

Enterprise Software Licensing End User Perspective

OVERVIEW

As the storage industry evolves, greater emphasis is being placed on improving the management of the storage subsystem in the SAN environment by allowing a single client and corresponding staff administrator to manage the entire data archival and retrieval process. Efficient data management is the key to many companies' survival as they work to achieve more with fewer resources. The initial challenge of data management was connecting a number of attached devices whether optical disk, RAID arrays and tape under one storage subsystem. The greater challenge today, is creating the software to manage these devices and the data that resides on each of these devices under a single, aggregate viewpoint.

The growth of the storage industry clearly rests in software development as companies' work to improve data management in a heterogeneous equipment environment. This involves software that can manage the interface among various storage subsystems in order to deliver the data to a single client that includes a framework that describes each device attached to the storage network. EMC's recent marketing promotion emphasizing software as core to the company is just one indication of the importance being placed on software's role in data storage. McData's acquisition of SANavigator and HP's acquisition of StorageApps are two other examples. Similar to other technology curves, the cost of data storage related equipment continues to decline while software prices remain stable or increase as new, innovative features are introduced.

These emerging newcomers to the software industry are attempting to take a fresh look at established areas in software, like licensing structures, in order to appeal to a broader base of customers by offering flexibility in licensing options. Over the past couple of years, storage and software vendors have created new enterprise software licensing methods, which, in reality, have been slow to adoption by many end users in key vertical markets. Hattras' latest research has found that the majority of end users prefer a choice of licensing options for their companies, both perpetual and subscription based. While most IT executives typically select more traditional perpetual licenses based on capacity versus subscription licensing, individual departments with smaller budgets found that alternatives to the perpetual/unlimited plan, were often times more convenient for their specific needs and budget constraints.

While subscription licensing *is gaining* momentum, it is far from reaching critical mass. Previous research indicated that the market was taking a "wait-and-see" approach to Microsoft's endorsement of subscription licensing.

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“Results from the latest findings from a survey conducted in the January 14th issue of CIO Magazine, indicated that the “wait and see” period appears to be over. After Microsoft announced a new subscription licensing model in May 2001, claiming that it would simplify software licensing, CIOs disagreed.

Overwhelming results from the survey showed that the majority of IT executives are in disagreement with subscription licensing. In fact, Microsoft’s own research indicates that only 25 percent of its customers want to pay for software through subscriptions. The vast majority preferring a perpetual license.

The survey conducted by CIO Magazine, interviewed 122 IT professionals on their licensing preferences. Respondents represented a broad range of industries including; manufacturing/ process industries, computer-related industries, state or federal government, and medical/dental/healthcare. Size of companies interviewed and annual company revenues varied.”¹

It appears that end users are still in a state of transition when it comes to determining suitable licensing programs that will meet their individual needs. In the meantime, “outsourcing” the management and coordination of software licenses as well as overall storage and software purchases, is gaining in popularity. This is especially true for enterprise accounts in the financial and oil and gas sector. Firms don’t want the burden of managing more IT decisions and potential problems. They want to remain focused on their core competencies. In small to mid tier companies, end users are hopeful that an industry standard will soon be developed to help companies internally manage their software licenses and service and support easily from one central location. Licensing programs will need to evolve to meet the demands of the customer in the foreseeable future, as data storage continues to increase in the future.

END USER INTERVIEWS AND EVALUATION

(Compiled from 100 + one on one telephone interviews with CIOs, IT Executives, Software Asset Managers, Vendor Managers and Inside Sales Licensing Coordinators.)

Given these findings, we interviewed a cross section of approximately 100 end users from the telecommunications, financial, government, energy, and healthcare sectors to determine the specific needs of customers purchasing storage software. These specific vertical markets were selected, as they were sectors known for purchasing SANs and storage area management software.

The focus of our survey was to understand the priorities of end users selecting centralized management and storage software. Preliminary findings showed that software enterprise licensing, subscription licensing, service and support features, pricing and discounts, and understanding the overall purchasing process, were top priorities for customers. While the actual

¹ CIO Magazine, Software Licensing Debate, January 14, 2002.

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technology of the centralized management was also important, the end users polled seemed to focus on the ancillary features of storage area management.

Financial

The majority of the smaller regional or community institutions chose to outsource data center functions to third party companies. Many of the large financial institutions outsourced the license agreement negotiation and particulars to Management Consulting Firms like Deloitte, Accenture, and KPMG. The larger financial companies could not justify the employment of an individual to negotiate and manage licensing agreements. Given its dynamic nature, it was difficult for related positions in a particular company to stay up-to-date on latest practices and trends.

