

Evolving IT

Trends and their implications for
UK technology business leaders

2009



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Introduction

Many of our clients operate in the information technology sector. So we are well aware that, for these companies, the current recession represents yet another catalyst for change in an already changing landscape.

New technologies, business models, ecological considerations and demands for cost reduction are compelling both mature and emerging IT companies to rethink their routes to market and their service offerings. Long-established relationships between manufacturers, resellers, consultants and customers are in a state of flux, creating opportunity for new entrants to the market and presenting a real challenge to those businesses unwilling or unable to evolve.

This report draws on IDC's research expertise, our clients' experiences and our own commercial know-how. It outlines the underlying market drivers affecting the UK's IT companies in 2009 and explores how those drivers will affect successful IT businesses over the medium term. It also suggests how the traditional shape of the supply chain for hardware, software and services is evolving and how new revenue models are developing as a result.

Our report challenges IT businesses in the UK to ask searching questions. To what extent are they really dealing with the evolving market environment? How are they responding in terms of product and service offerings, income generation, strategic partnerships and staffing requirements? And are they ready to change funding requirements, business structures and M&A strategies in order to build long-term commercial value?

What the report clearly demonstrates is that significant new technological developments coupled with economic imperatives are creating real opportunity for those with a well developed strategy.



Wendy Hart
Lead Advisory Corporate
Finance Partner
Grant Thornton UK LLP

Foreword

It's a bad time for the UK economy, but the perfect opportunity for providers of IT products and services to take action – not only to survive the hardship but to establish competitive advantage in time for the inevitable upturn.

This report seeks to identify current trends in the IT market and determine how the underlying business drivers of end-users will accelerate change.

By recognising and responding to those drivers, owners and managers of middle market IT firms can secure competitive advantage and add value to their businesses.

The global ‘big picture’

IT has been a mature industry for some time, evidenced by prosaic growth and increasing commoditisation. History shows us that, when any business tool becomes commoditised, the shift to a utility model is imminent.

In a mature market, end-users become preoccupied with certain key issues. In the IT environment, there are three.

- Cost management
- Dealing with complexity
- Delivering efficiency gains

As the end-users’ use of IT has evolved, businesses on the supply-side have responded by changing their structures and behaviours, and a number of trends have emerged over the last two years. IT cost management is being addressed through the use of:

- virtualisation technologies and capabilities
- software as a service (SaaS)
- cloud computing.

Complexity is being managed through the use of:

- systems integrators (SIs)
- consulting services
- managed services.

Individual and corporate effectiveness are being enhanced through:

- security
- networking
- content management.

These nine key trends are likely to accelerate given the current market conditions. Suppliers should keep them in mind when considering their competitive positioning and how to build corporate value.



Reflecting on global market trends

Managing costs

End-users have taken a fresh look at the cost of their IT resources and are asking some basic questions about value.

Server farms, for example, are grossly inefficient. Servers hosting a single application typically demonstrate lamentably low utilisations of only 5% to 20% of capacity [Source: IDC, 2008]. By marked contrast, virtualisation technology can improve utilisation and reduce the number of managed objects by resource sharing. Server virtualisation enables the hosting of multiple operating systems and applications on a single server. The result is lower capital and operational expenditure.

As well as delivering cost savings, virtualisation can improve business flexibility. Because virtual servers can be deployed more rapidly than physical servers, an enterprise is able to react more quickly to changing business needs.

Until recently, virtualisation products and services have been targeted at the server and storage environments, but that focus is now shifting to the desktop. After all, with roughly 500 million corporate PCs deployed around the globe today, the benefits of consolidating desktops are vast. Suppliers such as Citrix, ClearCube and Wyse Technology are very active in this area.

“Now, more than ever, end-user companies are focusing on profit protection and cash flow management. But the best of them are also investing in IT, recognising that right now this will extend differentiation, enabling them to pull away from weaker competitors. IT suppliers need to demonstrate how their offering delivers one or more of these goals to the clients in their target verticals. The emergence of a multitude of SaaS subscription-based models, with their reduced cash flow burden on end-users, is perfectly timed to hit these user sweet spots.”

Daniel Smith
Head of IT, ISIS Equity Partners

Software as a service (SaaS) is a model of software deployment where an application is hosted as a service provided to customers across the internet. It is accessed when the user wants to use it, is paid for typically as a rental per active user and alleviates the customer's burden of software maintenance, ongoing operations, and support.

SaaS responds directly to end-users' most pressing demands.

- Software purchasers increasingly believe the cost of software is disproportionate to the value it creates.
- There is intense pressure to reduce the cost of acquiring and administering software.
- Organisations are striving to reduce risk and establish a far more tangible

relationship between benefit and cost, while gaining greater predictability of software management costs.

“We're seeing large enterprises move non-core assets off balance sheet and smaller, leaner firms with capital efficient plans that achieve profits rapidly. Such a trend will create specialised units with core products that can be on-sold at good margins. Efficiently run start-ups are well positioned to capitalise on this changing landscape. It is crucial that these businesses secure long-term value by building barriers and differentiators in their ventures which can drive acquisitions as the market recovers.”

Mark Gracey
Scottish Equity Partners Ltd

The market for SaaS has been driven largely by smaller, newer suppliers such as Concur, WebTrends and Qualys. But competition in the market is growing swiftly as traditional software companies begin to offer applications delivered 'on demand'.

