Market strategies for IT service products

Abstract

A dilemma frequently faces the directors responsible for market strategy of IT services companies.

Received wisdom advocates vertical market strategy as best practice, and very often the approach has big advantages. However, in some instances it may be unwise, undesirable or even impossible to comply with received wisdom and "go vertical".

So, when should the IT services company pursue a market strategy which is not vertically aligned?

Why vertical markets rule

If an IT services company produces a service product[1] providing a specific benefit to a clearly identified vertical market it is not hard to decide the marketing strategy.

A vertical market (for example, merchandise planning or library management systems) is populated by like minded individuals with similar issues, concerns and functional requirements.

It is often served by specialist publications, conferences and associations which makes it easy to talk to. Members of the market see as relevant the experience of their peers[2].

Consequently, if we are successful in turning vertical market focus for our service product into significant market share, we enjoy major benefits

- Our implementations tend to be similar in nature and so our delivery capability becomes more efficient and reliable.
- Our understanding of the client base and their issues improves our market understanding and so enables us to improve our service products.
- Our increasing reference base (and demonstrably efficient delivery capability) increases our competitiveness.
- We can reuse skills and software created for one customer in other situations.
- Our marketing programmes can be efficiently directed.

Product marketing can busy itself with its rightful concerns of customer requirements and competitive capability. Marketing programmes can be directed at our target market with confidence, using specialist publications; and we can become known to our prospects by attending well focused industry events.

According to Geoffrey Moore in “Crossing the Chasm” a fifteen per cent share in a particular segment is

[1] A service product is by definition a product of which professional services make up a substantial element.

[2] It is worth noting that in some markets, such is the rivalry, or concern over confidentiality, being installed at a similar company is a positive disadvantage.

about the minimum that will do to achieve these benefits. However, if we can achieve it, when the day comes when opportunities in our target market arise, there is a pretty good chance that the prospect will call us.

When the telephone starts ringing with unsolicited, self qualified enquiries, as a result of word of mouth referrals (from within that market, where they all talk together) we know that our marketing strategy is on the verge of greatness!

More leads means that we can grow our delivery capability whilst qualifying out the more marginal opportunities, leaving us with a higher win rate and better project margins when we do win.

The rest is "simply" a matter of salesmanship and a quality commercial and delivery process. A virtuous cycle of satisfied customers and referral then further lowers our sale cost, improves our delivery margin and so fuels further growth.

Why does it work?

Undoubtedly the successful execution of this strategy has led to rapid growth in revenue and profits for many IT services companies. But let's be clear about when and why it works. Two conditions must exist

1. There must be a vertical market niche of an appropriate size, where we have enough ammunition, ideally to dominate, but certainly to emerge as one of the top few participants in that market.[3]
2. The barriers to entry to the niche for competition must be sufficient to translate into real and enduring advantages for us.

The question for the marketing strategist is whether these conditions really exist.

Horizontal service products

Many IT services companies have built substantial businesses based on service products that are horizontal in nature rather than vertical. For example, they may be

[3] Of course there may well be good money to be made by starting up and selling a company which never achieves any significant share in a rapid growth market ….but that is a different story.

- functional such as accountancy, distribution, asset management or contact management systems
- enabling, such as database engines or code generators
- technology based (such as AS/400, COBOL, or a particular tool, or database such as Informix)
- geographical
- based on the size of potential customers.

What should the marketing strategy be for a service product that is essentially horizontal in nature? Received wisdom is very clear on the matter. For all the excellent reasons given above, the cry is to ***"go vertical!"***

Look at the demand in the vertical segments we can serve and the strength of our competitive position. Select the segment of a size where you can be one of the main two or three players and then define well focused sales and marketing plans directed at the chosen vertical market niche.

The wisest course?

However, there are reasons why this may not, in fact, be wise, desirable or achievable. There are very real risks and costs in moving from a horizontal to a vertical market. The questions to ask are:

1. Can we really afford to neglect our existing customer and prospect base which may not align with our new, focused vertical market strategy?
2. Does the new target vertical **really** constitute a niche? Are the barriers to entry to the niche sufficient to give us a decisive edge against a competitor who is prominent elsewhere?
3. Are we really in a position to establish a leading position in any particular niche?

Let's look at these questions in turn.

