Controlling Cost and Terms when Buying ERP Access

*Saving **40% to 70%** more than what is typically negotiated for lifecycle ERP access costs.*

Introduction

Using concepts introduced in this paper, a prospective buyer can achieve large reductions in typical initial and ongoing costs related to purchasing access to ERP software.

This paper is based on the experiences of the author acquired through 1000++ ERP software selection projects and continual interaction with the ERP software vendor community since 1995.

The Bad Deal

Nearly all aspects of the bad deal are due to the fact that the ERP buyer is stuck with the ERP. It's hard to identify a more difficult commercial situation for today's corporate leadership to escape than the software running their enterprise. Changing ERP is associated with unbounded costs and insidious risk, and buyers legitimately consider it with great caution. ERP sellers know this and routinely take advantage of the situation after the ERP is significantly implemented.

Original and ongoing costs for ERP access are typically 40-70% higher than what can be achieved using techniques described in this paper. Without adequate commercial controls for buyers, sellers can continue to escalate costs. This is particularly true with subscription ERP, which have fewer options for buyers to effectively control ongoing costs and creates a commercial environment the ERP sellers can exploit.

How did this unbalanced and unfair situation reach this point?

Much of ERP seller revenue depends on this imbalance—especially related to ongoing revenue. So from the seller's self-interest point of view, we know how it started and why it was pushed over the years. This self-serving commercial situation has also become their culture—making it increasingly difficult for buyers to effectively discuss cost control with ERP sellers and reach results described in this paper. Further, matters have only worsened with 'Cloud ERP' as more control is taken from buyers and as ongoing fees are typically much larger and more subject to unilateral exploitation than perpetual license maintenance fees. This ERP industry culture drives the following typical characteristics of the ERP sales function:

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- Selling to buyer's emotions, which is easy to achieve in most ERP sales situations.
- Selling based on 'close enough' and vague information—which tends to be accepted as the ERP buyers are not often clear about future-state process needs.
- Aggressive commercial control of the ERP buyer. ERP sellers, especially for subscription ERP, effectively make hostages out of their customers.
- Having no serious knowledge or respect for the buyer's huge risk exposure in acquiring access to and attempting to implement ERP.
- The sales people, resellers, and management at ERP software firms actually believe there is no problem with their standard deal. This mindset enables what appears to be resolved pushback to objectives described in this paper.
- ERP sales people are usually selected and promoted largely based on their allegiance to the ERP culture and their skill in manipulating and excelling in this environment.

What is less clear is why ERP buyers have largely accepted these bad deals which have become worse over the years and accelerated with subscription ERP. Hundreds of our ERP client projects have demonstrated that the vast majority of companies seeking to purchase access to ERP are simply not aware of the dreadful situation in this industry. Furthermore, even if buyers are aware to some degree, they don't possess the knowledge or resolve to rise above it. Sellers know this and have a culture of distractions as well as excuses why the superior balanced deal is allegedly not achievable.

In recent years during client ERP selection projects, the ERP sellers always went through some degree of the same sales process that attempts to force the bad deal. In all cases, when the buyer followed the processes described in this paper they were substantially successful in reaching ERP cost control objectives. However, it's nearly always a perplexing journey to navigate the smoke and mirrors to reach these objectives.

The Good Deal: Key Objectives for ERP Cost Control

The following ERP access details contribute to ERP access cost control initially and over time. These items are relevant whether one is accessing ERP with owned licenses or a subscription.

Achieving excellent initial ERP access costs: As a rough starting point, for well-established ERP sellers the excellent buyer cost is around 50% of general list pricing. But this general statement has many conditions based on the ERP seller

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and buyer, and may not be accurate in every case. Discussed later in this document is a concept called 'informed market cost' for ERP. This means that favorable initial and ongoing ERP access cost is achievable when the buyer is highly informed about what can be achieved in the sales cycle.

Ongoing ERP access cost control: This is the big one—and the source of most ERP industry revenue and company valuations. The three key areas of ongoing cost control are to arrange:

- Permanent escalation terms for maintenance/support fee or subscription fees for the initial ERP access purchased.
- Fixed amounts for additional perpetual license or subscription access (more users or modules) for at least two years. Longer for high growth companies.
- Permanent escalation terms for maintenance/support fees or subscription renewal fees for additional ERP access purchased in the future.

