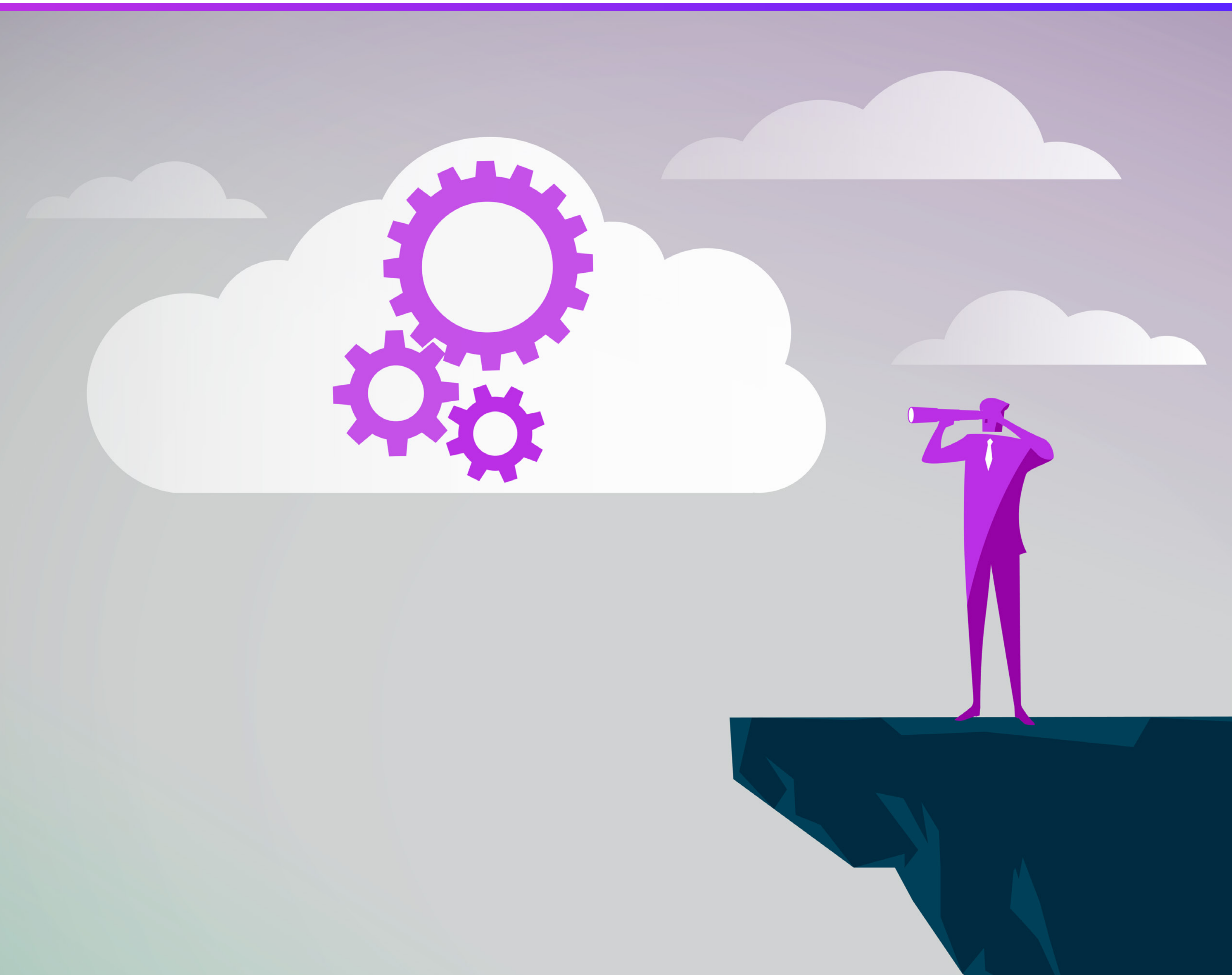
GUIDE

The CFO's Ultimate Guide to Successfully Transitioning to SaaS



The way a company monetizes its software has a huge impact on business success, growth and profitability.

CFOs and financial leaders strive to make their software companies even more successful and set them up for growth. Moving away from one-time perpetual license sales to recurring revenue models, as well as transitioning on-premises offerings to SaaS are top of the strategic project lists for many technology CFOs.

