Coronavirus Buyer's Guide

Software as a Service (SaaS)

April 2020

Supply Chain Risk Assessment

Stimulus Impact Analysis

Availability of Substitutes

Best Practices for Contracts

Historical Performance

There were only 17 publicly-traded software as a service (SaaS) companies in the United States prior to the Great Recession. As evidenced by the performance of these companies during the economic downturn, the SaaS operating model is robust in the face of economic downswings. None of the public SaaS companies declared bankruptcy or became insolvent. More than four-fifths of the firms continued their growth throughout the recession and became profitable shortly after. However, the reduction in growth rates was significant. Growth rates reached an average of 40.0% right before the recession, and fell to 10.0% by the recession's end.

Current Performance

There are between 50 and 85 public SaaS companies in the United States. During the Great Recession, many SaaS companies had just been publicly listed and, therefore, had robust cash reserves that enabled them to weather the economic downturn. These days, mature SaaS companies are still in a relatively safe position to weather the recession due to high profit margins, low investment in capital and, so far, relatively inelastic demand. In the past three months, the average stock price of public SaaS companies has dropped 11.0%, which is less than the Dow's decline of 20.9%.

Market Headwinds & Tailwinds

SaaS suppliers are recalibrating their businesses around these headwinds and tailwinds:

- Increasing demand for IT solutions on the back of widespread work-from-home and learn-from-home provisions
- Greater server traffic as demand for IT solutions spikes
- Declines in demand are expected down the line as recessionary pressures constrict the budgets of consumers and organizations
- Existing customers are seeking discounts as stay-at-home provisions interfere with their ability to continue paying their software subscriptions

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Risk Assessment

Upstream Suppliers

Upstream Supplier	Risk Before COVID-19	Risk After COVID-19	COVID-19 Impact
Computer Wholesalers	Low	Medium	• Computer production relies on the use of semiconductors, which have seen supply chain disruptions as a result of COVID-19. • Though many IT hardware vendors performed better than expected during first-quarter 2020, businesses and consumers are likely to constrict their spending on computing technology as the recession carries on.
Software Publishers	Low	Low	• Software publishers, based on their high profit margins and lack of capital investment required for operations, are in a favorable position to weather the recession caused by COVID-19. • Though software sales performed well in first-quarter 2020, new software sales will likely diminish as the slowdown carries on. However, due to the subscription-based nature of many software systems, these companies are likely to keep up revenue generation moving forward.
IT Consultants	Low	Low	• IT consulting is typically a branch of general consulting firms or attached to software and/or hardware vendors. • IT consultants are typically hired when companies make an initial investment in software. Therefore, as new software sales diminish, IT consultants are likely going to incur subdued revenues. However, their high profit margins and reliance on labor rather than material inputs will allow them to weather the recession.

CONSIDER THIS:
There is a limited number of semiconductor fabs or foundries (factories) in the world, meaning that supply chain disruptions stand to have a severe impact on the number of semiconductors in circulation.

Risk Assessment

Downstream Buyers

Downstream Buyer	Risk Before COVID-19	Risk After COVID-19	COVID-19 Impact
Industrial Manufacturers	Medium	High	• The US manufacturing sector is contracting, with prices decreasing 8.5% from February to March and employment falling rapidly during the same time period. • Demand for big-ticket items (e.g. washing machines and refrigerators) is declining swiftly, and factories that serve the oil and hospitality industries are also particularly affected.
Financial Institutions	Low	Medium	• Due to rising home vacancies and falling rents, property owners are losing out on revenues and their ability to pay back their loans is suffering. • Many banks are raising their lending requirements for consumers and limiting their business loans to existing small business customers.
Retailers	Medium	High	• Governments in 45 US states have called for the closure of “non-essential” retailers during the COVID-19 pandemic. Almost 200,000 stores are closed due to the “non-essential” provisions, comprising almost half of all US retail square footage. • Fitch has downgraded credit ratings for major retailers, such as Macy’s, Nordstrom and J.C. Penny.
Healthcare Providers	Low	Medium	• Many hospitals, in order to prepare for major influxes of patients with COVID-19, are not operating at full capacity. In this way, they are not generating adequate revenues. However, due to the necessary nature of hospitals, these organizations are unlikely to cease operations. • Dentists’ offices and elective surgery clinics are seeing drastically reduced demand.

CONSIDER THIS:
Some large auto factories have closed completely to protect workers.

CONSIDER THIS:
The US government has enabled Fintech companies to lend to businesses as part of the Paycheck Protection Program (PPP), which should aid companies excluded from receiving bank loans at this time.

Coronavirus Aid, Relief & Economic Security Act

How does the Federal Coronavirus Aid, Relief, and Economic Security (CARES) Act impact the SaaS market?

- Apportions to small businesses $350 billion for no-fee, low interest loans. Per Small Business Association (SBA) rules, a small business has fewer than 500 employees. However, this definition excludes many startups backed by venture capital when the venture capital firm and the startup have more than 500 employees combined.

- Companies that face a significant decline in gross income or are facing closure as a result of coronavirus orders are permitted to take a refundable tax credit against the Social Security payroll tax of up to $5,000 per employee. Since operating costs for SaaS businesses are mostly related to labor, they are well-positioned to benefit from this provision.

