Research Report: Best Practices

Why Every CIO Should Consider Third Party Maintenance

Trends in Third Party Maintenance Show Greater Acceptance and Adoption

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Purpose and Intent

This best practices research report addresses an emerging apps strategy known as third party maintenance (3PM), which is used to reduce the costs of maintenance and optimize legacy applications. Included survey results show how and why IT leaders are turning to 3PM as a part of their apps strategy.

Executive Summary

CIOs face a dual challenge of optimizing existing environments and working with business leaders to deliver innovation. As the cost of operating an ERP system consumes vital resources and budget, IT leaders must formulate apps strategies to rein in costs, integrate internal and external systems, and accelerate innovation and business value.

This report outlines eight optimization strategies that IT leaders should consider in their overall apps strategy, focusing on an effective and growing option known as third party maintenance (3PM). Third party maintenance (3PM) allows organizations to receive maintenance, tax updates, and regulatory changes with savings of at least 50 percent of existing vendor maintenance prices. Organizations on both newer and older releases with a stable applications core typically consider this option for both the short term and long term cost savings.

Successful implementation of optimization strategies including 3PM will free up funds for innovation projects and improve the business and IT relationship. As organizations apply their four paths to ERP in their apps strategies, the same techniques can apply to other application areas including CRM and supply chain management.

CIOs Face Massive Challenges with Existing ERP Apps

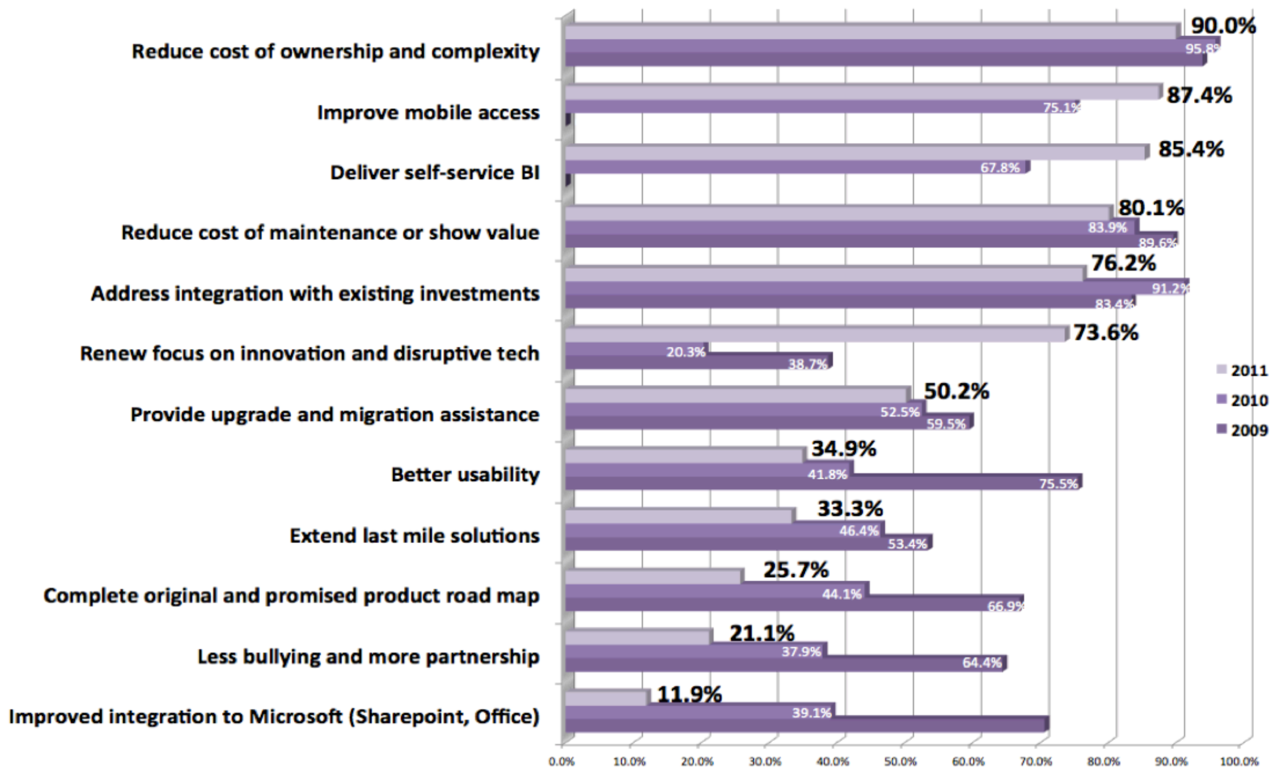
With the average Global 2000 ERP deployment nearing 11.5 years in service, ERP customers face a significant challenge with updating their existing investments. Installed pre-Y2K, users have attempted to work around the best practices of the 1990s while seeking to infuse innovation and application agility for the next decade. The challenge is daunting given the rigidity of existing systems, the inertia of legacy applications, and the quarter-to-quarter thinking in executive suites. As a result, CIOs face three major challenges in go-forward ERP apps strategies (see Figure 1):

