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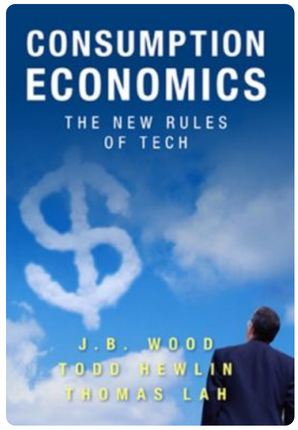

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Consumption Economics

The New Rules of Tech

J. B. Wood, Todd Hewlin and Thomas Lah • Point B © 2011 • 240 pages

Industries / Technology Industry

Take-Aways

- The "Consumption Gap" lies between what enterprise technology companies deliver and what their corporate customers actually use.
- The consumption gap manifested in 2008, with the convergence of the recession, the cloud and the iPhone.
- The cloud changes the basic interaction between tech firms and their corporate clients.
- Many "microtransactions" in the cloud cost just pennies per item.
- Technology clients could do more with less and get better pricing in the cloud so they demanded customization and productivity from IT providers.
- Apple has resisted commoditization of its laptops and smartphones while creating an entirely new product, the tablet.
- Like Internet games, tech firms can profit from "every click made by every end user."
- Tech companies must sell to end users, not to diminished IT departments.
- Customer service and support teams must assume a greater role in driving revenue.
- "Consumption Economics" is changing how tech firms operate and make money.

Recommendation

The "Consumption Gap" is the difference between what enterprise technology companies deliver and what their corporate customers actually use. Just as you'll likely never understand – much less use – all the functions and features of your smartphone, computer or software, tech firms frustrate their corporate clients with unnecessary bells and whistles. But change is afoot, and tech companies must prepare for a radical industry reworking. Tech consultants J. B. Wood, Todd Hewlin and Thomas Lah detail the transformations wrought by recession, the cloud and consumer electronics, and offer tech suppliers practical advice on adapting to those changes. *getAbstract* applauds this treatise on how technology itself affects technology companies and recommends its long-term vision to all business managers.

Summary

"The Money-Making Machine"

The enterprise technology industry once was enormously profitable. Catering to corporations' and institutions' burgeoning hardware, software and networking needs, the industry invented and produced state-of-the-art capabilities so complex that most clients couldn't keep up.

> *"How tech companies operate and how they make money will change more in the next 10 years than they have in the last 40 years."*

This "Consumption Gap" – the difference between what tech companies deliver and what customers actually use – is leading to a deceleration in industry profits. The consumption gap is a harbinger of radical change in enterprise technology.

In the past, technology companies dictated terms to corporate customers. Enormous technical progress enabled new high-tech products that were "not just compelling, but Wow!-compelling." Customers gladly paid up front for the latest, greatest electronic innovations, products and services. They were prepared to take most of the risk of implementing, using and realizing the benefits of new technology. Manufacturers received their payment at the start of a project but had little liability for the results; customers took the responsibility for getting their money's worth.

> *"The Consumption Gap is based on the idea that technology companies can add features and complexity to their products at a much more rapid rate than their customers have the ability to consume them."*

But as upgrades, advancements and novelties proliferated, clients struggled to keep up. In fact, executives identify just 14% of software installations as "very successful," while the "average effective usage rate of enterprise software is only 54%." For example, almost everyone uses Microsoft Word, but how many people even know that it offers more than 1,200 features?

> *"Tech is not immune to commoditization – it's just harder to spot."*

The consumption gap materialized in 2008 when the recession, the cloud and the iPhone converged, and when the worsening economy forced companies to do more with less. Launching trends that continue, firms bought less technology and negotiated better deals; they pushed vendors to accept more risk and responsibility, such as accepting "pay-as-you-consume" – instead of lump sum – remuneration. They also turned to suppliers to provide personnel to augment reduced corporate IT staffs. With the advent of the cloud and the iPhone (with groundbreaking versatility and customization that made users aware that their office IT was nowhere near as prolific or useful as their personal gear), clients now will pay for only the computing depth they have to have. They are no longer willing to buy capabilities they don't need or can't utilize.

