

The Australian private and public sectors have spent countless millions developing software which is often world-beating in a technical sense. In order to succeed globally we now must improve the management, sales, marketing and distribution of many of our homegrown products.

In the last twelve months, there has been concern voiced within the Australian information industry regarding the apparently flawed state of our country's software product industry.

Some pundits believe that, while Australia has universities filled with IT and Computer Science students and thousands of highly talented programmers hard at work in public and private enterprise, Australians have tended to take the lower risk, more certain option of fee-for-service contracting over the challenges of developing products for both the domestic and global markets.,

So why is this regarded as a sub-optimal outcome? Well, according to conventional business model wisdom, the sale of software licenses is economically superior to both the development of large client-specific applications and the business of implementing, integrating, testing, maintaining or patching existing products. Theoretically, software product businesses experience increasing returns to scale by virtue of a marginal cost of production close to zero

Having said that, Australians do possess skill and enjoy success in IT and communications industries, thanks largely to a substantial government sector and excellent public education system. Many local IT fortunes have been made selling tailor-made products and services to government and related enterprise, while our graduates have gained valuable experience in the local development arms of numerous multinational vendors.

However, in globally competitive terms, and especially when compared with the oft-cited Irish and Israeli members of our technology peer group, Australia should be exporting 10-20 times more software product than it currently does. The Australian Bureau of Statistics (ABS) reports that packaged (including enterprise) software sales dropped by 56 per cent in the last three years of the last century, while custom coding revenues grew by 26 per cent and outstripped product sales in absolute terms by a factor of six. While the peer-group statistics have questionable comparison value due to definitional ambiguities, and the ABS statistics can be partially explained by the boom in huge ERP deployments in the late 1990s, there are enough facts and anecdotes to support the case that Australia can pick up their game when it comes to the creation, marketing, distribution and sale of software products.

In terms of short-term financial return, Australian software entrepreneurs over the past decade may well have been better off custom coding ERP packages rather than developing new products. However, this has not helped our software market develop the necessary product development, management and marketing skills required to build significant, profitable, lasting enterprises.

#### *Systemic Impediments to Success*

From our experience there appears to be several reasons why Australia has produced few large, truly international software product companies:

1. **Global market access.** Australia is a tiny market that only comprises 2-5 per cent of total global sales for international vendors, with the US comprising in excess of 50 per cent of that total.

Yes, tapping this market has and can be done – but getting in front of, and staying in front of, these customers is not easy.

The difficulty in competing globally when management is a 14 to 22 hour flight from the coalface has sometimes been understated. Modern telecommunications has not changed the fact that physical proximity is an important part of building a trusted customer (and channel) relationship. International customers require local versioning, local support and a locally incorporated entity to sue if something goes wrong.

Our small local market also makes the offshore market entry decision (and its timing) exceptionally difficult, with meagre local revenues having only half to one third the purchasing power of the US dollar or pound.

2. **Lack of capital for start-up software ventures.** The absence of successful role models, an immature venture capital market and a dearth of venture capitalists who understand what makes (and how to help) a good software company have made it tough to grow faster than cashflow allows.
3. **Lack of aspiration.** Many Australians prefer to keep their businesses a modest and manageable size for many reasons including untested business leadership skills, an already high standard of living and a preference for anonymous success bred from our egalitarian culture.
4. **An independent and defiant mindset.** Australia's anti-authoritarian, underdog-supporting society breeds very clever entrepreneurs who take much pride in delivering a product twice as good at half the price of their goliath competitors. Unfortunately, this independence often also manifests as a non-collaborative attitude toward new business relationships.
5. **Lack of understanding and experience in packaging, marketing and distributing software products (as opposed to technologies).** Many companies fail to appreciate (and/or are unwilling to acknowledge) that marketing, business development and commercial acumen are more critical to success than coding (Visicalc, Lotus 123, WordPerfect, Mosaic, Navigator – need we say anymore?!) Many still harbour the belief that the better mousetrap will simply sell itself. These objections may stem from cultural pragmatism; a belief that all marketing is hype or bunk. Or, they may merely reflect our relative inexperience with technology product marketing. Whichever the case, the global game relies heavily on product marketing expertise, so we need to acquire it quickly.

The crying shame in all of this is that Macquarie's experience in working with and investing in Australian software companies has been generally very positive. Many of them offer superior product functionality, understand their customers' business processes and have a strong commitment to client service. If only we could bolt a North American business head onto Australian technical shoulders.

#### *Specific Issues in Product Management and Marketing*

We expand on the issue of inexperience in software product development, marketing and distribution because we believe that it is the single greatest factor holding back Australian software technologies.

