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Open Source Business Models in Transition

Part 2: life cycles, market sectors and new competition strategies

Conditions in the European IT markets have become tougher. In the open source field this has recently become noticeable, for example in web agencies or comparable business models. The first article in this series, in T3N 8, pointed to possible cost savings and capacity gains through offshore development. This part directs attention to emerging changes in the market and possible reactions in the form of strategic options. Using the case study of web agencies in the TYPO3 field, this article points to fundamental avenues of thought and starting points for solutions – which are applicable to other fields too.

The definition of the term „boom“ is relative. The current high in German and European growth rates, which is only the result of a cycle, cannot obscure the fact that the middle and long term prospects are less rosy. For example, DB Research, a Deutsche Bank think tank, predicts that, until 2020, growth in Germany will only average 1.5 percent. [1] But how do things look within the IT branch, which for 25 years has again and again been declared a wonder branch? A study by the EITO (European Information Technology Observatory) is currently working on the assumption that the growth rate in Europe will be only 2.9 percent [2], which means that the branch's growth rate will only just be higher than that of the economy as a whole and that returns will diminish. Many software enterprises are reacting with saving measures and are considering the introduction of standardised and automated development processes, the construction and implementation of libraries and similar means for taking pressure off. Just like outsourcing these measures have their place. They create free space and improve productivity. And yet they do not nearly amount to a real strategy which open source providers will be able to rely on in the future.

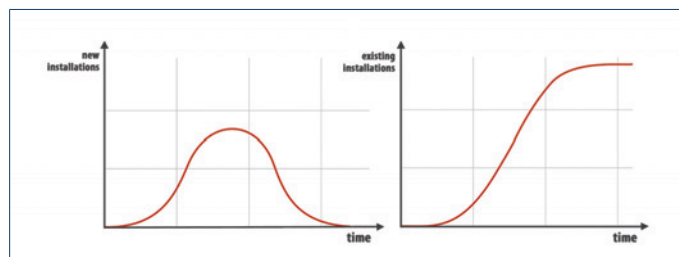
Market insights

At first glance it seems astonishing that the IT branch is not booming: the IT salesperson is always running up against medium-sized clients who are working with incredibly out of date IT equipment and who are a long way behind the state of the art in technology and organization. Thus a gigantic investment tailback could be dissolved by a fulminant surge of contracts – at least in theory. But business remains tough and the majority of potential clients hold back. And so reflections about the future security of a foundering market – achieved by adapting the business model – are highly appropriate. A little background analysis brings interesting realisations to light.

Order	Name	Proportion
1	Innovators	2.5%
2	Early adopters	13.5%
3	Early majority	34.0%
4	Late majority	34.0%
5	Laggards	16.0%

Investigations into the diffusion process of technologies and innovations usually reveal a classical distribution of buyers' inclination to innovate, which is presented in the table above. Typically there are five groups, of the „innovators“ are the clients most likely to get excited, while the „laggards“ are the last to get on board. This normal distribution of the uptake of innovations reveals that diffusions normally follow a non-linear S-formed course, which is

called a life cycle curve: weak growth to begin with becomes a phase of rapid growth following a breakthrough. Then follows a calming phase and, finally, degeneration. In the case of TYPO3 the depicted S-curve corresponds to the number of current installations.



The growth rates of technologies and innovations in the market generally go through three phases, with strong growth confined to Phase 2. The growth rate depicted here is that of TYPO3.

After the big wave

One of the main factors behind the declining growth rates pictured above (along with the structural changes among the market providers) is the fact that in later phases of the cycle it becomes more difficult to win over the late „majority“ and the „laggards“. If the growth phase is characterised by a small number of established providers, strong demand and attractive prices, disillusion soon follows because the pace cannot be maintained. In addition, good returns attract more providers who „ruin“ their competition with aggressive prices.

TYPO3 is technically challenging, which constitutes a barrier to market entry. To be sure a new agency can be created in an instant with Aldi PCs, „clever books“ and a little web space. At first the buyers only see that aggressive prices are being offered, and this is sufficient to alter the competition structure, regardless of these agencies ability to deliver.

