IT Costs Rise Out of Control

In a time of economic downturn and limited IT budgets, local governments are looking outside the box to cut costs. Leading industry analysts firm Forrester Research found that more than 70% of surveyed CIOs are planning to rethink their enterprise software maintenance strategies.[1] In another survey of 600 decision makers at North American enterprises, Forester reported that the top IT priority of those surveyed is to reduce software costs in any way possible. [2]

Many organizations across both the private and public sector believe they aren't receiving fair value in return for their annual support and maintenance fees. Software maintenance has increases to as much as 22% of initial software license fees and even higher with annual increases. Annual software support costs represent a significant and growing portion of today's IT budget.[3] Forester estimates that maintenance fees consume as much as one-third of IT software budgets.[4] As software vendors take rising support fees for granted, overall IT entitlements, including software maintenance fees are soaring to a record of 70% of total IT budgets.[5]

While CIOs are looking to reduce costs, many software vendors view their customer maintenance contracts as a “"cash cow". The philosophy is to "lock-in" clients on a proprietary system and gouge them because of the complexity involved with moving to an enterprise system. If maintenance costs are high enough, some customers won't have the budget to change. Vendor support contracts add annual increases to maintenance fees. These annual increases add up and in many cases organizations are essentially “re-buying' their licenses every three to four years.

According to Dennis Harward, Innoprise President and CEO, many new Innoprise customers were paying as much as $200,000 per year in maintenance fees. These same customers were using less than 20 hours a year in support with their former ERP software vendor. The costly maintenance fees were for ERP systems that were at the end of their life and were no longer being enhanced.

Third-Party Support Cost Savings Entices Market

According to AMR Research, in 2004 application software maintenance represented 35 percent of total revenues to all the ERP vendors compared with 31 percent for software license fees and 32 percent for services.[6] This is typical revenue spread in the software industry for “mature” markets and companies. What is not typical, however, is how new offerings and technology on the horizon

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[1] Forrester research report, “The future of Enterprise Software,” 2006
[2] Forrester research report, “ERP Applications – Market Outlook Improves Ahead Of The Architectural Battle,” 2006
[3] “Seven Reasons Why Software Licenses Choose Third-Party Support”, White Paper published by Rimini Street, 2010, Page2
[4] Forrester research report, “ERP Applications – Market Outlook Improves Ahead Of The Architectural Battle,” 2006
[5] “Taking the ‘Entitlement' Out of Enterprise Software,” Eric Keller, Wapiti LLC, 2006

[6] Vaman, Jagan N., <u>ERP in Practice: ERP strategies for steering organizational competence and competitive advantage</u>, Page 331

are changing the economic basis and model for software companies. Forester estimates that maintenance fees consume as much as one-third of IT software budgets.[7]

For most software companies today, maintenance is their most profitable business and has become more profitable as a combination of better management, offshore labor and self-service capabilities built into their software have decreased internal costs. Public and private consumers however, have not been on the receiving end of these efficiencies as their contracts are based on cost models and buying assumptions that in many cases are five to 10 years old, when costs and prices of enterprise software were at their peak. During that era costs were rising due to Y2K issues, a need to deliver high product quality and high demand.[8]

Fortunately for customers running their organizations on ERP software a realization that third-party support is a viable and cost effective option has taken hold. Organizations that have turned to third-party software support have incurred major costs savings – often more than a 50% savings compared to the vendor's annual support fees. Besides the immediate 50% savings, using third-party software support reduces several hidden costs that could potential save organizations 80% or more.[9]

There are several areas to point out that represent hidden support costs that are incurred from software vendor support. The first is the cost of paying support for software you have licensed but have not yet deployed. The second hidden cost is overhead cost and risk for deploying patches and updates. It is common for vendors to bundle patches and updates with hundreds of fixes and only one fix may be applicable to your organization. The vendor upgrade procedure requires you to implement and test all of the patches. You will be sent the one fix that is related to your organization. Another hidden cost is software customization. This is a major expense that is eliminated by using third-party support since many third-party providers offer customization at no additional charge.

