What you should know about software licenses …
…but didn’t realize until today.

The path to transparent license investment

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Summary

Licensing of standard software is now more confusing than ever due to the proliferation of type of use, metrics, platforms of deployment, and financial models. The granting of licensing rights has been legally developed over the course of many years and become increasingly complicated. The rapid succession of base technologies makes it difficult to correctly predict the long-term suitability of a software investment. The market share of standard software was 78% in 2010 according to figures by Forrester, and could rise to 82% by 2015 according to IDC. Hence, standard software has become a notable industry within the technology sector and is a major investment for its customer organizations.

This white paper illuminates, based on central questions the juggling of this investment and shows ways in which the detailed knowledge of license terms can make procurement more seamless and affordable while maximizing flexibility. Building a unified repository of all licenses to optimize cost and reduce risk is an indispensable component of incremental business development. At the same time, it's clear that rather than focusing entirely on IT compliance, the competitive environment has to be analyzed and the purchasing terms administered appropriately.

Content

Introduction

The volume of investments in standard software has made the software market one of the most attractive growth factors in modern economies. In 2010 the market of the Top 50 already had global revenues of approximately 250 billion USD, with 48% of this being divided between only four providers: IBM, Microsoft, Oracle and SAP, followed by a share of only 7.5% for the four next largest providers in the industry.

This concentration dictates the activities of those responsible for license management in client companies. These managers try to keep pace with constantly changing license models and product definitions by these market leaders, and try to understand, and abide by, the license terms. Pro-active procurement departments try to negotiate flexible frameworks for licensing in order to manage necessary changes without unexpected depreciations, and to avoid excessive prices. It is clear that thus far, the big providers have been unchecked in their ability to expand their market reach. As a result, software acquisition has successfully resisted the widely observed trend for cost reduction.

The things you need to know about software licenses are hidden in the procurement transaction terms. Because these are confidential, diverse and constantly evolving, they have so far eluded systematic analysis. In reality, a division of labor between asset management and procurement has formed, based on a differentiation of where information is obtained. While for each vendor, a variety of auxiliary tools are available for the discovery of software distribution and use in an organization, there is a lack of overarching systems for optimizing on contractual agreements. The following remarks focus particularly on this aspect.

Reality-Check: November 27, 2012

The Morning Download: Software Vendors Put on the Big Squeeze

Michael Hickins

Editor

The Morning Download cues up the most important news in business technology every weekday morning.

Good morning. "You are paid to squeeze, and you must squeeze to pay," the Patriarch tells Pancks the rent collector in Charles Dickens' Little Dorrit. Today, in real life, software vendors are doing the squeezing, and it's CIOs who have to pay. Software audits are costing some customers millions of dollars in retroactive fees and penalties, CIO Journal's Clint Boulton reports. And starting Dec. 1, **Microsoft** customers will have to pay more for software licenses that calculate fees based on the number of users accessing its products, reports ZDNet's veteran Microsoft watcher Mary Jo Foley.

Microsoft had earlier positioned this user-based option as an alternative to device-based pricing, a scheme by which companies are charged for each device accessing its products, even when several devices are owned by the same user. Now it is raising prices on the fee schedule charging customers per user rather than per device. “We believe in flexibility and choice which lets our customers optimize their licensing needs,” Carlos Cruz, Microsoft's general manager of world-wide licensing and pricing, told CIO Journal in response to an article on this topic last month. Some choice. **Forrester Research** analyst Mark Bartrick says Microsoft's policy is frustrating to CIOs concerned about software licensing compliance.

Ah yes, compliance. Because customers are like ex-cons who must check in regularly with their parole officers. Most of the major software vendors put their customers through software audits, but according to a recent survey of IT leaders, Microsoft was almost twice as likely to audit its customers as **Oracle** — the two most active companies in this type of punitive action, according to a report conducted by **IDC** and commissioned by software management application vendor **Flexera.** According to IDC analyst Amy Konary, companies that spend millions of dollars on applications can run into additional multimillion-dollar compliance problems on an annual basis. “It's a big risk for enterprises,” she told CIO Journal.

Best practice for successful license management

What have you invested in?

If one were to ask the question, in what form software investment is protocolled, one would receive a number of answers. IT would point to the asset manager, who in turn would name procurement, who may then name the legal department. There are no firm rules of where the license agreement is archived, and there are few who know where this is, or have actually reviewed it.

