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SOFTWARE/SAAS INDUSTRY

Avoiding a Scalability Crisis While Growing Your Business

AN ARMANINO WHITE PAPER

Growth in the SaaS market has been incredible in the past five years. Zenefits, which provides human resources software, went from $1 million to $10 million in revenue in six months. GuideSpark grew from $1.5 million to $20 million in two years with its employee communications solutions. Companies such as New Relic and Optimizely – application performance monitoring and customer experience optimization, respectively – have topped $100 million.[1] Successful companies in this industry are scaling faster than ever. And they must do so, because without strong growth, the chances of long-term, sustainable success are not very good.

According to McKinsey & Company, "supergrowers" – software and online services companies whose growth was greater than 60 percent when they reached $100 million in revenues – were eight times more likely than stallers (less than 20 percent CAGR) to grow from $100 million to $1 billion and three times more likely to do so than growers (between 20 and 60 percent CAGR).[2]

It's clear that for any young software/SaaS company, revenue growth is the number one focus. At the same time, rapid growth is an extreme test of your organization's ability to build the right organizational foundation at the right time for your expanding company. Without a fundamental core of skilled people, disciplined financial processes, and robust technology, explosive growth often results in a scalability crisis in the back office – one that can hobble or completely derail your ability to support your business' growth trajectory at the levels you want, need, and expect.

This white paper describes the steps software/SaaS companies should be taking and when they should be taking them to create the optimal back-office foundation for sustained growth.

GROW FASTER OR DIE

According to research from McKinsey & Company, if a software company ONLY grows at the rate of 20 percent annually, it has a 92 percent chance of ceasing to exist within a few years.[3]

[1] "How Has The SaaS Industry Changed Over The Last 5 Years?" Jason M. Lemkin, on Quora, October 9, 2014.
[2] "Grow Fast or Die Slow," Eric Kutcher, Olivia Nottebohm, and Kara Sprague, McKinsey & Company, April 2014.
[3] Ibid.

PROVING YOUR BUSINESS CONCEPT

It doesn't make fiscal or organizational sense for companies to start day one with a back-office infrastructure built to support a $100 million company. In the early days of a software/SaaS business, the absolute, primary focus is to get your product ready to bring to market as a commercially viable offering and find customers willing to buy it. There's a great sense of urgency – as it should be – on moving the company forward. Each and every employee is united in the singular goal of launching your first product and selling it.

At some point – potentially quickly – your business model starts to come together and your company begins hitting its stride. You're meeting projected results and the expected pace of development. In fact, not only are you hitting your metrics, but you're exceeding them. Your underlying business concept has been validated and the business is starting to take off.

When this happens, your business has hit an important inflection point. This critical milestone should trigger decisions about investments to build out the company with the right people, processes, and systems to support a rapidly growing business 3 months, 6 months, 12 months, and longer down the road.

"The very best organizations are those that are constantly seeing around the bend. It's not based on gut feeling, but based on the real progression of the business."

