Market Insight: State and Local Government IT Market Primer, United States, 2015

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The more than $70 billion U.S. state and local government IT market is turning the corner with a renewed focus on modernization and innovation, along with budgets back in positive territory. We provide technology and service providers' strategy leaders with key trends and positioning considerations.

Key Findings

- U.S. state and local governments' IT organizations exited the Great Recession stronger than they entered it, and they are turning their attention to modernization and innovation, with stable IT spend through 2018.

- The state and local government market remains fragmented, but areas of procurement convergence are starting to take hold, and innovative procurement ideas are opening the door to new thinking.

- During the next five years, state and local jurisdictions represent an attractive point of entry for digital innovation in emerging technologies, such as citizen engagement platforms or IoT.

- Traditional providers still dominate, but a new vendor ecosystem is emerging, especially within vertical-industry-specific software providers that are often funded by venture capital, tech incubators or crowdfunding platforms.

Recommendations

- Align your go-to-market strategy around the user tiering/agency/solution segmentation best-matched to your capabilities and ability to differentiate in a fragmented but slowly converging market.

- Recognize that IT acquisition and contracting practices are evolving to support increased flexibility and agility. Stay competitive by reviewing your agile software development capabilities, licensing terms or subscription fees in advance of procurement reforms.

- Evaluate new shared-risk business practices, and clearly articulate strategic value and return on investment.

- Invest in technologies and skill sets that will continue to be in high demand: cloud, analytics, health, human services and public safety. State and local governments also will likely be at the forefront of IoT adoption for infrastructure support and smart city deployments; now is the time to get on the ground floor.

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Analysis

This document provides critical inputs to the creation of a business plan for entering or launching new products and services in the U.S. state and local government IT market. This report is intended to provide technology and service provider (TSP) organizations' strategy leaders with a quick reference guide to:

- The business context in which state and local jurisdictions operate

- Key features of the market forces, challenges and competitive landscape

- Frameworks and tools to identify market segmentation, acquisition trends, and technology drivers toward effective market positioning and messaging

Macro Trends

U.S. state and local IT organizations exited the Great Recession stronger than they entered it, and they are turning their attention to modernization and innovation, with stable IT spend through 2018, despite the uncertain outlook for continued growth in federal grants worth more than $600 billion per year..

The public-sector IT market and its spending priorities are directly tied to economic conditions and political trends.

Economic Backdrop

Per a recent report by the National Association of State Budget Officers, the slow return to economic recovery is continuing, with "43 states enacting higher spending levels in fiscal 2015 compared to fiscal 2014." Some headwinds should be noted, however: Many state and local governments continue to deal with issues of infrastructure maintenance (for example, roads and bridges), or large pension liabilities that are threatening discretionary budgets. The dropping price of oil is also starting to impact energy-dependent states, such as Texas, Alaska, New Mexico and Louisiana, and a handful of states, such as Maryland and Virginia, still face deficits close to or exceeding $1 billion in their upcoming fiscal years.

Political and Budgetary Environment

Significant changes occurred in the political landscape in the November 2014 elections. At the state level, the Republican Party won control of the governor's office in 31 states and the legislature in 30 states. It now controls both the governor's office and the legislature in 23 states, while 20 states have divided control. At the federal level, the Republican Party won control over both chambers of Congress. With the debt ceiling debate lingering and sequestration remaining the law of the land until a compromise is found, cuts in domestic discretionary spending — which funds state and local execution of more than 1,100 programs, such as Medicaid, Temporary Assistance for Needy Families (TANF) and Community Development Block Grants — could be on the horizon. The American Recovery and Reinvestment Act (ARRA) provided critical support to smooth budget imbalances, particularly in social services. Other legislation, such as the Affordable Care Act, has

accelerated technology modernization in selected areas, such as incentive payments, health insurance exchanges and electronic health records. All told, state and local governments end up with a heavy reliance on federal legislation and more than $600 billion in federal grants, which could all change based on political outcomes and changing voter priorities. The Congressional Budget Office reported that the $607 billion spent in 2011 "accounted for 17 percent of federal outlays, 4 percent of gross domestic product (GDP), and a quarter of spending by state and local governments that year."

Based on the balance of all these forces, Gartner's fourth quarter of 2014 enterprise IT forecast shows that state and local enterprise IT budgets will return to modest growth in 2015 (see Table 1).

Table 1. State and Local Government IT Market Forecast

	2012	2013	2014	2015	2016	2017	2018
IT Market ($M)	73,018	70,889	69,930	70,673	71,984	72,875	74,207
Growth (%)	-	-2.92	-1.35	1.06	1.86	1.24	1.83

Source: Gartner (February 2015)

By and large, state and local governments' IT organizations exited the Great Recession stronger than they entered it. They had to learn how to do more with less, and one of the byproducts was increased centralized IT authority and governance. During the recession, they curtailed operational spending, prioritized cost containment/avoidance, extended the life cycles of major assets, pushed new requirements to future years, and consolidated agency/process areas. As the financial situation stabilized and federal stimulus funds appeared, they started looking to the future. These organizations are now moving on from cost-cutting mode to innovation and increased use of technology solutions to deliver services. They have streamlined business processes, have created more-powerful shared-service organizations and have started to adapt more-cooperative procurement processes; they are showing significant interest in cloud-based models and IT outsourcing initiatives. Government CIOs and CFOs increasingly require new technology projects to drive operational savings or impact bottom-line revenue. Technology strategies that cover these issues are built into IT cost optimization, and they can drive cost containment, cost avoidance, revenue maximization or revenue generation. ERP system modernization, streamlined case management systems and solutions to detect improper payments are examples of programs that directly support these outcomes and will continue to be in demand. In an effort to raise monies and manage processes differently, many governors are also looking at business cases for privatization of services, such as HR management, jail management or utility services.

