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MAP

INPUT® Research Bulletin

Route to:

A Publication from INPUT's U.S. Information Services Market Analysis Program

Public Company Analysis Shows Major Differences by Service/Product Type

INPUT has just completed its analysis of 291 publicly traded U.S. companies, whose primary source of income is the information services business. This analysis encompassed software products companies of all types, turnkey systems vendors, systems integrators, professional services firms, and processing and network services providers. Not included in this study were equipment manufacturers, privately held firms in all categories, and outsourcing companies (there were too few public outsourcers from which to draw conclusions).

The primary purpose of this study was to publish an update of INPUT's *Vendor Financial Watch*, which focuses on long-term revenue and profit growth patterns for a subset of public companies that have been active in these markets for at least five years. This research bulletin takes a different tack and focuses strictly on fiscal year 1992 company and industry performance, presenting several sets of operating ratios, which have proven to be historically indicative of the financial health of the industry and the specific companies reporting. The bulletin analyzes these results within the context of INPUT's traditional delivery mode categories.

PC Software Firms Lead in Net Margin

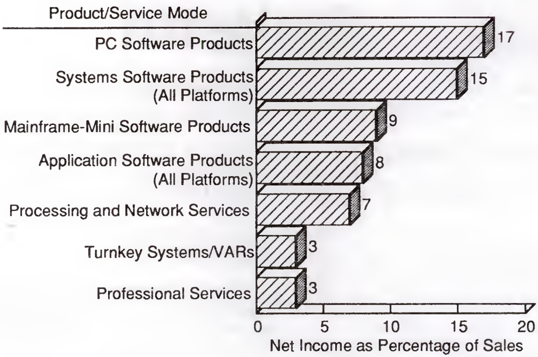
Analyzing net profit margins for 1992, INPUT divided reporting firms into seven groups, shown below in Exhibit 1. In terms of net profit margins, PC software products vendors led the field. Given the strong market swing to client/server computing architectures and the acceptance of powerful PCs as preferred computers, this does not come as a surprise.

Systems software products vendors benefited from the same client/server thrust, especially those who provide relational data base software and application development tools. The major drag on the systems software sector stems from operating systems for mainframes and minis, and most of those leading providers are actually equipment manufacturers who are not included in these figures.

Results were much less bullish in the turnkey systems sector, where declining hardware margins continue to hurt, and many vendors are instead moving toward software provider status. Professional services companies ranked equally low, with recessionary pressures and cost cutting at the bottom of the value chain combining to keep profits down.

Exhibit 1

Public U.S. Information Services Companies Net Income as Percent of Sales, 1992



Source: INPUT

Revenues per Employee

One traditional measure of company productivity is revenues per employee. Exhibit 2 presents those results by product/service provider type against an expanded sample of 291 public information services firms. Software products companies lead the list, reflecting the leverage available through the reselling of low-cost reproducible products. Close behind is the network services sector, where data base providers are able to apply some of the same leverage. The remaining three sectors, each more than 40% lower in productivity, carry the cost burdens of either direct billing of professional staff, or computer-intensive operations and equipment as primary revenue generators.

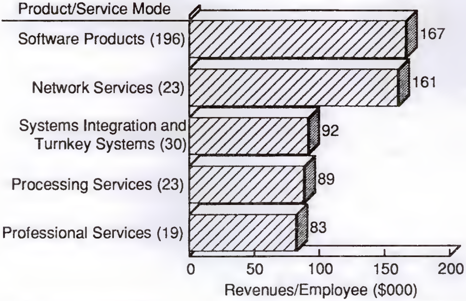
Selling, General and Administrative Expense Costs

In terms of effective, profitable operations, one key measure is the percentage of revenues expended on SG&A. As shown in Exhibit 3, this varies substantially within product/service modes.

Professional services firms, which are able to leverage partners' "rainmaking" efforts without defining them as a pure sales activity, have the most effective ratios here. Least efficient are processing services and software products companies, where sales commissions traditionally run high, and marketing can be costly in very competitive environments.

Exhibit 2

Public U.S. Information Services Companies Revenues/Employee, 1992

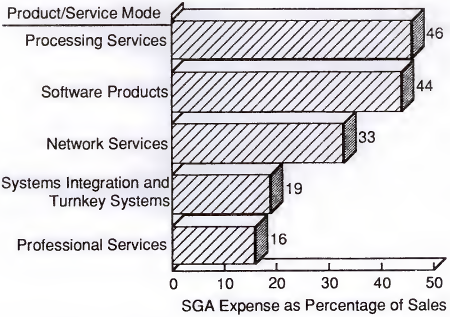


Note: Number in parenthesis indicates number of companies

Source: INPUT

Exhibit 3

Public U.S. Information Services Companies Selling, General and Adminstrative Expense as Percentage of Sales, 1992



Source: INPUT

Research and Development Costs

To stay ahead of the field in the never ending technology progression of the industry, it's necessary to invest in R&D or face extinction. True, many stable companies have created "cash cows" that generate continuing revenue streams with minimal ongoing R&D investment. But the client/server paradigm is abruptly ending that condition of financial bliss for most large platform players. Software companies in this study have recognized this fact, and are spending a respectable 11% of sales on their future products. The same can be said of the turnkey systems/systems integration category, which is investing 10% in R&D.

Some processing services companies may be in a position where the cash cow phenomenon is still at work, despite the relatively low sector earnings shown in Exhibit 1. But their 6% R&D investment may not be enough to protect the customer bases and revenue streams being lured by alternate solutions available from software and turnkey systems firms.

Generalizations May Be Hazardous to Your (Company's) Health

The financial ratios shown in the accompanying exhibits, and other comparative operating measurements for the industry, can serve as useful yardsticks of performance, but they cannot provide the "why" answers, which are needed before positive change can occur.

Companies finding themselves on the wrong side of such industry composites should not immediately assume themselves to be fatally flawed; but that negative position ought to trigger a review of internal operations and processes and closer analysis of competitive "best practices" to see how improvements can be made. Because the strenuous competition now characterizing the industry is not going to disappear, periodic review of such benchmarks are an important survival tactic, and provide the impetus for significant change where it is warranted.

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
Bob Goodwin at INPUT, 1881 Landings Drive, Mountain View, CA 94043-0848 (415) 961-3300