

# Free software, a new economic model?

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## Introduction

This module will examine the paradigm of free software from the point of view of an economic model. In other words, we will study the fit and viability of free software as a model of economic operation that can be sustained in the long term.

In the study of free software as an economic model, we are limited by the relative youth of businesses based on free software. However, considering that the economic rules of the market are generally the same, we will base our study on the differentiation introduced by the free software business with respect to traditional markets. This view will give us a realistic initial approach to the qualities of free software as an economic model.

First of all, we will explore the foundations of the paradigm of free software and, hence, its operation and possibilities. More specifically, we will describe the conceptual features of the underlying operational philosophy of the model, such as its social production.

We will then explore the consequences of the model based on free software from different points of view, taking into account its differences with traditional models of software production and business. The projection of these concepts should give us a better understanding of how the free software model could fit into the market in the near future.

Lastly, we will study how the free software model relates to the validity and viability of companies based on it, explaining the importance of combining strategy with opportunity.

## Objectives

After completing this module, students should have achieved the following aims:

1. To be familiar with the economics of the model based on free software.
2. To understand the fundamentals and implications of the free software model vis-à-vis the traditional model.
3. To understand the differentiation introduced by the free software model and evaluate its suitability for the creation of value for the market.
4. To explore the validity and viability of the free software model and exploitable business models.

## 1. Basis of the model

We are familiar with many of the technological features of free software that are similar to those of proprietary software to varying degrees. In other words, the fundamental differences – if any – between free and proprietary software are not based on the internal and external aspects of the product.

Broadly speaking, the technology applied to a product (for example, the design, architecture or specific implementation) does not in itself create a substantial differentiation between free and proprietary models, at least from the strict point of view of the finished product.

The differences between free software and other paradigms of software production (especially proprietary) mainly concern the specific features of the model of development, the user community and the differentiation of the product's value added.

These differences do not lie in technological aspects unique to the development of the application or software, but on the characteristics and implications underlying their production. In other words, free software sums up a particular orientation to create value in products and services that differ from the traditional point of view.

As explained in previous modules, the business models that exploit these distinctive features in a traditional market have been perfected in recent years. In all events, the chief value lies not in the software itself but in the capital acquired when it is adopted.

This capital formalises the foundations of free software. In other words, free software is based on the social production and network culture that not only allow but also promote its possibilities and effects.

The following sections will succinctly develop these two concepts. We will first of all examine the main features of social production before moving on to characterise network culture and its impact on the economics on which free software is based.

## 1.1. Social production

Advances in global communications and the democratisation of technology in recent decades could have influenced what we now consider free software in different ways.

That is, the ease of access to information and willingness to cooperate are not unique features of free software; they form a basis for the development of valid and viable alternatives in many fields.

While there are now many initiatives associated to varying degrees with social production, in this model, business organisations discover a way to encourage creation and attract value for their business models.

In *The Wealth of Networks*, Yochai Benkler explores this issue in detail. Below, we will discuss some of the most relevant aspects characterising social production.

### Economics of information

Information is a public good with economic implications at different levels as a result of the use of information technologies.

Innovation, as the creation of new information, may be adversely affected by situations with restriction or control, and facilitated by openness and collaboration on the production of information, knowledge and culture.

Hence, production or innovation in peer-to-peer networks or generates a spiral of opportunities characterised by motivation and efficiency with technological support.

### Development and distribution of information

The development and distribution of information can follow a variety of patterns, depending on how freedom is distributed between producers and consumers. In general, the more freedom given to producers, the less obtained by consumers.

Distribution channels for information influence how the latter is shared. The direction of the transfer and its aims also influence how information is shared.

In all events, licensing and patents can restrict the flow of information, while the quantitative growth of the network need not fragment or restrict it.

#### An example of social production

Wikipedia (<http://www.wikipedia.org/>).

#### Recommended reading

L. Morgan; P. Finnegan(2008). *Deciding on open innovation: an exploration of how firms create and capture value with open source software*(Vol. 287, pp. 229-246). IFIP.

#### Recommended website

Y. Benkler(2006). *The Wealth of Networks: How social production transforms markets and freedom*. ([http://www.benkler.org/Benkler\\_Wealth\\_Of\\_Networks.pdf](http://www.benkler.org/Benkler_Wealth_Of_Networks.pdf)).

#### Peer-to-peer networks

In this case, the term refers to the operation of the community, rather than the architectural or technological basis of communication.



## Implications of social production

Benkler maintains that the way we see the operational structure of the world around us is changing, especially in terms of how we all collaborate and interact with the integration of ideas and knowledge to create new knowledge.

