

Under the Buzz

Back to Basics in e-Business

July 2003 - Vol. 4, Number 7

Under the Buzz is an electronic "viewsletter" authored by Philip Lay, managing director at TCG Advisors, a strategy consulting firm based in Silicon Valley. It is published each month, and delivered free to subscribers via email. It is also posted on the TCG Advisors website at: <http://www.tcg-advisors.com/Library/utb/utb.htm>. Back issues are available at this same address.

In this month's issue:

1. Latest Twists and Turns in the Oracle vs. PeopleSoft/J.D. Edwards Tussle

More on the ongoing struggle between these enterprise apps to sort out who's going to own who in the upcoming battle against SAP and Microsoft.

2. Darwinism, Innovation and the Maturing Tech Industry: Interview with Geoffrey Moore

Following a speech delivered to TiECon 2003, a conference organized by The Indus Entrepreneurs, a Silicon Valley based network of mainly Indian entrepreneurs and professionals, Geoffrey Moore responds to wide-ranging questions posed by conference attendees on key topics of interest to all high-tech focused executives and professionals.

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1. Latest Twists and Turns in the Oracle vs. PeopleSoft/J.D. Edwards Tussle

Based on recent developments, PeopleSoft now appears to have made it much harder for Oracle to prevail in its hostile takeover bid; despite falling short of the 90% target of shares acquired that was required to formally complete its acquisition of J.D. Edwards by the July 17 midnight deadline, it is now virtually certain that Oracle would have to swallow both entities if it wants to prevail. Besides this hurdle, current indications are that Oracle may have to further sweeten its offer to somewhere around \$22 a share, resulting in an overall value of \$8B or more, unless PeopleSoft's stock price happens to fall prey to a widely predicted mid-summer swoon in the stock market.

Nonetheless, the fact that PeopleSoft managed to close the second quarter with such favorable results, combined with the lack of credibility in Oracle's change of tune about its pledge (or threat!) to discontinue PeopleSoft's products in the event of its bid being successful, tends to reinforce the impression that Oracle will fail in its bid. The vote of confidence by many customers who agreed to close business despite the assault on the company's ability to operate normally in the vital last three weeks of June, confirms that Larry Ellison's insistence on dismissing PeopleSoft's products as part of Oracle's initial gambit in the negotiations was a serious misjudgment.

Thus my sense is that the SCC's lengthening deliberations about the antitrust implications of Oracle acquiring the combined PeopleSoft/J.D. Edwards business are now most probably a moot point. In fact, any further time spent speculating on the outcome of this triangular skirmish is probably time that could be more profitably spent by each organization on customer-related business activities rather than on further company-to-company wrangling. After all, the recovery in enterprise spending on IT products and services has yet to materialize, and the most productive time of the year for software companies to close deals – the September to December period - is almost upon us.

2. Darwinism, Innovation, and the Maturing Tech Industry: Interview with Geoffrey Moore

Following a speech delivered to the 2003 conference of TiECon (The Indus Entrepreneurs Conference), Geoffrey Moore replied to a number of questions posed by conference attendees. I am hopeful that readers will enjoy the wide-ranging topics broached by the questioners and the detailed responses provided by Moore (responses are indented).

How do you survive in an ecosystem where just about every hardware technology is fast diffusing out to China?

This is Darwin at work. You must find the niches where your model is the fittest and not compete where another species has all the advantages. Personally I think “hardware” is an obsolete metaphor, for the value is virtually all created upstream in software.

What is your view on anti-global trade issues?

I think governments are part of the total eco-system, and we should expect societies to operate on the political level as well as others. In particular, incumbent gorillas have traditionally used their resource hoards to build strong relationships with government representatives. My take is that AT&T outflanked Mike Powell of the FCC recently using this resource. We certainly should expect the EU to explore its options as well. Americans tend to get righteous here, but we do our own version of protectionism as well. The net is, build this subsystem of variables into your strategy model, at minimum for your competitors, maybe perhaps for yourself.

