

MarketLine Case Study

# salesforce.com, inc.

The world's most innovative  
company?

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# OVERVIEW

## Catalyst

salesforce.com, inc. (Salesforce) was founded in 1999 and is based in San Francisco, California. Salesforce develops and sells customer relationship management systems (CRM) to businesses of all sizes worldwide. Its applications help companies record, track, manage, analyze and share information regarding sales, customer service and support, and marketing operations. In 2011, Forbes named Salesforce 'the world's most innovative company' and in September 2012, the company won the award for a second consecutive year. This case study explores what has made Salesforce the most innovative company in the world and the problems its faces.

## Summary

- salesforce.com, inc. (Salesforce) was founded by Marc Benioff in 1999 in San Francisco and the following year launched its first online sales force automation solution aimed at the customer relationship management (CRM) application market. The company launched its first online CRM app encompassing sales force automation, marketing automation, and customer service and support in 2001. In 2002, the company launched three new products: enterprise edition, offline edition and e-business suite and two years later, Salesforce undertook an IPO, raising \$110m (\$11 per share) with some high profile individuals from the tech industry, such as Oracle CEO Larry Ellison and CNET founder Halsey Minor among the early investors. The company has since gone on to become the world's most prominent enterprise software company and was named the world's most innovative company by Forbes in 2011 and 2012.
- In 2011, Forbes awarded Salesforce the title of 'The world's most innovative company,' citing the company's unwavering commitment to innovation and its willingness to take risks by acquiring companies that it feels will allow Salesforce to expand into a new area of operation or whose own activities will complement those of Salesforce and help it advance. The company demonstrated its ongoing program of innovation by winning the award (resoundingly) for a second consecutive year in 2012, a year during which Salesforce significantly strengthened its position within the increasingly important field of social media monitoring via the acquisitions of Radian6 and Buddy Media. These two companies now form the backbone of Salesforce's new Marketing Cloud.
- Salesforce has undoubtedly established itself as the CRM application provider of choice for a host of large companies and has branched out in to, and pioneered, new applications. This has seen the company grow significantly in size, both in terms of employees and revenues. However, its relentless drive for innovation and new applications has not come without problems. Despite revenue growth in recent years, the company posted its first loss since becoming publically traded in 2004 and it is also struggling to vary its revenue model, both operationally and geographically.

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# SALESFORCE: A HISTORY

salesforce.com, inc. (Salesforce) was founded by Marc Benioff in 1999 in San Francisco and the following year launched its first online sales force automation solution aimed at the customer relationship management (CRM) application market. The company launched its first online CRM encompassing sales force automation, marketing automation, and customer service and support in 2001. In 2002, the company launched three new products: enterprise edition, offline edition and e-business suite and two years later, Salesforce undertook an IPO, raising \$110m (\$11 per share) with some high profile individuals from the tech industry, such as Oracle CEO Larry Ellison and CNET founder Halsey Minor among the early investors. The company has since gone on to become the world's most prominent enterprise software company and was named the world's most innovative company by Forbes in 2011 and 2012.

## Salesforce provides innovative solutions for enterprise

Marc Benioff, a former Oracle executive, founded Salesforce in 1999 with a bold vision for what it called 'The End of Software.' Salesforce was founded as a company specializing in, and in fact pioneering, software as a service (SaaS) and sought to exploit the opportunities the Internet afforded companies in terms of recording, tracking, managing, analyzing and sharing information regarding sales, customer service and support, and marketing operations via CRM systems. The company launched its first online CRM application in 2001 and has since expanded to become a global player with service offerings across a diverse range of business areas, including: mobile, fleet management, call centers and social media listening. Salesforce has not achieved all of this growth and service expansion organically. Since its successful IPO in 2004, the company has embarked on an aggressive and fruitful program of acquisition and partnerships to aid its quest to become the leading provider of cloud-based enterprise solutions.

### Salesforce: The Early Years

Salesforce was incorporated in 1999 and in the following year, the company launched its first online sales force automation solution aimed at the CRM application market. In the same year, the company established a Japanese joint venture, Kabushiki Kaisha Salesforce.com, with SunBridge, a Japanese tech company, to assist the company with its sales efforts in Japan.

In 2001, the company launched its first online CRM application encompassing sales automation, marketing automation, and customer service and support. Its cloud-based solution eliminated, or at the very least significantly reduced the need for its clients to use costly servers and so instantly proved popular with companies looking to cut spiraling IT costs. In 2002, the company launched three new products: Enterprise Edition, Offline Edition and e-business suite. Enterprise Edition targeted larger organizations with complex structures and provided enhanced CRM functionality. Offline Edition enabled users to view and update customer and prospect information offline, while experiencing the same easy-to-use interface as the online applications. The company's e-business suite was announced as the first online CRM solution with full back-office integration and visibility, allowing enterprises complete insight into all customer interactions, including orders, invoices, and agreements, making Salesforce the first company to deliver an online, 360-degree view of enterprise customers. Such innovation has allowed the company be the first to market and thus provided the foundation for its success and helped it establish a reputation as a pioneer.

In 2003, the company entered into a strategic partnership with TIBCO Software to offer subscription-based integration between Salesforce.com S3 and enterprise applications. The company then launched its AppExchange and the Apex development platform. AppExchange is Salesforce's cloud computing marketplace through which end-users can access, download and install software apps. AppExchange offers both free and paid apps organized into collections, categories and industry solutions that encompass a variety of fields, including small business, customer service, education, manufacturing and real estate. The AppExchange again showcased Salesforce's innovative approach and commitment to developing new solutions to longstanding business challenges as it became the first public directory of its kind.

Salesforce's innovative approach and CRM systems allowed companies to easily collate valuable information on their customers, information that they were then able to use to track sales, track potential clients and produce more targeted marketing campaigns.

