Software BUSINESS

Strategy & Technology
For Software Executives

a webcom publication

Software Business Executive Report

September 22nd, 2008

The Fundamentals for a Sustainable SaaS Model

Christopher Cabrera, President and CEO
Xactly Corp.

For years, Wall Street has had trouble coming around to the Software-as-a-Service (SaaS) way of thinking. But over the past year in particular, we have seen some shifts in perception as more SaaS-based companies have received funding and, in a few cases, successfully completed their IPOs. The true test, however, comes in taking the invested capital and establishing a successful and sustainable SaaS model.

Proponents of SaaS are fond of saying "SaaS changes everything." This is definitely true for customers who are moving away from the constraints of on-premise software in record numbers and fueling the SaaS market's runaway growth. But it is also true for the way SaaS companies need to be run. From customer relations to revenue recognition, the old software business paradigms no longer apply when you're operating under the SaaS umbrella.

Taking their place is a new set of fundamentals that SaaS businesses need to understand and master in order to be successful over the long term. Here, derived from much experience spent in the SaaS trenches, are the four most important.

1. Subscription Model Changes Everything

One of the most significant paradigm shifts facing SaaS companies pertains to annual subscription agreements and revenue recognition. With SaaS, customers are subscribers and the challenge is one of dealing with the realities of monthly revenue recognition combined with maximizing annual recurring revenue. You are able to recognize 1-12th of the value of an annual contract each month, 1-24th of a two-year contract, and so on. To get more money in, you need to get longer-term contracts or bulk up the value of an annual contract. That is, get your customers to buy more over the course of time or more during a given period, or ideally both.

Much of your success in this hinges on how you go about incenting your sales people, and that's entirely under your control. You have the opportunity to get creative with incentive compensation for your sales staff. First, determine your ideal annual contract value. Then compensate them on achieving that value with additional compensation on term length. Also think about special performance incentive funds (SPIFs) around discount thresholds, add-on and multiple-module sales, up-sell and so on. Consider using non-cash rewards as an additional, highly personalized sales incentive. Essentially, your inventiveness with compensation and rewards can turn the revenue-recognition challenge into a positive for all involved.

2. Renewals are the Lifeblood of the Business

In the SaaS world, revenue is like electricity-your customer can turn it off or on at anytime. With SaaS, customers are now, for the first time, truly in the driver's seat. Compared to on-premise software, there is relatively little vendor lock-in with the SaaS subscriber model. So the challenge is to earn their business anew every year, which hinges on keeping them happy around the clock.

SaaS companies have to build comprehensive programs around ensuring customer success-making these programs just as robust as those designed to land new subscribers. This necessarily starts with hand-holding support during the "go live" period, which is essential both to a smooth implementation and to the transfer of knowledge to the customer. Equally important is establishing a dedicated renewals team, separate from the new business sales team. This provides the opportunity to tailor an incentive compensation plan specifically to the renewals effort, while giving each customer an on-going and highly motivated advocate within your organization.

Another strategy for locking in renewals revolves around providing customers with a seamless user experience, thus creating "stickiness" for your service. For example, sales compensation is highly synergistic with CRM and is a natural complement. Integrating sales compensation software with leading SaaS-based CRM offerings (i.e. Salesforce CRM, Oracle CRM On Demand and Microsoft Dynamics CRM) can offer users single sign-on and capabilities such as a commissions estimator to conduct 'what if' calculations to determine potential commissions per opportunity. This integrated capability makes it more difficult for customers to live without you.

Finally, draw customers closer to your business. One way is to reward them for referrals. Incent them, for example, with early access to new offering or upgrades. The idea being the more they put themselves out for you and act as your advocate in the marketplace, the less likely it is you'll lose them. By the same token, tap into their expertise and experience, just as they tap into yours. Let customers help drive product development-open a dialog to this end and pay attention to their product suggestions. Ownership breeds loyalty and subsequent renewals, plus you'll help ensure that your offerings continue to meet prevailing market needs.

3. No SaaS Vendor is an Island

Successful SaaS vendors surround themselves with partners that have complementary functionality. You need to cooperate closely with these partners to extend the value of your offerings, deepen your hold on your customers and increase your products' stickiness. In addition to complementary functionality, partners will have data that your offerings need, and vice versa. Maybe it's data that another SaaS product collects that can be used by your application for analytics. Or maybe it's data your application collects that another product can use to deliver a service. You need to have ways to easily integrate this data across your applications to create a seamless and synergistic solution. This can be done successfully through traditional data integration techniques as well as through highly flexible new Web 2.0 technologies and mashups.

One of the beauties of the SaaS model is how easy it is to create new value in this manner. For example, leveraging Salesforce.com's Force.com platform, Xactly recently created a mashup between its sales compensation management application, Salesforce CRM, Amazon.com and PayPal to create the market's first, end-to-end solution for non-cash rewards-from immediate awarding and online tracking of reward points to the ability to instantly cash these points in with a comprehensive rewards catalog to backend payment for the prizes. This is something entirely new, and the SaaS universe is rich in its ability to enable this kind of innovation across partners.

4. Netting it Out

With SaaS, the most important thing to remember is that customer success in paramount. Everything flows from that. The means and the mindset to ensure customer success must be woven into the very fabric of a SaaS company.

You need to get creative with sales compensation and motivate the right behavior, whether it's incenting differently for new customer acquisition or for multi-year contracts. Always be tuning your sales incentives to align with customer retention and annual recurring revenue.

You also need to be a partner, not a vendor. You must offer a valuable product, and then build additional value around it with complementary components and through synergistic partnerships with other SaaS companies. You have to give customers extraordinary care and attention, a seamless user experiences and a voice in your product direction to help drive renewals. You need to dedicate people to keeping a finger on the pulse of customer satisfaction. And you absolutely have to be strategic and innovative in incenting your people to structure the right kind of deals-from net-new to cross-sells/up-sells to ever-longer term renewals.

Finally, you need to remember that with SaaS it is phenomenally easier than in the on-premise enterprise software past to create altogether new types of products and services that deliver previously unheard of value to customers-a true mark of SaaS strength and sustainability.

Christopher Cabrera is a seasoned executive with more than two decades of successful senior management experience at both early-stage and public companies. At these companies, he has managed sales, marketing, operations and business development.

Prior to founding Xactly Corporation, Christopher was the senior vice president of operations for Callidus Software, an on-premise incentive compensation management company. At Callidus, he was responsible for the execution of worldwide sales and marketing strategies, customer advocacy, and strategic alliances with companies such as IBM, Accenture and Deloitte. Under his leadership, the company acquired more than 100 customers, contributing to the growth of annual revenues from zero to greater than $75 million and a successful IPO in 2003 raising more than $70 million.