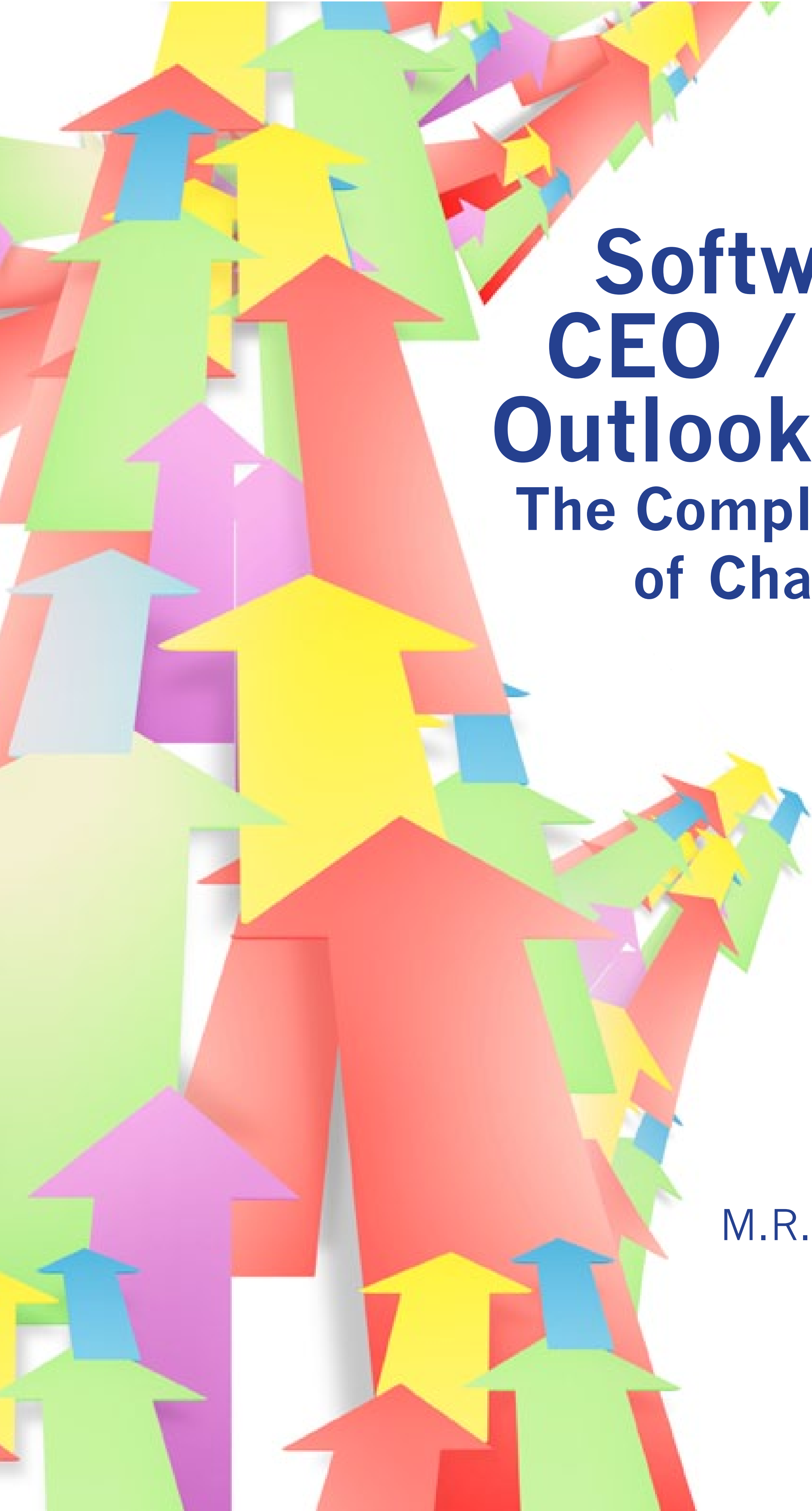


Software CEO / CFO Outlook 2014

The Complications of Change

M.R. Rangaswami

Sand Hill Group

Intacct.

INTRODUCTION: TRANSFORMATION REQUIRED

The software industry is in an era of explosive growth. Our 2014 study of CEO / CFOs' outlook reveals that 29 percent say their planned revenue growth over the next 12 months is 50 percent or higher; and within that group, 17 percent believe their revenue growth will increase by 100 percent or more. One CEO commented that his company has grown "twice as much" every year for the past three years.

In addition, 77 percent of the study participants believe the U.S. software industry's growth over the next 12 months will be better or significantly better than the past 12 months. And 69 percent believe that growth will be in the range of 10-30 percent or more.

Though welcome, the growth disrupts the status quo and causes significant transformation of companies' operating infrastructures. Software companies large and small are implementing and optimizing new business models and blazing paths in responding to raised stakes in the crucial effort to delight customers.

A key finding in our study shows software executives are struggling with maintaining equilibrium among operational and investing priorities that push the companies in opposite directions at the same time. The prioritization decisions are becoming ever more complex and increasingly interrelated. The decision choices are all interconnected; none of them are standalone.

Moreover, operational change must be funded, and that challenge is significant because of the opposite directions in prioritization.

This report provides a detailed look at how the software industry is performing and the transformational change and conflicting needs software companies must address. The growth opportunities are exciting, but the accompanying degree of change is challenging.

"There is a lot of transformation due to moving to the cloud space and capturing new business opportunities. In addition, there is still a need for hybrid solutions and investing to keep existing clients happy."
— CEO, Software Company

CONTENTS

EXECUTIVE SUMMARY

Software companies participating in the 2014 CEO / CFO Outlook study expressed positive opinions about the growth potential of the industry and their own companies over the next 12 months.

But growth is not just an opportunity; it's also a threat to the status quo in a company. The study found strong agreement among participants around the dilemmas they face from the changes due to industry trends and their methods for growing their businesses.

Due to the complexities of change, software companies are now pulled in conflicting directions at the same time regarding funding, resource allocation and prioritization for potential and new customers versus existing customers, existing versus new deployment and pricing models, and new versus existing methods and activities around meeting customer needs. Making progress in one area often causes regression in another area.

Some of the key takeaways of the study's insights include:

- The study's participants believe the factors that will have the greatest impact on U.S. software industry revenues in 2014 to 2016 will be Big Data / analytics and social/collaboration tools. Nearly half of the participants cited initiatives around "customer experience" as a revenue growth area. (See page 7.)

- Mobile is clearly a growth area (ranked #3 by the participants), but executives cited multiple challenges in six areas. (See page 9.)

- The in-depth phone interviews revealed that software companies' use of social media in marketing increased in 2014 with an almost equal use for supporting and maintaining existing customer relationships as for reaching prospective customers. In addition, 62 percent implemented collaboration tools in 2013 to 2014. (See page 8.)

- Although a majority of the participants believe security is a high-growth area for the industry revenues over the next two years, 54 percent of the executives stated that security is the most worrisome factor in the way the software industry is evolving. (See page 10.)

- The trend of moving to the cloud has accelerated even since 2013. The study discusses how cloud is raising the stakes and highlights some downstream effects (see page 11) along with several companies' impacts from cloud outages (see page 13).

- The trend in the decline of on-premises software has had varying impact to date on the study participants' companies. (See page 12.) But the companies participating in the study reported their plans for deployment models will change significantly in 2015. (See page 25.)

- Participants ranked "new business initiatives" as the biggest influence driving customer spending in the next 12 months and ranked five other influencing factors. (See page 13.)

- Seventeen percent of the executives reported their planned revenue growth for the next 12 months is 100 percent or more, and 15 percent said their planned profit growth is 60 percent or more. (See page 14.) When we broke down their responses into the six types of software companies participating in the study, it became clear that two types of companies expect greater revenue growth than others. (See page 14.)

- Software companies' top three growth opportunities over the next 12 months are also at the crux of the dilemma of being pulled in opposite directions at the same time. (See page 15.)

- Executives ranked five different Internet of Things technologies according to their competitive impact on the study participants' companies during the next two years. The area most seen as a competitive threat is IoT security solutions. Although several types of software companies identified one or two of the five technologies as a competitive opportunity, analytics-as-a-service companies perceive four out of five technologies as a competitive opportunity. (See page 16.)

