Driving Revenue Growth:
How to Profit from the New XaaS Model

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Chief Outsiders

Index

Introduction

If you are the CEO of a company selling products or services to other businesses, you undoubtedly are constantly on the lookout for new sources of growth. It's frustrating when your company is unable to realize its fullest potential for financial success.

Sometimes, the cause of these missed targets can be the inability to fully understand the customer or marketplace for your products or services. In other cases, it may be that changes to your marketing strategy or execution plan are needed.

But sometimes, a more sweeping solution – involving a critical adjustment to the core business model of your product or service – is the logical prescription.

An increasing number of companies are realizing that the last option – in particular, a transition to an as-a-Service model – is the answer to driving higher growth, more profitability, and more stable and reliable revenue streams.

To that end, I have developed this eBook – a tool to help CEOs strategize for – and execute against – an evolution to an as-a-Service model. In this eBook, you will learn:

1. What an as-a-Service business is, who is doing it and why;
2. How to know when it's time to think about embracing an as-a-Service model;
3. How to take your as-a-Service business to market efficiently and effectively;
4. What are the key metrics to track, and how to model such a business, and;
5. Some final tips to ensure you execute this transition successfully.

This eBook makes no assumptions about prior experience with as-a-Service models (sometimes referred to as XaaS). It is equally applicable to companies that have technology at their cores -- and those that don't. A massive amount of content has been written on related topics; that said, the main goal with this eBook is not to repeat or replace that material, but to simplify and help you begin – or at least consider – the journey.

Chapter 1 – What is as-a-Service and Why?

To put it simply, an as-a-Service business model is one where customers ‘subscribe’ to an offering for which they receive the value over time (as opposed to paying a one-time fee and receiving most of the value up front). Such business models have been used in the classic services sector for many years, but the more recent innovation is that companies that had previously sold their offering as a one-time ‘product sale’ are now converting to subscription business models.

Often these models are referred to as Something/Anything-as-a-Service or XaaS. For the remainder of this eBook, I will use the XaaS acronym to generically refer to such models.

Somewhat related to this concept are so-called ‘on-demand’ businesses that may not charge an ongoing subscription fee, but are always available to use, just like a XaaS service might be. Obvious examples are Uber and Lyft, which provide on-demand Transportation-as-a-Service. Although Uber does not (currently) charge an ongoing subscription fee to its customers, many elements of this model are similar to a true XaaS business, and much of the discussion in this eBook still applies.

Who is doing it?

XaaS is not a new concept. Early examples of the business model include:

- Office machines/copiers (initially selling subscriptions to service and supplies, and later to the entire solution, including the machines themselves)
- Cleaning services (where individuals or businesses subscribe to daily or weekly cleaning of their homes or businesses)
- Magazines and newspapers have long delivered Information-as-a-Service via subscription
- ‘Club’ models, including book-of-the-month and record-of-the-month clubs, that have been popular for decades

Beginning in the late-1990s, the Internet's enhanced distribution model – particularly where digital content is concerned – spurred the rise of many consumer-oriented XaaS offerings. Many of us are probably regular consumers of such XaaS services without realizing it. Examples include:

- Music subscription services like Spotify and Apple Music;
- Online subscriptions to newspapers and other content that used to be in print form;
- Cloud-based storage services, including photo and hard drive backups;
- Your subscription to your Internet Service Provider (ISP);
- Even social media solutions like Facebook can be thought of as examples of XaaS models. The only tweak is that – instead of paying with cash – users pay with their privacy and personal information, which Facebook then monetizes in various ways.

By the early 2000s, software companies began offering their products as ongoing, subscription services (Software-as-a-Service or SaaS). One of the pioneers of this transition from installed, licensed software to cloud-based SaaS is Salesforce.com, which was founded in 1999 and went public in 2004 on the tag line "No Software." Since then, the majority of new software companies have utilized a SaaS model, and most legacy software companies have been busy transitioning to that model (some more successfully than others).

The current wave of XaaS model transitions is happening in businesses that you would not automatically think of as being obvious candidates. These include:

- The incredibly popular Amazon Prime offering, providing the outcome of Free/Fast-Delivery-as-a-Service (among other benefits);
- Venerable General Electric's effort to replace the outright sale of jet engines with the subscription-based 'power by the hour' concept. Similarly, GE's lighting division has now become an Energy-as-a-Service business;
- And the recent repositioning of office supply retailer Staples to become an 'office services provider.'

As you can tell from these examples, almost every possible kind of business is embracing the XaaS model these days. No matter what the offering, the advantages to both buyers and sellers, described next, are fundamentally similar.

Advantages of XaaS

Markets (including both sellers and buyers) are increasingly adopting XaaS models, given some very clear benefits.

Advantages for buyers:

- Lower up-front costs – customers pay over time as the value (outcome) is received;
- Less risk – ability to (eventually) turn off the service when it's no longer needed;
- Higher quality – service providers are highly motivated to retain the ongoing business of their customers.

Advantages for sellers:

- Subscription services provide more predictable, recurring revenue streams (and what business doesn't want that?);
- Higher margins in the long run – as sales/marketing costs are mainly incurred upfront vs. a non-subscription model, where the offering is re-sold/re-purchased every month, quarter, or year;
- Greater chance to upsell or cross-sell to customers – and customers are 'stickier.'

The point about customers being 'stickier' is worth elaborating. This is a funny way of saying that customers are stuck with you for the long term. For offerings that aren't sold as a subscription, the buyer must make a repurchase decision every single time. At that decision point, it is possible (and often tempting) for the buyer to reconsider other options, or discontinue the new purchase altogether. With the subscription model, however, it is simply easier for the buyer to continue with the status quo – as long as the outcomes remain valuable.

Subscriptions Everywhere

From your own personal experience, how many subscriptions of all sorts (i.e., magazine, cable, phone) do you stick with just out of natural momentum? If you are like me, it's quite a few. The same dynamic applies with B2B purchases, where the inclination to stick with what works today is even stronger, since the risk of change can be significant.

Sounds good? Investors think so, too. In fact, while investments in SaaS companies originally took hold in the venture capital (VC) space, increasingly it is more conservative private equity (PE) firms that are driving significant new investment into XaaS model businesses – and for good reason. The article title says it all: "Profits-as-a-Service."

Characteristics of a XaaS Model

In general, XaaS models exemplify the following four characteristics:

1. Provide recurring/subscription revenues. Customers agree to pay a recurring fee for ongoing access to the offering. Frequently, such models charge a monthly fee with a minimum term, during which they are committed to maintaining the service. (More on XaaS pricing later in this eBook.) Note that many companies that provide what we think of as 'services' are not automatically XaaS businesses. For example, a house cleaning service that offers $50 cleanings at customer request is not a XaaS business – although it may be an on-demand business, if the service is truly available whenever the customer requires it.
2. The focus is on outcomes, not features. Successful XaaS models think of themselves as actually charging for the value of the outcomes that the service provides, vs. the features of the service itself. For example: Meal delivery service Blue Apron enables customers to subscribe to regular deliveries of fresh, ready-to-cook groceries, along with an associated recipe. But, more than just a box of food and instructions, what Blue Apron customers are really paying for is convenience, luxury, fun, and the satisfaction of knowing they are supporting local, sustainable farmers. The food box is simply the 'outcome delivery mechanism'.

3. The offering is standardized in some way, and not totally bespoke. The economics of XaaS businesses make the most sense when the offering is repeatable at some scale (either to the same customer over and over again, or to multiple customers, or, preferably, both). Back to the Blue Apron example: customers may believe they are getting a meal personalized to their requirements but, in fact, Blue Apron is delivering the same food box to thousands of customers every day.

