

## The SMB Market & Enterprise Applications

### Introduction

It used to be that being a small or midsize business (SMB) meant that you couldn't get the time of day from large IT product and service vendors.

How times have changed...

With large enterprise spending on IT still in the doldrums, AMR Research claims, "Most enterprise application vendors are pursuing the Small and Midsize Business market, looking for new growth opportunities."

Why SMB? The answer is simple – the market is huge. According to AMR Research's piece [IBM SMB One Year Later: Expressing SMB Needs](#), "The SMB market is the fastest growing sector with a total IT market worth in excess of \$200 billion (possibly 500,000 companies)." In another piece, [SMB IT Spending Is Robust and Growing Into 2005](#), AMR also claims those companies spend a greater percentage of their budgets on IT than larger companies do,

and the IT budget growth for SMBs "looks encouraging for 2005."

AMI-Partners also reports total US spending on enterprise software reached \$14.6 billion in 2003 and nearly one billion of this came from the SMB market. AMI goes on to state it believes, "SMBs will raise spending in this area (enterprise software) at a staggering 14.3 percent compounded annual growth rate."

### What is an SMB Company?

What exactly is an SMB company? Although each analyst firm and vendor has a slightly different view on what constitutes an SMB company, the consensus seems to be a company with a thousand or fewer employees and/or revenues of \$500 million or less. AMR and others have opened up a debate questioning how companies classify prospects and customers as SMBs or large enterprises. In AMR's [An SMB by Any Other Name](#), the article claims an executive board member at

SAP recently commented, "There's no such thing as an SMB - it's absurd. Nobody starts a company one morning and says 'I want to be an SMB.'" How vendors segment prospects can be critical. The article goes on to say, "Inappropriate segmentation means vendors risk losing business, while customers risk project failure or at best misaligned expectations."

### SMB Go-To-Market Strategies

Tapping into the SMB market is not going to be easy, or even achievable for many enterprise application vendors. Most vendors are not even considering a true small business thrust. Instead, they are focusing on the medium business market – specifically the companies with revenues and employees close to the upper limits of the SMB range. According to Ovum's piece [Looking at the S in SMB](#), "These firms (midsized firms) are substantial, have relatively complex needs and a budget equivalent to a department or division of a much larger firm making it a

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lucrative arena to play in. As a result, mid-sized firms are starting to see the results of this attention with better-crafted offerings and more flexible pricing structures hitting the market. It's a potential win-win all round."

Go-to-market strategies are also complex for the SMB market. No large IT vendor can afford to take its highly-compensated sales team and send them out to call on any but the largest SMB companies. Vendors need to create new, lower-priced, less complex products and offer them via new distribution channels. This is a strategy that IBM has been employing with some success. It introduced a new product line called Express and according to AMR, "Express products are rolling out thick and fast through 2004. Express is really a prepackaged product for a specific need, designed and developed for midsize companies and delivered through (IBM's) Independent Software Vendors (ISVs) and reseller channel."

Ovum also makes a case for pursuing smaller companies,

which it claims represent well over 80 percent of the SMB market. Ovum recommends that IT vendors seek relationships with Telcos who already have "contacts and contracts" with virtually every small business. According to Ovum, "The key to success in the small business sector for large suppliers is volume: Telcos could provide the volume and the likes of IBM or Oracle could supply the solutions."

Another possible go-to-market strategy for enterprise application vendors is the ASP model. AMI-Partners reports that over one million US and Western European firms currently use ASPs and they project that number to increase to over 3 million by 2008. Providing enterprise applications that work well in an ASP model might well become an important avenue of growth in this market.

### Areas of Analyst Agreement

Although it is difficult to find a lot of SMB data from analyst firms at this time of year (many IT spending

predictions come out in the beginning of the new year), some clear areas of consensus did emerge:

1. The SMB market is the hottest IT market in 2004
2. SMB IT spending will increase next year, and SMB's will spend a higher percentage of their revenue on IT than large companies.
3. The mid-sized companies will outspend the small companies.
4. CRM is a major area of interest among SMBs.
5. Other areas SMBs are targeting for spending include wireless, security and networking equipment.
6. Enterprise application vendors would do best to focus on the mid-sized business market.
7. The SMB companies do not want complex solutions that require costly implementation. They prefer solutions that work "out-of-the-box," even if it means sacrificing some functionality.

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### Areas of Analyst Differences

There are many areas of disagreement among analyst firms regarding the SMB market. One of the most obvious is that each firm seems to have its own definition of what the SMB market is. Some firms only look at revenue, others look at number of employees, and some look at a combination. The break-points between small, mid-size, and large firms also vary considerably.

IT spending growth by SMBs is another area of conflicting views. For instance, AMI-Partners claims 13.3% growth for 2004 while Forrester pegs the number at half that amount at 6.6%. For 2005 SMB IT spending growth, the only figure we could locate was from AMR Research who puts the number at 6.6%.

The size of the total worldwide SMB IT market is also an area that showed some disagreement. Once again, AMI-Partners came in high at \$538 billion while AMR Research came in at less than

half that with an “excess of \$200 billion.”

Views on the penetration of enterprise applications within SMBs also varied widely. Both AMI-Partners and Bitpipe conducted surveys of SMBs to determine what applications they have installed. Although their numbers are close for large businesses, they are off by an order of magnitude for small and medium businesses. For example, AMI-Partners puts CRM penetration in small businesses at five percent while Bitpipe puts the number at 47 percent (most of this discrepancy could be caused by how the firms asked their questions and how they defined CRM. In Bitpipe’s case, CRM was not defined to the survey respondents so they may have included contact managers, help desk solutions, and any custom applications the respondents use to help manage their relationships with their customers).