Salesforce was the first service that allowed companies to do this via one, integrated platform and this helped the company attract a number of blue-chip clients including: Le Meridien, Siemens, Bohler-Uddeholm, Textron Fastening Systems, Adobe, and Fujitsu. According to a report issued by Morgan Stanley, more companies chose Salesforce for their CRM solution than any other vendor, including Siebel Systems, between 2000 and 2002.

The company had firmly established itself as the CRM system provider of choice, but was now ready for the next phase of development. In order to progress to this stage, an injection of capital was required.

## **Salesforce's IPO**

In June 2004, one month later than originally expected, the company launched its IPO on the New York stock exchange using the ticker CRM. 10 million shares of Salesforce stock were priced overnight at \$11, well above the initially planned range, meaning that the sale translated in to a \$110m capital injection for the company. On its first day of trading, the stock quickly appreciated, selling at over \$15 for most of the day before closing at \$17.20. This represented a first-day gain of over 55%.

The company's IPO had been a success but the process had not been without problems. The offering had been scheduled to take place in May 2004, but was postponed after a New York Times article, which followed Benioff for a day and featured a lengthy profile on the company's founder, was deemed to have violated SEC regulations which stipulate a so-called 'quiet period' prior to such a share offering. Nonetheless, the offering provided the capital injection the company had been seeking to help it expand and progress.

## **2005-present: growth driven by development and acquisition**

In 2005, the company formed a strategic partnership with KDDI to offer on-demand mobile CRM solutions for the Japanese market, strengthening its offering and position in a key Asian market.

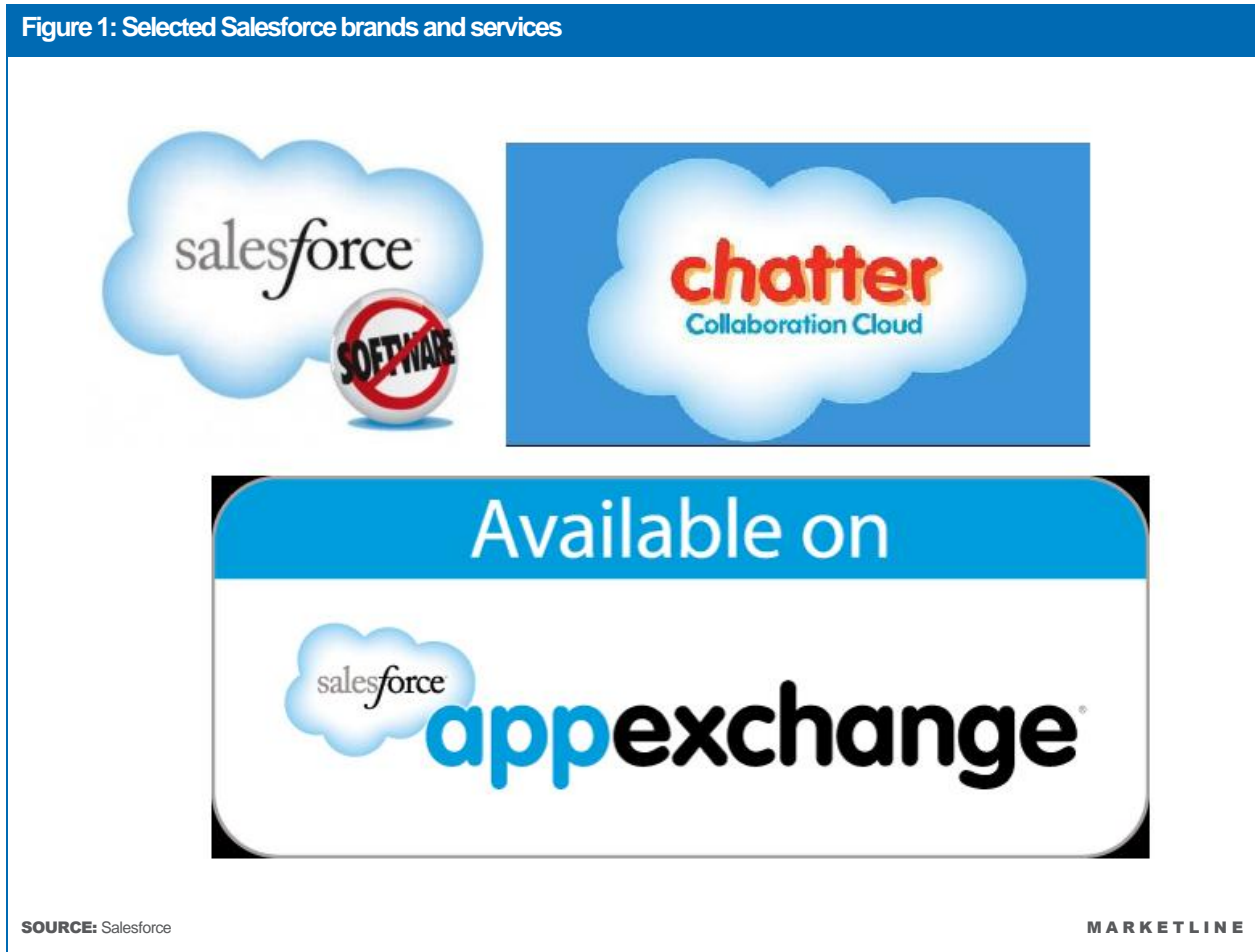
In 2006, the company embarked on a long acquisition trail when it bought Sendia Corp., a privately-held on-demand wireless application, for a cash consideration of \$15m. This purchase was aimed at broadening the appeal of the company's revolutionary AppExchange via wireless access to enterprise applications on most mobile devices. At the time of the deal, only 60 of the AppExchange's 209 apps were mobile-ready. The expertise provided by Sendia allowed the company to significantly increase this offering and in November 2011, Salesforce launched AppExchange Mobile, a marketplace for the Mobile Enterprise. The company sees this as a crucial future development strategy as mobile devices have become what it calls 'the main method for consuming information' and they are quickly becoming the main method for interacting with enterprise applications.