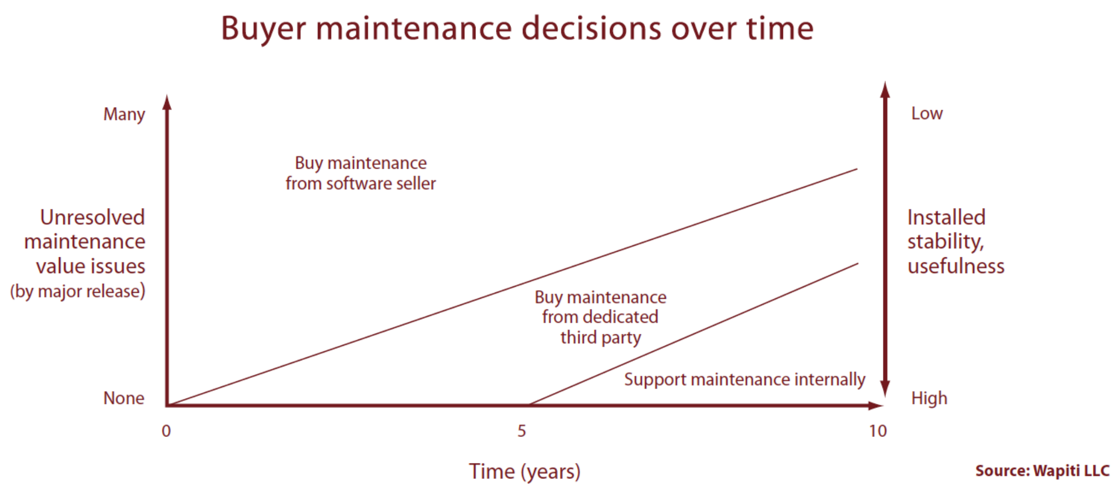
Therefore, the initial 50% cost savings from using third-party support is just the basic cost savings. By taking into account the hidden costs, many organizations will save up to 80% by embracing the trend to use third-party support. Organizations that move to a third-party support save enough to license the next generation of software and have funds left over for other critical IT projects.[10] Research analyst Ray Wang stated, "When evaluating how a third party might help maximize your IT dollars, don't discount third-party software maintenance vendors. It's a growing trend, despite

[7] "Taking the 'Entitlement' Out of Enterprise Software," Eric Keller, Wapiti LLC, 2006
[8] Ibid.
[9] Seven Reasons Why Software Licenses Choose Third-Party Support", White Paper published by Rimini Street, 2010, Page 2
[10] Ibid., Page8

completive pressures from large vendors to stymie third-party maintenance vendors."[11] The performance of the third-party support industry reflects a major growing trend. Rimini Street, for example, reported a more than quadrupling of sales booking in calendar year 2008 and the first half of 2009 compared to the year-earlier periods.[12] Rimini Street provides support for Siebel, PeopleSoft, JD Edwards and SAP. Other third-party support companies offer pay-for-use support, such as netCustomer who supports Siebel, PeopleSoft and JD Edwards.[13]

Key Value Factors

Organizations look at six key value factors (product quality, functionality, expansion potential, technological-functional timeliness, seller interaction and value enhancements) when they evaluate software maintenance. These factors evolve and change over time. When these issues are examined together as a function of time (see following chart), software buyers chose one of three different maintenance options: purchase standard maintenance from the seller of software, the most expensive option; purchase maintenance from a dedicated third-party provider, the medium-priced



option; or support it internally, the least expensive option assuming that very little modification or change will be needed to the system.[14]

The above chart indicates that over time it would be prudent for organizations to consider different types of maintenance support. The higher the number of unresolved maintenance issues (poor quality, functional enhancements needed, etc.) that exist, the greater the likelihood that buyers will obtain maintenance from the primary software seller. On the other hand, the longer a company remains on a single release with little desire to upgrade in the near future, the less monetary and

