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Route to:

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Digital Stakes Claim to Open Client/Server Leadership

At Digital's corporate strategy briefing in mid-September, CEO Bob Palmer and other Digital executives defined their corporate strategy to over 200 financial and security analysts in an upbeat environment which contrasted dramatically from the same forum in 1992.

At the earlier meeting, Palmer had just assumed the CEO role from founder Ken Olsen, who had occupied that position from Digital's founding. Palmer inherited a company that was losing $3 million per day, and eating up most of the net worth the company had built up over the last 20 years. The stock price had plummeted to an historic low, and there was real concern for Digital's survival. A great deal has happened at Digital since then, and the picture painted at the briefing was decidedly more optimistic.

- After eight consecutive quarters of net losses totaling $3.6 billion, Digital achieved a $113 million profit in the last quarter.

- More than 18% of Digital's total work force—20,000 jobs—has been eliminated. This had an understandable, traumatic effect on morale, but the company has now attained a more sustainable expense and cash flow base, which the survivors should find comforting.

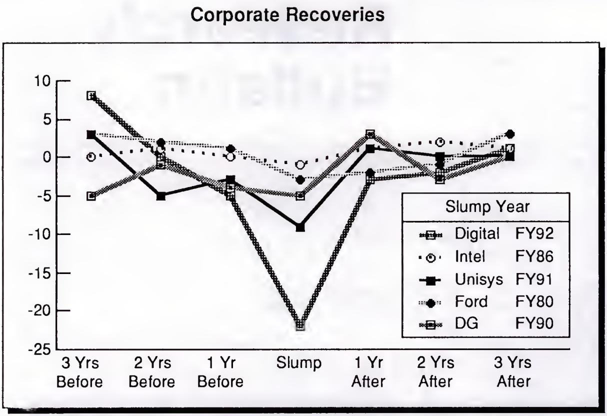
- Of the 15 senior managers who made presentations at the 1992 briefing, only one returned to speak in 1993. Clearly, Palmer has now installed his own executive team.

- Based on tracking of earnings per share, Digital's financial fall, and its recovery, are among the most abrupt and dramatic in high-tech history. (See Exhibit 1).

- Research and development spending has been cut from a bloated 13% to a more typical 9.4% of revenues. But the $1.4 billion allocated to R&D still places Digital in the top ten of all U.S. industrial companies. Given the prior tendencies to establish overlapping, conflicting and vaguely focused research organizations and projects, one can hope the downsizing has improved potential ROI from this area.

- Palmer recently recruited Ed Lucente, a highly regarded IBM sales executive, to take over Digital's worldwide sales and marketing operations. Lucente has moved promptly to do what outside observers have counseled for years: the phasing of Digital's straight salary sales force into a commission-oriented posture.

Exhibit 1



New Organization Keys on Business Units

Palmer unveiled a dramatically different organizational structure, based on three product lines, one service unit and five industry marketing sectors, each with P&L responsibility. This may seem like apples and oranges at first glance (See Exhibit 2), but in fact makes sense, given the commoditization of the hardware businesses, and the higher value available through industry concentration. Older hands in the information technology world will remember how IBM's market dominance in the 1960's and 1970's was achieved using a strictly industry-oriented sales and support organization. The new Digital approach takes that emphasis a step further, with full P&L responsibility in each vertical organization.

An interesting contrast to this new structure is provided by the prior, thoroughly Byzantine organizational approach, which featured more than 140 interdependent business units.

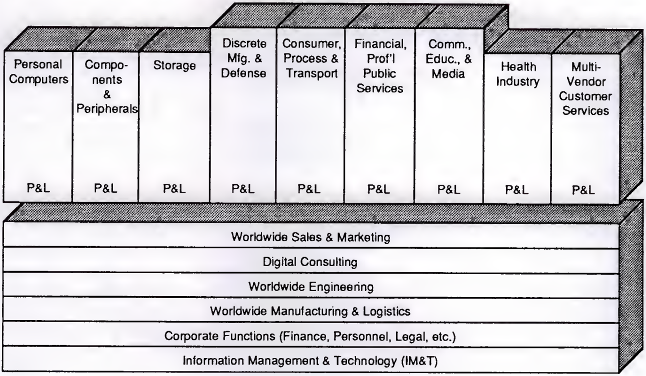
Product Strategy Keys on Alpha AXP, Open Standards, Client/Server

In the new world of low-margin hardware, Digital is focused on adding value through delivering open client/server computing solutions, based primarily on Alpha AXP platforms. Digital's briefers were careful to position Alpha AXP in three major computing environments: OpenVMS (for current VMS users), UNIX and Windows NT. And the incorporation of two major market thrusts, open systems and client/server computing, as Digital's headline strategies, ought to play well on Wall Street, as well as many executive suites.

Because of the great interest in client/server, it behooves any vendor to claim a presence and credibility in this dynamic growth area. Digital

Exhibit 2

Digital's Business Units



is well-positioned here, because of its long history in delivering networked systems with some degree of distributed processing. When Lucente was asked from the floor about the percentage of Digital's revenues that might be attributed to client/server, his reply, only slightly tongue in cheek, was "All of it!" This is, of course, a definitional issue worthy of debate, but the response does say a lot about Digital's intense focus on this new computing paradigm.

Currently, more than 800 software partners are producing over 3,100 applications for Alpha AXP, over half of them on UNIX. One of the major success criteria for Alpha AXP will in fact be the number of application developers that will commit to Alpha AXP as a platform of choice. It is astute of Digital to position itself in both the Microsoft and UNIX worlds, since the ultimate result of this competition will probably be a split decision, with both sets of platforms holding a strong but not dominant market share.

