

# THE SWEET SPOT IN THE EYE OF THE STORM

## A Clarion Call to SaaS Revenue Leaders

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December 22, 2022.

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# INTRODUCTION

In 2022 the SaaS Market crashed, and continues its descent as I write this. Headed into 2023, we are faced with a continued drop, both in growth rate and in public and private company valuations. After a stormy 2022, few revenue leaders have had time to take inventory of the situation and rethink their approach to 2023. As a result, organizations have not yet taken significant precautionary actions for 2023 beyond superficial cost cuts.

The moment to rethink your approach is now. In the next weeks, we find ourselves in the Sweet Spot in the Eye of the Storm, as portrayed on the front cover<sup>1</sup>. Why do I say that? To have performed so well up until now, without deep insights into how SaaS machinery works, positions you to tap into immense opportunity.

Over the past decade we all pursued growth. But growth in and of itself is a means to an end – a metric meant to push us to the top, proof that we can outpace the rest of the market, attract attention from potential acquirers or venture capital, and ultimately become the market leader. Although the unknown economic environment in 2023 may make it difficult to hit our growth targets, it offers an incredible opportunity to achieve a market leadership position or at least to move ahead of the competition.

In this write-up I share how you can find the sweet spot for your business right now, while you are in the eye of the storm, and use these insights to prepare for a great 2023. Why is this so important? Vladimir Ilyich Lenin once said: *“There are decades where nothing happens, and weeks when decades happen.”* This quote feels eerily descriptive of the times we are in, and suggests to me that doing well in the next decade depends on what we do in 2023 – which very much depends on the actions we take over the next weeks. So in these coming weeks, we will be in the sweet spot!

## The Storyboard

**Act 1.** The 2022 SaaS crash.

**Act 2.** Root cause(s) analysis of the SaaS crash.

**Act 3.** Principles of Recurring Revenue.

**Act 4.** 2023 The Dawn of a New Era

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<sup>1</sup> The image was taken by NASA's Hubble Space Telescope in the Omega or Swan Nebula, also known as M17, about 5,500 light years away. (J. Hester (ASU))

## ACT ONE

# THE 2022 SAAS CRASH

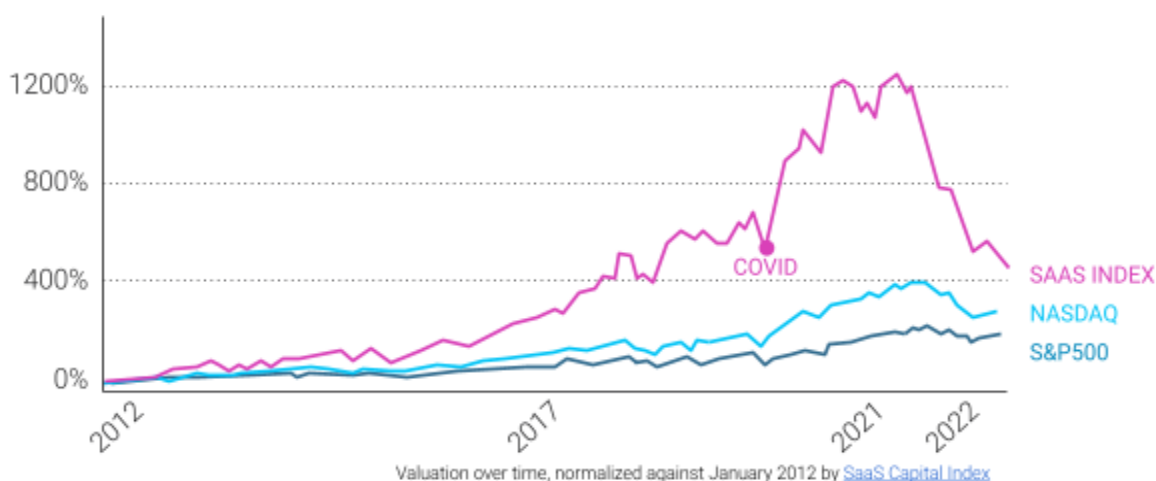
By many metrics, 2021 will go down in SaaS history as the best year ever, with a whopping 291 SaaS IPOs. At Winning by Design, we have been fortunate to have been involved in many of them on their journey from \$10M to \$350M in Annual Recurring Revenue (ARR). We were given a front-row seat and with it an opportunity to gain the deep insights I share with you here.

### 1.1 2022: the Year of the SaaS Crash

In mid-November 2021, the SaaS stock market peaked<sup>2</sup>. At the start of 2022, the casual observer could have judged everything to be fine. But by then, geopolitics and other emerging challenges had started to slow down the economy. In February, many marketing leaders noticed a sluggish lead flow, and months later sales leaders noticed more and more deals being delayed. I must emphasize the nuance here: deals were not lost, they were delayed. Naturally, the booking performance fell short next, and soon afterwards the growth rate began to decline.

FIGURE 1.1

**The Meteoric Rise Over a Decade and the Dramatic Fall of the SaaS market in 2022**



VCs and portfolio leaders at PE firms began to raise the alarm, slowing down funding and delaying IPOs. With less money available to invest, valuations of startups dropped. Around the same time, market reporter Rebecca Szkutak published an article with the headline

<sup>2</sup> The SaaS Capital Index, as of 11/30/2022

*Record-Setting Venture Capital Market Shows Signs Of A Slowdown*<sup>3</sup>. By early summer the situation worsened, and to avoid a down-round, most VC/PE firms recommended their portfolio companies cut costs by as much as 20% across the board<sup>4</sup>, while others asked to surgically pare down expenses<sup>5</sup>. But by then, it was too late; the damage was done.

While this did not come as a surprise to many who had warned for years that this decline would happen sooner, the speed at which this happened surprised many of us. What warning signs was the industry seeing that raised their quivers, that no one else saw as a red flag? Having spoken to many, I believe this stems from a combination of three factors:

In mere months, years' worth of growth were wiped out and reset to the levels of 2019.

**Factor 1.** The 'grow-at-any-and-all-costs' approach — which as we will come to learn, clashed with SaaS business fundamentals and principles.

**Factor 2.** The use of unskilled labor at critical growth points, causing widespread operator error.

**Factor 3.** Availability of unlimited funds with little oversight and guidance, which amplified factors 1 and 2. Many board meetings have been derailed with the question, "*If I give you twice as much money, can you grow faster?*"

At Winning by Design, we believe that once you surpass \$10M in ARR, you can no longer hold individual people solely accountable for success nor failure; a SaaS business at this scale of revenue is starting to act and behave as a system. As James Reason famously wrote<sup>6</sup>: "*The basic premise in the system approach is that humans are fallible and errors are to be expected, even in the best organizations. Errors are seen as consequences rather than causes, having their origins not so much in the perversity of human nature as in "upstream" systemic factors.*". In the following section, we will examine some of the *systemic factors* that caused the SaaS Crash.

## 1.2 The Impact of Unskilled Labor

Operator Error is defined as an unintended consequence due to a wrong decision or deviation from a known process. For example, early on (and for a short while), Sales Development Reps, or SDRs, found email automation tools to be quite effective. This was a remnant of the Salesforce era. But it was mainly due to the simplicity of the value proposal, "*You are currently paying \$2M over three years for your CRM solution. Can I interest you in a demo that does the same, but for \$5,000/month?*"

Today, unskilled labor, aided by industrial-grade technology, can reach anyone, anywhere, at any time, at an unprecedented scale. With it, a carefully nurtured brand name that took years to build

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<sup>3</sup> Record-Setting Venture Capital Market Shows Signs Of A Slowdown, by Rebecca Szkutak, New York-based reporter covering venture capital, startups and investors.

<sup>4</sup> Adapting to Endure, Founders All Hands, Sequoia Capital, May 2022

<sup>5</sup> VC firm IVP warns startups to 'surgically pare down expenses', Business Insider November 24, 2022. [Gated!]

<sup>6</sup> Human error: models and management by Dr. James Reason, Professor of Human Psychology of the University of Manchester, March 18, 2000

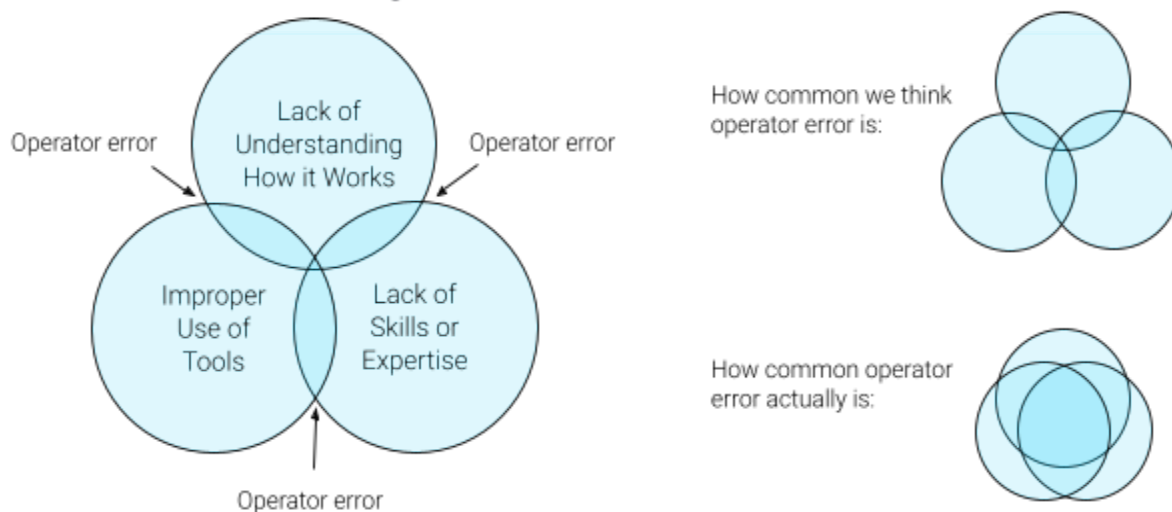
can now unintentionally be destroyed in a matter of weeks. The use of unskilled labor happens across all GTM roles, including marketing, sales and customer success.

SaaS companies are notorious for the use of unskilled labor that rely on technology to perform critical tasks on a large scale, and they do this with little investment in education or training. This makes SaaS companies vulnerable to Operator Error.