SaaS providers that play in the 'horizontal' markets have begun to add industry-specific or 'vertical' offerings, through both organic development or acquisition. In addition, providers are partnering up to expand market penetration and offer a wider range of features and functions.

We're seeing a fundamental shift in the way software is acquired and used – and every traditional software provider should be considering how to respond. After all, the change to a more

subscription-based software application will radically affect a provider's funding structure.

"Existing traditional providers' current applications may not be suitable for use in a SaaS model and this will lead to existing providers investing by means of acquisition or partnering with new entrants who have developed SaaS product and business models in their market space."

Barney Quinn
Chief Executive, Workplace Systems

"Developments in cloud and SaaS offerings are well suited to start-ups and SMEs, and this is beginning to create a new wave of lean businesses adept at using these technologies. In our experience, security concerns still play on the minds of larger enterprises when considering moving company information to the cloud, and still prefer service-based offerings from existing, mature vendors. For other vendors that have been shrewd with cash, acquisitions afford an opportunity to further gain this expertise, and these smaller, innovative and lean businesses could help fuel the return to M&A."

Nick Heyward
Barclays Commercial

End-users' demand for lower and more controllable costs is driving another major shift in the market – the rise of cloud computing.

Cloud computing is the logical extension to SaaS. It provides the same capabilities as commercial SaaS software while allowing users to develop, deploy and run applications that can easily grow in capacity, scalability, performance and reliability. All of this is independent of the nature and location of the underlying infrastructure.

Cloud computing responds to users' demands. It reduces capital and operational expenditure and minimises the risk associated with the cost of running software.

"The growing number of businesses both using and considering using SaaS models is mirrored by the upsurge in interest from within the traditional software supplier community in Intellect. It's clear that the concept of this alternative delivery method is widely understood and that current economic conditions encourage both users and suppliers to investigate different commercial models and for users to worry less about operating IT and more about the benefits which include speed of deployment."

Charles Ward
COO, Intellect

These three offerings are environmentally friendly. Server and storage virtualisation calls for fewer hardware devices, reduced data centre footprints, lower energy consumption and fewer carbon emissions. SaaS and cloud computing both reduce the number and size of inefficient, under-utilised computing installations – by moving computing execution to hyper-efficient, purpose built data centres, they represent altogether greener solutions. For example, at least one such data centre draws its power directly from a hydroelectric power station.

Virtualisation, SaaS and cloud computing are being seen as significant pillars of green.

"Statistics suggest that more than 3.5 million people in the UK are now regularly working from home as companies are looking to provide their employees with the flexibility to work from home in order to meet green objectives, reduce property costs, increase productivity and increase employee satisfaction. Employees must be provided with access to all the applications they would normally use within the office, but this must be accomplished without introducing additional technical complexities or latency while enforcing appropriate levels of data security and providing visibility into true costs of mobile working."

Paul Blair
Head of Secure Connectivity & Email Group,
Vodafone Business Services

Managing complexity



For all its benefits, IT brings great complexity which many companies struggle to manage. As a consequence, many are seeking help from system integrators, consulting service providers and managed service providers.

The success of these IT service companies is critical to software providers, and hardware manufacturers rely upon them for a very large proportion of their revenue. In the event of an economic downturn, consultancy firms and SIs risk more immediate and profound suffering than others due to the discretionary nature of their services. So they are increasingly eyeing up partnerships with mid-market SIs rather than traditional supplier-vendor relationships.

End-users are likely to be demanding systems integration services even in the depths of a recession, especially in the following areas.

- Cost-cutting projects with rapid payback.
- Applications homogenisation in the wake of mergers and acquisitions.
- Enhancing and updating legacy and packaged applications, providing faster implementation times, lower risk, and increased profit margins on IT investment.
- Projects involving infrastructure improvement, such as data centre consolidation and virtualisation.

Overall, SI vendors who invest in emerging areas, stay close to their customers, and focus on efficiency will be well positioned to capitalise on an upturn in the market. But they will need to understand how market drivers such as SaaS and cloud computing will affect

their infrastructure and then lead, or at least keep pace with, their customers.

A word of warning: this promising position could be jeopardised by the IT skills shortage. This shortfall shows no sign of abating: it is now being fuelled by a lack of interest in technology among Western economies and a lack of skills among job candidates from the Near and Far East.

Consulting service providers are complementary to system integrators. They offer IT advisory services focused on strategy, assessment and planning, and design and architecture. These companies are in a similar position to SIs, both in terms of their vulnerability in an economic downturn and in being in pole position for growth once the economic upturn arrives. Their advice is pivotal for the futures of many vendors and many are held in high esteem for their expertise.

In difficult market conditions, clients are likely to focus on application strategy, portfolio and modernisation strategy, design, and ERP-related consulting. Their focus will be not only on business processes but also on solutions. New mid-market solutions from companies such as SAP and Oracle offer interesting opportunities in both developed and emerging economies.

Service providers need to consider which business model will help them serve these new clients. And with ongoing skills shortage, consulting services will put more emphasis on retraining their existing workforce.

Providers of managed services – that other means of managing complexity – should be better placed to withstand the downturn because of their

“The move towards packaged software offerings in the ERP space is driven by a number of factors. These include the high cost of developing unique bespoke solutions together with the dependence on one source of support for mission critical applications. However, current research indicates that this is still the most prevalent way of purchasing software solutions. The move towards packaged ERP applications will in future be assisted by the market consolidations currently taking place in this sector. This enables independent software vendors to use the facilities of a mainstream supplier as a base for their vertical software.”

