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Research Brief for Users of Oracle and SAP Enterprise Applications

Is Third-Party Software Support Right for You?

Analyzing the Operational, Legal, and Financial Implications of the Third-Party Option

EXECUTIVE SUMMARY

At most enterprises, software is the first or second largest category of IT spending and consumes 25-40% of IT costs in most industries.(1) Accenture recently found that maintenance and support consumes 50-60% of software spending, primarily delivered by software publishers. Within 3-5 years, enterprises spend as much on support as on the original software purchase. While this is a necessary cost of business, Aberdeen(2) and Gartner(3) have found that many enterprise leaders are dissatisfied. Third-party software support typically increases satisfaction and cuts maintenance costs 50%.(3) These gains enable IT leaders to do more for the business. Furthermore, this option buys time to consider longer-term software choices. However, third-party support is not for everyone. This brief summarizes top considerations.

TOP OPERATIONAL CONSIDERATIONS

- ***Modifications*** – third parties usually support issues with modified code. Publishers usually do not, requiring the enterprise to carry that cost or in some cases forego valuable modifications.
- ***Expert first call response*** – third parties usually dedicate a senior engineer as the primary contact from first call to final resolution. Publishers typically use junior customer care representatives or technicians for the first call on an issue.
- ***Upgrades*** – third parties do not deliver future publisher-built upgrades or new releases.

TOP LEGAL CONSIDERATIONS

- ***Publisher validation*** – as reported by publications such as Information Week and CRM Magazine, publishers acknowledge the legality of the third-party choice.
- ***Intellectual property protection*** – third-party support providers need to operate in ways that protect the intellectual property rights of the publisher, such as only working in customer environments and not accessing publishers' subscriber-only systems.
- ***Provider risk*** – some third parties have incurred or could face legally mandated financial penalties for intellectual property rights violations.

TOP FINANCIAL CONSIDERATIONS

- ***Annual expenses*** – typical publisher costs are 18-22% of license purchase costs, increasing at least 2-5% per year. Third-party subscribers typically cut that cost in half.(2)
- ***Software replacement point*** – subscribers typically pay again the equivalent of the purchase price in about three years with publishers, five years or more with third-party providers.
- ***Re-engagement for upgrades*** – customers wishing to acquire new upgrades or releases can re-engage with the publisher. Relicensing typically costs less than paying "back" support.

IS THIRD-PARTY SUPPORT RIGHT FOR YOU?

The best candidates for third-party support share these characteristics:

- ***Stable*** – enterprises that operate in more stable environments and have upgrade cycles greater than 36 months
- ***Highly modified*** – enterprises that are operating a highly modified software version that makes it difficult to easily take advantage of software patches or fixes
- ***Planned replacement*** – when migrating to another application (cloud or on premise) and the business need to cut costs leading up to parallel operations and eventual system shutdown
- ***Duress*** – enterprises that are in a state of extraordinary financial challenges and budget cuts

  The expenditure with software publishers for ongoing support makes sense for enterprises with these characteristics:

- ***Initial deployment of a major release*** – enterprises needing the numerous corrective patches and support calls following the deployment of a major release
- ***Highly dynamic technology environment*** – enterprises maintaining a frequent system upgrade cycle every 18-36 months.

HOW TO CHOOSE A THIRD-PARTY SUPPORT PROVIDER

- ***Select*** – identify a third-party partner that can satisfy the business requirements for all needed software support services: software support, application and technical managed services, and traditional consulting services. Identify the expected savings
- ***Validate*** – confirm that the preferred third party service provider's delivery practices, processes, and methods do not violate your software publisher's intellectual property rights
- ***Confirm*** – verify that the preferred partner's financial viability is not threatened by litigation

Third-party support can be a powerful strategy to take back control of the enterprise roadmap from the software publisher. Managed effectively, this alternative drives significant operational savings, improves services levels, and frees the IT support organization to focus on innovation.

IN THIS BRIEF

YOUR SOFTWARE SUPPORT OPTIONS

After the installation and rollout, enterprise software users enter the support phase. In this phase, business leaders request additional reports and dashboards, and users seek additional training. IT staff need additional help to answer questions, fix problems, and get things done for internal customers.

When IT staff needs additional help, the default choice is to obtain support services (also known as "maintenance") from the software publisher. Another choice that is growing in popularity is to obtain support services from third parties, independent from the software publisher. This Research Brief focuses on software support services for customer-owned (licensed), installed on premise software.

Software support is separate from the license purchase. Support is an ongoing service of providing product support and updates – after the publisher releases the software and the customer starts using it.

You might think of software support in these terms:

- ***Corrective*** – the process of developing changes to repair bugs or fix issues. In addition, it is the process of helping to resolve usage inquiries and issues.
- ***Adaptive*** – adjusts the software to function in new environments, keeping it current and suitable for changing enterprise needs.
- ***Perfective*** – adds new features or improves user interaction.
- ***Preventive*** – makes future changes and fixes to the software simpler to accomplish.

Obtaining support services from the software publisher is the default choice made by most enterprise leaders. However, it is not necessarily a satisfying choice. Common customer satisfaction issues with publishers' support services center primarily around value and cost:[2]

