intellect

Software and IT Services Report 2007
SME Results

May 2007

Foreword

This survey is the first of what will be a regular series of surveys to be carried out by Intellect to ensure that it keeps its ‘finger on the pulse’ of the concerns and issues facing the SME sector of the software industry.

This sector is one of the most important sectors of the UK economy both in terms of direct contribution to Gross Domestic Product (GDP) and employment, and also with respect to the significant increases in productivity which it facilitates in the rest of the economy, ranging from the ‘City’ through to Government services. Some figures illustrate these points well. In February 2006, the UK Treasury revised how it estimated the overall value of ‘Own Account’ software investment to the UK economy. The resulting recalculation led to the raising of UK GDP for 2003 by a whole 1%. The latest figures also show that the UK Software Development Industry by itself employs one million people and produces an annual Gross Value Added (GVA) of £30bn, representing 45% of the UK’s total GVA.

Nevertheless, the industry is poorly served by data; surprisingly since this is a data processing industry, but perhaps this is just another example of ‘cobbler’s shoes’. This paucity of industry data is only one of the key issues that the newly-established Software Group within Intellect is determined to address. The Group has been established to identify the key issues faced by companies within the software sector in the UK, to devise proposals to address those issues and then to influence those organisations that can effect their implementation.

We believe that we can only meet these objectives by engaging more directly with the widest possible range of companies within the sector, in particular those traditionally known as the Small Medium Enterprises (SMEs). Intellect has a large membership of companies of this type and size and we therefore plan to invest considerable effort in consulting and engaging with this membership, in part by carrying out surveys both on the general economic health of the sector but also on particular issues. We are also aware of the large number of very small software companies who belong to organisations sponsored by the Regional Development Agencies, and we have therefore started discussions with these bodies on how we might collaborate in order to widen still further the number of SMEs consulted through these surveys. In addition we are establishing links with other Trade Associations who we believe share many of the concerns of our own members: for example those representing companies in the games and embedded software industries.

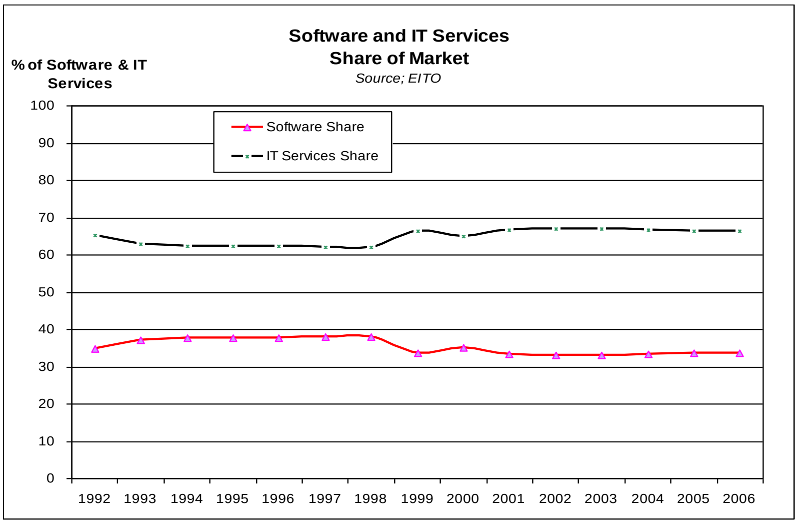
Every report that is published and every speech that is given emphasises the importance of the SME sector in delivering employment, innovation and economic growth, and yet each is bereft of hard data relating to the concerns of this sector of the economy and so is left relying on the views of consultants and representatives of large scale enterprises for their understanding of the state of the industry. It is crucial that this situation is changed and I would urge all SMEs to participate fully in the consultations that Intellect will be carrying out in the future. In the meantime I am encouraged by the level of participation in this first survey, 88% of respondents were small to medium size businesses and commit that the Software Group will shape its agenda to reflect the views expressed in it.

Nigel Hartnell
Chair
Intellect Software Special Interest Group

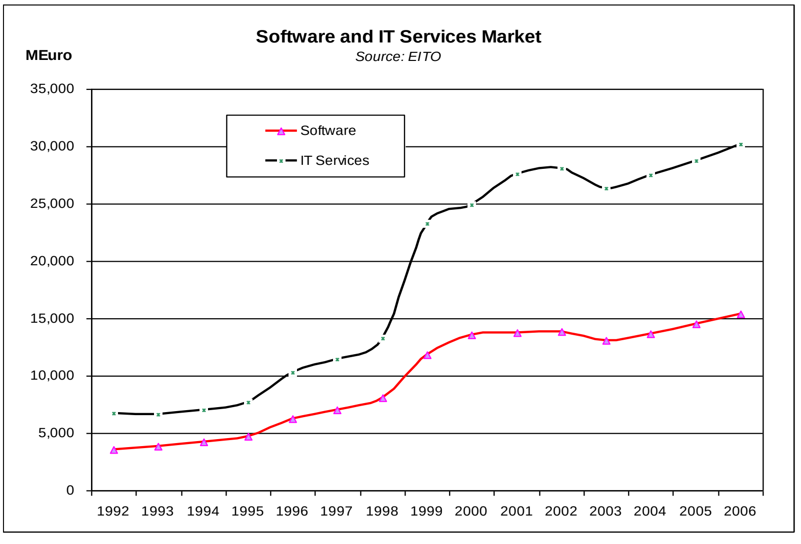
Introduction

On 30 October 2006 leading businessman from the software and IT services sector and prominent analysts of the sector assembled in London to discuss the future direction of the sector. The overwhelming conclusion was that the software and services sector is either about to change or had already begun that metamorphosis. That means that some sectors of the business have already reached or past their zenith thus either their development had ceased or the sector was in decline, whereas other sectors were developing apace and some that were in the infancy might be about to enjoy meteoric growth. It was also clear that the sector now operated in a truly global market with many of the old taboos now considered irrelevant. The changes were happening due to changing attitudes towards sharing, working practices and the habits and wishes of the end-users. Since that meeting, Intellect has conducted a survey on the software and IT service sector.

