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"Companies that have already established a strategic role for IT in their business are more likely to include IT as an integral partner in their M&A activities and, thus, to improve the probability of success in their M&A initiatives."

— David N. Rasmussen, Guest Editor

Can IT Make or Break a Corporate Acquisition?

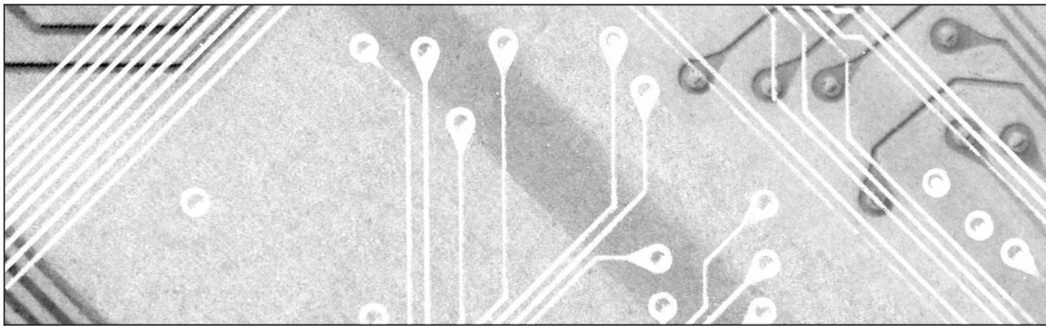
Best of Both Worlds

Leveraging an M&A transaction requires both parties to put politics aside and make decisions in the best interests of the merged entity. A merger offers a rare opportunity to rationalize the IT portfolio, allowing the companies involved to seize the moment for their competitive advantage.

Might Makes Right

A merger is not a lovefest. The acquiring company inevitably calls the shots, deciding who, what, when, and where. You think the folks who run the acquiring company's IT systems are going to voluntarily phase themselves out of existence? It's not gonna happen.

CUTTER CONSORTIUM



Cutter IT Journal

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Part of Cutter Consortium's mission is to foster the debate of, and dialogue on, the business technology issues challenging enterprises today, to help organizations leverage IT for competitive advantage and business success. Cutter's philosophy is that most of the issues that managers face are complex enough to merit examination that goes beyond simple pronouncements. Founded in 1987 as *American Programmer* by Cutter Fellow Ed Yourdon, *Cutter IT Journal* is one of Cutter's key venues for debate.

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Opening Statement

by David N. Rasmussen, Guest Editor

Welcome to this issue of *Cutter IT Journal*. This month we are examining various perspectives on the challenges IT executives face when their firm seeks to acquire or merge with another company. Both in the due diligence phase and during integration of acquired IT departments, there are distinct procedural steps that can lead to a successful acquisition or a disastrous implementation of the target company's IT operation.

This isn't the first time we've addressed this important topic. Three years ago, Cutter Senior Consultant Mike Sisco (an author in this issue) was Guest Editor for an issue on M&As[1] that highlighted the topic as a result of a growing economy. Now the world economy is in decline. But the issues with M&As, as you'll see, are much the same.

In our call for papers on this subject, we began with the heading "Managing IT Acquisitions — The Good, the Bad, the Ugly!" In this edition of *CITJ*, our contributing authors have done an excellent job of presenting arguments for and examples of these three scenarios. They describe many of the challenges IT executives face in getting a seat at the M&A table, along with the consequences encountered when IT is not involved in M&A considerations from the beginning. They also offer practical suggestions on procedures and frameworks that, in their collective experience, have helped to achieve successful acquisition results and to improve IT's contribution to business value.

However, don't be misled into thinking that IT's M&A work is a "piece of cake." As Ram Reddy so succinctly points out, "If the IT function is fortunate enough to be invited to the pre-acquisition due diligence party, it is about as popular as chicken pox at a grade school picnic." The challenges IT executives encounter when their company seeks to combine business operations with another firm begin when the CIO learns about a potential acquisition or merger. In the best of cases, the CIO will be involved with the executive team in such deliberations from the very beginning of the process. In the worst case, the CIO finds out late in the due diligence process when he or she receives a phone call asking him or her to be in "Timbuktu" the next day to evaluate the target company's IT operations. As our guest authors tell us, late entry into the due diligence process by the IT executive staff can lead to potentially major surprises downstream in the integration process.

Our authors this month represent a cross-section of international perspectives on the topic of IT due diligence in M&A transactions. The first author, Ram Reddy, is director of enterprise application services for SAIC, an employee-owned research and engineering company in the US. Michael Gentle is a senior information manager in a pharmaceutical company in Switzerland. He has lived through several M&As in Europe and North America, on both the acquirer and the target sides, in the sectors of pharmaceuticals, telcos, consulting, and enterprise software. Steve Andriole is a Cutter Fellow and serves as the Thomas G. Labrecque Professor of Business Technology at Villanova University, where he teaches and directs applied research in business/technology alignment and pervasive computing. Pamela Hollington is a director for Rebound Consulting Ltd. in North Vancouver, British Columbia, Canada. Cutter Senior Consultant Mike Sisco is a former CIO and founder of MDE Enterprises, Inc., an IT manager training company.

We begin this issue of *CITJ* with Reddy, who positions the discussion with his article about the necessity of IT inclusion in the business considerations for an acquisition. He leads off with the aforementioned quote and then goes on to describe a framework designed to help IT become a much more popular and welcome participant at the pre-acquisition due diligence party. Using a hypothetical example, he leads us through a series of steps focused on strategic alignment, metrics development, and integration planning. Reddy concludes with some guidelines for measuring M&A success. He also provides good cautionary advice regarding the importance of early problem identification and learning from less-than-successful experiences.

Michael Gentle suggests a good mystery novel is about to unfold in his article *Dial M for Merger.* Instead, he opens with an abrupt statement designed to give us a wake-up call, reporting that a recent study showed

"75% of senior management underestimated the critical role of IT in achieving merger success, and only 16% involved IT in due diligence." He proceeds to discuss key factors contributing to this situation and suggests steps the CIO can take to change it. Gentle reviews some of the key business drivers for M&As as he describes three distinct types of mergers and the characteristics of each. He goes on to discuss a number of critical success factors for both due diligence and integration, concluding with a particular suggestion on how IT can enhance its own M&A credentials.

We now come to some pragmatic advice from Steve Andriole, who depicts M&A initiatives as opportunities for undertaking technology reengineering. Since an M&A transaction often involves the integration of separate IT functions into one, he suggests that this is a great time to rationalize the collective technology. Andriole offers a methodology for examining the strategies, leadership, culture, organization, awareness, technology, metrics, and sourcing approaches of *both* parties, not just the target. He is focused on creating the best "fit" between the parties in order to maximize the benefits of working together.

According to Andriole, these assessments can lead to identifying a set of opportunities for business improvement. But rather than focusing on different considerations for the due diligence and integration phases, he helps us look at the opportunities that may exist for achieving an integrated IT operation that is better than what existed prior to the acquisition.

In our next article, Pamela Hollington takes a slightly different tack. While our other authors address the issue of whether IT "can make or break a corporate acquisition," Hollington argues that IT due diligence should be a major factor in the decision of whether the M&A transaction occurs or not. Hollington makes the point that examining the target company's IT operations can reveal a lot about the rest of the company. Attitudes towards IT security, investment, personnel qualifications, and so on, can provide important insights into the behavioral characteristics of senior management and other target business functions — discoveries that might well give the acquiring company second thoughts about an M&A. On a more nitty-gritty technical level, Hollington also provides some sage advice on the subject of integrating industry-standard ERP systems with custom, home-grown systems. She goes on to build a strong case for the inclusion of IT in the due diligence phases of an M&A, which should be helpful for all CIOs who anticipate increasing acquisition activity.

Lastly, we come to Mike Sisco's article, *True Tales from the Acquisition Trail.* He enlightens us with stories about actual experiences from the 45 M&A projects he has worked on over the years. Sisco's six short stories describe the challenges relating to:

1. Software license compliance
2. Disputed software ownership
3. Business closure or elimination
4. Employee responses to an unwelcome M&A announcement
5. The consequences of poor planning and implementation

6. The breadth of IT's influence on other business functions

As with our previous articles, Sisco provides a tutorial on due diligence considerations, highlighting a number of the more subtle aspects of M&A work.

The articles in this edition of *CITJ* serve as an excellent tutorial for achieving successful M&A initiatives. Our guest authors strike some common themes, with which I concur:

- Companies that are acquiring other firms significantly increase their risk of failure by not involving IT early in the due diligence process.
- Because IT supports the information needs of all business functions, much can be learned about corporate management and other business functions through the conduct of IT due diligence.
- Formal IT business practices (frameworks, tools, work rules, etc.) are absolutely required to achieve successful M&A results.
- More than other functions, IT can identify potentially costly roadblocks to successful integration if engaged early enough.
- Executive management's lack of knowledge and understanding of IT's role in their business can seriously jeopardize the success of new M&A initiatives.
- Gaining a seat for IT at the executive table is a critical success factor for M&A implementation — yet it remains a challenge for our industry.

Clearly, there is much synergy among the authors in their experiences with IT due diligence in a merger or acquisition. It's interesting to note, however, that only Gentle comments on one particular challenge for the IT function with regard to M&A initiatives — namely, the impact of layering a major acquisition program on top of IT's normal responsibilities in keeping the business running. The absence of supplementary staff to shoulder some of this dual workload can be a major risk for an M&A. As Hollington points out, "I think that, too often, management figures, 'It's all just bits and bytes — how hard can that be to consolidate?'" Work overload is often a major issue for the IT function, especially when M&A projects are included.

An important point made by Gentle, and implied by the other authors, is that companies that have already established a strategic role for IT in their business are more likely to include IT as an integral partner in their M&A activities and, thus, to improve the probability of success in their M&A initiatives. To provide maximum business value, IT must be involved in a potential merger or acquisition from the outset, when the first discussions about the possible transaction occur at the executive table. In my opinion, however, the burden of inclusion resides not with corporate management, but with the CIO. CIOs who can speak the same business language as their executive colleagues are more likely to receive an invitation to the corporation's executive table. The ability to explain IT value in terms of ROI, EPS, and net income goes a long way in establishing that credibility.

ENDNOTE

[1]Sisco, Mike (ed.). "M&As: Can IT Make the Difference Between Success and Failure?" *Cutter IT Journal*, Vol. 18, No. 10, October 2005.

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The Path to M&A Success:

A Metrics-Driven Approach to IT Integration

by Ram Reddy

If the IT function is fortunate enough to be invited to the pre-acquisition due diligence party, it is about as popular as chicken pox at a grade school picnic. Typically, everyone involved in the due diligence exercise is vested in concluding the deal speedily and moving on to the next acquisition candidate. From the investment bankers to the non-IT executives who support the acquisition, there is a lot of emotional investment in getting the deal done.[1] But to truly enable a successful acquisition (as measured one to two years after the acquisition is completed), the IT function has to ask questions about and validate the business case for the acquisition. If done correctly, this validation exercise should highlight business metrics (cross-selling across product and service lines, cost savings in raw material procurement, etc.) that can be measured to see if the acquisition delivers the promised benefits. The pre-acquisition validation activity takes time and resources, often prompting non-IT executives to ask the IT function to focus on IT integration tasks and leave the business case alone!

Most IT organizations have developed playbooks to integrate standard IT technologies such as networks, e-mail, and data centers. The cost savings from this standard IT integration are relatively small compared to the benefits derived from realizing the business case. The business case is built on deriving certain benefits from leveraging technology-enabled business processes between the acquired and acquiring companies. At the due diligence phase, both the acquiring company and the target company are putting their best foot forward and do not want to air out their "dirty laundry" business processes — most of all not in front of the IT function. So how can IT engage with the business to successfully facilitate acquisitions?

In this article, I will present a framework through which IT can be a welcome guest at the due diligence party. Fortunately, the foundations for developing the framework exist within the IT function today. IT supports all the technology-enabled business processes that enable the company's service delivery or manufacturing operations. The first prerequisite is for IT to develop a comprehensive set of metrics to measure the automated business processes that support the enterprise. For example, how much does it cost to execute a purchase order or generate an invoice? Armed with internal metrics on the basic business processes that make up "contact to sale/contract," "order to cash," and "procure to pay," the IT function can contribute to the due diligence by evaluating the key elements of the target company's technology-enabled business processes to determine if the acquisition can be successful.

