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Secrets to Successful Partnering

Insight from Industry Leaders



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Can Open Source put you out of business?

Can Open Source Put You Out Of Business?

As a CEO, you are always concerned about a technology that lies within your peripheral vision, then roars into center view, smacks you in the face and puts you out of business. Is Open Source such a potential threat? Yes, it is.

On the "Strategy & Leadership" forum on www.softwareceo.com, which I moderate, someone posted this question: "As you are aware, open source software depends on volunteer development. Some companies do not care if their employee writes code for open source during work hours. How do you react to this issue?" This counter-intuitive question-why would you ever have someone work on something that doesn't contribute to your business?-led me to wonder, as a CEO of a "traditional" software company, what would I do about Open Source.

So for the past few months, I have conducted intensive research into this subject, reading dozens of articles, delving into these two wonderful and recommended books, Donald Rosenberg's *Open Source: The Unauthorized Papers* and Martin Fink's *The Business and Economics of Linux and Open Source*, and interviewing the following people, who I thank for their help in preparing this column:

- Joe Alsop, Founder and CEO, Progress Software
- Karen Copenhaver, Partner, Testa, Hurwitz & Thibault, LLP
- Marc Fleury, Founder and CEO, JBoss, Inc.



SECRETS TO LONG-TERM SUCCESS Insight From Brian Turchin

- Greg Gianforte, Founder and CEO, and Alan Rassaby, General Counsel, of RightNow Technologies
- Roger Heinen, Managing Director, Flagship Ventures
- Dan Kusnetzky, Vice President, System Software Research, IDC
- Douglas Levin, Founder and CEO, Black Duck Software
- Alex Pinchev, Executive Vice President, Worldwide Sales, Red Hat
- Donald Rosenberg, president, Stromian Technologies

Open Source Is A Disruptive Technology

There are five reasons why I conclude that Open Source is a disruptive technology.

1. The "Practical Majority" Is Adopting Open Source - Geoffrey Moore in his famous book *Crossing The Chasm* wrote about how adoption of a new technology by "Innovators" and "Early Adopters" is absolutely no guarantee of success. You must cross the "chasm" to reach the "Early Majority" of buyers, or, like AI many years ago, the new technology will die. Open Source has crossed the chasm.

A March 16, 2004 Forrester Research report, "Open Source Moves Into Mainstream," found in its survey of 140 large companies in North America that 60% are adopting open source-which is not just Linux, but other Open Source software such as Apache, MySQL, Tomcat, and Perl/PHP/Python--and, of those, 53%, a surprising number, are using Open Source for mission-critical applications.

2. Open Source Businesses Are Becoming Successful Businesses - How can software be "free" and be sold, at the same time? Seems like a contradiction in terms. That's on the surface. But as you dig deeper, it becomes clearer how Open Source Business models work, and, in some ways, they are not much different from traditional software businesses.

Red Hat Recently Concluded Its First Profitable Year - Red Hat is the bellweather Open Source company. In fiscal 2004, Red Hat turned in its first profitable year with a very healthy net margin of 11 %, making a net income of \$14 million on \$126.1 million in revenue. And interestingly enough the stock market thinks Red Hat is a red-hot growth company raising its market capitalization to \$2.6 billion for an Internet-bubble type revenue-to-market cap ratio of 1 to 23. More established, well-thought of companies have a range of revenue-to-market cap ratio from 1 to 4 or 1 to 8.

The Services/Support Open Source Model - If you think of a software company traditionally having three revenue sources--license fees, maintenance/support services fees and consulting fees--Red Hat omits the first and concentrates on the last two. In particular, they concentrate on something we all do, the recurring revenue of the maintenance/support services, except they use an annual subscription model--which had a very impressive 72% growth rate from 2003 to 2004.

The Dual License Model - In an interesting business model twist, MySQL AB, a private, Swedish database software company, acts both as an Open Source company and a "traditional" software company. It owns the copyright to the MySQL software just like a proprietary software company. If you use MySQL, the database software product, internally, you can use it under the Open Source General Public License. But if, as a software company, you want to incorporate it in your product, then you need to buy a commercial license. So, on one side, it earns money like Red Hat, selling annual support subscriptions for an Open Source product, and, on the other side, it gets license fees just like a "traditional" software company.