In 2007, Adobe Systems and Salesforce.com together launched the Adobe Flex Toolkit for Apex, a set of programming tools, which combines the capabilities of Flex and the company's Apex platform to create internet business applications. During the same year, the company and Google formed a strategic global alliance to launch Salesforce Group Edition featuring Google AdWords, which integrates Salesforce on-demand CRM applications with the Google AdWords platform to achieve integrated sales and marketing success. Subsequently, the company launched Force.com, an on-demand platform which was the world's first platform-as-a-service (PaaS).

In 2008, the company launched Force.com Development-as-a-Service, the world's first developer tools for using PaaS. It also launched the Force.com Toolkit for Adobe AIR and Flex, a new set of tools and services to enable development of rich internet applications on Salesforce.com's Force.com platform. Later that year, Salesforce.com and Datasul, a Brazilian provider of integrated management software solutions, jointly launched the Datasul Fleet Management solution, an app which allows fleet operators to track and manage fleet costs. In the same year, Salesforce.com and Google expanded their global strategic alliance to make it easy for companies of all sizes to run their business in the cloud with Salesforce for Google Apps.

During the year, Salesforce.com became the first publicly traded SaaS vendor to receive the prestigious ISO/IEC 27001:2005 Security Certification (ISO 27001), cementing its status as a market leader in all aspects of its business.

Subsequently, the company started building its first international data center in Singapore and launched Salesforce CRM and Force.com platform applications for iPhone on Apple's App Store, further strengthening its mobile offering.



In the same year, the company acquired InStranet, a provider of knowledge management technology for business to consumer (B2C) call centers.

Salesforce.com and Glovia International, a subsidiary of Fujitsu and a provider of extended enterprise resource planning (ERP) solutions, launched glovia.com Order Management on Force.com, a sales process management tool. Salesforce also started offering Force.com for Amazon web services to extend the power of cloud computing to more enterprises. Subsequently, Salesforce unveiled Force.com Sites, a new capability of the Force.com platform, which allows customers to run their web sites in Salesforce's cloud.

Also in 2008, Cathedral Partners teamed with Salesforce.com and Appirio, a partner of Salesforce.com, to develop an on-demand customer marketplace, which connects buyers, sellers and advisers of privately-held companies.

In 2009, Ingres, a provider of open source database management software and support services, deployed Salesforce CRM to support its global business growth and Fair Isaac, a provider of analytics and decision management technology, selected the company's service cloud for further customer collaboration and empowerment through an online community. Later the same year, RehabCare Group selected the Force.com platform to build a custom healthcare application to run on its staff's Apple iPhones. This illustrated Salesforce's status as the software and platform of choice for a wide range of applications.

In the same month, the company introduced Salesforce CRM for Twitter, which enables companies to search, monitor and join conversations taking place on Twitter directly in the service cloud.



Later in 2009, the company launched Mobile Lite, a free mobile offering, which provides customers with instant access to Salesforce CRM from anywhere, and was available for Apple iPhone, BlackBerry and Windows Mobile devices.

In mid-2009, the company opened its new data center in Singapore to support its growing presence in Asia, a key growth market for the company. In the same period, the company invested in Practice Fusion, a provider of free, web-based physician practice applications.

In the same year, Salesforce joined forces with Unit 4 Agresso, the parent company of financial software specialist CODA, to form FinancialForce.com, a new company that delivers finance and accounting applications. In the next month, the company partnered with Cisco to offer a complete contact center in the cloud, integrating Salesforce's Service Cloud 2 with Cisco Unified Communications. Subsequently, Dell and Salesforce together launched Dell-Salesforce.com solutions, which offers CRM applications through the cloud for small and medium enterprises (SMEs).

In 2009, Salesforce.com unveiled Salesforce Chatter, a secure enterprise collaboration application and social development platform that allows companies to collaborate in real time with a secure, private social network for their business. This application is central to the company's vision of the 'social enterprise.' Chatter serves as a social network inside companies, allowing co-workers to update groups on projects and deals, solicit comments and initiate conversations within the office and Benioff sees this as the next progression for social media.

In 2010, Salesforce.com launched Spring'10, its new generation release with new features across the Sales Cloud 2, Service Cloud 2 and Force.com. During the same year, the company introduced Force.com Visual Process Manager, a capability of the Force.com platform which enables companies to design and deploy business processes inside their applications, without software. Subsequently, Salesforce.com and VMware formed a strategic alliance to jointly deliver, sell and support a new enterprise Java cloud called VMforce.

Later in 2010, the company completed the acquisition of Jigsaw, a privately-held leader in crowd-sourced data services based in San Mateo, California. This acquisition allowed for a strategic entry into the \$3bn cloud-based, business contact data services market. During the same period, Fujitsu and Salesforce expanded their global partnership to help companies deploy cloud computing.

In January 2011, the company completed the acquisition of real-time communication technologies provider Dimdim for approximately \$31m. Founded in 2007, Dimdim provides critical real-time communication technologies such as presence, messaging and screen sharing, meaning that the acquisition allowed Salesforce to enhance its offering.

The company unveiled Service Cloud 3, the next generation of social contact centers in March 2011, once again proving its commitment to constant innovation and development. In the same month, Intuit and Salesforce.com formed a strategic alliance that will make it easier for several small businesses to manage customer information alongside their financial data.

In May 2011, the company completed the acquisition of Radian6, a social media monitoring platform. Radian6's technology captures conversations every day across Facebook, Twitter, YouTube, LinkedIn, blogs and online communities. The intelligence gained from these conversations helps companies to better market and sell to prospects, serve customers and also understand customer perception of the company's brands, products and its competitors. This is a vital tool for modern businesses and so provides Salesforce with a major selling point.

