Predicts 2022: SaaS Dominates Software Contracting by 2026 — and So Do Risks

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https://www.gartner.com/document/4009001?ref=TypeAheadSearch

Software providers SaaS offerings continue to grow rapidly, giving providers significant market power that will fundamentally change how sourcing, procurement and vendor management leaders negotiate and manage contracts. Discounts will shrink and other concessions will rise in importance.

Overview

Key Findings

Software and SaaS providers are gaining market power, which will enable them to:

- Transition customers to subscription and SaaS (with a price premium) and away from perpetual licenses.
- Limit price negotiations to only their largest customers.
- Charge for use of APIs to drive revenue even when customers use other providers' software with theirs.
- Produce SaaS offerings targeted to certain verticals at a significantly higher price.

Recommendations

Sourcing, procurement and vendor management (SPVM) leaders who negotiate IT contracts must:

- Ensure they have sufficient perpetual licenses before availability ends. This allows enough time to plan and budget for significant cost increases required to pay for subscriptions and SaaS.
- Maintain leverage with providers by examining requirements with sufficient time to create a competitive environment before renewal, gathering spending data from all business units, building a vendor roadmap and using short term negotiation tactics. Use online marketplaces to reduce time spent on less strategic contracts.
- Ensure competitive offerings are fully assessed so as to have sufficient leverage when negotiating integration platform as a service (iPaaS) deals, and that hidden costs such as API calls and future price caps have been fully vetted and negotiated.
- Assess whether their organization needs the capabilities offered in vertical industry products and push for deeper discounts based on unneeded features, as well as being an earlier adopter or reference customer.

Strategic Planning Assumptions

By year-end 2025 (YE25), a majority of the top 20 software vendors will phase out the sale of new perpetual licenses, increasing costs by at least 35%.

By YE25, customers will negotiate commercial terms for less than one-third of the software and SaaS contracts negotiated in 2021, fundamentally changing IT procurement.

By YE24, integration costs associated with iPaaS subscriptions and hidden fees will increase overall SaaS/software subscription costs by at least 20% versus 2021.

By YE25, SaaS customers buying into industry vertical offerings will see 40% higher subscription costs but will spend 30% less time on customization.

Analysis

What You Need to Know

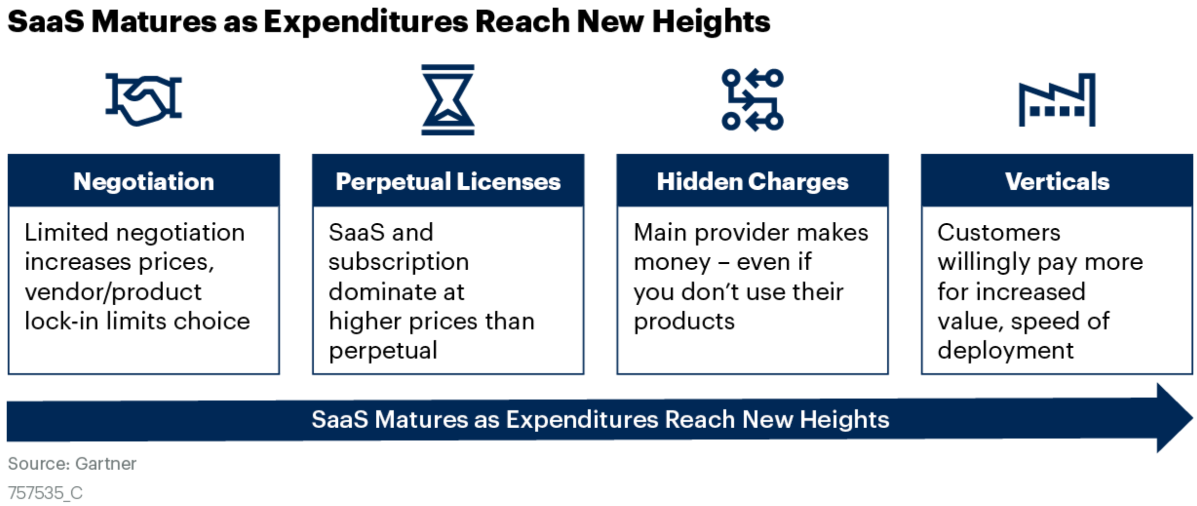
The traditional perpetual license software market has been evolving to one of software as a service. In some markets, including CRM and human capital management (HCM), the market is already mostly SaaS. But overall in 2021, the market is software and SaaS. As we move through the planning horizon, a large majority will be negotiating SaaS contracts by 2026 versus 41% in 2020.[1]

