Technology, Media & Telecommunications

Rational exuberance

2005 Global Survey of CEOs in the Deloitte Technology Fast 500

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Contents

Foreword

Growth is back at the top of the agenda for the world's fastest-growing technology companies. CEOs in the Deloitte Technology Fast 500 are more confident about their companies' prospects than at any time in recent years and are aggressively pursuing new growth opportunities. Yet they remain committed to the idea of growing organically rather than through acquisition, an approach that suggests we will not return to the irrational land-grab frenzy of the dot-com era.

In this Deloitte Touche Tohmatsu (DTT) Global Technology, Media & Telecommunications (TMT) Industry report, we look at the key challenges and strategic priorities driving companies at the forefront of the technology sector – issues that will ultimately affect every industry. We also reveal the markets and technologies that are expected to grow the fastest.

Our findings are based on a survey of more than 480 CEOs in the Deloitte Technology Fast 500, a group of companies from which tomorrow's technology goliaths will likely be drawn. This group – the best of which have grown more than 400,000 percent over a five-year period – represents almost every corner of the globe and spans a wide range of technology industries. Yet the one trait they all share is an extraordinary track record of growth and success.

Whether you are an established technology leader, a fast-growing company, or just polishing your business plan, I hope the insights in this report will help you steer your own company or venture to new levels of profitable and sustainable growth.

Igal Brightman.

Igal Brightman
Global Managing Partner
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Introduction

The emerging global technology sector is entering a period of significant optimism and growth – creating a wealth of new market opportunities.

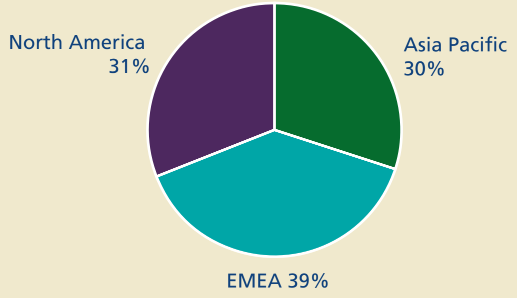
Yet questions still remain. Which technologies will provide the greatest opportunities? How are these opportunities best exploited? How will the global economy affect the sector's growth prospects? To find out, DTT's Global TMT Industry Group in collaboration with the TMT practices of its member firms recently surveyed CEOs from the Deloitte Technology Fast 500, our annual ranking of the fastest-growing technology companies in North America, Europe, Middle East and Africa (EMEA) and Asia Pacific.

The CEOs in this year's global survey are more confident than at any time in recent memory and are fully committed to a strategy of aggressive growth. Yet they plan to achieve that growth steadily – through organic growth – rather than through a merger or acquisition as many did during the dot-com era. They are focusing on fundamentals such as product development and innovation. Pursuing opportunities in their home region, rather than abroad. And steadily expanding their use of IP-based applications beyond e-mail and into customer-facing applications and supply chain collaboration.

Their greatest challenge – surely the sign of a growing sector – is finding enough qualified workers and leaders to achieve their ambitious growth goals.

Figure 1: Deloitte Technology Fast 500
Deloitte's Technology Fast 500 is an annual ranking of the world's fastest-growing technology companies. This elite group includes 500 companies from each major region: North America, EMEA and Asia Pacific. More than 480 CEOs from the Deloitte Technology Fast 500 participated in this year's global survey, with significant representation from every region. The survey addressed the full range of business challenges, from strategy and marketing to operations and finance. It also looked at the growth prospects for individual companies and the economy overall, including an assessment of the market's hottest growth areas over one-year and three-year time horizons.