The company entered into a definitive agreement to acquire Model Metrics, a mobile and social cloud consulting services company in November 2011. With this acquisition Salesforce added mobile and social expertise, allowing the company to further transform customers and empower its global partner ecosystem. Also, in the same month, VisiStat, a cloud-based web analytics company that provides key business insights for small/medium businesses and enterprises, announced its integration with Salesforce, enabling users to import leads generated by VisiStat's LeadCaster solution directly into Salesforce.com.

In December 2011, the company further enhanced its offering when it signed a definitive agreement to acquire Rypple, a web-based social performance management software provider. With this acquisition Salesforce will enter into the human capital management (HCM) market for the social enterprise.

In the same month, Salesforce.com in partnership with NTT Communications, which provides a broad range of global networks, management solutions and IT services to customers worldwide, together launched the Tokyo data center. The Tokyo data center will support adoption of Salesforce's social enterprise services among the company's growing customer base across key markets in Asia.

Later the same month, Dell expanded its partnership with salesforce.com to deliver a comprehensive, integrated CRM solution by integrating the Salesforce Sales Cloud and Service Cloud to a variety of back office applications including finance, order management, and billing software using Dell Boomi. The expanded solution helps growing businesses connect with their customers faster and become more responsive across channels.

The company's commitment to, and investment in, innovation, coupled with this series of strategic partnerships and acquisitions had made the company for a leading candidate for companies looking for enterprise solutions and given it a foothold in many markets.

# THE WORLD'S MOST INNOVATIVE COMPANY

In 2011, Forbes awarded Salesforce the title of 'The world's most innovative company,' citing the company's unwavering commitment to innovation and its willingness to take risks by acquiring companies that it believes will allow Salesforce to expand in to a new area of operation or whose own activities will complement those of Salesforce and help it advance. The company demonstrated its ongoing program of innovation by winning the award (resoundingly) for a second consecutive year in 2012, a year during which Salesforce significantly strengthened its position within the increasingly important field of social media monitoring via the acquisitions of Radian6 and Buddy Media. These two companies now form the backbone of Salesforce's new Marketing Cloud.

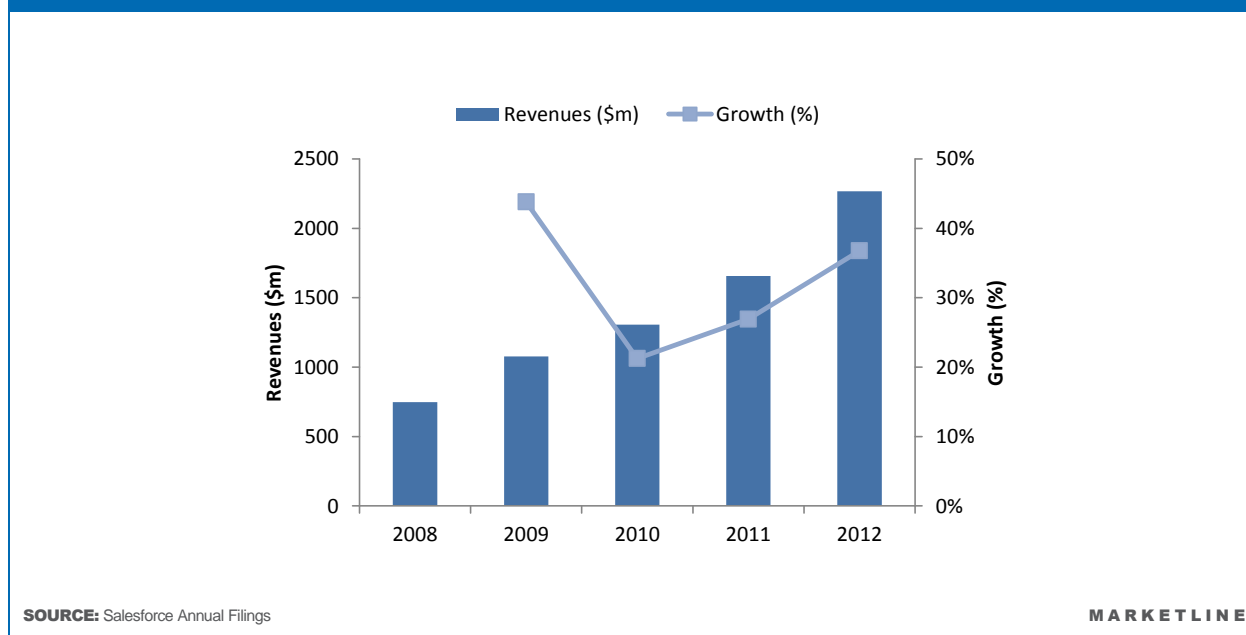
## Salesforce sees innovation as a continuum

Since its inception, Salesforce has developed, improved and expanded its service offering. When the company was formed and announced that its mission was to bring business software to the Web, it was widely derided as a company and a concept doomed to failure. Salesforce has proved the doubters wrong and grown to a business with annual revenues of over \$2bn and given Marc Benioff the status as the world's leading innovators. In short, it has revolutionized the world of software with its cloud-based solution. The company however refuses to stand still, instead seeing innovation as a continuum with no defined end destination. This explains the company's continued investment in innovative solutions and moves into new areas, particularly in the field of social media.

## Pioneering software as a service (SaaS)

When, at the turn of the millennium, Marc Benioff advocated the idea of software as a service (SaaS), stating that his company's vision was for 'the end of software' it was derided as a concept that would never take off. The idea was for a new software delivery model in which software and associated data are centrally hosted on the cloud. The service is then typically accessed by users using a thin client via a web browser. The appeal of the system is that it removes the need for the customer to have costly, high-maintenance servers on-site, reducing IT support costs by outsourcing hardware and software maintenance and support to the SaaS provider. This makes the service appealing to large companies and providers that execute it well, like Salesforce, have reaped the benefits. Once a ridiculed idea, SaaS has become the delivery model of choice for many business applications, most notably accounting, collaboration, customer relationship management, management information systems, enterprise resource planning (ERP), invoicing, human resource management, content management and service desk management. The growth and acceptance of SaaS has helped Salesforce consistently grow revenues year-on-year to become a \$2bn+ turnover business in 2012.

