Optimize and Transform

The New Way Forward for Software Companies

Our heritage is steeped in software development and software providers, so we possess a fundamental understanding of the industry’s distinctive challenges.

It’s not an overstatement to declare that software companies are experiencing some of the worst economic conditions of the last few decades. In fact, for some younger businesses, this is the first time they’ve encountered any major obstacles on their journey to growth.

Software companies are in an environment where the underpinnings of their business are fundamentally changing — most likely permanently — impacting every corner of their operations. This kind of evolutionary step requires a new way forward for software companies, one that balances the need to reduce costs without sacrificing strategic initiatives, technology innovation and digital transformation. Although optimizing the business while simultaneously transforming can be a challenge, it’s undoubtedly achievable — at Persistent we collaborate with clients every day that are recasting their companies in this manner.

In this white paper, we’ll explore the headwinds that software companies are facing, the key levers for navigating through them, and why Persistent is the premier partner working with software and tech companies through this period of unprecedented change.
Current Challenges

Concurrent financial and business challenges are battering software companies from every angle, creating a situation where continuing in a business-as-usual posture is an untenable strategy for future growth.

Macroeconomic headwinds, global unrest and rising operational costs are converging to hit software companies’ bottom lines, with declining revenues and plummeting company valuations. VC funding has dried up entirely or at best reflects lower valuations than previous rounds, diluting shareholder value and compounding market headwinds.

This is especially true of businesses that thrived during the pandemic, as the need for digital services powered by software rapidly accelerated, resulting in massive increases in headcount and operational spend.

The trend is now reversed, as the global economic picture is forcing an overall spending and investment pause among enterprises and consumers and while profitability, rather than lightning quick growth, becomes the new valued metric for market success.

The end result is a collective tightening of operational belts among software providers, manifesting itself most vividly in widespread industry layoffs at a scale not seen for more than a decade, along with higher SG&A costs and EBITDA concerns. The situation is further impacted by recent failures of several regional banks, which is putting all financial institutions under stress and making it difficult for software companies and all businesses to access capital or making it more expensive to do so.

Biggest tech startup layoffs worldwide as of January 2023, by number of job cuts

<table>
<thead>
<tr>
<th>Company</th>
<th>Date(s)</th>
<th>Number of job cuts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amazon</td>
<td>16.11.2022 &amp; 4.1.2023</td>
<td>18,000</td>
</tr>
<tr>
<td>Meta</td>
<td>9.11.2022</td>
<td>11,000</td>
</tr>
<tr>
<td>Microsoft</td>
<td>18.1.2023</td>
<td>10,000</td>
</tr>
<tr>
<td>Salesforce</td>
<td>4.1.2023</td>
<td>8,000</td>
</tr>
<tr>
<td>Uber</td>
<td>6.5.2020 &amp; 18.05.2020</td>
<td>6,000</td>
</tr>
<tr>
<td>Booking.com</td>
<td>30.07.2020</td>
<td>4,375</td>
</tr>
<tr>
<td>Cisco</td>
<td>16.11.2022</td>
<td>4,100</td>
</tr>
<tr>
<td>Twitter</td>
<td>4.11.2022</td>
<td>3,700</td>
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<tr>
<td>Better.com</td>
<td>8.3.2022</td>
<td>3,000</td>
</tr>
<tr>
<td>Peloton</td>
<td>8.2.2022</td>
<td>2,800</td>
</tr>
</tbody>
</table>

Number of employees

Source: Layoffs.fyi

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Additional Information:
Worldwide: March 2020 to January 2023
Software Company Segmentation

Persistent works with some of the most well-known and largest software companies in the industry. Although each business is distinct in its history, organization and focus, we’ve segmented software companies into four primary areas based on their size, market, financial results and funding / investment sources, as well as our decades of insight into how software companies can effectively optimize operations. Although we’re detailing challenges within each specific segment, in reality all segments are experiencing these issues to varying degrees, bringing financial and operational pain.

