



The Challenges of SaaS

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Experience Listens.



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Introductions

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What is “SaaS”?



Defining SaaS

The Delivery Model is Just the Beginning

Software as a service (SaaS) is a software application delivery model in which customers pay to access and use software functionality over a network through a hosted, web-native platform operated by the software vendor (either independently or through a third-party).

- Not *just* a change in delivery model
- Requires significant shift in thinking
- Forces fundamental changes in thinking across the business
- Changes many assumptions about being a successful software vendor

Defining SaaS

The Delivery Model is Just the Beginning

	Software as a Product	Software as a Service
Delivery	Installed	Hosted
Development	Longer cycle, “big bang”	Short, continuous cycle
Pricing	Perpetual license + maintenance	Subscription (all inclusive)
Allocation	Capitalized	Expensed
Additional Costs	Installation, maintenance, customization, & upgrades	Configuration
Platform	Multi-version	Single Platform
Updates	Larger, less-frequent	Shorter, frequent
Sales Focus	Close the deal	Prove value in first 90 days
Feedback Cycle	Long	Short
Profits	Initial sale	Ongoing
Success	New license revenue	Lack of churn

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What does SaaS promise?

The Promise of SaaS



SAAS Capabilities and Opportunities

(December 2007)

- Surveyed over 300 members of the IAMCP (International Association of Microsoft Certified Partners) and also partners at an unnamed major IT distributor
 - 76% said that SaaS will “dramatically impact” the partnering landscape
 - 70% view SaaS as a “big” opportunity (not a threat)
 - Many firms already engaged in SaaS-related activities
- SaaS has the potential to change the way business is done
- 2008 brings increased vendor participation in the SAAS space from SAP, Microsoft, Cisco Systems, IBM and others

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The Promise of SaaS

The McKinsey Quarterly

Delivering Software as a Service

(June 2007)

- McKinsey finds that SaaS is a growing priority for CIOs and VCs
- Multiple factors are spurring the growth
 - Decreasing cost of bandwidth
 - Customer frustration with traditional software buying cycle (license + maintenance contract + upgrades)
 - Perceived increase in control over the vendor relationship
 - Early SaaS success stories -- Salesforce.com, WebEx, etc. demonstrate broader value proposition

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The Promise of SaaS



Making SaaS Savvy Investments

(November 2007)

- The most “impactful” trend in software
- The “SaaS shift” is in full swing
- Over the next several years it will become pervasive in almost all areas of the software market

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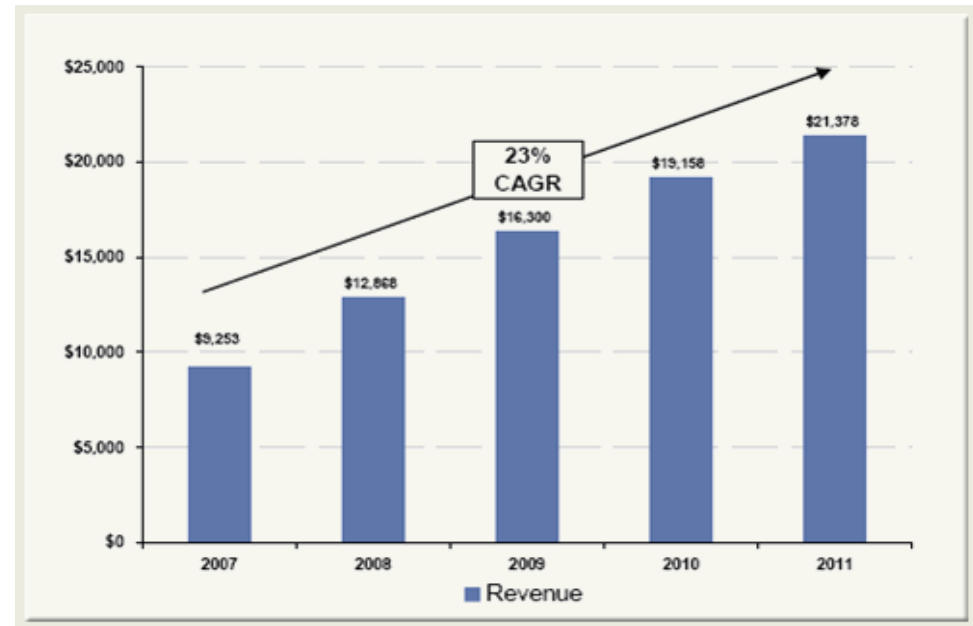
The Promise of SaaS



