



NEW RIVER _____
Marketing Research

**SMBs Offer the
Largest
Opportunity for
Linux and Open
Source: True or
False?**

December 2006

*New River Marketing Research
PO Box 1516
Concord, MA 01742
Telephone 978 793 1357
Fax 978 897 4804
www.newrivermarketingresearch.com*

SMBs Offer the Largest Opportunity for Linux and Open Source: True or False?

Introduction

In his paper, titled *The Yin and Yang of Open Source Commerce*¹ published in November 2005, John Terpstra², made the following observation: "The world is preoccupied with the need for Linux to achieve a dominant share of the high-end server market as the acid-test of being enterprise-ready. The mental assertion being that when Linux reaches maturity in the enterprise market place (500+ users per company) it will magically be ready for the market as a whole. This patently ignores the fact that small sites do not have the same complexity of needs as exists in the enterprise market."

Linux vendors such as Caldera, LinuxCare, Red Hat, SuSE, and Turbolinux, and others in the 1999 – 2001 period were all focused on gaining credibility in the enterprise market. Most vendors such as IBM, HP, Dell, Intel, and AMD, however, are aware that the bulk of profitable business is in the SMB market.

Terpstra says that among large companies such as HP, IBM, etc., the belief is that servers sold with Windows produce a higher per-unit revenue than if the same system were sold with Linux. As a result, it is not in the best interests of the major hardware vendors to actively promote the sale of business solutions that reduces overall revenue and at the same time antagonizes a major business partner, namely Microsoft.

Linux vendors tried to work with large vendors to capture large business opportunities with the intent to drive them toward commercial profitability. No one company was willing to actively promote a Linux platform solution to the SMB marketplace that would directly compete with Microsoft server-based solutions even if this could be demonstrated to be the most viable target market for a Linux initiative. The reason: Linux business units were creating tensions inside large IT vendors.

The determination of Linux vendors to "make it big" resulted in nearly all development budgets being spent on fulfilling the needs of the enterprise customer. As a result, today there are few, if any, Linux server solutions that are as simple to install as some of the Microsoft Windows servers and provide the same type of end-to-end business application solutions to the SMB market.

Terpstra says that after six or seven years of intense development, Linux is a viable alternative to the high-end UNIX platform. Reason: Linux operating system vendors wanted to break into the market. They decided to ride into the market on the coattails of the OEM hardware vendors. This automatically led the decision to target the enterprise market space, a move that made it necessary to position Linux against traditional UNIX offerings, but in markets they did not already serve. For example,

¹ <http://linuxplanet.com/linuxplanet/reviews/6062/1/>

² John Terpstra was CEO/President, PrimaStasys, is co-founder of Samba, was a development VP at Turbolinux, VP, Technology and OEM strategist, Caldera, Linux Evangelist, SCO, and contributed to the creation of UnitedLinux. He is currently employed at Intel and is considered a visionary in the open source community.

New River Marketing Research
PO Box 1516
Concord, MA 01742

Telephone 978 793 1357
Fax 978 897 4804
www.newrivermarketingresearch.com

SMBs Offer the Largest Opportunity for Linux and Open Source: True or False?

HP and IBM would rather capture UNIX business that was held by Sun than to displace their own UNIX business with a lower revenue Linux business solution. The Linux marketing strategies (and Linux business initiatives) were adopted to protect existing business units within these companies.

Terpstra argues that during 2003 – 2005, neither Red Hat nor SuSE specifically targeted the SMB marketplace with an office infrastructure solution. If Linux vendors had approached SMBs, they might have a powerful installation and management system. There were approximately 16 – 18 million Samba³ servers in 2005 of which about 11 million ran on Linux. The vast majority of Linux/Samba servers are in use in small businesses and in home networks. The enterprise Samba customer is more likely to use AIX, HP-UX, or Solaris. Terpstra says, "If Linux companies had focused on SMB markets, the operating system market share picture would look much better for Linux than it does today."

SMB Server Market

Gartner reports⁴ that Dell (because of its affordability), HP (because of its breadth of products and solutions), and Microsoft (because of its simplicity and ease of use) are the IT providers most cited as vendors that understand the unique requirements of the SMB market, and the majority of SMBs spend most of their IT dollars with Dell and Microsoft. In comparison, Cisco ranks 4th and IBM ranks 5th among SMBs in terms of IT dollars spent.

Server Installed Base by Company Size

Based on some research by Terpstra⁵, the installed server base in 2005 for various company sizes was as depicted in Table 1. Table 1 indicates that over 92% of installed servers are in SMBs.

Table 1. Server Installed Base by Company Size

Company Size	Global Number of Companies	Number of Servers	Percent of Total Servers	Percentages of Customers
Greater than 500 employees	50,035	3.9M	7.7%	0.18%
100 – 499 employees	329,336	4.68M	9.1%	1.16%
20 – 99 employees	2,541,245	9.9M	19.3%	9%
Less than 20 employees	25,451,655	32.7M	63.9%	89.7%
Total	28,372,771	51.2M	100%	100%

³ The Samba project is an Open Source/Free Software suite that provides seamless file and print services to SMB/CIFS (read Windows) clients.