Market Positioning

The state and local government market remains fragmented, and a user tiering/agency/solution segmentation approach is still needed; however, areas of procurement convergence are starting to take hold, and innovative procurement ideas are opening the door to new thinking.

The state and local market is one of the most fragmented and decentralized vertical markets in the U.S. There are 50 states, more than 3,200 counties and approximately 19,000 cities. Thus, its structural differentiation is in contrast to the federal government market, and providers must not simply establish a pointed go-to-market strategy according to the major levels of government (state, county and municipal) but, rather, divide it into three major strategic lines to effectively address and resource this diverse market: user tiering/agency/solution segmentation.

User Tiering

The state and local government market is extremely broad, and providers need service offerings and messaging strategies in place that pare the size and diversity of state and local governments into manageable subgroups. A user tiering approach offers a starting point for providers to classify targeted messaging, pricing and penetration strategies. Providers must recognize that the size of a jurisdiction can offer considerable market distinction and direction. With new technology models, such as cloud-based services, providers can build more-effective targeting approaches via a user tiering strategy.

Figure 1 provides an example of a traditional user tiering map for the state and local government market. Each tier represents organizations with similar IT budgets, complexity of system integration requirements, utilization rate of external providers and buying characteristics.

Figure 1. State and Local Market User Tiers

Tier 1	Tier 2	Tier 3	Tier 4	Tier 5
Top 30 States	States 31-50	No States	No States	No States
Top 10 Counties	Counties 11-50	Counties 51-150	Counties 151-350	Remaining Counties
Top 10 Cities	Cities 11-50	Cities 51-150	Cities 151-350	Remaining Cities

Tier 1	Tier 1A	Tier 1B	Tier 1C
Top 30 States	States 1-4	States 5-14	States 15-30
Top 10 Counties	Counties 1-3	Counties 4-7	Counties 8-10
Top 10 Cities	Cities 1-3	Cities 4-7	Cities 8-10

Source: Gartner (February 2015)

The first tier represents the largest state and local government accounts (top 30 states, top 10 counties and top 10 cities, by population size). It is important to span all levels of government, because jurisdictions such as Los Angeles County or New York City have more-sophisticated IT requirements and greater spending flexibility than many states. In addition, although there is a smaller proportion of overall government segments in the first and second tiers, these agencies represent the majority of IT spending in the state and local governments. Often, TSPs view Tiers 3

and 4 as equivalent to the small-and-midsize-business market. The fifth tier represents mostly small resellers, localized providers or nothing at all. Increasingly, Tiers 3, 4 and 5 represent important areas of potential cloud adoption.

When reviewing Figure 1, it is important to note that each tier can be subsegmented to provide further market penetration. The lower the tier, the more organizations there are to target, and subsegmentation may be more suitable. For example, Tier 1 has only 50 targets, whereas Tier 4 has 400 entities.
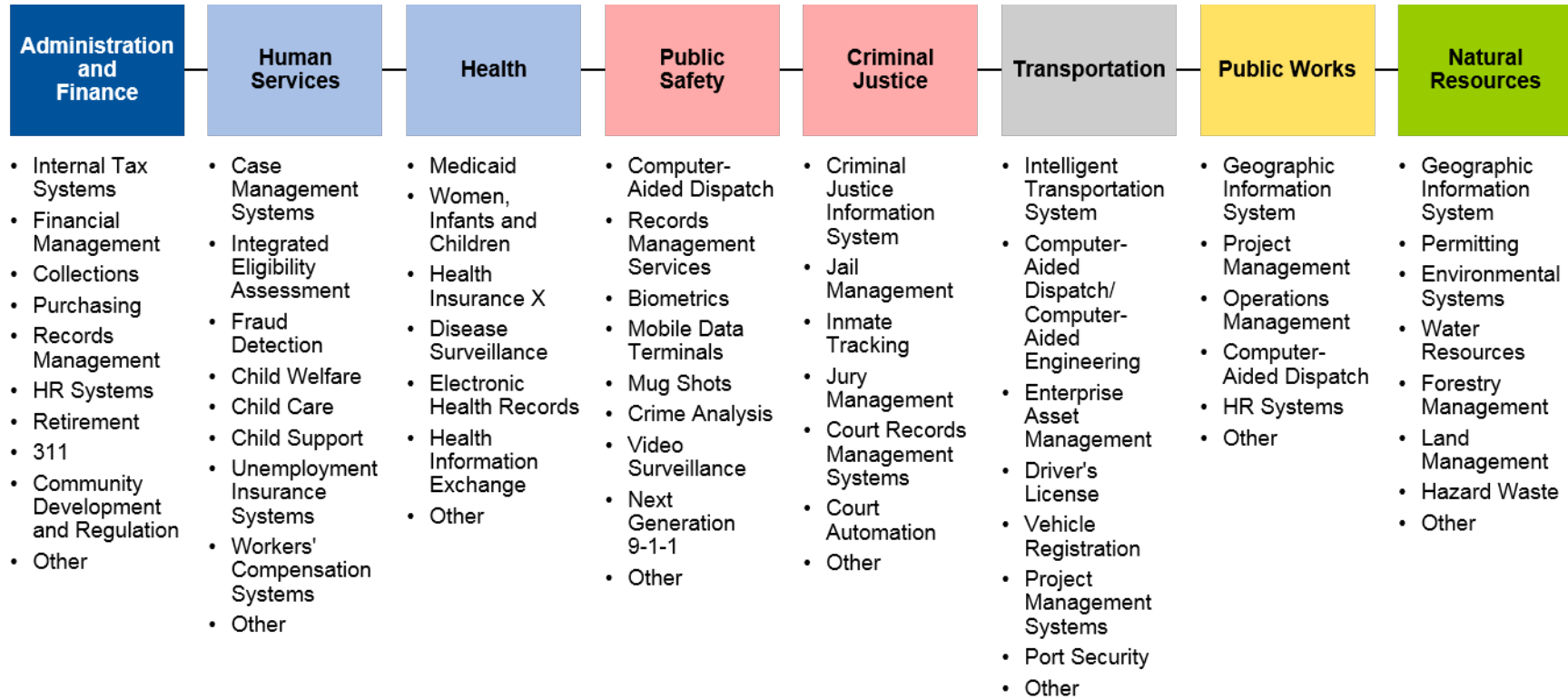
Given the depth and breadth of state and local governments, entrants new to this market choose to focus on a single tier at a time and then proceed linearly, depending on relative positioning. Local government software providers often begin at Tier 4 and focus their expansion opportunities upward, whereas large providers compete over Tier 1 agencies and strive to redefine service/pricing offerings to move downward.

