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Disrupted or Disruptor

The Strategic Imperative of AI for Vertical SaaS

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Introduction

Vertical SaaS

The rise of Vertical SaaS over the past ten to fifteen years has demonstrated the power and resiliency of offering industry-specific solutions. The most successful of these companies build dominant market positions by becoming mission critical to their customers' daily operations.

This rise of Vertical SaaS was, in many cases, the result of displacing legacy, on-premise software vendors in specific markets. As an example, Primavera dominated construction project management through the 1990s and 2000s. Primavera, which was acquired by Oracle in 2008, offered an on-premise solution, targeting enterprise customers, using a licensing model with high upfront costs for deployment and training. Procore, founded in 2002, disrupted this market by using a cloud-based approach making its platform accessible from anywhere which was critical for construction sites where teams need mobile access. Their SaaS pricing model also made the software accessible to small-to-mid-tier construction companies and then enabled them to gradually move upmarket with more sophisticated features. Procore has gained significant momentum over the past decade with revenues forecast to be $1.1 billion in 2024.

The attractiveness of this approach has been validated by the success of multiple publicly traded Vertical SaaS companies and privately held unicorns. As an example of the 1st major wave of Vertical SaaS IPOs between 2012 – 2015, the six companies in Table 1 had 10-year returns ranging between 236% to 3,666%:

Vertical SaaS Companies IPOs 2012 – 2015

Company	IPO Date	10-Year Return
Guidewire	2012	236%
Veeva Systems	2013	700%
Q2 Holdings	2014	434%
Five9	2014	806%
AppFolio	2015	1,656%
Shopify	2015	3,666%

Table 1

As further evidence of this success, our "Market Breadth vs. Market Depth: A Comparative Analysis of Horizontal and Vertical SaaS Companies" report, includes a detailed analysis of twenty five publicly traded Vertical SaaS companies that have a

combined market capitalization of $358 billion, $36.2 billion in revenue, growing at a 21% average CAGR from 2019 (FY2020) through 2023 (FY2024).

The potential of Vertical SaaS extends beyond public markets, with private unicorns like Aurora Solar (Solar), Cloudbeds (Hospitality), and Forter (e-Commerce) further demonstrating the upside of well-executed Vertical SaaS models.

Despite this success, significant market opportunities remain relatively unexplored, primarily due to two key challenges:

1. Legacy vertical SaaS providers had limited success incorporating predictive AI into their solutions due to data infrastructure, data silos, and training limitations.
2. Difficulties in penetrating industries characterized by low annual contract values (ACVs), tight profit margins, and/or high price sensitivity, such as Field Services, Agriculture, Retail Grocery, and Creative Services.

Index Ventures, in their "The Next Logical Iteration of Vertical SaaS" article, states that the "…next logical iteration of vertical SaaS will be vertical AI – vertically focused AI platforms, bundled alongside workflow SaaS, built on top of models that have been uniquely trained on industry-specific datasets."

Generative AI and emerging Vertical AI companies will disrupt Vertical SaaS companies if they are not able to quickly adapt by adding their own AI capabilities. However, simply adding AI capabilities will not be sufficient if an AI tool or an emerging competitor upends a company's business model.

Chegg, a Vertical SaaS company which offers online tutoring and textbook rentals, grew its overall subscribers ("Subscription Services" and "Study/Study Pack") from 1 million to 8.2 million from 2015 – 2022, prior to the launch of ChatGPT in November 2022. As Stephen McBride, Chief Analyst at RiskHedge, mentions in his article, "Taken to the AI Slaughterhouse," "…suddenly, everyone had access to their own interactive AI that could function in many ways like a private tutor… for free."

Since ChatGPT's launch, Chegg's "Subscription Services" subscribers decreased 25% from 5.1 million in Q1 2023 to 3.8 million in Q3 2024 as shown in Figure 1. Chegg's stock price has decreased 93% over this period.

