

# CIO DECISIONS

ALIGNING I.T. AND BUSINESS IN THE MIDMARKET ENTERPRISE

# SAP

## COMES DOWN TO SIZE

THE GERMAN SOFTWARE GIANT—RENNED FOR ITS COMPLEXITY AND COST—IS MAKING SURPRISING INROADS AMONG SMALLER BUSINESSES. BY ELLEN O'BRIEN

**OK, LET'S GET** the ugly stuff out of the way. SAP is too big, too expensive, too complex, too robust, too rigid and yes, too German, with its Walldorf headquarters seemingly too far away for U.S. customers. That's what you still hear from some grizzled SAP users. ■ You can find guys who say their first marriages fell apart while they were logging hours during a global R/3 upgrade, reading complicated licensing agreements late into the night. They share a pain and a language unique to those who have entered into a relationship with the world's third largest independent software company: Does 5-1-2 help us out? Should we skip version 4.6c? What about Enterprise? And of course: What the hell is NetWeaver, anyway?

No doubt about it, SAP AG once had a reputation for finding itself in situations messier than melted chocolate. Yes, you can still find wisecracks who mention Hershey Foods in any conversation about SAP. It was 1999 when a CEO at the world-famous candymaker told analysts that trouble with his new enterprise software system would mean a scary Halloween for stockholders.

The fact, the fiction, the myth, the legend: SAP carried it all into the midmarket in 2003. That's when it set about the sizable task of recasting itself as the friendly giant, one strong enough to carry the workload of the largest global customers but flexible enough to fold into the smallest of shops.

Turns out SAP may have the last laugh. The punch line: It's working. Not only is Hershey's a customer reference these days, but a growing number of small and midsized shops are sweet on the notion that SAP—with \$10 billion in annual revenue, it's the established market leader in enterprise resource planning (ERP) software—has the clout and know-how to help them grow and compete in the new global economy.

The company that runs \$8.8-billion Adidas also takes care of business at well-known smaller companies like Jo-Ann Stores Inc., with annual revenue of less than \$2 billion; companies like Tumi Inc., a luggage maker aiming to beat the \$600-million mark with a European expansion plan; and changing companies like the Seattle Times Co., a newspaper business with less than \$500 million in revenue looking to tap new revenue streams. Even further down the food chain, SAP helped Soy Basics LLC, started by a guy with a little seed money and a recipe for making candles out of soybeans, grow rev-

and fewer than 2,500 employees. Is it winning every deal? No. Are customers who used to fear SAP's size and strength considering it? Yes. Does SAP have a huge advantage with small and midmarket customers who know that suppliers and buyers around the globe recognize SAP and have joined its developer and partner network? You bet.

"I'm able to open an office in Hong Kong in a day," says Jim Walsh, vice president of IT at Tumi, a company specializing in lightweight, durable travel bags for the jet-set crowd. It racked up \$200 million in sales last year and is betting its U.K. and Asia business will triple that number by 2008. Walsh, who earned his SAP stripes at Bruno Magli before arriving at Tumi in 2001, came on board just as the high-end luggage company was deciding on SAP. Tumi's IT topography includes a South Plainfield, N.J., headquarters; a New York City design center; a European and a U.S. distribution and repair center; offices in Hong Kong, Taipei and Taichung; 65 retail stores; and more than 1,000 dealers, such as Nordstrom, worldwide.

When Tumi purchased the full mySAP ERP suite (for a price Walsh won't disclose), the company had two primary goals: e-commerce and its U.K. expansion. It also had a growing list of concerns: too much inventory, a backlog of customer orders and no real-time visibility into revenue forecasts. Its legacy system wasn't up to the task, Walsh says, and there was a goal of shortening product-to-market cycle time after designers dreamed up patented Tumi features like its Fusion Z abrasion-proof fabric. Walsh oversaw the implementation of SAP modules for sales and distribution (SD), warehouse

## **"WE PAID A LOT OF MONEY FOR THIS SOFTWARE. ONE WAY WE CAN LEVERAGE IT IS TO USE IT AS RECOMMENDED."**

**—JIM WALSH, VP OF I.T., TUMI INC.**

enue from \$1 million to \$20 million in five years.

