

# Pay the right price! For the right software!

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In the Credit Management industry, software has often carried a base price and a per-account charge as well as implementation charges and professional fees.

With the ability to access valuable business functionality over the Internet, the concept of a named user licence, or even a concurrent user licence, becomes difficult to manage and contradicts the concept of universal availability. Per-cpu licensing similarly becomes unmanageable in the context of server clusters and on demand utility computing.

A new paradigm is required if outdated commercial concepts are not to stifle the improvements available via alternative application software delivery mechanisms where customers are able to access application software on a utility basis.

This article is intended to offer a view of the alternative charging models available to customers in the emerging world of the web-enabled ASP.

## **The Traditional Pricing Model**

Commercial package licensing is usually priced according to the maximum number of users expected to be using the system concurrently, or limited number of named users. In addition annual support and/or maintenance of between 10 and 20 per cent of an initial licence fee will be applicable. The traditional pricing model is used by the vendor to maximise the licence fee from each customer. This recovers the intellectual value invested in software as, once the contract is completed the opportunities for continuing additional income are limited to the annual support fee and charges for software modifications to keep pace with business change, a reactive position that can label an application as legacy early in its life.

Customer disadvantages of the traditional model are related to the flexibility of the system costs. For example, if a customer is running a debt collection system and the business is seasonal, with peaks around Easter or Christmas, the licence cost will normally be calculated according to the number of users required at the maximum of the anticipated peak. During quieter times, there will be significant costs incurred for which no benefit is derived.

### **Example:**

Acme Gifts supply novelty gifts and chocolates to their agents via a catalogue. The collections department consists of 50 full time collectors supplemented in January by an additional 50 collectors and by 25 in February to chase debts unpaid 30 days after the Christmas peak. The system is licensed using a concurrent-user licensing scheme, each user licence costing £2,000. No additional licence costs are incurred due to additional functionality or number of accounts being processed. The maximum number of users (during the Christmas period) is therefore 100. At £2,000 per user this will require an initial cost of £200,000 and a recurring annual fee of £40,000 (at 20 per cent of the initial licence fee). During 10 months of the year there are only 50 users of the system, giving a five-year lifetime cost of £8,000 per user—or 4 times the headline cost in licence fees alone. If in addition there is a licence element related to the maximum allowable number of accounts in the system, then

the requirement to allow for the peak transactions over the Christmas period magnifies the problem. In this pricing model, there is a disincentive for the supplier to improve the effectiveness of the software as, by maintaining the number of users required to collect the debt at a higher level, the licence fee income is maintained.

However this model offers savvy organisations the opportunity to negotiate discounts on list prices and if you can time the purchase, substantial discounts are available.

### **Risk/Reward Value Pricing**

One alternative to the traditional model is to base the licence cost on the value of transactions being stored or processed by the system. In a debt collection system this could be related to the total value of debt recovered through the system. If a customer were to submit a total of £200,000 worth of debt into the system and £150,000 was subsequently collected (the remainder being either passed to a debt collection agency, processed through litigation or written off) then the customer would be liable to pay to the vendor a percentage of the £150,000.

Using this model, the vendor has an incentive to increase the efficiency and effectiveness of the system as his income increases in proportion to the end result without necessarily increasing vendor costs. The customer also benefits from improved efficiency in reduced staff and accommodation costs. However a careful appraisal of what percentage rates will be applied is required from the start and on an ongoing basis, which can demand substantial management time and appropriate controls.

#### **Example:**

Acme Gifts collections agents average £500 per hour when collecting outstanding debt. During the post-Christmas peak, when the additional temporary staff are employed, the average drops to £400 per hour as a result of using less experienced staff. If the vendor is receiving 10 per cent of the collected revenue then, during the peak period, Acme collect a total of £40,000 per hour of which £4,000 is paid to the vendor.

By improving the system, the vendor is able to increase the average collection rate from £400 to £500 per collector. Acme reduces the number of collectors to 90 and recovers an additional £5,000 per hour, which no longer gets written off or sent to litigation.

