Market Roundup
July 3, 2002

IBM Introduces Linux Virtual Services for Business

By Charles King

IBM has announced Linux Virtual Services, a new e-business on demand offering that provides enterprises access to hosted Linux-based business applications, server processing, data storage, and network capacity via the Internet. According to the company, Virtual Linux Services allow customers to buy only as much power and capacity as they need in pre-determined "service units" and provide them secure access to computing infrastructure without the expenses of buying, deploying, and managing physical hardware. Rather than the physical Web, application, and database servers typically used by conventional hosting centers IBM's service will be powered by Linux "virtual servers" running on IBM zSeries mainframes. By partitioning processing, storage, and network capacity for individual clients, IBM says it can isolate and map resources to client demand that deliver the same level of separation between customers that physical servers do. By using Linux Virtual Services, enterprise customers can consolidate workloads from distributed servers, and smaller businesses can access mainframe processing capabilities without making additional infrastructure investments. IBM is offering customers a choice between "ready to go" server platforms including an Apache-based Linux Web server, DB2 database software, and WebSphere, and also provides an option to deploy Linux environments for custom applications. The company also offers Linux porting services to customers currently running custom applications on non-Linux platforms. Linux Virtual Services includes 10% additional processing capacity per virtual server (beyond what is contracted), allowing customers to subscribe based on their normal capacity requirements but still handle unscheduled workload surges. Additional capacity can also be purchased for scheduled workload peaks such as batch processing. IBM's Linux Virtual Services are currently available with pricing negotiated according to contract.

Since continuing tough times have contributed to the collapse of a number of well-known hosting services, some might question the wisdom of IBM's new Linux Virtual Services. We agree that the initiative carries some risks, but we also believe that it offers the company a pair of important strategic opportunities. First, the new services should provide a figurative soapbox IBM can use to declaim (and demonstrate) the effectiveness of its mainframe-based virtual Linux servers, which have been decried as mere smoke and mirrors by some competitors since being introduced by IBM late in 2000. While IBM has made some notable wins among major telecom, financial services, and retail clients who have deployed virtual Linux servers on zSeries mainframes, every new business solution has its doubters. From this standpoint, the new initiative will offer locations where the company can demonstrate the literal efficacy of these solutions, as well as provide a service that those interested (or even doubters) can use to dip a toe in the water. IBM wins in either case,

The Sageza Group, Inc.
836 W El Camino Real
Mountain View, CA 94040-2512
650·390·0700 fax 650·649·2302
London +44 (0) 20·7900·2819
Munich +49 (0) 89·4201·7144
Amsterdam +31 (0) 35·588·1546

whether satisfying its customers or answering its critics. The new initiative also gives IBM a chance to put its money (and technology) where its mouth is on the utility computing initiative the company began promoting earlier this year. While utility computing (where services are delivered on and billed according to customer demand) are a hot topic around the industry, building the necessary support infrastructure and making it work requires considerable investment and expertise (making the concept a tough sell in a slow economy). Given that IBM possesses said infrastructure and expertise in-house, the company's Linux Virtual Services hosting centers could serve as both living laboratories for utility computing development and marketing centers for potential customers.

That said, are IBM's new Linux services a sure sell? Not by any means. Large enterprises including LL Bean, Sonera, Deutsche Bank and Banco Mercantile may have successfully deployed virtual Linux servers in zSeries environments, but leading an idea into the broader market is always harder than providing it to early adopters. Additionally, while consolidating the workloads of dozens or hundreds of physical servers onto a single mainframe makes sense technically and logistically, it runs contrary to traditional IT practices, and despite the air of techno-geek insouciance many IT staffers cultivate, most are deeply conventional when it comes to their work and working environments. In other words, while we expect IBM's claims of reducing infrastructure, management, and employee expenses will resonate among enterprise managers, many IT staff members will embrace it as happily as they would a rabid dog. Finally, the difficulties many previous hosted service providers (read ASPs) have encountered could also color IBM's chances here. To that end, competitors who lack equivalent solutions will, reasonably enough, take advantage of every available opportunity to cast aspersions on Linux Virtual Services, and promote the multitudinous benefits of their own tried and true solutions. The overarching lesson here is that while it is hard enough to create demand for an utterly new product, selling a service that in any way resembles a less than completely successful endeavor offers one's competitors ammunition for the taking and one's customers food for doubt. The way to succeed in circumstances such as these is to be patient, take the long view, and publicly celebrate your victories. That strategy has worked for IBM in the past, and we believe is likely to continue to do so in the future.