Operator Error can be found at the intersection of three factors: an industry-wide misunderstanding of how SaaS works, the use of unskilled labor, and the improper use of tools. Each on its own causes Operator Error; the three of them combined are disastrous.

**FIGURE 1.2**

### **The Unskilled Labor Challenge**



Due to the rapidly changing and unregulated nature of SaaS industry, business leaders (egged on by investors to achieve growth) started to depend on advice from practitioners who based their advice on tiny sample sizes. The most provocative yet damaging advice would draw a crowd and be amplified through conferences, engagements, and social media. The largely self-inflicted SaaS Crash can be remedied by addressing these issues.

Three fundamental principles of SaaS pertain to this larger argument:

1. The entire customer lifecycle works as a closed loop system,
2. Its non-linear growth is based on marginal gains across this system, and
3. It leverages the passing of time to achieve the compound effect of these marginal gains.

The lack of understanding of these fundamentals, and of operating according to these principles, caused operator error as SaaS leaders used low-cost, unskilled labor to operate this industrial-grade machinery.

## 1.3 The Eye of the Storm

As we approach the end of 2022, this crash is not over. Far from it. As Michael Miao from IVP reported, in October of 22 *we are only 9 months into a downturn that on average lasts 3 years*<sup>7</sup>.

The economic conditions that gave rise to the crash have not changed, and the corrective action of cost cutting has not helped – indeed, it may have had an adverse impact.

Organizations have not changed the way they operate their SaaS machinery. And now at the start of 2023, we foresee the largest revenue churn event in the history of SaaS. This is largely due to contraction – an inevitable consequence linked to the overbuying that occurred during the COVID years. This contraction will cause a lack of growth in account expansion. This will hurt late-stage startups and scaleups the hardest, as they depend on growth from existing customers. This lack of growth from expansion will naturally shift eyes to acquisition. But these efforts too can be vulnerable to the challenge of operator error.

Stakes are high for SaaS companies, but they may be even higher for buyers. A tight economy creates enormous pressure to not waste company money. As indecision and the involvement of higher-ups increases, sales cycles will lengthen. As Ted McKenna and Matt Dixon point out in their book *The Jolt Effect*<sup>8</sup>, *“The Fear Of Messing Up exceeds the Fear Of Missing Out.”*

Most enterprise sales organizations will catch on to this around May 2023, a few months after they have returned from their annual Sales Kick-Off. Even if the economy stabilizes over the summer, which many economists still consider a highly suspect scenario, it will be too late. There will not be enough time to take corrective action to close the gap. This coming decrease in the growth rate will be accompanied by an increase in burn rate. More and more CEOs will find it harder to get funding at acceptable valuations. They will find themselves needing to “stop the bleeding,” and they will feel compelled to cut more costs.

While the 2023 storm may not present a pretty picture, when we look underneath the surface, we notice that the SaaS machine is working exactly as it is supposed to. If we learn the root cause of the 2022 SaaS Crash and use this as an opportunity to understand how the SaaS machine fundamentally works, we can apply SaaS’ fundamental growth principles and make 2023 a breakout year for many SaaS companies.

As famed Formula 1 world champion Ayrton Senna once pointed out: “You cannot overtake 15 cars in sunny weather, but you can when it’s raining.”

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<sup>7</sup> Market Downturn and How The Best CFOs are Navigating it by Michael Mae, October 20

<sup>8</sup> The JOLT Effect: How High Performers Overcome Customer Indecision, by Matt Dixon and Ted McKenna

## ACT TWO

# ROOT CAUSE ANALYSIS

As an electrical engineer, I am used to building on the knowledge of those that came before me, a heuristic you'll find that applies both to a chip and to a software module. As an engineer, you will not reinvent fundamental components each time. Instead, you rely on defined elements that have been tested and iterated to near perfection over time. This results in both a high success rate and a low time between failures (MTBF). This is the reason we complain when our phone call drops, instead of celebrating the one time it gets through.

What I find astonishing, as an engineer, is that in the trillion dollar SaaS industry, founders use very few models — and if they do, they are often rudimentary and outdated...not to mention the extensive misuse of existing models. The industry uses a series of rules of thumb, a handful of which people follow almost religiously<sup>9</sup>:

- **LTV to CAC Ratio:** LTV/CAC ratio should be 3:1, which means you should make 3x in revenue vs what you spend acquiring customers. Generally, 4:1 or higher indicates you could be growing faster, and you are likely under-investing in marketing and sales.
- **Rule of 40:** Rule of 40 says that profit margin + growth rate should exceed 40%. Generally, 40 or higher indicates a great business model. If your “rule of 40” metric is 50 or higher, you could be growing faster and are likely under-investing in marketing.
- **T2D3/T3D3:** SaaS investors during “growth at all costs” times looked for early-stage revenue growth that follows the pattern of Triple-triple, double-double-double. Or even Triple-triple-triple, double-double-double. When this pattern presented itself, investors flocked—never mind the unit economics or profitability.
- **Magic Number:** A metric that reflects sales efficiency. It measures how many dollars worth of revenue are generated per dollar spent on acquiring new customers through sales and marketing. The ideal benchmark for the Magic Number is between 1 and 1.5. Below 1 is inefficient; above 1.5 may indicate more growth could be attained by spending more on sales and marketing.

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<sup>9</sup>15 Metrics Every SaaS Company Should Care About by Hubspot, October 18, 2022

A rule of thumb is described as a broadly accurate guide or principle, based on experience or practice rather than theory. We need rules of thumb. They are vital. But we can and must go further, and use a more scientific approach.

At Winning by Design, we have developed a series of frameworks to model the growth of a SaaS company, described in the sections below. As Scott E. Page points out in his book, *The Model Thinker*, models can be used to Reason, Explain, Describe, Communicate, Act, Predict and Explore, which he communicates with the acronym REDCAPE<sup>10</sup>.

## MODELS TO ARCHITECT A SUSTAINABLE RECURRING REVENUE BUSINESS

<b>Revenue Model</b>	Maps the exchange of goods and services against three revenue models: ownership, subscription, and consumption.
<b>Data Model</b>	Standardizes the metrics of the <i>entire</i> customer lifecycle, complementing the acquisition funnel with the expansion funnel. Referred to as the Bowtie.
<b>Mathematical Model</b>	Acquisition and expansion operate in different mathematical domains, behave differently, and require different approaches to maximize outcomes. A Growth Formula (GF) is the mathematical expression that describes sources of growth in a particular Go To Market motion.
<b>Go-To-Market Model</b>	Aligns the most expensive resources along proven frameworks, each with its own methods, tools, cost structure, and outcomes.
<b>Growth Model</b>	Recognizes the different phases of growth, each responding to different forces and having to obey to different performance metrics.
<b>Operating Model</b>	Creates a uniform operating model so customers who move across different departments have a seamless experience.

To serve the SaaS community, we have made these models available through an open-source initiative at [www.TheScienceOfRevenue.com](http://www.TheScienceOfRevenue.com)<sup>11</sup>. Over the past 18 months, we have had over 1,000 students go through the Revenue Architecture course<sup>12</sup>. To be of use to all of us, who may have yet to have the opportunity to go through this course, we have deduced these models into principles that can be used daily (Act 3).

Next, we will use a few basic concepts of the Data Model and Mathematical Model. In May of 2023, we will launch a book detailing these models' use in Revenue Architecture.

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<sup>10</sup> *The Model Thinker: What You Need to Know to Make Data Fork for You* by Scott E. Page, 1st edition, published 2018

<sup>11</sup> *The Science of Revenue, an Open Source Initiative for Revenue Architecture*, by Winning by Design

<sup>12</sup> *Revenue Architecture Classes 2023* by the Winning by Design Revenue Academy



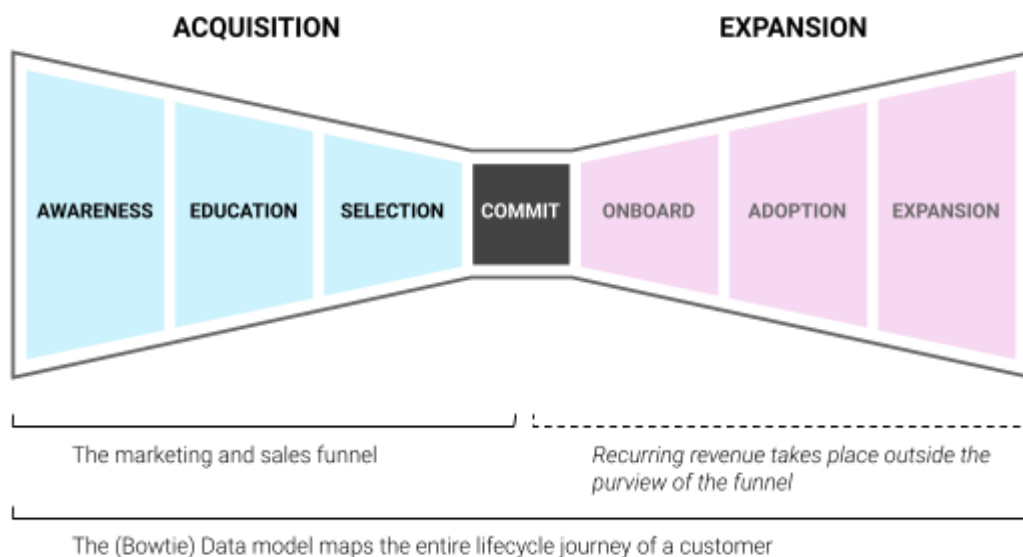
## 2.1 The Bowtie: A Data Model for Recurring Revenue Operations

A recurring revenue business typically focuses its most valued resources around customer acquisition— a mistake that is often subconscious.

This misguided approach is often caused by mis-using one of the few proven models that has stood the test of time: The Marketing and Sales funnel. Although the Marketing and Sales funnel can be used to model acquisition, it falls short when modeling the behavior of recurring revenue, which takes place entirely outside the funnel. This approach contrasts with the typical 'sales funnel' or 'marketing funnel' that many Revenue teams have used historically to measure their performance across a sales process. With the advent of recurring revenue models, a new model is used, which we will refer to as the “Bowtie.”

