paddle

Survive or thrive

How operational efficiency can strengthen SaaS in a downturn





The only complete provider of payments infrastructure for SaaS companies.

Paddle helps SaaS companies grow faster with fewer distractions. As a SaaS merchant of record, we take away the complexity of managing a 'best in breed' payments stack — handling all payment routing, tax collection, compliance, invoicing, subscription management, renewals, reporting, and fraud protection.

Learn more at **Paddle.com**

paddle

Contents

INTRODUCTION

How the SaaS market has changed in 2022 **4**

PART ONE

How SaaS businesses have responded **11**

- Cash runway
- Headcount planning
- Customer retention
- Account expansion

PART TWO

What will SaaS prioritize in 2023? **20**

PART THREE

Three steps to SaaS success in 2023 **24**

INTRODUCTION

How the SaaS market has changed in 2022

From rising inflation and interest rates to cost-of-living and energy crises, geopolitical and economic uncertainty has cast a dark cloud over major SaaS markets in 2022.

With the US, UK, and Eurozone heading into recession, what has been the effect on global SaaS and how can companies successfully ride out the storm?



> While no SaaS company will completely avoid the scars of recession, there are opportunities for companies to emerge stronger and get ahead of the competition. Those with the ability to overhaul processes and boost their operational efficiency should be feeling particularly bullish.”

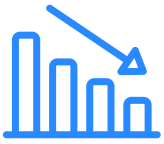


Christian Owens
CEO, Paddle



The bad news for SaaS

On the one hand, SaaS is not immune to the global downturn.



Valuations are falling

In March, Social Capital CEO Chamath Palihapitiya explained[1] that investors would pay 8 x ARR for a SaaS company when interest rates are zero, but for every 1% increase, the valuation decreases between 15 and 20%. With interest rates heading north, valuations for private and public SaaS are tumbling (the average market capitalization is down[2] 57% YoY).



Restricted access to capital

With non-existent rates and easy access to capital, many SaaS companies focused on all out growth over the past few years. Now that capital is more expensive, investors are holding back and SaaS scale-ups are having to reign in their spending to avoid downrounds.



Consumers (and businesses) have less purchasing power

With the increasing cost of living, consumers are monitoring their expenditure and reducing 'nice-to-have' subscriptions. B2C SaaS will feel the heat first (greater churn and less sales), which will filter through to B2B SaaS as businesses increasingly have less revenue.

The good news for SaaS

On the other hand, SaaS companies are uniquely placed to ride out the storm.



Historical performance

SaaS has only experienced comparable economic conditions once before and passed the test with flying colors. Between 2008 and 2010, over 80% of SaaS companies grew[3] during a recession and many SaaS giants, such as Slack and Asana, were born.



Popularity

SaaS is firmly embedded in the world of work. In 2021, 99% of businesses used[4] at least one SaaS product and global spend on SaaS surpassed $150 billion. Given its integral part to working lives in every industry, especially the move towards remote working, SaaS is verging on ‘must-have’ status.



Efficiency opportunities

With record levels of investment, the SaaS mantra was ‘spend, spend, spend’ without much care for operational efficiency. Now SaaS needs to cut costs, there is a wider scope to improve efficiency than other industries by simply focusing on metrics and unit economics.

An optimistic market?

To cut through the noise and get a clear picture of the SaaS landscape, **we asked 100 SaaS Founders, CEOs, CFOs, and Finance Leaders what's been happening in practice.**

From increasing demand to healthy margins, SaaS confidence varies according to specific products, business models and markets, but many forward-looking companies share one common trait: a shift in mindset from growth at all costs to lean operations and sustainable growth.

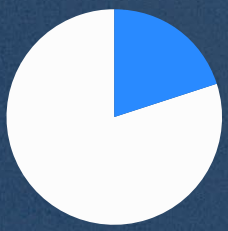
Be it extending the cash runway or accelerating towards profitability, managing resource costs or prioritizing retention, having a clear strategy for the next 12-18 months is key to navigating today's choppy waters and taking advantage of the calmer seas on the horizon.