Making SaaS Savvy Investments

(November 2007)

- 23% projected annual growth
- \$21.4 billion industry by 2011
- Representing 14% of addressable market



Source: Goldman Sachs Research estimates and IDC

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The Promise of SaaS

Gartner

Predicts 2008: SaaS Gathers Momentum

(January 3, 2008)

- By 2009
 - 40% of new business software vendors will offer a SaaS model
 - 100% of Tier 1 consulting firms will have a SaaS practice
- By 2010
 - 15% of large companies will begin projects to replace their ERP backbone (financials, HR, and procurement) with SaaS solutions.
 - 85% of SaaS vendors will offer performance SLAs in standard contracts
- By 2012
 - More than 66% of independent software vendors (ISVs) will offer some of their applications optionally or exclusively as SaaS

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We expect more customers to opt for term or subscription based licensing versus the traditional perpetual model and move toward outsourced solutions.

Very simply put, software in an On Demand world will change the way customers buy, vendors sell, and investors invest.



It is clear that the traditional software business model is unwinding.

'On demand' is becoming the preferred method for licensing and deploying software.

The impact on valuations and creating sustainable shareholder wealth are enormous.

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But, there are challenges. . .



Challenges of SaaS

- Design and development
- Revenue models
- Sales and compensation
- Partners and distributors
- Customer service
- Product support and maintenance
- Research and development
- Legal
- Valuation and funding
- Exits and liquidity
- SaaS pure-play vs. dual environment
- Deciding if SaaS is right for you



Challenges of SaaS

Design and Development

- Upfront design and development requirements are greater with SaaS than with traditional software delivery models
 - Infrastructure
 - Hosting
 - Billing
 - Other systems
- This can require
 - Greater upfront resources
 - Increased initial investment
 - New and different skill sets
- Consider available third party SaaS platform providers
- Challenges presented by developing one application to cover all users (covering “the long tail”)



Challenges of SaaS

Revenue Model

- Subscription model is different from perpetual pricing
- Subscription pricing means:
 - Lower short term revenue
 - Slower revenue growth
 - Slower cash inflow
- In return for the prospect of:
 - Predictable, compounding revenue stream (less volatility, better ability to plan)
 - No end-of-quarter frenzied pricing discounts (better margin potential)
 - Higher long term revenue
 - Shorter ROI time scale
- When does it start to pay off?



Challenges of SaaS

Sales and Compensation

- Sales model differs from traditional software
- Sales compensation structures also differ
 - Commissions based on ongoing customer usage and revenue
 - Not on sale of large up-front licenses
- Dealing with renewals and churn is key



Challenges of SaaS

Partners and Distributors

- SaaS can require adjustments to existing partnerships
 - Competitors
 - Partners and resellers
 - Systems integrators
- Also creates opportunities for new partnerships for
 - Application integration
 - Data integration
 - Data mining
 - Upstream providers (e.g., Business Process Outsourcers) looking to embed SaaS offerings as part of their solutions



Challenges of SaaS

Customer Service

- Perhaps the biggest challenge?
- SaaS presents different issues
 - Hosting (rather than shrink-wrapping)
 - Data center operations
 - Systems and network monitoring
 - Billing
- Requires a different model
 - Managing customer expectations
 - Customer education
 - Changes required to capture the full value of SaaS solution
 - Architectural, managerial, governance, procurement, etc.
 - Leveraging increased ability to collect customer feedback and data
- Additional issues presented when transitioning legacy customers to SaaS (or maintaining them after others have transitioned)



Challenges of SaaS

Product Support and Maintenance

- SaaS model shifts the burden of support to the vendor
- Focus on the risks of reliability
 - Must ensure that customers can access their apps
 - One outage or crash can affect all customers
- Service levels (SLAs)
 - Trend toward SLAs (although most SaaS vendors do not provide them at present)
 - Adoption will depend on criticality of the application, size of deal, etc.

