

Chapter 10

Software as a Service and the Pricing Strategy for Vendors

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ABSTRACT

Software as a Service (SaaS) has been a dominant information technology (IT) news topic over the last few years. It is a new phenomenon where software as a digital product, instead of being locally installed and delivered as a product, has been shifted to being installed in data centers and delivered as a service. The users do not need to worry about the installation and maintenance of their software since these tasks have now become the responsibility of the vendor. In reality, many people are still puzzled about SaaS with other new technologies. Next to that, there are numerous enterprise users who hesitate to adopt SaaS solutions because of the idea of storing data outside their company. This chapter elaborates on the state-of-the-art of SaaS from both scientific and business perspectives to help readers better understand this technology.

INTRODUCTION

This chapter describes the diverse aspects of Software as a Service, which makes it valuable for many different readers. It starts with the background of SaaS, followed by its definition and main characteristics. Next to that, we show how readers can see SaaS differently from traditional software and how it is interrelated to other technologies such

as cloud computing, Web 2.0, Application Service Provider (ASP), and Software plus Services (S+S). The benefits and risks of adopting SaaS from different literatures will also be compared and explained in detail. In addition, we will present several scenarios for how SaaS is currently being delivered in the market and introduce our Pricing Strategy Guideline Framework (PSGF). In this chapter, several new deliverables that are produced during our studies and interviews with nineteen different SaaS companies will be presented. The

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main deliverable itself is the PSGF framework which aims at providing SaaS vendors with a set of guidelines to ensure that all the fundamental elements with respect to pricing are included in their pricing strategy. Our framework will be useful especially for small-to-medium SaaS vendors – particularly the startup vendors, which tend to have less experience in pricing their SaaS solutions and dealing with several issues in the aforementioned scenarios like low sales cycles, chaotic pricing, and entering a new market segment (Geisman & Nelson, 2008). The framework including all layers and elements will be described in detail with several examples as well. Our framework has been constructed from several existing theories and has been successfully validated by a number of experts in the field.

Several contributions from both scientific and business perspectives are conveyed from this book chapter. From the scientific perspective, the matrices of SaaS key principles and SaaS benefits and risks, which also specify to which groups they are applied, certainly add value to the existing SaaS literature. Furthermore, the six scenarios introduced in this chapter have never been examined in previous SaaS studies. However, this chapter's most significant contribution is the framework itself, as this research presents the first SaaS pricing framework available. In most of the available academic software pricing literature, authors are using mathematical formulas, whereas this book chapter does not, making it more favorable to readers. Finally, from a practical business point of view, our framework presents all fundamental elements related to the pricing of SaaS solutions which is very likely to be quite useful for many SaaS vendors.

BACKGROUND

'Software' is a general term used to describe the computer programs, procedures, rules, and the associated documentation, in relation to the

operation of a computer system which are stored in a read/write memory unit as part of the digital system (Langholz, et al., 1998; Wordreference.com, 2009). This term was first introduced by Tukey (1958), and has become an integral element of the English language and has been included in many other languages. At that time, when the computer era began, the manufacturer sold the computer as a physical machine, which included the operating system and rudimentary software at no additional cost. This situation has changed after IBM announced on June 23, 1969, that it would unbundle the hardware and software in the future. Later on, this has been seen as the birth date of the software industry as we know today (Kittlaus & Clough, 2009). Within a few decades the software market has dramatically grown.

From that time until today, in most situations, customers are required to buy the software license, install and run the software on their local computer or server before they can use it. The installation files can be stored on CDs or other storage devices like diskettes, USB sticks, etc. The licenses and CDs are usually sold by software vendors. Since this type of software is installed on the premises (in the building) of the users rather than on a remote facility, it also commonly known as '*on-premise software*'. Also, because this type of software has been used for ages compared to the new software phenomenon, it is also known as traditional software.

The Internet boom in the mid-1990s has shifted the way in which companies - including software vendors - are doing business. The Internet has become not only the medium for marketing their software, but also turned out to be the major requirement to deliver their software. In other words, without the existence of an Internet connection, this new type of software cannot be utilized by their customers. This new phenomenon began in the late 1990s with the concept of Application Service Provider (ASP), which has evolved into another software hype, most popularly known as 'Software as a Service' or SaaS (Hoch et al., 2001).

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