Our customer base

A company's customer base is its greatest asset. Everywhere you look there are products, while the customers hide themselves away behind elaborate screens that are very difficult indeed for the outsider to penetrate.

Everyone understands that it is at least ten times harder and a very much longer process to win business from people you don't know, than from people you do.

Unfortunately for our newly hatched vertical market strategies, for *real* companies with *real* histories, our customers, prospect base and (increasingly importantly) our personal networks, seldom line up neatly in our newly favoured market segments.

On the other hand, if we want the rewards of a vertical market strategy, we must attack our new market with vigour if we are to make an impact. This plan is guaranteed to fail without obvious senior management commitment and the deployment of our best people.

Consequently, we are torn between nurturing our new born, at attending to our existing base that feeds us. Unless we are very lucky, our new vertical strategy will take time to translate into revenue and inevitably, when the revenue outlook turns down, the sales function is driven back to the existing base or starve waiting for the new vertical market strategy to develop.

Where service is a substantial portion of what we deliver, this is a "double whammy" as services professionals are directed away from the new preferred service area back to the old customer base, completely undermining the strategic thrust.

The familiar "portfolio analysis" model demonstrates the point. If we look at our different business streams in the context of the market attractiveness and our competitive position, we can categorise them as "dogs", "seed corn", "stars" or "cash cows" as illustrated below.

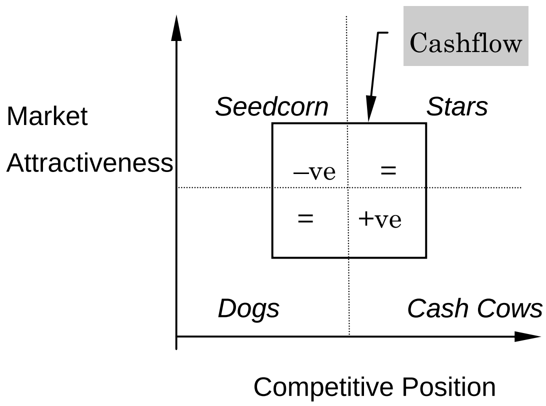

Figure 1 Portfolio Analysis Model

In our own base we are in a strong competitive position, but without vertical focus we will not be achieving the virtuous cycle of improved delivery, references and word of mouth referral that we so covet. Our own base is our "cash cow", with steady, if unspectacular, business that does not require substantial investment.

But we want to be a "star" and reach a strong competitive position in an attractive vertical. As we build to that position, even if we have an existing bridgehead, we will have to incur further cost to establish and consolidate a strong market position.

According to the theory, as broadly applied to product companies, the cash cow funds the seed corn. But in IT services companies, where margins are never high, great strain is put on the business as we move our professionals out of the steadily earning cash cow areas, into our seed corn projects. Chargeable utilisation falls and unless we are well funded from somewhere, the reduced profits will set alarm bells ringing.

The bottom line is that swinging the business across to a better vertical market will require cash.

How distinct are the verticals?

Many UK IT services companies have built solid businesses selling products to horizontal markets. Given that there are costs and risks to "going vertical", it is worth considering whether or not the benefits we expect from the identified vertical will accrue. The question boils down to this. *If we can achieve a strong niche position, will it give us a substantial edge over competition? That is, are the barriers to entry for competitors sufficient to keep them out*?

Barriers to entry can take a number of forms. For example

1. Functional requirements in each vertical segment may well be sufficiently different that successful implementations in one vertical gives a marked and demonstrable advantage against a competitor who has not had the same experiences. This competitive edge will be in the form of skills,

product functionality, reusable code, business insight and of course the references themselves.

2. Access to prospects may be the issue. For example, it is reasonably easy to gain access to (not very rich) local authority buyers through specialist magazines and conferences. It is more difficult to reach the movers and shakers in the big financial institutions (who are rich, and so better courted) without existing contacts.
3. It can be difficult to participate in some markets that are gated on access to technology or confidential know-how.

New markets are often opened up by new software technology, which is often proprietary. Whoever secures privileged access to such technology can gain an enduring advantage. For example, if you wish to write application software for set top boxes you will need to secure access to confidential specifications of the payment algorithms, which are, for obvious reasons, tightly controlled.

