Oracle's Drive to License Monopoly and Indentured Servitude

Provided by

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Oracle's sustained dominance has less to do with innovation and customer satisfaction than contractual policies that lock customers into paying exorbitant fees. A system of tyranny and mysticism makes understanding these costs, let alone reducing them, next to impossible. This white paper discusses the details of Oracle's strategy to hold your money hostage and concepts for how to liberate those dollars.

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Overview

Primary Policy Tools

These are four primary policy tools Oracle uses to block customers from managing the value of their investments and making rational decisions about how licenses are deployed and managed. CSI Numbers, License Sets, Matching Service Levels, and Re-pricing.

- A CSI (Customer Support Identifier) refers to all the software that was purchased at the same time. In Oracle's transactional view of its customers, they view all these products as 'bound' together at the time of an order, and work hard to prevent customers from taking action on any part of the order that doesn't include the entire order.
- A *license set* refers to all software that shares source code or falls within a common product category. An example of a license set is Enterprise Database and the extra-cost options, such as Partitioning and Advanced Security.
- *Matching support levels* dictates that all software within a license set be supported at the same level, i.e., at all, in most cases.
- *Re-pricing* refers to Oracle's contractual right to adjust your maintenance and support fees all the way back to list price, eliminating the effect of any original discounting when quantities and/or line items within an order, or a license set are reduced or removed.

In aggregate, these four policies force customers into an all-or-nothing agreement with Oracle. Since most IT shops can't sweep the floor of Oracle completely, and need the highest levels of support on at least some of the mission critical Oracle technology, they are generally forced to renew the entire estate at the highest costs regardless of the business need or the justification for mixed levels of support.

Fair Value in 12 Cents on the Dollar? Any conversation about Oracle should include a review of Oracle's highly profitable model and how companies inadvertently trap themselves into a form of indentured servitude via software support fees. Conversely, Oracle wins the lottery every day via these fees. To illustrate, consider that Oracle's maintenance and support services fees, as explained by co-President Safra Catz, "is basically 100% profit". Today, it represents 46% of Oracle's total revenues but 74% of Oracle's total margins. Within the support business itself, the newly reported "profit margin" is 88%. This means for every dollar you spend on Oracle maintenance and support services, *your* recognized value is 12 cents at best.

It follows that everything Oracle does is purposefully designed to nurture this maintenance and support services revenue; the proverbial golden goose. From its policies to its acquisition strategy, Oracle is unequivocally clear that locking customers into perpetual support fees is its highest goal. Therefore, your goal should be to *unlock*—or at least loosen—Oracle's deadly grip on your money, but that is certainly easier said than done for many reasons as we'll discuss herein.

The purpose of this white paper is to educate Oracle's customers on how they got where they are, i.e., writing huge checks to Oracle that seem impossible to optimize or, worse yet, tie back to business value. There are good and viable strategies for wresting these fees back to manageability. But caution, the odds, rules and policies are all stacked in Oracle's favor, and against you so professional assistance in defining strategies and operationalizing tactics is always highly recommended.

Sidebar: NET(net) wants to be *unequivocally clear* that Oracle's customers should not license any more of its software without first assessing the financial profile of the existing estate. While this is a relatively straightforward exercise, few do it and even fewer have the right tools, processes or experience to unravel the past's expensive mistakes, and more to the point lack the expertise to know what to do about it. Note that this is not a technical exercise whatsoever; rather, it is a proprietary algorithm that is automatically generated from your custom data inputs. From this exercise, we can understand where opportunities exist, quantify the dollars that are being held hostage, develop an action plan to liberate them, and set forth to negotiate their freedom.

Our Oracle Optimization experts can execute this assessment in approximately 72 hours.

In a fairer fight, Oracle's customers would never agree to a financial relationship weighted eight to one against them. As you may guess (and are likely experiencing whether you know it or not), the odds are stacked wildly in Oracle's favor via a few tyrannical policies masterfully disguised as elegant conditions in your contractual agreements. These policies are outlined in its unilaterally controlled technical support terms, and taken together, lead Oracle to boldly state (publicly, via Form 10-k) that virtually all its customers renew support in perpetuity despite their resentment of doing so.

It is naïve to think that customers renew due to satisfaction with the software itself. Moreover, it's a stunning misrepresentation by executives at Oracle. Rather, customers overwhelmingly report that they feel forced to renew mostly due to the punitive effects of *re-pricing* because of limitations on the *orders*, *license sets*, and *matching support levels*. While there are nuances within these policies, they are remarkably easy to understand in a single dimension. Add decades of buying history, rife with product name changes, unbundling of capability, price increases, M&A activities, contractual innovations, unilateral controls, etc., and the plot thickens to an indistinguishable mush. Large suppliers (especially of software) capitalize on the dizzying layers of complexity that these dimensions introduce. Smart sales reps use this (we call it mysticism) against their clients purposefully; unfortunately, thoughtless reps do as well, but without the premeditation.

Lest anyone be confused, NET(net) views this use of mysticism (inadvertent or otherwise) as a form of commercial extortion, especially considering that Oracle makes its software freely downloadable on its website, and often includes unlicensed software with complex licensing rules in the downloads; and then holds customers accountable to the hundreds of pages of ever-changing, compliance-related documentation.

