

WHITE PAPER

Innovation in the SaaS Ecosystem: salesforce.com's AppExchange Delivers Expanded Opportunities

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IN THIS WHITE PAPER

This White Paper discusses salesforce.com's evolution in the emerging software-as-a-service (SaaS) ecosystem. IDC believes that the software industry has largely moved beyond the educational phase of software on demand and that the associated benefits of the delivery model/service have been largely recognized by companies of all sizes and across a spectrum of industries. Customers understand the merits of purchasing on-demand offerings, which is apparent from the revenue that on-demand providers have gained. IDC estimates that worldwide revenue associated with software on demand reached \$3.7 billion in 2006 and expects it to grow to \$14.8 billion by 2011, representing a compound annual growth rate (CAGR) of 32%. Salesforce.com continues to lead as the number 1 on-demand provider, with an impressive \$452 million in revenue for calendar-year 2006 and growth that continues to be above 50% year over year. The company also reached its 1 millionth subscriber in December 2007 and is on track for a \$1 billion run rate in early 2008.

There is a growing battle in the broader SaaS ecosystem for customer mindshare, and IDC believes that on-demand providers will increase marketing and demand generation efforts in order to attract new — and retain current — customers. The growth in partner relationships and enabling partners to take advantage of the on-demand opportunity will be a critical component to the success and longevity of the delivery model.

With the importance of partnering relationships at the forefront to help expand the reach of on-demand providers, online marketplaces have become a device that companies can use to attain new partners and customers. In 2006, salesforce.com launched AppExchange in the pursuit of becoming a core aspect of the dynamic purchasing patterns of customers and partner opportunity. Marketplace initiatives such as AppExchange help to centralize the customer experience, generate business for partners, and increase the ecosystem reliance forming around salesforce.com. IDC believes that marketplaces can offer a number of benefits to customers, including access to a variety of IT goods and services, integrated business processes, as well as a sense of community among partners, developers, and customers alike.

This White Paper, sponsored by salesforce.com, explores the state of the SaaS ecosystem today, including the attributes of hubs and a discussion of salesforce.com's AppExchange as a tool to help increase its ecosystem reliance.

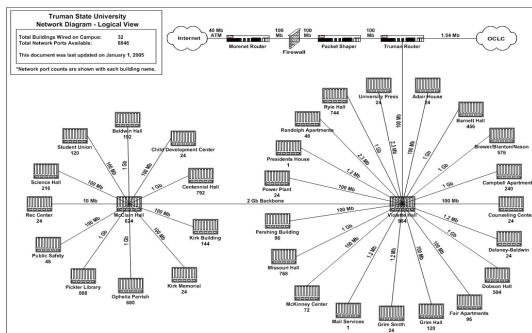
THE EVOLVING SAAS ECOSYSTEM

The software-on-demand delivery model continues to gain appeal with both customers and vendors alike. In 2006, the software-on-demand delivery model generated \$3.7 billion in revenue, and IDC believes this opportunity will reach \$14.8 billion by 2011, representing a compound annual growth rate of 32%. The adoption of software on demand will continue to accelerate over the forecast period as providers continue to focus on aggressive customer acquisition strategies to maintain growth rates and increase revenues.

To increase the penetration of software-on-demand offerings in the overall software market, providers will need to devise effective partnering strategies because the broader software market is moving from a time where few software companies dominated the software landscape to a new ecosystem where many more companies are participating beyond just software companies. This indicates that the software industry is shifting from a partner-centric environment, in which relationships were primarily handled in a one-to-one fashion, to a network-based ecosystem (see Figure 1).

