focus of this report, much less specific companies, so awkward. There's a definite trade-off between elegance and accuracy. Despite all the efforts to categorize the state of the SMB ASP market, there are ultimately only four approaches to this space:

- *A narrow range of applications developed for a vertical market.*
- *A broad range of applications developed for a vertical market.*
- *A broad range of applications developed for a horizontal market.*
- *A narrow range of applications developed for a horizontal market.*

Having said that, our focus here is on retail ASPs that offer SMBs a broad range of business administration applications, constituting a comprehensive workflow hub. ZANTHUS selected this niche because it best represents the initial goal of the industry to make ASP services a mass-market phenomenon. "The original vision was for the mass-market," says Peter Lambert, editor-in-chief of A-com, a respected industry publication covering ASP market trends. "You don't get mass-market out of large enterprises, but so far, no one has cracked that nut."

Table 2.2, below, lists some of the ASPs we examined in developing this report. The table describes providers in terms of the types of applications and services they offer. The terms used in Table 2.1 to describe the landscape of applications and services are used here as well.

## 2.2 SMB Market Players

Table 2.2 lists some of the ASPs we examined in developing this report. The table describes providers in terms of the types of applications and services they offer. The terms used in Table 2.1 to describe the landscape of applications and services are used here as well. An Asterik (*) indicates a detailed case study is available. See Chapter 10.

| PROVIDER & APPLICATIONS | PROVIDER & SERVICES |
|---|---|
| **Agillion**<br>Suite of ecommerce apps with sales, marketing and extensive CRM capabilities, along with customized customer Web pages. | **Agillion**<br>Scalable, customized Web service, including Web development, Web hosting, Web maintenance, data storage and basic customer support. |
| **Agiliti***<br>Suite of ecommerce, front and back office apps and collaboration tools from Vignette and Microsoft; catalogue & transaction tools from Intershop; and apps from Oracle that integrate third-party applications. | **Agiliti***<br>Scalable, customized IT services with server management, data storage, Internet access, Web hosting, application hosting & email. Extended customer support. |
| **Apps4biz**<br>Vertical suite of extensive CRM apps geared toward international manufacturing businesses; apps designed to integrate with Microsoft applications. | **Apps4biz**<br>Basic customer support. |
| **Atyourbusiness**<br>Suite of administration apps with extensive HR and accounting functions; includes collaboration capabilities. | **Atyourbusiness**<br>Extended customer support. |
| **Brightlane**<br>Suite of administration apps with extensive HR and accounting functions; includes extensive financial and banking capabilities. | **Brightlane**<br>Internet access, Web hosting and basic customer support |
| **Cloudwise**<br>Horizontal suite of apps with business, IT and Net services. Administration apps include HR (atyourbusiness), accounting (Netledger), ecommerce, sales and marketing (UpShot). | **Cloudwise**<br>Scalable, customized IT & Web site development and maintenance services; data storage, network configuration and email. Extended customer support and Web hosting. |
| **eAlity**<br>Horizontal suite of administration and ecommerce apps. Accounting, HR, CRM and sales apps. | **eAlity**<br>Email, data storage, extensive customer support and consulting services. |
| **Freeworks** (defunct)<br>Horizontal suite of administration apps with HR and accounting apps as well as basic CRM apps. | **Freeworks** (defunct)<br>Web hosting and basic customer support. |

(continued on following page)

# 2.2 SMB Market Players (continued)

Table 2.2 lists some of the ASPs we examined in developing this report. The table describes providers in terms of the types of applications and services they offer. The terms used in Table 2.1 to describe the landscape of applications and services are used here as well. An Asterik (*) indicates a detailed case study is available. See Chapter 10.

| PROVIDER & APPLICATIONS | PROVIDER & SERVICES |
|---|---|
| **HotOffice* (defunct)**<br>Suite of collaboration and communications apps. Intranet with chat, tracking, scheduling and contact functions as well as Web presentation, conferencing, marketing and sales application tools. | **HotOffice* (defunct)**<br>Basic customer support. Email, extended external communication access via wireless and Palm. |
| **OfficeClip**<br>Suite of extensive collaboration applications. | **OfficeClip**<br>Basic customer support. |
| **OpenAir***<br>Horizontal suite of business administration applications with extensive accounting, sales and marketing applications geared for professional services organizations. | **OpenAir***<br>Customization, storage and back-up. Basic customer support and extended communication access via WAP and Palm. |
| **Outtask**<br>Horizontal suite of administration apps, including extensive ecommerce, administration and collaboration apps | **Outtask**<br>Email, Internet access, data storage, IT services and extended customer support. |
| **Proacttechnologies**<br>Suite of administration apps around HR and financing with some collaboration apps. | **Proacttechnologies**<br>Basic customer support. |
| **Rivio***<br>Suite of administration apps with accounting, collaboration and HR applications, including procurement services. | **Rivio***<br>Web hosting, customization and basic customer support. |
| **Simpata**<br>Suite of administration apps with extensive HR and resource apps, in addition to collaboration and basic accounting apps. | **Simpata**<br>Basic customer support. |
| **SmartOnline**<br>Horizontal suite of administration apps with extensive accounting, finance and HR apps; sales & marketing apps. | **SmartOnline**<br>Basic customer support. |
| **vJungle**<br>Horizontal suite of administration apps including apps to ease integration with third-party software. Suite provides mainly collaboration and accounting apps; HR, marketing and additional finance apps will soon be available. | **vJungle**<br>Web hosting, email, storage and basic customer support. |
| **Zland**<br>Horizontal suite featuring ecommerce apps, including extensive sales and marketing applications in addition to administration apps, including accounting and HR functions. | **Zland**<br>Internet access, email, customized applications and Web sites. Extended customer support with administration training. Application maintenance and upgrades with extended technical support. |

Source: © 2001 ZANTHUS

# 3.0 THE MARKET RIGHT NOW

About a year ago, a number of industry observers issued very generous forecasts for the ASP market. The hype surrounding the early 2000 ASP market conjured up Keynesian images of extravagant leisure. In his 70-year-old essay "The Economic Possibilities of our Grandchildren," the economist John Maynard Keynes imagined technological progress would bless the masses with a surfeit of leisure, which they would spend reading books, attending the ballet and otherwise cultivating their interests in the arts.

According to the Giga Information Group in early 2000, so-called 'software outsourcing companies' generated a modest US$ 360 million in revenue in 1999. The company predicted a dramatic increase in sales for 2000—an estimated US$ 1.4 billion—US$ 3.6 billion in 2001 and upwards of US$ 20 billion by the end of 2003. Wall Street valued many of the leading enterprise-level ASPs at multiples of 50 to 100 times revenues and more than 500 ASPs, broadly defined, emerged in the US alone.

Just six months later, early in the fourth quarter of last year, IDC forecast that worldwide spending on ASP services for enterprise applications—the majority of sales to date—would reach only US$ 2 billion by 2003. In a press release, Clare Gillan, group vice president of IDC's Applications and Information Access research stated, "Awareness of ASPs is slowly penetrating the market. Although buyers are beginning to learn about ASPs, their degree of knowledge is very limited."

More recently, in January of this year, the nonprofit Internet Business Services Initiative released survey results confirming that large companies are signing on with ASPs at a faster rate than SMB market companies. Most analysts agree that market gains will largely accrue to enterprise-level ASPs like USInternetworking, Corio and eOnline. "At the moment, 80% of the value of ASP contracts is being derived from the large companies," says Ben Pring, an analyst for the GartnerGroup. "So, I've consistently said for three years or so now that this will not take off in the SMB market in the way that some people suggested it would. It will take off in the large company space and that's exactly what's happening now."

Why hasn't the ASP market lived up to its initial billing? Ignoring for a moment the ➜*threshold issues* and competitive threats discussed later, the most succinct answer is that as far as the SMB market goes, ASPs are ahead of the curve. More specifically, using concepts popularized by Geoffrey Moore in *Crossing the Chasm* (1991), the market is on the cusp between ➜'*early adopters*' and the ➜'*early majority*.' Current ASP customers are largely early adopters who are willing to put up with the hassles associated with emerging technology for the thrill of the new. Early majority customers, on the other hand, are those who are anxious for technological solutions, but want demonstrable proof that these solutions will indeed solve their problems—and at a price they can afford. As Moore states, this latter group wants "evolution not revolution. They want technology to enhance, not overthrow, established ways of doing business."

The aggressive investment environment of the

➜***Threshold Issues***
*Customer requirements that need to be met before new technologies can reach critical mass.*

➜***Early Adopters***
*People who see the value of emerging technologies and are willing to utilize these new offerings to enhance their business processes despite the potential risks.*

➜***Early Majority***
*People interested in emerging technologies who wait to adopt until these offerings have demonstrable value.*

ⓘ SURVIVAL TIP:
The ASP industry's present troubles are rooted in aggressive investing in a low-demand market.

last two years encouraged the development of companies before their time. The rationale for this situation is known in investment circles as the 'the call of compound interest.' The first players or the first movers in a market are typically accorded the greatest financial rewards. The earlier a company can gain acceptance of its 'paradigm-shifting' technology, the more it benefits. The trick is to anticipate change early enough to be a market leader, but not so late as to leave substantial sums on the table.

In the bloodrush of the early market, venture capitalists gambled heavily on the model, building up and later, tearing down, companies like HotOffice, an early ASP with a sound product now defunct due to a lack of funding. "Sometimes," explains Heidi Roizen, a venture capitalist with SOFTBANK Venture Capital Group, "what happens is that the financial models don't fit together. For example, companies may take on investment at a very heady valuation and then the market gets more sanguine and they have to take on more money...[A] lot of times, the entrepreneurs decide it's not worth continuing it, there's not enough left in it for them."

Today's ASPs are in a position similar to that of Xerox's WordStar PC in the early-80s. The advantages of the model are clear and compelling, but somehow, customers are slow to adopt it. Xerox introduced WordStar in April 1981 with much fanfare. Designed as an office automation system for business professionals, WordStar offered a number of commercial firsts, notably the first graphical user interface (complete with windows that allowed for multiple applications), the first bundle of integrated applications, the first mouse-driven interface, the first bitmapped screens, and the first Ethernet LAN connection.

All of these advances made for a disconcertingly unfamiliar product in a market dominated by inexpensive, standalone PCs (WordStar also lacked a spreadsheet application, which perhaps more than any other program, spurred the sale of desktop computers). In short order, like many ASP offerings, the product fell into Moore's chasm between early adopters and the mass market. The main lesson? The voice of the customer should be adequately represented in the product development process. Not that customers are always right; no, their opinions often reflect popular misconceptions. But even when customers are patently wrong, it's valuable to know how far wrong and why. The point is that technology companies should be customer-informed, but idea-led. They need to understand how customers think, but test customers' opinions for conceptual sense.

WordStar made obvious a number of good ideas—ideas promptly incorporated into Apple's Lisa and Macintosh systems and later, Microsoft Windows. In this way, it served as one step in a larger evolutionary process, just as we suspect ASPs, in their current form, will eventually give way to a utility model along the lines of energy or telecommunications services. The specific path to that scenario isn't clear. Right now, ASPs are like actors who understand the main narrative line, but have mislaid their scripts and are forced to improvise for the first time. But this fervent casting about for direction shouldn't obscure the inherent power of the model.

## 4.0 WHAT SMBs WANT TO KNOW

Last year Cynthia Adkins' five-person concierge and event services firm, Concierge At Large, Inc., was growing rapidly. The plucky entrepreneur knew it was time to look for some outside help. Developing new business, serving clients and managing staff was enough without having to keep the books, administer employee benefits and troubleshoot the office network. On top of that, cash was tight. For her, the ASP model offered a way to minimize some of her administrative duties.

"As a small-business owner, I wanted to do as much of business as I could over the Web and I didn't have enough capital to invest in some of the services I wanted," says Adkins. Because she considers herself an early adopter and because many of her clients are high-tech firms, she was open to new, relatively untested solutions. After researching the alternatives to a large-scale installation, she opted for a Web-based ➜*workflow platform* from Rivio, Inc. This platform offered Adkins the applications she needed for a reasonable monthly fee, without the headaches or ongoing maintenance costs typically associated with client-server setups.

**SURVIVAL TIP:** An ASP's value proposition is liberation—from infrastructure nightmares—from finding and retaining IT staff and from the elimination of risk associated with technology obsolescence or poor performance.

