

Running a Profitable Open Source Company

A Case Study

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Overview

- Open Discussion
 - Feel Free to Ask Questions Anytime...
- Background
 - We've been giving out open source web applications since the start of the Web (originally Selena Sol's Scripts Archive).
 - We started our company 1 year ago.
 - The idea was to continue to give everything we do away to the open source community yet still make a living...
- NOT MEANT AS A VENDOR TALK! – This is just a study of our own experiences to share...

Overview

- At heart, I am a techie, not a business person.
- But I've learned a lot over the last year...
 - Goal: To share a techie's experiences learning about business as a case study

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- Throughout...
 - Talk about successes
 - And temper with real-world discussion of issues and problems...

Why Singapore?

- Co-Founder married to Singaporean – lots of business contacts
- Inexpensive place to start
 - Forgiving to make mistakes (which we did)
- Great taxes (corporate) and personal (~12% flat)
- Asia is a huge potential market
- Singapore is one of the only English-speaking countries (we have many expat techies)
- Easy to import talent – tech visas were quick...
- Singapore government gave us a lot of subsidies to start an Internet company
- The whole island is wired up

Recipe for a Company

- A Market
- A CEO to provide direction
- A COO to management day-to-day
- A CFO to watch the cashflow
- A CTO to keep techs cutting edge
- Legal to protect yourself
- Strategic Alliances/Marketing to find the market
- Sales to grab the market and make it concrete
- Employees to do the work

That simple? Of course not...

Recipe for a Company

- You may think that you and a friend are capable of starting a company, especially from a tech standpoint.
- The lesson I've learned: Business is HARD.
 - Consider even the small things... obtaining an office, auditing books, expense reporting, etc that a company has to have in order to show due diligence when asking for a loan or funding
- That doesn't mean it's not rewarding, just hard work.
- Some history...

History

- We actually started eXtropia in the US in September 1998.
- At the time, we were just two techs trying to start something new
- I am sure that had we continued, we would have quickly burned out trying to do both business and tech at the same time at a pace that we were satisfied with.
- Then we got a call from Barclays Capital (an investment bank who made us an offer we couldn't refuse...

History

- During the next year at the Investment bank we learned a lot more about business and operations.
- After a year there, it was time to finally start our own business... but our lessons learned indicated to us that we needed a good business team.
- We started with the two of us plus three on the business side.
- We started with a CEO, COO, and Marketing and Sales manager
 - Why? (next slide)

The Management Mix

- The reason we started with whom we did was a matter of finding people with good business sense while still being inexpensive in terms of cash.
- Although it would have been nice to have married our technical skills with business people who came from a tech background, it just wasn't possible – they don't exist or they are paid very well.
- We choose as CEO and COO individuals who were not technophobes and enjoyed technology but had come from different industries and wanted to learn...

The Management Mix

- When the two of us started the company, two of us owned 50% each.
- When the two of us started the company in Singapore, we gave away 33% of the company to the initial people who already were comfortable enough that like us, they could help pay for their stock (capitalize the company) and wanted to build something from scratch while learning.
- They learned tech, we learned business.

Incentives for Management

- A year ago we would have never given away so much stock because we founded the web site for six years previously.
- Then, when we started we realized that it would increase our stock value if we had other people on board who knew what they were doing within their roles.
- Note that we are not a public company, but still the valuation of the company can be tied to its private stock and revenue/profit projections.

Why This Mix?

- It turns out that the CEO and COO were extremely capable in terms of getting on board two others we didn't know we desperately needed
 - CEO had ties to an extremely talented lawyer
 - Not only an Advocate and Solicitor of the Supreme Court in Singapore
 - But also the Dean of Law (NuS)
 - The academic background proved useful for dealing with open source license issues

Why This Mix?

- Likewise, our COO had ties with someone who was able to stand in as our part-time CFO
 - Our part-time CFO (we don't make enough yet to need a full-time one) is a director of several companies and has brought several to IPO.
- The lesson?
- Good business people beget good business people...
- Likewise, as techs, we brought people who are very good at what they do on our side...

The Next Step...

- After starting the company with a strong business team, we needed to move forward.
- Find a market and grab it...
- When we started the company, we felt the ASP market seemed to be quite strong in Asia
 - Asia is full of SMEs which are the primary target market of ASPs
- So we felt there was a market but we had to do something about it...
- Hence the next step was getting our Marketing and Sales director in full gear...

Marketing...

- Another lesson is the difference between marketing and sales...
 - Most think marketing == sales
 - Both support each other...
- Marketing is necessary to make sure Sales does not burn time on going after useless leads
 - Sales can make sales on a random basis
 - But targeted sales is much more effective
- Requires a lot of work
 - Product Research
 - Target Company Research
 - Developing Sales Collateral, Advertising, etc.

Sales...

- Once Sales is backed up by marketing, the work isn't done.
- You must also devote time to sales *engineering*.
 - Sales also needs tech support
 - They can
 - manage the relationship
 - write the proposals
 - But can't
 - answer the detailed questions
 - come up with timelines to do projects
 - Answer how complicated it is to fit something into a set of infrastructure

Open Source In The Mix

- So that's what makes up a company, at minimum...
- But what about us? We had a team, now we needed to figure out what to do.
- Prior to starting a company, we had always worked full-time at other companies and then did our open source at night.
- Now the company was ours. What to do?
- If we worked long hours at our company, it would make the company succeed, yet the open source would suffer...

