COMPUTERWIRE MarketWatch
CIO Agenda

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IT INDUSTRY INTELLIGENCE

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CIO Agenda Watch is an integrated news, analysis and research service from ComputerWire. It takes an in-depth view of the prevailing sentiment among CIOs and fluxes in their procurement preferences, to gauge the likely impact on the dynamics of the technology market.

Coverage takes in adoption patterns of enterprise technology, leased assets, and business support systems. We assess attitudes to ROI and TCO, and how the realization of business value of IT systems can influence the pace of adoption of core technologies, and shape emerging technology trends.

Every month it offers the industry's most comprehensive guide to trends unfolding in the enterprise IT markets, by talking directly with CIOs and consolidating all key ComputerWire outputs to crystallize the latest thinking among this influential circle.

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In This Month's CIO Agenda Watch

BUILDING A SERVICE FRAMEWORK TO TRANSFORM THE BUSINESS
All too often, rationalizing software architecture is a field of dreams endeavor undertaken with blind faith. But sometimes, the restructuring of a business leaves no choice for standing still. We examine one case.

Helvetia Patria is a Swiss-based insurer that was the result of a 2000 merger. The new entity sought to extend its business via an online strategy that could optimize its indirect go-to-market strategy. Using local banks to brand and resell its insurance products in six European countries, the newly merged organization sought the obvious best of both worlds: the efficiency of a common back end, the local autonomy of its national subsidiaries, and the mindshare that its local partners such as banks, brokers, and agents, already enjoyed with their clienteles.

Helvetia's e-business strategy would ultimately consolidate roughly 15 services and platforms. When the project began in year 2000, many of the sales processes were manual. "The goal was to improve front-end business processes so the agent could focus on selling and building the relationship with the client," said Didier Beck, head of the company's e-business center.

Since the company's channels were diverse, it faced the classic reuse challenge to maintain a single source of core services that could be tailored to the needs of each of the retailing networks. The notion of reuse is one of the oldest banging around software development organizations. It was the driver behind component-based development approaches that sought to modularize generic pieces of software with common interfaces, a process whose barriers have been lowered a bit with the emergence of modern service oriented architectures and web services standards.

Interestingly, the solution, which used an insurance industry framework devised by HP's consulting services arm, adopted a similar approach described in our profile of Con-Way Inc (CIO Agenda MarketWatch, May 2006). The solution involved a framework of 150 services that built on infrastructure components such as session or data-handling and printing, security, and multi-channel (client) capabilities supporting deployment on HTML web page, Java-based, or Pocket PC clients.

It was implemented as a three-year project to enable Helvetia's units to quickly roll out new products and services that could be offered through its channels.

A core element of the solution borrowed the Bill of Material concept from the manufacturing sector because the insurance industry lacked a generic metamodel structure for describing the content of a specific insurance product. In fact, admitted Nick Stefania, deputy head of the e-Business Center, he had implemented such a concept "by accident" in a previous position with another Swiss insurer about 15 years earlier. But the reuse of this approach was hardly coincidental in that several members of Stefania's previous team moved with him to Helvetia.

The initial idea was to establish a central competency center that would develop core components or services that would be deployed out in the provinces. The team soon learned that in a diverse, autonomous organization, such a monolithic centralized approach wouldn't work. "To develop the business logic, you must be close to the business experts in the local market. So we had to figure out what components could be generic, and what was the part that had to be developed locally," said Stefania.

Consequently, some components, such as storage of customer policies and claims, lent themselves to centralized development and deployment. The same was true for development of infrastructure-related functions such as data-handling or printing. However, other logic such as policy descriptors, varied by country or in some cases by sales channel, and those had to be developed locally.

Consequently, the project drew developers from each of the national subsidiaries to Zurich for four-to-six-month periods to master the framework, then return to their home offices to develop the localized solutions. By the time that the project concluded in 2003, Helvetia had changed the financial model, requiring local units to pay for the new platform and project support. At the same time, they also offered local units the option of not using the internally developed solution, an offer that the Spanish unit took up.

However, for the rest of the units, it has been estimated that the new e-business insurance services framework has delivered 20% savings, primarily through lowering the cost of adding or managing distribution channels.