- Companies can postpone payment of the 6.2% Social Security payroll tax for the rest of 2020. Payroll costs constitute the largest cost category on average for SaaS providers. This provision stands to benefit SaaS companies by allowing them to conserve cash until revenues pick up.

- Relaxes some limits on the carryback and use of net operating losses (NOLs). This is especially important for startups that typically incur net losses in the first several years of operation.

- Allocates $500 billion for financial investments to assist states, municipalities and eligible businesses. This includes emergency relief for qualifying midsize SaaS businesses with 500 to 10,000 employees.

Creative Procurement Opportunities

What substitutes and creative procurement opportunities should buyers consider in the wake of market disruption?

Demand for SaaS is currently high, but buyers have limited cash on hand. Some providers are offering free services or free trials of their services at this time in hopes of locking in users down the line. For example, Zoom is offering unlimited meeting minutes for non-paying users.

DID YOU KNOW? Usage of the Zoom app has increased around 300% since the implementation of widespread work-from-home policies and Zoom's unlimited meeting minutes offering.

In the wake of COVID-19, SaaS companies know that diminished revenues are on the horizon. Suppliers are issuing discounts on existing subscription contracts with customers in order to preserve these sources of revenue through the recession.

In order to save cash and remain liquid, many SaaS providers are likely to halt their ongoing investments in research and development (R&D). R&D has historically been a major cost category for vendors, and the current pace of innovation in the SaaS market reflects this. Moving forward, there will likely be a period of technological slowdown in this market to reflect diminished investment in R&D.

Contracts & Payment Terms

What strategies can buyers adopt to mitigate risk in contracts and payment terms?

Pay close attention to service guarantees in existing contracts
Due to recent upswings in demand for SaaS offerings, providers may be unable to meet uptime guarantees or other service guarantees established in the contract. Buyers should seek out such contract provisions and use them to incur service credits or other benefits.

Plan ahead during initial negotiations
Buyers might have different license needs now versus one year in the future. Buyers should discuss the downsizing/scaling up of licenses when negotiating the initial contract, especially if buyers are planning to change the number of user licenses once employees return to offices. Buyers hold the most negotiation leverage when discussing the initial software acquisition.

Check contracts for provisions about the frequency of releases and upgrades
Many SaaS providers are limiting their spending in research and development (R&D) to maintain their cash reserves. This decreased spending on innovation could result in delayed product upgrades down the line. In this way, the license might not hold the same value for the buyer. Buyers should consider leveraging this reduction in R&D spend to seek subscription discounts.

Buyers should assess whether COVID-19 prevents them from carrying out their contractual duties
Buyers should check the specific language of their SaaS contracts to see if the coronavirus would qualify as cause to terminate the contract. Alternatively, buyers can leverage the effect of the coronavirus on their operations and revenue generation to request subscription discounts.

Best Practices

Key Takeaways

- ProcurementIQ has identified **falling demand** from industrial manufacturers and retailers as the most significant source of market risk in the SaaS market. Manufacturing is contracting due to lesser demand, supply chain disruption and factory closures. “Non-essential” retailers are being forced to close their brick-and-mortar locations in 45 states.

- All but one of the SaaS vendors that were publicly listed prior to the Great Recession are still in business. Moreover, the one company that is no longer in service was acquired and did not become insolvent at any point.

- Buyers should examine their existing SaaS contracts for service guarantees. It is possible that certain vendors are unable to maintain guaranteed uptime levels due to increased server traffic. Depending on the agreement in place, buyers can gain service credits or leverage more favorable contract terms.

- The CARES Act’s definition of “small business” is a business with fewer than 500 employees. However, some startups with fewer than 500 employees do not meet this definition because the CARES Act takes into account the joint number of employees from particular startups and the venture capital firms that finance them.

- SaaS providers face the most risk of supply chain disruption from computer wholesalers that rely on semiconductors. However, risk from these upstream providers is not likely to result in the disruption of software offerings.

Appendix

Related Reports

Contract Management Software
This software is used to author, store, organize and analyze a buyer's various contracts. These features help buyers structure better deals, remove revenue recognition delays, consolidate contract value, avoid contract penalties and more.

CRM Software
CRM software is designed to manage a company's sales and marketing, as well as the customer and technical support processes. CRM software systems generally come with tools to track activities, manage and analyze customer data, and oversee workflows and processes.

ERP Software
Enterprise resource planning (ERP) software improves and automates core back-office business functions. There is a high degree of overlap between ERP software and complementary business software that addresses back- and front-office business functions, such as sales and marketing, customer relationship, procurement and human resources.

Human Resources Software
This type of software is designed, developed and published to help companies improve and oversee talent management and performance by automating daily administrative processes related to company workforces.

Learning Management Software
Learning management software (LMS) programs are software applications that remotely administer education courses or training programs. Key buyers include educational institutions, healthcare providers, government agencies, finance and insurance firms and IT firms.

Procurement Software
Procurement software helps businesses track the activities of procurement departments. This software is used in every part of the procurement process, from drafting requests and vendor selection to invoicing, payment and receipt verification.

Security Software
Security software publishers develop and distribute various programs that protect a system from malware and spyware, including viruses, worms, trojan horses, adware, system monitors and tracking cookies. Security software employs a number of methods to provide security to a system, such as data encryption, scanning, applying fixes to system vulnerabilities and fortifying existing measures. Once detected, internal threats are removed and incidents are recorded.