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The Impact of Digital Transformation on Technology Vendors

A Summary of the
IDC Directions 2016
Conference

Perspective by
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A Summary of the IDC Directions 2016 Conference

One of the most anticipated events in the Waterstone calendar each year is the IDC Directions conference. For those who are new to IDC, it is a highly regarded research company that specializes in technology-related markets. Waterstone often leverages its analyses to help clients understand the size and growth prospects of the markets they are in (or want to be in).

The Directions 2016 conference featured IDC analysts sharing their latest thinking on how the technology market will shape up over the coming five years—both in terms of broad trends and in specific sub-segments. Three members of the Waterstone team attended, catching up with both IDC and many of the attendees—software and hardware companies of all shapes and sizes wanting to better understand the direction of the markets in which they play.

This year's theme was "Digital Transformation at Scale." The key message was that digital transformation (snappily shortened to DX in IDC lingo) was now becoming mainstream across all industries that seek to leverage IT to deliver new products and services and vastly increase scale, and to open the doors to markets never before thought possible. No longer, says IDC, is IT merely a cost; IT is a strategy unto itself. The scale theme also elicited some gasps as the question was posed, "How could you service clients who will need 1000x the transactional power and data capacity as they do today?" IDC believes this scaled-up world is closer than many think and that vendors need to be ready to service it.

Technology vendors that fail to embrace the digital transformation imperative and the Third Platform opportunity risk losing relevancy over the coming decade.

Central to many of the talks was the concept of the "Third Platform," the technology-backed Services that drive value. We have collectively shifted through the First Platform (hardware) and Second Platform (software) into a position where Services like cloud, mobility, big data/analytics, and Internet of Things (IoT) matter the most. Technology vendors have experienced this first hand: IDC estimates that, globally, software revenues are falling, while Third Platform Services revenues have already surpassed software and are predicted to continue to grow rapidly.

DX and the Third Platform are real and important trends for both buyers of technology and providers of it. For buyers, they provide clear direction on how they should be shaping technology spend and strategy over the coming decade in order to stay relevant to end consumers. For vendors, they represent a huge serviceable market opportunity, and vendors must play an active part in them if they wish to remain relevant over the next decade. In pursuit of this, there are four themes that emerged repeatedly throughout the conference that Technology vendors should focus on, which we summarize in this paper.

1. Enterprise Technology Buyers Are Developing Digital Strategies and Resetting Expectations of Technology Vendors

The distinction between a business strategy and a technology strategy is diminishing. In order for companies to act fast, at scale, offering end consumers appealing products and services, companies must make enabling technology a core part of their overall strategic approach. This requires a digital transformation—moving from legacy customer interaction systems and processes to something much more nimble and with customer experience at its heart.

Building new technologies around real-time consumer experiences necessitates a shift from internet-enabled business to a digital one. Such a digital transformation requires clear and long-term leadership, driving joint efforts focused on business strategy, IT transformation, and new innovation. However, IDC's CIO Survey revealed that 93 percent of responding CIOs found digital transformation difficult, driving a huge increase in complexity for the IT divisions. Traditional models of integration, licensing, and management that were not designed for digital are exacerbating the problem. Legacy systems, which account for roughly 80 percent of resources currently invested, pose a particular challenge. CIOs are beginning to understand how they need to act going forwards, though they are much less confident in execution.

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There are no easy answers. As a first step, CIOs must work much more closely with line-of-business leaders in order to assess technology needs. They must understand how the business could evolve and think about how the IT function can enable (not merely support) these plans with existing hardware, software, and resources. If these plans don't exist, the IT function must find or build suitable scalable platforms for the lines of business to leverage. IDC also suggests CIOs adopt a more Silicon Valley-type approach to technology innovation, which emphasizes frequent customer experiments supported by in-depth analytics and augmented with strategic pivots as needed.

The most successful technology vendors will understand this trend amongst their buyers—and help CIOs on their digital transformation journey.