➜***Workflow Platform***
*Like an operating system that supports applications on a PC, workflow platforms support multiple applications over the web.*

The most compelling promise of the ASP model for SMBs is substantial cost-savings. Savings are accrued in a number of ways. Firstly, cash-strapped companies like Adkins' freshly started venture don't have to make upfront investments in hardware and software to gain access to vital back office applications. Secondly, because applications are rented over the Web, there's no need for expensive IT staffers to maintain and update the system. Thus, the prospect that ASPs can provide SMBs with the administrative resources that until recently were affordable only to the Fortune 500.

ASPs in the SMB market offer a wide variety of services that leverage collective buying power. From office supply and equipment procurement to health benefits purchasing, there are ASPs ready to meet every need. Customers can acquire products/services, comparison shop, post requests for quotes, provide quotes, or just receive advice, with greater access to critical information than ever. Prior to the advent of ASPs, these resources were the exclusive privilege of big-budget enterprises.

Using Web-based applications for human resources management and payroll processing like those offered by Simpata could potentially save SMBs serious money, allowing these businesses to spend more on refining their core competencies. "If you look at benefits, a typical company spends $3,500 to $4,000 a year per employee," explains Simpata's vice president of marketing, Chuck Moxley. "In addition to these costs, just the administration of benefits and employees in terms of time and other costs can run another $1,500 per employee. So if we can save a company those added costs-per-employee, we feel that is a pretty strong value proposition."

Another driver of the ASP model in this space is time to market. By using an ASP, companies can minimize the resources devoted to infrastructure development. SmartContractor, an ASP serving electrical contractors with time-saving services developed by OpenAir, has taken advantage of this dynamic. When asked to describe the benefits of using an ASP, Chad Blevins, the company's vice president of development says, "The first thing we get is a faster time to market. If we had to go and develop each one of the applications we provide, any one of them would be enough to consume our company."

WHAT SMBs WANT

ASPs can also help address a number of troubling IT issues. Many companies, regardless of size, have difficulty attracting and retaining qualified IT personnel. SMB market companies face a particularly small pool of available IT talent. Besides the cost of top-tier IT professionals, few aspire to careers developing and maintaining small-to-middling LANs. The opportunity for personal and career growth is just too limited. "A lot of companies can't find qualified IT staff," says Rob Austin of the Harvard School of Business. "When they do find the right people, they cost too much. And when it doesn't work out, they don't have anyone to call."

Moreover, ASPs can make typically volatile IT costs more predictable. As new hardware and software solutions are introduced, companies using ASPs don't have to worry about playing an expensive game of catch-up. Kneko Burney, a widely cited analyst at Cahners In-Stat Group, singles this out as a unique benefit of ASPs. "The appropriate technology solutions to participate in this economy will keep on changing at a breakneck pace, so the customer—particularly the smaller customer who has very limited resources—isn't interested in buying a platform that will be out of date or even obsolete a year from now," she asserts. "That's why application services are poised to become very important to a lot of businesses—because they are, so to speak, future proof. The service provider can adopt the latest and greatest technologies and provision them to their customers without the customer having to feel the pain of continual updates and new solutions."

# 5.0 ANTICIPATING MASS ADOPTION: SMB CUSTOMER'S THRESHOLD REQUIREMENTS

While the ASP model promises several compelling benefits, there are a number of threshold issues ASPs must address before the SMB market adopts the model in high numbers. By threshold issues, we mean issues ASPs must resolve before potential SMBs even consider the subscription model as a viable alternative to the near-ubiquitous client-server platform. Technical issues like broadband access, the reliability of the Internet, data integrity and platform integration all fall into this category, and each will require time and money to tackle effectively.

As Heidi Roizen of SOFTBANK states, "We're simply not there yet. I don't think we've yet reached a level of reliability, availability and ubiquity. There is going to have to be a lot of money invested in the infrastructure to enable small businesses to take advantage of the shift [to the subscription model]. But when that happens, you will see mass adoption."

Even though demand for broadband exceeds supply, the roll-out of digital subscriber line (DSL), cable modem, satellite-based and other high-bandwidth services has been slow. Cable modem has proven the most popular so far, with just about five million subscribers at the end of 2000. The market's immaturity is even more evident when viewed from the perspective of service providers. As of June of last year, Cox Communications had the most cable modem subscribers, a mere 3.3% of the customers in its system, according to the Yankee Group.

DSL's headway is even more limited. While Cincinnati Bell had the highest percentage of lines being served with DSL (29,000 or 2.9%), SBC Communications in San Antonio, Texas, had the most DSL in service, but the lowest overall percentage of

ANTICIPATING MASS ADOPTION

➔*Service Level Agreement (SLA)*
*A contractual agreement between the provider and the end user to ensure mutually agreeable levels of service, typically with pre-defined penalties if such levels aren't met.*

➔*Managed Service Provider (MSP)*
*A company that aggregates and manages IT and applications and services from one or more vendors.*

**SURVIVAL TIP:**
Face technical threshold issues dead-on and provide low-risk applications. Issues concerning broadband access, the reliability of the Internet, data integrity and platform integration must be resolved before SMBs will abandon the security of client-server platforms for the ASP subscription model.

DSL lines (359,000 or nearly 1%). And just last year, a number of DSL providers shuttered their doors, including Northpoint and Jato. Other DSL providers like Rhythms and Covad have slashed jobs in the face of diminishing returns, all during a time of tremendous demand for broadband services.

Why? Because when Congress passed the 1996 Telecommunications Act in the name of "leveling the playing field," it inadvertently created an environment where no single company can make enough money on broadband to justify the necessary expenditures on infrastructure and marketing. Right now, providing broadband entails a nightmarish allegiance among Internet service providers, Baby Bells, long distance telephone providers, competitive local exchange carriers and cable companies. As noted by George Gilder in a recent article for *The Wall Street Journal*, "as many as four parties routinely battle for low or negative-margin chunks of $40 monthly bills."

Industry visionary, Cameron Chell, founder of two prominent ASPs, FutureLink and cMeRun, in addition to the Chell Merchant Capital Group, explains, "It's not that we can't get broadband down to the end users. It's that we can't get broadband because telcos are so busy and inefficient that you sell a customer a product, you get ready to get it installed and it's six weeks to get the bandwidth that you want."

Given this situation, Forrester Research recently predicted that the number of broadband connections would double by the end of 2001—a jump hardly sufficient to meet demand borne by the desire for seamless business-to-business transactions, more online consumer purchasing, increasingly rich online media and the growing popularity of telecommuting. Unfortunately for ASPs, the sluggish build-out of broadband services is, at least for the foreseeable future, an insurmountable obstacle to mass-adoption.

Even where broadband services are readily available, they aren't always reliable. Some studies suggest that up to 50% of DSL connections fail on the first attempt. An owner of an architectural firm, who wished to remain anonymous for this report, said access to his ASP was down for days due to an indeterminate problem. The incident prompted him to rethink his reliance on an ASP for critical business administration applications. "I'm real confused about what's the best solution [for my business]," he says. "I like the idea of not having to be so dependent on a line that apparently broke. It's something you can't control."

SOFTBANK's Roizen has experienced similar troubles. "Here I am in Atherton, California with probably the highest concentration of Internet executives in the world," she notes, "and my cable modem is down 20% of the time." Imagine if she were a small business trying to manage its personnel records, employee benefits and most importantly, payroll, online.

In order for ASPs to compete effectively with the best LAN experience, guaranteed access is a must. The industry is far from developing service standards that offer recourse for ASPs that don't live up to their promises. However, a few ASPs are now ensuring access and offering financial accountability through ➔*service level agreements* (SLA) as a way to attract wary end users.

Seattle-based Telicor, a ➔*managed service provider* (MSP) dedicated to managing the telco portfolios of mid-sized companies is distinguished by its focus on service. John Barnhart, vice president of next-generation services, asserts that guaranteeing service availability is something service providers haven't done for very long. "In my experience, I've seen more SLA agreements that do not actually have penalties, " says Barnhart. "The provider will guarantee a type of service without specifying what will happen if they don't meet their guarantee. But without some quantification or enforceable penalty, there really isn't much meaning to an SLA. For an SLA to have any teeth whatsoever, there have to be some penalties associated with it."

SLA agreements vary depending upon customers' particular needs and are often complicated. Companies like Telicor develop their SLAs around four basic metrics: bandwidth performance, application performance, response time and repair time. Not until ASPs maintain high standards along these lines and with an acceptable degree of accountability, will customers' hesitations about reliability be laid to rest.

Along with increased reliability, ASPs have to deal with widespread and largely exaggerated security concerns. Most SMBs are cautious by nature, especially when it comes to new technology. They see every news report of hacker activity as another excuse to dismiss Web-based services. Because most ASPs don't have the resources to provide in-person customer support, they have to rely on channel partners to ensure their customers' sensitive financial data, employee records and other important information aren't vulnerable to hackers or abuse by third-party ASPs hosting the data remotely.

As a service-oriented value-added-reseller (VAR) offering Microsoft/Great Plains applications to medium-sized businesses, Andata Technology helps to ease customers' security fears by walking them

ANTICIPATING MASS ADOPTION

through the installation process. The company's vice president of sales, Bruce Boedigheimer, admits that "you can talk firewalls, virtual private networking and encryption all day long, but the vast majority of the people you talk to really don't understand what the heck it all means. They're taking a leap of faith."

Despite her initial enthusiasm for the ASP model, Concierge At Large's Cynthia Adkins concedes that she waited "quite awhile" before outsourcing critical business applications. In the beginning, she was uncomfortable with the notion of placing her contact database on the Web. "I wasn't ready to do that at the time. It's the core of our business—our contacts. I wasn't confident about putting that on the Web," says Adkins. "Now that there are a few of them [ASPs] out there and I've been able to work with most of my applications over the Web for almost a year...I'm taking the next step." Adkins has become such a believer in the ASP model that she's recently entrusted an ASP to handle the company's general IT needs.

So far, ASPs have tried to lure normally risk-averse SMBs with promises of cost-savings and other benefits while figuring out how to make the model work. That's too much to ask of customers. The current technology infrastructure demands humility. ASPs can't reasonably host mission critical applications in today's environment. The situation calls for a migration strategy where ASPs first offer SMBs relatively low-risk applications like time and attendance tracking programs; then, as the infrastructure improves, promote more critical applications like payroll processing.

The historical pattern is clear: many innovators try to introduce new technologies before these solutions are standardized enough to be useful to a broad market. Thomas Edison's light bulb was hardly an instant success. Most early forms of the light bulb either shattered from the heat produced or would burn out after only a few minutes. The light bulb didn't become commonplace until the invention of a glass that could withstand the heat and ensure a relatively long life. As with Edison's light bulb, ASPs haven't achieved the necessary standards of quality to gain real traction in the SMB market.

In addition to security and connectivity requirements, the integration of applications is also vital, whether sourced from an ASP with its own proprietary software or an aggregator bridging software developed by others. In some situations, the collective benefits of the ASP model can be outweighed by the time and expense associated with integration. As technical salesman Chris Taylor of Computer Integration Technologies, Inc. (one of Agiliti's partners) notes, "It may look good on paper or in a PowerPoint presentation, but when the rubber hits the road, the application needs to work and work well." Once integration standards have been established, ASPs will be free to focus on differentiating their offers.

*THE CURRENT TECHNOLOGY INFRASTRUCTURE DEMANDS HUMILITY. ASPs CAN'T REASONABLY HOST MISSION CRITICAL APPLICATIONS IN TODAY'S ENVIRONMENT.*

Just as the consumer appliance industry didn't expand vigorously until the emergence of the standardized electrical plug, ASPs won't reach critical mass until common standards are developed that facilitate the seamless integration of hosted applications and native systems. "The reason hitting any critical mass of users is going to be a problem," observes Cameron Chell, "is that a lot of these enabling technologies that make applications integrate just aren't in place yet and are going to take some more time. Hitting their numbers and creating true dynamic ASP revenue in the meantime is going to be tough."

# 6.0 THE REMAINING ROADBLOCKS TO SUCCESS

Aside from the technical challenges facing ASPs in the SMB space, there are significant marketing challenges, most notably, the inherent conservatism of target customers. Most Internet use among SMBs has been outwardly focused as a vehicle to facilitate more timely and cost-effective purchases, check on competitors and pertinent markets, find new vendors and conduct marketing. SMBs aren't, on the whole, using the Web to refine internal processes or store data. Use of the Internet to simplify in-house tasks, even when recognized as advantageous, requires change. Change isn't easy, no matter the size of the business.

SMBs' most pressing concerns include cash flow, the retention of qualified staff and managing tasks not central to their core competencies. Particularly for small businesses—those with fewer than 100 employees—the type of administrative concerns many ASPs seek to address are handled by owner/operators or their immediate assistants. Most of these people don't understand ASP offerings on a technical level and more importantly, have a difficult time figuring out the cost-benefit tradeoffs involved in adopting the service. Based on ZANTHUS' own quantitative research, even SMBs convinced ASP services would yield increased efficiencies still doubt the ultimate value of the model.

