CASE STUDY

Xero: A Microsoft Software-Plus-Services Partner Case Study

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Overview of the Company

Xero has experienced rapid growth as one of the industry's few 100% software as a service (SaaS) companies. Starting with a carefully defined target market and a seemingly universal small business accounting SaaS offering, the company has enjoyed early success. With IPO funding in the bank, Xero's customer-centric organization is well-resourced for further growth. Continuing to educate the market about the benefits of SaaS while working collaboratively with other SaaS providers to ensure the best customer experience will help position Xero for further success. Figure 1 provides a partner profile and revenue breakdown of Xero.
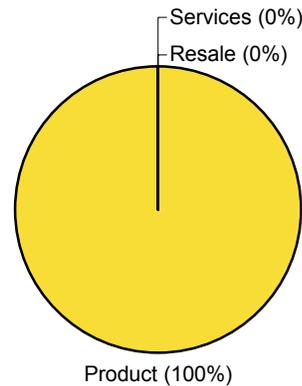
FIGURE 1

Xero Partner Profile and Revenue Breakdown

Partner Profile

Revenue (US$)	<$1 million
Employees	50
Headquarters	Wellington, New Zealand
Customer Segment Focus	100% 1–99 employees
Revenue Generating Activities	Software Product Development
Specialization	Financial Applications

Revenue Breakdown

Services (0%)
Resale (0%)
Product (100%)

Source: IDC, 2008

Xero, a Microsoft Gold Certified Partner, was founded in 2006 by Rod Drury, a 20-year veteran of the IT industry, and Hamish Edwards, a small business accounting specialist. Headquartered in New Zealand and traded on the New Zealand Stock Exchange, Xero is a 100% SaaS company specializing in online accounting software for small businesses. Although Xero is a relatively young company, the combined experience of Drury and Edwards has guided it to achieve its shareholder targets in its first year. With an initial focus on the United Kingdom, Australia, and New Zealand, Xero plans to grow into a global organization that uses SaaS to "unlock the magic of technology to small businesses," said Xero Chief Executive Drury.

Transitioning to an S+S Business Model

The Xero executives made two fundamental decisions when building their SaaS business. First, they strategically selected their target market and service offerings. Drury observed that the small business market was underserved by the large software companies, creating an opportunity for the right solution provider. It then became apparent that SaaS was a natural choice for small businesses and the companies that serve them. According to Drury, "What is good about software as a service is the cost-effective platform for aggregating a very large market of small businesses. That is the key thing about SaaS. It makes it economical to develop a solution for these very large markets." While the SaaS model is cost-effective for service providers, it also has financial benefits for small businesses through a reduction in up-front costs, reduced maintenance requirements, and a predictable monthly expense.

In choosing to focus exclusively on SaaS for small businesses, Xero intentionally deselected the enterprise space where integration and consulting is an expected component of software sales. Drury explained that "when you are going for volume like we are, you can't be locked into consulting and integration. You leave that for partners." That decision allows Xero the freedom to provide the best experience for its small business customers.

The second strategic decision the Xero executives made was to ensure that the company had adequate funding from the outset. Recognizing the importance of stability for SaaS customers, Xero's leadership understood that the company's success was dependent on customer confidence and satisfaction. Sufficient funding ensures the necessary infrastructure is available for customer support while also signaling stability to prospective clients.

Drury used the funds from the sale of a previous IT business and the sale of Xero shares on the New Zealand Stock Exchange to ensure the company was adequately funded, helping to offset any potential cash flow issues associated with the SaaS model: "With the software as a service business, you normally get paid a monthly fee rather than an up-front license. Imagine a license with a monthly fee broken over a two-year period; you'd need 24 times the customers to get to your natural breakeven point on a license sale," said Drury.

Up-front funding has enabled Xero to put in place its own business infrastructure too, including back-office and billing systems and the necessary resources dedicated to customer care. The company's cash reserves have also subsidized the necessary sales, marketing, and CRM resources to keep Xero's business growing.

Managing the Business

"SaaS isn't about your technology; it's about your business model. The technology is very different, the skills are different, the mindset inside the company is different, the pricing and support are different, and the distribution strategy is different," Drury explained. Coming into the market as a pure SaaS organization, Xero has minimized the internal transition struggles experienced by organizations that shift from traditional business models to a SaaS business or that have added SaaS as a new line of business.

Drury believes many companies that are making the shift to SaaS will do so through the acquisition of successful SaaS businesses. In addition to providing early funding for the business and increasing customer confidence, Xero's decision to go public was intended to provide some protection against acquisition. Drury explained that "being a public company early on means that we don't necessarily need to get sold quickly. We can build a long-term business." This is important in Drury's eyes because he believes SaaS is a long-term strategy for the service provider and for the customer.

Keeping the customer base growing has required Xero to divert some financial resources to educating customers and prospects about the benefits of SaaS. Like many other organizations working in the SaaS space, Xero has also found that readying the market has been a challenge. "We are certainly in front of the market, so there is a bit of market education to do," commented Drury. Customers don't necessarily come to Xero looking for an online system. It is incumbent on the industry to sell the benefits of SaaS to the customer.

Lessons Learned

Taking care of the customer has been the foundation of many decisions made by the Xero leadership team. According to Drury, "You really have to be focused on the customer experience and be listening to customers. It is very much a customer-driven culture. That is really key to being successful as a SaaS business. It is all about the service. The service part of software as a service is really key."

Xero puts the customer first in many areas of the business. Because Xero is publicly traded, customers are given visibility into its business operations, which helps to demonstrate the company's stability and good business practices. The company has also worked to ensure adequate customer support touch points with 75% of the employees dedicated to customer service and business operations. Xero's service contracts also help ensure that employees are attentive to customer needs by giving the customer the freedom to leave at any time. The absence of time-based contracts forces Xero to earn the customer's business every month — a critical part of a software-plus-services business model.

The software and development maintenance cycle for a SaaS provider is different from that of a traditional software provider. According to Drury, "The innovation cycle is incredibly fast." Xero provides software updates every two to four weeks, doing "bite-sized chunks of work and getting it out there and educating the customer." The fast development cycle is advantageous because the customer is quickly able to see Xero delivering on product promises.

Future Outlook

Xero views SaaS as a winning strategy today but still sees room for expansion: "There are a whole lot of other innovative things you can put down that pipe," said Drury. Accounting software may be only the beginning. "Once you have the channel in place, then you can add other things like CRM, procurement portals, and business networking. Our accounting system is a beach head application. Once we have the relationship with the customer, there are all sorts of additional services we could offer them," explained Drury.

In addition to complementary service offerings, Xero sees opportunities to improve the delivery of the software. "We are now pulling things back to the Web and using techniques and technology like Ajax to give a rich browser experience," said Drury. "Once the architecture on those applications is cleaned up and you have a pure SaaS multitenanted architecture, then you look to introduce some of the plus services." For Xero, the "plus services" includes smart client and offline technologies along with mobile interface and smart client strategies.

In addition to Xero's own product offerings, an ecosystem is developing among SaaS providers. Some organizations are collaborating across the industry and sharing their customer bases. Others are building specialized practices to work with Xero's offerings. Among these are spin-off accounting firms that work with Xero's accounting applications and training providers that help customers maximize their SaaS investment.

As the SaaS ecosystem develops, Drury believes it is "important for the software as a service industry to work together on the issues of security and respecting customer data." This will help increase customer confidence in SaaS offerings while also ensuring the success of the industry transition to SaaS.

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