

PROGRESS EMPOWERING “SOFTWARE AS A SERVICE”

A change in your business model

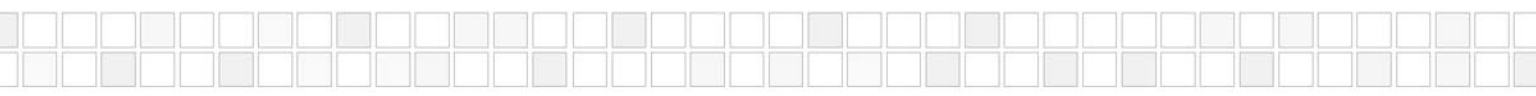


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1.0 PROGRESS EMPOWERING SOFTWARE AS A SERVICE

This document has been created to provide general information on the delivery of Progress-based applications as a service. The target audience is ISVs who are developing, or have developed, an application and desire to begin delivering that application as a service.

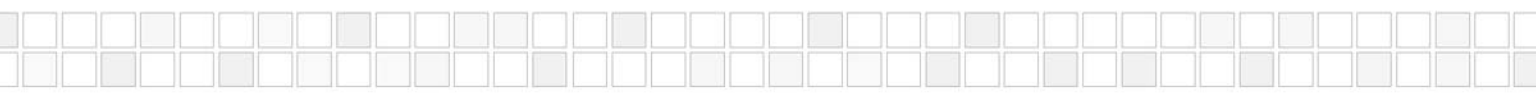
Software as a Service

The software industry is in a critical state of change. The ubiquity of the Web and Internet has now enabled companies of every size to take full advantage of the power, simplicity, and flexibility of services-based business computing. What has been called “hosting” or “outsourcing” of applications has now evolved into today’s “Software as a Service” (SaaS) and represents a marketplace that is growing annually at exponential rates. IDC estimates that the SaaS market will continue to increase over the next five years at a 21% CAGR, reaching \$10.7 billion by 2009. Today, many companies are choosing to move their applications from Host and Client/Server-based architectures to a Services Oriented Architecture (SOA) in order to reap the benefits associated with the highly efficient Web- and Internet-based methods of software delivery.

Delivering Software as a Service

One of the key foundations of this new market and method of delivering Software as a Service is the service-oriented approach to delivering applications. This new approach is transforming the nature and role of the traditional ISV. The mission of the SaaS ISV moving forward is no longer the creation of packaged software products for customers to install. Instead the SaaS provider creates functional software-powered services and applications for customers to use, delivered to agreed performance levels, throughout the life of the service contract/commitment.

Moving from being a vendor of software products to becoming a provider of software-powered services requires a fundamental change to the business model. Rather than being paid up front for the sale of the product, a SaaS provider is compensated for customer usage of their services. This pay-as-you-go model compels vendors to focus on providing value and performing at a superior level of customer service. SaaS providers are therefore obligated to continue to support and work on the customer’s successful use of the application/business process, throughout the life of the contract. This reality is what provides the motivation for many SaaS providers to deliver applications built on a Service-Oriented Architecture—thus aligning the basic principles of service delivery with the application architecture.



In choosing to deploy SaaS, it is important to understand how you intend to offer your software-powered services/applications: self-hosted (at your own offices/locations); outsourced or remote hosted (located at a remote data center site, possibly through an unrelated third party); or customer hosted (where a large customer has the capability to manage and support the required application infrastructure themselves). That choice, combined with the application's particular deployment constraints (e.g., character, client/server, pure HTML, etc.), will have a potentially huge effect on the overall SaaS delivery model.

Progress Empowering Software as a Service

Progress recognized very early on the value and power of the Software as a Service business model and created what is now one of industry's longest-running SaaS offerings (formerly known as the ASPen Program). The deliverables are broken into three areas:

- 1) Commercial Terms/Licensing Services
- 2) Business Empowerment Offerings and
- 3) Technical Empowerment Offerings including Application Transformation.

The starting point for any company interested in delivering SaaS is having the correct contractual relationship with Progress Software Corporation. The cornerstone of this relationship is the Service Provider License Agreement (SPLA). The SPLA gives organizations the legal right to provide Progress-based software as a service to their constituents. Through the SPLA, and a full range of products and developer services, Progress provides everything necessary to build, deploy, integrate and manage highly capable, and very efficient, SaaS-based application architectures.

