



# Champions Trophy

## Case Competition 2011



## Case 1: Xero

9 February 2011

Case prepared by Mr. Patrick Hadfield and Ms. Riddhi Gupta under the supervision of Mr. Sunny Gu. This case has been prepared solely for The Champions Trophy Case Competition. All data in this case has been obtained from publically available sources and Xero. This case is not intended to serve as an endorsement, a source of primary data, or an illustration of effective or ineffective management.

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## **Benjamin Banker**

**From:** Benjamin Banker  
**Sent:** Wednesday 9 February 2011  
**To:** \* Xero Project Teams  
**CC:** David Dollar; John Jobs; Peter Partner; Warren Wallstreet  
**Subject:** Xero Strategy Presentation

Team,

Xero has hit the sweet spot!

Small and medium businesses want to do what they're good at – and this could mean moving away from off-the-shelf accounting and personal finance solutions.

Xero imagined the future with Software-as-a-Service well before any of its competitors – nimble, innovative, fun-to-use, low cost software on the internet that not only satisfies accounting needs but enhances how customers do their business.

The uptake of Xero's award winning technology solutions can speak for itself – there has been exponential growth in customer volumes. CEO Rod Drury has driven partnerships with industry, telecommunications and banking heavyweights around the world. Xero has won the trust and support of experienced innovators such as Sam Morgan, Peter Theil, and Craig Winkler.

Don't let Xero's strong results distract you from Drury's ambitious foray into the world of cloud computing where many have failed. Software-as-a-Service technology is anyone's game. Cloud computing and SaaS are megatrends that are hard to argue with and Xero has proven its ability to envision how new technologies can shape business in this brave new world.

With global competitors hot on their heels, Drury is looking to drive Xero into an unprecedented phase of growth.

Your team has been invited to give a presentation of no more than ten minutes to share what you believe Xero should consider as they move forward, and therefore how best to move forward. Our researchers have attached company and industry information, some of which you may find relevant.

Regards,

**Benjamin Banker**

Senior Vice President

SYG Consulting Group



# The Business



# The Business

## Products<sup>1</sup>

Xero provides online accounting systems for two broad categories of users: businesses and personal.

### **Xero for Business**

Xero's core offering is an online accounting system designed for small businesses and their advisors. It assists businesses with the preparation of their accounts for compliance or decision making purposes.

Xero for business is a "Software as a Service" SaaS solution meaning it is provided over the internet and the user pays an ongoing fee for access. This contrasts to a software package, such as MYOB<sup>2</sup>, where the user pays the one-off cost of the licence and installs it on a computer. SaaS allows customers to manage their accounts from any internet connection in the world, from a desktop computer or a portable device such as a laptop, iPhone, Blackberry or windows mobile device.

Xero for Business is a relatively low cost accounting package, as there is no additional hardware, any consulting fees, or customisation required. Since users access the existing application from the internet, time is not spent on implementation.

The cornerstone of Xero's marketing is simplicity. Xero believes that SMEs do not understand or enjoy accounting, and would like a service that makes it painless. It is branded as "The world's easiest accounting system". Appendix 1 contains testimonials describing why customers use Xero.

Xero for business includes the following features:

### **Dashboard**

A real-time view of the business at a glance, providing a snapshot of all transactions. See appendix 2 for a screenshot.

### **Banking**

Automatic importing of bank/PayPal statements and transactions, bank reconciliation module, visibility of cash balance and cash flow.

### **Invoicing**

Produces invoices, customisable invoice layout, sends repeat invoices to regular customers, tracks goods sold through inventory items report and send invoices to customers via email.

### **Payables**

Displays all outstanding invoices, set up repeat payables for regular suppliers and track stock purchases using inventory items.

### **Multi-currency**

Automatically converts currencies in real time, manages foreign currency invoices, calculates gains and losses and reconciles foreign currency bank accounts.

### **Expense Claims**

Reimburses personal expenditure. Approve or decline requests, set payment date and reconcile expense claims payments.

<sup>1</sup> <http://www.xero.com/accounting-software/> and <http://www.xero.com/web/>

<sup>2</sup> Mind Your Own Business, an accounting software application with over 1 million users in Australia and New Zealand. <http://myob.co.nz/myob/our-story-1257828256921>

## Contacts

Stores information about business contacts. Users can add, delete or edit details, trace amounts owing from/to them and organise contacts into groups. Integrates with Skype and Google Maps so users can speed dial contacts and view their location.

## Reporting

Generates interactive reports in real-time which can be exported to Excel and Google Docs. The reports include GST<sup>3</sup> returns.

## Fixed Assets

Records cost of assets, manages depreciation schedule and accounts for sales or dispositions.

Xero is a horizontal accounting solution, meaning that it includes a wide breath of modules. A vertical product will specialise in a single module (e.g. tax or job costing). The features that a business, or its accountant, have access to depends on its subscription. Xero offers the following three options<sup>4</sup>:

<p><b>\$ 19</b> PER MONTH</p> <p><b>SMALL</b></p> <p><i>Ideal for freelancers and small property investors</i></p> <ul style="list-style-type: none"><li>• Up to 5 Accounts Receivable and 5 Accounts Payable invoices per month</li><li>• Up to 20 reconciled bank statement lines per month</li></ul>	<p><b>\$ 29</b> PER MONTH</p> <p><b>MEDIUM</b></p> <p><i>Great for most small and medium sized businesses</i></p> <ul style="list-style-type: none"><li>• Unlimited invoicing</li><li>• Unlimited bank reconciliation</li></ul>	<p><b>\$ 39</b> PER MONTH</p> <p><b>LARGE</b></p> <p><i>Essential for businesses that bank or transact in foreign currencies</i></p> <ul style="list-style-type: none"><li>• <b>Multi-currency</b></li><li>• Unlimited invoicing</li><li>• Unlimited bank reconciliation</li></ul>
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All prices in US Dollars. Choose your pricing plan once you've ended your trial and are ready to pay.

Users running multiple organisations on Xero receive a discount of 25% of their total subscription fee.

<sup>3</sup> Goods and Services Tax. A New Zealand consumption tax of 15% of the net price of the good sold. Businesses can claim GST paid for expenses but have to pay GST collected on their sales.

<sup>4</sup> See Financial Information section for exchange rates.

<sup>5</sup> Source: <http://www.xero.com/pricing/>

## Xero Personal<sup>6</sup>

Xero Personal helps individuals to manage their own finances. Like the business package, Xero Personal is online and subscription based. It is currently priced at \$34USD per year. Features include:

- displaying your financial position, including all bank account balances;
- categorisation of spending and saving, including distinguishing between essential and non-essential spending;
- interactive charting;
- presenting options for “getting back on track” (i.e. what you need to do to meet targets if you missed them); and
- customised access to allow trusted people (e.g. spouse, financial advisor) access and exclude others.

Appendix 3 contains testimonials and screenshots.

Xero Personal was launched on 29 March 2010. CEO, Rod Drury, believes that it is complimentary to the business service. In a media release<sup>7</sup> Rod says:

*“For customers who use Xero’s online business accounting service, Xero Personal will give them the ability to lodge and track business expenses - paid for from a personal account or credit card, directly back into Xero. We’ve been able to leverage our existing platform investment to extend our suite of tools, from small business accounting through to personal finance.”*

## Markets

Xero’s business service is targeted at Small to Medium Enterprises (SMEs) and Xero Personal is targeted at individuals. In New Zealand, SMEs encompass micro-enterprises (less than five staff), small enterprises (six to 49 staff) and medium enterprises (50 to 100 staff)<sup>8</sup>.

Xero’s market is not confined to New Zealand, and the company is global in its reach. It has sales teams in the United Kingdom and Australia, and is developing a presence in the US market. As at 31 March 2010, Xero had paying users in over 50 countries (see appendix 4). The financial section shows a breakdown of Xero’s revenue by country.

## Strategy

### The Opportunity

#### SMEs

The New Zealand SME market is large, accounting for over 99% of New Zealand businesses (approximately 350,000 firms in total<sup>9</sup>). Traditionally the SME market has been difficult to serve since it is fragmented.

#### Service Features

Xero believes that there has been little product innovation in this market, and there is a gap for accounting software with the following benefits:

- Easy to use – understandable and automated.
- Mobile – accessible from any location or device with internet access around the world. Not confined to one computer like a software package.
- Short implementation – no installation, customisation or purchase of additional hardware required. Automatic (and free) updates.
- Back-up ready – no need for manually backing up data like software computer packages. All inputs are stored securely on the internet.

<sup>6</sup> <https://www.xero.com/personal/>

<sup>7</sup> <http://www.xero.com/downloads/pdf/announcements/290310-xero-launches-personal-money-manager.pdf>

<sup>8</sup> <http://sme-centre.massey.ac.nz/>

<sup>9</sup> <http://sme-centre.massey.ac.nz/>

<sup>10</sup> <http://www.xero.com/investors/reports/>

## Global Financial Crisis

Xero also believes that the global financial crisis creates an opportunity for its offering because SMEs are capital constrained and would prefer paying a low ongoing fee, to a large upfront cost for a software license, consultation and installation. No additional hardware is required to operate Xero.

