Industry Pundits: Move to SAAS Is 'Permanent'

May 1 2007

The transition from packaged software to software as a service is well under way and will be a permanent change, speakers said at the New Software Industry conference.

The move away from the traditional packaged software model toward software as a service, with all its associated new business and revenue models, is a permanent one, speakers said at the New Software Industry conference here on April 30.

"Prices will likely eventually go to zero for any standardized software product but, fortunately, the industry has found other ways to make money off software, Michael Cusumano, a professor at the MIT Sloan School of Management, said in a presentation titled "The Changing Business of Software."

While software product companies tend to have a given life cycle, there is now a different evolution curve, from product and process innovation to services. "Product platform disruptions are generating new services and business models," Cusumano said.

There are currently 200 software firms listed on U.S. stock exchanges, which is half of the 400 peak in 1997. The number of publicly listed IT services firms is also sharply down over the past five years, indicating more maturity in these markets, he said.

While only 20 percent of Web-based enterprise software vendors are

publicly listed, Cusamano noted that the number of companies offering Web-based software is on the rise.

"There are also new business model dimensions, with all sorts of new revenue models, including subscription and advertising based ones. So, is this rise in services and business models temporary or permanent?" Cusamano asked.

"The temporary argument goes that we are in a transition phase between the platform and business model innovations, while the permanent argument says that software is not commoditized and prices will fall close to zero and the future is SAAS - software as a service - , where it is free, but not really free as it is supported by advertising or indirect revenues, and that other commoditized high-tech industries will follow," he said.

Cusamano told the audience that the answer depended on the time frame being considered going forward, but that he believes the change is permanent.

But he also pointed out that while services contributed to the profits of software product companies, this contribution is not linear, with sweet spots at the low and high ends of the spectrum.

"Services at the lower end make products attractive, but also have lower margins and can hurt profits when they become too important," Cusamano said.

Investors also placed too much value on products over services at product companies, Cusamano said, adding that "they - investors - don't seem to fully understand the value of services. There are sweet and sour spots where and when services increase the performance of most product firms, but the benefits and negatives vary by product category."

But Cusamano said that most software product firms could, and should, exploit services. Managers should plan to take advantage of the sweet spots and not let services just happen to them over time.

"Hybrid firms need to keep their products as the engine that drives services and maintenance. They also need to look at how best to 'servitize' their products, to find the special value and revenue opportunities, and to use services to make their products less commodity like," Cusumano said.

Ray Lane, the managing partner at venture capital firm Kleiner Perkins Caufield & Byers, said the landscape for enterprise software has changed. There are now more than 1 billion Internet users, with consumer-based Web 2.0 applications also now migrating into the enterprise.

"This has bifurcated the industry into category leaders and innovative startups, which represent less than 10 percent of the total number of companies in the software industry, while the rest are trapped in a no man's land," Lane said.

But both groups have an advantage in terms of research and development. Startups have disruptive innovation and the category leaders have continuous innovation, he said.

Lane said that while the notion of SAAS may sound trite, it is here to stay. "It is going to go much, much further," he said.

While companies like Oracle and SAP have included SAAS as part of their model, it has been very difficult for them to take all their product versions and the architectures with which they were built and make these available as services. "It would take 10 years to convert them all to a full services model," Lane said.

Next up was Timothy Chou, who helped Oracle set up its "on-demand" business and who also authored the book "The End of Software."

"We are in the midst of a huge transition and SAAS has already happened. You may not have noticed or realized this as yet, but it has," Chou said.

The traditional revenue and business model for software has already transitioned, Chou said, noting that the cost for delivering software to a user for an auctioneer, such as eBay, would have cost $100 a user a month under the traditional model.

That cost dropped to $10 per user under SAAS, and to just $1 over the Internet.

"This move to SAAS is hugely transformative if you look at the economic implications of the shift. But we are far from done with this in the software industry," Chou said.

Specialization would be a huge influencer going into the future; games are important; and service also mattered, Chou said.

"Why does specialization matter? Nobody ever had to take a class on how to use Google as Google set out to do just one thing: search. So, specialization has huge implications for how software is designed and delivered in the future," he said.

In the future, authors will write specific, specialized, localized software. "Did you know that Citibank has more programmers than Oracle? The future looks like tons of vertical, specialized applications," Chou said.

Service is important as it is the discovery of known information. "The information is there. The surface Web, what you see and find on Google,

is 100TB. The deep, deep, deep Web, which includes proprietary corporate knowledge, has more than 1 million terabytes and, so, new ways are going to have to be found to make this available. This is an amazing amount of information," Chou said.

Going forward, innovation will come from places we have not yet seen. "We are somewhere between infinity and beyond," Chou said.

Copyright 2007 by Ziff Davis Media, Distributed by United Press International