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SAP Acquires SuccessFactors for $3.4 Billion

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On December 3, SAP announced its intention to acquire SuccessFactors (SFSF) for $40 per share or a total of $3.4 billion, a 52% premium over the closing share price of $26.25 from Friday, December 2. While the exact details were unexpected, the notion of a large packaged software vendor buying new capability and delivery expertise from a cloud vendor is not unexpected. Just last week in IDC's annual Predictions Webcast and document, the following prediction was made: "2012 will see lots of SaaS consolidation led by big packaged software names. In 2012, we will see the contenders for cloud app platform leadership — Oracle, salesforce.com, Microsoft, SAP, and others — accelerate their acquisitions of established cloud app/SaaS vendors. … IDC predicts Oracle or SAP will make a bid for SuccessFactors, NetSuite, or Workday in 2012."

The price paid by SAP is essentially a 10x+ premium over trailing revenue, a high watermark even in the recent history of cloud valuation, which saw Oracle buy RightNow in October for a 22% premium over market cap, and HP value Autonomy's SaaS business at 145% of estimated (not broken out) 2010 revenue. With 2010 revenue of $205 million, SuccessFactors has yet to show a profit. SuccessFactors offers guidance that its revenue will be close to $400 million in 2012. SuccessFactors has historically plowed its revenue back into R&D and marketing. Despite this, SAP's senior executive anticipates that SuccessFactors could contribute $750 million in revenue in 2015. In a post-announcement conference call with analysts, SAP repeatedly used the phrase "cloud powerhouse" in describing its aspirations, and SuccessFactors, and SAP's revenue expectations for it, is clearly a cornerstone in that strategy.

SuccessFactors' cloud-based offerings include:

- Organically developed employee performance management suite including goal management, assessment, career and succession planning, and compensation management
- Organically developed talent acquisition/recruiting
- Organically developed linkages of individual goals to corporate goals through their Business Execution offering
- Learning management through an acquisition of Plateau earlier this year
- Social HCM through acquisitions of Jambok in social learning and CubeTree in social networking
- Workforce planning and analytics through the acquisition of Inform
- An organically developed employee profile and recordkeeping solution called Employee Central

What are not included in SuccessFactors' current portfolio but are in process are the HR transactional elements of workforce management, benefits administration, and payroll administration. These bread-and-butter components are a strength of SAP's on-premise Business Suite.

This particular move in HCM is a surprise at this time in that SAP has recently made much of its next-generation Career OnDemand talent and performance applications built on the Business ByDesign SaaS framework. Career OnDemand was slated to roll out in phases with Phase 1 (including talent profiling) already available and Phase 2 due out in early 2012. Clearly with SuccessFactors being now fully fleshed out in all major facets of talent management, SAP leaps from a fledgling offering to the front of the pack. SAP will need to clarify the future of Career OnDemand when road maps are revealed once the acquisition is finalized in Q1 2012. They cannot do so now as discussions between the companies are prohibited by law until the closing. Despite this, that Career OnDemand was not mentioned by SAP Co-CEO Jim Hagemann Snabe during an analyst conference call when he described how SAP's line-of-business cloud offerings for sourcing, sales, and travel and expense management would benefit from SuccessFactors expertise is telling and does not bode well for the future of Career OnDemand.

Surely this acquisition is SAP's attempt to jumpstart their entrée into the growing market for SaaS-based systems. It certainly does so for talent, but the huge elephant in the room is Business Suite, which holds the key for Core HR, those functions that are the bread and butter for SAP HCM customers, covering HR recordkeeping, benefits administration, workforce management, and payroll. The SuccessFactors acquisition does little to ameliorate the Core HR challenge at this point. SuccessFactors's Employee Central is their core HR entry, but it is in its early days and does little more than act as an employee master datacenter at this point. Business Suite clients would not be able to replace Business Suite capabilities with Employee Central as it is in its current form. But SuccessFactors CEO Lars Dalgaard gave one indication during today's analyst call on future possibilities. He affirmed that the combination of Employee Central and the SuccessFactors Talent Management Suite could become an option for SAP customers looking to replace their on-premise HCM suite with a cloud-based solution, stating "it's the customer's choice."

