

Software risk or renaissance?



Artificial intelligence (AI) is driving a structural shift across the technology landscape. This transition has sparked recent fear regarding the long-term viability of traditional software vendors and their established business models. Much of this fear stems from the perceived disruptive threat of AI challengers and the falling cost of software development.

In our view, AI brings both risk and opportunity to software. It is a mistake to view the sector as a monolith. Software is as diverse as the applications and industry verticals it serves. Consequently, the impact of AI will vary significantly across the spectrum of vendors. When the market penalises the sector as if it were a homogeneous entity, it creates some opportunity to identify mispriced assets. We believe a number of enterprise software incumbents remain among the most attractive investment opportunities today.

What exactly are the concerns? We break these down to four distinct areas.

1. Lower cost of software development, enabling customers to rapidly build bespoke internal tools to replace incumbent solutions.
2. Accelerated competition from new software entrants who can exploit the same lower cost of development to come to market quickly.
3. Displacement of traditional software by AI-native applications that change how work is done.
4. Lower workforce headcount resulting from higher AI-driven productivity or professional displacement, affecting seat-based pricing models.

All of these concerns are both valid and, to some degree, observably taking place. The risk-weighted impact, however, depends on the software category and the software vendor being considered.

- **First**, while AI does unlock productivity gains in coding, enterprise software is more than just packaged binaries. For example, a software customer may be acquiring embedded domain knowledge and industry best practice (such as in supply chain software) or technical specialisation and depth (such as electronic design automation). In-house development is not a one-and-done. A software customer is contracting with a proven vendor who provides continuous development, security and compliance, and service guarantees. It offloads complexity and development risk for the customers, who can then focus on core competencies while benefiting from the vendor's future product innovation.
- **Second**, there are categories of software that have always been difficult to displace even in the face of competing options. Attributes contributing to this include systems of record, operational embedment, network effects or where outcomes must be deterministic and the cost of error is high. Enterprise Resource Planning (ERP) software is a category that ticks these boxes. Having access to AI alone does not change the long-standing reality that new entrants must contend with these barriers.

- **Third**, AI is an openly accessible capability rather than the exclusive domain of new entrants. Incumbent vendors can find themselves better positioned to integrate AI into their existing suite and leverage its benefits for customers in a way that outside vendors would struggle to replicate. For the customer, adopting integrated AI features can be more effective and cost-efficient than stitching together disparate tools or risking a move to an unproven new platform.
- **Finally**, there is material uncertainty regarding AI's future impact on the labour force. While workforce contraction in isolation could be a headwind for software vendors using seat-based pricing, those that can unlock higher productivity will capture their share of the value generated, regardless of the specific pricing mechanism. We are already seeing this take place with consumption models or new pricing tiers, such as the newly introduced Microsoft 365 E7 suite, which offers expanded agentic capabilities and is priced at a premium of over 70% to the preceding E5 tier.

AI is a transformative development, and we expect further emergence of compelling new applications that could change how people work. Because the software sector is so diverse, what this means for any given vendor depends on their specific circumstances. For some software names, AI will be disruptive and a risk to their business models. For the highest-quality software vendors like SAP, Microsoft and Intuit, AI is likely to bring a 'renaissance' of opportunity.

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