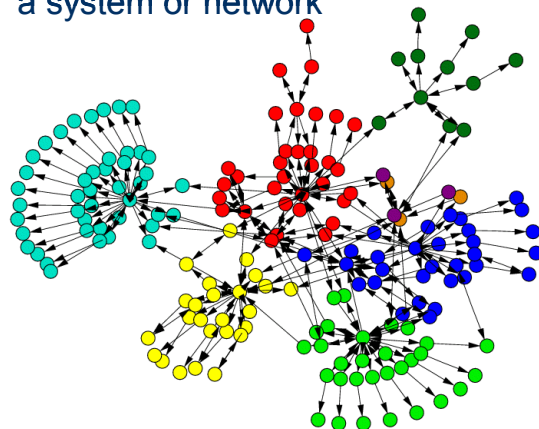
FIGURE 1

Why Now? New Software Ecosystems Are Developing



New software ecosystems

- Many more companies are participating — not just "software" companies
- Ecosystem must be managed as a system or network



Old software ecosystems

- A few companies dominated the landscape
- Ecosystem managed on a relationship-by-relationship basis

Source: IDC, 2008

Driving this new ecosystem development is the software-on-demand delivery model. The traction gained from on-demand providers has forced traditional software, services, hardware, and telecommunications companies to reevaluate their business and partner strategies, indicating that the old partner paradigm needs to evolve to support the dynamics of the on-demand delivery model. To a large extent, many of these companies are trying to determine the right type of partner to help them take advantage of the on-demand opportunity. IDC believes that these partnering relationships and this ecosystem development will be key to maintaining software-on-demand growth.

The disruptive nature of the SaaS model has progressed along the path of seriously threatening traditional partner revenue and profit streams. Two big wrinkles for partners are the subscription revenue stream and selling a "virtual" product whereby there is nothing to physically ship, implement, or keep on the shelf. There will be no simple and/or easy answer to the critical question on the minds of on-demand providers and partners today, which is: How will SaaS affect my business?

However, the SaaS delivery model represents uncharted waters when it comes to partnering and larger ecosystem development. To better understand the partnering landscape within the SaaS ecosystem, IDC conducted a special study at the end of 2006 entitled *The Software as a Service Ecosystem: Winners, Innovators, and the Next Generation*. According to the results of the study, the SaaS ecosystem is in a nascent state despite the fact that 67% of interview respondents indicated that SaaS is very important to their business strategies. In addition, 91% of participants revealed that they plan to increase their level of commitment to their SaaS partnering strategies, which not only provides a positive outlook but also signals that the models for successful partnering are still forming.

IDC believes that the software industry is embarking on a new journey with partners and that the SaaS delivery model is where unfamiliar and unique opportunities lie. IDC believes that the channel strategies for SaaS providers will eventually be significantly different from what those in the software world have known for the past few decades. Traditional channel partners have some potentially big changes ahead, particularly in terms of securing top-line revenue as part of partner engagements.

Becoming More Prominent in the SaaS Ecosystem: Characteristics of Hubs

IDC trusts that unique partnering opportunities, business ventures, and customer solutions will be revealed as more participants develop practices around on demand. Any player active in the SaaS ecosystem has the potential to emerge as a hub. Hubs are companies that become important to the ecosystem from a business perspective. Basically, the higher the tendency for firms to link themselves to a particular company, the greater the likelihood of the company evolving into a more prominent hub because firms will connect to one another according to where they can realize the greatest business benefit.

However, it is not the quantity of links to a company that will make it a hub but rather the quantity and *quality* of connections due to the belief that the company will create new business opportunities. IDC believes that certain characteristics will drive a company toward becoming a hub. These key attributes include technology, market, and sales enablement as well as partner rewards and incentives and partner infrastructure:

☒ **Technology enablement.** Partners expect effective technology enablement offerings and technology road maps, as the "green fees" for developing a relationship and technology enablement are usually considered a cornerstone for partnering activity. Technology enablement is the ability of a hub to attract partners with the following:

☐ **Development and deployment framework.** A hub will have to provide a common development and deployment framework based on a set of Web services standards that a partner can build to have some degree of reliance. In addition, the hub will need to publish a technical road map so partners can plan their own activities around the hub. This would also include a partner's perception that a hub offers a quality solution from which the partner can build business and that increases the hub's accountability in the ecosystem.