### 1.2. Networked economy and culture

The implications of social production have become apparent in many fields in recent times, particularly in free software. The interaction of knowledge and the refinement of ideas is now a good way to encourage and further develop a concept.

This view of production as a collaboration to qualitatively achieve a given aim contrasts with the more traditional view of the market of ideas and knowledge, where the importance lies more with the final adoption of the product than with consensus, fit or quality.

David Bollier's *When Push Comes to Pull: The New Economy and Culture of Networking Technology* explores how the evolution of information technology has allowed a new point of view to emerge that contrasts with the centralisation and hierarchy of the traditional model.

The following sections will now briefly examine the main economic and cultural features of networked culture considered by Bollier.

#### The push and pull models

The push model is based on mass production, anticipating consumer demand and dynamically managing time and the location of production resources.

The pull model is based on the openness and flexibility of the production platforms used as resources. This model does not anticipate consumer demand, but rather customises products according to demand using fast and dynamic processes.

#### Value creation networks

In pull models, the sharing of information and best practices substantially improves the corpus of knowledge of all members of the network.

This network promotes and integrates open business models based on the creation of value and product customisation or differentiation.

#### Recommended website

D. Bollier(2006). *When Push Comes to Pull: The New Economy and Culture of Networking Technology*. (<http://www.aspeninstitute.org/atf/cf/%7bDEB6F227-659B-4EC8-8F84-8DF23CA704F5%7d/2005InfoTechText.pdf>).

Hence, pull model platforms formalise, improve and increase the flexibility of innovation and evolution through the community, without incurring the costs of a similar implementation in a push model.

### **Target market**

Push models are successful in areas where consumers are not very clear on what they want and prefer to make their selection based on predefined typologies.

By contrast, in pull models, consumers want to form part of the production and selection process, in the sense that they may not know exactly what they want, but they are sure that they want to participate and form part of the process.

### **Production**

Push models tend to seek alternative forms of production that may be more economically competitive (for example, lower production costs), while pull models tend mainly to seek the best ways to add value to the production network.

This special orientation of pull models favours the scalability of the production network and the union of the best participants for production specialisation.

### **Cooperation**

Pull models favour the creation of relationships based on trust, the sharing of knowledge and cooperation among members of the network, to everybody's benefit.

This ethos is often transformed into a system of collective government for the sustainable and fair management of shared resources.

In this sense, companies based on pull models should provide guarantees for the recognition of network members, since the model is based on trust and the creation of value.

### **Education**

With push models, the activity of students is focused on the construction of static knowledge as prior training for a subsequent hierarchical society.

Pull models promote alternative forms of education in that information technologies allow students to enter a dynamic flow of activity with access to many independent resources for creating their own corpus of knowledge (and sharing it).

## 2. Characteristics of the free software model

The foundations of free software formalise a structure in which cooperation and the sharing of knowledge among members allow for the innovation, production and evolution of global knowledge.

The creation of value is undoubtedly an important goal for all members of the community (be they users, developers, etc.) and for the model itself. Hence, the decentralisation, freedom and independence that are the mark of the community offer guarantees for the consolidation and cohesion of production and social capital.

The free software model is based on differentiation in relation to the values that govern the traditional market, both from the point of view of software development and of appreciation of the value created.

While it is true that, from a traditional point of view, some of the features of the free software model are also applicable to other paradigms of development and value creation, the free software model introduces new features to the perception and appreciation of the values associated with the traditional market.

In this section of the module, we will determine the features of the free software model by comparing them with those of a traditional model, with the aim of assessing the real differentiation introduced by the model in daily practice.

First of all, we will discuss the model from the point of view of software development, before moving on to analyse the implications of differentiation as a paradigm based on social production.

### 2.1. Software development

The methodology of free software development is possibly one of the factors popularly considered as a differentiation compared to other software development paradigms, such as the proprietary model. But is this really the case?

From the point of view of software production, there are points in free software development that clearly overlap with other development models, such as proprietary, since the production methodologies have a certain independence from specific implementations.

However, the fact that software production may be more or less consistent with other models or that some of the requirements for code freedom are more or less necessary in practice, this does not mean that there cannot be significant differences in other aspects leading us to evaluate the whole as innovative.

Fuggetta's article *Software libre y de código abierto: ¿un nuevo modelo para el desarrollo de software?* explores these and other aspects of the differences between the development model of free software and the development model of proprietary software. The following sections will briefly outline some of its findings.

### Context

The success of free software can be attributed to a range of technological and economic aspects affecting its innovation and production.

