# Predicts 2024: Demand for Generative AI Will Drive Higher IT Contracting Risks and Costs

> The use of GenAI tools and techniques in IT projects will likely carry long-term pricing implications, license compliance costs and contractual risks. Sourcing, procurement and vendor management leaders must negotiate contractual concessions and protections to gain long-term benefits from GenAI use.

## Overview

### Key Findings

- Software vendors are either incorporating GenAI into existing product capabilities or selling it as a premium add-on. Many sourcing, procurement and vendor management (SPVM) leaders and their business partners have yet to thoroughly evaluate GenAI pricing models, which are still evolving, risking unanticipated future costs such as higher pricing and hidden fees that could well exceed potential GenAI gains.

- SPVM leaders who fail to do the necessary due diligence on licensing prerequisites risk significant unbudgeted costs from downstream license impacts and possible license noncompliance scenarios when incorporating GenAI into IT contracts.

- Software vendors are driving customer interest by suggesting GenAI can yield significant cost reduction and improved productivity when added to IT contracts. This will put more pressure on SPVM leaders to identify and mitigate the potential for consequential IT contract risks, a challenge that will be increasingly difficult for those whose organizations lack sufficient enterprisewide guidance on responsible GenAI use and adoption.

## Recommendations

- Demand transparency from software vendors to ensure pricing and terms are thoroughly understood and documented. This must include any additional costs required to support and use GenAI's full capabilities. Negotiate concessions such as renewal pricing caps to avoid significant price increases, especially when introductory discounts or free trials are offered.

- Create a core cross-functional team of experts including technical architects, IT, business, software asset management (SAM) and legal to assess the software compliance risks associated with the use of GenAI in IT contracts. Educate the business about potential compliance risks, and proactively negotiate resolutions and contractual protections upfront.

- Collaborate with the core cross-functional team to develop and publish an enterprisewide "Responsible Use of GenAI" policy. Make compliance a prerequisite when sourcing GenAI tools/functionality as well as developing metrics to measure and report vendor performance. Negotiate remediation and protection clauses for any breach of your Responsible Use of GenAI policies.

## Strategic Planning Assumptions

- By 2027, a majority of organizations' enterprise application software costs will increase by at least 40% due to generative AI product pricing and packaging.

- By 2027, software license compliance fees will increase by at least 20% due to a failure to address GenAI-related risks in contracts.

- By 2027, 80% of IT contracts that do not explicitly call for responsible use of GenAI will fail to deliver desired outcomes.
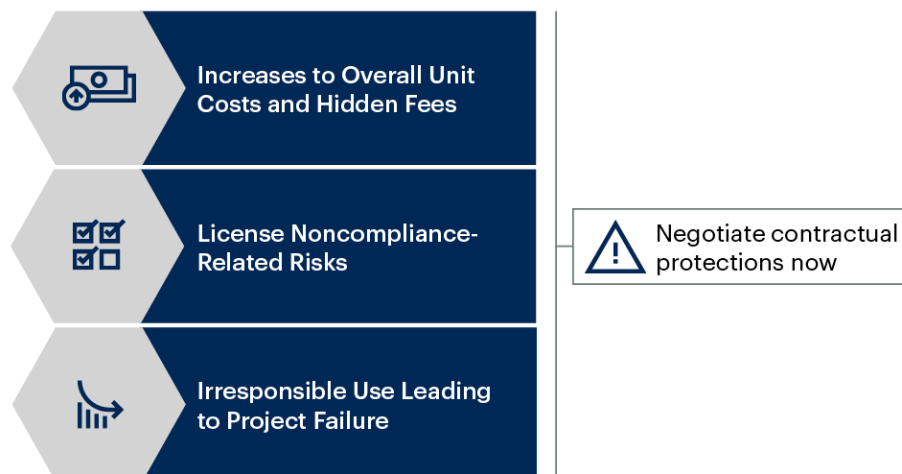
## Analysis

### What You Need to Know

Generative AI (GenAI) is at the forefront of several software vendors' strategies and will fundamentally change the way organizations operate. Large language models (LLM) within AI can be trained to read and decipher vast amounts of text, allowing it to interpret and generate humanlike textual outputs, which brings business productivity opportunities (see Board Brief on Generative AI). SPVM leaders will need to adapt their SPVM strategies to enable their organizations to maximize GenAI opportunities while also managing IT contract-related risks.