Further factors: a few years ago one could have counted the number of content management systems on one hand. The most recent figures indicate that today there are around 700 systems in competition. As a result, competition increases not only within the community but also between systems. In addition, today's content management systems are much easier to understand, they have become so-called „commodities“. All this leads to distribution battles. The cause of the problem is a suddenly very far-reaching compatibility of all software systems and service providers. In the TYPO3 community there is also the upcoming shift from Version 4 to Version 5.

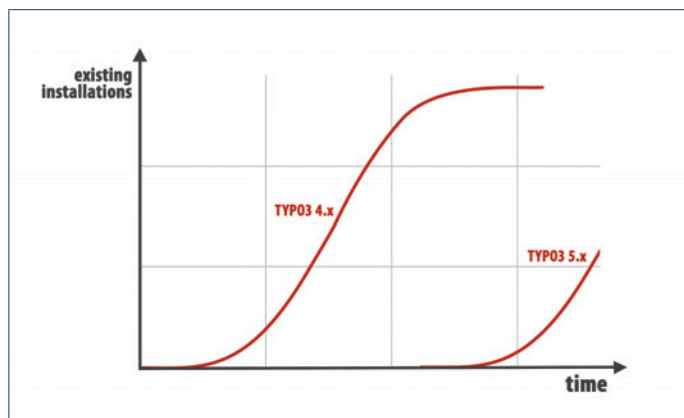
A break in the trend

In the field of TYPO3 the third phase, which has just been entered, will be followed by the degeneration phase, and this will pose many questions about the future. The time of TYPO3 Version 4.x is nearing an end, as is, presumably, that of the bulk of TYPO3 extensions with the arrival of Version 5.

Trend-breaking, discontinuous changes are especially common in technology intensive branches. With the work on TYPO3 Version 5 such a break in the trend appears imminent. Looking at the currently published conceptions and the roadmap of „Phönix“, it becomes clear that much will go over board during development so that the path is cleared for important new elements and functions. Version 5 appears suited to initiating a second life cycle, which should again follow the classical life-cycle phases. That means that Version 4 and Version 5 will run alongside one another for a period of time. A critic might say that the community and TYPO3 market are „sitting on the fence“, ie between Version 4 and Version 5. Moreover, the two versions will be experiencing periods of weak growth at the same time.

While the distribution of Version 4 enters the degeneration phase, Version 5 will be entering the first phase of the cycle. Because many extensions will presumably lack compatibility there will be many migration problems. Websites will be converted to Version 5 as soon the most important TYPO3 5.0 extensions become available. Again, the innovators will be those who make the conversion first. After an initial stage, hence when know how has been distributed and more extensions are available for Version 5, the new cycle will move into a growth phase, in which „early adaptors“ seek to take advantage of the superior performance of Version 5.0.

The new functions of TYPO3 5.0, for example the better integration through SOAP, WebDAV and the content repository, will present new opportunities. Without doubt Version 5 will meet many of the important preconditions for TYPO3 finding a good place in the foreseeable new world of strong integration.



In the transitional phase between Version 4 and 5 both TYPO3 versions find themselves, to begin with, in a phase of weak market growth.

Business, quo vadis?

In view of the foreseeable changes, what are the strategy options for web agencies and developers? Neither the old V4 cycle nor the new V5 cycle promise attractive growth in the short term. Version 4 will soon begin the fourth phase (degeneration). V4 entities will be around for a long time, for many users belonging to „late majority“ group and too many „laggards“ will want to delay conversion for as long as possible – after all their websites will continue to run. Notwithstanding that many agencies and developers, in addition to their day-to-day business, will have to make twice the effort for the sake of the two versions – twice the effort despite

doing poor business. Presumably not all businesses will survive the conversion phase in good shape. Often the margins will be too tight, the market prices too low, and too often time budgets will not allow the twofold orientation and development, especially in the case of very small teams. Thus there is every reason to expect a degree of market adjustment.

