



B2B Information Services

The Opportunity for Strategic Growth

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Introduction

The B2B information-services market has enjoyed enviable growth rates over the past decade. Average margins are about 25 percent, and they soar to more than 50 percent for industry leaders. Growth and profitability have been driven by a surge in the number of professional knowledge workers globally and the increasing importance of data and information in decision making—trends that are likely to continue unabated. Because the data and solutions provided by B2B information-services companies become embedded in the work processes of users, these companies enjoy relatively stable and predictable revenue streams.

These sound fundamentals and growth prospects will only improve as economies of scale drive further consolidation in the industry. Large players benefit from superior distribution channels. They also have the wherewithal to invest in value-adding enhancements to their current offerings and in the shift from print to digital publishing. For some, the opportunity to expand across the value chain is also a motive to consolidate. What is more, the recent decline in market valuations makes this a particularly opportune time to pursue consolidation.

Players that seek to build a B2B business—such as B2B media companies seeking to increase scale, diversified media companies seeking to broaden their portfolios, or private-equity firms—must overcome significant challenges, however. Deal making has become exceedingly difficult, as a mismatch in expectations exists between buyers and sellers, and it remains hard to obtain financing. Even if the climate becomes more favorable for deal making, companies still face the challenge of selecting the right targets. For all the outward signs of health, some segments of the business are becoming commoditized, and acquirers must work hard to find targets with truly distinctive sources of value.

The opportunities available to successful acquirers are well known to the largest and most successful B2B media companies. The Thomson Corporation, prior to its acquisition of Reuters to form the world's largest B2B media company, announced 158 acquisitions from 2000 to 2007. Over this same period, Reed Elsevier announced 97 acquisitions and Wolters Kluwer announced 77. The incumbents were not the only ones to see these opportunities. Warburg Pincus joined forces with Mason Slaine, an industry executive, to create MLM Information Services, with at least \$250 million available for investments that appear to be focused on consolidating the tax-and-accounting-information market. Other well-known information-industry consolidators include Veronis Suhler Stevenson, Providence Equity Partners, and Permira.

To succeed, we believe companies should follow the lead of successful B2B acquirers and build upon their core assets (for example, unique content and solutions, technology platform, and privileged relationships) by targeting players that will benefit from their superior distribution channels and enhance their value proposition. To pursue this strategy, acquirers should emphasize gaining scale in local markets, embedding unique content in tools and solutions, and developing scalable technology platforms.

The landscape

B2B information services comprise professional publishing (including trade publishing), syndicated information, and related advisory services targeting decision makers in a wide range of industries—finance, law, health care, media, and scientific research, among others. The value chain includes the collecting and processing of information as well as its dissemination. This approximately \$200 billion market¹ has an enviable record of growth over the past ten years—6 percent to 8 percent a year, roughly double the rate of global GDP growth. We expect it to emerge from the downturn with a rela-

1 2008 McKinsey estimate of global revenues in the B2B and professional-publishing markets.

tively healthy 5 percent rate of growth in 2011.² Earnings before interest, taxes, depreciation, and amortization (EBITDA) margins in the industry average 20 percent to 30 percent, but they are as high as 50 percent to 55 percent for leading players such as the former Choicepoint insurance-information business that is now part of Reed Elsevier.

The low cost of providing data relative to its value has driven the industry's growth and profitability. In almost all cases, the cost to users of syndicated data and information is a small fraction of sales—typically less than 2 percent of the revenues they collect³—but its value, as well as the risks arising from not having the right information, is disproportionately high. Buyers are thus relatively price-insensitive.

The unique characteristics of B2B information services ensure the relatively stable and predictable revenue streams valued by investors. Unlike B2C publishing, the B2B information-services market is essentially nondiscretionary. It is not driven by high-grossing blockbuster products or offers. The B2B business model relies less on advertising and more on subscriptions, which feature an increasingly high proportion of multiyear contracts and solution-based offerings. Indeed, some B2B businesses are entirely subscription-based, with no advertising component. Knowledge workers rely on information as part of their work process and are continually seeking to gain an advantage over their competitors by gleaning unique insights from new data and improved statistical models. Once these data and models become embedded in the workflow of their users, they are difficult to remove.

