290T: The Business of Software

Homework 3 – ProfitLogic Case

1. **Which of the three options (as enumerated by John Bible) would you recommend for ProfitLogic?**
   - **pursue the software tools strategy**
   - **give the ASP model a chance to become profitable**
   - **cut the burn rate to $500k/mo and continue building custom ASP models**

pursue the software tools strategy

Albert Lee

While I believe it could be very difficult operationally to change models again, I recommend that ProfitLogic pursue the software tools strategy. The company is desperately in need of new business and the largest market is within the licensed software arena. Continuing to provide custom ASP services may allow the company to last in the short term, but it is just delaying the inevitable and pushing aside potential business in the short term. In terms of competitive pressures, this short term business could be very important for ProfitLogic's chances to grow as fast as possible and outrace any competition. As the company improves their reputation and establishes stronger relationships with their customers, it is likely they will have a much better opportunity to move them into an ASP model at a later date. At that point, the company should have more financial and operational resources to explore the smaller but growing ASP market.

Ashley Tan

In the long term, I would recommend the software tool strategy option because

1. The customers as well as the sales and marketing like this option.
2. In the long run, it has more opportunity to grow. The company seems to want to have a sustainable business and is not planning on selling the business anytime soon.
3. The funding from Bain Capital can help this transaction.
4. Smithfield is a big, $25 billion, Tier 1 customer. It looks like ProfitLogic is targeting its market towards the Tier 1 customers. The software tool strategy option works very well for the Tier 1 customers since they have money to buy the license and support it with their in-house IT stuff.
5. Tier 1 customers have the largest revenues, $544 billion and they are more likely to invest in IT than any other tiers.
6. The licensed application software is the largest portion of the retail applications market.

Gabriel Eirea

1. I would recommend the software tools strategy.

   It requires:
   - a huge investment on the short run, in a very bad time for getting investment.
   - a complete company reorganization.

   But:
   - this is what the clients want
   - there is a competitor pursuing this strategy
   - as we learned in class, it is not a good idea to oppose the "inherent force of the cycle"

Leo DeLuna

Scott should accept the Smith account but on the condition that Smith agree to help fund the development software costs, thus alleviating the burn rate. Smith would serve as a strong reference customer.

Ram Rajagopalan
My recommendation is to pursue the license software model, and maybe then adapting ASP to work with licensed software. There is opportunity for a smooth transition from current ASP model to the license software model.

+Retailers invest 30% of IT total investment in license software, vs. 4% in ASP. ASP market downsized from US$ 30 billions to US$8 billions. No new ASP customers in sight. Customer count (Boyce) is 4 times less for ASP model, so it implies cost cutting (reducing burn rate) by firing, which lowers company's morale.

+Competitors promise of licensed software and ASP on top of that is serious threat to ProfitLogic's positioning. ProfitLogic's desire to standardize their backend and front-end is already a lot of work in direction of having a full licensed software.

+Retail industry invests 30% of revenues in training, implementation and customization of IT projects. Selling licensed software can take advantage of this, by offering courses for training employees at industry sites and also offering implementation and maintenance services.

+Many retailers seem very reluctant to buy into ASP model, given high prices demanded by ProfitLogic for ASP. Key clients (large amounts of spending) prefer or insist on licensed software. ASP model is great for Tier 2 clients (some IT investment but not experts, enough sales so that ProfitLogic's software makes a difference for the price). But Tier 2 retailers account for around 9% of total retail market. Tier 1 in contrast, accounts for 64% of total market.

give the ASP model a chance to become profitable

Myra Liu
Give the ASP model a chance to become profitable:
+ There is a great deal of adjusting and learning if the company pursues the software tools strategy. Although it may be the future for the market, it does not seem like the company is currently ready to handle such major business transformations concurrently.
+ Custom ASP is the least scalable for the future and does not provide exceptionally promising profits. Its profit is similar to the licensed software model but has less market appeal.
+ The economics of the Standardized ASP model shows the most profit.
+ Not so long ago, ASP was the "next big thing" now everyone is betting on the licensed software model. However, this may change again and ProfitLogic can not continue its chase without ever settling down to grow.
+ Standardizing the ASP analytical platform will benefit the company regardless of their software or ASP strategy. It seems logical for the company to standardize it and give it time to mature.

