nextlevelbusiness
the growth accountants

Software Leaders Survey 2019

Foreword from the CEO

"We are delighted to present the Software Leaders Survey. For the first time we have a clear picture of the landscape for smaller software businesses in the UK.

As already a specialist in supporting the accounting and finance needs of software businesses our goal with the survey was to further support the UK software industry through sharing a deeper understanding of it with a particular focus on the small and medium sized software businesses that operate within it. We believe software represents a fantastic opportunity for the UK as an industrial sector and also for the talented entrepreneurs in the UK who are able to harness talent and work on solving problems through software that bring real value to their customers on a local and global stage.

The overall technology sector in the UK is already growing 2.6 times faster than the overall economy and even within this bright sector software represents a particularly bright spot reporting double digit growth rates. This level of growth does not come without it's own challenges and this survey shows where both the challenges and the opportunities lie for software businesses here in the UK.

By comparing the insight we have generated surveying small and medium sized software businesses in the UK to other non-software UK businesses of a similar size and also to larger global software companies we are uniquely able to provide perspective and insight into the sector here in the UK.

Finally, I would like to thank all those that participated in the survey and the team here at Next Level Business for pulling it together and urge those reading to take positive action for yourself, your businesses and the wider UK software industry."

-**Paul Layte, FCA**

Sampling and method

- We sampled UK SME software developing businesses (turnover and employment levels presented as graphs following this slide) and compared these results with the 2017 Gov.uk survey of generic UK based SMEs as well as with Key Bank Capital Market's (KBCM) 2018 global software business survey, which included global software businesses of all sizes.

- When comparing results, the phrase 'Software SMEs' refers to our own survey sample / results. The phrase 'UK SMEs' refers to the results from the gov.uk survey, and 'global software companies' refers to KBCM's survey findings.

Contents

Product

Executive Summary

- **Disruptive innovation** - many UK software SMEs had high ambitions for their product, with 75% of respondents saying that they currently, or eventually aimed to provide a product to replace legacy software. Being innovative within the industry would help software businesses to gain market share from legacy software providers.
- **Uptake gap** – AWS was the most popular web hosting service, however the uptake from UK software firms was much less than from global ones. As well as this, 3 times as many UK firms hosted through Microsoft Azure than did global firms. AWS has a strong position in the market, whereas Microsoft Azure has an opportunity to own the future market, as small firms will grow and potentially increase the value of services needed in terms of web hosting.
- **Investing in innovation** - 90% of UK software firms plan to introduce more products or services in the next 3-5 years. By diversifying the range of software products provided, an SME can hope to boost and grow sales, especially if providing complementary products, or value-adding extensions to existing software.
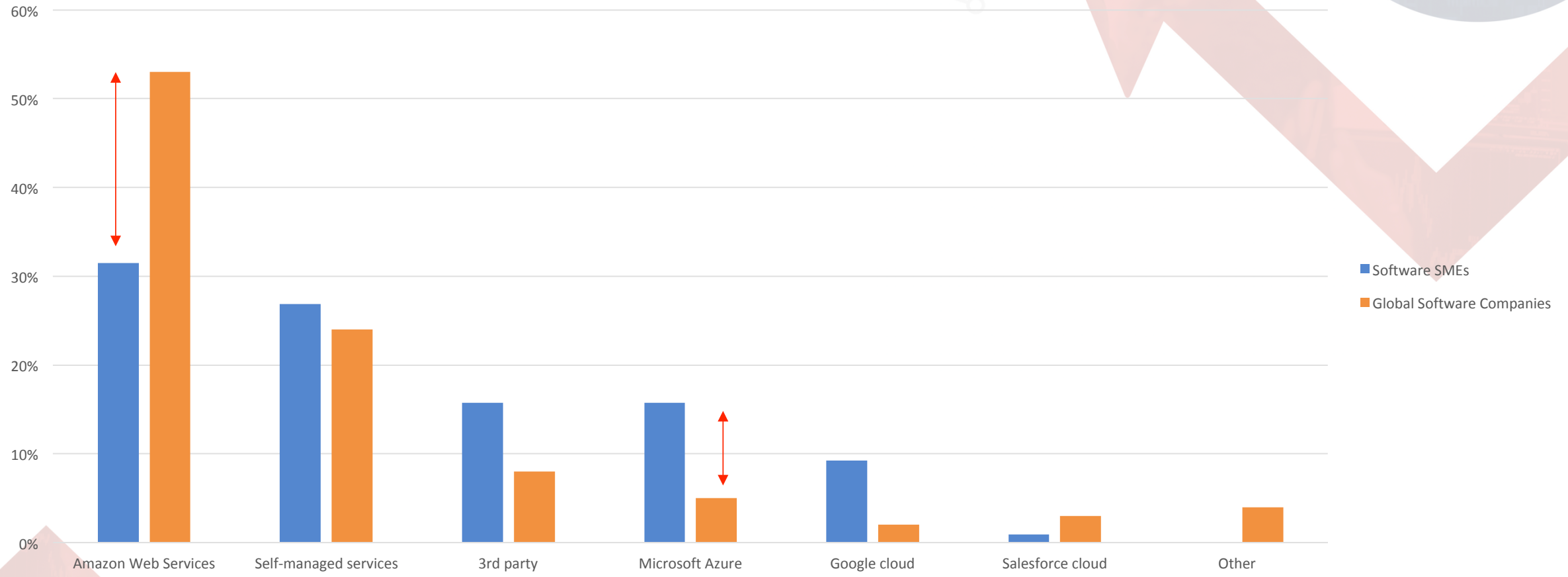- **Product innovation** - 80% of UK software businesses developed new, or improved existing, products and / or services in the past year. Software SMEs in the UK have already been making steps towards innovating and improving the range of products they provide or have optimised existing products to hold a competitive edge in the market.
- **Not just software** - it was common for software business to generate revenue through additional professional services. The majority of both UK (68%) and global firms (71%) made some amount of revenue through the provision of professional services, this is likely to be through consultancy and customer success advice etc.

Disruptive innovation: ¾ of UK software businesses currently, or eventually aim to, provide a product to replace legacy software.
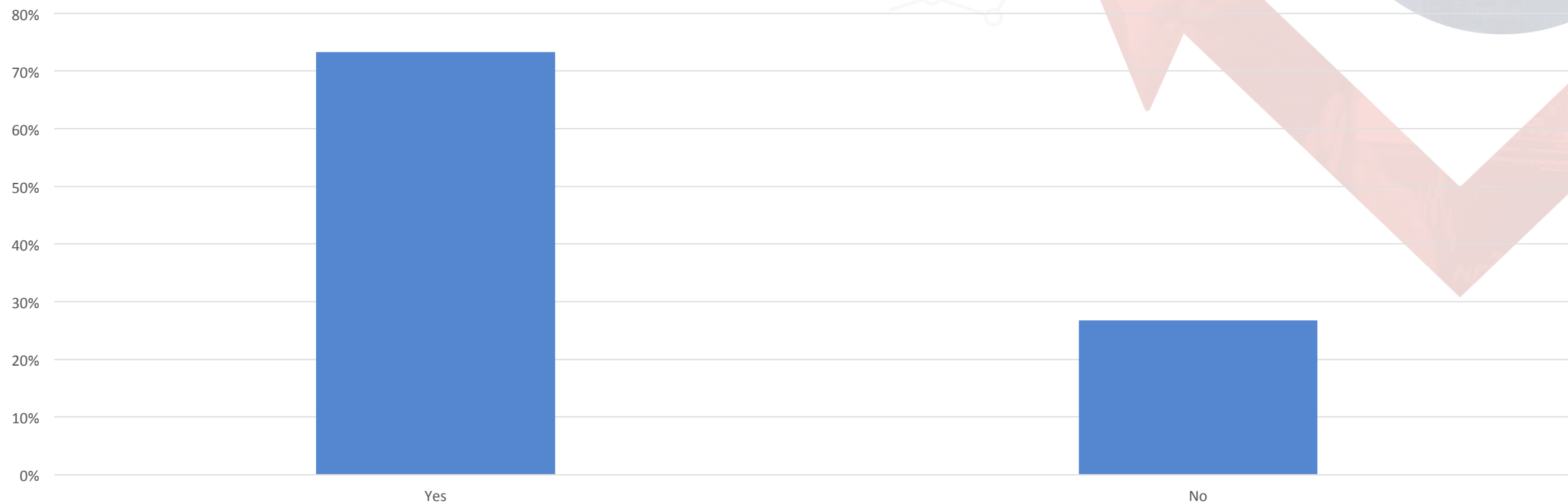
- This question presented the attitudes towards the software that is provided by SMEs in the UK. Many businesses believed their product is – or will be - innovative and useful enough to replace legacy software. The reason for this question was because it is important to understand – given the shift from legacy to cloud based software – who in the UK SME software market is working towards growing their businesses complementary to this paradigm shift. More and more buyers of software are realising the benefits of being 'in the cloud' as opposed to using traditional, legacy software. Software firms who want to achieve success should definitely be aiming to take advantage of this and pave the way for buyers in the market to easily make this shift.

Uptake gap – AWS was the most popular web hosting service, however the uptake from UK firms was much less than from global ones.

Legend:
- Software SMEs
- Global Software Companies

Categories: Amazon Web Services, Self-managed services, 3rd party, Microsoft Azure, Google cloud, Salesforce cloud, Other

- Amazon Web Services is easily the most popular method of providing software, for both UK SMEs and global software businesses. The gap in uptake suggests however that there is room for AWS to market and sell its services to smaller firms within the UK.
- The case is quite the opposite for Microsoft Azure; with more than twice the amount of UK SMEs using Microsoft Azure than global firms. This could suggest that Microsoft Azure has a strong foothold on the 'future' market, meaning their subscription turnover might rely on these small companies growing and increasing the value of the services required from Azure.

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Investing in innovation: 90% of software firms plan to introduce more products or services in the next 3-5 years.
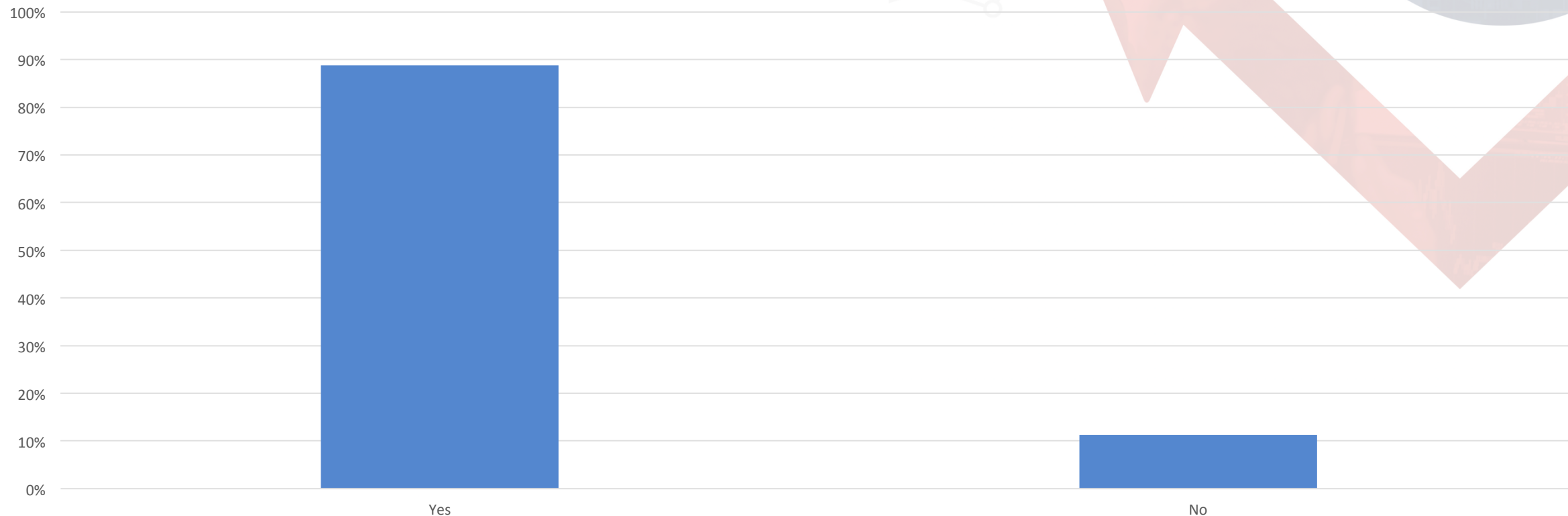
- It looks as though a lot of the respondents were ambitious and forward thinking, with 9 in 10 of those planning on introducing more products and services within the next 3-5 years. Innovation in this industry is key, and being able to sell multiple products (particularly ones complementary to each other) is a great way to grow. A software firm who rolls out a new product after having success with one or a few already is in a great position. They can market to who they already have as customers e.g. offering the new product as a bolt-on to their current plan – as well as this they have already built credibility for themselves and as more products are created, brand awareness should dictate that customers will 'stick with what they know' and buy products through brands they have a rapport or relationship with.

Product innovation: 80% of software businesses developed new, or improved existing, products and / or services in the past year.
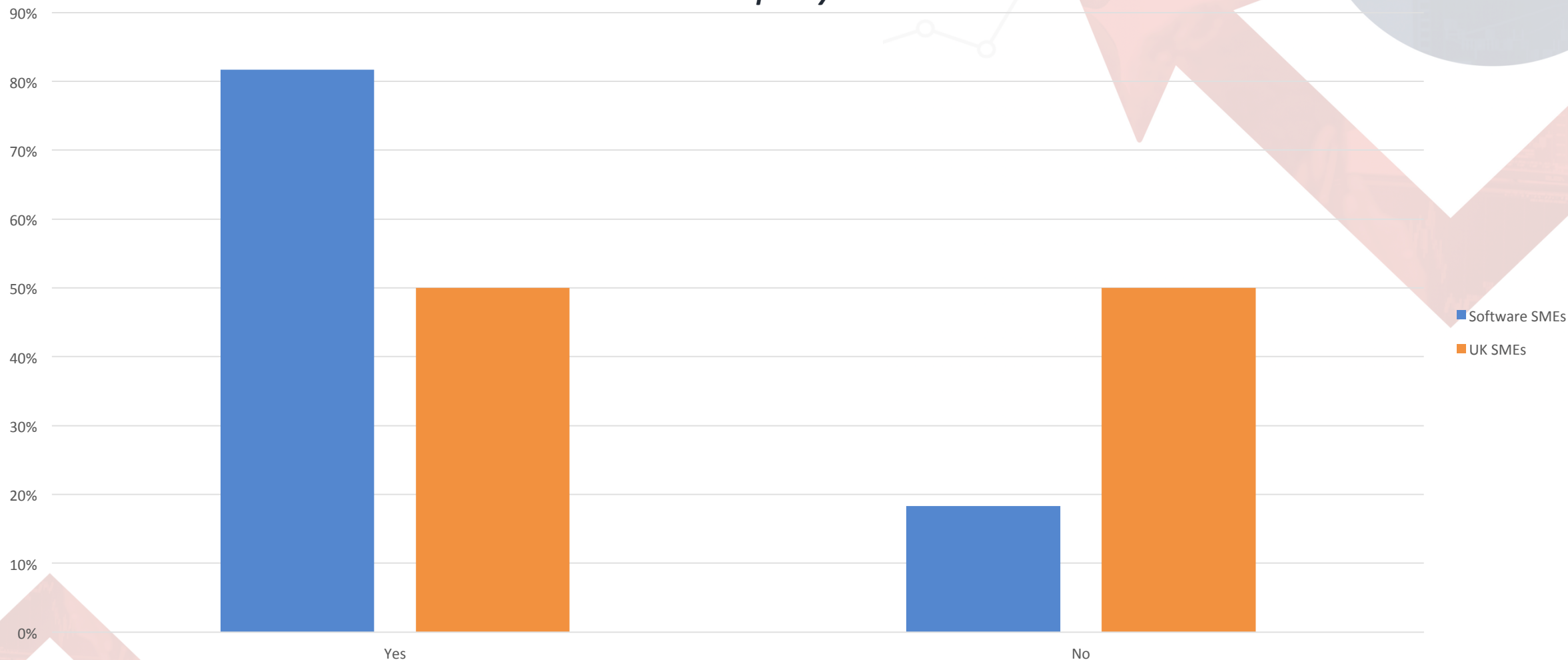
- Software SMEs showed more of disparity between answers whereas UK SMEs were split completely in half. 8 in 10 software SMEs have developed and / or improved products and services which gives an idea of the constantly innovating and improving business culture which is important for the survival and growth of modern software developers and distributors. The results of UK SMEs as a whole are difficult to analyse as different industries rely much more on innovation than others – some industries may not be relevant to any sort of product development at all.

Not just software: it was common for software business to generate revenue through additional professional services

These businesses are probably not providing any type of additional professional services – it may be advisable for UK SMEs to follow the path of global software businesses and provide some level of revenue-generating professional services.

Although there were many more UK firms providing no additional professional services which generated revenue, they looked to outperform global software business at providing very high-value professional services.

- Software SMEs
- Global Software Businesses

- The majority of UK software SMEs made only 10% or less in additional revenue from providing professional services as well as software. Globally, more software firms than UK SMEs made additional revenue through professional services, however UK SMEs seemed to overshadow software firms globally at the higher end of the scale as a higher percentage of UK firms generated additional revenues from 26% to over 200%.

- Examples of how these services are provided could include customer success managers, consultancy after subscribing to the product, project management etc.

- Being able to integrate some kind of professional services to be sold with - or alongside - software means a whole new revenue channel can be unlocked. Finding the right kind of services to provide would be a challenge to overcome but depending on the software and the areas it has applications in can be a start. For example, a CRM software provider may decide to offer consultancy in how to communicate with prospects, marketing strategy or sales training.