The cause is that employees tend to trivialize the existing legal complexity – the overwhelming desire is to ignore the written contract as it is difficult to grapple with otherwise. Often the archived documents contain handwritten alterations whose legal validity employees aren't sure of. This is an inevitable consequence of the heat of negotiations just prior to completing a deal worth millions. But are the many details, footnotes and cross-references really insignificant for the legally watertight implementation one aims for? Those who believe these details don't matter probably aren't aware of the heated negotiations that went before.

Typically the further distribution of licenses in the enterprise is assisted by a lucid spreadsheet that contains all details that procurement believes the asset manager needs to know – an oversimplification that omits important footnotes for a careful management of the investment. The result governs the potential of changing, transferring or exchanging licenses acquired. Or it forces the timing for required renewals giving impetus to further investments. In this environment, it is key to consolidate such licenses bearing different names, but being equivalent from a compliance view. Or to include reassignments or re-purchasing of licenses into such consolidations.

What does best practice suggest?

What's desirable in the digital age is the automated conversion of written agreements into data structures that provide all legitimate stakeholders with a consistent format across all software vendors. This creates a reliable basis for all further processes, and also leads to demands for vendors to keep the documentation of license terms consistent. Following this conversion, compliance measures become easier to administrate, including an effective self-audit. Web-based solutions such as License12 show that this is a realistic proposition.

What do your agreements mean for your business operations?

As soon as the licenses have been bought, they can be used and distributed within the enterprise. This is often triggered by a report from procurement about the successful acquisition, naming the licenses, additional quantities or license levels. This information is usually forwarded to software distribution or CMDB (Configuration Management Data Base) and quality checked by the asset manager. Through other channels, the asset manager also receives information about licenses that are no longer needed by individual users when these users take on new responsibilities that require different systems to be used. In larger organizations, there is a centralized project and portfolio management, so that several departments can participate in the requirement tracking for additional software licenses. If software can be distributed without license keys, the actual distribution of software is sometimes higher than the actual license level of existing contracts permits. Even when a license key has been acquired, use outside the negotiated settings is possible and may lead to unexpected financial liabilities during audit.

All of these scenarios call for a corresponding governance, meaning the establishment of concrete evaluation processes to determine license requirements, keeping in mind the most effective use. These processes require a shared centralized database that consolidates all information about licenses already acquired and currently being negotiated. It is obvious that the license definitions of vendors are the basis of correct procedure. But how, then, to manage changes in definitions that many vendors impose regularly? Who can analyze the effects of such new dynamics and react appropriately?

A further confusing aspect to the market is the presence of resellers to whom the vendor delegates specific market segments. Even while vendors try to keep a consistent approach across all their resellers, each reseller has his own terms of service, licenses and support terms for the licenses they sell. And often the individual reseller may give his own customers privileges that only make sense specifically for that market segment and don't easily transfer to the market as a whole.

What does best practice suggest?

Fundamentally, licenses granted in perpetuity are not unilaterally changeable and persist. However, the content of license agreements should be transferred into a transparent schema that can be maintained consistently over the years and is able to provide an audit trail of re-naming, bundling, options and product dependencies. To keep licenses perpetual, a future purchase of additional licenses must match the original products. If the vendor has changed products and does not allow the purchase of additional licenses of the same kind, such changes should be auditable and the legitimacy of such unilateral changes should be understood.

All of this calls for a repository of all relevant license products master data for large vendors and a service that updates this information and notifies the licensee of the resulting advantages and risks. Such a repository includes price lists, definitions of metrics, definitions of license rights, as well as the dependencies, re-naming and re-bundling among products, as well as other information.

When changing resellers, it's important to assess to what extent such a change affects the continuation of old licenses. This allows for notifications for crucial terms to be included in subsequent license agreements, and the effective documentation of future license rights.

The repository maintenance for the diversity of vendors is such an intensive activity that only few web-based systems, such as License12, can be as current and deliver the right transparency.

How do you manage your risks?

A quick look ahead: Many enterprises are not aware of the risks they enter if they purchase standard software licenses from the market leaders. They assume that multinational companies will act honorably and fairly, and trust the representations of their account personal. However, what we observe is that each salesperson benefits from each successful transaction, meaning that transparency is not a priority for the salesperson. While this may be true for all software vendors, market leaders create particular product lock-in for their customers. Switching to the competition after a successful first introduction of a market leader product is unlikely because the combined cost of depreciation, re-implementation of interfaces with other software, and user training tend to make it unprofitable.

The most important risks are easy to list:

1. **Suitability of software for solving a business logic requirement**
   An indisputable dilemma of today's business culture is the pressure to implement a solution as soon as a problem has been identified. Large software projects are usually complex, hence nobody can a priori exclude the risk that the software may not solve the problem effectively.