The split of the sector between software and IT services is essentially the same as it was in the early nineties. That is a one-third to two-thirds split in favour of IT services.

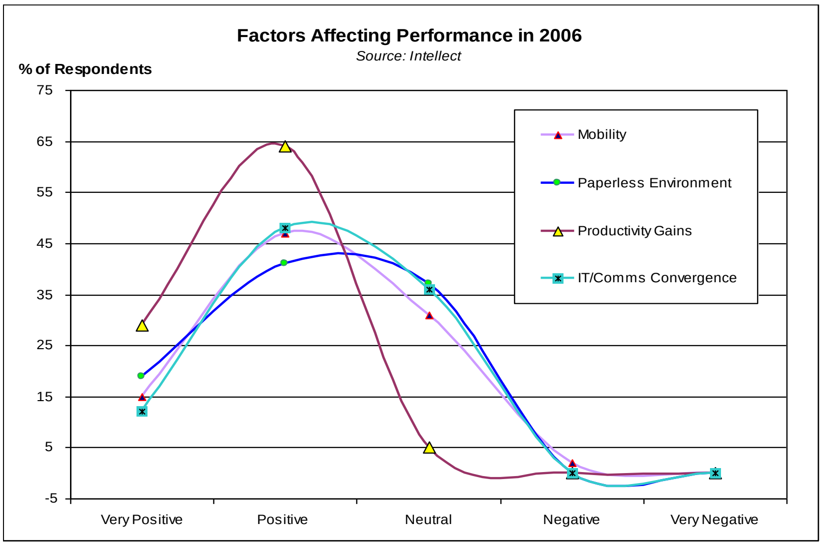


For many years until 2001 both software and IT services experienced rapid growth. Thereafter came uncomfortable years of post Y2K and bursting of the dot.com bubble. That was followed by steady growth in 2003, 2004 and 2005. Richard Holway recently stated that he *believed that growth would largely be in line with gross domestic product which if you took out inflation meant that you would actually have to have a top line growth rate which is about 5% or maybe even 6% at the moment in order to make that come true*.

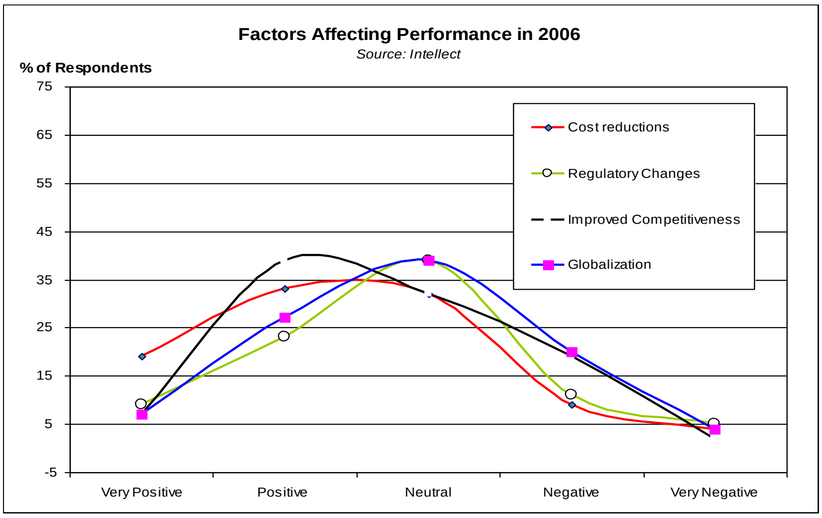


A 2006 review

It is difficult to know how productivity gains would have anything other than a positive impact on ones business therefore it is no surprise to see it ranked so positively. Respondents believed IT & Comms convergence, paperless environment and mobility had a broadly positive affect on their businesses in 2006.