The Tech Titans

Hyperscalers such as AWS, Microsoft and Google generally capture most of the headlines given their pivotal roles in the industry. Skyrocketing growth during the pandemic led to a massive scale-up of their businesses, creating a significant backlog for their cloud services. Now they’re challenged with translating those backlogs into revenues, while simultaneously pushing ahead with innovation and optimizing spend on operations.

Some are dealing with simultaneously supporting traditional and cloud-based products / offerings and maintaining development teams for both without much leverage between the two. Virtually all have made massive and very public headcount reductions, trimming the massive scale-up in resources commenced during the past decade, which impacts global staffing and delivery models, employee morale and market confidence. There is a tighter focus on controlling revenue to SG&A costs to drive greater degrees of profitability companywide. And all of this is occurring as the need to maintain competitive differentiation through innovating on existing offerings and developing new ones.

The Recently Public

ISVs, particularly firms that went public within the last decade, need to deliver new and updated products to the market at lightning speeds. They are searching for ways to optimize new product development through low-code / no-code tools and newer technologies, often through partners. This group is also looking at existing products and platforms to see how they can be monetized or how to reduce operating costs associated with them.

On the financial front, many took substantial market cap hits coming out of the pandemic and are delivering flat shareholder returns compared to previous years. Like others, they want to optimize their staffing models, as overhead remains high in current software development centers in different locations. They’re also struggling to improve margins as client investment that can fund new product development and innovation remains paused in the current economic climate.
The Early Scalers

Private equity-based companies, which in the past experienced transactions in a three- to five-year lifecycle, are being forced to wait as cycles stretch out because revenue acceleration is not happening at the anticipated pace — many are being asked to conserve cash at least until 2025, which is easier said than done with increased pressure on operational spending.

This leaves many of these companies struggling to add staff and development talent at a time when development and delivery are critical to differentiation against more well-known competitors, and they’re searching for a way to dial up and down these resources on the fly. Unlike some more established companies, these companies also need to show consistent and scalable license growth in a profitable way, whereas investors were previously willing to provide more leeway during times of rapid expansion.

The Digital Natives

VC-funded businesses, particularly late-stage companies which were hoping to either go public or be acquired, have similar kinds of challenges with funding delays and cash conservation, as well as competitive challenges as their customers turn to more established providers that are perceived as safer long-term choices for investment.

Some are looking for ways to hand off lower-margin services to partners, via a professional services model, while ensuring that high-quality levels are maintained in order to protect the brand and its competitive positioning. Many of these newer companies also need assistance getting a foot in the door to enterprise clients, either in industries on which they already focus, or new ones that present growth opportunities.
Navigating the New Way Forward

Key Levers for Success

Collectively, these companies are confronted with the reality that they cannot invest like they did just a few years ago, but they can’t afford to simply stop innovating. It’s like a kind of intermittent fasting, where they’re going on a diet and making sure that they’re optimizing the spend where they can, while still fueling innovation and not stepping back on creating competitive differentiation.

It’s a challenging balance, but it’s also creating outstanding opportunities for companies to become leaner and stronger, better prepared to weather economic uncertainty, and develop meaningful engagement with partners like Persistent that can help them achieve their goals.

Some software companies balk at the idea of making major changes that might result in offloading part of their development work, especially those that have never done so before. They believe that software development is part of their intrinsic company identity, and that all development is core to their business and too valuable to hand-off to a third-party provider. It’s an understandable position but unsustainable, as views on what is truly “core” in software development are rapidly changing and require new strategic thinking. And realistically, companies can create greater efficiencies by handing-off lower-value development to experienced partners and optimize the overall business for cost and resources – all without losing core development capabilities at the heart of their enterprises.

