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BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS



Looking for telesales
performance metrics?
See pages 4-5.

On Measuring Your Interactivity IQ

Why do some companies inspire an almost cult-like loyalty among their customers while others inspire indifference? In a market where installed base customers are often the only ones spending money, creating loyalty is not an academic exercise – it's become a survival strategy. And companies whose leaders don't understand loyalty-building are probably most likely to vanish.

Loyalty obviously has many roots. Most of us feel a modest sense of loyalty to companies with good products, good service, fair prices. But this kind of loyalty doesn't run deep, because there's no real interaction between the company and its customers. Real interaction is what engages us and leads to deeper commitment.

*In fact, we see this principle at work every time a speaker stands up in front of an audience. "In a live setting," marketing consultant Michael Katz recently pointed out, "it's well known that the more you can get your audience to participate, the more likely they are to stay with you and ultimately internalize what you've got to say. Interactivity **causes** interest."*

For companies with thousands of customers, of course, interacting with everyone is a scary thought, and it's tempting to conclude that it can't be done. But certainly some companies do manage to achieve a much higher "interactivity IQ" than others. To get a sense of how your own company scores in this area, try answering these six questions:

★ How much authority do your customer service people have?

- They're told to do whatever's reasonable – including issuing a refund – to win back an unhappy customer.
- Our customer service people are supposed to explain and enforce our rules as consistently as possible.
- I haven't a clue – top management doesn't deal with customer service policies.

Typically, low-level customer service people handle the majority of customer problems – billing disputes, lost disks, password snafus. If you encourage your people to be real problem-solvers, you deserve a full four points. If you're mostly concerned about rules and consistency, give yourself a zero for encouraging a bureaucratic mindset. And if you're clueless about how your company handles customer interactions, deduct three points from your score.

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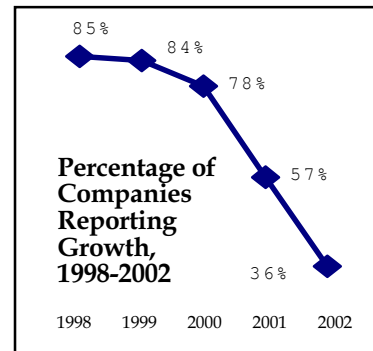
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“A Fundamental Change in Economics”

If you're feeling nostalgic about the good old days, industry analyst Brian Turchin says there's good reason: In the last five years, software companies have experienced a “pervasive” collapse in growth rates and profitability across virtually every industry segment.

“We've all heard stories about high-flying companies that Wall Street now shuns like lepers,” says Turchin. “This isn't just anecdotal evidence—there really has been a fundamental change in the industry's economic profile.” To “put some statistical meat on the anecdotal bones,” Turchin recently analyzed the income statements of 220 public software companies. Here's what he found:

- **Overall growth rates have tanked:** “An astonishingly high number of companies grew in 1998 and 1999,” Turchin reports. In 1998, 85% of his universe of 220 public companies reported positive growth, both from organic sales growth and from acquisitions. The following year was virtually unchanged—84% grew—but then the downward slide began. “By last year only 36% of companies reported any growth,” he says.



- **The rich are getting richer:** Despite the decline in year-to-year growth rates, Turchin's data shows that the software market as a whole has been growing steadily. Between 1998 and 2002, total sales for his 220 companies grew from \$59.9 billion to \$94.3 billion. Trouble is, the rising tide isn't lifting all boats. Instead, bigger companies seem to have captured most of the growth dollars at the expense of smaller rivals. Last year 44% of companies with more than \$100 million in sales grew, while only 31% of smaller companies reported any growth. And if Microsoft's growth is excluded from total industry revenues, last year the remaining share of the software marketplace actually shrank by 3%.
- **Profits are shrinking, too:** “Surprisingly, even in the champagne years of 1998 and 1999 the majority of software companies weren't profitable—only 46% managed to generate more revenue than expense,” says Turchin. By 2001, the percentage of profitable companies had dropped to only 27.6%. Last year showed an uptick to 32%, he adds, which “may be attributed to cutting staff to bring salary expenses in line with revenue numbers.”
- **Small companies are in especially deep trouble:** For small companies, the profit comparisons are even more grim than the growth numbers, Turchin reports. “In 1998, a fabulous business year, a majority of large companies were profitable, but only 35% of small companies were,” he says. “In 2001, the worst year, only a mere 12% of small companies were able to eke out a profit—which means that almost nine out of ten were unprofitable! For big companies, the situation was getting worse, but 48% were still able to remain profitable. As a breed, smaller companies are much more at risk than larger ones.”

