The Future of Software Licensing: Software Licensing Under Siege

Sponsored by: Multiple Vendors

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The Future of Software Licensing is a multiclient initiative conducted by IDC with the participation of several companies across the software industry, namely:

- Adobe Systems Incorporated
- Autodesk, Incorporated
- Informatica Corporation
- Ingram Micro Incorporated
- Intel Corporation
- Microsoft Corporation
- Oracle Corporation
- PeopleSoft, Incorporation
- Platform Computing Incorporated
- Progress Software Corporation
- SAP AG
- Software and Information Industry Association (SIIA)

INTRODUCTION

Change is in the air in the software industry. Continued low software market growth rates, shifts in customer purchasing trends and an increasing interest in alternatives to traditional software business models have set the stage for a potentially disruptive impact on vendor licensing policies and practices.

In addition, a general lack of understanding about the impact of licensing and software license compliance issues by the media, end users, and partners have helped perpetuate misinformation and fears about licensing practices, creating a difficult environment for software vendors to make effective changes to a licensing strategy.
To set the standard for the direction of software licensing and supply vital information on where licensing is headed and why, IDC conducted a landmark study of 100 software vendors and 100 software customers through the fall of 2003 and winter of 2004. For this study, IDC employed the Delphi Method, which was developed by the Rand Corporation in the early 1960s. This research approach enables the exploration of ideas and involves an iterative process by which these ideas are refined with the intent of either building consensus or establishing a stable view of strategic alternatives. IDC’s version of the Delphi Method involves surveying members of two panels. Three to four surveys were conducted using an iterative design where the results from one survey are used to help develop the survey questions and issues to be explored on the subsequent survey. Respondents will be provided complete anonymity regarding their responses.

The results of this study show that software vendors are taking many different licensing approaches to accomplish a similar set of goals. These goals include:

- Increasing the predictability of software revenue
- Developing a better understanding of how customers are using software products and maintenance offerings to better gauge their respective values, and then more accurately reflecting these values in price
- Considering the value of software as part of a broader solution

Software customers believe that in order for vendors to improve the effectiveness of current licensing practices, they must place a greater focus on clearly understanding customer business needs. At the same time, customers are looking for greater flexibility — and simplicity — in terms of their software contracts, a difficult demand for software vendors to meet.

This white paper summarizes the findings of IDC’s *The Future of Software Licensing* study. This is one of several key documents and outreach initiatives by IDC that will help software vendors develop an essential "road map" to successfully navigate changes to their licensing policies, maximize revenue from software licensing, and communicate this "road map" to external audiences.

**THE STUDY**

The goal of IDC’s *The Future of Software Licensing* study is to examine today’s software licensing landscape, identify the potentially disruptive forces impacting traditional software licensing models, and provide a statement of direction for the software industry in light of these impacts. This paper consists of three main sections:

- Current Software Licensing Landscape
- Landscape Altering Forces
- The Road Ahead
CURRENT SOFTWARE LICENSING LANDSCAPE

Navigational Framework

This section is designed to establish baseline values and an understanding of terms that can be used as a foundational framework for evaluating the information presented in this white paper.

IDC has created a software licensing taxonomy based on a value chain that characterizes the role of licensing in the creation and marketing of software products — from an intangible vendor asset to a salable product. As shown in Figure 1, the value chain begins with the creation of intellectual property and, through a series of links, progresses through the development of code to the creation of packaged software. Next, the value of the software asset is manifest through the vendor’s license model and commercialized to customers and partners through negotiated terms, a volume license program, or standard terms targeting one-off incidental purchases.

**FIGURE 1**

Software Licensing Taxonomy Framework

While the vocabulary used within a software licensing context can be quite broad, the following key terms and definitions will be essential navigational tools for readers of this white paper:

- **Software license.** A license is an agreement granting rights to use packaged software or components of that software to a licensee.
Licensing method: The licensing method describes how the vendor collects and recognizes the revenue from the sale of its software. There are two key attributes — subscription and perpetual, which are defined as follows:

- **Subscription**: Subscription licenses are paid for with a recurring (often annual) fee to continue using the software. If the fee is not paid, the software stops working. The customer does not own the software license.

