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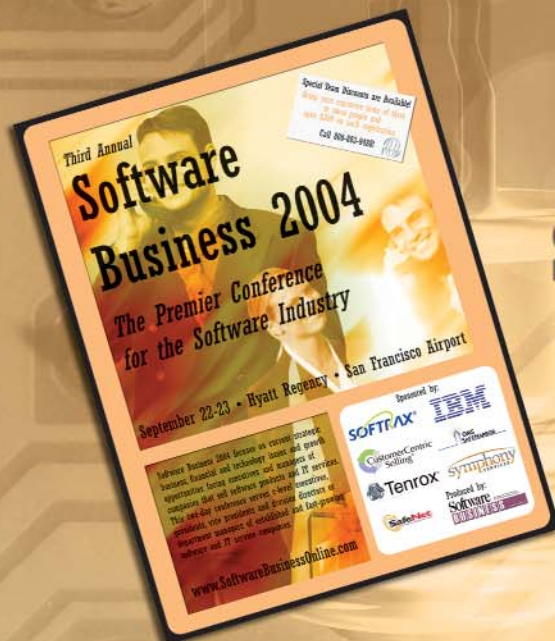
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HOW AN UNCONVENTIONAL CEO ACHIEVED UNCOMMON RESULTS



TREND MICRO'S STEVE CHANG



Preview the
Software Business
2004 Conference
- see insert

TREND MICRO: HOW AN UNCONVENTIONAL CEO ACHIEVED UNCOMMON RESULTS

On August 21, 1998, at the Grand Hyatt Hotel in Taipei, Taiwan, Trend Micro held an IPO celebration party. At a triumphal moment in a founder's life, Steve Chang, who wanted to "emphasize the coming of Trend Micro's new age and the need to seek change and originality," did something just a tad unusual. He came to the event, which had about 300 formally attired well-wishers in suits and evening dresses, regaled head-to-foot in a London punk outfit: hair dyed pink; earrings and a nose ring; sleeve-

\$437 million public anti-virus software company. It has had uncommon results over the last 7 years, growing from \$67 million in 1997 to \$437 million in 2003, an average of 32 percent growth per year, with a healthy annual average net income of 12 percent.

And Trend Micro must be doing something right. While other software company stock prices continue to languish, its stock price has more than doubled in the last year from \$16.01 on July 31, 2003, to \$41.01 on July 31, 2004.

Returning to Chang, I discovered his openness to new ideas by accident. On July 14, 2004, I had traveled to Trend Micro's offices in Cupertino, California, to conduct an interview with Chang. It didn't turn out exactly as I had planned.

Chang, who lives in Taiwan, was in Cupertino to run a strategic planning session with his executive team, most of whom had flown in from overseas as well.

Normally, when I conduct an interview, the CEO is more than eager to discuss why his company is exceptional. But with Chang it was different. He certainly talked about his company quite enthusiastically, but as Chang learned about my research into "what strategies drive long-term success," our conversation changed. He shifted the conversation to talk quite candidly about his company's issues and asked me about my findings. What a turnaround. Usually, no one wants to air any dirty laundry. But there was more.

Chang, who has been called "an excitable, unscripted CEO,"ⁱⁱⁱ took another unusual step. His executive team was supposed to end that day's strategic session with a pleasurable outing to a winery. He still held the winery event but now asked them to return to the office. He was eagerly seeking outside views to challenge his and his executive team's thinking and so wanted me to give an impromptu speech about my research findings—which is what I did.

My experience may suggest he is too impulsive, but he can be patient as well, when needed.

Founders often adopt a hub-and-spoke management style in which, the founder, the hub, keeps decision-making power to himself and seeks information from each executive separately, the spoke. He doesn't share information he collects with the other executives. As a result, the founder is the only one with a total business picture. In a small company, this can work.

But when a company gets too large, the founder finds work falling through the proverbial cracks. There are just too many people and too much going on for one person to retain everything in his head in order to make all the decisions. He needs to develop a next layer of executives who now have decision making authority, and information needs to be shared so all executives understand the total business picture. Unsuccessful founders are usually those who are rigid in their style and can't adapt. They want to retain full control. The result is that their business flounders, perhaps becoming a walking-dead where revenue stays flat, or they get taken out of the job by board members.



EXECUTIVE STRATEGY

Insight From Brian Turchin

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less t-shirt; a newly applied tattoo on his shoulder; a white iron chain around his waist; riding pants; and mountain climbing boots. Quite a sight.ⁱ

We Americans normally think of Asians as reserved individuals. Clearly, Chang is not. In fact, in Japan he was called "that crazy foreigner" because he didn't conform to the usual business norms of wearing suits (he wore casual clothes) and drinking when out with customers.ⁱⁱ

In a dramatic way, Chang's actions demonstrate openness to doing things differently.