4. Offerings tend to be complete or bundled solutions. To deliver the outcomes discussed in the second point, the offering needs to be capable of delivering at least some of the value/outcomes itself, and not just as a piece of a larger offering provided by others. That is why Blue Apron does not just deliver boxes of groceries to customers, but also includes detailed recipes and instructions, to help users understand precisely what to do with the contents. You can further enhance the experience by joining their wine club 'service.' A delivery of the food, alone, would not produce the desired outcomes.

Tool 1 – Business Model Alignment Assessment

To better assess how closely aligned your current business model is with a XaaS model, review the following table. For each factor, assign your company between 0 and 10 points.

Score yourself as follows:

- **0 to 10 points** – There would be significant work to undertake to convert your business model to XaaS;
- **11 to 29 points** – Your model, and your marketplace, potentially is ready to embrace XaaS;
- **30+ points** – With a few tweaks and improvements, you nearly are already there!

	0 Points ➡	⬅ 5 Points ➡	⬅ 10 Points
Pricing Model	My customers pay me 100 percent up front for my offering. I need to resell it to them every time they purchase it.	Some elements of my offering are already sold as a recurring subscription (i.e., maintenance or add-on services).	I already sell my entire offering via a recurring subscription fee.
Value Expression	When I market/sell my offering, my focus is on features and capabilities.	I balance features and benefits when I market/sell, but rarely talk about bigger-picture outcomes.	When I market/sell my offering, I focus entirely on the valuable outcomes that the offering delivers.
Standardization	My offering is delivered in a unique way to each customer.	My offering is similar for each customer, although some customization is required.	My offering is completely identical for each customer (although they may use it in different ways).
Completeness	Customers consider my offering just a tiny piece of the overall solution they require. It doesn't deliver any valuable outcomes on its own.	Customers consider my offering to provide a significant contribution to their desired outcomes, although some other key elements are required.	Customers consider my offering to deliver the majority of outcomes they desire, without significant extra requirement of adding other elements.

Note that even if your business has a current score of 10 points or less, this does not preclude you from a XaaS transition. The advantages of such a shift may still be very significant for you; however, the level of change to get there is greater, and the path ahead will be somewhat more challenging.

Chapter 2 – Is It Time to Transition?

No doubt you have heard many friends, advisors, peers, and the media at large talking about high-growth companies that use an 'as-a-Service' business model. The trials, tribulations – and valuations – of tech 'unicorns' like Uber, Twitter, and Salesforce dominate the business media these days. Interesting and exciting, but that's not your business. It's entirely possible you don't even consider your business to be a 'tech company.'

So, how do you know it's time to consider a transition to a XaaS business model? Here are some signs:

1. Revenue growth is not achieving your expectations, given the opportunity in the market;
2. The cost of marketing and sales is too high, relative to the revenue that you are generating;
3. You need to effectively 're-sell' your offering to the same customers, repeatedly, each month, quarter, or year;
4. Your business only has a limited ability to cross-sell and up-sell other products or services to its existing customers;
5. As your offering expands and improves, it is becoming increasingly complex for your customers to own, operate, or otherwise benefit from it;
6. Your customers are demanding real outcomes and value, and are becoming increasingly disinterested in paying for either your product's features or your time;
7. Competitors (or substitutes) are beginning to implement subscription models, and are growing faster or gaining market share;
8. Some of these new competitors have the potential to 'disrupt' your business entirely and cause significant – or even terminal – damage in the long run.

Tool 2 – Current Business Model Pain Assessment

Use the following tool to assess your overall level of concern or pain around the eight issues described above. Next to each one, assign a score between 0 (meaning your business is experiencing no pain/concern at all relating to this issue) and 10 (meaning your business is experiencing dramatic pain and a high level of concern relating to this issue):

Issue	Pain Rating 0 = No Pain 10 = Extreme Pain
Revenue growth	
Cost of marketing/sales	
Need for continuous (re)selling	
Limited cross/up-sell opportunities	
Complexity for customers	
Customers demanding more value	
Competitors growing/gaining share	
Business being disrupted	
Total / 80	

Here's how to read the results. If you scored:

- **20 points or less:** Your current business model is in great shape – keep it up! Monitor and re-assess on a quarterly basis for changes to these scores.
- **21 to 40 points:** Yellow flag – there is probably some value in considering a XaaS model.
- **41 to 60 points:** Orange flag – you need to seriously consider a XaaS model for your business
- **61 to 80 points:** Red flag – you are getting your lunch eaten – time is of the essence!

Pain On All Sides

Keep in mind that your potential buyers or customers are often experiencing the flip side of many of these issues – so it's not only your business that is feeling the pain. It is usually when motivations and value are misaligned between buyers and sellers that markets (and businesses) are most inefficient – leading to slowing growth and ebbing profits. Such a situation needs to be addressed to the mutual benefit of both parties.

Now, suppose your score on the preceding exercise is high enough that you want to continue this exploration. It's important to note that XaaS business model transitions (like most significant changes to your business and operational model) also have requirements and risks. To name a few key ones:

- **Leaves your comfort zone.** Change is usually hard, and a shift in business models is one of the hardest, as it impacts almost every element of a business.
- **Impacts short/medium-term revenue.** Shifting to recurring, subscription-style revenue streams has many advantages, but one big disadvantage is giving up the recognition of upfront revenue when the initial sale is made.
- **May impact short/medium-term profitability.** Shifting revenue out over time can also impact profitability – at least in the short run, until the power of the recurring revenue model kicks in.
- **Requires a solution that offers demonstrable value to the market.** If the basis of your business is to sell a low-value or low-quality offering, and then move on as quickly as possible to the next buyer, then the XaaS model isn't for you.
- **Benefits from having cross-sell or up-sell possibilities.** Related to the previous point: Such models are more powerful when there are opportunities for add-on purchases and enhanced offerings. XaaS is not for 'one-and-done' businesses.
- **Requires a mindset of ensuring long-term customer success.** This model requires customers to basically 'subscribe' to the value you are delivering them, over an extended period of time. Support models that are based on 'fire and forget' will not be effective for XaaS businesses. Continuous customer engagement, with a focus on true customer success, will be required.

These may sound like big caveats or hurdles to overcome. But – trust me – for most businesses that want to drive high-value, long-term relationships with customers, the ROI is significant. Later in this eBook, we will deal with how to effectively address each of these issues.

But what if these considerations sound too big or too scary, relative to the rewards? In that case, you have two choices:

1. **Continue to monitor both your current situation (as per the earlier pain assessment tool) and your readiness to address the requirements.** Set a reminder to revisit this assessment on a quarterly basis. Proceed when the factors are more clearly indicating a direction.
2. **Talk to an expert.** Often, the hurdles seem more daunting than they really are, and the benefits too nebulous. Having someone experienced on your side who has been through numerous, similar transitions, can be the difference-maker in rendering the most appropriate decision (and then implementing it effectively).

Chapter 3 – Taking XaaS to Market Successfully

Like any successful product or service, a XaaS (Something-as-a-Service) business needs well-defined goals, a clear positioning, and an integrated go-to-market plan. While each of these areas could take an entire book to cover in detail, I'll highlight some important elements, as they particularly apply to XaaS.

Tool 3 – Defining Your Growth Goals and Roadmap

A good practice for any business trying to grow is to complete the following 'growth roadmap' exercise. The steps are simple, using the grid below:

1. Put your overall growth target for next year in the middle.
2. Now indicate on the chart what percentage of that growth you intend to come from each quadrant.

This exercise is best done as a team, with each leadership/executive team member (or even board member) completing it independently. Afterwards, you can compare, discuss, and consolidate the answers into a single statement of strategic intent. I also recommend doing this over a three-year time horizon with annual breakdowns, given that XaaS transitions (or launches of new offerings) will take some time to be fully realized.

Obviously, whichever part of your business you are considering transitioning to XaaS should be listed in the New Offerings category (two right quadrants) – unless you are focused on improving or perfecting an existing XaaS offering.

