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Software & IT Services – sector report United Kingdom

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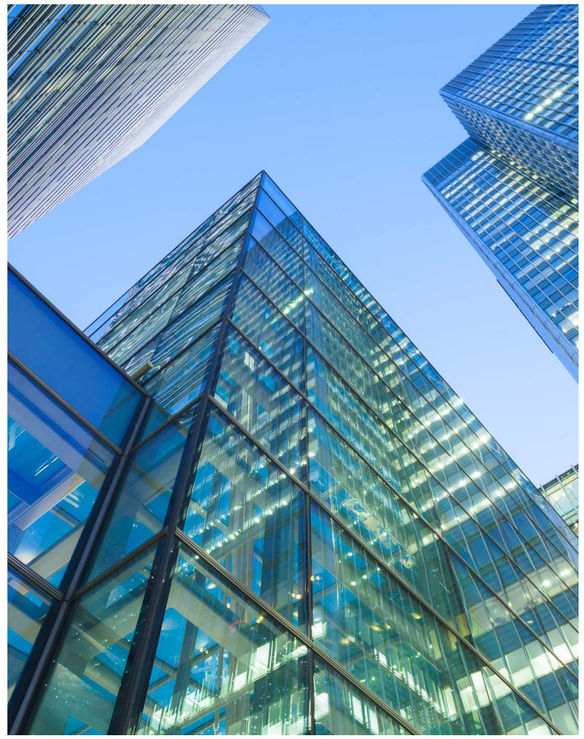
As a highly innovative economy, the UK remains at the forefront of emerging technology development. The UK tech sector is the 3rd most valuable in the world behind the US and China, with the combined value of UK public and private sector tech companies breaching £812bn in 2022. When combined with a continued drive for digital transition and adaptation to a new working environment, we anticipate continued strong growth in the market in the coming years. Challenges are evident in the form of filling the labour gaps required for such transition, re-skilling existing and future generations when noting the advent of AI. In addition, the growing burden on energy and data infrastructure will require significant investment to minimise disruption and reinforce security across an increasingly complex ecosystem.



Sector rating (global): Medium Risk
Sector rating (United Kingdom): Medium Risk

Strengths	Weaknesses
High value add, representing high margins in IT consulting, software and cloud computing.	Low barriers to entry in some segments, prompting competition for clients but also for workforce noting the labour gap particularly in certain skill sets.
Significant share of recurring revenues in segments such as managed services due to the reliance of corporate and public infrastructure.	Sensitivity to cuts in corporate IT investment, which can come during downturns as businesses look to reign back.
Broad customer base (industries, retail, banking, insurance, transport, etc.) which provide insulation to economic volatility.	High reputational risk and many ESG-linked challenges to cope with: decarbonisation, water and soil utilisation, employee's and customer's healthcare, among others.
Powerful long-term growth drivers (digitisation of the economy) which will remain in the forefront for the foreseeable future.	Traditionally weaker margins outside of consulting, software and cloud computing which can be impacted by rising labour and other input costs.
Positive legacy of the Covid-19 outbreak on future IT investment, with the rise of hybrid working driving greater expenditure on reliable infrastructure to support a remote workforce.	

Key trends and challenges that will shape the industry:

1. **Remote working:** Positive fallout of the pandemic on demand for remote, cloud-based professional solutions. In turn this will require continued investment in infrastructure to support as we move to the new normal.

