

Little Fish and Large Blue Chips

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Both the quantity and quality of crystal ball gazing in LISA have climbed sharply over the past year or so. This development has been driven by a number of factors, including a general uncertainty about what the future holds and an apparently greater willingness of industry members to put pen to paper. Indeed, the fact that industry members have the time even to think about whether the industry "has a future" is a sign that at least part of it has achieved a degree of stable maturity.

The single most prominent discussion topic, however, would seem to be "industry consolidation". This featured heavily at the March 1997 LISA Forum - Europe in Mainz, and is examined elsewhere in this edition of the LISA Newsletter. In contrast to the approach taken by many other analysts and industry observers, this article argues that, in reality, what is happening is that there is process of concentration - rather than consolidation - underway in a relatively small segment of the localization industry. Over-emphasis on this trend is masking the dynamic expansion occurring elsewhere.

The fishpond

From the viewpoint of a smaller services vendor, there are a number of issues related to "consolidation" which appear to have been largely overshadowed by the recent events at the large-volume end of the market.

Of the speakers in the Panel Discussion "Industry Consolidation: Death, Rebirth, or Confusion?", Renée Weissbach of Mendez came closest to pinpointing the one single factor which, while not necessarily making the excessive focus on "consolidation" entirely irrelevant, at least puts it into much sharper perspective.

She talked of the "sharks, trout and goldfish" (1) which will populate the localization "swimming pool" of the future. To term the shoals of specialist localization boutiques goldfish is undoubtedly more diplomatic than to call them minnows, but more than a few would certainly prefer to be viewed as piranhas. However, what is particularly interesting about this analogy is that it comes from one of the largest "sharks" around, which

evidently feels comfortable about sharing the waters with a large number of smaller market operators.

In turn, the small fry need not feel particularly threatened by the predators as long as they stick to their own feeding grounds, the niche markets in which they excel. (Nevertheless, we should always remember that sharks die unless they keep moving). In a word, what Renée was talking about was *segmentation*.

Segmentation: the wider perspective

The overall market for localization services is characterized by heavy segmentation in terms of both suppliers and clients. Given the traditional emphasis within LISA on the larger, high-profile services providers and hardware and software manufacturers, most of whom are operating in the minimum delta shrink-wrap market, this fact sometimes - although perhaps understandably - tends to be ignored.

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International Data Corporation (IDC) put the worldwide market for packaged software at \$105 billion in 1996, a figure which is forecast to rise to \$120 billion this year. Although the customers of the larger LISA localization providers account for a significant share of this total, any concentration on the mass market masks the fact that an enormous amount of software is being written - and often localized - outside this area. This includes, for example:

- Business software (e.g. standard business management software), workflow management, imaging and archiving, etc.
- Financial and banking applications.
- Medical applications.
- Process management, MRPII, logistics.
- Defense and aerospace.
- Auto industry, automation, and so on.

In addition to custom software, standard applications are also customized, providing further revenue potential for localizers. One feature of these markets which must be emphasized is that in many cases the software is developed by, or in close collaboration with, the original user organizations themselves. For these companies, software development may be an important component of their business growth strategies, but - like language functions - it does not form part of their core activities.

It is thus unsurprising that the localization of software and documentation is often regarded as no more than a necessary evil (and an enforced expense). Far from participating in the localization process, as much of the workload as possible is placed firmly with the localizer, who is frequently unable to establish

the form of "partnership" championed in LISA circles.

These sectors of the overall market for localization are still largely the province of the localization boutiques, ranging in size from micro-enterprises to medium-sized companies grossing \$10 million or more.

Who's selling what?

One of the established paradigms of the localization industry is that localization is undertaken by "localization service providers". But the direction in which parts of the industry have been moving recently puts a question mark over this definition.

The trend towards simship in the shrink-wrap sector and the increasing ability of large localization companies to extend the value chain by offering production, packaging, distribution and even fulfillment options shows that what they are offering their customers is more of a product and less of a "service" in the classic sense.

