Pipe: A New Way to Fund SaaS Growth

The Rise of Software as a Service

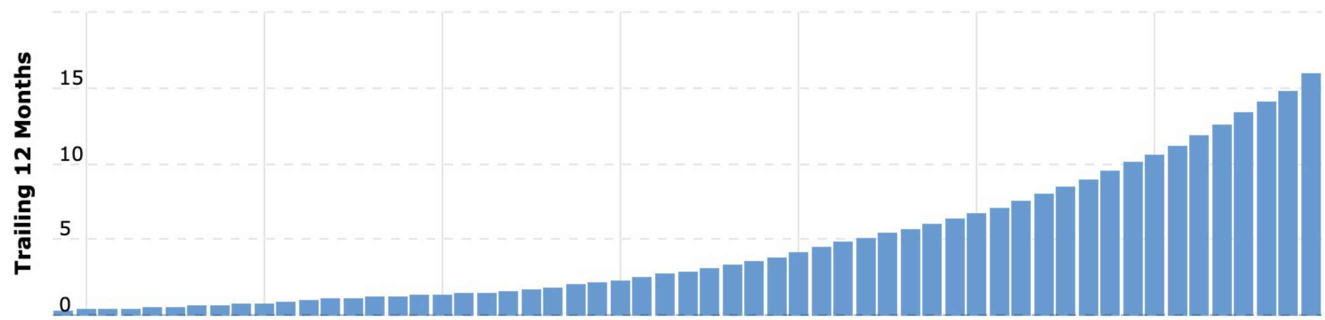
1965 proved to be an unforgettable year: Dr. Martin Luther King Jr. led his famous civil rights march in Alabama from Selma to Montgomery, Operation Rolling Thunder Launched In Vietnam, The St. Louis Gateway Arch was completed on the banks of the Mississippi river, and IBM rolled out their 360 Model 67 which included features that facilitated time-sharing applications, thus giving birth to what would become the industry now known as Software as a Service, or SaaS. It wouldn't be until four years later that astronaut Neil Armstrong would proclaim as he became the first man to set foot on the moon, "That's one small step for man, one giant leap for mankind" - but his statement might have been just as appropriate describing those first steps taken by IBM engineers that allowed banks and government offices to access computing power as a value-add service.

Technically these time-share applications were a precursor to pure SaaS offerings, as the services provided were more hardware-driven processing power. Pure shared software offerings would have to wait until the 1990s when the expansion of the internet gave rise to Application Service Providers (ASPs) who sold access to software from a centralized server over a network to an end user. But those ASPs were clunky and the quality of the networked software was often subpar to their desktop/on-premise counterparts.

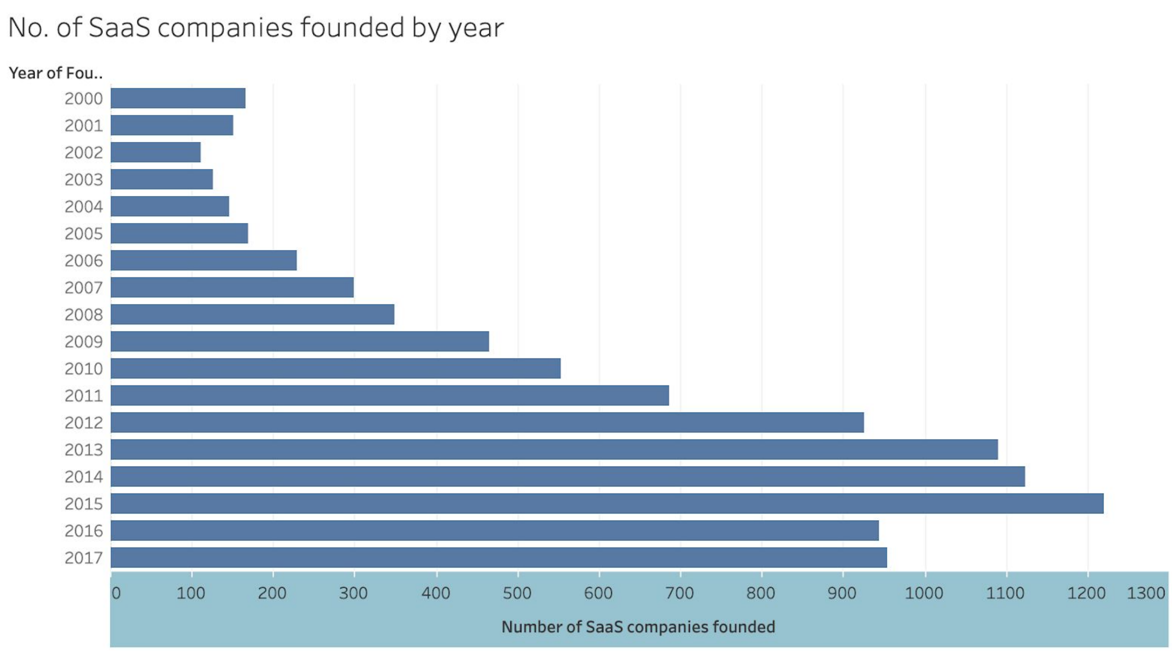
The modern-day SaaS industry can be traced back to a company that originated as a packaged software company. Concur went public in 1998 on this packaged model, but saw its market value plummet in the crash of 2001. In response, the company evolved into a pure SaaS business, ultimately selling to SAP for $8.3B in 2014. Possibly one of the most famous SaaS companies, Salesforce was founded in 1999 and went public in 2004 at a valuation of $1.1B (the company's current market cap is $165 billion). And the ultimate meta-SasS business, Amazon Web Services--which is not only a SaaS company in and of itself, but also provides a platform for thousands of other SaaS companies--launched in July 2002 and ended 2018 with over $25 billion in annual revenue.

