Is SaaS or On-Premises Cheaper for Manufacturers?

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Some companies in the manufacturing industry have the perception that SaaS is cheaper than on-premises deployments, while others have the opposite perception. There is no uniform answer, so CIOs and IT leaders should guide financial executives with this four-step process to make the right decision.

Quick Answer

What facts can be used to determine the comparative cost of SaaS and on-premises solutions?

- Conduct an analysis of the total cost of ownership (TCO) over the intended lifetime of the software in question.
- Do not ignore the hidden costs often associated with SaaS as well as renewal price uplifts.
- Determine cost optimization opportunities by cost component.
- Examine the ramifications of the implementation cost.

More Detail

This question has no general answer. The cost comparison depends on an enterprise's current cost and spending situation to be used as a benchmark and on a comparison of the various offerings on the table. Although many vendors tend to tout SaaS as cheaper, the situation is more ambiguous in reality.

Is SaaS Cheaper in Total?

Often Not: Build a Model and Conduct an Analysis of Your TCO

To determine your individual cost factors, you must create a customized TCO analysis for cost transparency to be used as leverage during negotiations with vendors. Our Toolkit: Comparison of Total Cost of Ownership Between On-Premises and SaaS Business Applications for Midsize Enterprises offers a template that ensures you will not ignore any major cost factors.

To uncover and expose all relevant costs, use three cost categories:
Figure 1 shows a sample cost comparison over five years.

**Figure 1: Sample Analysis of TCO for On-Premises Versus SaaS**

- **Software and initial services** — Software license or subscription, professional services like consultants needed during a implementation or upgrade
- **Application infrastructure** — Local as well as renting hardware, storage, etc.
- **Recurring long-term people cost** — Maintenance and support, local system administration and ongoing operations and optimization

(A more complete process to prepare for negotiations is laid out in 8-Step Playbook to Optimize Software and SaaS Negotiations.)

Are SaaS Costs Simple and Transparent?

Not Always: Do Not Ignore the Hidden Costs Often Associated With SaaS
Our analysts often review SaaS proposals where a number of hidden cost components are not explicitly listed, which can lead to higher-than-expected TCO. They include additional fees for offerings such as (see Mitigate Unforeseen SaaS Costs by Negotiating Fees for Support, Sandboxes and Other Key Variables):

- Languages and country packages, industry-specific compliance, encryption
- Storage, sandboxes, bandwidth, API calls
- Premium support, setup and backup fees

These offerings can cause additional costs of 50% and more. Sandboxes alone can cause an uplift of up to 30%. After the initial contract ends, renewal price uplifts often occur unless price protection clauses are included for future years.

Can SaaS Be Made Cheaper by You?

**Hardly: Determine Cost Optimization Opportunities by Cost Component**

For each of the three cost categories introduced above, there are limited opportunities to influence the cost in a SaaS model:

- **Software cost** — Subscriptions are often more expensive in total after a number of years, compared to perpetual licenses plus annual maintenance and support fees. Vendors typically do not offer price elasticity for business applications. Unlike many other IT costs, subscriptions can (and often do) become more expensive year over year. Companies need to include a cap on price escalation even beyond the runtime of the current contract, ideally for the entire lifetime of an application.

- **Application management services (including support)** — SaaS deployments do not always allow the use of lower-cost resources, different application management service providers or similar. In the “one to many” model of SaaS, exceptions to the standard set by the provider are difficult and often impossible to negotiate.

- **Technical infrastructure (hardware, etc.)** — Always included in the SaaS fees, these are potentially cheaper in the cloud, especially for infrastructure as a service (IaaS) and storage. But SaaS providers have not passed these savings onto their customers. Subscribers have close to zero influence over the technical infrastructure choices of the SaaS provider. Unlike options you have with on-premises, using “cheaper” hardware, delaying upgrades or replacements and similar cost-saving activities are not an option with SaaS.

Is SaaS Cheaper to Implement?

**Rarely: Examine the Ramifications of the Implementation Cost**

Despite the common notion that it's much faster and easier to implement a cloud/SaaS solution, that is not always the case. Some steps are less expensive, such as the technical installation of an initial
version or of incremental updates. A number of steps create the same effort, especially the business-related activities, such as defining business capabilities and updating processes to match the SaaS capability, organizational change management, harmonizing business processes and configuring the solution.

But some steps create more effort and are therefore more expensive with SaaS, such as building modifications, extensions and integrations.

Table 1 provides an overview of the typical tasks in the implementation of a business application. This focuses on the major phases of an implementation:

- **Major implementation tasks** along the life cycle of a business application.

- **Typical degree of effort** gives a rough indication of the effort needed for the respective task. These efforts can differ significantly based on the nature and the functional scope of the application and the different situations among projects.

- **Comparison of effort (on-premises versus SaaS)** gives an idea of how the effort changes when a SaaS-based business application is implemented, compared with an on-premises implementation.
Table 1: SaaS is Not Fast and Easy to Implement

<table>
<thead>
<tr>
<th>Major Implementation Tasks</th>
<th>Typical Degree of Effort</th>
<th>Comparison of Effort: On-Premises Versus SaaS</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Build Strategy</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Build business app strategy.</td>
<td>Large</td>
<td>◀▶ No change</td>
<td></td>
</tr>
<tr>
<td>Build business app architecture.</td>
<td>Medium</td>
<td>▲▲ Moderately more</td>
<td>Decide which processes can/should be SaaS-based and which must be on-premises.</td>
</tr>
<tr>
<td>2. Select Vendor and Product</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Build requirements analysis.</td>
<td>Medium</td>
<td>◀▶ No change</td>
<td></td>
</tr>
<tr>
<td>Run workshops.</td>
<td>Medium</td>
<td>▼▼ Moderately less</td>
<td>No local setup of demo system necessary, can be accessed via the web.</td>
</tr>
<tr>
<td>Negotiate contract and terms.</td>
<td>Medium</td>
<td>▲▲ Moderately more</td>
<td></td>
</tr>
</tbody>
</table>

Source: Gartner (August 2016)

CIOs should resist the temptation to assume cloud ERP is “inexpensive and easy to implement” software that can solve problems “out of the box.” The perception that it is “cheaper” is, in most cases, based on references that have not been using a cloud ERP suite for a long time (See Survey Analysis: Cloud ERP Can Be Quicker, Cheaper and Easier to Use — Or Not and Survey Analysis: Cloud Financials May Not Be Cheaper Than On-Premises, a survey conducted online in September 2019 with 137 Gartner Research Circle respondents).

Recommended by the Authors

Research Roundup: Negotiate Software and SaaS Contracts to Reduce Costs and Risks

8-Step Playbook to Optimize Software and SaaS Negotiations
How to Cut Software and SaaS Costs and Quickly Improve Cash Flow in Times of Crisis

Optimize Costs and Improve Cash Flow by Negotiating Payment-Related SaaS Contract Terms

Tool: Checklist for Negotiating Optimal Cloud SaaS Contract Terms and Conditions

Consumption-Based Pricing Is Emerging From Leading SaaS Providers, but Beware

COVID-19-Induced Downturn Will Disrupt SaaS Pricing Models