In Karl-Erik Sveiby's "Customer Adaptation" scale (2), these companies have shifted away from the "Knowledge Organisation" companies with high customer adaptation (criteria include: small, creative, adhocracy, no economy of scale in production, economy of scope in intangible assets) and towards the low-adaptation "Service Company" (large, productive, hierarchical, economy of scale). At the moment, they are probably drifting towards the middle of the scale, where they are likely to stay due to the knowledge-based nature of the industry itself.

The localization boutiques are still firmly positioned under the "Knowledge Organisation" category, particularly as regards their flat adhocracy and restricted economy of scale. They are selling services, rather than products, and are unable to leverage any significant economy of scale - not that the latter factor is necessarily a key advantage in a

digital economy with lower barriers to market entry.

In addition, the relative lack of structure in this segment as a whole sees a lot of cross-fertilization between the boutiques, both in the form of intercompany collaboration and migrant personnel. This segment also benefits from what Austrian economist Joseph Schumpeter termed "creative destruction", where the entrepreneurial culture "incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one" (3). The result is a vigorous, dynamic environment where old companies die and new ones take their place, and where ideas and people are constantly being "recycled", gaining value with every change.

The phases of company growth

Using the Sveiby model described above as a basis, we can characterize the small and medium-sized boutiques as flexible organizations constantly recycling their skills. Generally managed by their owner(s), they seek to maximize disintermediation by establishing very close bonds with a limited number of clients.

The large companies servicing the mass market have a more hierarchical structure. Their owners no longer have centralized control and the companies are more heavily dependent on outside capital.

In a series on "Mastering Enterprise" published earlier this year in the Financial Times (4), Neil Churchill identified the "Six key phases of company growth":

1. Conception/existence
2. Survival
3. Profitability/stabilization
4. Profitability/growth
5. Take-off
6. Maturity

The localization boutiques are generally scattered across phases 2-4, aiming to achieve stability and long-term growth. The (surviving) large companies are clustering in phases 5 and 6, and it is the events here which have triggered off the current excitement about "consolidation".

Consolidation and concentration

But what is actually happening? The "FT Guide to Management and Finance" defines consolidation as:

1. The process of rationalising an industry by acquisition in order to increase concentration. 2. A period of digestion in a company's history following rapid change and/or expansion.

In fact, both of these processes are underway. The second definition can be applied to companies in all of the phases described above, but it is the first one which is of greater interest here, in particular its reference to *concentration*. The current wave of acquisitions by companies such as Bowne and Lernout & Hauspie (L&H) is driven by a desire to maximize market share, and not only in the shrink-wrap software sector.

This is plain from L&H's licensing deal with (amongst others) GMS for the T1 machine translation engine and the announcement of its plan to establish a large translation center in Belgium for both human and automated translation services. This project will be financed to the tune of some \$35 million by the little-known "Brussels Translation Group", apparently a private fund (5).

That Bowne and L&H should increase their participation in the localization and translation market by acquisition, rather than generic growth, is not surprising. The recent Silicon Valley Survey by *The Economist* magazine (6) rightly points out that "Technology is now advancing across such a broad front that even

a fairly big firm cannot keep up in all sectors. Acquisitions save big firms from being left behind".

The real losers are likely to be some of the medium-sized companies, especially those focusing too heavily on either localization or the lower end of the "straight" translation market.

With hundreds of millions of dollars being invested in the localization and translation sectors, especially by outside investors, it is clear that these new conglomerates are attempting to achieve domination, or even near-monopolization. However, the changing nature of the digital economy may work against them.

The problem centers around the question of what is the "unique" of these larger operations. Any language services enterprise, regardless of size, can now offer a blend of software localization and high-end/low-end translation, coupled with various automated and semi-automated language technologies. The amount of money available for capital spending certainly plays a role, but the financial barriers to introducing new technology are decreasing just as fast as the technology itself is changing.

What fuels these large new operators is economy of scale (and to a lesser extent, economy of scope). In a digital economy, however, this "fuel" may not have the same effect as it has traditionally had in industrial production environments.

From great white shark to large white elephant?

In a Web article entitled "Exploring the Evolving Transformations in American Life", G. A. Keyworth, II, argues that "Along with the diminished barriers to new entrants that define the cyberspace economy go diminished economies-of-scale. Taken together, they

mark the decline of the concept of a monopoly or, at least, of an enduring monopoly. ... Even where monopolies do emerge, the pace of technological change is threatening to make them short-lived."

