



CLABBY ANALYTICS

Opinion

Oracle: The Great Systems/Application Integrator?

Executive Summary

In one of the most brilliant competitive moves in the industry over the past several years, Oracle Corporation recently decided to purchase Sun Microsystems for \$7.4 billion — and, by so doing, thwart IBM's plans to take over Sun's product lines and installed base. By buying Sun, Oracle can prevent IBM from strengthening its hardware product line with Sun technologies and patents; it can exercise controls over IBM's direction in the Java world; and it can expand into new businesses (such as remote office support, Open Office, systems support/maintenance, hosted services, and cloud computing).

But, was the acquisition of Sun really worth \$7.4 billion? If you believe that Oracle wants to challenge IBM as a top-to-bottom, hardware/software/services systems integrator — then maybe “yes”. But *Clabby Analytics* (that's me) believes that Oracle will ultimately jettison Sun's hardware business (R&D investment required is too high — and margins are too low); farm out Solaris (does Oracle really need to control a commodity operating environment?); and, make little effort to improve its newly acquired My/SQL database (because that database competes with its own database products). Plus Oracle really doesn't need Sun's virtualization and provisioning middleware environment; nor will it necessarily need Sun's professional services business.

The bottom line: Oracle will not get \$7.4 billion worth of value out of its Sun acquisition in the near term. But its move to prevent IBM from buying Sun may have prevented IBM from acquiring Sun and quickly trebling its investment (IBM's synergies from a Sun acquisition were far greater — hence IBM could have better leveraged an investment in Sun to grow its hardware, software and services businesses). Accordingly, Oracle's move to buy Sun makes very good sense from a competitive perspective.

Introduction

When Lawrence Joseph “Larry” Ellison, Oracle Corporation's chief executive officer, announced his company's plan to acquire Sun Microsystems for \$7.4 billion, Mr. Ellison claimed: “Oracle will be the only company that can engineer an integrated system — applications to disk—where all the pieces fit and work together so customers do not have to do it themselves.”

On face value, this is a laudable statement. *Clabby Analytics* (that's me) is a strong believer that information technology vendors should perform a lot more applications/-systems integration in order to save their customers the time and great expense related to performing applications/infrastructure/systems integration work.

The big question on the table is this: “will the purchase of Sun really help Oracle simplify the task of applications integration for its customers?”

Oracle: The Great Systems/Application Integrator?

If you look closely at what Oracle would get in its proposed Sun acquisition, Oracle would acquire:

- Sun systems and storage hardware (note: Sun's RISC hardware business has been on the decline for years. And the acquisition of Sun's x86 product line puts Oracle in direct competition with several of its most precious business partners);
- A variety of Sun infrastructure products (virtualization, provisioning, etc. — products that Oracle already has);
- Sun Solaris (Unix) operating environment (Unix sales are on the decline thanks to the erosive effect of Linux — so is acquiring a Unix a real good idea?);
- Sun systems/storage/network management products (Oracle already has a strong suite of management products);
- A variety of new applications (Open Office, remote desktop, etc). Oracle needs to decide if these types of applications strategically important to mission. If so, will Oracle invest heavily in these environments in order to build its presence in office environments? And, does Oracle really want to go head-to-head with Microsoft with Linux-based alternative solutions?)
- Control of the billion dollar Sun MySQL open source database blunder; and,
- Control of the Java language environment (Sun has never really made any money with Java — so how will Oracle magically make money in this space?)

The bottom line: Oracle is already building integrated application solutions that run from application-to-disk on a wide number of platforms. With a Sun acquisition, the only thing that really changes for Oracle customers is that Oracle will own its own hardware (a failing RISC platform and a low margin x86 platform — and storage). Yes, Oracle will get some new applications, and a programming language environment (Java) — but does the acquisition of these orthogonal components really help Oracle drive more value to its customers? Clabby Analytics thinks not!

A Close Look: The Problems With Oracle's Plan

Clabby Analytics sees the following problems with Oracle's new strategic plan:

- The purpose of information systems is to help businesses flow business processes. Efficient business process flow leads to organizational efficiency — and organizational efficiency translates into better profitability. To truly help its customers, Oracle is going to have to do far more than just provide integrated applications that run on Sun systems and storage. Oracle is going to have to build a professional services organization to help its customers flow processes.

