



## The future of SaaS: Is there **light** at the end of the tunnel?

Software firms transitioning to SaaS saw market capitalizations rise nearly 300% while revenues and margins remained mostly flat: These valuations seem hard to justify today, and will be harder to justify tomorrow.



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## EXECUTIVE SUMMARY

The shift to SaaS is real. It has given birth to new application leaders, forced traditional software companies to shift their business models, and altered end-user expectations forever. Investors like SaaS companies, evidenced by the surging valuations of these firms. But many of these valuations seem difficult to justify.

To shed light on this, AV&Co. undertook a series of analyses: These included a complex survey of approximately 700 buyers of enterprise applications, analysis of nearly 30 publicly traded application firms, interviews with industry executives, and tapping into our own knowledgebase from assisting dozens of firms throughout the application ecosystem with their strategic and operational challenges.

Some of our findings were striking. For example, we tracked eight publicly traded enterprise software firms through the first five years of their transition to SaaS. On average, revenues and margins dipped in the early years for all firms, before recovering only to pre-transition levels at roughly five years. Over the same period, the average market capitalization of these firms surged nearly 300%.

In evaluating these firms, investors are betting on long-term recurring revenue, sustained high growth rates, and eventually stable profitability. They are ignoring traditional measures, e.g., current operating margins. But as SaaS penetration in certain markets approaches a ceiling, and new customer acquisition begins to slow, the end of the tunnel may be nearing. It is not clear how these SaaS firms will look when we reach it.

To offset decelerating growth, many market leaders are focused on driving up/cross-selling of the existing base (mostly via M&A), and minimizing customer churn. But those tactics might not be enough. Soon they may need to consider traditional tactics, (e.g., cost cutting and price increases), to boost operating margins. But cost cutting, (e.g., reduced spending on Sales and Marketing), may just slow growth faster. And price increases, with few exceptions, are likely to alienate price-sensitive SaaS buyers.

In sum, it's not clear if there is light at the end of the tunnel for SaaS firms. They will increasingly struggle to maintain high valuation multiples in the face of traditional operating challenges.



## INTRODUCTION

Although the shift to SaaS has been occurring for 15+ years, accompanied by fast growth and flashy headlines, many pureplay SaaS companies have yet to show a profit. More gradually, traditional software players are evolving, and have added SaaS as an offering or shifted to a SaaS-first strategy. Facing an existential threat as customers buy more directly from SaaS providers, and as SaaS reduces the need for implementation services, channel partners are scrambling to identify and deliver new, sustainable services, and tweak their business models to survive.

As we reflect on the SaaS / Software and IT Services firms we work with daily, there are some fundamental questions the market has yet to answer about the future of SaaS:

- Are SaaS economics attractive to providers and investors?
- How have customer needs and expectations evolved with the growth of SaaS, and how will they evolve going forward?
- How must reseller channels evolve given the shift to SaaS? Or will they even survive?

To shed light on these questions, AV&Co. undertook a series of analyses: These included a complex survey of approximately 700 buyers of enterprise applications, analysis of nearly 30 of publicly traded application firms, interviews with industry executives, and utilization of our own knowledgebase from assisting dozens of firms throughout the application ecosystem with their strategic and operational challenges.

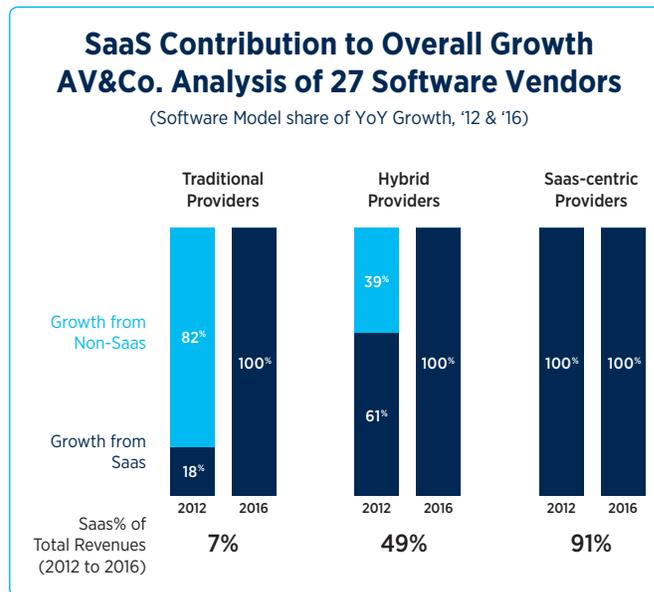
This first edition of thought leadership attempts to answer some (admittedly, not all) of these questions. A follow up edition will address the future of resellers in a SaaS world.

### **The Transition to SaaS is Clear**

Twenty-four percent of spending on enterprise applications went to SaaS-based solutions in 2015. That number is expected to grow 50% by 2020 and reach 36% of application spending. As noted in Figure 1, in 2016 100% of the growth experienced by application firms we analyzed was due to SaaS. For traditional software firms (defined as <25% of revenues from SaaS) as recently as 2012 only 18% of their growth came from SaaS. For hybrid firms (25-75% of revenues from SaaS), only 61% of their revenues came from SaaS in 2012.



Figure 1: SaaS now accounts for all growth at application firms



SaaS pureplays, e.g., Salesforce, are market share leaders vs traditional stalwarts, e.g., Oracle and SAP. The world's largest software firm, Microsoft, is driving its own aggressive transition to SaaS, most notably by “encouraging” customers to shift to the Office 365 suite, the SaaS version of the ubiquitous Microsoft Office Suite.