1. **A mandate to rein in overall costs.** In the latest survey on third-party maintenance, ninety percent of ERP owners cite reduction in the cost of ownership and complexity as their key concern. That's been the top priority for the past three years of the survey. Often, these projects have accumulated more than 10 times the original license cost in implementation, maintenance and upgrades and continue to drain corporate coffers. Consequently, 80.1 percent of respondents seek a reduction in the cost of maintenance or wish to see more value. Furthermore, the high percentages of shelfware (i.e. purchased software not in use), the inability to keep up with upgrades, and the questionable value from ERP vendor support drive CIOs to find additional cost savings.

2. **Challenges in integrating internal and external systems.** Surrounded by rigid application extensions, work-arounds, complex point-to-point integrations, user exits, flex-field hell, and customizations, many organizations have lost the ability to easily connect internal and external information sources. Amidst post-merger integration projects, CIOs must integrate ERP systems with a number of legacy systems and a growing list of purpose-built SaaS solutions. This issue is mentioned by 76.2 percent of respondents.

3. **Pressure to speed up innovation and business value.** CIOs face the challenge of extending the life of an aging system or dealing with an expensive reimplementation. Unfortunately, the business side of the house can no longer wait for IT to deliver innovations in the ERP environment (73.6 percent of respondents). In fact, 87 percent of respondents indicate a need to enable mobile access, and 85 percent implement self-service business intelligence (BI). Many have also sought SaaS solutions as an option to plug the innovation gap.

Figure 1. Common Challenges Organizations Face With ERP



Source: Software Insider Survey: ERP Challenges Q3 2009 n = 163, Q2 2010 n = 261, Q3 2011 n = 242

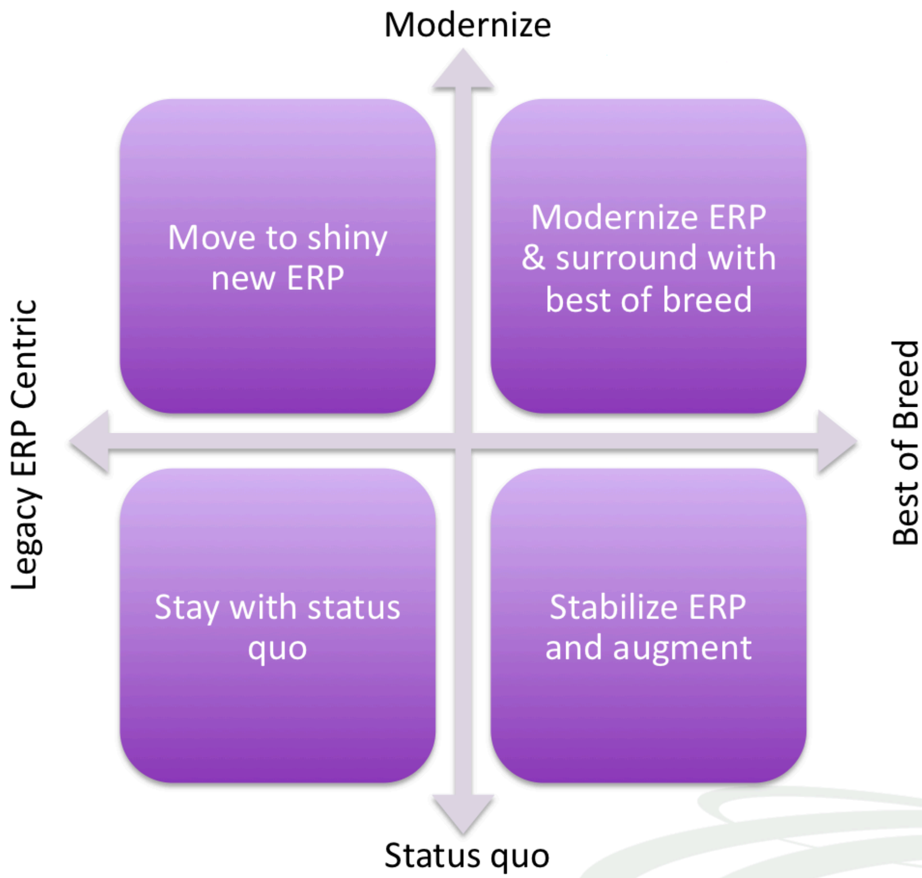
Four Paths Guide Most ERP Optimization Strategies

Common strategies address the balance between status quo and modernization, and the decision to stay legacy ERP-centric or move towards best-of-breed. The common strategies in this approach do not include the increasingly popular option to replace the legacy system. Based on interviews with over 300 ERP customers since 2009, the four paths can be classified as (see Figure 2):

1. **Stay with status quo**. Some organizations may choose to continue business as usual. The catalysts for change include major events such as new business models, merger and acquisition, or changes in regulatory requirements. Status quo includes keeping the system moderately current with tax and regulatory updates.

