Bessemer's Top 10 Laws for Being "SaaS-y"

Running an on-demand company means abandoning many of the long-held tenets of software best practices and adhering to these new principles.

By: Byron Deeter, David Cowan, Bob Goodman, Philippe Botteri,
Jeremy Levine, Anil Sarin, Devesh Garg, Adam Fisher and Gary Messiana

Fall 2008 Release

Bessemer Venture Partners is a global investment group with offices in Silicon Valley, Boston, New York, Bangalore, Mumbai, and Tel Aviv. As the oldest venture capital practice in the United States, BVP has partnered as an active, hands-on investor in Ciena, Ingersoll Rand, Parametric, Skype, Staples, VeriSign, and W.R. Grace, among many others. More than 100 BVP-funded companies have gone public on exchanges in Canada, India, London, and the United States. Bessemer has been focusing on SaaS and recurring revenue businesses for the past 15 years, investing in industry pioneers such as Verisign, Cyota, Postini and Trigo, and the firm has today a portfolio of more than a dozen active SaaS investments. Find out more about BVP's SaaS practice online at www.bvp.com/saas.

When we first published Bessemer's Top 10 Laws for Being "SaaS-y" in early 2008 in conjunction with our annual invitation-only SaaS CEO Summit, we were overwhelmed with the positive response and feedback we received. We continue to incorporate the best elements of this feedback into our evolving SaaS success profile that follows below. Like your SaaS products themselves, we now intend for these laws to be periodically refined through major releases to reflect the changing landscape of the SaaS world.

The fundamental driver for this publication is the absence of well understood SaaS best practices, and the counter-intuitive nature of many of our most important findings. This work is literally the result of conversations with dozens of SaaS executives from within our past and current portfolio companies, as well as hundreds of executives from other leading public and private SaaS companies. In addition to this core document, we have also published online several additional whitepapers with supporting details and examples behind many of these laws to answer some of the more sophisticated questions.

At Bessemer Venture Partners we fundamentally believe that the emergence of Software-as-a-Service is currently the single most important trend in the software industry and that this tectonic shift in the global software ecosystem is just beginning. We have been fortunate to be investors in many of the early SaaS winners (such as Postini, Netli, Trigo, and Cyota), and continue to invest actively behind one of the largest SaaS portfolios in the venture capital industry. Periods of tremendous transformation create tremendous opportunity, and we consider ourselves privileged to be working with many of the great entrepreneurs who are currently creating the next giants of the software industry.

****

****

Bessemer's Top 10 Laws for Being "SaaS-y"

1. Your key monthly business metrics are: **CMRR (Committed Monthly Recurring Revenue), Churn, and Cash flow** - "Bookings" is for suckers

2. **Customer Acquisition Cost (CAC) and Customer LifeTime Value** (CLTV) are the best indicators of long term value creation

3. **Tune before you scale**: the Sales Learning Curve is even more critical for SaaS and it takes at least $300k MRR to climb it. Stop at three sales reps until at least two of them are making $100K MRR quotas

4. **Separate your "hunters" and "farmers"** and pay them all on CMRR growth

5. SaaS is a whole new ecosystem where traditional IT channels don't work – **Focus your business development efforts on *business services* channels**, but you will need to sell directly for a long time as these new set of partners are not easy to ramp-up

6. By definition, your sales prospects are online **- Savvy online marketing is a core competence** (sometimes the only one) of every successful SaaS business

7. **Stay local - Prove your business in North America first.** Only after reaching $1M in CMRR should you consider hiring European sales and services execs behind customer demand. Save Asia for post-IPO

8. **Single instance, multi-tenant, single datacenter -** Have only one version of the code in production. Really. "Just say no" to on-premise deployments

9. **The most important part of Software-as-a-Service isn't "Software" it's "Service"!**

10. **Be prepared to cross the desert -** SaaS requires R&D and sales expense up front for a multi-year stream of revenue, so it demands enough investment capital to fund 4+ years of runway. Load up for the long trip and pace your consumption of calories!

BONUS LAW: You can ignore one of these, but not more than two. Great companies innovate, but pick your battles!

