

Software Product Industry Survey 2005

Finnish software product business in 2004

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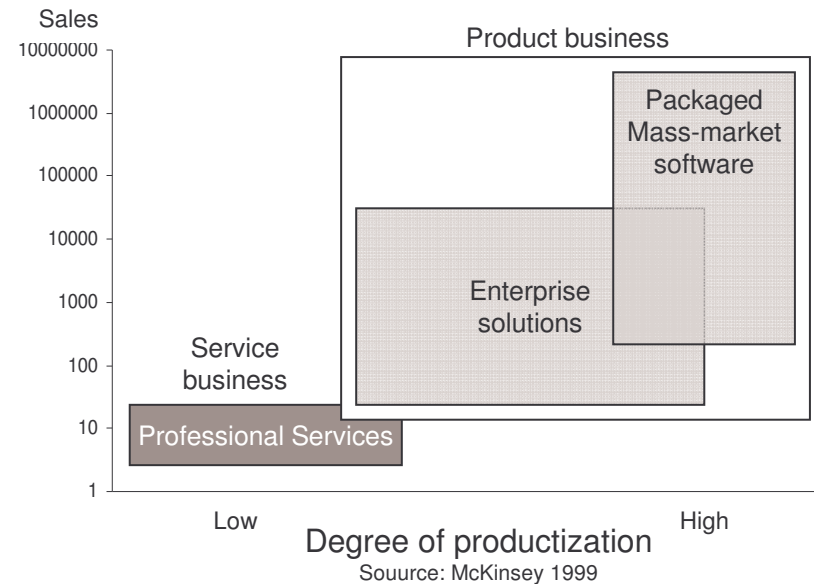
Current state of the software product industry in Finland

- The software product revenue grew 21% reaching 1.19 billion € in 2004
 - International sales increased also by 7% amounting to 405 million € in 2004
- Profitability increased from the previous year's 0.1% to 2.2% in 2004
- Employment increased by 3.3% from previous year to 12 400 software professionals
- Less than half of the companies (46%) have international operations and most of them receive only a small share of their revenues from abroad
- Vast majority of the companies (73%) belong to their founders; VC and foreign ownership is relatively low



The focus of the survey: software product business

- **Software product** is an application that is productized and can be customized to suit the customers' needs by configuration
- **Software product business** is business concerning software products where the customer tailored parts are not an essential part of the whole software
- **Own software product business** is software product business, which is based on company's own, in-house developed and maintained software products
- In Finland the software product industry generates approximately 30 % of the whole software industry's revenues



Decisions concerning SW product business are made:

		in Finland	Abroad
SW development is done:	in Finland	Included	Included
	Abroad	Included	Not included

Background and implementation of the research

- This was the eighth time the Software product industry survey was conducted
- The research was commissioned by the Centre of Expertise Software Product Business in co-ordination with Ministry of Trade and Industry and National Technology Agency
- The survey was conducted during May-June 2005 using a web-questionnaire
- Invitations to participate in the survey were sent to 2 298 companies
 - Sources: company classification of Itella Finland and contact lists of the Centre of Expertise for Software Product Business
 - Software product companies can be found under several industry classification codes (e.g. software design, databases, telecommunication etc.)
 - We received 285 (last year 275) responses, of which 220 (last year 196) did software product business in 2004
- According to the estimates of different industry and research institutions there were approximately 1 100 software product companies in Finland at the end of 2004 (1 100 in 2003)
- We received responses from 220 software product companies i.e. from ca. 20% of the companies in the industry
 - Responding companies generated over 65% of the whole industry's revenues and over 87% of the international revenues