Figure 2: salesforce.com, inc revenues (\$m) 2008-2012



## Acquisition and partnership as means of obtaining intellectual property

One of the key strategies adopted by Salesforce since 2006 has been to acquire or partner with companies that operate in areas in which Salesforce has little or no expertise. The company has realized that trying to expand into new areas organically would be both costly and time-consuming and so where it makes sense, it has opted to purchase existing tech firms, or form bi-lateral partnerships that allow it to benefit from the knowhow of companies such as Adobe, Dell and Fujitsu.

In 2006, the company made its first acquisition when it bought Sendia Corp., a privately-held on-demand wireless application, for a cash consideration of \$15m. This purchase was aimed at broadening the appeal of the company's revolutionary AppExchange via wireless access to enterprise applications on most mobile devices. At the time of the deal, only 60 of the AppExchange's 209 apps were mobile-ready. The expertise provided by Sendia allowed the company to significantly increase this offering and in November 2011, Salesforce launched AppExchange Mobile, a marketplace for the Mobile Enterprise. The Sendia deal demonstrated Salesforce management's understanding of when an acquisition was the correct way of expanding its offering to include new innovations and this is a strategy they have repeatedly adopted ever since.

Consequently, it is fair to conclude that the company constantly adapts its innovation strategy and this has never been more apparent than in the foundation of its new Marketing Cloud.

## The Marketing Cloud

In May 2011, the company completed the acquisition of Radian6, a Canadian social media monitoring platform. Radian6's technology captures conversations every day across Facebook, Twitter, YouTube, LinkedIn, blogs and online communities. The intelligence gained from these conversations helps companies to better market and sell to prospects, serve customers and also understand customer perception of the company's brands, products and its competitors. This is a vital tool for modern businesses and so provides Salesforce with a major selling point, particularly when one considers the number of people now accessing such social media sites. For example, Facebook has 1 billion active users and Twitter boasts 500 million registered users. These large numbers demonstrate the impact that effective social media listening and engagement can have if properly exploited and this is exactly what the Salesforce Marketing Cloud is aimed at achieving.

In June 2012, Salesforce announced that it had reached an agreement to acquire Buddy Media for \$689m.

This huge outlay, \$467m of which came in the form of cash, demonstrates Salesforce's firm belief in social media as a huge area of opportunity.

Buddy Media develops apps for social media sites such as Facebook and MySpace and enables brands to build, promote and monetize applications across social media. Bloor analyst Gerry Brown states that 'BuddyMedia, in particular, provides Salesforce with some great enterprise technology, as it enables segmentation and targeting of social media users by sentiment, age, location, emotion and intention,' all of which is invaluable information to companies looking to roll out targeted market campaigns. This expertise fits perfectly with the company's vision for a holistic marketing service in the cloud and since their respective takeovers, both Buddy Media and Radian6 have been combined to form the new Salesforce Marketing Cloud.

The Salesforce Marketing Cloud was launched amid great fanfare at Salesforce's annual Dreamforce conference in September 2012. The Marketing Cloud would seem to be a bad sign for some marketing app vendors such as Marketo, Silverpop, Eloqua and ExactTarget, who have focused their efforts on integrating their SaaS Cloud software with Salesforce's cloud platforms. According to Gerry Brown 'the start point for B2B marketing automation projects is nearly always to access and integrate the client's valuable CRM data, which is most often held within the Salesforce cloud.' If Salesforce is able to offer a complete, integrated marketing solution through its own cloud platform, third party apps risk becoming redundant. In this way, the Marketing Cloud is therefore part of Salesforce's strategy to fill out its own social platform product portfolio.

The Marketing Cloud once again showcases Salesforce's innovative approach and its striving to pioneer new ideas and applications.

Salesforce claims that the Marketing Cloud is 'the only unified social marketing suite' and although this strapline creates what Brown describes as 'an uneasy truce' between the company and marketing applications vendors, Salesforce is so strongly convinced that its integrated approach is the way forward that it is prepared to risk its relationships with third party app vendors.

**Figure 3: Salesforce Marketing Cloud**



SOURCE: Salesforce

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## The world's most innovative company

The Marketing Cloud is just the latest example of a Salesforce innovation revolutionizing and altering accepted wisdom within a particular field. The company started by pioneering SaaS with its CRM in the cloud solution and has not looked back since. Marc Benioff states that 'innovation is a continuum. You have to think about how the world is evolving and transforming. Are you part of the continuum?'

This belief is central to Salesforce's modus operandi and its fear of being left behind means that it is not only part of the continuum, but in its vanguard. This has been recognized by Forbes Magazine, which bestowed the title of 'The World's Most Innovative Company' upon Salesforce in both 2011 and 2012.

Compared to some of the other companies that feature high in the list, Salesforce has a low enterprise value. For example, Apple (5<sup>th</sup>) and Google (7<sup>th</sup>) had enterprise values of \$303.4bn and \$138.1bn respectively as of October 15<sup>th</sup> 2012, both of which dwarfed Salesforce's value of \$20.7bn.

Salesforce tops the charts however, as a result of its innovation premium. Forbes developed the innovation premium methodology in conjunction with HOLT a division of Credit Suisse and the publication describes it as a measure of 'the proportion of a company's market value that cannot be accounted for from the net present value of cash flows of its current products in its current markets.' In short, it is the premium the stock market affords a company because it is expected to launch new offerings and enter new markets that will generate even bigger income streams in the mid to long term.