Despite lower prices and improved performance the CMS field is far from being a user paradise. The typical user is constantly reading about sensational accomplishments, about the fabled possibilities for marketing afforded by blogging, about the power of permission marketing, about the growth possibilities of online shops, about the promise of user generated content for customer connection. He or she is subjected to a hail of buzzwords and temptations, just like in the rest of the IT landscape. But when he or she actually wants to „have something“ the reality is more modest: most providers can do „everything to some extent“. Large parts of the branch offer a bland concoction of the ordinary. Hardly any provider is truly competent with respect to a specific area for which it offers comprehensive problem solving at reasonable prices that work for the provider too. By far the largest proportion of providers gets bogged down on too many sites. As a result, performance profiles begin to resemble one another, and performance spectrums and providers become largely interchangeable – another reason why prices and returns are in the pits. The starting points for new, profitable strategies are therefore to be found in just this area.

New strategies

Competition strategies are enduring and long-term concepts for business models, which, in view of heightened competition between providers, are especially suited to prevailing over competitors. Competition strategies are built on the thought that the trading company gains a competitive edge of such clarity and degree that it becomes difficult to compare it to as many competitors as possible. For of all things it is the similarity of performance offered on the market which leads to unaffordable (and sometime ruinous) price competition. The core achievement of a competition strategy is thus to lead a company away from intensive competition. In a way, the competition is to be levered out.

Differentiation strategies have much to offer in this regard. Differentiation, the attainment of an overall clear distinction from competitors and the use of this differentiation as a competitive advantage, is achieved by stressing focal points in one's own performance profile. In doing so, an advantage for the potential customer must appear, an advantage that is so attractive that he or she is willing to pay more. To be clear: this is not a matter of special performance promised solely in advertising. The real and genuine differentiation from competitors only works when that differentiation is substantial. Usually, differentiation must therefore play a deep and comprehensive part in the business model. The service for customers should not be confined to development and implementation (as happens often in practice). Service should extend far beyond that. The customer does not want a drill, what the customer wants is a hole. In practice this means that it is not enough to implement a blog. There is potential for differentiation in additional professional, energetic and result-orientated support at online PR. This also increases the competitive advantage because successful blogging becomes more affordable for the customer.

A conceptual grid for differentiation options

Competitive differentiation can be achieved in a number of ways. It can rest on technological competencies or on the specialisation for market segments (or on a combination of both). It can be cre-

ated individually and strengthened through strategic alliances. Here are a few examples.

Market focal points

The demand among public establishments for open source solutions is high, not least because of the recent LiMUNIX major project for the City of Munich, in which 14 000 desktop PCs were migrated to Linux [3]. The saving in licence fees is one of the reasons for this. Another important reason is that the authorities' special applications require flexibility and independence through open sources. An investigation by the Fraunhofer Institute for Industrial Engineering and Organization (IEO) predicts an annual growth in demand by the „publics“ of around 25 percent [4] – many city councils and other authorities are keen to follow Munich's lead. Thus we witness the opening of an attractive market sector.

TYPO3 could certainly play an important role in e-government. However, the acquisition of projects from the public sector requires special knowledge and experience, not only with the particular procedures with respect to the awarding of public contracts, but also with the particular demands and standards of public IT. This constitutes a certain hurdle, as it were a market entry barrier for the specific segment. Of course it is not out of the question that a company could work its way in and overcome the barrier. To be sure, entry into a long term strategic alliance with a partner with public sector experience, either on a contractual or company law level (joint venture, merger), may make sense as an alternative path. Complementary expertise profiles improve the common service spectrum, increase the common potential for differentiation and place both partners at „eye level“. If entry into this sector succeeds, the enterprise can enjoy strong demand as well as competition of lesser intensity (due to the entry barriers).

Functional focal points

For the developers or organisers of important TYPO3 extensions it is often an automatic consequence of what they do that the function of the extension becomes the focal point of their business. Rupert Germann, for example, is best known within the TYPO3 community as „Mr. tt_news“. It is hardly a surprise that a large part of his business activities belongs to the area of the presentation of flexible datasets. Presumably it is assumed that nobody has more expertise in this area than he does. In the same way other developers construct points of differentiation, for example in the fields of shop solutions, blogging, web 2.0/Ajax, tracking and logging, multilingual websites with complex character sets or permission marketing. It is true of all technical functions that a considerable effort has to be made (market entry barrier of the sector) in order to develop state of the art solutions. However, it is noticeable that expertise are only built up and communicated in the technical domain. For the customer, notwithstanding good technical competence, something is still missing. What use is a brilliant technical solution for the user when, in the end, the mailing action does not produce the desired result?