Survey participation in the region

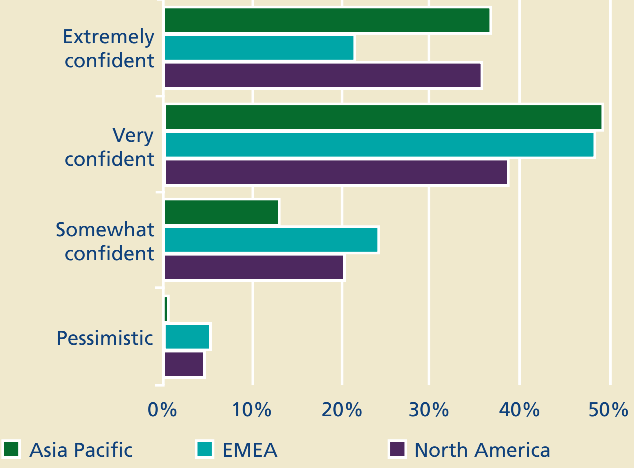


Up, up and away

From cautious optimism to rational exuberance

Over the course of a year, the CEOs of the world's fastest-growing technology companies have replaced cautious optimism with unbridled confidence. According to our survey, CEOs around the world are more confident than at any time since the dot-com bubble burst. In fact, three out of four are **very confident** or **extremely confident** (see Figure 2) about continuing their company's current rate of growth.

Figure 2: High confidence in sustained growth



Question: How confident are you that your company will sustain its high level of growth over the next 12 months?

Most CEOs expressed very little concern about current economic conditions – a dramatic shift from a few years ago – despite the fact that economic conditions vary tremendously between countries.

However, there may also be a sense that the technology sector, particularly at its leading edge, is becoming relatively impervious to macroeconomic conditions and that the latest technology advances will always have value because of their ability to generate new market opportunities and competitive advantage.

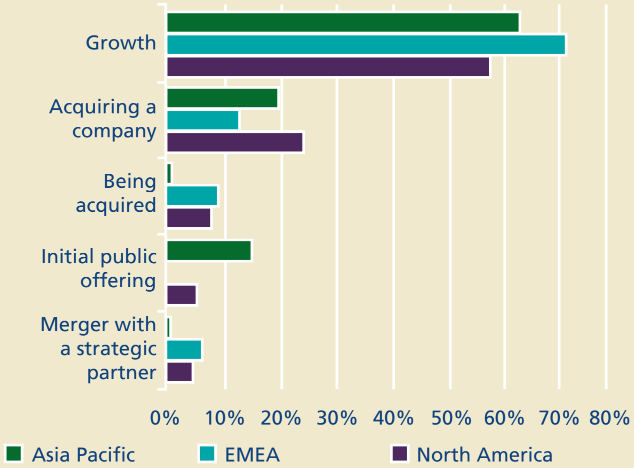
This positive outlook is driving businesses to focus their business strategies and operational priorities on growth. Half of our global respondents consider **growth** to be their biggest financial challenge – far ahead of **managing cash flow**, which came in second at 22 percent. This is quite a change from recent years, when profitability was far and away the top priority.

Growing from within

Companies remain committed to organic growth

Despite overwhelming growth pressure, companies remain strongly committed to growing their business from within – rather than through a merger or acquisition. Roughly 60 percent (see Figure 3) of our respondents consider **organic growth** their company's most likely growth scenario, a result that is fairly consistent across all regions. Acquiring a company is a distant second at roughly 17 percent. The number of companies expecting to go public is also very low, particularly in EMEA.

Figure 3: Growth is the key short-term strategic direction



Question: What do you consider the most likely scenario for your company within the next 12 months?

One of the main advantages of organic growth is lower risk. Organic growth allows a company to preserve and protect its corporate culture, while reducing the chances of falling into short-term thinking or becoming a slave to the stock market. A merger or acquisition, on the other hand, can be extremely disruptive, in some cases even causing a company to lose the autonomy and character that made it successful in the first place.

