ENTERPRISE SOFTWARE CUSTOMER SURVEY 2007

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Preface

Senior-level technology and business decision makers at major enterprises report that software accounts for a large and growing portion of IT budgets. Innovation is critical to these influential customers, and they expect significantly more innovation from the software industry in the years to come.

A new *Enterprise Software Customer Survey* from McKinsey & Company and Sand Hill Group examined the strategies of 475 senior IT and business executives[1] to determine how software budget levels will change, who will control the spending, what industry trends will most impact their company in the near term, and what role innovation plays in their decision making. The results draw a picture of continually increasing software budgets, a shift to more decentralized purchase decisions with increased roles for the business side in purchasing decisions, and the increasing importance of software innovation that respondents predict will come from small vendors.

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Increasing Software Budgets

Software will account for an increasing portion of IT budgets.

Senior IT decision makers say their plans for 2007 call for 31 percent of the IT budget to be dedicated to software spending, and that portion is likely to increase to 36 percent over the next 2 years given ongoing initiatives (both spend reduction and new investments). The current 2007 results represent a 1.7 percent increase in the software share of the IT budget compared to 2006, further demonstrating that we are in a software market upswing. At the macro level, the way in which these companies will deploy their software budgets is consistent with results from prior years: spending will continue to be directed to new initiatives (31 percent), new licenses (23 percent), maintenance (21 percent), deployment (12 percent), training (9 percent), and other initiatives (3 percent).

Software Purchasing Decisions

The majority of software purchase decisions are still made centrally, although line-of-business buying is expected to increase.

According to our *Enterprise Software Customer Survey*, the dominant model for software purchasing remains centralized, with respondents reporting 69 percent of aggregate software budgets as centrally controlled this year. However, many enterprises may be moving to a more decentralized model where business leaders and end users wield more control. When asked how this spend would be controlled in the future, 40 percent responded that software spending would be more business-unit (BU) controlled in 2 years versus only 28 percent of respondents predicting further centralization. It should be noted that this trend is a reversal from last year's results, in which a greater fraction of respondents indicated they were further centralizing the control of software spend (38 percent further centralizing versus only 23 percent decentralizing). We believe this shift in sentiment is a natural outcome of the bottom-up nature of the diffusion of the current software innovation wave – as end users and business leaders play an increasing role in experimenting with and deploying new innovative products and technologies, the control of the software spend will naturally spread out across the organization.

Similarly, the influence of the business side of the organization continues to play a significant role within software decision making. While IT is a decision maker in 64 percent of all software decisions, business leaders are similarly involved and act as decision makers in 38 percent of all decisions (eclipsing the CFO and finance department who are decision makers in only 18 percent of deals). Similarly, while business users are less often the decision makers, they are being formally consulted or acting as decision maker in 61 percent of all software decisions. It is worth noting that the responses we received from both the IT side (CIOs, VPs of IT, and directors of IT) and the business side (CEOs, COOs, CFOs, CMOs, and other VPs) were remarkably in tune with one another, indicating that both sides accurately perceive the role they and others play. Within this world software sales forces will need to increasingly build relationships and develop materials tailored to the business decision makers in parallel with the IT discussions they are already having, and may even want to consider campaigns focused exclusively on the business side of the organization (e.g., “try before you buy” models).

Software Industry Trends

Innovation and Service-Oriented Architecture (SOA) are top-of-mind issues for software customers.

When asked about the big trends likely to make headlines our respondents had some clear favorites and predictions for the new year. "Service-Oriented Architecture" was the top pick on the list selected by 23 percent of all respondents, followed closely by "Software on New Devices" with 20 percent of all respondents. The findings are difficult to compare to the 2006 survey. Last year we presented a combined "SOA/Open Source" option to respondents who ranked it in the middle of the list. When offered separate selections respondents made it clear which was more important: SOA ranked at the very top of the list, and Open Source fell into the bottom half. However, this doesn't necessarily mean Open Source is losing favor with customers, and indeed may mean that it has become mainstream and less of a new "trend."