- Among a list of nine business goals, participants identified their top three goals. Follow-up in-depth phone interviews revealed that succeeding in the opportunities reflected in their goals also necessitates operational changes. (See page 18.)

- The majority of participants reported that their company headcount will increase or increase significantly over the next 12 months. However, the top driver is not acquiring new skills. (See page 19.) We also sliced the data to identify the types of companies that will increase headcount per driver of the increase. (See page 19.)

- The top four ranked methods for tracking business in 2014 are the same as the top four methods cited by participants in 2010 and 2011. But two aspects have changed in 2014. (See page 20.)

- The study revealed 10 aspects of business, due to growth, that executives find difficult to balance because they keep impacting each other with conflicting demands. (See page 24.)

- Companies must change their operational infrastructure to align with new deployment and pricing models. And there are new types of pricing pressures that arise because of the current growth trends in the industry. (See page 26.)

- Twenty-nine percent of the surveyed companies are using performance-based pricing models based on value, success, or outcomes. (See page 26.)

- Meeting customer needs is becoming much more problematic in 2014 than it was just one year ago, and executive participants ranked it high among business problems that most often keep them up at night (so to speak). (See page 27.) And the challenge is exacerbated by the pace of growth. The study revealed eight examples of the challenges in how meeting customer needs is changing and involves difficult choices. (See page 28.)

- Study participants also pointed out issues with change associated with growth in the areas of IPO trends, valuations, focus on earnings, proliferation of APIs, and workforce technology. (See page 29.)

RESEARCH METHODOLOGY

This report is the third in Sand Hill Group's ongoing series of software industry CEO / CFO Outlook studies since 2010. The goals of this series are to:

- Provide insights into the current and future state of the software industry
- Identify new trends and track evolving trends
- Assess the goals and challenges of software companies

For the 2014 study, 76 respondents participated in an online survey of quantitative questions during March and April and 13 participated in individual follow-up, in-depth telephone interviews, which included some questions not asked in the online survey.

All online and phone participants were guaranteed that their identities would remain confidential in order to protect the strategic nature of the corporate information they provided.

Insights for this report came from top executives ranging from chairmen to vice presidents. CEOs and presidents comprised 50 percent of the survey respondents; 17 percent were CFOs. CEOs comprised 70 percent of those interviewed by phone.

For benchmarking purposes, we included a few questions in the online survey that were identical to those asked in the prior years' surveys, and this report includes information tracking those evolving trends.

This report on the findings of the 2014 CEO / CFO Outlook study is intended to give software company executives and investors directional insight as they make decisions.

Although we focused on surveying a wide variety of software companies, the study is not necessarily a representative sample of U.S. software companies or of companies outside the United States.

Respondent Profile

Type of Organization	
Application software solutions	43%
Vertical industry solutions	19%
Other (Analytics as a service, Data as a service, R&D, System integrators, Private equity investors, IT advisory & services)	14%
Infrastructure software solutions	13%
Platform/developer software	8%
Security software solutions	3%

Title / Position	
CEO	37%
CFO	17%
Other	16%
President	13%
COO	10%
Chairman	7%

Number of Employees	
1 - 99 employees	70%
100 - 499 employees	18%
500 - 599 employees	4%
1,000 - 4,999 employees	7%
More than 5,000 employees	1%

Company Product Strategy	
Single solution offering	39%
Multiple solutions integrated as a suite	34%
Multiple solutions offered separately	27%

Financial Structure	
Private, self-funded	38%
Private, backed by venture capital or private equity	31%
Private, backed by individuals or angel investors	20%
Public	7%
Partnership	4%

Annual Revenue	
Less than $10 million	49%
$10M - $49M	37%
$50M - $99M	4%
$100M - $999M	6%
$1 billion or more	4%

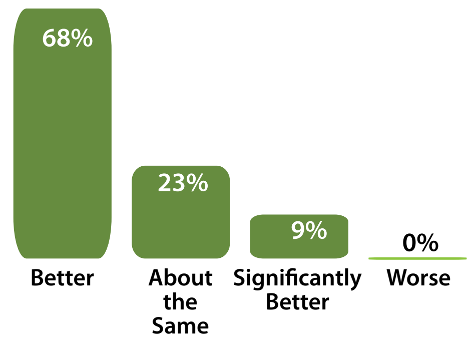
GROWTH MARKETS

Areas of Growth Opportunity in 2014 to 2016

The survey revealed that most participants share the same opinion about the software industry's growth potential. When asked how they believe the overall U.S. software industry will perform in the next 12 months compared to the past 12 months, the majority stated it will be better or significantly better. And more than half expect industry revenue to grow in the range of 10-30 percent or more in the next 12 months.

Figure 1

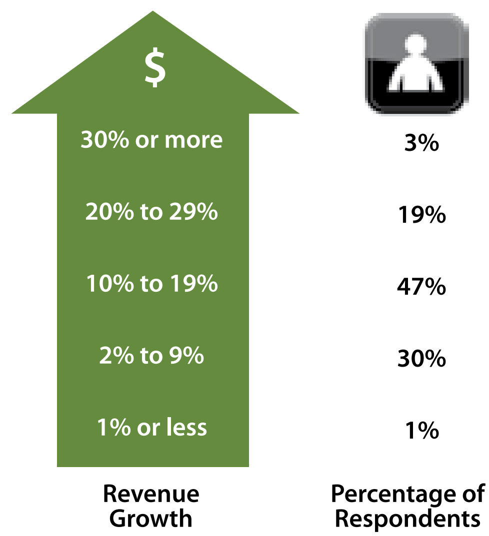
Expected Growth of Software Industry Over the Next 12 Months Compared to the Prior 12 Months



We asked participants to select all the factors they believe will have the greatest impact on software industry revenues in 2014 to 2016. As Fig. 3 reveals, they strongly believe that Big Data and analytics as well as social/collaboration tools will be the dominant factors, followed by mobile and security initiatives.

Figure 2

Expected Growth of U.S. Software Industry Revenue Growth Over the Next 12 Months



Big Data / Analytics

Executives interviewed by phone cited the "explosion" of Big Data and analytics as both the biggest change and the most exciting aspect of the way the industry will develop over the next 12 months. They commented that:

- "The entire notion of business insights and intelligence from analyzing Big Data and converting it to actionable decisions is exciting."
- "The use of unstructured data for application development" is very exciting."

Figure 3

Factors with Greatest Impact on Software Industry Revenues in 2014-2016

	Big Data/ Analytics	Mobile	Security	Customer Experience	Internet of Things	Social/ Collabora-tion Tools
Overall Totals	85%	70%	63%	44%	40%	85%
#1 Factor	42%	47%	30%	47%	28%	11%
#2 Factor	39%	27%	48%	22%	28%	37%
#3 Factor	19%	25%	22%	31%	45%	52%

Social Media

In the online survey, social and collaboration tools tied with Big Data / Analytics as the factor that will have the greatest impact on industry revenue in 2014 to 2016. The in-depth phone interviews revealed that software companies' use of social media in marketing increased in 2014. One executive stated that his company increased social media activities to reach prospective customers. Another commented that his company increased its use of social media by 100 percent this year due to the company's growth; three-fourths of their social media efforts are focused on retaining customers.

Of the companies participating in phone interviews, 23 percent use social media primarily to reach prospective customers and build their brand; 24 percent use social media solely to support and retain customers; and 53 percent use it to support customers, build their brand, and reach prospective customers.

Several executives interviewed by phone commented that the way social is now integrating with the enterprise business world is an exciting aspect of the industry's growth potential. One commented that social data and search is an exciting part of the growth of cloud and SaaS.

Collaboration Tools

The study found that software companies also increased their use of collaboration tools in 2013 to 2014. Among the executives participating in phone interviews, 38 percent of their companies have not implemented collaboration tools. But 62 percent increased their use of collaboration tools in 2013 to 2014:

- 24 percent implemented software to collaborate with external customers or partners.
- 31 percent implemented tools to improve internal collaboration.
- 7 percent are currently looking at tool options.

> **"We implemented some internal collaboration tools so our developers can talk to QA. Being separated even by just a couple of floors makes a difference."**
> ***— CFO, Software Company***

Salesforce.com's Chatter is the tool the participants most often implemented in the past 12 months. Others include Yammer, Zendesk, Basecamp, and HipChat.