Because of the large contribution to the ERP seller's future revenue, they are typically quite resistant to terms that put in place long term cost control for buyers. This is especially true in the ERP subscription access model.

Delaying ERP access fees: ERP has no value to the company until a successful go-live event. Implementations typically take many months before cut-over to a live environment is achievable. Further, for ERP sellers there is little cost to release the implementation instance of new ERP, and if hosted there should be low costs to host such an ERP instance. Therefore, why not use this as the basis to seek terms to pay a portion of the ERP access fees once the system is actually supporting the business? This of course is aggressively resisted, as sellers understandably like the cash flow. And considering the high incident rates of implementation issues, even more important to them is having the buyer 'invested' in the project with no easy paths to leave. Notwithstanding, this should be explored or at least used as leverage for achieving other favorable terms depending on the circumstances of your proposed application.

Paying for ERP twice: When transferring from one subscription ERP to another, during the ERP implementation the ERP buyer typically pays for both simultaneously. With owned licenses there are options to mitigate or eliminate this double charge, but not with subscription ERP under the ERP seller's default approach. This issue is different from the prior topic on 'Delaying ERP fees', but is largely solved with the same solution to postpone payment for the new ERP until it has successfully gone live and the prior ERP can be retired.

Ability to retire license rights: If you no longer need certain modules, users or device types, it is good to have explicit options to retire such licenses and the associated costs. Nearly all ERP contracts make this unclear, and the units of measure of ERP access rights can make targeted retirement even more difficult.

License conversion process: If for example, at some point in using the ERP system the buyer discovers it needs a few less full licenses and more shop floor licenses, they could convert the excessive currently owned full licenses into the required shop floor licenses instead of purchasing more shop floor licenses. This would likely be done based on the values of the licenses as negotiated in the original purchase agreement.

Multi-tenant cloud migration: What happens in 8 years when the ERP Company wants to retire single instances of their ERP and effectively start to force customers to migrate to a multi-tenant subscription access model? There should

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be a contractual path that enables the migration to occur without the buyer losing hard fought commercial terms, including permanent cost control, and otherwise prevents the buyer from being treated poorly by a seller attempting to take advantage of the situation. Keep in mind, such a migration for an aggregate of customers greatly benefits the ERP seller.

Ability to have data access to retired ERP: When a company moves to a new ERP, there is usually some data that is best accessed within the old ERP for some period of time before other archival methods will be satisfactory. With classic perpetual licenses, the ERP buyer can keep the old ERP going at little cost for a few more years for archival purposes. With Cloud ERP no such option is proactively offered, which means the default approach will be the ERP seller someday charging full rates to keep their then old ERP live or the buyer enduring some non-optimal alternate archival approach. Based on this, informed buyers will arrange for some low cost access option with a cloud ERP provider accessing their ERP for archival purposes under a cost structure that replicates the seller's low cost to keep the data in their system.

Transfer rights: If a company is sold, in full or a subset, one would reasonably assume the new owner would continue using the company's ERP. This is not the case. In fact, in most ERP contracts such transfers are prohibited, setting the stage for opportunistic and avoidable charges up to and including a full ERP (re)purchase by the new company owner with new commercial terms!

Methods to achieve target ERP access costs

Buyer/Seller Alignment: Aligning the buyer's needs to candidate ERP capabilities is a critical first step. Without this being done well, the discussion of initial and ongoing ERP access costs will be subject to incoherence and errors that usually turn into cost increases and other unfavorable results over time. The alignment steps are:

1. How much ERP is needed? This question is inherently difficult to accurately answer and creates more detailed questions such as:
    - What are the business process areas that should legitimately be in ERP scope for the buyer seeking ERP access?
    - How many users are estimated to access the system and in what different ways?
    - How many devices may be used to view or input data into a new ERP?
    - What integrations are contemplated with ERP and how do they impact licenses?

