Software: Should You Buy or Rent?

GROWING COMPANIES NEED TO EVALUATE THEIR TECHNOLOGY NEEDS TO SEE WHICH SOFTWARE MODEL WILL BE THE MOST EFFICIENT FOR THEM. BY LIZ GOLD

Planning to dump your traditional on-premise software in favor of a Web-based application? Ask yourself this: Will it help run your company more effectively?

"That's the key," said Treb Ryan, chief executive of OpSource, a software-as-a-service delivery provider based in Santa Clara, Calif. "I think the best SaaS applications aren't just a straight-up replacement for what you were doing prior, but they actually allow you to do things you couldn't do before."

For Jim Vignola, chief executive of Vignola Hospitality Resources International Inc., a 13-employee hotel supply company based in Jefferson City, Mo., his decision to use SaaS was prompted by outgrowing his existing out-of-the-box software. "We quickly learned that hosting on our server did not work as far as remote salespeople having access to the same real-time information that we all did in the office," said Vignola, who previously used Sage Software's BusinessWorks and Intuit's QuickBooks. "That's when we began looking at Web-based services."

Ultimately, Vignola decided upon NetSuite — a San Mateo, Calif.-based on-demand financial software company — for its

IMAGESSHUTTERSTOCK ILLUSTRATIONGALINA RYBATSKY accounting, customer relationship management and e-commerce services.

He said that he didn't consider the extra updating costs of maintaining an on-premise software application, and wished that he had taken the SaaS plunge sooner, even though it was a bit more costly.

"I think it's a better deal," Vignola said. "We've been happy with it so far, because the upgrades can be done on a continual basis. It's a little more money, there was an upfront fee primarily for training and implementation, [but] once you get behind that, I think it's very cost-effective."

SOFTWARE BY SUBSCRIPTION

Though the terms SaaS and "on-demand" are often used interchangeably, the definition of on-demand is how a software solution is supplied to a user, while SaaS is just one model of on-demand software delivery, according to Jim Nauen, vice president of sales and marketing for Centage Corp., the Natick, Mass.-based parent of the management and financial software Budget Maestro. SaaS is delivered over the Internet and payment is by subscription.

"An application service provider will host the application for you 'on-demand,' but you have to maintain the application yourself or pay for it separately," Nauen explained.

Open source on-demand products offer users access to the software's source code, which gives a company the ability to analyze the software's rough spots and relay that information back to the vendor, according to Doug Harr, chief information officer of Ingres Corp., an open source products and services concern based in Redwood City, Calif.

SaaS has become an increasingly popular alternative to traditional, on-premise applications for small and midsized businesses because of convenience and pricing models. The software eliminates typically expensive upfront licensing costs, is friendlier to system upgrades and takes the pressure off IT departments to oversee the application's maintenance and daily technical operations.

But for Nauen, operating internal software offers companies one major advantage that the SaaS model does not: control. "If you outsource to a company that has thousands of customers and you're a small business, are you even going to be heard if you have a problem?" he asked. "Secondly, your IT department knows your business inside and out, so you'll be able to control and customize the applications specifically to the way you run your business, not change your business to the way the SaaS provider wants to run your application."

In November, a study conducted by technology researcher Forrester Research Inc. reported that 9 percent of small and midsized businesses are currently using SaaS. The research found that security, payroll processing and e-mail were the model's most popular applications, and that 2 percent of small and midsized businesses plan to implement SaaS during 2007. The report listed integration and security issues as the biggest reasons for the slow adoption.

Another report released last year by Stamford, Conn.-based Gartner Inc., a technology consulting and research company, predicted that SaaS will grow seven times faster than on-premise software deployments in the next three years.

By 2011, 25 percent of new business software will be delivered as SaaS, according to the report.

E-MAIL: THE EXCEPTION FOR SAAS SKEPTICS

"E-mail seems to be something that people are okay with the level of security that outsourcing providers are providing," said Nauen, acknowledging that his company uses an SaaS model for its office data and e-mail applications. "It's kind of the crown jewels, the accounting information, [that] people tend to have more problems with."

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Amy Wohl, a technology blogger and president of Wohl Associates, a consulting firm specializing in office automation and applications and systems software based in Merion Station, Pa., agreed: "I think in many cases it's being used for applications which are not the mission-critical application of the business," she said. "Will that change? Well, yes, when people get more accustomed to it and realize it's completely safe to use. I think that it will happen, too, but it hasn't happened yet."

Ingres Corp.'s Harr, however, uses the on-demand services of Intacct, a San Jose, Calif.-based financial management system applications company, for his company's core business applications. "We've all been of the experience of buying expensive software, sticking it in the data center and then spending a lot of money to keep it running," Harr said of his company's decision. "[The software] fit in the way we wanted to buy and the way we wanted to work."

"We're really beginning to see broad acceptance of software as a service," said Aaron Harris, vice president of engineering for Intacct. "SaaS provides very tangible benefits to small companies who don't necessarily have the expertise on staff to manage the IT associated with hosting business applications, or perhaps they don't have the capital to make an initial big investment. What we've seen over the years is larger businesses becoming attracted to the model. They pay as they get the value, as opposed to making huge upfront investments hoping they'll be able to make that up over time and service."

