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Cloud Computing and SaaS: A Practical Guide for Financial Professionals

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Ernie Humphrey
Proformative
EHumphrey@proformative.com
Company Fax: (408) 624-9500
Phone (408) 400-3993 ext, 107

"I have no idea what anyone is talking about," said Oracle Corp. Chief Executive Larry Ellison, when talking about Cloud computing at a financial analyst conference in September (2008). "What is it?"

Cloud Computing and SaaS: *What Every Finance Professional Needs to Know* Ernie Humphrey & John Kogan

CFOs, Controllers, and Treasurers around the country are watching with great interest as a major business transformation takes place. A makeover that is no less than a complete change in the economic and deployment models for corporate IT and for finance and accounting applications. A new opportunity has emerged for many firms to access the technology they need to compete and succeed when meaningful capital expenditure is either not an option or simply not desired. Cloud Computing and Software as a Service (SaaS) are re-defining the business landscape, and they're about to change the very manner in which many firms operate.

In the face of a prolonged global recessionary environment - or perhaps because of it, the adoption of this new technology is accelerating. According to IT

research and advisory company Gartner, Inc., global Cloud services revenue will reach \$68 billion in 2010, a 16-plus percent increase from 2009. Worldwide revenue for SaaS delivery, meanwhile, grew to over \$7.5 billion dollars in 2009, an 18 percent jump from the previous year. And there's every reason to think these growth rates will accelerate going forward.

Major technology players like Oracle, SAP, Microsoft, and Intuit are also watching this transformation with great interest. These firms are concerned with what could virtually turn their worlds—and their revenue models—upside down. So what's driving this tremendous change? Will these conditions persist? What do we know and not know about Cloud Computing and SaaS at this stage of the game? What issues currently frame the debate around the adoption of these technologies? There are many questions, to be sure, but one thing is fairly certain: companies will be built and destroyed with this revolution, and the winners will be the professionals who understand and, where appropriate, embrace these new technologies.

Cloud Computing, An Overview

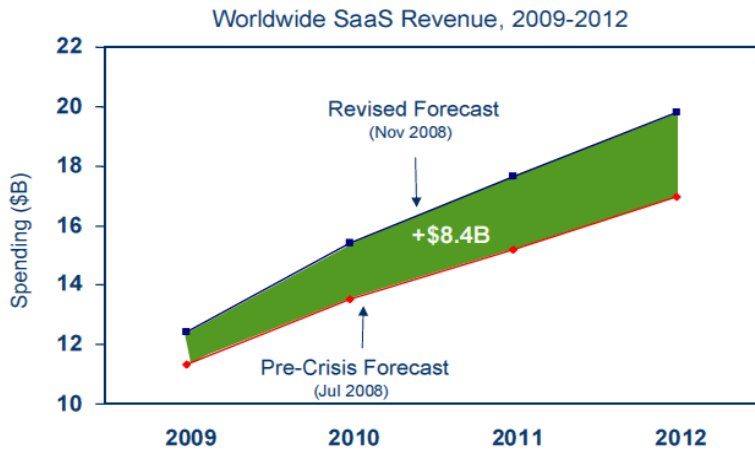
Cloud Computing is, in essence, taking a company's server infrastructure, the kind usually found resident in a closet or dedicated room or entire building, and moving it. Moving it off the premise, off the balance sheet, and on to someone else's site and books to be configured, built, and managed. And, finally, rented back to the company and accessed via the Internet.

A useful analogue is to the utility model of electricity generation. In the early years of the industrial revolution, companies built their own power plants for their own corporate campuses. Not surprisingly, companies realized over time that it was far cheaper and easier to buy power from the growing and stable local utility than produce their own. The utility, which assumed the capital

Worldwide Software Revenue for SaaS

Enterprise SaaS Categories	2009	Mkt %	2008	Growth
Content, Communications and Collaboration (CCC)	2,573	34.2%	2,143	20.1%
Customer Relationship Management (CRM)	2,281	30.3%	1,872	21.8%
Enterprise Resource Planning (ERP)	1,239	16.5%	1,176	5.4%
Supply Chain Management (SCM)	826	11.0%	710	16.3%
Other Application Software	472	6.3%	387	22.0%
Office Suites	68	0.9%	56	21.4%
Digital Content Creation (DCC)	62	0.8%	44	40.9%
Total Enterprise Software	7,521	100.0%	6,388	17.7%

Source: Gartner (November 2009)



costs and provided ongoing management at massive scale, simply “rented” power back to the company. Cloud Computing offers the same kind of arrangement: Need more server power? Simply order more from your provider, instantly. No need to buy more servers and add IT folks, just click a mouse and get what you need.