Through our transformation work, we know that software company CEOs and CFOs are focusing on efficiencies in their global software engineering and IT resources, as this represents one of the largest and most essential cost centers. In this context, Persistent has identified six primary levers that software businesses can pull to achieve a balance between optimizing and transforming. With 30-plus years’ experience, Persistent has proven repeatedly to software companies that these actions create positive outcomes and strengthen a company’s value proposition — and given the current status of the market, they are even more relevant today. Each lever and its accompanying actions are not for every company, and the degrees to which companies execute on them will vary by their strategy, size, market, operations, revenue, etc. Nonetheless, they can provide companies with methods to re-think and re-cast their strategies to ride out current economic disruptions and prepare for future ones.
Software companies are constantly making choices about where to recruit and hire engineering talent as part of their strategic globalization strategies. Some decisions are driven by client proximity, others by available technical skills, depending on a company’s current business. Cost, of course, is always a consideration, but the accelerating growth of the past few years made throttling costs less critical, as companies had to hire talent wherever they could to meet exploding demand. This rush to build-up resources resulted in many centers to be established in higher-cost locations with high overhead and sub-optimal scale, impacting client delivery and potentially a software company’s reputation to deliver on its promises.

Now that demand has subsided, it’s the perfect opportunity for software companies to right-shore their global engineering footprint, avoiding additional investment in high-cost locations and taking advantage of lower-cost countries such as India, Mexico and Romania through either BOT (Build-Operate-Transfer) contracting, recruitment outsourcing, or full outsourcing. Whatever the approach, it’s not just about cutting headcount to try and achieve short-term cost gains. The goal is to find an optimized blend of engineering resources, costs and talents that can provide enough scale to continue long-term digital transformation efforts and deliver services to customers. Persistent regularly collaborates with companies to consolidate and optimize software engineering resources, with experience in managing and monetizing development centers and product teams. This collaboration often leads to discussions about going even further with cost optimization by having Persistent take on a company’s IT infrastructure and cloud resources.

Software companies are taking a hard look at services delivery capabilities in their in-house capability center and ensuring they match-up with current service demand, future strategies and profitability targets. This kind of scrutiny can lead to a partial or full carve-out of specific services to appropriate partners that have capabilities to deliver those services with better levels of scale and optimization, versus what software companies can achieve on their own. This allows a company to focus on services that are most critical to its core business by keeping key resources that scale in capability centers, while leveraging partners to optimize sub-performing or sub-scale operations and monetizing them for additional revenue.
Lever 3

Legacy Carve-Out

Sustaining non-strategic products for historical reasons takes up valuable time, resource, and budget — and continuing this practice in tough economic times is hard to justify. A better approach is to de-emphasize these products or even steer them toward end-of-life and rely on partners for maintenance and support going forward. This could involve either a full P&L takeover by a partner or another provider, a full or partial carve-out, or staff optimization and augmentation. With this lever, software companies can free up resources for mission-critical, higher value solutions that have a greater chance of generating significant gains in revenue and profitability. It also optimizes costs for maintenance and support of legacy or end-of-life products — but it’s incumbent on a software company to ensure that legacy support is delivered with a sufficient quality, so as not to damage the brand long-term or deter customers from engaging with the company again.

Lever 4

Professional Services

Similarly, another lever for software suppliers is leveraging professional services via partners, versus delivering services themselves, and focusing on higher gross margin products. Professional services are traditionally high-cost / low-margin for software companies to maintain over time, and those with a stronger focus on selling products with higher gross margins can achieve longer-term value. Relying on partners for professional services frees up management bandwidth to focus on what’s important for the core business, optimizes expenses, and improves the overall bottom line.

As professional services are also a margin drag relative to licensing revenue, companies need to determine whether a carve-out of some or all services or allowing a partner to white-label all services is the better approach to remove those costs from the books. There is some degree of risk involved with this lever — services may be provided by a third-party, but the services delivered are ultimately a reflection of a software company’s label and brand. It’s essential to select third parties with proven scalability, experience and attention to customer care, and then ensure a smooth transition in either a carve out or white label approach, to mitigate risk.
We’ve also utilized the approaches in some of these levers ourselves to optimize operations while maintaining a commitment to innovation, so we can bring a best-practice approach to our discussions with companies aiming to do the same.