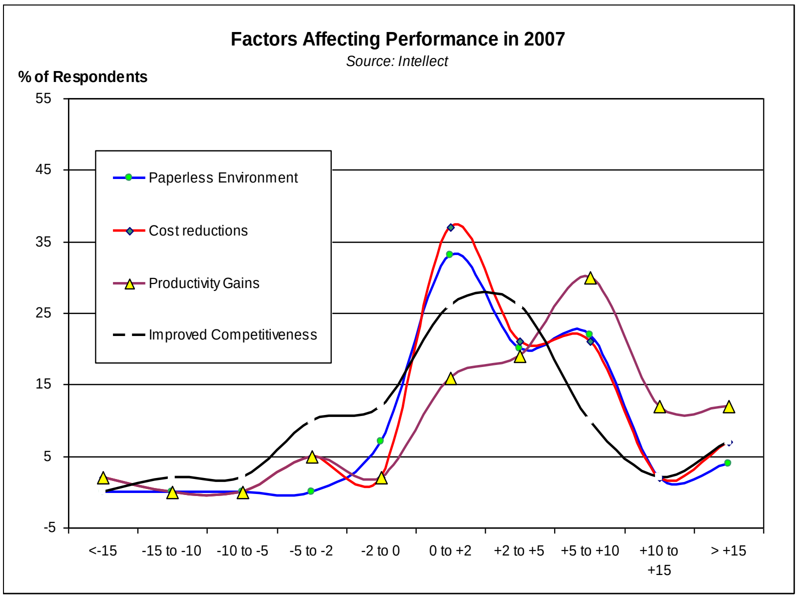


Whereas they thought globalization, improved competitiveness, cost reductions and regulatory changes had an essentially neutral affect on their businesses. It is interesting to note that some respondents had a less than positive view on the effects of improved competitiveness and cost reductions.

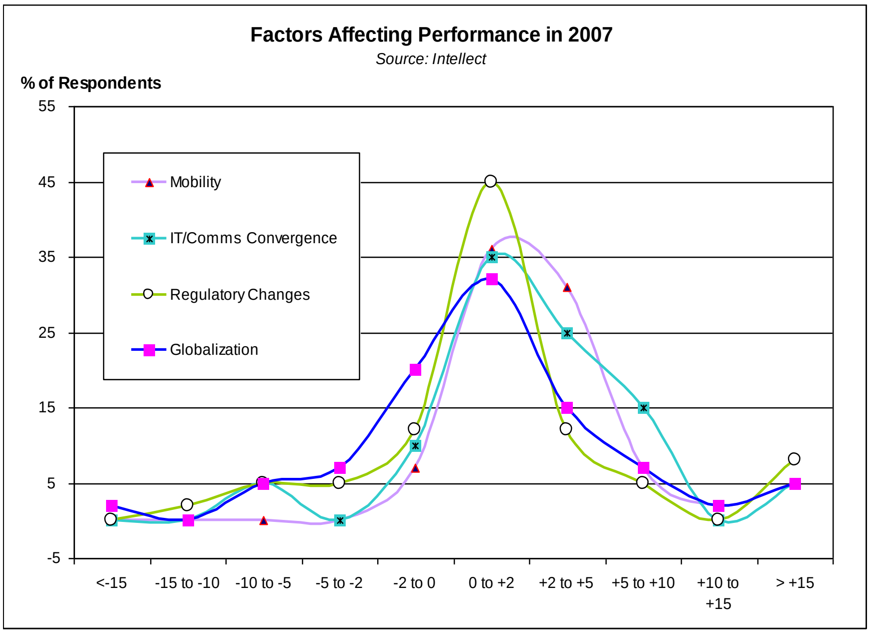


2007 Forward Look

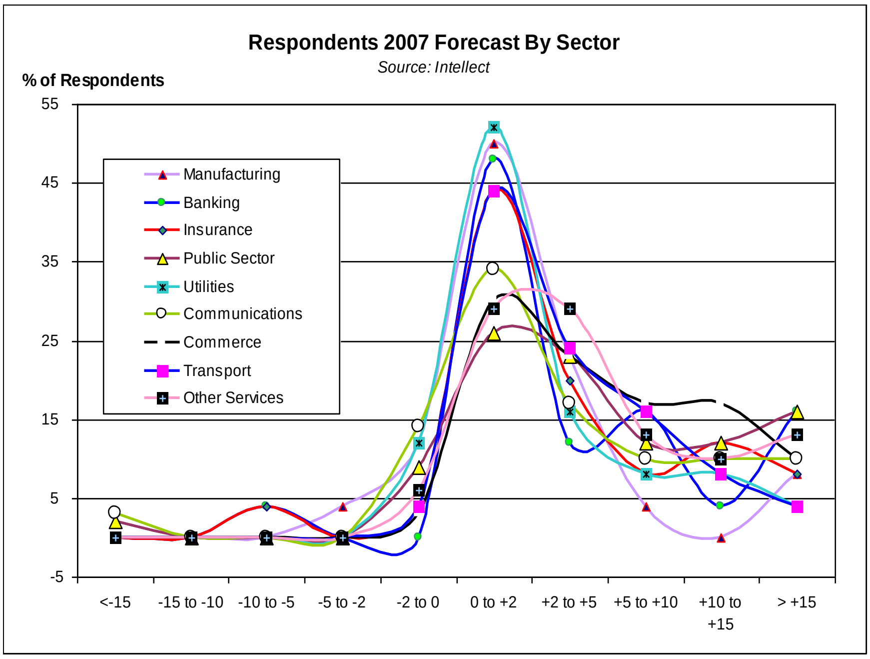
Looking to 2007, respondents believe that cost reductions, paperless environment, improved competitiveness and productivity gains will all have a distinctly positive affect on their businesses.



