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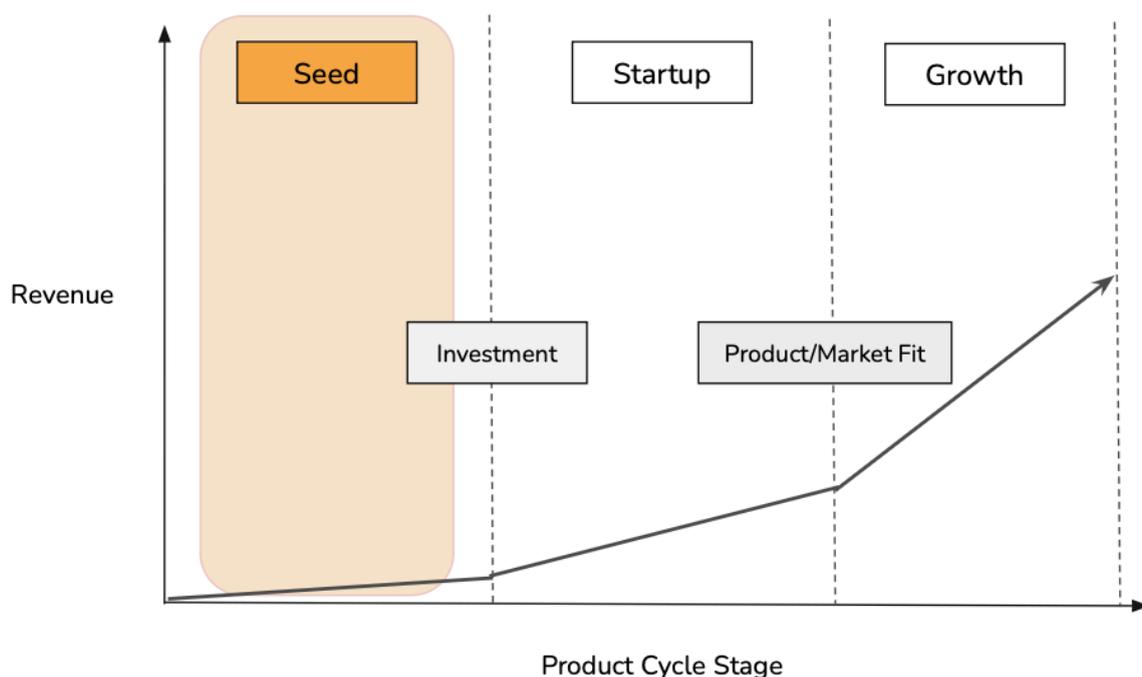
[Essentials of Software-as-a-Service \(SaaS\) Business.](#)

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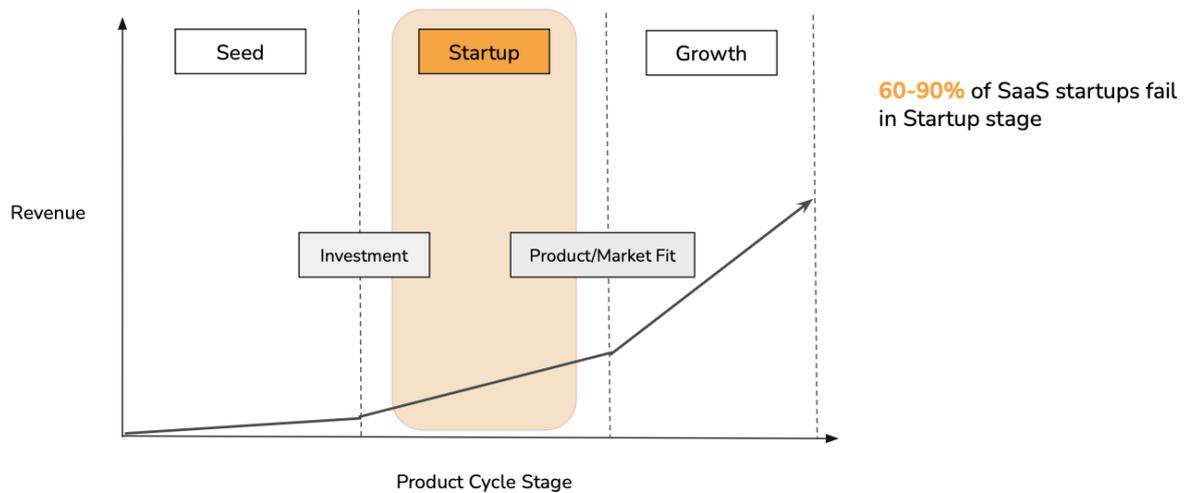
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## 1.3 SaaS StartUps Failing

