



BEST PRACTICES:

Understanding and Comparing Software Price Quotes

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Software pricing is notoriously complex. Buyers often end up frustrated with the long list of fees and the detailed calculations behind them. Moreover, when different vendors price in different ways, comparing price quotes is like comparing an apple to an orange.

This complexity results from the fact that software is largely intangible, costs a lot to engineer, and costs next to nothing to reproduce. Software companies must find a way to sell based on the value of the system, not just mark up the variable cost of the software.

Regardless, creating an apples-to-apples price comparison is not that difficult. In this presentation, we'll explain common pricing components and show you how to compare quotes on an apples-to-apples basis.

WHAT YOU WILL LEARN

- Total Cost of Ownership (TCO)
- Definitions of common fees
- On-premise software pricing
- Software as a Service pricing
- How to compare price quotes

Total Cost of Ownership and Comparing Apples to Apples

When evaluating software price quotes, it is imperative to compare total cost of ownership (TCO) on an apples-to-apples basis. Easier said, than done...

For software of any real sophistication (e.g. multi-user software for businesses), there isn't just one sticker price. There are a number of up-front and future costs to consider, and not all of them are costs directly from the software vendor.

Software vendors will charge a license fee for their software, annual support fees, and some other service fees. However,

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there is also the cost of hardware, third-party consultants and other ancillary fees to consider. You have to add this all up for each system to truly understand the TCO for each system.

The second major challenge buyers face is to compare price quotes comprised of mostly up-front costs with those that are mostly recurring costs - monthly or annual. The former is typical of traditional, on-premise solutions. The later is more common with emerging Software as a Service (SaaS) offerings.

To help, we'll start by defining the most common components of software price quotes.

Common On-Premise Pricing Components

Fees & Expenses	Explanation
Software license	On-premises software companies typically charge a one-time license fee (i.e. "perpetual license"), often based on the number of users of the system. You are buying the software and you own the right to use it forever.
Annual maintenance & support	The maintenance and support fee entitles you to ongoing customer support, as well as new releases of the product. This fee is typically charged once per year and is 15% to 20% of the software license fee.
Installation	Assuming that you do not have your own IT staff, the software vendor or reseller may charge you a fee to install the software at your office and get the basic system up and running.
Data migration	Most organizations already have some system in place; therefore, there is typically a requirement to migrate data from the old system to the new system. This can be difficult, so vendors must charge for the work.
Customization / configuration	Almost all businesses are unique in how they do what they do; therefore, many software buyers will want to modify the software to meet their needs. Again, this is difficult work, so vendors must charge for the work.
Training	All vendors provide training, and most leave it to the customer to determine how much training they require. On-site training is valuable, yet expensive; meanwhile, web-based training is often offered for free.
Server hardware	If you buy an "on-premises" system, you may need to buy a new server computer on which to run it. The scale of your system (e.g. number of users), will determine how powerful - and expensive - a server you need.
Personal computer hardware	If the new software requires more powerful computers, you may also have to buy new computers for each user. In other cases, you may be able to use your existing computers.
Other hardware	You may need to buy networking gear or backup drives to go along with your new system. Be sure to ask your software sales representatives what other infrastructure they recommend.
Ancillary service fees	Some software systems interoperate with ancillary services, such as pricing databases in construction, claims processing in medical or tenant screening in property management. These are often priced separately.

Common Software as a Service Pricing Components

Fees & Expenses	Explanation
Subscription fees	SaaS systems are often sold on a subscription basis instead of charging up front for a perpetual license. This offers lower up-front costs, but over time the cost is comparable to perpetual licensing.
Set-up fees	With a SaaS system, there is less up-front work, as software does not have to be physically installed on-premise. However, there are still costs of configuring the new customer account, hence the set-up fees.
Data migration	Most organizations already have some system in place; therefore, there is typically a requirement to migrate data from the old system to the new system. This can be difficult, so vendors must charge for the work.
Customization / configuration	It is less common to customize a SaaS system, but some SaaS buyers will want to modify the software to meet their needs. Again, this is difficult work, so vendors must charge for the work.
Training	Most SaaS system training is performed on-line and over the phone, as well as “in-line” and “in-context” as the people use the system. Web-based training is often less expensive or free of charge.
Personal computer hardware	SaaS systems often require less powerful personal computers, since they are typically accessed through a web browser and little computation is performed on the PC. Still, it may be time for new computers.
Ancillary service fees	Some software systems interoperate with ancillary services, such as pricing databases in construction, claims processing in medical or tenant screening in property management. These are often priced separately.

Comparing Quotes: Step One

The first step is the most straightforward: Add up all of the up-front, non-recurring costs for each solution. This includes software, hardware and related services. Total what it will cost to get started in year one with each solution. These are just the up-front costs.

	Example A (On-premise)	Example B (On-premise)	Example C (SaaS)
Software license	\$35,000	\$25,000	\$0
Installation	\$2,500	\$0	\$0
Data migration	\$5,000	\$6,000	\$7,500
Customization	\$10,000	\$12,000	\$5,000
Training	\$10,000	\$8,500	\$0
New hardware	\$25,000	\$24,000	\$12,000
TOTAL	\$87,500	\$75,500	\$24,500

Comparing Quotes: Step Two

Next, calculate a net present value* (NPV) of the future costs of each solution over the next nine years. Add the NPV of future costs to the upfront costs from the first step, and you have the present, total cost of each system - an apples-to-apples comparison.

	Example A (On-premise)	Example B (On-premise)	Example C (SaaS)
Subscription fees (annual)	\$0	\$0	\$15,000
Maintenance & support (annual)	\$6,300	\$3,750	\$0
NPV of recurring costs (years 2 - 10)	\$36,454	\$21,699	\$86,796
Total upfront costs (year 1)	\$87,500	\$75,500	\$24,500
NPV of recurring costs (years 2 - 10)	\$36,454	\$21,699	\$86,796
TOTAL NPV OF ALL COSTS	\$123,954	\$97,199	\$111,296

* NPV calculates the current value of future payments. Basically, money you spend in the future is less expensive than money you spend today, given that you can invest money for some rate of return today, before making future payments. Calculating NPV in Excel is very easy if you use the function, "=npv()". For the purposes of this analysis, we assume a "discount rate" of 5%.

Summary

After reading this presentation, you should be better prepared to evaluate software pricing. You will still come across variations in pricing terminology and licensing models, but we have covered the most common components of software pricing.

The important thing to keep in mind is that the price of software is only part of your return on investment (ROI) calculation. The biggest determinant of your project's success will not be what you pay for the software, but how effectively you implement and use the system.

Buyers should assess pricing carefully and negotiate a good deal. However, project success will only come from making the most of the software's capabilities and convincing your team to use it to its fullest.