



UNDERSTANDING THE IT LOBBY: AN INSIDER'S GUIDE

JUNE 2008

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ACT

THE ASSOCIATION FOR COMPETITIVE TECHNOLOGY (ACT) IS AN INTERNATIONAL ADVOCACY AND EDUCATION ORGANIZATION REPRESENTING MORE THAN 3000 SMALL AND MID-SIZE INFORMATION TECHNOLOGY FIRMS FROM AROUND THE WORLD. ACT ADVOCATES FOR AN ENVIRONMENT THAT INSPIRES AND REWARDS INNOVATION, AND PROVIDES RESOURCES LIKE THE INNOVATORS NETWORK TO HELP MEMBERS LEVERAGE THEIR INTELLECTUAL ASSETS TO RAISE CAPITAL, CREATE JOBS, AND CONTINUE INNOVATING.



TABLE OF CONTENTS

EXECUTIVE SUMMARY	2
INTRODUCTION	3
COMPANIES STRATEGICALLY CHOOSE—AND CHANGE—THEIR BUSINESS MODELS	4
PRIMARY BUSINESS MODELS IN SOFTWARE DISTRIBUTION & SERVICE.....	6
PUBLIC POLICY IMPACTS ON BUSINESS MODELS	8
LOBBYING MODELS.....	10
A WORD OF CAUTION TO POLICYMAKERS	12

EXECUTIVE SUMMARY

The information technology (IT) industry is often puzzling to legislators and regulators. The industry is technically complex and incredibly fast-moving, and because information technology is so diversified, the industry rarely speaks to governments with one voice.

IT industry groups often approach policymakers about a common concern, yet advocate for different solutions. However, all companies—even when they differ on policy—are increasingly attempting to show how their position benefits the public interest. Usually this means appealing to broad social goals like *innovation, openness, jobs, or economic growth*. The issue is made even more confusing when *opposing groups* say their positions will create the same result of “more innovation.”

When you peel back the rhetoric, however, most of the policy differences among IT companies are the result of competing business models.

IT companies constantly experiment with new business models for their products and services. Some license their software or sell subscriptions, while others give away software to generate hardware and services revenue. More recently, we’re seeing free software and online services that are supported entirely by advertising.

In reality, there is nothing inherently superior to any of the business models. While each has its own particular benefits and costs, it is clear that business model competition benefits innovation and consumer choice.

Yet, as the IT industry lobbyists become more sophisticated, some are pushing policies that benefit themselves at the expense of competitors with different business models. Often this is done by conflating how they do business—

their business model—with public interest values and goals. While there may be genuine public support for similar policy measures, company lobbyists are driven by profits—not the public interest.

As public officials wade through the complexities of technology policy, they should consider the following principles to ensure that new policies promote goals that benefit the public—without needlessly promoting or locking-in one business model at the expense of another:

- **Many Software Business Models Compete Against Each Other.** Ad-based, licensing, and services models all compete in the market for various IT products.
- **There are Multiple Public Interest Goals to Be Balanced.** Backward compatibility, accessibility, environmental sustainability and interoperability are all potential public interest goals that must be balanced. No single goal is supreme.
- **Specify Goals, Not Standards.** Adhere to a goals-based policy that allows the industry to innovate and compete to satisfy public interest goals, without limiting how the industry achieves those goals.

INTRODUCTION

The goal of this paper is to give policy-makers a better understanding of the information technology (IT) lobby and the competing interests that drive it. The hope is to enable lawmakers and regulators to make more informed decisions on policies that affect industry, consumers and the overall economy.

We describe the major business models currently used in the IT industry and how certain policies positively or negatively affect them. We also examine lobbying tactics that are being employed to enhance business model competition, and others that are used to limit competition.

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Jonathan and Braden wish to acknowledge **Nora von Ingersleben** for her valuable assistance in research and editing.

COMPANIES STRATEGICALLY CHOOSE —AND CHANGE—THEIR BUSINESS MODELS

Increasingly, *how you do business*—your business model—is just as important as *what you sell*.

Business model innovation involves creating new value from the ways that businesses package, promote, price and place their products and services—referred to as the “4 Ps” of marketing. For instance, companies can price their product in a number of ways, including through discounts, bundling, and introductory pricing.

Companies choose business models to pursue opportunities or respond to threats in the marketplace.

Business Models Reflect Opportunities and Respond to Threats

Companies choose business models to pursue opportunities or respond to threats in the marketplace. Two examples below illustrate that business models are often not sustainable in the long run—companies must adapt or die.