Changing Times, Changing Strategies?

By Jim Balderston

The EU announced this week that it would be keeping a close eye on Microsoft's recently unveiled Palladium technology, which the company says is designed to improve security for PCs and content and applications stored and run on therein. The Palladium technology consists of both software and hardware, with specialized computer chips providing encryption for PC data. One of the potential uses of such technology would be to limit both software and content piracy. The EU's incoming Director General of Competition Phillip Lowe said that the EU wanted to ensure that any new technology introduced by the IT industry had certain levels of interoperability, and expressed concerns that Palladium-encrypted files might not be accessible to people using other operating systems. Meanwhile, similar issues were raised by a report published this week from Cambridge University, which discussed a number of potential implications of the Palladium proposal, noting that Palladium-equipped applications could be a lock-out of competitors, and stating that Palladium was more an effort to protect incumbent technology firms than consumers. Microsoft officials were quoted as saying the company may well require licensing fees for the use of Palladium-related technologies. The EU is still in the process of pursuing its own anti-trust case against Microsoft, and has taken a harder line with Microsoft than have U.S. regulators.

Microsoft is among many companies that have benefited from the boom cycle of the past twenty years. Unlike many of the companies now so prominently featured in the news, Microsoft is not anywhere near going bust. However, the ever-widening scope of corporate misfeasance and outright fraud is clearly having an impact on both the investing and voting public. When one considers the close ties of the White House to Enron, and its ongoing pro-business, anti-regulation stances, it is not hard to assume that a backlash — or at least a pendulum swing in the opposite direction — is in the works. Microsoft has always been a very aggressive company; it has run afoul of regulators on a number of occasions and yet despite these run-ins has always

The Sageza Group, Inc.
836 W El Camino Real
Mountain View, CA 94040-2512
650·390·0700 fax 650·649·2302
London +44 (0) 20·7900·2819
Munich +49 (0) 89·4201·7144
Amsterdam +31 (0) 35·588·1546

returned to its traditional modus operandi. Palladium is potentially a very powerful technology, allowing for the identification of users vis-à-vis individual content files and applications. While some — most notably in the entertainment industry — would welcome such developments, the issue of vendor lockout (as an anti-trust issue) most likely will become a more prevalent in regulators' minds as the political tide turns back to controlling the excesses of corporate misdeeds. In short, Microsoft may be facing a very different regulatory environment in the coming years, one that is going to be much less tolerant of its "embrace and extend" attitude toward standards and the marketplace at large. Palladium offers potential benefits to both consumers and Microsoft. Where one interest ends and the other begins will likely be resolved in a much different, and less compromising, environment than Microsoft has enjoyed in the past two decades.

Listen.com Gives a Swimming Lesson

By Jim Balderston

Listen.com, a San Francisco-based company that offers digital music subscription services, has signed a non-exclusive deal with Universal Music Group, a division of Vivendi Universal, to distribute some UMG titles for a fixed monthly subscription fee of $10. Listen.com's Rhapsody music service will include music from the recording industry's top five labels, which include a vast majority of all songs published; in effect, giving Listen.com a leg up on even the industry's own music sites. According to news reports, the deal between the two companies took sixteen months to negotiate. Under the terms of the agreement, users will not be able to burn digital music onto CDs, but only to play it via the Rhapsody software. The Listen.com offering will feature approximately 175,000 tracks total. The company said it hopes to expand its offerings by extending its agreements with the recording companies to allow for music to be stored and burned onto CDs.

Slowly, how slowly the entertainment industry is moving into the new digital age. We suspect that the prolonged negotiations between Listen.com and UMG consisted of a great deal of handholding on the part of the people at Listen.com, who spent that time making all the comforting cooing noises to UMG that a parent makes to a reluctant toddler poised at the edge of the pool. "You can do it, I'm right here, I won't let anything bad happen to you," was probably the sum and substance of Listen.com's sales pitch.