**R&D IP Creation**

Given current uncertainties, many companies struggle with maintaining a strong R&D posture, as spending reductions inevitably hit a company’s ability to invest in new product development. As a result, there is an increased emphasis on ecosystems and external providers to provide access to IP and R&D resources. These are generally extremely high cost, and some companies struggle to add additional capabilities themselves beyond what they consider core given financial constraints. Tapping a partner for specific IP provides more flexibility and a variable cost structure for software companies to access additional R&D capability based on their strategic initiatives. In the current market where capital is constrained for the most valuable types of development, software companies can investigate a model where they’re directly funding development with a partner for an ongoing royalty payment in lieu of development fees. In this approach, a software company can gain access to talent and technology expertise without adding significant overhead and maintain a competitive posture to bring new software products and features to market, and both companies have an opportunity to add to their bottom-line revenues.
Lever 6

Enterprise Access

The final lever can involve elements of the previous five levers and is primarily geared toward gaining access to enterprise clients. At Persistent, our core business for 30-plus years has been data and software, with a wide array of software companies as our clients — including some of the largest in the industry. While serving software companies through Digital Engineering will always be a primary focus, our success in this space is leading to swift growth among enterprise clients in a variety of industries.

With enterprises making cloud, data, AI and other technologies a priority, and with software becoming so central to how all enterprises operate, Persistent’s software heritage and expertise puts us in a unique position to work with enterprises on developing new capabilities and products. In turn, we’re also able to facilitate connections between various software companies and enterprise clients looking for specific software solutions to solve their most pressing business and industry challenges. Given our deep perspective of the software landscape, and our history in Digital Engineering, we can help guide software providers and enterprises to a collective understanding of how they can work together in a beneficial way, and then determine which elements of the other levers might come into play.

Deciding which lever (or combination of levers) to pull starts with determining which ones will have the desired effect of generating cost savings and operational efficiencies while still allowing critical digital initiatives to continue — in other words, ones that will allow a company to simultaneously optimize and transform for a future growth. At Persistent, we regularly engage with software companies in discussions about all levers to chart the best new way forward, and each playbook can be tailored to a company’s specific needs and desired outcomes. The graphic below offers some guidance, based on our client experiences, of the applicability of each lever by type of software company.

<table>
<thead>
<tr>
<th>The “Tech Titans”</th>
<th>Low-cost Engineering</th>
<th>Capability Center Evaluation</th>
<th>Legacy Carve-Out</th>
<th>Professional Services</th>
<th>R&amp;D IP Creation</th>
<th>360 Degree</th>
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<tbody>
<tr>
<td>&gt;15 Years public “The Still Scaling”</td>
<td></td>
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<td>The PE Backed “The Early Scalers”</td>
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<td>The VC Backed “The Digital Natives”</td>
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Partner with Persistent to Optimize and Transform

Software companies can chart many courses and pull many levers to create efficiencies and new transformational value during economic disruptions. One of the most critical parts of any plan to optimize and transform is selecting the right partner, with the best combination of perspective, talent and expertise to address a company’s specific issues and challenges. This partner should have a vested interest in collaborating with a company to achieve its goals, an ability to pivot to overcome roadblocks, a focus on customer service, and possess capabilities and offerings that can make a real impact.

