

Application Service Providers

An Internet based system to reduce travel costs, enhance human resource services, and reduce overall IT cost.

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Application Service Providers

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Executive Summary

Application Service Providers (ASPs) is an internet based system that can reduce overall IT costs, provide additional support service in fields such as human resources, and minimize travel costs by connecting associates over the internet. In this presentation there will be a review of types of ASP business, a list of advantages & disadvantages, and an explanation of the proper procedures to optimize the costs while reducing the risks.

There are some financial advantages with utilizing ASPs. There are multi-service ASPs, such as EDS or IBM, who can cut overall IT costs by 10 to 20 percent. Smaller, more focused ASPs such as WebEx can enable people from around the world to have conferences without having to travel any further than their desk.

There are some risks. Designing customized markets with one-size fits all in a billing package is difficult. There could be hidden costs in adopting an ASP service. Finding a vendor and writing the contract will cost about 3 percent of the total cost, which could reach above \$500,000.

The costs and risks with ASPs can be significantly reduced if the proper provider-customer relationship is established and if standardize procedures are implemented to insure that the ASP meets contractual obligations. If not, fail-safe systems are put into place to quickly recover. It can be expected that the bottom-line savings can potential reach \$100,000 to \$1,000,000 depending on the level of outsourcing provided.

What are ASP's?

The Faulkner's Advisory for IT (FAIT) report, ASP Market Trends, states that Application Service Providers offer outsourced software for a monthly fee. The value proposition is to cut costs and accelerate implementation times with a bundled package containing data storage, training, consulting and any other value added services¹. This outsourcing of software is also commonly called Software as a service (SaaS).

Reviewing the characteristics of service businesses can differentiate ASPs from other common IT business models. Products are anything that can be offered to a market for attention, acquisition, use, or consumption that might satisfy a want or need². The computer industry has grown rapidly out of selling products, either hardware or software. Once the hardware or software was sold, the customer relationship ended and so was the income stream. The industry sustained the earnings growth by providing upgrades every 18 months thanks to Moore's law. Services, on the other hand, are products that consist of activities, benefits, or satisfactions offered for sale that are essentially intangible, such as banking, hotels, tax preparation²,... and ASPs. The service business may not end at the point of sale and may require a long-term commitment such as phone services and Internet providers.

Service businesses, like ASPs, should have four main characteristics²:

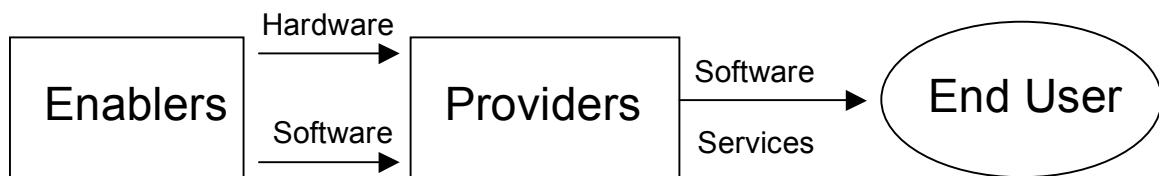
- Intangibility** Services cannot be seen, tasted, felt, heard, or smelled before purchase.
- Variability** Service quality depends on who provides them, when, where, & how.
- Inseparability** Services cannot be separated from their providers. There is a provider-customer interaction with services because the customer is involved when the service is being produced.
- Perishability** Services cannot be stored for later sale or use. Services cannot be stored to handle peaks in demand. Service firms must use design strategies for better matching between demand and supply.

¹ Faulkner Information Services, Figueiredo, Daniel, 3/8/2003, ASP Market Trends

² Armstrong & Kotler, Marketing An Introduction, pages 223-249, 2003

Analysis of Enablers and Providers

The web source ASPnews.com publishes a monthly ranking of ASP businesses by dividing them into two categories, enablers and providers¹.