It also provides new capabilities for cross-selling or up-selling products. With the new e-business framework, it is much easier for banks offering mortgages to also sell homeowners insurance. In the past, it would have required a manual step. It is accomplished through a web services request that, under the covers, calls on the Helvetia framework to expose underwriting, policy proposals, and printing services so the customer can sign the contract on the spot. Previously, it would have required deployment of a conventional fat client that would have been difficult if not impossible to maintain given the company's diverse channels networks. With a web service, the current version of the service is always delivered to the point of sale.

According to Beck, the main reason for choosing HP was that it offered to share its knowledge of the framework with the Helvetia team so it could become self-reliant in the future (in developing extensions). Beck claimed that none of HP's consulting rivals was so willing.

But there's another angle to the story that might require taking things with a grain of salt. While it wasn't a quid pro quo, the Helvetia team that developed the services on this framework was subsequently spun off into a separate business that resells the solution to other insurers. It includes some members of the HP consulting team who were on the original engagement.

IS OPEN SOURCE CHEAPER?
The reason why open source software is growing popular within enterprises has nothing to do with open source itself. The lure is all about price.

The myth of open source software is the aura of freedom that surrounds it. Although that's the public image of open source, the reason why open source software is growing popular within enterprises has nothing to do with open source itself. Instead, the lure of open source is all about price.

Instead, the lure of open source is all about price. The perception is that (1) open source software levels the playing field and therefore makes software cheaper; (2) you can download and deploy the software for free, and (3) when you actually pay for something, you're "only" paying for annual subscriptions to technical support.

At first glance that sounds like a great deal. Instead of paying the purchase price, you only pay the equivalent of the 15%-20% that you were going to pay anyway for annual maintenance.

That's great for customers, who can now eliminate the need to fork out huge upfront purchase costs for traditional "perpetual" licenses. But for any vendor that's been in the business for over five years, that's a major disruption to cash flow. If they can't count on those upfront sales, how are they going to fund product development?
If you're a vendor, you could juggle the numbers so that after four or five years, your annual subscriptions end up to what you would have received had you sold a license up front and then collected annual maintenance.

But wasn't the idea of software by subscription supposed to give customers the freedom to pull the plug at any time? In theory yes, but then the customer must also factor in the cost of migrating to a competing product. In the case of open source offerings like Linux, the moving from Red Hat to SuSE or vice versa might be nominal. But moving from MySQL to Ingres or Postgres might be another matter altogether.

Consequently, over the long haul, software shouldn't get cheaper just because it's open source or offered by subscription. Vendors still need to charge enough so they can afford to stay in business. Conversely, if a customer needs a product that can help them establish or maintain competitive edge, they'll pay whatever it's worth to them. It's the laws of supply and demand producing a price that the market will bear.

Nonetheless, subscriptions for JBoss, MySQL, or Red Hat subscriptions are typically lower than licenses for WebSphere or WebLogic, Oracle, or Windows, respectively.

But the pricing has nothing to do with the fact that those products are open source or offered via subscription. It's that the products like middleware, entry-level databases, and operating systems are perceived by the market as commodities. Nothing more and nothing less.

THE HUMANITY OF OFFSHORING

The primary concern of the typical CIO when it comes to offshore services may be cost savings and potential productivity improvements, but what of the 'softer' human issues?

The role of CIO has probably never been so stressful since the turn of the millennium, when everyone thought that system crashes would lead to a silicon Armageddon. Offshoring is the latest high-tech panic, although this time the ones making filthy lucre are in the boardroom, not the IT department. Ubiquitous media coverage of cheap Indian IT staff has brought awareness to everyone from cost-conscious board executives, to staff wondering if their job is on its way to Bangalore.

The pressure from above to outsource work to India and other low-cost labour countries is intensifying, and hardly any major outsourcing contract does not involve a major offshore option. Every major IT services provider has recruited extensively in India: IBM has almost 40,000 employees there now.

All arguments against the use of offshore labour have fallen flat, and all those we might have expected to voice them have gone quiet. Tony Blair has spoken in favour of offshoring, visiting Tata Consultancy Services - India's largest IT services provider - last year, knowing that the opposition cannot touch him on his support of offshoring.