Beyond tiering, vendors should also incorporate agency and solution maps into their segmentation approach.

Agency and Solution Maps

The agency map helps in understanding the major agency silos in the state and local government market and how to target distinct decision makers. TSPs must align large-scale modernization efforts according to these segments, where the majority of budgetary authority still resides. The state and local government solution map allows providers to link technology developments with segmented business processes and solutions that drive IT initiatives. Providers must be able to discuss the agency's cornerstone applications that form agency modernization plans and support major business processes, as well as allow for flexibility in adapting to emerging solutions that become foundational spending areas. These solutions often underscore net new spending in the marketplace. We have aligned the agency and solution map (see Figure 2) for ease of use, color matching the ones closely aligned.

Figure 2. State and Local Governments' Agency and Solution Map

Administration and Finance	Human Services	Health	Public Safety	Criminal Justice	Transportation	Public Works	Natural Resources
• Internal Tax Systems • Financial Management • Collections • Purchasing • Records Management • HR Systems • Retirement • 311 • Community Development and Regulation • Other	• Case Management Systems • Integrated Eligibility Assessment • Fraud Detection • Child Welfare • Child Care • Child Support • Unemployment Insurance Systems • Workers' Compensation Systems • Other	• Medicaid • Women, Infants and Children • Health Insurance X • Disease Surveillance • Electronic Health Records • Health Information Exchange • Other	• Computer-Aided Dispatch • Records Management Services • Biometrics • Mobile Data Terminals • Mug Shots • Crime Analysis • Video Surveillance • Next Generation 9-1-1 • Other	• Criminal Justice Information System • Jail Management • Inmate Tracking • Jury Management • Court Records Management Systems • Court Automation • Other	• Intelligent Transportation System • Computer-Aided Dispatch/Computer-Aided Engineering • Enterprise Asset Management • Driver's License • Vehicle Registration • Project Management Systems • Port Security • Other	• Geographic Information System • Project Management • Operations Management • Computer-Aided Dispatch • HR Systems • Other	• Geographic Information System • Permitting • Environmental Systems • Water Resources • Forestry Management • Land Management • Hazard Waste • Other

Source: Gartner (February 2015)

Depending on the jurisdiction, state and local government organizations may have more than 100 agencies, each with its own agenda, responsibilities and ideas regarding government service delivery. Providers must align their market offerings with state and local government segments and the unique dynamics of those segments, identify and group the major agencies that direct IT spending across state and local governments, and incorporate other agencies within those major groupings. Gartner has identified eight such groupings that best cover the diversity of functions within the state and local governments.

When reviewing Figure 2, keep in mind that although these eight major groupings represent the majority of IT spending, each grouping also has a different impact based on the level of government. For example, public safety is usually more locally based, whereas healthcare will have greater weight among state-level jurisdictions. Similarly, different agencies are impacted by federal government legislation and mandates. Lately, the focus on the Affordable Care Act has made an operational and technology impact on state departments of health and insurance.

The technology solutions outlined are representative of larger-scale agency modernization initiatives and cornerstone issues within each segment. Providers can use this map to link agency requirements with agency-specific strategy.

As providers build strategies, they must understand how business processes are supported by technology solutions. To this end, Figure 2 can be used as a road map in understanding agency-specific requirements, highlighting product functionality within core solutions and aligning messaging to reflect solution activity.

As vendors consider their channel strategies, they also need to be cognizant of the state and local procurement approaches.

Procurement Trends

Sales cycles in government are multifaceted. The time frame associated with government sales can vary from six months to three years, as projects can be delayed, given current budgetary constraints. However, the typical procurement cycle is 12 to 18 months, with complex decisions on the longer side (outsourcing) and work in smaller jurisdictions on the shorter side of the spectrum.

Figure 3 outlines the major steps in a traditional state and local government agency procurement cycle. The first phase typically focuses on an internal needs assessment, which is then forwarded on to the agency director and procurement body. This is an important step in the process and is sometimes ignored by providers new to the market. By injecting themselves at the ground level and influencing the initial strategy and requirements developed by the agency, providers can increase their visibility and market positioning.