Why this seemingly contradictory behavior? Because even though their business administration procedures may be hopelessly convoluted, most SMBs are loathe to abandon their inefficient, but nonetheless workable systems, in favor of an unproven alternative. In effect, they have become accustomed to inefficiency and recognize that any step—even one towards greater efficiency—will require substantial resources. Will the time, effort and cost of implementing an ASP solution and retraining employees prove cost-effective? When faced with the prospect of outsourcing, that's the central question many SMBs ask. There's a tremendous inertia here, much like the resistance to switching cell phone providers, where customers are forced to weigh the benefits of a better rate plan against the pain involved in changing phone numbers. In the absence of clearly superior alternatives, customers will invariably stay with what they have.

**SURVIVAL TIP:**
Beware of the SMB market's conservative disposition. SMBs gravitate toward traditional business processes, largely manual processes that yield palpable evidence of what they consider "real work"—resisting even the best technological solutions.

There are at least two other prominent characteristics of SMBs that pose particular challenges for ASPs: like-sized companies tend to stick together and older managers who resist technological advances run many companies in this market. In general, SMBs tend to do business with other companies of the same size, working at the level of personal relationships. Most SMBs prefer to work with other SMBs in a circle of mutual support. When approached by a larger company, these customers expect to receive significant personal attention. In practical terms for ASPs, this means making costly in-person sales or training calls, or at the very least, having a strong call center.

Without indulging in stereotypes, it's safe to say that older managers tend to resist new, unfamiliar technologies more fervently than their younger counterparts. In research ZANTHUS has conducted, we found a number of businesses where HR directors or office managers explained that their older superiors would fight moving to a subscription model for business administration applications even if they recognized the benefits of the change. Upper management at these firms favored traditional, largely manual processes that yielded palpable evidence of what they called "real work."



The other main marketing challenge for ASPs in this sector is the persistent elusiveness of a 'killer app,' or the ideal set of applications covering every small business' needs. The major players in this space are desperately seeking the perfect combination of functionality, scalability and ease-of-use. "The real confusion is: nobody knows what the right bundle is for small businesses," concedes Mickey Freeman, former vice president of marketing for the shuttered HotOffice.

**SURVIVAL TIP:**
When targeting segmented markets, create custom applications that will satisfy customer needs without losing economies of scale.

Enterprise-level software doesn't provide the right functionality or price-point for SMBs. Chuck Welch, director of product development at eScout, a B2B portal that both partners with and uses Simpata's services, says, "When you weigh the functionality of a PeopleSoft or an SAP against its cost, the value is not as good. Simpata's functionality was just as good and their price was a lot better."

Many ASPs targeting SMBs offer scalable applications that offer a higher return on investment than those offered by enterprise software developers. Concierge at Large's Adkins looked at outsourcing her company's back office applications to industry giant SAP before selecting Rivio. "Ultimately, it came down to cost," she says. "We were still building the company and our client base. I wasn't willing to commit such a large percentage of our capital to an ASP that I didn't know I was going to need."

In an effort to improve the value of their applications, several ASPs have developed configurable software. To realize the full potential of the platform, many SMBs will require industry-specific adjustments. From law firms to manufacturers, across our various quantitative studies in this market, SMBs have demanded ASPs deliver applications that accommodate their unique needs. Jason Saul, the founder and CEO of B2P, an ASP serving non-profits using Rivio's platform, says, "Rivio is unusually flexible in providing us with a lot of input and customization. Their system essentially has open ports that you can plug things into. We are able to integrate virtually anything we want to integrate into their platform and they will willingly accommodate channel partner requests."

The dilemma for many ASPs is to find a way to allow for enough customization to satisfy customers without losing the economies of scale gained by producing 'generic' applications. OpenAir has made some inroads in this direction. The company's suite of applications has what amounts to on/off switches. This feature gives the firm a quick and easy way to customize applications by turning on the features customers want and turning off the ones they don't. It was this feature that SmartContractor took advantage of in order to resell the platform to its niche market quickly and with minimal expense.

# 7.0 CROSSING THE FINANCIAL DESERT

ⓘ **SURVIVAL TIP:**
In the present market shakeout, retail ASPs in the SMB space will be well served to prioritize market segmentation strategies to target and retain high-revenue customers and forgo giveaway tactics and other market penetration strategies that drain precious resources.

The unprecedented swiftness of the current economic downturn and the consequent emphasis on profitability has shaken the confidence of some investors in the ASP model. Already, the downward swing has claimed a considerable share of ASPs in the SMB space, among them, early entrants like RedGorilla, HotOffice and FreeWorks. Still, there appears to be plenty of venture capital for deserving companies—companies that meet new, more conservative standards of success. "The venture capital in this space hasn't dried up," asserts Cameron Chell, the head of Chell Merchant Capital Group. "They're going to be demanding more customers upfront and I think that the ASPs you see coming out of the start-up phase are going to be much more focused [than first-generation concerns]."

The key criteria for securing additional venture financing in this environment include steadily growing revenues (if not outright profitability), technological superiority, strong channel partnerships and superior service. Doubtless, achieving profitability in a new category flush with competitors requires a winning business model and a lot of luck. In times of economic distress, companies with a strong customer base can simply focus on keeping their current customers happy—an economical strategy if the conditions are right. But when the investment community demands growth through innovation, new distribution channels or even aggressive marketing, a significant burn rate is almost inevitable. As Chell notes, "If you've built up an infrastructure that's burning $5 million or $10 million a month and, all of a sudden, you can't get your funding, it doesn't take too long before you're out of business."

Hitting revenue targets, much less becoming profitable, will prove hard for many ASPs competing in a space where many services are offered for free. Early on, like a host of B2C concerns, many ASPs adopted a tiered-service strategy designed to maximize customer acquisition rather than revenue-generation. This penetration pricing approach meant offering an introductory suite of services for free in hopes of building a sizeable customer base quickly, then offering so-called 'premium' services for a fee. Some players pursued this strategy regardless of early warning signs about the volatility of the dotcom economy and the fact that their companies offered services that were virtually indistinguishable from competitors, making their upsell strategy a difficult proposition.

Up until the end, for instance, Taphan Bhat, vice president of marketing at the now-closed FreeWorks claimed the company's time card, expense reporting and basic accounting applications were unique, despite the fact that numerous ASPs offer similar applications. "What we offer simply does not exist," he posited. "I don't know if anyone else is providing any of these services with so many uses. There are no applications that do what our applications can do."

Perhaps the most telling example of this phenomenon is HotOffice, a comparatively popular first-generation ASP in the SMB space. The company initially charged customers $12.95 per user per month for use of its Web-based suite of business administration applications. In August of 1999, shortly after closing what proved to be its final round of funding, one of the company's main competitors, Intranets.com, began offering a similar service without charge—for life.

In response, HotOffice re-tooled its service and launched a comparable free service, supported in part by advertising. In an attempt to control its burn rate, the company provided an ad-free version for the original subscription price. HotOffice gained an impressive 100,000 customers with this mix, but failed to gain enough paying converts to keep its original investors interested. In June 2000, HotOffice scaled back its workforce as it scrambled for additional funding. Six months later, the company closed its doors for good, bowing out gracefully by directing customers to Intranets.com.

*OFFERING BUSINESS APPLICATIONS AND SERVICES FOR FREE IN A RELATIVELY UNDIFFERENTIATED MARKET MAY INCREASE A COMPANY'S MARKET SHARE, BUT ADD LITTLE TO ITS BOTTOM LINE.*

HotOffice was neither the first nor the last ASP to run out of time. The company's demise, however, was hastened by Intranets' aggressive pricing model. "We never thought the free model had legs at all," says Mickey Freeman, HotOffice's former vice president of marketing. "We came from other business worlds where the Internet business model never made sense and where people will pay for something where they find value. On average, we probably made a third of what we could have with paying customers."

It's poor consolation for Freeman to know that his initial take on the free model was dead-on. While honoring its commitment to free service for life for its pioneer customers, Intranets.com recently introduced a premium service for $19.95 per month for every five users.

Until recently, a profit mentality hasn't been prevalent in the ASP space. The industry has been plagued with 'dumb competitors,' a concept described in Robert J. Dolan's and Hermann Simon's *Power Pricing: How Managing Price Transforms the Bottom Line* (1996). Dumb competitors are companies that provoke price wars or keep prices well below the perceived value of the product, eventually harming revenue and profitability for all players involved.

Dolan and Simon point out that "unless a firm has a very high level of product differentiation, it's own profits are to some extent under the control of its competitors.... allowing an industry to become focused solely on low price and market price has disastrous consequences." In a young market it's not surprising that companies are more concerned with market share than profitability. However, as the ASP industry faces increasing pressure to demonstrate profitability, offering business applications and services for free in a relatively undifferentiated market may increase a company's market share, but add little to its bottom line.

In addition to the recently enshrined 'path to profitability,' venture capitalists are looking for companies with a clear technological advantage.

According to Peter Gardner, a general partner at Allegis Capital, as the market enters a consolidation phase intellectual property will provide companies with a critical competitive edge. "I'm interested in ASPs that have proprietary technology within the platform," he says. "The technology layer inside the platform is much more sophisticated in this generation of ASPs than it has been in the first. And I think what we'll end up with is a mix of internally-developed applications and third-party applications."

Another important criterion for investors is a sound distribution strategy. Strong channel partnerships can help cash-strapped ASPs grow their customer base cost-effectively and in turn, boost revenues. Large financial institutions, Internet service providers, local and long distance telephone service providers, hardware manufacturers, independent software developers and even other ASPs can make powerful distribution channels.

Rivio is one of several ASPs in the SMB space that has adopted an aggressive channel partner strategy. The company has provided channel partners like Verizon Communications, Bank of America and BellSouth with customized versions of its business administration platform. These partners use Rivio's service, in turn, as an incentive for small business customers to remain loyal. Through its channel partners, Rivio has successfully marketed its proprietary, Web-based platform to thousands of businesses for a fraction of the money it would have spent otherwise. As Maury Domengeaux, the company's senior vice president of marketing, says, "Through our partners, we have access to over 15,000 businesses of the existing 30,000 small businesses [in the US]."

In addition to distribution strategies, systems integration is equally important to investors, whether implemented by the companies directly or channel partners. One company that's made a concentrated effort to tackle integration issues is vJungle. Abhijeet Rane, director of product planning, describes vJungle's advantage in integration technology this way: "In our view, the way this market is going to consolidate is that if companies don't focus on enhancing their applications through integration and lowering their customer acquisition costs through distribution channels, they will die."

vJungle relies largely on its channel partners for distributing its integration technology, OpenEx. As Gardner from Allegis Capital explains, "I think vJungle has the right distribution strategy—partnering with large companies that already have a large channel and customer base, as well as a strong market presence—rather than trying to deliver these integration platforms directly to the end user."

As with other Web-based business models, investors are demanding ASPs concentrate on the fundamentals. Because so many companies operated for so long on the assumption of continued venture capital, the industry is bound to experience a period of rapid consolidation. During this period, ASPs with the most compelling proprietary integration technologies and cost-effective distribution strategies will have the greatest advantages.

# 8.0 THE COMPETITION, OR FACING YOUR WORST FEARS

The most persistent and potentially, ruinous competitive threat to ASPs is their own customers. Customer-deployed solutions—standard client-server setups, company intranets or a combination of the two—present the gravest competitive threat to the ASP model. Based on clear-cut financial arguments or otherwise, customers must be persuaded that giving up a degree of control will yield measurable returns in cost-savings and operational efficiency.

In researching the appeal of various Web-based applications, we've found that SMBs are willing to put up with their existing, admittedly inefficient, processes, primarily for retaining control. Let's look at time and attendance tracking. For most SMBs, time and attendance is tracked manually. In the typical process, employees fill out time sheets (usually preprinted forms) by hand, and then turn them in to an administrative assistant or controller. The second party, in turn, reviews the time entries and puts the data into a log, either hardcopy or electronic. This information is then sent to the payroll department, or a provider like ADP. Companies that outsource payroll usually supply their payroll provider with the necessary information over the phone. A few fax the information and fewer still email it.

Despite the laborious nature of the process, most SMBs express few, if any, complaints about it. They estimate that employees spend only a few minutes each day entering their time and that the final tally requires only a half-hour or so on the part of an administrative assistant. Most recognize that the process could be made more efficient, but for the most part, time and attendance isn't an issue for them. Many managers at small firms don't demand a strict accounting of vacation and sick time, preferring to work on the 'honor system' in a loose, collegial environment.