Some vendors are already adding GenAI features into existing bundles (e.g., Salesforce) and subscriptions, and others are introducing GenAI as a premium add-on with licensing prerequisites (e.g., Microsoft 365 Copilot, ServiceNow [1]). For SPVM leaders, proactively researching how their vendors position and package GenAI offerings is an important early step in understanding potential risks of increased future unit costs or upselling at renewal. Furthermore, without doing the necessary due diligence on licensing, terms and conditions, and use rights, customers could be exposed to hidden fees, downstream licensing costs and noncompliance with software license terms (see Figure 1 below).

### Figure 1: Key Risks Associated With Generative AI in IT Contracts



**Key Risks Associated With Generative AI in IT Contracts**

- Increases to Overall Unit Costs and Hidden Fees
- License Noncompliance-Related Risks
- Irresponsible Use Leading to Project Failure

⚠ Negotiate contractual protections now

Source: Gartner
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SPVM leaders are now facing the challenge of justifying more investment into GenAI at a fast pace to satisfy business demand generated by the initial hype in order to potentially save money in other areas of the business. In the 2024 Gartner CIO and Technology Executive Survey, 79% of respondents indicated they had already deployed (9%) or planned to deploy (70%) generative AI by 2026. [2] Many users within organizations are already using GenAI tools to complete business tasks without any real guidance or governance, exposing organizations to data privacy and security risks (see Generative AI Security and Risk Management). This puts pressure on SPVM leaders not only to invest in GenAI tools but to also work with the business to implement internal usage policies.

When negotiating the inclusion of GenAI into software and SaaS contracts, it's crucial to address contractual protections in three areas: impacts to unit costs (including hidden fees), license compliance and responsible use.

*Gartner does not provide legal advice or services, and its research should not be construed or used as such. Work with your legal counsel to incorporate the recommendations herein using contract language customized to meet your internal legal and business requirements.*

## Strategic Planning Assumptions

**Strategic Planning Assumption:** By 2027, a majority of organizations' enterprise application software costs will increase by at least 40% due to generative AI product pricing and packaging.

**Analysis by:** Jo Liversidge and Hannah Decker

**Key Findings:**

> It is too early to tell what proportion of GenAI enterprise application customers will reap productivity gains that exceed additional costs within a typical contract term of three years, so it is imperative organizations push beyond quick, tactical wins onto more strategic differentiating and transformational use/business cases.

- Enterprise application software vendors are embedding GenAI capabilities into existing products, then using that to justify list price increases (e.g., Salesforce).

- Other vendors are offering GenAI features as an add-on, at an additional cost (e.g., Microsoft 365 Copilot, ServiceNow [1]).

- Credit/token-based pricing (tokenization) is increasingly being used as the pricing model for GenAI usage beyond the initial allowance included in the application, leaving customers perplexed as to how to forecast and budget.

- Several vendors have announced base pricing but have not made public the incremental costs based on usage. [1,3]

- Some vendors are offering free trial periods or free products to increase adoption rates.

- Software vendors are in a race to announce and launch GenAI products, sometimes before pricing models have been thoroughly considered. This elevates the risk of current pricing models changing often as vendors evolve their offerings. [4]

- GenAI is a rapidly evolving market, and vendors are likely to make ongoing changes to their offerings and associated pricing and packaging as the market develops.

- There will be costs for additional capabilities and capacity needed to support GenAI (e.g., costs associated with accessing customer data platforms, extra storage and integration). [5]

**Market Implications:**

- Pricing models will evolve over the next two to three years. There will be many fluid and dynamic changes to pricing and packaging, as vendors can't accurately predict application usage by customer, meaning they can't plan the path to profitability. Similarly, customers using current pricing structures to create cost projections and business cases should expect to review and amend these regularly as vendors' pricing models change.

- "No GenAI" low-cost software offerings will be marketed and targeted at risk-averse customers. Certain sectors and smaller customers may feel they cannot mitigate the risks associated with GenAI.

- Since customers will need the flexibility to stop and start trials for different use cases in an agile manner, there will be opportunities for vendors that have offerings with more modularity (e.g., nonbundled offerings).

- There are competing market pressures between open-source software (OSS) and large applications vendors. For example, academia requires low-cost options, which they can develop using OSS, versus vendors trying to gain market share. [6]

- Opportunities exist for software asset management platform vendors to develop and sell sophisticated solutions to track and predict usage of tokenized products, as this is largely missing currently and customers find it hard to budget and forecast.

**Recommendations:**

- When buying from incumbent vendors, ensure pricing models are thoroughly understood, along with how they scale and any hidden costs. Only enter into longer-term agreements once the use cases are proven for your organization.

- In the medium term (e.g., two to three years), employ all standard sourcing strategies to minimize cost increases; for example, running RFx (requests for proposals, information, quotes, etc.) for new capabilities or for upcoming renewals.

