Software Licensing 2016:
Seismic Shifts – Shaky Foundations

As Revenue Models Shift –
Not All Software Producers Are Ready for the Shakeup

FLEXERA SOFTWARE

Software Licensing 2016: Seismic Shifts – Shaky Foundations

Key Trends in Software Pricing & Licensing Survey – 2016 Report

Software Licensing: The Foundation of Everything

Software licensing and monetization are the foundation for making money in the entire software industry. Traditional software vendors and developers of the software apps that power intelligent and Internet of Things (IoT) devices – all depend upon licensing to monetize and protect their intellectual property. And when it comes to Software Monetization, the enterprise software marketplace is in the throes of a seismic shift.

To respond to new technology and customer requests, numerous options now exist in pricing, delivery and monetization. Failure to understand and implement these options will result in a weakened business foundation – diminishing a producer's ability to compete. In contrast, by taking a strategic approach to pricing and licensing, producers can create a flexible but strong foundation for their business, driving revenue growth and differentiation even as the software market shakeup continues.

Successful application producers understand that treating licensing and pricing as an afterthought would be detrimental to their business. They already have purpose-built Software Monetization technology in place which supports all their business models today and in the future. This enables producers to create a strong foundation that aligns business goals with software operations.

As we checked in on the key trends and practices in our 2016 Software Pricing & Licensing survey, two interesting themes emerged:

- Technology is driving seismic Software Monetization shifts in the industry
- Contradictions emerged regarding the effectiveness of some Software Monetization approaches – leaving some producers more vulnerable than others

Let's take a deeper look at the key software monetization, licensing and pricing trends of 2016.

The Perpetual Software License Is No Longer the Foundation for a Sound Revenue Model

While perpetual licensing remains a core software licensing model – it is no longer the sole revenue foundation for a healthy, thriving and growing application producer. New licensing models are on the rise. Software producers recognize the flexible appeal to customers of consumption models like pay-per-use and pay-for-overage models. And as cloud applications expand, the use of subscription models continues to grow.

Today, less than half – only 43 percent – of producers report that perpetual licenses contribute one half or more of their revenue. Moreover, when asked about plans in the next two years, respondents indicated a significant shift towards the use of new models, such as consumption-based models (42%) and subscription/term licenses (30%).

In the next 18-24 months, in what ways will your licensing strategy need to change?

42%	Add consumption-based models (pay-per-use, pay-for-overage)
30%	Add subscription/term

The reasons producers are making these changes? To make more money, compete more effectively, and better meet customer needs.

The Ground is QUAKING

56 percent of respondents changed their licensing and pricing models in the last 18-24 months. **And the rate of change is accelerating. 70 percent plan on making changes over the next two years.**

TOP 3 REASONS PRODUCERS CHANGED THEIR POLICIES:

1. **Generate more revenue**
2. **Respond to competitive dynamics**
3. **Improve relations with customers**

WHY DOES THIS MATTER?

Software pricing and licensing represent the art and science of maximizing customer value and capturing that value through revenue. Application producers need to provide the right model for their customers in the preferred environment and get paid for delivering that utility. If they don't, customers will find other solutions whose licensing models better align to how they want to use software.

As the use of new licensing models continues to expand, the foundation for how producers make money and monetize is shifting, leaving vulnerable those producers that have inflexible business models. Many producers are taking a step back and reevaluating how to drive predictable, recurring revenue streams with a mix of legacy and new solutions.

As noted, perpetual licenses still constitute a large share of the software market. However, with the growth of SaaS (Software-as-a-Service) and cloud, many producers are adding subscription licensing and consumption/usage models into their go-to-market strategy.

These models enable producers to withstand the shockwaves of change occurring in the software industry by enabling revenue growth, predictable and recurring revenue streams and flexibility to meet customer needs. Furthermore, offering a variety of licensing models allows producers to pursue new market segments in situations where the large up-front cost of a perpetual license may not resonate with customers.

Software Licensing Shockwaves: Cloud, Virtualization & Mobile

Enterprises' software consumption requirements have shifted well beyond traditional installed software. Most organizations are deploying applications in virtual environments. While virtualization is attractive for enterprises, it poses a potential for revenue loss for producers, such as when an enterprise clones a virtual machine and multiple environments.