Similarly, when asked which of a list of trends would most impact their business the new option of "Software Industry Innovation" claimed the top spot selected by 33 percent of all respondents, followed quickly by the two services trends that led the list last year, Software as a Service (21 percent) and Web Services/SOA (18 percent). When asked where the software industry most needed to improve, our respondents again pulled product innovation into the top slot, ranking it number one with 30 percent of all respondents. "Innovation" was closely followed by "ease of use" and "customer service" which rounded out the top-three list of the vast majority of respondents. It is worth noting that all three of these factors were ranked higher than "cost," which seems to have slipped in the rankings with only 14 percent of respondents ranking cost as their top issue for improvement, and nearly half (48 percent) of respondents omitting this from their top three areas. A closer look at the data yields an interesting comparison: while 21 percent of IT respondents ranked cost as their top concern, only 11 percent of business respondents ranked it similarly. While price will certainly continue to be a factor in purchase decisions, business customers seem to be placing a greater premium on the value that the software industry can deliver in innovative new ways.

Software Industry Innovation

We are still early in this software innovation wave with considerable product innovation, business model innovation, and process innovation yet to come.

Last year the *Enterprise Software Customer Survey* found buyers placing an emphasis on innovation. To further explore the role of innovation in the software buying process we asked a series of questions about the current state of software innovation. We began by asking respondents their opinions of the industry's position on the current software innovation wave. The vast majority of respondents clearly think the best innovation is yet to come. Fifty-five percent of respondents reported they still expect significant new technology innovations to come, and another 22 percent saw the industry near the peak of technology innovation with only business model and process innovations still ahead of us.

We polled our respondents to understand what type of software innovation they were looking for. Across the board buyers want more innovation, citing all of the various types of product, business model, and process innovation as important. At the top of the list were three flavors of product innovation: new integration between software, improved ease of use, and fundamentally new product areas. These factors were followed closely by new features in existing products, process innovation, and business model innovation.

We also inquired about the speed with which respondents were adopting various new software business models. The results showed a great degree of enthusiasm for business model innovation, with respondents predicting that more than 40 percent of their software budgets may be spent in alternative business models over the next 2 years (subscription, transaction, advertising, or another format). Even more striking in analyzing the fraction of respondents that plan to at least try each of the proposed alternative business models a whopping 80 percent plan some subscription/on-demand spend, 60 percent plan some transaction-based spend, and 33 percent plan spend funded by advertising! This broad willingness to experiment indicates alternative business models have hit the mainstream and software vendors of all types and sizes need to ensure their level of business model innovation matches the level of product innovation.

Few customers expect to see innovation coming from large software vendors.

When asked where this innovation is likely to come from our respondents resoundingly pointed to the community of small software vendors (59 percent). Only a small minority of customers expect software innovation to come from the largest software vendors (19 percent). Looking at the findings by buyer subgroups, 29 percent of IT-side respondents believe in the ability of large vendors to deliver innovation while only 15 percent of the business-side respondents share this expectation. Similarly, while 27 percent of large enterprises (greater than 1,000 employees) are confident in the innovative ability of large software vendors, this figure shrinks to only 21 percent of the midmarket respondents (100 to 1,000 employees), and only 11 percent of small businesses customers (less than 100 employees).

The findings should serve as a clear wake-up call to the large software vendors to either improve their level of innovation, step up their communications about their innovations to the business community and small and midmarket businesses, or both.

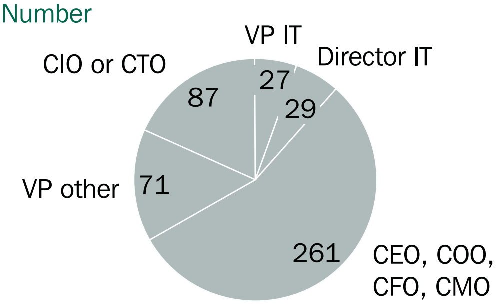
Notes

[1] In April of 2007, McKinsey & Company collaborated with Sand Hill Group to conduct an online survey of senior IT and business professionals around the globe. A total of 475 qualified respondents participated from the list of *Software 2007* conference attendees and the *McKinsey Quarterly* subscriber base. Respondents included CIOs, VPs and directors of IT, CEOs, CFOs, CMOs, COOs, and other VPs. Where available we have presented comparisons to results from last year's survey in March of 2006.