Also, banks demand more reporting by depositors and borrowers (Xero facilitates easy and frequent reporting) and businesses want to tighten their focus on cash flows.

## Partnerships

As a fragmented market, SMEs have been difficult to tap into. Xero believes that it can overcome this hurdle through two forms of partnerships.

## Telecommunication Companies & Banks

Telecommunications companies have access to SME clients, and are seeking to up-sell additional services to extract more revenue from their bandwidth. Banks also have access to SME clients, and there is potential for a product advantage since partnering with them enables integration between the user's bank account and their Xero account. The following extract from Xero's annual report explains further<sup>11</sup>:

*"Developing strategic partnerships with telecommunications carriers and banks continues to be a key part of Xero's international growth strategy... [Partnerships] have assisted with building Xero's brand and global credibility, and position us well for the next wave of mobile computing. Most recently, Xero entered into an exclusive joint marketing agreement with ANZ<sup>12</sup>... ANZ will work with Xero and its own online and direct sales channels to promote the benefits of Xero to its small business customers in these two key regions. Both companies will also be working on closer integration between the Xero system and ANZ's Internet banking platform."*

<sup>11</sup> <http://www.xero.com/downloads/pdf/reports/XeroLimitedAnnualReport2010.pdf>

<sup>12</sup> Australia and New Zealand Banking Group. Operates in more than 32 countries mostly in Asia, the Pacific, with some operations in the Middle East, Europe and the United States. <http://www.anz.com/about-us/our-company/profile/facts/>

## Accountants

Xero recognises that the decision about which accounting system an SME implements will be influenced by its accountant. Input from accountants is also valuable when designing new features or upgrades. Xero therefore offers benefits to accountants through its Partner Programme.

The Partner Programme is free for accounting practices to sign up to. Members receive Xero Practice Ledger, a version of Xero for business tailored to accounting firms. The following extract from Xero's annual report explains the merits of targeting accounting practices.

*"By encouraging accountants to set up their small business clients on Xero, they not only see how it benefits their clients, but that Xero can help them grow their practices... Converting the accounting partner client base to Xero has the potential to provide access to a very large customer pool."*

The following extract from Xero's website explains the benefits to accountants<sup>13</sup>:

*"Your clients are likely to be using a wide range of accounting systems, many of which you directly support. On a regular basis you face the challenge of receiving this data, and integrating it into your internal client accounting software... any change you make could take some time to implement. To make it easy for you Xero provides support to help you integrate your existing software."*

*"You know only too well how important it is to keep your firm's accounts up-to-date. To help you do this, you as a Xero partner, are entitled to a free version of Xero called Xero Practice Ledger. This is included in Xero Partner Edition... Partner Edition clearly highlights who among your clients may be having problems with their daily workflow. With this knowledge you can be pro-active in how you contact, assist and educate them"*

*"For partners who have more than 100 clients using Xero, we offer Gold Partner status. This gives you greater exposure on our web site and access to additional marketing and resources to help your practice stand out. We provide special technical assistance for bulk migrations and ongoing individual support."*

## Strategic Initiatives

Since Xero's initial public offering on 1 June 2007, it has taken many steps towards seizing the above strategic opportunities. The following are extracts from Xero announcements<sup>14</sup> regarding strategic initiatives:

<sup>12</sup> <http://www.xero.com/partners/simplify/>

<sup>14</sup> <http://www.xero.com/investors/announcements/>



**12 September 2007 – Partnerships with New Zealand Banks**

Xero today announced fully automated daily imports of bank transactions for Xero customers who bank with Kiwibank, ANZ and National Bank. An equivalent service has been available to Xero customers who bank with ASB since before Xero's June IPO. Xero is the only accounting system in New Zealand available to small businesses that offers this service.

**20 June 2008 – Xero Accredited by ICAEW**

Xero online accounting software has been accredited by the Institute of Chartered Accountants in England and Wales (ICAEW). ICAEW accreditation also allows the software to be recommended to all 130,000 ICAEW members who work across 162 countries worldwide.

**30 September 2008 – Operating update**

Release of iPhone, BlackBerry, and Windows Mobile interfaces. Integration with Google Docs and Skype.

**2008****28 August 2008 – Xero and Acclipse form Partnership**

Award-winning online accounting provider Xero and Acclipse, a leading Australasian accounting practice supplier, have formed an innovative new partnership. The partnership will see the seamless integration of Xero's client accounting software with Acclipse's web-based practice management and tax software, to provide a complete solution for accounting firms. It will deliver a much deeper level of integration between the two systems, providing significant gains in efficiency, as well as new opportunities for accountants.

**1 April 2008 – Market Update**

Xero has launched a software partnering initiative called Xero Network. This allows other business software applications to work seamlessly with Xero providing small business customers with a rich suite of integrated business services that require no integration effort on their part. Initial Xero Network partners include: payroll software (Payroll); job tracking software WorkflowPlus and Saleslink; and real estate management solutions Real NZ Software, and MyDesktop from Australia.

**4 December 2008 – Xero presents Xero Accountants Edition**

Xero Limited has announced a new product; Xero Accountants Edition, as part of the next phase of their strategy to establish a family of products focusing specifically on opportunities within the accounting profession. Stuart Bale, previously a Global Product Manager for MYOB, is driving Xero's accountants strategy.

**19 December 2008 – Xero to the World**

Online accounting provider Xero is releasing a global version of their small business accounting product on Monday 22 December. After delivering localised versions of Xero for New Zealand, the United Kingdom and Australia, the global version provides a configurable sales tax engine, allowing virtually every small business in the world to use Xero.

**1 April 2009 – Xero Teams up with Telstra**

Online accounting software provider Xero (XRO) has joined forces with Telstra, Australia's largest telecommunications and media company.

**2009****24 October 2008 – Xero Partners with Telecom**

Online accounting software provider Xero (XRO) today announced a partnership to provide small and medium sized businesses with accounting software through Telecom's Business Hub. "This is a significant relationship for Xero as it will allow us to gain access to the very diverse and wide spread New Zealand small and home business market. It also validates the go-to-market model for other countries," Rod Drury said. The Telecom Business Hub, launched last month, is a marketplace for New Zealand's 433,000 small and medium sized businesses to find and buy business-level IT and communications services.

**30 September 2008 – Xero takes on MYOB in Australia**

Xero Limited (XRO) announced today its award-winning online accounting software is now available for the two and a half million small businesses operating in Australia. "Two of Australia's largest business banks will be providing direct daily bank feeds into Xero soon after launch," Rod Drury said. Currently, Xero has daily bank feeds from all six of New Zealand's major trading banks. Mr Drury says Xero is very comfortable with its product going head to head against major competitor MYOB. Compared to MYOB's desktop model – where each user installs and manages their own version of the software – Xero is a multuser, web-based service, which is seamlessly updated every few weeks.

**21 December 2009 – Xero and Federated Farmers join Forces**

Online accounting software service Xero (XRO) has signed a Heads of Agreement with Federated Farmers to facilitate the roll out of its International award winning solution to members of Federated Farmers and the rural community. Xero CEO Rod Drury says Xero's accounting partners have asked the company to extend Xero to support the requirements of the rural sector. "Working with Federated Farmers gives us direct access to consult with industry experts in farming productivity and accounting," he says.

**29 September 2010 – Xero Invests in Company Developing Tax Lodgement System**

Online accounting software provider Xero (XRO) announced today it has made a small investment in Max Solutions Limited, the developer of online job costing software WorkflowMax. Xero will invest \$200,000 for a 15.9% stake in Max Solutions. The investment is to help Max Solutions fund the development of a tax lodgement system. This tax lodgement system forms part of an initiative by Xero to bring together a suite of 'best of breed' solutions for accounting practices so they can run their businesses entirely in the Cloud, and no longer have the expense and management of in-house servers. The suite includes other services such as document management, practice management, accounts preparation, eMarketing and website design and content management. Xero CEO Rod Drury says while Xero could have developed the tax lodgement system itself, this functionality is quite specific to New Zealand and sits closer to the WorkflowMax product. "We've decided Xero would be better to focus its resources on its international markets and make this investment in Max Solutions so it can grow its team in New Zealand."

**26 March 2010 – Xero to deliver online based school management system**

Online accounting software company Xero (XRO) has entered into an agreement with Schola Technologies to deliver an integrated online school management system for roll out in the 2011

**2010**

**2 November 2009 – Xero to Break into the Consumer Market**

Online small business accounting software provider Xero (XRO) will launch a personal money manager in early 2010. "There's an increasing blur between consumer and SME services and personal/consumer finance literacy is a hot topic on the global stage," says Xero CEO Rod Drury.