****

Bessemer SaaS Law #1. Your key monthly business metrics are: CMRR (Committed Monthly Recurring Revenue), Churn, and Cash flow - "Bookings" is for suckers.

Experienced software executives have been taught for years that there is a single critical metric by which the health of a growth software business can be judged: "Bookings". However, in the SaaS world, "Bookings" is ambiguous at best and often very misleading. A simple example would be if Customer A signs a one-year deal at $10,000 per month, and Customer B signs a three-year deal at $5,000 per month. The traditional metric of Bookings would value Customer A at $120,000 and suggest Customer B is more valuable at $180,000. This is misleading because in a recurring revenue model, Customer A is much more valuable to the business (assuming typical churn rates) as they will likely generate $360,000 of revenue for the business with renewals over that same three year period.

To achieve better business visibility, most SaaS companies focus on Monthly Recurring Revenue (MRR) – which is the combined value of all of the current recurring subscription revenue - instead of Bookings. We recommend companies actually take this a step further and keep a forward view of **Committed Monthly Recurring Revenue** (**CMRR**). The CMRR differs from the MRR from two standpoints: firstly, it includes both "in production" recurring revenues of customer and also those with signed contracts going into production. Secondly it is reduced by "churn" which is the MRR expected to be lost from customers that have announced they will stop the service. This metric is the single most important metric for a SaaS business to monitor as the change in CMRR provides the clearest visibility into the health of any SaaS business. For a more detailed explanation of CMRR and how it's calculated, you can signup to receive David Cowan's whitepaper *Measuring Growth Businesses with Recurring Revenues* at www.bvp.com/saas or send an email to saasvc@bvp.com.

If you calculate CMRR correctly, that single metric also gives you good forward visibility into, revenue, cash collections and **Churn**. SaaS executives need to track churn in detail from a "logos lost" (lost customers) perspective as well as the amount of lost CMRR. It's very difficult and expensive to grow subscription businesses if you have moderate customer churn, and prohibitive if your churn is high. Whereas the largest legacy enterprise software companies literally made hundreds of millions of dollars over the last decade with "shelf-ware" projects that never got fully implemented, project failure is not an option for SaaS businesses or the customer will simply turn you off, regardless of your contract terms. The top performing SaaS companies typically achieve annual customer renewal rates above 90% - with most of the churn due to death (bankruptcies) or marriage (acquisitions) - and over 100% renewals on a dollar value basis due to up-sells into this installed base.

Cashflow is the other key metric. To be fair, visibility into the current cash position and the change in the cash position has always been important for software executives, but is even more critical for SaaS businesses because the working capital requirements are higher and the payment terms are often stretched out over the term of the contract. Given the high cost of capital for private SaaS companies, wise executives will often offer slight MRR discounts to customers in exchange for quarterly or annual pre-payment terms, and provide incentives for their sales force accordingly.

Many of our top performing SaaS CEOs will orient their entire executive team objectives and bonus plans around these three metrics exclusively, because almost every other key success factor for the business is embodied in CMRR growth, Churn, or Cashflow.

Bessemer SaaS Law #2. Customer Acquisition Cost (CAC) and Customer LifeTime Value (CLTV) are the best indicators of long term value creation

It can be argued persuasively that SaaS is a lousy business model because your costs are front-loaded and your revenue only arrives in modest monthly or annual payments. However, as we know from the cable industry, subscription businesses can be very profitable over time.

The key to long term financial health is to keep customers happy so their payments keep coming, and coming, and coming…and over time add up to some really large numbers. But in this context, how do you calibrate your sales and marketing investment and how do you know if these tradeoffs make sense and are ultimately "profitable"?

The answer of the first question can be found through the **CAC Ratio.** This single number is the key to determine your level of sales and marketing investment and is very simple to calculate by looking at a quarterly GAAP P&L: you just have to divide the annualized net gross margin added during the quarter by the sales and marketing costs of the previous quarter.

$$\text{CAC Ratio (Q408)} = \frac{[\text{GM(Q408)}-\text{GM(Q308)}]*4}{\text{Sales \& Marketing Costs (Q308)}}$$

The CAC ratio determines the payback time on your sales and marketing investment: a CAC ratio of 0.5 for example means that half of your investment is paid back per year, so it is a two year payback period. So how should you use this ratio? The punch line is that a CAC ratio of a third (0.33) or less is bad – this suggests it takes you at least three years to payback your initial customer acquisition costs – so you should slam on the breaks on your sales and marketing spending until you can improve your sales efficiency. At the other end, anything above one (1) means you should invest more money immediately and step on the gas (and please call Bessemer immediately because we want to fund you!) as your customers are profitable within the first year.

