Executive Summary

Highlights

The PwC Canadian CEO software survey sought to identify a Canadian national cross-section of private emerging software companies. Using publicly available lists including the Branham 300, the Canadian Business Tech 100, the ROB 1000, D&B, and the Profit 100 among others, 485 companies were randomly selected to be targeted for survey participation. Below are the highlights of our survey resulting from the responses of 182 CEOs and 307 purchasing senior IT directors.

The CEO Survey

Profile of the Respondents

*The emerging company profile:* The Canadian software companies in our survey—small or large, new or old, profitable or not—are targeting their software solutions to small, medium and large enterprises. They provide solutions to a broad range of functional areas and sell into all industries. There are no apparent profitability trends among the various software markets or industries served and there is an equal split between profitable and unprofitable companies in each segment. Regardless of size or profitability, the majority of companies surveyed are involved in developing enterprise applications. Our survey focused on early-stage companies, half of which generate annual revenues of $2 million or less. One quarter generate between $3 million and $5 million and the remaining quarter have annual revenues of $6 million or greater.

*Ownership:* Founders own almost 60% of profitable emerging companies, a group that, in the majority of cases, is also the CEO. However, only one-third of these CEOs are sitting on the boards of directors of other companies sharing their vision and experience. Venture capitalists (VCs) and angels combined own 18% of profitable emerging companies—equal to employees, family and friends, and the bank.
Findings that Confirm PwC and Market Expectations

Based on our understanding of the market and our involvement with emerging companies, the following findings support our assumptions on the challenges CEOs face, the concentration of the employee mix and where research and development (R&D) is performed.

**The CEOs’ major challenges:** Emerging company CEOs are pointed towards an increased focus on business fundamentals. They identify their top priorities over the next two years as growing revenues with quality customers, raising capital (including accessing venture capital), and generating a positive cash flow. There is consistency and similar ranking of the issues across all companies, regardless of size, age or level of profitability.

**Other challenges:** Building the management team, attracting and retaining employees and managing growth were identified as key issues for the respondents. With intellectual property being the cornerstone of an emerging company’s success, technology and product development was also highly noted in the list of challenges.

**Employee mix:** R&D has the single largest concentration of employees, as a percentage of total full-time employment, regardless of size or level of profitability of the company. However, in spite of this concentration on R&D in their employee mix, CEOs consistently noted that “their success or failure will be based on getting the product to market,” and acknowledged that “to date we have been too focused on product and technology and not enough on marketing.”

**R&D location:** When CEOs were asked to identify where most of their R&D activity would be performed in 2004 and 2005, approximately 90% of them said Canada. The cost of human capital and tax incentives are by far the two most important factors. While many community leaders seeking to attract R&D operations frequently discuss issues like the local quality of life, access to universities and research institutions, and a lower cost of living, these factors have significantly less impact on the location decisions made by most Canadian software CEOs.

New Information Gained

**The software market:** The majority of companies surveyed realize the importance of the U.S. market for expansion, growth and survival. Over half of the respondents are planning to open a sales office outside of Canada in the next year, with most of these new offices planned for the U.S.

**CEO spending:** The top areas for CEO spending over the next two years, on a consistent basis across all sizes of companies, will be in the areas of direct sales, R&D, marketing and professional services, respectively. This is consistent with the need for companies to grow revenues with quality customers in the short-term given that most of the product development should be behind them.

**CEO growth targets:** Significant growth targets are being forecast by emerging software companies in line with their renewed optimism for the technology sector. Of the CEOs surveyed, 95% expect some level of growth in 2004, with almost half of them expecting growth of over 50%.
**Growth sectors:** Over the next two years, 43% of the companies surveyed believe the sector with the most positive outlook for future revenue growth over current levels, is financial services. The CEOs optimism also extends to the healthcare industry, with lower levels of support for services, government, technology and manufacturing. The retail sector scored lowest for positive outlook expectations.

**What the investor brings:** It is clear that CEOs expect more than money from their investors, whether they are bankers, VCs, strategic partners, or angels. Investors also perceive value-added capabilities as a critical success factor for their involvement in the first place. A significant number of respondents expect potential investors to be able to provide “reference to customers." The most common resources sought by software CEOs—in addition to funding and customer references—are strategic advice, support in global expansion, help in recruiting advisory and board members and senior management personnel.

**Raising capital:** Approximately 50% of all companies feel under-funded today relative to their competitors. Within the next six months 35% of all companies expect to seek funding. When looking out beyond six months, almost half of the companies expect to seek funding. Profitable companies intend to seek financing through any of the following sources, with no significant preference: U.S. venture capital, Canadian venture capital, strategic partners, private equity lenders and banks or other traditional lending institutions. 53% of unprofitable companies indicated they would seek funding from the Canadian venture capital market but a higher percentage, 57%, indicated they would be seeking funding from U.S. VCs.

**Surprise Findings:**

**The sales channel:** Over 75% of emerging companies rely extensively on a direct sales channel. Sales through other channels such as sales agents, value-added resellers, original equipment manufacturers and systems integrators were limited. Regardless of the size or profitability of their company, CEOs noted that the majority of their future revenues would come from selling existing software solutions to new customers in export markets.

