



Conference on ENTERprise Information Systems / International Conference on Project
MANagement / Conference on Health and Social Care Information Systems and Technologies,
CENTERIS / ProjMAN / HCist 2015 October 7-9, 2015

Key Metrics and Key Drivers in the Valuation of Public Enterprise Resource Planning Companies

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Abstract

As an industry matures, company valuations shift from a revenue driven valuation to a profitability driven valuation. Despite operating in a relatively mature industry, companies in the enterprise resource planning (ERP) software segment are still influenced by revenue driven valuations. The nature of the industry, with low delivery costs and high personnel costs, and the on-going switch from packaged software revenues towards “as a service” revenues protect the importance of revenues in this segment. With the development of the sector, the valuation drivers (key operating performance indicators) shift from revenue growth to profitability. In the ERP software segment top line growth remains the key driver especially with emergence of the Internet of Things and the concept of “Industry 4.0”, where an increasing number of devices are interconnected and can communicate with each other. The article analyses through regression analysis the current revenue and operating profitability based valuation levels of thirteen publicly listed in the ERM software segments against several key operating performance indicators. The results of our research show that future expected revenue growth remains the most important key operating performance indicator and both revenue and profitability driven valuations remain relevant. These findings are especially important for investors in the ERM software segment which are looking to sell their companies or to raise additional capital.

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Peer-review under responsibility of SciKA - Association for Promotion and Dissemination of Scientific Knowledge

Keywords: Valuation of ERP companies; valuation drivers; valuation metrics; ERP

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1. Introduction

1.1. Introduction

In today's globalized world, the enterprise resource planning system has become the backbone of corporations worldwide [1]. According to a study conducted by Su and Yang in 2006 and 2007 and based 298 completed questionnaires, "80% of respondents think it necessary to first adopt an ERP system as the backbone of company operations before deploying other enterprise systems" [1]. Forrester expects the worldwide ERP software market to reach \$50.3 billion in 2015 (see figure 1), highlighting the size and importance of the market [2].

The expected growth rates between 2012 and 2015, sourced from Forrester, show that the ERP software industry has reached a particular level of maturity (see figure 1). Gartner, reports a different market size of \$25.4billion in 2013 but similar growth rates of 2.2% in 2012 and of 3.8% in 2013 [3]. Typically, a maturing market is also characterized by increasing importance of profitability in valuations.

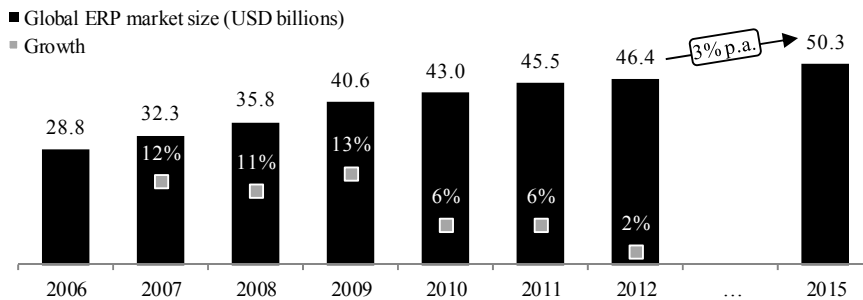


Fig. 1. Global ERP market size (USD billions), estimates by Forrester

1.2. Current technology trends influencing the valuations in the ERP industry

The key technological trend that influences the valuations in ERP industry is by far the cloud computing trend which is characterized by the switch from classical licensing revenues towards "as a service" (XaaS) revenues. While the XaaS model is attractive for clients as it offers "lower costs, scalability, quick implementation and reduced maintenance" [4] additionally to marginal initial investment and on-demand offering [5]. Cloud computing and the XaaS model is considered by experts "as the biggest development of the decade in computing" [6] and will likely continue to be implemented in the ERP software Industry. XaaS model changes fundamentally the revenue streams of the software developers as it implies the purchase of service rather than a prepackaged software [7]. This switch means that the software developers will receive monthly revenues per user rather than an one-time software purchasing revenue. The XaaS trend increases the influence of revenue on the valuations in the ERP software industry.

The second technological trend that influences the valuations in ERP industry is the emergence of the Internet of Things (IoT), defined as the "networked interconnection of everyday objects, which are often equipped with ubiquitous intelligence" [8] and the concept of Industry 4.0. which comprises additionally to the IoT, there other trends: Cyber-Physical Systems, Internet of Services, and Smart Factory [9]. The trends summarized under the Industry 4.0 concept, not only represent new systems that need to be interconnected with the ERP software, but also potentially new business segments. It is likely that ERP systems will play a defining role in the future of Machine to Machine connectivity which is "blurring [the] boundaries between virtual and physical systems" [10]. Heur suggests even that IoT will likely drive the evolution of the ERP software in the future by making "ERP flexible, intelligent and real-time" [11]. Furthermore, Hofmann concluded in 2008 that ERP vendors will have to invest in "high-performance computing, pervasive connectivity, Web services, and other trends" in order to stay alive in the future

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