Service Models – Comparisons & Total Cost of Ownership

by Coupa Software

Procurement software enables organizations to save time, money, and effort throughout the procure-to-pay cycle. It offers a direct and immediate ability to cut costs and control spending.

While there are dozens of procurement software solutions available, there are just three service models: "On-Premise", "Hosted" and "Cloud / SaaS / On-Demand." Let us first examine delivery methods for each of the service model and then compare the total cost of ownership (TCO).

Service Models – How Are They Delivered ?

"On-Premise Software" or "Traditional Software" Model

This software you purchase outright and then run at your physical location. On-premise software was most common until around 2005, when distributed procurement models became more prominent and web-based applications run from servers beyond the firewall became widely available and adopted. Because of the rise in popularity of running software from a remote location, on-premise software is sometimes referred to as "traditional" or "old-style" software. Though on-premise solutions are still prominent inside the enterprise, they represent a shrinking percentage of new applications sales.

With on-premise software, the usage rights you purchase up-front apply to a particular version of the software for an unlimited or perpetual term. In addition, you are entitled to buy support for the first few years of product ownership by paying yearly maintenance fees. Once a new "major" version of the software is issued, you may be required to pay another upfront fee to purchase usage rights for the new version. While you can forego or skip a new "major" version occasionally, if your software gets too out-of-date it may become unsupported in which case your organization will need to support and maintain it yourself and without help from the software vendor. You have to install on-premise software, or pay a third party to install it. You take responsibility over ensuring it is operating and available when your employees need it. You shoulder the support for any customizations you make to the software. You also take full responsibility for maintaining the software over time.

"Hosted" software service model

Some on-premise software vendors will hire a 3rd party to host your software if you buy software licenses from them. They will transfer the cost of the hardware, database and application server, along with their margin, as a bundled cost, so you don't have to worry about doing it yourself. This model is called ASP or Hosted ASP – and don't confuse it with cloud or on-demand software or SaaS. Sometimes ASP offerings prove even costlier than on-premise, so buyer beware.

The "Cloud / SaaS / On-Demand" service model

On-demand software refers to software that is available as a service and is not intended for installation on-premise. GMail and online billpay are examples of software available exclusively on-demand. Salesforce.com is largely credited with popularizing the on-demand movement for business

Cloud-based software is now available in almost every category of business software, including CRM, Accounting, HR, and Procurement.

Cloud-based solutions are easy to distinguish from their on-premise cousins:

1. Instant Deployment

   With on-demand software, you can access the application and start using it as soon as you sign up. You don't have to purchase hardware or system software (such as databases or application servers). You don't have to schedule IT resources to install the system before you get your hands on it.

2. No System Support Headaches

   Since the on-demand software vendor is responsible for maintenance, upgrades, and error resolution, you don't have to worry about staffing and delivering ongoing system support. Your IT group does not have to monitor the application to ensure it is running. Should service be interrupted, it is the software vendor's problem to make sure it comes back up immediately.

3. Buy-As-You-Need and Pay-As-You-Go

   With on-demand software, you can add user licenses as you need them, and cancel them when you don't, insuring that you only pay for what you need, when you need it. This is significant considering the vast majority of enterprise software applications are licensed for 20% to 50% more users than are actually using the system at any time.

4. Regular, Automated, Secure Data Backup

   On-demand software vendors can invest more in redundancy and robust infrastructure to insure its customers are protected from disasters. Typically they have redundant data-backup systems that do full backups daily and incremental back-ups in real-time across differing regional locations.

5. Built for Change

   Most on-premise software was built to a design which the vendor needed to be fixed and rigid. Because on-premise software is typically older, it is built on aging technology that inhibits rapid enhancement and drives up ongoing development and support costs for the software vendor. By contrast, on-demand software vendors use modern technology which keeps quality high and ongoing development and support costs low.

6. Time to Value

   Since customers don't have to spend extra cycles buying hardware or system software, they begin using on-demand software immediately. This means customers begin reaping the benefits of on-demand software right away.

Removing the Confusion

If you are having trouble telling whether a prospective vendor is trying to offer you an ASP solution and not a true on-demand solution, ask the following questions. They are usually quite effective at identifying the wolf in sheep's clothing.

1) Can I request a free trial?

Since a SaaS provider can set you up simply by creating a new account for your organization, the cost of allowing you to try their system in a limited capacity for 30 days is next to nothing. On the other hand, since a hosted ASP provider will be very reluctant to allow you to try their solution.

(2) How long will it take to set me up?