Generally, SMB companies are open to Web-based applications insofar as they are easy to implement and minimally disruptive to the way they currently do business. This combination of factors is important. Despite the promise of greater efficiency provided by Web-based services like payroll processing, SMBs are, for a host of reasons, wary about migrating to a new, unproven system. They feel much more comfortable with supplementary services like time and attendance tracking—services that offer comparatively marginal savings going with an ASP, but less risk in case of problems. The downside is that these services aren't generally associated with significant pain-points, and so aren't especially compelling.

This situation amounts to a Catch-22: customers are reluctant to adopt the ASP model for critical applications like payroll processing, yet aren't likely to realize the full benefits of Web-based services without making that leap. The key to mass-market adoption is disrupting this dynamic, whether through improved technology, more stringent SLAs or some other compelling factor. Otherwise, the status quo will prevail.

Beyond customers, there are a number of other serious threats to retail ASPs, among them, enterprise software developers like PeopleSoft, Ariba and SAP. If these companies decide to go downmarket, they could make for formidable competition. Peter Lambert, editor-in-chief of *A-Com* asserts that "companies like PeopleSoft have left behind client-servers entirely. They have re-architectured their applications towards a hosted environment, presumably to become ASPs themselves. They are learning how to manage their own applications in a hosted environment. They can leapfrog over pure-play ASPs, taking on ASPs' management role by partnering with big network service providers and cutting them out altogether."

With the advent of its .Net initiative, Microsoft has already joined the ranks of software developers entering the ASP market. The initiative centers on creating a standardized platform for customizing and integrating multiple online applications. As the world's largest software company and the third-largest ISP, Microsoft has the requisite market presence, capital, application development expertise and distribution channels to almost single-handedly set the integration standards for this market.

In a press release announcing its acquisition of Great Plains late last year, the Redmond, Washington giant made its intentions towards the SMB market clear: "Microsoft's acquisition of Great Plains will accelerate the success of small and medium companies globally with integrated, extensible business management software solutions needed to succeed in an increasingly interconnected economy."

To supplement Great Plains' suite of applications, Microsoft formed an alliance with Rivio. As part of this arrangement, Rivio will develop applications for Microsoft's bCentral, a portal aimed directly at small businesses. bCentral offers sales, marketing, accounting and other Web-based business administration applications. In addition, Microsoft announced in late January of this year to invest up to US$25 million building cpa2biz, the first online workflow hub for certified public accountants.

Established name-brand software developers like SAP and Microsoft could accelerate the adoption of the ASP model. As the physical infrastructure behind the Internet improves and ASPs are able to meet largely technical threshold requirements more easily, major software firms could reasonably move downmarket to capture the SMB space. However, companies like SAP will face several issues of their own, namely, learning how to develop applications solely for the Web. More importantly they will have to learn how to price what used to be exclusively enterprise software without inadvertently giving up a lucrative high-end niche for a comparatively low-margin mass market.

"I think there's a tremendous opportunity for the

*AS THE PHYSICAL INFRASTRUCTURE BEHIND THE INTERNET IMPROVES, …MAJOR SOFTWARE FIRMS COULD REASONABLY MOVE DOWNMARKET TO CAPTURE THE SMB SPACE.*

**SURVIVAL TIP:**
When differentiating your offerings, prepare for tomorrow's battles with upstream competitors such as Peoplesoft, Microsoft and SAP.

[Independent software vendors (ISVs)] that are able to adapt to the subscription model and make it happen," says Chell. "They are talking about being able to get instant distribution for their product, get all their money as a monthly recurring revenue and add some predictability to their budgets. When it comes time to upgrade, boom, everybody's upgraded at once. Talk about being able to move product downmarket. Individuals that never dreamed they would be computer-savvy will use computers in a powerful way as easily as telephones."

Many industry leaders have likened ASP services, in their most advanced form, to telephone services. When Chell started what many consider the first ASP, FutureLink, he described it as following a "computer utility model." He asserts that the way consumers currently use PCs compares unfavorably to the way consumers use telephones. Today, SMBs are forced to purchase PCs with a minimum level of functionality. If computing followed the utility model, these customers would purchase so-called 'dumb terminals,' making hardware and manual software upgrades a thing of the past. In contrast, as Chell points out, he can use a 15-year-old phone system to access the newest custom calling features because those features are centrally-managed. Of course, telephony is a mature market, designed from the beginning to provide centralized services with a minimum need for complicated end user hardware.

There's no doubt, however, that as the ASP model gains traction, traditional telcos and ISPs will enter the market more aggressively. These companies have a number of advantages, including IT expertise, large-scale facilities suitable for hosting software, the requisite pipe and a billing relationship with millions of potential customers. What's more, as revenues derived from their core business continue to decline, there's a powerful financial incentive for getting into the ASP market. "Lots of people [service providers] providing bandwidth, access and devices are suffering from a commoditization problem," says Gardner of Allegis Capital. "They're suffering from a margin problem. For them to maintain margin and build their businesses over time means delivering value-added services to their existing customer base."

Telecommunications giant Qwest Communications has already made bold moves in this space. The company's recently announced Apptimum program is targeted at ISVs looking to Web-enable their software. The program is also geared towards existing ASPs looking for an infrastructure provider, putting additional pressure on companies that offer their own IT infrastructure services. Moreover, companies participating in the program are required to build their services on Microsoft's .Net platform.

This combination of factors could easily lead to a scenario where a handful of companies providing horizontal services, most likely telcos and ISPs, along with a few ISVs and ASPs, dominate the industry. Chell considers this scenario likely, citing the telcos' ownership of the 'last mile'—the cable from the curb—and their existing relationship with customers as the chief drivers. Not that telcos will take on every aspect of provisioning ASP services. Telcos may have the financial resources and access to potential customers, but they don't have the necessary software expertise, development time or market nimbleness to offer an end-to-end solution. Telcos are more likely to continue partnering with ASPs and ISVs. "This is where the real opportunity lies in this space," claims Chell. "The telcos aren't going to build this [service] themselves because it's not a matter of providing network, it's a matter of building content, which they don't do."

For similar reasons, many ISPs are gravitating to the ASP model as they seek to provide services beyond low-margin bandwidth and dial-up services. Two years ago, after buying the Minneapolis-based ISP GoFast.com, Agiliti entered the market offering IT infrastructure services and best-of-breed applications. More of the larger ISPs like America Online, which has partnered with several ASPs and ISVs to provide its customers Web-based applications, are bound to follow.

Taking this argument to its logical conclusion, Chell concludes that retail ASPs "are going to end up owning a small, small piece of the pie," with some combination of telcos, cable companies and network service providers owning a majority share. "They will simply have the ability to offer up applications to the end user from a menu board and then all the integration will happen 'in a cloud.'" In the end, the only retail ASPs that may remain independent are those specializing in micro-niche, vertical applications.

Eventually, as the ASP model assumes critical mass, its continued success will depend less on applications and more on service. Dr. Sawhney at Northwestern University's School of Business predicts applications will, in effect, become 'invisible.' "Ultimately, the applications should not be in your face," he says. "They should be invisible. The logical evolution is that applications are a means to an end and the end is to run your business." In the near-future, when SMBs choose among ASP services, their first criterion will be service, with the applications a secondary concern. Quality of service, especially around integration, will be the main hook for attracting and retaining customers.

"Over time, the application and the value derived from computing will become more transparent," says Peter Gardner of Allegis Capital . "It's the services that will get purchased and utilized through the application. That's what .Net and a lot of other initiatives are really all about."

# 9.0 THE SURVIVAL TOOLKIT

If the ASP story were a classic three-act play, with a beginning, middle and end, at this point we would have witnessed only the first act. Traditionally, Act I lays the groundwork for the story, introducing the major players and the main character's dramatic need (or the central question the story will answer). Act II is usually the longest and most complicated part of the story: things become progressively more difficult, new and unexpected obstacles arise, and the story gains a sense of urgency as the consequences become increasingly dire. That is where we are now. It's only in the relatively brief third act when the main character's problem is resolved one way or another, altering the status quo.

By all accounts we're a long way from seeing many of the challenges facing the ASP industry resolved. While it's unknown when Act III will begin, much less end, this is the defining moment when the decisions that shape the future of the industry will be made. The following recommendations are intended to help current and potential ASP industry players develop winning strategies during the current economic slowdown and so, make it to the triumphant curtain call.

**SURVIVAL TIP:**
Partner for brand equity and channel exposure; piggyback on the reputations of SMB channel leaders.

## PARTNER FOR PROFITABILITY

If today's economic downturn goes on for several quarters, or worse, becomes a recession, many pure-play ASPs will falter. Even if these firms survive in the near-term, the long-term threat posed by established ISVs, telcos, ISPs cable companies and others, argues for the development of a broad-based network of partners. The most critical partnerships are those that provide a sales channel with ready access to target customers.

In this respect, telcos appear to be the best bet. Telcos are one of the few players who actually own the last mile, the connection from the curb to the customer. Many telcos are struggling with debt in a largely commodity business. They see services delivered on an ASP basis as a way to generate new, much-needed revenue streams. ASPs, on the other hand, could offer their expertise in software development, systems integration and managed services.

A significant bonus for pure-play ASPs in developing channel partners with established customer relationships is the potential to leverage their partners' brand equity. Many, if not most, SMBs are skeptical about the ASP model. Much of this skepticism stems from technical concerns like the reliability and integrity of applications delivered over the Web. This wariness may be curbed to some degree by association with widely respected firms. The more high-profile partnerships a company develops, the more creditable that company in particular, and the ASP model in general, will become.

Because its business model depends on reaching end users through large enterprises, Rivio has gone farther than most in establishing a network of channel partners. Rivio counts among its partners nationally-recognized companies like Bank of America, Verizon Communications and Microsoft. This network distinguishes Rivio from many of its competitors, who are floundering in their attempts to provide services on their own or with just a handful of 'no name' affiliates. The strategy has proven cost-effective, especially in light of recent estimates that dotcoms must spend at least US$20 million in marketing alone to make a substantial impact on mindshare.



### SELECT PARTNERS WITH THE NOTION OF CONTRIBUTING TO OR SERVING AS THE PRIMARY PLAYER IN AN END-TO-END SOLUTION

The ASP model is popularly touted as a way for SMBs to simplify their lives. The reality is that, given the current fragmentation in the IT market, customers are often forced to engage a number of firms to get what they want. Most of the pure-play ASPs we studied for this report focus exclusively on delivering Web-based applications, with some offering varying degrees of IT consulting, Web development and hosting, remote storage and communication services. The more service-centric companies, alternately billed as managed service providers (MSPs), application infrastructure providers and application hosting providers, mainly offer IT consulting and remote infrastructure services for a select number of applications with which they're familiar. Customers that want Web-based apps or IT services beyond those offered by their initial ASP have to work with a number of different companies.

The current consolidation is driven, in part, by the need for a broader, more efficient IT ecosystem, with companies contributing pieces to a larger whole according to their unique competencies. At least in the short term, nearly every flavor of ASP can fill an important niche, albeit for most, only as part of a grand partnership. Pure-play ASPs and ISVs can provide the software; MSPs, the IT consulting and necessary infrastructure; and telcos, ISPs, cable companies and other channel partners, the distribution. The combination of partners should resemble an old-fashioned watch, where every gear and wheel is necessary for its proper functioning and nothing could be added to improve it. The decisive trick in creating this watch-like structure is choosing the most complementary partners. If achieved, however, the resulting partnership has the potential to satisfy the desire of many SMBs for a one-stop shop for IT services.

**SURVIVAL TIP:**
Carefully verticalize your offerings. Select markets with unique needs and get a strong return on the extra investment of your company's time and resources.

### MARKET TO THE MOST PROFITABLE TARGET CUSTOMERS

Notice we said 'the most profitable,' not the largest group of target customers. The terms aren't necessarily synonymous. But despite the well-worn 80-20 rule, it's surprising how often we hear clients say their company needs only a small percentage of some existing market to turn a profit. The problem is, they haven't thought through which customers, exactly, they need to make a go of things. It's as though they intend to fish with a net, expecting every catch to have the same value.

In other research on the SMB market for instance, we determined that manufacturing firms make a poor target for ASPs. In most of these companies, only a handful of people use a PC on a regular basis. Their software requirements are complicated by the need for industry-specific process control systems—systems that interact with accounting, inventory and supply-chain management programs—and they tend to be slow to adopt new technology. A survey last year by the National Association of Manufacturers among 2,500 US companies revealed that only 10% of the firms used a fully-automated business process technology system.

