Why SaaS Makes Sense in a Slow Economy

When the economy takes a downward turn, corporate IT budgets are usually one of the first casualties, as has happened in the current recession. According to an October 2008 CIO Magazine survey, 40% of 234 IT chiefs surveyed said that they have cut spending, essentially freezing or scrapping new IT initiatives.

However, technology is a critical element of business, and despite the current economic climate, the need for reliable IT remains the same—especially when it comes to fundamental business applications, such as email or customer relationship management (CRM). As companies across all industries face tough decisions about where to put their limited dollars, three key reasons exist as to why a hosted or “software as a service” (SaaS) model makes great economic sense.

Financing

Most companies rely on some form of financing for their technology purchases (hardware or software), either through a vendor-sponsored payment plan, a specialty leasing agent or a straight bank loan. When credit markets are tight, as is the case in today’s market, it is difficult for many organizations, particularly smaller businesses and non-profits, to secure technology financing.

On October 27, 2008, *The Wall Street Journal* reported a jump in defaults on technology financing loans, which came after “years in which such loans flowed freely.” During this period, lenders regularly offered technology financing at 0% interest or no money down to businesses with limited liquid assets—mirroring the risky (if not reckless) approach that led to the meltdown of the subprime mortgage market, and the results have been similarly disastrous. According to the Equipment Leasing and Finance Association, which represents 700 lenders, the number of equipment loans written off as losses jumped from .48% in September 2007 to .86% in 2008, a leap of nearly 80%. Baytree Leasing Company LLC, which specializes in technology financings, confirmed that in October 2008 its default rate for commercial businesses was between 1% and 1.5%. To provide some perspective on these figures, the research firm Aite Group has predicted that in Q3 of 2008 the percentage of real estate loans being written off as losses by the top 100 U.S. commercial banks will be around 1%.

As a result of the spike in defaults, specialty lenders and banks, on which companies once relied to fund their IT initiatives, are now charging higher interest rates and requiring more money down, making it

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much more difficult to secure financing. Long gone is the zero-interest loan. Today, the standard interest rate for small businesses hovers around 8.25%.

Joining banks and technology financing businesses, hardware and software vendors that lend money directly to customers are also toughening their terms. Many now require a significant upfront payment—often up to 50% for software—in order to offset the risk of default. (Software vendors suffer more from defaults because reselling used software is illegal. Reselling used hardware is not.)

The impact of the financing crunch on smaller businesses is two-fold. First, it is simply harder to secure loans. In October 2008, the CIO Executive Council reported that nearly 20% of 31 CIOs surveyed postponed or canceled purchases *specifically because of unfavorable credit terms,* demonstrating how difficult, if not impossible, it now is for many companies to implement on-premise IT deployments—and foster growth—because they just can't afford them. In addition, in a down economy, while overall costs are important, day-to-day cash flow is vital. That means that even when financing is available, the jump in upfront payments can be a deal breaker for many smaller companies.

Second, when money is tight, few companies want—or can afford- to take on unnecessary risk. For IT executives, risk comes in the form of long-term commitment to a particular hardware or software purchase. If a company *is* able to secure technology financing in a difficult credit market, the costs have increased, reducing the overall ROI of the technology acquisition, which translates into increased pressure for the investment to result in to a successful IT initiative.

Flexibility

A word commonly used by the media in a down economy is "uncertainty." *Uncertainty about the markets. Uncertainty about employment. Uncertainty about the future.* Despite endless analysis and predictions from expert (and highly paid) financial pundits, the truth is that no one really knows when things are going to get better. While frenzied speculation keeps media outlets around the world in business, speculation is exactly what it is. In July 2008, the ever provocative *Huffington Post* featured a blog entry by Margaret Heffernan called "The Recession Narrative: Pundits Know Nothing."

For smaller businesses, the one certainty about uncertainty is that it demands flexibility around IT infrastructure and applications. In this case, flexibility means the ability to accommodate growth *and*

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reductions. While in-house software can scale up as your company grows, it doesn't work the other way around. The same goes for the associated hardware.

