



SAAS Industry Outlook

Time to Ride the Wave

November 2021



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Insights on the Development Path of the Global SaaS Industry

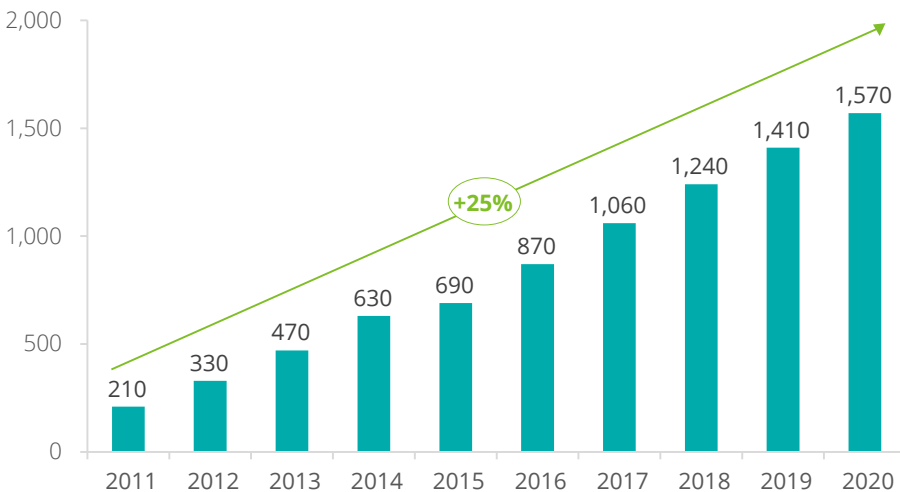
After over 20 years of development, the scale of the global SaaS industry reaches billions of dollars

From 1970s to 1990s, traditional ERP software manufacturers (such as Oracle and SAP) obtained vast enterprise customer resources in the global market. With the development of Internet technologies, one-time delivery and large-scale local deployment modes are increasingly unable to live up to enterprise customers' needs for efficiency and convenience. In 1999, Benioff left Oracle and founded Salesforce, which quickly became a pioneer of the SaaS industry, and therefrom SaaS was born.

After over 20 years of development, SaaS has become one of the most focused industry direction for the global tech industry. Currently, the global SaaS industry is undergoing rapid development. Along with continuous innovation of products and business models, and rapid changes of industry competition and product application scenarios, new market opportunities arise. Over the past 10 years, the global SaaS market size grew significantly, registering a compound annual growth rate of 25%.

Global SaaS Market Size (2011-2020)

Unit: US\$100 million



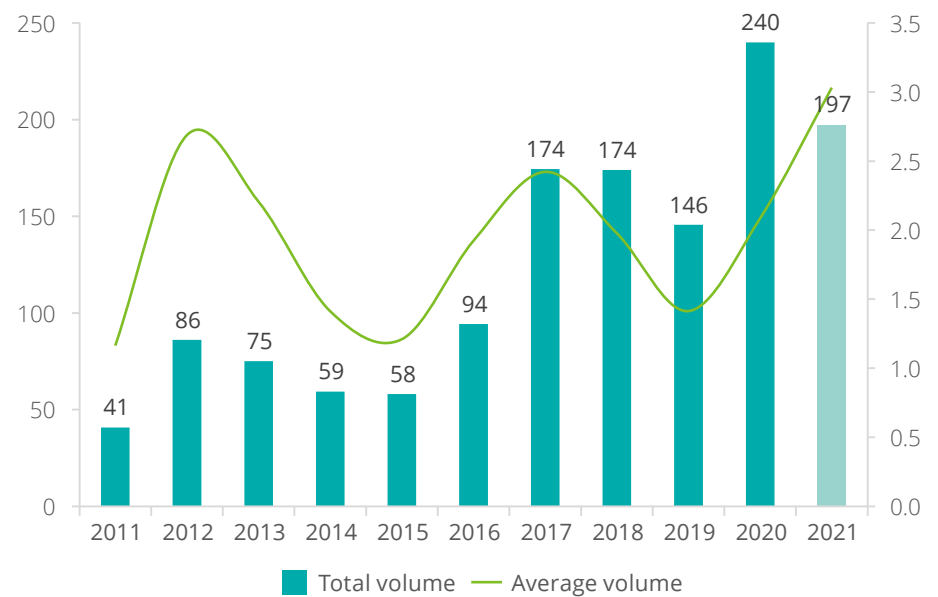
Source: Gartner; Deloitte research and analysis

Increasingly active M&A in the global SaaS industry with growth in both M&A number and volume

The global SaaS-related M&A continuously increased, from 35 in 2011 to 115 in 2020, contributing to a rapid increase in the total number of M&A. Meanwhile, the M&A volume grew significantly from about US\$4 billion in 2011 to about US\$24 billion in 2020, with a compound annual growth rate of 22%. In particular, due to the global spread of COVID-19 in 2020, the expansion of remote scenarios led to a distinct cloudization trend of software applications, and SaaS enterprises became more favored by capital markets.

Trends in the Total Global SaaS M&A Volume (2011-2021 M7)

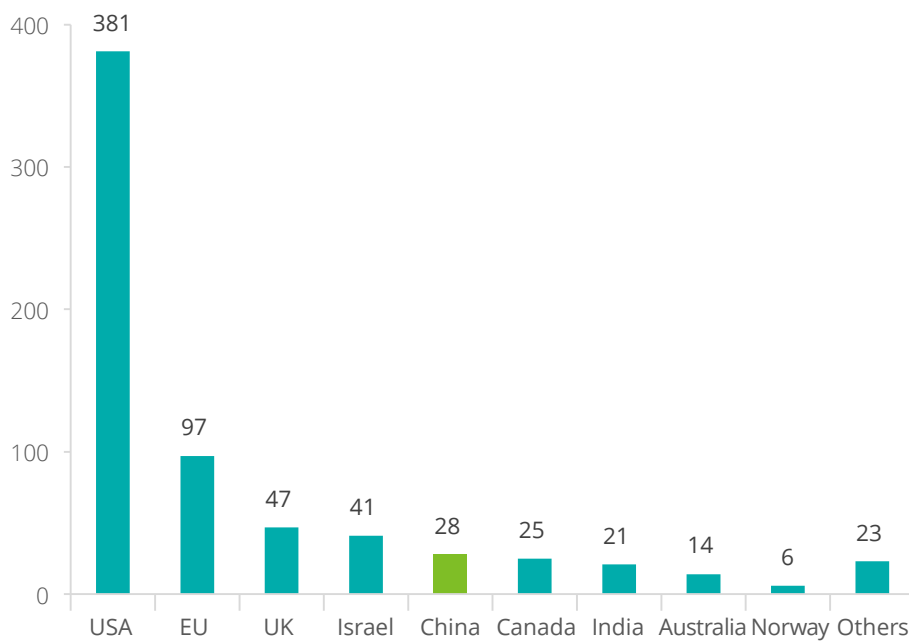
Unit: US\$100 million; US\$100 million per deal



Source: Mergermarket; Deloitte research and analysis

Countries in Europe and North America, especially the United States, have highly mature markets with many leading enterprises in sub-sectors/segments after more than two decades of development. The target companies of more than half of the Global SaaS M&A over the past decade are located in the United States while EU and other European countries accounted for close to 20% of the total Global SaaS M&A. China had twenty-eight SaaS M&A in the past ten years, lagging behind countries in Europe and North America.