Persistent is a proven partner of independent software companies that embodies all these qualities and more. We’re incredibly unique compared to larger providers that offer infrastructure and application outsourcing and management for enterprise clients — those kinds of offerings do not translate into the world of software development, which is why our skills and capabilities are so attuned to the specific needs of software companies. Our heritage is steeped in software development and software providers, so we possess a fundamental understanding of the industry’s distinctive challenges. We possess a boutique innovator’s mindset with an ability to scale. We have 30-plus years of unmatched Digital Engineering leadership and an extensive roster of client successes around the world. In addition, we have experience working with software providers to execute on all the levers mentioned in this report, from carve-outs and outsourcing, to professional services and connections with enterprise clients. We’ve also utilized the approaches in some of these levers ourselves to optimize operations while maintaining a commitment to innovation, so we can bring a best-practice approach to our discussions with companies aiming to do the same.
Imagine
Accelerated Growth
Imagine new business models, revenue streams and operational enhancements

Engineer
Product Development
Engineer tomorrow’s products and platforms for enhanced agility and growth

Modernize
Pivoting Products
Modernize products and processes for next levels of growth

Manage
Product Sustainability
Manage and sustain core and non-core revenue generating products

Lever 1: Scalable engineering
Lever 2: Capability center evaluation
Lever 3: Legacy carve-out
Lever 4: Professional services
Lever 5: R&D IP creation
Lever 6: Enterprise access

Value and Benefits
Innovation acceleration
Cost-savings
Scaling operations
Quality enhancement
Risk mitigation
Productivity gains

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Value and Benefits

Persistent works together with software companies looking to utilize different levers and make the fundamental changes to their business models that can carry them through economic uncertainty, and beyond. Each company is different, but there is some commonality to the kinds of benefits and value that can be created by engaging with Persistent for strategic and operational changes.

**Innovation Acceleration**

The need to develop new software products and features is even more critical in an uncertain economy to maintain revenue growth and remain competitive. Persistent teams help a provider accelerate software development efforts by an average of 30% within the first year of engagement, so companies can focus on operational savings and strategic changes without losing a competitive edge.

**Cost-Savings**

Although the outcome varies by company, Persistent delivers first-year cost savings for software companies that can range from 10% to 30%, putting processes and procedures in place that can create even greater savings longer term.

**Scaling Operations**

Given current economic conditions, it’s critical to have scalable teams in the right locations and time zones to ensure the most cost-effective development possible. Persistent works with companies to determine the best global map for services delivery and leverages low-cost centers around the globe to balance scale, quality and resources.

**Quality Enhancement**

Companies can leverage Persistent’s decades of experience in software development to identify potential areas of quality improvement, either through the application of new tools or by leveraging new skills and resources.
Risk Mitigation

Persistent’s track record as a trusted partner is bolstered by our long-standing commitment to security in data, systems and Partner with Persistent to Optimize and Transform processes. In addition, software companies engaging in a carve-out or outsourcing of engineering or professional services can be confident that working with Persistent will enhance their brands by maintaining and even exceeding expected service levels.

Productivity Gains

Leveraging our proprietary frameworks, accelerators and other technologies such as Generative AI and low-code / no-code tools, Persistent speeds up software development times which contributes to improved productivity and faster time-to-market for new products and services.

Conclusion

For software companies, an economic downturn is unsettling, but it doesn’t need to be their undoing. When Persistent engages with customers, many companies have cost optimization, resource rebalancing and operational flexibility on their minds, and discussions quickly progress to include ideas on how to make deliberate spending decisions without sacrificing innovation.

Even when grappling with belt-tightening, layoffs and reduced revenues, CEOs, CFOs and other company leaders can make definitive strategic decisions to reach higher levels of cost-efficiency and operational excellence, while still investing in digital and transformation initiatives that bring new avenues for growth. The levers that we outline in this paper provide enough flexibility to create near-term top-line benefits through monetization opportunities and can also sustain margin improvement over multiple quarters to improve EBITA and shareholder return.

Software providers that adopt this mindset will be best positioned to turn a time of turbulence to their advantage and emerge stronger on the other side. Persistent welcomes the opportunity to leverage our decades of software engineering experience to show companies this new way forward.