- ***No support with customizations*** – modifications are commonplace to adapt software to an enterprise's unique business processes and systems environment. Software publishers usually do not support modifications, such as helping to troubleshoot issues in modified modules. This lengthens the time it takes to resolve some issues and reduces customer satisfaction with their support expenditures.
- ***Untimely bug fixes*** – software publishers prioritize bug fixes and change requests. Until the publisher delivers relevant fixes, enterprise customers may need to live with problems or invest in custom patches, on top of their support expenditure.
- ***Unsatisfactory support service levels*** – enterprise leaders look for rapid initial responses and short times to resolution. A common complaint is that initial calls to publishers are fielded by junior customer service representatives, possibly in other regions, who are not able to understand or resolve many issues. A further aggravation occurs when enterprise employees repeatedly have to provide background information on their technical environment.
- ***Self-service inefficiencies*** – publishers' promotion of self-service tools, while empowering the customer, also push more research and resolution labor costs onto customers and can delay the time to resolution.
- ***Low value in stable environments*** – when the software is stable and effective, and the deployment of new modules or upgrades is not urgent, publishers' support costs may seem excessive.
- ***Limited value while migrating to the cloud*** – while migrating to the cloud, companies need to continue operating in parallel on their CRM, HCM, ERP, and other systems. In this case, the cost of publisher-provided support may seem excessive.
- ***Ever-increasing support costs*** – an unwritten rule of enterprise-level software is that support costs only go up — never down. Why? Support revenues are recurring, highly profitable, and help to lock in the customer to a long-term financial relationship. In times of increasing pressure on businesses to cut costs, software publishers apply their advantage to increase costs.

More enterprises worldwide are purchasing independent, third party-provided software support as an alternative to software publisher-delivered support. In their view, the experience with third-party support providers can increase value delivered and customer satisfaction, is a safe and legally sound choice, and reduces costs.

This Research Brief presents a balanced analysis of the operational, legal, and financial implications to consider when making this strategic business decision.

OPERATIONAL IMPLICATIONS OF THIRD-PARTY SUPPORT

How does the third-party support experience differ from support from software publishers? Let us explore what each offer and the key differences.

WHAT DO SOFTWARE PUBLISHERS OFFER FOR SUPPORT?

Leading software publishers for enterprises, such as Oracle and SAP, offer fee-based support services in standard and enhanced tiers. While enhanced services vary by vendor, standard software support from top-tier software publishers includes common services for non-customized implementations, during the publisher-defined time span of support:

- ***Software Break/Fix*** – updates and fixes to newly identified software issues
- ***Application and Technical*** – user support for standard and non-customized software and technical configuration
- ***Tax, Legal and Regulatory*** – global updates for change compliance

In addition, standard support services from software publishers often include:

- ***Access*** to product knowledge base
- ***Access*** to fee-based advanced customer support services
- ***Certification*** with select new products and versions from the software publisher
- ***Certification*** with select new products and versions from third party publishers
- ***Upgrades*** of licensed application products and technology
- ***Upgrade*** Tools and Scripts

SUPPORT OFFERINGS CHANGE OVER TIME

Most enterprise software publishers commit to supporting published software indefinitely, for as long as enough customers wish to pay. Commonly, software vendors offer multiple periods of varying support, usually based upon the software product's General Availability (GA) market release date.

Table 1 – Publisher Support Offerings

Support Services	Period of Standard Support (Up to 5 Years from GA)	Period of Extended Support (Additional 1-3 Years)	Period of Sustained Support (Indefinite)
Software Break/Fix	X	X	
Application & Technical Support	X	X	
Tax, Legal and Regulatory	X	X	
Certification with Most New Publishers' Products/Versions	X	X	
Certification with Most New Third-Party Products/Versions	X	X	
Access to Product Knowledge Base	X	X	X
Access to Fee Based Advanced Support Services	X	X	X
Product and Technology Releases	X[(a)]	X[(a)]	X[(a)]
Upgrade Tools and Scripts	X	X	X
Cost	18% - 22%	Additional 5-10%	Additional 5-10%

Table 1 Notes: Enterprise buyers need to explore the definitions and limitations of their rights to "minor" and "major" releases. In practice, publishers may adopt packaging or pricing strategies that force costly changes in license structures or require the purchase of new technologies such as Oracle Fusion Middleware or the SAP HANA database.

For enterprise resource planning (ERP) software, publisher's "standard" annual support fees typically range from 18% to 22% of the initial license charges. [4] In addition, annual increases of 2% to 5% are common. Once the time span of a customer's release enters a period of either "extended" and "sustaining" support, the publisher may increase the base annual fees by an additional 5% to 10%.[3]

These revenues represent a major annuity stream for companies such as Microsoft, Oracle, and SAP. For example, Citigroup Global Markets reported that software support accounted for over 53% of Oracle's total revenues and delivered a contribution margin in excess of 93%[6].

What does the software publisher invest to deliver these offerings, beyond the direct labor cost of handling customer inquiries? The most visible area of investment is in support infrastructure, including call/inquiry routing software, knowledge bases and web self-service portals, and support/testing environments (functional code, databases, operating systems, middleware, and hardware). Each component has a specified lifecycle and support timeframe. Another key investment is in development, dealing with the prioritized backlog of bug reports, enhancement requests, and major new functionality.

However, the value of the services delivered diminishes over time. As the table above shows, publishers eliminate significant service features once a product reaches a period of "sustained" support. Most noticeable are the exclusion of new software code break fixes, tax and regulatory updates, and product certifications.

Software obsolescence occurs when hardware or software manufacturers establish a pre-determined date for the end of "extended support," even if the software remains stable. Software publishers leverage the price structure and concerns over system obsolescence to incent customers to invest in, and possibly migrate to, new products.

WHAT IS NEW IN PUBLISHERS' SOFTWARE SUPPORT DELIVERY?

Industry leaders continue to simplify the enterprise software support experience. A prime example is the transition of support service delivery towards tool-based self-service. These automated support tools enable faster problem diagnosis and resolution, as well as to issue notifications proactively to prevent problems before they occur. For customers, a commonly expressed downside of the support automation trend is the loss of personalized support experiences and the transfer more support costs from the software publisher to a customer's internal support team.

WHAT DO THIRD PARTIES OFFER FOR SUPPORT?

Users of enterprise software are more frequently acquiring third party software support to control costs, increase service quality, and regain control of investment roadmap decisions.

