# 101 QUESTIONS to ask about your Cloud business strategy

## AND ANSWERS

on what you should know about aligning your business model with all of the changes that come from extending your solution into the Cloud.

THE YORK GROUP
INTERNATIONAL TECHNOLOGY PARTNERS

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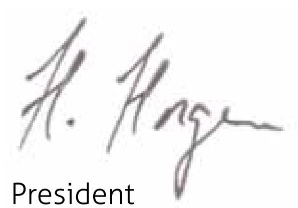
# Introduction

Whether you want to extend your existing business to incorporate Cloud solutions, or whether the Cloud is your business model, there are many questions that need to be answered.

We have worked with ISVs of all sizes, from early stage, funded companies to many of the world's largest software vendors, and the issues that face all of them are remarkably similar. Who are the best prospects for this new solution? How do we compensate our salespeople? Will we have to change our marketing approach? What is the right pricing model? Can we scale our customer support? Are there legal issues specific to the Cloud? And how will subscriptions impact our cash flow?

With the 101 questions and answers in this book, we hope we have anticipated many of the questions you might have about successfully selling your Cloud solution.

But if you need any additional help, give us call.



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# Fundamentals

There are many issues facing companies that are, or would like to be, active in the Cloud, everything from the surprisingly low overall spending, to fundamental decisions on product architecture. These are issues that impact many of the key elements in a Cloud business model, so in this section we want to lay the foundation for the following chapters.

## 1. What is the adoption of Cloud applications in the enterprise market?

There is often a perception that the Cloud has taken over the IT world. Analysts and vendors, both of which have a vested interest in driving a change in technology, focus on (often) misleading surveys, annual growth rates and spending in absolute terms as a way of reinforcing the perception the Cloud has become the dominant technology platform.

Many of the headlines we see tout huge Cloud adoption by enterprises, or "plans to adopt." It is not unusual to see reports indicating 60-70 percent of enterprises are using Cloud applications. However, many of the applications are free or low-cost solutions, such as Dropbox, Evernote, LinkedIn, etc. So, while corporations, or individuals within corporations, are using Cloud solutions, the level of spending and the penetration rate for enterprise-wide applications is still low.

The actual spending on Cloud solutions is still quite low. According to IDC, in 2014 the worldwide enterprise spending on the Cloud all-up (hardware, software and services) was around $100 billion. On a stand-alone basis that is a big number, but it was still only 5 percent of the total IT spending of $2 trillion. And according to Gartner, spending on SaaS solutions, just the software layer, was around $18 billion, or about 5.6 percent of the total enterprise software spending of $310 billion.

The annual growth rate for spending on SaaS in the enterprise space is running at 16-19 percent in all of the developed markets – North America, Western Europe and Japan. That is an impressive growth rate, but it is from a relatively small base and the growth rate is starting to flatten out. Two to three years ago, the growth in SaaS spending was running at 25-26 percent in the developed markets.

# Fundamentals

## 2. Should we wait until the market has grown more?

With the low adoption rates and so many barriers to getting real traction in the enterprise market, it can be tempting to sit back and wait until the market reaches it proverbial "tipping point," and then jump in with a Cloud solution. That would be a mistake. No software vendor can afford to ignore the Cloud for the following reasons:

- Customers are increasingly shortlisting only vendors offering both on-premise and Cloud solutions. They have all heard the hype, they have all seen the Cloud "adoption" figures quoted from various surveys. They all know there is something called the "Cloud," even if they don't always know what it means. So they want vendors to give them both options, even if they (and the vendor) know they will be buying the on-premise version.
- The availability of technologies such as the Microsoft Azure Stack and HP Helion will make almost every enterprise company Cloud-enabled. They may still elect to purchase and install Cloud-based applications on-premise, but it will open the door to hybrid and public Cloud solutions that can add value, which could represent the tipping point in terms of adoption. Vendors not having Cloud-based applications at that point could find themselves at a real disadvantage.
- The Innovator's Dilemma. Based on a book of the same name by Clayton Christensen (www.businessweek.com/chapter/christensen.htm), the theory is that successful companies can put too much emphasis on customers' current needs and fail to adopt new technology or business models that will meet their customers' unstated or future needs. Christensen argues, such companies will eventually fall behind as new entrants start by attacking the lower end of the market and gradually gain market share with larger and larger clients. This is definitely the case with enterprise software. There are few, if any, vertical markets that do not have SaaS solutions starting to successfully compete with legacy vendors. It is surprising how much large, sophisticated companies are willing to sacrifice features for simplicity and cost;
- Companies articulating a clear Cloud strategy are rewarded by analysts and investors. Whether it is logical or not, the market today puts a much higher value on companies having a significant portion of their revenues coming from application-related recurring revenues than from maintenance.

The upshot is vendors and channel partners need to make an investment today that may not drive a significant return for another two-to-three years. Even under the most optimistic predictions, the $100B

Cloud spending in 2014 will only double by 2018, which still leaves it at less than 10 percent of the overall market. But getting a strong foothold in that 10 percent is essential to long-term growth.

## 3. What is the difference between public, private and hybrid Clouds?

There is a joke about Cloud computing – "There is no Cloud, it is just somebody else's computer." That captures the essence of public versus private Cloud. When you use Azure or AWS (Amazon Web Services) to store your data or run your workloads, you are using someone else's computer – you are using a public Cloud. Everything takes place on someone else's computer – the application runs there, you upload the data, the computations run in their datacenter, etc.

# Fundamentals

Most of the well-known SaaS applications are public Cloud infrastructure. You may have a piece of client software installed on your machine, which is the case with back-up software such as Mozy and Carbonite, and web-conferencing solutions such as Skype and WebEx, but the applications, storage and compute cycles are on the vendor datacenter not yours.

A private Cloud is your own datacenter. In one sense, you could say your existing datacenter is your own "private Cloud," but Cloud is usually synonymous with multi-tenant architecture *(more on this in Question 5)*, where your infrastructure is capable of running pure SaaS applications, but in your datacenter.

A hybrid Cloud is what you would expect – a mix of private and public Cloud. A company might be running its core applications on its own datacenter and using the public Cloud for non-strategic applications or for bursting. For example, because of the massive investment a company might have made in implementing an on-premise ERP solution and integrating it with a lot of back-office functions, it might elect to stay on-premise, but use public Cloud applications for CRM or HR modules.

Bursting refers to spikes in workloads, which can be due to seasonal cycles (such as the year-end rush for retail) or unanticipated spikes. In either case, many companies are using their own datacenters for the predictable workloads and rather than investing in extra capacity that sits idle until a spike occurs, use a public Cloud to handle the extra compute cycles. This reduces their investment in fixed infrastructure and allows them to pay-as-they-go for the variable needs.

> The highest rates of adoption for public Cloud applications are the small and mid-sized business (SMB) markets

## 4. Which Cloud format is seeing the greatest adoption?

You will find more details in the section on Target Markets for SaaS solutions, but the adoption rate varies dramatically across vertical markets and company sizes. The highest rates of adoption for public Cloud applications are the small and mid-sized business (SMB) markets – they get more immediate benefit from access to new technologies; they are, as a rule, less concerned with security or feel the security offered by big Cloud vendors is better than their own; and, they have less of an investment in infrastructure.

Private Cloud is clearly the preference for large enterprises. They like the architecture of multi-platform solutions because it allows them to reduce their total cost of ownership by moving data and workloads across their own network of datacenters. There are large international companies with datacenters in many parts of the world and have an infrastructure that is larger and more cost-effective than many of the public Cloud application vendors.

Over time, it is likely the hybrid Cloud will be the dominant platform in the enterprise market. The large vendors are making this easier. Microsoft, for example, has an Azure Stack solution that can be installed in a private datacenter, not only making it possible to run multi-tenant Azure applications in-house, but offering seamless integration with the Microsoft Azure public Cloud infrastructure. HP Enterprise has an offering called Helion, which is an infrastructure stack (hardware, operating system infrastructure software, etc.) that is optimized for multi-tenant solutions, which can run as a private Cloud, but also integrates with the Azure public Cloud.

# Fundamentals

## 5. What is the difference between IaaS and PaaS?

There is still some confusion about terminology. You can have multiple tenants on a single virtual machine (VM), but you have to pay for the full VM whether you have one or eight tenants on the environment. So, while you do have multiple tenants you don't have a multi-tenant product architecture. The main differences are:

**Managed Hosting (VM or ASP model)**

- Single instance per tenant
- Dedicated server for each customer or group of customers
- Can have multiple VMs
- For example, hosting a .NET application on Azure

**Multi-tenant**

- Single instance, multi-tenant
- Multiple clients share single database
- Single logical instance of an application
- App is responsible for isolation and sharing

The driver for many companies when choosing the architecture is the cost of rewriting the application. With the ASP or VM model, very few modifications, if any, have to be made to the product. In many cases, clients don't really know or care about the difference. They just know the application runs on someone else's hardware, they can access it through a browser and they pay for it on a monthly basis. For ISVs choosing this route, it gives them an opportunity to have a "Cloud" offering at little cost while transitioning the business model.

At some point though, the cost of supporting all those virtual machines, and perhaps multiple versions of the product, become greater than the cost of rewriting the product. Multi-tenant architecture will drive down the operating costs and allow an ISV to scale the business much faster.

## 6. What does building a product as PaaS mean?

Another consideration when it comes to product architecture for a multi-platform product is whether you want to be SaaS, the pure software application layer, or whether you want your solution to be a platform as a service (PaaS) on which others can add value. There is a growing school of thought that pure SaaS products will become a commodity. Customers can easily switch to other products with similar functionality if they get a better price. "Stickiness" is really important with SaaS – you want to prevent your clients from going elsewhere. Let's look at a well-known example.

A segment of the market thinks office productivity suites are becoming a commodity – that Google Docs and Office 365 are more or less interchangeable. We see this in many other markets such as CRM. For this reason, Microsoft is encouraging ISVs to build solutions on top of SharePoint. This can be simple add-ons and extensions or full-blown applications. The reasoning is customers who use these other applications and incorporate them into their business processes, will find it more difficult to move to another office productivity suite. SharePoint and the associated applications become the glue (platform) that makes the client relationship sticky.

We see the same thing in CRM. Both Dynamics CRM and Salesforce.com have built large ecosystems of developers that have their own applications running on Dynamics CRM or Salesforce as the underlying platform.

For an ISV, this becomes a fundamental product architecture issue – if you want to be a platform, you will need to build the solution so it is easy for others to integrate with it.

# Fundamentals

## 7. Why do SaaS companies have a higher market multiple?

Investors place a much higher value on revenues generated by SaaS companies than by on-premise companies, even if the on-premise firms have a large maintenance stream that is also classified as recurring revenues.

There are two primary reasons for the higher multiples:

- Revenue predictability. The theory is subscription revenues will renew year-in and year-out, so the revenues you end the year with are the revenues you start out with at the beginning of the next year. There's no need to recreate revenues from selling perpetual licenses.
- Revenue growth. Because subscription revenues are "locked in," you are almost guaranteed to increase your overall revenues by selling more subscriptions. If you sell the same number of subscriptions in year two as you sold in year one, you will grow by 100 percent, a growth rate that is difficult to achieve with perpetual license sales.

Both reasons make sense, but we are not convinced the premium for SaaS companies is fully justified, especially when that premium is two-to-four times an on-premise company:

- Most SaaS companies are relatively young, so they are growing from a small base. Over time, the growth rate will start to flatten out as the revenue base increases. It is easy to grow by 100 percent in year two, but adding the same amount of subscriptions in year three results in a growth rate of 50 percent, 33 percent in year four, and so on.
- For most SaaS companies, growth is offset by Churn (see Question 14), or non-renewal of subscriptions. Across all types of applications and markets the average Churn rate is 19 percent. This means 19 percent of new subscriptions simply replace revenues lost from non-renewals.
- Lower profitability. SaaS companies typically spend a much higher percentage of revenues on sales and marketing, so most of the industry leaders are unprofitable. Investors have been willing to overlook the losses and focus on growth, but at some point cash flow and earnings per share will have to be justified.

Investors place a much higher value on revenues generated by SaaS companies than by on-premise companies

## 8. What business model issues need to be addressed when moving from on-premise to the Cloud?

Most elements of your business model will need to be reviewed. We will cover all of them in other sections of this book:

- Pricing – how do you establish the right pricing model and level when you go from perpetual licenses?
- Marketing is different for SaaS solutions – managing the customer acquisition costs becomes essential, driving the need for more automation.
- Sales compensation will change – traditional salespeople are not excited about collecting commissions based on $19 per user per month.
- Sales organization – can you use the same salespeople and should you consider having hunters and farmers?
- Target market – who are the best prospects for your Cloud solution? Does SaaS open new market opportunities for you?
- Customer support – How do you scale customer support to handle larger volumes of end user questions when you no longer have a customer's internal IT serving as the first point of contact?

# Fundamentals

## 9. What is the biggest impact on a business model?

Cash flow is the biggest issue for most SaaS vendors, whether they are born-in-the-Cloud start-ups or on-premise ISVs moving to the Cloud. Moving to the Cloud by itself doesn't necessarily disrupt your business model, it is the move to subscription-based revenues that drives organizational changes. The fact you are collecting revenues on a monthly, quarterly, or annual basis impacts every decision you will make in every aspect of your organization. In the SaaS model, you make all of the investments up-front – product development, marketing, sales, even customer support, before you collect a single dollar of revenues, and you will continue to make those investments to grow the business while revenues from the first subscribers start to trickle in.

## 10. Should I anticipate making any changes to our organizational structure?

In most cases you will. The traditional software company are often organized along well-defined functions:

- Product development comes up with great ideas/solutions and sends them to marketing.
- Marketing creates awareness, generates leads, which are then passed to sales for follow-up.
- Sales takes prospects through the closing process, inks the deal and turns clients over to support.
- Support nurtures the relationship to ensure satisfaction and hopefully drive more revenues.