- **Perpetual**: Perpetual licenses are paid for on a one-time basis, giving the user the right to run the program as long as he/she chooses. It does not imply a right to upgrades, which are typically sold separately as part of a maintenance agreement or on a per-upgrade basis. Some vendors sell perpetual licenses on a term basis, which on the surface appears to be subscription based because the payments are spread out over time. However, from a deal perspective, it amounts to a financing approach in which either the vendor or a third party helps amortize payments over a specified period. The software does not stop running after that time period, and the customer is granted a perpetual license.

**Software maintenance.** An agreement between the licensee and software developer through which the developer continues to improve the packaged software product by repairing known faults and errors or enhancing, updating, or upgrading the product. It may also include technical support and is generally priced as a percentage of either the net or list license cost.

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**Licensing and Maintenance Models**

The remainder of this IDC white paper describes the results of three vendor and three customer surveys. The first set of surveys were designed to help understand current software vendor and customer licensing practices, and the relative importance of disruptive forces that have the potential to alter them. The second and third sets of surveys were designed to understand the likelihood of various future scenarios.

The results of this study reveal a software licensing landscape that is far reaching and diverse. One of the main goals of this study is to make this complex landscape easier to navigate. We will begin by painting a picture of the current landscape, then applying the navigational framework described earlier in the paper to understand the key characteristics of software licensing.

**Licensing Methods**

Licensing methods — perpetual versus subscription — are fundamental characteristics of a software license approach. In this study, 75% of the software vendors’ aggregated software revenues were associated with perpetual, rather than subscription, licensing methods. It is important to consider that this question was asked in terms of total software revenues, not the total number of customer contracts. Perpetual license sales are generally recognized as revenue up front, while subscription revenues are recognized over time. As a result, while we would expect
perpetual revenue to dominate in the current licensing landscape, subscription revenue already makes up a respectable portion of the total market.

Based on changes to vendor and customer licensing practices described later on in this document, IDC expects subscription software revenue to increase as a proportion of total software revenues.

**Software Maintenance**

Software revenue can be divided even further to understand the current proportions of license versus maintenance (see Figure 2) for predominantly subscription and perpetual licensing methods.

As a general trend, IDC is seeing maintenance revenue increase as a proportion of overall software sales. This represents a shift in purchasing patterns and growing emphasis on recurring revenue streams. Most of the software customers that participated in this study purchased software maintenance (98%), and the primary reason for doing so was that it was required by the software vendor as part of the software purchase. Customers from large companies ($1 billion or more in revenue) cited their own company policy as the top reason why they purchase maintenance.

From a budget perspective, the customers surveyed allocated an average of 20% of their IT budgets for software maintenance as compared to 32% for new licenses for company-owned machines. However, data presented later in this white paper indicates that for many of these customers, the percentage of their budget spent on maintenance will increase by an average of 12% in the next year while the percentage of their budget spent on new licenses will decrease.
An interesting observation related to the mix of license and maintenance is that software vendors offering a subscription licensing method reported an average of 37% of their subscription software revenues in maintenance. A generally accepted thought is the distinction between license and maintenance becomes less salient with subscription licensing methods, but the data in this study shows that is usually not the case. An important point to consider is that vendors often define maintenance differently. However, IDC provided standard definitions to the panelists for this study.

**Volume Licensing**

Most (61.2%) software vendors sell their software via volume license agreements, which reward customers that purchase high volumes of software with price discounts and other benefits. The larger the software vendor in terms of revenue, the more likely the vendor is to offer a volume discount program.

Figure 3 shows a breakdown of volume licensing offerings according to the offering type: enterprise agreement, site agreement, single-user agreement, OEM, and other.

Nearly half of the software vendors interviewed had a single volume licensing strategy that applied to all products, while the rest indicated that their strategy applied to some product lines or a single product, but not all of the company's offerings.

