RESEARCH NOTE

WHAT NETSUITE'S GROWTH MEANS FOR ERP

TRIMTAB CONSULTANTS
404-257-1000

NUCLEUS RESEARCH

THE BOTTOM LINE

Netsuite announced record revenues for 2013, with 34 percent growth over the previous year. This growth, along with the growing momentum of other cloud ERP vendors, shows decision makers across verticals are increasingly looking to the cloud to manage their business-critical transactions and data. Adoption of cloud ERP drives competitive advantage for companies by reducing initial and ongoing costs and driving greater value and agility over time.

THE ANNOUNCEMENT

On January 30, NetSuite announced operating results for its fourth quarter and fiscal year ending December 301, 2013, touting a 34 percent growth in revenues over 2012 and the fourth year in a row that NetSuite delivered accelerating revenue growth. NetSuite provides financial and ERP software in the cloud, as well as accounting, customer relationship management (CRM), professional services automation, HCM, and e-commerce modules that enable companies to manage most of their core business operations in a single cloud-based suite.

NetSuite's growth has been fueled by companies' increasing willingness to move ERP to the cloud as well as the company's investment in building out its partner channel and its broadening application footprint both organically and through acquisition (Nucleus Research *n164 - NetSuite brings ERP and HCM together*, October 2013). In its ongoing analysis of NetSuite customers, Nucleus has found they achieve rapid payback by automating processes, increasing productivity, and reducing or avoiding the IT costs traditionally associated with supporting an ERP solution.

WHY IT MATTERS

NetSuite's growth is not surprising given the clear ROI benefits of the cloud. As financial decisions makers have become more comfortable with cloud applications, other ERP vendors with compelling cloud solutions, such as Acumatica, FinancialForce, and Plex

Systems have gained considerable momentum, even in more traditional verticals such as manufacturing (where Plex specializes). Key benefits for cloud ERP deployments include lower initial and ongoing costs but also the ability to maximize value from the application over time.

In the traditional ERP world, companies had two choices: either dramatically change their business processes to align with the software, or customize the software to meet their needs. Once customized, traditional ERP applications began the evolution toward legacy systems: although customers were paying significant annual maintenance fees to access application upgrades and enhancements, those upgrades created significant internal disruption and cost, as upgrades required significant testing and rebuilds to avoid broken customizations. Organizations skip upgrades and other enhancements over time because of the cost and disruption associated with upgrades. In fact, Nucleus has found 90 percent of companies are not on the latest version of their core transactional applications.

This approach leads them to a situation where they're always below the value curve. Until they upgrade, they're not maximizing value from their investment in the application, and once they do, they're immediately behind as new advancements have been delivered that they can't afford to leverage (in the figure below, each $ represents a new upgrade investment).

THE TRADITIONAL ERP VALUE UPGRADE CURVE
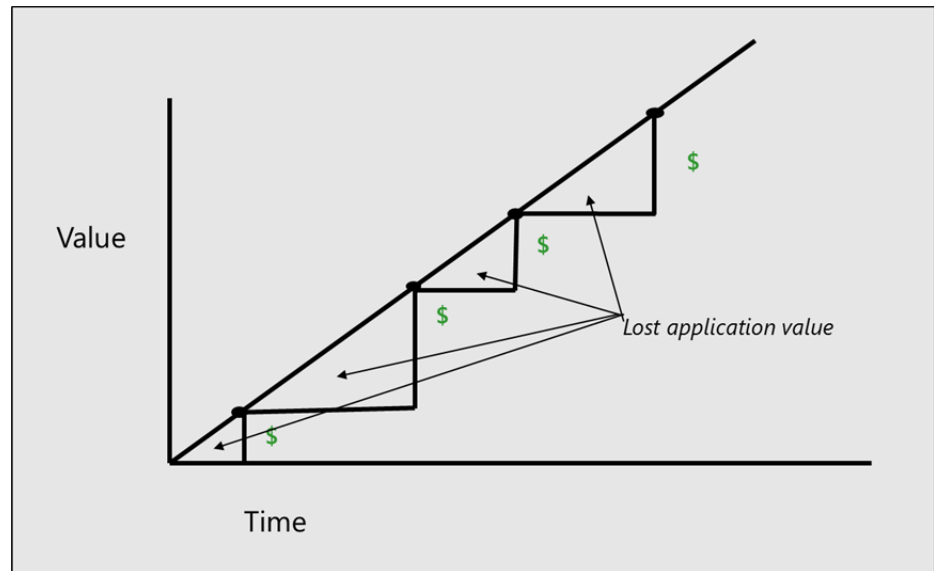
In contrast, cloud ERP applications are configured instead of being customized, and upgrades are more incremental, less costly, and less disruptive, enabling companies to stay on the value curve and maximize the returns from their investment on an ongoing basis. This has always been true of cloud applications; the difference today is that decision

makers are much more willing to consider entrusting their transactions and data to cloud applications in the enterprise.

