

MIP



Nonprofit Focus: Understanding Total Cost of Ownership (TCO)

Understanding long-term and hidden costs in software deals

This paper provides guidelines to boards of directors and software purchase decision makers on what to expect to pay for a new software system at initial purchase and more importantly, over time. This type of analysis is called the “total cost of ownership” (TCO). While there are many standard ongoing charges for new software, there are areas where nonprofits can get caught with high ongoing costs that they did not anticipate when they initially chose a software package. This paper helps software purchasers become aware of possible hidden or long-term costs to look for during vendor/product review prior to purchase.

How much is it?

Nonprofit boards and organizations are under tight constraints to manage budgets and make every dollar count. Since there are few purchases with as many associated costs as software, and as it can be difficult to correct a bad software fit after an organization’s vital data is in a given system, it pays for nonprofits to take a close look at the associated costs of new software — especially the reoccurring costs that they will have associated with their continued use of a given system.

Prices vs. Costs

The price of software is often presented or initially considered in terms of a licensing fee. However, there are many other costs associated with a new software system beyond this initial system “price”. Some of these are one-time installation related charges, such as data conversion costs or consulting fees and others are ongoing costs that an organization will pay each year of use. It is estimated that license costs typically represent only a third of the total cost of a new software installation — and some vendors push it far beyond a third. Which of these fees are justified? Which are above average? What should decision makers look for and consider when comparing vendors or examining a new system to ensure they are getting a true picture of costs over time? There are several cost areas where purchasers need to pay special attention to ensure they are comparing “apples to apples” in system cost comparisons and getting accurate long cost information.

Included or Added On?

Software often comes in module format. That is, a core system is sold with additional functionality available at an additional cost. On one hand, a modular system can be great because it lets an organization buy just the functionality needed, without having to pay for “bells and whistles” functionality that looks good, but that your particular staff really will not use (either due to skill level or time availability) or that you do not need because they do not match your programs or requirements. On the other hand, modules can bring in the cost of a system that initially looked less expensive when you were quoted a basic system price, but is not valuable to your organization without the extra-cost modules.

The key to keeping software value up and cost of ownership down is to stay focused on the elements of the software that your staff really needs and will use to streamline their everyday activities and key tasks. Advanced features that sound wonderful but take weeks of set up and training, or that your staff won't have time to use will likely be ignored in favor of basic features that are needed daily. If your team or programs grow, you can add the new modules later.

What to look for: Are the features you use every day in the core package? Or are they extra cost "optional" modules? Be sure you understand what features you are getting specifically for the quoted module price. Compare the precise functionality of the core systems and then compare the related end prices before you invest in a given system.

The way in which modules are broken out from the core functionality of the system can be confusing in a software demonstration and can greatly affect your costs. Vendors typically show a full module system in product demonstrations — yet can make initial price quotes based on basic systems. There can be a big disparity in what you are seeing in a demo and what you are actually getting for your quoted price. Be sure that the demonstration you see is based on the module set, features, and price that you are being quoted.

Year after Year: Maintenance and Support

As we all know, technology marches forward, changing constantly. Software companies must update their software to accommodate these changes, including adapting new operating systems, new hardware in the marketplace and networking systems, new peripheral devices and integration with other software packages that arrive on the scene. Software vendors also want to meet their customers' requests and make their software better. Thus, software vendors issue maintenance releases to their existing customers, to keep the software and customers current with changing technology standards. Often these costs are rolled into a technical support plan — these ongoing fees pay for technical support of the customer. Support and maintenance is usually a percentage of the software licensing fees. This will be the minimum of your annual costs for the software package.

Things to look for: How much is the percent that determines the annual fees and what is the precise number it is based on? Every module or user "seat" can add to the bottom line and the annual fees. One major software vendor currently charges 25% of the set software licensing costs each year for maintenance and support fees. This is why it is so important to be clear about the features that you need and will use — you pay each year to have them. Often nonprofits are told that full feature sets mean you have room to grow — but it's better if you only pay for what you need today and use all the features of that module you are buying — because you will be paying a percentage on it yearly!

Stunning Deal? Radical Price Cuts? Why "Sticker Price" still matters.

Imagine this scenario: A salesperson drastically drops her software costs — nearly in half! — to beat the competition, because she really wants your business. Isn't that a great deal?

