7701 France Ave. S., #200
Minneapolis, MN 55435
952-841-6330
www.isamgroup.com

Eight Great Myths of Software Asset Management

By Michael Swanson, ISAM President

"Best-in-class" companies spend less than half of what an "average" data center spends in software costs! To look at it another way, an average data center would have to negotiate all of its ISV software for "free" if it wanted to achieve the cost structure of best-in-class companies. There are many myths about how good these best-in-class companies are and how they got there. While many of these firms are devoted to enhancing their negotiation skills, establishing the proper policies and procedures for a software asset management team, or trying to find the lowest possible cost for a product, the basics of lowering software costs are simple.

Every company, regardless of size or industry can achieve best-in-class prominence by imitating those who have successfully achieved that status. One way of doing that is not to fall for any of the myths of Software Asset Management (SAM). The rapid changes in mainframe hardware technology, software licensing, and vendor consolidation have left many companies trying to figure out how to manage a decreasing budget with increasing business demands. This has resulted in the development of IT Asset Management and, more narrowly, SAM.

In its early stages, Gartner Group called SAM "a new and evolving system of managerial goals, strategies, and implementation tactics."[1] Hope appeared on the horizon when IBM announced PSLC pricing on April 6, 1994. Yet the following year, many grappled to understand the implications of Computer Associates' purchase of Legent Software. Software pricing grew to such complexity that by 2000 the top five ISVs had over 250 unique pricing tiers. By 2002, Meta was predicting that this confluence of issues would drive OS/390-z/OS independent software vendors to reduce overall costs.[2] The problem was simple: perceived diminishing value on mainframe software. Costs rose while many software features remained the same.

1. *IT Asset Management Keynote: Orchestrating Order from Chaos*,
Joe Pucciarelli, 1996.
2. META Report: The Shifting Sands of Mainframe Software,
Bill Snyder, 2002.

7701 France Ave. S., #200
Minneapolis, MN 55435
952-841-6330
www.isamgroup.com

The reality today is that those vendors that have offered solutions to perceived Software Asset Management problems have not really resolved the problems. In fact, they have left companies with the same issues they had before. Companies are not spending any less on software, and the chasm between vendors and customers is as big as ever. There remain those on both sides of the fence pointing the finger at the other as the source of the problem. In the midst of all the chaos, large IT institutions, software vendors, and Fortune 500 companies have come up with their own strategies to reduce software costs, with few proven results. Jobs have been created to follow these SAM practices, while others have been lost for failing to reach the "promised land" of these practices. The result has been discouraging for many companies, not for a lack of effort on their part, but because they bought into the "Eight Great Myths of Software Asset Management."

Myth #1: Low software costs depend on data center size.

Reality: Although larger data centers often have the muscle and reputation to negotiate steep price cuts, discounts aren't what makes a company best-in-class. They don't have the ability to manage hundreds of products running on dozens of large LPARs. Large data centers struggle to get a handle on their product inventory usage and must rely on discounts to manage their software costs. Conversely, small data centers are often more efficient in managing their costs. They tend to have an easier time understanding their inventory, usage, and product value. The average large data center (one with over 5,000 MIPS) has over 300 products, compared to 92 products at data centers smaller than 500 MIPS, so it is not surprising that smaller data centers manage their software costs better. The reality, however, is that there is a statistically insignificant relationship between large data centers and low software costs.

Myth #2: Low software costs depend on having good negotiators.

Reality: Some of the best negotiators have the worst cost structures. They negotiate 50 to 90 percent discounts on artificially high cost scenarios. What a company may perceive to be a good negotiator, can, and often does, work against them. Many vendors want to build relationships and offer discounts based on relationships. When a company's approach to a vendor is to try to get the biggest discount possible, a vendor will often stiffen in their position of discounting. They may even raise the base price offered to the customer and then offer a discount, only getting the customer back to a "negotiated" list price. To be sure, a company will never benefit from creating a hostile negotiating environment. But in reality, although SAM managers may negotiate with great fervor, a well-managed data center can pay full list price and still end up with a lower cost data center.

