Seven Common Mistakes in IT Procurement…

And How to Avoid Them

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Information Technology (IT) departments are constantly evolving their infrastructure and services to keep pace with an ever-changing technology landscape. They must continually explore the marketplace for software, hardware, and services to keep their organizations ahead of the curve within their industry, or at least stay technologically compatible. All too often, a new technology can displace a long-standing IT investment, creating the need for additional investment in licenses, support, and transition efforts.

Unfortunately, many organizations lack a consistent and long-range approach to IT Procurement. Deals are often pushed through on short timelines, and broader issues are not given the consideration they deserve. Without a thorough and scrutinized approach, the end result is often a purchase that costs too much in the long-run (e.g., hidden costs, runaway increases in maintenance and support) and leads to unforeseen hassles such as license compliance issues, scalability problems, and compromises in deliverables. In the worst case, the end result can be a financial commitment to a technology that becomes obsolete during the term of the agreement.

At Symphony, a key part of our practice is IT sourcing and procurement services. Unfortunately, sometimes we are called in too late and have to deal with the aftermath.

In this white paper, we will discuss seven common mistakes that we see companies make when procuring hardware, software, and services – and some best practices to avoid them. Here is a list of the areas we will cover:

Mistake 1: **Getting locked into contracts without escape clauses**

Mistake 2: **Over-spending by "super-sizing" the deal through bundling**

Mistake 3: **Ignoring the "devil in the details"**

Mistake 4: **Obsessing over initial price instead of paying attention to total cost and risk**

Mistake 5: **Buckling under quarter-end pressures, from outside and within**

Mistake 6: **Writing a "blank check" for maintenance and support or SaaS renewals**

Mistake 7: **Failing to explore other viable options**

While we believe that these issues cross company and industry boundaries, the impact to you, as an IT professional, will depend on the products and services you offer to your organization, the number of employees/divisions that you support, the level of centralization/decentralization at your company, and your overall purchasing power with suppliers.

Mistake 1: **Getting locked into contracts without escape clauses**

IT deals are based on a set of terms and conditions that are usually presented in the form of a contract. These contracts are commonly referred to as a Master License Agreement (MLA), a Master Services Agreement (MSA), a Statement of Work (SOW), or a Professional Services Agreement (PSA). IT professionals often sign these documents without properly understanding the long-term commitments they are making on behalf of the corporation, failing to realize that the commercial and legal terms of an IT purchase are just as important as its technical attributes.

To this end, companies should strike a balance between evaluating the technical viability of a solution, *and* analyzing the legal terms and total cost of ownership. This can be achieved by deploying resources that are equally focused on structuring deals that are both rich in technology and offer the best long-term investment. The key point to remember is that are no “standard” contract terms. Terms that deal with pricing and discount structure, warranty, maintenance and support, renewal, service level metrics, rights to suspend usage, conversion rights, and installation services, are just a few examples of important areas that you should negotiate with your suppliers to ensure the deal matches the specific IT and business needs.

For example, most contracts are designed by suppliers to restrict the customer’s ability to terminate for convenience. Suppliers often cite “revenue recognition” as a key reason for restricting their customer’s termination rights. However, you must ensure that you can exit the contract or reduce your financial commitment if business conditions change. Without this protection, you are likely to get stuck with paying for products and services that are no longer needed.

> *TIP: When negotiating a deal for hardware, software, or professional services, negotiate terms that allow you to terminate for convenience based on reasonable notice to your supplier. The need to terminate for convenience may arise from changes to the company’s technology roadmap, a reduction in work force, merger and acquisition (M&A) activity, re-prioritization of IT projects, budget limitations, or supplier performance issues.*

Consider the situation of hiring of a system integrator to implement an ERP software module. What if half way through the program, you need to change, cancel, or suspend a program due to budget constraints? Or, what if you determine that a lower cost alternative to that ERP module will suffice? Unless there is a structured agreement that allows for “termination for convenience”, you may be locked into paying the system integrator all of the fees quoted for the “project”. This problem is exacerbated if you do not have a structured agreement that helps you understand the cost structure throughout various project phases and deliverables, making it difficult to determine how much of the total project costs have been incurred as of the date of termination.