☐ **Service reliability and scale.** Appearance of downtime and unreliable service will detract partners from wanting to work with a hub. Companies that have the reliable infrastructure to enable the delivery of SaaS offerings as well as support those offerings will be in a position to become hubs. This indicates that a hub's ability to scale will factor in heavily as customer acquisition increases.

☐ **Developer program and support.** The expansion of a partner's business will fail without developer support. At a basic level, hubs have to provide access to developer tools and APIs, shared/dedicated development and testing sites, and technical support to integrate solutions with a hub's offerings.

☒ **Market enablement.** Market enablement consists of a hub's ability to increase the growth and adoption of SaaS-related products and services:

☐ **Market presence.** Market presence is a vital component for hubs because without an established presence in the ecosystem, there is little reason for a partner to want to work with a hub. Market presence can also be determined by the level of commitment the hub demonstrates to the SaaS delivery model. Although overall market presence is important (i.e., total revenue, degree of current partnering activity) to the development of hubs, these firms will need to demonstrate SaaS-specific impact (e.g., SaaS knowledge, share, growth) to maintain this position over the longer term.

☐ **Go-to-market strategy.** Without a clear go-to-market strategy for partners, hubs will not provide the market reach that partners will expect. Bringing solutions to market is a vital component as well as need in the SaaS ecosystem. A successful go-to-market strategy will aid in gaining exposure

and thus market presence to attract partners to a hub's network. From a partnering perspective, a clear go-to-market strategy is the foundation for partner market planning and the creation of marketing tools, and it guides partner investments such as market development funds (MDFs) and other market-based initiatives.

☒ **Sales enablement.** Sales enablement represents the hub's ability to generate sales opportunities for partners by providing:

☐ **Accessibility.** Accessibility consists of a hub's ability to provide the necessary tools and access to information such as pricing, product, and other partners. Accessibility includes whether a hub is considered easy to work with, as hubs have to make working with partners intuitive, straightforward, and predictable. Clear and consistent pricing and rules of engagement should be determined along with an appearance of sound commitment to the success of partners.

☐ **Exposure.** The level of exposure offered to a partner through association with a hub's network offers a compelling reason for why a company would want to connect to a particular hub. A hub acts as a channel itself for related SaaS offerings and services whereby new customers and partners can be gained from the exposure offered through a hub. This exposure can manifest itself through exposure to the hub's sales force, existing channel partners, and marketing efforts through devices such as directories, internal sales training, sales tools, and other similar activities.

☐ **Customer acquisition.** From a sales expansion perspective, SaaS has a low penetration of the overall software market; therefore, customer acquisition and new sales are vital to the SaaS ecosystem. The degree to which a hub can help drive leads and assist partners to develop new business is critical to remaining a hub.

☒ **Partner rewards and incentives.** Partner rewards and incentives constitute a reward structure for influence and sales channel activity. Many companies have reward structures for indirect sales (e.g., agent commissions, OEM, or resale activity). Success in the SaaS ecosystem will require a structure that also includes a mechanism to recognize and reward firms that engage in influence activity. This model helps both parties become invested in the relationship and the mutual success that can be experienced. It helps to demonstrate commitment on behalf of both parties and incents a partner to want to work with the hub.

☒ **Partner infrastructure.** Partner infrastructure consists of the development of a comprehensive partner program. The development and implementation of an effective partner program is a significant endeavor. Beyond the logic inherent to the program itself (e.g., three-tier structure, points systems), an effective program requires supporting systems (e.g., PRM systems) and integration within existing sales and delivery processes.

