Breaking Analysis: Lower for longer - Tech spending remains tepid by, David Vellante

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We’re getting used to the phrase, “higher for longer,” referring to the realization that interest rates are expected to remain elevated for a period of time. This trend is having an inverse effect on enterprise tech spending growth rates. Prior to the Fed’s tightening binge for example, IT decision makers (ITDMs) in aggregate expected annual [...]
We’re getting used to the phrase, “higher for longer,” referring to the realization that interest rates are expected to remain elevated for a period of time. This trend is having an inverse effect on enterprise tech spending growth rates. Prior to the Fed’s tightening binge for example, IT decision makers (ITDMs) in aggregate expected annual technology spending to increase by 7.5%. Eleven fed interest rate hikes later, ITDMs estimate that their 2023 budgets will be up only 2.9%, with an expectation, or perhaps it’s a wishful hope, that their budgets will increase 3.8% in 2024.

In this our 200th Breaking Analysis, we preview the current spending climate and where AI fits in relation to other sectors. We’ll also share with you a snapshot of the leaders in terms of spending velocity for their platforms; and how their performance compares to peers relative to earlier survey periods.

Decelerating Spending Outlooks – A Two Year Theme

**Enterprise CXO Spending Forecasts Over Time**

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One of the superpowers of ETRs approach is its strict adherence to consistency over time. This allows for apples-to-apples comparisons that highlight changes at the margin.

In the above graphic we take an example using enterprise tech spending projections. The chart shows ITDM’s expectations for annual spending growth over the past 10 quarters. The survey month and year is shown at the bottom starting with the September 2021 survey and the time series runs quarterly through October 2023. The survey N’s each quarter range from 1,500+ to more than 1,700 completes.

The blue line shows the 2022 outlook starting in the September 2021 survey. At that time, ITDMs expected their 2022 spending levels to grow by a robust 7.2%. That figure peaked as we exited 2021 to 7.5%. Then as we progressed through the year, two significant events changed the outlook: 1) Russia’s invasion of Ukraine that February; and 2) The Fed’s relentless tightening cycle. The result is obvious in terms of a deceleration in spending expectations for the year 2022, exiting the year at 4.6%.

[Note: Actual 2022 growth estimates have from Gartner and IDC have ranged from flat to up 5.5%. We believe the figure was somewhere in the low single digits for 2022].
**Downward Revisions Continue into 2023**

The expectations for 2023 are shown on the red line. Fed tightening was having the desired effect - at least on tech spending, perhaps not so much on the consumer side. Entering 2023, expectations for the year were for 4.1% spending growth. Notice the meaningful deceleration as the Fed actions continued through September of this year to where ITDMs now believe their 2023 budget growth will be around 2.9%.

They’re hopeful that in 2024, we’ll see an uptick to spending increases of 3.8%. But given the current climate, uncertainty around debt, the election and divisive politics, the likelihood of more downward revisions is currently higher than lower.

**Generative Al Stealing from the Pie**

Generative AI is in some ways both a blessing and a curse. The excitement, potential and magic of LLMs is fantastic. It creates urgency and mobilizes teams to focus on creating new forms of value, new business models, restructure processes, etc. But given the economic climate, what we’re seeing is generally not a lot of new money coming into IT budgets at the top line. Rather there’s a reprioritization happening.

The chart above shows relative spending activity across the nearly thirty sectors in the ETR taxonomy. The vertical axis is Net Score for the sector, which is ETR’s proprietary measure of spending momentum. It essentially represents the percentage of customers that are accelerating spending in a sector by netting out those that are managing spending levels that are flat to down. The horizontal axis shows Sector Pervasion which is calculated by the number of customers spending in a particular sector divided by the total N of the survey, which is around 1,725. Think of it as a proxy for market presence on an account basis, not a dollar basis.

The red line at 40% represents a highly elevated spending level. Note that during the pandemic, Cloud, Containers, RPA and AI were the four sectors consistently above 40% on the Y axis.

The squiggly line at ML/AI represents the change in position over time. Spending levels in AI began decelerating in late 2021. Firms had over-rotated a bit on the sector and we’re directing funds to refresh
infrastructure as we exited the isolation economy. But then ChatGPT is announced and the accelerated momentum returns. Almost every other sector – not all but most – started to decelerate on the vertical axis, which is an indication of shifting budget priorities to fund AI.

With generative AI, clear business value is still being sought. Budgets remain tight and other projects are being delayed while the AI experiments ramp up.

