ChangeBEAT

Of Mushrooms and Compost Heaps

How to make a mature industry feel young again

Abstract

Is the IT industry suffering from advancing old age, or just the mother and father of all hangovers after the Y2K scam and the dot com bust?

In this paper, Ian Henley from *ChangeBEAT* looks again at the "mature industry" argument and concludes that the industry's fate is in its own hands.

Introduction

In *A Mature Industry? I Don't Think So!* [1] we looked at the state of the IT software and services marketplace. In the second paper in this series, we look at medium-term prospects and at what must be done if future growth levels are again to exceed GDP.

The story so far

That the industry is in a bad way is beyond dispute, but the point at issue is this. Has the IT industry matured to the point where it can never again grow faster than GDP? Or is it suffering from other problems which, if addressed, could mean a return to higher levels of growth? This is an important debate, which affects us all. If it becomes received wisdom that the industry is doomed to a future forever in the doldrums, investment will be depressed and management may lack the conviction to do the things that must be done.

Distinguished industry analyst Richard Holway[2] has advanced four arguments to support his view that the market has "matured" and that consequently future growth in the IT industry will be limited to the level of GDP. They are:

- We can't go on like this! No exponential lasts forever
- No industry gets bigger than 5%
- There is no "next big thing"
- It's time for a phase change

In our previous paper, we looked at these arguments and found them unconvincing in themselves. The first two arguments amount to the same thing, and we see no inherent reason why the IT industry should face some sort of glass ceiling at 5% of GDP. The "no next big thing" argument overlooks most immediately the results already being delivered through the

[1] For a copy, please email *info@ChangeBEAT.com*

[2] Richard has asked me to make it clear that these arguments are his. We fully acknowledge Richard's leading role, and the excellent work done by Ovum Holway, in informing this debate.

commercial exploitation of the Internet[3]. In the medium term we can see no reason why a plethora of new, high-growth IT markets will not emerge beside the more mature markets in items like PCs, ERP and spreadsheets.

Furthermore, technical innovation will continue to enable new developments. Whatever you may have read[4], Moore does expect his law to apply for at least the next ten years[5], and even if silicon then runs out of steam there will be new biotechnologies to continue to improve price performance[6].

A doubtful analogy

In response to our paper Holway cites the "automobile analogy" comparing the development of that industry since 1964. He persuasively points to the impressive technical innovation that has taken place and the three-fold increase in car volumes. "Automobiles pervade all aspects of society," he says, "but still the market has shrunk from 4.5% to 4.2% of GDP over the last forty years." This looks like a powerful argument, but can the two industries reasonably be compared?

The automotive industry does a certain thing: make cars. It has a clearly limited size (around one per adult person) and no amount of innovation can alter this fact. Sure, you can pack a car with electric windows, fuel injectors, extra valves and go-faster stripes, but it is still a car, and its principal added value is to move us from A to B. To meet the demand, the structure of the supply side of the car industry has stabilised around a well-defined value chain, with well-defined interfaces. Each element of the chain provides the focus for intense competition. Specialist companies work their own disciplines, for example: the production of tyres; upholstery; engine casings; power

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[3] According to silicon.com on Monday 10th March "China's ecommerce market, currently valued at $500m per year, is projected to expand to $23bn within three years."

[4] Ovum Holway Hotnews 13th Feb 2003

[5] "Moore's Law states that the number of transistors per square inch on integrated circuits (which relates to computing power) doubles every year. Asked if Moore's Law would run its course in the foreseeable future, Moore replied, "Another decade is probably straightforward." Reuters; 11th Feb 2003

[6] "…in biotechnology, variants of Moore's law are already popping up in such fields as bioinformatics and biochips. Red Herring; Feb 10th 2003

trains; assembly; distribution; or after-sales service. These specialist companies are themselves served by second order specialists who help them improve some specific aspect of their business. Price in a limited market is a huge issue and so cost is ruthlessly ground out of the supply chain, module-by-module, piece-by-piece. This is a truly mature industry.