Figure 3. State and Local Governments' Procurement Process
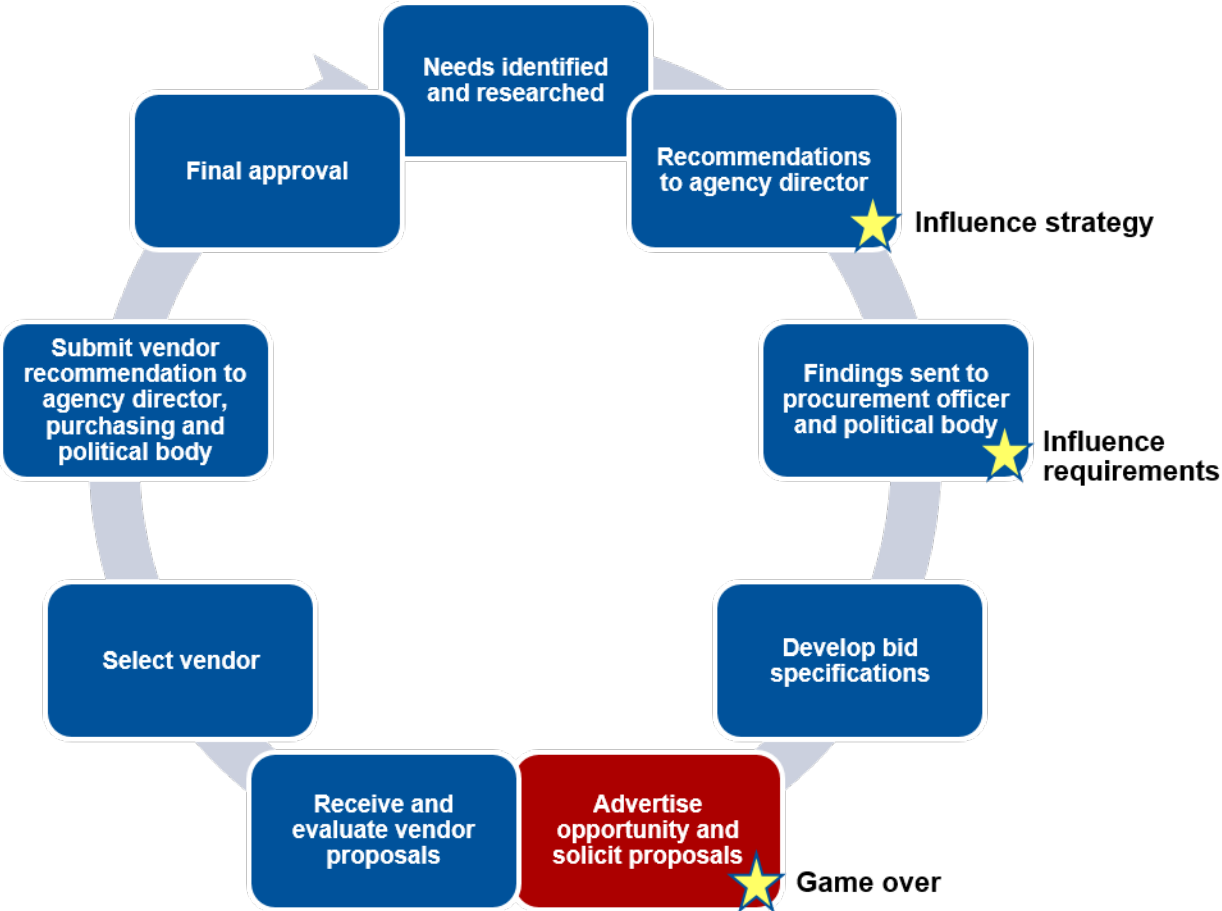
Source: Gartner (February 2015)

Another way to increase market positioning is by looking at the second phase of the procurement process, in which there is typically emphasis on creating final requirements, developing the RFP, and soliciting and receiving proposals. Providers must become part of the process at this point or before; otherwise, traction is lost.

The last two procurement phases are internally focused and necessary components for winning contracts: evaluation and recommendation/approval. The evaluation process can separate providers from one another in a competitive environment, often changing a static proposal into a working document that creates future strategy and utilizes the technology initiative to impact business. Once selected, there is still the agency director and procurement organization's final signoff, as well as finalization of contract terms.

Looking at the big procurement picture, TSPs must keep the following top of mind:

- Invest in the long term, given the length of the procurement cycle.

- Maximize visibility with key decision makers and influencers.

- Be prepared to represent traditional technology development (for example, system integration), as well as emerging technology options (for example, long-term application outsourcing [AO] contracts).

- Zero in on new budget realities and governors looking to drive alternative ways of procurement: cloud, business benefits and long-term AO contracts.

- Target states seeing the biggest change, with politics being a potential accelerator.

While the traditional procurement approaches we describe above remain prevalent, two emerging trends are worth noting: convergence in procurement practices from a multitude of angles and innovative acquisition practices.

Examples of convergence in procurement practices include:

- The Western States Contracting Alliance/National Association of State Procurement Officials (WSCA/NASPO) multistate consortium. This contracting alliance allows for several Western states to pull their resources and leverage greater economies of scale to procure goods and services at a better cost. This alliance provides not only productivity and cost savings to member states, but also opportunities to aggressively mine the contract for the vendors that manage to gain a seat at the table.

- Cooperative procurement services, such as provided by the state of Missouri.

- States becoming providers to other states, such as the Oklahoma Office of Management and Enterprise Services - Information Services Division (OMES-ISD) entering into an agreement to make the Texas Department of Information Resources (DIR) its "preferred source."