The CFO’s goals:

- **Grow company revenue and overall valuation**, with recurring revenue worth far more than one-time revenues,
- **Take products to market quickly** to capture new revenue streams and grow into new markets,
- **Increase the company valuation** through strong renewal rates and profitable pricing strategies
- **Drive profitability** and enable long-term investment.

When a software company offers recurring revenue models, it also benefits customers. The finances of it are appealing. Acquisition cost of the software drops, allowing customers to try the software or adapt their usage in line with needs, without a massive upfront investment in rapidly changing technology. The customer’s expense also shifts from CapEx to OpEx.

Recurring revenue models lend themselves well to a software-as-a-service (SaaS) deployment model where the supplier provides the full solution and the customer uses the solution without the expense of hosting, maintenance, or updates.

Many software suppliers will continue to offer on-premises deployments for some time, but the trend toward SaaS is clear. As found by IDC, subscription public cloud services, including SaaS and platform-as-a-service (PaaS) models, show an anticipated growth in compound annual growth rate (CAGR) of 18.8% between 2020 and 2025, jumping from $240.9M to $570.1M in that time.[1]

This "SaaSification" of products provides benefits for the supplier (including recurring revenue and scalable deployments) and customers (such as elimination of the need to host or manage the software, easy upgrades and role-based personas) alike. SaaS deployment models also make it easier to measure and monitor customer adoption and engagement trends, allowing suppliers to proactively support and strengthen the customer relationship for ongoing subscription renewals.

The transition to SaaS is optimized when CFOs, senior finance staff, product managers and the teams working with them understand the functionality, financial implications and benefits of this deployment model.

INSIGHT

"58% of total software revenue will be from the SaaS delivery model by 2025."

–IDC[2]

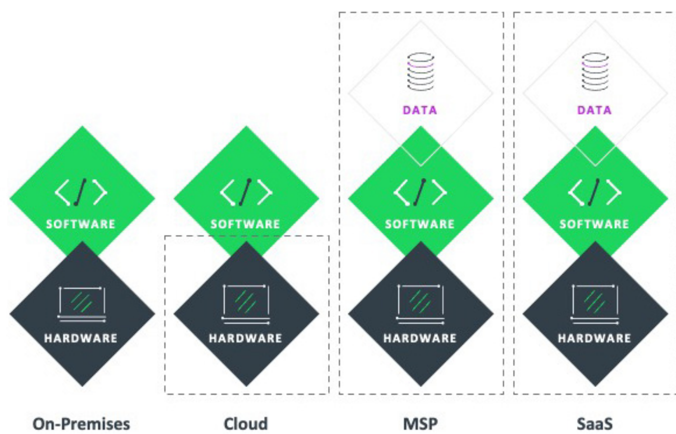
HOW TO

Optimize Software and Services Deployment with SaaS

SaaS is a deployment (delivery) model, in which a software supplier chooses to host the software and provide it as a service to the end customer. The burden of running the service is entirely with the supplier. Compared to on-premises deployments, SaaS is more expensive for the supplier to run, because the supplier is responsible for all costs related to hosting and management. The end customer has nothing to do with the hosting, maintenance, or updates.

Contrast this with other deployments. With on-premises software, the customer receives the binaries and manages everything else themselves. With cloud deployments, solutions run in the cloud (as opposed to a local data center), but the solution may be managed by the end customer.

SOFTWARE AND SERVICES DELIVERY/DEPLOYMENT



COMMON SOFTWARE DEPLOYMENT MODELS

	On-Premises	Cloud	MSP*	SaaS**
Producer Sells	Software	Software	Software	**Service**
Customer Buys	Software	Software	**Service**	**Service**
Platform Provider	Customer	**Public Cloud**	**Intermediary**	**Producer**

**MSP: Managed Service Provider*
***SaaS: Software-as-a-Service*

SaaS solutions usually run in the cloud, but not all cloud deployments are SaaS.

Subscription lends itself well to the SaaS model. The subscription monetization model provides the recurring revenue stream from the customer that is necessary in order to maintain the service.

SEE HOW

Teradici*'s move to subscription, with Revenera as a trusted advisor, drove its triple digit recurring revenue growth and increased the value of the company.*

READ THE CASE STUDY

INSIGHT

SaaS and subscription, *two current trends in software, go hand-in-hand, but are not the same.*

- ***The Software-as-a-service (SaaS) deployment (or delivery) model*** refers to how the software is deployed and delivered to the end-customer.
- The ***subscription monetization model*** refers to how that software is monetized.
- When multiple models are used together, the result is a ***hybrid model***.

