

# Conversation of Trust

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# Conversation of Trust: Optimizing Software Revenue and Customer Satisfaction with Compliance Support

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## Executive summary

Successful business relationships depend on trust between buyers and sellers. The software industry, however, has historically struggled with trust as it relates to the exchange of fair value. In fact, according to IDC, the typical corporate account's software usage exceeds its contractual agreements by 15-20<sup>1</sup> percent. This phenomenon costs software vendors billions of dollars annually. It's also a problem for corporate customers who need to comply with contract terms as a matter of both business ethics and compliance with corporate governance guidelines. Ultimately, any ongoing disparity between authorized use and actual use undermines trust between buyer and seller.

Software vendors, of course, have adopted a variety of strategies for avoiding these disparities and/or ensuring that they are fairly compensated when such disparities arise. These strategies include license enforcement, software audits, and enterprise licensing. Each of these strategies may be appropriate under specific conditions. None of them, however, are perfect for all situations. In some cases, for example, an audit may be too costly and/or intrusive. In other cases – such as when spikes in business activity give customers a legitimate reason for temporarily exceeding license parameters – rigid enforcement mechanisms may be counter-productive.

Unfortunately, software vendors have typically failed to provide customers with an effective means of pro-actively discovering disparities between authorized and actual use. This lack of a robust self-policing capability greatly increases the likelihood that customers will inadvertently violate their contract terms. It also prevents customers from defending their own integrity by either restricting their use or offering vendors fair additional compensation for observed additional use.

Software vendors and customers seeking to build trust-based relationships therefore need a new model for facilitating that trust – one that is scalable, non-intrusive, and can accommodate the changing needs of customers operating in dynamic markets.

This new model is compliance support. Essentially, compliance support gives customers full visibility into their actual software use – however they may agree to define that use (i.e. concurrent users, named users, node-locked, etc.). With this usage data in hand, customers can engage in fact-based “conversations of trust” with vendors to arrive

at mutually agreeable decisions about value received and corresponding fair compensation.

The results of these conversations include increased revenue for vendors, verifiable compliance for customers, and relationships between the two that are strengthened by mutual trust and cooperation. The embrace of compliance support by the software industry thus offers substantial benefits to vendors, customers, and the market as a whole.

## The fair value challenge

Selling software is not like selling hard goods – especially when it comes to the sale of enterprise applications into large corporate accounts. Software vendors don't pack a certain number of units into a box and ship them off to the customer. Instead, they provide the customer with code based on an understanding of how the customer will be entitled to use that code across the organization. The terms of that entitlement form the basis of a legally binding contract between the vendor and the customer.

Vendors and customers enter into contracts in order to ensure that they make an exchange of fair value. During the negotiation process, each party tries to gain any advantages it can. Vendors try to get as much money as possible in exchange for goods and services they deliver. Customers try to gain concessions on price while maximizing deliverables. But, in the end, both parties must accept the terms of the contract – and agree to fully comply with those terms for the entire period of time that the contract is in force.

Software contracts can include a wide range of terms. Some of them address ancillary services such as implementation and support. Some of them address access to future upgrades. The core terms of any software contract, however, are price and use. Customers want to keep the price down and only pay for as much use as they really need. Vendors want to keep the price up and ensure that they are getting paid for as much use as actually occurs.

The first challenge in engineering the exchange of fair value in a software sale is therefore to define “use.” This is no small matter. In fact, “use” of software can be defined in many ways including:

- **Named users:** The vendor entitles the customer to have a given number of specified individual employees who use the software.

<sup>1</sup> “IDC 2007”

- **Concurrent use:** The vendor puts no restrictions on who is entitled to use the software, as long as the customer's total number of simultaneous sessions does not exceed a specified number at any time.
- **Node-locked:** The vendor entitles the customers to only use the software on a specified set of end-user desktops.
- **Server- and/or CPU-based:** The vendor restricts the customer's entitlement to a specific number of physical servers and/or a specific number of CPUs within those servers.
- **Transaction-based:** The vendor entitles the customer the right to execute a specified number of transactions (which must also be appropriately defined) with the software.
- **Functional restriction:** The vendor bases pricing on entitlement for a particular type of use – i.e. in the production environment, in a development environment, or in a disaster recovery environment.