To answer the second question and make sure you are building a profitable business, the key indicator to look at is the **Customer LifeTime Value (CLTV)**. The CLTV is the net present value of the recurring profit streams of a given customer less the acquisition cost. A profitable business will have a positive CLTV. To make the calculation simple, let's assume that a customer generates $1 of annual recurring revenue for a company with a CAC ratio of 1.0, a 70% Gross Margin and 10% each of R&D and G&A costs. The $1 of revenue will generate $0.7 of gross margin and $0.5 of profit each year ($0.7 less $0.1 of R&D and $0.1 of G&A costs). Over 5 years, this customer will generate $2.5 of profit (5 years x $0.5/year). A CAC ratio of 1.0, means a $0.7 upfront acquisition cost, making the CLTV equal to $2.5-$0.7= $1.8. This is equivalent to ($1.8/5) = $0.36 of annualized profit or 36% profit margin. The calculation can be refined with a better allocation of the S&M costs (part of them are used to support current customers) and by discounting the profit streams (in this example, a 15% discount rate would reduce the CLTV to $1.23 or 25% annualized profit margin). For young companies it may be more of an art than a science to estimate the lifetime period of the customer as your churn data is still limited, but we very conservatively take 3-4 years for SMB customers, and 5-7 years for enterprise customers.

To learn more about the CAC ratio and CLTV, you can read Philippe Botteri's white paper "*CAC Ratio - One Number to Manage your SaaS S&M Spend*" also available at www.bvp.com/saas.

Together, CMRR, Cashflow, Churn, CAC, and CLTV make up the "5 C's of SaaS Finance.

Bessemer SaaS Law #3. Tune before you scale: the Sales Learning Curve is even more critical for SaaS and it takes at least $300k MRR to climb it. Stop at three sales reps until at least two of them are making $100K MRR quotas.

Years ago Bessemer was fortunate to invest behind Mark Leslie at Veritas, and as a result our firm became big believers in a concept Mark helped pioneer around the Sales Learning Curve (SLC). The core concept is that software organizations often fail because they staff up their sales efforts too quickly and make them too large before the sales model has been refined. This concept is even more critical for SaaS businesses given the large upfront investment required to acquire customers. Ramping up too quickly will burn precious cash reserve and could sink the business.

While the CAC ratio helps SaaS businesses at scale to manage their Sales and Marketing spend, the SLC is a helpful framework for early stage businesses before you have meaningful data. To understand when the business has started to climb the sales learning curve and is in a position to hire more reps profitably, you have to think in terms of CMRR instead of bookings. You know you can profitably scale sales when a couple of sales reps are at an annualized run rate to sign annual contract values (CMRR x 12 months) equal to twice their fully-burdened cost of sales. In this case, fully-burdened is not just the salary, bonus, and benefits of the sales rep, but also allocations for sales engineering support, executive support, marketing expense, and professional service expenses associate with securing the customer.

For a direct, enterprise sales business model, these thresholds are likely to be around $80,000-100,000 CMRR (approx. $1-1.2M annualized), and for tele-sales models, this may scale down to $60,000-75,000 MRR ($720,000-900,000 annualized). It is usually time to accelerate sales hiring when at least two out of three sales reps are hitting quotas at these numbers, and the business has achieved some scale to suggest that the processes are repeatable- at least $300,000 of CMRR. The "repeatable" aspect is critical: too often companies scale their sales force aggressively after their first senior rep is getting traction in the market and then quickly realize that the new hires struggle to sign their first deal because they don't have three VP's and the CEO alongside them.