Unique, ideally proprietary, content is an important source of value—but providing that content through tools and solutions is now the key driver of success in the B2B information business, and this lies behind the wide difference in margins noted

above.⁴ In recent years, value has shifted from aggregating data to offering data through value-adding tools that are easily updated and together provide a comprehensive solution for users' business needs. For example, one B2B company serves accounting firms and corporate tax departments with an integrated software solution that digitizes the flow of papers related to tax filings, tracks compliance and approval steps in the process, generates reports, and stores the related data on its servers. The company embeds several sources of data into this software solution, including customer data (income statements and receipts), federal and state tax forms, and tax laws. Once in the system, the data can flow between different software applications to generate forms, compare taxes for different years and jurisdictions, and generate alternative scenarios that allow users to compare different tax outcomes based on changing assumptions.

Such solutions yield significant savings for users by reducing the time required for tax preparation (to the extent that some accountants are abandoning hourly billing in favor of “value-based billing”) and eliminating the need to devote office space to paper files. In contrast, B2B information businesses built on the mere aggregation of data, such as Dialog or DataStar, have failed as stand-alone companies because advances in solution design based on customer insights have rendered such aggregated data less useful.

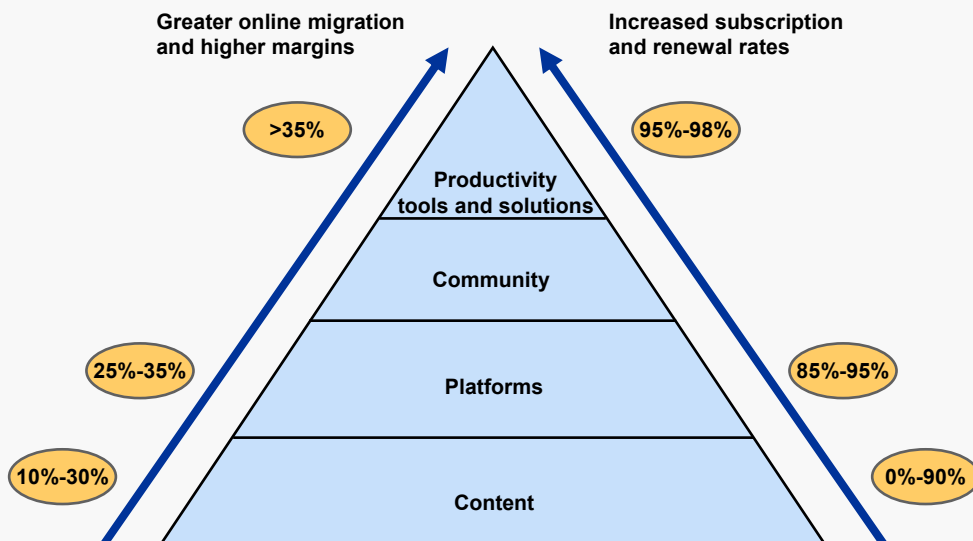
Exhibit 1 highlights the increases in operating margin and renewal rates as service provision shifts to tools and solutions. While data alone (that is, content) provides margins ranging from 10 percent for commoditized information to, on occasion, 30 percent for unique or proprietary information, data that are embedded in tools and solutions provide

² Based on estimates from Veronis Suhler Stevenson, PWC, and Outsell.

³ The cost of bespoke information or customized data is significantly higher.

⁴ Some players have proprietary content by virtue of “user panels” they develop (for instance, Nielsen's set-top boxes) or exclusive arrangements with content providers. Other players have data that are not proprietary, such as tax forms or legal records that are in the public domain, but that differ across many local markets and jurisdictions. If a player is the only one in the market to invest in gathering and disseminating it, the data will be unique until other players are able to follow their lead.

Exhibit 1

Build off of content, but migrate to productivity tools and solutions

Source: The Thomson Corporation (adapted by McKinsey via the addition of community as an important element for B2B trade publishers)

margins exceeding 35 percent.⁵ Having the right content is a prerequisite to compete in the B2B industry, yet good solutions can help to differentiate among similar players. The best-performing companies have both.