The Bowtie must cover two critical gaps: the adoption stage—where sellers must ensure that customers achieve the expected impact, and expansion—the critical activity of growing the business together with your customer. Together with Onboarding, these additional stages create a system to generate recurring revenue (growth).

**FIGURE 2.1**  
**Seeing the Whole Customer LifeCycle**



Unlike conventional models focused on finding and landing a customer, the Bowtie maps the full lifecycle journey. A GTM motion correlates to how the company deploys its customer-facing resources across the entire lifecycle journey, to not only help the customer acquire its products/services, but more importantly achieve the desired outcome, or impact.

There are a dozen GTM motions in use today. The most popular GTM motions are Inbound, Outbound, Targeted (ABM), Channel, and Product Led Growth (PLG). In a SaaS business with \$50M in ARR, we may find as many as five different GTM motions<sup>13</sup>.

## 2.2 The Growth Formula

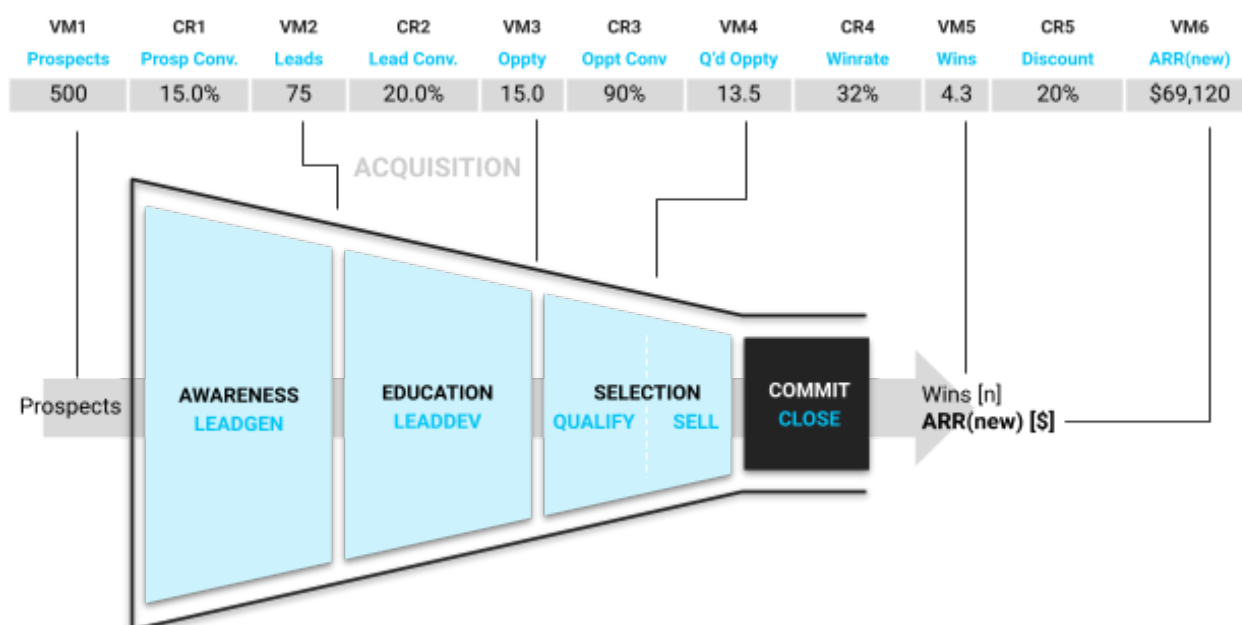
To demonstrate how the SaaS market crashed, I will focus on the acquisition part of the business first, and only on the most rudimentary GTM Model: Inbound. To do this I will depict the relationship between a group of Prospects and Revenue Growth in a mathematical expression called a Growth Formula (GF).

A Growth Formula can be used to model growth. It describes the relationship between the amount of Leads and the Annual Recurring Revenue (ARR) generated for any GTM motion, in this example GF(Inbound). Note that different GTM motions such as Product Led Growth (PLG) or Account Based Strategies may use terminology unique to its GTM motion, which is often propagated by the tools used.

For example an Inbound lead is called an MQL, whereas in PLG it is referred to as a PQL<sup>14</sup>, or in ABM as an MQA<sup>15</sup>. To avoid getting lost in acronyms, I refer to these metrics in a more analytical way, VM(n), and CR(n), in which VM(n) stands for Volume Metric, and (n) marks the spot in the Bowtie. Similarly, CR stands for Conversion Rate, and (n) relates to the spot in the Bowtie<sup>16</sup>.

**FIGURE 2.2**

**The Relationship Between Leads, Opportunities and ARR(new). The ACV is \$20,000/year.**



<sup>13</sup> Go To Market Model, by Jacco van der Kooij, September 9, 2020

<sup>14</sup> Product Led Growth Metrics, by Product Led Growth Collective

<sup>15</sup> The Top 9 ABM metrics to Determine Your Campaigns Success by Growth Natives, May 11, 2022

<sup>16</sup> The SaaS Sales Method, Sales as a Science by Jacco van der Kooij

With this standardized language, we can discuss a scenario in which a booming economy of 500 prospects (VM1) develops into 75 leads (VM2), which through a series of sales development efforts earns on average 4.3 wins (VM5). See figure 2.2.

Across these 4.3 wins, it appears an average of 20% discount (CR5) was extended against a list price of \$20,000/year. This secures an ARR(new) of \$69,120. This provides us with the Growth Formula (GF) for this specific inbound GTM motion, or GF(inbound):

{Formula 1a} GF (inbound):  $ARR(\text{new}) = \text{Prospects} \times CR1 \times CR2 \times CR3 \times CR4 \times (1-CR5) \times ACV$

{Formula 1b} GF (inbound):  $ARR(\text{new}) = 500 \times 15\% \times 20\% \times 90\% \times 32\% \times (1-20\%) \times \$20,000.$

GF (inbound):  $ARR(\text{new}) = \$69,120$

### 2.3 A Normalized Growth Formula (nGF)

As one can see, the Growth Formula in its original form {Formula 1b} is anchored on the amount of prospects we start with. Prospects can refer to the amount of visitors to a website, for example. So in this case, it tells us \$69,120 in ARR(new) is generated from 500 prospects.

Sales teams may prefer to anchor on “*how many leads are needed to secure one deal?*” while Rev Ops teams may prefer to anchor on what it takes to generate \$100,000 in ARR(new), creating a stackable revenue model.

When we anchor a Growth Formula on a specific metric to suit a specific purpose, it is referred to as a normalized Growth Formula or nGF. In the case of Formula 1b, we have anchored on 500 prospects, a number that will generate 4.3 wins. Dividing the number of prospects by 4.3 wins normalizes the Growth Formula on a single win: it tells us that it takes 116 Leads to secure one Win and therefore \$18,000 in ARR(new).

{Formula 1c} nGF(inbound):  $ARR(\text{new}) = 116 \times 15\% \times 20\% \times 90\% \times 32\% \times 80\% \times \$20,000$

nGF(inbound):  $ARR(\text{new}) = \$18,000$

Remember, every GTM approach has a different Growth Formula, which most organizations do not use today. Instead, most mix the data from different GTM motions. This lack of proper use of data is one of the fundamental reasons for the SaaS Crash. I am going to demonstrate this next by using a Growth Formula to stress test the business.

### 2.4 Running Scenarios Using the Growth Formula

The use of a Growth Formula allows us to run scenarios and stress test this model. Let us step through five scenarios, one for each quarter, starting at Q1 of 2022. Each quarter we increase the

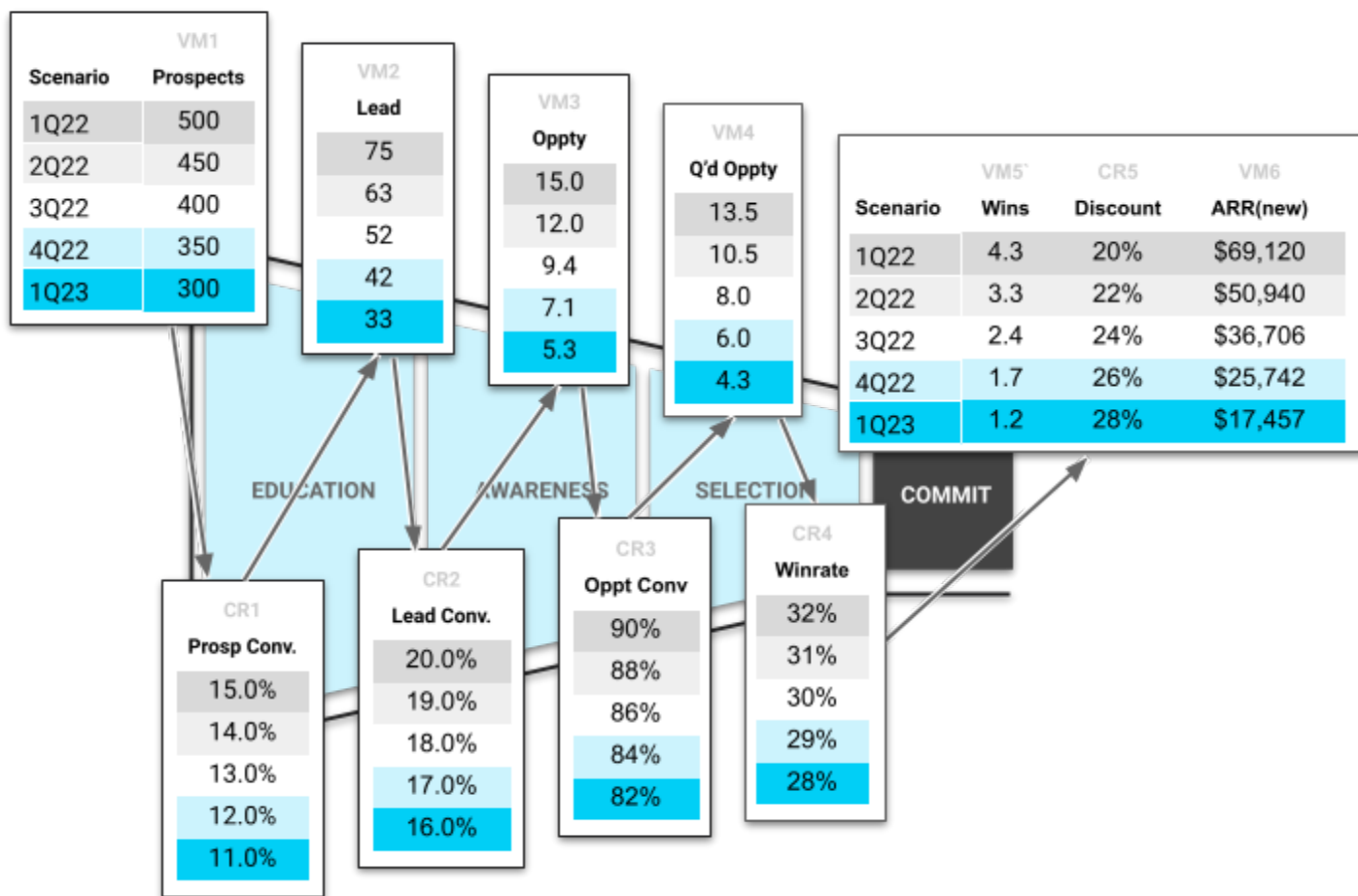
stress on the system by decreasing the number of Prospects (VM1) by 50, from 500 to 450, to 400, and so on. But realize this, and this is extremely important:

SaaS works as an interconnected system, meaning when a market goes south, it is not just the prospect volume going down, it's also the quality. The entire system is impacted, and each function is impacted.