To then quickly quantify the total business impact from productive sales executives, you can use the "Rule of 78's". To use round numbers, let's assume a salesperson sells $10K of new CMRR every month for twelve months. The new customer closed in January will then generate $120k of revenue that year (12 months x $10,000), the February deal generates $110,000, the March deal $100,000 and so on. Consistently delivering a deal per month in this progression gives you a total of 78 months of cumulative recognized revenue. The Rule of 78's shows the first year revenue amount for such an effort (78 X $10K = $780,000). It is critical to note that unlike a traditional software company model where missed periods can be made up with a few large transactions at the end of the quarter, SaaS revenue can not be recaptured. If the salesperson delivered every month as outlined but missed just his or her January deal, $120,000 of revenue is lost forever. A lost subscription month is lost forever, and no amount of year-end heroics can recapture it. This means that revenue closed earlier in the year (or even quarter) is far more valuable than the same size deal later in the year. It is therefore critical to establish a sales compensation plan that rewards early and consistent performance. The power of SaaS is further illustrated when you realize the same 12 logos that generated $780,000 the first year will generate $1,440,000 in year two – the "Rule of 144" - assuming net neutral churn and up-sells.

Bessemer SaaS Law # 4. Separate your "hunters" and "farmers" and pay them all on CMRR growth.

As soon as you have climbed the Sales Learning Curve and have a sizeable customer base, you should supplement your sales force with renewal-oriented account managers. When a SaaS company starts to hit the sales inflection point, it is important to keep the new business reps (the "hunters") busy with finding new deals, while a team of account managers (the "farmers") tends the established customers.

Both teams are critically important for the health and growth of the business because CMRR is a function of new sales net of churn from your existing accounts, so you should have dedicated experts for each of these two revenue groups as soon as is practically possible. Once a company has a few sales reps achieving quota and a significant customer base, it is time to hire dedicated account management experts who are compensated to focus exclusively on customer service, renewals, and up-sells.

As all good sales VPs will tell you, the compensation plans of the sales team will drive behavior, so it is critically important that you structure the sales and account management plans to align with the key metrics of your business: CMRR, Churn, and Cash flow. For sales, they should be paid on <u>new CMRR</u> with a standard deal structure (such as a one year deal, with quarterly pre-payments), and incentives for more favorable <u>cash flow</u> terms (such as multi-year pre-payments).

The CMRR incentive should be logical, because you are paying for new business added which is similar to the traditional "bookings" comp plans. To give you a concrete example with easy math, let's assume your enterprise sales reps are on incentive plans at $120,000 base and an additional $120,000 bonus at quota. Let's assume their quota is $120,000 MRR. In simple terms (and simple is good for sales comp plans), the rep gets to keep every dollar of new MRR they bring in for the year – and the business gets to keep the other 59 months of revenue in a five year customer relationship. You can play with minimum thresholds ($60k MRR to be eligible for a bonus) and accelerators (you get to keep 2x the MRR for every dollar above quota), but the core idea is critical.

In addition, although compensating sales reps for cash flow may seem a bit unusual, it's actually very logical. As a private company, you have a VERY high cost of capital (well above 10%), whether you raise venture capital, angel money, friends and family investments, bank financing, or all of the above. You are taking money from outsiders already at expensive terms, so why not get it from your customers for "free" instead? If your customers are larger than you, they likely have a relatively low cost of capital and long term budget cycles that are already accustomed to large licensed software purchases. As Board members, we would strongly encourage a company to offer a customer a 5% + price discount for a multi-year pre-payment, and we would happily give the sales rep a modest incentive for pushing this option. It can be one of the rare win-win-win (company, customer, and sales rep) situations in life!

You should think of account management as a sales function, and they should be compensated in a similar fashion – but modeled on your CMRR and churn assumptions instead of a new CMRR sales quota. Each account manager should have a portfolio of existing customers, and you should model the expected CMRR from this group net of up-sells and churn. These numbers will vary widely based on your line of business and corporate focus, but a "typical" account manager may start the year with 20 customers and a starting CMRR of $200K. Your model will suggest that they should end the year with only 18 of these customers (churn of $20k), but that the average account should grow by 15% with up-sells and additional seats (net up-sells of $180k * 15% =

$27k), so their net CMRR quota might be $207k or $210k for the year. While the up-sells are equivalent to new CMRR and can be compensated at the same level, CMRR renewals are typically compensated less (we often see 1/3 of new CMRR comp).