A SAMPLE ACQUISITION SCENARIO

A high-level overview of a typical acquisition scenario will provide the background for discussing how to develop, implement, and use the business process metrics framework. The biggest driver for a company to acquire other companies is the expected higher financial returns to be gained from leveraging the assets (people, process, and IT) across multiple companies and realizing economies of scale or scope. A few specific business reasons for acquiring another company are to:[2]

- Add new product or service lines
- Buy market share
- Acquire new technologies, talent, and service capabilities
- Penetrate into new areas/regions[3]

To develop and explain the framework, let's examine the acquisition process within a fictitious company called "Applied Electronix" (AE). AE is one of the world's largest manufacturers and distributors of electronic components and switches used in the manufacture of consumer electronics such as TVs, display devices, and gaming consoles. AE also sells electronic components to hobbyists in the areas of model aircraft, miniature trains, and the like. With annual sales of over $4 billion, the company is seeking to expand its market share by acquiring manufacturing and distribution capabilities to expand its product offerings.

In the next two sections I describe, within the context of the AE scenario, how to develop the acquisition metrics framework. The approach presented in this article can be used for manufacturing or services companies. By applying the framework to evaluate the forecasted acquisition synergies, companies can identify the critical metrics for monitoring and measuring acquisition success. Once the critical metrics are identified, they can be used to zero in on the areas that IT must integrate to enable the business processes to deliver the projected financial benefits.

BUSINESS STRATEGY AND IT SYSTEMS

AE is considering the acquisition of Touch Screen Devices (TSD), which would add to its product offering and fill a fast-growing segment of the market. AE's management team feels that TSD would see a substantial increase in sales to industrial and "hobby shop" customers by leveraging AE's order processing and distribution capabilities. AE predicts there will be synergies from the acquisition that will substantially reduce the operating costs for both TSD and AE after the acquisition and integration of operations.

To support the pre-acquisition due diligence, the first order of business for AE's IT organization is to identify the proposed acquisition's fit with AE's existing strategies. Figure 1 shows a possible representation of a set of AE's strategies and the resulting fit of the TSD acquisition. Most companies (especially publicly traded firms) have a set of articulated strategies, and the IT function should have an updated list of them to use as the foundation for developing the framework. In AE's case, the strategic driver of "increase market share as the lowest-cost provider" offers the best fit for the TSD acquisition.

Business strategies are operationalized through business processes. The next step in developing the framework is to identify the collection of business processes within AE that directly align with the business strategy. Certain standard business processes are embedded in packaged application software such as enterprise resource planning (ERP), customer relationship management (CRM), and supply chain management (SCM) systems. The broad categories of business processes fall under areas such as "Order to Cash," "Procure to Pay," and so on. In our scenario, AE's business strategies are operationalized through the collection of automated business processes enabled by the enterprise applications and manual processes that fall under the category of Order to Cash. If your company does not have its business processes formally defined across the value chain and mapped to business strategies, an acquisition exercise would be a great place to introduce the concept.

To develop the acquisition framework, it is important to drill down from the business strategy to identify the broad category (or categories) of business processes that support the strategy. As depicted in Figure 1, the IT function has identified the Order to Cash business processes as the ones that have the potential to yield synergies in the TSD acquisition. Armed with this information, IT can now engage the acquisition team in validating the strategy and the business processes identified for the potential acquisition.

The framework shown in Figure 1 should not take an inordinate amount of time and resources to develop. Speed is of the essence in pre-acquisition due diligence,

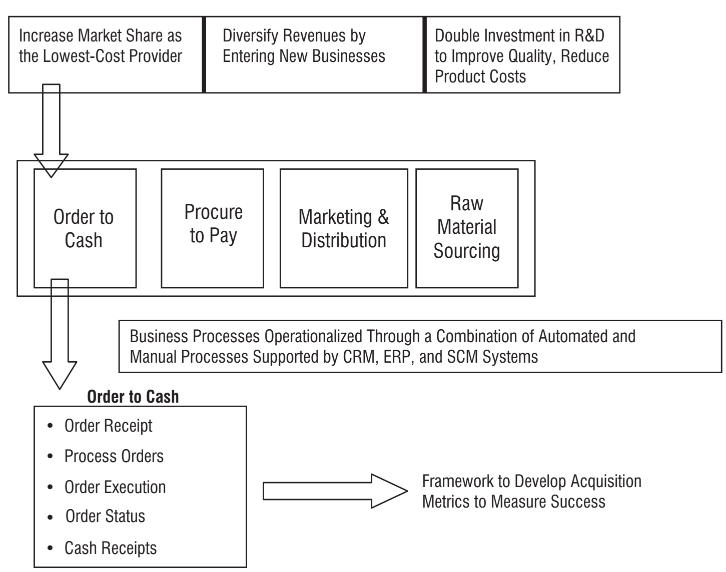

Figure 1 — From business strategy to developing an acquisition success metrics framework.

and overanalyzing and trying to nail down every detail will not get IT a seat at the table. This is counterintuitive to most IT professionals, given that we have been trained to elicit requirements in accurate and actionable detail. Nevertheless, developing a discussion draft framework rapidly should be the primary driver. Getting the functional representatives (from operations, finance, etc.) on the acquisition team engaged quickly in refining and validating the framework in Figure 1 will set the stage for developing the acquisition metrics and identifying the areas of IT integration to support the synergy goals.

DEVELOPING THE METRICS FRAMEWORK

Figure 2 describes the distinct business subprocesses that constitute the Order Receipt, Process Orders, Order Execution, Order Status, and Cash Receipts processes. The next step is to determine the performance metrics for the business subprocesses that have been identified as critical to delivering the synergies from the acquisition. In Figure 2, the metrics depicted for each business process are for the acquiring company; in this case, Applied Electronix. It is fully within the purview of the IT function to obtain access to data and subject matter experts in order to develop these metrics. The metrics can be developed quickly with help from the cost accounting function. In many corporations, the metrics may already exist, and it is just a matter of collecting and presenting them in the framework format to assist the acquisition team.

With the metrics framework in hand, the IT function can contribute to the due diligence exercise by directing attention to the specific business processes that could provide the desired operating synergies after the acquisition is completed. In our acquisition scenario, AE determines that there would be operating synergies from the Order Receipt, Process Orders, Order Status, and Cash Receipts areas. Even though TSD is unable to provide the matching transaction metrics for its current operations, AE is confident that its own operating metrics (illustrated in Figure 2) are the most cost-effective, efficient, and scalable in the industry. The IT function, armed with the granular business processes in Figure 2, will have to work with the non-IT team members to determine which metrics make sense for a particular acquisition candidate. For example, for some acquisitions, cycle time may not be a significant contributor to operating synergies and may be dropped from the framework.

The key point to underscore here is that the IT function is helping the acquisition team identify tangible business processes that will be key to realizing the financial gains from post-acquisition operating synergies. The critical business processes identified in Figure 2 help determine the integration path for IT.

Furthermore, the critical business processes provide the foundation for developing a dashboard to measure the success of the acquisition (see Figure 3). The metrics dashboard is a subset of the metrics that were presented in Figure 2; it will include those metrics

	Cost/Transaction	Cycle Time	Availability
Order Receipt (Multichannel)			
Web Self-Service	$0.12	3 minutes	24/7
Catalog	$5.25	12 minutes	7AM-6PM, M-F
Wholesale	$140.00	45 minutes	8AM-3PM, M-F
Process Orders			
Automated	$0.05	3 seconds	24/7
Manual	$20.00	20 minutes	7AM-6PM, M-F
Order Execution			
Pick	$7.25	14 minutes	6AM-6PM, M-F
Pack	$1.20	2 minutes	6AM-6PM, M-F
Ship	$0.70	30 minutes	6AM-6PM, M-F
Order Status			
Self-Service	$0.02	30 seconds	24/7
Customer Service	$3.80	2 minutes	7AM-6PM, M-F
Mail/E-Mail/Text Alerts	$0.08	2 seconds	24/7
Cash Receipts			
Invoice	$2.50	8 minutes	8AM-4PM, M-F
Receive Payment	$4.80	12 minutes	8AM-4PM, M-F

Figure 2 — Metrics framework to determine acquisition success: Order to Cash process.

deemed essential to achieving the business synergies. The dashboard will contain baseline target metrics at the time of the acquisition, and these will be updated periodically post-acquisition to show progress toward achieving those targets.

DETERMINING THE IT INTEGRATION PATH

A review of the IT integration options will set the stage for understanding the dashboard metrics. There are four IT integration options for an acquiring company once it identifies the critical business processes.[4] They are:

1. Total replacement of IT systems
2. Evaluating and standardizing on systems that provide synergies
3. Integrating critical systems across the two companies
4. A combination of 2 and 3

AE's IT function can now evaluate the IT integration options to determine which will best support the realization of the business process synergies. Option 1 is discounted immediately, and the focus shifts to the areas identified as critical — Order Receipt, Process Orders, and so forth. Having this framework allows the IT function to raise a red flag prior to the completion of the acquisition if it discovers potential showstoppers.

If there are critical synergies that may not be attainable due to an inability to integrate the business processes and supporting IT systems, the framework enables the IT function to provide the acquisition team with early guidance. For example, AE's IT function may find out that it will not be possible to achieve the Order Status transaction metrics given that TSD outsources its manufacturing operations to a number of subcontractors. In our scenario, AE still decides to carry out the acquisition because the synergies from other areas are compelling and attainable.

That being the case, the metrics framework provides direction to AE's IT function, laying out the integration path for TSD's Order Receipt, Process Orders, Order Status, and Cash Receipts functionality. Using the metrics framework, AE develops and executes the IT integration approach in order to roll up TSD's operations in the Order to Cash business area. AE's integration approach is to use Option 4 listed above — standardizing TSD on AE's Order Receipt and Cash Receipts systems and integrating with TSD's Process Order and Order Status systems. This focus allows the IT function to execute on an integration strategy that is measured and reported through the dashboard illustrated in Figure 3. If AE fails to achieve the target metrics for the critical business processes, management can focus attention on the problem areas and evaluate and implement corrective actions to realize the target goals.

It's worth noting that the framework's focus on specific business processes prevents the IT organization from becoming overtaxed in terms of resources. Without the benefit of this framework, the typical acquiring company would try to integrate most of the acquired company's business processes without measuring the benefit of doing so or assessing the synergies of integration. Many readers may have encountered this phenomenon during the heyday of banking mergers. At that time, many small/regional retail banks had superior online banking applications. When a larger bank acquired one of these small banks, it would replace the small bank's applications with its own online banking

		Cost/Transaction Target	Cost/Transaction Current (Q1)
Order Receipt (Multichannel)			
	Web Self-Service	$0.12	**$0.85**
	Catalog	$5.25	**$8.00**
	Wholesale	$140.00	Not Applicable
Process Orders			
	Automated	$0.05	$0.05
	Manual	$20.00	**$40**
Order Status			
	Self-Service	$0.02	**$5.50**
	Customer Service	$3.80	**$12.00**
	Mail/E-Mail/Text Alerts	$0.08	$0.08
Cash Receipts			
	Invoice	$2.50	$2.50
	Receive Payment	$4.80	**$3.90**

Figure 3 — Metrics dashboard for measuring post-acquisition success.

applications, which often did not have the usability or features of the small bank's system. If we were to apply the metrics framework to the banking example, the framework would have a column to measure customer satisfaction, which in turn would drive the integration strategy.

DEALING WITH INTEGRATION CHALLENGES

IT integration is where things tend to fall apart after an acquisition. Often the business processes that the acquiring company intended to combine to provide operating synergies turn out to be like oil and water.[5] This leads to situations where the post-acquisition synergies are never realized due to the difficulty in merging the business processes. In the best-case scenario, the acquired company continues to operate as it did before, without any reductions in overall costs. In the worst-case scenario, the acquired company's business processes and systems are force-fit into the acquiring company's systems, resulting in degradation of service levels, increased operating costs, and general employee and customer dissatisfaction.

When it becomes evident that the acquisition or the acquisition strategy is not delivering the desired financial returns, one of the usual suspects blamed for the failure is the IT function. This outcome is less likely if the IT organization used the metrics framework and dashboard I've just described. Business processes projected to yield operating synergies would have been evaluated before the acquisition and monitored afterwards (via the dashboard) for progress on delivering the integration benefits. For example, in our scenario, if AE projected that TSD's Web self-service costs would drop from \$0.85 to \$0.12 per transaction after the acquisition, those costs would be measured periodically and reported on the dashboard (see Figure 3). Failure to achieve the target metric for the Web self-service business process allows management to focus attention on a specific integration problem area and to evaluate and implement corrective actions to realize the target goal.