On the flipside, professional services firms appear to be prime candidates for ASP services. Many firms in the areas of law, insurance, finance, advertising, architecture and consulting, among others, have the right characteristics. They have a relatively high computer-to-employee ratio and because labor accounts for much of the expense side of the ledger, they tend to seize on technologies that promise greater efficiencies. Their corporate cultures tend to encourage a hardy spirit of adaptation to change. And many are willing to take a chance on new technology, in part because being on the 'cutting edge' is a point of pride.

The goal here is to define your target customers in as much detail as possible—industry, company size, location, annual revenues and the like—and then consistently market to those customers and those customers only. Don't be tempted to broaden the scope of your marketing efforts or to change your marketing messages to appeal to a larger audience until your initial target market is thoroughly saturated. Demonstrable success among one customer segment will help back up your company's claim to a leadership position when the ASP market finally breaks open.

### OFFER IMMINENTLY USEFUL AND CUSTOMIZABLE APPLICATIONS

On the surface at least, this recommendation appears to be obvious. But a quick survey of Web-based applications for the SMB market reveals a plethora of engineering-driven, look-a-like programs. As vJungle's director of product planning, Abhijeet Rane, notes, "The ASP business is not about just serving up one-off applications. At the end of the day, any ASP's focus has to be on business process. 'Is my application going to enhance a business process for my customer?' The problem with the industry is that nobody has really focused on that and they're only beginning to now."

A better understanding of how customers handle their various administrative tasks would undoubtedly help pure-play ASPs and ISVs develop applications that 1) constitute a process improvement and 2) match customers' workstyle preferences. One of the most stubborn barriers to ASP adoption is simple inertia. SMBs in particular are wary about changing even admittedly inefficient processes when the alternative doesn't represent both a clear improvement and something their employees, each with their own peculiar habits, will actually use.

The seemingly easy solution to this dilemma is to build applications customized for various vertical markets. The major pitfall here is that the more ASPs customize their offerings, spending more time and money on increasingly narrow slices of the market, the less cost-effective they become. SMBs expect their critical business applications to be tailored to suit their individual needs. Law offices, for instance, require time sheets with a substantial notes section where staff can narrate each day in considerable detail. Still, SMBs won't pay prices approaching those of high-end SAP or Siebel products just to have their ASP-delivered applications customized. ASPs must somehow strike a mutually beneficial balance between developing generic and relatively inexpensive applications for a broad market and highly customized applications for a narrow market.

Both Rivio and OpenAir have gone down this product development path with some success. Their 'generic' platforms support basic, easy to implement customer-defined changes that allow a certain degree of customization. Only time will tell, however, if they allow enough customization to satisfy most SMBs, who are used to inexpensive, industry-specific, shrink-wrapped software.

**SURVIVAL TIP:**
Such things as periodic audit-log reviews, third-party certifications and compliance verifications will reassure potential customers with security concerns.

**SURVIVAL TIP:**
Add a systems integration practice to your portfolio of offerings to enhance your reputation for good customer service and increase your chances for strategic alliances with SMB channel leaders.

### ALLAY TARGET CUSTOMERS' CONCERNS ABOUT SECURITY WITHOUT MAKING UNREALISTIC CLAIMS

Of all the threshold issues described earlier over which ASPs have control, security demands the most attention. A recent ASP Industry Consortium survey among potential customers showed that security topped the list of concerns. Our proprietary research suggests that SMBs don't expect 100% foolproof security. But they do expect considered answers to questions about server access controls, disaster-recovery plans, virus protection and authentication, encryption and packet filtering, among other things. Many of these concerns are now addressed in SLAs especially those around access to customers' data, and published security policies. However, ASPs shouldn't wait for the SLA stage in the customer acquisition process to explain their security policies and procedures in detail. They should also give customers a way to verify compliance with these measures through periodic audit log reviews, a third-party seal of approval or other means.

### BECOME A SYSTEMS INTEGRATOR

Many traditional systems integrators see ASP services as a prime opportunity to expand their portfolio of services and, at the same time, generate predictable revenues from monthly subscription fees. As the ASP market consolidates, with telcos, ISPs and other powerful channels taking leadership positions, ASPs that don't want to be relegated solely to the software development pool would be wise to bolster their systems integration expertise. This is an area in which many channel partners have had little success. And who better than the software developer to provide the integration necessary to ensure maximum end user uptime? Successful integration is a threshold requirement for SMBs to consider the ASP model. It's integral to meeting customers' expectations for reliability, customization and scalability, and promises the chance for ASPs to build a good reputation for customer service independent of their channel partners.

There are potential financial benefits of systems integration beyond the obvious service charges. Proprietary integration technology tends to attract both channel partners and venture capital. ASPs pioneering systems integration in this space have the potential to establish industry-wide standards—a compelling selling point in the investment community. vJungle, which has evolved over the past 18 months from an original application provider to a managed infrastructure provider, has emphasized its proprietary integration technology, OpenEX, to great effect. Its integration focus has appealed to big-name partners like Hewlett-Packard and investors alike. In the midst of the troubled early 2001 market, the company landed over US$15 million in second round financing.

As noted earlier, Cameron Chell, observes that many of the enabling technologies for seamless integration have yet to be developed. For the right company, systems integration could be a lucrative niche.

### DEVELOP SUPERIOR CUSTOMER SERVICE

One of the long-standing flaws of many IT companies is a lack of attention to customer service. Because these firms are replete with engineers, product development tends to claim the lion's share of the resources. Customer service is typically treated as an afterthought. Or, equally as bad, considered a technological problem, as though an efficient CRM system could actually replace the need for reps with the requisite responsiveness, knowledge and problem-solving authority.

**SURVIVAL TIP:**
Develop a reputation as the customer-facing ASP with close attention to personal service and attractive service-level agreements.

Accustomed to working with companies of a similar size and with a comparable emphasis on personal service, SMBs are highly sensitive to customer support issues. According to a recent IDC survey of ten executives with companies using ASP services, the most decisive factor in selecting their ASP was the provider's service level agreement (SLA). This factor was followed closely in importance by integration services, customer support and security measures. Respondents rated the four factors nearly equal in importance and all are intimately related to customer service.

*ONE OF THE LONG-STANDING FLAWS OF MANY IT COMPANIES IS A LACK OF ATTENTION TO CUSTOMER SERVICE.*

Despite the importance of customer service, however, most retail ASPs provide scant details about their customer support system on their Web sites. A review of twenty representative sites in the SMB space reveals only six with a substantial reference to customer support. What's more, most of these sites list only toll-free numbers and generic email addresses. This dearth of customer service information is cold comfort to potential SMBs skeptical about outsourcing critical applications.

To stand out among the pack and reassure potential customers, we recommend ASPs highlight their approach to customer service and provide a few details of their standard SLA. SMBs would appreciate knowing, for instance, how ASPs resolve integration or other backend problems and what penalties, if any, are assessed for falling short of SLA benchmarks. The considerable gray areas here led to the nascent MSP market. While many of these companies have limited intellectual property, they understand the value of delivering high-quality customer service to habitually wary customers.

Seattle-based Telicor has carved itself a unique niche in the area of managed services. Acting as a singe point-of-contact service consultant, Telicor monitors its customers' SLAs with their respective telco vendors. "Our philosophy is to blend the technology of the telecom industry with the customer service focus that you receive in a more retail environment into a single call," says the company's vice president of next-generation services, John Barnhart. "From the customer's perspective, we are the responsible party and deal with the backend." The company's main goal is to prevent customers from experiencing the 'ping-pong syndrome'—being bounced from one company or service representative to another in trying to resolve their problems.

Telicor understands the importance of establishing partnerships with similar customer service goals. “We use partner organizations to provide the backend services,” says Barnhart. “So, when we are initiating a relationship with a partner organization, we assess their capacity for handling service calls and try to keep our expectations closely aligned.” Likewise, it’s crucial for ASPs to confirm that potential partners share their customer service philosophy.

As ASP services approach the commodity or utility stage, customer service will only grow in importance as a valuable distinguishing feature. Given how we see the market evolving, ASPs well-practiced in upholding high standards of customer service will have a decisive advantage in partnering with large ISVs, telcos, ISPs, cable companies and other concerns historically not associated with such levels of customer service.

## THE SURVIVAL TOOLKIT

Overall, SMBs stand to reap considerable benefits from outsourcing their business administration applications and IT infrastructure management. But until the ASP model becomes easy to adopt and implement it won’t be widely accepted. As the market continues to consolidate, the companies that survive will distinguish themselves by their proprietary technology, channel partner network and/or their commitment to a high level of customer service. While these survivors may not dominate the industry as their founders once dreamed, at the very least they will eventually share a profitable piece of the mass-market pie.

# 10.1 CASE STUDY: OPENAIR

## *OpenAir*

| URL | CEO |
|---|---|
| www.openair.com | William O'Farrell |

| FOUNDED | HEADQUARTERS |
|---|---|
| 1999 | Boston, MA |

OFFERING

Suite of integrated Web-based business administration applications for accounting, sales and marketing.

TARGET MARKET

Small-to-mid-sized professional services firms.

INVESTORS

Fidelity Capital, 3i, iHatch Ventures, Rex Capital.

STRATEGIC PARTNERS

XO Communications, Platinum, Micronpc.com, Jamcracker, Microsoft Great Plains Business Solutions, Accpac, Exodus.

PRIMARY COMPETITORS

Rivio, OfficeClip, Simpata, SmartOnline and others offering critical workflow applications to small and mid-sized professional service firms.

PROPRIETARY TECHNOLOGY

Integrated suite of business administration applications.

FINANCIAL STATUS

Privately held.

**OVERVIEW**

OpenAir is a leading example of what may be considered a 'traditional' ASP. The company writes and offers software on a subscription basis via the Web. Jeff Hunt, vice president of marketing for OpenAir, is confident about the company's business model. He thinks the company compares favorably to the competition, particularly aggregators. "The aggregator helps with one of the two main things you want to accomplish with an ASP," he says. "One of them is providing a single place to go where you can solve a whole set of business solutions so you don't have to manage a number of different vendors. The other is to have really good integration across the different modules. There are many people out there trying to provide a platform that's truly integrated who have had varying degrees of success. However, there's nothing out there that's done nearly as good as a job of integrating the solution as we're able to do by developing the whole thing in-house."

OpenAir launched in March of 1999 as Timebills.com. Accordingly, the company's core competency is in developing and delivering time and billing applications over the Web. Lately, its offering has expanded to include a larger suite of applications designed to help small-to-medium-sized professional services firms manage their business. This integrated, proprietary suite includes three modules. The first module is for time tracking and billing. It includes automated payroll through a payroll provider, a client billing system and an internal expense reimbursement tool. The second module is a project tracking application similar to Microsoft Project. The third module consists of a proposal writing and tracking tool.

Under development is a resource management tool that will allow customers to inventory and track their in-house skill base. At this point, the suite is available only to customers as an integrated bundle. In OpenAir's view, the whole of its offering is greater than the sum of the individual parts; however, in response to customers' needs, OpenAir is developing a modular offering that will allow customers to select features à la carte.

OpenAir built its business strategy on two basic premises: that ASPs can solve business administration problems experienced by SMBs and that the only way to offer a truly integrated solution to those problems is to design the application from scratch. OpenAir has determined that, at around 20 to 50 employees, a business reaches a level of complexity in its operations where going with an ASP becomes a compelling solution. The company posits that small-to-medium-sized professional services businesses stand to gain considerable time and cost-saving efficiencies by adopting hosted, subscription-based applications.

OpenAir isn't putting all of its eggs into the proprietary applications basket. The company is also positioning itself as a software developer for aggregators like Jamcracker. As Hunt says, "We're straddling the fence by partnering with some of the aggregators. So we think we have a more powerful model because we're completely integrated and provide a broad solution ourselves, but we're hedging our bets by partnering with application aggregators as well."

**SURVIVAL TIP:**
OpenAir has a decided advantage over competitors in its ability to perform remote customizations to tailor applications to specific customer needs.

Unlike some of their erstwhile competitors, OpenAir has adopted a per user monthly subscription model. The company feels this pricing structure, along with strong partnerships, is the surest way to profitability. Hunt cites RedGorilla as an example of a firm with a poor revenue model. "RedGorilla was our first head-to-head competitor and they went away with the other sock in the dryer recently," he says. "That's because they were mainly trying to offer a free solution where revenue streams depended on advertising and upselling. And that's just a tough model."

