

SaaS Finance

A Complete CEO Handbook



Introduction to SaaS Essentials

In recent years there has been a surge in the SaaS economy. Customers are increasingly adopting the subscription-based pricing model to satisfy growing IT needs—despite limited IT budgets particularly for SMBs and startups. According to Gartner, the Global SaaS industry is forecast to grow to \$195bn in 2023 from \$167bn in 2022.

In all this expansion, one major challenge remains, in collaborative technology tools has made it easier that is how software providers manage their business for businesses to hold off on hiring full-time finance processes and capture, share, and use financial resources while still having access to a worldwide metrics. When developing a SaaS business, many pool of highly talented individuals. Businesses can companies utilize spreadsheets, disconnected now engage fractional CFO's and advisory Boards and systems, and other manual processes to manage get around to hiring a full-time CFO later, while still their business. These companies also tend to take meeting their needs for more sophisticated financial the same methods and principles used to maintain a leadership.

traditional software business and implement them

in the SaaS business. The result is sub-optimal and **Three broad categorization of the finance and does not accurately offer insights into the state of the accounting function in an organization:**

business. Considering all this, one question pops up, A. Strategic Finance that is - when should a SaaS business start worrying B. Tactical Finance about a robust financial and accounting system? At C. Operational Finance an early stage, or when they grow into an SMB, or as an enterprise business?The answer is, from the absolute beginning. No matter what stage a business is in, it has to keep track of the cash inflows and outflows. That makes accounting essential.

The most basic needs are clerical and can be met with technical training, but the more advanced needs to understand the business deeply, add a strategic component that is best met by specialists with extensive business experience. It first requires understanding which roles, needs, and paths the business is likely to

encounter. Eventually, most successful businesses will outgrow their initial accounting staff and need greater depth as the number of dimensions in the financial function increase.

If they understand what their eventual needs will be in advance, there are many ways that businesses can take risks and get what they need, when they need it, without financially overcommitting. Developments



A. Strategic Finance



Strategic finance typically focuses on driving organizational change, which is why it is required to focus on multiple aspects of the business (rather just a single area). Such strategic thinking is often complex and involves understanding the delicate relationship between the organization and its environment.

Strategic CFOs are able to provide insights that can drive positive changes within the organization and create a comprehensive financial plan. They also understand the business' financial operations, but their objectives are different from the operational CFO's. When developing their strategies, a strategic CFO needs to be forward-thinking, while an operational CFO is concerned with past and present financial analysis. Listed below are the tools that every SaaS business must have:

1. Know how much your business is worth with Management Valuation Analysis Model.

- What is the business worth each year, based on comparable Peer Transaction multiples?
- What does your SaaS business' valuation look like in different ARR scenarios?

Startup founders often are unaware of the true value of their business. This in turn results in them being undervalued. It is very important for founders to know what their business is worth each year, and this could be known from comparable peer transaction multiples. Future is uncertain and your ARR varies with different possible scenarios. Therefore, this should also be taken into account in valuing your business.

2. Know exactly what investors look for before investing.

- What are the key qualitative narratives (eg: Problem statement, Target Customers, Unique Selling Points, Competitive Advantage, Funding Ask etc.) that you would like to share with Potential Investors?
- What financial and operational trends should be shared with Investors?
- Is your SaaS Metrics scorecard favorable to attract investors?

It is common for startups to struggle with the report they want to present to the investors. They lack the necessary experience to know exactly what the investors look for. Oftentimes some key qualitative narratives such as competitive advantages, target customers and unique selling points are missed and there is a poor understanding about the important SaaS metrics that the investors favor.

An investor Executive Summary Report of your business needs to be strategic with the financial and operational trends that are to be shared with the investors and accurate- hitting the right notes that investors look for.

3. Test out all the possible scenarios in today's the TAM SAM SOM model using top-down estimates or **rapidly changing world.**bottom-up extrapolation of peer companies' revenues based on market concentration.

• How is your business likely to perform in Stressed or unforeseen scenarios?