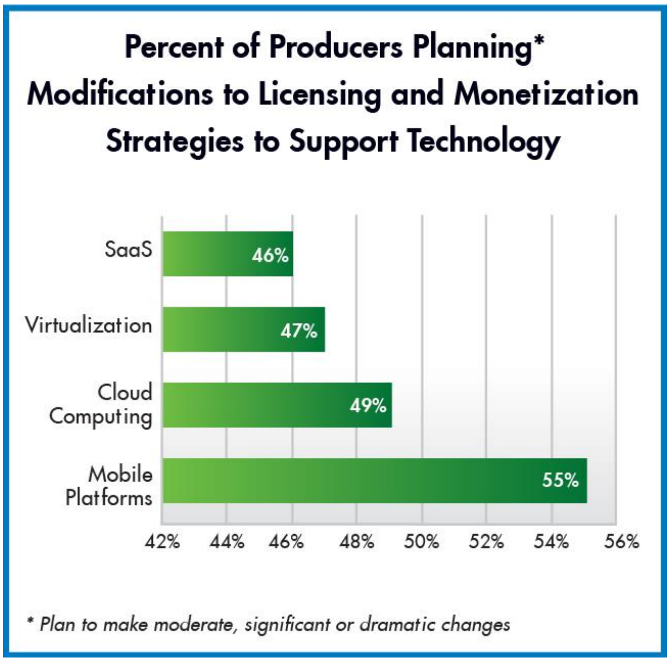
In addition, many enterprises are moving to cloud software deployments, which offer flexibility for enterprises and reduce the traditional maintenance burden. Many producers are responding by enabling cloud deployments of their software in addition to traditional on-premises deployments. Further, many "modern" apps have gone straight to the cloud with no on-premises installation option.

All told, enormous shifts are occurring in the enterprise software market based on the growing strength of the enterprise customer's voice.

FAST FACT

More than a third of respondents (36 percent) say less than half their applications are delivered as traditional installed software.

It's no surprise that these seismic shifts are also reflected in the data as producers plan to modify their Software Monetization strategies to capitalize on SaaS, virtualization, the cloud and mobile:



WHY DOES THIS MATTER?

What's behind this seismic shift? Enterprises increasingly want to align their software investment with the benefits received, and a perpetual license model is losing favor. A perpetual software license requires higher upfront costs, which some organizations have difficulty justifying before the software has proven its value.

As new models shift the very foundation of the software industry, software makers should carefully weigh options and identify a plan that will absorb the shock and ensure their continued strength. A good 4-part plan would include:

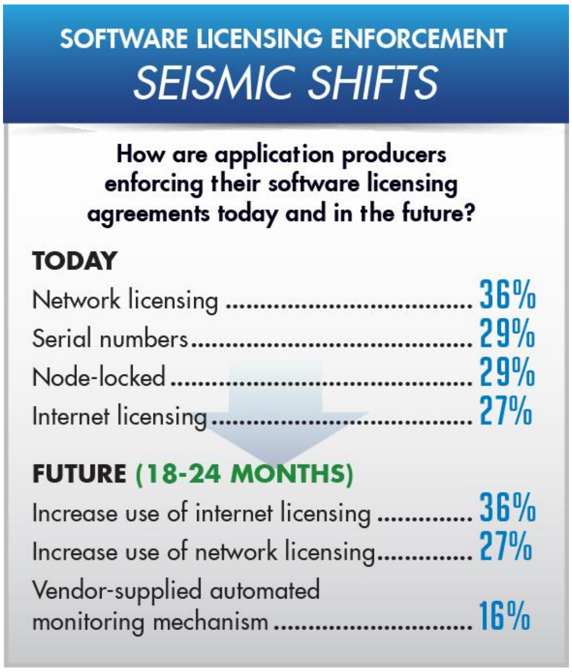
1. A clear definition and comparison of software monetization models
2. A business case for adopting or adding new models
3. An analysis of whether a variety of licensing models offers greater monetization potential versus just a single model
4. A detailed examination of operational considerations and impacts

This discovery and definition process helps an organization navigate the hundreds of different types of software licensing models available today to select those that offer the highest impact and best fit.

