Software as a Service: it’s about the business model, stupid

This white paper stresses an alternative view to the prevailing technology platform bias in current discussions around the development of the SaaS industry.
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There seems to be a near universal consensus that Software as a Service (SaaS) is going to have a major impact on the business world in the next few years. In spite of this, virtually all of the discussion around SaaS to date has focused on technology—and that SaaS is merely a different technology delivery model.

The simple fact is that SaaS isn’t about technology at all. SaaS is a business model. More specifically, SaaS should be defined as IT services delivered on or off-premise, independent of traditional perpetual licensing models, with a focus on services delivered as a subscription-based expense and not via software licenses or the technology required to deliver these services. In almost every sense, SaaS goes against the traditional software industry approach to business. As a result, mainstream SaaS adoption will require a major mindset change on the part of all participants, not the least of which is the existing IT channel.

Technology is not the main market inhibitor. The online services market is fragmented not just in terms of what is being sold, but also who is currently buying SaaS. In order for SaaS to “cross the chasm” from early adopter purchasers to mainstream customers, innovation and change in the existing service delivery model has to occur. And in spite of fears from some quarters in the existing IT channel who regard SaaS as a potential threat to revenues, the fact is that traditional ISVs and IT resellers (the mainstream market’s traditional trusted advisors) stand to gain the most from SaaS.

According to leading industry analyst Jeff Kaplan of THINKstrategies, “If 2008 is remembered as the year that a new generation of on-demand services, including SaaS and cloud computing, gained widespread acceptance and accelerated adoption, then I think 2009 will be the time when winning channel partners will become more critical to on-demand service providers. Their next challenge is to build an effective indirect go-to-market strategy and a set of strong channel relationships, so they can rapidly and profitably extend their market reach and satisfy the needs of specific market segments. The need to build a successful channel strategy has become even more essential because of the current economic crisis, which is placing greater financial constraints on many on-demand vendors' direct sales capabilities and making customers even more hesitant to do business with new suppliers. Instead, companies will try to reduce the number of vendors they rely upon and will prefer to turn to their existing suppliers, including their local resellers.”

From the technology industry standpoint, there is a shared view as to why end users will drink more from the SaaS well. The need for a major software upgrade and driving down IT costs are seen as the key reasons for triggering SaaS adoption. Customer benefits are seen to include lower cost of entry, reduced risk, higher ROI, quick responses to changes in demand, rapid deployment, increased security, and the ability to focus on core business. SaaS promises to shift operational expense (OpEx) and capital expense (CapEx) from the end-customer to the SaaS provider, while reducing time to deployment and improving accessibility.

While this is all true, a more significant trend appears to have passed many by. Namely, that the end customer will drive the direction of SaaS rather than being led by vendors. For too
long, the IT industry has dictated its own standards for sales, distribution, and marketing—driven by innovation in technology rather than necessarily meeting the real needs of end customers. In fact, customers have been incredibly patient.

According to HP Senior Vice President of software Tom Hogan: “I'm a line of business executive and have never gotten back from IT a service that's been agreed to in anywhere near the time frame that I found reasonable. So anything that can be done to speed deliverability is welcome.”

The reality is that customers are taking an 80/20 position on software deliverables. In other words, they would rather have 80 percent functionality today rather than 100 percent in 18 months time - as well paying 10 times as much for the privilege.

Clearly current economic conditions are helping to drive customer behavior. According to Jeff Kaplan: “There are already plenty of reports that corporate executives are making severe cutbacks in their operating budgets and planning layoffs. Industry analysts are also expecting IT budgets to be reduced and capital spending to slow. However, successful businesses and IT organizations will not be those who sit on their hands and wait for the crisis to pass. Instead, it will be the ones who find new ways to perform their day-to-day duties and achieve their strategic objectives.”

Customers are well aware there is plenty of room for improvement in the way businesses procure and utilize technology and software applications. Says Kaplan: “Analyst studies have found that a third of enterprise software deployments fail to be completed, and those which are completed typically cost twice as much and take twice as long as originally planned. And, once the software is deployed many organizations discover it is not used as much as expected because it is not user friendly or the organization over-provisioned their software licenses in anticipation of usage levels—which never materialize.

Numerous analyst studies have also found that most IT organizations spend 75–80 percent of their time simply keeping their systems and software up and running. This leaves little time to focus on strategic initiatives or innovative projects. During past economic downturns, many companies decided to outsource their IT operations in order to focus their energies on their core business. Unfortunately, industry studies have found that well over half of these outsourcing deals failed to achieve their business objectives and were either terminated or significantly restructured.”

With this kind of history, it isn’t surprising that end customers are reacting the way they are. But where does this leave the traditional trusted IT advisors to end user companies, that is, VARs and resellers? In principle, they have much to gain.