• **Will you be able to cover operating expenses in B. Tactical Finance**

case of delay in raising funds?Tactical financial teams (generally the Financial

• How does different pricing tiers affect your Planning & Analysis teams), are not just focused on ARR growth?crunching numbers, but they develop a more holistic

• What does faster Product Development entail understanding of how the organization operates. in terms of increasing the team size and time This helps business leadership get a firmer grasp of

to hit the market?

In today's rapidly changing world, it is challenging for businesses to plan for tomorrow. And, lack of planning can have its own detrimental effects. To prevent this and to be future-proof, businesses must test out all the possible scenarios and equip themselves with the necessary tools. It starts with understanding your business well, such as understanding how different prices affect your ARR growth, will you be able to cover operating expenses in case of delay in raising funds, what does product development entail in terms of increasing team size and much more. Gaining a perspective on these things, gives you an understanding of how your business is likely to perform in stressed and unforeseen scenarios.



4. Study the market you are targeting to what cash flow numbers actually mean because of **maximize your potential.** their in-depth knowledge of your company systems

and processes. As someone who knows the business

• What is the estimated size of your market?inside and out, CFOs know reasons why your service

• Do you have clarity on your potential TAM, SAM, is performed or how and where your product is SOM made, which provides them valuable insight into the company's financial health. Listed below are the tools

every SaaS business must have:

Startups today lack a clear picture of what the market size of their business or a particular product is. This prevents them from reaching the highest potential possible. It is crucial to know what the size of the market is and here's where a team of experts are necessary to estimate the size of the market using

1. Ensure the blueprint (Annual Operating Plan) for building your business is accurate and aligns with the greater vision of the business.

An annual operating plan is a prized document – it's the blueprint for building your organization in any given year. You wouldn't build a house without architectural drawings. Many SME CEOs run their organizations with only a sketch of what they are building. The process may be generally rushed and multiple perspectives on decision-making is most often missed. These result in ambiguity and undesired outcomes. According to our experts, a financial planning and budgeting model must answer these fundamental questions:

- What is your expected revenue growth trend?
 - How is your MRR evolving - how much is acquired, churned, upgraded or downgraded each month?
- What is the accurate cost of sales for my SaaS business?
- What is Unit economics (LTV, CAC metrics), Gross margin and Contribution margins?
 - What is your expected Product Development expenditure, Sales and Marketing, Administrative and Overheads?

This model should also be consistent with the greater vision of the organization and must align with the Board and leadership teams.

2. Keep your financial model updated to know the deviations from budget.

- What do your actual business transactions translate into Recurring Revenue trends and metrics?
- How does your business' Actual performance compare with that of Budgeted?
 - Are you aware of how your business's actual performance is when compared to the budget?

Most businesses are unaware of it. Knowledge of this variance on a regular basis is important to guide the company towards its desired goal. While it is normal for the actuals to vary from that of the budget figures, what matters the most is - are there efforts taken to get the business back on track. And, in order to know the deviation from the desired path, a constant update on the current state of business is crucial. An updated financial model not only gives the variances, but also provides you with an understanding of how your actual business transactions translate into recurring revenue trends and metrics.

3. Know whether your business is trending ahead or behind the plan (Budget) and adjust management decisions accordingly.

- What is your Revenue, Subscription and Services margin looking like?
- What is your Cash burn rate and what is the expected Cash Runway duration?
- When should your business initiate fund-raising discussions?.
- Are you having enough cash to manage your short term requirements?
 - How is your business' actual performance compared to budgeted at the start of the year?
- Why did such variances occur?

Budgeting is a critical planning process, but you will never stick to your budget. The point of a budget is to set expectations you can measure performance against. Comparing actual results against budget allows you to measure your year-to-date performance, judge whether the company is trending ahead or behind plan and adjust management decisions accordingly.

This is done by knowing your revenue and how subscription and services margins look like. You should also be aware of your cash burn rate, the expected cash runway duration and whether you can manage

your short term requirements with the cash you have. Alongside these, leaders must also look ahead and have a view on when to initiate find-raising discussions. Without reports to measure your performance, you are flying blind and won't be able to fundamentally understand why variances occur etc.

