OPINION

10 Challenges for Software CEOs

As the industry evolves, vendors must ask themselves tough questions about their current operations - and be ready to act on the answers.
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Dec. 05, 2005

Given the fast-paced and dramatic evolution of the software business, what are you doing to re-engineer your company's business at the same pace? In just a few years, will you be capable of producing an increased number of better-quality products for 50 percent of the current cost to produce them?

Your competition will - both your traditional challengers and upstarts you've not yet heard of.

CEOs need to challenge themselves to ensure their companies are ready to adapt to the new world of software and remain competitive. Here are ten questions to ask yourself to start this soul-searching.

1. What is core to your business - and what is context?
As an industry and as a country we are innovators. We're experts in ideation - translating customer needs into products. Is writing the software code the core of your business? Or is it the application and the ideation, the customer experience, selling and marketing that are core to your business? Today, a lot of software companies who would never have had this debate five years ago think about it every day. There's a shift in the software industry about what is core and what is context. In the software market today there is no room for anything but an extraordinary focus on the core. Look what happened in hardware. Everyone used to think manufacturing was core to the PC business. Now no one does.

2. How much are you really spending on innovation?
Most companies think of research and development budgets as innovation budgets. Today, that really isn't the case. Wall Street is looking for profitability, growth and innovation - but there isn't actually much wiggle room to innovate. If you analyze the R&D budgets of the largest software vendors, you'll find that only 5 to 10 percent of R&D is spent on innovation - the rest is spent on adding features to current products in order to keep current clients on board.

That's just not enough to fundamentally change your competitive position. Where will your next big thing come from? Optimizing R&D performance can give you the bandwidth to better balance R&D spending between today's products and those that will keep you healthy tomorrow. Challenge your managers to provide you with your innovation spend - and be sure to know how it is calculated. If you don't your board will very soon.

3. Are you hooked on maintenance?
Most vendors build software with a misguided focus. In order to meet the needs of current and new clients, companies feel they must build in every "corner-case" client request into the next release. That way, the client remains a customer and continues to pay maintenance fees. But this orientation also results in giant, bloated products that are expensive to upgrade and maintain. As much as 70% of the code in mature products is rarely if ever used.

Maintenance revenue is like a drug - vendors are afraid to quit. But in order to break this unproductive cycle, vendors need to begin to productize for the masses and provide custom implementations and support for clients who need them. This requires employing a services model for both development and support to handle corner case needs. Finding a way to efficiently meet individual client needs will result in a better system for both vendors and customers. But you'll need architecture and a business model that will enable this.

4. Are you really maximizing services revenue?
Wall Street used to want software companies to hold the services portion of their revenue down below 25 percent. Software services became like car radios - many manufacturers throw them in for free and lose money. This attitude led to $1 billion of software services for every $100 million of software sold - most of which flows to services companies not those making the software. And services became the stepchild in software companies. ISVs are now making an active move to regain some of that lost services revenue.

Integrators may be making 45 to 60 percent gross margins while many software vendors only make 20 to 30 percent. For software companies services need to be profitable with at least a 50 percent gross margin in order to be a growth part of your business model rather than a necessary evil. A well-planned approach is required which does not alienate the SI's as some of this revenue shifts back to the software company. Megavendors are already breaking that barrier. Just look at Oracle.

5. Do you know if your customers are really happy?
Enterprise buyers are holding all the cards these days. Following the crash of the technology bubble five years ago, they've demanded - and received - better prices and more accountable solutions from their vendors. Yet as software vendors preach a commitment to ROI-driven products and new pricing models, many do not actually know how satisfied their customers really are. Most of the surveys I have seen lately would say they are not. How many feel complacent with your solution? How many are actively searching for a new solution? This may sound trite but really understanding what the customer wants rather than selling what you have is now more than ever a key to survival.

6. Are you truly leveraging the vendor ecosystems?
New technologies like services-oriented architecture, open source and utility computing are disruptive, especially as the megavendors work them into their strategies. But small and mid-size vendors can succeed by playing via these vendor ecosystems. Collaboration is key.