- For any bundled offering, ensure you understand and document which products are included; how each product is priced (e.g., user- or credit-based); any limits that apply (e.g., number of credits, storage or API calls); pricing for additional usage (e.g., blocks credits); and the ability to disaggregate the product(s).

- When supporting the business in building a business case for GenAI investments, ensure they understand the pricing model and how costs will scale.

- Negotiate a maximum price uplift of 3% to 5% for renewals to protect against list price increases, product rebundling, and loss of any negotiated discounts.

- Negotiate contractual terms to prevent repackaging of credit allocations during the term of the agreement to ensure the value of prepaid tokens or credits is not diminished.

- Fully assess any free-of-charge offerings and understand the included quantities of credits or tokens of the free product. Negotiate the price for when the free-of-charge period ends, before starting the project. Communicate to business stakeholders the risks of accepting free products.

- Work with your stakeholders to understand whether any additional software is required to support your GenAI deployment and negotiate this alongside any GenAI licensing if offered by the same vendor.

**Related Research:**

Quick Answer: What Should You Know About Generative AI Enterprise Applications Pricing?

Negotiate Consumption-Based SaaS Pricing for Variable Demand and Uncertain Forecasts

Quick Answer: How Is Salesforce Pricing Its Generative AI Products?

Quick Answer: How to Respond to Microsoft 365 Copilot Hitting the Market

Quick Answer: How Is ServiceNow Pricing Its Generative AI Products?

How to Pilot Generative AI

Assess the Value and Cost of Generative AI With New Investment Criteria

**Strategic Planning Assumption:** By 2027, software license compliance fees will increase by at least 20% due to a failure to address GenAI-related risks in contracts.

**Analysis by:** Mike Tucciarone

**Key Findings:**

- Many software vendors have started announcing generative AI capabilities and pricing models to the market. Some of these are complex and can lead to downstream compliance issues associated with vague or missing usage allowances, whether it be the primary or secondary metric (see Quick Answer: What Should You Know About Generative AI Enterprise Applications Pricing?).

- Organization leaders are currently, and rightly, focused on risks associated with scope, IP and confidentiality (see Identify the Strategic Benefit, Cost and Risk of Generative AI Use-Case Types). As a result, software compliance risks can go overlooked and be a surprise to multiple stakeholders. Risk can even erode the business case of the GenAI capability altogether.

- As evidenced by Gartner inquiries with sourcing, procurement and vendor management leaders, software compliance risks continue to increase significantly over time. While audits of perpetually licensed products may not be as prevalent for certain software vendors, software vendors are modifying their business practices to shift their attention to subscription licensing. This is especially problematic since most GenAI software capabilities will be available on subscription licenses. [7]

- Software compliance risks can manifest in multiple ways, including excess utilization of software entitlements and insufficient understanding of vendor-specific licensing requirements (e.g., see Resolve SAP Digital Access Licensing With This 3-Phase Approach). Incorporating GenAI functionality will add noncompliance risk attributable to the vendor the functionality is being sourced from, but could also create noncompliance risk attributable to other (existing) software vendor relationships, too.

**Market Implications:**

- GenAI-related revenue, growth and backlogs will be extremely important to software vendors, and they will be laser-focused on these metrics to demonstrate their leadership in the nascent GenAI market. Vendors will be looking for opportunities to drive additional GenAI revenue, whether by customer adoption of GenAI, renewals to incorporate GenAI capability into existing solution sets, or software compliance to position GenAI capability as a commercial solution.

- For organizations not adopting or slow to adopt GenAI capabilities, software vendors will position software compliance as a means to gain leverage with customers. Vendors will utilize compliance gaps and exposures as an opportunity to drive customers toward GenAI-related capabilities as part of compliance resolution. For example, they may offer to limit or forgive the compliance costs associated with existing solutions should the customer be willing to negotiate on the newest GenAI solutions, whether the customer has a compelling business case or not.

- Organization leaders adopting GenAI capabilities also face compliance risks for misunderstanding requirements due to a fundamental lack of expertise with GenAI capabilities, licensing models, requirements and growth.

**Recommendations:**

- Deliver market intelligence to IT and the business on established and new compliance business practices of current and prospective software vendors in the context of any GenAI investments. In areas where you lack expertise, leverage internal and external resources, including research, consultants and third-party advisors to eliminate blind spots.

- Create a core team of cross-functional experts to assess software compliance risks as part of any net new pilots or investments. Inform them of areas in contracts that represent potential compliance risk. The focus should be both on compliance risks associated with the procured GenAI functionality, but also any compliance risk to established software vendor relationships resulting from GenAI functionality. The cross-functional team should be led by sourcing, procurement and vendor management and made up of software asset managers, technical architects, IT, the business, and legal counsel.

