

Controlling ERP License Cost and Terms

*The average ERP license purchase price is about **double** what should be paid*

*Typical contract terms accepted by buyers leave them with **no effective control***



Tel: 360-699-6150 / 888-421-8372

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INTRODUCTION

This document addresses how to reach very favorable buyer cost and terms when purchasing ERP software licenses and software maintenance programs. These techniques strike a reasonable balance between a fair reward to the software vendor for valuable ERP software and the buyer of such software.

The experience of hundreds of ERP software selection projects and comprehensive interaction with the ERP software vendor community is the basis for the procedures, guidance, and opinions in this document.

THE TYPICAL ERP LICENSE PURCHASE ARRANGEMENT

The typical purchase arrangement for ERP software licenses and maintenance are subject to the following factors:

- High software license costs: Costs for the type of licenses purchased are often double from what can be achieved including original costs and costs over time (some of which is unexpected).
- Poor cash flow: Substantial cash is released way too early; long before actual value can be realized from ERP software licenses—and relationship control is reduced.
- Maintenance: Maintenance terms are not well constructed and are tied to unnecessarily high license cost—resulting in immediate and ongoing high costs.
- Software contracts one-sided: Contracts developed by sellers do very little to protect buyer's legitimate interests in this complex business relationship—large changes are always needed and achievable.
- Buyer control and options are poor: Cash released early and one sided contracts equals little control for buyers over time. Control is very valuable in this type of complex business relationship.

Relative to what can be achieved when ERP is purchased properly; this typical ERP license purchase arrangement adds up to significantly more cost, risk, and frustration over the life of using the ERP software.

THE TYPICAL ERP LICENSE PURCHASE ARRANGEMENT – WHY IT EXISTS

ERP can take unlimited forms. In general, and for a specific prospect, the seller of ERP can configure their ERP offering with different parts and license rights—and still call it ERP. The buyer tends to assume software capabilities based on the names of the modules/parts and license types, investigate some parts of an ERP in fair detail—but in the end really does not know what they're being offered. This is an environment ripe for mischief on the part of the seller—as more revenue and control can be easily gained. Therefore it is no surprise that over the years the ERP industry sales techniques and personnel have effectively institutionalized this opportunistic and illegitimate sales process. This has happened to a point that it is cultural and considered reasonable and fair by the ERP industry—and this is the basis for difficulty in achieving the right purchase arrangement.

On the other hand the ERP sellers might argue they have expensive sales and development costs in place and the amounts they want to charge for ERP and maintenance are reasonable. Some of the factors are reasonable on the surface, but as explained in this document, none of these factors should override the buyer's legitimate interests in properly purchasing ERP licenses and maintenance services.

OTHER ERP PROJECT COSTS

This document does not address the purchase of database software, implementation services, hardware/technical infrastructure, or other costs in an ERP software project. The drivers and options for these items are quite different than ERP licenses and maintenance—and therefore the buying approach is different.

KEY CONCEPTS AND ASSUMPTIONS

Before going farther, a few key concepts and assumptions that influence the content of this document are presented:

Inaccurate information is everywhere: Any information, from any source, that suggests specificity in what ERP software licenses and maintenance programs should cost is **always wrong**—and usually significantly. Based on many factors, the final actual prices paid for ERP software license greatly vary—and to a lesser degree for the maintenance program. Therefore, in a selection project do not presume any software vendor with a functionally/technically competitive offering is more or less expensive than other candidate software vendors. In ERP selection projects we have seen vendors greatly alter their apparent 'list prices' and then 'best price' to meet a real competitive situation.

Only ERP software license: This document only addresses the purchase of (1) ERP software licenses, (2) ERP software maintenance programs, and (3) any other software that fundamentally enables the functions of ERP to operate (e.g. a portal license to enable collaboration with suppliers, field service module, or middleware). All other costs for implementation services, hardware and infrastructure, database to run the ERP software, etc. are not addressed and are handled differently.

Flexible product: ERP software, like most any other intellectual property, has virtually no incremental cost (to the seller) to deliver to a new customer on the day a purchase decision is made. All technical and sales investments made to that date are sunk costs—regardless of whether the prospect says, "*Yes, I would like to buy,*" or "*No, we have decided to go with another software vendor.*" In contrast, physical products, such as a tractor, that have a significant fixed cost to build and deliver each new unit, do not have this cost attribute and inherent selling flexibility.

