5. Conclusion

The traditional business valuation models are not capable of measuring the true business value and the potential of software development companies. These models are not adequately addressing the intangibles and human capital of a software company. Market based valuation models could not be used due to the absence of listed software companies in Sri Lanka.

BV as a multiplier of Annual Revenue	% of Companies
<2	17%
2<5	76%
>5	7%

Table 34: Business Value as a multiplier of Annual Revenue

The business value of a Software company can be represented as a multiplier of its annual revenue. It was found that only 7% of the respondent companies are having a business value more than five times their annual revenue. Business value has fallen less than two times of the annual revenue for 17% of the respondents. Business value has fallen in between two to five times of the annual revenue for 76% of the respondents. Therefore we can conclude that companies which are doing average on the factors considered for the business valuation model in this research context falls under this spectrum and for those which are doing below average possess a market value less than two times of their annual revenue. Those 7% of the companies whose business value is more than five times of their annual revenue are the ones doing well on the identified factors affecting the business valuation model.

The business value of a software company is highly correlated with the annual revenue and profit margin. Further growth of revenue is also a considerable factor in deciding the business value.

Annual revenue of an offshore software development company highly depends on the number of software engineers employed. Product Maturity of the product contributed to increase the revenue of the company, when there is a product presence. It was found that offshore software development companies with product presence were maintaining attractive revenue per engineer ratio than pure offshore software development companies.

Revenue growth of software companies is highly dependent on factors such as employee growth, service domain attractiveness, growth strategy focus, technology capability and stakeholder risk avoidance. For offshore software servicing companies, there is a one-to-one relationship with the revenue growth and employee growth. Companies have gained domain expertise by servicing different service domains in their past projects. If these companies are having an expertise on service domains where there is a rapid demand and tendency for offshore software services then these companies have a very good potential to grow in the future. Other than Virtusa all other software companies are not in a position to attract new businesses on their own. These companies are too small to create their own brand name and market in the US and Europe. Therefore good partnerships and alliances with US and European companies and the senior management's ability to develop new partnerships that provide competitive advantage to access into new markets, service domains and to access new technologies are key critical factors for future revenue growth. Technology capability of the company and its staff is an essential factor for surviving in the technology industry. As a whole most of the Sri Lankan companies have done well on this parameter. Client satisfaction, delivering what was promised and repetitive projects from existing clients will provide a guaranteed source of revenue in the future. The best example in Sri Lanka is Virtusa, which has many large scale projects from existing clients where they have successfully delivered many small scale projects in the past.

Profit margins of Sri Lankan offshore software companies are not highly satisfactory though the revenue per employee is very high. Profit margins are very dependent on billing utilization and staff attrition rate of a company. Billing utilization is not at a satisfactory level for the industry as a whole and staff attrition rates are very high in the private sector software development companies. Cost and schedule overruns are much evident in many of the software companies and most of these companies have one or two customers contributing a large portion of their revenue. Therefore the bargaining power is very low for these small and medium scale software companies. Collectively all of these factors are eating in to the profitability of the industry. Further, billing utilization is highly dependant on the process maturity level and further it was found that profit margins are highly dependant on the level of process maturity. Process maturity is another parameter that the industry is not doing well at all.

Process maturity highly dependent on the quality level of engineers, which was derived from their level of experience and education level. The commitment level of senior management to invest and motivate their staff to develop and improve the process is another factor contributing to the process maturity of a company. Process maturity is hardly connected to the number of years in business operations.