One note of caution: it can be difficult for businesses to simultaneously execute against a XaaS and non-Xaas model – especially for the same offering. Many elements of the go-to-market plan are quite different between the two models, and being 'stuck in the middle' is never a strong strategy or execution plan.

Creating a Clear Positioning

Now that you have high-level, multi-year growth goals in place for your XaaS offering, it's time to think about one of the most critical elements of successful sales and marketing – defining a clear position in the market.

Simply put, the 'positioning' of your XaaS solution describes why it matters, what it does, why it's relevant, and how it's different. These elements are encapsulated nicely in the following generic positioning statement:

To **<key target market>**
<Your solution> is the **<category in which it competes>**
that **<key competitive advantages>**
so customers can **<key customer benefits>**.
Believe this because **<proof points>**.

Here is an example of a fictional company, using this positioning construct:

For **mid-sized bakeries,**
Warbly is the only **bakery service provider**
that can **connect your baking machines to the Internet of Things**,
driving more **cost-efficient operations and higher margins**.
Over **50 leading bakeries** use Warbly today!

Can you clearly describe your new XaaS solution using this framework?

To understand the power of positioning, think back to how many times you have heard of a new business or product, went to its website, and left two minutes later thinking, "I have no earthly idea what these guys actually do!" Unfortunately, that reaction is far more common than you might think – and it might even be happening with your product, service offering, or business, since it is so difficult for you to see your own message through an outsider's eyes.

Positioning = Strategy

Note that 'positioning' is a strategic construct. Although the positioning statement (as above) will likely never be used verbatim in your marketing, it is the foundation for 'messaging' – the words (and other media types) that your marketing and sales communications efforts actually deliver to the market. Unclear positioning will result in an ineffective message.

So the next step in bringing a XaaS solution to market is to create the positioning statement for it. In my experience, it is difficult to spend too much time and effort on this initiative, since it so central to your success in the market. In short, the following positioning 'workshop' could be completed to create and test a strong positioning statement (this example assumes positioning for a new XaaS offering):

Pre-workshop:

- **Understand the market and prospects:** Assign someone from the team to compile (or create) the necessary background information to foster a valid discussion across your team. Specifically, the better you understand potential buyers' pains and motivations, as well as competitors' offerings (including their own positionings), the more powerful your own positioning discussions will be. Don't do positioning in a knowledge vacuum!

Workshop:

- **Bring the key stakeholders in your organization together:** These may include executive team members, board members, and key marketing and sales people. A group sized between five to eight people will foster a prolific brainstorming session. As tempting as it might be, positioning should almost never be done by the CEO (or CMO) sitting in a room alone. Even if you are the sole founder and employee of a new venture, enlist the help and involvement from others.
- **Decompose the elements of the positioning framework:** For each element from the framework (in **<bold>**), brainstorm with the group and attempt to reach agreement (based on your understanding of the market and the nature of your XaaS solution). Less is more. Too many benefits, differentiators and – especially – target markets will result in fuzzy positioning, with little market power. You may want to divide each element (target, benefits, differentiators, etc.) into its own discussion session, instead of trying to tackle them all at once. This is an area where experienced, outside facilitation can be very impactful.
- **Bring it together:** Bring the elements together, and see how they fit. This will take a few cycles of iteration, since they are obviously co-dependent. The result will be a complete draft positioning statement that the team agrees is the right starting point.

Post-workshop:

- **Test:** Get outside the building! Call three customers and test the positioning statement with them. Do they understand it? Does it sound valuable? Can they accurately repeat it back to you in their own words? Do the same for three members of your target market that aren't yet customers. Be cautious – it is very easy to fall into 'selling' mode, versus testing and learning mode. This is another area where the use of an unbiased third-party is often beneficial.
- **Finalize:** Based on your testing, it is almost certain that you will gain insights that will lead to tweaks – or even more substantial changes – to your original positioning statement draft. Get the group back together and finalize it based upon what you learned. If the changes are significant, test it again and repeat. Congrats!

When you are thinking through the customer benefits element of the positioning statement, the interesting concept of **'Outcomes-as-a-Service'** deserves extra consideration. Rather than thinking of the benefits of your XaaS solution in terms of what its features do, try to think of them in terms of the 'outcomes' that your customers desire. These outcomes are what your customers are actually paying for. Your XaaS then becomes the 'outcome delivery mechanism.'

For example, the Blue Apron Meals-as-a-Service, discussed in Chapter 1, provides convenient deliveries of groceries along with a recipe – ready-to-cook. But the real 'outcome' they are delivering is satisfaction – empowering you to serve a healthy, fresh, meal to yourself and your loved ones. If you can envision such a valuable outcome for your customers, you have the basis of a powerful benefit statement for your XaaS solution.

Wash, Rinse, Repeat

You may need to repeat this entire process a few times to reach the most powerful positioning for your new XaaS solution. Don't give up, and don't cut the process short! Positioning new products – and especially those using new business models – is probably one of the most essential and challenging strategic marketing efforts you will ever undertake.

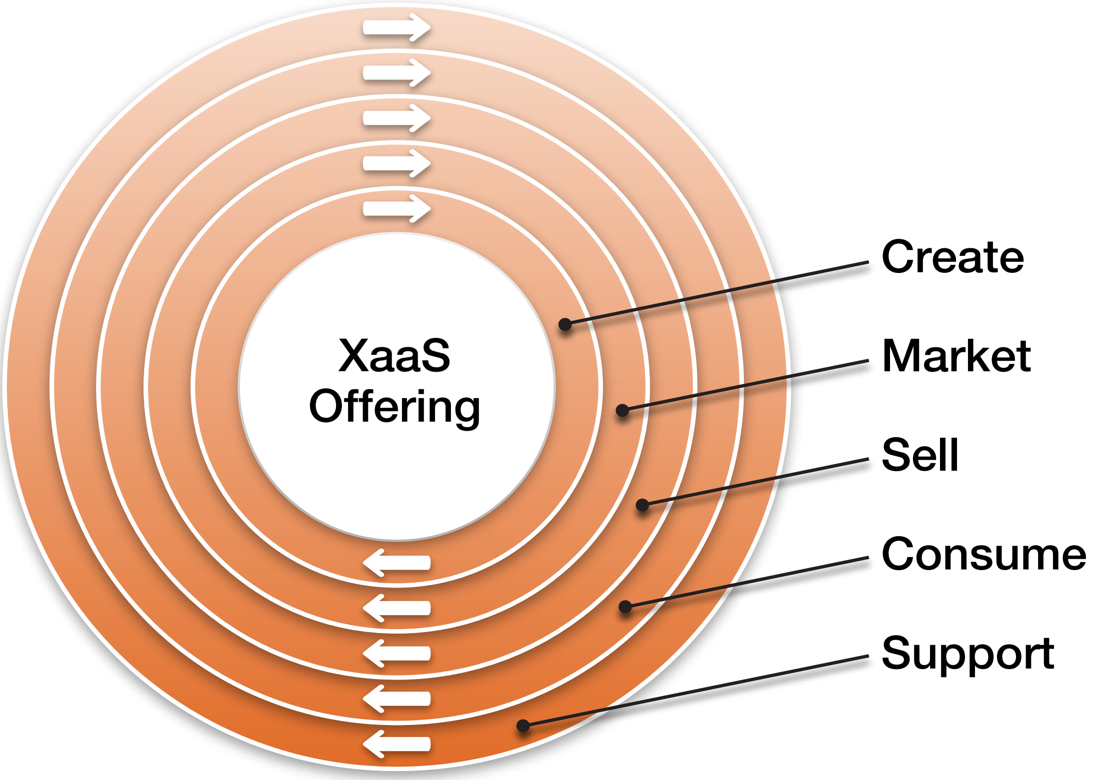
Go-to-Market for XaaS

Now on to the main event – how to take your new XaaS solution to market! What this requires is a go-to-market 'plan' – basically a description of the methods your organization will use to achieve specific goals with prospects or customers.