The bottom line is that an IT contract should have an “out” clause to respond to changing business needs.

Mistake 2: Over-spending by "super-sizing" the deal through bundling

It's often difficult for IT departments to draw the line between the "musts" and "wants" of a potential solution. Evaluating a complex purchase that is heavily populated with technology decisions is not an easy task, which can make it difficult to differentiate between what is critical and what is not. The process is further complicated when special discounts and bundled pricing programs are offered by suppliers who want to encourage their customers to buy more than what is required in terms of capacity, performance, and features. This is what we call "super-sizing" the deal.

Along the same lines, companies sometimes feel compelled to buy additional software or hardware to take advantage of deeper discounts. While this may appear to be a cost saving relative to the list price, in the end, it can drive up the overall costs by over-buying. Bundles can also create future obligations in the form of maintenance and support fees for on-prem products or inflated renewals in the case of SaaS (Software-as-a-Service) software.

The reverse scenario can also become problematic—if you underestimate your requirements and try to create a piecemeal solution, you are not taking advantage of the economies of scale and the costs can easily spin out of control and exceed your budget. Unless you have spent significant time evaluating the current environment, identifying shortcomings, and developing a strategy for solving the problem, it is impossible to make a smart technology bundling selection.

To address this, reach out to multiple suppliers to help map out your requirements and gain a broad understanding of what solutions are available. Because technology changes so quickly, solutions that were not viable six months ago may now show promise. However, you should do this "research" without making any commitments to these suppliers. Once you have a good sense of your starting requirements and growth projections, then it's time to embark on getting detailed quotations. Only then is it possible to objectively evaluate potential pricing bundles that have a confirmed return on investment (ROI).

> *TIP: If you do take advantage of bundled pricing, be sure to negotiate terms into the contract that protect your investment. For example, you can negotiate that if your need for some of the bundled items does not materialize, the solution can be scaled back to allow credit for the unused portion. Additionally, you can sometimes negotiate to eliminate price increases or penalties that would be applied to the components that you decide to keep.*

The key point is to prevent bundling and "special" pricing to lure you into incurring more costs in the long run. Make technology investments based on confirmed project scope and what makes sense financially.

Mistake 3: Ignoring the "devil in the details"

A common cause of frustration and unanticipated expense in IT procurement happens when deals are entered into prematurely without the fine details getting ironed out by those who will implement and manage the solution.

For instance, it's possible to negotiate a price structure for software licenses that are based on the number of users, divisions, entities, or other factors. However, from an operational perspective, these numbers may change too frequently to be monitored effectively or precisely. It's important to have members of the implementation team participate in supplier meetings and to review the sections of the contract that deal with implementation so that you can avoid or minimize certain unnecessary and burdensome administrative and operational activities.

Another example of hidden details can be seen in the pricing for "additional purchases". It's possible to have a great deal on the first 100 units, but what happens when unit 101 is needed six-months down the road? Does the same discount structure apply? Do you have to buy an additional 100 units to receive aggressive discounts when you only need one?

> *TIP: Take the time to negotiate flexibility into your deals. This can include adding contractual language that protects you against upward or downward changes in your requirements. For instance, what happens if the license user base decreases due to unexpectedly poor adoption? In this case, you should have a contract provision that allows you to scale back your requirements, such as reducing annual maintenance and support commitment or lowering the number of users in a SaaS (software as a service) model. In case of anticipated growth, lock in pricing for a period of time, and scale-up by purchasing additional licenses only when needed.*

Managing professional services can fall into the same dilemma. An initial scope may be well priced, but what happens when there is a change and the project expands or contracts? These types of issues, if left ambiguous at the beginning, can lead to unpleasant pricing surprises and strained relationships with your service providers.

