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The Z-Theory and The Mid-Market

Executive White Paper

March 2004

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Executive Overview

The CRM industry is shifting gears and if the buzz is to be believed the focus now is all on the "mid-market" — that segment of companies that is smaller than the behemoths that traditionally buy new technology first (aka "early adopters") but larger than the small companies that usually wait for prices to come all the way down to earth before investing in new technology. But this view of the world may not be on target. Dividing the market this way essentially says that there is a pecking order that is ruled primarily by size. Beagle research shows that there most definitely is a pecking order but it is not as one-dimensional as size alone would lead us to believe.

More important in determining primacy of action are such factors as a company's comfort with risk, the company's available resources or ability to invest in new technology, and the importance the company places on the potential benefits that a new technology like CRM can provide. For example, Beagle research shows that the early adopter CRM market certainly has large companies included in the mass of enterprises that have adopted CRM. But there are equal numbers of smaller or mid-size companies in the early adopter cohort that, if based solely on size, would be considered mid-market companies. So the question that arises is "Why have some mid-size companies already bought while others remain on the sidelines?" Current market theories fail to explain this.

The CRM adoption curve is more complex than size alone can predict and this Beagle Research Group Executive *White Paper* identifies three parameters that affect how a company determines when it should invest in new technology and suggests a scoring metric for determining predisposition to adoption. The parameters relate to a company's size, but size alone masks the important nuances that determine why one company forges ahead on the technology adoption curve while others wait. The more holistic model proposed here takes into account why factors other than size are needed to help vendors identify their most likely prospects. Such a model can also aid end users in evaluating the fit for new technology to their businesses and corporate cultures.

The Mid-Market Misnomer

There has been a great deal of discussion recently about the CRM "mid-market." If you follow the logic being bandied about in the marketplace, CRM has been through an early adopter phase and is now embarked on a mid-market phase, which will be followed by a late adopter phase. But is that right? Many market prognosticators hew to the logic — first proposed by Geoffrey Moore in *Crossing the Chasm* — that early adopters are typically large companies with big budgets for technology. The logic says that it is these large, well-heeled companies that spend on new technology more or less as experiments — if the experiment succeeds the company has a new way to steal a march on its competition and if the experiment fails, the sunk cost is chalked up as part of the cost of being on the leading edge.

Extend the logic a bit further and you arrive at the mid-market. The conventional wisdom is that these companies are smaller than early adopters, that they have fewer resources to invest in IT projects, and they are more conservative. These traits help ensure that mid-market companies are not usually the first to buy into new technologies. Nevertheless, as the market cycle leadership turns from early adopters to the mid-market it is generally expected that the technology in question must become less costly to buy and easier to implement and maintain if it is to appeal to this group. The need for lower costs for acquiring a license might be obvious but the costs of hiring outside parties to implement and, in some cases, maintain technology — especially in CRM and other enterprise software — can represent as much as half to two thirds of the total cost of ownership (TCO) and it is these costs especially that must be disciplined. But labor costs are harder to compress than license costs, so the goal of cost lowering is essentially on of cost avoidance — done by making products simpler and easier to use, thus avoiding the need for labor.

The last group of buyers according to this framework is the late adopters — those technology conservatives who might never buy into a new technology or who will wait until a technology has reached commodity status and only then pick up what is now a well-established technology for conducting business. For comparison, these laggards can be thought of as the business equivalent of your grandmother without an ATM card. All this sounds reasonably plausible, but it is also wrong for several reasons.

Mixing Metaphors

Ever since Moore's *Crossing the Chasm*, we have had a clear idea of the importance of the early adopter market and a market life-cycle metaphor that provided a rough road map that delineated what to expect as the market unfolded. Moore postulated a lifecycle divided into three or four sections based on a standard bell curve, which represented the population of potential buyers.

The early adopters were at the far left and there were not many of them. Moore noticed that many technology companies have great difficulty transitioning from this small population of buyers to the next and larger segment in the middle, which he referred to as the "mainstream" and subdivided into the "early majority" and the "late majority" cohorts respectively.

The mainstream is where vendors want to sell their products because most of the potential demand and potential profit to be earned in a product lifecycle is in the mainstream. Though the revenue per deal may be lower in the mainstream than in the early adopter phase the number of potential buyers is so large that it dwarfs other sectors.

Some of Moore's greatest contributions have been to explain that the buyers in the mainstream not only had fewer resources to invest, that they frequently were smaller and more conservative companies, and there was less profit potential per deal. For those reasons he counseled that successful vendors in the mainstream would be those who could contain the costs of their solutions to make them more affordable and profitable. At some point, though, market participants merged the concepts of mid-market size and mainstream realities placing excessive emphasis on company size to the exclusion of other relevant factors.