The most critical thing to keep in mind with XaaS go-to-market plans is that they require a level of continuous integration between its elements that is beyond what typically is seen for non-XaaS offerings. The reason for this is that non-XaaS offerings generally follow a step-by-step process, where the steps are connected in a linear fashion:

Step 2 follows after Step 1 is complete, then Step 3 follows after Step 2, and so on.

With XaaS solutions, these should no longer be thought of as discrete steps but, rather, a continuous flow, where each element is happening all the time and in close conjunction with each other.



Fundamentally, these two contrasting constructs embody the core difference between non-XaaS and XaaS. Most of what we'll talk about next essentially boils down to the strategic and tactical implication of this difference, when considering your go-to-market plan.

To be a little more specific, core elements of a go-to-market plan include (at least) the following:

1. Strategic Product Roadmap
2. Pricing Model
3. Channel/Partner Model
4. Corporate Communications Model
5. Demand Generation Model
6. Prospect Engagement (Sales) Model
7. Customer Success Model

Delving generically into each of these elements is beyond the scope of this chapter – instead, we will focus on some of the particular characteristics of each element that tend to be unique or particular to XaaS models.

1. Strategic Product Roadmap

Whether or not your XaaS offering involves a physical product, the concept of 'roadmapping' the evolution of that offering is important, because customers will be expecting their subscription to include continuous, ongoing improvements and enhancements. Of course, these should not be done simply to add new bells-and-whistles, but to evolve the delivery of the valuable outcomes inherent in your offering.

For non-XaaS offerings, the goal typically is to create as many features upfront as possible, deliver them as one package, and then create and release new versions of the offering at discrete points in time. Think of this as delivering a large (but infrequent) 'burst' of new value (reselling it to the customer each time).

With XaaS offerings, on the other hand, it's more common to deliver new capabilities incrementally – even if they are ready all at once – in order to pace the constant stream of increased value over time that customers are expecting to receive with their subscription.

A caution: Continuously providing new and enhanced value can go a long way to helping retain customers for the long term, but managing constant change can also be difficult for them if not handled prudently. Always think carefully about the 'usability' of your solution, in terms of how easily a customer can consume it over time, and adapt to any changes. Also, note how critical the Customer Success function (discussed later in this eBook) is to a XaaS offering.

2. Pricing Model

Probably more has been written about effective pricing for XaaS offerings than any other element of this model. That's because when most people think about XaaS, the first thing that comes to mind is the ongoing, recurring nature of the pricing model. A few initial thoughts about transitioning to a XaaS pricing model:

- Think in terms of value-based pricing, where value is based on the outcomes that you are delivering.
- Where to start? If you are starting from scratch: get out there and talk to prospects about how much they value the outcomes you will be delivering. Assuming you are transitioning from a non-XaaS model, you do have a starting point! They were paying for something before – now they are paying for so much more value.
- To that point: Don't underprice. The outcomes are clearer, which means the value is now higher. Don't simply take your pre-XaaS price and divide by the time between repeat purchases in your current model.
- One way to avoid underpricing: Segment your target customers. Some will be more willing to pay for enhanced outcomes, while others won't be willing to pay as much because the outcomes are less valuable to them. Rather than offering a lowest-common-denominator price, segment your offering and price accordingly.
- Finally, beyond basic segmentation, don't overcomplicate your pricing model. The best models are easy to explain and understand. Test your model with prospective customers, just like you tested your positioning statement earlier in the process.

3. Channel/Partner Model

Historically, XaaS offerings have not been the domain of channel or distribution partners, due to challenges in working a partner into the continuous cycle of creation, delivery, and consumption we discussed earlier. It's much simpler when a product is created and a partner sells or distributes it. You simply give them a cut of the revenue, and then move on to the next deal.

As more and more offerings shift to the XaaS model, companies have begun to figure out how to involve channel partners more closely (and you can imagine how motivated channel partners are to avoid being shut out of this new business model). This mainly requires a mindset shift on both sides – think in terms of adding a 'channel' circle to the diagram above. Channel compensation often is based on a percentage of the first year's subscription revenue, with the percentage declining (or being eliminated) over time, depending on how critical the partner is in the ongoing support and delivery of the XaaS offering.

In the end, channel partners can be extremely helpful in getting your XaaS offering to market – but only if they, like you, are ready to truly embrace the XaaS model. Effective partners are already doing this with other customers – be wary if you are their first!

4. Corporate Communications Model

In the sense we are using it here, 'corporate communications' refers to activities designed to get your message out to the market that aren't directly related to demand generation. Such activities could include public relations, industry analyst relations, investor relations, social media, and general brand marketing.

XaaS Communications for Public Companies

If your company is public (or wants to be one day), it is critical that investors and financial analysts alike clearly understand the intent, goals, and execution plan around your XaaS transition. That's because – as we will discuss in greater detail in Chapter 4 – revenue recognition will be delayed, and company profitability will likely take a hit in the short to medium term. Happily, unlike a decade ago, today's investors have a better understanding of the value and power of recurring revenue models, and are more willing to forgive some of the shorter-term impacts – as long as they clearly understand your intentions and financial model.

The key distinction here, again, is to think in terms of customer outcomes. The more your corporate communications vividly describes these outcomes, the easier it will be for your prospects to imagine the experience, and decide to engage with you on a subscription basis. This is the 'air wars' of messaging – laying the foundation for successful 'ground wars' focused on demand generation.

5. Demand Generation Model

This is considered the 'ground wars' of messaging – tactically executing against a marketing plan that drives leads, opportunities and, ultimately, recurring revenue streams. The essential principles and practices of demand-gen marketing are not that different for XaaS offerings – although one fairly recent methodology merits deeper consideration: Account-Based Marketing (ABM).

The ABM approach is most often used if target customers are mid-to-large sized organizations. It focuses on driving continuously increasing 'engagement' levels with prospects, by using some of the concepts of 1:1 marketing popularized at B2C companies. Since buying decisions in such companies rarely are made by a single individual, the concept involves targeting multiple stakeholders across the organization, and measuring those engagement levels until a critical threshold is reached. This concept meshes with a XaaS model quite well since, with that model, the notion of driving continuous, ongoing engagement needs to happen as much after the sale, as it does before.

6. Prospect Engagement (Sales) Model

As with demand generation, many of the traditional practices used in building an effective sales machine still apply to a XaaS model, but with a few key differences:

- Sales force compensation: As the pricing model changes, so, too, does the variable compensation model for your direct sales force. Somewhat similar to the channel partner compensation discussed earlier, it often is the case that salespeople keep a certain percentage of the contracted recurring revenue over some period of time – often the first year – and then a smaller (or zero) percentage after that. Having said that, it is becoming increasingly common to compensate salespeople over the entire life of the customer, to ensure that the mindset of sales matches the goals of the XaaS strategy, and does not remain 'fire and forget' as is often the case with non-XaaS models.
- Another common element of prospect engagement is the use of the solution itself. Many XaaS solutions offer some kind of free trial in which the solution itself becomes a key marketing and selling tool. This doesn't apply strictly to internet services – with some creative thinking, virtually any XaaS solution can adopt a similar approach. If your solution is not its own most effective salesperson, then you are missing some incredible revenue generation opportunities.

7. Customer Success Model

Customer success (support, service, account management, or whatever it is called in your organization) is the outer ring of the continuous go-to-market cycle, and it is truly more critical in a XaaS model than ever before. Since customers are subscribing to an ever-evolving ongoing service, your customer success function is core to the solution itself and to the valuable outcomes that it delivers. In a very real sense, customer success IS part of the product; customer success IS part of the marketing; and customer success IS part of the sales force.