REALIZING M&A SUCCESS

The metrics framework can allow an acquiring company to measure and validate that the acquisition synergies are being realized and are delivering the projected financial returns. Alternatively, it can also provide an early warning indicator that the synergies from the acquisition or acquisition strategy are *not* being delivered as projected, so the company can take corrective action. Knowing early on that you are failing to achieve the expected acquisition synergies may be even more important than knowing that your acquisition strategy is on the path to success.

Blaming the IT function for the failure of an acquisition strategy is of no lasting value to a corporation. Conversely, identifying the critical business process areas that failed to support an acquisition or an acquisition strategy *is* of lasting value to a company as it seeks to use M&As to realize its strategic goals.[6] The lasting benefit from this approach is that the business process metrics framework provides a corporation with tangible measures of its core operating competencies.

ENDNOTES

[1] Pfeffer, Jeffrey. "Curbing the Urge to Merge." Chap. 24 in *What Were They Thinking? Unconventional Wisdom About Management*. Harvard Business School Press, 2007.

[2] Chari, Murali D.R., Sarv Devaraj, and Parthiban David. "The Impact of Information Technology Investments and Diversification Strategies on Firm Performance." *Management Science*, Vol. 54, No. 1, January 2008, pp. 224-234.

[3] In some instances, a company may assemble a portfolio of acquisitions in a "holding company" mode. In such a case, the acquiring company is not looking for any operating or strategic synergies across the acquired companies. The integration of the acquired companies typically will not extend beyond sharing commodity IT services such as e-mail, data centers, service desks, and so on. The metrics framework presented in this article does not apply to holding companies.

[4] Robertson, David, Peter Heinckiens, and Jeanne Ross. "The Hidden Demon: How IT Foils Acquisition Success." *Perspectives for Managers*, No. 144, May 2007.

[5] Roberston et al. See 4.

[6] Pfeffer. See 1.

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Dial M for Merger: The Role of IT in M&As

by Michael Gentle

IT is inextricably linked to the success or failure of mergers and acquisitions (M&As). With the average IT budget anywhere from 2% to 10% of revenue and up to 50% of capital spending, it is likely to account for at least 10% to 20% of projected post-acquisition benefits. (M&A expert Frank Vielba estimates at least 30%.[1]) Then there's the critical role of IT in supporting the business: if operational systems stopped working, some sectors would grind to a halt (banking, retail), while others would see severe impacts on costs and delivery capabilities (manufacturing). So not surprisingly, the high rate of M&A failures — at least 50% — is often directly linked to IT integration problems and their associated costs.[2]

One would logically think, then, that the CIO would be one of the key players in the pre-merger due diligence phase. Well, think again! The unfortunate reality is that IT is often conspicuously absent before the ink dries on a deal — or is called in far too late in the process. In the worst-case scenario, IT is presented with a *fait accompli*, together with instructions to merge the information systems of the new company and to generate $*x* million in savings within some impossible time frame, such as six to 12 months. This situation was accurately captured in a *Computerworld* cartoon in which two Dilbertesque execs are strolling around the offices of a target company, and one says to the other, "Hey, this merger will probably go much smoother than we thought; they're using the same brand of computers as we are!" Comic exaggeration? Unfortunately not. A 2002 study of M&As in Europe and North America (with target companies of $100 to $500 million) found that 75% of senior management underestimated the critical role of IT in achieving merger success, and only 16% involved IT in due diligence.[3]

In this article, I will show why such a situation exists and what the CIO can do to increase the chances of being invited to the table. I will also present strategies for successfully carrying out pre-merger due diligence and post-merger integration.

THE BUSINESS DRIVERS FOR M&As

A firm grasp of the business drivers for mergers and acquisitions (terms I use interchangeably in this article) is essential to understanding why a company might be a potential acquirer or target and what can be expected to happen after the event. This will increase the chances of IT participation in the pre-merger due diligence phase and enable a better understanding of the decisions IT will be asked to make in the post-merger integration phase.

The simplest type of acquisition, which I'll call Type 1, is between two companies in the same sector. The transaction eliminates competition between them and generates economies of scale through increased production capacity and reduced procurement costs. The newly merged Type 1 company generally offers the same kinds of products to the same customer base. Examples of such mergers can be found in transformational industries (e.g., oil, steel), banking, or retail.

Next up the complexity scale (Type 2) would be a company that acquires another for product/market expansion or consolidation, such as expanding the product portfolio, gaining access to new channels, or breaking into new geographic markets. Type 2 companies generally expand their customer relationships by cross-selling each other's products or by consolidating existing products. Examples would be two pharmaceutical companies merging to obtain a more balanced drug pipeline or a fixed-line telco acquiring a mobile operator.

Finally, at the top of the scale (Type 3), we have the high-risk, strategic growth bets that seek to build a new value proposition around either brand-new products or an innovative combination of existing products. Type 3 companies expand their existing customer relationships and build new customer relationships by selling new products — or the vision of new products to come. Examples would be the merger of computer and telecommunications companies or of media and Internet companies.

These three categories are not mutually exclusive and can overlap. But for the purposes of this article, they correspond to the main drivers for most mergers.[4] Each of the three M&A types will result in different business objectives, which, again, will influence IT's participation in the pre-merger phase and what it will be asked to do post-merger.

HOW DIFFERENT TYPES OF MERGERS INFLUENCE THE ROLE OF IT

Most of us are probably familiar with Michael Treacy and Fred Wiersema's value discipline model,[5] which describes how companies generally have one of three disciplines in which they excel and which orients their strategic focus:

- Operational excellence (execution), with the main focus on efficiency, streamlined operations, and cost effectiveness
- Product leadership (innovation), with the main focus on brand marketing, design, and time to market
- Customer intimacy (customer relationship management), with a focus on delivering tailored products and services to a finely segmented customer base

The value discipline of a company is a good indicator of what its M&A business objectives are likely to be and how this will influence the role of IT.

The One and Only

Companies in Type 1 mergers usually have a value discipline of operational excellence. They are very likely to be in a commodity business, and commodity businesses are primarily cost-driven. IT is therefore usually viewed more as an overhead than as a source of value-added competitive differentiation. This makes it more likely that IT will *not* be asked to be part of the pre-merger process. After the merger, the focus will logically be on cost savings and efficiency, both from a technology perspective and an IT organizational perspective. Both will no doubt be centralized, with the inevitable rationalization and attrition this will entail.

The new CIO will be asked to merge the two IT organizations in order to generate $*x* million in cost savings in around a year — and sometimes even less. These figures, which will usually have been put together without any IT participation, become an integral part of the cost savings that Wall Street expects — or more accurately, that it has been led to expect by the board of the new company.

The fundamental conclusion here is that the post-merger integration is first and foremost a business exercise in generating the expected cost savings — *by doing whatever it takes and doing it as quickly as possible*. It is not a rational exercise in comparing processes and systems to come up with the "best" solution. Surprisingly, it may not even be a question of business alignment. All that will come after the Wall Street expectations have been met, even if that means revisiting the original decisions later.

The business realities of Type 1 mergers are very well described in an article by Manjari Mehta and Rudy Hirschheim,[6] which examines three Type 1 mega-mergers of oil companies. In all three case studies, none of the CIOs were present during the due diligence phase, and they received their integration orders only after the official announcement.

It Takes Two to Tango

Type 2 mergers are very different from Type 1 mergers. Commodities and cost drivers make way for portfolio and value drivers. New products, markets, and channels enable an increasing focus on customer relationships and customer value. And if, as is likely, one or both of the companies have a value discipline of product leadership or customer intimacy, this focus will be even more pronounced.

In Type 2 mergers, IT is usually viewed less as an overhead and more as a source of value-added competitive differentiation. This makes it more likely that IT *will* be asked to be part of the due diligence phase when it becomes essential to identify any potential process and system weaknesses that could later impact IT integration costs — or even disrupt operations.

Post-merger, the CIO will of course be required to generate the requisite $*x* million in cost savings, but that is unlikely to be the main objective. The main focus will be to ensure that IT can not only continue to support both existing businesses, but also support the new business objectives of product/market expansion or consolidation. The timeline for such an integration is necessarily much longer, around two years or more, as opposed to the aggressive "Wall Street schedules" of Type 1 mergers. There will be some short-term rationalization and attrition of IT staff, but far less than for Type 1 mergers. This is because the initial focus is more on keeping existing systems running, especially when, as is sometimes the case, the two businesses can be quite different. Both companies' systems will usually run in parallel for as long as one to three years until new systems are in place that are capable of supporting the merged businesses.

Then again, merging the systems may not be possible. For example, a pharmaceutical company with prescription products acquiring a consumer health company with over-the-counter (OTC) products will never have merged systems in some functions (e.g., sales and marketing), because prescription drugs and consumer drugs are essentially two very different businesses with very different product cycles and very different regulatory environments. In one such real-world example, the post-merger integration of the sales and marketing functions simply meant that the two IT sales and marketing heads ended up reporting to the same CIO. Apart from that, it was business as usual.

Close Encounters of the Third Kind

Type 3 mergers build on Type 2 mergers in terms of how IT is used and what IT will be asked to do. Because the Type 3 merger seeks to build a new value proposition around new products or an innovative combination of existing products, IT's role is likely to be key. IT is therefore apt to be part of due diligence. However, it is also likely that IT could be shut out of the due diligence phase for confidentiality reasons, so as to limit the risk of leaking information about a high-profile Type 3 acquisition.

Post-merger, apart from realizing the obligatory cost savings, the main focus and challenge for IT in a Type 3 acquisition will be to help build the new products and services to support the value proposition of the new business model. This will require the key IT strengths of both companies, thereby reducing even further the risks of short-term rationalization.

In Type 3 mergers, there will be aggressive timelines, not for cost savings, but for bringing to market these new products and services. This can sometimes be a challenge. After a fixed-line telco acquired an Internet service provider, the B-to-B arms of each business were still running as two separate companies more than two years after the merger. During that time it proved very difficult to provide enterprise customers with a combined telephone and Internet service with a single face to the company — one of the M&A objectives for product convergence. So instead of dealing with a single point of contact for service provisioning, invoicing, and the help desk, customers of the newly merged company found that, despite a new logo and company name, it still felt as if they were dealing with two different companies — which of course they were. This example illustrates how post-merger integration complexities can prevent or delay the realization of M&A business objectives.

Table 1 summarizes the three categories of mergers and how they influence the role of IT.

Table 1 — The Three Types of Mergers and How They Influence IT's Role

M&A Type	Main Characteristics	Main M&A Business Objectives	Main Role of IT Pre- and Post-Merger
1	• Commodity businesses • Companies in the same sector • Cost-driven • Focus on execution	• Increase market share through reduced competition • Achieve cost synergies	Pre-merger: • Likely to be viewed as overhead • Unlikely to be part of due diligence Post-merger: • Centralize for efficiency • Eliminate duplicate systems
2	• Non-commodity businesses • Companies in the same or overlapping sectors, with different market focus • Product- or customer-driven • Focus on innovation and/or customer value	• Leverage new or consolidated products, markets, or channels • Increase customer value	Pre-merger: • Likely to be viewed as a source of competitive differentiation • Likely to be part of due diligence Post-merger: • Keep existing business running • Support business objectives of new/consolidated products, markets, and channels
3	• Non-commodity businesses • Companies in different sectors, but with convergence potential • High-risk, strategic bets • Focus on innovation and/or customer value	• Market new products, or innovative combinations of existing products • Change the rules via a new value proposition	Pre-merger: • Same as Type 2 — but could be excluded for reasons of secrecy Post-merger: • Keep existing business running • Support business objectives of new value proposition

SUCCESSFULLY CARRYING OUT DUE DILIGENCE

If IT is invited to participate during the due diligence phase, the CIO will be asked to evaluate the target company's infrastructure, processes, and systems to see whether they will be able to support the business objectives of the merged company. This phase will require key IT staff to visit the target company for anywhere from two weeks to a month or more, followed by further consolidation work. And therein lies the first challenge — how to reconcile the demands of this time-intensive phase with the day jobs of the people concerned. There are no magical solutions. Expecting IT personnel to absorb the M&A workload without lightening their other responsibilities is a losing proposition, both in terms of meeting their normal commitments and — probably more important — doing the quality due diligence required for the M&A decision-making process. The closer the CIO is to the board, and the more IT is seen as a value-added partner rather than a mere internal service provider, the easier it will be for the CIO to get early warning signals about pending M&A activity and to plan accordingly.

> **Expecting IT personnel to absorb the M&A workload without lightening their other responsibilities is a losing proposition.**

Once this team is set up, it will evaluate a wide variety of subjects. These will include the obvious "hard stuff," such as infrastructure, applications, data quality, operations, disaster recovery, and the various sourcing and maintenance agreements for hardware, software, and services. The key things to identify here are the business benefits and service levels of production applications and their associated costs, risks, and levels of regulatory compliance. Software licensing and outsourcing agreements require particular attention, because contractual conditions, especially pricing, may or may not extend to a merged entity.