The Explosion of Cloud Services

Today, nearly every aspect of business operations--specifically infrastructure (IaaS), Platform (PaaS) and Application (SaaS) needs--are handled by cloud-based services, and worldwide revenue growth reflects this fact. Concur earned $41M in its first year as a SaaS business in 2001. That revenue grew to $600M when it sold to SAP in 2014. Salesforce has seen its revenue grow to over $13B over the last 20 years as seen in the revenue chart below.



It was estimated by Crunchbase in 2018 that there were over 11,288 SaaS companies in the world, and while total market estimates vary, Gartner projected that worldwide public cloud revenue is growing above 17% year-over-year to $250 billion in 2020 and $331 billion by 2022, with more than $110 billion and $143 billion coming from SaaS businesses alone in 2020 and 2022 respectively. Another report by Research and Markets has the market even bigger with SaaS revenues hitting $220 billion by 2022.



What's clear is that cloud services are an undeniable part of the global economy. Today it is much more difficult to find a company big or small that does not leverage some kind of cloud-based service. And as internet access expands to the other 4 billion people in the world in the decade ahead, this trend will only become more pronounced.

When MRR Cannot Pay The Bills

The challenge many SaaS companies face is that while they may sign large one or multi-year contracts worth millions of dollars, the majority of their customers will pay them on a monthly basis, in what is known as monthly recurring revenue, or MRR. The problem is that these customers can be expensive to acquire: customer acquisition costs (CAC) are spent upfront to sign these customers and then there is a period of time required for the company to earn back that CAC (the payback period). A general SaaS industry standard has that a company should try and limit its CAC to ⅓ of what they expect to earn from that customer over the life of their contract(s) - often easier said than done. So if a company expects to earn $1 million from a customer, they will spend $333K to acquire that customer through various sales channels. That is money the company spends upfront before one dollar of revenue is earned. Additionally, if the customer signs a one year $1M contract, their monthly payments will only be $83K, meaning it will take the company a full four months to earn back that CAC - a lifetime for a fledgling startup!

It is because of this that companies will often offer customers discounts upwards of 20% to 30% to prepay their contract at once upfront. In the example above, if a company offers that same customer a 30% discount on the $1 million contract if they pay it upfront, the company would be paid $700K at the time of signing, earning back double their $333K CAC immediately.

But even with steep discounts, the majority of SaaS customers don't want to or are unable to pay the full value of their contract upfront. Therefore, SaaS startups are forced to raise growth capital to fund the acquisition of all their new customers. And customer acquisition is just one reason a SaaS startup would need to raise money. There needs to be continual investment in the product: new and existing customers have new and unique product needs that have to be addressed else they will churn out.

Historically, SaaS companies have turned to venture capital for these financing needs. When raising venture capital, founders are selling equity in their company--equity that will be worth billions should the company find massive success. Over the course of a company's private life, a founder can sell off as much as 50% to 75% of the company (sometimes more) to fund growth and product development. 75% of $1.1 billion (the IPO value of Salesforce) is $825 million! That is expensive capital.

A Better Solution

The beauty of SaaS contracts is not only does the revenue recur, but also without that software, most businesses would not be able to function properly or efficiently. As Vista Equity Co-Founder, billionaire Robert Smith has said:

"Software contracts are better than first-lien debt. You realize a company will not pay the interest payment on their first lien until after they pay their software maintenance or subscription fee. We get paid our money first. Who has the better credit? He can't run his business without our software."