**Table 1: Forbes Top 5 World's Most Innovative Companies 2012**

Company	Enterprise Value (\$bn)	Innovation Premium
Salesforce	20.7	75.1
Amazon.com	92.7	58.9
Intuitive Surgical	13.4	57.6
Tencent Holdings	46.5	52.3
Apple	303.4	48.2

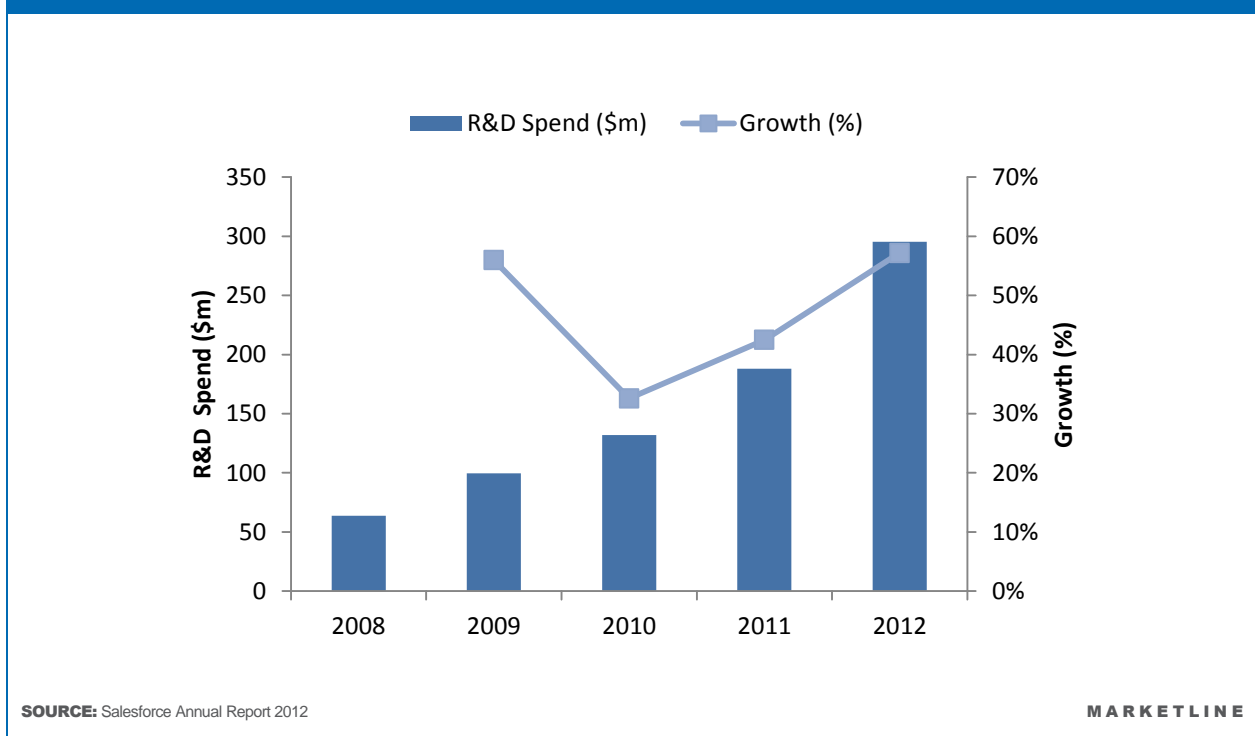
SOURCE: Salesforce

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The innovation premium given to Salesforce (75.1) is far higher than its closest rival (58.9), clear recognition of the company's dedication to innovation and its willingness to take risks through acquisition and in-house development.

This is also shown by the company's R&D spend in recent years, which has risen from \$63.8m in FY2008, to \$295.3m in FY2012. Furthermore, after a slowing of the growth in R&D spend in 2010, the company has begun to once again ramp up investment in R&D with spend in 2012 over 57% higher than in the previous year. To put this into context Microsoft increased its R&D spend by 3.4% and 8.9% in 2011 and 2012, and Apple by 33.3% and 41.7% during the same periods. This shows that Salesforce was prepared to ramp up its R&D spend at a much greater rate than its competitors, although it should be noted that in absolute terms, both Apple and Microsoft spend significantly more.

Figure 4: Salesforce R&D spend 2008-2012



This use of significant resources for R&D is evidence of Salesforce's desire to remain at the forefront of technological development and not just enter new markets, but establish them.