Software vendors may also grant corporate customers an "enterprise license," which sets no limits whatsoever on the use of the software within the organization – although the contract may define the bounds of such a license to ensure that changes in the business don't result in use beyond that which is anticipated at the time of the agreement. This type of license may also include some type of a periodic "true-up," whereby the customer agrees to pay for actual use according to a pre-defined schedule in exchange for the flexibility of using the software on an as-needed basis.

Each of these approaches will be appropriate in different situations. For example, a node-locked model may make the most sense in a 24/7 contact center where different users may occupy any "seat" at any given moment – but where users won't need access to the software from home or on the road. A transaction-based model, on the other hand, may be more appropriate for applications that are exposed to the customer's customers via the web – making it impossible to accurately predict total utilization in advance.

Software contracts may apply these definitions of "use" in fairly complex ways. For example, a contract may stipulate that the customer will pay \$1M per year for up to 1,000 concurrent users of products A, B, and C – but that any use of product D will be charged at \$100 per quarter for each of the first 20 unique (i.e. "named") users, after which the rate will drop to \$50 per quarter.

Vendors and customers who enter into these types of contracts in good faith must clearly have some means of monitoring compliance with these various complex models of "use." If they don't have such a monitoring mechanism in place, there won't be any way to ensure that the terms of the contract are being honored and that a fair exchange of fair value is actually taking place. The clear definition of customer entitlements therefore only has real meaning

when it is accompanied by an effective means of managing use in the context of those entitlements.

### Software vendors' models for managing use

Historically, software vendors have adopted several models for protecting their business interests when it comes to use of code by customers. Their decisions about which of these models to apply depend on a variety of factors: the nature of the software, go-to-market strategy, operating margins, corporate culture, previous positive or negative experiences with a given customer, the country where the software is being used, etc. Vendors mix and match these models as they encounter different situations and fine-tune their business models.

These models include:

- **License enforcement**

Under this model, agreed-upon entitlements are enforced by mechanisms that may either completely disallow access to software outside of those entitlement terms or only allow some limited amount of "overdraft" leeway. This model provides a high degree of confidence for the vendor. It may, however, inconvenience the customer temporarily if there is an immediate and legitimate business need for exceeding the entitlement. Strict enforcement may also induce customers to stay within their contractually stipulated entitlement limits in situations where it is actually to the vendor's advantage to have them exceed those limits (either temporarily or on an ongoing basis) – so that the vendor can realize additional revenue from the additional use.

- **Software auditing**

Under this model, the vendor undertakes a direct examination of the customer's use. This is often accomplished by dispatching either vendor or third-party staff to the customer's site to retrieve usage data captured by some sort of monitoring mechanism installed on the customer's systems and/or to observe usage in real time over some period. This model has the advantage of allowing both vendor and customer to discover any use of the software in excess of contract terms, so that fair additional compensation can be paid to the vendor, if appropriate. Disadvantages may include the high cost of maintaining and dispatching audit teams – as well as the fact that customers may perceive an audit as invasive and adversarial.

- **Enterprise licensing**

Under this model, the vendor provides software to the customer without stipulating specific use restrictions – although certain limits and conditions may be incorporated into the contract to protect the vendor from contingencies such as mergers or acquisitions. The advantage of this model is that it eliminates the need to monitor specific use parameters and address unanticipated fluctuations in those parameters.

The primary disadvantage of this model is that it may not reflect fair value. For the vendor, this may mean loss of potential revenue. For the customer, it may mean paying for more software than is actually being used – which can result in rapid erosion of the business relationship with the vendor.

Theoretically, there could be a fourth alternative: relying on the customer's own software metering capabilities. This model has historically been applied to common desktop applications, where "use" is simply defined and the architecture of the software itself readily allows for monitoring across a known set of desktops and servers. Conventional off-the-shelf software metering tools, however, are not capable of accurately tracking the use of more complex n-tier, multi-component enterprise applications in today's dynamic corporate computing environments. Corporate IT departments therefore do not have the technical wherewithal to ascertain whether or not they are in compliance with their software contracts – or to quantify the exact extent of their excess utilization.

In fact, many corporate customers are looking for their software vendors to take a more active role in helping them comply with their agreements and better plan future technology expenditures.

