

Annex Newsflash

Annex Newsflash 2006-07

February 3, 2006

An **OPEN** Client Edition

Market Trends

Boost Business Performance w/ Award
Winning Business Intelligence App.

Ads by Goooooogle

Holiday Retail Trends

Deloitte's 20th Annual Holiday Mood Survey.
17,000+ Consumers Polled.

Advertise on this site

INDUSTRY & IT SERVICES TRENDS

Updated 2/03/06, 11:50AM MST, adds [Chart](#)

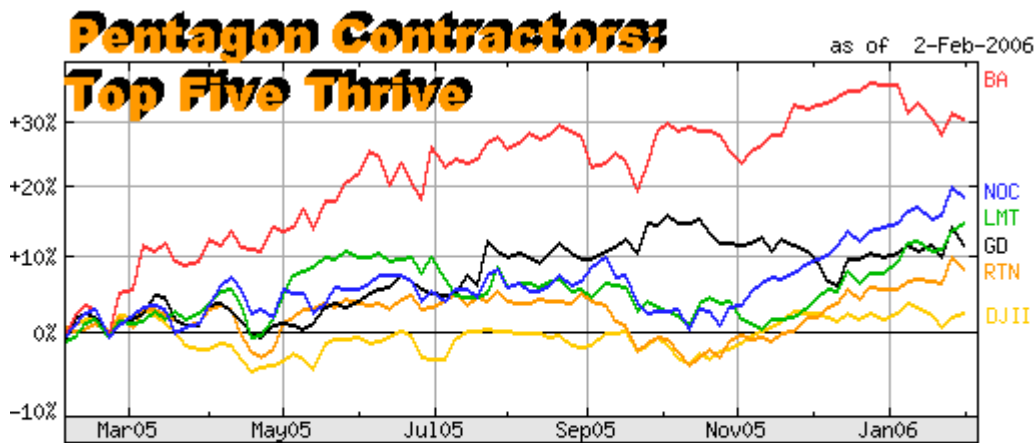
An Update to Industry Stratification Trend

Defense to Services

Top 5 Pentagon Contractors Thrive in War Economy, Move into IT Services Arena: "Death Merchants" Are Coming...

SCOTTSDALE, Feb 3 - It's been a long time coming, but a trend that we first foresaw nearly 16 years ago, is finally coming into focus. Big defense contractors are moving into the IT services arena. The global war economy is spawning not just a big military spending bubble, but also offshoots into commercial sectors - just like the NASA space exploration program affected civilian life on Planet Earth.

Not that we foresaw back in 1990 a global war economy developing in the 21st century, mind you. True enough, we did say that "[perpetual war for perpetual commerce](#)" was the MO of the New World Order that arose after the Cold War from the ashes of the Soviet Union. But only now can we connect the two trends into one.



Top 5 defense contractors outperform Dow by a country mile: War is great!

Meanwhile, the global [defense contractors](#) are not only outperforming the Dow by a country mile, they are doing it in part by becoming the first group of big IT customers to be turning into IT services vendors. And that's exactly what we did say in March 1990 would happen, when we predicted that the "best of breed" users would morph into IT services vendors, and move up to the top of the IT industry food chain:

"...An increasing number of large multinational corporations appear poised to enter the "brave new world" of networks, distributed databases, and global solution. ...a new breed of [information services vendors](#)... as the industry goes through a phase of stratification, it may be hard to tell a current user from a current vendor.... Users who first become very proficient with implementation of their industry's integrated global solutions are likely to market that "know how" to other users [in competition](#) with today's computer vendors."

(An excerpt from [Annex Bulletin 90-13](#), Mar 30, 1990)



The above chart, also published in March 1990, depicted the shape of the IT industry pyramid as we saw it after the industry stratification. At the time, we could only point to American Airlines' Saber system as a case in point.

Since that time, there have been sporadic examples of customers turning vendors in conjunction with IT companies' integration contracts (e.g., IBM-Ameritech, IBM-Telstra, IBM-Novartis; Capgemini-TXU, EDS-Bell South; EDS-Commonwealth Bank; HP-CIBC; Accenture-CSC-Dupont; etc.).

By and large, however, this trend has been slow developing. Until now...

