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Market Roundup
December 20, 2002

Sony, Matsushita Team Up on Linux for Consumer Electronics
By Charles King

Sony and Matsushita Electric announced that they will jointly develop a Linux-based embedded operating system for use in consumer electronic products. The two companies plan to use the new software mainly for audiovisual equipment, but envision future environments where devices such as TVs, microwaves, refrigerators, and automobile navigation systems will be connected through common networks. The companies aim to complete development of the new OS by next spring, and said they will allow free use of source code by other electronics vendors. Based on the success of the joint development project, Sony and Matsushita are considering setting up an industry forum for digital home appliance-use Linux, and said further details will be discussed with companies that have voiced support for such a project including Hitachi, Sharp, NEC Electronics, and IBM.

When reading the tea leaves of this announcement, we believe that while some obvious details rate comment, other more subtle considerations are also at play. The most notable issue, of course, is the central position Linux holds in the announcement and what effect the Sony/Matsushita deal might portend for Microsoft. Though Sony reportedly downplayed such controversy, noting that the company uses a range of operating systems in its products including various flavors of Windows, it is reasonable to regard the joint development project as a blow to the progress of Microsoft's embedded version of Windows CE. Consumer electronics is a sector Microsoft has obvious designs on, so even a partial defection by partners of the size and influence of Sony and Matsushita will be rightly seen as a blow. That the companies announced their intention to promote their Linux solutions among other notable consumer electronic vendors at a time when Microsoft is feeling increasing pain from open source options in other sectors simply adds salt to Redmond's wounds. Does that mean Microsoft's dreams of dominating consumer electronics as it does desktop PCs has been effectively quashed by Sony/Matsushita? Hardly, but the deal exposes one of Microsoft's essential weaknesses: the company depends to a large degree on the kindness of partners for its own success. In sectors where Microsoft has a smaller profile and track record than many rivals, those partnerships are particularly crucial.

The subtler and more important consideration in this story is the apparent transmutation of Linux. The evolution of Linux among businesses has largely been driven by the flexibility and cost effectiveness of open source IT solutions, but the Sony/Matsushita partnership suggests it also has a place in products and environments where style and simplified functionality are the primary drivers. The fact is that consumers could care less about techno-evangelism, be it Linux or Microsoft-based. Instead, most are more concerned

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about affordability and ease of use. If the Sony/Matsushita project works, we believe it should cast Linux in a new role as a technology that allows engineering savvy companies to both escape annoying licensing fees of proprietary operating systems and gain greater autonomy in developing and taking to market a wide variety of technically adept and consumer-friendly digital electronics products. Looking further down the road, if Sony and Matsushita succeed in promoting this new OS, it could provide a transparent means for interoperability between electronics products from a host of vendors. Should that day come to pass, Linux literally will become a household word.

AOL: Will It Kill the Goose?

By Jim Balderston

The press reported this week that in September AOL secured a patent originally filed in 1997 covering the basic functions of instant messaging, i.e., monitoring a network to see who is on it, and letting multiple users communicate on that network. The patent came as part of AOL's 1998 purchase of Mirabilis, which pioneered the ICQ instant messaging technology. At the time, Mirabilis had some 11 million registered users. Since gaining the patent, AOL has made no official announcement on the subject, nor has the company filed any legal action against other companies offering competing instant messaging services, like Microsoft or Yahoo!. By virtue of its acquisition of Netscape Communications, AOL also holds patent to browser cookies and the Secure Sockets Layer protocol, which is used widely for secure online consumer commerce activity. AOL has not litigated its patents in either of these technologies.

Essentially AOL has been granted a patent on what was once known as the "chat" function, which was around before Mirabilis filed for its patent. It's not that new, it's not that complex, and it's probably been used by the vast majority of Internet users at some point or another. Kind of like email. Or a browser.

