

# Software Product Industry Survey 2006

## Finnish software product business in 2005

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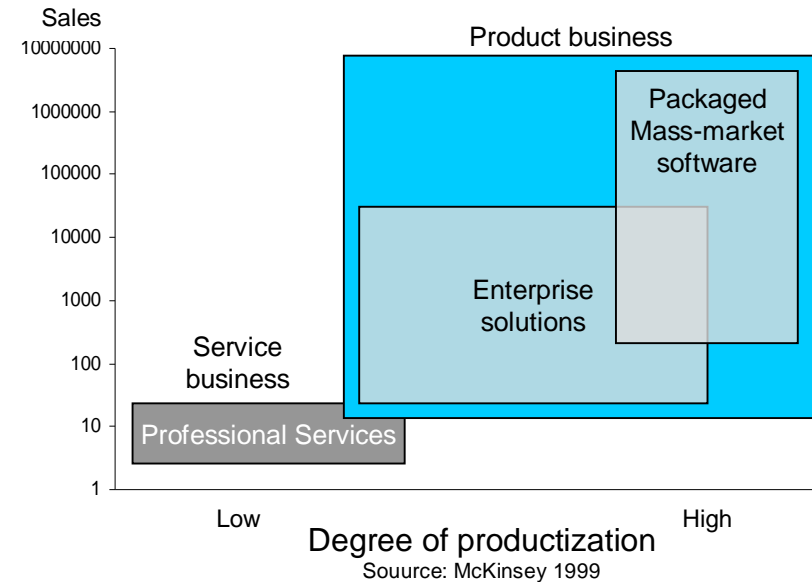
HELSINKI UNIVERSITY OF TECHNOLOGY



Centre of Expertise  
for Software Product Business

# 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 ninth time the Software product industry survey was conducted
- The research was commissioned by the Centre of Expertise Software Product Business and Federation of The Finnish Information Industries in co-ordination with Software Entrepreneurs Association, Ministry of Trade and Industry and National Technology Agency
- The survey was conducted during May-June 2006 using a web-questionnaire
- Invitations to participate in the survey were sent to 1 1863 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 233 (285 in 2004) responses, of which 184 (220) did software product business in 2005
- According to the estimates of different industry and research institutions there were approximately 1 100 software product companies in Finland at the end of 2005 (1 100 in 2004)
- We received responses from 184 software product companies i.e. from ca. 17% of the companies in the industry
  - Responding companies generated over 68% of the whole industry's revenues and over 80% of the international revenues (estimation)



## Current state of the software product industry in Finland

- The software product revenue grew by 9.2% reaching 1.3 billion € in 2005 (1.19 billion in 2004)
  - International business increased significantly by 24.2% (7.1%) amounting to 504 million € (406 M €)
  - Domestic revenues grew by 1.4% (29.7%) and was 798 M € (786 M €)
- Profitability (profit/revenue) increased from the previous year to 2.8% (2.2%)
- The industry employs ca. 12 340 software professionals (12 400), the amount stayed on the last year's level
- Over half of the companies (59%) have international operations but most of them receive only a small share of their revenues from abroad
- Vast majority of the companies (69%) are owned their founders; VC and foreign ownership is relatively low but increased from last year's level



