Industry Bulletin from The Starr Conspiracy Intelligence Unit

What the Globoforce IPO filing means for the market

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FORT WORTH, Texas (November 14, 2013) - Late last week, a significant moment in the HR technology industry quietly occurred. Globoforce, one of the category leaders in enterprise recognition, filed its intentions to go public with the U.S. Securities and Exchange Commission. Pricing for its IPO is set at $75 million, with the intention of listing on the NASDAQ under the stock symbol THNX.

This filing is a significant move toward establishing the recognition solutions market, a major emerging category of enterprise software. According to Globoforce's S-1 filing, IDC estimates that the North American recognition market will grow to $32 billion by 2016 and the enterprise social software market will grow to $4.5 billion by the same year.

Editor's note: Globoforce is not a client of The Starr Conspiracy. The views expressed in this document are based on publicly available company filings and our company's industry knowledge, research, and perspectives, not any company briefings or otherwise nonpublic or confidential information.

The recognition market

Even though recognition software is a hot emerging category, the industry itself is not new. Think about years-of-service awards — the proverbial gold watch. Players in the market, such as O.C. Tanner and Michael C. Fina, that focus on **rewards and recognition** can trace their heritage back 50 years or more. Today, rewards such as watches, pen sets, and coffee cups are still big business, but these companies also offer points that can be redeemed for merchandise that the program participant chooses.

However, in the past decade, a new generation of solutions, such as Globoforce and Achievers, have come on scene. Their focus is less on merchandise and more about Software-as-a-Service and social media to engage employees. The basic idea is that recognition drives engagement, and engagement drives positive business outcomes, such as productivity, customer service, innovation, and employee retention.

What's going on? A battle for market share

In any market, there are two types of companies — profit companies and market share companies. **Profit companies** focus on a business model that is familiar to most — they are in business to make money and must see black ink on the books month to month. Typically, a profit-driven company will spend about 5 percent of gross revenue on sales and marketing, but can go higher if the company wants faster growth.

Market share companies operate in a fundamentally different way. They spend disproportionately on sales and marketing in an attempt to capture market share to increase valuations ahead of an IPO or an acquisition. It's not uncommon to spend 25 to 35 percent or much more on sales and marketing for market share companies. The model is this:

- **Step 1: Secure private funding.** Overspend on sales and marketing.
- **Step 2: Go public.** Expand market share and platform capability with multiple acquisitions. Overspend on sales and marketing.
- **Step 3: Get acquired.** Shift to profit strategy. Pull back on sales and marketing.

In the world of HR technology, the best example of the market share strategy playing out occurred in the integrated talent management category:

- SuccessFactors won the category when SAP acquired it in 2011 for $3.5 billion (11.9x LTM).
- Taleo finished second when Oracle acquired it in early 2012 for $1.9 billion (6.2x LTM).
- Kenexa finished third in the category when IBM acquired it in mid-2012 for $1.3 billion (4.1x LTM).

Even though SuccessFactors and Taleo were similar in size in terms of revenue, SuccessFactors came in first and commanded the premium in part because of its willingness to invest in sales and marketing — 47 percent of gross revenue in 2011. This investment eclipsed the level of investment of Taleo (36 percent in 2011) and Kenexa (23 percent in 2011).

What Globoforce is doing right

Globoforce is the first mover in the second step of the recognition market share battle. Its SEC filing confirms that the company is making a market share play. It's spending aggressively on sales and marketing — more than double a typical ratio for a profit company. And as its investment in sales and marketing has gone up, it has posted wider losses. This is the way the game is played, and there will be room to spend more aggressively after the cash injection following the IPO.

	2010	**2011**	**2012**	**2013** (six months ending June 30)
Gross revenue	$100,010,000	$135,805,000	$157,691,000	$84,261,000
Sales and marketing	$7,805,000	$11,097,000	$16,862,000	$10,161,000
Sales and marketing spend as a percentage of gross revenue	7.80%	8.17%	10.69%	12.05%
Comprehensive income (loss)	$3,096,000	($804,000)	($1,836,000)	($3,186,000)

Although we don't know how Globoforce will spend after its IPO, we believe these are important areas of focus:

- **Heavy emphasis on brand awareness:** Awareness of recognition as a solution category is far lower than other, more established categories, such as payroll and enterprise learning management. With no one dominating the market, awareness is also low for brands within the category. There's still an opportunity to become the brand that's synonymous with the category.
- **Increased demand generation efforts:** The main focus should be on live events and digital media. There's a need to continue to educate the market on the business value of the category and the solution.
- **Acquisitions of performance solutions:** Globoforce has drawn a bead on performance management and positioned its solution as a possible replacement for the dreaded annual review that does little to drive engagement. Acquiring smaller players with innovative approaches to social performance could drive market share and differentiation.

What the market is getting wrong

Because the company filed its original S-1 in January 2013, many industry watchers believed that the company's hesitation with moving forward was based on its bank of unredeemed rewards points as a liability. Our take is that this view is shortsighted; a digital version of "run on the bank" is highly unlikely. Furthermore, it misses the point on what is most disruptive about this category — it's becoming less about the rewards and more about the stickiness of recognition. We believe that recognition as a technology solution is well aligned to the working styles of the 21st century workforce.

Conclusion: Only the first shoe

Although it went by quietly, don't underestimate the significance of this filing. Past is prologue, and we believe that a flurry of activity will follow this move — expect further IPO announcements and subsequent acquisitions over the next 18 months.

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There's a new era of enterprise technology that can finally unleash the full promise of human potential. If you're on board, we're ready to get you there.

The Starr Conspiracy Intelligence Unit (TSCIU) delivers growth-oriented strategy, research, and advisory services, providing the guidance and key insights you need to grow market share and increase profitability. Let's face it: The protectors of the status quo in marketing fall back on outdated formulas that won't deliver growth and aren't sustainable. We've seen it before and that approach to marketing is dead.

TSCIU takes your business as personally as you do and we will challenge you to shift your perspective. Most important though, we deliver marketing clarity so you can make decisions with confidence.