One can see where AOL might very seriously consider enforcing this patent and maybe the one for cookies and SSL as well. After all, the company that was supposed to be a source of near endless revenues for future AOL Time Warner annual reports has fallen a little short of that once lofty vision. In fact, AOL is dragging the mothership down. The idea of testing the waters with some active litigation against some very deep pocket defendants must be tantalizing to AOL — especially if they could get in front of the right judge. But such a move, whether ultimately successful or not, would likely cost AOL more in the long run than it would help in the short. In fact, AOL could shoot itself in the foot rather grandly by trying to either force consumers to come to AOL to be able to have chat sessions or force other companies like Microsoft or Yahoo! to pay up. In the first case, AOL would find consumers — and technology vendors — looking for an alternative which they would eventually find. In the second case, suing Yahoo! or Microsoft in an attempt to hinder their customers' use of an extremely popular Internet application would only firm up AOL's already poor image as a customer-unfriendly company. Before suing, AOL needs to remember that as the largest online service, its customer growth is closely tied to the overall adoption rates of Internet usage as a whole. If it removes or places a tax on one of the most popular features online, it will only slow adoption rates or reduce time spent online by present users. That means less revenue, less spending, and less activity growth for everyone trying to run a business online. So AOL can stand up for its own narrow interests, and perhaps hurt itself, or AOL can best serve its own interests by allowing the Internet pie to grow ever larger, and compete for its fair share. Which will it be? Decisions, decisions, decisions.

Is Web Services a Product or a Feature?

By Myles Suer

Cape Clear Software this week upgraded its Web Services Software, Cape Clear 4. Cape Clear automates data sharing between disparate enterprise applications. The company claims this version enhances the product's business application and information security systems integration through a programming tool that helps present information from several applications in a single window. This is intended to support embedding content in enterprise information portals. Cape Clear 4 is priced at $1,500 per developer, with typical enterprise installations ranging from $50,000 to $100,000.

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Web Services is a key software trend with impact on both the enterprise and users of enterprise systems. But, we are concerned when companies such as Cape Clear hype themselves on the immediate ROI proffered by Web Services. We expect that there will be a time when Web Services will lower application integration costs; however, with the exception of products from vendors that are pushing Web Services components within their existing applications, we believe that realizing an integration cost reduction will take time. Given this, we believe there is compelling and continuing need for middleware to bridge legacy applications into Web Services compliant solutions — especially for industries such as financial services. This in itself could be a sustainable focus for a company in Cape Clear's position.

Both of the major application server manufacturers (IBM and BEA) have announced integration brokers for their Java server software. Moreover, Enterprise Application Integration (EAI) companies including WebMethods must view Web services as strategic and essential to their remaining in business. Given this, we believe that firms such as Cape Clear need to seriously consider an exit strategy since the value of a separate and distinct Web Services product may be short lived. At this point, it is not clear who will be the ultimate provider of Web Services. EAI and application server companies both have strong cases. One can clearly imagine scenarios where both play and where EAI players continue to add value by making proprietary systems capable of speaking Web Services, but this hinges on a loosening of corporate IT budgets to undertake what some may consider being busy work projects of dubious short term ROI.

Twenty Bucks a Month? That Was Your Grandma's Internet

By Jim Balderston

A market bifurcation in consumer access price points seems to be at work, as low cost Internet service providers like United Online continue to amass new subscribers and more traditionally priced ISPs are beginning to offer packages at the $10 price point. United Online was born out of a merger between Juno and NetZero — which both offer dial-up access at sub ten dollar levels — and United Online continues that with a $9.95 dial-up access package. United Online has seen increased growth, with more than 600,000 new subscribers since last year, a third of its total subscription base. Earthlink is now offering a $9.95 discount offering, competing directly with its standard $21.95 per month dial-up access package. Meanwhile, the DSL Forum reports that DSL subscriptions increased by five million worldwide between July 1 and September 30, an increase of 20% over the previous three month period. According to the DSL Forum, more than 30 million people are using DSL for Internet access worldwide. The DSL Forum estimates there are about 15 million high-speed cable modem connections in the US — about twice as many as DSL connections — yet worldwide use of DSL as a high speed connection is higher than cable connection.

Here it is; the defining line between those people that use the Internet and those that need it. Aside from road warriors, dial-up is for people sending and receiving small numbers of email, maybe surfing a bit, and occasionally trying to purchase a little something online. File downloads, even viewing complex Web pages and conducting transactions online, becomes an increasingly painful process with content-heavy pages and a barrage of pop-up ads clogging up the throughput. Dial-up is for people who only check the Internet.