The outcome from the assessment of the hard stuff will give the IT due diligence team an idea of how well applications actually meet business requirements, at what cost, and how well they are likely to scale and integrate into the operations and architecture of the merged entity.

Softly, Softly …

Due diligence should also include other less obvious "soft stuff," such as IT governance, organizational culture, investment planning, the supply/demand model the IT department works to, and a qualitative analysis of the IT budget in terms of innovation versus maintenance. The key thing to identify here is the target IT department's business model; that is, how it builds and sells its products and services, at what costs and margins, and how it interacts with its business customers. This will enable the acquirer to position the target company on an IT value scale, from internally focused service provider to externally focused, value-added partner.

The outcome from the assessment of the soft stuff will give the team an idea of how easy it would be to integrate the two companies culturally. The further apart the acquirer and the target are in terms of their IT business models (service provider versus business partner), their organizational setups (centralized versus decentralized), and their organizational culture (command and control versus empowerment), the greater will be the challenge of the CIO in post-merger integration.

In the case of international mergers — more and more the norm in a globalized world — the soft stuff is significantly amplified when country politics and cultural differences are thrown into the mix. An elementary best practice would therefore be to ensure that the due diligence team is suitably staffed with at least one or two people who speak the language of the target company's country — or even better, who have actually worked or lived there.

Finally, the due diligence team should also carry out an early identification of projects that are currently in progress and those that are in the pipeline. This offers a snapshot of the maturity of the investment planning and project monitoring processes — something any target company would understandably want to look good at. For example, a UK retailer that was going to be visited by a due diligence team from an American retailer felt that it did not have its house in order when it came to investment planning and project monitoring. It therefore contacted a project portfolio management (PPM) software vendor and requested a very urgent pilot to get its demand pipeline and ongoing projects into the PPM tool within the short space of one month. The vendor replied that the timescales were far too ambitious for the scope of the work required. What happened afterward is not known, but this example illustrates how far a target company's IT organization may be willing to go to present a professional face to a due diligence team.

SUCCESSFULLY EXECUTING POST-MERGER INTEGRATION

The most immediate concern for IT after the official merger announcement is to know who the new CIO will be. Until this happens, integration cannot start, because people will understandably be thinking about their jobs. While great care is taken to achieve a politically acceptable balance at the board level (for employee and shareholder reasons), there is unfortunately no such requirement for IT — the name of the new CIO is of absolutely no interest to CNN and the *Wall Street Journal*. So not surprisingly, he or she is very often from the acquiring company. The successful management of the transition of the target company's CIO will go a long way in reassuring his or her staff about their future — especially if they are key people whose presence will be critical during the integration process. This cannot be overstated; the CIOs of both the acquiring and target companies must do everything in their power to retain essential IT personnel during the post-transition phase.

The first and most important organizational task of the new CIO is to communicate to the *whole* IT department — and not just senior management — the business reasons behind the acquisition and what IT will be asked to do and why. The sooner this happens, the better. Otherwise, people will make up their own scenarios about the future. This once again underlines the vital importance of staff retention during the early post-merger days.

One of the first and most tangible achievements for the newly merged IT department is to ensure that the new company Web site is up and running and that e-mail is merged into a single system. By then, the real work will have already started; that is, integrating disparate systems from each company, bought or built at different times, by different people, for different reasons. The term "driving a square peg into a round hole" does not even begin to describe the complexity of the task at hand. And this already tall order must also be accomplished without disrupting existing operations or upsetting any customers.

In an ideal world, the new CIO — or the IT integration program manager reporting to him or her — will go through a process of identifying the "best" systems from each company based on a set of rational and objective criteria. In reality, though, this hardly happens. The acquiring company inevitably calls the shots, and with the exception of a few systems from the target company that manifestly provide better and faster cost synergies, the acquirer's systems dominate, especially in Type 1 mergers. This is just as well, because it is questionable whether a consultative, democratic, and rational approach could ever work. After all, a systems manager from company A is unlikely to tell her counterpart from company B, "You know Jim, your CRM system and underlying architecture are really much better than ours. We should definitely standardize on yours. I therefore agree to trash our system and phase myself out of existence."

The term "driving a square peg into a round hole" does not even begin to describe the complexity of the task at hand.

Objectively merging the IT departments of two large companies is a nearly impossible task. You need to retain key staff for the integration phase, but you also have to let go of others as part of the inevitable rationalization process. The "best" systems won't always survive. This organizational and systems juggling act will be most severe for Type 1 mergers, and less so for Type 2 and Type 3. By definition, there's going to be a painful transition period in which you're going to have to phase out both people and systems, and you want to try to keep that period as short as possible. So in a perverse way, the strong-handed approach is probably the most pragmatic answer.

HOW IT CAN ENHANCE ITS M&A CREDENTIALS

Successfully executing a merger is one thing. But what can IT do to ensure that it is invited to the due diligence table in the first place?

As I already mentioned, the closer the CIO is to the board and the better IT is positioned on the value scale, the more likely it is that the CIO will be part of the due diligence process. An effective strategy for the CIO in terms of enhancing IT's M&A credentials would be to play the APM (application portfolio management) card. APM allows a company to manage its portfolio of applications from a value perspective as opposed to a cost perspective. APM enables a company to track its applications over time like financial assets, emphasizing not just costs, but also benefits and risk, all the way to their planned retirement date.[7]

The CIO can then present to the board the value of the IT portfolio and show how it would help to value the company better during potential M&A discussions. The mere fact of talking to the CEO and the board about how the IT portfolio would fit into a potential M&A scenario (as acquirer or target) would significantly increase the chances of the CIO being part of any subsequent M&A discussions. When it comes to M&As, then, APM could very well stand for "*acquisition protection* management."

In conclusion, IT clearly has a very strong role to play in ensuring the success of M&As. Unfortunately, it is often brought into the picture when it is too late. The approaches outlined in this article will, I hope, enable IT to not just succeed in the upstream and downstream M&A phases, but also to create the right conditions to get the CIO invited to the table early in the game.

ENDNOTES

[1]Vielba, Frank. "Reducing the Mergers and Acquisitions Risk." British Computer Society (BCS), July 2006.

[2]Mehta, Manjari, and Rudy Hirschheim. "Strategic Alignment in Mergers and Acquisitions: Theorizing IS Integration Decision-making." *Journal of the Association of Information Systems*, Vol. 8, No. 3, March 2007.

[3]Mehta and Hirschheim. See 2.

[4]For a more detailed analysis of the different types of M&As and how they require fundamentally different approaches, see Uhlaner, Robert T., and Andrew S. West, "Running a Winning M&A Shop," *McKinsey Quarterly*, March 2008, from which this category breakdown was derived.

[5]Treacy, Michael, and Fred Wiersema. "Customer Intimacy and Other Value Disciplines." *Harvard Business Review*, January-February 1993, pp. 84-93.

[6]Mehta and Hirschheim. See 2.

[7]Managing IT applications from a financial asset perspective is covered in detail in my book *IT Success! Towards a New Model for Information Technology* (Wiley, 2007).

RECOMMENDED READING

Bandukwalla, Ali, Pavel Krumkachev, Shalva Nolen, and Rajat Sharma. "How CIOs Can Make Mergers, Acquisitions, and Divestitures Work for Them." *CIO*, 6 June 2008.

Chabrow, Eric. "IT Plays Linchpin Role in High-Stake M&As." *InformationWeek*, 26 June 2006.

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Technology and M&As: Event Planning for Technology Reengineering

by Steve Andriole

Mergers and acquisitions (M&As) — and even divestitures — represent opportunities to reengineer technology acquisition, deployment, and support. Like other major corporate events (such as missing earnings estimates five quarters in a row), M&As can be exploited to make decisions that somehow get endlessly tabled in the routine ebb and flow of many companies.

The argument here is that events that have the significance of a merger or acquisition should be exploited — not just in terms of the business, but according to the technology opportunities they create.

There's a methodology to M&A event reengineering. Assessments yield recommendations within the context of industry benchmarks and best practices. But, as always, corporate cultures and the biases and idiosyncrasies of the post-M&A senior management team will limit the reengineering that can actually occur.

So what are the possibilities here? M&As are life-changing events for most companies. They are usually triggered by (sales, growth, management) problems or the chance for senior management to make a significant amount of money. M&As occur when going it alone is tough, when there's investment pressure to grow and organic growth is beyond a company's reach, when investors want a return on their investment, when the founders want to cash out, and when — in the case of a public company — the Wall Street analysts who cover the stock need to see some excitement to keep the buy recommendations coming.

Unfortunately, there's a great deal of research that confirms that mergers and acquisitions are not beneficial to shareholders.[1-3] Nevertheless, the possibilities to "prune" the ranks (code for shedding employees, closing stores and plants, etc.), rebrand the company, and otherwise reinvent the company's mission are many. The key is to seize the opening presented as event planners do when they have to organize a large wedding in 60 days. There are two steps to the process. The first *assesses the existing environments* of the companies seeking to merge.[4] The second *identifies the opportunities for meaningful — yet realistic — change*.

ASSESSING THE EXISTING ENVIRONMENTS

How do you assess the players? There are all sorts of due diligence templates, M&A "playbooks," and other approaches, methods, tools, and techniques that teams use to determine the "current state" of business technology at the merging companies. My colleagues and I like one that touches "hard" and "soft" bases.

Strategy

As the template in Figure 1 indicates, there are eight areas to be assessed. The first is strategy. The key questions here address the existence and quality of a company's strategy. A 10-slide PowerPoint presentation on the technology infrastructure and applications architecture is not a strategy. Assessments about strategy are pragmatic, not theoretical.

Here is a list of questions we always ask:

- Is there a comprehensive business technology strategy — one that addresses alignment, infrastructure, applications, delivery, communications, security, support, governance, and funding?

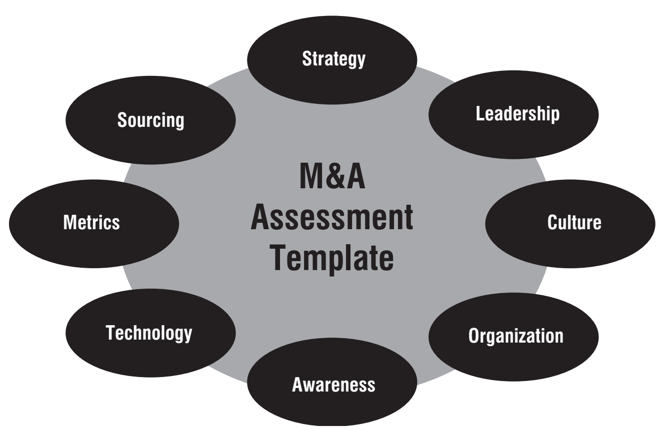

Figure 1 — The M&A assessment template.

- How old is the strategy? Who owns it? Does it have senior management's blessing, or is it an internal IT document?
- Are there clear expectations about technology's role at each company? Is technology a cost center, a profit center, or a little of both? How entrenched is the prevailing philosophy?
- Is the strategy "real"? That is, is it actually followed, or is it primarily window dressing?
- Does the strategy contain insights and profiles of the competition's use of technology?
- Does the business side understand technology, or is it a black box to most of them?
- Is there a discretionary technology budget, or is everything already committed to running the infrastructure?

If there's no strategy (or one that's only a formality), then there's relatively little leverage in rethinking the strategy on behalf of the transaction.

If there's a strategy that's real, supported, and actually followed, then there's hope for change, because the senior management team (SMT) has ascribed value to planning and execution — value that can be leveraged on behalf of the merger or acquisition in play. If, on the other hand, there's no strategy (or one that's only a formality), then there's relatively little leverage in rethinking the strategy on behalf of the transaction. This assessment is important on several levels. First, if the M&A parties have no strategy, then it's impossible to assess the effectiveness of one strategy over another. Second, without a strategy, it's impossible to frame the right questions about applications, data, communications, or even infrastructure. But, third, if a coherent strategy *does* exist, it represents a benchmark against which post-transaction performance can be assessed.

Leadership

The second area is leadership. The challenge is to assess the competence of each company's SMT. Are the teams unqualified, delusional, biased, unintelligent — or professional and effective? Here's the assessment list:

- Is the leadership well respected internally and externally?
- Is the leadership stable — that is, likely to survive the transaction?
- Will either SMT (or both) emerge from the transaction with huge net personal financial gains? Are the SMTs motivated to stay with the new company after the transaction?
- What is the average age of the SMTs?