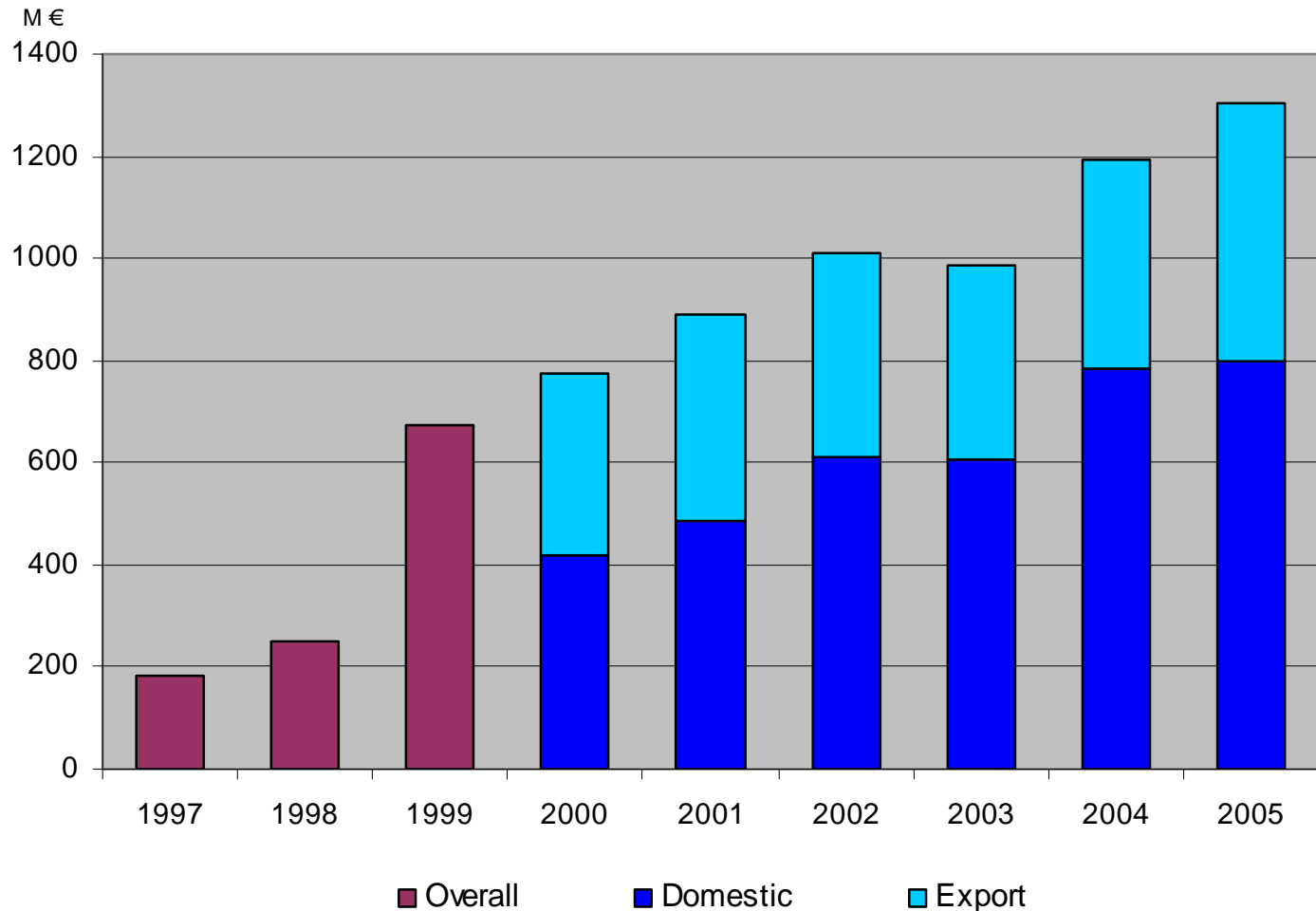
## Basic information of the companies who responded to the survey

- Size: most of the companies are small or mid-size
  - 30% of the companies generated less than 200 000 € on software product business in 2005 (31% in 2004)
  - Average share of software product business was 68% of the overall revenue (58% in 2004)
  - Average revenue per employee was 109 000 € (111 000 € in 2004)
  - 32% of the companies employed 5 people or less (31% in 2004)
- Age of the companies
  - Average age is 13 years (median 11 years) and average age of the software product business is 10 years (median 7 years)
  - Older companies are usually more profitable
- Profitability has improved from last year's 2.2% to 2.8%
  - 24% of the companies had profitability over 15% (27% in 2004)
  - 15% of the responding companies were unprofitable in 2005 (14% in 2004)
- Financing: external finance is sought in order to facilitate growth
  - 36% of firms intended to seek external financing in 2006-2007 (36% in 2004, 41% in 2003)
- Location: industry is geographically very concentrated
  - 86% of the companies are located in the proximity of technology centres and universities
  - 52% of all the companies are located in the capital region, 72% of the larger companies (software product business revenue >3 million €)



