CIOs and their shifting relationship with SaaS

SaaS vendors and investors should take note of shifting buying behavior
Overview

The rapid penetration of many software categories by SaaS vendors over the last few years has driven a fragmentation of decision making in the software purchase cycle. Those most impacted by this have been IT departments whose control and influence over such purchases has in some cases diminished. Our recent survey of 195 enterprise-level software decision makers points to further growth opportunities for SaaS vendors, but also at the need for SaaS vendors to consider their product and sales strategies as forward-thinking CIOs adapt to the new landscape, and as hybrid cloud deployments become increasingly common and complex.

Over the last few years, we at Parthenon-EY, have encountered an increasingly large number of SaaS vendors whose customers are not the CIO. Whether it is the Head of Sales, Director of Engineering or CMO, the introduction of SaaS has eliminated the technological barriers that had previously prevented business units from purchasing their own software tools. In order to understand the impact of this shift on the IT department, Parthenon-EY conducted a survey of 195 key IT purchase decision-makers in enterprises across the US. Through this research we uncovered four key findings that will influence the development of the SaaS enterprise software market over the next several years:

1. There remains significant continued runway for SaaS penetration. All CIOs recognize the value of SaaS tools.
2. CIOs are feeling a loss of control over the enterprise IT ecosystem, but few have found a palatable response.
3. A small set of forward-thinking CIOs are leaning into the SaaS revolution by accepting the increased ecosystem complexity and providing collaborative support for business unit needs.
4. SaaS vendors, particularly those whose product and sales teams have been happy to fly under the radar of IT departments, could start facing headwinds in the future.

Successful SaaS vendors will develop both best in class user features and be responsive to the forward-thinking CIO agenda.

Runway for continued SaaS expansion is significant

As the world of SaaS vendors and products expands at an accelerated pace, so have investments in SaaS companies large and small. According to Dealogic, 2016 looks to be on-pace to beat last year’s record of 1,526 transactions. Over the past three-plus years alone, transaction volumes and values have increased at an impressive 17% and 22% CAGR respectively. Indeed, software companies shook hands on more than US$100 billion worth of deals during this time period with an increasing number of deals focused on SaaS companies.

While this rapid acceleration in SaaS deals may make some concerned about an overheating market, there appears to be significant additional runway for enterprise SaaS to continue to grow. In Parthenon-EY’s 2016 Survey of CIOs, we found that SaaS has continued headroom for growth across the entire enterprise software ecosystem. While certain software categories (like CRM) are more penetrated by SaaS than others (like Supply Chain Management), CIOs see significant runway for SaaS across their portfolios.

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1 We defined forward-thinking CIOs as those who were quicker to adopt SaaS and more likely to adopt in the future.
2 451 Research Group M&A Data as of 07/31/15; accessed 08/01/15
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As SaaS solutions and the use of the cloud continue to proliferate, so have vendor sales and marketing tactics aimed at flying under the radar of the enterprise CIO’s watch. In many instances, SaaS companies have gained traction by delivering products that cater to specific business unit needs with little or no consideration paid to IT Departments concerns. For many SaaS companies, this has been a successful go to market approach as they have gained access to the business unit budgets that were previously untapped by software vendors. However, if forward-thinking CIOs are to be believed, this period of CIO disintermediation appears poised to reverse course. Parthenon-EY’s research indicates that CIOs are feeling a loss of control, but are beginning to find ways to take that control back.

SaaS revolution disrupts CIOs’ centralized decision-making

According to the latest research from Parthenon-EY, CIOs are expressing concern over challenges to centralized control of their company’s IT infrastructure, with many of them anticipating that these threats will only increase in future. The emergence of SaaS offerings, and the ability for business units to deploy SaaS with limited IT support, has been the root cause of this disintermediation.
The growing prevalence of SaaS has created a chaotic IT purchasing environment where business units are making IT purchases that CIOs may only be tangentially privy to in some cases, and in others, completely uninvolved. In our 2016 Survey of CIOs, Senior IT leaders and CIOs indicated that they are responsible for three-quarters of IT purchasing today, but expect their influence to decrease to two-thirds of the overall responsibility in the next three to five years. Whether or not the CIO has visibility into these purchases, the CIO is still responsible for this ever-expanding vendor portfolio and the consequences of shadow IT purchases.

