Vertical Markets Gain Momentum in 2004 IT Spending

The Gartner Dataquest Global Industries Practice has just released its updated publication of IT spending across 14 vertical markets, 43 sub-vertical markets, seven regions and 40 countries. IT business spending worldwide is forecast to reach $2.1 trillion in 2004, growing 3.9 percent. Key forecast highlights include:

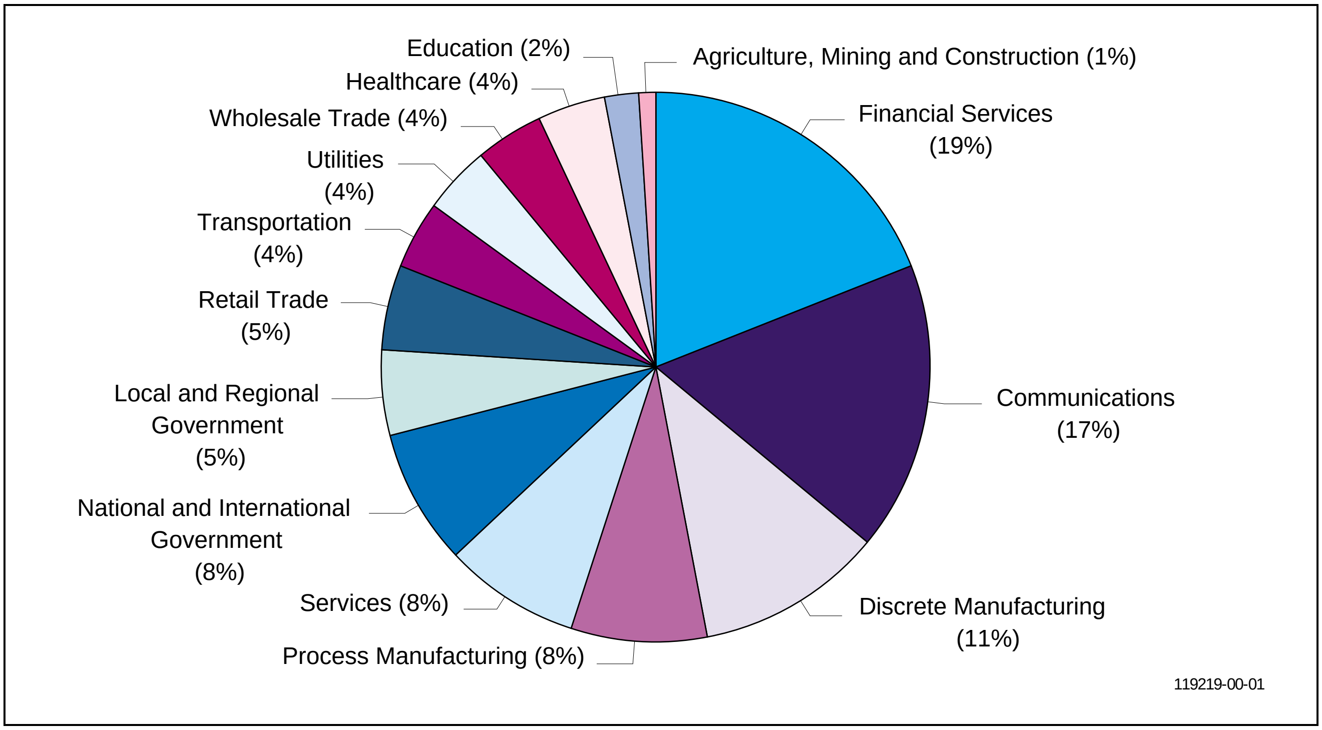
- The U.S. government continues to be a vital vertical market for the growth in overall IT spending. National government continues to be one of the best markets, with growth projected at 6.4 percent.
- The communications industry, after several years of severe decline, is forecast to recover in North America with 3.3 percent growth, but in Western Europe, carriers' continuing financial woes will result in a projected 1.1 percent decline in 2004.
- A strong trend toward outsourcing continues throughout all vertical markets. Process management spending is projected to grow at a compound annual growth rate (CAGR) of 9.3 percent worldwide from 2002 through 2007, reaching $129 billion in 2007. IT management is projected to grow at an 8.3 percent CAGR from 2002 through 2007, reaching $177 billion in 2007.
- Spending on internal IT services (salaries paid to IT personnel) is projected to remain flat through 2007 as clients in all vertical markets continue to embrace outsourcing. Enterprises also seek efficiencies through system consolidation, thus requiring less technical staff. These trends will outpace salary increases, resulting in a 0.04 percent decline in internal service spending over the next five years, to $491 billion in 2007.
- Changes in currency affect the growth forecast when comparing countries. To help clients evaluate the impact of recent currency changes, the IT Services forecast database now includes multiple currencies, although our analysis will continue to be presented in U.S. dollars. Note: Forecast currency was taken into account for the IT Services forecast, but not for the other forecast components. The IT Services forecast includes the impact of currency changes for the first half of 2003 and applies the most recently available exchange rates to the 2004 forecast. Gartner Dataquest does not forecast exchange rates for future years; thus rates for 2005 through 2007 are constant for all currencies.