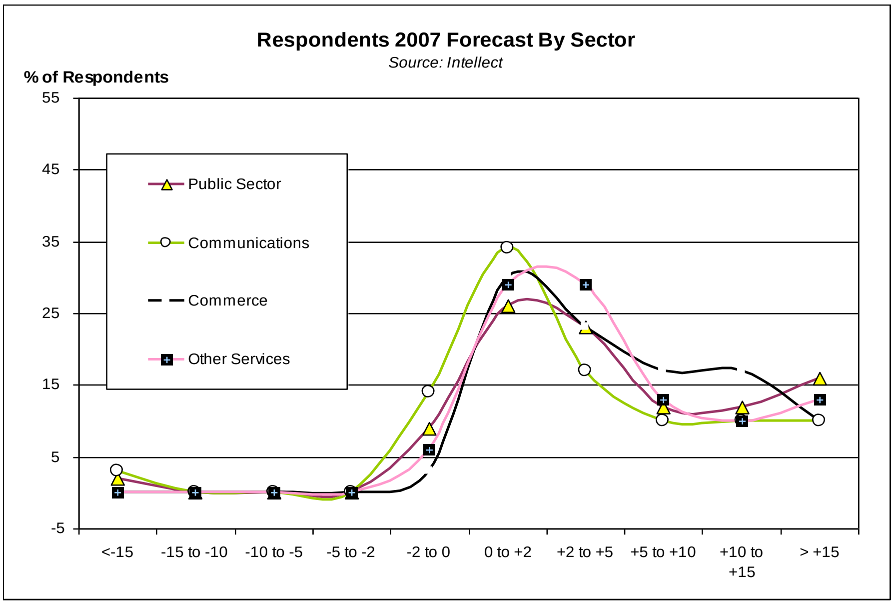
They also believe that regulatory changes and globalization will have fairly balanced affect on their businesses. It is thought that mobility and convergence will have a more positive affect on business in 2007.



The Intellect survey of the Software and IT Services sector also reveals that most respondents believe that all the sectors of market will grow between 0 & 2% in 2007, with second most popular forecast being between 2 & 5%.



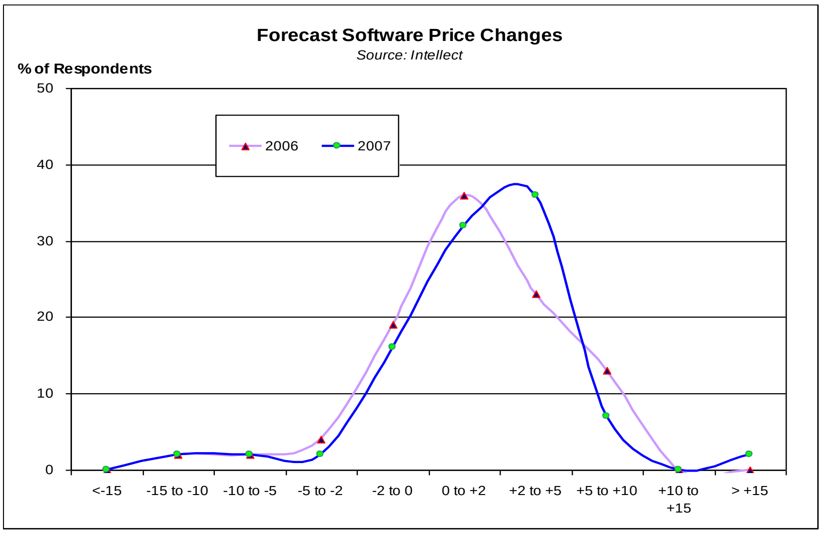
The survey respondents split their consensus forecasts for 4 sectors. Those sectors were Public Sector, Communications, Commerce and Other Services.

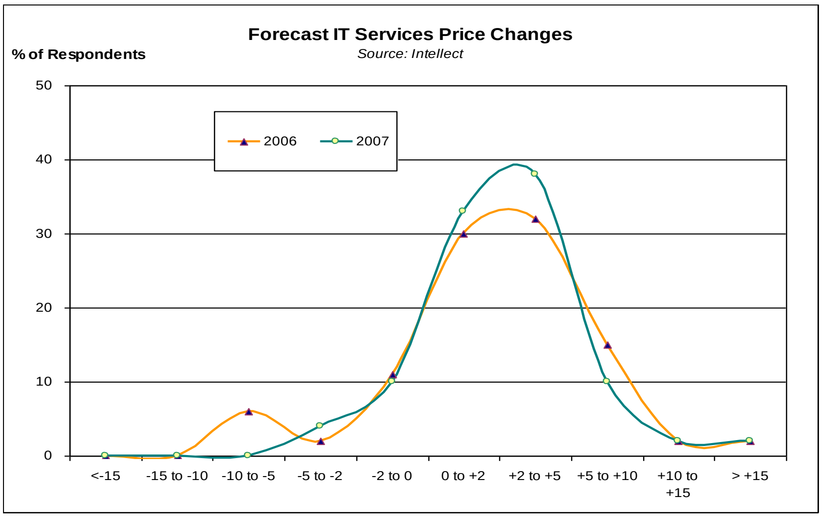


In each of those sectors, 0 to +2% was the dominant forecast.

Software and Services Pricing

The low market growth expectation can be of little surprise since today as Richard Holway put it we are a society where people and businesses *demand more for less.* The respondents to the Intellect survey concurred with that concept and foresaw little or no increase in prices during 2006 with a slight improvement in 2007. They predicted that the price for IT services would increase marginally faster than those of software.