Challenges of SaaS

Research and Development

- Traditional “plan-driven” development approaches do not work
- Agility is key
- Rapid releases and upgrades
- Focus on
 - Absorbing rapid and immediate feedback
 - Leveraging usage data to guide development
 - Meeting customer needs
 - Ever tighter deadlines
 - Early and frequent testing
- R&D must deal with the entire SaaS platform
 - Platform and tools for hosting and serving the software
 - Software itself
 - Billing
 - Customer service
 - Service aggregation

Challenges of SaaS

Legal

- Contracting model is different with SaaS
 - Driving contracts online
 - Dealing with mixed contracting model
 - Identity validation
- Contract duration strategy – trials, 1 yr, 3yr, etc.
- Preparing for service levels agreements (SLAs)
- Termination and migration
- Security
- Data privacy (and data usage)
- Transition of legacy customers (for those customers that have purchased long-term contracts for updates and maintenance)
- Making SaaS subscription model work within traditional procurement cycles
- Use your contracts to education customers and “sell” the benefits of your SaaS model

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Challenges of SaaS

Valuation and Funding

- VCs love SaaS
- Estimated that as many as 90% of new software companies funded by VCs have SaaS models
- More cash required to fund company to breakeven
 - 3 - 4x more
 - Large upfront infrastructure investment
 - Slower revenue growth and cash inflow
- Valuation can take an initial hit, but appear to attain a premium (as subscription revenue grows and compounds)
- How soon does SaaS catch up with the traditional perpetual model?
- Another important factor is renewal rates / expected life of subscriber; without longevity, model doesn't work
- Calculation ultimately dependant on the company's particular business model



Challenges of SaaS

Exits and Liquidity

- SaaS is more highly valued by the market
 - Wall Street and private investors have attached a premium SaaS and recurring revenue models in general
 - Lenders appear willing to provide more debt with safer cash inflow (will sometimes lend off this rather than AR or tangible assets)
 - SaaS acquisitions and IPOs have heated up
- Measures of valuation can differ for SaaS companies
 - Revenues (traditional)
 - Bookings growth (reported revenue + changes in deferred revenue)
 - Cash flow growth rate
- Exit valuations
 - Traditional enterprise software: 1.4 – 4x trailing 12 month revenues
 - SaaS models: 1.5 – 2.5x traditional enterprise valuations



Challenges of SaaS

Pure-play vs. Dual Environment

- Difficult to move to SaaS incrementally
- Many ISVs opt for dual environment
- This can create issues
 - Customer retention and service (during and after a transition to SaaS)
 - Continuing to operate in a dual operations during transition (customer support, R&D, etc.)



Challenges of SaaS

Deciding if SaaS is Right for You

- Evaluate your situation
 - Does the data used by the application either originate outside the firewall or go outside the firewall at some point in time?
 - Is the application used by a distributed workforce?
 - Is a *network effect* important to the success of the application?
 - Is quick implementation (with low upfront costs) important?
 - Does the application require heavy integration with other applications?
 - Does the application require heavy customization?
 - Does the application address a business process that *should* embody a strict process and industry-wide best practices?
 - What level of training is required?
 - Can the applications be readily adopted by an individual or a small department rather than a whole enterprise?
 - Is the application computationally intensive/time critical?
- Evaluate your team
- Survey your customers (and your investors)

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Thank You.



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