   ### *What does best practice suggest?*

   The true suitability of software can only be assessed on the project. Therefore a good software contract should use exchange rights to shift that risk to the vendor. Involved staff, primarily the lawyers and leading negotiators, should take care that such terms are implemented. However, software can be used to fill the crucial role of ensuring that special conditions, once obtained, are consistently applied to each new offer.

2. **Sustainability of license rights for evaluating ROI**
   The purchase of license rights remains financially more attractive than models of rental or subscription. The perpetually valid license right is therefore still the most common form of license model. This longevity is critical from the point of view of technological progress, forcing the provider to periodically upgrade to new technological platforms. While the licensee may have been current on maintenance by paying a substantial fee every years, vendors view such technology paradigms as an opportunity to make new money. Instead of reaffirming existing rights on the new platform, many providers levy upgrade fees or request that new licenses be bought.

   What does best practice suggest?

   Creating an audit-trail of licensing rules and terms in a corresponding repository and the protocolling of vendor specific alterations to principle rules secure the full exploitation of license rights purchased earlier. For individual client enterprises establishing an individual proof of such rights is cumbersome, since the relevant vendor information is not openly published and explained, to avoid unpleasant debate with the installed base. In addition, there are no standards for software that would allow the definitions to be understood outside of the circle of seasoned experts.
   Since these frequent changes challenge even experts, centrally administered platforms are necessary to affect the processing and analysis of contracts.

3. **Unplanned expenditure due to unmonitored license distribution**
   The distribution of licenses should be in accordance with the regulations set by the licensor. However, these are complex and often incompletely documented. Questionnaires have revealed that many businesses take a pessimistic view of their ability to observe these license rules effectively. If an audit flags a deviation, the resulting retrospective purchase of licenses can be costly. For this reason, it is easier for organizations to exceed their demand of licenses – they over-license. The sales strategy of vendors encourages this behavior.

   What does best practice suggest?

   It is clear that an exact match of supply and demand results in lower cost than over-licensing. Some organizations find it difficult to determine the exact demand because assessment happens at a point in time when the distribution of licenses is not reflecting the real needs – as at inventory, for example. Scanning programs exist that can help with this. However, the discovery abilities of a scan program may not be up to date, or the applicable license modalities may not be reflected in the scan, such as in the case of multiple login and other license metrics.
   The effort involved in finding such individual needles in the haystack has to be put in relation to the advantages that can be negotiated with vendors in an over-licensing strategy. In order to set favorable quantities, all license returns due to restructuring or fluctuation should be included in assessing the demand. Experienced procurement sections defuse the license verification to a point where unplanned costs are minimalized, either by way of slight over-

licensing or by modifying the audit terms.

4. **The lock-in effect**
   The past few decades have shown how certain „mega-trends“ can propel large vendors into the market positions they now occupy – Microsoft with their dominance in personal computers, Oracle in the area of database technology and SAP for business applications under the ERP label. A decision in favor of one such vendor can only be revised with great effort. The battle for the so-called install base sometimes takes the form of acquisitions of niche specialists, reducing exogenous competition.

   What does best practice suggest?

   The breadth of offerings from each large vendor and standardization of interface technology now invites for more competition for certain part systems, such as business intelligence or CRM. The available knowledge about alternative offerings is decisive to the outcome of a license negotiation. Precise benchmarks should be used to illustrate to the vendor that the currently available rival offerings and corresponding license terms are more attractive, or associated with a lower cost of introduction. Knowledge of the quarterly cycle is helpful, particularly in the competitive situation between SAP and Oracle, who diverge by a month in their reporting dates. Putting the seller under pressure and neutralizing one’s own temporal pressure increases the chances of a closure in one’s own favor, even when a lock-in situation exists.

How to optimize in future?

The goal is clear: What matters is that the desired software licenses are provided in sufficient quantity, in good time, and at as low a price as possible. Meanwhile, any crucial flexibility in administration and use as well as fitness-for-purpose must be ensured.

Optimizing on price

Today, standard software is being sold based on a price list (that customers may not have access to), and large discounts are given depending on volume. Nobody can say exactly what discount is appropriate for a particular volume, as software is an immaterial good. The oft-reported rules-of-thumb for discounts are regularly contravened in individual cases. The more difficult the market environment, the more frequent the exceptions.