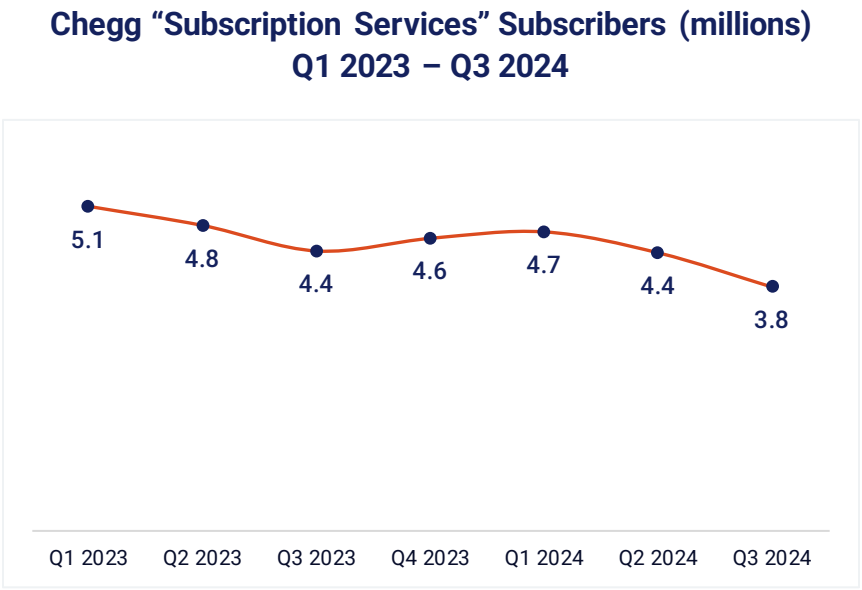

Figure 1

Chegg highlights the most disruptive threat is when a company offers a service for free which another company is monetizing. Chegg provides an initial case study for how AI, in this case a generative AI tool, can impact a Vertical SaaS business…we expect more examples over the next several years.

Vertical AI

Definition

Vertical AI is an AI solution specifically designed and optimized for a particular industry, leveraging domain-specific data, workflows, and industry expertise to solve unique challenges within that sector. Unlike Horizontal AI platforms that provide generalized solutions across multiple industries, Vertical AI is deeply tailored to the specialized terminology, regulatory environments, and operational complexities of specific industries.

Overview

The race to become the dominant players in specific vertical markets is well underway with over 100 Vertical AI companies identified by our team to date. These companies have raised almost $7 billion in funding although the ten companies in Table 2 represent 58% of the total.

Vertical AI Funding

Vertical AI Company	Industry	Funding (millions)
Tempus AI[1]	Healthcare	$1,300
KoBold Metals	Energy	$895
Paper	Education	$390
Cresta	Contact Centers	$270
Viz.ai	Healthcare	$252
EvenUp	Legal/Personal Injury Lawyers	$235
Abridge	Healthcare	$208
Sift	Telecom	$208
Harvey	Professional Services	$201
Truveta	Healthcare	$195
	Total	**$4,154**

Table 2

[1]Tempus AI had its IPO in June 2024 (NASDAQ: TEM)

Bessemer Venture Partners, which built one of the largest and most successful Vertical SaaS portfolios, has been actively investing in Vertical AI companies over the past several years. Their Vertical AI portfolio includes EvenUp, Abridge, Fieldguide, Lumachain, Plenful, Prospera (acquired by Valmont Industries), Raft, and Statespace.

The Bessemer Venture Partners article, "Part I: The future of AI is vertical," states that "unlike their predecessors (Vertical SaaS), these Vertical AI applications are able to target the high cost repetitive language-based tasks that dominate numerous verticals and large sectors of the economy — such as legal, healthcare, and finance — that were largely out of bounds for legacy vertical software."

Several leading venture capital firms believe that Vertical AI taps into a significantly larger market opportunity than captured to date by Vertical SaaS companies as described in Table 3 below:

Vertical AI Market Opportunity Perspectives

BESSEMER VENTURE PARTNERS	"Given Vertical AI's ability to both capture new markets and tap into more sizable TAMs within those markets, we predict that Vertical AI represents an even larger market opportunity than that of legacy Vertical SaaS."
greylock	"The broader magnitude of this paradigm shift cannot be understated: an estimated 80% of the world's data is unstructured"
NfX	"…the market for these companies is not the existing SaaS markets, but the cost of doing the entire work itself, a market we believe to be at least an order of magnitude greater."

Table 3

Publicly Traded Vertical SaaS Companies: AI Activities

The publicly traded Vertical SaaS companies profiled in our report have been adding AI tools to their solutions over the past several years, including AI Agents & Co-Pilots, Generative AI Platforms, and Workflow/Task Automation as shown in Table 4. Other AI tools, such as Chatbots, have been around for a while but are now being upgraded with more advanced Generative AI capabilities.

Andreessen Horowitz highlights in their "Vertical SaaS: Now with AI Inside" article, that AI is enabling the "…third wave of vertical SaaS: cloud + fintech + AI…which is the most impactful force in the category to date." This third wave "… is increasing VSaaS (Vertical SaaS) revenue per customer by enabling vertical SaaS companies to take on tasks previously too complex for software."

