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What Cloud Vendors Don’t Want You to Know About Pricing and Contract Terms

Behind the Complexity of the Cloud Purchase

In the past decade, cloud computing has fundamentally changed the way enterprises deploy, use and manage IT. Its impact on the business has been both disruptive and immeasurable, and its adoption continues to accelerate thanks to mobility, big data and the consumerization of IT.

As companies become increasingly comfortable with cloud environments, the cloud purchase itself presents new risks and challenges. If not carefully navigated, overspending threatens to neutralize the value of the benefits that have attracted companies to a cloud delivery model. The quality of each buyer's sourcing and vendor management capabilities has a big impact on this evolving subcategory of IT spend.

Internal Factors Impacting Potential Overspending on the Cloud Purchase

When evaluating the cost and strategic advantages of moving to the cloud, companies must first look internally to the challenges and considerations presented by their existing computing, sourcing and vendor management environment. This includes:

- Redundancy. Most companies have spent decades investing in traditional IT infrastructure like software licenses, network equipment and data center technologies. Investing in the cloud may create redundancy across the IT portfolio, thereby increasing the risk of underutilization of existing IT resources.
- Architecture flexibility. For most buyers, integration between cloud and on-premise IT will be a requirement. Some cloud solutions are stove-piped, but many (particularly those targeted at the enterprise) offer standards-based interfaces. Depending on the cloud offerings selected, and the degree of flexibility of the existing IT architecture, companies may find themselves unable to fully capitalize on the benefits of cloud computing because their architecture cannot integrate well.
- Decentralization. The cloud also drives decentralization of IT – which may be inconsistent with historical IT management strategies for some businesses. Cloud computing options make it easier for disparate groups within the business (strategic business units, departments, etc.) to identify and purchase solutions that work best for their unique business needs. This has a direct impact on the leverage and governance needed to effectively negotiate with and manage vendors. On a related point, when everything is provided as a service, companies have more freedom to pursue a "best of breed" IT strategy. This has obvious benefits, but also introduces another layer of cost for integration, management, governance and support services.
- Lack of insight into vendor behavior. Another factor is unfamiliarity with new IaaS, PaaS and SaaS players. A lack of insight into vendor behavior, solutions and ROI adds opaqueness to the purchasing process. What is the fair market value for a service? Which contractual terms are justifiable, and which are not? What are the "gotchas" in this model down the road?

It's only now that enterprises have started to see the cloud as a viable place to run core business applications. This represents the next wave of cloud adoption, but IT and IT sourcing organizations should take note: these migrations will be complex, costly and rife with opportunity for overspending.

External Factors Impacting the Cloud Purchase

After assessing the internal factors that affect the cloud purchase, companies must analyze the external factors. These include:

- SLAs. As mentioned earlier, cloud IT is a service buy that requires crystal clear service level agreements (SLAs). The service itself has to be clearly defined and detailed, along with the vendor's performance obligations. Of course, this is a best practice for any IT purchase, but its importance is elevated in the cloud. Without clearly defined specifications and SLAs, companies are exposed to greater risk of increased costs, poor service delivery and project failure.
- Solution flexibility. Another consideration is solution flexibility. The cloud may make deployment and management easier, but it's done on the vendor's terms. Unlike non-hosted applications and infrastructure, most cloud-based solutions aren't easily configured. Understanding the limitations of configurability and customization, as well as whether you will lose critical functionality once you migrate to the cloud, is paramount.
- Ancillary services. Hand in hand with solution flexibility (or inflexibility) is the possible need for ancillary services to make the cloud-based solution work for you. Regulatory compliance and stringent security protocol in many businesses often require companies to enlist additional professional services ranging from the basic (e.g. custom reports) to the complex (e.g. integration). It's imperative that companies understand how a vendor will support and bill for ancillary services, and exactly what volume of these services will be required.
- Vendor roadmap. Lastly, companies should be forward-looking in their cloud vendor purchases. Because companies are no longer licensing an on-premise product with customer-controlled upgrade timing, they are wholly vulnerable to the vendor's roadmap. This has its advantages since companies no longer have to worry about installing updates and upgrades. But, depending on the vendor's vision for the service, customers may find themselves eventually paying for functionality they don't need, forced to change usage patterns or processes to match functionality changes, or face issues with surrounding ecosystem compatibility (for example, leading to forced upgrades of other integrated systems).

High-Risk Areas in Cloud Purchasing

Ease of management and reduced IT costs are the two biggest drivers behind the accelerated adoption of public, private and hybrid cloud environments. One factor in achieving these benefits is how well your IT sourcing team can navigate the vendor evaluation and contract negotiation process.

The contract pitfalls associated with cloud purchases are numerous. Overlooking just one of the pitfalls below can lead to overspending, unexpected fees and poor vendor performance:

- Minimum purchase clauses: This is especially true with SaaS. Buyers should not fall prey to requirements to buy more licenses than they need (or have a minimum number of users) over the term of the contract. Buyers should also push for the flexibility to decrease users/licenses at regular intervals so they can reduce the number of users in the event that business needs change. Without attention to this factor, you may easily be locked into spend that's not aligned with your needs.
- Ability to ramp up: Companies should require vendors to specify their ability to ramp up new users/usage quickly. What happens if your company takes on a major client or acquires another company? Or if business demand spikes? Answers and pricing should be specified in the contract – not just in sales talk.