Acme loses the cost of 10 collectors, and the vendor receives an additional £450 per hour as their reward.

### **Per - Transaction Pricing**

The advent of Web ASP services presents an opportunity that can fit the business demand as it develops. In this case the ability to price each individual transaction according to its value to the business process enables the customer to make an informed decision as to whether the activity should be performed or not, and be charged accordingly. This pricing model ensures that the customer only pays for those activities from which they derive value when used. In a simple transaction-based pricing system, for example, the cost of a customer trace may be 75 units, setting up a payment arrangement 10 units, and each arrangement instalment processed attracts an additional charge of 2 units. A unit could be considered to be like electricity or gas units and the customer would enter into a contract where the supplier could set the price at, say, 10p per unit for an anticipated use of up to 100,000 units per month with additional units charged at say 8p per unit. The customer can then control the cost of the service provided, and can increase or decrease the volume of work processed by the vendor. The actual pricing model that is agreed

between the vendor and supplier could take a number of forms, eg:

- a one-off up-front payment for access to the service, followed by a per-unit tariff
- a contract subscription, where the customer commits to a minimum monthly charge, which in turn includes a pre-agreed level of usage. Any usage over this pre-agreed amount would attract a per-transaction charge.
- an Enterprise subscription, where the customer commits to a high volume of transactions for an agreed charge, with usage either unrestricted or restricted only under a 'fair use' policy.

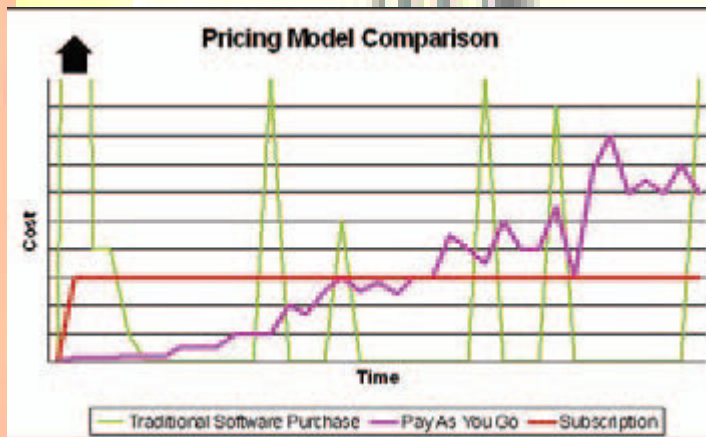
A customer can benefit from these pricing formulae in a number of ways:

- the customer can elect to add to their existing systems by placing a small number of transactions through the new service in order to test the effectiveness of their exist-

- ing system against a potential replacement
- the system can be used to smooth peaks in demand
- the system can be implemented immediately using a basic but proven configuration and extended over a period of time with customer-specific requirements rather than having to wait until a lengthy implementation cycle is completed.

To maximise the value of this model, however, a gradual transition may be required to use Web ASP services on a process by process basis in order to minimise disruption to the business and give time to exit existing application support software.

### Price Model Comparison Chart



This diagram illustrates the effects of the alternative price models over time.

### Which model suits best?

In order to determine which pricing model suits best, a number of factors need to be considered such as:

1. Do I have budget available to purchase a licence to use? (Do not forget to include the costs of infrastructure and personnel to implement and manage the system).
2. Do I want to be able to increase and decrease my usage of the system during peaks and troughs in my business cycle?
3. Do I need to be able to outsource some of my work during staff holidays or at other times?
4. If I make significant improvements in user performance, do I want to be able to reduce my costs by reducing the number of users without losing the ability to increase them later?
5. Do I need to make provision for technology updates during the life of the project?
6. Am I happy to continue paying an annual licence fee to my supplier for licences I no longer use?
7. Am I happy to wait while my supplier schedules software development resource in order to amend my collection strategy?
8. Would I like the vendor to share my goal of maximising individual collector performance?
9. Would I like to reduce my working capital by paying for my system on subscription?
10. Do I want to be able to use a relatively simple, or low volume, service to test the benefits before committing large amounts of resource (people or cash) to a major project?

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