EXAMPLE 1: GAS STATIONS

Business models for gasoline filling stations, for instance, have undergone several iterations. In the early days of the automobile, gas stations sold only gasoline. During the 1930s, the depression forced people to consume less, so filling stations added repair bays to build service revenue. Today the gas station features self-serve gasoline that generates slim profit margins of only a few cents per gallon. Their real profit comes from the cigarettes, beverages, snacks and lottery tickets sold in the “mini marts.”

EXAMPLE 2: MUSIC DISTRIBUTORS

Music distributors have also had to adapt their business models to evolving distribution technologies: from records to tapes to CDs, and now the struggle to earn revenue from digital music. It used to be that consumers would buy their music—most recently as a CD—at the local record store or on Amazon. Today there are a number of music distribution models, including single song downloads, monthly subscriptions, and premium streaming services. There is also bundling with hardware devices—Apple developed a successful business model by integrating its iTunes music site with its iPod devices.

Some Companies Operate Multiple Business Models Simultaneously

Companies can operate multiple and even competing business models simultaneously. For many years IBM was primarily a hardware company selling mainframes and minicomputers. When new competitors and technologies emerged, IBM emphasized its software and services, while still earning significant revenue from its legacy mainframe hardware business. According to IBM.

I can remember when people used to think of us as a hardware company. Now they think we're a services company. But we're really very balanced across hardware, software and services.¹

— Marc Lautenbach
General manager of
IBM Americas

Today, in addition to its hardware business, IBM operates two distinct software business models. As a supplier of open source software, IBM installs and provides support services for the Linux operating system that runs on its server hardware. At the same time, IBM is a major developer of proprietary software. In 2006, IBM was the second largest software company in the world—behind only Microsoft—and software was the company's main profit generator.²

By selling software on the one hand and giving it away to drive hardware and services on the other, IBM maintains business models that actually compete with each other. In the next section, we further discuss the different types of business models commonly found in the software market and how they compete.

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PRIMARY BUSINESS MODELS IN SOFTWARE DISTRIBUTION & SERVICE

There are four major business models for distributing and servicing software:

- **License Software or Sell Subscriptions for Software Use** – Software has generally been licensed through “shrink-wrapped” products sold through retail channels or arrangements with hardware vendors, and

For decades, the 4 Ps have been covered in introductory marketing courses and put to use in many industries, but software companies have come up with their own mix of marketing elements.

customers usually pay a flat fee (e.g. the Microsoft Windows operating system and Office products). Newer licensing models include subscription-based software-as-a-service (SaaS), on-demand software hosted by the producer and remotely accessed by customers, and pay-as-you-go use of software for a monthly fee.

- **Give Away Software to Help Sell Hardware** – Hardware vendors often bundle free software to enhance the value of their hardware. IBM offers Linux on its web servers, giving customers a Unix-compatible operating system at no cost. Apple gives away iTunes music software, both to attract users to its iTunes website and to enhance the value of its iPod portable music players.

- **Give Away Software to Generate Service Revenue** – Software companies such as Red Hat and Novell give away software for free in order to make money from support, software maintenance, integration and customization services.
- **Give Away Software to Sell Ads and Collect User Data** – Some software companies rely on an ad-based model similar to newspapers and television. In this model, businesses provide content (search results, travel information) and services (email, instant messaging) and infuse these with advertising to the consumer. By collecting data on its users, companies such as AOL, Google, and Yahoo can better target advertising to their user base.

Table 1 (next page) shows that software companies have a variety of options for implementing each element of the marketing mix.

For decades, the 4 Ps have been covered in introductory marketing courses and put to use in many industries, but software companies have come up with their own mix of marketing elements. The ad-based model, for instance, is a new twist on the business model pioneered by television and radio broadcast industries. What’s changed is that the web advertising model doesn’t just broadcast, it narrowcasts ads to a highly specific user demographic.

Historically, business models haven’t been viewed as being about “values.” The selection of a business model is usually about making money, not a political statement or morality play. But that, too, has been changed by software companies, as discussed below.