"I like to see SaaS comp plans where the commission dollars paid are not percent based but rather directly tied to the MRR. When a customer tries to negotiate a contract from $10k to $9k MRR, the sales rep feels the pain of $1,000 out of his or her pocket, and suddenly becomes much more effective at holding prices!"

Gary Messiana, Bessemer Entrepreneur-In-Residence and former CEO, Netli

Bessemer SaaS Law #5. SaaS is a whole new ecosystem where traditional IT channels don't work – Focus your business development efforts on *business services* channels, but you will need to sell directly for a long time as these new set of partners are not easy to ramp-up

Unfortunately many software executives have spent years building deep relationships with executives at the major software and integration companies like IBM, Oracle, HP, and Accenture…only to find they aren't much help to SaaS businesses.

SaaS products, by their nature, do not require massive amounts of systems integration work to implement, so they're not a great fit with the traditional system integrator (SI) business model. SaaS products don't pull through large stacks of hardware boxes and software licenses so they're not very attractive to traditional independent software vendor (ISV) partners either. ISVs and SIs have both spent decades building up deep relationships with the IT organizations, but many SaaS vendors now prefer to sell to line of business instead so these executive relationships are much less valuable.

Channel relationships are very hard for any small company to establish even when interests are directly aligned, but this challenge is proving even more difficult for most SaaS companies given the restricted value proposition to the SI and ISV community. Therefore, it is still the case that most SaaS businesses have to be comfortable with the fact that they will live or die by their ability to sell directly, and only if they are successful alone will they be able to build meaningful channel relationships with the new generation of partners and resellers.

In recognition of these dynamics, many of the early SaaS leaders have started to focus their business development effort on *business services* channels, i.e., partners that provide technology enabled or managed services to the same customer segment and can enrich their offering by adding a SaaS application. These business services channel partners range from marketing agencies to payroll providers to accounting firms and have started to understand the power of SaaS when many of the ISVs and SIs do not. However, this trend is just emerging and we have not seen any of them generating a significant portion of the SaaS company revenues, but we think this will accelerate in 2009.

In addition we have been encouraged lately by an increased partner focus among many of the early SaaS leaders (Salesforce.com, Cisco/Webex, etc…). In particular, we have seen the emergence of a new generation of smaller, more nimble and SaaS-savvy SI firms. These firms are primarily working with public SaaS vendors like Salesforce, but have started to extend their set of partnerships to late stage private companies.

This may be the Bessemer "law" that is evolving the most rapidly, and I sincerely hope that by the next update we will have numerous established channel partners that "grok" the SaaS business model and are incentivized to support SaaS vendors.

Bessemer SaaS Law #6. By definition, your sales prospects are online - Savvy online marketing is a core competence (sometimes the only one) of every successful SaaS business.

You sell a product that requires an internet connection and a web browser for access, which means your prospects are online! Numerous studies show that your customers are now doing most of their primary research online, and it should not surprise you. As a consumer, you wouldn't imagine buying a car, making an offer on a home, planning a vacation, or completing other large purchases without first doing some research online. The same is now true for executives at your target customers. You should therefore be aggressive in marketing to them online.

This is a clear example where business-to-business (B2B) marketers need to learn from their business-to-consumer (B2C) counterparts. The most innovative B2C companies are lead generation machines, leveraging search engine optimization (SEO), viral marketing, Search Engine Marketing (SEM), email marketing, and other technically-advanced methods. Yet many B2B companies don't have a clue.

The incumbent technology leaders like IBM, Oracle, or SAP, have done very little in online marketing, and thus have given their smaller challengers a huge opportunity. Private SaaS companies have so many disadvantages against the larger incumbent vendors that it is imperative for them to exploit this potential advantage. Whether they use an automated product like Eloqua (as is the case with a dozen of our companies) or a team of marketing analysts and spreadsheets, online marketing and demand generation is simply a "must have" for SaaS companies.

Bessemer SaaS Law #7. Stay local - Prove your business in North America first. Only after reaching $1M in CMRR should you consider hiring European sales and services execs behind customer demand. Save Asia for post-IPO.