This approach requires both a significant mindset shift, as well as an execution shift – particularly for organizations that think of the customer service function as a cost center staffed with relatively low-paid employees or contractors, situated far from the strategic core. Increasing focus over the last decade on Net Promoter Scores and other measures have helped highlight the importance of this function, but still not as strongly as a XaaS model requires.

No NPS? Start Now

If you aren't measuring your Net Promoter Scores on an ongoing basis – start now. This will turn out to be a critical XaaS metric as we will discuss further in Chapter 4.

Since the customer success function is effectively part of the solution, and since the solution should be selling itself, it follows that customer success now becomes a critical part of the selling machine. This is not only about customer retention (another critical XaaS metric), but about customer expansion (upsell and cross-sell). In most XaaS companies, customer success and sales work very closely together to facilitate the growth of each customer account.

Bringing It All Together

The most critical thing to remember is that driving growth with a XaaS model requires well-defined goals, a clear positioning, and a highly integrated go-to-market plan. Hopefully this chapter has helped you pull some of that thinking together.

Chapter 4 – XaaS Metrics and Models

The title of this eBook talks about "Profitable, Recurring Revenue Streams," but so far, we have spent a lot of time reviewing the 'recurring' element, and less talking about profits. Now it's time to address that.

The Audience for This Chapter

What follows is a discussion of metrics and financial models, targeted primarily to the CEO or executive who is not a financial professional. (For you CFO types, I recommend The SaaS CFO blog as a good resource to review.) I have simplified concepts wherever possible, but precise accuracy of terminology or calculation is sometimes sacrificed. As a former public company CEO myself, I fully realize how complex FASB/ IFRS and GAAP accounting rules are (especially for public companies or those that want to become one someday). When the time is right, always seek the help of an accounting professional.

The domain of metrics for Something-as-a-Service (XaaS) businesses was developed on the backs of software companies that transitioned from perpetual license models to SaaS models beginning in the early 2000s. These models required a fundamentally different way of thinking about revenue and expenses versus non-recurring revenue models. Key differences include:

	Non-XaaS Businesses	XaaS Businesses	Implication
Timing of Revenue Recognition	Revenue is recognized when the customer takes possession of the product or receives the one-time service.	Revenue is recognized evenly over the life of the XaaS subscription.	This deferral could make your company revenues initially look like they are growing slower than a non-XaaS business.
Timing of Cash Receipts	Cash is received upfront.	Customers sometimes are allowed to pay over the life of the subscription, alleviating the large upfront investment.	Cash flow can be delayed.
Investment in Sales and Marketing	Promotion and sale of one-time purchase may be easier. Beneficial timing of marketing/ sales expense that is aligned with revenue/cash receipt.	Possibly more complex 'solution sale,' focused on valuable outcomes (with timing of marketing/ selling costs not aligned with revenue recognition).	Potentially more complex, lengthier marketing/sales cycles and larger upfront costs with no immediate revenue offset.
Investment in Customer Success	Tends to be 'you bought it, you own it,' with ongoing customer support often a paid extra.	Requires continuous (and usually increased) investment in ongoing 'customer success' to retain and grow customers.	More costly support investment than your business is used to.

Taken all together, it's not hard to see that shifting to a XaaS model could have a significant impact on profitability (at least initially). In fact – in the short term – the more you sell, the more money you are likely to lose! So why would anyone want to transition to such a crazy model?

Key Metrics

To answer that question, it's necessary to understand a few critical metrics that will become inputs to any XaaS operating/financial model:

Churn Rate

Apologies for starting on a negative note, but one of the most important metrics for a XaaS business is the rate of customer departures, or 'churn.' Usually, this is expressed as a percentage of existing customers that depart for the period you are considering (monthly or annually). For example: If you have 100 customers and, on average, two of them cancel or do not renew their subscriptions each month, then your churn rate is 2 percent per month.

Note that churn rate can be expressed both terms of the number of customers (as above) and also in terms of dollar churn. For example, in a given month it is possible that 'only' 2 percent of your subscribers churned, but that this resulted in 5 percent dollar churn because these customers were particularly large. Both customer churn and dollar churn should be monitored and investigated.

The opposite of customer churn is customer retention. The retention rate is simply 1 minus the churn rate. (2 percent monthly churn = 98 percent retention.)

On a more positive note, the concept of 'net churn rate' has been created to account for the net impact of losing some customers in the period, while also expanding others to buy more of your solution. Extending the example above: If your monthly churn rate was 2 percent, but you increased your revenue from existing customers by 4 percent (by up-selling an enhanced service or cross-selling a different offering), then your net churn rate is plus 2 percent.

XaaS financial models are very sensitive to net churn rates, which is one reason why the Customer Success function is so critical to XaaS businesses.

Monthly/Annual Recurring Revenue (MRR/ARR)

Since your XaaS business is now selling a subscription to your solution, it is now possible to think of your revenue stream in terms of monthly or annual recurring revenue, depending on how you decide to run your business model. (In general, lower-priced solutions targeting SMBs and mid-sized businesses tend to think in terms of MRR, while larger-ticket solutions targeting enterprises think in ARR terms.)

Using Monthly Recurring Revenue as the metric, it is calculated as follows:

Ending MRR = MRR at the start of the month
+ Monthly revenue added from new customers in the month
+ Monthly revenue from expansion of existing customers in the month
- Monthly revenue lost from churned customers in the month

(You will note that the last two components equal net churn)

Obviously, since it accounts for the addition, expansion, and churn of customers, this is one of the most important and closely watched XaaS metrics by executive teams, investors, and other key stakeholders.

Active Users/Customers

Monthly Active Users (MAU) is a metric commonly used in SaaS companies that tracks the number of system users that actively completed a task with the system in the last month. If the ratio of active users to total (paying) users is low, that is a clear sign that the solution is probably not delivering the value to users that it intends and that churn is likely to become an issue.

Outside of the world of software, the notion of tracking active usage metrics is equally important. Your definition of an ‘active customer’ can vary, depending on what is appropriate for your offering, but the same logic applies. Strong growth in the number of active users tells you that your business is gaining traction and appropriately delivering the outcomes that the market requires. This metric is especially meaningful when used in conjunction with Net Promoter Score (discussed later in this chapter).

Customer Acquisition Cost (CAC)

Simply put, this measure is an indicator of how much it costs you to acquire a new customer. More complex models can also take into account the cost of expanding revenue from existing customers. Specifically:

CAC = Total expenditure on customer acquisition (sales and marketing)
/ Number of new customers acquired in the period

CAC can also be calculated on a dollar basis (with the denominator being the dollar value of new customers acquired). In either case, the logic is similar.

Obviously, a lower CAC is better than a higher one, and understanding this metric in your business can lead to good discussions around the efficiency of your go-to-market plan, and whether particular marketing and sales initiatives are driving your CAC up or down on average.

Customer Lifetime Value (LTV)

Since they are often used together, a close partner to CAC is Customer Lifetime Value – basically, the essence of the power of a XaaS model. It is calculated as follows:

LTV = Average revenue per customer (over the period in question – month or year)
x The number of periods that you expect the customer to be retained

Obviously, the higher the churn rate, the lower the average LTV of your customers.

LTV/CAC Ratio

Now that you have the LTV and CAC estimated, it is possible to calculate the LTV/CAC ratio. As you can tell, this one metric basically incorporates all the previous metrics. Given the margin structure that Software-as-a-Service businesses generally target, a LTV/CAC ratio of 3.0 or better is a common goal for high-growth businesses. A ratio below 1.0 is an indicator that a business is having to spend too much to acquire customers, relative to what they return. A ratio above 5.0 might indicate they aren't spending enough on acquiring customers – meaning there is lots of untapped market opportunity being left on the table.

Another way to think about LTV and CAC is in terms of the 'payback period'. For example, a LTV/CAC ratio of 3.0 might imply a LTV of $3,000 (over a 3 year period) and CAC of $1,000. Therefore, the payback period would be one year. We dive deeper into this in the model example below.