SaaS is for real. It is here to stay. Increasingly, it is the new normal. And it has been disruptive:

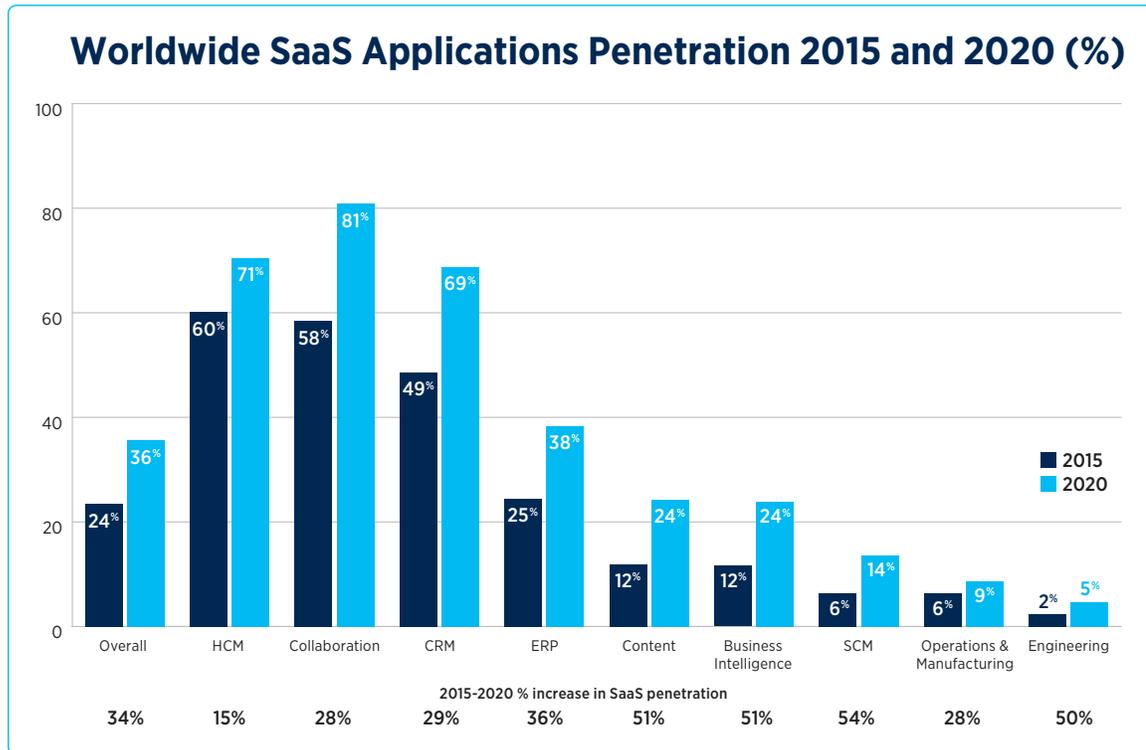
- It has brought the birth of new pureplay SaaS vendors, squeezed traditional software vendors, disrupted reseller channels, and altered customer expectations forever.
- SaaS has also “opened up” new buyer segments (e.g., midsized and small firms). These firms previously could not afford sophisticated applications, but now can thanks to OPEX-based subscription pricing and the leaner deployment requirements of SaaS solutions.

**Figure 1** – Traditional: Intuit, Oracle (software division), SAP, PTC; Hybrid: Adobe, Ansys, Atlassian, Autodesk, Callidus Software, Jive Software, Nuance, Sage; SaaS: Brightcove, Cornerstone onDemand, Demand Ware, Intralinks, Marketo, NetSuite, New Relic, Paycom, Qualys, Salesforce, SPS Commerce, Ultimate Software Group, Veeva Systems, Workday, Zendesk. Sources: AV&Co. Analysis

## The Transition has been Uneven

The impacts of SaaS have not been evenly distributed across a sea of application vendors. Per Figure 2, different enterprise applications are transitioning to SaaS at different rates.

**Figure 2: SaaS adoption is pervasive but varies by application**



Human Capital Management (HCM), Collaboration and Customer Relationship Management (CRM) were some of the earliest applications to start a transition. By 2020, those markets will be near 70% SaaS – arguably approaching a “SaaS ceiling”, or full SaaS penetration. Vendors in these markets are increasingly faced with decelerating growth, price compression, and traditional vendors who have “woken up” to SaaS – rather than fight it, they now embrace it.

Other markets are just now starting to accelerate a transition. Enterprise Resource Planning (ERP), Content Management, and Business Intelligence (BI) have seen mostly modest SaaS adoption to date, but will likely double their penetration over the 2015-2020 period. Vendors in these markets should expect many of the dynamics experienced in Content Management and CRM, with one major exception: Traditional software vendors will not be so slow to shift to SaaS this time around in these markets.

And still other markets, e.g., Supply Chain Management (SCM), have seen low adoption to date, and are not expected to accelerate much in the near term – but their time will come.

**Figure 2** – Sources: IDC Worldwide Software as a Service and Cloud Software Forecast, 2016–2020 August 2016; IDC WW Human Capital Management and Payroll Applications Forecast June 2016; IDC WW Business Analytics Software Forecast August 2016; IDC WW Enterprise Resource Management Applications Forecast June 16. Note: ERP (not HCM) includes payroll applications.