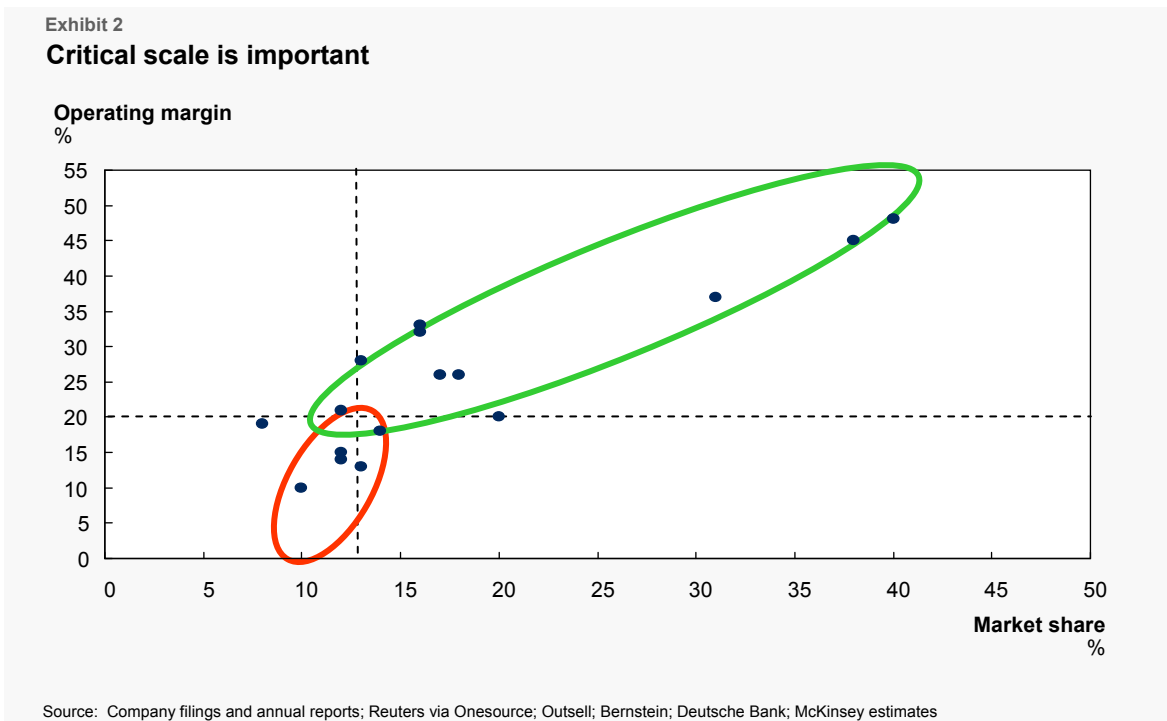
The case for consolidation

The industry's sound growth prospects and fundamentals will improve with further consolidation. Some sectors, such as health care and science, are neither highly developed nor concentrated. Even in sectors that appear very concentrated, such as law and financial services, there are subsectors that remain fragmented, such as electronic data and discovery, a billion-dollar segment in the North American legal-information market.

⁵ In the B2B media business, 10 percent margins are considered low. To be competitive, a company needs margins of at least 25 percent to 30 percent, which would enable reinvestment in new products and services. Companies that are vertically integrated often have margins as high as 55 percent.

The most compelling reason for industry players to consolidate is the strong relationship between size (measured by market share) and returns. Players with more than 15 percent market share in the sectors in which they compete earn attractive returns, while those that have not yet achieved scale are relatively less profitable (Exhibit 2, overleaf).

These better results are prompted by several economies of scale in distribution as well as the collecting and processing of information that enable large players to reach more customers, offer better products, and cut their costs. Importantly, leading players enjoy superior distribution channels. Because they provide a wide variety of data and tools through a common user interface, it is easier for customers to buy an additional product from them than it is to negotiate deals with many smaller players. In the financial-services industry, for example, they occupy coveted space on the desktops of knowledge workers, who need dedicated terminals for fast trade execution. And through long usage, leading players have become the trusted industry standard favored by their professional users. In addition, the larger players have the resources to create distinctive solutions, such as



the tax software discussed above, and to improve their data in other ways, such as correlating data to enhance its utility and standardizing taxonomies to enable effective tagging, storage, and retrieval of data for improved search outcomes.

The shift from print to digital publishing, which is well under way but not yet complete, also requires investment, and thus favors larger players. The fixed costs of new technology can be shared at these big firms across a larger portfolio of publications, and the benefit becomes even greater as more titles or databases are added. The typical incremental investment required to go digital is 2 percent to 3 percent of revenues for a few years for a large player—but is a much higher percentage of revenues, as much as 15 percent to 20 percent, for smaller players. Indeed, during the transition phase, total costs may actually increase as spend on physical distribution continues while the company builds the technology infrastructure and the savings from the switch to digital are not yet realized. Larger companies are better prepared to bear this burden. After the transition, the editorial and technology costs remain relatively fixed, and each

additional subscription can be delivered at little or no incremental cost.⁶

The shift online has varied significantly by industry, with larger B2B players leading the way. The financial-services industry was one of the first to migrate online and has achieved nearly complete digitization; however, 31 percent of scientific, technical, and medical (STM) information and 39 percent of legal information is still print-based.⁷ The market for textbooks has not shifted online as rapidly as expected because financial incentives for print distribution remain high.

