THOUGHT LEADERSHIP

EMERGING NATIONS & GLOBAL SOURCING – CASE FOR INORGANIC GROWTH?

Author: **BOBBY VARANASI, COP**
Chairman & CEO

THE CASE FOR GOVERNMENTS INORGANIC GROWTH STRATEGIES

Let me start with the positive news: Since 2008 and through the economic crisis, mergers and acquisitions have become key drivers of growth for many global service providers. This particular trend has been spearheaded by providers from India, as its IT services industry surges ahead in its quest for capturing larger deals, as also creating compelling value that goes beyond commoditized services. Targeting and acquiring small, boutique or value players with compelling technology solutions has become a route to creating much-needed front-end consulting and solutioning approach to their robust and proven back-end service capabilities. These deals cover both software and services, but are typically oriented toward garnering “vertical/ domain” competencies that could be layered around technology services. While one may assume that this is the route a new industry takes as it surges toward maturity, in a globalized world, the assumption that this trend sets the case for cross-border acquisitions alone can be quite restrictive. In fact domestic acquisitions – treated as industry consolidations by many – have grown in tandem with cross-border mergers and acquisitions. Will this trend continue? Will it create increased dexterity among industry players from emerging nations? Do local and regional economics contribute positively to a cohesive play in the globalized marketplace?

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Enter the Commodity Era

Yesterday's value is today's commodity - a fact that has been proven time and again across a host of industries. Is that reflective of maturity, or competition, or both? In the global services marketplace almost non-existent entry barriers have enabled companies from a plethora of emerging nations – struggling at the one end to sustain whatever's left of non-competitive old-school industries, while pooling scarce resources and creating new ones – to enter into play through offering lowest-level commoditized services that touched the bottom end of the services pyramid, and had only one leverage – a lower econo-commercial cost base [typically manifested by way of labor arbitrage]. While some nations have moved from labor to skills/ capability arbitrage, not much has translated beyond creating higher scale for the very same commodity services. Small and medium-sized companies across emerging economies – from Malaysia to Brazil, from Poland to South Africa – continue to be plagued by one question – that of increasing irrelevance with both their service models and lack of market spread. Interestingly, they continue to view organic growth as a way to grow, a fact that has been proven to be both difficult and unsustainable, in the context of services that continually chase costs in the absence of any other value-creator. What are the pertinent reasons for providers staying away from efforts surrounding internal consolidation or going global through deploying inorganic strategies?

Most small and medium-sized companies have been formed by entrepreneurs who leveraged the technology boom of the 90s, thereby creating product-oriented companies that sold software –more often than not beginning their businesses as resellers or distributors of products. Moving on to offering services around the very products they sold has been the most common claim for capabilities in the outsourcing area. While this enabled many firms from South-East Asia and Latin America to lay claim to their position in the global services marketplace, other emerging nations from Middle East, Africa and Central / Eastern Europe haven't had that flexibility, thereby leaving them with the only way to enter the industry – leveraging their language capabilities [read call centers]. Neither of the two seemingly distinct models have been able to withstand the complexities of this industry, resulting in such companies becoming irrelevant quickly. Entrepreneurs got themselves into a bind – fighting the emotions of having to survive in an industry that's more complex than their models could accommodate, and fending off the demons of competition through demanding protectionist measures [localization barriers] or through restricting themselves to the local marketplace where outsourcing hasn't yet penetrated sufficiently enough for organizations to make sense of its value-propositions.

A lesson from India will perhaps make the point succinctly. Realizing the restrictions placed by commoditized services where differentiation is nigh impossible, the only way to remain relevant was to create compelling value with an industry – read business layer. This realization helped move firms from technology centricity toward acquiring capabilities that enabled them to speak the client's language in a compelling manner. Enter acquisitions – creating the required differentiation by going after firms that already had such a value and market recall. Within the ITO and BPO industry, over 320 M&A deals were signed in 2009-10 worth over $18 billion. Nearly 61% of these deals were domestic acquisitions, accounting for well over 56% of the overall deal values. While US still is the dominant leader in this area, firms from India and China are starting to lead the marketplace in terms of the wider nature of such deals that are industry/ vertical-centric. India alone saw cross-border acquisitions worth well over $ 8.6 Billion in

2009. While deals in the areas of virtualization – SaaS and cloud computing – are beginning to become dominant especially in the US, deals in vertical areas – healthcare, insurance, transportation & logistics – are the core areas of focus for offshore service providers [esp. from India] as they notch up their vertical capabilities.