4. Provide decision makers with accurate information to make effective decisions.

- What explains my current MRR and ARR?
- How much was the new MRR and how much was the expansion MRR?
- What is my average Annual Contract value?
- What is the share of Subscription revenue and Services Revenue?

Decision makers need information to make effective decisions. Most startups face immense challenges by not making use of the information available to understand their businesses. Management Information Systems (MIS) make this possible. A typical MIS report includes the reasons for your current MRR and ARR, the share of revenue between subscription model and services model, your new MRR and how much has it grown and much more. This report is generated monthly.

5. Give the true picture of your business's performance to key stakeholders.

- Are you tracking the critical top 10 SaaS KPIs for your business and benchmarking against industry?
- How does your sales and marketing spend and CAC metrics compare with industry?

- What are the drivers that need to be worked on in order to improve the business's scorecard?

To give a true picture of your company's performance, you should first track the 10 critical SaaS KPIs and see how it compares with the industry benchmark metrics including the CAC metrics. This will give you a clear picture on the drivers that need to be worked upon.

Board members want to see the numbers behind your company's progress laid bare, and they want to see your framework for improvement. They have the same goals as you—to build a successful business—and they have the expertise and perspective to help. But they can only do that if you give them the right numbers to work with.

6. Understand the ROI coming from your Sales and Marketing efforts.

- Is your current Sales & Marketing Expenses giving you an Optimal ROI in terms of Client Acquisition?
- Are you overspending on certain channels and under-spending on more effective channels?
- Should you increase the spend on Sales-led growth or reduce?
- Is your CAC Payback and Unit Economics

It also facilitates communication within and outside healthy?

the organization, for example- employees within the organization are able to easily access the required We speak with many sales leaders who are frustrated information for the day to day operations. with the lack of clarity on the ROI of their investments and surprised when their new tools fail to deliver meaningful performance improvement.

The truth is that driving sales growth today requires fundamentally different ways of working. You must first know if your current sales and marketing expenditure gives you optimal ROI in terms of client acquisition and also perform a thorough analysis of your channels- from less effective to most effective ones and allocate

expenditure accordingly. Along with deciding whether to increase or cut expenditure on sales-led growth, you should also ensure your CAC payback and unit economics are healthy. These are just a few things to keep in mind in order to improve performance. A Sales Channel ROI Analysis Model is to be deployed to understand and gain insights from above discussed factors better.

7. Know the true value of your customers with customer cohort analysis.

- How is your customer cohort evolving over a period in terms of the MRR generated?
- How is my Net dollar retention improving for a cohort?

Most businesses not only hope to acquire more customers but also retain the existing customers base. However, often they fail because they are unaware of what their customers want. This is where customer cohort analysis comes in. In this model you try to correlate initiatives in your own business such as price increase, new offers, new product version launches amongst others to see how they may affect the customer lifecycle. This gives you a clear idea of how your customer cohort is evolving in terms of the MRR generated over a period of time. Also, it answers some crucial questions such as, How much of MRR was retained and how much churned, How many Customer logos were retained and how many were lost, Are new Cohorts showing better or worse performance due to product feature change or pricing change and much more.

8. Get the list of management priorities right for your executives to make informed decisions.

- What is your business' financial health indicating?
- What are the actionable insights that can help

steer your business for the next quarter?

- What should be the Management Priorities from a Financial Management standpoint?
 - What are the best avenues to invest the funds raised to maximize value accretion - Sales and Marketing Channels, Product development etc?

A CFO Insights Summary report essentially answers this fundamental question: What should be the Management Priorities from a SaaS Financial Management standpoint. A good executive summary grabs your Board/ potential investor's attention and lets them know what it is you do and why they should read the rest of your business plan or proposal. It's not unusual for either the Board or investors to make an initial decision just based on reading an executive summary, so it's important to get it right. It speaks directly to the CFO about the financial health of the organization, actionable insights needed to accelerate the business ahead and potential avenues to invest the funds raised for maximum value creation

C. Operational Finance

Operational Finance in SaaS businesses helps leaders get a strong grasp on accounting and financial reporting, operational risk, and other accounting processes.