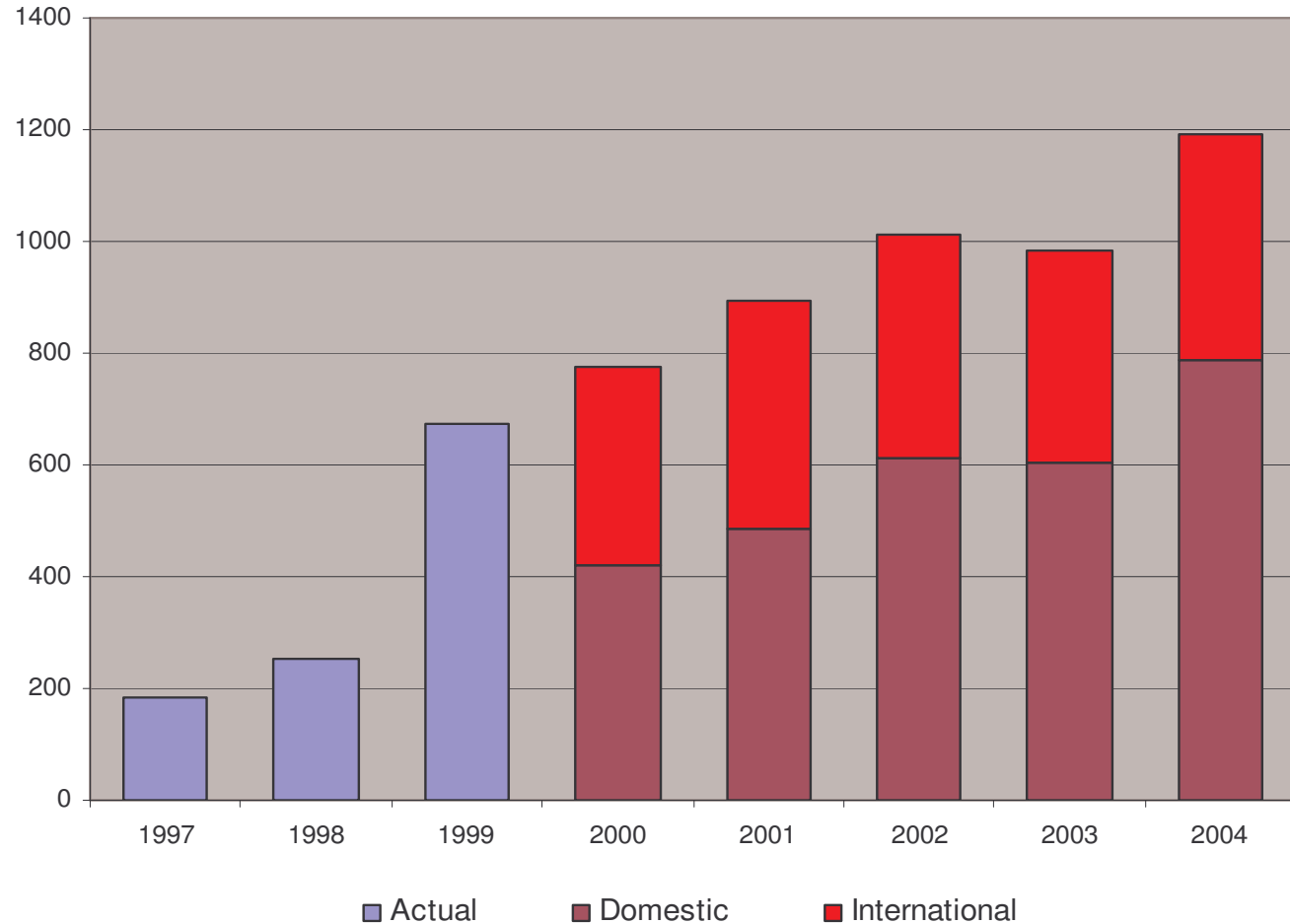
Basic information of the companies who responded to the survey

- Location
 - 86% of the companies are located in the proximity of technology centres and universities
 - 52% of the companies are located in Uusimaa, 70% of the larger companies (SW product business turnover >3 million €)
- Profitability has improved
 - 27% of the companies had profitability over 15% of turnover (24% in 2003)
 - 14% of the responding companies were unprofitable (20% in 2003, 25% in 2002)
- Age of the companies
 - Average age is 12 years (median 11 years) and average age of the software product business is 10 years (median 8 years)
 - The amount of start-up companies has decreased from 2000 to 2003 and then the amount has stabilized
- Size of the companies
 - 31% of the companies generated less than 200 000 € on SW product business in 2004 (34% in 2003, 38% in 2002)
 - Average share of SW product business was 58% of turnover (55% in 2003)
 - Average revenue per employee was 111 000 € (113 k€ in 2003, 107 k€ in 2002)
 - 31% of the companies employed 5 or less people (27% in 2003, 34% in 2002)
- Financing
 - 36% of firms intended to seek external financing in 2005-2006 (41% in 2003, 30% in 2002, 43% in 2001)