So what does Cloud Computing mean in terms that a CFO can appreciate? Simple: No more buying servers. Servers that will probably not ever be fully utilized.

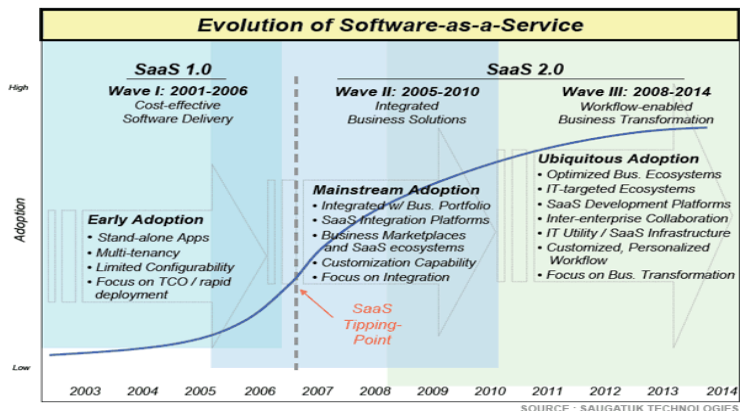
Servers that start losing value as soon as they’re delivered.. Servers that require switches and routers, backup power, redundant bandwidth, and expensive HVAC systems. Servers that need company IT staff specifically dedicated to their maintenance and special rooms in which to be housed. The economic cost of a server is not just the cost of the hardware, but the full cost of everything that must go with it - usually many times the simple up-front CAPEX.

With Cloud Computing, servers become someone else’s responsibility. They buy it, and you rent it. You rent it by the megahertz, gigabyte, or bits per second. Similarly, you don’t have to staff your server room with the proverbial “IT server guys” because you no longer need them. Cloud service providers hire them and you rent their services. And because everything is done in volume, and by people who do this and only this for a living, you can reap great economies of scale and reduce capital expenditures and IT operating costs while improving performance.

Software as a Service, An Overview

SaaS, meanwhile, is essentially taking existing server-based, CD-based accounting and finance software (or any other application software) like Quickbooks, Oracle, SAP, or Hyperion, and tailoring access to be available over the Internet. Once done, it can be placed on someone else’s server infrastructure in the Cloud, where it can be rented on a periodic basis. If 50 people need to use the accounting system, then 50 seats are rented. If the need grows to 500 users, or shrinks to five, the number of seats rented grows and shrinks accordingly, and so do costs. For the user, this transition means no more up-front licensing or server infrastructure costs and can mean far lower customization and integration expense since true SaaS systems are designed from the ground up to be Web-based and user-configured and customized.

Like Cloud Computing, SaaS can trim the number of IT professionals on staff. This is a tremendous shift given how much of IT spending comes in the form of administration and support—Gartner estimates the percentage to be upward 60 percent of all IT spend. To put that in perspective, if a firm’s IT costs are \$5 million per year, \$3 million of that goes to “just keeping the lights on”. Adopting SaaS-based applications moves expenses typically associated with

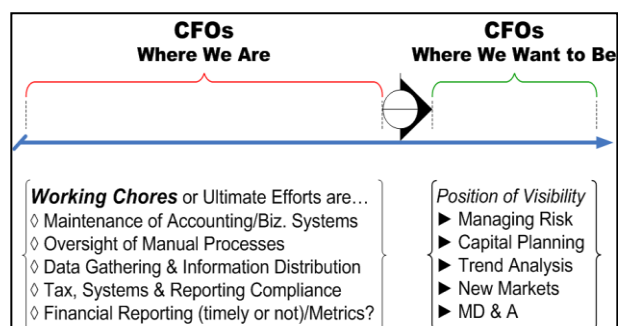


technology adoption from the capital expenditures line over to operationing expenditures. Adopting SaaS-based applications affords a company the opportunity to avoid both CAPEX and OPEX costs associated with traditional applications even as it gains direct access world-class business applications and IT expertise.

The stage is set for continued rapid growth in the area of Cloud Computing and the adoption of SaaS-based applications. In all likelihood, the drivers of this growth will not change over the next few years as the economics of a scaling industry become even more compelling.

What are Executives Thinking?

So why isn't every company moving to the Cloud and adopting SaaS-based applications? Economics aside, these technologies are simply not for everyone. Cloud Computing and SaaS are both relatively new business models and they are by no means void of risk. Now, more than ever, senior executives have a keen focus on risk as well as reward. And at this hour, there's still much these corporate leaders don't know.



