

Industry Solution Company Executive Summary



GLOBAL MARKET RESEARCH

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Introduction

This report is based on expert opinions contained in the market research study conducted by TNS Research in November 2003, Microsoft internal research and the study of just over 1,550 ISVs by HI Europe between June and August 2003



The Industry Solution Companies Population

- There are just under 20,000 industry solution companies based in Asia Pacific and Greater China. The country breakdown is as follows:

<u>Country</u>	<u>No.</u>	<u>Source</u>
Australia	3500	Australian Bureau of Statistics
PRC	5700	CSIA
India	3500	NASCOM, Microsoft internal research
Korea	2705	Korea Software Industry Association
NZ	600	Information Technology Assoc of NZ; NZ Software Association; Microsoft internal research
Singapore	300	Singapore Information Technology Federation
Taiwan	399	Microsoft internal research
Hong Kong	297	Microsoft internal research
Indonesia	200	Microsoft internal research
Thailand	600	Software Park Thailand
Philippines	500	Microsoft internal research
Malaysia	600	Pikom Malaysia
Vietnam	400	Microsoft internal research
Total	19,301	



Industry Solution Companies - influence over IT spend

- The total IT spend in the Asia Pacific and Greater China region for 2003 was \$US 74.8b.
- We estimate the industry solution partners have visibility over 30% or \$US 22b of that spend.

Country	IT spend CY2003 (US \$m)	30% of IT spend (US \$m)
Australia	13,148.3	3,944.50
PRC	24,770.5	7,431.14
India	5,446.0	1,633.81
Korea	12,221.9	3,666.57
New Zealand	1,940.1	582.03
Singapore	3,033.1	909.93
Taiwan	4,633.9	1,390.18
Hong Kong	2,524.4	757.32
Indonesia	1,303.6	391.08
Thailand	1,924.9	577.47
Philippines	1,031.2	309.36
Malaysia	2,358.9	707.68
Vietnam	458.6	137.59
Total	74,796	22,438.68

Source: IDC WW Blackbook 3Q03



Industry Solution Companies – Observations

The marketplace for Industry Solution Partners:

- Many of the markets in this region are small, developing business communities and still in early stages of automating business processes. ISVs have tended to service multiple industries within their immediate community to survive and grow. In addition, many companies who installed systems in the last five years are using first generation integrated business systems.
- As a result, it is not surprising that over half of the companies profiled in the HI Europe survey stated that they offered four or more applications and market across multiple industries. This is likely to imply that there are still a significant number of custom applications (over 50%) being installed in several countries.
- This also makes it difficult for ISV's to obtain the industry expertise necessary to become a dominant solution provider in a specific industry, and will put pressure on their ability to survive in the early years of operation.



Industry Solution Companies – Observations

The survival rate of startup companies:

- In most countries, up to 30% of all start-up companies go out of business within the first two years of operation. Limited financial capability, poor customer support, a lack of global presence, and a lack of business acumen, plus poorly defined target markets, are the primary reasons for failure. The pressure on small start-up ISVs has been accentuated by the growing influence of the larger ISVs and Sis, who now operate offices in all major markets and dominate the large enterprise customer opportunities.
- It is also true that up to 20% of start-up companies remain in business for over five years, in some form. Expert opinions from the TNS Research suggest that this is primarily as a result of a clear market focus, access to capital and strong management with a clear business plan.
- This has a spin-off effect on the professional developer, who may within any five year period be forced to work for three different employers. This would tend to imply that the developer has yet another reason to maintain technology skills which are current and in demand by the broader business community.
- These conditions are favourable to platform suppliers who can help the small ISV with development costs, and provide management methods & software which the ISV can apply across customer segments.



Industry Solution Companies – Observations

Small companies in the ISV survey:

- These companies typically have between 5 and 50 employees or contract staff. Their annual sales are less than \$US2m.
- The majority of these companies derive 30% or more of their revenues from the sale of application software license fees. The application may or may not be owned by the company selling the license. HI Europe's ISV survey shows there are a significant number of companies (32% of all companies surveyed) who use multiple channels to sell their applications.
- Approximately 59% of all smaller-sized ISVs in the HI Europe survey are delivering applications which support web services. Over 70% of all ISVs who are developing web services applications do not belong to a Microsoft partner program.
- Many of these ISVs may be developing web services applications using Microsoft technology and not belong to a Microsoft partner program.



Industry Solution Companies – Observations

Large companies in the ISV survey:

- Of the 20,000 industry solution companies in the region, there are approximately 200 locally based companies who are involved in delivery of package applications, with sale revenues in excess of \$US10m p.a.
- As a part of the HI Europe ISV survey:
 - 103 profiled local companies stated their revenues exceeded \$US10m p.a.
 - They have a staff of more than 50 employees
 - Most of their customers (85%) are in this region
 - 72% offer four or more products to the market
 - 71% sell through more than one channel
 - 72% of these companies offer applications which support web services
 - The majority of their applications are ERP and CRM solutions, with an even spread of coverage across all industries
 - Notably the healthcare and manufacturing industries get the same attention by these large ISVs as finance and government sectors. With such diversity in industry coverage, this could suggest there is still a high percentage of custom solutions being supplied to the market in this region



Industry Solution Companies – Observations

The ISVs profile has changed:

- The marked differences between the operating and financial profile of a Systems Integrator and an Independent Software Company has permanently blurred. Companies today make, customize, and install applications within a variety of partnership models.
- Today companies manage application portfolios not single products. The financial model of an industry solution partner is a cash flow business. To allow for the long delivery and application development cycles, companies who survive tend to be extremely conservative cash managers, holding as much as 12 months of their direct expenses in liquid assets.
- While these companies are still creators of application software assets, their actual reported revenue mix of software and services is changing in favor of services. We suspect this is largely due to two key reasons: i) common functionality is quickly commoditized, and it's easier to discount software than labor from an accounting view; ii) local ISV's are in 'locked horns' competition with larger global ISVs on application function, and their main point of differentiation lies in their local industry knowledge and people skills.



Industry Solution Companies – Observations

Industry Solution Companies are selling applications owned by other companies – Why?

- Three main reasons....
 - i) Through maturing technology, application software is easier to develop and, as a result, the asset value of an owned application is lower
 - ii) Technology cycles are shortening, putting pressure on application development cycles
 - iii) During periods of minimal growth, investing in the right channel and account relationship is regarded by many ISV's to be as important as application ownership.
- As a result there is a marked movement away from ISVs making their own products and only using their own direct sales force to sell the solutions. In the HI Europe ISV survey, over 30% of companies surveyed use multiple channels to sell their application and 55% of companies surveyed have four or more applications to sell.



Industry Solution Companies – Observations

Business growth:

- Industry Solution Partners represent a capability of significant interest to country governments. Many governments have initiated value creation projects. For example, Australia, India, Singapore and China have started business development initiatives with the local ISV community, to create local employment opportunities and to extend this to create export income.
- Application development (AD) and business process outsourcing (BPO) offer two significant business opportunities for almost all Asia Pacific and Greater China countries. This activity is well established for end-user companies engaging companies in India, but there is now a growing trend for large Industry Solution partners in North America and Europe to engage ISVs and SIs to provide application development and business process outsourcing services as subcontractors.
- IDC has forecast significant growth in the number of AD and BPO industry solution partners in Australia, China and India. This services opportunity will drive the creation of new revenue streams and competencies and seems likely to expand the overall influence of the large Industry Solution Partners.