In many companies, these functions are really silos with little communication between them. Getting sales and marketing to work together can be enough of a challenge, never mind getting collaboration across all four areas! Many software companies are finding this structure is unworkable. Developing, marketing, selling and supporting a multi-tenant solution creates cross-function dependencies with which very few companies are prepared to deal:

- Product development has to reduce support requirements by building support capability

# Fundamentals

into the SaaS solution itself. For example, building user analytics into the product to learn how users interact with the product and where they run into problems.

- Customer support increasingly relies on automated support platforms to capture client satisfaction/dissatisfaction with specific functionality. This information is fed back to product development to improve the next version of the product and to marketing to help sharpen the value proposition.
- Marketing is taking over many phases of the sales process through marketing automation and lead qualification. This means sales gets involved much later in the process.
- Product development needs to make it easier for a salesperson to close a deal – often by developing a simpler, standardized deployment that takes the cost and complexity out of the implementation process.
- Customer satisfaction starts during the onboarding process, putting more responsibility on sales to provide a seamless hand-off to customer support.

For many on-premise ISVs, this will be disruptive to their organization because it is almost impossible to do it incrementally. People don't like change. The biggest barrier to a successful SaaS business model is the internal resistance to do things differently.

Some companies have successfully re-engineered their entire organization and have found the transformation has had a positive impact on their on-premise business as well. It requires a cultural shift, becoming a customer-centric services organization with all of the changes described above making them a better company.

Others have found they simply can't change the current culture or organizational structure, so they have set up a new business unit, with its own product development and a separate sales and marketing team. Customer support is the one function that can be modified to accommodate the SaaS solution while still taking care of existing clients.

The biggest barrier to a successful SaaS business model is the internal resistance to doing things differently.

# Financial Metrics


There is an old saying that you can't manage what you can't measure, and this is especially true for companies operating with a subscription model. The on-premise, perpetual license business model can cover a lot of sins. You might take a bit longer to close a big sale, and it might cost a bit more than you had expected, but when you collect that big check, you get an immediate in-flow of cash. Not so with SaaS, and there are a wide range of critical metrics that can help determine a company's ultimate success.

## 11. Why are financial metrics so important?

Investors funding SaaS companies are obsessed with financial metrics. Metrics are more important for SaaS-based companies than they are for companies selling on-premise solutions. Tracking and measuring revenues as well as expenses, growth rates, Churn rates and more are essential to success.

There is a good reason investors and company owners are finding the subscription model so attractive. It is the recurring revenues. In the on-premise world, you need to go out and find new customers every year in order to maintain the same level of revenues – much less grow your top line.

In SaaS, assuming you can keep your Churn rate under control, you start the New Year with the same level of revenues as you ended the previous year. As you add new customers, the recurring revenue base continues to grow. Unless something goes very wrong, it is almost impossible for revenues to shrink.

The bad news is this takes time to happen. You have to grow the revenues over time and during that time you are making investments, sometimes big investments, in order to reach your cash flow break-even point.

So measuring and managing all of the components impacting your cash flow is really critical. There are a lot of SaaS companies that go broke before they can reach break-even. Monitoring the right metrics will give you an early indication of whether you might be heading for trouble, giving you time to take corrective action.

# Financial Metrics

Financial ratios determine the value of your company – customer acquisition costs, growth in monthly recurring revenues, Churn rate. They all impact what your company is worth.

## 12. What are the key financial metrics to track?

There are dozens and dozens of SaaS-specific metrics that can be measured, but the most important ones are:

- Revenue metrics – tracking the top-line growth rate across different time horizons
- Churn rate – the percentage of your subscribers who don't renew, for whatever reason
- Customer Acquisition Costs (CAC) – the investment in sales and marketing to sell one new subscription
- The cash flow chasm – how long it takes for you to break-even on a cash flow basis

## 13. What are the most common revenue metrics?

Revenue metrics for on-premise companies are pretty simple – what are your annual revenues and how fast are they growing? In SaaS, there are many ways of looking at your revenues:

### SAAS: REVENUE METRICS

**MRR** - The most common is the Monthly Recurring Revenues. How much do you collect from all of your clients every month?

**ACV** - The Annual Contract Value is just what it says – the amount of revenue a client generates during a 12-month period, regardless of whether they are paying monthly, quarterly or annually. If you are collecting $1,000 per month, the ACV would be $12,000.

**TCV** - The Total Contract Value is the amount customers are legally obligated to pay you. If they are willing to sign a three-year contract for $1,000 per month, the total contract value is $36,000.

**LTV** - The Lifetime Value of a client. You won't be able to measure this until your SaaS business has been up and running for many years, but this becomes a critical number when you are measuring the return on your customer acquisition costs. If you can keep your clients for five, six, seven years or longer, you have a much healthier business than if they leave after two or three years.

## 14. What is "Churn" and why is it a big deal?

Simply put, the Churn rate is the percentage of clients who sign up for a subscription and stop paying, for whatever reason, whether they went to a competitive product or simply didn't find a compelling need for this type of solution. There are a number of ways of measuring Churn, but in its most basic form, it is the inverse of your renewal rate. If 97 percent of your clients renew their subscriptions, then the Churn rate is 3 percent.

There are different ways of measuring Churn:

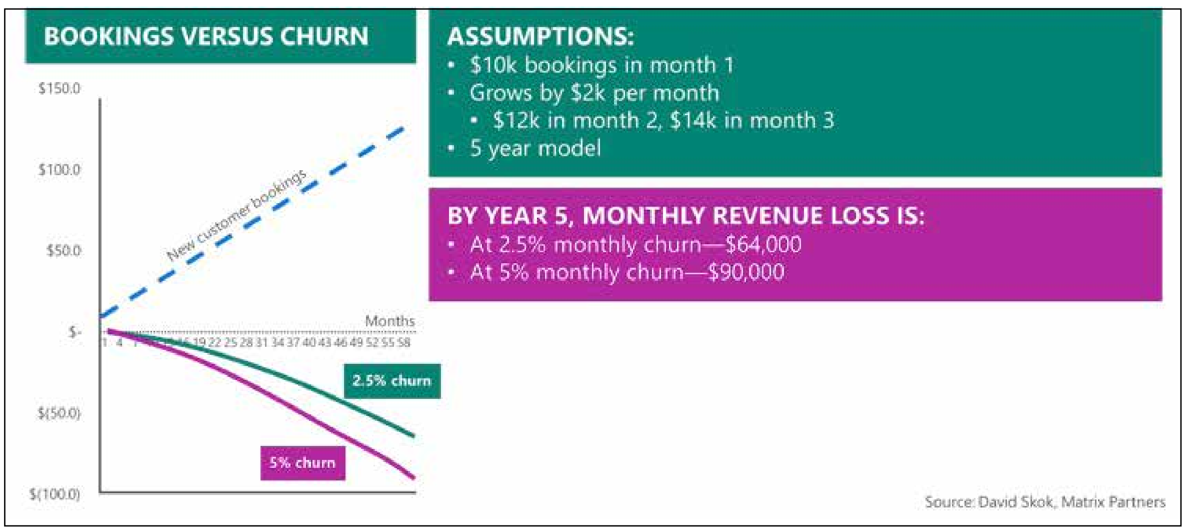
- The most common is the loss of monthly revenues, which takes the amount of the subscriptions into consideration.
- Bookings are the total contract values. For example, a 12-month contract for $1000 per month is $1,000 in monthly recurring revenues, but $12,000 in bookings.
- And some companies will also look at the customer count instead of, or in addition to, monthly recurring revenues. The customer count doesn't factor in the revenues, so it does offer some extra insight. Let's take an extreme example where there's one client producing $100,000 in monthly revenues and 100 clients producing $1,000 each. If

# Financial Metrics

the large client leaves, you would have a 50 percent Churn rate based on your revenues. If 20 of the smaller clients leave, you would have Churn of 20 percent in your customer base, but only 10 percent in your monthly recurring revenues. In a business based on monetizing every relationship by selling more to existing clients, losing a large number of small clients will hurt you in the long run.

The graphic below shows how harmful even relatively low Churn rates can be over time. This is a chart from David Skok, a partner with Matrix Partners, one of the leading venture capital firms specializing in SaaS. In this model, he shows the net revenue loss from a 2.5 percent and a 5 percent Churn rate respectively. The assumption is that you start the year with $10,000 in bookings and you add $2,000 in new bookings every month over a five-year period.

With a monthly Churn rate of 5 percent, at the end of five years you would have lost $90,000 in monthly recurring revenues – revenues you would still have if your Churn rate was 0 percent. Not only is that almost $1 million in annualized revenue loss, but on a monthly basis, it offsets new bookings. So you can see how damaging Churn rates can be.




## 15. What are the major causes of Churn?

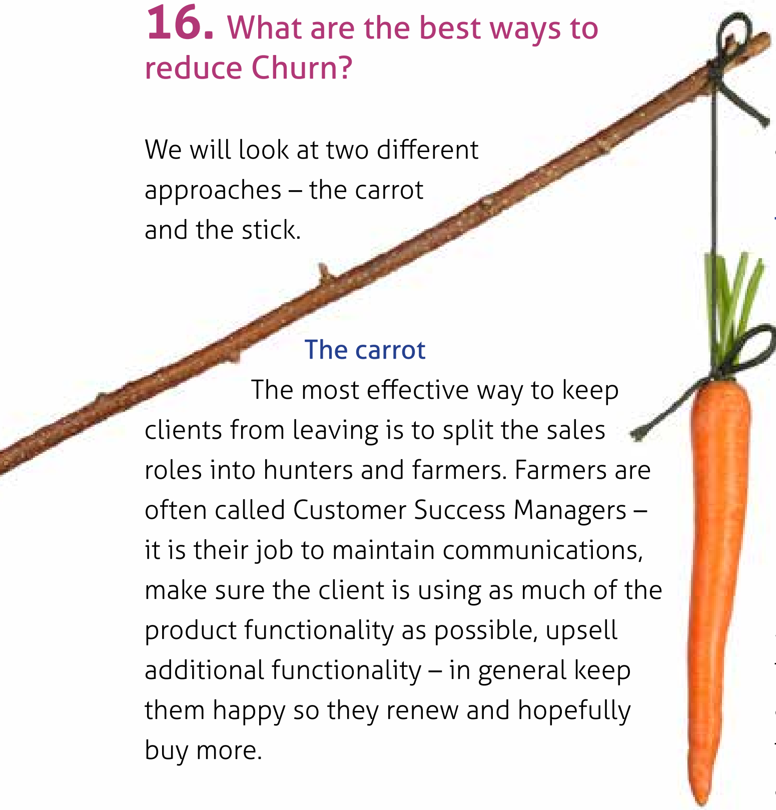
A study done by the Customer Success Association, a trade group specializing in customer support and retention, indicates the top four reasons clients leave:

### REASONS CLIENTS LEAVE

1. They just don't see the value of the solution, at least not enough to justify continuing to pay for it. They tried most or all of the functionality and it didn't meet their needs.
2. They're not happy with the vendor. This is something that happens quite often, signing up for a great looking technology, but not getting enough support from the vendor during the onboarding to actually make it work.
3. They never fully adopt the application. There are a lot of clients who sign up, but never get around to using it, or using enough of it to make it worthwhile. As opposed to reason #1, it's not that the product doesn't have enough functionality, it's that they don't use it.
4. The client's business isn't doing well and they get rid of all non-essential spending.

# Financial Metrics

## 16. What are the best ways to reduce Churn?



We will look at two different approaches – the carrot and the stick.

### The carrot

The most effective way to keep clients from leaving is to split the sales roles into hunters and farmers. Farmers are often called Customer Success Managers – it is their job to maintain communications, make sure the client is using as much of the product functionality as possible, upsell additional functionality – in general keep them happy so they renew and hopefully buy more.

By building analytics into the solution, you can measure customer engagement. One of the nice things about true SaaS solutions, as opposed to hosted or VM versions of on-premise software, is that you can measure how much of the product your clients are using, where they are running into trouble or the functionality they never use. By measuring how much they use the product, you can get early warning signals on those who are most likely to leave.

An extension of this is to really understand the functionality that makes people stay. What are the features they fall in love with and can't live without?

### The stick

But there are punitive ways to keep clients from moving. For example, a lot of SaaS vendors have moved away from the traditional month-to-month, and are locking clients into contracts of a year or longer. They still advertise the cost per-user per-month, but they have a minimum duration on the contract.

Some vendors make it very difficult to get the data back or to migrate it to another application. They force customers to export their data into multiple csv files, making it almost unusable.

Another trick is to require a phone call. A lot of people would gladly cancel a subscription if they could do it online. They want to avoid the confrontation or sales pressure of dealing with someone on the phone.

…if a client leaves in less than three years there is a high likelihood a vendor will lose money on that customer.

## 17. What role does customer support play?

Traditionally, customer support has been seen as a cost center, something to be managed and reduced in order to preserve or improve margins. But with SaaS, it is seen as an important part of the client retention strategy, thereby increasing the "C-L-V," or client lifetime value. This is the total revenue you collect from a client during the entire length of the subscription. The longer they stay, the better it is for you.

Based on the metrics used by many venture capital investors, if a client leaves in less than three years there is a high likelihood a vendor will lose money on that customer. There won't be enough time to recover the customer acquisition costs, provisioning cost or client support costs. In the SaaS world, keeping a customer can become at least as important as selling to a new customer.

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## 18. What is "negative Churn?"

You can actually have a negative Churn rate if you sell more to existing customers. Squeezing out more revenue dollars from an existing relationship can more than offset the revenue loss from Churn.

There are a number of things you can do to achieve negative Churn. You will see why it is so important to have farmers who are working the accounts on a regular basis – something hunters are unlikely to do, regardless of the compensation structure.

One way is to increase customer usage. When you look at businesses like Dropbox, a big part of their strategy is to give you new ways to use more storage.

Another is to have products with multiple tiers, going from freemium to silver to gold to platinum. Again, this is where the farmers are invaluable, helping customers justify using more features that will move them into a different tier.

Many SaaS companies have a family of products. For example, a lot of ERP vendors have CRM, HR and other products they work hard to upsell to existing clients.

## 19. What are Customer Acquisition Costs (CAC) and why are they important?

CAC - Customer Acquisition Costs - are all of the expenses incurred during the marketing and sales cycle. These costs are the investment made up-front and can be easy to underestimate. If not measured accurately, some of the other metrics become much less meaningful.