At the start of the evolution to SaaS, customers had more power than technology providers. Customers often chose SaaS for a discounted price as they ceded control over release cadence but got new functionality faster and experienced less complexity in terms of deployment, maintenance, and support. But as SaaS gains momentum, power shifts away from customers toward providers because of SaaS’ s “stickiness,” which ensures customers renew or lose all access to the service.

SaaS products are typically highly differentiated and switching costs are usually high. This gives technology providers significant power to set prices, dictate terms and tell customers to take or leave their offerings. Profitability in traditional perpetual license software markets is relatively low (vs. SaaS), translating into relatively few new entrants, and ones that appear will be less likely to be well-financed or strong enough to take market share from dominant players.

Because of these trends, Gartner predicts that by YE25, a majority of the top 20 software vendors will sunset sales of new perpetual software, requiring shifts to their SaaS or subscription offerings, increasing costs by at least 35%. Organizations that don’ t want to use SaaS will not be immune from significantly higher, SaaS-like pricing, as tech providers move from perpetual licenses to committed subscriptions and pricing more closely emulates SaaS offerings (see Figure 1).

Figure 1: SaaS Matures as Expenditures Reach New Heights



Gartner

Large organizations are used to healthy negotiations with suppliers that often yield discounts or more favorable terms. Gartner predicts that by YE25, large organizations will negotiate pricing and commercial terms for only one-third of the software and SaaS contracts they negotiate in 2021. Only huge organizations or those with sufficient leverage will be able to negotiate price as providers use their market power to reduce the cost of doing business.

Even providers whose offerings are regarded as "open" to third-party integration will increase prices — not increasing the price of their own software, but making it more expensive to integrate other vendors' software into theirs. This will effectively erase potential savings organizations have identified by using a best-of-breed approach. Gartner believes that by YE24, integration costs associated with iPaaS subscriptions and hidden fees will increase overall subscription costs by at least 20%.

This is not the only reason costs will increase. In some cases, organizations will willingly pay higher prices for improved value. For example, Gartner also predicts that by YE25, SaaS customers buying into industry vertical offerings will see 40% higher subscription costs than buying generic offerings but will spend 30% less time on customization.

Strategic Planning Assumptions

Strategic Planning Assumption: By YE25, a majority of the top 20 software vendors will phase out the sale of new perpetual licenses, requiring shifts to SaaS or subscription offerings, increasing costs by at least 35%.

Analysis by: James Smith, Mike Tucciarone, Rob Wilkes, Marie Sienkowski

Key Findings:

- To date, few top 20 SaaS vendors (by revenue[2]) that had on-premises, perpetually licensed products have eliminated them. An example is Salesforce, which stopped selling perpetual licenses for Tableau Desktop, Tableau Server Core and Tableau Server Interactor on 1 May 2021 (Perpetual License End of Sale [tableau.com]).
- As a service (aaS) and subscription-based software have been the predominant growth engines of the global software licensing economy over the last decade. Big names like Salesforce, Workday and ServiceNow have only ever been SaaS. Large traditional software vendors like Microsoft and SAP are moving to SaaS more and more for their new product offerings, and Gartner believes it is only a matter of time before these vendors stop offering perpetual licenses altogether.
- SPVM leaders are interested in moving from purchasing new legacy perpetual licenses to products purchased as a service or as a subscription thanks predominantly to a lower initial price tag.
- Providers encourage the move to SaaS and subscription so they can simplify their product offerings and their support operations, and minimize the threat of customers' nonrenewing support while still having access to the product.
- With customer interest growing and higher profitability and lock-in of SaaS offerings, suppliers will attempt to simplify their product offerings by ceasing sales of new perpetual licenses (or making them cost-prohibitive). Support and maintenance services will be offered for the current version of the products while new features/enhancements will go into SaaS/subscription products.