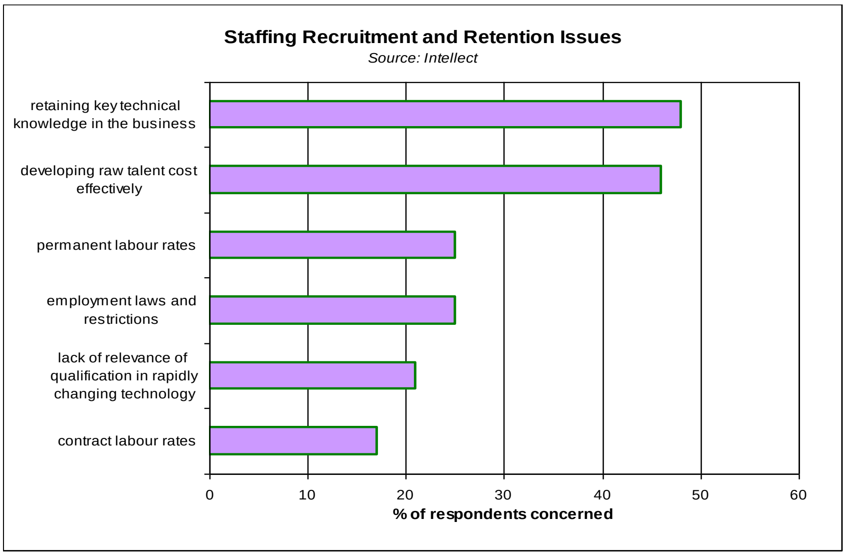


There is a distinct difference between the ways in which large, medium and small companies view the current market status. The vast majority of small companies see orders improving, the decision making cycle and staffing levels remaining the same and do not expect to grow by acquisition. They are split on the size of projects between larger and the same.

Many medium size companies believe the decision making cycle is the same and expect to grow by acquisition. They are split on whether orders are improving or will remain the same, whether they expect to increase their staff or retain the same staffing levels and on whether project size will remain the same or increase. On this, there is a split in the medium size business with the larger medium businesses clearly believing project sizes are become larger. Most large companies also see orders improving, projects being larger, expect to grow by acquisition, and on balance see the decision making cycle and staffing levels remain the same.

Staffing and Recruitment

On the recruitment / staffing front, apart from the small medium size companies who seem to have an additional problem with permanent labour rates, the main issues are getting or developing staff with the right skills and then retaining them. Half of the respondents to the Intellect survey thought "developing talent cost effectively" and " retaining key technical knowledge in the business" were major issues. 25% of respondents also saw the lack of relevance of qualifications due to rapidly changing technology as a significant problem. That issue was touched upon by Richard Holway when he said "*I think we've got to forget about educating our children which I've heard so many people say recently in order to compete for the very type of ICT jobs that will not exist in a few years time because all those jobs will be undertaken in India. We must actually educate them for the ICT enabled world of tomorrow."*

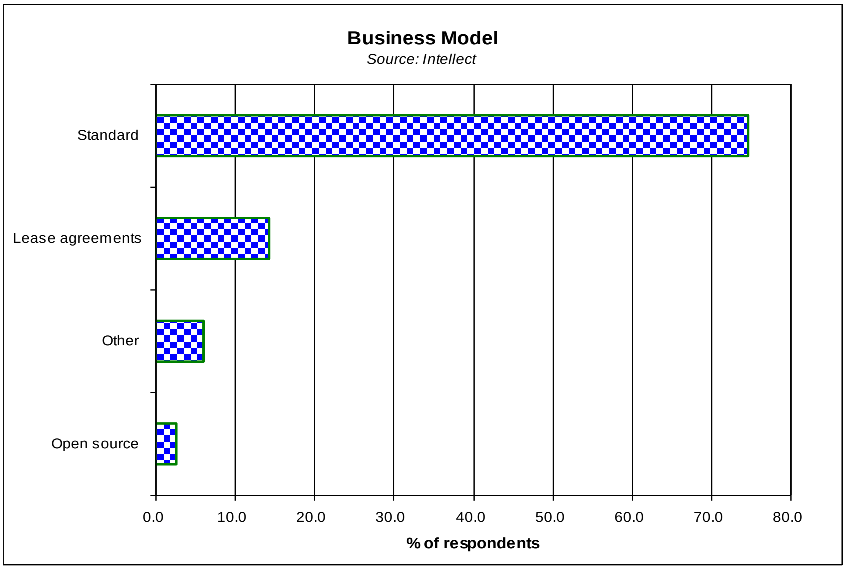


And Robert Lindley said, *"There's been a lot of focus on the supply side, on the individual supply side, that is the qualifications of individuals going into the labour market. These are important but arguable. I would say the skills agenda is in danger of being flogged to death, being certainly oversold, and it is now time we shifted our attention not so much to the qualities of those who enter into employment but the qualities of the organisations which they work for and to focus much more on that. Not to the exclusion of concern about the supply of skills, the quality of skills, and their appropriateness, but to recognise if we are going to get much higher productivity in key sectors of the economy we will need more than just a plentiful supply of graduates."*