The Spending Momentum Leaderboard - OpenAI Tops all Names

Generally, established tech companies are adapting to this new reality. Many series B and C startups that either aren’t AI companies, and/or haven’t nailed product or go to market fit are struggling. However mainstream enterprise tech firms raised a lot of capital during COVID, they have strong balance sheets, they’re making moves like Cisco with Splunk and many, like CrowdStrike & Palo Alto Networks are growing. Big name bellwethers like Dell are throwing off cash and, in the case of Dell, it’s promising to return 80% or more of free cash flow back to back to investors. So company managements have generally adjusted nicely and have revised earnings estimates to what appear to be conservative levels.

The chart below shows the leaderboard in terms of spending velocity or Net Score on their respective platforms.

In general, the leaderboard is seeing downward spending momentum

<table>
<thead>
<tr>
<th>Vendor</th>
<th>Net Score</th>
<th>Y/Y Delta</th>
<th>S/S Delta</th>
<th>Adopt %</th>
<th>Increase %</th>
<th>Flat %</th>
<th>Decrease %</th>
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The chart shows the Net Score granularity in more detail with the percent of the citations shown in the last column (i.e. survey Ns). Net Score breaks down by new adoptions, spending increasing, flat spending, spending decreasing and replacements. Net Score is calculated by subtracting the spend lesses from the spend mores and that’s what you get in the green column.

Note the red line at 40% representing a highly elevated level.

You’re probably not surprised that OpenAI shot up to the #1 position and is holding that with a 78% Net Score. They are far ahead of any other player, even though their Net Score is down 10 percentage points from last quarter’s survey. But they weren’t even in the survey last year at this time and yet they have an N that’s higher than Databricks and Snowflake.
**Snowflake** was #1 in this metric for years and they came down to **Databricks’** level a couple of quarters ago. Snowflake’s Net Score continues to decelerate. Remember this is an account-based metric, it doesn’t reflect spending levels. Both Snowflake and HashiCorp have come down to earth and they each show a meaningful Y/Y Net Score decline. But also notice that this is largely due to the percent of customers shifting to flat spending as opposed to spending declines and defections.

**Wiz** is the other notable call out on this chart as we’re seeing a meaningful change both Y/Y and survey to survey.

ETR recently added a FinTech sector to its taxonomy and the data on Shopify and Stripe is interesting, but out of scope for this Breaking Analysis.

**Will AI Eventually be the Spending Icebreaker?**

We’re somewhat limited in how deep we can go with the current survey because ETR is in its quiet period and has two Webcasts this month to release its results. So for now we’ll leave it there and wrap up with some thoughts on what to look for in the months and quarters ahead.

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**Some thoughts on the market ahead**

- AI initiatives are not creating meaningful incremental funding
- Rather they’re stealing from other budget buckets
- While 75% of enterprise customers are actively evaluating GenAI, of those, the vast majority (80%) are still in eval mode - with privacy, legal & compliance concerns presenting key hurdles before deployment
- Until until definitive business value can be realized via labor cost reductions or revenue generation, it is likely that the spending climate will remain cautious as higher for longer appears to be the new normal
- Right now, prudent guidance from company managements is in play & comps are easier...a significant shift in sentiment however could bring estimates down.

As we’ve highlighted, thus far, AI initiatives are not creating meaningful incremental funding for ITDMs. Rather they’re stealing from other budget buckets.

While 75% of enterprise customers are actively evaluating GenAI, of those, the vast majority (~80%) are still in eval mode – with privacy, legal & compliance concerns presenting key hurdles before production deployment is feasible. While plenty of “shadow AI” activity is happening, the risks are more in focus than was the case in previous cycles such as cloud and Big Data.

In our view, until until definitive business value can be realized via labor cost reductions or revenue generation, it is likely that the spending climate will remain cautious as higher for longer interest rates appears to be the new normal.

Right now, prudent guidance from company managements is in play and comparisons are somewhat easier than they were coming out of the pandemic. But uncertainty remains and a significant shift in sentiment...
could bring earnings estimates down and cause market ripples.

The world is eagerly waiting for AI to widely benefit firms beyond Nvidia, Internet giants and the pure play AI companies. The real test of AI in our view will not only be the benefit that accrues to technology firms, but rather the adopters of AI across all industries. Meaningful increases in productivity can address economic headwinds, a sizzling job market and drive earnings growth. But until then, that will require technologies such as generative AI to go into production at scale and drive clear business value.

Until there’s clear evidence of economic impact, it’s best to keep watching for icebergs in the waters.

Keep in Touch

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Remember we publish each week on Wikibon and SiliconANGLE. These episodes are all available as podcasts wherever you listen.

Email david.vellante@siliconangle.com | DM @dvellante on Twitter | Comment on our LinkedIn posts.

Also, check out this ETR Tutorial we created, which explains the spending methodology in more detail.

Watch the full video analysis:

Image: patpitchaya

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