### STRATEGIC PARTNERSHIPS

OpenAir participates in two distinct types of partnerships: those intended to expand its customer base, and those that will help it provide a more complete solution for existing customers. OpenAir's strategic partners, Go2Net, Inc.com, Micronpc.com, SkillsVillage.com, XO Communications and Jamcracker provide the company with a broad range of channels and potential customers. With this group, OpenAir benefits from exposure both to vertical markets like those served by SkillsVillage, and broader markets like those served by Micronpc. With its integrated services partners, OpenAir displays the same type of diversification. Powerpay.com provides a focused payroll service to a wide audience, while Smartcontractor provides a broad range of services to a niche market.

SmartContractor provides an integrated business services platform via the Web for electrical contractors, though the firm plans to expand its target market to include HVAC and plumbing contractors. Chad Blevins, vice president of business development for Smartcontractor says, "Our business model is based around creating successful partnerships with companies like OpenAir." The company determined that customers needed help tracking jobsite operations and issuing accurate invoices that account for the materials and services involved. OpenAir's suite of applications allowed Smartcontractor to meet this need. Blevins says, "It hit squarely where our customers needed help."

Blevins states his company looks for a number of qualities in potential partners: a service that meets customers' needs; flexible technology; the right mindset and management philosophy; and a readiness to participate in an active partnership. Blevins says he wanted to ensure that potential partners would not "dump their product in our lap and then not work with us."

So far, Blevins has few complaints about his firm's relationship with OpenAir. "The problem we have with OpenAir is probably also their biggest strength. They release a new version of their product every month. For us, it is difficult to keep up with that. Keeping pace with them is the biggest issue we have."

As part of its effort to keep its product delivery options open in a volatile market, OpenAir has partnered with Jamcracker, a popular aggregator. What made OpenAir attractive to Jamcracker was a shared understanding of the most promising target customers, namely, professional services firms. Jamcracker is interested in professional services companies because these businesses routinely deal with problems an ASP can solve—quick growth, a large number of remote users and high employee turnover.

Amede Hungerford, Jamcracker's director of business development, describes the beginning of the partnership this way: "We just found OpenAir's service very compelling for what many of the small-to-medium-sized professional services firms need to get up and running and automate their services." On a larger scale, Hungerford describes Jamcracker's overall target market as companies in a wide variety of industries with several hundred to 5,000 employees that have a fairly high percentage of remote users and want to focus their IT resources on more strategic issues.

Hungerford says, "We've found a really strong partnership there [with OpenAir]." Jamcracker is a young firm in a nascent industry. OpenAir was one of the company's first partnerships. Jamcracker has kept the partnership quite active, even pulling OpenAir personnel into its 'customer forums'—workshops and seminars that address topics of interest to its customers.

Not all of OpenAir's partnerships have proven to be as active. Liz Allen, director of business development for SkillsVillage, has seen the partnership between OpenAir and SkillsVillage wither on the vine from lack of attention. Allen concedes SkillsVillage is more responsible than OpenAir for the lack of communication. Both companies have changed focus since the partnership began, and communication between the firms has slowed to almost nothing in recent months. "I don't know how their service is being spun now compared to how it was spun before. I don't have the faintest clue what they're doing now."

SkillsVillage initiated its partnership with OpenAir back when OpenAir was still known as TimeBills. At that time, SkillsVillage was primarily a contractor-matching site—the company helped match IT freelancers with appropriate firms. In its previous incarnation as TimeBills, OpenAir's applications gave SkillsVillage contractors a convenient way to manage their businesses so they could focus on their core competency—IT consulting and execution.

Since then, SkillsVillage has become an ASP, offering an application for creating private staffing networks on the Web. SkillsVillage's application also automates time tracking and time-off approvals. During the same period, OpenAir expanded its range of products to include proposal writing and tracking, and project tracking.

Allen took pains to emphasize her firm's culpability in the communication breakdown with OpenAir and pointed to other partnerships that had languished of late. "Our business model has changed so much, a lot of the older partnerships that we have, we haven't really spent a lot of time working with them on an ongoing basis," she says. "It's probably just as much our fault as the other companies' fault; probably more our fault."

**STRENGTHS**

Perhaps OpenAir's most compelling aspect is its proprietary technology. The company's platform is easily customized for specific customers, making it a very cost-effective solution for vertical markets. The applications are designed so that each feature has, in essence, an 'on/off button' that allows users to select or deselect features as necessary. The selection process can be done simply and quickly without any changes to the basic programming of OpenAir's applications. Hunt says, "We have one version of the software but [have] built in a switching mechanism that allows you to turn features on or off depending on your company's needs and workflow. So, we've got a million different permutations of the software. We can customize it by spending an hour on the phone with your account administrator and flip the switches appropriately, setting it up to work exactly how you need it to."

The ability to customize an application for customers in the course of a short telephone conversation versus a month of onsite work by a systems integrator gives OpenAir a decided advantage over some of its competitors. SmartContractor took advantage of this capability when it first partnered with the company. Blevins says, "We don't have what I would call a customized set of code. We have a version that is just certain flags on and off so their system knows when somebody comes from our system and what version to throw up."

Recognizing that most small business customers have concerns about the reliability of Web-based hosted applications and remote data storage, OpenAir has created an onsite appliance to compensate. Hunt describes the appliance as "a server where we take our software, pre-deploy it and bring that server to your office. So, you're hosting the software and the data." This setup is different from traditional client/server arrangements because here, there is no client. The software is iterated on the appliance every month automatically, so customers aren't burdened with a static application.

OpenAir has developed competitive advantages in terms of both technology and business strategy. The company designs its applications with an uncommon flexibility that is attractive to both customers and partners, allowing the company to serve vertical markets with ease. In addition, the company has positioned itself to take advantage of two possible growth areas in the ASP market—applications design and aggregated delivery. Should the firm's initial strategy of creating proprietary applications fail to generate sufficient revenue, the company will still be positioned to capitalize on the growth of the aggregator market through its relationship with companies like Jamcracker.

**WEAKNESSES**

Support is expensive, and like their ISV counterparts, ASPs generally don't provide on-site technical assistance. OpenAir provides in-person customer support only in rare cases as part of the set up and configuration process. As Hunt describes it, "We provide a very extensive customer service through traditional resources: the telephone and email. We also have a professional services team that is able to go out and help with specific configuration or integration needs." The drawback to a barebones support system, however cost-effective, is that it does nothing to alleviate concerns many small businesses have about switching to hosted applications. ASP adoption will be partially dependent on how quickly SMBs trust the infrastructure behind the model.

On the technical side, the fact that OpenAir's platform can be customized solves some problems and introduces others. The customization capabilities are necessary to accommodate the needs of each particular customer; however, allowing customers to pick and choose applications means the perpetuation of a mixed application environment. Faced with this option, customers will be more likely to evaluate OpenAir's offering on a module-by-module basis against more familiar, best-of- class applications. It's unlikely customers will choose OpenAir's project management application as a standalone program over a better-known, best-of-class option like Microsoft Project, especially when these larger, well-established software manufacturers migrate their products onto the Net in a subscription-based format.

According to Hungerford of Jamcracker, the prospect of the software giants entering the Web hosted applications space isn't a threat. In fact, he thinks companies like PeopleSoft and Oracle represent prime partnering opportunities.

Chad Blevins with SmartContractor also dismisses the sizable shadow thrown by the software giants, not because he considers them partner material, but because he predicts the adoption rate of ASP services will be so slow there simply won't be enough willing customers for these powerhouses to gain a substantial foothold.

Given the recent acquisition of Great Plains by Microsoft, this dependence on a slow adoption rate may be misplaced. With this acquisition and its overall .Net strategy, Microsoft seems to be entering the ASP market with gusto. The company is also in a position to assume a substantial portion of the burden of educating potential customers in order to speed adoption.

In the meantime, Hunt foresees that OpenAir will continue its two-pronged strategy of serving as a 'traditional' ASP and a software developer for aggregators. With its customizable technology and strong partnerships, OpenAir is well positioned to be a winner either way.

# 10.2 CASE STUDY: RIVIO, INC. (FORMERLY BIZTRO, INC.)

### *Rivio, Inc. (formerly Biztro, Inc.)*

| URL | CEO |
|---|---|
| www.rivio.com | Navin Chaddha |

| FOUNDED | HEADQUARTERS |
|---|---|
| 1999 (Biztro) | Santa Clara, CA |

OFFERING

Suite of integrated, Web based-business administration applications for accounting, collaboration, HR and procurement.

TARGET MARKET

Small businesses in need of comprehensive business administration applications.

INVESTORS

Accenture Technology Ventures (formerly Anderson Consulting Ventures), Bank of America, BellSouth, FleetBoston Financial, Internet HealthCare Group, Marsh & McLennan Risk Capital Holdings, SOFTBANK Venture Capital.

STRATEGIC PARTNERS

B2Pcommerce, Bank of America, BellSouth, FleetBoston Financial, Microsoft, Metavante Corporation, Verizon Communications.

PRIMARY COMPETITORS

OpenAir, OfficeClip, Simpata, SmartOnline and others offering business critical workflow applications to small businesses.

PROPRIETARY TECHNOLOGY

Integrated suite of business administration applications.

FINANCIAL STATUS

Privately held.

**OVERVIEW**

"We help small businesses manage their internal operations more efficiently and cost-effectively," says Maury Domengeaux, Rivio's senior vice president of marketing, when describing the company's value proposition. Rivio provides an integrated platform of back office applications allowing SMBs to outsource a wide range of mission-critical administrative tasks, which give users the opportunity to focus on their core competencies. The company has approached the market with a two-pronged strategy: develop superior integrated and functional applications, and distribute its platform aggressively through well-branded partnerships.

Rivio's growing proprietary Business Services suite currently includes five application modules: 'My Desk,' 'My Company,' 'Administration,' 'Marketplace' and 'Resources.' The 'My Desk' module consists of applications designed to help manage employees' time and business expenses. Specific applications include time sheets, task lists, checklists, expense forms, invoices, purchase requests and travel requests.

'My Company' is a collaboration module intended to streamline internal company communications. The module offers customers a relatively easy way to inform staff about company events, corporate policies and procedures as well as update the company's address book, phone book, organizational chart and job openings.

The 'Administration' module addresses central administrative tasks like payroll reporting and compensation tracking. The module includes QuickBooks data importing and employee self-registration set-ups.

The 'Marketplace' module is designed to help customers easily find the most appropriate vendors for payroll services, employee health benefits and business insurance and office products, among other things. The module offers customers products/services from well-known vendors like ADP, Dell, OfficeMax and iPrint.

Finally, the 'Resources' portion of the package is an informational library designed to meet the needs of small businesses. The module allows users to acquire online advice and best practices information from experts in accounting, marketing, trade shows and other critical business functions. The module also provides project planning templates, directories, customizable HR and legal forms, and promotional items to build brand awareness.

Rivio's business strategy is based on the premise that integration is king. Its Web-based applications are designed to work together to form a comprehensive suite as well as work with popular third-party programs. "The most effective way to architect a small business productivity package is to develop applications which are aware of each other while sharing data," says Domengeaux. "Patching other people's applications together is much more difficult than it is to build the application suite from the start in order to have it work well with third-party applications."

**SURVIVAL TIP:**
Rivio's recently announced strategic alliance with kingmaker Microsoft is the result of a lot of aggressive business development work done long ago. Rivio got its trophy partnership because of its heightened exposure in the marketplace.

Not that the company intends to launch substitutes for leading applications like QuickBooks. "We do our integration at an import /export level," explains Domengeaux. "We constantly make decisions whether or not we need to develop an application because it needs to be tightly integrated into our platform or the application is one that we can link with a best-in-class supplier."

As a guideline for making product development decisions, Rivio first determines if there's a best-in-class product in the category. If there is, then the company works to accommodate the transfer of data between that program and its own application. "We can add in select third-party apps that extend our value," says Domengeaux. "For example, there are tons of payroll suppliers out there, so there is no reason why we should try and produce payroll. We just need to make sure that we can extend data to a payroll supplier so that the small business owner can get a turnkey solution."

Consider Rivio's Administration module. The company's basic administration bundle uses QuickBooks-generated data; this feature allows administrators to import employee data into the module for payroll processing. Rivio's application will generate the necessary payroll data from QuickBooks and supply processing instructions to the customer's payroll service. The premium version of the product even allows customers to print their own payroll checks.

## STRATEGIC PARTNERSHIPS

Rivio's business model entails using channel partnerships as a vehicle for both distribution and branding. So far, Rivio has focused on winning over ISPs, financial institutions, telcos and other companies with access to large numbers of SMBs. As part of its Integrated Business Services Network, Rivio has partnered with national, top-tier companies like Bank of America, FleetBoston Financial, Verizon Communications, BellSouth, and most recently, Microsoft.

