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TCO of On-Demand Applications Is Significantly Better for SMBs and Mid-Market Enterprises

Decision Point:	Optimizing the Applications Delivery Model for the SMB and Mid-Market Enterprise
The Bottom Line:	The TCO for on-demand solutions is much better than that of traditional on-premises solutions even when evaluated over a 3- to 5-year period. On-premises solutions require significant investments in IT infrastructure and application deployment, support and update resources.
Who Should Read:	CEO, CIO, CMO, marketing, sales, product management, business development

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On-Demand Application Solutions Are a Disruptive Technology

To capture more SMB and mid-market enterprise wallet share, some upstart application vendors are offering viable alternative delivery and pricing models that provide end users with enterprise-level capabilities they can implement rapidly and more affordably without additional IT infrastructure or staff. A careful investigation of the various options can lead to a significantly better TCO for deploying a business application solution.

It's imperative for enterprises to understand how on-demand solutions are changing the IT landscape in SMBs and mid-market enterprises. In his book, *The Innovator's Dilemma,* Clayton Christensen describes disruptive technologies in the following way: most technologies are "sustaining," in that they incrementally improve the price or performance of a particular product or service over time. But disruptive technologies dramatically reduce the price or performance of a particular product or service and create a new path. These disruptive technologies are pernicious, because most vendors that are sustaining their products or services can't immediately adopt the new path since it changes their whole economic model.

The on-demand applications delivery model propagated by vendors such as Salesforce.com and NetSuite can disrupt giants such as Siebel, as seen in its recent financial results. Siebel now offers Siebel CRM OnDemand, which targets the IT-constrained mid-market enterprises.

As described in the May 2005 DecisionNote, *Appeal for On-Demand Solutions Is Expanding*, almost 50% of medium businesses and mid-market enterprises want on-demand solutions for accounting/finance, CRM, inventory management, merchant services and CRM.

What Does the TCO for the On-Demand Model Include?

The TCO for on-demand models should include the following 3- to 5-year costs for functionally similar solutions:

- Subscription costs versus license costs for an equivalent number of users
- Application support and maintenance costs
- Implementation and customization costs
- Host server computers, storage and maintenance costs
- Internet access costs
- End-user technical support costs
- End-user IT support personnel requirements
- User training costs

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TCO Calculation

For this example, we evaluated a solution that provides a broad range of functionality (see Exhibit 1) for the mid-market user's front- and back-office needs. We evaluated an on-demand solution versus an on-premises licensed solution. NetSuite offers the combined functionality of MAS90 and SalesLogix Advanced from Best Software, and it's available as an on-demand delivered solution.

Because the two solutions offer similar features and functions, we evaluated a 20-user and a 100-user solution for companies with 20 to 99 and 100 to 1,000 employees, respectively, during a 5-year modeling period.

IT systems and applications support people account for as much as 30% to 60% of the total 5-year costs. The TCO for NetSuite is about half that of Best Software (see Exhibit 2). Although the 5-year software and maintenance costs for Best are lower than NetSuite, the support costs for Best (the cost for IT infrastructure and application support resources to install, integrate and update the applications) is three times the amount for NetSuite. These ongoing support costs, which account for 86% of Best's 5-year costs, eclipse the costs of the software and maintenance.

Exhibit 1.
Features and Functions for Medium and Mid-Market Solutions

Customer Relationship Management	Enterprise Resource Planning
Salesforce Automation (SFA)	General Ledger
Sales Order Entry	Accounts Receivable
Customer Support Self-Service Knowledge Base	Accounts Payable
E-Mail Campaigns	Bank Reconciliation
Partner Relationship Management	Payroll/Direct Deposit
Return Merchandise Authorization (RMA)	Payroll Tax Tables
Web Site/Store	Business Alerts
Web Access	Purchase Orders
Sales Commission Management	Inventory Management
Offline Sales Capability	Sales Order Entry
	Web Store
	Online Customer Ordering