Vertical Market Snapshot

Gartner Dataquest tracks hardware, software, internal services, external services, telecommunications equipment and telecom services in the vertical market IT spending forecast. The largest vertical markets worldwide continue to be financial services, manufacturing, and government, which together represent about 43 percent of total IT business spending in 2004 (see Figure 1). Communications represent about 17 percent of total IT spending, but this includes spending on the backbone infrastructure and wholesale carrier telecom services, which skews a vertical market comparison.

The fastest-growing industries worldwide for the five-year period through 2007 include services at 6.0 percent CAGR and healthcare at 5.5 percent CAGR. The industries behind the pack include communications at 2.6 percent CAGR and discrete manufacturing at 3.7 percent CAGR. Of course, vertical market growth varies by region and by IT component. Table 1 presents a snapshot of IT business spending from 2002 through 2007 worldwide. Further forecast details can be examined in the published database.

Figure 1
Worldwide IT Spending in Business by Vertical Market, 2004



Source: Gartner Dataquest (December 2003)

Table 1
Worldwide IT Spending in Business by Vertical Market, 2002-2007

	2002 ($B)	2007 ($B)	CAGR (%) 2002-2007
Agriculture, Mining and Construction	27.6	34.0	4.29
Communications	361.5	410.9	2.59
Discrete Manufacturing	229.1	274.1	3.65
Education	42.5	54.3	5.03
Financial Services	356.2	436.9	4.17
Healthcare	68.7	90.0	5.55
Local and Regional Government	106.3	135.8	5.02
National and International Government	143.7	184.9	5.17
Process Manufacturing	158.5	194.3	4.16
Retail Trade	103.3	125.8	4.03
Services	146.2	195.6	5.98
Transportation	85.4	103.8	3.99
Utilities	80.3	103.1	5.14
Wholesale Trade	72.3	87.3	3.84
Total	**1,981.5**	**2,430.7**	**4.17**

Source: Gartner Dataquest (December 2003)

Key Vertical Market Highlights

Financial Services

As the financial services industry heads into 2004, an IT spending recovery continues in banking, with a more modest recovery in insurance. The capital markets sector is poised for an upswing, following a pattern of greater IT spending volatility than in banking or insurance. Much of the investment focuses on supporting customer-facing business processes, such as branch refresh in banking, advisor platforms in brokerage, and agent workflow in insurance. Investments in networking and infrastructure also show increases, with notable infrastructure outsourcing contracts in the global banking market in particular. Spending on improvements in back-office processing exhibits slower growth than anticipated across all three sectors, although large financial service providers report strong interest in using offshore resources for back-office improvements. Although concerns about regulatory compliance contribute to spending, a subtle shift from cost saving toward revenue generation goals has put wind in the sails of the financial services forecast.

Manufacturing

Buoyed by economic indicators that suggest a bright recovery for the sector, manufacturers are reinvigorating their IT budgets and IT spending plans. Indeed, the latter half of 2003 witnessed a number of multimillion-dollar enterprise resource planning (ERP) projects. However, the vast majority of projects for the coming year will continue to fulfill tactical requirements and pent-up demand for hardware and software needs. Enterprises will require tangible return on investment (ROI) from these projects. To prevent scope creep and budget overgrowth, manufacturers will continue to sign smaller-scale projects. Even manufacturers that sign multimillion dollar contracts that span multiple years will use the contracts for piecemeal projects through the next two years, continuously monitoring and reviewing the results of IT projects and renegotiating the contracts. Growth in IT spending for external services will be driven by the need to redesign and integrate business processes, continued demand for outsourcing services, and revitalized interest in consulting services. However, competition from offshore vendors will drive down the price of consulting and integration services, resulting in a more modest growth in external services spending over the next three years as compared with spending in the late 1990s.

