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Is consolidation overdue in the tech marketplace?

FINANCE

By Howard Smith

Few sectors of the economy have escaped consolidation. Indeed, a quick look at recent merger and acquisition activity (M&A) in banking, energy, health care and manufacturing reveals abundant examples of consolidation.

What is noteworthy, however, with the exception of the proposed Oracle and PeopleSoft business combination, most M&A activity has been outside of the tech sector. Recent data and industry dynamics suggest that this trend is about to change.

According to VentureWire News Alert, a news service of VentureOne, venture-backed high tech "companies are seeing better opportunities for exit in M&A rather than through IPOs."

In the third quarter of 2004, "fourteen venture-backed companies completed IPOs, raising a total of $1.72 billion. In the M&A field, 90 venture-backed U.S. companies, led by information technology, were acquired for a total of $5.89 billion of transaction value."

While drawing too many conclusions from one quarter's activity is a risky proposition, abundant warning signs have been in place for some time now that explain the uptick in high-tech M&A: slow growth, shrinking profits and outsourcing are all signs that point to overdue restructuring.

Here in New Hampshire, for example, the shakeout and contraction of the tech market in the wake of 9/11 and the trend toward outsourcing has created business conditions ripe for consolidations. This year alone we note 19 tech-related mergers in the state, including the recently announced acquisition of Bedford-based Imaging Automation by Viisage, in a deal worth about $30 million.

> So far this year, there have been 19 tech-related mergers in N.H.

Consolidation Factors

Managers need to consider various strategies in light of these consolidation trends. For managers to succeed, they must first gain an understanding of what factors drive market consolidation: spreading fixed costs over higher volumes; demand for bigger and more stable suppliers; increased scale and scope in product offerings; and redundant applications and solutions serving similar market needs all signal the opportunity for consolidation.

For example, in storage and hardware, where technology is relatively mature, companies are choosing to reap scale advantages by acquiring peers or by repositioning themselves by making acquisitions across segments. In software, companies are targeting point applications that enhance enterprise applications.

Management strategies for dealing with these imperatives depend on the unique circumstances of each company and its industry. Market leaders make acquisitions to head off challengers and increase scale to create cost advantages and increase installed customer base.

Challengers respond by rolling up smaller companies to achieve scale or by merging with a peer to drive radical changes in cost structure.

In other cases, challengers may increase business scope by acquiring players in adjacent spaces and combining the offerings into solutions. Small companies attempt to carve out a defendable market niche by creating entry barriers based on proprietary technology, innovation and strong customer ties.

To determine how your company can benefit from the coming consolidation activity, managers must watch for the first sign of these trends in their market and carefully position their company to benefit as an acquirer or as a target. Both strategies require substantial investment in time and resources (both human and financial) in order to be successful.

For companies whose strategy is to grow by acquisition, managers also must give careful consideration to post-merger integration activities (which may conflict with day-to-day management), additional human resources and access to capital.

For target companies, managers need to carefully position their company for sale at a time when it can demonstrate a track record of increasing profitability and possession of key capabilities, products and customers which are attractive to industry participants.

As these industry dynamics play out, managers and investors who act quickly can position themselves to reap tremendous rewards. Investors are increasingly impatient to realize the millions of dollars in potential value to be had from mergers and acquisitions and will pressure managers to act. By understanding the drivers of consolidation and appropriately positioning their companies, high-tech managers can plan for a successful exit. NHBR

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