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Growth

Executive Summary

- **High growth** - 1 in 4 software SMEs experienced a growth rate of over 100% in the past 12 months, although over 30% of them had a growth rate of 9% or less. This shows how much disparity there is between software SMEs in the UK in terms of growth and performance in the market – it's important to consider, however, that some firms may be sacrificing profit for growth and vice versa. When measuring performance for your business, keep in mind what your objectives are and what KPIs are relevant to this.
- **Expecting change** - over half of software SMEs expect their sales revenue to grow by more than 200% in the next 3 years. This coincides to an extent with the growth rate experienced, however there were still two thirds of respondents who had a growth rate of less than 70% over the past year, so it's possible that some companies are not forecasting sales & growth as accurately as possible.
- **Heavy innovation growth** – UK software firms are undertaking growth-stimulating activities such as building products domestically and selling them to the world. The three most cited growth-related activities being undertaken were developing and launching new products and services, research and development investment as well as increasing exports and tapping into new overseas markets. Breaking into overseas markets as a software providing firm is a great way to stimulate growth as there is not too much red tape surrounding it as it is not a tangible export, and it is relatively low-cost once the software has already been developed.
- **Big 4 advice areas** - legal, finance, marketing and growth were the 4 most cited areas that software firms sought advice in. This makes sense in both a software & an SME context. Legal advice is likely to be sought by both new business owners who are developing intellectual property etc. as well as software firms who may be interested in licensing and contracting laws. Financial advice is often a priority for smaller firms as they are likely to want to raise funds and manage cashflow on a subscription basis.
- **Threats to SMEs** - the 3 obstacles to success cited most by software SMEs included staff, competition in the market and obtaining finance. It's likely that software businesses need to hire and train quite highly skilled staff for development of their product etc. In addition, where many producers are creating software for similar purposes (CRM, databasing etc.), it is understandable that staying competitive, and therefore competition in the market, may be perceived as an obstacle to success for some software SMEs. Finally, obtaining finance is likely to be virtually vital to the success of a software firm, especially in early stages as there is likely to be a lot of research & development, staff and training costs – without these, there is not really a capable business so it is no surprise this was one of the most cited perceived obstacles to success.

High growth: 1 in 4 software SMEs experienced a growth rate of over 100% in the past 12 months.
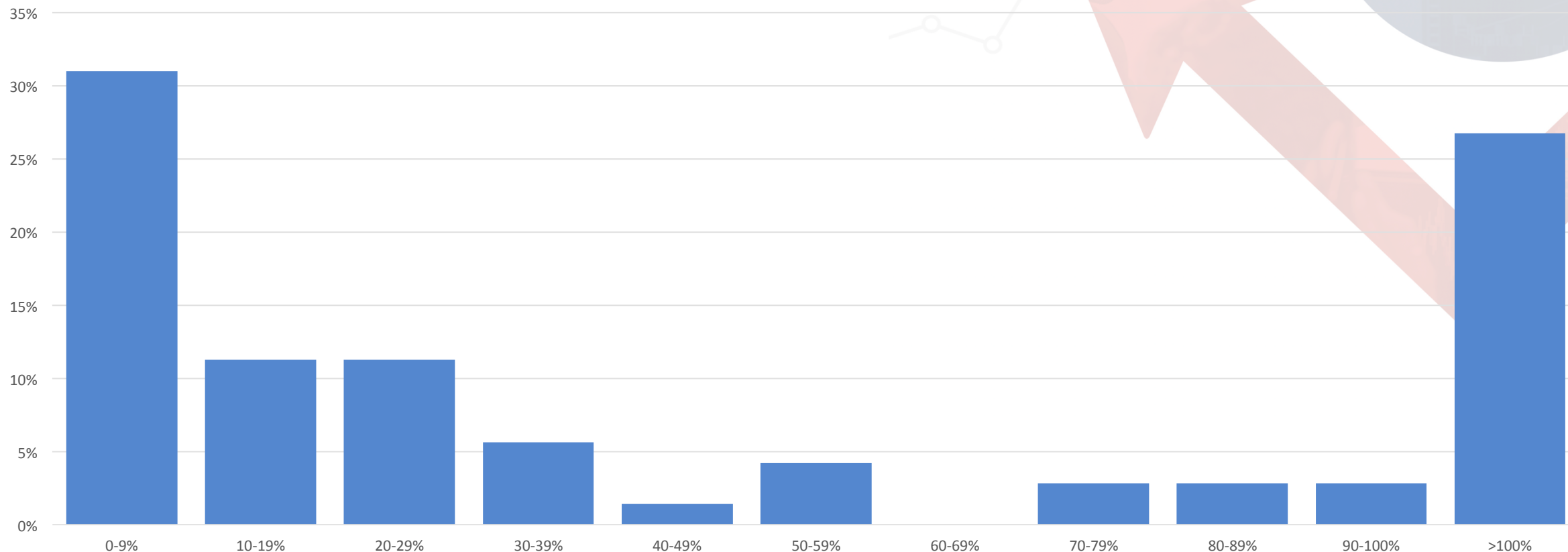
- The growth rate for software firms in the past year was very mixed, however there was a clear majority who experienced 9% or less growth in the past year. The second most popular response was a growth rate of over 100% which shows a huge disparity between growth of different SMEs operating within the sector.

- The high growth firms are likely to be ones who have fully developed their product, have existing subscribers and are gaining more or upselling to their current ones. Low growth could be explained by a lack of marketing to new prospects, an inability to achieve the finance necessary to increase capacity, or simply a product which is niche and therefore limited by the potential customer base.

- Profitability should also be taken into account here. Usually profit can be sacrificed for growth and vice versa – so not being profitable but having a high rate of growth can be a positive for a business, depending on their specific objectives.

Expecting change: over half of software SMEs firms expect their sales revenue to grow by more than 200% in the next 3 years.
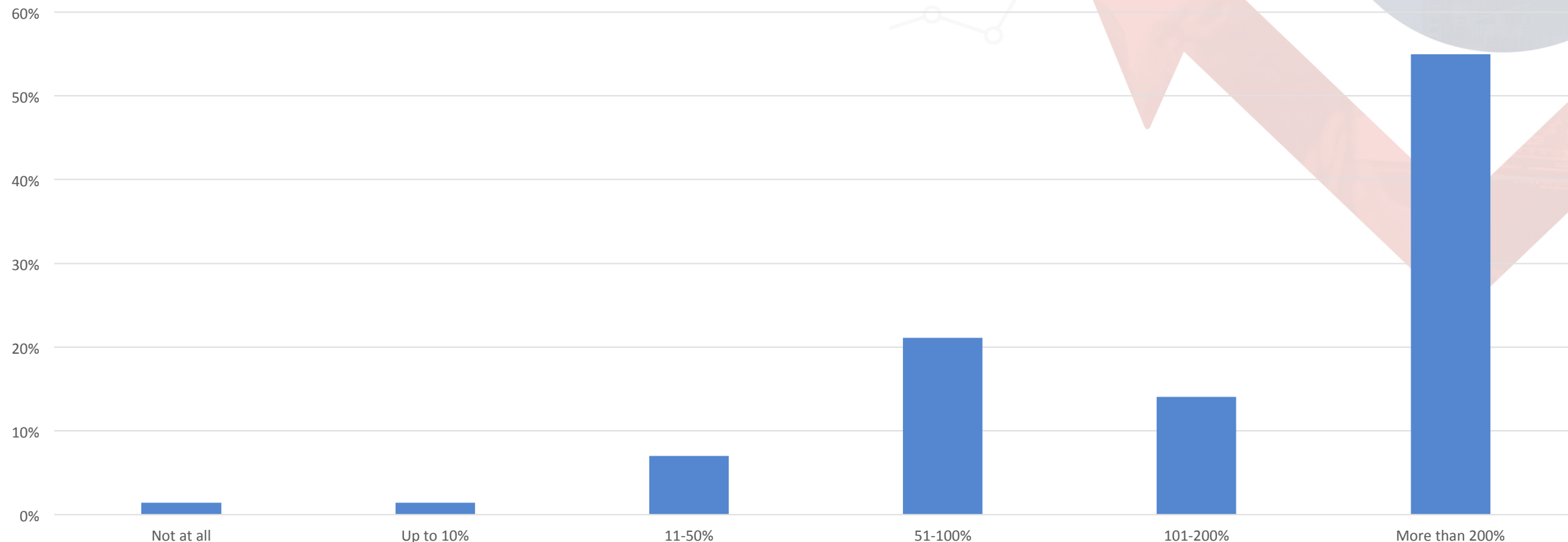
- These findings are reflective of the fact that the majority of software SMEs are growing at a healthy rate and are undergoing growth-related activities. Especially with smaller sized firms, engaging in growth-related activities and having a high growth rate will help lead to increased sales and therefore sales revenue. These expectations are prospective and it will be interesting to see what proportion of these firms meet their target / expectation within the next 3 years.

- Sales revenue is likely to be increased mainly (because these firms are small) through acquiring new customers, and as they develop a customer base, future sales revenue may be increased through upselling to current / retained customers.

Heavy innovation growth: build at home, sell to the world

Innovative – building the product domestically

Selling to the world

Legend: ■ Software SMEs ■ UK SMEs

Chart categories (x-axis): Develop / launch new products / services; Research and development investment; Increase exports or tapping into new overseas markets; Increase workforce skills; Introducing new working practices; Increase leadership capability of managers; Capital Investment

- Developing and launching new products / services was the top response for that of software SMEs, unlike UK SMEs who mostly cited increasing workforce skills as a growth-related activity they were undertaking. A software company thrives through innovation and development of products which is why it makes sense that this was the most cited answer for this question. Alternatively, UK SMEs may have in-house training, health and safety courses, apprenticeships etc. to offer to increase workforce skills which, for software companies, in many cases can be unwarranted or unnecessary.

- It follows that research and development is a software SME's secondary priority as without research it is not possible to develop a great product without initially laying the foundations of research and pre-market development.

- It is also worth mentioning the third biggest priority, increasing exports and tapping into new overseas markets, is often much less difficult for software companies as 'exporting' simply implicates having people / businesses from foreign countries subscribe to your software service.

Big 4 advice areas: legal, finance, marketing and growth.


Business growth was a popular advisory topic for UK SMEs across all industries – growth is vital for SMEs to survive.

Legend: Software SMEs (blue), UK SMEs (orange)
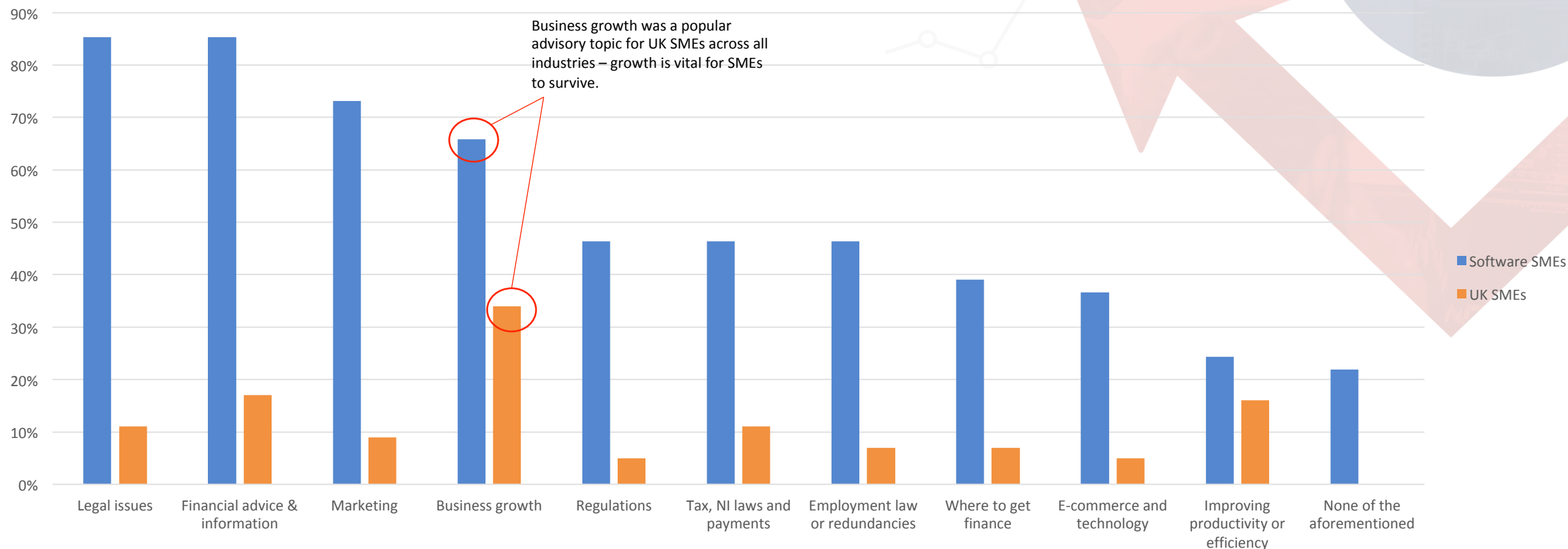
- Software companies mostly sought advice on legal issues – with over 80% of respondents citing this. The legal implications for software development are many and are likely to increase over time. Many of these laws are likely to be related to privacy, GDPR as well as patenting and intellectual property law. It would be useful for software SMEs to have an idea of exactly what their potential legal issues are before seeking advice so that they can make sure they are getting exactly what they need and are solving issues promptly. A patenting or IP issue could lead to much bigger problems if not resolved swiftly.

- Financial advice and information was the second most popular topic of external advice sought by software SMEs. A recurring theme within this report is that software firms often need heavy investment and financial backing so it is no surprise this was a topic that affected the majority of software SMEs. It is also key for growing firms to understand how to properly manage their finances and how to segregate spending across different departments etc. financial advice can be critical to the success of a software firm, and some services such as R&D tax credit appraisals can actually generate some cash inflow for innovative software firms.

- Interestingly, the only two categories of advice sought which had more consistent results across UK and software SMEs were that of business growth and improving productivity or efficiency. Seeking business growth advice is an apt reflection of the fact that SMEs, and especially those at the smaller end, are actively seeking to improve and grow their businesses to get a foothold in the market, but may not have the business expertise to understand independently how to do this. Increasing productivity or efficiency is unsurprisingly a fairly universal area of advice sought by businesses because being more productive and efficient leads to higher profit margin and therefore better financial performance.

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Threats to SMEs: the 3 obstacles to success cited most by software SMEs included staff, competition in the market and obtaining finance



Legend: ■ Software SMEs ■ UK SMEs
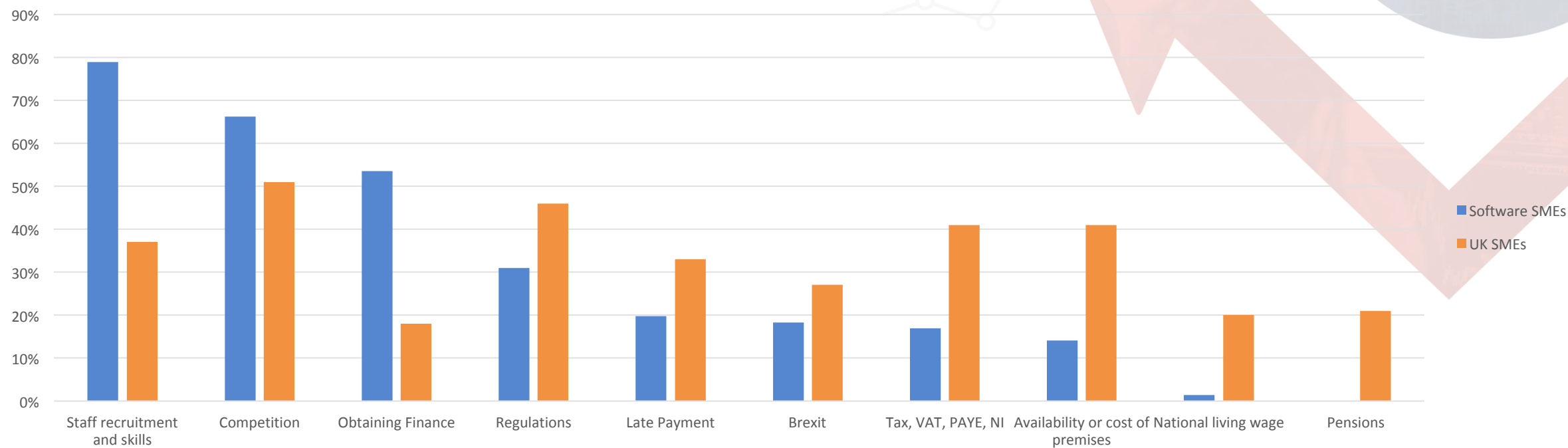
- The biggest challenges for software SMEs reflect the nature of the business and gives an insight to the way in which they operate – these factors also are interlinked and have implications on one another.

- An explanation for the difficulty in staff recruitment and costs could be that software firms need highly skilled developers and software engineers, which would be of limited supply in the market. Finding the right people is vital for software firms to succeed and gain a competitive edge in the market.

- Competition in the market is an interesting challenge to consider. A lot of the software products in the market are there to provide similar services to each other (e.g. Xero, Sage, Quickbooks etc.) and so need to be highly competitive in order to succeed. Even being slightly behind in terms of development, UX or pricing can be hugely detrimental to the success of a software company, and in particular, an SME. As aforementioned, these obstacles all link to each other and in this case, it is feasible that competition also has an effect on staff recruitment. If there are firms in the market presenting competitive pay and benefits packages or having more effective recruitment processes, it potentially leaves other firms with an even smaller pool of labour to employ.