Government

Government continues to be a major vertical market spurring growth in IT spending. At the U.S. federal government level, IT spending will be driven by increased spending within the defense segment as well as major modernization projects in key civil agencies, such as Homeland Security, State and Treasury. Moreover, the increase in systems integration projects and outsourcing initiatives will drive expenditures to external services vendors. In addition to the growth at the national level, 2004 is an important transitional year for state and local government organizations. After 18 to 24 months of slowed growth and even a market contraction, state and local governments' IT spending will grow in 2004, buoyed by strong economic growth, new budgetary discipline and a new fiscal year beginning in July. Key areas of growth at this level include increased agency modernization within health, human services and labor, new initiatives directed at the business value of IT, and projects focused on revenue maximization, revenue generation, cost containment and cost avoidance.

Healthcare

IT spending by the healthcare market is driven by the numerous pressures with which healthcare providers and payers must contend, including the need to improve clinical care and customer satisfaction, curtail medical errors and inaccuracies, stem revenue leakage, address staff shortages and reduce manual intervention. As such, clinical automation, the Health Insurance Portability and Accountability Act of 1996, integration, standardization, infrastructure buildout and revenue cycle improvement top the list of technology priorities in the healthcare provider market. However, healthcare organizations continually struggle to demonstrate the business value of many implementations and technology contracts. For example, skepticism of the business value of outsourcing, lower-than-anticipated cost savings from past outsourcing deals, and high-profile contract cancellations are factors slowing the healthcare industry's acceptance of outsourcing. But the inability to efficiently manage IT and business processes will continue to drive healthcare organizations to outsourcing — along with consulting, systems integration, business process outsourcing and transformation services that are increasingly being bundled into outsourcing contracts by vendors.

Retail

The retail sector has traditionally approached technology conservatively. It was very common to view IT as a tactical solution focused on cost cutting and not as driving revenue generation. But that historic approach is rapidly changing. Ongoing research indicates that vast numbers of retailers are looking to improve what they're doing from a technology perspective. Retailers' long-term investments in merchandising and supply chain will continue in 2004. But most interesting will be retailers' focus on the store. Point-of-sale upgrade will continue as a technology driver for the next two years. Retailers are demonstrating keen interest in self-checkout and kiosk devices to improve service. Wireless devices and applications will become more prevalent among customers. Employee productivity will be a major focus. Possibly the most exciting evolution or revolution is radio-frequency identification (RFID).

Utilities

Moving into 2004, utilities will continue to focus on streamlining operations and improving productivity over new growth initiatives. Improved management or restructuring debt and capitalization will drive continued focus on technologies that will support a better overall financial position and corporate governance. The strong emphasis across all three major utility sectors (electric services, natural gas and water) remains clearly on investing in technology that can create clear productivity improvements — a key decision factor in proving return on technology investment and in justifying IT budgets. However, a common emphasis across the utility industry on productivity improvements is translating into slightly different software investment focus near-term for water utilities on both collaborative and front-office applications, while electric services and natural gas utilities are most likely to prioritize software investment related to systems applications and information management. Security management applications (software) and security firewalls (hardware) remain among the strongest near-term focuses for electric services and natural gas as industry security initiatives become more stringent. Software, telecommunications, and external services growth in this sector will translate into significant, but specific, opportunities for technology and services providers as utilities continue to link their investment in technology with the opportunity to improve utility performance.

Communications

The outlook for IT spending by North American communication service providers (CSPs) in 2004 is optimistic. Most CSPs have been able to get finances in order through outsourcing, offering new services, contract wins in managed services, and tremendous cutbacks in capital expenditure over the past several years. While system consolidation and the retirement of legacy software applications are on the rise, most North American carriers are forecast to increase spending in software. Pent-up demand for hardware replacements is expected in 2004 from some CSPs, although not enough to induce growth. Gartner Dataquest projects that CSPs will continue to gain outsourcing contracts, thus impacting business unit and IT technical staff.