To gain a better understanding of just what CFOs, Controllers, and Treasurers are thinking—or not thinking—about the Cloud, Proformative recently conducted a survey of thousands of these professionals across the country. 80% of the respondents were director level or above. And most, not too surprisingly, came from companies that would be described as small- or mid-sized were the potential windfalls of moving to the Cloud and adopting SaaS-based applications are, on the surface, more compelling. Here's what the survey found regarding executives and the Cloud:

- ✚ 55% agreed that Cloud technology will be very important to their companies
- ✚ 32% recognize they need to be educated about the Cloud
- ✚ 61% had only a basic knowledge of Cloud Computing and SaaS
- ✚ 14% reported no knowledge of the Cloud and SaaS
- ✚ 75% recognized that SaaS and Cloud Computing could reduce their company's IT CapEx
- ✚ 65% of respondents recognized that SaaS based applications could reduce operating risk

While these technologies are in the early stages of adoption, Cloud Computing and SaaS are clearly emerging as 'front of mind' for many of these executives. The survey also bore out the reality that some executives perceive these concepts less favorably than others, and for a number of valid reasons.

Cloud Risk

It's been said that in a CFO's world, great economics get you promoted, but inadequate attention to risk can get you fired. Unsurprisingly, this equation gives pause to finance and accounting professionals who as a group, tend to resist new technology until it is well proven. According to Proformative's research, the main objections offered by financial executives reluctant to 'enter the Cloud' include:

- **Loss Of Data Security In A Cloud Environment**

Concerns around data security in moving to the Cloud are certainly valid on many levels, and 67% of respondents to the Proformative survey cited it as a potentially major risk. Often times, however, those raising the objections fail to compare the security of their own on-premise data versus

Cloud-based data management. For most firms, the internal IT department will have less expertise in securing data than an outsourcer with teams of security specialists focused on data storage and security. In all but the largest companies, IT personnel also have much more on their plate than data security. Before dismissing the Cloud and SaaS-based applications on the basis of data security, a valid comparison should be done between one's existing data security and those firms offering applications in the Cloud. Many IT departments compare outside providers against an imaginary "ideal", not against what actually exists in their own company. This should be recognized and moved past by savvy IT consumers as simply a Not Invented Here (NIH) syndrome that will hold your company back.

- **Difficult To Integrate Within An Existing IT Structure**

Lack of integration with existing systems was cited by 70 percent of survey respondents as a major risk for 'going' SaaS. But integrating data across applications and various sources presents an ongoing issue for any company. In some cases moving to SaaS-based or other Cloud-based applications can actually *assist* a company in improving communication between systems. Often, the transition gets firms away from "version lock" that inhibits the correlation between technology and what is needed to support and drive business growth. A Cloud environment tends to facilitate "one version of the truth" in terms of important data that is passed between many systems by providing a single core database that is accessed by all other systems in real time.

- **Loss Of Data Ownership and Provider "Divorce"**

Data ownership and partner divorce are absolutely key considerations when moving into the Cloud. Both issues are best addressed explicitly in your legal agreement and service level agreement (SLA) with firms offering cloud-based services and applications. At the very least, the SLA should include specific provisions of data ownership, intellectual property rights around data, scope of software license (term versus perpetual), impact of mergers and acquisitions, vendor indemnification for IP claims based on technology or content provided by vendor, right of contract termination, transition of customer operations to alternative solutions, transition of data and back-ups, cancellation fees, and migration time and costs. In essence, the legal agreement and SLA form a 'pre-nuptial' agreement with a provider to protect the value and integrity of data in the event of a break up.

Cloud Rewards

For some, the transition to the Cloud brings enough promise to jump in with both feet. Indeed, 65 percent of survey respondents recognized that SaaS could reduce their company's operating risk.

According to our research, the primary reasons many CFOs have adopted and embraced the Cloud and SaaS-based applications include:

- **Reduced Upfront Cost To Purchase Hardware, Support, And Software**

The upfront cost savings in choosing a SaaS based versus a conventional application can be substantial. In many cases this savings can run into the millions and be a large percentage of all dollars spent on adopting technology.

- **Pricing Flexibility Based On Needs**

If nothing else, the last three years has taught business professionals that the paradigm of the global economy can change in a matter of weeks and that the ability to effectively react to and embrace

change can determine the success and long-term viability of a company. Access to best-in-class technology that allows a company to “pay as it goes” and only incur expenses as it utilizes resources is very compelling in any economic environment. Moving to a SaaS-based application in the Cloud can often afford firms this opportunity. Pricing structures and terms need skillful negotiation, but having the flexibility to utilize and directly measure the ROI of IT resource consumption should be compelling to any CFO.