Therefore, it is reasonable to discuss how one can purchase ERP software licenses in a way that reflects actual and real-time need versus unreasonable business terms that require buyers to pay for software licenses many months before any productive use will occur—and potentially years before all licenses will be fully used.

IMPORTANT NOTE - BEFORE USING THIS INFORMATION

This information is released as it generates interest in our services for ERP cost control, ERP software selection, and ERP pre-implementation readiness. However there are risks with the broad dissemination of this information. Techniques in this document can be considered aggressive and/or unique (for example an ERP sales person may say, "I have never had any one ask for that"). Therefore don't be surprised at pushback. Because of this aggressive and fairly unique approach, we request users of this information refrain from telling candidate ERP vendors that you are following guidance from Engleman Associates, Inc. We have had persons misinterpret and/or misuse the procedures resulting in an unfair and/or counterproductive request of candidate ERP vendors. In these situations, it puts us in a questionable light if we are referenced as the source. Also this information is meant for use by one or more team members on their own project—and not to be directly used, in any way, by companies that provide similar ERP services.

ERP – WHAT IS IT COMPRISED OF?

ERP, from a particular seller, is a software license grant that has various functions and usage rights—and often many user-specific limitations to the full functionality, metrics, and tools that do exist. To describe ERP, we start with a cylindrical barrel (to the right). For a specific buyer—a specific ERP seller will put various functional modules, tools, and usage rights in the barrel.



However buyers are not very clear about what functionality and tools they need—and further can be misled by representations of what the software can and cannot support. Finally the sellers are not really sure what the buyer needs—and will tend to put less software parts and usage rights in the barrel—than more. Many mistakes will likely be made—which usually cause strain and extra costs for buyers.

HOW ERP IS SOLD

ERP is typically sold in following two key units of measure: (1) modules/parts, and (2) user license rights.

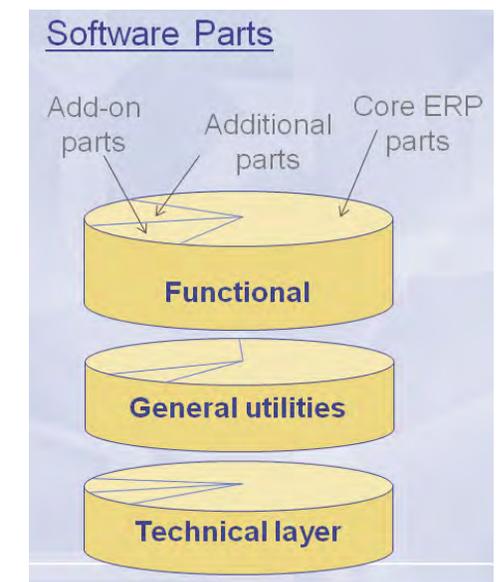
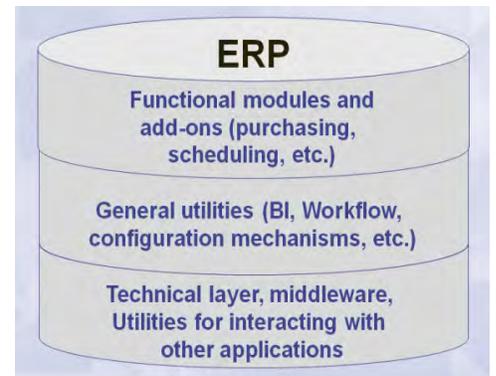
Modules/Parts: ERP is broken into three layers for the purposes of describing ERP modules/parts. These layers are:

- Functional
- Utilities
- Technical

Typically a subset of all the modules/parts an ERP seller offers is determined to be needed for a particular prospect of the ERP seller. The diagram to the right shows three groups of parts that typically exist within each layer (as layers were described in the prior section). The modules/parts are placed in the following groups:

- Core ERP modules/parts
- Additional modules/parts
- Add-on modules/parts

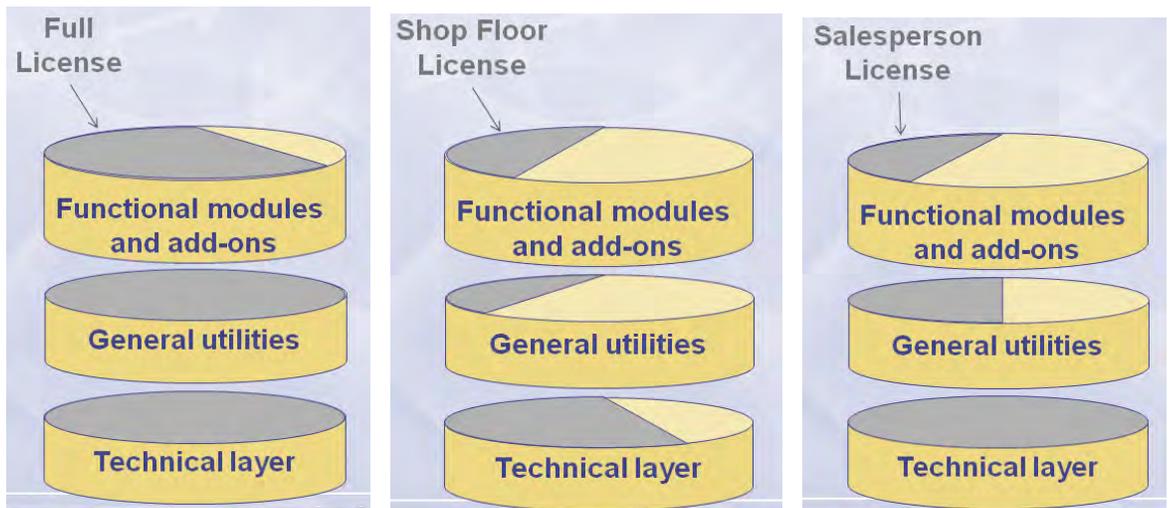
User license rights: Notwithstanding the software parts that are offered to a buyer of ERP, it does not mean a particular future user has access to all the software that was purchased. Typically different license types will carry different usage rights. These limited



usage rights are usually:

- Not well explained—or even well understood by the seller
- Difficult to assess and understand the impact to specific users
- The source of much frustration and extra costs over the life of the commercial relationship with the ERP seller.

Three examples of different usage rights are shown below. The first is a ‘Full license’ that would imply all software is accessible—however the diagram shows there are some of the functional modules or add-on software that is not accessible (the grey color shows what is included). The other examples have narrower needs to access ERP and the access rights shown reflect an ERP seller’s estimate of this lower need. In upcoming sections of this document it will be shown how to establish a reasonably clear opinion on a user types access rights and then how to arrange for these rights while controlling costs.



CLOUD VERSUS ON-PREMISE ERP

For the purposes of discussing ‘*What can system users do in the ERP?*’, the cloud-based offerings also need to explain all that they offer and what subset of modules/parts and access rights they propose to offer to meet the buyers need. So the review process is the same for this section. In other sections of this document, there are further comments about purchasing access to a cloud-based ERP.

DEVELOPING ERP LICENSE AND COST PLAN

This document section details steps to design the buyer's *ERP user access plan*. This plan will describe proper functional and user access with buyer safety and options in mind. This should reduce (potentially greatly reduce) user limitations and in turn the potentially costly remedies to resolve or mitigate these limitations—when they are detected. Key in this approach is that before any ERP seller is talked to about software costs, the buyer first designs the *ERP user access plan* in language that is clear and in terms that provide unambiguous appropriate access to the ERP. And where there are uncertainties in future user's activities, the plan should err in the buyer's favor. It is important to state that this buyer-favored *ERP user access plan* will not necessarily raise ERP license costs (and ongoing maintenance)—as compared to a lesser configuration from an ERP seller.