A SaaS provider can activate your application instance within minutes simply by creating an account for your organization, but will have a suite of data loading tools that can accept your data in standard file formats and automatically upload it into the system. Furthermore, they will have administrative tools that your super users and system administrators can use to start creating your user accounts, profiles, and business rules right away. As such, they will be able to set you up in a matter of days, as it typically takes longer for the request to reach their support department than it does the support department to set you up. In comparison, it could easily take a hosted ASP provider, who will have to get FTP'd data dumps from you and do customizations on their end, a matter of weeks to set up even a moderately sized organization.

(3) What's the minimum term I have to agree to?

And how does that affect my annual, or monthly, fee? A SaaS provider will generally prefer and only require a yearly contract. The subscription fee will be the same whether you agree to only one year, three years, or five years. In addition, a SaaS provider will let you start with a small number of seats and add more over time for a fixed incremental fee.

On the other hand, the perpetual license provider who uses a hosted ASP model will need to sign you on for at least three years, and will try to persuade you to sign up for long term deals of up to five or seven years, often by way of a small "discount" for longer terms.

Furthermore, the perpetual license provider with the hosted ASP model will try to sell you as many seats as you are going to need over the term of the agreement, and not the number of seats you need today.

(4) How often do you release updates?

A SaaS provider would probably respond that they release updates every month or two. A perpetual license provider will likely state they have one major update a year. Furthermore, critical patches could take weeks to be applied to your installation, as they have to patch, and test, each installation they have separately.

Conclusions:

Cloud based solutions represent a true paradigm shift not only in the way a software solution is delivered but also in the business model i.e. how the customer pays for it. On the technology side, cloud service model outscores others in terms of pace of innovation, ease of deployment and reduction in burden on IT. On the business side, only the cloud model transfers the risks from customer to the vendor because the vendor has to earn and keep customer's business.

Therefore, it should come as no surprise that the cloud model is gaining traction in the businesses of all sizes – small firms to large, Fortune 10 companies.

Comparison of Service Models

Service Model	On – Premise	Hosted (a.k.a. ASP)	Cloud (a.k.a. SaaS)
Description	Software purchased outright and then run at your physical location	On-premises software hosted by vendors from which you purchased the software	Software that is available on demand as a service and is not intended for installation on-premises
Advantages	Suitable when users are in one location, customizable.	Customizable, easy to operate when users are in different locations	User configurable, easy to operate, low and predictable costs, speedy deployment, constant innovation
Disadvantages	High and unpredictable costs, difficult to implement, slow innovation	High costs, difficult to implement, slow innovation	Don't own software license, just the right to use
Procurement Solution Providers	SAP, Ariba Buyer, Oracle, Basware	SAP, Oracle, Ariba, Basware	Coupa

Figure 1

Service Models – What is the TCO ?

The introduction of cloud based solutions has disrupted not only the service delivery models but also the business models. Legacy software vendors are scrambling to refine their business models to stay in business. Let us take a real life example where the author was involved in evaluating service models for procurement software for a Fortune 1000 company.

Input - Following is some key data for coming up with the TCO

Let us assume a typical Mid sized enterprise with 10,000 users, 5,000 suppliers and around 120,000 requests, purchase orders and invoices. Also, let us say the company is growing at 10% per annum.

	Current	Year 1	Year 2	Year 3	Year 4	Year 5
Users	10000	11,000	12,100	13,310	14,641	16,105
Suppliers	5,000					
Transactions - Requests, POs + Invoices	120,000	132,000	145,200	159,720	175,692	193,261
Estimated Growth Rate	10%					

Figure 2

TCO for On-Premise Software Service Model

Assumptions:

- Bundled license costs - On-premise software vendors typically bundle in procurement software license along with database, app server and also throw in some hardware.
- However, the software requires extensive customization and hence assumed 5 – 7 resources for the effort.
- 15% annual maintenance fees payable to the vendor
- One internal IT resource for maintenance working half-time on the application.

With the above assumptions, the TCO for on premise solution would come to -

	Year 1	Year 2	Year 3	Year 4	Year 5	Total after 5 years
CAPEX						
License	$2,000,000	$0	$0	$0	$0	$2,000,000
Upgrade						$0
Customization	$750,000	$500,000	$300,000	$300,000	$300,000	$2,150,000
Database						$0
App Server						$0
Server Hardware						$0
CAPEX TOTAL	**$2,750,000**	**$500,000**	**$300,000**	**$300,000**	**$300,000**	**$4,150,000**
OPEX						
Maintenance & Support	$0	$300,000	$300,000	$300,000	$300,000	$1,200,000
Internal IT Maintenance	$50,000	$50,000	$50,000	$50,000	$50,000	$250,000
Training	$15,000		$15,000			$30,000
OPEX TOTAL	**$65,000**	**$350,000**	**$365,000**	**$350,000**	**$350,000**	**$1,480,000**
TCO	**$2,815,000**	**$850,000**	**$665,000**	**$650,000**	**$650,000**	**$5,630,000**