# THE PROBLEMS FACING SALESFORCE

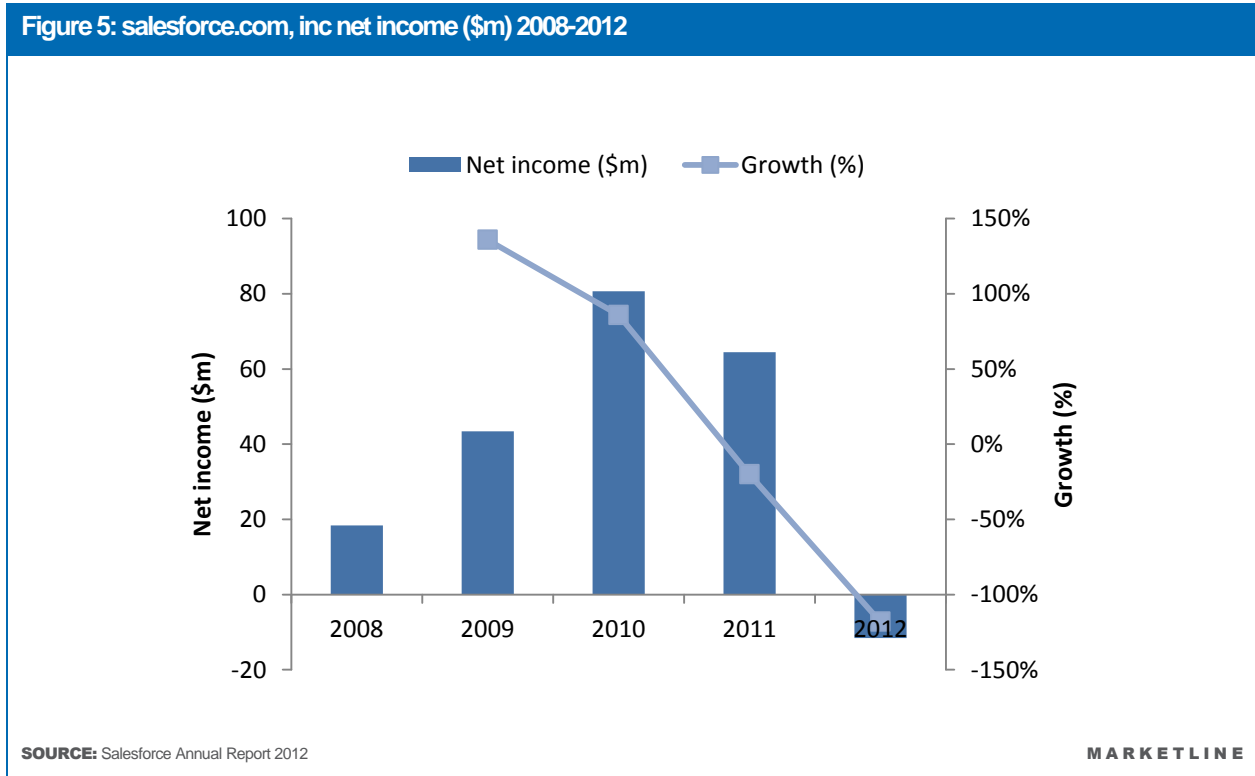
Salesforce has undoubtedly established itself as the CRM application provider of choice for a host of large companies and has branched out in to, and pioneered, new applications. This has seen the company grow significantly in size, both in terms of employees and revenues. However, its relentless drive for innovation and new applications has not come without problems. Despite revenue growth in recent years, the company posted its first loss since becoming publically traded in 2004 and it is also struggling to vary its revenue model, both operationally and geographically.

## The company faces three key issues

Despite revenue growth in recent years, the company posted its first loss since becoming publically traded in 2004. The company is also struggling to vary its revenue model, with its subscription and support division still accounting for over 93% of total revenues. Furthermore, Salesforce also faces the problem of geographical concentration, with the Americas contributing over two-thirds of all revenue.

### 2012 saw the company post a net loss

Since 2008, the company has consistently grown revenues year-on-year to become a \$2bn+ turnover business in 2012 with the annual growth rate never falling below 20%. (See figure 2). Until 2011 this translated into strong growth in the company's bottom line, with net income growing by 135.9% in 2009 and by 85.9% in 2010. However, 2011 saw a fall in the company's net income from \$80.7m in 2010, to \$64.5m and this alarming situation worsened in 2012 as the company posted its first net loss since 2003. Salesforce's 2012 net loss of \$11.6m represented a 118% decrease in the company's bottom line.



This is a worrying development for the company because if this trend persists, its ability to invest in R&D and recruit top class programmers will be negatively affected. The loss can be attributed to spiraling costs. In FY2011, the cost of revenues was 19.5% of revenues.

This had increased to 21.6% in FY2012 and according to Forbes is the result of 'sky-high sales and marketing costs.'



Furthermore, its title as the world's most innovative company has come at a cost. R&D costs soared in 2012 to reach \$295.3m, so while the company's constant striving for innovation and to pioneer new computing solutions has helped it establish itself as a leader in its field, Salesforce must be careful that R&D spending does not spiral to unsustainable levels.

The signs are that this trend is not isolated to 2012. The company itself has projected net loss per share of \$0.55 to \$0.51 for FY2013 and results for the three quarters to October 2012 show that this looks to be accurate. For the nine months to October 2012, the company posted a loss of \$249.6m. The company recorded a one-time, non-cash charge to income tax expense during this period in the amount of \$149m to establish a valuation allowance against a significant portion of its deferred tax assets. This accounts for some of the large loss, but a \$100m loss remains.

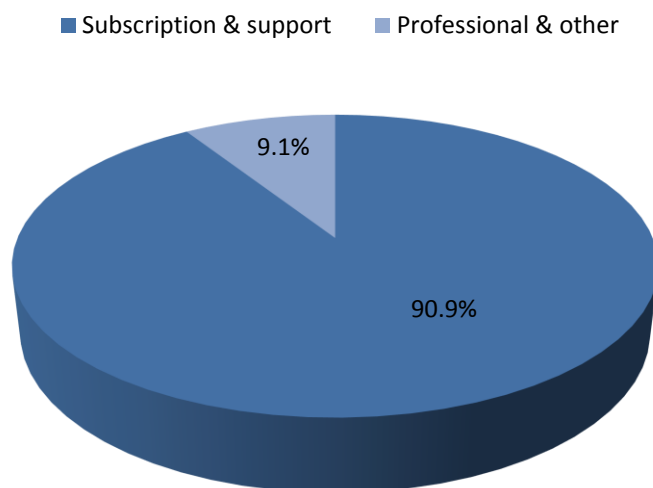
## **The company depends on subscription revenue**

Salesforce divides its operation into two divisions: subscription & support and professional services & other. Subscription revenues are comprised of subscription fees from customers accessing the company's enterprise cloud computing services and revenues from customers purchasing additional support beyond the standard support that is included in the basic subscription. The professional services comprises revenues from income streams such as process mapping, project management, implementation services and other revenue (primarily training fees.)

The company is heavily reliant on subscriptions and support for revenue. While subscriptions are often viewed as a good source of revenue due to their recurring nature, it should also be noticed that subscribers are under no obligation to renew at the end of their service contract. This poses a risk to Salesforce, as the company derives over 93% of its revenue from subscriptions & services.

Furthermore, the company's reliance on this division has only grown in recent years. In 2008, subscriptions and services accounted for 90.9% of all revenue, but by 2012, this had grown to 93.8%.

