

How Software Firms Can Outpace the Rule of 40

Consistently beating this magic number remains elusive for large, established firms. But it's possible with the right moves.

INSIDE THE RULE OF 40

The formula is used as a high-level gauge of performance for software businesses ...

$$\begin{array}{c} \text{Growth rate} \\ + \\ \text{Profit margin} \\ > \\ 40\% \end{array}$$

... and those that exceed the margin have valuations that are **2X** those that don't, and achieve returns up to **15% higher** than the S&P 500.

Beating the Rule of 40 year after year is tough

Many companies are able to outperform the rule in a single year, but are not able to sustain it. Of 86 software companies:



3 WAYS TO STAY ABOVE THE MAGIC LINE

Companies that consistently beat the Rule of 40 for five years can do so at all stages of their life cycle.



BALANCED GROWTH AND PROFITABILITY

Half of the outperformers saw revenue growth **between 10% and 30%**, developing new products and adapting their business models to keep growing.



STRONG REVENUE GROWTH

One-third of companies had modest profitability but grew revenues **more than 30%**, investing in hypergrowth to achieve scale.



FOCUS ON PROFITABILITY

Almost one-fifth of these companies grew **less than 10%**, instead focusing on efficiencies and the advantages of scale and scope, such as pricing power and cross-selling.



CRACKING THE RULE OF 40 CODE

Companies that sustainably beat the rule display a few common patterns.



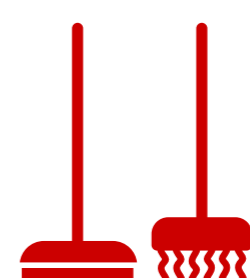
FARM AS MUCH AS YOU HUNT

Get more value from existing customers rather than focusing excessively on new ones. Deploy customer success activities and customer-friendly innovations.



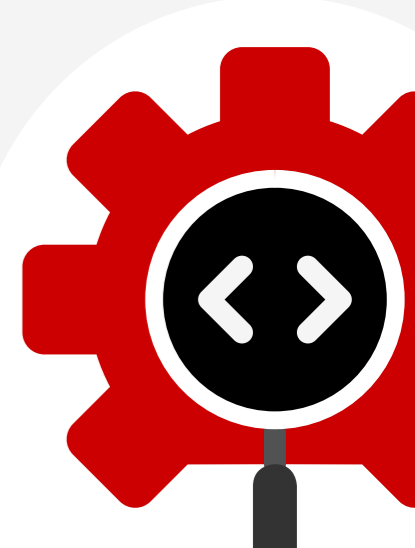
NAIL THE ENGINEERING

Balance the need for new software features with maintenance. Refocus resources by streamlining roles, supporting critical developers and adopting modern design practices.



CUT THE CLUTTER

Create operational efficiencies through automation, cutting duplication and management layers, and reducing nonessential tasks to free up your frontline resources and talent.



Read more:

[Hacking Software's Rule of 40](http://www.bain.com/rule-of-40)
www.bain.com/rule-of-40