HOW TO

Select the Most Beneficial Software Monetization Models

Monetization models fall into two categories: recurring and one-time (non-recurring):

Recurring:

- **Outcome (aka "value-based")** is billed based on measurable customer value. It is a logical model,similar to a contingency fee, but more difficult to implement, measure and budget for (for both the supplier and the buyer).
- **Usage-based** is billed based on actual usage of the software.
- **Subscription** (aka "term licensing") is billed monthly or yearly. It is a much simpler model than other recurring models. Subscription delivers a steady revenue stream.

One-time:

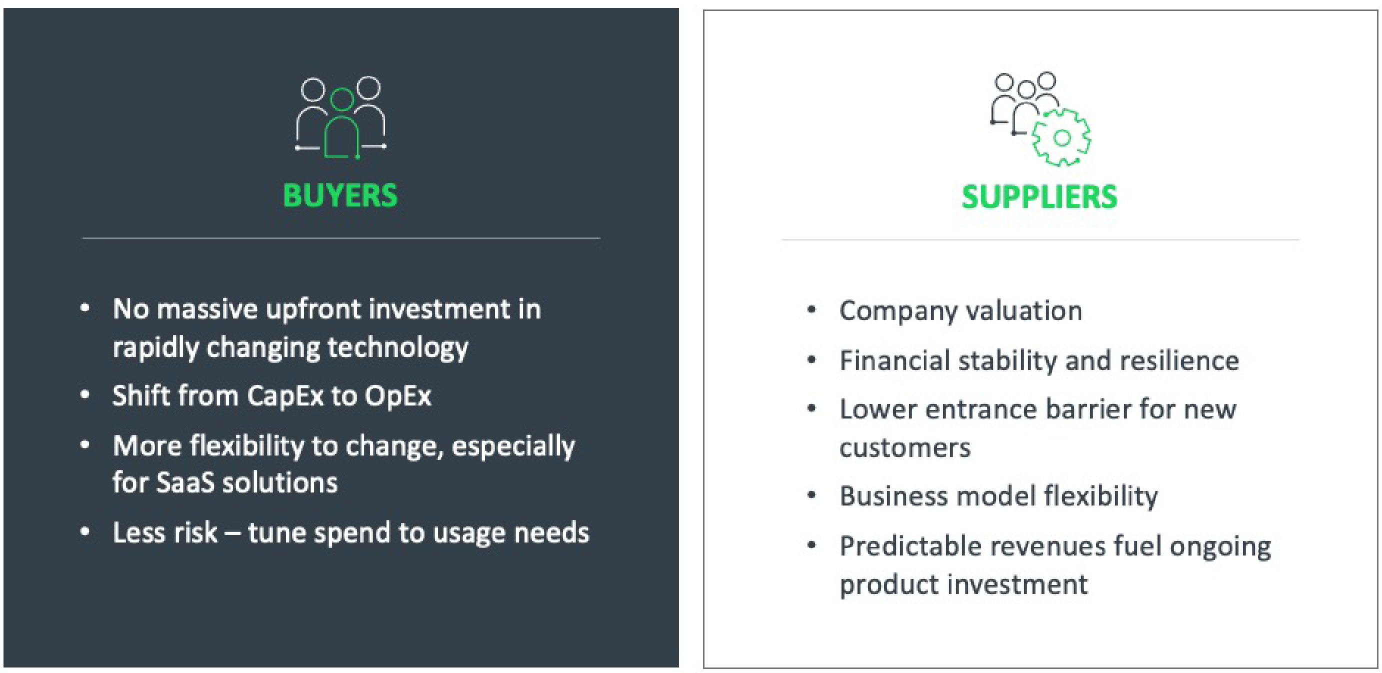
- **Perpetual** (aka "perp") involves a large upfront investment, which does not recur. Because it is a lumpy revenue stream, perpetual is much less valuable to the company that's selling it.

Subscription monetization is popular and desirable because it delivers advantages to suppliers and buyers of software. For suppliers, subscription provides more visibility, stability, and predictability in the revenue stream. These attributes benefit the company valuation, strengthening the supplier's ability to continually invest in the product. When moving to SaaS, the software supplier absolutely needs a recurring revenue stream from the customer in order to maintain the service. Subscription is the ideal way of delivering this recurring revenue to the supplier.