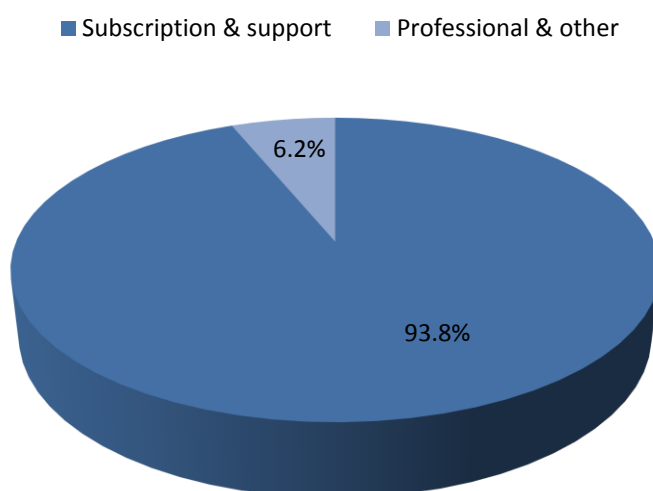
Figure 6: Salesforce revenue by division (%) 2008



SOURCE: Salesforce Annual Report 2012

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Figure 7: Salesforce revenue by division (%) 2012



SOURCE: Salesforce Annual Report 2012

MARKETLINE

This over-reliance on subscriptions & services is concerning as it places the company under great pressure with regards to client retention and new business. Should it fail in any of the areas, the company's business will be adversely affected and the fact that subscriptions & services is growing faster than professional & other (37% vs. 32% in FY2012) suggests that this problem may intensify if left unaddressed.

## Salesforce is geographically concentrated

As we have seen, the company's operations are concentrated around its subscriptions & services division, and there is also a geographical concentration with Salesforce relying on the Americas for the vast majority of its revenue. In FY2012, the Americas accounted for 67.9% of its income. By way of comparison, Europe was the source of 18% and Asia-Pacific contributed 14.1%.

While it is fair to state that this overexposes the company to market forces in the Americas, most notably the US, it should be noted that this is an improvement on previous years. In 2010, the Americas accounted for 70.8% of all revenues and in 2011, 68.5%. This shows that the company's acquisitions and partnerships in Asia and Europe are bearing fruit and the company is taking steps to rectify a problem it has identified.

**Table 2: Salesforce revenues by region (\$m) (%) 2010-2012**

Region	2010		2011		2012	
	Revenues (\$m)	% of total	Revenues (\$)	% of total	Revenues (\$)	% of total
Americas	923.8	70.8%	1,135.0	68.5%	1,540.3	68.0%
Europe	232.4	17.8%	291.8	17.6%	408.5	18.0%
Asia-Pacific	149.4	11.4%	230.3	13.9%	317.8	14.0%
<b>Total</b>	<b>1,305.6</b>		<b>1,657.1</b>		<b>2,266.6</b>	

**SOURCE:** Salesforce Annual Report 2012 **MARKETLINE**

Having made steps to become more geographically spread, the company must now continue to concentrate its efforts on ventures in Asia and Europe to further reduce its exposure to North American markets.

# CONCLUSIONS

## Salesforce has established itself as a leading CRM provider, but does face challenges

In 2011, Forbes named Salesforce 'the world's most innovative company' and in September 2012, the company won the award for a second consecutive year.

Since it was founded in 1999, Salesforce has continually innovated and pioneered new computing solutions, most notably using the concept of software as a service (SaaS) to differentiate itself and provide a better offering to its customers. Where the company has seen fit, it has acquired companies and their associated intellectual property to expand its range of services and remain in the vanguard of innovation. Its heavy investment in R&D and this willingness to acquire has most recently seen it launch its first-of-a-kind holistic marketing solution, the Marketing Cloud. Salesforce CEO Marc Benioff sees innovation as a continuum and this refusal to stand still helps to explain why the company continues to be seen as the world's leading innovator and is the CRM provider of choice for many blue-chip companies.

The company does, however, face a number of key challenges. Despite revenue growth in recent years, the company posted its first loss since becoming publically traded in 2004 and there are signs to suggest that this is not a short-term problem. If this trend persists, its ability to invest in R&D and recruit top class programmers will be negatively affected. The company is also struggling to vary its revenue model, with its subscription and support division still accounting for over 93% of total revenues and this situation worsened in 2012 and if it goes unaddressed, the company will be greatly exposed to adverse changes in its subscriber base. Furthermore, Salesforce also faces the problem of geographical concentration, with the Americas contributing over two-thirds of all revenue and although the company's acquisitions and partnerships in Asia and Europe are bearing fruit, it must now continue to concentrate its efforts on ventures in Asia and Europe to further minimize its exposure to North American markets.

If Salesforce is able to address these imbalances and continue to invest heavily in R&D, it should remain a fixture on the list of large tech companies and the most innovative firms in the world for years to come.

# APPENDIX

## Definitions

Cloud Computing: the use of computing resources (hardware and software) that are delivered as a service over a network (typically the Internet)

Enterprise Resource Planning: integrate internal and external management information across an entire organization—embracing finance/accounting, manufacturing, sales and service, customer relationship management

Enterprise Value: the market valuation of an entire business

PaaS: Platform as a Service. A category of cloud computing services that provide a computing platform and a solution stack as a service

SaaS: Software as a Service. A software delivery model in which software and associated data are centrally hosted on the cloud

Thin Client: a computer or a computer program which depends heavily on some other computer (its server) to fulfill its traditional computational roles

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## Further Reading

Salesforce.Com, Inc.: MarketLine Company Profile

Microsoft Corporation: MarketLine Company Profile

Apple Inc.: MarketLine Company Profile

Global Software & Services: MarketLine Industry Profile

## Ask the analyst

We hope that the data and analysis in this brief will help you make informed and imaginative business decisions. If you have any questions or further requirements, MarketLine's research team may be able to help you. The MarketLine Research team can be contacted at [ReachUs@MarketLine.com](mailto:ReachUs@MarketLine.com).

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