Almost all businesses will look to go global at some point if they continue to grow. But SaaS vendors face more barriers to globalization than traditional software companies because you can't just localize the UI and ship a new CD to some remote country. Given the different architecture and high service level expectations in the SaaS industry, companies are faced with questions about latency, data access and security through replicated local datacenters, in-country customer support personnel, packaged integration with other regional software and SaaS products, and other similar issues.

Simply put, North America is a massive market with a rising tide around SaaS. There is no need to go global early and force this cost and complexity upon your organization. In most SaaS sub-markets, we find that Europe is roughly three years behind the US in adoption, and Asia is slightly behind Europe – although we have recently seen some interesting pockets of activity in Japan and India that may be accelerating. A rough rule of thumb is that you should look to pass $1M CMRR ($12M Annual Contract Value) before even considering Europe, and even then you should let customer deals pull you into the region as you incrementally hire sales and services professionals. Unless you have some extremely unfair advantage in Asia, wait until Europe is a clear home run before even considering opening up a sales war on another front. Your default position should be to consider Europe as your pre-IPO growth story, and Asia only after you're a high-flying public company.

Bessemer SaaS Law #8. Single instance, multi-tenant, single datacenter - Have only one version of the code in production. Really. "Just say no" to on-premise deployments.

This is a guiding architectural principle for best-of-breed SaaS companies. The notion of a multi-instance, single tenant offering should only apply to legacy software companies moving to a dedicated hosting model because they don't have the luxury of an architectural re-design. It is possible to use virtualization to provide multiple instances, but this hybrid strategy will make your engineering team much more expensive and much less nimble. If designing a SaaS product out of the gate, the best situation is single instance, multi-tenant. There are hybrid models that have worked, but in general it is a hard and fast law that should not be debated and we will leave the hybrids to the "clean tech" entrepreneurs.

The same can typically be said about a single global data center. You want to leverage your core infrastructure as much as possible, even when expanding internationally for as long as possible. You should invest early in backup and disaster recovery, but stick to one data center as long as possible and at least past $2M CMRR.

SaaS companies have this debate all the time, and yet the recent data is pretty clear: most SaaS companies can get by with a single datacenter in North America until well past their IPO. In fact, Salesforce.com is passing $1 billion in revenue and announced plans for additional datacenters only a year ago.

Data centers are extremely expensive and create significant organizational complexity on every level. Many of the historical issues around data backup, disaster recovery, and global application latency that caused companies to add a second datacenter can also now be better addressed in other ways.

With a single code base in North America, it will obviously make it much more difficult to sell a SaaS deal to foreign governments or defense departments (yet another reason why the Swiss military probably won't be a beta customer for you!), but focus is a good thing. You still have the vast majority of the global market available to you, and the macro trends are only moving even more in your direction.

It really does add a lot of overhead cost and operational complexity that is hard to absorb unless the business is at scale…meaning typically $2M++ of CMRR. And when you do open a second facility make sure it's funded by customers, typically as part of a broad international expansion.

Bessemer SaaS Law #9. The most important part of Software-as-a-Service isn't "Software" it's "Service"!

One of the most valuable and least appreciated assets of a SaaS business is the detailed usage data of your customers. For years, product marketing and product management groups in license software businesses have attempted to guess at the behavior of their customers. Good PM's would interview, survey, and even watch their customers as they used the product, but it was very hard to truly know how they were using the product on a detailed level and incorporate this feedback in the major annual releases. SaaS businesses should instead learn from their consumer internet peers, and the user interaction methodologies of businesses like Google, Apple, Yahoo, LinkedIn, Yelp, Facebook, and others. These businesses are constantly taking advantage of their web application architecture to analyze detailed customer usage data, a/b test variations, iterate on small details of a page or a feature, and evolve the product each and every day.

There are three levels of being Service Savvy, and SaaS businesses should strive for all three:

1) Basic proactive monitoring for likely churn or up-sell opportunities – this is too simple not to do, and all SaaS businesses should do this well. You already know who logs into your product, how often, what they do inside the product, and what results they achieved. So now you need to track the key usage metrics and measures, and create internal dashboards to know which customers are getting the most value (potential up-sell candidates!) and which are likely to churn (time to proactively intervene!). Work with your marketing team to automate "low usage" reports internally, and low usage escalation emails to your customers to ask them for an explanation of the behavioral changes.