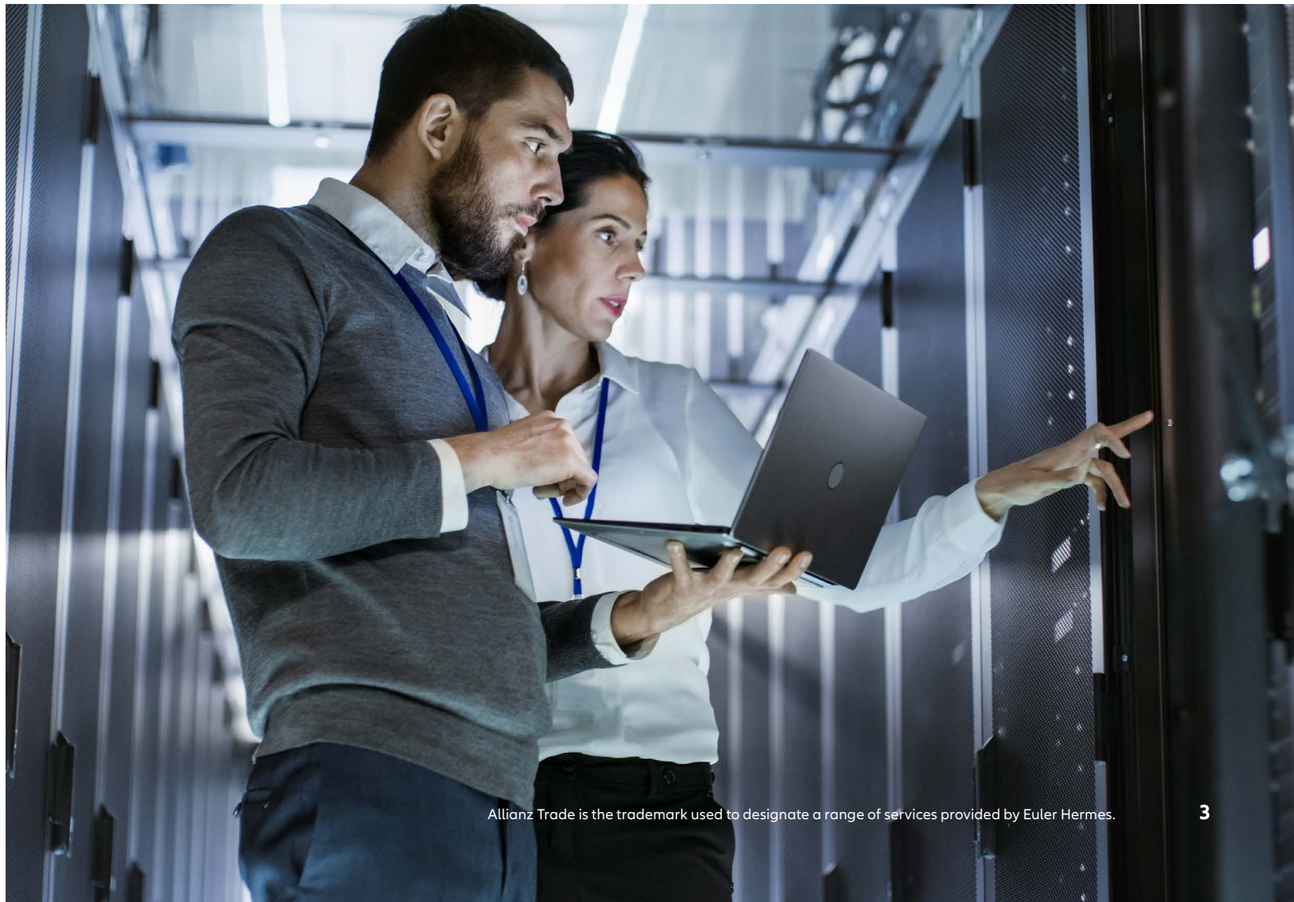
2. **Labour shortages for highly skilled IT professionals:** Will lead to higher labour costs, intense competition for certain skill sets and a need to re-skill the existing workforce and future generations.

3. **The impact and potential of AI + Cyber Security:** Huge potential for growth, but will require continued regulatory change and effective security to prevent disruption particularly in critical services.

4. **Digital transition:** Rising data usage will require appropriate data centre infrastructure and higher energy usage requirements.

5. **Software as a service (SaaS):** The emergence of this delivery model provides the ability to reduce upfront costs and assist cashflow management for no maintenance or management work. However, at the same time it can result in vendor lock-in and security issues.

