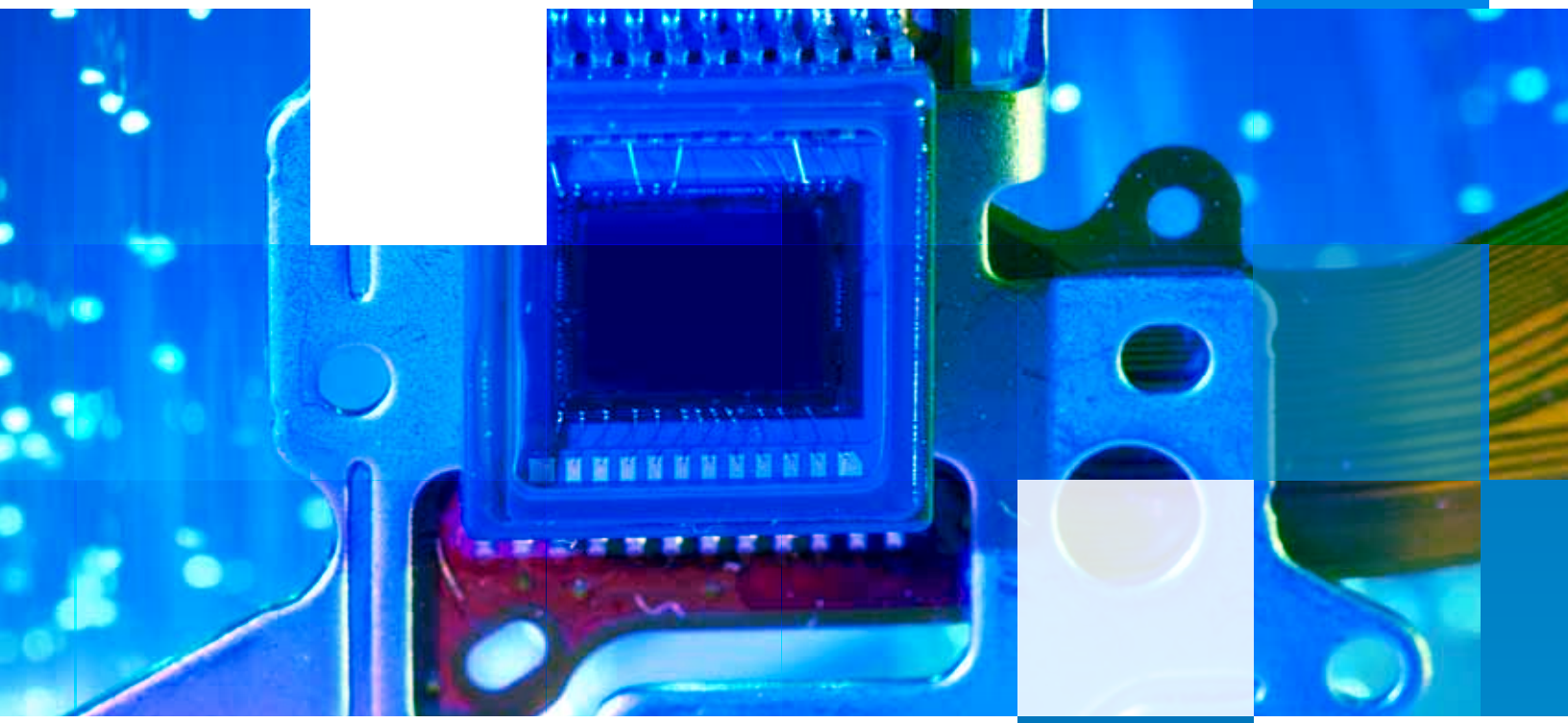
WHITE PAPER

Reducing Software Costs While Increasing Cost Predictability and Control



– Mikko Marttinen

Abstract

Effective software procurement addresses contractual and overall cost of ownership through commercial options that derive optimal value for the business. Savings are often possible but depend on organisation's spend, maturity in the category, existing contractual agreements and availability of alternative solutions for the software. This white paper provides insights into typical factors that affect software costs and provide tactics to allow organisations to reduce and manage costs for existing and new software.

Infosys™
Portland

Introduction

Leading procurement organisations want the lowest total cost of ownership and the best terms consistent with business requirements. Software procurement is an activity that licenses the rights to use software as well as providing ongoing rights for the continuous use of the software. This may include software licenses, maintenance & support services and professional services like, implementation, customisation, integration, upgrades and new versions or releases.