2. Technology Vendor Sales Processes Are Evolving and Targets Are Changing

The old-school approach to technology sales—where the relationship focus is before the contract is signed, then quickly tapers off once the money is in the vendor's bank—does not suit this Third Platform-orientation well. Services relationships are ongoing and can be very profitable if customer retention levels are high. High retention can be driven by a number of things, but perhaps most clear is the trend for technology vendors to invest in Customer Success. This is much more than just a label; Customer Success is a new orientation, focused on ensuring the customer gets rapid and real value from a vendor's products.

Sales targets are changing too. The digital transformation imperative and opportunity is broad, covering firms in almost all verticals, whether SMB or the largest enterprise. The advent of cloud and mobile have actually levelled the competitive playing field between large and small enterprises; small firms can be agile, fail fast, and scale fast and have fewer legacy hang-ups. Similarly, smaller, younger organizations also feature a special but increasingly prevalent challenge: dealing with millennials as decision makers, who often have a different technology world view and set of expectations from service providers.

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No matter what type of customers a technology vendor has or is seeking, the vendor must look more broadly and deeply to understand their evolving needs and likely wants and then service them efficiently and effectively over the entire customer lifecycle.

3. The Internet of Things is Real and Could Disrupt Technology Vendors More Quickly Than Many Expect

The Internet of Things is already taking off, and IDC's analysts emphasized repeatedly that the companies they talk to are not merely sketching out plans on drawing boards; rather, they are moving into production. Many predictions were a flurry of hockey-stick growth charts and incredibly large numbers (IDC projects IoT as a \$1.46 trillion market in 2020). Amidst all this, we took away three clear messages, two from the conference rooms and one from the hallways:

- Adoption of Third Platform technologies (cloud, mobility, big data, IoT) significantly surpassed that of more traditional software (2016 CAGR of 12.7 percent compared to 5.1 percent). Actual spending, however, was seen as being driven by the lines of business rather than by the IT divisions, reflecting the idea that IT investment is no longer necessarily the domain of just the CIO and his or her team.
- Near-term investment now will drive exponential expansion over the next 5 to 10 years. IDC projected IoT applications to grow 10x over the next five years, with particular ramp up coming from cognitive artificial intelligence (AI). IoT platforms offer a compelling story of both growth and customer loyalty. However, IDC doesn't see any consolidation on standards over the next five years: IDC's mantra was "follow the trends and see what endures."
- The rate of IoT growth and adoption will catch many companies off-guard and well behind forward-thinking peers in their industries. In the hallways we heard the occasional skepticism, with comments such as "this isn't real IT; it won't impact me or my company." IDC survey results showed the same: IT buyers in the U.S. and Europe believed in the promise of IoT, but they were hesitant about investment; business leaders were interested in IoT strategies but unclear about where to begin. In contrast, 86 percent of companies in Asia Pacific revealed plans to invest in IoT in the next year.

4. Industry Clouds Offer Significant Opportunity, and Technology Vendors Should Take Leading Roles to Kickstart

Industry clouds are a way in which multiple organizations in an industry can work together to create incremental value to all involved parties using technology. An example might be a service that pools together data or facilitates combined purchasing. To operate, industry clouds need a number of things: a common platform, common data structures, common data compliance rules, value-sharing agreements, and underlying hardware and software needed by participants. This is a big growth area that is expected to move in tandem with the growth of the Internet of Things.

Industry clouds are a substantial commercialization opportunity for company IT departments, and there is a clear opportunity for technology vendors to help lead the process of getting industry clouds started. Indeed, IDC's research shows industry clouds have a much better chance of success when done in partnership with a technology vendor that can leverage its client list and relationships to forge the initial industry-cloud approach.

IDC concluded with a sharp warning to technology vendors—vertical markets can transform quickly with the launch of an industry cloud, and other vendors can be locked out if they don't take the lead. IDC's message was clear: take action now to avoid being left behind.

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Waterstone Management Group is a boutique management consulting firm that helps technology companies and their investors create measurable value by identifying and capitalizing on disruptive growth opportunities and driving excellence in Services, Cloud, and Customer Success performance. To learn more about the opportunities and challenges presented by digital transformation and the Third Platform, please contact:

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