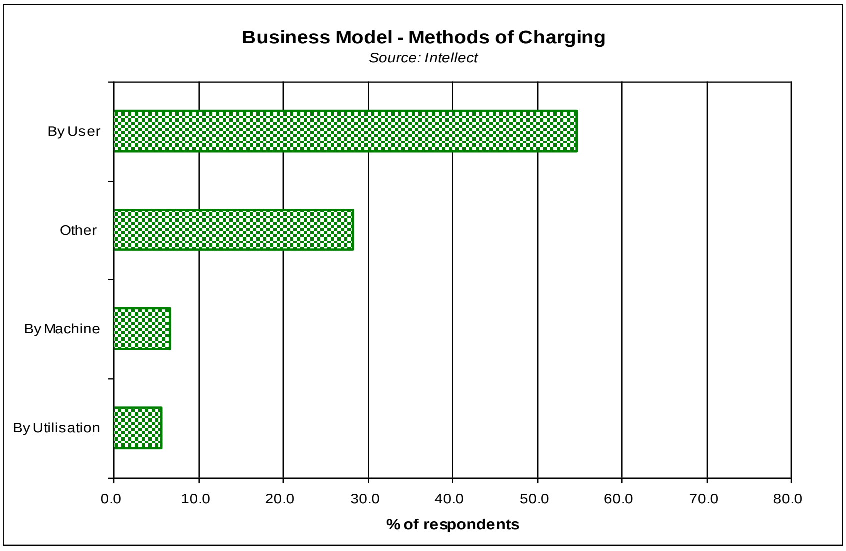
Perhaps what the sector is saying in a roundabout way is that they need to develop their own staff in their own mould and retain them, that is a type of old fashion apprenticeship and long-term retention.

Business Models

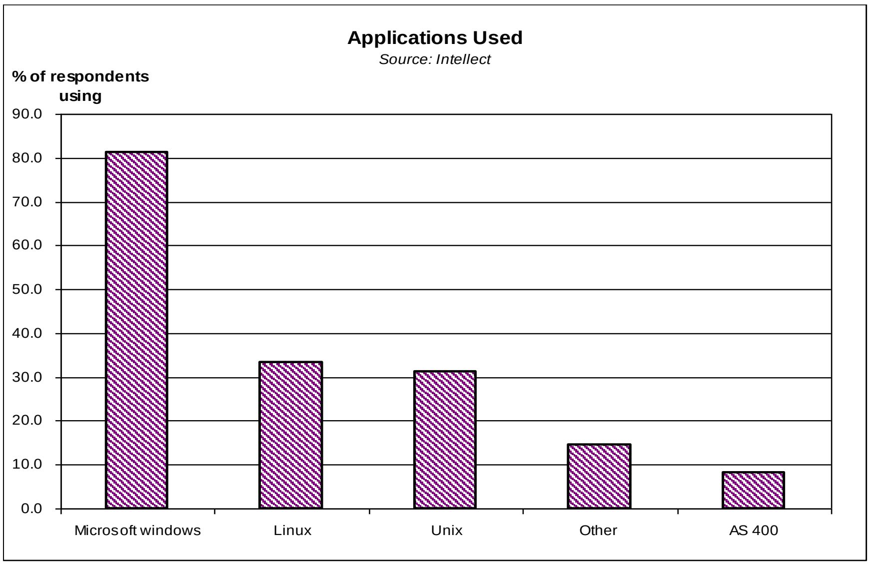
Of the companies that replied to the business model question, which were predominantly smaller businesses, the vast majority use the standard model of sales of licences, maintenance, advice and integration.



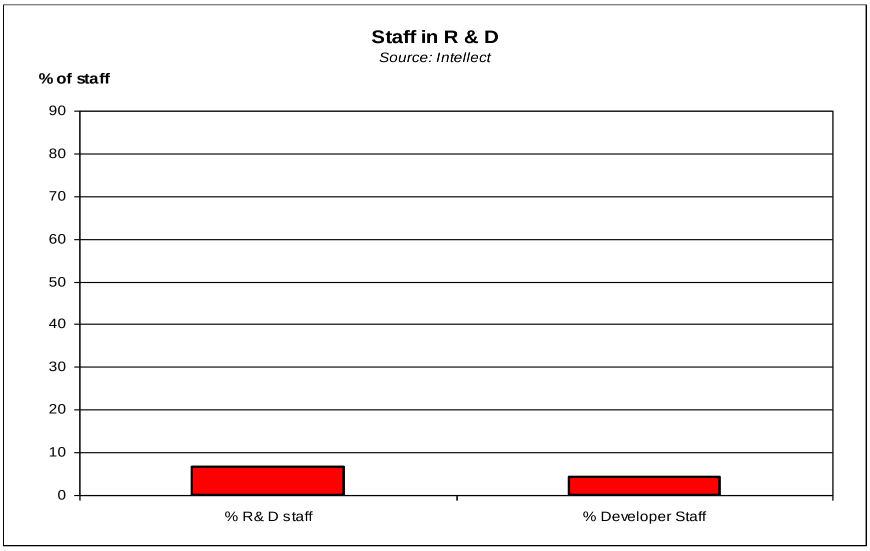
Those smaller businesses primarily charge by the user. The “other” charging method includes numerous variations that are mostly dependent on the nature of the service provided by the respondent.



Unsurprisingly Microsoft Windows is the most commonly used application by IT service providers. However, the survey does reveal that Linux is now used by as many as Unix.