Enterprise software users have been purchasing third-party software support since 2002. Firms engaged in the delivery of third-party support are responding to specific conditions within the markets they service. Ray Wang of Constellation Research reports:[7]

- ***Continuing cost pressures*** – budgets continue to be level or declining. With additional pressures to innovate and otherwise do more, CIOs must find fat without trimming bone.
- ***Receiving minimal value from support services*** – most felt they were paying too much for too little, especially with reported increases of as much as 8% in publishers' support prices.
- ***Declining plans to upgrade*** – challenging economic conditions are driving company leaders to search for additional cost reductions.
- ***Expecting better service*** – service quality continues to play a key factor in decisions to switch to third-party support. Over 60% of respondents had experienced poor levels of service from publishers.

- ***Slowing pace of vendor innovation*** – more than 50% of respondents believe their vendor has been too slow to deliver new capabilities, such as SaaS deployment options or key functionality in areas such as strategic HCM and social CRM.
- ***Disliking the customer experience*** – about 30% of the survey respondents have had bad experiences with their vendor, typically with sales or support representatives.
- ***Delivering self-support*** – almost 30% of respondents already provide their own support. These organizations have no need to pay for support when they are doing all or most of the work.

Third-party support is a replacement of a software publisher's support, often at a fraction of the cost. Third-party support focuses primarily on keeping your system stable and compliant without forced upgrades. Third-party support services generally include at a minimum:

- ***Diagnostic and fix*** services for software issues/bugs
- ***General product inquiry***/use support
- ***Global Regulatory, Tax and Security*** advisory and update services

Furthermore, leading third-party software support providers include advanced support services to safeguard the licensee's enterprise software investments. Such services usually include but are not limited to the following:

- ***Service Transition*** – there is a formal transition process during which the support provider and the software user implement a phased approach to transitioning support services. Each phase has defined activities necessary to transfer knowledge of the customer's practices, processes, culture, and technology, including the archiving of all software publisher products and updates to which the licensee has rights (whether deployed or not).
- ***Lifecycle Management*** – no ERP system supports the business needs forever. At some point, licensees will need to evaluate options. Leading support providers include business advisory services for customers ready to re-engage the software publisher to obtain new software products or major releases.
- ***Interoperability*** – the technology foundation upon which enterprise applications run – middleware, databases, operating systems, and hardware – change over time, even if the application code remains stable. Interoperability support underpins third-party support providers' lifetime support commitment. Third-party support providers play a key role advising and providing technical expertise, often partnering with key technology vendors to ensure the ongoing interoperability between applications and their dynamic infrastructure foundation.
- ***Cloud Migration*** – most third party support providers are well experienced in supporting hybrid IT environments of on premise and cloud software deployments. Third-party support teams deliver assistance and guidance to facilitate a smooth transition from on premise to the cloud, enabling clients to extend the value of their core enterprise software investments by adopting innovative cloud software.
- ***Virtualization*** – many enterprises are deploying virtualization technology to increase the utilization, efficiency, and availability of systems. Third-party support teams deliver assistance and guidance to leverage virtualization technologies to the benefit of clients.
- ***Tax Monitoring*** – in order to provide tax updates, support providers monitor, advise, and implement code changes on a continuous basis for compliance areas such as Country and state/province budgetary and income tax changes, payroll and social/social security tax rate adjustments, unemployment insurance, sales and use taxes, GST and VAT changes, treaties, and rate updates.
- ***Regulatory Monitoring*** – similar to tax monitoring, providers track, advise, and implement code changes for regulatory changes made by global rule making bodies such a: AICPA, GAAP, FASB, PCAOB, COSO, GASB, SEC, IASB, IFRS, and SEPA.

- ***Security Advisement*** - although business software is protected by multiple layers of IT security technology, third-party support providers give advice on how to create an integrated, multi-layered, multi-component approach to protect the licensee's core business software.
- ***Lifetime Support Policy*** – unlike the software publisher, third-party support providers work to keep the software products they support running indefinitely. Most support policies provide access to support experts for the duration of the relationship with the provider.

WHAT MAKES THIRD-PARTY SUPPORT SERVICES DIFFERENT?

While price is a top-of-mind difference, there are additional valuable distinctions with third-party support services:

- ***Break/Fix Support for Customizations*** – the provider delivers software diagnostic and fix assistance customized as well as standard code. In contrast, publishers usually will not support customized code. Third-party support for customizations reduces the in-house support burden and provides additional expertise when needed.
- ***Rapid Response*** – 30-minute response time on critical Issues is typical.
- ***Personalized*** – providers typically assign to the enterprise customer one key engineer as a primary contact, rather than drawing from a pool – a one-to-one support model versus the software publisher's one-to-many model. This makes the support contact more knowledgeable about the enterprise environment and past issues, which speeds issue resolution and reduces common customer frustrations.
- ***Expertise*** – typically, enterprise customer issues are fielded from the first request to final resolution by an expert-level engineer who is capable of resolving the reported issue. In contrast, many publishers use junior personnel for the initial response to issues, which may lengthen the time to explain the issue and obtain a final resolution.
- ***Issue Management*** – dynamic issue tracking systems deliver real-time updates to enterprise contacts about reported issues. Escalation systems assure timely access to the right resources. Note: some software publishers offer similar capabilities.
- ***Customized Reporting*** – powerful issue management systems enabling personalized reporting on service level agreement performance metrics.
- ***Fraction of the cost*** – providers typically offer a minimum of 50% savings over software publisher support. [(3)] Furthermore, often the support fees are adjusted downward to match the licenses actually used (excluding unused "shelf ware"), creating additional savings.

Third-party support providers offer break/fix, inquiry, and tax/regulatory update and advisory services. These offerings are in place of and generally comparable to those provided by the publisher.

What third-party support providers do not offer is the right to acquire (at no extra cost) publishers' new software releases, new software made available after a support contract is cancelled. Enterprises that later decide to acquire these releases will need to negotiate with the publisher. As detailed in the Financial Implications section, the primary choices are to either license (or re-license) the software or to pay some portion of previously avoided maintenance fees. At this time, many enterprises reevaluate the fit of their licensed software. For some, migrating to cloud-delivered software is the best choice.