1. Standard software vendor contracts can introduce high risk for the buyer and lead to unplanned and increased costs if not covered by the contract.
2. Software pricing models are complex and range from outright purchase capital models to operating pricing models.
3. Software pricing is often influenced by the market conditions at the time of purchase and discounts are often feasible
4. Generally you should aim to negotiate a discount on a license fee and then apply 'fit for purpose' maintenance services against the discounted license fee.
5. Software procurement often requires a high degree of interactions between different areas of an organisation in order to maximise value from the procurement process. Make sure to document the software procurement strategy with the technical team.

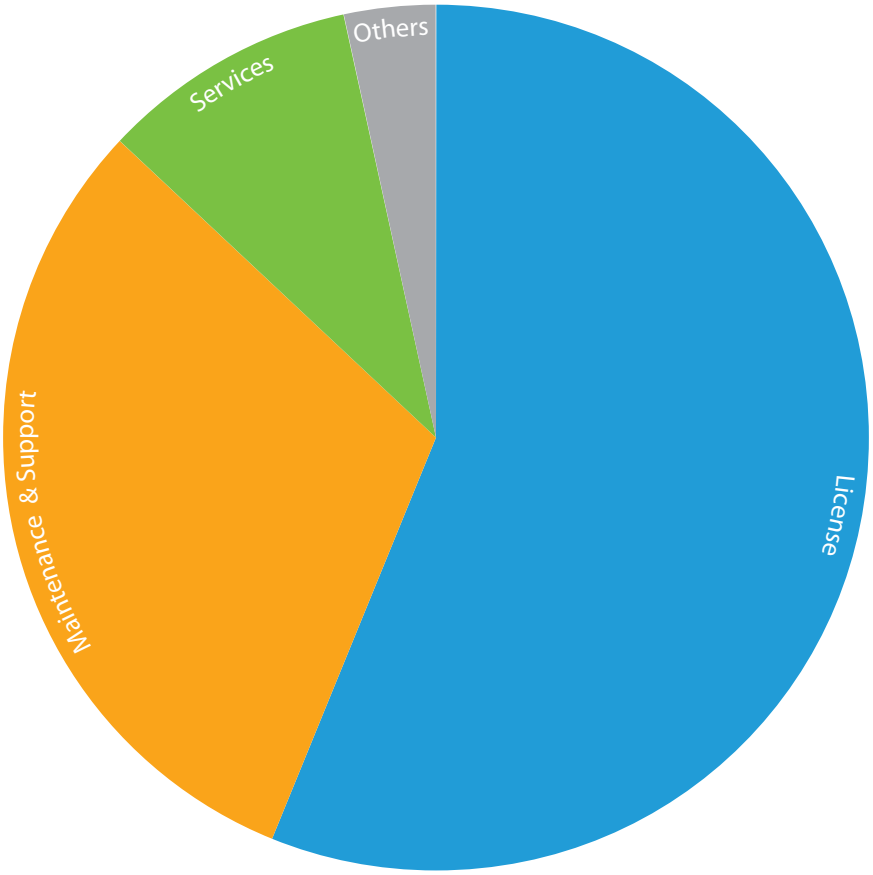
Where to start?

How should an organisation engage the supply market, and what are the often neglected cost factors that can increase overall cost if not addressed? Using resellers is often appropriate and cost effective market engagement model for standard of the shelf type of software. Resellers can assist in streamlining costs, capitalising on organisation-wide purchasing volumes, reducing vendor management activities and providing software product catalogues with specific prices. Enterprise software is often high volume or designed to meet a specific need for the business and therefore requires negotiations with vendors to establish terms and conditions suitable for the business. RF(X) process is not often used as a market engagement model for software, but it is often beneficial to outline the detailed requirements that address new needs or issues with existing software contracts.

Vendors' standard contracts can introduce high risk for the buyer, as they don't generally specify all components of software and associated services, leading to unplanned and increased costs if not covered by the contract. Also, sometimes the terms are subject to change at software vendor's discretion, which may result in increased business risk and cost for the organisation. Ideally all terms and vendor's responsibilities should be contractually defined and not subject to change unless an amendment to the contract is signed by both parties.

Typically there are 3 main types of contracts that need to be considered when optimising software spend. These contracts are software licenses, maintenance & support services, and professional services often related to project work (e.g. implementation services). The key commercial considerations for these 3 main software contract types are outlined below.