## Pricing has Forever Changed

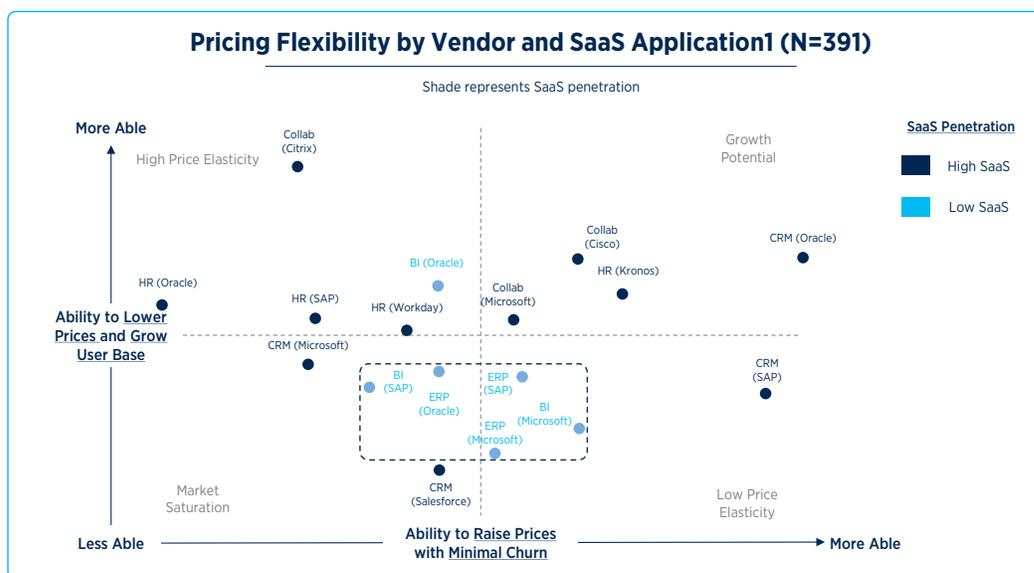
SaaS has changed the pricing dynamic also, as noted in Figure 3. Markets with high SaaS penetration experience a wide range of pricing levels, and a corresponding wide range of vendor capabilities to raise or lower prices and achieve positive results. For markets with low SaaS penetration, the pricing bands are much tighter, and the ability of vendors to raise or lower prices is much more consistent across vendors.

There are reasons for the difference: SaaS players frequently entered markets with much lower pricing compared to software competitors. Their strategy was to quickly gain share and establish themselves as credible market leaders. They prioritized growth over near term profitability, and set an expectation that profitability would come later. For the most part, investors have supported this strategy.

But this approach to pricing also disrupted expectations for all application customers, not just SaaS customers. SaaS pricing made some software customers begin to consider the prices they were paying for software as excessively high, while other software customers remained comfortable with their current pricing and vendors. SaaS pricing also appealed to very cost conscious buyers, who may not have bought anything before a SaaS option was introduced. They expect all applications to have low pricing. The result of all of this is the wide range of perceptions on vendor ability to raise or lower prices. This is much less of an issue in low SaaS markets. Customer sentiment toward pricing is more level headed.

It will be interesting to watch, as high SaaS penetration markets begin to mature, if pricing coalesces around tighter bands as we see in mature software markets - This has implications for the future of SaaS pricing, and ultimately the ability of SaaS vendors to compete on price, stabilize pricing, or potentially raise prices.

**Figure 3: Pricing flexibility is more varied for SaaS vendors vs software vendors**



**Figure 3** – Source: 2017 AV&Co. SaaS Survey, IDC, Gartner, Expert Interviews

## HOW CAN SAAS VALUATIONS BE JUSTIFIED?

At Altman Vilandrie & Co., we assist software and SaaS companies and application resellers with their strategic and operational challenges. We also assist investors in their evaluation of the same types of companies. We have worked with a range of management teams, and conducted deep analyses across the application ecosystem. With every question we answer, new questions arise. Of those, one seems incredibly important regarding the future of the application industry: Are SaaS valuations justified?

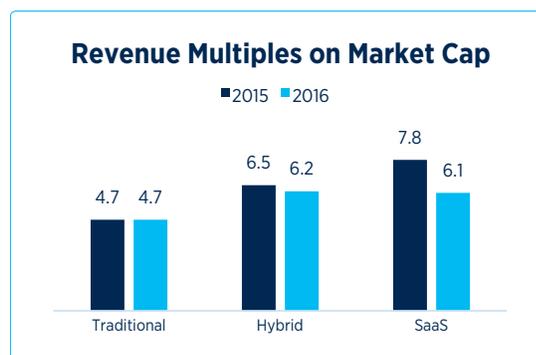
To address this we evaluated a range of publicly traded software and SaaS firms, and compared them across three vectors:

- A. Traditional financial performance metrics
- B. Customer Lifetime Value (CLVs) estimates
- C. Market cap growth relative to revenue and operating margin growth

### A. Software vs. SaaS: Financial Performance Metrics

SaaS firms have high valuation multiples, as noted in Figure 4, driven by the perceived value of long-term recurring revenue relationships and sustained growth rates. But are these multiples justified? To answer this, we pivoted to another question: How do Software, Hybrid and SaaS firms stack up against each other across some basic financial performance metrics?

**Figure 4: SaaS multiples exceed software comparables**

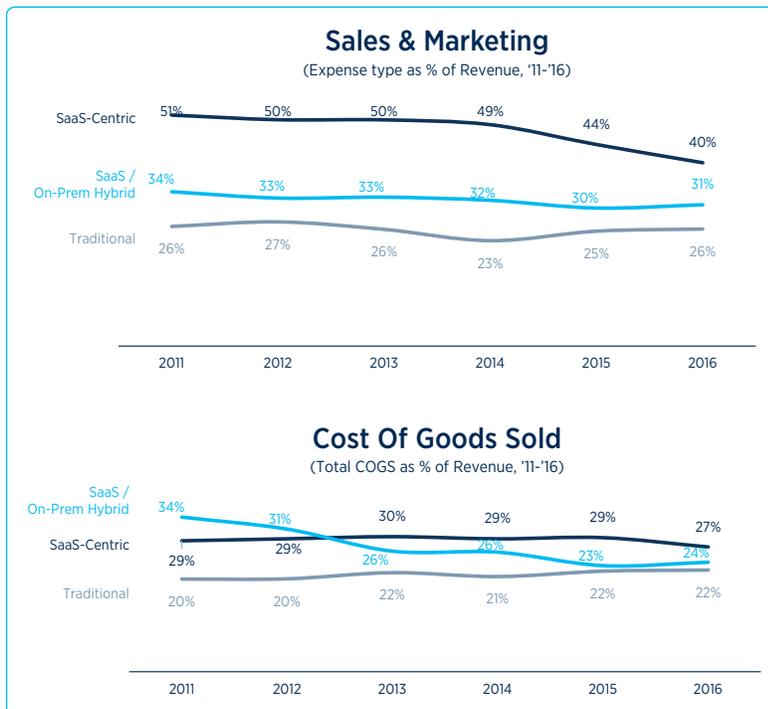


Per figure 5, we evaluated 28 application firms across three categories: Software firms (>75% of revenue from software vs other categories); SaaS firms (>75% of revenues from SaaS); and Hybrids (<75% of revenues from Software or SaaS). Across two key financial metrics (Sales and Marketing as a % of revenues and COGS as a % of revenues), Software companies perform much better, followed by Hybrids. SaaS companies had poorer metrics (though it is worth noting that SaaS firm metrics have improved slightly in recent years).

