



## Inside SaaS (Part I of II)

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By Joe Ruck, President and CEO, [BoardVantage](#)

Software-as-a-Service (SaaS), has become the 'next big thing' in IT. Reducing costs for vendor and customer alike, SaaS represents a superior business model that will drive out other delivery methods where a utility approach is appropriate. For highly customized environments or systems that represent a competitive edge for the customer (e.g. proprietary trading systems), SaaS will make limited inroads, as the SaaS success model is strongly tied with cost sharing over a multi-tenant base. It's important to realize that while SaaS will be a major part of the future, it will not be the only future.

### Customer Benefits

The benefits to the customer of SaaS are compelling and fall primarily in six areas:

- Reduced cost
- Reduced risk
- Increased leverage
- Increased flexibility
- Faster deployment
- Increased quality

#### Reduced cost

The application's design, development, maintenance and support costs are spread over multiple organizations. While many of these costs may be internally hidden from cross-charging against a project, they are real nevertheless.

#### Reduced risk

Unlike in enterprise software SaaS applications are operational 24x7 and accessible from any Internet connection. Since it is working already, the customer should be able to evaluate the working application that can easily be evaluated against the organization's requirements. There is no risk of the system not meeting requirements, as it is already operational. Implementation consists mainly of training and typically takes a day or less, not months.

#### Increased operational leverage

IT departments are under increased resource pressure to do more with less. Instead of using resources to develop functionality that is essentially the same throughout the industry, IT departments can now concentrate all their efforts on those applications that directly encapsulate the organization's competitive edge.

#### Increased operational flexibility

Organizations often prefer to lease space rather than buy it. They avoid tying up capital that could be more profitably employed elsewhere. They are also able to scale expenditures with the business – which is key if profitability is to be maintained.

#### Faster Deployment

No ROI can start before the application is installed, and here SaaS scores a huge advantage in being immediately available. This cuts implementation times of six to eighteen months to a few weeks.

## Increased Quality

Any successful SaaS business depends on a steady flow of renewal business with well-established vendors typically quoting a retention rate of 95% or more. Conversely a vendor, who experiences a steady loss of customers at renewals, is at risk. Even if they have a high rate of customer acquisition, if the “churn rate” is high, it will become the undoing of the business. Smart vendors realize that the only way to avoid this failure scenario is to have great customer satisfaction, far greater than was ever the norm with on-premise software. So effectively, when embracing a SaaS model, vendors implicitly accept a more service oriented approach than was ever present with on-premise software. This acceptance will directly and tangibly result in a big boost in product and service quality – key buying criteria for most customers.

SaaS vendors are well-equipped to deal with this challenge because high traffic from many different users will quickly test the system’s weaknesses. In contrast, an enterprise vendor with a thousand customers with their own unique combinations of hardware, software, and patches will have a hard time addressing the issues because of the sheer volume of combinations. This is why even large established software vendors still uncover new bugs daily and why you may report a problem they have never previously seen. Often these bugs are the result of a subtle interplay between the user’s environment and the vendor’s software. Sometimes even reproducing the problem may be impossible. With a SaaS approach, vendors have only one environment to manage and this can be used to guarantee the success of problem isolation, fixing, and regression testing.

All software has bugs. SaaS vendors uncover bugs quicker, and can fix faster, than an enterprise software approach to deliver a much higher quality experience. More cynically, SaaS vendors simply can’t afford for bugs to continue unfixed because ignoring them will almost certainly impact their top line in the very near future.

## Vendor Benefits

SaaS does not just make life easier for customers – it also benefits vendors.

- Reduction in support costs
- Lower cost sales model
- Predictable revenue stream
- Competitive advantage

## Reduction in Support Costs

Setting up an environment to replicate the bug on a particular environment is expensive and time-consuming. At the same time the customer is working on the (not unreasonable) assumption that the software should work in any vendor-stipulated environment, leading to frustration and a conviction that the software was not adequately tested. Although not unfair, it is an unrealistic point of view, given the number of permutations.

SaaS removes this class of problem entirely. Since enterprise software companies spend a large portion of their engineering budget on product support, eliminating this issue presents a non-trivial advantage to SaaS vendors. Support calls will continue of course but they are reduced in volume and the bulk is limited to customer assistance, dramatically reducing the costs in support, testing and QA that would normally be required.