- Broadly scoped statewide IT contracts with a single vendor: for example, the $681 million Unisys hybrid cloud deal in Pennsylvania, or the Los Angeles County's move to Microsoft's hosted Office 365 platform for its 100,000 employees.

- Increased recognition that federal General Services Administration (GSA) contract vehicles are also available for use by state, local and tribal governments for a number of areas:

  - Cooperative Purchasing: A variety of IT products and services, as well as security and law enforcement products and services, are available through Schedule 70 and Schedule 84. According to a GSA blog, "the usage of Schedule 70 by state and local governments increased almost 30% last year to $846 million in volume."

  - Disaster Purchasing: Goods and services to aid in the recovery from presidentially declared major disasters or acts of terrorism.

  - Public Health Emergencies (PHEs): Goods and services, using federal grants, in direct response to Health and Human Services (HHS)-declared public health emergencies.

  - 1122 Program: Equipment in support of counterdrug, homeland security and emergency response activities.

Innovative acquisition practices emerging in the marketplace include:

- Proactive and cooperative terms and Conditions: Under the leadership of New Jersey state CIO E. Steven Emanuel and e.Republic's Center for Digital Government, a dozen state and local governments partnered with industry to release model contract terms to procure cloud services.

- Philadelphia's FastFWD initiative is offering challenges to startups to bring innovative solutions to the market faster.

- The sharing economy concept is also finding its way into the state and local government market, such as MuniRent, which helps municipalities rent equipment to each other.

- Zero-cost, outcome-based, shared-savings clause contracts are all options that state and local governments are increasingly becoming familiar with, and looking for ways to leverage.

- Social Impact Bonds (also known as Pay for Success Bonds) are contracts with the public sector, whereby payment is issued based on improved social outcomes that result in public-sector savings. Several states have introduced Social Impact Bonds legislation (for example, Maryland in 2013), and a few are already proceeding with pilots.

Messaging

While the technologies may be similar, every state and local government organization is unique, with a different culture, local politics, history, budget, expectations and governance. As such, for vendors that are maturing toward selling value and outcomes and not simply features, a "one size fits all" messaging strategy rarely works. In the latest Gartner CIO Survey, 95 state and local CIOs make one thing abundantly clear (see Figure 4): When it comes to metrics, the only two they seem to care about are return on investment and strategic value, so vendors should craft their messaging accordingly.

Figure 4. Responses From 95 State and Local CIOs on What Metrics Are Most Important to Them
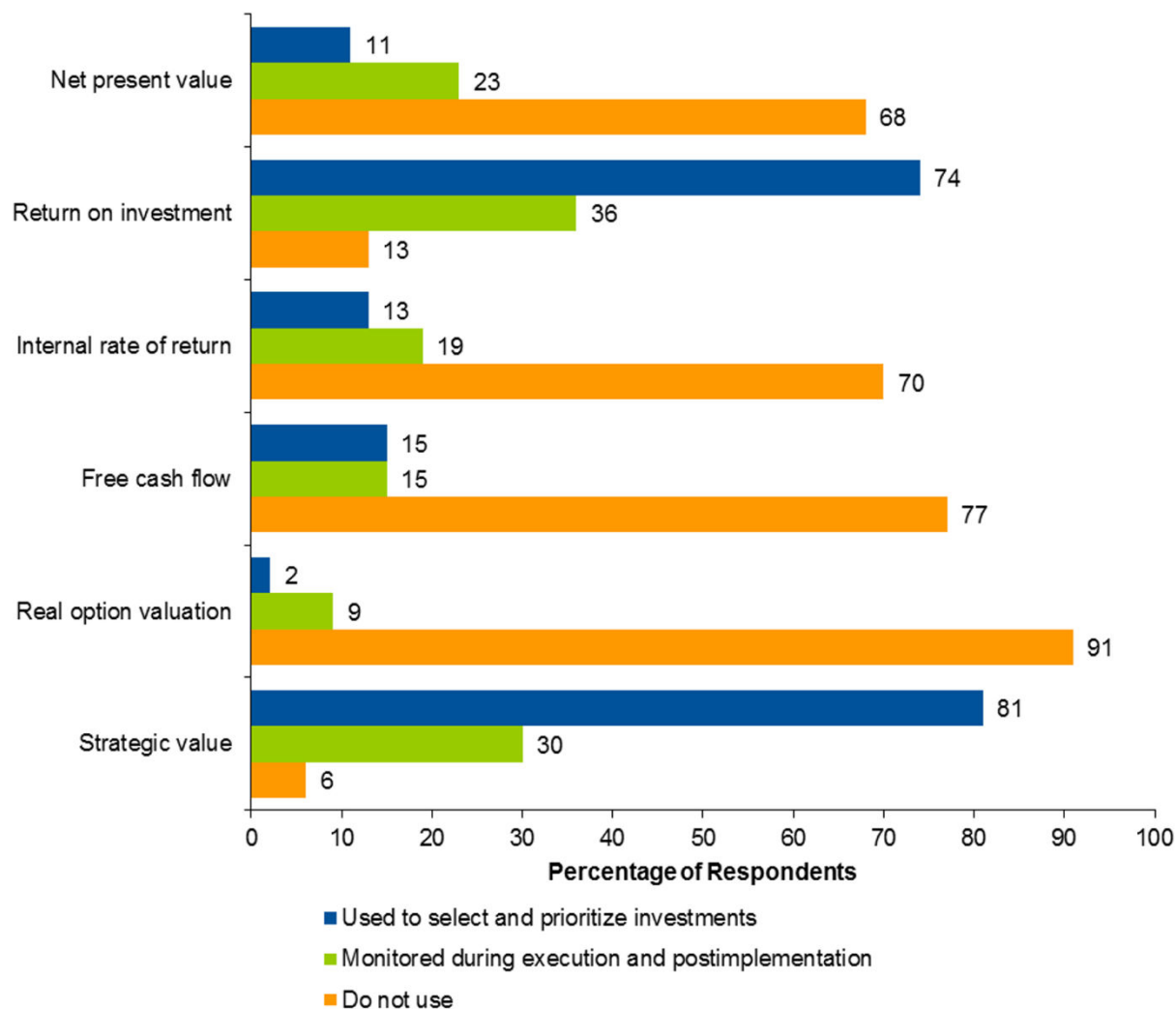
Source: Gartner (February 2015)