A common on-boarding practice when enterprises get started with a third party support provider is to create an archive of all licensed software publisher releases (installed or merely available), enhancements, fixes, upgrade scripts, and product documentation. This ensures that the enterprise has custody of and ready access to all assets to which they are entitled, before cancelling publisher-delivered support services. These assets may help enterprises and their third party support team to resolve future issues, such as writing custom code to resolve a publisher's bug.

Third-party support is a viable alternative to software publisher support. It delivers valuable benefits to enterprise customers while providing both essential and innovative services.

LEGAL IMPLICATIONS OF THIRD-PARTY SUPPORT

Third-party support is a safe choice. However, enterprise leaders need to look for a few key characteristics to decide if they are choosing a safe provider.

PUBLISHERS VALIDATE THE SAFETY OF THIRD-PARTY SUPPORT

The industry leading publishers of enterprise software consistently state the validity of third-party software support industry. However, they aggressively protect their support revenue streams in cases of perceived intellectual property infringement.

> "I think it is fine that there is choice." – Jim Hagemann Snabe, SAP CEO, SAPPHIRE 2013

> "SAP does not prevent the use of third-party maintenance providers." "We promote the concept of customer choice and we have for years." – Bill Wohl, SAP VP of Global Communications, by Mary Hayes Weier, *Information Week*, February 2009

> "Oracle does acknowledge the legality of third-party support" – Juan Martinez, CRM Magazine assistant editor, *DestinationCRM.com*, February 2011

COURTS AFFIRM THE NEED TO PROTECT INTELLECTUAL PROPERTY

While enterprise software publishers have validated the choice to acquire support services from third parties, the processes followed by some third-party providers has led to litigation. Here is a very brief summary.

SAP AG/TomorrowNow

According to Oracle, TomorrowNow downloaded without authorization thousands of documents and programs from Oracle's Customer Connection technical support website using customers' contract credentials (current or already expired). In addition, TomorrowNow downloaded copyrighted support material for which the customers did not hold a license. [8] The courts ordered SAP to pay Oracle a total of $292 million in 2011.

CedarCrestone

Oracle alleged that longtime services partner CedarCrestone was stealing Oracle software for use in its services offerings. Oracle sued CedarCrestone for copyright infringement, breach of contract and unfair competition and sought unspecified damages. In 2013, the parties reached a confidential settlement.

Rimini Street, Inc.

Oracle sued Rimini Street (RS) alleging that certain RS processes violate Oracle's license agreements, infringed upon copyrights, and violated other federal and state laws. An additional complaint alleged that RS had copied, distributed, and created derivative works from Oracle IP – then using materials obtained for one customer to support a different customer. In October of 2015, a jury awarded nearly $53 million in damages to Oracle. Since that time, RS has been ordered to pay Oracle additional legal fees and accrued interest. A second legal battle, covering a more recent time period, is now underway.

WHAT DOES THIS MEAN FOR ENTERPRISE LEADERS?

While third-party support providers account for only a small percentage of the enterprise software support market, a growing number of enterprises are selecting independent support services as a safe choice. The legal landscape among third-party support providers may change over time. Nevertheless, enterprise buyers should look for providers that:

- Protect the publisher's intellectual property and thereby are not at risk of costly litigation
- Are not facing legal judgments that could affect their processes or even their viability

Here are some characteristics to look for:

- ***Remote access*** – support is performed entirely through remote connections to the enterprise clients' systems and environments.
- ***Consultative work*** – the support provider's staff perform all work just as a consultant would do sitting in a client's office.
- ***Client environments*** – most or all code fixes are authored by the third party provider, in the client's environment.
- ***Individual fixes*** – code fixes are specific to each individual client.
- ***Restricted sites*** – the support provider's staff do not access any password-protected websites from the software publisher to provide code fixes.
- ***Restricted downloads*** – the support provider's staff do not download any material from a software publisher on a client's behalf – no tools, no documentation, no patches or other program code.
- ***No provider copies*** – the third-party support staff do not store on the provider's systems any copies of the work product or related documentation, assuring that any fixes (such as program code and documentation) are the sole property of the client.

Furthermore, Gartner Research recommends: (3)

- ***Legal guidance*** – review software license and support contracts with legal counsel to ensure compliance with IP protection requirements, specifically in areas such as product downloads and the use of third parties for support services.

By performing a modest amount of due diligence, enterprise buyers can be confident that they are making a safe choice from a safe provider.

> "The validity of third-party support has never been an issue, only the manner in which it is delivered. My management team and I have worked diligently to implement and preserve the integrity of our software support delivery model that protects the intellectual property rights of our customers and third-party software publishers. It is a model validated by the federal court's recent findings, and more importantly by Oracle itself." – Matt Stava, Spinnaker Support CEO

FINANCIAL IMPLICATIONS OF THIRD-PARTY SUPPORT

There are three primary approaches being used for ongoing support of enterprise software applications, each with its own set of costs and benefits:

1. In-house support, is a method used to control or reduce cost but carries risk should key team members leave the fold. For this reason, organizations frequently outsource to back-up or augment in-house resources. In this white paper, we will not further discuss this approach.
2. Ongoing support provided by the software publisher. Many enterprise IT leaders question whether the high annual support fees charged by software publishers deliver sufficient benefit and payback. Industry analysts such as Aberdeen, [2] Accenture, [1] Constellation [7,9] and Gartner [3] suggest that CIOs on average are overspending on software licenses and support. Furthermore, most software licensees effectively re-buy their enterprise applications every three to five years through support fees and other support-related costs – such as in-house headcount augmentation or oversight. However, many organizations view this as their best option, particularly if they intend to upgrade and stay current on new versions and/or drive to the Cloud.
3. Third-party software support, which is an increasingly popular option. Analysts and media often report how third parties offer more personalized service for half the cost of software publisher prices.