David Hurley
Anglia Business Solutions

contractual business model. However, they will still be subject to aggressive cost-cutting by their customers and contract tenders. Pipeline activity will tend to favour smaller deals. Clients negotiating new or expanded contracts will welcome shorter-term, quickly-embedded ROI projects with boundaries that are clearly defined and deliverables that are single phase optimised. Large projects, particularly in the short to medium term, may well be prone to delay and stalling. Core ERP upgrade plans may be delayed, but if outsourcers can show managed service savings with improved operational performance, companies will evaluate the level of risk and payback and may proceed anyway.

On the upturn, managed service companies will have more opportunities

“An early message here is stop buying into complexity; there will soon be no need. Far more virtual ‘black box’, ‘plug and play’ technologies are rapidly becoming available. Service delivery companies and certainly managed services companies will play an increasingly important role in providing optimised solution sets which integrate black box virtual appliance technologies. Those service organisations with IP and experience with delivery will shine here. ‘Hands off’ consultancies will be less successful.”

Sheldon Stoutt
Tribune

“Companies are under increasing pressure to control headcount costs and are showing reluctance to invest in additional headcount to support complex systems that are not deemed to be a core competency of their existing IT and support functions. There is a movement towards managed services to divert support for entire solutions to third parties in order to take advantage of more advanced technical knowledge, cost predictability, service management, and regular solution upgrades.”

Paul Blair
Head of Secure Connectivity & Email Group,
Vodafone Business Services

to show customers how they can respond with greater speed to changing market dynamics. It is this that makes them so valuable as a partner to IT manufacturers and software developers fighting to access end-user sales opportunities.

Enhancing individual and corporate effectiveness

End-users require continual access to IT systems that give them all they need to do the job – so enhancing effectiveness is crucial. That’s why secure systems and ubiquitous system access through networking are such significant market trends.

Secure systems cover web security, messaging security, endpoint security, network security, identity/access management and vulnerability management. Each plays its part in ensuring continuity of access.

Demand in this market remains strong thanks to several factors:

- Heightened threats: historically, the level of fraud rises during a recession and is forecast to do the same during this downturn.
- Regulatory compliance: many regulations and IT best practices prescribe security requirements with which organisations, especially within regulated verticals, must comply.
- Subscription revenue: security software is only as good as its last update. For the security solutions to remain effective, they must be updated. Subscription-based services will ensure that security vendors continue to receive some revenue, unlike other products that rely on the purchase of new hardware or software.

- Hosted services: hosted services, especially for messaging and web security, are likely to gain in popularity. By using SaaS offerings, organisations can reduce staff and benefit from economies of scale that the SaaS supplier is offering.

Security, therefore, is likely to perform well in both the short and medium terms. That said, for businesses in this area – such as Websense, Norton and LANDesk – to thrive, they will need to keep a close eye on the environment. They need to stay in close contact with their partners up and down the supply chain to understand temporary cash flow and order dynamics. They may also have to reduce prices where they can, or move to subscription-based models.

“True business effectiveness can only be brought about through strong leadership, acute fiscal awareness, trusted partnerships and the ability to tap into proper IT resource anywhere, anytime, anyplace and ‘on demand’. Organisations will need to rethink the tendency to ‘over-protect’ networks, to the detriment of the business. We will quickly get to the stage where the technology enables us to run security protected virtual machines, even over local or wide-area networks, so that security of applications and data can be assured. There will be a move to protecting and securing entire infrastructures rather than just components.”

Sheldon Stoutt
Tribune



“Companies spend a significant amount of time developing IT security policies but, in most cases, don’t have the tools available to enforce these policies. A study conducted on behalf of Vodafone identified that one in three individuals had never read their employer’s IT policy or didn’t even know there was one. With the trend towards mobile working, the ongoing stories in the media about lost or stolen laptops and senior management being held legally responsible for data security, it is critical that companies have a clear mobile strategy for protecting their data. Companies need to be able to introduce systems that enforce security policies plus be in a position to report on compliance in order to meet regulatory or corporate policies.”

Paul Blair

Head of Secure Connectivity & Email Group,
Vodafone Business Services

Due to the defensive nature of market demand in difficult trading conditions, networking is not as robust as security over the medium term. However, it will still be a critical enabler of most aspects of IT and, without its ability to deliver application access, many aspects of IT will suffer. In the current market, a business’s ability to process and disseminate data is a key determinant of success.

The internet protocol network has become an important tool in business segments differentiated by network-based applications. Even though market drivers for network spending are strong, the diverse range of network suppliers, from Vodafone to Cisco, need to be prepared for sales cycles to be longer in the short term. Delays in decision making are inevitable – with IT budgets constrained, infrastructure investments are being evaluated more closely.

Network suppliers will continue to provide the underlying enabling capabilities that corporate applications demand. Their importance will increase over time as the prevalence of SaaS and cloud computing increases. Corporate competitiveness is increasingly based on the availability of corporate applications to mobile staff via the internet.

Content and media technologies also play a role in enhancing effectiveness. Encompassing document management, web content management, capture and image management, digital asset management, and records management, their growth is likely to remain strong in the medium term. Even in tough trading conditions, organisations tend to continue spending on content

management software: they help to support compliance, ensure litigation readiness, reduce e-discovery costs and improve operational efficiency.