Many start-ups underestimate their customer acquisition costs and overestimate their sales projections. It is the main reason so many of them go broke – they simply run out of money. The same is true for traditional software companies expanding into the Cloud – they may have cash flow from their on-premise sales and they may have people and resources that can be shared across product groups, but if they aren't measuring their customer acquisition costs properly, it will take much longer before their move to the Cloud starts to pay for itself.

To properly calculate your CAC, you need to include all of your costs, such as overhead, salaries, Adwords, telemarketing, search engine optimization and everything else that goes into sales and marketing.

## 20. What are the industry standards for CAC?

CAC is typically measured against the length of a client relationship – the less you spend and the longer each subscriber stays with you, the more profitable you will become. VCs want to see the lifetime value of a client being at least 3x the CAC. In other words, if you spend $1,000 to gain a new subscriber, you should generate at least $3,000 in revenues over the lifetime of the subscription.

This standard is also expressed in another way – you should be able to recover your CAC in less than 12 months. Now think about that for a minute. VCs are saying you should be willing to spend up to one year of revenues to gain a new client, before you start collecting a dollar in subscriptions. Not to mention the other costs you have in running your business – rent and utilities, salaries and benefits for non-sales and marketing resources (administration, product development, support), hosting and infrastructure costs, etc. That is why driving CAC down as much as possible is a key consideration for SaaS vendors.

If you are just starting out, you won't know what the lifetime value is, so you will need to make some assumptions. But this is also a good

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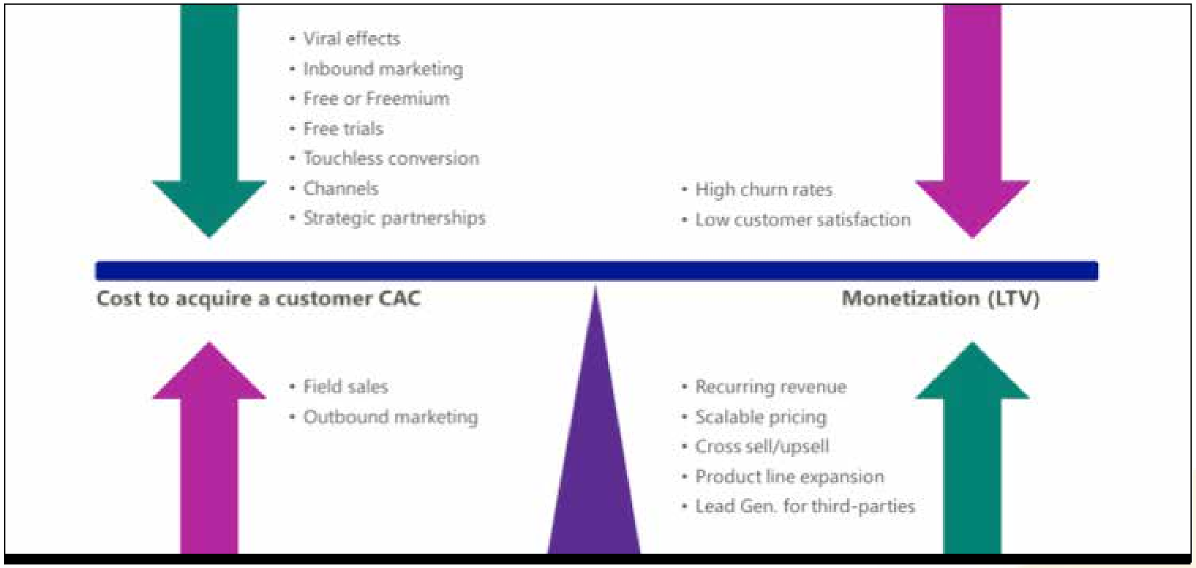
exercise to determine the sensitivity to longer term Churn. Start out by looking at the return assuming a three-year lifecycle. If the numbers look bad, see how long the average lifetime has to be. The longer it is, the more likely you are spending too much money on customer acquisition compared to the subscription value.

## 21. What are the best ways to reduce CAC relative to lifetime value?

In the previous question we talked about the industry benchmark being 1:3. Clearly, being able to extend that to 1:4 or 1:5, will have a significant impact on your profitability. Some of the leading SaaS companies have ratios of 1:7. The ratio can be improved in two ways: reducing the CAC (the initial investment in winning a client) and/or increasing the average revenues per client. David Skok, from Matrix Partners, has a graphic that summarizes the key elements.




Source: David Skok, Matrix Partners

The green down arrow on the left side of the balance identifies the tools you can use to reduce your costs – many of them are tied to marketing automation *(see section: Marketing Cloud Solutions)*. Marketing automation is essential in reducing the up-front costs of acquiring new clients. Conversely, field sales, in fact, any human intervention during the sales and marketing process, drives the costs up. On the right side you will see the factors that impact the monetization of a client relationship – what are the things that increase or reduce the revenues per client. Here again, you can see the importance of having low Churn rates and selling more services, modules or usage to existing clients.

## 22. Do sales cycles change for SaaS solutions?

One of the perceived benefits of a SaaS offering is a vendor can shorten the sales cycle. This is accomplished through marketing automation and free trials. With on-premise software, the objective is very often to get a prospect to install the software on their machine, use it, fall in love with it and write a check. It's a process that takes work and consumes resources for the prospect, which can be avoided when they can try the solution on-line *(See Questions 34 – 35)*.

Another factor in shortening the sales cycle is the financial model, especially for SMBs that might have limited budgets. For example, making the decision to spend $25,000 for a business intelligence solution, plus another

# Financial Metrics

$25,000 for implementation, might be more difficult than deciding to spend $2,000 a month for a SaaS solution with similar functionality.

The industry benchmarks for sales cycles are based on the Annual Contract Value:

| ACV | Ideal sales cycle |
|---|---|
| >$2,000 | 14 days |
| >$5,000 | 30 days |
| >$25,000 | 90 days |
| >$100,000 | 90-180 days |

## 23. What is the "cash flow chasm"?

The cash flow chasm refers to the length of time you spend building up your revenues to get to your cash flow break-even point, and the cumulative negative cash flow you will incur. You have all of your development costs to build the solution, your office expenses, hiring marketing and salespeople, marketing programs – all before you collect any revenues. Then when you do collect revenue, it may come in small monthly payments.

You will have a lot of these expenses whether you have perpetual or subscription licenses, but when you sell a perpetual license, e.g., for $100,000, it helps cover a lot of those costs. The subscription equivalent might be $4,500 per month, which means it will take 22 months for you to collect the full $100,000. In the meantime, you continue to invest in sales and marketing to build up your recurring revenues, resulting in a cash flow chasm that has to be covered by other funds, either from investors or from your own pocket.

For the sake of example, let's say you have hired a salesperson who is expected to close $5,000 of new recurring revenues every month. They will have an initial non-revenue-producing period of time for their onboarding and training, followed by the sales cycle necessary to close the first subscription. When you add in salary, benefits and overhead, it will take the average salesperson 11 months before they reach their cash flow break-even, i.e., the monthly revenues they have generated exceed their monthly cost to you as an organization.

And that's the not so good news. The bad news is, if you look at an individual salesperson as a profit center, they would have had losses for the first ten months, and those losses add up. In fact, it will take an average of 23 months before the aggregated profits they generate offset the cumulative losses.

But the good news is that from that point on, those revenues are recurring and hopefully growing. Every new dollar of subscription revenues generates good margins, because the cost of the salesperson is covered by the subscriptions that were sold during the first 10-11 months.

## 24. What is the best way to eliminate the cash flow chasm?

The simplest thing to do is to avoid monthly payments when possible. The overall trend in the industry is to move to annual contracts with payment up-front. This is relatively simple to do in the enterprise market because large companies have money in the bank and in most cases would prefer to make one payment per year rather than have to set up a monthly payment process in their accounting system. It can be more difficult in the SMB market where the expectation and the appeal of SaaS solutions is monthly payments. However, even in the SMB market, most vendors either mandate annual payments or offer a significant discount to encourage an annual payment.

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## 25. What things impact the price level?

Many of the factors that impact SaaS pricing are also applicable to pricing for most other products and solutions. Some of the considerations that will impact your pricing, either at the top-line level for your solution or for specific clients or prospects, include:

**Competition.** If you are entering an established market, the existing competitors will be your first benchmark. If there are one or more dominant players, it would not be a good idea to introduce a completely different pricing model, unless you have a truly disruptive solution. And with competition, you will likely have to be more aggressive in offering discounts as prospects shop around looking for the best deal.

**Services.** The level of services you provide can impact your pricing, because you will be looking at the overall margin you get, not just the revenues from your solution. There are complex solutions that generate services 2-to-10 times more than the license, in which case you can be more flexible in the price you end up charging.

**Discounts.** Should you be prepared to offer discounts? In some countries no one wants to pay the full list price – they expect a discount, so it is not uncommon to factor this into the list price.

**Customer types.** Some customers and vertical markets are more price sensitive than others. We have seen companies operate with one (higher) price list for oil and gas and a different (lower) price list for retail.

**Contract length and payment modality.** In subscription models, vendors often provide discounts for longer-term contracts or for payment up-front instead of monthly. Providing a 5-10 percent discount for paying annually up-front can be a less expensive form of financing for a small software company than going to investors.

**Prior orders.** Is this a long-standing relationship? Repeat business is more profitable than net-new business.

The point here is that setting your initial list price, as well as understanding what you are willing to accept in a price negotiation, will depend on many factors.

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## 26. Should we have multiple tiers for our SaaS pricing?

There is no single answer to this question. As a basic rule, it is better to keep things as simple as possible, especially if the solution is being sold through marketplaces and/or app stores.

Having tiers does make sense if the value for each tier is distinctly different and the differences can be articulated. It is not uncommon to have a freemium and a pro version, which effectively are two tiers. If you are considering additional tiers such as silver, gold and platinum, the distinction between each has to be obvious. This can be based on many factors, such as the number of users, access to additional modules or functionality, the quality of customer support, etc.

Companies run into trouble when they have a long list of features with 20 checkmarks for silver, 25 for gold and 30 for platinum. Many prospects won't bother to spend the time looking at the differences – the pricing model is a source of confusion.

As with many other aspects of business, "Keep it Simple."

## 27. What are the most common free usage pricing models?

Free usage has been the foundation for many of the best-known SaaS applications on the market. There are a number of variations:

### Freemium

There are many well-known brands that have built very successful businesses on the freemium model, including Evernote, Dropbox, Skype and many others. We will come back to freemium in more detail later because it is a business model that needs to be used with some level of caution. But the most common principles of using it are:

- Customers get a free basic version. The vendor's objective is to get them to upgrade to a paid version. So the freemium version will normally have some limitations, such as the amount of storage or free for one or two users.
- Freemium is usually a volume-based business, driving huge amounts of traffic to the website. Because most of the users won't be paying anything, and even paying users will be relatively small monthly subscriptions, automation is essential so the transaction becomes a self-service model.
- Conversion rates are low, so you need a large addressable market. When you look at the companies mentioned above, each one of them has hundreds-of-millions of potential users.
- Everything needs to be simple. The value proposition has to be easy to understand. The product has to be easy to install and use. Most importantly, it has to be very simple to convert to the paid version.

### Ad-based revenues

Ad-based models are different from freemium in that users get the full-function product. Facebook and Yahoo make most of their money from advertisers – companies that want access to millions of users.

While Yahoo and Facebook are well-known because they address a very large audience, we have also worked with companies that focus on specific verticals. The value to the advertisers comes from this focus.

One of the challenges with ad-based models is stickiness. If the offering doesn't provide some unique value, there is nothing to keep users from going elsewhere. Yahoo lost a lot of its users to Google and Facebook has been losing many of its younger users to Instagram, WhatsApp and SnapChat.

# Pricing Considerations

In addition to advertising revenues, there is tremendous value in collecting demographic data, but this is true across many SaaS applications, not just the free-use products. Data analytics is a booming market and many enterprise SaaS vendors are generating, or plan to generate, significant revenues from this. Uber, for example, sees itself as a data company not a SaaS vendor.

### Related services charges

Another variation of free usage is a related services model. A couple of examples of this are Zynga, which shot to fame with Farmville, and Clash of Clans, a popular mobile phone game. They offer a basic version you can play for free. You start paying for add-ons to make the game more interesting or complex. This business model usually involves a fairly significant up-front investment because you have to have so many of the add-on features ready to go before you start marketing.

These games are most effectively sold through marketplaces and app stores, which take a share of the revenues for being the distribution and fulfillment platform.

An important thing to keep in mind with this model is transparency. There have been a number of horror stories of in-app apps that result in enormous phone bills. Users, very often kids, start playing a game and click on options without knowing each option triggers a new bill. In this model, you need to make it clear each new feature incurs additional charges.

Data analytics is a booming market and many enterprise SaaS vendors are generating, or plan to generate, significant revenues from this.

## 28. What is "per unit pricing?"

Per unit pricing is emerging as a common pricing model because it most closely aligns with actual consumption, making it more of a utility pricing. Some examples are:

### Metrics-based, per unit of measure

There are many ways to establish metrics-based pricing. Back-up and storage is a familiar example. Cloud-based systems such as Mozy and Carbonite have tiered pricing tied to the amount of storage you use, while Windows Azure is a pure utility model with pricing based on storage, bandwidth and other services that are consumed.

The more moving parts there are, the more difficult it is to keep the pricing simple, but that should always be the objective. Customers like the predictability of knowing how much the services will cost. However, even if the pricing is simple, the billing process can be complex and many ISVs use third-party metering and billing services such as Zuora and Metanga.

### Per transaction

Some solutions lend themselves to per transaction pricing. Doc2Data provides on-line invoice processing and charges based on the number of invoices that go through their system. NeoGrid manages on-line sourcing and procurement events and charges per event.

This is another example of value-based pricing – customers pay for what they use. If it is a high-volume business such as invoice processing, it can be priced in tiers. It is usually pre-paid with an adjustment if the usage exceeds the tier or on a pure consumption basis with billing at the end of the month for the exact consumption.