2. **Move to shiny new ERP.** Other organizations may choose to stay current with their latest ERP release. In many cases, these CIOs bite the bullet and go with a full reimplementation to get to the latest version of their legacy system. The cost of a reimplementation must be balanced against status quo. However, many CIOs gain peace of mind knowing that their ERP landscape remains with one vendor.

Figure 2. The Four Paths to ERP Optimization



3. **Stabilize ERP and augment.** Organizations may choose to isolate their legacy ERP system and surround it with complementary applications. SaaS applications and two-tier ERP play a key role in enabling extensibility in legacy ERP for customers. Augmentation with third-party solutions not only ensures that business users gain critical functionality, but also provides users with leverage in future contract negotiations. For example, if the vendor of a third-party solution also has its own ERP system or it partners with other ERP providers, it may represent a viable alternative for a future replacement of the incumbent legacy ERP. This improves the customer's power in future negotiations with the incumbent vendor.

4. **Modernize ERP and surround with best-of-breed.** Some CIOs will upgrade their core ERP system and then modernize by adding best-of-breed apps on top of their legacy apps. Most organizations aspire to achieve surround strategy. Unfortunately, most organizations lack the will power and resources to complete this approach.

Apps Optimization Strategies Must Align with the Software Ownership Life Cycle

The overarching strategy is to take a life cycle approach to your ERP system ownership. Across the ERP ownership life cycle of selection, implementation, adoption, optimization, and renewal exists seven categories of solutions CIOs have deployed to optimize their ERP costs and in some cases extend the life of their application investment:

1. **Application extension and usability.** Users often complain about the poor usability of their ERP solutions despite the move to web-based and role-based user experiences. Application extension and usability solutions allow each user to improve and craft his or her own user interface. In some cases, the solutions provide composite app creation capabilities in independent tool sets that inter-operate across different ERP technologies. In other cases, customers have chosen to add their portal.

   "We just gave up with usability. Now we have everything exposed through our SharePoint portal. It's not the best solution, but it's the most cost effective approach," stated the CIO of a large media and entertainment concern.

2. **Application life cycle management.** Whether it is instance consolidation, upgrades, test data management, or performance planning, these vendors ease the process of managing the complexities of the ERP application life cycle. Two distinct product types exist – data solutions and applications.

   The CIO of a Fortune 100 insurer pointed out, "Upgrades now move so much faster because the ALM applications help us anticipate what will break, what's not custom, and how we can resolve the situation."

3. **Archiving, storage, and data management.** Information management solutions improve system performance, address regulatory requirements, and provide content management solutions across the enterprise. These solutions provide practical tools to deal with the data deluge from a massive amount of information.

   A director of ERP at a large aerospace organization said, "Our ability to archive information with the new data archiving solution helped improve system performance by 2X for our ERP system and also put us in better shape for regulatory audits."

4. **Integration.** Most customers are opting for more than point-to-point and ERP-centric integration. Hybrid environments are emerging as the norm, given the rapid adoption of SaaS solutions. Therefore, organizations seek coordinated approaches for not only data and metadata, but also process integration.

   "Almost two-thirds of our applications live in the cloud. From CRM, to expense management, to HR and incentive comp, we have to tie back to our ERP in a scalable fashion," noted The VP of enterprise apps at a professional services organization.

5. **Database optimization alternatives.** Database optimization solutions for ERP reduce the costs of ownership and in some cases improve the performance of the core app. While Oracle database is the predominant vendor for large enterprises, options from IBM and Microsoft give most customers greater choices to virtualize, provide backups, disaster recovery, and high availability without additional licensing hassles.

   "Since moving off of Oracle database to IBM, we've saved millions on warm and cold backups, virtualization, and disaster recovery. I'd think the same would be for SQL Server, but we're an IBM shop," noted the IT director of a global pharma organization.

6. **Virtualization.** Virtualization allows organizations to consolidate server infrastructure costs for development, testing, training, and production environments. Organizations often gain from 50-135 percent in savings from virtualization initiatives.