What do you think about the prospect for open-source to revolutionize software?

I think it changes things at the margin, particularly where self-organizing communities can make a contribution. I do not think it changes things at the center because differentiated IP normally has to be centrally planned and managed. The primary zone of interest is where a commoditizing category is still dominated by a proprietary solution – think Solaris and NT – where there is a margin difference that is creating a magnet to attract alternatives. But the winners in this game are not the developers of open source but rather the customers of the category, so from an investment perspective, you don’t want to be invested in this layer but rather in some other layer of the stack that can leverage the outcomes.

What do you think the impact of business process outsourcing is on the American economy? Employment shifts – do you expect to see social problems for Indians?

Outsourcing to me is an exercise in Darwinism, where the ultimate process owner ends up being the one that is the fittest. This is a threatening process as it disturbs existing power structures. Those structures can be expected to react and resist. On the positive side, exposing a culture and an economy to Darwinian selection makes it stronger—that is a great reason to support outsourcing in my view. Also, exporting work to the less developed economies is the most constructive form of foreign aid I can think of. All in all, I think the forces of enlightenment (which one normally defines as those that agree with one’s own point of view!) should support this, but many will not.

Deflation is a natural result of benefits of technology. Growth would come from spreading the wealth globally. Why not recognize this reality?

I think we can recognize a reality without capitulating to it too early (consider one’s own mortality, for example). When it comes to accepting commoditizing profit margins, I am with Dylan Thomas who said, “Do not go gentle unto that good night. / Rage, rage, against the dying of the light.”

In this age of open, easy communication, has not sustainability come down to sustained execution rather than sustainable technology edge?

Commoditization eventually hits all markets, and so eventually operational excellence becomes paramount. That said, customer intimacy strategies on top of commoditized

offers can still generate preferred margins. Product leadership strategies, however, at some point are devalued to a level of uselessness.

In light of the "new realities" of today, what role shall our universities play in the fostering of true innovation, and what can be done to ensure that such innovation is brought to market?

I think the greatest value of universities is that they aggregate smart people who then find each other and collaborate to innovate. The curriculum is secondary at best. I do not think one can 'train' people to be successful at Darwinism, except in the most general, liberal arts sense. So I hope universities will continue to seek out stimulating agendas, recruit professors who are passionate about them, and students who are bright and creative enough to take advantage of the whole system.

Do you see consolidation of enterprise software around few platform vendors as the pundits predict? What's the cycle for "best of breed" to return if at all?

I think we are at the far end of a pendulum swing, where there is maximum advantage for the incumbent gorillas (i.e., dominant market leaders). But they are not particularly good at innovation, so as long as you think new and interesting problems will emerge (and when in the course of human events have they not?), the pendulum should swing back. At MDV (the VC firm where I am a venture partner) we are actively investing in enterprise software, as we have been doing for the past two decades.

How do you deal with the cultural differences between product and service groups within one organization?

The issue, I believe, is somewhat different. I think that product organization set up their captive service organizations for failure because they ask them to play far too many roles, many of which are mutually exclusive. Independent service providers have to focus on a subset of the whole smorgasbord of roles in order to succeed.

Talk to us about the value proposition using "hard" ROI as the discussion point. What is the "tipping point" for "hard" ROI in the market?

The more mature the market, the harder the ROI has to be. Conversely, the less mature, the softer it should be. It is pretty much that simple.

What is the root cause of technology deflation over supply, globalization?

Like all booms, this one attracted imitators too. The interesting question is whether we are at a digestion point (like 1984-5) or an inflection point (the age of tornadoes is past). Can't tell from here.

It looks like wireless LAN – IEEE802.11 or WiFi has crossed the chasm and is now into the tornado phase. Who are the winners and losers? With the new dynamics, what's next? Broadband Wireless Access, IEEE802.16 or WIMAX? What should we look for?