6. **ESG:** Energy and water usage are growing factors for the sector. Data centres are estimated to use between 5-20mn litres of water every day (dependent on the size) as cooling towers are a popular method for controlling overheating. How the industry accounts for this huge and growing usage is going to be an area of increasing importance in the coming years and require investment, research and sustainability measures.



Sector Overview:

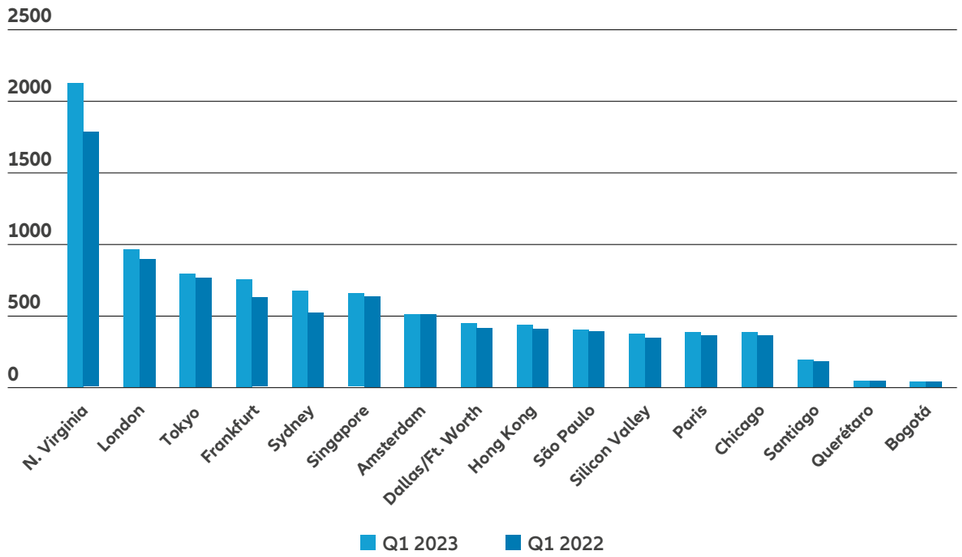
Broad in scope, the industry can be divided into five main subsegments of Consulting, Programming, Managed Services, Software and Data Processing. The former 2 segments being the most fragmented, while the latter 3 are far more concentrated with regional and global players.

The global IT services sector is expected to grow by +9.5% in 2023, defying a more challenging economic environment and showing that digital transformation remains a priority among companies. The IT services segment, estimated at around £1,015bn, should grow by about +8%, with companies placing a greater emphasis on cloud computing. Artificial intelligence in particular is seeing booming investment from all client industries, with financial services and industries leading the pack. Software, valued at around £650bn, will see +12% growth as companies accelerate the modernisation of their legacy software solutions. Though a generally high-margin industry with recurring cash flows, it could however suffer from the tightening of financing conditions across most markets. This is especially the case for start-ups or companies operating in frontier markets. The sector is also vulnerable to an acceleration in salary growth amid fierce competition for talent and a shortage of skilled labour in emerging applications

Data requirements increased from 2 zettabytes (Zb) in 2010, to 79Zb in 2021. Requirements are expected to reach 181Zb in 2025 which translates into a massive need to develop data storage capacity, leading to growth in the requirement for data centres across the globe, with companies spending £159bn on IT solutions for data centres in 2021 alone. The acceleration of AI will only drive further growth in requirements in the coming years.

North Virginia in the US remains the largest worldwide data market, noting its proximity to central government (the largest data producer in the world), with FLAP (Frankfurt, London, Amsterdam & Paris) being the most attractive location in Europe thanks to the proximity to the Internet Exchange

Figure 1: Inventory (MW)