Development of the Finnish software product business turnover ¹⁾

- Software product business revenue increased by 21.0% amounting to 1.19 billion € in 2004
- International business grew by 7.1% amounting to 405 M €
- Growth was evident in small, medium-sized and large companies

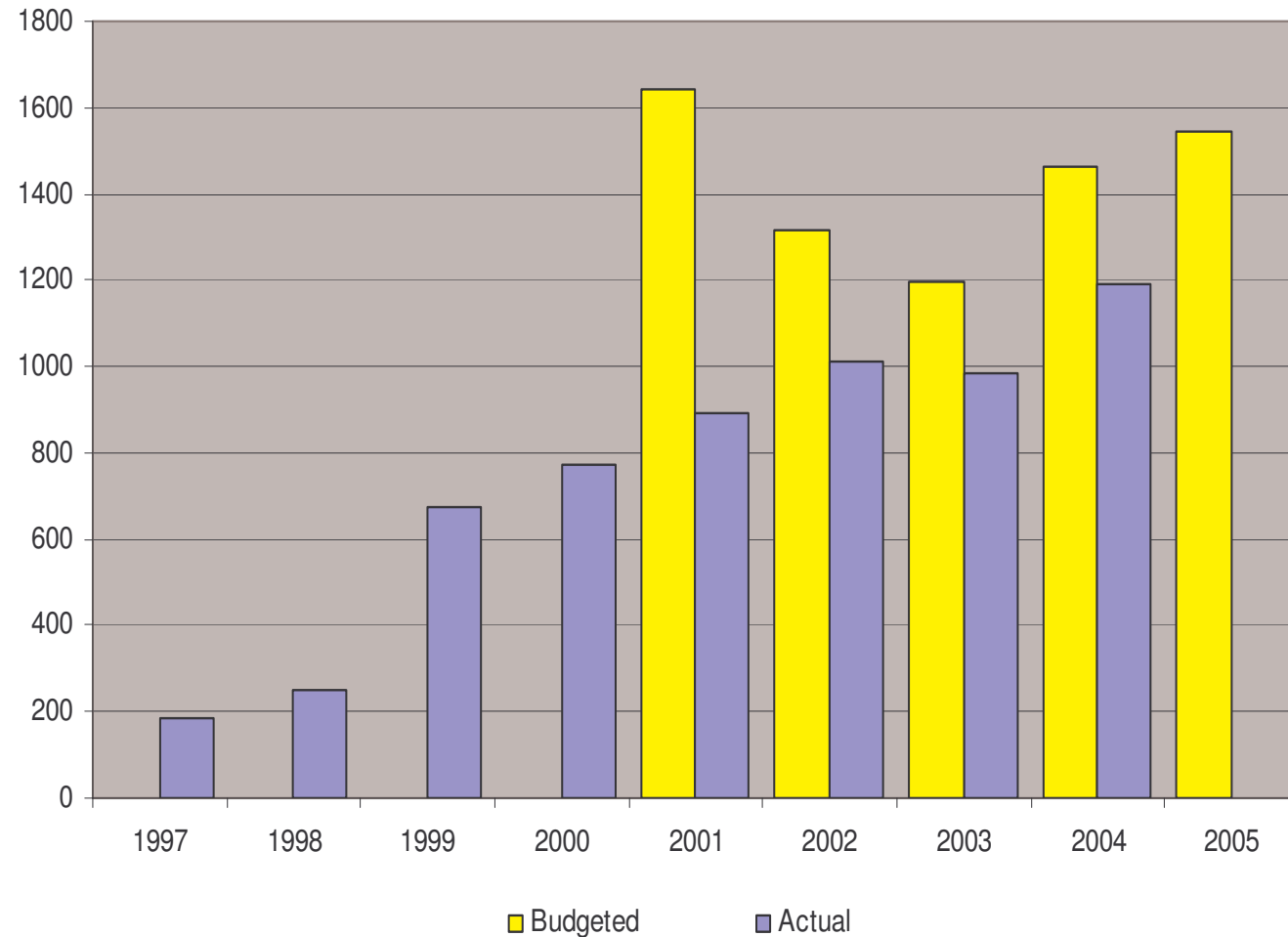


¹⁾ Extrapolated to the industry level



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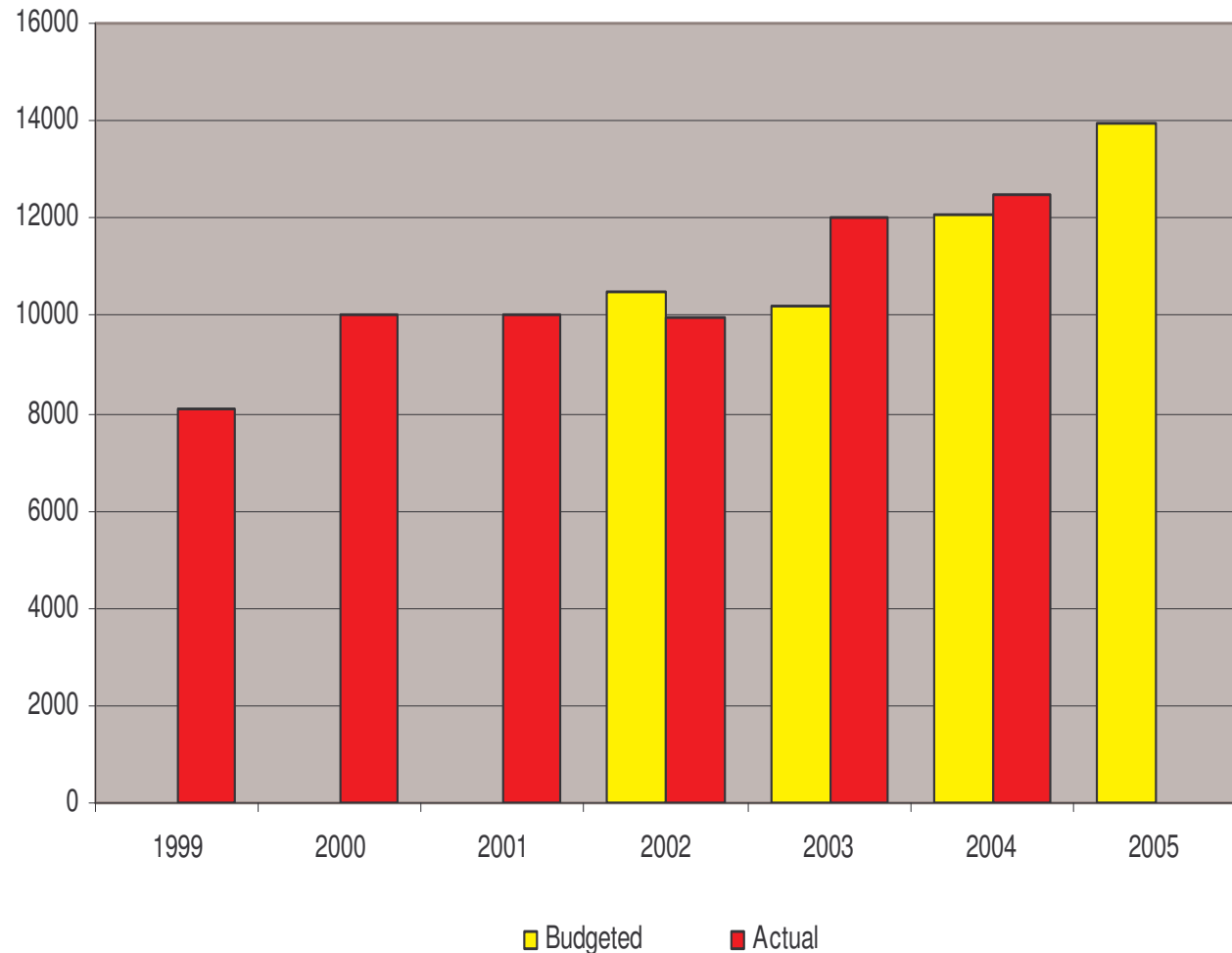


¹⁾ Extrapolated to the industry level



Software product business personnel ¹⁾

- Software product business personnel increased 3.3% (20% in 2003)
 - Employs approximately 12 400 software professionals
 - Especially smaller companies (turnover from SW product business <3 M €) recruited more personnel
 - Large companies' (turnover >3 M €) number of personnel decreased by 3%
- Companies are planning to recruit more personnel in 2005