When open standards technologies tornado, it is never the companies in that category that are the big winners because the absence of barriers to entry leads to immediate and drastic price deflation. Instead, it is the products and services on top or below that layer of the architecture that should flourish. Look for the thing that can remain scarce. In the media world, for example, this has always been the popular artist.

Category Commoditization: What does it mean for Telecom? What about VOIP? Is routing a commodity? Could you please comment on potential impact for a Cisco?

Complex systems do not commoditize quickly, but high-volume operations do. Over time, of course, everything commoditizes. Taking these two notions together, the short-term outlook for Cisco bodes well, as analog data types (voice, video) continue to drive the need for greater integration and complexity of networks. There is commoditization at the low end, and it will be interesting to see what Cisco can do with Linksys in that regard.

When do you think the next tornado will come? In what area? How about wireless games applications?

Games, in general, are hit-driven businesses, and they will continue to drive dust-devils around specific games. But it is key to look at who is going to pay how much for what and to whom. A profitless tornado is a dangerous thing. Right now, in the US, wireless gaming looks like it could be just that for many members of the wireless value chain.

The dot.com era had huge excess and lost credibility as a result. How do we bring trust among customers in order to enable a new round of buying activity?

In an era of retrenchment, it is key to get back to more immediate, more verifiable returns on investment. Customers are willing to re-explore their relationships with disappointing vendors at the margin, meaning when the problem is such that they cannot get anybody else to solve it. That is where we have to work to earn our way out of the penalty box.

I disagree with your assertion that this is the maturing of technology. It is like the U.S. Patent Office saying in 1895 that "everything can be invented that has been invented" or an Intel exec saying in 1981 "every application which can use a micro processor has used it already." I would argue that 2000-2003 is a very minor glitch in the onward march of technology. Please respond.

Innovation is perpetual. The human race will never run out of cool new stuff. It is marvelously inventive. The debate, instead, is about whether the computer technology sector of the economy will, going forward, be able to capture a disproportionate amount of the economic returns from ongoing improvements in Moore's Law. I think there is increasing evidence that, as standards commoditize, it will be the customers of these companies, rather than the companies themselves, that capture most of the gains. The market has gotten better and better at reining in the classic gorilla game formula of "high-value proprietary products embedded in high-volume open architectures." I would love to be wrong, of course, and as a venture investor I continue to swim against this tide. But I don't think it is a foolish concern.

Large companies are usually slow to innovate. Entrepreneurs generally do it much better. What will be the change in the equation between the two in the coming three to five years, vs. in the last three years or so?

This equation has not changed in my lifetime, and I do not expect it to going forward. There are simply too many dynamics in too many large companies that resist disruptive innovation. That said, keep an eye out for a new book from Clay Christensen called *The Innovator's Solution* that does its best to help the large companies re-enter the fray.

How do you distinguish and know the difference between reality and "a vision you believe in"?

Reality bites back. Seriously, at the beginning you cannot know, but you can stay alert for "Darwinian moments," when you discover either that you or the status quo has the true competitive advantage. As long as you migrate toward the frontier of increasing competitive advantage, you are playing the game as best you can.

"Reality" is, of course, important. However, if you are too tied to "reality," don't you lose vision and then are you doomed?

Vision is part of reality. The dichotomy you propose might be better stated as between the exceptional and the ordinary or between the disruptive and the conventional. In both cases, to take the innovative side of the battle, you must have good models and clear thinking (since you have little to no useful data to guide you).

Will Japan ever wake up from its deflationary hibernation?

I think it may require the next generation to get there. It looks very much as if the current generation of business and political leaders are hopelessly bound to a set of conventions that lock the problem securely in place.

Do you see the current shrinkage in technology companies rolling over into technical training and business education?

Let's hope so. The worse thing you can do is hyper-educate a group of people for a dwindling marketplace. Again, Darwinism is at work and will inexorably separate the competitive from the non-competitive responses.

Where in the cycle do you see storage service as a category (SAN/NAS/issue)?