Figure 3

TCO for Hosted Service Model

Assumptions:

- No Capex for software license. However there is a software subscription fee.
- Software requires extensive customization and hence assumed 3 - 5 resources for the effort.
- Separate charges for supplier enablement, transaction fees
- Fees are charged to suppliers for transacting electronically

With the above assumptions, the TCO for a hosted solution would come to -

	Year 1	Year 2	Year 3	Year 4	Year 5	Total after 5 years
CAPEX						**$0**
OPEX						
Supplier Enablement	$2,500,000	$0	$0			$2,500,000
Customization & Implementation	$100,000	$50,000		$50,000	$25,000	$225,000
Subscription	$100,000	$100,000	$100,000	$100,000	$100,000	$500,000
Transaction Fees	$132,000	$145,200	$159,720	$175,692	$193,261	$805,873
Supplier Fees	$750,000	$750,000	$750,000	$750,000	$750,000	$3,750,000
Training	$25,000		$25,000			$50,000
TCO	**$3,607,000**	**$1,045,200**	**$1,034,720**	**$1,075,692**	**$1,068,261**	**$7,830,873**

Figure 4

TCO for Cloud / SaaS / On-Demand Service Model

Assumptions:

- No Capex i.e. software license etc. however there is a software subscription fee

With the above assumptions, the TCO for a cloud solution would come to -

	Year 1	Year 2	Year 3	Year 4	Year 5	Total after 5 years
CAPEX						**$0**
OPEX						
Subscription	$500,000	$500,000	$500,000	$500,000	$500,000	$2,500,000
Implementation	$0	0	0	0	0	$0
TCO	**$500,000**	**$500,000**	**$500,000**	**$500,000**	**$500,000**	**$2,500,000**

Figure 5

Total Cost of Ownership - Analysis

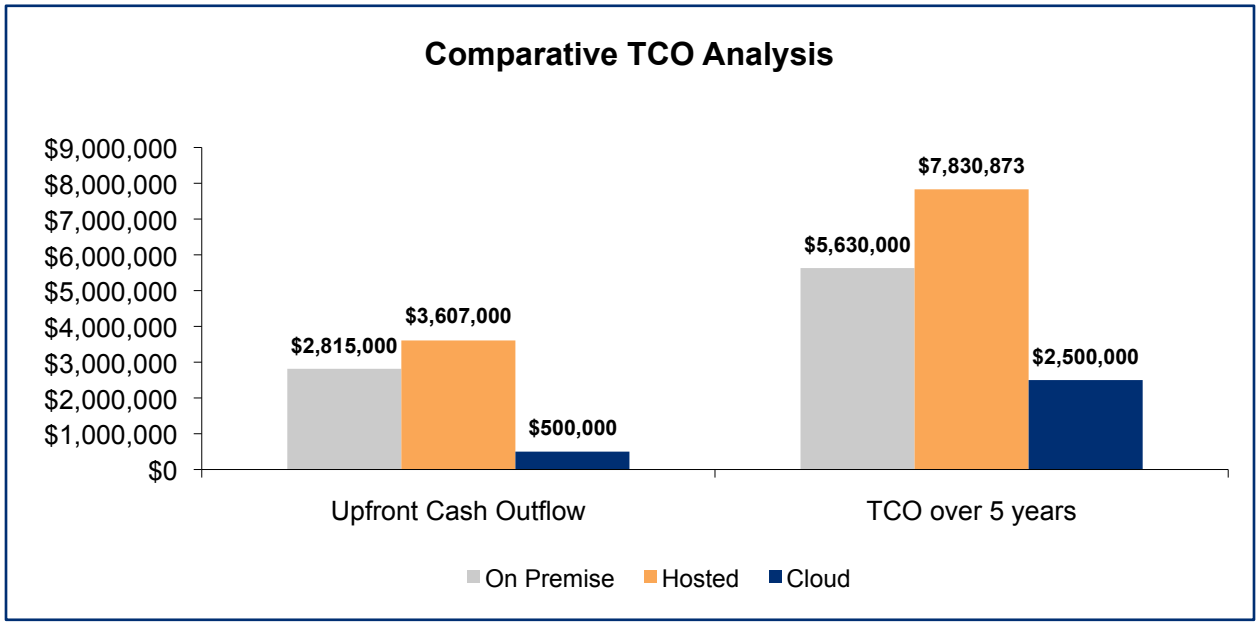

Figure 6