Our clients often report that many Oracle reps pursue license true-ups with religious fervor, viewing customers as thieves who are purposefully stealing software. To further complicate the matter, Oracle is an exceptionally technical array of products that most above low-level management personnel do not understand, and may even fear. Who can argue with a database administrator that states a need for a million dollars of software, or a software audit that outlines ten million dollars of compliance fees with a speedy and quiet resolution for several hundred thousand dollars disguised and posing as an incredibly good deal alternative?

The List Price Game: The actual value of Oracle's software was obscured about 30 years ago when the aforementioned policies reached full maturity. In this sense, Oracle has become its own market maker, complete with the ability to create a "list price" at whatever value it chooses, only to turn around and discount it as deeply as it needs to in order to secure another maintenance and support services renewal stream. One of the most fascinating dynamics of Oracle's business model is the role of list price. Software, after all, is intellectual property and only the sunk cost of research and development must be accounted for. Not to point out the obvious, but hardware margins must account for not only research and development, but also raw materials, manufacturing, physical testing and shipping. In other words, all other things being equal (such as sales, marketing and operations,) the supply chain for software is as simple as clicking the *Save As* button.

Re-Pricing

How it Works

It's foundational to understand the breadth of discounting that Oracle awards, as discounts range from 0 to 100 percent. For example, the database is free for up to ten days per year so long as it's the failover node of an active/passive cluster. Conversely, any online order less than $25,000 gets no discount at all. That said, most Oracle deals sold in the channel are discounted between 25 – 40%, and when sold direct, are generally discounted even more, certainly beyond 50% off of list for over $400,000 of list license value. A high list price and corresponding deep discount enables Oracle's re-pricing policy to move the goal line out (often times beyond reach) as customers approach it by utilizing less software.

The importance of re-pricing to Oracle's continued dominance necessitates an example. The foundational element of re-pricing is the CSI (Customer Support Identifier), which is the unique identifier for the products associated with a software order. Oracle considers the discount associated with each CSI to be based in part on the size of the original order. As mentioned above, re-pricing refers to Oracle's right to forfeit original discounting as products are reduced or eliminated from the maintenance and support services renewals in subsequent years.

For example, consider an order of 100 Processors of Oracle Database Enterprise Edition that is awarded a hypothetical discount of 80%, resulting in a yearly support fee of $209,000. A few years later–through server consolidation–the customer finds itself paying support for 50 Processors that are not in use. This customer is mistaken to believe that eliminating 50 Processors from the support renewal will result in a yearly savings of $104,500, or half the fee as commensurate to half the Processors. Rather, if Oracle is feeling extremely generous, it will re-price support to a net discount of 60%, for $0 in savings to support half the processors. This ability to revise history results in an enormous shift in the balance of power and enabled Oracle to successfully discourage most clients from being able to reduce their support footprint. In most cases, the customer can only begin to save money when the amount of the reduction or elimination exceeds the re-pricing ability of Oracle.

Sidebar: We're somewhat amazed that no one has sued over this issue, or that the DOJ or the EU has not taken action against Oracle over its monopolistic practices, specifically with regards to how re-pricing is non-commensurate to industry standard discounting. The re-pricing schedule should align linearly to a more accurate range of discount percentages off list, as opposed to between 0 to 25 percent. In other words, it's not re-pricing in and of itself that is usurious; rather, it's the wholly fictional discount scheme Oracle applies it against.

Note that this example doesn't account for the average 3% Inflationary Adjustment Rate (IAR). Nor does it account for the price increase from $40,000 to $47,500 (of Database Enterprise Edition) that was enacted mid-2008. Keep in mind that Oracle's re-pricing policy applies to current list prices, not the list price of when the licenses were originally acquired; another fundamental problem most clients don't consider up front. In this case, the 16% increase in price is roughly equal to the compounded increase of maintenance over a 5-yr period, assuming we forego net present value.

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Your Current Estate

How to Assess

And this brings us full circle to Oracle's profit model of locking customers into support payments, and what you can do about it. There are three tiers of analysis that we undergo to assess a client's "investment" in Oracle.

First, as mentioned above, we reverse engineer the renewal fees across all line items within each annual maintenance and support services contract. For example, a renewal amount of $4,180 per Processor of Enterprise Database represents a discount of 60% off a list price of $47,500, assuming that support is calculated as 22% of net license fee. Like the rings of a palm tree indicate its health and growth during any given year, the renewal amounts indicate how well each license agreement (i.e., CSI) was negotiated at origination. Furthermore, years of IAR can cause software support to be well out-of-market, in which case, the licenses themselves become financially impaired and transform from an asset on your balance sheet to a liability in your operating budget. It is vital to understand that not only are Oracle field sales personnel generally unwilling to help customers assess their license estates in this manner, but they are also penalized for doing anything that could be construed as helping a client gain better financial management over these impaired assets.