# Development of the Finnish software product business revenue 1997-2005 <sup>1)</sup>

- Software product business revenue grew by 9.2% (21.0%) amounting to 1.3 billion € (1.19 in 2004)
- International business grew by 24.2% (7.1%) and was 39% (34%) of the overall revenue
- Domestic revenue grew by 1.4% (29.7%)
- Mainly large companies' revenues grew
- The most internationalized business areas: mobile sector and games & media

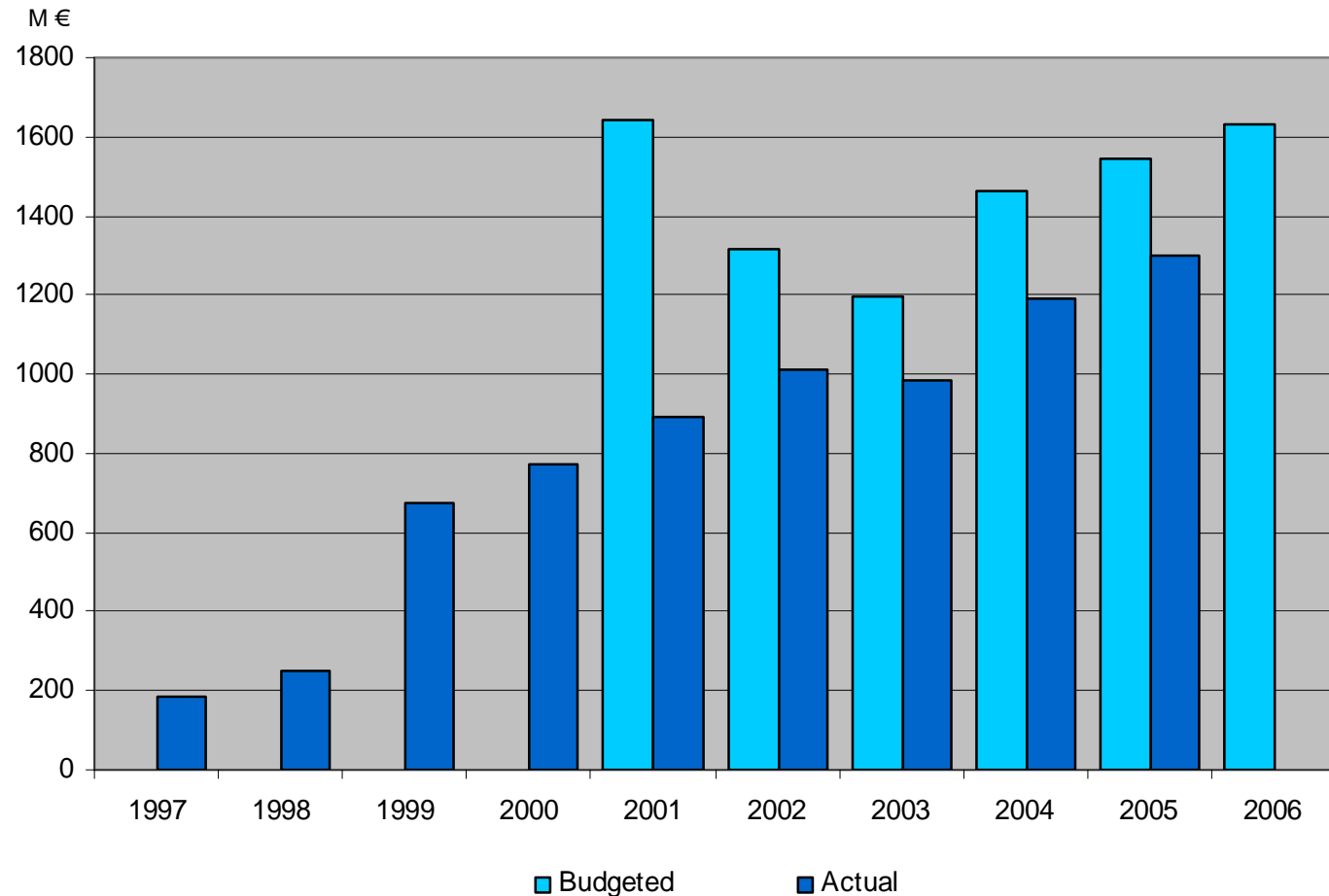


<sup>1)</sup> Extrapolated to the industry level



# Development of the Finnish software product business revenue <sup>1)</sup>

- Companies's budgeted revenues have risen for the past three years
- Actual revenues have followed the budgeted figures, which predicts growth also for this year
- Companies' estimations are more realistic now than in the beginning of the millennia
- 31% (24%) of the firms stated that their biggest client represented for more than a third of their revenue

