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Management Update: CRM on Demand Is More Expensive Than You Think

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Application Hosting Services

Application hosting services provide the hardware, software, networking infrastructure and ongoing maintenance to enable a company to run applications externally by connecting electronically using a browser. Sometimes the services are provided by the software vendor — Salesforce.com, RightNow Technologies, NetSuite, SalesNet, and ACCPAC International. In other cases they are offered by third-party providers. For example, IBM provides hosting services for Onyx Software and Siebel Systems, and Surebridge and Aspective provide hosting services for Microsoft CRM.

Application Service Providers

Application service providers (ASPs) typically target small and midsize businesses that need to implement a CRM solution quickly, and lack the resources to acquire and manage the application and infrastructure. Advantages touted by vendors include lower upfront costs and implementation fees, and the ability to add and subtract users on a flexible, pay-as-you-go basis.

Larger companies are now evaluating ASPs because they want access to these benefits. Some organizations use CRM ASPs to test the potential of the software before buying an expensive CRM package. Many CRM companies offer users this approach. These arrangements cost less initially, but often include hidden costs and risks. Contracts often vary from traditional licensing arrangements, so organizations should ask detailed questions about contract terms, and licensing and pricing models when signing these deals.

Get a Breakdown of Costs

If the hosting is not provided by the software provider, negotiations will be even more complex. In Gartner's experience, the hosting provider will not be allowed to negotiate terms that relate to the software vendor's intellectual property. Issues associated with license rights should be negotiated directly with the software vendor. Companies should ask for a breakdown of costs, in case the relationship between the vendor and the hosting party is terminated.

Set-up Costs

Some vendors charge for set up on top of monthly fees. For example, IBM has charged $100,000 for a bundled solution, including integration, database installation, business planning and workflow set-up for Onyx On Demand services. Some deals also include fees to cover installing software.

Vendors like Salesforce.com do not require software installation fees. Some of the first Siebel OnDemand customers were not charged set-up fees. These fees are not justified, because the software should already be installed at the hosting vendor's site. But fees to cover customization, custom training and success validation are not uncommon. Vendors usually charge between $12,000 and $36,000. The fees are only justified if you do not have the internal resources to perform these tasks.

Free pilot periods: Several CRM ASPs are offering a "free trial," during which companies can pilot the application, paying any fees. Should they elect to extend a successful pilot, companies should negotiate all contract terms and minimum discounts. You will have little leverage if the pilot is successful. Minimum discounts will ensure some flexibility for renegotiation if the pilot reveals unexpected requirements. Companies may need to include more users than expected, or load more data, for example.

In the United States, Siebel was offering a 90-day money back guarantee if its customers were not happy, but this deal is no longer officially available. A one-month's free trial is available in Europe, the Middle East and Africa, but this is contingent on signing a year-long contract. RightNow Technologies will offer use of its software for 60 to 90 days, or until users are happy with the pilot, before requiring payment for licenses and hosting.

Many of these offers are not reflected in the contractual payment terms. Organizations should negotiate delayed payment for software and hosting so that it isn't due until they are happy with their pilot project. If there is a time restriction on this pilot, like 30 days, ensure that some flexibility is built into this, so that, if the deal is not canceled beforehand, the remaining 11 months of fees do not suddenly become due on the 31st day. Be aware that, for most vendors, it is only the licensing and hosting fees that are free during the pilot period. Anything requiring professional services will have to be paid for.

Term of the Licenses

Many of these licenses are time-restricted or nonperpetual in structure. Unlike traditional licenses, this means that the company does not have any residual rights when the contract expires. With a traditional, perpetual license, customers can continue running the software at the current version after the contract ends. This is not the case with ASP licenses, and exposes customers to the risk of unreasonable price increases on renewal of contracts. It is imperative to negotiate price caps tied to an index like the consumer price index, or a prenegotiated percentage. For example, Siebel OnDemand contracts allow the price to be locked in for the duration of the contract, but thereafter there is no protection. Some contracts allow the vendor to shut off the service completely if the account is more than 30 days overdue. This gives the vendor tremendous leverage if a company wants to dispute a payment.