However, for some products (accountancy packages and distribution control, for example) these high barriers to entry **do not exist** to the same extent. Differences in implementation from one vertical to another are, in reality, relatively small and are soon outweighed by other factors in the competitive evaluation. In these markets, competitiveness from functionality and experience provides only a low barrier to would be competitors.

As far as the marketing communications are concerned, we need to understand what our prospects really need to hear. It is a valid assumption that some of our customers will like to know that we have a focus on their particular market, but do they really need to hear any more than the difference between:

“We are suppliers of Horizol” and

“We are suppliers of Horizol *to your vertical market segment*?”

In other words do we really need to have more than a vertical veneer to our marketing material? Can’t we get away with no more than a couple of brochures and a case study or two?

The danger is this. What is true for us, is true for our competition. If we retrench our marketing to one vertical, to which the barriers to entry are low, we give competition a free run in all the other verticals , and they can still come and give us a hard time in our own vertical with nothing more than a couple of brochures!

Is there a vertical for us?

To summarise the argument to date

- Moving to a vertical has risks and costs.
- The barriers to entry in a proposed new vertical need to be low for us but high for potential competitors if we are ever to benefit from a strong niche position

Consequently we need to ask, "Is there a niche of the right size where we have a prospect of being a leading player, with enough of a bridgehead to succeed and where the barriers to entry are sufficiently high to competition to keep them out?

Couched in these terms we can understand that the legitimate answer may very well be an unwelcome and stark "No".

Opportunities to establish a strong position in a growing market of the right size, with high competitive barriers to entry, (which we can overcome) just don't come along every day. In the meantime the best strategy may be "steady as she goes" even if this does lack a little something on the charisma front.

In the meantime

Rather than making an ill advised and expensive assault on a vertical market where you can't win in the medium term, be prepared to hold off until the right one does appear.

In the meantime, you might as well accept that lead generation is going to continue to be a key issue. At least if you explicitly understand that, for the moment, you are not "going vertical", you can view your marketing programmes as a series of more pragmatic campaigns. For example

- Look again at your key account management. Are you really doing everything you can to expand your existing bridgeheads?

- Consider introducing more generalised marketing programmes that will appeal to all of your existing base.
- If your product addresses multiple vertical markets, with low barriers, why not exploit the fact? Use "veneer" marketing; that is, do the minimum necessary to appear to have vertical focus, and mount guerrilla tactics to find and win the local business that should be yours.
- Look again in the cupboard. Is there something there that can be used to give an additional spin to your "veneer".
- Can you forge an alliance with a vertical market application provider and present yourselves as specialists at integrating with that vertical application?
- Alternatively, look for more innovative ways to promote yourself in a large amorphous market. Consider identifying a particular change agent operating across the horizontal market, such as legislation, hardware obsolescence, mergers and acquisitions, change of distribution or channel strategy and promote yourselves as experts in managing that change.

Stay on the look out for the day when you can establish the winning vertical market strategy that will turn you from a solid and dependable business to a rising star.

Just occasionally there may be an opportunity to at least get the product side of the new offering developed off the back of customer funded projects, but such opportunities just will not occur every day.

If they do occur, the management will need the awareness and commitment to seize the day. They will also usually need cash, which existing backers may, or may not, be willing to provide, depending on their attitude to the risks involved.

In conclusion

Vertical niche markets are the place to be, but if you aren't there yet, don't be persuaded to "dash for the vertical" without good reason.

Implementation of a vertical market strategy requires people to move from the cash cow into the seed corn areas. For the services company especially, this is likely to put a strain on cash flow unless you have a combination of good luck and good judgement to win a back-to-back series of customer funded projects.

Stay alert for the main chance, even though you may have to wait.

Be creative with your existing assets in the meantime. Look for marketing "veneers" to enable you to compete in low barrier to entry verticals at minimum cost.

Consider orienting your marketing around "agents of change".

Stay alert for the main chance and understand that when the moment comes, you will need cash to get there[4].

About the author

Ian Henley, chairman of *ChangeBEAT*, is recognised in the IT software and services market as a leading expert in improving business performance. He specialises in business strategy, marketing and sales and is well known through industry publications and Intellect where he provides advanced sales and commercial management training.

[4] *ChangeBEAT* wishes to acknowledge the contribution of Paul Godfrey, Director of Marketing at the Cedar Group, in the development of the ideas expressed in this paper.