### Per device

On the mobile side, pricing can be per user or per device. Avema is a Canadian company that provides Cloud-based mobile expense

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management solutions. Ubitexx is a German company bought by BlackBerry, with an IT services management solution for mobile devices. In both cases they charge per device. One of the advantages of per-device pricing is users often have multiple devices – they might have a phone plus a tablet or a phablet. Avema deals with large companies that have thousands or tens of thousands of devices, so they have tiered pricing. Ubitexx charges for the exact number of devices.

## 29. Are there revenue-sharing models?

Revenue sharing is another model that is truly value based. It is one that is often seen with e-commerce and marketplace engines.

With this model, the vendor does not charge an up-front fee. They participate in the revenues processed through their billing engines, so the pricing is based purely on consumption. Customers like it because it eliminates the up-front costs, but they will sometimes try to negotiate a cap on the pricing in the event they are a huge success and the volumes result in a monthly payment they would find hard to swallow.

## 30. Can we still charge a perpetual license fee?

In an example of the more things change the more they stay the same, there is nothing to prevent you from charging a perpetual license fee for a cloud offering, in the same way you do for your on-premise solutions. Acumatica, which is an Azure-based ERP system, offers its clients both options. Salesforce will sell perpetual licenses to very large clients on an exception basis.

It overcomes the total cost of ownership objection. In the enterprise market there can be a reluctance to pay a subscription forever *(See Question 37)*. Some industries, such as regulated utilities, want to capitalize the software rather than expense it so it can be used to help justify rate increases.

If you do offer this as an option, you will want to bill separately for the infrastructure costs you incur – this can be a separate bill you send monthly.

## 31. What is the difference between freemium and a free trial?

Many people use the two terms interchangeably, but they are not the same thing. Freemium is a limited functionality solution that can be used for an unlimited duration, while a free trial is a full-function product that can be used for a limited duration. Freemium products are designed to provide some level of value with the hope a reasonable percentage of the unpaid users will see enough value in the "Pro" version to upgrade to the paid version.

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# Pricing Considerations

## 32. Should we have a freemium pricing model?

Freemium can be a great marketing tool, but there are number of considerations that go into making the decision. First of all, it might be free to the end user, but it isn't free to you. You still have to cover the infrastructure and usage costs of supporting the unpaid users and if your solution consumes a lot of storage, bandwidth or compute cycles, those costs can add up quickly.

Second, freemium works best when there is a very large addressable market. The conversion rate from freemium to a paid subscription is quite low. Across most types of applications, the typical conversion rate is 1-3 percent. Companies such as Dropbox and Evernote are at the higher end of that scale, but they have a large budget for marketing automation and client communications to encourage conversion. If you are selling into the corporate market with 100,000 prospects (for example) the sales and conversion funnel is not very promising:

- Let's say you do a great job of marketing and are able to drive 20 percent of the addressable market to your website. That would result in 20,000 visitors.
- If you have an effective automated process on your website, you might get 10 percent of the visitors, or 2,000, to sign up for the freemium version.
- If you have the typical conversion rate of 1-3 percent, you will end up with 20-60 paid subscriptions.

In the meantime, you are paying to support almost 2,000 non-paying users. When you factor in all of the costs associated with getting them your CAC will be off the chart.

## 33. Can freemium be used for the enterprise market?

Yes, it can work in certain cases. In the enterprise space the conversion rate is likely to be higher because the target market is well-defined and the companies finding their way to your website are doing it for a reason. The challenge for many ISVs is to provide enough value in the freemium version to make it interesting for a prospects to sign up, but not so valuable that it removes the incentive to upgrade to the paid version. This can be a difficult balance to find.

It can also work when there is a suite of products with a base product that has value on a stand-alone basis, but is the platform for higher-value modules. Giving the base module away can make sense if it effectively locks clients in to your other modules.

> Free trials are a cornerstone of SaaS marketing. So if you have a solution that lends itself to a free trial, do it.

## 34. What are keys to making free trials work?

Free trials are a cornerstone of SaaS marketing – a "try before you buy" strategy that is so much easier for Cloud solutions than for on-premise. So if you have a solution that lends itself to a free trial, do it. But there are some basic rules to making them successful:

- The trial version has to be self-service and easy-to-use. If it requires live data to be uploaded or there is risk someone will get lost trying to navigate through the solution, free trials might not work.
- It needs to be a full-function product so prospects can see what they get.

# Pricing Considerations

- If there are limitations during the free trial period, such as limited storage, a maximum number of documents or records, explain what the limitations are and they will be removed in the paid version.
- Free trials are typically 30 days, but we are seeing a trend to reducing this to 14 days. If they haven't started using it in 14 days, they won't use it in 30 days.
- Communicate, communicate, communicate during the free trial period, whether it is by e-mail, on-line chat or phone support. If not, your conversion rate to paid subscriptions will be low.
- Make it easy to pay for the subscription. If they have entered personal information to activate the free trial, such as their name, address, phone number, transfer this into the billing fields automatically.

As with freemium, the objective is to have a high conversion rate. You are spending money driving traffic to your website and the difference between a 10 percent conversion rate and a 20 percent conversion rate is enormous. Companies using the free trial should be treated as if they are paid subscribers with the same onboarding process and customer support.

## 35. Are free trials right for every SaaS solution?

To be successful, free trials should be self-service. But this isn't always possible. Some solutions are simply too complex to allow a prospect to navigate by themselves. If they get lost or confused they will blame the product. And for some solutions such as ERP, prospects will want to use live data, which is not always possible with a free trial. If a free trial won't work, there are some alternatives such as:

- "Sandbox" demo in a controlled environment with client data. This requires spinning up a separate instance for each prospect, which can be time-consuming and require Cloud resources that you have to pay for. This is not unlike a proof-of-concept in an on-premise sales process, with the same advantages and challenges.
- Videos and canned demos to demonstrate the product functionality. These would typically be in the form of an overview video with separate videos for each component or module.
- Money back guarantee – generally speaking not the preferred choice, but it is one way of overcoming buying resistance if the client isn't confident your solution will deliver on its promises. This approach requires a disciplined approach to qualifying prospects.

## 36. Is there a standard formula for converting perpetual pricing to subscriptions?

Many factors impact the price. However, there is a simple formula to help get an idea of what the monthly subscription might be. It's called the "Rules of Three:"

**Formula for subscription pricing**

1. Take your perpetual license price,
2. Add in three years of maintenance,
3. Divide the total by three to determine the annual subscription price, or by 36 to get the monthly subscription price.

For example, if your perpetual license is $100,000 and you charge 20 percent in annual maintenance, the annual subscription would be $53,333, or roughly $4500 per month.

Our experience has been most SaaS solutions fall within a conversion period of 30-40 months. However, there are exceptions, especially if you are facing born-in-the-cloud competition. These competitors often underprice their solutions because they don't fully understand the costs of running a SaaS business, or because their solution doesn't provide the same level of functionality. In

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many cases they are following the "80 percent of the functionality at 50 percent of the price" game plan, which can be quite disruptive to established vendors.

## 37. Are SaaS clients concerned about total cost of ownership?

It depends on the market segment. This is less of a concern for the SMB market than it is for the enterprise market. In many cases, SMBs don't have the cash or the datacenter infrastructure, so do not need to compare the total cost of ownership (TCO) of on-premise versus Cloud.

Enterprise clients, however, do have a choice. For them it isn't a cash flow issue – they have the money in the bank to pay for an on-premise license and they have the datacenter and resources to run it. For companies, it comes down to a lease vs. buy decision.

When an ISV introduces a subscription version of their products, the typical conversion rate is three years. From the customer's perspective this also means the break-even point for them is three years. When the CFO sharpens his pencil and runs the numbers, it is hard to

justify making SaaS payments for a product that might have an 8-year replacement cycle.

Now, you can add in other costs the company has when running on-premise software, such as personnel costs, hardware, etc., -- but for a lot of companies this is a sunk cost – they have the people, they have the hardware.

So there needs to be a compelling economic reason for them to buy a SaaS solution.

## 38. What about cost-based pricing?

Many ISVs, from start-ups to some of the largest companies in the world, take a manufacturing approach to setting their price. They start their pricing calculation by figuring out what their costs are, and going from there.

You have to ask yourself, "What do your customers care about?" They are looking for value, for business benefits, for commitments made and kept.

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What is the one thing they couldn't care less about? Your costs and your ROI.

What you make on the transaction is of no concern to them. So while we absolutely agree you need to know what your costs are, you need to start at the other end of the equation when developing your pricing. Determine the value you bring to your clients and price accordingly. Sometimes that will produce a price much higher than cost-plus-pricing. If you set your value-based price and you can't make money at that level, you have a bigger problem with your business model.

## 39. Do SaaS customers expect to get discounts?

Customer discounts tend to be very different with SaaS than on-premise.

While the numbers vary from product to product, across all sectors the average customer discount for on-premise software is 19-to-23 percent. The discounts can be even higher if the product generates a lot of services.

In SaaS, the average end-user discount is 7-to-9 percent. There is a general acceptance that SaaS is a standard solution offered at a standard price. If the price is $79 per user per month, prospects don't quibble as much as they would for on-premise.

SaaS discounts are rarely based on the list price – they are provided for other reasons. Getting the first reference accounts is a good reason to offer a discount. It is also quite common to offer a discount for committing to a longer-term contract, or for making annual payments instead of monthly.

# Target Markets for SaaS Solutions

As mentioned earlier, the overall enterprise spending on Cloud technologies – hardware, software and services – is roughly 5% of the total spending worldwide. This means that you can't spend marketing Dollars to go after 100% of the market.

But the 5% is an average, and there are wide variations based on geography, the type of applications, vertical markets and the size of companies. The challenge is to identify the prospect profile that is most willing, or least unwilling, to buy Cloud solutions, and focus limited resources on that segment.

## 40. What types of Cloud solutions are most commonly used?

Based on our experience and data we have seen, some of the most commonly used Cloud-based applications are:

- CRM – in 2015 roughly 50 percent of CRM purchases were Cloud-based, and this is expected to increase to 62 percent by 2018
- E-mail and archiving
- Business intelligence
- Marketing automation
- Storage
- Collaboration
- Practice management for healthcare and legal practices
- Distributed mobile workforces, such as sales, field services, etc.

Cloud adoption varies widely by region:

- The United States represents roughly 60 percent of Cloud spending, while it is roughly 35 percent of all IT spending
- Germany and France on the other hand have much lower Cloud adoption rates, in large part because of their concerns about privacy and security
- Latin America has become an attractive market for SaaS with annual growth rates of 25-26 percent
- Emerging markets, such as Africa and South Asia, are adopting Cloud solutions because they have not made investments in physical infrastructure
- Japan has been a relatively slow adopter because the enterprise market is dominated by facilities management firms that see the Cloud as a competitor
- The UK and the Nordic markets have Cloud spending that is proportionately higher than their spending on on-premise.

## 41. Should I be concerned about cannibalizing my on-premise sales?

One of the biggest concerns for many companies moving to the Cloud is the fear their top-line revenues will decline if they introduce a SaaS version of their product. We have seen this many times when working with large publicly-held companies. Senior management is concerned with hitting their quarterly numbers so investors stay happy; the VP of sales has a revenue target that can

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# Target Markets for SaaS Solutions

best be reached by selling perpetual licenses; and salespeople worry about a reduction in commissions.

It is an unjustified concern. The likelihood that a SaaS offering will replace an on-premise, perpetual license sale in the enterprise space is quite small, for a number of reasons:

1. **Overall market adoption.** When you see all of the hype from analysts and industry pundits, the perception is the majority of new sales are SaaS. It is true that a large percentage of companies are using some Cloud applications, or are planning to test Cloud applications, but the actual spending is still quite low. According to Gartner, the worldwide enterprise software market in 2014 was $320 billion, of which roughly $18 billion was for SaaS. In other words, only 5.6 percent of spending is on SaaS. The adoption rate varies greatly by company size (SMBs are earlier adopters), geography (about 60 percent of SaaS spending is in the U.S.) and types of applications (Cloud spending on CRM is much higher than other applications), but the fact remains that almost 95 percent of spending is for on-premise.
2. **SaaS applications are often developed to access new markets.** Many companies move to SaaS in order to sell to customers they don't have today. We have worked with many large vendors that sell complex solutions to the enterprise market. They develop a SaaS solution to sell to mid-market prospects that don't have the budget or business needs for complex solutions.
3. **Enterprises buy Cloud solutions for a specific reason.** *See Question 44.*

The upshot is the decision to buy a Cloud solution is often a binary one – they are buying it for a specific reason and have a clear preference for the Cloud. In relatively few cases are enterprise companies deciding between two solutions providing the same functionality – one on-premise and the other in the Cloud, which means the potential for cannibalization is limited.

> Many companies move to SaaS in order to sell to customers they don't have today.

## 42. Why are SMBs so eager to adopt SaaS?

In terms of company size, SMBs (small and mid-sized businesses) are much more enthusiastic about the Cloud than larger enterprises. There are a number of reasons for this:

- Start-ups don't invest in hardware; they do everything in the Cloud.
- SMBs have a simpler decision to make when it comes to refreshing their hardware – do they reinvest in a new server and 10 desktops or do they move everything to the Cloud? It is a binary decision, whereas enterprise companies have a large datacenter that is refreshed in increments.
- Cash flow is an issue. SMBs might not have the cash to spend $25K on a BI solution and another $25K for services, but they are willing to spend $2,000 per month to get the same functionality.
- SMBs are often less concerned about security, or if they are, recognize the big Cloud providers are probably more secure than the server they have sitting under their desk.
- The need for flexibility, rapid deployments, accessing applications from outside an office (e.g., from a coffee shop, etc.)