However, while the vendor can make the distinction, it doesn't mean that this distinction is visible or relevant to the customer. Of those companies with
predominantly subscription-based revenues, 72% bundle license and maintenance together, and another 11% have plans to do so. Conversely, 40% of companies with predominantly perpetual revenues bundle license and maintenance, and 9% have future plans to do so.

**Channels**

According to the results of the study, vendors report that most of their software is sold directly to customers. As a group, the software customers that participated in this study purchase almost half of their software through resellers, with mid-market customers (those companies with between $100 million–$999 million in revenues) the most likely to buy through a partner.

Both customers and vendors reported high levels of satisfaction with their channel partners. Customers are, on the whole, satisfied with the channels through which they buy their software. Vendors are content with the amount of time it takes the channel to get up to speed on licensing changes, as well as the way in which the channel implements their licensing policies and practices.

**Current Landscape Challenges**

The current software licensing landscape can be challenging for both software vendors and customers. Vendors are struggling with the reality that it is growing increasingly difficult to make money as a traditional software company (i.e., through perpetual licensing).

Customers are unhappy with the complex, inflexible licensing models that they feel dominate the current landscape, and, according to previous IDC studies, believe that future licensing changes will not be beneficial for them. Even the largest software customers, those that would seem to have the most influence over software vendors, do not believe that software vendors are acting with the customer's best interests in mind. Furthermore, customer dissatisfaction with a vendor's licensing approach can often delay or kill a deal.

According to the study, despite the fact that many of the current landscape challenges pit vendor versus customer in adversarial roles, the two groups share a set of common motivations, which can be summarized by the following categories:

- Increased predictability
- Decreased complexity
- Improved alignment with value
FIGURE 3

Characteristics of Volume Licensing Offerings (%)

Source: IDC's The Future of Software Licensing: Software Licensing Under Siege, 2004
In addition, vendors should be concerned with the sentiment of the channel and the financial community with respect to software licensing, although the survey results demonstrate that, for the most part, they are not.

**Increased Predictability**

From a software vendor perspective, the study reveals that a key motivation for investigating licensing change is a desire for more predictable revenue. The perpetual licensing model, which is predominant in the industry, results in revenue peaks and valleys and a high sensitivity to the economic climate. While this model served software vendors well in the heyday of the late 1990s, it dealt a harsh blow once the economy turned south in 2001. In 2004, as the Dow flirts with 32-week highs, other forces, such as the software complexity crisis and disruptive business models, are shining light on the weaknesses of the perpetual model.

One of these weaknesses is visibility. With the perpetual model, it is difficult to determine or predict the future health of a software company. While maintenance can help smooth out revenue and provide an indication of future earnings potential, customers are resisting increases in maintenance. In order to grow the amount of deferred revenue, and therefore improve future visibility, software vendors need to investigate alternatives to perpetual licensing models.

Customers also desire increased predictability — they would like to have a better handle on their software costs. This desire transcends software licensing and operational issues, and it illustrates the level of complexity in the current licensing landscape. While in theory, perpetual licensing models should provide customers with good visibility into software costs, in practice this is not the case.

**Decreased Complexity**

To gain access to the software that they need to run their businesses, customers must navigate a lot of territory. Over half of the medium and large customers that participated in this study are managing more than 40 software contracts, and one-third of this group is managing more than 70 software contracts at one time. Most of these customers — 70% in aggregate — report that the complexity of managing these contracts has increased in the last year. The software complexity crisis is indeed alive and well, not just on the technology side of managing software but also on the business side.

Taking a subscription licensing approach may reduce complexity but won’t necessarily eliminate it entirely. Over half (56.6%) of the customers with subscription-based licenses said the complexity of these arrangements had increased, while 70% of customers with perpetual licenses noted increased complexity.

When it comes to tracking an increasingly complex licensing environment, most small and medium-sized companies said they rely on internal processes, rather than electronic tools, to track these licenses. Half of the companies with perpetual licenses rely on internal processes only to track licenses, with addition or subtraction of users being the key focus. Only 4% of the customers in the study reported that they track software license compliance.
Complexity and noncompliance are inextricably linked. Software vendors are generally optimistic when it comes to software licensing compliance, reporting on aggregate that some 80% of their customers are in compliance and that they expect this number to increase by a few percentage points in the next year. IDC contends that 20% amounts to a $40 billion problem (considering the worldwide software market was close to $200 billion in 2003.)