Business Empowerment offers both custom one-to-one programs and one-to-many workshops to help you increase revenue, improve marketing and improve sales effectiveness. Business Empowerment for SaaS concentrates on the following key areas: SaaS Business Model/Plan development and Go-to-Market Planning, which focuses on new market opportunities as well as expansion within existing markets.

Technical Empowerment is a global program consisting of education, communication, consulting services and an application transformation approach to SaaS that helps our partners and customers bring their applications to a new level of competitiveness. The Technical Empowerment Program provides the knowledge, support, and resources needed to understand the concepts of application transformation and what it means to the business, and it delivers the skills to communicate and execute on those concepts in a services-based delivery model.

Products and Services

Progress Software has a rich set of development, management, integration and deployment products that can dramatically improve a company's time to market in providing Software as a Service. The platform for building new or refitting existing Progress-based applications is the Progress OpenEdge® 10 business application platform with its underlying Service-Oriented Architecture (SOA). Along with OpenEdge 10, there is also OpenEdge Management, OpenEdge Replication, Sonic™ SOA Suite, and other deployment services. With this rich set of tools, organizations can not only achieve their immediate goals of deploying applications as services, but also be assured of being prepared for next-generation applications incorporating Web Services components.

1.1 CHARACTERISTICS OF SOFTWARE AS A SERVICE

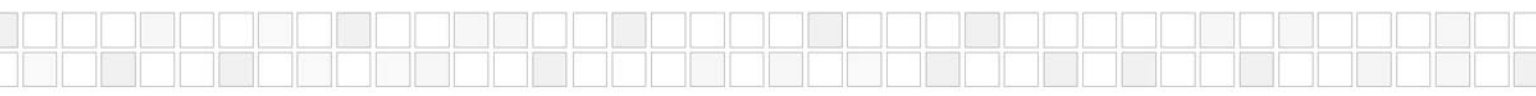
What is Software as a Service?

According to leading industry analysts and active Service Providers alike, software-powered business solutions that are delivered as a service all share several common characteristics. These include:

- > **Focus on process automation rather than technical implementation and custom coding**—SaaS offerings provide access to, and the ongoing management of, business processes for improved efficiencies within an organization. The focus shifts from the ability to implement a package to an ability to streamline a business process.

- > **Provide application accessibility**—In the majority of cases, SaaS providers do not sell the rights to the application outright, nor do they deliver and install a solution in the traditional sense. Instead, SaaS providers deliver access to software-automated processes as a service offering. Accessibility, policy-driven configuration, and personalized customization give the users of the service the ability to have control over how the application is used, rather than how it is implemented.

- > **Evolution of a Service-Oriented Architecture (SOA) and approach to software development/deployment**—ISVs are realizing that in order to gain economies of scale for delivering SaaS, it is in their best interest to begin to evolve their internal development of applications toward SOA deployments. In the long run, it will help to compete with pricing pressures as well as improved efficiencies in the upgrade and maintenance of future releases.

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- > **Central management of services**—The SaaS applications are hosted, managed, and maintained in a centralized data center enabling a reduction in overall support and maintenance costs. From this data center (hosted themselves or outsourced), the SaaS provider offers access to its applications/services via the Internet and a Web-based interface. A SaaS provider then has the opportunity to become a service aggregator, potentially partnering with other vendors and suppliers to deliver a standard offering that is customized through the dynamic integration and secure access to, and provisioning of, multiple software-powered services.
 - > **Offer a one-to-many service**—In order to accomplish the “economies of scale” associated with SaaS, the providers develop a multi-tenant application that supports multiple end-users accessing a single source of the application business logic and database. This process may be an evolutionary one by traditional ISVs or may be one that is developed right from the start by net-native SaaS providers. Although appearing customized from the end-user's perspective, no customization of the application's core logic occurs.
 - > **Guaranteed performance and reliability via service level agreements**—End-users or customers expect the Service Provider to deliver contracted services with a guarantee that certain metrics are met, such as accessibility, reliability, and overall throughput or performance. This is usually established through a robust data center infrastructure that is backed with an uptime guarantee via a Service Level Agreement (SLA).