# Target Markets for SaaS Solutions

## 43. What are the biggest barriers to enterprise adoption?

The enterprise market has been slow to embrace public Cloud applications for a number of reasons:

- The first and most important reason is security. Whether it is personal information or product information, companies have been reluctant to store information outside their firewall. This is changing. The rapid adoption of Office 365 is a good indication corporate attitudes are evolving.
- IT departments sometimes see the public Cloud as a threat to themselves. Decisions on buying SaaS solutions are increasingly being made by lines of business or functional areas within a company, such as marketing. However, anything to do with IT that requires resources or integration with other systems will be owned or influenced by the IT department.
- For real-time applications, latency is an important consideration. Bandwidth and transfer speeds have dramatically improved over the last five years, but for applications that require instant response rates, the distance from a data center can create user dissatisfaction.
- One of the main benefits of SaaS for an ISV is it is highly standardized. All of your clients will be on the same code base and version of the product. But for larger companies this can be a disadvantage, because they like to customize applications to work with their own processes and workflows.
- The perception is SaaS solutions are cheaper than on-premise, but this is not always true for larger companies. In most cases, they already have a large datacenter and their own IT staff. If the SaaS offering is simply a replacement of functionality, on-premise can actually be cheaper.
- Companies are concerned about getting locked in with a vendor. How do they get their data back or transfer it to another SaaS application if they decide to switch?
- Directly tied to that, is the concern about vendor viability. If the vendor of an on-premise software goes out of business, the company still has the application running on their system and there is no business disruption. But if a SaaS vendor goes out of business, they may no longer have access to those applications.
- Compliance with government regulations such as HIPAA.
- For companies outside the U.S., the Patriot Act is a big issue. The Patriot Act can give the U.S. government the right to access personal information on foreign nationals if the data resides on a datacenter owned by a U.S. company or the subsidiary of a U.S. company. This is a major barrier to adoption around the world, even in countries like Canada and Australia.

## 44. When and why do enterprises buy public Cloud solutions?

Understanding why enterprise companies buy SaaS solutions will help you identify the best opportunities to pursue:

- Functionality that is only available in a Cloud solution. Examples of this can be mobility, collaboration, IoT, etc.
- Workload variability. Companies with dramatic swings in computing needs are attracted to the Cloud because they can run a smaller, more cost-effective datacenter for their core requirements. Retailers, for example have most of their computing needs in the month of December. Having applications that can burst those workloads to the Cloud means that they can use a smaller datacenter the rest of the year.
- Operating expense vs. capital expense. Some companies want to move as much off their balance sheet as they can, preferring

# Target Markets for SaaS Solutions

to have operating expenses that go through the profit and loss statement rather than fixed assets that show up on the balance sheet and are depreciated over time.

- Decommissioning datacenters. We see this quite often in the healthcare sector where hospitals decide they don't want to be in the datacenter business. They are looking for ways to use third-party infrastructure and support through managed service providers or by moving to Cloud-based applications.

## 45. Does being in the Cloud make it easier to sell internationally?

There is sometimes a belief SaaS solutions are easier to sell in new markets than on-premise software. Since it is a web-based solution, you just need to post it on your website, a marketplace or an app store and away you go. Orders will come in from all over the world and you can make money while you sleep.
It is probably more accurate to say the Cloud makes your solution available to customers in new markets, but it doesn't eliminate the need for marketing, sales, customer support and, in many cases, localization. There are also legal issues that can be a barrier - data privacy and data sovereignty are big issues in many countries which can make a Cloud application less attractive than a comparable on-premise solution.

## 46. China was a hot market for on-premise technology – what about the Cloud?

China has become an attractive market for on-premise software as piracy rates have declined, but it is a more challenging market for SaaS for a number of reasons:

- Culturally, the Chinese prefer to buy rather than rent. The idea of paying indefinitely for something they could own is something they resist.
- Rightly or wrongly, many Chinese are concerned about data sitting in the Cloud where it might be accessed by their government. There is a fear all large datacenters will be accessed by the government and they are better off storing data on their own infrastructure.
- SaaS is technically regarded as a telecommunications service, which requires a license that can only be acquired by a Chinese company or a joint venture partner. The legislation is under review and may change.

## 47. Are there any overlooked markets that might be interesting?

One of the more interesting markets for all software products, whether delivered on-premise or from the Cloud, is Latin America. It is a large market many vendors ignore as they focus their attention on North America, Western Europe and Asia-Pac. While there are complications related to foreign exchange and withholding taxes, it can be an attractive market for the following reasons:

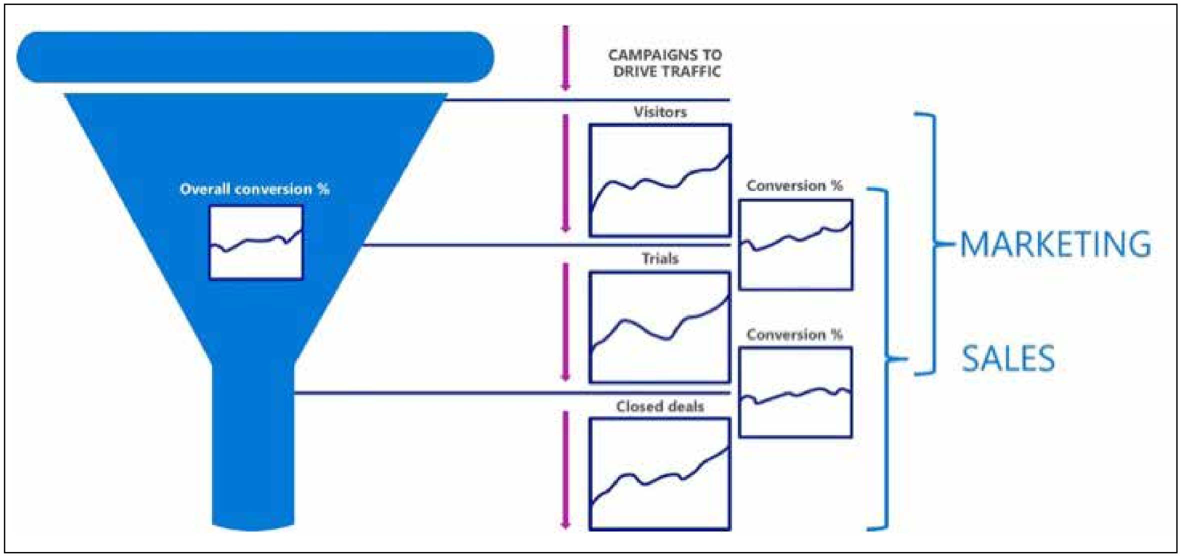
- It is a large SaaS market with annual spending of roughly $1 billion in 2015 and an annual growth rate of 25-26 percent, which is considerably higher than other major markets.
- It is overlooked by most vendors, so there is less competition.
- Channels are mature and well-developed. Software has been sold through channels since the 1970s and there is a large population of strong, sophisticated channel partners.
- The markets are heavily concentrated in a handful of countries. Brazil typically represents roughly 50 percent of the IT spend and Mexico 23 percent. Argentina, Chile, Colombia and Venezuela combine for another 23 percent, meaning six countries are responsible for 96 percent of the IT spending.

# Marketing Cloud Solutions

## 48. What is the biggest change in marketing?

There has been a major shift in how marketing is done and it is being driven by what is called buyer-centric marketing. There are two main factors behind this shift. The first is the need to keep the customer acquisition costs as low as possible. The second is a change in buyer behavior, which we will come back to.

The result is marketing taking over more and more of the sales process. In a traditional model, marketing is responsible for the first phase in the sales funnel – creating awareness and generating leads, leads that are passed along to the sales team for follow-up. Now, marketing is becoming responsible for the front-end of the sales cycle *(see graphic below)*. The combination of buyer-centric marketing, content marketing and marketing automation takes prospects through as much of the sales process as possible, with sales getting involved only to close a deal. The Holy Grail for many companies is to have the whole process automated, but this isn't always possible. The key is to delay human involvement as long as possible in order to minimize the cost of sales.




## 49. How do I develop a value proposition for my solution?

Building the value proposition is the foundation for most marketing programs – you need to articulate why someone should buy your solution and the benefits they will get from using it. As former Harvard marketing professor Theodore Levitt is quoted as saying, *"People don't want to buy a quarter-inch drill. They want a quarter-inch hole."* Sell the hole, not the drill.

There are entire books dedicated to this topic, but a useful framework is the "FAB" model:

**F** stands for Features – what does the product do?
**A** stands for Applications – how is the product used?
**B** stands for Benefits – how does it actually help a customer?

## 50. How do I find SaaS buyers?

This is perhaps the most fundamental change in marketing – you don't find them, they find you. Changes in marketing are being driven in large part by a change in buyer behavior.

# Marketing Cloud Solutions

Prospects for Cloud solutions are much more likely to be self-educating. They have identified their needs and pro-actively start looking for a solution to meets their needs.

In fact, 77 percent of prospects for Cloud solutions have done some level of research before they contact a vendor. More than half short-list vendors based solely on their own research, before they reach out to the selected vendors. That is why they are called "invisible buyers." As a vendor you don't know who they are or what they want until it might be too late to influence them.

It really has become a buying process more than a sales process. In the traditional model, you run e-mail or telesales campaigns to reach out to your prospects or suspects, expecting to educate them on your solution and hoping to generate interest. That is changing.

The key to success now, is to get a better understanding of who the prospects are, developing messaging for them specifically and finding ways to connect with them that are not salesy or marketing pitches. It is not about you or your solution, it is about them and their needs.

## 51. What is buyer-centric marketing?

Buyer-centric marketing is a focus on the individual and how you get information about the benefits your solution offers to your prospects. The building blocks of this new marketing approach are:

1. Start by defining personas and buying roles, which are not necessarily the same thing.
2. Define the steps you want to take a buyer through as they educate themselves. Remember, the new buyers are more likely to be self-educating.
3. Develop and provide content that gives a prospect the information they need to make an informed decision, hopefully the decision to subscribe to your solution.

## 52. What is the difference between "personas" and "buyer roles?"

Personas are job roles or positions that can benefit from your offering in one way or another. For example, a VP of sales might be interested in a CRM system because he wants to improve sales efficiency by standardizing some of the sales processes; the CFO might want better visibility into forecasting for budget reasons; the VP of marketing wants to automate and track marketing processes. They all benefit from a CRM system, but the needs and benefits will be different for each persona.

The buyer role is different from the persona. It defines their influence in the purchase decision rather than how they benefit. There are five major buying roles which could be different personas in different companies.

1. The champion is the person driving the process to adopt a new solution internally. In the case of CRM, any one of the personas might drive the process.
2. Influencers may have a say in the solution that is ultimately purchased. For example, IT might be involved in deciding whether to go with an on-premise or a Cloud solution.
3. CxOs tend to be decision-makers. They might set the overall parameters up-front and then wait for the recommendations before making a decision.
4. Users are the people who actually have to spend time with the technology, such as salespeople with CRM.
5. Ratifiers are the ones who can derail a purchase. Procurement is a classic example.

The key take-away is the buying role can be different in each sales process. The VP of sales might be the champion in one company, while

# Marketing Cloud Solutions

the VP of marketing is the champion in another company. You won't necessarily know until you start engaging directly with a prospect. This makes the marketing process more complex. Traditional marketing might be a generalized campaign to blast information out to a large market segment in an effort to generate leads. In marketing 2.0, it is more personalized with a specific message for each persona and buying role.

## 53. What are the keys to an on-line or digital marketing strategy?

In this brave new world of marketing, the objective is to somehow get to the invisible buyers and get relevant information into their hands that will ultimately lead them back to your website so you can engage them in some form of conversation.

The fundamental building blocks are discussed in the following questions and include:

- Social media campaigns
- Paid search and search engine optimization
- Content marketing

## 54. How should I use social media in my marketing?

The first step is to find the so-called "digital watering holes" – the places your personas are most likely to go for information – and post useful information there. Within the social media realm, LinkedIn is usually the first place they go. It can also be Twitter, maybe Facebook, industry blogs, etc.

Ideally, develop yourself as a thought leader around relevant topics through your own blogging and publishing or by writing something other sites are willing to post. An easy way to get started, is to comment and add value to blog posts from others – a simple way to create some awareness.

# Marketing Cloud Solutions


Content is king. Develop content to drive engagement through social media.

## 55. What are some best practices for search engine marketing (SEM)?

Here are some tips for optimizing your SEO/ SEM campaigns.

- Use negative words to reduce unwanted visitors. For example, if someone is selling "eye glasses," they would add "wine glasses" as negative words to avoid paying for irrelevant searches.
- Individual landing pages are key to effective content marketing (more on this in the next question), as well as helping to improve your search scores.
- Videos greatly increase conversion rates and your search scores *(See Question 58)*.
- Content is king. Develop content to drive engagement through social media. Social media engagement improves your SEO results.

## 56. What is a landing page?

Let's start by describing what your standard web page looks like. It will typically have menus to guide a visitor to other parts of the site. There might be rotating messages designed to appeal to different visitors and the overall content covers a wide range of topics. Your home page has something for everyone, but rarely does it have something specific to any one profile of visitor.

A landing page is different. It has information that ties directly to the message you sent to a targeted persona. For example, if you have developed a message around marketing automation for CRM that has been "planted" in the relevant digital watering holes, and it is targeting a VP of marketing, there would be a link to a landing page on that topic. And you would know the person clicking on that link is doing it for a very specific reason.

The landing page is designed to engage that visitor further. It should try to capture their information, for example by offering an e-book, white paper or other worthwhile information that can be accessed by registering their name and e-mail address. A landing page should not have a menu bar that lets them navigate to other parts of your website – the landing page should keep them from wandering off before they complete the conversion step.

# Marketing Cloud Solutions

## 57. What are the keys to successful content marketing?

There are a few basic principles of effective content marketing:

- Make it useful and relevant to the target buyer. Remember, the invisible buyer is trying to solve a problem specific to them.
- This is a building process. A short blast using Twitter or LinkedIn will have limited effect. It takes time to establish thought leadership.
- Build yourself or someone in the organization as the subject matter expert. Instead of having everyone posting to LinkedIn, consider having one person as the company's voice so you can create a critical mass of content positioning that person as a thought leader, even if the content contributions come from multiple people within your company.
- Don't be afraid to be provocative, as long as you are reasonable. There is nothing like creating a bit of controversy to raise your profile.
- Don't try to sell anything through the content. You are providing a service that creates interest in what you do. Let content be content and sales be sales.
- Make sure you maintain quality in everything you do. Spitting out content for the sake of content will be counter-productive.