**26 May 2009 – Xero and HSBC team up**

Xero announced today that daily automated bank feeds from HSBC Bank are available immediately into their award-winning online accounting software.

**11 May 2009 – Xero Partners with British Telecom**

Leading online accounting solution provider Xero, announces it has entered a reseller agreement with UK telecommunications giant British Telecom Group plc. Xero will offer its award-winning service to BT small business customers via their business applications service portal. Xero was selected after an extensive evaluation process to be made available to BT's over 1.7 million small business customers.

**3 June 2010 – Xero Enters into Distribution Agreement with ANZ**

Leading online accounting software provider Xero (XRO) has entered into a regional agreement with ANZ to distribute its online accounting services to ANZ customers. The agreement allows for exclusive distribution in Australia and to explore opportunities in Singapore, New Zealand and more broadly across the Asia Pacific region. Xero will offer ANZ's 450,000 small business customers in Australia an online, integrated banking and accounting solution that allows them to understand trading performance and cashflow position in real-time.

**27 January 2010 – Xero extends Small Business Accounting Solution with Yodlee**

Online accounting software company Xero (XRO) has entered into an agreement with US based Yodlee, Inc. - the world leader in online and mobile personal finance management (PFM) and payments solutions. Yodlee's Software development Kit will be used to extend automated daily bank account feeds to Xero's online solution, increasing customer account access to more than 11,000 financial institutions and account sources, including 100 throughout Australia. Yodlee is the leading provider of secure and personalized online PFM services in the U.S., powering 85% of the industry, with more than 20 million consumers at leading bank and portal sites.



## Looking Forward

Xero CEO, Rod Drury, characterises Xero's current stage in its business cycle as "the end of the beginning." He believes that Xero has built its functionality and a strong foundation in New Zealand, that it can now leverage to the next phase, "hyper-growth". From an interview with Xero CEO, Rod Drury, we know the following about its future direction:

### Growth Opportunities

One of Xero's key growth opportunities is entry into the US market. Since Xero has many growth opportunities that all require scarce capital, it would like its entry into the US to be self funding. To do this, Xero is targeting "low-hanging" fruit, meaning selling services that require no or small modification to its existing suite and targeting high affinity groups online. Xero has established an office in San Francisco and is developing a sales team.

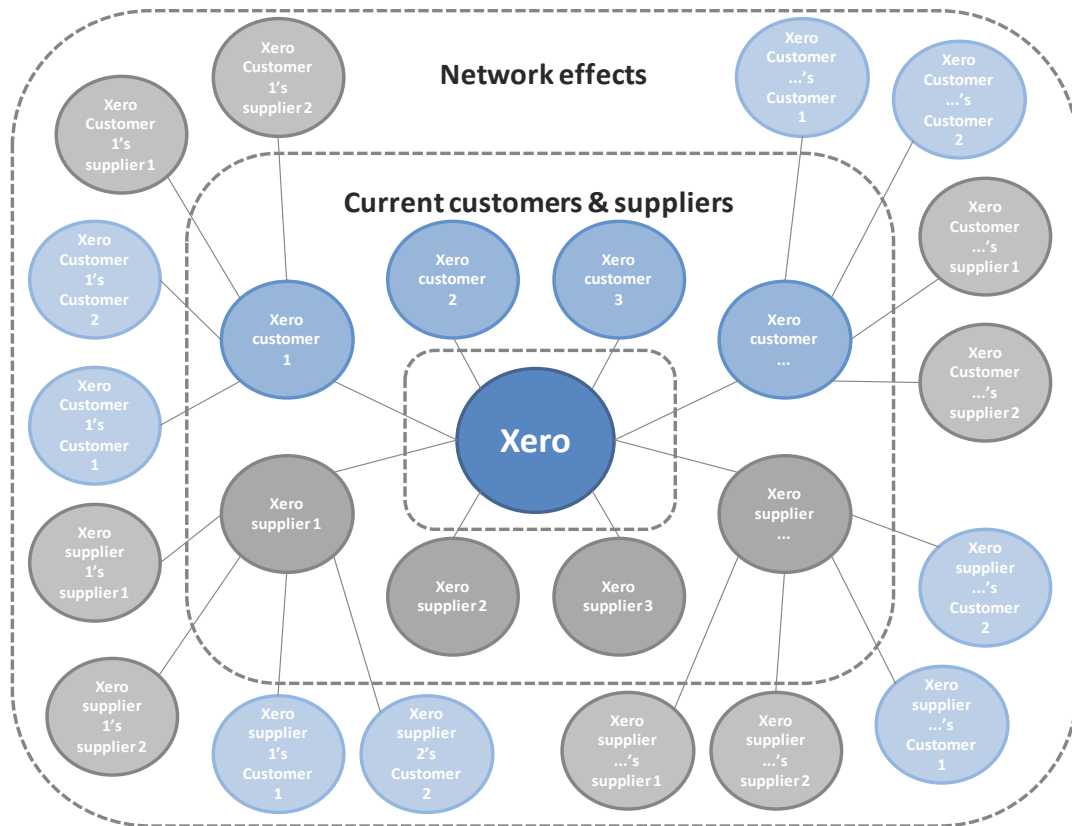
At this stage Xero intends to focus on its core markets and target developing markets at a later date (e.g. China and India).

To increase revenue within its target markets, Xero plans to further add to the breadth of its product features. CEO, Rod Drury, believes that SMEs connect to thousands of data sources without assistance from Xero, and this presents an opportunity to further integrate Xero with other systems. For example, an SME may perform a credit check before selling to a customer on account. Integrating this function into Xero further improves Xero's value proposition and increases switching costs, since rival systems may not have this functionality.

Looking beyond the SME market, Xero believes that it could develop a service for larger enterprises. CEO, Rod Drury, says that there is segment of the market that is larger than an SME and demands more functionality, but is too small to afford a ERP solution. Rod explains that this would involve increasing Xero's vertical presence into manufacturing modules, data security and others. He believes that this segment of the market would consider a \$10,000 annual subscription fee cheap.

A shorter term opportunity is presented by network effects. Rod describes the opportunity as selling to customers and suppliers of current SME customers. Network effects would increase the functionality of Xero's service for customers, since they will be more integrated with parties they deal with, and it will allow Xero to grow its customer base rapidly. The below diagram depicts the network effect.

<sup>15</sup> Enterprise Resource Planning. A highly customised accounting system for large companies. ERPs typically involve long implementation times and are designed around business processes.



## Competitive Advantage & Challenges

Rod believes that Xero has four core competitive advantages that will underpin its strategic direction:

- **Service features** – ease of use, mobile, low capital expenditure and short implementation.
- **Partnerships** – banks, telecommunications companies, accounting practices and others.
- **Personnel** – see below.
- **Funding** – successful capital raising in excess of \$50 million supports service development and expansion. Many of Xero's smaller competitors have not been as successful in raising so much capital.

Counteracting this are three strategic challenges:

- **Marketing** – affording a global marketing campaign that raises awareness of Xero so it can achieve its ambitious growth targets.
- **Human resources** – recruiting talented developers in New Zealand to support the development of further service features.
- **Listed company** – managing expectations for short-term returns when management intend Xero to follow a long-term growth strategy.

## Personnel & Investors

Xero has formed a strong management team and Board. It has also benefitted from the backing of high profile investors. The following extracts provide selected profiles:

### Shareholders<sup>16</sup>

#### Peter Thiel



Peter invested NZ\$4 million to support Xero's expansion into the US market. He will also join Xero's US Advisory Board.

Mr Thiel co-founded and led PayPal, the online payments company, which was acquired in 2002 by eBay for US\$1.5 billion. He was also the first external investor in Facebook, and serves on its board. He is currently President of Clarium, a San Francisco based global macro fund manager.

The investment in Xero will be made through Valar Ventures LP, Mr Thiel's New Zealand investment firm. Valar Ventures focuses on helping New Zealand companies in the post-revenue phase move into global markets. The Xero placement is the firm's inaugural investment.

#### Craig Winkler



Craig Winkler has been involved in software programming and business consultancy since 1984. While studying an undergraduate degree at the Royal Melbourne Institute of Technology he started a software company in partnership with a fellow student and grew that to form part of MYOB Group, which he co-founded in 1991. In July 1999, MYOB listed on the Australian Stock Exchange with Craig Winkler as Chief Executive Officer.

In early 2009, Archer Capital – HarbourVest made a successful takeover offer for MYOB. Along with other shareholders, Craig Winkler sold his estimated 28% stake to Archer Capital – HarbourVest private equity consortium.

### Directors<sup>17</sup>

#### Sam Morgan Non-Executive Director



Sam is best known for founding online auction website Trade Me which, in 2006, sold for \$750 million. Sam also built a successful online dating and friend reuniting businesses in New Zealand, Australia and Canada.

Sam is an active investor and philanthropist. Sam's holdings include a number of other successful web businesses including Visfleet and Sonar6.