In June, SAP announced a milestone: It had 10,000 Business One customers, buyers of its preconfigured software for customers with fewer than 250 employees. By August the company had added another 800 to the list. Business One, however, is just part of SAP's strategy to win what it calls the small and midsized enterprise (SME) market. SAP also offers All-in-One, a collection of preconfigured, vertically designed software packages for companies with less than \$1 billion in annual revenue. Like the full-blown mySAP offering used by the world's largest companies, All-in-One packages are built around SAP's core R/3 architecture. Its chief selling points are that it's simplified and customized for the unique requirements of particular industries—from cosmetics to semiconductors. To date, SAP has acquired 8,300 All-in-One customers. And of course, the mySAP Business Suite, SAP's premier product, is one it aims to sell to any customer at the higher end of the small and medium-sized (SMB) space.

In fact, more than two-thirds of SAP's 34,600 global customers already fall into the midmarket, which SAP defines as any company with less than \$1 billion in annual revenue

management, materials management (MM), customer relationship management (CRM), business warehousing, production planning (PP) and financial/controllers (FI/CO).

"We went live, and everyone was waiting—waiting for something to go wrong," says Walsh. "Why? Because of stories you hear, because of a project of this magnitude. We were getting rid of a homegrown legacy system that always had a list of projects about six months long attached to it." And? "And nothing happened," Walsh says. Or actually, a lot happened, but all of it was planned, he says. "We shipped orders that first day."

Currently running one ERP instance, Tumi considered ERP providers other than SAP—but SAP had a blueprint for European expansion and a set of best practices that impressed Walsh.

"Our motto is that we paid a lot of money for this software, and we now need to leverage it—and the one way we can leverage it is to use it as recommended," says Walsh. "We did look at Hershey's," he adds. "What we learned is that you better keep your employee base fully trained, and you better support it."

Walsh was able to reduce inventory by 30% and move Tumi's primary warehouse to a smaller facility as a result—all while increasing sales and order volume by 25%. Like him, plenty of midmarket CIOs are choosing to spend more money on SAP than they might on a smaller player to get the benefits their growing midsized companies need: standardization across satellite branches or foreign distribution centers, reduction in warehouse costs, and greater visibility into supply chains.

Begrudgingly, warily or bravely, midmarket CIOs are more willing than ever to give SAP a seat at the table.

### THE SIZE STIGMA

"I'm either confident or crazy—and I've been called both," says Jon Nicolaisen, president and principal of Soy Basics LLC, a New Hampton, Iowa, manufacturer of Beanpod candles. His brother, employed at the Milwaukee-based SAP partner et alia, advised to him buy the full-blown mySAP and assured him that if his idea for biodegradable candles took off like wildfire, then \$300,000 worth of SAP software would be priceless. With six employees at the time, Nicolaisen was hardly a typical SAP customer.

"A lot of people don't even think about putting in SAP unless you have \$1 million in revenue," says Nicolaisen, an entrepreneur who had plenty of capital when he started. "A lot of that is just the stigma SAP has."

Bill McDermott knows what Nicolaisen means. He's president and CEO of SAP Americas, a division covering North and South America and Canada that brought in \$3.1 billion

or Oatmeal Cookie candles than they can sell.

"Honestly," says Nicolaisen, "I had my financial guy come in my office—it wasn't that long ago—and we were talking about the business, and we agreed that without SAP there is no way we could be doing the business we are doing. I mean, our SKUs—we have so many damned SKUs—you are talking about three brands, 2,000 SKUs and 6,000 retail customers." Soy Basics runs SAP modules for sales and distribution, manufacturing and financials.

"It's about real-time order fulfillment and inventory replenishment," he says. "We're not producing candles that we don't need. We were absolutely doing that before based on our own projections."

But what about SAP's reputation for requiring such enormous IT effort that it burns out even the biggest teams?