Key Commercial Considerations for Software Contracts



License

- Leverage before initial license purchase
- Market conditions and timing of negotiations
- Licensing type selected
- Capital and Operating model licensing
- Number of licenses
- Definition of usage rights and license scope
- Volume aggregation opportunities
- Protecting future license pricing
- Limiting users restrictions

Maintenance & Support

- Support level entitlements
- Apply 'fit for purpose' maintenance services against the discounted license fee
- Contract for basic maintenance with option to move to higher level
- Cap on maintenance increases
- Warranty period
- Record of support services

Services

- Supply panel arrangements with agreed discounted rate cards
- Value based contracting
- Integration with vendors
- Long tenure pricing
- Limiting T&M work
- Level of configuration and customisation
- Project management

Others

- Internal compliance initiatives, e.g. software or service catalogues
- Demand management, e.g. software asset management
- New software licensing models, such as Saas and Cloud

Software license pricing

The price of the license is not typically based on the software development costs. Pricing is often influenced by the market conditions at the time of purchase and discounts are common. The best time to control future costs is prior to making the initial purchase of software. That is also when the best deal for maintenance and value add services can be negotiated, reducing overall total cost of ownership of the software.

There are several licensing types and pricing / deployment models offered by software vendors. The type of license used (e.g. user/volume/access/enterprise/network) is not only important for setting the initial license cost but may also impact your total license cost over the lifecycle of the product, especially if there is a change in the volumes/requirements. Pricing / deployment models are complex and range from outright purchase capital models to operating pricing models, such as subscription or rental. Operating models allow 'pay as you go' pricing and offer more flexibility and reduced initial investment with the option to discontinue use at the end of subscription /rental period. Value based pricing models aim to ensure value for money and a balanced risk / reward relationship with a vendor.

Volume aggregation presents often a large opportunity when competitive bidding is an option. Volume and frequency of use are the main drivers for licensing arrangements allowing for various pricing mechanisms, e.g. cost per user / transaction / business unit. For bundled contracts, negotiating separate licensing arrangements for each product, can reduce the cost being paid to the service provider.

Vendor supplied / developed software will often be licensed for use with restrictions. Therefore, it is essential that any software contract should include detailed definition of usage rights, license scope and services provided by the vendor, thereby limiting the risk of unplanned future costs. Use of software should not be restricted to named users or licensee's employees, as licensee may permit its contractors to use the software when providing services to them. Similarly there should not be any restrictions for affiliates or outsourcing service providers of the licensee to use the software.

Initial maintenance requirements and pricing

What is the level of maintenance required / available from vendors? The starting point for defining maintenance requirements is often the vendor's standard maintenance and support agreement and then the buyer will try to negotiate these to ensure their requirements are met. Often, a much better approach is to define the service requirements based on business needs. These can then be reviewed with the buyer's technical team to ensure that the organisation has the critical requirements, and the service performance results (in case of an existing software) needed for the negotiation process.

Negotiating discounts on maintenance is often more difficult than on licenses but will be worth the effort, as the recurring maintenance fees will often cumulate to higher fees than initial license costs. Typically software maintenance is priced as a percentage of listed license fee at time of purchase. The problem with this model is that it is often not based on the services that the organisation requires. Generally the goal should be to negotiate a discount on a license fee and then apply 'fit for purpose' maintenance services against the discounted license fee.

The warranty period that the licensor provides can have a significant impact on the overall maintenance fees. The sooner the warranty period ends, the sooner the maintenance fee commences.

The difference between 12 month warranty and a 90 day warranty can represent a significant portion of the total cost for the software.

New versions and releases

Typically software vendors will agree to provide support for older versions. It is important to agree on the number of versions that the vendor supports and that any potential price increases that may occur when remaining on an older version are capped at a reasonable level. The nature of the improvements and corrections contained in the new version or release should be assessed to understand any potential effects that the changes may have to software ability to meet specific requirements. Ideally the contract should also cover reduced support situations and reduced maintenance fees when new versions or releases are no longer provided.

Future maintenance requirements and pricing

Some vendors offer to protect the discounted license price for future maintenance renewals, whereas others use the current license price as a baseline. The ideal situation is to apply discounted maintenance fee against the discounted license fee, and then protect the price list for future renewals. Keep in mind though, that typically maintenance and support fees cover only the standard software and any customisations and integration may attract additional maintenance and support fees.