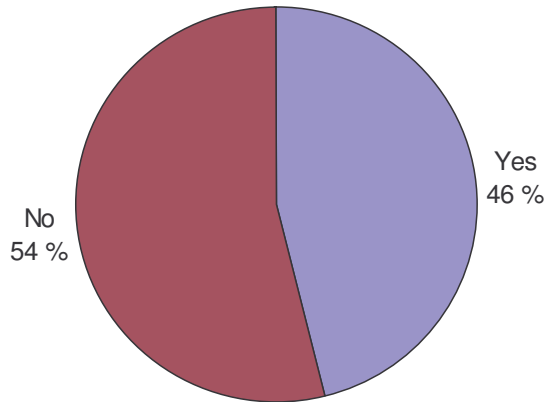


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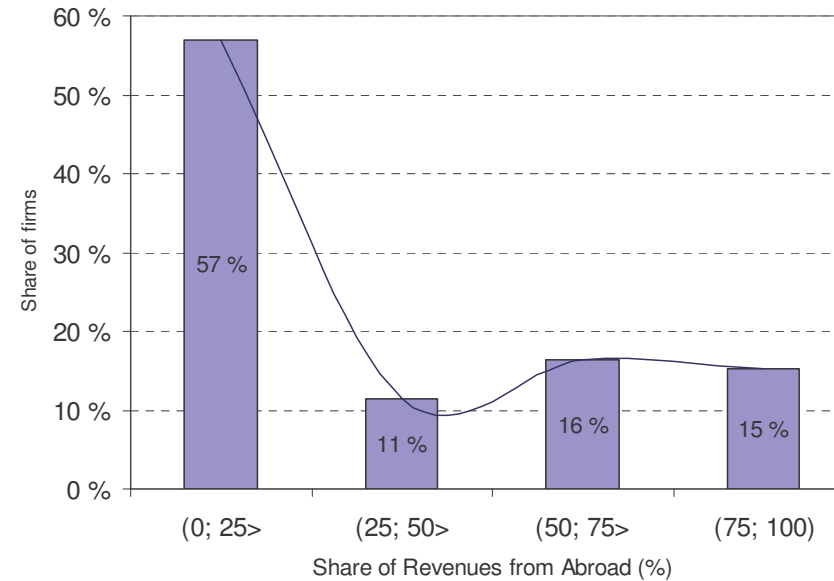


International operations

Revenues from Abroad?