Its decentralisation, cooperation and freedom of use and exploitation have made free software the standard-bearer of a new philosophy for addressing and solving a variety of problems.

According to Fuggetta, many beliefs on free software can also be applied to proprietary software, so it is a good idea to explore the topic thoroughly.

### The development process

From a technological standpoint, the development of free software is not a new paradigm, since most projects have a limited number of collaborators. Moreover, incremental and evolutionary development methodologies are not unique to free software.

Nonetheless, free software has managed to motivate both developers and users to get involved in the project, sharing and associating the development and evolution of the software with the needs of the community.

### Defence of customer rights

Problems related to customer protection arise mainly in reference to software packages, since the customer already owns the code in custom developments.

#### Recommended website

A. Fuggetta(2004). *Software libre y de código abierto: ¿un nuevo modelo para el desarrollo de software?*  
(<http://alarcos.inf-cr.uclm.es/doc/ig1/doc/temas/4/IG1-t4slibreabierto.pdf>)

For software packages, it may be enough to be able to access the source code without subsequently modifying or redistributing it. The company's user support should also abide by rules that facilitate the handing over of the code in the event that the company cannot maintain it.

### Dissemination of knowledge

The spread of knowledge through access to the source code is insufficient, since the subjects on software engineering reveal that documents describing the software architecture are also needed.

Moreover, in the event that this knowledge could be disseminated, it would only be necessary to publish its source code (without the right to copy and redistribute the software).

### Cost

The fact that the software is released under a free license does not mean it cannot be commercialised or that its development does not have an associated cost (although we do not know the extent of this).

In addition, just because we cannot quantify or centralise its cost, this does not mean that it is not distributed among the collaborators, even indirectly by companies with little or nothing in common with the world of software.

### Effectiveness of the business model

The main business models that actually exploit free software engage in the development and distribution of pure open source packages or free and proprietary software platforms. Other forms of business can be set up to a greater or lesser extent with both free and proprietary software.

Moreover, there is currently no evidence to suggest that a company based solely on services will be profitable over time.

### The software industry

Europe does not have an industrial strategy to unify the actions of the various companies involved. Hence, offering support to free software is not a strategy in comparison to the creation of innovative products.

## 2.2. The cooperative paradigm

While some of the features of the free software model are not innovative from a classical perspective, as we saw above, those that motivate a change in market perspective are.

#### On profitability

In *The Business of Software*, Michael Cusumano argues that software companies will increasingly depend on the combination of revenue from licences and services.

To analyse in detail the differentiation introduced by the free software model compared to other traditional models, we will need to assess the aspects of production and the creation of value and knowledge underpinning the model.

In his article *Open Source Paradigm Shift*, Tim O'Reilly identifies these and other features of free software that are differentiating and which create a competitive advantage that can be exploited for profit. The following paragraphs will briefly outline some of his findings.

### Change

Free software has deeply transformed the structure of the benchmark market, often with implications extending beyond those imagined by its creators.

These changes are based on product quality, lower production costs and the use of standards, in addition to differentiation in marketing, distribution and logistics.

### Software as a commodity

In a context of permanent standardised communications such as the current one, all communication applications are interchangeable (a web browser, for example). In other words, the use of standards means that software can be considered a commodity.

Hence, when the revenue-generating potential of an application is diminished because of the commoditisation process, a new market will emerge for proprietary products, especially if they exploit the global communications network.

Moreover, free software remains a viable model for companies providing services, although we cannot expect similar profit margins to those of the modern software giants.

### Network collaboration

The culture of software sharing has grown since its origins at the same pace as the Internet, whose participatory architecture is present in virtually all of its functionalities.

#### Recommended website

T. O'Reilly(2004). *Open Source Paradigm Shift*.  
([http://www.oreillynet.com/pub/a/oreilly/tim/articles/paradigmshift\\_0504.html](http://www.oreillynet.com/pub/a/oreilly/tim/articles/paradigmshift_0504.html)).

Free software is the natural language of the networked community, resulting in a style of collaboration and participation unique to its members. This collaboration is critical to the success and differentiation of leading Internet applications, since it has highlighted the importance of treating users as co-developers of the software.

### **Customisation and software as a service**

Nowadays, we are used to considering applications as artefacts rather than static processes. Programs require engineering for their creation but the dynamic languages that allow for the cohesion of components (such as data management scripts) offer the perspective of a dynamic and evolving process of the application.

Many of the services offered on-line (such as search engines) require constant revisions and updates in order to perform their functions properly. This generates a new business paradigm for computers and information technology in general, and for the exploitation of software as a service in particular.

