SaaS Capital Insights

In the first quarter of each year, SaaS Capital conducts a survey of B2B SaaS company metrics. This year's study marked our 9th annual survey, and it continues to grow with over 1,400 private B2B SaaS companies responding this year, making it the largest survey of its kind. Below are our findings on retention.

It also needs to be explicitly noted that this data was collected in early 2020 and is based on 2019 performance metrics, before the impact of the COVID-19 pandemic. Benchmarking comparisons should be made to the same time period for your company.

2020 B2B SAAS RETENTION BENCHMARKS

Based on its compounding effect on growth, revenue retention is now well established as the most important metric for ensuring medium- to long-term business health. New sale bookings versus revenue retention is the SaaS version of "offense wins games, defense wins championships." Due to its importance, we publish a lot of research on retention rates, and below is our most recent survey data cross-referenced against other important figures like growth rate, funding, and business model.

First, let's establish definitions. We asked companies to report their net and gross annual revenue retention data. Customer account retention may be a useful metric for you to track, but our focus in the survey, and generally the retention metric we think is the most important, is based on revenue. We define net retention as:

(Monthly Recurring Revenue in December of 2019 *only from customers who were customers in December 2018)*

÷

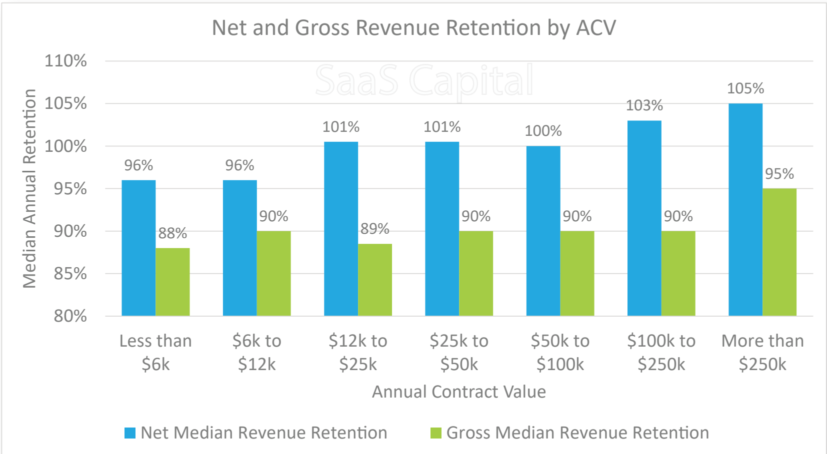
(Total MRR in December 2018)

This number can be anything from 0% to well above 100%, as it includes up-sells, new product cross-sells, and price increases. Annual gross retention is the same formula, excluding the upsells, cross-sells, and price increases. (For a fool-proof method, set each customer's 2019 MRR to be less than or equal to their 2018 MRR.) For this reason, gross retention cannot exceed 100%.

The data for very early-stage companies is so volatile that we have excluded companies with less than $1 million in ARR from the following analysis.

Retention by Annual Contract Value

The chart to the right shows median net and gross revenue retention across a range of annual contract values (ACVs). For retention, benchmarking by ACV is the best starting point. More than by company age, revenue level, or industry, companies with a similar ACV have the most in common. They will be organized similarly, go to market similarly, and support customers similarly. The opposite is true of two companies selling a $19.99/month product versus a $250,000/year product.



This year's results mark two interesting differences from what we have historically seen. The first is that data from our previous annual surveys had consistently shown that higher gross retention levels were directly correlated with higher ACVs. This relationship made intuitive sense. Higher-priced solutions more often involve a longer sales cycle, in-depth scoping and implementation, and dedicated support and account management. While the data still shows that the companies with the very highest ACVs have the highest gross retention, it is otherwise relatively consistent across the rest of the board.