While the importance of the web will drive continued investment here, there’s a downside. As long as the downturn continues, cutbacks may put a dampener on large new digital asset management projects, at least until the economy starts to recover. Of course, when confidence returns, expect postponed major projects to be fast-tracked.

Despite this relatively positive view of the content market, service providers should focus intently on retaining their customers. It will be more profitable to sell to existing customers than to try to capture new ones. The trend for large organisations to reduce and consolidate the variety of content and media platforms in use is likely to create new opportunities for expansion within existing accounts for enterprise-level providers.



Drawing conclusions from global trends

These trends might appear to paint a relatively complex picture. But the industry is simply coming to terms with the fact that it is now a mature, globally driven commercial market. Because of that, suppliers are seeing relatively slow overall growth, albeit with some well-defined hot spots.

Given current trading conditions, most end-users are looking to reduce costs and extract more value from their existing IT assets. They are struggling to deal with the complexity of what they already have and are worried about adding more. At the same time, under pressure to optimise staff productivity, they are seeking to ensure their workforce has exactly the right information that it needs to do the job; when and where it needs it.

Despite the doom and gloom, several sectors are well-placed to respond to market demands. Mid-market businesses within the IT sector must understand and exploit these opportunities in order to build value and sustain competitive advantage.

“In our experience, periods of economic downturn represent great opportunities for companies and products that provide consumers with an inexpensive escape (such as cinemas). Those companies that do this and are not reliant on advertising spend as their primary source of revenue should be in particularly good shape.”

Michael Kaplan

Investment Manager, Albion Ventures LLP

The UK – situation and challenges

The UK is characterised by a small number of large companies, an even smaller number of mid-sized companies and a very high proportion of small companies [Source: Intellect Technology Association, 2008].

This profile is almost certainly caused by the acquisitive nature of very large companies headquartered both in the UK and overseas, particularly in the US.

Small UK companies can find themselves ideally placed to lead the market through both innovation and more aggressive corporate strategies. Senior management must look closely at their business models. Are they able to capitalise on the opportunities in the market?

Key business questions

- Do we have the most effective channel structure to get products and services to our target markets?
- Do we have the correct partners to add value to our business propositions?
- Do we have the IP assets necessary to provide transparent value to an end-user?
- Do we have the right skills in the right places to be able to implement and support marketing initiatives?
- Do we have the close links with the tertiary education system to identify and commercialise emerging IP?

To optimise the business model of the company, a business leader should consider taking advantage of the many smaller suppliers with either valuable intellectual property or access to market. This will help them to fulfil market demand and add value to their companies.

In difficult trading conditions, poorly funded businesses, however innovative, might struggle to survive. And that represents a clear opportunity for potential acquirers.

Businesses that have developed critical mass and a clear market focus will continue to be attractive targets for overseas acquirers. While the short-term shock of the downturn has put the brakes on acquisition activity, the UK remained the most active market in Europe during 2008 with US interest bolstered by the recent strength of the US dollar against the pound. This trend seems set to continue as sterling denominated businesses represent a relative bargain.

The implications of shifting IT business models

It used to be that several dominant business models characterised an industry – competitive advantage being mainly achieved through better execution and product innovation. The technology sector is no different (see table below).

But the ICT market is increasingly characterised by hybrid businesses with multiple and co-existing business models. The jury remains out on some, while others, such as Apple, are spectacularly successful. Execution and product innovation are still clearly critical, but no longer seem sufficient without other ingredients of sustainable success.

The nine core trends that are reshaping the industry mean that IT businesses must re-evaluate the models they use to get their products and services to market – constantly questioning and improving. That need has become even more pressing because of the consistently high degree of business model innovation and disruption in the market.

To compete effectively, a modern technology business must consider a refreshed mix of business models.

Deep pockets (particularly in the US) have allowed for experimentation and some uniquely disruptive market entry, but this is quite rare and risky (Google and Amazon are two examples). At worst, it has caused businesses to be confused – both to themselves and the market.

Currently, the key trends in business model innovation are:

The traditional 'component' business models in the technology sector

Business model	Value proposition
Independent software vendor	<ul style="list-style-type: none">• Development and marketing of relevant software that aids the effectiveness and /or efficiency of a business or individual
Value-added reseller	<ul style="list-style-type: none">• Expertise in a particular market segment's technology needs• Selling a range of third party technology products relevant to expertise and needs• Complementing products with a range of in-house services to enhance fit to client needs
Dealer	<ul style="list-style-type: none">• Stocks a range of popular technology products typically fulfilled with minimal customisation
Systems integrator	<ul style="list-style-type: none">• Heavily customised solutions• The complex design, integration and implementation of complex in-house, client and supplier technologies
Distributor	<ul style="list-style-type: none">• Acts as an intermediary between ISV and channel to ensure credit, product and skill availability
Consultancy	<ul style="list-style-type: none">• Expertise to expose, diagnose and propose a resolution to a unique client need
Outsourcing	<ul style="list-style-type: none">• Expertise to run and manage large scale IT deployments on behalf of typically large organisations – resources placed as a mix of near-shore and off-shore



A tendency towards a services-led approach

- Companies are changing their sales value propositions to ask how they can help customers truly solve business problems. To do this, they lead with consultative and managed services and efficiency software, and then add on packaged software and hardware.
- Many businesses have been investing in this for a while and will continue to do so. In 2008, services made up 50% of the revenue stream of value-added resellers (VARs) as they move increasingly into the traditional SI space [Source: IDC]. As these companies mature, they move further up the food chain to remotely manage and monitor, which gives them the power to predict the future for their customers' IT environment and to advise them on future needs and direction. This evolution is likely to see it go to the farthest end of the spectrum where the channel organisations become the lynchpin of solutions to the customer.