Number of Global SaaS M&A by Country (2011-2021M7)

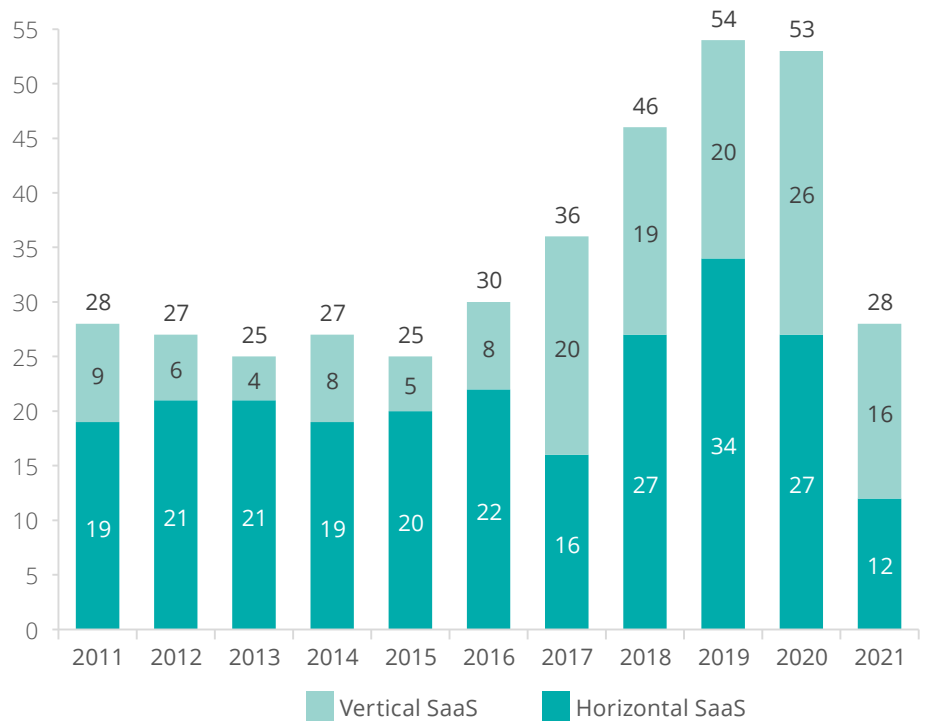


Source: Mergermarket; Deloitte research and analysis

From horizontal SaaS to vertical SaaS in developed countries

The analysis of US SaaS M&A during the past decade shows that the number of SaaS M&A is relatively stable from 2011 to 2015 with horizontal SaaS dominating the market and accounting for 68% of the total M&A. After 2015, a new trend towards vertical SaaS emerged with a strong growth momentum.

Distribution of US SaaS M&A - by Horizontal and Vertical SaaS (2011-2021M7)



Source: Mergermarket; Deloitte research and analysis

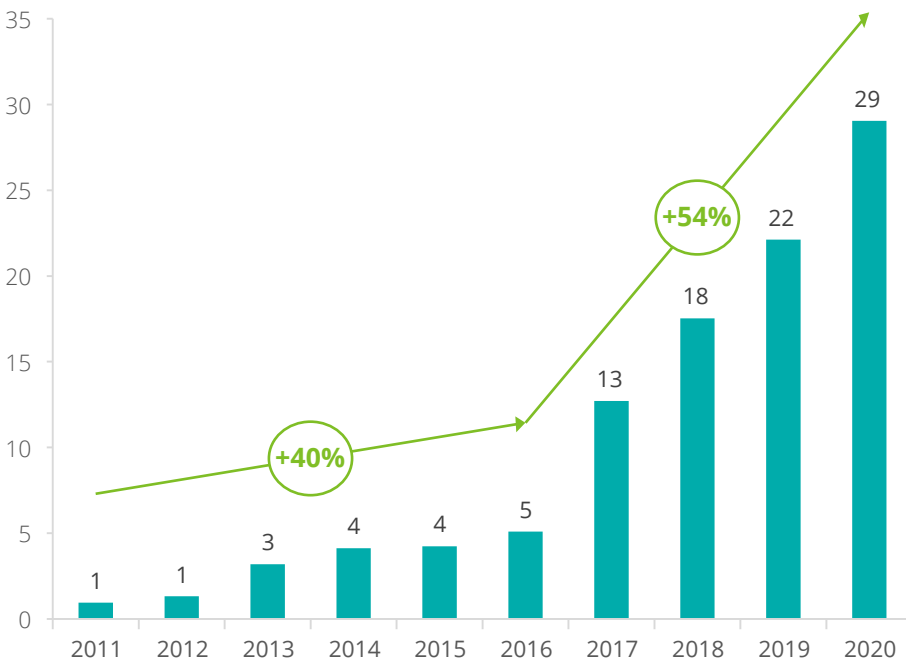
Evolution of China's SaaS Industry

Despite a late start, China's SaaS Industry gradually enters the fast lane

Compared with the global SaaS industry, China saw budding development from 2004 to 2005 and started late around 2010 with early-stage exploratory development. After 2016, Along with rising awareness of "cloud" and acceptance of SaaS by enterprises, China's SaaS industry sets off a new wave of development with the domestic SaaS market entering the fast lane.

China's SaaS Market Size (2011-2020)

Unit: US\$100 million



信息来源: Gartner, 德勤研究与分析

China's SaaS industry witnessed several important stages since 2005:



Budding – 2005-2010

SaaS first entered the Chinese market. Inspired by foreign vendors, domestic cloud vendors and traditional software enterprises started to venture into SaaS. In 2007, Alibaba announced its entry into the software industry, which was regarded as the formal beginning of the domestic SaaS industry. User-end enterprises were still in the stage of popularization of traditional software and lack understanding of SaaS.