Source: CBRE, Allianz Trade

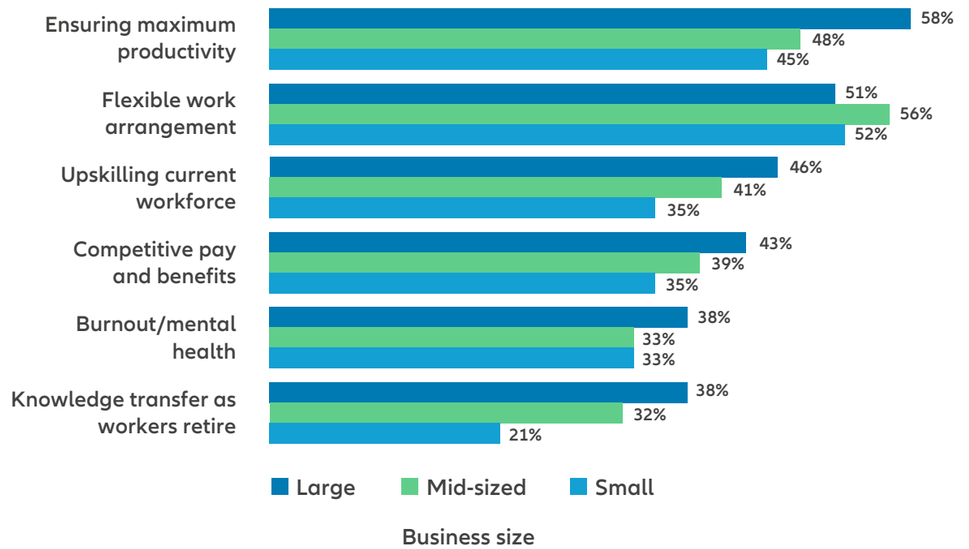
Enhancing productivity through digital transition/transformation:

One of the key issues keeping employers up at night is productivity. It is not enough to simply implement new technological transformation, it is also crucial to build the skill base of the people using the technology. With that in mind, the success and effectiveness of digital transition should be measured based on whether productivity of the workforce has been enhanced by those changes.

Although emerging technologies may create new job roles, it more often evolves existing job roles. For instance, network administrators need to add cloud skills, software developers need to become familiar with AI algorithms and cybersecurity specialists need to leverage automation. Digital transformation will continue to be a far-reaching aspiration for years to come, and the goal of enhancing productivity will provide more clarity in direction and more metrics for success.

Work arrangements are closely tied with productivity, so in an era where remote working is on the rise, the effectiveness of transformation initiatives is going to be closely tied to how seamlessly they interact with remote working arrangements.

Figure 2: Top Workforce Priority



Source: CompTIA, Allianz Trade

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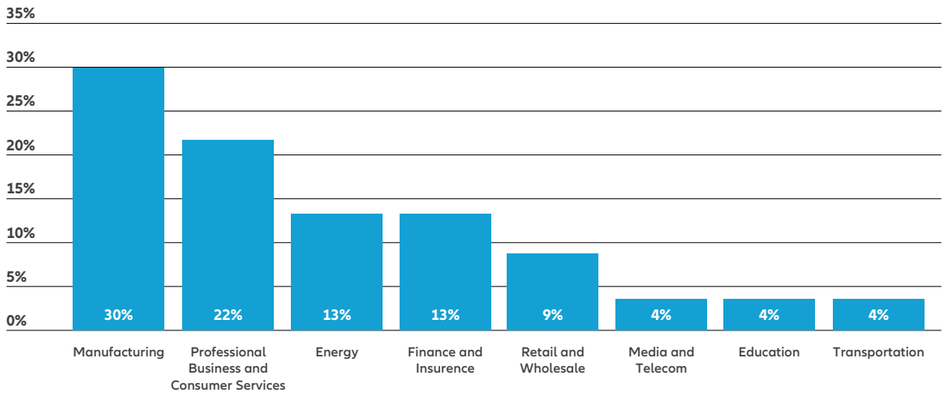
Impact and Potential of Generative AI:

The use of generative AI has the potential to make a significant contribution to economic value, with projections suggesting that it may add as much as £3.5 trillion globally across a variety of applications. AI is being utilised by high-performing organisations not only for the purpose of lowering costs but also for the intention of developing new business models and improving existing services. The use of AI also suggests a shift towards more AI-integrated job tasks, which has the potential to improve both overall productivity and job quality within the workforce.