When comparing costs between software publisher support and third-party provider support, one must consider a range of factors, including:

- ***Cost of initial software licenses*** – Software license purchase price establishes the baseline for annual support fees.
- ***Annual support fees*** – The software publisher's annual support fees typically range from 18% to 22% of initial software license charges [4] with annual increases ranging from 2% to 5%.
- ***Costs associated with time/event-driven changes in support levels*** – Software publishers typically vary maintenance/support level and cost of support based upon age of software version. "Standard" support is initially provided in exchange for 18% to 22% of software license purchase price. In time, the software publisher will mandate a 5% to 10% price increase to retain the standard level of support. This service is sometimes referred to as "extended" support. After more time, the publisher will again raise support pricing by 5% to 10% for a reduced level of support – sometimes called "sustaining" support.
- ***Cost of software upgrades*** – For a myriad of business and technical reasons, organizations opt to "stay current" by upgrading to the latest software releases. However, a surging number of other organizations are investigating and adopting third-party support alternatives so they can keep what they have without paying more for less. Upgrading to a new software version is not an insignificant expenditure ($250,000 and up). Enterprises are increasingly seeking options rather than feeling forced to upgrade.
- ***In-house support costs*** - Using the application as delivered by the publisher, enterprises often pay additional expenses for internal help desk staffing and initial issue resolution, ongoing staff training, system administration (including user management, backups, and database administration), software bug fix patches and updates, and software upgrades.

Software publishers typically charge clients at least 2X more for annual support than do third-party providers. A choice is made by the software vendor to maximize software support profit margins, which Citigroup Global Markets reports can be as high as 93%.[6]

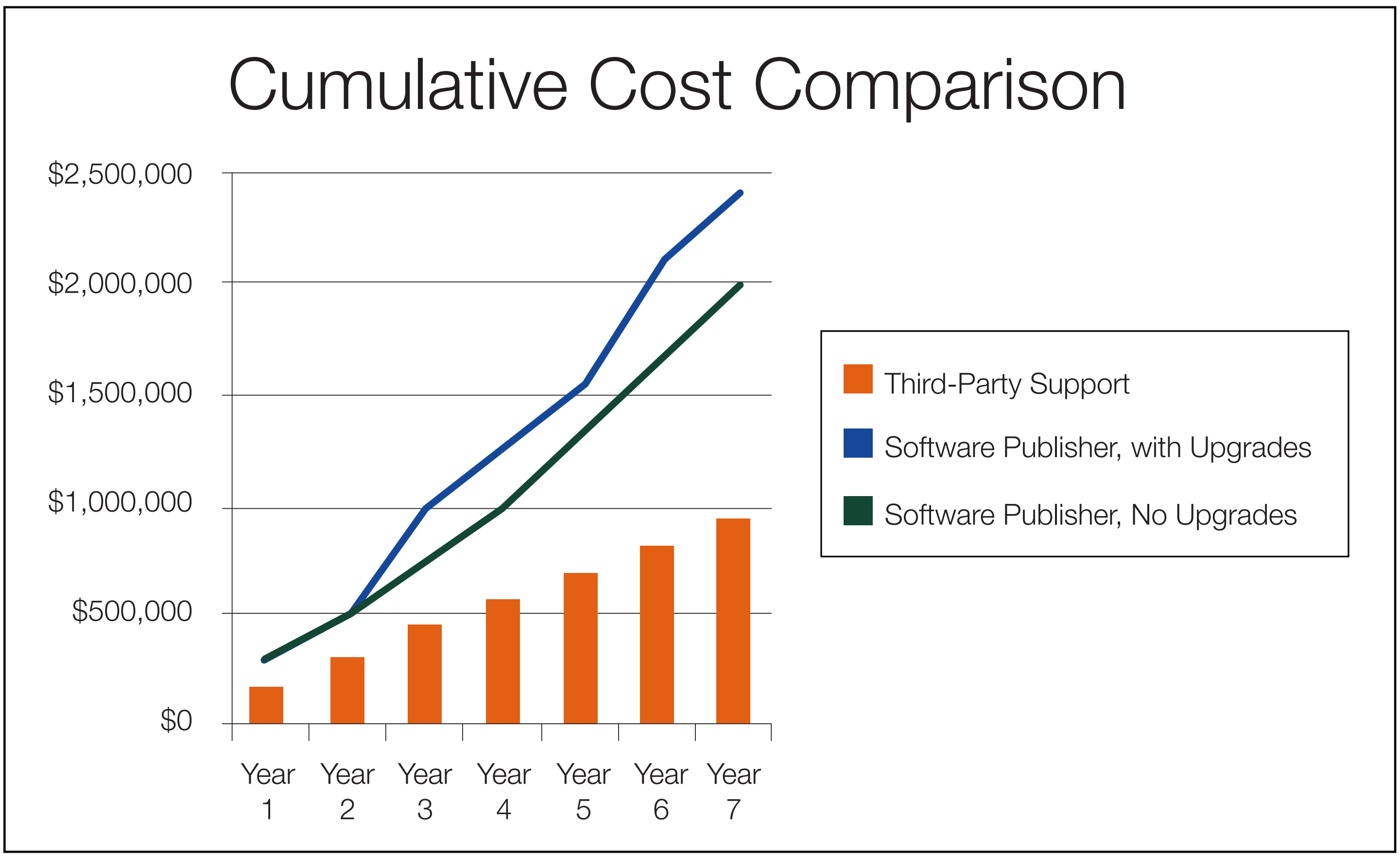
Major software publishers direct a substantial portion of research and development to acquisitions, cloud-delivered SaaS applications, integrations, etc. Many clients of these publishers have current or longer-term needs and priorities that simply don't align with the publishers' priorities. Forced upgrades to avoid diminished support at higher cost (with loss of customizations) are now being averted because third-party support has surfaced as a proven, safe, and higher-value alternative.

