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Ariba/SAP, Fees and Future Networks

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This paper contains select excerpts from [Ariba and SAP…Exploring the Network Elephant in the Cloudy Room]() and [Nipendo Product Review: Next Generation E-Invoicing](), originally published on Spend Matters PRO for our subscription members.

The Network Fee Elephant Gun

Now that we've dispensed with much of the cursory coverage of the SAP and Ariba acquisition, we thought it appropriate to take out the elephant gun and aim right for the pachyderm (that's "very large animal with tough skin" for the non-vocabulary nerds) staring us down. If you're curious about what the giant metaphorical creature is, you shouldn't be: it's Ariba's supplier-funded, network-based business model.

Over the years, we've attempted to analyze who pays for how much transactional connectivity through Ariba. In short, larger suppliers with high dollar volumes transacting through the network (regardless of the number of actual documents changing hands) with multiple trading partners are far more likely to pay substantial annual fees than smaller suppliers that transact infrequently, and those with low-dollar volume transactions.

Ariba has many suppliers paying thousands – sometimes tens of thousands or more, per year – to transact with multiple trading partners, which has helped offset the cost of Ariba's P2P application for buyers, allowing it to compete on price as well as product. Yet many procurement professionals believe that suppliers will factor any additional transaction costs they may incur into their pricing. Still, Ariba has had the upper hand because their SaaS-based P2P deals require companies to only work with companies through the network (Ariba CD customers have options to take suppliers off the network, something providers such as Vinimaya, Hubwoo, WALLMEDIEN, OB10, Transcepta and others can theoretically enable – and have, in certain cases).

Ariba believes it has pricing power in the network. In analyzing recent quarterly results, we explored the topic in detail. A few years ago, Ariba made the important strategic decision to shift away from buyers carrying the bulk of the P2P fee burden (at least future costs), instead putting these costs onto suppliers as transaction-based (dollar volume) network fees. The result of this shifting business model gave Ariba much more flexibility to pursue aggressive pricing for its SaaS modules (P2P, sourcing, and spend analysis) to the point of offering prices to win select deals that competitors would just walk away from. Curiously, these prices were not just limited to the eProcurement and e-Invoicing areas. We can reference several situations where Ariba's quoted pricing for SaaS-based options over a 3-year term were between 15-30% that of the competition. However, the beauty of this pricing for Ariba was that if they could eventually drive significant P2P network volume in these deals — even those starting beyond transactionally-focused areas – they would more than make up the difference by having suppliers pay greater and greater fees.

Cost Obfuscation

There are lots of perspectives on the merits of this strategy. By obfuscating the actual total costs to both buyer and supplier at deal signing, Ariba is usually at an advantage because buyers need less of a capital budget to invest. But some organizations believe that suppliers will just raise their prices to compensate for higher transaction costs over time. Spend Matters' own analysis at the time of Ariba's last major price increase was based on discussions with a range of buying organizations. A number of these companies planned to take select suppliers with high-dollar POs/invoices off the network because they are hit hardest under the new pricing rules (these companies had the choice because they were CD customers – SaaS customers do not have this flexibility).

After running the numbers for a larger buying organization transacting $500MM in annual volume using either Ariba Buyer, P2P, or just the Ariba Supplier Network, we concluded that for the great majority of suppliers, the fee increases [and the fees themselves] are negligible. In fact, 70% of suppliers (as of the fall of 2010) would continue to transact for free, according to Ariba. However, high-dollar volume transaction suppliers faced a significant increase under the new pricing model.

Specifically, our analysis suggests that larger, financially healthy suppliers (with a low cost of capital) – and multiple trading relationships and revenue going through the Ariba network – submitting fewer documents per annum are those that stand to disproportionately assume the costs of the network fee increases. Looking a this, we wrote "it could be argued that the new Ariba network fees place a larger burden on large suppliers to subsidize smaller ones, those most likely to leverage Ariba as a primary sales channel to win new business."