Mobile

Ranked in the online survey as the #3 factor (see Fig. 3) for the greatest impact on software revenues in the next two years, mobile was also an area of discussion in the in-depth phone interviews. Executives observed that:

- "HTML5 is exciting because it will make it a lot easier to develop rich .mobi apps."
- "Mobile is becoming more and more prominent and will bring the biggest change to the industry. It's also the most interesting factor because it has challenges and presents both threats and opportunities."

Forty-six percent of the interviewed executives stated mobile apps are not related to their business or that they have no challenges because they are executing to plan. The other executives cited the following challenges in their companies' efforts to create mobile apps:

- "Recruitment of Android engineers has been our biggest need for the past two years. iOS has more engineers, but that platform has a smaller market share."
- "It's challenging to stay up to date on multiple platforms."
- "The actual market for tablets is not nearly as high as has been advertised."
- "We need to create a larger percentage of mobile apps on almost a monthly basis."
- "Bringing enterprise-grade mobile apps to market is challenging. First, it's difficult to convey all the data that users are used to seeing in the desktop experience. Second, the mobile feature-rich environment is still lagging behind the desktop environment, especially in the area of graphical rendering of information. We live in a very highly graphic world, and it demands a lot of bandwidth and computing power; but that bandwidth and power isn't always available on the road."

"For us, success in the mobile space is different than just building mobile apps. We want to target the right customers. That's not easy to do today. The difficulty is making sure we're not wasting money on the wrong customers—ones that would be unprofitable for us."
— CEO, Software Company

One executive stated: "Mobile is clearly a growth area. But it's not a challenge for our company because we're in the Salesforce.com world, which has a phenomenal mobile platform."

Security

In our 2011 survey, Big Data was not yet on the radar screen, and respondents ranked cloud, mobile, and security as the top three factors that would drive industry growth the following year. The belief in 2011 was that mobile would create a big demand for better security services and better security integration. That same belief was cited by participants this year.

54%
Cited security as the most worrisome factor in the way the software industry is now evolving.

When selecting all of the drivers that will make the biggest impact on software industry revenues in the next 12 months, 63 percent of participants ranked security as the #4 driver (see Fig. 3). However, 54 percent of the executives participating in phone interviews said security is the most worrisome factor in the way the software industry is now evolving.

Many of the study participants believe there has been "too much of a blind eye" to security in the growing trend of software being managed and hosted in the cloud. One executive commented that the continual news about security breaches in mobile and other areas, not just cloud-based solutions, could cause a setback for the industry.

"Security is definitely the most troubling aspect about how the industry is evolving. There is no doubt about it. We're getting more and more questions from clients about it this year, asking us about authentication, permissioning, and encryption."
— CEO, Software Company

Figure 4

Types of Software Projects that will be Biggest Drivers in Customer Spending the Next 12 Months

	Big Data/ Analytics	Cloud Computing	Mobile	Functional Solutions	Enterprise Social Networking	Vertical Industry Solutions
Overall Totals	71%	70%	69%	69%	68%	67%
#1 Driver	23%	40%	25%	15%	2%	14%
#2 Driver	31%	26%	19%	13%	7%	14%
#3 Driver	18%	13%	19%	25%	9%	19%
#4 Driver	17%	7%	14%	20%	19%	19%
#5 Driver	7%	7%	17%	17%	22%	18%
#6 Driver	4%	7%	6%	10%	41%	16%

Cloud Computing

As shown in Fig. 4, for the most part, the study participants perceive very little difference in the types of software projects that will be the biggest drivers in customer spending in the next 12 months. The highest number of responses was again tied to Big Data and analytics projects, with cloud right behind in driving spend.

> **"It's exciting to think about the next steps for cloud computing over the next 12 to 18 months. The industry is doing things with cloud now that nobody thought of two or three years ago."**
> ***— CFO, Software Company***

In the phone interviews, executives had much to say about the cloud's impact on the industry. The trend of moving to the cloud has accelerated even since 2013, they noted, and a big driver of that acceleration is Amazon's continual effort to drive down costs, which is leading to enterprises adopting cloud for core business functions such as ERP.

They also pointed to several downstream effects of cloud adoption:

- More and more people will get comfortable with not having data stored locally.
- "We're now starting to see a snowball effect of cloud solutions that can be easily integrated with current solutions."
- "The stakes for cloud companies have been raised. There is pressure to take over markets and build fast."
- "The drop in cost in cloud computing will enable greater speed and frequency of innovation, leading to more disruption."
- "The ability to accelerate time to market for new apps is exciting for customers but, for software companies, it increases the challenge of meeting demands for qualified talent."

The online survey looked deeper into the impacts from customers' accelerated move to the cloud model. When asked about the impact of the decline of on-premises software, most respondents indicated the trend has not made a significant impact on their company's growth in 2013 to 2014.

> **"So many software firms are moving to offer cloud solutions. In the past we concentrated on getting the next customer. Now firms need to make sure they minimize churn. So now there is more emphasis on the post-sale relationship and creating a true partnering alliance than before."**
> ***— CEO, Software Company***

Figure 5

Impact on Surveyed Companies' Growth in 2013 to 2014
Due to Decline of On-Premises Software

Major impact Loss of business unless we provide other offerings **7%**	**Moderate impact** from existing customers but greater demand from potential customers **14%**
Low but growing impact **21%**	**No impact 58%** 46% - Cloud-only company 12% - Customer base prefers on-premises solutions

We asked the executives participating in phone discussions which company they believe will make the most progress at competing with AWS' cloud leadership this year. Their opinions:

- 15 percent predicted it will be IBM in the short term, Oracle in the long term.
- 23 percent think Salesforce, Dropbox, Wal-Mart, or Syntel have a chance in the long term but not the short term.
- 31 percent say Google is the only company that has a real chance of competing with AWS.
- 38 percent said they haven't yet seen a company that can compete with AWS.

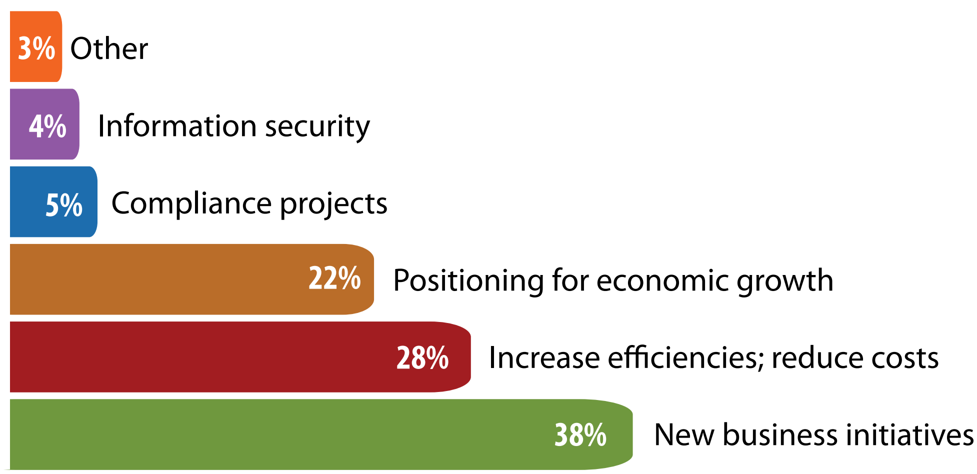
"AWS has a leap ahead and will maintain it.
But Google has potential."
— CEO, Software Company

Drivers for Customer Spending

The online survey asked participants to select the factor they believe will be the biggest influence in driving customer spending in the next 12 months. More than one-third expect that "new business initiatives" will influence customer spend the most. That was also the case in 2011. The 2010 participants ranked "increasing efficiencies and reducing costs" as the top factor, which is understandable given they were emerging from the global recession over the two prior years.

Figure 6

Expected Biggest Influence Driving Customer Software Spending in the Next 12 Months



In addition, with software companies moving so much of their business to the cloud, they also must invest in redundancies for business continuity. Executives participating in the phone interviews discussed their experiences with cloud outages in 2013 to 2014.