The best SaaS products become essential and life-long tools of a company. The monthly fees paid for them become annuities. If these payments are continuous and reliable then why would a SaaS business not be able to borrow money against them as an alternative to the extremely expensive venture capital they typically raise?

Today, we are pleased to announce our investment into the series seed of Pipe, a financing platform built for SaaS companies to get instant access to non-dilutive cash flow to grow their business. Pipe works with SaaS vendors to help them grow organically by pulling their cash flow forward. Pipe turns their clients' MRR into their ARR by advancing them the full annual value of the contract upfront - meaning they can cashflow their business and invest into growth. MaC Venture Capital is investing alongside a noteworthy group of investors that includes Craft Ventures, Fika Ventures, Naval Ravikant, WorkLife Ventures, Liquid2 and The Weekend Fund.

Pipe was founded by an extraordinary team of serial entrepreneurs: Harry Hurst, Josh Mangel, and Zain Allarakhia. Based in LA, the team is well seasoned with a proven track record of working together. Josh and Harry previously co-founded Skurt, an on demand car rental service that was acquired by Fair.com. After the deal, both continued on to the product division—having been acquired for their proprietary technology and domain expertise. Similarly, Zain has a thorough pedigree in development of financial services, graduating from Braintree and Plaid and into this new venture alongside Josh and Harry.



Credit Culture

The concept of business or consumer credit dates back over 5,000 years and has become such an ubiquitous part of everyday life that we almost don't even think about it (unless it starts to get us in trouble). While taking on too much debt and overextending yourself is obviously a bad thing, the use of credit helps millions of Americans buy homes and allows the United States to fund various programs that keep the country running. From credit card companies extending credit to consumers to banks extending credit to businesses to nations buying each others' treasury bonds to extend credit, trillions of dollars have been earned through credit culture.

More recently, a crop of venture-backed startups have taken advantage of credit culture to capture billions of dollars in value. Brex ($2.6 billion valuation) makes it easier for entrepreneurs and startup employees to obtain credit cards that make the process of business expenses and reimbursement much more efficient. Affirm ($2.9 billion valuation) provides a lending platform that is an alternative to credit cards. The company's platform offers loans with no late fees, no compound interest and no balance to be carried, enabling consumers to receive instant financing and make simple monthly payments for their purchases with no hidden fees. ZeroDown ($150 million valuation) offers affordable home buying solutions. The company's platform purchases houses on behalf of the owner and offers affordable periodic financing to buy back the property, enabling users to find the right amount to finance their home purchases and free up capital for other investments.

Pipe is following this path, and capitalizing on this credit culture trend by extending credit to those SaaS providers and creating a new asset class for investors: a fixed income-like product to yield attractive returns from asset-backed, predictable, recurring revenue streams.

How Pipe Works

By advancing capital against their recurring revenues, Pipe removes a critical growth obstacle for many SaaS companies. Pipe's platform assesses customers' key metrics by integrating with its accounting, billing, and subscription management systems - and makes an instant decision on whether the company qualifies for a PipeLine of finance. Facilities range from $10,000 per month to several million dollars per month for later-stage companies.

Pipe can work in two simplistic ways. A SaaS vendor can sync their existing billing platform (Zuora, Chargebee, Stripe, Recurly, SaaSOptics etc.) and select a bucket of subscriptions (receivables) to sell to Pipe in real time against the facility limit they set for them on a monthly basis. This enables the vendor partners to get instant access to cash flow that they previously would have had to wait 12 months to realize, without needing to change the workflow/payment flow. They will continue to collect the monthly payments from their subscribers on Pipe's behalf and remit them to Pipe as their collections agent.

The Pipe checkout product allows vendor partners to create a custom checkout environment for each new contract they sign with their subscribers, and in turn, their subscribers to checkout and pay for their contract in monthly installments via ACH or Credit Card. Pipe pays the vendor upfront for the year and then handles the term billing for their customers.

Marlon Nichols led the Pipe Series Seed round for MaC Venture Capital.

About MaC Venture Capital

MaC Venture Capital is the result of the merger between successful Los Angeles and Bay Area based Seed funds, Cross Culture Ventures and M Ventures. MaC Venture Capital is an early stage venture capital firm focused on finding ideas, technology, and products that can become infectious. We invest in technology companies that benefit from shifts in cultural trends and behaviors in an increasingly diverse global marketplace.