- Obtaining finance also was a largely cited obstacle to success. Software firms have a lot of costs to think about – highly skilled staff, marketing, development, hardware, app / software maintenance and so on. Raising finance consistently is a challenge and competition in the market can even affect this (e.g. 'losing' to a competitor for an investor's money).

- There are some obstacles that UK SMEs cited which did not seem to be a problem for software SMEs. Some of these are simple to explain, for example the national living wage could be a problem for SMEs in the hospitality and retail sectors as they are likely to have low-skilled staff to pay and could be worried about having to offer the national living wage to all of their staff, increasing costs massively. Availability and cost of premises are also an issue perhaps for brick-and-mortar based SMEs and businesses who have tangible goods to store, but for a software firm they realistically only will need an office to work from, unless they work from a remote basis, in which case premises should barely be an issue at all.

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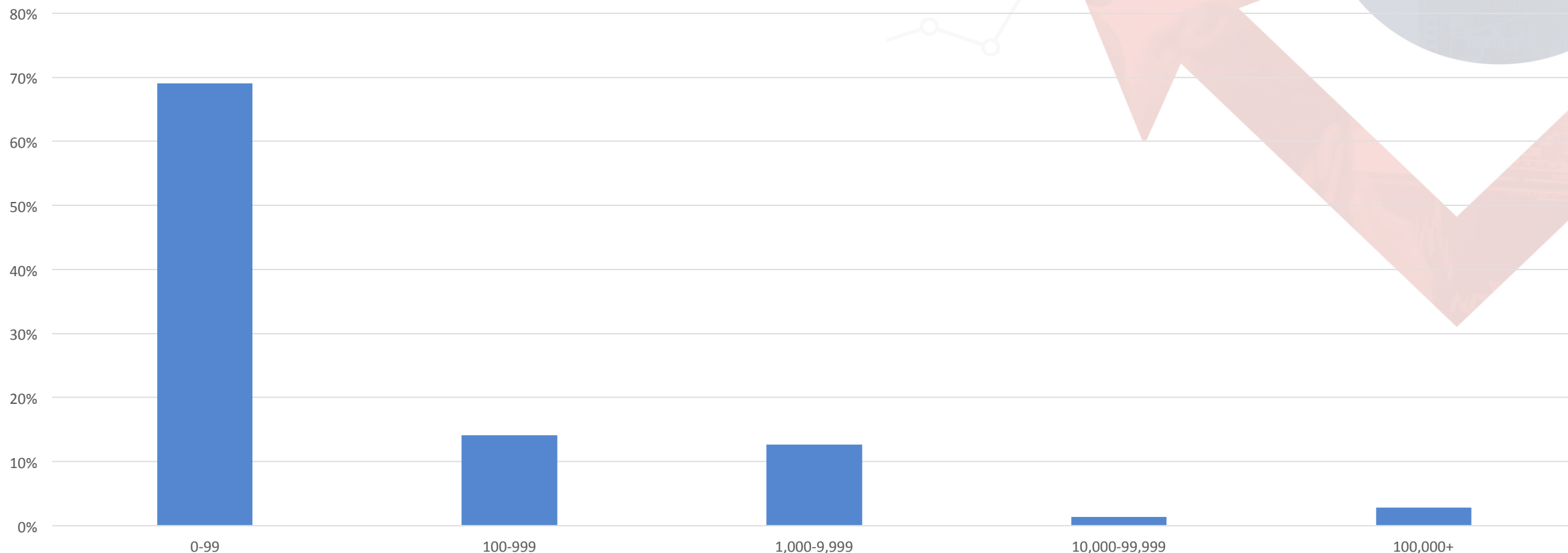# *Customer*

Executive Summary

- **Customer service** - more than 80% of software SMEs provided a consistent level of technical support to clients. This is likely to have advantages in customer retention. Customers being able to request assistance when using software is a good way for businesses to build and maintain relationships, improving the overall customer experience. Having an efficient and well-processed technical support system in place could help to achieve a competitive edge within the market and offer services of better quality than other players in the market.

- **Small customer base** - 7 in 10 UK software firms manage 99 or fewer subscriptions. Knowing how many subscriptions you manage is a difficult way in which to measure success. Factors such as contract size and contract length are important to understand what this stat actually means in reality. Understanding this means asking questions such as *'How much are these customers worth to my business*?'. For example, it may be more profitable to manage 30 subscriptions worth £1k a month each than 200 subscriptions worth £150 per month each, as the acquisition costs and other costs would be spread across fewer subscriptions.

- **Growth processes** – When asked 'to what extent do you have a consistent and reliable (acquisition/retention/upselling) process?' customer upselling was the least cited, and retention was the most. It is important to have a consistent and reliable process for customer retention as 80% of future software revenue will be generated from only 20% of existing customers. Nurturing and retaining customers is extremely important for subscription businesses because each customer will have an acquisition cost attributed to them, so retaining a customer for some period of time is the only way to offset this and to start generating profit.

- **Maintaining and growing** - customer acquisition was the most important metric cited by respondents by far, at almost 90%. It seems as though, however, maybe UK SMEs have their processes misaligned, as, if acquisition is considered the most important metric, then it would make sense that it would also be the exercise for which businesses had the most consistent and reliable processes. It would be in the best interests for the majority of these SMEs to develop their acquisition process to the point where it can be consistently followed and repeated to achieve results.

- **Know your customer** - the customer metric which was understood by the most respondents was average revenue per user (ARPU); the least was upsell rate. Acquisition costs and lifetime value were cited as being understood by an equal percentage of respondents, second to ARPU. Understanding these metrics, particularly customer lifetime value, is necessary when considering subscription software businesses as this can help with forecasting cashflows as it is relevant to understand a customer's potential value to the business over a longer period of time, with recurring revenue. Average revenue per user is also important to understand as it can help SMEs to recognise their 'good' and 'bad' customers which means being able to tell where they should focus their efforts, and who are their key accounts.

- **Low churn** - two-thirds of UK businesses had a churn rate of 0-4% as a percentage of revenue. This range of churn rate was cited by almost 3 times as many UK firms than global businesses which shows that UK firms are currently in a good position. The reason for this is potentially that, because the UK firms are much smaller than global ones, they have more capability to manage their customers more closely and keep customer satisfaction up. As well as this, the fact that many SMEs have a consistent and reliable customer retention process in place, this could be the reason why churn rate is so low.

Customer service: more than 80% of software SMEs provided a consistent level of technical support to clients.
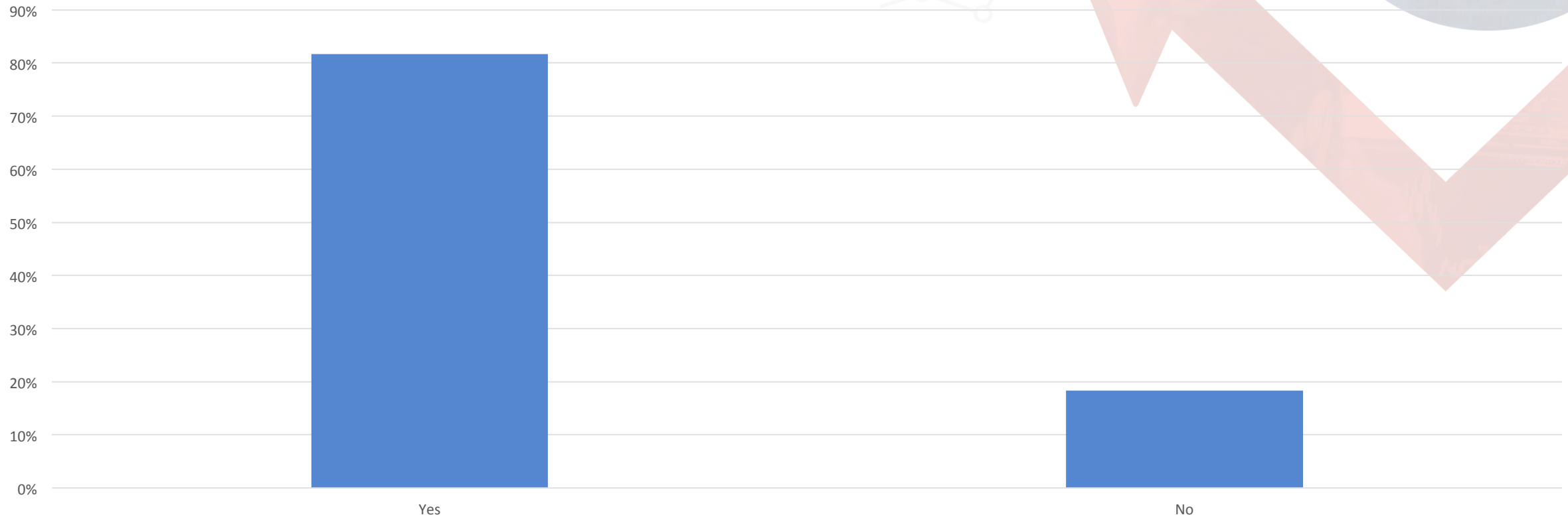
- Most software SMEs provided a level of technical support to its customers consistently. A major reason for this is likely to be customer retention. If a subscriber is becoming unsatisfied as they can't get help using a software product, they may choose to unsubscribe or switch to an alternative which includes this level of support. As well as this, if a consumer has a choice between two complicated software products that do the same or similar things, they are almost certainly going to choose the one which provides technical support so they can use the product much more easily. software providers who want to retain a customer base should consider providing this kind of support – it could also help to attain customers in the first place.

Small customer base: 7 in 10 software firms manage 99 or fewer subscriptions.

Chart showing percentage of software firms by number of subscriptions managed:
- 0-99: ~69%
- 100-999: ~14%
- 1,000-9,999: ~12.5%
- 10,000-99,999: ~1.5%
- 100,000+: ~3%

- Knowing how many subscriptions you manage is a difficult way in which to measure success. Factors such as contract size and contract length are important to understand what this stat actually means in reality. Understanding this means asking questions such as *'How much are these customers worth to my business*?'. Understanding your customer metrics really is vital to being able to benchmark your business and understand the quality of your customers as well as the numbers.

- In most cases, it will be beneficial to be picking up more subscriptions for your software product, but it is equally beneficial to fully understand the growth implications that derive from this. For example, every new subscriber is likely to be a new revenue stream, potentially a new monthly / quarterly / yearly invoice to chase as well as (depending on how your business model works) the increase in employment that may have to be undertaken in order to keep on top of growth and continue to work efficiently.

Growth processes: customer upselling was the exercise for which the least software SMEs had a consistent process.

Question: To what extent do you have a reliable and consistent customer _____ process?

Legend: ■ Not at all ■ Not much ■ Highly variable ■ Variable ■ In the main ■ Totally
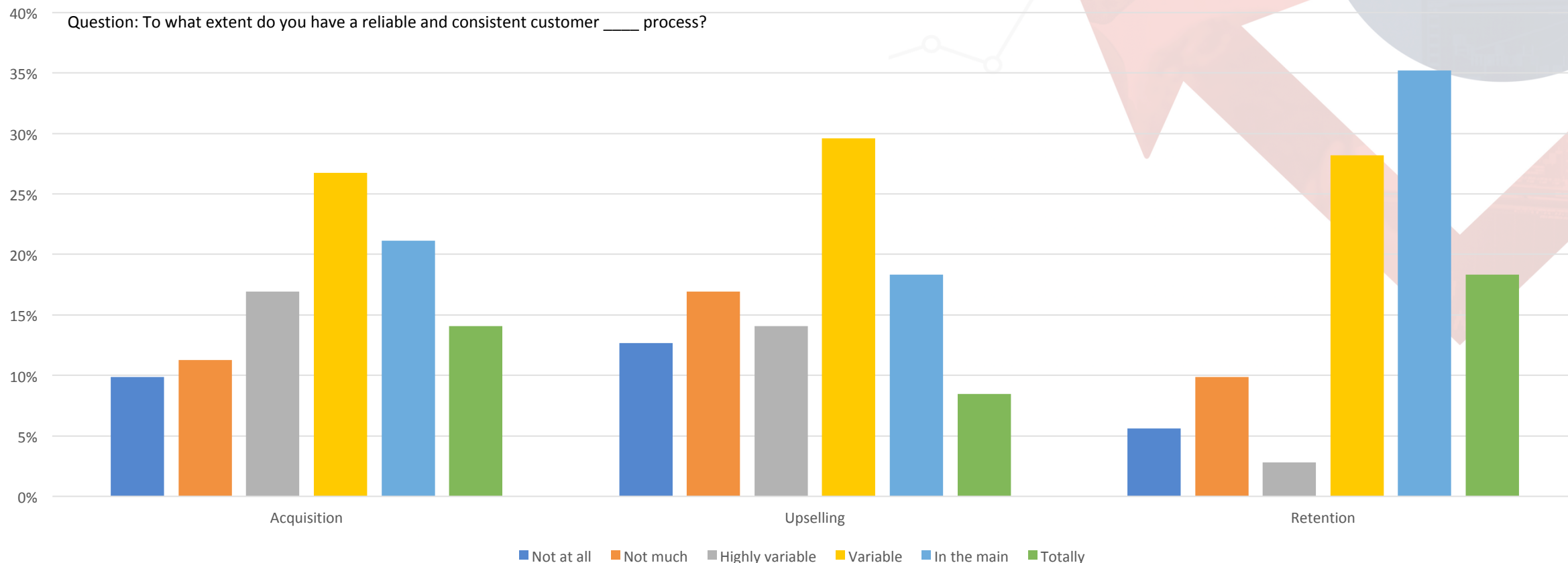
- Only 8% of UK software SMEs said that they totally had a reliable and consistent upselling process. The majority said that it was variable, or that they didn't have much of a process in place. The importance of these findings is that, processes like these which are not fully understood can lead to lost revenue, because without a 'best practice' for upselling being in place, different sales people may use different methods and therefore some sales processes will not be optimised.

- The customer metric which most businesses had a reliable and consistent process for was retention, with 5 in 10 business founders saying they had a consistent and reliable process either totally or in the main. Retention is a very important area in which to have a process for, as around 80% of future subscription revenue will come from existing customers. Having a process in place for this will help solidify your customer base, meaning potentially a more reliable and predictable source of revenue, and when optimised with a great upselling process, may lessen the need to look to acquire customers, reducing operating costs as well as freeing up time to focus on other aspects of the firm.

- Acquisition provided more middling answers with most respondents citing their process was reliable and consistent either totally, variably or in the main. Acquisition is important but should only be the main focus of smaller firms with a very small customer base. Small firms will always need to acquire customers to begin to generate revenue and can only focus on retention and upselling once they have a number of subscribers.

- The 'take-home' point from these findings is that software SMEs in the UK could do more to make sure they have repeatable processes in place which are understood by all people relevant to the sales processes. The smallest of these are likely to need to focus mainly on customer acquisition and the ones which are slightly bigger and have an existing customer base should pay attention to their upselling and retention processes – not only as separate processes, but how they can create synergies between them and optimise them.

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Maintaining and growing: customer acquisition was the most important metric cited by respondents by far, at almost 90%.

Only one respondent in this survey cited customer upsell as their considered most important metric, which could simply be because of the early stage of business that the sample would likely be in. It doesn't make sense to prioritise customer upsell with a small or non-existent customer base.

Customer acquisition	Customer retention
Customer upsell	

(Bar chart: y-axis from 0% to 90%. Customer acquisition ≈ 85%, Customer retention ≈ 14%, Customer upsell ≈ 1%.)
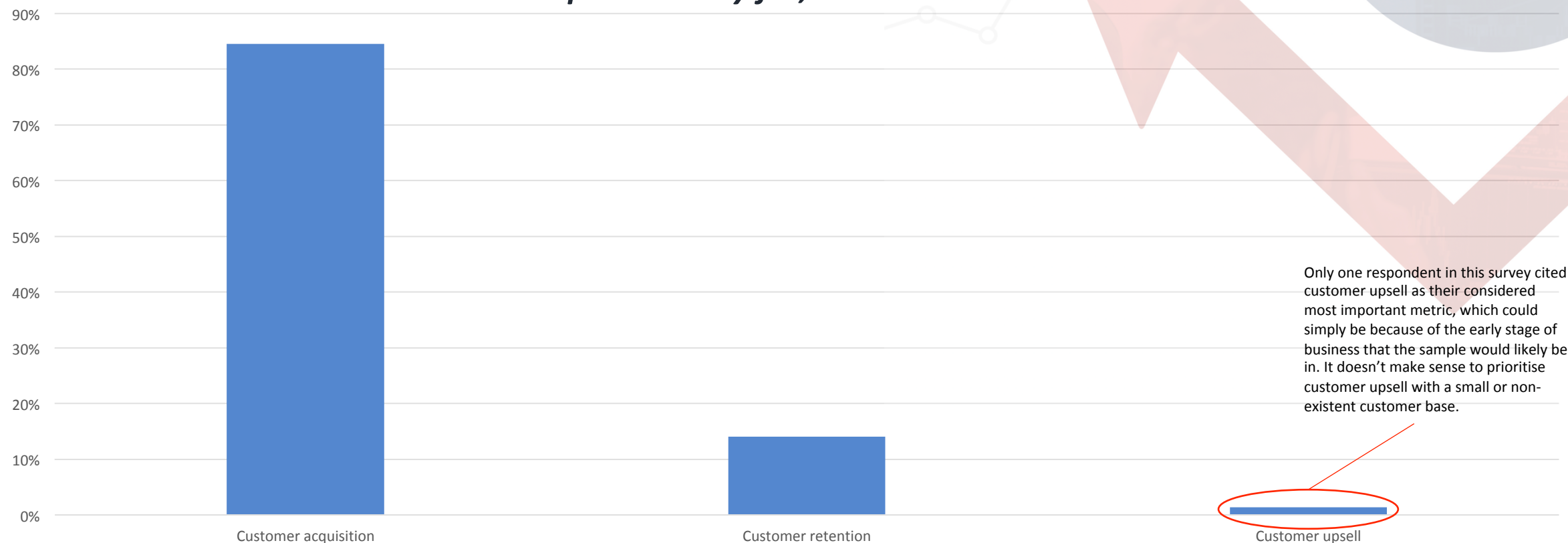
- The most important metric cited by respondents was customer acquisition, which is understandable as many of those surveyed were in the early stages of business, meaning that they are interested in building a number of subscription customers before anything else. This also helps to make sense of why only one of the respondents cited customer upsell as their most important customer metric. If you have no customer base and hence no one to upsell to, it makes sense to not find this metric so important. The same goes for customer retention rate. Few customers subscribed means few customers to retain and thus not much importance placed on this metric.

