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Software Shifts Gear

Upstarts Try to Outrun High-Tech 'Dinosaurs' as On-demand Subscriptions Gain Ground

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By Dan Fost, Staff Reporter

It had all the typically brash, overblown bravado of the Internet-era startup. When Marc Benioff launched his company, Salesforce.com, at a hype-filled event in San Francisco in 2000, he pronounced that his company would bring about "the end of software."

Five years later, Benioff now has armloads of ammunition in his continuing war on software.

In one of the biggest technology trends of the year now ending, Benioff's model -- alternately known as "on-demand" software or "software as a service," in which companies no longer buy multimillion dollar suites of software but instead pay a few hundred or thousand dollars for programs that run over the Internet -- is catching on fast.

Salesforce.com is nearly doubling its revenue every year. A host of other companies with names like NetSuite, RightNow, Taleo and Arena Solutions offer software as a service and claim to have the momentum that will ultimately bring down industry giants like Microsoft, Oracle and SAP.

And the big guys are paying attention. Microsoft's Bill Gates came to San Francisco last month to unveil his company's foray into software as a service, largely responding to the threat posed by Google.

"This affects everyone who uses software," Gates said at the time. "It's a broad sea change."

In a memo to his staff that found its way online, Gates further elaborated on the rise in software services and likened the trend to the disruptive wave that the Internet brought to Microsoft's business.

Larry Ellison, the chief executive of Oracle, was an early investor in Salesforce.com and owns more than half of NetSuite. Ellison announced at his Oracle OpenWorld conference in September that his company would redouble its efforts in on demand.

"We do see more and more companies wanting to adopt the on-demand approach," said Chris Hummel, vice president of services for Oracle global sales support. "We have more than 500 customers using Oracle's on-demand services," to the tune of \$300 million in the last fiscal year.

The upstarts say it's too late. This is one time, they argue, where the giants just can't be nimble enough to change.

"The Oracles and SAPs of the world are truly dinosaurs. Their extinction is imminent," said Greg Gianforte, founder and CEO of RightNow, an on-demand firm in Bozeman, Mont., that sells customer relationship management software similar to that of Salesforce.com.

He said for a big company to adapt an on-demand model, it would need to overhaul its technology, its financial structure -- even its corporate culture -- and cannibalize its existing business in the process.

The task may be daunting, but Oracle, SAP and Microsoft aren't just any dinosaurs. They've become wealthy by being nimble enough to adapt to changes the tech world throws their way. The Internet was supposed to seal their doom -- and yet they've grown bigger than ever.

"Our research and development budget more than dwarfs all of these companies probably put together," said Oracle's Hummel. "We're putting a lot of those R&D dollars into the delivery of software."

Faster response

Experts say both types of software, on demand and on premise, are likely to survive.

"It gets harder and harder to catch a big competitor flat-footed than it used to be," said Mitchell Kertzman, a venture capitalist at Hummer Winblad Venture Partners and a former software industry CEO who competed with Microsoft and Oracle while running Sybase and then Liberate.

"Big companies are much more aware of these threats and respond to them faster than they used to."

In addition, he said, "not every piece of software should be delivered as a service. There is software that should live only behind the firewall."

Yet in a surefire sign of this technology trend, startup entrepreneurs are retooling their pitches, making all software on demand, Kertzman said, even if it shouldn't be.

While defending the big firms' ability to adapt, Kertzman notes that he's a big fan of on demand. He said it arose after the economic downturn, when companies "realize they overbought technology and cut back their budget significantly."

Body blow

Although big tech firms kept waiting for customers to come back when their business rebounded, it never happened because the customers realized they didn't miss all the big software.

It's what on-demand advocates say is the Achilles' heel of the enterprise software industry: the enormous size, cost and complexity of its offerings.

"There are few entities you hate more than enterprise software vendors," said Michael Topolovac, CEO of Arena Solutions, a Menlo Park firm that sells on-demand software for manufacturing firms.

"They're mean, evil, nasty people," he adds, tongue only slightly in cheek. "They'll sell you something that costs thousands of dollars and then walk away."

Once the big companies get the big bucks, it's argued, companies then have to hire outside consultants to stitch the software together with their other applications. Once all that is accomplished, software upgrades come out, costing thousands more dollars and causing another painful installation process.

On-demand companies argue that they remove all those headaches. "We can't afford to build shelfware," said Michael Gregoire, using a disparaging term for software so complex it sits, figuratively, on a shelf, unused.

Gregoire, a former PeopleSoft executive, is CEO of Taleo, a San Francisco company that provides on-demand recruiting software. "We build a product that has to work every day."

Because companies subscribe to on-demand software, often with a month-to-month contract, the on-demand companies argue they can walk away from the deal any time they are dissatisfied.

"If they don't like you, they don't renew," said Zach Nelson, CEO of NetSuite, which provides a package of software to run almost all financial aspects of a small to midsize company's business. "Renewal is everything."

Many big firms have embraced the new solution. Taleo counts among its customers United Health, Dell Computer, Citigroup and Bank of America. RightNow says it runs customer service for Motorola, as well as for nearly every Cabinet-level government agency in the United States.