Matt Armanino
COO & Consulting Partner
Armanino LLP

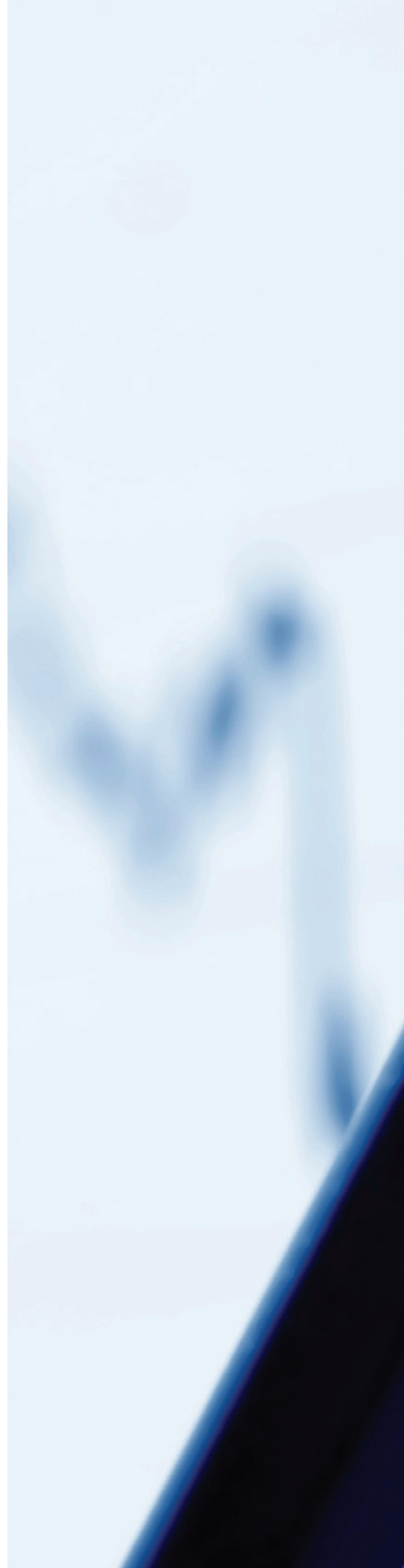
HITTING A CRISIS OF SCALE

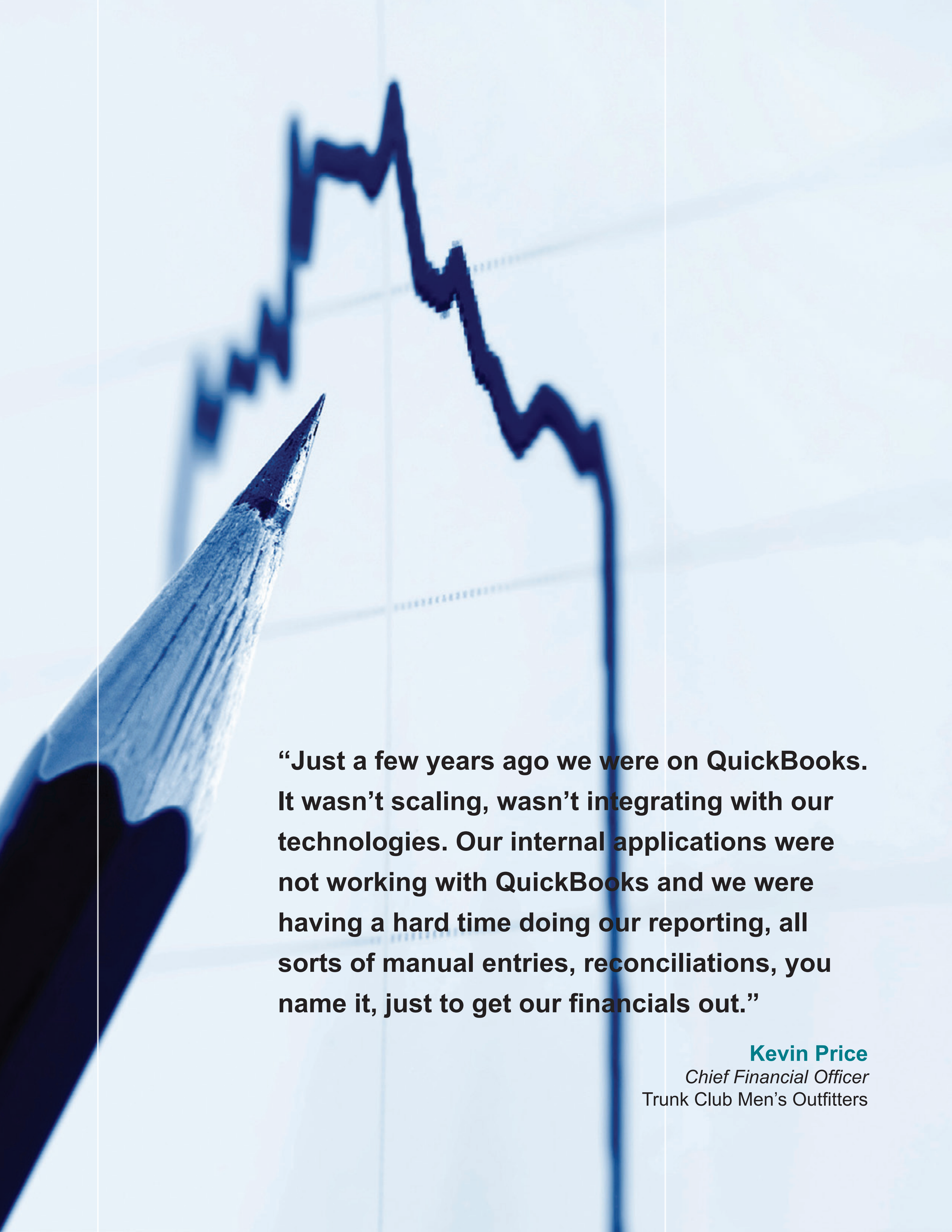
What happens if you miss the point in time where you should be investing in the back office? What if you stay too small, remain too informal in your thinking, and under-invest in the infrastructure for too long?