More than three-quarters (77 percent) of their companies experienced cloud outages during the past year. For 69 percent of those companies, the outages lasted for several hours. One executive reported that his company faced an outage for four days.

The impact to their businesses from the cloud outages ranged as follows:

- 58% - low impact
- 20% - negative impact on customers because of inaccessibility of applications or websites; loss of revenue
- 2% - unknown impacts because the companies do not track impacts from cloud outages

GROWTH STRATEGIES

The study found that software executives are very enthusiastic about their companies' growth opportunities over the next 12 months. Seventeen percent reported their planned revenue growth is 100 percent or more; 15 percent said their planned profit growth is 60 percent or more.

Figure 7

Surveyed Companies' Planned Revenue Growth Over the Next 12 Months

Revenue Growth	Percentage of Respondents
100% or more	17%
75% to 99%	8%
50% to 74%	4%
25% to 49%	29%
10% to 24%	34%
1% to 9%	8%

Figure 8

Surveyed Companies' Planned Profit Growth Over the Next 12 Months

Revenue Growth	Percentage of Respondents
60% or more	15%
40% to 59%	7%
20% to 39%	14%
0% to 19%	54%
-1% to -19%	6%
-20% to -39%	3%
-40% or less	1%

As displayed in Fig. 9, when we broke down their responses about their companies' growth into the various types of software companies, it became clear that the preponderance of growth expectation is in the vertical solutions companies and the applications software companies.

Figure 9

Planned Revenue Growth Per Type of Company

100% or More
Vertical solutions
Application software solutions
Platform/developer software
Infrastructure software
Security solutions

75% to 99%
Other
Application software solutions
Infrastructure software

50% to 74%
Vertical solutions
Application software solutions
Other

25% to 49%
Application software solutions
Vertical solutions
Infrastructure software
Platform/developer software
Security solutions

10% to 24%
Application software solutions
Infrastructure software
Vertical solutions
Platform/developer software
Security solutions

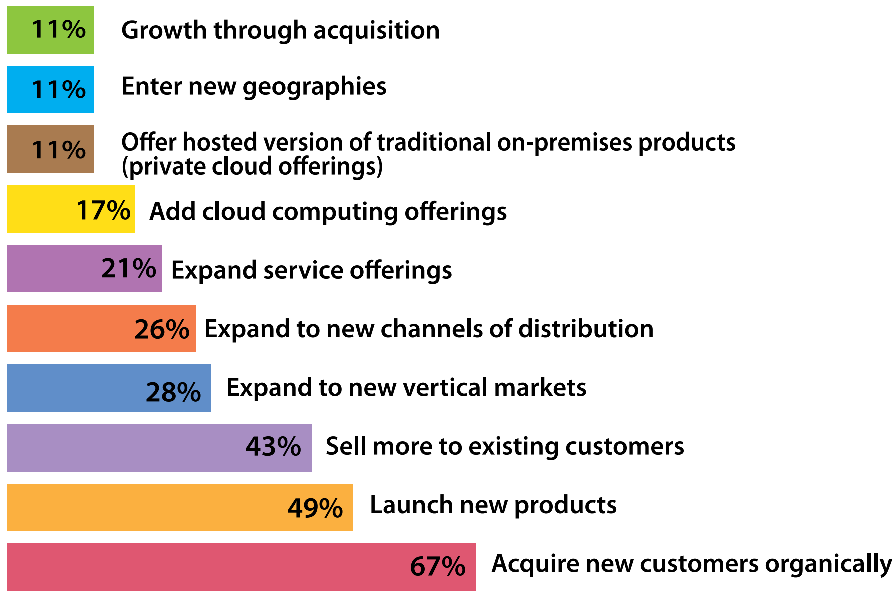
1% to 9%
Other
Application software solutions
Vertical solutions

Over the next 12 months, the study participants believe their companies' top three growth opportunities are "acquiring new customers organically," "launching new products," and "selling more to existing customers."

However, these three strategies also are at the crux of the dilemma of software companies being yanked in opposite directions. The section on Complexities of Change later in this report presents insights shared by the study participants about this dilemma.

Figure 10

Top Three Growth Opportunities for Surveyed Companies over the Next 12 Months



The study revealed that high growth opportunities do not necessarily exist across the board. When we segmented participants' responses about their top growth opportunities, we found that the majority of the opportunities were cited by infrastructure companies and application software companies, as shown in Fig. 11.

Security solutions companies—which one would assume would have many opportunities, given the need discussed earlier in this report—see their greatest opportunity in the cloud but, surprisingly, see little opportunity in launching new products or acquiring new customers organically.

Figure 11

Top Growth Opportunities Over the Next 12 Months Per Type of Company

Growth Opportunity	Apps	Vertical	Infra-structure	Security	Platform
Acquire new customers organically	✓	✓	✓	✓	✓
Launch new products	✓	✓	✓	✓	✓
Sell more to existing customer	✓	✓	✓	✓	✓
Expand to new vertical markets	✓	✓	✓		✓
Expand to new distribution channels	✓	✓	✓		✓
Expand service offerings	✓	✓	✓	✓	
Add cloud computing offerings	✓		✓	✓	
Offer hosted versions of on-premises products (private cloud offerings)	✓	✓	✓	✓	✓
Enter new geographies	✓	✓	✓		
Grow through acquisition	✓				

Internet of Things

The Internet of Things (IoT) movement is both a growth opportunity and a threat to software businesses. As Fig. 12 illustrates, the survey found mixed opinions around the Internet of Things as an area for growth opportunity in 2014 to 2016.

Most respondents view the IoT technologies as a competitive opportunity. A few believe they face a competitive threat in the area of sensor technologies and security solutions for the IoT. However, this is a nascent market, and many of the respondents believe the IoT will have low or no impact on their business in the next two years.

Figure 12

Internet of Things Technologies That Will Have Significant Impacts on Surveyed Companies' Growth in 2014-2016

	Competitive Opportunity	Low Impact	Competitive Threat	No Impact
Wearable Tech	13%	15%		65%
Sensor Tech	25%	13%	1%	55%
Smart City Tech	21%	11%		59%
Security Solutions for IoT	31%	20%	3%	37%
Smart Home Tech	14%	14%		64%

Several respondents segmented in the "other" category as to type of business indicated the Internet of Things is an opportunity for them. An Analytics-as-a-Service company identified four out of five IoT technologies as a competitive opportunity, excluding only sensors. An R&D company designated sensors, security, and Smart City technologies as opportunities, but not Smart Home tech or wearables. A systems integration firm identified Smart City technology as a competitive opportunity. A respondent in the area of IT services ranked wearables and sensors as areas of opportunity.