"You want to know something?" says Nicolaisen. "I was just down at that SAP ASUG thing [Americas' SAP Users' Group conference], and people are complaining about how it can be cumbersome. Now, I'm thinking to myself, 'I don't know what bitchin' about it is going to change.' Then I'm thinking, 'Why would it work great in one place and not in another?' I'll tell you why. They are cutting corners. We tried that once," says Nicolaisen. "We tried to force orders through the system because we didn't understand it. We tried to outsmart SAP. Well, don't do that. It's not going to work for you. You aren't smarter than SAP."

Make no mistake, not every mom-and-pop shop in the U.S. is prepared to open its checkbook for SAP. For one, a lot of smaller companies prefer niche players, the small

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in revenue last year and that cites the midmarket as its fastest-growing revenue base.

"We did encounter an image problem in the midmarket," says McDermott, who arrived at SAP Americas in 2002, after five CEOs had shuffled through in five years. "The neuro-association around SAP was that it's a real 'best platform' but [that] it's tailored mostly for large companies—that it might be more horsepower than a small or medium-sized company might need.

"No doubt about it," McDermott says. "Two years ago, it was a very different [client] meeting than it is today. Two years ago, I spent most of my time in these meetings working on changing people's minds. Now I can spend a few minutes. The rest of the meeting is really about how we are going to make them a best-run business."

Not so long ago, the idea that SAP could help a starting entrepreneur like Nicolaisen was laughable. Now, using what he likes to call a strong, Midwestern work ethic and SAP software, Nicolaisen is living the American dream.

Since March 2001, when sales of Soy Basics' Beanpod candles totaled less than \$1 million, the company has catapulted to \$20 million in annual sales of its soot-free soybean-based products. Nicolaisen credits SAP with helping him make sure his retailer customers don't get stuck with more Daisy

vertical-industry specialists who understand unique change-order processes and one-of-a-kind payroll quirks.

"We love going up against the big guys," says Gord Rawlins, who runs Toronto-based CMiC (Computer Methods International Corp.), just the sort of niche industry software vendor that SAP will have to beat out as it continues its All-in-One strategy of building what it calls "microvertical preconfigured solutions," designed with the help of hundreds of independent software vendors SAP has pulled into its SME web.

"We almost never see SAP," says Rawlins, whose company is targeting midmarket construction companies with less than 5,000 employees now that it has cornered many larger clients in the building industry. "One of the reasons that we don't see SAP, in my opinion, is that they don't try to think about software as project based. It's still very process based for them. And construction companies are all about managing projects. Oracle is a bigger challenge. Oracle is willing to say anything in the sales process. That's just my experience." (Oracle declined to comment for this article.) Certainly, SAP's two largest ERP competitors—Microsoft and Oracle—are doing everything possible to make sure smaller companies remain sufficiently afraid to open the door to SAP.

# SAP: A MARKET SNAPSHOT

**WHEN IT COMES** to less-than-large-enterprise customers, market share numbers can get confusing.

For starters, many vendors define small and midsize companies differently, and in some cases they've been known to cut data into the most appealing shapes.

SAP does not disclose revenue or percentage of sales related to deals with small and midsize enterprise (SME) customers, which it defines as companies with less than \$1 billion in annual revenue and fewer than 2,500 employees.

One way to follow SAP's progress in the SME market is to watch year-over-year sales of products geared specifically for smaller companies. For example, the preconfigured Business One package for companies with less than 250 employees now boasts 10,800 customers, which SAP says represents 54% growth over last year.

Larger midmarket companies also have a choice of the full-blown mySAP Business Suite or All-in-One, a vertical-specific package for SMEs that SAP developed with partners around the world.

## EXPANDING DIRECT SALES

SAP's sales strategy to attack the SME space has so far been a hybrid model that combines a strong reseller channel—including partnerships with companies like IBM and Hewlett-Packard—with the company's direct sales force. Now SAP Americas CEO Bill McDermott says, "We have to expand our direct channel. I think we have many customers who like working with SAP direct, whatever their reasons are."

But what about the "reseller is king" philosophy that persists in the midmarket?

"The point—and it goes against conventional thinking—is that the reseller is the problem in the midmarket," says Jim Shepherd, senior vice president at AMR Research. "Buyers who are interested in SAP software want to see an SAP person in the room. They want to know if something goes wrong, they can go to SAP direct—not Joe's Computers." Some smaller companies with numerous branches and satellite offices also find the local-reseller approach less appealing, Shepherd says.