“Profitability and Growth Trends in the Software Industry,” Brian Turchin, president, Cape Horn Strategies, 2625 Hewlett Ave., Merrick, N.Y. 11566; 516/377-4244. E-mail: bturchin@capehornstrategies.com.

★ **How much of your total annual revenue do you generate from maintenance and professional services?**

- More than 40%.
- 15%-40%.
- Less than 10%.

Services are almost always a sign of high-touch, ongoing relationships with customers. If services contribute more than 40% of your revenues, give yourself four points. A services contribution of 15%-40% is about average; give yourself two points. If less than 10%, you've probably adopted a hit-and-run sales model that's worth zero points.

★ **How much product design input do you collect from users ?**

- We often brainstorm with users about new products and services.
- Our sales and support people tell us what we need to fix.
- We invite our users to beta test products that are nearly finished.

Customers who know you're really listening will be loyal for life, so give yourself four points for actively soliciting their ideas. An impersonal fix-it approach is far less creative; that's worth two points. And beta testing may find bugs, but it's not a way to get significant creative input; one point.

★ **How would you describe your presence at major shows?**

- We often place top-level executives as speakers, hold customer meetings, and give press interviews.
- We exhibit, but usually send only sales reps.
- We don't have time to attend industry events.

Attendance at shows is down lately, but live events are still a great opportunity for meeting customers and other influencers face to face. Collect three points if top management actively works the crowds, one point if booth bimbos and glassy-eyed sales reps represent you, and zero for staying home.

★ **How do your customers communicate with each other?**

- We run at least one major user conference every year.
- We host a moderated Web forum.
- Our customers just complain when they talk among themselves, so why encourage them?

Take another four points for building the kind of interactive user community that can support live meetings, three points for supporting a good online forum, and a goose egg for worrying about negative remarks (even if they're likely).

★ **How do you deliver post-sale services and support?**

- We assign a dedicated relationship manager to every major customer, to help them navigate our services offerings.
- Each service offering has its own contact person.
- Our customers should be smart enough to find what they need.

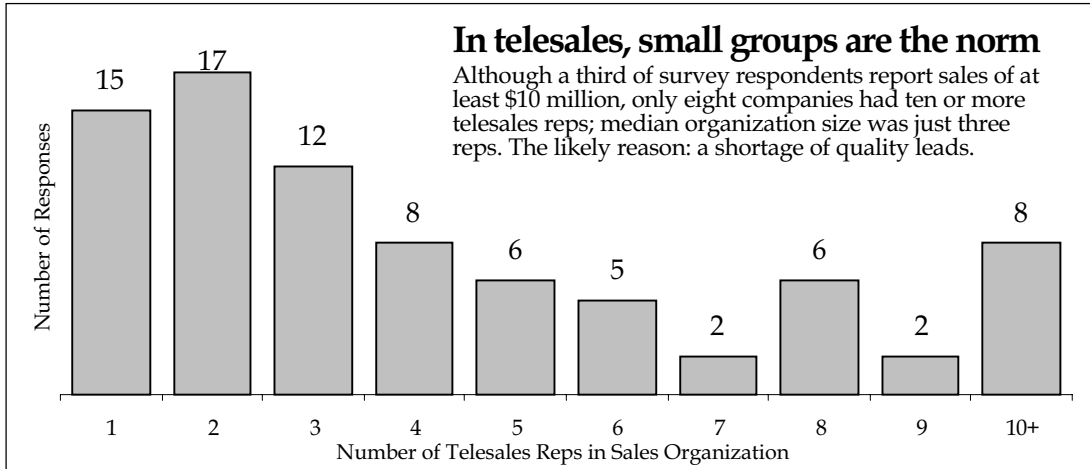
Four points for giving customers a trusted guide to your inner workings, two points for putting knowledgeable contact people in charge of individual services, and zero for expecting your customers to bounce around like a pinball game.