Salesforce.com's Benioff boasts that his clients include Nextel, Kaiser Permanente, Symantec, Staples, Cisco and Merrill Lynch.

When the software firm Sybase sought to change some of its own internal operations about three years ago, "We looked at several technologies out there," said Thomas Volk, an executive vice president of Sybase. It was using Siebel Systems for its customer relationship management software, known as CRM, which handles a company's sales and customer service operations.

As Sybase investigated and tried out Salesforce.com, Volk said, it found that the software "gives us the flexibility we want and the functionality we need. We could integrate our own needs at lower costs than the previous system."

And by putting all the data at a remote site -- what Arena's Topolovac calls "in the cloud" -- users everywhere can access the system easily. Topolovac said his frequent travel beats up his laptops so much that he gets a new one every six months, but he never has to replace the data because it's all "in the cloud."

Anyone who has bought something on eBay could understand an on-demand system. Nelson, the NetSuite CEO, offered up a demonstration in which he could track and assign sales leads as they came into the system. He could then easily analyze which sales reps had acted on which leads and see where the sales were coming from.

Yet it's never easy to switch software providers, even to on demand. Mike Williams, chief information officer at the global construction firm Parsons Brinckerhoff, said his firm has long relied on Microsoft and Oracle and isn't likely to change soon.

"It would require a lot of effort," he said in an e-mail -- "a compelling business case, a realistic return on investment, a strong project plan, a very on-board management team, a CIO willing to put it on the line, and an IT team that is not afraid to retool its skill set -- but it could be done with an appropriate lobbying/on-boarding/change management plan. I suspect we are not atypical and the biggest challenge would be change management during the process of weaning the organization from legacy platforms and applications."

But that's a change from just a few years ago, when on-demand firms' biggest hurdle was persuading companies that they would provide enough security for their data.

'Total sea change'

"It's gone from people questioning the model to people demanding the model," said NetSuite's Nelson. "Over the last 18 months to two years, it's been a total sea change. Companies know we'll manage that information better than they possibly could. They want it stored offsite so it's more easily accessible to their people around the globe."

So why, if the move to on-demand is inexorable, couldn't Oracle or Microsoft adapt, or even just gobble up the innovators, as they've done with the emergence of other new technologies?

RightNow's Gianforte and others cite several reasons:

-- Big software firms that are accustomed to selling big software packages would have to rewrite all their applications from scratch.

-- Big software firms have made extensive use of third-party resellers, who install and maintain the software. Those firms are cut out of the on-demand model. "If Oracle and the others are going to embrace this model, they have to alienate all their business partners and build a whole new ecosystem," Gianforte said.

-- On-demand companies pay for the software as they use it, whereas the legacy systems get large up-front payments. "It's a very difficult model to transition to, especially for a public company," Gianforte said.

-- The existing players who sell big packages of software "have traditionally slammed home a deal, collected a bunch of money and run off to the next one," Gianforte said. "In the software-as-a-service model, you pay as you go. If you don't deliver customer success, you don't get the renewal and you're out of business."

In addition, notes Subrah Iyar, chairman and CEO of the online conferencing company WebEx -- one of the first on-demand companies, although it didn't coin the phrase -- Microsoft's old advantages no longer apply.

"It's a much more level playing field than the previous generation," Iyar said.

"In the previous generation, software innovation happened on the desktop. Now it happens on the Web, and Microsoft is not in control of the Web."

"We believe they'll get a share of the market," Iyar said, "but not an unfair advantage."

For its part, Microsoft points out that on-demand software is not seeking to displace the PC, and most PCs still run the Windows operating system, Microsoft's bread and butter.

And Microsoft is now dabbling in giving away lighter versions of its Office software to small businesses, and supporting that with advertising -- much as rivals like Google might do with the host of open-source competitors now gaining traction.

Some software certainly will go to an on-demand model, said Tim O'Brien, group manager of platform strategy for Microsoft.

"But there are a number of scenarios where businesses or consumers will want the richness of their software on premise or on their local machine. It wouldn't be a great idea to paint the world with that broad brush and say it's the end of software as we know it."

On demand explained

The movement sweeping the business software field is known by a pair of interchangeable names, "on demand" or "software as a service." These refer to a change in the way software is sold. Instead of software that is delivered by CD or bought in a bulky package, on-demand software is delivered over the Internet.

The software resides on servers operated by the company that sold it. That allows many users to have access to the software at the same time. It also allows the company to update the software whenever it wants or needs to, without hawking an expensive upgrade.

Sometimes companies pay up front for this service, but often it's sold as a subscription: Companies pay a monthly fee for however many users they want to have access to the software, and the host keeps the system working.

Michael Topolovac, CEO of Arena Solutions, offers the analogy of the power industry. If you don't have power, you could buy a generator. As your business grew, you'd establish a generator room, have fuel trucked in and keep mechanics on staff to run it. But wouldn't it be nice if someone would establish a power plant and run lines to your business, so you don't have to have all that distraction?

"On-demand software," he said, "is the power plant."