Satrajit Chatterjee
Recommended strategy: stay at current burn rate of $750K/month
- give ASP model a chance to become profitable
- simultaneously standardize the backend to
    - hedge against failure of the ASP model
    - allow partial transition to License model

- reduce operational costs and build client base

Long term strategy:

- Provide a services solution for the initial model building by experts -- this is Profit Logic's USP and core competency and differentiates ProfitLogic from the competition
- After this phase of engagement switch to a License based model of software for day-to-day operations and forecasting

Christian Adler

give the ASP model a chance to become profitable! They still have the chance to switch to the license based model later. (Try to combine advantages of licensed software and ASP).

Why use this strategy:

- burn rate can be maintained at $750,000 per month (can keep up business for longer without getting new cash).
- it would be still possible to customize/fine-tune the software for special customers to keep the competitive edge.
- no high up-front costs for customers.
- system would offer the customer the possibility of using a standardized user interface and running real-time -simulations (like with licensed software).

cut the burn rate to $500k/mo and continue building custom ASP models

2. What should Scott Friend do about the Smithfield's account?

Florian Fuchs

Q2: Accept the Smithfield's account to pursue the strategy pointed out above!

- use the deal to help funding the transformation from the ASP to licenced software
- probably supporting this by negotiating special terms that software is half customized/half standardized in cooperation with Smithfields
- will lead to a complete product in the end which can be sold to other customers

Myra Liu

2. Although difficult to do, I think Scott Friend should turn down the Smithfield account. Smithfield needs a licensed software product. ProfitLogic is far from that and would not be serving their customer the right solution by taking the deal. If they are honest about their position, like they were with Marsh & Wood, Smithfield may be willing to work with them. Marsh & wood also wanted to buy licensed software initially and ProfitLogic turned them done due to:

+ Time and resource to build
+ Organization not set up for licensed software
+ ProfitLogic's reputation for analytic prowess
+ Not convinced they could standardize analytic capabilities

Egan Lau

2. Scott can agree on the licensed software product request, but he should re-negotiate with Smithfield so that Smithfield would pay more to help finance the business model change.

Rachel Rubin

He should tell Smithfield they are building a licensed software tool and that they can adopt the ASP model with less customization in the short term but get the licensed software tool as soon as it is available.

Christian Adler

Do not accept the Smithfields deal!

- software not yet built.
- expense and time required to build the software are too high.

Scott Hafeman

What should Scott Friend do about the Smithfield’s account?

- Don’t take the deal, possibly suggest a smaller deal or learning engagement
- Further distorts the long-term corporate vision: management is too susceptible to bending the company to the customer’s request to complete the project
- Pivotal Marsh & Wood conversation exposed senior management flaw that “we weren’t convinced that our analytic capabilities could really be standardized”

3. Where does the Application Service Provider (ASP) category fit in the Software lifecycle presented in lecture 2?

Will Plishker
between HW/SW Turnkey and Service
- not custom, but IT is bundled
- there are enough customers to merit not doing a custom solution every time
- there is not enough market pressure to pull companies into HW/SW Turnkey
    - or significant computational power or high maintenance cost are required
    - or IT know-how is not there yet

Florian Fuchs
- I think ASP in generals fits best in the Internet VAS category: a highly standardized service which is provided via the internet
- In the case of ProfitLogic ASP was more like a kind of services solution as there was constant customization and adjustment of the application necessary. But this seems to have been just the wrong business model for this kind of application, skipping the phases of turnkey HW/SW and enterprise SW

Egan Lau
It is really a Turnkey HW/SW.

Joyojeet Pal
It seems to fit in somewhere between Enterprise Software and Broader Market SW.

Tom Chang
The ASP category fits in the Internet VAS segment of the Software lifecycle. Most applications that have moved to an ASP model began as in house software applications. Examples are Salesforce.com, Turbotax, Kana Online, etc.