According to the director of technology at an international health care firm, “It is definitely unruly. The biggest pain of it is that I have to pay for SaaS solutions on a credit card. They don’t want a purchase order … Someone buys $100/month software and that person leaves and then we lose that software because he left. That is what keeps me up at night.”

The increasing loss of IT control disempowers CIOs from overseeing vendor portfolios, despite risks to the organization. Of the CIOs we surveyed, 78% are uncomfortable with business unit, end-users purchasing software. Yet, CIOs’ approaches to managing this changing landscape vary considerably, with some having adopted fairly robust management processes, while others have nothing at all in place.

“There is no organized data governance policy to go along with ad-hoc [SaaS] purchased software,” according to one CIO.

In stark contrast, the CIO of a major US power utility said, “Like many organizations, we went through a huge exercise to centralize all technology purchases to make sure we have our arms around what we are buying. We have a budget process that captures 90% of purchases … The process is very formalized.”

With individual business units, departments or teams increasingly able to purchase one-off software, CIOs are expressing their dissatisfaction.
“A $500k purchase can be approved by a business unit leader who decides that he or she needs something. Purchasing this SaaS was a blatant violation of going outside the system ... and we did not even know about it until they needed to integrate with Oracle,” one CIO told us.

“These scenarios of shadow IT purchases are primarily because of SaaS. With SaaS, they can bypass our servers. A lot of them say the same thing to me, that their package is easy to maintain and we can cut hours and costs. Unfortunately, the business units buy into that marketing way too easily,” concurred a major fast food chain CIO.

Further complicating the picture is the fact that CIOs are managing ever increasing complexity in their cloud infrastructure. In Parthenon-EY’s 2016 Survey of CIOs, CIOs indicated that they often managed a mix of environments, including on-premise, hybrid cloud deployment, and full-cloud applications. Software categories that have seen more penetration of SaaS (e.g., CRM) also typically have the most complex IT infrastructure, with a significant mix of SaaS, hybrid cloud, and on-premise deployments.
Forward-thinking CIOs are embracing SaaS

While some CIOs resist SaaS deployments, forward-thinking CIOs are embracing this change in order to regain control of their IT ecosystems. They are adopting SaaS significantly faster than their peers and taking a business partner approach to IT management.

The CIO of a major US power utility explained, “There have been efforts by IT to take back control [of purchasing]. Those efforts are not going to be successful in the long term. Anything that you try to stop is going to become the trend. If you ask certain CIOs, they’ll say that they have no cloud, but you can find people all over the place who are using CRM or Dropbox, whatever it may be, it’s the cloud.”

It is not as if forward-thinkers are excited about the proliferation of SaaS products across their portfolios. In fact, forward-thinkers are actually 9% more likely than the average CIO to say that they have too many vendors. What differentiates forward-thinkers from the average CIO is that they have begun to see the scope of the “shadow” IT purchases in their organizations, and have started to consider how to address the challenges.

Forward-thinkers do not believe the solution to this chaotic purchasing environment is mass vendor consolidation. They expect the long-term role of IT to evolve from exclusively technical implementation to one that begins to incorporate business unit needs analysis as a core function. To that end, forward-thinkers have taken a portfolio management approach to much of their IT infrastructure. They are choosing to work with their business units and serve in an advisory role to provide enhanced integration capabilities and cost controls. As a result of this new proactive orientation towards SaaS, forward-thinkers actually expect to manage more vendors in the future than they do today.
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Figure 5: Percent of survey respondents who say they expect more software vendors today, All CIOs and Forward Thinkers

Q: How do you expect to change the number of software vendors that your organization currently engages with in the next 3-5 years?