2) Rapid testing and development cycles of your application based on customer feedback. Look at what your customers are doing in the product, not what they tell you they're doing. Look at which pages, features, and sub-components are getting the most active usage and why. Look at the outliers and understand whether there exist some interesting additional opportunities.

3) Analyze the aggregated data to determine best practices and benchmarks across your customers. You can actually add value to your customers businesses by making them better in your product, and your product better by watching your best customers.

The other subtlety of a service offering is that customers have to be able to use the offering in production to recognize its value, and for your business to convert CMRR to MRR and GAAP revenue. This implementation time is measured as the time from the day you acquire a new order until the day it goes into production. You want this lag to be as short as possible, and growth in this number is a strong leading indicator of possible product and/or implementation problems. Prudent SaaS companies have made wise investments in process and technology to make this time as short as possible. These investments span the range of simple items like streamlining workflows and improving user training to fully automated self-provisioning models that allow turn ups to happen without human intervention. As a general rule, the higher your price point the lower the need for automated provisioning and the lower your price point the higher the need. A fairly typical implementation range for SMB focused SaaS providers is 0-60 days, and enterprise focused offerings typically range from 2-4 months. Although "average implementation time" is typically not a key executive metric, it should be tracked as a second level metric and promoted as a primary metric if you are out of range or the trends are inappropriate.

Bessemer SaaS Law #10. Be prepared to cross the desert - SaaS requires R&D and sales expense up front for a multi-year stream of revenue, so it demands enough investment capital to fund 4+ years of runway. Load up for the long trip and pace your consumption of calories!

There is no denying that the cash flow characteristics of a SaaS business are wonderful in the long term, but lousy in the short term. The traditional software model with $100,000-$1 million licensed software and "net 60" payment terms presents a far rosier cash flow picture than monthly subscription streams of $5,000-50,000. This means SaaS companies must have impeccable financial stewardship.

There have been many promising SaaS startups that stepped on the gas too early and were wiped out as a result. Always model the business with a comfortable cash cushion and recognize that most SaaS businesses paradoxically consume more short-term cash if you start growing faster. As a business, it is critical to weigh forward investments carefully. SaaS businesses typically require multiple rounds of investment and a good amount of capital. For example, it took $126m to NetSuite to go public, $66m for DemandTec, $61m for Salesforce and $45m for SuccessFactors. We believe that the best of the second generation SaaS businesses may be more efficient than many of these predecessors, but in almost all cases, significant capital will be required to build a dominant SaaS business.

As you grow the business, you should also constantly trade off cash vs. growth. If you must replenish supplies while still crossing the desert – and most SaaS businesses will need to raise multiple rounds of funding - optimize your growth rate (sales rep recruitment and marketing spending) so that you maximize your CMRR when you need to fundraise next. As private investors and public acquirers become more SaaS savvy, multiples of CMRR will likely become the primary valuation metric.

Bonus Law: You can ignore one or two of these rules, but not more - Great companies innovate, but pick your battles!

You might be reading this and saying to yourself, "But wait - we've got a great channel partner that is going to take us to the moon!" or "I took an early chance in Europe and it's now driving the majority of growth for my entire business." To which we would say "good for you!" Nothing is absolute, and we certainly believe it is possible to ignore one or two of these core tenets and still succeed.

In fact, several of the companies we have worked with have also chosen to break one of these laws at some point in their lifecycle with success. Even within our current portfolio, a couple have made early channels start to work in scale, one has enjoyed success with an early bet on Europe, and one is actually having a huge amount of success with a hybrid model.

However, if you find yourself questioning several of these Ten Laws, then it's probably time to step back and take a hard look at your business. As former SaaS CEOs and investors ourselves, we have learned the hard way that much of the battle is just learning from the mistakes of those who went before us. In our analysis of more than a hundred SaaS businesses, we encountered several successful companies that were on the borderline with one or two of these laws each, but none that challenged several of them. We hope that these laws can help you run your SaaS business more effectively, and we always welcome new insights in these or related areas.

* *