Introduction

Anyone starting a software business today is highly likely to do so in a Software-as-a-Service framework, while established software firms are rapidly transitioning from a product/up-front licence model to a SaaS model.

Why is this? It's obvious you might say: It's because SaaS is a better business model.

Indeed. I would just add a follow up question; better for whom?

Done well, a SaaS business can be superior for all stakeholders, including customers, the software provider, and its equity owners. The best business models ensure that everyone in the ecosystem is a beneficiary of continuous progress. Let's explore that a little further.

SaaS Done Well

If I am the SaaS customer then I want:

1. Software that is fit for purpose, stable, secure, and intuitive.
2. Seamless updates to the latest version.
3. Extreme value for money (i.e. a large consumer surplus), or at the very least transparent pricing that is fair/proportionate to value derived/usage.
4. To share in the progress/economies of the software supplier (features, learning, use cases etc).
5. To be able to easily switch suppliers if I am not happy.

The purpose of business is to profitably create and service a satisfied customer. It therefore follows that the software provider (and, by definition, its equity holders) should strive to give customers what they want. Numbers 1 & 2 above are table stakes. Smarter, long-term oriented SaaS companies deliver on numbers 3 & 4 as well. But they are doing so to make 5 more difficult. And that's fine if the customer is sticky because the product is excellent, and the SaaS provider is still delivering extreme value for money. But if the SaaS provider abuses (either through pricing or lack of product development/support) a sticky customer relationship, then trust breaks down and competition will eventually work its way into the cracks.

If I'm building a SaaS business for the future, or investing in one, I would strive to deliver on 1 to 4 above, but I would also want the relationship to be very sticky, and yet, would not seek to abuse that stickiness in any way.

There are many reasons not to exploit customer stickiness:

- Your customers become your advocate reducing new customer acquisition costs.

- Your business is far more robust against competitive threats.

- In an increasingly open and transparent world, trust-based relationships are the only ones that will endure.

In a sense we can think about a customer stickiness continuum which distinguishes between good, bad, and neutral degrees of lock-in (h/t David Henry). The categorisations may not be perfect, but I'll hazard a guess that such a continuum may look broadly as follows:

SaaS: Customer Stickiness Continuum (from the perspective of the customer)		
Good Lock-in	Bad Lock-in	Neutral Lock-in
- High customer surplus (i.e. great ROI) - Product utility gets better with use/over time - User competence improves with use	- Long term contracts - Deliberately technically difficult/awkward to switch	- Client integrates the software with other systems (though this can turn to bad lock-in if abused by the SaaS vendor)

There are other **useful things a SaaS provider can do**, many of which are not possible outside a SaaS framework, which is what makes SaaS such a wonderful business model.

1. Pricing flexibility. Because software usage is measurable in real time, the SaaS provider can design pricing that is more attuned to the value derived or the perceived value derived by the customer.

2. Upsell identification. Highly engaged users are easily identified, as are usage patterns that indicate upsell or product development opportunities.

3. Managing churn. Usage visibility allows the SaaS provider respond to low/stopped usage to proactively find out why, instead of seeing that customer churn away.

4. Ecosystem Enhancement. Visibility on effective usage facilitates product improvements that benefit the entire user base (users are more like family members than faceless customers).

Finally, **a long-term oriented investor** in SaaS businesses will most likely be interested in seeing:

- A clear articulation of the business model.
- A healthy dynamic in the classic lifetime value to customer acquisition cost dynamic. This is not always easy to measure and often leads to over investment in CAC against an LTV than never materialises. Low churn and a high net dollar retention are strong indicators of a quality business.

- A customer centric/product excellence ethos which manifests in upsell opportunities (and therefore a high net dollar retention).
- A steady, or preferably declining, customer acquisition cost.
- A dedicated business function that is focused on customer success (i.e. ensuring customers actual use of the product delivers extreme value for money).

Conclusion

The defining benefit of the SaaS business model is its ability to service its customers well. When that's the case, everyone wins.

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