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- Data ownership, return and protection: Establish data ownership immediately in the contracting process. This includes who owns the data as well as the data migration procedures and costs. Data cleansing and migration procedures can add another layer of cost and complexity as you switch to the cloud. Additionally, because your data will reside remotely and (most likely) within a multi-tenant architecture, your contract should clearly communicate the vendor's disaster recovery, business continuity and data confidentiality commitments.
- Renewal rate increases: Be sure to address renewal rates in your contract by inserting language that limits or prevents renewal rate increases. Not doing this empowers your vendor to enact unreasonable rate increases once your contract term is up.
- Termination costs and transition assistance: At some point, you may switch vendors. Specifying termination costs and data transfer guidelines upfront in the contract makes this process far less painful and costly.

As the cloud market matures, and more vendors enter and exit, buyers should take caution. Transparency into contract terms and pricing has never been more important.

- Integration: Depending on the state of your IT infrastructure and architecture, integration may be a sticking point for your cloud investment. Many cloud vendors charge for data integration or data transfers beyond a certain level. Understand your integration needs going in to the vendor evaluation and contracting process, and make sure all pricing and terms reflect those needs.
- Professional services: Most companies are used to paying professional services fees to keep their traditional IT investments up and running. However, custom reports and tweaks in functionality for cloud-based solutions can be a different beast. There is little visibility into what constitutes a fair price for professional services in this category of IT, which makes it that much more important to specify costs and projected service needs up front in the contracting process.

Special Considerations for the IaaS Purchase

Compared to SaaS and PaaS cloud services, IaaS is more complex and requires a detailed systems design that lays out specific requirements for equipment and services. In an IaaS purchase, the opportunity for overspending – and savings – is significant. While hardware costs will inevitably be passed onto clients (sometimes, unjustifiably), there is some level of pricing flexibility for services provided.

Without question, the greatest area of risk within the IaaS buy is a company's ability to define scope and requirements with precision. Below are questions that buyers must ask to protect themselves from hidden costs and spending pitfalls during the IaaS purchasing process:

- What is pricing a la carte? IaaS vendors are renowned for their lack of pricing transparency. Some providers are less willing to share line-item list prices with buyers, so the onus is on you to request a la carte pricing that breaks down every aspect of the IaaS service. This includes equipment costs, lease rates, discounts, front-end services and other services/features that fall outside of the base cost of service. Unless you have this data in front of you, you can't accurately plan your spending or negotiate pricing effectively.

- Is infrastructure dedicated or shared? IaaS vendors are often unjustifiably profitable in a multi-tenant environment, where multiple businesses are sharing the same infrastructure. It's up to you to determine if a shared or dedicated infrastructure is best for you – but, if you choose shared, make sure you're paying a fair price that's well below dedicated infrastructure pricing. Furthermore, be sure to understand the metrics that will define performance, such as oversubscription ratios and capacity. For example, seven of one vendor's servers may be able to perform at the same level as 10 of another vendor's servers. And, keep this in mind: if it's a dedicated infrastructure, what are the costs after it has fully depreciated?

- How will disaster recovery be handled? With IaaS, you are putting the flow and security of your data into the hands of a service provider. Your contract should specify how and how often that data will be backed up. Also, what is the cost? Don't assume business continuity/data recovery plans are included in your contract price. Finally, it's wise to determine if you or your vendor should get business insurance to cover any losses in revenue caused by outages.

- When do scheduled outage windows occur? Speaking of outages, companies should ask their vendors when scheduled outage windows will occur. Vendors plan these outages well in advance to perform upgrades and systems maintenance. It's up to you to determine how tolerant your business ecosystem is of this schedule. For example, a retailer can't afford to have an outage occur during the holiday shopping season. A bank, on the other hand, can easily weather an outage scheduled on a Sunday when financial institutions are closed.

- What is the vendor's refresh rate? Technology and business change rapidly. How will your IaaS vendor keep up? This is a fundamental question that should be addressed in every IaaS contract. It's important to understand how often your vendor updates servers, security and other infrastructure components, and how that cost is accounted for in the contract. Is it bundled in? Is it at an extra fee? Determining those answers now will help you determine which vendor is best for your long-term IT, business and budgetary needs.

- How can my vendor optimize their process and solutions for greater cost efficiency? IaaS vendors have made a science out of efficient service delivery, but that doesn't mean there isn't room for improvement. To avoid overspending, companies must have their own IT professionals review and QA vendor processes, solutions and suggestions. Many times, vendors propose large-scale (and costly) solutions for minor issues. For example, do you really need additional tape backup for development servers, or is snapshot imaging stored on less expensive disk storage adequate? These are the types of questions that are best answered by your internal teams, and will play an instrumental role in reducing your IaaS spend.

  Another common opportunity for optimization is storage. Companies should inquire about different tiers of storage and select a storage platform that has "waterfalling" capabilities. These capabilities enable server to automatically retain frequently used data in Tier 1 storage and relegate infrequently accessed data into lower performance storage. This can reduce costs in the long term.

IDC predicts cloud IT infrastructure spending will reach $53.1 billion by 2019. At that time, IDC estimates cloud IT infrastructure will account for 46% of all enterprise IT infrastructure spending.

Conclusion

The cloud purchasing process is more complex than many IT buyers anticipate. Like traditional software and hardware purchasing, there are many nuances of pricing and terms that are not transparent. This issue is compounded by the fact that customers bear increased responsibility to accurately establish their unique usage profile. How will applications be used and by whom? What customizations will I have to make? How tolerant will my business be to one vendor's style of infrastructure management? How much storage will I need now and in the future?

Without clear focus on these areas – and a deep understanding of the less transparent ways that vendors seek revenue – companies will overpay for their SaaS, PaaS and IaaS investments. But, with the right mix of pricing visibility and insight into contract and vendor behavior, buyers can increase the value derived from their cloud purchases and maximize savings.