Top Business Goals

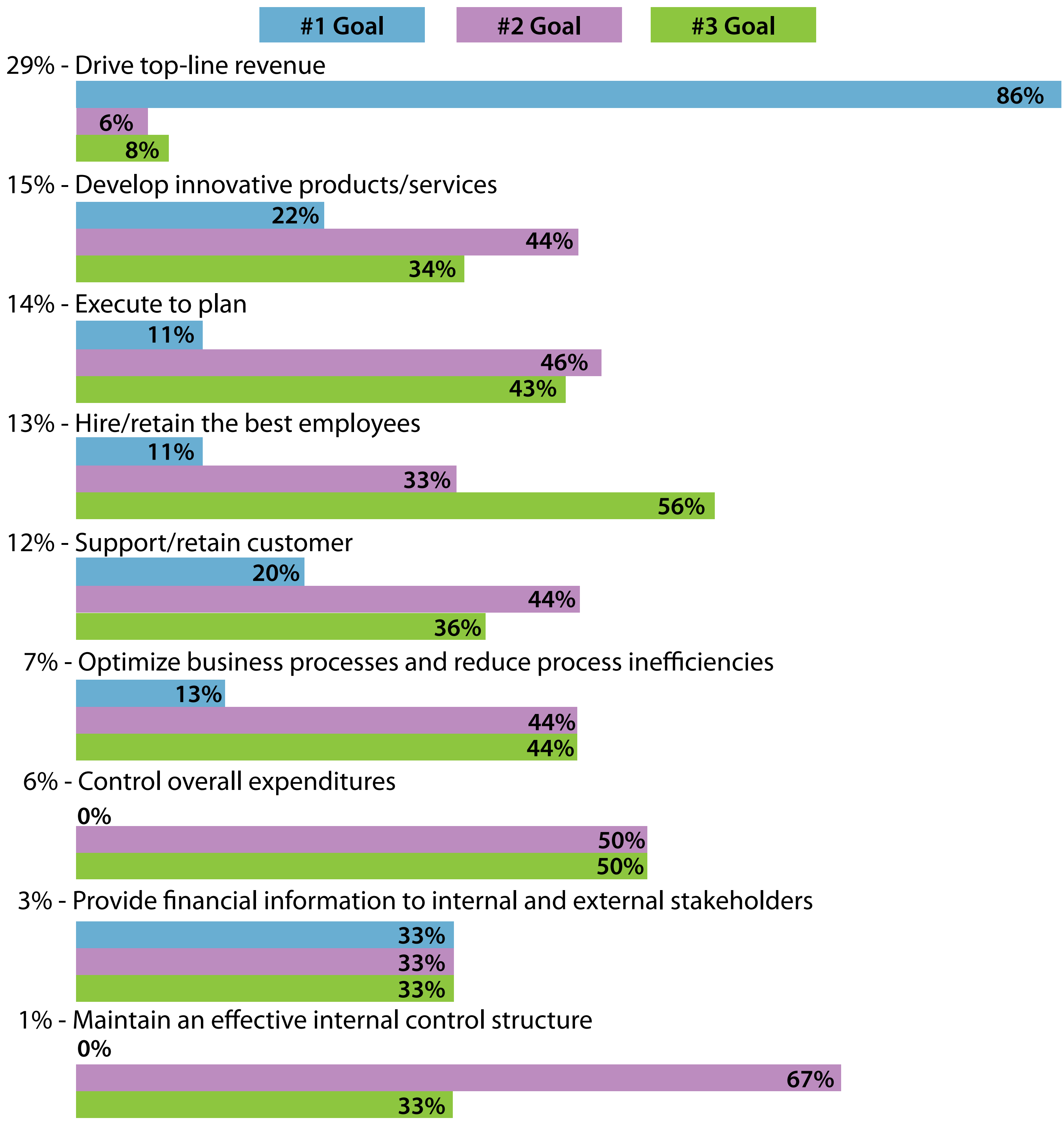
Driving top-line growth is #1 goal of 29 percent of the surveyed executives for the next 12 months. Developing innovative products ranked as goal #2, followed by "executing to plan" as goal #3.

"We're still privately held. We replaced our management team, switched our model to SaaS four years ago, and changed direction so we can continue to grow."
— CFO, Software Company

In our 2010 survey, respondents indicated their top three goals were (1) driving top-line growth, (2) optimizing business processes and reducing process inefficiencies, and (3) controlling overall company expenditures. “Developing innovative offerings” rose to the #1 goal a year later. 2011 respondents also ranked “driving top-line growth” as goal #2 and “hiring/retaining the best employees” as goal #3. We asked the 2014 participants to identify their company’s top three business goals among a list of nine goals.

Figure 13

Surveyed Companies' Top Three Most Important Goals for the Next 12 Months



In the in-depth phone interviews, we followed up the discussion on goals with this question: "Which of the following seven issues most often keeps you up at night, so to speak?" The answer options were: staying ahead of the competition, satisfying investors, meeting customer needs, maintaining company growth, improving the bottom line, hiring or retaining the right people, or other.

More than half (54 percent) of the executives participating in the phone discussions responded with "maintaining company growth."

A CEO pointed out that maintaining growth is an operational issue as well as an opportunity. His company tripled its internal recruiters this year to deal with the talent need associated with growth.

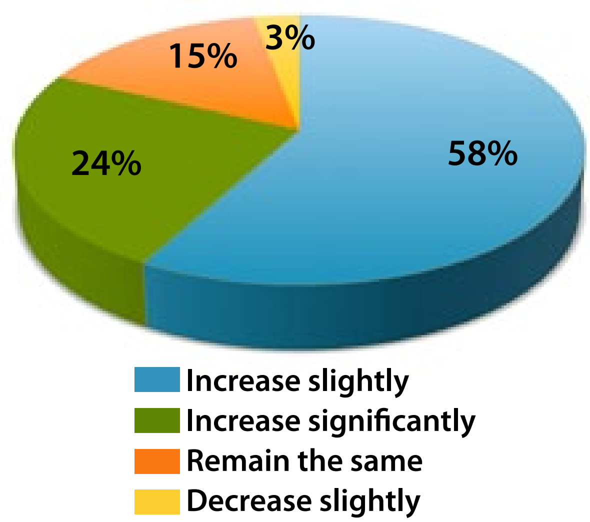
TALENT NEEDS

In the survey we asked participants how they expect their company's headcount to change over the next 12 months. The majority (82 percent) reported that their headcount will increase, with 24 percent of that group predicting it will "increase significantly."

A CEO commented, "We can't hire all the A+ people we need in order to meet customer needs."

Figure 14

Surveyed Companies' Expected Headcount Change over the Next 12 Months



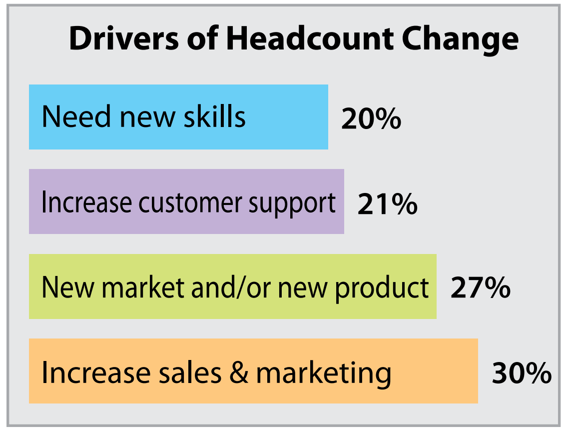
"Talent is a huge issue. As the speed and frequency of innovation increases, there is a huge need for next-gen savvy people. But there aren't that many out there. And it's becoming more difficult to bring people into the United States. The country and the world need to figure out how to manage this, or it will box us in for innovation."
— CEO, Software Company

While the increase in headcount implies growth, other data in the survey offers insights as to the significance of the headcount change over the next 12 months.

We asked participants to rank the drivers of their expected headcount change this year. As Fig. 15 shows, executives ranked "increase sales and marketing" as the primary driver.

Interestingly, despite ranking "entering a new market or developing a new product" as the #2 driver, they ranked "needing new skills to develop new products" last.

Figure 15



For a more in-depth view, we sliced the data according to respondents' type of company. As Fig. 16 displays, there are some gaps in which type of company needs to increase headcount for particular drivers.

Figure 16

Top Growth Opportunities Over the Next 12 Months Per Type of Company

Driver	Vertical solutions	Infrastructure software	Application software solutions	Security solutions	Platform/developer software
Increases sales and marketing	✓		✓	✓	
New market or new product	✓	✓	✓		✓
Increase customer support	✓		✓	✓	
Need new skills	✓		✓	✓	

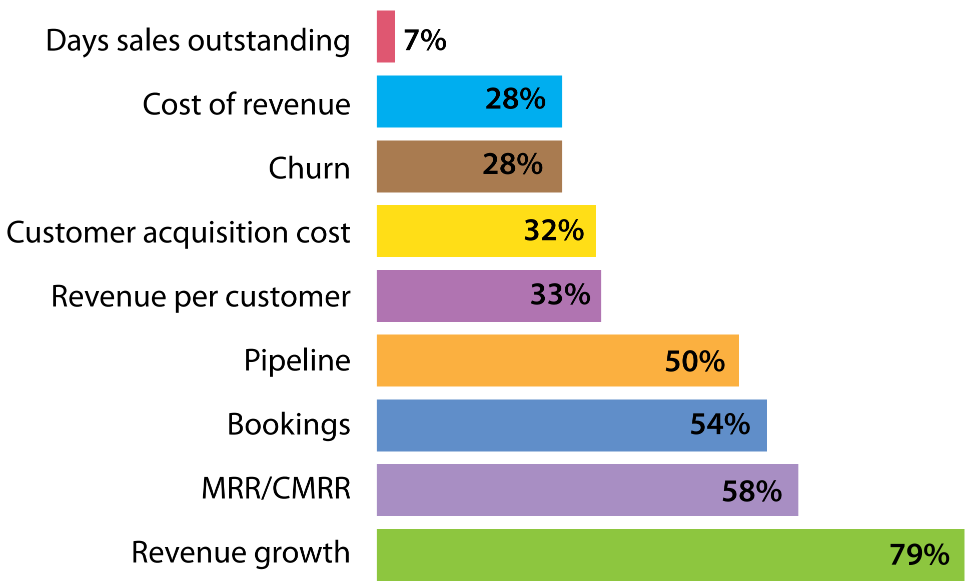
BUSINESS PERFORMANCE METRICS

As with the prior years' surveys in this ongoing CEO / CFO Outlook series, we asked this year's participants to select the most important measurements they use to track their business (among the 10 measurements, they could select all that applied).