The vast majority of license structures utilized in the financial industry are perpetual in nature. Ninety percent (90%) or more of those agreements are perpetual tied to discount tiers based on volume purchases (additional clients). Perpetual unlimited licenses are achieved at the enterprise level but not for data storage management – the applications are just not wide-ranging enough. Subscription licensing is making an impact but appears to be reserved for those applications that represent a major investment representing a significant cost difference (approx. 1/3 less) relative to the cost of a perpetual license. Microsoft and Oracle are pushing subscription licensing. The “buy-in” or initial cash outlay is much less and therefore, the Total Cost of Ownership (TCO) is less. Licenses are first and foremost application driven. Customers purchase technology to fulfill needs - everything else represents a secondary consideration.

The financial industry may be one the most demanding industries when it comes to financial budgeting and reporting. Companies don't want a license agreement that has the possibility of increasing costs throughout the year. Companies typically budget on an annual basis and license costs should remain within those annual boundaries. Companies don't want to keep “resetting the bar” throughout the year. Therefore, licenses should be predictable and apply all over the organization unconditional to branch location.

- Upgrades, both minor and major, are deemed as very important.
- Depending on the business model utilized by the data center – subscription licensing can be appealing if data center behaves as profit center and bills user costs internally to various departments or incorporates the costs as part of the total charges billed to outside customers.
- Prefer to have all license options presented independently or as “un-packaged,” allowing for the customer to assemble a distinctive license agreement.
- History of product is very important as new products need to have service and support included. Products with a longer history in the market and familiarity may not warrant the cost of service and support. The history of the product also influences the structure of the license. For new software, perpetual licenses are preferred that include new feature upgrades and support.

Telecommunication

The telecom industry tends to view license agreements in the here and now. Agreements are evaluated for more immediate application versus future needs of the organization. Service and support options are key to license agreements as network downtime can be extremely costly.

- Tier prices are beneficial. Offered discounts based on tier pricing need to be articulated up front to allow the data center to negotiate agreements based on future growth.
- View software application in real time. Difficult to foresee needs in the future. More interested in meeting immediate needs and have a pricing structure based on today versus what the company will need in the future.
- Licensing agreements based on capacity have not been well received – equate this structure as similar to having a tax for extra processing power even when software is being utilized on the same server.
- Less concerned about discounting and more concerned about the current need and time frame for deployment.
- Service and support is very important and major part of license consideration. Escrow agreements are enforced to make sure that they have help especially for software that supports networks. The level of the support and maintenance agreement is reflective of the dependence on outside parties and the damage any downtime could cause.
- Discount levels are negotiated up front and it's important that affiliates have license access under those same discounts.
- Prefer 3-year contracts, as they want to avoid disruptions at lesser increments. Seek tier pricing with volume discounts at exponential rates. Perpetual licenses are the most sought after, as companies' desire software ownership given the length of contract terms.

Energy/Oil and Gas

The petroleum industry is one of the largest consumers of data storage in the world today. Due to its unusual requirements relating to the collection and use of data, gas and oil companies need terabytes and even petabytes of storage capacity. A single three-dimensional seismic survey can total millions of individual traces and multiple terabytes of raw data. A typical project accounts for not one 3-D data volume but several that must be accessed simultaneously.

While many outsourced suppliers have emerged to serve the needs of the petroleum industry in recent years, the majority of the oil and gas companies prefer to manage their own systems and software licensing programs in-house primarily for security reasons. Other technology concerns are related to overloading the capacity of storage solutions. Therefore, system and software updates are constantly being added with the latest technologies for enhanced performance.

Due to the tremendous amount of storage systems required for branch offices scattered throughout the world, getting a handle on the enterprise software licenses is challenging. The nature and size of the business results in individual departments within the oil companies

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managing their licensing agreements in one fashion, while the corporate IT departments have a different set of requirements.

- Petroleum *service contractor* companies control its IT departments internally and also manage the software licensing for some smaller petroleum companies. Outsourcing is not a viable option because of the critical nature of the data.
- Corporate IT departments favor perpetual licenses as they can amortize the cost over a three or more year period. Individual departments often prefer a subscription license as they are typically restrained by annual budgets.
- License agreements can be negotiated for the entire company, tailored to specific needs and incorporating diversity requirements and international nuances. Flexibility in the license is key. Standard template licenses are not typically acceptable.
- Preferred license matrix is capacity-based.
- Licensing should be structured so it is available to all business partners without any restrictions. A pre-approved amendment document is needed so changes can be made in case of an acquisition, without renewing the entire contract.
- Industry prefers technical support to be separate from the license. Must have access to technical support on-line and be able to purchase hardware and software on-line.
- Selection of vendors is determined by a number of variables: delivery time frame, support, training, availability, and price of the product.

Healthcare

In the healthcare sector, outsourcing through application service providers (ASPs) represents a trend which has been a growing business segment of the health care information technology market over the past several years. “Healthcare is an especially appealing market for ASPs because of the systems fragmentation, shortage of IT staffing, and intense cost containment pressure.”

For software applications, the healthcare customer is typically licensed under the service provider’s umbrella license. The majority of software licensing is managed by an ASP. Consequently, when the contract with the ASP lapses or terminates, the end user needs to renew the ASP contract, find another provider, or obtain a license to the appropriate the software.