Cybersecurity:
Cybersecurity, data privacy, and privacy issues are becoming increasingly difficult to deal with as generative AI systems grow more incorporated into commercial operations. Taking into consideration the changing environment, it is apparent there is an urgent requirement for continuous investments in artificial intelligence capabilities, solid governance frameworks, and a qualified workforce that can manage the next generation of technological developments.

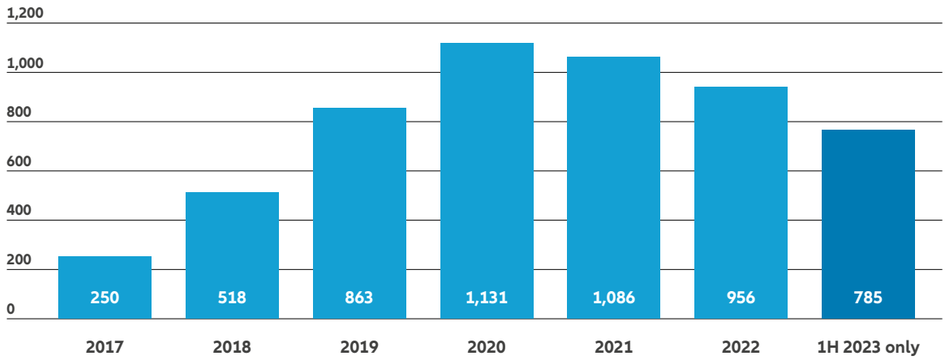
Figure 3: Top industries targeted by cyber attacks

The percentage of extortion cases by industry observed in incident response engagements in 2022.



Numbers do not add up to 100% due to rounding.
Source: IBM, Allianz Trade

Figure 4: Number of cyber-related claims per year

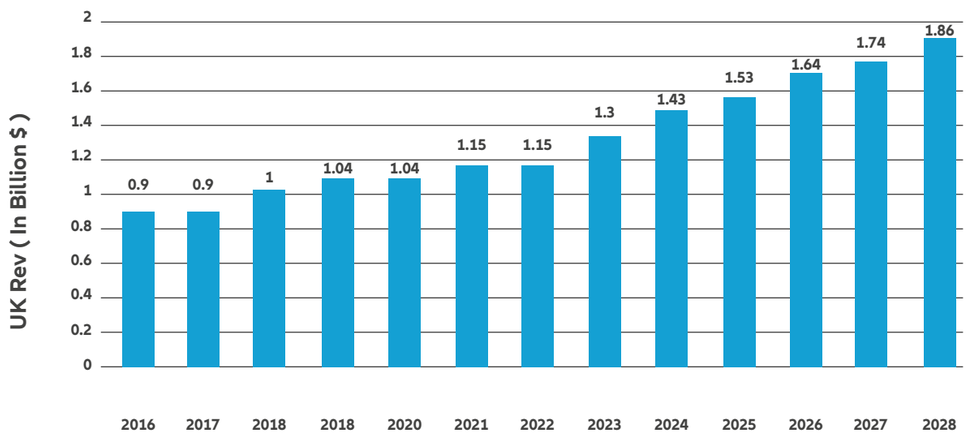


Totals include all cyber-related claims per year. Numbers may change in future due to updated reporting.
Source: Allianz Commercial

AI's ability to power future ransomware attacks, with automated attack processes, more convincing phishing (success of fake voice-overs) and faster malware development present major issues for corporates, with the IMF recently sharing its concerns about the long-term risk of AI affecting the behaviour of financial markets. Critical service providers such as hospitals or power companies, and businesses in the midst of structured finance transactions could all see disruption at critical times leading to significant consequences.