- **Opportunity For Collaboration**

A significant barrier to any initiative that goes across departments or borders is effective collaboration. A full 71 percent of respondents to the Proformative survey that have entered the Cloud report increased collaboration and greater confidence in their systems. The ability to share accurate information and collaborate in real time facilitates effective collaboration. The inability to communicate, collaborate and make decisions in a time sensitive manner kills many strategic initiatives that look brilliant on paper.

- **Top Line Revenue Growth Through Efficiencies**

Cloud-based applications can significantly reduce the hours financial and accounting professionals spend on IT-related issues like software upgrades, cumbersome security administration, software training, software downtime, etc. As a result, these professionals are able to focus more time on what makes them most valuable to their companies: driving efficiencies and top-line revenue growth. Of companies operating in the cloud, 69percent reported higher ROI as one of the greatest benefits realized of cloud computing and SaaS. In and of itself, this makes the idea of Cloud computing compelling to professionals up and down the corporate ladder.



Emerging Realities

All together, it is fair to say that in general small and mid-sized companies are adopting the new technology fairly quickly and big companies are staying on the sidelines, apparently waiting for some of the dust to clear. As Cloud Computing and SaaS continue to prove themselves, they will surely make their way to even the biggest companies, some of which are already adopting these technologies on a divisional or Business Unit level to try them out.

In the meantime, we are all still learning about the Cloud and SaaS. Is the security better than a small company could afford? Sure. But is it better than a big company’s infrastructure? No one knows that yet and, as they say, “your mileage may vary”. There are myriad questions, to be sure, and plenty of unknowns. But, thanks mostly to companies that have fully embraced the Cloud and SaaS, there are a good number of things we do know, including:

1. Data security concerns need to be examined by comparing “apples to apples”. In other words, how does data security at your firm compare to the security offered at a firm offering Cloud-based applications.

2. Establishing data ownership should be standard practice in an SLA with any provider of Cloud-based services. Agreeable separation terms from a provider of Cloud based services are evolving into a standard set of conditions.
3. The gap between the functionality of SaaS based and non-SaaS based applications is narrowing greatly from the gap that existed only 12 months ago.
4. IT departments will not disappear in the wake of Cloud computing-based applications, but they will need to redefine their value proposition to an organization. It will become more about managing services and vendor relationships than the maintenance and management of hardware and software systems.

It is still relatively early in the game, but clearly a good body of knowledge is beginning to take shape out of the collective experience of the first movers. Indeed, based on our conversations with financial executives from many of these firms, a number of best practices have already emerged for the benefit of any company or executive considering the Cloud or implementing SaaS-based applications. Specifically, the executives we talked to suggest that companies:

1. Need to fully understand their current and future business needs, and that an application directly addresses those needs. This is true of both “traditional” and Cloud or SaaS solutions.
2. Consider the due diligence in choosing the provider of a SaaS-based application just as (if not more) important as when looking at other potential business partners.
3. Try an application before buying it.
4. Create metrics to measure the success of the application.
5. Devote the resources necessary for a successful implementation even if it means outside consultants.

Success stories about effective leveraging of this new technology all start with the same words of caution: Cloud computing and SaaS-based applications are not magic and nothing replaces good business processes. A clear understanding of current and future business needs, the ability to effectively communicate these needs, and a diligent vendor selection process are all prerequisites to realizing the potentially compelling benefits associated with this technology. Inadequate attention to any one of these fundamentals could easily derail a project involving Cloud-based applications and technology.

What Moving To The Cloud And Saas-Based Applications **Can** Do:

1. Offer opportunities for increased collaboration
2. Offer one version of the truth in terms of critical data used in accounting and analysis
3. Offer price flexibility that allows IT costs to more closely correlate with business expansion and contraction
4. Offer a shift in costs from up-front Capital Expense to ongoing Operating Expense

What Moving To The Cloud And Saas-Based Applications **Cannot** Do:

1. Remove the need for good business processes and practices
2. Remove the need for comprehensive due diligence when selecting a technology provider
3. Remove the need for diligent implementation plans and related expenses

4. Remove the need for all internal IT staff
5. Remove the need to stay focused on data security and related risk management issues

Summary

In the end, Cloud Computing and SaaS-based applications will transform the way that companies consume IT services and business applications. This technology is coming, and CFOs and IT leaders will be challenged to explain their position in the next few years if not sooner. Entering the Cloud and implementing SaaS-based applications won't be for every company, of course, but every company needs to take the time do the investigation.

CFOs need to be ready when their CEO or a board member asks, "So, what's our strategy on Cloud Computing and SaaS?" One way or the other, somebody better have an answer.