Because critical health care applications often require twenty-four hour support availability, readily accessible support personnel is a crucial issue. It is vital for specific hours to be set for available support, (e.g. regular business hours, evenings, weekends, or 24x7) as well as the need level of support required during those hours.

To estimate the size of the ASP market in healthcare, an analysis was performed of the type of applications that could be outsourced to an ASP and the size of the software application market. The most likely applications for ASPs are laboratory information services, practice management systems, scheduling, materials management and purchasing applications with total revenues of

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the top 100 vendors around \$106 million in 1998. Therefore, it is estimated that the ASP healthcare market today is in the neighborhood of \$278 to \$500 million.”²

- Industry prefers perpetual licenses based on capacity.
- Industry prefers one overall license to cover all software. Does not want to manage multiple licenses.
- Subscription licenses are too risky due to its short-term nature. Industry cannot risk systems being shutoff for any reason that would result in a compromise of health and safety.
- Prefers to have upgrades included. Upgrades are sometimes offered as the only discount mechanism.
- Industry is slow to adapt to new technology. Eventually will be forced to evolve due to recent changes in government regulations for the healthcare industry.

Government

The Federal government has gone through a major transition in the structure of IT purchases and software licensing over the past year. All negotiations were done through the General Service Administration (GSA) which outsourced a third party vendor to negotiate with IT vendors. Agencies could either own their own equipment or lease it.

Since the GSA is the overall purchasing agency for the Federal government, it was their role to create an “ideal” IT purchase structure that would be suitable for all agencies. The goal was to offer a structure that could be applied nationwide and offered a complete tool set that provided functionality from multiple vendors. After several revisions, it was decided that IT departments can not be standardized, especially for storage area networks. The GSA also determined that multiple vendors and tool sets are needed to run departments efficiently. Research found, not surprisingly, that the total cost of ownership was not reduced when using one vendor exclusively.

The following is the feedback gathered from a number of government agencies across the U.S.:

- Majority of agencies want a site license on a perpetual basis. For smaller installations, subscription licenses are acceptable as smaller offices have a difficult time forecasting their storage demands.
- GSA holds the majority of the site licenses for the Federal government.
- GSA prefers to buy directly and not use a third party vendor or contractor.
- Government prefers one overall license based on a capacity model.
- Government prefers service and support to be bundled in with the license with renewal every year for maintenance.
- Upgrades need to be bundled in with license as budget will not cover upgrades during the year.
- Government prefers to work with vendors that offer both lease to buy and lease to lease options on all hardware and software.

² From, “Negotiating ASPs” by Healthcare Information and Management Systems Society, February 6, 2002

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- Government agencies are learning to negotiate better with IT vendors. In the past, deals were not negotiated to the discount levels equivalent to the private sector given the volume of business.

SUMMARY CONCLUSIONS

Enterprise Licensing Structures

Enterprise Licensing structures that appeal to buyers, as expected, are often at odds with aggressive, “vendor-favorable,” licensing structures. From the perspective of the buyer, enterprise licensing structures that allow for predictable, financial management are the most critical component for the buyer. The main components of a user favorable licensing structure would include:

- easily understood and measured metrics.
- clearly defined unit / product set pricing and discount levels.
- maintenance based on percentage of price paid, not list.
- clearly defined upgrade / future pricing.
- breakdown of options to allow customer to assemble a unique and attractive configuration.

Clearly, these concerns often are not consistent with software licensing practices we have seen in the past and continue to see today. Aggressive vendor favorable licensing structures, though contributing to the bottom line, have alienated customers and vendors. In markets where competition has evolved and is healthy, strategic advantage will go to those vendors whose licensing structures are perceived as amenable to the buyer. From our research, it is clear that the visibility of corporate purchasing decisions have taken on new, strategic importance.

Perpetual Licensing & Subscription (“Rent vs. Buy”)

Our research indicates that overall the perpetual licenses are more appealing and that the ability to own, rather than rent, is preferable. However, these findings should not disqualify subscription as a viable licensing strategy when cost and/or flexibility are major concerns.

Service and Support

These decisions are dependent upon on resident “Subject Matter Experts” within the specific account relative to the product set and technologies on the negotiating table. In general, service and support should be seen as deal “sweeteners” or possible deal breakers. If the buyer possesses strong skills and deep familiarity with the product set, then service support does not become as crucial to the negotiating / buying process. If the particular product set and technology are relatively new to an environment, and relative skill sets are lacking, then enhanced service support can be a crucial factor in winning over buyer hesitation / reluctance.

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Several years ago licenses typically included numerous upgrades throughout the year and vendors included the upgrade free of charge. Today, vendors usually release only one upgrade per year, because the technology is much more advanced and costly to deploy. With only one upgrade being released annually, vendors are still charging the same price as when they produced multiple upgrades. Many users feel that the cost for upgrades needs to be adjusted and reduced accordingly.