Table 1 MARKETING MIX (the 4Ps)

	PRODUCT / SERVICE	PRICE	PROMOTION	PLACEMENT / DISTRIBUTION	
	What are you selling?	How do you earn revenues from your product?	How do you raise public awareness of your product?	How does your product get to the customer?	
SOFTWARE DISTRIBUTION BUSINESS MODELS	License Software or Sell Subscriptions for Software Use (Microsoft, SAP)	<ul style="list-style-type: none"> • Shrink-wrap software • Software-as-a-Service • User support • Software update 	<ul style="list-style-type: none"> • Software license fees • Volume discounts for OEMs • Per-use subscriptions 	<ul style="list-style-type: none"> • Advertising • Trade shows • Marketing partners • Public relations 	<ul style="list-style-type: none"> • Sell direct • Retail channel • Value-added resale partners • OEM bundling • Software download
	Give Away Software to Help Sell Hardware (IBM, Apple)	<ul style="list-style-type: none"> • Server hardware, iPods, etc. • Warranties • Maintenance & Upgrade Plans • Training 	<ul style="list-style-type: none"> • Sales or Lease contracts • Fees from follow-up services 	<ul style="list-style-type: none"> • Contribute to the development of free software • Advertising • Public relations 	<ul style="list-style-type: none"> • Deliver & Install • Direct sales • OEM bundling • Software download
	Give Away Software to Generate Services (IBM, Red Hat, Sun)	<ul style="list-style-type: none"> • Systems integration • Training • Support contracts • Service level agreements 	<ul style="list-style-type: none"> • Fees from follow-up services 	<ul style="list-style-type: none"> • Contribute to the development of free software • Advertising • Public relations 	<ul style="list-style-type: none"> • Direct sales • Deliver & Install • Software download • OEM bundling
	Give Away Software to Sell Ads and Collect User Data (Google)	<ul style="list-style-type: none"> • Content (search results, travel information) • Services (email, instant messaging) 	<ul style="list-style-type: none"> • Paid placement ads • Content-targeted advertising • Contextual ads based on user behavior 	<ul style="list-style-type: none"> • Word of mouth • Public relations 	<ul style="list-style-type: none"> • Software download • OEM bundling • Accessing on-demand applications

PUBLIC POLICY IMPACTS ON BUSINESS MODEL

Obviously, laws and regulations can influence the selection and success of business models. Table 2 (next page) describes how the four software business models are affected by certain public policies.

It should be stressed that the public policy impact on business models is not necessarily a zero-sum game. Enforcing and expanding anti-piracy laws will help licensing models, but have little direct impact on models based on giving away software for generating hardware and services revenue. In other cases, a law that helps one model will hurt another: open source preferences or requirements will disadvantage companies using a software licensing model.

Politically astute businesses know that certain laws can impact a company's chosen business model. As discussed in the next section, companies will sometimes advocate for laws and regulations to break down barriers for business, or to advantage their business model above others.

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Table 2 THE 5TH "P"

PUBLIC POLICIES THAT HELP OR HARM BUSINESS MODELS

		Help	Harm
SOFTWARE DISTRIBUTION BUSINESS MODELS	License Software or Sell Subscriptions for Software Use (Microsoft, SAP)	<ul style="list-style-type: none"> • DMCA Copyright law – recognizes technical protections as legal fences for digital property. • Software Patentability – promotes return on investment for software developers and sharing of innovations. • Law Enforcement counterfeiting and anti-piracy efforts – reduces IP theft. 	<ul style="list-style-type: none"> • Weak Legal Protections for Intellectual Property – counterfeiting and piracy reduces sales of legitimate software. • Government Preferences for "Open" Software or Systems – puts proprietary software at a disadvantage. • Limits on Software Patentability – reduces ability for earning returns on investment and limits willingness to share innovation.
	Give Away Software to Help Sell Hardware (IBM, Apple)	<ul style="list-style-type: none"> • Government Preferences for the kind of software they're giving away. • Procurement Policies that heavily weight initial costs – focus is on "free" and not implementation and maintenance costs. • Limits on the IP Protection – harms competing software that is proprietary licensed. 	<ul style="list-style-type: none"> • Competition Law biased against bundling and tying – harms ability to package software with hardware. • Software patents can require license fees that raise costs of giving away software.
	Give Away Software to Generate Services (IBM, Red Hat, Sun)	<ul style="list-style-type: none"> • Government Preferences for the kind of software they're giving away. • Interoperability Mandates requiring implementation of open standards – increased software availability means more opportunities for services revenue • Limits on the IP Protection – harms competing software that is proprietary licensed. 	<ul style="list-style-type: none"> • Software patents can require license fees that raise costs of giving away software.
	Give Away Software to Sell Ads and Collect User Data (Google)	<ul style="list-style-type: none"> • Government Preferences for the kind of software they're giving away • Open Access requirements on communications networks – increases number of potential eyeballs for viewing ads 	<ul style="list-style-type: none"> • Privacy Regulations and Opt-in Mandates – restricts information that can be collected and diminishes ad relevancy to the user • Restrictions on Sale of Trademarked Terms as Ad Keywords – reduces ad sales based on popular company names

LOBBYING MODELS

There are lobbying strategies to suit every business model—but they are not equivalent in terms of serving the public interest or stimulating innovation and competition.