**Figure 4** – Sources: 2017 AV&Co. SaaS survey; AV&Co. analysis of 27 software companies: Intuit, Oracle (software division), SAP, PTC, Adobe, Ansys, Autodesk, Callidus Software, Jive Software, Nuance, Sage, Atlassian, Brightcove, Cornerstone onDemand, Demand Ware, Intralinks, Marketo, NetSuite, New Relic, Paycom, Qualys, Salesforce, SPS Commerce, Ultimate Software Group, Veeva Systems, Workday, Zendesk



Figure 5: SaaS firms have higher operating expense profiles



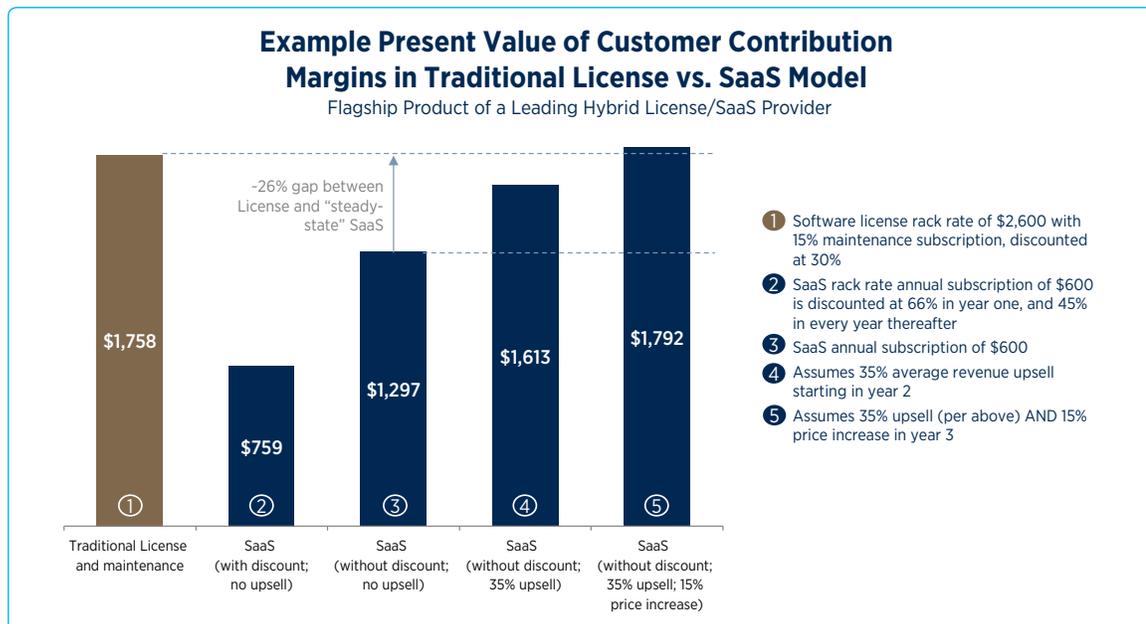
Those bullish on SaaS insist this is not how to evaluate SaaS firms. Rather, we should focus on recurring revenue over time, or better yet, free cash flows. This is difficult given the pace of change in the market, especially at firms undergoing a transition from software to SaaS. It also varies based on the penetration of SaaS in an overall market, e.g., CRM vs Business Intelligence.

**Figure 5** - SaaS-Centric providers generate >75% of Rev from SaaS; Hybrids generate 25-75% of Rev from SaaS; Traditionals generate <25% of Rev from SaaS. Traditional: Intuit, Oracle (software division), SAP, PTC; Hybrid: Adobe, Ansys, Atlassian, Autodesk, Callidus Software, Jive Software, Nuance, Sage; SaaS: Brightcove, Cornerstone onDemand, Demand Ware, Intralinks, Marketo, NetSuite, New Relic, Paycom, Qualys, Salesforce, SPS Commerce, Ultimate Software Group, Veeva Systems, Workday, ZendeskSources: AV&Co. Analysis

## B. Software vs. SaaS: Customer Lifetime Values (CLVs)

Nonetheless, we evaluated one well-known software firm as it transitioned to SaaS. For this firm, we could compare customer lifetime value estimates for a typical software customer vs a typical SaaS customer. Per Figure 6, we found that the company would have to drive significant up/cross selling (an incremental 35% of subscription list pricing) as well as price increases (15%) for SaaS customers to reach the same CLVs as its software customers.

**Figure 6: For SaaS firms to match software firm contribution margins will require aggressive up/cross-selling and price increases**



Still, one could argue that over time these CLVs could improve, and SaaS customers could become more attractive, and potentially justify valuation multiples. How much CLV improvement could justify a valuation hike?