> **There will always be crises, but when you get through them you have proved your company's right to exist!**
>
> Source: Paddle - Running a SaaS business in 2022 survey



29%

of senior SaaS leaders found 2022 challenging



20%

were very optimistic (9-10/10)



8%

were not optimistic (less than 5/10)



71%



Average level of optimism for the year ahead

Source: Paddle - Running a SaaS business in 2022 survey



PART ONE

How SaaS businesses have responded

There is no one-size-fits-all solution to successfully grappling with a downturn, but our survey found **four** common areas of focus for SaaS companies:

1. **Cash runway**
2. **Headcount planning**
3. **Customer retention**
4. **Account expansion**



1

Cash runway

Cash is king yet again. In May 2022, Y Combinator told[5] founders that "the best way to prepare [for the downturn] is to cut costs and extend your runway". Meanwhile, Co-Founder of Craft Ventures David Sacks advised[1] his portfolio companies to extend their cash runway to 2-4 years to ride out the storm.

The rationale is clear: extending cash reserves avoids the need to raise investment at a time of limited capital and minimize the risk of a valuation-busting downround. Even bootstrapped companies should bolster their reserves as a protection buffer.

How are SaaS companies extending their cash runway?



46%

of SaaS companies have reforecasted, rebudgeted or reviewed how and when they next raise capital

Source: Paddle - Running a SaaS business in 2022 survey



Reducing burn rate

Burn can make or break in a downturn (just ask checkout software Fast, which closed its doors in May 2022 after burning through $10 million a month), so it's no surprise that reducing burn has been high on the SaaS agenda.

Our survey found that **16% of SaaS companies are prioritizing burn metrics in 2022** with a particular focus on their Burn Multiple, which correlates business spend and ARR generation to determine growth efficiency.

According to David Sacks, who believes the three things that matter most in a downturn "are growth, burn, and margins," companies should be aiming for a Burn Multiple of <2 (spending less than $2 for every $1 of incremental ARR that you generate). Anything >4 is cause for concern, especially if you are a mid-stage company (early-stage companies tend to have higher costs and thus higher burn multiples).



Minimizing operational costs

During recessions, businesses and consumers audit their expenditures in order to stop paying for things they don't need. For some businesses that's re-evaluating non-essential projects, while for others it's cutting non-essential costs.

Our survey found that nearly a quarter (23%) of SaaS companies have reviewed or consolidated app and software usage across the company in response to the downturn.

After salaries and hosting, apps are often the third largest outlay for a software business, especially if they have built a tech stack in-house with a variety of tools. Analyzing which software is vital and what can be streamlined helps improve margins.



Reforecasting regularly

In times of uncertainty, SaaS companies are regularly reviewing their expenses and focusing on the most impactful activities. For instance, SaaS companies are looking at the ROI of their sales & marketing spend (i.e. the value of LinkedIn ad spend), the cost-value (CAC-LTV) ratio of acquiring customers, and the cost of goods sold (COGS) to see where sizable expenses are coming from.

By analyzing what works on a quarterly basis and reforecasting the budget accordingly, companies better allocate funds and maintain control over cash spend.



The bottom line

SaaS companies need robust, accurate data to sustain their cash runway for 18-24 months and give themselves the best chance to succeed when the market bounces back.

2

Headcount planning

From recruitment and onboarding costs to salaries and rewards, talent is the number one expenditure for SaaS companies. As companies try to minimize operational expenditure (OPEX), layoffs can seem the only option.

For example, events platform and former unicorn Hopin made[6] 29% of its workforce redundant (242 people) in July 2022. However, SaaS companies are also managing headcount costs without layoffs.

How are SaaS companies managing headcount in a downturn?

35%

of SaaS companies have made changes to the hiring plan in 2022

Source: Paddle - Running a SaaS business in 2022 survey



Increasing human capital efficiency

Do more with what you have. In times of constraint, SaaS companies are looking to boost the productivity and motivation of the existing team.

This includes analyzing team performance, rethinking learning & development programmes, and investing in areas that enhance human efficiency, such as automating processes and buying tools that free up employees' time.

Enablement also helps retain the overperformers, who will be less interested in switching companies if a company is performing well in a downturn.



Reducing resource costs

In tandem with boosting efficiency, SaaS companies are streamlining associated workforce costs.