The IT industry is just not comparable. Look first at the supply side structure of the IT industry. It is true to say that we are beginning to see the emergence of a middleman (in the form of the outsourcing companies) but apart from that, the IT industry is far from the highly structured value chain that gets cars on the road. The elements of the value chain are not even that well defined, and because of the complexity of IT systems and the absence of clearly defined value chain elements and interfaces, the supply side continues to evolve.

Another clear point of difference is that IT does not do one thing. It does many, many things. There is no limit to the way in which IT, when properly applied, can add value, or the size of the markets it can enable. IT is applicable to every single industry and is indispensable. One could, of course, say that in a limited way the same is true of the car, but whereas innovation in the car industry merely helps one company take market share from another, innovation in the IT industry can result in whole new markets.

Sure, the market for PCs or even ERP systems may be maturing, but the market for Web-based consumer purchasing is in its infancy. Reliable voice recognition, for example, is not far away, and it takes little imagination to see that many new markets will be driven by that innovation. As soon as someone creates a computing application that realistically manages corporate knowledge, or a device that we clip to our ear (or implant in our brain) to enable us to understand a foreign language, or manage our health (or one of a million other things), new buoyant IT-based markets will be born.

A mature industry? I don't think so. Comparing the automobile industry with IT is like comparing a mushroom with a vast compost heap.

But what about unit labour costs?

Holway's final argument in support of his mature market contention is that even if demand does continue to grow, "we are now in a period when volume increases will struggle to keep pace with price decreases."

Now this is an important point, and not one we dispute in the short term. Clearly, as night follows day, the stalling of the market has led to price reductions and this is leading in turn to job losses and reductions in professional pay. Additionally, we are seeing the entry into the UK market of overseas companies with lower cost structures. Even if they are not expected to take more than 5% of market share by 2006[7], and even if they will be restricted in many of the things they can do, they can still be expected to exert a downward pressure on labour costs for a long time to come.

However, as in all things, this is really a question of supply and demand. What will ultimately decide the fate of the industry is the speed with which demand is re-established. If this problem is addressed and demand is re-established sufficiently quickly, unit costs will rise again.

Happy Days?

However, this does **not** mean that we believe *Happy Days Are Here Again* for the IT sector. Alas, far from it. Demand has certainly stalled, but our belief is that it has stalled principally because of understandable **loss of confidence**, compounded by the serious economic downturn. Customers have lost confidence, because the IT industry has a poor record of delivery and is not perceived to deliver on its promises. In addition, there is the lingering perception that Y2K was a con trick which, added to the dot com fiasco has produced a customer base that looks at the industry with cynicism and even distaste.

The IT industry has an image problem. Actually it is worse than that. It has a substance problem. You don't believe me? You think our problems are due to market mechanics outside of our control? Consider this:

[7] Ovum Holway

- John Higgins, the Director General of Intellect says "There is undoubtedly genuine concern within Government about the effectiveness of their past IT investments. With public spending increases already underway, it is vital that the industry avoids more problem projects in the public sector if confidence is to return."
- According to Computing[8], the Government has lost £1.5 billion on failed IT projects since 1997[9].
- Richard Christou[10] draws attention to the wide scepticism among customers about the payback they earned on that great 1990's bubble, ERP.
- Bob Bartlett, Managing Director of the SIM Group, and committee member of Intellect addressed City IT on HMS Aurora as follows: "Our problem is credibility. People are fed up with technology that does not work and powerful systems that do not fulfil the basic needs expected of technology. Morgan Stanley has estimated that over the last two years, $130 billion has been wasted in the USA on unneeded software and technology that does not work. According to Gartner, the figure globally is $540 billion over the last two years. And it's our lack of professionalism and integrity that is allowing these inefficient systems to be delivered. After decades of investment, businesses have come to realise they would have often been better off not investing in technology and at the same time avoided very frustrating management problems."
- Alistair Cox, the new CEO of Xansa, who has arrived in the IT industry from the glamorous world of cement, brings a breath of fresh air. "In 12 months" he says, "I'd like our clients to say, 'If you want an innovative, guaranteed, high return investment, then work with Xansa'. Is that too much to ask?" Is it too much, indeed?