Technology Trends

During the next five years, state and local jurisdictions represent an attractive point of entry for digital innovations in emerging technologies, such as citizen engagement platforms or Internet of Things (IoT):

- **Focus on fraud/waste/abuse and improper payments —** Given the need to drive bottom-line savings, state and local governments have underscored technology strategies that identify fraud, waste and abuse activities. Moreover, many government organizations have also become more proactive in these areas by utilizing front-end services that detect improper payments to increase government efficiency. Technologies such as analytics help drive initiatives in these areas.

- **Opportunity in the cloud —** Budgetary pressures continue to force state and local government organizations to embrace new models for technology modernization. Cloud-based models that provide a different financing approach to technology modernization represent an important alternative to traditional on-premises-based initiatives, and they can allow even small municipalities with small IT budgets to leverage the computing power and infrastructure governance of large organizations. Presently, software as a service (SaaS) adoption continues to grow within small and midsize governments, as well as tertiary agency segments, but adoption of infrastructure as a service (IaaS) is picking up steam. Examples include the $681 million cloud deal between Pennsylvania and Unisys, or California's CalCloud deal with IBM. As providers respond to the cloud trend, they should acknowledge the likelihood of reduced blockbuster integration contracts, decreased proprietary development and greater drive to interoperability in solution development.

- **Rise of analytics —** State and local government organizations are increasingly turning to analytic tools to help understand the effectiveness of government service delivery. These tools can help pinpoint inefficient processes, target better cost-of-delivery scenarios, and help increase funding for more effective operations. Business intelligence and related tools are being actively incorporated in new agency modernization initiatives. Examples include the Indiana Management and Performance Hub and its initial focus on the state's infant mortality rate; the Florida Department of Children and Families' efforts to use data to identify at-risk children and families; the Iowa Workforce Development, which is applying big data analytics to detect unemployment fraud; and the Chicago SmartData project.

- **Focus on human services modernization —** The spike in demand for government services during the economic recession has forced many human services agencies to reassess their technology systems and plan for next-generation updates. Many human services agencies are investing in new eligibility/enrollment systems, case management frameworks, and modernization within state-automated child welfare information systems and unemployment insurance services.

- **Emergence of Next Generation 9-1-1 (NG9-1-1) —** The NG9-1-1 initiatives are transforming the technology framework for public safety organizations across the nation. Many efforts currently focus on wireless broadband services to incorporate new information feeds during the 911 process (from text and photo to live video services). As FirstNet deployment gets underway, it will provide substantial opportunity for additional broadband services, as well as modernization of traditional public safety applications, such as computer-aided dispatch, records management systems (RMSs) and video surveillance systems.

- **Health benefits exchanges (HBXs) —** The Patient Protection and Affordable Care Act created a new market for IT services through HBXs. These exchanges will be run by state health or insurance agencies, and they will provide government-mandated marketplaces for insurance offerings. Now that they are up and running, ongoing maintenance and enhancement opportunities will present themselves.

In addition, vendors should very carefully monitor the following areas:

- **The battle for local broadband —** Congress gave the Federal Communications Commission (FCC), under the Telecommunications Act of 1996, the power to regulate telecommunications services. Twenty states have outlawed or restricted municipal broadband networks, but the FCC could reverse those restrictions if it exerts this power. The outcome of this tug of war could have important implications for the types of solutions that vendors can deploy.

- **Open data policies —** From Connecticut to Palo Alto, California, "open by default" approaches are sweeping the country. Chattanooga, Tennessee, for instance, developed the ChattaData portal to share metrics on violent crime, job growth, and investment or literacy rates to track whether city budgets align to programs that work. This will open markets for innovative companies that can find a way to unlock value.

- **Emerging needs based on changing legislation —** States that have legalized marijuana consumption, such as Colorado, are now implementing case management systems.

- **Citizen engagement —** This area is starting to take hold around Next Generation 311 systems, as evidenced by the unprecedented number of customer contacts with New York City's 311 system in 2014: more than 28 million.

- **Public safety —** Besides FirstNet, many opportunities are developing around several areas, such as adoption of repurposed military technology, body-mounted cameras, predictive policing, or coordination with federal agencies.

- **Emerging technologies, including the following:**

  - IoT and smart cities

    - Chicago's Array of Things project uses sensors on light poles to collect local weather and air quality data, as well as pedestrian traffic estimates, in real time

    - A pilot program in Austin, Texas, is underway to ease traffic woes by utilizing drivers' smartphone data. The city rolled out a Traffic Management System, which allows engineers to change signal timing on most roads during and after events that are expected to draw in large crowds.