SAP likes to compare its SME sales performance with its largest competitors—Oracle and Microsoft. When looking only at the largest vendors in the SME space, SAP says that it has 36% market share and estimates that Oracle has 24% to Microsoft's 23%, with Sage Software Inc. grabbing 17%.

But that snapshot looks only at SME customers currently using one of those four providers. That leaves out a lot of customers and plenty of unknowns. "The biggest competitor right now is none of the above," says Joshua Greenbaum, founder of Berkeley, Calif.-based Enterprise Application Consulting. "This is a deeply fragmented market. SMBs are fragmented by geography, by vertical industry. A lot of them aren't using any of the big three: Microsoft, Oracle or SAP." —e.o.

When it comes to Microsoft, SAP likes to talk about "co-competition" instead of competition as well as projects like Duet, the jointly developed interface between SAP and Microsoft Office. But it's not clear that this good-natured approach can continue.

"I've had a lot of trouble lately finding anyone at Microsoft to say anything kind about SAP," says Joshua Greenbaum, principal at Enterprise Application Consulting in Berkeley, Calif. "[CEO Steve] Ballmer made a big point at a Microsoft partner show in Boston, talking about how they threw SAP out of some deals. They showed a little movie about it. SAP bashing is a cottage industry at Microsoft—and not vice versa. I don't imagine for a Redmond second that could go on very long. The gloves will have to come off."

On the other hand, SAP and Oracle are constantly slugging it out, and McDermott says he considers it his job to "stay classy" when dealing with customers and the press.

"They [Oracle] will go to any length to try to create an illusion for the customer," McDermott says. "The biggest challenge by far is not getting caught up in the sincerity attack of the day," he says, referring to Oracle's assault on SAP's credibility. Last year the two got caught up in a public hissy fit over who had the best market research numbers regarding ROI; it came to a head when Oracle told *Wall Street Journal* readers in a full-page ad that SAP's customers were less profitable than their peers. (The one thing everyone outside the two companies agrees on is that tangible ROI for ERP customers can be a long time coming, and both companies struggle with customers who want fewer support and maintenance costs.)

AMR Research says that globally, SAP finished 2005 with more than twice the ERP revenue and market share of Oracle. In North America, recent estimates from Forrester Research put SAP's market share at about 38%, versus Oracle's 33%. (For more on the competitive landscape and SAP's midmarket sales strategy, see "SAP: A Market Snapshot," left.)

Both companies acknowledge that most of the midmarket remains untapped and that they must derive new license revenue from this coveted sector now that most large enterprises have chosen an ERP provider. But CIOs at smaller companies have plenty of choices among smaller vendors.

"When [potential] Business One customers go shopping, they will often times be comparing SAP's product to a Microsoft or NetSuite product," says analyst Sanjeev Aggarwal, who specializes in SMEs at the Boston-based Yankee Group.

SAP has an advantage, Aggarwal says, when it comes to selling Business One to customers that already run SAP at headquarters. (SAP says 150 of its 10,800 Business One customers are large-enterprise customers who deployed Business One at subsidiaries.)

"The other advantage—when compared to MS—is that Business One is an integrated set of functions. To do that with MS, you have to put [together] different pieces, various bolt-ons," says Aggarwal. "That means accounting, e-commerce and inventory management. To get all those functions in MS, you would have to buy a couple of different packages."

Other selling points, he says, are that Business One is not written in SAP's proprietary Advanced Business Application Programming (ABAP) language and that SAP has been aggressive about making acquisitions that add functionality to Business One. In July, for example, SAP acquired Praxis Software Solutions Inc. to add e-commerce and Web-based CRM technology.

Still, Aggarwal has some clients for whom SAP Business One isn't a first choice. "When a company has a very big mobile workforce, NetSuite has a better offering, I think, because they offer the on-demand model," says Aggarwal.