1.2 MISUNDERSTOOD CONCEPTS OF SOFTWARE AS A SERVICE

It is important right from the start to understand that pricing a SaaS offering has little relation to current product-based pricing models. If you desire to build an increasing, recurring revenue stream; to generate more revenue over time than possible in your product-based sales efforts; intend on dominating your particular vertical market space; or if you desire your company to be valued at an attractive price/earnings ratio, then this is the right model for you. Before going much further, it is helpful to address some commonly misunderstood concepts regarding delivery of SaaS:

SaaS will save my customers money over time.

False. Properly priced and delivered, SaaS will not “save” any money; rather, it will allow your customer the flexibility to take advantage of a variable IT spend, based on both the functionality of your software and the metric to which you attach your software's value.

I will “make less” than I would have if I sold my product “normally.”

False. SaaS is the greatest “pull” sales model ever discovered; it is almost always a result of customer (end user or market) demand. Put another way, in almost all cases a SaaS “sale” is made because it was impossible to consummate the deal in any other manner (e.g., SaaS deals are deals that you would not otherwise have made).

My company will be more “at risk” if I deliver SaaS.

False. SaaS needs to be viewed as a risk-sharing model, locking in the value up and down the value chain, with clearly defined and understood pricing metrics for the use of your solution. If you have correctly aligned the metric and metric costs associated with the delivery of SaaS, it becomes impossible for any participant in the value chain to argue with the value.

Can I replace my current product-based revenue stream if I offer SaaS?

Yes. Over Time. Correctly priced SaaS, over time, will overtake your product-based revenue run rate. You will run aground if you price on a “divide by 36” method; instead, if you have correctly aligned your pricing metrics and metric costs with your target market, not only will you replace sporadic “chunks” of revenue from product sales with regular and growing recurring revenues, but you will enter each new accounting period (month, quarter, year, ...) with the majority of your revenue target in place.



1.3 MARKET LANDSCAPE

There are a number of different classes of companies that are adding the Software as a Service capability to their traditional offerings and operations. These companies comprise virtually every segment of IT providers, including Independent Software Vendors, Business Process Outsourcers and Systems Integrators, as well as the traditional Infrastructure Service Providers.

Traditional ISVs

Many ISVs may question the business sense of establishing a SaaS Provider model alongside their traditional product sales model. ISVs need to look at this model as a business and revenue expansion opportunity—a means to generate incremental business. It is a chance to reach new geographic markets and new segments of existing markets. Experienced Progress Application Partners (APs) have shown that by offering Software as a Service on an appropriate recurring metric with an appropriate metric cost, a typical end-user service customer will generate between two and three times more revenue within a three-year period in comparison to the traditional product licensing customer.

Industry experts and our own APs' experiences have shown that Software as a Service and traditional licensing models can co-exist without market cannibalization. Because the potential of the Service Provider market is so vast, and because the majority of prospects are customers that could not otherwise afford to purchase these applications, adding the SaaS model to the AP's roster of services will generate additional revenue, not cannibalize existing revenue.

Business Process Outsourcers (BPOs) or Business Service Providers (BSPs)

Business Service Providers are organizations that provide all forms of business applications and desired services over the Internet. They break down into two major categories:

- 1) Vendors who designed their application from the start as services (net-native SaaS providers) and have begun to aggregate service offerings in addition to their existing business applications based on a common platform. (e.g. Salesforce.com)
- 2) Vendors and/or Service Providers that have domain expertise in a business process area and provide not only the software-powered services, but also add the end-to-end responsibility for a specific business process either by executing the process itself, or providing business and technology expertise as part of their service offering. The best example for this is outsourced payroll processing and services. (e.g. ADP)

BPO has been going on for years and will continue to grow even more, based on the new model of SaaS. The advantage of BPO is that users are engaging a 3rd party with specific expertise to provide a service where you have no expertise, and is not a core competence for the organization, yet it is a business requirement.

SaaS providers will begin to appear from many different IT categories, but the key tenants will be Domain Expertise, Service Delivery Capabilities, and Quicker “Time to Value.”

1.4 SOFTWARE AS A SERVICE—BUYING HABITS

Small- to Medium-Sized Businesses

Many industry analysts believe that the Software as a Service model ultimately makes the most sense for the small to medium enterprise (SME). These enterprises are faced with many business challenges that make them ideal candidates to capitalize on this business model.

The foremost market force affecting the success of these companies is speed. The ability to capture market share quickly is critical—as is the ability to quickly put in place an infrastructure to support rapid growth. Because the initial investment required by the customer is minimal and the time to bring an application live is extremely rapid, the potential of the SME market for SaaS is vast.