- Today, large SIs are being acquired by suppliers anxious to build out their own service expertise – see, for example, HP's acquisition of EDS. At the same time, the SIs have been buying other smaller partners, because they see themselves as a link to the highly sought-after small and medium businesses. They have their eye on a new look that is a market footprint with managed services as well as all the products needed to deliver the solution. It is because of their managed services offering that they will be able to see or even predict the products the customers need. The market is demanding reduced cost and a movement from capital expense to operating expense, so channel companies are having to migrate their businesses to managed services and offer leasing and other ways to shift their business from resale to annuity revenue flows.

“Companies must understand how mission-critical their product is to VARs and resellers, not just to end-customers. If any part of your channel isn't gaining significant value from the sale, your product will be deprioritised in favour of something that does.”

Michael Kaplan
Investment Manager, Albion Ventures LLP

A tendency towards channel partners increasing their power and position

- Channel partners are in a unique position to introduce new concepts for IT efficiency and to influence sales. This is because they have connections at both ends of the supply chain.
- The business strategies and health of channel companies directly affect the performance of IT suppliers. This means that suppliers must consider how they are relevant to the channel and its customers.
- IT companies need to be aware of changes taking place within the channel community. There is a battle for effective channel capacity and vendors often assume it to be an infinite resource. The opposite is true.

“Companies with strong recurring revenue models that have built compelling software service offerings which are embedded into their customers' workflows continue to be very attractive. What we see that doesn't work is software companies cramming a perpetual licence product into an SaaS model without transforming their product and sales cycles to match. SaaS companies that remember they are 'service' companies are the ones that win customers and, most importantly, retain customers.”

Michael Kaplan
Investment Manager, Albion Ventures LLP

A tendency towards annuity and other revenue model innovation

- Many new entrants have tried to win business from incumbent industries or suppliers by offering new types of revenue model. In parallel, and as a reaction against large capital outlay and un-used licences, many user organisations have looked for a more effective method of linking use of technology with payment. Likewise, most users have simply looked for good-enough functionality.
- Some regard the combination of the two trends as heralding a new software economy while others regard it as a sign of a maturing market. Either way, the development can be characterised as IT as a utility with customers wanting to pay only for what is needed, when it is needed. Non-IT sector equivalents include construction equipment hire, executive jet timeshare, car clubs. The term ‘anything as a service’ or ‘XaaS’ has sprung up to describe this emerging trend.
- With little or no capital expenditure (as infrastructure layers are owned and provided as a service by various different providers), barriers to entry are lower.

Several other models have also been deployed:

- Advertising revenue-based models – such as those deployed by Google or MySpace

- Rights or collaboration models such as:
 - Open source (such as SugarCRM) – where software is licensed with relaxed or non-existent copyright terms or restriction
 - Creative commons – where selected intellectual property rights for an asset are waived to promote distribution so that another revenue stream may result through eventual commercial use
 - Crowdsourcing (such as Cambrian House) – where mass collaboration is deployed (via seekers and solvers) to resolve a variety of challenges
- Usage models such as ‘free-mium’ – where a basic but suitably functional product may be offered in order to create demand for essential add-ons for specific segments or power users. LinkedIn and LogMein are good examples.

All of these models are being deployed as new ways to attract customers and provide a better balance between cost of production and cost of consumption.

“Companies are looking for flexibility in pricing and are increasingly seeking models that avoid significant up-front investment and can be structured to allow full allocation of costs to end-user departments rather than directly absorbed by IT. IT companies need to be in a position to offer their customers this flexibility or risk losing business to others who can do.”

Paul Blair

Head of Secure Connectivity & Email Group,
Vodafone Business Services





A tendency towards internet availability of products and services

End-users now expect IT applications to be available at any time and wherever they happen to be. This is particularly true for customer/prospect facing applications such as Customer Relationship Management (CRM) or Enterprise Resource Planning (ERP). It is an expectation that requires applications to work seamlessly with a growing range of mobile access devices, from mobile phones to network-enabled laptops. This growing demand is driven by the increasing number of mobile workers. By 2012, that number is expected to reach one billion worldwide – up from 750 million in 2006 [Source: IDC, 2008].

IT businesses are having to reconsider their partnership arrangements for both application development and application delivery. Many do not have the skills or experience to convert current applications so that they can be accessed from devices that are not computers. Equally, most do not have the capability to deliver or support internet-based applications. Partnerships with specialist developers and suppliers are the only viable way forward for these companies.

Such arrangements change the very nature of software development. They drive developers towards business models based on SaaS and cloud computing. In doing so, they fuel the fundamental shift that is already taking place in the industry.

A tendency towards increased packaging of offerings

Channel companies, particularly the larger consultancy firms, are systematically putting together packaged offerings. These packages include all steps of a transformation initiative and all the expertise and capabilities needed to implement them.

