IT Considerations in Mergers and Acquisitions

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The Merger and Acquisition (M&A) market is showing signs of life. Due to some positive shifts in the economy, businesses are again evaluating their portfolios and developing strategies for growth and profit improvement. Start-ups and small businesses view an M&A transaction as the predominant exit vehicle, and venture capitalists and private equity firms remain open to investments in small to medium businesses. In fact, a strategic acquisition or shedding of a less-than-stellar division or unit is often the solution of choice when driving toward satisfying the shareholders. However, it is well documented that close to 70% of mergers and acquisitions fail to meet expected results. All too often, an Information Technology (IT) professional is not included in the group of trusted advisors assembled to identify the risks and rewards of the proposed deal. Assigning accountability early for all IT aspects of the deal will contribute significantly to improving the success rate of the acquisition.

Involving an IT professional in due diligence prior to finalizing the purchase can help ensure that the five common IT "landmines" have been assessed and quantified for their impact on the valuation:

- Software and hardware licenses
- Outsourcing agreements
- Transitional services agreement
- Penalty clauses
- Post Merger Integration (PMI) costs

Software and hardware licenses – A license is required for nearly every component of a company's technical architecture. The types of licenses, as well as the terms and conditions, are as varied as the number of software vendors existing in the enterprise today. You can no longer assume that all licenses are transferable to the new company in an acquisition. With subscription services becoming more prevalent in the IT industry, you cannot even assume that the acquired company owns the licenses! An IT professional can help you do your homework on this one and analyze every agreement that exists for equipment and software critical to supporting the business. Finding out post-close that you do not have the legal right to use software that is running your business – or that you have a huge liability – can lead to months in court (if audited) and an unexpected expense that can directly affect your bottom line.

Outsourcing agreements – Outsourcing as a model for delivering IT services to an organization is no longer the exception. It is not uncommon to find deals with terms of five, eight or even ten years at a cost of millions. Although the service being provided is often core to the running of the business, if the service will be terminated, the obligation to the contract is sizable and the penalties are steep. The negotiation team needs to be fully aware of the potential financial impact these agreements represent.

Transitional services agreement – It is rare when a company can be completely integrated into a new organization on the closing date. If the company being acquired is part of a larger entity, or has outsourced all IT related services, agreements will need to be put in place to ensure business continuity during the transfer of ownership. A short transition period is desired but could exceed a year or more depending on the complexity of systems to be integrated. Establishment of appropriate Service Level Agreements (SLAs) in conjunction with a reasonable transitional services agreement provides the foundation for a cost-effective continuity plan.

Penalty clauses – If acquiring part of a business from a larger entity, beware of penalty clauses tied to a successful disentanglement of infrastructure and systems from the selling organization. Your IT knowledgeable advisor is invaluable in this assessment as it requires a level of expertise gained through experience implementing architectures and applications. There are documented cases of sophisticated corporations seriously underestimating the task at hand resulting in hundreds of thousands of dollars in penalties PER MONTH.

Post Merger Integration (PMI) costs – IT is the largest cost driver when integrating companies. Give full consideration to the approach that will be taken to merge the organizations and systems during the due diligence phase. If the business objective is to ultimately have the operations under one set of systems, factor the cost projections (which can be quite extensive) into the deal.

Below are some IT best practices that successful organizations have implemented.

- Assign an IT professional as a trusted advisor from day one.
- Stretch due diligence beyond the financials and include a comprehensive IT review.
- Engage the IT representative in review and negotiations of all transitional service agreements required for business continuity.
- Outline a Post Merger Integration (PMI) strategy during the due diligence phase. The risks and costs must be known and factored into the final deal.
- Plan for the time required to find the devil buried in the details!

If a merger or acquisition is in your future, and you're interested in ensuring these IT best practices are included in your process, don't hesitate to contact us for more information.

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