⁴ *Dataquest Insight: What IT Providers Need to Know About SMB Infrastructures*, G00144321, October 2006, 12 pgs.

⁵ <http://linuxplanet.com/linuxplanet/reviews/6062/1/>

SMBs Offer the Largest Opportunity for Linux and Open Source: True or False?

SMB Server Installation Data

Small businesses that had a server said that they had an average of seven servers deployed on their site with two of them being appliances. Mid-sized businesses cited running, on average, 25 to 45 servers in their environments with approximately 10 of them appliances.

Approximately 13% of small businesses and 25% of mid-size businesses said that they are currently using server virtualization. Those SMBs that have implemented server virtualization said that they are reducing server count by approximately 20%. About 20% stated that they are using both VMware and Microsoft Virtual Server 2005. One-third said that they use Virtual Server 2005 only, and 30% said that they are using VMware only. About 15% of SMBs said that they are using open source solutions for virtualization (Gartner indicated that this number is higher than other indicators).

About 40% of servers deployed by SMBs are based on the Intel Pentium architecture. About 36% of SMB servers are using Intel Xeon as their processor. Also, about 8% of SMB servers are powered by AMD processors (lower than the overall market share for AMD servers). Most SMBs (nearly 60%) are using dual processor servers.

Dell is the most popular brand of server (about 67% share) used by North American SMBs, especially in the small business server segment with HP 2nd (approximately 20% share) and IBM 3rd (about 9.5%), and Sun 4th (2.7%). HP (25.7% share) and IBM (19% share) show more strength in the mid-market than in the small business market because they have a broader range of products and solutions in this market; however, Dell still dominates the mid-market segment with a 50% share while Sun has a 8% share.⁶

In terms of server shipments in the small market segment, Dell has a 52.7% share, HP, a 29.7% share, IBM, a 16% share, and Sun has a 1.4% share. In the mid-market segment, Dell has a 50% share, HP, a 32% share, IBM, a 10.5% share, and Sun, an 8% share.

According to Gartner more than 75% of North American SMBs have Windows 2003 Server deployed in their environments on nearly 50% of their servers. There are also a significant number of SMB servers running Windows 2000 Server. Approximately one-third of North American SMBs (mostly mid-sized SMBs) are running Linux, but on less than 10% of their servers. The primary functions being served by Linux systems continue to be with Web servers and database servers. Microsoft SQL is the primary database being used by North American mid-size businesses.

⁶ In *User Survey Analysis: SMB PC and Server Plans, North America, 2006*, G00144072, November 2006, Dell has a 55% share, HP has a 22% share, IBM has a 14% share, Sun has a 3% share, and White Box has a 6% share, 22 pgs.

SMBs Offer the Largest Opportunity for Linux and Open Source: True or False?

Gartner indicates that in small businesses Windows Server 2003 is run on about 54.3% of systems, Windows Server 2000 on 27.7%, Windows NT on 7.6%, Linux on 7.6%, NetWare on .7%, and Solaris on 1.5%. For mid-size businesses, Windows Server 2003 is run on about 47.7% of systems, Windows Server 2000 on 24.6%, Windows NT on 7.6%, Linux on 13%, NetWare on 4.6%, and Solaris on 3%.

Even though Linux has gained ground in the UNIX replacement market, would Linux have a larger share of the overall server operating system market, if the same level of effort had been expended at replacing Windows NT/9x/200x servers? This is one of several questions that we attempt to answer in this research.

Characteristics of the SMB Market

According to Pereira⁷, among SMBs, IT vendors tend to target the SMB market as if the two populations were one entity, but small businesses (SBs) act quite differently from midsize companies (MBs). IT buyers at small companies often are the owners themselves or even an office manager. They typically have no IT department. Small companies do not have deep pockets. They will not spend the money or time on training and do not realize what it costs them not to do so.

Mid-sized companies are more likely to have IT departments that do the purchasing. Microsoft tends to define midsize customers as having 25 to 500 employees.

About one-third of all infrastructures are sold at the time of application deployment. Given that, the influence that ISVs exert on what infrastructure is chosen by the customer is immense. And what solution providers are going to see a lot more of is ISVs trying to push their customers towards Linux and open source software. Microsoft has been moving into the SMB space with applications that compete with the ISVs. ISVs have discovered that they can make a compelling counter argument that TCO is a lot less when using the software running on open source software versus Microsoft applications running on top of Microsoft databases and related software. Most SMB customers are not deeply committed to SQL Server and all things .NET. Therefore, Microsoft has trouble selling the concept that .NET-based application stacks are less expensive to deploy than new open source infrastructure.