#### Sam Knowles Non-Executive Director



Sam is well known as the past Chief Executive Officer of Kiwibank Ltd, stepping down in September 2010, having successfully lead it from idea to a significant market position and profitability over a 10 year period.

Sam has had a 25 year career in management in banking and financial services.

<sup>16</sup><http://www.xero.com/investors/announcements/>

<sup>17</sup><http://www.xero.com/people/>

## Management

### Rod Drury Chief Executive / Executive Director



A recipient of New Zealand's most prestigious hi-tech award the Tait Flying Kiwi in 2009, Rod is renowned for entrepreneurial skills in the technology sector. In early 2006 prior to setting up Xero, Rod sold his award-winning email archiving software company, Aftermail, to USA publicly listed company, Quest Software.

In 1995 Rod developed one of New Zealand's first Microsoft development companies, Glazier Systems, which was acquired by Advantage Group in 1999 and continues today as InterGen. In 2000, Rod co-founded Boston based Context Connect, which holds several mobile directory patents.

Rod is a director on the board of the New Zealand Stock Exchange and also sits on the New Zealand Trade & Enterprise Beachhead Advisory Board. Previously he was on the board of TradeMe and SQL Services.

### Hamish Edwards Co-Founder and Global Head of Sales



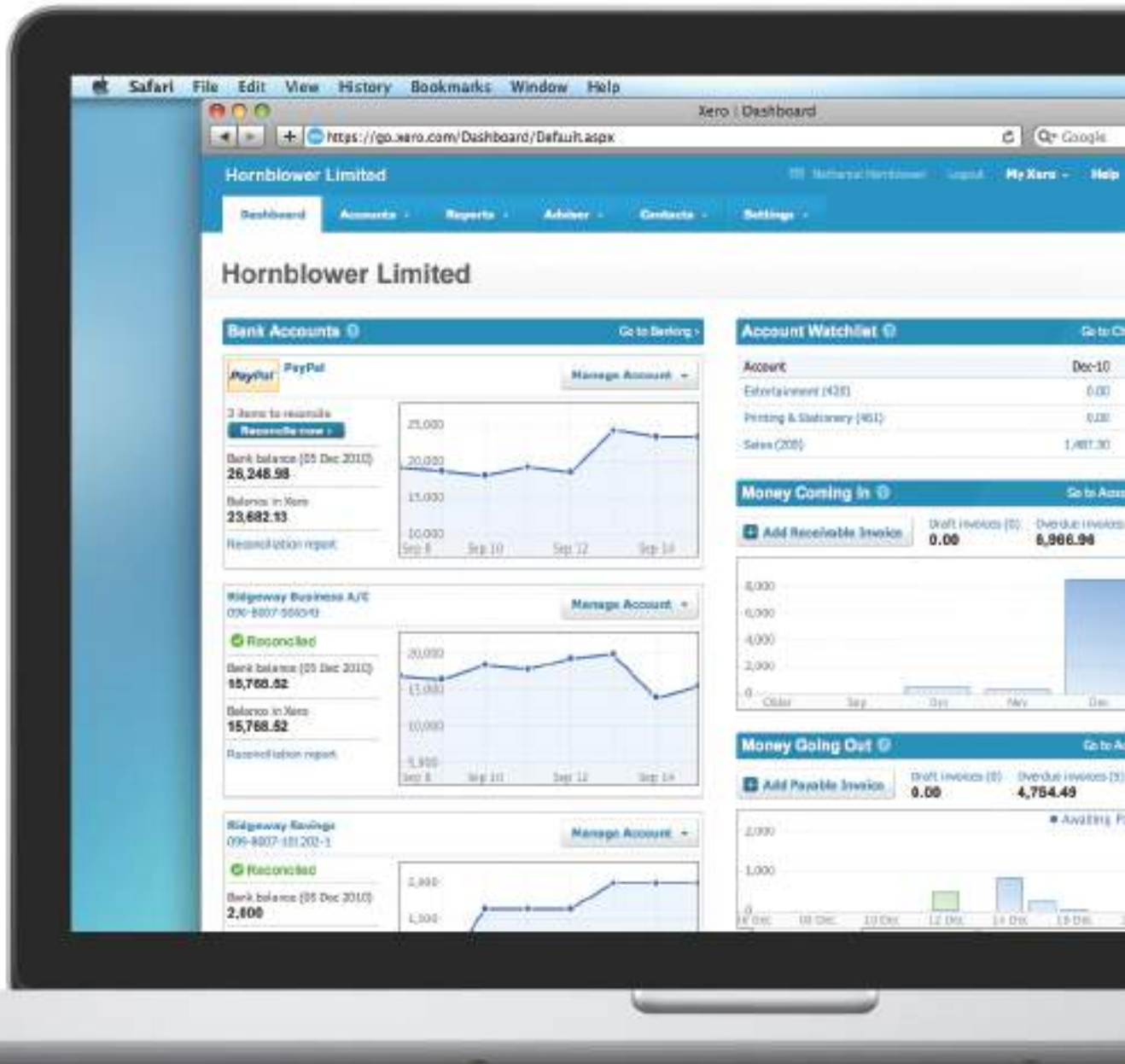
Hamish is a co-founder of Xero who oversees growth in existing regions and our expansion into new markets.

Formerly Hamish established Xero in the UK where he was responsible for banking relationships, partnerships and the accounting industry.

Hamish is a small business expert and has been featured in or written for Real FD, Accountancy Age, Accounting Web, the Fairfax Group, the National Business Review, M2 Magazine and various other publications.



# The Industry



# The Impact of Cloud Computing and SaaS on Markets and Enterprises

## What Cloud Computing Really Means

Segment <sup>18</sup>	Description	Value Prop	Customers
SaaS	Packaged apps delivered over the Internet. Provider costs are low compared to conventional hosting.	Lower cost of ownership Reduced up front investment	Large enterprises SMEs
HaaS/ Utility Computing	Virtual data center storage and servers IT can access on demand (enterprise) Virtual hardware (consumers)	Lower costs Reduced time to market	SMEs Consumers (early adopters)
Web Services	APIs delivered over the internet, discrete services like Google Maps, Payroll, credit card processing rather than full blown applications	Reduced time to market Increased functionality	SMEs Larger enterprises
PaaS	Complete development environments, constrained by vendors' design and capabilities	Similar to HaaS Adds integration layer Predictability in application behaviour & pre-integration	SMEs

## Global SaaS Adoption Rates

**Source:** Forrester Research Author Blogs

Software-as-a-service (SaaS) is an important new set of capabilities and engagement models in the IT industry, particularly in the emerging world of cloud computing. We project that SaaS offerings will grow from 7% of total software revenues in 2010 to 17% in 2013. Forrester recently surveyed nearly 3,000 technology decision-makers worldwide and found that emerging geographies – Latin America, China, India, Russia – are heavy adopters of software-as-a-service. Latin America led with the highest rate of SaaS adoption, with 30% of companies reporting SaaS use. For comparison, North America, where many SaaS deployment options initially saw traction, showed 25% adoption and represented 7% of overall software budgets. Other emerging geographies that reported high adoption included emerging Asian countries (China/Hong Kong/India/Russia). This group reported 21% SaaS usage and 8.9% of software budget going to SaaS. More established Asia Pacific economies (Japan/Australia/New Zealand) reported only 16% SaaS adoption and only 6.5% of software budget going to SaaS<sup>19</sup>.

<sup>18</sup>Darmouth Center of Digital Strategies

<sup>19</sup>Forrester, Liz Herbert, [http://blogs.forrester.com/liz\\_herbert](http://blogs.forrester.com/liz_herbert)



## Global Industry Information - Extracts

### Top investment bank predicts drive toward the clouds is inevitable

**Source:** Goldman Sachs - *"Tectonics: Unstoppable shift toward SaaS continues"*

The shift toward on-demand IT cloud services is now inevitable. SMB's are particularly being drawn to adopting cloud technology as they are forced to look for cheaper sources for business critical applications. Forty percent of respondents to the survey indicated that they were more likely to adopt a SaaS solution in times of a weak economic climate, chiefly due to the cost saving benefits available.

An 'SaaS first' policy is being enacted in the majority of small and midsize businesses. Goldman's survey highlights that 58 percent of respondents always consider an SaaS option when making an application purchase decision. A total of 39 percent prefer an SaaS option, if available.

Web conferencing and sales force automation continue to rank as the most utilized SaaS applications; accounting and billing shows significant improvement, underscoring broad acceptance in all application areas. Accounting and billing, call centre automation, and eRecruiting were the largest gainers, with 20 percent, 18 percent, and 17 percent increases, respectively, from April 2009.

Data warehousing, supply chain management, and product life cycle management require more customization, or are more embedded within the core of a company than cloud applications. They are also utilized by a smaller group of individuals, which could impact the time to, or volume of, deployments.