In order to avoid ballooning costs when working with a professional services provider or system integrator, define a robust change management framework and ask the supplier to provide the cost structure that is behind this framework. This will help you assess the impact of scope changes. Open-ended exposure to scope changes may become problematic, especially if these changes occur deep in the project cycle, beyond the point of no return. The intent is to ensure that not only do you clearly understand what you are paying for now, but that you also have a framework for change management with your supplier.

The following areas are also very important for you to keep in mind when it comes to managing the details in a professional services project:

- Agree in advance to the schedule, milestones, deliverables, as well as roles and responsibilities and pricing structure
- Tie your payments to the deliverables and their timing, not on a calendar date or hours worked
- Define acceptance procedures, ongoing service levels, and intellectual property ownership issues, if applicable

These are just some of the creative cost-related terms that that can significantly reduce your financial exposure and ensure that costs are not open-ended.

Mistake 4: Obsessing over initial price instead of paying attention to total cost and risk

When negotiating any deal, it is tempting to focus on price alone. After all, there is a sense of satisfaction that comes with seeing a good discount or calculating the degree to which the department beat a budgetary benchmark. However, many companies pressure the supplier for a few thousand dollars of product costs while overlooking certain risks that will likely cost them significantly more, that is, the proverbial penny-wise and pound-foolish.

For example, in the case of a mission-critical solution like data back-up storage, the cost of a failed solution can mushroom well beyond the price you paid for your equipment if you lose valuable data or are unable to recover it in a timely manner.

> *TIP: While price is a major component of total cost, you should also consider other parameters that can impact the cost competitiveness of an IT solution. Maintenance and support, implementation costs, the need for additional hardware or software, and warranty are a few examples of other critical cost drivers. Even a product's technical performance can have a direct impact on cost — a product that fails to perform to expected levels may require additional, unexpected investments to compensate for shortcomings in performance.*

When looking at the purchase of infrastructure hardware equipment, you must look beyond the quoted price of the equipment alone. Ask questions such as:

- How well does each supplier's equipment meet the requirements for capacity, speed, and availability?
- What additional investment in software and personnel is required to make the solution work?
- How can the supplier be held accountable for the results that they claim their solution will deliver?

In addition to focusing on reducing the total cost, make sure to prioritize and balance between price vs. risk. Price is important, but its level of importance varies from deal to deal. For instance, in a system integration purchase that we negotiated for a client, although we obtained a small price concession with the service provider, we focused more of our attention on getting flexibility for scope changes and termination for convenience. The project had not been well-defined internally due to time pressures and the risk of change or cancellation was relatively high. Midstream, the project was completely cancelled and an alternate solution was pursued. Had we obsessed over price, we would have been able to save no more than $50K. As it turns out, the ability to terminate with no penalties was a $3M sigh of relief for our client.

Mistake 5: Buckling under quarter-end pressures, from outside and within

There are two types of quarter-end pressures that companies normally face when it comes to IT procurement. The first, and the most common, is externally driven by suppliers that are aiming to meet their financial targets. This serves both the salesperson assigned to the deal in the form of commissions and bonuses, and the supplier in the form of revenue. Discounts and the proverbial “throwing in the kitchen sink” are not uncommon as the quarter comes to a close.

The second form of pressure comes from IT organizations that succumb to the fearful “use it or lose it” phenomenon when it comes to making capital purchases. They fear that if their budget is not spent within the quarter or fiscal year, they may lose those funds in the next budget cycle.

Combining these two pressures can lead to disastrous consequences as both sides are now motivated to rush through the entire process without the appropriate due diligence. Unless you have the necessary technical and business skills and resource bandwidth assigned to ensure this due diligence, deals of this type carry a lot of risk and are prone to failure.

> *TIP: If you are feeling the pressure from a supplier to close a deal, evaluate what the potential additional savings will be. The last bit of discounting available at quarter-end will often be made available again if the deal does not close within the allotted time. Don’t make a hasty decision when the small, incremental discount is not worth the risk of spending money prematurely on a solution that hasn’t been properly vetted within your company.*

In responding to quarter-end pressures, keep a few key facts in mind:

- There will be other quarters, and barring any unusual circumstances, suppliers will offer the same incentives again (if not more). Remember, technology and price/performance ratios are constantly improving in your favor.