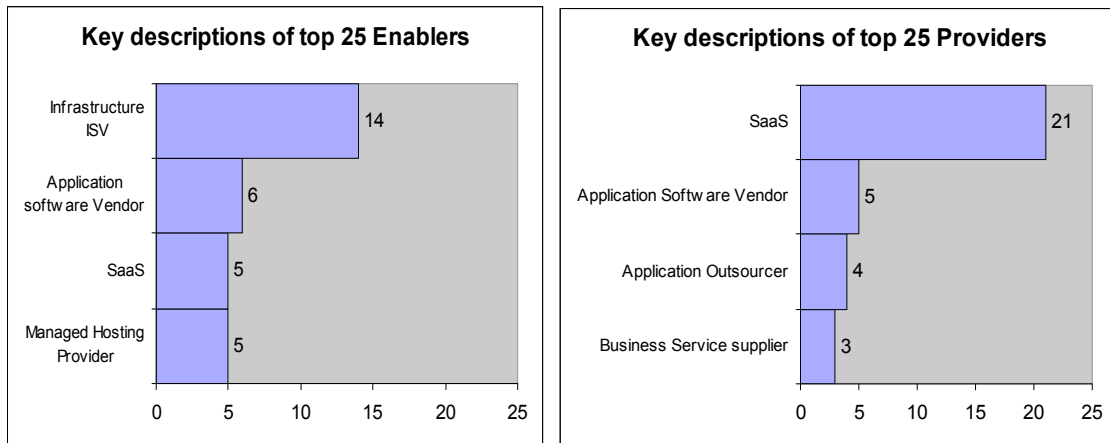


The terms enablers and providers gives some insight in the structure of the ASP business model. The Enablers are typically upstream suppliers that provide the hardware and support services that “enable” the providers to service the end customer. The providers are the companies that may be more dependent on establishing and maintaining the provider-customer relationship.

¹ ASPnews.com Staff. June ASPNEWS Top 50. June 5, 2006 Retrieved from <http://www.aspnews.com>

Enablers & Providers

The following Pareto chart gives the most common descriptions of the two categories.



The most notable enabler category was Infrastructure ISV (Independent Software Vendors). These are companies that provide hardware and software support services to ASP businesses. Well known and financially very large businesses dominate this category. IBM, EDS, Hewlet Packard, Sun Microsystems, and the behemoth Microsoft all are considered top businesses that provide infrastructure support. One noteworthy company, Adobe, was listed as an application software vendor. It made the list as an ASP that could provide value to our company.

The term Software as a Service (SaaS) dominated the provider category. The companies that made this list were not as well known or had the same financial size as the enablers. The providers were very diverse in the type of businesses and typically were focused on more traditional business services instead of IT support. There was WebEx, which provides a chat room alternative to videoconferencing, Employease, which provides human resource support, and Vocus, which provides corporate communication and public relationship support¹.

¹ ASPnews.com Staff. June ASPNEWS Top 50. June 5, 2006 Retrieved from <http://www.aspnews.com>

Companies of Enablers and Providers that offer value to our company

Employease

Employease provides hosted, web-based human resources and benefits management software and services for more than 1000 companies. The Software as a Service handles a wide variety of HR functions such as benefits administration, employee self-service, manager self-service, and recruitment. Employease also offers outsourced human resources service such as employee call center operations, benefits carrier billings, invoice reconciliations, enrollment support, and fulfillment services. Hoovers reported that Employease agreed to be acquired by [Automatic Data Processing \(ADP\)](#) in August 2006.

Adobe

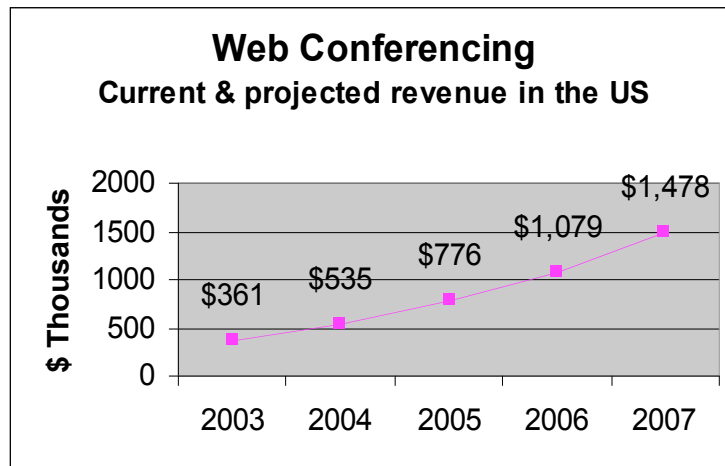
Adobe is a classic example of a successful ASP. Its business strategy was to provide the document reader for free on the Internet. This allowed Adobe to provide a service to anyone who wanted to read documents from Adobe's customers who purchased the upgraded writing software. The services that place Adobe into the enabler category are the application development solutions for companies to improve Internet applications.

WebEx

WebEx is a provider of web conferencing systems (*see next page*) that let parties conduct meetings and share information over the Internet. WebEx's hosted services enable companies to convene with employees, clients, and partners to make presentations, exchange documents, share applications, and edit documents electronically. WebEx also offers services that help businesses provide live technical support for their customers, accessible through Web browsers.

Promising trend in Web Conferencing

Web conferencing delivers an internet-based, real time, collaborative environment, which is suitable for meetings, presentations, training, and multi-person business interactions¹. Webex accounts for 67% of the market share. They charge just \$0.33 per minute per participant versus thousands of dollars for video conferencing, which doesn't include the initial video equipment costs. The world wide 2009 projections are expected to hit \$2.7 billion.