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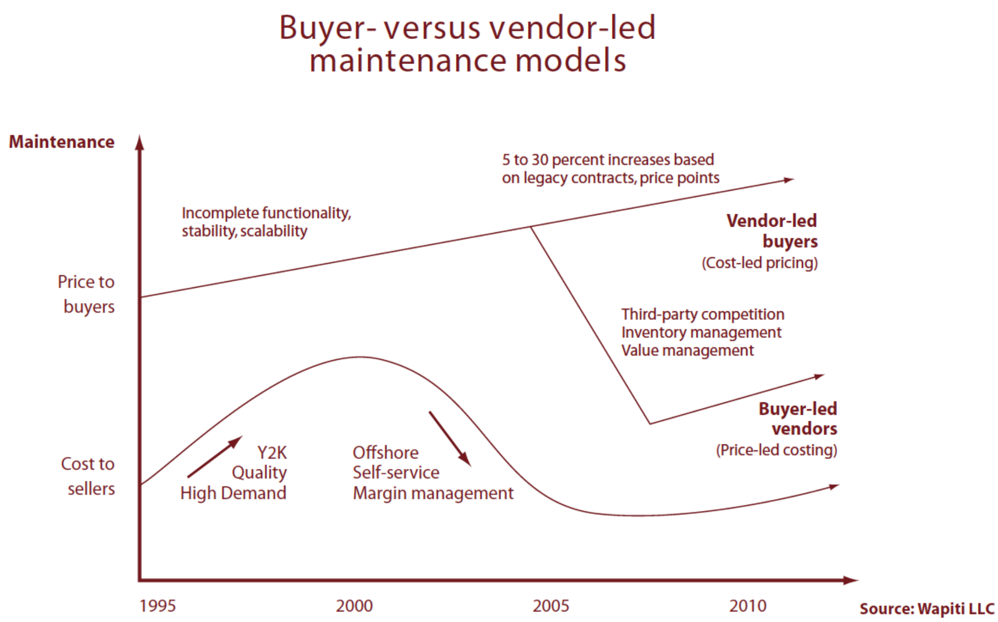
[11] eWeek, "How to Spend (and Not Bust) Your 2008 IT Budget," January 2, 2008
[12] Seven Reasons Why Software Licenses Choose Third-Party Support", White Paper, Rimini Street, 2010, Page 8
[13] netCustomer. April 23, 2010. April 23, 2010. < http://www.netcustomer.com/>
[14] Rimini Street. April 23, 2010. <http://www.riministreet.com/>

strategic advantage there is to remain on traditional maintenance plans. In the past third-party support was limited to "gray-market" providers for legacy packages such as were offered by Dun & Bradstreet. Today, a wide array of third-party providers are emerging that will support ongoing software products. [15]

More Choices For Support and Maintenance

Public and private software buyers are demanding better value for software maintenance while software sellers/vendors have a much lower cost model. Now buyers have two substantial choices for software maintenance (see below chart).



Cost-led vendors are traditional software vendors that have based their pricing model not on the ultimate value to the customer but rather on the business model they need to remain viable. Many of today's traditional software vendors are burdened with this model and are unable to change it easily without major revenue disruption. While they have not changed the price by which they license maintenance to their customers, they have changed their cost basis. Through a combination of off shoring, automating technologies, self-service, etc. they have been able to rapidly decrease the cost of customer maintenance. These benefits are being passed on to corporate shareholders rather than the customer base. On the other hand, price-led vendors are newer players that are choosing to take advantage of these recent cost trends and offer buyers a less expensive offering to support a stable software release. They address a portion of the market that is satisfied and productive with their current software offerings and with little need to use future functional enhancements or releases. The savviest organizations will move toward buyer-led maintenance models.[16]

[15] "Taking the 'Entitlement' Out of Enterprise Software," Eric Keller, Wapiti LLC, 2006
[16] Ibid.

