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Microsoft Business Solutions: Strategic Next Step or Misstep?

Application Delivery Strategies
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In December 2000, Microsoft entered the enterprise application market with the formation of its Microsoft Business Solutions (MBS) division, which was built from the acquisition of Great Plains Software and the subsequent acquisition of Navision in July 2002. The above notwithstanding, we believe that, during the next four years, Microsoft's entry into the midmarket will do little to change the dynamics of the midmarket enterprise application market, which will remain fragmented among numerous best-of-breed vendors.

META Trend: During 2003/04, Tier 1 ERP vendors will focus on the small and medium business (SMB) market, vertical extensions, and technology infrastructure. During 2004/05, vendor viability concerns will drive SMB ERP market consolidation as these vendors become increasingly threatened by Tier 1 vendors and Microsoft. By 2005/06, Tier 1 ERP vendors will leverage their application breadth and component architectures to reduce application complexity significantly.

To date, vendor selection for midmarket enterprise applications has had higher levels of risk because the market has been split among an array of segment-focused small vendors with limited scope and financial muscle. Recently, newly interested Tier 1 vendors are reaching out to midmarket customers but still trying to address issues around product, pricing, complexity, and distribution. Microsoft's foray into enterprise applications has been targeted specifically at small and medium businesses (SMBs - businesses with less than $1B in annual revenue). The blend of its enormous financial resources and competency with the reseller channel, along with an acquired product portfolio of products purpose-built for the segment, appears to have created the proverbial 800-pound gorilla that will finally provide SMB organizations a safe choice vendor.

However, on closer examination, Microsoft's enterprise application group, MBS, is in fact a small and unprofitable division of Microsoft, with a patchwork product portfolio of four overlapping ERP products, a CRM product on a separate code base, and a non-integrated channel (not to mention a small business accounting package that has failed to dent Intuit's segment dominance with Quickbooks). To address the lack of cohesion in product strategy, Microsoft has been selectively leaking information about Project Green, a revised single code base that will be built on top of the Microsoft business framework. Because Project Green is tied to the Longhorn release of Windows, nothing of substance will likely be seen until 2005/06. Although MBS has stated it will support the existing product set through 2013, it has neither articulated a clear product-by-product migration strategy nor a reason why four distinct product sets or brands need to remain. This confusion will continue through 2007, at which point Microsoft, focusing on broader strategic efforts, will elect to rationalize the product set as opposed to continuing with a phased consolidation approach.

To some extent, MBS is a means to an end for Microsoft. The strategic component of the enterprise application portfolio is the Microsoft Business Framework (MBF), which has two layers: a set of standard services designed to support processes within enterprise applications and a toolkit of common business objects with standard properties and methods. MBF, initially undertaken by Great Plains, has recently been moved into the server-and-tool division, which, at 12 times the revenue of

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MBS (and a 34% profit as opposed to MBS's loss of 44% of revenue), has the resources to support the 300 developers currently engaged on the project. As significant, moving MBF to server and tools represents a greater commitment to drive interest within the ISV and development community. Microsoft clearly recognized that garnering broad developer support for MBF is best handled by an organization whose success is intimately tied to this community, as opposed to one whose interests are often in direct conflict.

This is an important move for Microsoft, because it is now facing significant competitive pressures in the midmarket from both SAP and Oracle. These Tier 1 ERP vendors face diminishing new enterprise opportunities and, realizing the untapped potential of the midmarket, are putting substantial effort into this segment. Significantly for Microsoft, the success of these two vendors in this segment not only comes at the cost of lost application revenue, but also carries with it the potential marginalization of the .Net framework (via SAP's NetWeaver architecture and the Oracle Application Framework). In this light, Microsoft's attempt to push its platform objectives by now providing enterprise applications seems a natural defensive strategy.

The question of MBS's position in this strategy is put to the test when considered against IBM's moves in the midmarket. IBM's WebSphere Express product line for small and medium businesses creates a competitive alternative to current Microsoft development environments. It is a pre-emptive strike against Microsoft's .Net technology and will catalyze various application markets to effectively compete at the low end (see SIS Delta 1304). As important, IBM's clear strategy of avoiding any direct involvement in the enterprise application business, other than through partnerships (i.e., IBM's partnership with Siebel and Onyx to provide hosted CRM solutions to the midmarket), is essentially signaling a "will not compete" clause to the ISV community. To assure that MBS's existence is not mutually exclusive to Microsoft's strategic platform objectives, MBS must ultimately provide an application environment that both demonstrates the capabilities of the platform and provides new development opportunities. Creating this environment has been, and continues to be, a significant challenge for MBS.

Microsoft's initial acquisition of Great Plains also included Solomon (see Client Advisor 568). Segmenting these different code bases was based on customer size, with Great Plains eEnterprise being targeted at organizations with 500-5,000 employees, Great Plains Dynamics and Solomon targeted at organizations between 50-500, and Microsoft Small Business Manager for those below that mark. The strategy had to be discarded when Microsoft acquired Navision (see Client Advisor 672-5), a European-based ERP vendor that previously acquired another company, Damgaard (renamed to Axapta). Currently, MBS is segmenting these products across a complex intersection of industry, organization size, budget, and functional factors, which is more an effort at "marketing away complexity" as opposed to addressing it head on. With Project Green announced, MBS has put itself in a paradoxical situation of defending its current portfolio approach, while admitting that it is confused enough to require a single code base in the future but not yet articulating a migration strategy. MBS appears betwixt and between being a federation of product teams and a single-source supplier of enterprise applications, which means confusion about .Net investments for the development community. The fear for these developers is that they may end up competing directly with Microsoft at some point. This plays directly into the hands of IBM and undermines Microsoft's broader platform objectives. Furthermore, the confusion with its product portfolio does little to support MBS's financial objectives. In 2003, MBS lost $254M on revenues of $567M. More important, Microsoft's guidance of 24%-30% growth for 2004 falls well short of the 60% year-on-year growth needed to achieve Microsoft's goal of making MBS a $10 billion business by 2008. This is a scenario that would logically point to an acquisition strategy, yet this is no longer practical because it will only exacerbate an already convoluted product portfolio.

Through 2007, these dynamics will create real uncertainty around the MBS product portfolio. It is this uncertainty that negates its potential as the midmarket safe choice. Midmarket organizations do not necessarily increase their risk profile when looking at vendors like Epicor or Scala Systems (Scala has a single code base, well-thought-out integration with MS CRM, and a stated commitment to supporting MBF).

Business Impact: Current MBS prospects must factor the four-year Project Green unification

march as a key criterion in their purchasing decisions.

Bottom Line: Midmarket organizations must not automatically assume reduced risk with MBS as a strategic enterprise application supplier. MBS's product portfolio confusion will become rationalized by 2007.

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