Foreign Revenues Share Histogram

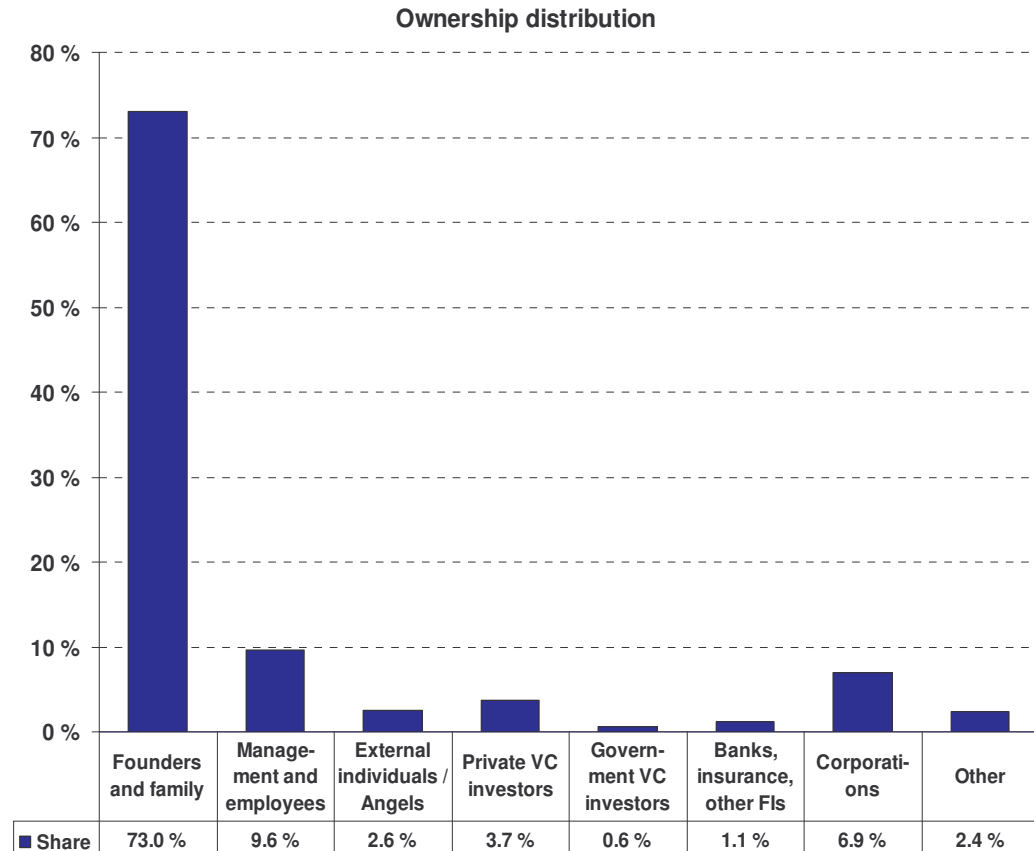


- 46% of companies reported revenues from abroad (50% 2003, 46% 2002, 37% 2001)
- Most of the companies are in the beginning the internationalization process, some are very internationalized
- Average share of revenues from abroad 31% (31% 2003, 39% 2002, 38% 2001)
- Geographic coverage 9.4 countries on average (6.3 in 2003, 8.1 in 2002, 4.6 in 2001)
- The most common exporting countries Sweden, USA and Germany (same as in 2003 and 2002)
- The most common international sale channels were own direct sales and reseller/agent (same as in 2003 and 2002)

Conclusion: The share of internationalized companies has stabilized and is ca. half of the companies, the main challenges still lay in increasing the internationalization rate

Ownership and financing

- 73% of the companies are owned by founders and their family members (70% in 2003)
- Share of VC ownership was 3.7% (7% 2003, 3% 2002)
- Share of foreign ownership was 4.2%
- 36% of firms intended to seek external financing in 2004-2005 (41% in 2003, 30% in 2002, 43% in 2001)
- Significant number of companies (31%) seeking external financing had to change business plans due to problems with availability of financing (25% in 2003, 24% in 2002)
- Young firms still find availability of risk finance as a significant barrier for the emergence of new software product companies (64% of <2 year old firms, 57% in 2003, 71% in 2002)