A Case In Point

On average, early adopters tend to be large companies. Mainstream companies tend to be smaller companies that expect the business worth of a technology to be proven before they will invest. But there are plenty of examples of rich, smaller companies that take on new technology as the means to gaining competitive advantage and the converse is also true — there are plenty of large but conservative companies that do not adopt new technology until much later than the small-medium-large model would suggest. In fact, while the average CRM using company from the early adopter period is a large company, the *median* CRM adopting company in the early adopter cohort is squarely in the mid-market.

What the Research Shows

Beagle research shows that the *average* company using CRM today has revenues of about $9 billion, which makes the average CRM early adopter a very large enterprise. However, the *median* company using CRM today has revenues of only about $300 million, which clearly positions it in the mid-market. Keep in mind that an average is a simple mathematical statement derived from the data — in this case total revenues / total population — and it is subject to skewing by a few large data points, in this case, the number of large multi-billion dollar enterprises that have adopted CRM. On the other hand, the median is the statistical mid-point of a population — the peak of the bell curve. There are equal numbers of individuals on the bell curve to the right and to the left of the median and there is no mandatory relationship between the average and the median. As a matter of fact, in the case of companies using CRM there is a great divergence between the average and the median.

Three Key Indicators of CRM Adoption Avidity

The implications of this finding are significant because they clearly show that small, medium, and large companies are in the CRM early adopter cohort and, more importantly, it strongly suggests that there is a broad distribution of company sizes at all stages of adoption — in the mainstream and beyond. So what differentiates early adopter companies from their mainstream counterparts?

The companies that make up the early adopter cohort have several major attributes in common that differentiate them from the rest of the market, though size is not likely one of them:

1. They have *resources* to invest in expensive, new, or relatively unproven business technology, which often cannot show a positive ROI.

2. They are *comfortable with the risks* (risk tolerance) inherent in investing in business technologies that are not fully proven.

3. They actively seek out innovations that help them gain a *competitive advantage*.

Resources

Although abundant resources are generally associated with large companies, plentiful resources can also be found in many smaller companies that generate high margins for their products and services — inspite of their size. For example, in sectors such as finance, and some parts of technology and telecommunications high profit margins make these companies "richer"' than similar sized companies in less highly leveraged industries providing them with the resources to plow into new technology should they decide to (see Competitive Advantage below).

Risk Tolerance

A company's comfort level with risk can be influenced by several factors including an entrepreneurial culture, high liquidity (see above), or simply the knowledge that the industry is highly competitive (see below), changing rapidly and that standing still is no option. We see these traits in technology companies (entrepreneurial), financial companies (liquidity), pharmaceutical companies (liquidity, rapid change), automotive (highly competitive), and many others.

Competitive Advantage

Much the same can be said about competitive advantage — it is simply another motivator that can bias some companies to take action in adopting new technology while it can also provide a bias against standing pat. Companies seeking competitive advantage know that leveraging information technologies such as CRM are good investments in assuring future profits.

Whether discussing resources, risk, or competitive advantage, one thing is certain — there are a limited number of companies that can lead in any criterion at any time. Companies with high levels of any of these attributes — or a combination of these attributes — form the core of early adopters as high levels of resources or comfort with risk trail off in the general population.

Assessing Receptiveness to Adoption or Avidity

Understanding a company's or a market's propensity to adopt new technology can vendors understand who their best customers and best markets are and save time and resources for the vendor. At the same time, for an individual company to understand its own propensities may help managers avoid an early plunge into a new technology that the broader organization may not be ready for warding off a potential disaster. A rudimentary assessment and rating system can be built from the three receptivity indicators discussed above. Such a scoring system can enable both end customers and vendors to demystify the CRM acquisition process to determine a purchase and implementation scenario that best fits an organization's temperament and needs. Table 1 summarizes a prototypical scoring system based on aggregate scores for the three receptivity indicators and divides the market into five primary parts.

Table 1: Avidity score ranges by cohort.

Cohort	Resources	Risk	Competitiveness	Cohort Range
Early Adopter	4 - 5	4 - 5	4 - 5	13 -15
Chasm	4 - 5	3 - 4	3 - 4	10 - 13
Mainstream	3 - 4	2 - 3	2 - 3	7 - 10
Mainstream / Late Overlap	2 - 4	1 - 3	1 - 3	4 - 7
Late Adopters	1- 2	0 - 1	0 - 1	1 - 4

Source: Beagle Research Group, March 2004

Factors To Consider In A Rating System

Each organization — vendors and end users alike — should consider what factors to deem relevant in a rating system. Some suggested areas follow and we stress that it is the total score that is important and there are various ways to achieve any specific score. That said, specific scores in any attribute area will determine the specific method for proceeding with each customer.