License Conversions

Some vendors offer hosted and on-premises options, and perpetual and nonperpetual license types. For example, Cincom Systems and RightNow Technologies will allow customers to buy out the nonperpetual licenses and make them perpetual but continue to pay a hosting fee, if that is still required. Conversion or buyout provisions are rarely documented in the contract, nor are the pure hosting fees stated.

Companies may be forced to pay full price for the perpetual licenses, if these are not negotiated in advance. This is because, rather than rewarding customers for loyalty, many vendors are likely to exploit customers that are locked in to using a product that their end users are familiar with. Negotiate a credit for the software component of the deal, which can be applied to any future perpetual license fees.

When converting from one license type to another, vendors may demand that customers sign a new contract. Organizations should ensure that any rights negotiated in the initial contract are retained in the new one.

Pricing Metrics

Although most prices for CRM ASP arrangements are “per user, per month,” new deals are appearing. These are priced by usage metrics (number of transactions or capacity, or both). Some vendors primarily charge per user but include “hidden” metrics to supplement these. A vendor may assign a maximum data storage capacity for customer data, based on the number of users. For example, it may assign 10 megabytes of storage capacity to each user, which can be spread over the total customer data stored. If this capacity is exceeded, extra fees will be due.

So far, we have not heard of any organization being charged these additional fees, but these agreements are relatively new. During the next three or four years, organizations will collect many contact history and sales proposals, and then these limitations will become very costly. Avoid having too many pricing metrics, as they will become difficult to manage and predict, and will eliminate some of the flexibility these models purport to offer. Check how the pricing metric is defined and measured, and how often.

Discounts

Organizations should understand how much adding extra users, capacity or services will cost. Many vendors offer volume pricing structures that offer differing prices per user for different ranges of user numbers, as well as for longer contract terms. Contract terms usually vary between one and three years, with lower pricing for three-year deals.

Some vendors are offering very low entry prices because they hope to gain a foothold in the market. But these prices will not last for long. Lock in prices and discounts for the duration of your contract, or ensure that these volume discounting bands are included in the contract and that you are entitled to reduced pricing if your aggregate usage would put you into a new band. Many vendors will revert to list prices when adding additional users, or even when renewing annual contracts, unless discounts are locked in.

Reducing Users

Check if fees will be reduced if the number of users or transactions decreases. Some vendors charge penalties, and others do not allow a reduction in users.

Fees for Customers or Business Partners

Many companies are offering customer self-service, which can reduce costs and, in some cases, improve service. These organizations may want to allow their customers or consumers to access the CRM application. Similarly, some companies need to give business partners or suppliers access to the CRM application to execute sales service and marketing processes effectively.

Most CRM ASP contracts we have reviewed have either explicitly limited access to employees of the licensed company, or have been vague about whether customer and supplier access was allowed or included in the price per internal user. The per-user model does not work well if the application has too many unpredictable and unidentifiable users. Paying $100 per user per month for a salesperson might be acceptable, but no organization can pay such a fee for each of 10,000 or more customers. State explicitly that customer and partner access is included in the per-user fee for employees, or negotiate an alternative licensing metric that would be more appropriate for these unpredictable, but potentially large, external communities.

Adding New Functional Modules

If the ASP sells several functional modules separately, like sales, service and marketing, be sure to lock in discounts or maximum prices for adding modules, functions or user types later. Ensure you understand what is included in the base price and what might cost extra by including generic descriptions of the functions in the contract. Anything substantially similar to what is described should be included without an additional fee.

Some vendors will charge additional fees for items like computer-telephony integration or contract management. Many vendors have separate arrangements and pricing for customer service and support. Check if the telephony component — scripting, auto dial, scheduled call back, interactive voice-response, skills-based routing, recording and monitoring — is included when you license these services.