As shown in the chart below, revenue growth ranked #1 as the measurement selected by the majority of the respondents. Ranking as #2 - #4 and cited by more than 50 percent of the participants, were monthly recurring revenue / contracted monthly recurring revenue (MRR/CMRR), bookings, and pipeline.

Figure 17

Most Important Measurements Used to Track Business



It is significant to note that the top four ranked methods in 2014 are the same as the top four methods cited by participants in 2010 and 2001. But two aspects have changed:

1. Approximately the same percentage of companies in 2014 use churn as in the 2010 and 2011 surveys, but it ranked lower this year.
2. The ranking of CAC in 2014 is approximately the same as in prior years, but the percentage of participants using this method is twice as many as in 2011.

2010	2011
Revenue 77%	Revenue 75%
MMR/CMRR - 63%	MMR/CMRR - 65%
Pipeline - 55%	Bookings - 52%
Bookings - 50%	Pipeline - 49%
Churn - 28%	Churn - 25%
CAC - 26%	CAC - 16%
DSO - 19%	DSO - 14%

We also asked participants to rank three aspects of financial processes in their business: importance of the process, ease of completing the process, and the level at which cloud computing has improved or will improve the process.

As Fig. 18 displays, the majority ranked "optimizing the customer renewal process and decreasing churn" as the most important aspect. They ranked this factor also as the area where the cloud has the highest impact in improving the process.

Participants also ranked "quick and accurate revenue and expense planning/ forecasting" as a highly important process. However, 26 percent ranked the cloud's impact on this factor as not applicable.

As to ease of completing the process, the majority reported that the "ability to streamline the financial consolidation and close process" has the lowest level of ease.

Figure 18

Surveyed Companies' Ranking of Financial Processes

Ranking: 0=not applicable; 1=low; 5=high

Quick and accurate revenue and expense planning/forecasting

	Importance of Process	Ease of Completing Process	Level that Cloud Has Improved or Will Improve Process
#0	3%	0%	26%
#1	3%	7%	11%
#2	1%	11%	11%
#3	24%	40%	16%
#4	26%	25%	21%
#5	43%	17%	16%

Visibility, accuracy, and efficiency in the Lead-to-Cash process

	Importance of Process	Ease of Completing Process	Level that Cloud Has Improved or Will Improve Process
#0	10%	9%	31%
#1	7%	13%	9%
#2	7%	13%	13%
#3	16%	40%	13%
#4	38%	19%	19%
#5	22%	6%	15%

Visibility, accuracy, and efficiency in the Procure-to-Pay Process

	Importance of Process	Ease of Completing Process	Level that Cloud Has Improved or Will Improve Process
#0	17%	18%	42%
#1	17%	8%	8%
#2	19%	8%	12%
#3	26%	35%	16%
#4	8%	8%	10%
#5	13%	23%	12%

Accurate revenue recognition, deferral, and reporting

	Importance of Process	Ease of Completing Process	Level that Cloud Has Improved or Will Improve Process
#0	7%	8%	42%
#1	5%	4%	9%
#2	17%	11%	11%
#3	19%	30%	15%
#4	21%	26%	15%
#5	30%	21%	8%

Visibility into the utilization and profitability of the Professional Services Organization

	Importance of Process	Ease of Completing Process	Level that Cloud Has Improved or Will Improve Process
#0	18%	15%	42%
#1	5%	11%	8%
#2	11%	19%	11%
#3	26%	30%	15%
#4	21%	15%	13%
#5	19%	9%	11%

Delivering real-time, relevant information and KPI performance to all stakeholders to drive business

	Importance of Process	Ease of Completing Process	Level that Cloud Has Improved or Will Improve Process
#0	18%	9%	31%
#1	5%	7%	7%
#2	11%	20%	11%
#3	26%	33%	24%
#4	21%	18%	16%
#5	19%	13%	11%

Streamlining the financial consolidation and close process

	Importance of Process	Ease of Completing Process	Level that Cloud Has Improved or Will Improve Process
#0	11%	9%	40%
#1	16%	15%	14%
#2	22%	6%	4%
#3	22%	32%	17%
#4	16%	21%	10%
#5	13%	17%	15%

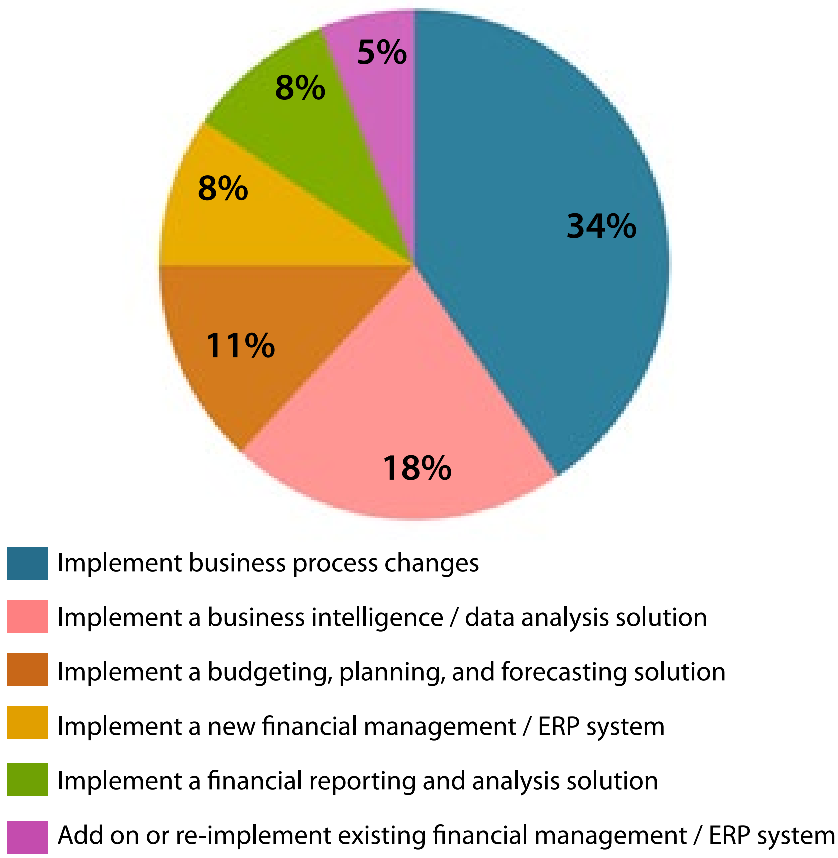
Optimizing the customer renewal process and decreasing churn

	Importance of Process	Ease of Completing Process	Level that Cloud Has Improved or Will Improve Process
#0	7%	6%	31%
#1	4%	6%	18%
#2	7%	16%	6%
#3	15%	31%	6%
#4	20%	27%	16%
#5	46%	14%	23%

Fig. 19 displays the methods the participants' expect to use during the next 12 months to improve their financial processes.

Figure 19

Surveyed Companies' Most Likely Method of Addressing Financial Processes



COMPLEXITIES OF CHANGE

While the study found that the CEO / CFO outlook for the next 12 months is enthusiastic about growth opportunities, both the online survey responses and the in-depth follow-up phone interviews reveal that a new set of challenges and high degree of change accompany the growth.

Competing interests pull software companies in two different directions. It is difficult to balance the effort to acquire new customers without risking the satisfaction level of existing customers. Newer deployment and pricing models—cloud and subscription-based software—are more cost-effective for the software vendors as well as new customers. Yet they still must invest in supporting their existing system structure in order to maintain competitiveness with their existing customers.