The degrees to which hubs can meet the criteria identified will also determine their relative strength and position within the SaaS ecosystem. Although these characteristics are not necessarily new to the software industry, the on-demand delivery model presents the change and challenge. The on-demand model has altered not only vendor revenue recognition practices, sales compensation plans, and provider accountability but also customer expectations and partner economics. Elements driving a hub's formation must include transparency, trust, and open communication so that other ecosystem participants can develop strategies accordingly. Salesforce.com is one such company that has built an ecosystem of customers, developers, and partners whose success is increasingly tied to the continuous innovation and opportunity the company presents.

salesforce.com's AppExchange: Creating New Business Opportunities for Customers, Developers, and Partners

Until recently, the majority of SaaS providers focused on direct sales efforts, which have been successful in terms of driving adoption and increasing revenue. However, IDC believes that partnering will be key to market expansion in the SaaS ecosystem. Therefore, SaaS providers should build out their formal partner road maps and be as explicit as possible about the direction that partners can take to eliminate conflict.

To help companies work more efficiently with partners, salesforce.com introduced Salesforce to Salesforce, a new product offering that is designed to help salesforce.com customers share data such as leads, opportunities, and deals with their partner ecosystem, including resellers, distributors, suppliers, and so on. Salesforce to Salesforce is intended to help customers automate business processes inside and outside the organization.

One of the ways in which salesforce.com has also increased its ecosystem reliance is through the development of its online marketplace, AppExchange. Online marketplaces are becoming one of the devices that hubs can use to establish their position. Online marketplaces serve as a one-stop shopping experience for customers to gain access to a variety of IT goods and services. A marketplace functions as a virtual shopping mall and offers a way to increase customer "stickiness" by acting as a resource for future purchases. IDC believes the benefits of an online marketplace include:

- ☒ **Business process enablement.** With the ability to integrate multiple offerings and serve them as a single service to customers, online marketplaces offer an integrated way toward business process development/execution, which is often a problem for organizations.
- ☒ **Community.** Part of the appeal of an online marketplace is the sense of community where developers, partners, and customers can share successes and challenges in an open forum.

Salesforce.com's AppExchange was launched in January 2006 as an online marketplace to bring the same consumer experiences and technical advancements as eBay, Google, and Amazon.com to businesses. AppExchange gives customers,

developers, and partners the opportunity to become part of the emerging SaaS ecosystem to help solve specific customer pain points. AppExchange is a marketplace for salesforce.com-compatible applications to be uploaded, evaluated, reviewed, downloaded, and sold by salesforce.com customers, developers, and partners. AppExchange has grown to over 350 partners building 750 applications that are preintegrated with salesforce.com. In addition, over 100 industry-specific applications have been developed. According to the company, there have been hundreds of thousands of test drives, tens of thousands of installs, and hundreds of success stories.

AppExchange is built on the company's Force.com platform, which is based on salesforce.com's Apex Code. Apex Code, which is the core, publicly available building block of salesforce.com, is a Java-like language that allows developers to create custom applications that are stored and run off salesforce.com. Partners are also able to build native applications on salesforce.com, and Visualforce allows new user interfaces to be developed for any device to help ease access into customers' data. To download applications off AppExchange, a company has to be a current salesforce.com customer. The following are the four main solutions and pricing levels in the company's portfolio:

- ☒ **Group Edition.** Designed to enable small marketing teams to collaborate and manage customer relationships, Group Edition helps manage and track campaigns, manage leads, and monitor the progress of Google AdWords advertising campaigns. Group Edition costs \$600 a year for five users.
- ☒ **Professional Edition.** Targeted at companies of all sizes, but providing less functionality, customization, and integration capabilities than Enterprise Edition, Professional Edition includes applications for sales force automation (SFA), marketing automation, and customer service and support. It can be rapidly implemented and is priced at \$65 per user per month.
- ☒ **Enterprise Edition.** Enterprise Edition is a highly customizable solution that can support multiple divisions and processes, including workflow automation, product line forecasting, and revenue allocation. Intended for large companies, it is priced at \$125 per user per month.
- ☒ **Unlimited Edition.** For \$195 per user per month, enterprises have unlimited custom tabs and more custom objects available than what is included with other salesforce.com editions. The Sandbox developer environment and Platinum support are included in the price.