Market Implications:

- Gartner expects that most perpetual licenses will no longer be generally available for new purchase and will only be available as a renewal or for "true-up" purposes by YE25. The maintenance and support for these perpetual licenses will only be offered until the next full version update is released and then for a short period of time (estimated to be about three years) after that. This is in line with how some of the largest providers have already migrated to online products. Most subscription products cost roughly one-third the license cost of the full perpetual license, but that cost is about one-third higher than software maintenance at 25% of license costs.
- To accelerate migration to their cloud offerings, many of these suppliers will rely on tactics to force customers to move sooner than they are prepared to move. Audits of companies hanging on to their perpetual licenses will most definitely increase based on Gartner's previous market observations when new products replace older products. These audits will attempt to find customers "out of compliance," with the only option to become compliant being acquiring a new license either as a subscription or in a full move to the cloud version of the product.
- This forced move to the cloud or subscription will not happen overnight. Due to revenue recognition of existing contracts, and the substantial impact to top-line revenue for most suppliers, the existing support models will need to be continued at least through 2024. This should give astute SPVM leaders the ability to plan their migration to the subscription/aaS model or find credible, long-term third-party support for these products.
- Government regulation could keep perpetual software available longer. Many governments require the ability to bid and withdraw from subscription agreements, which would need to be supported. With subscription products requiring continual payments to maintain access, governments could start to require software vendors to offer some form of perpetual licenses as a means of getting off a subscription or cloud version. However, the chance that this will be a global requirement is slim and may encourage software players as a group to exit select markets.
- The growing trend of vendors rendering perpetual license support unaffordable or unavailable should be a strong catalyst for expansion of the existing market of

third-party support firms. However, like many aging programming languages, contracted resources who can work with the legacy perpetual versions will become increasingly expensive as the market shifts to subscriptions. As a direct result, these contractors may not have the same dashboards and administrator consoles to configure the applications as they did in the perpetual versions.

- Within three to five years after the conclusion of new perpetual license sales, support for existing products will reach end of life. This will require customers to evaluate third-party maintainers, rely on internal experience to provide self-maintenance of the object code or migrate to the subscription/aaS product. This will also be a prime opportunity for legacy customers who are not receiving significant discounting considerations for migrating to the new subscription licenses to consider alternatives in the marketplace.

Recommendations:

- SPVM leaders in charge of the software category must collaborate with asset managers to understand where key pieces of software have been purchased as perpetual licenses, if there is a third-party option to offer support, and how the organization could be impacted in moving to the cloud.
- If licenses are required/necessary to stay in their current perpetual status, SPVM leaders must negotiate amendments prior to or during the upcoming renewal, and prior to the forced migration. The amendments should require support to be maintained for a minimum amount of time (36 to 60 months) upon the suspension of sale of new licenses. Attempt to gain the ability to purchase add-on licenses for those already purchased.
- Failing to get a concession to buy additional perpetual licenses, IT finance leaders must be prepared to increase the operating expense budgets by as much as 35% to absorb the increased cost of the move to subscription licensing.
- When a supplier identifies that a perpetual license will no longer be offered, ensure the asset management team is aware and makes necessary purchases of additional licenses that will be needed in the short to medium term. Keep all records regarding the license switch date, entitlements, and deployments. The likelihood of an audit

will be heightened until either the relationship with the vendor is resolved, or you have moved to their subscription or SaaS offering.