While the first tier of analysis is concerned primarily with commercial elements, the second tier focuses on contractual elements such as product titles, versions, editions, quantities, metrics, and terms & conditions. The general principle is that Oracle seeks to simplify its contracts over time, thereby forcing its customers into a one-size-fits-all model. One size does not fit all, however, especially as customers change, grow, divest, merge, etc. For example, licensing financial applications by revenue may have made sense ten years ago, but now may trigger incremental license fees even though there is no incremental use of the software itself. A premeditated strategy designed to repair the value of these underlying assets may provide substantial savings under the care and guidance of trained optimization experts and a highly skilled negotiator. Also included in this second tier of analysis is a view towards the future, especially with regards to the lifecycle of the software. There are good times and bad times to negotiate, and clients often mistake the bad times for the good times. In addition, you can't make a good deal with an uncooperative person, so if your Oracle representative doesn't demonstrate that he or she has your best interests in mind and is fully prepared to do what is necessary to help you get the most out of your considerable investments, it's time to find someone who will.

Beyond the License

Moving into Appropriate Use

The final and most time-consuming tier of analysis is systems analysis and design, as well as business process re-engineering. This level of effort is rarely initiated as an exercise in cost reduction; rather, a killer application, a scheduled hardware refresh, an M&A activity and an outsourcing agreement are examples of when major change presents the opportunity to re-consider the cost and structure of software agreements. It is naïve to believe that, for example, substantial savings are enough to re-prioritize IT around unscheduled server consolidation. More realistically, it is common for major changes (that can result in *major* savings) to take a year to plan for and execute. But when those changes are scheduled to occur, it is vital to consider all three of these tiers together, but do so without causing Oracle to react opportunistically, which leads us to the next point.

Play Smart

Strategy with Oracle

Most successful advances redirect attention from the point of attack in order to confuse and move the defense. For example, most customers are reminded to seek a reduction in support when the renewal is pending, and Oracle has strong defenses set up in anticipation of this. On the contrary, you should assess support spend at least six months before the renewal is due. You should assess how reducing core counts could enable a corresponding reduction in Oracle Processors before you go through the consolidation efforts only to find that the savings you had envisioned do not materialize. Generally speaking, if Oracle's goal is to keep you locked into paying support, then it will figure out a way to out-price your efforts to save money.

And if Oracle can't contractually lock you into paying support, then it will set politics into place that make the battle seem not worth fighting for most. Case in point, Oracle is infamous for instigating internal competition such as pitting field and support sales personnel against each other. Since field sales reps are punished for being party to reducing annual support, support reps are actively seeking to catch them trying. Said differently, your field rep is competing with support dollars to sell you net new licenses, and support will typically win. We've seen Oracle walk away from multimillion-dollar deals that knowingly threatened a burgeoning support stream.

Watch the Shot Clock

Preparation is Key

Another example of Oracle's internal competition is how understaffed its legal and contracts teams are. To increase overall margins, Oracle has been moving these teams off shore for the past several years as well. Customers end up waiting for days and sometimes weeks to get an executable license order reverted. As a result, they have precious little time to accurately assess the merits of an order before signing it. Add to this the felt pressure to execute a tabled deal or else never see the same discount again. In all of this, Oracle has somehow trained many of its customers to believe that doing business with it is an honor. NET(net) is here to say that it isn't, of course.

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Summary

Overcoming Roadblocks

Oracle makes it difficult, but there are specific methods and tactics to overcome the roadblocks discussed in the white paper. Recommendations:

1) Data is key. Collect and assess all of your renewal documents. You cannot determine if there is latent value in your Oracle estate without knowing your contract and maintenance history. Fortunately, this is information readily available from Oracle.

2) Calculate your historic discount rates. You need to know if your Oracle estate is subject to historic pricing deficiencies. If you are not sure you are market optimized, then there are various sources to find that information.

3) Understand how to maximize your efficiency by operating within Oracle's rules, and know when to break them. They are always there, but it does not necessarily mean that you cannot break or bypass them.

4) For both new CapEx and existing OpEx, carefully sequence optimization activities, deal structuring and re-negotiations to avoid the Re-pricing and Matching Service Level traps.

If you are unsure how to do this, we have Oracle Optimization experts at the ready, armed with well documented tactics, and strategies, all available to you with zero risk. Contact us today to find out how we can help you.

About NET(net)

Celebrating more than 10 years, NET(net) is the world's only fully technology-enabled consultancy exclusively specializing in IT Investment Optimization, strategic sourcing and strategic supplier management. We help clients Find, Get and Keep more economic and strategic value in their IT Agreements, Investments and Relationships. With over 1,500 clients around the world in nearly all industries and geographies, and with the experience of over 15,000 field engagements with over 300 technology suppliers in XaaS, Cloud, Hardware, Software, Services, Healthcare, Outsourcing, Infrastructure, Telecommunications, and other areas of IT spend, we have helped clients capture incremental value in excess of $150 billion since 2002. NET(net) has the expertise you need, the experience you want, and delivers the performance you demand. Contact your NET(net) representative, email us today at info@netnetweb.com, visit us online at www.netnetweb.com, or call us at +1-866-2-NET-net to see if we can help you capture more value.

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