3. Open Source Can Rapidly Commoditize and Threaten Existing Leaders In A Market - It's common knowledge that Linux, first released in 1991, has commoditized the Unix software market. According to Dan Kusnetzky, IDC's VP of System Software Research, "the Unix software market has been shrinking while the Linux has been growing along with the market." And we know that Sun Microsystems with its proprietary Server and Solaris operating system has been hurt since Linux runs on "cheap" Intel boxes.

But in an indication of the potential speed to market impact an Open Source product can have, Marc Fleury, founder and CEO of JBoss Inc., created and released the JBoss Web Application Server as Open Source code just three years ago in 2001. Yet this open source product is already having a market impact. In a survey by BZ Research, the use of its JBoss in enterprises from 2002 to 2003 nearly doubled from 13.9% from 26.9%. And according to Kuznetsky, it is knocking on the door of its formidable rivals BEA with its Weblogic web application server and IBM with its Websphere. And the Forrester Research report, cited earlier, found to its surprise that there are more enterprises that "plan to use it than use it today."

4. "Traditional" Software Companies Already Finding Value In Using Open Source - RightNow Technologies is a \$35.9 million provider of on-demand customer support software solutions that on May 14, 2004, just filed an S-1 in preparation for its initial public offering. Greg Gianforte, Founder and CEO, said using Open Source, "is fundamental to his business for two reasons. First it provides an economy of scale with our hosting platform. We host 850 active customers and served over 100 million on-line customer service sessions in the first quarter of this year. With the Open Source platform we get economies of scale that drive our infrastructure cost to a single digit percentage of revenue...And second, we embed Open Source components, using the appropriate Open Source licenses, in our application. It's allowed us to speed the development of new product capabilities to the market."

Joe Alsop, CEO of Progress Software, a \$309 million public software tools company, saw opportunity in Open Source creating a subsidiary, NuSphere, that provides Open Source products and services such as

PhpED, which provides a PHP development environment. Commenting on the value of Open Source, Alsop, who started his business in 1981 with the notion that there has to be a better way to build software, said the following: "There is too much software, too much functionality that has been coded a hundred, a thousand, ten thousand times over. We need more reuse... Open Source gives you a chance to take a well-tested piece of code used by a lot of people and build on top of it.. This has tremendous advantages for the industry and for the society. For the industry, it will allow smaller companies to add value in particular niche areas. For society, it will produce a better quality product."

5. "Traditional" Software Companies Are Open-sourcing Their Software - Two recent announcements reveal that large vendors are open-sourcing their own software, exploring how doing such can help them create new value. BEA, a \$1 billion public provider of infrastructure software, recently announced that it will release source code for Workshop, its developer environment. Alfred Chung, Chairman and CEO, said the following: "We open-sourced Workshop to work with Tomcat(an open source Webserver), and Tomcat has a huge contingent of developers.. Once you do that, Tomcat users can become Workshop users, and then they can become Weblogic[BEA's web application server] users."

In May, Computer Associates announced it would release the source code for its Ingres database product for Linux. According to Mark Barrenechea, CA's senior vice president of product development, "Overall, Computer Associates' goal is to tap into the broad open-source development community and create a "stack" of open-source software specifically tuned for management."

Open Source Is Still Not A Slam Dunk

Despite these new developments, Open Source is no slam dunk. Although it gets easier and less troublesome as time goes on, it still has its own set of issues.

The biggest and most confusing issues concern intellectual property. As an example of what can go wrong, last year CISCO ran afoul of the major Open Source license, the General Public License(GPL). In June, 2003, it bought Linksys, the maker of wireless gear for the home market, for \$500 million. Linksys made a wireless Wi-Fi router which sold for \$129 and had been a smash hit, selling 400,000 units in the first quarter of 2003. But this router used Linux which is licensed under the GPL. The Free Software Foundation, which controls the licensing process for Linux, said that the firmware based on Linux was a "derivative" work. It threatened CISCO with a law suit and said that either CISCO provides the source code for all of the "derivative work," the source code in the firmware, or rip out the Linux code. CISCO ended up open-sourcing all of the firmware source code, which it now publishes on the Linksys site.