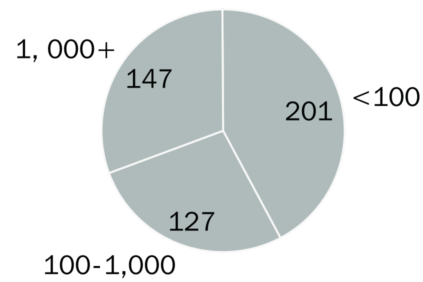
EXHIBITS

Enterprise Software Customer Survey Respondent Demographics
N = 475

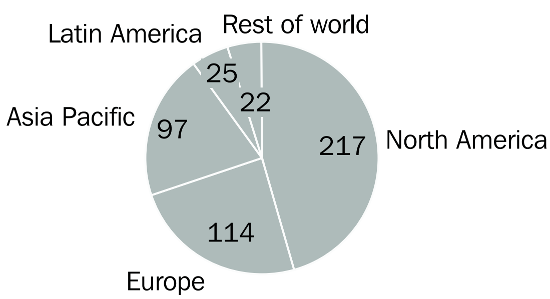
Respondents by role
Number



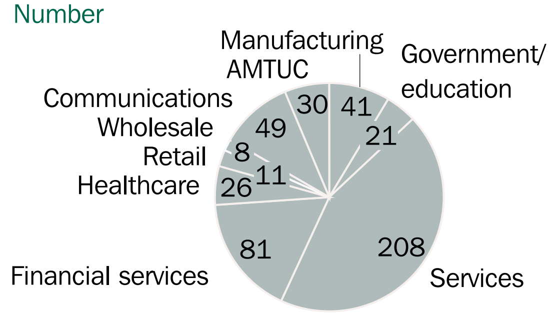
Respondents by company size
Number



Respondents by location
Number



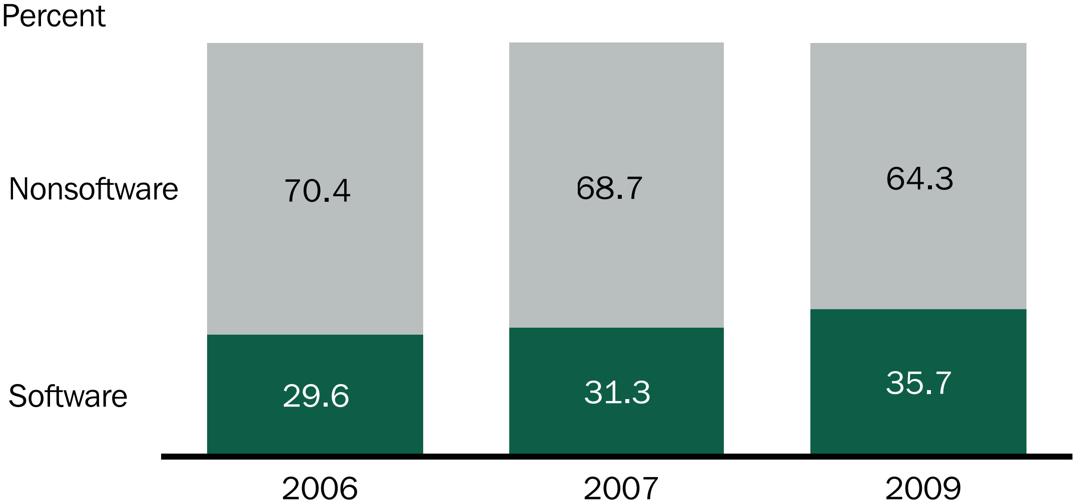
Respondents by industry
Number



Software Share of IT Budget

Approximately what percent of your organization's total IT budget is dedicated to software related spend? What percent do you expect this will be in 2 years?

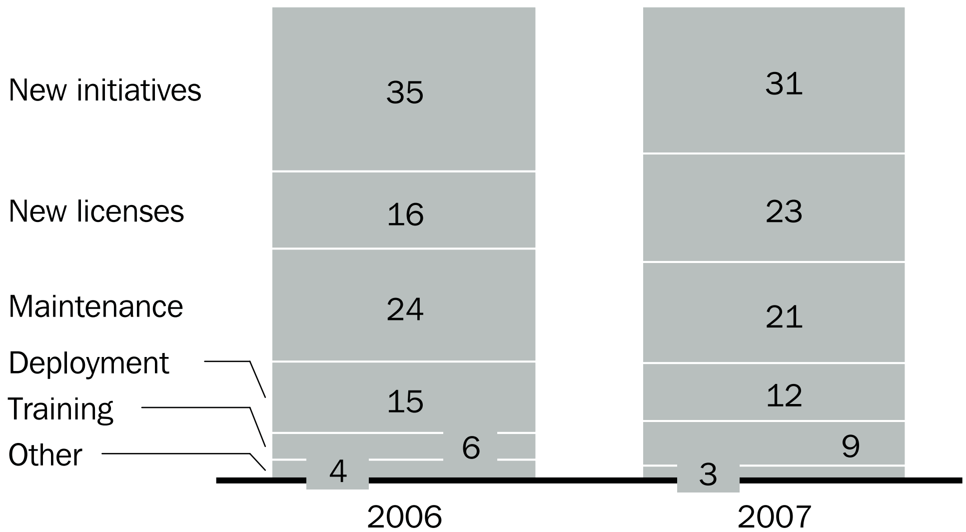
Trend in software share of IT budget
Percent



