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NAVIGATING THE FINANCIAL COMPLEXITIES ASSOCIATED WITH ENTERPRISE SOFTWARE ACQUISITIONS

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For large enterprises and enterprise software vendors the growth of SaaS and cloud-based solutions delivers tremendous benefits and unanticipated roadblocks. The benefits are clear – fast time to deploy, scalability and on-demand pricing. Less apparent are the contractual issues which impact the financial performance of both the customer and vendor.

FOR THE VENDOR:
lower initial deal sizes as the timing of revenue on a cloud transaction is spread over time versus being recognized at the time of sale.

FOR THE CUSTOMER:
unintended P+L impact caused by accounting regulations which require changing financial allocations from capital to operating.

FOR BOTH:
tension caused by the vendor's desire to book maximum deal revenue at the time of sale and the client's desire to secure the lowest possible price and not pay for software and maintenance before a product is in use.

Add another layer of complexity. Often overlooked in the evolution from on-premise to subscription to cloud is the shift in where software is deployed. No longer reserved for the data centre or administrative functions, today virtually every employee in every company is connected to enterprise apps. The result? In many cases, long roll-out periods and more expensive, not cheaper, IT costs.

40%

The stakes are large. A 2015 survey revealed that over 40% of Chief Financial Officers believe that staying current with changing technology is the greatest challenge facing their finance teams, higher than either regulatory compliance or talent management. [1]

LET'S HAVE A CLOSER LOOK AT THE ISSUES:

The Move From Perpetual License to Subscription and Cloud

Virtually all traditional software vendors are moving from on-premise, perpetual licenses to subscription models. Why the stampede? Competition from smaller, more nimble companies? Yes. Better functionality? Yes. Company valuations have also become a driver as the venture and equity markets favor recurring revenue models. Software vendors have forever been challenged by choppy, inconsistent revenue streams since they sold licenses in huge dollars. To negotiate bigger discounts customers got smart by pushing deal decisions to quarter or year-end. The downside? One big invoice for licenses not yet deployed and 100% of maintenance charges which go live on day one. Cloud has become increasingly important. According to a Gartner Group survey, by the year 2020, over 80% of software vendors will change their business model from the traditional license and maintenance model to a subscription solution.[2] Over 55% of larger companies will have implemented a cloud-based SaaS strategy by 2025.[3]

CapEx vs OpEx

Capital expense (CapEx) vs operating expense (OpEx) is a big issue for many companies and a concept which many software sales execs do not understand. It rolls off the tongue, "Budgeting for your subscription solution is really simple because your monthly bill is classified as an operating expense." The problem? Corporate America universally built its business model classifying software licenses as a capital purchase that is amortized over the life of the asset. While it may be a great option from a technical and operations standpoint, subscription / SaaS solutions can pose significant problems for finance and senior management. Subscription / SaaS appear not on the balance sheet as CapEx, but on the P+L statement as OpEx. With ongoing pressure in many organizations to reduce their OpEx, this change introduces a significant cost accounting issue, especially in industries like utilities, oil and gas or public sector agencies where OpEx budgets are tight. The CIO or business owner is squeezed between the operational benefits of SaaS and needing to sell a business case which disrupts the organization's traditional budgeting and accounting practices. Deals with strong operational benefits often fail because of this CapEx to OpEx conversion. CapEx spending accounts for almost 70% of IT spend in North America and Europe.[4]

Revenue Recognition

The bogeyman is at the deal table. Rigid guidelines around revenue recognition drive sales behavior for software vendors. In all perpetual license transactions and many subscription / cloud sales the vendor's behavior at deal time is driven by their desire to book the revenue from the entire deal in a particular fiscal quarter, even when deployment takes 2-3 years. Hence 11th hour discounts if the customer signs for the whole deal today.

Rollout Schedules and Aligning Project Benefits to Deployment

Large enterprise deployment schedules rarely follow a big bang approach where software is deployed and goes live in one day. More likely is a deployment schedule which spans 12-36 months. Where many vendors exchange deep software discounts (perpetual license, subscription or cloud) for a large upfront commitment, the customer's business case is underwater until well into the deployment period.

The Answer

The business benefits of enterprise software have never been more powerful. But the challenges of strategic procurement, vendor management, good deal strategies and managing the right mix of CapEx and OpEx require smart thinking beyond the business benefits. For almost 20 years Central has been helping software vendors and enterprise clients with specialized financial and accounting solutions that allow both parties to meet their business objectives: optimizing transaction size and maintaining revenue recognition for the vendor and maximizing available discounts while better matching of costs within CapEx and OpEx budgets for the client. As the move to cloud has accelerated, Central has been actively developing new products which address major procurement challenges faced by both customers and vendors.

Who relies on Central? Eight of the top ten global software companies, more than forty top enterprise technology companies and many Fortune 1000 companies choose Central when they need a partner who understands that, despite compelling business cases for cloud software, many enterprise clients need specialized treatment to satisfy their CapEx and OpEx business requirements.

Sources:

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Central Technology Services is the software industry's leading financial services partner specializing in assisting Fortune 1000 companies and their vendors manage the financial, operational and budgetary issues associated with acquiring enterprise software and related technology assets. Central's suite of software license solutions helps enterprise companies better manage their business, balance sheet and EBITDA drivers to leverage the industry's evolving range of subscription, cloud and perpetual license software options.

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