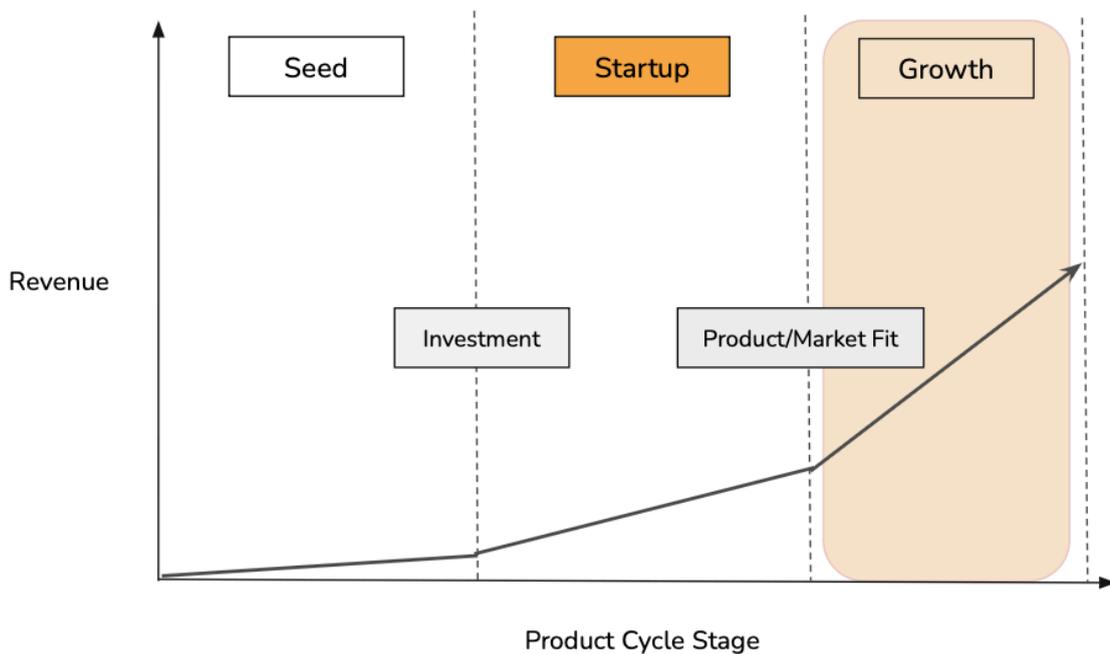
In this video, we will discuss an important topic, the failure of software as a service startups. In one of the previous videos, I mentioned that mostly startup companies are creating software as a service products. By examining why startup companies in this field often fail, we will gain valuable insights into the software as a service field as a whole. To better understand the stages that startups go through and where they are most likely to fail, let's take a look at a graph of the product cycle stages. This graph, based on my earlier research on software as a service, illustrates the various phases a company undergoes when an entrepreneur is creating a venture.



The first stage is called seed. During this phase, an entrepreneur typically gathers a group of friends or colleagues to create initial prototypes of the product. However, at this point, the company doesn't legally exist. Funding usually comes from family, friends, or the entrepreneur's own funds.



It is only when the entrepreneur receives an initial investment that the company begins to legally exist and can start selling products. This marks the beginning of the startup phase. Surprisingly, this is the stage where 60 to 90% of software as a service startups fail. This high failure rate represents a significant waste of resources, which is why practitioners and researchers are actively seeking tools and techniques to reduce the probability of failure for SaaS startups during this critical phase.



The goal for these companies is to successfully reach the growth phase. This phase is where a company has established a strong foothold in the market, and its customer base begins to expand rapidly. However, as we've seen, the vast majority of SaaS startups fail before reaching this stage.

To better understand why this happens, let's examine two key aspects where SaaS startups often struggle: the technical aspect and the business and management aspect. By exploring these areas in more detail, we can gain insights into the unique challenges faced by SaaS companies.

### ***Technical Aspect***

Firstly, what is the technical aspect of creating a software as a service product? This primarily relates to the barriers to entry, which are the forces that can make it difficult for new companies to enter and compete in the market. In the SaaS industry, these technical barriers are generally lower compared to other industries, where strict governmental regulations and large initial investments can be significant hurdles. However, there are still some technical challenges that SaaS startups must overcome:

#### **Integration Complexity**

- challenges with integration with other platforms

#### **Data Security and Privacy**

- failing to meet security and privacy standards

#### **Scalability and Performance**

- the ability to scale efficiently can be challenging

### ***Integration Complexity***

- First, there is integration complexity. SaaS products often need to integrate seamlessly with a variety of other platforms and services. Achieving this can be complex, especially for startups aiming to cater to businesses with existing IT infrastructures. Ensuring compatibility, maintaining data integrity during transfers, and providing flexible APIs are critical technical challenges.