- As this survey was aimed at SMEs and not larger businesses, these results are specific to the issues faced by them –perhaps a lot of SMEs are still trying to grow their subscriptions and it could be valuable to understand the solutions to the obstacles to success that were cited by SMEs earlier in the report. Being able to get an insight into how to overcome obstacles related to business growth and success is absolutely vital for small businesses and seeking advice is a great way to help with this.
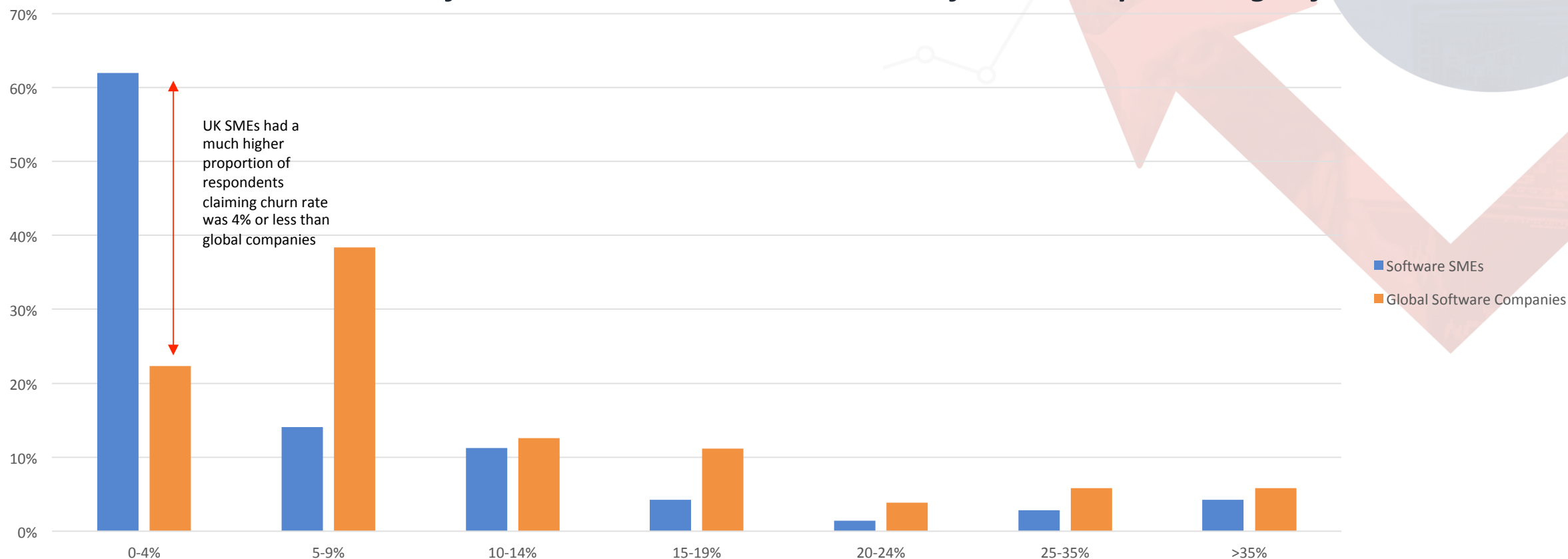
Know your customer: the customer metric which was understood by the most respondents was average revenue per user (ARPU); the least was upsell rate.
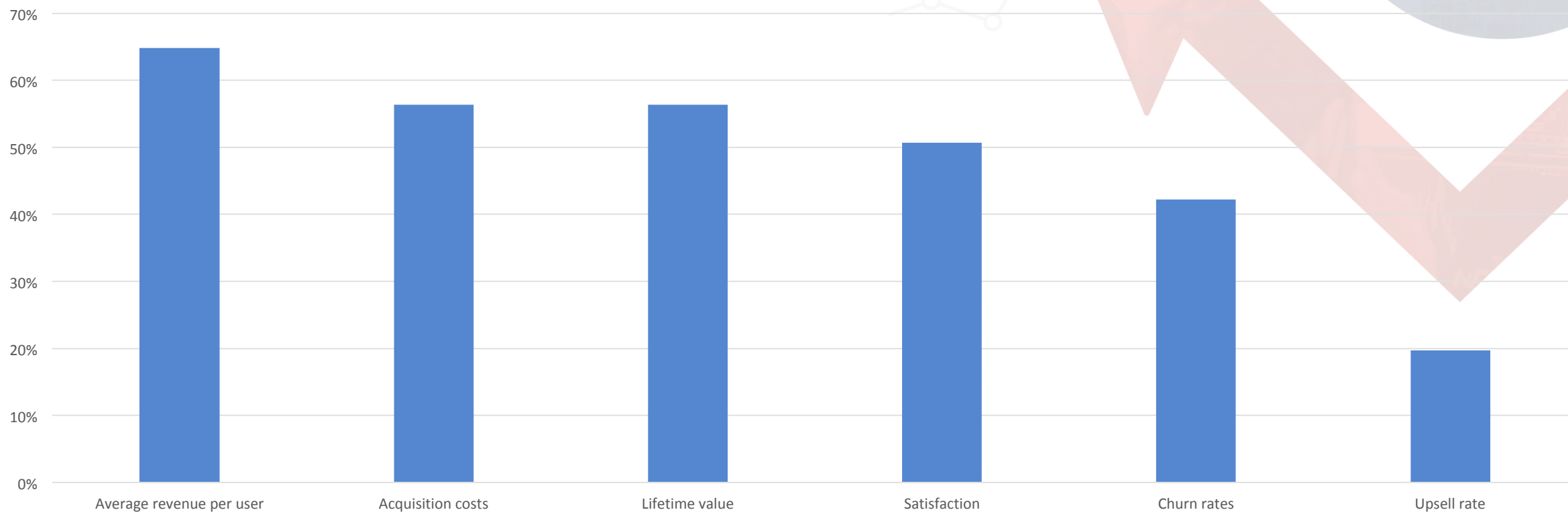
- The metric most understood by survey respondents was ARPU, which can be a monthly or annualised calculation of how much revenue a single customer generates. This is a statistic which can allow a subscription business to understand who are their 'good' and 'bad' customers, and therefore an indication as to which relationships are rewarding to maintain and who are the most valuable customers to retain. It is also a metric which ties in heavily with customer lifetime value, which is a metric to realise the value of a customer over the entirety of their subscription.

- The customer metric for which the fewest respondents had a clear understanding was upsell rate, which follows on from the last question. It is likely that few businesses had a customer upsell process because they did not understand the value in upselling to customers. Less than a quarter of respondents understood this customer metric and this knowledge gap could prove to be costly.

- The second least understood customer metric was churn rates, with less than half of respondents saying they had a clear view of this. This is the rate at which customers are unsubscribing from your services, expressed as a percentage of customers or as a percentage of revenue. Understanding churn rates should help to understand customer retention also, as if your churn rates are high, customer retention is low – meaning there may be lost revenue which could have previously been prevented.

- Roughly half of respondents understood customer satisfaction and had a clear view of it. This is probably the most ambiguous statistic of these six to understand, as it is difficult to quantify satisfaction of a product or service – net promoter score is one of the most powerful measuring tools for customer satisfaction, so it would be interesting to understand how many of the respondents are using this to measure customer satisfaction. Again, many of these metrics tie in together so it is important to understand how, for example, are your churn rates reflective of customer satisfaction rates? How does you customer lifetime value look if there were changes to your upsell rate? Looking at these metrics should be done holistically in order to get the most accurate overview of your businesses performance.

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Low churn: two-thirds of UK businesses had a churn rate of 0-4% as a percentage of revenue.

UK SMEs had a much higher proportion of respondents claiming churn rate was 4% or less than global companies

■ Software SMEs
■ Global Software Companies

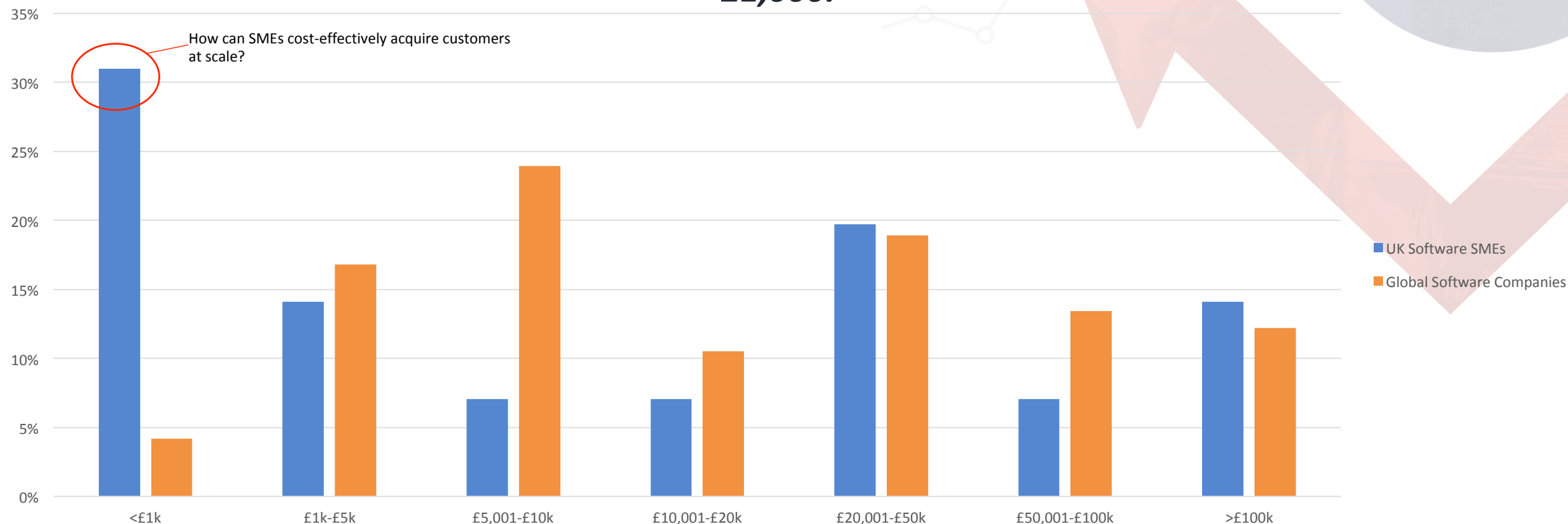Chart categories: 0-4%, 5-9%, 10-14%, 15-19%, 20-24%, 25-35%, >35%

- The UK software providing SMEs look to be doing really well in terms of customer retention compared with the rest of the industry. With most of the respondents having a churn rate of 4% or less, and less than 5% going above 35% churn rate, they seem to be performing reasonably well. In contrast, the majority of software firms globally by majority were experiencing churn rates of 5% or more, with 6% of respondents reaching a churn rate of over 35%.

- This potentially means that UK software small and medium firms are able to either generate a more loyal customer base, or have better processes in place in order to retain customers enough that only a small percentage disengage their subscription. Again, as aforementioned, it is critical to understand churn rates as well as other customer based metrics. Subscription businesses thrive when they have a customer base which they understand and respond to.
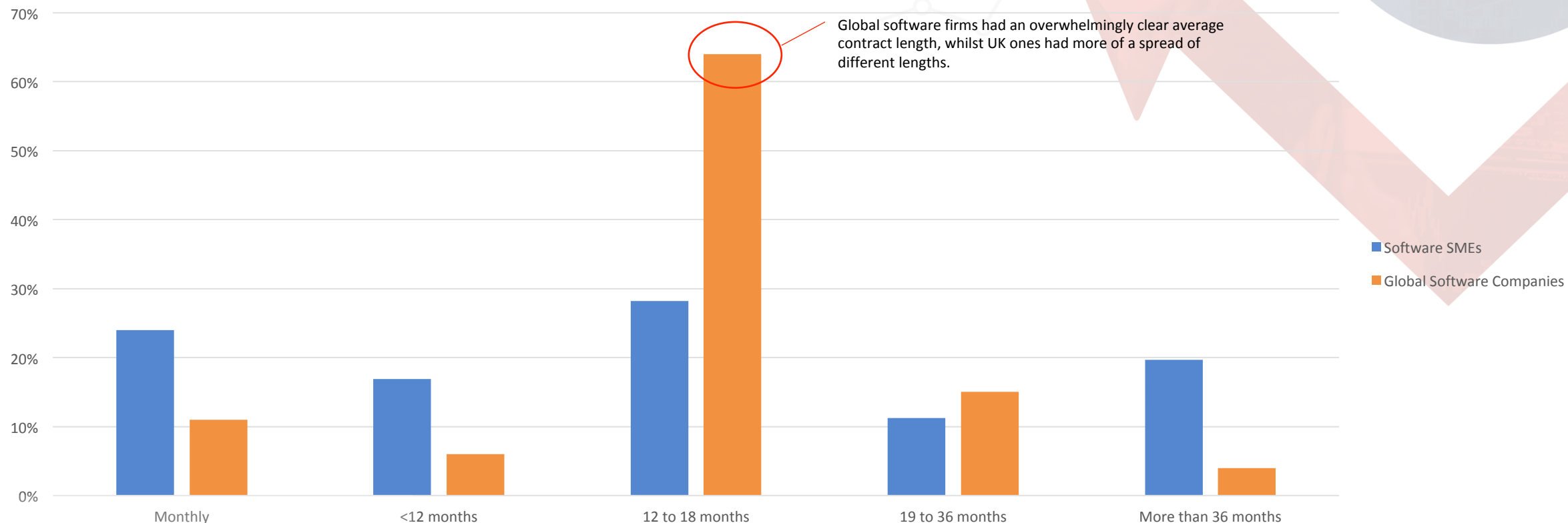
Contracting & Pricing

Executive Summary

- **Inexpensive contracts** - over one-third of UK software SMEs had an average contract value of less than £1,000. About a third of UK SMEs answered that their average contract value was under £1,000, whereas for global companies, it was the least cited answer. This could mean that either UK firms are under-pricing their software, or potentially that the contract lengths were shorter for UK software providers, and therefore overall contract value was lower. A challenge that software leaders will now face is how to more cost-effectively acquire customers at scale.

- **Smaller business, shorter contracts** - 4 in 10 UK businesses had average contract lengths of 12 months or fewer. The contract length which was the most popular between both UK and global companies was 12-18 months, with two-thirds of global companies having their average contract length in this range and around 30% of UK SMEs citing this as their average contract length. It's likely that many of both of these samples provided B2B software as this usually would have a much longer contract length than B2C software products. B2B subscription business is a lot more to do with managing accounts and maintaining relationships over a period of time, and B2C is usually shorter length contracts with a much higher volume of customers.

- **Similar pricing:** 4 in 10 UK software SMEs priced by the number of seats / users in each subscription. This was also the most popular method of pricing for global software companies. It is likely that this is the case as pricing by seats and users is applicable to the majority of subscription software providers. Understanding the most effective pricing method for your subscription business is essential for success, alongside knowing what level of pricing is best to set. Under-pricing customers can lead to problems with revenue and cashflow which will scale up with the number of subscribers your business has. If all customers are under-priced and create a revenue gap, this will only increase with your subscriber base.

Inexpensive contracts: 3 in 10 UK software SMEs had an average contract value of less than £1,000.

How can SMEs cost-effectively acquire customers at scale?

Legend:
- UK Software SMEs
- Global Software Companies

Categories: <£1k, £1k-£5k, £5,001-£10k, £10,001-£20k, £20,001-£50k, £50,001-£100k, >£100k

- Under £1,000 was the value of each contract that customers signed, according to 1/3 in 10 UK software SMEs who responded. This was actually the most popular answer for UK software SMEs, yet the least for global software firms. This could mean that UK software SMEs are under pricing their software, but it is important to consider the length of these contracts. A monthly rolling subscription will obviously be worth a lot less than one which is signed for a year or more.

- The most popular answer given by global software companies was £5,001-£10k. This is a lot larger than the contracts signed by UK software SMEs in the sample, but it is understandable as there were companies of all sizes included within the global software sample. The difference between the two groups' most cited answer is considerably large and shows that perhaps as a company gets larger in size, potentially it has a better ability to sign longer and more valuable contracts which could be down to credibility, brand awareness or more effective pricing strategies.

Smaller business, shorter contracts: 4 in 10 UK businesses had average contract lengths of 12 months or fewer.

Global software firms had an overwhelmingly clear average contract length, whilst UK ones had more of a spread of different lengths.