Start – 2010-2015

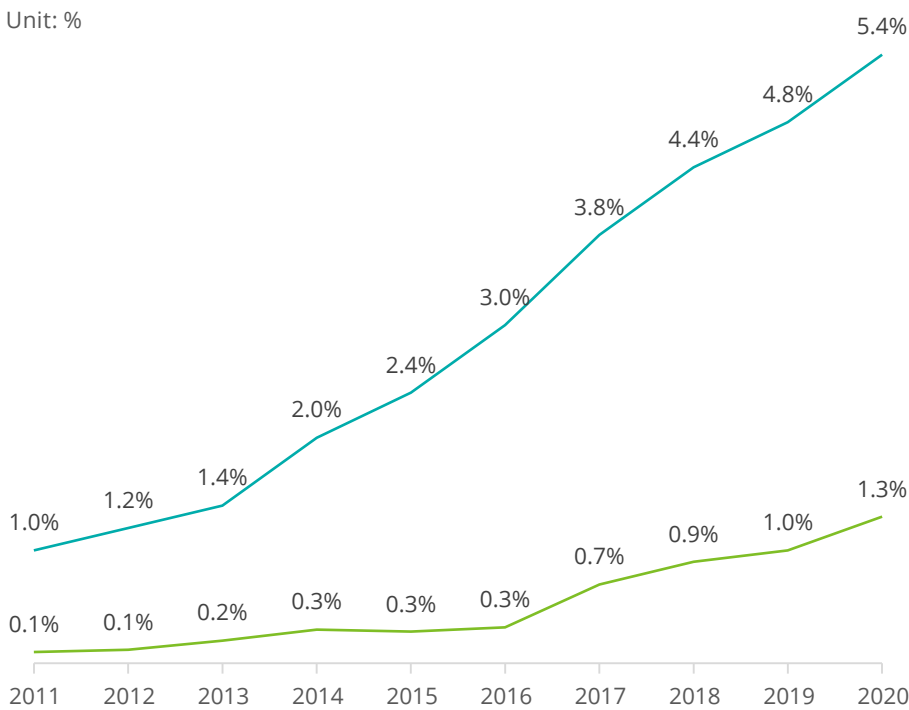
Innovative vendors actively deployed. Cloud services were launched in China but not yet popularized. Traditional software based on local deployment was still the mainstream. Vendors were committed to market education and promotion, and most SaaS products were localization of software with the same functions in the United States. Many start-ups, Internet companies, and traditional software companies were established or transitioned to the SaaS industry, such as Youzan, Weimob, and Raycloud. After ten years of development, these enterprises now have been listed and become major forces in the domestic vertical SaaS. Kingdee, Mingyuanyun and other companies also entered into the SaaS industry around 2011 to 2013 and launched relevant products.

Fast Growth – From 2015 Till Now

Cloud technologies have been improved, and technology business is gradually expanding. The market education of "cloudization" achieved initial success. Vendors made breakthroughs in technology innovation, and SaaS is gradually recognized and promoted for application. More and more innovative enterprises are entering into the market, leading to fiercer competition where technology has become the core competitiveness. With enterprises' digital demands, large-scale application of SaaS requires vendors to provide downstream customers with products that are more innovative and more aligned with the characteristics of the industry to solve the core pain points.

From the perspective of market size and the proportion of SaaS in IT spending, China's SaaS market is still in its infancy. In the United States, the share of SaaS in overall IT spending has been growing steadily over the past decade, accounting for more than 5% of IT spending in 2020. In contrast, although rising sharply year by year, the share of China's SaaS spending in overall IT spending is just 1.3% in 2020, leaving much room for growth.

Share of SaaS in IT Spending in China and the US

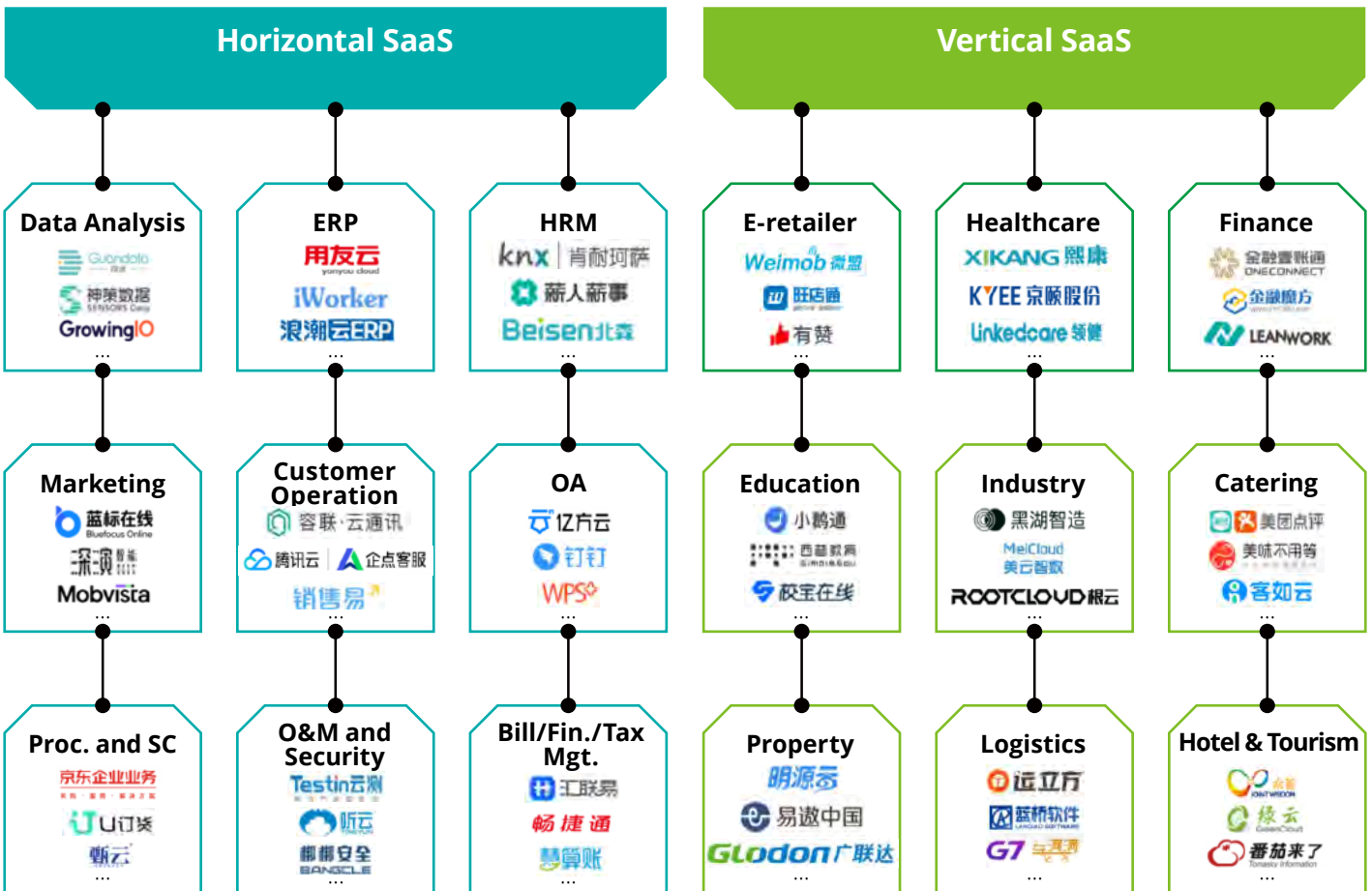


Source: Gartner; Deloitte research and analysis

No existing giants in spite of numerous industry participants

The domestic SaaS market is fragmented, where there are leading enterprises for each link of horizontal SaaS (such as procurement, HRM, CRM, OA, and video conference) and each segment of vertical SaaS (such as e-commerce, catering, logistics, and education). Overall, at the current stage vendors in the bottom layer of the industry explore the demands of the market segments, vendors in the middle layer seek growing space, and vendors in the top layer are committed to breaking the growth ceiling. However, unlike the US market, there are no billions-of-dollars-worth giants.