Chang's company, Trend Micro, is one you probably don't recognize. But for the Taiwanese, it is the most recognized brand name of any company. And for the Japanese, they are as familiar with Trend Micro as we are with Trend Micro's two major competitors, Symantec (makers of Norton Anti-virus products) and McAfee, Inc. (On June 30, 2004, it changed its name from Network Associates to McAfee, Inc.)

In 1988 Steve Chang and his wife Jenny founded Trend Micro in Los Angeles, California. Today, headquartered in Tokyo, Japan, Trend Micro, a 2004 Sustained Success Superstar (see sidebar) is a

Chang overcame this potential obstacle as his own words show: "As a founder, you must be patient with your new executive hires...After spending time looking for the right professional who shares your vision and culture of the company, you must have the courage to step back. You empower the professional to do his work and don't get too involved in his job. A common mistake people make is getting too hands-on."^{iv}

Ok, so how does this unconventional CEO consistently generate profitable growth?

How Do You Consistently Generate Profitable Growth?

Certainly luck plays a role in success. Trend Micro was lucky in being the first mover in Asia. And it is lucky in that the nature of anti-virus software is such that companies are reluctant to change software companies. But in 1990, there were 250 anti-virus software companies. Today, there is only a handful. So success is more than being lucky. What strategies did Trend Micro use to secure its success?

- **"Focus On The Essentials and Sacrifice the Rest"** - We know that focus is a foundation for success. But what's different with Chang is his consistent and persistent focus. Chang said, "Strategy is about focusing on the essentials and sacrificing the rest."^v And according to Peter Firstbrook, program director, security & risk strategies, META Group, Trend Micro has done just that, having an amazing laser-like focus on their business. And the authors of a Harvard Business School case study commented: "Although very entrepreneurial, Steve Chang held fast to a single strategic focus for over a decade. Rather than attempt to provide all security products to all customers, Trend Micro concentrated on developing 'best-of-breed' antivirus solutions."^{vi}

In 1998, Chang faced a threat from Network Associates. They had recently shifted strategies to be a security suite player and were acquiring companies to fill in their product line. Using a favorite tactic of suite players, they tried to undercut Trend Micro's position. They offered a discount on their anti-virus software if a customer bought their suite, attempting to turn Trend Micro's antivirus software into an expensive and unneeded luxury. Chang had a critical decision to make. Does he become a suite player himself? Does he get acquired (Network Associates offered to buy Trend Micro for \$700 million), or does he stay with his best-of-breed competitive strategy. After some internal discussions and talks with customers, he decided to stay put. And since 1998, Trend Micro has grown over 650 percent, from 7,398 million yen to 48,088 million yen in 2003. Not bad, by any standards.^{vii}

Chang's consistent and persistent business focus allowed him to build on his company's strengths, just as we will see in the next section.

- **Innovation Isn't Just About Your Software Products** - Trend Micro has many product firsts under its belt: the first antivirus product for a server in 1993; the first Internet gateway protection anti-virus software in 1996; the first e-mail anti-virus software product in 1998; the first Internet content security service in 1999. But innovation applies to more than your products; it is a pervasive notion that applies to other areas of your business as well. We see this in a new type of global organization and in a new service offering.

In a 2003 Business Week article, "Borders Are So 20th Century," Steve Hamm cites Trend Micro as an example of a new form of global organization, a "transnational" organization. This is a company that aims to transcend nationality altogether. Hamm quotes C. K. Prahalad, a professor at the University of Michigan Business School, who says "'There's a fundamental rethinking about what is a multinational company...Does it have a home country? What does headquarters mean? Can you fragment your corporate functions globally?'"

Hamm focuses on Trend Micro's capability to be "among the first responders to viruses, often delivering 30 minutes before market

leader Symantec." How can they do this? He says, "Trend Micro is able to respond so quickly because it's not organized like most companies. It has spread its top executives, engineers, and support staff around the world...The main virus response center is in the Philippines, where 250 engineers are willing to work the evening and mid-

Trend Micro - Summary Financials (in millions)				
	Revenue	Percent Growth	Net Income	Percent of Revenue
2003	\$437	12%	\$84	19%
2002	\$391	37%	\$70	18%
2001	\$285	56%	\$40	14%
2000	\$182	47%	\$33	18%
1999	\$124	40%	\$20	16%
1998	\$89	32%	\$4	4%
1997	\$67		\$8	12%

Source: Trend Micro

night shifts necessary to keep ever-vigilant. Then there are six other labs scattered from Munich to Tokyo." Chang commented in the article, "With the Internet, viruses became global. To fight them, we have to become a global company."^{viii}

Not only has Trend Micro organized globally to handle the virus threat, as a Harvard Business case study astutely noted, "Chang structured the company to exploit every possible geographic advantage or resource around the world."^{ix}

Always building on the strategy of being a best-of-breed antivirus software company, he chose to put his main virus response center in the Philippines. Why? Because the Philippines has a very educated English speaking population who will work for 1/5 the cost of engineers back in Taiwan, where Trend Micro's R&D group is located.