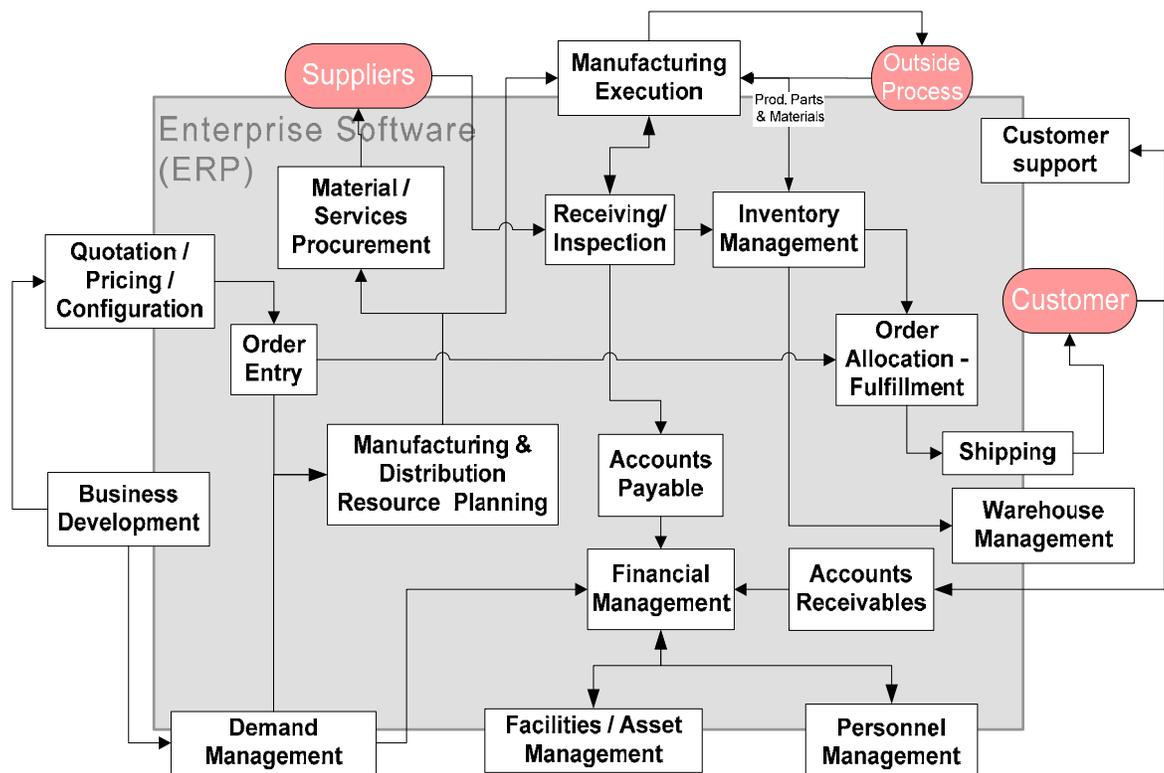
Cloud-based ERP: Steps in this major section on *Developing ERP License and Cost Plan* are materially relevant for accessing cloud-based ERP, except for a few additional actions in the step on developing objective ERP license costs.

BUSINESS PROCESS AREAS INCLUDED

The business processes that should be included are a function of:

1. The processes typically supported by the class of ERP being reviewed.
2. Elements of the ERP buyer's business processes that may be (1) more complex, or (2) significantly different than 'typical needs'.

These business processes included are shown below in a sample ERP software footprint diagram as small boxes with white backgrounds. The reach of ERP is shown by the gray box that underlies many of the process boxes.



The business process boxes that are dissected by the ERP boundary are more carefully reviewed to better understand exactly what processes (within these process boxes) are contemplated to be in ERP and what processes are out of ERP. This forms the discussion as to what the buyer expects should be included in a candidate ERP software vendor's offering.

Some process areas that are not considered to be properly supported by the class of ERP being reviewed may still be in the ERP project scope. Independent software may be offered by the ERP seller for these apparent non-ERP process activities (software owned by the ERP seller or third party). Independent software can be compared against other third party offerings and the level of integration the ERP has with the independent software.

ERP USER LICENSE TYPES

As was presented in an earlier section of this document, just because a buyer of ERP licenses certain functional modules (e.g. material planning)—this does not mean a particular user license can access some or all of the material planning functionality. This potential licensing limitation drives an important need to challenge and arrange appropriate software access to functional elements of the ERP as well as ERP system tools and utilities.

Another reason to carefully plan for future user access is based on the reasonable potential for how modernized ERP can be used by a company. Specifically modern ERP can support more business processes and offers truly effective collaborative workflow mechanisms and very useful metrics and exception scan tools. All of these items cause more users to access ERP and users stay connected more—some continually. ERP sellers licensing models and assumptions don't usually model this modern usage well—and one result of this is upsell opportunities for the seller.

USER-TYPE DEFINITIONS TYPICALLY USED

The following are some typical user license examples.

Full License: This ERP license type is intended to have (1) broad rights to the functions within ERP business process footprint diagram and (2) access to use workflows and metrics that are developed. This license type would be used by typical ERP users that conduct much of their activities within ERP (e.g. purchasing role) and others that have various occasional, but potentially broad, duties that are conducted within ERP. For example, this could include executives who review metrics, participate in selected workflows, and may make occasional changes to some customer or vendor record. This would typically be a Named user type license.