This assessment is about survivability, motivation, and competence. Who will survive the merger or acquisition? How motivated will they be? Details about the employment contracts and other "event" provisions are essential here.

Culture

Culture is the third assessment area. Could there be a more important one? Years ago, US Healthcare was purchased by Aetna, but which was the "acquiring" culture? There were aspects of the entreprenurial US Healthcare culture that Aetna found intriguing, aspects it wanted to emulate. Was culture part of the valuation of the deal? Here are some questions to ask about corporate culture:

- Is the culture anchored in the past, with policies and procedures that have persisted for over a decade?
- Is the culture risk averse?
- Is the culture entrepreneurial?
- Is the culture introspective — able to reflect and change?
- Is the culture a learning culture?

These sorts of questions are intended to assess how flexible a culture is and how adaptable it might be following a merger or acquisition.

Culture clash is a major M&A concern. What happens when two completely different corporate cultures merge? Those responsible for post-transaction integration worry a lot about the synergism — or lack thereof — of the cultures in an M&A. Who is responsible for mitigating culture clash?

Organization

Organization is the next assessment area. The most obvious questions address organizational structure, reporting relationships, people, and — especially — governance. Here are the key questions:

- Who reports to whom in each company? What does the organizational chart look like?

- What does the "unofficial" organizational chart tell us about intracompany influence and decision making?
- How well governed are the companies? Is governance clear and concise, or is it the source of conflict?
- How persistent are the organizational structures?
- Are there organizational performance metrics?
- What is the general level of competence, knowledge, and energy of the management teams?

These kinds of questions are intended to assess how tight, consistent, and disciplined the organizations about to merge actually are. Undisciplined organizations will threaten post-transaction performance. Ideally, the most disciplined organization "wins," though "discipline" should be assessed on multiple levels. People are an asset to the transaction — assuming, of course, that they are smart and energetic.

Awareness

Awareness is the next area. Here are the questions to ask:

- Are the companies forward thinking?
- Are the workforces "current" and well trained?
- Are there shared expectations about the role that technology plays at each company?
- Is technology perceived as a business enabler?
- Do the companies reflect upon their own strengths, weaknesses, opportunities, and threats?
- Do the companies understand the conventional and unconventional competition?

These questions are designed to assess each company's self-awareness and its ability to objectively assess what it does well and what it does poorly.

Technology

Technology is always front and center in a merger or acquisition — or at least it should be. Here are the major questions:

- Is technology standardized?
- Are the applications rationalized?
- Is security sound?
- Is there adequate backup and recovery?
- Is the database management architecture optimized (enough, for example, for meaningful business intelligence)?
- Are the computing and communications infrastructures empirically effective?
- Are the communications, applications, and data architectures well documented?
- Is automated asset management in place?
- Are there robust network and systems management policies, procedures, and technologies?

This list is shorter than the list we actually use: the full list is extremely detailed. The above technology questions focus on acquisition/deployment/support principles rather than the instances of each technology category. The key is to understand and define the discipline and best (or worst) practices to which each company subscribes.

Metrics

How "measured" are the companies? Are they total quality management/balanced scorecard companies, or do they manage and measure themselves more intuitively?

Here are some questions to ask:

- Do the companies publish quantitative performance metrics — and track the metrics?
- Are performance metrics tied to compensation and other incentives?
- Are the companies "empirical" or "subjective"?

Technology is always front and center in a merger or acquisition — or at least it should be.

Sourcing

How is technology sourced and delivered? These days there's no more important question than how technology is acquired, deployed, and supported.

Here are the essential questions:

- What are the sourcing strategies and predispositions?
- What are the sourcing histories of each company?
- What distinctions are drawn between operational and strategic technology?
- What successes and/or failures have the companies had with their sourcing strategies?

These questions are designed to profile each company's sourcing orientation — and possibilities.

IDENTIFYING THE OPPORTUNITIES

So what do we do with these assessments? At the very least, the assessments — referred to as "conditions" in Figure 2 — define the degree of freedom with which the managers of the merger or acquisition can maneuver. Beyond that, the assessments define "open" versus "closed" reengineering opportunities. Finally, the assessments help us make recommendations about which technology acquisition, deployment, and support strategies can be reengineered according to vertical industry benchmarks and best practices and the specific requirements of the companies in the transaction.

Figure 2 presents all this in a picture. But let's talk about what goes into the cells in Figure 2's matrix. Perhaps the best way to convert "conditions" to "recommendations"

Findings / Areas	Condition	Open	Closed	Recommendation
Strategy				
Leadership				
Culture				
Organization				
Awareness				
Technology				
Metrics				
Sourcing				

Figure 2 — The M&A assessment matrix.

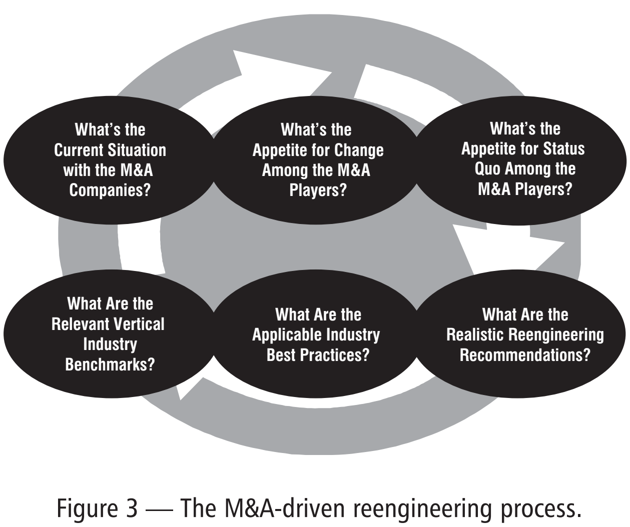

Figure 3 — The M&A-driven reengineering process.

is through a series of if-then statements — which we use to scope the range of reengineering possibilities. The "formula" for all this (see Figure 3) is simple.

Strategy

Companies that subscribe to the value of planning and the development and implementation of strategies provide more reengineering opportunities than companies that do not. The discipline and specificity of strategic planning provide a framework for assessments, possibilities, and recommendations. The reconciliation of the competing strategies of the M&A companies is key to the assessment. Companies in the same vertical industry but with slightly or significantly different strategies need to blend their short- and long-term business models and processes to optimize the transaction. This reconciliation process is a negotiation among the senior management teams of the M&A companies. While it's a platitude to simply state that the transaction will take the "best" each company has to offer, objective assessments about strengths/weaknesses/opportunities/threats are essential to extract the best — and avoid the worst — strategic thinking across the companies. When there's a predisposition to strategic thinking, there are chances to rethink the strategy with business models and processes that exploit the strengths of the M&A transaction. This is tremendous reengineering opportunity.

Leadership

Leadership competency and motivation will significantly determine what's possible. Usually, an M&A transaction makes a lot of people rich. The members of the acquired company's SMT will almost always have provisions in their employment contracts that trigger vesting, bonuses, severance, and retention compensation, among other goodies. These "packages" must be managed toward post-transaction integration and performance — not an easy task. Brutally honest assessments must be made about the teams that will persist throughout and beyond the transaction. Who will be there? Are they any good? What are their management biases? Are they risk averse? These questions define the degree of freedom for reengineering the post-transaction company. If the surviving management team is risk averse, insecure, and of mediocre competence, then the extent of reengineering will be limited. If, on the other hand, they are smart, motivated, and entrepreneurial, then there are lots of possibilities.

Culture

What will the post-transaction culture look like? The post-transaction SMT will define some aspects of the culture, but the larger question is the extent to which one culture will dominate the other. As the Aetna/US Healthcare transaction suggests, sometimes the smaller company's culture ends up having a disproportionate influence on the culture of the newly merged entity. Corporate cultures that are conservative and disciplined will attempt fewer changes than ones that are more entrepreneurial. Beware of cultures that are psychotic, angry, and punitive — they're out there, and they seriously restrict what can be done. M&A due diligence teams that encounter unexceptional management teams in psychotic cultures have learned to lower expectations about what reengineering is possible.

Organization

Organizational structures are as varied and idiosyncratic as laptops and cars. We all think that our structure is the best, but nearly all of us reorganize on a regular basis. M&A transactions represent occasions to rethink reporting relationships, leadership performance metrics and incentives, and human resources (HR) policies and procedures. Obviously, corporate culture and leadership will determine how much opportunity actually exists, but here the due diligence team can communicate industry best practices (along with what the competitors are doing) to the companies for their consideration. An M&A provides air cover to SMTs that want to reorganize themselves; best practices data provides ammunition to change agents.

Awareness

An M&A offers a chance to reinvest in the people who actually do the work. Forward-thinking companies value human assets and invest in their capabilities. They also pay attention to perceptions, such as the way the troops perceive the relationship between business and technology. If they see the relationship as strong, then human capital management will be optimized; if they do not, then the relationship will be suboptimized. M&A transactions provide opportunities to reengineer the overall relationship between business and technology by investing in better business relationship management, more and better trained business analysts, and better project/program/portfolio management and processes that synchronize business and technology priorities.

Technology

The possibilities of technology are extensive. If we make the (admittedly large) assumption that there's an "open" view toward strategy, organization, and awareness, then there are possibilities in the applications, networks, data, organization, and security areas. The application portfolios of each company must be fully rationalized. Here the best application *should* win. ERP, HR, spending management, business intelligence, and related applications need to be assessed with reference to the going-forward strategy, the organizational structure, team capabilities, vendor stability, and a variety of related considerations. Migration will be part of the post-transaction agenda. The objective is to rationalize, modernize, and standardize. The computing and communications infrastructure also needs to be assessed with similar rationalization, modernization, and standardization objectives in mind. Existing provider contracts should be reevaluated and renegotiated — an option provided (one hopes) by previously negotiated vendor contracts that allow for renegotiation when a company is acquired.

The internal politics surrounding applications, data, networks, and even security often limit a company's ability to optimize business technology investments. M&A transactions can offer opportunities to neutralize — for a time at least — the politics that inhibit rationalization, modernization, standardization, and optimization.

We all think that our organizational structure is the best, but nearly all of us reorganize on a regular basis.

Metrics

Again, depending on the culture, organization, and leadership, M&A transactions present openings for change — such as introducing (or enhancing) metrics for performance management. M&A transactions permit companies to restate performance metrics and institutionalize metrics-based performance. The "new start" that a merger or acquisition permits can be an empirical one. That said, if the movement to empirical performance metrics strains the culture or the post-transaction SMT too much (i.e., metrics start getting rejected as overkill, wasteful, or nondiagnostic), then it will fail. Companies must therefore seek a balance as they try to improve their metrics-based performance.

Sourcing

Technology delivery is one of the areas that an M&A transaction can — and should — dramatically affect. For many companies, outsourcing is much more of a political issue than it is a business strategy. I'm referring not to any kind of "keep jobs at home" bias, but rather to the internal politics emanating mostly from technology organizations that resist outsourcing to protect careers. However, the acquisition of a company that already outsources its technology can present an opportunity to the acquirer if there's an appetite for a core competency assessment about technology. There is a widespread industry consensus that infrastructure should be outsourced, unless a company decides that both operational and strategic technology is a long-term core competency. Given sourcing best practices, there's ample rationale for outsourcing elements of the computing and communications infrastructure. An M&A transaction offers a chance to at least vet alternative sourcing strategies.

SEIZE THE M&A!

The assessments my colleagues and I conduct can help determine the extent of the reengineering of technology acquisition, deployment, and support that is possible. If there's an appetite for change — driven by change-oriented corporate cultures and leadership — then an M&A event can be used to implement industry best practices. Some of these best practices include:

- Organizational structures that optimize the business technology relationship and enhance technology's ability to support the business (e.g., structures that emphasize the role of business relationship centers [BRCs] and business relationship managers [BRMs])
- Reporting relationships that facilitate cooperative business technology strategy (e.g., BRMs reporting jointly to business units and enterprise technology)
- Increased investments in business relationship management, business analysts, and project/program/portfolio management
- Technology standardization, especially within the computing and communications infrastructure, but within the applications portfolio as well
- Auditable security, backup, and recovery policies and procedures
- Pilot-based technology adoption
- Empirical performance metrics
- Infrastructure outsourcing
- Selective applications hosting (software-as-a-service)

These best practices, among others, represent reengineering objectives. If they can all be addressed, then the merger or acquisition is more likely to succeed than if they're ignored. Assessments of the culture and the leadership determine how close we're likely to come to best practices–driven reengineering.

Mergers and acquisitions present reengineering opportunities that are few and far between. Many companies can change only when a major event occurs. An M&A certainly qualifies as a major event — ideally, the companies involved in these transactions can seize the moment for their competitive advantage.