Distribution of Software Spend

How does this spending divide across the following categories? Allocate 100%.

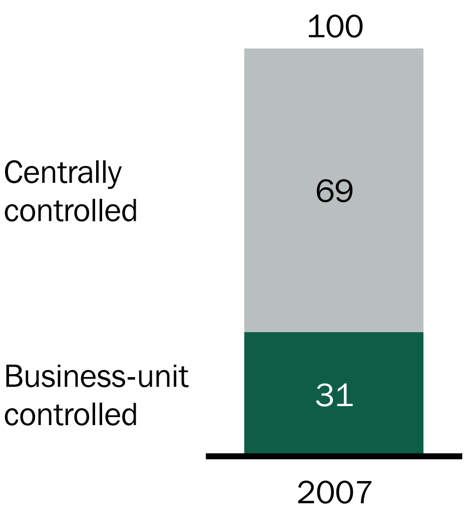
Software budget dedicated to categories
Percent



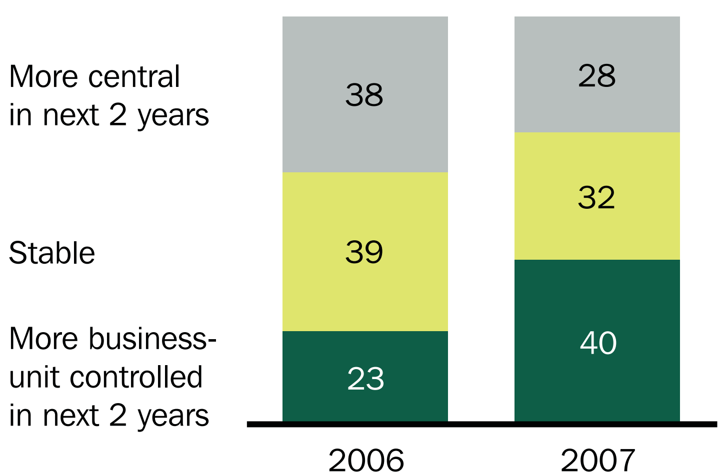
Software Purchase Centralization

Please estimate what portion of final software purchase decisions (specific software brand/product selections) are centrally controlled vs. controlled by business units, today and 2 years from now?