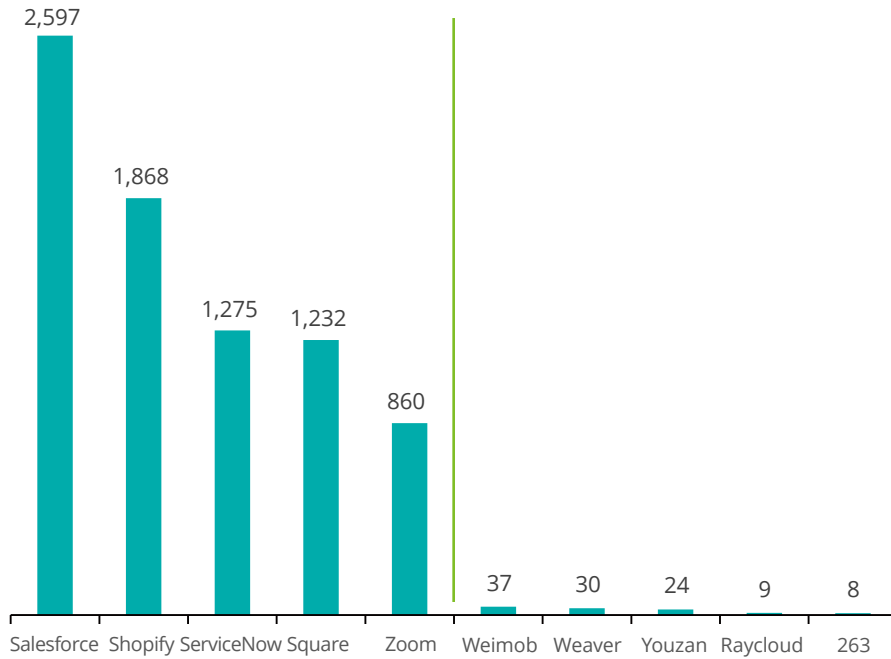
China's SaaS Industry Map (For Instance Only)



Source: Enterprises' official website; Deloitte research and analysis

Market Value of Leading SaaS Enterprises in China and the US (2021 M8)

Unit: US\$100 million



Source: Wind; Deloitte research and analysis

Multiple types of participants enter the SaaS market, where competition and cooperation coexist

China's SaaS market mainly consists of three types of participants: traditional software vendors (such as Yonyou, Kingdee), independent SaaS vendors (such as Youzan, Beisen) and Internet vendors extended from the C-end to the B-end (such as Alibaba, Tencent). The three types of enterprises have distinctly different characteristics in their development paths.

Traditional software vendors have clear advantages in software development and key customer resources in the industry. Their SaaS products are usually based on traditional software systems and have advantages in the cloudification of traditional software such as ERP. However, they are more revolved around traditional software development and customization, leading to a lack of cloud service experience.

The development background of independent SaaS vendors often stems from insights on demand pain points. They can solve these pain points with flexible and lightweight products, but are often challenged by capital shortage, low growth ceiling in industry segments, and excessive reliance on traffic giants.

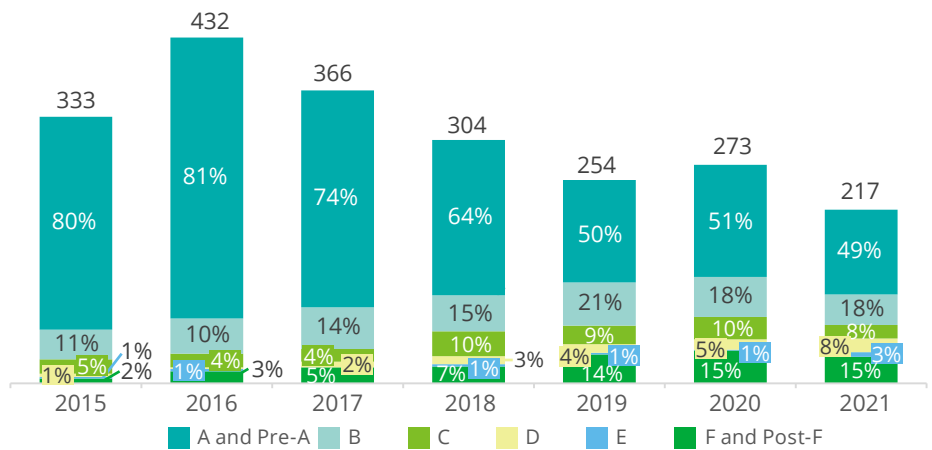
Internet giants, with their traffic advantages, are more likely to build product ecology via PaaS. However, they have less experience in 2B industry scenarios and software related to process management, resulting in a need to integrate the capabilities of independent SaaS vendors.

As investment boom calms down, mature enterprises are more favored by capital markets. Industry resources may be further converged towards leading enterprises of different industry segments, resulting in higher degrees of industry concentration.

Among SaaS-related investment and financing events from 2015 to 2021, the proportion of pre-A investment and financing events decreased significantly. However, the amount of single financing events showed an overall upward trend (decrease in 2020, but strong rebound in 2021). From the perspective of investment and financing, as investors have a more focused interest in mature enterprises, the market is likely to witness a further convergence of resources towards them in the future, therefore gradually promoting industry concentration and incubation of domestic SaaS giants.

Number of Investment and Financing Transactions for China's SaaS Enterprises (2015-2021M8)

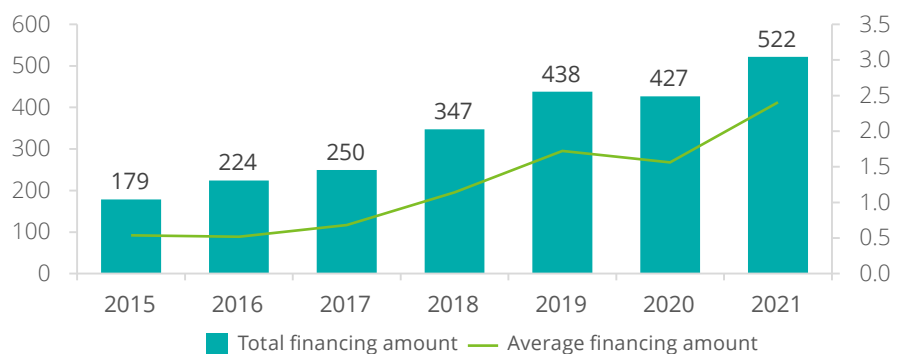
Unit: %, Transaction Number



Source: ITJUZI; Deloitte research and analysis

Number of Investment and Financing Transactions for China's SaaS Enterprises (2015-2021M8)