Source: NetSuite VAR, Intente and Yankee Group, 2005

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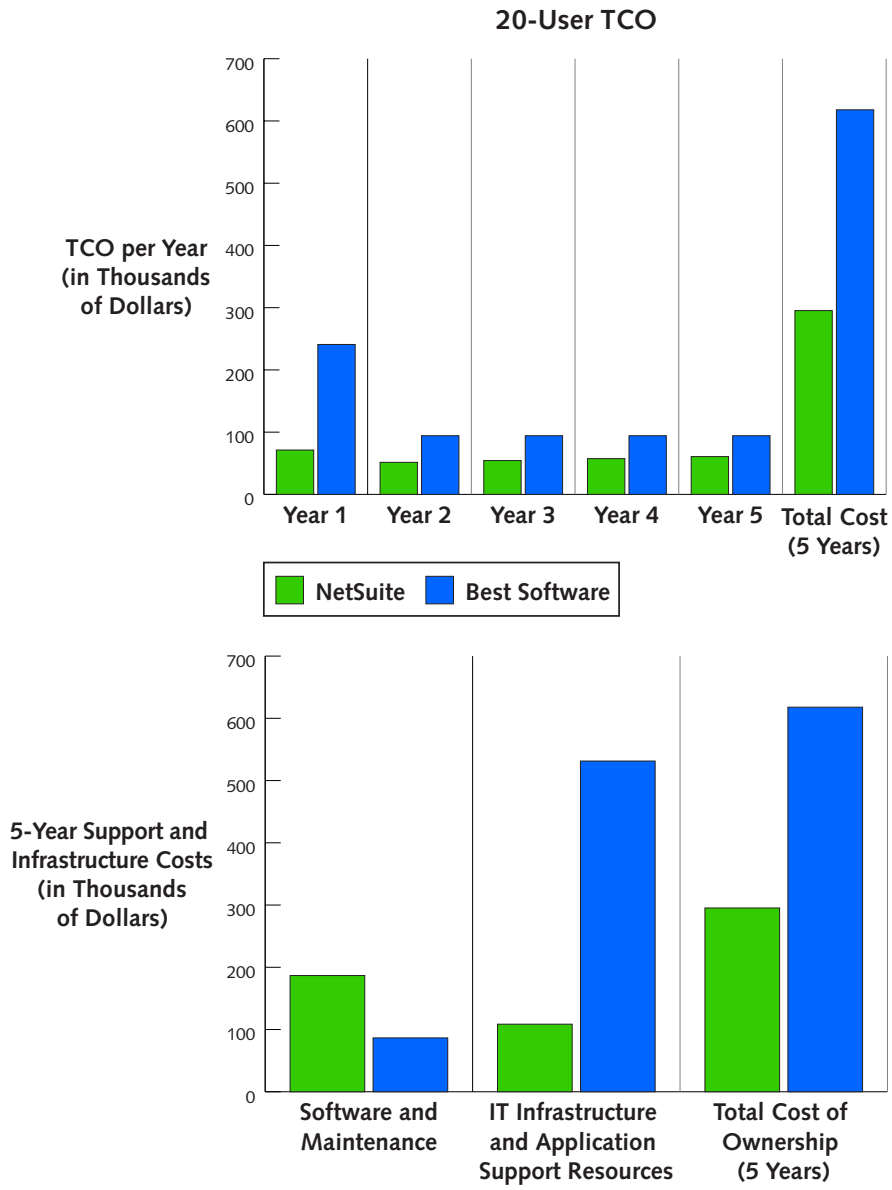
Exhibit 2.
20-User TCO for NetSuite and Best Software



Source: Yankee Group, 2005

According to Larry Kennedy from New England-based Intente, a NetSuite partner, “Care and feeding costs are where on-demand solutions have gained a significant total cost of ownership advantage over traditional on-premises licensed software. By reducing implementation, hardware, data center and people-related costs, on-demand solutions like NetSuite offer a lower TCO than licensed software solutions. Further, NetSuite’s integrated solution covers both front- and back-office application areas and is much easier to use and efficient compared to several applications that have to be integrated.”