Myth #3: Low software costs come from good vendor discounts.

Reality: A discount is relative to some cost structure utilizing a commonly accepted set of assumptions, including hardware configuration, software configuration, and pricing metrics. Any change in these variables can dramatically alter the baseline cost the vendor uses to determine a discount. Although a discount may look good as presented by the vendor, it can be above list

7701 France Ave. S., #200
Minneapolis, MN 55435
952-841-6330
www.isamgroup.com

price based on actual usage. Discounts are often based on a given region. Some territories commonly give (and know how to get) very substantial discounts, while other territories are known to offer their customers these “discounts” that are actually above list price. A typical data center will spend $5,500 per MIP on its software costs. Negotiated discounts represent between 5 and 15 percent of the total savings opportunities. Product inventory is the single largest contributing factor to software costs. Over 35 percent of mainframe software products have replacements available. A best-in-class company might pay a greater amount for its software even though it typically utilizes 36 percent fewer products than an average data center. The reality is that over 80 percent of savings opportunities are directly attributed to managing product inventory and configuration and have nothing to do with discounts.

Myth #4: Low software costs come from large number of Enterprise License Agreements (ELA) with best-in-class terms and conditions.

Reality: Although ELAs often helped data centers during the growth of the 1980s and 1990s, during slower growth years, they have often hurt companies by generating many of the costs going toward unused inventory and capacity. A common problem associated with ELAs negotiated prior to 2001 was that data centers were growing at 20 to 35 percent annually and thus wanted large capacity amounts imbedded in their ELAs. Since 2001, data center growth has slowed dramatically, leaving many companies with excess capacity. The notion that best-in-class companies negotiate large ELAs as a cost protection was true during high growth years. As old ELAs were renewed, they were negotiated with similar product configurations. Companies often do not allow adequate time to review their inventory mix and configuration in order to understand the current value of their data center’s core products. It is not uncommon for an ELA to have a “waste factor” of over 50 percent to pay for products and capacity not essential to the data center. ELAs are commonly sold for a great discount, only for customers to realize that if they were to purchase the products that were providing the highest usage (over 90 percent) and limited the usage of the products they keep to where they were being utilized over 90 percent, they could reduce costs by over 50 percent. ELAs are padded with bundled-in products and discounts, in much the same way that a 20-course meal might be offered to someone on a diet. The reality is that best-in-class companies have the fewest ELAs and are smart in buying only what they need when they need it.

Myth #5: Low software costs come from using best-in-class processes.

Reality: Good processes are essential, but software vendors don’t reduce your invoice because you have a good process. SAM processes are designed to support financial objectives, which are seldom understood before the processes are implemented. Business processes are typically transactional in nature and assist in reducing labor costs associated with change management, data collection, inventory management, invoicing, etc. The issues surrounding managing software costs are not correlated with processes. Companies known for their best-in-class business processes may excel with their processes, but they frequently fail to achieve the same results when applying them to SAM. Some of the lowest cost data centers lack any formal process in managing their software. Conversely, some of the best processes deliver savings, but fail to address core business problems in managing software costs. In fact, in a study

7701 France Ave. S., #200
Minneapolis, MN 55435
952-841-6330
www.isamgroup.com

conducted on a random sampling of over 100 companies, there was found to be no correlation between processes and costs.

Myth #6: ELA discounts and "Terms and Conditions" are restricted by SOP 97-2, SOP 98-4, and SOP 98-9 ("SOP" is a Statement of Position by the AICPA's Accounting Standards Executive Committee)

Reality: The AICPA (American Institute of Certified Public Accountants), FASB (Financial Accounting Standards Board), GAAP (Generally Accepted Accounting Principles), and SEC (Securities Exchange Commission) don't tell vendors how to price software. They only govern how to recognize the revenue. There are no accounting rules that restrict a vendor's ability to negotiate the price and terms of a contract. The level of discounting, in particular, is not addressed in any way in these accounting pronouncements and therefore cannot be used as an excuse by a vendor. The terms and conditions within a license agreement can certainly impact the vendor's timing of revenue recognition, and this is a real issue for the vendor (and its shareholders).