It is also important to consider how maintenance fee increases are dealt with. One way to address this issue is to cap any potential increase to an inflation index. An alternative way is including a pre-determined cap on maintenance increases over the contract term, which should give you a better way to predict and control your maintenance costs, assuming it does not change.

Limiting project costs

For project work, reducing the vendor base and establishing supply panel arrangements with agreed discounted rate cards are often appropriate and effective strategies. Adoption of total cost of ownership approaches through more strategic, value-based contracting with preferred vendors will allow sharing of the project cost and risk with vendors. Integration with vendors often provides access to specialised disciplines at discounted structure, available for long term assignments while increasing flexibility and scalability for resourcing. Long term strategic relationships will help project resourcing by understanding vendor's resource mix and capabilities.

Limiting the amount of time and material based project work and ensuring that the requirements are complete and final (rather than developing them progressively) will also limit the risk for unpredictable costs for project work. Vendors are often reluctant to agree to fixed or capped pricing for project work like implementation or customisation. Instead, consider including payment milestones plans and fees at risk methods to ensure the vendor is sufficiently 'motivated' to complete work in time and in budget.

If there is a large amount of customisation required, it should be carefully evaluated if that software serves the purpose before proceeding with the vendor. Customisation often leads to higher overall cost, as the product is no longer the mainline product, it will attract additional development and maintenance fees. Quality issues leading to high defect rate requiring rework can also play a major cost factor, especially if the software is new or if there is a high level of customisation. Overall, for project work, it should be noted that adherence to standard commercial or contract requirements will not often be enough to ensure cost predictability and control. Additional focus needs to be placed on including sufficient requirements for project management, risk management, quality management and acceptance testing all supported with appropriate governance structures.

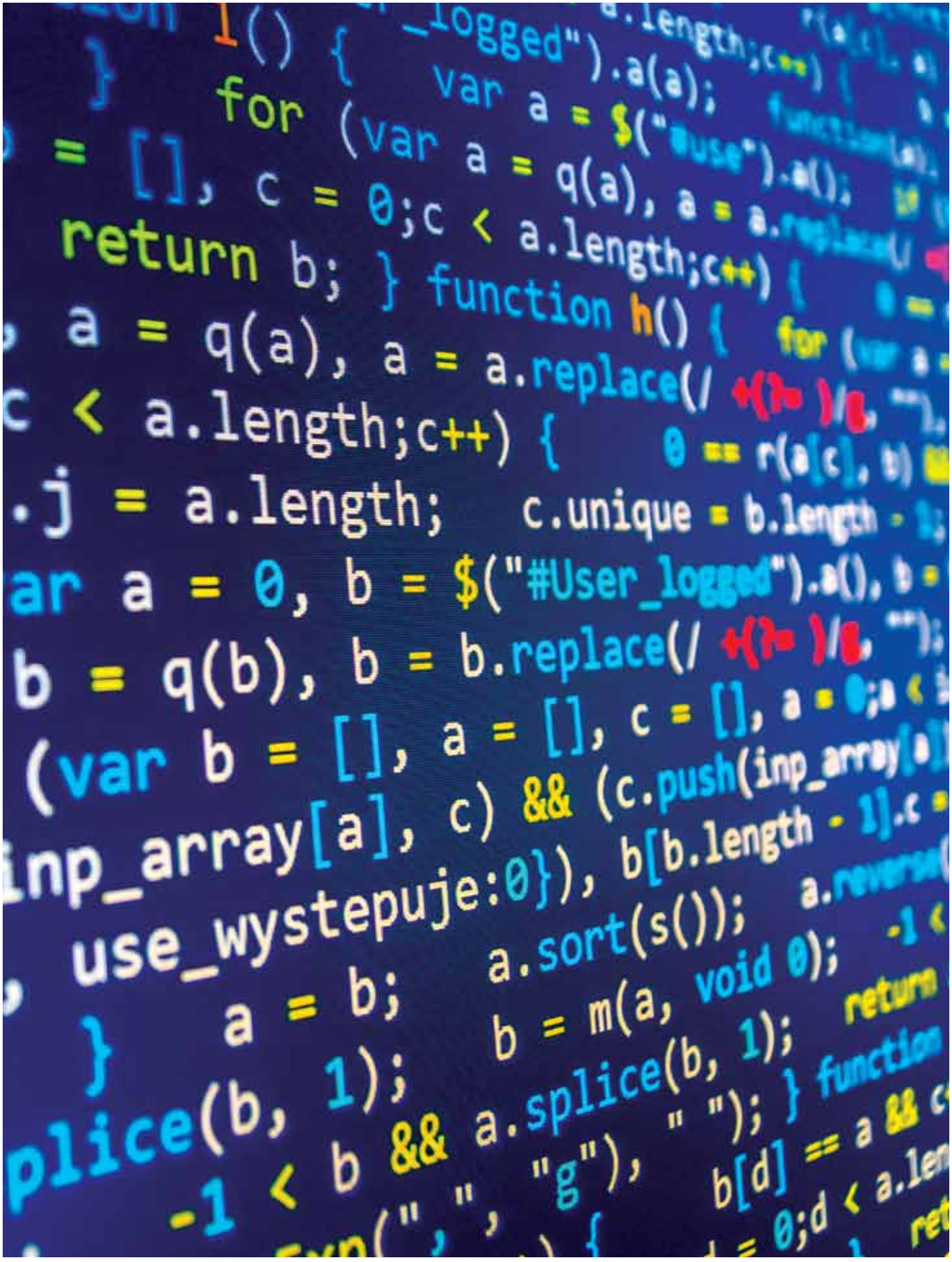
Reviewing existing and new software requirements