**SaaS and the reseller: death or glory?**

As Kaplan notes, the SaaS channel ecosystem will be crucial. However, what will this model look like? At SaaS-IT, we firmly believe that the emerging hosted services distribution channel will be broadly analogous to the distribution models found in established retail supermarket
businesses. This model is highly attractive due to an ever-increasing number of small to mid-size (SMB) customers who want to reap the benefits of enterprise-class software without being burdened by their associated hardware, software, and maintenance costs.

Instead of necessarily licensing software and running it on-premise, the software can be hosted as a service if appropriate. Companies “rent” these services from hosting resellers for a monthly per-user fee.

This new model offers huge market potential for resellers of hosted services. To continue with the supermarket analogy, it is the technology and software vendors (the “farmer”) who deliver the production elements (“raw milk”) to hosting service providers (white label service providers), who in turn build services (“cheese”) and also act as wholesalers to distribute the “cheese” for SMB customers to use in their businesses. Resellers provide the “supermarket” where their customers can choose among the array of services (“cheeses”) that the reseller offers. The only difference is that hosted services don’t have to be physically delivered through the reseller, whereas cheese must be delivered to the supermarket. The end customer’s perception is the same in either case: the reseller provides both cheese and hosted services.

![Diagram of Cheese Distribution](image)

![Diagram of Hosted Services Distribution](image)

Of course, delivering hosted services is far more complex than selling cheese, but the successful distribution of hosted services needs more than a “wholesale distributor” (the hosting service provider or white label service provider); it needs a supermarket to make all
the service offerings available to customers, packaged and priced just the way that works best for the reseller’s shoppers. The role of the reseller as trusted advisor to the end customer should thus make them one of the key players in this new hosted services distribution model.

As René Speelman, a project leader at Sogeti Group, a $1.5 billion division of Cap Gemini says in relation to SaaS: "It's all about trusting the partner you're working with."

And as the trusted advisor to their customers, resellers need to help them understand the benefits of the new SaaS model and how combining SaaS with on-premise systems can improve running their business and reduce costs. By helping customers see the benefits of hosted services, resellers should be able to ensure their share of the growing SaaS market.

However, hesitating to embrace this new way of doing business will give reseller’s competitors the opportunity to get their foot in the door and build trust with their customers. And these competitors won’t necessarily be other resellers—they may be other trusted business advisors. In the world of SaaS, resellers may find themselves competing with an accountant rather than an IT salesman.

In summary, traditional IT resellers and ISVs should see the emerging SaaS market as a huge opportunity. However, completely new skill sets will be required as well as a change of mindset from selling technology solutions to genuine business solutions.

According to Computer 2000 founder and author of ‘Channel Excellence’ Axel Schultze: “Today we see that not only is there a place for partners, the SaaS industry may actually provide more partner opportunities than the traditional IT industry ever has. Given the roughly 14 million small and medium businesses in the US alone that may not have purchased any business software because of their size, SaaS will provide the technology for them and hundreds of thousands of potential implementers may provide the consultancy. Vendors will need to work with those kinds of partners in order to address the huge market potential. Partners will need to align with those new SaaS vendors in order to develop a symbiotic relationship of expertise of business processes and application functionality."

However, it will require a change of mindset. There is much to learn from other industries. Major Fast Moving Consumer Goods (FMCG) businesses such as Coca-Cola have long recognized the importance of a stable, streamlined sales and distribution system to bring their products from factory to consumer with a variety of channel players, each accepting and getting paid for their value-added role in the system. In a similar way, success in SaaS will not be about trying to play every role in the chain, but on focusing on developing a uniquely differentiated value added part in the overall ecosystem. At the end of the day, the genie is out of the bottle and the customer is king once more.
About SaaS-IT

SaaS-IT is Europe’s leading Software as a Service (SaaS) business enablement consultancy. SaaS-IT provides a bespoke mix of practical, real world consulting services to allow small to medium size ISVs, value added hosters, and mainstream software vendors to optimize their SaaS business capabilities.

Unlike larger generalist and technology led consultancies, SaaS-IT delivers an unrivalled level of business partnership expertise to ensure SaaS market opportunities are properly validated and optimally executed where appropriate.

SaaS-IT consultants have extensive expertise, understanding, and experience of local European market conditions and are best positioned to advise on all aspects of SaaS business enablement including messaging, pricing, sales and marketing, demand generation, licensing models, product development lifecycle, and support operations.

Press contact

Anders Trolle-Schultz
SaaS-IT Consult Ltd.
Gainsborough House
2 Sheen Road
Richmond, Surrey
TW9 1AE, United Kingdom
e: ats@saas-it.net
t: +45 2425 0303