SaaS (Software-as-a-service) is a software billing and delivery model that is superior to traditional software license sales methods, with a reconstructed business model and a unique system of practices. However, many SaaS practitioners have found many problems in practice and often make the same mistakes they have made before.

The Business Of SaaS series of articles will take you on a quick tour of how a SaaS business works, help you better understand the SaaS business model, enable you to determine which model to sell your product under, and (if you are already running a SaaS business) be able to assess its health and start improving it.

I. Why SaaS is getting hotter and hotter?

1. For customers

Customers like SaaS because it is convenient and can be accessed directly without installation. Secondly, it does not lead to meaningful data loss when hardware failure and human error occur in the machine. Further, SaaS companies can implement continuous software improvements based on available data from IT (e.g., the ratio of time the software is accessible).

SaaS is also usually cheaper than software sold under other billing models, which is important to users, such as when they are unsure which software they should adopt in the long term, or when their need for software is only short-term, they tend to pick the cheaper product.

2. For Developers

Developers like SaaS mainly because of the delivery model, not the billing model. Most SaaS is developed and run continuously on the company's infrastructure (there are some notable exceptions in enterprise SaaS, but the vast majority of B2C and B2B SaaS access the Internet through servers maintained by the software company).

The software company has no control over the environment in which the code is executed, which is the main reason for the development friction and customer requests for service support that once existed. All software deployed on customer hardware is affected by system configuration, interaction with other installed software, and operator error. These must be taken into account in development and treated as customer service issues.

Companies that sell both SaaS and locally deployed software often find that the average number of service support requests per customer is more than 10 times higher under local deployment.

3. For Businesses and Investors

Businesses and investors like SaaS because the economics of SaaS are incredibly attractive compared to selling software licenses.

Revenue from SaaS is typically compoundable and predictable, which makes cash flows from SaaS businesses very easy to predict, and companies can then plan against those cash flows and (through investors) trade future cash flows for current cash flows to fund current growth. This has made SaaS companies one of the fastest growing software companies in history.

4. SaaS Sales Model

In general, there are two ways to sell SaaS, and the sales model determines almost all aspects of a SaaS company and product. A typical mistake for SaaS companies that can take years to correct is often a mismatch between the product or market and the chosen sales model.

The SaaS sales model defines more about the product (and the company), such as whether the company is selling to users (B2C) or enterprises (B2B), whether it is self-sufficient with light capital investment or requires accelerated incubation participation with venture capital, or what technology stack the company should be built on.

Second, low-touch SaaS sales model

In the low-touch SaaS sales model, customers can buy directly without continuous one-on-one communication with a person, which is suitable for most customers. The main sales channels of this model include official websites, email marketing, and the common free trial of software. The advantage of a free trial is that customers are able to start using the product at a very low cost and can easily and successfully continue using SaaS.

Low-touch products also involve sales teams, but they are often structured as so-called "customer success" teams whose goal is to ensure that users are successful with the free trial and convert to paying users before the trial ends, rather than convincing people to buy the software.

Customer service in low-touch products is primarily handled at scale, for example by optimizing the product to reduce manual intervention scenarios, creating replicable educational resources at scale, or minimizing the use of human services. That said, many companies with low-touch sales models also have excellent customer service teams. the economics of SaaS depend on long-term customer satisfaction, so customer service teams are also likely to be heavily invested.

Low-touch SaaS is typically sold on a monthly subscription basis, with price points clustered around $10 for B2C applications and between $20 and $500 for B2B applications. This equates to an average contract value (ACV) of about $100 to $5k.

Low-touch SaaS businesses do not often use ACV, they use monthly price points more often, but will use ACV metrics when doing side-by-side comparisons with high-touch SaaS businesses. If you ask a SaaS entrepreneur with a low-touch model what their most important metric is, they will say MRR (monthly recurring revenue).

Basecamp, Atlassian (which has successfully gone public and is the parent company of Jira, Trello, Confluence and other products) are examples of low-touch SaaS businesses.

Third, high-touch SaaS sales model

Some customers need some help in deciding whether they need to adopt a certain product. The high-touch SaaS sales model is designed around a process that requires a lot of manpower as a way to convince an organization to adopt the software, help it succeed, and continue to use it.

The heart of the organization is almost always the sales team, which is typically divided into several specialized roles: sales development representatives (SDRs), who are responsible for finding prospects for the software, business representatives (AEs), who serve specific customers, and account executives (AMs), who are responsible for ongoing user adoption. Account managers (AMs).

The sales team is usually supported by the marketing team, whose main job is to generate enough qualified leads for the sales team to follow up with the sales team to evaluate whether to follow up.

There are many really good products on the high-touch model, but first and foremost, product and R&D are usually less important than the sales engine in a high-touch SaaS business.

In SaaS companies with high-touch sales models, the organization of the customer service team is highly variable, but no matter how it is organized, the consensus is that the customer service team is heavily used. The high-touch model has a customer-per-unit price that is several orders of magnitude higher than the low-touch model.

It is important to note that while high-touch sales to consumers are in principle possible (e.g., insurance business is all sold through commissioned agents), the vast majority of high-touch business in SaaS is sold to businesses (B2B). In B2B, there are various types of expected customer profiles, ACVs (defined as average contract value or annual contract value), and transaction complexity.

At the low end of the market, the average contract value (ACV) for selling SaaS products to "small and medium-sized businesses" (SMBs) in a high-touch model is typically $6k to $15k or more. Everyone defines SMBs differently. In terms of how a company operates, SMBs are those companies that have a certain level of complexity in their business and need to spend $10,000 to use the software. High-end market customers are often referred to as "enterprises", such as mega-corporations or government organizations. Large enterprise transactions start at six figures, with no upper limit.

The most important measure of high-touch SaaS is ARR - Annual Recurring Revenue, which is all of a company's non-churn revenue minus some non-recurring expenses (e.g., one-time set-up costs, consulting services, etc.). Since the economics of SaaS grow over time, one-time revenues, especially relatively low one-time profits, are not of the greatest interest to entrepreneurs or investors.

Salesforce is typical of high-touch SaaS, and they have written a book about this model. Smaller high-touch SaaS businesses also exist in large numbers, although they are less common than low-touch SaaS businesses, largely because in low-touch SaaS, increasing customer visibility is a customer acquisition strategy, while in high-touch SaaS the visibility strategy is not optimal. For example, there are many small SaaS businesses that earn six- and seven-figure revenues per year selling services to a strictly defined vertical.

IV. Hybrid Sales Models

Some companies have successfully used both low-touch and high-touch models to sell the same product, which is relatively uncommon in SaaS businesses. The most common result of using both models is that one model dominates and (because the dominant model permeates all of the company's operating programs) usually kills the other model.

A more common hybrid model is the adoption of only certain elements of the other sales model. For example, many low-touch SaaS companies have customer success teams, but are really more like inside salespeople. High-touch companies typically borrow fewer tactics than low-touch companies; one of the most common situations is where a company has a product that it does not (substantially) sell and uses a low-touch model to sell that product with the goal of generating leads for the product the company actually sells.