Market Research

Worldwide Verticals: Manufacturing, Banking Top IT Spenders

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Letter to the Editors

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Executive Summary

Worldwide IT spending hit nearly $1 trillion USD in 2004 and is on track to reach $1.2 trillion USD by 2008. That amounts to a compound annual growth rate (CAGR) of nearly 5%, according to International Data Corp. (IDC) -- welcome news for an industry not long ago in retrenchment. **Discrete manufacturing, government and banking are the hottest worldwide verticals** and represent the biggest growth opportunities for OEMs throughout 2008. The global communications/media industry will rebound from the moribund state it has experienced in recent years, spending more than $90 billion USD worldwide on IT this year, according to IDC. The firm believes transportation, education and construction will stay near the bottom of the IT spender list.

In order to capitalize on the attractive vertical market opportunities, **vendors must understand the dynamics and market conditions** in their target space, according to Gartner Inc. Economic, political and technology cycles vary widely by industry. Certain segments, such as federal government, require a high degree of domain expertise in order to compete. OEMs looking to enter a new area to them should study up on the space and consider partnering with a company that has experience.

Banking, Manufacturing On Top

Worldwide share of total IT spending by vertical market and region, % and $USD, 2004-2008

2004	North America	Western Europe	A/P (Mature)*	A/P (Dev.) **	Rest of World
Banking	10.4%	14.7%	9.7%	13.7%	12.0%

Discrete Manufacturing	11.1%	12.8%	12.3%	12.6%	10.0%
Government	10.6%	13.6%	8.8%	11.8%	10.1%
Communications/Media	8.3%	7.2%	10.4%	15.7%	11.6%
Services	8.9%	6.8%	10.2%	1.7%	5.3%
Process Manufacturing	7.2%	9.2%	5.9%	3.1%	8.7%
Other	34.3%	28.9%	33.1%	24.4%	32.4%
Business Total	**90.8%**	**93.2%**	**90.4%**	**83.0%**	**90.1%**
Total* **	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
2008					
Banking	9.9%	15.1%	9.8%	14.1%	11.8%
Government	10.8%	13.8%	8.7%	12.1%	10.6%
Discrete Manufacturing	10.6%	12.4%	12.0%	12.6%	9.8%
Communications/Media	8.7%	7.5%	10.5%	16.6%	11.5%
Services	8.7%	6.8%	10.6%	1.8%	4.8%
Process Manufacturing	7.1%	9.0%	6.2%	3.6%	8.9%
Other	34.1%	29.1%	33.1%	24.4%	32.8%
Business Total	**89.9%**	**93.7%**	**90.9%**	**85.2%**	**90.2%**
Total* **	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

* A/P mature countries are Australia, Hong Kong, Japan, New Zealand and Singapore

** A/P developing countries are India, Indonesia, Korea, Malaysia, Philippines, China, Taiwan, Thailand, Vietnam and other

*** Includes consumer IT spending

Source: IDC, 2004

IDC, Gartner and AMI-Partners all agree **the world economy will continue to improve in the next few years**, led by the U.S., China and Asia/Pacific regions. This will strengthen the outlook for vertical IT spending. In this exclusive OEM Connect report, analysts from IDC, Gartner and AMI-Partners Inc. all weigh in on the developing vertical trends and opportunities.

Global Share

Good news: Virtually **every vertical market will increase its IT spending** in the next three to five years. Worldwide IT spending reached nearly $1 trillion USD in 2004 and will grow to an impressive $1.2 trillion USD by 2008, a compound annual growth rate (CAGR) of nearly 5%, according to International Data Corp. (IDC), a market research firm in Framingham, Mass. "2004 ended on a rousing note. I'm very optimistic about IT spending in almost every vertical market," says Anne Lu, program manager for IDC worldwide vertical market research. Lu is co-author of "Worldwide IT Spending 2005-2009 Forecast Update by Vertical Market," which IDC will publish in June.

The small and medium-sized businesses (SMBs) worldwide IT spending picture is even brighter, according to AMI-Partners Inc., a New York market firm that covers businesses of all sizes and specializes in SMB research. By contrast to IDC's outlook, "We think large enterprise IT spending is flat. SMBs, on the other hand, will see year-over-year IT spending increases of between 12-13%," says Steve Reynolds, managing director for AMI-Partners. "The SMB space is much more dynamic than the large enterprise segment." AMI-Partners defines SMBs as companies that have between 1 and 999 employees. In general, SMBs weathered the recession better than large enterprises, he adds.