Forty percent of respondents indicated that they would be more likely to use SaaS solutions in a weaker economy, due to perceived total cost of ownership (TCO) benefits

Most people with a vested interest in technology would agree that the cloud phenomenon will continue to grow at an exponential rate. What will be interesting is the perceived future migration of companies from public cloud solutions, to private ones which walk the thin line between the corporate firewall and the internet.

### SaaS Revenue to Grow Five Times Faster Than Traditional Packaged Software 2009- 2014

**Source:** IDC July 2010

IDC forecasts the SaaS market to reach \$40.5 billion by 2014, representing a compound annual growth rate of 25.3%. By 2012, IDC expects that less than 15% of net-new software firms coming to market will ship a packaged product (on CD). By 2014, about 34% of all new business software purchases will be consumed via SaaS, and SaaS delivery will constitute about 14.5% of worldwide software spending across all primary markets.

The SaaS model has become mainstream, and is quickly coming to dominate the planning – from R&D, to sales quotas, to partnering, channels and distribution – of all software and services vendors.

Enterprise IT plans are rapidly shifting to accommodate the growing choices for sourcing most or all IT software functions, from business applications to software development and testing, to service and desktop management, as SaaS services become available from established vendors and new models for accessing functionality in the cloud creates lower-cost options and more tailored models for consuming IT services.

By 2012, nearly 85% of net-new software firms coming to market will be built around SaaS service composition and delivery; by 2014, about 65% of new products from established ISVs will be delivered as SaaS services. SaaS-derived revenue will account for nearly 26% of net new growth in the software market in 2014.

Traditional packaged software and perpetual license revenue are in decline and IDC predicts that a software industry shift toward subscription models will result in a nearly \$7 billion decline in worldwide license revenue in 2010. As a result, a permanent change in software licensing regime will occur.

<sup>20</sup>Goldman Sachs, <http://www.commensus.com/news/top-investment-bank-predicts-drive-toward-clouds-inevitable>

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SaaS segment mix will shift toward infrastructure and application development and deployment/PaaS, and away from U.S. dominance. IDC expects that by 2014, applications will account for just over half of market revenue. This shift will happen in part as a result of increasing IT cloud spending by enterprise IT groups and commercial cloud services providers (cloud SPs) relative to end-user spending.

## Competitor Information

### Deloitte Independent Advisor Report – Competition Extract 2009<sup>21</sup>

There are few start-ups in the accounting sector because of limited resources available to potential competitor to Xero. The investment required to establish a SaaS business is significant. Over time and as SaaS becomes more widely adopted, it is possible that other competitors may emerge. Xero wants to capitalise on the market opportunity that now exists by accelerating its international growth plan, and thereby cementing its position as a leading SaaS accounting software provider before others get a strong foothold. Barriers to entry into the Xero target market for competitors include:

- Historical focus on a vertically integrated business
- Established competitors are likely to have revenue cannibalisation and channel conflict issues if they were to fully move to an online accounting software offering

### Intuit

Intuit is a provider of business and financial management solutions for small and mid-sized businesses, consumers, accounting professionals and financial institutions. Intuit products and services assist customers in North America, Asia, Europe and Australia, with offices in the United States, Canada, the United Kingdom and other locations. Revenues in FY2010 totalled over US\$3.5 billion with 7700 employees worldwide.

**QuickBooks:** Create invoices, pay bills, manage expenses and generate reports on revenues, profits and spend.

**Quicken:** Money management, budgeting and personal finance software to help consolidate accounts, track spend, and pay bills.

**TurboTax:** Step by step tax guidance, automatic tax data extraction and reporting to help prepare and record tax returns for both personal and small business taxes in the US.

Quickbooks, Quicken and TurboTax are flagship products and all have online SaaS counterparts available. A range of other off the shelf solutions are available for payroll processes, making payments with credit cards via mobile phones, managing inventory, capturing customer data, performing pricing and reporting analysis. Web services include building and managing websites and offering online banking facilities to SMEs.

<sup>21</sup>Deloitte, Xero Report

*“The innovation and customer-driven focus that inspired these breakthroughs and alliances leads us to expand further, solve larger problems, and bring new products and services to more people and businesses. Now in our third decade, we’re creating a greater array of “Right for Me” customer-driven products and services to help manage a broader array of small businesses.”<sup>22</sup>*

## Sage

Sage provides business software, services and support to small and medium sized businesses. A worldwide network of 40,000 accountants and 27,000 business partners provide additional local expertise, implementation and support. With Sage’s network of and solutions for accountants, customers can benefit from the ability to exchange data seamlessly with their accountant. Sage business partners build close working relationships with larger, Sage customers, help to tailor their solutions, deliver large scale implementation, provide specialist knowledge, on-site support and other added value services.

- Accounting
- Customer Relationship Management (CRM)
- Payment processing
- Human Resources
- Taxation and other products for accountants
- Development platforms
- Enterprise Resource Planning (ERP)
- Payroll
- Financial forecasting
- Job costing
- Business intelligence
- Business stationery
- E-business

*“We believe we are not just a software supplier but a partner in our customers’ businesses helping them run their businesses more effectively and realise their ambitions. Our partnerships are built on the ongoing dialogue we have with our customers, the provision of high quality support and advice and the loyalty and trust that results from this. Our emphasis on support is backed up by the resources we put behind it. Across the business as a whole, more than 40 per cent of our people work in technical support, customer service or customer training roles.”<sup>22</sup>*

A range of off the shelf, license based solutions are provided. Sage products and services reach customers directly, but also through retail, business partners and accountants.

<sup>22</sup>Intuit, Corporate Website, [http://about.intuit.com/about\\_intuit/](http://about.intuit.com/about_intuit/).

## MYOB

MYOB identifies the needs of SMEs and aims to deliver user friendly and affordable accounting software in Australia and New Zealand. Over 20 years, MYOB has built up a client base of over 1 million clients, offering 100 products spanning accounting, payroll, retail point of sale, client relationship management, websites, tax and much more. MYOB has a family of solutions designed specifically for accounting practices to allow practices to control resources and manage workflows, while working more closely with their clients. MYOB is not publically listed. MYOB's ability to deliver expert advice and assistance to clients is supported by a professional network of partners, accountants, certified consultants, bookkeepers, developers and education providers.

Over the next three years, MYOB has committed \$AU 90 million for the research and development of products and services. This is likely to increase scope for MYOB to work with both partners and customers and expand offerings in technology products. MYOB has only recently entered the SaaS space with an accounting offering. (See Competitor News for details.)

<sup>23</sup> The Sage Group, Corporate Website, <http://www.sage.com/ourbusiness/aboutus/whatmakesusdifferent>.



# Financial Information



## Financial Information

The following details financial information relating to Xero.

The conversions below may be useful for subsequent financial statements.

Currency Conversions<sup>24</sup>

1NZD = 0.5604 EURO

0.7646 USD

0.4810 GBP

0.7687 AUD

<sup>24</sup> Exchange rates at 26 January 2011 sourced from <http://www.oanda.com/>

## Headline Financial Information

6 months to:	30-Sep-07	31-Mar-08	30-Sep-08	31-Mar-09	30-Sep-09	31-Mar-10	30-Sep-10
<b>Non-financial metrics</b>							
Paying customers	204	N/A	2,200	6,154	12,000	17,000	27,000
Xero partners	52	111	192	269	N/A	N/A	N/A
Employees	N/A	50	55	N/A	73	N/A	101
<b>Profit &amp; loss (thousand \$NZD):</b>							
Sales	24	110	333	626	1,271	1,887	3,727
Total revenue (excl. Interest)	222	167	421	698	1,350	2,045	4,053
Operating expenses	2,232	2,914	3,845	4,519	5,020	7,854	7,970
Depreciation & amortisation	103	239	376	497	638	770	957
Net profit after tax	(1,725)	(2,585)	(3,465)	(3,286)	(3,813)	(4,637)	(4,726)
<b>Balance sheet (thousand \$NZD):</b>							
Cash	12,625	9,517	6,280	3,807	25,996	21,397	16,564
Property, Plant & Equipment	402	472	464	375	397	367	406
Intangibles	536	1,065	1,474	2,029	2,371	2,948	3,634
Total assets	14,195	11,879	8,834	7,117	30,239	26,672	23,795
Interest bearing debt	28	26	24	20	0	0	0
Total liabilities	293	558	813	2,097	1,748	2,078	2,924
<b>Market:</b>							
Diluted earnings per share	(0.04)	(0.04)	(0.06)	(0.06)	(0.05)	(0.05)	(0.05)
Ordinary shares outstanding	55,000,000	55,000,000	N/A	55,460,000	87,218,000	87,631,000	88,331,000
Share price (closing)	0.82	0.79	0.76	0.89	1.34	1.59	1.48
Dividend (thousand \$NZD)	0	0	0	0	0	0	0

**Notes:**

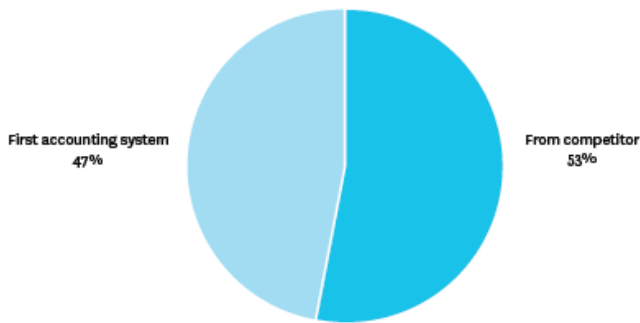
Xero's financial year end is 31 March  
 During the September 2009 half year, Xero issued \$23.2 million of shares to Craig Wrinkler and \$5.8 million of shares under its share purchase plan.  
 N/A refers to information not available.  
 September 2010 result excludes \$4 million of shares to be issued to Peter Thiel in October 2010.  
 Xero raised \$15 million in its IPO on 1 June 2007.  
 Xero's share price is \$2.73 as of 19 January 2011.  
 Intangibles typically refer to capitalised development costs.

