STRATEGIC ANALYSIS OF SAGE IN THE SMALL BUSINESS ACCOUNTING SOFTWARE MARKET

by

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Abstract

This paper applies a strategic analysis framework to analyse Sage Simply Accounting. It considers business environments, current strategies, and relies on concepts such as five forces, the resource base view of the firm, and blue ocean strategy. A strategic hierarchy delineates creating and protecting profits in new and existing markets for a firm's offensive and defensive strategy.

Sage has several programs to protect profits including customer loyalty tracking and a customer focus culture. Development focuses on existing customer needs.

Firms pursue different strategies in existing and new markets. Sage focuses on delivering profits above the cost of capital in existing markets. In new markets, Sage can apply concepts from blue ocean strategy to achieve superior profits.

The analysis found that Sage has strong strategies to drive profitability. The lack of innovation exposes some vulnerability and there are opportunities to reshape the offer for the Hispanic market.

Keywords: Strategy; Internal Analysis; External Analysis; Profitability; Cost; Value; Differentiation; Five Forces; Blue Ocean Strategy; Sage; Intuit; Simply Accounting; QuickBooks.

To my wife, Angela, and kids – Memphis and Josh.

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From the works of Porter and Grant, and the very useful synthesis by Boardman, Shapiro and Vining, I have gained confidence in the dimensions of a business strategy analysis. There is no doubt in my mind that strategy is the ‘great work of organizations’ as Sun Tzu wrote. I am growing increasingly curious about business strategy – what it is, what it could be, and what it should be. Special thanks to Pek-Hooi Soh for providing a light and Michael Parent for inspiration.

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Glossary

Active Customer Base	Active customer base is a measure of the total number of customers who have purchased and registered a product or service within the last 2 years. (See also Installed Customer Base)
Disruptive Technology	A disruptive technology is a type of technology innovation that enters the market in a state inferior to the dominant incumbent technology. It improves rapidly and eventually displaces the incumbent technology.
Enterprise Resource Planning (ERP)	Computer software designed to consolidate multiple business management functions into a single software environment. The business management functions typically include purchasing, order entry, manufacturing, accounting, sales force automation, customer relationship management, and human resource management.
Enterprise Software	Computer software designed for multiple users within an organization.
Four Actions Framework	A technique to create a new value for customers in an industry by looking at the existing cost structure and determining which costs to reduce or eliminate as well as which new costs to add, or to raise to create a completely different cost structure. It therefore allows for simultaneous lowering of costs and increasing of product differentiation.
Installed Customer Base	Installed customer base is a measure of the total number of customers who have purchased and registered a product or service from the company. The metric has no time limit. (See also Active Customer Base.)

Chapter 1: Origins of the Small Business Accounting Industry

Robert Grant captures the essence of strategy best in the succinct statement that strategy is about winning (Grant, 2002). It is with this in mind that this paper explores a strategic analysis of the small business accounting software market for the general manager and senior leadership team of Sage Simply Accounting. The small business accounting software market in Canada is a $100 million dollar market with no dominant leader. Sage aspires to become the dominant leader. This strategic analysis aims to uncover what Sage needs to do to win against its main rival - Intuit QuickBooks. Employing a different set of lenses than those typically used by the firm for day-to-day strategic analysis, the analysis delves deeper than the expedient. However, it does not attempt to be comprehensive in the choice of tools used. Instead, it relies on selected well-researched tools in strategic analysis. The desired outcomes are the identification of new opportunities, new strategies for Sage to explore, or confirmation that current strategies are on the right track.

The strategic analysis framework of Robert Grant informs the structure of the analysis. Using this framework, the strategic analysis develops from two key pillars: an external environment analysis to achieve a 'profound understanding of the environment', and an 'objective appraisal of the firm's resources and capabilities' (Grant, 2002). Chapter one lays the foundation of the industry and quickly proceeds from the historical context to the current state of affairs in the industry. Chapter one also discusses the pivotal role that geography plays in the foundation of the industry and product scope. Starting outside the firm, chapter two explores the environment, relying chiefly on assessing the competitive forces. This chapter also considers the role of government, the life cycle stage of the industry, and the overall profitability. Concerns about the political, economic, social, and technological environments interlace the analysis. In chapter three, the focus shifts to assessing the resources and capabilities within the firm. It also looks at the goals, values and culture of the firm since these provide insights into the firm's motivation to win. The final chapters consolidate the analysis from the internal and external environments and identify strategic options for the firm to be successful.

1.1 Introduction

It is essential for a business to keep accurate and objective records. One reason is to conduct regular business operations and the other is to attract capital. Good record keeping supports reporting taxes to the government, tracking expenses and customer payments, and recording invoices. Records provide evidence for the sources and uses of funds and form the basis upon which a business can attract and retain capital. While most businesses start up as an entrepreneurial venture with the owner's capital, attracting external capital is often crucial to support the growth and expansion of the business. Investors need objective reports on the performance of the business in order to make an initial investment or continue investing in a business. Without the ability to attract and retain capital, businesses, as we know it, would be very different. To begin with, businesses would be restricted to operating on a small scale at the "mom and pop" level. They would not have the funding to capitalize on expansion opportunities. We would also see a significant reduction in innovation, resulting in a general lower standard of living for our society. The ability to access and retain capital is the motive power of our modern economy and one of the pillars that make this possible is an objective and reliable financial data record keeping system.

In 1494, an Italian friar, Luca Pacioli wrote the earliest known recording of the double entry bookkeeping system (Smith, 2008). In his book, Luca Pacioli described a method he observed merchants in Venice using during the Italian Renaissance. His work set the stage for the development of the accounting and bookkeeping profession, which assist businesses with recording and reporting on financial transactions. Bookkeeping using the double entry system uses accounts in a set of transaction record keeping documents called journals and ledgers to track all business transactions for a specified period. All the accounts then relate to a simple equation; the total asset accounts must be equal to the sum of the total equity accounts and liability accounts. At the end of each business-reporting period, conventionally a year, entries in journals and ledgers transfer to the balance sheet and a profit and loss statement. A statement of cash flow can also be prepared from the records. These documents are the primary business reports that communicate the performance, health and well-being of a business.

1.2 Development of the Accounting Software Market

The personal computer revolutionized double entry bookkeeping. It enabled converting paper based journals and ledgers into digital journals and ledgers. Bookkeeping was one of the first paper-based procedures software applications on the personal computer supported. With the proliferation of personal computers, bookkeeping software expanded rapidly. Today, they are called accounting software and in the US and Canada the products serving small to mid-sized or medium size (SME) businesses represent a US$2 billion industry. Adjacent to the SME market is the Enterprise Resource Planning (ERP) market that serves Fortune 500 companies. Oracle and SAP are two key players in the ERP market, which has a very high concentration ratio. The medium size business market is very fragmented with several players commanding only a small market share. This market serves Fortune 1000 companies and high growth businesses typically with revenues from US$25 million to US$1 billion. Key players in the medium size market are Sage, Microsoft, Epicor, Infor Global Solutions, Lawson Software and NetSuite. In the small business market, the concentration ratio is very high with Sage and Intuit dominating the market.

The small business market typically includes businesses from start-ups with no revenues to franchises with US$25 million in revenues.

The target of our analysis is the small business accounting software market in Canada. Here, the first challenge is defining the scope of the small business market. There is no clear line that divides a small business from a mid size business (also known as a mid market business). Industry Canada, a department of the federal government of Canada, considers all businesses with less than 100 employees a small business (Statistics Canada, 2008). Sage Simply Accounting and Intuit QuickBooks with combined revenues of about US$100 million are the two main products targeting the small business market in Canada. Studies of the Simply Accounting customer base show that the heaviest concentration is below 20 employees. See Figure 1-1 for Simply Accounting customer segments. It shows that close to 90% of customers have less than 20 employees. Usually, the number of employees is an effective gauge for identifying a small business. However, there are small businesses with over 20 employees but the employees are mostly part-time, e.g. food franchises. Alternatively, the business may experience seasonally high employment, e.g. farms, golf courses, and ski resorts. In these cases, the revenues provide a better criterion for assessing the size of the business. Despite the shortcomings with using number of employees, industry insiders generally use it since it is most often accurate in predicting the size and complexity of the business.

Figure 1-1 Simply Accounting Customer Segments

	Customer Segments by Number of Employees					
Products	**1**	**2-9**	**10-19**	**20-29**	**30+**	**Total**
First Step	6%	0%	0%	0%	0%	6%
Pro	8%	39%	10%	5%	2%	64%
Premium	3%	17%	5%	2%	1%	28%
Enterprise	0%	0%	1%	1%	0%	2%
Total	17%	56%	16%	8%	3%	100%

Source: Author

In the design of accounting software, product development decisions include determining the scope of operations of the target user's business, the number of users likely to need access to the software, and the knowledge and expertise of each user. When considering scope of operations, key considerations are, concurrent user access, how the business manages inventory and the daily volume of transactions recorded in the system. As a result, the accounting software intended for a corner grocery store or franchise location such as Buns Master is very different from accounting software for an international business with employees in multiple countries, extensive inventory management needs, and transactions in multiple foreign currencies. Therefore, while number of employees or even revenues may offer a quick proxy for determining whether a business is a small business or a mid size business, the design of accounting software for these markets also considers the expected scope of business operations. A common misconception about accounting software is that it only provides functionality for bookkeeping. While accounting software provides standard modules that include a general ledger, accounts receivable, accounts payable, inventory, payroll and banking, it goes far beyond just storing transactions in ledgers and journals. It also provides general management tools to help businesses serve the needs of their employees, customers and suppliers. It tracks employees, customers and suppliers personal and business contact information. It helps with completing and filing government forms. Furthermore, it records quotations or estimates sent to potential customers and provides reminders and alerts to do follow ups or process transactions. For many businesses using accounting software, it is the nerve centre of their business from an operational and resource management point of view. However, accounting software typically does not provide the special tools for calculating income or corporate taxes. There is a separate software market that handles tax. In addition, while accounting software will have a strong audit trail for records, there is a separate market that serves the specialist needs of auditors.

In the Canadian market today, there are two dominant small business accounting software – Sage Simply Accounting and Intuit QuickBooks. Each software developer has roughly 50% market share. After several years of fierce competitive battles, the rivalry remains intense. Each competitive move to increase market share results in a response from the other competitor. No one is clear about how to escape the stalemate, break away, and emerge as the leader. This is not a very comfortable position for Intuit since the software developer is used to being the market leader. In the US market, Intuit holds more than 90% market share, making it a virtual monopoly. In contrast, Sage's main product in the US, Peachtree Accounting, only has a 2% market share.

Sage has declared that it wants to be the leader in the Canadian market, but it is not clear which specific strategy will accomplish this goal. Product development's focus is enhancing the top of the line product (Enterprise) that targets a niche with higher revenue per sale but significantly lower units than the other products. Product management is raising prices to bring the price of the product to parity with the competition. Product marketing is considering expanding into the Latin American market for small business accounting. The company is executing on several different business level strategies in an effort to mitigate risks inherent in pursuing only one strategy. There is no singular and focussed alignment around the goal of becoming the market leader. Should it continue this way, or should it focus? If it decides to focus, on which specific strategies should it focus? These are the concerns of this strategic analysis.

1.3 Sage Group plc

Founded in North East England in 1981, the Sage Group plc is a premier United Kingdom operating company. Eight years after incorporation, Sage went public with a listing on the London Stock Exchange (LSE). Today, Sage is a business management solutions provider of software and services for small and mid-sized businesses around the world. Sage products are available in over 160 countries with market leading brands in Canada, England, Ireland, France, Spain, and South Africa. These products include software and services for accounting and bookkeeping, payroll, human resources management, inventory management, customer relationship management, supply chain management, and payment processing. With more than six million customers worldwide, Sage generated revenues of £1,439.3 million ($2 billion Canadian) in its most recent fiscal year ending September 30, 2009. Over the past 29 years, Sage has grown rapidly by employing a mergers and acquisitions growth strategy (See Appendix A). However, the company maintains an organic growth rate of about 7% and an overall net operating profit margin of 13% to make it a blue chip stock on the LSE's FTSE 100.

In North America, Sage's business solutions portfolio has 13 brands of accounting software differentiated by geographic focus, business size, scope of operations and vertical market. See list in Table 1-1. The brands span global, US and Canadian geographic markets, business sizes from start-up to mid-sized businesses and industry verticals such as manufacturing, retail, non-profit, construction, real estate and health care. Sage grew its accounting software portfolio by entering new geographic markets and acquiring the market leader in its category or the player with the second largest market share. For example, in the US, Sage acquired Peachtree, which had the second largest market share in the small business accounting software market. In Canada, Sage acquired the Simply Accounting product line, which was the market leader in the same category. Under Sage stewardship, the brands have generally maintained or increased their market position. A key aspect to Sage's globalization strategy is to develop local leadership for the local brands – in effect, a global company operating locally. Therefore, brand identities remain intact post acquisition. In fact, several years after Sage acquires a brand, customers often do not realize the change in ownership. With the need to promote cross selling customers from one Sage brand to another, there is now a focus on developing the Sage brand awareness.

Table 1-1 Sage Business Solutions Accounting Software

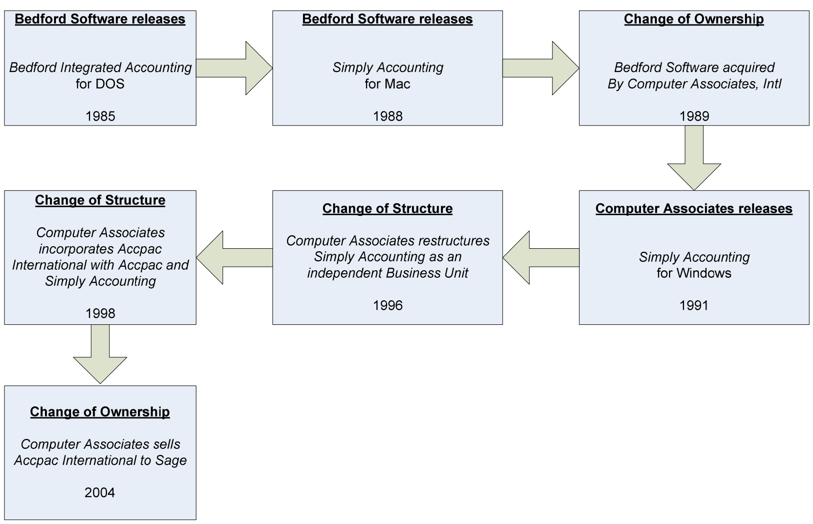
No.	Product Line
1	Sage Accpac
2	Sage BusinessVision
3	Sage BusinessWorks
4	Sage DacEasy
5	Sage ERP X3
6	Sage MAS 90, 200 and 500
7	Sage Master Builder
8	Sage MIP Fund Accounting
9	Sage Peachtree
10	Sage PFW
11	Sage Pro
12	Sage Simply Accounting
13	Sage Timberline

Source: Sage.com

Based in Richmond, BC, Simply Accounting is the flagship accounting software product in the Canadian business unit of Sage. The first incarnation of the Simply Accounting software was a product called Bedford Integrated Accounting released in 1985 by Bedford Software, a Burnaby-based firm. The software operated on the Microsoft Disc Operating System (MS DOS). Following on its early market success, in 1988, a Mac version titled Simply Accounting released. This was the first release of a product with the brand name Simply Accounting. A year later Computer Associates acquired Bedford Software and quickly set about releasing a Windows operating system version of Simply Accounting. The first Windows operating system version of Simply Accounting debuted in 1991. It went on to benefit from the spiral growth and eventual dominance of the Windows operating system in the small business market. Since Windows was rapidly emerging as the standard operating system for small businesses, Computer Associates throttled further development of the Mac version and focused investment in the Windows market.

Under the ownership of Computer Associates, Simply Accounting established a market leading position in the small business accounting software market in Canada. However, the competition grew more intense and Simply Accounting started to lose market share. When Sage acquired Simply Accounting in 2004, the product had an installed customer base of 400,000 users in Canada. This was nearly twice the number of customers using the competing product from Intuit. Simply Accounting was also the best selling small business accounting software with 57% market share. In the province of Quebec, Simply Accounting market share was closer to 98% as it was the only bilingual (English and French) accounting software on the market. The brand was clearly the leader, but it was also slowly losing market share, particularly from new sales at retail. See Figure 1-2 for major milestones in the history of Simply Accounting leading up to the acquisition by Sage.