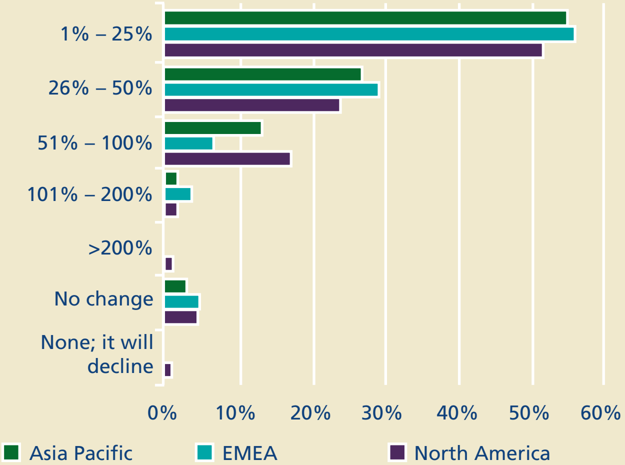
Will companies be able to maintain their commitment to organic growth? Or will rising market demand force them into hasty acquisitions? In many cases, the answer will depend upon their ability to attract the right talent.

Searching for talent

The main barrier to growth is finding enough good people

Last year, the top operational priority was developing a strong sales and marketing strategy. Well, the strategy seems to have worked. An overwhelming 94 percent of our respondents expect to increase headcount this year (see Figure 4), with more than four out of 10 planning to grow by at least 25 percent. That's a significant increase over last year. Yet the vast majority expect to grow less than 100 percent, which suggests their goals, although aggressive, are not irrational or unattainable.

Figure 4: Steady growth in workforce forecast



Question: How much will your workforce grow in the next 12 months?

However, a major barrier to growth is finding enough qualified talent. CEOs in Asia Pacific and North America have made it their top operational priority to find, hire and retain qualified employees (see Figure 5). CEOs in EMEA have done the same, although they place equal emphasis on developing a sales and marketing strategy.

Figure 5: Hiring is becoming a challenge

Question: What is your biggest operational challenge in managing your company's rapid growth?

CEOs around the world are also committed to engaging employees in the company vision, rating it as one of their top three personal challenges.

In all three regions, the emphasis on finding good people is significantly higher than in previous years. While other operational challenges remain important, people is clearly the biggest issue.

The bad news is we may be witnessing the early stages of a long-anticipated global labor shortage. With baby boomers in developed countries poised to retire and fewer young people entering the workforce, many nations are on the cusp of a severe labor crunch expected to last for decades.

The problem will be particularly acute in Western Europe and in Asian countries which have low immigration such as Japan. North America will be slightly less affected due to relatively high immigration rates. Yet even this region is already experiencing an acute shortage of talent in critical areas such as science and engineering. Governments with restrictive immigration policies may need to change their stance in order to facilitate talent acquisition.

With qualified workers in increasingly short supply, talent management is likely to become a strategic imperative. Companies will need to shift their focus from acquisition to development and retention building their own pool of talent, instead of relying on the vagaries of the external labor market.

Companies will also seek to expand their use of resources from developing countries such as India and Mexico, which are expected to have a surplus of labor and talent. Business leaders will press their national governments to loosen restrictions on foreign immigration, while continuing to shift more and more work offshore.

Developing leaders

Leadership development surpasses profitability as the biggest CEO challenge

The increasing emphasis on people extends all the way to the top of the organization. CEOs in every region have made it their number one personal challenge to develop leaders and delegate responsibility, with profitability running a close second (see Figure 6). That's a big shift from the past few years, when profitability was far and away their top personal priority.

Figure 6: Key CEO challenges are delegation, leadership development

Question: What is your biggest personal challenge as CEO?

Recent studies show a sharp increase in CEO turnover worldwide, driven by investors' insatiable demand for results and by accounting scandals that have put top executives under unprecedented scrutiny. In response, companies of every size are investing heavily in executive development programs and succession planning designed to identify and groom the next generation of leaders.

Products remain paramount

Product development and innovation continue to be a top business priority

A high-growth company is generally only as good as its next product line. So it's no surprise that CEOs continue to place a high priority on product development and innovation. In total, a third of the companies in our survey rated "developing and bringing new products to market" or "competitive products" as their biggest challenge to sustaining revenue growth (see Figure 7). "Building strategic relationships" ranked second at 14 percent.

Figure 7: Growth depends on strength of product line and strategic relationships

Question: What is your biggest challenge in sustaining your company's revenue growth?