## 58. Should we be using videos as part of our marketing?

Video is a great way to improve your conversion ratios.

Based on a study by Aberdeen Group, 95 percent of best-of-breed websites use video. The conversion rates help explain why. Sites using video have website conversion rates of 4.8 percent compared to 2.9 percent for websites without video. The higher conversion rates obviously reduce the customer acquisition costs.  Another metric from the study indicates video reduces the number of website visits needed to convert a visitor to a buyer.

## 59. Are there marketing automation tools to make our lives easier?

The good news is, there is no shortage of marketing automation tools on the market. In January 2014, there were 974 companies in 43 categories. But that clearly wasn't enough, so as of January 2015, there were 1839 to choose from!

There are large, fully-integrated marketing automation engines such as Marketo and HubSpot, which can be great for larger companies that are making a real commitment to marketing automation, but they can be expensive and time-consuming to implement.

Just as a sampling of the 1839 options, here are examples of solutions for different categories of marketing, many of which are reasonably priced:

**Landing pages:**
- Unbounce
- Wufoo (forms)

**Social publishing:**
- Hootsuite
- dlvr.it

**Video:**
- Vidyard
- Wistia
- Brightcove
- Vimeo
- Brainshark

**Lead scoring:**
- Velocify
- Infusion

**Marketing automation (low end)**
- Leadsius
- Sales Autopilot
- Azuqua
- Spokal
- JumpLead
- Nurture
- Infusionsoft
- Genoo

This is an evolving market so don't be surprised if this list continually changes.

# Sales Organization and Sales Compensation

The questions we get most often are about sales organization and compensation, especially for companies that are transitioning from on-premise to the Cloud. At the end of the day, it is the salesforce that drives revenues, and if they are not properly trained, motivated and compensated, they won't produce the results a company expects. This is probably the most disruptive change to a company's business model.

## 60. Why is it so difficult to get our salespeople to focus on SaaS?

The reason is money. Salespeople tend to be "coin operated." They are motivated by money and will sell the product or service that generates the biggest commission check. Given the choice of selling a perpetual license for $100,000 or a subscription for the same solution producing $4,500 per month, they will quite naturally focus on selling a perpetual license.

## 61. We are a small company. Can we use the same salesperson?

The simple answer is that you shouldn't use the same salesperson. It is better to hire

The question a company of any size should ask itself, "Is the Cloud solution strategic or opportunistic?"

salespeople who are dedicated to selling subscriptions and services. The profile and skillset tends to be different and it can be difficult to retrain an existing salesperson. However, for many smaller companies this might not be an option because there isn't budget for a new hire.

But this isn't an issue that affects only small companies. It is something most companies have to think through, regardless of size.

Large software companies, for example, will often have key account managers who are responsible for everything sold to an enterprise client. They don't want separate sales calls for Cloud solutions.

The question a company of any size should ask itself, "Is the Cloud solution strategic or opportunistic?" If it is a defensive move (e.g. having a SaaS offering just in case a client or prospect insists on it), there is no need to have SaaS salespeople. The more strategic it is, the more compelling it will be to hire dedicated sales resources.

# Sales Organization and Sales Compensation

## 62. How can we adjust the compensation structure to encourage SaaS sales?

If you decide to use the same salesperson and you want them to drive some level of SaaS sales, there are a number of things you can do to influence their behavior.

- Separate quotas. Give them a specific quota for perpetual licenses and SaaS subscriptions, both of which become KPIs they have to meet. The challenge with this approach is they are likely to continue selling what they are comfortable selling and will try to exceed their quota for on-premise to compensate for not hitting the SaaS quota. When/if separate quotas don't work, the next step is to...
- Adjust the commission structure. Reduce the commission on the on-premise sales until they retire the SaaS quota. For example, let's say the salesperson gets a commission of 8 percent and has a quota of $1 million for on-premise and $250,000 for SaaS. Reduce the commission for on-premise sales to 4 percent until they hit the $250,000 SaaS quota, and only then do they get the normal 8 percent. You will find they will work as hard as they can to retire the SaaS quota, then focus on selling on-premise for the rest of the year.
- Same-size the commissions. If you have two versions of the same solution, one on-premise and one delivered in the Cloud on a subscription model, pay the salesperson the same commission in absolute dollars regardless of how it is sold. If a $100K perpetual license produces a commission of $8K, pay the same commission for the subscription sale. This hurts your cash flow, but it removes the incentive for a salesperson to push on-premise.
- No deal-based commissions. This is not a major trend by any means, but it is surprising to see how many companies have moved away from paying commissions based on specific transactions. They implement quarterly bonuses based on a number of KPIs, which could include revenues, renewals, customer satisfaction, etc.

## 63. SaaS isn't strategic for us – do we need to worry about compensation issues?

At one level you could say "No," and from your perspective you might actually want to encourage your salespeople to focus on perpetual licenses. The risk is you have clients or prospects who absolutely, positively want a SaaS solution and if they can't get it from you they will go somewhere else – and you don't get a sale for either on-premise or SaaS.

## 64. Should we have hunters and farmers?

This is one of the most common questions from companies extending from on-premise to the Cloud – how do we incentivize our salespeople to focus on account management? It is not a question for born-in-the-cloud ISVs, because their business model is almost always based on having hunters (salespeople who close the sale) and farmers (account managers). There is a good reason for that. Pure hunters aren't interested in account management; it isn't in their DNA. If you offer your salespeople some form of bonus compensation tied to renewals, they will see it as a nice bonus when renewal time comes up, but they are unlikely to do anything during the year to earn it.

Farmers have two primary responsibilities. The first is to ensure customer satisfaction and license renewals. *Question 15* highlighted the top four reasons for Churn. The first three can all be addressed by having account managers who are working with your clients.

# Sales Organization and Sales Compensation

The second responsibility is to get more revenues from existing clients, to maximize the return on the initial customer acquisition costs and to help achieve negative Churn. This means farmers need to have a sales mentality and a compensation package that rewards them for the growth in usage.

Compensation should always be tied to the value a salesperson brings to you as an organization.

## 65. What are the main metrics for sales compensation?

Compensation should always be tied to the value a salesperson brings to you as an organization. For a SaaS company, this usually comes down to one or a combination of:

MRR - Monthly Recurring Revenues
ACV – Annual Contract Value
TCV – Total Contract Value

However, many ISVs have complex solutions that require services. When service revenues greatly exceed the license value, focusing only on subscription revenues won't align compensation with the value of the client relationship. Compensating on the gross margin or the total deal size would be a better option.

Another metric often seen with fast-growth SaaS companies is compensation based on net-new logos rather than revenues. Many solutions are sold using a "land and expand" strategy. Salesforce.com is an example of that. A lot of their sales have been to individuals in large companies with the objective of getting more and more people within the same company to use it, until it gets adopted as the overall corporate solution.

This should impact compensation. It is better for a company to have 100 clients generating $1000 each in revenues than two clients generating $100,000 each. So paying commissions only on the revenues won't lead to the best outcome.

## 66. Is there an industry standard compensation program for hunters and farmers?

Sales compensation is a complex topic involving a wide range of variables. You would be advised to research this question more deeply. However, there is a commission formula that is used quite widely.

For contracts with a duration of one year or less, whether it is month-to-month or locked in for 12 months, the industry standard for monthly subscriptions is to pay the salesperson 100 percent of the first month subscription fee – 1/12 of the annual contract value is 8.3 percent, or roughly the standard commission for software sales.

The farmer would get 20 percent of the hunting commission for a straight renewal. However, you also want the farmer to actively expand

# Sales Organization and Sales Compensation

the use of the product, so they would typically get a commission equal to 40 percent of the sales commission for the first year of expanded use, e.g., more users from the same company. This would go back to 20 percent for renewals after the first year.

By way of example:

- If the hunter brings in a subscription of $1,000 per month, a commission of $1,000 is paid.
- If the contract renews for the same amount at the end of the first year, the farmer gets a renewal commission of $200.
- If the farmer does a great job and doubles the subscription to $2,000, a commission of $600 is paid. That's $200 for the $1,000 renewal and $400 for the $1,000 increase.

## 67. What about longer term contracts?

This is where the metric changes from MRR (monthly recurring revenues) or ACV (annual contract value) to TCV (total contract value). If you sign a three-year subscription and maybe even collect the entire amount up front, the salesperson will expect to receive a full commission on the full amount, as they would if they were selling an on-premise license.

The industry standard is to pay 60 percent of the regular commission for the second year and 20 percent for the third and following years. In some respects, the hunter is also the farmer since the renewals are baked into the contract, so they get the renewal fess.

In the example of a $1K-per-month subscription, they get $1,000 for the first year, $600 for the second year and $200 for the third and any additional years. There are a couple of reasons for the digressive commission:

- You are still likely to pay a farmer for managing the account.
- Longer term contracts, and especially up-front payments, usually involve an extra discount to the customer. It is a business decision the vendor and client agree on and isn't always fully attributable to the salesperson.

Since it is a longer term commitment, the hunter is also the farmer.

At the end of the day, you have to decide what is important to you. If you really want to get longer term contracts, then you might want to pay a bigger percentage, maybe even the full commission, for the extended term.

## 68. Should we use deferred commissions?

When contracts and billing are month-to-month or quarterly, it can be tempting to stagger the commission payment so the salesperson gets 50 percent of the commission at the start of a subscription and the remainder at the end of the first year. This is done to 1) better match the commissions paid with the cash received; and 2) reward salespeople for subscriptions that are successfully renewed through the first year.

This can be counter-productive.

First, salespeople should be focused on adding new accounts and helping build monthly recurring revenues. Reducing the immediate reward for a "hunter" will be a disincentive for many salespeople. Second, it makes commission tracking more complicated. Third, and perhaps most important, the salesperson shouldn't be held responsible for the quality of the product. Customers elect not to renew for many different reasons, most of which have nothing to do with the salesperson (unless they have been setting unreasonable expectations).

# Sales Organization and Sales Compensation

## 69. How do we establish quotas for subscription sales?

A simple formula for setting the quota is to use an OTE (On-Target Earnings) multiplier, which is usually 6-8 times the on-target compensation. For example, if an inside salesperson is expected to have fixed and variable earnings of $100,000 and the multiplier is 6, then the annual quota would be $600,000 in recurring revenues.

The quota measurement is usually the recurring revenues that will be generated – not the amount actually collected. For on-premise software it's easy. If their quota is $1 million, then that is the amount they sell and you collect from their customers.

But with subscriptions the revenues build up over time, so salespeople get quota credit for the annual contract value. For example, if they sell a subscription paying $5K per month, they get quota credit of $60K, even if the money hasn't been collected.

## 70. Is quota tracking different for subscriptions?

With on-premise software, the timing of revenue collection isn't really critical. A salesperson with a $1M quota could take it easy for the first half, then work overtime during the second half to hit their quota. If they close everything in December, they still hit their number, the company collects the money and books the revenues. Not an ideal scenario, for sure, but manageable.

With SaaS though, it is really important to book the deals as quickly as possible. If the salesperson waits until December to close all of their deals, the company has lost a full year of revenues – revenues that will never be recovered. For this reason, quota tracking and compensation is structured to motivate the sales team to get deals done sooner rather than later. There are a couple of approaches, which are variations on the same theme.

The first one tracks the progress measured against the annual quota with a lower commission rate for the first 25 percent of quota achieved. The commission percentage increasing as they get closer to their quota. For example, they might get 25 percent of their normal commission for the first 25 percent of their quota, so instead of getting a full month subscription revenue as their commission, they only get 25 percent of it. Once they hit 50 percent of their quota, whenever that is during the year, their commission goes to the normal percentage, and they get a 50 percent accelerator once they hit 75 percent of their quota. A really good salesperson who hits 75 percent of their quota in the first quarter, would get a 50 percent bonus on everything else they close that year. A lousy salesperson who stays below 25 percent of their annual quota for most of the year gets penalized, and will probably want to find something else to do.

> ...quota tracking and compensation are structured to motivate the sales team to get deals done sooner rather than later.

The second method breaks the yearly quota into quarters. The commission is based on how well they do measured against the quarterly number. Again, good performers get rewarded and poor performers get penalized.

# Sales Organization and Sales Compensation

## 71. Should we be using inside sales?

There has been a big move toward replacing more expensive field salespeople with less expensive inside sales for SaaS solutions. The lower the ARR (Annual Recurring Revenues) and the more standardized the solution, the more sense it makes to use inside sales. This also ties in with the change in marketing, where prospects move further along the sales funnel through self-education and self-qualification.

## 72. What is the best way to assign territories for inside sales?

One of the biggest issues is how, or whether, to assign territories. According to a survey by The Bridge Group, a firm that specializes in sales consulting, the approaches used are:

| How territories are assigned | percent of respondents |
|---|---|
| By geography | 30 percent |
| No territories | 27 percent |
| Round-robin | 12 percent |
| By vertical | 8 percent |
| Geo & vertical | 6 percent |
| Named accounts | 6 percent |
| Geo & named accounts | 5 percent |
| Other | 6 percent |

While assigning territories by geography is still the most widely used, it is becoming less popular. In 2010, "no territories" and "round-robin" (sequential assignment of leads to the next salesperson as they come in) totaled 20 percent of the responses, so combined, they have almost doubled in popularity.

The type of territories used is often tied to the price of a subscription. Lower-value subscriptions lend themselves more to round-robin or no territories because the level of engagement with a prospect is relatively low, while higher-priced subscriptions are more likely to be assigned based on named users.

# Cloud Channel Programs

As we discuss below, channels will still be an important part of the software business, but different companies have different concerns:

- On-premise ISVs that are using their SaaS solution to move from enterprise to SMB segments might find themselves using channels for the first time, and need to build a program from scratch;
- On-premise ISVs that already have a channel often wonder about the changes they need to make to their existing program – do they need different partners? What about discounts and client ownership?
- Born-in-the-cloud start-ups that are selling into the enterprise market might need channel partners with the resources and credibility to sell to and support large clients.

## 73. Do we even need partners to sell Cloud solutions?

A lot of analysts predict partners will be "disintermediated" – a fancy word meaning there will be no need for them. Business will be done through electronic channels, such as marketplaces and direct sales from vendor websites.

