

# Software Investor: Software as a Service Beyond Tipping Point

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By Renee Boucher Ferguson

Ann Winblad, a co-founding partner of Hummer Winblad Venture Partners and to many in the software industry a bellwether of successful trends, believes that software as a service is beyond the tipping point of customer adoption.

With SAAS no longer the domain of small companies that can't afford on-premises software implementations, users extend across a broad swath of small, midsize and enterprise companies, according to Winblad.

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And adoption is continually on the rise. Winblad points to several recent analyst reports to underscore her point: a survey by AMR Research that says 40 percent of companies are using hosted CRM (customer relationship management) applications, while 49 percent intend to use on-demand applications on an incremental basis; an IDC report that shows SAAS growing at 29 percent annually; and an Aberdeen Group report that said 70 percent of 631 companies surveyed are looking at or planning to use SAAS.

What's not in place for the nascent industry is traditional channel partner adoption. That model—one promulgated by the biggest software companies in the world, such as Microsoft and IBM—relies on partners and integrators to both develop on top of and resell another company's software products to customers.

"VARs and SIs [systems integrators] have lived off this model for the past 30 years—that's why they exist," said Winblad, from her San Francisco office. "That channel is gradually changing."

Winblad said she is seeing companies such as Accenture and IBM start to play a bigger role in the SAAS market—but they are just at the beginning. It's only when those "old-fashioned" channel partners have figured out how to play in the SAAS paradigm of subscriber license fees (versus perpetual-license fees), and quick ROI (return on investment) versus months-long projects, that the SAAS market will see another point of acceleration.

Winblad is in a unique position to understand the trends and vicissitudes of an emerging market. Her company, founded nearly 20 years ago, was the first venture capital fund to invest exclusively in software companies.

Over the years, Winblad and her partners have funded companies based on distributed network computing, the Internet and SAAS, as well as desktop software, embedded systems and client/server technologies.

Hummer Winblad's first SAAS investment was in 1998, with Employease, a company that today has more than 1,500 companies using its on-demand human resources software. All told, Hummer Winblad has invested in 11 on-demand companies.

In sussing out on-demand companies to invest in, Winblad said she looks for "true" SAAS companies.

"We see a lot of fake SAAS companies," said Winblad. "They are not multitenant; they have not done the hard technical work to build the applications. This is not easy to build. They have to have management that's thought this out before; they have to be truly multitenant."

Multitenant occurs when a software company puts all its customers on a single server so that software upgrades—which happen frequently in the on-demand world—can be distributed at once, to all users.

[Click here](#) to read about security issues with SAAS.

The on-premises model, on the other hand, calls for a single-tenant model, in which each customer's software implementation is on a separate server from other companies that may be using the same software.

In addition to multitenant capabilities, Winblad said on-demand software must be built using a services-based architecture that supports open standards, which in turn facilitate easier integration.

Then Winblad looks at market opportunities—underserved markets (such as the midmarket, which does not have the breadth and technical staff to take on on-premises software) and new categories such as business intelligence for Web analytics.

She rattled off a number of companies under the Hummer Winblad umbrella—Five9, Infopia and Employease—that represent specific processes that could not have been done with on-premises software.

**Next Page:** Some misconceptions about on-demand software.

"It's been quite an exciting space to look at," said Winblad. "We really have looked for core new areas that are business processes that are core

to multiple enterprises, not just one vertical, and have the same characteristics: rapid deployment, rapid ROI and core processes for mid to large companies."

Hummer Winblad also invests in companies that have a Web services element but aren't strictly modeled on SAAS. For example, it funds a company called Widgetbox that has a Web services architecture but is not multitenant. It also funds open-source companies that have yet a different model, one in which they have their own open-source stacks and use them to assemble portfolios.

The bottom line for Hummer Winblad: companies that represent massive changes, according to Winblad.

"Open standard, open source, virtualization, grid computing, SOA [service-oriented architecture] and the ability to deliver software as a service," said Winblad. "If you look at our portfolio, we have very few client/server companies."

But despite the rise—and use—of on-demand software, there are still some fundamental misconceptions to overcome. The first is that SAAS is mainly easy-to-deploy software with variable pricing for small businesses.

What is Microsoft doing to keep up with SAAS? [Click here](#) to read more.

"There would be a lot of incumbent companies that would like to continue to cast SAAS as that, but it's not true," said Winblad. "When we look at the SAAS market, it is a broad brush across small, mid and very large customers."

Another misconception about SAAS is that the applications are difficult to integrate with other on-demand applications and, more important, with on-premises applications. "That is a fabrication from companies that are not part of it," said Winblad. "The truth about this is that all these companies that are true SAAS—multitenant—are built on a services architecture and integration platform that makes it easy to integrate with each other and with on-premises software."

What's driving adoption of SAAS is the ability for customers to choose best-of-breed software and look at the way their businesses really operate, according to Winblad. "That's why you're seeing new categories like spend management [that represent] business processes that can bring a very, very rapid ROI to a corporation," she said.

Despite the rosy picture, there are some basic pitfalls for SAAS companies to overcome. Mainly it's about execution: the ability of startups to continue to execute in the face of not only mounting customer demand but also increasing competition from relative stalwarts such as SAP, Oracle

and Microsoft, each of which is making a play in the on-demand applications market.

Customer demands on software vendors never lessen, which means a lot of execution pressure on SAAS companies, according to Winblad. "There are some big poster children, certainly Salesforce.com, and the stronger they are, the stronger the whole segment will be," she said.

At the same time, on-premises competitors have yet to come out with true multitenant software to compete head-to-head with smaller, pure-play SAAS vendors.

SAP has a "hybrid" model of single-tenant software with multitenant upgrade capabilities; Oracle acquired Siebel, which has multitenant capabilities but not under the Oracle stack; and Microsoft is expected to come out with its multitenant CRM version, code-named Titan, in the second quarter of 2007.

Does that mean companies may, at some point, turn solely to on-demand software for their enterprise needs? Not likely, according to Winblad.

"Are people going to rip out SAP? No, they're not going to throw out the baby with the bath water. They're just slowly going to drain the tub," said Winblad. "They're going to really look at what their business processes are and say, 'What are the things we can have as a service, and what are core proprietary?' Whatever is your competitive advantage."

The shift won't be an easy one for the software industry, it seems.

There is a period of time where a certain number of old-guard software companies will make radical adjustments—a move that's necessary, according to Winblad.

"SAAS is about fundamental models: how you price software, how you compensate sales, how you develop. It's a fundamental change in business models and cultures. In software communities, that is probably the hardest thing for incumbents," she said.

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