



How Private Equity Firms Can Use Software as a Service to Improve Portfolio Company Management

WHITE PAPER

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When a private equity firm acquires or invests in a business, frequently there are issues that go beyond changing management, product mix, or business strategy to turn around an underperforming company. The company's management information systems may be inadequate to meet the demands of a growing or complex business. More often than not, companies have a patchwork of legacy software systems that don't share information and are expensive to maintain. This often makes it difficult for investors to obtain timely, accurate, and consistent information on how the business is performing and to measure the results of initiatives designed to turn the business around.

System improvements must often be made quickly, but cost can and often does become an issue. A great deal of capital has already been tied up in the acquisition, and the longer problems go unaddressed, the more difficult it becomes to maximize returns on investment. The challenge is making improvements to the company's information systems while minimizing capital expenditures on additional software and other technology components necessary to deliver the needed capabilities.

Software as a service (SaaS) is a mode of software delivery that enables companies to access software via a hosted Web application rather than through an on-premise installation. This option can be an attractive and cost-effective solution to acquiring critical software capabilities. With no traditional software or hardware to implement and maintain, companies can be up and running quickly and inexpensively. SaaS applications can also be leveraged across multiple portfolio companies to enable more consistent reporting, making it easier for the private equity firm to manage its investments.

IN THIS WHITE PAPER

This IDC Financial Insights white paper shows how SaaS solves many of the common administrative problems facing private equity companies today.

SITUATION OVERVIEW

Business Software Systems Are Critical, But Often Overlooked

Without good information, one cannot pinpoint problems, understand them, or know what actions are needed to fix them. In some cases, legacy information systems can actually compound problems. For example:

- Many businesses start off using Excel spreadsheets to manage their finances. As the business grows, however, spreadsheets become increasingly complicated and confusing. Each department may have its own set of spreadsheets, using different formats and assumptions that cannot be shared or aggregated across the business.
- If the business does have an accounting system, it is often a small business system such as QuickBooks. Again, as the business grows and becomes more complex, it needs a more sophisticated application that can support international accounting standards, multiple currencies, or complex business structures.
- Private equity firms must take an active role in managing their portfolio companies. However, this is made more difficult when each company has different business applications and inconsistent reporting tools.

The SaaS Option

SaaS is growing in popularity as a way for businesses to gain access to sophisticated information systems with a low initial investment. Rather than purchasing the software, and the hardware and support staff required to run it, companies access it over the Internet from a third party that manages and maintains it reliably in a dedicated datacenter.

The primary advantages of SaaS are as follows:

- **Low initial cost.** The implementation and setup costs associated with SaaS are typically a fraction of the cost of an on-premise software installation on the company's servers. Additional cost savings are realized by not having to acquire computer hardware and support staff to maintain it.

- **Predictable costs.** SaaS systems are paid for with a monthly subscription fee, typically based on the number of users, or "seats." As the business grows, additional capacity can be added as needed.
- **No maintenance costs, upgrades, or bug fixes.** These are taken care of by the software provider and covered by the subscription fee. Updates can be delivered with greater frequency and transparency.
- **Enterprise resource planning (ERP) software,** a software category that includes financial and human resources management as well as manufacturing functionality, is increasingly available via the SaaS model. In addition, software vendors have largely closed the gap between the functionality of their SaaS offerings and their on-premise software. This addresses one of the major concerns that companies have historically had about SaaS, which is that it offers a lower level of functionality compared with traditional on-premise solutions. Now companies can obtain equivalent functionality at lower cost and complexity.

However, there may be some disadvantages to the SaaS approach, which may apply to some companies:

- **Limited customization options.** Early SaaS offerings provided only limited customization. However, as they have matured, they have provided greater customization capabilities, allowing companies to tailor the solution to their requirements. Companies that require a high degree of customization may still need to license an on-premise copy of the software. However, they should consider carefully whether this is necessary as customizations can significantly drive up costs. Software delivered via the SaaS model may actually fit their requirements quite well and enforce best practices.
- **Dependency on the vendor.** This can be a concern if the SaaS provider is small, is not well capitalized, or does not have much of a track record. With well-established companies now offering SaaS versions of their flagship products, customers can feel confident that providers are both stable and able to support them fully.
- **Security and availability.** Since SaaS is accessed over the Internet, it may present security issues, and the user has less control over how these are addressed. However, companies need to be realistic about their own security capabilities and the cost to implement them; even a substandard SaaS implementation is likely to be superior to what most small companies could put in place with limited resources. Recognizing the importance of security, larger SaaS vendors have built their datacenters with robust security that also undergoes regular audits and certification by independent agencies.

Some prospective users have been concerned about the risk of their data being inadvertently shared with other users in a multitenant environment, where multiple users share the same software. This issue can be easily addressed with high-quality access control measures or by storing the data in a separate database.

- **Data portability.** If a SaaS customer decides that it needs to switch to another provider or wishes to bring the software in-house, it may run into difficulties if the SaaS provider uses proprietary data standards or has inadequate migration tools. This is something to ask about during the sales process; the best providers recognize that good migration tools help them bring on new customers, even if they also make it easier for existing customers to leave. It should be clear from the outset what happens to the data if the provider goes out of business or the customer terminates its subscription; careful planning can go only so far toward mitigating this risk.

As the SaaS model matures, many of the concerns that early customers have had are becoming less of an issue. Due diligence is still important, but customers will encounter fewer difficulties than in the past because vendors have taken steps to ensure greater system reliability and security. It is important to carefully evaluate SaaS vendors to ensure that their customization capabilities and security measures are in line with your business requirements.

FUTURE OUTLOOK

The IT environment is changing in ways that make SaaS a better choice for a growing number of companies. Network speeds and computing power continue to increase, making SaaS systems nearly as responsive as on-premise systems. In addition, modern browser technologies can support the latest user interface standards. For private equity companies looking to improve the technology infrastructures of their portfolio companies, SaaS has an important advantage: Once a private equity firm has selected a standard SaaS ERP offering, it can feel confident that its portfolio companies are all operating according to the same procedures and benefit from receiving information in a consistent format. Acquired companies can be brought up on the shared platform quickly, allowing management to focus on increasing value.

In short, SaaS software is an attractive option for companies experiencing rapid growth. By reducing up-front costs and employing licensing models that shift costs from large capital expenditures to periodic operating expenses, SaaS helps companies conserve capital that can be more productively directed toward increasing growth and profitability.

ESSENTIAL GUIDANCE

SaaS brings the power of enterprise-class ERP systems to resource-constrained and cost-conscious companies of the sort most commonly managed by private equity firms. IDC Financial Insights recommends that readers consider the following key points when making a decision on whether to move their ERP systems to a SaaS model:

- Experience is important if one is seeking to leverage the SaaS model over multiple portfolio companies, as a failure out of the gate requires starting over. A strong licensed software offering can be an asset, if the company has effectively transferred it to the SaaS model.
- The SaaS provider must have a strong service and support organization because its clients will be dependent on it for the duration of the subscription.
- The SaaS offering must be able to evolve and grow with the company using it. This is something that smaller, fast-growing providers may be challenged to provide.
- The reporting systems should be robust and flexible. Do not focus exclusively on functionality, because getting reliable information out of a portfolio company is crucial to increasing the value of the investment.

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