As a result, each Conversion Rate (CRn) across all functions, from Lead Generation to Lead Development to Sales, will see a marginal decline in performance.

In Figure 2.3, we see the result of the simulation: it shows that in each quarter, the results in response to the economic situation worsen just a tiny bit. For example, Opportunity Conversion (CR2) starts at 20% during Q1, and declines to 19% in 2Q22. Similarly, the win rate (CR4), drops from 32% to 31%. It is likely that as the economy tightens, sales teams will feel forced to increase the discount from 20% in Q1 to 22% in Q2. In most SaaS operations, this marginal change would go completely unnoticed.

**FIGURE 2.3**  
**What Compounds On the Way Up Compounds on the Way Down**



At first, the speed at which this happens seems slow and ignorable, but as the changes accelerate, the nature of compounding creates an unstoppable effect that increases momentum in both speed and size of impact: The Snowball Effect.

What we see unfolding over the remainder of the year is a steep decline in ARR(new) from what once was \$69,120 all the way down to \$25,742. **This snowball effect applies powerfully to companies as they ascend and as they fall.**

It's important to realize that this drop in ARR(new) requires the exact same quantum of people campaigns, and spend. We are now getting lower results from the same spend, thus increasing the ratio of Client Acquisition Cost to newly acquired ARR and expected LTV.

Assuming these were the mechanics adversely affecting SaaS companies in 1H2022, one might expect most organizations to take corrective action towards the end of 2022. We will learn that most took little action, and the few actions that were taken along the mindset of "Grow at any and all cost" made matters worse, for example, increasing the spending on SEM.

Either way in this simulation, by the time we arrive in 4Q22, this organization is only securing 40% of the revenue that it previously did. And remember: this part of the organization is supposed to grow! And it continues to get worse, since neither the cause of the issue has been removed, nor have any operational changes been made.

## 2.5 The Price of Growing at Any and All Cost

When revenue started to drop in the spring of 2022, many experienced board members directed their CEOs to "sell yourself out of this." They issued this command rather than reflecting and responding to this decline by considering a new approach. CEOs told their troops to continue along the same course – and just improve the outcomes. In other words... *work harder*.

In the early summer of 2022, VCs and board members noticed an industry trend of declining revenue across all companies within their portfolio, as well as with companies in peers' portfolios. By the time they discovered this trend, the damage was done. Actually, the damage was still unfolding. One consequence emerged in hiring: because the large amount of job reqs that were opened in January of 2022 (following a record 2021) were finally filled around April/May, costs escalated right around June – just as revenues were starting a persistent decline.

Until 2021, revenue growth rate was the determining factor of the valuation of the company, and the underlying bias behind the popular mindset of "Growth at any and all costs."

This is when we started to hear about *sustainable growth* as compared to *scalable growth*. Scalable Growth, as used in the SaaS world, ignores cost. Consider the embedded assumptions in these formulae:

**{ Statement 1a } Scalable Growth = Growth as a function of Velocity**

Note that this does not mention cost at all. This is rightfully so in the world of Startups, where one needs to fund losses to establish growth, and revenue growth is over-weighted as the key metric. In 2021, this bias continued all the way to IPO, and in a number of well documented cases such as Uber, this would continue well beyond IPO.

Today we are beginning to see a greater appreciation of the frame of Sustainable Growth, which can be defined as:

**{ Statement 1b } Sustainable Growth = Growth as a function of Velocity and Cost**

By making growth a function of both velocity and cost, we do not just add a variable; we are opening up an entirely new dimension. The concept of sustainable growth is not new. We see “Sustainable Growth” entering talk tracks at industry events in late 2019 . I myself headlined several events in which I presented the concepts of Sustainable Growth at events such as RevOps<sup>17</sup> and SaaSStock<sup>18</sup> and . What we did not know then was that across the ocean, an infectious disease was brewing that would change our world forever.

**2.6 COVID Worsened the Situation by Inflating Growth**

When COVID hit in February of 2020, it hit all global markets at the same time. Around the world, people were dispatched to work from home, where they relied on cloud-based services to remain at least somewhat productive.

COVID catapulted the adoption of SaaS products, and with it, the valuations of SaaS companies. Many doubled down on the “grow at any and all cost” approach properly fueled by the demand. This only amplified behavior that was already broken: the use of unskilled labor, the “grow at any and all cost” mindset, all were further amplified with access to even more funding.

It pains me to write this, but as of this moment, December 22 2022, there is no meaningful change in behavior, no significant improvement in market conditions, and worse, we see more uncertainty in Europe and a new COVID-strain brewing in China.

This suggests to me that we should not expect the macro economy in 2023 to be any different, and that it may indeed get worse. All this notwithstanding, for those of us who prepare for this change, we can achieve our ultimate goal.

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<sup>17</sup> OpsStars 2019, Closing Keynote - Sustainable Growth: by Jacco van der Kooij, November 2019

<sup>18</sup> SaaSStock 2019, Opening Keynote, by Jacco van der Kooij, October 2019

## ACT THREE

# PRINCIPLES FOR SUSTAINABLE GROWTH

Much of the SaaS market is guided by rules of thumb passed through word of mouth in boardrooms and at conferences, and distributed to the masses via online events. These rules of thumb invariably lack the accuracy needed to operate a SaaS business. Or as Andrew Wilkinson so eloquently describes it<sup>19</sup>, *"Here's the number I used to win the lottery."*

The inner workings of Recurring Revenue can be explained by the series of Models outlined in Act 2. While Revenue Architects are expected to understand and master these six models, not everyone in a company who is involved in the operation of recurring revenue should have to study and become a certified Revenue Architect. To create a shorthand of these fundamentals, I am sharing the following ten SaaS principles.

### SaaS Principles for Sustainable Growth

1. Recurring Revenue is eating the world.
2. Recurring Revenue is the result of Recurring Impact.
3. Impact Expansion results in Revenue Expansion.
4. A customer commits based on the priority of the impact.
5. Risks have shifted from the buyer to the seller.
6. Rapid growth is caused by marginal gains.
7. Repetition compounds marginal gains.
8. Compounding causes a cumulative disproportionate impact.
9. Sustainable results require an Operating Model.
10. SaaS was born from, and thrives in, a crisis.

Adhere to these principles and you will succeed and thrive in 2023 and beyond. These principles will orchestrate your efforts around your customer's success, which will in turn lead you towards market leadership. Market leadership will give you the opportunity to meet your investors' interest in accelerated growth or an increase in profitability.

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<sup>19</sup> Twitter Quote "Here's the number I used to win the lottery" by @AWilkinson September 30, 2022



## Principle #1 Recurring Revenue is Eating the World

In his prescient 2011 article titled *Why Software is Eating the World*<sup>20</sup>, Marc Andreessen predicted that more and more major businesses and industries are being run on software, pointing out that software was (is) also *eating much of the value chain of industries that are widely viewed as primarily existing in the physical world*. In everything from cars to retail to oil and gas and beyond, he noted, *embedded software delivers value and offers dynamic new products and services*. Today we continue to discover the implications of Andreessen's argument.

Marc was spot on in his vision—we are the ones who mistook his words. To help us better understand the implications, I would argue that a more apt title might have been *Why Software **delivered as online Services** is Eating the World*. After all, it was not CDs with software on it, purchased for a million dollars upfront that caused all this growth. It was Software sitting in the cloud, which we commonly refer to as Software as a Service (SaaS). I realize you all know this, but, and this is critical: fundamentally it was NOT SaaS alone that caused the growth.

If companies no longer needed server hardware, but they still had to buy SaaS products, and they paid in the form of an upfront license measured in hundreds of thousands, if not millions of dollars, there would not have been 1,000 software IPOs over the past decade.

So what caused all this growth? It was the business model of Recurring Revenue! Recurring Revenue made it possible for software to eat the world. Recurring Revenue helped make it all digestible<sup>21</sup>.

{ **Statement 2a** } Why software Is Eating the World.

{ **Statement 2b** } Why Software as a Service Is Eating the World.

{ **Statement 2c** } Why Recurring Revenue Is Eating the World.

Over the past years we have finely focused on engineering a software product that lives in the cloud. I cannot help but ask myself: what would happen if we spent the same amount of engineering capacity on designing, building and operating Recurring Revenue as a business model?

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<sup>20</sup> Why Software is Eating the World, August 20, 2011, by Marc Andreessen

<sup>21</sup> Software is eating the world but it does so because of recurring revenue, March 2022, by Jacco van der Kooij



## Principle #2 Recurring Revenue is the Result of Recurring Impact

In philosophy and science, First Principle thinking breaks down complicated problems into basic elements<sup>22</sup>. The book (and movie) *Moneyball* shows how the Oakland A's, a baseball team with little money, changed the fundamental thinking of the industry regarding the use of metrics by building a championship team from a group of misfits. Under the leadership of a visionary GM, the team thrived by gauging talent using a completely different assessment of value—prioritizing the ability to get on base over common metrics such as speed and power<sup>23</sup>.

