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SaaS Survey Part II: Experience with SaaS

This issue is dedicated to analyzing what is the most valuable survey of the year—our report on companies implementing SaaS solutions in the marketplace. But there are some scary lessons SaaS software companies still have to learn *See pages 1-8.*

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Introduction: Responses and Method

In our first SaaS survey, we polled those planning to release SaaS products, those who were evaluating doing so, and those who had thought it over and decided not to. The results were published in our August 31st issue. That first survey was intended to find out what the software companies thought might be involved in creating and releasing a SaaS product.

This second SaaS survey probed the companies actually producing SaaS products. We received 147 replies, and dropped the responses of those answering *No* to our second question, *Are you currently selling a SaaS software product?* The answers of the 93 who answered *Yes* (the "Doers") are presented in this report, along with some comparisons with answers from the first survey (the "Considerers"). In both surveys those who responded were software managers and executives, including a large proportion of VPs (including VPs of Finance) and CEOs. On the whole, the present survey shows the experience of the Doers vindicates the expectations of the Considerers.

In tallying the responses we eliminated from each question those who did not respond to it (never more than three, or 3.2%, except where noted). The results, we believe, reflect the experience of companies that are actually designing and delivering SaaS software to the market.

Part I: Company Characteristics

In the first place, these are not all companies that were started for the purpose of jumping on the SaaS bandwagon. Two-thirds of them have been in business more than five years, and two-thirds of them also have non-SaaS products on the market. Overwhelmingly they are small companies: 80% of them are between $1 and $25 million in annual revenue and only 2.2% are above $500 million.

22.8% are venture-funded, and 9.8% are public. Only 3.3% say that their revenue is exclusively from SaaS products. To gain some idea of the spectrum of revenue from SaaS and non-SaaS product sales, we asked two questions, and have arranged their answers in the table on the following page:

Vendors' Percentage of Revenue	From SaaS Products	From non-SaaS Products
None	**3.3%**	**25.0%**
Up to 25%	**48.4%**	**20.7%**
Up to 50%	**16.5%**	**22.8%**
Up to 75%	**11.0%**	**20.7%**
Up to 100%	**20.9%**	**10.9%**

We included the *None From SaaS Products* answers in the belief that these persons have released a product, but are not yet receiving revenue from it.

Part II: The Market

Although SaaS technology would solve many problems in the consumer market (installation, versioning, support) the SaaS Doers tell us that they are 93.4% focused solely on the business market; 5.5% aim at both consumer and business markets.

72.8% of the companies have found that SaaS enabled them to enter new markets, while 27.2% have not found that to be the case.

Asked for the primary reason for their customers to choose a SaaS system, the companies cited from among the three choices offered them as follows:

65.9% believe their customers are looking to *quickly gain access to new capabilities without an extensive testing, prototyping, and heavy IT involvement* (54% of the Considerers thought so). A substantially smaller group (22%) believe their customers want principally to put their SaaS applications on the books *as an operating expense, not as a capital investment* (36% of the Considerers thought so). Only 12.1% believe their customers are mainly concerned with replacing *existing client/server applications with SaaS applications*.

Centralized application maintenance might naturally lead to a decline in professional services, but as we will see later (Part IV: Pricing and Distribution), most of the software companies have figured out how to keep their services operations fully occupied. Although 13% reported they did not have such an operation, the majority (73.8%) of those selling professional services reported that there would be no change in their professional services operation. But 8.8% reported a downsizing, and the remaining 17.5% redeployed their service personnel.

Part III: Product Architecture, Hosting, and Costs

With a focus almost exclusively on the business market, the question arises of how far the software companies will accommodate their customers in terms of levels of service, customization, and security concerns.

The survey found that about half (48.9%) of the companies offered more than one level of service (such as Standard vs. Professional), while slightly over half (51.1%) did not.