Companies in Asia Pacific primarily focus on delivering competitive products – with features and quality at least on a par with what other companies offer. North American companies primarily focus on new products – offerings that are superior, or at least substantially different, relative to products currently on the market.

North American companies also place a strong emphasis on hiring the right sales people – even higher than customer loyalty – underscoring the importance of finding the right talent in critical areas.

IP-based applications proliferate

Business use of IP-based applications continues to get broader and deeper

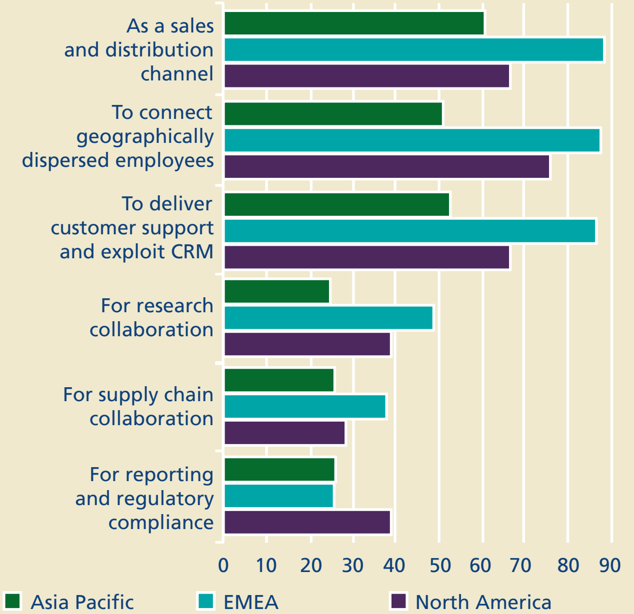
IP-based applications have become truly indispensable business tools, particularly for communication and customer-facing activities. They have changed the way companies structure themselves internally, enabling far-flung employees to connect and work together as a team. And they are starting to have a similar impact externally, enabling diverse organizations to coordinate their efforts through supply chain collaboration and research collaboration.

The use of IP-based applications around the world continues to expand. Companies are using **more types** of applications and using those applications **more often**. In fact, roughly 60 percent of the companies in our survey consider IP-based applications "very important" or "extremely important" to their strategic plans.

IP-based applications can be divided into three tiers, based on usage penetration (see Figure 8):

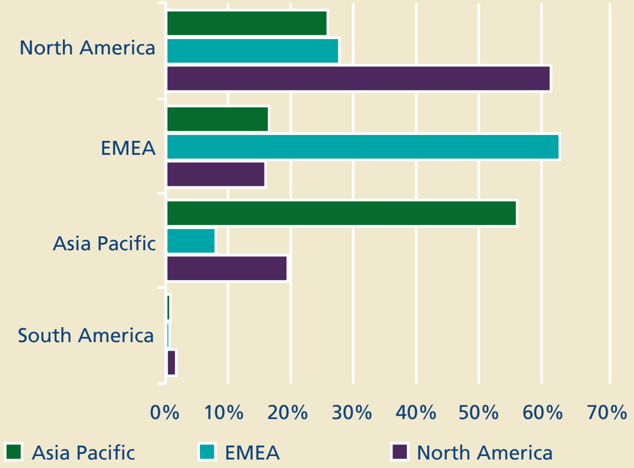
- The top tier focuses on communication. The vast majority of companies use IP-based applications extensively for communication (e.g., e-mail and messaging). Penetration is essentially 100 percent in North America and Europe and roughly 73 percent in Asia Pacific.
- The second tier includes: (1) sales and distribution, (2) connecting geographically dispersed employees, and (3) customer support and CRM. The majority of companies use IP-based applications for these activities, but not as extensively as e-mail and other communication-centric applications.
- The third tier includes: (1) research collaboration, (2) supply chain collaboration, and (3) reporting and regulatory compliance. Less than half of the companies in our survey use IP-based applications for these activities, although penetration levels are rising.

Figure 8: Growing range of IP-based applications



Question: How is your company using IP-based applications? (Please select all that apply)

Figure 9: Focus on regional, not global, markets for growth



Question: Which of the following geographic markets represent opportunities for significant growth for your company over the next five years?