Transportation

IT spending by the motor freight subsegment makes up 38 percent of the industry total, with air travel following at 24 percent. Logistics services (warehousing, couriers and other services) is the fastest growing subsegment, at 4.7 percent CAGR. Sluggish economic recovery from 2002 through 2004, severe passenger airline price competition and overcapacity in motor freight and ocean shipping segments all act as inhibitors to IT investment. Emerging forces that will drive growth include:

- Shippers' demands for up-to-date supply chain information delivered by logistics management systems and Web portals
- Availability beginning in 2005 of lower-cost RFID tags and readers for real-time cargo location and status reporting, driven by Wal-Mart and U.S. Department of Defense mandating RFID use on inbound cargo
- Government security regulations for electronic cargo manifests in advance of shipments
- U.S. Transportation Security Administration deployment of CAPPS-II passenger pre-screening systems and databases

Western Europe Highlights

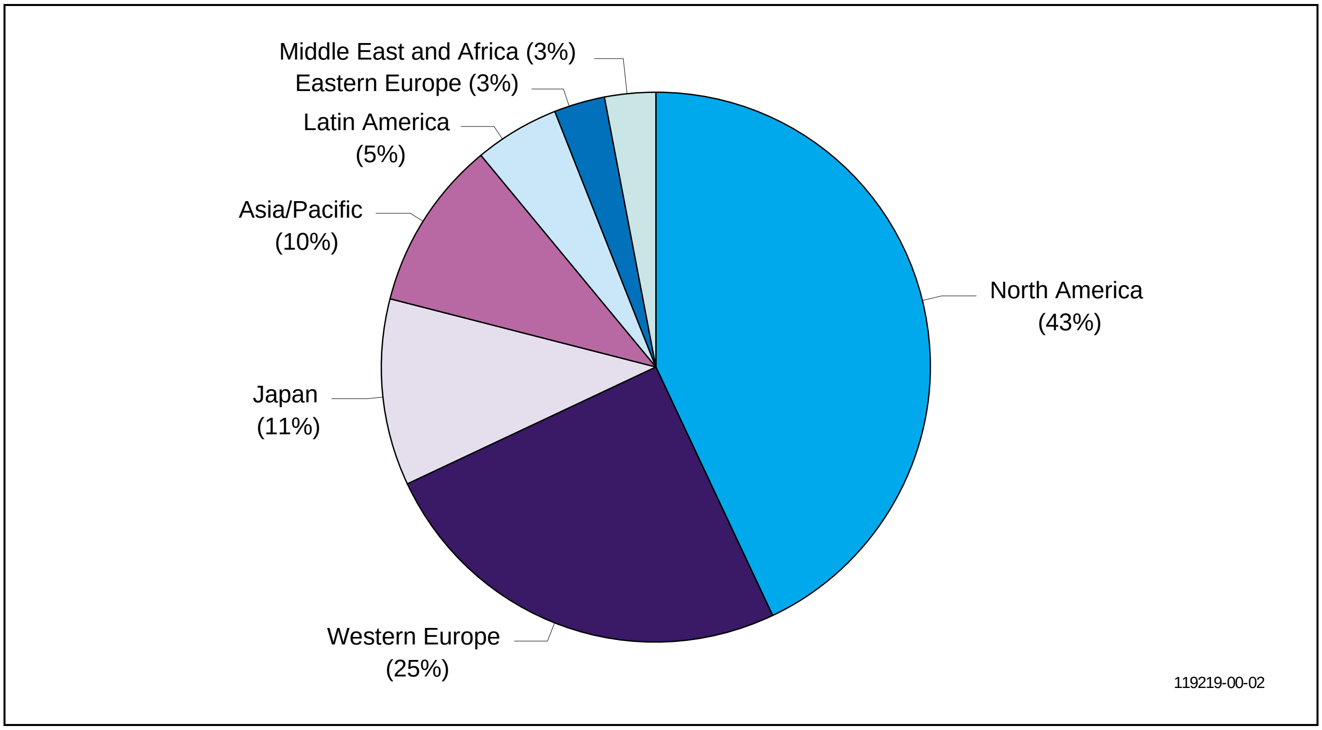
Western Europe will be second in overall size for enterprise spending on IT Services (behind North America), as shown in Figure 2. However, Western Europe will be next to last for growth (just ahead of North America). That forecast growth, a respectable 6.2 percent CAGR from 2002 through 2007 in U.S. dollars, looks rather disappointing when currency fluctuations are removed by using the base currency, declining to 1.8 percent CAGR when calculated in euros. Annual growth from 2003 through 2004 will be nonexistent, at negative 0.04 percent (euros). The worst-performing industry for IT Services across Western Europe will be communications (negative 3.9 percent CAGR in euros), while the best performers will be healthcare (5.3 percent CAGR in euros) and national and international government (4.5 percent CAGR in euros). Communications is still suffering a hangover from its boom years earlier in the decade (overcapacity and lower-than-expected demand) and from its own outlay on third-generation licenses. By contrast, the public sector has proved more resilient to economic turbulence and is at last trying to get extra value through outsourcing.

