Negotiating and Managing ERP Agreements

By Chuck Langenhop, CMA

An often-overlooked aspect of ERP projects is the contracting process. An ERP purchase is not a simple commodity purchase, but executives should not be so intimidated by proposed agreements that they sign them without reaching a good mutual understanding with their VAR. In order to negotiate and manage pricing and other terms, the customer needs to ask questions while beginning to develop a strong partnership with the VAR.

In general, a new ERP may cost between $5,000 and $10,000 per user. While return on investment (or ROI) is hard to quantify, it is a real concept that may justify a higher cost solution – or eliminate a lower cost solution. While it is important to have a budget, the primary objective should be to identify the "best fit" product accompanied by a single experienced vendor. The following tips should help in the evaluation stage:

- Review the number of users currently and forecast additional users on the new system. Provide the new user count to the vendor. If the system being considered is based on concurrent users rather than named, estimate a lower count accordingly based on the split between heavy and casual users.

- For products that are in excess of your budget, determine whether there is additional functionality that justifies the cost. Conversely, determine whether the added capabilities would introduce too much complexity for the size of your company. If an ERP is oversized, the implementation timeframe could be longer and the system could ultimately add more overhead than your company should accept.

- For products that are at or below your budget, determine if there are functionality gaps that would require costly modifications or add-on products. Always consider the Total Cost of Ownership.

- For all ERPs under consideration, ask the vendors to provide infrastructure specifications and determine what third party client-server purchases or upgrades will be required.

Having conducted demos and performed other due diligence, you select the vendor with the "best fit" solution – and not necessarily the one that presented the lowest cost proposal. The VAR will present two documents for your consideration: the license agreement and the implementation services agreement. The following tips should help with negotiating licensing:

- The cost of discounts may be shared between the publisher and the VAR. Because VARs only have limited economic ability to discount their commission earnings, the publisher funds much of the discount. For that reason, it does very little good to find VARs representing the same product and trade them against each other. If, for example, your company is interested in a Brand A, find a reseller that is qualified and has created a good rapport with your team. Ask that VAR to negotiate a "Best and Final Offer" with the publisher. The alternative strategy of having two

Brand A VARs work independently with the same publisher to improve the pricing can be counterproductive.

- Separate the implementation into two or more phases to avoid buying shelf ware. For example, your company may be interested in CRM or advanced manufacturing but may not be ready for those capabilities with the initial Go Live. Remove those modules from the license agreement and ask if the VAR can guarantee pricing for some period into the future.

- Similar to the above, it is not necessary to license more users than your company needs initially. Additional user licenses can be acquired later as you implement additional modules and expand the impact of the new ERP.

- Request a clarification on the base for calculating annual maintenance – is it list price net? If for example, the annual maintenance rate is 20%, the list is $200,000, and the net is $180,000, is the on-going maintenance $36,000 or $40,000?

Separately, the services agreement with the VAR specifies their charges for implementation services. For a mid-tier ERP implementation, the VARs cost will often be .75 to 1.5 times the cost of the software. VARs will generally not agree to a fixed fee because of the risk of scope creep. In the above example, on the $200,000 list, the VAR may charge $150,000 to $300,000.

Business process design and training are the two largest components of an implementation. The actual installation of the ERP, set-up of parameters, and cutover support are relatively small by comparison. In spite of the time & materials nature of most agreements, you can still negotiate. Here are some suggestions:

- Ask the VAR to provide a range in days. The VAR may estimate that a 4-month implementation may require 60 to 90 days of support. Ask how much support the VAR will need in order to deliver the ERP at or near the low end of the range.

- Work with the VAR to determine how much of the project can be performed internally or with less expensive contractors. It is better to have the VAR provide masterfile conversion templates and then assign the data collection responsibilities to less expensive personnel. Also consider the "Train the Trainer" approach rather than have the VAR train all users. Finally, review your internal IT administration capabilities. If you do not have a network administrator onboard, an IT outsourcing firm may be able to provide a resource at a lower rate than the VAR.

- Review the rate schedule. Some VARs may have a blended rate such as $180/hour, and others will have a tiered structure over a range such as $150 - $225/hour. If the latter, ask how the work is delegated to lower cost consultants. Also ask hard questions about evening and weekend overtime premiums.

- Discuss the provisions for expense reimbursement and determine if they are typical and customary.

- When the implementation kicks off, provide the VAR with a work order. Conduct regular budget reviews and require supplemental work order approval for out-of-scope efforts, such as modifications, documentation, and additional training.

- Minimize the amount of modifications. One major reason for cost overruns is that users want the new system to look more like their old system or to emulate old processes. In many cases, these requests represent an unwillingness to learn or adapt to the new ERP (temporary buyer's remorse). Assign a budget upfront in VAR hours and ask the VAR to provide an estimate on a work order each time a mod is requested.

- Designate the IT administrator and one or more "super users" to be trained by the VAR in user permissions, report writing, business intelligence queries, and work flow development.

On a final note, have a qualified attorney review all contracts prior to execution. The attorney should explain the various legal provisions such as the terms of warranties and maintenance, and help negotiate terms that are not industry standard, such as the transferability of the license to additional sites and affiliates. Even where the "rights and responsibilities" language is non-negotiable, counsel should explain what recourse the company will have in conflicts such as prolonged system failure or change in vendor's business ownership.

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Chuck Langenhop is Director of ERP Transition Management with CFO Advisory Services, LP. Chuck assists companies with ERP selection and implementation projects. He can be reached at 214.377.3704 or clangenhop@cfo-advisory.com.