The value of this ratio that makes the most sense for your business will depend on your margin structure and your appetite for investing in future growth. To calculate this for yourself, you need a model.

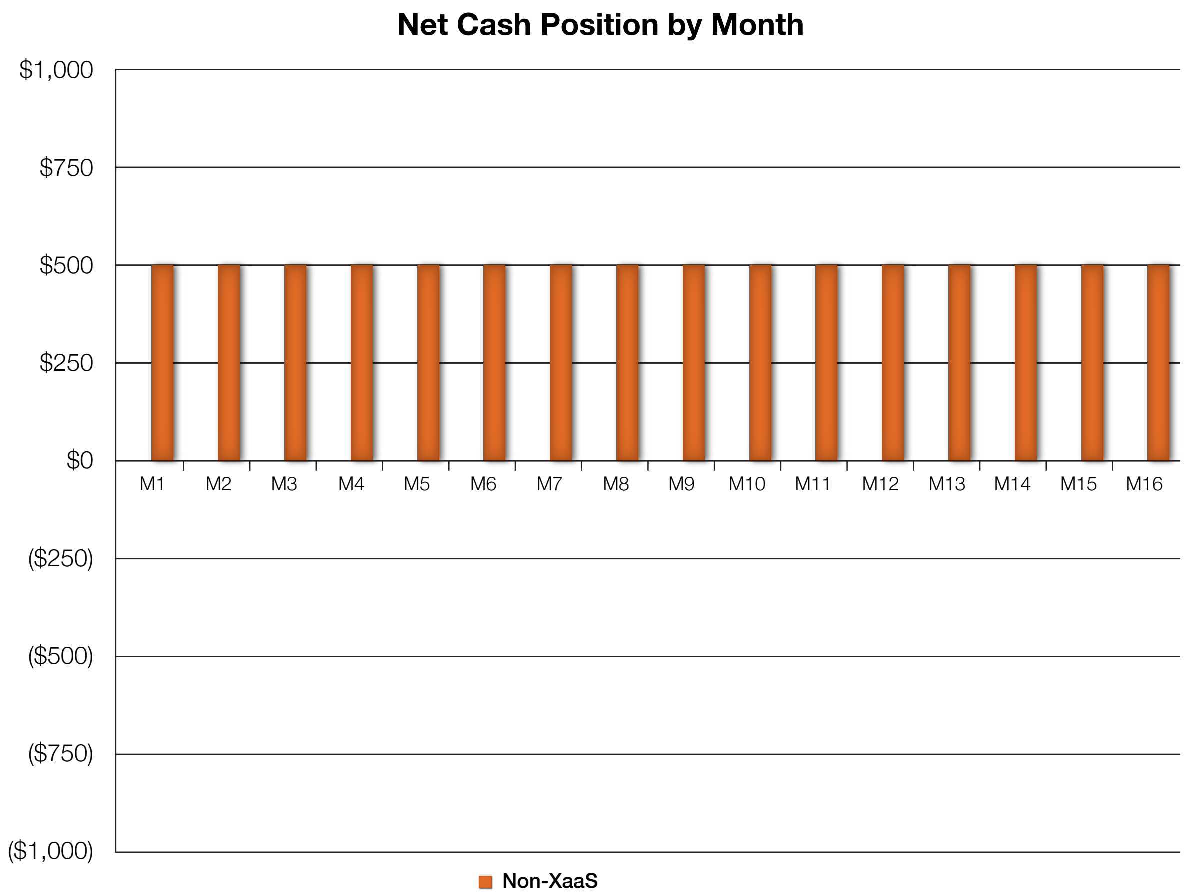
The Power of the Model

By now, you probably have gathered how a XaaS financial/business model would be constructed, based on the key model inputs described above.

Let's oversimplify, and compare a non-XaaS model to what could be a substitute XaaS model for a similar offering. Here are the assumptions:

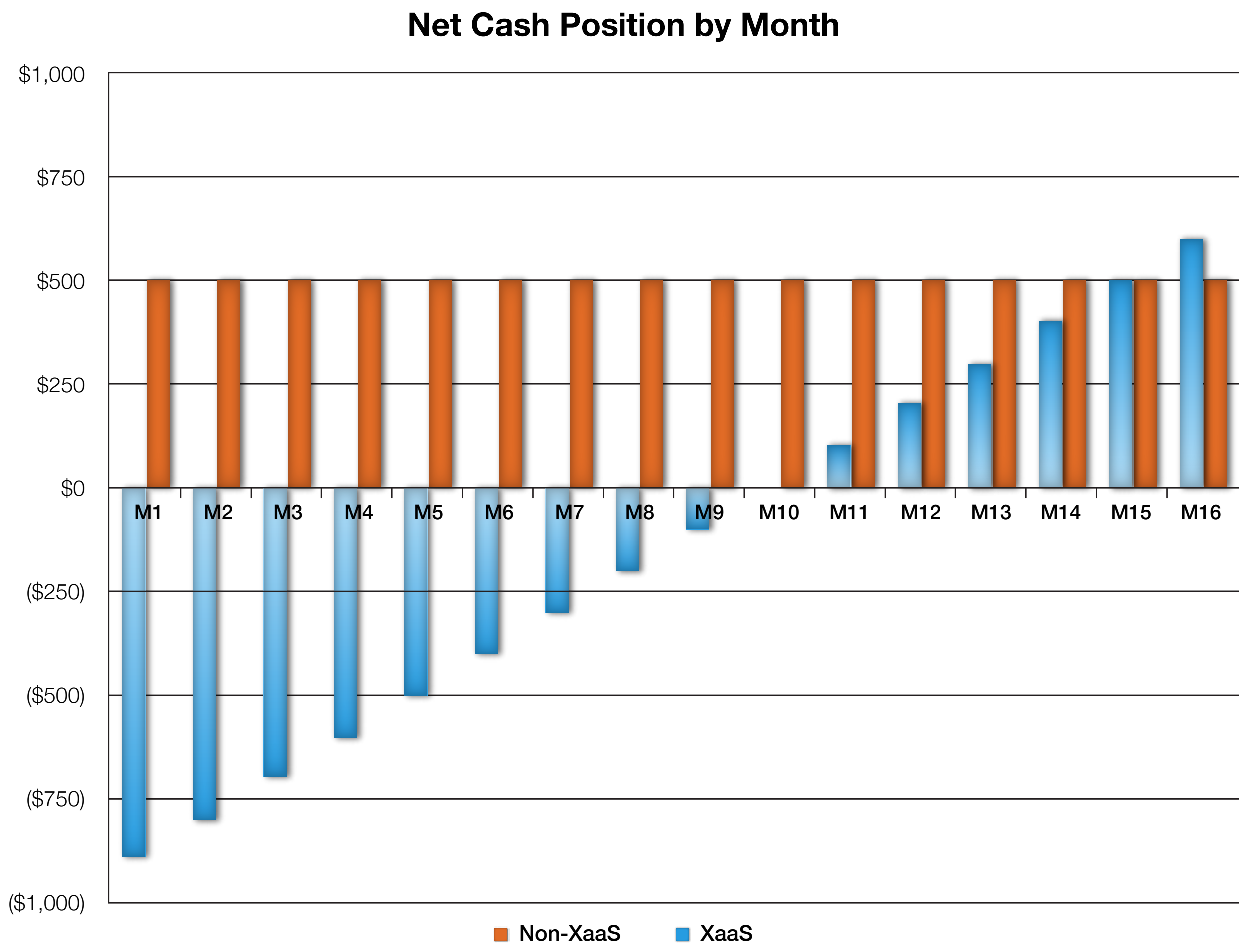
- Non-XaaS, upfront price: $1,500
- XaaS MRR price for XaaS version of offering: $100/month (assumes the customer actually pays monthly)
- CAC: $1,000 (upfront sales and marketing cost to acquire the customer)
- LTV: $3,600 (assume the average customer stays for 3 years)