This can include the salary package, by offering equity instead of increased salaries and putting a cap on future deals, and non-essential perks, such as allowances for corporate travel, off-sites and co-working subscriptions. SaaS companies are also looking at the tools their workforce uses.

For example, building and running fragmented software costs considerably more in human resources than a unified platform.



Managing hiring plan

Endless hiring is a growth-at-all-costs strategy. Now, SaaS companies are considering hiring freezes, pulling back from opening new roles and avoiding replacements to natural departures as a way of minimizing headcount spend.

However, for some companies, it could be the time to hire great talent. Some of the largest names in tech and SaaS have slowed or frozen hiring, such as Salesforce and Meta[7], which opens up opportunities for smaller SaaS players with cash reserves to hire great talent. Openview's State of SaaS Talent report[8] found that 64% of New York's SaaS startups plan on hiring more people in 2022 than they did in 2021.



The bottom line

Over a third of SaaS companies have changed their hiring plan in response to the downturn, reducing short-medium term costs and enabling them to react quickly to arising opportunities.

3

Customer retention

In a market downturn, all companies can expect greater churn as customers feel the pinch. SaaS businesses that retain the most customers will therefore come out of the downturn in the healthiest shape.

Not only does retention guarantee revenue flow and extend cash reserves, but with budget freezes reducing sales & marketing spend, it's considerably easier and cheaper to retain customers than find new ones.

How are SaaS companies minimizing churn and retaining customers?



32%

of SaaS companies have prioritized churn/ retention to track business performance in 2022

Source: Paddle - Running a SaaS business in 2022 survey



Articulating 'must-have' value

SaaS companies are creating retention strategies that convince customers their product is indispensable. This includes analyzing product value for each customer segment, cross-referencing this value with customers' business health, and establishing a verifiable ROI for each customer.

Customer-facing teams are also increasing direct customer communication and explaining the core and additional benefits of the product.

What's more, customer success teams are creating a playbook for retaining customers with reasonable concessions, such as set rates for customers asking for a discount.



Reducing customer friction

Make it as easy as possible for customers to stay with you. SaaS businesses are optimizing payment processes to avoid losing customers by involuntary churn (i.e. as a result of credit card failures or renewal issues) and removing barriers to service, such as temporarily removing paywalls to certain features.

In addition, SaaS companies are making it easier to activate recently-canceled subscribers by offering promotions and removing the need to re-register if they want to return to service (i.e. one click reactivation).



Making customers rethink cancellations

On the flip side, SaaS companies are adding friction to cancellation decisions. This can be explicit, like adding cancellation flows that entice people to stay with salvage offers and free upgraded plans, or implicit, such as highlighting the wider uses of your products and helping customers make the most out of their package.

In addition, promoting a loyalty programme, extending free trials to particular customers, and encouraging upgrades from monthly to annual subscriptions also make customers think twice about canceling.



The bottom line

Retention is a valuation-enhancer, with companies boasting impressive net revenue retention (NRR) metrics, high renewals and win backs likely to have the pick of investors post-downturn.

4

Account expansion

In a downturn, all the talk is about ‘survive’, but what about ‘thrive’? Happy customers buy more in a recession and the SaaS model enables companies to expand their revenue by focusing on existing customers.

From using in-app analytics to determine customer preferences to monitoring app usage for account expansion opportunities, SaaS companies can use their existing data tools to target specific customers with extras, add-ons, and upsells. What’s more, expansion revenue[9] (increasing customer spend after the initial sign-up) is ready-made for a recession as it enables SaaS companies to increase revenue without needing to acquire new customers.

How are SaaS companies expanding revenue from existing customers?

50%

of SaaS companies have changed their go-to-market strategy (e.g. with new pricing or a greater focus on retention)

Source: Paddle - Running a SaaS business in 2022 survey



Upselling

For SaaS businesses, upselling is selling a higher subscription plan for the same product, such as moving from ‘free’ to ‘paid’ or ‘standard’ to ‘premium’. Whether it’s multiple email accounts (i.e. Calendly) or more messages (i.e. Slack), SaaS businesses are setting limits to encourage existing customers to upgrade to more feature-rich subscriptions.