SCORING:

18-23 — You're a champion at customer interaction, and your customers are likely to feel genuine loyalty.

10-17 — You're doing a few things right, but not enough to stand out.

0-9 — Chances are, you don't give a hoot about your customers, and they know it.



Benchmarks: Telesales Metrics

As the cost of face-to-face sales calls keeps rising, software marketers have been slowly rethinking the telesales model. Telephone selling to consumers still has a bad reputation (usually well-deserved), but in business-to-business segments a well-run telesales group can usually generate as much revenue as a more expensive field sales force – and at lower cost.

There’s just one hitch: A telesales effort takes intensive management, in part because telesales reps typically burn through large numbers of leads every month. Keeping track of leads, close rates, and other internal metrics is not a trivial job; if the process breaks down, telesales can quickly become an expensive boondoggle. As a result, telesales managers tend to be hard-core metrics mavens, measuring and comparing everything in sight.

This wealth of internal data, however, doesn’t help managers answer the broader question of how a company’s telesales effort compares against industry benchmarks. In fact, telesales benchmarks are notoriously difficult to develop. Terms like “inquiry” and “lead” vary widely in meaning from one sales organization to another, and some telesales groups routinely hand over bigger deals to the field sales force or to resellers, so “close rates” become especially tricky to compare.

Still, it’s possible to define at least some rough benchmarks for telesales performance. We recently collected data from 86 software companies about their telesales efforts, and we’ve summarized our findings here and in the accompanying charts:

PRODUCTIVITY METRICS

Despite broad differences in products and lead generation metrics, the most common denominator for most telesales productivity is *revenue generation*. And it’s especially helpful to compare revenue generation and productivity metrics in terms of the size of the telesales group:

- **Average transaction size:** The sweet spot for telesales deals seems to

Productivity Metrics

	Number of Telesales Reps			
	1-2	3-6	7+	All
Average Telesales Transaction Size	\$25,000	\$25,000	\$11,000	\$25,000
Average Sales per Rep per Day	\$1,000	\$4,150	\$2,436	\$1,500
Average Talk Time (hours)	4.0	4.75	4.0	4.0
50% range	3.0-5.0	2.0-6.0	3.0-5.0	3.0-6.0
Annual Leads Handled per Rep	500	400	438	500
Close Rate	5.0%	7.0%	9.3%	7.5%

Definitions: Average Talk Time = "In a typical day, how many hours does an individual telesales rep actually spend talking to prospects?" Annual leads per Rep = "Total annual number of leads handled by your telesales group divided by total number of telesales reps." Close Rate = "Percentage of total telesales leads that produce some sales revenue." 50% Range represents the middle half of all responses.

fall around \$25,000, a transaction size that's usually too large for direct response and Web channels, and too small for face-to-face direct sales.

- **Sales rep productivity:** The average telesales rep spends about four hours a day on the phone, handles some 500 "qualified" leads per year, and generates \$1,500 in revenue per day. Mid-sized groups (3-6 reps) seem to be the most effective in terms of revenue generation, producing over \$4,000 in sales per day for each rep. However, large groups (7+ reps) tend to have the best close rates: They get at least some revenue from 9.3% of the prospects they contact. (This higher close rate is offset by the lower average transaction size that prevails among larger telesales groups.)

LEAD GENERATION

Keeping the sales pipeline filled with leads represents a huge hidden cost for most telesales groups—in fact, lead generation generally represents a bigger per-rep cost than salaries and commissions.

- **Cost per lead:** Lead generation costs tend to rise with average transaction size: Not surprisingly, marketers are willing to invest more to acquire a lead that might convert to a big-ticket sale than they will for smaller deals. Thus, companies with transaction sizes under \$10,000

Lead Generation Metrics

	Average Telesales Transaction Size				All
	Under \$10,000	\$10-\$25,000	\$30-\$99,000	\$100,000+	
Annual Budget per Rep	\$75,000	\$79,167	\$60,000	\$133,334	\$70,588
Annual Leads Handled per Rep	1,014	1,275	333	370	500
Cost per Lead	\$67	\$111	\$250	\$273	\$114
Qualified Lead Ratio	17.5%	25%	30%	15%	25%
Close Ratio	5%	6%	10%	10%	7.5%

Definitions: Annual Budget per Rep = "Total annual spending for all telesales lead generation activities (including allocated salaries and overhead) divided by total number of telesales reps." Annual Leads per Rep = "Total annual number of leads handled by your telesales group divided by total number of telesales reps." Cost per Lead = Annual Budget per Rep divided by Annual Leads per Rep. Qualified Lead Ratio = "Percentage of your total telesales leads who requested information, responded to offer, were a former customer, etc." Close Ratio = "Percentage of total telesales leads that produce some sales revenue."