Related Research:

Market Share: Enterprise Application Software as a Service, Worldwide, 2020

4 Steps to Successful SaaS Negotiations and Vendor Lock-In Prevention

Strategic Planning Assumption: By YE25, customers will negotiate commercial terms for less than one-third of the software and SaaS contracts negotiated in 2021, fundamentally changing IT procurement.

Analysis by: Mike Tucciarone and James Smith

Key Findings:

- Software vendors are shifting from perpetual licensing to SaaS subscriptions. For example, Gartner estimates as of the first half of 2021, 40% of SAP' s revenue was associated with cloud versus 60% software and support revenue. If that proportion of cloud revenue increases by approximately 5% each year, SAP will be a predominantly cloud business by YE23.
- Many large software vendors have moved away from selling bundled solutions to selling individual solutions (e.g., Dynamics 365 is now leveraging an individual application model). While customers may be attracted to the ability to buy individual applications, they now perform many more SaaS deals with software vendors versus one-time large deals, reducing their buying power. As a result, customers have many more small deals and simply don' t have as much leverage.
- Customers subscribing to SaaS solutions know vendor lock-in at renewal is real. The easiest renewal negotiations are those customers maintaining subscriptions commitments and leveraging existing contractual provisions for renewal price protections. The most difficult renewal negotiations are those customers reducing requirements too close to renewal and the vendor knowing the customer has

implemented and adopted the product. If this occurs, timing is on the vendor's side and viable options are limited.

- Online marketplaces have become more prevalent (e.g., Amazon Web Services [AWS], Google, etc.). With easy access to these marketplaces, customers can and are purchasing marketplace products without the need to engage the software vendor directly or interact with sourcing or procurement within their organizations.

Market Implications:

- As SaaS subscriptions take a higher proportion of customer software spending, customers must change the way they approach software spend. Software vendors will take advantage of customers who:
    - Do not keep pace with change
    - Lack understanding of vendor go-to-market strategies
    - Lack visibility into spending and roadmap by vendor
    - Do not start preparing for renewal well in advance
- SPVM leaders used to spending their time and attention on "big deals" with particular vendors will see that time is spent across more and more SaaS transactions that may not even gain sourcing or procurement oversight. As a result, customers won't have "big deal" leverage and must come up with alternate means to gain leverage and drive market-competitive deals with software vendors.
- Negotiations with software vendors at renewal are already an uphill battle and will only increase with more movement to SaaS and subscription. Customers who do not have additional requirements to put on the table, start the renewal process early to establish leverage or conduct a market review will most likely have little leverage to negotiate the renewal. They will have to accept what the software vendor puts on the table. The vendor will require customers to renew or lose data and the environment as directed in the agreement.
- Online marketplace deals will not be negotiable. They will be an effective way of acquiring items with limited spend, leverage and risk, but the terms of that marketplace will be binding. Time and attention freed up by buying from marketplaces can be spent on key vendors.

Recommendations:

- Pull all spend data from different business units into one holistic view per vendor. This view should provide visibility to all upcoming contracts, key dates, fees, and commercial levers. Organizations with a clear vision of the vendor will be better equipped to internally plan for upcoming negotiations and pull commercial levers.
- Develop a vendor roadmap by determining what products you anticipate buying from a vendor and when. This view will provide additional leverage during SaaS negotiations or at renewal by being able to discuss beyond the current deal. Find leverage by preparing to discuss downstream vendor opportunities to paint a more strategic partnership picture or pull forward roadmap items to drive additional cost savings. An example of an opportunity could be co-terming aspects of total spend with the vendor by moving renewal dates forward or backward as allowed by their specific terms and conditions.
- Prepare for large or complex renewals by understanding your requirements 12 to 24 months ahead of contract expiration, so that you have a realistic possibility of leaving an incumbent provider. For more details, see Tool: 5-Phase Checklist for Tier 1 Software and SaaS Enterprise Contract Renewals.
- If your requirements are going up, leverage this to renegotiate for more scale. If requirements are staying the same, leverage any renewal protections you have. If requirements are going down, use an RFP to create leverage and position the possibility of leaving with a clear internal communication strategy to avoid mixed messaging to the vendor. For more details, see 3 Steps to Improve Software and SaaS Renewal Negotiation Preparation Strategies.
- Take advantage of online marketplaces to efficiently manage time spent, and focus energy on strategic vendors. Know where limited spend and leverage deals exist, and use online marketplaces to get quick wins so that more time can be spent on bigger vendors with more opportunity for impact. Understanding this will help sourcing but may require an increase in the staffing handling vendor risk management to ensure that the terms of service protect your organization and that your data is handled in accordance with your policies.