For the near term, however, the move adds a pop to SAP's most recent publically stated strategy for Business Suite, articulated at this year's SAPPHIRE — a hybrid on-premise and cloud approach that parlays HANA in-memory capabilities to more effectively architect the core while building out cloud capabilities at the edges where customers are seeing the best value-to-risk ratios: CRM, HCM (particularly talent management), sourcing, and travel and expense management. To date, SAP relied on organic development for the cloud component of this strategy, first introducing SAP Sourcing OnDemand, followed by Travel OnDemand and Sales OnDemand, also announced at this year's SAPPHIRE conference, and most recently the launch of Career OnDemand. Buying SuccessFactors acts as a steroids injection to that approach, promising SAP the scale it needs to be profitable and credible quickly.

Dalgaard will be tapped to head SAP's SaaS and cloud businesses, which have been in a state of transition since former Oracle exec John Wookey left in April 2011. Wookey was brought in to develop strategy for large enterprise SaaS, and among other accomplishments, he led the consolidation of all SAP OnDemand development onto the ByDesign platform, as a means to streamline development for the growing diversity in SAP customer size groups, and to align the OnDemand group better with other key SAP strategic pillars, notably in-memory. Under the leadership of veteran SAP executive Peter Lorenz, SAP spent much of 2010–2011 proving the viability of its LOB-focused OnDemand apps, including Sourcing, Sales, Travel, and Career, and building credibility around supporting and orchestrating hybrid implementations, which is how SAP believes most customers will want to consume their software capability. Organizationally, SAP also noted that SuccessFactors will remain a separate entity, a good move for a number of reasons, not the least of which that non-SAP SuccessFactor customers will be more at ease with SuccessFactors continuing to run on its own.

SuccessFactors has 3,500 customers and 6 million users with only roughly 15% also SAP accounts. Customers of both companies benefit by now working with one vendor. For the companies, this combination brings opportunities that are perhaps more compelling — new cross-sell opportunities for SAP to expand wallet share and access the other 85% of SuccessFactor's customers, while SuccessFactors gets head-of-line access to SAP accounts.

That SAP is paying a 50% premium seems to underscore an urgent need by SAP to offer a counter to inroads made by Workday into SAP's customer base. Increasingly competitive upstarts like Workday are building a full HCM suite organically on a modern object-based SaaS architecture. The SAP acquisition of SuccessFactors does little to combat Workday's edge in the short term for an end-to-end HCM solution in the clouds, but it does bring instant leadership in talent management and experience as a cloud services provider. SAP gets a powerhouse employee performance management suite, a very well-known brand in talent, and tremendous talent and IP in rapidly rolling out SaaS applications.

SAP's premium paid also speaks to the sense of urgency in building out a public cloud portfolio, especially on the heels of Oracle's recent activity. Given the projected pace of growth in delivering solutions as a service, and providing customers the choice of conventional IT center deployment versus accessing cloud-based services, all major vendors have moved aggressively to road map how they service-enable at least a part of their portfolio, and in cases where the technical hurdles to operationalize new services, and the sales and marketing hurdles to penetrate markets with several existing SaaS players (like HCM), it has made sense to buy customers, capability, and credibility. Assessing the 60 or so vendors in various functional markets who will make between $40 million and $140 million in 2011, many large packaged software vendors may feel they have a compelling need to purchase somebody and not lose market share as their buyer base pivots to cloud, even though the valuations are dizzying.

While there are functionality and platform overlap challenges to come, the alternative to not making this move, in light of competitive pressures, makes addressing those challenges worth the effort. The real question is whether SAP is committed to deliver an end-to-end HCM solution in the cloud for large enterprises. For large enterprises, its strategy has been to integrate on-premise core HR with cloud-based talent management and employee performance management. SAP will need to clarify whether it is committed to deliver an end-to-end cloud-based HR solution for midsize to large enterprises and what that road map would give this new acquisition.

This is yet another phase in the consolidation of the talent and HCM market. It is mirroring in many ways what we saw in CRM. First, we consolidate for parts, then for share, and then the biggest fish picks up the largest of the smaller fish. Buckle your seat belts, this isn't the end of this folks.