   The CIO of a retailer wrote, "We were able to consolidate 15 data centers into three facilities. Virtualized environments provided us with power, labor, and management savings of 57 percent over two years."

7. **License Management and Optimization.** Solutions in this category focus on helping clients manage their license usage, optimize license type selection, and avoid overspending on software licenses. IT asset management systems often provide these capabilities. Many large enterprises lack an understanding of how much shelfware may be in production, and lack the ability to accurately select the best license models for their organization. In some cases, where allowed by law, the used software market provides users with opportunities to unload or acquire older releases of software.

   "Since applying a license management and optimization solution, we uncovered hundreds of unused licenses and discovered where we had low usage patterns. At renegotiation, we had the data to effectively renegotiate our maintenance contract," noted the procurement officer of a large financial services concern.

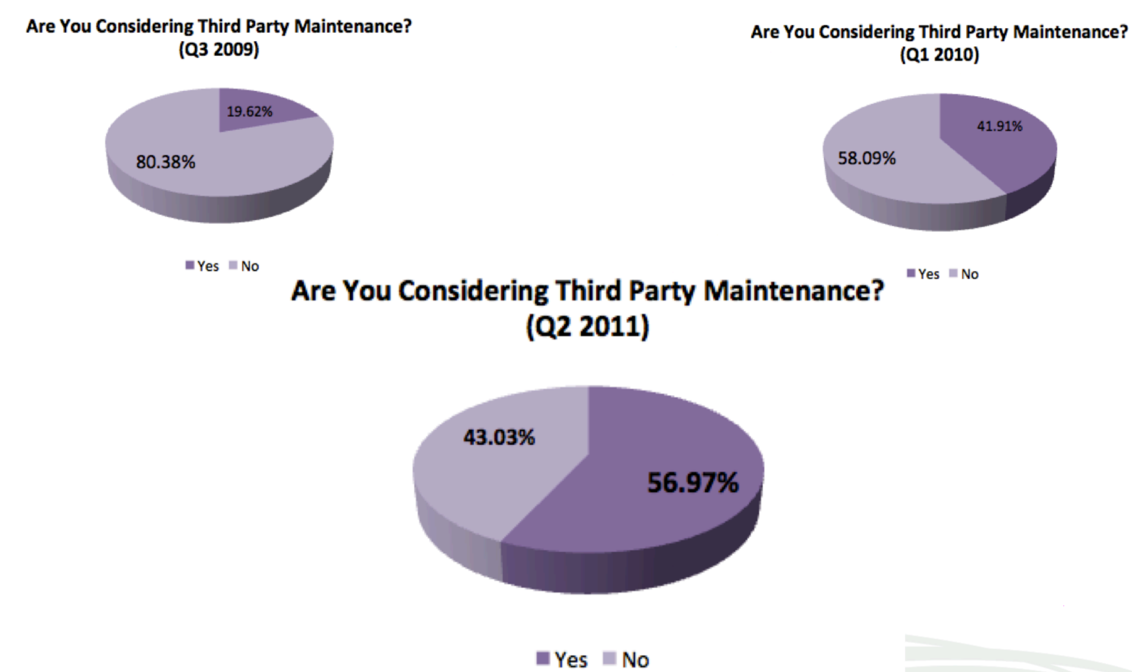
Third Party Maintenance Provides CIOs with Options and Opportunities

Third party maintenance (3PM) allows organizations to receive maintenance, tax updates, and regulatory changes with savings of at least half the cost of existing vendor maintenance costs. Organizations on both newer and older releases with a stable applications core typically consider this option for both short-term and long-term cost savings. However, once a customer has elected 3PM and leaves vendor support, it no longer has access to new upgrades and the latest releases.

For an organization with a highly customized environment, an upgrade to the next release will require as much effort as a new implementation. Consequently, many customers turn to 3PM when they no longer receive value for their maintenance dollars or they no longer need access to the future upgrades. Other customers can download the upgrade and apply it after the transition to 3PM. This approach may be appropriate in cases where the customer first needs to stabilize the ERP environment, perhaps with the help of the 3PM provider. In fact, survey results from the past three years now show a majority (57 percent) considers 3PM as part of their apps strategy (see Figure 3).