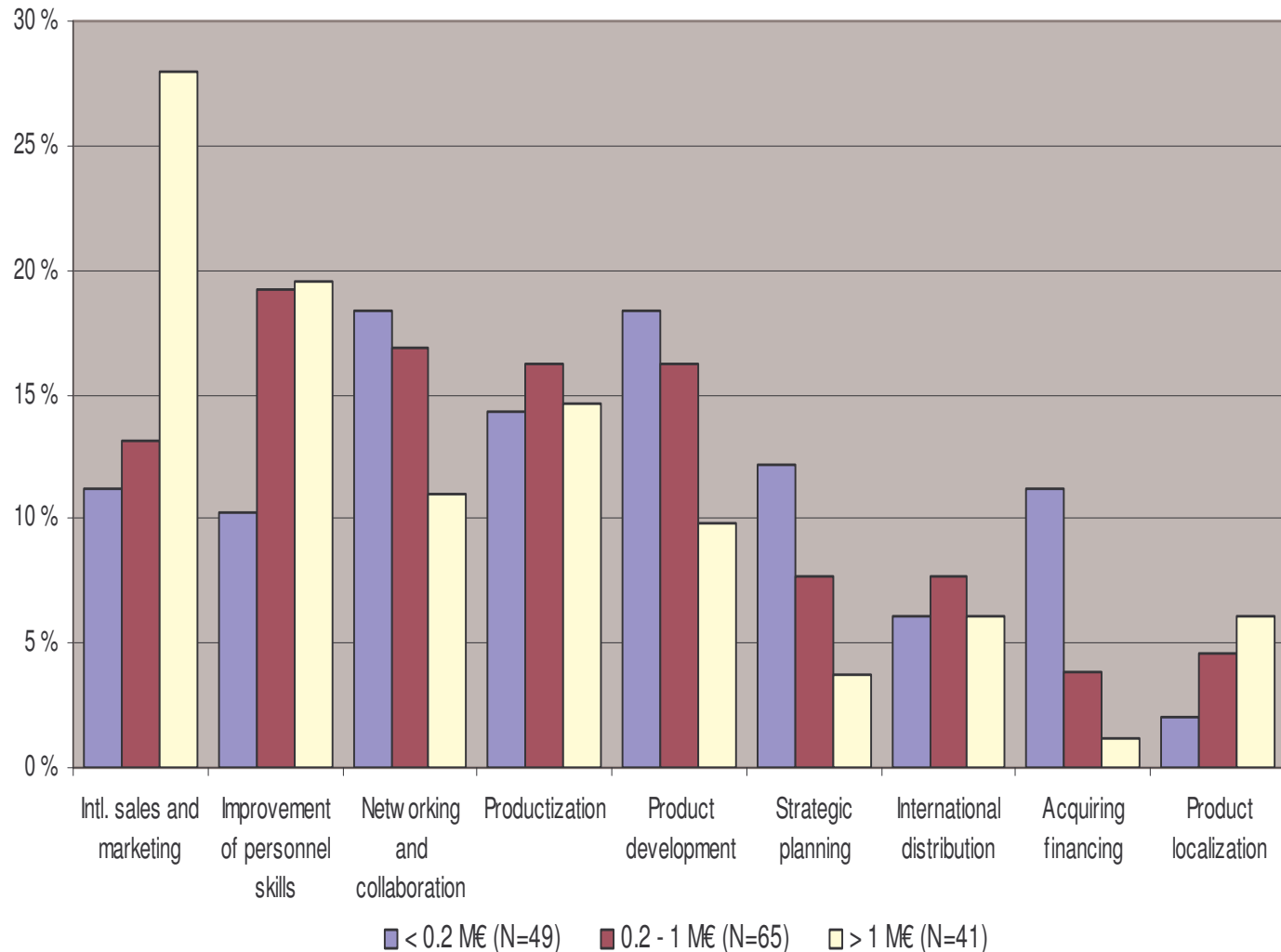


Conclusion: no significant changes in growth orientation, use of external finance, and availability of financing