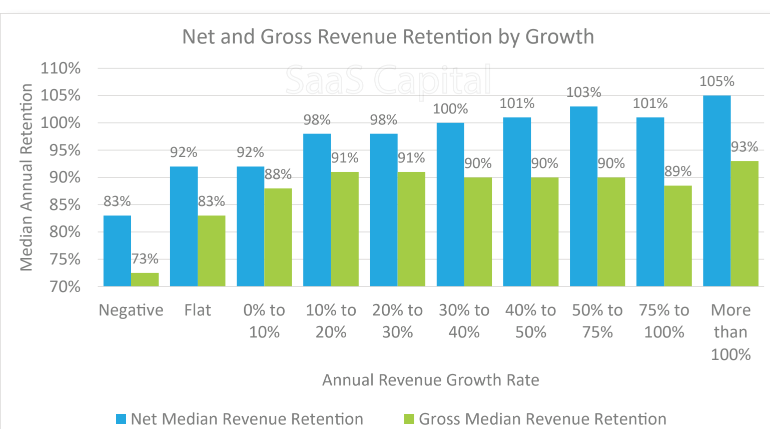
The second change is that this year's survey shows higher net retention correlated with higher ACVs.

Previous surveys had shown that, aside from the very small ACV segments, net retention was fairly consistent across all ACVs. The new data show a general correlation of increasing net retention with rising ACV.

We are not sure why the relationship switched this year. Data from our own portfolio and discussions with prospective borrowers have revealed that gross retention is the more "natural base" retention. Net retention is more influenced by organizational structure, compensation incentives, product pricing and tiering, and product function. From those anecdotes, we have seen gross retention more predictably correlate with ACV and net retention to be more variable company-to-company. We will again update this data next year, although the bigger story will likely be the impact of the coronavirus and economic shutdown.

Retention and Growth Rate

The chart below shows the relationship between retention and growth rate. Generally speaking, higher growth is associated with higher retention and vice versa. This is the "leaky bucket" metaphor. The higher your retention, the easier it is to grow that much faster because you don't have to first refill the bucket before adding to it. The impact of retention is also cumulative as it repeats and expands on itself year after year. The opposite is also true.



There is a small but obvious trend of higher net retention and higher growth for companies growing more than 10% annually. This trend is intuitive as net retention includes what are essentially new "sales" in the form of price increases, upgrades, upsells, and cross sells, which help grow revenue year-over-year. We need to be honest with the data, however, and note that the differences are quite small, increasing from 98% for companies growing 10% to 20% per year to 105% for companies growing more than 100% per year, so we know that there is much more than just upsell ability determining whether a company grows 10% or 100%. Other factors impacting growth include the competitive landscape, technology platform age (a.k.a. "technical debt"), marketing budget, and pricing methodology.

Gross retention does not share as strong of a relationship with growth rates as net retention for companies that report positive growth. The median gross retention rate for a company growing at least 10% was 90%, and relatively flat across all growth rates.

Flat or shrinking revenue is correlated to poor gross and net retention, and in a meaningful way. Back to the leaky bucket – if customers leave regularly, it is difficult to grow.

Retention and Channel Sales

Channel sales has been an area of increasing interest for the SaaS model over the last few years, and we are frequently asked about the impact of a channel sales strategy on retention. First, as was the case in our 2019 survey, there is no difference in net or gross retention between companies that have a channel program and those that do not. Both groups report 100% net and 90% gross retention.

Selling strategy shows a slight potential impact on retention. While there is no meaningful difference between retention and whether the channel partner provides a simple introduction or the customer is jointly sold by the partner, net retention drops to 95% if the sale is 100% managed by the partner.

Retention for Horizontal vs. Vertical Solutions

Looking at whether a company sells a vertical-focused product (dental office management software) versus a horizontal product (new hire applicant tracking) shows virtually no difference in retention. Net median revenue retention was the same at 100%, while gross retention was 90% for vertical-focused companies and 89% for horizontal-focused companies.

Retention in VC-Backed vs. Bootstrapped Companies

How do bootstrapped companies compare to VC-backed companies? Data from our 2019 survey showed that both net and gross retention averaged 4 percentage points higher for VC-backed companies when compared to their bootstrapped peers. This year, we find VC-backed companies holding the 4-percentage point lead in net retention with 101%, versus bootstrapped companies reporting 97%. However, bootstrapped companies narrowed the gap on gross retention to just 1 percentage point, supporting the comments above that gross retention is the "natural base" retention.

"Across all SaaS companies, median net retention is 100% and median gross retention is 90%, consistent with prior years' data. "

Higher average net retention for VC-backed companies makes sense from the standpoint VC firms are looking for exceptional returns from a few significant outliers. Previous research has also shown that a higher percentage of VC-backed companies have a customer success (CS) lead reporting to the CEO earlier in their life than their bootstrapped peers, and younger companies spend more on CS when they have VC backing.