PAY ATTENTION TO THOSE SERVICE CONTRACTS

When first introduced in the late 1990s through ASPs, many in the software industry thought that SaaS would be primarily used by small and midsized businesses that didn't have a lot of internal-processing resources, according to Wohl.

"The software companies liked that idea, because from their point of view, that would extend their market without cannibalizing their existing customers," Wohl explained. "However, as SaaS got out into the world, what we found was that while there were small and medium-sized businesses that used the software, you might also get very large companies using it. This kind of arrangement can be attractive to a company of any size."

Still, companies both large and small need to be aware of their SaaS service agreements. Companies should check to see if the provider is SAS 70-certified, offers more than a 99.9 percentage of uptime, and that there is a written agreement regarding actions should the vendor renege on its service.

"Most SaaS or hosted application vendors will offer some sort of service-level agreement, but won't actually give you a comfortable recourse if it goes down," Nauen said. "Many small companies aren't thinking it through. It sounds like a really good idea, but they haven't thought through the worst-case scenarios."

SaaS providers also mainly operate in a multi-tenant environment, which places customers' data on shared servers, according to Sean Rollings, senior director of product and industries marketing for NetSuite. "You have complete partitioning of the database for all the data for security purposes and for operating purposes," Rollings said. "But from an efficiency, cost and performance standpoint, it is very effective for the customers, and for the vendors, they're able to pass a lot of that savings on to the customers."

In an SaaS model, according to Rollings, customers using a particular vendor will receive upgrades at the same time, which makes for more streamlined service and support, as well as helping to identify problems more easily.

"The only two things you need to buy are your laptop and an Internet connection," said OpSource's Ryan. "You don't have to buy a server. You don't have to get a database to run it on. You don't need to get back-up and disaster recovery. You don't need to hire a system administrator to run all of that for you. You just go buy it from the SaaS provider and all of that is included in the price. That's very valuable for small and midsized businesses."

If a company decides to go the SaaS route, according to Wohl, they're buying the use of the software, which is installed on someone else's infrastructure and managed by them as well. The user company does not own the software. "You're using the software just as if you've owned it, but you're not responsible for where it's installed and how it works," Wohl said. "Someone else takes care of that for you."

Before entering into a contract, Nauen urged companies to do a cost analysis that covers the projected life span of the software. "The typical break-even scenario for a software vendor on a lease-versus-perpetual-license-and-support model is to have the two costs break even somewhere between two and three years," Nauen said. "After that it gets much more expensive from the leasing perspective for the customer."

Ryan suggested that companies take a "look under the covers" and investigate whether a vendor is willing to become a true partner in serving your business. "Unfortunately, SaaS companies want to have their cake and eat it, too," he said. "They'll end up writing a contract that ends up a lot like a regular software contract, and you want to make sure it's based on your actual usage of the software, and not just effectively another way to get you to pay the upfront license."

Rollings compared the agreements to mobile phone contracts, where the bill "reflects what your original purpose was, and if you have any volume-related, additional capability or users, you would see an incremental cost for that."

IS TRADITIONAL SOFTWARE BECOMING OBSOLETE?

"I don't think we're ever going to get to a point where 100 percent of users buy 100 percent of their software in the SaaS model," Wohl said. "There are lots of users in companies of every size who are still using very old software simply because it does what they want it to do and they don't feel they need to replace it or update it. In smaller companies, people tend to keep using whatever they've got as long as it works. For them it's a value issue."

Vignola advises companies that are thinking about making a change to SaaS to be aware of an adjustment period for staff to get acclimated to the new system. "With any new software there is a learning curve," he said. "It did take our people a while to adapt to it."

While SaaS may be a tempting alternative to more expensive traditional software, according to Nauen, small and midsized businesses do have other choices to get their software needs met. "The truth is there are many, many good SMB-focused accounting and [enterprise resource planning] packages with correspondingly smaller price tags," Nauen said, adding that his company does not offer an on-demand option — yet. "For us, the demand is not there. When the market demands it, we'll deliver that application."

Though there are companies that want to take their existing applications and use an SaaS model, NetSuite's Rollings said that the transition to a multi-tenant environment can be challenging. "It is very difficult to take a traditional software application and try to make it Internet-based," he said. "Just putting it on a server and delivering it by the Internet doesn't give it that capability for customization and upgrades that you would have if the application would be built from the ground up. You're seeing people trying to find a way to do it because that's where everything is going."

Ingres Corp.'s Harr said that companies that are on the fence about software as a service usually have fears about loss of control, lack of customization and security issues. "In my view, every one of those arguments is really mitigated by a good SaaS provider," he said. "I just think the SaaS solution has many advantages over the traditional perpetual licensed model. Not only are you getting the best delivery model, you have the opportunity to get the software with a superior design and the most modern techniques within that solution. There is no reason anymore to build up big data centers for your company." SMB