If you were reading the trade press in the late 1990s, this probably sounds familiar. During the dot.com and e-commerce bubble days, analysts predicted stores would disappear – there would be no more need for brick and mortar because everyone would be shopping on-line.

But here we are, many years past the dot-com bubble and approximately 90 percent of retail sales worldwide take place in a store. People might do their research online, but most people still like to go into a store where they can see and touch the products. The ultimate paradox of this is Apple. Great technology, often revolutionary, and they get most of their sales through retail stores. Microsoft and other tech companies, including Google and Amazon are building retail stores.

The same will be true for channels. Yes, there will be some solutions people sign up for online. But in the business market, customers want a trusted advisor who can guide them through the many choices, help integrate new solutions with their existing infrastructure and provide post-sales support. Channels are not going away any time soon.

## 74. What are the channel options?

The number of channel options actually increase for Cloud solutions:

- We still have the traditional channels we have for on-premise – resellers, project services (what were referred to as systems integrators in the past) and distributors. The role they play might change and some of them may disappear, but these categories are here to stay.
- Managed Service Providers, or MSPs as they are often called, could become the dominant channel for SaaS solutions targeting small and mid-sized businesses.

# Cloud Channel Programs

- Pure-play resellers are companies formed to focus on the recurring revenue model – they only work with SaaS products and, for the most part, do not build up a big professional services staff.
- Hosters, such as Rackspace, are virtual distributors providing infrastructure as well as sales and marketing enablement services to ISVs.
- Syndicators and aggregators bundle together multiple solutions that fit together, for example Office 365 and a practice management solution for doctors and clinics.
- Marketplaces have the potential to become a leading platform for Cloud sales. It is still early days, but there are a few notable successes and many are starting to grow in importance.
- And finally, affiliate marketing can be a low-cost way to generate referrals. They are not a channel in the classic sense since they don't actually sell the solution to an end user, but they can be an effective channel to reach and funnel prospective clients to you.

## 75. How do marketplaces work?

There are two types of marketplaces. For illustrative purposes, we refer to them as the "eBay model" and the "Amazon.com" model. The eBay model is more of a listing catalog with links back to the vendor's website. You will need a way to provision and bill for your solution. In the Amazon model, the marketplace takes care of everything – hosting the application, provisioning, billing and collection, and then remit a percentage back to the vendor.

In either case, the costs to a vendor can consist of three components:

1. Some marketplaces will charge set-up fees, especially if there is a lot of up-front integration involved or if there is considerable domain expertise, such as specific verticals.
2. There is often a listing fee per product, but the amounts are fairly low, typically $100-$300 per solution per year.
3. Where the marketplaces want to make money, and where you want them to make money, is on commissions based on revenues. The typical percentage emerging for business solutions is 20 percent. This can be higher for specialty sites and less for marketplaces that are more like listing directories.

However, you cannot just list your product on a marketplace and wait for the orders to flood in.

People might do their research online, but most people still like to go into a store where they can see and touch the products.

Someone has to do the marketing. Either you do it or you pay the marketplace or your partners in your channel ecosystem to do it. There are no shortcuts to success.

## 76. Is affiliate marketing a good option?

Affiliate marketing can be a cost-effective way to generate new leads. There are many categories of affiliate marketers – it can be industry websites, bloggers, other vendors, etc. What they have in common is they have a lot of traffic coming to their website and they provide information and content of interest to those visitors.

By definition, this is volume-based anonymous marketing. People come to the websites and don't have to register for basic access. No one knows who they are until they do something to engage with the website.

# Cloud Channel Programs

Affiliate marketing is a click-through model. A visitor sees a link to the website, or a banner ad, or a whitepaper they want to download – and they click on it. Ideally this will bring them to your website. You have to be able to track where they came from so you can pay your affiliate marketing partner.

But be selective. There are 10s of thousands of affiliate marketers. Not all of them have business models or reputations with which you would want to be associated. Protect your brand by being selective.

Affiliate partners are usually compensated using a variable structure. For example, with small payments for specific activities such as registering for a newsletter, signing up for a free trial, etc., the total costs should be in the range of 3-5 percent of the first year subscription value.

## 77. Are managed service providers (MSPs) a viable option?

We are starting to see the rapid emergence of regional managed service providers. The typical MSP has 50 clients with 20 endpoints (PCs, tablets, phones). They manage everything for the clients, which are usually too small to afford a full-time IT person.
From a channel perspective, there are three primary benefits MSPs provide:

- Geographic concentration. They will be within a one to two-hour drive of most of their clients, so they can drive out in the morning if on-site services are required, do the work and drive back in the evening.
- Domain expertise. This can be around verticals markets or specific types of solutions, such as security or CRM.
- Finally, they already have a business model based on subscriptions. They don't have all of the transition issues to deal with that can be such a challenge for traditional resellers.

The biggest challenge with the MSP model is scalability. MSPs are more interested in selling new services to existing clients than trying to find new clients for your solution, so the revenue opportunity per MSP is limited to their installed base. This means you will need a large network of partners with each partner driving a modest level of revenues.

## 78. Are most value-added resellers (VARs) active in the Cloud?

While resellers will continue to be an important part of the food chain for B-2-B solutions, in most major vendor ecosystems, fewer than 20 percent of channel partners have made a significant investment in building a Cloud business. This is the biggest challenge for all software vendors that rely on a channel. In many cases, the partners are the point-of-sale, the customer-facing entity that will influence the prospect with regards to Cloud versus on-premise. As long as 80 percent or more of partners continue to focus on selling on-premise solutions, it will slow down overall Cloud adoption.

As you go out into the market to look for reseller partners, you have to be very aware of where they are in the adoption cycle. There are basically four categories:

- On-premise service providers who have no interest in the Cloud. They see their business as being installation and support of hardware, networking gear and related software and have no intention of changing.
- Resellers who claim they are in the Cloud, but are still focused on installation and implementation with no real business model for Cloud solutions.

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- Pure-play resellers are companies set up to sell subscription licenses. They want to build-up a big book of recurring revenues without investing in professional services beyond what it takes to implement the solution.
- The final category is where a lot of traditional resellers will end up – hybrid partners. They are perfectly happy to sell and install on-premise or in the Cloud, depending on the client requirements.

Finding good partners willing to make a commitment to marketing, selling and supporting a new solution can be difficult in the best of times. But when only one-in-five partners are viable candidates for a Cloud solution, you will need to make sure you are targeting the right ones.

## 79. What are the characteristics of successful Cloud-focused VARs?

With Cloud resellers still in the minority, it is important to identify the best candidates. Here is what to look for:

1. An existing Cloud-based model that seems to be working. You don't want to be the first Cloud solution that they are selling.
2. There are a range of services they could be providing and they don't include installation and implementation, which have traditionally been a big part of their business. Some of the services to look for include:
   - Change management and business process re-engineering
   - Cloud transition strategy
   - Custom application development
   - Data migration and integration

   These services tend to be higher-value services than the services associated with hardware and network deployments.
3. And finally, they should have a compensation model for their salespeople that pays them for selling subscriptions, which is a lot different than selling an up-front license and some boxes. Prospective partners need to have figured out something that makes it worthwhile for their salespeople.

> ...fewer than 20 percent of channel partners have made a significant investment in building a Cloud business.

## 80. What discounts do Cloud VARS expect?

The traditional partner discount for on-premise software is 40 percent. There are variations depending on factors such as volume, the level of services a partner can generate, the partner's participation in sales, marketing and technical support, etc., but the industry standard is 40 percent.

What happens to your partner discounts when you move to the Cloud?

With payments coming in the form of subscriptions, is there enough margin to keep everyone happy? Vendors usually look at the equation from their own perspective and decide they can't afford 40 percent. They go to their partners with an offer of 20-to-25 percent and sometimes less for renewals.

For the partners it comes down to simple math. If they have been selling software with a list price of $100K and 20 percent maintenance – they get $48,000 when they close the deal.

Now, looking at the same transaction, but on a subscription basis, the typical conversion pricing leads to an annual payment of $53,000,

# Cloud Channel Programs

with maintenance included. If the partner is lucky enough to get a 40 percent margin from you, and they can collect the first year up-front, they get $21,000. This is why, given the choice, partners will almost always push the on-premises version. Even if they were to get a 40 percent margin on renewals, it would take them almost three years before they collect the same amount they would for selling an on-premise plus maintenance for three years.

Many vendors recognize this is a challenge and are offering an aggressive discount structure to attract partners. NetSuite, for example, has a program called SP100 that gives partners a choice if they bring in a contract for two years or longer:

- 100 percent of the first year subscription, and 10 percent of all renewals; or
- 50 percent of the first year subscription and 30 percent on all renewals

For most companies, this is not a viable option – they cannot give away the first year's revenues. However, it does highlight how important margins are to partners. Our recommendation is to offer partners the same percentage discount for on-premise and subscriptions. However, over time partner margins are likely to decline, for the following reasons:

- Even a 40 percent discount will be hard to sustain because of the costs you incur to host and maintain your Cloud solution, which erodes your margin more than on-premise software.
- Many of the big vendors are driving down partner margins, pushing their channels to generate more services to offset the lower discounts.
- As more partners build up their recurring revenue stream, and have a guaranteed cash flow that covers all or most of their operating expenses, they will become less reliant on product margins.

## 81. Who should own the client relationship and do the billing?

This is a very difficult issue for vendors and partners alike. Many vendors see moving to the Cloud as a way of taking control of the client relationship, cutting out their channel partners and invoicing directly. However, most partners hate this. In part, because they see it as a threat to their business if they give the vendor billing control. Plus, they provide their clients with a range of products and services. From the partner's perspective it makes life simpler for the client if there is one source of billing.

In deciding who has the relationship and does the billing, we make the distinction between a referral partner and a strategic partner (a partner that does the marketing, sales and support). Referral partners should never handle the billing, while strategic partners would, in most cases, own the client relationship.

## 82. Should we allow our partners to host our solution?

This comes up as a question in jurisdictions that have laws around data sovereignty, i.e., data, especially personal data, has to reside on a datacenter located in that country. Even the largest Cloud vendors (Microsoft Azure, AWS and Google) cannot afford to have datacenters in every country, and even when they do, concerns about the Patriot Act (See Question 99) make it preferable to host the applications and data locally.

If the partner has their own local datacenter, it can seem like a convenient solution to have them host and provision your solution. We would not recommend you do this. Many of the jurisdictions that have data sovereignty laws and do not have an Azure or AWS datacenter, are countries where you would not want to take

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your partner to court and expect to win, for example Colombia and Kuwait. If your partner is hosting and provisioning, as well as billing and collecting, you have effectively given them complete control over your business in that market. If the partner decides to stop paying, they could still continue to provision and bill for it and you would have little or no recourse.

The preferred option is for a vendor to identify a mutually acceptable hosting partner in the territory.

## 83. Does it make sense to use two-tier distribution?

One of the big questions around the Cloud business model is the role of large distributors. Traditionally their value proposition has been to operate as a warehouse and a bank. They carry physical products from many different vendors, handle the shipping logistics needed to process orders from thousands of resellers, and provide those resellers with financing until they can collect from their clients.

What happens when software is no longer shipped in shrink-wrapped boxes, but is delivered from the Cloud? And when an increasing number of companies no longer have their own servers and internal networks, just devices their employees use to access their business applications? And when customers are paying every month for their subscriptions, will partners still need a financing facility from a distributor?

Distributors will still have a role to play. Most of them have developed or purchased billing and provisioning platforms that allow them to aggregate and bill for Cloud solutions from multiple vendors, simplifying life for the big vendors and their partners.

However, our experience has been many software vendors see the Cloud making it easier for them to deal directly with their resellers, since they no longer have to worry about physical distribution. They have their own provisioning and billing platforms, which are highly scalable. It doesn't really matter whether they are dealing with 50 partners or 5,000 partners, it is all automated.

# Customer Support

Customer support takes on greater importance for SaaS solutions – if clients can vote with their feet and go elsewhere if they are unhappy with a vendor or the perceived value of a solution, Churn rates go up. Customer support is also an important element of the on-going sales process, finding opportunities to drive more value for a client by helping them expand the usage of your solution.

## 84. How is supporting Cloud clients different from supporting on-premise clients?

The basic objectives are the same – fix problems and increase customer satisfaction. However, the client expectations and your delivery platforms can be very different.

For one thing, as in so many other ways, you are penalized by the financial model. You will be collecting your revenues over time, but you absorb the customer acquisition and onboarding costs up-front. The more you spend resolving problems during onboarding, the longer it will take before you reach your break-even point from the monthly payments.

Speed is essential with SaaS. Customers today expect issues to be resolved quickly, which is one of the reasons it is important to build automation and self-service support platforms into your customer support.

Another difference is a key business requirement that is driving SaaS adoption – mobility. If you are catering to this market, your support platforms need to be available on mobile devices as well.

Additionally, support moves from internal IT to you, the vendor. With an on-premise solution, the users within a company would call IT. Now they will be contacting you instead. This means you will be dealing with less savvy users. All of those questions the internal IT person could answer will come back to you, and many of them will be questions about functionality. "How do I print a document?" "How do I change a field from green to blue?"

As a result, you will want to provide support that is less technical and more user-friendly. In many ways you will need to dumb down your support.

# Customer Support

## 85. What can we do to minimize support requirements?

To the extent possible, you should try to eliminate the need for support before it even becomes an issue:

- A lot of issues come up during the deployment, especially in the enterprise market. With on-premise software, you or your partner would be quite happy to send a team of people on-site and bill for the implementation. SaaS clients, even in the corporate market, are increasingly looking for quick and inexpensive deployments. Across a wide range of technologies and verticals, we have seen SaaS solutions that are doing well, almost always offer a standardized remote deployment package, with fees ranging from a few hundred dollars to a few thousand.
- Developers need to understand how the new breed of clients think and use technology. Rotate your developers through a few shifts in customer support to answer questions. Chances are, they will find ways to modify the product to help eliminate those issues.
- Usability labs can be a great way to test out your installation process during your product development.
- If you can, you should consider building pro-active notification into the technology – a system that automatically alerts users to known issues that can impact performance. It is all about communications and heading your clients off at the pass before they feel the need to pick up the phone and call you.