As another example of what can and does go wrong, Karen Copenhaver, a partner at law firm Testa, Hurwitz & Thibault, who is an expert in Open Source licenses, describes the following risk to venture capital firms with software companies in their portfolio.

"One of the investor's portfolio companies is a potential acquisition candidate, with a term sheet negotiated and signed. The acquirer begins its due diligence with an inquiry in the origin of the company's technology, conducting interviews with the development team and running code-scanning tools to identify embedded copyright and license notices. After a few days, the acquirer informs management of the erstwhile target, to its great surprise, that the company's developers made inappropriate use of "open source" software program obtained over the Internet in developing the company's products. The acquirer tells management that it has serious concerns about the impact of these problems on the proprietary nature of the company's code, and that there is already a significant decrease in the acquirer's perceived value of the company's technology. With due diligence review just begun, the negotiating leverage of the parties has quickly tilted away from the target."

There are also surprising challenges working with the Open Source community, even when those in the community are very willing to help. RightNow Technologies wanted to use HtDig & LibHtDig, open source code for a WWW Search Engine. The issue, though, was this code was licensed under the General Public License which, as we saw earlier, can cause you to open-source proprietary code that you don't want open-sourced. But there was a solution. Alan Rassaby, General Counsel, Vice

President of Legal and Risk Management, judged they could use another license, the Lesser General Public License (LGPL) which has less onerous provisions. One problem. Exactly who in the open source community do you get to agree that Rightnow Technologies can use the LGPL license? Rassaby solved this problem by working with the HtDig Open Source community. He helped them formalize their not for profit association by developing by-laws, meeting procedures, a Board of Directors, etc. Then having identified 200 or so members in the association called for a member vote on whether RightNow would be allowed to use the LGPL license, which they did.

What To Do Now

Regardless of these challenges, Open Source is turning our industry upside-down, causing all of us to re-think how we run our business. So it makes sense to get educated, to discover how Open Source can help you and to plan ahead so Open Source doesn't hurt you.

Get Educated

When a new technology emerges, I remember the tale of WordPerfect Corporation, who, in 1990 had 80% of PC-based word processor revenues with its namesake software product. In 1991, Microsoft released version 3.0 of its Windows 3.0 operating system and conquered the desktop world. While Microsoft was developing its competing product, Word, Wordperfect Corporation took two years to learn the Windows operating system and new Graphical User Interface. By the time they went to market with its Windows operating system version, it was too late. They lost their market to Microsoft's Word product, never to regain it.

Keeping this mind, start an Open Source pilot project. There is nothing like first-hand experience. The insights gained will give you a better perspective on the value of Open Source.

In addition, train your IT managers and programmers on the business risk Open Source poses to you. Since as we know lawyers and programmers tend to speak two different languages, Copenhaver recommends a two-phase training program. First train the IT managers so they are on board with your policies. Then, have the IT managers educate their own programming staff.

Explore Ways Open Source Can Help

Provide New Growth Opportunities - Dan Kusnetzky, IDC's VP of System Software Research, says "in any category of software market that he tracks, if there is an Open Source product, it is the fastest growing product in that segment." So he "advises software companies to look at software for the Linux platform and Open Source markets as a potential growth area for their business, an area where it might be wise to invest their R&D dollars."

As an example, LogicLibrary, a Pittsburgh-based private company, just broadened their product line. With the advent of web services and the Service-Oriented Architecture(SOA) there is a coming avalanche of software "objects." LogicLibrary saw a need for these "objects" to be managed, especially since reuse would provide a real value. So they developed Logidex, which treats software as an asset that can be managed like any other asset. On May25, 2004, they extended their product line by announcing a new product add-on which helps ensure compliance with Open Source licenses.

Cut Development Cost and Speed Products To Market - Going beyond the pilot, expand the use of Open Source in your product. Roger Heinen, managing director, Flagship Ventures, past Senior Vice President, Developer Division of Microsoft and Senior Vice President of the Software Division at Apple Computer-makes this fundamental point: "Open Source allows you to use a much bigger and broader toolkit to pull together a development project. It used to be that to build a software product, you could assemble tools from maybe a dozen vendors. Now there are 82,000 Open Source projects on Sourceforge.com. So the chances of having to start from scratch are very low." Code reuse saves you dollars and speeds your product to market, as we discussed with RightNow Technologies' use of Open Source earlier.