The Revenue in Business Intelligence Software market in the UK

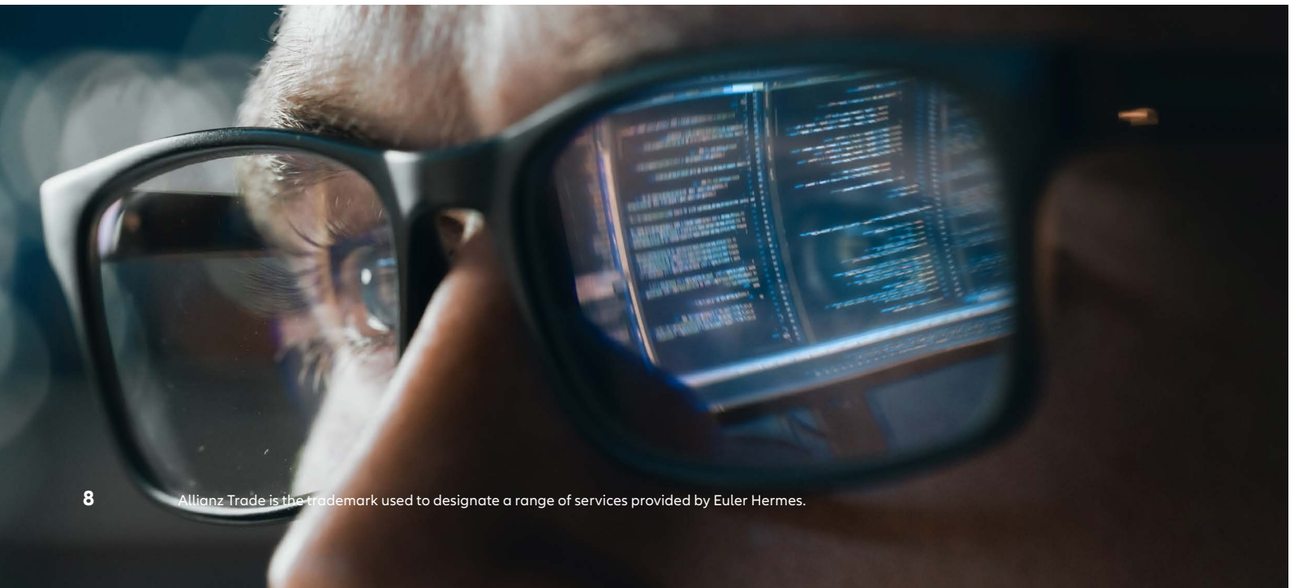
Figure 5: Revenue in the Business Intelligence Software market



Source: Statista, Allianz Trade

The market for business intelligence software in the UK has exhibited steady expansion from 2016 to 2023. From 2016 to 2023, there was a progressive escalation from £0.7bn to £1bn. This indicates that Business Intelligence technologies are being consistently adopted and integrated into business practices. A significant increase in revenue is anticipated to commence in 2024, culminating in anticipated revenue of £1.13bn. The market is anticipated to expand at a compound annual growth rate (CAGR) of 6.79% between 2024 and 2028. It may also suggest an increasing demand for related jobs, such as data analysts, Intelligence developers, and data scientists.

The UK IT and software market has a positive outlook, with major prospects for growth, investment, and innovation, especially as businesses increasingly rely on data-driven decision-making to achieve a competitive advantage.



Labour shortages for highly skilled IT professionals

IT professionals are in high demand due to the increasing reliance on technology across the economy. With the advent of AI and Machine Learning, the sector is facing labour shortages that are driven by skill gaps in software development, cybersecurity and digital marketing, among others.

Demand for cyber security experts as an example is growing at a time of constrained labour supply in the US and Europe, with the current global cyber security workforce gap standing at 3.4mn people.

Shortages are being driven by accelerated evolution in tech, lack of specialised skills an aging workforce, intense competition for global talent along with long and complex hiring processes.

Fundamentally, this produces cost implications for hiring and importantly retaining staff in these areas, particularly around mission-critical transformation projects. Investment in training, competitive compensation and leveraging automation to streamline IT teams are of key importance to mitigate these labour supply constraints.

What top skills are in shortage in the UK

Source: Forbes, Allianz Trade

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