Enterprises can find additional opportunities to save. Most enterprises have unused seats (shelf ware) for which they pay support fees. Leading third-party providers rationalize and reduce their fees based on actual software usage. Also, costs for applying software updates frequently exceed these conservative estimates. In sum, these additional opportunities may support third-party claims of 70 percent or more in annual savings.

COMPARING THE FINANCIAL IMPLICATIONS OF PUBLISHER VS. THIRD-PARTY

For comparison's sake, we will illustrate three software support cost scenarios.

1. ***Software publisher***, no new version upgrades – transitioning from initial support to medium support (same service, more money), to lower value support (less service, more money).
2. ***Software publisher***, new version upgrades every three years.
3. ***Third-party software support***, full-service, 50% of software publisher cost.

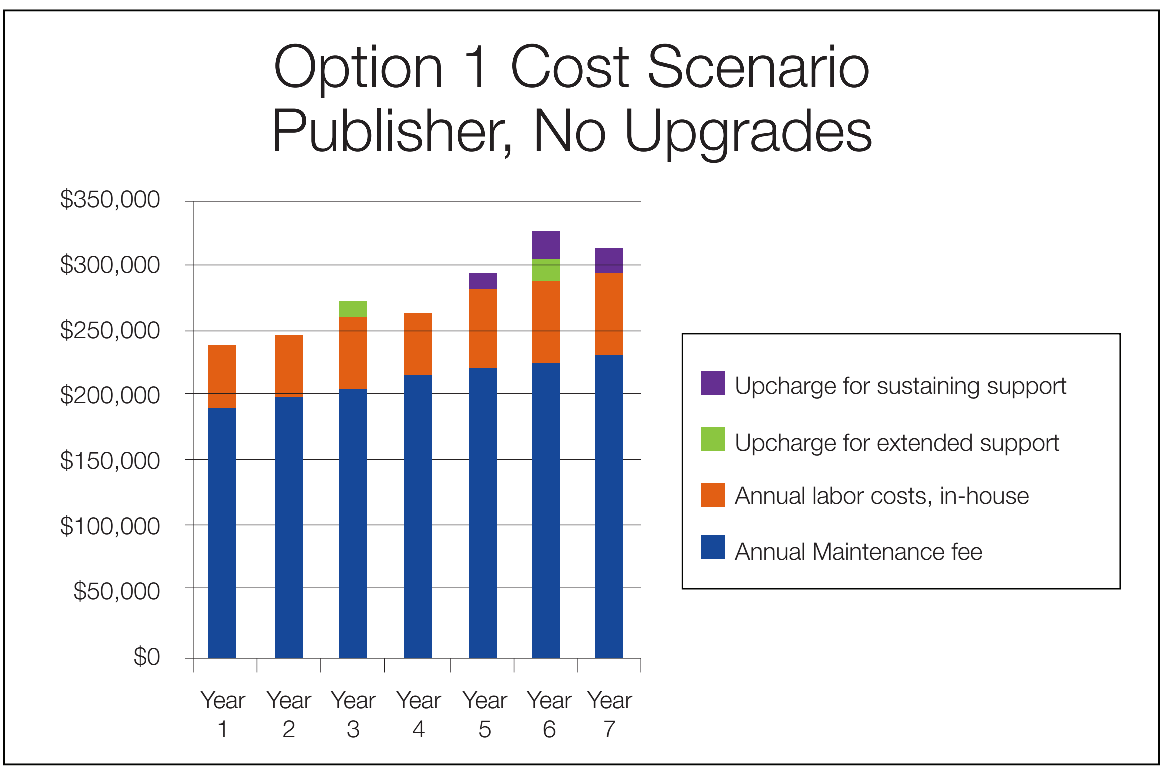


ASSUMPTIONS FOR OPTION 1:

Support provided by software publisher with <u>no version upgrades</u> taken

- Support window of time: 7 years
- Initial software licenses charge: $1,000,000
- Year 1 annual support fee: 19% of initial software license charge
- Annual maintenance fee increase: 3.5%
- Forced to "extended" support: Year 3
- Cost of extended support: 7.5% increase in year 3
- Forced to "sustaining" support: 7.5% increase in year 6 (less service)
- In-house labor costs for support: 26.3% of publisher support fees

OPTION 1: Publisher, No Upgrade							
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Annual maintenance fee	$190,000	$196,650	$203,533	$210,656	$218,029	$225,660	$233,559
Annual labor costs, in-house	$50,000	$51,750	$53,561	$55,436	$57,376	$59,384	$61,463
Forced to extended support	$0	$0	$15,265	$0	$0	$16,925	$0
Forced to sustaining support	$0	$0	$0	$0	$16,352	$25,000	$25,000
Annual Cost	$240,000	$248,400	$272,359	$266,092	$291,758	$326,969	$320,021
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Cumulative Cost	$240,000	$488,400	$760,759	$1,026,851	$1,318,609	$1,645,578	$1,965,599