Within the 12 countries of the euro zone, the euro-based CAGR from 2002 through 2007 is predicted to vary from a low of negative 0.5 percent in Greece to a high of 2.3 percent in Ireland. Outside the euro zone, the United Kingdom does better with a euro-based CAGR of 3.3 percent (or 5.7 percent when calculated in U.K. sterling). IT Services in Britain benefit particularly from a more mature market for outsourcing, including business process outsourcing (BPO), and from the award of some big government outsourcing contracts: £2.7 billion ($4.5 billion) from the National Health Service over three years and £3 billion ($5 billion) from the Inland Revenue over 10 years.

Generally, across Europe, outsourcing is gaining in acceptance, maturity and adoption. More deals (measured in total contract value) are being done and more big deals are being done. However, the market is becoming polarized: Big outsourcing deals can only be won by big providers. So there is a clear advantage for the global, tier 1 vendors (especially IBM Global Services but also HP, EDS, CSC and CGE&Y), while tier 2 and below are getting squeezed out of markets beyond their domestic boundaries. Best-performing service lines in Western Europe will be IT management, which is forecast to grow at 3.7 percent CAGR (euros), and process management (the IT part of BPO), which is predicted to do even better at 6.0 percent CAGR (euros). Consulting and SI are still in the doldrums at negative 0.9 percent and negative 0.2 percent respectively (CAGR in euros), this low growth being due to lack of demand, poor ROI and offshore price pressure. Gartner Dataquest expects those service lines to recover in 2005.

Of the five IT segments included in the forecast, IT services has the highest CAGR from 2002 through 2007 of 6.2 percent. Internal services has the lowest CAGR as more dollars are moving to external service providers. Both telecom and hardware have relatively low growth rates of 2.3 percent and 0.9 percent respectively and software has a fairly positive growth rate of 5.7 percent.

Figure 2
Vertical Markets Business IT Spending by Region, 2004



Source: Gartner Dataquest (December 2003)

About the Global Industries Practice

The Global Industries team within Gartner Dataquest provides IT vendor clients with global IT spending forecasts and market opportunities by vertical market, product and service component, and geography. Global Industries combines in-depth, demand-side surveys with supply-side interviews and surveys to provide clients with a panoramic view of the IT industry within each vertical market. Vertical Market analysts include:

- Susan Cournoyer, Financial Services (banking, insurance, capital markets)
- Geri Cruz, Manufacturing (pharma/life sciences, automotive, high-tech, aerospace, chemicals)
- Bob Goodwin, Transportation (air, rail, maritime, trucking, logistics)
- Venecia Liu, Communications (telecommunications, electronic media)
- Cynthia Moore, Energy and Utilities
- Jeff Roster, Retail, Wholesale, and Consumer Products
- Rishi Sood, State and Local Government, Federal Government

- Peter Redshaw, European Vertical Markets
- Cathy Tornbohm, European Vertical Markets
- Minjoo Chon, Asia / Pacific Vertical Markets
- Rika Narisawa, Japanese Vertical Markets

By Bob Goodwin,Venecia Liu,Rishi Sood, Geri Cruz, Jeff Roster, Susan Cournoyer, Cynthia Moore, Peter Redshaw, Rob DeSouza, Cathy Tornbohm, Minjoo Chon, Rika Narisawa, and Ellie Babaie.

This document has been published to the following Marketplace codes:

ITSV-WW-DA-0220

For More Information...

In North America and Latin America:	+1-203-316-1111
In Europe, the Middle East and Africa:	+44-1784-268819
In Asia / Pacific:	+61-7-3405-2582
In Japan:	+81-3-3481-3670
Worldwide via gartner.com:	www.gartner.com

119219

Gartner