Surprisingly, many of the largest vendors, those that stand to lose the largest percentage of this $40 billion, are relying on the honor system and "gentleman's agreements" to ensure customer compliance. The concern is that the potential customer backlash of stricter compliance policies and audits would outweigh any benefits resulting from improved compliance. Electronic tools may be provided to customers by these large vendors to help them track users, but the accuracy of the data depends on the ability of the customer to apply these tools correctly, and there is little or no reconciliation of this data with the paper contract.

Medium-sized software vendors are more likely than large or small vendors to use electronic mechanisms to track compliance, relying equally on node-locking hardware devices and license servers to do so. In addition, 92% of software companies in this size category reported that they perform audits — conducted electronically or by themselves — as compared to 48% of vendors with greater than $1 billion in revenues and 53.6% of vendors with less than $100 million in revenues.

In addition, nearly 70% of vendors in which subscription licenses make up more than half of software revenues track and monitor customer utilization, while only 35% of companies with a majority of software revenues through perpetual licenses do so.

**Improved Alignment with Value**

"Value" is oxygen that software vendors and customers breathe while traversing the software landscape. While it is intellectually obvious that software has value, and that this value brings life to software vendors and customers alike, it isn't always easy to "see" it. According to this study, 72% of software vendors and 70% of software customers strongly believe that the software industry must place a greater focus on clearly establishing the business value of software.

Previous IDC studies on software licensing have revealed that customers and vendors often disagree on what this value is, and how to measure it. The greatest price-value disconnect exists for infrastructure software and back-office applications. Infrastructure providers are challenged with a product set that is increasingly looking like a commodity in the eyes of customers, as well as customers that use open source as a vendor management tool. In the ERP space, it's difficult to make the connection between the traditional per-user metric and the value derived by using the software. After all, what is the correct measurement of the value of an accounting clerk having access to an accounting system, or a CFO obtaining timely and accurate information on a company's financial position? Does this vary according to customer size or industry? How can the value of the software be isolated?

From the software vendor perspective, finding the licensing model that correctly reflects the value the software brings to the table is an elusive quest, which will only increase in difficulty as the nature of software evolves over time. For example, take
the case of a software package that is part of business process outsourcing (BPO) offering provided to customers by a third party. How can a software vendor price its products to accurately reflect the value of the software as part of a larger solution, provide an attractive (or at least passable) model to the BPO partner, and ensure that the partnership does not cannibalize potential software deals?

The questions surrounding value in the current and future software licensing landscape do not have easy answers. The vendors in this study — particularly those with predominantly perpetual licensing models — are concerned with how changes in customer perception of the value of software will alter the software licensing landscape in the future. Most vendors surveyed in this study believe that in order to alleviate this disconnect, customers must improve their disclosure of business requirements so that vendors can better establish value and help customers maximize their investments.

Implications for Channels

Coverage models and the ways in which software companies evaluate and reward their partners are changing as the emphasis moves from volume to value. Indeed, one of the most important trends to watch over the next two years will be the shift from resale-focused agreements to ones based on the partner's ability to influence the customer decision. Influence partners don't sell software, but rather influence sales through their role as trusted advisors to accounts. Vendors that reward this activity are establishing streamlined fulfillment channels that will likely lead to continued pressure on margins for the actual delivery of software while raising the rewards for new partner types, thereby splitting the total compensation package.

The potential fallout of this evolution toward influence programs is staggering. At present, indirect sales channels account for more than 40% of all end-user software spending worldwide. Significant changes to partner compensation models could have a major disruptive effect on the software value chain and divert billions of dollars in software spending to the vendors that are most efficient in matching the needs of end users. According to this study, many of the licensing changes that software companies have made recently impact either the composition of or compensation to their channel partners. Radical swings in programs and compensation policies could disenfranchise vendors from an otherwise loyal partner following.