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### **Consensus Opinion**

It is clear that SMBs are spending on IT, and they are spending at a higher rate than large companies. We expect to see enterprise application vendors stepping up their attempts to penetrate this market. They will do this using several strategies:

1. They will create (or continue to create) simpler, out-of-the-box solutions that are easy to implement and maintain by SMBs
2. They will focus their sales efforts on the larger of the SMB companies – the “M” in SMB.
3. They will look for alternate sales channels into the SMB market, as their current sales forces cannot sell to smaller companies profitably.
4. They will partner with, or acquire firms that already have a sales presence in the SMB market.

For IT spending in SMBs in 2005, we expect to see growth between the predictions of AMR and AMI-Partners – probably somewhere in the eight- to nine-percent range.

Bitpipe’s survey of SMBs also provided insight on the shift in IT spending by SMBs from 2004 to 2005. The survey found a decrease in spending for hardware and communications equipment, along with increases in spending for packaged software, and internal and external IT services. (see Table 2). Bitpipe’s findings also point toward increased spending on software applications. Combining that with AMR’s research indicating planned expenditures on CRM software by SMBs, we believe CRM packages targeted at the SMB market will enjoy considerable success in 2005.

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### Summaries Of Analyst Views and Predictions

| Table 1 – SMB Statistics and Trends                                   |                  |                |              |              |
|---|------------------|----------------|--------------|--------------|
|   | AMI-Partners     | AMR Research   | Forrester    | Yankee Group |
| 2004 SMB IT spending worldwide growth                                 | <b>+13%</b>      |                | <b>+6.6%</b> |              |
| 2004 Total SMB IT and Telecom Worldwide Spend                         | <b>\$868B</b>    |                |              |              |
| 2004 Total SMB IT Worldwide Spend                                     | <b>\$538B</b>    | <b>\$200B+</b> |              |              |
| 2004 SMB Telecom Worldwide Spend                                      | <b>\$340B</b>    |                |              |              |
| 2004 SMB spending on new PC hardware                                  | <b>+14%</b>      |                |              |              |
| 2004 growth in PC shipments to SMBs                                   | <b>+17%</b>      |                |              |              |
| 2004 projected PC shipments to SMBs                                   | <b>71M units</b> |                |              |              |
| 2004 % of annual revenue spent on IT by SMBs (US)                     | <b>6.4%</b>      |                |              |              |
| 2004 SMB spending on wireless services growth                         |                  |                |              | <b>+94%</b>  |
| 2005 SMB overall IT spending growth (US)                              |                  | <b>+6.6%</b>   |              |              |
| 2005 IT spending growth of larger SMBs - 250 to 999 employees (US)    |                  | <b>+10.8%</b>  |              |              |
| 2005 SMB spending on software (US)                                    |                  | <b>+7.2%</b>   |              |              |
| 2005 SMB spending on infrastructure (US)                              |                  | <b>+9.3%</b>   |              |              |
| 2008 SMB IT and Telecom Worldwide Spend                               | <b>\$1.1T</b>    |                |              |              |
| SMB's planning to purchase security and/or Internet bandwidth in 2004 |                  |                | <b>86%</b>   |              |

| Table 2 – Change In Distribution of IT Spend From 2004 to 2005 |                 |                         |                  |
|--|-----------------|-------------------------|------------------|
|  | 1-999 Employees | 1,000 – 4,999 Employees | 5,000+ employees |
| Hardware   | -               | -                       | -                |
| Packaged Software  | +               | +                       | +                |
| External IT Services   | +               | +                       | +                |
| Communications Equipment                                       | -               | +                       | +                |
| Internal IT Services   | +               | +                       | -                |
| Other IT   | +               | +                       | +                |

Source: Bitpipe Member Survey July 2004

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|                                    | AMI-Partners | AMR Research | Bitpipe | Forrester | IDC | Yankee Group |
|------------------------------------|--------------|--------------|---------|-----------|-----|--------------|
| Business Process Management        |              |              | X       |           |     |              |
| Content Management                 |              |              | X       |           |     |              |
| CRM                                |              | X            | X       |           |     |              |
| Knowledge Management               |              |              | X       |           |     |              |
| New PCs                            | X            |              |         |           | X   |              |
| New Servers                        |              |              |         | X         |     |              |
| Networking Equipment               | X            |              |         | X         |     |              |
| Web Services                       |              |              | X       |           |     |              |
| Wireless services                  | X            |              |         |           |     | X            |
| Security and/or Internet bandwidth |              |              | X       | X         |     |              |
| Hosted Applications                | X            |              |         |           |     |              |

|         | Small Businesses |         | Medium Businesses |         | Large Businesses |         |
|---------|------------------|---------|-------------------|---------|------------------|---------|
|         | AMI-Partners     | Bitpipe | AMI-Partners      | Bitpipe | AMI-Partners     | Bitpipe |
| CRM     | 5%               | 43.7%   | 12%               | 45.8%   | 54%              | 59.2%   |
| ERP/SCM | 3%               | 50%     | 11%               | 74.5%   | 60%              | 77.5%   |

|  | 2004            | 2008           |
|--|-----------------|----------------|
|  | Number of firms | Over 1 million |

Source: AMI-Partners

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