Small Firms, Big Growth

IT spending in worldwide SMB vertical markets, estimated 2005-2008

Segment	2005	2008	CAGR, 2004-2008
Professional services	$126 billion	$181 billion	9.48%
Manufacturing	$124 billion	$163 billion	7.1%
Wholesale/Retail	$115 billion	$158 billion	8.3%
AMTUC*	$76 billion	$101 billion	7.4%
FIRE**	$63 billion	$90 billion	9.3%
Other Business Services***	$93 billion	$133 billion	9.4%
Worldwide Total	**$597 billion**	**$826 billion**	**8.5%**

* Agriculture, mining, transportation, utilities and construction

** Finance, insurance, real estate

*** Non-information services such as restaurants, printing, dry cleaning

Source: AMI-Partners, 2005

China, India and other Asia/Pacific countries will see the highest growth rates in SMB IT spending. "You have a **lot of business formation going on in China and India**. That boosts the Asia/Pacific region and worldwide consumption of IT," says Reynolds.

Making up 11.9% of the total, **banking was the leading vertical in terms of IT spending** worldwide last year, according to IDC. Accustomed to spending big on IT infrastructure and packaged software, the banking sector spent $115 billion USD on IT in 2004. Banks will increase their IT services spending to $67.6 billion USD this year, according to IDC. Surprisingly, after years of painful cutbacks, discrete manufacturing emerged as a very close second place at 11.8%, or $113.4 billion USD spent, with discrete manufacturing lagging at 7.5%.

Government is another hot vertical worldwide. "Government is one of the biggest growth areas," says IDC's Lu, and it will see a compound annual growth rate (CAGR) of 7% between 2004 and 2008. The worldwide government market will surpass $142 billion USD in 2008, driven by e-government and security initiatives. Gartner analyst Emma Rose says national government is one of the top verticals in the hot Asia/Pacific region, along with communications/media, financial services and discrete and process manufacturing.

Leading the Pack

Top vertical market in each worldwide region, 2004

Region	Top Vertical
North America	Discrete manufacturing
Western Europe	Banking
Asia/Pacific (mature)	Discrete manufacturing
Asia/Pacific (developing)	Communications/media
Rest of World	Banking

Source: IDC, 2004

The **communications/media segment will experience higher growth than most** of the other verticals through 2008, partly because it went through such a sharp downturn in recent years. This sector will spend more than $90 billion USD this year on everything from PCs to networking gear to peripherals and storage, according to IDC.

U.S. Vertical Outlook

The United States is by far the largest regional consumer of IT products and services, spending nearly $500 billion USD by 2008, according to IDC. In that region, the strongest verticals in order of size are discrete manufacturing (with automotive and high tech in the lead), federal and local government, and banking, according to IDC. **The average CAGR for each U.S. vertical is roughly 6%** during the forecast period, according to IDC. "The biggest spenders, like the federal government, will grow faster than that," says Lu.

Gartner analyst Rishi Sood concurs. "We've seen **explosive growth in the federal government space** in the U.S. over the last three years. We saw IT spending hikes hit 50%," says Sood, vice president of government research for Gartner, in San Jose, Calif. Gartner estimates that growth rate will slow considerably, to between 5 and 7% in the next two years, somewhat lower than IDC's estimate.

Sood believes IT spending in the U.S. federal government sector will slow and plateau in the foreseeable future, as **an effect of tax cuts and the ongoing wars** in Iraq and Afghanistan. "We have burgeoning budget deficits. Leading up to the next presidential cycle, spending will slow considerably," he says.

U.S. Vertical Trends to Watch

U.S. vertical market highlights in 2004 and anticipated in 2005

Vertical	Trend
Communications / Media	• Further consolidation expected • Demand for business process outsourcing (BPO) will increase
Federal Government	• Changes in the governmental healthcare are leading to increased opportunities in defense, veteran affairs and health/human services for vendors with domain expertise • Demand for BPO is growing
Financial Services	• Demand for offshore outsourced IT services to increase, along with BPO • Moving away from paper checks to electronic payments
Healthcare	• External groups increasing pressure to increase patient safety through advanced computer-based patient record (CPR) systems • Cost control continues to be a key market force
Manufacturing	• Weak U.S. dollar could spur demand for U.S.-made goods • After years of focusing on cost-cutting, manufacturers have accumulated significant cash reserves • More business investment focused on strategic growth initiatives expected
Retail	• Sector undergoing major point-of-sale (POS) refresh • New technologies (including RFID) will drive re-engineering projects • Outsourcing will hit hard in 2005

State and Local Government	• State and local governments well-positioned to achieve significant fiscal growth
Transportation	• Third-party providers investing in the complex supply chains they need to serve transportation customers • Shippers demanding immediate status updates on their goods • Cost-pressured carriers are demanding more gains in employee productivity
Utilities	• After a sustained period of streamlining operations, management focused on new growth initiatives • Energy trading solutions a critical area of investment this year

Source: AMI-Partners, 2005

Some **significant opportunities will remain in the U.S. government sector**, however. The newly created position of U.S. director of national intelligence will drive restructuring and force consolidation within the CIA and the FBI. "This will require greater infrastructure support and application sharing," leading to opportunities for vendors that have domain expertise in the military, says Sood. Vendors lacking Department of Defense experience need not apply, he adds.