#### REALIZING THE BENEFITS

Founded in 1974 by five former IBMers, SAP currently has 34,600 global customers. (The acronym originally stood for the name Systeme, Anwendungen, Produkte in der Datenverarbeitung—which translates to Systems, Applications and Products in Data Processing.) By 2010, SAP has a goal to grow the worldwide customer base to 100,000 and to increase business in the SME segment from a current 30% of new orders to at least 40%.

Some of those new customers belong to the Wellborn Cabinet Inc. dealer network, a \$250-million, privately held

## AN SAP VETERAN SAYS, NO PAIN, NO GAIN

**CIO BILL YEAROUS** knows what an SAP implementation can cost. "You work hours like you wouldn't believe," says Yearous, vice president and CIO at the Seattle Times Co. "People probably work harder than they are ever going to work."

At the media company, Yearous started an SAP project with seven dedicated team members—and lost every one of them along the way. A few landed new jobs as a result of their SAP experience, but most were "burnout losses." And Yearous is OK with that. "It's actually been an unintended blessing," Yearous says. "We were able to bring in people who were accustomed to working in that SAP type of environment."

Yearous was brought aboard to ensure that the newspaper—which owns the entire mySAP Business Suite but, like many SAP users, has some unused modules sitting on the shelf—tapped the software for its full potential.

He is a CIO whose early experience with SAP led him to believe the software is worth the effort it requires. In 1994, Yearous saw SAP at work in a semiconductor company where he was director of IT. Then, in 2000, as a project manager at a \$270-million consumer goods company (specializing in fishing tackle), Yearous installed SAP in 14 locations in more than a dozen different countries.

"I was averaging about two to three hours of sleep a night" toward the close of the 18-month project, recalls Yearous. "There's just a lot to do. When you look at their deployment methodology, there's literally thousands of things to do." One surefire way to get in trouble, he says, is to devise your own workarounds. And Yearous disagrees with those who say that SAP is too rigid. "To cut a check, for example, typically they will have dozens of options. Where you get into trouble is trying to do something outside those best practices."

One of the chief complaints about an SAP implementation is that you need an Advanced Business Application Programming, or ABAP, developer on staff. (ABAP is a language invented by SAP.) At the privately held Seattle Times Co., Yearous discovered that one way to reduce the cost of SAP development work is to send a chunk of the ABAP work overseas for modules such as financial/controllers (FI/CO). "The resources in India are very

good and very competent in making FI/CO types of changes." But, he warns, you should not offshore any configuration work for less mature SAP modules—SAP's Human Capital Management, for one. "Then it's a disaster—you absolutely don't want to offshore that," Yearous says.

His goal in implementing SAP's HCM and finance modules—that means Organization Management/Personnel Administration (OM/PA), Time Management, (TM), Payroll and FI/CO—was to have an integrated system for the 2,000 people who were using 10 different application systems, all requiring unique interfaces. Right now, "Our direct savings comes from a reduction in maintenance contracts and those various hardware and software vendors," Yearous explains.

And SAP standardization has made financial reporting much simpler. "Before, we would have to pull information from multiple systems, and it was very labor-intensive to maintain these things year over year," he says. It has also improved the flow of information throughout the company. "Now we track information that we didn't have the ability to track, so that every employee can see what their vacation bank allowance is, what their sick allowance is, and they can electronically request vacation time."

Of course, there are perils to being an IT leader at a media outlet. In a May *Seattle Times* blog, technology and business writer Brier Dudley commented on the release of Duet, a joint Microsoft-SAP project that links SAP back-end systems with Microsoft Office front-end products. He wrote, "I'm crossing my fingers and hoping this newspaper uses Duet to add a Microsoft interface to its SAP expense management system. The SAP interface is so strange and awkward that I avoid doing my expenses for months, leaving my money in someone else's pocket."

Yearous concedes: "Even though I'm an SAP advocate, I would acknowledge that the interface is cumbersome" for new or occasional users. "If it's core to your job function, it's great. But to remember the commands when you only do it five or six times a year—like expenses—then you do hear some complaints," he says.

And on the company's potential move to Duet, he says, "That's something we might consider next year."—E.O.