This willingness to reconsider how to assess value has spread throughout other sports: we have the InEos cycling team using the concept of marginal gain<sup>24</sup>, while the Golden State Warriors redefined basketball based on the efficiency of the 3-point shot<sup>25</sup>. All these real life scenarios successfully challenged previously accepted First Principles. This has happened in Software sales as well, where we changed the First Principle by adopting Recurring Revenue as a business model. We succeeded in supplanting a First Principle, but we have failed to adjust the operational part of the business accordingly.

What so many hypergrowth companies get fundamentally wrong, especially early on, is assuming the goal of a SaaS machine is to generate recurring revenue, and that to increase the growth rate you need to win lots of deals.

Growing revenue by winning more deals sounds pretty reasonable, right!? It is an incomplete understanding. This assumption leaves out the key question of *what produces the recurring revenue*. What's missing from the following formula?

**{ Statement 3a }** Customer ⇒ \_\_\_\_\_ ⇒ Recurring Revenue

If, say, Netflix wants recurring revenue from its customers, it needs to provide something of value on a regular cadence. If Netflix were to stop producing new shows for their audience each month, eventually people would stop paying, right? Netflix customers want new monthly content in return for their monthly payments<sup>26</sup>.

**{ Statement 3b }** Customer ⇒ Recurring Impact ⇒ Recurring Revenue

A broader name that applies generically across different industries is *Recurring Impact*. If a customer does not perceive they are getting this impact month over month, and year over year, they will stop paying. It's really that simple. Recurring Revenue should be seen as a result. It is the dynamic of *Recurring Impact* that drives recurring revenue growth.

Successful companies establish a uniform language of identifying, developing, and growing recurring customer impact, not just recurring revenue.

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<sup>22</sup> First Principles: The Building Blocks of True Knowledge by Farnham Street

<sup>23</sup> The True Story That Inspired Moneyball by Daniel Johnson, February 18, 2022

<sup>24</sup> Core Principle and Marginal Gains, March 11, 2015 by Sir Dave Brailsford

<sup>25</sup> Understanding Features of Successful the 3 Point Shots in the NBA, Nate Bailey, Karan Bhuwarka, Hin Lee, Tim Zhong Massachusetts Institute of Technology, MIT (Dated: December 13, 2018)

<sup>26</sup> How Netflix is Changing the TV Industry by the Investopedia Team, September 3, 2022

## Principle #3 Impact Expansion Results in Revenue Expansion

Many companies who pursue recurring revenue fail to harness the power of recurring revenue because they fail to understand how it results from recurring impact.

These companies may have found a way to artificially increase recurring revenue by selling more deals, or bigger deals – yet fail to realize why their customer is buying, or rather what the customer is buying. This may explain why so many companies fail to inform their customers of the recurring impact they provide every month. They are not aware of this; “customer impact” is a foreign language they do not speak.

Instead they pursue *unhealthy growth*, which is based on the pursuit of recurring revenue growth without delivering recurring impact. You can recognize an organization pursuing unhealthy growth by the following characteristics:

- A maniacal focus on winning more deals,
- A corresponding insatiable hunger for leads, and
- Look for constant affirmation of how great they are (often via a Net Promoter Score or company valuation).

All these efforts lack one common quality: they are not centered around achieving impact for the customer.

In a world where buyers have dozens, if not hundreds, of SaaS services, each with a renewal, companies that provide the customer with recurring impact will be rewarded with recurring revenue. No recurring impact, no renewal.

Let's examine the characteristics of an impact-centric organization:

- Positioning their offering based on the impact it offers.
- A maniacal focus on achieving the promised impact for customers.
- A growing pressure to find the right kind of customers based on impact. They change their lead generation mindset to quality over quantity.
- The ability to measure the impact provided to a customer. They produce and carefully track a regular, periodic impact report for the customer.
- They close the loop and feed customer information back into the organization: Engineering, Product Management, Marketing, Sales and the C-suite.

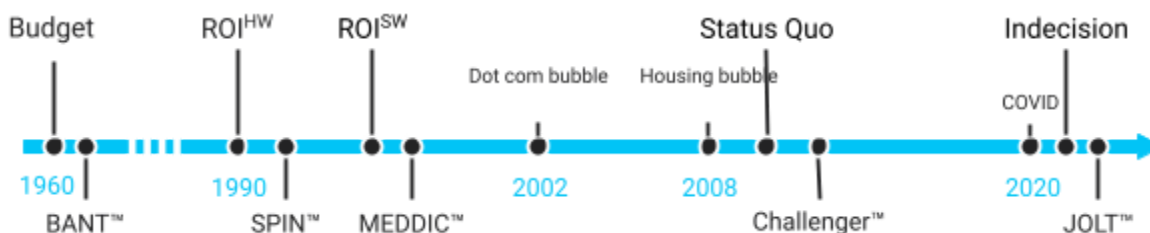
In 2023, companies who measure the recurring impact customers get from the product, and as a result develop a deep understanding of the impact a customer achieves with their product, will differentiate themselves.

## Principle #4 A Customer Commits Based on the Priority of the Impact

Most organizations rally around the mistaken thesis that availability of budget, or a Return on Investment (ROI) model, drives the purchase. This was true in the past, but it is no longer.

**FIGURE 3.1**

### Beyond Budget and ROI



Historically, the B2B market has been built on hardware products with steep upfront costs<sup>27 28 29</sup>. IBM's first generation mainframe computers were not only extremely pricey, but they required a significant investment for installation. This generated a culture in which sellers rightfully pursued buyers with sufficiently large budgets. Thus BANT, the sales methodology developed by IBM in the 1960s, begins with the letter B which stands for "Budget."

**{ Statement 4a }** *Most companies have no problem finding the budget to buy SaaS services.*

The advent of the Internet caused extensive innovation in the 1990s. This forced companies to scrap their IT systems prematurely and replace them with newer systems that operated at a significantly lower cost or produced higher revenues. To validate the premature purchase, sellers used an approach popularized as Return on Investment (ROI) analysis.

**{ Statement 4b }** *Each SaaS product, by its very nature, offers an amazing ROI.*

Most companies in the early 2000s would buy one (or at most two) perpetual software platforms a year. How times have changed!

Today, buyers commit to as many as a dozen new SaaS services a year, and hundreds of renewals a year.

All these SaaS services individually easily fit within the budget, and all of them have a 10x ROI. So trying to fit the budget and offering a 10x ROI is not what it is about. If these qualities are not why a SaaS product is purchased, what is?

**{ Statement 4c }** *Today, SaaS Services are bought on the priority of the Impact a service provides.*

<sup>27</sup> The History of SaaS, by Johnson Hur

<sup>28</sup> The History of SaaS (Software as a Service), by Uvaro

<sup>29</sup> The History of SaaS: From Emerging Technology to Ubiquity, by Victoria Fryer

As mentioned earlier, the reason we noticed a decline in growth over the summer, is not that deals were lost to a competitor. Intriguingly, what we found is that deals are delayed due to customer indecision<sup>30</sup>.

Note that during the client acquisition process, budget and ROI are relatively static, whereas priority constantly fluctuates. Different stakeholders may emerge. Conversations may be more about priority than about ROI. Shifting organizations or priorities can lead to indecision. This is new to sales organizations, many of whom are not familiar with how to overcome indecision.

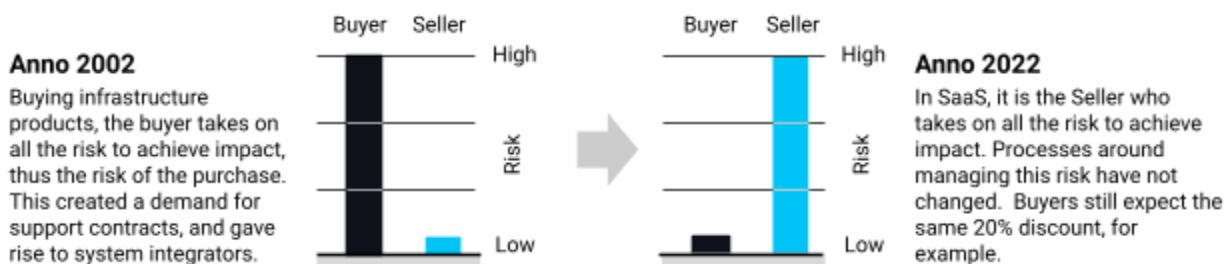
In 2023, successful SaaS GTM teams will position and sell based on priority, not budget. This means asking “*Why now?*” rather than “*Why do you need this product?*” or “*Why us?*”

### Principle #5 The Risk has Shifted from Buyer to Seller

We have experienced a number of significant shifts in the move to SaaS. Many of these shifts have been ignored, causing daily disruptions and even fractures between departments within SaaS organizations who do not understand the implications. I find it astonishing that the industry never responded to the tectonic shift of the risk from buyer to seller when we moved from an ownership-based pay model to a subscription-based pay model<sup>31</sup>.

FIGURE 3.2

#### How SaaS Shifted Risk Of The Deal Shifted From the Buyer To The Seller



Allow me to explain with an example. With a \$10M hardware purchase of servers that are paid for upfront, the buyer takes on the lion’s share of the risk. The product was built for the customer, shipped to their location, and installed within their network. Since they paid up front, and the asset is fixed in place, if anything goes wrong—the buyer bears the risk.

In contrast, the seller takes on the lion’s share of the risk with SaaS. The seller must build the infrastructure, develop the software, and host the service. Due to the fractional revenues a SaaS service provider receives each month/year, it is common to take anywhere from 15 to 25 months to recoup just the customer acquisition cost, or CAC.

<sup>30</sup> The JOLT Effect: How High Performers Overcome Customer Indecision, by Matt Dixon and Ted McKenna

<sup>31</sup> The SaaS Sales Method, Sales as a Science by Jacco van der Kooij

Most companies will need a customer lifetime 3x that amount to run a profitable business with healthy margins. That means the customer needs to keep renewing for anywhere from 45 to 75 months. That leads to many years of achieving impact and earning renewals.