## Lower Cost of Sales

There are a number of factors that typically drive up the length, complexity, and hence, cost of a sales cycle:

- Extensive ‘needs analysis’
- Multiple presentations to stakeholders in IT
- Multiple presentations to the business users
- Supported trials
- Customized implementations

Some of these attributes flow from the simple fact that in many cases, enterprise software purchases are so heavily customized that they might be more properly referred to as consulting projects. For SaaS vendors, there is no need for proof-of-concepts, since the actual application is readily available. Any trials can be fully automated without the need for extensive pre-sales support. There is no need for extensive requirement gathering since the application is not a customized implementation, but is instead a working system, ready for deployment.

Since the product was designed for Web access and can be demonstrated over the web, the need for face-to-face meetings diminishes and it makes sense to adapt marketing and sales processes accordingly. Prospects can test-drive the system, review whitepapers and get pricing online --all without ever needing (or in many cases, wanting) to talk to a sales representative in person.

With Sales and Marketing representing the biggest single cost to an enterprise software vendor, the SaaS advantage here is clear.

### **Predictable Revenue Stream**

Traditional enterprise software vendors operate on the basis of a one-time perpetual license, backed by an annual maintenance charge, and topped off by consulting fees. Revenue recognition is typically based on delivery of the software, not the installed system. This 'delivery of the software' often leads to a severe hockey stick shape in quarterly revenue, as the majority of the quarter's revenue is booked in the last 2 weeks of the quarter. Such a business is almost impossible to accurately predict and leads to panic measures at the end of quarter to meet targets.

In a SaaS model, there is no one time license fee, but instead a regular monthly fee, which is recognized as revenue only when the service is delivered (and so in almost no risk of being cancelled or backed out by that time). Such a model means that new account growth notwithstanding, a SaaS vendor knows that a substantial portion of their quarterly revenue is effectively guaranteed.

### **Competitive Advantage**

Finally, perhaps the most compelling benefit for vendors is the somewhat circular observation that it is of benefit to their customers. Practically this benefit is manifested when a leader in the space begins to get the benefit of an increasing returns dynamic. This comes about as leaders in their respective spaces are increasingly able to roll-up customer input in new product, which over time makes their domain expertise so strong that it's impossible to match by on-premise vendors or late-arriving players in the segment. In 2008, this means that even such established Enterprise software vendors as Oracle and SAP are introducing SaaS delivery models.

## Inside SaaS (Part II of II)

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By Joe Ruck, President and CEO, [BoardVantage](#)

### Concerns for Customers

A SaaS approach does not suit all applications or industries, and would-be customers should be aware of the possible drawbacks.

- New skill sets
- Competitive edge
- Customization
- Integration
- Security and accountability
- Impact on IT

### New Skill Sets

Customers new to SaaS often make one of two mistakes when evaluating a solution. First, IT departments may apply the same criteria to procuring SaaS as they apply when buying on-premise software. Another common mistake is one made by the business user, which naively assumes that buying a service means that they can cut IT from the process altogether. That is rarely a good idea, and IT has a crucial role to play in SaaS evaluations.

### Competitive Edge

Just as PCs did not kill the mainframe, neither will SaaS kill off on-premise software.

One obvious example regards those applications that offer a competitive edge. While sales is critical to all organizations, few companies would claim a competitive edge in how sales data are stored or forecasts rolled up. So while using a SaaS contact management solution makes more sense than installing and managing one of your own, it would make no sense for a company that, for example, derived its competitive edge from sophisticated logistical scheduling, to supplant that with a SaaS solution.

### Customization

Since SaaS solutions derive most of their financial benefits from being shared over multiple tenants, it might be assumed that any customization flies in the face of this. In fact, customization is an increasingly available capability for SaaS.

However, the basic economics remain the same and any cost of customization, no matter how low, must still be borne by that single customer. As always, care should be taken with customization since requirements are seldom clearly articulated, let alone implemented. Any discussion of customization needs to be considered in a discussion on competitive edge. It makes little sense to spend money customizing a non-competitive edge process.

### Integration

Traditionally the Achilles heel of all packaged applications, integration has benefitted greatly from recent advances in web technology with Service Oriented Architecture (SOA). And today most SaaS vendors provide a form of programmatic web based API to enable read/write access for content.

While historically a concern for SaaS vendors, increasingly ease of integration has instead become an actual advantage for SaaS vendors given their ubiquitous ease of access over the web.

