

Nonprofit Software Focus: Total Cost of Ownership

Understanding long-term and hidden costs in software deals

This paper serves as a guideline for nonprofit boards of directors and software purchase decision-makers who are budgeting for new software systems. Your organization's budget should take into account the initial software purchase, along with hidden costs the new software may present over time. This type of analysis is called the “total cost of ownership” (TCO). While there are many standard ongoing charges for software, certain decisions can leave nonprofits facing high ongoing costs that they did not anticipate when initially choosing a software package. This guide introduces software purchasers to the possible hidden or long-term costs to look for prior to purchase, during the vendor/product review process.

HOW MUCH IS IT?

Nonprofit boards and organizations are under tight constraints to manage budgets and make every dollar count. There are few purchases with as many associated costs as software, and it can be difficult to correct a bad software fit after an organization’s vital data has been integrated into the system. So nonprofit professionals must take a close look at the associated costs of new software — especially recurring costs that can crop up after continued use of a the system.

PRICE VERSUS COST

The price of software is often presented, and 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 costs are one-time charges during installation, such as data conversion costs or consulting fees, and others are ongoing costs that an organization pays annually for each year of use. License costs typically represent only one-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 nonprofits look for and consider when comparing vendors and examining a new system, to ensure they are getting a true picture of costs over time? There are several areas where purchasers must pay close attention to ensure they are making “apples to apples” system cost comparisons and receiving accurate long-term-cost information.

INCLUDED, OR ADDED ON?

Software often comes in a module format. That is, a core system is sold with additional functionality available for 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”. On the other hand, modules can increase the cost of a system that initially looked less expensive when you were quoted a basic system price. Ultimately it depends on whether the system is valuable to your organization without the extra-cost modules.

The key to keeping software value up and the 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 daily 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, likely will be ignored in favor of basic features that are needed daily. As your team or programs grow, you can opt to add 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 which 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, which could 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 may be a disparity in what you see in a demo, versus what you are actually getting for your quoted price. Be sure that the demonstration you see is based on the same module set, features, and price for which you are being quoted.

YEAR AFTER YEAR: MAINTENANCE AND SUPPORT

Technology marches forward, changing constantly. Software companies must update their software to accommodate these changes, including adapting to 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, they issue maintenance releases to their existing customers to keep the software and customers current with changing

technology standards and needs. Often these costs are rolled into a technical support plan, whose 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: What percentage of your Licensing fees 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 percent 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, because you pay every year to have them. Often, nonprofits are told that full feature sets mean you have room to grow. **But it's better to pay for only 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? Beware — it may not be. It's common 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, after the initial "savings," thousands of dollars over the course of a few years. How does this happen? The key lies in maintenance and support costs, which are typically a percentage of the software license price. The percentage-pricing structure makes it imperative to know the exact price that the annual maintenance and support fees are based on. Often in these "fire-

sale” situations, annual fees are not based on the lowered sales price, but the higher original “sticker” price of the software — which can be substantially higher. At 10 to 22 percent 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 \$5,000. But at 25 percent annually, on the original price of \$10,000, the organization will pay that “saved” \$5,000 in just two years — and will continue to pay the 25 percent fee on the original price each year after that. One way to avoid this situation is to directly ask the vendor about the percent of annual support and the number it is based on.

TRAINING: HOW MUCH DO YOU NEED, AND HOW MUCH SHOULD IT COST?

New software training can be a substantial expense for nonprofits. Appropriate staff must each be trained on the new software. In addition, the costs for future training must be considered, as there will likely be some staff turnover. Often, software vendors rely on this factor to drive their own revenue.

Training costs per vendor can vary, from less than \$1,000 to more than \$5,000 for a week of training, per new user. This amount can represent 10 to 15 percent of a nonprofit employee's salary, and a significant added cost to the total adoption cost, as well as a recurring cost to meet staff turnover — so it is an important 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 other staff, as well as daily users? Is the training available locally, or only in a single location, which could incur additional travel costs?

TIME = MONEY: THE VALUE OF EASY DAILY USE

The complexity of a software solution will impact cost over time in hard and soft dollars. For example, complex software may incur more training costs for supplemental training, and have a longer time-to-productivity ratio, as staff overcomes a more difficult learning curve before the system is maximized. 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, drag-and-drop querying or reporting tools can help staff spend more time on their critical tasks and less time on administration or wrestling with the system's more complex features. More complex software will likely result in the need for increased 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 employees who will use it every day. Are there timesaving features, tools or shortcuts already built in? Determine the processes that are critical to your organization — whether it is setting up donor profiles, managing grants, or running a report. Make sure those activities most critical to your success are easy to carry out 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 needed 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 a vendor specific questions regarding the range of consultants available for help, their costs, and the level of customization that your organization will need. You may want to ask other similar nonprofit organizations what their system customization costs were, to gain a better idea of what you can expect before committing to a purchase. One of the largest expenses we have found for new users of Fund Accounting software is the transition of their Chart of Accounts. For customers who were previously using Quickbooks®, you will want to ensure your consulting services include assistance with this transition.

CONCLUSION: LOWER YOUR RISKS

Nonprofit organizations vary in size, budget and program needs, which means that different systems and support services are better fits for different organizations. No matter the end costs, as a steward of the nonprofit, you need to make sure your organization is met with the lowest possible financial risk, and is as informed as possible about the true costs of a given software package. Always ask about return policies and service guarantees, and don't hesitate to inquire about costs up front. Be sure to ask for specific prices in each of these key areas:

- 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 (or affordable) in the demo. Be sure you have an accurate 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.

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