Due to the agreed confidentiality, there is no room for public speculation on price. In order to determine whether one's own negotiated price is typical of the market segment, one has to turn to third parties. These are usually consultancy or analyst firms, which have always more or less accurately assessed the pricing of a software offer as part of their expertise by way of a contract benchmark. This incorporates the creation of expensive studies, whose foundational comp data can rarely be validated externally. Instead of trusting a vendor, whose conflict of interest is well known, one's only option seems to be to trust a „reputable" consultancy firm.

What does best practice suggest?

A contract benchmark is a sensitive issue, as the comparative data are usually confidential. In addition to this, each licensing deal will have individual terms that are based on the negotiating skills of both parties. It's only possible to establish a secure negotiation guideline if the benchmark makes the characteristics of the licenses comparable, and is based on a sufficient number of data points.

Prior to trusting the results of a software contract benchmark, the statistical significance of the sample should be determined. Likewise, attention should be paid to the extent to which older data can skew the results, or whether their weighting has been reduced according to circumstances. A first example of such a transparent processing of a contract benchmark has been available at License12.com since mid-2012.

Containing the Deal Volume

Naturally, an effective closure aims at the exact coverage of a licensing demand. In cases where the pace of adoption for certain solutions is not predictable, the demand might outpace the already agreed volumes. In order to satisfy the frequently strict compliance rules of vendors, it's necessary to purchase with future needs in mind. In order to get the advantage on your side, you should consider any license returns due to restructuring or fluctuating staff numbers when you assess demand. Determining the target volume for upcoming negotiations is therefore no simple task.

With the initial license deal for software from a new vendor or a new product line, particular care is required: For one, the demand cannot with certainty be established at the outset, due to a lack of experience with the product. Secondly, the new product line is in greater competition with other products and vendors, opening up remarkable room for negotiation. The price level for this case shows considerable variation that should be explored using different deal volumes.

What does best practice suggest?

The optimization of licensing from the aspect of deal volume always requires a careful exploration of the pricing structure of the vendor. A „roadmap" is needed that structures the future licensing development in accordance with milestones to be achieved. These milestones can represent targets of revenue or profit, but also the acceptance of the software solution within the organization. Basing negotiations on a roadmap creates additional confidence in one's planning so that each variant can be credibly communicated. First the readily available discounts for each order volume should be ascertained via benchmarking in order to fully understand the pricing consequences of your various options.

Timing

Vendor behavior is dictated by quarters. Sales representatives reveal as much when negotiating with customers: Special discounts and flexibilities are presented three weeks prior to the end of a quarter if the customer isn’t already close to successful deal completion. Indecisive customers are treated to special conditions just before the end of a quarter. This behavior is even clearer at the end of a business year, with the annual report about to be presented to shareholders, with implications for the careers of the personnel involved.

What does best practice suggest?

This rhythm of vendors should be considered when planning one’s own license purchases. The typical delay for establishing demand, internal communications and the reaction time of the vendor must be added when determining the right time to contact the vendor. This may seem like over-optimizing, but can yield price advantages of 20-40%!

What to consider in organizational aspects

Team

Current practices in license purchasing by staffs are sometimes influenced by the self interests of the individual and their role. If one wishes to take advantage of the optimizations detailed in this exposé, it is very important to include these individuals in one’s purchasing – asking their opinion and considering third party training.

One central component of good team development is the creation of uniform standards for all relevant issues, in order to change the general willingness for modernizing license management. Change is easier if everyone has to make adjustments. Systems that provide a high degree of transparency and low work effort for the individual, such as License12, can improve the adoption of such uniform standards.

Tools

Tools should not be restricting, but supporting creativity. Often a few proven methods are already in use, particularly concerning direct interdepartmental communication. If, however, there are cultural differences to bridge, the tool can be part of that effort, in the course of establishing particular work-flows or bridging a language gap.

In choosing tools, you should seek to minimize barriers of entry and maximize degree of automation. Acceptance of tools will depend on the extent to which they

a) further productivity (➔Avoid thief of time!)
b) allow for transparency
c) avoid changing the reward structure

Web-based tools should be evaluated on whether they are easy to adopt and easy to de-activate and replace, in order to avoid entering into new lock-in. When the purpose is market research, you should prefer open systems to the proprietary systems of established players.

Supervision

Good license management enables significant savings. In order to implement the recommendations made herein, frequent and systematic feedback is essential. To that end, try to establish a departmental review of the changes and the effectiveness of employed methods and tools, to be scheduled at regular intervals. Let your employees decide to what extent market information and benchmarks should guide your decision processes.
In this way, you can create an implicit check of the efficient use of novel processes and the new transparency that comes about with well-sourced procurement-supporting.

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