⁶ Our analysis shows that a shift to digital publishing ultimately yields a savings of approximately 10 percent relative to print distribution costs. The analysis assumes that editorial costs typically represent around 70 percent of content creation and distribution costs for print publications (excluding sales and marketing costs, which are roughly constant in both print and online sales) and that editorial costs will remain constant following a shift to online publishing. Consequently, the effective savings from an online transition is the 30 percent printing and distribution cost less the costs of the technology-delivery platform. The technology costs typically represent about 20 percent of the total content and distribution cost for a mature online publication, yielding a savings of approximately 10 percent of the original costs.

⁷ Digitization statistics provided by Outsell.

Large players are also well positioned to reap benefits from their scale in collecting and processing data. To serve subscribers seeking real-time behavioral data, large B2B players collect proprietary data through robust user panels (typically exceeding 10,000 users). Nielsen uses such panels to track television viewing and consumer trends, and utilizes the data it obtains to provide branded metrics and consulting services. IMS Health has built upon the data it tracks from its medical-prescription panel to begin investing in consulting and advisory services in health care (for example, advising pharmaceutical companies on which segments to target in a new product launch). Such players can also use their scale with regard to the volume of data collected to negotiate advantageous terms with offshore data-processing centers, thus significantly lowering their cost structure.

Apart from economies of scale, there is another compelling reason to consider acquisitions: the decline in market valuations relative to earnings makes this a particularly opportune time to invest in a sector with such strong prospects. Average EV/EBITDA multiples are currently half what they were from 2004 to 2007, while P/E ratios have declined from an average of approximately 19 in 2006 to an average of approximately 11 today.⁸ While shares have gotten cheaper, the underlying cash flows remain robust.

The challenges

Although the industry is fundamentally attractive, there are several challenges to overcome when investing in the sector.

While valuations have come down significantly, it has actually become more difficult to complete deals. Buyers and sellers do not agree on valuations, and owners may refuse to sell at “lowball” prices. Even when a buyer and seller can agree on a deal, cash-poor buyers face the challenge of obtaining financing. And antitrust concerns will

limit the ability of larger players to expand into already-concentrated markets—though this is not a concern for smaller players or with regard to fragmented markets.

Even if these obstacles can be overcome, challenges remain. Many acquirers have had difficulty finding targets with truly distinctive information. In many B2B sectors, there may be only one or two players with valuable content, because some industry leaders have exclusive deals with information providers (for instance, IMS prescription data) and others have succeeded in building databases that are difficult to replicate. If there are no acceptable targets, companies wishing to enter a sector must wait until data become widely available (for example, when court records in the legal sector are digitized). In such cases, however, acquirers have faced the challenge of adding a tool to make the now-commoditized data distinctive. Other acquirers have lacked a scalable IT platform, making it difficult to integrate acquisitions and realize the benefits of the new data. There are also notable instances of acquirers being lured by the headline impact of large deals for which they overpay, making it difficult to recoup their investment despite significant cost synergies.⁹

Acquirers have also made the mistake of targeting sectors in which value is harder to extract, such as education (where digital migration has been slow) and trade publishing (where the economics are based on advertising, similar to B2C). In such cases, the market has reacted favorably to divestiture. For example, when Thomson, Reed Elsevier, and Wolters Kluwer recently disposed of their educational assets, the market reaction to this news was to increase their stock prices. In the case of Reed Elsevier, the company announced its intention to divest its B2B trade publishing business, Reed Business Information (a deal that was not completed), at the same time it announced a plan

⁸ Calculated as of June 23, 2009. The P/E ratios were as follows: 19 in 2006; 15 in 2007; 10 in 2008; and 11 in 2009.

⁹ As is true generally, acquirers in B2B information services have a tendency to overpay, and historically most of the value has gone to sellers. Our analysis of transactions in multiple sectors over the past 10 years shows that approximately 60 percent of acquirers overpay for their targets, and their stock prices decline as a result. The analysis covered 1,338 transactions from 1997 to 2008 in which both the acquirer and target were publicly listed and the transaction price was greater than \$500 million.

to acquire Choicepoint to build its US risk-information business into the number-one player. While it may not be possible to disaggregate the market impact of the individual transactions, the 9 percent lift in stock price upon opening after the announcements acknowledged the wisdom of both of these deals, which would have consolidated assets in one market while exiting a less attractive one.

