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Joint Venture, Merger or Acquisition? Justify

Liberalization which was introduced in India in 1991 opened the doors for many businesses in the sector of information Technology. This is how **TNS Technologies** was born in the year 1993. Mr. K V Rao was the visionary who made this organization scale new heights. In the year 1992 Mr. Rao said "Today the masses are more interested in the quality and authenticity of information but after a decade or so you will see that there will be a third dimension associated to it and that is speed." And today we realize how true it was.

TNS technologies started in Mumbai with 10 IT engineers under the leadership of Mr. Rao. This number kept on increasing exponentially with increase in business year on year. Now the talent pool at TNS is as huge as 50,000 employees from over 30 nationalities and 42 plus global delivery centers in over 30 countries. Their services span:-

1. Product engineering.
2. Application development.
3. IT Infrastructure Management.
4. Business process outsourcing
5. Testing.

With a view of business expansion TNS offered a public issue in the year 2000 and due to its excellent history, the issue observed a subscription of about 20 times before it got listed on the NSE.

In the year 2007 TNS had a client database of more than 800 that includes major giants from various sectors like Banking and Finance, Health care, Manufacturing, Education institutions, Government bodies and media. It was then a $5Bn industry competing with global leaders like Infosys and Cognizant.

The Effect of Recession

Towards the end of 2008 the West observed a financial turmoil which started with the fall of Lehmann Brothers, one of the oldest financial institutions in America. This was considered even worse than the "Great Depression". Many other companies had to wind up their businesses and suffered huge losses worth billions of dollars.

The effect of recession was also felt by the IT sector and TNS also became one of its victims. It stopped getting new business. Many of the existing contracts were taken back, the receivables turned into bad debts and now the future of TNS was actually going for a toss. This effect was also seen on the stock market with most of the companies including TNS were trading at their life lows.

The expenses of the company were steady but the income was declining QoQ. TNS thus, had to utilize its reserve to meet its expense. But this was a temporary treatment as one cannot go on depleting one's reserves. So the management initiated cost reduction at the senior level in the form of reductions in their major allowances. All the talent transformation programmes and trainings were put on hold. In order to be able to pay the fixed costs with less business, the HR had to take this tough decision of terminating its employees who are not able to achieve the desired productivity. The target was to lay off 20% of the workforce. The working hours were made intensive, increasing it by 2hours. There were no increments, no new recruitments the entire company was at a freeze.

This was a tough time for the management, HR team as well as the employees. The company then ran out of liquidity and this was a serious threat to it. The salaries of the employees were not paid for two months. But this did not continue for long, the company started taking some aggressive steps in order to clear the pay rolls of their employees. They eventually started selling their assets. This had hit them hard on their financials and there was a speculation in the stock market that this company is filing for bankruptcy since it is into huge debts and the stock was traded at a discount rate.

Now one thing is looking pretty clear that TNS technologies is not going to sustain on its own for long. It needed some financial backing in order to move through these hazy days of down turn.

Now if we do a swot analysis for TNS we find that:

1. Strength: Excellent team of employees with great technical talent and willingness to co-operate in these difficult times, the good will of the company and the rich client database that will again get the business back after the downturn is over.

2. Weakness: The Company was financially unstable and was finding it difficult to take critical decisions, was losing hard on cash and having a tough time paying the fixed costs and employee salaries.

3. Opportunities: Indigenous market.

4. Threats: Due to poor short term financials i.e. it was using its long term assets to pay for its current liabilities, the company feared shut down.

Joint Venture

Looking at the excellent history of the company, many other corporate were convinced that it is just a temporary down turn and when the market will come up, TNS will come back strongly due to its strong work force with great technical expertise.

But there was one sector in India which actually never faced much of recession and that is the telecommunication sector. Even during the recession, there was a steady increase in the number of subscribers. One such telecom giant was **Eastern Communications**. Established in 1995 this Telecom Company was in the business of cellular and land based communication. With yearly revenue of about $8Bn and net profit of $2.1Bn, it was one of the best among its competitors.