Figure 1-2 *Simply Accounting Ownership History*



Source: Adapted from J. Carlton Collins, Accounting Software Advisor, 2003

Since acquiring Simply Accounting, Sage has made significant investments in leadership, research and development, operational effectiveness, and in marketing to bolster the Simply Accounting market leadership position. Sage recruited Laurie Schultz, a former vice president from Intuit, to lead the Simply Accounting business unit as general manager. As the general manager, she owned the profit and loss of the business unit and full executive level responsibility to execute measures to ensure the business unit succeeds.

As a former executive of Intuit, Laurie Schultz brought insights into the strategic intent and tactics of the competition. She led the implementation of measures to stop defection and restore the rate of new customer adoption at retail stores where Intuit focused on making inroads. She also heavily invested in strengthening the relationship with the major retailers, for example with Staples, which accounts for 70% of unit sales in the retail small business accounting software category. Laurie also spearheaded the implementation of a measurement system for customer satisfaction. The measurement system tracked customer loyalty and the entire business mobilized to maximize the score. Laurie also cut prices and maintained price levels below Intuit. By 2008, when Jamie Sutherland became the new general manager for Simply Accounting, customer satisfaction was the highest throughout the whole of Sage. Over the past three years, he maintains a monthly average of 50% of the unit sales at retail.

1.4 Intuit, Inc.

Founded in 1983, Intuit is a market-leading provider of financial management solutions for small to mid-sized businesses and consumers. Based in Mountain View, California, the company is listed on the Nasdaq stock exchange and indexed in the Nasdaq 100. Intuit has three core brands that are household names and respected for ease of use and innovation. These brands are TurboTax (QuickTax in Canada), Quicken, and QuickBooks. The TurboTax software is for income tax preparation and Quicken helps to manage personal finances. Over one-third of the company's revenues come from its tax and personal finance products. The QuickBooks brand is a small business accounting software. It is the choice for over four million US businesses. In the most recent fiscal year ending July 31, 2009, QuickBooks contributed US$579 million on total revenues of US$3.1 billion. At retail stores in the US, QuickBooks took 94% of the unit sales during the year making it the undisputed market leader.

QuickBooks entered the small business accounting software market in 1992 and quickly became a success. It offered small businesses easy to use accounting software without the typical accounting jargon. The product's design optimized foremost to meet the needs of small business users who wanted a tool to help run and operate their business. The need to keep good records for sales and income tax reporting was secondary. This simple design principle created breakthroughs in usability that resulted in QuickBooks stealing market share from the incumbents and growing to become the market leader in the US.

Intuit has significant knowledge about selling through the retail sales channel from its experience with consumer tax and personal finance. It therefore leveraged its channel relationships to obtain prime retail point of sale marketing for QuickBooks. As a result, its market share grew rapidly. By the QuickBooks tenth anniversary in 2002, Intuit was reporting market share of over 80% of the unit sales at retail.

While Intuit was able to displace the competition quickly in the US, the battle for the Canadian market proved a lot more difficult. It had to contend with Simply Accounting, which had a clear dominant position and considerable brand awareness. In addition, it found that the Canadian consumer valued the accountant or bookkeeper's recommendation above improvements in usability. There were also different federal and provincial government regulations, and requirements for supporting multiple currencies and multiple languages, which were not present in the US market.

Despite several challenges, Intuit was determined to establish a leadership position in the market and executed several aggressive tactics to capture market share. Estimates show that 75% of sales at retail were from buyers who made a decision about the accounting software brand they prefer before arriving at the retail store (Schultz, 2008). These buyers where influenced in their purchase decision by advertising, a friend, business associate, but most often by an accountant or bookkeeper. The other 25% of unit sales at retail are from buyers who made a purchase decision at the retail store and so Intuit focussed on attracting these buyers. To reach these buyers, it is crucial to ensure the product packaging, in store promotions and store personnel are effective in helping them to choose your product. One of the most effective messaging on the product packaging is to make the claim that the product is a leader in the market. Intuit therefore carefully constructed its product marketing messaging to make claims in the Canadian market communications which where only accurate for the US market. In so doing, it was able to convey the impression that its leadership position in the US market also applied to the Canadian market.

To strengthen its ties with retailers in Canada, Intuit made the bold move of encouraging its existing users to do upgrades at retail. This was an innovative strategy since typical retailers earn a 20% margin on sales, which you can avoid when upgrading existing users by selling the upgrades using the direct sales channel. However, by paying this extra cost, Intuit was able to raise the awareness of QuickBooks at retail and improve the relationship with retailers. The retailers earned more from QuickBooks products as unit sales rise from upgrades.

To bolster further its position in the Canadian market, Intuit purchased the Canadian distribution rights of the third place competitor MYOB (Mind Your Own Business) from its Australian parent company. After acquiring the rights to distribute MYOB in Canada, they discontinued the product. This reduced the number of competing solutions in the market and effectively created the duopoly that remains today.

The tactics employed by Intuit were effective in making significant in-roads into the Canadian market. However, Simply Accounting later responded with counter measures to stabilize the market share of new users entering the market. Both companies have since started employing similar or counter tactics at retail. No one is averaging over 50% market share month over month. In addition, neither company has been effective at making any significant in-road into converting existing users from the other product. The accounting software market has proven to be stickier in Canada than what Intuit experienced in the US. Gradually, the market share battles are subsiding and price has steadily started to increase in the market. There are now clear signals that mark a shift in focus from market domination, as measured by unit sales, to profit maximization.

1.5 Geographies

Since Sage and Intuit operate in both the US and Canada, it is important to understand some differences between the two markets and geographies in general. Unlike some software applications, such as Microsoft Word and Microsoft Excel which remain the same in the US and Canada, accounting software is custom made for each geographic market. The customization required may include changing how specific functionality work; or, more specifically – supporting additional languages, currencies, and tax codes. Very often, it includes adding entirely new features that are essential for the market.

Perhaps the most significant difference between the US market and the Canadian market is language. French and English are official languages in Canada whereas English is the only official language in the US. While for most provinces the official language of business is English, the Province of Quebec's official language of business is French and New Brunswick is officially a bilingual province. New Brunswick is a relatively small province accounting for only 2% of the Gross Domestic Product (GDP) of Canada (Statistics Canada, 2009). However, Quebec contributes 23% of Canada's GDP and represents 19% of the population (Statistics Canada, 2009). This makes it a significant contributor to economic activity in Canada and therefore an important market to serve.

Another major difference between the US market and the Canadian market relates to currency. Most US small businesses conduct business within the US. When they do business internationally or in Canada, they typically do business in the US dollar. For these businesses, there is no need for multi-currency support in the accounting software. In contrast, in Canada, many small businesses do business in the US and find that their customer or vendor in the US would prefer to do business in US currency. The ability to process transactions easily in Canadian dollar or US dollar is therefore an essential requirement for their accounting software.

In the small business market, no one has been able yet to create a dominant global application. Geographic markets tend be dominated by a locally developed product. In the mid-size business market and above, there are a few global players. One example is Sage Accpac. It is available in over 120 countries. Consolidating the global market in the mid market is an easier challenge from an engineering point of view because the applications are fully customizable and flexible. Customizability and flexibility creates complexity in the step up and implementation of the software. However, in the mid market, a consultant typically does the implementation and so shields the end user from the complexity. In contrast, in the small business market, the end user often does the setup and implementation and therefore it is necessary to make this experience as easy as possible.

Chapter 2: Profitability in the Small Business Accounting Industry

This chapter considers the competitiveness and profitability of the small business accounting software industry in Canada. The main objective is to determine the current and future prospects for profitability in the industry. In assessing the attractiveness of the industry, a key consideration is how the industry is capable of sustaining value for the incumbents. There are several conceptual tools available in the strategic literature to assess a business external environment. However, a tool only is as good as how well it is used. Moreover, there is no well-known empirical evidence that comprehensiveness in external analysis has a higher success rate. As a result, the analysis uses only a select set of well-understood tools.

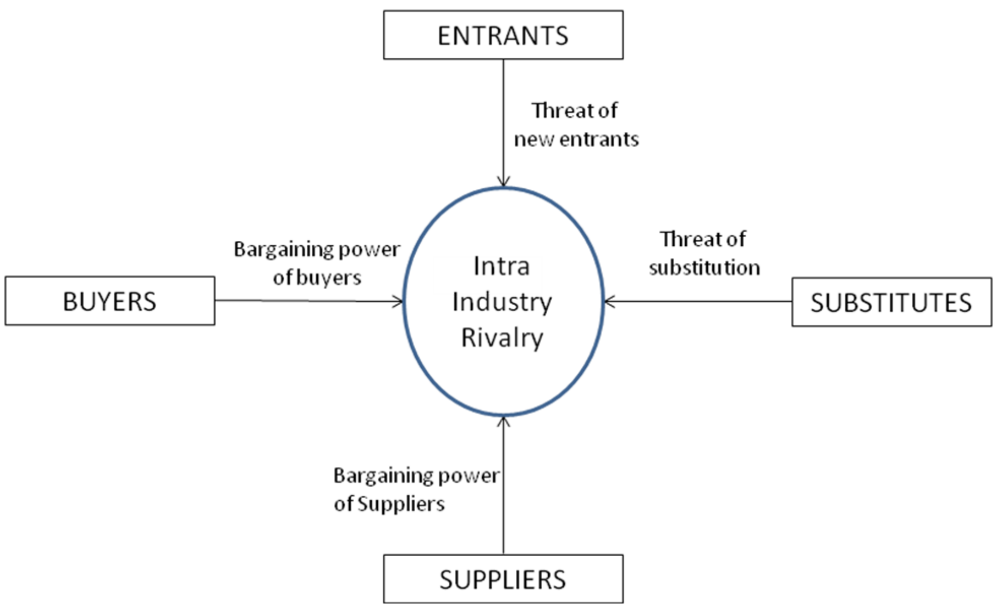
Our goal in external analysis is to achieve a 'profound understanding of the environment' (Grant, 2002). The analysis begins with characterizing the structure of the industry using the qualitative technique in Michael Porter's five forces framework (Porter, 1980). Next, it explains the role of government in the industry. It then proceeds to consider the overall maturity and growth prospects of the industry with respect to the industry life cycle. Since the purpose of strategy is to maximize shareholder value, the chapter concludes with a review of the actual financial performance of the incumbents.

The methodology of the analysis is an adaptation of Porter's view on industry analysis. While its roots are in the five forces framework, it grows and branches off in its own direction and not the direction prescribed by Porter. The reader should not expect Porter's prescriptions for anything beyond using the five forces framework for characterizing the essential, inherent good or bad influences on the industry profitability.

2.1 The Structure of the Industry

The industry structure influences the competitive behaviour of incumbents and the potential strategies that may be used. The structure emerges from the underlying economic power of the participants in the industry. Michael Porter's five forces framework is a straightforward and intuitive tool to structure sizing up the current state of competition within an industry. See Figure 2-1 for the five forces shaping the structure of an industry. These forces are internal rivalry among the incumbent firms, the bargaining power of buyers and suppliers, and the threat of new entrants or substitution. The combined strength of all these forces determines the industry's overall level of profitability. We will now assess each force individually, beginning with the threat of new entry and proceeding clockwise.

Figure 2-1 Forces Driving Industry Competition



Source: Adapted from Michael E. Porter, Competitive Strategy, 1980

2.1.1 Threat of New Entrants

The threat of entry into the industry is a function of the barriers to entry and the expected retaliation from incumbents. If barriers to entry are low, then there is a high threat of new entrants. Alternatively, if the barriers to entry are high, then there is a low threat of new entrants. A high threat acts as a restraint to prevent profits from increasing within the industry since it will attract new entrants. New entrants have the effect of lowering the profitability of the incumbents. In his study of industries, Porter observed six major barriers to entry: Economies of Scale, Product Differentiation, Switching Costs, Cost Disadvantages Independent of size, Access to Distribution Channels and Government policy.

Economies of scale are an effective barrier to entering the industry. The cost of establishing a marketing development fund in order to promote a new product in the market will present a barrier for small companies to enter the market. However, this barrier does not apply to larger companies. For example, Microsoft was a recent late entrant to the industry. Leveraging its success and experience in the mid-market with Microsoft Dynamics, Great Plains and Navision, and coupling it with the successful Microsoft Office, it introduced Microsoft Office Accounting for small business. With its significant resources, Microsoft was able to fund the marketing and development of awareness for its product. Analysts expected them to do very well. However, the ability to enter the market does not guarantee success. Microsoft failed to gain the support of accountants and bookkeepers who influence sales to small businesses. It also found that most small businesses where quite happy with their existing accounting software and resisted switching even at a deep discount. The value from the integration between Microsoft Office and the accounting software rang hollow. They were not able to price low enough to cover the switching costs and remain profitable. In 2008, Microsoft announced it was withdrawing from the market and discontinuing further development of Microsoft Office Accounting. The failure of Microsoft to be successful in this market will serve as a deterrent for other larger companies with the resource capability to overcome the economies of scale barrier. They will need to ensure that they are able to become successful after they enter the industry.

The market consists of mature products. As mentioned earlier, the first windows version of Simply Accounting was released in 1991 and the first version of QuickBooks was released a year later in 1992. As a result, there are not a lot of feature differences between the products. Competitive comparisons tend to confirm that the core value offered to customers is roughly the same. However, branding and positioning creates product differentiation. For example, Simply Accounting positions as the preferred solution recommended by accountants and bookkeepers whereas QuickBooks positions as easy to use and preferred by small business customers. Both products also have loyal and satisfied customers who act as evangelists touting the merits of their preferred solution. The current level of product differentiation creates an entry barrier, as a new entrant would have to develop a similar level of differentiation in order to compete effectively in the market.

Another important barrier to entry is the presence of switching costs. Accounting software and the services provided by accountants and bookkeepers are complementary goods. The consumer of accounting software needs to know that their accountant or bookkeeper will support the accounting software they are using. If the accountant or bookkeeper is not familiar with the accounting software, then the accountant or bookkeeper may charge the customer more. It takes the accountant or bookkeeper longer to prepare financial statements from records stored in unfamiliar systems. In addition, if customers switch to new accounting software, they lose the ability to do historical reporting. This leads to higher costs for moving to new accounting software.

The final significant barrier to entry is access to the dominant distribution channel. In the case of Simply Accounting, over 90% of new customer sales are at retail. QuickBooks estimate is about the same. This makes the retail channel extremely important to the current business model. Retailers will not support “me-too” products that do not sell well and just take up space on their shelves. To access the retail channel requires significant funds to build awareness for the product and to pay for marketing in the retailer’s catalogues, flyers, and for product placement at premium locations in store displays. While a new entrant may have the funds to invest in the retail channel, especially if they are a large business – for example, Microsoft had no problems raising the funds – smaller companies who want to get into the industry may have to invent a new channel to reach customers.   However, reaching customers is only half the battle. They must also convince customers that their product will complement the accountant or bookkeeper’s service and confirm this claim prior to purchase.

Table 2-1 summarizes the main barriers to entry and the overall effect of all the barriers (Porter, 1980). Despite some sources of barriers to entry, which are medium or low, the sum effect of all the barriers to entering the industry is high. This means profitability generated in the industry will remain in the industry because it is not easy for new entrants to enter.