So, while current use-management models may be quite applicable to certain types of vendor-customer relationships, a significant opportunity exists for software vendors and their customers to work more effectively together in order to more closely align contract terms and actual use, so that both parties can have maximum confidence that an exchange of fair value is in fact taking place – and the disadvantages of existing models can be overcome.

### **The compliance support alternative**

Compliance support is a particularly attractive alternative for software vendors seeking to ensure the exchange of fair value in an atmosphere of trust. Under the compliance support model, vendors provide customers with the tools they need to monitor their own software use – and compare that to their contracted entitlements. The customer is then free to decide whether or not to share this usage data directly with the vendor. In other words, the vendor empowers the customer to manage its own compliance with the contract.

Compliance support fills a glaring gap in enterprise IT management, since IT departments universally lack a reliable means of monitoring their own use of n-tier enterprise applications. So, instead of being invasive, compliance support technology is actually a value-add provided by the vendor to the customer – enabling the customer to better budget, plan, and justify its investments in software.

Compliance support mechanisms must obviously be customized to fit the particular application being monitored. Today's sophisticated enterprise applications are typically comprised of a variety of functional components that invoke complex sets of software processes. To monitor the use of such applications, it is therefore necessary to instrument these components and processes in a way that accurately measures "use" according to whichever entitlement structure is being applied (named users, concurrent use, etc.).

Effective compliance support should present usage data to customers in a way that facilitates appropriate decision-making. That is, it should make it as easy as possible for them to answer their most important compliance-related questions, such as:

- Has use of the software exceeded the terms of the agreement with the vendor?
- If so, by how much?
- How often has excess use occurred? Is excess use continuous? Is it occurring during specific times of the day, month, or quarter? Has it only occurred during infrequent periods of peak business activity?
- Is excess use restricted to specific modules, locations, departments, or users?
- What do these current utilization trends imply about future needs?

Based on these insights, customers can make informed decisions about compliance. In some cases, the customer may simply find that use is in full compliance with the existing agreement. In other cases, the customer may find it necessary to restrict use in order to eliminate use that is both excessive and unnecessary. In still others, the customer may determine that the amount of excessive use is too trivial or transitory to warrant any action at all.

However, in many cases, customers will discover use that exceeds the terms of the agreement in some substantive manner – and which therefore requires a re-structuring of that agreement. Armed with the data provided by the compliance support tool, the customer can engage the vendor in a "conversation of trust" during which both parties can seek to resolve the situation in a way that 1) fulfills the now-documented requirements of the business and 2) ensures the exchange of fair value.

Customers may also use the insights they gain from compliance support to better predict their license requirements for the future. This can help them make sure they get the full amount of budget they need to fulfill those projected needs.

It's worth noting that there are several reasons to source compliance support technology from a third party:

- 1) Delivery by an impartial third party adds legitimacy to the data produced. Customers need to trust this

data, so the technology should provide a layer of transparency and independence to the gathering of evidence of use.

- 2) Compliance support technology is fairly challenging to develop – so it's unlikely that enterprise software vendors will want to "re-invent the wheel" themselves when third-party solutions are available.
- 3) An open third-party solution is likely to offer greater flexibility than an internally developed, hard-coded, solution when it comes to accommodating the changes in licensing models that will inevitably occur over time as a result of market forces.
- 4) A third-party solution that is available today will enable vendors to implement compliance support immediately with customers using current versions of their software – rather than forcing them to wait until a future version of their software is released (and customers finally migrate to it).

It's also important to note that compliance support can be implemented in conjunction with other use-management models – as well as on its own. For example, compliance support can be used to complement an enterprise license agreement, so that appropriate adjustments can be made to both entitlements and compensation at the end of the year. Similarly, it can be used to validate very large-scale audits – rather than completely replacing them.

The key principle driving interest in compliance management is the need that corporate IT organizations have to gain greater visibility into their actual use of software relative to the entitlement terms granted by their strategic vendors. Without this visibility, customers will invariably have difficulty maintaining compliance with their software license agreements – no matter how well-intentioned they may be.

### Revenue, trust, and the customer experience

Software vendors face a variety of challenges as they seek to optimally leverage their intellectual property in order to maximize business performance. Compliance support has emerged as a viable strategy precisely because it addresses these challenges in a unique and effective way.