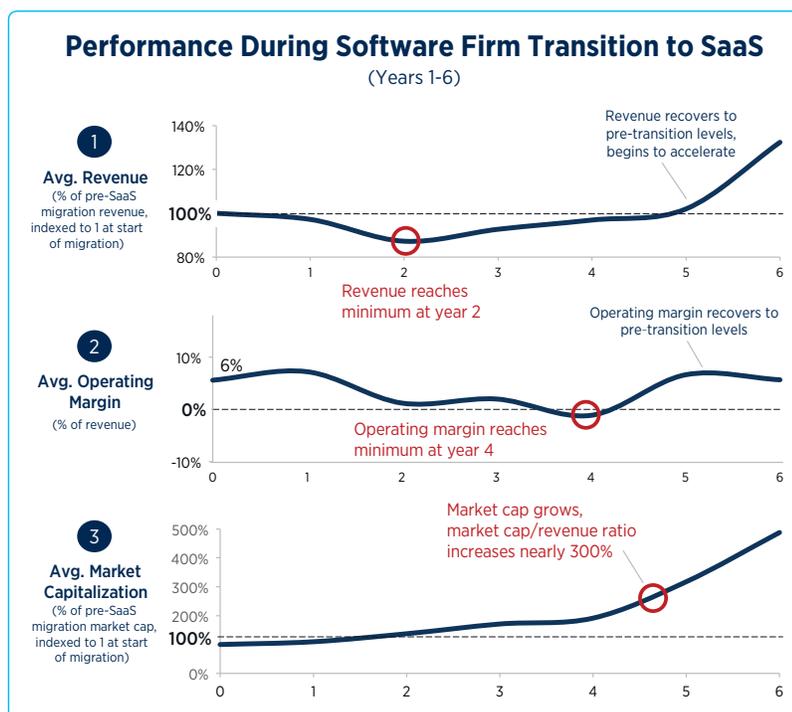
**Figure 6** – Source: AV&Co. Research and Analysis, Provider website, earnings call and financial statements, Trefis Research, Bridge Group, ZS Associates Research, Pacific Crest SaaS Survey. Assumptions: 6 year customer lifetime in both traditional and SaaS models. SaaS gross margins slightly lower than traditional (65% vs. 70%). SaaS new logo commission higher (in 2013, 10% SaaS vs. 4% traditional). SaaS cash flows accumulate over a longer period of time, resulting in less value due to discounting (time value of money). WACC 8%. \* Contribution margin is calculated from the revenue for the product subtracted by the cost per acquisition (e.g. Sales Commission) and annual cost from the product (e.g. COGS)



## C. Software vs. SaaS: Market Cap Growth

To test this, we conducted an additional analysis: We examined eight publicly traded software firms with stated strategies to shift from software to SaaS. We evaluated them over the first 5 years of their transition, as noted in Figure 7.

**Figure 7: Financial metrics dipped in the first 5 years for software firms transitioning to SaaS – but market caps surged ~300%**



Across the eight firms, revenue fell in the early years, dropping on average 20% by year two before recovering slowly to pre-transition levels by the fifth year. After that, revenue growth appears to accelerate. The margin story was less clear. Average operating margins slowly fell from 6% to slightly negative by year 4, before recovering to pre-transition levels between year 5 and 6.

Most interesting, during the same five-year period, while revenue and margins dipped before recovering only to pre-transition levels, the average valuation of these firms increased by nearly 300%. That's quite a rise in the face of modest financial metrics during the period.

*Is it reasonable that a company transitioning customers from one method of consuming an application to another has in parallel increased its value by 300% in five years?*

**Figure 7** – AV&Co. Research and Analysis; Autodesk, Callidus, Adobe, Intuit, PTC, Oracle, Sage and Ariba 10Ks, 10Qs, and Earnings Call Transcripts



There's no way to prove today's SaaS firms are over-valued vs their software counterparts. But the misalignment between traditional financial performance metrics and current valuations is noteworthy.

We discussed this analysis with an early SaaS-industry veteran who played a central role in successfully guiding his firm through its transition from software to SaaS. His firm also saw a healthy valuation improvement during the transition. He cautioned us that we should "...only be looking for long-term recurring revenue. Five years' worth, that's how we thought about it." We asked: "When does the five years start?" He replied: "That's a good question. We kept pushing it out to be frank."

## **A Day of Reckoning Looms**

Customers are indeed transitioning away from software to SaaS – and investors clearly value where customers are going vs where they have been. SaaS firms are held to different standards vs. software firms – Investors look past traditional financial performance metrics in favor of long term recurring revenue expectations.

But it is also clear that SaaS firms, especially early leaders, will struggle to achieve double digit growth rates forever. As SaaS penetration levels reach ceilings (60%, 70%, 80% in certain markets), SaaS pureplays have started to see growth for their core solutions decelerate.

## **Grow in Every Direction One Can**

Many are trying to maintain high growth by expanding into adjacencies, via a mix of organic development and M&A, and drive cross/upselling. M&A is increasingly the more attractive path, as acquirers can pick and choose among proven applications, and the impact on revenue growth can be immediate. But it is expensive: Salesforce spent more on acquisitions in 2016, over \$4B, than in the previous 10 years combined, based on public reporting. It is also important to note that most SaaS firms are not finding the same success from expanding into adjacencies they saw with their initial solutions.

## **Easy to Adopt = Easy to Leave**

Managing churn is also a challenge to sustaining growth rates. Indeed, one of the earliest value propositions for SaaS was its ease of adoption vs software. But SaaS leaders have found that "easiness" can be a double-edged sword. SaaS is easier to adopt, but also easier to churn for a customer: SaaS requires less upfront investment vs a multi-year software license, and therefore less cost a customer must spread out over time. SaaS is also typically less expensive to install, which again means less cost to spread out over time. If the overall investment is smaller, customers may be less reluctant to throw it away and start fresh with a new solution.

SaaS firms aren't only challenged with managing overall customer (or logo) churn, but also user churn within a customer account. SaaS buyers often purchase seats for their employees, then learn over time that some subset of seats is not being utilized. They then reduce the number of seat subscriptions. Such "seat churn" is less frequent with software licenses because it is much more difficult to identify unused licenses vs subscription seats. And again, licenses are typically multi-year and paid for upfront, so there's little incentive to audit usage post-purchase.