## 86. Can we use analytics to reduce support?

When you sell your on-premise solution to a customer, your knowledge of how the product is being used pretty much stops at the door. They may have purchased a 500-user license, but you have no way of really knowing how many people are using it, what features and functions are the most popular, or the problems people run into that discourage them from using your solution. This all changes when you move to SaaS.

If you have an analytics engine built in, you will be able to track which features and functions are being used. You might find that 80 percent of your customers are using a function that you thought was unimportant. How much are they consuming and what are the consumption patterns?

If the analytics engine is able to collect information on workflows, you can start to identify issues that impact productivity.

And you will be able to measure response times. In a client-server environment, customers are used to immediate response times. In the Cloud, latency can be a real source of frustration, especially for real-time applications. Tracking response times could trigger a decision to set up your application in a second data center so you are closer to your clients. This would reduce a lot of support calls for something you have no control over.

And finally, the analytics engine should be integrated with your back-end support automation, to make the customer case management and trouble-ticket processing more efficient.

## 87. Is support a "one size fits all?"

Customer support programs can come in different shapes and sizes depending on the price and complexity of the solution. Some of the variables include:

- Your availability – something that will usually be documented in your Service

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Level Agreement (SLA). In the SaaS world, there is an expectation that support will be 24/7, whether this is through an automated platform, live chat or telephone.

- Tiered support programs, for example, with bronze, silver and gold programs. Pricing can be handled in different ways. Sometimes they are baked into the pricing model, so if subscriptions have pricing tiers, support packages would be included in the respective tiers. For others, case support packages are sold independently of the subscription. In this case, a base support package is offered regardless of the price of the subscription and advanced support packages are sold separately.
- The level of automation you use. High-volume, low-priced subscriptions have to have automated, self-service support programs, while complex solutions will require more handholding. You will need to find the balance that is right for you.

## 88. What are some of the ways to automate customer support?

The good thing about self-service is SaaS clients overwhelmingly prefer it, in the same way marketing SaaS solutions is becoming self-service. Consumers of SaaS are much more self-sufficient throughout the entire business cycle.

There are a number of self-service platforms you can use, including:

- FAQs, or Frequently Asked Questions, which have been a standard part of software support for a long time. It is simply a collection of questions and answers that have been documented in the past. They are stored in an on-line repository and potentially segmented by category.
- A knowledgebase is more comprehensive than FAQs, collecting more than just questions and answers. It also contains information from a wide range of constituents that can include internal staff, customers and partners. The search capability is more sophisticated than an FAQ and the documents can include both public and private documents, whereas an FAQ is all publicly available. A good knowledgebase platform will also have the ability to create user groups, tagging documents that are relevant to each.
- The next level up in automation involves setting up customer forums, which can be great for generating peer-to-peer support activity. Offering social support through customer forums lowers customer service and support costs while creating a positive customer experience. And since discussion boards or forums have been around in various forms online for quite some time, they offer a framework customers recognize, know how to use and can easily understand.

## 89. How do customer communities work?

Communities have been around a long time and are widely used in open source. That business model depends on large communities willing to share information and help fellow members resolve problems without any form of direct compensation. There are a number of key components, including FAQs, forums, content and a knowledgebase, so you can see having those components already in place provides a great platform.

It is the additional functionality that makes communities so powerful:

- Online community platforms also have a built-in email listserv so customers or members can participate in forum discussions through their email inboxes and not just online, which is the case with forums.
- Online community software allows you

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to get a better idea of how and in what capacity your customers are participating, for example, tracking the level of interaction.

- Community analytics also help you learn about your customers' likes and dislikes regarding your company and products for better decision making on product development, as well as your on-going customer communications.
- Finally, online communities tend to have tighter integration with CRM systems or association management software, which allows you to push or pull data from the two systems and create a better experience for your customers.

## 90. Should social media be part of our support program?

Social media should be monitored on a regular basis, and from a business perspective, the pecking order is Twitter, LinkedIn and Facebook. Twitter in particular has become a popular place for people to complain about a product or a service. You need to monitor any hashtags that could involve your solution to pick up on any potential discontent as soon as possible.

LinkedIn can, in some ways, be set up to work as your customer community with a closed group. However, it would be better to use a community portal that is optimized for support and interactive communications. There are 100s of solutions available, some of them free. Even the most comprehensive solutions are usually priced at less than $1,000 per month, sometimes much less.

## 91. Is e-mail support an option?

This is what most companies start with because it can be assigned to an existing resource, such as a tech support person or a sales engineer. It has the benefit of users not expecting an immediate response time. In fact, the auto-response for most e-mail support systems indicates the user will get a response within 24 or 48 hours.

The risk is no one follows up. You should: 1) make it part of someone's job description to answer the e-mails, and 2) have an internal tracking system.

Another benefit of e-mail is it allows templated responses. Many systems require a description of the problem. Keywords trigger relevant responses; such as links to an FAQ or a knowledge base.

## 92. What about live chat?

Real-time chat is growing quickly as a preferred form of support. According to the Association of Support Professionals, roughly one-third of companies use it. They found the significant factors for deciding to implement chat support are:

- Deflecting or eliminating telephone and e-mail support cases
- A higher level of customer satisfaction, because they are getting a more immediate response to their issue
- Lower cost per case
- No need to worry about foreign accents and the potential for misunderstandings or frustrations
- It is more personalized than other forms of web-based support
- Each session generates a transcript which helps document disputes or trigger follow-up actions

# Customer Support

## Real-time chat is growing quickly as a preferred form of support.

Here are some numbers and guidelines you might find useful.

- Live chat isn't ideal for complex support issues – it just isn't practical to describe or resolve some issues in a chat window
- Live chat programs are relatively inexpensive, with typical pricing in the $20-40 per user per month range
- At volume, an efficient support person can handle up to three simultaneous chats
- There can be short delays as the support person goes back and forth between chat windows
- Most live chat programs aren't optimized for mobile

### 93. What are some of the pros and cons of telephone support?

Complex solutions might require trained telephone tech support personnel. Advantages include:

- This is the highest-touch, personal support for clients, next to going on-site
- Remote desktop sharing can be used to diagnose and potentially fix problems in real time
- It provides the tech support person with more information that can guide the decision to escalate or not, if the problem can't be fixed over the phone

Some of the disadvantages include:

- It can be inefficient if you have dedicated staff sitting idle waiting for calls
- Conversely, in order to avoid idle staff, calls tend to get backed up, sometimes with wait times creating customer dissatisfaction
- It can be awkward to provide links to other resources without a chat window
- There is often a perception that outsourced call centers in exotic locations sometimes result in misunderstandings due to accents or poor quality phone lines

# Legal Issues


Moving to the Cloud and recurring revenues changes the nature of your relationship with your clients. It becomes more of a service-based relationship than a transactional relationship, and if you are storing personal information in your application it raises the potential for significance liabilities if the data is hacked.

This section is not intended to provide legal advice, simply to discuss the business impact of certain legal issues. We strongly recommend that you contact your attorney for advice that is specific to your situation.

## 94. Do we need a EULA (End User License Agreement)?

With on-premise software, the end-user license agreement (EULA) is necessary because you are transferring the right to use the product to your client. You are not handing over the product or the intellectual property, simply the right to use it.

However, with a pure multi-tenant SaaS solution, you are provisioning a service, you are not transferring the right to use the software, nor the right to run it on their hardware. The relationship will be governed by a services agreement. Keep in mind, this is for true SaaS solutions. If you are hosting your on-premise solution or running it on virtual machines (VMs), you still need to license the software. This is also true if there is client software running on the customer's hardware – you need to transfer the right to use your software on their infrastructure.

## 95. Will we have to pay partners if they are terminated?

The first issue is client ownership and the right to bill the client. What happens if the partner owns the client relationship and has been responsible for billing? You need to have a provision in the agreement giving you the right to contact the client and start billing them directly in the event of termination. Otherwise the partner will continue to collect revenues that should be going to you.

Next, does your partner continue to get paid for the subscription?

If your partner sold an on-premise license, they would have kept the cash and received compensation for having generated revenues for you. But if they sold four subscriptions and were terminated, they would not receive the compensation they feel they have earned. This could pose a problem for you. It would not be unreasonable for a partner to sue to receive that compensation.

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Our suggestion is to plan for termination and build a termination fee into the agreement that reflects the investments and obligations of the partners, and the specific statutory protections that might exist in a given jurisdiction. It is easier to get this agreed to when you are signing a contract than after things have gone badly.

## 96. Who is responsible for customizations made by a partner?

If the partner has customized the solution for their customers, for example building custom apps as a front-end to your solution, what happens if you change your code base and it breaks the API?

It isn't a big concern for on-premise software, because the client has both applications running on their hardware and everything keeps working. But if everything is in the Cloud and they can't access your solution because the connection with the front-end application is broken, there is going to be a problem.

There are ways for you to manage this risk. You can:

- Provide standard SDKs for all third-party apps
- Require certification;
- Require your partners put their source code into escrow so you can update the APIs before you provision upgrades to your clients

## 97. What does an SLA (Service Level Agreement) typically cover?

There are four main issues the SLA should address – control, operational risk, business risk and penalties, rewards and transparency.

### Control

You would normally guarantee a minimum level of availability, such as 99.5 percent uptime. However, you should define permitted exclusions to performance, such as downtime for maintenance, and also specify the performance is dependent on the client's internal network. If they are down, it shouldn't count against your guaranteed availability.

Response time, or latency, is also impacted by the client's internal bandwidth. You are delivering the service to their door, so to speak, but if their network can't handle the data flow and slows down the response time, that isn't your responsibility.

Fail over is also a decision made by the client. Do they want redundancy? Do they want redundancy across geographies?

### Operational risk

Operational risk includes the perceived risks around security, privacy and data ownership. This is a major concern in the corporate market. Data retention and ease of data migration policies need to be spelled out. In some countries, the data retention period is mandated by law. One of the barriers to Cloud adoption in the enterprise market is the concern about data lock-in – how difficult or easy will it be for them to bring their data back in-house or move it to another application? Privacy breaches raise liability issues and grows in importance and sensitivity every time a bank or large retailed gets hacked.

### Business risk

Business continuity is a concern of most companies – if there is a problem, how long will it take to get it fixed? How do they escalate the issue based on severity?

Are you planning product changes that could impact their ability to run other applications? A little bit earlier, we mentioned the risk of partner customization no longer working, but

# Legal Issues

that risk applies to any back-end system you are integrated with by the client. There is a well-known HR SaaS solution that updates its product every month. They have to maintain a large professional services team to help fix whatever integrations no longer work.

### Penalties, rewards and transparency

- SLAs almost always have penalties for not meeting performance guarantees
- How do you handle refunds? Do you automatically credit it against the next month's billing? Would you allow customers to request an actual payment?
- What if you are hosting the solution on your own datacenter and you just can't keep up. Would clients be able to terminate the agreement if you consistently fail to meet performance guarantees?
- If you have great performance, such as 99.99 percent uptime, or exceptionally low latency, brag about it on your website and in your marketing collateral. The actual difference in a production environment might be minor, but the perception could be very positive for you.

## 98. Should we consider cyber liability insurance?

Cyber liability insurance is becoming a business necessity for vendors whose SaaS applications store personal and financial information. Insurance companies now offer polices to protect against the costs associated with a privacy breach. Although they are expensive, the cost of a breach could put you out of business.

According to the Ponemon Institute, the direct costs of fixing each record, such as notifying a client, issuing new credit cards, penalties, etc., is about \$154 per record and about \$3.5 million per breach. If you add in the lost revenues from bad publicity, the costs can be many times higher.

The U.S. had the highest per-record cost at \$217 followed by Germany at \$211. India was lowest at \$56 per record. Sorted by industry, the highest costs were in the healthcare industry at an average of \$363 per record.

For many companies, sustaining a loss of this magnitude would put them out of business. For that reason, it is strongly recommended you at least research what the cost of a policy would be.

## 99. Why are non-U.S. companies so concerned with the Patriot Act?

The Patriot Act is a U.S. law that gives the U.S. government the right to access personal information on foreign nationals if that information resides in a datacenter owned by a U.S. company or the subsidiary of a U.S. company.

This is more of an emotional issue than a practical issue. Technically, the U.S. government has to justify why they want the information, get a warrant from a U.S. court, then get a warrant from a court in the local jurisdiction, for instance Germany, before they can access the information.

But the emotional aspect of this overrides the practical side – people are scared to death the U.S. government is going to get its hands on their personal information. This is one of the reasons the big U.S. Cloud vendors are having a tough time breaking through in markets like Germany and France.

# Legal Issues

## 100. Are there European privacy laws we should know about?

Europe takes data privacy very seriously, and has always been concerned with protecting personal information for its citizens. The Safe Harbor Treaty between the U.S. and Europe used to make it easier for U.S. companies to comply with data privacy laws, allowing the data was stored in a U.S. datacenter that complied with the terms of the treaty. However, it was invalidated by the European Court of Justice at the end of 2015, and new legislation makes it more difficult for U.S. SaaS companies that collect personal information as part of their applications.

The EU has finalized its new General Data Protection Regulations (GDPR), which will take effect in 2018. www.consilium.europa.eu/en/policies/data-protection-reform/data-protection-regulation/ provides more details, but the key elements include:

- Raising the age of consent for digital data collection from 13 to 16
- Deleting information from servers if a right to be forgotten request is made and approved
- Creating a single data protection office to deal with all complaints
- Requiring all companies to inform the EU within 72 hours of a data breach occurring.

The laws apply to all companies, regardless of whether they are based in Europe or not, if they are collecting data from an EU citizen. And non-compliance can trigger a substantial fine, equal to 4% of a company's global revenues. For example, an ISV with $10,000,000 in revenues, regardless of where those revenues are generated, could be fined $400,000.

# Resources

## 101. I want to know more - what other resources are available to me?

The York Group has dedicated entire webinars to many of the topics covered in this book. A list of, and access to, short video summaries of those webinars are available in the "Video Tutorial Library" on The York Group website. Additionally, you can access key white papers and industry links. CLICK HERE.

**Still have questions?**

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