SaaS GTM teams must be trained on identifying more of the right customers (based on potential impact) early on, and fewer of the wrong customers.

*Quality over quantity.*

Premature churn presents a huge risk, which explains two popular SaaS strategies:

- Quality-based over Quantity-based outreach programs: the ability of an organization to determine if Impact can be achieved early in the process to keep the churn impact low.
- Product Led Growth, in which the CAC in many cases is about one to three months, making a PLG customer profitable within a year.

## **Principle #6 Recurring Revenue Is Sensitive to Marginal Gain**

As you can see in the example in Figure 2.3, the Recurring Revenue machinery is highly sensitive to marginal gain. This is due to three factors:

- Factor 1.** There are many actions and interactions between a seller and all those involved on the buyer side, along the entire lifecycle of a customer.
- Factor 2.** All these actions and interactions are connected and influence each other, so a small change in one affects the next. For example, a bad discovery call can lead to a poorly informed demo.
- Factor 3.** The changes often amplify each other. For example, a discount and its impact on win rate<sup>32</sup>.

The combination of these three factors represents a system highly sensitive to marginal gain – a system so sensitive we may call it volatile. This fundamental understanding of marginal gains sets top performers apart. There are many practices where marginal gains in the most basic of tasks can make a big impact, yet are frequently unrecognized:

- Consistent messaging from first touch throughout the entire journey.
- Starting/ending meetings on time, with an agreed next step as a result.
- Following up diligently on agreed action items.
- Sending monthly impact reports to customers.
- Use of uniform language within the company.
- Great hiring and onboarding process.

Tackle one basic task per month. Do this for 12 months across 12 actions and you will see systematic and qualitative improvements.

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<sup>32</sup> Relationship between discount and win rate by Jacco van der Kooij, November 17, 2022

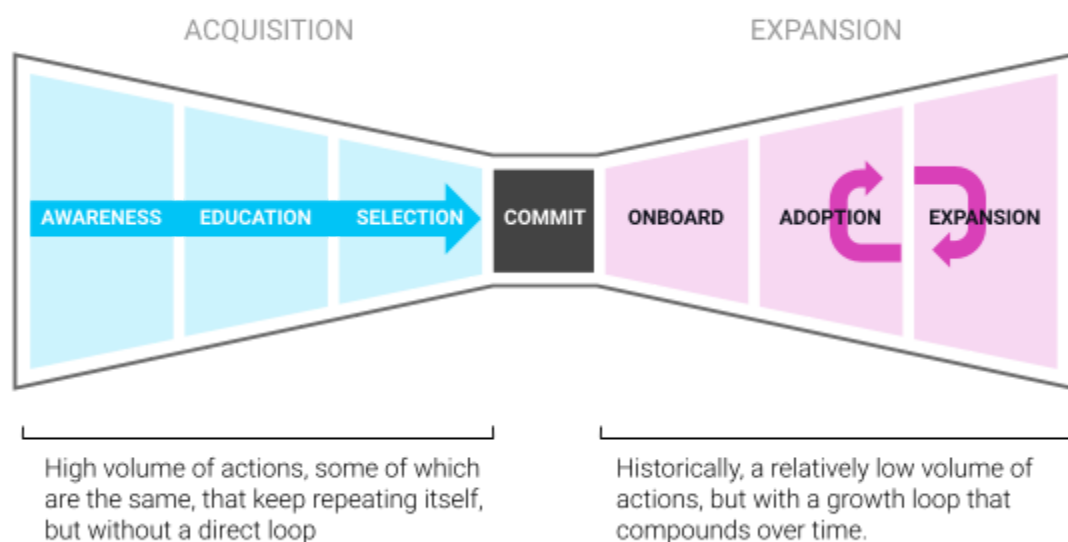
At first, each of these actions may seem isolated. But the Recurring Revenue savant knows they are all connected into a coherent system that depends on and amplifies each element. For example, hiring a person who during the interview demonstrated their meeting management abilities, and the time-sensitive nature of following up is likely to result in higher-quality customer interactions as well.

## Principle #7 Repetition Is A Critical Factor in Recurring Revenue

As presented in Principle #6, a Recurring Revenue system is susceptible to small changes, especially if these changes are repeated over and over again.

**FIGURE 3.3**

### The Circle Game – Creating a Compounding Growth Loop



There are two different ways of repetition (as visualized in Figure 3.3):

- During Acquisition**, there is no direct Growth loop. The customer invariably goes through the “buying process as a first-time customer” only once. In this process they are exposed to a relatively high concentration of high-engagement actions over a short time frame. For example, the sales cycle may be an intense three months in which two dozen meetings are held across the organization. This involves a high repetition of online and in-person meetings.
- During Expansion**, there is a direct Growth loop. For example, an annual increase of the sales price of 6%. That means that each year, you keep increasing the price, causing growth based on growth based on growth. The higher the amount of repetition over time, the more insane the impact is, and the harder it is for a human to comprehend that impact without opening a spreadsheet and calculating it out. For example, an annual increase of the price by 8% over 7 years.

## Principle #8 Disproportionate Impact

Ask a typical sales leader what they need from the organization to double revenue, and they will say, "I need 2x the amount of leads at the same quality as today, and I need 2x the amount of people to call on all of these!" This assumes a linear relationship between leads and wins.

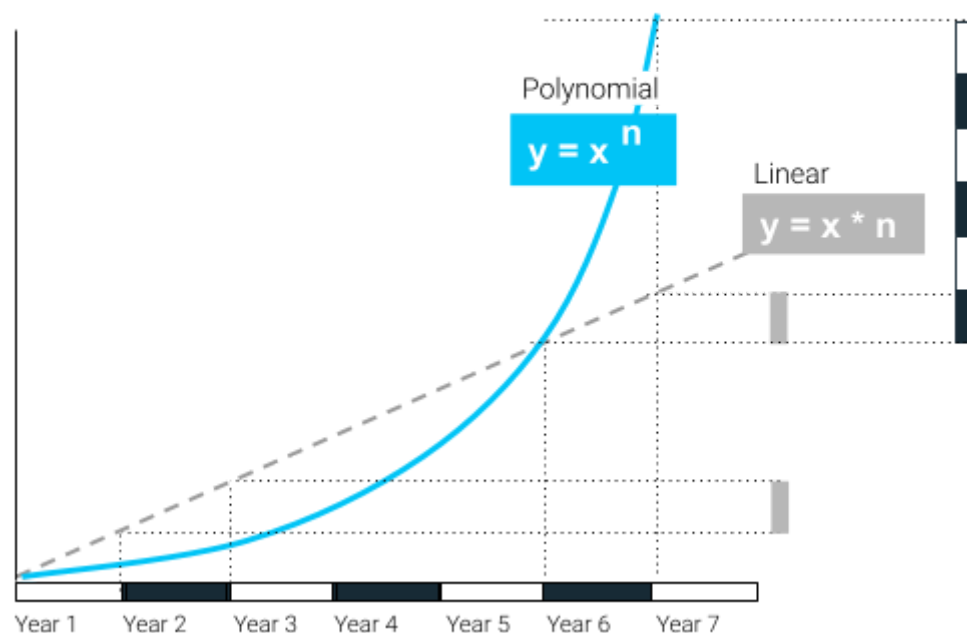
As we have proven elsewhere, we can increase performance of the entire system by making marginal improvements across a small number of conversion points.

For example, if we follow the idea of a Growth Formula, a more manageable 15% improvement across 5 conversion points will yield double the revenue. Here's how that works:

1. 15% increase in the lead volume, say from 100 to 115 leads per month
2. 15% increase in lead-to-opportunity conversion, say from 2% to 2.3%
3. 15% increase improvement in qualification, say from 60% to 69%
4. 15% improvement in win rate, from 20% to 23%
5. 15% improvement in price by reducing the discount

This growth follows a *polynomial* curve (sometimes incorrectly popularized as exponential growth due to its similarity<sup>33</sup>) The next figure illustrates linear vs. polynomial growth.

**FIGURE 3.4**  
**How Compound Delivers more Oomph**



Consider an example: a platform that sells for \$20,000/year, and maintains the same price which results in a total revenue of \$100,000 over a 5-year period. The seller makes the same amount of money in year 6 as they do in year 1.

<sup>33</sup> An Introduction to Exponential Functions

However, when you increase the price annually by 10%, it starts to follow a *polynomial growth* curve. This shows that growth in year 6 is far greater than the growth in year 1.

In the first years both models seem to yield, against a relatively small number of 10 projects, similar revenue. However, this relatively small increase of 10% in the price, over a relatively small amount of projects, through the effects of repetition (Principle 6), and along a polynomial growth curve results in a huge (34%) increase. And using a very similar cost structure.

**FIGURE 3.5**

**Demonstrating the Non-Linear Impact on Growth Over a 5-year Period**

	No annual increase	10% annual price increase	Number of Customer Projects.	Impact with no annual increase	Impact with a 10% increase
Year 1	\$ 20,000	\$ 20,000	10	\$ 200,000	\$ 200,000
Year 2	\$ 20,000	\$ 22,000	10+12	\$ 440,000	\$ 484,000
Year 3	\$ 20,000	\$ 24,200	10+12+14	\$ 720,000	\$ 871,200
Year 4	\$ 20,000	\$ 26,620	10+12+14+16	\$ 1,040,000	\$ 1,384,240
Year 5	\$ 20,000	\$ 29,282	10+12+14+16+18	\$ 1,400,000	\$ 2,049,740
<b>Total</b>	<b>\$ 100,000</b>	<b>\$ 122,102</b>		<b>\$ 3,800,000</b>	<b>\$ 4,989,180</b>

Although I realize many may consider this a simple insight, even the smartest people rarely recognize the full impact of these effects<sup>34</sup>. A few key observations:

**Observation 1.** The total amount earned per project is obviously higher with \$122,102 which is a difference of \$22,102, equating to approximately one extra project.

**Observation 2. The gap is growing each year.** It starts with \$2,000/project, but in year 5 it has grown to \$2,982/project, and this is important – in year 5, this is pure profit.

**Observation 3.** This keeps growing along 2 axes, for more revenue per project, and more projects. Over a 5-year period this compounds into an extra \$1,189,180 in revenue, or a 30% increase.

