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SmartSpend™ Bulletin

5 Tips for Negotiating a Microsoft Enterprise Agreement

Changes in the current business climate combined with Microsoft's mission to move enterprises to the cloud is altering how it does business with its largest customers. Companies that plan to renew their Enterprise Agreements, or purchase the vendor's offerings for the first time, can leverage the forces driving Microsoft's behavior at the negotiation table.

Microsoft's transformation from an on-premise software giant to a cloud leader has been nothing short of impressive over the last several years. The company's perseverance and focus have been rewarded by soaring quarterly profits and stock prices, and a successful reorganization of its business.

While the vendor is committing its most powerful R&D, sales and marketing resources to the cloud, some Microsoft enterprise customers are still operationally and contractually locked into on-premise implementations. This has prompted the vendor to take aggressive measures to migrate these customers to the cloud. Outcomes include several pricing and licensing changes, a spike in formal and informal license audits (often disguised as Software Asset Management engagements), and increased contractual complexity and inflexibility.

The Microsoft Enterprise Agreement has always been a potential hotspot for overspending – and that's truer than ever today. The sheer volume of subscription and licensing choices for Microsoft's offerings are overwhelming. EA renewals and first-time negotiations have never been more complex. And a volatile business climate has added new fiscal pressure to both customers and Microsoft.

There are an increasing number of license and subscription optimization challenges to navigate when doing business with Microsoft, as well as new cost, flexibility and licensing/subscription opportunities on which to capitalize. As Microsoft continues its metamorphosis and enterprises' budgetary and usage requirements rapidly evolve, customers should prepare for a more challenging sourcing and vendor management environment.

While the vendor's cloud-based offerings may be the future of its enterprise business, most Microsoft customers are still operationally and contractually locked into on-premise deployments.

Microsoft customers have gained leverage in the past by waiting until the very end of their EA term to renew. **This is no longer the best tactic**.

WHAT'S DRIVING MICROSOFT'S FRAME OF MIND

The conditions that have precipitated more aggressive contract negotiation behavior from Microsoft are varied. NPI has identified the following five factors:

- Pressure to move customers to subscription-based offerings. Microsoft is on a mission to move its enterprise customer base away from traditional on-premise software to its subscription-based cloud services. Revenues for its commercial cloud offerings are experiencing substantial growth, while traditional software revenues decline and the mixture strains Microsoft's ability to support a multi-faceted business. Microsoft's success is being judged on how well it achieves this mission, and customers will find themselves under greater pressure to move to the cloud or pay the price via more contractual and pricing complexity for on-premise solutions. Most customers have made the leap to 365, and are at least experimenting with Azure. The good news is the deal window is still open for any new cloud spend with Microsoft.
- Pressure to stick to standard pricing, terms and licensing practices. Microsoft has a very structured hierarchy for approving deviations from standard pricing, terms and licensing. Sales reps and account managers have little influence in the matter, and decisions are ultimately made at the licensing desk where customer relationships and requirements have little bearing. Microsoft aims to further standardize these practices, most obviously noted when the vendor released its Online Service Terms – a single, standard set of terms that replaces its multiple Product Use Rights documents for online services. While Microsoft touts the benefits of a more centralized and simplified approach to contractual documentation, the reality is that these measures are making it more difficult for customers to receive concessions from Microsoft based on their unique user environment.
- Pressure on sales reps and channel partners to forecast revenues accurately. Microsoft is putting unprecedented pressure on its sales teams and channel partners to improve revenue forecasting and enforce on-time renewals. In fact, sales commissions and fees paid to resellers are negatively impacted when EAs are not renewed on time.
- Pressure to manage contractual and licensing resources against quarterly and annual pipeline. As a public company, Microsoft is tasked with accurately predicting revenues. To do so, the company must have clear visibility into their selling pipeline and be able to close purchases and renewals faster and earlier in quarterly sales cycle. There are a limited number of legal and licensing desk resources available to process these transactions, and it's nearly impossible to process paperwork less

than two weeks prior to a calendar year, fiscal year or quarter end. Handling these peaks in deal volume is a challenge for Microsoft's enterprise business and delays in this pipeline can have a domino effect on quarterly and annual revenues, stock price and overall market perception.

Customers need to leverage the vendor's desire to prevent spillover and leverage purchases and renewal timing accordingly. Contrary to common wisdom, Microsoft may be more flexible in negotiations outside of their peak sourcing times.

- Pressure to reduce quarterly revenue disparity. Across NPI's client base, more than 40 percent of EA renewals occur in Q4 of Microsoft's fiscal year (i.e., April/May/June). This is in contrast to Q1, which typically accounts for less than 20 percent of EA renewals. This creates lumpy demand for licensing and legal resources, lumpy forecasting risk and lumpy cash flow. One of the objectives of moving to subscription-based licensing is to smooth this pattern.

NEGOTIATION MISTAKES TO AVOID

Clean house before you renew. It's not uncommon for a material portion of licenses and/or subscriptions to be dormant or underutilized – even in environments that are meticulously managed.