Unit: %, Transaction Number

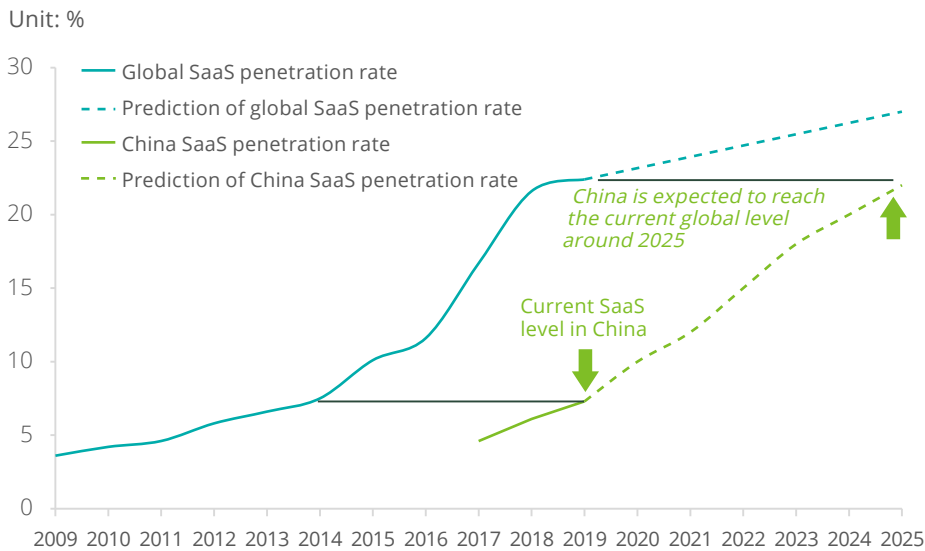


Source: ITJUZI; Deloitte research and analysis

The industry enters the critical period of development

Compared with the corresponding historical period of the global SaaS industry, the evolutionary path of SaaS market penetration is basically the same. The development of China's SaaS industry lags behind by about five years. It is expected that domestic SaaS market enters the critical period of development in the next five to ten years.

Comparison of Global and China's SaaS Penetration Rate



Source: Gartner, IDC; Deloitte research and analysis

There are three main drivers. First, China's macro economy is transitioning from rapid growth to stable growth, therefore presenting the structural characteristics of saturated economy and resulting in more urgent needs of operation efficiency improvement for enterprises. Second, due to rising labor costs, the advantage of demographic dividend gradually weakens. This promotes enterprises to reduce human costs and improve deployment efficiency through information technology means and standard processes, so as to cope with the increasingly fierce competition in the external market. Last, with the constant improvement of IT infrastructure and the deepening of mobile digitization in the whole society, the IT revolution gradually shifted from individuals to industries.

Industry development with Chinese characteristics

Trend 1: China is still in the critical period of economic development. In response to digital upgrading accelerated by COVID-19 and the pressure of revenue growth, enterprises are more focused on SaaS applications for business growth

In 2019, China's per capita GDP exceeded US\$10,000, ranking 59th in the world, which was one sixth of the per capita GDP of the United States. Thus, rapid and sustained development is still China's current significant strategic mission. At present, China's mobile Internet is developing rapidly with a mature e-commerce industry and high levels of digitization in most enterprises of emerging industries. Meanwhile, macro policies actively support and guide the digital transformation in fields such as retail, logistics, manufacturing, and government affairs.

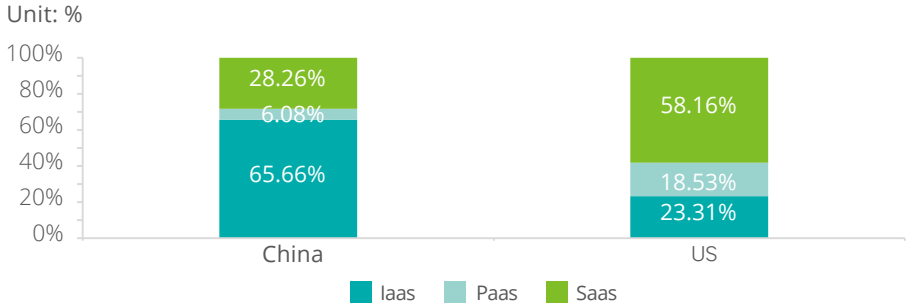
Since 2020, COVID-19 accelerated the progress of remote online work, resulting in huge digital demands in horizontal SaaS industries such as education, retail e-commerce, online supply chain management, Office Automation and electronic contracts. Enterprise users give priority to upgrading products that are conducive to improving customer service capability. For example, catering SaaS vendors help offline restaurants develop ordering systems using mini programs to realize contactless ordering; ERP vendors in e-commerce retail help enterprises build member management systems; Marketing SaaS vendors help enterprises conduct online marketing and reach customers remotely through traffic platforms.

Trend 2: There is still room for improvement for China's IT infrastructure, and the construction of IaaS and SaaS will be promoted simultaneously

In spite of rapid growth in cloud computing in recent years, China is still in the early stage of infrastructure deployment. According to Gartner, in 2018 the cloudization rate was about 40% for Chinese enterprises and 85% for US counterparties. There is still much room for growth for China's IaaS market.

The gap in IT infrastructure also leads to huge differences in the product structure on the cloud market between China and the United States. According to the statistics of China Academy of Information and Communications Technology in 2019, the structure of China's cloud computing market is inverted compared with that of the United States. With the further deployment of the underlying PaaS and IaaS infrastructure in the Chinese market and the continuous improvement of the quantity of access equipment, the large-scale application of SaaS will continue to mature.

Comparison of Global and China's SaaS Penetration Rate



Source: Gartner, IDC; Deloitte research and analysis

Trend 3: Cultivation of SaaS business models with service as the core is an important prerequisite for industry development

Influenced by the development path of Internet technology companies to a certain extent, domestic SaaS companies are focused on attracting large numbers of users via the freemium model first and then seeking methods to realize revenue. Therefore, most SaaS companies "focus more on traffic instead of product" in terms of investment. The SaaS business model with "service" as the core has not yet formed.

For example, enterprises' existing offline operation and management mode is negatively impacted by the COVID-19, inspiring the industry to rapidly develop horizontal products, such as video conference, live broadcast, procurement management, OA, and electronic contracts. However, most of them are launched using the freemium model, because it is difficult to promote with the payment mode. Meanwhile, due to the relatively weak control over user data privacy, many SaaS enterprises have developed a business model of marketing and promotion by providing free functions in exchange for user information. The user experience is challenged, which increases the difficulty of promoting horizontal SaaS applications under the payment mode. However, the business model with "service" as the core is crucial to the continuous development of SaaS products, requiring SaaS enterprises to refocus on the construction of product capabilities.

Trend 4: Cloud vendors inevitably play an important role in China's SaaS market

With a relatively weak base, China's traditional software industry lags behind in the basic software field and still relies on customization as the main business model, resulting in weak competitiveness in the field of SaaS. Cloud vendor giants (such as Alibaba and Tencent) take advantage of traffic to differentiate from others through PaaS and horizontal SaaS products, and quickly occupy the market using the Internet ecological thinking. Innovative SMEs focus on the core pain points of enterprise customers, quickly seizing the vertical application market through core product functions, but they often rely on the traffic or platform ecology of cloud vendor giants.