Table 2-1 Sources of Barriers to Entry

Sources of Barriers to Entry	**Industry Characteristics**	**Force of Entry Barrier**
Economies of Scale	▪ Cost of marketing development funds and developing the influencer channel through engagements can be spread over large unit sales	Medium
Product Differentiation	▪ Incumbents for over 20 years ▪ Loyal and satisfied customers ▪ High brand awareness	High
Capital Requirements	▪ Capital requirements to startup a software firm are low	Low
Switching Costs	▪ Transaction data is stored in proprietary formats ▪ Historical reporting requires all data to be in the same system ▪ Accountant's complementary service	High
Cost Disadvantages Independent of Size (e.g. Experience Curve)	▪ Cost of maintaining and updating incumbent old technology is higher than new technology ▪ Minimal usage of proprietary product technology	Low
Access to Distribution Channels	▪ Retailers will only carry high volume products ▪ Accountant's and bookkeepers influence sales	High
Government Policy	▪ No policy that makes it harder for new entrants to enter the market	Low
	Overall Effect of Entry Barriers	**High**

Source: Adapted from Michael E. Porter, Competitive Strategy, 1980

2.1.2 Threat of Substitutes

Substitutes offer consumers an alternative to the products of the industry. They present the biggest risk to lowering profitability within the industry when they are experiencing gains in their price-performance attributes relative to the industry's products. Gains in the price-performance attributes occurs when the price is lowering compared to consumers' willingness to pay; or, the consumers' willingness to pay for the product is increasing relative to the price. There are four main threats to substitution in the industry: Shoebox, Microsoft Excel, Custom Home Grown Products, and the Mid-Market Products. Another threat to substitution comes from pen and paper; however, the price-performance trade-off versus the industry's products has been rapidly declining for this threat. Existing and new consumers entering the market are more likely to choose one of the four main threats than resort to pen and paper. As a result, we consider the impact of this threat negligible at this stage. The four main threats to substitution all have the ability to lure customers of the industry's products and therefore curtail the industry's ability to increase price.

The first threat of substitution comes from what the industry refers to as the 'shoebox'. Consumers can choose not to use any accounting software and store all their receipts in what is often an actual physical shoebox. They will choose the shoebox because they find accounting software expensive, hard to use or overshooting their needs. With the shoebox, they have the least amount of work to do; but they may have to pay a little more for the bookkeeping services provided by the accountant or bookkeeper. Alternatively, they may substitute with personal tax software if they are just operating a self-employment business. In both cases, receipts are stored in a box until tax time. The shoebox is not gaining in its price-performance attribute. However, it puts a restraint on price increases and therefore constrains the industry's profitability.

The second threat to substitution comes from Microsoft Excel. This product is the market leading spreadsheet application. It has a lot of functionality – but most people only use a small fraction of it. You can easily do basic tracking of revenues, expenses, and sales tax. Consumers who substitute with Microsoft Excel will supplement it with the services of an accountant or bookkeeper. They substitute paying for the accounting software with paying for the accountant and bookkeeper to do a little more work to complete their records at the end of the fiscal year. The price-performance trade-off of Microsoft Excel is much better than the shoebox. For very small businesses, the price-performance trade-off with Microsoft Excel can be better than with accounting software. However, it has remained relatively stable with respect to the industry's products over the past years.

The combined threats of the shoebox and Microsoft Excel have a significant impact on the industry's profitability. To illustrate, let us consider the size of the market that uses these substitutes. Since number of employees is one criterion used to define the industry, we can use it to estimate the full size of the market. In Canada, there are 2.7 million small businesses with less than 20 employees (Statistics Canada, 2008). All these businesses are in the addressable target market for accounting software. However, Simply Accounting and QuickBooks combined customer base is estimated to be only 800,000 or 30% of the total market. This means there are roughly 1.9 million businesses that are using a substitute. Sage estimates the shoebox and Microsoft Excel account for over 80% of the substitution.

The third threat to substitution comes from custom home-grown products. Both the price and performance for these solutions are usually higher than the industry's products. It is then usually only an option for customers who can afford the higher price. An example might be a high tech start up business that initially has low revenues and less than 20 employees. The business may have unique needs not met by the off the shelf solutions provided by the industry incumbents. As a result, the start up business then sees a trade-off among using a mid-market product, using some of its existing software development resources to develop a custom in-house solution, or settling for one of the industry's products. There is a high opportunity cost for the business in using its own development resource to build accounting software instead of working on the business's core product. However, the performance advantages are great since the solution will meet the precise needs of the business. Comparing the price and performance for this substitute against the price and performance for the industry's products gives the industry a distinct advantage over this substitute.

The fourth threat to substitution comes from the products offered in the mid market. As price increases in the industry, consumers will begin to look at the mid-market and consider if they should pay a little extra and get greater performance. In addition, with price increases, mid-market players have a greater incentive to 'dummy down' their applications in an effort to attract more businesses from the small business market. As a result, there has been very little price increases in the industry and there remains a wide spread between the price of the industry products and the price of mid market products. The industry offers a significant price-performance advantage over the mid market and very often customers in the mid market downgrade to the small business market to realize the savings. To illustrate, the estimated price for a mid-market product comparable to Simply Accounting Enterprise is around $40,000. Simply Accounting Enterprise costs only $6,000.

The spread in the price between the mid market and small business market reconciles the trade-off between ease of use and flexibility. Ease of use is vital for the existence of the small business market. Conversely, the mid market thrives on offering flexibility to allow businesses to operate the way they want. The price in the two markets reflects these two separate values. It is not likely that price in the small business market would increase to the same level as the mid-market because most small businesses simply would not be able to afford it. They would switch to a lower cost substitute. However, some businesses need ease of use as well as flexibility and are willing to pay a little more than they are accustomed to in the small business market. Recently introduced products, such as QuickBooks Enterprise and Simply Accounting Enterprise, focus on solving this need. However, from a holistic point view, profitability will remain constrained by the pressure to be low cost in comparison to the mid market.

Table 2-2 summarizes the four main threats to substitution. Of the four threats, two are high and two are low. The magnitude of the threats from the shoebox and Microsoft Excel far outweigh the magnitude of the other threats considering that only 30% of the potential market is using accounting software. Therefore, the overall threat of substitution is high. If incumbents try to extract exorbitant profits from the industry, they risk losing customers to the substitutes. This keeps the industry profitability lower than its full potential.

Table 2-2 Four Threats to Substitution

Sources of Substitution	**Industry Characteristics**	**Impact of Threat**
Shoebox	▪ Least amount of work for the consumer ▪ Minimal insights into the ongoing success of the business ▪ Used when industry products are considered expensive, hard to use or overshooting needs ▪ Supplemented with the services of the accountant/bookkeeper	High
Microsoft Excel	▪ Market standard spreadsheet application ▪ Used for basic tracking of revenues, expenses and tax ▪ Better price-performance tradeoff than shoebox ▪ Supplemented with the services of the accountant/bookkeeper	High
Custom Home Grown Products	▪ Higher price, higher performance ▪ Lower price-performance trade-off than industry products	Low
Mid-Market	▪ Higher price, higher performance ▪ Lower price-performance trade-off than industry products ▪ Dummy down products are not the same as software built from the ground up to be easy to use	Low
	Overall Impact of Threats to Substitution	**High**

Source: Author

2.1.2.1 Disruptive Technologies

Disruptive technologies can make substitutes more attractive and lower profits for the incumbents. In mature markets, mainstream firms have a common tendency to ignore some new entrants or substitutes to their industry. These threats while benign at first can grow rapidly to become a serious business risk. The substitute experiences rapid growth from a technology trajectory that has a lot more capacity for enhancements than the technology employed by the mainstream firms. Initially considered a trivial technology that performs less than mainstream products on key performance attributes for mainstream customers, the substitute can only satisfy the needs of a small section of the market. In many cases, the incumbent firms will adopt the new technology and enter the market segment as well. However, when the technology fails to realize a return similar to the returns in the mainstream market, they withdraw. Even though the technology might never overtake the performance of the mainstream technology, it later advances and soon overtakes the needs that the marketplace demands. By this time, the incumbent firms are no longer familiar with the technology and it is not easy to imitate quickly. Clayton Christensen studied this phenomenon and described it as disruptive technology (Christensen, 1997). It accounted for the downfall of many firms in the hard disk drive industry.

One of the main reasons incumbent firms are disrupted is they fall into a common trap of only listening to their mainstream customers under the misapprehension that if they only listen to their customers then their customers will be loyal forever. It is indisputable that customers will be loyal to organizations that provide them with superior market value. However, superior value is contextual base on the customer’s next best alternative and changes in technology often increase the value of alternatives. Whether by attrition, or by technology disruption, firms lose customers over time. Therefore, supplementing strategies for customer retention with strategies for customer acquisition is necessary.

In the accounting software market, online invoicing, led by FreshBooks, threatens to be disruptive. FreshBooks is a software as a service (SaaS) application and it shares many of the characteristics of a disruptive technology. See Table 2-3. With over 1,000,000 users, FreshBooks is capturing the low end of the market and customers dissatisfied with traditional accounting software. Large numbers of existing customers often complain that they wish the incumbents would only fix bugs and usability problems and stop adding new features. This concern from customers suggests firms in the mainstream market are overshooting demand.

Table 2-3 Technology Disruption from Online Invoicing

Disruptive Technology Characteristics	Online Invoicing
Your best customers can't use it	Yes Not rich enough for mainstream customers
Straight forward technology (not drawing on new science or discovery)	Yes Online invoicing uses the internet
Simpler and more convenient than mainstream products	Yes Internet deployment is easier than the desktop – no software updates, no installation issues
Different in the rank-ordering of the value of attributes	Yes These customers value the convenient internet delivery above all else
Lower than mainstream unit sales gross margin	Yes Both the price and the unit sales gross margin are significantly lower

Source: Adapted from Clayton Christensen, Innovator's Dilemma, 1997

In response to this threat, incumbents Sage and Intuit both released online invoicing products as well, Billing Boss and Billing Manager respectively. These products are largely "me-too" products with weak differentiation and no competitive advantages within the product-market segment; hence, they have failed to achieve a similar level of success as FreshBooks. Since Sage's competitive advantages do not leverage into this market segment it is at risk of making a common mistake at this stage. Typically, faced with only marginal success incumbents will retreat from the market and return to focus on their mainstream customers. However, Sage should avoid this common pitfall and fix the product's differentiation and competitive advantages within the segment. Since it does not have first mover advantages within the segment, it is not benefiting from positive word of mouth marketing. As a result, Sage needs to redouble efforts into promoting the product as an alternative to FreshBooks.

The success of FreshBooks so far has not had a huge impact on industry profitability since the product is limited to invoicing. However, the product will mature and attract more customers. It has the potential to consolidate most of the substitution now occurring in the market. If this happens, and it expands into full accounting software, it will undoubtedly crush the incumbents.

2.1.3 Bargaining Power of Suppliers

Suppliers can alter profitability in an industry by threatening to raise prices. While this force can be a strong source of power in some industries, it is relatively mild in this industry. The suppliers are fragmented and so they lack the ability to dictate terms to the firms in the industry. One major supplier is Microsoft. The firms rely on development tools provided by Microsoft. However, Microsoft provides generic development tools for all software developers and not exclusively for firms in this industry. It therefore does not have a strong lever to influence the industry.

The only supplier group that could have a major impact on profitability is labour. In fact, payroll accounts for the firms' largest expense so labour could yield significant power. However, employees tend to be very satisfied with the firms in the industry. Intuit won a prestigious award for being one of the top 50 best employers in Canada (Hewitt, 2008). The award considers input from employees and leaders. Among other things, it measures employee's engagement with the firm in terms of willingness to refer the firm, loyalty, and the desire to exert extra effort to contribute to the firm's success. Sage also has very high employee satisfaction. In the recent financial downturn, Sage took several measures to reduce the extent of layoffs. There are several career development programs. Attrition rates tend to be low; and, several employees have been with the company for over 10 years. There are no labour unions, and no signs that one is imminent. Firms view employee satisfaction as essential for customer satisfaction and the continued competitiveness of the firm. They consider employees' costs investments, which realize long-term benefits for the firm. This relationship between the firms and employees is collaborative, not antagonistic. With clear alignment of goals, Employees are committed to helping the firms maximize shareholder value. As a result, the potential for suppliers to affect profitability adversely in the industry is very low.

2.1.4 Bargaining Power of Buyers

Buyers have the ability to affect profits within the industry by bargaining for lower prices and threatening to switch to a substitute. There are two main buyer groups: small business and accounting professionals. Accounting professionals includes accountants and bookkeepers. Each of them has an average of 30 clients. Their clients will often purchase the accounting software that they recommend. This makes accounting professionals extremely influential. The small business group is fragmented and so lacks the ability to collectively bargain for lower prices.

A few accounting professionals will exclusively only support one firm. However, many of them will support all firms in the industry while also having a preferred firm. Accounting professionals rarely switch from one firm to another. The case is more likely that they will move from being exclusive to start supporting more than one firm. They consider supporting and working with a firm a long term investment and are willing to work closely with the firm. For example, they will attend annual conventions and participate in providing product feedback. They are very active in the product beta program and enjoy having a direct link to the product development group. While they have been able to preserve lower than market prices for themselves due to the value they provide as influencers, they do not usually attempt to push this value to their clients. They do not have the capability to threaten credibly to backward integrate but they can threaten to recommend a substitute or the competitor.

Within the accounting professionals' buyer category, bookkeepers perform a unique dual role. Most of them recommend software to their clients and require the client to purchase the software from the firms. However, some allow their clients to outsource the entire bookkeeping and payroll services. In this scenario, the client does not need to purchase accounting software. In addition, the bookkeeper does not pay any additional fees for the software since they benefit from the discount privileges created for bookkeepers who are influencers. The industry has not been able to quantify the extent of the impact from bookkeepers who are performing this dual role. However, Simply Accounting has an estimated 6,000 bookkeepers who on average serve 30 clients and QuickBooks has an estimated 4,000 bookkeepers, so the impact could be substantial. As price increases, bookkeepers are likely to offer this option to clients who complain about price. This gives bookkeepers a lever to affect the profitability of the industry.

Table 2-4 summarizes seven conditions to assess for the presence of buyer power (Porter, 1980). While this buyer group does not appear to have strong buyer power base on these seven conditions, the ability of this group to influence substitutes is quite powerful. For this reason, firms in the industry typically court this group and go to great efforts to ensure they are satisfied.

Table 2-4 Conditions of Buyer Power: Accounting Professionals Buyer Group

Buyer Group: Accounting Professionals	Does this apply?
1) It is concentrated or purchase large volumes relative to seller sales	Yes – indirectly
2) Accounting software represents a significant fraction of the buyer's costs	No
3) Accounting software is standard or undifferentiated	No
4) It faces few switching costs	No
5) It earns low profits	No
6) Buyers pose a credible threat to backward integration	No
7) Accounting software is unimportant to the quality of the buyers' product	No

Source: Adapted from Michael E. Porter, Competitive Strategy, 1980

With the small business buyer group, we know that the majority of them use the industry's substitutes. The ability to substitute is a real power that small businesses have over the firms in the industry. Since small businesses abstain from the industry's products at a high rate, on one hand, it lowers the current profitability of the industry. On the other hand, it indicates there is a huge opportunity for the industry to increase profits if it converts more small businesses away from substitutes.

Despite several attempts by incumbents to switch customers from one firm to another, this is rarely successful. Accounting software is very sticky – consumers require a powerful incentive to switch firms. In addition, most small businesses that purchase do so base on a recommendation from their accountant or bookkeeper and have no originating preference for one product over another. These consumers are typically not price sensitive. For example, if their accountant tells them to buy Simply Accounting, then it does not matter if QuickBooks has a $50 discount, they will only purchase Simply Accounting.

The criteria for assessing buyer power for the small business buyer group are in Table 2-5 (Porter, 1980). From this analysis, the buyer power appears to be low. However, yet again, we cannot ignore other circumstances. The buyers have the ability to use a substitute augmented with the services from an accountant or bookkeeper. This gives the buyers a lever to keep prices low in the industry.