How to succeed

Despite these challenges, investment in B2B information services remains an attractive growth opportunity. Success will be driven by deal-making expertise and the ability to select and integrate the right targets to add unique content and services to core assets.

As a threshold matter, companies with good credit (single-A rating or better) or significant cash may be able to close deals even in a market with tight credit. These companies may be able to gain long-term advantages by making acquisitions early, while many of their rivals cannot.¹⁰ Players that are unable to finance deals now can lay the groundwork for deals when credit markets ease by building “preferred partner” relationships with potential targets through joint ventures or distribution agreements. Large players can address antitrust concerns through careful selection of targets, especially those in B2B segments or sectors that are highly fragmented, such as some medical and scientific niches.

Indeed, all players should focus on selecting targets that will allow them to generate additional value from their core assets. Acquirers with a track record of delivering economic returns above their cost of capital¹¹ have typically sought out smaller deals, including business units being sold off by large companies, and integrated backward along

the value chain into data collection to secure access to unique sources of information. The larger company can often add value to another company’s quality product by increasing the product’s distribution through its superior channels and by adding the product to its tools and solutions. Moreover, the postmerger integration is often smoother when a larger company acquires a smaller one.

With that optimal deal in mind, a successful acquisition strategy will emphasize building scale in local markets, embedding unique content into tools and solutions, and investing in platforms.

Somewhat paradoxically, successful acquirers aim to gain scale by serving a number of small, local markets, as they recognize the value of local-market information even for global players. To trade local-market securities or to price derivatives, it is essential to have real-time local-market information on the desktops of professionals. Similarly, because tax codes, accounting standards, and laws differ by country (or even state or province in some instances), professionals need local-market information to do their jobs.

A notable exception relates to scientific research, which is rapidly becoming truly global as world-class researchers demand access to the same information regardless of the location of their labs or research institutes. In this sector, successful players should focus on building a global business with access to the world’s best scientific content and offer this to researchers over a single distribution platform.

Acquirers should also aim to fill any gaps they may have in the content they deploy in their solutions or in the range of tools that make up those solutions. This strategy will vary based on a company’s core assets. Larger players with an existing suite of products should focus on acquisitions that provide more data to populate their offerings or that add versatility to their solutions. Smaller players with unique proprietary content may need to seek deals with players that have expertise in building tools, whether larger players or other small ones. Many B2B players have grown sequentially, emphasizing content or tools at different stages of their develop-

¹⁰ For insight into the benefits and risks of making strategic investments during a financial downturn or waiting for signs of recovery, see “The crisis: Timing strategic moves,” by Richard Dobbs and Tim Koller, in *The McKinsey Quarterly*, April 2009.

¹¹ Defined as a positive spread between return on invested capital (ROIC) and weighted average cost of capital (WACC).

ment. For example, Thomson's tax and accounting division initially emphasized content, and then it added tools for data collection and analysis, which helped its margins to expand. Later, it acquired additional sources of data to better populate the tools.

Finally, successful players will need to invest in lean, flexible IT platforms that scale easily to provide speed and stability as the volume of customers using them grows. Despite the demonstrated value that accrues to large players that have invested in scalable technology platforms, many players have not built modular solutions that are easily scalable or that allow "mass customization" to rapidly meet client needs. Often as B2B information businesses grow, or as companies merge, players piece together an IT platform of hardware and software from legacy systems to avoid making significant investments (a billion dollars or more for the largest players) in a new IT platform. Successful players realize the importance of designing a flexible system and are prepared to migrate to a new system when necessary. Indeed, the industry's

most successful players routinely invest 6 percent to 8 percent of revenues each year in technology infrastructure and services, compared with the less successful players that invest less than 5 percent. Although this difference is not great on a percentage basis, the dollar amount can represent a difference of \$100 million to \$150 million per year in investment.

* * *

B2B information-services markets around the world are fundamentally attractive, and many are also ready for significant consolidation. Successful companies will have a strategic growth plan that includes selectively investing in quality assets and specific subsectors and niche products, and adding scale as they go online and migrate their businesses toward productivity tools and solutions. Media companies that position themselves in the most attractive markets and grow through sensible acquisitions will distance themselves from their competition.

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