More than half (60.2%) provided an API or other tools to enable customers (or systems integrators) to customize systems. Half of these companies (51.8%) provided tools both for data integration and software configuration; 33.9% provided only for data integration. A bare 4.3% provided configuration-only tools. The 7.1% who offered *Other* APIs mentioned "Authentication, Data Retrieval, and Visualization;" the others had further unspecified APIs in their plans.

At the foundation of the SaaS products themselves there is little Open Source software: only 15.4% of companies reported using it as the basis for their products (Considerers had projected 16%). Commercial components or services, on the other hand, figured in the development of over a third (39.8%) of the products (Considerers had projected 68%). Over two-thirds (68.9%) found that developing SaaS software (*including coding, testing and QA, roll-out and deployment, and support and maintenance*) was cheaper under the SaaS model, while 31.1% reported that the SaaS model was more expensive (59% of Considerers took this view).

On the question of the interval for pushing a major update (*significant new features and functionality, not just incremental improvements and bug fixes*) of the SaaS product to customers, the companies were fairly evenly divided as to the interval, with once-per-year leading slightly (33.7%) over twice-per-year and thrice-per-year (each with 30.4%). Only 5.4% chose to wait more than a year between major updates.

When faced with the SaaS choice between a centralized data architecture (multi-tenancy) and keeping a separate database for each customer, 37.6% chose centralized, while 62.4% chose to give each customer a database. Because some customers will not let their corporate data be stored on an outside server, 58.2% of the companies allow customers to install the SaaS software on their own servers, behind their own firewall, rather than on the vendor's servers. The companies that offer this option report their experience as follows:

Although the largest category (37.7%) is those reporting that fewer than 10% of their customers want the SaaS software placed behind their own firewalls, there is also a large number (26.4%) reporting that more than 50% of their customers want this protection. 17% of the companies report that 31-50% of their customers want behind-the-firewall installation, and 18.9% report that 11-30% are likewise mistrustful of placing corporate applications beyond their own firewall protection.

On the question of whether to host one's own SaaS product, or to outsource this task, the vendors were fairly evenly divided, with a slight majority (53.3%) choosing to outsource (for Considerers the figure was 80%). Those who chose to do the hosting themselves (defined as *hardware infrastructure (servers, storage, security, backup, etc.*) reported their costs as follows:

Percentage of SaaS Revenue	Percentage of Vendors
1% to 5%	**31.8%**
6% to 15%	**47.7%**
16% to 29%	**9.1%**
30% or more	**0%**

These figures are based on those who responded to the question, less the 11.4% who said that they did not know the answer to the question.

Those who outsourced the hosting reported their costs as follows:

Percentage of SaaS Revenue	Percentage of Vendors
1% to 5%	**26.0%**
6% to 15%	**48.0%**
16% to 29%	**6.0%**
30% or more	**2.0%**

These figures are based on those who responded to the question, less the 18% who said that they did not know the answer to the question.

Part IV: Pricing and Distribution

After costs comes pricing, which involves the definition of what is a sale and how much it will cost the customer. The advantage of subscription revenue is considerable, particularly if initial costs can be controlled and ongoing costs tied as directly as possible to customer numbers.

Rather than try to work through the exact pricing models, we looked for trends. For instance, when asked whether the basis of their pricing was seats, concurrent seats, or named users, we received these answers:

Seats	**27.4%**
Concurrent Seats	**23.3%**
Named Users	**49.3%**

But 21.5% of the companies did not answer this question, presumably because they found other models more useful:

Per project	**7.6%**
Per account	**40.2%**
Both	**22.8%**

Here only 1.1% (one) company failed to answer, but 29.3% of the total answered *None of the above*. On the whole there appears to be a great deal of flexibility in pricing options.