Shop Floor License: This is an ERP access point for production workers to conduct barcode type transactions and other data entry that is designed into production work. This license is also used to access production documents such as product/assembly prints, procedures, specifications, etc. Depending on a production floor layout, these shop floor license access points could be located by work center, machine, or other arrangement that enables efficient access by production workers. This must be a shared type license as the shop floor node could be accessed by (1) any production worker that was proximate and needed access, and (2) multiple production shifts. This license could still be a 'Named user license' but the name would be something like 'Work Center #2' and multiple workers could access this node. If a worker needed to

identify themselves, the worker ID would just be a piece of data in the transaction they were conducting—and not some user login process.

Limited ERP license: Some ERP sellers will make the case that various ERP users (of processes within the ERP boundary) have predicable duties and can effectively use some 'limited access' type user license. This pre-narrowing of rights is problematic as it is not easily know what duties a particular user will actually need. Unless an ERP sellers 'limited license' is completely defensible as appropriate for a type of ERP user, then it is better demonstrate to the seller the uncertainty of the 'limited license' and to arrange for full licenses at a reduced 'limited license' type cost. Some limited access license could be for:

- Business development/sales
- Field service
- Engineering (PLM/PDM type functions)
- Warehouse

NAMED LICENSES VS. CONCURRENT LICENSES

As stated in a prior paragraph, modern ERP usage increasingly has many system users continually wired-in conducting normal transactions, observing metrics, and processing workflow actions, etc. This 'constant on' trend is diminishing the utility of the shared *Concurrent user* license for the normal full license users. In purchasing ERP, *Named users* type access to ERP is effectively what should be sought. However there may be one or more small groups of conditional users for which the *Concurrent user* license model has merit.

LICENSE QUANTITY NEEDED NOW & AFTER GO-LIVE FOR 1 TO 3 YEARS

The buyer should only pay for what software licenses are needed for the first go-live event and pay later for licenses needed later. The chart below shows an example based on some of the users types used in the prior section.

License Types >>	Full	Shop Floor	Sales
Units of Measure (for next two lines)>>>	Persons	Access Point	Persons
Initial license quantity estimate:	60	15	5
Licenses added over time estimate:	30	10	4
Total planned licenses:	90	25	9

It is important to know that many ERP software sellers will typically encourage buyers to purchase all current and estimate future user needs at the start—based on 'apparent' deeper discounts that can be arranged based on the larger purchase. The approach in this document effectively renders this typical pricing incentive meaningless—mainly because license cost objectives (next section) are well below the typical discounts and predicable pricing will be arranged for future needs (for 1 to 3 years).

OBJECTIVE COST PER LICENSE TYPE AND OTHER SOFTWARE

In this section we set forth the process to put objective costs on:

- ERP user license types (developed in the prior step).
- ERP modules/parts that cannot (or may not) be reasonably defended as 'it should be in core ERP'.
- Other software that does not directly support business processes, such as middleware, database, utilities, etc.

COST FOR ERP USER LICENSE TYPES

These ERP user license types were established in an earlier step in this document. In this step the buyer develops the per-user cost for the different user-types (see example in chart below). There are known price levels that are very favorable to the buyer, but not so aggressive that the candidate vendors are discouraged. This is the part that is not easy to know for the buyer, but is very important to reasonably establish—therefore outside competent input should be sought. WITHOUT ACCURATE PER USER-TYPE COST DATA THE OVERALL TARGET ERP COST WILL HAVE NO SERIOUS MEANING.

License Types >>	Full	Shop Floor	Sales	
Units of Measure (for next two lines)>>	Persons	Access Point	Persons	
Initial license quantity estimate:	60	15	5	
Licenses added over time estimate:	30	10	4	
Total planned licenses:	90	25	9	
Objective cost/license:	\$2,500	\$1,500	\$1,800	Totals
Initial license costs:	\$150,000	\$22,500	\$9,000	\$181,500
Follow-on license costs:	\$75,000	\$15,000	\$7,200	\$97,200
Totals:	\$225,000	\$37,500	\$16,200	\$278,700

Once per user-type costs are established for the different user-types, these amounts are multiplied by the estimated user counts to develop a total target cost for software that covers the ERP software functional footprint. The amounts in the chart above are only representative and each ERP project would have factors that would adjust these numbers.