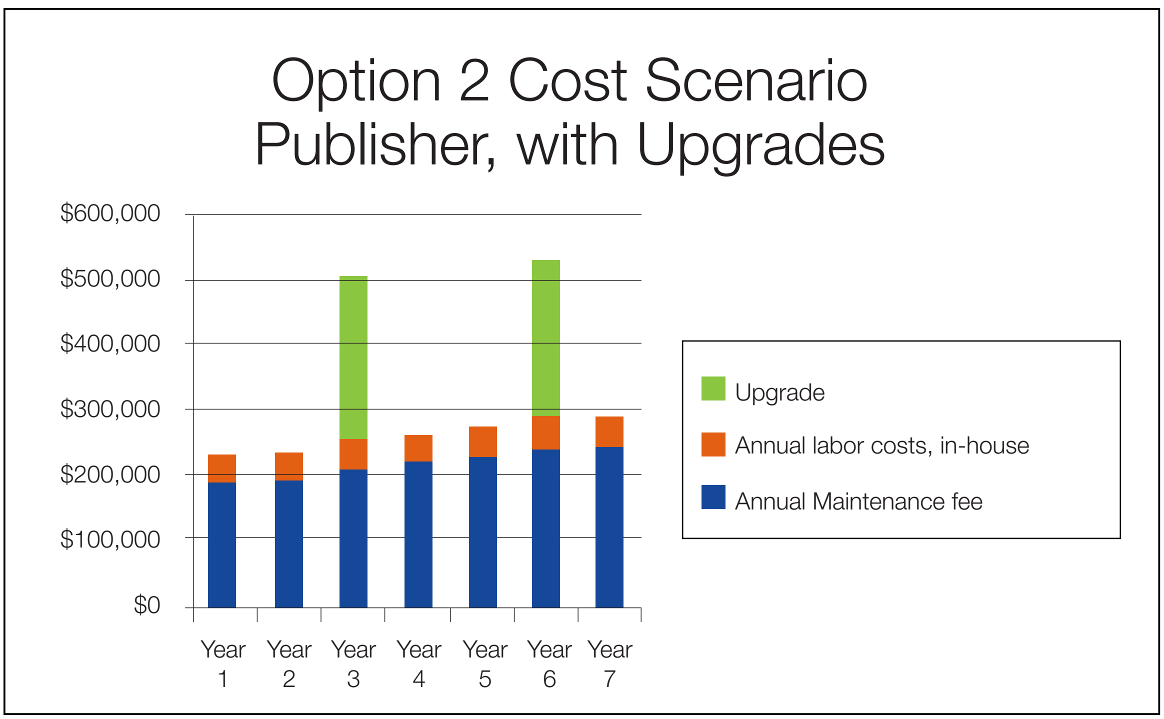


ASSUMPTIONS FOR OPTION 2:

Support provided by software publisher with new version upgrades taken

- Support window of time: 7 years
- Initial software licenses charge: $1,000,000
- Year 1 annual support fee: 19% of initial software license charge
- Annual maintenance fee increase: 3.5%
- New version upgrade, year 3: $250,000
- New version upgrade, year 6: $250,000
- In-house labor costs for support: 26.3% of publisher support fees

OPTION 2: Publisher, with Upgrades							
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Annual maintenance fee	$190,000	$196,650	$203,533	$210,656	$218,029	$225,660	$233,559
Annual labor costs, in-house	$50,000	$51,750	$53,561	$55,436	$57,376	$59,384	$61,463
Upgrade			$250,000			$250,000	
Annual Cost	$240,000	$248,400	$507,094	$266,092	$275,406	$535,045	$295,021
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Cumulative Cost	$240,000	$488,400	$995,494	$1,261,586	$1,536,992	$2,072,037	$2,367,058

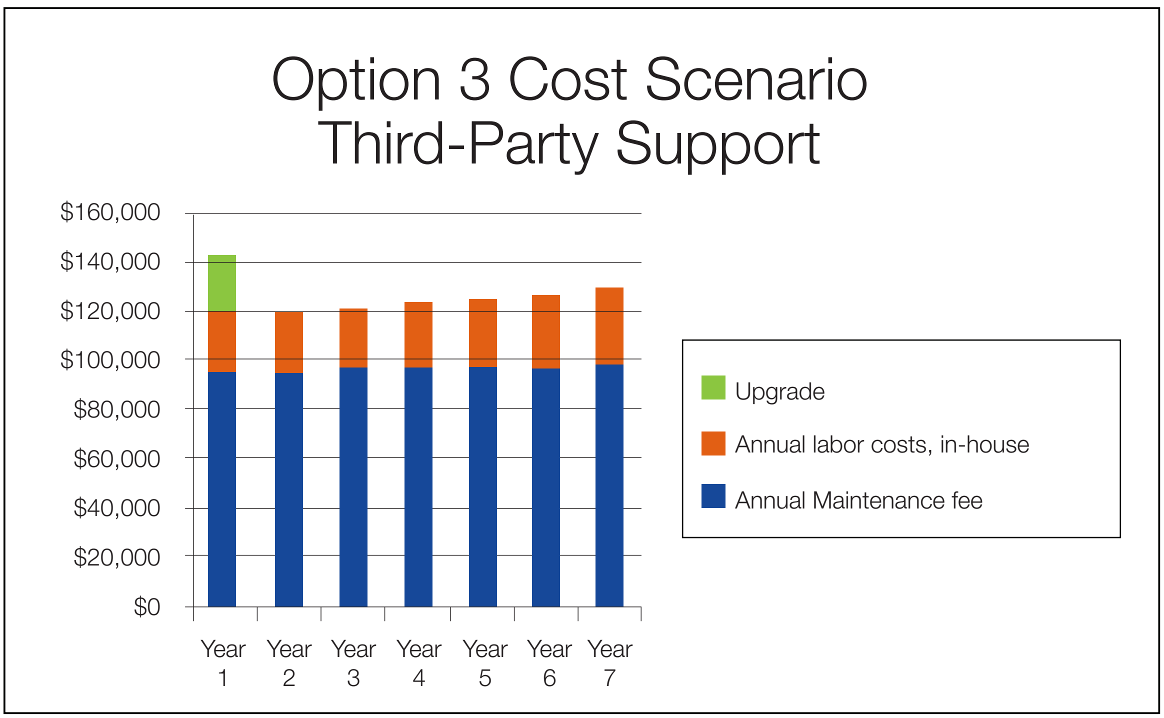


ASSUMPTIONS FOR OPTION 3:

Support provided by third-party beginning year 1

- Support window of time: 7 years
- Initial software licenses charge: $1,000,000
- Year 1 annual support fee: 50% of software publisher support fee
- Annual maintenance fee increase: 2.0% upon renewal of multi-year contract
- In-house labor for onboarding: $25,000 one time cost
- In-house labor costs for support: 50% of software publisher support fee