Current Fee Structure

Under the current fee structure, as of the 2010 price increase, roughly 12% of transacting suppliers were hit by network fees (this was using one transacting relationship example). But large suppliers like a Dell, Grainger, or Staples transacting $1.5 million per year would pay $2,325 in transaction fees annually (versus $1,500 before the price increase). This number maxes out per trading relationship at $20,000 annually, which would represent $12,903,225 in volume (up from a cap of $10,000,000 or $1,500 in annual transaction-based fees).

On the recent earnings call, Ariba hinted there might be room to raise network pricing further. In this regard, Bob Calderoni suggested, *"I've always felt there's an opportunity to get a better yield than we currently do out of the network. I think today we have an effective yield of only about five basis points. Our pricing is 15 basis points, but it's free for some suppliers up to a certain level. So we got a net yield today of about five, maybe a little bit more than five basis points. The opportunity is certainly there to drive that yield up through business model changes, whether we change the basis points or we change some of the caps or some of the floors. I like to put some time in between those changes. And so I don't anticipate any changes in the near-term here, but that opportunity remains. And like we have in the past, you'll probably see, every 2-3 years, there'll be some tweak…whenever we do a model change, we tend to be above 30% [network growth]. So without a model change,* *we'll be similar to what you see today, high-20s, somewhere between the 20% and 30% range."*

The fundamental crux of the deal and whether it is a huge financial success (or not) based on the current network operating structure and arrangements for SAP and Ariba will be whether or not the continued fee structure remains viable. Regarding this specific topic, we observed:

> *"As Ariba debates fee increases – an increase in 2013 would be within the 2-3 year window that Bob suggests in the above quote – its competitors for network connectivity are increasingly providing identical transactional services at fixed (and sometimes free), volume-based prices (e.g., Basware, OB10, SAP/Crossgate/Hubwoo, Tradeshift) that buyers have the option of paying for suppliers in which they often receive a material discount for doing so. Moreover, some competing connectivity offerings are beginning to move further down the path embedding discounting programs as a core component of their offerings where for Ariba it is secondary … For Ariba to justify any type of fee increase to suppliers, we believe they'll need to embed low APR early payment financing options at the core (which could easily pay for itself by allowing Ariba to maintain its margin while in fact getting rid of basic transaction-based fees, provided they played the model correctly)."*

Looking Ahead

Overall, it's clear that Ariba network fee increases are once again on the table for Ariba customers — whether they occur 2013 or 2014, they are definitely coming. If Ariba can succeed in wrapping new value around the supplier network for larger transacting suppliers, perhaps these new fees will be accepted without protest, and without price increases on a SKU basis for buyers that would otherwise find themselves paying for them, one way or another, in their larger transacting relationships.

And SAP and Ariba will need to completely flesh out this point if they opt to exercise network-pricing power over suppliers. Done right, with added benefits for vendors, SAP could come out looking much better than Ariba did after the last price hike, when it faced initial push-back. But pursued incorrectly, with any price increase, SAP will open itself up to dozens of lower or fixed-price per document pricing models (not to mention free approaches) performing the same commodity service for cases where SAP/Ariba customers are not locked into their proprietary network.

Where all this is going is simple. SAP and Ariba will need to de-commoditize supplier network connectivity to preserve pricing power to drive, maintain, and grow the high margin network/cloud connectivity business. The combination of an expanded network value proposition focused in supply chain finance/discounting, supplier management (and risk management), advertising/discovery, supplier benchmarking, and related areas could prove critical defining elements to drive differentiation for SAP and Ariba to justify – and even raise – their premium connectivity pricing.

Beyond Fees: The Future of P2P, Supplier Enablement, and Networks

Ariba and SAP may have their work cut out for them in coming up with network offerings that map to acceptable fee structures that gain the full support of customers – buyers and suppliers alike. But regardless, Spend Matters believes that the network future is already here:

- Enablement is finally at the forefront of consideration in eProcurement and e-invoicing decisions (initial implementations, upgrades, and bolt-ons included!)
- The line is blurring between what resides in a network and what resides in an application (workflow, routing, exception handling, dispute resolution, content management, supplier management, etc.)
- Other initiatives are, in a stealthy manner (e.g., discounting), forcing the enablement and on-boarding question – and e-invoicing
- Everyone is gunning to "be like Ariba" from a valuation standpoint and the network model looks attractive to pursue (and to position as)
- Current RFP volume/dealflow is outstanding by historic levels for both P2P and network enablement
- Technology innovation is happening faster than ever