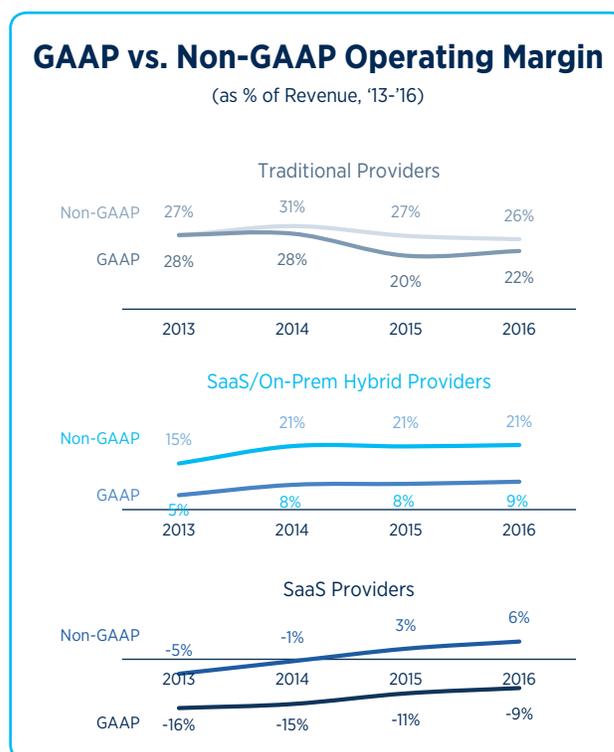


The overall churn dynamic within SaaS gave rise to new function at SaaS firms: Customer Success. A mix of customer support, customer training and installed base marketing, the Customer Success function at SaaS firms fights the frontline battle to minimize churn and maximize application utilization at each customer. Indeed, some of the most important and high-profile executives at larger SaaS firms are Heads of Customer Success.

## FACING A GROWTH CHALLENGE, WHAT CAN SAAS FIRMS DO?

Beyond cross/upselling, and churn reduction, what else can SaaS firms do to maintain valuations when faced with growth deceleration of the core business? One option may be to focus on improving operating margins and CLV's via more “traditional levers”, e.g., raise prices and/or cut expenses. The improvement required to reach software company operating margins is not trivial, as noted in Figure 8. Operating margins as a percent of revenue (both GAAP and non-GAAP) have been much healthier for Software and Hybrid firms relative to SaaS firms. It is worth noting, however, that both Hybrid and SaaS firms are improving. For the software firms we assessed, operating margins as a percent of revenue held steady in the 20-30% range for 2013-2016. Over the same period, the same metric for Hybrid firms moved from 5-15% (GAAP and non-GAAP) to 9-21%. For SaaS firms, operating margins improved from -16% to -5% to -9% to 6%.

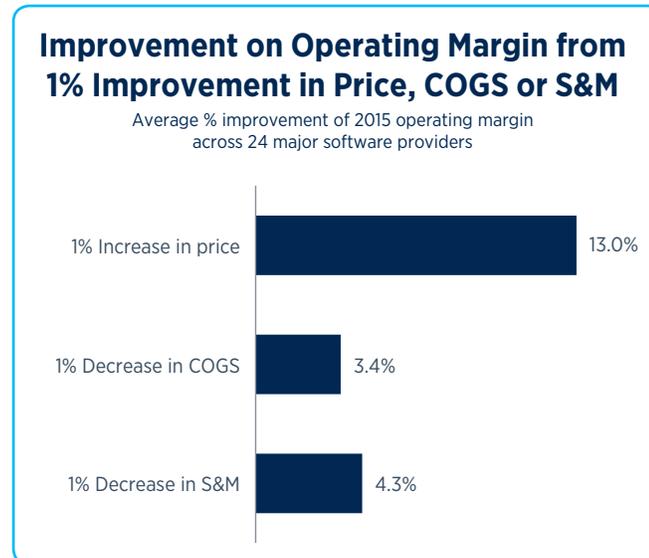
**Figure 8: SaaS margins are improving, but still far behind**



## Are price increases an option?

Per Figure 9, price increases, would have greater impact than cost cutting on operating margins – But how would the market react? We evaluated this question via two tests.

**Figure 9: Price increases could accelerate SaaS operating margin improvement**



## Test #1: Which Vendors Can Increase Prices?

We surveyed nearly 700 software and SaaS buyers in the US via a complex discrete choice exercise, to determine the impact of price increases across a range of SaaS packages and vendors. Specifically, we evaluated SaaS offers for:

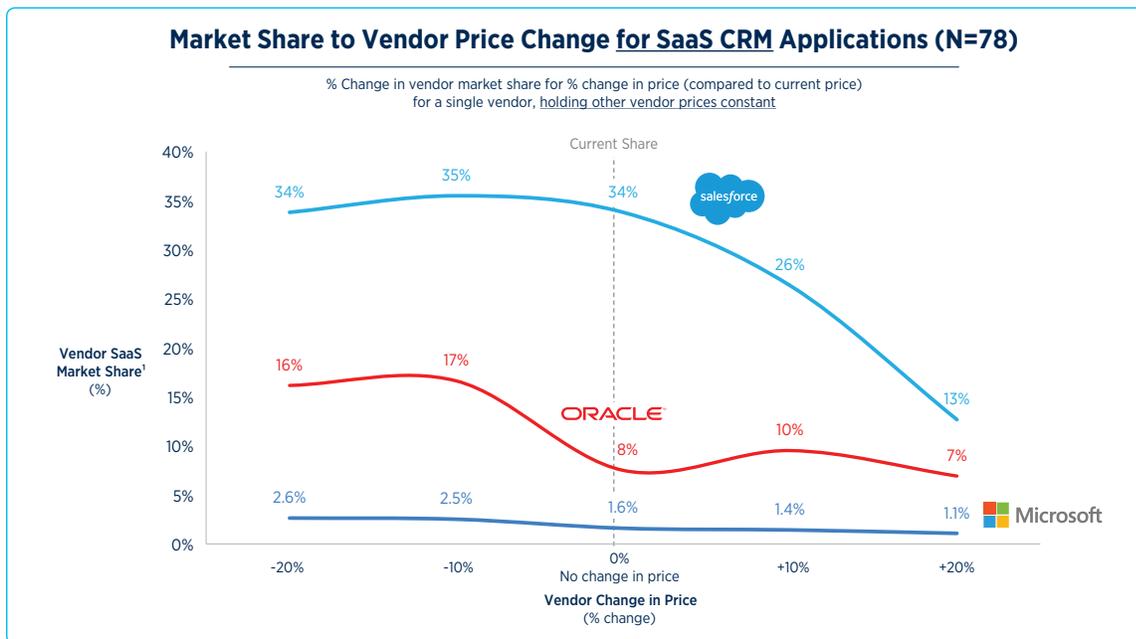
- > Customer Relationship Management (CRM) SaaS – Salesforce, Oracle, Microsoft
- > Enterprise Resource Planning (ERP) SaaS – SAP, Oracle, Microsoft
- > Human Capital Management (HCM) SaaS – SAP, Oracle, Workday, Kronos
- > Business Intelligence (BI) SaaS – Microsoft, Oracle, SAP

