# Is SaaS the Silver Lining to the Cloud?

WRITTEN BY:
Prashant Nema
Chief Technology Officer
408.654.6360
pnema@svb.com

Bronwyn Dylla Bailey
Research Director
SVB Capital

The economic recession and financial crisis have cast a dark cloud over most of the venture capital industry. The popular press continues to report bad news: poor exit markets, reduced venture investment and employee layoffs at technology firms. Despite these glum reports, innovative technologies are still being developed and many promising venture-backed companies are maintaining revenue growth. One example is companies developing the software-as-a-service model, the technology more commonly known as "SaaS." As a provider of banking services to SaaS technology companies and as a consumer of SaaS offerings, SVB has observed SaaS as one of the bright spots in the venture capital industry. We expect that SaaS innovation will expand during the economic recession and SaaS technology will become a mainstay of enterprise computing.

This article kicks off the SVB series on SaaS technologies.[1] The first article describes SaaS technology and explains why demand for this technology is increasing, despite the economic downturn. The second installment provides SVB's view of best practices in SaaS adoption by enterprises and the third article discusses the best way to use SaaS in an enterprise's operations.

We expect that SaaS innovation will expand during the economic recession and SaaS technology will become a mainstay of enterprise computing.

## WHAT IS SAAS?

SaaS is a delivery model using a commercial vendor to develop the software, host its operation and provide Internet-based access and application support to customers. Rather than licensing, installing and maintaining software on clients' computers or servers, vendors let users access the software via the Internet on pay-as-you-go basis.

[1] The term "SaaS" has been used to describe a number of types of remote technologies and may sometimes be used synonymously with "cloud computing." In this article, we refer to SaaS specifically as remote location software applications, in contrast to remote storage, platforms, or infrastructure.

The SaaS model incorporates a number of characteristics:

- The SaaS provider hosts the software on its own or third party premises, rather than at the enterprise. The applications are accessed through Web-based interface typically run from a Web browser. This delivery mechanism allows for easy scalability as new users are added.
- The enterprise customer can opt either to share the tenancy with other customers, thus enabling the customers to share the total cost and creating economies of scale, or decide to be a single tenant, thus providing greater security.
- The SaaS model includes systematic support of the software, rather than annual maintenance and upload of fixes and patches, to all subscribers.

The types of services currently migrating to SaaS platforms are conferencing applications, e-commerce, payroll, human resources, customer relationship management, logistics, general ledger accounting, enterprise resource planning (ERP) and software lifecycle management. Other applications that are expected to migrate to SaaS platforms include secure content management, content backup, project management, Web content management and location-based services. [2]

The concept of providing software remotely is not new. In the early 2000s a number of companies operated as Application Service Providers (ASPs) whereby they hosted application processing such as software on third party servers. ASPs were generally not extremely successful. Many different customer-specific applications were run by one ASP, and the vendor typically could not provide expertise on each of these applications. ASPs often did not provide shared services to multiple enterprises, nor did they provide administration or subject matter expert (SME) consulting services. Moreover, ASPs reputedly did not thoroughly test security and integration issues before roll out and problems were often discovered after implementation. Finally, under the ASP model clients frequently had to license the software and thus incur higher costs up front.

## THE SAAS MARKET IS GROWING DURING THE ECONOMIC DOWNTURN

The popularity of SaaS solutions is based on the intersection of advances of SaaS technologies and the greater demands for information technology (IT) solutions — without incurring dramatic increases to the IT budget. Cost-sensitivity has particularly increased during the current economic downturn and has benefited SaaS vendors. While the overall U.S. economy is expected to contract by an annual rate of almost 3 percent during 2009[3], a recent IDC study[4] projects that the SaaS market will expand during the same year to $10.7 billion worldwide, an increase of over 40 percent compared to 2008.

The growth in the adoption of SaaS and the subscription-based model of software utilization is being driven by small enterprises. A recent survey by McKinsey & Company and SandHill Enterprise Software found that companies with less than 100 employees spend more of their software budget on subscription-based software (26 percent) compared to their larger counterparts (11-17 percent).[5] Yet, the size of software budgets across all companies continues to grow from 30 percent of the total IT budgets in 2006 to an expected 35 percent in 2010.[6] The same survey asked respondents to determine which model of software delivery would be best for their company and an overwhelming 74 percent of respondents chose one form of a SaaS platform.

[2] Abhijit Dubey and Dilip Wagle. "Delivering Software as a Service," McKinsey Quarterly, May 2007.

[3] Economist Intelligence Unit. "Global Outlook," August 2009.

[4] Richard V. Heiman, Henry D. Morris. "Economic Crisis Response: Worldwide Software as a Service Forecast Update," IDC, December 2008.

[5] SandHill Group and McKinsey & Company. "Enterprise Software Customer Survey 2008," 2008. Number of respondents equaled 857.

[6] SandHill Group and McKinsey & Company. "Enterprise Software Customer Survey 2008," 2008. Number of respondents equaled 857.

## SAAS MEETS CIOS' NEEDS

Aside from reduced operational costs, CIOs find many benefits from SaaS. For instance, there is minimal implementation, maintenance and support overhead. In addition, the rise of the subscription-based model is influenced by CIOs' desire to easily dial up the capacity and utilization of software with the actual demand by the business users. This allows software usage to grow along with the company. Finally, companies are becoming more willing to outsource non-proprietary software needs. SaaS and other technologies using virtualization may play a critical role, as CIOs and executives find ways to boost productivity in light of increased global competition and squeezed IT budgets.