Explore The Value of Open-sourcing Your Own Proprietary Code - Just as BEA and Computer Associates are doing, it is time to explore new ways of thinking about how open-sourcing your own proprietary code can help you. Martin Fink, in his book *The Business and Economics of Linux and Open Source* provides one example. Since you still must sup-

port customers when are you are ending the life of a product, it might make sense to open-source your product and build an open-source community around your code. Even with your open-sourced code, you could still derive revenue by offering a maintenance/support contract.

Plan Ahead So Open Source Can't Hurt You

Establish A Software Adoption IP Review Policy - When starting your pilot project, establish an open source notification process. Gianforte, who as I mentioned before uses Open Source software, explained "We have an internal process where a lead individual in our engineering group works closely with our general counsel. Before using Open Source software, our developers must get approval from both the R&D Open Source representative and from the general counsel. Prior to every major release, we audit the software to ascertain whether components have been used, whether we have the appropriate Open Source licenses, and whether we reposted our Open Source modifications back to the Open Source community."

Further Rassaby, RightNow Technologies' legal council, in sending me their detailed written notification policy and flowchart, pointed out that their policy is not just for Open Source software but for third party software as well, which might have its own license issues.

Check Whether You Unknowingly Have Open Source In Your Product - Programmers, without realizing the potential threat to your business, may have already used Open Source software in building your software product. To find out, use software such that offered by Black Duck Software, www.blackducksoftware.com, which not only scans your source code looking for copyright notices, but also compares your source code to the Open Source code it has in its own very large library of Open Source software. After scanning, it provides you with a list of potential problems which you can investigate and resolve.

Watch Out For Open Source Competitors - The Open Source software development process has the potential, like with the JBoss web application server, to field a competitive product rapidly.

It can do this because of the following. Normally, "users" are non-technical business personnel. But with Open Source, "users" are technical who can play two roles: that of "users" but also that of "developer." As such, having access to the source code, they not only can give you the appropriate detail to solve bug fixes, which business end-users have a hard time doing, but they can actually make bug fixes themselves. Further, not only as "users" can they make worthwhile suggestions on how to improve the software, they can make these improvements themselves. Combine this with Metcalfe's law "the usefulness, or utility, of a network equals the square of the number of users," where the Internet has vastly grown the number of "users", and you have an engine for the rapid development of bullet-proof software.

So, especially if you sell broadly-used middleware software, scan the horizon for potential Open Source competitors.

Final Thoughts

In my research, one question came up over and over again: "Is Open Source good or bad for our industry?" On the one hand, not unexpectedly, we have Steve Ballmer, CEO of Microsoft, who said "Linux is a Cancer" and "it is an intellectual property destroyer." (This was gleefully reported on Red Hat's web site!)

On the other hand, Richard Stallman, the father of the "Free Software" movement says it is a natural right that software should be free: "For beings that can think and learn, sharing useful knowledge is a fundamental act of friendship. This spirit of goodwill, of helping your neighbor voluntarily, is sciences' most important resource. It makes the difference between a livable society and a dog-eat-dog jungle. I think this is the most important reason software should be free. We can't afford to pollute society's most important resource. It's not a physical resource, It's a psycho-social resource, but it's just as real for that."

Added to this, I can certainly imagine a doomsday scenario. If you are old enough to remember when Atari came out with the first electronic game, Pong, you might also remember that Atari didn't own the rights to the cartridge design used in its game machine. After Atari grew rapidly to a multi-billion dollar company, discounters appeared, hoping to get in on a hot rapid growth marketplace. But eventually, with too much competition, discounters dropped the game cartridge price so much that the profit was sucked out of the gaming industry and it collapsed. Could Open

Source's software product commodization suck the profit out of our industry in the same way, destroying it?

But, after my research, I have concluded that Open Source is a vibrant and positive challenging force in our industry. As Alsop said, "It focuses all of us on searching for and providing value to our customers." Talk to those in the Open Source movement and you can sense the heady excitement that existed during the early days of microcomputers and the Internet, that sense of possibilities, of new and original thinking, of mission, and of sheer fun.

However, no one knows what the future will be. You can't afford to wait and see what will happen. Take action, now, to understand and deal with both Open Source's opportunities as well as its threats.

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