Resources

Having the money to purchase a software license is an obvious first step. But this parameter also requires an understanding that the organization must also budget for services and for at least the potential for cost overrun must back this up. Moreover, people and time must be factored into the equation, as implementing systems that fundamentally affect core business processes will undoubtedly require the attention of senior managers as well as the rank and file.

Risk

While many people say they understand risk and are comfortable with it, few ever have a "Plan B" for what to do when things go very wrong. Having a Plan B implies there is a Plan A but Beagle research shows that slightly over half of the early adopters of CRM never had a formal plan based on an analysis of the business prior to implementation. Perhaps one reason that it is so difficult for many organizations to "rev down" from a failed implementation is that they do not know what their starting point was. Understanding risk and being comfortable with it requires an assessment and a plan, without these two components a potential adopter's risk score should be kept low.

Competitiveness

Although nearly every business will position itself as competitive or highly competitive, what needs to be assessed in this area is different. This assessment must be made in the context of the market or industry as well as in the company's relationship to the industry. Management may want to contest its rivals on every deal but rating competitiveness should also include identifying an individual (or a culture) that has a driving need to be first and to leverage new ideas and products to get there. A highly competitive individual may be the executive sponsor or coach in the sales process and it will be critical that this person remain heavily involved in the delivery and roll out of the solution.

The Z-Theory

With an understanding of the average and median values of the early adopter market as well as our analysis of CRM adoption avidity scoring we propose the Z-Theory of penetration for the CRM market. Although some outliers will undoubtedly exist, we believe that about 80 percent of the adopters of CRM technology can be plotted within the boundaries of a "Z" shaped figure.

We note five distinct areas of the graphic representing specific types of CRM buyers that are detailed below.

1. ***Early Adopters*** (score 13 to 15) — This classic group typically scores high in all three key indicators of receptivity and, as we have seen contains companies of all sizes. Median company size (by revenue) and high average size suggests that the shape of this plot is asymmetrical — relatively large on the left indicating the large number of smaller companies and tapering into the largest company size. Small and large companies have much in common and the adoption pattern is Boolean. Either small companies have the assets and inclinations and buy early or they buy late when costs are more reasonable. Large companies that do not buy early are probably in markets or industries that have little need for a technology and they may buy later as a defensive measure if at all.
2. ***Chasm Cohort*** (score 10 to 13) — The Chasm Cohort is an overlap group that has characteristics in common with early adopters and the mainstream. This earliest part of the early majority (a component of the mainstream) scores less highly in risk tolerance and for that reason is regarded separately.
3. ***Mainstream*** (score 7 to 10) — Every vendor dreams of doing well with the mainstream users because there are so many of them. Unfortunately, many vendors take the view that this group is relatively homogeneous and confuse the mainstream with the mid-market — nothing could be further from the truth. As the graphic shows, there is broad diversity between adoption scores among companies of the same or similar size. Some very large and very small companies are part of the mainstream. This heterogeneity by company size is one of the key factors that make assessing the mid-market so difficult.
4. ***Late Overlap*** (score 4 to 7) — As with the Chasm Cohort there is some continuity between the mainstream and Late Adopter cohorts signified here by the Late Overlap Cohort. Late Overlap companies may act for reasons that are intrinsic to the whole group including reasons that more or less affect the

whole sector such as government regulation, economic trends, or an internal threat such as a disruptive innovation[1].

5. ***Late Adopters*** (score 1 to 4) — Like early adopters, this group will contain companies of all sizes though there will be proportionately more small companies than large ones in the cohort. Late adopters score lowest in receptiveness ratings; they have the fewest resources, are most risk averse, and usually do not acquire technology for competitiveness reasons. For example, a government entity may install CRM to ensure that it can provide constituents with a level of service comparable to commercial enterprises, but such implementations will be done to catch up with market standards rather than set a standard.

The Mid-Market

By applying the mid-market range from the company size axis to the market penetration graphic, it is easy to show that at any point in a product lifecycle one can find abundant evidence that mid-sized companies will be engaged — for their own idiosyncratic reasons — in selecting and implementing advanced enterprise technology such as CRM. Of course, adoption avidity scores decline over time and across the market life-cycle and this approach accounts for this reality. Using a scoring system to rate more fine grained predictors will provide both vendors and end users with the tools they need to successfully implement advanced technology like CRM. There are implications for how each group should approach the task, to which we now turn our attention.

