
EXECUTIVE BRIEFINGS

EXECUTIVE GUIDES FOR STRATEGIC DECISION-MAKING

Software As a Service

Selective hosting can boost flexibility and speed.

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Today's Providers Offer Lower Cost, More Service

The more heavily organizations rely on everyday applications, the less attention they want to pay to them. Rather than paying expensive support staffs to manage complex applications and their underlying IT “plumbing,” many customers would just as soon pay an outside organization to buy the software, maintain it, upgrade it, debug it and make sure it’s up and running whenever the organization needs it.

This concept, once known as the application service provider (ASP) model, has returned and is now called “software as a service.” More than just the name has changed. Since the original ASP model went bust earlier this decade, pioneers such as Salesforce.com Inc., Salesnet and Net-Suite Inc. have been joined by major software vendors such as Microsoft Corp. and Siebel Systems Inc. in offering

software as a service. The new providers offer better support tools, lower prices and more customizable offerings than the first wave of ASPs, and customers are more receptive because of increased pressure to reduce their fixed costs for hardware and support staff.

Today’s software-as-a-service vendors (also known as managed service providers, or MSPs) may offer services such as security, maintenance, and monitoring and reporting of network servers, in addition to customized applications. In a fully outsourced network management arrangement, the service provider can manage advanced features like IP telephony, messaging, call centers and virtual private networks. And since the late 1990s, prices to manage a single server have fallen from a high of \$2,000 per month to around \$100 per month.

Generally, the best candidates are everyday applications that a customer and its competitors all use to conduct routine tasks, or applications or IT functions such as security or database management, where it’s especially difficult or expensive to find qualified staffers. Security as a managed service, such as virus protection on VPNs, is attractive “because it’s a hot topic” and qualified staffers are hard to find, says Art Schoeller, an analyst at Boston-based Yankee Group Research Inc. Hosted contact center and voice self-service systems are also gaining strength as companies find that these technologies require specialized staff.

Scalability — the ability to quickly support many more

users — is another advantage, because a service provider usually has the staff and equipment on hand to easily accommodate more users, whereas the customer would have to buy more equipment and hire more staff before expanding its user base. And while the price of software as a service has fallen since it was first offered in the late 1990s, customers and analysts agree that lower costs aren’t the best reason to consider it. Instead, they say, software as a service offers lower upfront costs, more predictable ongoing costs, and the ability to get the latest technology more quickly than by buying and implementing it in-house.

Even companies famed for their cutting-edge use of technology, such as American Airlines, are using hosted application providers for new or specialized functions, such as voice self-service systems. Some companies contract out for the “heavy lifting” of maintaining a data warehouse while keeping the data analytics function (which is closest to the business) in-house. Sometimes, a vertical market provides a “hot spot” for software as a service.

In a September 2005 report, Forrester Research Inc. analysts Jost Hopperman and Pascal Matzke said that an increasing number of North American financial services companies are looking for alternative methods for hosting their core banking applications. Companies in the chemical industry can take advantage of hosted services that make it easier for them to manage the material safety

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data sheets required for the chemicals used in their products.

In some cases, the company delivering the software comes from within the industry itself, such as large physician practices or hospitals that host electronic medical records software for smaller providers. Hosted ERP and CRM software can allow even small organizations, such as the Sea Dogs hockey team in New Brunswick, Canada, to gather information about customers and fine-tune their marketing campaigns.

In general, the closer an application is to an organization's core mission, the less likely the organization is to opt for software as a service. The Hong Kong Jockey Club, for example, uses an outside provider to host and manage the Web sites that provide information about the company but manages all its transaction and betting-related sites itself.

"An ASP model is hard to apply in areas that are core, or where there is sensitive information and data," agrees Greg Au Yeung, vice president and

head of IT investor services in Asia at State Street Bank. The more integration the "delivered" software will require with existing applications, and the more difficult that integration is, the less attractive software delivery will be.

Companies that feel that managing their own applications and infrastructure gives them a unique advantage will continue to opt for the in-house IT route. Crutchfield Corp., a catalog and online merchant of consumer electronics, uses off-the-shelf software, but only if it fits cleanly into the organization, can do 80% of what a homegrown application does without a lot of customization, and reduces maintenance and management so the IT staff can focus on more business-critical systems.

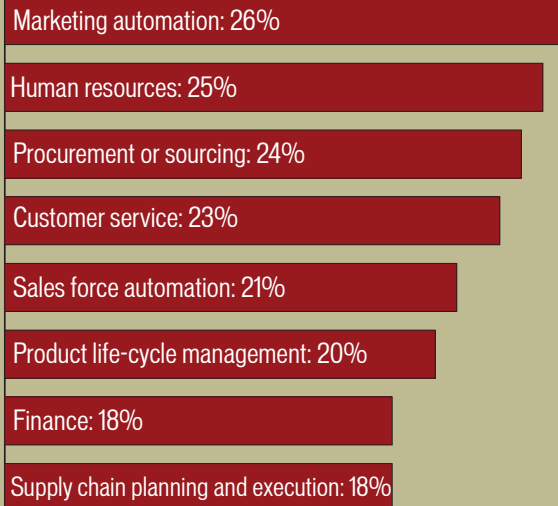
Just as deciding whether to go the hosted software route takes careful consideration, so does choosing and monitoring a service provider. Security and reliability — two major concerns that helped sink the first wave of hosted application providers — are still very real issues to address

Commonly Hosted Applications

- New or challenging technologies, such as voice-response systems.
- Commodity applications, such as CRM.
- Applications that require skilled or expensive staff, such as security or data warehouses.
- Applications commonly used throughout a vertical market, such as electronic medical records (health care) or safety data (chemical industry).

Demand for Hosted Applications

Would you seriously consider purchasing the following software as a hosted application?



Note: Multiple responses allowed

Source: 2004 Forrester Research survey of 1,383 IT decision-makers at North American companies

(preferably, with the help of a lawyer) before signing a service contract. What levels of application performance and uptime will the service provider commit to? Who is responsible for complying with regulations governing the security of the data and that require disclosure if customer data is compromised? Does the service provider have a financial stake, just as the customer does, in achieving compliance? And finally, if the service provider fails to deliver, what is the company's backup plan for finding another provider to keep its vital business applications running?

If all this sounds like a lot of work, it is. Outsourcing any function, whether it be

emptying the wastebaskets or keeping your ERP system running, just means you've chosen someone else to do it better and/or less expensively than you can. It's up to someone in the customer organization — very possibly the IT organization — to evaluate all the long-term costs and risks and then monitor and manage the vendor relationship. Software as a service is not an invitation to become less involved in your business or to hand off something you can't do well, but an invitation to think about how to add value to your business — and source your applications accordingly.

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