  - **Driverless vehicles —** Some states' Department of Motor Vehicles are now exploring privacy, security, safety, liability, proper usage and standardization issues.

  - **Wearables —** Pilots are already underway to evaluate the use of Google Glass for live public transport monitoring, or inspections and audits.

Vendor Ecosystem

Traditional providers still dominate, but a new vendor ecosystem is emerging, especially within vertical-industry-specific software providers that are often funded by venture capital, tech incubators or crowdfunding platforms.

The state and local government vendor landscape is broad and diverse, with many players targeting specific aspects of the marketplace. Providers can find opportunity within this arena by looking at it from different angles. Professional services firms, software providers, hardware companies and

agency-specific firms can take a more traditional approach, or define the market according to market leadership. The traditional approach for grouping the vendor landscape is by service line (consultants, integrators and outsourcers), software (enterprise versus point solutions), or level of government (state, county and municipal). However, this approach does not include any cross-sectional groupings for driving technology choices, strategic partnerships or areas in which providers are already operating. Gartner's approach segments the competitive landscape across four major categories, which better define market leadership:

- **Professional services firms —** Professional services firms dominate the top tiers of the state and local government marketplace. Their strategy includes both broad coverage and unique footprints: service orientation, agency specialization or state-specific success. Ever-changing technology requirements often help accelerate the success of professional services firms. The rollout of state HBXs has shone an interesting light on this group, with some performing particularly well and coming to the rescue of other states, while others came under fire for their performance. Examples of the major professional services firms currently in this space are Accenture, CGI, Ciber, Deloitte, HP, IBM, Maximus, Unisys and Xerox.

- **Enterprise software —** ERP firms, such as Oracle and SAP, have effectively created products for agency-specific processes like integrated tax management or human services case management. Similarly, content management and workflow firms have accelerated market offerings to service agency-specific processes.

- **Local government orientation —** Migrating downward through the User Tiering Map, competition from professional services firms drops significantly. Smaller software companies have been successful with local governments in their ability to provide better cost and implementation services. Some local-government-oriented firms have built a national presence or moved upward into Tier 1 or state-level accounts. These include firms like Accela, Cityworks, CSDC Systems, SunGard and Tyler Technologies. During the past two years, there has been rapid consolidation in this end of the market, with Infor acquiring Lawson Software and Hansen, or GovDelivery buying NuCivic to add Drupal-based analytics to its suite of government Web traffic solutions.

- **Agency-specific specialties —** Agencies drive large-scale modernization initiatives, and many firms specialize in agency-specific solutions. These companies have varying degrees of specialty — from providing alternatives to critical business issues facing the agency and representing innovative thinking, to having deep brand identity. Examples of firms in this space include CH Mack (health), Fast Enterprises (tax), Intergraph (public safety), Motorola Solutions (public safety), NIC (e-government), Social Solutions (human services) and Socrata (budget applications).

Against this backdrop, however, some interesting developments are starting to shake the ecosystem:

- Microsoft announced in late 2014 that it was aligning Azure, Dynamics CRM Online and Office 365 for Government into a suite specifically targeting all levels of the government market.

- Google announced in 2015 that it is setting up a mobile innovation lab for government.

- In 2014, Andreesen Horowitz, a venture capital firm, led a $15 million investment round in OpenGov; the Govtech Fund announced its intent to back 15 to 20 companies with initial investments around $500,000; and more states than ever are starting innovation investment funds.

- Civic tech companies are thriving, with a recent Knight Foundation report showing that 241 organizations have received more than $695 million in investment from 2011 through 2013, and there are more options than ever before to solicit investment opening via crowdsourcing platforms.

These developments bear watching, both by existing and aspiring vendors — the pace of change in service expectations, technology innovation and acquisition approaches will only increase, and the market landscape will likely change dramatically during the next five years.

Background and Context

The U.S. state and local government market is large, and it continues to evolve rapidly. Despite continued budgetary uncertainty, it is a market where technology has proven to be particularly helpful, as governments were asked to do more with less during the Great Recession. Vendors can find significant opportunities in this market based on the following considerations:

- **Market size —** Gartner forecasts that the state and local market will reach $74.2 billion by 2018. The public sector (federal as well as state and local government) represents the largest single vertical market in the U.S. If vendors are looking to diversify their market footprint, this is an opportunity-rich environment.

- **Forces driving change —** The political election cycle brings new executive leadership to state and local government enterprises every four years. This helps bring new and fresh executive decision-making ideas to ongoing service delivery needs. At the same time, citizens interact with government agencies mostly at the state and local levels, and they are increasingly savvy and demanding when it comes to digital experiences.

- **Continued need for efficiency —** Even in jurisdictions where revenue is increasing, the need for services outpaces budgets. State and local governments continue to look for solutions that help contain costs, drive citizen satisfaction and maximize utilization of all funding sources, including federal grants. Similarly, the need to have balanced budgets creates a whole new paradigm in the state and local government market, pushing enterprises to streamline government service delivery and maximize program efficiency via greater technology adoption.

State- and local-specific go-to-market considerations are as follows:

- **Established relationships —** Deep relationships with decision makers can position providers as trusted advisors, influence long-term technology planning, and fend off new entrants as uncertain or unproven commodities. Vendors new to the government industry should consider partnering with existing participants to establish credibility and relationships.

- **Public-sector acquisitions —** Vendors new to this market need to take into account several important differences from commercial market dynamics, such as prolonged sales cycles, nontechnical decision makers, aversion to risk and strict procurement guidelines.