Rivio relies heavily on the brand equity of its channel partners to validate the ASP model and speed customer acquisition. "The strength of the brand and the channel reach of our partners are critical for us," says Domengeaux. "We won't go out and spend millions of dollars trying to attract small businesses. We'll leverage the existing brand, strength and reach of our partners. That is really powerful for us."

The partnerships provide Rivio with a steady revenue stream as well as exposure to thousands of potential customers. The company customizes its suite of applications to suit the needs of each partner. The partners pay (an undisclosed) fee to license the platform and, in turn, can either offer the service for free to its own customers as an incentive to remain loyal, or charge a small monthly fee. Domengeaux says, "We can Web-enable a channel, [allowing them to offer] a turnkey suite of back office applications to their customers, tying a small business clientele base to our channel partners." For larger companies interested in utilizing the ASP model, this strategy makes Rivio an attractive prospect.

Bank of America chose the Rivio platform as a value-add to its portfolio of financial services. The company's senior vice president of small business Internet/eCommerce, Mike Anzenberger, felt Rivio's offering provided a cost-effective solution for its small business customers. "Ninety-percent of small businesses perform the same key processes, and Rivio's applications can help small businesses perform those processes more efficiently for less money." The company was impressed enough with Rivio's product to invest in the company. Other channel partners like FleetBoston Financial and BellSouth have also opted to invest in Rivio, helping to make the company financially stable.

The most recent addition to Rivio's channel partner strategy is its Solutions Provider Program, a spin-off of its Integrated Business Services Network initiative. The program is designed to encourage ISPs, ➜*value-added resellers* and other small business providers to develop Web-enabled application services using Rivio's proprietary platform. Similar to its approach to financial institutions and telcos, Rivio provides participating companies with customized versions of its application suite. In return, partner firms receive up to 15% of the revenue they generate through subscriptions.

***➜Value Added Reseller (VAR)***
*A company that resells an established product, along with consulting, customization, integration, or other value-added services.*

Rivio also generates transaction revenue. Prominent marketplace suppliers like ADP, Dell and OfficeMax share a portion of the revenue they accrue from Rivio customers. This is a mutually beneficial relationship that allows Rivio to offer a more comprehensive service for its customers than it could otherwise and allows suppliers take advantage of a more or less captive business audience.

**STRENGTHS**

Rivio's greatest strength is its distribution strategy. Sooner than its closest competitors, the company recognized the importance of establishing a far-reaching network of channel partners to ensure its platform was widely available and to leverage its partners' brand equity to legitimize the ASP model.

Rivio's recently announced partnership with Microsoft is a real coup. As part of this relationship, Rivio will provide customized applications for the software maker's small business portal, bCentral. The applications will be built on the Windows 2000 and .Net platforms and co-branded versions of Microsoft's bCentral services will be integrated into the Rivio Business Service Platform.

In a case of success breeding success, the company's early and aggressive dealmaking made this latest partnership possible. In January of this year, shortly after Microsoft's acquisition of Great Plains, Microsoft's vice president of bCentral, Satya Nadella, stated in a press release, "We are pleased to join Rivio's Integrated Business Services Network. Its established distribution channels are a welcome asset to our efforts and will instantly broaden our ability to deliver bCentral services to small businesses."

This partnership marks a giant leap forward for Rivio in the small business space. The Microsoft connection will provide Rivio with a more robust product and enhance its credibility among partners and customers alike. Small business customers especially are drawn to brand-name products and services. This move also gives Rivio a competitive leg up on competitors like Jamcracker that have chosen to aggregate best-in-class applications specifically to capitalize on the greater awareness of these applications.

Arthur Williams, a prominent analyst with the Giga Information Group, describes the symbiotic channel partner relationship this way: "The most creative aspect of Rivio is the discovery of a source of business anxiety among large banks and telcos and the creation of a service designed to ameliorate that anxiety. The anxiety in question is the retention of small-business customers in the increasingly competitive Web environment. Not only do Rivio's service offerings encourage retention, but since they represent core infrastructure, they are strongly addictive."

This relationship ultimately creates a best-case scenario for everyone involved. Rivio's partnership with Bank of America, for instance, gives the company exposure to the financial behemoth's 1.7 million small business customers, while Bank of America gains an affordable and effective customer retention tool. Over 5,000 Bank of America customers are using Rivio's platform—a number that's growing rapidly. Part of the platform's appeal is that it's an affordable solution to common small business administration problems. Cynthia Adkins, founder and CEO of Concierge at Large appreciates Rivio's dedication to building an imminently useful platform. She remarks that one of the deciding factors for going with Rivio was that "it seemed they were really trying to put together a tool to use, not just something to stick advertising on."

**WEAKNESSES**

Like its competitors, Rivio's most immediate challenge is accelerating adoption of the ASP model. Most small business customers are still uncomfortable with the notion of using applications offered only over the Web. This discomfort is largely attributable to a fear of losing control over critical applications—a fear exacerbated by the unreliability of high-speed Internet access and severe market volatility. The company's distribution and branding strategy, however, will help ease non-technical concerns among target customers.

As Rivio grows, its ability to customize and scale its applications to address the peculiar needs of all its customers may diminish. At least one of Rivio's channel partners, B2P, wonders how long the company can continue to accommodate an increasingly diverse customer base. B2P's founder and CEO Jason Saul says, "Rivio and other ASPs are looking more at the common denominator solution than looking at building a solution that tilts in one direction. Ultimately, you have a fight to try and resist over-customization towards [the needs of] one channel or another. There's a careful balancing act that needs to happen." Rivio, along with its competitors, will have to maintain a high level of responsiveness to its channel partners and end users without sacrificing the cost-effectiveness of its offerings.

Rivio also faces the challenge of scaling its platform appropriately. As Williams of the Giga Information Group points out, the company's "software is new, relatively untested, proprietary and relatively primitive. So, subscribers risk addiction to software they may well outgrow, similar to Intuit's QuickBooks." The company's partnership with Microsoft may help ease concerns in this area given the software maker's expertise in developing applications for businesses of any size.

Finally, Rivio's greatest asset—its broad distribution network—could eventually become its greatest threat. It's conceivable that any one or a combination of Rivio's channel partners could reduce the company to a mere software developer. As ASP services come to resemble commodities like electricity, the power in the relationship will be weighted even more heavily in favor of the distributors of the platform.

In the short term at least, Rivio's partner-building activities are likely to keep the company afloat during a tumultuous period of consolidation. The company has proven itself a fierce and wisely-positioned competitor in an uncertain economy. It's highly attentive to the changing tides of the market, consistently updating its platform and pursuing the variegated distribution deals that are currently helping other dot-coms survive today's rough seas. In this sometimes embarrassingly young market, Rivio stands out as one of the few respectable elders.

# 10.3 CASE STUDY: HOTOFFICE

***HotOffice***

| URL | CEO |
|---|---|
| www.hotoffice.com | Michael Franz |

| FOUNDED | HEADQUARTERS |
|---|---|
| 1995 | Boca Raton, FL |

OFFERING

Suite of collaboration and communication applications.

TARGET MARKET

Small-to-mid-sized businesses in need of basic business administration communication applications.

INVESTORS

Intel.

STRATEGIC PARTNERS

Staples, 3Com, Bigstep, Cisco Systems, Employeematters, Encanto, Covision, MindSpring (now EarthLink), OneCore, Peak, Prodigy, Pumatech, b2bsherpa, skillsVillage, Sprint, Stamps, US WEST (prior to Qwest merger), Verizon Communications.

PRIMARY COMPETITORS

Intranets.com.

PROPRIETARY TECHNOLOGY

Integrated web-based collaboration and communication software.

FINANCIAL STATUS

Defunct December 2000.

**OVERVIEW**

Sometimes, trailblazers succeed only in discovering new lands rather than claiming a lasting stake. Perhaps nowhere is this phenomenon more prevalent than in the Internet economy. Before the recent market break, pure-play etailers argued that the inherent efficiencies of the Internet made them serious competitors with established bricks-and-mortar companies. Last Christmas, familiar brand names like Kmart (online as BlueLight.com) and Wal-Mart, companies slow to launch an online presence, saw substantially more traffic than pure-play upstarts like Buy.com and Outpost.com. The latter pioneered the B2C model (albeit, in fits-and-starts); the former, learning from the mistakes of their predecessors, made it work.

The ASP industry is no stranger to this dynamic. Founded in 1995, HotOffice was, until recently, a provider of Web-based intranet services for small businesses. Started as a search engine, the company's first iteration as an online collaboration tool debuted as HotOffice 1.0 in 1997. From that point forward, the company's portfolio of services continued to expand. By May 1999, it offered an elaborate intranet collaboration and communications platform that included enhanced email, a contact management application compatible with both Outlook and Palm, group calendaring, bulletin boards and other Web-based applications that made it easier to communicate both internally and externally.

HotOffice implemented a powerful three-pronged distribution strategy through channel partners like

Sprint and Staples, select value-added-resellers and a number of lesser, revenue-sharing partnerships. The company marketed its offering aggressively via print ads in national newspapers and in business tech publications as well as through targeted radio spots. The first-quarter of 2000 saw 100,000 new users. In August, the company received PC Magazine's coveted "Editor's Choice Award" on the "strength of its [platform's] completeness."

The company continued to innovate furiously through October in hopes of impressing investors with its technological acumen; however, in November, the company failed to receive a much-needed cash infusion. It promptly laid off half of its staff. Just two months later, the company officially called it quits, sending home its remaining skeleton crew for the last time.

How did this dire fate befall an early entrant with an award-winning product? As in most break-ups, personal or business, there's more than one answer, depending on whom you ask. Most of the company's troubles, however, can be traced to sheer bad timing. Mickey Freeman, the company's former vice president of marketing, chalks up its demise to what he calls "the first-mover disadvantage."

Right now, ASPs are caught up in educating target customers about the model and easing prevailing concerns about the reliability and security of the Internet. Even with a consistent, if low-level, media buzz, the task is hard. In 1997, when HotOffice 1.0 debuted, the job was undoubtedly much harder. "Everyone believed in the technology," says Freeman. "What they weren't sure of was, would people change the way they work and adopt us as their service?" While HotOffice scored a number of early funding successes, many potential partners and customers hedged, waiting for some signal event to prove the idea had mass-market appeal. Moreover, initial partners like Sprint found the service more difficult to market than expected.

Curiously, as the industry evolved with mayfly-like speed, HotOffice's status as a first-generation entrant became a liability. Significant funding sources shied away from the company, worried that the market was premature. Allegis Capital is a leading high-tech venture capital firm that manages over US$ 400 million. Peter Gardner, a general partner with the firm, says it "hasn't made any investments in that first-generation ASP model," content to wait out the early-market chaos.

HotOffice closed its final round of funding in July 1999. That put the company in line for additional funding in spring of the following year. Enter: the tech stock crash of April 2000. The crash took the wind out of sympathetic VCs and potential buyers—especially other dotcoms. "We had multiple acquisitions and other funding scenarios that went away because the valuations of the companies prepared to buy us were significantly impacted by the crash," explains Freeman. Twice in the month following the crash, HotOffice was left holding the proverbial bag when jumpy buyers abruptly called an end to negotiations.

At the same time, the company faced unprecedented competition from Intranets.com. Like the telecommunications and radio industries before it, the ASP industry has struggled with finding the right revenue model. Many companies blithely pursued a strategy of building market share by offering services free of charge. HotOffice, working from a business plan developed prior to the free PC, free Internet access, free everything craze, opted for a subscription-based revenue model.

In August 1999, Intrantets introduced a free service comparable with HotOffice's service offering. HotOffice responded in early 2000 with its own free, ad-supported version of its popular subscription-based platform. Freeman and his colleagues privately scoffed at this "hybrid" service. "We never thought that the free model had legs at all," says Freeman. "People will pay for something they find value in." By all accounts, HotOffice offered an exemplary product. But, at least for a crucial while, free was the expected standard. Although the free platform spurred a ten-fold increase in HotOffice's end user base, few became paying customers.

Despite the fact that the company was meeting all of its internal financial goals and on track to reach profitability by April 2002, last April's downward spike, a newfound conservatism among investors and a savage price war comprised a baleful Trifecta for HotOffice. The dark lesson here is that even companies that presumably do all the right things don't always make it.