Legend:
- Software SMEs
- Global Software Companies

Chart categories: Monthly, <12 months, 12 to 18 months, 19 to 36 months, More than 36 months

- About 3 in 10 UK software SMEs, and 6 in 10 global software companies, had average contract lengths of 12 to 18 months. This is a popular period as it is long enough that businesses can achieve their payback period and short enough that it does not discourage buyers from signing up. It is almost a given that these contracts are probably written in B2B sales, as businesses will utilise software for projects that are ongoing and over a slightly longer period of time.

- The next most common average contract length was monthly, with about a quarter of UK software SMEs averaging around this range. Contrary to the point above, these are much more likely to be B2C sales, as your average consumer software is usually on a rolling monthly contract (e.g. music services, paid phone apps etc.) – with these smaller contracts, customer retention is a huge factor to pay attention to because it is a lot easier for a customer to opt out of a monthly subscription than of a 12 month contract.

Similar pricing: 4 in 10 UK software SMEs priced by the number of seats / users in each subscription.
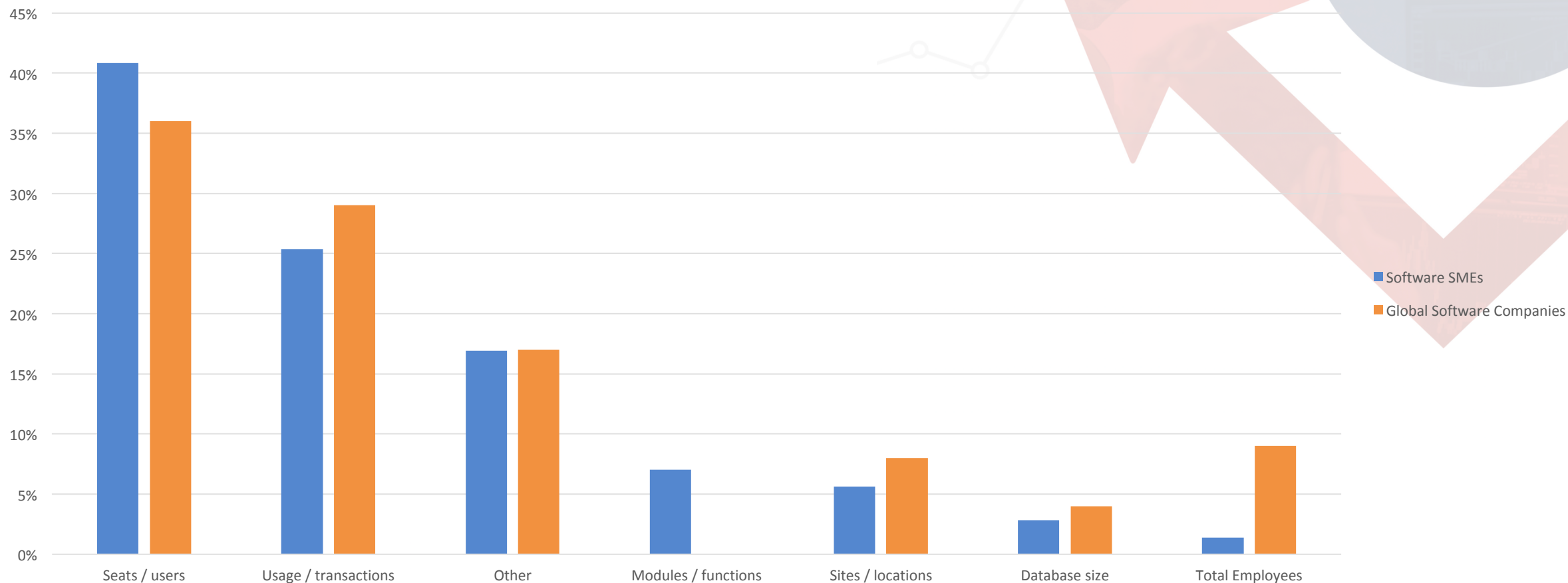
- The most popular method of pricing for software firms globally and for UK SMEs was by seats / users, i.e. a price per month per each user. This is probably the least complex way of pricing, is applicable to most software and is fairly independent of the size of the business. The least popular pricing method of UK software SMEs was by total employees – this is probably due to difficulties in determining how to measure the customers employee numbers accurately, and it is likely that only very niche software will have apt reasoning to be priced in this way.

- Understanding how to price your product, as well as what prices you should set is massively important for success in the subscription software industry. Under-pricing software can be a huge issue for revenue as the more subscribers you have could multiply the effects of a revenue gap per customer. It can also be a problem as, if you have recently taken on a client, it can be difficult to reprice them and will potentially make them unsubscribe as they wouldn't have a long and nurtured relationship with your business.
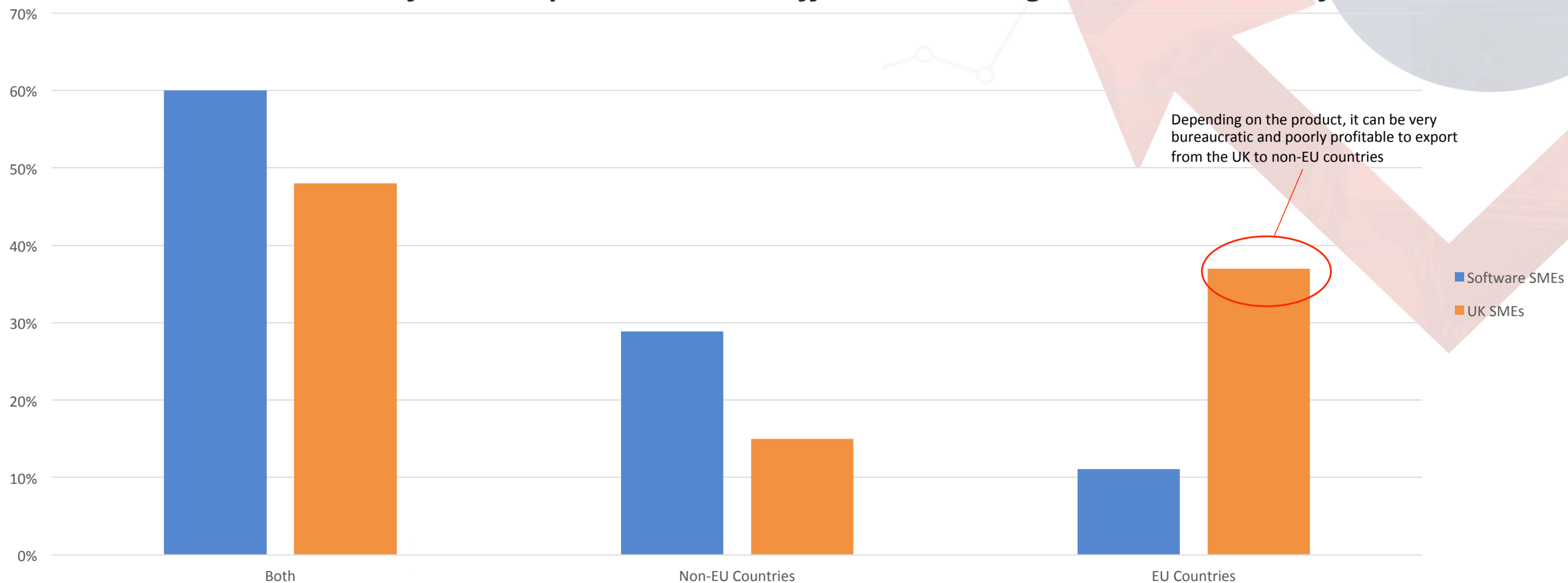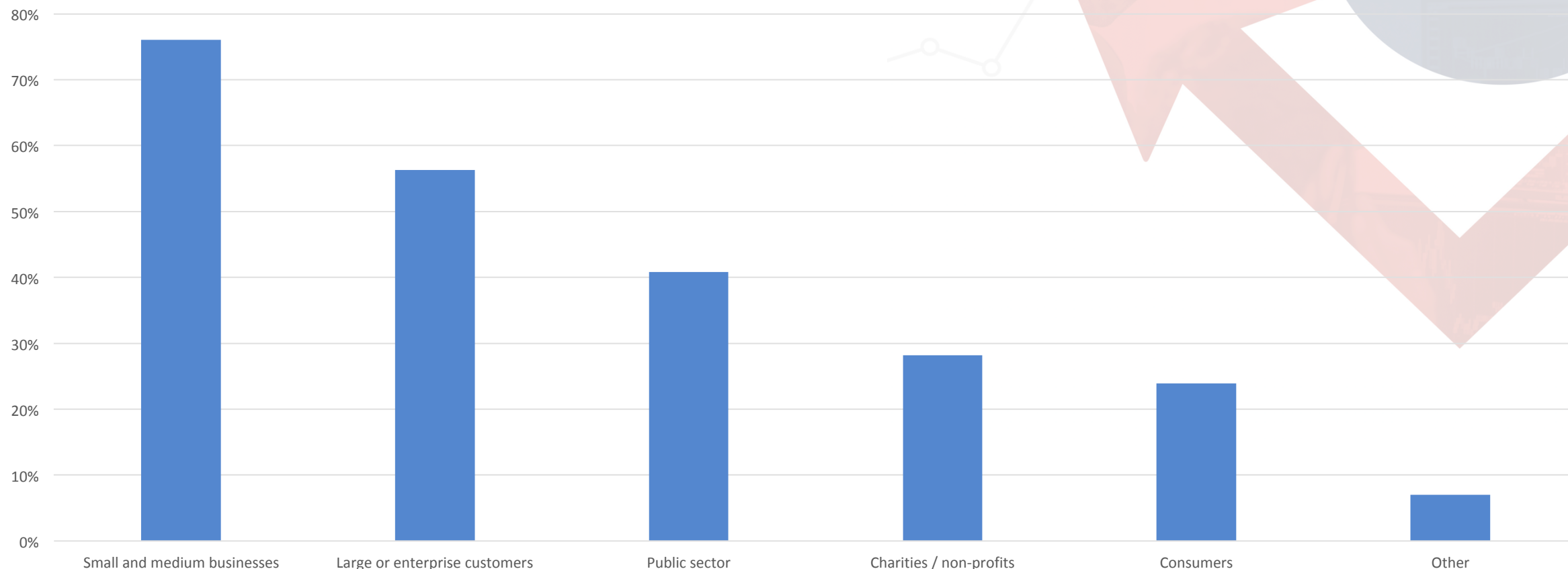
Sales & Marketing

Executive Summary

- **Sell to the world** - software exporters were indifferent to selling inside or outside of the EU. 6 in 10 software SMEs claimed to export to both EU and non-EU countries. The proportion of UK SMEs which sold exclusively to the EU was three times that of software SMEs. This is likely to be because of the nature of the product. Because software is an intangible product, there is no regulation around exports associated with tangible goods. Only 15% of UK SMEs sold exclusively to non-EU countries, which illustrates the point that in industries other than software, regulation and bureaucracy can be a limiting factor in where you can sell your goods to. Exporting is a good way to increase the number of subscribers to your software, however this will depend on your software and whether it has international applicability.

- **SME to SME world** - around 4 in 5 UK software SMEs sold to small and medium businesses – it's likely that this is mutually beneficial as the SME subscribers would be able to use software that is more cost-effective for their business, i.e. because the software providers are smaller and the software is less developed, they currently may not charge a large price, or perhaps are keen to negotiate deals to earn subscribers. The producers are benefitted as it would likely to be much more difficult to gain large or enterprise customers at the current stage in their business, as larger businesses would probably expect to invest in software that is completely shelf-ready and had minimal issues which may be associated in newer software from a younger firm. So the take-away point from these results is that SMEs are helping each other to grow, through the provision and uptake of software.

- **Tunnel vision** - combined, over 60% of software SMEs used only a single sales channel. Only around 40% of software SMEs used a mixed sales strategy, which could be to do with a lack of sales and marketing funding, however some strategies such as internet sales are relatively inexpensive, so it could be feasible to be running at least 2 sales channels at once. SMEs should look at the opportunity of all sales channels as a way of maximising their sales volumes and therefore the return on their product investment.

Sell to the world: software exporters were indifferent to selling inside or outside of the EU

Depending on the product, it can be very bureaucratic and poorly profitable to export from the UK to non-EU countries

Legend:
- Software SMEs
- UK SMEs

Categories: Both, Non-EU Countries, EU Countries

- Software SMEs 'export' or sell their products outside of the EU at a higher rate than general UK SMEs. One of the reasons for this is that there is no physical product to have to transport and export, meaning a much easier and quicker logistics chain to sell their product outside of the EU compared with UK SMEs who may manufacture or sell physical products. For tangible goods providing firms, exporting to just EU countries is probably the most efficient thing to do, as import and export laws are much less strict between countries within the EU compared to if UK products were being exported outside of the EU.

- Expanding your reach to foreign countries is potentially a method which could be used to increase your customer and prospect base as well as to raise brand and product awareness in general.

SME to SME world: around 4 in 5 UK software SMEs sold to small and medium businesses.

Bar chart showing percentage by customer type:
- Small and medium businesses: ~76%
- Large or enterprise customers: ~56%
- Public sector: ~41%
- Charities / non-profits: ~28%
- Consumers: ~24%
- Other: ~7%

- The main buyer of the survey population's software was small and medium businesses – generally subscription software is sold B2B as it is usually built for specific functions (e.g. CRM, HR, sales etc.) and is not as applicable to the consumer market. As well as this, many small and medium businesses may not want to attribute too much spending towards software, and so if software SMEs are in early or beta stages of their product, the businesses can come together and agree a mutually beneficial deal. It is possible that larger businesses will only want to utilise software that is 'shelf-ready' and has minimal further development needed – large or enterprise customers are also likely to have a bigger budget to spend and so will want the very best (a premium product for a premium price).

Tunnel vision: combined, over 60% of software SMEs used only a single sales channel.
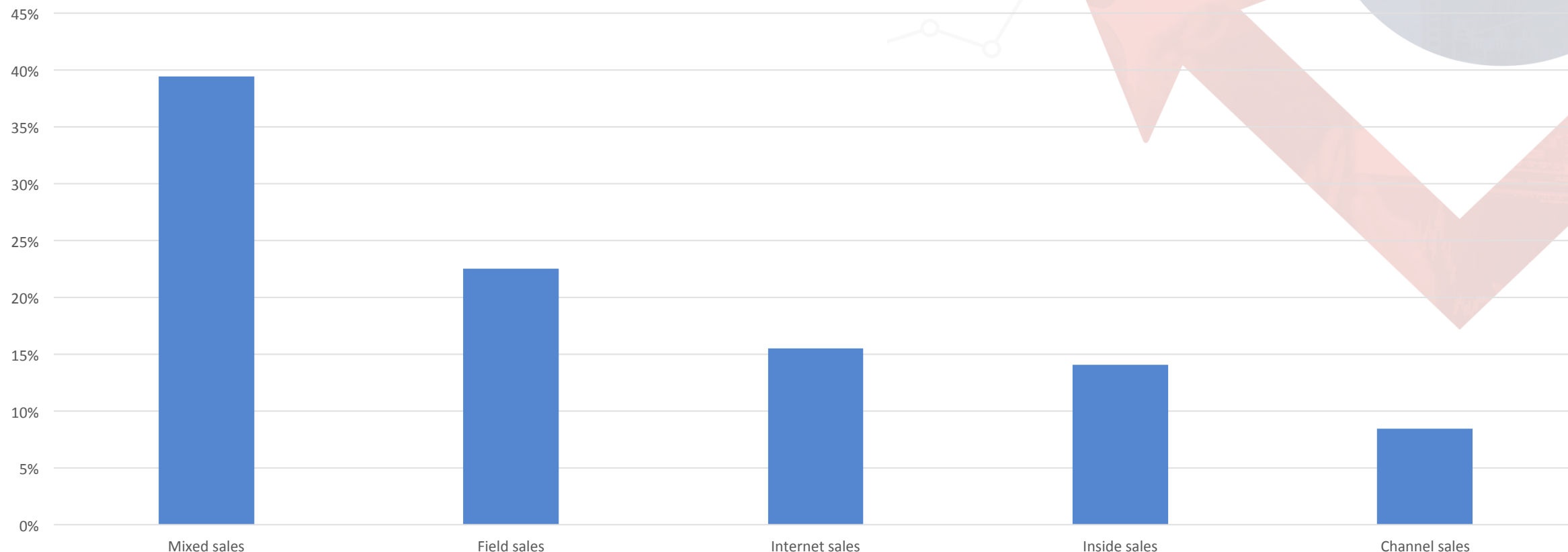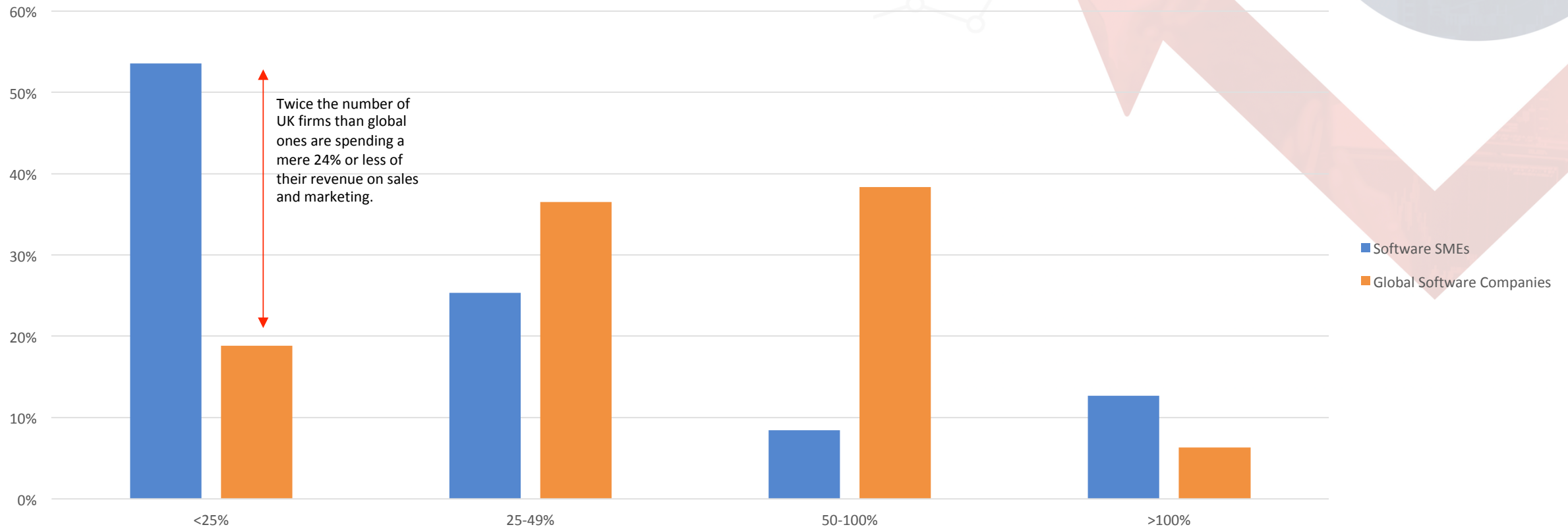

- The majority of respondents chose to use a mix of different sales channels including field, inside, internet and channel sales. This could be a method that businesses use to spread the risk and cost of marketing so they can figure out which channel works best for them. Small firms who are ambitious will strive to test and understand how different channels & processes work and what kind of returns on investment they can expect.