(T)he rise of the subscription-based model is influenced by CIOs' desire to easily dial up the capacity and utilization of software with the actual demand by the business users. This allows software usage to grow along with the company.

Even with long-term cost savings, initial costs incurred with deploying a SaaS platform continue to provide a barrier to adoption. Moreover, some old school CIOs may be hesitant to create such a dramatic shift within the organization. Another common barrier is the continued concern about the lack of security, reliability and flexibility, particularly when choosing an upgrade timetable. In one instance, Google's Gmail service, which could be classified as software as a service, recently went down for several hours, potentially causing great expense to its business users. As SaaS offerings become more secure and reliable, the long-term financial benefits will become more compelling.

## VENTURE CAPITALISTS CONTINUE TO BACK SAAS

Despite the steep decline in the amount of capital and number of financing rounds completed by venture capitalists in the last two quarters, SaaS companies are finding new funding sources from venture capitalists and many other SaaS providers continue to receive backing by their investors. In April 2009, New Enterprise Associates (NEA) led a $75 million Series E round in Workday, Inc., a provider of SaaS applications for managing business resources.[7] NEA was one of the investors in WebEx Communications and Salesforce.com, two well-known and highly successful SaaS application providers. Newer companies are also receiving funding, such as Zendesk ApS, a provider of on-demand customer support software, which received a small Series A financing round from Charles River Ventures.[8] Daptiv, a mid-stage SaaS company offering on demand project management software, is backed by Kennett Partners and Bay Partners. (Disclosure: SVB is both a client of and investor in Daptiv.)

Venture capitalists continue to support SaaS companies in part because of the continued demand for their products. SVB expects to see more venture firms back SaaS companies offering solutions for infrastructure (e.g., security and content management) and general enterprise applications (e.g., web analytics and location-based services).

## VENTURE-BACKED COMPANIES ARE ADOPTING SAAS

Just as VCs are backing SaaS companies, many young venture-backed companies are adopting SaaS solutions. Arguably, the most ubiquitous example of SaaS adoption by VC-backed companies is customer relations management solutions (CRM). Some of the most notable examples include Salesforce.com, SugarCRM and ZoHo. One benefit of these SaaS services is migration to a Web-based solution, which allows anytime, anywhere access to the software by sales partners across the company. Another benefit is that SaaS systems allow the flexibility to switch users on and off, enabling the user base to grow in tandem with the company.

[7] Scott Denne. "NEA Bets on SaaS Again in $75M Workday Round," Dow Jones VentureWire, April 30, 2009.
[8] Scott Denne. "Zendesk Seizes Series A for Help Desk SaaS," Dow Jones VentureWire, May 6, 2009.

In addition to solutions related to CRM, SVB predicts that more VC-backed companies will begin to move some of their human resource software-based activities from in-house to SaaS solutions.

## CONCLUSION: SAAS COMPANIES COMPETE WITH OLD PLATFORMS

Many SaaS companies are currently seeing revenue growth due to increased demand for their platforms even during the slowdown in the economy. A number of enterprises are considering the adoption of SaaS solutions, in part because they are lower cost solutions, but more importantly, because the performance and security features of these software offerings are on par with older, license-based platforms. Applications delivered using SaaS are still the new kid on the block, but these solutions have matured to a stage that enterprises typically view the performance and security quality as equivalent to license-based solutions.

A number of enterprises are considering the adoption of SaaS solutions, in part because they are lower cost solutions, but more importantly, because the performance and security features of these software offerings are on par with older, license-based platforms.

SaaS is still a growth area for the enterprise software sector. SVB is bullish on the prospects for SaaS-based companies and considers this segment a bright spot during venture capital's difficult economic times.

## ABOUT SILICON VALLEY BANK

Silicon Valley Bank is the premier commercial bank for companies in the technology, life science, venture capital/private equity and premium wine industries. SVB provides a comprehensive suite of financing solutions, treasury management, corporate investment and international banking services to its clients worldwide. Through its focus on specialized markets and extensive knowledge of the people and business issues driving them, Silicon Valley Bank provides a level of service and partnership that measurably impacts its clients' success. Founded in 1983 and headquartered in Santa Clara, Calif., the company serves clients around the world through 27 U.S. offices and international operations in China, India, Israel and the United Kingdom. Silicon Valley Bank is a member of global financial services firm SVB Financial Group (Nasdaq: SIVB), with SVB Analytics, SVB Capital, SVB Global and SVB Private Client Services.

More information on the company can be found at www.svb.com.

*This material, including without limitation to the statistical information herein, is provided for informational purposes only. The material is based in part on information from third-party sources that we believe to be reliable, but which have not been independently verified by us and for this reason we do not represent that the information is accurate or complete. The information should not be viewed as tax, investment, legal or other advice nor is it to be relied on in making an investment or other decision. You should obtain relevant and specific professional advice before making any investment decision. Nothing relating to the material should be construed as a solicitation, offer or recommendation to acquire or dispose of any investment or to engage in any other transaction.*

SVB› *Find a way* | SVB Financial Group

Silicon Valley Bank Headquarters
3003 Tasman Drive Santa Clara, California 95054 U.S.A.
Phone 408.654.7400 svb.com

© 2009 Silicon Valley Bank.® All rights reserved. Member of FDIC and Federal Reserve System. SVB, SVB> and SVB>Find a way are all trademarks of SVB Financial Group.
Rev. 09-02-09.