ENDNOTES

[1]McClenahen, John S. "How Much Value Creation?" *Industry Week*, January 1999.

[2]Straub, Thomas. *Reasons for Frequent Failure in Mergers and Acquisitions*. Gabler, 2007.

[3]Zaheer, Aks, and David Souder. "The Strategic Value of Mergers and Acquisitions." *Strategic Management Research Center Review*, Vol. 7, No. 1, November 2004.

[4]I am not drawing a huge distinction between a merger of relative equals and acquisitions of much smaller companies by larger companies. While there are obviously significant differences there for other analyses, the focus here is on reengineering business technology in response to a major event — a merger, an acquisition, or even a divestiture.

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Deal or No Deal? Why IT Due Diligence Should Drive the M&A Decision

by Pamela Hollington

I have been involved in company acquisitions from both the "acquiring" side and the "being acquired" side. When I was with a large paper company, we acquired a number of smaller organizations, and I was on the due diligence team for the IT area. I've also worked on a number of consulting assignments in which the client organizations were involved in mergers and acquisitions (M&As). I've seen firsthand what the process can be when you're looking at the possibility of merging not only independent companies, but also independent IT systems and IT organizations.

In this issue of *Cutter IT Journal*, many of the authors discuss whether IT can make or break an M&A. I want to take a somewhat different approach and talk about whether IT should make or break the decision to go through with the M&A in the first place. In my opinion, there are cases where IT should at least strongly influence the final decision.

"IT'S JUST BITS AND BYTES"

Sure, some companies are sophisticated enough in their M&A processes to have actually defined policies and procedures for evaluating the IT systems and organization of the target company as part of their due diligence activities. But for too many others, not enough attention is paid to *whether* and *how* IT can be merged across organizations. I think that, too often, management figures, "It's all just bits and bytes — how hard can that be to consolidate?"

Part of this attitude comes from industry advertisements that portray technology solutions as a panacea for all of a company's woes. I remember a popular advertisement that ran a few years ago for one of the computer chip manufacturers. Though it never specifically said so, the commercial implied that if you just implemented this company's chip, you'd be able to improve your order processing, your inventory and warehouse management, and, of course, your bottom line. "It's just that simple!" they suggest. So I guess we can't entirely blame senior management for not giving proper consideration to the technology side of things. Nevertheless, it is our job to help them understand that it isn't always (or ever?) as easy as it is portrayed.

Through my consulting experience, I've helped a number of organizations select and implement new computer systems. In almost every case, part of the market scan involves talking to similar companies about what they use. It has always surprised my clients to see that so many other companies have homegrown, ad hoc, and piecemeal systems, or that, if they do have a package, it is supplemented with all kinds of external databases, spreadsheets, and the like. This means that if the company you are targeting for acquisition claims to be using a solution that is compatible to yours, or that is well-known and "industry standard," you will still need to find out *how* they're using that system and whether or not the integration will be manageable.

If they have an industry-standard ERP package but use only selected modules, importing and exporting data to other tools or systems to keep their organization operating, then what may have seemed like a simple consolidation of systems may be much more complex. Though the main data may reside in a common database, if their add-on tools are removed or compromised, their business operations may also be affected.

If they have homegrown systems with which you're hoping to integrate, you'll need to know what operating system, programming language, and database environment the systems are built on. You will also want to find out whether you will have access to the source code. I've worked on many projects in which it seems pretty straightforward to transfer the data from one system to another, but technical issues, such as proprietary databases or structures, make it much more difficult to get the access you need.

Even when due diligence is done and everything seems fine on paper or in the review, significant problems often arise when a merger goes through. As reality sets in, you realize that it won't be as easy as it appeared. In the end, it all comes down to not only *asking* the tough questions during due diligence, but also *validating the answers* to those questions through observation and business analysis.

WHAT A REVIEW OF IT CAN TELL YOU

I can't overstate the importance of looking at the target company's IT systems *and* IT organization. This is a subtle distinction, perhaps, but a critical one. My point is that you will need to understand both the technology *infrastructure* and the IT *organization* (i.e., the structure, policy, and team members).

The IT Infrastructure

The IT infrastructure includes the hardware inventory (what they have, what state it is in), the network configuration, and the software inventory and its configuration (well-integrated versus clumsy and piecemeal). From an infrastructure point of view, you should look not just at their equipment inventory, but also at the state of that inventory. Yes, they might have a PC on every desk, but what condition is it in? I worked with a client a few years ago who bragged that everyone in the company had a PC, and that all these PCs were running the "latest" operating system. Yet when I went to use the PC assigned to our key contact, their project coordinator, the keyboard simply didn't work. I literally had to "bang" on certain letters to make them type. When I asked her how the company could possibly operate like this — surely, a person of her stature deserved decent equipment to do her job — she said that a new keyboard would cost too much and, besides, then everyone would want one!

Before worrying about the "state of IT" in the target company, the first step is to determine when you need to worry about consolidating IT and when you don't.

The IT Organization

In terms of the IT organization, the structure, the policies and procedures, and the staff makeup can tell you a lot about the overall company. For example, lax security standards in IT may reflect a cultural issue in terms of the organization's security "mindset." If there are no passwords for system or application access, or if those passwords are shared and not kept secret, you may find that there is no segregation of duties, no ownership of roles, and no integrity in terms of data accuracy.

As for IT resources, both the number and skill level of the target company's IT staff can also raise some flags. Many times I've asked my clients whether they have an IT organization, and they proudly declare that, yes, they have an IT manager who is really dialed into the organization. After more discussion, however, I find that the "IT manager" has absolutely no IT background. Instead, he or she has moved up through the ranks, and for some curious reason, many of them seem to have come from the shipping or warehousing area. (I've had that experience in three different client environments.) These individuals may be keen, and they may be more IT-literate than others in their company, but they are not qualified technically or from a business perspective to act as "manager" of the IT organization.

Beyond IT management, you should evaluate the credentials and capabilities of other personnel in the IT organization. Do they have training in areas of IT, or have they just "shown an interest" and been adopted into the IT group? Are there enough IT professionals to manage the day-to-day maintenance and support issues, as well as tackle the longer-term operational and strategic tasks?

Then again, the substandard state of the target IT organization may be the reason one company is buying another. For example, if the acquiring company *knows* how to apply IT to improve the operations of the company it is buying, it may see a ripe opportunity in enabling the target company to flourish with enhanced IT and operational support. But if the acquirer does not enter the deal with that intention, the burden of taking on the IT "mess" of the new company may negate, or at least reduce, some of the benefits it was hoping to realize.

Looking at the IT infrastructure and organization tells you what kind of importance the organization places on IT. It also tells you about the company's culture of spending and investing, not only in IT, but in a broader business sense. Consider again the example of my client's decrepit keyboard. Old and outdated computer systems and equipment may reflect financial woes, or they may indicate a lack of understanding of how IT can and should help the organization — IT is seen as a cost rather than as a benefit.

TO MERGE OR NOT TO MERGE

Before worrying about the "state of IT" in the target company, the first step is to determine when you need to worry about consolidating IT and when you don't. In almost all acquisitions, there will be some form of reporting that needs to happen up to and down from the "head office." But does this require fully compatible and/or integrated systems or just a robust pipeline for data communication?

I see two distinct types of acquisitions. On the one hand, you may be acquiring an organization for the purpose of diversification. For example, say your shoe company is buying a boot company. If you are doing this for market diversification, you may plan to continue operating the boot company independently. In that case, consolidating systems and environments may be less important and/or less immediate in terms of timing. You may choose to have the entities operate completely separately, or you may need only a low level of system integration for reporting and analysis purposes, but not for daily operational support.

On the other hand, you may be acquiring an organization for expansion purposes. For example, your shoe company may be buying another shoe company with the objective of expanding your brand and/or your depth in the industry. Your intention in this case is to support all of the products of the merged organizations through one, single entity (the merged entity). All sales, distribution, management, and support functions will be handled in one place. In this case, the need to consolidate and standardize the IT systems is much more pronounced.

When managing an acquisition, therefore, the degree of integration of the IT systems and structures will depend on the purpose of the acquisition. I see three distinct degrees of integration:

1. The two systems do not need to integrate at all; they will operate completely independently.
2. The two systems need to "interface" so that consolidated reporting and analysis can occur. This interface may, for example, be done through a third system or set of processes that combines and consolidates the required data across the two systems.
3. The two systems need to be fully merged. In other words, one system will replace the other, or a new system will replace both of the existing systems.

As with so many other areas of risk management, you have to be sure that the level of analysis and due diligence you conduct is meaningful and worthwhile. For example, conducting a field-level analysis of the data structures of the target company's systems (identifying field names, attributes, relationships to other fields, etc.) would be inappropriate — and unduly expensive — if your intention is allow the acquired company to operate completely independently, using its current operating structure, processes, and systems. In other words, if the intention of the acquisition does not include consolidating or updating the computer systems and structures, it's probably pointless to conduct detailed due diligence in that area.

Having said that, you may find yourself in a bit of a catch-22 here. If you don't evaluate the target company's IT systems and structures at some level, how will you know the integrity of the entity you are acquiring? Yet if you analyze in too much detail, you may be wasting time and effort, and therefore money. So the big question is, "How much is enough?"

As with so many other areas of risk management, you have to be sure that the level of analysis and due diligence you conduct is meaningful and worthwhile.

I recommend conducting your IT due diligence in stages. If you are acquiring an entity that will be operating independently, you may first do a high-level analysis of the IT systems and structures to see if they are of high integrity and are operational and maintainable. If you find problems in those areas, then you can delve further to determine how bad the problems are and how much you will need to invest to fix them after the acquisition. If the "how much" is too large, you may decide not to purchase the company.

Then again, you might be acquiring an organization because you can implement a sophisticated IT structure and system that the target company isn't able to manage (either financially or culturally), and you see a benefit in taking the organization to "the next level." In that case, some of the fundamental analysis of the IT systems and organization may not be necessary. If your plan is to completely overhaul the acquired company's IT systems and structure, then you may want to focus more on data integrity and completeness (whether you can get at the data, and whether it is meaningful and accurate), rather than on the application side of things.

The Case of the Misguided Mandate

Whatever degree of integration you intend to pursue, it's critical that you make the intention of your acquisition clear. I once worked with a client that was acquired by a "parent company" significantly larger in sales and marketing terms than it was. I remember the IT executive from the parent company coming to visit and reviewing the newly acquired company's order and sales management system. (Both companies had their own, custom-built systems.) He noticed that some of the terminology on the screen was different from what they used at the head office (e.g., "Product" instead of "Style," "Article" instead of "SKU") and requested that it all be changed. In fact, this wasn't so much a request as it was a mandate.

> **The changes that were made were completely meaningless and a waste of effort.**

The changes were made, which created a lot of work for the IT group (screens had to be modified, reports had to be updated, and so on) and much confusion within the newly acquired organization. The customer service and inventory management groups were now seeing new terminology that didn't make sense to them.

As it turned out, there was no operational interaction whatsoever between the acquired company and the parent company. There was no product sharing or sales and marketing data sharing, nor was there any staff crossover, where one person may have had to deal with both sets of data or standards. The changes that were made were completely meaningless and a waste of effort. In fact, even though the screen names had changed, employees continued to use the "old" terminology in spoken communication, which created even more confusion for new hires.

This misguided exercise in standardization resulted in a real cost in terms of the time IT spent making and implementing the changes (changes to code, testing, updating documentation, training the users, etc.). Furthermore — and perhaps more important — it incurred an opportunity cost in terms of the more valuable work the IT group could have been doing during that time.

THE COST OF GETTING IT WRONG

Mind the Gap

If the intent of an acquisition is to coordinate the internal business operations of the organizations involved, the cost of getting IT due diligence wrong could be significant. If the technology environments and systems of the organizations cannot be merged or linked, then the gap between them could result in large investments of programming effort to make them work.

Sometimes, however, no amount of programming can make two disparate systems talk to each other. The gap may not be a simple case of "your data is in your system and mine's in my system." It could be that the data structures and contexts aren't even similar. For example, in a sales management environment, you may track all orders by customer number, with a customer having multiple ship-to and/or bill-to locations, whereas the organization you've acquired may instead track orders by account, where each "account" has only one shipping and one billing address. Though it might not be impossible to consolidate the data to a common level across the two systems, it could be cumbersome or impractical to do so.