- The least popular method of sales was through channel sales. Channel sales involves selling your product through a 3rd party distributor, which may be more relevant for larger software businesses with clearly established product, target market and mature financial understanding of their product.

- Field sales was the most popular single sales channel - it consists of going to prospects in person and possibly demonstrating the product, running a presentation or something similar. This is a very effective method for software companies to sell their software, as they can show prospects exactly how everything works, show them what they can expect from the software and answer questions there and then. Also proposing and negotiating prices can be done in a much more fluid, effective way in person as everything can be communicated with no delay and real conversations can be had to discuss pricing, compromise on contracts and so on.

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# *Operations*

Executive Summary

- **Low growth spending** - 5 in 10 software SMEs only spent under 25% of their revenue on sales & marketing in the past year. Global firms were spending much more, with over 70% spending between 25-100% on their sales and marketing operations. In terms of acquisition, UK SMEs may be stalling their progress by not having more resources pooled towards sales and marketing, two of the most key functions in the acquisition of new customers. Almost 15% of UK SMEs, however, did spend over 100% of their revenue on sales & marketing, meaning that they likely raised finance to pay for this. Depending on how the money is being spent, this could mean that either companies which have not long launched their product, and are not making much revenue, could be spending on sales & marketing, or perhaps it could mean an inefficient sales & marketing process, where businesses are spending too much in places where cost efficiency could be improved.

- **Expenditure priorities** - over two thirds of software SMEs spent more than 25% of their revenue on research and development. The main difference between spending on sales & marketing and spending on research & development was that, where the majority of UK SMEs spent less than 25% of revenue on sales & marketing, they spent over 25% on research & development. The reason for this could be that research & development is considered as essential to create a viable product to sell.

Low growth spending: 5 in 10 software SMEs only spent under 25% of their revenue on sales & marketing in the past year

Twice the number of UK firms than global ones are spending a mere 24% or less of their revenue on sales and marketing.

Legend: Software SMEs, Global Software Companies

Categories: <25%, 25-49%, 50-100%, >100%

- A huge proportion of the respondents said that they spend less than 25% of their revenue on sales & marketing. It is possible that perhaps the attitude towards sales & marketing is less confident, less aggressive and less well funded compared with their larger counterparts.

- In contrast, about 15% of software SMEs actually spent more than they generated in revenue on sales and marketing. A lot of the implications surrounding these findings is that some businesses put a lot more emphasis on sales and marketing and see more value in doing so. It may also be possible that some firms are effectively marketing and growing sales in a less cash-intensive way, for example by utilising social media and other (mostly) free, lower cost and higher ROI marketing channels. It is also important to consider that different firms will distribute their product in different ways, which will cause a variance in costs.

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Expenditure priorities: over two thirds of UK software SMEs spent 25% or more of their revenue on research and development
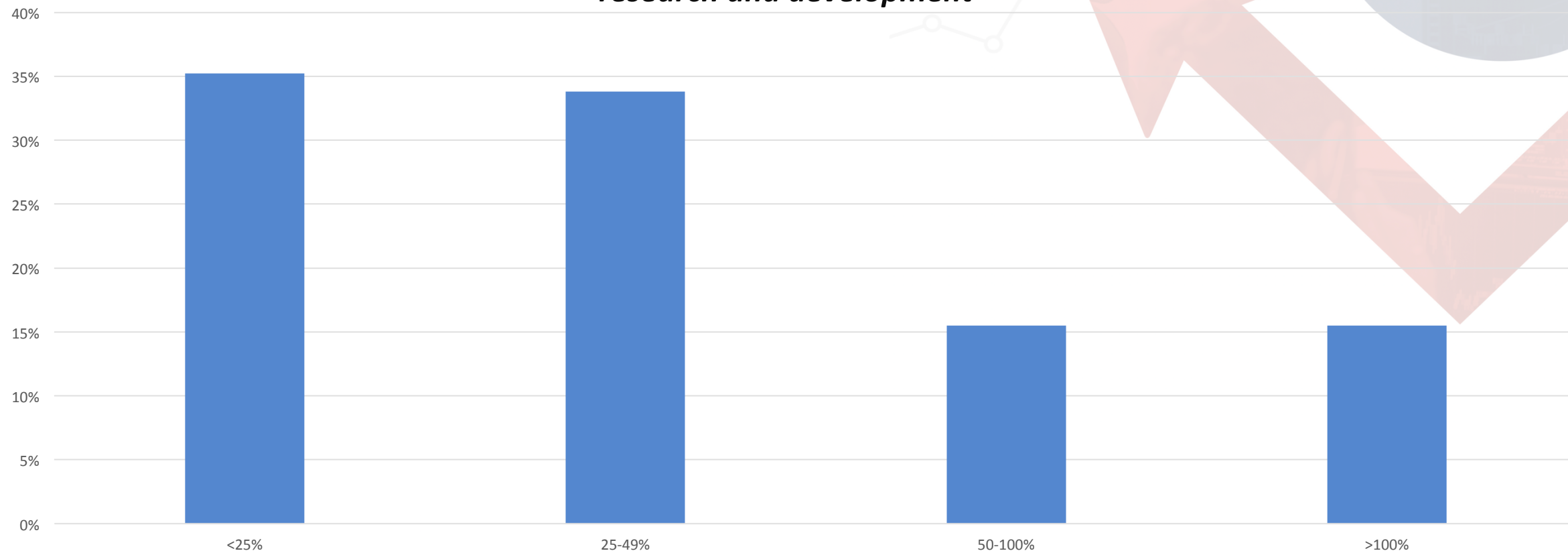
- Spending on research and development showed more spending towards the higher end of the spectrum compared with sales and marketing spending. 3 in 10 software SMEs spent over 50% of revenue on R&D and a total of 17% spent over 100% of revenue on R&D costs.

- The main difference between UK software SMEs' R&D spend and sales & marketing spend was that the majority of respondents spent less than 25% of revenue on sales & marketing, whereas the majority spent over 25% on research & development. It is possible that for smaller software businesses in the lifecycle they still have high R&D expenditure relative to S&M expenditure as they look to build and mature the product quickly to better gain sales and marketing traction in future.
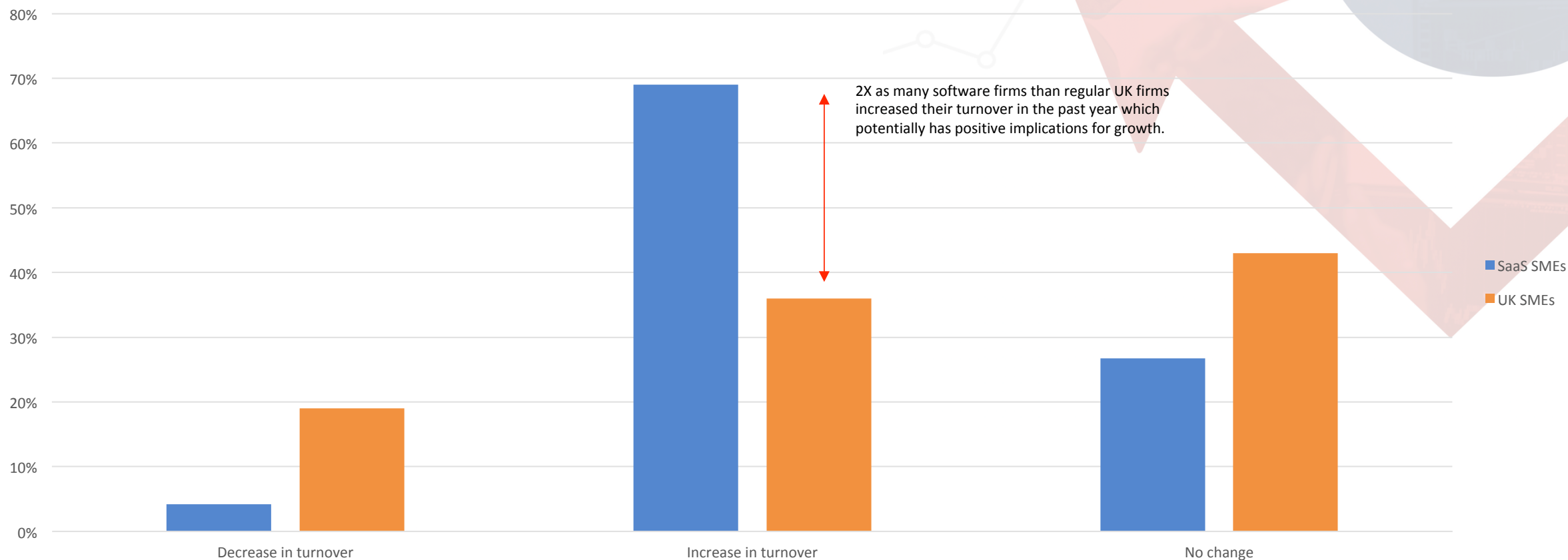
40

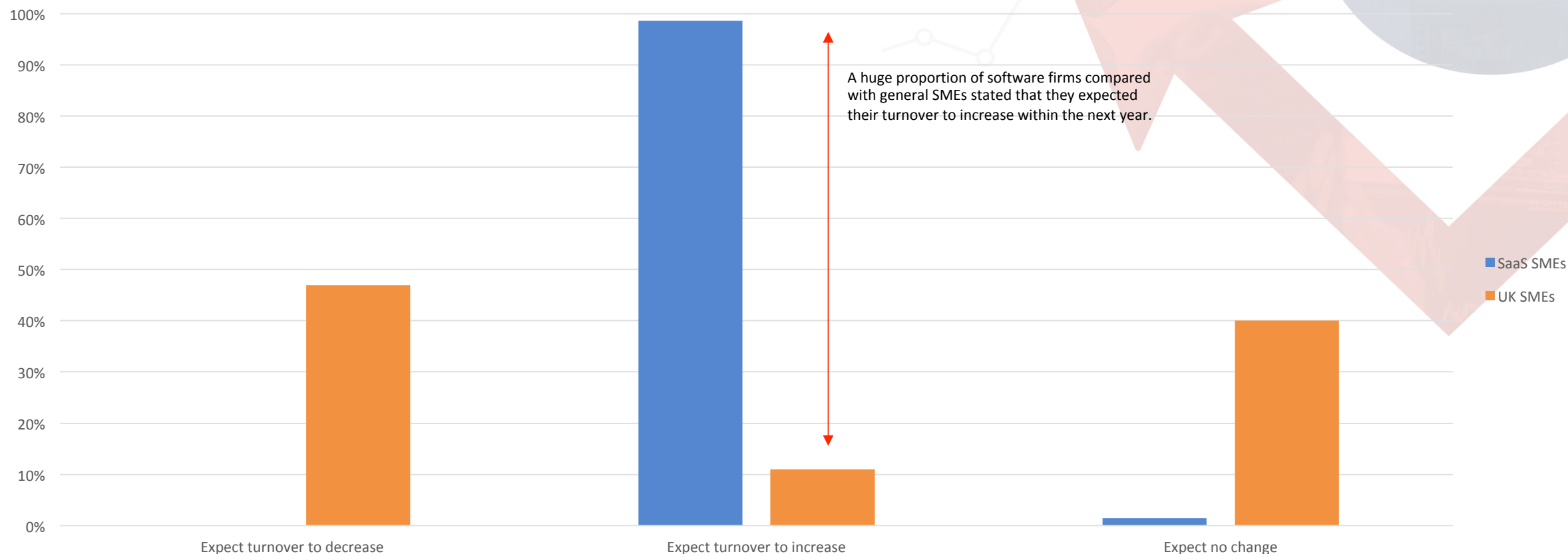# *Cash*

Executive Summary

- **Double the growth** - twice as many UK software firms than UK SMEs had an increase in turnover in the last year. Software SMEs seemed to have performed very well in terms of generating more revenue than general ones. Only 4% of software firms had experienced a decrease in revenue in the past year compared with 19% of UK SMEs. This is positive for software providers however it is still important for business owners to consider the effects of growth and rapidly increasing turnover – they need to make sure that they have the capacity for growth.

- **Highly ambitious** - almost 100% of software firms anticipate an increase in turnover over the next 12 months. This illustrates the ambitious and growth-focused mindset of software SMEs. As the majority of software firms did increase their turnover in the last 12 months, it translates that the majority of firms would also expect an increase in turnover in the next year.

- **Profit gap** - just over half as many software firms made profit in the past year compared to general ones. Over 5 in 10 software businesses were cashflow negative. These findings might suggest that financially, software firms may not be performing quite as well as other SMEs within the UK. Because so many software SMEs reported an increase in turnover during the past year, however were not profitable, this could mean that sales revenue is being diluted by costs associated with overheads, production and development. It's also important to note that most of these software SMEs work on a deferred revenue model, meaning that financial reporting may not show the full picture. As well as this, the majority of software SMEs reported that they were cashflow negative, meaning that they have less cash in the bank now than they did a year ago. It is difficult to understand why this is, however the subscription model may again be a factor – potential late payments and bad debts could cause cashflow problems for many small businesses.

- **Poor profits** - 50% of software SMEs have a gross profit margin of less than 50% on purely selling software. This is where UK software SMEs were hugely outperformed by global software companies, as five times as many UK firms made less than 50% gross profit than global companies. On the other hand, the majority of global companies (over 60%) made between 71-90% of gross profit purely through selling software. Perhaps UK software SMEs should use this range of gross profit as a benchmark, however it is important to consider other factors, such as how much they are growing. Usually, profit is sacrificed to allow for growth and vice versa.

- **Obtaining finance?** - two-thirds of software firms applied for finance in the past year but half of these did not receive the amount requested. This means that a large proportion of software providers are struggling to raise the necessary finance to be able to keep afloat and grow as a business. Contrastingly, almost 60% of general SMEs managed to raise all or more of the finance that they had requested. It is important to consider that software companies have a lot of sunk costs surrounding research, development, software production, highly skilled staff costs etc. so it may be the case that software SMEs are simply requesting much more money than other SMEs and therefore are being refused more often, or the amount of money borrowed is negotiated to a lower amount.

- **Fast payback** - 5 in 10 UK SMEs had a payback period of only 3 months or fewer. This means that the costs associated with acquiring a new customer were recouped within 3 months or fewer. It seems like UK SMEs are performing well with this short payback period, as over two-thirds of global software businesses had payback periods of 18-36 months. At a surface level, it would look as though UK software firms are hugely out-performing global firms, however it is important to consider other factors – for example, perhaps global firms are signing much longer contracts which would be much more expensive to secure and therefore the payback is more relevant when proportioned in line with contract length and size.

Double the growth: twice as many software firms than UK SMEs had an increase in turnover in the last year

2X as many software firms than regular UK firms increased their turnover in the past year which potentially has positive implications for growth.