**Sources:**

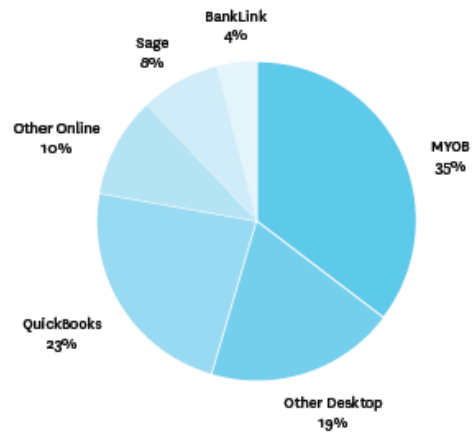
Xero market updates, half yearly reports, and annual reports. <http://www.xero.com/>

Extracts from 2010 CEO Presentation

Previous accounting system used by Xero customers



Customers acquired from competitors



Source: Xero new users since 01 July 2009

Nearly half of Xero's customers are first time users - Xero is developing a new market

## Break even

-  New Zealand direct sales Now
-  United Kingdom direct sales October - December 2010
-  Australia direct sales January - March 2011

## Overall costs

2nd half calendar 2011

Country	Potential Market (SME's)	Market share scenarios		Implied Customers		Sanity check	
		Low %	High %	Low %	High %	Competitor	Customers
New Zealand	322,000	10%	20%	32,200	64,400	MYOB	700,000
Australia	1,200,000	5%	10%	60,000	120,000	Sage	5,800,000
United Kingdom	4,300,000	1%	2%	43,000	86,000	Intuit	7,000,000
United States	25,000,000	0.5%	1%	125,000	250,000		
Potential Customers				260,200	520,400		



## Segment Reporting<sup>25</sup>

	New Zealand (\$000s)	United Kingdom (\$000s)	Australia (\$000s)	Inter-segment eliminations (\$000s)	Total (\$000s)
<b>2010 Group (unaudited) For the six months ended 30 September 2010</b>					
Total segment revenue	3,664	1,339	1,772	-	6,775
Inter-segment revenue	(948)	(833)	(1,267)	-	(3,048)
Revenue from external customers	2,716	506	505	-	3,727
Depreciation & amortisation	(945)	(5)	(7)	-	(957)
Interest	434	-	1	-	435
Segment net (loss) / profit before tax	(4,769)	18	35	4	(4,712)
Non-current asset additions	1,367	10	21	-	1,398
Segment assets	24,213	766	986	(2,170)	23,795
Segment liabilities	3,371	637	886	(1,970)	2,924

## Shareholdings<sup>26</sup>

Twenty largest shareholders as at 27 May 2010

Shareholder rank and name	Holding	Percentage of total shares on issue
1. Anna Stuck & Kenneth Drury (Rod Drury)	14,668,002	28.12
2. Givia Pty Limited (Craig Winkler)	19,500,000	22.23
3. Hamish Edwards & Tineke Edwards & Andrew Finch	6,960,000	7.93
4. Jasmine Investment Holdings Limited (Sam Morgan)	2,911,117	3.32
5. Bank of New Zealand	2,177,778	2.48
6. Anna Grigg & Alastair Grigg & Claymore Trustees Limited	1,800,011	1.82
7. Nicola Wilson & David Wilson & Christopher Ritchie	1,503,488	1.71
8. Graham Shaw & Delwyn Shaw	1,330,555	1.52
9. FNZ Custodians Limited	1,197,791	1.37
10. W5 Limited	1,005,561	1.15
11. Accident Compensation Corporation	718,502	0.82
12. Craig Walker & Catherine Walker	683,994	0.78
13. Xero Limited (Employee Restricted Share Plan)	627,006	0.71
14. ASB Nominees Limited	574,886	0.66
15. David Kirk	559,400	0.64
16. Anthony Bishop & Andrew Finch	540,000	0.62
17. Sparkbox Limited	505,555	0.58
18. Phillip Norman	505,546	0.58
19. Fletcher Brown & Karen Oakley-Harness	464,000	0.53
20. Philip Fierlinger & Hadley Fierlinger & Murray Harden	397,000	0.45

<sup>25</sup><http://www.xero.com/downloads/pdf/reports/2010-xero-interim-report.pdf>

<sup>26</sup><http://www.xero.com/downloads/pdf/reports/XeroLimitedAnnualReport2010.pdf>



# Appendices

**Sarah's finances - Spending & savings**

Total income in last 30 days	Total spent in last 30 days	Total overspent in last 30 days
6,287.00	6,923.41	636.41

Where your money is going (Pie Chart):

Flexible Expenses	2,798.20
Essential Expenses	4,125.21
Savings Goals	2,388.98
Uncategorised	382.26

**My finances at a glance**

**Accounts**

Westpac Savings	4,388.98
Westpac Cheque	-3,243.08
TSB Savings	500.00
MasterCard Zero	1,102.74

**Net worth**

Net worth: 122,948 Assets: 337,992 Liabilities: 438,043

**Recent spending & savings**

Flexible Expenses	2,798.20
Essential Expenses	4,125.21
Savings Goals	2,388.98
Uncategorised	382.26

**Goals**

11 goals on track 7 goals off track 3,999 overspent on 7 goals

Clothing & Small Purchases: 30 per week



## Appendix 1: Customer Profiles<sup>27</sup>

It's a fine balance running a successful business and raising two small boys. Time is an absolute premium. With Xero the consolidation of several functions means Rebecca doesn't have to spend hours inputting numbers.



Xero also allows Rebecca and her family to travel or have a holiday. There's no losing sight of the business while away, as tasks such as invoicing and reconciliations can be done from anywhere there is internet access.

Paying monthly makes sense too.

*"The ongoings are affordable and stops that feeling of having paid a lot of money up front for accounting software that does not fit your business,"* says Rebecca.

Rebecca McLeod – Made4Baby

Mark and Anne Inglis need access to their financial information 24/7 and from anywhere. They run three successful businesses on Xero: Middle Peak a motivational speaking and mentoring business; Peak Fuel a high performance food and drinks brand and; Limbs4all a charity for victims of landmines and other disabled in Nepal, Tibet and Cambodia.



*“So much of my life these days is travelling the world,” says Mark. “We’ve got projects in Kathmandu, Cambodia, Australia, Malaysia, Taipei, Europe and the UK. I need access to my data and my accounts no matter where I am.*

*“Unfortunately I wasn’t born with an accountant’s brain so I’ve always struggled with the books as Anne can tell you! With Xero, I find everything is streamlined and obvious, it’s just so user-friendly.”*

Using their previous accounting system ‘Difficult Books’ as they called it Mark found it too hard to stay on top of his travelling expenses and invoices.

*“I can use Xero at basecamp Everest and across Tibet. There are few places in the world that I haven’t been able to get online and work.”*

**Mark Inglis**

<sup>27</sup><http://www.xero.com/whosusingxero/>

## Appendix 2: Xero for Business - Dashboard <sup>28</sup>

**Hornblower Limited** | National Hornblower | Logout | My Items | Help

Dashboard | Accounts | Reports | Advice | Contacts | Settings

### Getting Started with the Demo Company

Try out the features and get familiar with Xero using your own demo organisation.

- Watch the Getting Started tour.
- Here's 10 things you can try out in Xero.

There is full online help in Xero and you can always contact Customer Care at anytime to ask us a question.