Their management team identified that there are serious issues with their operations with respect to data management. Due to this they were not able to implement their CRM strategies the way the marketing team intended to do. They came up with a conclusion that instead of having a dedicated team to manage their customer database when it is feasible to get it done by the experts in the sector.

EC was planning to come up with various other services like direct to home (dth), 3rd generation mobile and broadband internet in a period of 2 years. This would substantially increase the need for IT infrastructure management as well as data base management. So they analysed that instead of offering them a contract or getting it outsourced, it was better to get it done mutually by sharing profits through a Joint Venture in the required proportion and the profits thus earned in the first two years of the JV can be channelized for the upcoming business which is going to initiate after 2 years.

Considering this scenario and the capabilities of TNS, EC decided to approach them for the JV. They knew that financially TNS is in a bad shape which would help them to negotiate the deal in the way they want it to be.

Legal Aspects that need to be discussed:

1. Holding shares
2. Board of Directors
3. General meeting
4. Management Committee
5. Non-Compete
6. Confidentiality
7. Break of deadlock
8. Termination
9. Applicable law

Advantages of the JV to TNS as per EC:

1. Improve their financials.
2. Telecom sector is at peak so can receive huge profits.
3. Business diversification after 2 years will lead to more business thus more revenue.
4. A good means to tackle recession.
5. A permanent business until the JV survives.

Disadvantages according to TNS:

1. Major share of the JV will be from EC.
2. Might lose core business after the down turn is over.
3. The business proposal of EC may be too optimistic.

Merger

ACS Software is an emerging entity from Europe. It provides world class IT based services and business solutions. It has 15 years of experience in the industry with a vast reach (150 branches around 40 countries all over the globe). It has also become number 1 IT based company in the region. It is highly innovative TNS technologies and has excellence in execution. It has strategic alliance with IT majors so that it can deliver products which are highly efficient.

Main revenue for the company comes from E-commerce solutions. The firm had revenue of $50 Million in year 2000 and it crossed $5 Billion in 2010.The sales turnover has raised 100 times in past 10 years. The net profit for the company was around $1.75 Billion.

The company withheld the recession storm over it by searching for new untapped market. During recession period firm took various cost cutting measures and posted growth of over 20% over previous year. The company is also poised to grow over 20% for next 5 years.

The company's focus is on having long term client relations. It has signed many long term deals with renewed companies. The new business for the firm comes from untapped markets like Latin America, Russia and few parts of Africa. The Company now focuses on Emerging markets for their growth Strategy. The Firm has also educated various other entities in the emerging market about how IT based solutions would help them to check cost and grow their businesses. In this way, it has plans to generate revenue from these markets in future.

The company is also looking for mergers and acquisitions or alliances which can drive growth forward. It is cash rich company with zero debt. It has cash reserves around $ 1 Billion which can be used for any strategic Merger.

The Firm is also enjoying a credit rating of B++

Advantages and Disadvantage

1) TNS technologies will have huge access to the domestic market of ACS software.

2) Win -Win situation for both i.e TNS technologies will get financial support & flow of new orders & ACS software will be able to use its human capital & technology for further development.

There is a big challenge in front of TNS technologies. All seems well to a large extent. But, in business you never take leaps without proper objective calculations. If the major indirect financial flows are going to be based out of TNS technologies ability to leverage its business potential in Europe, then how worthwhile is it to actually go in for this merger?

What are the immediate financial requirements for TNS technologies to sustain its operations and what potential does Europe as a market really offer to TNS technologies in this regard?

Let us take a simple example. With the advent of new technologies like Mobile internet and 3G, the internet penetration is expected to zoom up. Now it is up to TNS technologies to build specific scales of business in these regards to tap such untapped markets. Is it feasible to think of such new ideas and implement them swiftly? And if so would it be rational for TNS technologies get into a merger agreement under such scenarios?