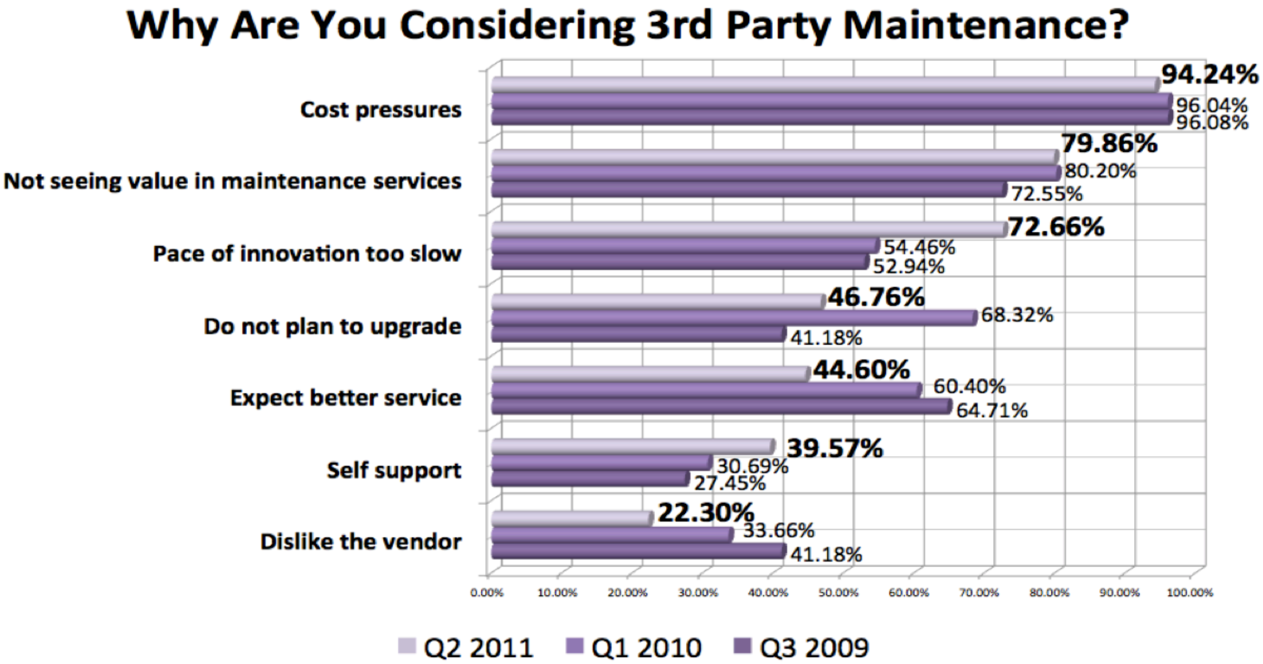
In general, organizations often seek 3PM services for seven reasons (see Figure 4):

Figure 3. More Than Half of Respondents Seek Third Party Maintenance



Source: Software Insider Survey: State of 3PM Q3 2009 n = 51/260, Q1 2010 n = 101/241, Q2 2011 n = 139/244

Figure 4. Seven Reasons To Move To Third Party Maintenance



Source: Software Insider Survey: State of 3PM Q3 2009 n = 51/260, Q1 2010 n = 101/241, Q2 2011 n = 139/244

1. **Continuing cost pressures.** IT budgets continue to be flat or shrinking. Organizations must do more with less, and at the same time are feeling pressure to innovate. CIOs, therefore, must find fat without trimming bone. About 94 percent of respondents cited cost pressures as the number one rationale to seek 3PM. Most organizations spend up to two-thirds of their budget keeping the lights on, leaving very little to spend for innovation. 3PM therefore represents an attractive option for saving money on ongoing support.

2. **Gaining minimal value in maintenance services.** Most respondents believe they are paying too much for too little. Many clients have not applied upgrades and patches for years. Others make five support calls a year for $1M in support costs. Costing $200k per support request, boards and CFOs question the value. The sentiment among respondents has held steady for the past three years with about 80 percent stating value as a key factor. In such cases, 3PM offers a way to improve the cost-to-benefit ratio for ERP maintenance.

3. **Slowing pace of vendor innovation.** The pressure to innovate has increased. Survey results show an 18 percent jump over last year in respondents stating that the pace of innovation is too slow. Business leaders are putting the pressure on IT to move fast. Third party maintenance uptake increases when vendors fail to innovate and business would like to free up budgets for innovation. These include SaaS deployment options or key functionality in areas such as strategic HCM and social CRM.

4. **Declining plans to upgrade.** Unlike Q3 2009 where worsening economic conditions led to a 27 point increase in interest in 3PM, more customers now plan to upgrade and see 3PM as part of this strategy to stabilize the environment and then upgrade.