Digital continues pushing for a leadership role in both client and server computer price performance. Major announcements on October 12 of new Alpha AXP models are the latest steps in the campaign.

Digital Making Aggressive Move into Services

Digital clearly recognizes, as do most other leading equipment providers , that diminishing hardware margins pose a severe threat to growth—even to survival. This has led them to move strongly into the information services market, with most attention paid to systems integration, professional services such as IT consulting and software development, and outsourcing activities. By INPUT's calculations, Digital already generates the

Exhibit 3

Digital's Worldwide Information Services Revenues—1993

Sector	Revenues ($ Millions)
Professional services*	2,800
Outsourcing	300
Total	3,100

* Systems integration revenues, based on INPUT's definition, constitutes about $2.3 billion of the overall services total.

fourth largest information services revenue stream in the industry, trailing only IBM, EDS and Andersen Consulting. In 1993, Digital's information services revenues (not including traditional hardware) are expected to pass the three billion dollar mark—22% of the corporate total. (The breakdown of these revenues is shown in Exhibit 3). This achievement is due in large part to its strong established presence in the network integration business; clearly a Digital core competence.

In assigning all 140 internal data centers to its outsourcing functions, Digital has made significant client/server computing and networked resources available for outsourced contracts from customers. This is now a $300 million operation in which aggressive sales activity may be expected.

In hiring Gresham Brebach away from McKinsey earlier this year to head its new Digital Consulting organization, Digital has emphasized its determination to expand its position as a leading player in the services industry. The former Managing Partner of Andersen Consulting, Brebach has the skills and the reputation to lead such a charge. The main questions about the Digital strategy are those that also haunt IBM, HP and Unisys. First, can Digital create an 'objective' selling environment divorced from its hardware vendor image? Second, can Digital move into the customers' executive suites to deliver the high-priced strategic consulting McKinsey has become famous for, or will they be relegated to the IT implementation arena, where competition is fierce, and billing rates under more pressure? Third, can the company

Exhibit 4

Scale and Scope of Global Operations

- 15,000 professionals, in 100 countries
  - 1,000 program managers
  - 2,000 business and technology consultants
  - 7,000 trained in open client/server
- More than 100 professional service centers worldwide
- Two-thirds of professionals outside United States

Exhibit 5

Digital's Strategic Risks and/or Opportunities

- Overcoming perception of "equipment vendor" limitations in providing services
- Ability to sell consulting services at strategic level
- Reorient sales force to commission status, open systems focus
- Maintain financial recovery momentum
- Establish Alpha AXP as viable platform for UNIX and Windows NT

convince its prospective buyers that it is serious about selling something other than VAX?

Digital's current arsenal of resources applied to consulting activity is impressive, as described in Exhibit 4, and somewhat surprising to those that have not followed the company's services repositioning. Recently Digital has begun to trumpet the kind of success stories that are crucial to credibility in the high-tech services business. As a result, Brebach and his key deputies, mainly hired from the high-powered consulting operations Digital seeks to emulate, are poised for rapid growth in consulting activity. The analysts' next briefing should provide a good benchmark of their success.

Strong Leadership is Needed; Fortunately, It's Available

To complete Digital's escape from the abyss, Palmer and his lieutenants will need to skillfully execute the strategies they have announced. (See Exhibit 5 for a summary of opportunities). This isn't an easy task, but it's hard not to be impressed with Palmer's energy, forthrightness and willingness to make tough decisions, plus his articulation of the new vision for Digital. In addition, the line-up of new executives appearing at the recent briefing was impressive. It seems likely Digital's recovery can continue and that's welcome news for Digital's current and potential customers, and the industry in general. After all, the market can always benefit from viable choices among networked solutions, based on open systems, client/server computing and a solid support and services organization.

This Research Bulletin is issued as part of INPUT's Information Services Market Analysis Program.
If you have questions or comments on this bulletin, please call your local INPUT organization or
Robert L. Goodwin at INPUT, 1881 Landings Drive, Mountain View, CA 94043-0848, (415) 961-3300.

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INPUT Worldwide

Frankfurt
Sudetenstraße 9
D-35428 Langgöns-Niederkleen
Germany
Tel. +49 (0) 6447-7229
Fax +49 (0) 6447-7327

London
17 Hill Street
London W1X 7FB
England
Tel. +44 (0) 71 493-9335
Fax +44 (0) 71 629-0179

New York
400 Frank W. Burr Blvd.
Teaneck, NJ 07666
U.S.A.
Tel. 1 (201) 801-0050
Fax 1 (201) 801-0441

Paris
24, avenue du Recteur Poincaré
75016 Paris
France
Tel. +33 (1) 46 47 65 65
Fax +33 (1) 46 47 69 50

San Francisco
1881 Landings Drive
Mountain View
CA 94043-0848
U.S.A.
Tel. 1 (415) 961-3300
Fax 1 (415) 961-3966

Tokyo
Saida Building, 4-6,
Kanda Sakuma-cho
Chiyoda-ku, Tokyo 101
Japan
Tel. +81 3 3864-0531
Fax +81 3 3864-4114

Washington, D.C.
1953 Gallows Road
Suite 560
Vienna, VA 22182
U.S.A.
Tel. 1 (703) 847-6870
Fax 1 (703) 847-6872

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