Use of IP-based applications in all of these business areas is growing steadily. Even in the top tier, where penetration is essentially 100 percent, usage continues to expand through a growing diversity of communication applications.

Regionally, EMEA has the highest penetration rates for all types of IP-based applications, except in the area of reporting and regulatory compliance, where North America has a substantial lead.

Staying home

Fast-growth companies continue to focus on their own regional markets

Despite all the talk about globalization, most fast-growth companies are keeping their sights focused at home. 60 percent of our respondents see their own region as the best source of growth (see Figure 9). However, that number is down slightly from last year – implying that some of the fastest-growing companies may be approaching their limit for national or regional growth and will look further afield for opportunities to sustain their impressive growth.

Examining the results by region, 37 percent of our respondents consider North America as the best growth market, with EMEA close behind at 34 percent. Asia Pacific, at 26 percent, is a distant third. Although North America retains the top spot, its lead is steadily declining, suggesting that a presence in the United States is no longer considered a prerequisite for success.

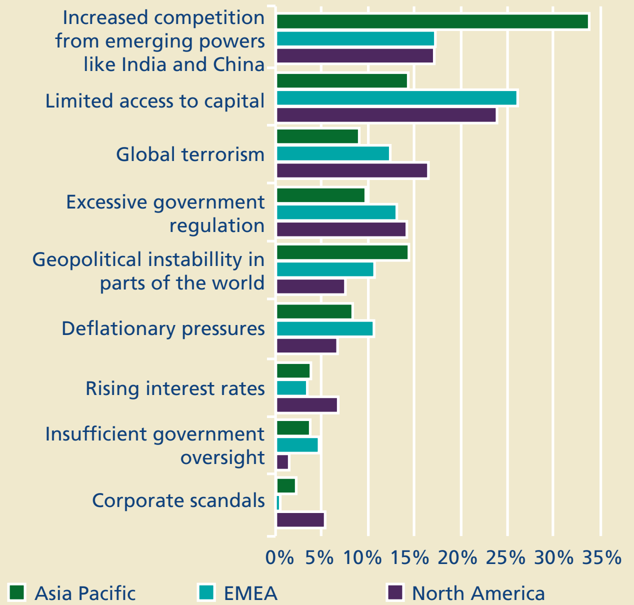
Looking for threats

CEOs worry about access to capital and competition from India and China

Although CEO confidence is at an all-time high, fast-growth companies remain vigilant, constantly scanning the horizon for potential threats that could prematurely limit their growth. In Asia Pacific, companies are most worried (see Figure 10) about increased competition from emerging powers like India and China – two sleeping giants with a combined population of 2.4 billion. China is making huge strides in many business areas and is destined to become an economic superpower (if it isn't one already). India, on the other hand, is the world's dominant supplier of offshore services, yet remains a step behind in many other areas.

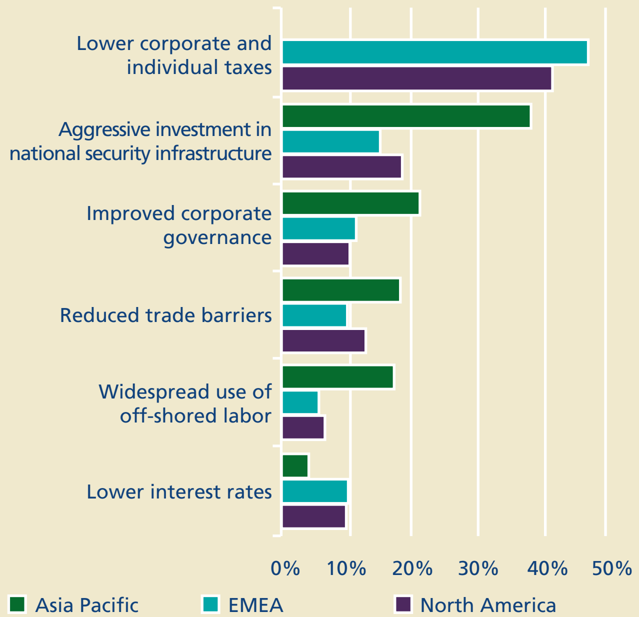
In Europe and North America, companies are most concerned about gaining access to capital to support their aggressive growth goals. They are also somewhat worried about global terrorism, competition from India and China, excess regulation, geopolitical instability, and deflationary pressure – although their level of concern is generally down from last year.

