

M&As: Small can be Powerful

Whether it is to add powerful complementary products and IP to their existing portfolios, to increase their list of blue chip customers, enhance their referrals in Europe and the Americas or improve their standing in the global markets – Indian IT-BPO companies are going for mergers and acquisitions, and taking the inorganic growth path. They are using the inorganic route to

- Innovate in their delivery models or service offerings
- Focus on niche areas such as engineering, telecom, GIS and IMS and attain leadership positions in these segments
- Develop and market IPR

While the industry is accustomed to frenetic M&A activity from the top 20 players in the IT-BPO market, it has only been in the recent past that even small and medium sized companies have jumped into the fray. In a number of situations, it is virtually a case of 'small taking over large', with the least possible discomfort to the acquirer. In fact, most emerging companies have managed to 'digest' the acquisitions quickly and efficiently, and gain major benefits from these takeovers.

Driving the M&A action

The increase in M&A action, particularly among the smaller organisations, has been spurred in large parts by the prevailing global landscape, where some assets have become cheaper for Indian companies owing to the recessive economic climate the world over.

"The current slowdown in the US and European economies has opened up a lot of outbound acquisition opportunities for mid-tier companies, at reasonable valuations. Small US services firms in the range of USD 20-100 million with limited offshore delivery will find it difficult to maintain growth and profitability, in this tough economic scenario. They will therefore be willing to merge with or be acquired by Indian companies with strong delivery capabilities. Various Indian IT services companies have been acquiring organisations with front-end strengths in the US and Europe, and helping them to grow by leveraging their own financial/delivery skill sets," says Niteen Tulpule, Director, Corporate Finance, KPMG.

According to analysts, low valuations will continue to trigger more M&A activity by Indian IT services companies that have cash reserves. While some players will stick to the 'string of pearls' acquisition strategy, adding small niche companies to their fold, others will be more ambitious and focus on big ticket acquisitions. A number of mid-sized companies, in fact, are already spending in the sub-USD 50 million range to acquire larger firms that help them close the competency gaps, and beef up domain expertise wherever required. The challenges of course are ensuring cultural integration and creating synergies within these extremely complex deals.

M&A: Here to stay

Commenting on the trend of M&As in the IT-BPO industry in India, especially SMEs, Rajul Garg of GlobalLogic Inc. says, that it has been triggered

by an increasing realisation that scale is extremely important in this sector. "This scale allows smaller companies to survive and grow faster and more efficiently. The M&A trend has also been catalysed by the increased availability of capital."

Subinder Khurana, Head of Delivery, Analytics Practice, Cognizant agrees; though he points out that in the case of SMEs, the focus is more towards acquiring depth. "Yes, the underlying drivers for M&A are very strong and scale is a major differentiator in outsourcing. Larger companies have a higher share of customer mind and an advantage in creating a global, redundant and efficient delivery platform. SMEs, on the other hand, can build deep niche knowledge, and will, in fact, survive only if their capabilities are significantly superior to competition. The larger players will find it more efficient to acquire than to build these capabilities. The need for scale and depth will continue to drive M&A in the sector," he says.

Cognizant, which acquired marketRx, gained three strengths through this takeover. It acquired a very strong Business Analytics capability (since marketRx was one of the largest Analytics companies in India), deep domain expertise in the life sciences space that complemented and strengthened its own capabilities (today, the two companies jointly serve 27 of the top 30 global pharmaceutical companies) and the aspirational platform-based delivery model, affording higher revenues per FTE.

According to KPMG's Tulpule, M&A will continue to be a dominant theme in the Indian IT-BPO industry. In his view, while large Indian IT companies are focusing on adding capability or a geographical presence through M&As that are largely outbound in nature, mid-tier and small-tier IT services companies are witnessing a consolidation and merging with or acquiring companies of similar or smaller size. The aim is to fill gaps in their service offerings and compete on larger contracts.

Analysts like KPMG say that within the BPO realm, the inorganic route has become popular as a means of acquiring markets and clients (as in the case of Minacs' acquisition by Transworks); acquiring alternative delivery capability (Peoplesupport's acquisition by Aegis); adding knowledge services to their business to provide high value services (Marketics' acquisitions by WNS); gaining captives and shared service centres to lock into long-term contracts and adding expertise in a vertical (acquisition of Aviva's Captive operations by WNS and Philips BPO's acquisition by Infosys); and expanding into the domestic market (Intelnet's acquisition of Sparsh).

“Mid-tier IT-BPOs are also themselves becoming a target for large US/European players looking to augment their delivery capability in India.”

Niteen Tulpule, KPMG

Of pain, gain and working around the challenges

Pain and challenges are an intrinsic and inextricable part of M&A initiatives and by innovatively overcoming these concerns, companies are realising major benefits. According to Anil Bakht, CEO of ESS India, a company that was 'acquired' by Beyondsoft, "the cultural differences between companies (especially when the acquisition is cross border in nature), make integration difficult. A lot of these cultural and business issues however, can be tackled through face-to-face meetings, even if it means travelling internationally. This will lead to a better understanding and better execution of plans. Challenges can then become opportunities and advantages."