Still, companies that develop their own proprietary technology and set up 'rainy day' funds to minimize their dependence on outside funding sources have better odds of surviving hard times. Heidi Roizen of SOFTBANK asserts that companies with proprietary technology like Microsoft, Oracle and Siebel Systems present a more attractive risk to VCs than those without any native technological advantages. "You can look historically at companies in this space and the biggest market caps have gone to those that create proprietary technology," she says. To succeed, she believes that ASPs will have to control their burn rates and to sock away money to survive periods of

**SURVIVAL TIP:**
The now defunct HotOffice was an early market entrant with an award-winning product and a fatal inability to educate its target partners and customers about the benefits of its model.

investor impatience. She adds, “Patience needs to be interpreted as money.”

As a venture capitalist Chell says investors of late have expected too much from the growing ASP industry. “Here’s the short-sidedness of the VCs,” he explains. “It took the telco industry a hundred years to grow up. The ASP industry is two, maybe three years old and we’re already delivering hundreds of millions of dollars of applications or data over the network.” Despite what some may think, Chell doesn’t believe VC funding has dried up altogether; instead, he says VCs have simply become smarter and more demanding. Roizen concurs, saying that, after several years of tremendous capital flows where multiple versions of the same idea received funding, the current belt-tightening among VCs is a natural “contraction.”

Unfortunately for Freeman and his erstwhile partners, the contraction came at the worst of times. Intranets.com had the necessary funding to carry on, while HotOffice didn’t. Bowing to the inevitable, HotOffice determined that its customers would be best served by switching to its rival’s service. The company facilitated the move for over 750 of its customers before finally shuttering its doors.

As might be expected, Freeman is bitterly disappointed by HotOffice’s demise. He says the company’s management was strong and even Heculean internal efforts couldn’t have saved the firm. He’s justifiably proud of the platform HotOffice created. And at the very least, can take solace in knowing the company exited the stage with uncommon grace.

# 10.4 CASE STUDY: AGILITI

### *Agiliti*

| URL | CEO |
|---|---|
| www.agiliti.com | Tom Kieffer |
| **FOUNDED** | **HEADQUARTERS** |
| 1999 | Bloomington, MN |

OFFERING

Suite of ecommerce applications (Vignette® V/ Series and Intershop enfinity™) and scalable customized IT infrastructure service.

TARGET MARKET

Small and mid-sized businesses in need of ecommerce business critical applications and infrastructure IT services.

INVESTORS

American Express Financial Corporation, Dell Ventures, GATX Ventures, Inc., Lafayette, Brightstone Capital, Norwest Equity Partners, Affinity Capital Management, Delphi Ventures, Bill Cadogan, The Rahn Group, Transamerica Business Credit Corporation.

STRATEGIC PARTNERS

Dell, Microsoft, Sun, Intershop, Vignette.

PRIMARY COMPETITORS

vJungle, Outtask, Zland, Cloudwise.

PROPRIETARY TECHNOLOGY

Developed ecommerce platform applications with Intershop.

FINANCIAL STATUS

Privately held.

**OVERVIEW**

Agiliti exemplifies the fiercely adaptive nature of many ASPs. After buying an ISP, Agiliti entered the ASP market and became known as a leading aggregator. However, now the company presents itself as an IT infrastructure provider. Although the company continues to offer Web-based workflow apps, its latest Web site emphasizes its secure technical infrastructure services.

Agiliti has always offered a wide-variety of IT outsourcing services, including application hosting, server management and power maximization, a choice of basic or managed ISP services, email, and virtual collaboration services secured via virtual private networking (VPN) and a managed firewall. Agiliti's rentable platform allows SMBs to subscribe to name-brand IT services applications from Oracle. The company manages and licenses these programs for a monthly fee.

With Agiliti's rentable integration platforms, the company provides access to high-quality third-party applications that their customers already feel comfortable using. This approach allows Agiliti to make good on its promises of superior service and delivery. Agiliti also offers third-party ecommerce and ebusiness applications from the Vignette v/Series, which is comprised of customer relationship management (CRM) tools, Web content management tools, collaboration and communication applications, along with marketing tools that will help increase sales. This offering also includes catalogs, transaction and merchandising management tools from Intershop.

Agiliti's business model entails the delivery and management IT services via the Internet on a subscription basis. Targeting SMBs in need of Internet-based infrastructure and applications, Agiliti mainly assists retailers, manufactures and software developers.

For instance, Agiliti helped Net Perceptions get a handle on its need for greater IT resources. Net Perceptions is a software developer that designs Web site applications for matching product recommendations to visitors' preferences. As a company that had outgrown its IT infrastructure, Net Perceptions needed more bandwidth as well as better security and backup procedures. Instead of expanding its in-house IT infrastructure, Net Perceptions opted to house its servers in Agiliti's operation center. Agiliti provided Net Perceptions with additional bandwidth, dual backup power generators and multiple Internet access connections. The set-up improved Net Perceptions' network performance and security at a reasonable cost.

Founded in 1999, Agiliti has evolved in a logical, stepwise fashion. After purchasing GoFast.com, an Internet service provider, Agiliti entered the ASP scene and became known primarily for its technical and ISP services. In 2000, Agiliti made noteworthy strides, becoming known as a quality aggregator offering scalable, third-party applications and customized IT services through a tight-knit group of channel partners. Then and now, the company offered bundled applications in three areas: business services, IT services and ecommerce services.

The company has recently started repositioning itself in the market. Earlier this year, Agiliti appointed a new vice president of sales and marketing, Michael Miller, formerly with Dell Computer Corporation. In a February press release, Miller described the repositioned Agiliti this way: "We will continue to broaden our presence in the service provider market space through aggressive channel partnership programs. Agiliti is unique in its focus on enabling IT services firms with the ability to leverage the powerful new ASP-based IT outsourcing model."

The most noticeable change to Agiliti's offering is Intershop enfinity™, a scalable integration platform that allows customers to implement online transactions. Agiliti has worked closely with Intershop to develop a proprietary integration platform, while changing the presentation of its ecommerce and business applications. The company's original IT and ecommerce offerings have changed slightly, with some applications added and others dropped. Its previous business services module has been folded into an expanded version of its ecommerce package, which features more applications from Vignette than before.



**SURVIVAL TIP:**
Agiliti's strong relationship-building skills and technical prowess have contributed to its financial stability but the ASP's true differentiator is its ability to finesse the bundled offering.

### STRATEGIC PARTNERSHIPS

Throughout these changes, Agiliti has continued to pursue an aggressive partnership strategy. The company has consistently partnered with name-brand firms, lending the firm credibility as well as serving the practical function of providing the backbone of its service. To date, Agiliti has acquired close to 40 national partners, many of which are technology integrators and consultants, hardware companies, hosting providers and software developers. Microsoft, Sun, Dell, Intershop and Vignette are considered strategic partners, with the latter two having the greatest brand presence on its Web site.

Agiliti's partners have also expanded the company's marketing reach. Through Intershop, Agiliti gained Highland Software, a Web development and systems integration firm, as both a partner and customer. Agiliti offered to host Highland's applications when Highland was considering various Web hosting solutions to meet its customers' needs. Bruce Spengler, president and CEO of Highland, says, "We were looking into the possibility of hosting Web sites and applications for our customers. Application hosting is a completely different business from what we do, but it's an essential element in providing a service to our customers. So we were looking for a good company to take on that role."

The relationship enhanced Agiliti's customer base and, at the same time, gave Highland a value-added service the company couldn't offer on its own. "We didn't want to make the capital investment to set up our own hosting facilities," says Spengler. "So in the case of offering the Intershop application, we would have only been able to sell our customers Intershop's software directly. They would have to set up Intershop on their own server and they would have had to expend all their own capital. So partnering with Agiliti has been great."

### STRENGTHS

Agilti's strong technical knowledge and service expertise are part of its central value proposition. These competencies allow the company to help many of its partners serve smaller businesses that wouldn't otherwise have the financial resources to take advantage of its services. Andata Technology, a value-added reseller that provides Microsoft/Great Plains financial software to mid-market companies, values Agiliti's marketing and in-person customer support. "The partnership with Agiliti has given Andata a whole new way of selling to prospects," says Andata Technology's vice president of sales, Scott Boedigheimer. "Agiliti has made it easier for Andata to implement the software rental via the Web business plan."

Agiliti's impressive technical know-how, combined with its strong relationship-building skills, enticed Computer Integration Technologies, Inc. (CIT) to partner with the company. CIT supports Agiliti's integration and connectivity services. Chris Taylor, a technical salesman for CIT, cites "technical knowledge, comfort level and a history with the people at the organization" as the chief reasons his firm selected Agiliti. "We had a long-standing business relationship with Agiliti from an ISP perspective. They were the biggest local technical provider and their understanding of the technical aspects helped them deliver."

In addition to technical competence, Agiliti boasts financial stability. Despite the recent economic downturn, Agiliti started off 2001 on an auspicious note, landing an additional US$40 million in funding. The company's financial strength helped garner a number of partners. When deciding whether or not to partner with the firm, Andata's Boedigheimer asked, "Is the company going to be around in two years? " The answer came back in the positive largely because "Agiliti is especially strong financially," says Boedigheimer. "From a financial perspective, they really minimized that concern we had going into it."

Agiliti's business model wisely allows the experts to do their jobs while its core business has always been IT infrastructure and service. The company's recently departed vice president of marketing, Feisal Mosleh's comments still appear to ring true: "Our strengths are not the applications, because we're not application experts. Our strength is bundling applications together into something that makes sense for the customer." By partnering with application, hardware providers, technology integrators and consultants with high service standards, the company can focus on service and delivery, assured that their partners, the true providers of customer and technical support, are best-suited to meeting customers' particular needs.

**WEAKNESSES**

Although Agiliti now underplays its former incarnation as an ASP aggregator, the company still provides the products and services associated with these categories. This fact, combined with the company's bold rejection of its previous billing, only contributes to the current confusion about the ASP market among potential partners and customers. The important thing for the company at this point is to be consistent in its branding strategy from here forward.

Agiliti is also vulnerable to some looming competitive threats, specifically, the possible dominance of telcos, ISPs, cable companies and others that control existing channels to thousands, if not millions, of potential customers. Major telcos like Agiliti's own technology partner, Qwest Communications, have already taken aggressive steps to implement the outsourcing business model and others will surely follow suit. Qwest's recently announced Apptimum program directly targets ASPs looking for infrastructure services.

Some of Agiliti's current software partners could effectively cut out the proverbial 'middleman' by partnering with other better-known infrastructure and network service providers like Qwest. This scenario would force Agiliti to build-up its proprietary technology and continue ardently pursuing new distribution channels, otherwise, the company might find itself outside looking in during a period of intense consolidation.

Agiliti's new focus on IT infrastructure provisioning and associated services should serve it well in the currently fragmented market. As the market consolidates, the company can profitably position itself as a partner with proven technical expertise. Fortunately for Agiliti, its positive financial outlook and extensive network of partners gives it room to maneuver in a chaotic market.

# METHODOLOGY

Throughout the development of this report, from mid-October 2000 through April of this year, ZANTHUS conducted intensive primary and secondary research. We conducted over 35 interviews with a diverse array of thought and market leaders to present a complete, 360° view of the market. We interviewed a number of leading industry analysts, academics, venture capitalists, business writers and industry association representatives on the basis of their industry knowledge. We also interviewed a host of market leaders, chosen from an initial pool of 20 representative companies, along with a sampling of their partners and customers. We then supplemented these first-hand accounts with insights gleaned from a wide variety of news sources.

Although we've tracked developments in the ASP industry on a continuous basis, drawing on industry contacts and business tech publications, the volatile nature of the industry means that some of the information in this report will invariably be obsolete at the time of publication. We plan to periodically update this report as part of our ongoing series on the pervasive computing concept. In this way, we will help readers like you understand the once and future history of the industry.

# INDEX

# ABOUT ZANTHUS

Headquartered in Portland, Oregon, ZANTHUS is a market research-based consulting firm serving high-technology companies. ZANTHUS offers a broad portfolio of research services. From company and product naming to customer loyalty, ZANTHUS has developed a best-of-class process to yield rich, actionable results. The company's research methods expertise ranges from traditional focus groups and telephone surveys to the latest electronic group testing and Web-survey techniques. All informed by rigorous quality standards.

ZANTHUS' primary research capabilities are complemented by thorough, reliable market intelligence efforts. The company's Macroreports series present a unique synthesis of primary and secondary research. These reports provide critical findings from survey research and in-depth interviews with academics, industry analysts and market leaders. All designed to help identify opportunities for increased performance and profitability in clients' existing markets and beyond.

Contact ZANTHUS by calling 971/404.0275, or by email at info@zanthus.com.

Visit us on the Web at www.zanthus.com