By eliminating the expensive support costs, mid-market enterprises benefit from a lower TCO with an on-demand solution. In addition, the overall value provided by on-demand solutions is significantly higher when you include the IT infrastructure and services infrastructure that is behind the on-demand solutions. SMBs and mid-market users can’t replicate this value even with a significantly higher investment.

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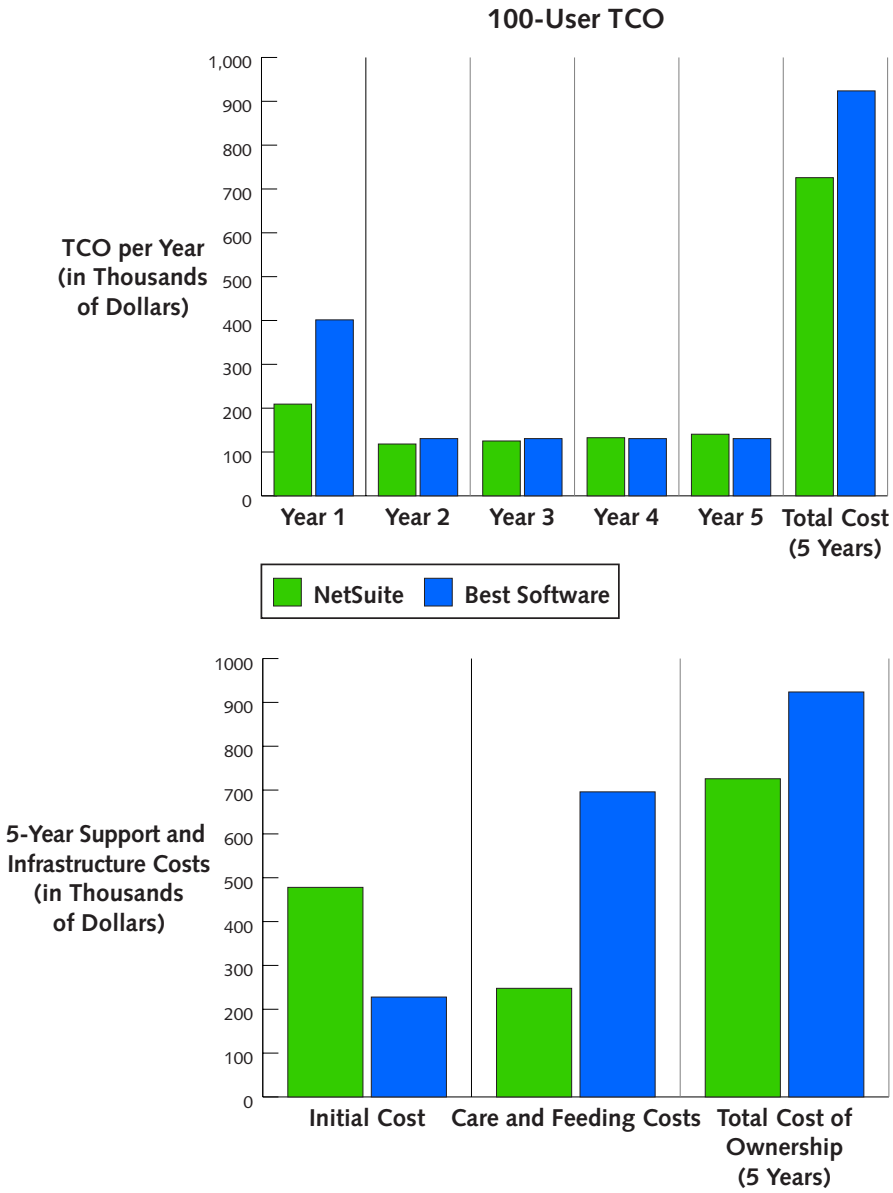
Exhibit 3 shows similar details for 100 users at a mid-market company. The TCO for Best Software is about 1.25 times that for NetSuite, because the Best Software license costs are amortized over a much larger number of users and the infrastructure and support resources are similar to the 20-user case.