It is expected that cloud vendors will inevitably play an important role in China's SaaS market. How to find an appropriate model for collaborative development with cloud vendors? It is an important issue to be considered for China's SaaS enterprises in order to further develop and grow.

Trend 5: The balance between product standardization and customization is an important path for the development of China's SaaS industry

In the Chinese market, the IT spending of most enterprises mostly flows into hardware rather than software in traditional industries. Enterprise customers in traditional industries are more accustomed to a procurement mode in line with one-stop package of "hardware + software". For software products, leading enterprise customers in many industries prefer customized software products in one-time delivery, but are less willing to periodically pay for the use of standardized software products. Their purchasing habits are still being cultivated, so it is difficult for them to quickly adapt to the deployment of standardized SaaS products.

Due to COVID-19, many enterprises adopted "remote work", showing that education of the market has made a breakthrough to a certain extent. More and more enterprise customers find it increasingly difficult for high customization to cope with the simplified, lightweight and rapid deployment requirements arising from the rapid changes in the needs of their downstream customers, leading to a better development environment for SaaS products. However, it will still take a long time to change the consumption habits of Chinese enterprise customers. The balance between product standardization and customization will remain a long-term requirement in the development of China's SaaS industry.

China's SaaS Categories and Enterprise Screening Criteria

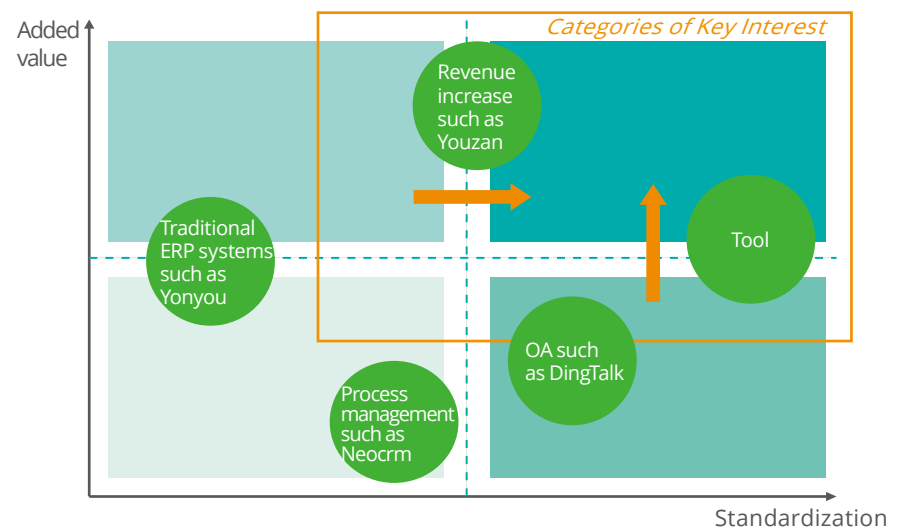
Screening criteria for category selection

After the domestic investment boom in SaaS products from 2015 to 2016, the performance of many SaaS enterprises was lower than expected, resulting in a gradually cooling off market. From 2020 to 2021, based on the improvement of mobile Internet and the digital infrastructure in the whole society, and the impact of COVID-19 on people's life and work, SaaS products for enterprise customers witnessed a new round of investment boom, in which how to choose a better SaaS product for investment became the topic of interest and continued thinking for many investors. Deloitte believes that an excellent SaaS vendor shall have two characteristics: whether SaaS products create value for customers and are easy to standardize, and whether application scenarios and market space of the SaaS products are large enough.

Valuable standardized products should be able to offer visible value to customers

Standardization and value creation are the basis for the success of SaaS products. From the perspective of the profit model of SaaS products, only standardized products can realize profitability. By providing standardized product modules, controlling their own development investment, increasing customer base and attracting customers for repurchase, enterprises can realize stable growth of profits. In addition to standardization, good SaaS products should be able to offer visible value to customers. The value creation of SaaS products is reflected by the two aspects of "revenue increase" and "costs reduction". Products that can truly achieve these two purposes shall earn customers' recognition and willingness to pay.

SaaS Product Categories of Key Interest



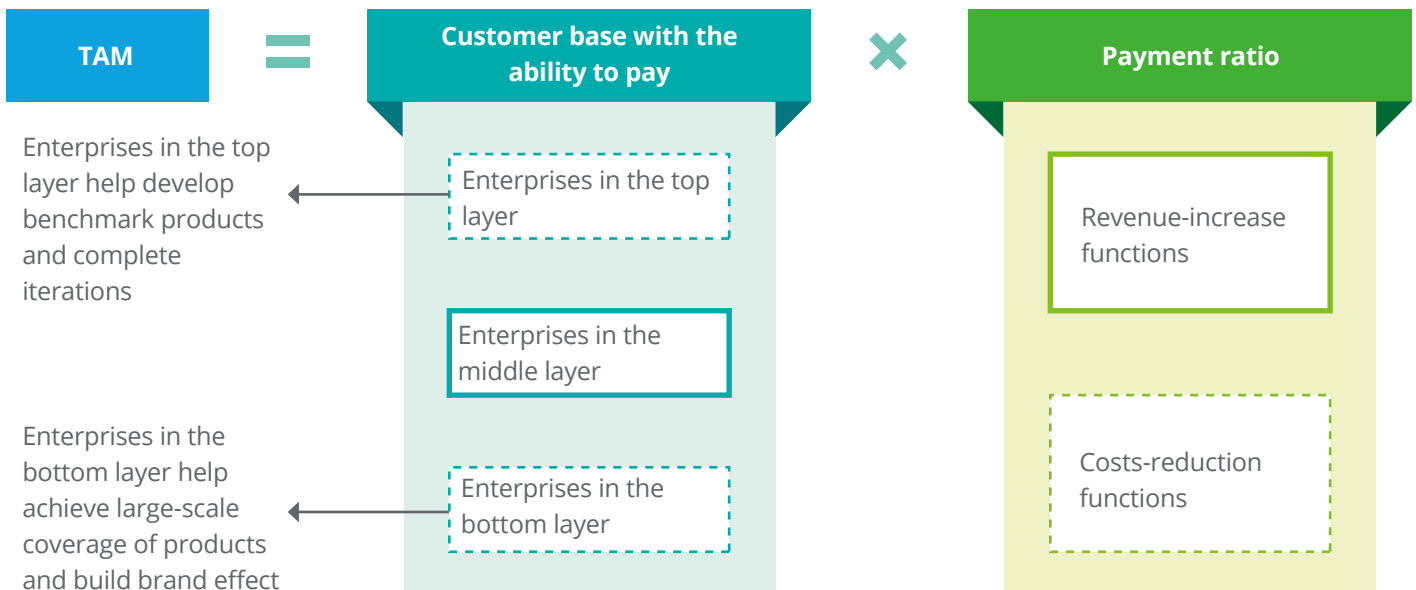
Source: Deloitte research and analysis

Customization and extension of low value functions are the key to raising the ceiling of SaaS products:

Considering that China's SaaS products are still in the stage of starting towards rapid development, attention may be drawn to software services with high added value that not standardized. Enterprises may focus on continuous iterative optimization of non-standardized products, and develop standardized product modules to improve value. Meanwhile, enterprises may look to standardized products with lower added value for whether there is room for adjustment and function optimization so as to improve product performance, and consider their future development potential from the aspects of meeting demands, smooth operation and added value of data, eventually to improve existing products towards the goal of high added value and high standardization.