### ***Data Security and Privacy***

- Next, SaaS startups must prioritize securing their applications by protecting against external threats and ensuring that data handling complies with international regulations. Failing to meet these security and privacy standards can undermine customer trust and lead to legal and financial consequences.

### ***Scalability and Performance:***

- And finally, as SaaS platforms gain more users, they must be able to scale efficiently to handle increasing loads. This requires optimization and infrastructure

management, which can be technically challenging for startups with limited resources.

## 2. Business and Management Aspect

While the technical barriers to entry in the SaaS industry are relatively low, research has shown that the majority of SaaS startups fail due to challenges in the business and management aspect. This is a critical area where many companies struggle, and it's one of the key reasons why this course exists – to help you understand and navigate the complex business landscape of software as a service. Let's explore some of the most common issues SaaS startups face when it comes to business development and management:

### Establishing Credibility

- absence of testimonials from previous customers
- difficult to persuade potential customers of the product's value



### Managing Cash Flow

- slow revenue accumulation
- relying on investor funding to manage cash flow in early stages



### Establishing Credibility

- *absence of testimonials from previous customers*
- *difficult to persuade potential customers of the product's value*

One of the primary challenges SaaS startups face is establishing credibility in the market. Often, these startups are attempting to enter a market where established IT vendors are already operating, providing custom-made software solutions. As a startup, you may be offering an innovative product with operational and functional advantages, but even if you succeed in creating a great product, you lack the credibility that comes with a proven track record. The problem lies in the fact that you don't have references from previous customers who can vouch for your product's quality and effectiveness. This makes it difficult to convince potential customers to trust in your product's value, as they have no real-world examples of its success.

For example, Dropbox faced the challenge of establishing credibility in the crowded cloud storage market. To overcome this, they released a non technical demo of their product,

launched a beta version to early adopters and implemented a referral program that rewarded users with additional storage space for every new user they brought in. This strategy not only helped Dropbox build their user base but also established credibility through user testimonials and word-of-mouth referrals.

### ***Managing Cash Flow***

- *slow revenue accumulation*
- *relying on investor funding to manage cash flow in early stages*

Another significant challenge for SaaS startups is managing cash flow. As we will explore further in upcoming videos, the pricing and revenue models of SaaS companies are very specific and can create cash flow difficulties, especially in the early stages of growth.

To illustrate this, let's consider a simple example. Imagine you are a SaaS vendor who has created an excellent product priced at 10€ per month. Even if you are successful in acquiring 100 customers, which is a significant achievement for a startup, your monthly revenue would only be 1,000€. However, your expenses, such as server costs, salaries, and marketing, are likely to be much higher than this amount. This discrepancy between revenue and expenses can put a severe strain on your cash flow and make it challenging to sustain your business operations.

For instance Slack, a popular team collaboration tool, faced similar cash flow challenges in its early days. They implemented a freemium model, allowing users to access a limited version of the product for free while offering more comprehensive paid plans. We will explore this model type in detail later in the course. So this strategy helped Slack with organic growth by balancing cash flow and customer base expansion.

Given these cash flow challenges, SaaS startups such as Slack, often rely heavily on investor support in the early stages of development. Securing funding from investors can provide the necessary capital to cover expenses and sustain the business until it reaches a point of profitability.

### Entering Market with Innovative SaaS Product

- significant time and resources are required to develop and educate the market about the product's value and how it meets their needs



### Finding Product-Market Fit

- time-consuming and requires significant resources
- company must know the target audience and their pain points
- risk of misinterpreting market demands



### Entering Market with Innovative SaaS Product

- *significant time and resources are required to develop and educate the market about the product's value and how it meets their needs*

A third challenge SaaS startups often face is entering the market with a product that is so novel and innovative that it essentially creates a new, previously non-existent market. In this scenario, the startup is solving a problem that no other company has attempted to solve before. This situation differs significantly from the cases we have previously discussed. For example, when Salesforce entered the market, they were stepping into the already established sales automation software market. However, when a SaaS startup creates an entirely new market, they face a unique set of challenges. On the one hand, being the first mover in a new market can be advantageous, as there are no direct competitors to contend with initially. On the other hand, creating a new market from scratch requires a substantial investment of time and resources. The startup must educate potential customers about the problem they are solving, the value their product offers, and how it addresses the customers' needs. This process of market education and development can be costly and time-consuming for a SaaS startup.