Control of software decisions
Percent

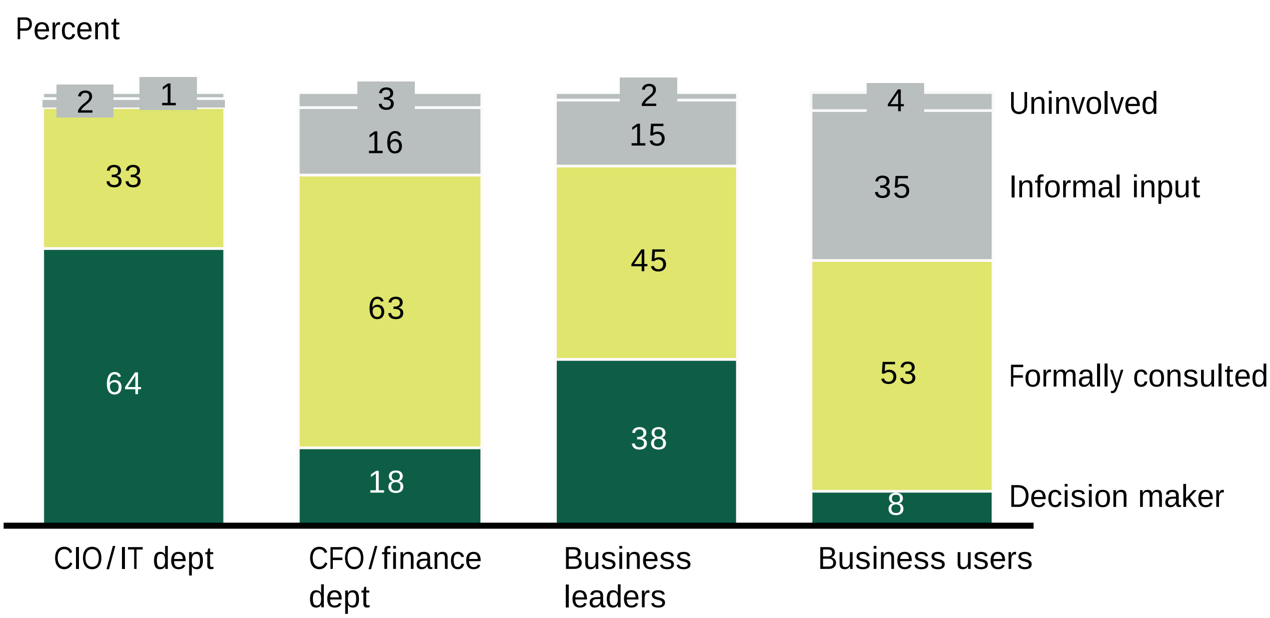


Trend in control of software decisions
Percent



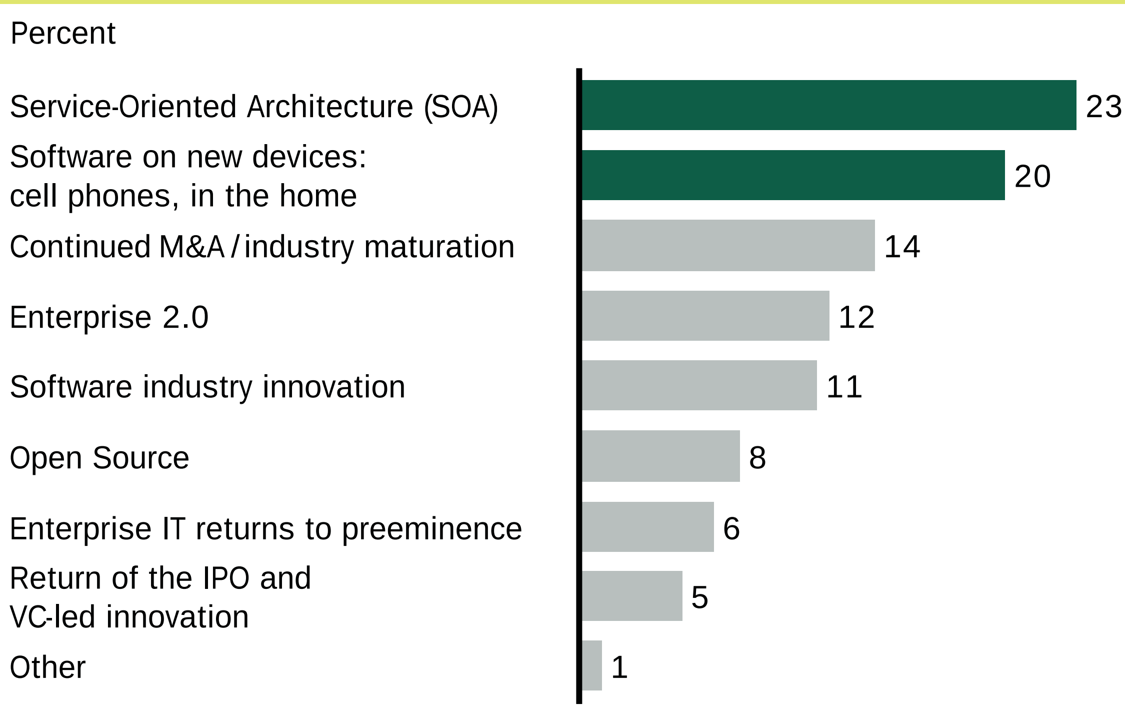
Software Decision Making

For central software purchases, how involved are each of the following in software-related spend decisions?