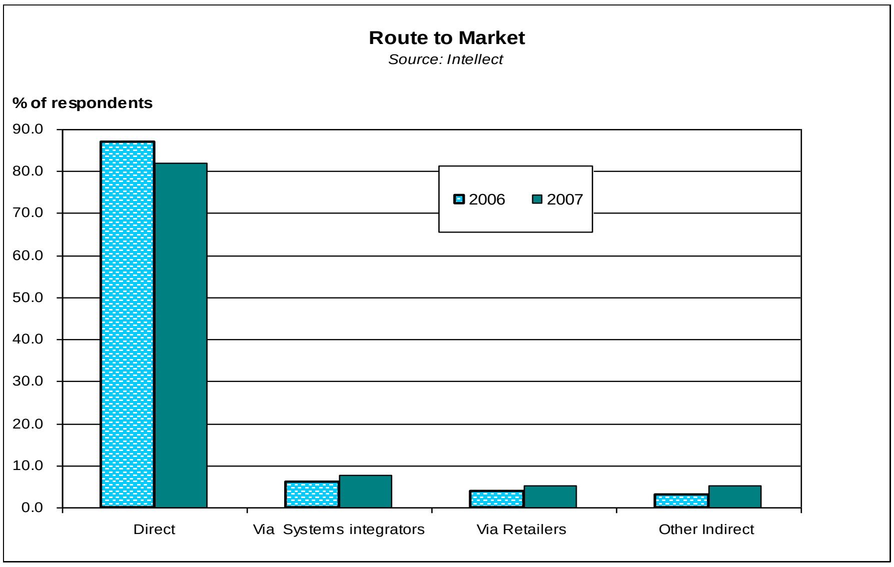


The respondents to the Intellect survey reported that only 7% of their staff were R & D and only 4% were developers. This means that around two-thirds of their R & D teams are developers. Small businesses do not employ overseas R & D staff. Respondents either intend to retain or grow their R & D teams in 2007. Two-thirds of R & D teams use open source software.



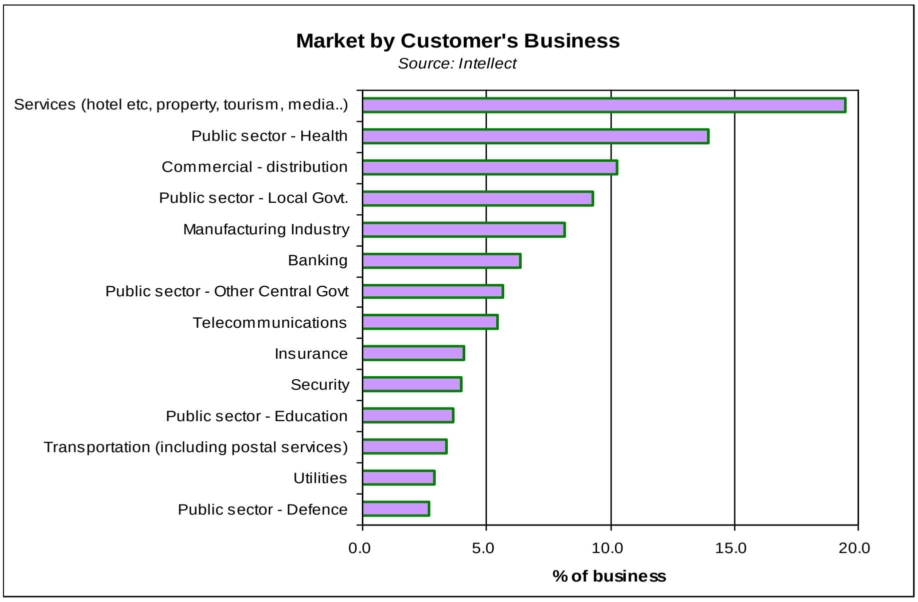
Business Sources

Overwhelming the respondents to the Intellect survey that were predominantly smaller businesses sell direct to the end-user. The view was that this will diminish in 2007 but the overwhelming majority of business will remain direct.

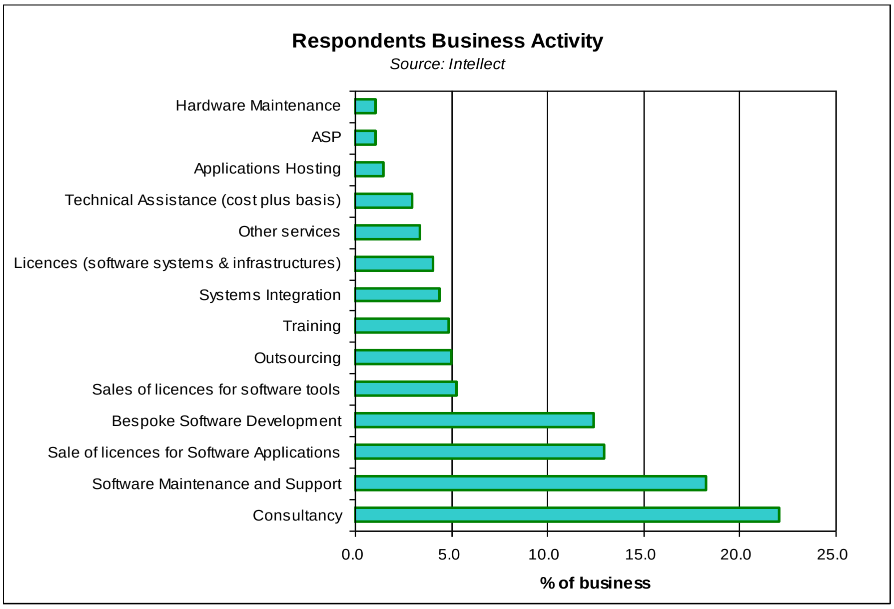


The spread of business source for the Software and IT Service sector appears to be very diverse and relatively evenly spread, however it is recognised that the answers are based on small company respondents and therefore does not reflect the overall market.