OPTION 3: Third-Party Support							
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**
Annual maintenance fee	$95,000	$95,000	$95,000	$96,900	$96,900	$96,900	$98,838
Annual labor costs, in-house	$25,000	$25,875	$26,781	$27,718	$28,688	$29,692	$30,731
Onboarding, archiving (in-house	$25,000						
Annual Cost	$145,000	$120,875	$121,781	$124,618	$125,588	$126,592	$129,569
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**
Cumulative Cost	$145,000	$265,875	$387,656	$512,274	$637,862	$764,454	$894,023



Another Important Factor is Price Erosion

Another financial consideration is price erosion, which is a decline in the average selling price over time. This is based on evolving market value, customer perceptions of contributions to business value, and enterprise development cost. Analysts suggest that the market value of enterprise software erodes between 5 and 12 percent per year. Gartner says, "More price erosion and vendor consolidation is expected in 2015 because of fierce competition between cloud and on-premises software providers." For example, Gartner predicts that sales force automation (SFA) prices could decline by as much as 25% by 2018. [10] Other application and infrastructure product prices will also drop. "This will be caused by incumbent on-premises vendors discounting their cloud offerings heavily to try and maintain their customer base." When you factor in price erosion, an enterprise's software repurchase point moves even earlier in the support life cycle.

WHAT ABOUT REENGAGING WITH THE PUBLISHER FOR UPGRADES?

Since enterprise business needs change over time, a company eventually will need to evaluate the fit of their current software version, whether supported by the software publisher or a third-party provider. The main options are to stay put, switch to another application, re-license the latest version of the software, or re-engage with the publisher to acquire recent upgrades. Some organizations will conclude that their current enterprise software is good enough. Switching to a new enterprise application is costly and challenging, whether delivered through the cloud or installed on premise.

Another option is to re-engage with the publisher to obtain access to upgrades. Some third-party support providers claim that an enterprise can return to the software publisher at any time with little or no penalty. Supposedly, the savings during the term of third-party support more than offset any re-engagement penalties.

Enterprise software publishers claim that their support customers will gain access to "free" upgrades and releases. As noted above, upgrades really are not free. Enterprises pay for access to the upgrades through their annual fees, and deploying upgrades can incur large additional costs.

Publishers have established penalties for enterprises that choose to re-engage after cancelling. Typically, the asking price is the payment of all support fees that would have been paid had service continued without interruption. Reportedly, many enterprises negotiate the actual terms.

A survey of a few companies that explored re-engagement yielded the sample data below. Each company spoken with had been under the third-party support model for three to five years. They were offered two options to return to software publisher support. In every case, relicensing was less expensive than paying "back" maintenance, as was future maintenance.

Before reengaging, these are key factors to explore:

- ***Negotiate upgrade rights*** – enterprises that intend to stay on publisher delivered support services must negotiate upgrade rights during the initial acquisition process. Focus on eliminating forced license type-changes during version upgrades and including all new technology tools necessary to run the upgraded version.
- ***Understand restrictions*** – understand the restrictions placed on it by the software publisher to mitigate any risks of returning to the vendor for support. These restrictions rarely are defined in the master license or service agreement, but rather may be detailed in the publisher's application and technical support policies.
- ***Identify pricing and packaging changes*** – enterprise buyers need to evaluate pricing and packaging changes and charges in what otherwise could be considered "like-for-like" version upgrades. For example, licensing types and details may change. Publishers sometimes repackage modules, with two or more new products replacing the core functionality of a previously licensed product. Furthermore, enterprises may need to acquire new middleware and other expensive technologies that are required to run the updated software versions.

RECOMMENDED NEXT STEPS

Summary

The voices of discontented IT and business leaders are growing louder, questioning the support fees costs and annual increases. Customers of leading enterprise software publishers effectively re-buy their applications every 3-5 years through support costs and fees. It is not just the value and cost of support that is concerning. Also concerning is the lack of personalized and responsive support.

Furthermore, the third-party support option buys time for customers to consider additional choices. They can negotiate more effectively by having more than one possible vendor. They may choose to reengage with the software publisher in the future in order to obtain significant new capabilities. Meanwhile, business and technology needs change. Customers may wish to explore future replacement from the latest offerings on the open market. Many customers find it valuable to set the timing based on business needs rather than recurring "sunset" dates set by software publishers.

Recommendations

For enterprises that operate in a highly dynamic business environment and therefore upgrade systems every 18-36 months, it makes sense to acquire support from software publishers.

However, other enterprises may find that third-party support is a better choice. The key characteristics of these enterprises are:

- ***Stable*** – Enterprises that operate in more stable environments and have upgrade cycles greater than 36 months
- ***Highly modified*** – Enterprises that are operating a highly modified software version that makes it difficult to easily take advantage of software patches or fixes
- ***Planned replacement*** – when migrating to another application (cloud or on premise) and the business need to cut costs leading up to parallel operations and eventual system shutdown
- ***Distressed*** – Enterprises that are in a state of extraordinary financial challenges and budget cuts
- ***Contract renewal time*** – when needing choices that make expenses more competitive and increase the value received relative to the investment

Determine if the cost of software publisher-delivered enterprise software support greatly exceeds the value received. If so, choose a partner carefully:

- ***Select*** – identify a third-party partner that can satisfy the business requirements for all needed software support services: software support, application and technical managed services, and traditional consulting services.
- ***Validate*** – confirm that the preferred third party service provider's delivery practices, processes, and methods do not violate your software publisher's intellectual property rights.
- ***Confirm*** – verify that the preferred partner's financial viability is not threatened by litigation.

Third-party support can be a powerful strategy to take back control of the enterprise roadmap from the software publisher. Managed effectively, this alternative drives significant operational savings, improves services levels, and frees the IT support organization to focus on innovation.

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