Table 2-5 Conditions of Buyer Power: Small Business Buyer Group

Buyer Group: Small Business	Does this apply?
1) It is concentrated or purchase large volumes relative to seller	No
2) Accounting software represents a significant fraction of the buyer's costs	No
3) Accounting software is standard or undifferentiated	No
4) It faces few switching costs	No
5) It earns low profits	No
6) Buyers pose a credible threat to backward integration	No
7) Accounting software is unimportant to the quality of the buyers' product	Yes

Source: Adapted from Michael E. Porter, Competitive Strategy, 1980

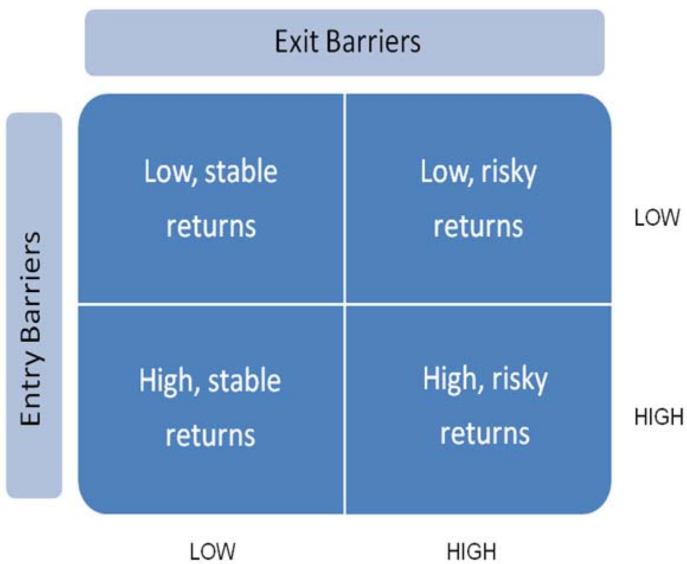
2.1.5 Competitive Rivalry

The final dimension to Porter's five forces is the level of internal rivalry within the industry. Several structural factors lead to more rivalry in an industry. These factors are: 1) numerous or equally balanced competitors, 2) slow industry growth, 3) high fixed costs, 4) lack of differentiation or switching costs, 5) capacity augmented in large increments, 6) diverse competitors, 7) high strategic stakes, and 8) high exit barriers.

The relevant factors for this industry are the balance of competitors, industry growth, strategic stakes, and exit barriers. The fact that the market shares are equally balanced creates the tendency for one firm to try something to increase its share, hoping the other firm is not paying attention. The industry is experiencing slow growth, making competition a zero-sum game. Increases in market share come at the expense of another firm. However, since the barriers to exit are low, unsuccessful firms will choose to leave the industry instead of resorting to desperate tactics. As a result, incumbent firms know that if they aggressively attack new entrants they can force them out of the industry.

Entry and exit conditions interact to give us a view of an important aspect of profitability in an industry. In some industries, it is hard to get in and hard to get out, characterized by high entry barriers and high exit barriers. Sometimes it is hard to get into an industry, but easy to get out, characterized by high entry barriers and low exit barriers. Alternatively, it may be easy to enter the industry, but hard to get out in the case of low entry barriers and high exit barriers. In the final scenario, it is easy to enter the industry but also easy to exit get out. Figure 2-2 illustrates these four entry and exit conditions. The best possible condition for sustained profitability in the industry, is where it is hard to enter the industry, but easy to leave. This is the case for the accounting software industry. Under this state, the incumbents experience high, stable returns. It is hard for new entrants to enter the industry, and if they enter and fail, it is easy for them to leave. The industry therefore enjoys high and stable returns.

Figure 2-2 Barriers and Profitability



Source: Michael E. Porter, Competitive Strategy, 1980

The industry firms use several tactics to try to gain market share. The most important is using price. Price typically comes in to play in the industry's cyclical buying season that runs from December to April. This is the period where 80% of the annual new retail units sell, and so the incumbents jockey for a more favourable position by discounting. Price competition is usually mild with firms never giving up discounts of more than 50%. There are no ‘fire sales’ or cutthroat pricing. Rivals match discounts off the list price quickly, resulting in a sustained equal market share for new units between the rival firms. In the past couple years, Intuit raised list prices and Sage followed suit. This is a continuing trend. Price in the industry is steadily increasing, indicating that the rivals are shifting strategy to favour profitability above market dominance.

In summary, there are close to 1 million small businesses in the small business accounting software market. They span industries from retail grocery stores and coffee shops to construction companies such as homebuilders and roofers. The threat of new entrants is low because the barriers to entry are high. This is a plus for industry profitability. The most powerful suppliers in the industry are the employees and they are very satisfied. This is another plus for profit. The main alternative to using accounting software is to outsource some or all the accounting function to a bookkeeper. With over 1.9 businesses choosing one of the substitution options, the threat to substitution is quite high. This is a minus against industry profitability. Both buyer groups have the ability to bargain away profits by threatening to substitute. This is another minus against industry profitability. Entry and exit barriers allow for high stable returns in the industry. The rivalry is significant but not destructive and price is slowly beginning to rise, which is very advantageous to industry profitability. Overall, there are three plusses for profit and two minuses. As a result, the industry structure and dynamics favours increasing profitability. The industry is therefore attractive for incumbents and their shareholders.

2.2 The Role of Government

Government is an important factor to consider in the accounting software market. It influences the entry requirements to the industry and the cost of operating in the industry.

Federal and provincial regulations establish periodic filing and reporting requirements. In Canada, two of the main areas where governments have a major influence on the market are in sales tax and payroll. In addition, there are special reporting requirements for firms doing business in the construction industry. Meeting the government reporting requirements for sales tax and payroll drive significant demand for small business accounting software.

In Canada, there are separate filing and reporting requirements for the federal goods and services tax (GST) and the provincial sales tax (PST). There is also a harmonized sales tax (HST) that the federal government is promoting to the provinces. The HST is a single aggregated tax that covers sales tax collections and filing requirements for the federal and provincial governments. Three provinces have already adopted the HST. BC and Ontario will do so as well on July 1, 2010. Even though the GST is the same rate throughout the country, provincial sales tax rates vary by province. As a result, the HST is 12% in BC, 13% in Ontario, New Brunswick, and Newfoundland and Labrador, and 15% in Nova Scotia. The province of Alberta does not have a provincial sales tax. With the GST and HST, taxes paid on purchases offsets the taxes collected on sales and the business remits the difference to the government. The accounting software has to be aware of these sales tax regulations and allow the business to accurately track, and report on taxes collected on the sale of goods and paid on the purchase of goods throughout the country.

While all governments regulate hiring, compensating and terminating employees, the rules, processes, forms and filing requirements are not the same. In Canada, employers must withhold amounts from employees paycheques for income tax, employment insurance (EI) and Canada pension plan (CPP) premiums. The employer also pays a portion of the EI and CPP premiums. Employers also contribute to the worker’s compensation board, typically based on a percentage of wages paid. Many employers also make benefits contributions for their employees, for example short-term disability and medical services plan. They must therefore remit funds to the Canada Revenue Agency (CRA) or other payroll authority on a defined schedule.

The CRA publishes updates to the tax tables twice per year. Employers use the tax tables to calculate income tax deductions and withhold the amount from employee paycheques. For each calendar year, employers must file a federal form called a T4 that totals the incomes and taxable benefits that employees earned during the year. When an employee leaves, the employer must create and file a record of employment (ROE) with the CRA. Paying employees involves several government documents, calculations, and filings – and, the fines for failing to comply with the regulations can be quite high. Small businesses therefore rely on their accounting software to be compliant with meeting these regulations. This creates both an ongoing cost of operating in the industry, but also is the most profitable activity of the incumbents.

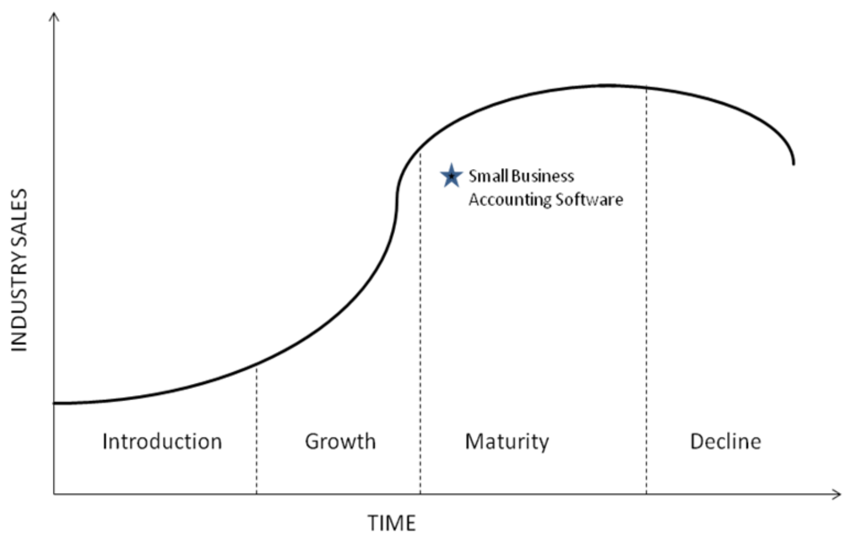
There are also sector specific requirements such as the contract payment reporting system (CPRS) in the construction industry. Construction businesses must determine if a supplier is a subcontractor from the construction industry as per the qualifications rules set by the CRA. If the supplier is a contractor from the construction industry, then the business must report the value of goods purchased from the contractor in excess of $500 per year. Accounting software helps businesses to track suppliers to report under the CPRS and to print or electronic file the reports.

While government plays a significant role in the industry, it does not favour one firm over another nor does it explicitly attempt to regulate the economics of the industry. However, it creates the conditions for customers demanding the incumbents' products and services. The incumbents do not compete on government compliance as an area of competitive difference. They all equally support government requirements. The compliance requirements form a small barrier to entry since new entrants will have to ensure they support enabling their customers to meet ongoing government requirements.

2.3 The Industry Life Cycle

The industry formed in the early 1990's, so it has been around for 20 years. An industry life cycle has four phases: introduction, growth, maturity, and decline (Grant, 2002). Between 1991 and 2002, increasing demand propelled the industry from introduction to maturity. Figure 2-3 illustrates the current stage of the industry. At maturity, growth in sales declines and revenues tend to be flat year over year. Firms tend to defend market share, maximize profits and look for opportunities to diversify or introduce new products. Incremental innovations can sustain a mature market. However, the market is a prime target for radical and disruptive innovations that reconstructs the trade-off between cost and value.

Figure 2-3 The Industry Life Cycle



Source: Robert M. Grant, Contemporary Strategy Analysis, 2002

Industry decline follows maturity. However, there are no indications at this time that the industry will enter the decline stage.

2.4 Overall Industry Profitability

The purpose of a financial performance analysis is to determine if the industry is profitable. To accomplish this, we need to review the financial performance of Sage and Intuit since the two companies make up more than 90% of the market share in the Canadian small business accounting software industry. There are two schools of thought around assessing if the incumbent firms are financially successful. One considers only the net operating income reported on a firm's financial statements prepared according to generally accepted accounting principles (GAAP). This way provides reasonable objectivity and is the method most commonly used in business. The other method accounts for the cost of capital using a measure of the weighted average cost of capital. It also considers the theoretical opportunity cost of capital to arrive at economic profit. While we acknowledge that the economic profit is more precise, in this study, we rely on the GAAP reported net operating income instead of the economic profit to measure profitability.

The performance analysis compares the corporations Sage and Intuit instead of the operating business units, Simply Accounting and QuickBooks, respectively. Some revenue information is available for the operating business units – In Canada, Simply Accounting annual and QuickBooks revenues are about US$100 million –but these numbers are rough estimates since internal policy on revenue recognition and revenue sharing agreements among business units can distort reported revenues. Expense data is not available but since both operating business units operate in a larger corporate structure, they share costs with other business units in the corporation and internal transfer pricing policy can conceal the actual cost of shared services consumed. Even though the true cost of doing business in the industry is hard to determine, since the barriers to exit are low, firms not profitable would most certainly exit the industry.

Sage generated revenues of £1.439 billion in its operating currency, British sterling, in 2009. Net operating profit was £280.6 million. Sage also issued dividends year over year during this period. See Table 2-6. Over the past 3 years, revenues grew on average by 17% and operating profits averaged 9%. See Table 2-7.

Table 2-6 Sage Multi-Year Financial Performance Summary

Multi-Year Financial Performance Summary					
Full Year (£m)	**2005**	**2006**	**2007**	**2008**	**2009**
Total Revenue	759.6	935.6	1,157.60	1,295.00	1,439.30
Operating Income	199.3	235.8	255.2	267.4	280.6
Net Income	132.4	152.6	154.1	166.3	189.5
Div per share (pence)	2.88	3.59	7	7.21	7.43

Source: Sage

Table 2-7 Sage Year over Year Growth

Year over Year Growth	**2006**	**2007**	**2008**	**2009**	**Average**
Revenue Growth	23%	24%	12%	11%	17%
Operating Income Growth	18%	8%	5%	5%	9%

Source: Author's calculations

Intuit generated revenues of US$3.182 billion in its operating currency, US dollar, in 2009. Net operating profit was US$682 million. See Table 2-8. Over the past 3 years, revenues grew on average by 11% and operating profits averaged 7%. See Table 2-9.

Table 2-8 Intuit Multi-Year Financial Performance Summary

Financial Performance Summary				
Period (million)	**2006**	**2007**	**2008**	**2009**
Total Revenue	$2,342	$2,672	$3,070	$3,182
Operating Income	$559	$637	$650	$682
Net Income	$416	$440	$476	$447

Source: Nasdaq.com

Table 2-9 Intuit Year over Year Growth

Year Over Year Growth				
Period (millon)	**2007**	**2008**	**2009**	**Average**
Revenue Growth	14%	15%	4%	11%
Operating Income Growth	14%	2%	5%	7%

Source: Author's calculations

At the close of trading on May 28, 2009, Sage valued US$4.5 billion and Intuit valued US$11.3 billion – making Intuit almost three times the size of Sage. Both companies had revenue and operating income growth over the past 3 years. Sage had a slightly higher growth in both revenues and profits. At the end of the last fiscal year, Intuit reported earnings at $1.41 per share and Sage reported earnings at $0.20 per share. Intuit's debt is 89% of equity while Sage's debt is 83% of equity. We can therefore conclude that both companies are profitable and sustainable businesses with no imminent risk of insolvency.

Just as there are several metrics to assess a firm's profitability, there are several metrics for overall industry profitability. A reasonable metric is return on invested capital (ROIC) (Porter, 2008). Incumbents need to realize a better return on capital than their shareholders could at an equivalent level of current risk. The ROIC satisfies this requirement since it provides a measure that compares easily with performance measures of other market assets and removes the influence of individual firm's capital structure. The average ROIC between1992-2006 for the pre-packaged software industry (SIC Code 7372) is 37.6% (Porter, 2008). However, for US industries as a whole, it is about 14.9%. Sage's average ROIC for the past 4 years is 15%; Intuit's average ROIC for the same period is 25%. See Table 2-10 and invested capital calculations in Appendix C. The industry's average is 20%, which is well below the average of the pre-packaged software industry but slightly above the average for US industries as a whole.

Table 2-10 *Sage and Intuit Return on Invested Capital*

Intuit	2009	2008	2007	2006	Average
EBIT	704,615,000	750,275,000	723,503,000	610,211,000	697,151,000
Invested Capital	3,708,856,000	3,213,183,000	3,205,811,000	1,827,586,000	2,988,859,000
ROIC	19%	23%	23%	33%	25%
Source: Intuit.com, and author's calculations					
Sage	**2009**	**2008**	**2007**	**2006**	**Average**
EBIT	280,600,000	267,400,000	255,200,000	235,800,000	259,750,000
Invested Capital	1,977,200,000	1,836,100,000	1,614,900,000	1,641,400,000	1,767,400,000
ROIC	14%	15%	16%	14%	15%
Source: Sage.com, and author's calculations					

It is important to note that the profitability we see here is rooted in the external competitive forces that make profit possible and the firms' competitive advantages. The relevant competitive forces are, the barriers to entry that make it hard for small firms to enter the market, the high threat of substitution, the incumbents preferring to compete base on differentiation and brand rather than price, and the lack of large power bases in the supplier and buyer groups. In the next chapter, we will consider how the firm's competitive advantages contribute to profitability.

Chapter 3: Sage Sources of Competitive Advantages

In this chapter, we proceed from an external analysis of the industry to an internal analysis of the firm. Three main components for a firm analysis are the goals and values, the resources and capabilities and the systems and structures. In considering these components, the primary objective is to determine the firm's source of competitive advantage and areas of weakness. The goals and values establish what is important to the firm. Resources are the tangible, intangible and human assets of the firm that deploy to accomplish the firm's goals. From the firm's resources, there may be competencies that uniquely differentiate the firm from the competition. Competencies can emerge from the resources or they may develop through focussed effort.