The existing software is often under multi-year, fixed cost agreements. It is important to look at upcoming existing requirements in order to build a procurement strategy for addressing software spend before renewing existing agreements and terms. New requirements will typically give greatest opportunities for savings, so investing time to develop a strong procurement strategy to address issues is critical. Relevant stakeholders of an organisation can be involved in planning and development of these requirements, to optimise cost.

Review of software license and maintenance contracts will often reveal that many of the licenses are obsolete or the organisation has not been able to take advantage of upgrades. Bundled licensing arrangements may have also led to sub-optimal results, if licensing has not been individually reviewed. Some licenses may be over-specified and include unnecessary support elements, e.g. 24/7 for applications that were only used during normal business hours. Review and re-specification of support requirements, including removal of unnecessary services, is often required to ensure appropriate support levels and optimised maintenance scope and pricing.

Typically there are spare licenses. Often this is a result of buying licenses without centrally managed processes and systems in place. Introduction of software asset management processes and systems will support identification and cancellation / re-allocation of excess idle / unused licenses.

Additional benefits can often be achieved by establishing arrangements with a single provider to control licenses and manage software assets across the organisation. This often includes creation of central register of products and licenses based on an audit of existing software and cancellation / re-allocation of licenses. Development of comprehensive reporting will keep the organisation focused on software costs throughout the product life-cycle.



Conclusion

Software procurement often requires a high degree of interactions between different areas of an organisation in order to maximise value from the procurement process. Whether it is a single requirement or a group of requirements associated with a larger project, a software procurement strategy should be developed with stakeholders. Strategic sourcing opportunities require leveraging competitive bidding and volume aggregation, which can deliver large opportunities but may not be feasible for all software. Internal compliance initiatives with the ordering and approval policy and mechanisms, such as software or service catalogues, are effective ways to manage types of software purchased while channeling volumes to preferred vendors. New software licensing models, such as Software as a service and Cloud, will change the way many companies will buy and manage software in the future. Demand management initiatives, like software asset management processes and systems, are often effective way to enforce internal and supplier compliance to agreed pricing and terms.

There are many commercial options to drive value from software procurement but deriving optimal value from software procurement requires full evaluation and determination of appropriate value drivers for your organisation. This can be achieved by conducting software procurement focused assessments and diagnostics to determine appropriate opportunities for implementation.

About the Author

Mikko Marttinen
Engagement Manager – Infosys Portland

Mikko Marttinen is an Engagement Manager and a member of the global Infosys BPO IT category council. Mikko has extensive global experience in procurement for over 18 years. Mikko's background is Management Consulting, Procurement, Category Management and Strategic Outsourcing.

About Infosys Portland

Infosys Portland is a subsidiary of Infosys BPO Ltd., a part of Infosys Ltd. Its mission is to improve the efficiency and effectiveness of its clients' procurement and supply chain activities. We achieve this by providing thought leadership, specialist subject matter expertise, a global delivery model, and best-in-class technology solutions. By increasing the value delivered and improving the efficiency of procurement and supply chain operations, our clients are able to achieve more for less.

Infosys™ Portland

For more information, contact info@infosysportland.com

www.infosysportland.com