Dichotomy of Pursuits

The important question to ask is this – why are companies from emerging nations [ex-India, ex-China] not pursuing this proven model for growth? The answers lie in their ecosystems. I shall delve into the four most important factors:

An Unproven Location: Most emerging nations haven't been able to – as yet – position themselves as compelling value destinations. On the contrary they are busy trying to insert themselves into global listings of competitiveness – based on assessment parameters that are sometimes irrelevant or meaningless in their own national context. But then that seems to be a trend no one's willing to question. In this melee, providers from such marketplace are given short shrift, as governments have taken it upon themselves to speak industry language they are neither good at nor comfortable with. The rankings – consequently – take a beating when it comes to a reality check, much to the chagrin of the domestic providers themselves who lament that government shouldn't be in the driver's seat. Hence providers have no other option but to pursue their growth strategies within the limited information they have about the industry's trends, with services that are commoditized to the point of zero comparisons, creating a vicious cycle of irrelevance!

Sweat & Equity: Single-entrepreneur led firms are aplenty in most emerging nations, struggling with single-service models and a few domestic clients acquired through relationships, not via showcasing value accrual. Such firms find their leaders significantly reluctant to give up equity for growing inorganically. They would rather raise funds from non-interest non-risk bearing sources [read government grants] that allow them to "go global" without the risk of more sweat. In pursuit of such strategies, service capabilities – enhancements, sustenance – takes a raw beating, since leaders are trying to protect their turf, rather than trying to accept the fact that their firms are irrelevant, and non-competitive. This in turn results in "propping up mediocrity", a blame that is squarely fixed on governments who are unable to increase their market contributions. Is it the government, or the industry to blame?

Lack of Private Capital: Traditional financial institutions have – and continue to – stay away from providers who have neither the intellectual capital nor hard-assets that could be collateralized for raising capital. Private sources – VCs and PEs – do not support this industry in many nations given that providers are stuck in a bind with thoroughly obsolete service models, thin balance-sheets, and a "how-to-do-without-help" mindset [diametrically opposite to the "can-do" mindset that VCs expect]. No capital indicates a debilitating inability to invest, further leading entrepreneurs to the point of driving companies that have neither the competence, not the ability to take on competition.

Lack of Trust: Given similar business models exist within a single market/ nation most providers are small and seemingly insignificant. Their ability to create scale through domestic consolidations is a clear and present opportunity, but an initiative that gets little attention, as ownership issues become more important than "value" questions.

The Opportunity

There is no denying the opportunity cross-border acquisitions presents. Providers investing in their clients, or vice-versa transcends all boundaries, and tends to focus on pursuing collective growth strategies, where value is accrued and sustained by both. Given the inherent limitations placed on domestic service providers in developed markets – *their need to go global, their clients' needs to reduce / rationalize on high price points, their needs to increase wafer-thin margins* – and the latent opportunity offshore service providers can offer – *lower price points, competent workforce, reduced client acquisition costs, higher margins* – cross-border acquisitions seem to be the most rational strategy. Considering them in the first place itself has been a challenge [for factors mentioned above]. However I don't see any other way out for commoditized service providers. The tendency to indulge in conversations of "scale" vs. "value" is a moot point - both needs to be achieved, and achieved quickly. Competitive pressures have not only manifested - exponentially - to the point of unmanageable complexity, they have resulted in blurring the lines between providers and clients, software and solutions, services and processes, technologies and products. A bundled view to these components, with the end-goal of creating a measurable and tangible set of business benefits is what should drive providers if they are to remain in the industry. In pursuit of such an end-goal, cross-border acquisitions become a meaningful and sustainable approach where co-creating and co-ownership for outcomes become key drivers of growth.

About The Author

Bobby is the [founding] **Chairman & CEO** of **Matryzel Consulting Inc,** a strategy consulting, sourcing advisory and management firm headquartered in New York. Matryzel advises corporations and governments worldwide adopt concerted strategies aimed at enhancing competitiveness while focusing on their core competencies. He advises federal governments across four continents on ICT sector development with particular emphasis on policy development, industry-government partnerships aimed at creating GDP growth and enabling positive economic impacts. Bobby has advised Fortune 500 customer organizations on Strategic Planning, Mergers & Acquisitions, JVs, Private Capital Investment Evaluations, Process Reengineering, Pricing Strategies, Sourcing Relationships, Business & Financial Modeling et al, contributing immensely to global sourcing for clients. He is a sought-after speaker in conferences and round-tables worldwide where he moderates panels and presents content on thought leadership. He has been quoted and published in Forbes, fDi, Economist, The Outsourcing, ZDNet, CIO Africa, Brazil Exportati, Times of India, Business Week, New Straits Times, Malaysian Business, Technology Inquirer, Logicall Worldpress etc.