Total addressable market (TAM) determines the ceiling of the products

We can simply break down TAM as: customer base, customer's ability to pay and customer's repurchase rate



SaaS products are more in line with the functional needs of medium-sized enterprises in the middle layer. In terms of digital needs, large-sized enterprises in the top layer are usually more sensitive to their own corporate security and less willing to share data and usage habits, therefore they prefer highly customized software development. Small-sized enterprises in the bottom layer have limited ability to pay and are used to the freemium model of software products for a long time, thus it is difficult to cultivate continuous willingness to pay in the short term.

Therefore, in the short term, the Chinese market is more suitable for the development of SaaS applications in rugby-ball-shaped industries (complex business processes, good IT foundation, and strong profitability) such as finance, healthcare, education, travel services, manufacturing, and construction. The inverted-pyramid-shaped industries (such as energy, communications) are less likely to standardize and modularize vertical SaaS applications, mainly because the leading enterprises in these industries have a powerful voice and strong financial strength, and prefer to purchase one-time customized software products and outsource IT for long-term updates and maintenance. Most enterprises in the pyramid-shaped industries are small in scale and low in profitability, and are expected to "follow the trend" in the middle and late stages of industry development rather than take the lead in promoting SaaS applications. The rugby-ball-shaped industries have a large number of enterprises in the middle, with regional concentration and low levels of monopoly. These medium-sized enterprises are more likely to accept the SaaS subscription model.

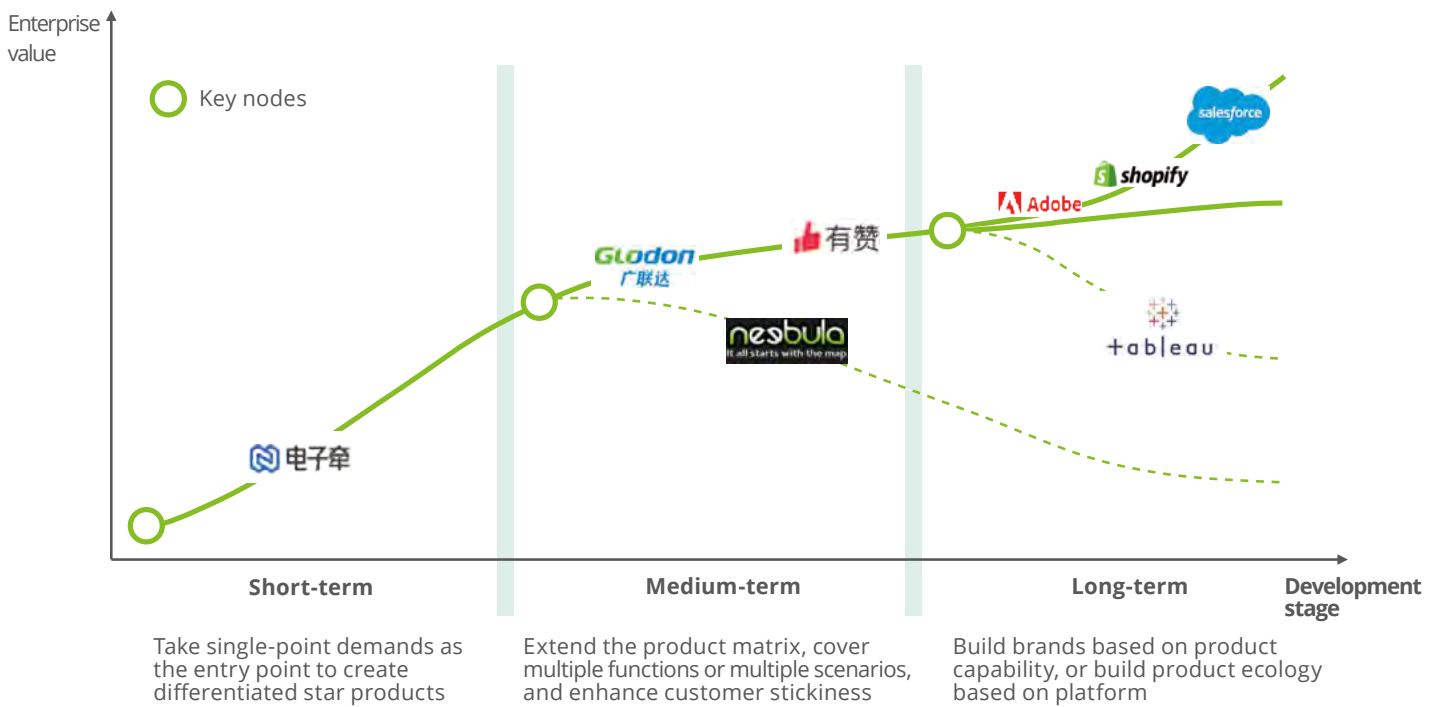
Enterprise customers are more willing to pay for revenue-increase SaaS products. Compared with the corresponding historical periods in Europe and the United States, which exhibit distinctive features of saturated markets, the Chinese market is still growing steadily and the demographic dividend has not yet completely disappeared. On the other hand, due to the popularization of mobile Internet on the consumer end, the digitization of C-end in the Chinese market is far higher than the supply side of enterprises, and revenue-increase software products that can help enterprises increase sales, acquire users, innovate products and innovate business models in the short term are more popular. The urgency of enterprise customers' needs for revenue-increase products at this stage is much higher.



Focus on SaaS product portfolios and target customers in different stages

After determining which categories of SaaS products are worth investing in, the core question is how to determine which SaaS enterprises under the same category are worth investing in. In our opinion, we can consider two dimensions: SaaS product portfolios and target customers. Looking at the development path of star products of SaaS enterprises, we divide them into three growth stages (short-term, medium-term and long-term), and determine the growth conditions of SaaS products in different stages from two dimensions: product portfolios and customer segment characteristics.

Development path of SaaS product portfolios in different stages



Source: Deloitte research and analysis

Short-term development: Take single-point demand as the entry point and create differentiated star products

In the initial stage, the success of a SaaS product mainly relies on taking the single-point demand as the entry point and using the single-point core product to hit the pain points of enterprise customers, so as to quickly realize the paid use of standardized products. Starting from the actual pain points of users and making breakthroughs from the implementation of a single point of functionality, instead of looking for a big and comprehensive solution, help realize direct and effective effects, and make it easier to obtain long-term and stable payment from enterprise customers. In terms of customer base, the core point is to develop and maintain benchmark customers: developing benchmark customers, iterating quickly in complex scenarios, and creating differentiated star products.