First, let's see what the net cash position looks like for the non-XaaS model:



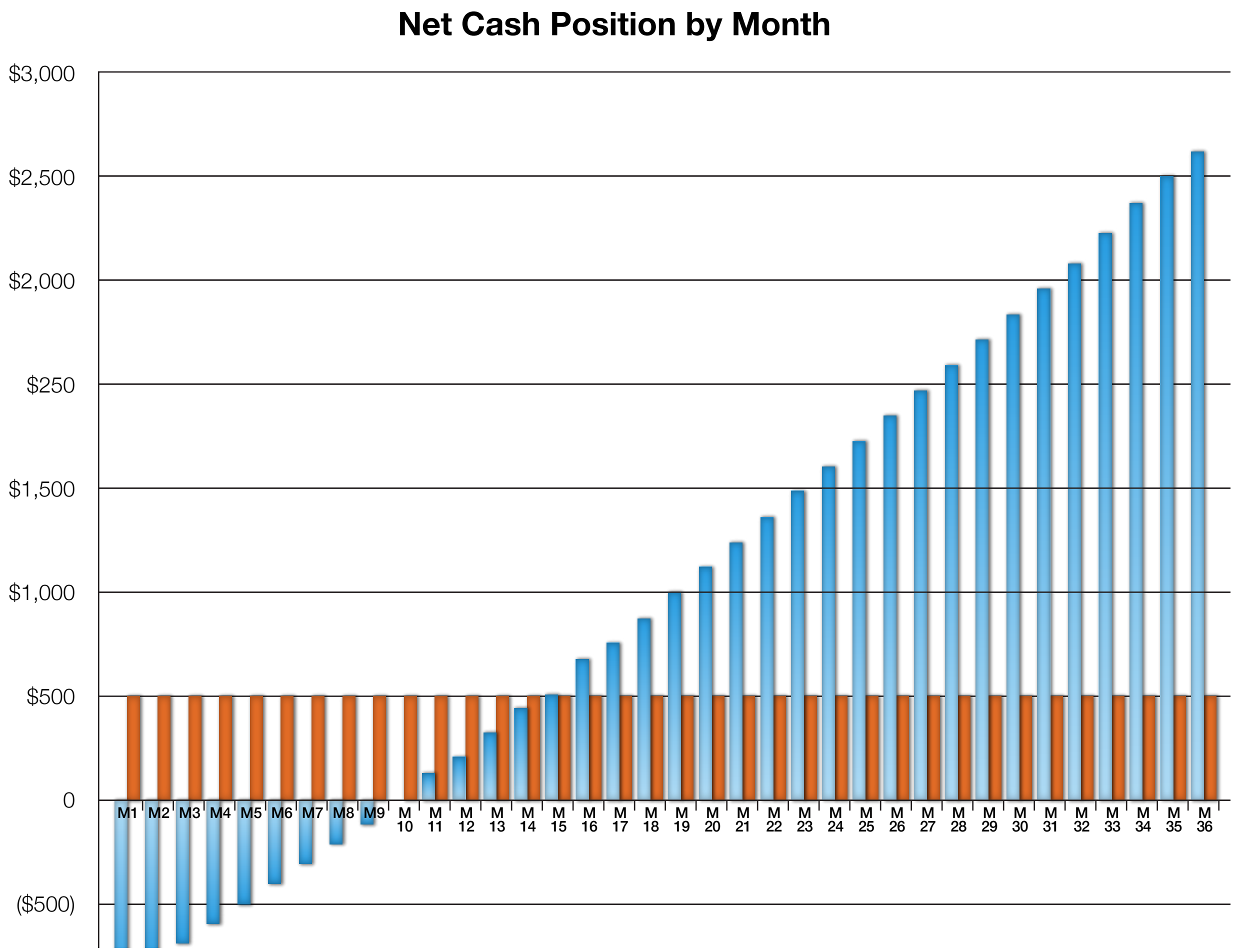
Pretty simple. Because CAC is $1,000 and the price (paid upfront) is $500, the business is immediately in the positive by $500 cash. In our super-simple model, this doesn't change over time – everything is static for non-XaaS businesses, until an attempt is made to 're-sell' their customers to get them to buy the next product or enhancement.

Now how does this compare to our XaaS model? One word: yikes!



While the non-XaaS business remains cash-flow positive $500 all the way through, the XaaS version of this model loses $900 in the first month ($100 MRR minus the $1,000 CAC). It's not until month 10 that this customer becomes cash-flow break even (this is the 'payback period' referred to earlier). But notice that something magical starts to happen in month 16.

Let's zoom out a bit more:



Now the full power of the XaaS recurring revenue model becomes clear. Since the customer stays for 3 years ($3,600 LTV), without additional marketing/sales cost, the cash/revenue begins to really pile up. And if net churn was negative (you grew existing customers at a rate faster than you lost them), the curve would begin to arc up even faster!

This chart shows fundamentally why CEOs are adopting XaaS models (and investors are rewarding those that have them).

Now, you may question the assumption of putting the non-XaaS price at 'only' $1,500 while the XaaS MRR was $100. Hopefully the earlier discussing of pricing explained why this could be possible. As we discussed in the pricing section of Chapter 3, do not simply take your non-XaaS price, and divide by the LTV period. A XaaS model provides continuous, ongoing, and ever-improving value, based on the outcomes you are delivering over time.

You are truly focused on the success of your customers and they feel it. Yes, this model could cost more in developing and delivering the service, but the net effect is still likely to be highly positive for customers, and you should be able to price accordingly.

I'll avoid a more extended spreadsheet exercise here, but the concept of developing a XaaS financial model (based on your existing financial model) should be fairly clear:

- Start with your current P&L model;
- Add assumptions (based on your research) for average key XaaS metrics per customer (churn rate, LTV, CAC, MRR);
- Extend the model using these assumptions by adding in the relevant periods (i.e., if you are using MRR then your model will need to be built out by month. This means your current model – which is probably quarterly – will need to be enlarged).

If you would like to start from a template, or just take a look at one, here are a few good resources:

- Simple template (Google Docs);
- Here is a complete but more complex model from the SaaS CFO blog (that only your CFO will love – but larger or public companies will want a model with this degree of completeness);
- And here is a model that sits somewhere in the middle, in terms of complexity.

Bottom line: Your main role here as the CEO is to help set the key assumptions of the model. Building the model, itself, can be left to your financial wizard or spreadsheet guru.

Net Promoter Score

Before we leave the topic of metrics and models, it makes sense to briefly touch on the importance of the Net Promoter Score (NPS) to any XaaS business. Very briefly, the concept of NPS is to ask your customers a simple question:

"On a scale of 0 to 10, how likely are you to recommend <solution> to a friend or colleague?"

The calculation of your overall score is quite simple – basically tally the percentage of responses that give scores of:

- **0 to 6:** These are your 'Detractors' – they will actively say negative things about your solution to other potential customers.
- **7 and 8:** These are your 'Passives' – they will generally avoid stating a strong opinion to potential customers about your solution.
- **9 and 10:** These are your 'Promoters' – they will actively say positive things about your solution to other potential customers.

The NPS is the percentage of Promoters **minus** the percentage of Detractors. For example: if 50 percent of your respondents to an NPS survey were Promoters, and 20 percent were Detractors, your Net Promoter Score would be plus 30 percent.

Benchmarks vary widely by industry but, in general, really good NPS scores are greater than plus 50. Those scores falling between 0 and 50 denote that some work needs to be done; and below 0 is a huge warning sign of a solution/business in trouble.

As you can tell from the metrics discussion above, NPS is even more critical to a XaaS business, since the model is so sensitive to net churn (customer expansion minus departures). Improving or dropping NPS scores can form a powerful **early warning system** to use in predicting future trends of these key XaaS metrics.