This agreement gives Listen.com the platform to leverage the momentum of more and more people under 18 who are downloading and swapping music files, while UMG can claim it is now boldly embracing the Internet. As a result, perhaps UMG will begin to understand the universal power of word of mouth as a marketing and promotions tool and how digital music swapping networks are a pure embodiment of word of mouth. Word of mouth carries authority and power that $20 million promotion budgets increasingly waste on ever more jaded and sophisticated consumers. In contrast, word of mouth never gets stale. We suspect realization of this opportunity may take eighteen months or more. Meanwhile, other significant hurdles remain, and the industry knows it as evidenced by UMG's licensing of only a fraction of its track library. How will the music industry price digital content in a world market? Content priced to maximize revenue in the Untied States will not sell in parts of the world where incomes are a fraction of the U.S. average. Pirating content will still be irresistible in such situations. How UMG and the other media giants address this question will be the real telling point: a conundrum that, when solved, shows that the media giants have jumped into the deep end of the pool without their water wings.

Sun Hosts Bavarian Open Source Love Fest

By Joyce Tompsett Becknell

Last week, Sun Microsystems held a press conference in Munich, Germany. In attendance along with Sun were Apple Computer, the Bavarian Chamber of Commerce (Industrie- und Handelskammer fuer Muenchen und Oberbayern — IHK) and the Munich representative of the Social Democrats (SPD), the party currently in control of the Munich city government. The title of the press conference was "Linux, Solaris & Co.: Open platforms create freedom alternative to monoculture." The conference was played out as a roundtable, hosted by freelance journalist and author Tim Cole, who specializes in the Internet and online topics. The main thrust

The Sageza Group, Inc.
836 W El Camino Real
Mountain View, CA 94040-2512
650·390·0700 fax 650·649·2302
London +44 (0) 20·7900·2819
Munich +49 (0) 89·4201·7144
Amsterdam +31 (0) 35·588·1546

of this conversation was to explore the ongoing commitment of German government and business organizations to choosing open source solutions over a monoculture (which in this context was spelled Microsoft) and for the technology vendors to demonstrate their overwhelming support and admiration of the open source movement.

Munich in the summertime usually means tranquil afternoons spent in shady beer gardens and leaving work early on Fridays to get a head start on the steady stream of traffic heading to Italy and Greece for the weekend. Summertime is relatively quiet on the continent because at any given time so many people are on holiday. Invitations to the event were sent to both business and trade press, and they dutifully showed up despite the bad coffee and the tempting weather outside. The first thing we noticed was that although we were handed the standard press kit when we arrived, there were no press releases or announcements happening that day. The Chamber of Commerce and government representatives were happy to extol the virtues of open source for their environment and to explain why the move made sense to them. Both Sun and Apple were happy to stand up and give the usual vendor statements of undying commitment and support to the needs of their customers. But why this event? Why today? Why here in Munich? Surely the IHK or the SPD had signed some sort of order for significant volumes of product? Yet there were no ISVs or integrators present and there was not one application vendor to be seen anywhere, not even lurking about the food table.

This event seems to be part of the ongoing excitement here in Germany regarding the open source movement. Last month the Ministry of the Interior and IBM got together to talk about how they were fully behind the open source movement and now we have Sun and Apple along with representatives from one of the two wealthiest states in Germany and its capital city announcing much the same thing. And yet we can't help but notice that underneath the noise, not much has transpired. We have seen no signs of any products or solutions or euros changing hands in exchange for new hardware and software or even contracts for the same. Of course some of this sentiment is truly heartfelt as the open source movement is much admired here. But some of this seems to be more about a negative customer reaction to strategic Microsoft licensing policy rather than a wholesale switch to a new platform. And when it came time for questions and answers from the press, the local press was more interested in asking Sun whether Java truly was an open platform, and they challenged Apple on how they would respond if Microsoft decided to stop developing its products for the Macintosh operating environment. Not one question centered on the solutions being developed, the customer problems being solved, or the expected sum of money to be spent on open source solutions in the next fiscal year. We were somewhat underwhelmed by the whole experience and as we continued to listen, we found ourselves searching for the reason we had been brought to this event...

The Sageza Group, Inc.
836 W El Camino Real
Mountain View, CA 94040-2512
650·390·0700 fax 650·649·2302
London +44 (0) 20·7900·2819
Munich +49 (0) 89·4201·7144
Amsterdam +31 (0) 35·588·1546