Cloudy Prospects

The diagnosis of the full impact of cloud computing on technology companies remains unsettled, but "seven shifts" are likely:

1. **Risk will transfer from the client to the vendor** – Companies typically purchase goods and services under a capital expenditures model; that is, they pay up front for an asset they will employ. But cloud computing clients will pay in "microtransactions" (MTs) only for what they use. This à la carte pricing, sometimes at only pennies per item, means that tech firms must drive volume to make money. This forces providers to make it easier for clients to make the most of their IT capabilities. With that new responsibility, vendors will shoulder the front-end costs of development and sales, lengthening the time required to show a profit.
2. **"Simplicity will be king"** – Customers don't want expensive complexity; they want their tech products to function neatly and cheaply. Increasing commoditization is driving costs down, and implementation via the cloud will happen more quickly. As on an iPhone, IT fixes and upgrades will load automatically and more frequently.
3. **Tech firms will compete with "cloud customer aggregators"** – As corporate IT units downsize and consolidate, new "infrastructure as a service (IaaS) providers" will cut out the middleman – and that means tech firms. For example, Amazon will sell data storage directly to corporate users, elbowing out firms like 3Par, EMC and Symantec.
4. **The "channel ecosystem" will evolve** – As their broker's role diminishes, firms that work as consolidators between tech firms and users will be under threat. The cloud enables tech giants to sell directly to even the smallest prospects. IT units will increasingly bypass current providers to buy services directly through the cloud.
5. **Software prices will decline** – Enterprise tech will feel the pinch of falling software prices – just note Apple's 99-cent apps. In 2010, a major US government agency transferred its email to the cloud; it expects a 50% drop in costs over a five-year period.
6. **End users will dominate** – Electronic mobile gadgets will increasingly empower corporate end users to take over tech-related decision making from diminished IT departments. Google and Salesforce – companies accustomed to working with consumers – are making inroads in marketing directly to organizations.
7. **User data will drive solutions** – Tech firms' access to masses of user-generated data will likely close the consumption gap. Information that firms once stored on corporate servers will be in the cloud and

handy to tech suppliers, who will analyze "every click of every mouse on every screen" to create bespoke solutions for their clients.

The Apple Way

Commoditization and pricing pressures mean tech firms are beginning to hit "the Margin Wall," where the total costs of a client transaction exceed the earned revenues. To survive, tech firms must drive customer consumption in new and unique ways. Apple provides a good example: Smartphones and laptops are now commodities, but Apple distinguishes its offerings with cheap, volume-driven apps; singular, elegant and easy-to-use products; and in-person service and advice from its Genius Bar experts in conveniently located Apple Stores. What's more, Apple blazed the trail to a brand-new market: the iPad, which defines and dominates the tablet field.

A New Way to Make Money

Because MTs will generate "tens of dollars" and not "tens of thousands" of dollars per transaction, volume is crucial. Thus, tech firms will have to "own...the job of driving consumption." They must excel in: 1) getting end users to go beyond the basics and engage with more sophisticated product features, 2) advertising an existing application directly to nonusers and 3) encouraging current customers to consider novel apps.

> *"As an industry, we face a growing gap between what our products are capable of doing and what our customers actually do with them."*

One way to engage in all three areas is to embrace the techniques that game companies pioneered on the web: Internet game players advance through levels to amass more points or rewards, to get feedback on their rankings, and to participate in a virtual group of fellow contestants. Similarly, IT end users should be able to move directly to advanced product levels, see how they stack up against their colleagues and receive recognition for mastering different apps. By applying these ideas to corporate clients, tech companies can profit from "every click made by every end user."

"Consumption Development," Marketing and Sales

Cloud-based and customer-led changes will compel tech firms to alter their business processes, starting with product development. Instead of taking years to build a new product and loading it with add-ons, firms will have to create bare-bones offerings rapidly and ship them quickly. By using "intelligent listening," "consumption innovation" and "in-product upsell," tech firms will capture client feedback, adapt and customize their products based on actual client usage, and layer on capabilities that allow users to upgrade instantaneously to more valuable enhancements.