Packages usually include a combination of:

- in-depth domain expertise
- integrated IT solutions
- programme/project management
- organisation and change management capabilities.

The packaged solutions also include tools and templates for quick, less expansive delivery. This trend is resulting in shorter engagements with higher impact.

What are the implications?

For the UK-based technology business, what are the implications of these business model shifts?

While some value drivers that have historically fuelled the market are evolving, many others remain unchanged and still hold true.

The impact of the new drivers on the well-established ones depends on the specifics of a business and its market sector.

- The tendency towards a service-led approach may extend customer focus but also poses the challenge of how to economically replicate similar solutions to maximise profitability. This is likely to be particularly true for businesses used to higher volume transactions of minimal variety. It will also pose challenges for businesses yet to reach a critical mass in a particular skill.
- A tendency to package offerings may need to be examined carefully to determine whether it strikes the right balance between financial outcome, strategic rationale and market-led reasoning. Many packages owe their origin to internal convenience rather than market-led thinking.

- The tendency towards different revenue models may need to be looked at in the context of launching new offerings. Is it sensible to help businesses cut costs by providing good-enough propositions (for instance Open Office instead of Microsoft Office) while exploring new revenue streams such as support or hosting services?
- The trend towards increased partner power is moving channel companies closer to the centre of decision-making and solution design. Businesses may want to take a fresh look at their partners to see which still meet their needs.

These tendencies point to the need for a renewed clarity of mission, the exploration of alliances and ultimately the need for mergers and acquisitions.

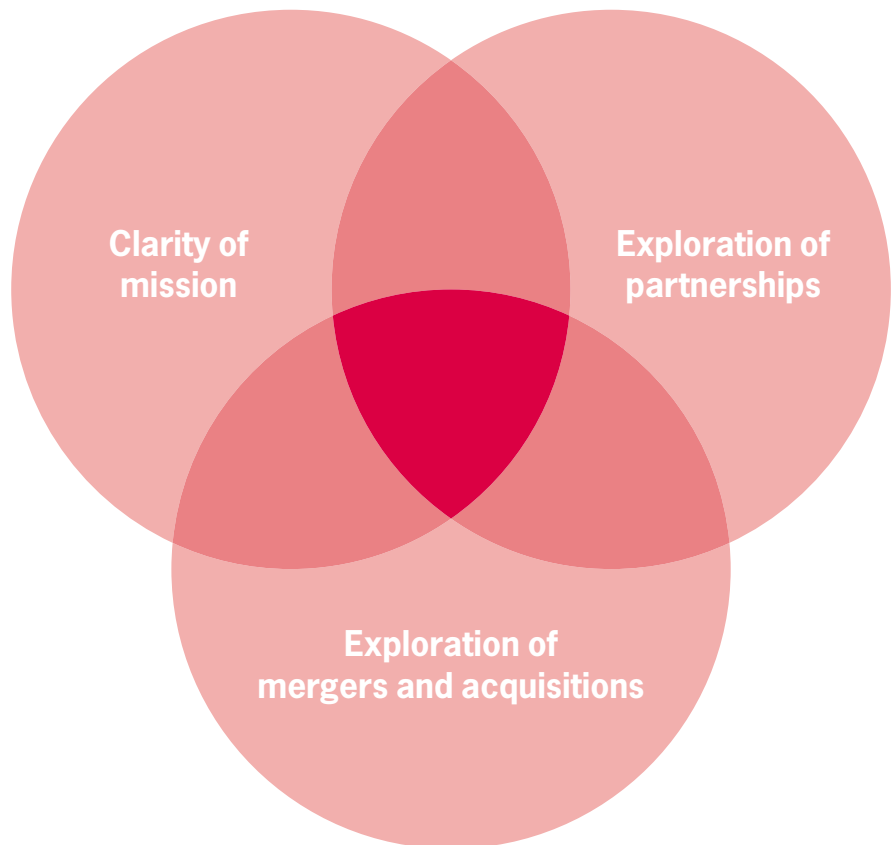
Ask yourself whether your business is constrained by its current business model. And don't wait for the next market disruption to affect how valuations may be made.

Building value ahead of the curve

The modern technology business will need to become an evolved hybrid of business models in order to compete. However, a mixed business model can cause confusion. So the challenge will be to find the hybrid model that best enables a business to prosper and scale without confusing itself or its markets. In preparation for the next cycle of economic growth, three fundamental elements offer the potential to develop enduring value (diagram opposite).

Customer focus	<ul style="list-style-type: none"> • Existing and potential customers and vertical audiences • Depth and breadth of client or segment relationships • Market-relevant innovation
Force multipliers	<ul style="list-style-type: none"> • Number of valuable partnerships and opportunities, as well as channel strategy
Market potential	<ul style="list-style-type: none"> • Strength of the market and the potential for the company to grow within the market
Corporate strategy	<ul style="list-style-type: none"> • Potential exit strategy and company leadership, vision and funding
Technology/solution	<ul style="list-style-type: none"> • Strength and differentiators of product/solution • Image, prestige and position
Financial outcomes and operations	<ul style="list-style-type: none"> • Cash generation, plus predictability and repeatability of revenues at acceptable cost

Elements offering the potential to develop enduring value





Clarity of mission

Given the changing market, there is a risk of appearing confusing. This means that it's important to:

- reaffirm mission and direction
- put in place a coherent, logical, unifying strategy.

Ask yourself this: What were you trying to build and is it still relevant for the markets you're targeting?