This is what the industry is in denial about. Forget talk of mature markets and the inevitability of low profits and minimal growth. Start thinking about how

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[8] 13th March 2003

[9] We welcome the initiative by the Office of Government Commerce (OGC) to improve this situation

[10] Intellect Industry Lunch with Richard Christou, Fujitsu Services 31/01/2003

we restore the customers' confidence that the money they spend will give them consistent business benefit at low risk.

Nothing fails like success

Success breeds success, which ultimately breeds complacency and then failure. The IT industry has had it too good for too long. Many companies have developed a culture careless of their customers' success. The investment community evaluates IT company performance primarily on revenue growth over a ninety-day cycle. The industry has accepted these rules, and plays by them. Because you get what you measure, the touchstone of behaviour is "Make the quarterly number!" Those that do are heroes. Those that don't are toast.

In many IT companies this mentality has been developed to the extent that it paralyses management teams from dealing with real business issues. If it won't affect this quarter's number, it isn't worth doing.

It is a hard, tough thing to say, but it has to be said: with a few honourable exceptions, the IT industry is unprofessional. It is more interested in closing a fast deal this quarter, than its customer's success. It does not have the skills to help the customer build and sell a business case. It does not see it as high priority to apply best practice project management techniques to ensure it delivers what it promises.

It should also be said, in the interests of balance that the customer's own buying practices are just as much to blame for these failures as carelessness or opportunism by suppliers. Typical competitive buying processes are expensive for the supplier and often rely on long-winded and poorly written tender documents, which are in effect nothing more than a "wish list" of features that have little bearing on the achievement of business returns. Combine this with poor communication with potential suppliers and unimaginative purchasing managers armed with tick lists who are measured crudely on discount (rather than benefit achieved) and life becomes very difficult indeed for even the best intentioned supplier.

So what do the customers make of all this? Listen to Mike Gravatt, London Borough of Richmond-upon-Thames assistant director of finance, as he awarded a ten-year outsourcing deal to ITNET. Did he talk about latest technology, flashy new systems and exiting new glitzy products? Did he talk about the medium-term prospects of an exciting IPO for his supplier? Alas no; he said, "We are looking for a low risk, high ROI solution."

It is as simple as that. If the industry delivers low risk, high return solutions to its customers, for long enough to establish a pattern of trustworthiness, it will win back confidence and happy days will indeed return. How long will it take to win back this confidence? That depends on whether the industry is ready to hear these messages and actually do something about it.

So what can we do?

So what can be done? The answer is simple. Simple to say, but hard to do.

- IT companies must focus on the ROI of the solutions they sell. They must be able to formulate good quality business cases for the acquisition of their IT solutions and explain them to the customer in compelling terms. The industry must then take great care to ensure the customer then gets the benefits and make sure they understand what has been achieved.
- The industry must become expert at risk management throughout the lifetime of any project. Risk management must become as much the concern of the sales function as of delivery.
- Standards of project management must be made consistently excellent.

To achieve this, pro-active executive leadership is required, backed up by programmes of clearly defined and continuously improved business processes, excellent tools and clearly defined and well-run management review and inspection.

There are two other initiatives we want the industry to drive.

- There should be a "charm offensive" to explain to the customer base that IT is a powerful tool that can improve their businesses *when properly applied*. IT companies must agree to adhere closely to a code of the highest professional standards.

- Customers must be educated about what IT companies need in order to put together a solution that satisfies them. When unprofessional or insufficiently detailed Invitations to Tender are issued, companies should refer these back to an industry body for independent action to protect the customer's long-term interests, rather than produce a response based on insufficiently professional material.

In the next paper in this series we will look at some more of the practical measures the industry can take to improve its professional standards.

About the author

Ian Henley is the Chairman of *ChangeBEAT*, which works with IT companies to transform and improve their businesses.

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