

Sacré bleu, could Sage be ahead of the curve?

Originally published as part of the Megabuyte Market Intelligence service on 23rd May 2014

Last week Sage announced the release of the latest version of its mid-market ERP X3 offering at a showcase event in Lisbon. Across a two day event we met with a number of key representatives from the France-based mid-market management team to discuss both the new product and the go to market strategy. What particularly stood out is that, in contrast to past software releases, Sage appears to be ahead of the curve in the mid-market.

Sage provides a range of business management software and services in the areas of accounting & payroll, ERP, CRM and payments. In recent years Sage has attempted to streamline the business by divesting a number of vertical applications, in addition to restructuring a number of isolated regional operations into more centralised business units. Following the structural overhaul, at its core, Sage is focused on providing horizontal market solutions for start-ups & small businesses, SMEs and mid-market companies.

Sage ERP X3 targets companies with around 100 to 500 employees, and sits at the heart of the company's offering to the mid-market. The newly released Version 7 of the product is built on an entirely redesigned HTML5 browser and device agnostic web interface, allowing for increased mobility, usability, data accessibility and business intelligence capabilities. Out of the box ERP X3 Version 7 is provided as a single core solution that can be customised by partners for a particular market niche. Moreover, as a web enabled application the new version of ERP X3 allows users flexible deployment options.

In addition to enhancing the usability of the product itself, Sage has simplified its go to market strategy for the mid-market. Rather than there being two editions, as was the case with Version 6 (standard & premium), there will be one software edition of Version 7 that will be priced at three levels dependent on the type of user. To add flexibility, pricing will be offered on both a perpetual licence and subscription basis, increasing the accessibility of the product to the lower end of the mid-market. On top of the core X3 offering customers can integrate a choice of solutions from independent software vendors, as well as add-on applications from Sage, such as HR management and payments.

As mentioned above, the architecture upon which Version 7 is built lends itself to a choice of deployment options. Initially the product will be offered with the core system of record deployed on-premise. However, as the product was demonstrated at the event in a public Cloud environment, we expect a Cloud-delivered option to be on the horizon.

In terms of its growth strategy the management team made clear that, in the mid-market, Sage is focused on new customer acquisition, as well as the migration of a number of its SME customers to ERP X3. This differs slightly from Sage's strategy in the small businesses arena, where there is also a drive to re-engage currently non-active users by moving them to a subscription based model.

As Sage generates a large amount of recurring maintenance revenues from its mid-market customers, this is less of an issue. However, we suspect that some of the functionality that comes with Version 7, particularly around the integration with other Cloud applications, will be an incentive for current ERP X3 customers to migrate to the latest edition.

Turning to financial performance, recently released interims from Sage highlight that in the six months to March, Sage ERP X3 grew revenues by 7%. Growth was below expectations for double digit increase due to a weak French market, which accounts for just under half of the division's total revenues. However, ERP X3 continued to grow well internationally, with organic revenues outside of France up 22% on the prior year period, including strong growth in both North America and South Africa. Following the release of Version 7, the management team is confident of a return to double-digit growth in the coming periods.

Megabuyte View

It is clear to us that the pace of change to a Cloud and subscription based business model in the enterprise software market is accelerating, albeit at different rates depending on the end customer. At the top end of the

market, our recently published analysis on Sweden-based IFS highlights that, so far, a conservative view towards the Cloud has paid dividends. However, for those vendors targeting the SME market, the absence of a credible Cloud strategy has already started to have a negative impact on financial results.

The mid-market is where we expect to see the next significant step change in the move to the Cloud. This is perhaps best highlighted by the progress of ERP SaaS vendor NetSuite in recent years. Towards the end of 2009 and into 2010, NetSuite was reporting quarterly year-on-year growth rates of between 3% and 6%. Since then, the growth rate has increased quarter-on-quarter to 34% for the three months to March 2014, bringing quarterly revenues to \$123m.

Further supporting this argument, FinancialForce has made a number of acquisitions to build a more complete ERP solution and, following its recent investment from Advent, we would expect its momentum to continue to accelerate. Meanwhile, for the established mid-market vendors, Microsoft's integration of Dynamics with Office 365 looks to be one of the most forward looking in terms of a transition to what we would describe as next generation ERP solutions.

Turning our attention back to Sage, we have in the past been critical on the time that it took to bring its small business SaaS accounting solution Sage One to market; something that we believe has benefited a number of SaaS vendors such as Xero and Kashflow. In contrast, whilst it may have taken four years to develop, with ERP X3 Version 7, Sage certainly looks to be on the front foot in terms of the mid-market's transition to the next generation of enterprise software.

In addition to company size dynamics, the region in which a company is domiciled can often have an impact on the preferred software deployment model, with the US leading Europe in terms of Cloud adoption. With this in mind, Sage has clearly adopted a go to market strategy for ERP X3 Version 7 that can adapt to suit the demands of a particular region.

For its core, primarily French, European market we would expect that, in the short term, customers are likely to continue to consume ERP X3 as on-premise solution purchased through a perpetual licence. In the US, in contrast, there is likely to be higher demand for subscription based pricing and, when released to the market, a Cloud delivered solution. Over time we anticipate that the European market will follow the current trend set by the US.

Even with a go to market strategy to suit each of its target markets, one of the primary challenges for Sage in the mid-market will be to establish the company's brand in regions where it is not as well known, such as the US and, in a similar vein, re-energise the brand in regions where it has become known as the laggard. However, if Sage can successfully navigate these initial hurdles we believe that ERP X3 Version 7 has the potential to disrupt the current market for mid-market ERP solutions.

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