Research Brief

Growing Vertically: The Opportunities and Risks

Abstract: Gartner Dataquest highlights the key business issues that vertical market practice leaders must consider in establishing, growing and developing their industry practices.

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Recommendations

- Evaluate how a vertical market strategy is right for you and where it is valuable. A vertical market strategy is not an all-or-nothing proposition.
- Develop deep industry business and technical expertise to determine market needs, identify vendor gaps and assess your internal capabilities to fill those gaps.
- Continuously evaluate the effectiveness of your vertical market strategy.
- Don't be afraid to exit poorly fitting markets — or ones that have passed their time as significant growth opportunities.
Don't Overlook the Risks in Pursuing Vertical Market Opportunities

An effective vertical market strategy builds long-term client relationships and drives business development. The preponderance of vertical market strategies among external service providers (ESPs) masks the inherent risks of dedicating resources, staff, staff and intellectual capital to specific industries, as highlighted in Figure 1. Gartner Dataquest's Global Industries (GI) cluster provides the foundation research to guide IT service providers in maneuvering through the risks, identifying opportunities and developing industry relevance and specialization in the following vertical markets: communications, energy and utilities, financial services, healthcare, state and local government, federal government, manufacturing, life sciences, retail, and transportation.

Figure 1
To Go Vertical or Not to Go Vertical: Top Five Reasons

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<thead>
<tr>
<th>Top Five Reasons to Go Vertical</th>
<th>Top Five Reasons Not to Go Vertical</th>
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<tbody>
<tr>
<td>1. Developing closer customer relationships</td>
<td>1. Fewer total addressable customers</td>
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<td>2. Greater revenue from value-added services</td>
<td>2. Greater revenue from targeting larger accounts or greater volume</td>
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<td>3. Brand will have breadth to be understood in multiple industries</td>
<td>3. Brand will splinter as industry campaigns target different issues</td>
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<td>4. More knowledgeable industry specialists on staff</td>
<td>4. Higher staff utilization rates with generalist staff</td>
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<td>5. Technology partners with strong industry name recognition</td>
<td>5. Industry technology players are less reliable than large tech vendors</td>
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Source: Gartner Dataquest (November 2002)

The selection of the right vertical markets and the matching of internal capabilities will be the difference between growth and no growth for many ESPs. As vertical-market practice leaders endeavor to build and develop their industry practices, Gartner Dataquest recommends they assess the following critical business issues, which are supplemented by insights from GI's industry research.

What Are the Leading Business Trends and Technology Drivers?
Deregulation, mergers and acquisitions, and globalization top the most critical business trends driving the energy and utilities industries. In the manufacturing vertical market, the leading business trends include...
depressed revenue and profits, mass customization, globalization and the drive for innovative products.

**What Are the Major Buying Centers?**
The chief information officer (CIO) and the IS department have been the traditional IT purchasers for IT. But chief-level executive officers (CXOs) and business and functional unit executives have played a critical role in buying solutions supporting business processes. Key executive-level IT influencers and buying centers in healthcare provider organizations include the chief administrative officer (CAO), chief operating officer (COO), chief financial officer (CFO), chief of staff or chief medical officer (CMO), and the chief of nursing. In retail, the vice president of merchandising, the vice president of marketing, and the vice president of logistics lead purchases of merchandising/point of sale, customer relationship management (CRM) and supply chain management (SCM) solutions.

**What Are the IT Spending Metrics?**
Gartner Dataquest predicts that the combined IT spending of the U.S. federal, and state and local government represents the second-largest vertical market for total IT spending and is the fastest-growing market for external services. Unlike other vertical markets such as financial services, manufacturing, and communications, the government sector invested robustly in external IT services in 2002 to continue agency modernization projects and fulfill homeland security mandates.

**What Is the Market Outlook for Industry-Specific IT Products and Services?**
During the next six months, the IT market in retail will be stagnant. Replacement of point of sale (POS) solutions and the addition of new functionality will begin to drive the market out of the doldrums over a two-year time frame, with robust growth expected in three years. Gartner Dataquest anticipates a similar trend for the IT market in transportation.