For instance, it's unequivocally beneficial to lobby policymakers to remove legacy regulations that prevent competition from new business models. However, some companies also lobby to erect new regulatory obstacles for competitors, and increasingly they are doing so by associating their business model with public interest values.

The Technology Industry isn't known for its lobbying skills (but it's learning fast!)

Companies from many different industries have for decades lobbied policymakers by appealing to public interest values. But the software sector is new to this game, and because of its technical jargon and frenetic pace, the industry is not well-understood by many policymakers.

Software companies can exploit this lack of understanding when lobbying for legislation and regulation. As a result, there's a serious loss of transparency in the process, allowing companies to cloak self-serving regulation with the cover of public interest.

Lobbying to Remove Barriers to Competition

First, let's describe beneficial lobbying efforts to eliminate barriers to innovation and competition. Consider the case of discount real estate brokers and their ongoing battle with traditional real estate agents, as described in a segment last year on CBS News *60 Minutes*.³

Beginning in 1999, eRealty.com offered improved online display and tracking tools

for prospective home buyers. Moreover, the company relied on agent productivity software to cut costs, allowing it to aggressively discount the commissions charged to both sellers and buyers. Traditional Realtors, who are fiercely protective of their 6% commission rate, invoked their association rules to cut-off eRealty's access to home listings. eRealty fought back in court, and joined other online discount brokers to lobby against new restrictions sought by traditional Realtors. The U.S. Justice Department later sued the Realtors for antitrust violations in connection with their actions against discount brokers.

In this case, online discount brokers *should* be lobbying to challenge legacy regulations that protect incumbents from competition and technological obsolescence. Businesses, consumers, and our economy all benefit from lobbying efforts to remove barriers to competition.

Lobbying to Create Obstacles for Competitors through Business Model Favoritism

While it often makes sense to lobby against barriers to competition, it rarely serves the public interest to erect barriers that favor specific business models. Yet companies will try to game the system to their advantage by lobbying policymakers to create policies that favor *their* business model *over those of their competitors*. This game becomes particularly effective when business lobbyists align with grass-roots advocates who have a genuine interest in similar policy outcomes. For example, millions of Internet users sincerely believe that recorded music and video should be openly available for download and sharing, irrespective of how artists earn their living. Their opposition to copyright laws provides cover for a 'fair use' lobbying campaign by businesses

that want to sell advertising alongside popular file sharing services. For these businesses, the sincere—if misguided—wishes of file sharing advocates is a cloak for lobbying for policies that favor their business model.

An illustrative example of this sort of lobbying occurred last year when Google petitioned the

Federal Communications Commission to create new rules on an upcoming spectrum auction.⁴ Google advocated for “explicitly enforceable and unwavering obligations” of open-access on winners of the 700MHz spectrum auction.

GOOGLE’S STRATEGY ON SPECTRUM

Google packaged an open-access pitch to the FCC that focused on how the public at-large would benefit if spectrum licensees were forced to open their networks to any handset, software application, wholesale reseller, and third party interconnection. If the FCC complied, Google promised it would bid at least \$4.6 billion for the spectrum.

The FCC granted most of Google’s wish and required the eventual owner of the spectrum to open its network to devices and applications. Google’s was not the winning bid, but as the *New York Times* reported:

Google’s main goal, however, was not to win, but to make sure the reserve price was met so that the openness conditions would become effective, ensuring that its search, e-mail, maps and other services would be easily available on phones operating on those frequencies. And while the company had willingly taken the risk that it could end up winning, it was not without trepidation. “Our primary goal was to trigger the openness conditions,” said Richard Whitt, Google’s Washington telecommunications and media counsel.⁵

Google’s public policy pitch was a crafty and bold maneuver. By asserting public interests, Google convinced the FCC to skew the spectrum rules to favor Google’s ad-based business model over competitive models that receive revenue from monthly subscriptions or operating networks.

“If Google had won a license, there was only downside risk for them,” said Gregory L. Ross-

ton, a former FCC official and senior fellow at the Stanford Institute for Economic Policy Research. “Now they can just spend \$1 million a year on a law firm to ensure Verizon lives up to the openness requirements.”⁶

Although lobbying for open access makes sense for Google, it had other options besides lobbying the FCC. It could have bid for the auction without FCC strings attached, just as other carriers have bid at prior spectrum auctions. It also could have negotiated partnerships with winning licensees after the auction. Instead, Google took the political route, and government regulation now forecloses some of the ways that a wireless operator can run its business.