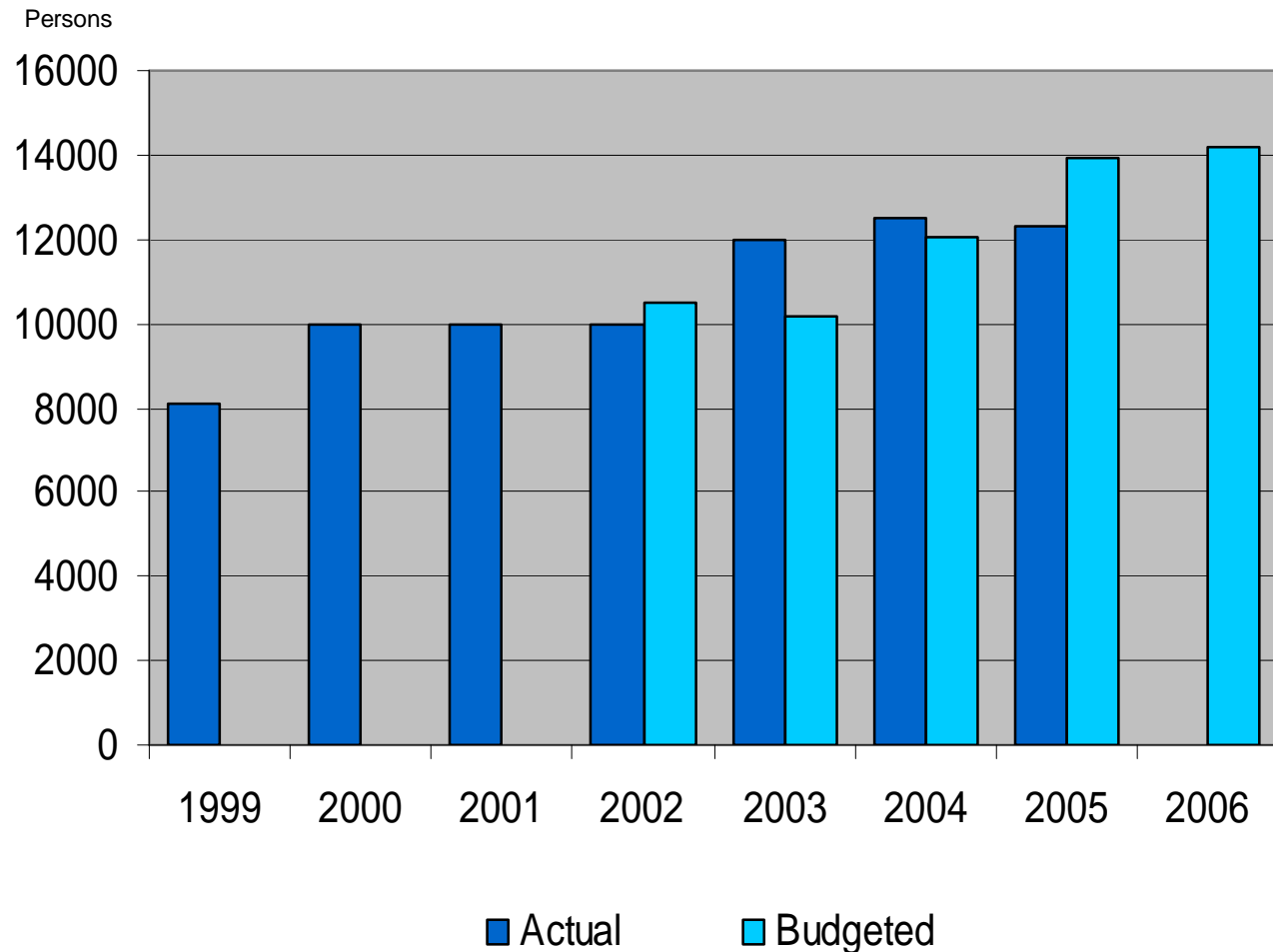


<sup>1)</sup> Extrapolated to the industry level



# Software product business personnel <sup>1)</sup>

- The amount of personnel in software product business stayed on last year's level
- Software product business employs approximately 12 340 persons