Implications for Vendors

It has been discussed elsewhere but it bears repeating, the mainstream user has many of the same requirements that the early adopters have, however, because the mainstream user has different motivations and fewer resources, that user is more risk averse. And more often than not the true mainstream user recognizes that the opportunity for gaining competitive advantage has been ceded to the early adopter; a strong motivation for the mainstream user then is to keep up, to avoid losing ground to the early adopter. It is therefore pressure on resources, risk avoidance, and the need to keep up with the earlier adopters that drives vendor reaction to the mainstream cohort.

Strategies such as simplifying implementation, maintenance, and management, are necessary adaptations by vendors to the mainstream market. But beyond product strategies, vendors need to dedicate attention to understanding the motivations of their buyers. Doing so will enable vendor representatives to more accurately identify not just whether a buying process is active but also the quality of that process.

[1] Such conditions can operate at the higher end of the mainstream to promote mainstream companies to quasi-early adopter status or make what are otherwise mainstream companies look like late adopters.

Too often part of the qualification routine in a typical sales process involves confirming that the prospective customer has budgeted funds for the software, services, hardware, and ancillary bits that are needed to make any implementation project successful. But few bother to determine the avidity of the customer for the solution missing critical information that might communicate that a particular customer will need more rather than less training, for example, than the higher scoring mainstream customer that purchased at the same time.

On the other hand, emerging companies in emerging markets may take this information in an entirely different direction. For example, an emerging company in a new niche may use this strategy as a way to better identify early adopters. Very often such companies find that they sell well in early stages of a conventional sales process only to lose momentum as a decision point gets closer. Many discover that they lose to "no decision" or that there is no budget for their product only after investing heavily in a sales and demonstration process. By definition when selling a highly conceptual product in a new market, vendors must look for early adopters and more than identifying a budget, vendors should identify who in the organization is the real risk take and is able to get funding through unconventional routes.

Implications for End Users

End users can make effective use of a scoring system such as the one introduced here because it is really a tool for bi-lateral qualification. The same tools can and should be used by both parties to determine a user's readiness for purchase as well as a vendor's capability to make the project successful given the customer's profile and needs. For example, a risk averse end user may feel more secure using a longer delivery cycle with smaller and more frequent deliverables; conversely, an end user feeling competitive pressures may opt for fewer, larger deliverables over a shorter period. But the main point is that by understanding one's own needs better a customer organization can be proactive in ensuring the use of the tools and plans that will best fit its needs and help assure success.

The Importance of Benchmarking

The foregoing discussion drives home the point that it is critically important for end users to diagnose their own needs before approaching vendors because at least some vendors will mistakenly misclassify their position in the market, and possibly apply the wrong emphasis to their requirements. There is no substitute, therefore, for end users to perform their own analysis in the form of a baseline study, prior to engaging a vendor. Another point worth contemplating is that the needs analysis must encompass much more than the solution requirements and metrics that must be put in place to meet them. A baseline study should also include a thorough and conscious evaluation of a company's comfort level with the three major attributes cited above as well as an inventory of talents and skills needed to make the project work, and the competitive climate (as opposed to only evaluating the company's internal competitive position) that the company finds itself operating in.

Organizations that routinely assess prospective client avidity may find that they are better able to sell the mix of products and services that a customer needs. Automating this process through the use of a simple survey and scoring tool would be a logical next step.

Beagle Research Conclusions

There is plenty of evidence that company size by revenue is a less than sufficient indicator of propensity to purchase CRM solutions. Beagle data shows that small, medium, and large companies make up the early adopter cohort of the CRM adoption curve. The major part of the CRM adoption life cycle is now underway targeting the vast mainstream — a grouping of companies of all sizes whose common characteristics are aversion to risk, smaller budgets, and a need to keep up with companies that have already been down the CRM adoption curve. Vendors who confuse the mainstream with mid-sized companies put themselves at a disadvantage by overlooking larger and smaller companies that may be more inclined to spend on CRM than the prototypical mid-market firm.

What matters is not the size of a company but the internal pressures such as risk aversion and the ability and inclination to afford CRM as well as market competitiveness. These three factors balanced through a CRM Adoption Avidity Score can help to determine a company's go/no go adoption decision not just for CRM but also for many new or advanced business technologies. At the same time, end users can use such a system to "take their own pulse" and assess whether or not the time is right to take on new technology. Generating a CRM Adoption Avidity Score should be part of every sales process as well as an important part of any self-analysis a company goes through on the way to the CRM market. Performing this analysis will enable vendors to make more intelligent decisions about how to deploy limited sales resources and help end users better understand their technology and business needs.

Beagle Research Group is a consulting and research organization focused on emerging companies and technologies that will have an important impact on the way business is conducted in the years ahead. Our work is based on professional standards of quantitative and qualitative research which informs all of our publications.

This document was researched and written by Beagle Research Group. The information it contains is accurate as of the date of publication.

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