



# **IT'S ALL ABOUT THE MONEY:**

## **How SaaS Companies Are Solving the Sales Compensation Problem**



WHITE PAPER – NOVEMBER, 2006

DEVELOPED BY  
SOFTWARE & INFORMATION INDUSTRY ASSOCIATION (SIIA)  
Software-as-a-Service Executive Council  
ISV Best Practices Committee

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How Software-as-a-Service Companies  
Are Solving the  
Sales Compensation Problem**

*White Paper*

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*December, 2006*

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## INTRODUCTION

As Software-as-a-Service (SaaS) companies accelerate into their mainstream markets, they are discovering both that a direct sales force is the most efficient channel and that traditional software compensation plans are ill-suited to SaaS' recurring revenue model. Goldman Sachs' Rich Sherlund points out that traditional software companies' cost of revenue (marketing expenses plus those associated with fielding a large direct sales force) can be as much as 82%. SaaS vendors are finding that the mismatch between relatively small revenue bites and large one-time sales expenses can pose a larger problem.

The SaaS model not only provides independent software vendors (ISVs) with the impetus to change, it virtually requires dramatic reform to sales compensation strategies. Many companies are having difficulty because they don't know where to begin.

At OpSource's SaaS Summit 2006, software venture capitalist Ann Winblad called sales compensation "one of the trickiest things" in adopting the SaaS model. "You cannot make this change," she said to a large roomful of software executives, "without making a serious change to your sales compensation plan and making it match your revenue recognition model."

## NOT ALL REVENUE IS CREATED EQUALLY

Key Ventures' David Dame agreed. "You cannot compensate a SaaS salesman," he said at the same venue, "like you compensate an enterprise software salesman."

The problem is two-fold:

- SaaS companies take smaller bites of revenue over longer periods of time. Paying large one-time commissions for each new sale will break the SaaS vendor's bank.

- Just as important, such a structure does nothing to motivate salespeople to shorten their cycles and bring in new customers more quickly.

Even though total revenue generated over the long term may actually be greater than in the traditional software model, the SaaS company cannot recognize it immediately. New contracts show up on the balance sheet as de-



much as a one-year deal. This simply cannot be true.

Administratively, this approach often causes more problems than it solves. How will early contract terminations impact sales comp? How can the SaaS vendor structure a plan that adequately addresses more flexible agreements (such as a 1-year with automatic renewals or month-to-month that offers pre-pay discounts)?

Moreover, such a plan does not match the SaaS ISV's revenue recognition model, as Winblad advises. This means the sales organization will be running at cross-purposes to the rest of the company, focusing on bringing down elephantine deals instead of steadily growing recurring revenue streams.

"Elephant hunters," Winblad said, "that have lived too long in the enterprise software world." One



- Ultimately, SaaS "hunters" are turned into "farmers" as they learn to pay more attention to satisfying their base than to winning new business.

While some of these issues are soluble, the resulting compensation plans often are very complicated, making them difficult for salespeople to understand and for companies to manage.



