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*White Paper*

## **Doing Business with an ASP**

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## Doing Business With An Application Service Provider

### What Is The Right Answer For Your Company?

Companies have spent the past couple of decades learning how to select, purchase, and implement packaged software products. More recently, they have become practiced at crafting the business cases required to support the significant financial investment required to procure and implement enterprise-wide solutions, as well as the skills required to manage the third-parties often needed to make those solutions work. Unfortunately, many companies are now desperately struggling to realize the benefits outlined in their original business cases. Just when you think you can come up for air, another challenge appears on the horizon. The growing acceptance of the Internet as a legitimate means of commerce, and the “dot com” revolution, require that companies learn how to evaluate and select solutions offered by the increasing number of Application Service Providers (ASPs).\*

In its simplest form, an ASP is a company that offers a “one-size-fits-all,” hosted software solution accessed via the Internet. The solution may offer high-end, expensive software functionality, or the benefits of a “community” or “marketplace.” Whatever the particular solution may be, ASPs generally offer their customers quick, easy access to Web-deployed software on a “pay-as-you-go” basis (e.g., transaction-based pricing, subscription-based pricing).

Perhaps the easiest thing to do for now would be to ignore these “crazy dot com” companies, but that would deny your organization access to some of the most exciting software solutions to emerge in quite some time. Many companies that started out a few short months ago as “dot coms” have evolved into emerging software companies offering sophisticated and powerful Web-deployed solutions. As with the evaluation of enterprise-wide software packages, a structured and rational approach should be used when evaluating the offerings of ASPs.

#### **Establishing A Common Vocabulary**

Before proceeding with the discussion of a framework that can be used to evaluate ASP offerings, it may be helpful to define some of the terminology used in the framework. For the purposes of this discussion, we will use the following definitions:

**Application Service Provider** – A company that offers a shared, hosted software solution on a transaction or subscription-pricing basis. Most commonly, this solution will be accessible via the Internet.

**Transaction-Based Pricing** – Paying a predetermined amount per transaction (e.g., \$1.00 per transaction, 2% of the value of the transaction) for access to an ASP software solution.

**Subscription-Based Pricing** – Paying a predetermined amount on a periodic basis (e.g., \$10,000 per month) for a given level of usage of an ASP software solution (e.g., up to 2,000 transactions per month, unlimited access given to 2 users within your organization).

**Licensing** – Paying a one-time fee, in addition to a yearly maintenance fee, for essentially unlimited use (with certain restrictions) of a given software solution (e.g., \$250,000 up front, 15% of up-front fee per year in maintenance).

**Hosted Solution** – Having a third-party implement, operate, and maintain a software solution on your behalf (e.g., the seller of the software solution, commercial third-party hosting company). Note that ASP solutions, by their very nature, are hosted solutions.

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\* This framework can be broadly applied to Business Service Providers (BSPs) as well. BSPs can be defined as third parties that provide hosted solutions and/or labor that modify, reduce, or eliminate certain components of your business (e.g., headcount, specific business processes, entire functions).

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**Self-Hosted Solution** – The traditional licensing of a software solution by a company that is implemented, operated, and maintained by that company for its own benefit. The traditional approach to purchasing and implementing enterprise-wide solutions is an example of a self-hosted solution.

#### Developing A Decision Framework For Your Company

Although the issues and approach will vary somewhat based on the business application of the solution you are evaluating, you should consider the following benefits and challenges often associated with ASP solutions when determining whether such a solution is right for your company.

#### ***Benefits Often Associated With ASP Solutions:***

- **Quick-Start Capability** – ASP solutions (depending upon the application involved and the need for integration with your other information systems) can be made operational in a matter of hours or days. By signing a transaction-based usage agreement, receiving a little training, and configuring your account, you can be up and running with some ASP solutions within a day. This is a far cry from the multi-quarter procurement and implementation cycles often associated with traditional software solutions.
- **Low Up-Front Costs** – Many ASP companies will allow you to get up and running on their solutions with little or no usage commitment. This, plus the fact that no additional investment in hardware and technical talent is required to get started with an ASP solution (assuming no integration is required), makes the upfront costs of adopting an ASP solution near zero. This provides the additional benefit (or problem – depending on your perspective) of the decision of whether or not to use an ASP solution often falling outside of a company's traditional technology procurement and capital approval processes.
- **Access To A Marketplace Or Community** – Since ASP solutions are shared by users across different organizations, ASP companies may offer the benefits of a marketplace or community to their customers. This may be a marketplace of likeminded buyers and sellers of a given commodity or a community of individuals within the same industry with similar backgrounds and interests. A related feature often offered to members of an ASP's community is access to pre-negotiated rate agreements with product/service providers. ASPs are uniquely positioned to provide these benefits.
- **Easier Upgrades And Maintenance** – Because ASP solutions are shared solutions, with little or no installation of software required by the user, upgrades and enhancements can be made available to all users of the solution “instantly.” If the solution is designed to benefit a relatively narrow set of users (e.g., all working in a similar industry, all working in a similar business function) the solution may become functionally rich very quickly and this enhanced functionality can be passed onto all users relatively easily. Users may realize much quicker access to features and functions in an ASP environment than is often possible from the traditional internal systems development lifecycle.
- **Access To Traditionally Expensive Software Functionality For Smaller Companies** – Many traditional software companies are now offering their solutions on an ASP basis in order to make what is often very expensive, high-end software functionality available to smaller customers on a pay-as-you-go basis. These solutions may have been otherwise financially out of reach for mid-markets customers or smaller businesses.