For example, Shopify, an e-commerce platform, faced this challenge when they entered the market with the innovative idea of making it easy for anyone to set up an online store. At the time, e-commerce was largely dominated by big players, and small business owners and entrepreneurs believed that creating an online store required substantial technical expertise and financial investment. Shopify had to educate their target market about how their user-friendly platform eliminates barriers and enables individuals without technical backgrounds to create, customize, and manage their online stores efficiently and affordably. By successfully educating the market and demonstrating the value of their product, Shopify was able to create and dominate a new market segment.

### Finding Product-Market Fit

- *time-consuming and requires significant resources*
- *company must know the target audience and their pain points*

- *risk of misinterpreting market demands*

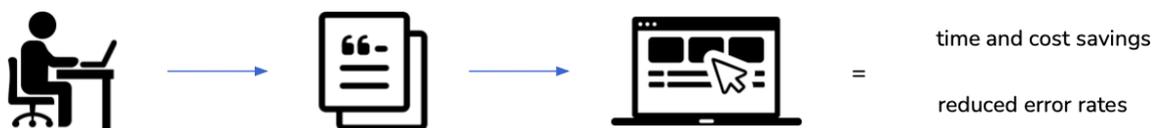
One of the most critical challenges for SaaS startups is finding product-market fit, which is the perfect alignment between the product's features and the market's needs. Many startups struggle to achieve this balance, either by misinterpreting what the market truly wants or by failing to adapt their product based on user feedback and behavior.

Achieving product-market fit requires a deep understanding of the target audience, their pain points, and the unique value the product offers. Startups must be willing to iterate on their product, making necessary changes and improvements based on user input and market trends. This process can be time-consuming and resource-intensive.

Let's take Instagram as an example, which began as a mobile app called Burbn. It was a feature-rich application that allowed users to check-in at locations, make plans with friends, and share photos. However, the founders noticed that users were most engaged with the photo-sharing feature, often ignoring the other functionalities. Based on this insight, the team decided to pivot their focus solely to photo-sharing, streamlining the app and rebranding it as Instagram. By listening to user behavior and focusing on the features that resonated most with their target audience, Instagram was able to find the perfect product-market fit.

#### Automation of processes

- implementing process automation is challenging
- need for a clear understanding of which processes can and should be automated



#### Overlooking the Power of Metrics

- failing to implement robust tracking and analytics systems from the start

#### Automation of processes

- *implementing process automation is challenging*
- *need for a clear understanding of which processes can and should be automated*

The fifth challenge SaaS startups face is the need to automate their processes. As I have previously mentioned, the SaaS industry is all about scalability. Due to the typically low price point of SaaS products, vendors must scale up their customer base to generate sufficient revenue to sustain their business and remain competitive. This is where process

automation comes into play. Scalability in the SaaS context is heavily dependent on the automation of processes. This means that various aspects of the business, such as customer onboarding and sales, should become increasingly automated over time, reducing the need for manual intervention by salespeople or developers. To illustrate it, let's consider email communication with potential customers. When reaching out to your first customer, you might manually compose and send an email, which can be time-consuming and costly. However, when approaching your second customer, you can reuse the email template from the first customer, saving time and effort. As you progress to your third customer and beyond, you may implement an automated email system that sends personalized emails at the click of a button, further streamlining the process.

So automation offers several other benefits for SaaS startups:

- *Time and cost savings*

Firstly, by automating repetitive tasks, startups can save time and money, allowing them to focus on other activities that directly contribute to business growth, such as product development and strategic planning.

- *Reduced error rates*

Secondly, automated processes are generally less prone to errors compared to manual ones, as they eliminate the risk of human mistakes. This can lead to a more consistent and reliable customer experience.

However, implementing process automation is not a simple task. It requires careful planning, investment in the right tools and technologies, and a clear understanding of the processes that can and should be automated. Many SaaS startups struggle with this aspect, which can contribute to their failure.

### ***Overlooking the Power of Metrics***

- *failing to implement robust tracking and analytics systems from the start*

The last critical challenge that we will discuss and that SaaS startups often face is underestimated the power of metrics. Many startups focus solely on product development, pouring all their resources into creating and refining their offering. However they fail to implement robust tracking and analytics systems from the outset. This oversight can lead to a lack of clarity regarding the company's performance, missed opportunities for optimization, and a higher risk of failure.

So throughout this video, we have explored several reasons why SaaS startups often fail. But what is the way out of it? These companies should address these challenges in a very specific way by utilizing Software-as-a-Service specific business strategies. In the

upcoming videos, we will discuss these strategies in detail, covering topics such as the lean approach, minimum viable product, validated learning, and key business metrics. Looking forward to seeing you there.