Now, multiply this by thousands of accounts, and extend this over ten years, and you can see why SaaS is such a powerful model – if, that is, you apply the aforementioned principles. But if you are not focused on impact, and as a result you are churning more than you are growing, this machinery starts to work in reverse. And as we explained in Act 2, this is where we find ourselves today.

<sup>34</sup> Compounding Knowledge by Farnam Street (and Warren Buffet)



## Principle #9 Recurring Revenue Operating Model

Most SaaS businesses today operate with no oversight or consistent approach; the organization as a whole simply trusts that if each department just does its thing...and hands it off to the next department, everything magically works together.

So each department “*does its own thing*,” they pick their own tools, often each with their own methodology, and they use their own data/metrics and dashboards. To make matters worse, every 2 years or so, the leadership of the department is changed, and the new leader is free to once again “*does its own thing*” pick new tools, a new methodology, implement a new approach (CS), hire a new team (sales), or spend a lot of money on popular campaigns (Marketing).

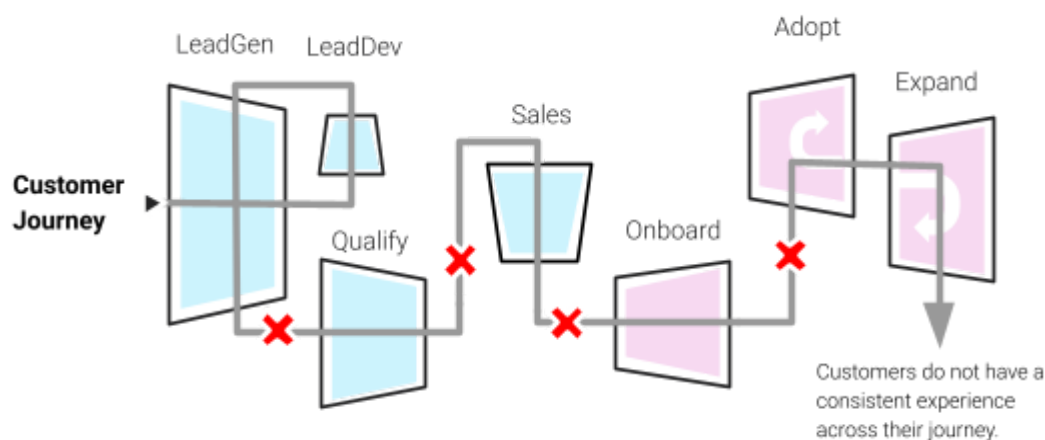
This is not an exception; it is the norm. A new sales leader will come with a preferred sales methodology, e.g. MEDDIC, Challenger, etc. Both are great, that is not the problem, but I ask you to imagine walking into the Ford manufacturing plant and imagine the impact of a new leader deciding on a whim to change some of the tools, metrics, approaches, etc. And to do this without informing any other department of these changes. Would that work?

As a business gets bigger and bigger, like a factory, it needs a uniform operating model. This provides the customer with a consistent experience, and enables it to respond faster to changing market conditions,

Without such an operating model (similar to that of an Operating System), it becomes virtually impossible for a SaaS business at \$50 to 350M to adapt to any new changes. A uniform operating model leads to a common language and a standardized data model.

**FIGURE 3.5**

**Non-interoperability Between Functions Is Commonplace.**



SaaS companies who want to be successful in 2023 and beyond must align all GTM functions (better yet, the entire business) along a uniform Operating Model. We recommend this Operating Model to be fundamentally based on delivering Customer Impact, and considering Recurring Revenue as the result. Successful companies using Product Led Growth (PLG) as their GTM motion are already leading and paving the way.

## Principle #10 SaaS Thrives in Crisis

SaaS was conceived in the late 1990s as a technology solution to overcome infrastructure inefficiencies. This led to the birth of SaaS during the dotcom bubble burst in 2001. In the mid-2003-2007 time period, SaaS matured – at first not in the SMB industry, but rather in the VSB (very small business) industry. This stigma of being a solution for small companies would take more than a decade to get rid of.

As the financial market suddenly collapsed following the real-estate bubble in 2008, CAPEX budgets fell away. SaaS in those days was deemed an Operational Expense due to its monthly fee structure. As a result, SaaS entered what we know today as the Golden Era around 2012, and for the next decade, anything that was “SaaS” would sell, generate incredible valuations, and fuel hundreds of companies who would go public.

CFOs became more familiar with the impact of SaaS expenses on their budgets, and soon the CAPEX vs. OPEX advantage disappeared. Selling became harder and harder. Every SaaS vendor was now selling based on the pitch, *"All you need to do is win one additional deal a year, and the software practically pays for itself."* And as more and more vendors flooded the marketplace, and right when this pitch was getting really tired, COVID happened.

COVID represented a once-in-a-lifetime industry-wide critical event. Overnight it created a massive boost for SaaS software providers, as many leaders had to rush to "get Zoom licenses" or equivalent software products to keep their teams productive. With it, SaaS overcame its stigma and became part of the Enterprise toolstack.

What does all this mean? SaaS is responsive to a crisis, and in the various crises of 2001, 2008 and 2020 SaaS did not just survive, it uprooted the entire market, and it thrived. Why is that?

SaaS is fundamentally customer-centric. Remember the principle that Recurring Revenue is the result of Recurring Impact, which makes SaaS solutions responsive to a customer's needs. Then consider that in 2020, COVID caused delays on shipping containers, which in turn delayed shipments of physical goods such as routers, forcing manufacturers to wait for months to source all the materials needed to increase production to meet the demand..

Compare that to founder Eric Yuan of Zoom, who scaled up cloud capacity to address the increased demand, and was able to fix bugs, address regulatory issues, and the like. He even went to work on the product himself, and his team was able to scale wide and deep in a matter of days, sometimes even hours, not months or years.

Let's call it what it is: the SaaS Crash of 2022 was the result of Operator Error, by all of us. But the recurring revenue machine is still in place and fully operational. In 2023, we will see that SaaS can and will thrive, even in a crisis it created itself.

## ACT FOUR

# 2023 THE DAWN OF A NEW ERA

While the Golden Age of SaaS may have come to an end, SaaS is just beginning to realize its full potential. Instead of a frivolous solution that disrupted nearly every business, SaaS has now matured into a robust solution that today's broader markets depend on. 2023 will be a transformative year, and SaaS leaders will need to take swift action early in the year for their organizations not only to be a part of the transformation, but to reap the rewards.

The entire transformation can be captured simply by: *Stop Doing What Doesn't Work and Do More of What Works*. It guides us what to do next:

- Guidance #1** Set a clear goal
- Guidance #2** Measure what is working.
- Guidance #3** Stop Doing What Does Not Work.
- Guidance #4** Do More Of What Works.
- Guidance #5** Start Now. Time is of the essence.

### Guidance #1 Set A Clear Goal

What we are trying to achieve: do we want to be profitable, do we want to grow faster, grow more efficiently, or become the undisputed market leader? The past decades have been all about achieving maximum growth in the shortest amount of time, and we should celebrate what has been accomplished since the first appearance of that now famous statement, "Software is Eating the World."

#### { Statement 5a } Revenue Growth ⇒ Growth Rate ⇒ Valuation

We did it!<sup>35</sup> But now it's time to move on. We have grown out of adolescence and matured. Which means that we now have to carry bigger responsibilities, and act accordingly. We are shaking off the frivolous, and while in the midst of the economic storm, taking on what lies ahead.

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<sup>35</sup> A Record Year For IPOs by Sophia Kunthara of Crunchbase, December 9, 2021

Unless you are a company such as a security software company that stands to gain from the storm<sup>36</sup>, your growth trajectory will change in 2023. Many of you may fear that this will change your valuation. It may, but it does not have to!

The growth you pursued all along was just a means to an end. It resulted in Market Leadership – look at companies such as Snowflake and Adobe. Market Leadership enables a company to sell more products, or to produce at a higher volume and a lower cost. And the great news is that there are more paths to achieve an end goal of higher valuation.

**{ Statement 5b } Achieve Sustainable Growth ⇒ Market Leadership ⇒ Valuation**

**{ Statement 5c } Achieve Customer Impact ⇒ Market Leadership ⇒ Valuation**

And herein lies the answer to 2023. Whether you adjust your goal to market leadership via the sustainable growth path (seller-centric), or via achieving customer impact (buyer-centric), both will position you for dynamic growth. With several years of experience, you can rally the entire GTM team around a new goal that achieves not only the same result, but a better long-term result, which follows a more natural growth motion. *You are in the sweet spot, even while being in the middle of the storm.*

## Guidance #2 Measure What Is Working

When you operate a SaaS business and have grown well beyond \$10M in ARR, you have become a revenue factory, and, as a factory, your company should have become dependent on standardizing and executing the right processes. But now (and this is important): *what got you here, in this sweet spot, will not get you where you are going next.*

You can no longer use a dataset averaged over 2021 and 2022. The world has changed and will continue to change. You have to understand the story behind the data:

- Step 1.** Create a data model that covers the entire lifecycle of the business, e.g., expand the funnel into a Bowtie.
- Step 2.** Obtain the data and establish a trendline for the past 18 months, increasing the weight of more recent data over that of historical data.
- Step 3.** Develop a Growth Formula for each of your key GTM motions based on this trendline. This should be somewhere between 3 to 5 GTM motions.
- Step 4.** Aggregate all Growth Formulas, one for each GTM motion, into your 2023 model.

This may sound complicated, but it should not be. It should take an organization less than a few days to get a general idea of the situation. If it takes longer, you are not doing it right. Do not be afraid to make assumptions.

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<sup>36</sup> A 2 trillion dollar market opportunity for cybersecurity technology and service providers, by Bharath Aiyer, Jeffrey Caso, Peter Russell, and Marc Sorel. McKinsey, October 27, 2022.