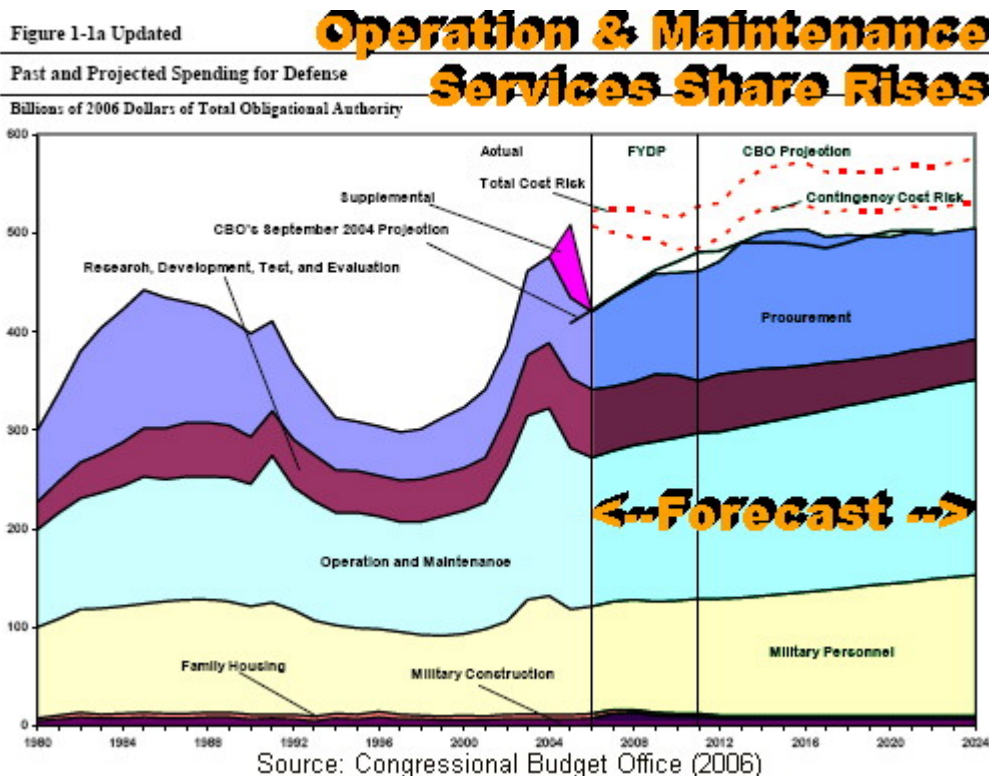
Defense Contractors Turn Services Vendors

At Lockheed Martin, for example, the largest Pentagon contractor, the "Systems & IT" sales accounted for \$18.7 billion in 2005, representing half of the company's total business.

At Boeing, the world's second largest defense contractor, the various types of services accounted for 30% of total revenues in 2005, or over \$16 billion in revenues. Excluding the commercial airline business, however, services accounted for half of Boeing's revenues, just as with Lockheed Martin.

Or take Northrop Grumman, for example, the third largest Pentagon contractor. Its [Information Technology](#) web site looks and feels like that of any other big IT services company. More importantly, Northrop's "Information & Services" segment's revenues were \$10.7 billion in 2005, or 32% of its total business.

And so on... you get the picture? Defense contractors are morphing into IT services vendors.



One look at the above Congressional Budget Office (CBO) chart about the past and future defense spending will help explain the reason for it. Not only has the Pentagon spending been soaring ever since the mid-1990s (starting with our military intervention in the Balkans in 1995), but the Operation and Maintenance share of it has been steadily rising. And that's where the IT services come in.

"Death Merchants" Are Coming: What's To Be Done?

For the time being, the bulk of the defense contractors services revenues is coming from their government contracts. But all of them are increasingly venturing into the commercial arena, where the traditional commercial vendors such as IBM, EDS, HP, CSC, Accenture, Fujitsu, Capgemini etc. operate.

The latter group of vendors can ignore this new trend only at their peril. Some, like HP, for example, are not just standing by; they are doing something about it. As has been widely reported, HP and CSC are in merger talks. And lest we forget, CSC is the 10th largest Pentagon contractor.

Of course, acquiring competitors is only one way of playing into this trend. Another would be taking a page out of the defense contractors' playbook and entering their turf. IBM, for example, exited the federal market, including the Pentagon, in 1994, when defense spending was down and it looked as if the "peace dividend" may pay off.

Not so, as we have seen subsequently. We first identified the "perpetual war for perpetual commerce" trend in 1994, at the height of the Bosnian war. Ten years later, it was not only still with us; it was accelerating (see "[Privatizing War](#)," Apr 19, 2004). Any global IT services competitor that is still ignoring it will be doing it at the expense of its future growth opportunities.

Some may refuse to part-take for moral reasons. After all, "defense contractors" is a polite term for "death merchants." And some companies may decide that no amount of money is worth participating in a mass destruction of human life.

CSC, for example, has divested itself of two former DynCorp units for such reasons (see "[CSC: Gearing Down on Purpose: Sacrificing Profits for Morals](#)" Feb 2005). But all global IT services vendors need to evaluate at least the threat that the defense contractors' incursion on their turf represents, and then formulate a strategy for how to respond to it. Hopefully it won't be an "ostrich approach."

Happy bargain hunting!

Bob Djurdjevic



For additional Annex Research reports, check out...

2006 IT: [Update to Industry Stratification Trend \(Jan 2006\)](#); [An IT Potpourri \(IBM, Fujitsu, Accenture \(Jan 2006\)\)](#); [IBM Beefs Up iSeries \(Jan 2006\)](#); [IBM: Smaller Is Better \(Jan 2006\)](#); [U.S. Patents Decline \(Jan 2006\)](#); [Accenture Excels Again \(Jan 2006\)](#); [Frank Cary Dies \(Jan 2006\)](#)

2005 IT: [A Forgettable Year \(Dec 2005\)](#); [A \\$100B Gain! \(Nov 2005\)](#); [HP:](#)