Financial Community

A software vendor's licensing model has a direct impact on the reporting of revenue. Revenue influences the external evaluation or perception of the health and stability of a given software vendor, yet this study revealed that many software vendors are operating in a vacuum with regards to the financial community.

The software vendors indicated that while the opinion of the financial community is important to manage, it has very little influence over licensing directions. More than half of software vendors reported that financial analyst understanding of their license model has little or no impact on their companies. As one might expect, software vendors with over $1 billion in revenues are more concerned with financial analyst's licensing opinions than smaller software companies; however, only 40% of large
software vendors believe analyst sentiments about licensing have an impact on their company.

In addition, most software vendors think their licensing models maximize shareholder value. In this era of change, 40% of software vendors do not know what impact new and emerging licensing models will have on their shareholders' value.

LANDSCAPE-ALTERING FORCES

The software licensing landscape is in the process of dramatic change such as we have never seen before. According to the study, over half of software vendors have made licensing changes in the last year, and more than half are considering making changes in the next 12 months. In addition, 35% of the vendors that made changes to their licensing models in the last year are also considering changes in the next year. The larger the software company, the more likely it is to consider making changes, which makes sense considering that larger vendors are more likely to have multiple product lines and licensing strategies. IDC has seen a trend of simplification and rationalization within these larger vendors, where acquisitions or decentralized product licensing strategies result in a myriad of licensing models.

IDC believes it is the intersection of several forces (some of which were introduced in the Challenges section of this white paper) in a "perfect storm" that has the potential to alter the software licensing landscape. To recap, these forces include:

- Software vendor desire for more predictable revenue streams
- Software customer desire for more predictable software costs, and greater simplicity and flexibility in software licensing models
- Changes to software customer perceptions of the value of software
- Increasing prevalence of, and interest in, new delivery models such as software as a service and utility computing
- Software vendor drive to increase the level of customer compliance to the terms and conditions of the software license
- Technology dynamics, such as open source, virtualization, or dynamic resource allocation technologies

These dynamics, and certainly others that may be unique to specific software markets or companies, are having a profound impact on the software licensing landscape. In this study, IDC asked software vendors and customers to indicate their opinions on the relative strength of these forces.
Top Dynamics Contributing to Change by Customer and Vendor

Vendors
1. Customer demands for greater flexibility in licensing models
2. Growing vendor preference for more predictable revenue streams
3. Customer demand for greater simplicity in software models

Customer
1. Customer demands for lower software costs
2. Technology dynamics such as open source virtualization or dynamic resource allocation technologies
3. Customer demands for change in software models

According to the study, software vendors believe the greatest impact to licensing models will result from vendor desire for more predictability and the customer desire for increased flexibility and simplicity. Technology dynamics, such as open source, virtualization, or dynamic resource allocation technologies, were least likely to have an impact, according to the vendors surveyed for this study.

Conversely, the customers believe that their demands for lower software cost will play the largest role in contributing to software licensing changes, with technology dynamics such as open source the next most influential factor. It is interesting to note that customers believed that technology dynamics were stronger change catalysts than both vendor desire for more predictable revenue and customer demands for more predictable IT costs.

Disruption in Perspective

In order to identify the disruptive impacts of the forces described above, IDC analyzed vendors and customer responses to the survey questions (see Figures 4 and 5). To read these figures, look at the symbol that is highest up on the y-axis for a corresponding x-axis category of disruptive forces and match that symbol to the effect listed on the key. The higher a symbol on the y-axis, the more likely this cause and effect will occur according to the survey respondents.

According to the results of this survey, customers believe that their demands for lower costs will have the greatest impact on licensing meters, such as per user, per server, etc., while technology dynamics, such as open source and changes to the perceived value of software, will impact the channels through which software is sold. Customers also believe that changes in the composition of the software ecosystem will impact the overall value of software as part of a total solution. This makes sense considering the value of software in the eyes of a customer might differ when the software is delivered as part of a BPO offering versus when the software is provided as a standalone product.
As would be expected, both customers and vendors made a connection between a drive to increase the level of compliance and changes to the way in which software licensing is tracked and monitored.

