

What's in store for 2007?

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Hiring competent internal staff foremost on execs' minds



Callaghan

Cullen

Humrichouse



Wadhvani

Wilson

Winwood

For many executives it's that time of year again – time to sit back and mull over the fate of the industry, wondering what's in store for the New Year.

IT Services Business Report talked to several industry players recently. We asked them to make projections for 2007 and comment on potential opportunities as well as challenges.

We found out that the most common thought keeping them awake at night is how to hire the industry's best recruiters and salespeople so that they can capitalize on IT's continued growth. But there are lots more thoughts and predictions.

Following are some excerpts from interviews with six industry players. Keep reading to find out about where they see growth in the industry and some key trends to keep an eye out for.

Brian Callaghan, CEO, Apex Systems Inc.
Jack Cullen, CEO, Modis, MPS Group Inc.
Jim Humrichouse, president, Pinnacle Technical Resources
Rick Wilson, managing director, GulfStar Group
Michael Winwood, president, Technisource
Sunil Wadhvani, co-chairman and CEO, iGATE Corp

ITSBR: What are some of the big trends for the IT services and staffing industry in 2007? Anything in particular that is worrisome?

Wadhawani: The supply of quality candidates will get tighter in 2007. What's next is that offshore will be used in a different way. While the volume of offshore software maintenance will continue to grow dramatically, the whole brand-new area of offshore recruitment will start growing now.

And because of the ongoing pressure on margins, staffing companies will look at new recruiting models that are cost effective. A big piece of this will be offshore. Some companies are seriously starting to do pilot programs. In most cases they are partnering instead of setting up offices [offshore] on their own. Several of the large [staffing] players are figuring out how to leverage the offshore model to reduce their cost structure [for sourcing and recruiting]. The key is how to increase the productivity of the recruiters in the United States even further.

For the industry in general, I'd divide the IT services sector into three segments: IT staffing, IT solutions in the U.S. and offshore IT solutions. IT staffing will have moderate growth. Offshore IT solutions companies will experience very high growth. But U.S. IT solutions firms will face challenges because of competition from offshore.

Winwood: I think that – within the pure staffing space – we won't see a huge amount of change. I think larger clients expect more than staffing; it has to be valued added. So, do you just provide the bodies or take on the full, deliverable responsibility? Either you create volume as a vendor or you become a commodity.

In the 1990s there was more willingness from the client to pay a higher bill rate for the right, qualified candidate. This time it's not so. Clients are still able to use their buying power and they still see it as a commodity – unless you are prepared to show value through specialization or take more responsibility.

Humrichouse: I see a continuing evolution and tool proliferation in 2007 – proliferation of VMS and MSP programs, margin compression. You need to get a specific niche where you can find higher margins. Continuously evolving is key. You have to be adaptable and understand the challenges for clients and find ways to serve them.

We have a VMS tool that is structured for solutions business. We started Progata five years ago. It is not project management software but it is a sourcing tool that can be used for solutions.

Callaghan: One trend to keep an eye on is healthcare reforms (proposed bills that, if passed, will mandate that all businesses offer their employees healthcare insurance) and their impact on the staffing industry. Let's say if California puts something in place, all of a sudden we'll have a lot of costs involved. For a lot of us the margins are razor thin. We don't know how much of the costs we'll be able to pass on to the customer. It will ultimately fall back on us to be more efficient.

ITSBR: Will recruiting and retention of consultants, recruiters and salespeople be a challenge in 2007?

Callaghan: We always focus on retention. Our model is different. We take folks who have not worked in the industry, but have talent. This approach is similar to how we were brought into the industry ourselves. We know that it can be learned rather quickly if there is someone teaching you well. Folks in this business have a deeply rooted opinion of how things are done. That is their way. A lot of these folks struggle to change their habits. With our approach, we are able to mold the newcomers.

Cullen: Retention for me is critical. Knowing that you are in a high-demand market, your consultants are the most valuable commodity that you possess. You have to keep that person

billable for as long as you can. If the client is out there shopping to get a person at a rate below the market, there is another client pulling them out with rates higher than market rate.

Our sales team and recruiters are in touch with our consultants regularly. But if someone comes to the consultants with a comparable or higher offer, they will be forced to take a look at that, no matter how many times you meet them. So we have incentives to make sure they complete the assignments and go for other assignments with us. We have sign-on bonuses. We offer bonuses for completing the assignments and bonuses for accepting consecutive assignments. We offer additional training programs for them.