Meeting and exceeding aggressive growth goals without the right infrastructure often triggers a scalability crisis – one that can knock your business off its hockey-stick growth curve. It will be obvious when you're in such a crisis because:

- Errors start to happen
- Critical processes such as renewals and billing start to break down because they are largely manual
- Customers and partners become frustrated because it's harder to do business with your company
- You lose control and visibility of the processes that form the backbone of the business.
- You no longer know with certainty how your company is performing at a given moment in time.

Any or all of these things can happen in a very short amount of time when you're experiencing enormous growth. But it doesn't have to be this way.





"Just a few years ago we were on QuickBooks. It wasn't scaling, wasn't integrating with our technologies. Our internal applications were not working with QuickBooks and we were having a hard time doing our reporting, all sorts of manual entries, reconciliations, you name it, just to get our financials out."

Kevin Price
Chief Financial Officer
Trunk Club Men's Outfitters

PLANNING FOR THE FUTURE

To avoid the pain and setbacks of a scalability crisis, you need to plan well and early and then invest to execute the plan at the right times. With a plan in place, you can continually validate that the business is on track with building the foundation for long-term, sustainable growth without over-investing too soon or waiting too long to make the investments. You can accelerate investment when needed or back off if growth slows.

The hard part is, of course, creating the right plan. You need a thorough understanding of what will be necessary to support your company in terms of people, processes, and technology. That's where choosing a partner with deep technical and accounting experience in the software/SaaS industry can help. An experi-enced business consulting firm can provide invalu-able guidance and insight on what investments you should be making at specific intervals, based on your expectations for growth over the next quarter, twelve months, and so on.

Your partner will help you evaluate your current processes and systems and make recommendations that address issues such as compliance, changing regulations, and scalability. For instance, while spreadsheets, small business software, and manual controls work fine for early days of a start-up business, they're too risky, time-consuming, and error-prone for a rapidly growing business. Your trusted advisor can help you address automation of your business processes with robust systems designed to scale with your business.

Improving and standardizing your business processes will be another important part of your plan to support growth. Here are some common business processes that are particularly important to software/SaaS companies:

REVENUE RECOGNITION

Revenue recognition is a key metric for software/SaaS companies, as it is for nearly every type of company. It drives other important metrics such as net income, earnings per share, and EBITDA (earnings before interest, taxes, depreciation, and amortization). As such, it informs many business decisions.

For all of these reasons, it's critical for your business to have accurate, GAAP-compliant revenue recognition policies. If you're currently evaluating software solutions and you're finding that none seem to support your revenue recognition policies, you should re-evaluate whether your policies are, in fact, GAAP-compliant.

Be aware that the requirements for recognizing revenue are changing. IFRS 15 Revenue from Contracts with Customers takes effect in 2017 and establishes a five-step model.

that will apply to revenue earned from a contract with a customer, regardless of the type of revenue transaction or the industry. While giving software companies greater flexibility, the new requirements also add a greater level of complexity to revenue recognition. Software/SaaS companies will need the right systems and processes to ensure compliance. Those systems should also enable you to capture information in a way that enables you to forecast accurately.

BILLING

While the upside of a subscription business model is a predictable, recurring revenue stream, the downside is the complexity of managing such a model. Depending on your offering and specific business model, your company may have a variety of different levels of functionality that have differing prices: for example per seat per month pricing. Or maybe you have a usage-based model and you bill customers based on actual consumption.

Whatever your model is, you may need a robust system to support the complex requirements of subscription and/or metered billing. Otherwise, as your business grows in revenues and complexity, you run the risk of over-charging or undercharging customers. What is needed is a structured, transparent way to capture and control rates and billing with supporting systems and GAAP-compliant processes, with the ability to pro-rate should a customer upgrade or downgrade in the middle of a billing period.

CONTRACT AND RENEWAL MANAGEMENT

Renewals are the lifeblood of a SaaS company, which makes managing them effectively as critical as your sales organization's ability to bring in new custom-ers. However, just as software/SaaS business models create complexity for billing and revenue recognition, these models also make contract and renewal management more complex than in other industries.

Your company needs a way to manage contract complexity and uniformly handle contract additions and deletions that occur between renewals. In addition, it's critical to have a system that offers industry-specific support for automating renewals, helping you retain more customers and increase customer lifetime value.

