

Why ASP Doesn't Work....Yet

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Perhaps one of the hottest topics in recent years in the Information Technology business has been Applications Service Providers (ASP) service delivery model. ASP was going to be the hottest market for 2000 with phenomenal growth rates. But as yet ASP growth has been very sluggish, and in recent reports many industry analysts have been adjusting their forecasts for the ASP market drastically lower. (See. "The Incredible Shrinking ASP Future", Louis Trager, the Net Economy, December 4, 2000)

ASP was the model whereby smaller enterprises could use the "expensive" Tier 1 applications but not pay the Tier 1 license fees. The Internet will be the network, and the applications will all be web-enabled allowing the use of the Internet as a cheap global ubiquitous network and any network browser as the applications interface. Cheap access and use of Tier 1 applications, a cheap network, and cheap hardware -- what a great formula for making money and serving customers who previously couldn't afford the software, hardware or networks. ASP was going to be the way dot-coms got their IT infrastructure. However, the technical reality doesn't support the strategic vision of the ASP marketers.

So What Happened?

ASP has failed so far for four reasons:

- Major independent software vendors (ISVs) have not accepted the ASP model and in fact sabotage the ASP model through their licensing practices
- The Internet is unsecured and customers don't feel comfortable with their private data on a public network
- Major software packages either aren't Web Enabled or don't allow multi-customer usage
- Customers are unwilling to accept Vanilla packaged solutions

The idea of the ASP is a good one. And there have been some pockets of success. To make the ASP model work, the provider must be able to take advantage of several economies relative to hardware, software licenses, and most importantly minimizing applications customization and thus reducing labor support costs. The ideal ASP customer would accept the ASP product with little or no applications modification and not mind using a relatively unsecured Internet network. This combination is rare in the real world, and especially not for the major applications such as SAP or Oracle. They simply don't come out of the box working. There are 'connect the dots' implementations, they always need modification.

Fallacy 1 – Low Cost Access to Brand Name Software

Major ISVs do not see the ASP model as a win-win. They feel that they will lose lucrative license fees, become disintermediated from their customers, and generally lose control of their business. Most ISVs have developed some form of “ASP Certification” which is really a form of pre-selling licenses to the vendors at traditional fees. ISVs insist that the end customer hold the license rather than the ASP. Generally, the only way the customer gets per seat pricing or subscription pricing is by the ASP doing some financial engineering and accepting the customer as a risk. The ISVs have simply added a light coat of ASP paint to their existing way of licensing their software.

For the ASP vendor, licensing fees still represent about 30% of the cost of provisioning an ASP solution. The reality of ASP license pricing has gone a long way to making the ASP model not economically feasible.

Fallacy 2 Customers will use the Internet for a low cost network

The ASP model will use the Internet to provide almost free network access for the ASP customer and their users. The problem is that customers don't want their data running over the Internet in a public/unsecured manner. Access to the Internet POP (point of presence) may also add a large monthly cost depending on where the customer's facilities are located relative to the Internet Service Providers POP.

All in all, after the Internet network is provisioned with firewalls to provide security and the customer pays for communications lines to backhaul to the POP, the Internet is not a very cheap network. The other problem with the Internet is that as a public network, there are no dependable SLA's to which a vendor will commit.

In the case where a customer does not have a large network requirement for their application, the ASP model becomes very tough to economically justify. Experience has shown that Infrastructure and telecommunications represents about another 30% of ASP cost.

Fallacy 3 – The Customers will Share a single version of the application

The premise is that a single image of the application will support multiple enterprises. This simply is not the case and most of the major ERP applications do not contain the proper logic to allow multi-customer single image operations. The traditional data center outsourcing technique of consolidating smaller workloads of different customers on larger machines to generate savings through economies of scale on hardware and reducing the number of individual software licenses does not apply in the ASP model. Customers will not accept being hosted on a shared infrastructure as the operating systems and applications themselves do not provide the necessary levels of security and privacy that most customers demand.

A significant technical issue that is currently being addressed by the ISVs is that most of their applications are not Web enabled and consequently work very poorly over the Internet and cannot be operated using a browser. This issue is being addressed by the ISVs in future versions of their software.

Fallacy 4 – Customers will accept Vanilla solutions

One of the major economic levers in the ASP model is that customers will accept a vanilla implementation developed for their industry that they will accept with minimal customization. There are two major problems with this, one is that vendors can provide packaged solutions that meet the majority of customers needs in a given industry, and the second is that customers will accept minimal customization

ASP providers attempt to build application packages that are industry solutions and can be implemented with almost no customization. From the ASP provider perspective, this is the only way to hold down ongoing support labor costs. The ratio of support personnel to ASP customer is perhaps the most vital critical success factor for ASP providers in determining whether they will make money or lose money.

Industry packaged solution remove the customer from the technology, and provides an out of the box solution. There are two problems with this approach. First, it is rare that an out of the box solution can truly meet a customer's perceived needs. Secondly, for the vendor who chooses to develop an industry solution, they better make sure the industry is large enough and they will get enough market share to support their investment in the packaged solution. Also essential to the vendor is to make sure the solution can scale, both larger and smaller. Some industry solution providers have found that after they have sold to the larger enterprises their packaged solution, they cannot economically scale to smaller enterprises because of component costs in their standard solution.

Customers, on the other side of the equation, have several problems with packaged solutions. First, most customers have some form of legacy systems, unless the ASP solution replaces all the existing systems, it will be difficult to economically justify the cost of the ASP application while there are still costs in supporting the legacy systems. Because of the difficulty in justifying retained legacy costs, the dotcom world was eagerly marketed to by the ASP providers, thus ignoring the retained legacy cost issue. Secondly, there is a pretty narrow set of industry solutions that can support generic vertical industry systems, and by their very nature (because of existing or prior regulation) they tend to be in large mature industries with few large players that already have industry solutions, like the travel, banking, and insurance industry.

So what's a Customer to do?

The ASP marketing headlights are clearly ahead of existing technology. The ISVs need time to modify their packages to allow multi-customer images and support Web browsers. As a possible customer of ASP services there are several ASP-like services that make very good sense to investigate today. First, any enterprise that is still preparing its own payroll (regardless of size), needs to contact one of the major payroll services,

they can save you money and keep you out of trouble. Email has become an ASP service that does allow vendors to take the economies of scale, is largely decoupled from customer legacy systems, and can economically use the Internet. Several Fortune 500 companies have used the ASP model for email services and are having good success.

The ASP Service Delivery model will become reality. The largest cost to be leveraged in the ASP model is the cost of labor in support of ASP packages. As the ISVs mature their offers to include more functionality the desire of customers to modify the out of the box solution will decrease. As the ISV's products become more similar they will increase competitiveness amongst themselves that will in turn require them to accept subscription style license pricing.

ASP is a great Service Delivery Model, just not today.