- 33% of all CIOs expect more vendors
- 45% of forward thinkers expect more vendors

Source: Parthenon-EY’s 2016 Survey of CIOs

One executive told us, “I want our teams to have the software that makes them effective and dynamic, and if that means having more applications because a legacy ERP with modules doesn’t do the trick, then I’m ok with that. But I also need them to allow IT some insight into what they are purchasing, what they are doing with their purchases, and for them to give us a heads up about what type of integrations they need. Otherwise we can get into some serious trouble that has consequences for both the business unit and the company as a whole. I want to be supportive of everyone’s needs, but I want to have some basic oversight in return.”

“In the long term, the role of the IT administrator [in the cloud world] is to solve business problems through technology. As my technical staff shrinks, my analyst staff grows. It is more about the IT administrator’s ability to understand business needs and get solutions,” said another CIO.

Greater CIO influence will shift the terms of the deal

As the CIO begins to exert more influence on SaaS purchases, they will do so with a fundamental awareness of business unit needs, but will also overlay the key considerations of the overall IT environment. SaaS vendors and investors in SaaS businesses should be encouraged by the forward-thinkers, but prepared to respond to this new world. Rather than focusing solely on developing products with solely the end-user in mind (as some SaaS vendors have done in the past), successful SaaS vendors will give more consideration to the enterprise-wide IT agenda. The CIO’s key considerations for SaaS offerings include the following four key tenets:

1. Security and compliance
2. Platform capabilities
3. High service levels
4. Price stability
1. Security and compliance
The more SaaS companies and their investors understand the forward-thinking CIOs’ new agenda, the better investment decisions they will make. These CIOs stress that security, compliance and integration are key requirements as they work with business units in the software purchasing environment.

“This comes back to my philosophy about IT purchasing. I don’t need to control the purchase itself, as long as IT has an opportunity to vet the products and service to ensure that our fiduciary responsibility – security, data protection, market-competitive pricing and terms – is fulfilled,” said the director of IT for a lighting manufacturing company.

“Compliance is a huge risk for us,” said one CIO. “There are a series of important questions around compliance, integration, data privacy and security, and who owns the data, which a business unit leader doesn’t ask.”

2. Platforms capabilities
In addition, CIOs report that SaaS providers should offer broad platforms over point solutions serving specific needs. “We have a strong preference towards platform solutions. One of the ways to reduce IT expense is to have one system. The IT point of view is to have simple but sophisticated systems. We just want simplicity,” commented one CIO.

It is also important to note that – perhaps because of lower costs associated with integration – incumbent vendors have a slight edge when customers evaluate options. Only 11% of the CIOs surveyed said that they would actively seek a non-incumbent vendor.

3. Price stability
Generally, users of SaaS solutions have experienced and accepted marginally higher total cost of ownership (TCO) relative to on-premise solutions. Only 25% of the CIOs we surveyed believe that TCO for SaaS solutions is actually lower.

At times, though, the total cost of ownership is hard even for CIOs to understand. “The cloud subscription model is easy to describe, but your two-for-one premise has a lot of components and some are intangible ... Would I want those people who are worried about applying patches today to do other IT-related work within a company? Probably, but I don’t know how to put a dollar value to that,” said one director of IT.

However, despite their acceptance of high initial TCO, continuous incremental price hikes will not be tolerated by most CIOs. Those who responded to our research said that pricing for existing features must be kept stable with more limited increases over time. However, CIOs do indicate that they are willing to tolerate price increases alongside meaningful feature additions or improvements.
4. Higher service levels
In return for the higher TCO that is anticipated with SaaS products, CIOs expect a higher level of service from SaaS providers. Almost 80% of our CIO respondents said that SaaS solutions come with a higher expectation for service quality. This is inherent in the SaaS model, since updates are managed centrally by the vendor where active customer support is critical.