An example is the “service sector” which appears to be the biggest market at 20% of all business. That figure is achieved by many smaller companies having substantial business in this area. The larger and medium size companies responding to the survey had very little business in “service sector”. Generally, small companies do not have the capacity to compete for large business contracts in banking, insurance and the public sector. This means that the chart is weighted by the proportion of each company’s business and not weighted by the actual value of the business. The chart is a fair reflection of where smaller companies find their business.



The chart below has the same weaknesses as the chart above, but nevertheless is a good indication of the business activities of small and small medium size companies in the IT services sector. The prominence of the 4 activities at the bottom of Activity chart is driven by the business activities of small companies. It is a fair reflection of the business activities of small companies but perhaps not of the overall software and IT services sector.



Conclusion

The survey has highlighted a number of issues, some already understood, and some that are perhaps not so well known, highlighting the need for more data.

The sector itself expects to grow broadly in line with the macro analysis of the industry. That growth levels are on the whole expected to be between 0-5% perhaps supports the conclusion of the 30 October meeting that some areas are already in decline, while others are approaching their peak. It is interesting to note that, while SMEs expect an increasing number of orders to aid their growth in 2007, the larger medium-sized companies are expecting to grow mainly by acquisition, with large companies expecting to acquire while taking on even larger projects.

The sector's view on increased productivity as having an overall positive affect on business will come as little surprise, but more interesting is the number of respondents who did not have a positive view of cost reductions or improved competitiveness in terms of improving performance. Interesting also is the overall neutral view of respondents to globalisation as a performance-enhancing factor. Both of these areas would be interesting areas for development.

Staff training, skills and retention are key issues for respondents, and the answers suggest that it may be necessary to focus more on job-specific training as a way to increase the required skill-set of employees. The perceived wisdom of encouraging skills development in academia may not be the answer for many companies. In addition, it is interesting to note the small number of R&D staff employed for respondents; further attention to this trend may also be warranted.

The Intellect Software and IT Services Survey has taken an initial step towards developing meaningful and worthwhile data sets for the software sector in the UK. The Software Group will look at these results, and build on them to ensure that those participants in the software industry are able to be as competitive as possible.

Intellect's Software Group

Intellect is the UK trade association for the IT, telecoms and electronics industries. Its members account for over 80% of these markets and include blue-chip multinationals as well as early stage technology companies. These industries together generate around 10% of UK GDP and 15% of UK trade. For more information go to www.intellectuk.org

Background

Today it is clear that software is the key technology behind much of what is driving the innovative aspects of the economy, and is at the heart of the revolution taking place in the use of electronics and telecommunications services by the consumer. In economic terms, it offers the potential opportunity to increase UK productivity and enable the UK to compete in an ever more competitive global economy.

What is the Software Group?

The Software Group has been established as a Special Interest Group, to give a voice to Intellect's software companies and, in particular, the SME community. As such its purpose is to represent the views of the software industry (as represented by its members) and to seek to optimise the trading environment in which Intellect members operate. It will do this by identifying the key issues facing the software industry, devise proposals to address these issues and then seek to influence the relevant organizations to effect their implementation. In doing this the target audience would include customers, government, the media and other industry associations.

Membership

Membership of the Group is open to all Intellect members with an interest in software. This includes broadly-based IT companies with a significant software business, non-IT companies with a captive IT business and firms that provide professional services to or invest in the software industry. However, the initial focus will be on issues that are affecting SME companies whose sole activities are in software. As a result of this initial focus we would hope to attract even more SME software companies to become members of Intellect.

We would also aim to act as a magnet for the software community outside of the traditional companies to draw in companies and associations that operate in the newer, rapidly expanding sectors of the software market including mobile, leisure, entertainment and embedded software. In addition we seek to establish working partnerships with regional organizations that support many of the thousands of small software companies within the UK.

The Management Committee

The Group is steered by a management committee comprising:

Chair: Nigel Hartnell, FFastFill plc
Vice-Chair: Stephen Kingan, Nexor Ltd

Dave Andrews, IBM UK Ltd
Simon Downing, Civica plc
Anis Karim, Logotech Systems
Matt Lambert, Microsoft UK Ltd
Tim Pearson, RM plc
Keith Wishart, ESRI UK Ltd

For further information, contact Carrie Hartnell
T 020 7331 2007
E carrie.hartnell@intellectuk.org

Intellect is the trade association for the UK technology industry.

Intellect provides a collective voice for its members and drives connections with government and business to create a commercial environment in which they can thrive. Intellect represents over 800 companies ranging from SMEs to multinationals. As the central hub for this networked community, Intellect is able to draw upon a wealth of experience and expertise to ensure that its members are best placed to tackle challenges now and in the future.

Our members' products and services enable hundreds of millions of phone calls and emails every day, allow the 60 million people in the UK to watch television and listen to the radio, power London's world leading financial services industry, save thousands of lives through accurate blood matching and screening technology, have made possible the Oyster system, which Londoners use to make 28 million journeys every week, and are pushing Formula One drivers closer to their World Championship goal.

In the past 12 months 14,500 people have visited Intellect's offices to participate in over 550 meetings and 3,900 delegates have attended the external conferences and events we organise.

The technology industry contributes over 10% of the UK GDP and directly employs over a million people in the UK.

For more information visit www.intellectuk.org

intellect

Intellect Russell Square House 10-12 Russell Square London WC1B 5EE
T 020 7331 2000 F 020 7331 2040 E info@intellectuk.org W www.intellectuk.org