

Microsoft Hits Enterprises With Huge Price Jumps on Software Licenses

Alvin R. Park, Alexa Bona

Although much attention has focused on Microsoft's subscription-based pricing, the most significant effect on Microsoft's customers is the elimination of version upgrades. For most, this will significantly increase the cost of upgrading software licenses.

NEWS ANALYSIS

Event

On 10 May 2001, Microsoft unveiled its new version 6 licensing programs — Open, Select, Enterprise Agreement and Enterprise Agreement Subscription. They will replace its version 5 programs on 1 October 2001.

Analysis

The substantial, complex changes Microsoft has made to its licensing programs will affect all Microsoft software products and customers. The main effects include:

- Enterprises with four-year upgrade cycles for Microsoft Office will typically pay 68 percent to 107 percent more to upgrade.
- Those with three-year upgrade cycles will typically pay 35 percent to 77 percent more, depending on their volume discount level.

Microsoft believes it has simplified its licensing; Gartner believes Microsoft confuses simplification with the elimination of options. Either way, most enterprises will pay much more. A typical enterprise with 5,000 desktops that upgrades Microsoft Office every four years will have its fees increase from \$900,000 to \$1.7 million.

The following three parts of the announcement will have the most significant effects:

Elimination of Version Upgrades: Microsoft will eliminate Version Upgrades (VUPs), Product Upgrades, Competitive Upgrades and Language Upgrades. VUPs offer the cheapest upgrade mechanism for enterprises upgrading less than twice every two to three years, and most Microsoft customers use them. Customers now have two choices:

- Rebuy the licenses.
- Buy Software Assurance (SA), formerly called Upgrade Advantage (UA).

SA Replaces UA: SA now becomes the only way to upgrade, apart from rebuying the license. SA is priced annually at 29 percent of the license cost for desktop products and 25 percent for server products. In most cases, these prices are lower than UA prices, but they are not lower than VUP prices and are significantly higher than industry norms of 17 percent to 22 percent.

Furthermore, Microsoft does not include technical support in SA as do most other vendors. SA provides perpetual rights to versions released during the term of the agreement. However, if enterprises want SA, they *must* buy it at the same time they buy the license. The break-even for SA is about three and a half years. Gartner recommends the following:

- Enterprises that upgrade every three years should buy SA.
- Enterprises that upgrade every four years or longer should rebuy the software.

Subscription Pricing Now an Option Under Enterprise Agreement (EA): This new offering of nonperpetual licenses is available for enterprises with 250 or more PCs and is priced at 85 percent of the cost of the perpetual license. Microsoft calculates the break-even point at five to six years.

Given the degree of lock-in with this license agreement, Gartner does not believe the price will attract most enterprises. To ease concerns, though, Microsoft offers a buy-out clause for the end

of the third year for one and a half times the third-year fee. However, Gartner believes that by 2005 Microsoft will eliminate buy-out clauses from Subscription Agreements (0.7 probability). Enterprises not exercising the buy-out option must renew their subscription or uninstall the software. Gartner recommends the following:

- Enterprises considering subscription licenses must carefully analyze the total cost over the entire period the application will be installed, including the buy-out clause, and compare this to the perpetual EA or Select licenses.
- If subscription is appropriate, enterprises should negotiate for a price cap of 5 percent to 8 percent for subscription renewals.

Analytical Sources: Alexa Bona and Alvin Park, Software Asset Management

REGIONAL HEADQUARTERS

Corporate Headquarters
56 Top Gallant Road
Stamford, CT 06902-7700
U.S.A.
+1 203 964 0096

European Headquarters
Tamesis
The Glanty
Egham
Surrey, TW20 9AW
UNITED KINGDOM
+44 1784 431611

Asia/Pacific Headquarters
Level 7, 40 Miller Street
North Sydney
New South Wales 2060
AUSTRALIA
+61 2 9459 4600

Latin America Headquarters
Av. das Nações Unidas 12.551
9 andar—WTC
04578-903 São Paulo SP
BRAZIL
+55 11 3443 1509