    These are the typical license access dimensions—but there's often more and their impact needs to be understood. The following three steps help determine appropriate buyer needs.

    a. Business process areas: ERP has typical core functions, like accounting. However, depending on the business seeking ERP and the class of ERP being reviewed, there will be functional objectives in the project scope that ERP cannot support or for which an ERP buyer has other options. The "ERP Boundary Diagram Sample" below demonstrates the ERP boundary. The biggest indicator that a function should be within the ERP boundary is if the function materially depends on other ERP functions and there are few or no apparent independent offerings for the function. If the reverse is

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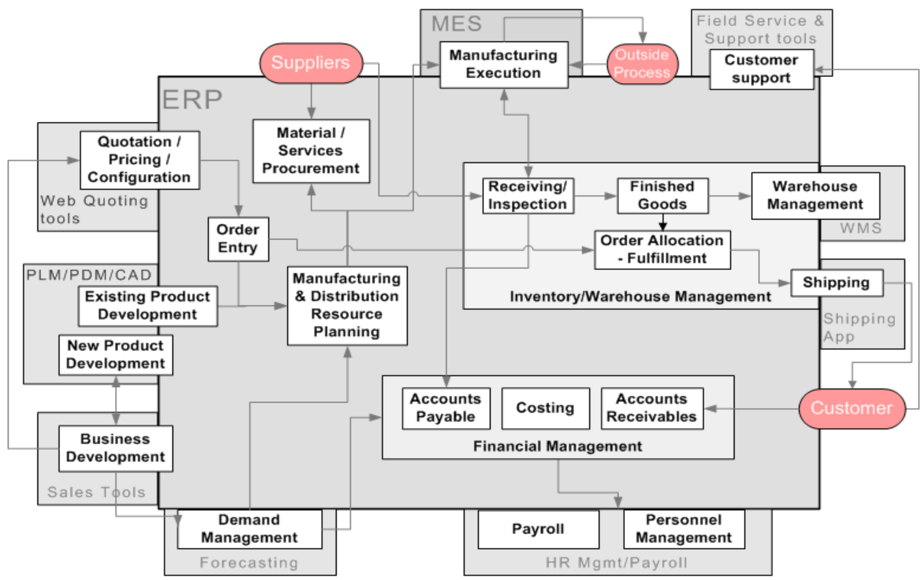
significantly true, then then the function is likely not within the ERP boundary—for example payroll functionality. ERP sellers may offer functionality deemed to be outside the ERP boundary, in which case the buyer should know they have options and should more carefully screen such elements of an ERP offer.



ERP Boundary Diagram Sample

b. User and device access: Establish estimates for the type of users and devices that are projected to need to interact with new ERP. The actual ERP usage requirements will not be known until well into the business process design phase of the implementation. This is the reason for seeking fixed pricing and terms for future ERP access for at least two years, which enables safer initial ERP access purchase with known amounts and terms to buy more when the need is confirmed.

c. Integration needed with ERP: There may be other applications existing or in the project scope that need to share data and processes with ERP. These should be described in reasonable detail, as some ERP sellers have licensing dimensions based on indirect users or transaction volume which can result in very undesirable fees that must be contained in order to reach the appropriate ERP access pricing.

2. ERP access approach for the ERP buyer: Consider the ERP buyer's options for accessing their ERP or other applications in a subscription approach (single tenant or multi-tenant) versus perpetual licenses hosted by the ERP seller, an independent hosting entity, or hosted by the ERP buyer. Important factors to consider when accessing ERP in a subscription model hosted by a third party entity are comprehensively explained in another Engleman Associates white paper called *Dependable and Controlled Access to Cloud ERP*.

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3. What exactly does a particular ERP seller offer? Before any ERP offer is created, the buyer must understand what actually exists with an ERP seller and their licensing approach and options. Determine:
    a. What is the ERP seller's 'whole' offering before the ERP seller starts narrowing it down to what they think the buyer needs.
    b. The ERP seller's pricing architecture—meaning what are the dimensions proposed for developing an eventual software cost offer, such as modules, a core ERP concept, user types (shared or named), devices, integrations, transaction volumes, buyer's gross revenue, territory, technical-level access rules, and more. *This step is not seeking an actual cost offer or proposal*, but instead an understanding of the ERP access pricing architecture.
    c. ERP options for (1) multi-tenant subscription and (2) single tenant subscription or perpetual license access. Also determine differences in access functionality rights, built-in tools, and other differences and options, if any.
4. Alignment: Align the ERP buyer's needs established in step #1 and #2 to each ERP seller's offering as established in step #3. This alignment is focused on functions within the ERP boundary discussed earlier—and this often requires continual containment of the ERP sellers as their sales process is designed to expand past the boundary. Remember, the buyer is still only attempting to establish an informed point of view as to what software access rights are needed from a particular ERP seller, and in this step is deliberately not seeking any pricing. This buyer/seller alignment exercise is inherently complicated, but it must be conducted. Otherwise, a typical ERP deal will likely have many ERP access cost estimate errors and unexpected pricing impacts over time.