- Mainly larger companies increased the number of their personnel
- Smaller companies fell behind their last year's budgeted personnel figures

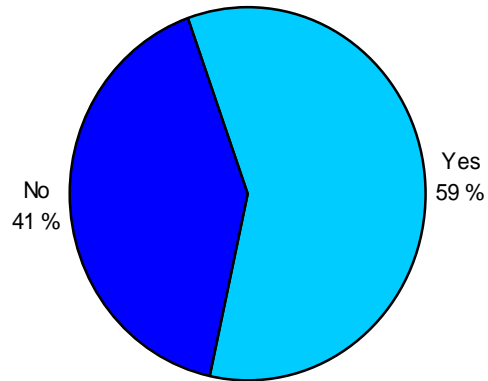


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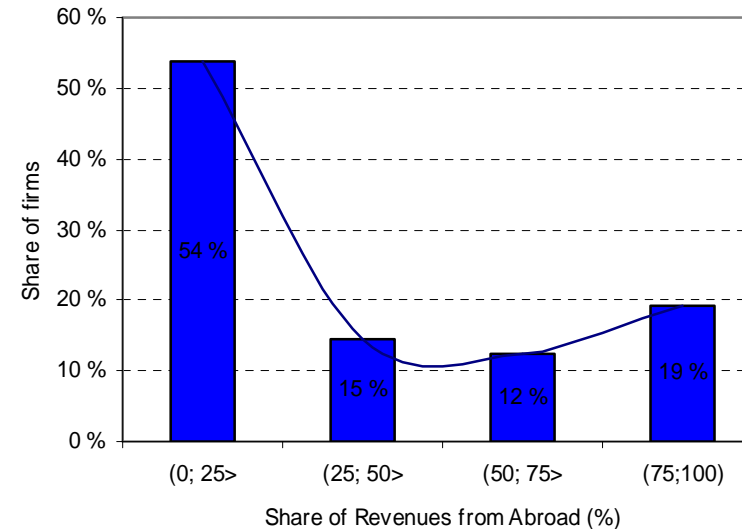


# International operations

Revenues from Abroad?