Compensation by telesales organization size

	Average Performers	Top-Performing One-Third	Worst-Performing One-Third
1-2 telesales reps	\$50,000	n/a	n/a
50% range	\$30-\$75,000	n/a	n/a
3-6 telesales reps	\$52,500	\$71,350	\$45,000
50% range	\$40-\$75,000	\$60-\$100,000	\$30-\$55,000
7+ telesales reps	\$55,000	\$73,000	\$42,500
50% range	\$45-\$75,000	\$60-\$100,000	\$30-\$50,000
All respondents	\$51,000	\$72,350	\$45,000
50% range	\$40-\$75,000	\$60-\$100,000	\$30-\$50,000

Compensation = base pay plus commissions. 50% Range represents the middle half of all responses.

typically spend \$75,000 per year to provide a rep with more than a thousand leads, each costing about \$67. At the other end of the transaction spectrum, companies with average transaction sizes over \$100,000 will spend \$133,334 to produce only 370 leads per year at a median cost of \$273. Moreover, high-end companies also seem to invest more effort in the selling process: The close rate for transactions worth more than \$100,000 is 10%, compared to 5% for deals under \$10,000.

- **Qualified lead ratio:** Ideally, telesales efforts should target prospects who've shown a definite interest in buying—for example, people who requested information, responded to an offer, or were former customers. Finding enough of these "qualified" prospects, however, is usually too difficult or too expensive. To keep the lead pipeline full, most companies give their telesales reps a substantial number of less-qualified leads, which may include magazine bingo card leads, names from directories, or people who just dropped off business cards during a trade show contest. Finding enough qualified leads is a problem at all levels of transaction size, and it helps explain why software telesales groups tend to be much smaller than their consumer counterparts.

COMPENSATION

Salaries and commissions represent the other major expense of operating a telesales group, but—unlike field sales reps—telesales reps are relatively inexpensive employees. Overall median pay (base pay plus commissions) for the reps in our survey is \$51,000; half earn between \$40,000 and \$75,000. There's some increase in pay in larger sales organizations, but it's not dramatic: Median pay in the large telesales groups is \$55,000.

Not surprisingly, higher performance translates into significant pay premiums for most telesales jobs. The top-performing one-third of telesales reps earn more than 40% more than average performers; the worst-performing one-third earn about 12% less. But even the best telesales reps are still remarkably affordable—in fact, only the top 25% of the best-performing one-third earn more than \$100,000.

Behind the Scenes

By Software Equity Group, L.L.C.

After 10 very difficult quarters, Q2 provided reason for guarded optimism about the nation's economic outlook. The technology sector led a sustained and impressive stock market rally. For the quarter, the S&P 500, Nasdaq and Dow were up 14.9%, 20.4% and 12.4%, respectively. Improved earnings reports, smaller inventory reserves, continued Fed rate cuts and an aggressive monetary policy were the catalysts many investors needed, choosing to ignore several negative indicators. Investors also seemed comforted by a more stable geopolitical picture, but major challenges in post-war Iraq, the "road map" in Israel and the Palestinian territory, and a new peacekeeper role in Liberia, loom as potential spoilers.