Buyer establishes target costs for ERP access: In the earlier section on *The Good Deal: Key Objectives for ERP Cost Control*, the concept of 'informed market cost' was introduced. Again, this means the initial and ongoing ERP access costs achievable when the buyer is highly informed and executes the buying process well. The scope of this white paper is intended to establish this concept, not to attempt specifically detailing how to confidently locate and defend the 'informed market cost'. A rough rule of thumb is the 'informed market cost' is usually at the most half of whatever is being presented by sellers as retail pricing. The savings can usually be even more when the disciplined buyer/seller alignment exercise from the prior section creates insight and tactics to have sellers include more access rights at little to no additional costs. In most cases, once the 'informed market cost' is established, the candidate ERP sellers should be briefed on the target amounts, again in the context of the alignment exercise. Finally, to achieve the 'informed market cost' and related commercial terms, the ERP buyer must effectively execute on most of the tactics in the next section of this paper.

Present target cost amounts to ERP sellers: ERP target cost details are best held for the final two candidates—a time when they have a better chance to win, have invested time, and are less likely to drop out based on the target pricing seeming too aggressive. The long list candidates can be told qualitatively of the cost control objectives—mainly about escalation terms for maintenance/support fees or subscription fees. The presentation of the target costs should also include the following concepts:

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- Objectives-not demands: The selection team is not demanding any of the stated cost and terms objectives be met, but instead communicating objectives that the selection team believes can generally be achieved. This is important, as an ERP vendor sales team and process will potentially react poorly if they believe they have an aggressive and apparently firm demand from a prospect. They need time to work toward the objectives in a process that is described in a following section.
- Not typical negotiating: Most advisors and rules will say: 'Don't be the first to mention price in negotiating'. Based on the approach in this document, it is typically helpful if the buyer gets the ERP software cost objectives on the table. It has been the experience of Engleman Associates, Inc., in hundreds of projects, that the finalist ERP sellers will not be anywhere close to the objective ERP costs we will set forth. There are exceptions to this point with smaller companies seeking ERP, upgrade options for existing ERP, and ERP delivery innovation that a vendor may show. So if any of these situations are detected, it is usually best for the ERP software vendor to present their pricing approach first.
- Use target costs and not target discounts: Target costs for well described ERP access is far more precise than stating a target discount. First, the sellers have been known to move around the list pricing to manipulate the offer price based on a specific discount. Secondly, if software vendors believe the target price is apparently a trial balloon (asking for 60% off list pricing would likely be interpreted this way), they will likely say 'no', believing the buyer has no real basis or confidence in the objectives and that other sellers will also not meet these ERP license cost objectives.

In summary the suggestions above for presenting target ERP access costs are designed to start the conversation based on the accurate alignment exercise while not scaring off finalists. Then the process can unfold to actually arrange an ERP access purchase that significantly meets the cost and commercial terms objectives, and be a process in which the sellers come to the conclusion that the buyer's cost objectives and commercial terms are far better than losing the sale, the sales commissions, and all the ongoing customer revenue. But to get to this final desired result, the buyer usually has to navigate a barrage of smoke and mirrors, and that is the basis for the next section on tactics.

Tactics for Achieving the Key Cost Control Objectives

This section describes general techniques used to control the iterative process of reaching the ERP access cost control objective described earlier in this paper.

Competition is critical: There must be at least two finalists for which detailed discussions are happening, and the ERP buyer should strive to always be mechanical and not show any particular enthusiasm (otherwise called 'buy signals'). The ERP sellers are accustomed to buyers projecting buy signals, and this will typically place a drag on the sellers providing the ERP access cost and terms being sought. The mechanical, non-emotional approach is read by the ERP sellers as 'we are not winning', and this usually contributes to the proper seller motivation needed.

Your ERP access cost objectives are eminently reasonable: ERP access cost objectives in this paper are reasonable considering the buyer's legitimate

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needs, and nothing in the objectives is actually unfair to the ERP seller—notwithstanding their predictable claims.