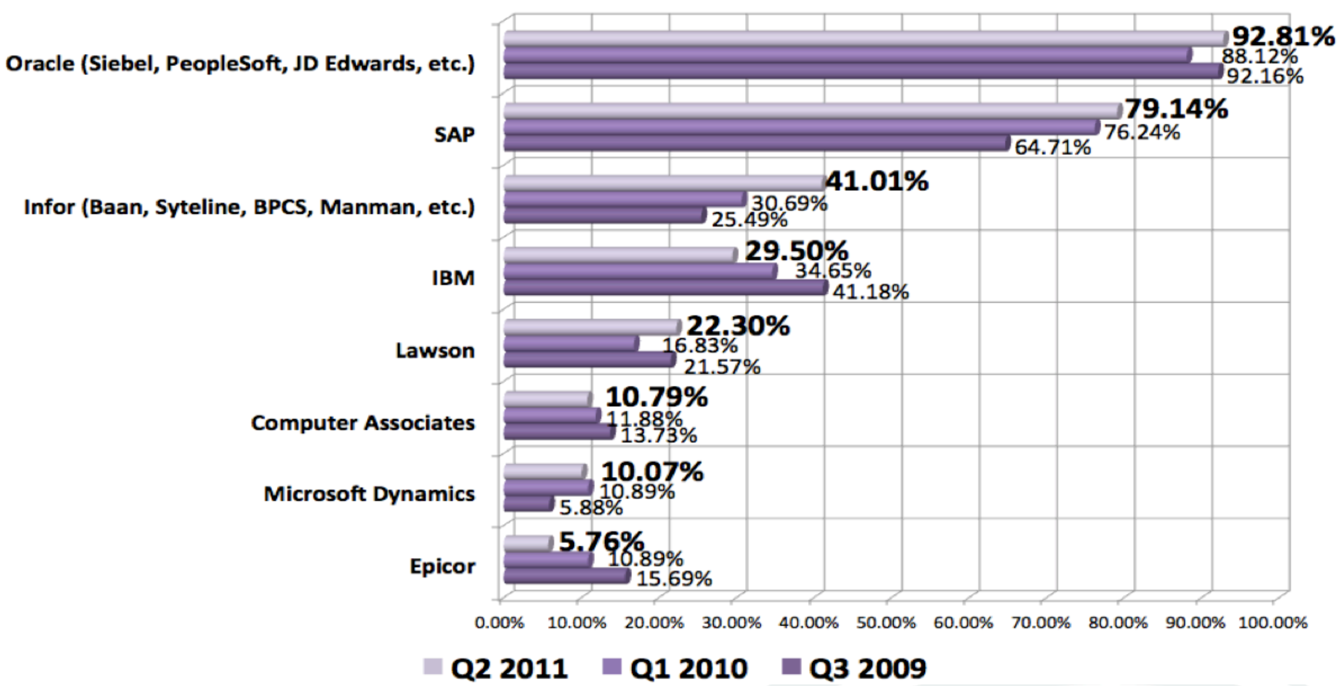
5. **Expecting better service.** Unfortunately, expectations for better service continue to drop. Service continues to play a key factor in decisions to go to 3PM. More than 20 percent of customers have given up on expecting better service between Q2 2011 and Q3 2009. The experience of 3PM customers often points to improvements in service satisfaction, even though the costs are less.

6. **Delivering self-support.** Over the past three years, our survey shows a doubling in the respondents who already provide their own support. These organizations have no need to pay maintenance when they are doing all the work. For such customers, 3PM provides a backstop to the customer's own self-support program.

7. **Disliking the vendor.** Vendor likability has increased. This year 22 percent of survey respondents said they had a bad experience with their vendor, down from 40 percent a year earlier. The good news - vendor sales teams have improved how they engage with customers. The reality – these numbers still represent high disapproval ratings which play a factor in moving to third party maintenance.

Survey respondents also indicated which applications they most likely will move to 3PM (see Figure 5). Oracle-acquired products led the pack again in 2011. Just under 93 percent of respondents considering 3PM are planning to move over an Oracle acquired product. SAP followed with almost 80 percent of the surveyed planning a move to 3PM. Infor (43 percent), IBM (29.5 percent), and Lawson (22.3 percent) rounded out the top five apps for 3PM consideration.

Figure 5. Oracle and SAP Remain Top of Mind for Third Party Maintenance



Source: Software Insider Survey: State of 3PM Q3 2009 n = 51/260, Q1 2010 n = 101/241, Q2 2011 n = 139/244

Actionable Advice: It's Never Too Late to Consider Third Party Maintenance in Enterprise Apps Strategy

Third party maintenance should be part of the arsenal in every CIO's apps strategy. Take these seven steps to begin an evaluation:

1. **Determine total cost of maintenance.** Calculate your maintenance payments, number of FTE's supporting the application, cost-to-perform upgrades, projected reimplementation costs, amount of shelfware (i.e. software purchased and incurring maintenance fees, but not deployed), and any additional maintenance-related expenses.