Exhibit 3.
100-User TCO for NetSuite and Best Software



Source: Yankee Group, 2005

A more detailed TCO analysis should include company growth projections and a comparison of the overall value of the on-demand solution as compared to on-premises solutions. As the number of users increases, IT infrastructure and IT support costs may not increase proportionally. Also, if the application vendor has user block pricing, where the price per user drops significantly as the number of users significantly increases, the on-premises solutions could yield a lower TCO during a 3- to 5-year period.

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Advantages of On-Demand Solutions

On-demand solutions include implementation, maintenance, training, support and application management services delivered by the application vendor directly and may be augmented by a channel partner that provides integration and customization services and on-site hand-holding to enable a quick and productive ramp-up. The end user accesses the applications through a web browser and pays a monthly per-user cost. Some vendors offer a hosted solution in partnership with a VAR with a disguised monthly subscription fee that includes license, maintenance, and implementation and customization charges, and at the end of the term, customers own the application licenses—more like a financed on-premises solution.

Advantages of an on-demand solution include:

- Faster implementation and ramp-up time to productive use of applications
- Lower upfront and ongoing costs
- No additional IT infrastructure for servers, networks, and storage and IT resources to support these
- No additional IT application support staff
- Guaranteed service-level agreements (SLAs)
- Vendor provides an enterprise-class infrastructure with appropriate servers, networking, and storage systems, and is responsible for regular and more frequent application upgrades; regular customer data backups and required restores; and security and compliance requirements

Disadvantages of On-Demand Solutions

- Require the availability of broadband internet service at customer location
- Difficult to implement if lots of upfront customization is required
- Applications need to support a service-oriented architecture (SOA) and web services integration model to deploy and deliver good performance

Recommendations for Vendors

- **Seriously investigate the success and growing popularity of on-demand business models if you aren't already providing these types of solutions.** On-demand solutions address some of SMBs' and mid-market enterprises' buying behavior, business challenges and purchase drivers. Because these end users are cost-conscious and lack IT-application-centric resources, the TCO of on-demand application solutions is attractive to them. However, applications need to support web-based architectures and services.
- **Include channel partners such as VARs and systems integrators in your go-to-market strategy for on-demand solutions.** These partners are necessary to develop loyal end users. They provide the customization, the integration and—more important—the hand-holding to quickly ramp-up user adoption and productivity. The channel partners must focus primarily on SMB and mid-market customers. Vendors need to develop a separate sales support and technical support function to work aggressively with these partners.
- **Develop support tools and methodology to help customers evaluate TCO alternatives.** Very small and small businesses buy based on ease-of-use, price and features/functionality. However, medium businesses and mid-market enterprises buy based on a solution's ability to meet a high percentage of their feature and functionality requirements. In addition, they want help developing 3- to 5-year TCO models that enable them to compare costs of the on-demand model to traditional software models.
- **Communicate your on-demand solution message to SMBs with powerful, relevant collateral.** Provide case studies and references, and educate this customer segment about strategies for using the new generation of powerful web-based applications for collaboration within and outside the enterprise.
- **Make on-demand solutions easy to integrate and customize.** On-demand solutions must support end users' business processes and integration with complementary applications. The lack of IT resources at smaller businesses necessitates easy integration.