The factors previously discussed have introduced new dynamics to the Microsoft EA negotiation. They've also exposed new pitfalls that can lead to higher costs and less contract flexibility. Potential mistakes to be avoided include:

- Waiting until the last minute to renew. In the past, Microsoft customers have gained negotiation leverage by waiting until the very end of their EA term to renew, especially if this timing coincided with Microsoft's quarter or fiscal year-end. This is no longer the case – especially for fiscal year (June), calendar year and quarter end purchases and renewals, when volume chokes the system. Microsoft is going to great lengths to get customers to renew much earlier in the quarter, including offering better pricing and discounts or allowing clients to adjust contract dates. Customers need to know how they can leverage deal timing to get more favorable concessions and greater flexibility.
- Failure to rationalize and optimize discounts. Microsoft's "best-offer" discounts are rarely best-in-class. The difference between the discount one customer receives and what another customer with similar requirements receives can be substantial. When a subpar discount becomes the foundation for future EA renewals, overspending grows exponentially. Customers should perform price benchmark analysis on all facets of their Microsoft estate to validate they're getting a fair deal and ensure they pay a price that's at or better than market.
- Over-focusing on pricing and under-focusing on programs and terms. Having visibility into what constitutes a fair price for Microsoft's offerings is the first step in reducing EA costs. But it's only half the battle. To effectively lower costs, customers have to understand how their unique business requirements align with standardized terms (especially for cloud offerings), the dozens of licensing/subscription permutations and the options available to them. With more options available, it's important for customers to understand which licensing and subscription programs best support their technology, business and cost management requirements; and the compliance and cost details surrounding migration from current states to future states. Furthermore, companies must understand where Microsoft is willing to be flexible as it relates to terms governing price protection and usage elasticity – particularly amid economic volatility – and negotiate those terms into their EA accordingly.

- Believing that Microsoft EA negotiations are a one-time event. Most companies view the Microsoft EA renewal as a single event. They deploy their brightest IT and sourcing resources to handle the EA, but once it's signed, these resources are effectively "off the case." This is a mistake. Before the ink is dry on a renewal, Microsoft's account team is working on the next one. Informally referred to as "T minus 36" (a three-year countdown until customer renews again), Microsoft follows a cyclical and successful methodology for ensuring each customer expands their Microsoft estate and spend at the next renewal event. For example, once the EA is purchased/renewed, companies must be prepared for the next event – the true-up. Following the true-up is auditing, which has become very common for Microsoft customers. Customers that haven't recently been through an audit should expect to undergo one in the near term. In most cases, this will drive another round of negotiations which will require skillful interpretation of licensing programs, terms and conditions.
- Relying on your reseller (LAR/LSP) or account rep to optimize your licensing/subscription. There are a variety of ways to license and/or subscribe to Microsoft products. A particular enterprise's Licensing Solutions Provider or account rep may not be well versed in all of the options available. However, they are well trained (and motivated by incentive) to take customers down a path to higher licensing costs. Be sure to question Microsoft's licensing specialists on how to better structure licensing for lower spend, and consider getting unbiased expertise to assist the sourcing team with vetting the recommendations.

5 TIPS FOR NEGOTIATING YOUR MICROSOFT EA

- [ ] Perform price benchmark analysis on all major elements of your EA spend and inspect contract terms for flexibility. Build in time to perform price benchmark analysis on all pricing and discounts ahead of your EA negotiation and/or renewal – it's a sure-fire way to identify material savings and eliminate "waterfall" overspending in subsequent renewals. Inspect the T&Cs governing your EA for flexibility, particularly as it relates to price protections and usage elasticity. Remember, the pressure is on to migrate customers to Microsoft's newest cloud offerings and the deal window is open for customers who can effectively align their long-term cloud strategies with Microsoft's direction.
- [ ] Clean house before you renew. For customers that have deployed significant 365 licenses (7,500 or more), do a formal "housecleaning" so you have an accurate baseline for your renewal requirements (we refer to it as 365 Usage Optimization Analysis). When NPI performs this user-by-user analysis for our clients, most estates yield 10 to as much as 30 percent dormant or underutilized licensing – even in environments that are meticulously managed. It's a tedious and time-consuming self-audit, but it can yield big payback. For example, a recent project found $4M in 365 deployment that was duplicative, dormant or mismatched with the optimal (lowest cost) profile. For an even broader analysis, conduct a full license position assessment (LPA) that covers all Microsoft products used in your environment. Ideally an LPA should be started about nine months prior to your renewal.
- [ ] Don't wait until end of term to renew. Microsoft is highly motivated to wrap up EA renewals early. This can be seen in the promotional pricing and discounts they're currently offering to customers.

5 TIPS FOR NEGOTIATING YOUR MICROSOFT EA (CONTINUED)

- ☐ Be prepared for an audit – it will happen. The best way to handle an audit is to prepare for one, and not to rely on Microsoft's Software Asset Management (SAM) tools, which invariably lead to higher customer costs. Enterprises should utilize their own methods and tools to determine license counts, and scrutinize whether certain users truly require all products – before they are contacted by Microsoft's SAM teams. It's also important that customers proactively manage/monitor license counts and compliance throughout the term of their Microsoft agreements. Being caught off guard is the surest path to costly penalties.
- ☐ Be careful about what and how much information your team shares with Microsoft's sales and account reps. Do you have contractors accessing Microsoft's solutions? How many? Where are they located? What versions of product are you running? These questions are all slippery slopes – be careful how and when you share this information as it can be used against you. Similarly, divulging too much information about which competitive products are being evaluated can have a negative impact on price negotiations. For example, your Microsoft sales team knows a switch to Oracle is too difficult for some organizations. Counterintuitive as it may be, saying that Oracle is in the running for your business may motivate Microsoft to become less flexible on price and terms during the negotiation.

ABOUT NPI

NPI is an IT procurement advisory and intelligence company that helps businesses identify and eliminate overspending on IT purchases. We deliver transaction-level price benchmark analysis, license optimization advice and vendor-specific negotiation intel that enables IT buying teams to drive measurable savings. NPI analyzes billions of dollars in spend each year for clients spanning all industries that invest heavily in IT. NPI also offers software license audit and telecom carrier agreement optimization services. For more information, visit www.npifinancial.com.

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