Essential foundations

In the short term, a company should consider:

- undertaking a fundamental review of the company's strategic understanding and plans for target markets and product offerings
- Adjusting and refining the company's business model
- developing rigorous and validated business plans
- developing and honing value proposition and market positioning
- focusing on chosen products and their USPs
- shifting to high-spending segments or verticals such as government.

In the medium term, a company should establish presence and reputation via industry networking. It should develop value-added services and products that provide stability to income generation – that is, by-products.

A re-appraised clarity of mission is the cornerstone of value creation, and the removal of confusion is paramount.

Exploring partnerships

There are two aspects of partnering that require deeper exploration.

1. Complementary partnerships and alliances. These are essential to extending core capability. Why should a business feel burdened to innovate all elements of a solution when so much is now available 'as a service' either on an ad hoc or strategic basis?
2. Distribution channels. These are essential for extending sales reach and effectiveness. They may not appear to change as much or as often as the technology markets they serve, but a subtle undercurrent of change causes a dramatic shift. The traditional IT channel is split into those delivering products and those delivering services. But the next generation channel has begun to emerge with companies such as Amazon and Google offering services such as backup, recovery, and desktop applications.

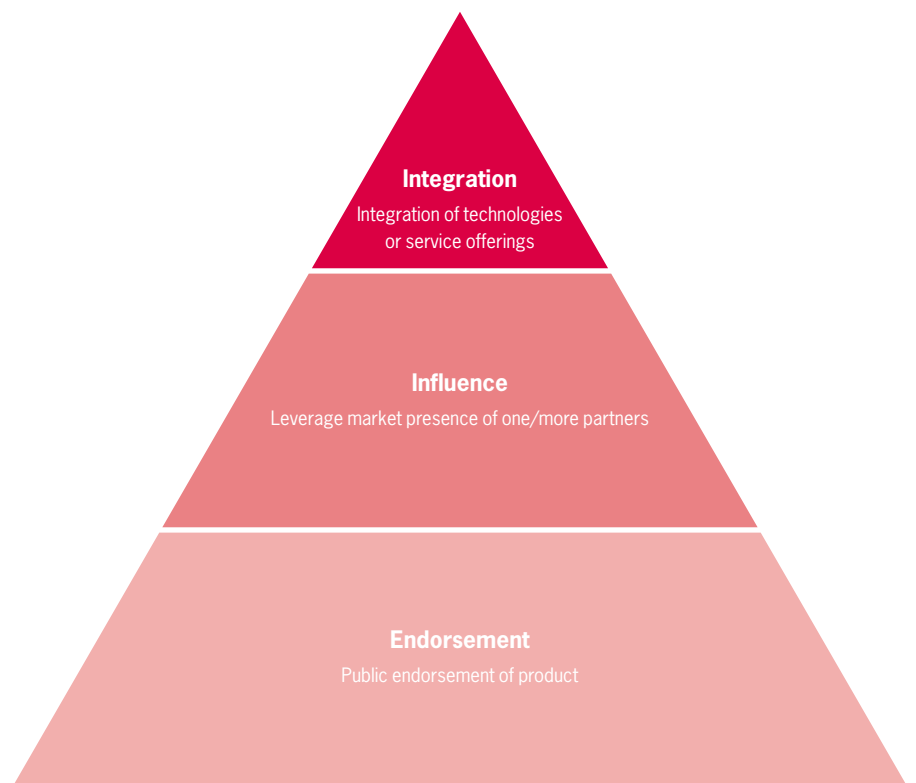
So what are the essential foundations and pathways to consider in respect of value creation?

- A full refresh of necessary and appropriate vendor accreditations/authorisation. Understand who your most important allies are and how you are related. They can provide vehicles, tools and mechanisms to support business model transition and introduce your business to like-minded businesses.
- Examination of opportunities to provide niche or augmentation solutions in big picture offerings. Understanding how your solutions are implemented can provide a rapid route to deeper and broader relationships. What part of the jigsaw do you provide? Was this a one-off or is it repeatable in the context of a partnership? Can any of the new business trends be deployed through this partnership? Can this be used to build and defend value? Examples of businesses that have successfully risen to this challenge include Monitise in the mobile banking sector and Focus Business Solutions in the independent financial adviser market.
- Appropriate quantity and quality of sales and partner representation in desired markets. How are solutions sold? Does the network have effective capacity and are there loyal and motivated teams within it?

In the medium term, the following become more relevant:

- Partner to partner networking. Enabling your partners to work with each other to build upon your solutions – to promote innovation and to position your solution as a core element of a customer’s infrastructure.
- Appropriateness. Alliances or partnerships within firms that have complementary offerings will allow you to extend your offering at a minimal cost.

The diagram below illustrates how an integrated short- to medium-term programme can create value.



Exploring mergers and acquisitions

M&A presents the opportunity to achieve improved presence in rapidly changing global markets – something difficult to achieve through organic growth alone. Good value deals are currently available for acquirers with ready access to funds.

We expect larger acquirers to focus on smaller technology businesses during 2009 as they monitor the decline in the valuations of larger targets. Moving into 2010, we believe the software industry will witness an M&A surge.

- Large application vendors will strengthen their technology stacks via significant acquisitions
- Industry specialists, for example in banking, insurance, healthcare, public sector and retail, will be another source of acquisition activity
- IT infrastructure vendors will acquire services providers and adjacent technology vendors to become full data centre providers

So what are the essential foundations and pathways to consider?