But some existing customers do not want to shift to the newer models, or they want the vendor to invest in hybrid solutions. Software companies must change their sales commission structure to work with new pricing and subscription models where the revenue comes in phases and hopefully expands over time.

> **"When a company grows as fast as we are growing, each customer can be a fire drill. But as a mature company, you need to have stable processes in place to support thousands of SaaS customers."**
> ***— CEO, Software Company***

As mentioned earlier in this report, change requires funding to support it. Software companies need to invest in marketing campaigns to grow their business by acquiring new customers and need to invest in innovative product development. But they also need to invest in maintaining the existing products and satisfaction of existing customers.

In a highly competitive market, with the ease of cancelling a subscription to software, vendors must invest strongly in delighting customers. Some are developing entirely new cultures around their customer service activities, and many are investing in social media or technologies that enhance the customer relationship.

Some are even experiencing brand confusion as they focus on the competing customer paths.

In the midst of all this change, software executives' prioritization decisions are becoming ever more complex and increasingly interrelated. The decision choices are all interconnected; none of them are standalone.

Areas of Competing Interests Impacting Executive Decisions

All of the above areas of change and pulls in opposite direction cause some imbalances in operations and budgets. We asked the executives participating in phone interviews to describe the areas of their business that are most difficult to keep balanced because those areas keep impacting each other.

Highlights of their comments are as follows:

- Maintaining the legacy cash cow versus investing in innovating new products
- Investing in sales/marketing versus product development
- Speed and momentum in developing new features and functionalities versus quality
- Necessity to spend a lot of time in interviewing and hiring versus necessity to innovate and get jobs done
- Investing in customers versus investing in customers that will lead to profit
- Growth versus earnings
- Revenue versus expenses
- Growth versus culture
- Maintaining existing brand versus redefining brand

Nearly one-quarter (24%) of the executives stated they have challenges in trying to balance funding and effort to develop new offering versus meeting the needs of existing customers and enhancing existing products.

"In trying to grow the business, it's difficult to balance investing in the sales and marketing side versus investing in the product management and engineering side. You never have infinite resources. So you have to place bets and make trade-offs."
— CEO, Software Company

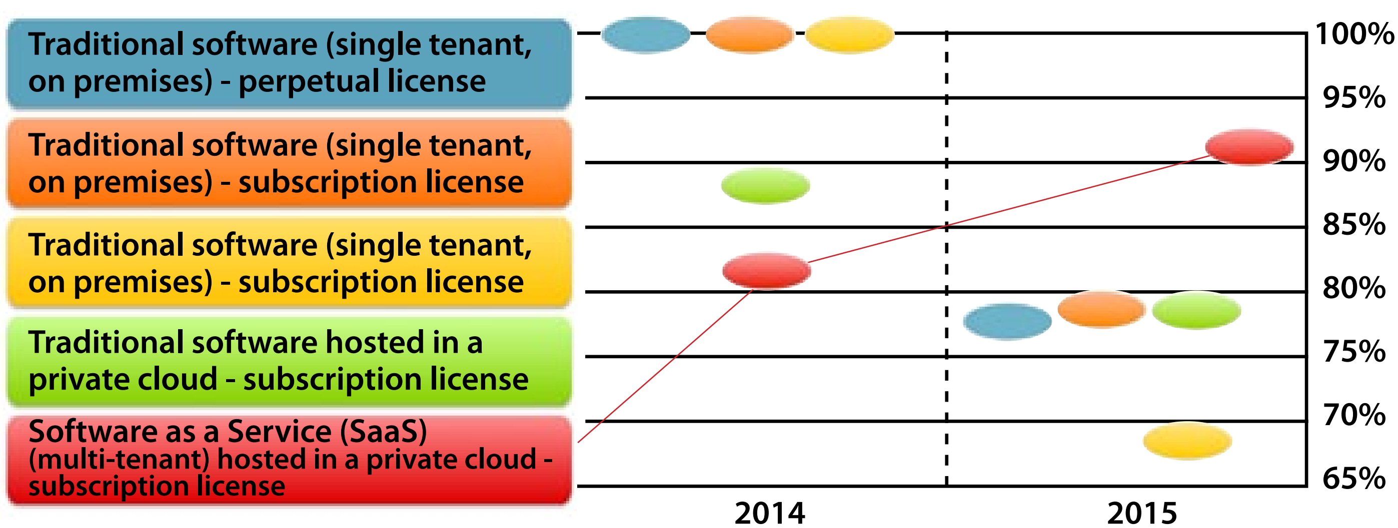
“It’s difficult to balance sales and marketing. Hopefully they’re both active at the same time. But if sales are down, investing in marketing must increase.”
— CEO, Software Company

Deployment and Pricing Models

In our 2010 CEO / CFO Outlook study, 57 percent of the participants deployed on-premises software. That model dropped in 2011 to 48 percent. All of the participants in 2014 reported that they still offer on-premises solutions this year. As highlighted in Fig. 5, to date the decline in on-premises software has not made a significant impact on the companies participating in our study. However, more than 25 percent stated they do not plan to deploy software in an on-premises model in 2015. As Fig. 20 shows, the participants indicate significant changes in deployment models in 2015.

Figure 20

Delivery and Deployment Methods Surveyed Companies are Using



In our CEO / CFO Outlook survey in 2011, an executive predicted: “Cloud-based initiatives will drive a lot of growth in the next two to five years. After that, the pricing model will shift more to value-based pricing and the software industry will reinvent itself once again.” This is happening now.

For our 2014 study, we asked the executives participating in phone interviews if their companies currently use any success/value/outcome-based pricing models. As Fig. 21 shows, more than one-quarter of the interviewed participants reported that their companies are using performance-based pricing. One company implemented its new value-based pricing model in 2013; another implemented it six months ago.

Some are more successful than others at transitioning to performance-based pricing. One company is succeeding at using both a value-based and a success-based pricing model. But the COO at a vertical industry solutions company stated: "Whenever we experienced a pushback on pricing in the past, we tried offering success-based pricing. But in every case the customers chose the traditional pricing model instead of success-based pricing." But performance-based pricing is becoming more common in the industry today, and the company is considering offering it again.

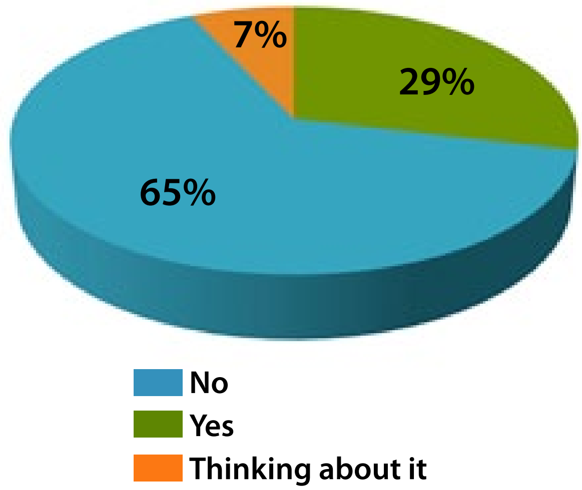
A vice president at a software company described his company's strategy around value-based pricing. "We use this pricing around billing for new technologies that our customers demand that we implement and also around new technologies that we push out."

We also asked the executives about their biggest pricing pressure this year. Nearly one-third of them described pressure coming from competitors lowering their price if they can't compete on value.

An executive stated that, while this is a typical ploy in the industry, this situation has greatly accelerated since 2013. The fact that there are now more players in the market because the cloud makes it inexpensive to start a new company only exacerbates selling on price versus value.

Figure 21

Using Value-Based, Success-Based or Outcome-Based Pricing?



"The traditional pricing models are pressuring us. CIOs are used to buying this way (perpetual license with maintenance), but we don't want to sell this way. And enterprises want transparency in pricing for a true-up at the end of the year. But we don't have apples-to-apples ways to compare the traditional models with new models."
— CEO, Software Company

Some participants reported that this pricing pressure is causing their companies to change their sales/marketing strategies to make their products' value proposition clearer and make sure it resonates with potential customers.