Objective costs for add-on software: The objective cost for these add-ons is driven by the following pricing influencers. These influencers are valid whether the ERP seller owns and sells the add-on module/part or it is offered by a third party software company.

1. Relative value and cost: If the ERP licenses are \$130,000, then the buyer should not want the cost for a field service management capability being more than 10% of this amount.

2. How many users will use the add-on software: If only a few users of the add-on software exist, this lowers the value. If more exist, then the value goes up.
3. Current market pricing: What is the cost on the open market for such software for the contemplate usage of the buyer.
4. Value to the buyer: What is the value and imperative to buy software to support the business processes? If it is lower on both these items, this can further lower the objective costs. If it is high, a higher cost could be in order.
5. What portion of the software purpose is supported by core ERP: There may be business process elements of the software that is already supported by core ERP. If this is true, then a further reduction in price is typically in order.
6. Integration status: Representations of integration of add-on software to the core ERP are almost always overstated. To the extent integration efforts are going to be heavier than expected—then this can be the source of a further discount.

MAINTENANCE COSTS

The maintenance offering from ERP sellers typically includes access to the (1) ERP software upgrades and patches, and (2) remote support services. First a proper and comprehensive maintenance package should be established with an ERP seller. Then the maintenance amount to seek is about 22 - 24% of the prior established objective pricing for license fee—which typically will result in a 30 to 50% reduction from standard amounts. Some sellers break apart the support element from the software upgrade element; therefore there is some recasting of costs to see if the 22 - 24% is being met. There should be rules that the net maintenance amount can't be raised each year more than the lesser of a (1) metric that reflects general inflation, or (2) yearly cap.

POINT-PERSON FOR ERP COST AND TERMS DISCUSSION

Have a carefully selected point person represent your company in ERP license and maintenance cost and terms discussions with these ERP sellers. This person should:

1. Be highly knowledgeable and confident about the cost and terms objectives.
2. Have a believable image of actual skill and resolve to achieve the ERP cost and terms objectives with candidate ERP vendors.
3. Be able to quickly detect ERP vendor excuses and sales tactics and communicate to the ERP vendor sales persons that these tactics have been detected.

There can be a second person assigned to the effort to achieve the ERP license cost and terms objectives. This person could deliberately take the role of the 'good cop' to work with the candidate vendor on easier elements of the potential purchase arrangement while the lead company point-person handles the more challenging and disagreeable components.

All other selection team personnel are explicitly instructed to not talk about cost and terms issues with anyone from the candidate vendor firms. Executives should be fully aware of the process being used and be reminded to disregard any calls directly to them from the candidate vendor firms on the topic of cost and terms.

DISCUSSIONS WITH ERP SELLERS

As stated earlier, ERP software sales persons and their sales managers and executives are selling ERP software full time. Buyers enter into this complex search and purchase every 8 to 20 years. Based on the typically unprepared buyers the ERP software industry's sales processes are heavy with emotion-based and tactics-driven sales techniques. And the discussion of ERP license and maintenance costs is especially subject to convoluted, ambiguous, and misleading statements—since this is the area that ties to revenues for the seller (and commissions for the salespersons). This sales environment exists—because it works for the sellers. And it is cultural, so most ERP sales persons would not even recognize there is a problem with this current status.

It should be emphasized that there are individual sales persons and sales managers that are honest and good people, but the industry they work in—and its culture—makes it difficult for these good attributes to materially shine through.

VENDORS WILL MEET THE OBJECTIVES

If the ERP cost and terms objectives are well constructed per the procedures in this document and the vendor interaction is orchestrated well, then it is largely true that any ERP software vendor will substantially meet the ERP license and maintenance cost objectives.

TIME REQUIRED FOR ERP LICENSE COST DISCUSSIONS

This ERP license and maintenance cost control process occurs over some time (3 to 8 weeks – or more) and is usually interesting and often convoluted. Even as professional advisors supporting this process Engleman Associates, Inc. encounters simplistic excuses and tactics—that burn up time, energy, and patience to process. So the key is to have sufficient time to conduct this process and to recognize the excuses and tactics that are often used to suggest there are problems to various objectives the buyer sets forth.

KEEP THE INTERACTION VISIBLY COMPETITIVE – ESPECIALLY FOR THE FINAL TWO

During the entire selection process, keep the clear presence of competition. It is considerably harder to gain further concessions after the vendor has determined that they have apparently won—or even have conditionally won. The key is for buyers to presume that the selection team may find influential selection information all the way to the finish line that makes the final outcome uncertain—and in turn show no favoritism. The candidate software vendors will read this and it will give the buyer much more authority and control.