At the state/local government level, Sood believes the growth picture is the inverse of that at the federal level. "After 9/11, most states and agencies had huge budget deficits. In the last three years, their IT spending did not grow but contracted by an average of 10%," he says. But **the start of fiscal 2006 sees most agencies and states finally operating in the black**. "They can focus on major tech projects they had to put aside for the last several years," says Sood.

With almost all vertical markets, management will look for projects that offer opportunities for **cost containment, cost avoidance, revenue generation and revenue maximization**. As an example of revenue maximization, many healthcare providers are installing new Medicaid systems in order to get the highest level of reimbursement from the federal government.

Market Factors

OEMs attempting to sell into particular verticals must be mindful of the specific dynamics and conditions in each market space while also being aware of overall market forces. For example, according to Gartner, **business process outsourcing (BPO) is on the rise across the board** in U.S. verticals as the economic outlook continues to be uncertain. No matter what vertical they target, vendors would do well to focus on that industry's unique business processes.

Vendors must **adapt their marketing with industry-specific messages** that will change depending on market conditions, according to a Jan. 2005 Gartner report, "Vertical Markets Responded to Fluctuating Conditions in 2004." In the next two years, industries will either be in a period of growth (financial services and retail), possible rebirth (state and local utilities), stabilization (manufacturing and communication/media) or eventual slowdown (federal government). A company's approach must match the prevailing conditions.

Who Buys What?

Top vertical IT buyers by IT category and vertical's share of worldwide product segment, 2004

Product	Top Vertical	% of Worldwide Product Market
High-end Servers	Banking	20.1%
Mid-range Servers	Communications/media	16.7%
Volume Servers	Discrete manufacturing	13.4%
Personal Computers	Consumer/home	35.1%
Peripherals and Storage	Consumer/home	15.3%
Networking Equipment	Communications/media	40.6%
Traditional Workstations	Discrete manufacturing	21.3%
Packaged Software	Discrete manufacturing	13.0%
IT Services	Banking	15.9%

Source: IDC, 2004

Knowledge of the target vertical is necessary, but not sufficient, according to Reynolds of AMI-Partners. OEMs must put "a lot of thought into crafting programs that reach out to SMBs more efficiently. Traditionally, vendors would not serve this segment directly. But that is changing. Vendors want to understand the customer enough to create and own a category," says Reynolds.

For example, on the consumer side, HP has positioned itself to be the one name that comes to mind for everything related to printing photos. But there is no silver bullet. "It's a major challenge for vendors. There is no accumulated wisdom. They're looking for ways to do this," he says. Reynolds' advice? The first step is to **put aside a product-centric mindset and market to SMBs based on customer experience**.

World Economic Outlook

Annual % change in output, 2005-2006 projections

	2005	2006
World Output	4.3%	4.4%
United States	2.6%	3.0%
Western Europe	3.6%	3.6%
Japan	.8%	1.9%
United Kingdom	2.6%	2.6%
Canada	2.8%	3.0%
Developing countries*	6.3%	6.0%

*Includes Africa, Central and Eastern Europe, Russia, China, India, Middle East, Brazil, Mexico

Source: International Monetary Fund, April 2005

Both IDC and Gartner expect **the world economy to grow stronger in the next few years, led by the U.S., China and the Asia/Pacific region**. This will drive greater levels of strategic IT investment in the vertical markets that make up the global economy. IDC expects overall corporate profits will continue to increase in many industries, which will translate to increased IT investment. Vendors that have a good understanding of the environment they are selling into stand the best chance of capitalizing on the vertical opportunities.

About AMI-Partners Inc.

Access Markets International-Partners Inc. (AMI-Partners) specializes in actionable market intelligence, strategic consulting, venture capital and go-to-market solutions for the global Small and Medium Business (SMB) Enterprises market. Established in 1996, AMI-Partners is based in New York City. For more information, visit www.ami-partners.com.

About Gartner Inc.

Gartner Inc. is a research and advisory firm that helps more than 10,000 clients leverage technology to achieve business success. Founded in 1979, Gartner is headquartered in Stamford, Conn., and has over 3,800 associates, including approximately 1,000 research analysts and consultants, in more than 75 locations worldwide. For more information, visit www.gartner.com.

About International Data Corp.

IDC is the premier global market intelligence and advisory firm in the information technology and telecommunications industries. It analyzes and predicts technology trends so that companies can make strategic, fact-based decisions on IT purchases and business strategy. For more information, go to www.idc.com.

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Lauren Gibbons Paul has more than 15 years of experience as a writer and editor for leading business and technology publications, including *eWEEK, CIO, Managing Automation* and *Network World*. She has also done research assignments for a number of well-known analyst firms.

Methodology

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