- Proactively negotiate resolutions and commercial protections for any potential compliance risks. Mechanisms for compliance resolution include modifying the bill of materials to account for known compliance issues, leveraging a strategic investment in products like GenAI to negotiate compliance resolutions elsewhere, and utilizing strategic licensing constructs when compliance risks can be high (e.g., unlimited deals). Commercial protections include audit holidays, swap rights, and price protections for additional compliance-related demand, for example.

**Related Research:**Quick Answer: What Should You Know About Generative AI Enterprise Applications Pricing

How Can SPVM Leaders Enable Generative AI Adoption?

Deliver Insightful Market Intelligence to Become a Trusted Advisor to IT and the Business

**Strategic Planning Assumption:** By 2027, 80% of IT contracts that do not explicitly call for responsible use of GenAI will fail to deliver desired outcomes.

**Analysis by:** Rajib Gupta and Melanie Alexander

**Key Findings:**

- A survey in April 2023 of more than 300 HR employees in the U.S. found that 73% report are already using ChatGPT or a similar chatbot for their job. Additionally, 24% of HR leaders report that their teams use GenAI tools one or more times a day to conduct work activities. [8]

- The same survey revealed 35% of organizations are yet to finalize their guidance on use of GenAI tools and 77% of leaders view data privacy and security issues as primary concerns against the use of ChatGPT.

- Almost all SPVM leaders Gartner spoke with in 2Q23 and 3Q23 about GenAI mentioned the severe pressure they are facing to respond to rapidly escalating interest in GenAI features, capabilities and associated risks.

- Many IT product and services vendors have started embedding GenAI capabilities into their offerings, claiming significant cost reduction and improved productivity benefits.

- While more than half (55%) of organizations have issued guidance and 44% have released an internal policy on use of GenAI tools and techniques, some feel the need to take more steps to support safe use, according to a September 2023 webinar poll of legal, compliance and privacy leaders. [9]

**Market Implications:**

- Rapidly increasing interest in GenAI and support for new use cases is causing stealth proliferation of GenAI tools and techniques within the enterprise, leading to significant governance, risk and compliance (GRC) challenges.

- Vendors embedding GenAI tools and techniques in their products and services in an opaque fashion are further accelerating proliferation of these tools and techniques while enterprises are left to overcome governance challenges by themselves.

- The adoption speed of different GenAI tools and techniques are expected to be exponential, causing many unplanned and unstructured projects to be incubated within different parts of the enterprise (see Emerging Tech: Generative AI Adoption Trends and Future Opportunities) and brought into mainstream.

- Uncontrolled and irresponsible use of such tools and techniques exposes the enterprise to substantial risk on factors such as trust, transparency, fairness, bias mitigation, explainability, sustainability, accountability, safety, privacy and regulatory compliance, failing to deliver the desired outcome.

**Recommendations:**

- SPVM leaders should collaborate with cross-functional teams led by GRC counsel to develop and publish an enterprisewide Responsible Use of GenAI policy and make it an absolute minimum requirement when sourcing any GenAI product and/or services. These cross-functional teams should consist of representation from AI engineering teams, data science teams, data and analytics teams, marketing, legal, and business stakeholders.

- Publish your Responsible Use of GenAI policy on your vendor portal for easy referencing and educating your vendor base.

- Engage legal colleagues to draft standard master clauses for your master agreements to govern responsible use of GenAI as a commitment from the enterprise and responsibility from the vendor that includes the following:

  - Require vendors to provide training model datasets that use bias detection and control capabilities in order to proactively avoid potential harm (to people, to an organization's financial or reputational situation, or to a system such as supply chain).

  - Ensure vendors are contractually committed to providing GenAI-based functionalities and features that are explainable and/or at minimum, interpretable, by requiring model documentation and incorporating references to standards or frameworks, allowing for continuous evolution.

- Negotiate remediation and protection clauses for any breach of your Responsible Use of GenAI policies, within all IT products and services contracts.

- Develop Responsible Use of GenAI metrics to be measured and reported as part of ongoing vendor performance management.

**Related Research:**

An Early Look at Corporate Guidance on Generative AI

Generative AI: A Look at Emerging Governance Practices

What Legal and Compliance Leaders Need to Know About Large Language Model Risks

How to Support Responsible Generative AI Use in HR

 What Should I Know About Responsible AI?