Since SaaS is a subscription-based model, the customer need not come up with the substantial investment necessary for all the hardware, operating systems, databases, licenses, IT staff, and ongoing overhead. SMEs typically do not have the luxury of IT support. And by outsourcing a much-needed application to a SaaS provider, small to medium businesses can focus on their core business rather than divert funds and other resources to support advanced applications.

In addition, the SME market already relies significantly on outsourcing. A number of offerings to this market have recently emerged that are today successfully charging a monthly fee per desktop and remotely administering their customers' entire business applications and network. As a SaaS provider, the AP can bridge the gap between these organizations and high-performance business applications by offering a solution that is easily within reach.

Applications and Other Areas of Interest

Organizations of all sizes are looking at the potential benefits of moving to SaaS. In a recent study by AMR Research, the survey found that:

- > 61% of firms will likely support SaaS for one or more of their ERP business processes by year-end 2007
- > 52% of firms will likely support SaaS for one or more of their Supply Chain Management business processes by year-end 2007
- > 56% of firms will likely support SaaS for one or more of their CRM business processes by year-end 2007
- > 49% of firms will likely support SaaS for one or more of their Human Capital Management business processes by year-end 2007

There does not appear to be a significant level of prioritization taking place regarding which applications will or will not be considered for SaaS implementations. CRM is currently the most popular business process, most likely due to the number of offerings available and the distributed nature of the application, but others are not far behind.

Benefits of the SaaS Model

In the same AMR Research study, the buyers stated that they expect their SaaS implementations to drive the following tangible benefits:

- > 35% increase in users
- > 27% improvement in employee productivity
- > 26% decline in initial/start-up costs
- > 24% cut in 3 year TCO
- > 23% increase in ROI
- > 16 month decline in time to value
- > 15 month decline in implementation

The research identified five core decision influencers—Value Drivers—that buyers rely on to evaluate and ultimately select SaaS solutions:

- > *Customer Intimacy*—Vertical market knowledge and business process expertise
- > *Economic Impact*—The ability of the solution to tangibly reduce costs, increase productivity, compress time to value
- > *Risk/Resource Management*—The ability of the SaaS solution to work within and leverage existing technology and personnel assets and not require wholesale abandonment of resources considered valuable to the buying organization
- > *Technical Proficiency*—Critical features, functions, and solution capabilities
- > *Credible Mass*—The SaaS solution provider has the size, share, and financial resources to deliver on buyer needs

Source: AMR Research

2.0 DELIVERING SOFTWARE AS A SERVICE—BUSINESS ISSUES

The Growth of Software as a Service

According to IDC, the worldwide market for Software as a Service (SaaS) is healthy and growing stronger every day. IDC's *Worldwide and U.S. Software as a Service Forecast and Analysis, 2005-2009: Adoption for the Alternative Delivery Model Continues* paints a positive picture for the growth of SaaS. In this report, IDC analyzes the key supplier trends and events impacting SaaS.

Worldwide spending on SaaS reached \$2.4 billion in 2004, an increase of 39% over 2003, according to IDC. IDC predicts spending in this area to grow at a 21% (CAGR) and reach \$10.7 billion in 2009. IDC believes that the adoption of SaaS will be driven by customers' need to improve business processes, an increased understanding of and interest in the SaaS delivery model, growth in the number of SaaS offerings, and the creation of enablement programs to help ISVs take advantage of the SaaS model.

Progress wants to support our APs in the area of enablement by "Empowering Software as a Service" for Progress-based applications. Progress recognized very early on the value and power of the SaaS business model and created what is now one of industry's longest-running SaaS programs for APs (formerly known as ASPen).

This increase in demand for management and provisioning of software-powered services is twofold: the demand for low-cost, quickly implemented services has increased, and vendors' offerings have matured. While customers are struggling to cut software costs and management complexity, software suppliers are eager to increase overall product and services revenues and develop long-term income streams that are more predictable than the perpetual license fee.

Given the growth and resiliency of this market, all types of IT vendors are seeking to seize the opportunity, including APs, whose specialized and/or vertical domain expertise equip them to readily transition to the SaaS model.

2.1 MECHANICS OF PRICING

Pricing of SaaS requires that you carefully select a “metric” and a “metric cost,” as well as a “period” to come up with a subscription pricing model. The combination of “metric” and “metric cost” over a given time period results in the pricing for a SaaS offering.