Take Microsoft Exchange for email. If a company with 500 employees uses an in-house Exchange server, in addition to buying all the hardware (primary and backup servers, networking equipment, storage, etc.), it must also buy 500 client access licenses (CALs) and pay for ongoing support. Each CAL costs around $70 and is non-refundable. As the company grows, it must purchase a new CAL for each employee, even if that person is a seasonal or temporary hire for the holidays, a common situation when businesses can't afford to staff permanent positions. Most (if not all) employees need email accounts, regardless of how long they are going to be around to use them.

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For on-premise deployments of CRM software, user licenses are even more expensive. For example, a single user license for Oracle's Siebel CRM Professional for mid-sized companies costs $350 for a base application (sales option, service option or marketing automation). Add-on modules for additional functionality run from $60 to $2500 per module per user, and support is an additional annual per user fee.

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If that same company suddenly needs to lay off 20% of its workforce, then it now has 100 CALs that it can't use, plus an undetermined number of Oracle/Siebel licenses that it can't use (assuming that not every employee uses all elements of the company's CRM system). That amounts to a lot of money down the drain for the business, especially when money is already tight.

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The flexible SaaS model, on the other hand, is based around scaling the software up *or* down with your business. Hosted solutions allow you to add users on demand *and remove them on demand.* You pay on a monthly basis for only your active users. In a down economy, the likelihood of having to lay off active users goes up, which is why this approach makes sense when business is slow.

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A SaaS model also allows you to add and remove software, not just users, on demand. For example, you could lease SharePoint just for a special six-month project. Or you could decide that your business just can't afford mobile connectivity for every user right now. In an on-premise solution, you have already paid for the functionality, so you're in a "use it or lose it" situation. In the SaaS model, you can turn off mobile connectivity, and then turn it back on in three months when cash isn't as tight.

The flexibility of a SaaS model also results in faster ROI. With in-house software, you have to buy everything, set it up, test it, etc. It may be a long time before your company sees any value from it. With SaaS, you see instant results, or at least much quicker results, which is always important, but the importance of which increases in a down economy.

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Staffing

While layoffs may be inevitable in a down economy, your customers will expect the same level of attention, service and quality that they have always received. Successful companies recognize this and go above and beyond to preserve customer loyalty by showing that its business as usual, even when it's not.

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Moving to a hosted or SaaS model allows you to reduce your headcount without impacting the customer experience. How? Because it eliminates the need for expensive in-house IT experts. For example, if you utilize Microsoft Exchange for your email, proper maintenance requires at least one full-time, trained IT professional, who can easily cost six figures in annual salary and benefits. Freeing up that money will allow you to save positions that will have a direct impact on your customers.

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In October 2008, the U.S. Bureau of Labor Statistics reported that 2,269 companies cut at least 50 jobs in the previous month, the highest number since the aftermath of the September 11 attacks. Many economists predict that unemployment will jump from the current 6.1% to near 8% or 8.5% by the end of 2009, resulting in the highest unemployment rate the country has seen in more than 20 years.

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While the accuracy of those predictions has yet to be determined, the current reality is bleak. When layoffs are unavoidable, a SaaS model can help preserve the positive experience that your customers have with your company.

Conclusion

In any economy, there's no question that SaaS solutions are a smart option for smaller companies. They can be up and running quickly. They don't require a degree in computer science to administer. They are reliable. They can scale with your business. They even reduce your organization's impact on the environment.

In a recession, however, the benefits of SaaS are even more pronounced. While budgets everywhere are being squeezed or cut, businesses must continue to operate, and essential business applications, such as email or CRM, as well as productivity and customer service simply can't be compromised if companies are to stay competitive. This puts a great deal of pressure on companies to spend their money wisely. When every penny counts more than it ever has, the cost structure and flexibility of hosted solutions, along with the fact that they don't require expensive in-house IT expertise, make the SaaS model an especially wise choice.

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