- Use short-term negotiation tactics, including:
    - Any user issues with current functionality
    - Vendor turnover, if experienced (account executive/account manager/customer success manager)
    - Turnover in your organization (if you didn’ t originally negotiate the deal and are stuck with it)
    - Being a reference for the vendor

Key Findings:

- The complexity of SaaS integrations has led to huge growth of the iPaaS market, with many organizations turning to solutions from vendors such as Boomi and Informatica. Many of the top 10 software providers offer their own embedded integration solutions including Microsoft (Azure Integration Services), SAP (Integration Suite), Oracle (Integration Cloud) and Salesforce (MuleSoft) (see Quick Answer: When to Use (or Not Use) Embedded Integration Features Provided by Your SaaS Vendor). iPaaS has replaced traditional integration platforms such as ESB (Enterprise Service Bus) platforms, especially for midsize organizations for whom the cost of traditional integration platforms was prohibitive. They are now forced to adopt integration platforms to support ever-increasing SaaS application deployments, mobile applications, and APIs.
- SPVM leaders are often bypassed in the process of negotiating iPaaS deals, leaving important terms and conditions unnegotiated. This frequently results in large cost increases or missed opportunities for savings due to contracts that lack renewal price protections or tiered discounts for growth.
- Pricing metrics in iPaaS vary wildly by provider. For example, some offer core-based pricing, which is a fixed price per virtual processor; others offer pricing by user, endpoint connections, network load, number of actions (such as API calls) or number of messages or events distributed. As a result, it can be very difficult to compare pricing between vendors.

- Many SaaS providers offer embedded integration to enable connectivity to external applications and data sources, and typically charge additional fees to do so in the form of connectors. However, SPVM leaders are often unfamiliar with the secondary cost implications of this integration, which may come in the form of additional API call charges.

Market Implications:

- As more organizations move to a composable form of IT strategy, API integrations will become more prevalent and complex. Vendors that offer both SaaS and iPaaS solutions will experience higher growth rates as they look to bundle SaaS and iPaaS deals together in order to meet integration needs.
- In 2020 iPaaS was one of the fastest-growing markets in enterprise software with 38% growth year over year. This market grew over four times faster than the global software market last year (with 8.9% growth in 2020) and more than twice as much as the SaaS market (16%). The increasing consumption of SaaS is increasing integration needs, and consequently, iPaaS requirements. Vendors who do not currently offer iPaaS solutions will look to develop their own or acquire existing companies with offerings in this market.
- The growth of iPaaS will also have implications on the skills market. iPaaS skills will become more difficult to source, as system integrators with iPaaS skills are likely to be fully engaged with clients.
- Providers face little churn in their customer base, due to the inherent difficulty in switching iPaaS providers, and will continue to increase renewal prices significantly (see How to Successfully Migrate to a New Integration Platform).
- Vendors will seek to gain revenue through charges for API calls and other integration costs. They are often overlooked in SaaS contract negotiations. Some providers, such as Salesforce, include a set number of API calls within their subscriptions. If these limits are exceeded, customers are charged for the overage. This practice is likely to increase.