The results were quite clear: With only two exceptions, SaaS vendors who raised prices lost revenue market share, those who reduced prices saw share gains. This was to be expected. The two exceptions are noted in Figure 10.

**Figures 8 & 9** – SaaS-Centric providers generate >75% of Rev from SaaS; Hybrids generate 25-75% of Rev from SaaS; Traditionals generate <25% of Rev from SaaS. Traditional: Intuit, Oracle (software division), SAP, PTC; Hybrid: Adobe, Ansys, Atlassian, Autodesk, Callidus Software, Jive Software, Nuance, Sage; SaaS: Brightcove, Cornerstone onDemand, Demand Ware, Intralinks, Marketo, NetSuite, New Relic, Paycom, Qualys, Salesforce, SPS Commerce, Ultimate Software Group, Veeva Systems, Workday, Zendesk. Sources: AV&Co. Analysis



**Figure 10: Salesforce loses massively with price increase, gains little with further price cuts; Oracle could grow share by increasing or lowering prices**



- **Salesforce: Optimized, but Nowhere to Go**

For Salesforce, a price increase of 10% would see the SaaS leader lose nearly 1/3 of its share in our model – from 34% SaaS CRM revenue share to 26%. More interesting, if Salesforce reduced pricing by 10% the firm would see only a 1% gain in revenue share – essentially no incremental adoption. We conclude from this that Salesforce SalesCloud is optimally priced: Neither a price cut nor hike would improve the company’s market share position. That also means price changes will not help improve financial metrics in the face of decelerating growth.

- **Oracle: Upside in Every Direction**

The other exception is Oracle’s SaaS CRM business. If Oracle reduced prices, SaaS CRM revenue market share would more than double, from 8% to 17%. Uniquely, if Oracle raised prices, they would grow market share from 8% to 10%. Put another way, a 10% price hike, would yield 25% more revenue share – a fascinating outcome when compared to the rest of the market. From this we conclude Oracle is attempting to carefully manage the transition of current CRM software customers to SaaS in a way that maximizes overall company revenue and margins. Oracle could drive much more transition with a slight price cut. But Oracle doesn’t want to shift a current software customer to SaaS any faster than necessary to retain the customer. Oracle also doesn’t want to lose customers with a price hike. That means current Oracle SaaS customers are satisfied with their pricing, or they would churn in our model, as was the case with every other vendor we tested.

**Figure 10** – Current Share is for SaaS CRM in 2014 from IDC; Combined vendor revenue for 2014 SaaS CRM is \$5.1B; Market share is calculated from simulated share from conjoint analysis Sources: 2017 AV&Co. SaaS Survey, IDC

**Figure 11** – Source: 2017 AV&Co. SaaS Survey



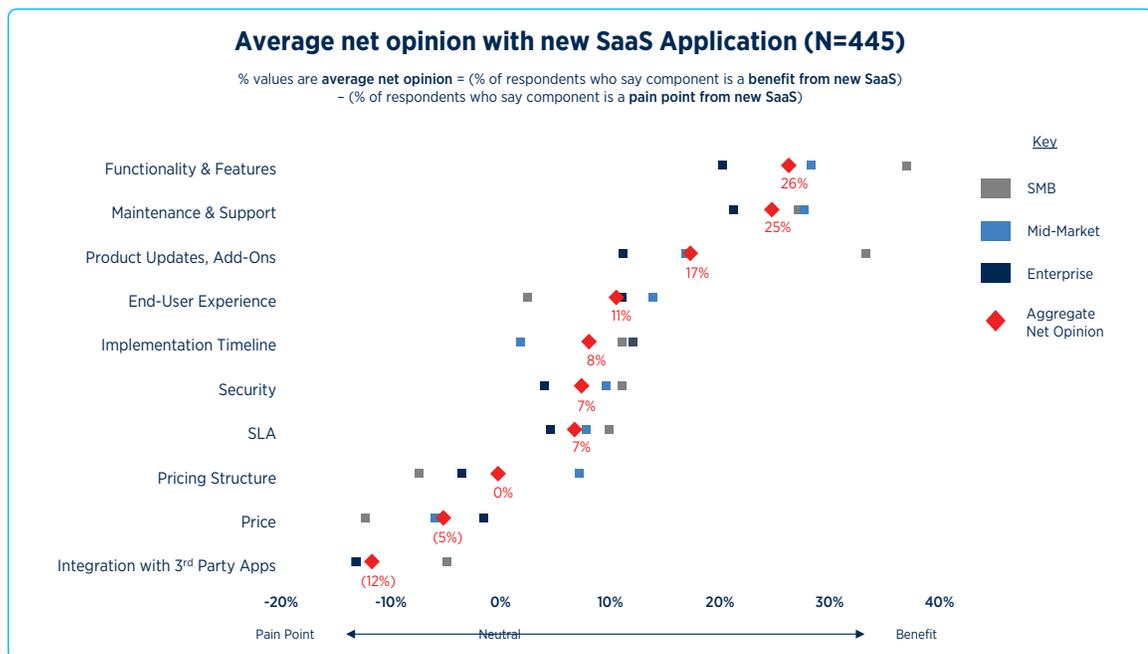
## Test #2: Will Customers Accept Price Increases?

