Software strategy

By Ashish Singh

What ISVs can learn as ASP wave turns to vapor

Just a year ago, independent software vendors (ISVs) were scrambling to defend their businesses from the new kids on the block—the application service providers (ASPs). The ASPs threatened to grow revenues from zero to over $6 billion in 2000, primarily through poaching market share. Venture funding underscored this threat: Five hundred new ASPs garnered a total of more than $10 billion in 2000. But the new wave, once considered a tsunami, turned out to be mere vapor when ASP revenues didn't even hit 10% of earlier projections. In addition, a Chuck Phillips' Morgan Stanley Dean Witter survey of chief information officers reported only 22% of respondents even used ASPs. What happened, and what should ISVs do now that they have clearer sailing?

First, they should understand and learn from the failings of the ASPs; for the fundamental concept of ASPs is sound. ASPs attempt to create software solutions—not just products, that can promote customer retention and lower total operating costs—and some customer segments value such a service. ASPs failed, however, because they:

- Got ahead of the customers' real concerns about security, reliability, and availability.

- Moved away from a pure, packaged offering (one size fits all) toward a "customized" solution without adapting pricing models to account for the real costs of the move.

- Did not integrate their offerings into the broader context of customer software infrastructure and processes.

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ASPs are ideally suited to bringing new customer segments to the market, such as small- and medium-sized companies without in-house infrastructures (the average ASP customer has less than 1000 employees). However, network security concerns prevent companies from using ASPs for mission-critical applications, such as enterprise resource planning, customer relationship management, and sales force automation. These security issues will likely remain roadblocks for the next two-to-three years, because most companies fear taking critical data and applications outside their firewalls.

Meanwhile, the ISVs misperceived the ASP threat because they:

- Saw ASP moves as an attempt at a radically new business model, instead of a simple expansion of distribution in their core, multichannel businesses. (Traditional retailers similarly misperceived Internet retailing at the outset.)

- Were unwilling to fully adapt their own core products to address the ASPs' target customer segments and thereby capture potential, incremental revenue for themselves.

So, what should ISVs do now? Whether they are application providers or software-development-tool vendors, they should start with the following four initiatives:

1 | Redesign their core products to function effectively over the Internet. This means using emerging Web service "standards" (XML, WebDav, .NET, etc.) and realizing the true potential of thin-client computing vs. a typical offer of traditional client/server architecture, force-fitted for the Web.

2 | Integrate the ASP offering into the existing, multichannel business model, focusing on the right customer segments. Innovative ISVs are employing their ASP offerings in several creative ways. Examples include: using them as proof-of-concept demos for selling the core product; reaching smaller teams within existing large customers; and reaching out to new customers altogether. Success hinges on recognizing the potential of ASPs to reach small- and medium-sized businesses cost-effectively. And it hinges on encouraging behavior within the existing field/ tele/channel sales forces to use the ASP channel seamlessly as part of the overall integrated sales model.

3 | Ensure integration with customer software infrastructure, via focused (limited scope) and service-assisted implementations to demonstrate early results and enable smaller, easier-to-digest process changes.

4 | Address the very real security concerns of customers, by adopting the latest encryption and security standards and by building innovative, hosted service offerings that operate within customer firewalls. Building a brand trusted for security can create a barrier-to-entry against startups.

5 | Define bundles of preferred solutions and create and/or work with "super ASPs" (likely the major system integrators) to offer the convenience of nearly one-stop shopping to enterprise customers.

The ISVs have some breathing room-but the time to act is right now. A new wave of ASPs, with services and applications optimized for Web delivery, built from the ground up, is gathering momentum. And this one will be harder to withstand if incumbent ISVs have not established their own, strong positions.

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