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Service Industry Association White Paper on IT Hardware Procurement

How Procurement Professionals can Protect Themselves from changes in vendor service policies.

Why should Procurement care?

Procurement and Strategic Sourcing Executives are tasked with making prudent selections of qualified vendors. This includes analysis of the financial stability of the vendor, the analysis of the product(s) viability in the marketplace, and the options for long-term support from other than the OEM. This last option is particularly important. A vendor with no competitors is difficult to control, and the organization can be “held hostage” to unpleasant policy changes or poor service. Anyone with Oracle (Sun, StorageTek) equipment has learned this lesson recently with budget-killing consequences.

What can Procurement do?

The adage “The best way to handle a problem is to avoid it” applies here. Sourcing managers can insist upon protective language in their new contracts in order to prevent other vendors making similar moves in the future. There are plenty of examples of good language to follow – starting with contracts familiar to almost everyone that deals with products from IBM. IBM contracts neatly spell out the rights of ownership, allow for independent service, independent financing, and support through their “banding” policy the flow of equipment throughout the secondary market.

Ownership and License Transfer

Buyers must protect the value of their purchases by making sure that they can sell, trade in, or lease equipment in the secondary market. This sounds insultingly obvious, but is not. The key is the ability to transfer any special purpose software with the hardware. Products without the ability to transfer special purpose licenses required to operate the hardware are lumps of debris which need to be written off within the initial warranty period. Contractual protection, in the form of a guaranteed right to transfer licenses, is essential to protecting value.

In some cases, vendors will insist on relicensing software for a secondary user, but these fees can easily overwhelm the value. Transfer fees and transfer rights need to be spelled out and part of the initial contract. IBM always separates the operating system license fees from hardware so that any piece of hardware can be freely traded.

Secondary Market Certification

Related to the transfer of hardware and associated licenses is the guarantee of original quality and eligibility for support provided in an orderly secondary market. IBM adopted the process of “Banding” many years ago and this has served well for decades. Users buying banded equipment are assured that the machine and the associated parts are original equipment and eligible for a new maintenance contract without further ado.

Counterfeit Parts & Machines

Unfortunately, the proliferation of actual counterfeit parts is challenging vendors currently operating without a Banding Policy. Buyers should be aware that counterfeiting is an issue in the supply chain and take steps to insist upon “banded” or otherwise officially “certified” parts. It is not sufficient to demand that parts be sourced only from authorized resellers – the supply chain is already riddled with problems where even authorized resellers may be in receipt of uncertain inventory. The Service Industry Association and the ASCDI are working towards effective standards for testing and validation that will allow used equipment to be transferred efficiently.

Financing and Leasing Options

Buyers need to make sure that they can finance or lease equipment without the interference of the OEM in the arrangement. This is currently a large issue with Oracle since the “entitlement” of service contracts is associated with the equipment owner and not the equipment user. Most forms of finance involve ownership by third parties, so this is a particularly messy and complicated problem which does not need to exist. Third party ownership should never prevent having a service contract with a vendor.

Rights to Independent Service

Buyers must protect their rights as equipment owners to service, or not service equipment as they see fit. If the vendor is the only source for service and the only source for trade in of equipment, then that vendor is a monopoly and negotiation is impossible. Business always needs alternatives in their supply chains and this is not an exception. Language as to availability of service, parts, training, and even diagnostic equipment belongs in every purchase agreement. An example of the principles to follow is provided in the Service Industry Association Hardware Maintenance Bill of Rights at www.servicenetwork.org (with page).