Calm amidst the Commotion: Licensing Flexibility

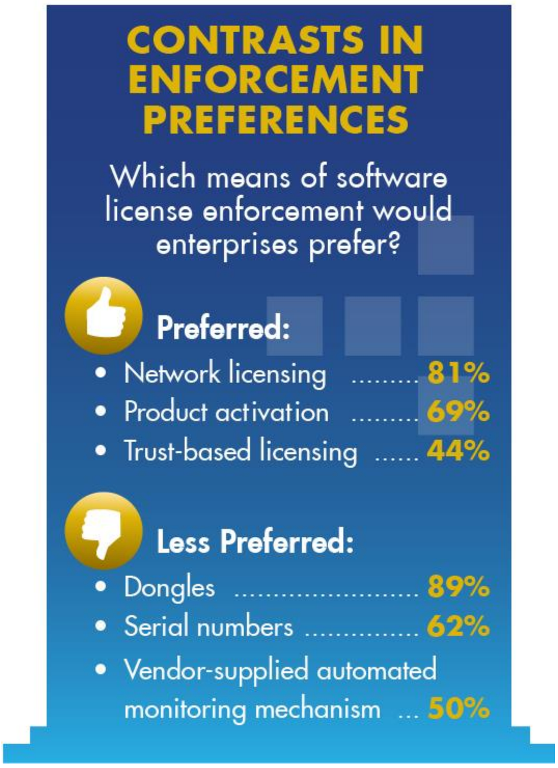
Software licensing plays an important role in growing producers' revenues – even while the very foundation of the business model is shaking. Licensing protects intellectual property while enabling producers to monetize it. Producers must determine the best path for monetization and compliance across a broad spectrum of options—from strict enforcement to a more lenient usage-based, trust but verify approach. The best approaches work flexibly and respectfully with enterprise customers to minimize overuse while offering the security needed to protect producers' IP.

Traditional enforcement focused on serial numbers, dongles, node-locked and networking licensing. The growth of cloud-based software appears to be driving change, with producers predicting increased usage of Internet licensing (software validated against a license server on the Internet provided by the vendor).



Interestingly, there is a contrast in the types of enforcement that enterprises prefer (see table below) compared to what producers are actually providing (see table above).

In addition to network licensing, enterprises also prefer product activation and trust-based licensing enforcement yet producers are still widely using serial numbers and node-locked for licensing enforcement. When producers do not deliver the enforcement mechanism their customers prefer – this can lead to a negative customer experience, which in turn can open the door for competitors.



WHY DOES THIS MATTER?

Today's enterprise users require flexibility in how they buy and consume software, therefore application producers must be able to support the entire software licensing and monetization spectrum, from "do nothing" and trust but verify approaches all the way to strict license enforcement that would prevent a non-compliant customer from operating the software.

With flexible Software Monetization automation in place, application producers can even vary monetization and compliance by multiple factors:

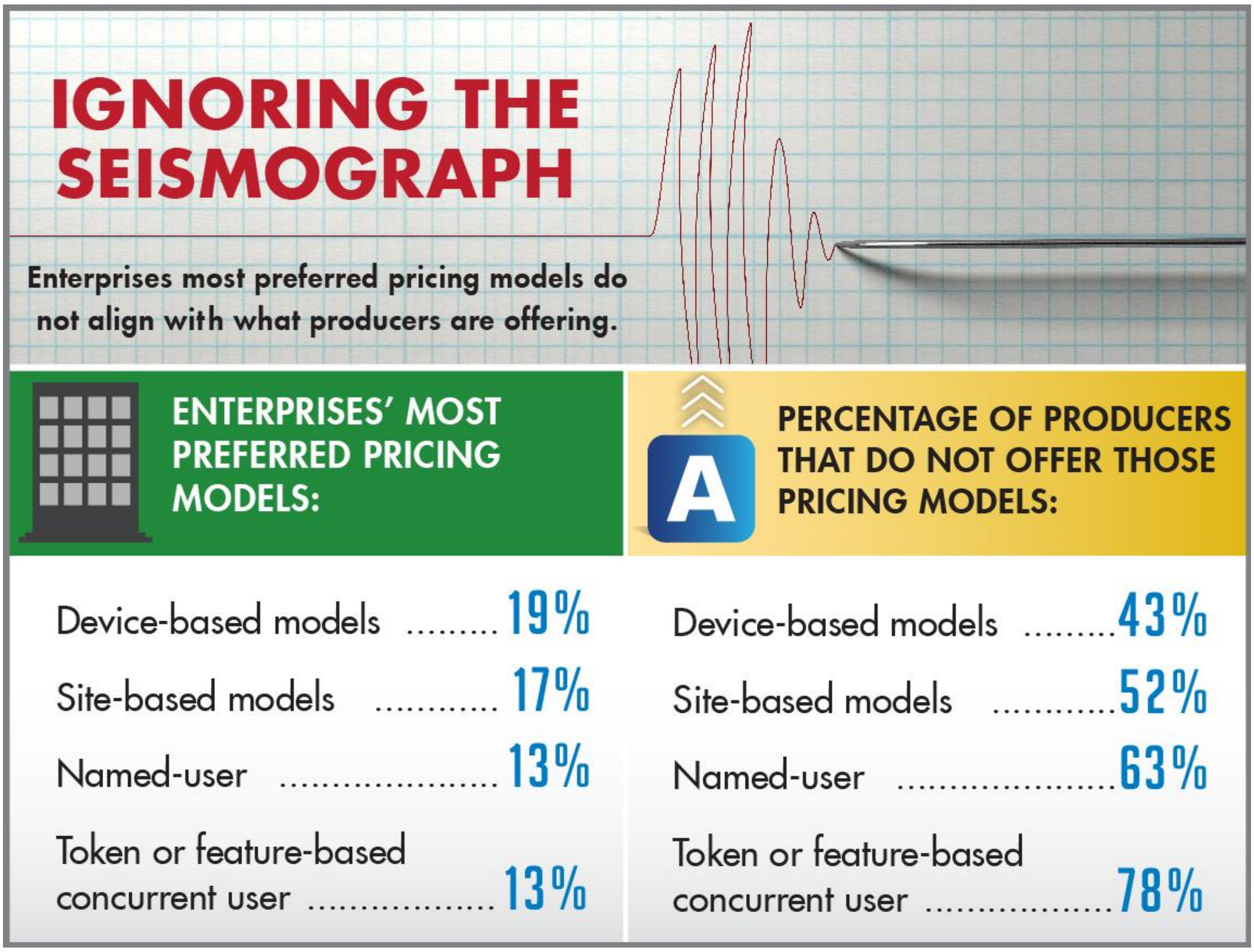
- **Market—**for large enterprises where governance exists, adopt a trust but verify, usage-based approach. But for markets where piracy is more likely, adopt a strict enforcement, denial of service approach.
- **Geography—**in regions that have more established accountability and auditing practices – enforcement might lean toward a more liberal compliance policy, compared to emerging markets with very weak intellectual property laws.
- **Product Type—**for enterprise-level, mission-critical software it may never be shut down due to overuse, but usage is tracked so that the producer and enterprise may have a true-up discussion. However, desktop software may utilize a strict enforcement policy if a customer tries to use more than entitled.
- **Product Lifecycle—**early stage products may need stronger enforcement to protect leading-edge technology, compared to mature products that may require less stringent enforcement and compliance in order to accommodate ease of use.
- **Virtualization—**producers can choose to detect and deny use of their software in virtual environments, or let customers use the software freely but collect usage data and have a true-up discussion.

By adopting technology that supports variable options, application producers gain important benefits in terms of revenue growth and customer satisfaction.

Fault Line: Software Pricing Models Delivered vs. Preferred

This year's survey revealed a fault line emerging – a growing gap between what producers, and their customers want. When looking at our producer survey results versus enterprise results, producers do not appear to be aligned with their customers when it comes to preferred software pricing models.

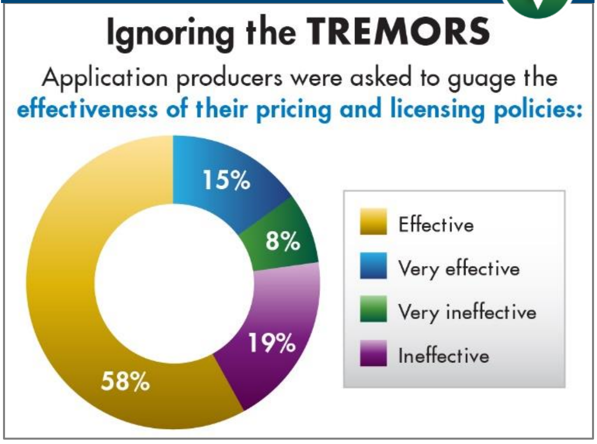
As referenced in the table below both enterprises' and producers' leading preference is for device-based licensing. However the contrast between the producer survey results and the enterprise survey results reveal misalignment, as site-based, token/feature-based, named user and client access licenses are the most preferred for enterprises which contrasts sharply with what producers are providing:



Chaos in the Rubble: How do Producers Know if Their Business Models Are Effective or Not?