A Comprehensive Guide to Responsible AI

Best Practices for the Responsible Use of Natural Language Technologies

Activate Responsible AI Principles Using Human-Centered Design Techniques

How to Ensure Your Vendors Are Accountable for Governance of Responsible AI

## A Look Back

*In response to your requests, we are taking a look back at some key predictions from previous years. We have intentionally selected predictions from opposite ends of the scale — one where we were wholly or largely on target, as well as one we missed.*

**On Target: 2021 Prediction** — By 2024, the average length of term of SaaS contracts will have reduced by six months, down from 39 months today, to present more flexibility for buyers.

Based on numerous SaaS vendor contracts reviewed by Gartner SPVM contract analysts in the 24-month period ending September 2023, the average length of term has dropped from 39 months to 35 months. Due to the volatility of the current market and vendors adding in new functionality to justify unit price increases (e.g., GenAI functionality), vendors are preferring shorter-term contracts, making price protection concessions more difficult to achieve by SPVM leaders.

**Missed: 2021 Prediction —** By 2024, business downturn language allowing reductions in subscriptions or contract termination will be included in 30% of new SaaS contracts (see Predicts 2021: Crisis Will Force Changes to Software and Cloud SaaS Contract Negotiation).

Since the pandemic, most organizations are now in a growth phase and license reduction clauses have been less of a priority for SPVM leaders. Vendors do not like allowing customers to reduce license quantities midcontract as it likely impacts their internal sales incentives. For example, some vendors have added a large premium to license costs if a customer wants a monthly rolling SaaS contract. Others have removed all license reduction language as a trade-off for good discounts, especially when price protection concessions beyond renewal are offered.

## Acronym Key and Glossary Terms

| GenAI | Generative AI |
|-------|---------------|
| SPVM | Sourcing, procurement and vendor management |
| LLM | Large language models |
| SAM | Software asset management |

## Evidence

[1] "For all new generative AI capabilities beginning with our Vancouver release, we will introduce a new set of premium-plus SKU offerings across ITSM, CSM, and HR SV." Bill McDermott, chairman and CEO, ServiceNow. ServiceNow (NOW) Q2 2023 Earnings Call Transcript, Motley Fool Transcribing.

[2] The **2024 Gartner CIO and Technology Executive Survey** was conducted online from 2 May to 27 June 2023 to help CIOs determine how to distribute digital leadership across the enterprise and to identify technology adoption and functional performance trends. Ninety-seven percent of respondents led an information technology function. In total, 2,457 CIOs and technology executives participated, with representation from all geographies, revenue bands, and industry sectors (public and private). Disclaimer: The results of this survey do not represent global findings or the market as a whole, but reflect the sentiments of the respondents and companies surveyed.

[3] Salesforce Announces General Availability and Pricing for GPT-Powered Features for Sales and Service, Secured Through Einstein GPT Trust Layer, Salesforce.

[4] Salesforce Announces AI Cloud — Bringing Trusted Generative AI to the Enterprise, Salesforce.

Salesforce announced the AI Cloud Starter pack (at $360,000 annually) on 12 June 2023, but within a few months informed Gartner it was no longer actively being sold (see Quick Answer: How Is Salesforce Pricing Its Generative AI Products?).

[5] "…lots of these AI products pull along Azure because it's not just the AI solution services that you need to build an app. And so, it's less about Microsoft 365 pulling it along or any one Copilot. It's that when you're building these, it requires data, and it requires the AI services. So, you'll see them pull both core Azure and AI Azure along with them." Amy Hood, CFO, Microsoft. Microsoft (MSFT) Q4 2023 Earnings Call Transcript, Motley Fool Transcribing.

[6] The Future of Open-Source AI Hangs in the Balance, Princeton University. Licensing Is Neither Feasible Nor Effective for Addressing AI Risks, AI Snake Oil.

[7] Gartner experienced a 21% increase in software compliance inquiries within SPVM from January 2023 through September 2023 versus January 2022 through September 2022.

[8] HR's Obsession With ChatGPT Has One Major Red Flag, Capterra.

[9] A Gartner Webinar Live Poll was taken during the webinar "Privacy for the General Counsel: What Legal Leaders Need to Know Now," on 7 September 2023. Multiple responses were allowed. n = 78.

## Recommended by the Authors

Some documents may not be available as part of your current Gartner subscription.

We Shape AI, AI Shapes Us: 2023 IT Symposium/Xpo Keynote Insights

Quick Answer: What Should You Know About Generative AI Enterprise Applications Pricing?

Quick Answer: Evaluating Microsoft 365 Copilot Pricing & Bing Chat Enterprise

Quick Answer: How Can SPVM Leaders Enable Generative AI Adoption?

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