“One of the promises of SaaS, in theory, is that if they manage a much larger IT footprint with multiple customers feeding off their service, then they should be able to do it faster and more securely than I can within my own system. Logic would have it that by virtue of being a SaaS provider, a much larger scale should help with speed, security and reliability. That is my expectation for the provider whether it is fair or not,” said one director of IT.

As buyer sophistication increases, SaaS vendors will be held to higher standards
As CIOs become more involved in the purchase decision-making and management of SaaS tools, the overall purchasing process will become more sophisticated. With both the business unit and CIO at the negotiating table, it will be critical for SaaS vendors to be able to service the concerns of both constituents. Successful SaaS companies will continue to deliver the best in class features that business units demand (and which got them in the door in the first place), but will also pay close attention to the overall client's IT infrastructure needs.

One forward-thinking CIO made note of the lack of sophistication in the procurement process when only the business unit is involved, “[SaaS providers] grossly oversell the advantages of SaaS... Any type of customization to the software adds a lot of cost in the development ... The business unit doesn't account for the IT spend that comes from integrating, managing and customizing a new system.”

And the potential consequences of not servicing both the business unit and CIO are severe. Because SaaS is so easy to deploy, it is also quite easy to replace. Our respondents' noted that their software vendor switching frequency has decreased from approximately 5 years to 4 years, and the frequency of vendor re-evaluation has decreased from 2.7 years to 2.3 years.

“You go into the switching negotiation knowing that there will be a better solution in the next three to five years,” said a director of IT.
Investing in a bright future for SaaS

The future outlook for SaaS remains bright. While SaaS businesses have seen dramatic growth in the last few years, the bulk of enterprise software still remains on-premise today. CIOs expect continued SaaS expansion across their software ecosystem in the future. While the first wave of SaaS took off in large part because of the disintermediation of the CIO, our insights suggest that the CIO will become more involved in the coming years.

Forward-thinking CIO’s have begun to transition from being the centralized IT purchaser who lacked visibility into business unit-level purchases, to the manager of the full spectrum of IT needs in an organization. SaaS vendors and investors looking to expand their presence and influence within organizations will be well served to consider the unique needs of the CIO. Having a product roadmap that extends from a user-focused point solution to an extensible and secure platform will differentiate the best SaaS vendors from those that are relegated to niche status.

Most CIOs in our survey – not just those categorized as forward-thinking – envision a world with significantly broader penetration of SaaS across the entire IT ecosystem. This brings both opportunities and risks to SaaS vendors and investors. While significant runway remains, SaaS vendors will have to employ a more inclusive strategy in order to win among the increasingly sophisticated purchasers of their products.

About Parthenon-EY’s 2016 Survey of CIOs

Parthenon-EY’s 2016 Survey of CIOs is a survey of senior IT leaders with the objective of understanding their perspectives on the key types of enterprise software they purchase and deploy in their organizations. This survey of 195 US respondents, represented by CIOs and senior IT purchase decision-makers in companies ranging from small and midsized businesses (SMBs) to the Fortune 500, was conducted in January 2016.
About Parthenon-EY

Parthenon joined Ernst & Young LLP on 29 August 2014. Parthenon-EY is a strategy consultancy, committed to bringing unconventional yet pragmatic thinking together with our clients’ smarts to deliver actionable strategies for real impact in today’s complex business landscape. Innovation has become a necessary ingredient for sustained success. Critical to unlocking opportunities is Parthenon-EY’s ideal balance of strengths – specialized experience with broad executional capabilities – to help you optimize your portfolio of businesses, uncover industry insights to make investment decisions, find effective paths for strategic growth opportunities and make acquisitions more rewarding. Our proven methodologies along with a progressive spirit can deliver intelligent services for our clients, amplify the impact of our strategies and make us the global advisor of choice for business leaders.

For more information please go to www.parthenon.ey.com.