> *"IT's dominance is giving way to the growing influence of the end business user."*

Consider how Facebook started: Its creators "wrote some code, put it out there and watched to see what users would do." Products such as Farmville, Skype and LinkedIn let users choose to pay for advanced levels of functionality.

The end user will control IT usage and costs, so consumption marketing will evolve to target the individual. Savvy tech marketers will generate visibility by creating a “microbuzz” around users’ experiences, providing data showing their deployment of a product’s feature relative to that of their co-workers, and alerting company executives to their staff’s overall use of that feature.

> *“Once off the radar for most enterprise tech companies, the end users are about to emerge as the key players in the next phase of the industry’s development.”*

As a tech company marketer, don’t just push your merchandise. To assure that end users opt for your services, become a valuable resource for them – “helping will sell, but selling won’t help.” When you have “disruptive technology innovations” clients don’t even know they want or need, “Provocation-Based Selling” (PBS) will get you in the door. Focus on four points in your PBS: 1) Provide an answer to an industrywide issue, 2) use introductions from social media to target the business end user, 3) emphasize client needs over your solution’s features and 4) conduct “pre-sales consulting” onsite to tailor your proposal.

More Than Service

Income from services such as “installation, implementation, integration and maintenance” contributes almost two-thirds of tech companies’ revenues. As clients increasingly make do with “good-enough IT,” profits from services will fall. Tech service personnel are reservoirs of untapped potential for adding new income streams from MTs in the cloud environment.

> *“Consumption Marketing needs to be about helping customers get the most value from their technology. Do that one thing, and the revenue will flow.”*

Train your service staff to provide value by advising end users and helping them realize the full benefits of their IT capabilities. Deploy your customer support department – with its day-to-day, close interactions with client users – to “own the number” – that is, to be responsible for generating MTs and increasing revenues. Expand services to include client education, “field services, managed services and outsourcing.” Like Salesforce, reposition and unite your support teams to act as an “Account Services Organization” that is responsible for guiding “Customers for Life.”

Quick Starts

To get ready for the new world of “Consumption Economics,” determine how much time your firm has before it hits the margin wall. “Buying runway” today will help position your tech company for the future.

> *“The Consumption Gap is huge, and its impact on the tech economy, and society in general, is almost incalculable.”*

Take 10 actions now:

1. Re-engineer your products to offer different levels for beginners and “expert users.”
2. Exploit the current expertise of your teams, clients and partners.

3. Withdraw or postpone an upgrade to one of your "legacy products" to conserve resources for "customer-centric development."
4. Build successes vertically in your clients' industries to position your company as a tech solutions leader for those fields.
5. Recombine your service offerings to align with client requirements.
6. Focus your customer service, support and training teams on boosting MTs.
7. Educate service teams in turning customer problems into new sales opportunities.
8. Give your service and sales teams the best tools and methods to help them close deals.
9. Start accommodating pay-as-you-consume clients. Get financial backing.
10. Acquaint your salespeople with PBS; apply it to a few of your top clients.

A Consumption Future

While no one can predict the future, some tech industry trends are imminent:

- Margins will fall, volume sales will reign and simplicity will trump complexity.
- Prices, even on already-low MTs, will continue to decline.
- Tech firms won't realize profits as quickly in the sales cycle, but may reap more earnings over the life of their business relationships with clients.
- Customers won't be chained to specific tech suppliers, whose fees from maintenance may disappear.
- Pay-as-you-consume processes will change tech firms' cash flow and revenue.
- Tech companies will hold money in reserve to adjust to new billing systems.
- Product sales will no longer determine pricing. Instead, tech firms will have to set prices according to the results they achieve and the value they add.
- Tech vendors will count "contracted monthly recurring revenue" as a gauge of success.
- Suppliers and clients will revisit continuing contracts and service agreements.

> *"We need to learn to qualify the customer's ability to consume."*

Tech firms face a sea change. Conventional methodologies and formerly critical skills, knowledge and assumptions may fall by the wayside. Progressive tech firms, their clients and partners will move ahead according to the new rules of consumption economics.

About the Authors

J. B. Wood is the president and CEO of the Technology Services Industry Association, where **Thomas Lah** is the executive director. **Todd Hewlin** is a managing director of TCG Advisors.

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