While the software customers believe that a growing vendor preference for more predictable revenues will impact licensing methods, such as subscription or perpetual,
the software vendors believe that this preference will have the strongest impact on the channels through which software is delivered. Software vendors also believe that changes in customer perception of the value of software, as well as technology dynamics, will impact the value of software as part of a broader solution.

**FIGURE 5**

Vendor Impressions of the Cause and Effect of Disruptive Forces

![Graph showing vendor impressions of cause and effect of disruptive forces.](image)

- Licensing methods such as subscription or perpetual
- Licensing meters such as per user, per device, tiered
- Volume licensing programs
- The overall value of software as part of a broader solution
- The way in which software vendors track and monitor licensing
- The channels through which software is delivered

Note: In this chart "1" is the normal mean, therefore any significant peak above or valley below would show statistically significant interest or lack thereof, respectively.

A: Growing vendor preference for more predictable revenue streams
B: Customer demands for greater predictability
C: Changes to customer's perception of the value of software
D: Drive to increase the level of customer compliance to the terms and conditions of the software license
E: Technology dynamics such as open source, virtualization, or dynamic resource allocation technologies
F: New delivery models, such as software as a service and utility computing
G: Customer demands for greater simplicity in software licensing models
H: Customer demands for greater flexibility in software licensing models

Source: IDC's The Future of Software Licensing: Software Licensing Under Siege, 2004
THE ROAD AHEAD

Future Scenarios

The current software licensing landscape will change dramatically in both the short and long term. The disruptive forces noted earlier, in addition to increased education, will exert great influence in shaping the terrain of the future. In fact, participation in this study has precipitated some of the software vendor and customer respondents to rethink their current licensing realities. Almost half of both software vendors and customers that participated in this IDC study reported that the results have prompted them to consider changing the way that they track software usage. In addition, over 40% of software vendors indicate that they plan on increasing the strategic importance placed on software maintenance, and close to 40% plan on rethinking their revenue mix of subscription versus perpetual license based on the study results.

IDC asked software vendors and customers to indicate the likelihood of several potential future software licensing scenarios. Based on the study results, the future state of software licensing will most likely be dominated by the following:

- Subscription pricing models
- Maintenance revenue
- Pay-as-you-go, utility models and software as a service
- Improved usage tracking by customers

It is also interesting to note the scenarios that vendors and customers consider to be less likely, such as the outsourcing of certain business processes (instead of automating them and running them internally). Only 2% of customers believe that this is a highly likely scenario for their companies in the next year. In addition, customers report it is unlikely their current level of noncompliance will increase, even with the increase in complexity of their environments.

In addition, while 33% of customers believe that it is highly likely that open source will become the underlying platform for their production software environments within the next year, only 20% of software vendors believe that open source licensing standards will be adopted by mainstream vendors by the year 2010.

Subscription Pricing Models

According to the results of this study, both software vendors and software customers generally agree that the software industry is moving toward subscription-based licensing.

In the next several years, the survey respondents from both groups believe this trend will continue. According to the study, 43% of software vendors and 26% of customers believe that, by the year 2010, it is highly likely that the majority of worldwide software revenues will be derived from subscription-based software offerings. The difference in percentages when comparing customer or vendor responses on this issue for software applications, infrastructure, and tools was statistically insignificant.
Considering the overall results of this study with regards to traditional perpetual licensing models, as well as the vendor and customer sentiment regarding the impact of disruptive forces on the perpetual/subscription licensing mix, IDC believes subscription revenue will make a steady climb. As mentioned earlier in this white paper, the study results indicate that subscription licensing models currently represent 25% of total software revenue. IDC predicts that this could climb to as much as 50% in the next two to three years.

**Potential Road Blocks**

The biggest obstacles to the growth of subscription licensing models include the associated challenges for vendors moving to this model. These challenges span operations, sales, product and service development, channels, and financial health. For example, software companies that are used to recognizing perpetual license revenues up front will have cash-flow challenges if they move rapidly to a subscription model. In addition, sales compensation models must be adjusted.