We believe these factors will combine to create a compelling business argument not just for investment in the P2P and network areas, but materially greater adoption than before. Moreover, consider the following:

- A rising tide lifts all boats – including new and innovative business models
- Despite economic uncertainties, P2P investment appears to be increasing, not shrinking
- Customers are, for the first time in many cases, acknowledging they need more than just tools for requisitioning, supplier portals, etc.
- Network growth, by our estimates, is outpacing application growth

But what will happen to networks by 2015 – or shortly hearafter? We already shared these predictions with Spend Matters PRO subscribers:

- Direct spend comes to the forefront
- Services (spend) get interesting, too – VMS intersections becoming increasingly important
- We don't think about "e-invoicing" adoption anymore – suppliers just become accustomed to submitting invoices electronically or do so transparently
- Truly "networked" P2P applications gain material traction, especially in the middle market
- Multiple tiers on one platform/network
- Interoperability...finally!
- Value-added network services rule the day
- Analytics get predictive and proscriptive – for all parties in transactions
- Financing becomes a much more frequent option in transactions (think credit cards)

In this environment, networks can become true business process platforms that sit between organizations, which is what we know that Ariba/SAP and others truly aspire to (and will achieve in due course). They'll be significantly more powerful in delivering this type of value and capability to buyers and suppliers alike.

Nipendo: A New Approach to Network Connectivity and Persistence

Compared to traditional networking and e-invoicing connectivity models, which focus on transactional mapping at the database level to allow for system-to-system connectivity, Nipendo takes a much more radical approach (more in this in a minute). Historic mapping models have large limitations in the speed of supplier enablement and the rigidity of the systems once connectivity is established. In contrast, Nipendo uses a model that, in their words, "converts transactions into a generic structure and format" in the platform/cloud space that exists between buyers and suppliers.

This approach may sound like a B2Bi translator (think Liason/Hubspan) that links different file formats through a hub or interchange model. But it's not, as Nipendo actually maps (or creates, as required) business processes and management associated with a particular transaction and buyer/supplier transaction through this connectivity and translation layer in a many-to-many fashion. This is what allows Nipendo to create, run and modify highly specific technical validations that go far beyond a basic 3-way match without requiring one-to-one customization (i.e., lots of time invested).

They can also persist data in this neutral format to link previous interactions and transactions with current (and past) processes rather than just creating an archive of past activity. All of these capabilities are enabled through the abstraction and state-handling capabilities of the Nipendo architecture. Of course data persistence and linking transactions (and alerts that organizations might configure) are not yet included in a typical RFP for e-invoicing – at least not yet. But Nipendo does go one step further than many of its e-invoicing peers through cross-module process automation that can capture and link data associated with specific exchanges between companies (RFX, PO, ASN, delivery notification, warehouse receipts, payment notices etc.)

This linkage can enable steps and processes with a greater degree of flexibility/granularity than other approaches (and they can be changed on the fly). For example, Nipendo can enable users to configure (and then alter) automation steps and activities for invoice reconciliation (invoice/PO matching, invoice/ASN matching, invoice/warehouse receipt matching, tax validation, etc.) on not only a granular set of criteria (e.g., country, category, supplier, P&L or location specific, or all of the above) but to modify a single element on the fly and change the overall processes without breaking any inputs or outputs.

This approach can also be applied to self-service invoice correction, OCR validation, digital signatures, archiving and even ad-hoc collaboration such as buyer/supplier chats – which can all be tagged and associated with not only the broader transaction but anything a company wants to define or define/re-define in the future – since the extracted form of the raw data at the most granular level of input rather than a snapshot archive persists in the Nipendo system. And this can even occur at a multi-tier level.

We must not ignore the technical plumbing that will enable the network future! And Nipendo, with its approach, provides hints at where the overall market is likely to head to enable radical adoption levels and capabilities across the buyer/supplier connectivity continuum divide.

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