Figure 10: China and India keep CEOs awake at night



Question: What is the biggest threat to growth in the technology sector over the next 12 months?

Figure 11: Lower tax, investment in security and corporate governance can all stimulate growth



Question: What would you prescribe to stimulate growth in the technology sector in the next 12 months?

Given their overall confidence level, it's clear that companies in Deloitte's Technology Fast 500 are for the most part unfazed by these threats. Instead of obsessing about **bad things** that **might** happen, they are focusing on **good things** they can **make** happen – creating innovative products, developing top talent, and finding new ways to grow.

Capitalizing on security

Seeing the need for security as an opportunity – not a threat

Government leaders continue to sound the alarm over security issues such as global terrorism, identify theft and online fraud. Yet, the CEOs in our survey do not consider security a major challenge. In fact, many view public and private investment in national security as a good way to stimulate growth in the technology sector – effectively turning the security threat into a potential market opportunity.

CEOs do not seem particularly concerned about lowering interest rates (see Figure 11), probably because interest rates in most countries are already extremely low. In fact, a number of governments (including the United States and UK) are gradually allowing interest rates to rise – a general trend that is likely to continue.

While tax levels were considered a constraint to growth by CEOs in North America and EMEA, none of their peers in Asia Pacific regarded lower taxation a potential stimulus for the technology sector.