Subscription licensing represents a large departure from the current model, and customers may be hesitant to move to subscription models where it is not clear that the vendor will deliver value on an ongoing basis (i.e., an antivirus software product where the product is only as effective as the last update). Vendors must find ways to continuously provide value to customers such that customers accept a model where they essentially buy into the product every month or every year.

IDC expects subscription pricing models will coexist with perpetual models for some time within vendor and customer environments, and that the rate of growth will vary according to:

- The type of software (e.g., applications, systems infrastructure software, tools)
- Region
- Target market, including company size and industry
- The type of software delivery model offered (e.g., software as a service)

**Maintenance Revenue**

A common belief held in the software industry is that the current maintenance phenomenon is reflective of a weak economy only, and that the license-to-maintenance pendulum will swing back toward license once the economy ramps up again. The results of this study do not support this belief.

The software customers surveyed expect that their spend on software maintenance will increase by an average of 12% from 2004 to 2005. In addition, 42% of this group believes that the percentage of their IT budgets spent on maintenance will continue to increase, while the percentage spent on licenses will decrease. For the additional money spent, software customers anticipate that they will receive additional value, with 44% of software customers believing that software maintenance will become a primary vehicle though which software vendors will offer services such as eLearning.
The vendors that participated in this study share this sentiment, with the aggregate results revealing that most agree it is probable that software maintenance will increase as a percentage of their company's overall software revenue. In addition, 27% of software vendors indicated that it was highly probable that in the next year, their company's mix of license and maintenance revenues will dramatically shift with maintenance revenue representing an additional 10% or greater amount of total company revenue as compared to the previous year.

According to the vendor community, this increase will be due, in part, to additional services offered within maintenance. Of the vendors surveyed, 25% responded that it was highly probable that within the next year, their software maintenance offerings would include services such as eLearning, home-use rights, and training, rather than just an update or upgrade insurance policy.

The elevated importance of maintenance to vendors means that a direct sales approach for maintenance renewals will become more prevalent. Most vendors believe it is probable that they will increase their investment in influence programs to focus partners on seeking out new deals while increasingly taking license and maintenance contracts directly, with 20% of software vendors saying this is highly likely in the next year.

**Potential Road Blocks**

As mentioned previously in this study, a barrier to increasing the cost of software maintenance is customer resistance to the idea of paying for upgrades that they don't believe they need. In order to increase maintenance revenues, software vendors must place a premium on understanding the components of maintenance that are most valuable to customers, and determine whether customers are willing to pay more for this value than they currently are.

Adding new features and services may result in a customer willingness to pay more for maintenance, but according to this study most customers buy maintenance as an insurance policy and for access to bug fixes and updates to items that cease to function or are out of date. These services are already offered as part of typical maintenance agreements. Customers place less of a premium on some of the services that vendors have or are considering placing into the maintenance offering, including advice on how to use the software and derive benefit from it. This will make it difficult for vendors to justify increasing their maintenance fees.

**Pay-As-You-Go, Utility Models and Software as a Service**

Another trend that is supported by both software vendors and customers is an industry move toward utility models and software as a service.

Utility models have a strong following within the customer respondents — 30% believe it is highly likely that the software industry will move toward a pay-as-you-go model in the next year. It is interesting to note that customers believe this scenario is more likely to occur for software applications than tools or systems infrastructure software, with 35% reporting that utility is highly likely for applications. Vendors were slightly more bullish, with 47% reporting that they believe the industry will move
toward a utility model in the next year. Like the customers, vendors believed this trend was strongest within the applications industry.

Software as a service has less support than pay-as-you go utility models, which is very interesting considering software as service models are more prevalent than utility models today and therefore have greater momentum than utility models to fuel proliferation within the next year. While the general customer sentiment is that demand for and adoption of software as a service will increase in the next year, only 11% believe that this is highly likely. Vendors also generally agree that software as a service will proliferate, with almost 30% indicating a belief that this is a highly likely scenario.