This includes determining your value metrics, analyzing product usage among various customer segments, optimizing where these limits are set, and using time-limited discounts (i.e. half price for the first three months) to those upgrading.



Cross-selling and add-ons

Cross-sells and add-ons are increasingly used by SaaS businesses looking to expand account revenue. Cross-sells are entirely different products that are suitable to the same user-type, such as Atlassian offering Trello to Jira customers. Add-ons are additional extras that work with the base product, such as Freshdesk offering additional bot sessions to its customer service software (when the customer is at checkout).

In the current climate, some SaaS companies are offering new packages to customers, including additional cloud storage or priority support, while others are even building purposeful add-ons for popular products.



Pricing

Adjusting your pricing in a downturn might seem risky, but that risk is minimized by data and outweighed by the returns.

For instance, SaaS companies are raising prices based on value metrics: if a product has a NPS over 20 then customers will likely pay more for it. Meanwhile, SaaS companies have added specificity to their pricing.

For some, that's adding new pricing layers beyond the traditional 'free, standard, premium' options, which better capture customer segments. For others, that's offering localized pricing (country-specific) or creating specific pricing structures per client (client-specific).



The bottom line

With customer acquisition costing[10] 4x more than upsells to generate another $1 in revenue, expanding revenue is a no-brainer when SaaS companies are trying to grow and keep a lid on cash spend.



PART TWO

What will SaaS prioritize in 2023?

In 2022, growth still reigned supreme with **60% of SaaS companies focusing on revenue growth metrics**, such as Monthly Recurring Revenue (MRR), Annual Recurring Revenue (ARR) and Average Revenue Per User (ARPU), to track business performance.

In 2023, SaaS companies have a much broader array of priorities ranging from cash flow and profitability to headcount and churn.

In particular, SaaS companies will focus on **three** core areas in 2023:

1 **Efficiencies**

2 **Customers**

3 **Product**

1

Efficiencies

The shift toward operational efficiency will continue next year with 31% of SaaS companies looking to control costs and achieve outcomes with fewer resources.

This includes greater reliance on sustainable metrics, such as a lower CAC-LTV ratio, increasing NRR and reducing the Burn Multiple, as well as a greater focus on unit economics. SaaS companies will look at their most expensive OPEX suppliers and consider negotiating prices or evaluating more cost-effective solutions, such as reducing license counts for internal software.

What's more, SaaS companies will likely rebudget to rein in marketing spend and look to accelerate growth in an efficient way.