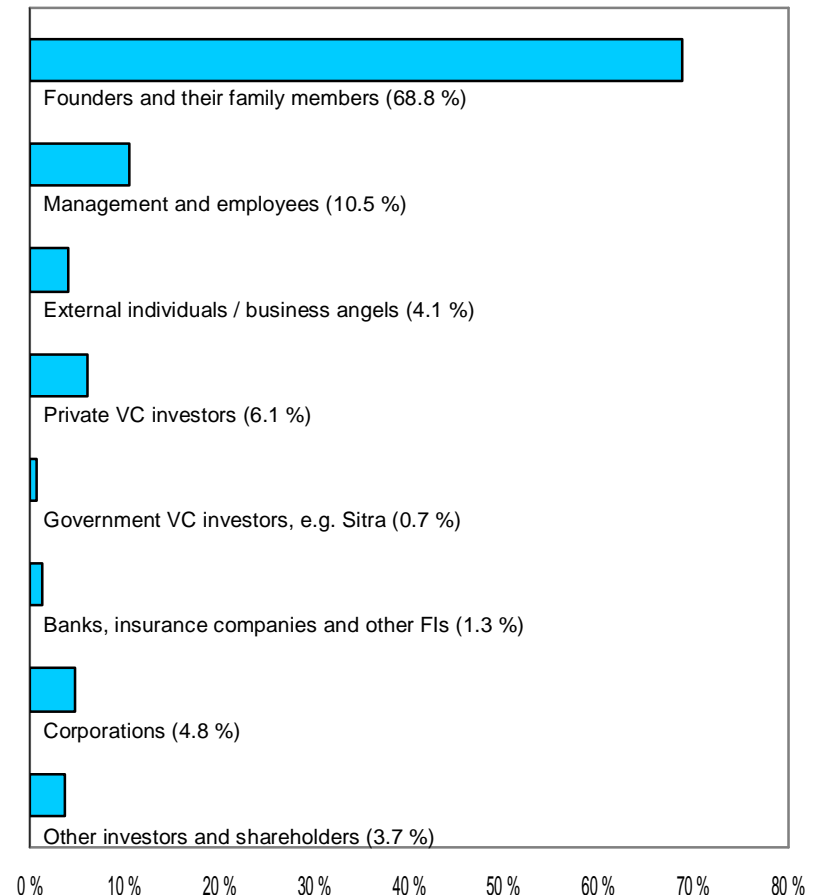
Foreign Revenues Share Histogram



- **59% of companies reported receiving revenues from abroad (46% 2004, 50% 2003)**
- **Most of the companies are in the beginning of the internationalization process, however some are very internationalized**
  - 19% of internationalized firms receive over 75% of their revenues from abroad, 33% of the intl. firms receive less than 5% from abroad
  - Average share of revenues from abroad 33% (31% 2004, 31% 2003)
- **Type of the software significantly affects the internationalization rate of the companies: companies who sell software licences are more internationalized, whereas when the level of customer specific customization increases also the internationalization becomes more difficult**
  - Vertical/Target customer segment reflects on the economies of scale, which in turn affects the internationalization efforts of the company
  - More internationalized companies invest more in R&D expenditure
- **Geografic coverage 7.8 countries on average (9.4 in 2004, 6.3 in 2003)**
  - The most common export countries were Sweden, Germany and USA (same as in 2002-2004)
- **The most common international sale channels were own direct sales and reseller/agent (same as in 2002-2004)**