**Which Vertical Markets Represent the Greatest Vendor Opportunities?**
Because of different business issues, technology drivers, economic environments and IT sophistication, not all industries adopt new applications and technology at the same pace. For example, the most immediate opportunities for Web services are in the financial services and healthcare sectors, with pockets of opportunity in communications and transportation.

**Which Emerging Technologies Will Impact Vertical Markets During the Next Two to Four Years?**
The financial services industry is piloting imaging and automated clearinghouse (ACH) solutions — technologies that address the industry’s cost containment initiatives today. But these technologies can also enable
new revenue streams in the future by enabling the institutions to offer new services: imaging technologies for check imaging and archiving services and ACH for payment processing.

**What Are the Key Trends in Channels and Partner and Alliance Strategies for Each Vertical Market?**

Energy holding companies, such as municipalities and Progress Energy, are acting as sales channels for hardware, software, and IT services and communications service providers. In the retail industry, ESPs are partnering with key software vendors (for example, IBM and Accenture partnering with Retek) to penetrate an industry whose IT purchases are driven by software — not services.

**What Are the Key Metrics Customers Use to Evaluate the Success of Solution Implementations?**

Although IT-related metrics, such as uptime, are important, industry-specific measures of business performance are critical in evaluating the success of deployments. The financial services industry is beginning to look at efficiency ratios and wallet share. Efficiency ratios compare IT assets with IT spending to gauge productivity while wallet share measures the number of products (for example, checking, certificate of deposit, insurance or retirement products) a financial services client has from a specific financial services institution.

**What Are the Critical Success Factors for Vendor Market Strategies?**

In light of the dramatic changes in the utilities market, ESPs need to articulate a vision for how utilities companies can manage the new business climate. In addition, they must demonstrate the ability to deliver productivity and efficiency to enterprises because cost savings are a dire necessity for this industry.

**How Do Solution Providers Differentiate Themselves in Terms of Market Strategies, Offerings, Best Practices and Competitive Positioning?**

ESP's that target financial services institutions utilize marquee clients as a critical and time-tested approach. Moreover, they attain industry credentials by hiring away key financial services executives. ESPs also join trade associations to glean insights about the factors that will help them win clients and validate their positioning.
What Are the Key Business Processes Being Targeted by Vendors and How Are Vendors Targeting These Business Process-Related Opportunities?

ESP’s in the communications market are targeting revenue assurance solutions, fraud management and improved care relations. In the manufacturing vertical market, ESP’s are flocking to product life cycle management (PLM) solutions as a key area of revenue growth for the next two years.

What Are the Leading IT Solutions?

Billing solutions garner the biggest demand by communication service providers, but provisioning and network management are the fastest growing. In the manufacturing vertical market, ERP still garners the highest demand, but SCM and CRM are the fastest growing solutions and are often a component of ERP upgrades.

What Are the Key User Selection Criteria for IT Products and Services?

Transportation providers deem functionality, vendor stability, client references, support services and total cost as critical to their vendor selection process. In addition to these factors, manufacturers consider contract terms, intimate knowledge of their business issues and long-term relationship building as important factors in selecting ESP’s.

Who Are the Leading Vendors in Particular Vertical Marketplace?

The leading IT service providers in manufacturing are Electronic Data Systems (EDS), IBM, Accenture, Hewlett-Packard (HP)/Compaq and Computer Sciences Corp. (CSC); in communications, they are IBM, Lucent, Ericsson, Conversys, EDS and Accenture.

How Will Emerging Business Models Impact the Vendor Competitive Landscape in Different Vertical Markets in the Next Five Years?

To capitalize on a new revenue stream, a number of utilities companies are spinning off in-house IS and other business units that have cultivated deep industry expertise in running or managing IT or business processes. The spinoffs pose significant threats to the vendors that already compete in this industry.
Gartner Dataquest Perspective

Gartner Dataquest predicts that the single greatest opportunity for services companies in the next three years will be focusing on the right vertical markets. However, one of the largest cost contributors to ESPs is continuing to focus on vertical markets that are not a good fit.

**Key Issue**

What approaches are companies using to effectively penetrate and develop vertical market opportunities?