Vertical SaaS
AI Solutions Matrix

Vertical Saas Company	AI Agents & Co-Pilots	Workflow/Task Automation	Generative AI Platforms	Content Generation	Conversational AI/Chatbots	Predictive Analytics	Computer Vision	Personalization Engines	Security/ Risks	Other
Procore	Agent Studio & Co-Pilots								Insights	
Veeva Systems		Vault CRM Bot			Vault CRM Voice Control					
Olo			AI Creative Assistant			Guest Data Platform				OrderReady, SmartQuote
CS Disco		Cecilia Auto Review	Cecilia AI							
Shopify	Sidekick			Shopify Magic						
Toast				Marketing Assistant	Toast Web & Toast Now	Benchmarking				
Doximity		Doximity GPT								
AppFolio	Realm-X Assistant	Realm-X Flows			Lisa (AI Leasing Assistant)					Realm-X Messages
Instructure					Panda Bot	Intelligent Insights				
Blackbaud	Blackbaud Copilot	Automated Invoice Scanning				Benchmarking, Impact Edge AI				

Table 4

Based on the above sample of ten of the twenty-five companies included in our Horizontal vs. Vertical SaaS Companies report, the most frequently offered new AI solutions are Co-Pilots, Workflow/Task Automation, and Predictive Analytics. Developing these types of AI solutions makes sense for these companies given that the best Vertical SaaS business models are designed to be mission critical to their customers' daily operations and workflows. Moreover, Predictive Analytics tools specifically enhance existing reporting and analytics capabilities within Vertical SaaS platforms, providing added value and deeper insights for their customers.

It is interesting, however, that only three of these companies to date, Olo, CS Disco, and Doximity, have developed Generative AI platforms. Pender Ventures, in their "Generative AI is Coming for Vertical SaaS" post, states that a Vertical SaaS company executive team needs to "…have a good answer for how you are approaching generative AI in your internal operations and potentially in your core product…" and have considered "how these technologies might change the competitive dynamics in your industry."

Only one of these companies to date, Procore, has announced plans to launch AI agents this year. Procore's Agent Studio will allow users to customize agents to streamline complex processes like managing RFIs, scheduling, safety, and inspections.

While Pender Ventures highlights the threat of Generative AI to Vertical SaaS models, Microsoft CEO Satya Nadella predicts the decline of SaaS models and the emergence of AI agents as the new standard. Nadella argues that AI agents will fundamentally change how businesses operate by:

- Replacing hardcoded business logic in SaaS applications with an AI tier that manages rules across multiple apps and databases.
- Allowing dynamic, real-time interfaces and autonomous decision-making.
- Seamlessly operating across multiple platforms, databases, and APIs, reducing complexity, and enhancing productivity.

Vertical SaaS companies have the following unique advantages, compared to their Horizontal SaaS peers, which will help them respond:

- **Industry Expertise:** have a deep understanding of market-specific requirements, terminology, compliance needs, and workflows that position them well to develop or incorporate AI agents that are optimized for their industries.
- **Existing Data Assets:** possess valuable industry-specific data sets that are crucial for training specialized AI agents.

Given the vast potential of the AI opportunity, it is a strategic imperative for every Vertical SaaS C-Suite to add or integrate AI capabilities into their solution suite. This can be achieved through internal development, partnerships with AI innovators and experts to jointly build these capabilities, and by acquiring emerging Vertical AI and/or Agentic AI companies.

Vertical SaaS executives need to be cognizant of the AI companies emerging in their markets to identify potential strategic partners or acquisition candidates. Table 5 highlights twelve companies categorized by their AI solutions.

AI Examples by Solution Type

AI Solutions	Examples
AI Agents & Co-Pilots	**Professional Services - Accounting: Basis** AI Platform for Accounting firms giving accountants a team of AI assistants **Logistics: Didero** AI agents that handle supply chain tasks like order tracking, RFQ processes, sourcing, onboarding, PO management, and payments. **Auto Dealerships: numa** AI platform that places AI agents into every facet of dealership operations. **Ema:** activates new AI employees to execute any complex workflow in the enterprise **Kognitos:** automate business operations by transforming simple instructions into self-maintaining AI agents
Workflow/Task Automation	**Financial Services: Zocks** "Meeting Assistant" for Financial Advisors that captures financial details during client meetings, prepares follow-ups, and seamlessly integrates notes into advisors' CRM and Task Mgt. solutions **Healthcare: Fathom** Autonomous medical coding, applying cutting-edge deep learning and NLP to code patient encounters **Professional Services - Legal: Spellbook** Expedites contract drafting and review using AI
Predictive Analytics & Insights	**Financial Services: Noetica** AI-powered knowledge extraction from complex financial documents (corporate debt, securities, and M&A transaction terms) **Healthcare: Viz.ai** Solutions include a lung disease software, using NLP capabilities on top of imaging AI, to mine clinical insights from the EHR and to identify and manage patients with lung disease
Personalization Engines/ Hyper-Personalization	**Education: Atypical** Tailored solutions for exam preparation and classroom management, helping students and educators achieve their goals **Gaming: Aimlabs** AI-based analytics & training platform that provides personalized training programs, which evolve with user performance, for professional gamers

Table 5

The emerging Vertical AI solutions highlighted in Table 5 underscore the potential risk to Vertical SaaS companies of missing significant incremental revenue opportunities or, in the worst case scenario, being disrupted by these companies in their markets.

