

IT SERVICES-WHO TURNED OUT THE LIGHTS?

The view from an M & A perspective

What a ride the IT Services business has enjoyed the last ten years! Double-digit profits were the norm; margins and revenue growth were often in the high 20s; new technologies, new systems and the exploding global economy all-converging at the same time greatly enhanced the need for IT Contract Staffing and Professional Services firms. We have looked at the impact on both staff augmentation activities and business solutions providers in this article. Our observations have been derived more on an anecdotal than scientific basis and consequently, we are dealing in broad market terms. We recognize that there are many exceptions to these rules.

Staff Augmentation

From entry-level to the most senior management positions talent was scarce and getting harder to find all the time. As difficult as it was to have so many unfilled requirements, most operators also filled more positions during those talent short years than they have in the past year.

Many staffing providers started to feel the slowdown beginning in Q4 2000. Most operators reported a very lean Q1 2001, some stabilization in Q2 and some positive signs in Q3. Ironically, many providers find it is still very difficult to find top quality contractors for senior level assignments. We all have heard various reasons for the slowdown many times so let's take a brief look again:

- Y2K issues consumed the operating budgets and mindspace for many customers throughout 1999 with concerns ramping up as year-end approached.
- Q1 2000 started out wonderfully for most operators and then they began to feel the beginnings of the "dot.com" meltdown.
- Many investors learned that a business model without a clear revenue path and bottom line or one built on unsound business principles was not a recipe for success.
- The technology world lost its luster very quickly as investors watched numerous business closures and bankruptcies.
- Manufacturers had bloated inventories.
- Consumers were filing unemployment claims in increasing numbers and no one seemed to know how long the market softness would continue and how deeply it would cut.

Market Characteristics

Some of the effects of this changing market include:

- Pay & bill rates have come down for many positions
- Contractors converting onto the clients' staff has increased
- Top skill, top pay contractors have reduced their own mobility
- Gross and profit margins are being squeezed
- Some operators have commoditized their own services
- Staff Aug firms are working much harder on contractor retention
- Benefits have increased and are available to more contractors
- Recruiters are staying much closer to their contractors
- Consolidation of staffing firms will increase during the next 18 months
- Savvy operators continue to redefine their business model for future prosperity

Many providers have learned that it takes less time to improve contractor relationships than to ramp up a marketing machine. Consequently many staffing firms with a strong marketing capability have continued to grow while firms traditionally stronger on servicing contractor needs typically aren't faring as well. However many of those firms haven't slipped as much as the firms who weren't particularly strong on either side of the equation. Will the new market be large enough to support all of these Contract Staffing firms?

Many knowledgeable observers believe our industry is glutted with far too many similar companies driving down operating margins with fierce competition to maintain some share of market and that many of these firms will have to join together to avoid extinction. There will be many more consolidations in future years as very large firms need to grow to remain globally competitive and smaller firms need to unite to maintain economic and market viability.

Some of the more cynical industry observers believe that anyone could have made money in this business the last several years and that this market brings the real cream to the top.

Professional Services Firms

The impact of the present economy on Professional Services firms has been much more selective. Depending upon the type of services provided and the industries served, some operators have flourished and others have endured the effects of diminished demand for their services. Some of the market gainers are firms:

- Working on mission critical projects
- That have a reputation for on-time, on budget delivery
- With expertise in front end systems such as CRM and Supply Chain Management
- Focused and capable on web-connectivity & security, the avant garde today
- With expertise in growing industry segments like Banks, Government, Entertainment, Healthcare & pharmaceuticals to name a few

Some of the businesses that have generally not fared as well are firms:

- Providing Internet Professional Services
- That are solely in the ERP space
- With expertise only in back-office systems like Accounting and Data Warehousing where tangible results appear to arrive more slowly
- Focused on high tech and/or most manufacturing
- That have not adapted to current market trends and needs
- That are providing services that can easily be postponed in the short term

PROSPERITY SUGGESTIONS

Perhaps the most interesting aspect of this soft market is that for many owners and operators this was the first time in their staffing industry career that they were faced with little or no growth, demand for workers and services at all levels has not exceeded the supply available in most situations. Savvy operators have been analyzing where their business is, where they want to be and are reviewing their options. Many are recognizing that this type of market may be the new reality now and in the future and that the past ten years may be the exception.

To address this new reality, frequent options under consideration as methods of ensuring survival/prosperity are buying or selling to a competitor. Many operators have determined that they will be unable to continue as before, changes need to be made to gain efficiencies, infrastructure, and access to capital or to lower costs. Acquiring or selling their business can address many of these needs. Some operators just want to lock in some value, as they fear the halcyon days are over. This may be too gloomy a view.

In the interim, what can you do to prosper in this market and at the same time improve your value in an acquisition scenario? First, you may want to slow down a bit and take stock. Some steps you may consider:

1. Carefully examine the productivity of each staff member, some questions to ask yourself and key managers:
 - What is this individual contributing to our profitability?
 - Would I hire this person today if they weren't already on staff?
 - Is their effort sufficient for success? You can't crank them up every morning.
 - Is their attitude appropriate for this business at this time?
 - Will they be successful as soon as they receive more knowledge or training? Is this all they lack?
 - Can they sell in this market environment?

2. Examine the profitability of each account?
 - What is the margin on each account? Is it acceptable?
 - Are the resources required to service an account consistent with its contribution to your business?
 - Can you replace marginal business with better business?
 - Would you take this account on today if it were a new customer?
3. Maintaining or increasing sales levels.
4. Increasing margins where possible.
5. Broadening your customer base when practical.
6. Monitoring credit and collections closely.
7. Weeding out poor performers & malcontents
8. Staying close to your key employees.
9. Maintain advertising & promotional activities, you benefit short & long-term.
10. Cut all other non-productive, non-essential expenses.
11. Review these issues at least monthly, monitor progress and adjust as required.
12. Reconsider your long-term objectives and review all options in light of what you now see in today's and tomorrow's marketplace.
13. Do you have the resources needed to realistically get your business where you want to take it in this millennium?
14. Should you sell and partner with a firm that has the infrastructure and the resources to grow your company?
15. Should you buy a competitor to strengthen your market position and to expand your mind share within your client base?

There are many steps that can be taken. Choose the path most likely to help you prosper. Sometimes the best path lies on the road less traveled. Make a plan for your company and be vigilant about its execution and the business can be fun again.