The SAN and NAS architectures look like they are both sound platforms for going forward, one more at the core, the other more at the edge. Both have crossed the chasm. Both are in price-elastic markets. Value is migrating toward the software, and there is still plenty of room for next-generation architectures to move things ahead (comparable to what Google has done to search).

Regarding deflation, our customer, a New York stock exchange company, wants to pay \$200,000/yr to save \$10,000,000/year. Is this deflation?

Only if they can get the service from someone else. Otherwise it is negotiation. Of course, you might want to consider a "discount for risk," especially if you are a start-up.

Please define "differentiation" and "pricing power."

Differentiation in this context means having something the customer wants that your competitor cannot give them (and *sustainability* means being able to keep things that way). *Pricing power* is a function of sustainable differentiation because that is the force which prevents customers from putting you in a bidding war with your competition. Put another way, being the exclusive path to a customer-desired outcome is the key to pricing power.

Can TiE successfully evangelize entrepreneurship globally? Does your "core versus context" model apply to non-high tech start-ups?

Core-vs-context applies to all institutions, even governments and NGO's. That said, there are a lot of issues with global entrepreneurship that are hard to see in the U.S. - access to funded customers, access to capital, rule of law, etc. True entrepreneurship has to read the environment and work within its constraints. That may well produce institutions that look nothing like the sort of stuff we see here in the Valley.

Please give us some concrete examples of "core versus context" in today's technology sector, preferably in enterprise software or communications infrastructure.

CRM is context for SAP, core for Siebel. Document management is core for Documentum and FileNet, context for Microsoft and IBM.

How do you see deflationary price trends having an impact on entrepreneurship versus incumbents?

I think it favors the entrepreneurs, if they can look forward and avoid the deflationary pitfalls in their emerging market. The reason is that you get to buy a whole lot of horsepower on the cheap. The main thing is to harness it to a proprietary innovation that has sustainable differentiation.

Are we beginning to see the investment infrastructure that broke so severely with the dot-bomb cascading tech crash, begin to repair itself? When will the number of seed investments return to their pre-boom days?

I think the limiting factor on seed investments is the lack of entrepreneurs, not the lack of interested investors. Part of the problem is that we taught some bad lessons in entrepreneurship to a whole generation. Another part is that we scared away all the true entrepreneurs in our rush to capitalize the bubble. But there are problems on the company formation side, not the capital side, of the equation.

How does a brand-new entrepreneur get business contacts? How does he network effectively? What are the best practices for getting consulting contacts?

If you have no contacts, and you want to consult, best to join a consulting organization and leverage its brand as you build up yours. If that is not an option, I believe in putting yourself in harm's way, by which I mean devoting yourself to a nasty, currently unsolved problem, and seeking out customers who are in such pain they are willing to take a chance on you to help them solve it.

The entire Indian offshore business is built on the basic principle of arbitrage. How do you see this "category" morph into a sustainable structure?

Arbitrage is like a funding head start. Those companies that evolve up the value chain will continue to prosper. Those that are playing a low-cost labor game only will get eliminated.

Regarding the much vaunted convergence of different information access devices, how painful is it to carry two devices on your belt? (How important is it to have one true converged device that enables realization of wireless potential?)

I am not a great fan of the converged device. I like the idea of "hiring" products and services to do specific jobs. In my case, I hire a Blackberry to be my portable Outlook, a Nokia cellphone to be my anywhere telephone, and a Skytel pager to be my emergency contact service.

'TiE' stands for 'The Indus Entrepreneurs', an association of Indian entrepreneurs and executives based in Silicon Valley. TiECON is the association's annual conference, attended by more than 1,500 members of the Indian business community, in addition to other technology-focused executives and professionals.

Under the Buzz offers a monthly commentary on e-business. The goal is to provide provocative and accurate insights into the latest events and thinking shaping this rapidly evolving technology sector. *Under the Buzz* also provides commentary on strategies for building sustainable competitive differentiation and maximizing market valuations. © 2003, Philip Lay

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