What Oracle really needs is a professional services organization that is focused on creating streamlined business process flows.

- Who wants Sun's RISC hardware? Sun's reduced-instruction set (RISC) medium and high-end servers have been on the decline from a sales perspective for years. Is Oracle really planning on building its turnkey solutions on a declining hardware platform? And if it is, is Oracle prepared to spend millions of dollars to revamp Sun's RISC line — and even more money to fix Sun direct and indirect channel

Oracle: The Great Systems/Application Integrator?

distribution problems. And, will Oracle really invest in a new marketing campaign to drive sales of its RISC products? (Remember, Sun's RISC products are low-volume, high-margin. To increase sales, Oracle will need to cut prices substantially on its RISC line — thus creating an unattractive low-volume, low-margin situation).

- Sun's x86 product line is well-engineered and performs extremely well. But that product line competes head-to-head with x86 products from Oracle's closest business partners (Dell, IBM, and Hewlett-Packard). In the case of Dell, Oracle/Dell and Red Hat (Linux) have a particularly strong partnership. Does Oracle really want to alienate its business partners and jeopardize its partner relationships by competing for low margin hardware business against companies who are very successfully moving its software products to market?
- What infrastructure software is Oracle really getting that it doesn't already have? Oracle has a strong Web services standards-based middleware offering (Fusion) that makes it possible for programs to communicate with other similar and dissimilar programs. From an infrastructure/middleware perspective, a Sun acquisition would give Oracle some pretty good virtualization and provisioning software (but Oracle already has virtualization and provisioning products — so what would it really gain?).
- How does owning an operating environment really advantage Oracle? Yes, Solaris is a very popular operating environment (declining in share of the RISC market, but with a good-sized install base on x86 architecture). Note, however, that x86 buyers are showing strong preference for the Linux operating environment. So how much will Oracle really be willing to invest in an operating environment that is on the downswing?
- Control of the Java language/environment could enable Oracle to make life difficult for vendors who depend on Java infrastructure. (Oracle could put up roadblocks and restrictions on the use of Java — and thereby advantage itself). But the Java environment was meant to be a rallying point for all of the industry and an alternative to Microsoft's .NET environment. If Oracle decided to take an adversarial position with Java, it would be shooting itself in the foot (because open source vendors and IT buyers would react very negatively to Oracle meddling with Java). And,
- Oracle will get some decent systems and storage management products out of this deal, should it occur. But does Oracle really want to be in the systems/storage management business (Oracle is an applications and database company — is moving into platform and storage management in its strategic best interest?)

What Is Oracle Really Getting Out of This Proposed Acquisition

Oracle's stated goal is to help its customers by simplifying the job of application integration. To simplify application integration, IT buyers need:

Oracle: The Great Systems/Application Integrator?

1. *Good middleware* — Web services-based middleware simplifies program-to-program communications. XML simplifies data exchange. Oracle already offers products that do this.
2. *Tuning/integration services* — Oracle already does this in two ways. Oracle creates packaged products that are turnkey when delivered to its customers. They can easily deploy these packages on their chosen hardware. And Oracle has tuning/optimization services that it currently offers.
3. *Application management products*. And,
4. *The ability to expand in hosted services*.

Oracle already provides good middleware, tuning/integration services, and application management products!!! A Sun acquisition offers little in the way of improvements to Oracle's Fusion environment. A Sun acquisition offers little in improvements to Oracle's tuning and integration services (unless Oracle really wants to focus on tuning its products specifically for Sun environments). Sun does have some decent application management products — but do those alone products justify Oracle's \$7.4 billion proposed acquisition? I think not...

Oracle's New Market Position: It Changes — But Why?

Mr. Ellison's statement (first paragraph of this *Opinion*) is indeed “literally” correct. Oracle will be positioned as an:

- Application maker (enterprise resource planning, customer relationship management, supply chain management, and so on...);
- Maker of systems/storage infrastructure; and as a
- Maker of systems/storage hardware.

By contrast, IBM is a maker of systems/storage hardware and infrastructure products — as well as a professional services provider. Hewlett-Packard (HP) is a maker of systems/storage hardware and some infrastructure products (although HP does not make its own middleware products — which *Clabby Analytics* considers to be a major strategic blunder) — as well as a professional services provider. Dell is a maker of hardware and management products — and relies on third parties to provide infrastructure and applications solutions that Dell tunes and optimizes for its systems/storage environments. And Microsoft is a maker of application solutions and infrastructure products — but does not build systems/storage hardware.