Political correctness

Even the Tories' knee-jerk patriotism cannot override their free-trade dogma. So politically, offshoring has had a smoother ride than it could have wished for in the UK, helped by a curiously low-key reaction by the usually rabid tabloid press, and an impotent left wing that can hardly object to the gains of poorer nations as long as they are made in high-tech software development centres rather than through sweatshop slavery.

The quality of work is no longer in question, and the cost benefits are clearly there for the taking for those prepared to invest in management expertise to overcome cultural issues. If you outsource, then offshore is almost a given, so the option to get all your staff a job at the provider under TUPE regulations has disappeared.

Firing is never fun, but what is a CIO to do? Well, perhaps the prevailing fatalistic attitude to the new globalized workforce should at least be tempered with some sensitivity.

Once outsourcing enters the boardroom discourse, there is the dilemma over when to communicate the company's plans to the workforce. Do you tell them at the start of the process, warning them of what might happen to their jobs, giving them time to make career plans or take training courses that could lead them into new positions within the firm? Or do you keep quiet, and spring it on them at the last possible moment in order to ensure that job insecurity does not hit the department's productivity?

In public, companies try to convince us that they always take the former option. They love to refer to their employees as their 'greatest asset': a rather dubious compliment. Even if they mean it, and they rarely do, by talking about employees in a term usually reserved for balance-sheet items such as fixtures and fittings, they betray a rather inequitable view of their relationship with the workforce.

Sacrificial lambs

When it comes to outsourcing, many companies view employees as more like something on the other side of the ledger, a liability to be discharged where possible.

Unions constantly complain of being kept out of the loop on outsourcing, and off the record, employers admit a preference for springing it on the workforce after working out who to fire.

Some may justify this with the renunciation of social responsibilities that comes with being a public company. Legally shareholders' concerns are the only ones that should be considered, but we wait with interest for the first company to be sued for showing employees decency and respect.

Not much chance of that company being Unilever. It has spent most of the last year finalising contracts with IBM and Accenture for human resources, procurement, and finance and accounting services.

All along it has claimed it has consulted employees and their unions, and yet it appears to have done nothing of the sort. Instead, after admitting that outsourcing was a possible part of its restructuring plans, it claimed right up until its finance and accounting deal with IBM was signed that the decision to outsource had not been made, and that it might still keep the jobs in-house.

Weeks after Guy-Joel de Lhoneux, a Unilever VP for HR shared service development, boasted to an industry conference how the company's ambitious plans to outsource its global HR function had got to final contract negotiations, a Unilever spokesperson was still trotting out the line that it had not decided whether or not to outsource. Staff are justifiably furious.

Such a contemptuous attitude to employees is more responsible for the general public's antipathy towards offshoring than any number of awkward conversations with call center operators in Hyderabad..
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TECHNOLOGY MARKET DIRECTIONS

Mega Vendors at Risk

Vendor consolidation is doing more than reducing the number of players in the enterprise applications field, it is contributing to the widening the gap between application/infrastructure mega vendors and pure-play application providers.

The mega vendors comprise SAP, Oracle, Microsoft, and Salesforce.com, which all offer both the applications and the infrastructure needed to run them. This also acts as a rallying point for third parties, which are the pure-play application players who make a living by creating best-of-breed application components designed for the platforms provided by the mega players.

As result of the increasing might of the combined players, vulnerable smaller vendors are having to commit to one of the large players because with adherence comes the chance of more business and increased financial viability. This has several consequences.

With the mega players focused on infrastructure, they have effectively outsourced their application functionality R&D to the application pure-plays. One of the risks is that once the application developer has provided a proof point for its

offerings, the mega vendor will scoop it up to add it to its ever expanding suites. Rather than supporting the ecosystem, the mega vendors risk stifling it by failing to allow pure-plays to grow. AMR Research's Jim Shepherd warns that unless the large vendors alter the structure of their ecosystems and create real opportunities for the smaller players, they will become victims of their own success.

The effect of the mega vendors' behavior on customer sentiment should not be underestimated. Customers want their vendors to have stability and longevity, but they also want choice. If the mega vendors are seen to be stamping out choice, customers will go out of their way to find alternatives – open source being a prime candidate.

But the ramifications go further. By abdicating responsibility for application functionality development, the mega vendors are also relinquishing the innovation reins to the application developers. Having spent a fortune directly or otherwise to gain market share, they risk throwing it away. They may subsume most up-and-coming innovative vendors, but a few will always get away and they could turn out to be a disruptive force. Salesforce.com has already proved that, and it will not be the last.