In another variation on pricing pressure, an executive at a system integration company commented that its offshore competitors changed their pricing model to be more like his company's model rather than the traditional offshore model. So his company now has to compete head-to-head with offshore pricing, but his company uses only U.S. talent.

Several executives said their biggest pricing pressure is trying to optimize products for a particular customer segment. For example, an executive explained that enterprise customers are more demanding about user experience. He said his company is experiencing a lot of customer demand to make products more simplified for users. Another executive explained his company's pricing pressure is to optimize for "the largest adoption" that will result in deeper user engagement.

A vertical industry solutions CEO pointed out that maintaining agility is a big pricing pressure common to many legacy companies. "The need for agility is growing because the ability to launch a product is significantly easier than it was two years ago. For a vendor that has been around for 20 years, this pressure is becoming increasingly more difficult."

Meeting Customer Needs

As discussed earlier in this report, participants in our online survey ranked their companies' top business goals. (See Fig. 13.)

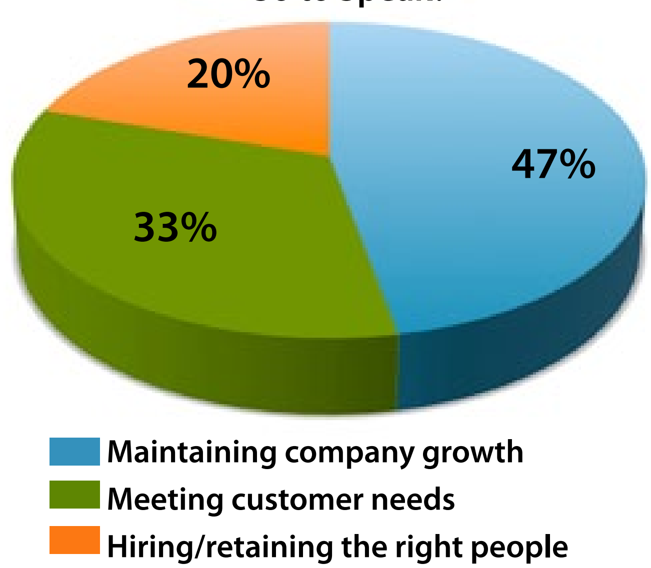
We followed up with the executives participating in the in-depth phone interviews and asked them what most often keeps them up at night, so to speak, among the following business issues: staying ahead of the competition, satisfying investors, meeting customer needs, maintaining company growth, improving the bottom line, hiring/retaining the right people, or other.

As Fig. 22 highlights, "meeting customer needs" figured prominently and was the goal receiving the second-highest number of responses.

We then asked them if the ability and effort to meet customer needs has changed in 2014, and 77 percent stated that it has. (See Fig. 23.)

Figure 22

What Keeps You Up at Night, So to Speak?



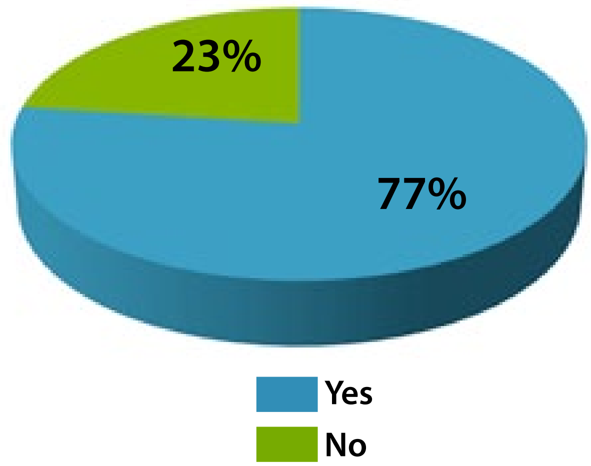
Several executives observed that what is involved in meeting customer needs is becoming much more problematic in 2014 than it was just one year ago. And the challenge is exacerbated by the pace of growth.

Here are some of the highlights in their comments about the current complexities of meeting customer needs:

- "Customers are getting more sophisticated in demands."
- "Customers are more demanding about our making our product easier to use; this means we need to integrate into other platforms."
- "Our customer demands have grown significantly; in fact, they have really exploded on the cloud side."
- "We can't hire all the people we need for customer support."
- "We have realized that the moment our solution gets deployed and is running successfully, a new set of requirements come from the customer. They start thinking about what else they can do with our solution. So we need to understand this and have ongoing dialogs with them."
- "Our existing customers—not our new ones—are asking for broader solutions for more types of users."
- "With the cloud it's a 'show me' market. For customer success these days you have to earn their satisfaction more than ever before."

Figure 23

Has "meeting customer needs" changed in 2013 to 2014



"We've been cloud based for a while. But it's becoming more and more important to meet customer needs *completely* because customers have a growing number of options and switching costs are lower."
— COO, Software Company

Change is challenging, but it represents huge opportunities.

ADDITIONAL INSIGHTS

Valuations. Almost half of the executives participating in the in-depth phone interviews had a common concern about an aspect of the way the software industry is currently evolving. Due to cloud computing, the lower barrier to entry is generating a huge amount of interest in starting new companies. As one executive stated, "There is so much you can do with so little capital these days. It's a great time to start a business."

However, they observed that startups today (especially those interacting with venture capitalists) are focusing too much on valuation instead of on what is differentiating and of value to customers. A CEO commented that the industry "is getting frothy on the valuation side."

Earnings. Several participants stated an opinion that startups are spending much of their revenue on sales and marketing rather than focusing on profitability.

An executive commented that the lack of focus on earnings is worrisome. And another said that too many software companies are sacrificing earnings for revenue growth. He added that this is happening across the board, among long-established companies as well as startups.

IPO trends. The study also found agreement among the interviewed executives that IPO trends are a worrisome development. They observed that going public was basically a right of passage 20 years ago, but today it is less fruitful, not as easy, and a bigger risk. One executive commented that because startups now find it more interesting to stay private longer rather than being acquired, a trend is building that makes going public a limiting factor.

APIs. An interviewed participant raised a point about the impact of the proliferation of APIs. He explained that the "problem of maintaining integration of many disparate systems through APIs is bringing the industry back to best-of-breed players, and that's problematic."

Workforce technology. In a phone interview an executive observed that CFOs need tools to find and reward people with specific skills, both internally and externally for third-party team members. He stated that HRIS technologies today do not accommodate doing this with a global third-party workforce.

ABOUT THE AUTHOR

M.R. Rangaswami thrives on creating influential communities that achieve global impact. Using his skills as a critic, cheerleader, and facilitator, M.R. has united leaders and advanced strategic initiatives in the field of software, corporate sustainability, and entrepreneurship.

He is the co-founder and CEO of Sand Hill Group and the publisher of SandHill.com, the premier online destination for strategic information on the cloud, mobile, Big Data, and Internet of Things software ecosystem. Contact M.R. at mr@sandhill.com.

Report Editorial: Kathleen Goolsby

Creative Design: Kathy Burk

SAND HILL GROUP

Sand Hill Group provides strategic management, investment, and marketing services to emerging market leaders. Sand Hill Group is best known for its work in the software and services market. As founder of the former "Enterprise" and "Software" conference series, Sand Hill Group has been credited with uniting the software business ecosystem of executives, entrepreneurs, investors, and professionals.

The firm is also the publisher of SandHill.com, the premier online destination for strategic information on the software business. The site's feature articles, blog posts, news, and executive briefings, along with its weekly newsletters, are read by thousands of top software industry executives.

Sand Hill Group also funds primary research into key technology and business model trends that impact the software business. Find out more at http://sandhill.com.

RESEARCH UNDERWRITER

Intacct is the cloud financial management company. Bringing cloud computing to finance and accounting, Intacct's award-winning applications are the preferred financial applications for AICPA business solutions. Intacct applications, in use by more than 7,300 organizations from startups to public companies, are designed to improve company performance and make finance more productive.

Hundreds of leading CPA firms and Value Added Resellers offer Intacct to their clients. The Intacct system includes accounting, contract management, revenue management, project and fund accounting, inventory management, purchasing, vendor management, financial consolidation, and financial reporting applications, all delivered over the Internet via cloud computing.

Intacct is headquartered in San Jose, California. For more information, please visit www.intacct.com or call 877-437-7765. Connect with Intacct on LinkedIn, Facebook, Twitter or YouTube.