Humrichouse: The biggest challenge is that we are constantly trying to hire talented people – consultants are one end of that but more important are the internal people. If you get the great internal people – recruiters, sales and administrative personnel – then you get the right consultants.

The key is not just finding and retaining, but recognizing them as they grow and develop. You have to have corporate processes in place to promote them. The most important thing that you can do as a CEO is to identify, develop and nurture talent and give that talent the opportunity they deserve.

Winwood: The things that I worry about are being able to hire recruiters and salespeople, and continuing the growth that we see. For 2007, we plan to drive a talent strategy where we hire people in the middle of a career change or fresh-out-of-college people, and put them in our development facilities in Dallas for three months to learn how to become a Technisource recruiter.

This strategy will be more successful in retaining recruiters than hiring from your competition. Smaller companies who follow this model will have a bigger chance of success.

ITSBR: What kind of trends will we see in the mergers and acquisition side in 2007?

Wilson: That depends on the size of the company and the nature of the business. The highest demand for IT staffing companies will be those with EBITDA north of \$4 million or \$5 million. Below that, the market will be better than prior years but the premium prices will be paid for larger levels of profits.

Other key factors will be vertical specialization such as healthcare or government or financial services.

Other features that are important are whether the company has had rapid growth or has a great management team – those could be factors that investors or buyers will pay a premium on. Having a technical focus can be a real positive for strategic buyers because they want to fill in the void they have in a service practice.

Companies that serve a lot through VMS, have lower gross margins and lower bill rates, there are still transactions for them but not premium multiples.

Buyers of IT services are both strategic and private equity groups. The equity groups have a lot of money, but are more interested in the IT services market and not pure IT staffing.

ITSBR: Which industry verticals will fare better in 2007? Which ones will struggle?

Wadhawani: Both IT consulting and staffing are cyclical industries. Certain verticals like healthcare that are dramatically increasing the use of their IT will be an area of growth.

Another piece is offshore software development. All the end users are realizing that this is what they have to do. Even medium-sized ones are thinking about doing this, independent of the U.S. economy. Government IT services will slow down because of the slowdown in government spending. The automotive sector will have pressure on margins.

Humrichouse: We are seeing two phenomena: companies that are trying to extend their Web platform to a mass audience, and post-merger integration. Any industry that is going through that will see activity.

Cullen: Financial services are back! That's the hottest single vertical that we have. The second one is telecom. We are still staying robust in the pharmaceutical and healthcare areas.

ITSBR: Are there any new technologies on the horizon to spur demand in the IT services sector?

Wadhawani: The adoption of service-oriented architecture (SOA) will start ramping up. It's too early to tell what the impact will be on the IT services industry. Near term, in the next three to four years, it will increase the demand for IT experts in this area. But the long-term impact is not known because the goal of this software is to bring down the need for customization and bring down the need for software development.

Other than that, ERP, CRM, consultants with Oracle, SAP, and PeopleSoft skills are in demand. VoIP, wireless – it's going on but we don't know how much impact it has on services companies because the volume of business that they might get through this is very small. The bulk of the industry's revenue comes from mainstream software development and maintenance.

Winwood: We are very focused in certain areas such as security, storage and networks. These skills are very much in demand. A lot of these skill sets are harder to send offshore. We are not into offshore outsourcing and we are heavy into the mid-tier market. But we are seeing some of the offshore guys getting into that market too.

ITSBR: Which business models will work better going forward? One-stop shop or companies with vertical industry expertise or companies with technology specialization?

Wadhawani: More generic offering such as staffing for mainstream skills will be more of a scale game. Large scale players will get more business and small companies will continue to struggle because clients are consolidating. On the other hand, there will be opportunities in niche areas, such as SOA, or industries like healthcare. Here smaller companies will be able to prosper.

Winwood: Small companies are going to struggle – especially with the economy slowing down. Vertical or skill set specialization or both are good. If you are a generic company or try to be everything to everybody, it's not as successful. This is because proactive recruiting is critical and that happens only when you specialize. This means that even if I don't have a definitive requirement at this time, we know that this might be in demand and go out and recruit those skill sets.

Cullen: Back in 1999, a client was looking for anybody who had technology experience. Now they need to know the technology and the area of expertise that they are working in. A lot of clients are looking for candidates who want to be permanent employees. So we are seeing a lot of temp-to-perm. We have been involved in temp-to-perm for 15 years. But, in the past few years, it has been more client driven.