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Recommendations for SMB and Mid-Market End Users

- **Develop detailed TCO models for different application delivery model alternatives.** Conduct this analysis for solutions or a combination of solutions with equivalent functionality. The analysis must span a minimum of 3 years; include company growth expectations and software licensing costs for the same number of users; annual maintenance costs, IT infrastructure costs, integration and customization costs; and the required IT and application support resources.
- **Carefully consider the benefits provided by a VAR.** Most vendors provide options to buy directly from the vendor or through a VAR. VARs can provide services such as industry-specific customization, integration with existing applications, migration of data from existing applications, training and coaching for ramping up usability. The VARs play a key role of a trusted business partner, adviser and ongoing support provider.
- **Pay attention to contract terms.** When evaluating on-demand versus on-premises options, review the fine print of the contract terms closely before making decisions:
  - Does the contract require a long-term commitment upfront?
  - How easy is it to change the number of users? What penalties or per-user price changes are associated with this?
  - How easy and flexible is it to upgrade functionality?
  - Does the SLA supporting the uptime guarantee for these business-critical applications promise at least 99.5%?
  - What options and penalties exist for canceling the service?
- **Seek the help of independent consulting/market research organizations to better understand the total cost of on-demand models.** These services feature business assessment and technology/solution selection in an objective manner. They will work with your company's internal experts to help refine requirements and make vendor selections based on detailed TCO analysis and feature/functionality requirements.

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Exhibit 4.
Detailed TCO Comparison (20 Users)

NetSuite Enterprise vs. Best Software (MAS90 and SalesLogix Advanced)

NetSuite: 20 Users	Year 1	Year 2	Year 3	Year 4	Year 5	Total Cost 5 Years	Percent of Total	
Subscription Costs	32,148	34,559	37,151	39,937	42,933	$186,728	63%	NetSuite price list, 7.5% annual increase
Application Support and Maintenance (from application vendor)	Included	Included	Included	Included	Included	$0	0%	Included in subscription
Implementation, Customization and Integration (VAR)	24,111	3,456	3,715	3,994	4,293	$39,569	13%	75% of first year subscription costs; 10% for years 2 through 5
Host Server Computers and Maintenance	0	0	0	0	0	$0	0%	Included in subscription
IT Infrastructure (including internet access)	12,000	12,000	12,000	12,000	12,000	$60,000	20%	Internet access: $12,000 per year
End-User Support and Administration	Included	Included	Included	Included	Included	$0	0%	Included in subscription
User Training	3,000	1,500	1,500	1,500	1,500	$9,000	3%	20 users in Year 1; 10 users in Years 2 through 5 (for turnover)
NetSuite TCO per Year	$71,259	$51,515	$54,366	$57,431	$60,726	**$295,297**	100%	
NetSuite TCO per Year (discounted for time value at 7.5% per year)	$71,259	$47,921	$47,045	$46,230	$45,472	$257,926		
Cumulative TCO	$71,259	$119,180	$166,225	$212,454	$257,926			

Source: NetSuite, Intente and Yankee Group, 2005

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MAS90 and SalesLogix Advanced: 20 Users	Year 1	Year 2	Year 3	Year 4	Year 5	Total Cost 5 Years	Percent of Total	
Subscription Costs	45,536	0	0	0	0	$45,536	7%	MAS90 and SalesLogix price list
Application Support and Maintenance (from application vendor)	8,196	8,196	8,196	8,196	8,196	$40,982	7%	Annual maintenance: 18% of first year license price
Implementation, Customization and Integration (VAR)	34,152	4,554	4,554	4,554	4,554	$52,366	8%	75% of first year subscription costs; 10% for years 2 through 5
Host Server Computers and Maintenance	73,500	3,500	3,500	3,500	3,500	$87,500	14%	Database server: $50,000; application server: $10,000; web server: $10,000; 5% annual support
IT Infrastructure (including internet access)	19,000	19,000	19,000	19,000	19,000	$95,000	15%	Internet access: $12,000 per year; $7,000 for security and utilities
End-User Support and Administration	57,500	57,500	57,500	57,500	57,500	$287,500	47%	One application support resource @ $50,000 plus 15% fringe
User Training	3,000	1,500	1,500	1,500	1,500	$9,000	1%	20 users in Year 1; 10 users in Years 2 through 5 (for turnover)
Best Software TCO per Year	$240,884	$94,250	$94,250	$94,250	$94,250	**$617,885**	100%	
NetSuite TCO per Year (discounted for time value at 7.5% per year)	$240,884	$87,674	$81,558	$75,868	$70,575	$556,559		
Cumulative TCO	$240,884	$328,559	$410,117	$485,984	$556,559			

