

## With PeopleSoft, Oracle Stacked Up To Take On 'Stack' Field

By J. Bonasia

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The dawn of a new year is the dawn of a new era for business software.

The dust is settling on Oracle's \$10.3 billion takeover of PeopleSoft, which closed on Jan. 7, merging the Nos. 2 and 3 business software firms. Oracle on Friday said it started handing out pink slips to some 5,000 PeopleSoft and Oracle workers, reducing the combined work force to about 50,000. On Tuesday, Oracle has scheduled a "launch event" to lay out more of its strategy and soothe worried customers.

Business software leader SAP has picked up new clients due to uncertainty around Oracle's 18-month effort to acquire its reluctant rival. And firms ranging from massive Microsoft to tiny **Taleo** are working hard to tempt PeopleSoft users their way.

Like revelers trying to shake off a mean hangover, investors are wondering what comes next.

Well, get ready for the battle of the "stack" providers.

A handful of huge vendors has emerged to sell all the parts of a complete business software stack -- applications, application servers, databases and middleware to manage integration, security, and Web collaboration..

These stack vendors, which provide applications and infrastructure software, are Microsoft, IBM, SAP and Oracle. Hardware giants Hewlett-Packard and Sun Microsystems also wield great influence on the software industry.

"An epic battle is going on right now for control of the software stack," said Christopher Lochhead, chief marketing officer of Mercury Interactive.

As a maker of software designed to help companies get optimum use of their software systems, Mercury is one of the major smaller planets orbiting the big boys.

Amid such market turbulence, one point has become clear: Size matters more than ever. Software buyers these days are demanding more functions, lower costs and tighter integration -- and they want it from one supplier.

Shooting For "Ease And Cost.

They want "one neck to choke" for their service and pricing concerns, said Richard Williams of Garban Institutional Equities.

"All this complex technology is coming together to facilitate business operations in the real world and the virtual world," he said. "The critical differentiator now is the ease and cost of so much software integration..

So while the stack players seek to broaden and deepen their platforms, the smaller application and infrastructure players are scrambling to ensure their futures.

Besides Mercury, many large software companies with annual sales of more than \$1 billion fall into this orbiting group.

They include Siebel Systems, Hyperion Solutions, Business Objects and BEA Systems.

The all risk being sucked in by the big stack players. Growth has slowed for the biggest software makers. Thus, many are being forced to buy smaller firms to spark new growth, says Clark Chang of Fulcrum Global Partners.

Mercury, which has posted steady double-digit sales growth the past year, is a good candidate to be acquired, says Chang. He has a neutral rating on the stock.

"Mercury could really help some larger companies because it is growing so fast," he said.

Some companies will go on acquisition sprees in order to compete. Some will merge with equals. Some will seek larger acquirers to rescue them. Others will remain independent and partner with the big boys. Many will disappear.

During his bitter fight for PeopleSoft, Oracle Chief Executive Larry Ellison famously pronounced that the software industry has grown up and a shakeout is badly needed.

"This is the recovery," he quipped at a user event last year. "You'd better enjoy it..

A new study by Booz Allen Hamilton supports Ellison's claim. The consulting firm found that the software sector "still has two to three times as many participants as it can sustain in a fully mature environment." Booz Allen says this situation arose from excess software capacity, more price-conscious buyers and the explosion of low-cost offshore rivals.

Indeed, recent earnings announcements hint at the growing threat from cheap offshore firms in India and elsewhere. Tata Consultancy Services of India reported 38% growth for its third fiscal quarter ended Dec. 31.

For Oracle and the others, single-digit growth has been the norm the last few years.

Tata also says it added 72 new clients in the quarter.

But SAP, which is slated to officially release results Friday, recently said it expects that its fourth-quarter sales rose 8%, with flat sales in Europe.

That was on the low end of its earlier expectations, and the news disappointed Wall Street. SAP shares fell.

India: A Concern.

Germany's SAP and its U.S. rivals should be deeply concerned about Indian firms that are fast evolving to offer more valuable services, says Bruce Richardson of AMR Research.

"Their ability to take away SAP's business is very imminent," he said.

SAP might seek to strengthen its ties with, or perhaps even buy, middleware firm BEA, says Richardson. That way, SAP could pick up needed innovation and strong talent, he says.

In the court proceedings surrounding Oracle's hostile bid for PeopleSoft, it surfaced that Oracle also had mulled acquisitions of BEA, Siebel and Paris-based Business Objects. The PeopleSoft saga even revealed that Microsoft briefly flirted with buying SAP in 2003.

Siebel, long the market leader for a key part of the total software stack called customer relationship management, now faces a squeeze from above and below.

On the high end, SAP and Oracle are improving their CRM products for large global clients..

And rivals Salesforce.com and RightNow Technologies -- which feature a "hosted" CRM business model to maintain the software and dole it out to clients as needed -- have reported strong growth among small and midsize clients.

The consolidation trend is hitting other parts of the software field. Last month, security software giant Symantec said it would pay stock at the time valued at \$13.5 billion for data storage vendor Veritas. That's one of the largest tech mergers ever, but investors remain leery. Symantec shares have fallen roughly 25% since the companies announced the deal.

One wild card in computing's evolution is the rise of open source software, most notably the Linux operating system. It has gained ground against Microsoft's Windows, and it gives all the players another big issue with which to contend.

It's far from the only issue.

The smaller software firms also face a new barrier.

The Fair Accounting Standards Board as of last month required that employee stock options to be expensed as a cost of doing business. That affects all companies, but cash-strapped startups had used generous options to attract employees.

The ruling means large companies with big cash flow can still pay hefty salaries to lure top programmers and managers, says analyst Williams. Smaller startups can no longer use their options.

Williams calls the decision "an absolute disaster" for small firms. "I see this rule as a tax on small business that will eliminate innovation.