When one considers the $21.95 price for a month of dial-up access in its full context, it seems increasingly exorbitant, as one adds on the price of a second phone line to allow the rest of the family to contact the outside world while Mom, Pop, Bud, or Sis fetch their email or check a few Web sites. That phone line puts that dial-up connection at about $45, about what most cable connections and some DSL packages costs. Why not switch? And one has to wonder just how many of those $22 dial-up accounts — paid for monthly and automatically on credit cards— are maintained simply to keep a consistent or long-term email address intact. For those users, the switch to the bare bones product will make even more sense today than it did a few years ago. As phone companies report net losses in wireline phone accounts due to a combination of competitive pressures, the heavy adoption of cellular phones and the migration to high-speed access through either cable or DSL, one really has to wonder if the $22 a month dial-up access fee has a future. We're betting it doesn't.

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Revenue not Customer: SAP to End Support for Versions 4.6 and Earlier

By Myles Suer

SAP announced this week that it will not support its enterprise resource planning (ERP) software versions 3.1i, 4.0b, 4.5b, and 4.6b under regular, full maintenance plans after December 2003. These versions were introduced between 1998 and 2000. As important, SAP announced that half of its 18,800 customers are currently using one of the versions to be rendered obsolete.

In a time where enterprise software ROI is increasingly difficult to justify, we find SAP's move curious. Although persuading customers to upgrade will potentially significantly increase SAP's bottom line (by growing revenue and reducing support costs), it will also affect the ROI of those who bought product as recently as two years ago. Let it be clear that creating an end of life is common for enterprise software. However, with ERP installations in particular taking several years to implement, the return side of the ROI equation could for many be measured in a year or less. This is for an investment often in the tens of millions of dollars. Making the matter worse, upgrading to the new SAP software can take a year to complete and cost additional millions for consulting, hardware, software, and training.

We believe that enterprise software makers need to rethink their software design practices — especially with the emergence of Web Services. They need to make their software modular and move to smaller, less expensive piece-at-a-time upgrades. This will extend the life of the suite but also enable the software manufacturer to spread out their software revenue opportunity. We know of new business models being tried by smaller enterprise software makers that amortize software payment over two or three years; this way upgrades come by continuation of the fee. This model eliminates thorny revenue recognition issues and can turn software from a capital line item to an expense. Steps like these will make the enterprise software ROI more real for purchasers. Lastly, because the whole suite is not flux, this approach makes testing simpler and reduces the number of bugs reaching end users. The era of big design on a year or longer design window is just too expensive and risky for all involved — especially customers.

Sageza Closed for the Holidays

Today, December 20, will be the last Sageza Market Roundup for the year. The Market Roundup will resume publication on January 10, 2003. The Sageza Group will be closed Wednesday December 25 through Wednesday January 1. With the thought of the holidays now front and center in everyone's minds, we at The Sageza Group would like to take the opportunity to wish all of our clients, friends, and their families the happiest and safest of holidays and a healthy and prosperous New Year.

On the cusp of 2003, the Internet is hardly new; however, we are reminded of something we said five years ago

"A search for holiday and religious Web sites reveals a plethora of sites dedicated to the various observances in this holiday season. Christmas, Chanukah, and Islamic Ramadan holiday sites are available in religious, informational, and commercial variants throughout the Web. While some sites focus directly on the religious elements of the holiday season, others attempt to capture the commercial spirit of the season.

This time of year — for those of a wide variety of faiths — brings forth a spirit that many wish would last the year 'round. We believe these Web sites — especially those offering informational instead of commercial material — offer a valuable resource for those looking to capture more of the holiday spirit than simply a large credit card debt for the new year. We do believe the Internet offers new ways for people to practice the holiday spirit of giving. For example, a substantial number of firms sent out electronic greeting cards to us this year, indicating that the savings over hardcopy cards and postage allowed them to make significant contributions to needy charities. While we have no illusions that the Internet alone will resolve the world's problems, we do believe that as a tool it can be used to address these problems in new — and perhaps effective — ways."

How prescient these words were. While the wealth and prosperity envisioned by some in the "new economy" has largely evaporated, the Internet has become an integral part of most businesses' and many people's daily lives. Such thinking today may be a given, but it is easy to forget that not all that long ago, the Internet was considered to be nothing more than a Jetson-based scientific pipe dream. Peace.

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