Be aware — it may not be! It's not uncommon for a large initial “sticker” price to be dropped in a sales situation, even by thousands of dollars, to create the appearance of value. This technique can be so impressive that new buyers may be drawn into a deal that will cost them not only the initial “savings” but a great deal more thousands of dollars over the course of a few years! How does this happen? The key is usually in maintenance and support costs — as mentioned above, typically a percentage of the price of a software license. The percentage-pricing structure makes it imperative to know the exact price the annual maintenance and support fees are based on. Often in these “firesale” situations, the annual fees are not based on the new lower sales price, but the higher original “sticker” price of the software — which can be substantially higher. At 10-22% of the original price, the yearly outlay adds up quickly.

Consider a \$10,000 “sticker price” system. If the price is halved, it seems like a terrific deal at \$5000. But at 25% annually, on the original price of \$10,000 (not the sales price) the organization will pay that “saved” \$5000 in just two years — and will continue to pay the 25% fee on the original price every year after that! One way to avoid this situation is to ask directly the percent of annual support and the number it is based on.

Training: How much do you need and how much should it cost?

Training for new software can be a serious cost for nonprofits. Appropriate staff must each be trained on the new software. In addition, the costs for future training must be considered, given the high level of turnover in the sector. Often software vendors rely on this factor to drive their own revenue.

Training costs per vendor can vary wildly, from less than \$1000 per user to up to \$5000 for a week of training per new user. This is often 10-15% of the salary of each user and a significant added cost to the total adoption cost, as well as a recurring cost to meet staff turnover — so it is a significant factor to review.

Things to look for: When comparing total cost of ownership of nonprofit software, it is critical that an organization review the recommended training for new adopters. How much is it per user? How much time away from the office is required? Does it require special training for systems administrators, executives and others as well as daily users? Is the training available locally or only in a single location that will incur additional travel costs?

Time = Money: The value of easy daily use

The complexity of a software package also will impact cost overtime in hard and “soft” dollars. For example, complex software may incur more training costs for supplemental training, and have a longer time-to-productivity as staff gets over a more difficult learning curve to maximize the system. Once training is complete, software that is easier to use will also save time day to day with built-in efficiencies. Tools such as data entry shortcuts or drag and drop querying or reporting tools can help staff spend more time on their critical tasks and less on administration or wrestling with the software's more complex features. More complex software will likely result in additional need for software support calls, which takes users away from their key tasks.

Things to look for: Look at the overall package. How complex is it? Determine the daily and critical tasks of users — are the features or processes in the software package easy to use? Ask those who will use it every day. Are there timesaving features, tools or shortcuts built-in? Determine the processes that are critical to your organization—whether it is to set up donor profiles manage grants, or run a report — and make sure those activities critical to your success are easy in the proposed system.

“Customizable” solution or Consulting Cost Center?

The level of consulting required for a new system can often depend on the size and complexity of an organization and its need, or the complexity of its technology mix. Some consulting is almost always needed for software systems. For the purpose of total cost of ownership analysis, an organization needs to monitor how much ongoing consulting it will require for efficient use of the system.

Customization can be a big added value to some organizations. A good rule of thumb is that the more customized a solution gets, the more time and fees it costs for initial set-up, and the more ongoing costs will be to maintain those customization settings. Every nonprofit and its programs are unique — customization can sound and be wonderful. But it helps to remain clear on the level of system tailoring that will help on key or daily tasks, save time and add value — because additional customization and consulting dollars can add up.

What to look for: Ask specific questions to a vendor regarding the range of consultants available for help, the costs and the level of customization that your organization will require to meet specific needs. You may want to ask other similar organizations what their customization costs were with the same system so you know what you are committing to before purchase.

Conclusion: Lower Your Risks

The variety in organizations’ sizes, budgets and program needs mean that different systems and support services will be right for different organizations. No matter the end costs, as a steward of the organization, you need to make sure your organization is subjected to the lowest possible financial risk, and is as informed as possible about the true costs of a given software package. Be sure to ask about return policies and service guarantees, and don’t hesitate to ask for the costs of up front —be sure to ask for specific prices in each area:

- Licensing fees
- Modules included, or extra costs?
- Support and Maintenance
- Training (cost per user)
- Consulting and Customization

Reduce the risk of getting stuck with more than you need, or software that sounded more complete in the demo! Be sure you have an adequate summary of the true cost of ownership over time, including hidden costs that crop up after you sign the contract, before you submit your software recommendations — and budgets! — to your board.

About MIP Products

The MIP Fundraising and MIP Fund Accounting software product lines from Best Software have been providing the specialized management needs of nonprofit organizations and governmental agencies for over 20 years. Currently over 9000 not-for-profit organizations rely on MIP products.

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