PERFORMANCE METRICS/FORECASTING AND PLANNING

As your company grows, you'll want to gain greater visibility into its performance in real time. Tracking key performance indicators (KPIs) – including customer counts, usage, customer satisfaction, churn, customer acquisition costs, customer lifetime value, monthly revenue, and others – can help you identify trends and problems quickly. A dashboard that gives you visibility into KPIs as well as the sales pipeline lets you easily measure and monitor how well your company is performing against your business plan.

The above processes aren't the only ones that could benefit from automation and optimization to support your company's growth. Evaluate your other accounting processes and reporting capabilities and include them in your plan as well.

"Working with Armanino to make the move to Intacct from QuickBooks really set us up for the next 2-3 years and where we want to go. Now we're set to scale the business and continue the growth we've had over the last year and a half."

Brandon Hollembeak
Technical Product Manager
Trunk Club Men's Outfitters

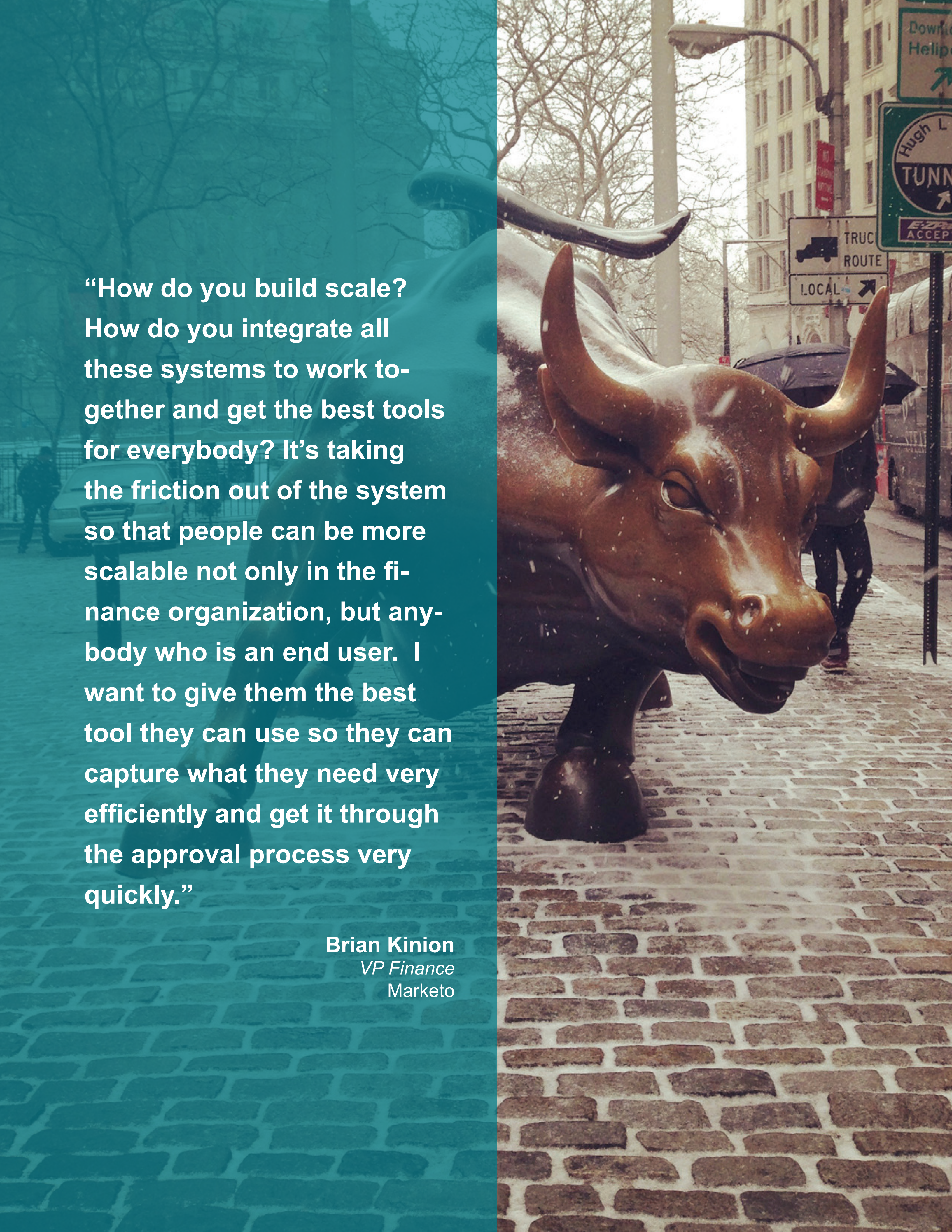
BECOMING A PUBLIC COMPANY

Going public is a major decision that permanently changes the way your company conducts business. Once it's public, your business will be subject to greater scrutiny and required to comply with a range of regulations. Your processes for accounting, compensation, financing, tax, and more will need to be reviewed and revised accordingly to help you become compliant with regulations such as Sarbanes-Oxley.

The level of maturity of your processes and supporting systems plays an important role in whether your business is ready to handle the reporting and compliance needs of a public company. Consider the following example for payables: an employee needs to purchase something for the business. Smaller, private companies often handle the process with paper, which increases risk and is not scalable as the company grows. On the other hand, companies with a robust system in place have a scalable, automated payables process that also provides auditable evidence for Sarbanes-Oxley compliance.