- **Transparency and the money trail —** Budgeting, appropriations and funding in the public sector are subject to public disclosure, as well as jurisdiction/agency long-term technology plans, and government websites often post this information to their constituents. There is opportunity in this market for providers that invest time to utilize this public information to better position themselves for both short-term strategies and long-term initiatives.

- **Repeatability drives margin —** Providers have a distinct advantage in the state and local government market if they take advantage of the ability to repeat the implementation of applications and services over multiple jurisdictions/agencies. If successful, this vertical can become an extremely attractive market, providing a significant margin of opportunity for providers. Furthermore, users of these implementations can be the most influential advocates of a given technology and assist vendors in selling to additional government arenas, as there is a lack of traditional competitive forces among governments. The reverse is true as well: Untapped, those vendors unable to repeat implementations will fall behind the curve.

- **Customer loyalty provides expansion opportunity —** Just as repeatability drives margin and creates inroads across jurisdictions, customer loyalty creates a lowered cost of sales over time and drives additional expansion opportunities within existing client jurisdictions. Providers in a given jurisdiction can use their reputation to explore opportunities in other agency segments within the same jurisdiction.

- **Federal impact on state and local governments —** The federal government offers additional funding from matching technology funds, block grants or formula-/incentive-based monies, increasing the speed at which technology is modernized at the state and local government level. In particular, stimulus legislation and healthcare reform reflect a continued commitment to transfer monies to state and local government budgets. Federal matching grants and policy mandates are major drivers of new technology implementation in select agency segments, such as health, human services and transportation. However, lack of direction or adequate appropriation by the federal government can also decelerate technology development, as state and local agencies petition for more direction or resources. Providers have the opportunity to accelerate technology initiatives by assisting these agencies in their petition for federal funding and navigate federal guidelines.

- **Vertical of verticals —** The state and local government marketplace is often illustrated as a series of vertical market segments, with each agency depicted as its own silo (health, administration and finance, and transportation). Each of these silos, or market segments, frequently has significant authority to launch large-scale agency modernization initiatives on its own. As a result, there is a large degree of opportunity for providers to focus on just a couple of agency silos and view the other segments as future growth opportunities (new technology development, partnerships or acquisitions). Although shared-service organizations and empowered enterprise CIOs are increasing (in number and reach), agency CIOs are still largely responsible for driving large-scale agency modernization requirements. Providers must be

cognizant of jurisdiction-specific legislation and budgeting to determine how to target shared-service versus agency CIO buying centers.

- **Rich versus poor agencies —** Providers must recognize that just as there is a fluctuating impact of agency segments based on government level, there is also fluctuation between agency segments based on funding process. Rich agencies (that is, tax, human services and public safety) are those segments seen as central to government operations or those that have additional funding sources outside of the general fund. Poor agencies (that is, public works, criminal justice and natural resources) usually depend on the general fund to support large-scale technology development and are not traditionally prioritized by political enterprises.

- **Hiring insiders to get inside —** TSPs new to the state and local government market sometimes hire former government officials to assist with government business or to serve as a conduit to influence decision makers. Although it is a good strategy for breaking into the market, it does not seal the deal. Furthermore, given the increasing number of private-sector hires taken from the public sector, policies have been adopted to limit business development by these individuals for defined periods. In addition, when dealing with high-level executives, the election cycles can quickly erode any given individual's connections.

The Impact

The U.S. state and local IT market is far from static. With change vectors in demand, budgets, technologies, procurement and contracting, or even the competitive landscape, vendors must stay vigilant and revisit their strategic plans at least yearly. As a result, as a strategy leader you should:

- Align your go-to-market strategy around the user tiering/agency/solution segmentation best matched to your capabilities and ability to differentiate in a fragmented but slowly converging market.

- Recognize that IT acquisition and contracting practices are evolving to support increased flexibility and agility. Stay competitive by reviewing your agile software development capabilities, licensing terms or subscription fees in advance of procurement reforms.

- Evaluate new shared-risk business practices, such as consumption-based pricing, zero-cost contracting or public-private partnerships, and clearly articulate strategic value and return on investment.

- Invest in technologies and skill sets that will continue to be in high demand: cloud, analytics, health, human services and public safety solutions. State and local governments will also likely be at the forefront of IoT adoption for infrastructure support and smart city deployments; now is the time to get on the ground floor.

Conclusion

At $70 billion and growing — albeit moderately — the U.S. state and local IT market remains an attractive area for technology vendors. When combined with the federal government market, the

overall public-sector aperture reaches $180 billion. The rules of engagement differ from the commercial sector, however, so it is of utmost importance for vendors interested in playing in this area to become familiar with them. A key aspect is to segment a market along the user tiering/ agency/solution dimension presented in this document. At the same time, this market is an attractive proving ground for innovators who not only want to do well, but also want to do good for society with infrastructure-enhancing, fiscally innovative and/or citizen-centric technologies.

Gartner Recommended Reading

Some documents may not be available as part of your current Gartner subscription.

"Forecast: Enterprise IT Spending for the Government and Education Markets, Worldwide, 2012-2018, 4Q14 Update"

"2015 CIO Agenda: A Government Perspective"

"Market Trends: Vertical-Specific Software in U.S. State and Local Governments"

"Predicts 2015: Government Adapts to the Digital Era"

"Cool Vendors in Government, 2014"

"Market Trends: Predictive Policing — A Growing Area in Proactive Public Safety"

Evidence

The analysis in this research is based on primary and secondary research. Gartner analysts conduct daily interactions with federal agencies as well as the technology providers in this market. Various links to sources are embedded throughout this research.

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