Conclusion

The rapid emergence of AI represents a pivotal moment for Vertical SaaS companies. While Vertical SaaS companies have demonstrated remarkable success over the past decade—with companies like Veeva Systems, Shopify, and AppFolio delivering exceptional returns—the emergence of Vertical AI signals an even more significant market opportunity. This transition is not merely an incremental advancement but a fundamental shift in how industry-specific software solutions can address previously untapped challenges.

The success of Vertical SaaS is based on providing industry-specific cloud solutions that are mission-critical to daily operations. However, these platforms are limited in their ability to process unstructured data and serve industries with low ACVs or tight margins. Vertical AI overcomes these limitations by leveraging advanced AI capabilities to tackle complex, language-based tasks—an area that is not addressed by current SaaS solutions.

The Chegg example serves as a stark warning to Vertical SaaS companies about the disruptive potential of AI. The decline in Chegg's subscriber base and stock price following ChatGPT's launch illustrates how quickly AI can upend established business models. This cautionary tale underscores the urgency for Vertical SaaS companies to develop comprehensive AI strategies.

Leading venture capital firms, highlighted in this article, suggest that the market opportunity for Vertical AI could vastly outpace that of Vertical SaaS, driven by AI's capability to analyze the estimated 80% of the world's data that is unstructured. While many publicly traded Vertical SaaS companies are already embedding AI capabilities through internal innovation and strategic partnerships, the pace and scale of these efforts must intensify to address the mounting challenges to their business models.

These challenges include not only the rise of well-funded Vertical AI startups but also the emergence of AI Agent solutions from industry leaders like Salesforce and ServiceNow, as well as innovative companies such as Ema, Kognitos, and Lindy. These solutions pose a serious threat due to their potential to disrupt and ultimately displace Vertical SaaS companies.

Looking ahead, Vertical SaaS companies face a pivotal strategic challenge: they must not only embed AI capabilities into their existing solutions and revisit pricing models but also proactively explore partnerships or acquisitions with emerging AI innovators. Companies that navigate this transition effectively are poised to capture potentially substantial AI-driven revenue opportunities and cost savings. Conversely, those that fail to adapt quickly risk seeing their core business models disrupted by more agile, AI companies or AI-capable competitors.

Appendix: Vertical AI Companies

We identified 118 Vertical AI companies, based in the U.S. and Canada, to date although we recognize there are likely many more companies competing in this space. Figure 2 shows the split of these companies by industry.

Vertical AI Companies by Industry (n = 118)

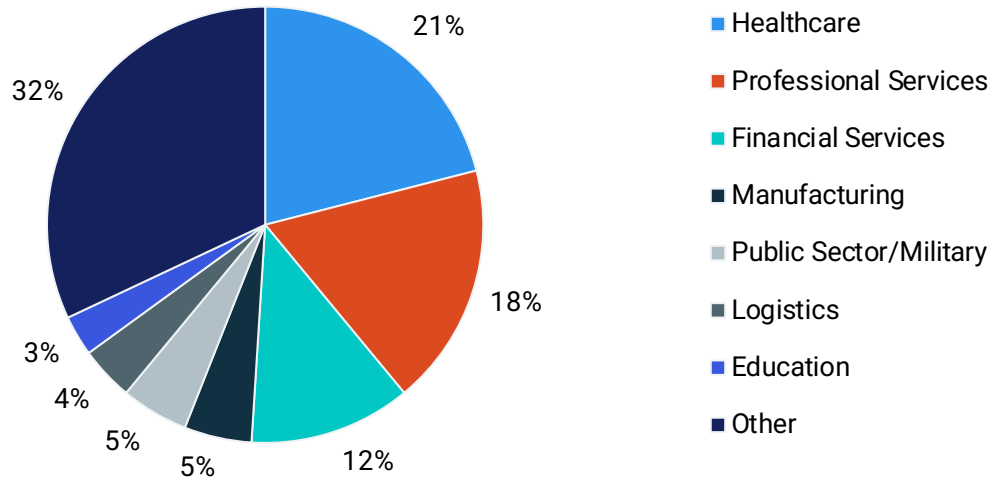

Figure 2

Bessemer Venture Partners article, "Part I: The future of AI is vertical," mentioned Legal, Healthcare, and Finance (Financial Services) as three vertical markets with high-cost repetitive language-based tasks. The Figure 2 chart reinforces this view given that these markets, with Legal included within Professional Services, represent over 50% of these Vertical AI companies.

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