In conducting an internal analysis of the firm, the ultimate goal is to arrive at an 'objective appraisal of resources' (Grant, 2002). The review begins with an assessment of the firm's goals, culture and values. A resource analysis follows with the identification of core competencies. Next, we assess the core competencies for current and potential sources of sustainable competitive advantages. From the sustainable competitive advantages, we determine the strategic assets. The chapter also considers how competencies can have unintended consequences and describes the organizational structure that executes strategy.

3.1 Corporate and Business Goals

Since Sage is a publicly listed company, it is not surprising that the primary goal is to maximize shareholder value. Considering that shareholder value consists of dividends and capital gains, Sage pursues policies to support shareholder value realization in both areas. Each year

Sage distributes a percentage of profits in dividends. For example, at the end of the most recent fiscal year, the cumulative dividends payout for the past five years was £366 million (approximately US$535 million). See Table 3-1.

Table 3-1 Dividends

Fiscal Years	2005	2006	2007	2008	2009	Total
Dividends Payout	£37M	£46M	£91M	£94M	£97M	£366M

Source: Sage 5 Year Summary, 2009

Capital gains are a function of both internal and external factors. The firm has little control over external factors such as the interest rate and other macroeconomic and socio-political factors that may influence the appreciation of the firm's share stock. For example, as interest rates rise, interest-bearing instruments become more attractive. Investors may shuffle the assets in their portfolio resulting in a downward pressure on stock prices. This is therefore outside the firm's control. However, the firm has direct control over internal operations that partially contribute to share stock appreciation. Internally, the firm can increase shareholder value by maximizing profit and this starts with the firm's goals. Figure 3-1 shows the six primary goals of Sage. The six goals reflect a balanced interest in achieving the well-being of shareholders, customers, and employees who are the firm's key stakeholders. The first expressed goal is for the benefit of shareholders. Market leaders can set price instead of being price followers so this goal supports maximizing profitability.

Figure 3-1 Sage Goals

Our Goals
• To be a leading supplier of business management software and solutions to SMEs in the key markets of the world. • To continue to establish products and services that offer the most compelling fit with a customer's country and industry • To have the most satisfied and active customers in our industry • To have the most trusted brands in our markets • To foster a dynamic, vigorous and innovative business measured by our strong organic growth rate • To be the most admired employer in our markets

Source: Sage

3.2 Corporate and Business Values

At Sage, there are five guiding principles that anchor all the goals and ambitions of the firm. The five principles are agility, innovation, trust, integrity and simplicity. All the principles support a culture embracing delivering an extraordinary customer experience. Agility is about anticipating and responding quickly to diverse customer needs. Innovation is rooted in improving the customer experience, products, services, and processes through being open to new ideas, creativity, and constructive exploration. Trust is about continuing to earn the faith customers put in the products and services. Sage products and services such as accounting, payroll, and payment processing sit at the centre of the day-to-day operations of businesses, so trust is vital. Integrity speaks to building trust and loyalty with customers. Customers need to feel that the organization can be relied to keep its promises. Simplicity concerns avoiding overcomplicating the products, services, business processes and generally the way the company does business.

These principles are central to how employees in the organization think and make decisions; they also form the basis to evaluate employee performance. See Figure 3-2.

Figure 3-2 Sage Principles

	Agility When customers need our services, we have to be ready and responsive, anticipating and interpreting their needs.
	Innovation We are always thinking about how we can improve the customer experience. Every aspect of how we work can benefit from creativity. We are open to new ideas and to exploring them constructively.
	Trust Our customers need to know and believe that we are on their side, that we are there to help them run a better business and that the advice we offer and the services we provide are in their best interests.
	Integrity Keeping promises is vital in building trust and loyalty with our customers. Whether it's as simple as telling someone you'll do something and then doing it or providing reliable, quality products on time to the marketplace, integrity is central to maintaining our credibility.
	Simplicity Few people enjoy complexity and bureaucracy, least of all people who have their hands full in actually running a business. Maintaining simplicity in a complex and challenging world can be hard, but we believe it is vital.

Source: Sage

Anchored by the Sage Principles, there is a cultural transformation occurring around delivering an extraordinary customer experience (ECE). A chief customer officer, reporting directly to the CEO is the executive sponsor for ECE. The shared goals of ECE are to drive business value through increasing customer satisfaction and loyalty. It also serves to standardize and cement a common shared set of organizational values as envisioned in the same brand promise (Figure 3-3). All employees at Sage attended company workshops on ECE. These workshops where hosted by senior executives demonstrating their importance to the organization.

ECE outcomes are in official employee performance measurements, fun activities and every decision the company makes. It is the company's way of doing business.

Figure 3-3 The Sage Brand Promise

We believe the Sage Experience should be extraordinary. We believe this is the way we will win in the market. *It is our state of mind. It is about doing the basics really well and seeking out opportunities to go above and beyond for customers.* *It is about creating an experience that customers feel compelled to share with others, it is about creating a memory, a lasting impression, that leaves customers feeling fantastic about Sage.*

Source: Sage

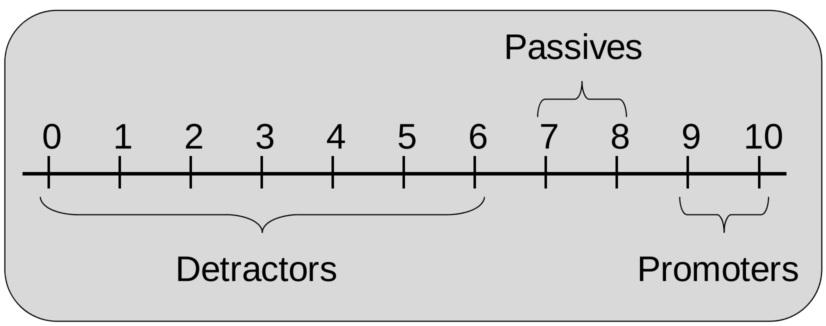
Supporting ECE is a popular metric for assessing customer loyalty. Fred Reichheld in his customer loyalty book, *The Ultimate Question: Driving Good Profits and True Growth*, describes a way to track customer loyalty and satisfaction using the net promoter score (NPS) system (Reichheld, 2006). NPS provides a key indicator of customer retention, repurchase and referral, which drive business growth and profitability.

In the NPS system, customers are asked to rate how likely they are to recommend the company on a zero-to-ten point scale as shown in Figure 3-4. Customers who score nine and ten are promoters or evangelists of the brand. They talk about the company's products and services, repurchase and persuade others to try the product over the competition. They are loyal and extremely satisfied customers who help the company to attract new customers. Customers who score seven and eight are passive. They are content, but they are not active in helping the business to attract new customers by recommending its products and services to friends and colleagues when given the opportunity. They may also switch if they get a strong recommendation to the competition. Scores lower than seven are detractors. These customers are not happy about something and are at a risk of defecting. They may dislike the company and are only still using the product because the switching costs are too high. Some are so bitter that they will actively discourage others from using the product. The NPS score is determined by subtracting the percentage of detractors from the percentage of promoters.

Figure 3-4   Net Promoter Score

The Ultimate Question

How likely is it that you would recommend this company to a friend or colleague?



NPS = % Promoters - % Detractors

Source: Adapted from Frederick F. Reichheld, The Ultimate Question, 2006

In the Simply Accounting business unit, each month, customers using the product complete a survey that captures the data to calculate the NPS. Currently, internal surveys show Simply Accounting is achieving a score of 46%. Externally, Satmetrix is an organization that tracks NPS for various industries. In March of 2010, Satmetrix released its 2010 Net Promoter Industry Benchmarks report. This report surveys customers in various industries to determine their level of satisfaction and loyalty to a sample set of popular brands. In technology, Apple leads the overall industry with the highest NPS of 78%. However, in the consumer software sector, Adobe leads with only 37%, followed by Intuit and Symantec tied with 36%. At 46%, Simply Accounting is clearly in an industry leadership position.

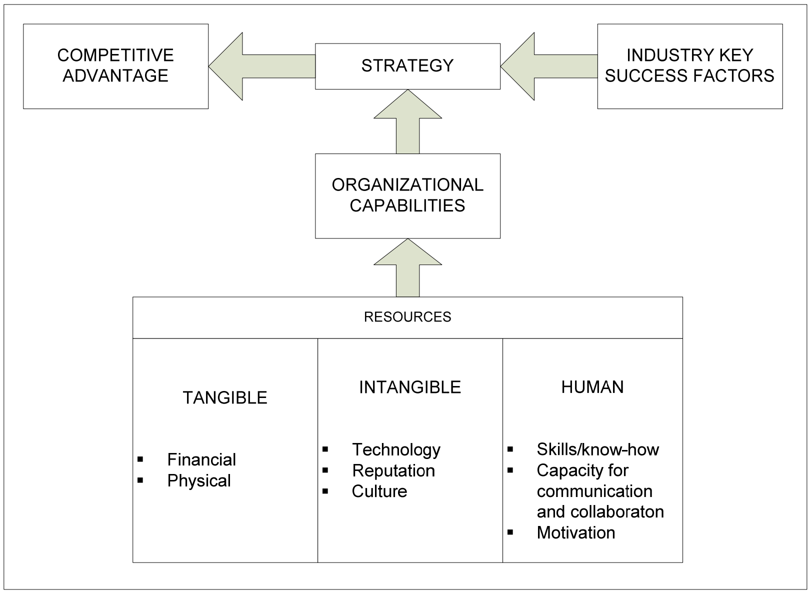
3.3 Internal Resources

The firm's resources are its tangible, intangible, and human resources that deploy daily to achieve its goals. Tangible resources are things such as financial and physical assets. Intangible resources are in the firm's technology, reputation and culture. Human resources include the firm's employee skills and the management and leadership. Within these resources lie the firm's competitive advantages. However, the path from resources to competitive advantages is not always quite clear. Figure 3-5 illustrates the links among resources, capabilities and competitive advantage.

Resources are the building blocks for the organization's capabilities. There is not necessarily a one-to-one relationship between resources and capabilities. A capability can be a unique firm level combination of its resources. In addition, not all of the organization's capabilities contribute to competitive advantages. Competitive advantages are capabilities that contribute to making customers choose the firm's product over the competitor's product.

Customers do not equally value all capabilities. There are even some capabilities, which customers do not value. However, most capabilities help to 'play in the game' while others 'help to win'. Examples of capabilities that help to play in the game are customer service, technical support, and product quality. All firms require excellence in customer service, technical support, and product quality in order to retain customers. Without these capabilities, firms simply would not be able to compete in the market. Both Sage and Intuit charge the same price for technical support demonstrating the absence of differentiation at this level. In addition, Intuit outsources some of these operations. An example of a capability that helps to achieve competitive advantage is the firm's multi-lingual operating skills. That capability is highly valued by customers in Quebec and contributes to Sage having over 90% of the local market share.

Figure 3-5 Resources, Capabilities, and Competitive Advantages



Source: Robert M. Grant, Contemporary Strategy Analysis, 2002

To determine which organizational capabilities flow through to competitive advantages for the firm, we need to consider the industry key success factors. The success factors are essentially the buyers' value criteria in choosing a product in the market. They are at different stages of the sales process. At the pre-sales stage, recommendation and brand awareness are key success factors. This means buyers tend to choose a product base on what they heard about it or whether or not they are familiar with the brand. At the sales stage, presence and effective promotion in the retail channel are the key determinants of success. The success factors in after-sales serve to prevent customers from switching to the competition. See illustration in Figure 3-6.

Figure 3-6 Key Competitive Success Factors

Source: Author

3.3.1 Tangible Resources

The firm has very strong financial resources and a solid balance sheet. In March, Sage issued US$300 million in US Private Placement loan notes. The funds will refinance some debt instruments previously employed to diversify the capital structure. Physical resources are low but since the company is in the software business, physical resources do not play a big role. Overall, from a competitive assessment point of view, Sage has adequate financial resources to maintain the business and attract additional funding for expansion, if needed.

3.3.2 Intangible Resources

From a technology standpoint, the first observation is Sage does not have any notable commercial patents. There are no significant revenues attributable to royalty income. However, since the source code is proprietary, it enjoys a small degree of protection from appropriation. A very high percentage of the technology is older than 10 years, which is not good. It is in fact a major area of internal weakness. Concerns raised by the product development group suggest features take too long to develop because they are compelled to use old technology. They refer to this as an escalating ‘technical debt’. Microsoft released the .Net Framework development tool in 2002, which provided significant savings in development since libraries of pre-built functionality was readily available to software developers. Some of the functionality would take weeks or months to create in the old Visual Studio C++ development environment. However, Sage did not take advantage of this development environment for five years and continues to under utilize the benefits available in this development environment. In the fast moving high technology industry, old technology is a liability exposing the firm to potential disruption from newer and more efficient technology. In spite of this overall vulnerability in the Sage technology portfolio, Simply Accounting has unique strengths in being a multi-lingual product with multi-currency capabilities. Customers value this, and the competitor does not have it. Simply Accounting therefore enjoys a competitive advantage in the small business market.

Sage enjoys substantial business unit level brand awareness in its portfolio to buttress against competitive forces. Unaided brand awareness for Simply Accounting is higher than QuickBooks in Canada. However, Sage and Intuit corporate have low brand awareness. Intuit has consumer brands such as Quicken and QuickTax with high brand awareness. Many consumers think of Quicken and QuickTax as accounting software even though they are for personal finance and tax respectively. It is not clear if the brand awareness of Quicken and QuickTax complements the awareness of QuickBooks. There are examples of cases where multiple brands under the same corporate portfolio complement each other in brand awareness and cases where they do not. Procter & Gamble products brand awareness does not rely on a corporate brand to connect the brands. In contrast, Microsoft's corporate brand awareness exceeds its individual product brands and therefore complements them. However, neither Intuit nor Sage has strong enough corporate brand awareness to effectively bridge and connect their individual brands.

3.3.3 Culture & Human Resources

The culture at Sage places a high emphasis on satisfying the needs of existing customers. A core value is to be customer led and not product driven. The resulting above industry average net promoter score is a reflection of the importance the culture places on serving existing customers. This value contributes to customer retention by preventing existing customers from switching to the competition. Customer loyalty also results in increasing revenues from upgrades, service contracts, and referrals. The only downside is existing assets are overtaxed and slow to replenish since the company avoids product innovation and staying current with technology advancements. Nevertheless, existing customers are happy with the incremental enhancements. The weakness is observable in the failure to attract large numbers of new customers and the inability to reinvent the value delivered in order to gain customers who are using substitutes.

From a human resource management point of view, Sage employees, management, culture and values align to utilize human capital effectively. Employees are motivated and have the tools and resources to do their jobs. They are also highly skilled knowledge workers with predominant expertise in accounting, business and software engineering. Average tenure is well over 5 years; and, the attrition and turnover rates are very low. The culture and values support delivering extraordinary customer experiences, which develops customer loyalty. Management is disciplined and fiscally responsible about investments. There is not a lot of waste since investments are customer driven. Furthermore, because the company does not undertake risky research and development projects, returns are generally stable and predictable.

3.3.4 Resources Summary

At the base of a firm’s competitive advantages are its actual resources. Sage has strong tangible resources with close to £300 million in cash from operating activities. There is strength in the intangible resources with some signs of weaknesses coming from old technology, and low corporate brand awareness. The culture highly values satisfying the needs of existing customers, often times to the detriment of acquiring new customers. The predominantly knowledge worker employees are highly skilled, motivated, and committed to the organization. Management exercises fiscal discipline in operations, thus ensuring profitability. Table 3-4 summarizes the inventory of Sage's resources. See Exhibit A for a comprehensive list and analysis of the resources.

Table 3-2 Resources Summary

Resource Classification	Resource Type	Performance Consideration	Competitive Impact
Tangible	Financial	£289.5M from operating activities	Strength
	Physical	5% of Assets	Irrelevant
Intangible	Technology	Old code Multilingual, multicurrency product	Some weaknesses, some strengths
	Reputation	Low Sage brand awareness High Simply Accounting brand awareness	Some weaknesses, some strengths
	Culture	High focus on existing customers Low focus on new customers	Some weaknesses, some strengths
Human Resources	Employee	High percentage of employees with accounting designations, business and computer science degrees Low turnover	Strength
	Management	Balanced, principled and strong customer centric vision, Risk averse (prudent)	Strength

Source: Adapted from Robert M. Grant, Contemporary Strategy Analysis, 2002

3.4 Competitive Advantages in Core Capabilities

The resources where assessed to identify strengths, weaknesses and areas which have no impact on the competitiveness of the firms. The resource strengths enable the firm's capabilities.