---

#### Bank Accounts

**BNZ Cheque** (02-0332-0345079-000) [Manage Account](#)

3 items to reconcile

**Reconcile now**

Bank balance (14 Sep 2009) **26,248.98**

Balance in Xero **23,682.13**

[Reconciliation report](#)

**ANZ Business Classic** (02-0332-0345079-000) [Manage Account](#)

**Reconciled**

Bank balance (14 Sep 2009) **15,768.52**

Balance in Xero **15,768.52**

[Reconciliation report](#)

**KiwiBank Savings** (02-0332-0345079-000) [Manage Account](#)

**Reconciled**

Bank balance (14 Sep 2009) **2,000**

Balance in Xero **2,000**

[Reconciliation report](#)

#### Account Watchlist

[Go to Chart of Accounts](#)

Account	Jul-08	YTD
Entertainment (142)	0.00	1,623.15
Printing & Stationery (451)	0.00	481.07
Sales (202)	123.50	46,303.24

#### Money Coming In

[Add Receivable Invoice](#) | Draft Invoices (1) **213.75** | Overdue Invoices (12) **13,269.56**

[Go to Accounts Receivable](#)

#### Money Going Out

[Add Payable Invoice](#) | Draft Invoices (2) **368.13** | Overdue Invoices (7) **6,160.59**

[Go to Accounts Payable](#)

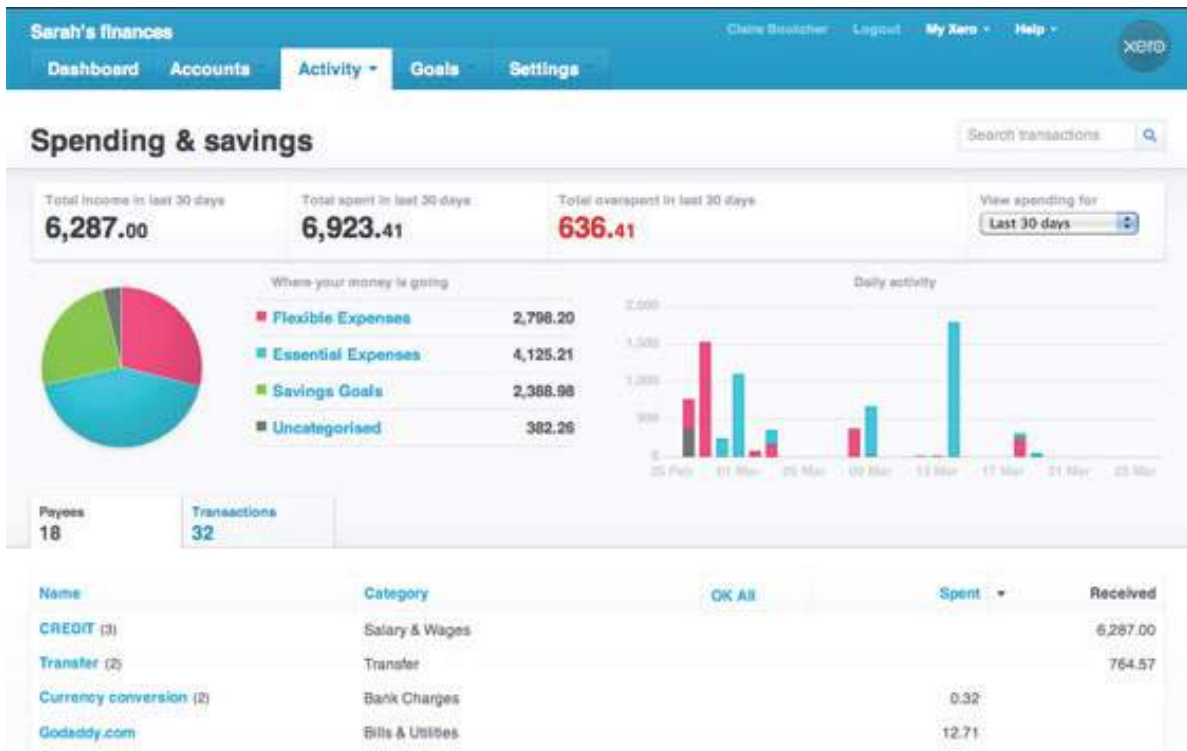
#### Expense Claims

[Add Receipt](#)

Your Current Claim	<b>11.52</b>	All Current Claims (2)	<b>31.52</b>
Awaiting Authorisation (1)	<b>99.15</b>	Awaiting Payment (2)	<b>1,250.00</b>

<sup>28</sup><http://www.xero.com/dashboard/>

## Appendix 3: Xero Personal - Screenshot & Testimonials <sup>29</sup>



*"It's very user friendly, impossible to screw up and the fact that you're very easily in control of your finances is quite satisfying."*

*Laura Macdonald*



*"Previously I used MS Money to manage my personal finances, but it was cumbersome and stuck on one PC - now it's all automated and online."*

*Tim Strawbridge*

<sup>29</sup><https://www.xero.com/personal/>

## Appendix 4: Competitor & New Zealand News

### List of Articles

1. At Last, Sage Enters SaaS Space (Jan 2011)
2. Small is Bountiful for Intuit (Sept, 2010)
3. Intuit Boss Apologies After Cloud Crash (June 2010)
4. MYOB launches online accounting package (May 2010)
5. MYOB takes to the clouds (March 2010)
6. Cloud Hanging Over the Cloud (Dec 2010)

### At Last, Sage Enters SaaS Space

19 January 2011

Accounting company The Sage Group plc yesterday launched its first SaaS accounting product newly developed from the ground up. Whereas the company's previous strategy has been to grow either by incremental development of existing products or by acquisition, this launch is quite different: they have built a totally new product with a new team and a different style. Essentially, they have created their own in-house start-up: other established software companies may take note of the approach.

... The Sage Group plc made a major product launch yesterday: its new "Sage One" is its first serious effort at an all new piece of accounting software in the SaaS space. The way the product was created is a significant departure in strategy for Sage, and one that is of interest to established software companies.

The conventional wisdom in the past has been that if you have a large market presence, you can't just build new products from scratch. It's thought to be too expensive, too time consuming, and too troublesome for your customers. Rather, the theory goes, you must make incremental developments of the products you have: it's safer, cheaper and doesn't rock any boats.

According to this strategy, the correct way for Sage UK to enter the SaaS market was to produce a SaaS version of its top selling "Sage 50" small business accounting package. Over the years since SaaS has come onto the agenda, Sage made a couple of attempts at "bringing Sage 50 on-line" and launched them in a fairly low key way. They achieved little.

With Sage One, the company has taken the opposite approach. They've used a totally new technology (Ruby on Rails), a totally different product philosophy (get rid of as much accounting jargon as possible) and targeted a market segment that is not obviously the biggest money earner (the simplest, smallest businesses) - coincidentally turning the development project into one of a manageable size. They've also risked a different business model.

If you're used to selling packaged software, converting to SaaS gives you a "Year One Problem": the money you get from a new customer in year one is less than you would have taken if you had sold them a perpetual license. In the case of the simplest Sage One, that's £60 as opposed to the £115 for Sage Instant Accounts. As any sales director will tell you, that's a bonus-destroying strategy. Of course, the money in years two and three is much higher, without the need to spend massive effort in selling maintenance renewals or upgrades, but most corporate executives aren't prepared to take that into account when negotiating the annual business plan.

Because of this business model issue, and because the technological mindset required to do a good SaaS product is so totally different from the way you build on-premises products, it's almost impossible to do it without setting up a new, separate team to compete with your existing business. Many large software companies (and Sage has been one of these

in the past) don't seem willing to make that investment: if you need to do something really new, the preference has been to make an acquisition of a start-up that's done it first.

On this occasion, Sage seem to have put the time, money and effort into building a team and getting a SaaS product right from the ground up. Essentially, they have built their own start-up rather than buying one. It's to their credit: those who hope to see real software innovation can only wish them well, and other large software companies will watch with interest.

## **Dow Jones Barron's Feature Report: Small Is Bountiful for Intuit**

11 September 2010

The consumer-finance software specialist has the lead position to exploit surging demand for business services from mom-and-pop stores.

The maker of popular personal-finance applications like Quicken and TurboTax is in the lead position to benefit from rising demand for affordable accounting and other programs to help run smaller businesses, an underserved software market estimated to total about \$30 billion. These bantam-weights, including everything from mom-and-pop stores to catering outfits to one-person consulting firms, want to participate in the digital revolution that now allows them to utilize more powerful software tools via the Internet.

Although Intuit made its name pioneering off-the-shelf consumer-finance software, its lesser known QuickBooks accounting software and other business products are aimed at the lowest rung of the small-business segment, where most concerns generate less than US\$1 million a year in revenue. Both Intuit and analysts who track the company contend that this area is virtually untapped compared to the much larger, and more mature, middle- and enterprise-sized business software markets. And there's no hint of a slowdown in Intuit's consumer markets.

"Intuit is the software stock to own for the next decade," says Cowen managing director Peter Goldmacher, who rates the stock Outperform. He thinks the shares, which were hovering around 44 last week after a solid run-up this summer, could rise another 25% over the next 12 months, to 55.

The 27-year-old company's business is divided into four categories of products and services: tax (44% of revenue), small business (39%), financial institutions (10%) and other, which includes Quicken and the Mint.com personal-finance products and services (8%). In fiscal year 2010 (July), Intuit earned \$685 million, or \$2.11 a share, on revenue of \$3.46 billion. Goldmacher estimates that it will earn \$2.38 a share in fiscal 2011 on revenues of \$3.8 billion.