ISVs still have more clout with the typical SMB customer when it comes to the application server because customers remain more wedded to their application providers than they are to their software infrastructure vendor.

Bova at Gartner⁸ states the following:

- There are 80 million SMBs worldwide
- SMBs are spending \$400 billion this year

⁷ Pereira, Pedro. *Microsoft Divorces the S from MB in SMB Products*, July 2005.

⁸ Tiffani Bova, Gartner, *Understanding the SMB Opportunity*, 2006.

SMBs Offer the Largest Opportunity for Linux and Open Source: True or False?

- IT spending by SMBs will outpace that of larger enterprises through 2007
- SMB IT spending is growing at a 7% rate this year

Key Characteristics of the SMB Market

Bova says, "solution providers new to SMB space jump into it with the notion that, as enterprise-level providers, they have seen it all, and the SMB market cannot be nearly as difficult. Nothing could be farther from the truth." SMB decision makers are notoriously difficult to persuade. Before a solution provider invests in an SMB strategy, some basic characteristics of this market are worth noting:

- SMBs do not necessarily see themselves as small or midsize companies
- Their processes, in many cases, are not less complex than those of larger enterprises
- If solution providers can demonstrate a comprehensive knowledge of the primary processes, performance indications, challenges and opportunities that take into account these customers' unique resource challenges, they already have a leg up on the competition
- Solution providers must tailor products and marketing messages to specific targets in the overall SMB market
- Solution providers need to build a matrix consisting of head count, vertical and subvertical markets, geographies, and various resource constants and then look at its solution strength in conjunction with various market opportunities
- A business case can then be built justifying investments in specific market targets
- In 90% of the cases Gartner has monitored, a shot gun sales and marketing approach when entering the SMB market is tantamount to failure.

Key Recommendations for Entering the SMB Market

Gartner suggests key recommendations when entering the SMB market:

- Don't under estimate the challenges associated with doing business in the SMB market

*New River Marketing Research
PO Box 1516
Concord, MA 01742*

*Telephone 978 793 1357
Fax 978 897 4804
www.newrivermarketingresearch.com*

SMBs Offer the Largest Opportunity for Linux and Open Source: True or False?

- Seek out or try to leverage fast-growing markets
- Subdivide the SMB market into smaller markets, and understand the characteristics and buying preferences of target customers
- Understand overarching trends and how they will affect your go-to-market strategy
- Complement market leaders, don't compete with them
- Define and market your competing values
- Find ways to penetrate deeper within existing accounts
- Benchmark yourself continually against SMB discipline leaders
- Be conservative with respect to technologies

The key to success is having a well thought-out, focused, differentiated, and competitive value proposition. Without it, being successful in the SMB market is almost impossible. Identify weaknesses in your competition, align yourself with industry-leading vendors, understand the customer's needs intimately and constantly evaluate the question: "Why is my company relevant to its SMB customers?"

Other Characteristics of the SMB Market

- The SMB customer generally cannot afford to have a full time IT staff --- they rely on independent consultants and on contractors
- About one-third of this market has a favorite vendor (consultant or contractor) they call when there is a problem
- Little pro-active planning --- systems are added when needed
- Non-critical servers are in active service for five to eight years without significant upgrade
- Newer hardware is purchased for use in the most critical roles
- Consultants generally help specify hardware configurations and help SMB customers to make the purchases from a hardware vendor or reseller

*New River Marketing Research
PO Box 1516
Concord, MA 01742*

*Telephone 978 793 1357
Fax 978 897 4804
www.newrivermarketingresearch.com*

Y

SMBs Offer the Largest Opportunity for Linux and Open Source: True or False?

- VARs that sell to SMB are strong supporters of white boxes --- white boxes allow components to be hand selected to create the right machine that a customer demands
- VARs and consultants send their customers to white box vendors because they sell a low cost product
- SMB customers are likely to purchase 30 – 60 days from first request/contact and want the solution to be deployed within 14 days of confirmation of order
- SMB customers who have had bad experiences tend to whine/grumble at VARs
- Most VARs install Microsoft software because they do not have time to learn Linux
- VARs mostly sell solutions following being invited to a vendor demo of how the software works
- It will take time to convert the SMB market to focus on Linux --- we need to convince the VAR that he can do more profitable business with Linux --- one way to do this is to demonstrate the glowing value of Linux
- Channel conflict is the kiss of death on trust

Summary

This paper is one in a sequence that looks at SMB as an important market segment for Linux and open source. The big question here is did Linux vendors make a mistake by targeting the larger enterprises versus going after the SMBs. There are other questions as well such as "How can Linux vendors attack the SMB market after Microsoft has dominated this market for several years, and Linux vendors have basically ignored it except in a few instances such as Novell (as well as Caldera) in the retail segment and in software stacks for file/print and Web application/database serving markets?"