Seismic events often result in chaos and confusion. And it's no less true in the software industry – where rapid change is leading to conflicting information as to what works and what doesn't. For instance, there is no broad consensus from producers as to whether their current approach to software pricing and licensing is actually working. According to this year's survey, application producers widely believe that the pricing and licensing models they implement are maximizing revenues:

73% of producers say their pricing and licensing policies are effective or very effective:



Despite this generalized belief that their pricing and licensing models are effective, many producers don't have the information and tools in place to adequately evaluate their effectiveness:

Producers Aren't Prepared to Assess Pricing/Licensing Effectiveness

51% do not track customer usage

45% do not conduct audits or license review

55% do not have technology in place to know what products, versions and platforms customers use

42% indicate their customers have some difficulty determining which products they are entitled to use

WHY DOES THIS MATTER?

Software monetization – and the licensing and pricing mechanisms put into place to enforce those licenses – drive at the very heart and health of a software business. Historically, however, producers have placed greater emphasis and strategic resources into developing their solutions rather than strategizing over how they're going to price, license and protect those solutions. Application producers would be well served to explore today's sophisticated software monetization technology to capture all the revenue they are due, while at the same time delivering a great user experience – thus creating order out of chaos.

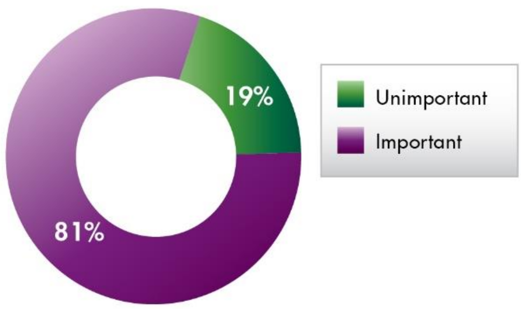
Preparedness: Enterprises Want to Be Compliant

Nobody likes surprises in business, and that includes enterprise users of software. The survey results confirm that despite all the seismic shifts occurring around software pricing and licensing – enterprises have every intention of being prepared and using only the software to which they have rights.

According to the survey data, enterprises want to be compliant with their software license agreements and feel it is important to track and manage licenses and usage – to reduce costs and compliance risk:

81% of enterprises rate managing licenses and usage as important compared to other objectives:

Compared to your other objectives, **how important is managing software licenses and usage** to your organization?



THE TOP 2 REASONS Enterprises Manage Licenses and Usage:

1. **Reduce software costs—74%**
2. **Ensure compliance with vendor agreements/reduce audit risk—71%**

WHY DOES THIS MATTER?

The vast majority of enterprises want to be compliant with the software license agreements and do everything they can to maintain compliance. One of the common problems is that enterprises can't keep up with the growing complexity introduced with multiple licensing models and IT infrastructure innovation. Software vendors need to provide technology to help enterprise customers stay compliant or invest in software license optimization technology to manage their software estate.

Software can be designed to recognize when it is being used in non-compliant ways and act accordingly. In fact, software can "self-audit". The same is true for hardware that includes embedded software and/or is network-attached. As an example, CAD and other segments of the technical software and hardware markets have done this for over 20 years, virtually eliminating the need for software license audits. The basic functionality is the same: the software stores use rights, measures and tracks actual use, compares use rights against actual use and enforces the license in whatever manner the software vendor defines.

For application producers today, it’s a fundamental business need – and Flexera Software predicts that end-users will start requiring self-auditing capabilities when they purchase enterprise software.

7 Key Areas Every Software Producer Should Care About

This survey report brings to light the seismic changes occurring in software monetization, licensing and pricing due to new technology, changing customer needs and market maturity. Even though shifting to a new business model seems complicated, it's become an essential revenue initiative for application producers. Here are 7 key areas that provide an important starting point as producers consider expanding their existing models:

1. **Create a clear definition and comparison of software monetization models**
2. **Identify the business goals for planned changes**
3. **Develop a business case for adopting or adding new models**
4. **Assess the monetization potential of various licensing models vs. a single model**
5. **Align compensation with the desired outcome**
6. **Culturally prepare for a new revenue recognition process**
7. **Review operational considerations**
   - How will we handle pricing?
   - What will the impact be on product numbering?
   - When should the subscription period begin and end?
   - What is involved in the renewal process?
   - How will co-termination work?
   - How will revenue recognition change?
   - What product changes need to be made?
   - Do changes need to be made to license key generation?
   - What key areas of the legal agreement should be reviewed?
   - Does sales compensation need to be adjusted?
   - What is the best approach to roll out to customers?

