ACQUISITION STRATEGIES

Buy buy buy in 2012?

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The main trends in outsourcing today are clearly the key drivers for M&A activity, namely transformation and cloud. Today's clients are demanding more sector and transformation capabilities, so the outsourcing contracts of today and tomorrow need to offer a lot more than the labour arbitrage they did in the past – hence the focus on snapping up niche specialists.

Transaction-based pricing is driving ever greater integration of IT and BPO and transformation projects bring a complex requirement to allocate consultancy over the lifetime of the projects. (ITO and BPO has always been very separate within legacy players, with separate P & Ls). This will force some strategic changes within key suppliers to bring skills together.

Also, the headcount in BPO deals has reduced, so companies must adapt their models by improving industry depth or finding IT partners. Those that fail to do so, are targets for acquisition and this will serve as a real shake-up for the industry.

Consolidation in the supply base is predicted to heighten in 2012. As the tier two players are no longer making money, especially those in the call centre space, we expect to see both pain and movement there. KPMG's Shamus Rae expands: "Some deals are known to be badly priced, with price drops promised which will cause further pain. They have not got the efficiencies right with integrating IT and BPO".

"Tier one players, such as Wipro and Infosys are working to fill their gaps. Tier ones and twos are trying to get into the public sector and acquiring carefully to create public sector credibility, without buying too much legacy, i.e. a shared service centre being sold off by Government".

Horses for Sources, however, predicts that outsourcing providers will shy away from mega-mergers in 2012, largely due to the shortfall of attractive second tier providers, that will bring more than just scale to the party. Instead of M&A activity, HfS predicts providers will invest in clients that help them develop domain expertise and business platforms.

Mark Ruckman, outsourcing consultant with Sanda Partners believes we could see a three-way merger of niche mid-size players to create a new large IT service provider.

According to suppliers, it's all about cloud and there's been a dramatic increase in demand, but the end users hold a different opinion. Regardless, the move to Cloud will shake out legacy players and force a lot of change.

Oracle's acquisition of Right Now Technologies, SAP's purchase of SuccessFactors and IBM buying of Emptoris are clear examples of major software players spending big to improve their cloud-based portfolios. This acquisition of both software and cloud-based platforms will continue and remain high-profile, as these players respond to customer demand for cloud and gear up for fierce competition.

"Oracle is moving aggressively to offer customers a full range of Cloud Solutions including sales force automation, human resources, talent management, social networking, databases and Java as part of the Oracle Public Cloud," said Thomas Kurian, Executive Vice President, Oracle Development. "RightNow's leading customer service cloud is a very important addition to Oracle's Public Cloud."

The acquisition of Emptoris and also DemandTec will extend IBM's Smarter Commerce initiative by adding cloud-based price, promotion and other merchandising and marketing analytics. IBM has clearly set out its stall for the cloud.

Oracle has been acquisition hungry whilst SAP's focus – despite successful acquisitions of Business Objects and Sybase and more recently, SuccessFactors – has been to innovate from within. Jim Snabe, co-chief executive of SAP believes innovating is 6 to 12 months faster than a large acquisition.

The antithesis to acquiring to plug capabilities gaps and strengthen market positions, is of course the requirement to sell off divisions and capabilities in order to survive. Potential candidates are CSC, HP and Wipro (to relieve itself from Infocrossing data centre and infrastructure assets). Many spokespeople mentioned it – though none were willing to go on the record saying it – but it seems the industry's money is on CSC being the first major to split and sell, with the prospect of its US public sector work, UK public sector work and financial services work going in separate directions. It's long been predicted that there would be a major acquisition of a western service provider by an Indian heritage firm. Let's watch this space.