Reasons for strong trend in web conferencing¹:

- Penetration into both the consumer and business markets
- Commoditization thus lowering prices
- Increase telecommuting as employees can leverage existing equipment such as home computers to collaborate with colleagues
- Increased use of broadband in the homes

¹ Gitomer, Jay. Web Conferencing Market Trends. 6/4/2006

Market Analysis of Stand alone and multi-service ASPs

The ASP market trend report¹ by Daniel Figueiredo divided ASPs into two broad categories: stand-alone ASPs, which focus on application hosting, and multi-service ASPs, which provide consulting and other services in addition to application hosting.

Stand alone ASPs

Dedicated ASPs require expensive infrastructure that must be supported solely from the funds generated via application hosting. This report noted that the stand-alone ASP did poorly in the tech industry fall out, with reported losses were in the billions.

Usinternetworking and Corio are both examples of companies that lost billions. The author explains that the slow implementation of broadband lines and the flooding of the market with ASP vendors were reasons for the trouble¹. Despite the failure in the past, companies with shrinking IT budgets and those that want to spend less time with IT tasks are seeking outsourcing as an alternative¹.

Multi-service ASPs

Multi-service ASPs were companies that provided more services than application hosting. The economic edge they have is diversification. Application outsourcing services involves several elements, which includes network pipes, software, and customer service experience¹. Notice the connection between the customer service experience in this technical report and how that was a key description of service businesses.

Figueiredo adds that large professional firms such as IBM and EDS may have the sufficient, but expensive, infrastructures to handle application hosting and they are able to diversify the risks by providing other professional services such as consulting.

Both IBM and EDS have appeared in the review above by ASPnews and in this FAIT report by Figueiredo. Additional reports based on the Gartner survey ranked IBM and EDS as the top in business and IT consulting and IT outsourcing². IBM and EDS should be considered as resources in ASP and IT outsourcing.

¹ Figueiredo, Daniel. ASP Market Trends. 3/8/2003.

³ ZDnet, Study: IBM, EDS tops in services, 10/06/03

Utilizing ASPs to assist in outsourcing IT Services

1) Kimberly Berryman, our banking expert, noted that our company might already be behind the pack. The report Outsourcing IT Services written made by James G. Barr in 2003 include examples of major banks who have outsourced their IT services; J.P. Morgan signed a seven-year; \$5 billion deal with IBM, Bank of America signed a 10-year, \$4.5 billion contract with EDS, and Canadian Imperial Bank of Commerce signed a \$2 billion agreement with Hewlett-Packard. The following are key questions from the same report in outsourcing IT services ¹.

2) Questions for Choosing an Outsourcing Partner.

- a) Is there a willingness of the firm to offer varieties of pricing options?
- b) What is the history in the firm's responsiveness to unexpected circumstances?
- c) What is the history of providing similar services to clients?
- d) Does the potential partner show a willingness to allow the client to interact with third-party vendors?
- e) Financial strength and long-term stability?
- f) What are the firm's conditions for re-negotiating contract terms when market conditions change?
- g) Examine the firm's availability of the right technical expertise.

3) Beware the Hidden Cost of Outsourcing

- a) The average cost of finding a vendor and writing the contract cost an average of \$500,000, or about three percent of the average total outsourcing expense
- b) Some transition costs are hard to quantify. It takes about a year for a vendor to wean itself from dependency on in-house technical staff.
- c) Cost for managing the contractor cost an average of \$300,000 annually.

4) Suggestions to help cut cost of outsourcing

- a) Do not outsource critical activities.
- b) Spend a lot of time researching vendors.
- c) Hire managers with experience in outsourcing.

¹ Barr, James G. Outsourcing IT Services. 2003. *Faulkner Advisory for IT*

Financial Advantages with ASPs

- Enable customers to solve their own problems to save money. Telephone base support is \$33 and email based is \$10. Online knowledge base cost less than a \$1¹
- Web conferencing saves travel cost. It enables people in different locations to conference all over the world. This is suitable for real-time meetings, presentations training and multi-person business interactions. ²Note that this is mentioned earlier
- Customer has more control over business relationship. The ASP provider must produce a fixed service term contract, where if the software is flawed they're responsible for repairs.³
- Customization saves money and reduces complexity. Businesses have the opportunity to customize their software so it will benefit that particular company.³
- ASPs lower IT labor and equipment, an immediate value that will be a business expense rather than an expense that will appreciate over the years. Overall cost savings are up to 15 to 20 percent a year. This in return eliminates staff, facilities, and training.⁴