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- **Easier Structuring Of Pilot Programs** – ASP solutions provide a unique opportunity for companies large and small to structure and engage in pilot programs. This allows the company to evaluate the solution in a controlled environment before implementing it on a company-wide basis. The quick-start capability and low up-front costs associated with most ASP solutions make this method of software delivery ideal for companies that want to “test drive” a solution prior to making a commitment to use it throughout the enterprise. A successful pilot may result in further rollout of the ASP solution or may result in a licensing of the technology.
- **Access To World-Class Infrastructure And Technical Support** – Many ASP companies have made significant investments in world-class hardware/software platforms, production environments, and operations staff to ensure the high-quality, consistent delivery of their service offerings to their customers. This high up-front investment in technical infrastructure and staff can be amortized across a large customer base. This can result in access to a more robust and secure technical environment for your ASP solutions than your company can afford for its self-hosted solutions.

#### ***Challenges Often Associated With ASP Solutions:***

- **Less Control Over Mission-Critical Software Applications** – Companies may choose to own and operate certain software applications themselves as a matter of policy. This is often particularly true with so-called “mission-critical applications” (those applications considered vital to the core functions of the business). Depending on the particular company situation, there can be significant benefits associated with operating and maintaining software applications internally. Self-hosting is not an option when using ASP solutions. However, the risks of using an ASP for mission-critical solutions can be lessened by performing appropriate due diligence on an ASP company prior to using its services, establishing service level agreements to clearly define your expectations of the provider, and clearly defining channels of communication and issue resolution. Risks can also be reduced by developing a system interface with the ASP or by implementing a process, such as regular backups of data, to ensure that critical data is received from the ASP on a regular basis.
- **Dependence On Emerging Companies To Provide Mission-Critical Applications** – There can be a certain amount of business risk associated with selecting an emerging company as a business partner. If this company fails to remain a going concern how will your company backfill for the services provided by this company? This risk is real but there are strategies that can be used to mitigate it and effectively manage it. The first strategy is to perform adequate due diligence on an ASP company in terms of the company’s overall financial health, cash position, revenue forecast, current customer base, and investors. Beyond this measure, requiring the provider to put the source code for its applications in an escrow account can ensure that you will have access to it in the event the company should fail to remain a going concern.
- **Greater Difficulty Getting Your Specific Needs Accommodated** – By their very nature, ASP solutions generally offer less ability to customize the application than traditional licensed software applications. While solutions that are designed for a particular industry or business function can become functionally rich very quickly, these same solutions are not well positioned to accommodate the unique needs of individual customers. ASP companies are highly motivated to accommodate enhancement requests that are of general interest to their target market, but are less inclined to accommodate company-specific or “one-off” enhancement requests. If your company has a true need for a significant number of unique modifications to an application, you should probably consider licensing that application.

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- **The Need For Integration** – Many of the ASP solutions that are available are still relatively early in their life cycles in terms of the breadth of their functionality. These so-called “point solutions” often require integration with other company systems in order to provide the full value expected from them. Depending on the architecture of the ASP solution, the skill sets within your company’s information technology group, and the skill sets of the professional services staff employed by the ASP company, integration can be relatively easy or quite difficult. The potential need for integration is an issue to be aware of. But, you generally will not have a clear picture of the effort required to integrate until you get to the point of evaluating a specific solution and get to know the professional services staff within the ASP’s organization. You should begin to explore integration issues early in the evaluation process.
- **Potential Higher Total Cost Of Ownership** – If you plan to use a particular ASP solution throughout your company for the foreseeable future, it is quite possible that transaction or subscription-based pricing could result in a higher total cost of ownership than licensing the solution (assuming that option is available). There are many factors that influence the total cost of ownership of a given application (e.g., technical platform it operates on, the skill sets within your current information technology group, license fee, yearly maintenance fee, your anticipated volume of usage). If you determine that you want to make extensive, high-volume use of an ASP solution, you should take the time to perform a traditional “lease versus buy” analysis to understand whether licensing the solution offers the most cost-effective option for your company.

The relevance and importance of the benefits and challenges discussed above vary on a situation-by-situation basis depending on the business processes, application, and company involved. An example of a framework used by one company to help structure its decision of whether or not to use an ASP solution is depicted in Figure 1. This company chose to license the solution it was evaluating based on the favorable cost-benefit tradeoff associated with licensing versus the ASP pricing model being offered. Although this particular framework was helpful to this company in this situation, your company’s decision process could quite likely be different.

### **Conclusion**

Many of the ASP solutions being offered today are functionally interesting enough to warrant some serious consideration by companies. Even though this is new territory for many companies, and has some risks associated with it, the potential payoffs are large enough to warrant further investigation. Taking a structured and rational approach to evaluating ASP solutions can help reduce some of the risks associated with these solutions and potentially make the benefits offered by them available to your company sooner rather than later.

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### **About The Authors**

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CarrierPoint is an Atlanta-based company that provides Web-deployed software solutions to the logistics and transportation industries. CarrierPoint both licenses its software and provides it on an ASP basis.

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**Figure 1. Sample Licensing vs. ASP Decision Framework**

This is a decision framework used by one company to evaluate the tradeoffs between adopting a licensed solution and adopting an ASP solution.