These data structure disparities can have serious impacts on an organization's ability to report on, manage, and analyze their data. These may include the time and money required to rewrite or modify IT systems to accommodate the differences — costs that should not be underestimated. We all know that modifying a system after it is developed and implemented is more expensive than making those same changes in the design phase of the project. Thus, the cost of modifying one or more systems to accommodate data structure and/or processing and policy differences can be significant. Your own operational expenses will determine just *how* significant the impact will be, but you need to consider the time and cost to:

- Analyze the required changes (your business analysis resource costs)
- Program the required changes (your architecture, design, development, and testing resource costs)
- Implement the required changes (your technical resource and training/implementation resource costs)
- Support and maintain the required changes (your operational support, help desk, and systems maintenance resource costs)

Working the Workarounds

Sometimes changes cannot be made to the systems, either because you don't have access to the source code, or you can't make the required changes effectively. In this case, you'll need to factor in the time and cost involved in creating and managing workarounds, such as:

- The use of spreadsheets to "map" and/or consolidate data

- The creation of "rogue" systems (e.g., Access databases, other homegrown solutions) to process and/or consolidate data
- The creation of manual reports (using word processing or spreadsheet applications) to reformat and present results

Workarounds can also be costly and time-consuming, since they take the time and energy of IT and business professionals away from their intended roles as they attempt to manage the disparate data and systems environments. Do you really want your senior managers rekeying and manipulating data that should be managed within the organization's IT systems? What are they *not* achieving while they're spending their time doing these mundane tasks? And what is the opportunity cost when IT personnel cannot work on other mission-critical or strategic initiatives that may better serve the organization?

Finally, these types of workarounds also have costs that are not related to resources. One is the loss of data integrity (i.e., everyone has his own version of operating data). Another is the loss of security and data control. The data may now be dispersed in many formats and on many sources that are not managed and controlled by your data management routines (e.g., nightly backups, access management, privacy procedures).

SHOULD IT MAKE OR BREAK THE M&A DECISION?

When you buy real estate in British Columbia, Canada, where I live, you have the option of submitting what is called a "subject offer." For example, you might very likely make an offer that is "subject to inspection." If your offer is conditionally accepted, you then hire an independent inspector to look at the property and the structure(s) on it, and to evaluate them and report on their state. You then have the option of clearing the subject and purchasing the property, or choosing not to complete the deal (and to get back any deposit made) by not clearing the subject.

This same concept ought to be applied to corporate M&As and IT due diligence. If you can't gain access to the IT systems and organization during the initial negotiation stages (you may be making a hostile bid, or you may not want your intentions to be made public), then you should be able to make an offer to purchase "subject to" the IT due diligence. If the conditional offer is accepted, and your IT due diligence finds that the IT systems and structure will require more investment than you care to make, then you could either walk away from the deal or renegotiate the purchase price based on the new information.

Unfortunately, I have not yet heard of a "subject to IT due diligence" offer being made in a corporate M&A, and there may well be times when you can't get access to the target company's IT systems and organization prior to an acquisition. In such cases, you need to assess the potential benefits and risks of the transaction based solely on the information you already have at your disposal. If you find yourself in a similar position, then at a minimum, consider the following questions before deciding on a merger or acquisition:

- To what extent do we need to merge or consolidate the IT systems and organizations of the two companies, based on the intention of the acquisition?
- What is the timing of such consolidation, if needed?
- What is the risk (in terms of financial outlay and time investment) of finding that the target company's IT systems and organization are outdated, insufficient, or ineffective?

It can be costly to integrate and/or consolidate IT systems and organizations. If the appropriate due diligence cannot be completed before making a decision to merge with or acquire a company, then an appropriate risk budget should be allocated to cover the potential impact from the issues listed above. If that additional cost cannot be included in the business analysis for a "go" decision, then IT *should* break — not make — the decision!

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True Tales from the Acquisition Trail

by Mike Sisco

Since 1990, I've participated in 45 company acquisitions. The acquired companies ranged in size from US $2 million in revenue to just over $5 billion in revenue, so I've seen quite a diversity of company situations.

The first thing that comes to mind as I recall these experiences is that each acquisition is different. I once worked for an organization that acquired more than 35 companies. Even though many of these companies looked very similar on paper (amount of revenue, number of clients, etc.), each was different. Every company has its own set of circumstances and therefore requires a unique strategy for assimilating it into the parent-company environment.

When I considered writing an article about IT's impact in mergers and acquisitions (M&As), I thought it might be helpful to share some of the merger challenges I've seen from my CIO vantage point. All of the discussion points come from actual experience, and I hope they can save you some pain when working in M&A situations.

TALE 1: WELL, THAT'S *ONE* WAY TO KEEP COSTS DOWN …

While conducting the IT due diligence to support one company acquisition, it became obvious that the company we were trying to purchase reduced expenses considerably by pirating software. In other words, the company purchased one set of software and simply copied it illegally to other employees as needed.

This company was small, but the compliance problem was significant and needed to be fixed. Resolving this software compliance problem was going to require an additional expense of over $400,000 in my IT transition budget.

This is not what senior management wants to hear, but the risks far outweigh the cost to resolve the situation. The penalty for software piracy is quite severe. According to the Business Software Alliance (BSA), the voice of the world's commercial software industry, the penalty for software piracy can be a fine for as much as $150,000 per stolen software program plus an additional $250,000 fine, or a jail sentence for up to five years, or both.

I don't know about you, but that gets *my* attention.

It's a challenge to keep your company compliant in terms of software licensing, and almost every company is potentially noncompliant in some way. The good news is that the BSA does not want to cause your company problems and will leave you alone if your intent is to comply. The bad news is that the BSA can recommend a software compliance audit be conducted, and a government agency can create a significant disturbance in your company when such an audit is performed. And as I noted above, penalties for software license noncompliance are quite stiff and can involve not only financial penalty, but also imprisonment.

If you encounter software license compliance problems in an M&A transaction, there are two ways to resolve the problem:

1. Point out the problem to the acquisition target and have the company resolve the issue before the merger is transacted.
2. Build an action item to resolve the issue into your IT due diligence plan and budget. In other words, take care of the problem soon after the merger transaction is completed.

Our company chose option 2 in this situation, which is probably the best approach for most companies. It's usually better to build in whatever financial contingency you need to close the deal and wrap things up financially upon signing the merger agreement than to create a situation that depends on the target company doing something.

Now to finish up the story. After the deal was done, we received a phone call from a young lady with the BSA, who had been notified of our compliance problem by a disgruntled employee from the acquired company. Being able to show her that we had identified the problem, put dollars into our budget to fix it, and included an action item in my IT transition plan was enough to prevent an audit. She asked me to send copies of our software license purchases and then left us alone when we complied with her reasonable request.

The Moral of the Story

When you detect compliance issues, be sure to get ahead of the problem by creating a proactive plan to address all issues.

TALE 2: YOU HAVE MY WORD ON IT!

Acquiring a company requires you to verify the ownership of certain types of assets, especially in IT. When a company reportedly has developed software to run its business, this becomes a major due diligence discovery issue.

There are many possible implications with regard to software ownership:

- Is there one clear owner? If additional owners pop up after the merger is announced, they want one thing — money.
- Has the company licensed its software to customers, and is it expected to provide annual enhancements and updates to the software? If so, this situation dictates support requirements and may even affect company revenue.
- Is the software stable? If not, your IT transition plan may need to be more aggressive about eliminating software that's under stress or lacks key functionality.
- How is the software supported, and how long will it be supported? The answers define what you need to do relative to staff, projects, the help desk, infrastructure, and many other aspects of IT support.

We were once in the midst of due diligence to acquire a small company that had developed healthcare billing software to run its business. The president and owner of the target company insisted that the company was the sole owner of the software.

We discovered in the company ownership documents that there had been a split in the company five years earlier that created his company, Company X, and another company, Company Z. It was also clear that Company Z had changed course and did not use the software in question, but it was not clear if it had an ownership claim to the software.

Like most small companies, the target company did not want its clients or employees to know that the company was being sold until the last possible moment. Many prefer it to happen after the merger is officially announced. When employees know an M&A is in the offing, that knowledge can interrupt the operation of the business. Until the deal is done, you don't want people worrying and using up a lot of energy unnecessarily.

We were concerned about the software ownership issue and couldn't find anything that clearly indicated Company X had full ownership. There was no separation agreement language or document that spelled out the ownership of the software, even though it was a key asset of the original company prior to its splitting into Company X and Company Z. All we had was the owner's word that there was no outside interest in the software.

We closed the deal and began working on transition items. About 10 days after the announcement, the president of our company got a phone call from the owner of Company Z.

What did he want?

You guessed it! He wanted money — $150,000 to be exact — because his company had a 12-year-old document from the very beginning of the original company that had a provision of software ownership in it. Company Z had a legitimate claim to part ownership of the software in case the asset was ever sold, and since this was an asset deal, it was in force. Fortunately, we had anticipated this possibility and built a financial contingency into our transition budget to cover such an event.

> **If additional owners pop up after the merger is announced, they want one thing — money.**

You might ask, "Why didn't you push harder or talk to Company Z to discover what the situation was?" The reason is that the president of Company X was a small-business owner, and he was paranoid about knowledge of his intention to sell the company getting out to his staff and clients. His worry was that if the merger did not happen, it would create a lot of headaches for him when he had to continue running his company. In small and midsized companies, this is a very real concern.

We could have approached the situation in one of three ways:

1. Force a discussion with Company Z. Of course, this could have created ill will with the owner of Company X and jeopardized the purchase.
2. Put language into the merger agreement that if outside ownership of the software is discovered within the first year, Company X is liable for the cost and will be required to reimburse our company for costs associated with it. This would work, but it keeps an open item in the works, something we don't really want to create.
3. Put a budget contingency in our financial plan to cover the additional cost of outside ownership in case it comes up. This is what we did, because we wanted a clear change of ownership and all financial issues completed when we closed the deal.

Our view was that this was part of the cost of the acquisition, so we budgeted for it. It's up to senior management to determine whether the issue is significant enough to affect the purchase price. In this case, it wasn't. When Company Z called, we were prepared for the issue.

Ten companies in 10 different cities spread across the US created quite a challenge for our due diligence team.

The Moral of the Story

Put a budget and transition contingency plan into place to offset potential third-party ownership challenges.

TALE 3: ONE OF THESE THINGS IS NOT LIKE THE OTHERS

We once acquired a Texas-based company that had been acquiring other companies like ours to build size. Their strategy was to increase their revenue substantially through acquisition and position the company at some point to be sold.

Our company was also growing through acquisition, but we had an operational plan for the long term, with the goal of taking the company public at some point. Our strategy was to stay in the business; the other company's strategy was to cash out by selling their aggregated company.

When we conducted due diligence, our acquisition target was running 10 separate companies. The only thing centralized was payroll processing. This meant each company had its own technology, different processes, a separate management team, and even separate accounts payable. Our approach was to centralize all the corporate support services such as payroll, accounts payable, accounting, human resources (HR), and IT as much as possible in order to cut costs and improve company profitability.

Ten companies in 10 different cities spread across the US created quite a challenge for our due diligence team. As I mentioned earlier, every company has a different set of issues and challenges.

Nine of the companies fit our model perfectly. This was the business we were going after. Unfortunately, one company based in Kentucky did not fit our model. Instead of providing billing services, they developed software and provided technology services to companies that competed against our company. That presented a real challenge. Obviously, we did not want to support our competition as we marched onward in our quest to consolidate that particular niche of the healthcare industry.

Our plan? Close down Company #10 and focus on the assimilation of the other companies.

Since Company #10 was a technology services company, and the entire staff was made up of programmers, business analysts, and technical support staff, it became my responsibility as CIO to take care of it. I'll never forget that first day when one of our HR managers and I met with the staff of Company #10 immediately following the merger announcement. We flew there and met with the general manager of the company to finalize our plans and to ensure we had "all our ducks in a row" before meeting with the staff.

I had taken the GM into my confidence, so he already knew about the strategy we were to take. In my due diligence effort, I was very impressed with the GM and his maturity. As I informed him of the eventual plan, he asked me two questions:

1. "What are you going to do to protect my clients?"
2. "What can we do to protect our employees?"

He never asked, "What are you going to do to protect me?"

The GM actually assisted me in framing the transition plan for his clients and his employees, which helped ensure a smooth transition. When I delivered the decision to close the office and communicated the transition plan, the fact that we had thought through the issues thoroughly and delivered a specific plan to help ease the pain made a big difference.

We succeeded in closing the office without putting clients and employees at risk. We gave people additional transition time, outplacement services, and even bonuses to help us for a short period of time in completing the transition project. These are costs that many CEOs would not want to incur, but our CEO stepped up to the challenge and helped me create an orderly and smooth transition.