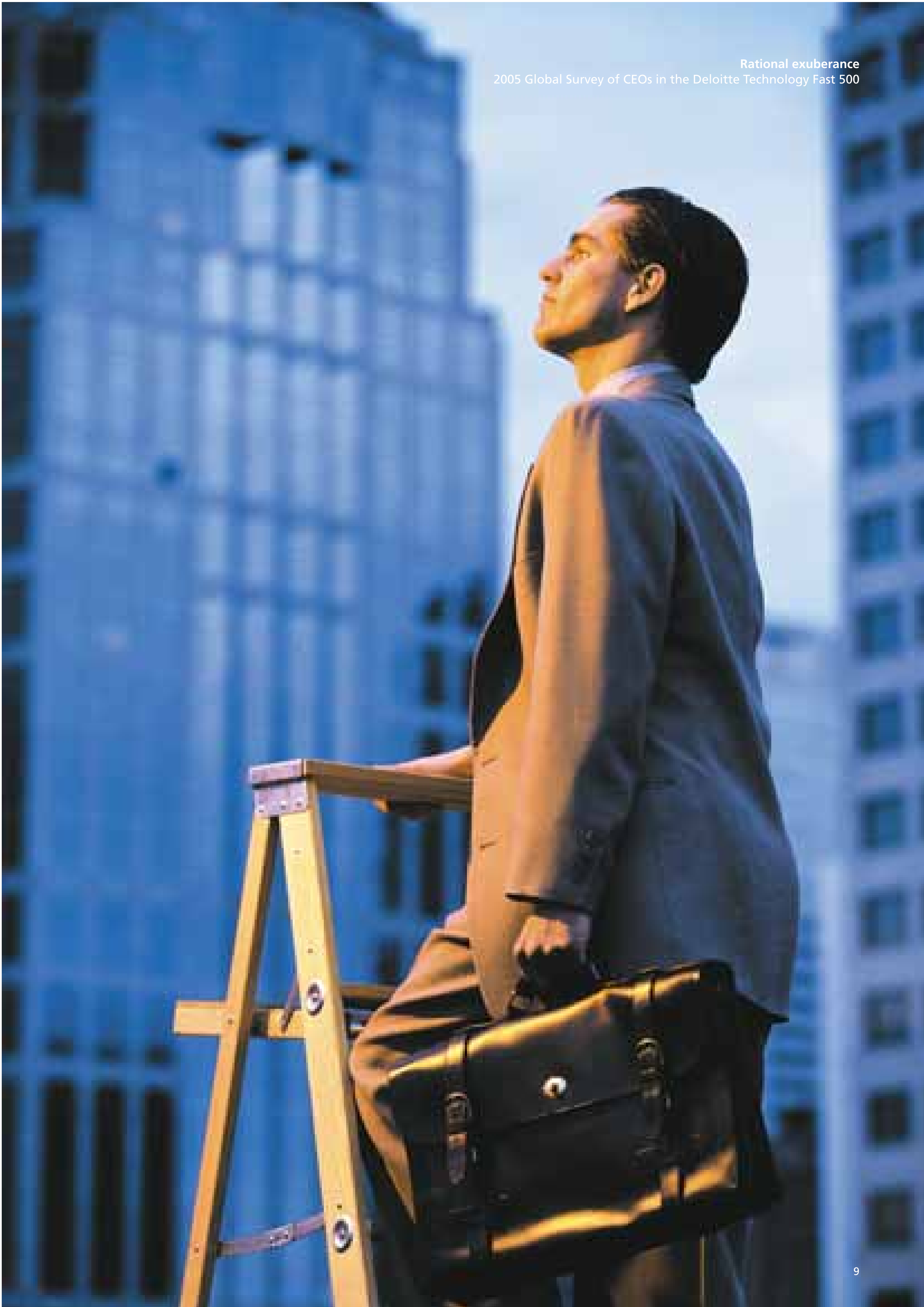
Hot, hotter, hottest

Hot growth picks from the world's hottest companies

CEOs of fast-growth technology companies have made their fortunes by accurately identifying and exploiting the best growth opportunities. We asked these proven visionaries to predict which technologies have the greatest potential for growth (see Figures 12 and 13) over the short term (the next 12 months) and the medium term (the next three years).

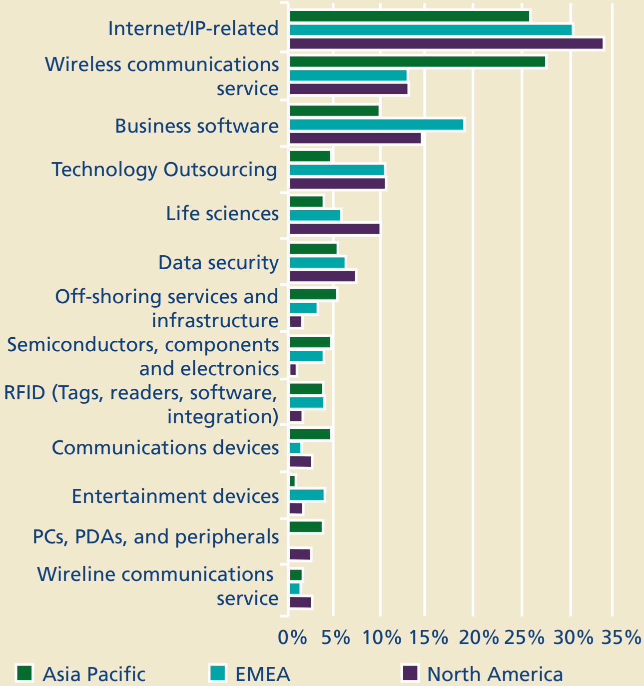
Given the increasing importance of **IP-based applications** to their own businesses, it's no surprise our respondents rate the Internet and IP-related applications as the industry segment with the greatest potential for short-term growth. Although the Internet has already generated significant value, there is still massive further potential to be exploited.

Wireless communications ranks second, except in Asia Pacific where it is in a virtual tie for first. In 2005, slightly over two decades since the first analog cellular networks were launched, the number of mobile subscriptions worldwide is expected to surpass 2 billion. Growth is expected to be particularly strong in developing countries such as China where wireless is leapfrogging wireline as the most efficient way to provide communications services to the masses.



Business software checks in at number three. PCs and other computing hardware have become increasingly commoditized, with minimal prospects for growth. Yet software remains a strong and profitable growth business – clearly demonstrating where the computer market's real value resides.