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—BILL YEAROUS,  
THE SEATTLE TIMES CO.

custom cabinet-building company based in the southern Appalachian Mountains. Wellborn runs SAP's R/3 version 4.6C, implemented over 18 months more than a year ago at its Ashland, Ala., headquarters. CIO Stanley Ezzell had the job of encouraging hundreds of dealers from Salt Lake to Scranton to invest in Business One so that dealers could track product orders and purchases in ways that can save them and Wellborn time, money and warehouse space. After six months of effort, Ezzell's pitch to get dealers to invest about \$20,000 in SAP software has attracted a handful of participants.

Just as SAP has worked to remake its image as the 800-pound gorilla, Ezzell faced a challenge when he began explaining why Wellborn dealerships should buy into Business One. "We made it very clear up front: SAP Business One is not the Enterprise product. It doesn't have a lot of the German thoughts and processes in it. It was designed by people who knew the small companies," Ezzell says. "It has an SAP logo on it, but that's it."

Ezzell fielded lots of funky inquiries during the pre-sales pitches. "We actually had people ask, 'Are they going to show up in Mercedes and BMWs to implement it?'" he recalls, chuckling.

Ezzell says he had no qualms about recommending SAP functionality. "Our concerns weren't on the technology side," Ezzell says. "Our experience with SAP has been rock solid. It wasn't so much a selection process other than going through the heartache of wondering whether SAP was too big for going down to these dealerships. We were talking about putting SAP potentially in dealerships that were one-half-million-dollar companies."

Within two months, Ezzell says, one of the dealerships that installed Business One reported that it had reduced its cost of sales by 6%. "They are finding efficiencies in terms of bar-code scanning and visibility into warehouses."

A full-blown SAP implementation like midsized Wellborn did—that's R/3 with Visual Composer, SD, MM, PP, Project Systems, HR, payroll and FI/CO—is a project that never really ends, and you go into it half expecting to lose some IT staffers before the go-live celebration. In contrast, Ezzell says, his dealerships have been able to count 14 days for a start-to-finish implementation.

Since his SAP purchase, Wellborn has been able to support a 40% growth rate without adding too many people, says Ezzell. "One of the challenges in our industry right now is product proliferation. Consumers want a yellow door with a green cabinet. To be able to do that in a legacy system took three to four months. With SAP, we can do that in a weekend."

## **"IF YOU'RE ASKING ME WHETHER SAP FITS IN THE MIDMARKET, I THINK IT DOES, ABSOLUTELY."**

**—KEVIN STACK, CIO, JO-ANN STORES INC.**

### **NOVICES, DON'T TRY THIS AT HOME**

It's hard to find anyone who would disagree that SAP has made serious and impressive headway in the midmarket; it's also hard to find anyone who looks forward to an SAP installation. (See "An SAP Veteran Says, No Pain, No Gain".) Even fans of SAP will tell you that the software's capability—its power—is what can make you crazy. By way of comparison, there are something like 40,000 tables in SAP; old JD Edwards users will tell you they worked with about 2,000.

"It's always a painful implementation," says Kevin Stack, CIO at Jo-Ann Stores Inc., which has annual revenue of \$1.9 billion.

Stack, who arrived at the Hudson, Ohio-based fabric and sewing supplies retailer last year, now has the tough job of "un-customizing" the SAP modules currently in place.

"Jo-Ann Stores put in SAP, and in my mind they highly customized it to meet the business processes that were in place before," Stack says. "Now my job is to un-customize SAP and move us back to SAP functionality, and I know it will work."

Stack was formerly the acting CIO in an OfficeMax division and managed the installation of some mySAP modules there. Too many companies, he says, try workarounds for SAP once they see the size and scope of SAP's recommended best practices. The way to save money and achieve long-term ROI with SAP, says Stack, is to rewrite old business processes so they make sense in your new SAP framework. This means CIOs have to think about their businesses and IT goals in new, strategic ways. It's not always the simplest route, but it's the way to get results, he says. Stack is bullish on SAP and its potential to show bottom-line results for midsized businesses.

"If you're asking me whether SAP fits in the midmarket, I think it does, absolutely. What's important, in any market, large or small, is that the software is flexible," he says. "And SAP is capable of that." ■

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