The Coming Software Shakeup
For further information:
Corrie DeCamp, Dallas: corrie.decamp@booz.com
Stephen Chen, Dallas: stephen.chen@booz.com
Booz & Company

04/13/2006
In a couple of years, the enterprise software industry may very well be unrecognizable.

Blame it primarily on consolidation. Five years ago, 11 companies controlled 90 percent of the database market; now only six do. In business applications, the trend is even more pronounced: Seventy percent of the market is now controlled by just 35 companies, compared with more than 120 companies in 2000. Such high-profile deals as Oracle’s recent acquisitions of Siebel and PeopleSoft have left only two vendors to choose from, Oracle and SAP, for top-tier integrated suites.

Looking solely at the economics, software buyers will be the short-term losers from this merger activity. With fewer companies vying for sales, the industry’s traditional 80 percent discounts, which large companies can count on for volume purchases, will be a thing of the past. More commonplace will be 50 percent off list price.

Initially, higher prices will hurt the purchasing companies that depend on enterprise software to coordinate their activities. But in the long run, pricing pressure could change the dynamics of the buyer–supplier relationship and initiate a profound shift in how software is delivered and in the types of programs companies implement.

As software prices rise, many chief information officers (CIOs), particularly those at medium-sized companies, will be unable to afford the huge, one-time hits caused by the purchase of licenses for large programs like enterprise resource planning (ERP) or customer relationship management (CRM) systems. Instead, they will seek to vary their costs so that their IT budgets grow and shrink along with their needs. That will increase the popularity of subscription pricing, in which companies pay annually for software licenses and reevaluate each year how many software “seats” they require. About 25 percent of software is already sold by subscription; that’s likely to increase to more than 50 percent in the next four years. This approach will also speed acceptance of “software as a service,” which lets customers access programs via the Web and pay only for the amount of time that they use the software. Higher prices could also energize the push to outsourcing, especially for smaller companies.

In reevaluating their costs and seeking alternatives, CIOs will also explore ways to overcome the growing complexity of their legacy systems. By reducing complexity in application portfolios — that is, by eliminating redundant programs and refocusing data acquisition activities specifically on information needed to enhance competitiveness — these executives can rein in maintenance costs and increase the amount spent on new development. Many CIOs will demand architec-
tural flexibility from their enterprise software providers to minimize the expense of adding and decommissioning applications.

This search for simpler solutions and greater adaptability will feed into another noteworthy change in the enterprise software industry — something we call “data-centricity,” which will transform the CIO from a manager of data into a provider of critical information to the business. For example, as software is stripped down, data takes on even greater value as it, not the application, points the way to the next innovation. The software suites, ERP systems, and business process programs are excellent at managing, manipulating, storing, and moving data, but they are not equipped to produce the insights required to outdo the competition in the day-to-day work activities of a data-centric organization. CEOs are demanding data that gives them an end-to-end view of the enterprise — that is, data integrated from multiple, fragmented sources.

In response to this demand, as smaller software companies are swallowed up by larger ones, and as top-tier applications migrate into content-rich information systems, the most innovative survivors will develop new industry-specific niche programs that analyze and transform data in real time so that it can be acted upon. For example, many consumer products companies have historically relied on custom solutions to assess the effectiveness of their store promotions and customer discount programs. Today, these applications are being incorporated into ERP and business intelligence software (with varying degrees of success). The most inven-
tive marketing software companies will rapidly improve their products, making them capable of providing more granular analysis more quickly, and also ensuring that these programs easily integrate with customers’ ERP systems. The upshot of these activities will be a greater emphasis on standardized platforms combined with hardware and software flexibility, making it easier to change suppliers, programs, and outputs as business conditions shift.

Pricing concerns will drive more cooperation among software buyers. CIO consortiums have been tried in the past, but they often failed; if a company could cut a pretty good deal with a software provider on its own, there was little justification to help a rival get similarly advantageous terms. But the prospect of higher prices changes the equation enough that customers of enterprise software will increasingly band together and demand both better deals for their industry and customized add-ons to large suites that meet the specific requirements of their sector.

Software purchasers may indeed pay a price for consolidation. But in the end, consolidation could cost the large enterprise software suppliers the most. For a short-term gain in revenue, they may end up having to adjust to a new software landscape that emphasizes customer flexibility; more efficient delivery mechanisms; open standards; the rise of smaller, niche data-centric applications; and greater simplicity. Software purchasers who understand this and take advantage of the opportunity to leverage changing industry dynamics will have the most to gain.

Resources


Mitch Rosenbleeth, [rosenbleeth_mitch@bah.com] is a vice president with Booz Allen Hamilton based in Dallas. Mr. Rosenbleeth focuses on technology strategies for companies in the consumer products and retail industries.

Corrie DeCamp, [decamp_corrie@bah.com] is a senior associate with Booz Allen Hamilton based in Dallas. Ms. DeCamp specializes in information technology for consumer products and retail companies.

Stephen Chen, [chen_stephen@bah.com] is a senior associate with Booz Allen Hamilton based in Dallas. Specializing in information technology, Mr. Chen works with companies in the consumer products, automotive, and financial-services industries.