By virtue of building its own applications (unlike its major competitors) that can run over its own infrastructure, that could run on Oracle hardware — Oracle would indeed achieve a unique position in the information systems marketplace if its Sun acquisition plan does indeed go through. But does this unique position really benefit Oracle's customers? Or would they benefit more greatly if Oracle focused on business process flow integration. Clabby Analytics believes the latter.

Why Oracle Will Jettison the Sun Hardware Business

There are three reasons why Oracle will ultimately jettison Sun's systems and storage hardware should its acquisition bid succeed. They are:

Oracle: The Great Systems/Application Integrator?

1. *Oracle is a software company* — To date, Oracle has been a software company (akin to Microsoft). Its expertise is in software engineering and software integration and deployment. Moving into the hardware business would be a huge departure from its strategy to date.
2. *Deep investment for low margins* — Sun essentially offers two lines of server hardware: its x86-based servers and its UltraSPARC/T1/T2 servers (high-end Unix/Linux servers). Margins on x86 based servers are comparatively lower than on high-end systems. And Sun has been losing market share in the high-end segment of the market (where Oracle could make better margins). For Oracle to stay in the Sun hardware business, Oracle would need to invest heavily in Sun high-end server hardware to make them more competitive with high-end servers from IBM and HP. And Oracle would have to be willing to live with low margins in the x86 market segment. Without heavy investments, Sun hardware would start to lag its competitors.
3. *Alienation of its business partners* — If Oracle does decide to stay in the systems hardware business, it will alienate its strongest systems integrator partners (particularly Dell — a company that has a strong strategic business relationship where Dell provides the hardware, Red Hat provides Linux, and Oracle provides the middleware/database/management environment). But it is also reasonable to assume that HP and IBM will be less than thrilled about bringing Oracle into deals where Oracle could take server and storage revenue from each respective company.

Summary Observations

Oracle's planned acquisition of Sun is a brilliant defensive move. By acquiring Sun, Oracle has prevented IBM from gaining control of some technologies that IBM could readily leverage — potentially trebling its investment in the short haul. Oracle did not have equivalent hardware, software, and services synergies with the Sun product line — and hence will not be able to leverage as much value out of its acquisition.

Will Oracle really get into the top-to-bottom, integrated systems business? I think not. Oracle's current software operating margin is in the 46% range. Does Oracle really want to deal with substantially less margin selling hardware? (Note: Sun's hardware business generates about \$9 billion annually — but still...).

In addition, this proposed acquisition would definitely create some go-to-market challenges for Oracle. Oracle counts on other vendors' feet-on-the-street (direct and channel sales organizations) to help move Oracle application and database solutions. Does Oracle really want to compete head-to-head with its channel partners? (If so, Oracle had better plan to spend another several tens-of-millions of dollars to strengthen its Unix/Linux RISC based product line; and to build and redeploy its own sales force around the world).

Finally, how will Sun customers make out after this acquisition? What is the future of Sun's RISC/cellular multiprocessing line? What is the future of Sun's x86 line? What will Oracle do to the Java movement? Will Oracle really keep Solaris — and invest heavily in it to keep it competitive? Will Oracle really expand Sun's remote office services and hosted services? Will Oracle actually keep Sun professional services alive?

Oracle: The Great Systems/Application Integrator?

Strategically speaking, Oracle's goal of providing completely integrated application/middleware/hardware solutions to its customers is exactly what Oracle should be doing. Clabby Analytics believes that IT vendors should aggressively use their engineering skills and expertise to build integrated solutions that lighten the systems/application integration load on their customers.

But the big question on the table is: "will the acquisition of Sun substantially help Oracle provide better integrated applications and simplified deployment to former Sun customers?" If Oracle keeps Sun's hardware, then the answer is "yes, Oracle customers who use Sun equipment — or are willing to switch to Oracle/Sun appliances — would likely benefit from the Oracle/Sun acquisition". But for the much larger share of Oracle's base, the customers who use Hewlett-Packard and IBM servers, the benefits will be negligible.

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