Subscription appeals to buyers because there is no large upfront investment—an advantage when buying technology that changes rapidly. Subscription is an OpEx, not a CapEx, expenditure. Because it can be changed as needs change, subscription is more flexible and less risky.

MOTIVATION FOR BUYERS AND SUPPLIERS

THE SUBSCRIPTION WHY



HOW TO

Prepare for the Transition

When moving to subscription—an economic model tied to the duration of a contract—as the logical monetization model for SaaS deployments, there's a time of transition with short term pain for long-term gain.

Shifting away from predominantly perpetual licensing (where revenues are recorded up front) will lead to an initial revenue dip. This initial revenue uncertainty is the impact of changes in pricing and predictability (for adoption and renewal rates). With that transition, the focus may change on how the finance team thinks about cash flow rather than GAAP revenue recognition.

Once implemented, subscription becomes a more predictable revenue stream, making it easier to forecast the business and to manage investors' expectations, long-term. This short-term tradeoff is often easier for private companies to withstand; the change usually makes sense for public companies, as well.

Several important metrics, which may or may not be new to companies shifting to subscription, are:

- **Annual contract value (ACV):** The value recognized in a single year of a multi-year subscription.
- **Annual/monthly recurring revenue (ARR/MRR):** The sum of all subscription revenue in a year/month.
- **Billings:** The number on the invoice that goes out the door to the customer, billings occur when the actual invoice is sent, based on the contract terms.
- **Customer acquisition cost (CAC):** The cost to acquire a new customer (e.g., marketing expenses), which in turn starts a new recurring revenue stream.
- **Lifetime value of a customer (LTV):** the total expected revenue over the lifetime of a customer relationship. The LTV must be larger than the CAC.
- **Revenue retention:** revenue change for existing customers over a period of time.

ARR is the single most critical metric for a subscription company. It brings all the major elements in the business together: renewal; visibility into components of renewals (such as churn and price increases); and capturing new business (with components including new logo revenue and upsell revenue from existing customers). Growth in ARR indicates a healthy software business. Examining ARR can also help uncover retention issues; if existing customers aren't renewing, ARR will be stunted or even negative.

Billings become even more important than they were before. Because billings is a metric more closely tied to the actual cash flow of the company, revenue (an accounting metric caught up in the GAAP revenue recognition role) becomes arguably less important than billings.

HOW TO

Drive Long Term Value

Customer success and retention are most critical for the ongoing success of a software company. Customer retention is the key driver of ARR and long-term value, so the supplier must be customer-centric, focusing on customer health to minimize net churn.

Contract length can help solidify long-term value. Typical billing for subscription (for SaaS or other deployment models) is through upfront installments, usually billed annually. Most common is the industry-standard three-year contract; the customer pays year one upfront at the beginning of the contract, pays year two on the one year anniversary of the contract start date, then pays for year three on the two-year anniversary of the contract start date.

Strong retention rates are crucial. The renewal rate and the gross retention rates percentages—signals of how much value customers receive from the software they license from the supplier—are the best indicators of customer health and customer success.

Look at retention rates by each product line or by type of software, then in aggregate for the company a whole. Retention can be measured in multiple ways and should be evaluated from multiple angles:

- **In terms of revenue:** gross revenue retention rates.
- **At customer level:** the renewal rate percentage measures renewals of the contracts that are up for renewal that year. A significant benefit of a contract renewable every three years, is that it has a built-in 100% renewal rate in year two and three.

Gross retention rates above 90% generally indicate a healthy product and healthy customer success rates.

HOW TO

Adjust Operations for a Customer-Centric Organization

To achieve a customer-centric model, a supplier must embrace a customer success mentality to ensure ongoing renewals. LTV must always remain larger than CAC. This requires organization-wide buy-in, likely requiring a shift in operations. Suppliers need to break down silos and align all roles—sales, services, support, customer success and renewals—with a customer-centric model, working together to drive customer value.

HEAR MORE

"The technology to move to subscription is the … easier part. Getting people to change, getting your sales process to change, getting your customers to change—that's the hard part."