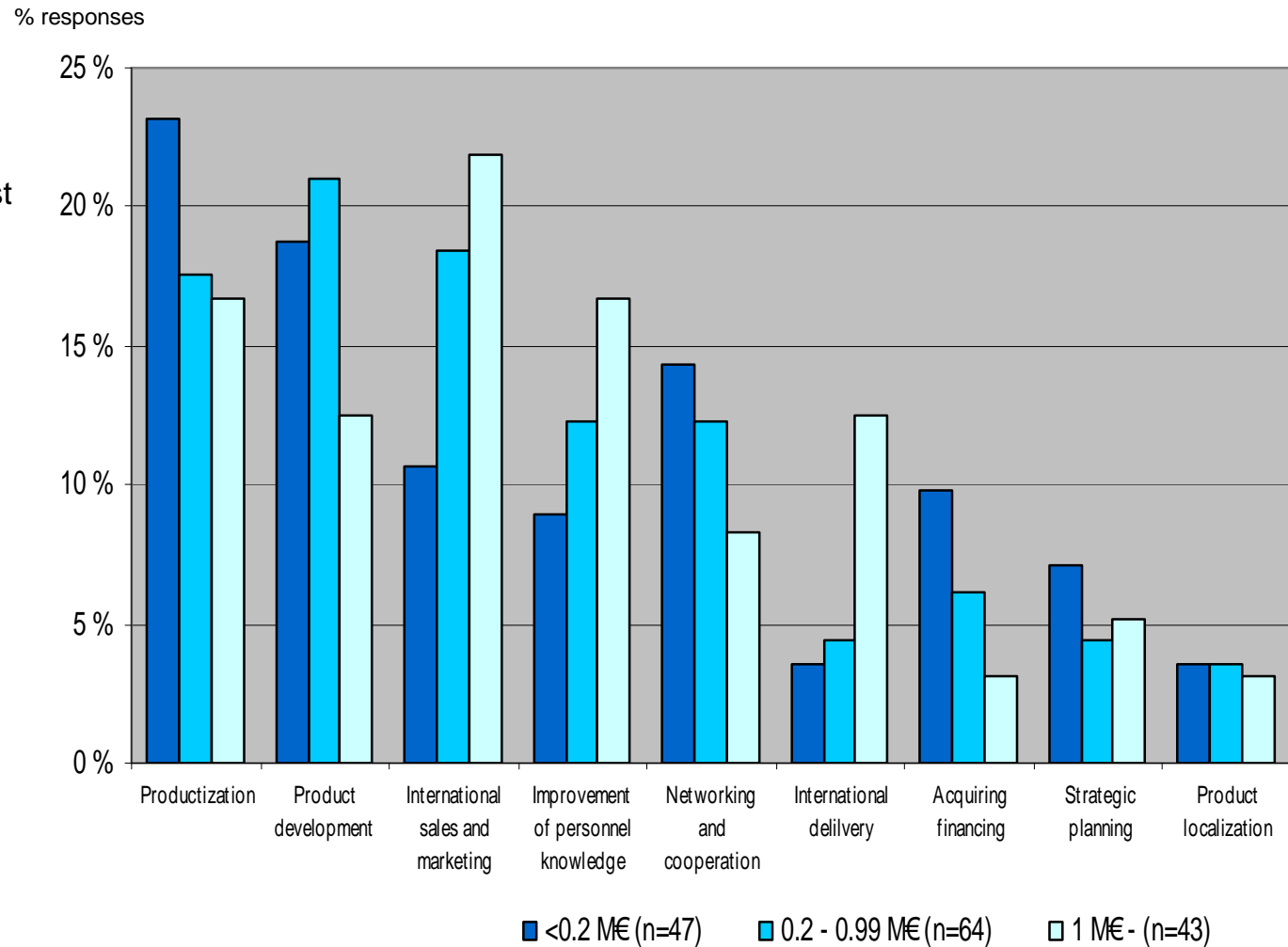
# Ownership and financing

- 69% of the companies are owned by the founders and their family members (73% in 2004)
- Share of VC ownership was 6.1% (3.7% in 2004, 7% in 2003)
  - 15% of companies had private VC owners
- Over 80% of the firms were wholly owned by Finns
  - Average share of foreign ownership was 6.1% (4.2% in 2004)
- 36% of firms intended to seek external financing in the next two years (36% in 2004, 41% in 2003)
  - 27% of the firms plan to raise equity financing, 16% capital loans and 11% dept finance
  - External finance was sought approximately 300 M € as equity, 80 M € as capital loans and 60 M € as debt
  - Equity finance preference to the other financing means is in line with current finance theories and software industry segment's features
  - Strong growth seeking focus and unprofitability are the major characteristics that distinguish companies seeking financing
- Significant number of companies (31%) seeking external financing had to change business plans due to problems with availability of financing (31% in 2004, 25% in 2003)
  - Usually meant reducing internationalization attempts
- Young firms still find availability of risk finance as a significant barrier for the emergence of new software product companies (67% of <2 year old firms, 64% in 2004, 57% in 2003)