- Gaining access to critical vendor relationships/accreditations that can open up new and lucrative markets

- Gaining access to scarce skills and expertise – in particular, sales, technical and managerial skills
- Gaining access to complementary technologies and products to create a more well-rounded solution offering
- Expanding into new markets around the world
- Reducing reliance on a single product or marketplace
- Looking for cost savings – for instance, with duplicated management or premises.

“Gaining access to critical vendor relationships/accreditations that can open up new markets will be particularly true in the secure systems markets where the investment and time to revenue in gaining accreditation and compliance in different sectors and geography are so great.”

Barney Quinn
Chief Executive, Workplace Systems

In the medium term, a company must achieve credible scale and develop a record of performance in the market. This will allow prime bidding on larger contracts.

Mergers and acquisitions can be seen as the purest form of value creation – particularly when undertaken strategically and in the context of renewed vision and alliance building.

“Successful deals in the small side of the IT services sector should include three things: 1) a clear schedule for cost savings post acquisition, 2) a complementary product/geographic mix that provides for future growth and, most importantly, 3) a management team in the target company that is ‘bought in’ to the sale and is receiving most of its payout only after the goals of the combined company have been achieved.”

Michael Kaplan
Investment Manager, Albion Ventures LLP

Conclusion

In times of financial upheaval, all businesses must consider how to survive, thrive and maximise their competitive advantage. But for IT businesses, economic uncertainty has come on top of the substantial and unprecedented transformation already underway within their own industry.

In developing this report, Grant Thornton has sought to identify the drivers underlying the transformation of the IT sector and the industry trends arising from it. In doing so, we have set out to help business leaders determine how best to drive and build value in the current and evolving market context.

Change in the IT industry is being driven by the demands of its end-users.

- To reduce costs and to extract greater value from existing IT assets
- To deal more effectively with the complexity of existing systems without increasing in-house staffing levels
- To respond to the pressures of the wider business in which they operate to optimise productivity and efficiency
- To seek a more effective paradigm for linking technology usage with cost, without having to start again in terms of infrastructure and technical knowledge
- To respond as far as possible to the green agenda in formulating new IT strategies

Much of the functionality of today's technologies has come to be seen as good enough or commoditised. But a maturing IT market has opened up opportunities to new businesses with business models not dependent on the old economics of capital expenditure.

There are opportunities to secure access to previously captive client bases through disruptive strategies and innovations. As a result, much attention is being focused on building new revenue-generation models on the back of existing market platforms. In some cases this is through open source or other innovative commercial arrangements, some of which we have explored in the body of the report. Meanwhile, 'anything as a service' (XaaS) – be it platform, software or service offering – will continue to fuel a fundamental shift in the relationship between technology supplier and customer.

In this difficult but exciting climate, the strategic imperative for existing IT businesses is to ensure the ongoing relevance of their market positioning and proposition. At the same time, the well-established relationships between the various links in the IT supply chain are likely to weaken. A clear strategy, new partnerships and relationships, new funding arrangements and resolute action are likely to be required to ensure that businesses can evolve in order to survive and prosper.

Above all, consider:

- whether your business is likely to be constrained or put at a competitive disadvantage by its current structure and business model

- how value drivers within your segment of the IT industry are likely to evolve over the coming months and years and whether your business is positioned to benefit or suffer as a result
- whether changes in revenue-generation models are going to create a shift in the funding requirements of your own business
- whether the current market conditions represent an opportunity to fill future market demand gaps either through acquisition or new strategic partnerships

Ultimately, those business leaders who are able to identify where the current technology trends and market drivers will impact on them – and to respond positively – will lead their businesses most strongly out of the current downturn. These companies will be the most attractive targets for overseas acquirers when the M&A markets return to full strength.



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Aspirational, rapidly growing technology companies require responsive, hands-on advisers with the skills base and experience to meet their changing needs. Grant Thornton has a strong track record of providing advisory services to dynamic, technology-based businesses. These services include corporate finance, project finance, business planning, taxation and audit.

Halarose Ltd



Disposal to management team

Election management software developer

August 2008

Grant Thornton provided lead advisory services

Axial Systems Ltd



MBO

IT network solution provider

March 2008

Grant Thornton provided lead advisory services

Alphameric PLC




Disposal of the hospitality business to Torex Hospitality Solutions Ltd

Software

July 2008

Grant Thornton acted as reporting accountant

Snell & Wilcox Ltd & Pro-Bel Ltd



Secondary MBO & merger

Media equipment

February 2009

Grant Thornton provided lead advisory and tax services

Tikit Group PLC



Acquisition of TFB Group Ltd

IT solutions for the legal profession

April 2008

Grant Thornton provided due diligence services

Fibre Technologies Ltd



VIMBO

IT hardware

April 2008

Grant Thornton provided lead advisory services

Sagentia Group PLC



Relisting of Sagentia from main market to AIM

Technology consultancy

June 2008

Grant Thornton acted as reporting accountant

Marshal Holdings Ltd



Merger of Marshal with 8e6 Technologies

Web & email filtering software

November 2008

Grant Thornton provided due diligence services and tax structuring advice

Tinglobal Ltd



Acquisition of Powercore International Ltd

IT reseller

March 2008

Grant Thornton provided due diligence services

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