**Potential Road Blocks**

A major hurdle to utility software models is the lack of availability and implementation of systems that accurately track usage for the purposes of real-time assessment and billing. While homegrown systems exist in limited fashion on both the customer and vendor side, most will not support the requirements and complexities of a pay-as-you-go model. Third-party systems are available and suitable but are not widely deployed.

Customer concerns about unpredictable IT costs are another hurdle to the acceptance of pay-as-you go models. In some cases, where customers don't have a handle on usage or where usage is subject to wide variations, utility pricing won't make sense from a cost perspective. In order to make a decision, customers must evaluate their usage patterns—a difficult task considering again the lack of tools within most customer environments to do so.

Software as a service shares some similar challenges, although licensing models can be perpetual, subscription, or pay-as-you go depending on the vendor and the delivery model. Cultural hurdles, fear over lack of control, and lack of a trigger event to force a decision on how to better manage software top the list of adoption challenges.

IDC believes that within the next few years, absolute dollars spent on software as a service will be greater than those spent on pay-as-you-go software models. However, given the vendor and customer sentiment, there is sizable interest in utility computing and several reasons why this model makes sense for vendors and customers. Pay-as-you go models will proliferate, but challenging technological, operational, and cultural hurdles (similar to those that software as a service models have had to overcome in the last five years) will keep spending at unimpressive amounts, at least for two to three years.

**Improved Usage Tracking by Customers**

This study has revealed a market need for tools to improve the level of intelligence that customers and vendors have on how, what, when, why, and where software is used. This intelligence could be used to give customers better visibility on how much software they should buy and what they should pay. Vendors will gain knowledge on which aspects of their software offerings are most valuable to customers and which are purely shelf ware.
One-third of the customers surveyed indicated that it is highly likely they will begin to collect more accurate data on their software use to help guide purchase decisions, while 26% of software vendors expect customer negotiation power will increase as a result of more accurate data collection.

Twenty-three percent of vendors strongly agree that in the next year customers will begin collecting more accurate usage data to guide purchase decisions and increase negotiating power.

**Potential Roadblocks**

Again, the availability of technologies is a stumbling block. While customers and vendors generally agree that there is a trend toward better intelligence on software use and stronger customer negotiation power, they are lukewarm on the adoption of tools to enable this. Customers are unsure as to whether or not there will be rapid adoption of tools to track software usage (19%), and they don't believe that in the next year there will be technologies available to control or more closely monitor use of software (although these technologies exist today).

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**IDC Recommendations**

This IDC study is designed to provide the reader with details on the current software landscape, insight into how and why this landscape is changing, and a glimpse into the future. The next step, of course, is an answer to the question “how do I get there from here?”

The destination and the most appropriate path will depend on the unique motivations and characteristics of the individual. However, the following advice is appropriate for all travelers, regardless of where they are headed within software landscape.

- **Do not underestimate the importance of providing continuous value.** Whether a vendor is looking to move toward a subscription licensing model or make changes to a volume licensing offering, it is extremely important to understand the value. Vendors will need to win their customers over with this value everyday and give them a reason to continue to spend money on their software.

- **Don't be an ostrich — but don't be a "Chicken Little" either.** Software vendors that bury their heads in the sand and refuse to acknowledge the changes that are all around will find an unfamiliar — maybe even hostile — landscape the next time they look up. Vendors should closely monitor landscape changes and the reasons for them, even if they aren't making modifications to their own licensing strategy. At the same time, the sky isn't falling down. Traditional and emerging licensing models will coexist for many years. The key is to determine which is most appropriate for the customer, the product, and the vendor.

- **Be aware of your impact on the environment — and its impact on you.** Software vendors often make licensing decisions in a vacuum, without fully...
considering the impact of these decisions on the channel, customers, and financial communities (not to mention their impact on other aspects of the software business models). In addition, vendors do not fully understand the potential positive and negative impact that these groups can have on software revenue if licensing models do not suit them. As the expression goes, “think globally, act locally.”

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