# Improvement areas

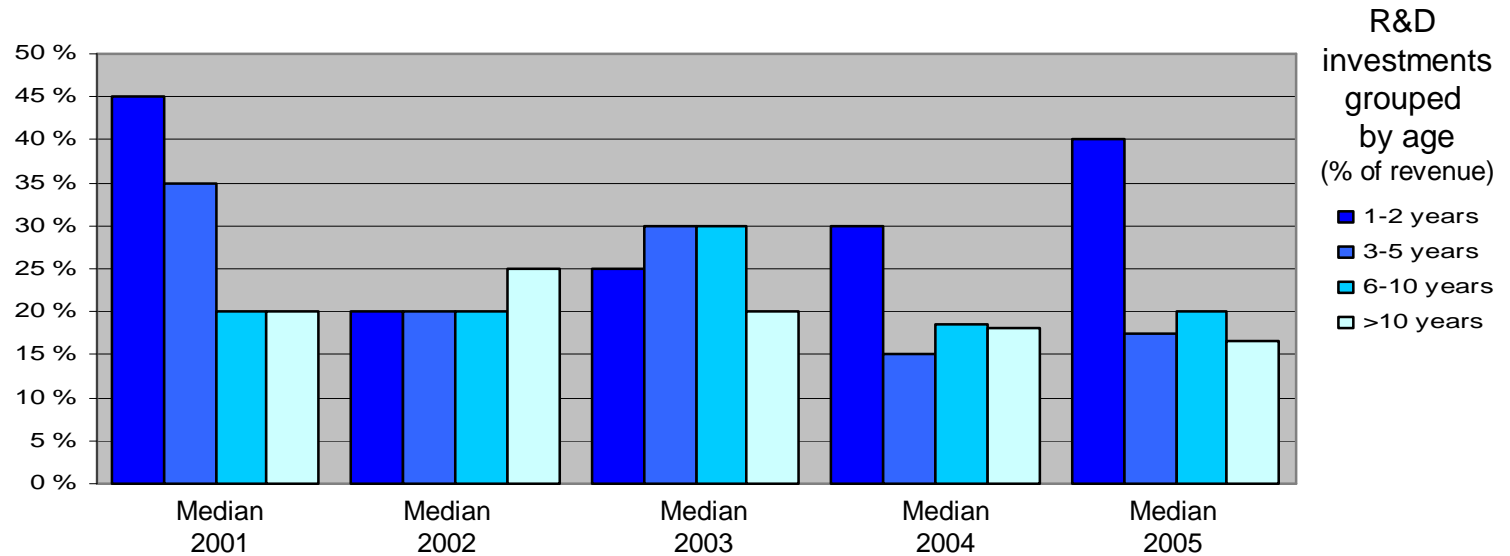
- The most important improvement areas were productization and product development, which have risen from last year's 4th and 5th place
- Companies are concentrating on scalability of the business related issues
- Focus of the small companies was in productization and product development
- Focus of the large companies was in international sales and marketing, productization and improvement of personnel's skills and knowledge



Companies are grouped according to revenue size



# Product development



- R&D investments of young firms increased for the third consecutive year
  - Companies with age of software product business 1-2 years invested in R&D on average 40% of turnover (30% in 2004, 25% in 2003)
  - Average R&D investment of the companies is 31% of the overall revenue
- The most important R&D focus areas for both small and large companies were the development of value-added services and raising of the degree of productization
  - 40% of the companies are investing in the development of new products (33% in 2004)
- The usage of subcontracting is growing
  - 35% of responding companies subcontracted significant amounts of R&D from domestic market (25% in 2004)
  - 16% of responding companies subcontracted significant amounts of R&D from abroad (12% in 2004)
- Open source software is used by the companies
  - 12% of the companies use significant number of open source components in their own software products



## Offering software as a service

- Offering Software as a Service i.e. usage of SaaS business model has grown: 53% of the respondents offered their software as a service (35% in 2004)
- Below are some basic figures shown in comparison between the companies who offer SaaS services and those who do not:

	SaaS	Non-SaaS
Average revenue related to software	5,8 M €	2,8 M €
Software product business's share of the overall revenue	77%	73%
Average profit	2,7 M €	0,2 M €
Average profitability (profit/revenue)	6,2%	8,6%
Percentage of companies conducting international business	60%	49%

- In the international markets offering software as a service has been a growing trend for the past few years – now also the Finnish companies have noticed the growth potential of offering services to the customers



# Summary

## Current state

- International business is growing fast
  - Finnish companies's revenues from abroad grew by 24,2%, whereas international markets grew by 1%
  - Especially the larger companies grew in the international markets
  - Mobile sector and games & media were the most internationalized verticals
- Companies have started to pay attention on the scalability of their business models and are investing in the future
  - Productization has gained importance of the improvement areas
  - Offering software as a service has increased
  - Young firms' R&D investments have risen for the third consecutive year

## Development areas

- Increasing the internationalization rate of their business is a challenge for most of the companies
  - Further improvement of the knowledge and skills related to internationalization especially in case of the SMEs
- Improvement of the knowledge and skills needed in software productization and product management
- The support efforts should be concentrated on the most promising clusters in order to develop internationally capable and competitive companies
  - The strengthening and development of networks and supporting services especially in case of small companies is important



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