Don't be in a rush: If an ERP buyer appears to be in a rush, the ERP sellers normally use this as an excuse for not effectively processing the buyer's cost control and terms objectives described in this document. Further, ERP sellers understandably believe that calendar time elapsing is not in their favor. Therefore, if the buyer is not in a rush, then the ERP seller will usually attempt to create a sense of urgency. In this situation, the sellers are more inclined to significantly deliver on the cost and terms objectives sought. Related to this topic, never be compelled by an ERP seller telling you 'to get the better deal' you have to close by a certain date. In these situations, you should tell the ERP seller that your company will close when the team has the right information from the finalist ERP sellers, and that you are well aware the 'informed market cost' can be achieved at any time—which is true if the buyer executes well.

Specific people on your team discussing cost and terms: Only designated people at the buyer's company should be empowered to discuss cost and terms matters with the ERP sellers. When the ERP seller assumes they can call anyone related to the project, they often will - either seeking their status through veiled inquiries or to present their concerns to one or more executives. They may claim the cost and terms objectives are simply unreasonable, or even make dramatic statements about having never offered such cost and terms. The buyer's team should be instructed to redirect the ERP seller to the assigned team and provide zero options for this potentially disruptive back-channel activity.

Continue to emphasize all selection factors: Notwithstanding this paper's focus on reaching the 'informed market cost' and related terms, the ERP sellers should never be led to believe the buyer is mainly buying based on costs. In a properly orchestrated ERP selection process, the other four key selection factors are (1) functionality to support business processes, (2) technical layer status of the ERP, (3) commercial terms (much more than just terms related to cost control), and (4) certain aspects of implementation services. Emphasizing all of these selection factors tends to create other competitive pressures on ERP sellers to further help achieve the 'informed market cost'.

Timing to present ERP cost and terms objectives: The initial ERP selection process should focus on functional and technical-layer priorities. After the status of these criteria are sufficiently known for the long list of ERP sellers, the topic of ERP cost and terms objectives can be generally introduced as an influencer for picking the ERP short list of candidates and choosing the final ERP. If actual ERP access target amounts are presented too early (when there are four or more sellers on the long list), candidate ERP sellers may self-withdraw on that basis. They don't tend to do this when they are one of two finalists.

Third party applications: For any functional objectives in scope but outside of the basic core ERP boundary (as shown on the earlier ERP Boundary Diagram Sample), it is instructive to test a few third-party alternatives from each application type against key functional and technical objectives to determine each product type's 'informed market cost'. At a minimum this should help encourage the ERP sellers to reduce their pricing, if needed for such applications types, and sometimes the buyer will discover better solutions with the specialty application developers.

Pricing reputation, or if existing vendor quotes already exist: As a general concept, pay no attention to early indications that one seller's software,

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maintenance, or subscription is more or less expensive than another ERP candidate. All of it is effectively wrong. The candidate software vendors will usually react to a competitive situation if they think they need to do so to win. This is especially true late in the ERP selection process after the sellers have invested time and money to reach the final group of ERP candidates.

Closing Key Points

After reading this document, it should be abundantly clear if one wants to achieve proper results they cannot depend upon the benevolent and reasonable behavior from the ERP sellers. Project after project, year after year, this has been the experience of our company clients. Remember, we are not calling the ERP sellers bad people, but they exist in a culture that can be abusive to the buyer, especially after the buyer has implemented the ERP and is effectively captured.

Most of this information relates to new ERP access purchases in which the buyer has huge leverage. But even if a buyer is apparently trapped in the typical bad deal, there can be a multi-year process to make significant improvements.

The long term status of the ERP industry: In our view this current situation is not sustainable, as the ERP buyers eventually will rise up in sufficient numbers to force the industry to change. Therein lies opportunity for ERP sellers. We contend that if a relevant ERP was offered with a fair deal as described in this document, one could argue that while the customer-specific revenue would likely drop significantly for the sellers, they would sell many more deals. These ERP sellers would not only stand out, but shine a bright light on the typical hostile offers from this industry.

This paper was developed by the EAI team, each of whom has over 20 years of experience arranging the favorable cost and terms objectives described in this paper. Significant amounts of money and commercial control are in play with new ERP purchases, and ongoing cost control improvements can even be made to existing ERP.

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