The Bottom Line: Build a Durable, Flexible and Effective Pricing & Licensing Foundation

As application producers plan for the future, this report brings to light examples of seismic shifts occurring in the industry, and recommendations for ensuring stability, growth and resilience despite those shifts. Clearly, flexible licensing models and new technology continue to expand and producers would be well served to include them in their strategies. The question also must be asked—are producers as effective in enforcement and monetization as they think? Solutions and tools to strengthen enforcement and monetization require consideration.

As SaaS, cloud, virtualization and mobile technologies continue to shake the foundations of the software industry, the time is right to rethink software monetization strategies and explore the recurring revenue and advantages afforded by an expanded business model approach.

Survey Background

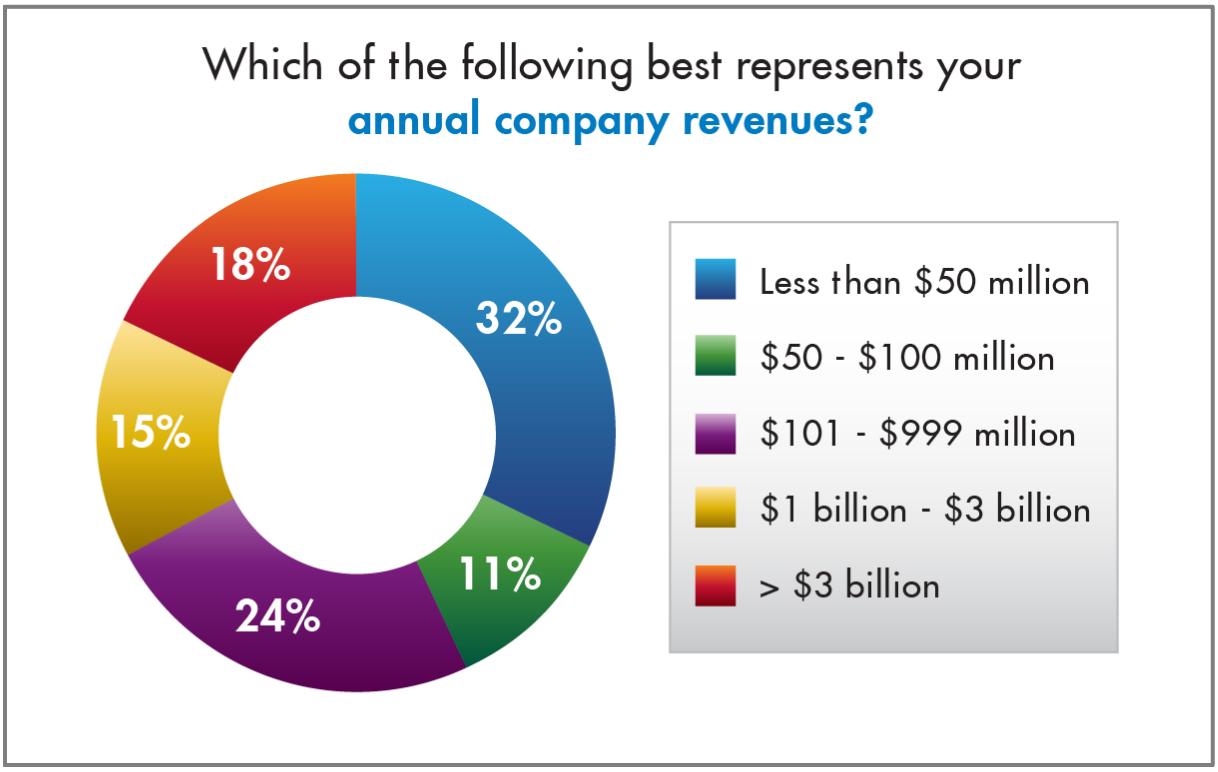
The *2016 Key trends in Software Pricing and Licensing* survey was conducted by Flexera Software. This annual research project looks at software licensing, pricing and enforcement trends and best practices. The survey reaches out to executives at application producers (Software vendors and intelligent device manufacturers) and enterprises who use and manage software and devices. Now in its tenth year, the survey is made available to the industry at large each year.

Methodology and Sampling

In total, 489 respondents participated in the survey, including 221 respondents to our enterprise survey and 268 respondents to our application producer survey.