## The Use of Assumptions

Assumptions are a critical element of science<sup>37</sup>. Assumptions help us fill gaps in our data until we can replace them with the actual data. When using assumptions, they need to be clearly called out. In many cases, we put off creating a Growth Formula because we can't find or get the data. Don't let the lack of data get in the way of starting this project. Instead, make an assumption, of which there are multiple levels:

**Level 4** Results from an random unrelated internet search.

**Level 3** Results from a recent personal experience (small sample size).

**Level 2** Relevant trend data from a peer company over the last 3 months.

**Level 1** Talk to a person in the field about what happened last week/month.

Strive for level 1 and 2 assumptions, and minimize the reliance on level 3 and 4 assumptions.

## Guidance #3 Stop Doing What Does Not Work

As we have come to learn, the biggest challenge for most companies is to STOP doing the comfortable but suboptimal things they have been doing for years.

Having worked with thousands of leaders at hundreds of SaaS companies, I've realized that leaders often lead with their gut feeling or intuition when making critical decisions; these intuitive decisions are based on qualitative data or observations.

But we have made a turn, and we are now at the dawn of a new era in which previously held perspectives will not only hold back progress, but will have an adverse and radical impact.

For example, over the second half of 2022, sales organizations started to experience a new phenomenon: the key reason that sales targets were missed was not that deals were lost, and not even that our champions and deciders 'went dark'. What we noticed is that customers across most segments, regions, and verticals started to deliberately push deals down the road. Research by the DCM Insights team confirmed this<sup>38</sup>. DCM Insights analyzed over 2.5 million sales calls via call recordings and machine-based learning, and noticed the presence of Indecision in 87% of all sales calls. They discovered that a relationship existed between the increase in Indecision and the number of deals being pushed out<sup>39</sup>.

Their findings, in a nutshell: The Fear Of Messing Up (FOMU) that buyers have is now encountered far more often than the Fear Of Missing Out (FOMO). They also found that when buyers felt forced to make a purchase, the FOMU increased, which in turn increased the level of Indecision. The higher the FOMU, the more likely the decision was delayed. Now I ask you, what do most sales organizations that fall short of their goals do at the end of the year? They offer a discount that expires at a set date! The seller intuits that they are using a tool that will

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<sup>37</sup> How Description Leads to Understanding, by Farnam Street

<sup>38</sup> The JOLT Effect: How High Performers Overcome Customer Indecision, by Matt Dixon and Ted McKenna

<sup>39</sup> How Sales Reps can Overcome Indecision, by Matt Dixon and Jacco vanderKooij

motivate the buyer to buy, but what they are actually doing is increasing the FOMU, and therefore increasing the chance of the buyer delaying her decision.

In other words, **the intuition of the sellers themselves is causing an adverse impact.**

I have seen this elsewhere: a race car driver who can “drift” a car through a corner knows that she has to steer the car in the opposite direction for it to work<sup>40</sup>. Is it hard? No. Once you know how to do it, can you repeat it? Of course! Just as savvy individuals learn to defy their first natural impulses when the situation dictates, good leaders trust their intuition when initial data tells a different story. Here are a few examples of where leaders need to defy their own intuition:

**Quantity vs. Quality:** In a down economy, you cannot increase the size of your pipeline by seeking to increase the amount of leads. Doing so will not correlate to more qualified opportunities, but lead instead to fewer.

**Discount vs. Win Rate:** An increase in discount does not result in an automatic increase in win rate. It radically decreases the amount of revenue committed<sup>41</sup>.

**People vs. Process:** When things go right, our first intent is to reward the person in charge, and when things go wrong, we have a tendency to blame and even fire people. Instead of recognizing individual traits, we should look for (and operationalize) the processes that give rise to these turns of events. As W. Edwards Deming would say, blame the process — not the people.

**Cost cutting:** Under the duress of needing to cut costs, firing a customer success rep often feels like an easy decision; after all, “*We already won the customer.*” Data tells us, however, that Customer Success impacts the revenue in three ways, which when combined, providing a far greater positive impact than the salary savings of decreasing CSM headcount <sup>42</sup>:

- Reduction of churn by preventing a scenario where a customer walks away.
- Increase in expansion, e.g., a customer buying more, and at the fraction of the cost compared to that of new customer acquisition.
- Increasing the length of the customer retention period, say on average from 5½ years, to 5¾ years, which we know from principle 8 has a disproportionate impact.

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<sup>40</sup> The Science Behind Drifting, Burt Brothers, November 2, 2018.

<sup>41</sup> Relationship between discount and win rate by Jacco van der Kooij, November 17, 2022

<sup>42</sup> The Rise of Customer Success as a Profit Center, by Julie Weill Persofsky, May 7, 2021.

### Stopping Is Not as Easy as it Sounds

Most of us love to start new things, especially if we do not get the results we had hoped for. We launch another campaign, hire another person, or buy a new domain. Each of these initiatives requires more resources and more energy. We keep starting new things, we keep opening new tabs in our browser. But we rarely close them.

This is because, for most people, the hardest thing to do is to stop. We do not easily give up on a campaign, fire a person we hired, or abandon an approach we carefully picked. We hate admitting we made a bad choice and we hope things will change. If something is not working, we consider it a failure; we are unable to see it as a successful outcome. We need to learn how to “Stop It.”

Here’s how you stop something: discuss with the team the project you are suggesting to stop, set a date and a target. If the target has not been reached by the set date, stop the project. And reassign the valuable resources to projects that are working.

### Guidance #4 Do More Of What Works

Many SaaS companies have been dependent on programs that ask “*Will it scale?*” as the primary decision criteria and have no regard for cost. In 2022, we learned that if it is not sustainable, it is not scalable<sup>43</sup>.

The LeadGen team at companies is feeling the impact of the lack of scaling in their GTM motion. Every day, they are faced with a near-maniacal frenzy around the production of leads to fuel a hungry sales team. On Inbound LeadGen, this led to excessive spending on SEO and SEM. In Outbound LeadGen, this resulted in the hiring and firing of large numbers of sellers.

These programs are designed around scalability, often automated via tools. But now these programs have both scalability and sustainability challenges. ‘*Scalable*’ in that doubling the spend does not double the results. ‘*Sustainable*’ in that to get to 2x the results, they often need to boost the spend by 3x, 5x or even 10x. There are many reasons for this: it is a crowded space, overuse of technology, and buyers being SPAMMED and PHISHED all the time.

So, what is working? Here are a few examples of what we have ourselves found to be extremely helpful in our own growth<sup>44</sup>:

- The use of content as outbound call,
- Channels and partners generating leads for you,
- Word of mouth spreading in a closed community,
- People attending educational workshops,
- “How to” videos on YouTube,
- Impromptu referrals from happy users, and
- Champions moving across companies.

<sup>43</sup> You can't scale that which you can't sustain, by Jacco van der Kooij, November 2021

<sup>44</sup> The fastest growing companies in Silicon Valley, Silicon Valley Business Journal, October 27, 2022

These successful programs share common qualities: they are hard to do, they have been developed natively, **and they generate a lower volume but a higher quality of leads**. And because they are hard, few companies will enact them. The key point for you is to do more of what works – even if it is hard.

### **Guidance #5 A Clarion Call: Start Now. Time is of the Essence.**

Bring the team together, do it now. Use your SKO/RKO to make this Clarion Call. Time is of the Essence.

Remember that SaaS operates on marginal gains. That means every little thing helps, and that means that every person has a role to play. Success in 2023 is based on everyone working together, as a team. What a fantastic message for an event to open the year 2023, based on scientific principles, and plenty of sports and team examples to use as a theme and to inspire.

Think of asking each team or function to identify a key action that they have seen as impacting the customer the most. We call this a Moment That Matters<sup>45</sup>. For example, a better discovery call, an improved approach to online workshops, or a better customer onboarding call perhaps.

Then ask that team how to cause a 10% marginal gain in that Moment That Matters. In the first quarter, aim for that. It's as simple as that. Next quarter, pick a different Moment That Matters. That gives you 3 to 4 improved actions per function for the year. Do this across all customer-facing functions.

Next, trust the power of your SaaS Machine. Trust that these marginal gains will compound over time. No need to rush, no need to bulk up and do dozens of actions per function every quarter. Do one patiently every quarter. Let time do the rest.

Your people will get the idea, and they will start to extrapolate that one Moment That Matters will positively impact other areas with growth potential. It is a beautiful thing.

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<sup>45</sup> The Power of Moments: Why Certain Experiences Have Extraordinary Impact by Chip Heath, October 3, 2017



## The Next Act is Yours

2022 marked the end of the Golden Age of SaaS, when SaaS was the new kid on the block, shaking up the establishment when leads were plentiful, in a fertile economy, when anything SaaS was hot. But times have changed, and we need to respond accordingly.

SaaS is adopted by most of the B2B market today, and its recurring revenue approach is known for all of its strengths and weaknesses. The strength is its customer-centric focus – SaaS businesses' ability to scale seamlessly with an increase or decrease in demand. The weakness of SaaS is that its marginal gain dynamics make it volatile and susceptible to Operator Error.

But, if we architect, build, and responsibly operate the SaaS machinery – the way it was meant to work – it will become the foundation for all successful Enterprise businesses. If we fail and pursue it as a way to make a quick buck as an owner, an investor, or even a customer, the next decade will see the demise of this model. It will be perceived as too volatile and as the primary cause of failed SaaS companies.

2012 may have marked the beginning of the Golden Age of SaaS. And indeed, over the next decade, it Ate the World. Will 2023 mark the start of a new era?

Going from Recurring Revenue to Recurring Impact will transform your business to one that is customer-centric. Your organization will become far more data-driven, by basing your efforts on Growth Formulas that use more relevant, real-time data instead of outdated averages. And by using the scientific models of Revenue Architecture, you will make your business sustainable for the decade to come.

With the insights provided here, I encourage SaaS leaders to rely on the same engineering prowess to design their Recurring Revenue machinery, as they already do when developing the product it represents.

The companies that came out swinging from 2012 to 2014 have become the last decade's winners. Similarly, those SaaS organizations that succeed in 2023 will be the winners of the next decade. And, what you do as an organization in the first weeks of 2023 will determine the outcome of 2023. Conversely, Indecision during such transformative moments comes with great consequences.

So here you are, right where you are supposed to be, in the Sweet Spot in the Eye of the Storm.

What are you going to do next?

**Want to keep going?**

If you want to stay informed about the latest in Revenue Architecture, and be notified about the release of the upcoming book on this topic, follow us on social media or contact us:

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