Most Significant News Stories

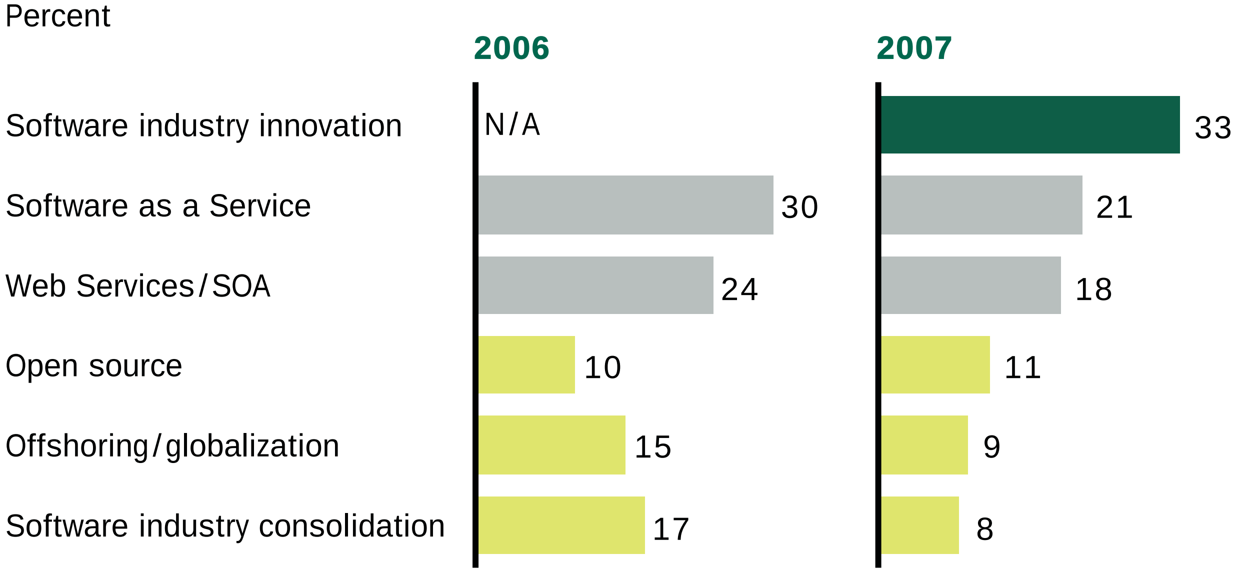
What is likely to be the most significant software news story of next 12 months?



Importance for Customers' Business

Please select the most important item for your business from the list.

Selected "most important" for your business
Percent



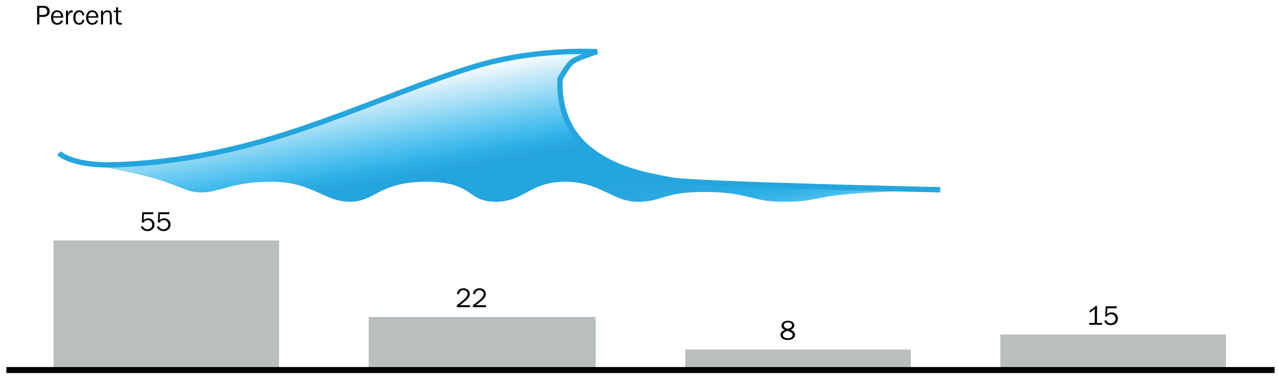
Industry Areas for Improvement

What are the areas in which you think the software industry in general could improve? Rank in order of importance.

Relative ranking of software industry improvement areas
Percent

Position in Innovation Wave

Where do you think the software industry is within its overall innovation wave?