In order to get some idea of the prices involved, and the amount involved in a typical sale, we asked the vendors to express their pricing in terms of a subscription cost per seat per month, and received these answers (only 4.3% did not answer):

$10 to $49 per month	**21.3%**
$50 to $99 per month	**18.0%**
$100 to $249 per month	**18.0%**
$250 or more per month	**15.7%**
Other	**27.0%**

The 16 *Other* answers included transaction-based, project-based, and unlimited users. Pricing by employee count was the most popular; any specific pricing given was in the lowest bracket of the pricing scale. "Operational budget based" was perhaps the most interesting answer. For software dwelling in the Internet cloud, pricing by seat may seem old-fashioned, but our asking for answers expressed in "seats" or "users" offered the best way to find a common denominator.

Accordingly, the typical initial sale was reported as (9.7% did not answer):

Seats/Users	**% of Vendors**
1 to 5	**31.0%**
6 to 20	**33.3%**
21 to 50	**15.5%**
51 to 99	**3.6%**
100+	**16.7%**

Follow-on sales during the following twelve months were reported as follows (12.9% did not answer):

Seats/Users	% of Vendors
1 to 5	**48.1%**
6 to 20	**19.8%**
21 to 50	**13.6%**
51 to 99	**3.7%**
100+	**14.8%**

Besides the actual use made of the SaaS system by customers, there is the subscription component to pricing, and the vendors described their options as follows:

Monthly, quarterly, yearly and multi-year	**32.6%**
Monthly, quarterly, yearly	**35.9%**
Yearly only	**14.1%**
Multi-year only	**0%**
Other	**17.4%**

Most of the *Other* answers were combinations not given above (such as Monthly, Yearly), but there was one report of "multi-year" as an option, and another of "single purchase."

The most common lengths of contracts reported by vendors were:

Month-by-month	**16.5%**
One year	**45.1%**
Two years	**13.2%**
Three years	**19.8%**
Four years	**5.5%**

Part V: Additional Revenue Beyond Seats/Users/Subscriptions

As we noted earlier on pg.2, company consulting operations are not going away. In fact the vendors tell us that they are a useful revenue-generator in addition to SaaS subscription fees. 69.2% say, *We charge up front for deployment services (training, testing, and deployment)*, while only 30.8% say, *We roll these costs into our subscription fees*. Those companies that charged up front for deployment reported this service revenue as a percentage of their SaaS revenue as follows:

Deployment Services as % of Revenue	Vendors Reporting
1% to 5%	**27.4%**
6% to 15%	**33.9%**
16% to 30%	**30.6%**
More than 30%	**8.1%**

Beyond deployment charges, the companies reported income from *software and configuration services*, including both data and application integration as a percentage of SaaS product revenue (6.5% did not answer):

Configuration and Integration Services as % of Revenue	Vendors Reporting
1% to 5%	**44.8%**
6% to 15%	**33.3%**
16% to 30%	**13.8%**
More than 30%	**8.0%**

The days of rich consulting fees for ERP systems for client-server enterprises are over.

Part VI: Distribution

Distribution questions covered everything from lead-generation to sales compensation. Asked to name their most effective lead generators, we found that these were distributed across the spectrum. Here is the percentage of the companies that named any one lead generator, arranged in order of popularity:

Tradeshows	**46.2%**
Search engine keyword purchase (such as AdWords)	**43.0%**
Web collateral (including white papers, case studies, videos, podcasts, etc.)	**41.9%**
Search engine placement	**38.7%**
Webinars	**36.6%**
E-mail	**35.5%**
Public relations	**35.5%**
Web-based advertising (banner ads, interstitials, etc.)	**30.1%**
Direct mail	**20.4%**
Advertising	**17.2%**

When asked, *Who are the analysts most likely to influence purchases of your product?* and given the choices below, the companies answered:

Gartner	**45.2%**
Forrester	**23.7%**
IDC	**15.1%**

When asked to name any others, nearly half said *None*. AMR was mentioned three times, and Aberdeen, Frost & Sullivan, and ZapThink once each. Two mentioned using directories and publications in vertical markets.

31.5% have a recommender program (4.3% gave no answer), and 38.9% are using software resellers.