We also surveyed attitudes on SaaS pricing over time, specifically at purchase vs 2-3 years post-deployment. The results, as noted in Figure 11, were more extreme than expected. More than nearly any other attribute (other than “ability to integrate with 3rd party apps”) SaaS customers express disappointment with the pricing of their SaaS solutions. We believe this reflects “latent sticker shock” from a combination of factors:

- The post-purchase reality of what their subscription commitment looks like over time relative to previous software license models, and
- The unanticipated cost of migration and deployment to get SaaS solution up and running.

It is worth noting that buyers are neutral on the pricing structure of their SaaS solutions, which likely reflects a modest appreciation for the OPEX model despite overall disappointment with the pricing itself.

Figure 11: Post-adoption, buyers less enthusiastic about SaaS pricing





## Pricing: The Third Rail for SaaS

Overall, pricing is not the lever we thought it might be to improve financial metrics. On average SaaS customers are smaller, with tighter budgets, and were likely drawn in by the aggressive pricing of early SaaS pureplays. They seem very unlikely to accept a price increase.

Cost cutting may be possible, but cuts (especially in Sales and Marketing) may further slow growth rates or even accelerate growth declines, which would further risk current valuations.

Shifting to an indirect sales model may reduce customer acquisition costs over time, but the upfront investment in a channel program, and aggressive scaling up of a partner network, can be arduous in the near term. That said, our analysis found that indirect channels should play an important role in SaaS going forward, especially in mid-market and enterprise deployments. As noted in the Introduction of this paper, we will address the future of resellers in a SaaS world in a subsequent paper.

## CONCLUSION

### Is there light at the end of the tunnel for SaaS? Maybe...

- SaaS is the sole source of growth in the application industry, and will account for more revenue in 2017 than software license sales.
- Customers increasingly prefer SaaS, and investors reward providers with higher market caps and multiples vs software firms. While recurring revenue is compelling, other SaaS financial characteristics are less so, e.g., low operating income and lower CLV's vs software
- High sales & marketing costs, higher COGS, churn risk and price compression are real challenges in the face of decelerating growth for more established SaaS firms
- In the face of these challenges, something needs to change to justify valuations going forward.

### Is pricing a lever SaaS providers can pull to improve financials? For Oracle, apparently yes. For Salesforce, no. For other firms, not so much.

- Price increases would be the most powerful lever for margin improvement
- But price increases present challenges – Access to low prices is among the major drivers for customers switching to SaaS
- To complicate further, customers are disappointed with SaaS pricing once they've adopted – suggesting SaaS is costlier to procure, deploy and operate than anticipated
- Nearly all SaaS vendors would lose revenue market share if they raised prices, and gain revenue share if they cut prices ... with 2 exceptions:
  - > Oracle could grow revenue share by raising OR cutting prices
  - > Salesforce would lose 1/3 of their revenue market share by raising prices, and gain nothing from cutting prices – We believe Salesforce's current pricing is optimal



### What this means for SaaS firms

- SaaS pureplays, and hybrid players exiting their transitions, must learn to improve their financial metrics before growth begins to slow – or risk a more rational review of their financials by investors
- SaaS firms should continue to pursue adjacent SaaS and services opportunities to sustain growth rates. But recognize that success with adjacencies is often more challenging than with the core business
- Look to reseller networks as a more efficient way to continue growing but at lower Sales & Marketing ratios (this topic will be explored further in our next paper)
- Customer Success operations help to mitigate churn, but SaaS firms should double down on analytical approaches to anticipate and counter churn as a mitigation strategy. The models for this already exist: mobile operators and cable companies (just two examples) increasingly leverage analytics to mitigate churn in their businesses
- Explore targeted and segmented price increases where possible. There may not be many opportunities for this, but relative to other financial levers to improve operating margins, price increases bring the greatest impact, and may be inevitable

### What this means for SaaS investors

- Investors should consider reasonable revenue, margin and other trajectories when evaluating software firms transitioning to SaaS, per our five year analysis in Figure 7.
- They should consider that SaaS firms need aggressive cross/upsell AND price increases to justify valuations.
- Acknowledge that the time is now for SaaS firms in markets with high SaaS adoption, e.g., CRM, to start operating more efficiently
- Consider that SaaS firms in markets yet to transition aggressively, e.g., BI and ERP, have more runway and should continue to focus on driving SaaS adoption

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## METHODOLOGY

This thought leadership was developed over the 2016-2017 timeframe, and involved many AV&Co. staff members. Our specific analyses included:

- SaaS / Software Buyer Survey (2016)
  - > ~700 IT decision-makers, 15 verticals
  - > Applications: CRM, ERP, HR, BI, Collaboration
  - > Focus areas: Current/future SaaS adoption, reasons for switching, spending on SaaS, application preferences, competitive dynamics, role of channel partners
  - > Methods: Conjoint, discrete choice exercise
- Financial Analysis of SaaS / SW / IT Services Firms (2016-2017)
  - > 27 public software and SaaS firms
  - > 5 IT services firms, technology distributors
- SaaS / SW Executive Interviews – conducted globally (2016-2017)
- Utilization of AV&Co.'s Knowledgebase of SW / SaaS / IT Services engagements (2014-Present)

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