Conclusions and Takeaways

- Across all SaaS companies, median net retention is 100% and median gross retention is 90%, consistent with prior years' data.
- Net retention is higher for higher-ACV products, while gross retention was mostly flat across ACVs. This relationship was reversed from prior years.
- For companies with ACVs below $250k, 90% gross retention is the norm. Very high ACV companies should benchmark to 95%.
- Companies with ACVs of $12k or higher report median net retention of 100%.
- Gross churn is not correlated with growth rate, but net churn is.
- The data show that high growth and high retention are correlated.
- Except for very low growth or shrinking companies, gross retention appears uncorrelated with growth rates.
- This year, venture-backed companies reported similar gross retention as bootstrapped companies. Previously they had reported higher gross retention. VC-backed companies still reported slightly higher net retention.
- Something not discussed above, but that we are asked frequently, is whether payment frequency (annual up-front versus monthly) impacts retention. The data show virtually no difference in retention rates between companies that receive customer payments primarily on a monthly basis versus those that predominately take annual up-front payments. Both groups show 100% net retention. Those receiving annual up-front payments reported 90% gross retention while those receiving monthly payments reported 91% retention.
- As a final note, it is worth repeating that this data was reported before the impact of the COVID-19 pandemic. Our survey data show that the number of SaaS companies serving a vertical industry and those with a horizontal product offering are about evenly split. Horizontal-positioned companies are somewhat better insulated from the impact of the crisis as they span across different industries. Vertically-oriented products are more impacted. Companies focused on health, digital remote communication, telemedicine, logistics, and food supply chain/grocery verticals are all benefitting from the situation. Companies focused on restaurants, non-essential shopping, and retail are all struggling. In the former case, new bookings are outpacing the original 2020 plans. In the latter case, new bookings have slowed, sometimes substantially, but increased churn is just starting to materialize. The ultimate level is still unknown and will vary by company. Best of luck to all operators as you navigate this unprecedented economic time.

About SaaS Capital

SaaS Capital is the leading provider of growth debt designed explicitly for B2B SaaS companies. SaaS Capital's growth debt is structured to provide a significant source of committed funding, deployment flexibility, and lower overall cost of capital, all while avoiding the loss of control and dilution associated with selling equity. SaaS Capital was the first to offer lending alternatives to SaaS businesses based on their future recurring revenue. Since 2007, SaaS Capital has deployed $209.5 million in growth debt to deliver better outcomes for 65+ clients, resulting in $753 million in total enterprise value created.

Benefits of SaaS Capital's unique, SaaS-focused approach:

- **Higher advance rates** - Capital availability is based on a multiple of your monthly recurring revenue (MRR) – typically 4x to 7x MRR
- **Capital availability that grows with your business** - The amount of capital that you can draw increases automatically as your revenue grows
- **Long-term source of capital** - The capital is drawn down over 2 years under the committed line of credit, and then either renewed, or repaid over the following 3 to 4 years
- **Efficient use of capital** - Capital is drawn down only as your business needs it, thereby reducing your interest expense
- **Flexibility** - No balance sheet covenants or cash reserve requirements

SaaS Capital is best able to assist companies with the following attributes:

- Sells a SaaS-based solution
- Seeking $2M to $10M in growth capital
- $250,000, or above, in MRR
- History of renewals greater than 80%
- Registered and principally banked in the U.S., Canada, or UK
- Revenue growth above 15% per year

Your business does ***NOT*** need to be:

- Venture Backed
- Profitable
- Billing your customers monthly

Visit www.saas-capital.com to learn more.

1311 VINE STREET | CINCINNATI, OH, 45202
7900 E GREENLAKE DRIVE NE, SUITE 206 | SEATTLE, WA 98103
WWW.SAAS-CAPITAL.COM

ROB BELCHER | MANAGING DIRECTOR | RBELCHER@SAAS-CAPITAL.COM | 303-870-9529
STEVE JAFFEE | MANAGING DIRECTOR | SJAFFEE@SAAS-CAPITAL.COM | 614-506-2770