Those with resellers reported them as offering the following services; they were allowed to choose only one category:

Implementation (setup and product training):	**36.4%**
Implementation and integration (data and/or product integration):	**6.1%**
Implementation, integration, and consulting (best practices, optimized use, etc.):	**57.6%**

The majority of those reporting the number of their resellers have small networks:

Number of Resellers **% of Vendors Reporting**

1 to 5	**61.5%**
6 to 25	**30.8%**
26 to 50	**7.7%**
More than 50	**0%**

66.7% of vendors using resellers offer a branding option that would keep their *product identity intact, but also incorporates the reseller's logo and company information into the SaaS product's initial login or home screens*; 42.1% offer an affiliate-label program to their resellers. Of the entire vendor group, with or without resellers, 30.8% make their SaaS software available on an OEM basis.

Part VII: Sales Compensation

Reseller compensation can be either on a one-time payment basis, or as a continuing payment over the life of the SaaS contract.

In the case of one-time payments, they range as follows:

No One-Time Payment	**50.0%**
1% to 5%	**0%**
6% to 15%	**17.6%**
16% to 30%	**20.6%**
31% to 40%	**2.9%**
More than 40%	**8.8%**

A number of the vendors give recurring payments to the resellers:

No Recurring Payment	**22.2%**
1% to 5%	**2.8%**
6% to 15%	**30.6%**
16% to 30%	**16.7%**
31% to 40%	**16.7%**
More than 40%	**1.1%**

The SaaS companies selected as their primary means of selling their SaaS products:

	Doers	**Considerers**
A direct sales force	**64.8%**	**40.3%**
A telesales group	**17.6%**	**22.6%**
Indirect marketing (E-mail, direct mail, web seminars, advertising, etc.)	**12.1%**	**34.2%**
Reseller programs	**5.5%**	**4%**

When asked how long it took to close a sale, the companies answered as follows:

Less than a month	**8.8%**
Less than three months	**40.7%**
Less than six months	**24.2%**
Less than 12 months	**23.1%**
Less than 18 months	**3.3%**

The companies were asked to choose when and how they compensated their SaaS sales force. 10.8% of all the companies gave no answer, and a further 3.6% said they had no direct sales people. Of those employing sales people, the choices in compensation were as follows:

No direct sales people:	**3.6%**
We pay our sales people the entire commission upon the signing of a contract:	**31.3%**
We pay our sales people on a pro rata basis over the life of the contract:	**36.1%**

60% of the "Other" choosers gave their compensation method; most simply said that the sales force received payment when the company did. These answers imply that the payments extend over the life of the contract. One answered "up front," and another said that salesmen received salary only.

Our final question was, *Do sales representatives receive additional compensation for incremental sales to existing SaaS customers?*

Not answering:	**14%**
Customers are assigned to the sales representative who made the original sale, who is further compensated when the customer buys additional seats/services from us:	**47.5%**
Existing accounts are assigned to an "account development" representative, who is compensated when the customer buys new seats from us:	**33.3%**
Commissions earned from sales of new seats are split between an original sales representative and an account manager:	**18.8%**

Some Highlights from our SaaS Surveys

Using SaaS products may be part of the corporate outsourcing trend, but many SaaS companies have discovered that it is cheaper to provide SaaS products than they had thought, and often cheaper to host them in house than to outsource hosting (pg. 2).

Architecture emphasizes individual databases for customers, rather than multi-tenancy solutions. This may be related to the high use of Named Users as the unit of pricing. This is a disturbing datapoint we'll be discussing further.

There are hints about vertical markets in the responses. If the grand strategy of SaaS is Google-Hosting-the-Planet (see George Gilder's recent *Wired* piece, "The Information Factories"), there is still room for small vendors serving vertical markets.

(Editor's note: We will be conducting follow-up surveys on SaaS product management, sales compensation trends, promotions, and related topics. We will also be examining further highlights of the survey in future editions of *Softletter.)*