¹ Rubens, Paul. Asp help keep customer satisfied. 8/30/2002. *ASPnew.coms*

² Gitomer, Jay. Web conferencing market trends. 2006. *Faulkner Advisory for IT*

³ Pallatto, John. Six tips for ASP success. 11/2003. *Ziff Davis Channel Zone*

⁴ Barr, James G. Outsourcing IT Services. 2003. *Faulkner Advisory for IT*

Risks and Disadvantages

- Flat rate billing ignores marketing flexibility. It is hard to design customized marketing with one-size-fits all billing package. ¹
- There are hidden costs that are unaware to companies when outsourcing. Finding a vendor and writing the contract cost about \$500,000 or three percent of the total. It takes about a year for a vendor to wean itself from an in house technical staff and managing the contractor costs \$300,000 annually. ¹
- Loss of control over outsourced businesses services vs. in house IT support²
- Provider system may crash or company may close down unexpectedly.
- Offshore Outsourcing has become very popular due to low personnel cost. Organizations should be aware due to the increasing tensions between countries overseas this could produce unstable situation. ¹
- Buyer's remorse can be recognized within the first year from unrealistic expectations from the client and the outsourcer. ¹

¹ Bernard, Allen. Asp fall flat on billing.4/23/2001. *ASPnews.com*

² Barr, James G. Outsourcing IT Services. 2003. *Faulkner Advisory for IT*

Final proposal for utilizing ASPs to reduce costs

Step 1 - Reduce IT costs by outsourcing portion of services

- a) Construct a team of internal IT support and consultants from EDS or IBM to determine what services can be outsourced. Remember that the provider-customer relationship is critical.
- b) This “Provider-Customer” Team should evaluate five alternatives of outsourcing¹:
 - i) **Out source specific** features rather than broad range of IT functions.
 - ii) **Co-sourcing** features some large contracts but can involve multiple outsourcing partners working in a collaborative arrangement.
 - iii) **Gainsharing** features outsourcing providers sharing in the client’s resulting profitability.
 - iv) **Application Service Providers (ASPs)** features hosting applications at remote data centers and enabling them to be accessed over the Internet or a VPN. They free customers from the burdens of managing IT systems in-house.
 - v) **Managed Service Provider (MSPs)** features assume the responsibility for critical services such as security monitoring.

- c) Calculate EVA on alternatives.

Suppose for example: A service generates \$200,000 per year in net benefits. Performing the service in-house requires a \$1 million capital investment for hardware and software. Outsourcing the service costs \$80,000 per year and performing the service in-house costs \$60,000 per year.

- i) In-house EVA = \$200,000 in net benefits - \$120,000 in capital costs (\$1million x 12% cost of capital) = \$80,000 EVA
Outsourced EVA = \$200,000 in net benefits - \$0 in capital costs - \$80,000 in outsourcer fees = \$120,000

¹ Barr, James G. Outsourcing IT Services. 2003. *Faulkner Advisory for IT*

Step 2 - Utilize Webex to reduce overall travel costs

\$8,000 savings per meeting can be realized if WebEx is utilized. If ten associates want to meet for a day then nine can travel to a common location for a total travel cost of \$9000 to \$10,000 dollars (\$500-\$750 transportation + \$250-\$500 food, housing & conference room costs.). WebEx charges \$0.33/minute per person for a total cost of \$1500 for the same meeting. The meetings can also be more effective since the participants are at their workstations if additional information is needed.

Step 3 - Enhance Human resources service by utilizing Employee services

The Software as a Service handles a wide variety of HR functions such as benefits administration, employee self-service, manager self-service, and recruitment. Employee also offers outsourced human resources service such as employee call center operations, benefits carrier billings, invoice reconciliations, enrollment support, and fulfillment services.

**Step 4 – Enhance benefits and minimize risks by establishing
standardize procedures for outsourcing and utilizing
application service providers.**

James G. Barr based the following on a list of recommendations from the report
Outsourcing IT Services written made in 2003¹.

- a) Contracts should include a provision to provide that a neutral third-party has access to all software source code and updates.
- b) Make sure that restrictions can be lifted in the event that the outsourcer shut down.
- c) Update the organization's business plan making sure to identify and alternate supplier(s) in the case of transition so that the organization will not be disrupted.
- d) Liability cannot be outsourced. When a customer's data is compromised, the outsourcing company and the outsourcing client are responsible for the action.
- e) Employees must be considered when choosing an outsourcing outfit. What effect would the decision have on its employees?
- f) Inform the employees of what is going on and communicate with them regularly.
- g) Come up with incentives for the employees in order to retain key technicians and managers during the outsourcing transition period.
- h) Ask employees to reexamine their skills and figure out what role they can play in the newly outsourced environment.

¹ Barr, James G. Outsourcing IT Services. 2003. *Faulkner Advisory for IT*

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