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OPINION

The Pros and Cons of Software as a Service



By Dale Troppito, The Gantry Group

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The software industry is in a critical state of metamorphosis. Much like a butterfly emerging from its cocoon, software is spreading new wings as a service. The trend began to take hold back in the mid-1990s with the introduction of the application service provider. ASPs were the first to capitalize on the Internet as an interactive delivery channel for application software and data exchange. But the ASP fell victim to the dot-com bust and became a pariah of the investment sector.

Today, we don't often mention the ASP acronym; instead, we speak of "hosted" or "managed" services and "outsourcers." But the underlying premise is the same: Software is being delivered as a shared service.

The Downside of Perpetual Licensing

For decades, the prevailing purchase model for software has been the perpetual, on-premise license, priced by the total number of enterprise user seats or by the site as a whole. For software vendors, this meant that the initial sale was the big revenue opportunity. Aftermarket revenue came from the sale of annual maintenance contracts, software upgrades and, possibly, add-on capabilities. But perpetual licenses have brought vendors perpetual heartburn because they fail to accommodate a desire for recurring revenue streams. The sales force must constantly forage for new customers in order to sustain revenue growth. Software vendors have longed for a model that would allow the business to flourish from an established, loyal customer base.

Buyers of software applications, on the other hand, were faced with making a large upfront investment -- and taking a large upfront risk -- with the perpetual license model. Unsure of the delivered business value, concerned about the software's ability to meet enterprise expectations and worried about cash-flow impact, buyers often refrained from signing contracts. Prohibitively costly license fees made enterprise systems inaccessible to many small and midsize companies. The perpetual license is now recognized as an inhibitor to software sales.

The Downside of On-premise Software

Buyers drove the requirement to have both the software and the associated corporate data on-premise. The prevailing concerns over enterprise control of the software and corporate data security made it impossible for buyers to consider any other licensing or delivery model. This meant that software vendors -- and buyers -- were condemned to continuous maintenance, software update and asset management activities. Software license management proved to be highly complex, and enforcement of companywide compliance was difficult.

As the effects of the stalled economy swept over enterprises at the beginning of this decade, resource-challenged IT departments, out of necessity, creatively looked for new models to reduce the internal work docket. IT departments began thinking pragmatically in terms of business processes and workflow that needed to be accomplished and not of the purchase of discrete applications. As a result, enterprises became receptive to business models that would reduce software maintenance costs and move not only applications and transactions but also complete business processes outside of the enterprise to increase efficiency and lower costs.

The Upside of Software as a Service

The Internet is the enabling technology that has transformed software into a delivered service. Indeed, the Internet makes it possible for enterprises to responsively access the latest version of software through a familiar browser interface on a transparently shared basis. Hosted services deliver the same level of software capability and performance as on-premise applications, but with centralized off-site management of application maintenance, upgrade management and infrastructure provisioning. Pricing is modeled as a subscription based on a metric reflecting usage. Relieved of the large upfront capital outlay and the ongoing drain of dedicating IT resources to software life-cycle management and customization, enterprises are gravitating toward this new view of software as a service.

Software vendors see great opportunity in adopting this outsourcing and subscription model. Not only does the subscription model bring vendors a recurring revenue stream, but it also typically bundles rights to software use, automatic updates, maintenance and technical

software vendors and enterprises alike. And the fact that vendors can meet revenue goals by farming the installed base, instead of hunting feverishly for new customers, infers that customer service just got better for enterprises.

Enterprises also see a number of advantages to this new service model. Their concern over managing cash flow is eased by the elimination of upfront costs for the applications and a predictable software life-cycle cost structure. In addition, corporations are less risk-averse in a software-subscription model because there is less at stake financially; they feel they have the option to re-evaluate their application choices at any time. Finally, outsourced services relieve enterprises of the often painful software installation and maintenance process, allowing them to focus on their core business.

No software sector is immune to this business model shift. Even ERP vendors are taking the plunge into the world of outsourcing their software as a hosted solution. Leading ERP vendors, such as SAP, PeopleSoft and Oracle, have established partnerships with providers to host their offerings. This will inevitably enable ERP vendors to move their businesses downmarket.

Once a software vendor crosses the threshold into the service world, a palette of opportunity presents itself. Vendors are naturally extending their offerings to include outsourced managed infrastructure services and data center services. The secondary leap into nontechnical administration and professional services becomes just a small step on the continuum. The net result is that the distinction between software vendors, hosted services providers and business process outsourcers is blurring.

The Implications of Software as a Service

The acceptance of software as a service by the enterprise community has overcome the objections and risks surrounding the concept of application outsourcing. Formerly, enterprises' concern over information security, integrity and availability alone would have scuttled any hope of entering into an off-premise relationship. However, the struggle to survive in a lagging economy over the past four years has tempered these concerns, putting cost reduction at the top of the corporate priority list. More than ever, enterprises are focused on business process efficiency and establishing performance metrics to benchmark and track against. This shift has dramatically changed the dynamic of the software selling process. Companies seek solutions that will have a nearly immediate, measurable positive effect on operating costs and business performance. The best software delivery model is one that achieves this primary goal, while assuring secure, always-available access to the applications with minimal need for IT resources.

Subscription-based pricing offers enterprises a "pay as you go" plan, requiring far less of an upfront investment. While the upfront lump-sum revenue afforded by a perpetual license sale is forfeited, software vendors usually gain in the long run through a long-term recurring

The downside for vendors is that enterprises are less invested -- both monetarily and emotionally -- in their software, making a review of their buying decisions more likely after deployment. Switching applications is far more economically feasible for a company in the subscription scenario. Even though the subscription model involves some implementation, the software is less entrenched within the enterprise's infrastructure than the installation of an on-premise application. Software vendors are trying to manage this trend by entering into multiyear service contracts with their customers. But the bottom line is that vendors that offer a hosted service have a customer base that's far less captive than in the past. To counter customer churn, the software vendor must continually resell the customer at subscription review time and make customer service a top business priority.

Dale Troppito is a managing partner and founder of The Gantry Group LLC in Concord, Mass. The Gantry Group, which specializes in technology return on investment, has established best practices for ROI assessments that rely on primary market research to validate accurate capture of the real value drivers and costs delivered by technology. You can reach Troppito at dtroppito@gantrygroup.com.



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