The goal of subscription pricing is to enable the end user to reap maximum value from the application. There are several aspects to this model. First, the end user pays a monthly fee to have basic service available independent of the amount of use, and commits to at least 24 to 36 months at this minimum level. This basic service would provide a base level set of functions required by the application, with the ability to add on additional services as desired, for a fee.

Metric, Metric Cost, and Period Definitions

Metric

> A unit of measure by which value is delivered from your application service, to your end user customer. It is imperative to choose the metric wisely, paying particular attention to such factors as commonly understood business or deliverable metrics in your target industry, on what basis your customers (the end users) charge their customers, a scalable metric that directly correlates value derived from your application to the success that users of your application exhibit. There is no one “universal” or “correct” metric that can be applied to all situations in all geographies; hence the freedom of choice can be rather too much of a good thing.

Metric Cost

> A per unit cost, which together with the metric will result in your recurring revenue stream. As with the choice of an appropriate metric, careful study and modeling of the metric cost as it scales up—or down—based upon your customer's use of your application should result in a commercially acceptable price point. In some cases, it may be beneficial to introduce the concept of a step-function pricing scheme; however, our advice is to use this only in competitive or difficult situations.

Period

> A unit of time over which the aggregate total of metric times metric cost is calculated. This will typically be monthly, although we have seen variants ranging from daily to quarterly and beyond. It is very important that you tie this concept into your license agreements.

Metric Unit Value Definition

The choice of metric unit value must align with the “value” your SaaS customers see in your offering. Choose a unit value that “makes sense” to your customers and the industry in which they operate.

Metric Indication/Comments

Per User

- > Usually applies where the SaaS offering delivers >80-90% of the functionality for a given user, and for applications that have a notion of an easily defined “user”. Complications arise from such notions as a “casual” user or a “power” user. Note that most SaaS offerings using a per-user metric are self-limiting in terms of revenue growth alignment with your SaaS customers (e.g., your SaaS offering may be so good that your customers experience tremendous growth, while you are constrained to a relatively small number of users and revenues).

Per Transaction

- > A per unit cost, which together with the metric, will result in your recurring revenue stream. As with the choice of an appropriate metric, careful study and modeling of the metric cost as it scales up—or down—based upon your customer’s use of your application should result in a commercially acceptable price point. In some cases, it may be beneficial to introduce the concept of a step-function pricing scheme; however, our advice is to use this only in competitive or difficult situations.

Hourly (or Time Based)

- > Metrics of this type offer an “all you can eat” pricing model for service consumption. This usually applies where the service provider is addressing complex labor-intensive markets with some inherent volatility (such as CAD/CAM or financial modeling).



2.2 THE OPERATIONAL CHALLENGES

There are a number of important issues to address to create a smooth and scalable billing process. This section discusses a few of these issues, including itemizing, metering, and prorating of bills, as well as provisioning challenges.

Itemizing Usage

With SaaS offerings priced along many different dimensions, it will be necessary at some stage to agree on the format and construction of detailed, itemized bills. In particular, it will be necessary to produce reports that identify the number of each metric for a given month, along with any status modifiers (e.g., for users: standard, casual, hourly), the number of metrics consumed (usage), and should provide some method of prorating, if a customer or transaction started (or terminated) during the period in question. Some SaaS providers send these reports every period with the corresponding bills; others create them only when necessary; but all of them need reports.

Metering/Billing

Although metering of service usage may not be technically difficult, it is difficult to integrate this information into administrative systems that can automatically feed a bill production process. Experienced SaaS providers recognize this as crucial to their scalability and profitability.

Provisioning

To set up a new service, the SaaS provider must create an authentication and authorization method and record for each service user, identify which service is accessible, specify the metric and metric costs to be assessed for service usage, provision resources (both hardware and software) with appropriate permissions, and create electronic information that can be fed into a billing system. In order to have a scalable service provision solution, there must exist an easy-to-use tool for the first three functions that ties into a system that automatically perform the last two functions.

Software is available to perform all of the above functions. Progress has partner recommendations for our APs, if you are interested in outsourcing/partnering with another service provider to perform any of these functions.