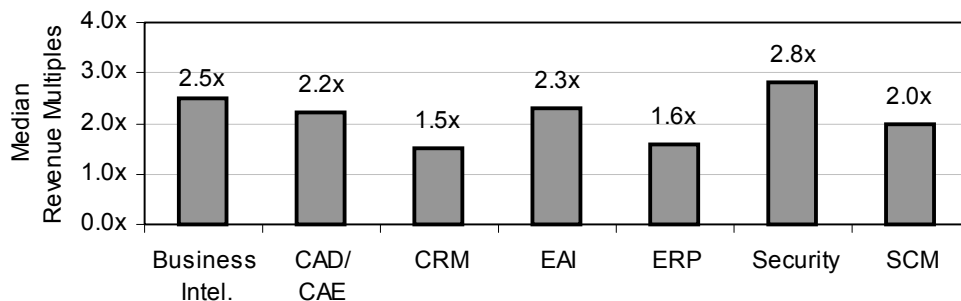
The average market value of the SEG-SEVENTY, our software industry public company index, climbed 10% during the quarter, following a 14% increase in Q1. The median revenue multiple grew 15% to 2.1 times trailing-twelve-month (TTM) revenue, while the median PE fell 16.3%, indicative of earnings growth exceeding market growth. The median multiple of EBITDA for the SEG-SEVENTY was 18.6x. The average revenue multiple was 2.7x, and the corresponding confidence interval at eighty percent was 2.4x to 3.0x.

Relative to the first quarter, total U.S. M&A activity increased 31% and dollar value was up 38%. M&A activity in the software industry continues to lead all other sectors. According to MergerStat, software accounted for 300 deals in Q2, approximately 15% of all U.S. M&A activity for the quarter.

Acquirers spent \$15.4 billion on software businesses in Q2, more than three times the \$4.7 billion spent in Q1. Note, though, this includes Oracle's \$6.2 billion bid for PeopleSoft, as well as PeopleSoft's \$1.4 billion bid for J.D. Edwards. The median software M&A multiple grew 9% to 1.2x. Strategic acquisitions continued to yield valuations considerably in excess of the median.

In summary, financial buyers reentered the market seeking sound investment opportunities for realistic prices. Industry consolidation among enterprise players, long predicted, became more of a reality, and strategic buyers seeking competitive differentiation, new markets and accelerated growth shopped aggressively and paid higher multiples. We expect these trends to continue for the remainder of the year and remain confident in our forecast of a 10% increase in software M&A for 2003.

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Microsoft Corporate Strategy

- **Microsoft.com** (www.microsoft.com/presspass) – Huge archive of financial data, executive speeches, calendars, research, and technology reports.
- **Directions on Microsoft** (www.directionsonmicrosoft.com) – Monthly newsletter focusing on technology trends; quarterly org chart of top 1,000 executives; \$795.
- **Microsoft Watch** (www.microsoft-watch.com) – Twice-weekly insider's newsletter by investigative journalist Mary Jo Foley; \$399.
- **Microsoft Secrets**, by Michael Cusumano – Seven strategies that underlie Microsoft's product and marketing methods; \$16.
- **All I Really Need to Know in Business I Learned at Microsoft**, by Julie Bick – A former employee explores the company's success-oriented culture; \$12.
- **Breaking Windows** (www.breakingwindows.com) – Good collection of internal e-mails and other source materials collected by author David Bank.

MEDIALIVE INTERNATIONAL chief executive Robert Priest-Heck, whose company recently acquired Comdex, on his decision to invite only exhibitors who appeal to corporate technology buyers: "The guys who sell massage chairs – we told them not to come." (Quoted in *The Wall Street Journal*, 6/19/03)

FICTIONWISE co-founder Scott Pendergrast on new European Union rules that require U.S. sellers of digital goods to collect taxes on sales of digital products: "I think paying it is ridiculous, and it's unfair for a foreign government to make me a tax collector. I have enough trouble keeping track of the U.S. tax code." (Quoted in *Computerworld*, 6/30/03)

AUTHOR Edward Tufte on the tendency of PowerPoint presentations to oversimplify complex arguments: "PowerPoint allows speakers to pretend that they are giving a real talk, and audiences to pretend that they are listening." (Quoted in *The Boston Globe*, 7/6/03)

SAP newly-appointed chief executive Henning Kagermann on his instructions to the SAP field sales force: "If you feel a client isn't ready for a solution, tell the truth. Sell it to them a year later." (Quoted in *Fortune*, 7/7/03)

SILVER LAKE PARTNERS principal Roger McNamee on his prediction that M&A activity will soon escalate in the overcrowded enterprise software segment: "For the last 12 years, the one thing you could count on is that no deal happened in software except when a company was in distress. So it's a virgin field, with massive excess capacity." (Quoted in *Business Week*, 7/14/03)

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