### **The Internet operating system**

We can consider the Internet as a single virtual computer that builds an operating system from the connection of several small pieces and allows anybody to participate in the creation of value.

The values of the free software user community are important to the paradigm as they promote the spirit of seeking out and sharing knowledge.

The commoditising of technology is part of the process that allows the industry to move forward to create more value for everybody. For industry, it is essential to strike a balance that will create more value than that obtained with individual participants.



### 3. Validity and feasibility of the free software model

In previous sections, we looked at the foundations of the free software model and the features that distinguish it from the more traditional models.

To evaluate the long-term sustainability of the free software model, we need much more data than we currently possess, i.e. a much wider time slot for a more precise comparison with traditional models.

Time will tell whether free software is a new economic model and what features and conditions will allow it to be so.

We will now offer some conclusions. Although, at the time of writing, business based on free software is still relatively new, we have highlighted the differences allowing the adoption of a new business perspective based primarily on promoting the cooperative production of knowledge.

#### Applications based on free software

The social production of a specific application or solution encourages the creation of value above and beyond its cost of production, affording it a competitive advantage over other market alternatives.

Free software-based applications, together with open standards, can offset some of the economic effects that strengthen products based on the traditional model. Thus, besides inducing a substantial differentiation with traditional applications, they allow for strategies and policies of coopetition between companies in a win-win paradigm.

#### The market

Social production has plagued the Internet with alternative initiatives to traditional models. Over time, social capital has become a significant value for innovation and development in open environments. We now have profitable business models that pay for the production of knowledge.

#### The business of knowledge

Innocentive (<http://www.innocentive.com/>) is just one website that rewards ideas that solve specific problems. On it, there are users who pose questions (seekers) and others that solve them (solvers) in exchange for a financial reward.

This and other examples have led to the creation of a new market logic, referred to in some contexts as Wikinomics and crowdsourcing. This logic is based on the pull model we saw above, i.e. the attraction of ideas and effort in contrast to the traditional push model.

In time, we will discover whether this market perspective allows the patterns of technology adoption typical of the traditional market to evolve towards a new situation.

### **The business**

The new market perspective can offer new business opportunities associated with the exploitation of ideas, concepts and knowledge for profit without owning the latter. In other words, the value of an application based on free software does not lie in the solution itself but in the capital acquired and generated with it.

Nonetheless, the validity and viability of free software as a model also depends on the particular design features of the company that exploits it. That is, it is essential to design the company around a solid and lasting business opportunity.

### **Risks**

Undoubtedly, the main risks for the model based on free software are obtaining a critical mass of users to ensure the project's viability and laying the foundations for a business model that will prove stable over time. We must also take into account the relationship between the initial investment and the expected benefits.

### **Business viability study**

Comprehensively analysing, designing and formalising the company will increase the guarantees of success of our free software-based business. To maximise these guarantees, the company's viability must be studied prior to its launch and formalised in a business plan.

Companies based on free software must complement the above aspects with the features of business models based on free software seen in the fourth module, creating a combination to formalise a sound basis on which to set up a sustainable business .

### **The free software company**

#### **See also**

In the third module of this subject, we took an initial approach to the main features affecting the business viability of the traditional software business, namely aspects of sales and marketing, along with the products and services covered by the business.

As with any business model, a company based on free software will also require detailed planning and design prior to start-up. In the previous sections, we emphasised the importance of carefully analysing the business fundamentals of the company as a condition for evaluating its validity and feasibility.

Both the basic features of free software and the implications that we have described throughout this module can exert different influences depending on the typology of the business opportunity and the context we seek to exploit.

Thus, the strategy of a company based on free software can and should characterise its actions in the differentiation of its business and the economic effects of its environment, as well as in social capital and production, in addition to coopetition.

## Summary

Throughout this module, we have explored the features of free software as an economic model, even considering the constraints of data limitations given the fact that business models based on free software are relatively new.

Firstly, the basics of social capital and the collective production of knowledge and ideas are not unique to free software. There are currently several initiatives demonstrating how cooperation and collaboration can be feasible in the innovation and production of knowledge.

These basics reveal the importance of the network of collaborators and their involvement and motivation in the global and individual progress of the members of the community. They also offer a viable alternative to traditional production models.

The implications of the philosophy of social production can also be explored from different points of view. While certain features of free software do not reveal major differences with other models, there are some features that can lead to important distinctions.

In the free software business, it is essential to strengthen and exploit the distinguishing fundamentals of free software in order to provide valid and viable alternatives to traditional models. These actions must inevitably be complemented by the detailed study and planning of the business opportunity to ensure the viability and future of the free software company.

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## Appendix

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Version 3, 29 June 2007

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