If your company is planning to go public in the future, it's never too early to start thinking about the more rigorous reporting and compliance requirements your organization will face. Going public and complying with regulations requires your business to have the right systems and controls in place. Savvy companies turn to experts with experience in guiding companies from private to public status to reduce risk, avoid last-minute surprises and delays, and help them prepare for the challenges ahead.

Finally, it's best to view compliance as a business transformation journey and not a one-time compliance event. In fact, compliance provides opportunities to improve your business and further optimize your business processes.



"How do you build scale? How do you integrate all these systems to work together and get the best tools for everybody? It's taking the friction out of the system so that people can be more scalable not only in the finance organization, but anybody who is an end user. I want to give them the best tool they can use so they can capture what they need very efficiently and get it through the approval process very quickly."

Brian Kinion
VP Finance
Marketo

LOOKING AT A REAL-WORLD EXAMPLE: kCURA

kCura is a SaaS company that experienced extreme growth and made corresponding investments in the back office to support that growth. The company offers software that helps corporations, law firms, and government agencies meet the challenges of managing large volumes of electronic evidence during litigation or investigations. kCura's year-over-year transaction volume growth is approximately 30 to 40 percent, putting it on a major growth path in a short amount of time.

CHALLENGE

- Rapid growth meant exponentially increasing volume and complexity of transactions for the accounting and finance team
- Invoices were created manually in QuickBooks
- Month-end close was highly dependent on spreadsheets