Figure 12: IP and wireless hold strongest prospects for growth in the short term

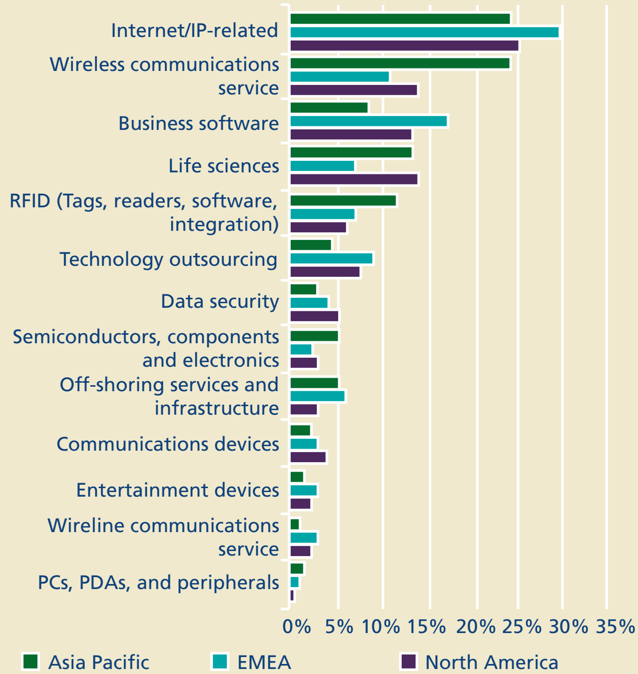


Question: Which industry segment has the greatest potential for growth over the next 12 months?

Long term growth predictions are largely the same. **Life sciences**, is expected to accelerate moderately. But the one technology that is most likely to take off is **RFID** (radio frequency indentification).

Over the next few years, analysts expect billions of RFID tags will be commissioned and deployed. Major companies and government agencies around the world – including Wal-Mart, Tesco, the US Department of Defense, and London's transport system – are starting to deploy RFID across a variety of processes, from supply chain to payment, laying the groundwork for widespread global adoption.

Figure 13: IP and wireless are strong drivers in the medium-term



Question: Which industry segment has the greatest potential for growth over the next 1-3 years?

Conclusion

Growth has regained its place at the top of the agenda for the world's fastest-growing technology companies. CEOs are more confident and optimistic than at any time in recent memory and most expect to continue their remarkable growth by systematically building on what they have already done. Growing organically, rather than through a dramatic merger or acquisition. Pursuing business in their home region, with only limited forays abroad. Continuing to focus on product development and innovation. And extending their use of IP-based applications – moving from basic communications and customer-facing applications to collaboration with suppliers and other strategic partners.

Their biggest challenge is finding, hiring and retaining qualified people to support their ambitious growth plans – a challenge that will only get worse as more experienced baby boomers retire from the workforce. With a shrinking pool of talent, particularly for top-notch leadership and other key skills, talent management is fast becoming a strategic necessity. By putting more emphasis on development and retention, and not just acquisition, companies can ensure themselves a steady supply of talent; and that's something no fast-growth company can live without.

About TMT

The Deloitte Touche Tohmatsu Global Technology, Media & Telecommunications (TMT) Industry Group consists of the TMT practices organized in the various member firms of Deloitte Touche Tohmatsu and includes more than 5,000 partners, directors and senior managers supported by thousands of other professionals dedicated to helping clients evaluate complex issues, develop fresh approaches to problems and implement practical solutions. There are dedicated TMT member firm practices in 45 countries and centers of excellence in the Americas, EMEA and Asia Pacific.

Deloitte Touche Tohmatsu's member firms serve nearly 80 percent of the TMT companies in the Fortune 1,000. Clients of Deloitte's member firms' global TMT practices include some of the world's top software companies, computer manufacturers, wireless operators, satellite broadcasters, advertising agencies and semiconductor foundries – as well as leaders in publishing, telecommunications and peripheral equipment manufacturing.

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