Capabilities result from the interaction of multiple resources and the learning and experience of the firm over time. For example, Sage has a core capability in managing relationships with accountants and bookkeepers. This kind of relationship takes several years to develop. It involves systems, programs, common values, product development responsiveness and talented resources responding to the needs of accountants and bookkeepers. Today, at the annual accountants and bookkeepers' convention, the close connection with the firm is easy to observe; but it is not easy to reproduce. Despite repeated attempts, Intuit is not able to create a similar bond with its accountants and bookkeepers.

Table 3-5 outlines selected capabilities contributing to competitive advantages. All of these capabilities deliver value to customers and align with the key success factors for the market. Customers choose Sage instead of the competition because of one of these capabilities. For example, they may choose Sage because of a recommendation, which is often the case. The recommendation results from Sage's capability in supporting and developing its influencer channel (primarily accountants and bookkeepers) but may also include educators.

Table 3-3 Core Capabilities

#	**Core Capabilities**	**Competitive Advantage Characteristics**
1	Relationship management of Influencer channel	Sustainable, Unique, Replicable
2	Relationship management of retail sales channel	Sustainable, Replicable
3	Brand management	Sustainable, Replicable
4	Rapid development and release of product increments	Sustainable, Replicable
5	Accounting software development skills	Sustainable, Replicable
6	Multi-lingual operating skills	Sustainable, Unique, Replicable
7	Building customer loyalty	Sustainable, Replicable

Source: Author

Strategic assets are competitive advantages with three core characteristics: sustainable, unique, and replicable (Boardman et al, 2004). Sustainable means the competitive advantage is not prone to imitation or appropriation. The competitive advantage can withstand the test of time and any challenge from the competition. Unique means the competitive advantage is one of a kind in the market or rare. It is not something that the competition also has. Replicable means the advantage can apply to other markets or industries. All the competitive advantages shown in Table 3-5 contain at least two of the characteristics. However, only relationship management of the influencer channel and multi-lingual operating skills embody all characteristics of a strategic asset. A strategic asset is a firm's most valuable competitive weapon.

3.5 Unintended Consequences of Core Capabilities

Although capabilities are the key contributors to a firm's success, it is also important to recognize that capabilities pave the way for excellence in one area while destroying capability in another area. Most people will agree that a company will eventually go out of business if it does not listen to its customers. Therefore, customer satisfaction is vital and companies are correct to develop the capabilities to focus on the needs of their existing customers. However, a less known fact is that companies can also go out of business for not listening to consumers who are not their customer (Christensen, 1997). Core capabilities can become core rigidities when they act as blinders limiting the organization's pursuit of creativity in uncovering and solving market problems (Leonard-Barton, 1995).

Consider Sage's capabilities in sound fiscal management that drives its strong year over year dividend yield for shareholders. Some of the resources driving this capability are risk-averse managers and research and development focus on "sure" customer needs as determined in customer surveys and customer idea suggestions. This capability ensures a generous return for shareholders from satisfying the needs of existing customers. It is tempting to think that there is no potential for harm with this capability since it is so intuitive. However, it has dangerous implications for the longevity of the business. It weeds out innovative and high risk ventures, which could yield high returns. In this regard, it turns into a source of rigidity for the firm – exposing it to a high risk of disruption.

Continual technology innovation is the only known organizational immunity for disruption in a technology-based business. Even though Sage has strong financial resources and capabilities to acquire external innovators, after commercial success, this is likely to become more and more difficult to do in the future. New technology diffusion is increasing at an astounding rate with the help of new media. Radio took 38 years to reach 50 million users; TV took 13 years; and the internet took 4 years. Facebook reached 100 million users in 9 months. Market valuation followed closely. The key point is a break-through innovation could now take less than 2 years to reach critical mass. At critical mass, the market valuation would dwarf Sage. Therefore, the strategy of acquiring for growth is not likely to work in the future. Developing and commercializing technology-based innovation is vital for longevity in technology-based industries.

3.6 Organization Structure

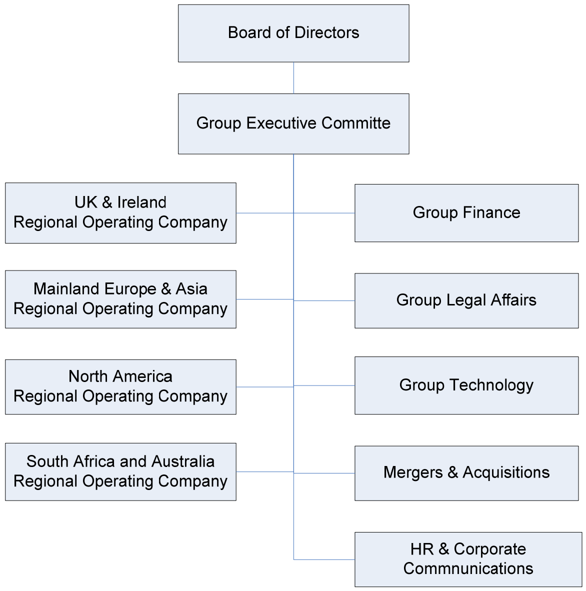
There are four main strategic levels within Sage –business unit, division, regional operating company, and group. All employees operate within one of these units directly or indirectly in a supporting role. The primary strategic unit is the business unit which is directed by a general manager. The next strategic entity is the division, and it consists of multiple business units or a single business unit with a disproportionately large revenue opportunity. Business unit decisions may occur at both the business unit level and the division level. If the decision is made at the division level, it is usually to align the business unit with the overall goals and objectives of the division’s product portfolio. The regional operating company consists of multiple divisions operating within a geographically close or similar region. Its primary function is to coordinate and control the divisions and drive growth in overall performance through operational excellence. The group level is the highest strategic level in the organization and it overseas the operations of the company as a whole.

Sage Group is structured as a conglomerate of highly autonomous regional operating companies. The structure supports a great focus on empowering local management to meet the needs of customers in their local markets. The group is controlled by an executive committee, led by Paul Walker, chief executive. The executive committee is responsible for overseeing the management of all Sage operations. Paul Walker further describes the role of the executive committee as follows:

> The Executive Committee is responsible for the development and implementation of strategy, operational plans, policies, procedures and budgets; the monitoring of operating and financial performance; the assessment and control of risk; the prioritisation and allocation of resources and the monitoring of competitive forces in each area of operation.
> --Paul Walker, Sage Chief Executive

This committee consists of chief executive officers (CEO) from the regions and group executives for finance, legal, mergers and acquisitions, technology, human resources and corporate communications. A CEO sits at the head of each of the four regional companies: UK & Ireland, Mainland Europe & Asia, North America, and South Africa & Australia. See structural illustration of the group in Figure 3-7.

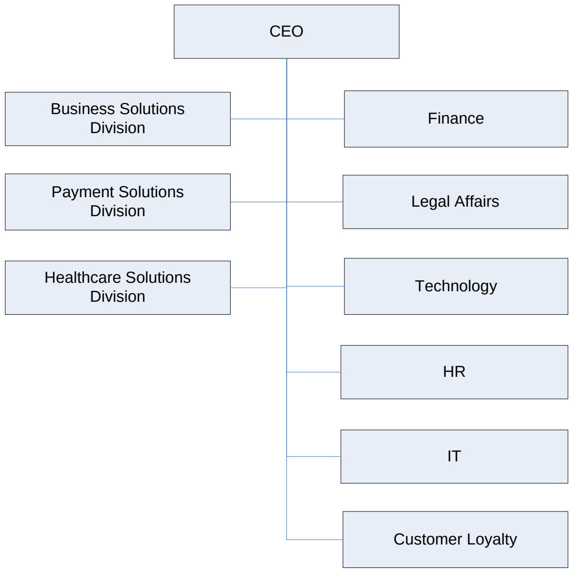
Figure 3-7 Sage Group Structure



Source: Author

The regional company CEO has autonomy over business strategy, administration, finance, development, sales and marketing for the region. Sue Swenson is the CEO of the Sage North America regional operating company. She structured the company as a divisional matrix organization with three divisions – Business Solutions, Payment Solutions, and Healthcare. Each division is led by a president. Sage North America also includes a unit for Information Technology and Customer Loyalty. The Information Technology unit oversees the consolidation and standardization of the company's networking infrastructure, desktop computer and servers, data storage, telephone, productivity tools and help desk. The Customer Loyalty unit focuses on customer retention and standardizing policies and procedures to ensure the culture embraces delivering consistently good customer experiences. Some functions common to both the group level and regional operating company level are: Finance, Legal Affairs, Technology and HR. These functions operate within a matrix structure with direct reporting to the regional operating company CEO and dotted line reporting to group level executives. See structural illustration of the regional operating company in Figure 3-8.

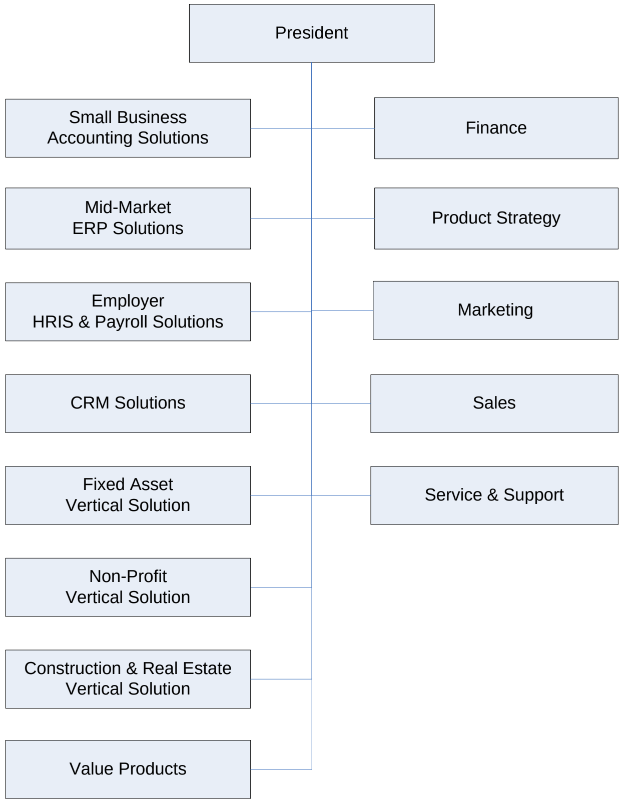
Figure 3-8 Sage North America Regional Operating Company Structure



Source: Author

Each division is led by a president. Jodi Uecker-Rust leads the Business Solutions division. Her division differentiates between strategic and value products. Strategic products are products with high growth potential or products in mature markets but with significant value if their lifecycle could be prolonged. Value products are mature products in declining markets. Value products are simply being harvested for as long they can generate revenues above the cost of supporting them. Within the strategic group are horizontal solutions for small business accounting, mid-market ERP, human resource information management (HRIS), and customer relationship management (CRM). There are also vertical solutions for Fixed Asset Accounting, Non-Profit fundraising and accounting, and accounting and project management solutions for the Construction and Real Estate market. The products in the division are supported by division level support functions for finance, product strategy, marketing, sales, service and support. Employees within these groups will typically have a direct reporting relationship with a leader in the functional area and dotted line reporting to the general manager of the product's business unit. See structural illustration of the division in Figure 3-9.

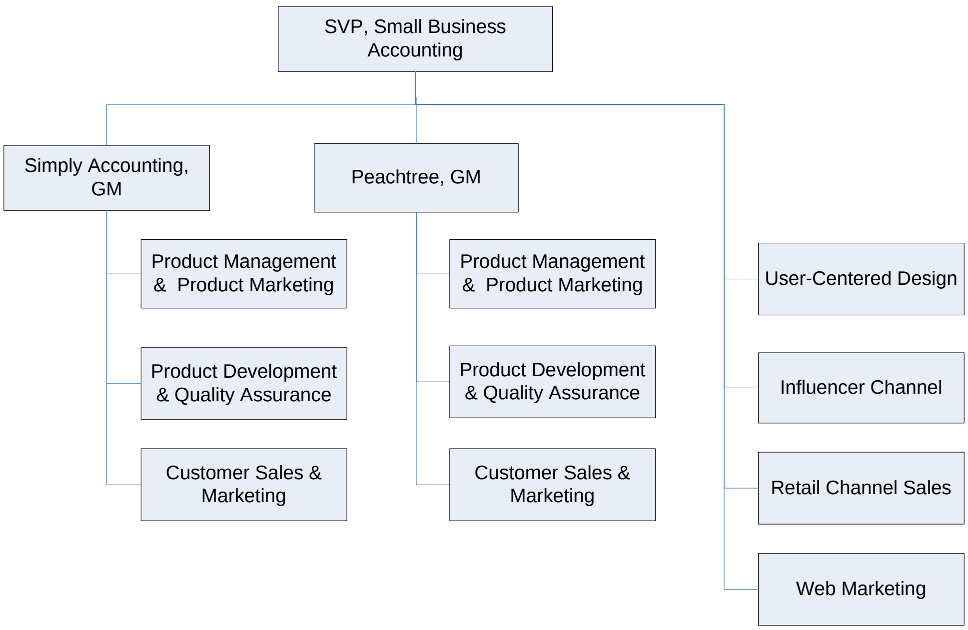
Figure 3-9 Business Solutions Division Structure



Source: Author

The small business accounting solutions business units consists of two separate business units: Simply Accounting and Peachtree. Connie Certusi, senior vice president, oversees both units. Simply Accounting focuses on the Canadian market and Peachtree is for the US market. Each business unit is led by a general manager. Jamie Sutherland leads the Simply Accounting business unit and Connie Certusi leads the Peachtree business unit. Structurally, the products are expected to stay within their geographic boundary. However, Simply Accounting has been looking at expanding into the US market by carving out a niche in the Hispanic market. The general manager for a business unit typically has multiple direct and dotted line reports. Direct reports typically include product management, product marketing, product development, quality assurance, user centred design, and channel sales. Dotted line reporting relationship will exist for service and support, public relations, legal, and a myriad of other functions typically referred to as “shared services”. See Figure 3-10 for the structure of the business unit. For simplicity, dotted line relationships are not represented.

Figure 3-10   Small Business Accounting Business Unit Structure



Source: Author

The relationship dynamics between Peachtree and Simply Accounting has important strategic implications. Despite having the product capabilities to compete in the US market, Simply Accounting retreated from the US market following the Sage acquisition to avoid having two Sage applications competing in the same market. The approach was to consolidate investments in attacking QuickBooks with one product instead of two. However, this approach is not working. Peachtree continues to lose ground against QuickBooks. Its market share is languishing at 2%. A new approach is required. Recently, a business case was approved for Simply Accounting to re-enter the US market and focus on the Hispanic vertical. Despite this change, Simply Accounting will remain constrained in how far it can go in the US market without a clear approach for alignment with Peachtree.

Chapter 4: Sage Business Level Strategies

Strategy links the firm with its environment. Drawing on the internal and external analysis, this chapter describes the optimal strategies for Sage. The ultimate goal of all business strategies is to be profitable. The strategy hierarchy provides a context to frame the various strategies that firms may pursue to secure profitability.

Business level strategies have two categories – one for creating profits and the other for protecting profits. Creating profits is about finding and developing profits in existing and new markets. Protecting profits refers to securing the profits that firms are currently enjoying from existing customers.

In existing markets, firms seeking to achieve superior profitability can pursue one of two generic strategies – differentiation and low cost leadership. Applying scope, broad focus or narrow focus, as a dimension to these strategies reveals a set of four possible strategies. However, since some firms are more concerned with a risk-adjusted rate of return above the cost of capital rather than superior profitability, they may pursue other strategies or a hybrid of the generic strategies.

While some strategists only consider the context of creating profits in existing markets, strategy is also very relevant for creating profits in new markets. The blue ocean strategy describes techniques for creating profits in new markets.