In other words, with its singular focus, Trend Micro innovated in its organization structure to respond to its changing circumstances such as the global threat of the Internet, or to take advantage of what other countries had to offer, such as a less expensive group of English-speaking customer support personnel.

In addition, because Chang had built such a rapid global response organization, he was able to innovate with a new service offering that created a new competitive advantage. He offers a two-hour service level agreement, which no other vendor offers. If, after being notified of a virus outbreak, Trend Micro doesn't respond in two hours or less, they will pay a penalty which can be as high as the full price of the software.

Innovation, we learn, is not just about technology but about a wider view of thinking that can involve any part of your company, including your organization and your service offerings.

- **The Bridge Between Focus And Innovation: Take High Percentage Shots** - There is a Yin and Yang affect between focus and innovation. On one hand, we learn we must focus and sacrifice the rest. While on the other hand, we must be flexible, open to change and innovate. How do you square these two ideas? Take high percentage shots.

Lane Bess, President of North American Operations, told me this story. Steve Chang, as he usually does, was preparing a theme for his most recent U.S. employee quarterly update. The theme was "Don't make mistakes." What does that mean? Chang, who plays tennis regularly, said to his employees that in tennis, the person who generally wins the big tournaments is simply the player with the fewest unforced errors. How do you have the fewest unforced errors? As they do in tennis, you take the high percentage shots. Chang urged

his employees to do the same thing.

How does this play out in business? Let's look at an example.

In June 2001, exploiting a buffer overflow in Microsoft's IIS web server, a new and particular nasty virus struck, Code Red. This type of worm delivered itself buried in HTTP requests and required no human intervention. This virus attack exposed a new chink in the IT infrastructure, the network layer. Code red spread to more than 250,000 web servers in less than nine hours. It strangled networks because it gulped up bandwidth rapidly in its voracious scanning and propagation.

Eva Chen, a founder and CTO, who sought a way to fight this new type of virus threat, had a brainstorm. While having dinner with her two young children, she realized that "Just as her kids sometimes had to be separated to bring calm to the family meal, maybe what she needed to do was to separate, or segment, the network."

However, this solution required her software to examine the TCP/IP data traffic. And to do this, you needed hardware which connected into the Internet directly. So Chen's solution required Trend Micro, a software company, to become a hardware company. This was a fundamental change in the company's focus, and so it was not a change that her executives liked.⁵

But Chang understand the potential threat the type of Code Red virus posed to his business. "Since I am a best-of-breed software company, if I can't stop the virus in the network layer, my business is over. So I considered either making hardware or aligning ourselves with those who did," he told me.

As far as hardware, he said "I have an advantage living in Taiwan. Everyone is making hardware. I will just call a friend, give him a hardware design, and he can manufacture it." So this was a high percentage shot.

As far as alliances, he created a high percentage shot. Before he agreed to build the hardware, he approached Cisco about including his new software in their network products. But Chang said Cisco's attitude was "I don't care about this software." He continued, "They didn't see a need." So, Chang reasoned that if he built the hardware device incorporating Chen's insight, market acceptance might change Cisco's mind.

In February, 2004, Trend Micro announced the Network Viruswall appliance. The market responded. In July, Trend Micro closed a deal with CISCO. Game, set, match!

Consistent and persistent focus, innovation, and taking high percentage shots are the steak and potatoes in Trend Micro's long-term success. But there are two side dishes that spice up the meal.

• **Choose Practices Which Scale Your Business** - Chang told me, "Anything not scalable is something we don't want to do." This translates into two specific business practices.

First, almost 100 percent of Trend Micro's sales are through the channel using system integrators, distributors and value-added resellers. And second, Trend Micro doesn't provide the usual implementation services that go along with a customer's software installation. Chang leaves that to the channel to handle.

In both cases, Chang has eliminated the more challenging aspects of scaling a software business. In direct sales, you are limited by the number of sales personnel you hire. Using the channel provides a multiplier effect extending the number of sales personnel and extending your geographical reach. And providing implementation services is a lower margin business because you are essentially hiring out your technical staff.

Avoiding direct sales and implementation services has a direct impact on Trend Micro's financials. In the past three years, its sales and marketing costs have been low, representing only 30 percent to 35 percent of its revenue. And inversely, its net operating income has been high, representing only 20 percent of revenue in 2001, rising to 31.5 percent in 2003.