On the upswing
The software industry technology innovations of the past 2-3 years are nothing compared to new technologies we're about to see

At the peak
We've seen the major software technology innovations for this wave, and what we need now from software companies are the products/ services, business model innovations, and process innovations that take advantage of them

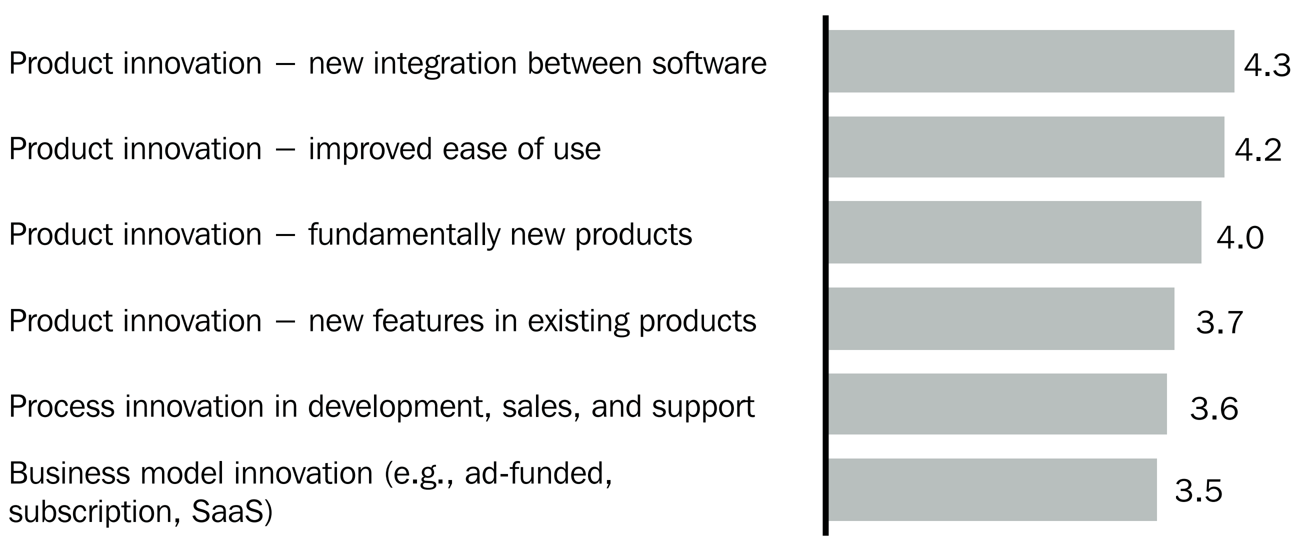
Past the peak
We've seen the major software technology innovations for this wave, and the business models and process innovations to deliver and monetize them effectively are already in place

What innovation wave?
The last few years have been business as usual

Importance of Types of Innovation

Which of the following types of innovation would you most like to see from the software industry? Rate each 1-5.

Importance of innovation
5 = extremely important, 1 = not important

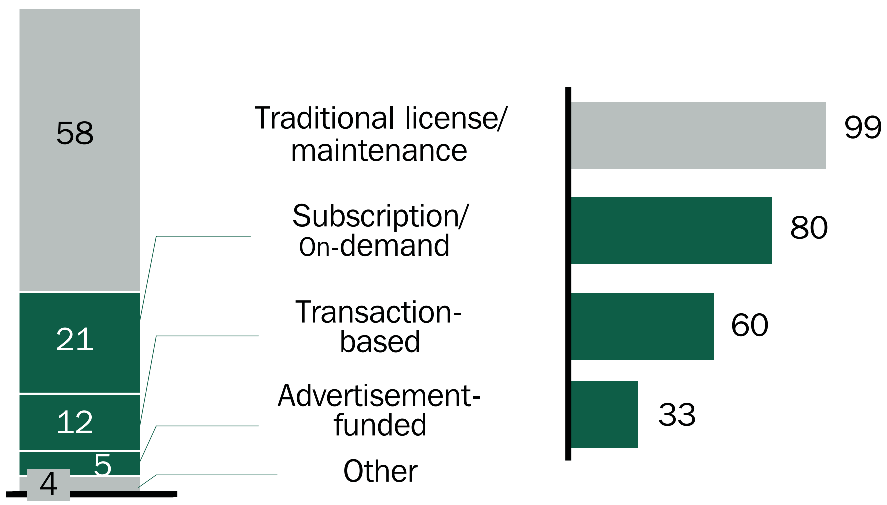


Business Model Innovation

As you think about your software spending, what percent of your total software budget would you like to spend in each of the following business models in 2 years? Allocate 100%.

Total share of software spend
Percent

Percent of customers planning on model
Percent



Source of Software Innovation

Who do you expect will deliver the greatest level of software innovation over the next 2 years?