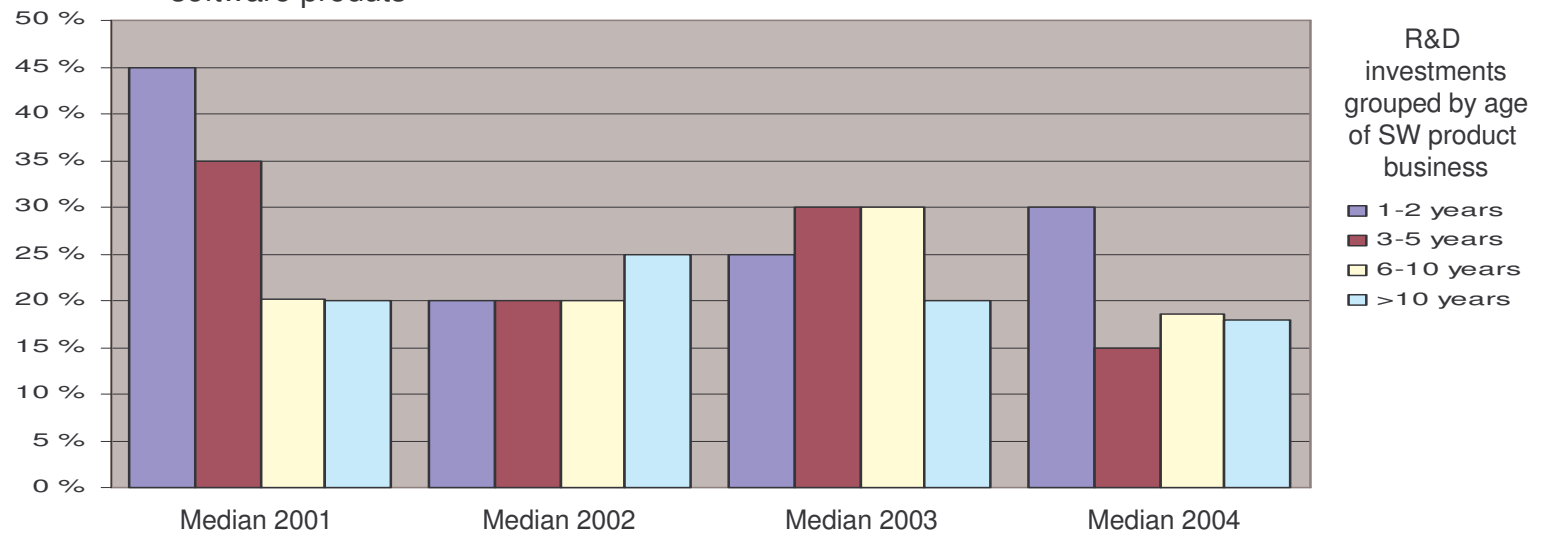
Improvement areas

- The most important improvement areas were product development and networking
 - Focus of small companies was in networking, product development and productization
 - Focus of large companies was in international sales and marketing
- Improvement of personnel skill and knowledge has risen amongst the large companies



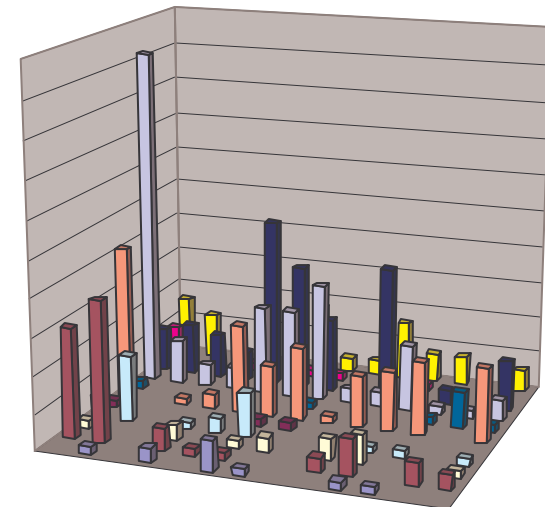
Product development

- R&D investments of young firms increased again in 2004, mature companies' R&D investments have fallen
 - Companies with age of software product business 1-2 years invested in R&D on average 30% of turnover (25% in 2003)
 - Companies with age of software product business 3-10 years invested in R&D on average 15% of turnover (30% in 2003)
- The most important focus areas of the R&D were development of the degree of productization and development of value-added services
 - The most significant focus area of smaller companies was the degree of productization
 - The significant focus area of larger companies was the development of value-added services
- The use of foreign subcontractors is still low
 - 7% of responding companies subcontracted significant amounts of R&D from abroad
- Open source components are used by the companies
 - 15% of the companies use significant number of open source components in their own software products



Software product industry clusters

- The purpose of the software product industry cluster research is:
 - To provide an internal classification of the software product industry
 - To find out the number and types of companies in each sub clusters
 - Identify potential clusters and companies, based on growth or other factors
- The use and identification of clusters allow the government funds to be targeted more efficiently
- The classification model is a matrix with dimensions for 1) types of software and 2) target markets
- For types of software the North American Product Classification System (NACPS) is applied
- The first software product industry cluster research project was the Capistus project early 2005



About the clusters

- The most popular customer target segments were horizontal applications (18%), industrial production (11%)
- The most profitable sub clusters were the horizontal applications (11%), training (10.8%), and real estate
- The most internationalized sub clusters were games & media, research & science, and telecommunications
- The largest software product business revenues were in the telecommunications (146 M€), horizontal applications (103 M €), and banks & finance (89.7 M€)
- The largest revenue per employee were in the banks & finance (120 000 €), retail & wholesale trade (111 000 €), and telecommunications (111 000 €) sub clusters



Current state of the industry and development areas

■ Current state

- Revenue has strongly increased from previous year
- The number of personnel has also increased
- Revenue per employee is still low compared to the most successful countries (such as USA and Israel)
- Financing situation is still very challenging for young firms and for companies planning internationalization

■ Development areas

- The support efforts should be concentrated on the most promising customer segment clusters
- Improving the understanding of the SW product business
- Strengthening and developing networks and supporting services in case of small companies
- Improving the knowledge of internationalization especially in case of the SMEs



Summary

- The change for the better has come
 - Revenues of the software product business grew significantly
 - The amount of personnel increased and the growth prospects for this year are good
- The profitability of the software product business improved
- Increasing the internationalization rate is still a significant challenge
- There are big differences in profitability amongst the customer segment clusters



Software Product Industry Survey 2005

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