A number of forces should help propel both revenue and earnings over the next few years. Intuit has the most-recognized brands in consumer and small-business financial software, a favorable demographic trend in which a younger generation embraces technology, and the ability to deliver products on-demand via the Internet. Either an individual or a small business operator might start out with, say, accounting software, but can easily expand into billing, payroll or credit-card acceptance, among other possibilities.

Cloud computing is already a fact of life at Intuit. About 60% of its revenues come from selling consumer and business products on-demand via the Internet, with more than half of those sales coming from selling software as a service, or SaaS.

SaaS offers significant advantages to both users and vendors. For users, it is a more flexible and cheaper software delivery system; for vendors, it provides more predictable subscription revenue that requires lower sales costs. For example, traditional software giant Oracle (ORCL), considered a very efficient enterprise-software outfit, still relies on thousands of very highly paid salespeople. Intuit has virtually no sales team because its products are sold mostly in retail stores and via the Web.



Intuit's big opportunity among small-business operators comes in part because it's geared to serve this market segment. It's on the other end of the spectrum from Oracle and its rival SAP (SAP), which pursue the very largest companies. Intuit can use its brand name on the Web in the same way that software-as-a-service pioneers Salesforce.com and NetSuite have successfully reached middle-market companies. Yet it doesn't require the same scale they do to profit.

There is plenty of low-hanging fruit. Of the 26 million businesses in the very-small-business software market, only four million use QuickBooks accounting software—both desktop and SaaS versions, CFO Williams says. Converting the nondigital mom-and-pops from paper ledgers to software is Job One, but after that, cross-selling a suite of business-software products, such as payroll, billing, credit-card processing and Website hosting presents an enormous growth opportunity, Williams says.

Of course, Intuit still has ample room to grow in the consumer segment, using its free Mint.com Website to convert individuals currently using accounting firms and tax outfits such as H&R Block (HRB) to TurboTax, says Goldmacher.

Intuit has challenges. Its business is still highly seasonal because of its tax business, consistently posting losses in its first and fourth fiscal quarters when sales of tax products lag.

But Goldmacher says it's Intuit's game to win or lose. "This company is benefiting from every single demographic, secular and macro change in the software industry. If they don't succeed, it is not because of a lack of opportunity. It is because of a lack of execution." CFO Williams assures Barron's Intuit is up to the task: "Our execution record has been good, [and] we don't get ahead of our headlights."

### **Intuit Boss Apologies After Cloud Crash<sup>32</sup>**

18 June 2010

The boss of Intuit has issued a full some apology after a major service outage which disrupted thousands of clients. The president and CEO of finance software company Intuit, Brad Smith, has apologised to customers for a widespread service failure earlier in the week, and has promised to earn back their trust.

Following a routine maintenance procedure on Tuesday night, an accidental power failure during that procedure affected both the company's primary and backup systems, taking a number of Intuit websites and services offline. The outage lasted until Thursday for some customers, when Intuit sites, including TurboTax Online, QuickBooks Online, Quicken and QuickBase, were brought back online.

"I deeply apologise for the pain we have caused those of you affected by this week's outage. We hold ourselves to the highest standards in dependability and customer service, and over the past two days, we have failed to live up to those expectations," Smith wrote. "My leaders and I have spoken to a number of you and there is simply no excuse for having such a negative impact on you. It is our priority to work with those of you who are affected and, where we can, make things right. We have all-hands on deck to help you resolve the issues caused by this outage."

In addition to the apology, Smith took pains to explain the root cause of the incident, the aforementioned "accidental but severe" power failure during a routine maintenance procedure that affected Intuit's primary and backup systems, and to state there was no evidence of a security breach or attack on the company's servers. Smith said at this time he does not believe there was any damage or loss to customer data.

<sup>32</sup> E Week Europe, <http://www.eweekurope.co.uk/news/intuit-boss-apologises-after-major-crash-7844?pfstyle=wp>

## **MYOB launches online accounting package**

Sydney Morning Herald, May 12, 2010

MYOB has launched a web-based version of its popular software packages. MYOB has launched LiveAccounts, its much anticipated answer to online subscription-based accounting packages. When it goes live next month, it will include feeds from more than 100 banks and will integrate payments with credit card companies, BPay, PayPal, eBay and government agencies. Users will be able to see on the landing page how many invoices are outstanding, how many have been paid and any banking transactions that took place overnight and they will have the option of creating and sending invoices. Expenses will be able to be coded to be allocated to cost centres automatically, decreasing the amount of data entry required.

“We’ve been driven by what our customers want and by our research. We’ve worked hard to hide the complexity of the system behind an elegant but sophisticated interface,” he said.

LiveAccounts will not have all the functionalities of existing MYOB packages, so existing high-end users who already have online integration via the company’s mPowered module, might not be interested in LiveAccounts. But early adopters and start-up businesses that have lesser requirements for many payroll and tax functionalities are the intended users.

The new system will enable MYOB to compete with internet-only providers such as Saasu and Xero, a market that has so far eluded it. Xero counts MYOB’s co-founder Craig Winkler as a non-executive director.

Customers will be asked to pay a monthly subscription fee per company – not per user – most likely to be about \$35. Current MYOB users will be able to fast-track the initial set-up by uploading data from their existing packages, but new users will need to learn the ropes.

The service will be hosted by Macquarie Infrastructure in Sydney and almost half of the R&D budget for the product will be reserved for tweaks and upgrades as requested by customers in feedback, Molloy said.

## **MYOB takes to the clouds**

Sydney Morning Herald, March 10, 2010

Leading business software provider MYOB has bowed to market pressure and will join the software-as-a-service cloud later this month. The new service is understood to be the company’s answer to the recent flurry of online accounting packages that include Saasu, Xero and Zoho.

MYOB is renowned for its tight licensing and software update practices. It is complex to learn and often requires users undertake specialist courses or pay to have initial records set up by a professional bookkeeper. It holds 70 percent market share in Australia, according to Open Briefing, an information portal for ASX listed companies. Reckon’s QuickBooks dominates the rest of the market. QuickBooks Online was released through a soft-launch in July last year.

Reckon business division CEO Gavin Dixon said sales of the online service has exceeded expectations.

“We had over 1000 users in four months and the growth rate has accelerated. We’re approaching 2000 users now,” Dixon said. Although online has not impacted sales of QuickBooks desktop packages, he said it has opened a new market for the company.

Saasu boasts on its website that it has taken clients away from MYOB. It offers packages ranging from free to \$95 a year for corporate customers. Xero is available directly to customers, costing \$29 to \$64 per month, as well as through Telstra’s T-Suite. Quickbooks charges \$250 a year per user. It will launch a new end-user self-registration website next month.

## NZ News

### Clouds hanging over 'the cloud' <sup>33</sup>

December 2010

... one of these obstacles include the Inland Revenue Department recently issuing a warning to Kiwi companies to maintain their primary business records locally rather than in off-shore data centres, as commonly occurs with cloud service providers.

The warning reminds companies that only data physically located in New Zealand would comply with record keeping obligations under the Tax Administration Act and the Goods & Services Tax Act. Each instance of a failure to keep New Zealand-based records could draw a fine of between \$4000 and \$12,000.

"Using cloud computing to back-up business records will not breach record keeping obligations, provided the primary business records are stored in New Zealand," says an IRD 'alert' out this month.

Rod Drury, chief executive of online accounting provider Xero, says his company's already in deep discussions with the IRD. The accounting data Xero stores for its clients is hosted in the United States. In a post on the Xero blog, Drury says there is "no issue for Xero customers as we have been working with the IRD for some time on a blanket dispensation and assisting IRD on policies around the cloud."

"We'd expect this to end up in a similar position to Australia where there is no onshore storage requirement, only that your records are available if requested." The company says it is working for a solution on behalf of the industry.

Holding data overseas also increases the cost of communications and increases the latency, or lag time between the stored data and the end user. IDC says the awareness of cloud computing amongst the business community had risen dramatically in the last 12 months up to 70 per cent of respondents in a survey of 252 companies felt familiar with the cloud concept.

IDC analyst Rasika Versleijen-Pradhan said a high proportion of respondents are either using or pilot testing cloud environments for at least part of their businesses. "There's also a greater level of penetration and acceptance of private cloud here than in Australia for short term projects," she says. The "private cloud" refers to a more secure fire-walled version of the public cloud which has been popularised by American storage giants like Amazon and Google. Private cloud was a more attractive option for corporate customers because it could guarantee greater security and the location of data could be designated by the client.

Google's head of Enterprise Apps for the Asia Pacific region Anil Sabharwal says the migration to cloud isn't a "rip and replace" process, but a gradual change in workers' habits and routines as well as IT infrastructures.

<sup>33</sup> Stuff Business News, <http://www.stuff.co.nz/business/industries/4465868/Clouds-hanging-over-the-cloud>