Open Source In The Mix

- In fact, that became the reality.
- With just two technical people and four business people, we had two people to do core tech work and four people who might be termed in the contracting world as “overhead”.
- We also had to choose a business model that would support open source development

The Business Model

- There are really only a few business models that surround open source
 - 1) You can release a restricted open source license forcing people to pay for a more open one if they use the work commercially
 - 2) You can sell services (contracting)
 - 3) You can sell products on top of the open source that are more niche but closed
 - 4) You can sell distributions

The Business Model

- We chose a hybrid
 - In the market we found ourselves in, we preferred to sell support around our open source. While this did generate some revenue, the sales effort involved was overwhelming on an individual website basis.
 - Yet the sales cycle for selling support to an ISP or an ASP was terribly long
 - So about 80% of our revenue comes from projects. Thus, we use a consulting model.

The Problem w/Consulting

- People only pay you for your hours that you work for...
 - In other words, “not a scalable business model”
- Thus is why we still write products on top of what we release. Although we release individual web applications and our toolkit open source, pre-integrated packages with workflow (eg Intranet) is product based

The Problem w/Consulting

- The other problem is that people only pay for the hours you work for them...
- This turned out to be a huge problem for open source.
- With only two techs, we really did not have time to work on the open source and support the free side of our web site.
- It took about 6 months to build the company to a self-sustaining profit model...
 - Details follow...

Growing to Profit

- In the beginning with only two techs we had to support the company and grow it at the same time.
- Within a month we had two more techs.
- Within two months, we had two more techs on top of that.
- Sounds simple?
- Not really, as we also had to take stock of our cashflow...
- In other words, we have from the very beginning needed to constantly balance giving back to the community and making sure we could pay everyone.

But First...

- I don't want to make it seem like open source was a *burden* to the company.
- Actually, it was crucial.
- It just wasn't immediately capable of being turned into direct profit.

But First...

- Because of open source and because we were known before we came to Asia, we were able to get large jobs even though we were a small tiny company.
- Being open source in Singapore was also new and generated about 6 separate newspaper and magazine articles about us.
- We became a weekly contributor to the Computer Times
- We became the content producer for the ASP Alliance Consortium of Singapore (App Service Provider)

But First...

- In other words, open source was the gateway to being known...
- Being known was a gateway to business contacts...
- Business contacts became the gateway to real sales...
- **HOWEVER...**
 - Such a sales cycle takes a **LONG** time to be realized and hence cash flow becomes all important.

Business vs Technical

- One thing we had always realized was that techies like R&D and the business likes making a profit...
 - So we tried to balance the two...
 - The reality is that cash flow ruled (next section)
 - But we've spent about 20% of our time on R&D in the last year. 5 man-months on developing a Java toolkit and 4 man-months on extended our existing Perl toolkit.
 - But it really took time to grow to be able to do this.

Cashflow

- Cashflow – Can you pay your employees and your bills on time?
- Or
- What's your risk appetite?

Cashflow

- Cashflow is important because frequently, especially in consulting, your clients will never pay you immediately – especially if the job or the company is large and bureaucratic.
- Thus, as a company, you must be prepared to pay employees and other bills while doing the job and before getting paid for it.
- This is why many people don't go into business. Managing and anticipating cashflow is a high stress job.

Cashflow

- If you are a single consultant, this is OK. Many consultants are used to invoicing a client and having a couple months of buffer saved up.
- A company has to multiply that by every employee and must also be prepared for the worst.
- The problem is that cashflow limits growth possibility. It's a Catch-22.

Cashflow – The Catch-22

- In a consulting firm...
 - You need jobs to pay for your employees
 - You get jobs by having employees capable of doing the job
 - The sales cycle for any large job usually takes several months to close (and may not!)
 - So when to hire a new employee is a special exercise in risk management.

Cashflow – The Catch-22

- The ideal is to have a job before hiring an employee.
 - But the job market is tough! It would be nice to get a job and just magically hire that Senior Java or mod_perl programmer, but business doesn't happen that way.
- So cash flow analysis is used to determine how many people you can hire in order to sustain growth.
- It also means that the company has to be capitalized.

Cashflow – The Catch-22

- I mentioned previously that we are not VC funded and we are not a public company.
- However, we still had to buy our own stock and capitalize the company (inject money).
- This is another reason why starting with 5 shareholders was advantageous – each of us could pool our resources together and capitalize the company to an amount that would jump start growth and fund the cash flow of salaries while jobs came in.

Cashflow – Was it Easy?

- No!
- And there were a couple months in the start where we almost couldn't pay paychecks. The clients we had worked with took longer than expected to pay.
 - They said “Sure we'll pay in a month after it goes through accounting”.
 - But it took 3 months.
- We ended up being able to absorb everything, but it was also a lesson.

Cashflow and Risk

- This sort of thing is, of course, extremely frustrating. You've done a good job and you need the money.
- But this is business reality.
- We've been fairly lucky to have had excellent financial guidance for being a small growing company. We started with 5 and now we are at 20 and still growing.

Cashflow – Growth Risk

- Of course, the key part here is that we were and are growing. Growing is what makes cashflow hard and difficult to predict.
- It's easy in a small company to stay small (eg 1 person company) and just consult yourself out. The risk of a lack of sales is much simpler – you either have a job or you don't.
- But in hiring people, you bear a responsibility towards them – to hire them because you truly feel that your company will be around next year.

Summary

- To wrap up...
 - Running a business is hardwork
 - But it's rewarding
 - You make your own success and failure
- These days dot-coms are falling by the wayside.
- It's important to know in your heart you want to do it because there will be hard work, long hours, etc.
 - At least in the beginning

Open Discussion

Questions?