The Growth of Network Appliance

The Network Appliance Case displays fundamental struggles of a fast-growing company in an evolutionary market. Undergoing leadership transitions and facing critical decision-making junctures, Network Appliance seeks to retain strong competitive advantage in the marketplace. In order to do so, it relies on the ability of its leaders to decide on growth and revenue strategy, product development assessments, sales tactics and business metrics evaluations. Significant recommendations in each of these categories pronounce a valuable and viable proposition for continued success.

Growth Strategy Analysis

Given the context of the unprecedented capital markets environment in 1998, NetApp’s management team should take advantage of the financing possibilities by being responsive to the valuation metrics of Wall Street analysts. As revenue multiples are one of the key valuation metrics used by the analysts, management should be inclined to focus on revenue growth, considering, of course, such an approach within the context of long-term viability. Attaining high valuations from research analysts would allow NetApp more flexibility to invest in size and share of the existing market as well as position itself as an enterprise solution provider for corporate information infrastructure. In this light, NetApp’s focus on revenue growth can be pinpointed by diversifying the product line to dominate existing markets, strengthening distribution channels and customer relationships, and expanding into new geographic areas.

In order to take advantage of the capital market environment, management should consider monetizing NetApp’s valuation by issuing a secondary offering. Given that the CEO can look forward to pursuing any of three potential new markets in the coming year, being cash rich would allow NetApp to place bets on all of the potential markets while still maintaining dominating presence in one particular market. With cash on hand, the management has the opportunity to mitigate the risk of its investment in future growth by placing pseudo call options on different markets.

Nevertheless, NetApp must attain profitability in order to decrease reliance on the continued liquidity of capital markets and be able to drive growth in the future using internal funds. Blind adherence
to revenue growth generation could lead to lack of market focus and the blurring of NetApp’s market position. Revenue growth must be consistent with the firm strategy of becoming an enterprise solution for existing customers and an enterprise solution for the larger market of corporate information infrastructure. To be capable of executing this strategy, the distribution and sales team driving revenue growth must be aligned with a strong management team.

In conjunction, customer service falls directly in line with revenue growth and generation. As depicted in the “April Lost Business” section of Appendix A of the case, the primary reason for lost business was lack of customer support. Phenomenal revenue growth without complementary upgrades in customer service could lead to failure in retaining clients (or capturing new ones) in critical new markets. Among three of NetApp’s sustainable strategies: lowest cost provider, superior product, or customer intimacy, the company has succeeded in demonstrating the success of its product strategy and must focus on customer intimacy in order to gain entrance to higher margin markets. Customer rapport will play an important role in the increasing of switching costs and locking-in of the value creation from attracting new customers.

**Product Strategy Analysis**

By expanding the universe of its product offerings and serving the different protocols, it seems clear that NetApp could potentially become the enterprise solution provider with the ability to fulfill both the departmental-level needs as well as high-level, corporate requirements. Although the market for database applications was not growing very quickly relative to the Windows-only or cache proxy market, database segments were estimated at $15 billion. At the time, NetApp’s served available market (SAM) only stood at $3.5 billion or 23% of the market. Thus, the size of this market certainly necessitates NetApp’s full attention. The company should increase its product offerings within the NFS and CIFS protocol market as well as serve markets requiring other protocols such as HTTP. In the technology industry, where there is a true, winner-takes-all dynamic, NetApp must increase its share of the $15 billion market to preempt competitive entry and dominance. NetApp has already increased its coverage of the
NFS market from 47% of $3.7 billion in 1995 to 67% of $5.1 billion in 1998. It is imperative that NetApp continues the increasing trend of its coverage.

Should NetApp choose to move into the database application market, the case notes that the company would need to serve a different set of customers; specifically, more CIO types and less functional managers. The move to this market could ideally complement the company’s ambitious strategy to transition into an enterprise solution provider targeting larger clients.

Exhibit 7 illustrates that the growth of the NT protocol market increased from 4% of $7.6 billion to 15% of $8.9 billion. In addition, 25% of the $2 billion market matched NetApp’s price points of $25,000 servers. Not to mention, the higher end of the market was projected to increase significantly. NetApp’s entry into this market would continue to complement its overarching strategy to provide enterprise solutions to large customers. The company should invest funds to develop the necessary capabilities to serve this market since many companies were beginning to implement UNIX and NT systems side by side. NetApp should proceed with development in the spirit of providing multiprotocol file service and increase its product offerings. Through this expansion of product offerings and by serving the different protocols, NetApp can become the enterprise solution provider fulfilling both departmental-level needs as well as corporate needs.