Legend:
- SaaS SMEs (blue)
- UK SMEs (orange)

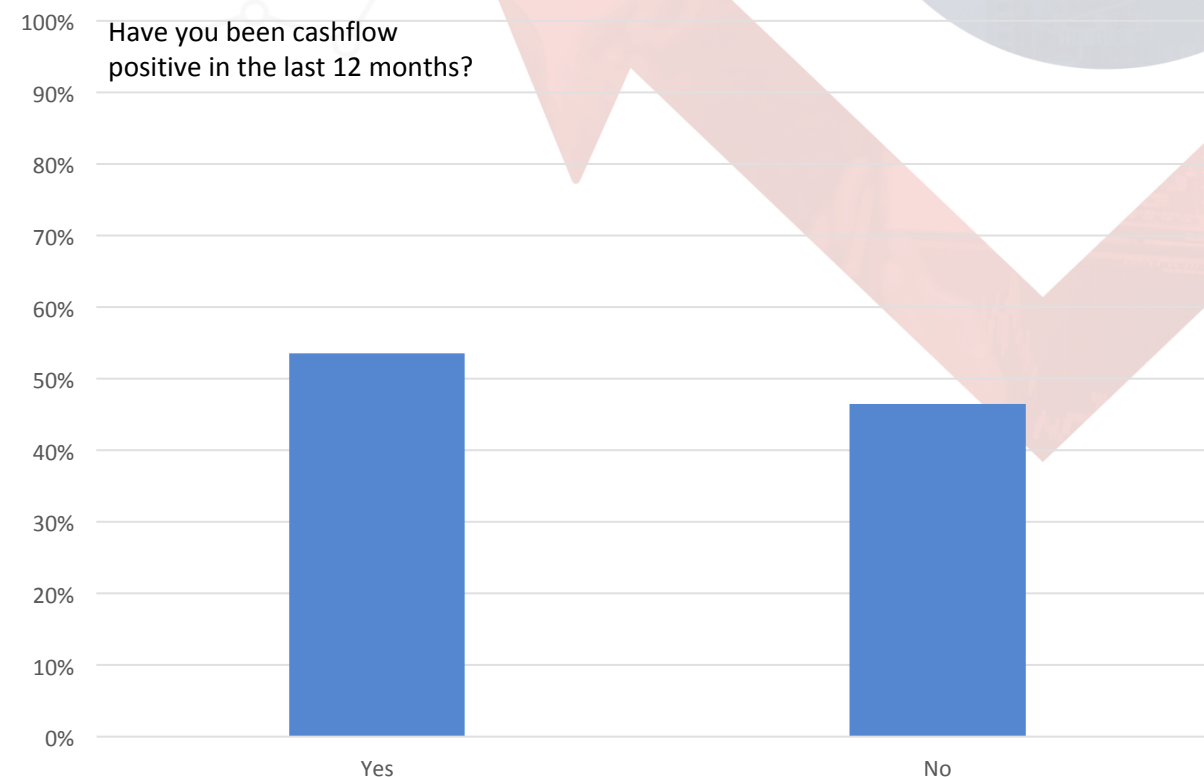Categories: Decrease in turnover, Increase in turnover, No change

- Small software businesses mostly achieved an increase in turnover over the past year. Less than 5% of respondents had reported a fall in turnover. The results show that software businesses are much more likely to be growing and revenue building than other SMEs in the UK. Software SMEs should make sure they are aware of, and can plan for, the effects of increasing turnover on their operations, business growth and capacity.

- Increases in turnover for software businesses is likely to mean increases in number of subscriptions to manage, the amount of deferred revenue received as well as potentially a responsive increase in employment to deal with the extra capacity. Increases in turnover also should mean, however, that businesses can afford to spend more money in places which can add value to their product, such as on research and development.

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Highly ambitious: almost 100% of software firms anticipate an increase in turnover over the next 12 months.

A huge proportion of software firms compared with general SMEs stated that they expected their turnover to increase within the next year.

Legend:
- SaaS SMEs
- UK SMEs

Chart categories (x-axis):
- Expect turnover to decrease
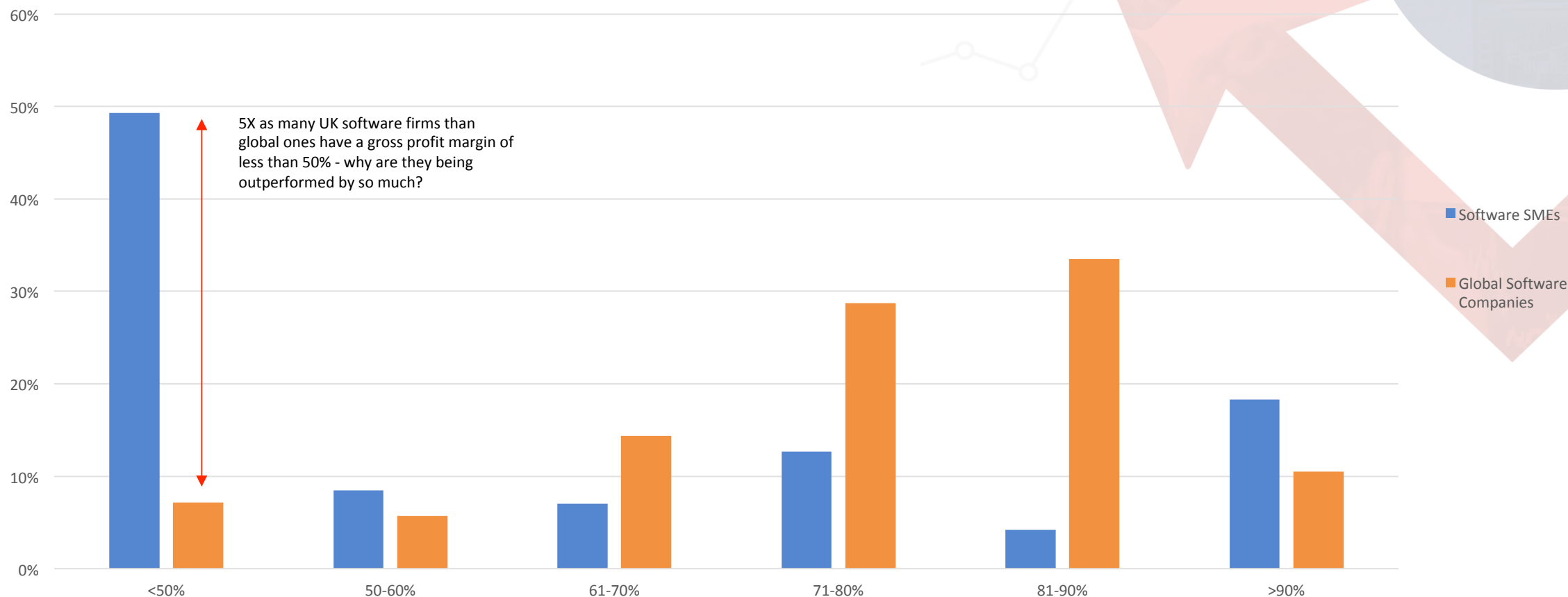- Expect turnover to increase
- Expect no change

Y-axis: 0% to 100%

- Almost all of the software SMEs who responded expected their turnover to increase in the next 12 months – a much higher rate than general UK SMEs - this expectation is largely justified as the majority of software SMEs did increase their turnover in the past year.

- The fact that more businesses expected an increase in turnover than actually did experience an increase in turnover in the past year could be explained by a lack of product delivery or perhaps the end of a start-up phase. Because of the nature of software production, it is not uncommon that a business may spend their first few months or years developing a product until it is ready to launch, hence business owners may have had no change in turnover as there was no product to deliver, but expect to increase their turnover on launch when they begin to gain subscribers. If a company is still raising finance, developing products or generally hasn't launched yet, then turnover is not a great measure of success in their circumstances.

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Profit gap: just over half as many software firms made profit in the past year compared to general. Over 5 in 10 software businesses were cashflow negative.

Have you been profitable in the last 12 months?

- SaaS SMEs
- UK SMEs
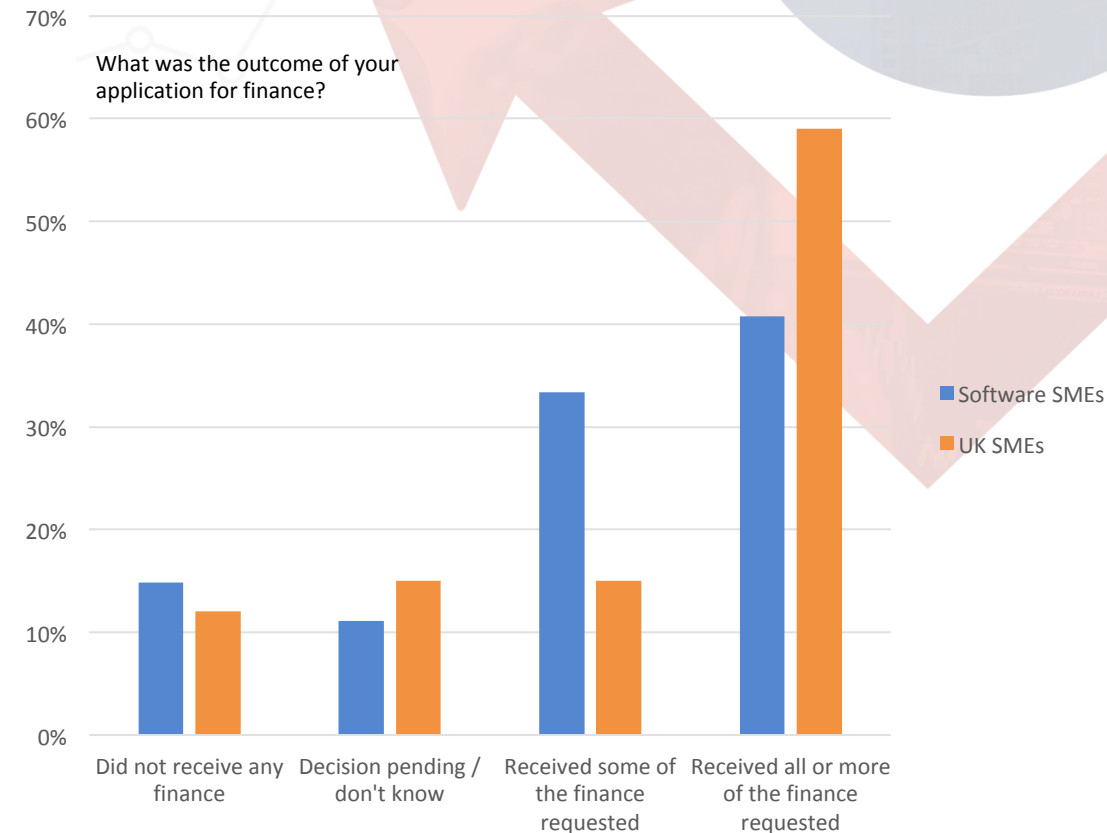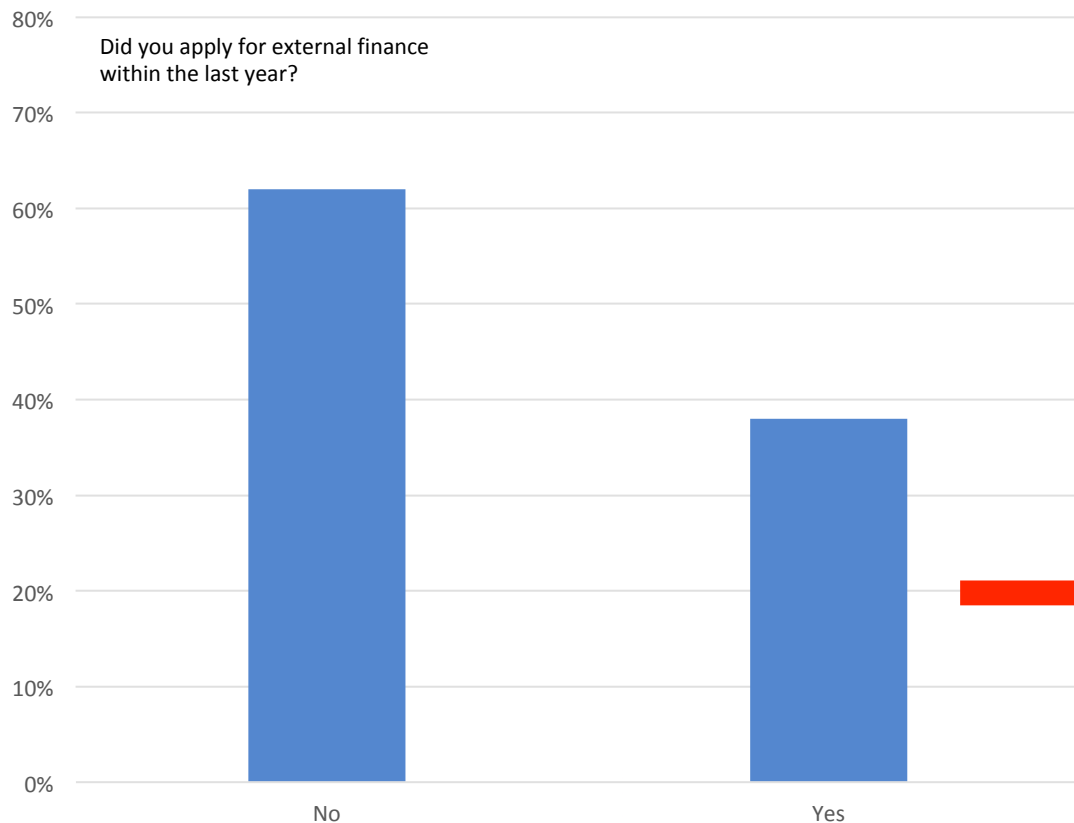
Have you been cashflow positive in the last 12 months?
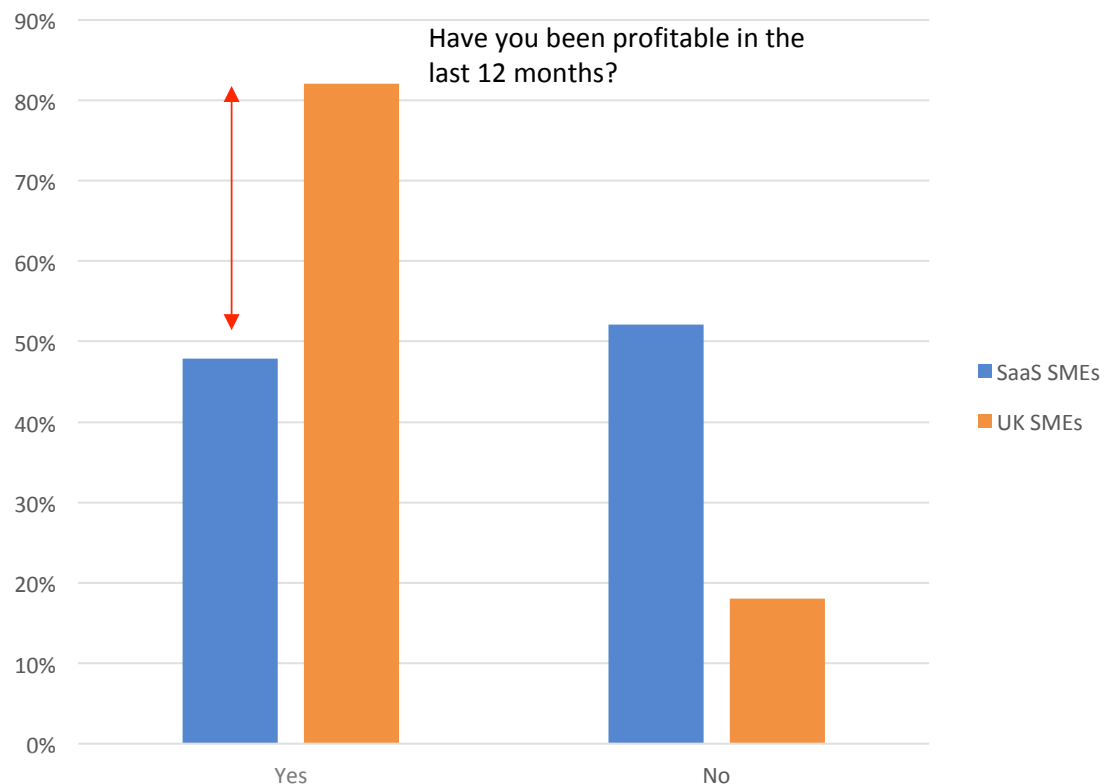
- The difference here could hint towards the cost of producing software. As so many companies increased their turnover in the last 12 months, yet less than 50% were actually profitable – this could indicate that the turnover level is being diluted by other costs associated with overheads, development or production.

- Another factor to consider is the fact that most, or all, of these software SMEs work on a deferred revenue model which could have implications for financial performance in terms of when the numbers are reported.

- It is important to take into consideration the fact that profitability is not the sole measure of how successful a business is. Other factors such as growth, development and other unquantifiable objectives can be just as vital to a successful business.

- The majority of software SMEs were cashflow negative in the past year, meaning that they had less cash in the bank compared to a year ago.

- Another reason for the majority of software SMEs being cashflow negative is potentially because early stage software businesses require large amounts of cash for both product development and initial sales and marketing pushes to generate a customer base from which to derive future revenue to support the businesses. Whilst this timing gap is often funded the reality of a smaller software business is a choice between raising finance to support faster growth and living with their means at a slower pace of growth.

Poor profits: 50% of software SMEs have a gross profit margin of less than 50% on purely selling software.

5X as many UK software firms than global ones have a gross profit margin of less than 50% - why are they being outperformed by so much?