– MARK THOMASON, IDC

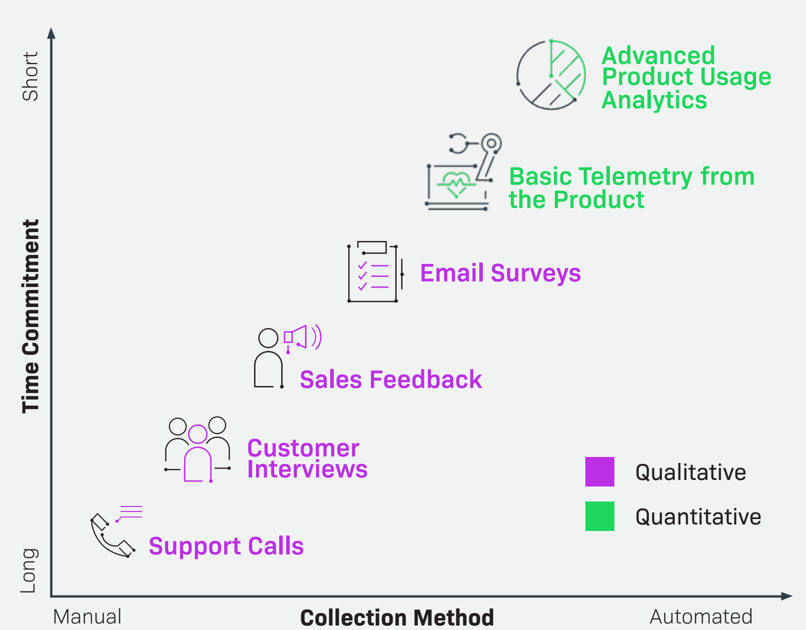
Steps for a customer-centric organization include:

- **Provisioning:** Enabling customers to deploy your solution rapidly.
- **Onboarding:** Supporting the customer journey.
- **Driving success:** Analyzing account health and renewal risk.
- **Renewals & upselling:** Monitoring consumption and creating transparency.

Software suppliers should rely on more than anecdotal evidence about renewals and about why churn is taking place. Operational requirements include measuring and tracking ARR on a monthly basis, identifying customer cohorts that are (or aren't) successful to identify where churn is happening, understanding software usage to predict (and prevent) churn, and proactive renewal management.

Advanced product usage analytics is the most effective way to collect quantitative data. That data can then be combined with qualitative methods (e.g., surveys, interviews, sales feedback and support calls) for a comprehensive view of how customers are using the product.

APPROACHES TO COLLECTING SOFTWARE USAGE DATA



Additional Resources

As your organization takes steps toward SaaS implementation, please turn to additional resources available from Revenera:

COMPANION GUIDE:

The Product Manager's Ultimate Guide to Successful SaaS Implementation: This guide offers technical considerations and best practices for software product managers and operations teams.

WEBINARS:

Path to SaaS Monetization for Product Managers, Product Operations and Finance Leaders: In three on-demand webinars, analysts and experts from Revenera take a cross-functional approach to understanding the market drivers, organizational impacts, and business processes critical to the successful adoption of SaaS and subscription models. These sessions provide the strategies you need to drive your SaaS monetization efforts forward.

- *Part I:* ***SaaS Monetization Trends and Forecast 2022***
- *Part II:* ***Plotting Your Course to SaaS: Technical Considerations for Product Packaging and Customer Entitlements***
- *Part III:* ***What Technology CFOs Should Know When Adopting SaaS and Subscription***

RESEARCH:

Revenera Monetization Monitor:
Software Monetization Models and Strategies 2021

Revenera Monetization Monitor: ***Software Usage Analytics 2021***

Revenera Monetization Monitor: ***Software Compliance and Piracy***

Monetize What Matters

Software suppliers face increased pressure to make sure that they're continuously improving software and delivering value to their customers. The pressure to secure recurring revenue streams continues at a steady pace, too. Transitioning to SaaS delivery, monetized through a subscription model, helps suppliers achieve the goals that matter to them and to their customers.

Software and IoT suppliers worldwide protect and monetize their SaaS, mobile, on-premises, and embedded applications with Revenera's Software and IoT Monetization solutions. It helps them drive more revenue from their software while protecting their IP. They protect their applications and devices, manage compliance, understand their customers' needs, and drive recurring revenue.

Contact Revenera to learn more about monetization solutions for entitlement management, software licensing, software delivery and updates, usage intelligence, and renewals and customer growth.

SEE MORE

Once Upon a Time,
The Software World Was Flat

FOOTNOTES

1. Thomason, Mark. IDC Market Forecast: Worldwide Software Business Model (Subscription and License) Forecast, 2021–2025, July 2021, IDC #US47143021e.
2. IDC Software Tracker Forecast 2H20 Release, May 2021.

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