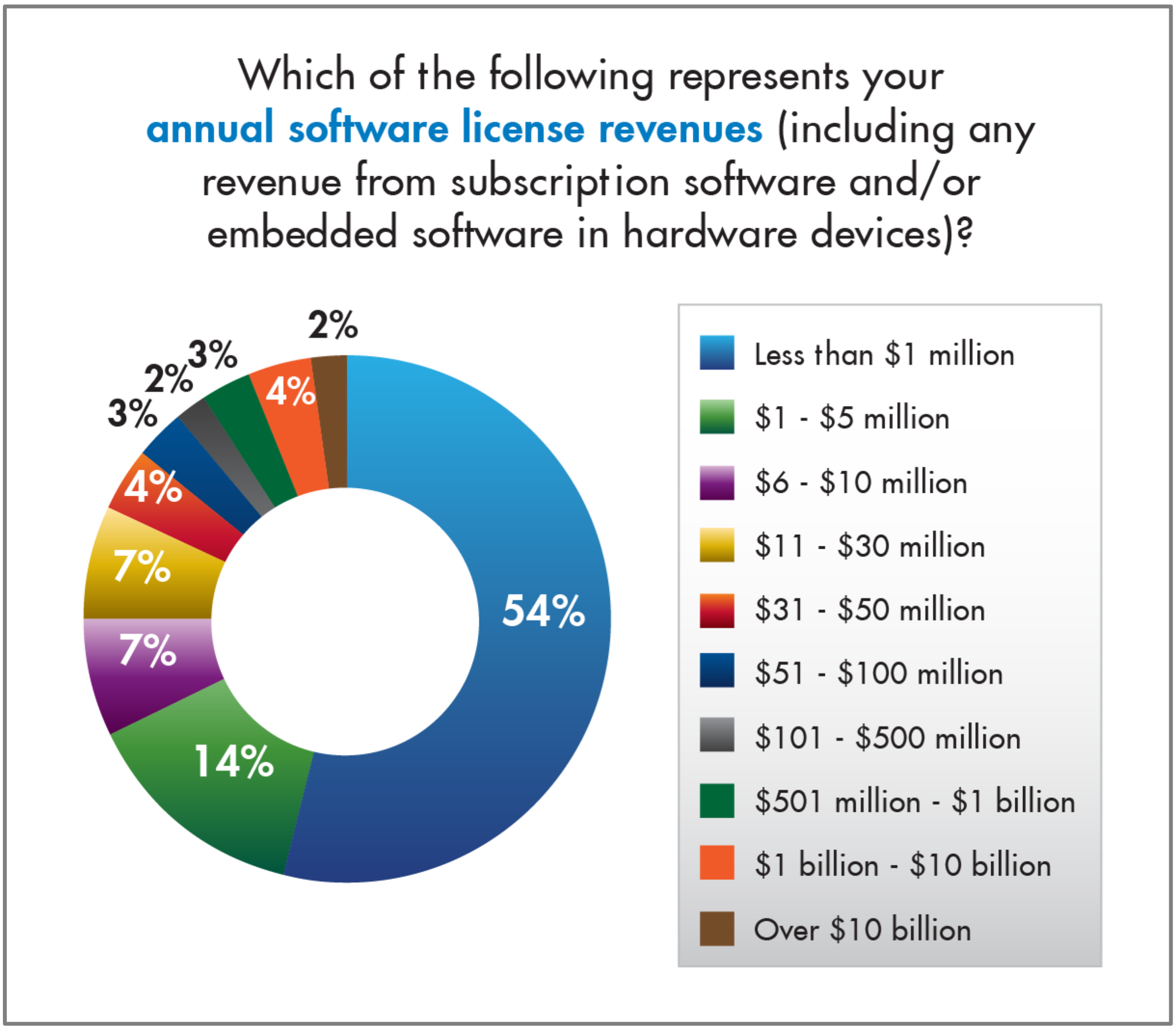
Enterprise Demographics

33% of the enterprise respondents were from larger enterprises of $1 billion or more in revenues and 18% were from companies with $3 billion in revenues or more. Among other places, 56% of respondents were from the United States, and the remainder from 37 countries across all continents.