**Exit strategy:** Approximately 90% of CEOs believe that their most likely exit strategy is being acquired or merged. Only 35% believe going public represents a likely exit strategy. While the IPO window is reopening, our survey findings suggest most software CEOs will not be considering this option any time soon. Finally, our findings revealed that only a small minority view selling or licensing the use of intellectual property as a likely exit strategy.

“We are unable to exploit our business plan in a more timely fashion due to our lack of capitalization.”

– CEO
The Purchaser Survey

Profile of the Purchaser

The software purchaser profile: Respondents in our survey came from a wide variety of industry sectors including technology, services, financial, manufacturing, government, healthcare, transportation and retail sectors. The purchaser companies ranged in size from one to 250,000 employees (with an average of 6,500 employees). 55% of the companies had revenues under $50 million, including 41% with revenues under $10 million. Over 70% of the purchasers have a company-wide IT strategy for purchasing and managing IT project spending. The scope of their purchasing mandate was primarily for operational needs in Canada, with 20% managing the U.S. mandate and 10% managing locations in Europe and Asia Pacific.

New Information Gained

IT spending: 75% of the purchasers believe their organizations have not purchased excess technology over the past three years relative to their needs. They believe their expenditures produced the expected return on investment (ROI) the majority of the time. Furthermore, the purchasers intend to increase their IT spending in the coming year. Our survey results suggest that IT directors will spend over $53 million on technology in 2004, and their expenditures will increase by 10% to $58 million in 2005.

Publications read: Our findings suggest that the most relevant places for an emerging company to market new technology is through technical journals and product reviews in industry magazines. Purchasers also refer to industry peers as equally valuable sources for information. Vendor white papers and trade shows are not being used by purchasers in any significant way. Publications that are commonly read among our respondents include Computer World (the highest percentage of readership), followed in order of preference by Business Week, CIO, ZDNet and PC World. All have a greater than 40% rate of readership.

Consolidation of IT suppliers: There has been a continuing debate over whether corporations prefer to buy a suite of technologies over “best of breed” point solutions. Software customers were asked their views on this trend and over half of the customers we surveyed are consolidating the number of technology suppliers they use. The reasons they gave are evenly distributed among the five following important factors: to create strategic partnerships, to reduce complexity of vendor management, to reduce technical complexity of integration, to leverage volume discounts and to facilitate one-stop shopping.

Discipline attached to purchase decisions: One-third of the purchasers surveyed indicated that they have increased the discipline they attach to making software purchases over the past year. However, in contrast to this trend, these purchasers are not spending any more time evaluating the financial viability of the vendors they are using—likely because they are dealing more with larger software vendors whose financial viability is not of major concern.

“The scandals and War shut off CEO/CIO purchasing. Leaders need to have confidence in the future before they will develop or purchase new products.”

~ CEO
Perception Gaps Identified – IT Purchasers and Software CEOs

The economic buyer: According to the purchasers surveyed, the manager of a company’s IT strategy is the CTO/CIO or IT manager 74% of the time. These same individuals are responsible for IT spending 49% of the time. A much lower percentage of CEOs, CFOs and COOs authorize IT spending and software purchases. Purchasers noted that company user groups were rarely able to authorize software spending. In contrast to this, the CEOs surveyed believe that the person authorizing IT spending at the purchaser is the CTO/CIO or the IT manager only one-third of the time. The vendor CEO perceives that the buyer CEO has a lower buying authority than purchasers give them. CEOs also believe that the COO and user groups have a higher level of influence over the ultimate purchase decision than purchasers ultimately give them.

Initializing the sale: Survey results indicate that purchasers prefer to be approached by potential vendors via email or through ads in trade publications. In fact, this approach was favoured above a request for proposal (RFP). This approach also beat out trade shows, information seminars, direct mail and white papers. Unfortunately, emails and trade publications are the method least used by software companies to initialize a sale and make contact with new customers. Our surveys show that software solution vendors prefer to make cold calls and use customer references to gain new business whereas these are the least preferred sales methods of the purchasers.

Factors that influence the purchase decision: CEOs and purchasers consistently agree that the features and functionality factor of a software solution is one of the most important factors to influence the purchase decision. However, our survey results identified significant differences of opinion on other factors, such as integration, product or solution cost, understanding customer needs, and after-sales service and support. These factors illustrate the discrepancies between most CEOs’ belief that they have a significant influence over a purchaser’s decision to buy their solution, compared to the purchaser’s actual response.

Payback criteria preferred: Purchasers’ responses on the payback criteria they used varied, and no one item stood out as being significantly more influential than the other. However, our survey results suggest that CEOs attach more importance to a software solution’s ability to reduce costs in the organization than the software purchasers require. Similarly, purchasers attach more importance to a software solution improving a company’s strategic decision-making ability and management effectiveness than CEOs do.

Time to value factor: One-third of software company CEOs believe that the value of their product or solution must be demonstrated within six months. However, according to one-third of the purchasers, the length of time a software purchase is required to demonstrate its value to the customer is not even applicable. In fact, less than 10% of purchasers believed that value should be demonstrated within this time frame.

“Our on-going risk is replacing our legacy systems, which are barely meeting our business needs in order to run on technology that is not easily supported or extensible.”

– Software purchaser