• **Best-of-Breed Strategy Requires In-Depth Expertise and Outstanding Customer Service** - Chang told me with some pride, "I can say less than 5 percent leave our company." This is quite outstanding since the industry average is 20 percent. Why is this important?

If you have ever coded for a living, you know the value of experience and knowledge when it comes to debugging. You will look for a semi-colon in the wrong place. Chang said it is the same way with responding to new viruses. It is an intuitive process. With the longevity of his engineers, he has years of stored knowledge and experience, something which he considers a competitive advantage.

How does he do this? In several ways. First, he said, "smart people like working with smart people." Trend Micro accomplishes this with a very selective hiring policy that only accepts 8 percent of applicants. Second, he creates an environment attractive to software engineers. For example, he runs an annual programming contest to see who is the best. Third, the nature of his work provides an ongoing challenge since, unfortunately, the creators of the viruses are clever and smart. So his engineers have to be clever and smart to think of ways to defeat them.

Besides offering the only two-hour service level agreement available, Chang has focused on developing a world class virus response center. So his centers have adopted two very stringent quality control standards: "ISO 9001-2000" and "Customer Operations Perfor-

mance Center (COPC)-2000" (COPC-2000 "is a comprehensive operations performance standard that specifies minimum operational requirements in critical functional areas that are important to end users and clients.").

Conclusion

At one point in the interview, I asked Chang why he chose to pursue only scalable business practices. He said, to my surprise, "I just copied Microsoft." But there were probably plenty of other anti-virus software companies that tried the same approach and failed. His company has, as the expression goes, "survived and thrived." What's different?

Clearly, Chang has withstood the market challenges of two much bigger players, the pressure of his competitors changing strategies to build security suites of software, the constantly changing nature of anti-virus threats from the PC to the LAN to mail server to the Network as well as the ups and downs of economy. Through all these changes, he stayed a best-of-breed anti-virus software company believing he still wins in the marketplace by doing so.

Over the years, his consistency in focus has allowed him to align his business actions to support his best-of-breed strategy: building a "transnational" global organization that allows a rapid anti-virus response; building a corporate memory of anti-virus knowledge that allows him to find solutions very rapidly so he can have a two-hour SLA; and building an anti-virus center that is ISO 9100 certified to ensure his anti-virus solution always do their job.

Yet, within his over-all strategy, he is vigorously changing his business model. With his Network VirusWall appliance and deal with Cisco, his software is now at the network layer. This TCP/IP connection now enables him to provide a broader array of anti-virus services, shifting to a utility computing model where he sells services on-demand.

With Chang we see a strong-minded-you might say obstinate-insistence on his best-of-breed strategy. Yet, we see a company equally committed to innovation and change. In Jim Collins and James Porras's classic book, *Built To Last*, they observe that highly visionary companies have "the ability to embrace both extremes of a number of dimensions at the same time. Instead of choosing A OR B, they figure out a way to have both A AND B." And they continue, "a visionary company doesn't simply balance between preserving a tightly held core ideology and vigorous change and movement; it does both to an extreme." With Trend Micro, this is so.

2004 Sustained Success Superstars™

Admittedly, in recent years, growth and profitability have been elusive targets. My company's research revealed that in 2002 only 44 percent of public software companies managed to grow. Even less, 32 percent, managed to be profitable. Not a pretty view of our industry.

Even though the numbers improved in 2003, they, however, are illusory. 55 percent of public software companies grew while 49 percent were profitable. In 2003 many software companies paid the piper for having poor earnings and a non-existent balance sheet. They went out of business or were acquired. So the stronger compa-

Sustained Success Superstars™			
Company	2003 Revenue (in thousands)	Consecutive Years of Profitable Growth	Column Written in Software Business
Microsoft	\$32,187	23	
Kronos	\$397	16	Sep/Nov 2003
Manhattan Associates	\$197	14	Nov/Dec 2003
Business Objects	\$561	11	May/June 2003
THQ, Inc	\$585	9	
Cognizant	\$368	9	
Mercury Interactive	\$507	8	July/Aug 2003
ANSYS	\$113.50	8	Mar/Apr 2004
Trend Micro	\$449.40	7	Sep/Oct 2004
EPIQ Systems	\$67.90	6	
OpNet	\$46.40	6	
Infosys	\$753.80	6	
SRA International	\$450.40	6	
Quality Systems	\$54.80	5	

Source: Cape Horn Strategies, Inc.; "Sustained Success Superstars" is a trademark of Cape Horn Strategies, Inc.

nies remained, increasing the percentages. It has been really difficult to generate profitable growth.

But this year, we discovered fourteen standouts, fourteen out of all 573 public software companies on the U.S. stock exchanges. Miraculously, in the midst of economic doom and gloom, they generated five consecutive years, or more, of profitable growth. I call this group the "Sustained Success Superstars™."

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