

EVENT FLASH

HCL Becomes a Formidable Player in the SAP Services Market with the Acquisition of Axon

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IN THIS EVENT FLASH

This IDC Flash examines HCL's recent acquisition of Axon and the implications of this merger to the services industry. In a continued effort to bolster its global service capabilities through acquisitions, HCL completed a major acquisition of United Kingdom-based Axon Group on December 15. Axon is a successful and well-recognized SAP service provider, especially in Europe, with strong systems integration and IT consulting skills.

With this new entity that generated more than \$600 million of SAP revenue in 2007, HCL is well under way in beating its Indian rivals in the race to become a formidable services player in the large SAP market. Even the largest global service vendors, such as IBM, Accenture, HP/EDS, Capgemini, and Deloitte, need to watch out.

SITUATION OVERVIEW

On December 15, HCL officially announced that it had finalized its acquisition of Axon to pursue its vision to become the number 1 SAP provider. In HCL's own words: "To be the world's leading consulting firm for large organizations, which have chosen SAP as their platform to transform their business and IT." Interestingly, HCL won this deal after outbidding Infosys' cash offer for Axon of about £407 million back in August (see *Infosys Buys Axon: Indian Vendors Get Increasingly "Transformational,"* IDC #cUK21400608, August 2008). Apparently, Infosys couldn't match or exceed HCL's bid, which of course underscores the importance of this acquisition to HCL.

The acquisition will enable HCL to expand its SAP business unit — now referred to as HCL AXON — to include more than 4,500 SAP practitioners, thereby almost tripling the firm's SAP capability and thus becoming a formidable contender in the SAP services market, competing against such major-league players as IBM, Accenture, HP, Capgemini, and Deloitte. In addition, this business unit currently partners with seven other SAP services providers, a partnership program that allows it to utilize a pool of 7,700 SAP specialists to deliver solutions to joint customers around the world.

Pros of HCL's Axon acquisition include:

- ☒ **Increased penetration as a services provider in the very large SAP market with access to Axon's client list.** Being an SAP partner creates an immense growth opportunity for HCL. According to IDC estimates, this market offers a \$35 billion–\$37 billion opportunity for service vendors, representing about 55–58% of the total packaged applications integration services market. Furthermore, Axon's largest geographic penetration (63% of total revenue) is in Western Europe, which represents the largest SAP consulting and systems integration (C&SI) services opportunity. IDC estimates that SAP's total Western European C&SI ecosystem was \$8.6 billion in 2007, far ahead of Oracle's C&SI market, which is estimated at \$4.8 billion. Coupled with a strong SAP alliance and ecosystem, the Axon merger will allow HCL to tap into this large SAP market, particularly in Western Europe.
- ☒ **Geographic reach.** The acquisition increased penetration in Europe, mostly in the United Kingdom, but also in the United States and Asia/Pacific, where the combined entity has local offices or delivery centers in India, China, Hong Kong, Singapore, Malaysia, Australia, New Zealand, and Japan. In Malaysia, for example, the HCL AXON business unit will now have a cadre of well over 700 SAP practitioners.
- ☒ **Traction in the eSOA space.** There are four current eSOA client cases with SAP and three more in the pipeline.
- ☒ **Complementary skills with front- and back-end capabilities.** Axon's "transform the business" capability complements HCL's "run the business" approach extremely well. Given the fact that clients are looking for full end-to-end services, this combination will be important in winning deals with large global enterprises. Besides, Axon's talent pool of practitioners with an average of 9.5 years of SAP experience — exceeding the credentials of most other service vendors — along with SAP Partner Excellence awards (in four of the past six years) should give this new entity a head start in the competitive SAP market.
- ☒ **Increased industry depth and breadth, providing greater access to customers and deeper level of intimacy.** Although the new company has a client base in 11 different sectors, its three strongest verticals (in terms of number of practitioners) are:
 - ☐ **High tech and manufacturing:** To date, the combined company has delivered more than 150 projects for over 90 customers around the globe with the help of a cadre of more than 550 practitioners.

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Filing Information: January 2009, IDC #216133, Volume: 1, Tab: Vendors

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- ❑ **Government:** With more than 500 practitioners, HCL AXON will be able to derive benefits from this fast-growing sector (where HCL previously had a very weak presence) along with a strong U.K. presence. Besides, it provides a unique public sector transformation methodology.
- ❑ **Retail:** One of HCL's strongest verticals, it boasts of 600+ practitioners with end-to-end SAP IS retail implementation capability, more than 60 projects delivered to date, and a strong pipeline. Examples of major clients are Kraft, Cadbury Schweppes, and Diageo.