Ben Levy of Headstrong reiterates the point about the integration challenge, stating that by finding the right partner, sharing the same vision and setting the expectations clearly, companies can create the roadmap to a win-win partnership.

According to Khurana of Cognizant, the aim should be to enable business integration in small, bottom-up serendipitous steps, rather than top-down, large-scale changes.

And that's exactly how IBM-Daksh combined, managed to overcome its initial integration hiccups to achieve a smooth transition. "The acquisition of Daksh has been one of the most successful IBM takeovers in the services space. One of the reasons why this acquisition succeeded is because IBM went through a process of gradual integration. Both IBM and Daksh benefited from this as it established a two-way flow of best practices. Daksh gained from IBM's emphasis on compliance and robust systems and processes. We integrated the financial systems, compliance and control and some elements of HR processes, which were very mature in IBM. There were certain operational and HR processes that Daksh brought to the table, which IBM felt were best of the breed and they took these to their other centres," says Pavan Vaish, Chief Executive Officer (CEO), IBM-Daksh Business Process Services.

Yet another challenge meanwhile is generating finance for the acquisition. Tulpule adds that smaller players looking at M&A for growth find it difficult to attract funding, if they are merely looking to add

M&As: Bringing a bouquet of benefits

Eastern Software (ESS): “The immediate advantage is that we are rid of the uncertainty about the future. We have lots of services revenues to supplement product revenues. Being part of a larger group enables us to take higher risks and bid for much larger jobs.”

Anil Bakht

GlobalLogic Inc.: “We acquired strategic capabilities, adding new domain strengths in the mobile, telecom and healthcare spaces. We also added new geographies like Ukraine and China into the mix. All these have enabled us to become a global leader in product development.”

Rajul Garg

Headstrong: “Since the merger in 2003, Headstrong has accomplished remarkable milestones, such as establishing a strong market position, an exceptional customer base, competing in all major geographical markets and sustaining growth in addition to consistent profitability.”

Ben Levy

QAI: “The acquisition is a major accelerator in our ability and velocity to be the dominant thought leader in our space, which is operational excellence in the IT, BPO and knowledge and human capital-driven sectors. The acquisition has given us huge market access into the USA, IP and the much respected QAI brand worldwide.”

Navyug Mohnot

IBM-Daksh: “The acquisition of Daksh enabled IBM to gain a solid presence in the fast-growing business process industry without building an entity from the scratch. When IBM acquired Daksh, it not only allowed IBM to start meeting client demands for business process services within a short time frame, but also provided it with the strength of the Daksh brand, which was already a well known and highly reputed name in the BPO space.”

Pavan Vaish

Sopra Group: “We have seen immediate advantages in terms of larger team, better learning due to large customers and complex projects.”

Pankaj Agarwal

KPMG: “The current slowdown in the US and European economies has opened up a lot of outbound acquisition opportunities for mid-tier companies, at reasonable valuations. Small US services companies in the range USD 20-100 million with limited offshore delivery will find it difficult to maintain growth and profitability in the difficult economic scenario. They would be willing to merge with or be acquired by Indian companies with strong delivery capabilities. Various Indian IT services companies have been acquiring services companies with front-end strength in the US/Europe and helping them to grow by leveraging their own financial/delivery strength.”

Niteen Tulpule

scale. “Private equity, for example, is not attracted to small generic services companies any more. PE players are more attracted to companies with either scale or niches. Since, getting an attractive valuation is a challenge, promoters may need to dilute to a large extent,” he comments.

In his opinion, small and mid-tier companies should therefore merge with companies that have service capabilities, vertical expertise and geographical strengths that are complementary to their own. This will allow them to mine clients by cross-selling services and de-risk by adding alternative geographies.

Citing the example of his company, the Sopra Group, Pankaj Agarwal states that the biggest challenge it faced during its acquisition initiative was managing business focus, as it moved from serving product companies to serving the offshore needs of large European firms.

“We managed this challenge through communication, education and reconfiguring the team and process,” Agarwal informs.

In the case of the Cognizant-marketRx merger, there were differences in the client engagement models of both companies. The challenge was to preserve the strengths of the marketRx model – high revenue per employee, trusted-advisor positioning with line managers, and platform-based service delivery, while allowing for synergies with the larger Cognizant organisation. Commitment from Cognizant’s top management to preserve marketRx’s proposition to its customers and employees, while allowing the synergies to emerge, enabled the acquisition to become a win-win partnership.

Adding yet another perspective, Navyug Mohnot, Head QAI, states that establishing trust and cultural sensitivity are the key challenges. “Also important is rapidly understanding each others’ portfolios and taking quick action. Nothing energises as much as quick successes and action,” Mohnot adds.

Providing companies have a robust integration strategy in place and have found ways to ease the process, M&As can become a major growth path for IT-BPOs, specially smaller and mid-sized ventures.