4 Steps to Successful SaaS Negotiations and Vendor Lock-In Prevention

Published 3 December 2020 - ID G00738881 - 9 min read

By Analysts Hannah Decker, Dawn Hubbard

Initiatives: Cloud Computing; Negotiating IT Contracts

Executive leaders find it challenging to facilitate negotiation of favorable terms and avoid lock-in with SaaS providers. They should use these four steps to reduce cost, mitigate risk and maximize leverage for their next SaaS procurement negotiation.

Overview

Key Challenges

- Executive leaders find it challenging to understand and communicate to stakeholders the inherent lock-in of the SaaS subscription model and the difficulty of changing SaaS providers due to high switching costs.

- It can be difficult to remain informed of competitors' offerings throughout the contract period.

- Negotiating SaaS deals requires leveraging other factors such as deal size, timing and vendor priorities to maximize SaaS bargaining power.

- Executive leaders often struggle to understand which key terms can and cannot be negotiated.

Recommendations

Executive leaders negotiating and contracting for SaaS subscriptions and planning to mitigate provider lock-in should:

- Educate stakeholders involved in the negotiation on the realities of having “digital landlords” by explaining the inherent lock-in of SaaS, enabling investigation of common hidden costs and requiring that the cost to switch providers be documented before purchases are made.

- Create leverage by ensuring a competitive process for the initial deal and reviewing the provider's competitors 12 to 18 months before each renewal.

- Maximize the organization's negotiation power through ensuring deal size, breadth of capabilities, knowledge of service line maturity and timing are leveraged to its advantage.
Introduction

This research is adapted from 4 Preparation Steps to Optimize SaaS Negotiations, which provides sourcing, procurement and vendor management (SPVM) leaders with four steps to drive effective SaaS negotiations.

Executive leaders find it challenging to understand and ensure communication of the commercial realities inherent in negotiating with SaaS vendors, who are becoming their “digital landlords.” As a result, they miss the leverage to facilitate the negotiation of better pricing and terms in their SaaS deals and leave their organizations more exposed to lock-in and future cost increases. They should follow four preparation steps for good preplanning and a robust negotiation strategy to obtain favorable concessions on terms and pricing (see Figure 1).

![Figure 1. Four Preparation Steps to Optimize SaaS Negotiations](image)

### Analysis

**Step 1: Prioritize Education on the Commercial Realities of Digital Landlords and Document Switching Costs Before Purchase**

Before negotiating a SaaS transaction, executive leaders should ensure all stakeholders involved in the upcoming negotiation are educated on the many challenges and risks inherent in the SaaS model (see Figure 2).
To facilitate effective negotiation of a successful SaaS agreement, it is important that the key stakeholders understand the subtle differences between on-premises software licensing and software provided as a cloud service. They also need to realize that once the contract is signed, most of their leverage disappears.

Understand That SaaS Providers Are the New Digital Landlords

SaaS customers pay for the right to use a provider’s capabilities for a defined period of time. They rent the entire hardware, software and service package through subscription payments. This means that the customer must keep paying if they want to access the capabilities. Unlike traditional perpetual license software, at the end of the SaaS term, the service stops working unless the customer renews for another term. Unfortunately, many leading SaaS providers offer no price protection, and certainly not if the subscription volumes are reduced on renewal. This results in unbudgeted renewal cost increases or customers paying the same amount for fewer subscriptions. Overall, SaaS customers are left with little commercial flexibility, and feel locked in with their new digital landlords. It is therefore critical that stakeholders are aware of this before entering into deals.

Identify the High Degree of Lock-In and High Barriers to Exit in SaaS Contracts
Based on our client proposal review data, initial contract terms are most commonly for three to five years or more. They have no option to terminate for convenience. At the end of an initial term, the hard switching costs (for example, the cost of another provider's subscription, training and implementation) and soft switching costs (for example, the new provider's future renewal costs or any hidden costs) are often unknown. They are, however, feared to be prohibitively high, and certainly are usually higher than the renewal increases, which tightens the vendor's lock-in and raises the barrier to exit.

Along with the costs, there are also risks with switching, such as data migration and implementation, as well as training and process change, which further increases vendor's lock-in and makes exit more difficult. Before entering any SaaS deal, it is essential to work with stakeholders to document switching costs, the risks and time required to switch providers. This should be reviewed annually.

**Anticipate Unforeseen and Unbudgeted SaaS Costs**

Fees for enhanced support, storage, APIs, encryption or “sandbox” test and development environments are frequently less than clear or buried within the SaaS provider's supplements or URL terms. This makes them easy for unsuspecting negotiators to miss and then face unexpected costs.

Executive leaders should ensure their direct reports work with stakeholders to clearly document the base storage entitlements in the contract and negotiate any incremental pricing for additional storage. They should recommend negotiating premium support options, sandbox requirements, language packs, encryption and API requests upfront and ensure that they are clearly documented in the contract.

**Step 2: Evaluate the SaaS Providers’ Competitors Before the Initial Contract and Renewal**

Executive leaders should seek an understanding of various SaaS providers in the market, including their full scope of capabilities, market share and financial viability. This can be achieved through collaboration with the internal sourcing team, through a market scan or through third-party resources. This evaluation should be carried out before the contract is executed and 12 to 18 months before the contract renewal.