Other key verticals are utilities, oil and gas, aerospace and defense, and financial services.

Cons of HCL's Axon acquisition include:

- ☒ There are challenges with every merger. First and foremost, HCL and Axon need to ensure that they are able to derive enough synergies from each other to increase their competitiveness. Blending two cultures is never an easy undertaking, but in this case the two companies believe they have sufficiently similar cultures to facilitate such an integration. Besides, by having Axon primarily take over to manage a separate SAP business unit, potential conflicts are likely to be mitigated. On the other hand, such a separation could make it difficult for the two entities to benefit from a mutual exchange of knowledge and experience to foster innovation.
- ☒ Even with an increased global footprint, the firm acknowledges that it needs to address some geographic gaps. In particular, the combined entity continues to be comparatively weak in France and Germany, though HCL is currently addressing this by hiring country managers to assist with the company's expansion efforts in continental Europe. HCL also realizes that it must strengthen its presence in Japan and in such emerging areas as Latin America and South Africa.
- ☒ From a vertical perspective, HCL has pointed out that it would like to strengthen its capability in some of the largest sectors, such as oil and gas, CPG, and life sciences, which not only require tremendous scale but also deep industry expertise. The new entity must make a concerted effort to grow its resources and capabilities here to meet the global needs of these large customers.
- ☒ Although Axon offers a business benefits realization program, which is an attractive offering to SAP clients, business consulting — especially from a business strategy perspective — continues to be a weak link. Axon is primarily a systems integrator and IT consultancy with limited business consulting expertise, an essential capability when assisting clients in their large transformational endeavors. It is incumbent upon the new firm to beef up its caliber in this case — perhaps through additional acquisitions.
- ☒ With a focused SAP practice, the new HCL AXON business allows HCL to compete against the likes of IBM, Accenture, and Capgemini for SAP-based SI projects. However, this SAP-only capability will restrict the new business unit to challenge these major leaguers for SAP contracts that require hybrid systems integration solutions, made up of a combination of SAP and other non-SAP applications. To successfully compete for such multitechnology contracts, HCL needs to successfully integrate and market the SAP-based offerings of its separate HCL AXON unit with its non-SAP ERP offerings. Building synergies between these different businesses will be key to HCL's competitive advantage.

FUTURE OUTLOOK

HCL's acquisition of Axon couldn't have come at a better time. First, many outsourcing deals are up for renewal — according to IDC's Services Contract database, \$54.6 billion in IT outsourcing contracts are coming up for renewal in 2009, an astounding opportunity for an outsourcer, such as HCL. Companies are not only currently reviewing their contracts for the purpose of renegotiating them but also seeking to consolidate their supplier base. Hence, competition for outsourcing deals has intensified, providing a competitive advantage to those service providers that can offer global scale and broad end-to-end services capability. With the Axon acquisition, HCL is in a much better position to compete in this current market — especially against its Indian rivals.

In particular, HCL (like many other major outsourcers) should be able to take advantage of Satyam's fraud scandal and potential demise. As of this writing, the fate of Satyam is uncertain, but it is clear that as the firm is fighting for survival, many of its rivals are seeing an opportunity to take over some of Satyam's client accounts and even increase their share of wallet with clients they have in common with Satyam. This debacle also presents strategic hiring opportunities for HCL and other service providers. However, the Satyam situation is hurting the market perception of all Indian and other offshore service providers at this time. HCL's challenge will be to ensure that its clients do not lose their trust in the company's financial stability (and longevity) and business model. Most likely, it will become necessary for all offshore providers, especially in the emerging markets, to take swift action to demonstrate that they are making efforts to enforce much more stringent business standards along with more transparency. The bottom line is trust and credibility — a reality that HCL must address with some very tough measures.

The Indian players are jockeying for market position to expand their global footprint through acquisitions, especially in Western Europe and the United States. In 2009, we can expect to see a continued acquisition spree by the Indian service players as they are striving to achieve double-digit growth in these tough economic times. Today, HCL is particularly well-positioned to continue to do so and expand its market presence. In particular, it has become a strong alternative contender to some of the largest service vendors, especially considering its price competitiveness.