The specific benefits associated with compliance support include:

#### Increased revenue

Corporate customers who discover that their software use exceeds the terms of their agreements will generally re-negotiate those agreements upward. They can be trusted to do so because 1) concrete knowledge that they are not in compliance with a vendor agreement creates strong ethical pressure to remedy the situation, and 2) there are legal and reputational risks associated with such non-compliance. Compliance support can therefore enable software vendors to obtain full financial compensation for actual customer use in situations where that compensation is currently inadequate. As noted above, full visibility into use also helps

customers more accurately project their future needs and therefore allocate sufficient budget for fulfillment or those needs – which also helps ensure that vendors realize the full revenue potential of every account.

#### Improved customer experience

Companies have different cultures. People have different personalities. Sometimes these cultures and personalities don't match well with the approaches vendors take to the enforcement of their software agreements. Such approaches may be viewed as heavy-handed or invasive. They may also connote a lack of trust, which can be deleterious to the overall customer experience. And it is ultimately this quality of experience that determines whether a customer will remain a customer over the long term or not. Quality of experience can also determine whether the customer engages in other activities that benefit the vendor – such as participating in beta programs or acting as a reference for sales prospects. By avoiding potential sources of conflict and promoting trust-based relationships, compliance support can significantly enhance the total customer experience – and help generate the ancillary benefits associated with that enhanced experience.

#### Reduced audit costs and staff requirements

Software audits can be time-consuming and expensive. In the case of a large global customer, such projects can be particularly resource-intensive. And, once begun, they have to be thoroughly completed to yield any meaningful results. Compliance support can enable vendors to avoid these resource drains – allowing finite budget dollars and key human resources to be reallocated where they can drive greater business value. By reducing the time and person-hours required for audits, compliance support also allows vendors to better scale their audit activities – which can quickly result in the generation of still more incremental revenue.

#### Enhanced product and brand value

Customers want to know about their software use. Visibility into that use enables them to ensure compliance with their contractual obligations. It can also provide them with insight that they can utilize for planning, chargeback accounting, and ROI analysis. By providing customers with compliance support, vendors therefore deliver significant added value. Vendors who offer this value ahead of their competitors also gain the branding advantages associated with innovation and demonstrable customer-centricity. A compliance support strategy also implicitly gives the customer permission to increase use when business conditions demand it – and then pay for that increased use later. This flexible accommodation of unanticipated demand further positions the vendor as a true business partner with the customer's best interests at heart.

Compliance support can provide many other ancillary benefits as well. For example, as they acquire new licenses, customers often wind up with maintenance agreements

that start on many different dates. This can make the administration of these agreements a total nightmare for both the customer and the vendor. With compliance support, this complexity can be eliminated by simply pro-rating any new maintenance agreements to the end of a fixed annual period (say, December 31) and then renewing all agreements on the same date based on the usage reported by the compliance support tool.

The bottom line is that the customer's visibility into usage vs. entitlement benefits everyone – and that everyone suffers if that visibility isn't there.

In a competitive marketplace, every advantage counts. That's why software vendors are constantly looking for ways to optimize development, marketing, sales, services, partnerships, and pricing. Compliance support can provide a similar "edge" when it comes to both realizing the full potential revenue of every account and establishing stronger long-term relationships with corporate customers. By enabling vendors and their customers to work more closely together to ensure fairness in their dealings with each other, compliance support offers a compelling new option to the software industry.

It's very simple, really. Every relationship can benefit from greater mutual trust.

#### **About Acrezzo Software**

Acrezzo Software provides solutions that power the business of software for multiple customer segments, including hardware and software producers, engineers and developers, helping them uncover revenue opportunities, streamline their infrastructure and reduce costs. Acrezzo's proven solutions have been simplifying the business relationship between software and hardware producers and their enterprise and government customers for more than 20 years, enabling Acrezzo to maximize the value of the software the world develops and uses. For more information, please go to: [www.acrezzo.com](http://www.acrezzo.com)





Acesso Software Inc.  
900 National Parkway, Suite 125  
Schaumburg, IL 60173  
USA

Schaumburg (Global Headquarters):  
+1 800-809-5659

United Kingdom (Europe,  
Middle East Headquarters):  
+44 870-871-1111  
+44 870-873-6300

Japan (Asia, Pacific Headquarters):  
+81 3-5774-6253

[www.acesso.com](http://www.acesso.com)