Well, these are questions to be seriously considered by TNS technologies.

Now let us look at the other side of the box. Why is it that ACS software wants to merge with TNS technologies? Well, typically ACS software stands to gain nothing in such a scenario at all. It cannot expect finance as TNS technologies is already battered in this regard. Nor can it leverage its business operation in USA that is already saturated to a large extent and where TNS technologies position is also battered up.

So what is it in here for ACS software??

Technology? Well yes. That is a lucrative deal indeed. As an emerging firm it is in need of technology, but this too is not going to be a certainty to prosperity. It should effectively capitalize on this technology in its business. So what is the actual probability of ACS software capitalizing on this technology? And why can't it do so in its present stature?

Being smaller in size than TNS technologies, it could risk its brand name and goodwill post merger and may be overshadowed by TNS technologies in all business activities post merger. In its present situation though, excluding high technical expertise, ACS software has an established base in Europe, it is experiencing growing revenue and may be able to expand its business reasonably well in future.

Then, in such a scenario, there is something that both TNS technologies as well as ACS software believe will act in ensuring their capacity to optimally leverage their abilities in capitalizing the Indian market in a much better way than other vice.

What is the game plan that both these firms foresee? And how is it that they can ensure its Materialization?

Acquisition

Now there is a new twist to the tale. Amidst all these proposals **CH Technologies**, a firm based out of China is suddenly foraying into the picture. This is not an altogether new firm in the scenario. It has been in the industry for quite some time now and has acted as a rival to TNS technologies for long.

In the past on several occasions, it has been successful in overpowering TNS technologies on occasions of bagging high profile contracts and has hence always rivaled TNS technologies in this arena.

One of the main advantages that this firm has over TNS technologies is its low labor cost. It has as a result mastered its ability in delivering services at a much cheaper rate as compared to TNS technologies. Now as a result of its growing leverage in the industry, it has plans to become a regional player and has plans to slowly supersede the Indian Tiger.

With the intention of monopolizing the Industry, it is offering to acquire majority stake in TNS technologies at three times the present value of the firm. Now this can be a dilemma for TNS technologies that is already flooded with a lot of proposals.

Would it make sense for TNS technologies to let itself be acquired by this Chinese entity and be with a minority stake? The chances of spinoff in future into its original identity would stand nil in such a scenario. Should it risk falling into such a proposition?

Well, it cannot be completely ignored either. The kind of capital infusion that TNS technologies can enjoy post acquisition is not something that it can experience elsewhere. Moreover, it can find itself in an altogether new base with fresh goodwill and brand identity.

TNS technologies need to seriously consider all these factors if it has to go ahead with the acquisition proposal.

Amidst all this, there is another game that TNS technologies could potentially play. It is well known that TNS technologies suffered as a result of its inability in getting back its receivables on time. Obviously, a large part of its sales were on credit basis. But, there is one cut to this entire story. As a result of internal analysis TNS technologies has found out that one of its competitors which has good influence in a prominent credit rating firm used their influence against TNS technologies. They managed to ensure the downgrading of their credit ratings and as a result a lot of investors who had invested in this firm started pulling out their money.

This was found out to be a prime reason for their fall.

The major outcome of the downgrading of their credit worthiness resulted into:

1) Blockage of their income (stoppage of payment)
2) No flow of any new orders.

Which can finally lead to –

1) Reduction in share price.
2) Huge Selling of shares in the secondary market.
3) Increase in interest rate on further loan.
4) Selling of collateral security if not able to pay back the loan within the stipulated time.

Considering all this can TNS technologies now can do something to instill back the confidence in their investors. And can all this strengthen back their position?

Questions:

What should TNS technologies go for?

1. **Joint Venture with Eastern Communications.**

2. **Merger with ACS Software.**

3. **Acquisition by CH technologies.**

Justify your choice.

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