The Moral of the Story

I learned in this acquisition that when you treat employees and clients the right way, positive things happen for your company. Eliminating someone's job just because you find them in the wrong place one day is unfortunate, but we needed to do it, and it was part of our plan as we acquired other companies. Our willingness to help people find other work and support their transition out of our company paid dividends by allowing us to execute smooth transitions without too many surprises. Smooth transitions actually save dollars in the long run.

In five years, we acquired 35 companies in the same niche of healthcare and grew from $30 million in revenue to more than $700 million. When we showed up at a target company's door, a lot of people already knew about our track record and our approach. One of the things we often heard from employees who lost their jobs as we assimilated their companies was, "We didn't like the decision to eliminate our positions, but we appreciated the fairness and consideration the company gave us to help ease our transition."

TALE 4: THIS COULD BE THE BEST THING THAT'S EVER HAPPENED TO YOU

Late one evening, I received a call from a young IT manager I had met. He was distressed because he was out of town and had just heard that his company had been acquired by a competitor.

He was flying back to his office and would be meeting with the new CEO on Monday. Knowing that I had a lot of acquisition experience, he called to ask me how he should prepare for this first meeting with his new boss.

I told him, "First, relax and take a deep breath. This might be the best thing that's ever happened to you."

I encouraged him to approach this first discussion with the new CEO by offering to assist him in any way he could to facilitate a smooth transition. In other words, he should go into the meeting and ask the CEO, "How can I be of help?"

The reason is simple. Senior managers look for people who will help them make things happen, and they try to eliminate or reduce the impact of those who will resist their efforts.

The odds that this manager would lose his senior IT management position were high, so he had legitimate reason to be nervous. The acquiring company had a CIO and didn't need two of them. However, we all look for people who can help us achieve our objectives, and when a knowledgeable person of influence who has a positive attitude pops up, more than likely we are going to find a way to make use of him or her.

That's exactly what happened. The manager lost his job but was able to contract with the new company to help in the merger activities. This contract lasted a year and gave the manager ample time to prepare for a new career opportunity.

The fact that we had thought through the issues thoroughly and delivered a specific plan to help ease the pain made a big difference.

The Moral of the Story

Good things happen to people who have positive attitudes and are willing to help the company achieve its goals.

TALE 5: LOOK BEFORE YOU LEAP

Several years ago, I was pulled into a large post-acquisition merger project. A fairly large manufacturing company had acquired another manufacturer and literally doubled in size overnight. Both companies were publicly traded and appeared to be doing well when the acquisition took place.

Three months after the acquisition, things had gone downhill. A host of other consultants and I were pulled in to try to salvage the situation. When we arrived, it was immediately apparent that, when acquiring the new company, the parent company had conducted only superficial financial and legal due diligence. It had conducted no due diligence of the IT function, nor of any other department — not even business operations.

Huge problem.

As a result, when the merger was announced, all kinds of problems erupted because there was no transition plan, and it took the parent company too long to begin managing the new business. Most of the issues seemed to be cultural differences, but these cultural differences in the operation of remote retail outlet stores caused immediate financial problems for the company. Significant resistance to changing policies and procedures and poor management and lack of an appropriate transition plan led to major personnel turnover. Within two months, the operations division acquired by the parent company was struggling tremendously. Unfortunately, the parent company did not have the bench strength to provide additional support beyond its original operations, so the new company's operations slowly deteriorated.

> **In order to be supportive, IT must be involved in the due diligence activity as early as possible and learn about every department's plans.**

One issue led to three … it was literally a cascading effect.

The managers found themselves in a reactive tailspin that they couldn't get out of. The operational issues quickly led to a decline in financial performance, which led to a drop in stock price, morale issues, client service problems, and so on. Instead of achieving cost reductions through economies of scale, the newly merged companies had to spend millions more to react to surprises and correct problems that popped up. Ultimately, the company filed bankruptcy and went out of business.

The Moral of the Story

Mergers require planning and proactive execution by all organizations within the company. Not conducting an effective due diligence sets you up for failure, which in the best case means missing your goals and objectives, and in the worst, going out of business.

TALE 6: EVERYTHING IS THE BUSINESS OF IT

The IT organization gets a triple dose of challenges during a company acquisition:

1. IT must support the existing technology of the acquired company after the acquisition is completed.
2. IT must manage the technology transition projects to assimilate part or all of the technology of the target company to the acquiring company.
3. IT must support each of the company departments' transition objectives that require technology support.

Most departments in an organization just need to worry about what they have to do within their own department. The IT department, on the other hand, has to know about everyone's plans in order to anticipate and plan the technology support required to help them achieve their objectives. Payroll conversions, office relocations and mergers, e-mail consolidation, and business application conversions take lots of time and effort. In order to be supportive, IT must be involved in the due diligence activity as early as possible and learn about every department's plans.

In the 1990s, I was CIO of a company that, as I've mentioned, acquired more than 35 companies. In every case, we organized a company due diligence team made up predominantly of the senior department managers. As the CIO, I was responsible for assessing, planning, and budgeting the activities necessary to support the technology requirements of the mergers.

We were highly successful in leveraging the financial results of the combined companies, and a big reason was that every department had a transition game plan ready to execute on the day we announced the merger to the world. With every new acquisition, our managers gained additional experience to the point that many transition activities got to be as routine as driving to work. We became an acquisition machine, and much of our success was attributed to the structure and discipline we implemented in our due diligence efforts for every new company situation.

The Moral of the Story

Getting all departments involved in early due diligence of a company acquisition is not a "nice to have" — it is a necessity.

WISDOM FROM THE TRAIL

I've seen many successes and learned much from a few failures on the trail of some 45 acquisitions since 1990. Many of the successful mergers I've witnessed were a result of proper due diligence and planning by all departments of the acquiring company. When a company conducts only financial and legal due diligence, there is too much opportunity for operational surprises that can put the management team into permanent reaction mode, something that prevents you from achieving your objectives.

To increase your odds of success in a company acquisition, I recommend conducting due diligence with all departments involved, especially IT. A key reason IT needs to be involved early is that many of the goals and objectives of the company and its department managers will require IT support. In order for the IT organization to position itself to fulfill these needs, early awareness of the needs and issues is paramount. If a company assumes that everything can and will get done in a timely manner, it is just engaging in wishful thinking.

Mike Sisco is a Senior Consultant with Cutter Consortium's Enterprise Risk Management & Governance and Business-IT Strategies practices. He is also founder of MDE Enterprises, Inc., an IT manager training company whose mission is to provide practical insight and tools to help IT managers of the world achieve more success.

Mr. Sisco was an IT manager and CIO for more than 20 years in enterprises ranging from startups to large distributed IT organizations. He has participated in more than 40 company acquisitions and led the IT due diligence and assimilation planning projects to support them. He has also been instrumental in the turnaround of several companies, including the turnaround of a technical services company from losing $2 million to a profit of $2 million in two years.

Mr. Sisco has written 14 books, published hundreds of articles, and provides education and consulting services globally to improve IT management skills. He can be reached at msisco@cutter.com.

THE CUTTER DIFFERENCE

Access to the Experts

The processes Cutter employs to generate research and to tackle client problems on the consulting/training front reflect our view that fostering collaboration among experts is the most effective way to create valuable new ideas and to fashion effective solutions. The composition of our community is also based on the belief that a group of cognitively diverse experts is hard to beat when it comes to addressing tough business challenges.

This philosophy is part of what differentiates Cutter Consortium from other IT analyst and consulting firms. Our more than 150 internationally recognized experts have come together to offer research, consulting, training, and executive education to our clients; they are bound together by a commitment to deliver top-level, critical, and objective advice. They have done, and are doing, ground-breaking work in organizations worldwide, helping companies deal with issues in the core areas of business-IT strategy, enterprise agility and innovation, agile software development and product and project management, enterprise architecture, business technology trends, risk management, metrics, team building and leadership development, business intelligence, social networking/ Web 2.0, and sourcing.

Cutter's goal is to help organizations leverage technology for competitive advantage and business success. We accomplish our mission by furthering the thinking in business technology, serving as a catalyst for collaboration between thought leaders around the globe, then giving clients access to this think tank through our products and services. We offer a different value proposition — *Access to the Experts*. You get practitioners' points of view, derived from hands-on experience with the same critical issues you are facing on a daily basis, not the limited perspective of a desk-bound analyst.

The Cutter community not only draws upon expert practitioners, but also innovative academics, allowing us to blend the frameworks provided by the top professors in key universities with the hands-on experience of best-in-class consultants worldwide.

Cutter's clients are able to tap into this collaborative, cognitively diverse community in a variety of formats, including online and multimedia research, mentoring and inquiries, events, and training/consulting services. With Cutter Consortium, you get the best practices and lessons learned from the world's leading experts — experts who are implementing these techniques successfully in organizations like yours right now.

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Cutter's research, inquiry response, consulting, and training are qualitatively different from that of other analyst firms in many vital ways:

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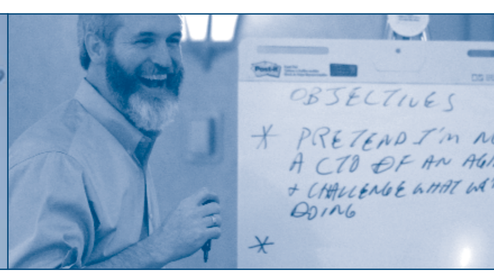

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— Paul Ramsay,
Service Delivery Manager,
Equinox,
Auckland, New Zealand

- **Cutter Inquiry Privileges give clients Access to the Experts — personalized guidance from the world's top practitioners.** Every inquiry is fielded by a Cutter Senior Consultant, Fellow, or Faculty member. Clients can purchase bundles of hours and may allot some of the inquiry time to senior executives, such as the CIO, pairing him/her with a top business-IT strategist so they can brainstorm every month. This allows the two of them to build a rapport and gives the Cutter expert a deep understanding of the issues the enterprise is facing. The Cutter expert quickly becomes a valuable advisor.
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- **Clients call Cutter "the thinking person's research firm"** because of Cutter's dedication to debate of the business-technology issues enterprises face and its success in attracting the thought leaders worldwide to conduct this debate. Clients get cutting-edge thinking plus multiple viewpoints so they can determine what's best for their individual enterprise/department/project.
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- **Written content is likened to "consultancy in print"** since it provides hands-on, actionable solutions from expert practitioners who are successfully implementing these ideas, whether it be IT strategic planning, security strategies, or risk management. This relates back to the fact that the content is written by the people who are at the forefront of their fields and who are guiding companies daily.
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- **Focus on sound project management, risk management, and change management** so IT can accomplish the changes business demands.
- **Emphasis on IT as an enabler of innovation**, as the hyperdifferentiator that will give your business the competitive edge it needs to succeed.

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About Cutter Consortium

Cutter Consortium is a truly unique IT advisory firm, comprising a group of more than 100 internationally recognized experts who have come together to offer content, consulting, and training to our clients. These experts are committed to delivering top-level, critical, and objective advice. They have done, and are doing, groundbreaking work in organizations worldwide, helping companies deal with issues in the core areas of software development and agile project management, enterprise architecture, business technology trends and strategies, enterprise risk management, metrics, and sourcing.

Cutter offers a different value proposition than other IT research firms: We give you Access to the Experts. You get practitioners' points of view, derived from hands-on experience with the same critical issues you are facing, not the perspective of a desk-bound analyst who can only make predictions and observations on what's happening in the marketplace. With Cutter Consortium, you get the best practices and lessons learned from the world's leading experts, experts who are implementing these techniques at companies like yours right now.

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Cutter Consortium's philosophy is that there is no single right solution for all enterprises, or all departments within one enterprise, or even all projects within a department. Cutter believes that the complexity of the business technology issues confronting corporations today demands multiple detailed perspectives from which a company can view its opportunities and risks in order to make the right strategic and tactical decisions. The simplistic pronouncements other analyst firms make do not take into account the unique situation of each organization. This is another reason to present the several sides to each issue: to enable clients to determine the course of action that best fits their unique situation.

For more information, contact Cutter Consortium at +1 781 648 8700 or sales@cutter.com.

The Cutter Business Technology Council

The Cutter Business Technology Council was established by Cutter Consortium to help spot emerging trends in IT, digital technology, and the marketplace. Its members are IT specialists whose ideas have become important building blocks of today's wide-band, digitally connected, global economy. This brain trust includes:

- Rob Austin
- Ron Blitstein
- Christine Davis
- Tom DeMarco
- Lynne Ellyn
- Jim Highsmith
- Tim Lister
- Lou Mazzucchelli
- Ken Orr
- Mark Seiden
- Ed Yourdon