Source: NetSuite, Intente and Yankee Group, 2005

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Exhibit 5.
Detailed TCO Comparison (100 Users)

NetSuite Enterprise vs. Best Software (MAS90 and SalesLogix Advanced)

NetSuite: 100 Users	Year 1	Year 2	Year 3	Year 4	Year 5	Total Cost 5 Years	Percent of Total	
Subscription Costs	103,000	83,850	90,139	96,899	104,167	$478,054	66%	NetSuite price list, 7.5% annual increase
Application Support and Maintenance (from Application vendor)	Included	Included	Included	Included	Included	$0	0%	Included in subscription
Implementation, Customization and Integration (VAR)	77,250	8,385	9,014	9,690	10,417	$114,755	16%	75% of first year subscription costs; 10% for years 2 through 5
Host Server Computers and Maintenance	0	0	0	0	0	$0	0%	Included in subscription
IT Infrastructure (including internet access)	20,000	20,000	20,000	20,000	20,000	$100,000	14%	Internet access: $20,000 per year
End-User Support and Administration	Included	Included	Included	Included	Included	$0	0%	Included in subscription
User Training	9,000	6,000	6,000	6,000	6,000	$33,000	5%	100 users in Year 1; 25 users in Years 2 through 5 (for turnover)
NetSuite TCO per Year	$209,250	$118,235	$125,153	$132,589	$140,583	**$725,810**	100%	
NetSuite TCO per Year (discounted for time value at 7.5% per year)	$209,250	$109,986	$108,299	$106,729	$105,269	$639,532		
Cumulative TCO	$209,250	$319,236	$427,535	$534,264	$639,532			

Source: NetSuite, Intente and Yankee Group, 2005

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MAS90 and SalesLogix Advanced: 100 Users	Year 1	Year 2	Year 3	Year 4	Year 5	Total Cost 5 Years	Percent of Total	
Subscription Costs	119,920	0	0	0	0	$119,920	13%	MAS90 and SalesLogix price list
Application Support and Maintenance (from application vendor)	21,586	21,586	21,586	21,586	21,586	$107,928	12%	Annual maintenance: 18% of first year license price
Implementation, Customization and Integration (VAR)	89,940	11,992	11,992	11,992	11,992	$137,908	15%	75% of first year subscription costs; 10% for years 2 through 5
Host Server Computers and Maintenance	73,500	3,500	3,500	3,500	3,500	$87,500	9%	Database server: $50,000; application server: $10,000; web server: $10,000; 5% annual support
IT Infrastructure (including internet access)	30,000	30,000	30,000	30,000	30,000	$150,000	16%	Internet access: $20,000 per year; $10,000 for security and utilities
End User Support and Administration	57,500	57,500	57,500	57,500	57,500	$287,500	31%	One application support resource at $50,000 plus 15% fringe
User Training	9,000	6,000	6,000	6,000	6,000	$33,000	4%	20 users in Year 1; 25 users in Years 2 through 5 (for turnover)
Best Software TCO per Year	$401,446	$130,578	$130,578	$130,578	$130,578	**$923,756**	100%	
NetSuite TCO per Year (discounted for time value at 7.5% per year)	$401,446	$121,468	$112,993	$105,110	$97,777	$838,793		
Cumulative TCO	$401,446	$522,913	$635,906	$741,016	$838,793			

Source: NetSuite, Intente and Yankee Group, 2005

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