Some of the most common problems we see include:

1. **Waiting to do strategic market research and analysis until product development is complete.** Too many companies have been in product development for three years or more, in the mistaken belief that perfect technologies will define markets and precipitate voluminous sales, with scant regard for market relevance and planning disciplines. Many companies do not even complete either Market or Product Requirement Documents. Obviously, this approach becomes more problematic as software niches become more commoditised and technological differentiation wanes.
2. **Continuing to develop in a commercial vacuum.** Many young companies have sold beta or early versions of products yet have never asked the users for their opinion. Many vendors fail to transform from a technology organisation to a sales and marketing machine. They fail to regularly talk to customers, they sell features rather than benefits, they fail to create a product management and marketing function, they don't conduct comprehensive grass-roots market research, and they fail to properly recognise and segment the market.
3. **Not having a handle on the economics of the software business.** Too few companies take a cottage industry approach to performance analysis, failing to benchmark the development, sales and support of their products against best practice or industry norms. Possessing realistic targets for average gross and net margins, sale returns, discounts and commissions and revenue per FTE is just the start. Companies should also have a good grasp of statistics relating to all other parts of the business, including lead generation, sale win-loss ratios, service calls per head etc.
4. **Failure to institutionalise and document R&D practices.** It is not unusual for the vast majority of the knowledge required to improve, implement and fix software to be retained in the minds of one or two early employees. Technical documentation is often seen as superfluous rather than facilitative; it is not good enough to have to figure it out by reviewing the code!
5. **Overemphasis on direct sales, perhaps caused by inexperience in partnering, joint ventures and alliances.** Even when distribution channels are established, this is often conducted in an opportunistically reactive rather than strategically proactive manner; through the signing up of customers and channel partners simply because they are interested in a product, without reference to their relevance to the vendor's market strategy. Many companies have not yet experienced how resource-draining partnerships can be, and enter into arrangements that consume much time but eventually lead to negligible revenue generation.

This last point is vital. Paradoxically, the striking of sales, marketing and distribution partnerships is the number one attribute of successful software companies, yet the majority of such partnerships do not yield net profits for the smaller partner because they are struck opportunistically without a real understanding of the needs of both companies' target customers. They also often fail to unambiguously motivate the partner to drive sales. They are very time-consuming to negotiate and, like any sales channel, can be expensive to manage.

Many small companies don't have the time or inclination to prequalify potential partners in terms of understanding which of them are doing worthwhile deals, how they like to structure them, and what their product strategy appears to be. Worse still, many aspiring proponents are not capable of articulating what they provide to the larger player. There needs to be a very strong incentive for a large player to give the average Australian company the time of day, let alone pump our products through their sales force.

## *The Future of Australian Software*

We believe that while there exists a technically talented software product development industry in Australia, it has yet to reach a comparable state of commercial maturity. We challenge our Federal Government to appreciate and respond appropriately to this issue.

Instead of channelling millions toward university research commercialisation, why not support initiatives like the NSW Entrepreneurs Workshop? Instead of spending millions more on technical education, why not spend thousands sponsoring more business plan competitions in our universities? Instead of giving tax concessions to multinationals, why not give corporate tax exemptions to net software exporters?

We realise that there is only so much the government can do. We realise that we don't have enough savvy and experienced marketing and finance professionals attracted to earlier-stage product (as opposed to branch office) software companies, or that they are not capable of influencing corporate strategy, perhaps because of techno-centric controlling shareholders and/or management.

We do understand that most Australian companies have not been concerned with market analysis and strategy because of the need to simply sell anything to anyone in order to keep the doors open in a small domestic market. They usually have no time to do anything else other than code the next release and keep a handful of customers happy by virtually giving away their customisation and implementation services.

We do recognise that Australians, usually having returned from a stint in the US, are increasingly taking on global product management and marketing roles for large software companies, and are bringing these skills and experience to bear with our earlier-stage aspirants.

We remain optimistic that the natural maturing of the Australian software product market will result in many commercialisation barriers falling, especially when accelerated by the threat and opportunity of globalisation and the influence of government, peak industry bodies and the financial community.

### ***About the Author***

Stuart Barton is a Senior Manager with Macquarie Bank's Corporate Advisory group. He was one of the founder's of the bank's technology venture capital business, and recently returned from 18 months working in the bank's Silicon Valley office. With experience across a wide range of technology financing transactions, including capital raisings, IPOs, cross border mergers and acquisitions and turnarounds, Stuart now focuses on investing in and advising enterprise software companies, particularly in relation to their finance, marketing, and expansion into the US. He is currently seconded to Intermine, a Macquarie Bank investee, as Chief Operating Officer.

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***Stuart Barton, June 2002***