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Clouds Looming for Server Software Vendors

Cloud computing challenges server software vendors to create new pricing models. The first step is to divorce software from hardware

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As cloud computing moves beyond startups and attracts enterprise users, major software vendors are being forced to reckon with a new challenge to their pricing models. Already the emergence of software as a service has caused many large software vendors to evaluate existing licensing models that charge a set price for each software package copy running on a machine. Now the emergence of cloud computing is pressuring top server software vendors Microsoft (MSFT), Oracle (ORCL), and IBM (IBM) to adopt a subscription-style type of pricing.

The issue is similar to the battle that raged years ago when corporate customers started buying servers with multiple processors. Prior to that, vendors sold software on a per-core basis, so a customer who paid $20,000 for a copy of Microsoft's software for a single-core machine was hit with a $40,000 licensing cost when he upgraded to dual-core servers. With virtualized servers, where several virtual machines can exist on one server, such math becomes more complex and can lead to even higher prices, a situation Microsoft tried early on to alleviate with a new pricing model.

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ADAPTING BUSINESS MODELS

As Microsoft, Oracle, and IBM adapt to the cloud business model, they're likely to see their software licensing revenue drop. How they will manage this is part of a new report from research firm TechAlpha that looks at how virtualization will affect industries ranging from software to storage. George Gilbert, co-founder and principal at TechAlpha, says Microsoft has been fairly advanced with its licensing efforts in the cloud, while Oracle seems to be lagging.

"The new principles of pricing with the ultimate destination of software in the cloud requires two things: capacity on demand and something that's divorced from the physical infrastructure," says Gilbert. "The idea that you install software on a box and it lives there for the useful life of the server is increasingly less relevant."

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This won't just apply to public cloud providers such as Amazon.com (AMZN). Enterprises will undoubtedly build their own clouds of virtualized computing power, in turn making the shift more painful for vendors such as Oracle, which currently has a limited offering on public clouds. Gilbert estimates that about half of Oracle's licensing revenue could be affected by this shift to subscription-based licensing.

DIVORCING SOFTWARE FROM HARDWARE

The solution seems to be divorcing certain software products from the hardware, and charging for it either on a per-instance basis as part of a computing cycle or based on a percentage of use for a specific amount of time. Because a customer can add capacity by moving a software product on a virtual machine to a bigger server for a temporary spike in demand, customers will demand the ability to pay for increments of both time and capacity. As customers measure their consumption, they can adjust their subscription each quarter.

As customers purchase less software up front, the move toward a subscription model will lead to a shift in the way vendors recognize revenue. The costs of building the software will stay the same, but the amount of time it takes to recoup that investment may stretch out longer. Revenue may also decline.

Gilbert points out that most corporate customers buy servers in anticipation of growth, rather than based on what current needs. Because software licenses are tied to those physical servers, customers are also buying more software than they need up front. With cloud computing enabled by virtualization, customers may spend less on both. It looks like in addition to open source, shrinking IT budgets, and competition from software-as-a-service companies, the big software vendors will also have to keep an eye on those looming clouds.

Provided by GigaOm—