In the field of permission marketing, ie the sending of information or advertising with the express permission of the customer, specialised providers with their own mailing servers have appeared because permission marketing does not work with the standard features of most websites. This fact indicates the presence of an un-met demand. After all, every user would prefer to run permission marketing from his or her own website and with an integrated database, instead of allowing an external provider to manage the mail-outs and address lists.

Permission marketing is a lucrative field for TYPO3: but more is required than gaining a technical grasp of „direct_mail“ or other extensions. Offering the customer necessary services and consul-

tation on the marketing plane contributes decisively to differentiation and to make distinguishing features even clearer. Here too strategic complementary alliances make sense, for they increase the problem solving capacity in the area of focus.

For example, permission marketing specialists on the technical side can co-operate with specialists in address trading, offline direct marketing or SEO. News and blogging experts can co-operate with PR experts, specialists for multilingual websites can co-operate with international offline agencies and translation services, and shop experts can co-operate with logistics and ERP specialists. For clarification: it will not be enough to have undertaken a few installations. Insofar as true differentiation is to be built up, the problem solving expertise in the chosen focus must be comprehensive and exhaustive. Everything else „waters down“ the profile: the differentiation strategy does not work and improved prices cannot be achieved.

Integration focal points

In the domain of integration and connectivity with other IT systems there is another large and rapidly growing field of activity. Businesses require comprehensive and seamless integration in order to reach elegant, productive and total solutions. That remains the case regardless of whether the integration is to be produced for a CRM, Groupware or ERP system, and regardless of whether the external system is open source or proprietary. Here specialisation is possible through the selection of individual external systems (eg vtiger, SugarCRM, eGroupWare, Exchange) or through general orientation (eg workflow systems or marketing and distribution support). Here too strategic complementary alliances are an effective means of strengthening differentiation: specialists in Groupware or Workflow systems can productively co-operation with organization consultants. A CRM focus goes well with marketing consultants and trainers and marketing specialists.

The examples above show that a differentiation strategy cannot be carried out in an instant. It would be woefully inadequate, for example, to pass oneself off as an expert for tourism websites and then hope for success. The communication of genuine differentiation is only the final building block. Genuine differentiation can only be produced when it is reflected in all value creation and is lived out in full: in staff politics, marketing communication, in distribution, in technology, product and service politics, financing, costing and PR. The examples above illustrate that it is the effort involved in the construction of a differentiation that tends to prevent competitors from imitating the strategy. Strategic thinking and action call for concentration and stamina.

Conclusion

Web providers, especially in the TYPO3 field, are entering difficult times. Adapting one's strategy is therefore essential. Reflections on effective strategies must by definition go deep into business structures. They touch upon the „DNA“ of a business, its fundamental cell structure. And in this case too a strong metabolism – or substance conversion – is a sign of vitality. The essential conceptual grid and categories are in principle transferable from the case study of TYPO3 to other markets and communities.

Part 3 of the series of articles called „Open Source Business Models in Transition“ will appear in T3N 10 and will concern the instruments and methods for the creation of strategic alliances as an efficient means for the expanded and modern adaptation of business models. For mergers, acquisitions, joint ventures and true contractual partnerships with national and international partners have for a long time been an effective means for smaller as well as larger businesses for speeding up the transition.

Links and Literature

Softlink 1891

- [1] DB Research – Global Growth Centers 2020: http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD000000000204270.pdf
- [2] EITO - European Information Technology Observatory: <http://www.eito.com/download/EITO%202007%20-%20ICT%20markets,%20March%2020071.pdf>
- [3] LiMIX-Project at Wikipedia: <http://de.wikipedia.org/wiki/Linux>
- [4] IAO Fraunhofer investigation: http://www.iao.fraunhofer.de/d/summary_oss.pdf

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Thomas Schlichtherle (43) studied business in Munich and, following his graduation, joined the international strategy consulting firm Mercer. In the past 20 years he has attended hundreds of businesses of all sizes. Since 2000 he has been working independently, and since 2005 he has been concentrating with the 'strategy factory' (www.tssf.biz) on the long term attendance of SMEs in the TIME sector. He works as a business angel for companies with good prospects and brings to bear expertise in capital and contact procurement as well as in business and strategy. One of his many focuses is his work with open source ventures.