Legend: Software SMEs (blue), Global Software Companies (orange)

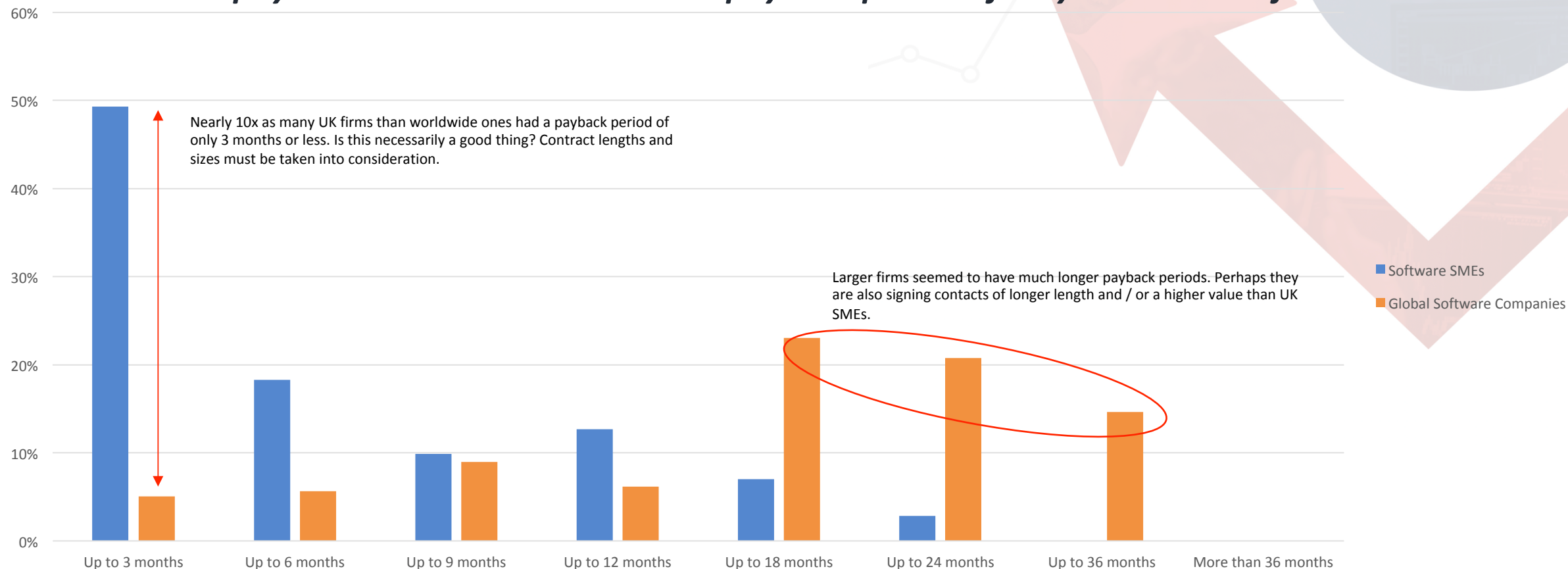Categories: <50%, 50-60%, 61-70%, 71-80%, 81-90%, >90%

- This really gives perspective to how UK software SMEs are performing financially compared with global software businesses. The majority of global software companies reported gross profit margins of 50% and higher, whereas almost 50% of UK software SMEs fell below the 50% mark. This is a huge difference and shows potential effects of under-pricing or mispricing products. Maybe some firms might need to reassess the way in which they price in order to make their gross profit margin higher. As you can see, global software companies' gross profit margins by majority fall in-between 71% and 90% - this could potentially act as a benchmark for UK software SMEs to aim towards. It is, however, critical to take into account the fact that some of these UK software firms may be growing at a high rate and so not making as much profit.

- Another notable observation of these findings is that almost twice as many UK software SMEs make over 90% gross profit margins compared to global software firms. This could imply that either these top performing firms are managing their costs very well and being conscious of finances, or perhaps they are able to charge premium prices because they are providing truly unique products.

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Obtaining finance?: two-thirds of software firms applied for finance in the past year but half of these did not receive the amount requested.

Did you apply for external finance within the last year?

What was the outcome of your application for finance?

- Software SMEs
- UK SMEs

- Finance is extremely important to a software-developing company, so it's understandable that the majority of software SMEs had applied to raise money.

- It is difficult to point out exactly why fewer software SMEs than UK SMEs received any or the total amount of finance they requested, but one reason could simply be because software firms would likely be requesting a lot more money than UK SMEs in the market.

- Applying for finance is a process which many new small businesses owners may not fully understand and this could be a reason as to why a number of firms received less than, or none of the finance requested.

Fast payback: 5 in 10 UK SMEs had a payback period of only 3 months or fewer.

Nearly 10x as many UK firms than worldwide ones had a payback period of only 3 months or less. Is this necessarily a good thing? Contract lengths and sizes must be taken into consideration.

Larger firms seemed to have much longer payback periods. Perhaps they are also signing contacts of longer length and / or a higher value than UK SMEs.

- Software SMEs
- Global Software Companies

Chart x-axis categories: Up to 3 months, Up to 6 months, Up to 9 months, Up to 12 months, Up to 18 months, Up to 24 months, Up to 36 months, More than 36 months

- Payback period is a calculation to find how long it takes to repay the original cost of gaining a customer, so lower is usually better. This metric ties in heavily with customer acquisition costs, as the cost of acquiring a customer is a function of the payback period calculation. The fact that such a high proportion of respondents had a payback period of 3 months or fewer really does reflect the findings that a large proportion of software SMEs in the UK do indeed understand their customer acquisition costs and therefore can price in a way to offset them in a short period of time.

- It was quite different for global software companies however. A mere 5% of global software companies had a payback period of 3 months or fewer, with the most cited response being up to 18 months – so for each customer these businesses gained, it took them within the region of a year and a half to recompensate the cost of acquiring them.

- It is, however, important to consider the length of contracts which are being signed. For example, if a software company writes contracts for 5 or 6 years and their payback period is 18 months, they will pay back their costs of customer acquisition in 30% of the time of the total contract length. On the other hand, a firm could have a payback period of 3 months, but if they are providing contracts on a month to month basis, there is a possibility that they may not even earn back the price of earning that customer. This is another metric where it is important to consider other factors which also contribute to overall performance.
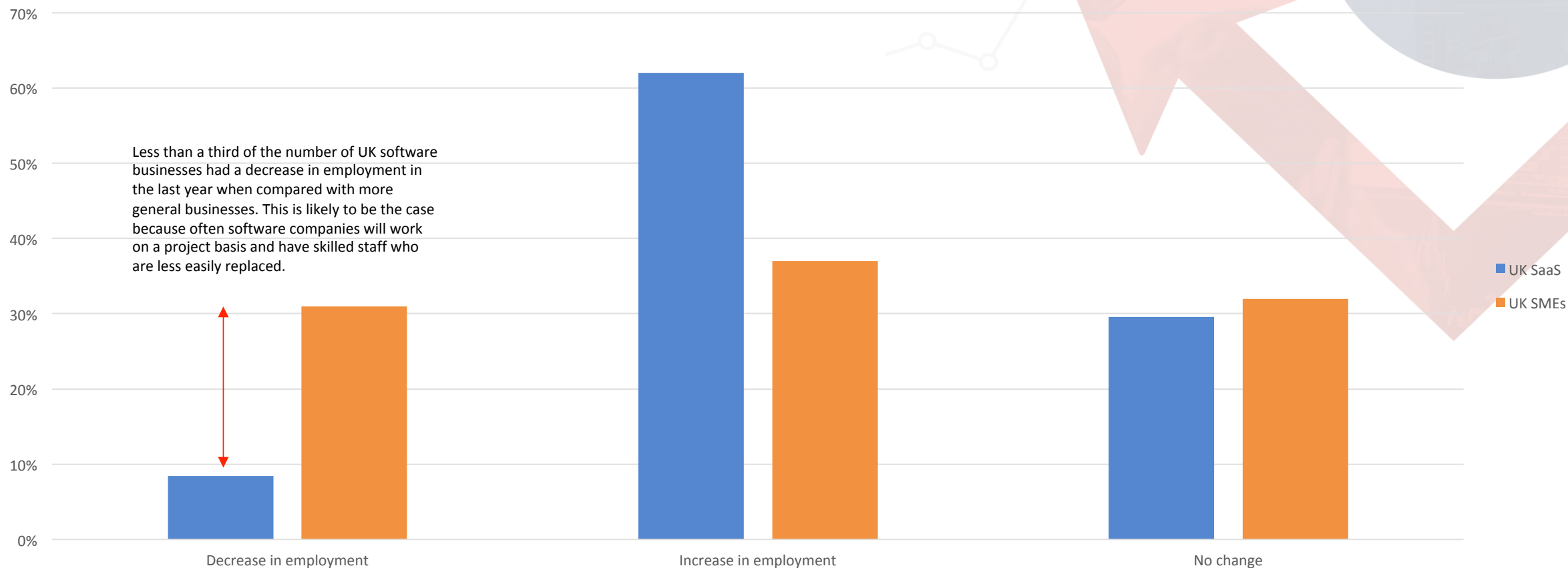
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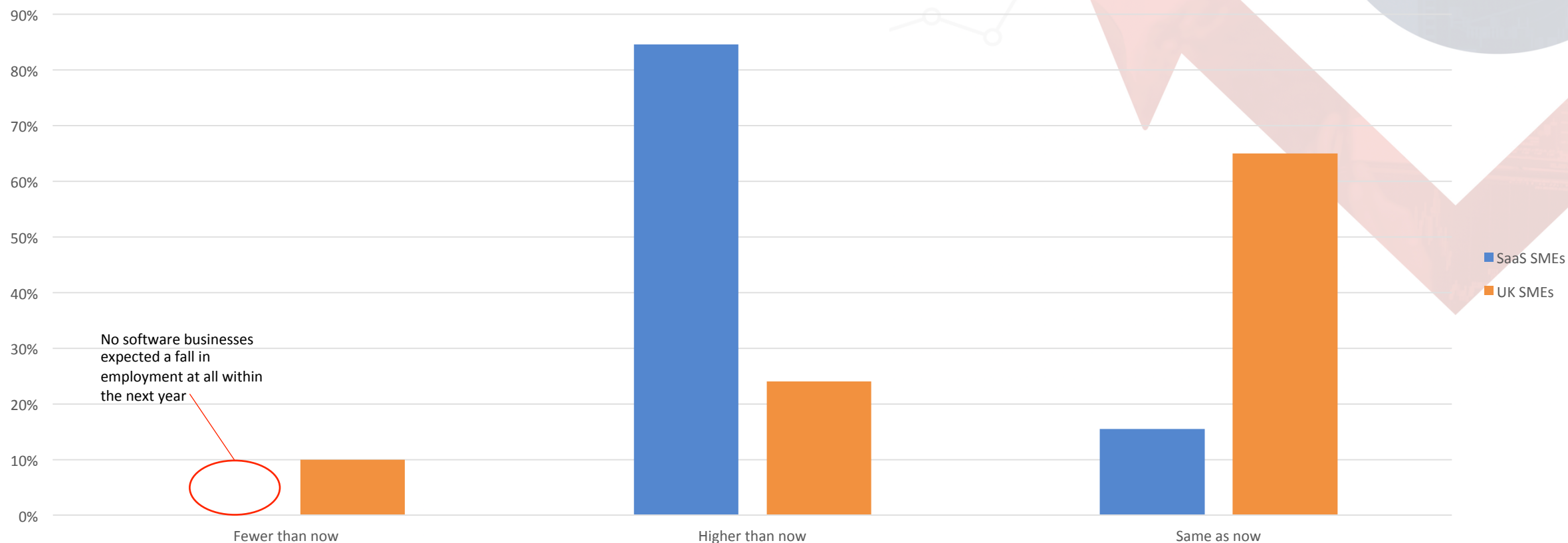# *People*

Executive Summary

- **Employment growth** – UK software firms by majority increased their level of employment over the past 12 months. 60% of respondents said that they increased their employment level in the last year, and less than 10% said they had a decrease in employment. General UK SMEs by majority also experienced an increase in employment, however three times as many UK SMEs experienced a decrease in employment than did software SMEs. Software businesses need skilled people to help develop applications etc. and especially in a small and growing stage of business will be looking to increase employment often.
- **Anticipating change** - 8 in 10 software firms expect to grow employment in the next year. As well as this, 0% of software firms expected a decrease in employment over the next year which illustrates further the point that ambitious young software firms are people-intensive and will look to increase their employment level. In addition to this, because the UK software firms are small, they may have finished their development of software and are looking to hire sales & marketing employees etc. ready to launch and push their product to market.
- **Staff skills** - 6 in 10 software firms invested in staff training in the past year. The results between UK general SMEs and UK software SMEs were very similar, with slightly more software firms investing in training than general ones. These findings could indicate that software SMEs need a certain skillset and therefore need to be trained more heavily. Following on from the point above regarding sales & marketing employees also may need to be trained in order to properly carry out the sales and marketing processes in place. New staff and training are vital to the success of small businesses so it is important that SMEs have efficient recruitment and training processes, making sure they are hiring the correct people and providing training for the correct reasons.

Employment growth: software firms by majority increased their level of employment over the past 12 months.

Less than a third of the number of UK software businesses had a decrease in employment in the last year when compared with more general businesses. This is likely to be the case because often software companies will work on a project basis and have skilled staff who are less easily replaced.

Legend: ■ UK SaaS ■ UK SMEs

Categories: Decrease in employment | Increase in employment | No change

- Software businesses owners mostly experienced an increase in employment over the past year, with less than 10% responding that they had a fall in employment.

- As shown by the graph, UK SMEs had more than 3 times the rate of decreased employment in the past year. Software businesses – especially small ones – consistently need people for development and research etc. – so it looks to be a rare occurrence for overall employment to fall for these companies at this stage in their business.

- Knowing that employment increases are likely to happen, as well as knowing how to manage this growth is vital to success for software SMEs. Increases in employment mean increases in costs and being able to plan and budget for this is imperative for businesses who want to grow and become / remain profitable.

Anticipating change: 8 in 10 software firms expect to grow employment in the next year.

No software businesses expected a fall in employment at all within the next year

Legend:
- SaaS SMEs
- UK SMEs

Categories: Fewer than now, Higher than now, Same as now

- Software businesses owners' expectations were different to general SMEs as many more anticipated a rise in the number of their employees, reflecting the high growth rate of companies within the software sector.

- None of the respondents anticipated a fall in their number of employees, which is understandable as small but growing businesses are likely to expect to stay the same or increase their level of employment to help increase the business' capability.

- These expectations mostly ring true for software SMEs, as shown by the change in employment in the previous graph, the vast majority of software businesses did increase their level of employment, with very few having it decrease – being able to anticipate changes like these means that businesses should be able to plan more effectively for the future.

Staff skills: 6 in 10 software firms invested in staff training in the past year.

Legend: ■ Software SMEs ■ UK SMEs

Categories: Yes, No
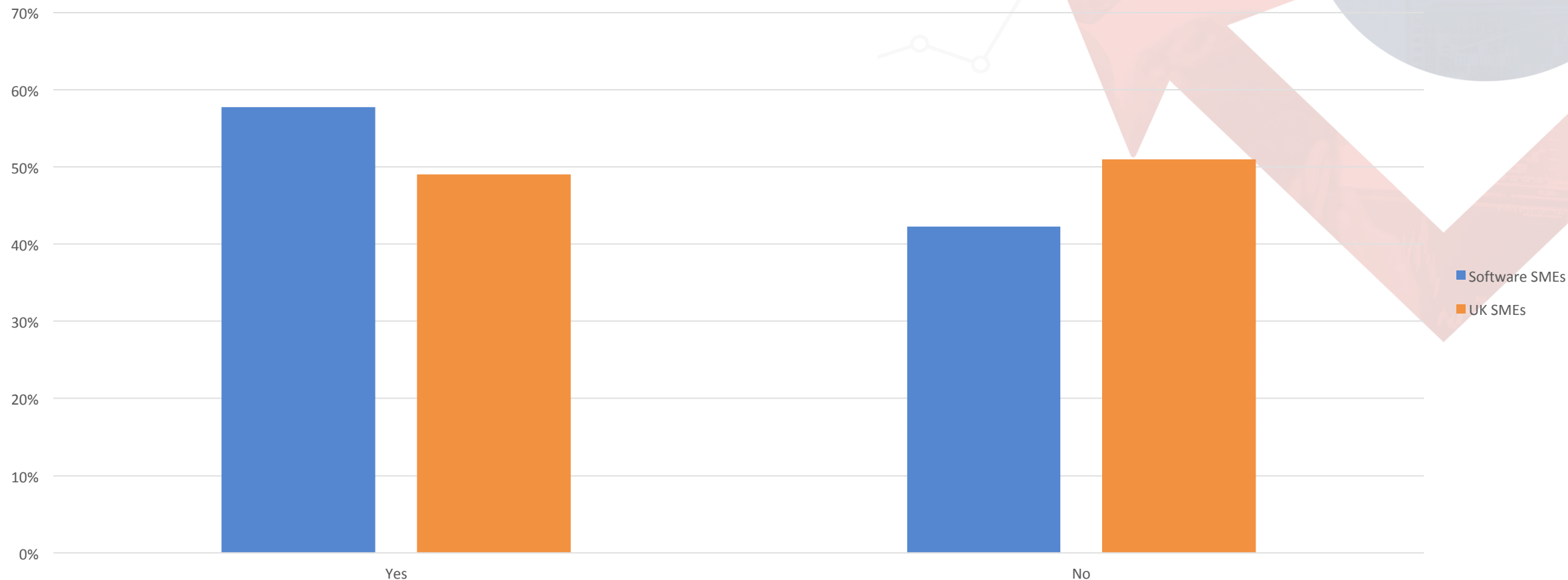
- Over half of software SMEs had arranged for staff training to take place within the last 12 months. The results were very even between UK and software SMEs with virtually half of each group responding yes and half responding no. It could be assumed that, because UK SMEs are businesses from a mix of industries, some firms simply don't need staff training as heavily as others.

- In terms of software SMEs, it is a bit more difficult to explain why these results are so. One explanation could be that the recruitment or hiring policies could be different between firms. For example, some software firms may hire people at a slightly less skilled level and dedicate time and expenses to train them while they work, while other firms in the industry may have stricter policies where they only hire qualified and highly skilled workers, eradicating the need for much, if any, staff training.

- Another point to consider is the stage at which the business might be in. For example a software firm which is closer to launching their product is much more likely to have a need to train sales and marketing teams, customer support staff and other employees associated with the delivery and implementation of their products. A software SME who is still at the research stage may only have staff who are already trained and are developing the product with the launch being some time away. Also, it is worth mentioning that other software SMEs may have been operating for long enough that they have already trained their staff in the majority and therefore do not have a priority in spending time and money conducting further training.