SOP 97-2 was issued October 27, 1997, and together with subsequent clarifying pronouncements SOP 98-4 and SOP 98-9, governs the revenue recognition for licensing, selling, leasing, or otherwise marketing computer software. In its most basic form, 97-2 states that revenue can be recognized when all four following conditions are met:

1. Persuasive evidence of an arrangement exists
2. Delivery has occurred
3. The vendor's fee is fixed and determinable
4. Collectibility is probable.

While the SOP goes into great detail regarding all four conditions, none of the provisions limits a vendor's ability to discount. One of the greatest impacts, however, is regarding the probability of collection. It is much more difficult for a vendor to refund or waive fees that were set in a contract due to SOP 97-2 Requirement 4 as that practice calls into question the probability of collection of future contract fees. Other terms, such as cancellation provisions or refund rights can also impact Requirements 3 and 4, and therefore impact revenue recognition.

Vendors should not attempt to hide behind these rules in failing to grant a customer favorable terms and pricing. The reality is that the accounting rules govern revenue recognition, and not business practice.

Myth #7: IBM's Workload License Charge (WLC) pricing will obtain the lowest possible IBM software costs.

Reality: When WLC was first announced by IBM on October 3, 2000 (see announcement 200-354), many viewed it as the software savior for the mainframe industry. The idea that a company could pay only for the capacity where the products were running—though it may have sounded new and innovative to some—had actually been used for years by many with major ISVs. But IBM was offering the public what it had asked for. While it is a good concept in theory,

7701 France Ave. S., #200
Minneapolis, MN 55435
952-841-6330
www.isamgroup.com

it does not offer what many think it does. When an IBM rep or outside third-party consultant offers to reduce a data center's IBM software costs by converting to WLC, many are quick to jump on board without executing a full financial analysis of all of IBM's pricing options. Although it is true that some products decrease in cost with WLC, other products actually go up. The challenge and responsibility of the best-in-class SAM team is to analyze the thousands of pricing configurations offered by IBM to see if WLC is the lowest cost alternative. That may seem a daunting task, considering the December 2004 IBM price book listed 124,478 line items of software prices. That represents a growth of over 5,000 pricing line items in one year. It becomes very challenging to find a software pricing configuration option that offers the lowest cost possible, thus making it easy to settle for WLC. For some companies, WLC will actually cause the total software costs to increase compared to current pricing options. The reality is that WLC may be advantageous for some companies and reduce the IBM costs for many companies, but for most companies it rarely is the best solution.

Myth #8: Best-in-class companies save the most money.

Reality: The measurement of best-in-class is often elusive in the absence of any formal metrics. SAM managers who have spent years diligently managing their software costs are often surprised to find out that they aren't the only ones who have worked harder and smarter. It is often the quiet SAM manager, unrecognized by management, who is doing the best job controlling software costs. An Executive Vice President of a Global 100 company once shared with me that he wasn't impressed with the manager who boasted of saving the most money. He wanted to find the manager who had done such a good job that there wasn't any money left to save. We often dream of following in the footsteps of the individual or company that is admired for all the savings they've realized. They boast of the millions of dollars that they've beat out of the software vendors. We consider large savings to equate to best-in-class. The irony is that if they were truly best-in-class, how could there be so much money to be saved? We don't view the most improved athlete as the best, yet we think of the most improved SAM manager (as measured by software savings) as the best. If you want to become a world class athlete, you don't emulate the most improved athlete, but rather set your sights on the best athlete. Once you reach elite status, it becomes more difficult to obtain that incremental improvement. The reality is that in benchmarking hundreds of companies, most best-in-class companies are rarely seen or heard of in SAM circles.