Salesforce.com also has the following offerings that are available at no cost:

- ☒ **Developer Edition.** Developer Edition is designed to allow developers to conduct integration testing and make additional customizations. It also includes access for two users.
- ☒ **Personal Edition.** Personal Edition is targeted at individual salespeople and offers contact and opportunity management functionality.

All AppExchange applications must be certified to ensure they meet salesforce.com's security standards and best practices. Certified applications receive primary placement on AppExchange and token access to Professional Edition accounts. The annual certification fee is \$5,000, and the certification process takes approximately 10–15 days. Salesforce.com conducts both qualitative (review of policies and procedures) and quantitative (network and application penetration tests) assessments of AppExchange applications.

CHALLENGES/OPPORTUNITIES

Salesforce.com has been a clear driving force behind the on-demand delivery model and has helped demonstrate that Web-enabled business applications based on a single multitenant infrastructure can be successful with both small and large customers. Since its founding in December 1999, salesforce.com has grown to 35,300 paying customers and 1 million subscribers and envisions that it is on its way to a billion-dollar run rate in its fiscal year 2009. In FY 2Q08, salesforce.com indicated that it had exceeded a \$700 million run rate. Clearly, salesforce.com has grown impressively by striking a balance between innovating for the future and staying close to what customers and partners need today.

With initial success in the small and medium-sized business (SMB) segment, the company has begun to penetrate the enterprise with a recent 61,000-seat deal signed by Japan Post. Its customer base also consists of Dell with a total of 40,000 subscribers, Citibank with 35,000 subscribers, Cisco with 30,000 subscribers, and Merrill Lynch with 25,000 subscribers. The company is estimated to have sold more than 100 deals with more than 1,000 seats in the past two years. However, salesforce.com will need to prove that it can penetrate beyond SFA in order to become a true platform provider.

The company has grown to be synonymous with the on-demand delivery model, and the AppExchange community has become an important go-to-market strategy for those building complementary applications. Salesforce.com has achieved its 750th AppExchange application, which demonstrates that the marketplace has obviously gained traction with numerous traditional and start-up companies deploying on-demand applications.

IDC believes that more companies will attempt to offer their own marketplaces as a competitive differentiator. Although these marketplaces could be seen as competing against one another, partners that join each marketplace theoretically can increase their reach by participating in more than one. It is not unrealistic to assume that as more online marketplaces, directories, and community sites develop in the SaaS ecosystem, companies would join multiple venues in order to expand awareness and gain mindshare.

The AppExchange represents one dimension of salesforce.com's growing ecosystem and future direction. Utilizing its Force.com platform, salesforce.com is encouraging and supporting the development of more on-demand applications, presenting partners with opportunities for differentiation and healthy competition in the SaaS ecosystem.

CONCLUSION

The SaaS ecosystem is an evolving network of participants and partners. Until recently, the majority of SaaS providers focused on direct sales efforts, which have been successful in terms of driving adoption and increasing revenue. However, IDC believes that partnering will be key to market expansion in the SaaS ecosystem. And although partnering relationships have been limited to date, many companies are evaluating their roles in the SaaS ecosystem, which will mean new relationships and business ventures.

One such opportunity for partners is through vehicles such as AppExchange. AppExchange partners have benefited from their relationships with salesforce.com in a variety of ways, but perhaps the most significant are in the form of market awareness and lead generation. Companies of all shapes and sizes from around the world continue to join the AppExchange. Salesforce.com currently has 24 Japanese ISVs offering applications through the marketplace. This demonstrates that salesforce.com not only has built an ecosystem in North America but also has begun to increase its international community reliance.

At the end of the day, many companies are looking to salesforce.com as a means to judge participation and economic opportunity in SaaS. Many are also looking to salesforce.com as a proxy for developing their own ecosystems, perhaps by creating their own platform offerings like Force.com. However, just as those companies are using salesforce.com as a guide, they are also looking at salesforce.com to learn from its challenges. It is certain that industry eyes will stay carefully focused on salesforce.com as it continues to build and expand its own ecosystem.

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