### Security and Accountability

From a security standpoint, the customer needs to perform due diligence on their vendor as they would any other third

party with access to their data. The SaaS vendor should have independent certifications such as SAS70 and third party security audits available for review.

Likewise, accountability needs to be viewed in the same light as any other contractor or service provider for what they are – an extension of your business. This includes a clear understanding of such issues as business continuity, service levels, and liability.

## **Impact on IT**

IT is responsible for many things – hardware, networks, software, installations, projects, service levels and applications. Suddenly business professionals can get all of these with little more than an Internet connection and a credit card. This legitimately might give IT pause about the impact of the model on its own profession. Articles such as ‘Does IT Matter?’ by Nicholas Carr (HBS) reinforce these concerns.

The outcome of large technology shifts, such as these, is notoriously difficult to predict. In one scenario IT departments will become smaller. However it’s equally possible to paint a more expansive and important view of IT, one which focuses on the competitive edge parts of the business while happily passing over utility applications to SaaS vendors. In that view IT will increasingly be focused on applications which will provide the company with competitive advantage. But even under those circumstances IT should maintain its role in the critical evaluation and of SaaS applications to make sure the vendor chosen will meet the standards set out for any company applications whether on premise or hosted externally.

## **Concerns for Vendors**

There are some issues with a SaaS approach that vendors need to consider:

- New skill sets required
- Customer acceptance
- Financial market acceptance

## **New Skill Sets Required**

In addition to the requirements for relevant systems management and general IT expertise, a SaaS business mandates a great emphasis on disciplined process (especially as regards to security and business continuity). This focus on process often flies in the face of a youth-oriented culture of aggressive individualism that exists in typical software companies. It’s no longer about ‘can-do’; it’s now about ‘must-do’.

Finally, creating an application suitable for multi-tenancy has fundamentally different constraints than one meant for a single customer. In fact it’s useful to consider a SaaS vendor as having two ‘applications’ –the one they provide to their end-users, and the one they use to run the SaaS business itself in terms of billing and provisioning their customers. In many established SaaS vendors these two application areas have roughly equal weight and investment.

## **Customer Acceptance**

Not all industries and customers are moving to SaaS at the same rate. Also, as discussed elsewhere, not every application is best served by SaaS.

Clearly a vendor needs to understand their own target market to know whether SaaS delivery would be of net benefit or loss to their customers. And timing is critical. Acceptance of and demand for SaaS is increasing all the time, and examples of first-mover success abound. Consider Salesforce.com which boasts a dominant market lead, in contrast to their position a few short years ago when they were a mere speck compared to then-formidable Siebel.

## **Financial Market Acceptance**

The financial markets have thirty years experience in the Enterprise software hockey stick, and almost none of SaaS vendors. As a consequence, it can be argued that SaaS vendors are still valued using metrics more appropriate for Enterprise software, and this undervalues the greater predictability and lower risk of a subscription based revenue stream, even though this also means a lower (but more sustainable) revenue growth rate.

## The Future of SaaS

Installed software is not going away. But SaaS, although not the one-and-only future in software, will be increasingly important, and before long dominant, powered by ever greater investment and more compelling innovation.

SaaS brings tangible benefits to vendors and customers alike, but only if the right SaaS product is applied to the right problem. For some problems, an on-premise mainframe is still the best.

SaaS will also make deeper inroads where it already enjoys success and branch out to pervade more and more functional areas. As this happens we will see an increased emphasis on acceptable standards (some through government regulations) of information security and data privacy, as well as an increased emphasis on open, portable data.

Finally, just as the emergence of the PC and personal applications led to the creation of a whole class of independent knowledge workers and contractors, it's likely that SaaS itself will alter business patterns by easing the collaboration between companies, facilitate partnerships, and move the focus from internal to external.

### About the Author



Joe is president and CEO of BoardVantage. He has led many high-technology companies through successful growth to IPO or acquisition. Prior to joining BoardVantage, Joe was senior vice president of marketing at Interwoven and part of the team that drove the company through one of the most successful IPOs of 1999. Previously, he held sales, marketing, and executive positions at Sun Microsystems, Network Appliance, and Genesys Telecommunications, subsequently acquired by Alcatel. Joe holds a BS in engineering from Oregon State University and an MBA from Santa Clara University.

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