2. **Calculate current usage.** Add up the number of support calls made, patches and upgrades applied, searches in the knowledge base, and additional support and service requests made of the vendor.

3. **Identify future requirements.** Determine upgrade timing, future conversions, and potential reimplementation needs. Map out business requests to be fulfilled and timing.

4. **Download latest upgrades and documentation that you have the rights to.** Whether or not you move to 3PM, you should secure your rights to software that your organization has paid for. Organizations should maintain a library of upgrades, enhancements, patches, and other materials paid for with maintenance and support fees.

5. **Plan migration strategy.** Consider dependencies in migration timing. Track existing performance metrics. Work with the OEM vendor to establish future SLAs for performance. Plan timing after financial cycles and work in parallel to secure enough future licenses to account for growth. Do not alert the vendor you will be switching. Of note, vendors can not legally require you to buy maintenance with new licenses.

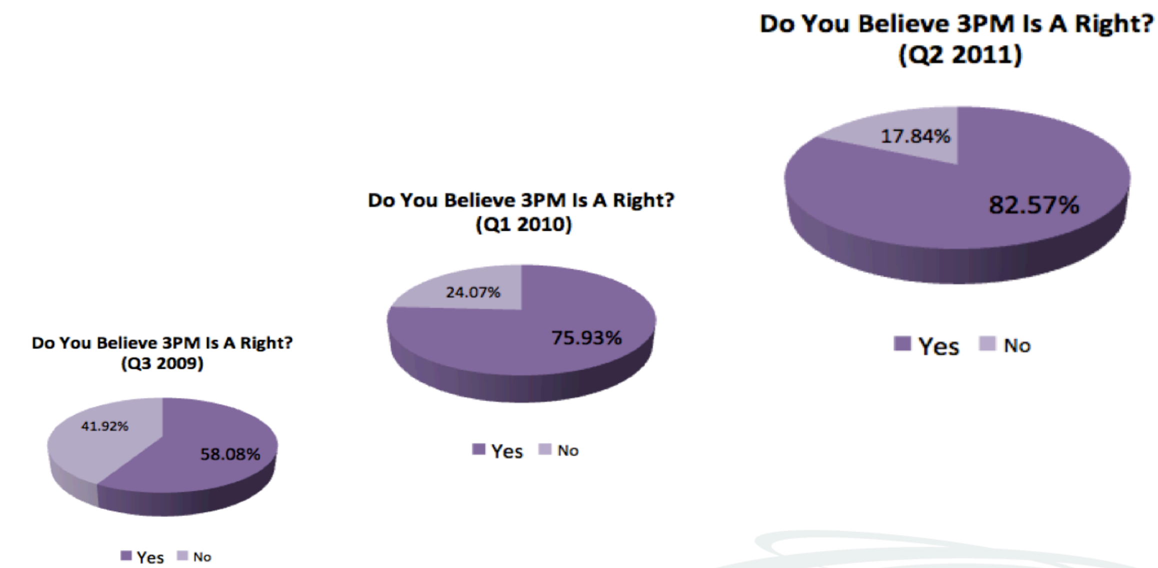
6. **Apply cost savings to new projects.** Sit back and calculate the cost savings of 3PM by halving your current maintenance costs. Plan out future projects with the optimization savings.

7. **Take a breather and consider future apps strategy.** Take a break. Think about the new and more innovative projects that lay ahead of the organization's future.

The Bottom Line: Users and User Groups Should Organize to Guarantee 3PM Rights

ERP customers should not take their right to 3PM for granted. The latest surveys show that 82.6 percent of respondents believe 3PM is a right (see Figure 6). Unfortunately, this right is under fire by major vendors such as Oracle who have taken legal actions against 3PM providers for improperly (i.e. TomorrowNow) or allegedly (i.e. Rimini Street) violating intellectual property rights.

Figure 6. Most Organizations Believe Third Party Maintenance Is A Right



Source: Software Insider Survey: State of 3PM Q3 2009 n = 51/260, Q1 2010 n = 101/241, Q2 2011 n = 139/244
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If providers have violated such laws, Oracle rightfully should defend its positions and protect its intellectual property. However, there is a lot of money at stake. For most software vendors, maintenance represents 50-80 percent of their revenue stream with almost 80-90 percent profit margins. Consequently, users and user groups have a responsibility to:

- Demand that their contracts include provisions that protect their right to 3PM.
- Require vendors to work out rules on how 3PM providers can deliver services without violating software IP provisions.
- Seek antitrust class action with the US Department of Justice (i.e. Christine A. Varney) and the European Union Competition Commission (i.e. Joaquín Almunia) against software vendors who hinder 3PM providers from providing services.