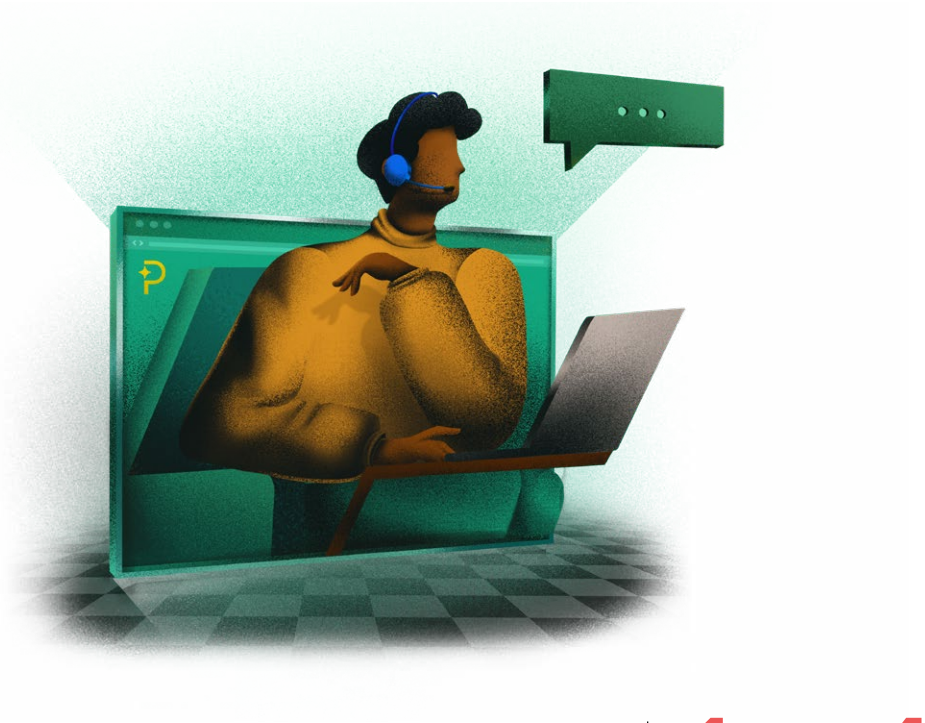
1 in 3

SaaS companies will focus on efficiency in 2023

Source: Paddle - Running a SaaS business in 2022 survey

> **"Growth at all costs is a fallacy."**
>
> Source: Paddle - Running a SaaS business in 2022 survey





2

Customer

For 25% of SaaS companies, 2023 is all about customer success and customer acquisition.

For those in the ‘success’ camp, prioritizing customers will help soften the blow of a recession by reducing churn and increasing the chances to upsell and expand account revenue.

Over the next year, they expect to focus on boosting customer satisfaction, receiving customer feedback and enhancing customer experience.

For those in the ‘acquisition’ camp, 2023 is the time to build new customer cohorts, streamline the acquisition process and get more clients on board.

1 in 4

SaaS companies will have a customer focus next year

Source: Paddle - Running a SaaS business in 2022 survey

> **“Focus on NPS. Get direct feedback from customers. Even when things are fine, show them [that] their feedback matters. Understanding their needs will help you drive your business [on to the right path].”**
>
> Source: Paddle - Running a SaaS business in 2022 survey

3

Product

For 18% of SaaS companies, it all boils down to product. SaaS leaders know that if customers can't live without their product, they have a high chance of seeing out the downturn if they can keep variable costs down.

As such, SaaS companies are looking to improve quality user experience, make the product easier to purchase and build 'stickiness'. That includes investment in product development (i.e. new features), improving product-market fit, and generally making the product better than the competition.

For some SaaS companies, that means moving toward a self-service product-led growth (PLG) model.

1 in 5

SaaS companies will have a product focus next year

Source: Paddle - Running a SaaS business in 2022 survey

> **"Focus on quality product and value delivered. If customers can't do without it and you keep variable costs down then you can't lose."**
>
> Source: Paddle - Running a SaaS business in 2022 survey



PART THREE

Three steps to SaaS success in 2023

The initial horizon might look cloudy, but there are ways to burst through into sunshine. Until 2022, SaaS growth was based on its resilient model, popular products, scalable revenue streams, and easy access to cash.

While financing will remain tight in 2023, the other characteristics remain. SaaS companies that maximize operational efficiency and see out the downturn have a lot to look forward to.

For 2023, SaaS companies should:

1. **Review their costs and take steps to increase their cash runway** (for 18-24 months)
2. **Focus on retaining customers and expanding existing customer accounts** (to 20-30% of revenue)
3. **Invest in product and improve product-market fit** (using NPS and CAC/LTV ratio)

> “The years of accelerated SaaS growth will return, but for now, finance and commercial leaders need to switch gears and channel a mindset that prioritizes operational efficiency over growth at all costs. Balancing proactive cost-reducing measures to extend cash runway with revenue retention and expansion strategies will best prepare SaaS to take advantage in 2023 and beyond.”



Daniëlle Keeven
VP Finance, Paddle







paddle

The only complete provider of payments infrastructure for SaaS companies.

Learn more at **Paddle.com**

References

1 Paddle, SaaS valuations are changing: Three key lessons for SaaS founders
2 Meritech Capital, 2022 SaaS crash
3 SaaS Capital, How do SaaS companies perform in a recession
4 Growth Marketing Pro, The ultimate list of SaaS statistics
5 TechCrunch, YC advises founders to 'plan for the worst' amid market teardown
6 UK Tech News, Events platform Hopin cuts 29% of jobs in second wave of layoffs
7 Protocol, Salesforce slows hiring, according to internal memo
8 OpenView, 2022 state of SaaS talent report
9 Paddle, Expansion revenue: An underutilized growth lever
10 Price Intelligently, 30% of your revenue should be expansion revenue