SOFTWARE AND IMPLEMENTATION COST RATIOS

Any reference by a software sales person about ERP software cost being a ratio of implementation cost is guaranteed to be 100% wrong—as it has zero applicability to a specific ERP purchase. ERP software costs and implementation services costs vary for many reasons independent to each other. Therefore the ratio exists only to mold buyer behavior.

DIFFERENCE FOR 'CLOUD-BASED ERP

Cloud-based software offerings typically are priced at a per user amount per month rate. Follow these instructions to develop a monthly amount that attempts to estimate a comparable amount to what is achieved in the ERP purchase amounts developed in the process in this document.

1. Translate the on-premise ERP objective costs and ten years of ongoing maintenance costs (with a 5% escalation per year) into a monthly amount (for 120 months).
2. Estimate a ten year cost for hardware, internal IT support for the ERP software, hardware servers and desktops, and other costs believed to be incurred with an on-premise ERP based approach. Divide this amount into 120 monthly additions and add this amount to the monthly amount calculated in the first step.

If ERP is purchased per the methods in the document, then the on-premise ERP should start to have an overall lower cost of ownership, than cloud-based ERP, around 4 to 6 years. Keep in mind this is a statement based on some broad assumptions, but it is made to counter the cloud-based ERP sellers that represent their financial model is significantly better than on-premise ERP. And note that on-premise ERP can be hosted and managed in the same way as pure-play cloud-based ERP.

CONTRACTS

ERP seller's license and maintenance contracts hold no effective control for buyers—as the collection of rules, exceptions and other terms effectively constrains any positive actions by a buyer to protect their rights. All of this is no surprise as the seller's attorneys develop the document and the whole area of licensing intellectual property is subject to much mischief by sellers. Without control in the relationship for the buyers, the ERP sellers will make decisions that routinely favor them and their revenue stream. And the long term effect to the buyer of a series of these one-sided decisions is strain, aggravation, and potential breakdown in the commercial relationship.

A general reason for ERP seller's interest in control: It is important to point out that the seller's interest for full control is not without some practical merit. As a group, buyers of ERP are the cause for many problems—and they don't usually recognize this situation. Therefore the sellers have a legitimate reason to buffer themselves from this situation.

Fixing these contracts—Not negotiating: It is very helpful for the buyer to have the attitude that these documents are inherently broken—relative to the buyer's legitimate interest. And that they must be fixed to proceed further with a specific ERP seller. Or in other words, the finalist ERP sellers need to understand that the typical 'give-and-take' of normal commercial negotiations is not what will happen if an ERP seller wants to ultimately win the business. Key areas to improve contracts are:

- ERP usage rights and future purchase terms arranged appropriately and clearly described.
- Software license (IP) transferability
- Maintenance escalation and termination rules
- Arranging future license purchase to be subject to the currently arranged rules.
- And many more fixes that are discretely less important—but collectively add up to more direct and qualitative control in the commercial relationship.

CONCLUSION

After reading this document it should be obvious that a significant effort is involved to achieve the proper purchase amount and terms for ERP licenses and ERP maintenance. Therefore, based on the magnitude of the task, it is important to remember and emphasize the purpose of such a detailed and time-consuming effort. The purpose is summarized in two reasons:

- Save significant costs on acquiring ERP today and over time.
- Improve control for the long-term relationship with the ERP vendor.

However, many ERP selection teams will be exposed to such advice but they get lost in the complexity of the process and come to believe that the acceptance of a more typical deal is inevitable. Exhausted from the overall process of selecting ERP, they start to trust the ERP sales persons, and they want the process over. Therefore, remember these key points to control the ERP buying process:

- Carefully plan and execute the overall ERP selection process—as described briefly in this document.
- Keep an appearance of a competitive situation until finishing contracts (whether the competition is actual or not).
- Have executives and project leaders understand the important goals and techniques of this ERP buying process and how they can best support the process.
- Have the buying company's interface to the vendors be firm, confident, calm, and have a low tolerance for the various vendor manipulation tactics listed earlier.
- Have sufficient calendar time—remembering the increased buying opportunities at the end of calendar quarters.
- ERP license and maintenance contracts must be fixed—if the ERP buyer wants any reasonable relationship control.