The mandate for open applications and devices forecloses collaborative ventures that require coordinated network control for optimization and feature calibration. As an example, last year AT&T Wireless and Apple joined forces to introduce the iPhone, including a novel way to view and retrieve voicemail, called Visual Voicemail. Under the new “Google rules”, would AT&T Wireless even be allowed to join forces with Apple to bring us the phenomenally successful iPhone?

The gist is this: the FCC endorsed interoperability and open access, and acted in a way that rigged the rules in favor of one specific business model. No matter who won at auction, Google gets an advantage for its ad-supported way of doing business.

A WORD OF CAUTION TO POLICYMAKERS

We expect companies to embrace public interest values in marketing campaigns appealing to multiple stakeholders, including employees, investors, and consumers. However, when a company links its business model to the public interest in order to obtain regulatory advantages, then it's *caveat legislator*.

Policymakers should be cautious when pursuing public goals through business regulation. There are risks that legislation, regulation, and procurement preferences can tilt the competitive playing field and undermine other public goals in unpredictable ways.

When public officials design policies to advance public goals, they should:

- Balance a value being advocated against other competing public interest values;
- Separate a value from the business models that currently provide it.

Balance Any Single Value Against Other Competing Values

Policymakers must balance the full range of public interest values when moving forward with legislation, especially when confronted by companies engaging in values-laden lobbying.

In the case of Google and the spectrum auction, "open" platforms were advocated as being in the public interest. But there's a specific caveat that all policymakers should consider—"openness" is often called for as a way to achieve interoperability, which very well may be a sound public policy goal. But interoperability is just one of several public interest goals to consider.

Other values might be adversely affected by forced openness to achieve interoperability. A study by Harvard's Berkman Center for Internet & Society identified potential drawbacks to interoperability—security threats, reliability concerns, lowered accountability, and less diversity in innovation.⁷

Policymakers should carefully consider the costs and benefits of a particular course of action on all the values affected. For IT-related policy decisions, these values should include reliability, lifecycle costs, productivity, accessibility, user privacy, security, and incentives for innovation.

Separate the Value from Associated Business Models

When policymakers do decide to pursue a public interest goal, they should avoid favoring a particular business model that happens to be delivering that value today.

What works in today's market may not be the best way to achieve a certain outcome tomorrow. Yet a procurement preference or mandate is effectively a lock-in to today's technology. Moreover, giving a regulatory upper hand to one way of doing business limits innovation and competition among business models. Ad-supported businesses, for example, advocate interoperability because it can lower access costs and bring more user traffic for selling advertisements.

On the following page is a graphical guide to avoid the pitfalls of legislating for special interests instead of public interests.

Whether you're erecting or eroding a barrier to competition and innovation, a simple rule would be "Stay focused on the public interest." And even in the face of persuasive lobbying, policymakers should avoid making rules in the grey area at the bottom of the chart.

In conclusion, it's key to remember that competition, innovation, and customer demand drive the ongoing evolution of business models in the software industry. There's nothing inherently superior about any particular business model, so when regulators pick winners among business models, taxpayers and consumers are sure to be among the losers.

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Public Interest	Set goals, but allow flexibility on how to meet them	Remove regulatory barriers to entry
Special Interest	Establish a preference for a specific standard	Lobby for a narrow exception
	Erecting Barriers	Eroding Barriers

END NOTES

¹ Dan Fost, "IBM Tops Oracle in Sales", San Francisco Chronicle, Oct. 27, 2006, available at <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2006/10/27/BUGQP-M0I2J1.DTL&feed=rss.business>

² Ibid. In Q3 2006, IBM software provided an 85 percent profit margin. Overall 37 percent of IBM's profit comes from software.

³ "Chipping Away At Realtors' Six Percent", Lesley Stahl, 60 Minutes, available at http://www.cbsnews.com/sections/i_video/main500251.shtml?id=2796105n

⁴ "Google Intends to Bid in Spectrum Auction if FCC Adopts Consumer Choice and Competition Require-

ments", July 2007, available at http://www.google.com/intl/en/press/pressrel/20070720_wireless.html

⁵ Miguel Helft, "An Auction that Google was Content to Lose", New York Times, April 4, 2008, available at <http://www.nytimes.com/2008/04/04/technology/04auction.html>

⁶ Ibid.

⁷ Urs Gasser and John Palfrey, Breaking Down Digital Barriers: When and How ICT Interoperability Drives Innovation, Nov. 2007, available at <http://cyber.law.harvard.edu/interop/pdfs/interop-breaking-barriers.pdf>