Case: LetSign

As an electronic contract business service product designed for enterprises with many signing business processes, a wide scope of needs and large scales of users, the tool product LetSign solves the core pain points of security and real person verification for electronic signature, and achieves the ultimate single-point product. Meanwhile, LetSign relies on the business needs of the ecosystem of ByteDance, and continuously summarizes problems and optimizes product performance by drawing on the large numbers of complex cases of product use processes, so as to quickly implement standardized products and achieve differentiated advantages in product capability.

Medium-term development: Extend the multi-core-product matrix, cover multiple functions or scenarios, and enhance customer stickiness

It is difficult to sustain the medium-term growth of an enterprise with single-point products, so it is necessary to achieve cross-scenario and cross-functional extension of the product matrix around developed functions or scenarios, deepen the breadth and depth of service to existing customers, and increase the stickiness of customers to the product matrix. The extension of the product matrix depends on the enterprise's own insight on the industry demand and the team's ability to develop multi-scenario and multifunctional products. The "1+N" model, which relies only on a single core product, makes it difficult to build a valuable product matrix and achieve growth in the medium term. Therefore, a multi-core-product matrix is the key to rapid growth in the medium term and to becoming a leader in the industry.

Case: Neebula

Neebula, as a SAAS application vendor of ITOM, hits the needs of enterprise users by providing quality ITOM capabilities. However, in the subsequent product portfolio development, although product extensions were made, there was a lack of quality products to complement them, resulting in weak customer stickiness and difficulty in creating new star products. Neebula was eventually acquired by Service Now.

Case: Youzan

Youzan provides complete solutions for enterprise customers and increases its penetration rate in the e-commerce industry by covering the needs of multi-scenario SaaS products for small businesses in e-commerce. Meanwhile, Youzan actively expands similar functional products in other fields across industries, refines marketing, live streaming and sales functions, and expands the markets of retail, education and overseas trade based on the demand characteristics of each industry, eventually giving rise to a multi-core product matrix.

Case: ROOTCLOUD

Based on its in-depth understanding of the machinery manufacturing industry, ROOTCLOUD enhances its service scope in the construction machinery field, and enriches the product matrix by grasping core demands, taking equipment condition monitoring as the entry point, and leveraging the "Root Cloud" PaaS platform ecology. Through realization of the needs of customized and complex scenarios for the leading enterprises, improvement and summarization of the standardized product modules, development of the aPaaS platform capability, ROOTCLOUD achieves the rapid implementation of multiple-core products, and expands the enterprise customers in the fields of construction machinery, automobile, and energy & chemical.

Long-term development: Build brands based on product capability, or build product ecology based on platform

Outstanding SaaS enterprises may build their brands based on product capability, and become the leader in a single category by continuously iterating the existing product matrix to meet the constantly updated user needs and increasing the market share of their own products. This development path is usually applicable to horizontal SaaS products, which can achieve rapid cross-industry expansion, while forming brand stickiness, cultivating user habits and building a moat of product capabilities based on their strong product capabilities.

Case: ZOOM

ZOOM is designed to create the ultimate enterprise communication cloud service.

ZOOM stands out in the relatively low-threshold and highly competitive video conferencing market, and its excellent product capability has helped it build a good brand image and become the product leader in a single category.

Case: Adobe

Relying on the product capabilities and brand influence of its flagship product, PhotoShop, Adobe continues to expand its product line and is now the world's largest creative/documentation software company with US\$7.104 billion in 2021 Adobe subscription fee revenue, accounting for more than 90% of overall revenue.

Outstanding SaaS companies may also actively build platform capabilities with their core products as the center, further develop modular functions, and cultivate their own platform ecosystem through self-development and external acquisitions. This development path can be realized according to cross-industry horizontal scenarios or strong commitment to the development of multiple scenarios in the industry.

Case: Salesforce

Salesforce, the most successful SaaS product company in the world, launched the first CRM management SaaS product in 2001, AppExchange platform in 2005 along with the development of aPaaS technology, and the PaaS platform "FORCE.COM" in 2008. Since 2009, based on the rise of a large number of SaaS vendors in the US market, Salesforce has built and grown its own ecology through frequent acquisitions, and eventually cultivated a mature product ecology.

Case: Shopify

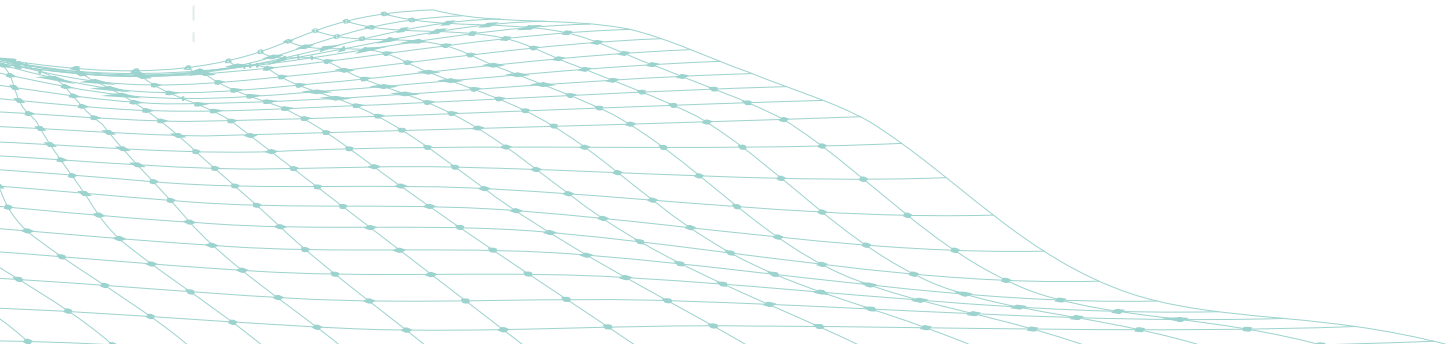
Shopify released its e-commerce SaaS product in 2006, opened API interface in 2009 to build its own platform, and went public in 2015. Shopify replaced Amazon's self-developed "Webstore Service", and became Amazon's preferred migration service provider, forming its own platform ecology.

In the long term, even though some of the outstanding SaaS companies have high quality SaaS products and business models, they still face the ceiling of development. In case of failure to build a brand based on product capability or build product ecology based on platform to further grow into a leading company, **they may be confronted with the choice of being deeply bound to the platform or being acquired by a platform-based enterprise.**



Case: Tableau

Tableau, a data visualization and analysis company, was acquired by Salesforce for US\$15.7 billion. As a data visualization and analysis company, Tableau specializes in data analysis to enable companies to better explore market opportunities and make appropriate decisions. The two companies have a high degree of overlap in terms of customer segments, while the product features are very complementary.



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