- Evaluating the entire solution, to ensure uncalculated risks are not being taken, requires more time than you may have at quarter-end. Consider specifying an evaluation period where it’s possible to “try” the solution before committing to a purchase. Recklessly speeding through a deal will set a precedent with the supplier that quarter-end pressure, not due diligence, is the strategy that will lead to a sale.

- If it’s possible to meet the supplier’s quarter-end deadline, what additional key terms can be put on the table for negotiation? For example, some suppliers will allow restrictive contractual terms to be modified at the 11^{th} hour to close a deal expeditiously.

That being said, there may be circumstances when there is no other choice than to close a deal before the end of a quarter based on internal pressures. If this is the case, make sure you take calculated risks in the race for the deadline. Keep in mind that you are much more prone to mistakes on these “quick” deals, so invest the right resources – both in terms of skill and time – to avoid surprises after quarter-end. This should include ample time for legal review, financial approvals, and having signors available to execute the contract by the deadline.

Mistake 6: Writing a “blank check” for maintenance and support or renewals

We briefly touched on maintenance and support (M&S) above, but it’s an important enough topic that warrants a focused discussion in this white paper.

M&S is an integral part of most on-premise hardware and software solutions because it supports the supplier's activities to maintain and develop the investment beyond the original purchase. This is a legitimate charge levied by suppliers that enable customers to benefit from upgrades, as well as technical support services. However, unless it is carefully examined and negotiated, M&S can become a point of uncontrolled financial exposure for a corporation. Over time, this can have a significant impact on the cost-effectiveness of the original solution that was procured. We have observed several situations where there were no control limits on M&S and a supplier was able to raise fees every year without constraint.

In the case of SaaS or IaaS (Infrastructure-as-a-Service), your fee structure is normally a subscription model with a contract term of one to five years. In these types of arrangements, however, your uncontrolled financial exposure can manifest itself in the form of unnegotiated – or poorly negotiated – renewal terms. In other words, unless you negotiate pricing and sizing terms in your contract during your initial purchase or your current renewal, you are exposed to increases limited only by your SaaS supplier's published list price.

Scrutinize whether or not an annual M&S or SaaS subscription increase from your supplier is even justified given the specific product that you are purchasing. For example, a higher fee structure is more justified in a situation where a product regularly undergoes updates and must interact with a wide range of platforms, forcing the supplier to make continuous investments in the product. Regardless, M&S and subscription increases should always be capped to control financial exposure. There are common metrics such as the consumer price index (CPI) that you can use to cap any proposed increases.

> *TIP: It's often possible to tame the commonly used language that gives your supplier the right to increase M&S and SaaS subscription fees. Negotiate terms that protect you by locking in rates and placing a cap on renewal increases.*

Here are some other points to consider when evaluating the M&S or subscription fees with software or hardware purchases:

- Spend time to understand the fee structure of each deal to ensure that all costs are well-understood. Is the M&S, for instance, for 24x7x365 support or only from 8 a.m. to 5 p.m. during the week? Does it include all releases or just patches and bug fixes?

- Include M&S and estimated SaaS renewal fees in the ROI calculations prior to making a purchase of hardware and software. Quantify the impact of annual increases on your long-term operating expenses.

- You don't have to accept the first offer for pricing if it seems too high. Industry standards for M&S are usually between 15-20% and SaaS pricing increases are generally tied to CPI. You, should attempt to negotiate a reduction if you are presented with anything higher.

- If you have had issues with support from a supplier during the previous term, try to negotiate for a credit on the next year's renewal.

- Beware of auto-renewal clauses that can go undetected until it is too late, creating new financial obligations that you did not anticipate. If your contract is set to auto-renew, be sure that you have a process in place to manage the notice period in order to avoid surprises.