Maintenance and Support

Ensure that updates and upgrades are guaranteed as part of the monthly fee and are not installed at the service provider’s discretion. Some contracts do not force providers to deliver any upgrades at all. Support entitlements (for example, response time, time to repair problems, number of permitted contacts) should be spelled out in the contract.

If the hosting provider and the software vendor are different companies, it should be clear who is providing support. If it is the hosting party, then create clear escalation processes in case a problem needs to be dealt with by the software vendor’s development team. Organizations should decide what will happen if the service provider (for example, IBM) terminates its agreement with the software vendor. In the contract, include provisions for alternative suppliers or for contracting directly with the software vendor for consulting services, along with a fee structure for these services.

Downtime

ASP contracts commit them to different levels of maximum downtime or guaranteed uptime. For example, NetSuite guarantees 99.5 percent uptime or you get your money back for that month. Other vendors state that downtime will not exceed a certain percentage each month, but exclude events outside their control, like natural disasters or failures by third parties. Many vendors claim that if they give you warning, an interruption in service does not count as downtime, but the warning may be as little as eight hours.

If downtime service levels are not met, negotiate penalties or escalation clauses. Although penalties can appear attractive, in our experience, escalating a problem within a vendor organization usually yields faster recovery times. Escalation clauses should oblige a senior member of the hosting organization to update a senior person within the user organization twice a day.

Training Fees

One of the advantages of the ASP model is that in-house support staff are not required. But some service providers' proposals mandate that the customer pays for at least two users to be trained in the CRM application. Training on general usage and new features should be done online, and users should be clearly notified of this training before new features are activated. Some vendors, like Salesforce.com, offer "day in the life" training for users, which is included in the monthly fee.

Integration and Customization

Many ASP systems need to be integrated into the customer's existing systems or customized. Most vendors will charge for this separately, at professional services rates. These rates should be defined and discounts negotiated in advance.

Organizations should define who owns the rights to customization. Companies customize for competitive differentiation, but these customizations could be deemed to belong to the vendor and provided as a standard deliverable to competitors. Companies should negotiate clauses restricting the sale of customizations to competitors. For example, to retain first-mover advantage the customization could be kept exclusive for a period of 12 to 18 months.

Data and Security

Ensure that data is owned by the company and can be transferred or migrated without fee if the customer requires the data for analysis, or if the deal is terminated. Most CRM ASP agreements allow for this, but the time frame varies. Some contracts state that if the company has not transferred the data within 30 days, the ASP has no obligation to provide or maintain the data. Ensure that you can decide the data transfer mechanism (batch, real time) and the format (flat file, relational database management system, spreadsheet, ASCII, original format or current ASP format).

Many contracts make the customer responsible for security, data protection and compliance with local laws, not the ASP. If customer data is being hosted outside its legislative region, make sure that the vendor is complying with any data protection laws governing customer data.

Termination Fees

Companies should ensure that they can get out of a contract in any given month, without financial penalty. Some vendors charge two months' fees to terminate a contract within the first year. Others charge nothing. Many agreements state that either party can cancel the agreement by giving 60 days' notice. Finding a replacement product within 60 days will be difficult. It would be more realistic to give 120 days' notice for mission-critical systems.

Tactical Guidelines

Organizations should review and negotiate the terms and conditions of contracts with application service providers supplying customer relationship management software. If they don't, they may pay 30 percent more than anticipated over a five-year period.

Bottom Line

- When evaluating CRM hosting deals, companies should not be beguiled by very low per user per month fees.

- Instead, they should explore the financial implications of issues such as set-up costs, hidden license metrics and termination fees, and others mentioned here.

- Where feasible, companies should obtain comparative estimates for an on-premises implementation or for an arrangement where the company purchases the hardware and software licenses and then contracts to an external outsourcing organization for management.

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