Recommendations:

- When negotiating iPaaS deals alongside SaaS deals, ensure competitive offerings are fully assessed and leveraged. It can be tempting to accept your SaaS provider’s iPaaS offering, but without a competitive process you will pay more and find it difficult to negotiate critical terms.
- When negotiating iPaaS contracts, ensure you have investigated all hidden costs and negotiated effective terms to protect future pricing. This includes a renewal price cap of 3% to 5% spanning at least two renewal terms, and tiered price discounts for additional licenses.
- During SaaS negotiations, ensure that embedded integration needs are clearly defined and negotiated. Identify API call costs that are a secondary pricing metric, and ensure this pricing is negotiated at the same time as the primary pricing metric. Ideally, this pricing should be tiered and should allow you to flex up as well as down based on changes in API consumption.

Related Research:

How to Compare the Disparate Pricing Metrics of Integration Products

How Are API Management Platforms Priced?

What Do You Need to Know Before Negotiating MuleSoft Contracts?

Strategic Planning Assumption: By YE25, SaaS customers buying into industry vertical offerings will see 40% higher subscription costs than buying industry-agnostic offerings, but will spend 30% less time on customization.

Analysis by: Jo Liversidge, Hannah Decker

Key Findings:

- A vertical industry product is one developed to fit the use case(s) of a specific industry. It is designed to offer more out-of-the-box capabilities, such as prebuilt data models, domain-specific features and preintegrated multiproduct capabilities. Examples of vertical industries are financial services, communications or manufacturing. Gartner identifies 11 key industries (see Note 1). Vertical-industry-specific software accounted for US$145 billion in 2020 and is expected to grow to US$243 billion by 2025.[3]

- Certain vendors have been selling specific industry vertical offerings for some years. For example, Salesforce launched Health Cloud and Financial Services Cloud in 2015. The acquisition of Vlocity by Salesforce in 2020 cemented its industry lead strategy. In February 2021 Microsoft launched new industry clouds as a reaction to the specific needs that emerged during 2020, as well as its desire to compete with Salesforce.
- Industry vertical products are typically more expensive than the vanilla application. This is not unreasonable since they typically include the general, base capabilities plus the industry-specific capabilities. Each vendor offers a different vertical industry SaaS product:
    - Salesforce offers an all-in price. Salesforce Health Cloud' s list price starts at $300 per user per month (pupm).[4] Included within this is a Sales and Service Cloud subscription (list price $175 pupm) for the same edition as the $300 Health Cloud.[5]
    - Microsoft offers Microsoft Cloud for Healthcare Add-On (ERP $95 pupm) and each capability enabled by this add-on has specific prerequisites.[6] These prerequisites are one to multiple Microsoft Dynamics 365, Power Platform, and Azure subscriptions, which, depending on the combination, will unlock varying features.
    - SAP layers different capabilities on top, with different metrics dependent on industry, so pricing is dependent on extensions purchased and their corresponding metrics.[7]

Market Implications:

- SaaS vendors offering vertical industry products will see a higher growth in revenue than competitors not offering such products. Customers want more out-of-the-box features that can be delivered quicker to accelerate digital initiatives. They will also be willing to accept a price premium in return for this greater speed and simplicity.

- It is likely more vendors will either develop industry-specific offerings or acquire companies that have developed such capabilities. The larger industry verticals that are projected to see growth will see more attention; for example, banking and investment services, and government (see Forecast Analysis: Enterprise IT Spending Across Vertical Industries, Worldwide).

- Vertical industry products are even stickier than vanilla offerings. This means a higher degree of lock-in. As a result, vendors with industry-specific products will experience less churn than their competitors that don't offer such specific products. Conversely, competitor vendors without industry offerings will see higher churn rates as customers are willing to pay a premium for shorter implementation periods and less customization needed with vertical industry products.

- Opportunities for co-development will present themselves between SaaS vendors and industry sector clients, offering opportunities for revenue sharing, royalties or significantly reduced pricing.

Recommendations:

- Assess that your organization needs all the capabilities offered in the vertical industry product, and that the capabilities are mature and meet your requirements. Push for further discounts for unused features.
- Leverage competition when considering an upgrade to an incumbent vendor's industry offering, or risk not maximizing discounts and other concessions.