Finally, although the network cache market was only $200 million and forecasted to grow to $1 billion, cache server appliances had significant synergies with the company’s data storage management business. In the vein of becoming an enterprise solutions provider, NetApp’s capture of network cache expertise could significantly expand the full-line of their services. Moreover, the acquisition of Internet Middleware Corporation (IMC) provides NetApp with the possible benefit of future popularity with the technology thus the resulting upgrade in stock valuation.

**Sales Strategy Analysis**

In order to reach the $14 million sales goal under the direct sales channel, as Mendoza pointed out, NetApp would have to sell more than 1,000 models at $12,000 each. However, the maximum capacity of sales from resellers stood at only $5 million. The indirect sales strategy could not physically deliver the
results necessitated by NetApp’s sales goals and consequently allows resellers to capture more than 50% of the margins.

In addition, a company’s sales strategy must be in line with its product and company strategy. In the case of NetApp, an indirect sales strategy does not directly complement the overarching company strategy: transitioning to become an enterprise solutions provider to selected large accounts. NetApp’s early sales and service strategy targeted early adopters and the firm needed to make radical changes within the organization in order to re-calibrate for the high-end markets.

In many cases, employing indirect sales channels can create a discontinuity with the customer. First, in this case, there is no guarantee that the reseller is properly representing NetApp and its products to customers. For instance, as demands for NetApp’s products moves further up the enterprise, sellers would interact with more Chief Information Officers rather than functional managers. Furthermore, there is no customer feedback regarding the quality of the product and service. NetApp would likely object to this lack of control since a clear objective should be to ensure customer satisfaction at every level of engagement.

In order to be an enterprise solutions provider to corporate information infrastructure, NetApp should therefore use direct sales channels in order to provide a complementary customer service that works with the sales team. Customizing products and services for large accounts necessitates close partnership with client companies and dedicated customer support. It was clear that several large NetApp customers indicated their need for vendor problem ownership. In order to match the level of customer support equivalent to on-site support units, NetApp must look to mobilize a dedicated sales team willing to actively manage client accounts by ensuring proper customer service. Appendix A shows that during the fiscal period of 8/23/97 to 9/19/97, sales people had surpassed their sales targets, paralleling an increase in uptime and opened calls per engineer. This illustrates the capacity constraint faced by technical support engineers and customer service representatives. An appropriate recommendation for NetApp would be to increase the hiring of both technical support engineers and customer service representatives in order to make up for such deficiencies.

Transitioning into a completely direct sales channel would clearly cause significant channel conflict and thus must be handled with the utmost diplomacy and sensitivity. Management should be
cognizant of this potential conflict and warn resellers sufficiently ahead of time before implementing changes. Clear honesty in the face of the reseller will emphasize NetApp’s dedication to success and leave the reseller relationships in tact for future development or redress. Mendoza’s demonstrated expertise in managing reseller relationships and his grasp of the CEO’s support suggest that the process of change should be difficult but entirely manageable.

**Decision Process Analysis**

The evolution and development of the decision process often manifests itself over time as a consequence of the culture of upper level management. Where a CEO employs a top-down management style, then the company will reflect a top-down command and control system. The system of business area metrics introduced by Dan in the NetApp case is extremely beneficial to ensure meritocracy within the company; assuming that the metrics are unbiased. However, business area metrics should be only one of many tools used for performance measurement. Furthermore, business area metrics should also instill accountability while continuing to ensure flexibility amongst employees. As NetApp grows in size, monthly business reviews that stage VP’s to present their progress toward objectives and metrics will function as expected. Four or five hours on a monthly basis dedicated to drilling through every function is a method that is bound toward failure in such large corporation. Metrics should furthermore be retained as flags of superior or inferior performance; however, the overall decision process should be pushed down the hierarchy. The CEO should consequently delegate his decision-making authority to those most knowledgeable to make those decisions. The formalization of this delegation of authority should be clearly publicized and articulated in order to mitigate the lack of clarity that may paralyze the organization.

NetApp clearly has significant decisions to make in order to ensure a strong growth and revenue strategy and viable product development directions. Sales tactics and business metrics evaluations are also at a critical juncture where the wrong decision could mean lost business or worse, company failure.