The upshot is that the leaders of the future may not be the current leaders. The mega vendors' preoccupation with infrastructure development and ecosystem control puts them at risk of losing touch with applications, innovation, and buyer sentiment.

Doubling Down on the Data, Disk and Density Triple

It is hard not to be skeptical when IT suppliers make public statements that the volume of data that businesses store is increasing by around 50% each year. And they have been making statements like that for some while.

Doubt springs not only because whenever there is an audience around, IT vendors seem unable to stop talking up their own businesses. There is also the fact that that a 50% per year increase represents exponential growth, literally not just colloquially, and a doubling of data volume every 18 months or so.

But while the estimate might not be spot on for the overall market, it is not hugely wide of the mark. One piece of corroborating evidence is that total disk shipments as measured in terabytes capacity were up by well over 50% last year, according to IDC. That continued a post-internet-bubble recovery that has been in progress for about three years. Between now and 2010, shipped capacity will continue that growth, showing 50% CAGR, IDC predicts.

Sadly for storage vendors, this does not mean that their cash registers will be ringing exponentially faster over the next few years. As capacity shipments have been blossoming, the price that customers have to pay for disk capacity on a per-megabyte basis has been falling steadily, and will continue to do so.

One reason for this is that cheap ATA disk has begun to displace more expensive disk gear inside data centers. But an even bigger reason is that for more than a decade the data density on all types of disk has been rising at about 60% ever year, and is set to carry on doing so for the next several years. The $10 or so that customers paid for each GB of disk capacity in 2005 will fall to $2 by 2009, and $1 by 2015, according to Horison Information Strategies.

Not that all of this newly affordable disk is or will be used to store unique, primary data. Some of it is instead being used for backup, as falling prices for overall storage systems have meant that businesses can afford to protect increasing numbers of applications using disk as well as tape, rather than solely with tape.

Other factors are the increasing penetration of IT into poorer parts of the planet, and the more efficient use of storage capacity everywhere as a result of better management software. The outcome is that a 50% increase in capacity shipments does not mean that average businesses are storing 50% more information every year. But it might not be hugely less.

Disk is any case only the tip of the iceberg, as far greater volumes of data exist on tape. According to a study by the University of California, Berkeley, about 80% of all digital data is held on removable media, which is mostly tape. Given that tape costs, performance, and longevity have improved hugely over the last five years, growth in data volumes has actually improved the prospects for future tape sales.

How much of the data growth is being driven by tightening data regulations is a matter of speculation, but in some parts of the world such as the US and in some industries, compliance is a major force preventing companies from discarding data that 10 or even five years ago they might have cast off quite happily. Horison estimates that primary, operational data might only represent 20% of all data, with archive and backup data comprising the remainder. Clearly that will be much lower in Europe, where both data-retention regulations and litigation lawyers are not as fierce as they are in the US.

Private Equity and the Tech Sector

The computer industry has witnessed countless mergers and acquisitions over the years, but during the past 12 months some industry observers have been pointing to the large number of private equity groups and investment houses that have acquired tech outfits.

Given the number of equity groups circling the IT sector at the moment, it would appear that there has been a recent rise in private equity groups acquiring tech companies, but an examination of the data collected by ComputerWire's Tech Finance team over the past five years shows there has been a steady number of equity buyers acquiring tech companies each year.

For example, in 2005 there were 28 M&A deals where finance-related groups acquired a company in the IT or tech sector. What is true is that 2006 is seeing a lot more activity. In the first six months of the year, there were 29 such deals. Yet a look back at previous years shows that this level of activity is not unusual. During 2004 there were 78 deals where finance-related groups acquired a tech company. There were the same number of deals in 2003, but 2002 was quieter with only 27 deals.

ComputerWire recently spoke to Advent Partners, a UK-based venture capitalist that manages approximately 550m pounds ($1.01bn) of investment funds. The VC admitted it was not shy about eschewing the traditional investment route and buying a company outright instead. This route usually gives the VC free rein to make the necessary changes to get a company's house in order, such as getting them profitable before pursuing a suitable exit strategy.