Jennifer Lung
The Application Service provided by ProfitLogic fits in the Enterprise Software stage in the software lifecycle. It just happened to be centrally hosted. By making it a licensed software, the company actually moves towards a broader market.

Niraj Shah
I think ASP is a red herring. It's just a delivery mechanism. The technical definition ("a third party entity that manages and distributes software-based services and solutions to customers across a wide are network from a central data center") seems to limit it to enterprise software. The difference between an ASP and Internet VAS is that with a VAS, connectivity is key (think salesforce.com or google.com). This is not necessarily true of ASPs.

4. Describe the ideal customer for an ASP solution.

Brian Park
An ideal customer for ASP would be one that:
- does not want to spend time and effort installing and maintaining a hardware/software solution inhouse
- does not want to pay a large upfront sum for a software license. They prefer to pay level, recurring payments because it is better froma cashflow / budgeting perspective.
- wants the product to be used in multiple locations with multiple people. This will be much easier to maintain with an ASP model.
- does not require real time processing
- may not be totally sure whether it will benefit from the solution. Might be easier to get out of an ASP solution than an installed version.

Jimmy Zhigang Su
The following are the characteristics of an ideal customer for an ASP solution:
- No desire to do software or hardware maintenance
- Low concern for security
- Low budget, low enough that it is not feasible to obtain the hardware and software required to run the applications on site.
- Desire to use the application from many remote locations

Satrajit Chatterjee
- Doesn't exist at least in this market segment :-)
    - Customers would never be happy about their data leaving the company
    - But in the interests of greater efficiency and profitability, they might compromise

==> In the light of this a (second-rung, non-established?)
retailer looking to grow by using any competitive advantage they can get would be an ideal customer

5. What was the impact on ProfitLogic of raising venture capital?

Brian Park
There were many different impacts on ProfitLogic of raising venture capital.

- In some ways, the company did not let the process of raising venture capital sway it from its goals. The company turned down the Marsh & Wood deal initially because they would not accept a software solution. This was even though Bain would not invest without a deal in place.
- Raising VC money allowed the company to have significant cash ($16mm) to pursue different business models. It allowed the company to make major changes and investments, which could be considered as a major benefit.
- On the other hand, raising VC money allowed the company to make large investments which were difficult to reverse. If the company had not had this significant source of funds, it might have moved more slowly and carefully and would have been more flexible to change. The VC money may have tied the company's hands when it needed to change business models.

Albert Lee
After ProfitLogic raised their venture capital, they had a new set of constiuents that they needed to focus on in their decisions. The company will face extreme pressures from these investors when evaluating deals such as Smithfield and run the risk of alienating future investors if they turn their backs on potential sales. Essentially, the short term pressures on the company to generate revenues are dramatically increased because the VCs are looking for security in their investments.

David Gelbart
The pile of cash raised from venture capital gave ProfitLogic much more freedom to choose their direction (e.g., going toward licensed software) since they can spend more than they make for a while.

Ravi Shanmugam
While the VC funding provided ProfitLogic with the funds it needed to scale up, it also gave the VCs an element of control over ProfitLogic's business, as the VCs were able to make demands such as requiring the signing of Marsh & Wood. Choosing the licensed software route will make such conflicts less likely, as the VCs tend to favor that route anyway.

Tom Chang
. In series A financing from Athena, ProfitLogic was able to hire and invest in hardware in order to help fuel growth of the company
. Series B financing from Bain Capital primarily allowed ProfitLogic to hire more employees to support the Marsh and Wodd contract and to build out the ASP offering
. Another key impact of raising venture capital was the influence that they had on ProfitLogic's business model decisions. This is seen in management's comments "licensed software models were gaining favor with the VCs" and "The VCs also made it clear that they valued subscription fees much more than consulting revenues."

Niraj Shah
While many entrepreneurs/start-ups want to raise VC funding, it is important to note that a VC investment comes a cost: control. So while more money may give entrepreneurs the freedom to do more, it also makes them responsible to another set of stakeholders.

Just to think about for class discussion

- **Would you consider ProfitLogic a successful software company?**
- **How is ProfitLogic doing now?**