Users and user groups must vigorously defend their positions in contracts and legal action or lose this right. Failure will result in a continued software maintenance monopoly. Success will ensure market competition and renewed innovation. Constellation believes users should work with user groups to set up working committees to ensure this right.

Parallax View

More Than Just Cost Savings in 3PM

By Frank Scavo, VP and Principal Analyst

Cost savings are an obvious benefit from 3PM, but improvements in service levels should not be understated. This is particularly true in cases where a customer has made major enhancements or customizations to a legacy system. Vendor maintenance contracts not only do not support such modifications, but they often remove the affected modules or programs from vendor support. In other words, once the vendor learns that a customer has modified the program code, the vendor often refuses to take support calls for the affected program.

Third-party maintenance providers are now competing on service as well as cost by explicitly taking over the customer's modified code and bringing it under the scope of the 3PM contract. For customers that have made customizations that are strategic in nature (e.g. to provide unique or differentiated functionality to their system), 3PM therefore becomes a strategic investment in supporting the core system.

Related Research

August 12, 2011, Research Report, R "Ray" Wang, "The State of the State On ERP Ownership and Optimization Strategies."

May 15th, 2011, Research Report, R "Ray" Wang, "Market Overview: The Market for SAP Optimization Options."

March 3rd, 2011, Research Report, R "Ray' Wang "Best Practices: The Four Personas of the Next Gen "CIO."

February 28th, 2011, Research report, R "Ray' Wang, "Best Practices: The Case for Two-Tier ERP Deployments."

Disclosures

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Enterprise Strategist and Disruptive Technologies Expert

R "Ray" Wang currently is a Principal Analyst and CEO at Constellation Research Group and the author of the popular enterprise software blog "A Software Insider’s Point of View." He previously was a founding partner and research analyst for enterprise strategy at Altimeter Group. With viewership in the millions of page views a year, his blog provides insight into how disruptive technologies and new business models impact the enterprise. A background in emerging business and technology trends, enterprise apps strategy, technology selection, and contract negotiations enables Ray to provide clients and readers with the bridge between business leadership and technology adoption.

Buyers seek Ray’s research in disruptive technologies and their impact on business processes, business models, and organizational design. Business topics focus on harnessing innovation, creating next-generation business and IT leadership, and applying the new rules of business. Technology topics include SaaS/Cloud solutions, Social CRM, Next Gen ERP and apps, business process transformation, Project Based Solutions, Order Management, Master Data Management, and middleware technologies.

For technology sellers, Ray provides strategic guidance in go-to-market strategies; reviews and designs software licensing, pricing, support, and maintenance policies; delivers competitive assessments; evaluates software partner ecosystems; and researches business processes such as the perfect order and customer experience for the enterprise and SMB markets.

Media Influence

Ray blogs at Forbes CIO Central and for *Harvard Business Review*. News organizations such as *The Wall Street Journal*, Bloomberg, *Business Week*, *Fortune, Inc*., The Associated Press, *CIO Magazine*, *Information Week*, *ComputerWorld*, *Financial Times*, *eWeek*, *CRM Magazine*, IDG News, ZDNet, *TechTarget*, and *Managing Automation* frequently seek his point of view. Ray is an energetic and passionate keynote speaker, and has also been featured on major TV news outlets such as CNBC.

Industry Recognition

In both 2008 and 2009, Ray was recognized by the prestigious Institute of Industry Analyst Relations (IIAR) as the Analyst of the Year, and in 2009 he was recognized as one of the most important analysts for Enterprise, SMB, and Software. In 2009, A Software Insider’s POV was listed in the top 20 of Jonny Bentwood’s Technobabble 2.0 Top Industry Analyst Blogs. In 2010, Ray was listed as one of the Top 5 Analyst Tweeters in Edelman’s TweetLevel Index, recorded as part of the ARInsights Power 100 List Of Industry Analysts, and named one of the top Influential Leaders in the CRM Magazine 2010 Market Awards.

About Constellation Research

We are a next-generation research and advisory firm. Our analysts bring real-world experience, independence and objectivity to our clients.

In a world of fluffy and trendy buzzwords, our clients seek our advice in achieving sustainable and pragmatic innovation. Clients expect our research agendas to span cross-role, cross-functional, and cross-industry points of view.

We serve the needs of buyers and end users who seek insight, guidance and advice in dealing with a dizzying array of disruptive business models and technologies. We provide the bridge between legacy optimization and future innovation. We help sellers understand the buyer's point-of -view and how to deliver value to their customers.

Our technologies team covers hardware to middleware to software to services. We advise the entire ecosystem of buyers, partners, solution providers, and vendor clients.

We look forward to building a partnership with you. You and your organization's success is our mission.

Warmest regards,

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