A NPS Rule of Thumb

As a very rough predictor of the average lifetime (in years) of your customers, take your NPS score and divide by 10. So, a NPS of plus 30 would translate into an average customer lifetime of 3 years (the average customer is retained for 3 years before churning). Use this rule of thumb with caution but perhaps there is some applicability to your business.

If you aren't already using NPS (and many, many are), then you should begin immediately – so you have benchmarks in place prior to your XaaS transition.

Your North Star Metric

A concept being discussed increasingly today in XaaS circles is the notion of a 'North Star Metric'. It is easy for XaaS companies to become overwhelmed by all these new metrics and measurements and thereby lose sight of the forest for the trees. A North Star Metric is the single metric which truly reflects the success of the business – it is the leading indicator that the company focuses on, above all others, to denote the success of the business.

Your North Star Metric might be NPS, or monthly active users, or any of the above. It might also be a metric not discussed here. It is likely that your north star will change over the evolution of your business (i.e., early stage XaaS businesses are sometimes more focused on growth than profitability). Whatever your situation is, pick a North Star and focus like a laser on it.

For more on this topic, please see here for a great article describing North Star Metrics.

Chapter 5 – Final Tips for Successful XaaS

Congratulations – you have made it a long way! It has been my goal to provide a practical and actionable overview of the drivers, characteristics, and execution models that should apply to most XaaS businesses (or business transitions).

It's easy to talk from the world of theory but I, like you, am a practitioner in the real world. During the last 15-plus years, I have been the head of marketing, head of products, or CEO of companies that have used XaaS models. In most cases, those companies were transitioning from a non-XaaS model (which I believe is even more challenging than starting one from scratch). Based on that experience, let me share with you a few final tips, tricks, and cautions.

XaaS and non-XaaS are fundamentally different ways of operating.

Don't let the discussion of metrics and financial modeling trick you into feeling that transitioning to XaaS is primarily a spreadsheet exercise. As covered in detail in this eBook, these two business models require fundamentally different operating models.

Because of that, it turns out to be **very** difficult for a company to run both non-XaaS and XaaS models simultaneously – and nearly impossible to do so for the same offering (product or service). Every organizational 'motion' is so distinct for XaaS, that trying to do both at the same time usually results in confusion and neither method being executed well.

Pro tip: If you are going to run both XaaS and non-XaaS models in your business, treat them as separate business units, with unique and largely independent marketing, sales, support, etc. This may feel like you are duplicating effort in some areas. That may be true to some degree, but better to duplicate, than to fail. An incomplete XaaS transition/model is the No. 1 failure mode I have seen for companies attempting to use the XaaS model.

Customer Success becomes the new power-center in your company.

Because NPS and net churn are such critical metrics in your model, it is more important than ever before to embrace a customer-first mindset and execution model.

Pro tip: Fund this function appropriately. Hire the very best leader you can afford (hopefully with XaaS experience). And then give the team a quota for retaining and expanding customer revenues.

Lock them in.

To maximize retention and minimize churn, successful XaaS companies 'lock in' their customers. Customer lock-in (also referred to as 'stickiness') is achieved when the pain that a customer will incur by churning is much higher than the gain they will get by doing so. Sources of customer lock-in might include:

- The benefits (outcomes) of your solution are so much better than any available alternative that there truly is no alternative;
- The solution is so much less expensive than any alternative. (Warning: price advantages are usually ephemeral);
- Your solution is deeply integrated into the customers' operations or other systems, in a way that would make it difficult to pull them apart.

Pro tip: Spend time thinking specifically about how to increase the lock-in of your customers. Powerful approaches to driving stickiness rarely happen by accident. One great method: simply ask some customers what you could do that would make it even less likely for them to leave. You might be surprised at what you learn.

Understanding churn is key to long-term success.

Many companies spend a lot of time and effort understanding why they lost deals during the selling cycle (win/loss analysis). In the world of XaaS, a lost (churned) customer is even more critical than losing a deal, since the whole power of the XaaS model is predicated on retaining subscription revenues in the long run, at minimal ongoing marketing/sales cost.

Pro tip: Make 'churn analysis' a critical function at your company. Assign this duty to a specific person, and review the results at least quarterly. Whenever a customer churns, the first priority is always to win them back. But, if that's not possible, then find out precisely why they churned, and track these reasons over time. Then, make adjustments to your strategy or execution to address the root causes.

Not all churn is bad churn.

Sometimes, churn can actually be a good thing. In many cases, a small percentage of customers drive the vast majority of customer support incidents. Sometimes, 'squeaky wheel' customers cause changes to the product or service roadmap that are not necessarily creating value for most customers. In those cases, churn can be a net-positive for the company.

Pro tip: Don't wait for low-quality customers to churn on their own. On an annual basis, do a customer profitability analysis. For the least profitable 25 percent of customers, consider changes to strategy or execution that could make them more profitable. For the least profitable of all (or any that are money-losers), be prepared to make a hard decision, and proactively part with these customers – unless there is a clear and critical strategic reason for continuing with such customers. Remember: Hope is not a strategy.

Standardization is essential.

Although you are delivering your solution in the form of a 'service', this does not imply that the service should be unique for each customer. Quite the opposite! A common failure mode encountered by many XaaS companies is when every customer is basically sold something different – which quickly becomes impossible to support at any scale. Such an approach may help ease the selling process up-front, but will ultimately cause customer dissatisfaction and lead to either churn or significantly reduced profitability.

One particular area where complete customizability impacts a XaaS business is in terms of pricing. If every deal is priced as a custom deal, then billing becomes extremely challenging. Many XaaS businesses leave money on the table because they effectively lose control of their billing processes.

Pro tip: Think in terms of configuration, not customization. Allow customers to configure your solution to their needs by choosing from options that you have pre-set for them. This applies to both the price list and the product, and allows you to control complexity vs. the free-for-all of complete customizability.

Your runway needs to be longer than you think.

Whether you are a new business, or a mature business transitioning to this new model, most of your key assumptions will have inadequate grounding. Market and 'voice of the customer' research can definitely help – and should be carried out by an outside professional to avoid bias – but even small nuances in the offering and go-to-market plan can result in big differences to the outcomes.

Pro tip: Create an 'expected-case' model to set targets for your team, but use a more conservative model for financial/cash planning. And this relates to my final tip:

Investors will be on your side – but only if you are honest with them.

As we have seen, there are many uncertainties and complexities involved in a XaaS transition, but the payoff can also be significant. Fifteen or even 10 years ago, most investors did not have a good understanding of the potential upside, and were impatient with the negative short-term consequences of adopting a XaaS model. The good news is that this now has changed.

Pro tip: Involve your investors early and often in the processes described above, including goal setting, solution positioning, go-to-market planning, and financial modeling. And don't forget that some of your most important investors are, in fact, your employees.

Perhaps you are the 100 percent owner of a private company – in this case, the investor you need to be most direct and honest with is yourself!

I hope you have come away with a deeper understanding of why and how to adopt a XaaS model. For more on this and other topics, please subscribe to my blog at the bottom of this Web page and always feel free to reach out to me directly with questions, comments, or to learn more about Chief Outsiders at bmathieu@chiefoutsiders.com.

About the Author

Blaine Mathieu

Blaine is a recognized expert in XaaS models and is focused on helping businesses grow rapidly by clarifying their market strategy/positioning and matching that with effective go-to-market plans. As a multi-time Chief Marketing Office and former CEO, he has 25+ years of experience in growing startups between 50 and 500 employees and in prominent private and public companies including Gartner, Adobe, Corel, Selectica, GoodData, and most recently with national management consulting firm Chief Outsiders. He holds undergraduate Business and MBA degrees from the University of Alberta and Athabasca University in Canada.

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