- Leverage the purchase of a vertical industry product to its full advantage. Industry products are priced higher and vendors are incentivized to sell them, so leverage your specific use case/geography to drive deeper discounts. Relatively early adopters will be useful case studies for vendors and this will also prove a useful point of negotiation.

Related Research:

Forecast: Enterprise IT Spending by Vertical Industry Market, Worldwide, 2019-2025, 2Q21 Update

Quick Answer: What Makes Industry Clouds Different From Today's Cloud Offerings?

3 Steps to Strategic Negotiation With Salesforce

A Look Back

In response to your requests, we are taking a look back at some key predictions from previous years. We have intentionally selected predictions from opposite ends of the scale — one where we were wholly or largely on target, as well as one we missed.

On Target: 2019 Prediction — By 2022, 85% of organizations with multiple SaaS contracts will suffer from unnecessary overpayment due to nonelastic pricing in contracts.

Analysis by: Eugene Quillen

In early 2020 a global pandemic erupted and accelerated a trend that was already underway related to the nonelastic pricing in SaaS contracts. From the beginning of the pandemic, Gartner fielded calls from clients looking to lower their spend on SaaS based on reduced usage and need, but found that very few clients succeeded in getting any relief under their existing contracts. Those that did get some concessions rarely got a reduction in costs but instead secured moving payments out into the future.

One bright spot for SaaS buyers is the emergence of B2B digital marketplaces where consumption-based pricing is commonly available. SaaS purchases based on the consumption models available on the B2B digital marketplaces can be ramped up and scaled down at any time. Unit rates for this flexibility are higher than the rates for the typical committed terms such as one to three years for traditional SaaS contracting. If usage flexibility is a key objective, explore options available on the B2B digital marketplaces. See Tool: IT Sourcing and Procurement Guide to Using Digital Marketplaces for real-world information about the AWS, Google, Microsoft, Oracle, Salesforce and SAP digital marketplaces and how to develop your digital marketplaces usage strategy. Beyond digital marketplaces, consumption-based pricing is just beginning to emerge.

Missed: 2019 Prediction — By 2022, 80% of the top 10 SaaS vendors’ customer contracts will be renewal discussions and not new deals.

Gartner estimates that Microsoft and Adobe are above the 80% renewals versus new SaaS contracts, and Google is very close. But most of the rest of the top 10 providers are well below 80% and are still executing many or most SaaS contracts to first-time customers. The top 10 SaaS vendors (by revenue) in 2020 were Microsoft, Salesforce, SAP, Oracle, Workday, Google, Adobe, UKG, Dropbox, and Epsilon (see Market Share: Enterprise Application Software as a Service, Worldwide, 2020).

Evidence

[1] 2020 Gartner Sourcing, Procurement & Vendor Management Survey: Results presented are based on a Gartner study conducted to identify the greatest challenges SPVM leaders are facing today when negotiating with and managing technology vendors. This primary research was conducted online in September and October 2020 among 279 respondents in North America (n=130), Western Europe (n=84) and Asia/Pacific region (n=65).

Qualifying organizations span various industries except agriculture, construction, nonprofit, real estate and services. Organizations were screened for having annual revenue for fiscal year 2019 to be greater than/equal to US$250 million. Organizations were required to have formal SPVM resource(s)/teams.

Respondents were required to be from corporate leadership, line of business (LoB) leadership or an SPVM functional area and be CIO, CPO/head of procurement, sourcing director/manager, procurement director/manager, vendor manager, supplier relationship manager, contract director/manager or procurement category manager. Respondents were required to have involvement in technology/SPVM resource(s)/teams.

Quotas were applied for countries/regions, organization size and function.

The study was developed collaboratively by Gartner’s SPVM team and the Primary Research Team.

Disclaimer: Results do not represent "global" findings or the market as a whole but reflect the sentiment of the respondents and companies surveyed.

*** Attention: research are originally in English and I have translated it into Chinese by Google Translate as instructed by Peter. In case of any discrepancy between the English version and the Chinese version, the English version shall prevail.*