It is not only "diminished economies-of-scale" which make such strategies risky: new technologies can render a substantial capital investment obsolete almost overnight. This has been seen time and time again within the past few years in the IT industry. The risk that this poses to the language service/product conglomerates should not be understated.

However, it is also most likely that, for a while at least, these emerging, vertically integrated language "hypermarkets" will themselves steal market share from other players. Least likely to be affected are the small, specialist boutiques. Low overheads and the ability to achieve rapid skills recycling from other operating areas, in particular high-end translation, make them flexible enough to react almost instantaneously to external threats — as long as they are aware of them. Complacency has no role in any entrepreneur's business toolkit.

The pain of being "middle"

The real losers are likely to be some of the medium-sized companies, especially those focusing too heavily on either localization or the lower end of the "straight" translation market, who will find themselves caught between a rock and a hard place. Nicholas Negroponte has argued that in the digital age, there is no room for "middle" anything: middle management, middlemen and mid-sized companies included. Economists refer to the same point when they talk of value analysis.

After a period of rapid growth, many medium-sized companies have leveled out at a plateau stage where internal consolidation and stabilizing productivity are key activities. The

level of external debt has risen to quite substantial proportions, and they no longer enjoy the flexibility to make quick entrepreneurial decisions. In short, they have lost many of the advantages of the small boutiques, but are still unable to benefit from the sheer size of the conglomerates.

Wood and trees

Debates about whether the localization industry has a future tend to miss the point. Equally off the mark are the regular attempts to redefine what localization actually involves. The question of the direction in which the industry is going is less important than to ask who is going with it. The real question is: Why bother to restrict the definition of the localization industry when in reality, anybody who wants to be a member *is* a member, regardless of their size or what they are actually doing? And where does this leave the localization "industry"? It is being pulled - and is also starting to push - simultaneously in a number of different, often opposite, directions.

It is becoming increasingly apparent that this industry is substantially more diverse and complex than some people are prepared to admit. At the mass market end, its dynamics are increasingly tied to those of its client market, restricting the scope for creative, entrepreneurial activities. The small localization boutiques, on the other hand, tend to thrive on ad-hoc, highly responsive, people-driven organizational models, forming and reforming loose alliances in an environment which frequently approaches creative chaos.

Conclusions and potential solutions

Monolithic corporate structures may have a certain appeal to the innate conservatism of institutional investors - even when they are investing in new technologies - but in the emerging digital economy, they will find it

harder to generate the enthusiasm for change needed to avoid overnight obsolescence. Massive capital tie-ups bound to inflexible redemption schedules can also obliterate any competitive advantage.

The problems faced by the small localization companies - how to achieve, and then manage, growth while retaining organic flexibility and independence - may be solved by adopting a "cell division" strategy. The company divides and multiplies itself, though overall control is still held by the original owners. This strategy can be used to target modest financial resources quickly to support growth markets, as well as making it easier to discard less successful operating areas.

Medium-sized companies, too, can fight off predatory attempts to steal their market shares. They can do this most effectively by concentrating on their core business, by stimulating organic growth and by keeping sufficient cash reserves to enable them to respond quickly to technological change. If they can identify complementary, rather than competitive, activities with other companies of similar size and at roughly the same stage of development, business alliances can also provide a degree of long-term security. Where their relationships with the small boutiques are concerned, though, they should remember that "circling the wagons" - exclusion instead of integration - works only in the movies.

References

- (1) Meeting Summary, LISA Forum - Europe, Mainz, March 1997.
- (2) Karl-Erik Sveiby, "The Knowledge Organisation". For more information on Sveiby and his publications, see <<http://www.sveiby.com.au>>.
- (3) Joseph Schumpeter: Capitalism, Socialism and Democracy, New York 1947

(4) Financial Times supplement "Mastering Enterprise", Number 8: "Managing Early Growth" (1997).

(5) Lernout & Hauspie press release, 14 March 1997.

(6) The Economist, Volume 342, Number 8010, March 29th 1997.

