

# When “Free” Isn’t Free

The problem: How do you create a commercial model for open source software that is perceived as “free”?

*Note: While this case study is nearly 17 years old, the lessons are still instructive today. When I looked at this problem for the first time, I was employed by UBS, and knew what we needed before we would use Open Source software. After moving to Red Hat, we were able to standardize and scale the model, and significantly change the software industry.*

Red Hat, now an industry giant, had a problem back at the turn of the Millennium. Open Source software, at that time, only known to geeks, was available freely. How could you charge money for the software to reflect the true costs of supporting and servicing software? At the time, there were at least 16 Open Source companies trying to make a commercial run based on Linux™ distribution, but only Red Hat remains a commercial company today.

Cause: Demand for Open Source software was beginning to build as corporations felt increasingly held hostage by proprietary hardware vendors that sold the hardware and operating systems as bundles.

As corporations became increasingly dependent on computers for their businesses, the costs of hardware were skyrocketing on servers, while in the PC world prices had plummeted. The industry leader in the server market. Sun, had proprietary chips, software and hardware. Other tech giants like IBM, HP and Dell each had their own proprietary hardware/software operating system, but had been unable to make serious inroads into Sun’s market share. As Intel chips for servers began to match Sun’s performance, the other tech giants saw the opportunity for servers costs to go the way of PC’s, and a chance for them to make greater inroads into the market.

Meanwhile, in order to make a massive production switch, corporations had to know that the servers would offer the same kind of stability and support that Sun had offered. They needed access to the software so their engineers could ensure that the business applications would run smoothly on the OS, and they needed to know that other large investments such as their database software would work as well.

## Solution: Create one of the first subscription models in the industry

Unlike today, when SaaS software sits in the cloud, this was pre-cloud and the actual software needed to reside on the machines directly. The service in this case, was comprised of three main things that are very expensive to corporations to manage.

1. Standard build and version control. A corporation cannot afford to have their engineers building a home-grown release of Linux. It needed to be standardized so that applications could run and test on it. Red Hat provided this service, using maintainers to build the best version of the software and administrative tools.
2. Testing and support with third parties. Perhaps most expensive for corporations, the commercial version needed to be tested against a wide range of software and hardware versions. This required partnerships with every major software and hardware vendors, and developing joint release and test schedules. Individual clients couldn't do this.
3. Global bug fixing and security patching. Red Hat stepped into the central role of continuing to improve and upgrade the software, aided by expert support teams.

So the service became the value-add, not the lines of code. Flipping this paradigm on its head from the traditional license plus maintenance made customers more aware of the value of running and supporting software. It also meant that Red Hat needed to prove its value daily to its customers, so that they would renew. Almost two decades later, Red Hat has renewals close to 100% of sales. This model was widely supported by customers for its transparency, and has been used by almost every open source company since then. Proprietary software companies also moved to the subscription model, with the difference being access to their software was via subscription, and not via license.

**Impact: Today, Open Source software is used by 78% of corporations on the planet, and has extended well beyond the realm of the operating system. Red Hat has a 20B market capitalization, Dozens of other Open Source Companies exist for other parts of the technology infrastructure.**

At the individual company level, server prices collapsed by 90%, and with software and support were still 1/7th of the previous costs. No wonder the model caught on! However, all business models change, and now increasingly businesses are managed in the cloud, especially small businesses. But the cloud based services use Linux under the hood, and the never ending increase in desire for compute power more than makes up for the price declines.