1. Recognize SaaS Revenue the right way.

- Is your SaaS recurring revenue recognised appropriately on an accrual basis
- Is accurate Deferred Revenue booked in your balance sheet liability

In most SaaS businesses, annual purchase leads to an initial bulk cash inflow. However, this is to be apportioned over the contract duration and shown as recognized revenue in a month. Connected to this closely is that the unrecognized revenue in your

income statement is to be taken to liability called 'Deferred Revenue' and apportioned monthly. Dealing with cash received against invoice as Revenue would be misleading and can lead to auditing red flags.

2. Apply the right accounting principles for a smooth month-end close process.

- Are you tracking your financial transactions closely and applying the right accounting practices
- Are you closing books regularly on a monthly basis to arrive at a financial performance view

Closing books is a time and labor intensive process. Things often go awry because of inconsistencies



in reporting, human-errors and compliance issues. Businesses often face challenges in applying the right accounting principles because they lack the necessary experience. Therefore it is very important to track their financial transactions and resolve inconsistencies and

compliance issues on a regular basis to avoid a pile up during the month-end close.

3. Get your financial health checkup done with an accurate chart of accounts.

- Is your Accounting system and Chart of Accounts setup accurately to reflect the accurate picture of your financial performance
- Are you clearly separating Cost of Sales from Operating expenses to calculate right gross profit margin
- Is your Customer Success team's cost well differentiated between Retention-focussed and Sales-focussed.

Small businesses need a chart of accounts to organize their accounting for more simple and accurate financial reporting since it helps categorize financial transactions accurately and track business performance meaningfully.

A chart of accounts offers a clear picture of the overall financial health of your business and gives insights into where your money is going. But these insights can only be gained when the chart of the account is accurate. Most businesses miss out on some of the most important things like separating cost of sales from operating expense to calculate gross profit margin and differentiating between retention-focussed and sales-focused costs of the customer

success teams. Therefore, It is very important for your Accounting system and Chart of Accounts to be set up accurately in order to reflect the accurate picture of your financial performance.

A person's hands are shown holding a tablet computer. The tablet screen displays a financial dashboard with a line graph, a bar chart, and various data points. The word "Statistics" is visible on the screen. Below the tablet, a spiral-bound notebook is open on a desk. The background is dark and out of focus, suggesting an office or business environment.

Bottom line:

The last decade has been the great unbundling of SaaS. What used to be wrapped up under the umbrella of a single big software business has now been split into hundreds of best-in-class point solutions that SaaS businesses are opting for. In all this, startups are also realizing the increasing need for a robust financial and accounting setup to deal with the periodic demands of their business. Hiring an expert team to manage accounting and financial analysis is the new trend. In this report, we have pointed out the importance of financial and accounting solutions through a list of essentials, needed by any new-age SaaS businesses.

If you're a Software-as-a-business and are looking for help with your financial and accounting setup, contact us today. We are a team of experts who are ready and waiting to help you take your business to the next level.



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About the Author:

Karthikeyan V Raaj has over 18 years of experience as a Senior Finance Executive and as a CFO business partner. He has championed strategic projects and helped transform finance functions to enable growth of his client organizations. Currently, he is the Founding Partner of ValueXPA, a Global technology-enabled Finance-as-a-Service Partner for Small and Mid-sized Businesses and Institutions. As a CFO Partner, he has advised and helped over 50 small and mid-sized businesses, start-ups and Not-for-profit Institutions - across areas like financial planning, tracking and managing their financial performance through systems, optimizing finance processes through automation and outsourcing.

His specialties include CFO Partnering on Strategic and Business Financial Advisory, Finance Transformation, Financial Modelling, Financial Planning and Analysis, Performance Management Reporting & Decision-support, Development of KPIs and Management Dashboards, Valuation and Analytical Process Automation using Low code/ No code tools. Earlier, he held leadership roles at Barclays and S&P Global. For Global Business Leaders/companies & Financial Institutions, he offered Financial Decision and Controller Solutions and also built & led Investment Research teams globally. He holds an MBA degree specializing in Finance and is also a qualified Engineer.

**For more information on business partnering
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