By creating products that are "hotpluggable" with Oracle Fusion or SAP NetWeaver, for example, clients can buy best-of-breed functionality while still reaping the advantages of the Big Guys. But you'll need to think differently in order to free up the resources to significantly increase your ecosystem R&D output without adding costs. It's about getting a bigger footprint faster and benefiting from ecosystem pull through.

7. Is acquisition really your path to success?
Today, many large vendors are buying innovation when they purchase other software companies. Strategic planning for lots of small and mid-size vendors is simply hoping that a consolidator buys them. But in reality, this consolidation is only another phase of industry growth. Consolidation is cyclical. In the early to mid-1980s, all of the big software companies - McDonnell Douglas, Cullinet, D&B - were buying up other vendors. Industry observers predicted these would be the only providers left standing - and they're not around anymore.

I'm not predicting the death of today's consolidators, simply calling attention to the fact that today's consolidation does not signal the death of small software vendors. In fact by embracing outsourcing, disruptive technologies like SOA and business models like software as a service small to mid size companies can redefine best of breed and compete more effectively.

8. Are your resources strategically located?
The original motivation to offshore work was to lower costs. It is a simple mathematical equation. Like it or not, you will probably have to offshore work to remain competitive. Take a look at the large chunks of product development lifecycle, services and support work being done offshore today already. But offshoring can only do so much. If you're not doing a good job building products onshore, you won't do a good job offshore either. As we try to become productive in a distributive development world the talent pool is shifting.

U.S. universities are simply not producing these types of skilled people in the quantities necessary to remain competitive. Outsourcing and offshoring aren't only about cost savings. They're about how to free up resources and find energy to innovate.

9. What is your product development outsourcing goal?
If you've got 200 people working in the development process offshore and 500 people working here in the U.S. doing the same, but you don't have a roadmap and end goal, you really don't have an offshoring strategy. Many experts say that vendors should have 70 percent of their product development lifecycle offshore or outsourced. A large portion of that work needs to be entrusted to a services vendor whose core expertise lies in that area. An AT Kearney study found that 98 percent of 2001 offshore software development was done by captive centers.

In 2005, that figure had dropped to 85 percent and they predict it will drop further. Some say by 2008 software company owned captives will only account for 20% of the PDLC work done offshore. It really isn't about cost anymore it's about value. It is a value arbitrage that balances productivity, quality, cost and predictability. The goal should be seamless multi-shore development tapping into the best most cost effective talent wherever it is in the world. And it must be done at scale. With 10-20% of your staff offshore it is lower risk, but this won't actually move the needle and probably isn't worth the effort. The days of putting your toe into the water are over.

10. Are you ready for a new breed of competitor?
Your competitors used to be three other companies just like yours. The next era will present two new formidable sources of competition. First, the mega-consolidated vendors who will dictate the solution stack and control distribution with keiretsu like ecosystems They will be able to offer your product and operate via tremendous economies of scale. Second, a new breed of competitor will arise from the East driving new metrics and changing the basis of competition.

Operating almost entirely offshore, ideation will not be a core competency but offering a product like yours at 50% of the cost will be. If they can get twice the R&D for the same budget, you're in trouble. Once they enter your segment the time to react is over. A proactive plan to keep them

out of your market is required and that means efficiency and innovation. Are you ready for these new competitors and do you know how you'll compete with them?

Software leaders need to challenge themselves to understand these changing dynamics and reframe their strategies accordingly. Vendors cannot continue to operate the way they have in the past. I often have software executives tell me, "On average, we're doing as well as our competitors." This isn't a defensible position. If you've got your feet in the freezer and your head in the oven, on average, you're comfortable - but you're really not. "On average" doesn't mean a heck of a lot in today's rapidly evolving, highly competitive software business.

It will always be risky to make a change. But when the fear of failure is greater than the desire to succeed, your fate is sealed.

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