4.1 Strategic Assessment of the Current Situation

The firm's external context shapes competitive markets strategy. The two main competitive forces in the external environment to contend with are the internal rivalry and the threat of substitution. There is some buyer power as well, but this is chiefly from the strength of the substitutes. The other forces are mild to low in impact. See summary in Table 4-1. Requirements for the external environment are to recognize and align with the existing power of the substitutes. Firms should avoid making them more powerful by doing things that make customers want to switch. Seek to diminish their power where possible. And avoid aggravating the competition and increasing the intensity of rivalry because this will only destroy profitability. Since there are only two firms, tacit cooperation can contribute to increasing industry profitability.

Table 4-1 Five Forces Summary

Force	**High Impact**
Potential Entrants	No
Buyers	No
Suppliers	No
Substitutes	Yes
Rivalry	Yes

Source: Author

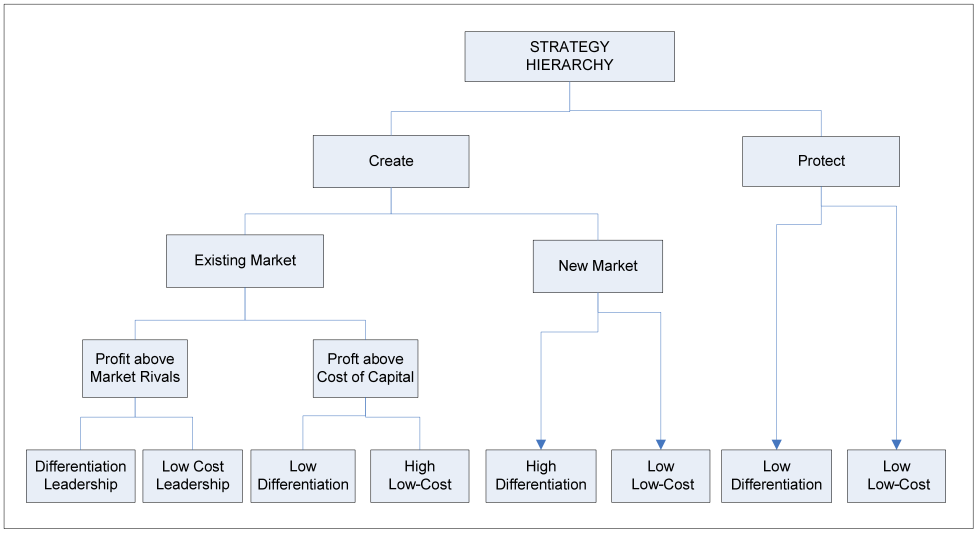
Sage is a profitable company. This clearly validates past competitive market strategies. In Canada, among its resources and capabilities, a core competency lies in managing the influencer channel. However, few companies would fail if past strategies guaranteed future success. In keeping with the ominous warning from Jack Welch, former chairman of GE, companies must learn to change before they have to. It is time for Sage to heed this warning. The threat of disruption from the internet is becoming more real, and core rigidities of the firm discourage technology innovation.

Despite having a strong balance sheet, there are some signs of vulnerability from overtaxing existing assets. Simply Accounting is a strategic growth product, yet a large percentage of the code base is older than 10 years. To illustrate, lets consider changes in Microsoft's Operating System code base over the past 10 years. Windows XP spawned from the solid Windows 2000 code base. Later a rewrite of Windows XP created Windows Vista. Vista paved the foundation for the now popular, robust and modern Windows 7. In contrast, Simply Accounting uses mainly Windows 2000 technology with functionality bolted on over the past 10 years. Over the past three years ago, it migrated to the mySQL database and converted one module to the latest development framework. However, despite these promising recent improvements, the technology is getter older faster than the company is acquiring core new age technology, thus escalating what development refers to as the 'technical debt'.

For an established business such as Sage, the two primary considerations are to create and protect profits. See illustration in Figure 4-1. Creating profits is a firm's offensive strategy. This is the firm's drive to gain new ground. Chief among Sage's offensive strategies are Billing Boss and First Step, which all target the low end of the small business market. In addition, there is also Simply Accounting Enterprise, released in 2007, which attacks the low end of the mid-market. However, perhaps the most important offensive strategy is the Spanish version of Simply Accounting and the expansion into the Hispanic market in the US. These products manifest strategies to attract new customers to the Simply Accounting franchise.

Protecting profits is a firm's defensive strategy. This is the firm's self-perseveration mechanism. It kicks in to safeguard existing assets. Some of Sage's defensive strategies are activities in building customer satisfaction and loyalty. For example, programs for tracking net promoter score and delivering extraordinary customer experience contributes to customer retention and repeat business.

Figure 4-1 Strategic Hierarchy



Source: Author

Creating profits rely on two approaches. One approach is in developing a new market, and the other is in defeating rivals in competitive battles in an existing market. The first approach derives profits from an attractive new market with minimal or no competition. Firms have to create and develop this market. Product differentiation is high in these new markets, but costs will not be as low as in an established market. Firms must innovate to access this source of profitability. The rate of failure is often very high. It is the path least travelled by established businesses and most feared. Only a few businesses have developed consistently repeatable and successful strategies for navigating this path. For example, Apple and Procter & Gamble are innovative companies that create new markets and earn hyper-profits for doing so. With a number of unsuccessful attempts, Sage has an unremarkable record of creating new market opportunities. This has served to curtail investments in innovation and affirm the historical dominant strategy of acquiring successful businesses instead of trying to create them (See Appendix A for list of Sage Major Acquisitions).

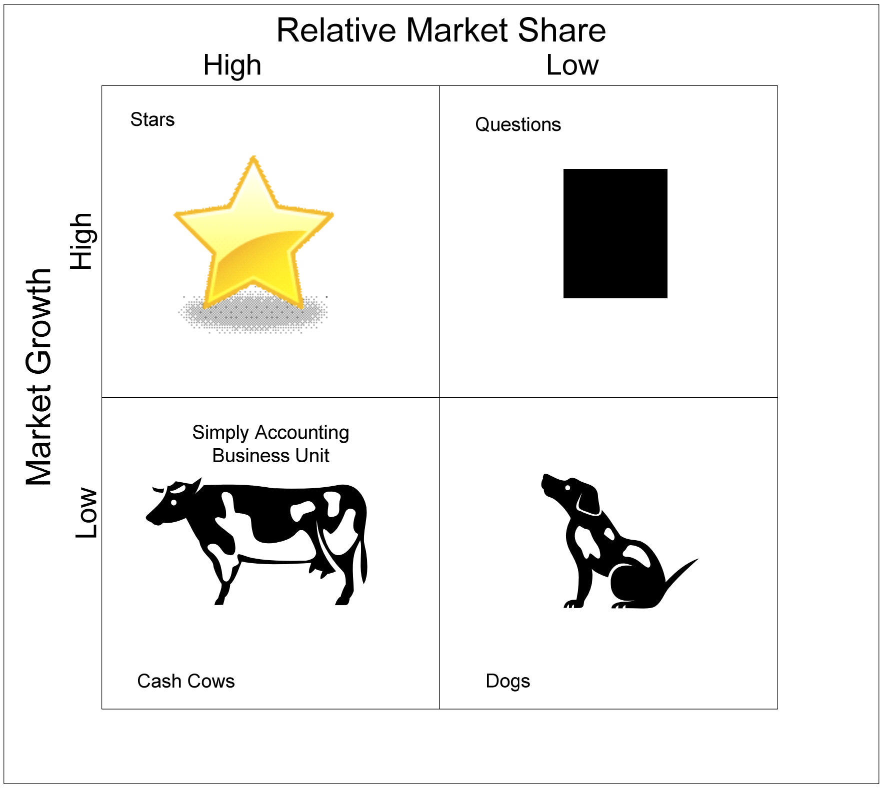
The second approach in creating profits comes from competitive advantages over rivals in an existing market. Firms may seek to establish a leadership position by earning superior profitability or they may only aim for profits above their cost of capital. Superior profitability specifically means earning more profits than the competition and it requires either a differentiation leadership position or a low cost leadership position in the industry. Leadership in differentiation or cost comes at a heavy price particularly for diversified businesses operating in multiple markets. Instead, most firms focus on achieving a level of profit above their cost of capital. To do so, they keep their costs as low as possible and provide some differentiation. It is often easier to lower costs than to create valuable product differentiation that commands a premium above market rate. A review of the 2010 Fortune 500 lists shows that most diversified companies aim for profits above the cost of capital rather than superior profitability. Sage is similar; it is neither a leader in differentiation nor a low cost leader. The dominant existing market strategy is to keep costs low and provide some product differentiation to realize a profit above the cost of capital.

Firms focussed on protecting profits will seek to keep their costs low and offer low differentiation. The goal of this strategy is to keep customers happy and prevent them from switching to the competition. Therefore, it is important to keep costs low and pass savings on to the customer. Differentiation – in the true sense of being able to command a price premium – is low since the firm fears losing customers. This strategy puts a premium value on keeping customers above any other consideration; internal programs emphasize customer loyalty and customer satisfaction. Charging a price premium may be feasible but the firm may choose not to exploit the opportunity. Sage extensively utilizes strategies to protect profits. It does this very well which is the primary contributor to its stable and predictable performance. However, the strategies around protecting profits may supersede other profit making strategies and contribute to some strategic inertia where bold moves do not get beyond the brainstorming stage. For fear of losing customers, there is avoidance of high risks. And since risks and rewards are inextricably interlinked, risk avoidance results in sub-optimal rewards.

From the strategic hierarchy, we know there are multiple dimensions to how firms may pursue sustaining profitability. The goal is to create strategies to create and protect profits. However, they all boil down to some level of differentiation, or cost reduction. Focussing on differentiation and/or lowering cost vary from firm to firm. Sage's dominant strategy with Simply Accounting has minimum differentiation and some cost reduction. This strategy evolved from the realities of what is important to the business for creating and protecting profits. It has been so successful for Sage in the past that it is not likely to change without a tectonic jolt to the organization.

Another perspective on Sage's choice of strategy is the corporate portfolio management view of the Simply Accounting business unit. Bruce Henderson from the Boston Consulting Group (BCG) developed a popular portfolio management matrix for comparing businesses base on the relative strengths of their competitiveness in their markets, and the overall industry attractiveness. Market share demonstrates relative competitiveness and market growth signals industry attractiveness. Known as the BCG Growth-Share matrix, it places businesses into four quadrants. See illustration in Figure 4-2. Simply Accounting is in the low growth, high market share quadrant.

Figure 4-2 BCG Growth-Share Matrix



Source: Adapted from Bruce Henderson, Boston Consulting Group

Businesses in the low growth, high market share quadrant are '*cash cows*'. They are assets to protect and harvest. They are difficult to change, because they have a lot of history and traditions that customers expect to continue. As a result, Simply Accounting is not going to implement any radical game changing ideas. However, there are some opportunities within existing markets and new markets to explore.

4.2 Strategies for Profitability in Existing Markets

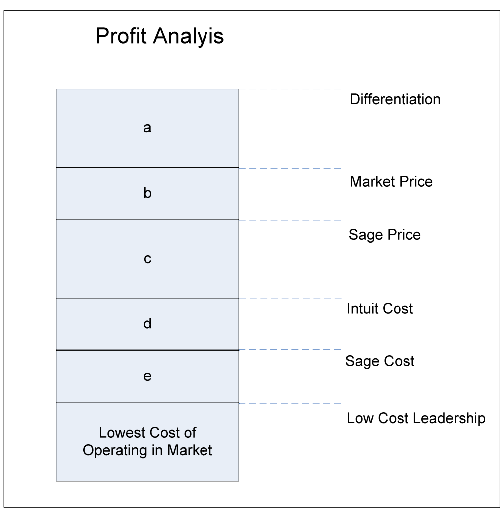
According to Michael Porter, there are three generic strategies for existing markets – differentiation, low cost leadership and focus (Porter, 1980). The focus generic strategy can occur with differentiation within a segment or with low cost leadership within a segment. In Porter's view, these generic strategies are the only way to achieve superior profitability. They form a strategic canvas that encapsulates the entire strategic options available to the firm. In his template for strategy, Porter further argues that the goal of the strategy should be to create a sustainable and favourable market position for the firm. Firms should pick a single specific strategy and use it to drive all business decisions. All the organization activities should align with the selected strategy. Everything the firm does should ‘fit’ in a complementary way. A key result of this particular strategy is the firm ends up having so many activities aligned with the strategy that it is difficult to imitate. This is a brilliant strategy and firms that can do it should do it. New businesses will want to consider this strategy and build the business with it in mind. However, established businesses such as Sage will find significant hardships and revenue risks in switching to Porter’s strategy.

Porter’s strategy is neither suitable nor practical for the Simply Accounting business unit, especially when you consider Porter’s prescriptions for execution that call for a singular approach. Nevertheless, the core concepts are still very useful and can be adapted to create a new strategic canvas. Strategy does not have to be a black and white decision between commanding a price premium (differentiation) and lowering cost, but instead can be a degree of both. Simply Accounting currently focuses on delivering both low cost and some product differentiation. The business keeps a tight reign on costs, while also driving growth in product differentiation. This generic strategic context best describes the strategy of both Simply Accounting and QuickBooks. Some strategists will lament that this is futile strategic convergence (Hamel, 2002). However, so far the firms have been extremely successful with this strategy. Furthermore, the duopoly nature of the market keeps strategies in check. As a result, a brilliant strategy that threatens to change the balance of power will draw attention and the rival firm will swiftly imitate it.

Simply Accounting should maximize profits by exploiting its strategic context. Under most circumstances, increasing buyers willing to pay a higher unit price or lowering unit costs will contribute to increasing profit per unit. A low cost leader and a differentiator therefore operates at the two opposite ends of the value spectrum. The cost leader is active at the beginning with the least average per unit cost of operating in the market. The differentiator is active at the end of the spectrum with the highest buyer willingness to pay price. Great value is realizable for firms able to operate at these extremes, however significant value is still available for firms operating in between, especially when no firm is actively operating at one of the extremes.

If a firm operates as a low cost leader in the market, it would face the lowest cost of operating in the market. At the lowest cost, the firm would be able to take of advantage of the maximum value available in the market. Altogether, there are five value add above the minimum cost of operation in the small business accounting software market. Figure 4-3 illustrates the value spectrum from low cost leadership to differentiation with intermediate value areas *a*, *b*, *c*, *d*, and *e*.

Figure 4-3 Small Business Accounting Software Market Profitability Analysis



Source: Author

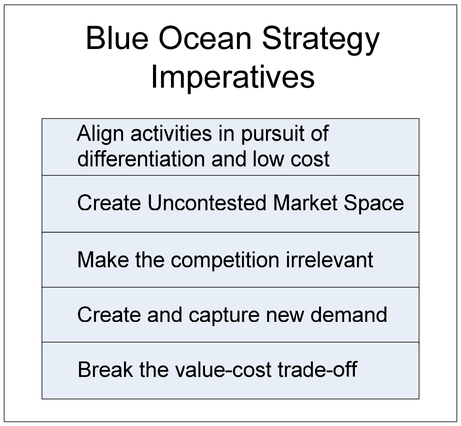
Value area *e* represents Sage's cost of operating which is below Intuit (value area *d*), but above the lowest possible in the industry. Value areas *c* and *d* combined contribute to Sage's profit. Value areas *c* and *b* contribute to Intuit's profit. Intuit is more profitable if area *b* is larger than area *d*. Observe here that Simply Accounting price is below the market price. Intuit's price is at the market price. In addition, no firm is enjoying a price premium (value area *a*). The immediate opportunity for Sage to affect profitability is to access value areas *a* and *b*. Value area *a* will be the most difficult and so the company should start with value area *b*. Accessing value area *b* is not simply a matter of raising pricing. It is also about raising buyers willing to pay for the firms product at the market price instead of the below market discount they have been used to. Increasing buyer's willing to pay will include augmenting the product's value proposition with real value desired by customers at a cost less than the benefit gained from the price appreciation.