WHAT HAS CHANGED

The arrival of cloud ERP players has changed the way financial decision makers think about their ERP monoliths for a couple of reasons:

- Increasing adoption of cloud ERP and other cloud applications have shown they have lower initial and ongoing costs than other applications and simply deliver better ROI (Nucleus Research *m108 - Cloud delivers 1.7 times more ROI*, September 2012).

- Cloud ERP adopters can take advantage of upgrades and enhancements, or change the configuration of their ERP instances, over time without the disruption associated with changes in a traditional on-premise ERP instance, so they can maximize value from their ERP investment. The demand for integration of emerging capabilities on the social, mobile, and big data fronts have made agility a more important application attribute.

- Other cloud applications in the consumer space have helped to educate both companies and individuals on the reliability, security, and availability for cloud applications.

- In general, decision makers have discovered that they have more options. As vendors have become more visibly accountable for their customers' deployment failures, and third-party support providers such as Rimini Street have shown customers they're not locked into maintenance contracts, buyers have more power over the lifetime of their engagement with a vendor.

- The lower switching costs associated with cloud applications, faster upgrade release cycles, and greater scrutiny of the return from traditional license maintenance investments have enabled smart decision makers to shift the ERP negotiation process.

Another big change has been the perception that one integrated ERP for all business management aspects was necessary. Microsoft and NetSuite, for example, started marketing the two-tier ERP strategy to larger customers that wanted a more manageable, less costly ERP to support subsidiaries a few years ago. That message has gained momentum, and as old monolithic ERP deployments have shown their age, organizations have started to look at edge applications – often in the cloud – that give them additional capabilities with the cost and flexibility of cloud solutions. In Nucleus's annual predictions, we predicted 2013 would be the year of the edge application (Nucleus Research *m148 - Nucleus top ten predictions for 2013*, November 2012). Moving forward, there's no technological or business reason why all accounting, production management, human resources, and customer management applications need to be delivered in one monolithic package when they can be integrated through the cloud.

THE CHALLENGE FOR TRADITIONAL ERP

The growing momentum of cloud ERP providers means traditional ERP vendors will both lose market share and see their maintenance revenues erode as organizations are more

aware of other options. A cloud message is not enough anymore. Vendors must be able to show that they've made the evolution to the cloud in terms of application delivery but also in terms of the ability to deliver increasing value, move toward configuration instead of customization, and justify any ongoing license investment, be it subscription or traditional maintenance fees. Today, the big players all have challenges and significant perceptions to change, although most have taken moves in the right direction:

- Oracle. Oracle continues to roll out its Fusion-based Cloud Financials, Cloud HCM, and other cloud business applications such as the Sales Cloud. However, like most traditional vendors, Oracle's big challenge has been in shifting its business and sales model to meet the demands of cloud application buyers (Nucleus Research *n97 - Cloud sales strategy 101 for Oracle*, June 2013).

- SAP. SAP's biggest successes in cloud to date have been with its acquisitions (SuccessFactors for HCM) and, of late, its cloud CRM offering.

- Microsoft. Microsoft is now delivering most of its ERP applications in the cloud, either on Azure or through partners.

- Infor. Infor is probably the most advanced of the traditional players, having not only moved much of its application portfolio to the cloud, but also delivered cloud options to help customers take advantage of the cloud for optimizing their on-premise deployments and potentially migrate part or all of their existing ERP footprint to the Infor cloud.

CONCLUSION

NetSuite's growing momentum is obviously a testament to NetSuite's ability to execute on its cloud ERP vision, but also a broader signal to the market that cloud ERP is an attractive and viable option that can provide competitive advantage, even for large enterprises. Nucleus expects most organizations will continue to have a combination of cloud and on-premise business applications for the foreseeable future. However, as legacy ERPs reach either end of life or an untenable support budget, companies will increasingly look to cloud applications as a way to not only lower initial and ongoing costs but have more flexibility to maximize value from their applications over time. As they do so, they will also be increasingly looking at the best application or module for their specific needs, making monolithic ERP a thing of the past.

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