**Step 3: Maximize Negotiation Power by Leveraging Other Key Factors to Obtain Concessions**

It is important to realize that customers have the greatest degree of leverage when they are negotiating a new SaaS deal, so it is essential to get things right from the start. Following are some other key factors that should be leveraged in any SaaS negotiation or renewal:

- **Deal size:** The greater the deal size is, the greater the organization's negotiating power. Executive leaders should ensure that the overall spend with the provider is being leveraged. They must ascertain that the analysis of current spend is aggregated across the entire business to take account of individual geographical regions or business unit deals with vendors in order to avoid smaller duplicated deals. Aggregating the current total spend as well as the potential spend is critical, as
some SaaS providers deliberately target selling to different business units or geographies in a single customer.

- **Breadth of capabilities**: The greater the number of modules or service lines under consideration, the more leverage a SaaS customer will typically have.

- **Service line maturity**: The purchase of immature service lines with fewer references will increase an organization's degree of leverage, due to the SaaS provider's desire to grow its customer base for less mature functions. Executive leaders should delegate their direct reports to research the product being purchased to see if it is a new product or a strategic product. For publicly traded SaaS providers, advise them to listen to earnings calls to see what products are being promoted to investors as innovative or strategic.

- **Deal timing**: Aligning a deal signing with the provider's quarter end or fiscal year end adds weight to a customer's degree of leverage, particularly around price negotiation.

- **Vendor promotions**: Promotions change frequently and may differ from the ones that were around for the initial deal, if a contract is being renewed. Executive leaders should ask their direct reports to research all promotions from the vendor or their partners in order to get the best deal. Some vendors default back to list price for contract renewals, so long-term pricing should be negotiated upfront.

- **Relationships**: Some vendors value high customer satisfaction scores. Executive leaders should leverage this relationship for renewal negotiations, particularly if the organization has acted as a reference for the vendor.

**Step 4: Ensure Identification, Evaluation and Rating of Key SaaS Terms to Minimize Risk and Avoid Hidden Costs**

In a SaaS deal, terms and conditions are just as important as price in their impact on the TCO. Executive leaders should ask their direct reports to work with the sourcing team to identify common commercial SaaS terms and evaluate how these terms will affect cost and risk. They must also ensure understanding of how easy or difficult these terms are to negotiate. The importance of negotiating specific SaaS terms will vary based on requirements identified by stakeholders.

It is common for SaaS providers to represent their documentation as standard and non-negotiable. But the reality is that SaaS providers do negotiate terms and conditions and each provider's appetite differs for what they will and will not negotiate. Many providers do not supply their documentation until a customer is ready to sign, which provides minimal to no time for negotiators to evaluate and negotiate critical terms. Executive leaders should ask their direct reports to ensure that the provider includes "baseline" or standard SaaS documentation that makes up a full deal at the time of proposal. This will allow negotiators to compare provider terms early and to eliminate providers that do not at least meet the organization's required minimums from data, security, risk and privacy perspectives.

**Rate Key SaaS Terms**
SaaS negotiators, as well as stakeholders, must score SaaS key terms by their importance to the business. From these scores, executive leaders should ensure a checklist of must-have terms is developed and determine the point at which the risk becomes unacceptable. Three most important areas of focus are:

- **SaaS price escalation at renewal** is often a high risk, because a buyer's leverage usually peaks just before the buyer signs the initial SaaS deal with the provider. Based on our SaaS interactions over the past year, a common mistake is leaving renewal price caps for "good-faith negotiations," resulting in significant (often double-digit) increases. And even when renewal price caps are offered in standard SaaS agreements, they are often higher than the common negotiated average of a maximum of 3% to 5%.

- In the SaaS model, the organization is significantly more dependent on the provider to be highly reliable as the provider is solely responsible for the entire end-to-end environment. Negotiating robust exit and performance terms, such as service-level agreements (SLAs), data processing agreements (DPAs) and security exhibits (SEs), is critical.

- In the last two years, Gartner has seen a shift toward increased difficulty in negotiating certain SaaS contract terms with vendors. For example, negotiating disaster recovery (DR) service levels has increased from a difficulty level of "medium" to "hard." If a vendor cannot amend certain terms to meet the organization's service standards (e.g., for DR or security), executive leaders should consider walking away from negotiations at that point, unless the identified risks can be mitigated. Conversely, given the economic effects of the recent pandemic, other terms, such as payment flexibility, have been more readily negotiable.

**Evidence**

1. Of the contract and document review inquiries related to new SaaS contracts that Gartner received during a 12-month period ending July 2019, over 64% of the deals were for a period of three years or more.

2. Conclusions are based on the 32% of Gartner SaaS document and contract inquiries specifically related to SaaS renewals. Data was collected from August 2018 to July 2019.

**Recommended by the Authors**

- **Toolkit: Prudently Accelerate Cloud Acquisitions for SaaS Using Gartner's Triage Methodology**
- **Leverage Contract Amendments to Accelerate Software and Cloud Negotiations**
- **Toolkit: Template for a Standard Amendment to a Cloud Vendor's SaaS Contract**
- **SaaS SLAs: Reduce Risk and Improve Service by Negotiating These Key Terms**
- **Optimize Software and SaaS Renewal Costs by Using Protection Clauses**
- **Mitigate Unforeseen SaaS Costs by Negotiating Fees for Support, Sandboxes and Other Key Variables**