4.3 Strategies for Profitability in New Markets

Modern technology is a driving force reshaping and resetting the boundaries of many industries and their markets. For example, the recently released Kindle creates a new niche for consuming written material. The even more recent iPad creates a new niche in personal computing. Great fortunes await the innovator. If only for a short time – ten to 15 years - before attracting competition and being forced to share the profits, companies can profit from being the first to establish a market. Blue Ocean Strategy (BOS) explains some of the fundamental concepts and techniques for developing new markets (Kim & Mauborgne, 2004). Kim and Mauborgne identified two ways to create new markets: create an entirely new industry or revise the value curve within an existing industry. Whichever the way chosen, new market development is a profitable strategy. Kim and Mauborgne found from a study of business launches in over 100 companies, that while only 14% of the launches were new market development strategies, they delivered 38% of revenues and 61% of total profits.

Five core concepts capture the essence of the approach with BOS. See Figure 4-4. These principles embody the essential requirements for creating a BOS. They summarize what firms need to do to implement BOS and thereby provides the criteria for evaluating if a firm is pursuing a BOS. We will now consider utilizing each of these concepts to formulate a BOS for Sage.

Figure 4-4 Key Concepts of the Blue Ocean Strategy



Source: Adapted from W. Chan Kim and Renee Mauborgne, Blue Ocean Strategy, 2005

The first concept is about alignment and fit of all activities to achieve both differentiation and low cost. Alignment of activities creates a formidable barrier to imitation because it is difficult for a potential new entrant to the market space to copy a whole system of activities. This concept also applies to strategic positioning in competitive markets. With BOS, alignment of the business activities achieves both differentiation and low cost. Aligning all of Simply Accounting activities would be extremely difficult since the company has significant assets to protect in existing markets. As a result, Sage would not be able to implement this aspect of BOS.

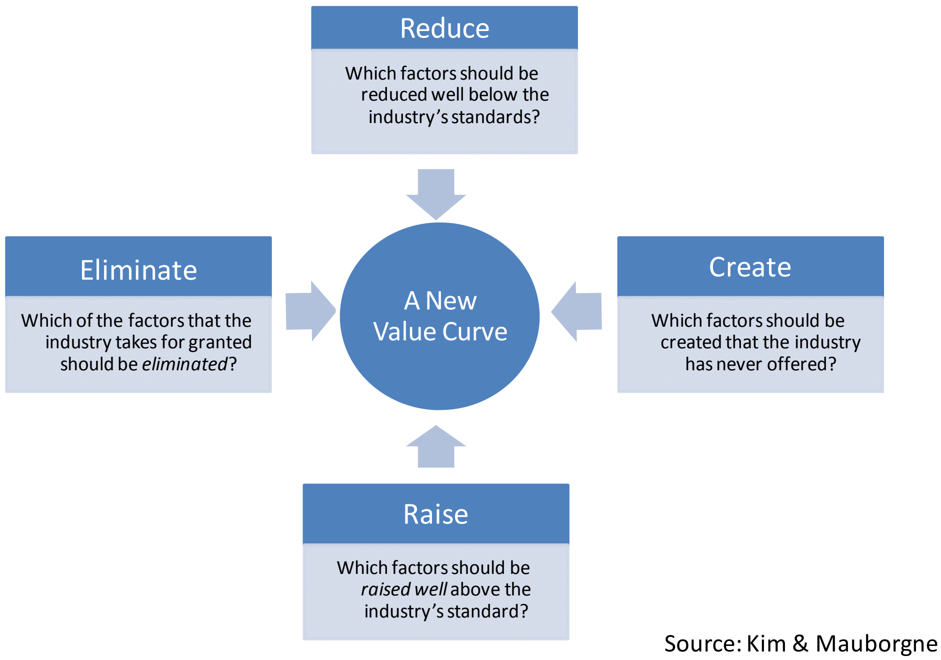
The second concept suggests creating a new niche that no competitor is currently serving instead of competing in an existing market. Sage is currently considering developing the Hispanic market in the US, which is a niche currently, not served by any competitor. It is in an adjacent geographic region for the Simply Accounting business unit and has unique requirements for which Simply Accounting capabilities are well suited.   The ability for both product and business processes to concurrently handle multiple languages is a unique capability of Simply Accounting.

The third concept speaks to the departure from current strategies around beating the competition. Instead of focusing resources on competitive comparisons, the firm focuses on the customer since no competition exists – the competition is irrelevant. With the Hispanic market, the competition would be irrelevant since it currently does not provide a solution for this market. In fact, no one does.

The fourth imperative is about seeding and growing new demand instead of tapping into and exploiting existing demand. Creating new demand in a new market is central to BOS. While the market may not necessarily be new and may simply be the isolation of a specific set of needs for a specific set of users in the larger market, demand must be new. The Hispanic market meets this criterion since they are not currently demanding Spanish language accounting software – Sage must create the demand.

The fifth concept refers to the value-cost trade-off. Typically, in existing markets, there is a trade-off between value and cost. Usually firms are stuck in the same functional relationship between cost and value. Michael Porter conceptualized an imaginary productivity frontier to explain the relationship between value and cost (Porter, 1996). The productivity frontier is essentially a cost-value function. On the productivity frontier, there is a relationship created between cost and value where increasing costs results in increasing value until value reaches a maximum and increases in cost no longer results in increases in value. However, it is possible for technology and innovation to create shifts in the productivity frontier and allow companies to find a new cost-value function. BOS pursues creating shifts in the productivity frontier resulting in a new functional relationship between cost and value. It also provides a framework to aid with this task of reconstructing the cost and value function. See Figure 4-5. To apply the framework, with the needs of the new market in mind, the firm can consider which costs (so called factors) to reduce, eliminate, raise or add. While some additional costs augments the value, there could be significant savings in reducing and eliminating costs that are taken for granted in the existing market, but not required in the new market.

Figure 4-5 Four Actions: A Framework for Value Creation



Applying the four actions framework to the Hispanic market reveals opportunities to both decrease and increase costs. This is the primary effect of the framework. See Table 4-2. The full multilingual ecosystem that exists in Canada for French is not necessary to the same degree for Spanish in the US. Spanish users in the US market are happy with consuming some English language products and services. While this market will benefit from Spanish accounting software, they do not need all supporting products and services to be available in Spanish. Eliminating the retail channel reduces costs significantly. The US retail channel is expensive to support. Moreover, Intuit owns the retail channel in the US. To illustrate the point, retailers earn more from sales of QuickBooks in the US than Sage earns from Simply Accounting in Canada.

With retail eliminated, there is no need for expensive packaging, which is for shoppers at a retail store. However, some costs will increase. There will be additional staff to provide customer service, technical support and translations. There will also be development costs to maintain a Hispanic product, and marketing costs to advertise and promote the product to the market.

Table 4-2 Four Actions Framework Applied to Hispanic Market

Decreasing Costs	**Increasing Costs**
Reduce ▪ Multilingual ecosystem	**Raise** ▪ Spanish support staff
Eliminate ▪ Retail presence ▪ Distinctive Packaging	**Create** ▪ Spanish product ▪ Spanish website ▪ Spanish marketing

Source: Author

Sage has conducted extensive analysis to validate the profitability of the Hispanic market. Execution of the marketing plan is underway. The results of the four actions framework provide insights into how to restructure costs and value to achieve a more desirable position in the market.

Chapter 5: Strengthening the Go Forward Plan

Established firms must build both offensive and defensive strategies. The small business accounting software market in Canada is a $100 million dollar market with no dominant leader. Sage and Intuit have over 90% market share. From an external analysis using five forces, we saw that the strongest external element is the threat of substitution. The industry is peaking at the top of the s-curve but there is no current sign of decline. The market is profitable for the incumbents and rivalry is giving way to profit maximization. However, there are internet-based technologies emerging that could have a disruptive impact on the incumbents.

Internal analysis reveals that Sage has strong financial assets and significant resources and capability. There are strategic assets in managing relationships with accountants and bookkeepers and operating a multi-lingual business. Furthermore, there are several other capabilities including making acquisitions. Sage also has a strong culture and values for protecting profits with regular monitoring and measuring of customer loyalty. However, internal rigidities around innovation limit the creative power of the organization.

The strategy hierarchy provides a context to frame the various strategies that firms may pursue to secure profitability. As opposed to the single strategy view expressed in Porter's market positioning, Sage needs to execute multiple strategies to protect and create profits. Sage does very well at protecting profits and the biggest opportunities now lay in creating profits in existing and new markets. There are opportunities to increase price in existing markets to increase profitability and the recent entry into the Hispanic market could benefit from cost savings and new value creation. In addition, the company has the internal resources to fund weaknesses identified in innovation and potential threats from disruptive technology.

Having considered the existing strategies of Sage with respect to some of the most well researched tools for strategic analysis, in my opinion, Sage is a strategically solid business. There is no need for drastic and radical changes to how the company does business. There are however some concerns about areas of the business that could be vulnerable to shocks in the market. There are also opportunities to enhance profitability from new and existing markets. The following recommendations address the concerns and opportunities:

1) Stay the course with Billing Boss. Incumbents often bail at this stage in the life cycle of a potential disruptive technology and it is crucial for Sage to remain steadfast and continue to pay to play in this potential market of the future.

2) Neutralize the threat from the internet. Sage could invest $10 million per year to neutralize the SaaS threat. Instead of fearing the internet, Sage needs to embrace the internet and create an option to capitalize on it as a delivery platform when it takes off and displaces the desktop.

3) Consider scaling back the dividend policy to fund a strong innovation centre within the organization.

4) Monitor and respond to over utilization of old technology – especially for strategic products such as Simply Accounting.

5) Raise buyers willing to pay to the market price by augmenting the value proposition.

6) Use insights from the four actions framework to decrease costs and increase value in the Hispanic market offering.

Appendices

Appendix A: Sage Major Acquisitions

Sage Major Acquisitions Table				
Date	**Company**	**Country**	**Value**	**Rationale**
1991	DacEasy	US	£14.6m	Accounting: New Territory
1992	Ciel	France	£4.6m	Accounting: New Territory
1993	Saari	France	£19.6m	Accounting: Mid Market
1995	Sybel	France	£16.6m	Accounting: Mid Market
1997	KHK	Germany	£40.7m	Accounting: New Territory
1998	State of the Art	US	£163.1m	Accounting: Mid Market
1999	Sesam	Switzerland	£11.3m	Accounting: Mid Market
1999	Tetra	UK	£81.1m	Accounting: Mid Market
1999	Peachtree	US	£190.5m	Accounting: Entry Level
2000	Best	US	£286.4m	Fixed Asset, Payroll, HR
2001	MIP	US	£13.8m	Not-for-profit Vertical
2001	Interact	US	£190.4m	CRM
2002	CPASoftware	US	£9.1m	Accountancy Vertical
2003	Grupo SP	Spain	£49.1m	Accounting: New Territory
2003	Softline	South Africa	£66.0m	Accounting: New Territory
2003	Timberline	US	£63.6m	Construction Vertical
2004	FLS	US	£10.4m	Payroll Services
2004	ACCPAC	Canada	£62.5m	Accounting: Entry Level & Mid Market
2005	Adonix	France	£78.4	Accounting: Mid-market
2005	Cogestib	France	£7.7m	Distribution Vertical
2005	Logic Control	Spain	£54.7m	Accounting: Mid-market
2005	Symfonia	Poland	£10.5m	New Territory
2005	Simultan	Switzerland	£10.7m	Accounting, Payroll : Mid-market
2006	Protx	UK	£20m	Merchant Services
2006	Emdeon Healthcare	US	£297m	Healthcare Vertical
2006	Elit	France	£21m	Transport and food distribution vertical
2006	Master Builder	US	£15.5m	Construction vertical
2006	Bäurer	Germany	£16m	Accounting: Mid Market, Retail & Mfg. Vertical
2006	UBS	Malaysia	£14m	Accounting: New territory
2006	Verus	US	£184m	Merchant Services
2007	KCS	UK	£20m	HR and payroll
2007	Creative	Singapore	S$10m	HR and payroll
2007	Xperts	France	€3m	Accountancy vertical
2007	Snowdrop	UK	£17m	HR and payroll
2007	Pro-Concept	Switzerland	£7.5m	Accounting: Mid Market
2008	Eurowin	Spain	€14m	Accounting: Entry Level
2008	DCS	Spain	€1m	Distribution Vertical
2008	Tekton	UK	£21m	Construction vertical

Source: Sage

Appendix B: Resource Analysis

Resource Classification	Resource Type	Resource Characteristics	Performance Consideration (+, -, =)*	Competitive Impact
Tangible	Financial (Corporate)	Borrowing capacity Internal funds generation	+83% Deb/Equity Ratio +£289.5M from operating activities	Strength
	Physical (Corporate)	Plant and Equipments Land and Buildings Raw materials	=5% of Assets	Irrelevant
Intangible	Technology	Patent, Know how R&D	-No patents -No royalty income -High percentage of code in mature technologies +Multilingual product +25% of staff	Some weaknesses, some strengths
	Reputation Capital	Brand equity, Customer loyalty, Company reputation	+Sage brand awareness +Simply Accounting brand awareness +500,000 Customers +10,000 Accountants/Bookkeepers +46% NPS Score	Some weaknesses, some strengths
	Culture	Norms and values	+High focus on existing customers -Low focus on new customers +Customer driven -Not technology innovative	Some weaknesses, some strengths
Human Resources	Employee	Training, experience, adaptability, commitment and loyalty, access to new talent	+90%+ college educated +High percentage of employees with accounting designations, business and computer science degrees +High percentage of employees with multi-lingual capabilities +20 years organizational learning and experience in developing accounting software +$5000 annual training allowance +Above average compensation +Located in major city close to universities +Low turnover	Strength
	Management	Vision, Values, Attitude to taking risks	+Balanced, and customer centric vision, Risk averse (prudent)	Strength

*'+' means advantageous,' –'means not advantageous, and '=' means irrelevant
Source: Adapted from Robert M. Grant, Contemporary Strategy Analysis, 2002

Appendix C: Return on Invested Capital Calculations

Sage	2009	2008	2007	2006
Total Assets	2,738,500,000	2,538,000,000	2,207,800,000	2,210,900,000
Excess Cash				
Cash	59,400,000	70,100,000	65,600,000	82,000,000
Current Liab	727,100,000	685,100,000	577,600,000	558,400,000
Total Excess Cash	0	0	0	0
Non-Interest Bearing Liability				
Trade Payables	252,800,000	247,200,000	212,300,000	190,300,000
Current Tax	62,100,000	69,200,000	56,300,000	63,500,000
Def. consid.	2,300,000	2,600,000	8,500,000	21,500,000
Deferred I	391,100,000	352,200,000	300,200,000	282,100,000
Retirement B	11,800,000	3,900,000	1,400,000	2,100,000
Def. tax	41,200,000	26,800,000	14,200,000	10,000,000
Total	761,300,000	701,900,000	592,900,000	569,500,000
Invested Capital	1,977,200,000	1,836,100,000	1,614,900,000	1,641,400,000
Source: Sage.com, and author's calculations				

Intuit	2009	2008	2007	2006
Total Assets	4,826,329,000	4,666,584,000	4,252,026,000	2,770,027,000
Excess Cash				
Cash	678,902,000	413,340,000	255,201,000	179,601,000
Current Liability	1,083,829,000	1,467,238,000	1,160,109,000	1,015,974,000
Total Excess Cash	0	0	0	0
Non-Interest Bearing Liability				
Accounts payable	104,963,000	115,198,000	119,799,000	68,547,000
Accrued comp.	175,010,000	229,819,000	192,286,000	167,990,000
Deferred Revenue	378,148,000	359,936,000	313,753,000	282,943,000
Income tax payable	358,000	16,211,000	33,278,000	33,560,000
Customer fund deposits	272,028,000	610,748,000	314,341,000	357,299,000
Current Liabilities. of discontinued operations			15,002,000	16,703,000
Other debt	186,966,000	121,489,000	57,756,000	15,399,000
Total	1,117,473,000	1,453,401,000	1,046,215,000	942,441,000
Invested Capital	3,708,856,000	3,213,183,000	3,205,811,000	1,827,586,000
Source: Intuit.com, and author's calculations				

Notes:

Intuit's Other current liabilities is assumed to be interest bearing liability

Intuit's Other long-term liabilities is assumed to be a non-interest bearing liability

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