The lack of a viable IPO market in the United States means that VCs are becoming a lot more creative in order to secure profitable exits, most commonly in the form of a trade sale. In order to achieve this, VCs sometimes need the power that complete ownership grants them in order to make an exit.

Nowadays, start-ups generally require a lot less cash to get their operations off the ground, as the price of commoditized technologies becomes ever cheaper. The advent of cheap software and cheap web technology means that companies often do not require as much investment as they did in the past, which in turn translates to less VC influence over their investment targets. But there are still certain industries where this is not the case, such as the chip sector where companies often require greater levels of funding than traditional tech start-ups.

What we are now seeing however is that some private equity groups are prepared to go one step further and attempt to build or create a dominant market player, often by purchasing two or three niche players in a particular market and then combining them into a "super entity".

We have seen this with Infor Global Solutions, which last month said it would pay $1.35bn in cash to acquire SSA Global Technologies Inc in order to create the third-largest enterprise applications vendor behind the likes of IBM and Oracle. Privately held Infor is owned by private

equity firm Golden Gate Capital, which along the way also acquired Geac Computer Corp Ltd last year for $1bn.

The telecoms sector has also attracted huge interest from investment community, which is awash with cheap cash looking for suitable investments that will provide steady and predictable returns. The former Irish incumbent Eircom Group Plc recently fell to Australian group Babcock & Brown Capital Ltd, while Danish carrier TDC AS fell to a consortium of private equity players known as Nordic Telephone Co. There was even talk that BT Group Plc could eventually fall to a group of private equity investors.

The VC community shows little sign of tiring of the IT and tech sector despite getting its fingers badly burnt during the dot-com crash. VCs are big enough to admit they were partly to blame, and are now on the whole a lot more choosy and demanding of their investments. VCs like Advent still see many large companies examining their product sets and wanting to plug any holes. This is likely to lead to an increased number of M&A deals over the next 12-to-18-month period, and investment houses are sure to want to be part of the action.

Gates' Exit Met with Ambivalence

How much is Bill Gates worth to Microsoft? It's an intriguing question, especially since he has announced that he will be leaving the company in 2008 after 33 years.

Does a senior executive's wage reflect their value to the company? In Gates' case, he was paid a $600,000 salary in fiscal 2005 and was awarded a $400,000 bonus: loose change to him. But he also owns over a billion Microsoft shares, and over the last ten years Microsoft's stock has more than doubled, making him quite a few pennies.

But does that reflect his current worth to the company?

Perhaps it is better to look at what happens to a company's share price when a senior executive joins or leaves. That is a reflection of what the market - the stock market at least - believes the executive is worth that firm.

When Sun COO Ed Zander left after 15 years there, Sun's stock fell 14%, shaving $2bn from its

market capitalization. When it was announced Zander was joining Motorola as CEO, Motorola's stock rose 4.2%, adding almost exactly $2bn to Motorola's valuation.

What happened to Microsoft's stock when Gates announced he is leaving in two years' time? Virtually nothing, and since then it has actually risen.

You could argue that since Gates announced an orderly transition, only leaving in two years' time, that the market is yet to react fully to the news. You could argue that since he will retain his title as chairman even after that date, the market doesn't consider him to be leaving at all.

But the timing of his announcement - it was made after the stock market closed for the night - was clearly chosen to try and avoid a sudden share sell-off should investors have panicked. The fact that Microsoft is more or less replacing Gates with two people, Ray Ozzie becoming chief software architect and Craig Mundie the chief research and strategy officer, also reflects Microsoft's

nervousness at having to announce Gates' news, and its attempt to reassure the market that he will not be missed.

Perhaps those measures taken together helped soothe investors' nerves. But the company's evident paranoia about breaking the news seems with the benefit of hindsight to have been wholly unjustified. What that says about the market's perception of Bill Gates' worth to Microsoft is worth noting, because it also says a lot about the market's perception of Microsoft as it finds itself in the current competitive environment.

Microsoft is perhaps facing its greatest challenge yet as it competes with Software as a Service (SaaS) in general, and Google in particular. The investment community was largely unmoved by Gates' imminent exit, which is perhaps a good barometer of the fact that he is leaving at exactly the right time, allowing some new minds to step forward and conjure up an effective Microsoft response to its latest challenges.
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