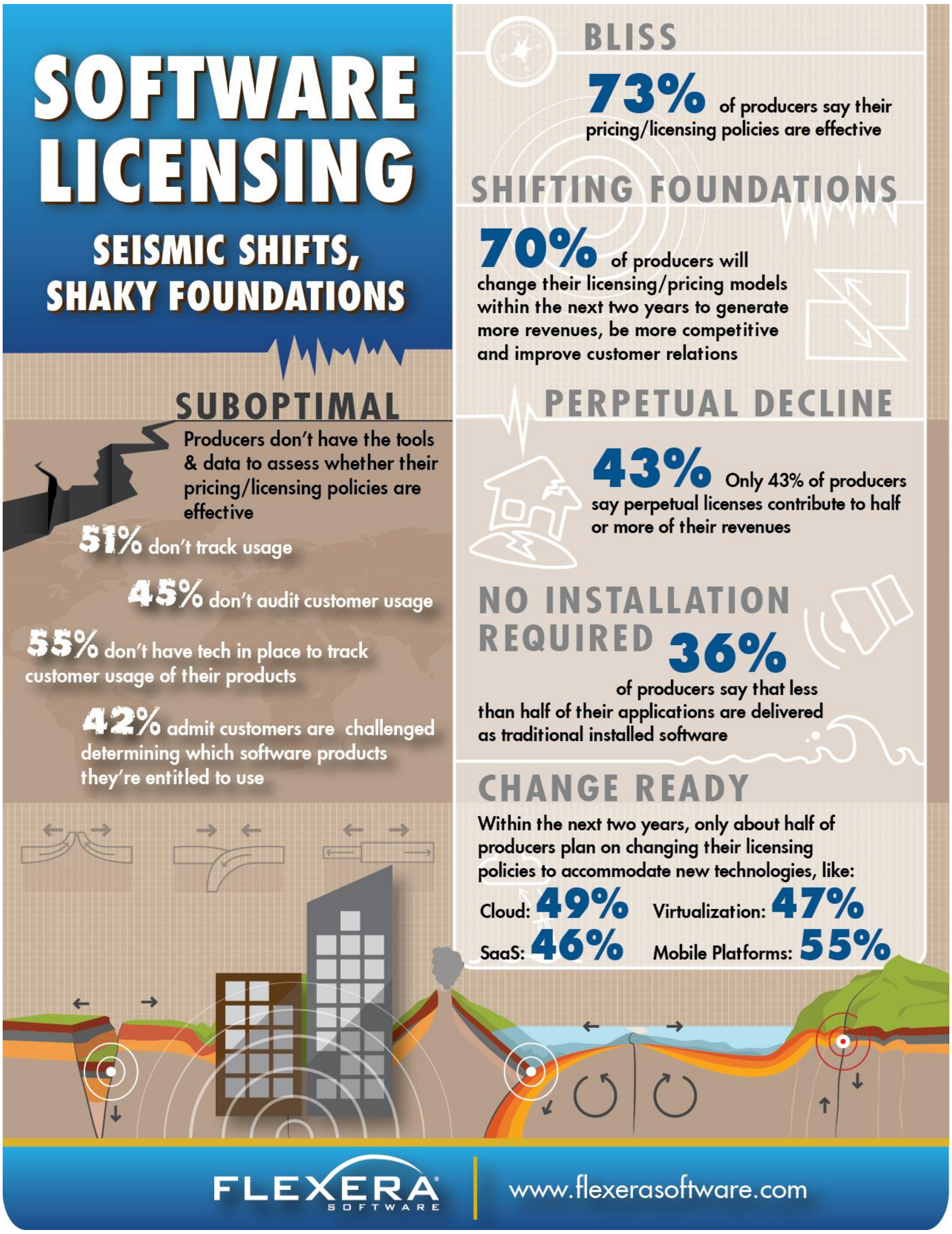


Application Producer Demographics

The largest segment of application producer respondents (54%) come from companies with under $1 million in revenues. 6% of the respondents were from companies with $1 billion or more in revenues. Among other places, 60% of respondents are from North America, and the remainder from 31 countries across all continents.



Infographic



About Flexera Software

Flexera Software helps application producers and enterprises increase application usage and security, enhancing the value they derive from their software. Our software licensing, compliance, cyber security and installation solutions are essential to ensure continuous licensing compliance, optimized software investments, and to future-proof businesses against the risks and costs of constantly changing technology. A marketplace leader for more than 25 years, 80,000+ customers turn to Flexera Software as a trusted and neutral source of knowledge and expertise, and for the automation and intelligence designed into our products. For more information, please go to: www.flexerasoftware.com.

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