2.3 SALES COMPENSATION MODELS

The SaaS provider model also presents new challenges in sales compensation. In some ways, a good industry to model from for SaaS compensation may come from the insurance industry, where local agents and reps have long been paid on an annuity basis. They often get a big check when a policy is first signed, but they get regular smaller checks as premiums are paid. They soon learn that getting big policies are nice—but you get rich having a large and diverse book of business where you get lots and lots of little checks from lots and lots of clients.

Most organizations may need one plan for acquiring new customers, another to grow revenue, and another to retain customers. To achieve these goals, many SaaS providers employ one or more of the following compensation models:

- > **Quarter-to-Quarter Revenue Growth**—This model focuses on growing revenue and will encourage the sales force to not only bring in new customers, but also get more revenue from existing customers. This model compensates the sales force in one quarter (or month) with a percentage of the increase in revenue relative to the previous quarter (or month). Quarter to quarter declines should not penalize the sales staff; rather they should reset the bar but result in a lower or no commission payable for that period.
- > **One-Time Participation**—This model targets customer acquisition, and is designed to drive net new seats from month-to-month by compensating salespeople with a large share of the per-seat, setup charge.
- > **Life Participation**—This model is designed to retain seats by compensating salespeople for ensuring that they will continue to stay and produce revenue. New seat sales may decline as salespeople grow and stabilize income.
- > **Declining Participation**—This model is designed to both retain seats and generate new seats, by using a diminishing sliding scale to compensate salespeople with shares of both setup fees and ongoing usage. The downside of this model is that it is a complicated model and can lead to increasing administrative overhead.

2.4 PROGRESS SERVICE PROVIDER LICENSE AGREEMENT (SPLA)

The current Progress Software Partner License Agreement does not allow an AP to provide software-powered services to unrelated third parties. Under the SaaS business model, a new license agreement is required. The Service Provider License Agreement (SPLA) should be used for all customers interested in the delivery of Software as a Service.

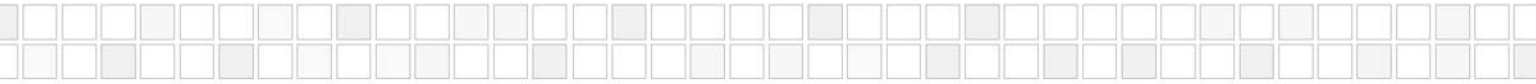
The Service Provider License Agreement specifies the terms and conditions governing the marketing, hosting and service delivery of Progress-based applications. Since the term “subscription service” model involves the use of the Progress products to operate the application, then the Service Provider will need to execute an SPLA with appropriate terms.

For more information or a copy of the agreement please contact your Account Representative.

3.0 APPENDIX: SELLING POINTS FOR SOFTWARE AS A SERVICE

Because of the value proposition of Software as a Service, the provider can offer an extremely attractive alternative. The benefits of the model include:

- > **Faster deployment:** The application can go live in 60 days instead of 9 to 18 months.
- > **Dramatically reduced capital cost:** Most infrastructure cost is included in the service fee.
- > **Predictable implementation/support costs:** Since the monthly fee is all-inclusive, chances of cost overruns are minimized.
- > **Improved support/increased productivity:** End user companies have a single point of contact from an AP who understands their business processes.
- > **Reduced costs/upgrade issues:** The SaaS provider handles most software and hardware upgrades required over time.
- > **Scalability:** Increasing customer demands for more computing power are easily met because applications running over the Web are likely to be more scalable than client server applications.
- > **Resource Management:** IT resources can now be focused on supporting and enhancing the organization's core business competencies.
- > **Risk Management:** When applications are purchased significant management bandwidth is consumed in managing and monitoring the lengthy implementation. SaaS will reduce this demand significantly by off-loading the tactical issues, thus reducing risk.
- > **Customer Intimacy:** Because of vertical and domain expertise, there is more of a focus on automating business processes, and less on implementing applications, resulting in a true business partnership.
- > **Vehicle for opening a broad range of non-traditional distribution channels:** Resulting in new business opportunities and more options for new revenue streams and pricing flexibility.
- > **Opportunity to build a recurring, annuity-based revenue model:** Financially, in the long run this is a more predictable and stable revenue model.





Worldwide Headquarters

Progress Software Corporation, 14 Oak Park, Bedford, MA 01730 USA
Tel: +1 781 280-4000 Fax: +1 781 280-4095
www.progress.com

For regional international office locations and contact information, please refer to
www.progress.com/worldwide

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