SOLUTION

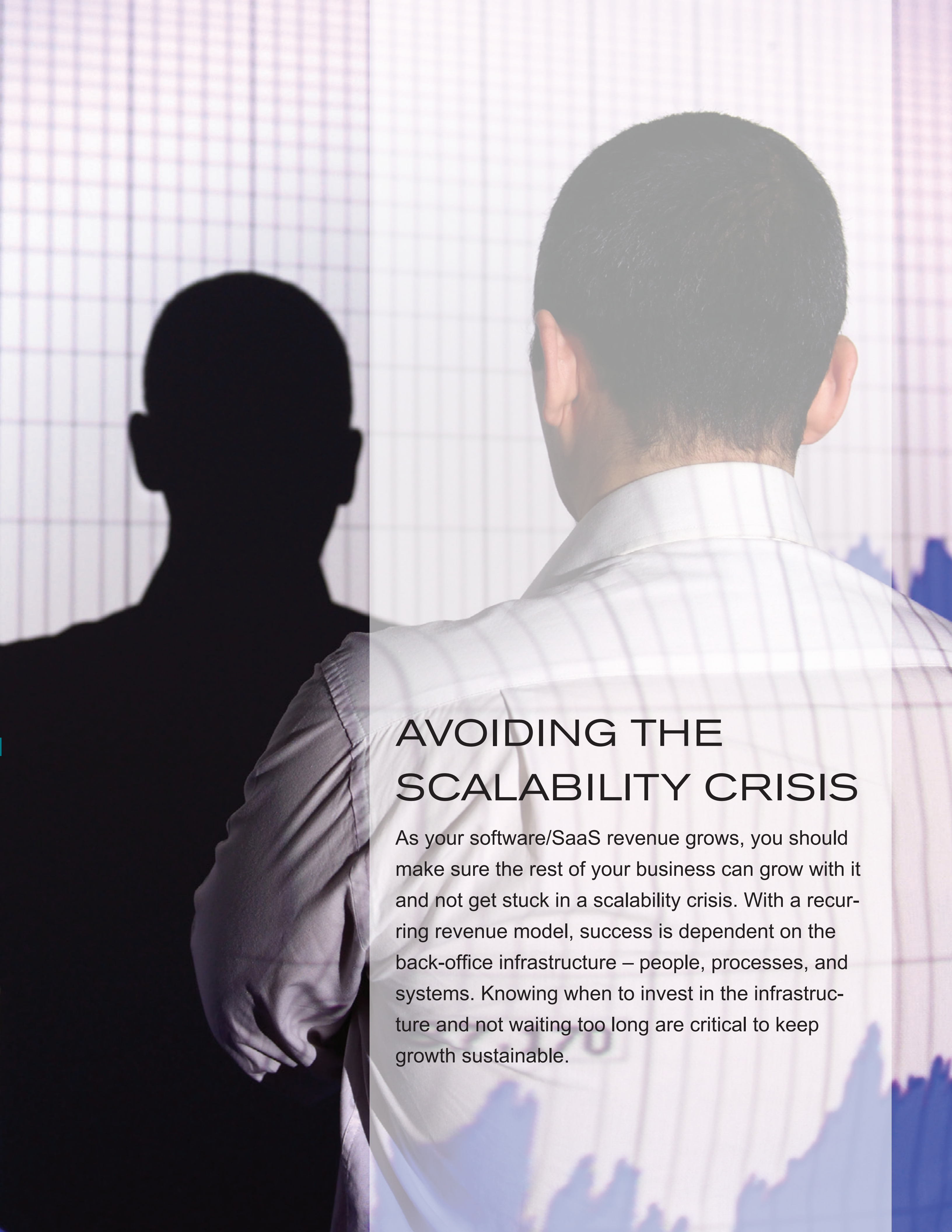
- Intacct, cloud-based financials
- Adaptive Insights, cloud-based budgeting, planning and forecasting solution
- Planning, training, and software implementation and integration services provided by Armanino

RESULT

- Went from handling thousands of lines in a spreadsheet for revenue recognition to a few clicks in Intacct
- Saved two days of work per month for one full-time employee
- Sped up and simplified month-end close
- Freed up more time for analysis

"We wanted to eliminate as much manual effort as possible so that we could not only continue to support the business as it grows, but have time to be analysts of the data as well. This meant fully integrating our best-of-breed approach."

Todd Bailey
Controller
kCura



AVOIDING THE SCALABILITY CRISIS

As your software/SaaS revenue grows, you should make sure the rest of your business can grow with it and not get stuck in a scalability crisis. With a recurring revenue model, success is dependent on the back-office infrastructure – people, processes, and systems. Knowing when to invest in the infrastructure and not waiting too long are critical to keep growth sustainable.

ABOUT ARMANINO[LLP]

Armanino provides an integrated set of accounting services — audit, tax, consulting and technology solutions — to a wide range of organizations operating both in the US and globally. You can count on Armanino to think strategically, to provide the sound insights that lead to positive action. We address not just your compliance issues, but your underlying business challenges, as well — assessing opportunities, weighing risks, and exploring the practical implications of both your short- and long-term decisions.

When you work with us, we give you options that are fully aligned with your business strategy. If you need to do more with less, we will implement the technology to automate your business processes. If it's financial, we can show you proven benchmarks and best practices that can add value companywide. If the issue is operational, we'll consult with your people about workflow efficiencies. If it's compliance, we'll ensure you meet the requirements and proactively plan to take full advantage of the changes at hand. At every stage in your company's lifecycle, we'll help you find the right balance of people, processes and technology.

ABOUT OUR CLOUD SOLUTIONS PRACTICE

Armanino consultants provide comprehensive services to the CFO organizations of fast-growing companies, including Microsoft Dynamics Implementation, Cloud Accounting Solutions and CFO Advisory services.

The firm's Cloud Accounting Solutions practice brings leading SaaS solutions to the strategic challenges faced by CFOs. Armanino's Cloud Solutions include business intelligence, cloud financials, budgeting, forecasting and planning, governance, risk & compliance, equity management solutions and customer relationship management (CRM). This deep bench of services provided by Armanino's business leaders who have served as CFOs, controllers, and FP&A directors helps finance teams to minimize time spent on low-value accounting processes and increase time spent on strategic decision making.

Contact us to schedule an appointment and discuss your business goals:

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