There are also times in which you should ask whether or not an M&S renewal is even needed. For instance, if you plan to sunset your existing ERP system and transition to a new solution, you may no longer have a need to renew M&S. In fact, you may find that it is more economical to receive support at a lower cost through a third party or on a time and materials basis from your software supplier.

Mistake 7: Failing to explore other viable options

When it comes to any kind of purchase, nothing increases negotiation power like introducing competition. Unfortunately, it is easy to kill competition by getting locked into a particular supplier or a particular technical solution prematurely.

Failing to consider multiple supplier and technology solutions can limit your choices and potentially increase the total cost of the solution. This is especially critical with large dollar investments that make it nearly impossible to introduce competition later due to the high switching costs, particularly in the case of high value infrastructure investments such as an ERP system, core database software, back-up storage, telecommunications services, or certain on-demand solutions.

Exploring a broader set of solutions can also increase your credibility with the suppliers. When you ask intelligent business and technical questions during the evaluation process, they realize that you are considering many options, not just theirs. It also leads to open dialogue with experts within the supplier's organization, allowing you to learn more about the technologies that you are considering.

There are several preliminary steps that you can take to ensure that you are spending your time with the right suppliers from the onset:

- Establish a sourcing team and document the selection criteria,
- Arrive at a list of suppliers that will be considered before you begin preliminary discussions about their capabilities,
- Screen these suppliers at a high level through preliminary meetings, demos, and conference calls, determining whether or not they are a good fit for the solution you are considering, and
- Once the list of suppliers has been narrowed down, send a Request for Proposal (RFP) to this "short list".

The RFP should include the technical specifications, support requirements, relevant information about the existing environment, service level performance metrics, and a deadline for submittal. Our experience shows us that sending an RFP to more than a handful of suppliers is not a productive use of an organization's resources and demonstrates that suppliers were not properly filtered during the preliminary dialogue.

Upon receiving the RFP responses from the contending suppliers, evaluate them side by side and select two to three suppliers that best meet your selection criteria. These are the suppliers with which you will negotiate final pricing and contract terms and conditions. Sometimes, you may have already determined your supplier of choice at this stage for specific, internal reasons, but, if you play it right, competitive price wars can lead to last minute price concessions from the supplier.

> *TIP: Be sure to communicate the role of each person on your team to the supplier and have each of your team members enforce this structure. For example, once the technical evaluation is complete, instruct the supplier that they are only to interact with the designated person on your team. If the supplier contacts others "just to see how things are going", they should get routed back to the designated lead. This creates a consistent message from your company and avoids the risk of any team member disclosing key information during the negotiation cycle.*

Keep in mind that negotiating two contracts simultaneously can be resource-intensive. In cases where you need to pursue several suppliers to keep the competitive spirit alive, you can outline and develop a term sheet with each supplier, but negotiate the final contract terms with only one.

It's also important to refrain from awarding business to one supplier until the details of the contract are completed and any relevant statements of work are settled with the supplier of choice.

In Summary

As the billions of dollars in annual IT spending attests, companies of all sizes continue to make investments in their hardware, software, outsourcing, and professional services. The work-from-home paradigm post-COVID is accelerating the demand for IT products and services in virtually all sectors of the economy. Experience shows us that most companies tend to leave significant dollars on the table and expose themselves to more risk than they should in their IT deals. This is often due to lack of resources or expertise, or in some cases, just a downplaying of the importance of a robust procurement process.

By employing the tactics of exploring terms, assessing technical viability, and striving to reduce the total cost, any company can obtain tangible financial benefits in IT procurement.

Although we could not deal with all of the issues exhaustively, we hope that we have raised your awareness on some of the key mistakes made in IT procurement, and provided some solutions that can help address them.

Symphony Consulting is a Silicon Valley-based consulting firm that specializes in IT procurement, supply chain analytics, and manufacturing outsourcing. Symphony provides valuable and effective IT sourcing and procurement expertise to companies and represents them on the business issues that involve the purchase of software, hardware, outsourcing, and services.

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